CAUSES OF AND SOLUTIONS TO THE RECENT FINANCIAL TURMOIL IN THE ASIAN REGION[1]

Given the global nature of the recent financial turmoil and the risks that even the best regulated economies are exposed to, lasting and fundamental solutions must lie in long-term prevention and joint action. Preventive measures should include urgent reforms to the international financial architecture to enable it to cope with changing market practices and to reduce the extreme volatility in fund flows that has been such an important factor in the Asian crisis. In the medium and longer term, efforts should also be made to develop stable and transparent debt markets in the region and greater monetary co-operation, which might also include the development of an Asian Currency Unit.

Introduction

I am delighted to be here today to help commemorate this important anniversary in such distinguished company. Having recently had my own fiftieth birthday, I can confirm that fifty years is a very venerable age, and I offer my heartiest congratulations to all those involved in central banking in the Philippines over this past half-century. The turmoil of the past eighteen months has made us all feel older and wiser, and it is appropriate that the Bangko Sentral should make use of this anniversary to provide us with an opportunity to review recent events and, more important, to look to what lies ahead.

The topic of this session is 'Causes of and Solutions to the Recent Financial Turmoil in the Asian Region'. I welcome the way in which causes and solutions are placed here in a regional context, because the nature of the problem in front of us is such that lasting solutions can only be found through wider co-operation, particularly among geographical neighbours. In fact, I should like to go one step further by suggesting that, if the turmoil we see around us is regional, the crisis we face is an international one. In first discussing the causes of the turmoil, I shall argue that individual jurisdictions, no matter how sound their economic fundamentals, no matter how effective their financial management, are finding it more and more difficult to cope on their own with an increasingly global and volatile financial system. And I shall sketch out Hong Kong's recent experience as a striking illustration of this problem. I shall then focus on what I see as the solutions to the crisis, emphasising that they should not simply address current problems: they should also aim at fostering the conditions that will help to minimize the extreme volatility that we have seen in our region over the last eighteen months.

The causes of the turmoil

Poring over the various commentaries week after week, and matching them against the initiatives that are being taken within the region and beyond, I have been struck by the way in which changing perceptions of the causes of the crisis have had an important influence on the solutions that are put forward. Over the last eighteen months the description of the problem has moved from being local to regional to international. As our own regional turmoil, in combination with other crises elsewhere in the world, threatens the stability of the whole global financial system, the focus is more and more on finding international solutions rather than on merely writing out prescriptions for individual economies.

One thing becomes clear from the profusion of explanations and theories that continue to appear in the newspapers and journals: we are unlikely to be able to produce a definitive and comprehensive explanation of the causes of the recent financial turmoil in the very near future. The turmoil and its effects on our region are still being played out: indeed, although encouraging signs of recovery continue to appear, the word 'recent' in the title of our symposium may well be wishful

1 This is the text of the speech by Joseph Yam, Chief Executive of the Hong Kong Monetary Authority, at the Symposium in Commemoration of 50 Years of Central Banking in the Philippines organized by the Bangko Sentral ng Philipinas in Manila on 5 January 1999.

thinking. We are still on shifting ground when it comes to finding adequate explanations and it will be some time before we can stand back and take a cool and dispassionate look at what has happened. Economic historians, after all, are still debating the causes and consequences of the 1929 Wall Street Crash.

The much more complex causality of present turmoil is enough to bewilder even the most talented economist, more especially since it includes a fair measure of irrational behaviour that falls more strictly within the province of the psychologist. The diverse effects of the turmoil are equally perplexing: they present an interesting reflection of the great variety of economic regimes that we have in the region and of their different stages in the economic cycle. The Philippines, for example, though not entirely unaffected, has passed through the turmoil with considerably less damage than many other economies in the region. In contrast, its immediate neighbour, Indonesia, has been set back years, if not decades. The mainland of China continues to see impressive growth under an economic system that is to a great extent insulated from the turmoil, while Hong Kong, the world's most open economy, is passing through a sharp but hopefully also a short recession.

While they vary from place to place, the effects of the current crisis are clear enough. What we see throughout the region, in differing degrees, is a sharp wealth loss, manifested in sudden capital flight, asset price collapses, and threats to currency and banking stability. These in turn have had macroeconomic consequences, such as declining or negative growth, growing unemployment, and deflation. They have, in economies as different as Thailand and Japan, brought to the surface severe structural weaknesses in financial systems. Quite why this should all have come together within the few months that followed the sudden collapse of the Thai Baht almost exactly eighteen months ago is something of a conundrum. There was no dramatic change in underlying economic fundamentals, which were, by conventional measures, healthy. Indeed, the financial turmoil in Asia erupted so quickly and unexpectedly that economists found it necessary to put forward special explanations.

The explanations fall into two main schools of thought: their differences derive more from the emphasis they place on different factors than from any fundamental contradiction, but the logic of their conclusions points to different solutions. The **first** school, usually identified with Professor Paul Krugman of MIT, is best summarized by the two fashionable phrases 'crony capitalism' and 'Asian values'. The emphasis here is on inept domestic policies, inefficient resource allocation to politically connected individuals, unrealistic speculation — particularly in real estate — and imprudent public spending, all fuelled by over-borrowing, poor bank supervision, extreme moral hazard, and a hubristic attitude generated by several years of fast growth. The trends were unsustainable, and the Nemesis came with a loud and very messy bursting of bubbles throughout the region. Asia's downfall, says Professor Krugman, 'was a punishment for Asian sins, even if the punishment was disproportionate to the crimes'.

The **second** school, led by Professor Jeffrey Sachs of Harvard, sees the crisis in less moralistic terms. The turmoil, he says, was a classic financial panic: a run on the banks and mass capital flight exacerbated by the maturity mismatch of many Asian banks and the currency mismatch of many Asian borrowers. This was accompanied by speculative attacks on currencies and the collapse of asset values. While this approach stresses the fragility of many of the banking systems in the region, it maintains that the Asian economies were in relatively healthy shape according to the usual indicators, and that the magnitude of the crisis far exceeded the faults and errors of individual jurisdictions.

Both the Sachs and the Krugman schools have much in common. But their logic points in different directions. One — the Krugman school — blames the values, institutions and policies of particular jurisdictions, and is country-specific, or at least region-specific. The other — the Sachs school — attributes the problem more to flaws in the global financial architecture: it says that, even if an emerging economy behaves reasonably soundly, global tidal waves that have little if anything to do with the fundamentals of that economy have the capacity to overwhelm its markets and trigger financial collapse. The problem, then, is an international one, and it is interesting that Professor Krugman himself is moving more and more towards this explanation, particularly as cracks appear and crises erupt in other parts of the world with far-reaching and often unexpected effects. The debt default in Russia, for example, affected mortgage-backed securities as far away as the USA and Brazil. The threatened implosion of a heavily-leveraged hedge-fund in the USA caused major losses to European banks and posed such a threat to the US financial system that a special rescue package had to be orchestrated by the Federal Reserve Bank. There is no denying that individual economies must put their own houses in order. But it is increasingly clear that this alone is not enough. It is no longer a question of just the 'Asian crisis' or even of the 'Asian flu' infecting other parts of the world: the problems erupting throughout the world reveal serious defects in the fabric of the world financial system.

The essence of the problem is in the highly leveraged and very large hedge fund flows that move around the world rapidly and without any regulation. They are subject to no disclosure rules. They dart from market to market, seizing on weaknesses and contradictions, particularly in the smaller, more malleable markets that are frequently carried away by euphoria or panic. By distorting or manipulating markets in search of profits they are capable of throwing many smaller, vulnerable economies into chaos. They have become, in the words of Ian Macfarlane, the Governor of the Reserve Bank of Australia, 'the privileged children of the financial scene, being entitled to the benefits of free markets without any of the responsibilities'. By exploiting the weaknesses of free markets they threaten the very survival of these markets. No small and open jurisdiction can do much on its own to resist their disruptive effects, and their powers for spreading chaos have threatened to disrupt even the strongest economies. In my opinion, no recent case better illustrates this than the dramatic ordeal that we passed through in Hong Kong in the summer of last year.

The Hong Kong experience: sound fundamentals threatened by speculative disruptions

Hong Kong's experience over the last eighteen months shows how even a sound economy can be put under severe strain by manipulative attacks from outside. We managed to survive this strain by taking, on the one hand, unconventional and controversial measures to prevent market dislocation that could have been very destabilising, and, on the other hand, belt and brace measures to strengthen the defence mechanism of our financial system. I am pleased to say that these actions have been successful, as reflected in the marked change in sentiment in our markets and the sharp fall in the interest rate premium for our currency over the US dollar. Although we continue to endure what has become a very painful economic adjustment, we can now work through this adjustment without it being grossly exacerbated by the kind of extreme market overshooting brought about by the manipulative attacks we faced last summer. The adjustment taking place is rapid and pronounced: we saw a decline in asset values of some 50% at the peak of the crisis, a doubling of our unemployment rate to around 5.5% and a fall in our GDP last year of 5%. However, if this is the adjustment necessary to re-establish our competitiveness we have, and are prepared, to accept it. But we can do without the collateral damage and general trauma of overshooting experienced by so many other economies in the region. We believe that our fundamental strengths can help us through this adjustment, just as they have helped us through the many other transitions of the past few decades, whether economic or political.

Amongst the fundamental strengths are, **first**, our ample foreign currency reserves: at the moment they are the third largest in the world, after those of Japan and the mainland of China. These reserves enable us to tackle unexpected shocks. **Second**, we have a rule-based monetary system characterised by currency board arrangements that work effectively under modern day financial technology. Our linked exchange rate system has a high degree of credibility. **Third**, we are very committed to maintaining open and liquid markets. **Fourth**, we pursue a prudent fiscal policy and have no external debt: the government sector, which is very small, is not a drag on the economy. **Fifth**, as a consequence, our economy, operating largely under free market discipline, is flexible and responsive to market forces. And, **sixth**, we have a sound banking system, which is strong, solvent, and able to cope with the tight discipline and interest rate movements necessary under our currency board arrangements: strengthened by some thoroughgoing reforms in the 1980s, the banking sector has weathered the current storms extremely well. Taken together, these fundamental strengths have enabled us to adjust to the new regional realities of the last eighteen months without the shock of a currency collapse: we have been able to maintain the external value of our currency while keeping it freely convertible, but we have also improved our competitiveness through the ability of the many other variables in our economy to respond quickly and flexibly.

But some of our fundamental strengths, ironically, have made us vulnerable to market manipulation. Our economy and our markets are small in relation to the rapidly growing volume of international capital. But they are liquid and open enough to be attractive for large players to seek to exploit the smallness of our markets and move prices to their benefit. And our policy response is highly predictable. This is particularly so with a rule-based monetary system in which capital outflow would, automatically and without discretionary decisions on the part of the authorities, lead to higher interest rates. I am convinced that much of the difficulty over the past year or so in Hong Kong arose not out of any problem in our economic fundamentals, but because, by being small, open and predictable, we are vulnerable to market manipulation. Given that there is not much we could do in the short term to enlarge the size of our markets, and given our firm commitment to openness, we had to resort to doing something unpredictable to defend ourselves.

The episode last summer, when we made purchases in the stock and futures exchanges to defend our financial system against a concerted speculative attack, is so well known now, and has been so thoroughly debated at home and abroad, that I can dispense with most of the details. The facts, in brief, are as follows. Since the Asian crisis erupted in mid-1997 we experienced a number of speculative attacks aimed at toppling the Hong Kong dollar and breaking its fifteen-year-old link to the US dollar. This link is successfully maintained by a strict and automatic currency board system, backed by more than adequate foreign currency reserves. During the attacks speculators took out large short positions against the Hong Kong dollar with the aim of destabilizing the linked exchange rate. On all these occasions the attacks activated the autopilot mechanisms under the currency board and drove up interbank interest rates to such high levels that the speculators (who had to borrow locally to fund their short positions) were forced to unwind their positions and incur heavy losses. The speculators failed, the currency board worked, and the link survived. But the interest rate volatility, and the consequent additional pain imposed on the community, was extreme: during one attack, on 23 October 1997, the overnight interest rate shot up to nearly 300%.

In August we faced a much more complicated situation, in which speculators launched co-ordinated and well planned attacks across our financial markets. Speculators had discovered that by intensively selling Hong Kong dollars over a short period they could temporarily drive up interest rates under the currency board system, which would exert a downward pressure on stock prices. By pressuring the currency and selling stocks short, they could realize a profit on stock index futures contracts, even if they could not break the exchange rate link. This double play strategy, backed by massive prefunding offshore (which protected the speculators against the interest rate volatility in Hong Kong) occurred with increasing intensity and formed the background to our controversial operations in the equity markets in late August. We used official reserves to purchase stocks to ensure that the speculators did not profit: in other words, we did the unexpected in order to prevent our predictable and transparent system from falling prey to manipulation. We had absolutely no intention of defending a given level of equity prices. Nor do we have any intention of playing a role in corporate decision making in Hong Kong. The substantial stock portfolio that we acquired during the operation has since been turned over to an independent body with wide representation, to be managed in a neutral and transparent manner.

We further followed the market operation with a package of technical measures designed to strengthen the currency board system and make it less susceptible to manipulation. At the same time, stock exchange trading rules have been tightened.

We were roundly condemned at the time for what many saw as a criminal breach of free market principles. Milton Friedman, for example, called our operation in the markets 'insane', and suggested that it was part of a plan to socialize Hong Kong. Less dramatic critics feared that it marked the beginning of the end of Hong Kong's fabled philosophy of positive non-interventionism. Gradually, people came to realize that, if this was an intervention, it was a very limited, one-off intervention designed to keep the markets free from disruptive and ultimately destructive forces, and to prevent a possible systemic collapse. The operation was perhaps more readily understood in Hong Kong, where people welcomed the speedy return of stability and reason to the markets, and where the additional interest rate volatility imposed on the community by unbridled speculation quickly became a thing of the past: it has to be recognized that this was a community already patiently enduring a painful economic adjustment, and that the additional pain inflicted by what amounted to a gross abuse of the system was weighing heavily on their patience and confidence.

More recently, and despite the edict from the Heritage Foundation that we should mend our ways or surrender our position as the world's freest economy, international opinion has arrived at a better understanding of our motivations. The success of the operation has, I think, helped. But so too has the growing realization of the magnitude of the challenge we faced. Since August, further problems with heavily leveraged, volatile fund flows have arisen elsewhere in the world. The LTCM crisis suggested that even the largest economies and their financial systems were at risk. World leaders have unanimously called for action. Even George Soros has vaguely called for international controls on the cross-border movement of funds, which, in his recent book, he describes as threatening the disintegration of global capitalism. I would not wish to speak in such apocalyptic terms. Nor would I go so far as to argue for controls. But I agree that we face a world crisis, and would add that if Hong Kong, with its sound fundamentals and prudent financial management, can be brought to the brink of systemic breakdown by aggressive cross-border speculation, then something must be wrong with the world financial order.

The essence of the crisis is this: on the eve of the twenty-first century, as markets continue to open up, as information technology continues to advance, and as investment tools become ever more sophisticated, the global financial system becomes less restrained by distance and national boundaries, less inhibited by information barriers, by time differences or by other physical limitations. Yet the management of the global financial system remains primitive and fragmented. It continues to depend largely on the unaided efforts of individual jurisdictions, which are increasingly handicapped by asymmetric information flows between public and private sectors, and which rely, when they run into problems, more on emergency fire-fighting than on preventive health. In short, the management of our global financial system has become grossly inadequate in coping with the demands of global finance.

Solutions

So what then are the solutions? I am acutely aware of the fact that a patient suffering from the contagious flu is not really in a good position objectively and dispassionately to prescribe medicine. Let me, nevertheless, put forward my views, for what they are worth. I shall look first at the immediate and palliative responses, and then focus more on the longer term preventive measures, since the most effective solutions lie not in short-term fixes, but in building healthy domestic and international systems that minimize the possibility of future turmoil.

Immediate and palliative responses are often necessary to cope with a shock to the system, particularly when the scale and nature of the shock are beyond expectations, even by the most pessimistic, as is the case with the financial turmoil of the past 18 months. These responses include, **first**, rescue packages mounted either independently by individual economies, if they have the necessary resources, such as Japan, or through the assistance of international financial institutions, such as the IMF, involving the provision of external financial resources. These packages are having some effect, and in some countries — Thailand, for example — have already helped stimulate recovery. It is vital that individual economies get themselves back on their feet if they are to move on and meet the challenges of and derive the benefits from continued global economic growth and development. The IMF and other international financial institutions have an important role to play in this, in mobilising international financial resources, from both the official and private sectors, to assist those who have stumbled and fallen, very much as victims of the internationalisation of financial markets. International financial assistance must surely be provided with conditionality; and the medicine may be strong and painful in order to minimise the moral hazard of bailing out reckless investors and imprudent lenders.

A **second** kind of immediate response is the kind of tactical counter-measure that we took in Hong Kong in August last year. We have devoted a great deal of time and energy to explaining the necessity of this measure, and you have already heard the reasoning behind it. We stand by what we did, and we do not think that we could have reasonably predicted, and therefore prevented, such an unprecedented, sophisticated, and concerted manipulative attack. But we do not pretend that we enjoyed taking the decision to enter the markets: it was an unconventional, highly controversial measure, which carried many risks. The success of the operation showed that we could defend ourselves, and that our system was basically sound. We have also taken measures to reduce the likelihood that such attacks will recur. But it would have been far preferable to have had a world environment in which such defensive manoeuvres were unnecessary.

A **third** immediate response has taken the form of exchange controls, most notably in Malaysia, and it is interesting that academics, including Professor Bhagwati and Professor Krugman, are increasingly attracted to them. These measures may well suit the needs of some economies, and a less extreme form of prudential regulation of capital flows has worked well in some places - in Chile, for example. But the worst time to introduce them is at the peak of a financial crisis, after the capital has already bolted. And capital controls are not a solution for all economies. For an open economy like Hong Kong they are unthinkable, as well as illegal, since our Basic Law prohibits them. Given that one of the themes of this talk is the dangerous state to which the world financial system has been brought by volatile cross-border fund flows, it is perhaps appropriate for me to restate here Hong Kong's commitment to economic liberalization and globalization. This is, in my view, the only long-term viable way forward towards a more productive use of resources and more even economic growth throughout the world. The problems that we now face should not cause us to overlook the many advantages that globalization has brought to our region. The current crisis has not demonstrated that this is the wrong path to follow — merely that that there are dangers and instabilities that have to be tackled. And if the imposition of temporary exchange controls is the only alternative available, responsible commentators should at least have the courtesy of giving a little respect to those in the most unenviable position of having to take difficult decisions that they consider to be in the best interests of their people.

Our task now is to ensure that liberalization and globalization remain productive processes, that our energies are devoted not just to short-term cures, but also to long-term preventive health. There are a number of initiatives that we might pursue, and I mention only a few of them with the aim of stimulating discussion. The **first**, and most urgent, is the reform of the international financial architecture to better regulate the volatile capital flows that contribute to market instability. This must include improved information and disclosure. The recent experience in this region has shown that problems were allowed to build up because of a lack of information about the full financial picture, both in terms of the destination and the source of the funds. Important steps are being taken in many Asian countries towards greater transparency in the public sector, and I am pleased to report that Hong Kong is playing a leading role in these efforts. But greater transparency among the regulators means that a serious asymmetry of information is emerging between the public and private sectors. We must now consider the need for greater disclosure on the investor side, since the virtual complete lack of information about the activities of huge global institutional investors poses risks to all participants in the markets — to other investors, to lenders, and to borrowers.

A **second** part of this architectural reform must be improved prudential oversight of capital flows, since mere disclosure is no guarantee that behaviour will be prudent. Part of the initiative must begin at home, since without effective domestic management international initiatives will lack a sound foundation. The Asian crisis has demonstrated that the approach towards capital account liberalization in some Asian economies was clearly inappropriate, given the weaknesses in domestic financial sectors. Poor supervision, lax accounting standards, close relationships between lenders and borrowers, and inadequate prudential safeguards all conspired with 'hot' capital inflows to fuel the crisis. Again, it is worth pointing out that this is not purely an Asian problem, as the LTCM episode revealed. Prudential regulation begins at home, but it must also be extended into a global prudential and regulatory framework, which would be an aid, not a hindrance, in the general trend towards a more liberal financial environment.

A **third** part of the reform must address cross-border manipulative practices in financial markets. Rules exist against the cornering of domestic financial markets. The blatant collusion and co-ordination in the various recent attacks on Hong Kong's markets, and the phenomenal financial resources the manipulators have been able to muster, underscore the need for domestic anti-trust principles to be applied to cross-border financial speculation.

These are matters of some urgency, and there is already a clear international consensus that they are necessary. Measures of the kind that I have just outlined are under active discussion in various international forums, including, at the latest count, the IMF, BIS, APEC, EMEAP, G7, G10 and G22 or G26. While we may be in agreement on what should be done, these are not easy issues to put into practice, and my concern is that discussion in so many different groupings may lead to delay and confusion. If action is not taken quickly, individual economies, and particularly the small and open economies, will continue to have to deal with the onslaught of unrestrained international capital using the piecemeal emergency responses that I have already described. The danger is that they will be forced into increasingly unconventional and controversial action that may deepen their own problems and impede the healthy development of an open global financial system.

I have spoken about the measures necessary to bring us out of the turmoil and back onto the track of balanced development and healthy growth. It is appropriate, as we celebrate fifty years of central banking in one of the oldest financial centres in the region, that we look even more broadly towards how the region's monetary system might develop in future decades. I should like to suggest two areas for development here: one relating to currency; the other to debt markets. These are important issues, and they will have a considerable influence on the broad shape of our regional economy in the next century.

First, the question of **currency**. The recent introduction of the Euro will, in my view, radically change the way in which the global currency system works and has important implications for our own region. Until now, the U.S. dollar has played a dominant role in world trade quite out of proportion to the size of U.S. trade flows. This is particularly the case in Asia, where, despite Japan's strong commercial and financial influence, the yen has failed to play a major role as an anchor. While the Hong Kong dollar has been well served by its solid link to the U.S. dollar, less solid commitments to the dollar in other economies have proved to be expensive and disruptive. Thus, despite the pre-eminence of the U.S. dollar, the Asian region as a whole lacks a viable exchange rate anchor. This is a problem that has to be addressed, and we would do well to look into it, especially once the current crisis has subsided. We have benefited from our own peg to the U.S. dollar, and other countries could similarly benefit from links to key currencies when they are in a strong enough position to make such links fully credible.

The introduction of the euro will challenge the supremacy of the dollar elsewhere in other hemispheres by introducing a second currency pole in the global currency system. It will also offer another solid investment option to Asian central banks. The time may come when we might want to consider the possibility of our own Asian currency — perhaps something along the lines of an Asian Currency Unit — that would form an anchor currency for our region. This is a long-term possibility, but it would have the advantage of reflecting the strong trade linkages in the region. It would also create bigger and more liquid markets that are less susceptible to manipulation. It would also help address problems of intermediating financial resources within Asia. At present, Asia's central banks invest massive amounts in foreign securities, particularly U.S. dollar assets, only to see volatile funds flow back to the region from overseas markets. By investing reserves directly in Asian financial assets, this type of costly and unstable recycling through developed markets could be reduced.

There are, of course, many obstacles in the way of creating an Asian Currency Unit. The various economies of the region operate under widely differing economic regimes, and are at different stages of development. An institution would be necessary to administer the system, and the politics involved would doubtless be very complex. But I believe that now is a useful time to raise this topic for discussion, at least at an intellectual level: successful implementation in the longer term would go a long way towards addressing the currency instability we have seen in the region over the last year and a half. After all, it has taken the more homogeneous Europe fifty years to bring the euro into existence.

A further long-term solution lies in the development of stable and transparent **debt markets** in the region. The excessive reliance in Asia on short-term financing from overseas lenders through weakly regulated banking systems, and all the turbulence that this has entailed, is a reflection of the lack of deep and diversified debt markets in the region. The essence of the problem is the failure of our financial systems to keep pace with the strong underlying growth in other sectors of the Asian economies: the industrial and trade sectors surge ahead, while the financial sector lags behind. Too large a share of Asia's financial resources has consequently been recycled through overseas markets, with the inevitable loss of information flows, and a tendency towards the kind of market volatility that has caused us such problems. We need to establish local debt markets that bring both borrowers and lenders into more direct and long-term relationships, and which leaves both sides less exposed in terms of currency and maturity mismatches.

Ironically, the underdeveloped state of our debt markets is attributable in part to the traditional absence of large budget deficits in most of the region, which has limited the development of government bond markets. Debt market development needs some official help, since individual issuers are not in a position on their own to create deep and liquid markets. The APEC initiative on bond markets — in which Hong Kong plays a leading role, will provide some impetus. The priority is to examine key impediments to the development of bond markets and to bring together all participants — market practitioners, government agencies, and international financial institutions, to tackle these impediments and clear the path for developing Asian debt markets. The obstacles are large but not insuperable. There is the lack of an objective credit rating system in a position fairly to assess borrowers in the region. There is also a lack of benchmark yield curves for pricing debt. Tax regimes also tend to provide unequal tax treatment for international and domestic bond issuers, and usually favour international issuers, even though they have no intention of recycling funds back into the domestic economy. Finally, the regional infrastructure for clearing and settling debt needs to be improved. Some of these impediments can be dealt with through domestic initiatives, and Hong Kong, like many other jurisdictions in the region, is taking action on many fronts. Others, such as harmonizing tax treatment of debt or taking forward the 'AsiaClear' network for linking financial systems, need concerted regional effort if a really solid regional debt market is to emerge.

Conclusion

To summarize: the solutions to the turmoil in this region require immediate remedial measures and long-term preventive strategies: they must comprise efforts by individual economies to put their houses in order and concerted, collective action within the region and throughout the international community. All of these diverse approaches are vital if we are to pull ourselves out of the crisis. I have argued, however, that, given the global nature of the problem and the risks that even the best regulated economies are exposed to, the most lasting and fundamental solutions must lie in long-term prevention and joint action. These preventive measures should include urgent reforms to the international financial architecture to enable it to cope with changing market practices and to reduce the extreme volatility in fund flows that has been such an important factor in this crisis. In the medium and longer term, they should also include efforts to develop stable and transparent debt markets in the region, and greater monetary cooperation, which might also include the development of an Asian Currency Unit.

At today's symposium we are both celebrating a fiftieth anniversary and addressing some of the difficulties that we currently face in this region. This is not a time for complacency, but it is perhaps useful to step back for a moment from present difficulties to reflect on how far we have come, as a region, in the past fifty years. Fifty years ago most of this region was still recovering from the devastation of World War Two; many countries were to face more upheaval in the years that followed. But over the last few decades the region has, through a variety of economic strategies and in differing degrees, enjoyed growing prosperity, greater stability, advancing cross-border co-operation, and, increasingly, freedom from the poverty and strife that confronted earlier generations. This has all been achieved in a context of globalization and economic liberalization. The current turmoil has interrupted some of this progress, and has reminded us that rapid economic expansion is not without its risks. The damage to some economies has been severe. But the foundations remain strong, and the prospects for the next half-century are, in my view, favourable ones. The signs of economic revival are already with us. Recovery may be a longer and more difficult process than some of us had expected a year or more ago. But there is no doubt that it will come. It is now up to us, as partners in this large and diverse region, to seize the initiative, and turn that recovery into an enterprise that will make us stronger, more cohesive, and more capable of managing the stresses and uncertainties that a global financial system must inevitably produce.