VIII. Conclusion: finding light among the shadows

There is no single or simple answer to current economic problems. While it might be thought easy to distinguish policies directed to macroeconomic stability from those related to financial stability, in practice it is not so straightforward. A lack of stability in one area commonly contributes to instability in the other. It may be recalled that in many industrial countries relatively high inflation in the 1970s and 1980s led investors to seek protection in property, which in turn contributed to excessive credit creation, bad loans and overexposed banks. More recently, in Japan, Mexico and South-East Asia, the other side of this process can be seen as weak banks and an associated credit crunch retarded recovery from macroeconomic disturbances. The challenging implication of this insight is that policy initiatives must be undertaken on a wide front if they are to produce a sustained improvement in living standards.

What is also being increasingly recognised is that the different policies required to support macroeconomic and financial stability share a number of underlying characteristics. Transparency in the conduct of monetary and fiscal policies is needed to provide an anchor for expectations. But transparency is also needed on the part of participants in financial markets if market discipline is to contribute to prudent behaviour. Another shared feature is that policies in both areas must avoid solving today's problems at the cost of making tomorrow's problems worse; moral hazard is a real issue. Finally, there seems to be a shared recognition in both areas that underlying processes are imperfectly understood and outcomes inevitably subject to uncertainty. Since even well-conceived plans do not always produce the results intended, perhaps the objective of avoiding truly bad outcomes needs to be given higher priority in designing policies.

What happened in financial markets between August and October last year reminded policymakers that the probability distributions which characterise asset price movements may have fat tails, at least on the downside. Interactions between various forms of risk, previously assumed to be separable, led to massive price movements which threatened the health of financial institutions and even the functioning of markets themselves. Recent dramatic events in many parts of the emerging world have made it clear that macroeconomic variables can be subject to extreme outcomes as well. Nor should one suppose that the advanced industrial countries are immune to such problems. While most forecasters expect continued and indeed accelerating growth, there are many specific uncertainties which imply that current forecasts must have a wide margin of error. What will be the effects on consumer confidence in Japan when corporate restructuring really gathers pace? What will be the effects

of the introduction of the euro on competition and prices in Europe, and on the financial structure through which monetary policy works? Will the spread of new technology lower unemployment by opening up new production possibilities or will it raise unemployment by displacing labour? Will Asian bank restructuring proceed rapidly or hardly at all? To these questions many more might be added, and the answers and policy implications are not obvious.

Nor is it obvious that the balance of current risks is symmetrical. In fact, a generalised resurgence of inflation seems less likely than further disinflation or even deflation. Uncertainty in itself erodes confidence and leads to lower spending. Imbalances work in the same direction. When they are eventually resolved, those who gain may not adjust spending upwards while those who lose commonly have little alternative but to retrench. Moreover, the specific imbalances referred to in the Introduction to this Annual Report also seem to imply some downside risk to the forecast. The overhang of productive capacity in traded goods worldwide could have a number of implications. It is already putting downward pressure on prices in the advanced industrial countries, even though export volumes from Asia have not yet fully responded to earlier depreciations. In the United States, protectionist pressures are on the rise even as the unemployment rate keeps falling from one low to another. And the intensification of price competition makes firms vulnerable to any significant acceleration of costs. Should profits come under further pressure in the United States, the effect on equity prices could be significant and this would in turn be expected to have an impact on consumption. Finally, record trade imbalances must at some point imply a lower dollar and an appreciation of the yen and the euro. Should this happen before the economies of Japan and continental Europe are growing healthily again, the downside potential for the global economy is obvious.

That policymakers have been conscious of these concerns seems to have been borne out by the actions they have taken to date. Interest rates have been lowered sharply throughout the industrial world and in many emerging economies as well. The easing which took place in the advanced industrial countries late last year was also consistent with the desire to help calm market turbulence through a further injection of liquidity. Moreover, it may be the case that monetary policy would work less effectively should prices actually fall in a generalised way, largely but not solely because of the constraint that nominal interest rates cannot fall below zero. If this were thought to be a potential problem, then the recent reductions in interest rates in some countries might also have been intended as a form of insurance against entering a deflationary trap from which it might conceivably be difficult to exit.

It would be a mistake, however, to conclude that the answer to current global economic problems is simply to ease monetary policy further. In a fundamental way, it was an excessively accommodating monetary policy over many years that created many of today's problems in the first place. In addition to considering some of the dilemmas faced in the conduct of monetary policy, greater attention has now to be paid to equally difficult issues concerning the choice of exchange rate regimes, fiscal policy and labour market reform. More directly in the area of financial stability, urgent action is required in

many countries to restructure banking systems and often the corporate sector as well. And a whole host of recent recommendations must now be implemented to ensure that, once financial systems are made healthy, they stay that way for the foreseeable future.

Policies to promote macroeconomic stability

Unique circumstances are conditioning the conduct of monetary policy in virtually every major region of the world. In the United States, the uncertainties and trade-offs faced by the Federal Reserve are in some respects normal, but in other important respects not. In conducting monetary policy to pursue domestic price stability, it is common practice to base inflation forecasts on some notion of the amount of excess capacity in the economy. What is unusual, however, is the degree of uncertainty currently surrounding such forecasts in the United States. Estimates of capacity levels based on labour market data are completely different from estimates based on capital stock data. Moreover, there exists to date no conclusive evidence either for or against the US economy having entered a "new era" of enhanced productivity growth.

Asset price movements have also imposed increasingly severe side conditions on the normal conduct of US monetary policy. While the global financial turbulence of last autumn contributed in some measure to the decision to lower interest rates, the previous run-up in equity prices, in association with the robust growth of credit, might have suggested that higher rates were called for. A similar conclusion is suggested by the recent rebound of stock prices to record levels and the associated impact on consumer spending. One great danger to continued global expansion at present is that the US economy will overheat and that fears of subsequent recession will undermine stock markets, reduce wealth and cut spending. Were the dollar to fall simultaneously, under the weight of capital outflows and a large trade deficit, a period of stagflation would not be an impossibility. With global financial markets now calmer, the need to avoid such a combination of events should be an important consideration in formulating monetary policy in the period ahead.

Last year's unique challenge in Europe was the introduction of the euro. This was masterfully executed, as attested to by the stability of intra-European exchange rates through all of last year. The challenge for the coming year will be how to conduct monetary policy given not just a new economic environment, but one that by design is supposed to be rapidly changing under the impact of the introduction of the euro itself. The fact that the cyclical positions, and asset price experiences, of many of the member states were widely different at the beginning of this year poses problems for the conduct of policy. And further complications arise from fluctuations in the value of the euro: both how to interpret them and how to respond to them. What is clear, however, is that the European Central Bank's objective is price stability and that the dangers of undershooting now seem at least as great as those of overshooting. The ECB has made it clear more recently that its response to

deviations from the inflation target will be symmetrical, implying that policy rates could indeed decline further depending on the circumstances.

Monetary policy in Japan is also being conducted in a highly unusual environment, namely one of falling prices. While the outcome is by no means certain, most of the ingredients seem to be in place for a continuation of such deflationary pressures. The burden of real debt borne by corporations continues to rise, impeding investment. Unit labour costs are increasing and restructuring will add to unemployment, further depressing confidence and consumer spending. While purchases do not yet appear to have been deferred in expectation of further price declines, as seems to be happening in China, the potential for this cannot be ruled out.

The Bank of Japan responded by lowering interest rates virtually to zero, increasing liquidity in the banking system and purchasing large quantities of private sector paper. To date, the effect has been essentially that of "pushing on a string", raising the issue of what more, if anything, might be done. The Japanese experience illustrates the limitations of monetary policy when nominal rates are already very low and excess capacity is already very high. It may also provide some indication of both the benefits and the limitations of making clear statements about the objectives of public policy.

One important development affecting Japan was the sharp rise in the value of the yen during the second half of last year. While this might well be helpful to Japan's competitors in Asia, there is no question that it will hurt the export sector, which is one of the few sources of support for the Japanese economy. In more normal circumstances, this might have been resisted through lower interest rates or intervention designed to signal that rates would be reduced if need be. However, without a credible capacity to deliver on such a promise, this unwelcome appreciation of the yen was more difficult to resist. The fact that market expectations were not anchored in a clear understanding of the role of the exchange rate in the conduct of Japanese policy was also not helpful. At the least, it should be clearly stated that the goal of ending the Japanese recession and avoiding the development of a deflationary psychology must, for the time being, take priority over concerns about the trade account.

Doubts about whether it would be possible to deliver on policy promises also militated against the adoption of explicit targets either for inflation or for the price level. In principle, either approach could play a useful role in helping prevent a downward spiral of price expectations and could thus lead to a welcome reduction in expectations about long-term real interest rates. In practice, however, economic agents must believe that the authorities have the policy instruments to achieve their targets. Currently this seems doubtful. While neither approach would thus seem very helpful on its own in the present circumstances, such a regime shift might still serve a useful ancillary function if only some other means could be found to effectively reduce the current output gap.

A combination of the very sharp fluctuations in the value of the yen and the introduction of the euro led, in the period under review, to renewed suggestions for better ways to manage cooperatively a tripolar global exchange rate system. Floating exchange rate regimes do indeed have their own

problems, not least the possibility of asset price bubbles if interest rates stay low as a rising exchange rate bears much of the burden of fighting inflation. However, no political agreement seems likely to alter significantly the current regime in which domestic monetary policy is directed primarily to domestic needs. An underlying problem of both academic and practical importance is the continuing propensity of investors to borrow in low and lend in high interest rate centres without considering the full potential for having to pay back in appreciated currency. The destabilising aspects of market failures of this sort need further investigation.

New questions concerning exchange rates also arose in many emerging market economies, with the principal lesson being that countries should eschew variable peg regimes in favour of either something much harder or the voluntary adoption of managed floating. In support of the former alternative, Hong Kong and Argentina successfully defended their currency board systems last year, by managing the system more flexibly (Hong Kong) or by threatening to dollarise and retreat from managing it altogether (Argentina). In both cases uncomfortably high interest rates simply had to be accepted. Other countries, such as Brazil, did not choose to float their currencies but were forced to do so in an environment of crisis. The outcomes were generally unsatisfactory. As in Asia last year, the trend was for currencies to overshoot and then rebound under stabilising macroeconomic policies. The Brazilian authorities also chose to let high interest rates make a contribution to this process, even though the effects on domestic debt service and the fiscal deficit were thought likely over time to put offsetting downward pressure on the real. To date, aided by a sharp improvement in the primary surplus and an unexpectedly good inflation performance, the bet seems to have paid off.

The next challenge for Brazil and other countries with newly floating currencies is to find some other nominal anchor to guide their domestic monetary policy over the longer term. This will not be easy given the lack of an anti-inflationary history, poor data on credit and monetary aggregates and the absence of reliable procedures for forecasting inflation. And without a transparent framework for conducting monetary policy, the management of episodic exchange rate pressures will also be difficult, even if less so than under a regime based on an adjustable peg.

There has been little debate recently about fiscal policy. It is commonly asserted that in Japan fiscal stimulus has (or at least had) a useful role to play in stimulating aggregate demand; in continental Europe continued fiscal consolidation is thought desirable; in the United States the fiscal position has greatly improved and no tightening seems required at this time; and in emerging markets fiscal restraint appears to be the appropriate short-run response when the exchange rate is under pressure. While these assertions have a large measure of validity, they all need to be qualified in the light of circumstances.

In Japan, where the limitations of monetary stimulus seem most in evidence, the impact of a large number of stimulative fiscal packages has been diminished by rising consumer saving. This surely reflects growing uncertainty about job security, but also inadequate pension provisions and the fear that

taxes will have to rise in the future to service accumulating debt. These latter concerns have been aggravated by the grudging nature of the fiscal response, which has failed to re-establish private sector confidence, and by the rhetoric justifying the pronounced fiscal tightening in fiscal 1997. Concerns about future tax increases have also risen with the growing recognition that current investment expenditures are being guided more by political considerations than the bringing forward of infrastructure investment that would be needed anyway. In Europe, the need for medium-term consolidation cannot be questioned. Still, it should be remembered that one of the benefits of a strong fiscal position is the scope it affords for allowing automatic stabilisers to operate. One cannot rule out the possibility of a situation arising in Europe in which fiscal stimulus may once again be an appropriate policy response. Finally, textbook economics would say that a tightening of fiscal policy in the United States would help reduce overheating domestically and the risk of a disorderly rise and subsequent sharp fall in the value of the dollar. In such circumstances, as politically unlikely as they might be, it would be all the more important for an expansion of aggregate demand to be encouraged elsewhere. In recent episodes of turmoil, the world has benefited materially from the continued strength of the US economy. However, exit strategies should now be the preoccupation for all prudent policymakers, including those in the United States.

Nor is it clear that fiscal restraint is always useful when exchange rates in emerging market countries come under pressure. In industrial countries with floating exchange rates and highly mobile capital flows, exchange rates are commonly presumed to weaken under fiscal restraint as domestic interest rates fall and capital flows out. By contrast, in emerging markets fiscal restraint may both strengthen the exchange rate and bring down initially higher interest rates by reducing the credit risk premium on foreign borrowing. This argument seems logical in the case of Brazil and Russia and other countries where the fiscal record is poor. Whether it applies to countries in Asia and elsewhere whose fiscal history is sound seems less obvious. However, recognising how fickle markets can be in a crisis environment, it might still make sense in such cases to cut the deficit initially but to reverse this stance as soon as confidence has been restored. While the question of timing remains controversial, this is essentially what happened recently in the crisis-affected countries of Asia.

Given global conditions of excess capacity and high or rising unemployment in Europe, Japan and much of the emerging world, supply-side reforms are also urgently required. This might seem paradoxical, since such reforms will eventually further increase productive potential. Yet we should not forget the principal insight of classical economics, namely that changes in relative prices can also contribute materially to the resolution of economic disequilibria. Even with adequate restructuring of the corporate and banking sectors (see below), current excess capacity in many industrial sectors means that investment in those areas will be weak for years to come, with associated multiplier effects on jobs and income. In these circumstances, it is essential that government restrictions and other profit-destroying impediments to investment in other

sectors, particularly services, be removed. While this applies most clearly in emerging markets, many industrial countries also recognise that they must move in the direction of deregulation. Steps taken in labour markets to increase the likelihood of the jobless being hired act in the same direction, particularly since workers spend and confident workers spend even more. This is perhaps one of the clearest lessons to be learned from the experience of the United States over the last few years.

Policies to promote financial stability

Before turning to how future financial problems might be avoided, the problems of today must be dealt with. The overhang of excess industrial capacity in many countries and sectors continues to be a serious threat to financial stability. Without an orderly reduction or take-up of this excess capacity, rates of return on capital will continue to disappoint, with potentially debilitating and long-lasting effects on confidence and investment spending. Moreover, the solvency of the institutions that financed this capital expansion will become increasingly questionable, potentially leading to credit rationing and strong headwinds affecting the economy as a whole. Processes of this sort are furthest advanced in South-East Asia, China and Japan. Unfortunately, in many respects, these economies also seem the least well placed to deal with them.

Closing down individual production plants in Asia is impeded by concerns about what traditional rivals might do. In any event, given heavy sunk costs, it often makes sense to continue producing at a loss as long as variable costs are being covered. In this particular respect, low interest rates and the continuing availability of finance through the banking system (or indeed from abroad) can be important disincentives to restructuring. Declarations of bankruptcy and asset sales at prices low enough to generate profits for new owners is another option, but one that has been hampered in Asia by the absence of adequate bankruptcy laws. Although progress has been made in a number of countries, it is not yet clear how new laws will be applied in practice. Finally, concerns about the social and political costs of laying off workers, and the effects on confidence in the absence of an effective social safety net, are a further major obstacle to industrial rationalisation throughout Asia. While the policy solutions needed to deal with these problems might seem obvious, implementation will be difficult and costly to shareholders and potentially to governments. It is telling that corporate restructuring is only just starting in Japan, almost a decade after the need for it became apparent. While restructuring seems to be beginning in China and Korea, as well as some other countries, it remains to be seen whether promises made will in fact be kept.

Another factor holding back corporate restructuring, not just in Asia but in many other parts of the world, is the already suspect soundness of the banking system. Aggravating this problem by recognising still more bad corporate loans may be necessary, but is hardly attractive politically. One reason for forbearance is that, with shareholder capital eroded in both the corporate and the financial sectors, the burden then tends to fall on the taxpayer. While depositors could in principle contribute, in many emerging

market countries governments have provided implicit insurance for all deposits in order to avoid bank runs like those seen in Argentina in 1995 and Indonesia more recently. With loan losses likely to amount to significant proportions of GDP, emerging market countries without well-established government bond markets could find that meeting their fiscal requirements will be challenging, even if it also provides an opportunity for the development of capital markets. As for countries with mature financial systems, the threat of major increases in government debt could still complicate macroeconomic policies by pushing up longer-term interest rates, as happened recently in Japan.

The manner in which the restructuring of the banking system is carried out will determine both how effective it is and how long it will last. The main objectives must be to re-establish solvency and profitability. As for guiding principles, effective restructuring should begin as soon as the problem is recognised and should be as comprehensive as is needed to alleviate unwarranted credit rationing. Avoiding political interference and being transparent about procedures and cost allocation is also essential. Finally, shareholders and managements of insolvent banks must suffer if moral hazard is to be avoided, although there may also have to be some limits to this in a systemic crisis. It is unfortunate that, in a number of countries, these principles have not always been applied as wholeheartedly as they might have been. Deficiencies in this regard will have short-term costs if recovery is delayed and longer-term costs if corporate restructuring is held back and past mistakes are eventually repeated.

While current problems in the financial systems of emerging market countries were primarily domestically generated, international capital flows clearly exacerbated them. The underlying reality is that even flows that are modest from the perspective of international capital markets can have highly disruptive effects on small economies. This suggests that such countries should dismantle controls on short-term inflows only very cautiously, particularly if there are doubts (and there normally will be) about the inherent stability of the domestic financial system. There should also be much less hesitation in using market-based prudential instruments, such as reserve requirements, to prevent banks from relying excessively on short-term borrowing in foreign currency. In association with a less tightly managed exchange rate regime, this could make a real difference.

Recent experience also suggests that countries wishing to accommodate such capital inflows, for whatever reasons, should make greater efforts to prepare themselves for the possibility of sudden outflows. One way of doing this is by building up foreign exchange reserves by running trade surpluses. The problem with this approach is that it would exemplify the fallacy of composition: what kinds of global imbalances would emerge if all emerging market countries endeavoured to do this? A less disruptive solution might be the one recently adopted by Argentina, namely to borrow reserves and arrange binding contingent lending facilities with the private sector. Given the swings of mood in these markets, the authorities might at certain times find it relatively easy and inexpensive to lock in longer-term foreign currency loans for later use. Finally, countries might then make use of the recently announced

Contingent Credit Lines offered by the IMF. In conjunction with similar private sector arrangements, this would be a joint testimonial to the soundness of the country in question and could contribute materially to the avoidance of contagion problems.

To say that emerging market countries should address their own problems is not to deny that part of the solution may be found in aspects of the functioning of international capital markets themselves. Imprudent lending has been motivated by both shrinking returns on traditional business at home and the belief that various forms of safety net would protect creditors should risks actually materialise. The former problem is likely to worsen as global competition in the provision of financial services increases and managements pay more attention to shareholder value. While it is possible that banks will respond by pricing risk more carefully, it is also possible that they will continue to be drawn into still riskier ventures.

The problem of imprudent lending due to safety net considerations has recently been subject to a number of offsetting influences. On the one hand, the losses suffered in Russia and China have made clear the potential for losses in emerging markets. Such experiences seemed by April 1999 to be having an effect on the behaviour of banks, even if the purchasers of emerging market bonds had lost little of their enthusiasm. This latter tendency will probably change, however, if recent suggestions that bondholders should normally share in any restructuring of a country's external debt are adopted. On the other hand, the inference to be drawn from the Long-Term Capital Management affair is that the regulatory authorities as well as the principal creditors considered that a non-bank financial institution was too complex to fail. This might be thought worrisome for the message sent out to much bigger banks and dealing firms with their own large proprietary trading operations.

Advances in technology and deregulation have not only altered traditional banking behaviour, but have also encouraged lending through securities markets and the use of such markets by the banks themselves. This too has implications for both financial and economic stability. In cyclical downturns, banks in many countries have traditionally lent to customers with whom they have relationships, which helps support spending and cushion the cycle itself. In contrast, markets tend to change course instantly, switching off credit to all but the most creditworthy. Indeed, as the banks themselves have become more dependent on such markets, either to securitise assets or to issue debt, they may also have become less capable of performing this smoothing function. Given also the observation from last year that credit spreads in financial markets tend to be highly correlated with the level of interest rates, the potential for greater cyclical swings in credit growth and associated spending would seem clear. The fact that liquidity may dry up as credit spreads widen has the further implication that, in a market-driven system, the downswings may be inherently more violent than the upswings. Finally, with more credit being provided by a multitude of investors in impersonal markets from which exit is easy, it is becoming increasingly difficult to organise concerted lending to sovereign borrowers in need of liquidity. Akin to the attitude of governments, banks ask why they should be bailing out others.

The implications of these recent developments for internal risk management procedures and public policy are important. Through various channels, financial institutions including banks are becoming exposed to higher levels of market risk. Moreover, market risk is more highly correlated with credit risk than previously thought, since market exposures are often built on leverage, and credit risk is also more highly correlated with liquidity risk than earlier realised. Furthermore, it is now evident that risk models can also offer a false sense of security because they may lose their predictive powers in extreme market conditions. Indeed, their mechanical use may actually contribute to market turbulence. While stress testing must then be relied on more heavily, greater attention must be paid to non-linear payoffs and to scenarios previously thought so unlikely as to be insignificant.

There are also implications for public policy which go beyond simply ensuring adequate internal risk management. If markets are becoming relatively more important in the financial system, and sentiment can change very quickly, it becomes equally important to monitor markets closely and identify concentrations of risk. In some countries where central banks have lost their responsibility for banking supervision, they have been given responsibility for overall financial stability. What this means needs to be better defined, as far as the support of markets is concerned. Whether central banks stripped of supervisory responsibilities will be able to obtain the information they require, when they need it, to use their emergency liquidity support powers wisely and effectively in a market-driven world remains a very open question. In continental Europe, the additional complications posed by having a supranational central bank interacting with diverse national supervisors also need careful attention.

As noted in the Introduction to this Annual Report, a large number of specific and practical recommendations have been put forward over the last year on how the stability of national financial systems and that of the international financial system might be improved. These suggestions build constructively on earlier initiatives of the G10 Deputies and the work of the various Basle-based committees, and there is no need to repeat them all here. A whole host of recent meetings have served two important functions: widening the range of participants and identifying areas of agreement and disagreement. While disagreements still remain, there are now enough areas of agreement that the time for implementation has surely arrived. This must be the principal task of the international community over the next few years, and it will not be an easy one.

International codes of practice are being recommended in many areas and should be high on the implementation list. Fortunately, experience with the implementation of the first of these, the Core Principles for Effective Banking Supervision, provides some indication of ways to move forward. The Basle Committee on Banking Supervision, through its Liaison Group and contact with regional groupings of supervisors, is itself playing an advocacy role and has been considering more active use of peer pressure. The IMF will monitor compliance in the context of Article IV consultations and has proposed a code of transparency for all those active in financial regulation. The presumption

is that greater clarity about the mandate, powers and accountability of supervisors will help them do a better job. The private sector can also help by imposing market discipline on countries whose supervisory regimes are lax. The proposal by the G7 countries that the IMF should publish its assessment of countries' adherence to international standards should help markets make better judgements. Finally, consideration might be given to denying rights of establishment in major financial centres to banks from countries whose supervisory regime is deemed inadequate. Clearly, recourse to so many different incentive systems indicates a belief that implementation of principles of best practice will be difficult at best. Moreover, there are formidable personnel and domestic incentive problems that could take years to resolve. Such considerations make it all the more imperative that efforts at self-help receive the full support of the international community.

Against the background of such challenges, the recent establishment of the Financial Stability Forum under the aegis of the Group of Seven represents an important step forward. The Forum brings together, for the first time, senior treasury and central bank officials, national regulators and the representatives of international financial institutions and international committees concerned with financial stability. Through its efforts, costly and often irritating overlaps in activity should be avoided and priorities set for implementation in a world where the needs are great but expertise is scarce. There is also a need to identify new areas of financial vulnerability and to ensure that action is taken to address them. Finally, political pressure should be exerted at the highest international level to ensure that unacceptable standards of behaviour do not remain hidden behind accounting, regulatory or other devices. To carry out its work effectively, however, the Forum will need to deal with the same membership issues that have bedevilled more traditional groupings. How can participation be kept small enough to be efficient, but at the same time made large enough to be adequately inclusive of both industrial and emerging market economies?

There can be a darker side to the operation of a market economy, particularly when financial markets are highly liberalised and expectations are prone to recurrent cycles of optimism and pessimism. Yet this should not blind us to the overwhelming merits of the system and the absence of any plausible alternative. The real task now is to improve the system we have, before suggested alternatives begin to look more attractive than they really are. Timely and effective actions that reduce the likelihood of a retreat into much tighter regulation and direct government control must surely be steps in the right direction.