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THE HONG KONG CURRENCY BOARD'S DEFENSE AGAINST FINANCIAL MARKET PRESSURE: A BEHAVIORAL PERSPECTIVE

MIRON MUSHKAT

Exchange rate regimes do not operate in an institutional vacuum, even when the scope for exercising policy discretion is distinctly limited. The Hong Kong linked exchange rate system is no exception. An interesting feature of the institutional environment in this case, not highlighted previously, is the apparent divergence in the assumptions of policymakers and market players regarding the merits of this mechanism in particular and currency boards in general. The corollary is that the Hong Kong monetary authorities need to intensify their efforts to disseminate relevant information, focusing especially on targets in the financial sector.

I. INTRODUCTION

CURRENCY boards have had a long, but uneven history. Once a common monetary vehicle, notably in the British Dominions, they receded into the background as the colonial era drew to a close and the newly independent countries opted for policy discretion. By the late 1960s, currency boards were confined to a cluster of small and very open economies. However, in recent years they have reemerged, gaining acceptance in both small and medium-sized open economies, particularly those with an unmistakable record of monetary instability.

Indeed, the adoption of a currency board seems to have effectively become the standard prescription for countries confronting a wide range of economic challenges, such as stabilization from high or hyperinflation (Argentina, Bulgaria, and apparently El Salvador), transition from centrally planned to market economy (Estonia and Lithuania), postwar reconstruction (Bosnia), and independence (perhaps East Timor and Palestine). The system has even featured seriously in normative discussions of the predicament facing large, comparatively less open economies in crisis, like Indonesia during the 1997/98 East Asian currency turbulence, Russia

The research for this paper was undertaken when the author was vice chairman and director of Economics and Strategy at INDOCAM Asia Asset Management (Hong Kong) and global head of Economics and Strategy at INDOCAM Asset Management (London and Paris).

following the August 1998 devaluation, and Brazil in the course of the 1999 defense of its exchange rate peg (Ghosh, Gulde, and Wolf 2000).

Currency boards are not without their critics. Roubini (1998) and Schwartz (1993), for example, cogently argue that such a rigid policy framework may hinder adaptation in a volatile environment and thus destabilize structurally fragile economies. For this reason, they assert, sacrificing policy discretion cannot be justified other than in exceptional circumstances. Nevertheless, empirical evidence mostly supports the view that the benefits associated with a currency board exceed the costs by a comfortable margin for small countries, which quite significantly depend on foreign trade and possess less than robust politico-economic institutions. Argentina's recent travails have not prompted a serious reassessment of the situation.

Theoretical justification, coupled with solid empirical underpinnings, is not the sole factor determining the effectiveness of currency boards in practice, however. No policy mechanism operates in a financial vacuum. A currency board is no exception to the rule. As De Grauwe (2000) has vividly demonstrated, the financial markets, particularly the foreign exchange markets, are often driven by their own version of fundamentals that diverges from that espoused by the mainstream scientific community (and hence the policy establishment). To put it differently, the validity of economic propositions, insofar as the financial markets are concerned, lies in the "eye of the beholder."

The purpose of this paper is to establish to what extent the assumptions guiding the Hong Kong government (which are to all appearances consistent with those of leading members of the economic profession both at home and abroad) with respect to the territory's currency board (known as the "linked exchange rate system" or merely the "peg") are shared by players in the financial markets. The Hong Kong economy rests on strong foundations and the territory can claim, at least for the time being, to have a credible government. Yet, on a number of occasions since its inception, the local currency board has been subjected to pressures, most intense at certain junctures, from the financial markets. The corollary is that the views of the architects of the system and players in the financial markets may at times differ materially. This possibility and its practical implications are explored below.

II. OFFICIAL PERSPECTIVE

The government position is reflected in speeches of the Financial Secretary (FS, the territory's de facto Minister of Finance) and members of the top management team at the Hong Kong Monetary Authority (HKMA, a quasi–central bank). In the case of the latter, the speeches are normally reproduced in the HKMA publications and are readily accessible. Those by the FS can also be obtained without undue difficulties from the Information Services Department. The views expressed in these documents are clearly and consistently stated. They provide an adequate foundation for identifying the key features of the official position regarding the issue at hand.

However, as might be expected, given the broad policy responsibilities of those involved and the political channels through which they communicate, the presentation is inevitably selective in nature and the relevant ideas are not thoroughly explored. A different path needs consequently to be pursued in order to gain the necessary insights. The one chosen here took the form of discussions/interviews with two economists who spearheaded the HKMA research efforts in recent years (while on secondment from the Reserve Bank of Australia and the World Bank).

Few would challenge the view that the present exchange rate regime in Hong Kong is underpinned by compelling political logic (HKMA 1995a; INDOCAM Asia Asset Management 1998; Jao 2001). It was conceived at the height of the confidence crisis triggered by tough Sino-British negotiations which featured unnerving posturing in the early stages with respect to the territory's post-1997 status. It quickly demonstrated its effectiveness as a political stabilizer and has since proved its value as such at several critical junctures, most notably during the Tiananmen Square incident. The frequency and severity of shocks emanating from the People's Republic of China has diminished in recent years, but there seems to be wide support for the argument that the currency board still provides useful political insurance in a potentially turbulent environment.[1]

The political dimension does not feature prominently in government statements. This is understandable as drawing attention to Hong Kong's vulnerabilities would obviously undermine confidence rather than enhance the credibility of the regime. The official position is that the China risk is minimal, if any, and that the "one country, two systems" formula, having demonstrated its effectiveness in the post-1997 environment, continues to offer a robust framework for managing a quintessentially capitalist and decidedly modern economy. The Taiwan problem and the uncertainties stemming from the nature of Sino-American relations are also depicted, in a typically pragmatic fashion, as minor irritants. Be that as it may, the two former HKMA chief economists acknowledged that the political insurance argument remains valid in many respects from an undeclared government standpoint (HKMA 1995a).

The economic side of the picture has always been associated with much greater diversity of opinions, both at the macro and micro levels (INDOCAM Asia Asset Management 1998; Jao 2001). Almost as soon as the dust settled on the decision to establish a currency board in order to dampen excessive exchange rate volatility, questions began surfacing with regard to the long-term costs to be incurred as a result of the switch to and specific aspects of the new configuration. While the flow

[1] The threats are not confined to China in the narrow sense of the term and could originate elsewhere; Taiwan and the United States, for example.

of questions seems to have followed a distinct cyclical pattern, their volume and intensity have clearly increased over the years on a secular basis.

The government view, as portrayed by the two former HKMA chief economists, is unambiguously tilted towards the positive end of the opinion spectrum (HKMA 1995b, 1995c, 1996a, 1996b). It is firmly based on the notion that, on the whole, the currency board is conducive to both price stability and economic vitality. The legitimate claim that this mechanism promotes a government restraint in general, and hence individual liberty, also merits attention, but it will not be pursued here because, despite the transformation of the HKMA into a rather powerful institution, such a claim does not appear to be sufficiently controversial or have concrete implications for the conduct of monetary policy.

The experience of the precurrency board floating exchange rate regime of 1974–83 is invoked by the government to bolster the argument that the present structure supports price stability (HKMA 1995b, 1995c, 1996a, 1996b). Inflation was rampant and variable during that period. This may have been due to the peculiar nature of an institutional framework which allowed commercial banks to create base money at will, and to the disruptive effects of the two oil shocks. Nevertheless, Hong Kong's monetary history probably lends substance to the contention that currency flexibility is not necessarily associated with price stability in small and open economies. The corollary is presumably that a shift in this direction would not in itself inevitably guarantee smooth adaptation to competitive pressures in a dynamic global economic environment.

By the same token, the government claims, such adaptation can proceed with a fixed exchange rate, provided domestic factors (labor and land), and product markets are flexible (HKMA 1995b, 1995c, 1996a, 1996b). Hong Kong's domestic markets are said to easily satisfy this criterion. The performance of the local economy in 1994–95 is cited as an illuminating example. Prior to the adjustment witnessed during this period, many service industries saw a decline in their competitiveness, as labor shortages and property price inflation drove up wages, rents, and other costs. In response, a large number of companies in the sector upgraded technology and lowered the intake of new workers. These microlevel adjustments and the correction in the property market helped to restore competitiveness in the mid-1990s.[2]

The government position extends beyond merely highlighting the flexibility of Hong Kong's domestic markets. Informed spokespersons almost defiantly assert that regarding the currency board as a source of inflationary pressures (due to exchange rate undervaluation with this also applying to deflationary pressures induced by exchange rate overvaluation) is a dubious proposition from an analytical perspective (HKMA 1995b, 1995c, 1996a, 1996b). They comfortably address the challenge posed by those who argue that an undervalued currency has often driven

[2] A similar adaptation is apparently underway at present (HKMA 2001).

the territory's domestic prices well above their American counterparts (at times an overvalued currency has driven them in the opposite direction), a divergence that cannot prevail without undermining competitiveness, given the link between the Hong Kong and U.S. dollars.

The first insight offered in this connection is that, impressions to the contrary notwithstanding, it is a moot point whether such a divergence has ever taken place (HKMA 1995c, 1996a). Consumer prices, which display a bias towards nontradable services, are considered by the government a not entirely reliable yardstick in this respect. Inflation in the tradable goods and services sectors, proxied by the domestic export and reexport price indices in Hong Kong and the producer price index in the United States, has followed a similar pattern at the two sides of the linked exchange rate system, reinforcing the belief among monetary policy circles that the architecture is fundamentally sound.

This is merely a factual clarification. The analytical claim is that one cannot leave productivity out of the picture. Specifically, the data show that since the inception of the currency board Hong Kong has more often than not enjoyed considerably higher productivity gains than the United States in the tradable goods and services sectors (HKMA 1995c, 1996a). In normal circumstances, this would have resulted in an appreciation of the local exchange rate. However, because the link to the U.S. dollar precludes such an adjustment, inflation in nontradable services has usually exceeded by a substantial margin that observed in the United States.[3]

Government interpretation of the underlying economic dynamics is thus sharply at variance with what is widely viewed as the conventional wisdom on the subject (lNDOCAM Asia Asset Management 1998; Jao 2001). Healthy productivity gains, mostly attributable to the relocation of low value-added activities to southern China, are deemed largely responsible for the historical upward drift in domestic prices in Hong Kong. The flattening of the inflation trajectory, monetary officials acknowledge, suggests that the pace of structural transformation / productivity improvement may be slackening (HKMA 2001). Nevertheless, the fundamental point highlighted here remains valid: under the linked exchange rate system relatively marked increases in domestic prices could be construed as a sign of strength (i.e., a jump in productivity) rather than as a symptom of deep-rooted malaise (i.e., a loss of competitiveness); and, of course, vice versa (HKMA 1995c, 1996a).

It might be possible to argue that, even if productivity differentials are the principal factor driving inflation on a comparative basis, the uncertainty induced by price volatility is detrimental to economic growth. Government representatives do not challenge this argument, yet they emphasize that inflation in Hong Kong, although consistently high under the currency board, has not taken the form of wide price

[3] By the same token, periods of comparatively modest productivity growth, although rare, have featured relative price stability, or even deflation, in nontradable services.

fluctuations. Indeed, during the free float period of 1974–83, inflation was not only significantly higher but also much more variable than in subsequent years. Furthermore, if variability is a relevant criterion, Hong Kong can be said to have enjoyed in the past two decades something akin to price stability by international standards (HKMA 1995c, 1996a).

The government attaches considerable importance to this aspect of the inflation picture in assessing the economy's growth potential. It is even more determined to highlight, linking volatility of key economic variables and uncertainty again, the potential risks to Hong Kong posed by shifts in relative prices under a free float (HKMA 1995b, 1995c, 1996a, 1996b). After all, given that merchandise exports and imports both exceed gross domestic product, the exchange rate is the most strategically relevant price in the territory. Allowing it, and hence export and import prices, to fluctuate in response to market pressures might thus be a recipe for greater uncertainty.

This conclusion, government representatives hasten to add, is not merely the product of abstract reasoning. Rather, it is comfortably anchored in extensive empirical work that demonstrates the difficulties confronting small and open economies faced with serious exchange rate volatility (HKMA 1995b, 1995c, 1996a, 1996b). In specific terms, this work strongly suggests that wide currency swings dampen export growth and that they have a similar effect on foreign investment. The effect is particularly pronounced when constraints stemming from insufficient economies of scale render hedging a costly proposition.

The positive government assessment of the relationship between the nature of the present exchange rate regime and economic growth extends beyond the external side of the picture. The unshakeable belief among monetary officials is that the currency board acts as a source of discipline in an increasingly complex institutional setting and provides in such a setting a policy framework that is simple, consistent, credible, and well-understood by agents in the domestic as well as the international arena (HKMA 1995b, 1995c, 1996a, 1996b). Its removal would heighten uncertainty about the direction of policy and the movement of key financial variables, affecting even those not engaged in foreign transactions. The implications for economic growth, according to this position, could be unambiguously negative.

III. MARKET PLAYERS' PERSPECTIVE

The view espoused by government representatives is not inconsistent with the conclusions offered by those who seek to enhance the understanding of the effectiveness of currency boards through academic inquiry. Most, albeit by no means all, research economists express similar opinions, whether on the basis of theoretical reasoning or empirical analysis (normally, and more importantly, the latter). It is generally thought that currency boards contribute to price stability and economic growth, particularly the former (Ghosh, Gulde, and Wolf 2000). However, it is not certain to what extent this verdict is shared by individuals who operate in markets for goods, services, and capital.

The focus in this paper is on perceptions of participants in the capital markets. The capital markets have been singled out for two reasons. First, from a purely practical standpoint, they are easier to identify at any point in time and are thus more accessible. Exporters and importers of goods and services constitute a very large and a highly fragmented group (indeed, the term "group" is probably inappropriate). Endeavoring to ascertain their opinions would consequently be a most challenging undertaking. Second, the capital markets have expanded by leaps and bounds in recent years and they now clearly dominate their goods and services counterparts. This renders them particularly relevant for analysts concerned with exchange rate management.

Fifty-eight professionals active in the bond and currency markets were interviewed by the author during a period extending over nearly ten months. They were predominantly senior portfolio managers and traders affiliated with banks, both of the commercial and investment variety, and asset management companies.[4] The interviews took place in Hong Kong, Singapore, Tokyo, London, and Paris (with Hong Kong serving as the principal platform).

The sample was not rigorously selected, as it is impossible to delineate the boundaries of the underlying population and locate its members. About 40 per cent of the interviewees were personally known to the author when he worked for international financial institutions in Asia (covering the region from a Hong Kong base) and Europe (London and Paris). The rest were identified by means of the snowballing method: those with whom the author was professionally acquainted were asked during the first phase of the survey to suggest others who might be able to shed light on the subject (Mushkat 1990; Wei et al. 2000).

Needless to say, no strong scientific claims can be made in such circumstances with respect to the findings. By the same token, it would be inappropriate to give the impression that they accurately reflect the sentiment on the market side throughout the existence of the present exchange rate regime. The interviews were conducted following the 1997/98 Asian currency crisis, during which the Hong Kong dollar featured prominently, in a distinctly defensive position, even though it eventually weathered the storm (Jao 2001). The new, postcolonial government in Hong Kong also arguably has not yet established its credibility, and this may possibly affect perceptions of currency board management in the private sector.

Survey results which do not fully meet the criteria of scientific validity may nev-

[4] Some functioning as an arm of large financial institutions, such as banks or insurance providers, and others operating independently with the latter category including hedge funds.

ertheless be relevant from a policy perspective. The views of a reasonable number of highly active intermediate- and senior-level professionals who collectively channel very substantial amounts of money through financial markets in which the Hong Kong currency board is embedded can be illuminating, regardless of whether they are representative in the strict methodological sense of the term. These views are examined here and juxtaposed with those of government officials.

Before focusing on views one comment may be in order. Academic economists normally postulate that market players possess ample information regarding factors they deem relevant. Our survey does not necessarily bear out this thesis. The bond and forex portfolio managers and traders interviewed did not display textbook-style perfect, or near perfect knowledge. For example, there was some ambiguity with respect to such fundamental questions as the exact period when the currency board was introduced and the precise nature of the foreign exchange regime that prevailed previously (Table I). The corollary is that policymakers cannot always expect economic agents, even highly motivated ones (and rather sophisticated ones from a technical perspective), to react in an "enlightened" fashion to developments in the financial markets.[5]

Insofar as views are concerned, it is perhaps worth noting that there is surprisingly no unequivocal support on the market side for the concept of the currency board as a form of semipermanent political insurance (Table I). While this cannot be inferred from the responses to question C alone, the impression given by a significant number of the interviewees was that possibly excessively a high degree of pragmatism is built into their position regarding China. When the issue was explored further, in several cases one could sense a strong inclination to minimize the risks on both the domestic and external fronts. This may well prove to be the correct reading of the Chinese political picture, but it needs to be emphasized that market players probably have a shorter time horizon than government officials and that their exposure to China has been more limited time-wise (largely confined to the post-Tiananmen phase of the reform era) and issue-wise (seldom extending beyond the economic/financial domain).

The public-private perceptual gap widens materially as one moves outside the realm of politics. A rather surprisingly large number of market players interviewed were of the opinion that a foreign exchange regime featuring a currency board is a distinct liability in today's turbulent economic environment (Table I). From a public sector perspective, or even a broader analytical standpoint, this position is difficult to reconcile with the picture of an apparently stable modern economy. After all, neither output nor prices have fluctuated significantly in the developed world for the past two decades or so. It would nevertheless be inappropriate to dismiss the

[5] The behavioral pattern underlying the responses obtained in this survey appears to be consistent with the idea that human information processing, however challenging the circumstances, is subject to limitations encapsulated in the notion of "bounded rationality" (Simon 1976).

TABLE I

MARKET PLAYERS' VIEW ON THE HONG KONG CURRENCY BOARD

Questions	Responses
A. The currency board was introduced in:	
1. Early 1970s	0
2. Late 1970s	3
3. Early 1980s	42
4. Late 1980s	2
5. Another period	0
6. Not sure	11
B. Before the introduction of the currency board:	
1. The Hong Kong nominal exchange rate was fixed to the British pound or another international currency	7
2. Fixed to a basket of currencies	0
3. Floating freely without government intervention (pure floating)	17
4. Floating in response to the forces of demand and supply but government intervened from time to time either directly through the forex markets or indirectly by taking action to affect the level of interest rates (managed float)	21
5. Was operating in a manner not described above	0
6. Not sure	13
C. The currency board no longer serves a useful political purpose:	
1. Strongly agree	1
2. Agree	10
3. Neutral	10
4. Disagree	26
5. Strongly disagree	5
6. Not sure	6
D. In today's turbulent economic environment, being saddled with a currency board is a distinct liability:	
1. Strongly agree	19
2. Agree	22
3. Neutral	3
4. Disagree	5
5. Strongly disagree	1
6. Not sure	8
E. Before the introduction of the currency board, management of the economy was more effective:	
1. Strongly agree	0
2. Agree	6
3. Neutral	13
4. Disagree	2
5. Strongly disagree	0
6. Not sure	37
F. Since the introduction of the currency board, the Hong Kong dollar has been almost always either overvalued or undervalued:	
1. Strongly agree	41
2. Agree	11

TABLE I (Continued)

Questions	Responses
3. Neutral	0
4. Disagree	2
5. Strongly disagree	0
6. Not sure	4
G. Since the introduction of the currency board, currency overvaluation or devaluation has almost always led to excessive deflationary or inflationary pressures:	
1. Strongly agree	25
2. Agree	16
3. Neutral	11
4. Disagree	2
5. Strongly disagree	0
6. Not sure	4
H. Since the establishment of the currency board, inflation has been highly variable:	
1. Strongly agree	19
2. Agree	18
3. Neutral	3
4. Disagree	3
5. Strongly disagree	0
6. Not sure	15
I. Bouts of deflation and inflation associated with the currency board have been economically very destabilizing:	
1. Strongly agree	13
2. Agree	26
3. Neutral	4
4. Disagree	9
5. Strongly disagree	0
6. Not sure	6
J. Under a more flexible exchange rate regime, coupled with effective fiscal and monetary policies, Hong Kong would have experienced significantly greater price stability:	
1. Strongly agree	6
2. Agree	28
3. Neutral	7
4. Disagree	3
5. Strongly disagree	0
6. Not sure	14
K. Under a more flexible exchange rate regime, coupled with effective fiscal and monetary policies, Hong Kong would have experienced significantly higher economic growth:	
1. Strongly agree	31
2. Agree	18
3. Neutral	2
4. Disagree	2
5. Strongly disagree	0
6. Not sure	5

TABLE I (Continued)

Questions	Responses
L. The economic advantages associated with a simple, transparent, invariable, and credible structure such as a currency board are often overstated:	
1. Strongly agree	5
2. Agree	17
3. Neutral	16
4. Disagree	7
5. Strongly disagree	4
6. Not sure	9
M. The Hong Kong Monetary Authority is an effective guardian of the currency board:	
1. Strongly agree	19
2. Agree	23
3. Neutral	6
4. Disagree	6
5. Strongly disagree	0
6. Not sure	4
N. The Hong Kong currency board has been tinkered with to such an extent over the years that it no longer qualifies as such:	
1. Strongly agree	1
2. Agree	4
3. Neutral	9
4. Disagree	33
5. Strongly disagree	7
6. Not sure	4

assessment offered by bond and forex portfolio managers and traders as a superficial knee-jerk reaction or a reflection of vested interest (in that currency boards restrict their options). The much vaunted economic stability has yet to manifest itself in the financial markets, where one crisis seems to follow another in rapid succession.[6]

Unlike government officials, market players cannot make a meaningful comparison between the present and previous foreign exchange regimes in terms of policy effectiveness (Table I). Lack of awareness, or possibly of conviction, on their part in this respect should not be construed as a neutral factor. The present status quo undoubtedly qualifies as a vast improvement on the preceding institutional configuration. If they were aware of this, or willing to entertain the idea positively, the interviewees and others at the financial frontline might have been more favorably disposed towards the Hong Kong currency board and better equipped to understand

[6] Asia, Russia, Brazil, long-term capital, and NASDAQ have unleashed powerful tremors that may not have derailed economies from their steady path, but have left an indelible mark on those who operate in the financial arena.

the forces driving its guardians. This presumably would have rendered them less likely to act in a manner inconsistent with the expectations of the latter.

The gulf between the official and market sides is deepest when it comes to assessing the economic dynamics under the currency board. Contrary to the insights offered by monetary experts previously affiliated with the government, the interviewees in the survey consistently portrayed the linked exchange rate system as a source of instability and a growth retarding mechanism. Perhaps most notably, they seemed to concur strongly with the notion that under the currency board the Hong Kong dollar has been almost always either overvalued or undervalued, brushing aside, implicitly at least, the analytically sound idea that deviation from "fair value" cannot be sustained for long within such an institutional framework (Table I).

If persistent overvaluation or devaluation is embraced as a realistic concept, the outlook inevitably darkens. Unlike their official counterparts, market players thus consider fundamental exchange rate disequilibrium under the currency board to be the source of nearly perennial excessive deflationary or inflationary pressures (Table I). They also believe that the inflation rate has been highly variable rather than confined to a relatively narrow range (Table I). Unsurprisingly, this leads them to the conclusion that the linked exchange rate system has been economically very destabilizing (Table I) and that Hong Kong would have experienced significantly greater price stability under a more flexible regime (featuring, of course, effective fiscal and monetary policies; Table I).

A similar line of reasoning is followed with respect to the growth side of the picture. Just a handful of the interviewees did not strongly agree or agree with the statement that a less rigid framework than presently in place (again, coupled with effective fiscal and monetary policies) would have allowed Hong Kong to enjoy a more robust expansion of output (Table I). By the same token, there was some reluctance to acknowledge the seemingly obvious institutional virtues of a currency board (simplicity, transparency, continuity, and credibility) and the possibility that these might impart a degree of vigor to the economy in the long run (Table I).

It might be argued that market players have misgivings about the fundamental merits of the linked exchange rate system because of reservations regarding the modus operandi of the HKMA or the fact that the present structure is the product of a long process featuring a high degree of policy innovation (or, to put it more explicitly, meaningful adjustments in the overall architecture). According to this view, a currency board of the classical variety has evolved to a point whereby it functions as an instrument liberally employed by a de facto central bank. If that is the case, the evidence generated in this survey does not provide the necessary reinforcement. The interviewees generally deemed the HKMA to be an effective guardian of the currency board and did not think that the system has been tinkered with to such an extent over the years that it no longer conforms, both in spirit and method, to the original specifications (Table I). The explanation for the divergence between public and private opinions pertaining to the issue at hand thus in all likelihood has analytical roots.

IV. POLICY IMPLICATIONS

The picture painted here is not without practical relevance. “Managing” the Hong Kong currency board is not a frictionless operation. Defiant markets, as distinct from compliant financial markets, can increase friction to painful levels. Outright defiance may have been the exception to the rule, but the HKMA has undoubtedly faced some serious challenges. Further, while there is not a definitive way to establish the validity of the argument (even the movements of the Hong Kong dollar vis-à-vis its U.S. counterpart and the spread between local and American interest rates are not free of “noise”), compliance appears to have diminished over the years.

The HKMA cannot assume that market players share its vision of reality. The median age and median number of months in the present position of the interviewees in this survey were thirty-six and forty-one respectively. To the extent that the sample is broadly representative of the population, the latter is clearly young and mobile. By the same token, only a fraction of those employed by large international financial institutions in senior- or intermediate-level positions in the forex and bond areas in Asia and elsewhere are Hong Kong Chinese (merely eight of the interviewees in this survey). Last but not least, tracking the Hong Kong dollar is at best a part-time pursuit for such professionals.

Government officials and armchair theorists may be puzzled by the rather fragmentary knowledge and certain selectivity in processing information by individuals who hold positions of responsibility in the financial frontline. If so, there is a case for reassessing the situation at the ground level and taking a more business-like/less academic approach towards those on the other side of the currency board fence. Unless one proceeds on the dubious assumption (probably valid just in the short term) that less than perfect knowledge and incomplete information search on the part of market players, or any other such “asymmetries,” work to the advantage of the monetary authorities, it is difficult to avoid the conclusion that there is a need to step up efforts to provide on an ongoing basis pertinent facts regarding the linked exchange rate system to relevant parties in the private sector.

Senior HKMA officials do not avoid the limelight, but they tend to express themselves in somewhat general terms. One also senses that, having won a number of critical battles, they no longer display the combativeness evident in the previous years (and a degree of “smugness” may have even crept in). At lower organizational rungs, there is an effective dialogue between the HKMA research arm and private sector analysts (particularly those in the financial community). Since most of the interviewees in this survey were not regular readers of the HKMA *Quarterly Bulletin* and seldom participated in its functions, it is legitimate to infer that the target audience is overly narrow and should include practitioners as well as analysts. Such a broadening of "marketing" channels should lower the "transaction costs" of maintaining the currency board in the long run.

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