

The Origins of Anti-Competitive Regulation: Was Hong Kong ‘over-banked’ in the 1960s?

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Summary

In the 1960s, Hong Kong was widely viewed as being ‘over-banked’, with claims that after the spectacular increase in deposit-taking in the 1950s the scope for new market penetration had expired. Competition among existing banks, therefore, was at the expense of the profits and viability of one another. The banks claimed that this excessive competition undermined the stability of the banking system by encouraging risky lending behaviour by banks, and that this situation called for anti-competitive regulation. These claims seemed to be vindicated after two banking crises in 1961 and 1965. The judgement that there were too many banks in Hong Kong has since become entrenched in the standard literature on the development of the Hong Kong banking system.

Two regulatory innovations were specifically aimed at this diagnosis of ‘excessive competition’ – both were retained for over thirty years, until the Asian Financial Crisis of 1997 led to a reassessment of the banking system in Hong Kong. After much negotiation, the Exchange Banks Association (EBA) introduced an interest rate ceiling for deposits to contain competition in July 1964. In May 1965, the Banking Advisory Committee (BAC) successfully urged the government to impose a moratorium on new bank licenses to prevent entry into the market. The Interest Rate Agreement was finally ended in July 2001. The moratorium on new licenses was lifted in 1978 (but re-imposed for 1979-81). However, new foreign banks were restricted to one branch office until September 1999 and three branch offices until November 2001.

Given the longevity of these regulations and their impact on the development of the Hong Kong banking system, it is perhaps surprising that there has been no reassessment of the reasons why they were imposed in the first place. This paper produces new evidence on the scale of banking activity in Hong Kong based on archival evidence and re-calculation of published data. Various measures of concentration and competitiveness are made that cast doubt on the ‘over-banking’ hypothesis. This then undermines the case for the anti-competitive regulation introduced in the 1960s.