HONG KONG INSTITUTE FOR MONETARY RESEARCH

PAINFUL TRANSITIONS: THE IMPACT OF ECONOMIC GROWTH AND GOVERNMENT POLICIES ON HONG KONG'S 'CHINESE' BANKS, 1945-70

Leo F. Goodstadt

HKIMR Working Paper No.16/2006

November 2006

Painful Transitions: The Impact of Economic Growth and Government Policies on Hong Kong's 'Chinese' Banks, 1945-70

Leo F. Goodstadt
Hong Kong Institute for Monetary Research
University of Dublin[1]

November 2006

Abstract

Hong Kong's Chinese banks survived the loss in 1949 of their traditional role in serving the trade and currency needs of Mainland clients and the restrictions imposed on the local gold market. But they allowed foreign banks to overtake them in financing the new manufacturing sector in Hong Kong. Using unpublished archival material, this paper traces how official banking policies encouraged them to cling to their traditional business model until forced to change by a collapse in the property market.

---

[1] School of Business Studies, Trinity College, University of Dublin, Dublin 2, Republic of Ireland

1. Introduction

As Hong Kong transformed itself into a modern manufacturing economy in the first two decades after World War II, its bankers enjoyed a privileged existence. They were free from virtually all official constraints. Statutory regulation was minimal and largely ignored by bankers and bureaucrats alike. The Government had no monetary policy. There was no central bank to influence bank behaviour, either through formal liquidity requirements or even moral suasion. There were no professional bank regulators, and the officials who dealt with banking issues were mostly uninterested and ill-informed. The statutory exchange controls on foreign currency and bullion markets were not enforced.

Within the industry, the most privileged of all were the local bankers. Officials placed great store on the survival of the 'Chinese native bank' as a traditional family enterprise which ought not to be subject to the full rigours of banking legislation or even to the laws which applied to the business world in general. Yet, this favoured group failed to make the most of the opportunities created by the modernisation of Hong Kong as it switched from entrepôt to manufacturing for export. Their status declined, and their numbers shrank.

This outcome is something of a surprise because it ran counter to historical trends in China. From the middle of the nineteenth century until the 1930s, Chinese banks on the Mainland had withstood the challenge from their foreign rivals. These had to contend with the handicaps of 'a formidable language hurdle; low-cost Chinese banks; complex, multiple currencies without a central bank...'.[2] Foreign banks faced very much the same difficulties in post-war Hong Kong and should have been at a serious disadvantage in competing against Chinese bankers.

The tempting explanation for this outcome is that colonial favouritism gave the foreigners their dominant position.[3] Yet, Sir David Li, a prominent Hong Kong banker and vigorous advocate of Chinese banking interests, has declared that 'Chinese businessmen in Hong Kong have never suffered from political or economic repression.'[4] Indeed, throughout the 1950s, the colonial administration was remarkably sympathetic to the difficulties facing the local Chinese banks, as this paper will recount. Furthermore, the Hang Seng Bank demonstrated that colonial rule need not constrain a Chinese bank. By 1964, this 'native' bank had overtaken all its foreign competitors except HSBC, to become the second largest bank in Hong Kong.

---

2 David R. Meyer, *Hong Kong as a Global Metropolis* (Cambridge: Cambridge University Press, 2000), p. 88. For an impressive example of their ability to counter foreign pressures, see Motono Eiichi, '"The Traffic Revolution": Remaking the Export Sales System in China, 1866-1875', *Modern China*, Vol. 12, No. 1 (January 1986), pp. 96-7, 99-100.

3 The advantages which colonialism bestowed on HSBC, Hong Kong's largest bank, are reviewed in Leo F. Goodstadt, 'Crisis and Challenge: The Changing Role of the Hongkong & Shanghai Bank, 1950-2000', *HKIMR Working Paper No.13/2005*, July 2005.

4 David K. P. Li, 'The Development of Chinese Banking in Southeast Asia', in Nyaw Mee-kau and Chang Chak-yan (eds), *Chinese Banking in Asia's Market Economies* (Hong Kong: The Chinese University of Hong Kong, 1989), p. 4.

This paper starts with a discussion of the colonial administration's banking policies and its reluctance to tackle the problems of local Chinese banks during this period. It then assesses the impact on the banking industry of Hong Kong's transition from dependence on the China trade to manufacturing for export to Western markets. There follows a review of three key elements in the traditional Chinese banking model: the revival of the gold market; the creation of a new international money market; and the emergence of a mass residential property market. The paper concludes that the inability of local Chinese banks to dominate the financial landscape despite cultural advantages and favourable government policies can be traced to their failure to modernise their business model. For this, they were not solely to blame. Official tolerance of poor management and outright malpractice reduced their incentives to change in a period when rapid economic growth was creating unprecedented profit opportunities. The analysis relies principally on unpublished archival material.

2. Fortunes of War

After Japan surrendered in 1945, Hong Kong's local, Chinese-owned banks were among the first businesses to resume normal operations in an economy ravaged by four years of enemy occupation. Their prospects looked very promising. Before World War II, these banks had flourished, handling mostly Mainland-related business. They had financed trade in a period when China's commerce was constantly disrupted by political anarchy and natural disasters. They had provided access to gold and foreign currencies first when China had multiple domestic currencies before the Guomindong established its authority and then as Japanese aggression provoked an outflow of capital from the Mainland. They had financed real estate on the Mainland as well as locally. These Hong Kong banks had continued to operate 'underground' throughout the Japanese occupation despite the savage penalties for black market activities. They resumed large-scale operation of their normal business of gold and currency dealing and payments for trade consignments less than a month after the end of hostilities in August 1945.[5]

Labelled 'Chinese native banks', they took on an almost romantic aura during the early post-war years. The *Far Eastern Economic Review* described their role in glowing terms:[6]

> *The influence of the native banks on the Colony's commerce and finance is enormous. Many well-established and financially potent native banks often finance, the biggest trade propositions as well as industrial and construction projects... A big native bank usually has branches in Canton, and other leading towns in South China, Shanghai and North China cities: many banks extend their activities as far as Malaya, the Philippines, Siam and Indo-China ...*

This was to prove the highpoint of both their status and their influence.

When bank licensing was introduced in 1948, Hong Kong had eight China state-owned and 13 foreign-owned banks; 33 Chinese-owned commercial banks; and 78 'Chinese native banks'. These categories were soon to be outdated. Yet, the 'native' label was to remain in use for more than a decade although

---

5 Commander in Chief Hong Kong to Admiralty, top secret telegram, 15 September 1945. Public Records Office (HKRS hereafter) 169-2-26 'Currency and Banking'.

6 'Conditions of Banking in Hongkong', *Far Eastern Economic Review* (*FEER* hereafter), 19 November 1947.

it proved very misleading. The distinction between Chinese commercial banks and the 'native' institutions reflected the Mainland's system. Until the Chinese Communist Party came to power in 1949, a very clear distinction existed between these two groups. The Chinese commercial banks were under tight government control, whereas their 'native' competitors operated outside the government's control and often outside the law.

Before World War II, the commercial bank's main business had been handling government loans.[7] After Japan's defeat, the Mainland authorities exerted even tighter control which, together with mounting inflation, undermined their profitability. The 'Chinese native banks' were the only sector of the banking industry that flourished, even in Shanghai, after World War II.[8] Given the dependence of Hong Kong on the Chinese economy before 1949, it was inevitable that the colony's banking structure was viewed in Mainland terms. This tendency was strengthened by the fact that the colonial administration in this period was negotiating the future regulation of its banking industry with the Mainland's central banking authorities, as the next section will explain.

The distinction between Chinese commercial banks and the 'native' variety was made all the more misleading by the efforts made by Mainland 'native' banks to shed this label when they transferred their operations to Hong Kong. They tended to go 'to great trouble and expense in registering themselves as companies, and, on the surface at least, follow Western banking methods', noted a senior official.[9] That trend was evidence that the 'native' classification was going out of favour. In fact, the prestige of the local Chinese banks was to shrink throughout the 1950s. By the end of the decade, their previous esteem had been replaced by what one official called a 'dubious reputation'.[10] The Government itself had dropped the distinction between the two types of local Chinese banking institutions by the early 1960s.[11]

In 1964, according to internal government statistics, there were 13 China state-owned banks; 36 foreign-owned banks; but only 38 local Chinese banks. In this last group, there were six small, unincorporated businesses which might be regarded as the last survivors of the 'native' banks which had been such a key feature of the industry in the early post-war period.[12] Foreign-owned institutions had become the dominant banking group in the booming, post-war, industrialised economy.

---

7 Leonard T. K. Wu, 'China's Paradox – Prosperous Banks in National Crisis', *Far Eastern Survey*, Vol. 4, No. 6 (27 March 1935), pp. 42-5.

8 See the impressive contemporary analysis in John Ahlers, 'Postwar Banking in Shanghai', *Pacific Affairs*, Vol. 19, No. 4 (December 1946), pp. 384-5, 386-7, 490.

9 Acting Financial Secretary minute to Attorney General, 28 January 1948. HKRS163-1-440 'Banking 1. Banking ordinance'.

10 M. 10 AS(E) to DES, 7 October 1961. HKRS163-3-7 'The Chiu Tak Bank Ltd 1. Application from ... for Banking Licence 2. Balance Sheet of ...'.

11 The Bank of England adviser on future banking regulation ignored the traditional classification in his 1962 report. 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).

12 'Exchange & Financial Markets: Hongkong Licensed Banks & Native Bank Firms', *FEER*, 17 November 1948. The 1964 data are derived from (6) Commissioner of Banking memo to Financial Secretary, 19 March 1965. HKRS163-1-3273 'Banking Statistics Various 1965'. On official confusion about the precise number of licensed banks, see (19) Commissioner of Banking memo to AS (E) 231 December 1965; (22) Commissioner of Banking memo to Financial Secretary, 25 January 1966. HKRS163-1-3273.

Statistical analysis of their decline is handicapped by the Hong Kong Government's refusal to compile economic data in this period. The first comprehensive and reliable banking statistics were collected only in late 1964, when Hong Kong had become a mature manufacturing economy. They show the local Chinese banks firmly in second place and unable to improve their position for the rest of the decade, as Table I indicates.

3. Blaming Hong Kong

This future fall from grace was not apparent to either the Mainland authorities or the colonial administration when, in 1947, the activities of Hong Kong's Chinese banks provoked a Sino-British crisis. The ruling Guomindong blamed Hong Kong and its unregulated financial markets for the relentless collapse of the national currency and galloping inflation on the Mainland.[13] The 'Chinese native banks' were identified as the principal culprits. In the midst of the financial chaos, the Guomindong were anxious to introduce legislation to reform the entire structure of deposit-taking businesses on the Mainland.[14] They were determined that the colonial administration should take parallel measures to suppress business activities and financial transactions in Hong Kong that were illegal under Mainland legislation.[15] The Guomindong ran a vigorous newspaper campaign to whip up anti-British sentiment on the Mainland and threatened to impose what amounted to an economic blockade on Hong Kong if banking reforms were not introduced. The British gave way, and agreed to what one member of the Legislative Council described as a 'leasing of our sovereign rights' in allowing the enforcement of Mainland laws within the colony's boundaries.[16]

In retrospect, British officials plainly had no need to capitulate to a dying régime. The colonial administration, however, was blind to the fatal weaknesses of the Guomindong, partly because of ignorance of Mainland politics and partly because of close working relations with Guomindong officials.[17] Until early 1948, British diplomats believed that they had little choice but to work for the survival of the Guomindong, and they only started to take seriously the possibility of the Chinese Communist Party's victory in May 1948.[18] By then, it was too late. In secret negotiations, the colonial administration had

---

13 The best account of the economic crisis faced by the Guomindong and of the Hong Kong relationship is Catherine R. Schenk, 'Another Asian Financial Crisis: Monetary Links between Hong Kong and China 1945-50', *Modern Asian Studies*, Vol. 34, No. 3 (2000), pp. 744-6 and 749-50 in particular.

14 'Conditions of Banking in Hongkong', *FEER*, 19 Nov 1947.

15 On the negotiations between the colonial administration and the Guomindong authorities, see in particular enclosures (15), (28) and (86). HKRS 163-1-402 'China Trade And Commerce Aide memoire re closer cooperation between China and Hong Kong in connection with trade and exchange control'; enclosures (165) and (289); and Colonial Secretary minute to Governor, 2 July 1948. HKRS 163-1-403 'China Trade & Commerce Aide memoire re closer cooperation between China and Hong Kong in connection with trade and exchange control'.

16 Sir Man-kam Lo, *Hong Kong Hansard*, 20 October 1948, p. 389.

17 The Governor, Sir Alexander Grantham, was personally involved in such relations. Wm. Roger Louis, 'Hong Kong: The Critical Phase, 1945-1949', *The American Historical Review*, Vol. 102, No. 4 (October 1997), pp. 1068, 1070-2.

18 David C. Wolf, '"To Secure a Convenience": Britain Recognizes China – 1950', *Journal of Contemporary History*, Vol. 18, No. 2 (April 1983), pp. 301-3.

already made major concessions to pacify the Guomindong, and legislation had been passed to control commercial and financial activities which the Mainland authorities had criticised.[19]

The 1948 Banking Ordinance had been enacted, requiring deposit-taking institutions of almost every kind to be licensed. To the Hong Kong public, officials justified the new banking law as essential to prevent firms without adequate resources from setting up as banks and also to suppress banking activities which involved speculation or breaches of trade and exchange controls in either Hong Kong or the Mainland.[20] But the supervision it imposed was minimal, and the ordinance was seriously flawed. Furthermore, the negotiations with the Guomindong proved a wasted effort. In 1949, the Chinese Communist Party came to power and needed no help from the British to solve the nation's problems of hyper-inflation, black markets, smuggling and speculation.

4. A Flawed Law

When the new law came into effect, Hong Kong had a two-tier banking industry. In the first group were the foreign banks and the China state-owned banks, whose stability the Government took for granted. The second group consisted of local Chinese banks, which officials regarded as the primary target of the 1948 Banking Ordinance. Initially, this latter group included a substantial number of so-called 'native' banks as well as conventional commercial banks. During the 1950s, the distinction between 'native' and 'commercial' blurred into insignificance. The commercial banks in this group retained much of the business model developed by Chinese bankers in the past, while the original 'native' banks borrowed from the practices and procedures of conventional modern banking.[21]

All banks in existence when the law came into force in 1948 were granted licences on application. Partnerships were licensed as banks contrary to the provisions of this ordinance, while other firms which were illegal associations under the Companies Ordinance also became licensed banks. Many licensed banks were not incorporated and so did not have to have their accounts prepared by approved auditors. Furthermore, officials forgot to insert a requirement into the original legislation to require banks to supply their annual accounts to the Government, and the law was hurriedly amended to remedy this omission.[22] Licences were granted to firms which had no genuine aspirations to function as banks or even to describe themselves as a bank.[23] Some were jewellers or goldsmiths who included their furnace and refining equipment on their balance sheets.[24] Others were money brokers and currency dealers

---

19 Treaty Series No. 9 (1949), Exchange of Notes ... for the Prevention of Smuggling between Hong Kong and Chinese Ports (London: Cmd 7615/1949).

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

21 The best account of local Chinese banks and their traditional business model are Catherine R. Schenk, 'Banking Groups in Hong Kong, 1945-65', *Asia Pacific Business Review*, Vol. 7, No. 2, Winter 2000, pp. 131-154, and 'Banks and the emergence of Hong Kong as an international financial center', *Journal of International Financial Markets, Institutions and Money*, Vol. 12 (2002), pp. 321-340.

22 Official discussion of these and other defects, and the risks to savings depositors in particular, are set out in HKRS163-1-440 'Banking 1. Banking Ordinance 2. Control over the opening and functioning of Native Banks in Hong Kong'.

23 *e.g.*, HKRS41-1-3015 'Tong Ho & Co. Ltd. 1. Application from ... for a banking licence 2. Balance Sheet of ...'.

24 *e.g.*, HKRS41-1-3024 'The On Tai Bank 1. Application from ... for a banking licence 2. Balance Sheet of ...'.

who were able to continue their principal business when their banking operations became insolvent or they voluntarily surrendered their bank licences.[25] Some were insolvent or fraudulent when they first applied for a licence.[26]

This indiscriminate official approval for firms to operate as banks regardless of their suitability was deliberate policy. Senior officials deleted a requirement in the draft legislation for all licensed banks to be limited companies. The colonial administration claimed that 'rogue' banks always had excellent lawyers and incorporated their businesses. The typical 'native' bank of good repute was, however, unfamiliar with the statutory obligations that incorporation would bring, the Financial Secretary insisted, so that it would be wrong to impose corporate status on them.[27]

Behind this decision lay a colonial preconception about Chinese business institutions. Officials looked on Chinese banks as financed not by shareholders but by a network of family and friends and as raising deposits not from the general public but from relatives and business associates.[28] In effect, the colonial administration was seeking to preserve commercial and social practices which had been appropriate to business with the Mainland during periods of political and financial turmoil and when the Chinese economy was barely touched by modernisation.[29]

The new law had established a Banking Advisory Committee with strong banking and business representation. Its members pointed out the dangers of issuing licences without further scrutiny to all existing deposit-taking institutions which applied. A. G. Clarke was acting Financial Secretary, and he rejected this advice on the grounds that 'the real purpose of the legislation was not the protection of the public'. But he admitted that a goal of the 1948 Banking Ordinance was 'to stop the setting up of any more mushroom banks'. As a result, he endorsed the committee's proposal that bank licences should be issued only to applicants with a paid-up capital of at least HKD1 million.[30] Thus, virtually any request for a licence was granted in the 1950s provided that the promoters were able to raise the minimum capital required and nothing discreditable about them was known to the Government. Their banking competence was a minor consideration.

---

25 *e.g.*, HKRS41-1-3014 'The Yue Cheong Hong Bank. 1. Application from ... for a banking licence 2. Balance Sheet of ...'; HKRS41-1-3023 'The Tak Fat Bank. 1. Application from ... for a banking licence 2. Balance Sheet of ...'.

26 *e.g.*, HKRS41-1-3003 'The China Industrial Bank of H. K. Ltd. Application from ... for a banking licence'.

27 Financial Secretary letter to Governor of the Central Bank of China, 19 February 1948. HKRS 163-1-440.

28 This account of the decision to protect 'Chinese Native Banks' is drawn from (33) 'Report of the Select Committee' [of the Legislative Council set up to report on the Banking Bill], 14 January 1948. HKRS 163-1-440.

29 This almost romantic view of the Chinese family enterprise still survives, even in analyses of Hong Kong firms with sophisticated modern corporate structures and impressive records of complex transactions on financial markets. An interesting example is Katharyne Mitchell, 'Flexible Circulation in the Pacific Rim: Capitalisms in Cultural Context', *Economic Geography*, Vol. 71, No. 4 (October 1995), pp. 367, 369-70.

30 M. 1 Acting Financial Secretary to Governor, 14 June 1948. HKRS 163-1-679 'Banking Advisory Committee'.

5. No Nursemaids

Clarke was only in temporary charge of banking affairs at this stage, and his successor reverted to the policy which had prevailed before Clarke had taken over. The new man tried to set standards for local banks by withdrawing the licences of the smaller, badly managed firms which got into trouble. Clarke remained convinced that Chinese businessmen should not be forced to adopt modern corporate practices, and he had little respect for his successor, who, Clarke later complained, 'knew little of the ramifications of Chinese family businesses [and] made use of the [1948 Banking] Ordinance to close down existing banks which were not in a satisfactory position'.[31] (This was a fair summary of what the 1948 Banking Ordinance required the Government to do.)

As soon as Clarke was back in command of banking affairs, the financial problems of the Nam Sang Bank provided him with an opportunity in 1950 to introduce a new policy of virtually unlimited tolerance for local Chinese banks, regardless of whether they were in breach of the 1948 Banking Ordinance or of civil and criminal laws generally. 'We never intended to set ourselves up as nursemaids and governesses to silly people who put their money into shaky institutions', he explained.[32] In 1951, Clarke made an effort to extricate the Government from all involvement in banking matters. The Banking Advisory Committee rejected this proposal, however, and so did the leading representative of the Chinese business community.[33] Clarke also raised the issue with the Governor, claiming that the legislation was unenforceable. 'The [1948 Banking] Ordinance gives me a small measure of control over banks', he said, 'But even this control cannot be made effective unless we have a competent staff of accountants'.[34] In fact, the annual licence fee of HKD5,000 per bank would have comfortably covered the costs of professional inspectors. He made no effort to recruit them.

In the meantime, Clarke had given the smaller local Chinese banks informal but almost total exemption from the 1948 Banking Ordinance.[35] Bank after bank ran out of funds, which the officials responsible for banking often discovered only when they inquired why they had not received their statutory copy of the annual accounts for a year or more. The owners would be sent for and persuaded to raise additional capital, which they were mostly happy to promise. Frequently, the injection of new funds merely bought

---

31 Acting Financial Secretary minute to Governor, 25 September 1951. HKRS41-1-3095 'Far East Commercial Bank Ltd. Application from ... for a banking licence'.

32 The account of this affair is based on HKRS41-1-3044 'The Nam Sang Bank - 1. Application from ... for a Banking Licence. 2. Balance Sheet of ... 3. Cancellation of the Licence of ...'.

33 (38) Financial Secretary in Circular 34 'Far East Commercial Bank Ltd - Bank Licensing Policy', 18 September 1951. HKRS 163-1-679; (8) Financial Secretary letter to Sir Man-kam Lo, 25 March 1952. HKRS41-1-6691 'Banking Operations Legislation for control of ...'.

34 Acting Financial Secretary minute to Governor, 25 September 1951. HKRS41-1-3095.

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

time before their inevitable collapse.[36] Clarke's tolerance did not prevent a severe fall in the numbers of traditional banks, and by 1955, 52 'native' banks had disappeared.[37]

6. A Manufacturing Make-over

The demise of so many was perhaps inevitable because they lacked the financial resources and the banking expertise to adjust to the drastic transformation that the economy was undergoing. Before 1949, normal commercial and financial business with the Mainland was in chaos not so much because of the mounting civil war between the Guomindong and Mao Zedong and the Chinese Communist Party as because of the collapse of the Guomindong's control of the economy and the national currency.[38] These chaotic conditions did not deter the average Hong Kong Chinese bank, although the bulk of their transactions were of such dubious legality that a conventional commercial bank could not touch them.[39]

The victory of the Chinese Communist Party, which became complete in 1949, spelled the end of the armed conflicts, political anarchy and economic disruption for which the local Chinese banking model had been designed. The party took total control of foreign trade and finance, suppressed smuggling and black markets and began to establish a centrally-controlled economy. In the process, Hong Kong's historical role of entrepôt and transhipment centre for the Mainland disappeared.

Although these developments were regarded by contemporaries as an economic disaster and a threat to Hong Kong's survival, a radical shift in the business environment had already been underway. Local industry had started to develop a growth momentum which was to transform Hong Kong into a major exporter of domestic manufactures in the 1950s. The shift from reliance on re-exports to domestic exports, with their much greater value added, was not immediately apparent because the published trade statistics were patchy for much of the decade. This crucial development is illustrated in Table II, which brings together both the confidential and the published data.

Overwhelmingly, factory production was concentrated in the light industrial sector, with the bulk of output sold abroad. Bankers found it difficult to make a distinction between commercial and industrial loans in an economy where the manufactured product, almost always, had been pre-sold to an overseas buyer.[40] Few manufacturers operated on their own account until late in the last century. They started

---

36 Instances of the problems referred to in this paragraph can be found in HKRS41-1-3012 'Yau Tak Bank. 1. Application from ... for a banking licence 2. Balance Sheet of ...'; HKRS41-1-3021 'The Wo Cheung Bank 1. Application from ... for a banking licence 2. Balance Sheet of ...'; HKRS41-1-3024 'Foo Kee. 1. Application from ... for a banking licence 2. Balance Sheet of ...'; and HKRS41-1-3065 'The Yue Man Banking Co., Ltd. 1. Application from ... for a banking licence 2. Balance Sheet of ...'.

37 Ricardo, 'Development of Banking in Hong Kong during 1955', *FEER*, 2 February 1956.

38 (27) Superintendent Imports and Exports memo to Colonial Secretary, 'Monthly Report – December 1947', 15 January 1948, p. 1. HKRS170-1-554-1 'Report I & E Department'.

39 'The Position & Business of Chinese Native Banks', *FEER*, 18 February 1948.

40 This point was made by both HSBC and Chartered Bank in response to an official request for banking statistics in 1960. (304) A. G. Small, Chartered Bank, 2 December 1960 and R. G. L. Oliphant, HSBC, 3 December 1960. HKRS163-1-625 'Banking Statistics – 1. Supply of ... to S of S 2. Policy Correspondence concerning...'.

production only after receiving a firm order from a foreign buyer (or a local import-export firm), which allowed financing of the factory's activities through letters of credit and other short-term facilities. The provision of trade finance and short-term capital secured against export orders largely via letters of credit, with additional income generated by the associated import and export transactions in foreign currency, left little room for speculation, and the management of credit risk was straightforward. Turnover, both of orders and loans, was rapid. Bank lending could thus support a much higher level of production in manufacturing than in other sectors, property and construction in particular. This was banking of the most traditional and conservative kind.[41]

7. Reluctant Lenders

Foreign banks took the lion's share of this business. They benefited, of course, from their traditional focus on commercial banking as well as from their connections in Hong Kong's new export markets in Western Europe and North America. Hong Kong's leading banking economist believes that the single largest lender to local manufacturers was HSBC and that this bank may have provided as much as half of industry's bank finance during the 1950s. He also demonstrates that HSBC achieved its leading position despite being slow to offer specialised services to industry and to establish a strong presence in manufacturing districts during this decade.[42] Quite simply, HSBC was reluctant to abandon the traditions of the China Treaty Ports, which had preferred British and Westernised Chinese clients, and it was very cautious about appointing Chinese managers.[43] Other foreign banks took much the same attitude.

Local Chinese banks ought, therefore, to have had little difficulty in competing for the new manufacturing customers. Yet, they were not enthusiastic about offering trade-based facilities to the local industrialist. They generally sought to compete with their foreign rivals by providing banking services which were of maximum convenience to the Chinese community. The new manufacturers, however, were not easy for them to serve. They exported to countries where modern commercial banking prevailed and in which transactions had to comply with increasingly strict import and export procedures and to be fully documented. These were orderly markets, very different from the Mainland conditions to which the local Chinese banks were accustomed. Not surprisingly, the average local Chinese bank retained a preference for the patterns of the past: financing gold and currency deals and lending to related parties for property projects in particular, even though they were increasingly exposed to modern commercial banking.[44]

---

41 Attitudes towards credit policies are discussed in Y. C. Jao, *Banking and Currency in Hong Kong*. *A Study of Postwar Financial Development* (London: Macmillan, 1974), pp. 46-9.

42 Y. C. Jao, 'Financing Hong Kong's Early Postwar Industrialization: the role of the Hongkong & Shanghai Banking Corporation' in Frank H. H. King (ed.), *Eastern Banking: Essays in the History of the Hong Kong & Shanghai Banking Corporation* (London: The Athlone Press, 1983), pp. 554, 558-50. His statistical evidence is hard to reconcile with the unpublished data gathered by the Banking Commissioner and presented here in Table III.

43 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. 306-11, 621-5, 704-5.

44 For an interesting profile of the local Chinese bank at the end of the 1950s, see Ng Kwok Leung, 'The Native Banks: Their Structure and Interest Rates', *FEER*, 11 February 1960

Another important factor was the ability of foreign banks to offer trade and industrial finance at margins which local Chinese banks found unattractive. Thanks to a 'liquidity loophole', foreign banks – with the exception of HSBC – had much lower costs of funds.[45] Although Hong Kong did not impose statutory liquidity requirements until 1964, the local Chinese banks, together with HSBC (as the major note-issuing bank), had to maintain a safe margin of deposits over their lending in order to meet the liquidity requirements of their local customers. Especially during the political and economic alarms of the 1950s, they had to be prepared to meet sudden demands for cash during any loss of confidence, either in the banking system or in Hong Kong's political survival.

Foreign banks, by contrast, were more likely to be able to meet flights of funds, either from Hong Kong or from its banking system, by transferring deposits to accounts with their overseas offices elsewhere.[46] Furthermore, head offices could manage liquidity on a global basis and act as lenders of last resort for a Hong Kong branch. In practice, they underwrote the Hong Kong branch's operations through nominal credit facilities made available to it in London and New York. As a result, foreign banks could allow 'loans and advances to industry [to] far exceed ... deposits', as a European banker informed the colonial administration.[47] This special advantage of the foreign bank was to continue even after the introduction of minimum statutory liquidity ratios under the 1964 Banking Ordinance because they were still permitted to satisfy the law's requirements through 'window-dressing' transactions with their head offices.[48]

It is a reflection of the Government's ignorance of the way in which the banks operated that, in the early 1960s, officials denied that a bank's loans could exceed its deposits, and thus they were unaware of the 'liquidity loophole'.[49] When the first comprehensive banking statistics were collected by the newly-established Banking Commission in 1964, the figures showed how significant was the influence of the liquidity loophole on the lending behaviour of the foreign banks. According to these unpublished data, the ratio of loans to deposits for the different banking groups at the end of 1964 was:

- *All banks*: 67 per cent;
- *local Chinese banks*: 73 per cent;
- *China state-owned banks*: 51 per cent;
- *HSBC*: 58 per cent; and
- *other foreign-owned banks*: 81 per cent.

---

45 The way in which the 'liquidity loophole' functioned and its impact on the banking system are discussed in more detail in Leo F. Goodstadt, 'Dangerous Business Models: Bankers, Bureaucrats & Hong Kong's Economic Transformation, 1948-86', *HKIMR Working Paper No. 8/2006*, June 2006, pp. 7-8, 14-6.

46 During the particularly severe political crisis in 1967, officials noted how United States corporate clients of FNCB (now Citibank) shifted deposits to accounts outside Hong Kong. M. 76 AS (EM) to Financial Secretary, 27 October 1967. HKRS163-1-3275 'Banking Statistics Various – 1967'.

47 (302) P. Mardulyn, Manager Banque Belge letter to Deputy Financial Secretary, 30 November 1960. HKRS163-1-625.

48 These arrangements are described in 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. 45. The Government tried consistently but unconvincingly, to argue that these arrangements were conventional deposits rather than 'window dressing'. *e.g.*, Sir Philip Haddon-Cave, Financial Secretary, *Hong Kong Hansard*, 11 April 1979, pp. 706-7.

49 See Deputy Financial Secretary's reply to Mardulyn, (303) 3 December 1960. Also (312) Statistician memo to DES, 'Banking Statistics', 22 April 1961. HKRS163-1-625.

Out of the foreign banks, 11 had loan books which exceeded the total value of their deposits. There were only six local Chinese banks with such high loan/deposit ratios.[50]

Later, when the Banking Commissioner undertook its first detailed analysis of the lending patterns of different groups of banks at the end of the 1960s, when Hong Kong was now a mature manufacturing centre, the difference in the lending patterns of the three groups of banks was very plain. As Table III shows, the foreign banks had built up a dominant position in the finance of industry. Clear, too, was the fidelity of the local Chinese banks to their traditional business model, with its preference for personal lending and the property sector.

It was also striking how conservative were China state-owned banks, both in terms of their loan/deposit ratio in 1964 and in their lending patterns shown in Table III. Their role was to serve the national interests of China in its international financial and commercial activities. Their involvement in the 'capitalist' economy of Hong Kong was subordinate to that priority and, hence, their lending to industry, property and personal customers was limited. But a subsequent section will show how they contributed to the Hong Kong's development as an international financial centre.

8. The Lure of Gold

The failure to exploit the opportunities offered by the boom in manufacturing for export was an error from which the local Chinese banks were not to recover in the twentieth century. Yet, it was to take time for the serious restrictions imposed by the traditional formula of gold, currency and real estate to surface.

Hong Kong's gold market was buoyed up briefly by the Mainland's insatiable demand for gold and foreign currencies as inflation spiralled out of control and the Chinese Communist Party's military victory loomed larger. However, after 1949, this business collapsed as, in marked contrast to the fallen Guomindong régime, China's new rulers rapidly imposed effective controls on all external transactions. Immediately after the 1948 Banking Ordinance was passed, it seemed that gold might be eliminated completely from the business model. London compelled the colonial administration, despite its vigorous protests, to comply with International Monetary Fund (IMF) restrictions and to close the free gold market in 1949.[51] Gold trading at free market prices was to remain illegal until 1970.

In 1953, Hong Kong was allowed to import gold again but only for transhipment. This decision opened a loophole which enabled Hong Kong to become the illicit gold centre for the Asian region. London bullion dealers dispatched consignments via Hong Kong to the nearby Portuguese enclave of Macao, which was not subject to IMF restrictions. Gold could then be smuggled back into Hong Kong, with minimal interference from Hong Kong law-enforcement agencies, to be freely but unlawfully offered for

[50] These data are derived from (6) Commissioner of Banking memo to Financial Secretary, 19 March 1965. HKRS163-1-3273.

[51] For details of the background to this trade, see Catherine R. Schenk's two articles: 'The Hong Kong Gold Market and the Southeast Asian Gold Trade in the 1950s', *Modern Asian Studies*, Vol. 29, No. 2 (May 1995) and 'Banks and the emergence of Hong Kong as an international financial center', pp. 321-340.

sale by local banks.[52] The complicity of both the London and Hong Kong authorities in this illegal trade arose from their anxiety to ensure Macao's survival. Officials believed that any threat to Macao's future would undermine confidence in Hong Kong and that, without the gold trade, Macao's economy would look very fragile.[53] The colonial administration's awareness of the role of local Chinese banks in this trade is highlighted by their heavy reliance in deciding official policy on advice from the Hang Seng Bank about the gold trade and the Macao relationship.[54]

As Table IV indicates, the gold market revived dramatically in the mid-1950s. It was a highly profitable business which helped to offset the declining fortunes of the rest of the re-export sector. Comparison of Table II with Table IV shows that the gold imported was equivalent to 19 per cent of re-exports in 1954, rising to 23 per cent in 1956. Its peak of 31 per cent in 1959 reflected, however, the fact the fall in the total re-export trade had been greater than in the gold market. It seems reasonable to conclude that the gold trade must have made a significant contribution to the survival of local Chinese banks in the 1950s. But it would be unsafe to infer from these statistics that the revival of gold dealing in the 1950s made up for the opportunities these banks missed by neglecting manufacturing.

9. The Money Changers

Currency dealing was the second pillar of the Chinese banks' traditional business model. The loss of the black market on the Mainland as the Chinese Communist Party took control proved a temporary set-back. The colonial administration succeeded in preserving Hong Kong's free market for United States dollars and other hard currencies. Hong Kong, nevertheless, was a member of the Sterling Area and, until 1972, was under an obligation to enforce the Area's exchange controls. In practice, it did nothing of the sort. In the early post-war period, the Governor, Sir Alexander Grantham, issued an informal but effective direction that the regulations were to be administered with as light a touch as possible.[55] A decade later, a confidential report by a United Kingdom official complained about the lack of enforcement and the dishonest or illegal means used to evade the controls.[56] In addition, Hong Kong ensured that London obtained as little information as possible on the size of the free currency market and the unauthorised outflow of hard currency from the Sterling Area.[57]

---

52 (31) Exchange Control memo to Deputy Economic Secretary, 'Import of Gold', 12 December 1966. HKRS163-1-308 'Import and Export of Gold'.

53 This long-standing arrangement was personally confirmed in 1962 by the Governor, Sir Robert Black, in a secret minute. M. 10 Governor to Colonial Secretary, 20 February 1962. HKRS163-1-608.

54 These contacts with the bank are recorded in: note to the file, 7 May 1963; Hang Seng Bank letter, 7 May 1963; M. 23 and 25, 12 and 18 June 1963. HKRS163-1-608.

55 Frank H. H. King, *The Hong Kong Bank in the Period of Development and Nationalism, 1941-1984. From Regional Bank to Multinational Group*, pp. 345.

56 Catherine R. Schenk, *Hong Kong as an International Financial Centre. Emergence and development 1945-65* (London: Routledge, 2001), p. 92.

57 (79) J. J. Cowperthwaite (Hong Kong) letter to W. F. Searle, Chief Statistician, Colonial Office, 8 June 1955. HKRS163-9-88 'Trade. Balance of Payment Statistics. Policy regarding preparation of ...'.

In theory, the average local Chinese bank was well placed to take advantage of the free currency market. Many foreign banks were categorised as 'authorised' institutions and thereby supposed to conform strictly to Sterling Area regulations. But, on the whole, foreign banks were able to escape from the constraints of exchange controls. United States banks in Hong Kong had ample access to American dollars, while continental European banks were able to flout Sterling Area requirements in their currency transactions.[58] For the sake of efficiency, the foreign bank sector found it convenient to maintain relations with individual local Chinese banks because, thanks to the free market, they offered faster and more convenient services to customers outside the Sterling Area.[59]

However, post-war recovery in Western Europe and Japan meant that the international scarcity of dollars was easing in this decade. During the early 1960s, the commercial importance of the free market for local Chinese banks waned still further. The attractions of sterling increased, thanks to high rates of interest and the general convenience of holding reserves in sterling, to which the Hong Kong dollar was then tied by a fixed exchange rate. The Hang Seng Bank, for example, stuck to its 'unauthorised' status after being taken over by HSBC in 1965. Yet, despite this local Chinese bank's freedom from exchange controls, it maintained substantial sterling holdings in London which were left uncovered, despite continuous speculation that the pound would devalue.[60]

Other local Chinese banks had started to take a different view of 'authorised' status in the late 1950s. They saw it as the way to present themselves as 'being completely trustworthy ... an approved bank in the eyes of the world'.[61] This added prestige was more than enough to offset any inconvenience of being subject to Sterling Area regulations, all the more so because officials made little effort to ensure that applicants would comply with their new obligations.[62] Applications for 'authorised' status continued in the 1960s, by which time the distinction between 'authorised' and other banks in terms of banking practice had almost disappeared, regardless of the strict letter of the law.[63] The incentive to change status was now plainly the desire of former 'native' banks for greater market credibility through promotion to the ranks of the modern, Western-style financial institutions and thus leaving behind the roles of money-changer and gold dealer.[64]

---

[58] The allegation came from HSBC. Circular No. 68 'Deutsch-Asiatische Bank' 10 December 1957; Circular 69 'Banque Nationale pour le Commerce et l'Industrie', 11 December 1957. HKRS 163-1-679.

[59] With discreet government endorsement. J. J. Cowperthwaite, Financial Secretary, *Hong Kong Hansard*, 29 March 1963, p. 135.

[60] The Hang Seng Bank's net sterling balances on the eve of London's devaluation in 1967 amounted to HKD194 million: 92 per cent of the total for 'unauthorised' banks and 12 per cent of the total for the entire banking industry. (92) Commissioner of Banking memo to Financial Secretary, 'Net Balances with Banks in U.K. as at 31st October 1967', 24 November 1967. HKRS163-1-3275.

[61] As the first Banking Commissioner was to lament in the following decade. (130) Commissioner of Banking memo to Financial Secretary. 'Hong Kong Industrial and Commercial Bank Limited', 5 February 1968. HKRS163-9-69.

[62] (131) Exchange Controller memo to Financial Secretary, 'Hong Kong Industrial and Commercial Bank Ltd', 9 February 1968 and M. 36 and 37, HKRS163-9-69 'Exchange Control. Banks Authorised to Deal with Foreign Exchange'.

[63] Exchange Control memo to Financial Secretary, 'Exchange Control: Appointment of Authorised Dealers in Foreign Exchange', 29 October 1965. HKRS163-9-69.

[64] (130). HKRS163-9-69.

10. An International Money Market

This concern with respectability emerged as a new wholesale banking operation was developing. Observers have tended to overlook Hong Kong's role as an international financial centre before the end of the 1960s and the extension of the euro-currency market to Asia.[65] Yet, in 1947, Hong Kong's free exchange market and its sophisticated international banking institutions made it the leading Asian financial centre. It had fallen to second place by 1960 only because of the rise of Tokyo and Japan's successful penetration of world markets.[66]

Almost unnoticed by contemporary observers, the Mainland had emerged as an important participant in Hong Kong's international activities early in the Maoist era. Traditionally, China had conducted its overseas trade mainly in United States dollars. The Korean War embargoes made any Mainland business transaction which involved United States currency, corporations or individuals vulnerable to disruption and seizure under American law.[67] But China could still use sterling, the world's other reserve currency in this period. By the mid-1950s, Hong Kong and Mainland bankers had created a new foreign exchange market in Hong Kong through which the Chinese Government was able to buy substantial quantities of sterling which it could use freely and at its own discretion.[68]

The funds to purchase this sterling were generated by the Mainland's exports to Hong Kong, the profits from its Hong Kong assets and remittances from overseas. But this process depended on the tacit cooperation of the colonial administration. Officials prevented the enforcement of exchange control regulations. These could have restricted the ability of China's state-owned banks to function with almost complete freedom from the constraints of exchange controls in managing its 'sterling offtake'.[69] These funds from Hong Kong provided the Chinese Government with a significant and growing source of what amounted to convertible currency. The confidential government files indicate that the new foreign exchange market was not the exclusive preserve of HSBC or the other British banks. Well-established local Chinese banks were also active in this market.[70]

Table V presents the confidential data collected by the exchange control authorities in Hong Kong on the growth of these transactions. The table illustrates the increasing importance of this new financial market to the Chinese Government as the mass campaigns of the Maoist era intensified. The sterling

---

65 Y. C. Jao, 'The Rise of Hong Kong as a Financial Center', *Asian Survey*, Vol .19, No .7 (July 1979), p. 687.

66 Howard Curtis Reed, 'The Ascent of Tokyo as an International Financial Center', *Journal of International Business Studies*, Vol. 11, No. 3 (Winter 1980), 'Table 3 Rankings of Asian International Bank Centers', p. 28.

67 Anthony Polsky, 'With Forked Tongue', *FEER*, 22 May-1 June 1968.

68 M. 106 Deputy Economic Secretary to Financial Secretary, 3 February 1968. HKRS163-1-2660 'Exchange Control Monthly and Half-Yearly Statistics of Foreign Exchange Transactions from January 1961'.

69 The illegalities involved were tolerated in order to facilitate the Chinese Government even when relations with the colonial administration were deteriorating at the height of the Cultural Revolution. M. 42 Assistant Political Adviser, 3 May 1967. HKRS163-1-3275.

70 (10) AE(E) memo to Financial Secretary, 'Bank of China Purchases of Sterling'. HKRS163-1-2055 'Exchange Control Monthly statistics showing China's Purchases of Sterling and Chinese inward remittances'.

obtained through Hong Kong covered a rising share of China's imports during the three years of famine which followed the failure of the 1958 Great Leap Forward. These financial arrangements were essential for maintaining the flow of vital imports in this period of natural disasters, especially as the catastrophe was aggravated by the Sino-Soviet dispute and the disruption of economic relations with the Soviet Bloc.

These arrangements became even more essential during the acute disruption of the domestic economy and Beijing's diplomatic isolation once the decade-long Cultural Revolution got underway in 1966. The Hong Kong foreign exchange market remained sizeable in volume for the next six years as the normal functions of China's Government were restored with considerable difficulty. It started to decline in relative importance only in 1973 when China's trade with the outside world was no longer restricted by a United States' blockade and the Sterling Area itself had come to an end.

During the Maoist era, in short, the worse the political and economic climate that confronted the Chinese Government, the greater Beijing's reliance on Hong Kong's financial institutions. There was thus a remarkably close parallel between the Hong Kong banks' relationship with the Mainland in this period and their historical role in the Mainland economy discussed in the first part of this paper.

11. The Perils of Property

Impressive growth by some local Chinese banks in the 1950s seemed to validate their attachment to the traditional business model with its preference for gold, currency and property. This success, nevertheless, contained the seeds of its own destruction. For too many of these banks, the speculative features of the model were masked by the 'real' assets which were involved. The risk of self-destruction built into the business model emerged dramatically in the early 1960s because of developments in the real-estate sector. In the meantime, however, the attachment to an outdated and increasingly risky business strategy continued, leading even the Hang Seng Bank, the biggest and best of them, to the edge of ruin.

Property owners faced considerable constraints on their freedom to redevelop urban sites in the early post-war period. In 1953, the law was amended to permit owners to clear occupants from damaged or dangerous premises and to rebuild them, which led to a sharp rise in the level of activity in the property market. Until 1956, however, there was a ban on the construction of buildings of more than five storeys (or 80 feet) in height.[71] The law was then changed, which made it possible for property developers to switch to multi-storey residential projects, with individual dwelling units pre-sold to the public. The business seemed conservative enough. An official report described how in 1958 speculation was not a concern and the market had focused on cheaper units. The scale of real estate ventures had altered dramatically, however, with the largest development that year offering 397 flats for sale. By the following year, a mass market was emerging, as the average unit became even cheaper and smaller in size. The largest single project contained almost 1,000 units, with flats now as small as 520 square feet.[72]

---

71 K. M. A. Barnett, Census Commissioner, 'Introduction', in W. F. Maunder, *Hong Kong Urban Rents and Housing* (Hong Kong: Hong Kong University Press, 1969), p. 1.

72 This account is derived from the *Hong Kong Annual Departmental Report by the Registrar General* for financial years 1957-58 (p. 3), 1958-59 (pp. 2-3) and 1959-60 (p. 3).

Property development was extremely attractive to local Chinese banks. Here, they had clear advantages over their foreign rivals. The promoters of these projects were more likely than the new manufacturing class to have personal connections with a local bank. The business itself was entirely familiar and, unlike industrial finance, required no knowledge of international trade practices or overseas consumer markets. The local Chinese bank frequently had associated companies which were active in property development and construction. Where the developers were not family or friends, bank proprietors and senior executives could become quasi-shareholders in their personal capacities by extorting the right to purchase units in the completed building at concessionary terms or better.

The lack of distinction between personal and corporate interests meant, of course, that loans for property projects were not arm's length, and the public's deposits were treated like equity capital. These dubious practices tended to aggravate the historical dangers of the property cycle itself, which even before World War II had led to calls for banking regulation.[73] The inability of individual bankers to resist the heady profits offered by property lending became a major threat to banking stability in the late 1950s. Inevitably, the developers' dependence on their bankers increased, and the commitments of local Chinese banks to real estate grew to a disturbing level, as the Government publicly acknowledged.[74] Officials were deterred from intervening, however, because they felt very dependent on the private sector's contribution to tackling the overcrowding and squalor in which a high proportion of the population was living.[75] So, the bankers were left to their own devices until such times as a new banking law was introduced.

The threat to banking stability had been increased by another risk: fraud or mismanagement which could halt a project before completion. Increasingly, the new, multi-storey developments were being sold on instalment terms prior to completion. This practice appeared to reduce a bank's exposure and to allow an increased turnover of its loans, which could lull its management into believing it safe for the bank to increase the leveraging of its property portfolio. The dangers of such complacency were illustrated in 1960. A project pre-selling 299 units ran out of funds before completion. In this case, a solicitor had diverted part of the purchasers' payments to other projects. The Government moved swiftly to introduce arrangements to protect instalment payments from frauds of this type.[76] This lesson, unfortunately, was not taken to heart by local Chinese banks as a group, and so were laid the foundations of the 1965 bank crisis.

---

[73] The impact of reckless property lending had been a major argument in favour of legislation to regulate banks in 1938. (9) [Ad Hoc Committee 1938], 'Report of Committee', p. 6. HKRS41-1-6691.

[74] The threat from over-involvement in property was a prominent complaint of a Bank of England review of Hong Kong banking. Tomkins, *Report on the Hong Kong Banking System and Recommendations for the Replacement of the Banking Ordinance 1948*, pp. 8-9.

[75] 'It would be very shortsighted to do anything to discourage' the developer. Cowperthwaite, Hong Kong Hansard, 17 January 1962, p. 6.

[76] The project was also riddled by breaches of building regulations and misrepresentation to the purchasers. Details are summarised in HKRS 'Peony House West Block Limited', 28 August 1961. HKRS 54-10-1(406) 'Papers and Documents handed in by Mr Turnbull of Messrs Deacons & Co'; (11) 'Peony House (West Block) Limited', 24 September 1960. HKRS70-3-13 'Building Control. Peony House – Failure of completion'.

Paradoxically, it was to be government intervention in the market that first intensified the property boom and then led to a crash which was followed by the worst bank runs in Hong Kong's history. The announcement in 1962 that building densities would be reduced from 1966 caused a rush to start new projects. These were planned on the basis of completion schedules that proved increasingly difficult to achieve.[77] The situation was aggravated by further controls introduced in 1964 to limit the hazards created by demolition and redevelopment of existing buildings. These regulations slowed down the rate at which construction could proceed and increased the risk of breach of building covenants.[78]

The extreme volatility of the property sector in response to changes in legislation, government policy and political shocks is illustrated by Table VI. A minor change in the law in 1953 unleashed pent-up demand for redevelopment. The 1955 changes in the law relating to building heights and redevelopment of rent-controlled property allowed this upsurge to continue at an increased momentum. The 1962 announcement of proposals to reduce building densities accelerated the trend. The 1964 constraints on rebuilding were followed by a sharp drop in developers' commitments to new projects. Market confidence was also damaged by the bank runs in 1965 and political agitation in the next two years. The real estate sector contracted to the levels of the early 1950s. Property involved far higher risks in the 1960s than local Chinese banks had anticipated and for which they were not adequately prepared, either financially or in terms of management capability.

12. The Costs of Complacency

The Government did not foresee the looming instability which would feed into the banking system from the property market, although officials had become aware of the vulnerability of the local Chinese banks towards the end of the 1950s. Nevertheless, when the Government's policies and performance came under review in 1959, the Financial Secretary saw little scope for improving current practices. When a bank's accounts were unsatisfactory, he stated, his officials would exert pressure on management to rectify this situation which, he declared, was usually effective. But 'small native banks' were ignored and allowed to fail. Tougher conditions were suggested for new licences: a minimum capital of HKD3 million to HKD5 million; the employment of adequate experienced staff; and a probationary period to monitor its operations. He warned, however, that these new obstacles to entry would be attacked as direct discrimination against local entrepreneurs in favour of foreign interests.[79]

Although the Financial Secretary had acknowledged the need for tougher scrutiny of new, local applicants, a licence could still be issued even though officials had serious reservations about the business model

77 The best account of the market consequences of the changing government regulations is Stephen N. S. Cheung, 'Rent Control and Housing Reconstruction: The Postwar Experience of Prewar Premises in Hong Kong' *The Journal of Law and Economics*, Vol. XXII, April 1979, pp. 46-8.

78 The Government was not prepared to accept criticism of its contribution to the creation and collapse of the property bubble. M. 9 PACS (L) to DCS, 15 December 1965. HKRS163-1-3284 'Problems Affecting the Real Estate And Allied Industries'.

79 (86) Financial Secretary, 'Memorandum to Members of the Banking Advisory Committee... Licensing Policy', 23 October 1959, p. 4. HKRS 163-1-679.

and financial arrangements of the promoters.[80] Officials only became concerned about the quality of a proposed new bank if there were a danger of it being located in a region of the colony where political hostility to the Government was already endemic.[81]

The price for past indifference among officials to mismanagement and misconduct became payable in the 1960s. The catalyst was a run on the Liu Chong Hing Bank in 1961. Officials had ignored its involvement in dubious property activities and corruption in the late 1950s.[82] Although the bank's 1961 crisis seemed to involve a liquidity problem, malpractice was also involved because the managing director had 'borrowed' HKD8 million from the bank. Liu Chong Hing was deemed too large to be allowed to fail, and its rescue was organised in 1961.[83] The managing director's death prevented criminal proceedings against him. Leading bankers grew alarmed, and HSBC led a campaign for a new and tougher law. After considerable delay, the 1964 Banking Ordinance was passed, imposing minimum liquidity requirements and restricting the freedom to lend to related parties.[84] The law had been introduced to control the sort of risks created by the property sector and its banking links. But it was too late for the Government to fend off disaster.

Between 1961 and 1965, nine local banks altogether were brought to the verge of collapse. When the Chiu Tai Bank ran into trouble in 1963, the colonial administration hoped initially that the police would start criminal proceedings which would lead to its closure. When this strategy failed, officials stuck to the policy of the previous decade and allowed the bank to fail at the expense of its depositors.[85] In 1965, the Ming Tak and the Canton Trust Banks were also allowed to fail. But official policy had in fact changed. With well over 100,000 depositors at risk, the potential for serious political unrest could not be ignored. The depositors were rescued and repaid in full with the help of a government loan and vigorous management of their assets in bankruptcy by the Official Receiver. But the community had taken fright, and total deposits with local Chinese banks dropped by 30 per cent from January to September 1965 when the crisis was over. By this time, the Hang Seng Bank had been taken over by HSBC, and another four, smaller banks had been kept afloat by the Government through injections of liquidity.[86]

---

80 HKRS934-7-104 'Far East Bank – Tsuen Wan'.

81 HKRS41-1-3099 'The Bank of New Territories, Ltd. Application from ... for a banking licence'.

82 For corruption and general disregard of building and related laws, see *Report of the Committee appointed to consider certain matters concerning the closure of the Chong Hing Mansion 1971* (Hong Kong: Government Printer, 1972), p. 9. On involvement in land auction scandals in 1957-58, see M. 30 ACS(L) to Colonial Secretary, 11 April 1961. HKRS165-9-226 'Land Sales Question of Upset and Reserved Prices. Auction Rings and Transfers of Ownership prior to fulfilment of Conditions of Sale'.

83 The downfall of this bank is summarised elegantly in Catherine R. Schenk, 'Banking Groups in Hong Kong, 1945-65', *Asia Pacific Business Review*, Vol. 7, No. 2, Winter 2000, pp. 145-6.

84 *Hong Kong Annual Departmental Report by the Registrar General for the Financial Year 1964-65* (Hong Kong: Government Printer, 1965), pp. 4-5.

85 The details of this inept procrastination are in HKRS163-3-7 'The Chiu Tai Bank 1. Application from ... for Banking Licence 2. Balance Sheet of ...'.

86 (6) and (16) Commissioner of Banking memos to Financial Secretary, 19 March and 25 November 1965. HKRS163-1-3273.

13. The End of Benign Neglect

The 1965 crisis provided the excuse to introduce new legislation which strengthened considerably the Banking Commission's powers of oversight and inspection, raised capital requirements, tightened the statutory liquidity ratios and restricted new branches.[87] It also led to a new approach to banks in distress. No licensed bank would be allowed to collapse at its depositors' expense until 1991 and the failure of the Bank of Credit and Commerce International (BCCI). Underlying this new policy was the 1964 Banking Ordinance which had created the structure which would allow licensed banks and their lending behaviour to be monitored.

A rejection of the benign neglect of the 1950s had become unavoidable because of the fatal weaknesses in the traditional banking model. Licences had been granted to anyone who could put up the minimum capital. How the bank was managed was not seen as a matter for the Government. As a result, officials looked upon preservation of the minimum level of capital as the measure of a bank's soundness. They attached little importance to liquidity and diversification of lending even though the 1950s witnessed major failures of banks that had concentrated their lending in a local wolfram mine, for example, and in fishing vessels.[88] The official files show that the only limit to official indifference was a serious threat of public discontent.

The rise and fall of the property market in the 1960s demonstrated that banking management and liquidity were the critical factors for banking stability, rather than the initial capital. More important still, the scale of banking had been transformed. Local Chinese banks had realised that they could not rely on family and friends for the funds to function as modern banks. They needed to mobilise deposits from the general public. Once a bank's depositors numbered thousands, the risk of riots in response to a bank's failure could no longer be ignored. The combination of mass housing and mass banking was too much for the traditional Chinese banking model, a fact that the colonial administration could no longer deny.

---

[87] J. J. Cowperthwaite, Financial Secretary, *Hong Kong Hansard*, 12 April 1967, pp. 282-6.

[88] *Hong Kong Annual Departmental Report by the Registrar General* for the financial years 1855-56 (p. 28) and 1956-57 (p. 25); and HKRS41-3-3007 'The Fu Shing Bank of H. K. Ltd. 1. Application from ... for a banking licence 2. Balance Sheet of ...'.

Table I. Banking Market: Percentage Shares of Total Bank Deposits and Loans & Advances by Bank Ownership, 1964-69[89]

Year-end	Total bank deposits (HKD mn)	China state-owned banks	Local Chinese banks	HSBC	Other foreign banks	Total bank loans & advances (HKD mn)	China state-owned banks	Local Chinese banks	HSBC	Other foreign banks
1964	6,743	11	33	32	24	4,562	8	26	28	28
1969	12,297	12	32	34	23	7,884	7	29	25	39

Table II. Domestic Exports & Total Exports, 1950-1960 (HKD millions)[90]

Year	Domestic Exports	Re-exports	Total Exports
1950	197	3,518	3,715
1951	312	4,130	4,433
1952	486	2,413	2,899
1953	635	2,099	2,734
1954	682	1,735	2,417
1955	730	1,804	2,534
1956	1,115	2,095	3,210
1957	1,202	1,814	3,016
1958	1,260	1,729	2,989
1959	2,282	966	3,278
1960	2,867	1,070	3,937

89 Derived from Goodstadt, 'Crisis and Challenge: The Changing Role of the Hongkong & Shanghai Bank, 1950-2000', July 2005, Tables I and II, pp. 24-5.

90 The data for domestic exports for 1950-52 are derived from the unpublished monthly reports in HKRS170-1-554-2/3. The data for 1953-58 are from the serial publication, *Hong Kong Annual Departmental Report by the Director of Commerce and Industry for the Financial Year* (Hong Kong: Government Printer). Figures for subsequent years and for all total exports are from Census and Statistics Department, *Hong Kong Statistics 1947-1967* (Hong Kong: Government Printer, 1969), p. 88. Re-export data before 1959 shown here represent the difference between total exports and estimated domestic exports. The Commerce and Industry Department estimated domestic export data up to 1958 on the basis of those items for which it had issued Imperial (later Commonwealth) Preference and Comprehensive Certificates of Origin. The former category was confined to the Sterling Area and Canada but did not cover the growing markets in Western Europe. The latter covered exports to the United States but not to other dollar countries which did not ban trade with the People's Republic of China. Domestic export figures before 1959 were thus underestimated, while the residual re-export figures were over-estimated.

Table III. Loans & advances by Bank Group and Purpose in 1969 (HKD millions)[91]

Banks	Manufacturing	Import, export & wholesale trade	Retail trade	Building & construction	Stock brokers	Professional & private individuals	Total
All banks	1,490	2,666	179	803	63	1,004	7,884
China state-owned	55	329	30	47	–	49	570
Local Chinese	303	552	35	307	33	706	2,263
Foreign & note-issuing	1,132	1,785	114	449	29	249	5,051

Note: The 'Total' column includes items not otherwise listed in the table.

Table IV. Imports of Gold and Specie for Re-export, 1949-60 (HKD million)[92]

Year	Value	Year	Value
1949	155.4	1955	396.3
1950	15.3	1956	490.4
1951	21.7	1957	403.6
1952	8.2	1958	257.9
1953	26.6	1959	302.2
1954	333.1	1960	292.8

91 Derived from Enclosure 76. HKRS163-3-12.

92 Table 6.2. Census and Statistics Department, *Hong Kong Statistics 1947-1967*, p. 88.

Table V. China's Imports and its Sterling Offtake from Hong Kong, 1957-73 (USD million)[93]

Year	China's Imports	China's Sterling Offtake from Hong Kong	Offtake/ Imports (%age)	Mainland Background
1957	1,510	255	17	Anti-rightist Campaign
1958	1,890	266	14	'Great Leap Forward'
1959	2,120	244	12	Sino-Soviet Split Natural Disasters
1960	1,950	263	13	Natural Disasters
1961	1,450	235	16	Natural Disasters
1962	1,170	297	25	
1963	1,270	412	32	
1964	1,550	524	34	'Four Cleans' Campaign
1965	2,020	636	31	
1966	2,250	714	35	Cultural Revolution
1967	2,020	641	35	Cultural Revolution
1968	1,950	667	34	Cultural Revolution
1969	1,830	679	37	Cultural Revolution
1970	2,330	840	36	Cultural Revolution
1971	2,210	938	42	Cultural Revolution US Embargo Ends
1972	2,860	1,246	44	Cultural Revolution Nixon Visit to Beijing
1973	5,160	1,311	25	Cultural Revolution

93 China's trade data are from State Statistical Bureau of China, *Statistical Yearbook of China 1981* (Hong Kong: Economic Information & Agency, 1982), p. 357. The sterling offtake from Hong Kong is converted into US dollars at the prevailing exchange rates. These funds technically were: External Sterling made available by the Hong Kong Exchange Control to China against Hong Kong dollars. The data for 1957-67 are derived from Floating Sheet 'Monthly List of Total Sterling Purchases by China' and enclosures (1) to (5) in HKRS163-1-2055; 'Monthly Reports from Assistant Financial Secretary to Financial Secretary'. HKRS163-1-2660. The sources for the data for 1968-73 are explained in Leo F. Goodstadt, *Uneasy Partners: The Conflict between Public Interest and Private Profit in Hong Kong,* (Hong Kong: Hong Kong University Press, 2005), pp. 233-4.

Table VI. Index of Urban Redevelopment Plans for Financial Years 1953-54 to 1970-71 (1959-60=100)[94]

Year	Index	Background	Year	Index	Background
1953-54	3	Rebuilding restrictions relaxed	1962-63	326	on densities
1954-55	20		1963-64	131	Restrictions on rebuilding works
1955-56	38	New legislation facilitates redevelopment	1964-65	155	
1956-57	52		1965-66	16	Bank runs
1957-58	74		1966-67	11	Star Ferry riots
1958-59	55		1967-68	5	Anti-British riots
1959-60	100		1968-69	9	
1960-61	129		1969-70	n.a.	
1961-62	286	Rush to beat constraints	1970-71	119	

n.a.: data not available

[94] The index is calculated from applications for court exclusion orders to redevelop existing urban tenement buildings. It is derived from Roderick O'Brien, 'Rent and Tenure Controls for Pre-War Buildings', *Hong Kong Law Journal*, Vol. 7, No. 1 (1977), 'Table 3 Exclusion Orders', p. 41. It measures the initial commitment of a developer to a project. It excludes 'greenfield' projects, which would not have been of great significance in this period. The table does not include data for 1969-70.