

Norman T L Chan: Reform and liberalisation in China – the positioning and future of Hong Kong

Speech by Mr Norman T L Chan, Chief Executive of the Hong Kong Monetary Authority, at the Hong Kong Economic Summit 2015, Hong Kong, 1 December 2014.

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Ladies and Gentlemen,

Hong Kong's success story – borrowed time and borrowed place?

1. I am glad to be invited to address the Economic Summit 2015. This year's theme is "Connectivity Breeds Opportunities" and "Breaking New Grounds for Economic and Trade Development". I would like to share with you my views on Hong Kong's positioning and prospect amidst the reform and opening up of Mainland China. I always believe that Hong Kong will be all the more prosperous as Mainland China continues to deepen its reform and open up further to the world. I do not subscribe to the view that our prosperity is built on borrowed time in a borrowed place.

2. There are some who think that time has changed and Hong Kong's golden years are behind us. With China's rise, Hong Kong will decline in its relative importance and relevance to the Mainland. Some also think that the Central Government will trigger a Plan B in favour of other Mainland cities to replace Hong Kong as its international financial centre if Hong Kong becomes unstable or is no longer reliable for whatever reasons. Indeed, there is even a feeling among some that Hong Kong will inevitably be marginalised no matter what as Mainland China's reform and liberalisation gathers pace and other Mainland cities bypass Hong Kong to establish direct trade and financial links with the world.

3. These people believe our future is doomed and would be eclipsed by the Mainland's reform and liberalisation. They tend to look back with fond memories of the "good old days" in the 1980s and 1990s when Hong Kong was the sole gateway between Mainland China and the rest of the world. So, I pose this question – Is their reasoning sound?

Will Hong Kong become irrelevant as Mainland China opens up?

4. First, let's look at the changes in the role of Hong Kong as an intermediate trading hub for Mainland China over the past few decades. In 1979, Mainland China's external trade amounted to a mere US\$30 billion and container throughput amounted to just 30,000 to 40,000 TEUs, which were mostly processed at the Kwai Chung Container Terminal in Hong Kong. By contrast, in 2013, the Mainland's external trade ballooned 140 times to US\$4.2 trillion with container throughput up to 190 million TEUs. The throughput at Hong Kong's container terminals increased more than 20 times from around 1 million TEUs in 1979 to 22 million TEUs in 2013. However, if the majority of the Mainland's imports and exports continue to be routed through Hong Kong, how many additional container terminals would need to be built? Could our road system cope with trucks hauling containers all over the territory? And is this what we want for Hong Kong?

5. In fact, Hong Kong's position as an intermediate trading hub for Mainland China's external trade has become more prominent over the past decades. In 1979, our trade intermediation activities (including logistics industry) accounted for about 15% of GDP and rose to 20% in 1990. Since China's accession to the World Trade Organisation in 2001, direct competition from the Mainland has increased, but the pie has also grown much bigger. The total trade volume of the Mainland surged from US\$510 billion in 2001 to US\$4.2 trillion in 2013. And, while the percentage of trade being directly processed in Hong Kong has been trending downwards (from 30% to 10%) during the same period, the value of goods has risen

sharply from US\$150 billion to more than US\$400 billion. Taking into account the fast-growing offshore trade, the total value of trade in goods handled by Hong Kong would jump from some US\$300 billion to US\$900 billion during the same period. This shows that the trade creation effect is much greater than the diversion effect. Hong Kong's trade intermediation activities (including logistics industry) amounted to US\$64 billion in 2012, accounting for 25% of our GDP and employing 770,000 workers (21% of the total workforce). These figures demonstrate that we should be able to seize the abundant business opportunities arising from the Mainland's expansion in external trade if we continue to fortify our trade relations with the Mainland and the rest of the world, just like our trade intermediation activities growing from 15% of GDP in 1979 to 20% in the early 1990s, and then to 25% now.

6. Let me illustrate with another example why Hong Kong will not be marginalised as the Mainland continues to open up to the world. Let's look at the opening of the cross-strait "Three Direct Links". Prior to 2008, there were no direct flights between the Mainland and Taiwan. Passengers had to make a mid-way stopover at a third place. As a result, Hong Kong became the busiest transit point between the Mainland and Taiwan by virtue of its favourable location. Some pundits predicted that the opening of the "Three Direct Links" would deal a devastating blow to the aviation industry between Hong Kong and Taiwan. On the contrary, air traffic between Hong Kong and Taiwan increased by 15% from an average of 118 flights per day in 2007, before the implementation of the "Three Direct Links" in 2008, to 136 daily flights in 2013. This clearly illustrates that as long as Hong Kong is able to maintain its attractiveness and competitiveness, we can continue to effectively perform our role as an intermediary between the Mainland and Taiwan.

Are Hong Kong and Shanghai deadly rivals?

7. The tale of the rivalry between Hong Kong and Shanghai is another hotly debated topic. But I have never thought of these two cities as deadly rivals. More than a year ago when Shanghai proposed the establishment of the "Free Trade Zone", some predicted that, within 2 to 3 years, Shanghai would wrest from Hong Kong the position as Mainland's offshore financial centre. They thought that further liberalisation of the Mainland's capital account would enable Shanghai and other Mainland financial centres to take business away from Hong Kong. There is some truth in it. As the Mainland's capital account liberalises, Shanghai will certainly carry out more cross-border and international financial activities and compete with Hong Kong. However, I would like to point out that the gradual liberalisation of the capital account is a two-way process, meaning a more efficient flow of funds into and out of the Mainland. It will then be much easier for Hong Kong to develop businesses targeting Mainland enterprises and residents, such as financing, debt issuance and wealth management. If we look at the size of the onshore renminbi financial market, with RMB110 trillion in total bank deposits and RMB160 trillion in total financial assets, we can imagine as the capital account continues to liberalise and create the necessary policy headroom for two-way fund flows, it would mean a huge market with enormous business opportunities for Hong Kong's competitive banks and financial institutions.

8. So, I do not believe Shanghai and Hong Kong are rivals. The two cities are situated in different regions and their real economies have different clientele. With capital account controls still in place on the Mainland, the further opening up of Shanghai, such as the development of its Free Trade Zone, will lead to closer and more extensive business, trade and financial links between the two cities, meaning more business opportunities. In 2000, there were 23 flights a day between Hong Kong and Shanghai. In 2013, this had increased to 75, clearly demonstrating that the continuous growth of Shanghai will result in more business exchanges with Hong Kong and creating a win-win situation.

9. Indeed, the launch of the Shanghai-Hong Kong Stock Connect on November 17 resonates with my assertions here in several ways. Last week, Vice-Premier Ma Kai told the visiting delegation of the Hong Kong Association of Banks that the scheme was not only a

milestone for financial co-operation between Hong Kong and Shanghai, but also a strategic move towards the Mainland's capital account convertibility and the opening up of its capital market. Furthermore, the Shanghai-Hong Kong Stock Connect adds another important channel for the circulation of renminbi between onshore and offshore markets. It is also a strong vote of confidence in Hong Kong's development as an international financial centre, reaffirming our unique role as the offshore testing ground for the Mainland's financial liberalisation.

Zero-sum vs positive-sum

10. There are also those who believe that to maintain Hong Kong's competitive edge, we must be the only conduit for foreign capital going into and out of the Mainland. It means a "single access" model, with Hong Kong as the only link and conduit between the onshore and offshore markets. The rationale for Hong Kong to continue to monopolise the access to the onshore market is understandable. It also serves practical purposes at the initial stage of the renminbi's internationalisation. But as the renminbi internationalisation progresses, this model is not sustainable in the long run. The aim of opening up the capital account and internationalising the renminbi is to foster general acceptance of renminbi in global trade and investment and as a reserve currency. To promote the extensive use of renminbi by corporations and investors around the world, renminbi business must flourish in different parts of the world. The development of the offshore renminbi market must shift from a "single access" model to a "multiple accesses" model. We pride ourselves as the world's most important offshore renminbi centre, still far ahead of other centres in terms of the size of the liquidity pool and various financial intermediation activities. But there is no time for complacency. Our task is to consolidate Hong Kong's unique advantages and leverage our first-mover position by incessantly upgrading our renminbi platform, making it the ideal choice for companies and financial institutions, on the Mainland and around the world alike, to conduct various types of offshore renminbi business. Our challenge, therefore, is to evolve successfully in the face of this shift and it is a philosophy that the HKMA has been actively pursuing in the past few years – exploring new policy headroom, improving our financial infrastructure, promoting Hong Kong's offshore renminbi business in overseas markets in collaboration with the financial industry, and co-operating with other places, such as London, Paris, Australia, Malaysia and Thailand in developing renminbi business.

A competition of soft power among international financial centres

11. As I have emphasised on many occasions, the competition among international financial centres is essentially a battle of soft power. That is not to say hard power is not important. Quite the opposite, the building of hard infrastructure such as airports, transportation system, telecommunications, and efficient offices, is a prerequisite for entering the race. Yet it can only go so far. Funds, especially at the wholesale level, tend to flow to and aggregate in the more efficient and safe financial centres. Therefore, the race ultimately depends on soft power, which is made up of a wide range of qualities and strengths that are difficult to quantify. They include, the most important of all, the rule of law, protection of property rights and intellectual property, the taxation regime, the soundness of financial institutions, the robustness of supervisory frameworks, the competency and integrity of professionals, such as financial practitioners, accountants and lawyers, the free flow of information, the free and convenient movement of people, and a favourable business environment. Hong Kong's competitive edge in hard power and soft power has been a hard-earned success made possible through the cumulative effort of successive generations. But I think the most crucial factor lies in the "can-do" spirit of the people of Hong Kong, a drive to always look for a solution, agilely and tirelessly, with no fear of obstacles or competition. Our economic transformation and development in the 1960s and 1970s, migrating from entrepôt trade to light industry and then finance, is a story of constant change and innovation. And, especially since the Mainland's reform and opening up, we have always been a testing

ground, a buffer zone and a springboard. When Hong Kong's manufacturing base moved to the Mainland, we changed to trade intermediation and focused on logistics management and offshore trade. We also developed our services industries, especially high value-added and modern services including professional and financial services. Our economy has always adapted and transformed itself in response to the constantly shifting economic landscape of the Mainland and the rest of the world.

Conclusion: leveraging the Mainland while engaging the world

12. The pivot of the Mainland's economic growth is expected to shift to domestic consumption, innovation and efficiency enhancement, as well as market opening. There will also be more Mainland companies investing abroad. The prospects of Hong Kong rest on whether we can ride on this trend, developing and introducing the right products and modern services for the Mainland market; whether we can attract more Mainland companies to use Hong Kong as the springboard to go global, and anchoring in Hong Kong their operating and treasury centres for overseas expansion.

13. I have always been optimistic about Hong Kong's future. Yet my optimism rests on the very presumption that Hong Kong people would continue to make the right choice for our future. Indeed it is our choice: what's the way forward? Where will it lead us? We could well choose to indulge in past success and languish in self-pity, fretting that our monopoly access to the Mainland market would chip away as reform and liberalisation continues to take hold. We could choose to squander our time and opportunities resting on our laurels. Alternatively, we can choose to maintain a healthy and positive interactive relationship with the Mainland on the basis of "One Country, Two Systems". We can cherish the hard-earned success made possible by the concerted efforts of generations of Hong Kong people and pass on our "can-do" spirit. We can also capitalise on our strategic position to leveraging the Mainland while engaging the world. I trust and remain hopeful that we would make the right choice that promotes Hong Kong's prosperity, maintains our stability and leads us to a bright future.