

CONFERENCE ON GLOBAL FINANCIAL CRISIS AND ECONOMIC DEVELOPMENT
FEDERAL RESERVE BANK OF CHICAGO

Chicago, Illinois
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I. Conference Introduction

- A. I'd like to welcome all our distinguished guests here today to the Federal Reserve Bank of Chicago. We are very pleased to co-sponsor this conference with the University of Chicago Department of Economics and the George J. Stigler Center for the Study of the Economy and the State.
- B. Any conference would be privileged to have one Nobel Laureate present; today we are doubly blessed by the presence of two, Gary Becker and Robert Lucas. And given the involvement of the University of Chicago in this event, who can say how many prospective Nobel Laureates are here with us today.
- C. We're fortunate to have George Soros as our luncheon speaker.
 - 1. George is known for his unusual approach to market capitalism, and will discuss financial markets regulation.
 - 2. It's rare to have such an adept capitalist argue that financial markets are inherently unstable and require increased governmental oversight.
 - 3. We look forward to hearing his views.
- D. Many of you here have addressed the issue of financial crisis at numerous gatherings over recent months. Admittedly, the number of major conferences focusing on financial crisis is fast matching the number of crises themselves. But in truth this is appropriate.

1. This is a time of low inflation and high economic growth in the United States. Yet financial crises in other countries are practically nipping at each other's heels, as they increase in frequency, and severity.
 2. Furthermore, financial crises are global in their impact. Addressing financial crisis should be of global concern — and of top priority — among academics, practitioners, and policy makers alike. One country's economic downturn is no longer only a domestic concern.
- E. As concerned academics, practitioners, and policymakers, I'm confident that we'll shed some light on the nature of these financial crises, as we discuss if and how they might be averted in the future. Perhaps some countries are particularly susceptible to financial contagion. Perhaps some new approaches to global crises are warranted.
- F. At our annual bank structure conference earlier this month, Joe Stiglitz aptly compared individual countries' experiences in the aftermath of financial crisis to that of a driver who's had an accident on a curve in the road.
1. At first, it's assumed that it's the driver's lack of skill. But if more and more accidents occur on the same curve, that curve soon becomes as suspect as the drivers.
 2. Today we address ourselves to road safety on the route to international financial stability.
- G. The changing nature of the global economy may have serious implications for the economic development of emerging countries.
1. Not only has the global economy become increasingly interdependent, but capital flows are at higher levels than ever before.
 2. Developing countries are particularly vulnerable to financial contagion and capital flight. It may be that developing countries are ill suited to protect themselves against financial crisis.
- H. The recent financial turmoil in Asia has caused some to question the sustainability of the Asian economic model.
- Was financial crisis inevitable for these countries?
 - Certainly, the Asian model for economic growth was effective in the early stages of development. But what was the source of growth for these countries?
 - Should we credit, as Krugman (and Alwyn Young) argues, high growth of capital and labor?
 - Can we rely on neoclassical growth theory to explain these countries' economic development?
 - Can the standard economic paradigm explain the magnitude and rapidity of the economic collapse we've seen in several crisis countries?
- I. It's also possible that the current financial troubles are simply a temporary setback for developing countries on the road to convergence, that is, on the road to being on a par, economically, with developed countries.

1. With high rates of return, capital flows to developing countries were abundant prior to the crisis.
 2. Thanks to this abundance of capital, and emulation of technology, convergence did indeed seem underway.
- J. And we must ask whether the economic problems these emerging countries are experiencing were caused by their pattern of growth at all.
1. Some would argue that non-market strategies such as relationship lending and state-managed investment may have caused problems for these countries as they moved beyond the nascent stage of development.
 - Without the price mechanism steering investment and production decisions, inefficient allocations can be expected to occur.
 2. Is it possible that a crisis occurred because such inefficient allocations, overlooked during periods of high economic growth, eventually had dire consequences.
 - What is the future for these emerging economies?
 - Has the Asian economic miracle ended, or will it reemerge?
- K. We'll begin the conference today by discussing Thailand, the first in a series of case studies meant to illustrate the elements of crisis and recovery in greater detail.
1. It's appropriate to begin with Thailand given that the devaluation of the Thai baht on July 2, 1997, was the first sign of the Asian financial crisis.
 2. Thailand along with Korea, Indonesia, and Malaysia were the first to suffer difficulties and bore the brunt of the crisis. Thailand's financial markets are now beginning to recover.
 - How is the economic recovery of Thailand proceeding now that the exchange rate has stabilized and interest rates have fallen below pre-crisis levels?
 - Has Thailand's fiscal stimulus package and structural reforms begun to take hold?
 - Can we share in the optimism that the country first to fall to the Asian crisis is now showing signs that the worst is over?
 3. These questions will be addressed by our first speaker.
- L. The case of Taiwan presents a marked contrast from that of Thailand.
1. While Taiwan experienced some characteristics of economic crisis, it didn't suffer the same fate.
 2. Taiwan is characterized by a healthy domestic economy with large foreign reserves and a very stable currency.
 - Why was Taiwan spared from the brunt of the Asian crisis?
- M. Later this morning we'll turn our analysis of global crisis to Latin America and focus on developments within Brazil and Argentina.

1. Both countries account for a large share of Latin American output, with Brazil contributing nearly a third of total output within the region.
 2. We've seen limited contagion effects in Brazil so far, but only time will tell if Brazil's economy will be protected over the long term.
 3. The real plan has shown real promise as inflation has been cut from levels of above 2000% in 1993-94, to 3.5% in 1998.
 4. Brazil must still contend with increasing fiscal and current account deficits; how Brazil deals with these issues will be of great consequence to us all given that Brazil's economy is crucial to the financial health of all of Latin America.
- N. Argentina's economy has strong implications for Latin America as well.
1. The Argentinean situation typifies the growing demand for new methods to protect against volatility.
 2. Their current examination of "Dollarization", that is, the total elimination of the Argentine currency and its replacement with the US dollar, shows the great lengths to which this country will consider to protect its economy from financial contagion.
- O. The economic turmoil confronting these and other countries has profound implications on the United States.
1. The U.S. has continued to provide refuge from the financial storm that has affected the global economy.
 2. U.S. consumers and investors accounted for nearly half of the growth in the world's demand and output last year.
 3. Price stability, high labor productivity, and our current budget surplus have contributed to the health of the U.S. economy.
 4. However, the ability of the United States to sustain the global economy can not continue indefinitely.
 5. The recovery of other nations from financial crisis is an important factor that will affect our future economic growth in the U.S.
- P. I look forward to the presentations and discussions during this conference.
1. Today we hope to hear from a selection of diverse perspectives to better understand recent financial crises, and what lessons can be learned in order to reduce their occurrences in the future.
 2. I believe this conference has gathered together some of the finest minds in our discipline; I have no doubt that we can shed some light here today on one of the central problems presently facing global economic progress.

II. Introduction of Sam Peltzman

- A. Now I'd like to introduce to you the moderator of the first portion of today's conference, the Director of the Stigler Center, Professor Sam Peltzman.
- Professor Peltzman is also the Sears, Roebuck Professor of Economics and Financial Service at the University of Chicago's Graduate School of Business, where he has served on the faculty since 1973.
- B. After receiving his Ph.D. in Economics from the University of Chicago in 1965, Professor Peltzman held research fellowships or professorships at Hebrew University of Jerusalem, UCLA, and the National Bureau of Economic Research.
- He has served as Senior Staff Economist for the President's Council of Economic Advisers.
- C. His articles, on issues related to the interface between the public and private economy, are widely published in academic journals. Also he is author of *Political Participation and Government Regulation*.
- D. In addition to serving as editor of the *Journal of Law and Economics*, Professor Peltzman is on the advisory boards of several academic journals and on the Council of Academic Advisers of the American Enterprise Institute.
- E. Please welcome Dr. Sam Peltzman.