Joseph Yam: Competition and cooperation among global and regional financial centres

Speech by Mr Joseph Yam, Chief Executive of the Hong Kong Monetary Authority, at the Concurrent Panel Sessions of the Lujiazui Forum, Hong Kong, 9 May 2008.

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There are two points that I would like to make.

First, given that many jurisdictions claim to be or wish to develop as international financial centres, we need to be clear about what actually defines an international financial centre. We in Hong Kong have given much thought to this, principally because Article 109 of the Basic Law of the Hong Kong Special Administrative Region requires that "The Government of the Hong Kong Special Administrative Region shall provide an appropriate economic and legal environment for the maintenance of the status of Hong Kong as an international financial centre". We obviously do not wish to fail in this legal responsibility.

I do not believe that being the nth largest foreign exchange trading centre or the presence of many of the largest international financial institutions are good definitions for an international financial centre. Indeed, with the advancement of information technology, there may be a tendency for the market place to migrate into cyber space. In my opinion, an international financial centre is a centre in which the function of financial intermediation, which is so important for supporting economic growth and development, takes place on an international dimension. In other words, an international financial centre is an international meeting place between those with surplus funds and those in need of funds. Thus when Hong Kong provides a significant platform for investors from, for example, Europe and America to invest their money in financial instruments issued by fund raisers from the Mainland of China, or provides the window for investors on the Mainland to access investment opportunities in the rest of the world, we qualify for the status of an international financial centre.

With this definition in mind, the crucial pre-requisites for an international financial centre are **first** the existence of sizeable overseas demand for international financial services – the mobilisation of savings overseas and the attraction of foreign capital – and **secondly** the willingness for such demand to be satisfied there. Of course, there are also the ability to provide those financial services and the many attributes that go along with that ability, including the protection afforded by the rule of law, an efficient financial infrastructure, a quality environment, and so on. But I think it is the existence of substantial demand for financial services from a large hinterland that comes first. New York, of course, has the largest economy in the world that is free and open to support its status as an international financial centre, providing financial services that mobilise US savings to the rest of the world and attracting foreign investments, and servicing domestic financial intermediation at the same time. London, of course, has much of the European economy in addition to the United Kingdom economy. Hong Kong has the Mainland of China, the third largest trading partner, the fourth largest economy, the largest foreign reserve holder and home to participants in the key financial markets that collectively form the largest player in the world.

The **second** point I wish to make is that, under "One Country, Two Systems", there are two financial systems in China, both in a position to serve the interests of the country in the all-important function of financial intermediation. This is unique and there are no relevant precedents in the financial history of the world. Because of the uniqueness of this arrangement, there is understandably considerable scepticism both internationally and within China on how it might work. Let me tell you. The two financial systems are different in a variety of ways, with the financial system on the Mainland operating in the developing environment of a socialist market economy and the one in Hong Kong operating in the familiar environment of a capitalist free market economy. We all know that where there are differences, there are opportunities for exploiting relative strengths, addressing relative weaknesses and maximising synergies between the two systems, remembering always the national interest of making financial intermediation more efficient for the country as a whole. In other words, there is a need to develop a complementary, mutually-assisting and interactive relationship between the two financial systems. This incidentally is national policy, articulated by Premier Wen on the occasion of the National Finance Working Meeting held early last year.

Given, however, that there are considerable controls in the financial system on the Mainland, including capital controls, and that the financial system in Hong Kong is among the freest in the world, to develop the complementary, mutually-assisting and interactive relationship between the two financial systems there is a need **first** to establish channels to promote the mobility in an orderly manner between the two financial systems of (1) money, (2) investors and fund raisers, (3) financial instruments and (4) financial intermediaries. Given also the increasing use and the clear prospects of the renminbi as a medium for international financial transactions there is also a need **secondly** to develop the ability of the financial system in Hong Kong to handle financial and other economic transactions denominated in the renminbi. **Thirdly**, as the mobility of money, investors, borrowers, financial instruments and financial intermediaries between the two financial systems grows, there will be rapid growth of financial traffic between the Mainland and Hong Kong. Consequently there is a need for robust links between the financial infrastructures of the two financial systems. This then is our strategy. In terms of actual measures – something that Antony also wants me to talk about – I would refer you to the eighty recommendations in the Report of the Focus Group on Financial Services published in January 2007 as Hong Kong's response to the Eleventh Five-Year Plan of the country published in 2006 and as Hong Kong's input to the National Finance Working Meeting in 2007.

As you may be aware, the implementation of our overall strategy and many of the detailed recommendations involve the relaxation of controls in the financial systems on the Mainland. While the benefits of financial liberalisation are clear, so are the risks to financial stability, as the Asian financial crisis of 1997-98 and the current turmoil in the developed financial markets demonstrate so vividly. Here there should be a strong emphasis, to quote the Premier again, on gradualism, controllability and the ability to take initiatives at the right time. And in the context of pursuing the complementary, mutually-assisting and interactive relationship between the two financial systems, financial liberalisation should not be seen as helping Hong Kong. We welcome support from the Mainland in discharging our legal responsibility in maintaining the status of Hong Kong as an international financial centre, but I hope I have convinced you that in developing our strategy and our recommendations, we very much have the national interest foremost in our minds.

As to Antony's question on whether Shanghai is a threat to Hong Kong's status as an international financial centre, I hope my description of our strategy will bring you around to the view implicit in that strategy that we see a complementary, mutually-assisting and interactive relationship, where relative strengths are exploited, relative weaknesses are addressed and synergies maximised; and not a relationship characterised by cut-throat competition, as some may have portrayed it.