ASIA FINANCIAL CRISIS CONFERENCE
FEDERAL RESERVE BANK OF CHICAGO

Chicago, Illinois
October 8, 1998

Opening Remarks

A. Good morning.

- I'm Michael Moskow, president of the Federal Reserve Bank of Chicago.
- It's my honor this morning to welcome you to what promises to be a lively and thought-provoking discussion on the topic of "Asia: An Analysis of Financial Crisis."

B. First of all, I'd like to thank our distinguished panelists and speakers for appearing at this conference.

- I think we have an outstanding line-up of speakers.
- I also want to thank the International Monetary Fund for co-sponsoring this event with the Chicago Fed.

C. This conference is an excellent forum for sharing information on the causes and consequences of the Asian financial crisis.

- The topic has dominated headlines throughout the world.
- Since July 1997, there have been more than 16,000 articles, journals, and reviews published nationally and internationally on this subject.
- An economist always hesitates to make an unqualified prediction, but I think it's safe to say that there will be many thousands more before the subject is exhausted.

D. Throughout this crisis, medical references have been commonplace.

- Asian economies are “ill” or in “poor health.”
- The name “Asian flu” has entered the national vocabulary.
- We worry about how contagious it is, and whether it’s reached epidemic proportions.
- Some have called for “economic penicillin” to solve the crisis.
- Others have said that any solution should be similar to a doctor’s approach to a patient—“First, do no harm.”

E. That’s probably not a bad oath for economists and policymakers, as well as doctors. And I think it’s useful advice in looking at the Asia crisis. But I hope we can do more than just avoid harm.

- I hope we can learn from this event and begin to develop policies to help prevent future crises. In that sense, the Asia crisis represents an opportunity for positive change.
- And I believe this conference is an opportunity to significantly increase our understanding of what constitutes effective policy.

F. Our understanding of the Asia crisis has already changed dramatically.

- When the crisis broke out with the collapse of the Thai Baht in July 1997, many believed the damage would be confined to a handful of small Asian economies. Some 14 months later, it’s clear how myopic that thinking was.
- The crisis has spread to other East Asian countries and Russia. And just a few weeks ago, Latin America has begun to encounter serious troubles.
- Some claim to have recognized the potential for crisis long before it began. Joke: (is Paul Krugman in the room?1)
- But most experts were taken by surprise by the speed and the timing of the crisis. The future is highly uncertain.
- But as Chairman Greenspan stated in September, it’s seems unlikely that the United States can remain an oasis of prosperity.

G. A basic assumption for our discussions at the conference is that the international payments system has been transformed in recent decades.

- Today, we have an interdependent, inter-linked global financial system with the ability to react to events at incredible speed.
- This global system has made a substantial contribution to living standards worldwide. But it also responds with brutal speed and efficiency in moving money away from potential risks.

H. Our task during the next three days is to develop a better understanding of this global financial system and the causes and consequences of the Asian financial crisis.

- To set the stage for our discussions, I'd like to briefly discuss two issues that are fundamental barriers to any long-term solution—the distortion of market forces and the resulting moral hazard.

- Addressing these issues must be the starting point in developing a fundamental solution. If you peel back the many layers of the Asian financial crisis, you'll find these issues at the core.

I. Focusing on market forces and moral hazard is important because they are key to preventing a bank crisis.

- The prompt resolution of a banking crisis is important, of course. But regulators tend to focus much of their time and attention preparing to pick up the pieces after the crisis.

- We can spend less time on resolving crises by spending more time on preventing them.

J. Ironically, many point to the turmoil in Southeast Asia as evidence of a breakdown of capitalism—a failure of market forces.

- But, this is mistaking the cure for the disease.

- It was the distortion of market forces—the common detour from capitalism—that led to economic problems in these countries.

K. Southeast Asian countries, along with others such as Japan and Russia, all skewed market forces in a variety of ways.

- Many succeeded for a while, enjoying incredible rates of economic growth. But the fundamental flaw in their systems eventually caught up with them.

- The boom was built on a house of cards. The cards began to collapse on July 2, 1997.

L. Now Southeastern Asia is witnessing the deterioration of its economic gains of the past decade.

- Thousands of companies have gone bankrupt.

- Unemployment has hit new heights.

- Hong Kong announced that its economy shrank 2.8 percent in the first quarter (most current?), its worst downturn since World War II.

- Economists predict Indonesia's GDP will fall some 15 percent this year. I could cite numerous other examples.

M. The Southeastern Asian countries provide a case study of the dangers of a half-hearted adoption of a market economy.

- The Asian economic miracle was fueled largely by a strong influx of foreign capital. Under a true market-based system, such capital flows would have been correctly allocated and invested.

- But such systems were not in place. These countries lacked the market discipline to ensure that financial institutions were properly allocating risk.

N. In many cases, dubious investments were cheerfully funded by banks as long as the borrower had the right government connection.

- Patronage became more important than profits.
- The fundamental function of banks as an efficient allocater of credit was subverted.
- Banks merely channeled funds to borrowers who were political allies, relatives, or industrial partners.
- The results were predictable.

O. The lack of market discipline left these countries susceptible to moral hazard.

- Indonesia, Thailand, and Malaysia have strong interlocking relationships between the public and private sector.
- There was an implicit guarantee of financial institutions since their owners were often related to government officials or had other ties to them.
- You could say that the seeds of moral hazard can be traced back to the family trees of Southeast Asia.

P. Such "crony capitalism" led to a blatant disregard of safety and soundness in banking practices.

- Financial institutions assumed their government would guarantee their liabilities in the case of default and felt little need to avoid risky practices.
- Banks were playing a game of "Win some, lose none." They reaped large gains from risky ventures in good times and expected the government to bail them out in bad times.

Q. Moral hazard led to an extreme misallocation of capital in Southeast Asian economies. And the lack of transparency in Southeast Asian banks left investors uninformed about the seriousness of the crisis, until it was too late.

R. As I mentioned earlier, it's these deviations from market-oriented capitalism that is the common thread connecting those countries suffering from economic crisis. They may differ in the way they distorted market forces, but the outcomes were essentially the same.

S. Now these nations must grapple with the question of whether they are willing to reform. Will they restructure their economies to be market-driven models?

- Some nations have grown impatient and threatened to turn away from globalization and toward isolation.
- Malaysia imposed currency and stock market controls in an effort to insulate its economy.
- Russia appears to be reverting to a less market-driven economy.

- And even Hong Kong, a bastion of free-markets, bought an estimated $15 billion worth of stocks to bolster prices after sell-offs by speculators.

T. Are Asian countries losing faith in free markets?

- Certainly there's growing anger among some officials, business leaders, and citizens about the crisis. And free markets are an easy target.

- But obviously no one can truly "opt-out" of the global financial community. That's no longer a realistic possibility.

- A return to prosperity for those countries in crisis requires a commitment to market reform. The two are inseparable.

U. I'm sure that market forces and moral hazard are two issues that will feature prominently in our discussions at the conference. There are, of course, a number of important issues that we'll cover during the next three days. Here are just a few of the key questions that we'll be discussing:

- What were the causes of the Asian financial crisis and why was its onset so sudden and unpredictable?

- How effective have international rescue operations been in dealing with the crisis?

- How should the international financial system balance the stability gained from a financial safety net against the potential risk of moral hazard?

- How has the opaqueness of Asian financial markets contributed to the crisis?

- Is the Asian crisis a failure of market–oriented capitalism or a failure of state-managed capitalism?

- How has openness to market forces affected the severity of the financial crisis in each country?

- And perhaps most importantly, what actions can be taken to prevent future crises?

V. The answers to these questions, and many others we'll be discussing in the next two days, will help shape the future of public policy related to the international financial system.

- I'm pleased that we have some of the leading experts from the academic, regulatory, and financial services industries to discuss these issues.

- I'll now turn over the podium to Greg Taylor, executive director of the IMF, who will be chairing our first panel discussion.

W. Again, I welcome you to this conference and look forward to some lively discussion during the next three days.