

Stability and Solvency: Obligations to Ourselves



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An Asian financial leader examines the debt dilemma that plagues the world economy.

Q: Although the global financial crisis of 2008 and the European sovereign debt crisis shook the world's economies, the Asian financial crisis of 1997-98 brought to light lessons that apply to the financial issues facing many nations today. What are those?

Many people in the developed world believed, rather mistakenly, that financial or debt crises would be the kind of mishaps that only occur in the developing world. However, considering what happened in the U.S. and Europe in the last five years, we have come to realize that this belief is misplaced and that prosperity and the good life have

to be earned. No economies — be they developed or emerging ones — will be totally immune. How does one get out from a financial crisis caused by excessive borrowing or leverage? The experience of Asia demonstrates there is no easy way out.

The hard lesson Hong Kong learned after the bursting of the property bubble in late 1997 is that one needs to persevere, endure the pain and pursue reforms that enhance the resilience of the financial system. Gradually, the economy will become more efficient, increase productivity and regain competitiveness. If this can be done, it should be possible to return to sustainable economic growth.

Q: Do you think the global economy is moving toward substantial growth, and is GDP growth strong enough to cover the indebtedness facing most major industrialized countries?

While borrowed money can make wonderful things possible, debt must be repaid with interest somehow, someday. The higher the interest rates and the longer the duration of the debt, the more we will have to pay back. A prudent person or enterprise must ensure there will be sufficient future income to meet the payment liability arising from the obligation. Likewise, heavily indebted governments can only service their debts when they have sustained economic growth and rising tax revenue. This would require them to use the borrowed funds wisely, in areas that would bring about economic and income growth over time.

Q: Why the rise in indebtedness?

There are many narratives about why this trend has occurred. Perhaps the financial “deepening” made credit much easier and cheaper for many households, corporations and governments to obtain. Or financial innovation in the form of securitization and financial derivatives, such as credit default swaps and collateralized debt obligations, enabled leverage to be amplified and distributed throughout the financial system and beyond. At the same time, it is far too tempting to spend or consume now and worry about payment later. That explains why, in addition to public debt, household debt has risen to very high levels all over the world.

But there is a limit, largely determined by market forces, to how much debt an individual or a firm can incur. Moreover, there is another important reason why people as well as the politicians elected by them would want to continue to spend beyond their means, even though they realize they could not afford to repay the debts in their lifetime. I would call this the “collective irresponsibility” syndrome. Precisely because the vote is cast in anonymity, voters will have no direct accountability for how they vote, no matter what the consequence of such voting decisions are.

While many people would agree that excessive debt and leveraging was a major factor leading to the crises in the U.S. and Europe, many would still think it possible to overcome the problems without having to deleverage. But once an economy falls into the trap of excessive leverage, it is hard to get out without going through a painful adjustment.

Q: The world seems to be in a volatile, daunting financial state, both on an individual basis and at the international level. Where does the solution lie?

Moving forward, the outlook for the macroeconomic and financial environment is very uncertain. It would seem clear to many people that the solution to excessive levels of debt is not through borrowing more money. It must be through deleveraging over time in the overly indebted sectors. For households and corporations, they should take precautionary measures, learn from others’ experiences and avoid overstretching themselves.

GOVERNMENTS’ RESPONSIBILITY

1

Implement credible and meaningful fiscal consolidation

2

Allocate resources to investments that will renew healthy growth

3

Pursue structural reforms that raise productivity and enhance competitiveness

At the national level, three things must be done at the same time. First, governments must implement credible and meaningful fiscal consolidation programs to reduce public spending and increase revenue. Second, governments, within their reduced budgets, should allocate resources to infrastructural and other productive investments that could facilitate the return of healthy growth in the medium to long term. Third, governments must pursue structural reforms that would enhance the flexibility and capacity of the labor, product and services markets that would over time raise the productivity and competitiveness of the economy as a whole.