Hong Kong and Singapore as International Financial Centres: A Comparative Functional Perspective[1]

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Abstract

Singapore owes its strength from its foreign exchange and derivative markets while Hong Kong thrives on its fund management industry and offshore lending. Both Singapore and Hong Kong may, therefore, complement each other in providing financial services to their clients. There is no zero-sum competition between the two, each serving two distinct geographic regions. Even if Singapore does succeed in developing its fund management industry, Hong Kong will not be adversely affected because the industry in the region is still in its infant stage and the market prospect for expansion is still great. The deciding factor for either Singapore or Hong Kong to emerge as the second international financial centre after Tokyo will depend on the speed of these two centres to recover from the Asian financial crisis, the use of technological advancement, and also the efficient provision of a wide range of financial products and services tailored to the needs of international clients at competitive price.

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INTRODUCTION

Since late 1960s, Singapore and Hong Kong have been with competing each other to be the next largest international financial centre after Tokyo. While Singapore had a head start in 1968 when the Asian-dollar market was first introduced, Hong Kong was lagging behind because of its moratorium on banking licences arising from the banking crisis in 1965 and, also its refusal to abolish the interest withholding tax on foreign currency deposits (Jao, 1997). Despite the setback, Hong Kong was able to gain its momentum later through various measures to develop itself into an international financial centre. With the reversion to China's rule in July 1997, Hong Kong continues to function as an international financial centre with China as its main hinterland.

The Singapore government, on the other hand, has indicated publicly that it will develop Singapore as the second international financial centre in the Asia-Pacific region after Tokyo in the next millennium. Singapore and Hong Kong are, therefore, direct competitors in the race for this second place. Each centre has its own distinct comparative advantages which make comparison somewhat difficult. With the onset of the Asian currency crisis since July 1997, both Singapore and Hong Kong are adversely affected. It is timely at this stage to assess their respective chances as the next important international financial centre in the Asia-Pacific zone after Tokyo.

Most of the comparative studies on the two centres do not have a conceptual framework for comparison. This paper uses the functional approach based on the framework set out by the Global Financial System Project of the Harvard Business School (Crane, & others, 1995) for this comparative study. The framework emphasises the role and functions of

the financial system in allocating financial resources, facilitating clearing and settlement of payments, managing risks and providing essential information on financial markets. The objective of this paper is, therefore, to provide a comparative analysis of Singapore and Hong Kong from a functional perspective. After the introduction, section two examines the similarities and differences between Singapore and Hong Kong in terms of their respective financial structure and development. Section three focuses on the main functions of an international financial centre. In this regard, section three analyses their respective role of the two centres in facilitating international trade and payments through its foreign exchange market, and their clearing and settlement system and facilities for treasury and liquidity management by their clients especially for multinational corporations (MNCs). Other functions include international financial intermediation, fund management as well as risk management. The fourth section will provide a critical assessment of the two centres as the second international financial centre in the Asia-Pacific Region after Tokyo.

FINANCIAL DEVELOPMENT AND STRUCTURE

This section will examine the historical background of the two centres, followed by an analysis of their respective transformation in the 1970s and 1980s. The final part summarises the existing financial structure and markets in the two centres.

Historical Background

After the Second World War, Hong Kong had already built up its reputation as a major commercial, manufacturing and shipping centre in the Far East. The transformation of Hong Kong from an entrepot into an industrial economy was largely due to the export boom of labour-intensive manufactured goods. It was not until the 1970s that Hong Kong began to

emerge as a financial centre. Singapore also has the same historical path as Hong Kong. It has traditionally been an important entrepot for trade and transhipment during the colonial days. With its entrepot activities growing in importance, Singapore registered a rapid development in infrastructure and banking facilities that marked the first step in creating its niche as a financial centre in the Asia Pacific region.

In the late 1960s, international banks started to look for an Asian city that would host the Asian Dollar Market. The market would be an extension of the rapidly growing Eurodollar market in a different time zone. Hong Kong and Singapore became the two natural contenders as Japan was still inward-looking at that time. However, the Hong Kong Government was unwilling to waive the 15% withholding tax on interest income from foreign currency deposits. In fact, the Hong Kong Government was still imposing a moratorium on bank licensing, following the bank crisis in 1965. The moratorium was only lifted in 1978 due to increasing pressure from international banks and also from the severe competition from Singapore. The lifting of banking licences led to a dramatic increase in the number of foreign licensed banks in the city. Other liberalization measures were also implemented to promote Hong Kong as an international financial centre. Moreover, the turning point came in 1978 for Hong Kong when China embarked on its ambitious open door policy. This enhanced Hong Kong as a financial centre and gateway to China.

On the other hand, the Singapore Government was more than willing to set up such a market to serve the region. Since 1968, the Singapore government has been providing special regulatory and tax treatment for commercial banks to set up a separate Asian Currency Units (ACUs) department within their banking organizational structure. The purpose is to promote a

viable Asian Dollar Market (ADM) to provide offshore banking facilities comparable to the Eurodollar market. Unfortunately, Singapore's economy was too small to absorb all offshore foreign currency deposits for domestic use. Secondly, the Southeast Asian economy was not at the take-off stage in the 1970s. As a consequence, a significant portion of such foreign currency fund was initially re-channelled to Hong Kong for its booming offshore lending, especially syndicated loans for corporate and sovereign borrowers in Japan, Taiwan, South Korea and Hong Kong itself. At that time, Hong Kong enjoyed some comparative advantages over Singapore as an important funding centre for the Asian-Pacific region. When the Southeast Asian economies registered a rapid economic boom in late 1980s, Singapore also evolved from a collection centre into a funding centre to the region.

Evolution and Transformation

Both Singapore and Hong Kong depended on centripetal forces (Walter 1993) to develop themselves as regional financial centres throughout the 1960s, 1970s and early 1980s. For instance, Singapore's strategic location between South China Sea and Indian Ocean, enhances its international trade which in turn requires trade financing. Its close proximity and central position to the Southeast Asia region are added advantages to its development as a financial centre since the region is fast industrialising and growing with increasing demand for funds. Hong Kong's privileged location in the Northeast Asia, on the other hand, makes it a gateway to China. Moreover, both Singapore and Hong Kong are situated at appropriate time zones that allow 24-hour continuous trading of foreign exchange and gold when the two markets in New York and London are closed.

With the onset of globalization in the 1990s, both Hong Kong and Singapore now rely more and more on centrifugal forces for their success as international financial centres. Such centrifugal forces have led multinational corporations to set up their operational headquarters in both cities for their funding needs, treasury operations as well as risk management. Because of the favourable economic infrastructure, Singapore and Hong Kong naturally become the business hubs for the operational headquarters (OHQs) of foreign multinational corporations. Indeed, from the 1993 Survey of regional representatives by overseas companies in Hong Kong conducted by the Hong Kong Industry Department, the availability of banking and financial facilities and infrastructure are identified as the two most important factors in choosing Hong Kong as a regional headquarters or regional office of MNCs. The same factors which include the provision of financial services ranging from treasury management, funding to risk management for MNCs also lead to the choice of Singapore over other cities in the Southeast Asia region as MNCs' OHQs.

Hong Kong has been the "China corporate centre" (Wu, 1997) while Singapore is the regional financial centre in the Southeast Asian region. However, prior to the handover of Hong Kong to China in July 1997, there was perceived higher political risk and escalating costs that prompted a number of MNCs to reallocate their non-China business operations from Hong Kong to Singapore. Examples of organizations that have relocated their OHQs from Hong Kong to Singapore include Union Carbide and Standard Chartered International Trustee Ltd (SCITL). However, there is also a reallocation of OHQs by MNCs from other regions to Hong Kong, and these MNCs include the Bank of America from San Francisco, Yaohan from Tokyo and British Airways from Singapore. Of greater importance is the recent trend among MNCs to set up two OHQs , one in Hong Kong and another in Singapore. For example, Hitachi Data Systems Corporation has planned to set up another OHQ in Singapore to

complement its regional headquarters in Hong Kong. This dual presence enables the OHQs to exploit their respective comparative advantage in each location, especially treasury management, sourcing of funds and risk management.

Financial Structure and Markets

Interestingly both Hong Kong and Singapore share a number of similarities in their financial structure (see Table 1). Firstly, they do not own any central bank. Instead they have their respective monetary authorities without currency issuing powers. Such issuing powers are delegated to a third party. In Hong Kong, three private commercial banks are entrusted with currency issuing powers within a currency board system with a pegging exchange rate system. In contrast, the issuance of Singapore currency is the prerogative power of the Currency Board but Singapore's exchange rate system is under a managed floating system.

In the banking system, Hong Kong and Singapore follow a three-tier structure with some differences. Singapore has an offshore banking system specialising in the Asian dollar market. Hong Kong, on the other hand, develops an integrated banking system coupled with the internationalization of the Hong Kong dollar. From a broader perspective, Hong Kong is an offshore banking centre for China. Non-bank financial institutions in Hong Kong are mainly privately owned including various pension funds. Of these, unit trusts and mutual funds number 1,003 of which 934 are foreign-incorporated. Hong Kong is still in the process of introducing a mandatory provident fund similar to that of Singapore (Sheng, 1997).

Table 1: Financial Structure in Hong Kong and Singapore

	Hong Kong	Singapore
Monetary Authority	Hong Kong Monetary Authority	Monetary Authority of Singapore
Currency Issuer (s)	Hong Kong & Shanghai Banking Corporation Standard Chartered Bank Bank of China	Board of Commissioners of Currency
Three-tier Structure	Licensed Banks Restricted Banks Deposit-taking Companies	Full licensed Banks Restricted Licensed Banks Offshore Licensed Banks
Non-Bank Financial Institutions	Insurance Companies Pension Funds, Unit Trusts, Others Development Loan Fund	Merchant Banks Finance Companies Central Provident Fund Post Office Savings Bank Insurance Companies
Other	Representative Offices	Representative Offices

Source: MAS, Singapore and HKMA, Hong Kong

Singapore, on the other hand, has a strong presence of non-bank financial institutions. Apart from merchant banks, finance companies and insurance companies, there is the Central Provident Fund (CPF) to provide social security for old age. However, the Singapore Government has been using this staid institution for macroeconomic stabilisation, and economic restructuring (Ng, 1996). One such restructuring is the development of financial markets and the fund management industry in Singapore which will be discussed in detail in the next section. While the Post Office Savings Bank is not as prominent as CPF, it is instrumental to mobilise savings to provide for the government, government-linked companies[2] and housing loans for the general public.

[2] Government-linked companies are mainly government owned companies which operate just like any commercial enterprises. There are about 600 of them in Singapore. Many of these companies are listed in the Stock Exchange of Singapore.

Table 2: Financial Markets in Hong Kong and Singapore

	Hong Kong	Singapore
Foreign Exchange Market Net daily turnover (1995)	US$ 90 bn	US$ 105 bn
Derivative Market Futures turnover contracts (1996)	5,749,955	22,568,545
Equity Market (1995) Market capitalisation Value traded Listed companies	 US$ 305 bn US$ 107 bn 542	 US$ 207 bn US$ 65 bn 297
Bond Market (1994)	US$ 12 bn	US$ 45 bn
Insurance Market (1993) No. of companies Total premium	 229 US$ 56.6 bn	 113 US$ 65.4 bn

Source: Jao, 1997.

When we look at financial markets (see Table 2), Hong Kong's equity market is larger and more active than Singapore's in terms of market capitalisation, turnover and number of listed companies. Together with a large number of unit trusts and mutual funds, Hong Kong is able to capitalise on these to develop its buoyant fund management industry. Hong Kong also has an active world class foreign exchange market which still ranks behind Singapore as the fifth largest market in the world. Even in the derivatives market, Singapore fares better than Hong Kong in terms of range of futures and options products and number of contracts executed in the exchange.

COMPARATIVE FUNCTIONAL PERSPECTIVE

Based on the functional perspective approach (Merton and Bodie, 1995), a financial system including a financial centre must perform six functions: (1) to provide facilities for clearing and settlement of payments; (2) to allow transfer of resources through time, across borders and among industries; (3) to provide a mechanism for the pooling of resources and for

the subdividing of shares among enterprises; (4) to provide risk management facilities; (5) to provide price information to help co-ordinate decentralised decision-making in various sectors of the economy; and (6) to provide ways of dealing with the incentive problems arising from asymmetric information.

Hong Kong provides services for clearing and settlement of Hong Kong dollar cross-border transactions and payments in the foreign exchange market. Singapore, however, does not need to provide such functions as transactions in Singapore dollar terms are restricted. The two financial centres also participate actively in third currency trading which requires clearing and settlement elsewhere. This paper will examine the foreign exchange services provided by the two financial centres. Next, it will discuss the role of Hong Kong and Singapore in providing international banking facilities which relate to function (2) involving international financial intermediation. The other important function of an international financial centre is fund management which covers direct finance in an international environment, i.e. function (3). Finally, the last section will analyse the comparative advantage in risk management by the two financial centres (function 4). Discussion on function (5) and (6) which are not unimportant for the success of a financial centre is, however, outside the scope of this paper.

Foreign Exchange Services

An international financial centre cannot be developed without a foreign exchange market, as exemplified by London and New York. In this respect, Hong Kong and Singapore are the two major foreign exchange markets after Tokyo. While Singapore has consolidated its position as an important foreign exchange market in Asia (Ngiam, 1996), it is still way behind London, New York and Tokyo in terms of average daily turnover (see Table 3).

Table 3: Net Foreign Exchange Turnover

(US$bn)	1995	1992	% change
United Kingdom	465	291	60
United States	244	167	46
Japan	161	120	34
Singapore	**105**	**74**	**43**
Hong Kong	**90**	**60**	**50**
Switzerland	87	66	32
Germany	76	55	39
France	58	33	74
Australia	40	29	37
Canada	30	22	36
Denmark	29	27	11
Belgium	28	16	79
Netherlands	26	20	30
Italy	23	16	50
Sweden	20	21	-7
Luxembourg	19	13	45
Spain	18	12	49
Austria	16	4	252
Others	39	31	23
Sum of the above	1573	1076	46
Global net total	***1230***	***820***	***50***

Source : Bank of International Settlements, Switzerland, Central Bank Survey of Foreign Exchange Market Activity (April 1995)

Unlike London and New York, both Hong Kong and Singapore do not have their respective currencies as major currencies in the international foreign exchange market. In this respect, they cannot serve as clearing and settlement centre for foreign exchange transactions in their respective currencies. Notwithstanding, Hong Kong is still better positioned than Singapore on two counts. Firstly, its Hong Kong dollar is pegged to the US dollar since October 1983 while the Singapore dollar is not pegged to any major currencies in the world. The advantage of this pegging is that the Hong Kong dollar carries no exchange risk vis-à-vis the US dollar and can act as a proxy for the US dollar in futures and option hedging. Secondly, Hong Kong allows its currency to be internationalised such that international borrowing and lending denominated in Hong Kong dollars are permitted. However, this is not

the case for Singapore. As a result, Singapore involves largely third country currencies such as the US dollar, Yen and Deutchmark with local currency trading amounting to no more than 5 per cent. On the contrary, US$/HK$ trade predominates in Hong Kong's foreign exchange market. However, both centres are actively involved in US$/Yen and US$/DM transactions.

Both centres are able to become important foreign exchange markets in Asia although their currencies are not major currencies in the world because of the following reasons: Firstly, Southeast Asian countries, notably Indonesia, Malaysia and Thailand, are primary commodity producing countries. The commodities they produce are traded in US dollar terms in international markets. This constitutes the supply of US dollars in this region. Secondly, export-oriented industries in the Asian region, particularly those related to the electronics industry, involve imports of electronics components and export of finished electronics products. These transactions are carried out in either US dollars or yen terms as most of the companies are either US or Japanese multinational corporations. Thirdly, even though every Asian country is under different exchange rate regimes, from basket pegging, managed floating to freely floating exchange rate system, Asian currencies are pegged directly or indirectly to the US dollar (Ng, 1987) and their intervention currency for foreign exchange market intervention is also in US dollars. Consequently, the US dollar has become the main vehicle currency in foreign exchange transactions in this region, constituting about 80 per cent of all transactions. Japanese yen ranks second as a vehicle currency accounting for the remaining 20 per cent (BIS, 1995).

For the moment, Singapore is ahead of Hong Kong in terms of foreign exchange trading turnover. With the Asian currency crisis starting from July 1997, it is difficult to

predict which centre will ultimately emerge as the second largest foreign exchange trading centre in Asia. But one thing is clear: the prospect of Hong Kong as number two will hinge on Hong Kong's ability to defend its peg and on the sustainability of the Chinese renminbi which if devaluated will cause another round of financial turmoil. Likewise, the current position of Singapore could be sustained provided Southeast Asian countries can recover fast from the Asian currency crisis.

International Banking Facilities

Apart from the provision of foreign exchange services, an international financial centre must also be able to facilitate international financial intermediation as well as extend direct finance through provision of issuing and underwriting facilities. Hong Kong is well ahead of Singapore in this respect.

Hong Kong has a late start in foreign currency lending because of its refusal to remove its 15% interest withholding tax on foreign currency deposits in the mid 1960s as we noted earlier. The withholding tax was finally abolished in 1982. Before 1978, foreign banks had already entered the offshore lending market by either acquiring equity interests in locally incorporated banks or establishing a deposit-taking subsidiaries despite the moratorium on banking licences since 1965 (Jao, 1997). With the complete lifting of the moratorium on banking licences in 1978, foreign banks, which are the cornerstone for the development of the foreign currency market, gathered their momentum by setting more new branches and subsidiaries in Hong Kong to deal with foreign currency deposits and offshore lending. As a result, foreign-incorporated licensed banks in Hong Kong rose from 40 in 1978 to 154 in 1995. However, unlike Singapore, Hong Kong does not have an offshore currency market as the domestic market is well integrated with foreign market components

Table 4: Comparison of Offshore Banking Centres of Hong Kong and Singapore

Variables	Hong Kong	Singapore
Nature of offshore banking	Integrated with domestic banking	Segregated from domestic banking
Reserve requirement	None	Exempt
Interest rate regulation	Exempt	None
Withholding interest tax	None	None
Access to funds by residents	Free	Upon approval of the Monetary Authority of Singapore (MAS)
Deposit insurance scheme	None	None
Foreign exchange control	None	None
Taxation on offshore loan interest and income	Only if earned without the intermediation of an overseas establishment	10%
Income tax on international loan syndication	Free	Free
Dividend distribution out of offshore profits	Free	Free

Source: Jao (1988, Chapter 7)

Singapore abolished its withholding tax on interest income of non-residents as far back as August 1968 to pave the way for the establishment of the Asian Dollar Market. In November that year, Bank of America was given official approval to operate the first Asian Currency Unit (ACU) in Singapore. In later years, interest income for non-residents is subject to only 10% income tax as compared to 40% income tax then (now 26%). Reserve requirements for foreign currency deposits maintained by commercial banks were also abolished in subsequent years[3]. The Asian dollar bond market also began to develop since 1971. Most of the Asian dollar bonds are denominated in US dollars while bonds denominated in other currencies such as yen, Australian dollar, deutchemark and European Currency Unit (ECU) are not as popular.

[3] Commercial banks in Singapore are required to maintain 6% cash ratio and 18% liquidity ratio.

Despite its late start, Hong Kong was able to catch up with Singapore as one of the leading off-shore lending centres (see Table 5). In 1995, Hong Kong provided offshore lending amounting to US$683.2 billion, ranking fifth in the world. In comparison, Singapore extended US$413.1 billion and ranked ninth. In terms of loan syndication, Hong Kong provided slightly more than double the amount of syndicated loans extended by Singapore between 1992 and 1995. They are two main reasons to account for this development.

Table 5: Comparison of Hong Kong and Singapore as International Banking Centres

	Hong Kong	Singapore
No. of financial institutions (1995)	1,763	1,032
No. of foreign banks (1996)	357	185
Deposit banks' foreign assets (1995)	US$705 bn	US$406 bn
Deposit banks' foreign liabilities (1995)	US$614 bn	US$436 bn
Cross-border inter-bank claims (1995)	US$381 bn	US$281 bn
Cross-border inter-bank liabilities (1995)	US$614 bn	US$365 bn
Cross-border credit to non-banks (1995)	US$324 bn	US$170 bn
Syndicated loans and NIFs (1995)	US$ 12 bn	US$ 2.3bn

Source: HKMA Monthly Bulletin of Statistics; MAS Monthly Statistical Bulletin; Hong Kong Annual Digest of Statistics; Singapore Yearbook of Statistics; IMF International Financial Statistics.

Firstly, Hong Kong has an advantage over Singapore in offshore lending in that China with its enormous needs for lending for its economic development provides a huge hinterland for Hong Kong's financial activities. To China, Hong Kong is a "Gateway for Foreign Capital," apart from its role as "Training Centre" and a "Show Case" (Sone, 1997). Specifically, Hong Kong provides more than 40% of China's foreign capital and serves en route for 22% of China's exports (see Table 6). Of particular interest is the fact that about 90% of syndicated loans for China are arranged in Hong Kong. If China were to continue to grow at a rapid pace in the next few decades, Hong Kong would definitely benefit through providing financial services, especially channelling of foreign capital, to finance China's infrastructure development. In short, Hong Kong is an offshore banking centre for China. The

only real challenge for Hong Kong is the rapid development of Shanghai as a financial centre which compete with Hong Kong in the same hinterland.

Table 6: Hong Kong's Share in China's External Economic Activities

	Total (A) US $bn	Hong Kong (B) US $bn	(B)/(A) %
Exports (1996)	151.1	32.9	21.8
Imports (1996)	138.8	7.8	5.6
Foreign capital used (1990-95)	171.3	72.8	42.5
External debt outstanding (end 1995)	118.1	37.4	31.7
Listed companies for overseas investors (market capitalisation) end-May 1997	12.4	6.7	54.2

Source: Sone, 1997

Secondly, Hong Kong can extend Hong Kong dollar loans offshore while Singapore is very much constrained in this respect because of its adherence to the policy for non-internationalisation of the Singapore dollar[4]. The existing arrangement in Hong Kong allows its resident companies to borrow Hong Kong dollar funds from local banks and invest overseas without involving the use of the US dollar as a vehicle currency, thus providing a saving of transactions costs in terms of bid-ask spreads. Moreover, Hong Kong also pegs its currency to the US dollar, thereby removing exchange risks in HK$/US$ transactions. The above advantages become obvious when Hong Kong businessmen borrow heavily from local banks to invest in China. However, such phenomenon is not likely to appear in Singapore. Any Singapore dollar loans for investment overseas is subject to a lending limit and also MAS approval on a case-by-case basis. As a result, Singapore companies have to borrow from the Asian dollar market to fund its investment overseas with higher transactions costs and exchange risks.

[4] For detailed discussion on non-internationalisation of Singapore dollar, see Ng (1996).

The competition between Hong Kong and Singapore as an offshore banking centre is not a zero-sum game. Firstly, Singapore has its own distinct hinterland, i.e. the Southeast Asian countries where Hong Kong may not have much comparative advantage as Singapore in terms of close proximity, cultural affinity and political solidarity in "ASEAN spirit." Secondly, Hong Kong alone is not able to meet all the financial needs of China. As long as Singapore is competitive enough in providing financial services, it can complement what Hong Kong lacks in meeting the growing financial needs of China. Thirdly, Singapore is better positioned than Hong Kong as a "cultural broker" and "knowledge arbitrator" between the west and China because of its "neutrality" and multi-racial society (Chan, et al., 1997). Such a "neutral" position of Singapore is greatly enhanced especially after Hong Kong reverted back to China in 1997.

The Fund Management Industry

The fund management industry in Hong Kong began with the setting up of regional offices in 1970s by fund management companies such as Gartmore and Barings to invest part of their portfolios of UK institutional clients in the growing economies in the Asia Pacific region. Later, other fund management companies such as Jardine Felming, Wardley & Schroders also seized the opportunity to service the growing pool of corporate sector pension funds and institutional investors domiciled in Hong Kong. By 1980, Hong Kong had already built up a critical mass of expertise and administrative experience in fund management. These fund managers then capitalised on the large inflow of funds from Japan, Europe and the United States into the growing Asian stock markets to set up a stronghold in fund management. In fact, Hong Kong thrives on its fund management industry because of its excellent telecommunication infrastructure, financial expertise, generous tax incentives and no

exchange restrictions. The establishment of the Hong Kong Code on Unit Trusts and Mutual Funds in 1978 together with all its amendments has also enhanced international investors' confidence. Another reason includes the rapid growth of wealth in this part of the world arising from the rapid economic growth over the past two decades. Lastly, unlike Singapore, it also did not have a mandatory public provident fund prior to 1997 to siphon off huge amount of funds for private fund managers to manage.

Singapore also has the same conducive environment as Hong Kong for its fund management industry. However, it has a late start as compared to Hong Kong. It was only in 1983 that a tax incentive scheme for offshore fund management was introduced. In the wake of restructuring the economy following the 1985 recession, the Economic Committee set up by the government to restructure the economy identified the fund management industry as one of the key areas for active promotion as part of the restructuring strategy for the financial sector (Economic Committee, 1986). However, the fund management industry continued to remain dormant as a result of a lack of institutional investors in the country. Moreover, the Central provident Fund (CPF) continues to siphon away a great portion of wage earners' savings which would otherwise have been managed by private fund managers. In September 1994, the government took a big step to liberalise the CPF funds. According to the plan, the liberalisation has three phases. In the first phase beginning from 1995, the CPF approved fund management accounts and unit trusts are allowed to invest in foreign stocks listed in selected regional stock markets namely Malaysia, Thailand, Hong Kong, South Korea and Taiwan. In the second phase starting from 1 January 1997, the limit on the proportion of foreign currency securities invested in such approved unit trusts and fund management accounts would be raised from 20 % to 40 %. In the final phase, the investment scope would expand to include investment in capital markets in the United States, Germany and Japan. Apart from liberalising

the CPF funds, the government also introduced measures to attract fund management professionals overseas to work in Singapore.

Despite the efforts made by the government, the fund management industry in Singapore is lagging behind Hong Kong's which is still the leading fund management centre in Asia. It manages more than US$250 billion funds in 1996 of which 71% were off-shore funds and 29% domestic funds. In contrast, Singapore managed only US$44.1 billion of funds of which 98% were sourced from off-shore markets. One reason for the slow growth of the fund management industry in Singapore is that Singaporeans generally prefer to invest in shares and stocks on their own rather than with professional fund mangers (Straits Times, 27 February 1998). The other reason is that CPF-approved unit trusts have generally not performed well since the liberalisation of CPF funds in 1986 as compared with non-CFP unit trusts[5].

In order to promote Singapore as an international financial centre, the government sets out the vision that Singapore be the Asia premier fund management centre over next five to 10 years. The target is to become a centre for managing Asian investment portfolios of both Asian and western clients; and to mange global investments of clients in Asia. To achieve the target, the government maps out six strategies, as shown in Table 7.

The Risk Management Industry

Since the breakdown of the Bretton Woods System in 1973, there had been an increasing volatility of exchange and interest rates in the international financial market. Such volatility was further exacerbated by widespread deregulation and financial innovation amidst

rapid politico-economic developments in the 1980s and 1990s. All these factors culminate in the emergence of a risk management industry in international financial centres including Hong Kong and Singapore. Previously, bankers and international lenders concentrated mainly on credit risks. In recent decades, with the widespread opening of financial markets, risk exposure arising from volatility of interest rates, exchange rates, and securities prices take the centre stage in risk management by both banking and corporate sectors. Other risks such as liquidity risks, operational risks, settlement risks and systemic risks also became increasingly important with the globalisation of financial markets. To protect themselves from these risk exposures, international financial institutions and MNCs have no alternative but to spend time and resources in risk management especially through hedging, portfolio diversification and seeking insurance cover. In this section, a comparative analysis of the risk management industry in terms of the futures and options market and insurance market between Hong Kong and Singapore will be conducted.

[5] The government attributed the sluggish growth in unit trust industry to the fact that the CPF investment limits for fund managers are too restrictive, and prevent them from diversifying their portfolios properly to maximise risk-adjusted returns (Straits Times, 27 February 1998).

Table 7: Singapore as International Financial Hub of Funds

The Vision:
Singapore's vision is to be Asia's premier fund management centre over next five to 10 years

The Target:
- To become a centre for managing Asian investment portfolios of both Asian and Western clients.
- To manage global investments of clients in Asia.

The Strategies:

1. Improve Regulations
- Relax licence qualifications for investment advisers without compromising on prudential standards.
- Strengthen supervision of the fund management industry with MAS building up its inspection capabilities.
- MAS to be eventually given statutory responsibilities for regulating unit trusts.
- Halve the processing time for applications to launch new unit trusts.

2. Place Out More GIC Funds
- GIC to arm out to 50% of Asian portfolios to private fund managers.
- Amount placed with fund managers in Singapore offices to be raised from S$10 billion to S$35 billion.

3. Liberalise the CPF Unit Trust Scheme
- Fund managers to get more flexibility to diversify their portfolios
- Raise disclosure standards so that CPF investors can compare unit trusts' performance and charges.

4. Enhance the Distribution Channel
- Foreign fund managers may market their products through local financial institutions, including POSBank.
- A class of independent investment consultants to be developed.

5. Develop Equity and Bonds Markets
- MAS to issue 10-year Singapore Government Bond to develop the long end of the yield curve.
- Statutory boards to issue bonds to finance infrastructure projects.

6. Foster a Strong Private Sector Role
- IMAS to play a key role in raising professional standards among fund managers.
- IMAS to help educate the public through investment fairs and seminars.

Source: Straits Times, 27 February 1998

The Futures and Options Market

The Hong Kong Futures Exchange (HKFE) started as a commodity futures exchange in 1976 (formerly called Hong Kong Commodity Exchange). Around mid-1980s, it shifted to index futures trading with the introduction of Hang Seng Index futures in May 1986. Now the Hang Seng Index futures is the flagship product for the exchange. In March 1993, HKFE entered into option trading with the launching of Hang Seng Index options. HKFE achieved another milestone when a brand new currency futures product called the ”Rolling Forex” was officially launched in November 1995. Now the “rolling forex” price is the benchmark price for leveraged foreign exchange trading in Hong Kong. HKFE has a linkage with the Philadelphia Stock Exchange for the trading of currency option products at HKFE during Asian trading hours. In addition, HKFE also has an agreement with the New York Mercantile Exchange to trade its precious metal and energy products in Hong Kong. On the Chinese front, HKFE maintains a close relationship with the Chinese Securities Regulatory Commission and the Chinese Commodity Exchange.

On the other hand, the Singapore government revamped the Gold Exchange of Singapore (GES) into the Singapore International Monetary Exchange (SIMEX) in September 1984. SIMEX was the first financial futures and option market in Asia, with the objective of serving international clients during Asia-Pacific hours. SIMEX then seek the co-operation and linkage with the International Monetary Market (IMM) Division of the Chicago Mercantile Exchange (CME) under a mutual offset system to ensure adequate liquidity and volume of transactions in continuous futures and option trading, thus providing an efficient and effective risk management centre in Singapore. This arrangement enables futures and option contracts executed in one exchange to be offset in the other at any time. The mutual offset system thus facilitates round-the-clock trading in futures contracts, lowers transaction cost and increases

efficiency in futures and option trading. In March 1996, SIMEX and the CME expanded their mutual offset system further to cover European futures. In the same year, SIMEX launched its automated trading system. In addition, a similar mutual-offset system between SIMEX and the International Petroleum Exchange (IPE) of London was arranged in June 1995 such that the joint Brent crude oil futures contracts can now be traded continuously for about 18 hours into different time zones stretching from the opening hours of Asia to the close of a US trading day.

Singapore is the world's fifth largest derivative market, after Britain, Japan, the United States and France (Straits Times, 1995). Its currency derivatives market ranks fourth in the world while its interest rate derivatives market ranks sixth (BIS, 1995). Such achievement is attained due to a number of factors. Firstly, SIMEX fills a vacuum that London, New York and Tokyo fail to cover in a region which recorded rapid economic growth in the last two decades. Secondly, SIMEX has a proven track record since its inception in 1984 despite the infamous Barings case. SIMEX is, therefore, well positioned to share the growth of derivatives trading in the Asia-Pacific region. Thirdly, its existing range of products receives added interest with the increased familiarity and experience with futures and options among users in the region. Lastly, with the expanded mutual offset system with a number of futures exchanges in the world, SIMEX is able meet the hedging and speculation needs of its international customers. On these aspects, Hong Kong is no match for Singapore in the futures and options market.

Although Hong Kong and Singapore possess the two major futures exchanges in Asia, after the Tokyo International Financial Futures Exchange (TIFE), in comparison, SIMEX has a much higher volume of contracts traded than that of Hong Kong. For example, in 1996,

SIMEX had a higher turnover of 22.6 million lots of futures contracts done compared with HKFE's 5.7 million lots of contracts. More importantly, SIMEX provides a wider range of futures and options products than that offered by its Hong Kong counterpart. From the contracts traded on HKFE and SIMEX, it can be seen that Hong Kong and Singapore trade in different products. While HKFE thrives on its domestic Hang Seng Stock Index Futures and Options, SIMEX trades in well diversified international products (see Table 8). This is so because each centre thrives on different financial services that lead to different products being traded. In Hong Kong, the fund management industry is relatively well developed and the risk is mainly stock market price volatility. Foreign exchange risk is less important especially after Hong Kong has pegged its currency to the US dollar since 1983. In contrast, Singapore has a developed Asian dollar market where interest and exchange rate risks are more prevalent than that in Hong Kong. Singapore also provides energy futures because it aims to be an international oil trading centre by taking advantage of its strategic position between oil producing countries (Middle East countries, Indonesia and Malaysia) and oil consuming countries and economies (Japan, Korea and Taiwan). However, Singapore has so far failed to introduce its stock index futures because of limited volatility in its stock market and also because of its relatively less developed fund management industry. With the strenuous effort given by the government to develop the fund management industry (Straits Times, 27 February 1998), stock index futures and options will be re-introduced in SIMEX in the near future.

Table 8: Contracts Traded in Hong Kong and Singapore Futures and Options Exchange

Hong Kong	Singapore
Hang Seng Index Futures	Interest Rate Futures
	• Japanese Government Bond
Hang Seng Index Sub-Futures	• Three-month Eurodollar
• Hang Seng Finance Sub-Index Futures	• Three-month Euroyen

• Hang Seng Utilities Sub-Index Futures • Hang Seng Properties Sub-Index Futures • Hang Seng Commerce and Industry Sub-Index Futures	• Three-month Euromark
Hang Seng Index Options	Stock Index Futures • Nikkei 225 Stock Index • Nikkei 300 Stock Index • Morgan-Hong Kong Stock Index • MSCI Taiwan Index
Stock Futures • HSBC Holdings Plc Futures • Hongkong Telecom Limited Futures • Cheung Kong (holdings) limited Futures	Currency Futures • Deferred Spot US Dollar/Japanese Yen • Deferred Spot US Dollar/Deutschmark
Rolling Forex Currency Futures • deutchemark • Japanese Yen • British Pound	Energy Futures • Brent Crude Oil • High Sulphur Fuel Oil
Three Month HIBOR Futures	Precious Metal Futures • Gold
HKFE Gold Futures	Interest Rate Options • Eurodollar • Euroyen • Japanese Government Bond
	Stock Futures Options • Nikkei 225 Stock Index Futures • Nikkei 300 Stock Index Futures MSCI Taiwan Index Futures

Source: Hong Kong Futures Exchange (HKFE) and Singapore International Monetary Exchange (SIMEX)

The Insurance and Re-insurance Industry

Another important branch of the risk management industry is the insurance and re-insurance sector which provides cover for risk exposure against potential losses with respect to property, liabilities and human resource. Hong Kong and Singapore have a well-developed insurance and reinsurance industry in the Asia Pacific region. In comparison, Hong Kong (228) has a larger number of insurance companies than that of Singapore (142) but the amount of insurance premium mobilised in Hong Kong (US$57 billion) is much less that that of

Singapore (US$65 billion). However, Hong Kong seems to have a better potential in the insurance and re-insurance industry than Singapore because of a number of factors. Firstly, insurance companies in Hong Kong enjoy relative freedom in investing their funds, especially in terms of locality. Accordingly, many of their assets are managed at foreign headquarters rather than locally in Hong Kong. Secondly, Hong Kong insurers also actively seek access to the Chinese insurance market. There exists a good opportunity for the reinsurance business between Hong Kong and China to flourish if China opens its insurance market and strengthens its insurance supervisory system. Thirdly, the insurance industry will propel further growth with the Hong Kong government's undertaking of various infrastructure projects including the building of the new airport, and also the booming cross-border trade with China. All these factors have resulted in an increasing demand for reinsurance protection which has yet to be realised fully in Hong Kong.

In comparison, Singapore has a stricter regulatory and supervisory framework that fosters the orderly development of the insurance and reinsurance industry. The regulatory regime in Singapore does allow adequate room for insurance companies to innovate in order to meet the needs of the public. In fact, MAS has embarked on a package of policies to enhance the financial soundness of the insurance industry. For instance, effective from the beginning of 1994, all direct insurers are required to appoint an actuary who will assess the long-term financial soundness of life insurers, in addition to executing the traditional duties of determining premium rates and valuing policy reserves. The Inland Revenue Authority of Singapore (IRAS) also allows tax-deductibility of general insurers' reserves for incurred -but-not-reported (IBNR) claims which are an integral component of general insurance companies' overall loss reserves. This move is in line with that of the development of other insurance centres. From 1998, insurance companies' investment limit in equities of total insurance funds

is raised from 35% to 45%. The limit for property and property share investment is also raised from 20% to 25% and the ceiling for foreign assets has been lifted from 20% to 30% (Straits Times, 28 February 1998).

SIMILARITIES AND COMPARATIVE COMPETITIVENESS

Despite their small economies, both Hong Kong and Singapore have experienced rapid economic growth in the past decades and have emerged as newly industrial economies (NIEs). Their positions as regional trade centres accentuated demand for financial services in their formative years. The presence of a critical mass of foreign and domestic banks has helped them to exploit opportunities for further financial development beyond the primary role of meeting the derived demand arising from regional trade and investment. Nevertheless, the growth of the two international financial centres is the result of different philosophies. Unlike Hong Kong, Singapore developed as an international financial centre mainly through active government policies. The Hong Kong government adopts a policy of non-intervention which allows “entrepreneurial capitalism” to flourish with success. Singapore is equally successful in that the government creates and maintains Singapore’s niche in the international financial market by adaptive maintenance of internationally competitive tax structures and constant provision of a sound and stable financial system. Surprisingly, both governments share the same belief: tight regulations and a high degree of transparency in the financial sector which are essential elements contributing to their status as international financial centres.

Obviously, Hong Kong and Singapore have their respective strengths and weaknesses as international financial centres. They are susceptible to threats from the Asia Pacific region in their strive for the second place after Tokyo. However, if they can overcome the threats and convert such threats to opportunities, they have an equal chance of becoming the second

international financial centre in the Asia-pacific region. Their respective comparative competitiveness are summarised in Table 9.

As Wu (1997) noted, the two financial centres need not be in non-zero-sum competition. In fact, there is an increasing economic interdependence and complementarity between the two centres. Wu argued that aside from foreign exchange trading and fund management, there is not much competition in other areas such as the derivative market and off-shore lending. In the former market, Hong Kong and Singapore offer different derivative products while in the latter, there is a distinct difference in geographical distribution of their respective offshore lending. Hong Kong tends to concentrate on markets in China, Taiwan, South Korea and Australia. Singapore's borrowers are mainly from Southeast Asia. In fact, Hong Kong and Singapore complement each other in their funding sources for their offshore lending. This is evidenced by an increasing bilateral flow of interbank funds between Hong Kong and Singapore, from US$57.5 billion in 1990 to US$ 72.7 billion in 1995.

Table 9: Comparative Competitiveness Between Hong Kong and Singapore

Hong Kong	Singapore
Strengths 1. Strategic position 2. Prudential regulations 3. Technological infrastructure 4. Low tax regime 5. Economic freedom 6. Skilled labour 7. Ancillary and support services 8. Political stability 9. Strong investors' confidence 10. English speaking	Strengths 1. Strategic position 2. Prudential regulations 3. Technological infrastructure 4. Low tax regime 5. Economic freedom 6. Skilled labour 7. Ancillary and support services 8. Political stability 9. Strong investors' confidence 10. English speaking 11. Good government
Weakness 1. High cost of doing business 2. Political stability depends on China	Weakness 1. High cost of business 2. Small nation among Malay archipelago
Opportunities 1. Rapid economic development prospect in China 2. Financial Liberalization in Japan 3. Financial Globalization	Opportunities 1. Rapid economic development prospect in Southeast Asia 2. Financial Liberalization in Japan 3. Financial Globalization
Threats 1. Emergence of Shanghai and Taipei as financial centres 2. Systemic risks arising from Globalization	Threats 1. Emergence of Bangkok and Labuan as regional financial centres 2. Systemic risks arising from Globalization

Source: The above table has been modified by the author from Cheong, el at. (1997), Dynamic Comparison of Hong Kong and Singapore as International Financial Centres, an Applied Research Project submitted to Nanyang Business School, Nanyang Technological University.

CONCLUSION

Singapore's strength lies in its foreign exchange and derivative markets while Hong Kong thrives on its fund management industry and offshore lending. Singapore and Hong Kong may, therefore, complement each other in providing financial services to their clients. In fact, there is no zero-sum competition between the two, each serving two distinct geographic regions. Even if Singapore were to succeed in developing its fund management industry, Hong Kong would not be adversely affected, because the industry in the region is still in its infant

stage and the market prospect for expansion is still large enough for the two centres to expand further without any “crowding out” effect.

London, New York, Singapore and Hong Kong have been successful as international financial centres because of their excellent telecommunications and good banking software and hardware. However, the age of round-the-clock global financial markets has yet to arrive because so far no international financial centre including Hong Kong and Singapore has yet been able to exploit the benefits of a seamless global financial trading in all financial products and services round the clock. At present, the global markets are, to a lesser degree, still segmented into different time-zones, national markets and instruments, and non-harmonised telecommunications and trading systems. Consequently, a global investor who needs to switch investments among countries and instruments bears high transaction and time costs as well as higher risks. This is because he has to face different segmented markets, traders, dealers and currencies, and clear and settle with multiple systems under different time zones and tax regimes. This presents a challenge and opportunities for Hong Kong and Singapore to become global financial market leaders if the two centres were able to reduce transaction costs and risks in global transactions that cut across time zones, national boundaries and products. Both Hong Kong and Singapore stand an equal chance to develop and exploit this potential to become the second international financial centre in the Asia-Pacific region. The deciding factors are the use of technological advancement and the provision of a wide range of financial products and services tailored to the needs of international clients at a competitive price and efficiently.

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