

## Tony Latter: Just another financial centre – or is Hong Kong special?

Address by Mr Tony Latter, Deputy Chief Executive of the Hong Kong Monetary Authority, at the Foreign Correspondents Club, Hong Kong, 25 April 2001.

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A quarter of a century ago many people in Hong Kong were seriously worried about the shrinkage of our manufacturing industry. Other locations in the region were showing signs of becoming increasingly competitive, and there was the emerging prospect of activity migrating across the Mainland border.

In retrospect, should we have been worried at all? Hong Kong's economy was performing well enough overall, and the service sector was growing at the expense of manufacturing as part of what proved to be a progressive and relatively painless process.

Today people express concern about loss of competitiveness in those very services which have been ensuring our continuing prosperity in the intervening years. Back-office functions, which first migrated from Central to Quarry Bay or Kowloon, are now moving to Guangdong - or maybe India or wherever. Should we worry? What will fill the gap? Is Hong Kong so expensive a place that it has priced itself out of range of any prospective business growth?

At the microeconomic level there will always be understandable and, especially in the social context, justifiable concern for the individuals who face uncertainties or job losses as a result of restructuring within the economy. But at the macro level this is part of evolution. The economy cannot progress without it. If we have faith in the operation of the market economy, the answer to the question whether we should worry is "No, we shouldn't". What we are witnessing is no more than the inexorable playout of the process of comparative advantage - perhaps one of the most proven laws of economics.

Comparative advantage hinges on relative factor endowments and their productivity. Some of these characteristics are, in large measure, static. Thus, for example, relative to other locations Hong Kong has an abundance of deep water but a dearth of flat land. This, very obviously, yields us a strength in port facilities over agriculture. Other characteristics evolve dynamically, such as our relatively well educated and qualified labour force; when this is set against the shortage of space, it is hardly surprising that Hong Kong should specialise more in providing high value-added services than in labour-intensive or space-hungry manufacturing.

As regards absolute cost levels, it is the high value added by members of the workforce in particular sectors which generates and justifies their high pay. The fact that Hong Kong appears to be, overall, a rather expensive place, relative to the majority of neighbouring economies, is a consequence and symptom of its success. As anyone can see by just looking around, this doesn't mean that we can no longer win any business. But we can only afford to pay ourselves what we are worth. If costs go too high and Hong Kong suffers an absolute loss of competitiveness (as opposed to there merely being shifts in relativities between sectors), then an adjustment process kicks in to restore competitiveness. Since we have a fixed exchange rate, this adjustment occurs through downward pressure on domestic costs and prices. We have seen this process very clearly and effectively at work over the past three years or so; for instance, the loss of competitiveness inflicted on Hong Kong by the currency depreciations elsewhere in the region in 1997 was made good largely through internal deflation within the space of about 18 months.

At risk of my labouring the point, look at cities such as London, Paris, Zurich, Tokyo and New York. In absolute terms they are expensive places, but they all generally thrive. The citizens don't hang their heads in shame at being in a high cost and high earning environment. Indeed, many relish it. But none of the businesses there can afford not to search continuously for greater control of costs, for higher productivity, for new products and markets, and so on. Competitive pressure may be intensified by globalisation and by the emergence of significant competition even from third world cities, where basic costs are hugely lower, but the very survival of the wealthy cities has not been seen to be seriously threatened on that score. Over a period of time there may be marked shifts in relative income levels between different locations – hopefully as the living conditions of the poor advance more rapidly than those of the rich, although sadly there has been less evidence of that than one might have wished for – but there is no reason to expect the great cities of the world to sink out of sight. And if you add Hong Kong to that list, you will see the point I am trying to make.

I'm not sure whether anyone a quarter of a century ago accurately predicted how important a contribution the financial and business services sectors would now be making to the Hong Kong economy. Looking ahead, I am definitely reluctant myself to make any prediction about the mix of activity twenty-five years from now. Ask anyone involved in financial services what path for this particular sector in the years ahead would be best for Hong Kong and he would probably answer that continued expansion would of course be best. Ask the same question to a neutral economist and he would probably decline to commit himself, saying only that the optimal strategy would be to allow the forces of comparative advantage to play out. Whether that favours further development of the financial sector, or of something completely different, who can tell?

I am often asked what we on the official side, or more particularly in the Hong Kong Monetary Authority, plan to do in order to ensure that our financial sector remains competitive and growth-orientated. I find myself torn between replying "Nothing at all" and "Everything possible". In fact both would be correct in their own way.

"Nothing at all" seems appropriate if one is content to allow market forces and the inexorable working of comparative advantage to fashion economic development. It is also consistent with Hong Kong's style of non-intervention. Picking winners is not easy. The offer of sweeteners, first to one sector then another, now to one class of customer then another, may, unless it can be very convincingly justified by thorough cost-benefit analysis, be at best a zero-sum game and at worst a recipe for eventual higher taxation, the burden of which ultimately falls on those least able to shift it away from themselves - typically employees and consumers.

"Everything possible" seems appropriate in the context of our role in encouraging and catalysing innovation, spearheading collective initiatives in cases where there is insufficient incentive for any single entity to launch them, building infrastructure, and so on.

In this latter regard I think that Hong Kong can take a certain amount of pride in some of the achievements in the financial sphere in recent years. In the interests of time let me mention only some of the developments in systems infrastructure with which we in the HKMA have been involved:

- first, the establishment of the Central Moneymarkets Unit as an electronic clearing and custodial system for debt instruments; although this dates back to 1990, the service has been progressively enhanced and extended since then, including, most recently, the building of linkages with similar systems in other centres in order to facilitate cross-border trading in bonds and other debt securities;
- second, the introduction of real-time gross settlement into the Hong Kong dollar inter-bank payments system in 1996 – we were one of the first economies in the world to adopt this procedure, which is nowadays regarded as the global standard;
- third, the launch last year of our US dollar payment system, which replicates in Hong Kong for US dollars all the existing payment facilities available for HK dollars, with the addition of real-time payment-versus-payment settlement of foreign exchange deals between HKD and USD – itself a world first for any currency pair.

You may reasonably ask what is the point of such projects as these. Broadly speaking, they have been directed at enhancing the efficiency of financial intermediation and reducing the associated risks. This in turn should both contribute to the soundness of the banks and other financial institutions, and benefit, even if only indirectly, all users of the financial system. And by continuously adapting and refining its systems Hong Kong seeks to retain its attraction as an international centre. In none of these projects was any huge injection of public money necessary.

These developments also illustrate very clearly the "can do" culture of Hong Kong. Most were executed in a fraction of the time that similar projects required, or are projected to require, in other centres. For instance, from start to finish the US dollar payments system took only about twelve months to implement. And this "can do" capability extends much more widely than the few examples in the financial sector which I have mentioned.

There are many characteristics of Hong Kong which may help explain the strength of its "can do" culture. Let me mention just four:

- One is the limited amount of red tape. I don't say "absence", but, even though the creep of bureaucracy may not have been held entirely at bay, it is certainly less intrusive here than in many other places.

- Secondly, geography has an influence. I am thinking in particular of the physical concentration of business within Hong Kong itself. Remote communication has not yet displaced human contact completely as the medium for doing business; indeed, face-to-face contact has survived much more extensively than some had predicted; and, to the extent that it is necessary or desirable to get people round a table in order to expedite some project, Hong Kong, because it is small, is one of the easiest places in which to do so.
- A third factor supporting the "can do" culture is the general quality and spread of people who are on tap to help get things done: Hong Kong has a good critical mass of expertise in all areas of financial and related services. Of course, I am not deaf to the difficulties sometimes expressed about finding extra people at a particular time with particular skills, but this is almost inevitable in a growing economy. Even then, some relief is normally available through drawing in temporary resources from outside Hong Kong if the occasion demands.
- Finally I would cite the work ethic. People work for long hours and with much loyalty in Hong Kong. Of course, this is not enough in itself. It is productivity that counts, but that is probably where Hong Kong scores; I don't have the impression that many people are passing the day gazing idly out of the window. The corollary of high productivity is that, as I noted earlier, by international comparison a lot of people here receive high salaries, but they certainly earn them. Otherwise they would not hold onto their jobs.

There is of course a downside to this strong work ethic. Many people appear not to have much time for fun. It worries me if people say they cannot afford the time for their favourite recreations or pastimes. It worries me when, late in the evening, someone jumps up from the dinner table immediately after the last mouthful, saying that he must get back to the office. But perhaps such people regard work itself as sufficient fun.

So, when people ask what is it that has made Hong Kong a leading business and financial centre, I would reply that it's not just the position in the Asian time-zone, or low taxes, or the legal framework, or the English language, or the entrepot trade with the Mainland, or the Convention Centre, or the airport with its excellent international connections, or the MTR, or the rugby sevens, or the hotels and restaurants, or the shops. It is of course all of those, but additionally, and arguably foremost, I would emphasise the people and the work ethic, and the fact that in Hong Kong you can get the job done. It is in this respect – and relating back to the title of my talk - that there is perhaps something really special about Hong Kong. We may take it too much for granted, but our "can do" mentality is acknowledged by outsiders as something special and is a crucial component of Hong Kong's reputation as a business and financial centre. It is something which we should continue to cherish and nurture, whether through facilitative economic policies or the educational system or whatever.

And so, as you battle against the incoming surge while you try to exit the MTR train (probably beneath a poster exhorting courtesy); as you are almost decapitated entering the lift by the person with his finger permanently on the doors-close button; as you are tripped over by the ubiquitous Hong Kong trolley being raced in and out of the pedestrian crowd; as your boss explains that, although vacation leave is of course an entitlement, it would be rather inconsiderate of you actually to take any; as the waiter throws you into a seat at Mr Wong's table, thrusts the napkin onto your lap and demands rather than enquires whether you'd like a drink - all before you've had a chance to explain that it is not in fact Mr Wong whom you have come to join; as the taxi appears deliberately to accelerate through the large puddle right by where you are standing; as your lunch guest spends the entire meal fiddling with his mobile phone, making it quite clear that he resents having been invited to a restaurant where he is not allowed actually to talk into it; as you discover that the dignitary who has agreed to propose the toast at your modest office-opening ceremony can in fact stay for only five minutes because he or she has to hasten along to your main competitor's gala dinner; if you are feeling increasingly stressed by all of this, just relax and console yourself that this is Hong Kong, and Hong Kong wouldn't be where it is if people had never been in a hurry to get on with things.