



CHAPTER 10

The Crash

The people are not to trust the rumours about the private banks and to do business with the banks with confidence.

Kyaw Kyaw Maung, Governor, Central Bank of Myanmar, 11 February 2003

On account of the rumours, something that should not be done was done. People have experienced mistakes. The Secretary-1 cautioned the people that if the banks suffer losses due to the rumours spread by destructionists, the country will also suffer.

The New Light of Myanmar, 16 February 2003

In late 2002, Burma began to experience what became a prolonged banking and financial crisis. Triggered by the collapse of a series of informal finance companies (in reality mostly ‘ponzi’ and ‘pyramid’ schemes), the crisis quickly extended into the country’s private banking sector. Subsequent ‘runs’ on the banks stripped them of reserves and prompted the adoption of measures to restrict withdrawals. In the panic a flight to cash led to a shortage of the kyat, and a liquidity crisis. Liquidity support, had it been rapidly and appropriately supplied by the Central Bank of Myanmar could have limited the contagion. Such liquidity support from the CBM, however, was too little and too late. Worse, the CBM’s orders endorsing restrictions on withdrawals and the recalling of loans from borrowers greatly impaired trust – the indispensable ingredient of financial stability. Burma’s private banks, which superficially had appeared to be performing strongly before the crisis (Chapter 9), were irreparably damaged.

Of course, as we have seen in these pages, financial crises are not new to Burma. What distinguished this latest drama, however, was that its genesis lay in the *private* sector. This meant that whilst its immediate impact upon the greater populace was perhaps not as great as the government-inspired

disasters of the past, its longer term effects, not least in sowing distrust in the market economy, were great indeed.

In this chapter we examine this latest financial crisis in Burma, critique the policy responses to it and consider the condition of Burma's financial system in its wake. The chapter is divided into five sections – first taking up the narrative of the crisis as it unfolded chronologically, a difficult if necessary task in the opaque world of Burma's political economy. We then outline what might be regarded as international 'best practice' responses to banking crises, and how the efforts of Burma's monetary authorities fell far short of this ideal. Following this, we examine the climax of the money-laundering question in Burma. Developments here were a partial trigger of the bank crisis, and money laundering suspicions in the aftermath of the crisis were to bring down the biggest names in Burmese banking. Finally, the chapter looks at what was left. Our narrative here takes us to the present day, to the winners and losers amongst the private banks, and the continuing distortions that plague Burma's monetary and financial system.

THE UNFOLDING CRISIS

The precise origin of Burma's latest financial crisis was shrouded in myth, rumour and innuendo. What was undoubtedly true, however, was that its immediate trigger lay in the collapse of a succession of 'informal finance enterprises' (the so-called *A-kyoe-saung lou-ngan*) through the second half of 2002. These enterprises promised investors very high rates of return. 'Interest' rates of three to four per cent per month were typically promised and, while no precise data were available, such returns (vastly in excess of the ceilings imposed on the banks) attracted a large number of investors. Generating returns as high as this in legitimate and productive activity is scarcely possible even under the most favourable of circumstances. In the case of Burma's informal finance sector they were at best a function of highly speculative investments in real estate, construction and commodity trading, at worst they were only made possible by a sector that was in large part made up of little more than gambling syndicates and ponzi schemes.¹ It is the nature of such schemes, and such strategies, that failure is never far away. Much of the activity of the informal finance enterprises was similarly 'extra-legal' on the liabilities side. They were not, for example, authorised deposit-taking institutions under the FIML, and as such could not legally accept deposits. A commonly adopted loophole was to describe depositors

as 'shareholders'. A blind eye seems to have been turned by regulators until very late.²

Exacerbating the crisis in Burma's informal finance sector were two potential crisis triggers involving the banks themselves. The first of these concerned the vexed question of money-laundering, and the Burma government's efforts to 'deal' with the problem. As we have seen, Burma's banks (and their principals) had long been rumoured to be involved in money-laundering. This, and the lack of systematic anti-money-laundering provisions in the country's banking laws, had led to Burma being consistently named by the OECD's 'Financial Action Task Force on Money Laundering' (FATF) as a 'non-cooperative' jurisdiction.³ In its annual 'International Narcotics Control' reports the US State Department too consistently highlighted both the significance of the narcotics trade in Burma's economy, as well as the lack of laws dealing with the laundering of the funds that flowed from it.⁴ Meanwhile, the US Treasury had long required all US banks and financial institutions to 'give enhanced scrutiny to any transaction originating in or routed to or through Burma, or involving entities organised or domiciled, or persons maintaining accounts, in Burma'.⁵

In the wake of these and other pressures, the government of Burma gave appearances of at last coming to grips with the issue and (as noted in Chapter 9) in May 2002 it promulgated the *Law to Control Money and Property Obtained by Illegal Means*. On paper this met many of the hitherto objections of FATF and the US State Department. Certainly for a while the customers of Burma's banks took the Law seriously, and in June 2002 there was something of a flight of funds away from the banks and a sell-off of the kyat, which for the first time breached 1000 kyat/\$US1. Matters were sufficiently serious, indeed, for a series of 'briefings' by government officials to assure Burma's banks that they should 'not feel threatened by the new law' (also as noted in Chapter 9).⁶ With depositors in the banks being placated for the while, operations returned more or less to normal. Rumours persisted, however, of large-scale withdrawals by certain 'sensitive' depositors. Such rumours were given credence in statistics supplied to the IMF by the CBM that showed declining reserves and demand deposits in Burma's banks during the final quarter of 2002 (IMF 2003). Of course, within six months of the promulgation of the anti-money-laundering law crisis and panic would descend upon Burma's banking system with greater force. Meanwhile the vulnerability of the banks had been laid open.

The second potential ‘bank-centred’ trigger for Burma’s banking crisis was a political scandal that brought about the resignation of Burma’s Finance and Revenue Minister, Khin Maung Thein. This occurred on 1 February 2003, just as fears of contagion from the finance scheme collapses were reaching their peak. The reasons for the Minister’s resignation were never publicly revealed beyond reports that he was being ‘investigated’ over his role in the crisis. More damaging to the banking system was that the rumour mill linked the scandal to the Asia Wealth Bank (AWB) – as we have seen, then the largest and most prominent of Burma’s private banks. Simultaneously other rumours circulated telling of large losses on investments in China, likewise concerning the AWB (Zaw Oo 2003). Whatever the truth or otherwise of the rumour mill, tales surrounding Burma’s banks were given credence enough such that, in early February, queues of anxious depositors formed outside all of the active private banks. Principal amongst these were those banks which had shown extraordinary growth in recent years, including the ‘big five’ of the aforementioned AWB, Yoma Bank, Kanbawza Bank, Mayflower Bank and Burma Universal Bank.

The transformation of what might have been a localised crisis (limited perhaps to one or two banks) into a systematic bank ‘run’ took only a matter of days. On 11 February the Chairman of the CBM, Kyaw Kyaw Maung, attempted to reassure depositors with the statement that ‘all 20 private banks established according to the Financial Institutions laws have firm financial standing and have the backing of the Central Bank’.⁷ To no avail. Indeed, the statement by the Chairman of the CBM may even have exacerbated matters since, in a country in which unpleasant truths rarely featured in state-controlled media, ‘ordinary citizens feared the worst’.⁸ Not surprisingly the banks soon found themselves running short of liquidity and, as a consequence, all manner of devices emerged in the attempt to maintain reserves by limiting depositor access to their funds.⁹ Initially these were *ad hoc*, and differed not only between banks, but even between different branches of the same bank. A degree of uniformity emerged, however, when on 17 February all banks (with the blessing of the CBM) imposed a withdrawal limit of 500,000 kyats per customer, per week. As the crisis continued this limit drifted downwards, and within a week some banks had reduced the maximum to 100,000, and then 50,000 kyats, per account.¹⁰

The crisis manifested itself in some unexpected ways. None more so perhaps than in the strengthening of the unofficial (market) exchange rate

of the kyat.¹¹ This had been declining for many years, but had precipitously fallen to a low of around 1,100 to \$US1 immediately before the crisis. At first glance this seems perplexing. Financial crises are usually times of great turmoil for the nation concerned, all of which was usually reflected in the 'price' of its currency. Of course, it is also true that banking and currency crises tend to go together. The reasons for the kyat's appreciation, however, were prosaic. Simply, and notwithstanding the little faith that the people in Burma had in the currency as a store of value, the kyat as a *means of exchange* remained indispensable, especially for everyday (small value) transactions. As a result there was a ready demand for it. With the onset of the banking crisis, moreover, a flight to currency (normally, as noted, not particularly valued as a safe haven – but now much safer than kyat denominated bank *deposits*) ensued. This flight led to a physical shortage of kyat supplies. With kyats scarce, their 'price' (exchange rate) appropriately rose. Of course all of this signified something else too – Burma's systemic banking crisis had now become a problem of systemic illiquidity too.

Less unexpectedly, Burma's financial crisis also manifested itself in more typical, damaging, ways. One of these was that the means of exchange created by banks (cheques, remittance facilities, credit and debit cards, electronic transfers and the like) quickly ceased to function and on 26 February the CBM ordered banks to stop 'all account transfer transactions'.¹² No explanation for this directive was given, but presumably it was aimed at ensuring that withdrawal limits were not evaded by the transfer of funds into different accounts, different banks or even different branches of the same bank (the latter a function of the lack of centralised account-keeping records by Burma's banks).¹³

Most serious of all was the way in which the banking crisis was now impacting upon the real economy. Data is lacking, but there can be little doubt that the vast array of anecdotes pointing to *severe* disruptions to production and distribution captured the essential truth.¹⁴ It was, of course, the case that most people in Burma still did not have bank accounts in any form. Many employers and businesses, however, did – and this was the source of most of the damage. Simply, from the onset of the crisis, a great many workers in Burma – in textiles and footwear factories, in construction, in fisheries, in almost all market-related activities – went unpaid for considerable periods.¹⁵ Suppliers and distributors were likewise materially affected. So too were contractors and transport providers. Saving the economy from complete seizure was the ever-ready fall-back

to informal payment mechanisms and, undoubtedly, the resilience of the Burmese people in the face of persistent economic distress. Such a fall-back, however, was hardly ideal and only entrenched Burma as a cash and barter economy.

The attempt at soothing words early in the crisis was supplemented on 21 February by what was purported to be more concrete actions by the CBM. According to reports, on this day the CBM provided a 25 billion kyats loan shared amongst the Asia Wealth Bank, the Yoma Bank and the Kanbawza Bank (Zaw Oo 2003: 2; EIU 2003a: 17). Attached to the loan was an interest charge of 4.0 per cent, and the loan was made against lodged collateral (of Burmese government securities). The loan represented a mere 3.5 per cent of total deposits in the banks (as at June 2002), however, and was a figure decidedly insufficient for the scale of the crisis at hand. By way of comparison, liquidity support provided by the Indonesian monetary authorities to its banks during the 1997/98 banking crisis amounted to 15 per cent of pre-crisis deposits (Enoch *et al.* 2003: 87).

In the on-going absence of sufficient, concrete and credible support, Burma's authorities attempted to assuage the crisis with yet more soothing words. On the same day the CBM loan was made, then Secretary-1 of the SPDC, Khin Nyunt, declared that there was 'no safer place' for frightened depositors 'to keep their money than in the banks'.¹⁶ Less helpfully, a few days later Brigadier-General David Abel, then Minister for the Office of the Chairman of the SPDC, was recorded as saying that some of the private banks had been found 'to be not operating in line with the Financial Institutions Law' in their lending practices.¹⁷

A concrete, but most unwelcome, plan emerged from the authorities a few days after these comments in the form of CBM endorsement of efforts by a number of the private banks to 'recall' loans.¹⁸ Such recalls, which were first made in early February, were a direct reflection of the banks' (by now) dire liquidity position. The recalls ranged from 20 to 50 per cent of loan balances outstanding, with most banks tending toward the latter as the crisis dragged on. The CBM-endorsed timetable for the loan repayments required that they be completed by the end of March. Government exhortation to this end was less than successful, and the deadline was later extended to the end of May 2003.¹⁹ This deadline too passed, but the repayment orders remained in place.

Coming on top of the restrictions on deposit withdrawals, there was much evidence to suggest that the loan recall announcements (even if

widely evaded) did great damage to private enterprise in Burma. Once more there were no official or even plausible data on what followed, but much contemporary reporting told of attempts by Burmese firms and individuals to meet loan calls by selling assets, and otherwise downgrading businesses and lifestyles. Representative of these were tales of home borrowers being given just days notice to return 25 per cent of the value of their home loans, of asset price deflation (especially for items such as motor vehicles and other durables – sold to meet loan calls), of job losses, of continuing difficulties for firms in meeting wage and supplier commitments and even of falls in the prices of some commodities.²⁰

In May 2003, with no seeming end to the crisis and no greater ability of depositors to access their funds, reports emerged of a growing ‘secondary market’ in frozen bank accounts. The going price was said to be between 60 and 80 per cent of face value. Meanwhile in the ongoing absence of adequate official support, the banks themselves continued their efforts to acquire liquidity. The Yoma Bank, then Burma’s second-largest private bank, was reported to be attempting to sell its fleet of cars in order to raise kyats.²¹

THE POLICY RESPONSE

Banks are inherently brittle institutions. They take in deposits (liabilities) which they promise to repay in full on demand, and use them to make longer-term loans (assets). Should all the depositors in a bank insist on repayment simultaneously, the bank would be unable to redeem its promise and it would fail. Moreover, the mere fear that a bank might fail tends to becoming self-fulfilling. As was the case in Burma in 2002/2003, once a panic starts it makes perfect sense for individual depositors to try and get their money out. Once sowed, fear is rarely limited to a single institution and systemic crisis is never far away.

The inherently risky nature of banking, and indeed the history of its fragility, has prompted the creation of a host of measures designed to mitigate against the worst of these risks. There is disagreement amongst economists and bankers on the margins of what can and should be done to alleviate the risks in banking. But upon the fundamentals, and especially upon the role of a central bank in a crisis, there is broad consensus.²² The most crucial function a central bank must perform in a bank crisis is to ensure that problems in individual institutions do not make the transition into a systemic banking panic. Prompt, credible and *visible* liquidity support

is the key to stopping this transition. In the early stages this involves the central bank coming to the aid of illiquid but not insolvent banks. Such assistance involves anything from coordinating a rescuing consortium of peer banks, to shifting government deposits to troubled banks, to acting as the time-honoured 'lender-of-last-resort'. Should the cross-over point be reached, and a bank crisis become a full scale systemic bank panic (as was the case in Burma) then there is really no option but for the monetary authorities to establish full depositor protection via a deposit guarantee. According to Frydl and Quintyn (2000: 11):

Such a blanket guarantee aims to stabilize the banks' funding and prevent, or stop, bank runs. As such, it is mainly a confidence booster. In addition, announcing a blanket guarantee buys the government time while the restructuring work is being organized and carried out.

A deposits guarantee delivers to the monetary authorities a potentially large contingent liability. But, as Frydl and Quintyn (2000: 21) note, it was 'possible that blanket guarantees, mainly being confidence boosters, are not called upon (...) that the mere announcement of such guarantees suffices to stop bank runs and restore confidence in the banking system'.²³ In short, the fiscal costs of a guarantee *could* be low. In any case, against the (very visible) cost of such a mitigating device must be juxtaposed the much larger economic and social costs of a systemic collapse. This was one of the 'lessons learned' of the Asian financial crisis in 1997, during which Indonesia, Malaysia, South Korea and Thailand all guaranteed ordinary bank deposits (Delhaise 1998).²⁴

The most egregious and damaging aspect of the failure of the monetary authorities in Burma to provide adequate short-term liquidity (much less a deposit guarantee) was that the costs of the crisis were transferred directly onto depositors and borrowers – the very cohort whose faith in monetary institutions was a necessary prerequisite in Burma's economic development. The stakes could hardly have been higher. Rebutting criticism of the Indonesian government's deposits guarantee declared in 1997, Enoch *et al.* (2003: 86) noted that:

To have tried to force depositors to bear the costs of the banking failures could have led rapidly to the collapse of most, or all, banks in the country, turning Indonesia into a wasteland of financial intermediation and returning it to a cash or barter economy.

As noted earlier, it was into 'cash and barter' that Burma's economy descended in the wake of the banking crisis. The economic costs of this regression have been, and will be well into the future, severe. The role of banks in creating media of exchange is one of the crucial functions they play in an economy. Banks, through their creation of non-currency media of exchange, form the basis of the payments system in most countries. In so doing they contribute what Frydl and Quintyn (2000: 52) perceptively categorised as a valuable 'input' into a country's production potential by allowing the division of labour. This input scarcely came to function in Burma in 2003.

The recall of loans is usually a last desperate step by banks to repair their balance sheets. According to the seminal work on 'bank runs', Diamond and Dybvig (1983: 404), 'the real damage from bank runs is primarily from the direct damage occurring when recalling loans disrupts production'. Such disruption has short-run effects in the temporary loss of employment by workers displaced from the sale of enterprises and productive assets, as well as the capital loss from the 'fire-sale' of assets. But there are also longer-run effects. These include the opportunity costs to future national wealth from the projects that *no longer* go ahead. They also include what Frydl and Quintyn (2000: 51) label the 'permanent loss of wealth' that comes from the 'disruption of the combination of specific capital, knowledge and skills in the liquidated investments'. Such costs have been well documented from previous crises, including the experiences in Indonesia through 1997/98, when loan recalls were similarly (initially) entertained (Lindgren *et al.* 1999: 25). Of course, what separates these experiences from Burma's in 2003 was that, in Burma, the very authorities that should have been preventing this outcome were enforcing it.

In the final analysis, much of the blame for Burma's banking crisis in 2003 must be laid at the door of the CBM and, to the extent that it did not enjoy operational autonomy, Burma's governing institutions more broadly. The CBM did more than simply neglect its responsibilities. Throughout the crisis it not only failed to respond to the growing crisis in the way that we have come to expect central banks can and should, but it actively encouraged reactions most likely to bring about systemic instability. It gave the impression (nothing in its actions was ever entirely clear) that the banks and their customers were on their own. Early (and quickly contradicted) announcements notwithstanding, the monetary authorities in Burma did not stand behind the country's banking system.

MONEY-LAUNDERING AGAIN: PERPETRATORS AND VICTIMS

As detailed above, the concerns over money-laundering were a contributing trigger to the sudden collapse in confidence in Burma's private banks. In the wake of the crisis, however, the issue and the pressure from offshore agencies over money-laundering increased dramatically, precipitating a series of events that would bring about the downfall of the biggest names in Burmese banking.

The first of these events came in the form of a decision by FATF on 3 November 2003 to impose 'additional countermeasures' on Burma. As noted, Burma had been designated a 'non-cooperating' jurisdiction by FATF since 2001, but this latest announcement came in the wake of what FATF called the country's continuing failure to address 'major deficiencies in its anti-money-laundering regime'.²⁵ The already existing measures against Burma required financial institutions in FATF member countries to 'give special attention to' relationships and transactions with Burmese enterprises. The additional measures announced on 3 November were much tougher and included: (1) Stricter 'know thy customer' requirements of financial institutions to Burmese entities, to better identify the 'beneficial owners' of funds. (2) Greater scrutiny of individual transactions on the basis that, involving Burma, they were 'more likely to be suspicious'. (3) The taking into account of Burma's 'non-cooperative' designation if and when deciding upon the authorisation of local subsidiaries, branches, representative offices and the like of Burmese financial institutions. (4) Warning *non-financial* institutions that transactions with any entities in Burma 'might run the risk of money-laundering'. It was this last point that was perhaps the strongest of all of these FATF countermeasures in that its effects necessarily extended beyond simply the financial sector.

Two weeks after the latest FATF announcement came another from the United States Treasury. It declared that Burma as a jurisdiction, and the AWB and the Myanmar Mayflower Bank specifically, were of 'primary money-laundering concern'. This declaration authorised the US Treasury Secretary (under Section 311 of the USA Patriot Act²⁶), in collaboration with other US government departments and agencies, to direct financial institutions in the United States to 'take certain "special measures"' against the banks in question.²⁷ Such measures ranged 'from enhanced recordkeeping or reporting requirements to a requirement to terminate

correspondent banking relationships with the designated entit[ies]'. In the case of this ruling specifically:

The designation of Burma is intended to deny Burmese financial institutions access to the U.S. financial system through correspondent accounts. Thus, the proposed rule would prohibit U.S. financial institutions from establishing or maintaining any correspondent account for, or on behalf of, a Burmese financial institution. This prohibition would extend to any correspondent account maintained by a U.S. financial institution for any foreign bank if the account is used by the foreign bank to provide a Burmese financial institution indirect access to the U.S. financial system. In such a case, the U.S. financial system would be required to ensure that the account no longer is used to provide such access, including, if necessary, terminating the correspondent relationship.²⁸

Both the AWB and the Myanmar Mayflower Bank were covered by the measures above, but the US Treasury also took additional 'independent action' against these two in order, it said, 'to reinforce the importance of termination of relationships with these two institutions, and to ensure that no exemptions are available for them'. The action against the AWB and Mayflower was 'the first time that the Treasury Department has used its authority under Section 311 against a foreign financial institution'. The reason for singling out the pair according to the Treasury was that they had information that the two were

...controlled by and used to facilitate money lending for such groups as the United Wa State Army – among the most notorious drug trafficking organizations in Southeast Asia. The Burmese government has failed to take any regulatory or enforcement action against these financial institutions, despite their well-known criminal links.²⁹

The ban on AWB and Mayflower would remain in place until it was 'demonstrated that they have severed their links with narcotics trafficking organizations'.³⁰

The Burmese government was not inactive in response to the declarations of FATF and the US authorities, and on 5 December 2003 it (finally) issued the regulations required to bring into force its *Law to Control Money and Property Obtained by Illegal Means* (which, as we have seen, was promulgated as far back as June 2002). On paper these rules (titled 'The Control of Money Laundering Rules') met many of the requirements of FATF and the US State Department.³¹ The government also established an

'Investigation Body' under the Ministry of Home Affairs to enquire into the specific money-laundering allegations against AWB and Mayflower.³² The Investigation Body was authorised to examine all accounts (and account holders) whose deposits exceed 30 million kyat. Its membership comprised representatives of the CBM, the Auditor General's office, the Ministry of Commerce, the Myanmar Chamber of Commerce and Industry and the Bureau of Special Investigation. The Investigation Body was asked to report within three months, but was instructed that it 'should be careful not to affect the regular functions of the banks'.³³

From this point the end for both the AWB and Mayflower came relatively quickly. Both had essentially ceased functioning in the wake of the banking crisis, but on 9 December 2003 the banking operations of both were formally suspended. This created more pain for depositors in the banks, who were prohibited from accessing their funds except during limited, specified, intervals. Of course, neither bank was allowed to take in new deposits, advance new loans or provide remittance or other services. Finally, on 31 March 2005, the banking licences of the AWB and Mayflower were revoked. Remaining deposits were refunded, but there was a sting in the tail for borrowers who may have thought they were off the hook. In an announcement published in the *New Light of Myanmar* on 2 April the CBM ordered that:

Persons who are liable to Myanmar May Flower Bank and Asia Wealth Bank concerning loans and overdraft, credit card and other outstanding liabilities are required to contact the respective banks and their branches and to settle their liabilities *immediately*. Failure to do so, they will be taken action [sic] under the existing laws.

The end of the AWB and Mayflower banks was not the only act in Burma's money laundering play, however. On 5 August 2005 the branches of the Myanmar Universal Bank, one of Burma's 'big five' private banks before the 2002/03 crisis, were suddenly sealed off by Burmese troops.³⁴ The chairman and the managing director of the Bank were arrested the same day, and various government statements hinted at money-laundering and other activities 'inconsistent with CBM laws'. Rumours linking the MUB with money-laundering had been around for some time (most talking up the Shan ancestry of the Bank's founder, Tin Sein, and his purported connections with Wei Hseuh-kang, a Chinese-born business figure who had been indicted for narcotics trafficking in the United States and Thailand),

and the move was taken to signify the desire of the Burmese government to be seen to be 'getting serious' on the money-laundering question. Other accounts placed less stress on money-laundering suspicions, and more on the close connections between the MUB and the then just-deposed Burmese Prime Minister, Khin Nyunt. In the end the MUB was not closed down in the manner of the AWB and Mayflower banks, but absorbed within the state-owned Myanma Economic Bank.

Throughout all of the above Burma had remained on FATF's 'non-cooperative' list with respect to money-laundering – appearing year after year in the organisation's annual report until, by 2005, it was the *only* country so designated. In October 2006, however, Burma too was removed from the list, FATF determining that the country had 'made good progress in implementing its anti-money laundering system'. This development was not quite a complete bill of health, with FATF cautioning that it would 'continue to monitor' Burma, and called upon its regulators to give particular attention now to 'dealers in precious metals and precious stones'.³⁵ Finally, and although not specifically confined to money-laundering *per se*, in the wake of the SPDC's crackdown on demonstrators in September–October 2007, the long-standing financial sanctions levied by the US were joined by similar measures imposed by countries such as Australia and Canada, and an extended and stiffened response from the EU.³⁶ As a financial jurisdiction Burma remains, in short, something of an international pariah.

LIMPING ON: BURMA'S FINANCIAL SYSTEM AFTER THE CRISIS

The 2002/03 banking crisis brought Burma's financial system to the point of collapse. In its wake, and as a consequence of the money-laundering problems noted above, a number of the country's most prominent financial institutions disappeared entirely. Many more were rendered moribund, a situation from which few have revived. Table 10.1 (overleaf) illustrates the big picture:

As can be seen from the data below, the damage wrought by the 2002/03 crisis was both sharp and prolonged – and even by 2006 most data categories had yet to return to pre-crisis levels. As might be expected, the 'run' of anxious depositors in Burma's private banks was reflected first and most obviously in the severe decline in demand deposits, which fell by over 70 per cent between 2002 and 2003 (April to end-March). Time and fixed deposits, given their maturity structure, fell by a more modest

Table 10.1 Private Bank Loans, Deposits and CBM Assistance, 2001–2006 (kyat millions)

<i>Year</i>	<i>Demand Deposits</i>	<i>Time and Fixed Deposits</i>	<i>Claims on Private Sector</i>	<i>Credit from CBM</i>
2001	206,349	450,560	416,176	15,601
2002	290,520	541,307	608,401	44,251
2003	82,948	386,298	341,547	96,692
2004	139,880	594,169	428,931	48,210
2005	209,324	697,736	570,924	7,739
2006*	243,719	818,039	590,127	4,500

* As at July. Source: IMF (2007), and author's calculations.

29 per cent. Of course, this deposit flight took place during a period in which withdrawal restrictions were supposedly in place – suggesting simultaneously perhaps both the scale of the panic and the ineffectiveness of the withdrawal controls. Recovery in both categories of deposits began in 2004, particularly for time and fixed deposits which reclaimed much of their pre-crisis momentum. As at July 2006, demand deposits remained depressed.

As noted above, perhaps the most damaging aspect of the 2002/03 banking crisis had been the cessation of lending and the recall of loans. Total loans outstanding to the private sector declined by 44 per cent across 2002 to 2003. An anaemic recovery took place in 2004, but by 2006 bank lending to the private sector in Burma – the main source of any prospective growth – had not reclaimed the levels of 2002. The final column in Table 10.1 displays the level of lending to the private banks undertaken by the CBM. The data here demonstrates the dramatic increase in CBM support in the crisis period, but it will be noted that the magnitudes involved fell well short of the amounts necessary.

Despite the overall destruction wrought by the 2002/03 financial crisis, there were winners as well as losers from the drama and its aftermath and, following the disappearance of the AWB and Mayflower banks (and subsequently the MUB), some considerable ‘shuffling of the pack’ took place amongst the private banks. The changes were most apparent at the top of the banking tree, with the ‘big five’ now replaced by a ‘big four’ with only Kanbawza Bank common to both sets. The other three members of the four were (in rough order of size), the Myawaddy Bank, Cooperative Bank and First Private Bank.

The Kanbawza Bank, which had been the fourth-largest private bank in Burma before the 2003 crisis, had emerged by 2006 as the largest private

bank in Burma. Placed under CBM administration at the height of the financial crisis, Kanbawza was permitted to resume 'normal' operations in February 2004, and by July claimed that deposits 'had increased six-fold'.³⁷ In 2006 these deposits stood at K50 billion, and the Bank had 45 branches across Burma. By way of comparison, and illustrative of the weakened state of Burma's private banking sector, the largest private bank *before* the crisis, the AWB, had deposits in excess of K80 billion.

The new second-placed Myawaddy Bank was officially a private bank but, as noted in the previous chapter, as an associate enterprise of Burmese military-owned companies it could be better considered 'semi-official'. Prior to the 2003 crisis, Myawaddy Bank was not particularly prominent and appeared to function as much as a corporate treasury as a bank. The difficulties experienced by other banks since 2003, however, gave Myawaddy new-found opportunities, and it numbered amongst the banks that reported a strong recovery across a range of banking activities. According to Tun Kyi, the Bank's Deputy Managing Director, deposits increased by about 40 per cent in the quarter following the crisis, with the Bank an apparent beneficiary of the flight of depositors from 'less well-connected' banks. Tun Kyi also claimed that customers of Myawaddy had been able to offer its products and services throughout the crisis period and beyond, 'which other private banks haven't been able to do'.³⁸

The third-placed Cooperative Bank was a post-crisis product of a merger (in June 2004) between the already-existing Cooperative Bank and the two smaller 'cooperative' banks, the Cooperative Farmers Bank and the Cooperative Promoters Bank. The merger gave the Cooperative Bank 13 branches in Burma, of which the original Cooperative Bank contributed eight. By 2005, the Cooperative Bank claimed to have K24 billion in deposits and paid-up capital of K1.5 billion.³⁹ Like Kanbawza, the Cooperative Bank asserted that deposits had enjoyed rapid growth in the immediate aftermath of the financial crisis, tripling in the period from February 2003 to end May 2004. On the liabilities side, loans had 'increased more than three-fold' from when the Cooperative Bank recommenced lending in November 2003 to mid-2004.⁴⁰

The fourth of Burma's 'big four' private banks was the First Private Bank (FPB). The FPB's chairman, Dr Sein Maung, emerged as the most prominent spokesperson of Burma's private banks following the demise of the AWB (and that of its outspoken figurehead, Aik Htun), and the Bank as one of Burma's most profitable. In 2006 the FPB reported that it had K16 billion in

deposits, 15 branches, 460 employees and profits for the year of K1.49 billion (up from K865 million in 2005).⁴¹ During 2005 and 2006 it also undertook a capital raising which increased the Bank's paid-up capital to K5 billion (from K1 billion).⁴² The capital injection was a consequence of the CBM's '1:7' capital/deposits ratio (more on which below), of which Sein Maung had been critical. In an interview in October 2005, he even claimed that the FPB had returned deposits because of the need to meet the new ratio – the primary reason for the fall in bank deposits from their high in 2004 of K27 billion.⁴³ The FPB reported that its lending book had expanded by nearly 60 per cent in 2005, with new loans being divided between the 'service sector' (41 per cent), manufacturing (27 per cent), with the remainder to unspecified 'trading' enterprises.⁴⁴

Beyond the new 'big four', mystery and ambiguity surrounded the operations of most of the other private banks. Nowhere was this more the case than for Yoma Bank, Burma's second-largest private bank before the 2002/03 financial crisis. Yoma Bank survived these events but, as we have seen, it was forced to both seek assistance from the CBM and 'liquidate' certain fixed and other assets. The CBM was unhappy with a number of practices (never publicly specified) of Yoma Bank prior to the crisis, and alleged that it had acted in ways inconsistent with the FIML. Though Yoma did not have the political 'connections' of banks such as Kanbawza, in contrast to the (even more entrepreneurial) Asia Wealth Bank, it continued to receive approval to conduct banking functions on a 'limited basis' after the crisis. These functions did not include, however, taking in new deposits, granting new loans, or continuing its credit card facility. At the Annual General Meeting of First Myanmar Investment (FMI) in September 2004, the ultimate parent company of Yoma Bank, FMI's Chairman, Serge Pun, announced selected financial results for Yoma Bank for the year ended 31 March.⁴⁵ According to the announced results, Yoma made profits of K231 million for the year, down from the K1.3 billion of the previous year but an astonishing (and scarcely believable) performance in the circumstances. Making the earnings result all the more remarkable was that the other figures released attested to the damage the 2003 crisis had wrought on Yoma. Deposits declined by 80 per cent from K135 billion in January 2003 to K27.6 billion as at end March 2004. Loans likewise suffered a 72 per cent fall to K31.1 billion (from K110 billion in February 2003). The *Myanmar Times* quoted Serge Pun as being 'cautiously optimistic' about Yoma Bank's future whilst acknowledging that it 'will continue to face acute challenges

with the restrictions on income flows'.⁴⁶ At the equivalent meeting in 2006 similar cautious optimism was expressed – but the bank remained largely moribund nonetheless.⁴⁷

Reports of a general revival of Burma's banks became relatively commonplace in the Burmese press after 2003, but elsewhere there were signs that cast doubt on the recovery narrative. Illustrative in this context were the reports of what was occurring in Burma's (especially Rangoon's) property market. A market normally dependent on credit, Burma's property market was in dire straights following the banking crisis. Of course, the property sector's decline was not wholly attributable to credit difficulties (the Rangoon market was almost certainly the subject of a price 'bubble'), but there can be little doubt that these were central. In the years since 2003, credit to the property market in Rangoon and elsewhere almost completely dried up – prompting complaints from property developers that they had 'to finance projects 100 per cent'. As a consequence of this, what residential construction did take place was piecemeal – each section needing to 'be completed and sold before there were funds to finance construction of a subsequent section'.⁴⁸ Most eloquent of all, however, was this complaint from a property developer from Hlaing Tharyar township, of the *practical* difficulties of business without bank credit: 'Buyers have to pay in cash, so they have to carry the money in bags, which is not very convenient (...)'.⁴⁹

THE CBM CONTINUES ITS MONEY-PRINTING WAYS

In the wake of the 2002/03 financial crisis a number of changes were made to the regulations the CBM imposed upon the banks. By far the most important of these was a new 'gearing' requirement (noted briefly above, and captured under the broad provisions of Article 57 of the *Central Bank of Myanmar Law*), that specified that banks had to hold paid-up capital to deposits in a ratio of no less than '1:7'. This requirement was similar to the 'gearing' or 'leverage' ratios applied to banks internationally prior to the Basel capital Accords (though such ratios were invariably expressed in terms of *assets* rather than deposits). As such, and on their own, such gearing requirements had been neither unusual nor inappropriate. In the case of Burma, however, with the Basel capital accords already (formally) in place, the new measure was potentially highly restrictive. Precision in this assessment is not possible, since (depending on the nature of a particular bank and its balance sheet) the new ratio could make certain

other regulations redundant (the deposit and profits reserve requirements notably) – or, in turn, it could be made redundant by *them*. Alternatively, however, it could ‘piggy back’ upon the other regulations and thereby create a most restrictive set of capital requirements for Burma’s banks indeed. The latter view was held by Myat Thein (2004: 12), who suggested that the measure may well help prevent ‘bank runs’, but only at the cost of making ‘legal [sic] banking unprofitable, and hence, unsustainable’. Myat Thein’s conclusion came from his assessment that, since Burma’s banks lent only about 70 per cent of their deposits (the remaining 30 per cent being sanctioned off into required liquid assets and reserves), the CBM’s 1:7 capital/deposits ratio was equivalent to an capital/assets gearing ratio of around 1:5, or 20 per cent. Such gearing ratios globally and historically have usually been significantly below 10 per cent (in Chapter 9 we noted the ‘consensus’ capital/assets ratio of 1/18, or around 5.5 per cent). The overall effect then was one that potentially greatly restricted the lending abilities of Burma’s banks. Unfortunately the available data on Burma’s banks disallows a definitive answer to the question but, anecdotally, there was much in favour of Myat Thein’s assessment. We have, for instance, already seen that one of Burma’s most successful banks, First Private Bank, had complained that the 1:7 capital/deposits requirement had forced it into a position of having to ration loans, and even ‘hand back’ some deposits.⁵⁰ In August 2006, and in the wake of what seemed to have been active lobbying of the CBM by the private banks, the new gearing ratio was relaxed to one of 1:10. Immediate problems were thus perhaps resolved, but the issue remained problematic for the future.⁵¹

Meanwhile on the ‘macroeconomic’ side of its responsibilities, the CBM continued to function after the financial crisis more or less as it had before it – as a financing arm of the state. As Table 10.2 opposite reveals, the CBM’s lending to the government, and the concomitant swelling of currency circulating outside the banks, overwhelmed the funds made available by Burma’s financial system to the private sector. The principal problem of macroeconomic policy-making in Burma, in short, sailed on.

With respect to its management of Burma’s exchange rate system, likewise the CBM continued to function more or less as before. Burma’s currency remained officially fixed at a rate of about K6:\$US1, from which the ‘market rate’ diverged ever more. In late 2007 Burma’s market exchange rate stood at around K1,300:\$US1. Meanwhile, hopes that the CBM might be granted a degree of at least ‘formal’ independence under Burma’s ‘new’

Table 10.2 CBM Lending to Government, 2001–2006 (kyat millions)

<i>Year</i>	<i>Central Bank Lending to Government</i>	<i>Currency Outside the Banks</i>	<i>Bank Claims on Private Sector</i>
2001	675,040	494,521	416,176
2002	892,581	718,633	608,401
2003	1,262,588	1,102,937	341,547
2004	1,686,341	1,347,598	428,931
2005	2,165,154	1,743,654	570,924
2006*	2,509,735	2,000,843	590,127

* As at July. Source: IMF (2007).

constitution being drafted (from late 2007) by a hand-picked committee of the SPDC have, perhaps not surprisingly, proved fruitless.⁵²

One change to the CBM that did take place, in June 2006, was in its *physical* location. In November 2005 Burma's government mysteriously founded the new capital city of Napyidaw, near Pinyinana (roughly in the centre of Burma). Most government ministries relocated almost immediately, but for a while it seemed that the CBM would remain in Rangoon (which remained very much the centre of Burma's commercial and financial activity). On 3 June 2006, however, the CBM and its 200 or so staff were likewise uprooted to Napyidaw.

NOTES

- 1 Most of the investors in the schemes interviewed by the author were in no doubt that they were ponzi (or 'pyramid') arrangements. This is not to say, however, that they appreciated the dangers therein.
- 2 For more on Burma's 'private services companies', and the types of schemes that they offered, see 'Bank Crisis Reeks of a Ponzi Scheme', Kyi May Kaung, *The Irrawaddy*, 26 February 2003, online edition, <www.irrawaddy.org>.
- 3 For the FATF report thus naming Burma *before* the financial crisis, see 'Review to Identify Non-Cooperative Countries or Territories: Increasing the World-Wide Effectiveness of Anti-Money Laundering Measures', 21 June 2002, <<http://www.fatf-gafi.org/>>.
- 4 The relevant 'International Narcotics Control Strategy Report' was released in March 2003 and is available at the website of the US State Department, <www.state.gov>.
- 5 United States Department of the Treasury, Financial Crimes Enforcement Network, FinCEN Advisory, 'Transactions Involving Burma (Burma)', April 2002, <www.ustreas.gov>.
- 6 Ko Cho, 'Junta introduces money laundering law'.

- 7 The Chairman's statement was published in the same day's edition of Burma's principal state-controlled newspaper, *The New Light of Myanmar*. As the crisis wore on, Burma's press ceased to report on the crisis.
- 8 William Barnes, 'A run on Myanmar banks affects crony capitalists', *South China Morning Post*, 28 February 2003. See also Naw Seng, 'On shaky ground', 17 April 2003, *The Irrawaddy*, online edition, *op. cit.*
- 9 In some of the banks this included the issue of 'tokens' that had to be redeemed upon the withdrawal of deposits. Other banks also discriminated amongst their customers – allowing, for example, those with larger deposits to withdraw larger amounts.
- 10 Notwithstanding these limits, an appreciation of the extent of deposit depletion can be gleaned from reports which estimated that the AWB lost almost a third of its deposits in the first two weeks of the panic (Turnell 2003).
- 11 Burma's 'Foreign Exchange Certificates' (FECs) likewise appreciated during the crisis.
- 12 Agence France-Presse (AFP) reported on 17 February that the AWB and Yoma Banks had instructed their customers not to use or honour *their own* credit cards. A similar instruction quickly followed from the Kanbawza Bank. See Turnell (2003).
- 13 For more on the problems Burma's banks face in communicating with each other, see Turnell (2002).
- 14 For a sample, see Kyaw Zaw Moe, 'Crisis Forces Businesses to Close, Crime to Rise', *The Irrawaddy*, 17 March 2003, online edition, *op.cit.*
- 15 Tony Broadmoor, 'Burma's Busted Banks', *The Irrawaddy*, 8 April 2003, online edition, *op. cit.*
- 16 Kin Nyunt's comments were quoted by the BBC on 16 February 2003, and are here cited from Zaw Oo (2003).
- 17 Reports of the Minister's comments can be found in the *Business Times*, 24 February 2003, online edition <www.business-times.asiaone.com>. He did not elaborate further as to what these breaches entailed.
- 18 For more on the issuing of the order, see Shawn Crispin and Bertil Lintner, 'As confidence in the banks collapses', *Far Eastern Economic Review*, 17 April 2003, p. 19. Some reports suggest that the CBM *ordered* banks to recall between 20 and 50 per cent of their loans. This could not subsequently be confirmed, but who made the order is less important than the fact that it was made with (at the very least) the CBM's blessing.
- 19 SPDC Secretary-1, Khin Nyunt, urged businesses at the annual meeting of the Burma Federation of Chambers of Commerce and Industry to 'repay their debts quickly'. These and other urgings fell 'on deaf ears' and, notwithstanding reported threats by some of the banks, there was little evidence that much in the way of repayments were forthcoming. In April, CBM officials allegedly threatened to 'take action' against borrowers who did not repay 'at least 20 per cent of their loans'. This threat seems not to have intimidated borrowers, however – one of whom was cited as saying that the authorities could hardly 'arrest anyone because nobody has broken any bank *regulations*' (emphasis added). Naw Seng, 'Bank Crisis Rolls On', *The Irrawaddy*, 7 May 2003, online edition, *op. cit.*

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- 20 Michael Backman, 'Burma's Banking Meltdown Goes Unnoticed Beyond its Borders', *The Age*, 20 March 2003, online edition, <www.age.com.au>.
- 21 Naw Seng, 'Yoma Selling Capital Assets', *The Irrawaddy*, 14 May 2003, online edition, *op. cit.*
- 22 For an overview of the debate regarding appropriate policy in a bank run, and the consensus emerging from it, see Latter (1997) and Goodhart (2002).
- 23 Such an outcome is even possible in practice, as was the case in Sweden during that country's banking crisis in 1991. See Frydl and Quintyn (2000: 56).
- 24 Of course such guarantees must be credible. In all four of these countries scepticism was only allayed once the guarantees had been established firmly within the law, and once they had been 'tested' in the difficult circumstances that persisted into 1998. Such credibility would have been more difficult to establish in Burma in 2003 but, given the *revealed* costs of the alternative, it should have been tried.
- 25 FATF's declaration on Burma, from which the following is heavily drawn, can be found at: <www.fatf-gafi.org>.
- 26 'Providing Appropriate Tools Required to Intercept and Obstruct Terrorism' (PATRIOT) Act, 2003.
- 27 The following draws on the official enunciation of these measures, as set out in the *Federal Register*, vol. 68, no. 227, Tuesday, 25 November, 2003: 66305–66311.
- 28 *Ibid.*
- 29 *Ibid.*
- 30 *Ibid.*
- 31 Details of the Law, as well as Rules supposedly designed to enforce and implement it, can be found at the online research pages of *The Irrawaddy*: <<http://www.irrawaddy.org/res/money.html>>
- 32 For more, see the website of the 'Democratic Voice of Burma' at <www.dvb.no>.
- 33 Details of the 'Investigative Body' were published on the website of *The Irrawaddy* on 5 December 2003, *op. cit.*
- 34 The actions against the MUB were widely reported around the world, representative of which were: Amy Kazmin, 'Burma's junta seizes privately owned bank', *Financial Times*, 8 August 2005; 'Myanmar Universal Bank taken over', *The Irrawaddy*, 9 August 2005, online edition; 'Myanmar Universal Bank scam latest', *Democratic Voice of Burma*, 9 August 2005, <www.english.dvb.no>.
- 35 Burma's removal from FATF's non-cooperative list was announced at the Plenary meeting of the organisation, held in Vancouver, Canada, from 9–13 October 2006. Brief details of the decision can be found at FATF's website, <www.fatf-gafi.org>.
- 36 Canada's Minister for Foreign Affairs declared on 14 November 2007 that his country aimed at imposing 'the toughest sanctions in the world' on Burma, including a ban on all financial transactions. Australia produced a list of 418 individuals and businesses it identified as being members of the SPDC or connected to it, blocking their access to the Australian financial system and freezing any assets they might hold in Australia. Brodie Fenlon and Tavia Grant, 'Canada imposes new sanctions on Myanmar', *Globe and Mail*, 14 November 2007; Reserve Bank of Australia, *Banking*

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(Foreign Exchange) Regulations, Sanctions Against Burma, media release, 24 October 2007, <www.rba.gov.au>.

- 37 May Thandar Win, 'Billions of kyat flow back to banks', *The Myanmar Times*, 19–25 July 2004, vol. 12, no. 225.
- 38 Moe Zaw Myint, 'Banking sector shows signs of recovery after troubled year', *The Myanmar Times*, 22–28 December 2003, Vol. 10, No. 197.
- 39 Moe Zaw Myint, 'Banking sector shows signs of recovery after troubled year'.
- 40 May Thander Win, 'Billions of kyat flow back to banks'.
- 41 Ye Lwin, 'FPB profits rise as loans pay off', *The Myanmar Times*, 20–26 November 2005, vol. 18, no. 343.
- 42 May Thander Win, 'FPB report provides new hope for banking sector', *The Myanmar Times*, 31 October–5 November 2005, vol. 15, no. 290.
- 43 *Ibid.*
- 44 'The nation's top 20 banks'
- 45 May Thandar Win, 'FMI posts robust financial results', *The Myanmar Times*, 20–26 September 2004, vol. 12, no. 234.
- 46 *Ibid.*
- 47 Zaw Htet, 'FMI profits beat the business blues', *The Myanmar Times*, 13–19 November 2006, vol. 18, no. 342.
- 48 May Thander Win, 'Economy tipped for brighter year ahead', *The Myanmar Times*, 16–22 January 2006, vol. 15, no. 300.
- 49 The property developer in question was Soe Myint, who was also a Director of Serge Pun and Associates (Myanmar) Ltd, a company associated with the Yoma Bank. The interview with Soe Myint appeared in Maw Maw San, 'Long awaited river-front project begins despite material prices rise', *The Myanmar Times*, 12–18 July 2004, vol. 12, no. 224.
- 50 May Thandar Win, 'FPB report provides new hope for banking sector'.
- 51 May Thandar Win, 'Banks claim a solid recovery', *The Myanmar Times*, 31 July–6 August 2006, vol. 17, no. 327. The strongest lobbyists seem to have been Dr Sein Maung of First Private Bank, and Thein Tun of Tun Foundation Bank.
- 52 Wai Moe, 'Junta presses on with "exclusive" constitution drafting', *The Irrawaddy*, 19 October 2007, online edition, *op. cit.*