Lee Hsien Loong: Post crisis Asia - the way forward

William Taylor Memorial Lecture by Mr Lee Hsien Loong, Deputy Prime Minister of Singapore and Chairman of the Monetary Authority of Singapore, before the Eleventh International Conference of Banking Supervisors, held in Basel, 20-21 September 2000.

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Introduction

Three years have passed since the Asian crisis struck in 1997. The crisis showed how unstable the international financial system could be, and how vulnerable apparently strong Asian economies were to a sudden shock. It has caused a searching reappraisal of the benefits and risks of globalisation, as well as the strengths and weaknesses of the Asian economies. I propose to discuss how attitudes towards globalisation have shifted, and what challenges Asian economies face in remedying the weaknesses uncovered.

When Mr Paul Volcker, Chairman of the G30, invited me to deliver the William Taylor Lecture to this distinguished gathering of banking supervisors, he asked me to share Singapore's experience in dealing with the financial turbulence. I will also explain how we are reforming and liberalising our financial sector, to benefit from globalisation while protecting ourselves against mishaps. Not all the lessons Singapore has drawn will apply to other economies because of differing circumstances. But I hope Singapore's case will illustrate the importance of basing financial reforms on a realistic appreciation of the risks and difficulties.

In analysing the Asian crisis, and in describing the Singapore experience, I will be underlining the importance of sound banking systems and strong supervisory oversight. I am particularly pleased to be doing this at a Lecture held in honour of a man who dedicated his life to these goals.

Pre-crisis wisdom

For a decade before the crisis, the conventional belief was that globalisation was an unmitigated good. The dramatic success of the Asian tigers had shown that openness to trade and foreign investments was a key source of economic growth. A 1992 World Bank study on the "East Asian Miracle" credited their success chiefly to market friendly and outward oriented policies.

There was broad intellectual consensus, including in the multilateral institutions, in favour of free markets: put simply, deregulation, privatisation, and trade and financial liberalisation were always good, and the faster the better. This was what John Williamson called the "Washington consensus", but the view went beyond the US Treasury, the IMF and World Bank.

One important element of this intellectual consensus was the liberalisation of capital accounts. Free trade in goods and services had enabled countries to exploit comparative advantage and international division of labour, and produced half a century of unprecedented global prosperity. It was argued that in the same way, free flows of capital would open new avenues for deploying savings and funding investments, and promote more efficient allocation of resources. Financial markets were globalising, driven by technology and deregulation. The faster countries plugged into the global network, the more they would benefit.

The pre-crisis consensus did acknowledge the risks associated with open capital markets. But it stressed the virtue of market discipline more than the possibility of market failure. Financial crises were the fault of inappropriate policies. The remedy was more liberalisation, deregulation and privatisation. Markets would work, if only they had access to timely and accurate information. So the emphasis was on policy transparency and data disclosure, to enable the private sector to make "correct" decisions. So steadfast was the faith in open capital markets that, as late as September 1997, after Thailand had run into trouble, the IMF and G7 countries were still lobbying member states to

amend the IMF's Articles of Agreement to give the Fund the mandate to promote capital account liberalisation.

Crisis shock

Given this worldview, the Asian crisis came as a tremendous shock. Financial markets proved highly susceptible to contagion and herd behaviour. Problems in one country triggered a loss of confidence in its neighbours. Manias, panics and crashes occurred on a titanic scale, shaking seemingly sound economies to their roots.

Structural flaws in the Asian economies undoubtedly contributed to the crisis. So did policy errors by governments and international institutions in responding to the problems when they emerged. The most serious flaws were in the financial and corporate sectors. Balance sheets were weakened by currency and maturity mismatches. Banks were lax in their credit practices. They borrowed short-term from abroad and lent long-term at home, often to related companies without proper assessment. Companies borrowed excessively, especially in foreign currencies without hedging their exposures, encouraged by implicitly pegged exchange rates.

But lenders in the developed economies could not escape blame either. They were only too eager to extend credit, based on the political connections of the borrowers, or on faith in an Asian miracle. Banks stampeded into the region. When sentiments turned, they stampeded out again, equally indiscriminately. The sudden massive outflow of funds, especially through banking lines, left countries in a severe liquidity crunch, and was an immediate cause of the crisis.

The punishment meted out by the markets was out of proportion to the crime. The damage was not just the 9% shrinkage in the GDP of the crisis countries, but the social dislocation and political turbulence that followed.

Indonesia suffered the worst, even though the IMF made a pre-emptive house call early in the crisis, and pronounced Indonesia's fundamentals to be basically sound.[1] The Indonesian government had pursued prudent macro policies and maintained steady economic growth. But companies had borrowed large sums from abroad, and the banking sector was afflicted by related party lending, poor credits, and weak provisioning. This, together with concerns about KKN – corruption, collusion and nepotism – was enough to turn an initial loss of confidence into a full-blown crisis of the body politic, forcing President Suharto to resign and pushing the country to the brink of chaos.

The origins of the Asian crisis thus lay in institutional weaknesses and inefficiencies. These grew more serious in the 1990s, but they continued to be masked by generally sound macroeconomic conditions and investor confidence in a sustained Asian boom. However, the sudden onset of the crisis cannot be explained without appreciating the panic-prone and panic-inducing behaviour of international financial markets.

Fortunately for most of Asia, the crisis, though severe, was short. The Russian default and LTCM debacle in the fall of 1998 were a turning point. The G7 countries, led by the US Federal Reserve, lowered interest rates promptly and decisively. While this lowering was motivated by domestic considerations, there was also a collective sense of concern over the weak state of the global economy. In the event, it helped restore liquidity and confidence to global financial markets. Now nearly all the Asian countries are recovering, though in different ways and to varying degrees.

Post-crisis caution

After this near-death experience, it is not surprising that countries are re-examining their belief in the global economic system. What lessons have countries learnt?

[1] IMF News Brief 97/19, 8 October 1997.

Firstly, unlike previous crises, the crisis was due mainly to a run on the capital accounts. Thus, there was no reason to rethink the merits of ***free international trade and investments***. These fuelled the last Asian boom, and are crucial if countries are to get their economies growing again. The most open of the Asian economies – Hong Kong and Singapore – were among the least badly affected by the crisis.

The devastating demonstration of the downside risk of globalisation could easily have triggered a nationalist and protectionist backlash. Such sentiments have surfaced to varying degrees. No country likes to be told what to do by the IMF, or be forced to sell off distressed banks and companies to foreign buyers, especially at fire sale prices.

But no country is opting out of the global system. All continue to court foreign investments and promote exports. Most Asian governments remain convinced that despite the attendant risks, globalisation is still the best way to achieve progress and economic development. On this most basic article of faith, there has been no change.

Secondly, the crisis has highlighted the problems of ***capital account liberalisation***. The IMF has acknowledged that capital flows can be highly volatile and a potential source of crisis.[2] Countries are now acutely aware that they must sequence capital account liberalisation judiciously, and to strengthen financial supervision and prudential safeguards as they liberalise. But there is still broad consensus that provided countries take these precautions, they can benefit from international capital flows. No Asian country has imposed exchange controls as a result of the crisis, except Malaysia. And even Malaysia continues to welcome foreign portfolio investments in its asset markets.

Thirdly, all the affected countries have recognised the dangers of over reliance on ***bank-based financing***. In most Asian countries, capital markets were undeveloped. Bond markets especially were illiquid or non-existent. This led Asian firms to rely on short-term bank financing to fund longer-term projects, thus exposing themselves to maturity mismatches. Further, when the banks got into trouble, the firms were left with no alternative avenues to raise working capital. Thin capital markets accentuated price movements when investor preferences shifted. As a result, the economies' ability to absorb shocks was severely impaired. So across the region, steps are now being taken to develop capital markets.

Fourthly, there is now greater recognition that effective ***prudential oversight and corporate governance*** are critical to maintaining a sound financial system. Many Asian countries fell short in these areas, and are now striving to remedy the weaknesses. They need to establish rigorous supervisory regimes, foster a sound credit culture in banks, and apply international standards of accounting, disclosure, and loan classification.

In this respect, the Basel-based committees, BIS, OECD, and other standard setting bodies have done valuable work, promulgating standards on banking supervision, risk management, corporate governance and public disclosure. Few would claim that these standards are Western cultural impositions, and that Asian banks and companies need different norms more suited to their societies and stage of development.

Fifthly, there have been stronger calls to improve the workings of ***the international financial system***, rather than adopt a hands-off approach. No plausible alternative to the existing market-based system has emerged. But the consensus view is that the robustness of the system can be improved, in particular through better monitoring, and greater transparency among market participants. This is work in progress. The Financial Stability Forum and other groups and agencies have made many proposals to this end. These proposals should help to reduce the risk and severity of future crises, though they will not eliminate them.

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[2] Joint statement by IMF and World Bank on "An Enhanced Partnership for Sustainable Growth and Poverty Reduction", 5 September 2000.

Managing the change

While the fundamentals for sound financial systems are universal, specific policies to attain them must recognise the unique socio-political context of each country. To succeed, countries must change, or at least modify, deeply embedded social structures and cultural practices. As the experience of the former Soviet republics and the former East European economies shows, such a far-reaching change can only be an evolutionary process; it cannot happen overnight.

The ***politics*** in each country will dictate the pace and texture of financial and economic reform. In Malaysia, Prime Minister Dr Mahathir Mohamed has made clear that in reforming and restructuring the corporate and financial sectors, his government's social and political objectives come first. In Indonesia, monetary and banking reforms, important as they are, are subordinate to more fundamental issues of political transition, security, and national cohesion.

The ***legal framework*** will constrain what is possible. In many Asian countries, laws are incomplete, and enforcement is weak. For example, not all Asian countries have adequate insolvency laws. Without these, borrowers have an incentive to become "strategic" debtors, deliberately defaulting on interest and loan payments. Creditors have no incentive to accept realistic write-downs, preferring instead to reschedule loans and reflect them as performing loans in their books. So supply of fresh credit remains weak.

After the crisis some Asian countries have passed new bankruptcy laws, and even established new courts to administer them. But enforcement continues to be difficult. As Acting Governor of Bank Indonesia Anwar Nasution said, in explaining the slow pace of corporate restructuring (this was when he was the Senior Deputy Governor): "it will take a while, partly because we have a very rotten legal and accounting system … the most important thing is that we have very weak bankruptcy procedures."[3]

The ***social values*** of each country underpin the formal structure of laws and institutions. A relationship-based approach towards doing business is part of the culture of most Asian societies. Few Asian societies have the "contract-based" commercial culture of the West, particularly the US, with its robust emphasis on legal and impersonal obligations. Few have made a practice of separating the ownership of firms from their management.

In some countries, there are close ties between the state, the banks and industry, e.g. the state-owned enterprises in China, and the *chaebols* in Korea. All over the region, ***family-based firms and conglomerates*** are the norm, especially in banking. Companies in the same group would do business with one another, maintaining trust on the basis of family ties and shared ownership. Even in Japan, where ownership of large corporations is not in the hands of families, long-term corporate relationships and cross-shareholdings have dictated business.

This was how entrepreneurship evolved in East Asian societies, and among the overseas Chinese in South East Asia. Many of these family firms were hugely successful, driven by the business acumen and entrepreneurial drive of the founding patriarchs, and supported by a web of networks, or *guanxi*.

But the world has changed. Family relationships may be an adequate basis for running a medium sized company, but not for an MNC employing tens of thousands of people. To be world-class, companies need to be led by the best man for the job, and this person is not likely to come from the same family, generation after generation. And business based on relationships rather than hard-headed commercial calculations is prone to abuse and under-performance, as was shown in the Asian crisis.

It will not be easy for the families to relinquish control. The instinct to hand an heirloom down the generations is still strong. There are also real practical difficulties. If the families sell out, who will the buyers be? Who will take charge of the companies? Most Asian countries lack a group of institutional shareholders who can exert market discipline and defend minority shareholder interests, like the

[3] Straits Times, 26 January 2000.

mutual and pension funds in the US. Nor have they developed a class of professional entrepreneur-managers, like those who drive MNCs in the West and Japan.

Changing these institutional features of Asian economies will be an arduous task. But over time the countries can, and must, change discredited practices. State-owned or family-run enterprises can be transformed into firms run along meritocratic lines by professional managers. Greater public ownership can strengthen market discipline and the incentive to improve returns for all shareholders. Companies that are not profitable have to be closed or restructured.

Asian leaders understand this. For example, the governor of the Bank of Thailand Mr Chatu Mongol Sonakul said, describing efforts to promote corporate governance in financial institutions and companies:[4] "What we are doing is a very long process. We're not talking of months or years. We are talking in, maybe, decades or generations. We're not changing our way of working; we actually try to change our way of life."

Governments play a key role in fostering and managing this process of change. They have to make the political judgment on how fast to go, how to sell the changes to the people, and what compromises are necessary. Only they have the mandate to decide, and only they can take responsibility for the outcomes. South Korea under President Kim Dae Jung is a good example of how this can work, as well as of how difficult the process can be.

External institutions like the IMF and the World Bank are also important, providing advice and applying pressure to do what is painful but necessary. This means that IMF and World Bank loans and assistance have to come with strict conditionality. But the line between essential conditionality and excessive intervention is a fine one.

In Indonesia, the IMF pushed the Suharto government hard, not just to deal with the immediate crisis, but to implement sweeping structural reforms. President Suharto interpreted this as a threat to his own position, and treated the IMF as an opponent rather than an ally. This contributed to a collapse of confidence, political turbulence, and finally Suharto's resignation in May 1998. Whether or not the IMF intended this outcome, it helped to precipitate a decisive and momentous change in Indonesia, the consequences of which are still unfolding.

Singapore's approach

Let me now turn to Singapore's experience in navigating through the crisis and preparing itself to meet the challenges of globalisation, especially in the financial sector.

Singapore is not entirely typical of the region. We are a small, open economy, about half the size of the Swiss economy, and heavily reliant on foreign trade. We are also a financial centre in Asia, and therefore highly exposed to disturbances in the international financial system. So it is not surprising that Singapore was affected by the Asian crisis. Our GDP growth plunged from 8.4% in 1997 to 0.4% in 1998. Retrenchments went up sharply. Our stock market fell, in line with regional markets.

Navigating the crisis

But overall Singapore was less affected than most of the region. The banks were unshaken, and Singapore companies did not keel over. Why was this the case?

Firstly our ***economic fundamentals*** were sound. We had pursued pro-business and pro-development economic policies for many years, and maintained consistently low inflation.[5] We had kept our economy open, and had taken a market-oriented approach towards economic development. So

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[4] Keynote Address, Meeting on Good Governance for Financial Institutions, Bangkok, 10 June 2000.

[5] Singapore's inflation averaged 2.1% between 1981 and 1999 while the average figure for the Group of Seven developed countries over the same period was just over 4%.

investments did not go into industries in which we lack competitive advantage, and Singapore companies were generally efficient.

Secondly, the Government had a strong ***financial position***. Indeed it continued to register a budget surplus throughout the crisis. We had no foreign debt, much less short-term debt. Foreign exchange reserves were comfortable.

Thirdly, ***our response*** to the crisis was to reduce business costs directly, to help businesses stay viable and so preserve jobs. No company was bailed out by the Government; no creditor was prevailed upon to maintain a loan to a failing borrower. Instead we granted rebates in taxes and government charges across the board, and reduced employers' monthly contributions to employees' retirement fund – effectively a wage cut. Fortunately union leaders understood the gravity of the crisis, and helped to persuade workers to accept this unpalatable prescription. Overall these measures amounted to 7% of GDP. The measures, and the population's positive response to them, instilled confidence among Singaporeans and foreign investors.

Fourthly, our ***banks*** were sound. Even during the boom years, our banks had been generally prudent and conservative in their lending policies. Also MAS had supervised the banks strictly, requiring high capital and liquidity standards, insisting on prompt and adequate provisions for non-performing loans, and frowning upon excessive expansion of bank loans. So when the crisis struck, the banks stayed on an even keel,[6] even as MAS required them to make large general provisions in anticipation of future NPLs.

Fifthly, we were lucky with our timing as we had deflated a ***property bubble*** early. Like several other Asian countries, Singapore had experienced a property boom. It started in 1993, and in just 3 years property prices had doubled. By early 1996, the property market was becoming dangerously overheated. The Government decided to prick the bubble. We restricted bank credit by capping housing loans at 80% of valuation, and imposed other anti-speculation measures. So by the time the Asian crisis struck a year later, property prices were already declining. The froth had been skimmed off. Had we not acted in 1996, the adjustment would have been more painful, and the banks would have had more serious problems with their loans.

Managing financial sector reforms

Although the crisis is past, we are not back to the status quo ante. While Asia was preoccupied with its problems, globalisation of financial markets proceeded apace, spurred on by deregulation and technology. With the internet, markets are becoming borderless. Banks, insurance firms, and now securities exchanges are facing cut-throat competition, and going through a worldwide wave of mergers and consolidation.

Singapore has to keep up with these global trends to remain a sound yet dynamic financial centre. For many years, we had regulated our financial sector tightly. We insisted on high standards of integrity and competence. We sought to protect investors, especially retail investors, by circumscribing what they could be allowed to invest in. We protected local banks and stockbrokers from foreign competition, in order to build up dependable Singaporean players. We sought to minimise risk wherever possible, and accepted the trade off for a less vibrant and innovative industry.

This approach had worked, and proved its worth in the crisis. But going forward, it no longer suffices. In the new environment, we need to take a bolder, less dirigiste approach. We should regulate with a lighter touch, accept more calculated risks, and give the industry more room to innovate. We need to liberalise and allow greater competition.

We will not abandon the high standards of integrity and sound financial management which we have built up. But our attitude to supervising risk must change.

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[6] Before the crisis, NPLs were 3% of loans. During the crisis, NPLs rose only to about 12%, most of which was on account of lending to the region.

We should focus more on systemic risk rather than protecting individual firms, or preventing risky products from reaching the market. We should allow investors to judge and take business risks for themselves. We should rely more on market discipline and full information disclosure to protect investors, rather than extensive formal and informal regulation. We need to shift emphasis from regulation to supervision, and from one-size-fits-all rules to oversight tailored to the characteristics of individual institutions.

We decided on these fundamental changes in our policy framework for the financial sector in 1997. We went ahead to launch it, just as the storm clouds were gathering, because we saw it as an essential strategic shift, independent of short-term ups and downs of economic fortunes. We felt confident of weathering the storm, although we did not know it would turn out to be a super hurricane.

We decided to make a phased transition over several years, rather than have a single big bang. We had seen how big bangs in some other countries had led to excesses and problems later down the road. We could not afford this risk, unlike the more established financial centres like London. Our regulators, financial institutions, and investors all needed time to develop new expectations of one another, and understand the new way things worked. We needed to manage the reform process in an environment made difficult by the Asian crisis, and keep the system on an even keel.

Over the last three years, we have systematically reviewed every part of the financial industry. We have freed up the use of compulsory savings in the state retirement fund scheme, demutualised and merged the stock and futures exchanges, deregulated brokerage commissions, opened up all areas of the financial industry to new entrants, and taken steps to develop the bond market.

I will focus on two specific changes, to illustrate the trade-offs and considerations in designing our liberalisation programme. The first is the review of our policy of not encouraging the internationalisation of the Singapore dollar. The second is our decision to open up the domestic market to foreign banks, while giving impetus to local banks to strengthen themselves.

Singapore dollar non-internationalisation policy

We have long maintained an explicit policy not to encourage the internationalisation of the Singapore Dollar. Being small and vulnerable, we are especially wary of large and volatile capital flows distorting our exchange rate, and thus damaging our real economy. Our international trade is 3 times our GDP, higher than any other country in the world. If our exchange rate moved up and down like the Japanese Yen against the US dollar, we would be in deep trouble.

Singapore has no capital or exchange controls. Anyone can move funds freely into and out of Singapore, whether in S$ or foreign currencies. The non-internationalisation policy does not try to prevent currency speculation *per se,* or to limit the flow of capital into and out of Singapore. It imposes only one restriction: non-residents may not borrow S$ for activities unrelated to the Singapore economy, though they may buy and sell as much S$ as they wish. This restriction on borrowing S$ is to make it harder for non-residents to accumulate ammunition through borrowing for a speculative attack on the S$.

Despite the non-internationalisation policy, there is virtually complete capital mobility in Singapore. Empirical studies have shown that domestic S$ interest rates are almost entirely determined by parity with offshore US Dollar interest rates, adjusted for future exchange rate expectations. In economist's jargon, the "interest parity condition" holds.

The role of hedge funds in the Asian crisis is controversial. There is evidence that the hedge funds were active in a number of the regional currencies before and during the crisis. Although some observers are convinced that hedge funds were the main culprits in bringing currencies down, the evidence is not conclusive. Nevertheless, we believe that our policy of non-internationalisation helped to protect the S$ against excessive volatility during this unstable period. Of course the policy could not have been effective if Singapore's economic fundamentals had not been sound, and if we had not had a floating exchange rate which could be managed flexibly in line with these fundamentals. We had an easier ride than Hong Kong, which also had a sound economy, but whose currency was, for good reasons, pegged to the US dollar.

Going forward, we intend to maintain the non-internationalisation policy, but to periodically review its scope and implementation. In the early phase of our development as a financial centre, international and regional business serviced out of Singapore could be conducted in US dollars. But as our financial centre matured, and our capital markets became more comprehensive and integrated, foreign players increasingly wanted to issue S$ debt and equity, and to hedge their positions using S$ swaps and repurchase agreements. At the same time, the Singapore economy and our foreign reserves have grown, and so has our confidence in withstanding pressures on our exchange rate.

Our policy needed to adapt to these changed circumstances while preserving its basic objective. As part of our financial reforms, we have progressively relaxed the S$ restrictions. Notably we have made an exception to the restriction on borrowing S$, to allow foreign entities to issue S$ denominated bonds and equity, provided they swap or convert the proceeds into foreign currency for use outside Singapore.

We will continue to evolve the non-internationalisation policy, as we gain experience and confidence with the liberalised rules. The policy will not compensate for unsound economic fundamentals, nor is it a foolproof protection against exchange volatility. But it would be unwise to discard a useful deterrent against would-be speculators who might otherwise be tempted to try their luck.

Banking liberalisation

The second example of our measured liberalisation approach is the opening of our retail banking sector, with simultaneous steps to help strengthen local Singapore banks.

Our starting position was different from most countries. Foreign banks (mostly British) dominated the Singapore banking system when we gained independence. For three decades, the Government has protected the local banks, especially in the retail business, to enable them to expand their market share. We believed that strong and well-managed local banks, with a significant share of the home market, were critical to the resilience and stability of our financial system. We wanted to be sure that in a crisis, we could count on major institutions whose long term interests were aligned with the Singapore economy. We still hold this view.

Like banks in other Asian countries, most of our local banks started as family banks, and are still run by their controlling shareholders. But strict supervision enabled them to grow into sound, well-capitalised institutions, free of the problems of improper and imprudent lending to related companies. By Asian standards, the local banks were exceptionally well run. But compared to the best international banks, they lagged in many areas: size, technology, expertise, range and quality of service, and shareholders' returns.

We could not afford to let Singapore banks fall behind, or deprive the rest of our economy of world-class financial services. In any case, because of globalisation and cross-border competition, a protectionist policy was becoming less and less tenable.

Therefore we moved last year to open up the Singapore market further to foreign banks. We hoped that this would spur efficiency and innovation among the local banks, and push well-run banks to seek scale and expand at home and abroad. We were convinced that unless we opened up, this transformation would never take place. There is no substitute for real competition.

We did not want the liberalisation to weaken our banks and destabilise the financial system. So we are not taking a big bang, *laissez faire* approach. Instead, we are phasing the liberalisation over five years, and opening the market to financially strong, committed foreign players.

At the same time, we are motivating the local banks to strengthen themselves. We have raised disclosure standards to international norms, and we now require banks to publish details of their non-performing loans and inner reserves, which were previously closely guarded secrets.

We are also raising corporate governance standards, which lie at the heart of the improvements required in Asian banking systems. We instituted nominating committees on bank boards, comprising a majority of independent directors. Their remit is to ensure that persons appointed to the boards and

to key executive positions are selected for their expertise, and their ability to contribute to the bank and to the interest of all shareholders.

Most important of all, we are requiring the banking groups to make a clear separation between their financial and non-financial businesses. The banks will have to divest all control of non-financial activities, and remove all cross-shareholdings. This will help ensure that all transactions with non-financial entities remain at arms length, that the interests of the bank are not confused with the other interests of the controlling shareholder, and that management attention stays focussed on the increasingly complex business of banking.

If this programme works, we hope a few Singapore banks will grow to become strong regional players. Of course, success cannot be guaranteed. If the local banks lose too much ground, some of our anchor players may end up marginalised, or being taken over. Still we have resolved to proceed, knowing that doing nothing would certainly lead us into more difficulty.

The local banks are strengthening themselves to compete in an open domestic market, and internationally. We have encouraged them to merge and consolidate with one another, or at least to form alliances and consolidate some of their back-end operations, so as to derive economies of scale. But the industry trends may be such that even this is not enough for them to hold their own against the large global banks. After all, even Deutsche Bank was not too big to feel the need for a merger partner. Local banks which want to be more than niche players may then need to contemplate not just foreign acquisitions, but cross-border partnerships with partners as large as or larger than themselves.

The smaller European countries are wrestling with the same issue. In Scandinavia and the Benelux countries, the pressing need for economies of scale has forced major banks to look beyond their domestic markets for partnerships, and cross-border mergers have been common.

In Singapore, the same thing is already happening in the telecommunications industry. The Government has decided to allow, and indeed to encourage, dominant local players like Singapore Telecom to go beyond foreign acquisitions, to seek foreign mergers. As Singapore banks increasingly confront the same imperative, we will have to consider exactly how far we are willing to trade off retaining a few Singaporean-controlled banks against the logic of globalisation.

Conclusion

The Asian crisis has led to a rethink of the consensus in favour of globalisation and free capital flows. The result has been to reaffirm the logic of globalisation, and the value of free markets and free trade. But it has also caused a more sober appreciation of the risks of international flows of capital, and clarified the necessary preconditions for countries to minimise the difficulties and reap the benefits from freer capital flows.

Singapore's experience in bringing our financial sector up to best practices during and after the crisis shows how complex and delicate a task it is, despite Singapore's relatively strong starting point. It will be even more challenging for countries in less favourable circumstances, to find their way forward in post crisis Asia. In this quest, these countries deserve the full support of the international community.