

CRISIS AND CHALLENGE: THE CHANGING ROLE OF THE HONGKONG & SHANGHAI BANK, 1950-2000

By 1950, the Hongkong Bank appeared to have only a very limited life expectancy. The imperial foundations on which its original fortunes had been built were fast disappearing. The British Empire in India had been replaced by four independent countries whose new governments were committed to state direction of their national economies and severe controls on the activities of foreign capitalism. A similar commitment to nationalism and state intervention, though less socialist in orientation, was starting to emerge in Malaya and Singapore which were still under British control. Indonesia, Thailand and the Philippines were increasing their restrictions on foreign banks.

Most important of all, Britain's "informal empire" in China had collapsed with the 1949 victory of the Chinese Communist Party which was dedicated to the eradication of both capitalism and colonialism from the Mainland. The outbreak of the Korean War and the subsequent imposition of a United Nations economic embargo on trade with China, quickly supplemented by a total United States ban on all financial and commercial transactions with the People's Republic, brought the Crown Colony of Hong Kong to the verge of ruin in 1951 and raised questions about the viability of British rule. By the turn of the century, however, the Hongkong Bank had not only survived the loss of its historical markets but emerged at the end of colonial rule in Hong Kong as a major international financial institution, relabelled as "HSBC," with its headquarters now established in London.

The Survival of Laisser Faire

Whatever else accounts for this remarkable triumph over adversity, market competition is not the explanation. Hong Kong has long boasted of its laissez-faire philosophy and its commitment to free markets, no state planning and no controls over investment, minimal economic intervention and no subsidies or tax incentives to promote economic development programmes. But when it came to the financial sector, the Government viewed unrestrained competition as a major threat to the stability of individual banks and of the financial system as a whole, and official constraints on competition lasted until well after the end of the colonial era. Thus, throughout most of the second half of the twentieth century, Hong Kong's financial services sector was not a free and open market. This paradoxical situation, it will be shown, reflected a general confusion and inconsistency among officials about how to manage economic policy, both before and after World War II, and an inability to understand how financial markets worked.

The Case for Government Intervention

In the early years after World War II, there was a curious ambivalence about laissez faire and whether or not the Hong Kong Government should play a direct role in promoting economic development, particularly of manufacturing industry. It has become fashionable to present this conflict of opinion as a clash between two sets of vested interests. On one side, it is claimed, were British colonial and commercial interests which had prospered through the China Trade, specialised in financial and commercial services and were thus opposed to any departures from laissez faire which would assist Chinese industrialists. On the other side, it is said, were their rivals, the Chinese manufacturers who were deliberately held back by laissez-faire policies. These measures served to protect British interests, it is alleged, first by restricting Hong Kong's industrial progress before World War II and then by depriving manufacturers of state incentives and subsidies after the war. The economy became unbalanced, it is argued, over-dependent on textiles and denied state support to encourage investment in large-scale projects and advanced technology.¹

A Sino-British Business Consensus

The historical record does not support such a simple classification of attitudes and interests into British and Chinese rivalries. Before World War II, an official Commission of Enquiry dominated by British financial and commercial representatives came out in support of the manufacturing sector, urging more interventionist government policies and a retreat from laissez faire. It recommended that Hong Kong should ignore London's policies that sought to confine industrial development to the United Kingdom, the Dominions and India. It accepted the case for the colonial administration to actively encourage manufacturing with tariffs and import restrictions if viable "infant industries" could be identified.² This interventionist-protectionist outlook persisted among leading British firms after World War II. The Jardine and Swire groups, Hutchison Whampoa and Wheelock Marden all joined forces with Chinese business interests – Cantonese as well as Shanghaiiese – to demand a drastic modification of laissez-faire policies. In particular, they campaigned for protection for local industries, government planning to prevent "excessive" competition and access to cheap capital especially for long-term projects and heavy industry.³

¹ This case is presented vigorously by Alex H. Choi, "State-Business Relations and Industrial Restructuring," in Tak-wing Ngo (ed.), *Hong Kong's History. State and society under colonial rule* (London: Routledge, 1999), pp. 144, 150, 154, in particular.

² *Report of the Commission...to enquire into the Causes and Effects of the Present Trade Recession...* (Hong Kong: Noronha & Co., 1935), pp. 74, 79, 82-3, 86, 89-90.

³ British interests were vociferous on these issues in the legislature. *Hong Kong Hansard*: H. D. M. Barton (Jardine), 23rd March, 1960, p. 93 and 19 March 1962, p. 71; W. C. G. Knowles (Swire), 19 March 1962, p. 102; J. D. (later Sir Douglas) Clague (Hutchison), 2 March 1955, p. 119 and 18 March 1959, p. 84. For Wheelock Marden, see Sen San, "Traveller's Tales," *Far Eastern Economic Review (FEER)*, hereafter, 24 August 1961; Robin Hutcheon, *Shanghai Customs. A 20th century taipan in troubled times* (Edgecliff: Galisea Publications, 2000), p. 204.

At the same time, there was total support from Chinese and British business for the rapid abolition of the sweeping powers to regulate the economy which the Government had exercised in the emergency conditions after the end of the Japanese Occupation in 1945. The entire business community rejected these controls even though they played an important part in protecting the expansion of the vital textile industry from cut-throat Japanese competition as that country's post-war reconstruction got under way.⁴ The sort of government intervention in the economy that business advocated had clear boundaries. It was not intended to facilitate state interference with business activities but to protect their markets and promote their profits.

Pragmatic Colonialism

The colonial administration reacted to changing economic conditions with some sympathy for business views. In 1954, the Governor, Sir Alexander Grantham, accepted an obligation to assist the manufacturing sector which was Hong Kong's only hope during the acute recession that had followed the outbreak of the Korean War in 1950 and the subsequent economic blockade of the People's Republic which ruined the China Trade. He felt compelled to reject "subsidies [and]...tariffs on imports of competitive foreign products, for in the long run such methods can only lead to inefficiency and cannot help the industry to sell its products overseas, where their main markets lie." But he acknowledged the case for "indirect help" – principally through cheap industrial sites and buildings.⁵ Within the bureaucracy itself, attitudes were more radical at this stage. In 1956, China began an export drive which led to widespread complaints of dumping both within Hong Kong and in the colony's traditional markets in Southeast Asia. Officials discussed imposing protectionist measures against Mainland imports but could identify no local industries of sufficient importance to warrant such retaliatory measures. By 1958, there was also a feeling that *laissez faire* was no longer relevant to the needs of what had become an industrial economy.⁶

But official apprehensions then shifted away from the Mainland which was grappling with the economic disasters that followed the collapse of the 1958 "Great Leap Forward." Mounting protectionism in Western markets was seen as the primary threat to Hong Kong's export industries, and the Government publicly posed the question in 1960 of whether to "to abandon our traditional policy of *laissez faire*" in order to control total production and regulate export prices.⁷ It subsequently expressed its willingness to listen

⁴ Catherine R. Schenk, *Hong Kong as an International Financial Centre. Emergence and development 1945-65* (London: Routledge, 2001), p. 7; Gene Gleason, *Hong Kong* (London: Robert Hale, 1964), p. 96; and FEER: "Hongkong's Trade in April 1952," 5 June 1952; Ron G. Whitehead, "Outlook for Hongkong Textiles," 23 October 1952; "Hongkong: Trade and Supplies 1952-53," 11 March 1954.

⁵ Sir Alexander Grantham, Governor, *Hong Kong Hansard*, 3 March 1954, pp. 18-9.

⁶ Hong Kong Public Records Office HKRS 270-5-44, "Commercial and Industrial Development – Major Policy," R. B. Black, Colonial Secretary, to Sir Hilton Poynton, Colonial Office, 19 July 1958; (30) "Chinese Economic Competition," 18 December 1958; Director Commerce and Industry to Financial Secretary, 9 September 1958; Commissioner of Labour to Director of Commerce and Industry, 9 September 1958.

⁷ A. G. Clarke, Financial Secretary, *Hong Kong Hansard*, 24 February 1960, p. 63-4.

to proposals to aid “infant industries.”⁸ As late as 1964, a new Governor was prepared to contemplate departures from laissez faire on condition that they promised tangible benefits.⁹

Thus, until at least the mid-1960s, the consensus within the business community was opposed to the colonial laissez-faire traditions and strongly in favour of policies to protect local producers and to foster investment. The colonial administration, for its part, had no ideological scruples about diluting its laissez-faire practices and made its decisions on pragmatic grounds rather than out of principle.

The Case for Interventionism Crumbles

If the colonial administration had given way to these pressures, both from the business world and from within the bureaucracy itself, the financial sector would have been considerably affected. In particular,

- Government supervision of new industrial investment to suppress unrestricted competition among manufacturers would have had an immediate impact on the freedom of banks to allocate loan finance and on their management of credit risks.
- The creation of an industrial development bank or corporation would have provided a source of subsidised funding which, by definition, would have undercut the banks and the stock exchange.

In the event, the Government did not abandon laissez faire. This decision had little to do with loyalty to the principle of non-intervention. Furthermore, it conflicted with the current wisdom in the Colonial Office which had encouraged colonial territories in the early 1950s to promote the growth of manufacturing through introducing development programmes, including state controls and trade restrictions where appropriate.¹⁰ Hong Kong’s decision to stick to its laissez-faire traditions was a matter of pragmatism and changing economic conditions, as two crucial examples illustrate.

- A major concern of the older and larger businesses was the impact on their profit margins of new entrants who opened under-capitalised factories and were willing to quote cut-throat export prices. By the end of the 1950s, the stresses caused by unrestricted entry of these new industrialists had been brought to a halt by an acute labour shortage. The extraordinary expansion of the manufacturing sector during the decade had reduced the unemployment rate to 1.3 per cent by 1961.¹¹

⁸ “Completely new industries” was the actual phrase used. J. J. Cowperthwaite, Financial Secretary, *Hong Kong Hansard*, 30 March 1962, pp. 131-4. Nevertheless, Cowperthwaite made this offer in the context of scathing remarks about state intervention generally.

⁹ Sir Robert Black, Governor, *Hong Kong Hansard*, 26 February 1964, p. 36.

¹⁰ HKRS 41-1-6032, “Colonial Industrial Development – Legislation to encourage...”

¹¹ H. D. M. Barton, *Hong Kong Hansard*, 16 March 1960, p. 94; K. M. A. Barnett, *Hong Kong. Report on the 1961 Census* (Hong Kong: Government Printer, n.d.), pp. 2, 33.

- The older and larger businesses also saw government intervention as the remedy for “anarchic” business conditions in which the smaller and more vulnerable firms were free to spoil the market by undercutting the established exporter even at the risk of their own bankruptcy. In the 1960s, an orderly structure was being forced on Hong Kong’s manufacturers and exporters by the system through which the Government administered the quotas that Western importing nations had imposed on Hong Kong’s textiles.¹²

Funding the Manufacturers

There was one major exception to the ebbing of interventionist pressures, however. Advocates of low-cost industrial finance proved more obdurate. They were encouraged by the support which the Governor, Sir Robert Black, gave to the concept of an industrial development corporation or bank, an initiative which he set up a committee to study.¹³ This body, which included local Chinese as well as British bankers, rejected the proposal despite intense lobbying from Chinese and British commercial and industrial bodies. The case it made in 1960 against the government provision of industrial finance was simple and apparently conclusive.¹⁴

- Neither the manufacturers nor the officials who supported the industrial lobby were able to produce evidence of any reasonable loan request that, in the past, had failed to obtain bank approval.
- Development strategies adopted by other Third World economies were inappropriate for Hong Kong. There was no shortage of investment funds or lack of entrepreneurs in Hong Kong. Its focus on light industries resulted in low capital/output ratios, which promoted full employment, rapid amortisation of investments and a high turnover of capital.
- The argument for an industrial bank in Hong Kong was misconceived. Its supporters were seeking to divert resources away from highly profitable light industrial operations and into longer-term projects. These would not be viable unless they were provided with capital at below market cost (which would come at the expense of booming, export-driven light industry).

Despite the unassailable logic of these findings, the struggle went on, thanks to the tenacity of officials in the Commerce and Industry Department. They returned to the fray in 1969. Although two confidential surveys conducted by the Department failed to produce any evidence that manufacturers were hampered by a lack of finance, its directorate mobilised industrialists to lobby once more for subsidised finance for small and medium enterprises at a time when the colonial administration was unusually

¹² H. D. M. Barton, *Hong Kong Hansard*, 19 March 1962, pp. 73-4; *Hong Kong Report for the Year 1969* (Hong Kong: Government Press, 1970), p. 50.

¹³ Sir Robert Black, *Hong Kong Hansard*, 25 February 1959, pp. 29-30.

¹⁴ “Report of the Industrial Bank Committee” (Hong Kong Government, January 1960, mimeo), pp. 3, 12-3.

vulnerable to political pressure.¹⁵ This ploy provoked significant opposition within the administration, which delayed the introduction of an industrial loan scheme until 1972.¹⁶ Its results were disappointing, and the scheme was wound up in 1976 and was not revived until after the end of British rule.¹⁷

The Case against Laisser Faire

The case for government intervention in the financial services sector was very different from manufacturing and the rest of the economy. There was a pattern of imprudent lending and incompetent management in banking which had made the financial system very vulnerable to downturns in the business cycle before World War II. The same defects persisted throughout the post-war period, causing chronic crises until the end of the 1980s. The urgent need for adequate measures to supervise financial institutions was unquestionable, and both local banks and the Hongkong Bank called for government involvement, which they regarded as essential for the healthy growth of their industry. Yet, within the colonial administration, there was a powerful culture of resistance to reform and a rejection of regulation. Until 1948, banking remained entirely unsupervised. From 1964, the Government had extensive legal powers which it exercised as minimally as possible, at considerable cost to the public and the economy as a whole.

Chaos and Crashes

Financial institutions and markets are the one sector of the economy where non-interventionism is not an appropriate policy even for the most laissez-faire régimes. The dangers of fraud, market failure and consequent public panic are particularly acute in this sector. Rumours of a deposit-taking institution in trouble were enough to trigger bank

¹⁵ Because of riots in 1966 and 1967 and continuing confrontation with the Mainland during the “Cultural Revolution.” The survey results were set out in a confidential paper, Industry Development Branch, “Report on the Fact-Finding Survey of Small-Scale Industry” (Commerce and Industry Department, 9 January 1969, mimeo.). The conflict between market realities and business lobbying is revealed by a comparison of two confidential documents: Industry Development Branch, “The Case for Improved Access to Loans for Re-equipment Purposes by Small Scale Industry” (Department of Commerce and Industry, IND 2/903, 27 October 1969, mimeo) and “Memorandum to the Loans for Small Industry Committee” (Commerce and Industry Department, IND 2/903, 4 November 1969, mimeo). See also Nancy Ma, “Hongkong: Tonic for the Small Man,” *FEER*, 8 April 1972.

¹⁶ The delay was caused principally by Cowperthwaite, it seems, who had publicly pointed out that the surveys discredited the case for any such scheme. Sir John Cowperthwaite, Financial Secretary, *Hong Kong Hansard*, 9 October 1970, p. 116. The scheme was introduced only after his retirement.

¹⁷ E. P. Ho, Director of Commerce and Industry, *Hong Kong Hansard*, 11 April 1973, pp. 705-6; H. C. Y. Ho, *The Fiscal System of Hong Kong* (London: Croom Helm, 1979), p. 62. The post-British scheme was longer-lived but was no better-founded or effective than its colonial predecessor. See Andrew Sheng, Deputy Chief Executive, Hong Kong Monetary Authority, *Government Information Services* (*GIS* hereafter), 28 September 1995; Market Research Division, “Survey of the Financing Situation of Small and Medium-Sized Enterprises,” *Hong Kong Monetary Authority Quarterly Report*, October 2000, p. 38; Small and Medium Enterprises Committee, *A Report on Support Measures for Small and Medium Enterprises* (Hong Kong: SAR Government, 2001), chapter 5; Tung Chee Hwa, Chief Executive, *GIS*, 24 January 2002; Legislative Council Panel on Commerce and Industry, *Progress Report on the Four Funding Schemes for Small and Medium Enterprises*, (CB(1)1670/01-02(03) 13 May 2002).

runs from which Hong Kong suffered in every post-war decade up to 1991.¹⁸ The alternative to state intervention is the risk of instability disrupting transactions across the entire economy. In consequence, to a much greater degree than manufacturing or commerce, the financial system needs an effective legal structure. But these were realities which officials tried to ignore throughout most of the colonial era.

Yet, the Government could not escape completely from involvement with the currency and financial institutions. In Hong Kong, as in the rest of the British Empire, such issues as the right to issue currency and what constituted legal tender were defined by law.¹⁹ The fundamental financial “product” was the bill of exchange, whose validity and acceptability in the market place were governed by statute.²⁰ The right to accept deposits from the public and then lend them out to the bank’s customers was regarded as a particular privilege at the beginning of the colonial era, which, at the time, London sought to police quite stringently.²¹ Not until 1948, however, was there any Hong Kong legislation for the licensing of local banks. Regulatory powers were introduced only in 1964, but their implementation was uninspired and ineffectual for the next two decades, as the following sections will explain.

To aggravate the situation, unlike most modern economies, Hong Kong until 1993 had no central banking institution to oversee financial institutions, monitor financial markets and maintain the stability of the currency. Initially, the Bank of England had mistrusted Hong Kong’s capacity to perform these functions. But even more important was the rejection of such a role by the colonial administration itself.²²

From very early in colonial history, the colonial administration showed little understanding of the importance of a legal structure to ensure the stability of the financial system. In 1895, for example, the Attorney General had to confess in the legislature that the entire currency in circulation lacked legal sanction, a fact that had been recently reported to the Colonial Office. On London’s instructions, legislation was rushed through in one sitting to regularise the situation, though without penalising the banks involved or outlawing the notes already in circulation.²³

Laissez faire reigned unrestricted. There were no legal restraints on the entry of firms and individuals into the financial services sector (except for the note-issuing banks), and few constraints on their business practices, apart from the ordinary provisions of company and criminal law. The colonial administration simply did not accept any

¹⁸ The last such incident occurred in July 1991 when “following the [collapse of the Bank of Credit and Commerce International’s Hong Kong vehicle], several banks were the subject of unfounded rumours.” *Hong Kong 1992. A Review of 1991* (Hong Kong: Government Printer, 1992), p. 72.

¹⁹ By the Bank Notes Issue Ordinance, 1895, now the Legal Tender Notes Issue Ordinance (Cap. 65) (both originally 2 of 1895), and the Foreign Notes (Prohibition of Circulation) Ordinance, Cap. 68 (originally No. 13 of 1913).

²⁰ By the Bills of Exchange Ordinance, Cap. 19 (originally No. 9 of 1885) and based on corresponding United Kingdom legislation.

²¹ Early colonial bank regulation is well illustrated from the Hongkong Bank’s own history. Frank H. H. King, *The Hong Kong Bank in Late Imperial China, 1864-1902: On an Even Keel* (Cambridge: Cambridge University Press, 1987), Chapter 4.

²² Catherine R. Schenk, *Hong Kong as an International Financial Centre*, p. 65.

²³ A. G. Leach, Attorney General, *Hong Kong Hansard*, 20 March 1895, pp. 38-9.

obligation to exercise supervision over Hong Kong's domestic financial institutions to protect either depositors or investors. Until World War II, the Government chose to ignore the chaotic banking conditions, and there was no statutory or administrative structure through which to supervise local banks.²⁴ Officials might be excused on two grounds for adopting this attitude between the wars. The first was a preoccupation with the instability of the currency, which, like the Mainland, was on a volatile silver standard.²⁵ The second was a shortage of the economic expertise needed to understand the way in which the financial system functioned.²⁶

Nevertheless, there was a growing recognition of the financial system's vulnerability during the 1930s. An official committee indicated very plainly in 1930 its awareness of two problems. The first was the drawbacks of a note-issue that was not under government control. The second, and far more serious, was the inadequate system for adjusting the money supply and the lack of a proper monetary policy – defects that were to persist until the 1990s, as will be discussed below. But both the committee and the colonial administration preferred not to become involved in these issues.²⁷

The danger signals grew clearer. The official commission reviewing economic policy referred to earlier warned of the fundamental instability of the local banking system which suffered from inferior management and excessive involvement in property – defects that were to handicap Hong Kong banking until the 1980s. These made “a financial collapse inevitable when a major depression occurs,” but the official report concluded lamely that “it may not be possible to legislate against this danger.” The commission took more seriously the fragility of “savings banks” and called for government regulation, but mainly to protect the poor rather than to promote financial stability.²⁸ A major crisis did occur in 1935 which demonstrated how imprudent bank lending was in the absence of government regulation and how the lack of a central bank exacerbated the vulnerability of the financial system to downturns in the business cycle. However, “the lesson of the 1935 crash was lost on the Hong Kong government.”²⁹

²⁴ Banking legislation between the wars was trivial and, apart from the note-issuing banks, was confined to banning Germans and other enemy aliens from banking (Banking Business (Prohibited Control) Ordinance, 1919) and allowing one local bank to take advantage of changing bullion prices by switching its capital from silver to gold and then back again (Bank of Canton Ltd Capital Conversion Ordinance, 1919 and Bank of Canton Ltd Capital Conversion Ordinance, 1926). This bank had to be rescued from collapse in 1935.

²⁵ On the currency stability problem, see Tony Latter, “Hong Kong’s Exchange Rate Regimes in the Twentieth Century: The story of three régime changes,” Hong Kong Institute for Monetary Research Seminar Paper, 5 February 2004, pp. 3-9.

²⁶ This lack of expertise is very evident from the official reports on the currency and the economy cited in footnotes 2 and 27. This situation lasted until the appointment of the distinguished economist, S. (later Sir Sydney) Caine as Financial Secretary in 1937.

²⁷ The committee did not use this terminology. *Report of Currency Committee, 1930* (Legislative Council Sessional Paper 7/1930), pp. 105-6.

²⁸ *Report of the Commission...to enquire into the Causes and Effects of the Present Trade Recession*, p. 104. The Government did not act on the savings banks recommendation principally because of opposition to official interference with the activities of traditional Chinese financial institutions. Gillian Chambers, *Hang Seng The Evergrowing Bank* (Hong Kong: 1991, n.p.), pp. 14-5.

²⁹ Elizabeth Sinn, *Growing with Hong Kong. The Bank of East Asia 1919-1884* (Hong Kong: Hong Kong University Press, 1994), pp. 52-4.

Not that officials felt able to ignore the crisis completely. A confidential committee dominated by business representatives was established, which in 1936 recommended radical reforms through new legislation. No bank should operate without a licence, which might be withdrawn if its affairs were not properly conducted. Official approval would be required for new branches. Most important, an “examiner of banking” should be appointed to supervise the industry, with powers to investigate and obtain information. London approved these proposals and gave special support to the creation of a banking examiner.³⁰ Within the colonial administration, however, these moves towards a larger role for government in banking regulation aroused serious opposition. Hong Kong’s senior financial official argued that a more stable banking system would lead to lower interest rates which would prove unpopular with the public. “The truth is I think that the Chinese depositor would much rather get a higher rate of interest and lose his entire capital every twenty years or so,” he claimed bizarrely, “than get a low rate of interest with security.”³¹

Officials were particularly alarmed by the prospect of an “examiner of banking” and preferred to bury the proposal. They ignored business lobbying in favour of protecting small savers in particular. They paid no attention to pressures from London to move ahead with legislation before the Japanese invasion in December 1941.³² Thus, Hong Kong lost the opportunity to put in place a comprehensive system to ensure the integrity of its banks, to monitor their stability and to enforce the standards of banking practice and prudent lending that would protect depositors. It was to be another three decades before the colonial administration implemented the 1936 proposals which had been endorsed both by leaders of the business community and by the United Kingdom authorities. In the meantime, imprudence and malpractice continued to reign virtually unchecked.

Laws with Flaws

In the first post-war years, the Government seemed at last to have grasped the importance of ensuring a sound banking system. For the first time, legislation was introduced to regulate banking activities. Officials expressed a desire in 1947 to end the situation in which firms were free to set up as banks without adequate resources. The Government wanted to curtail “organisations doing business of the nature of banking business which is not in fact of value to the Colony since they are engaged in speculation or in the infringement of trade or exchange control regulations of this Colony or of China.”³³ But these statements were misleading. The decision to introduce Hong Kong’s first banking law had been forced on the colonial administration by the terms of an

³⁰ HKRS 170-1-307 “Banking Legislation,” (46) J. J. Paterson, committee chairman, 2 May 1936 to R. A. C. North, Colonial Secretary; draft legislation, circulated 15 December 1936; Colonial Office to Governor, 25 November 1938.

³¹ HKRS 170-1-307 (55) Colonial Treasurer, 25 August 1936. He also raised practical objections which his memorandum showed were essentially excuses for inaction.

³² HKRS 170-1-305 “Banking Legislation,” (12) Financial Secretary, “BANKING LEGISLATION,” 16 February 1939; Crown Solicitor to Financial Secretary, 19 March 1940; (31) and (32) new draft bill circulated by Financial Secretary, 20 May 1940; J. J. Patterson to Financial Secretary, 3 June 1940. This file had been scheduled for review on 11 December 1941. The Japanese invasion began three days earlier.

³³ J. B. Griffin, Attorney General, *Hong Kong Hansard*, 17 December 1947, p. 334.

agreement with the Chinese Government, which was exerting intense pressure on the colony, both locally and overseas, attacking it as “the big leak in China’s economy [that] bears the main responsibility for China’s present economic and financial chaos.”³⁴

Perhaps not surprisingly in this strained political context, the Government tried to make the legislation as minimalist as possible, dispensing with any form of banking examiner or any requirement for banks to make regular statistical returns.³⁵ Nevertheless, the Banking Ordinance 1948 contained provisions to withhold and cancel bank licences and to investigate their soundness. Leading bankers expected these powers to be invoked to clean up the industry. But requests to use the ordinance to close down even the worst financial institutions were rejected at the highest level of the colonial administration on the grounds that prudential supervision of the industry was no part of the original legislation’s aims. As in the pre-war era, the Government suggested that the community was not much interested in prudential supervision anyway, and the Financial Secretary claimed “that Government itself does not seem to have received complaints, direct or indirect, from depositors who have lost their money.”³⁶ Almost inevitably, Hong Kong’s first Banking Ordinance did nothing to promote the creation of soundly-capitalised and properly-managed financial institutions.

By 1963, the Government was forced to acknowledge that further legislation was required to deal with “a number of bankers...[who] regard their banks as convenient channels for securing control of the public's funds for their own speculations in land, in shares and in similar ventures, without regard to banking principles.”³⁷ In the meantime, the industry could only be described as “notoriously unregulated.”³⁸ Little had changed since the 1930s and the economic commission’s criticism of perilous banking practices.

The Government’s attempts to introduce reforms, both through the 1964 Banking Ordinance and through subsequent measures, were bedevilled by five factors.

- Their focus was on “correcting managerial irregularities, rather than the structural deficiencies in Hong Kong’s banking system.”³⁹ Not surprisingly, because the 1964

³⁴ HKRS 163-1-403 “CHINA TRADE AND COMMERCE,” (165) Letter from Chinese side and “MEMORANDUM OF AGREEMENT,” 15 August 1948 ; (289) Governor to Secretary of State for the Colonies, 10 May 1948; Colonial Secretary to Governor, 2 July 1948.

³⁵ HKRS 163-1-440 “BANKING 1. Banking ordinance,” Attorney General to Financial Secretary, 27 July and 12 December 1947.

³⁶ HKRS 163-1-679 “Banking Advisory Committee,” M. 1 Acting Financial Secretary to Governor 14 June 1948; (86) Financial Secretary, “Memorandum to Members of the Banking Advisory Committee... Licensing Policy,” 23 October 1959. Nothing in the files cited here justified such a narrow interpretation. They show that Hong Kong officials had refused all along to appease the Chinese authorities with symbolic legislation that would then remain a dead letter. It should also be noted that the Financial Secretary made an effort to strengthen the criteria for the grant of new licences.

³⁷ J. J. Cowperthwaite, Financial Secretary, *Hong Kong Hansard*, 19 June 1963, p. 211.

³⁸ Catherine R. Schenk, *Hong Kong as an International Financial Centre*, p. 45. Chapter 3 of this excellent study gives a detailed account of the banking sector’s woes in these years.

³⁹ Y. C. Jao, *Banking and Currency in Hong Kong. A Study of Postwar Financial Development* (London: Macmillan, 1974), p. 243.

legislation reflected very extensively recommendations from the Bank of England which had no great familiarity with banking conditions in the colony.⁴⁰

- The Government felt obliged to accommodate significant deviations from prudent banking practice mainly on the grounds that, otherwise, banks would no longer be able to appoint as directors “men who were in the forefront of Hong Kong commerce.”⁴¹ In this way, the proper boundaries between personal and public interest were fudged, and directors’ misconduct became a marked feature of future banking collapses.⁴²
- The Government itself had mixed and often conflicting goals in framing the legislation, especially its desire to establish a degree of supervision without moving towards the creation of a central bank⁴³ or the introduction of a conventional monetary policy. In reality, the functions of a central bank became increasingly difficult to avoid, while monetary policy could not be ignored despite denunciations of any role for a Keynesian approach in an economy as open as Hong Kong.⁴⁴
- Respect for the law and the Government’s duty of enforcement were not regarded as overriding obligations on either officials or the banks. Both parties feared that Hong Kong could not survive if the laws governing financial transactions were strictly enforced. They colluded to conceal the fact that almost all foreign trade contracts were legally unenforceable from 1949 to 1967 because they did not conform to the requirements of foreign exchange controls (even though it had been to overcome this specific illegality that the first post-war banking legislation had been enacted, as mentioned above).⁴⁵
- Officials believed that the real threat to banking stability and financial integrity was excessive competition. Until the mid-1980s, they regarded a restriction on the number of financial institutions, rather than their effective supervision, as the crucial

⁴⁰ Robert Fell, *Crisis and Change. The Maturing of Hong Kong’s Financial Markets* (Hong Kong: Longman, 1992), p. 149. He was commenting on H. J. Tomkins, *Report on the Hong Kong Banking System and Recommendations for the Replacement of the Banking Ordinance 1948* (Hong Kong: Government Printer, 1962).

⁴¹ There were “three ...strictly unorthodox banking practices to which limits are set by the bill, i.e. unsecured advances to directors, share dealing and property investment, under one overall limit of 55% of capital and reserves (which is the total of the three previously separate limits) and an individual limit for any one of them of 25%; thus limiting total indulgence in these practices while giving some choice as to the extent of indulgence in each one.” J. J. Cowperthwaite, Financial Secretary, *Hong Kong Hansard*, 16 September 1964, pp. 331-2.

⁴² Robert Fell, *Crisis and Change*, p. 180. His views carry added weight as a former Commissioner both for Securities and of Banking.

⁴³ With Bank of England approval. Tomkins, *Report on the Hong Kong Banking System*, p. 6. Even after the establishment of a Hong Kong Monetary Authority had been approved, the Government had reservations about it acting as an “independent central bank.” Hamish MacLeod, Financial Secretary, *Hong Kong Hansard*, 28 October 1992, p. 473.

⁴⁴ Note the official admission: “The minimum liquidity ratio set for banks is designed not only to ensure the ready availability of funds to repay deposits but also to prevent the inflationary effects of credit creation through excessive bank lending.” (emphasis added) Sir John Cowperthwaite, Financial Secretary, *Hong Kong Hansard*, 26 March 1969, p. 205. However, his general rejection of Keynesian economics in Hong Kong can be found in *Hong Kong Hansard*, 10 March 1966, p. 57 and 25 February 1970, p. 363.

⁴⁵ The collusion to conceal this illegal situation was described with considerable frankness by Sir John Cowperthwaite, Financial Secretary, *Hong Kong Hansard*, 26 April 1967, pp. 294-5.

safeguard.⁴⁶ Officials even saw the vulnerability of the banking system as increasing with the market impact of more efficient banks.⁴⁷

Thus, the new supervisory framework that was established in 1964, despite considerable legislative tinkering over the next two decades, proved wholly inadequate to prevent chronic weaknesses and recurrent scandals in the banking sector and the financial markets.

Little Competition

It is possible to distinguish two related but often incompatible considerations in the Government's post-war policies for dealing with the financial services sector. The first was a constant anxiety about the fragility of the financial system rather than concern about the integrity of institutions. The second was an abiding reluctance to become involved in regulation.

The conviction that competition was dangerous was very deep-rooted. Even at the end of the twentieth century when Hong Kong had developed a robust regulatory structure, officials still claimed that competition was "a double-edged weapon... that...can pose a threat to banking stability...[and] threaten the wider performance of the economy."⁴⁸ As a result, from the mid-1960s until after the end of British rule, the colonial administration supported direct measures to limit the free operation of financial markets.

- *Price fixing:* A cartel was established to set charges, commissions and fees. Its powers were administered through the Hong Kong Association of Banks but only "after such consultation with the Financial Secretary as he shall consider appropriate."⁴⁹ Until 2001, it set the interest rates payable on Hong Kong dollar deposits, thus restricting price competition in the retail market.⁵⁰ Allowing the cartel to fix interest rates was estimated to have cost the banks' customers the equivalent of 0.3 per cent of GDP in 1987 and 0.8 per cent in 1991.⁵¹
- *Market entry:* Almost continuously from 1965 until 1981, a moratorium on new bank licences was in force. This ban was introduced during the 1965 banking crisis and

⁴⁶ For a good example of this distinction made clearly, though indirectly, in a major policy statement, see C. P. Haddon-Cave, Financial Secretary, *Hong Kong Hansard*, 15 March 1978, p. 623.

⁴⁷ The actual phrase was "harsh competition with larger banks." Sir John Bremridge, Financial Secretary, *Hong Kong Hansard*, 9 April 1986, p. 986.

⁴⁸ Donald Tsang Yam-kuen, Financial Secretary, *GIS*, 12 June 1997. This assertion of a direct connection between competition and vulnerability was disproved by market experience. See Guorong Jiang *et al.*, "Banking Sector Competition in Hong Kong – Measurement and Evolution Over Time," *Hong Kong Monetary Authority Research Memoranda* (20 April 2004).

⁴⁹ Hong Kong Association of Banks Ordinance (Cap. 364), section 12(1). Before enactment of this ordinance in 1981, the Association imposed its decisions through informal means.

⁵⁰ Until 1995, it had also set the minimum commissions and charges for such services as foreign exchange and securities. Stephen Ip, Secretary for Financial Services, *GIS*, 7 March 2001.

⁵¹ Consumer Council, *Are Hong Kong Depositors Fairly Treated?* (Hong Kong: Consumer Council, 1994), p. 7.

recommended by the Bank of England.⁵² From the start, the industry itself had reservations about this restriction,⁵³ and officials, too, eventually came to question its merits.⁵⁴ But even after the ban was lifted, foreign banks were still subject to severe restrictions on their branch banking. These were abolished finally in 2001, followed by liberalisation of market entry criteria the following year.⁵⁵

- *Informed choice:* Customers were deprived of the information to make a fully informed choice of banks because banking legislation did not require complete disclosure of key information in the published accounts of financial institutions, and Hong Kong in the 1990s still lagged behind other major financial centres, particularly New York.⁵⁶ Only after 1994 were the criteria for financial disclosure raised to match international standards.⁵⁷

Even Less Regulation

The problem was not that the Government lacked the legal powers to intervene effectively but that it saw no need to adopt coherent and coordinated policies about how they should be employed. Despite all its flaws, the new legislation conferred “draconian powers” on the Banking Commissioner (compared with the United Kingdom which did not enact similar but “much milder supervisory powers” for another fifteen years).⁵⁸ Yet, officials were as narrow in their interpretation of its provisions as they had been of the 1948 ordinance, and so failed to make effective use of the 1964 Banking Ordinance.

To camouflage the administrative inertia and regulatory failures, the powerful mantra of *laissez faire* was invoked to justify leaving depositors and investors at the mercy of the markets even when the financial stability of Hong Kong was at risk, as five policy decisions illustrated in the period from 1950 till 1987.

⁵² Its Hong Kong “expert” declared: “Too many banks chasing the available business is one of the basic causes of the reckless employment of customers’ money.” HKRS 163-3-249 “BANKING EMERGENCY 1965 – Matters arising from...staff etc.,” H. J. Tomkins to Financial Secretary, “Suggested measures to deal with the aftermath of the failure of the CANTON TRUST & COMMERCIAL BANK, LIMITED,” 5 March 1965, p. 8.

⁵³ HKRS 163-1-3185 “BANKING ADVISORY COMMITTEE,” Minutes of the Banking Advisory Committee Meeting, 18 March 1965, p. 3.

⁵⁴ Lifted temporarily in 1972, again between 1975 and 1978 and then substantially relaxed in 1981 covering applications from Hong Kong for the first time. T. K. Ghose, *The Banking System of Hong Kong* (Singapore: Butterworths, 1987), pp. 76-8; Sir Philip Haddon-Cave, Financial Secretary, *Hong Kong Hansard*, 27 May 1981, pp. 893-5.

⁵⁵ In 1974, the Government admitted the absurdity of the moratorium on new licences: “The fact is that it does prevent the participation in our banking system of some of the most highly reputable international banks in the world and inhibits the emergence of any new local banks.” C. P. Haddon-Cave, Financial Secretary, *Hong Kong Hansard*, 3 July 1974, p. 954.

⁵⁶ A comparison of disclosure standards in Hong Kong with the United States, the United Kingdom, Japan and Singapore is available in Consumer Council, *Evaluation of the Banking Policies and Practices in Hong Kong – Focusing on their Impacts on Consumers* (Hong Kong: Consumer Council, 1994), pp. 64-5.

⁵⁷ Hong Kong Monetary Authority, “Approach to Supervision,” (http://www.info.gov.hk/hkma/eng/bank/supervision/supervision_b4.htm). The reform process is recorded in *Prudential Supervision in Hong Kong* (Hong Kong: Hong Kong Monetary Authority, 2002), pp. 6.16-6.18.

⁵⁸ Fell, *Crisis and Change*, p. 140.

- There was a stubborn refusal until the early 1990s to contemplate the creation of a central bank or monetary authority despite lobbying by the Banking Commissioner for such a status for his office and then for a separate institution in the 1970s followed by similar advice from the International Monetary Fund.⁵⁹ This obdurate attitude persisted even after the lack of a central bank was shown to have added considerably to the complexities of protecting the financial system against devaluation.⁶⁰ Without this institution, there was no mechanism to link regulatory strategies with changing economic circumstances and downturns in the property and foreign trade cycles. Policy-makers in the Government Secretariat were remote from the regulators in the Banking Commission, while the regulators found it hard to coordinate their activities with their counterparts in the Securities Commission and with law-enforcement agencies.⁶¹
- There was a bland assumption that a laissez-faire approach would provide its own remedies for inadequate prudential supervision. Thus, in the 1950s, the smallest and most fragile banking houses were granted informal but almost total exemption from the 1948 Banking Ordinance.⁶² The Government was indifferent both towards their conduct and towards their potential collapse.
- Officials showed no understanding of how prudential supervision of financial institutions was vital for the stability of the financial system and the rest of the economy. In 1975, the Government disclaimed any obligation “to ensure that deposit-taking companies [other than licensed banks] conduct their businesses with complete safety for depositors.” Although registered with the authorities, these deposit-taking companies [DTCs] would not be subject to regular inspections on the grounds that these “would place [the regulator] and the Government in a position of responsibility for the prudential conduct of business by companies, which it is not intended to accept.”⁶³ The dangers of this policy were highlighted by the DTCs’ contribution to an alarming upsurge of property and stock market speculation in 1978, and some supervision was extended belatedly to them.⁶⁴ Nevertheless, “imprudence, mismanagement, and malpractice” continued to flourish and led to a spate of collapses among DTCs, whose failures helped to bring down seven licensed banks

⁵⁹ HKRS 163-3-249, Leonidas Cole, Banking Commissioner to Financial Secretary, 9 December 1969; Anthony Ockenden, Banking Commissioner, *GIS*, 22 June 1978; Philip Bowring, “Hongkong wary of controls,” *FEER*, 2 December 1977. There had been some awareness in the 1950s of the dangers created by the absence of a central bank, but the Bank of England was adamantly opposed to its establishment at that time and so, on the whole, was the colonial administration. Catherine R. Schenk, *Hong Kong as an International Financial Centre*, pp. 63-5.

⁶⁰ Notably when seeking to maximize the guarantees against future devaluations offered by the United Kingdom. See Sir John Cowperthwaite, Financial Secretary, *Hong Kong Hansard*, 10 July 1968, p. 326.

⁶¹ These weaknesses are discussed in the light of his personal experience as a regulator in the 1980s by Fell, *Crisis and Change*, pp. 150, 156-7, 159-60, 162, 180-1.

⁶² HKRS 163-1-441 “Names and Addresses of Partners of Banks required for the Banking Ordinance 1948,” Deputy Financial Secretary, “Banking Ordinance,” 26 January 1950.

⁶³ A suggestion from Hang Seng Bank that all depositors ought to benefit from prudential supervision was rejected. C. P. Haddon-Cave, Financial Secretary, *Hong Kong Hansard*, 5 November 1975, p. 189, 8 January 1975, p. 342 and 3 December 1975, p. 297.

⁶⁴ C. P. Haddon-Cave, Financial Secretary, *Hong Kong Hansard*, 16 November 1978, p. 209 and 28 February 1979, p. 554. Even so, prudential supervision of DTCs would only be “on somewhat similar lines” to licensed banks. Sir Murray MacLehose, Governor, *Hong Kong Hansard*, 11 October 1978, p. 18.

between 1982 and 1985.⁶⁵ This crisis was compounded by the failure of the Government to develop an effective monetary policy, and credit ballooned as the Government lost control of the money supply from 1974 to 1983.⁶⁶

- The Government failed to understand the extent to which the lack of regulation in other parts of the financial markets contaminated the banking (and DTC) sector. There was a stubborn reluctance to overhaul company law and the regulation of the securities industry until after major crises. The existing legislation became indefensible following the share collapse of 1973 and its inevitable corporate scandals which the Governor blamed on the way “*laissez-faire* produced excessive risks.”⁶⁷ But regulation remained ineffective until the 1987 global stock market collapse made it impossible to tolerate any longer the wholly inadequate regulatory arrangements for the securities industry. These had been defended previously in the name of *laissez faire* principles that had been “ineptly used and grossly abused.”⁶⁸
- The Government’s disregard for its regulatory responsibilities was so great that it consistently failed to provide adequate resources, both in terms of staff for prudential supervision of the banks and funds for the adequate supervision of DTCs. The situation was very similar in the securities industry, where an official inquiry found that the regulator had never been given the resources “to implement and enforce the legislation introduced in the 1970s.”⁶⁹

From a “Government” to a Global Bank

The Hongkong Bank was a major beneficiary of the Government’s inconsistencies in developing a modern regulatory system, as the analysis that follows will show. The market crises and corporate scandals that were a regular feature of Hong Kong until the establishment of the Hong Kong Monetary Authority in 1993 provoked regular “flights to quality” as nervous depositors fled to the highest-quality institution accessible to them, which was the Hongkong Bank group. As the largest financial institution, the group profited from the Government’s protection of existing banks against

⁶⁵ Y. C. Jao, “Monetary system and banking structure,” in H. C. Y. Ho and L. C. Chau (eds), *The Economic System of Hong Kong* (Hong Kong: Asian Research Service, 1988), p. 59. In 1978, customers’ deposits at the 241 DTCs were equivalent to 17 per cent of total deposits with licensed banks. In 1982, the figure rose to 22 per cent but slumped to 10 per cent in 1987, by which date 94 DTCs had closed their doors. *Hong Kong Annual Digest of Statistics, 1988 Edition* (Hong Kong: Census and Statistics Department, 1988), pp. 125-8.

⁶⁶ Yao in Ho and (eds), *The Economic System of Hong Kong*, pp. 54, 58-9.

⁶⁷ To quote the Governor, Sir Murray MacLehose, *Hong Kong Hansard*, 17 October 1973, p. 25. “There was virtually no regulation of the securities industry until...1974.” Y. C. Jao, “The Financial Structure,” in David Lethbridge (ed.), *The Business Environment in Hong Kong* (Hong Kong: Oxford University Press, 1980), p. 182. See also *First Report of the Companies Law Revision Committee. The Protection of Investors* (Hong Kong: Government Printer, 1971), pp. v-vii, 49; *Second Report of the Companies Law Revision Committee. Company Law* (Hong Kong: Government Printer, 1973); Leo Goodstadt, “COMPANIES LAW. Bull in a China Shop,” *FEER*, 21 October 1972; Philip Bowring, “Hongkong: Limited Securities Bill,” *FEER*, 8 October 1973.

⁶⁸ Securities Review Committee, *The Operation and Regulation of the Hong Kong Securities Industry* (Hong Kong: Government Printer, 1988), p. 32.

⁶⁹ Y. C. Yao, “Recent Banking Crises in Hong Kong and Taiwan: A Comparative Perspective,” in Nyaw Mee-kau and Chang Chak-yan (eds), *Chinese Banking in Asia’s Market Economies* (Hong Kong: Chinese University of Hong Kong, 1989), p. 28; C. P. Haddon-Cave, Financial Secretary, *Hong Kong Hansard*, 8 January 1975, p. 342; Securities Review Committee, *The Operation and Regulation of the Hong Kong Securities Industry*, p. 231.

retail price competition and the entry of new competitors, especially from overseas. The Hongkong Bank also did handsomely over a long period of time out of its privileged position as the colonial administration's principal banker. Nevertheless, its executives were frequently disenchanted by the economic consequences of laissez-faire policies and became outspoken advocates of government intervention.

Regulation under Laissez Faire

In the 1950s, the Hongkong Bank took much the same jaundiced view of non-interventionism in the financial services sector as the leading British commercial firms did of the absence of industrial development programmes and government aid for manufacturers. It joined forces with local Chinese bankers to demand an end to laissez faire and the introduction of government regulation to stabilise the banking industry. In addition, local bankers wanted the establishment of a central bank, and the Hongkong Bank proposed legislation that would have been a major step in that direction.⁷⁰

Initially, the bank also wanted the colonial administration to adopt an active monetary policy. In 1955, the bank took the lead in countering a burst of speculative activities through a credit squeeze,⁷¹ which was reinforced by the Government's transfer of funds out of the local currency and into sterling. However, the bank then changed its mind about the desirability of official leverage on the money supply. It lobbied successfully against further transfers of funds to London, and they ceased between 1959 and 1969.⁷² In the 1970s and 1980s, the bank went back to its original stance as it grew alarmed at the absence of an effective monetary policy and the enfeebled regulatory arrangements, both of which increased the vulnerability of financial markets in the opinion of its senior executives.

In part, this change probably reflected a sense of "unfair" competition. The bank pursued conservative lending policies but many of its rivals did not.⁷³ It campaigned vigorously but in vain for government action to halt the surge in share speculation that led to the stock market collapse in 1973.⁷⁴ This bubble was fuelled by the banking system, and a confidential government survey showed that lending against shares rose from 8 per cent of total bank loans and advances at the end of 1970 to 18 per cent at the end of 1972.⁷⁵ A similar situation emerged in 1982-85. Once again, the bank's senior

⁷⁰ Frank H. H. King, *The Hong Kong Bank in the Period of Development and Nationalism, 1941-1984. From Regional Bank to Multinational Group* (Cambridge: Cambridge University Press, 1991), pp. 567, 615; Schenk, *Hong Kong as an International Financial Centre*, pp. 64-5, 158.

⁷¹ Inflationary pressures appear to have been aggravated in 1954 by the bank's decision to redeem a significant quantity of banknotes repatriated from the Mainland after Mao Zedong's victory in 1949. HKRS 163-1-1943 "HONG KONG EXCHANGE FUND Operations by the Hong Kong & Shanghai Banking Corporation," letter to Colonial Office, 25 June 1959.

⁷² King, *The Hong Kong Bank in the Period of Development and Nationalism*, p. 338; A. G. Clarke, Financial Secretary, *Hong Kong Hansard*, 29 February 1956, p. 77 and 27 March 1957, p. 116; Sir John Cowperthwaite, Financial Secretary, *Hong Kong Hansard*, 1 March 1967, p. 83 and 25 February 1970, p. 363.

⁷³ See Tables I and II and the accompanying analysis in the Statistical Appendix.

⁷⁴ "Sandberg and the market," *FEER*, 23 September 1972; Stewart Dalby, "Will the bubble burst?," *FEER*, 2 December 1972.

⁷⁵ See Tables III and IV and the accompanying analysis in the Statistical Appendix.

executives were very vocal during the run-up to the crisis in warning that the regulatory system was breaking down and the money supply was out of control.⁷⁶

Benefiting from Official Blunders

Nevertheless, the Hongkong Bank profited directly from the regulatory ineptitude and the Government's fear of competition. The frequent bank runs and corporate scandals were a reminder to the community of the attractions of a large, conservatively-run institution, which helped to reinforce the proportion of total deposits held with the Hongkong Bank group. This "flight to quality" was very marked, for example, during 1965 in response to that year's severe banking crisis, and the group's share of total deposits rose sharply.⁷⁷ An even more significant benefit for the Hongkong Bank in 1965 was its chance to acquire the Hang Seng Bank which suffered a catastrophic run, losing 39 per cent of its deposits in the first four months of the year.

The accompanying table shows Hang Seng Bank's strategic position at the start of the crisis. It had outstripped the colony's second British note-issuing bank ([Standard] Chartered Bank) to become Hong Kong's second largest financial institution, both in terms of deposits and lending. At the time, the Hang Seng Bank's importance to the banking system was not recognised either by the community at large or even by the Hongkong Bank's chairman because of the absence of public information on individual banks. The Government, however, had been collecting detailed figures from each licensed bank since December of the previous year and understood that this leading local institution could not be allowed to fail and gave every encouragement to its rescue.⁷⁸

The Hang Seng Bank's Crisis, 1965⁷⁹

	31 Dec 1964 Deposits HK\$mn	31 Dec 1965 Loans & Advances HK\$mn	28 Feb 65 Deposits HK\$mn	28 Feb 65 Loans & Advances HK\$mn	30 April 65 Deposits HK\$mn	30 Apr 65 Loans & Advances HK\$mn	30 Jun 65 Deposits HK\$mn	30 Jun 65 Loans & Advances HK\$mn
Hang Seng Bank	661	483	547	485	404	458	428	461
Hongkong Bank	2,188	1,262	2,364	1,380	2,379	1,471	2,558	1,568
Chartered Bank	485	350	485	384	556	412	573	437
All banks	6,743	4,562	6,615	4,750	6,598	4,919	6,942	5,089

As the table demonstrates, the immediate consequence of the bank's takeover of Hang Seng in April was to halt the unsustainable flight of its depositors and to revive the community's confidence in the banking system. For the longer run, this acquisition

⁷⁶ Leo Goodstadt, "Controls come to the rock of laissez-faire," *Euromoney*, April 1979, pp. 121-3; "Whatever the Reasons, Hong Kong keeps Growing," *Euromoney*, July 1982, pp. 134-7; "Why Hong Kong still trusts interest rates," *Asian Banking*, January 1982, p. 56.

⁷⁷ Table I, Statistical Appendix.

⁷⁸ The paucity of statistical information on the true state of the banking industry at the time is illustrated by Our Editorial Staff, "The Banking Crisis," *FEER*, 18 February 1965.

⁷⁹ This table is derived from HKRS 163-1-3273 "BANKING STATISTICS VARIOUS 1965," Commissioner of Banking to Financial Secretary, 19 March, 5 July and 2 September 1965.

enabled the Hongkong Bank to defend its dominant market position. The group's share (including Hang Seng Bank) ranged from 43 per cent to 46 per cent of total deposits during political disturbances and business uncertainties from 1966 to 1972.⁸⁰ Even though the relaxation of the moratorium on new licences in 1981 and the influx of major international financial institutions raised the level of competition in the banking industry, the Hongkong Bank group appears to have still accounted for up to 42 per cent of total deposits in 1986. The bank's own Economic Research Department estimated that the share of total deposits had risen to 59 per cent by 1995.⁸¹

Entry Barriers

The colonial administration's entry barriers to foreign players were a major advantage to the Hongkong Bank. Its representatives on the Government's Banking Advisory Committee lobbied unsuccessfully during the 1950s against allowing more foreign banks to enter Hong Kong on the grounds that "there are more than enough banks already."⁸² As explained already, the 1965 bank runs were followed by a moratorium on all new licences. But this did not make the bank complacent about the threat of competition, and the Government's subsequent restrictions on branch banking by foreign banks were important in providing additional protection for the Hongkong Bank's already predominant position, as foreign banks bitterly complained.⁸³

Non-price Competition

The banking cartel and its restrictions on price competition were the colonial administration's most important anti-competition weapon. In the retail sector, because of the cartel, market share depended on non-price competition. Until 1984, the size of the branch network was crucial. Here foreign banks were restricted and smaller local banks lacked the resources to match the Hongkong Bank's ability to expand. In 1986, it accounted for the largest share – 31 per cent – of the total number of bank branches.⁸⁴

But in that year, as noted above, its share of total bank deposits was 42 per cent, which indicates that the number of branches was only part of the story in pursuing market dominance. Of growing importance were such factors as technology, new products and

⁸⁰ Table I, Statistical Appendix.

⁸¹ Y. C. Jao, "The Role of the HongkongBank," in Richard Yan-Ki Ho *et al.* (eds), *The Hong Kong Financial System* (Hong Kong: Oxford University Press, 1992), p. 49; Leonard K. Cheng and Changqi Wu, *Competition Policy and the Regulation of Business* (Hong Kong: City University Press of Hong Kong, 1998), p. 26.

⁸² Other members tended to echo the bank's sentiments. HKRS 163-1-679, Circular No. 49 "Yau Yue Commercial Bank," 18 February 1953; Circular No. 53 "Overseas Bank Ltd," 14 October 1953; Circular 69 "Banque Nationale pour le Commerce et l'Industrie," 11 December 1957.

⁸³ Schenk, *Hong Kong as an International Financial Centre*, chapter 3. See also FEER: P. H. M. Jones, "HONGKONG Flush with Money," 13-19 April 1969; Seth Lipsky, "HONGKONG'S LEGISLATION. Retreating from laissez-faire," 13 September 1974; Anthony Rowley, "Hongkong's unhappy neighbourhood. Foreign banks resenting the local cartel are pressing for greater government control," 2 March 1979.

⁸⁴ See Allan K. K. Chan and Helen W. M. Ho, "Bank Marketing," in Richard Yan-Ki Ho *et al.* (eds), *The Hong Kong Financial System* (Hong Kong: Oxford University Press, 1992), pp. 341, 351.

services and advertising.⁸⁵ In these fields, the scale of the Hongkong Bank group's operations gave it a significant advantage: it could afford to outspend its competitors in attracting deposits while holding down unit costs in the retail sector.

A Quasi-central Bank

In the wholesale sector, different conditions prevailed, and here the bank's traditional privileges as premier banker to the Government and manager of the clearing house were key factors in reinforcing its market share. Until the closing years of the colonial era, the Government was forced to rely on the Hongkong Bank both for normal banking business and in order to intervene in the financial markets in the absence of a conventional central bank. The bank's three most significant functions as "government banker" were:

- It assisted in maintaining the official exchange rate and cooperated with the colonial administration in ensuring that exchange control regulations were applied as minimally as possible.⁸⁶
- It administered the clearing house for the banks and DTCs.
- It acted as lender of last resort at whatever overnight rates the market would bear and aided banks in distress. (Rescue operations were underwritten by the Government.⁸⁷)

In the closing decades of British rule, the bank was forced to shed these roles, but removal of its privileges proved complex and protracted.

By 1983, the colonial administration could no longer abdicate responsibility for managing the external value of the currency. After an economic and political crisis had driven the Hong Kong dollar down that year by 28 per cent against its American counterpart, the Government linked the exchange rate to the United States currency. Maintenance of the linked rate became an overriding priority. This development transformed the Government's relationship with the banking industry and made it inevitable that officials would have to take direct responsibility for central bank functions that previously had been carried out by the Hongkong Bank.⁸⁸

The next area in which the Hongkong Bank's central banking functions came under challenge was its control of the clearing house. This role allowed the bank to use, free of charge, the surpluses of the banking system. In addition, the bank could lend out

⁸⁵ Y. C. Yao (ed.), *Hong Kong's Banking System in Transition: Problems, Prospects and Policies* (Hong Kong: Chinese Banks Association Ltd, 1988), p. 69.

⁸⁶ King, *The Hong Kong Bank in the Period of Development and Nationalism*, p. 345.

⁸⁷ For example, during the 1965 banking crisis, the Government pumped funds into the local Chinese banks. At its peak, this assistance totalled HK\$163 million – equivalent to 9.7 per cent of their total liquidity – HK\$104 million of which was channelled via the Hongkong Bank. HKRS163-1-3273, (13) Commissioner of Banking to Financial Secretary, 2 September 1965.

⁸⁸ As a Chairman of the bank later observed. John Gray, "Monetary Management in Hong Kong: The Role of the Hongkong and Shanghai Banking Corporation Limited," in *Proceedings of the Seminar on Monetary Management organized by the Hongkong Monetary Authority on 18-19 October 1993* (Hong Kong: Hong Kong Monetary Authority, n.d.), p. 60.

these funds at commercial rates to any institution with a negative balance at the end of the business day (making it technically illiquid). Pressure for reforms began in the 1980s with complaints from the banking industry about paying their major competitor for facilities provided elsewhere by central banks.⁸⁹ More serious, however, was the growing realisation that the clearing house role could enable the Hongkong Bank to insulate itself from government measures to enforce its monetary objectives.⁹⁰ At first, senior officials did not realise the seriousness of this situation.⁹¹ But in 1988, they took steps to ensure that all financial institutions, including the Hongkong Bank as the largest player, could be compelled to cooperate with official monetary policies.⁹²

In 1992, the bank ceased to be the lender of last resort. Henceforth, the Government would make liquidity available to banks with temporary shortfalls. This role was taken over in the following year by the newly-established Hong Kong Monetary Authority, which was now assuming all the Government's central banking functions previously carried out by the Hongkong Bank.⁹³

Not a Very British Bank

The retention by the Hongkong Bank of its quasi-central bank role until the final years of the colonial era did not make it a docile agent of the colonial administration or a bastion of British commercial interests. Indeed, the success of the bank in transforming itself from a privileged British institution enhanced by its monopolistic advantages into a major global bank required drastic cultural changes within a very colonial organisation. The chances of a radical shift in management attitudes seemed small in the first decade after World War II. The bank was a thoroughly expatriate firm. Its executives focused on British and international clients and insulated themselves from direct contacts with Chinese bankers and businessmen in Hong Kong with layers of Chinese compradors and Portuguese staff. There was no interest in mobilising deposits from the community at large or in serving a new class of industrial borrowers.⁹⁴

With considerable reluctance, the bank came to appoint Chinese staff to managerial positions and started to create a branch network to cater to the new manufacturing firms which were rapidly emerging as the backbone of the post-war

⁸⁹ Y. C. Jao, "The Monetary System and the Future of Hong Kong," in Y. C. Jao *et al.* (eds), *Hong Kong and 1997. Strategies for the Future* (Hong Kong: Centre of Asian Studies, 1985), p. 394, f.n. 33.

⁹⁰ On these issues, see Jao in Ho *et al.* (eds), *The Hong Kong Financial System*, pp. 43-5; Joseph Yam, "The Development of Monetary Policy in Hong Kong," in Y. C. Jao (ed.), *Monetary Management in Hong Kong. The Changing Role of the Exchange Fund* (Hong Kong: The Chartered Institute of Bankers, 1991), pp. 57-8.

⁹¹ Kevin Rafferty, *City on the Rocks. Hong Kong's Uncertain Future* (London: Viking, 1989, pp. 235-8. This author gives an excellent account of the various views involved.

⁹² The technicalities are summarised in Joseph Yam, *Review of Currency Board Arrangements in Hong Kong* (Hong Kong: Hong Kong Monetary Authority, n.d.), pp. 26-7.

⁹³ Although it was to take a further four years before the transfer was completed. Tony Latter, "Who or What determines Monetary Policy in Hong Kong?" *Hong Kong Monetary Authority Quarterly Bulletin*, May 2002, Issue No. 31, p. 56. On the changes, see Joseph Yam, "Central Banking and Monetary Policy in Hong Kong," in Hong Kong Monetary Authority, *The Practice of Central Banking in Hong Kong* (Hong Kong: Hong Kong Monetary Authority, 1994), Annex B.

⁹⁴ King, *The Hong Kong Bank in the Period of Development and Nationalism*, pp. 300-2, 310, 350-1.

economy.⁹⁵ The result of these internal developments was a drastic shift in the focus of the bank's expatriate executives. Around them, they could observe how the great names of British commercial history in the Far East were almost all fading.⁹⁶ The future belonged to Chinese entrepreneurs, and the Hongkong Bank proved very successful in picking winners whom it then backed enthusiastically against their British rivals.

The first important demonstration of this new business model came in 1979. Hutchison Whampoa, controlled by Sir Douglas Clague, a distinguished British public figure, had to be rescued from bankruptcy by the Hongkong Bank in 1975. After the firm had been restored to financial health, the bank had a choice. It could offload the company to a leading British conglomerate. Instead, it was sold to Li Ka-shing, a manufacturer who had made a fortune from real estate.⁹⁷ Far more dramatic was the bank's decision the following year to support a Chinese shipping magnate, Sir Pao Yue-kwong, in a takeover battle against the Jardine group, one of the most famous names in Britain's Asian empire.⁹⁸ This renunciation of any obligation on the part of the bank towards its British compatriots was followed by its support for a further foray against Jardine interests led by Li Ka-shing.⁹⁹

The lack of patriotic sentiment was apparent to the United Kingdom authorities. In 1982, the Hongkong Bank's attempt to take over the Royal Bank of Scotland was rejected. The Bank of England expressed its doubts whether "it could ever be right to allow control [of a United Kingdom clearing bank] to pass into hands not fully committed to the United Kingdom public interest." The British Monopolies and Mergers Commission accepted the Bank of England's views, observing that although the United Kingdom was the sovereign power in Hong Kong, "the Government there must have primary regard to the welfare of its population and the interests of its territory."¹⁰⁰ The British authorities realised that neither the colonial administration nor the Hongkong Bank were prepared to sacrifice Hong Kong's economic interests at London's behest.

⁹⁵ See King, *The Hong Kong Bank in the Period of Development and Nationalism*, pp. 350-68, 370, 423, 621-5, 704-5.

⁹⁶ On this process, see Lau Chi Kuen, *Hong Kong's Colonial Legacy* (Hong Kong: Chinese University Press, 1997), pp. 88-93.

⁹⁷ Anthony B. Chan, *Li Ka-shing. Hong Kong's Elusive Billionaire* (Hong Kong: Oxford University Press, 1996), p. 87; King, *The Hong Kong Bank in the Period of Development and Nationalism*, p. 711; Anthony Rowley, "A twist to the power game. Hongkong-Chinese interests snap up a huge chunk of Hutchison shares," *FEER*, 5 October 1979.

⁹⁸ Leo Goodstadt, "The weekend Wardley won Wharf for Pao," *Asian Banking*, August 1980; Robin Hutcheon, *First Sea Lord. The Life and Work of Sir Y. K. Pao* (Hong Kong: Chinese University Press, 1990), pp. 95-100.

⁹⁹ Christopher Marchand, "Showing the colours: Jardines pays heavily to keep its hold on Hongkong Land," *FEER*, 19 May 1988.

¹⁰⁰ Monopolies and Mergers Commission, *The Hongkong and Shanghai Banking Corporation. Standard Chartered Bank Limited. The Royal Bank of Scotland Group Limited. A Report on the Proposed Mergers* (Cmnd 8472/1982), pp. 88, 90.

An Overview

This account of the development of banking policies in Hong Kong after World War II and their effect on the Hongkong Bank highlights the peculiar nature of laissez faire in the colonial administration's management of the economy. There is considerable merit in the claim that finance was "the one sector where there seems to have been a true adherence to 'positive non-interventionism'."¹⁰¹ But another distinguished economic historian has argued that such non-interventionism was contrary to the true concept of laissez faire. The colonial administration totally disregarded its responsibility "for maintaining a sound currency and a sound credit structure," he insisted, thus rejecting a duty of the state which had led nineteenth-century Britain to restrict "the powers of bankers and the owners of capital" – in marked contrast to twentieth-century Hong Kong.¹⁰²

Unaccountable Government

How was the colonial administration able to survive the frequent crises and scandals that caused serious public panics? The answer lay in the peculiar political arrangements of the time. The Government was under no compulsion to account for its failings to the public because it appointed the entire legislature until 1985 when the first elections for a handful of indirectly-elected seats took place. Furthermore, the secrecy which surrounded the management of the colonial administration's reserves meant that the costs of bank and market failures could be concealed from the community. Rescue operations were financed by the Exchange Fund whose operations only became accountable after the establishment of the Hong Kong Monetary Authority.

Significantly, hard on the heels of the 1985 elections for a few indirectly-elected members, the colonial administration was forced to give the legislature for the first time a public account of decisions to rescue the latest bank failures and of the Exchange Fund's role.¹⁰³ Equally, for the first time since World War II, legislators refused to accept officials' invocations of Exchange Fund secrecy and cryptic references to threats to Hong Kong's financial survival.¹⁰⁴ This public discussion marked the start of a new era in regulatory policy as the colonial administration now faced real political costs if it failed to eliminate the market failures and corporate collapses that had been recurrent problems for the financial sector since World War II. The Government could be taken to task in

¹⁰¹ Schenk, *Hong Kong as an International Financial Centre*, p. 15.

¹⁰² A. J. Youngson, *Hong Kong's Economic Growth and Policy* (Hong Kong: Oxford University Press, 1982), pp. 13, 134.

¹⁰³ See Sir John Bremridge, Financial Secretary, *Hong Kong Hansard*, 9 April 1986, pp. 981-7. Bremridge made it plain that blunt criticism in the legislature of the Government on legal and political grounds had compelled him to defend his record publicly.

¹⁰⁴ Before World War II, at Hong Kong's own request, London had agreed that the Exchange Fund's secrecy could be relaxed. R. A. C. North, Colonial Secretary, *Hong Kong Hansard*, 13 October 1937, p. 111. No convincing reason was put forward to explain why total secrecy was imposed after 1945, especially when other territories under British rule, such as Malaya and Singapore, published their accounts. See Frank H. H. King, *Money in British East Asia* (London: HMSO, 1957), pp. 122, 158 *et seq.*

public by legislators who owed it nothing and who could compel officials to answer their enquiries.

Cultural Adjustments

The Hongkong Bank was able to survive the social and political transformation of Hong Kong during the uncertainties of the second half of the last century partly through its own willingness to look beyond the limits of its colonial past. Senior executives showed an unexpected capacity to overcome their lack of familiarity with Asian languages and culture. Despite these handicaps, they found ways to cultivate a new and very different generation of entrepreneurs as Hong Kong switched from its dependence on the China Trade to manufacturing for export in response to the Korean War and the economic blockade of the Mainland. These executives also had the perspicacity to allow the Hang Seng Bank to retain its separate and totally Chinese identity after its takeover in 1965. In this way, the very colonial Hongkong Bank had a wholly Chinese subsidiary to cater for those segments of the community which felt uncomfortable in a Western business environment.

In all this, the Hongkong Bank was very different to the rest of its British compatriots. None of them was able to retain the superior commercial status with which they had entered the 1970s. Unlike the bank, they had all been overtaken by Chinese rivals. Nor could any Hong Kong firm – Chinese or British – match the bank's success in transforming itself from a predominantly Hong Kong operation into a truly global enterprise.

Political Realities

The Hongkong Bank learnt throughout Asia that the tide of nationalism and anti-colonialism meant that it could not afford to put British interests ahead of the ambitions of the newly-independent nations.¹⁰⁵ Even in colonial Hong Kong, its British identity carried a political risk when radicalism ran rampant on the Mainland. For example, during the worst political violence of the colonial era when the extremism of the Cultural Revolution spilled over into bombs, strikes and rioting in Hong Kong during 1967, the bank lost 13 per cent of its total deposits.¹⁰⁶ Against this background, the bank had little incentive to display much sentimental attachment to its commercial compatriots when they proved unable to compete with their Chinese rivals in Hong Kong.

It took a similar attitude towards its political ties. As far as possible, commercial considerations were its priority in managing relations with the governments it encountered. Thus, the bank's Chairman made no secret of his opposition to Christopher

¹⁰⁵ For example, King, *The Hong Kong Bank in the Period of Development and Nationalism*, pp. 340-4.

¹⁰⁶ Between the start of the crisis on May 10 and the end of the active confrontation in October that year. HKRS 163-1-3275 "BANKING STATISTICS VARIOUS – 1967," (88) Commissioner of Banking to Financial Secretary, 6 November 1967.

Patten's political reforms for Hong Kong that were supported by London but opposed by Beijing.¹⁰⁷ But he was not afraid to ignore China's expressed wishes. For example, in 1984, Deng Xiaoping had asked the British Foreign Secretary to ensure that the colonial administration prevented the bank from moving its headquarters from Hong Kong because of the potentially adverse impact of such a relocation on international business confidence.¹⁰⁸ The bank nevertheless chose to shift its headquarters to London in 1993. Ironically, it did not suffer from the same displays of resentment from Beijing that had followed the Jardine group's decision to transfer its headquarters to Bermuda in 1984.¹⁰⁹ Any suggestion of retaliation in the 1990s against an institution as vital to Hong Kong's stability as the Hongkong Bank would not have been in Beijing's own interests.

By the end of the twentieth century, the post-colonial rulers of Hong Kong no longer felt any dependency on the bank. In 1980, officials had rejected the suggestion that there should be open competition for the Government's banking business instead of automatically using the services of the Hongkong Bank.¹¹⁰ In 2001, it was announced that henceforth, the Government's bankers would be chosen through open competition.¹¹¹ The Hongkong Bank would remain a formidable competitor for government business on its own merits.¹¹² But the new policy symbolised how changed was the bank's role in Hong Kong affairs.

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¹⁰⁷ Jonathan Dimbleby, *The Last Governor. Chris Patten & The Handover of Hong Kong* (London: Little Brown & Co, 1997), pp. 175, 226.

¹⁰⁸ This account comes from British diplomats who were present at the encounter with Deng in July 1984. The published version of Deng's remarks did not name the Hongkong Bank directly. Deng Xiaoping, *On the Question of Hong Kong* (Hong Kong: New Horizon Press, 1993), p. 14.

¹⁰⁹ On Jardine's retreat to Bermuda, see Leo Goodstadt, "The Flight from Hong Kong," *Euromoney*, July 1984, p. 99 and "The Bermuda Transfer," *Asiabanking*, May 1984, p. 36.

¹¹⁰ Leo Goodstadt, "Hong Kong: The fight for a market share," *Euromoney*, July 1980, p. 96. The Standard Chartered Bank was also given preferential treatment as a note-issuing bank but on a smaller scale.

¹¹¹ Denise Yue, Secretary for the Treasury, *GIS*, 9 May 2001.

¹¹² Already demonstrated by the bank's success in 2000 in winning the tender to provide the United States dollar clearing facility established by the Hong Kong Monetary Authority. *GIS*, 9 March 2000.

Statistical Appendix

This appendix provides a variety of statistical information derived from the unpublished monthly returns that the former Banking Commission used to obtain from the banking industry.¹¹³

Table I: The Banking Industry: Shares of the Hongkong and Hang Seng Banks in Total Bank Deposits and Loans & Advances (percentages)

Year-end	Total Bank Deposits (HK\$mn)	Hongkong Bank	Combined Hongkong & Hang Seng Banks	Total Loans & Advances (HK\$mn)	Hongkong Bank	Combined Hongkong & Hang Seng Banks
1964	6,743	32	42	4,562	28	38
1965	7,764	37	43	5,183	30	39
1966	9,094	34	42	5,475	30	38
1967	8,162	33	44	5,343	32	41
1968	10,367	31	43	6,038	28	37
1969	12,297	34	46	7,884	25	N. A.
1970	14,954	34	46	9,670	26	36
1971	18,785	34	46	11,836	23	34
1972	24,613	34	46	17,726	25	35

Note: N. A. indicates the figures are not available

Tables I and II illustrate the underlying dynamics of the banking market. Table I shows how the Hongkong Bank's market share of deposits benefited from a flight to quality during the bank runs of 1965 but suffered from political anxieties during the aftermath of violent confrontations with Maoist extremists in 1967. It also highlights the

¹¹³ Data for 1964-66 are taken from the statistical returns from licensed banks collected monthly by the Banking Commission. HKRS 163-1-3273, (6) Commissioner of Banking to Financial Secretary, 19 March 1964 and HKRS 163-1-3274, "BANKING STATISTICS VARIOUS – 1966," (28) and (42) Commissioner of Banking to Financial Secretary, 28 February 1966 and 31 January 1967. HKRS 163-1-3723 records the problems that arose in creating accurate and consistent data series. The data for subsequent years are also from unpublished monthly returns, and their source is explained in Leo F. Goodstadt, *Uneasy Partners: The Conflict between Public Interest and Private Profit in Hong Kong* (Hong Kong: Hong Kong University Press, 2004), pp. 233-4. Percentages in the tables may not add up to 100 because of rounding.

contribution to its market dominance from Hang Seng Bank after its takeover in April 1965. This table indicates the basic conservatism of the Hongkong Bank group combined with an acceptance of a responsibility to accommodate the economy's needs in times of crisis. Thus, it allowed its share of total loans and advances to expand during the 1965-67 crises, before shrinking back to the 1964 ratio in 1968.

The combined share of deposits captured by Mainland (i.e., "China state-owned") and local banks, as shown in Table II, was roughly equivalent to the Hongkong Bank group's share, a balance that was maintained over a long period. This table also shows how China's state-owned banks took market share primarily from the local banks after Deng Xiaoping's 1978 economic reforms allowed the Mainland banks to pursue commercial goals with diminishing political constraints. Both Mainland and local banks maintained more conservative ratios of loans and advances than the foreign sector overall.

Table II. Banking Market: Percentage Shares of Total Bank Deposits and Loans & Advances by Bank Ownership

Year-end	Total bank deposits (HK\$mn)	China state-owned banks	Local Chinese banks	Foreign & note-issuing banks	Total bank loans & advances (HK\$mn)	China state-owned banks	Local Chinese banks	Foreign & note-issuing banks
1964	6,743	11	33	56	4,562	8	36	56
1965	7,764	15	24	63	5,183	7	30	63
1966	9,094	14	25	60	5,475	7	29	64
1967	8,162	13	30	58	5,343	6	29	64
1968	10,367	11	31	57	6,038	8	30	62
1969	12,297	12	32	57	7,884	7	29	64
1970	14,954	10	33	57	9,670	7	31	62
1971	18,785	10	34	57	11,836	6	33	61
1972	24,613	9	35	57	17,726	5	32	63
1973	26,191	9	34	57	23,263	5	30	65
1981	105,529	14	30	56	128,204	15	26	59

Table III: Bank Lending against Shares Compared with Total Loans & Advances and
Total Deposits

	December 1970	December 1971	March 1972	June 1972	September 1972	December 1972
Percentage of total loans & advances	8.2	10.96	12.03	14.57	17.46	18.06
Percentage of total deposits	5.3	6.91	7.47	9.03	11.54	13.39

Table III indicates how lending for stock market activities ballooned as share prices took off in the early 1970s. Table IV casts additional light on this process with its examples of lending policies for selected banks. The Chartered and Hongkong Banks were note-issuing banks and pursued conservative lending policies. Mainland and local banks were also cautious. Foreign banks were freer to respond when customer demand swelled during a period of intense market activity (as occurred in the 1972-73 stock market boom). They were able to expand lending in excess of their local deposit base because they could arrange support from their head offices and were thus less constrained by statutory liquidity requirements.¹¹⁴

¹¹⁴ Jao in Ho and Chau (eds), *The Economic System of Hong Kong*, p. 45.

Table IV: Ratio of Loans to Deposits for Selected Banks (percentages)

Year end	1970	1971	1972
Chartered Bank	50	51	55
Hongkong Bank	49	43	54
Hang Seng Bank	54	53	54
Bank of East Asia	59	61	49
Bank of China	28	34	17
Bank of Communications	33	35	47
Bangkok Bank	217	165	114
Belgian Bank	127	103	103
Bank of America	302	299	284
First National City Bank	138	108	246
Chase Manhattan Bank	270	167	255