2006 KDI Conference on

ADOPTING THE NEW BASEL ACCORD:

IMPACT AND POLICY RESPONSES OF ASIA-PACIFIC DEVELOPING COUNTRIES

Opening Remarks

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KDI Main Conference Hall

Dr. Jung Taik HYUN
President
Korea Development Institute

The honorable Chairman of Financial Supervisory Commission, Jeung-Hyun Yoon,
Distinguished guests, and ladies and gentlemen,

It is my great pleasure to welcome all of you to this conference on "Adopting the New Basel Accord: Impact and Policy Responses of Asia-Pacific Developing Countries."

I would like to express my appreciation for all the distinguished speakers from home and abroad, who took time out in their busy schedule to participate in today's KDI Conference to share their insight and knowledge. Also I would like to thank all KDI staff members for successfully organizing this important conference.

In recent decades, we have observed that the changes in financial environments have played a major role in shaping macroeconomic outcomes in various countries. The movements in the financial sector reinforced the momentum of underlying economic cycles, and in some cases caused extreme swings in economic activity.

The well-known example is the Asian crisis in 1997, and even more recent case would be Korea's consumption boom and bust accompanied by rapid increase and severe adjustment of household debt in the early 2000s.

Due to these experiences, financial stability has received a considerable amount of attention, and we can all agree that a stable financial system is critical to the long-term economic growth. This is the reason why we need prudential regulations and require that supervisors ensure the soundness of bank operations.

One of the fundamental elements of banking supervision is to impose regulatory capital requirements based on the belief that capital is the last line of defense against bank insolvency.

In this regard, I believe the implementation of Basel II will enhance financial stability via better risk management of banks and bringing regulatory capital requirements more in line with current good practices.

However, there are two major issues concerning Basel II worth mentioning in the context of developing countries.

First is the difficulty that will be faced by developing countries when implementing Basel II. Since Basel II is an accord that was specifically meant for 13 member countries of the Basel Committee, there are no legal obligations for developing countries to adopt the New Accord. However, this does not necessarily mean that Basel II can be ignored by them. As their banks have to compete on an international level, they cannot help but follow the agreed standard of risk management to gain trust of other internationally active banks in this era of globalization.

Given this premise, many developing countries are preparing to adopt Basel II in the near future, but it is believed that many of the prerequisites needed before the implementation, such as sophisticated risk management system and efficient credit rating market, are currently beyond reach for these developing countries.

Second, there is a broad consensus among researchers that Basel II may extend the procyclicality of bank lending or the possibility of credit crunch in the SME sector due to its more risk-sensitive supervisory framework. In the developing countries, the impact can be much greater since financial risks of their banks are generally considered to be much higher than those banks in advanced countries.

To cope with those concerns, academics and policymakers argue that appropriate economic policy measures, such as more responsive counter-cyclical monetary adjustment, need to be developed to alleviate the potential adverse macroeconomic effect of Basel II.

In recognizing the importance of Basel II related issues not only for financial supervision but also for stable economic growth, KDI has conducted research projects and is holding this 2-day conference to share our findings with related personnel, supervisors, and academics from Asia-Pacific countries.

Accordingly, the conference aims at providing a better understanding of the impact of Basel II so that the friction created at the stage of implementation in Asian emerging market economies will be minimized. To achieve this goal, the conference will cover various issues on Basel II, such as (i) its impact on the financial markets, (ii) policy alternatives to be chosen in the implementation plans of Asia-Pacific developing countries, and (iii) adequate supervisory responses to the macroeconomic impact of Basel II.

We hope this conference will contribute in formulating the right guidance for both policymakers and related researchers by concentrating on the problems of Asia-Pacific developing countries relating to Basel II.

In closing, I would like to once again thank all the participants and especially recognize those participants from abroad for your presence as well as your valuable contribution to the conference.

Thank you.