

AN INTERVIEW WITH HONG KONG'S CHIEF EXECUTIVE, DONALD TSANG YAM-KUEN

During a November interview at his official residence, Donald Tsang Yam-kuen, Chief Executive of the Hong Kong Special Administrative Region, explained to the Hong Kong Journal why he expects the HKSAR to survive the world economic slowdown relatively well, though hardly unscathed. He also described some limitations that will shape its political future. The text follows:

Q. How will the global economic crisis affect Hong Kong and what can you do about it?

A. Well, the world is a very different world from the last crisis that we handled in 1998. It is much more connected, and for that reason this huge problem that erupted in the United States – particularly dealing with economic fundamentals of the largest economy in the world – will affect the rest of the world... [Including] Europe and Asia. Unless you live in the jungles of the Amazon, you'll be affected by it. And Hong Kong, being a global financial center in this time zone, of course will be affected.

As the level of commodity trade [declines] as a result of contraction of U.S. domestic consumption and European domestic consumption of Asian goods which hitherto have been passing through Hong Kong, we are seeing a reduction of container boxes going across the Pacific from here. And on the services side, clearly it will affect Hong Kong. The amount of trade, with a much less leveraged financial community, means that there will be less transactions, smaller volumes, and that will affect us. That will go into, also, adjustment to the real economy as well, all over the world....

We are in a way, in relative terms, less damaged so far because of the robustness and integrity of our financial institutions. You'll remember that we did a clean-up in 1998 and the years that followed. We merged the institutions, we strengthened the institutions, the regulatory regime has improved, we follow rigorously various edicts coming from [the Bank for International Settlements]. Our banks are well funded with sufficient liquidity which we put into them, and their capitalization is still very healthy. The end result is that none of them needs help. Also our securities market is very robust and all the transactions are being implemented, and there is no

failure in transactions. Of course, there will be ups and downs following...capital into the rest of the global market.

So, superficially, we are all right. But for this year, our growth rate is likely to be trimmed. Earlier in the year we thought we were going to make four to five per cent; I believe we will be very lucky if we can make anything like three and a half, three to three and a half....But we are lucky in relative terms to other economies in the region; some of them have already gone into recession. The unemployment rate remains very low at the moment...but inevitably it will rise in the coming months. The property market remains very stable, again because of the Asian financial crisis current property prices are only about 75 per cent of what they were at the peak in 1997 and 1998. So there isn't much bubble in that market. Then, of course, there is the mainland market which is still growing and which will continue to grow, perhaps with a slower pace in this year and next, but still a growing market and that is important for us. That will provide a very reasonable buffer for us to deal with the crisis to come.

The real challenge for Hong Kong is: how will we be able to come out of this crisis in two to three years time? In fulfilling our aspiration as a global financial center, what are the gaps between ourselves and say, for instance, New York and London that should be narrowed? This will be a real challenge.

Q. What gaps?

A. Gaps in terms of capitalization, popularity in terms of use by global financiers, in terms of market depth and breadth. There is a huge distance, quite significant, between ourselves and London and New York in terms of market sophistication, and also because of the size of the regional market as well. The economy of Asia as a whole is still relatively much smaller in GDP terms than America's, whose securities activities are concentrated in New York or compared with Britain and Europe where most of its securities activities are concentrated in London. After this shakeout, and with the continuous growth of the mainland market, then the various proportions of the global pie might change, resulting in a larger Asian slice.

Q. What would be the incentive for people to make that change?

A. It fuses stability, integrity and return. And here in Asia where you can see, at least so far, there is no debacle of financial institutions unlike what is happening already in Europe and the United States. These are in fact very important intermediaries. When you are dealing with global finance, people will want to place their resources, their money and their wealth in various destinations which will provide the best return, on the one hand, and the most secure return at the same time. And I think Asia can provide that. In Asia, and in Hong Kong in particular, because of our infrastructure, and because of our freedom from restriction on any currency movement, and because of our legal system which is reliable and familiar to our investors globally, we should be in a reasonable position to capture any new business arising from investors thinking of spreading their eggs in different baskets.

Q. One of the themes of the G-20 meeting was the need for more regulation. Do you think Hong Kong needs to follow?

A. Well, there was bound to be a critical look at the regulation of the investment industry, particularly at the level of high leveraging which we have seen in the financial markets over the last decade. Then people also have been questioning the wisdom of the various forms of control that we have. There are several schools of thought. [In] one school of thought you have a super-regulator as we have seen in London or in Australia, and there is also a multiplicity of regulators as you have seen in the United States and here, and elsewhere.

This particular turmoil does not give us the answer to this because even with the super-regulator of the U.K. you can see a total debacle in fact. And similarly in the U.S., even the concentrated expertise of the SEC could not prevent the downfall of Bear Stearns and Lehman. So that question is not answered. The way that financial products are being treated by accountants, the way they are being treated in the books of financial institutions and the amount of leveraging that you should allow to happen in the market will have to be critically examined, and some global consensus would be hoped for and would be very useful.

Hong Kong will be contributing to this process on the basis of experience here and what we have seen after the financial crisis in Asia. There is, to me, inevitably more control, but there is a danger here of overdoing it. The role will continue to grow; financial markets are essential instruments of the modern human race. We must allow [them] to advance,

but to advance at a measured pace and not suddenly to leapfrog as we have seen over the last few years. The problem that we have is that we have the best brains, mathematical brains, of this world not finding good jobs in modern [industry] and suddenly they find themselves in the financial markets making very complicated structures that few other people can understand. And they all are being employed in financial houses designing all these things—maybe a good use of human talent but on the other hand it is highly dangerous. Those talents must be harnessed somehow much better.

Q. The Europeans seem to want to go for heavy regulation. Do you see that as the future?

A. No, I think it is what we have to respect as individual sovereigns taking steps to deal with specific problems. So while we are all connected and our remedy will be in the same direction, the extent to which we apply those measures is very different depending on the seriousness of the situation....I think it is difficult to say who is right or who is wrong; we have to respect sovereign decisions of this kind. The real problem, as I see it, is not that government cannot intervene—government can and should at times—but in intervention we must at the same time have in the back of our minds a clear idea of how we get out of the mess.

In other words, we have to think in terms of exit strategy. For simple intervention, which we made in 1998 buying shares in the open market across the Hang Seng index, we were very clear in our minds that we should get out of the mess as soon as possible. For that reason, as you know, we securitized all the shares and put them back into the market without causing any major disruption. So while you can go headlong into nationalizing banks, buying into various financial institutions and getting yourself into corporate investments, unless you continue to do it this way—which I do not think is the way the world should be managed, bureaucrats running commercial organizations is not the best way to obtain economic growth—I do not believe those measures are sustainable in the long run. So we need to think of ways in which to get out of it.

But, again, it requires nowadays a coordinated strategy. Individual governments taking action would not be as effective as a coordinated approach. Not only being ineffective, it could in fact incur new risks in the markets, causing disruption elsewhere and reverberate back to you, hitting you at the end of the day—if you accept that we are connected after all. Say, for

instance, this time around Dublin decided to protect bank deposits in Ireland, suddenly the whole of Europe follows suit and so does the rest of the world. Now, are we going to do this forever? Of course not. We have to get out of it. But who is to get out first and who is to get out last, and how do we get out of it? That requires a lot of work and thinking, and that is simple compared to getting out of other institutions as well.

Q. Will China play a role in this or do they stand aside as they are not as integrated into the world system?

A. China is a global player in this, but of course it is inhibited by its own closed currency and its capital market is not yet open to trading and international transactions. But China being such a huge economy...has diverted its resources, for instance, into domestic building instead of such reliance on exports. If it maintains its economic growth by public investment as Premier Wen Jiabao has announced, surely it will help. In other words, trade with China will continue and we do not see a sudden shrinking of such a huge economy. It will maintain trade with neighbors, and developed economies like Europe and the United States will still find a ready market.

Q. But there talk that Chinese growth might slow down to 5%, which is high by world standards but for China would be very low.

A. No, I do not believe it will go down to 5%....If you look at it, China is hurt—as everybody is hurt by this financial crisis in terms of GDP growth—but it is so large. If you analyze the figures carefully, one would discover that the net export elements of China at the moment—gross exports less the amount of imports that contribute to those exports—is roughly 10% of the GDP. That will not be lost in its entirety. Even if it is lost by half, that doesn't mean the GDP of China will go to 5% from 12%. I would guess that China would put forward something like 8%, which is very decent and less heady for that matter. That would be very comfortable for the rest of the world and comfortable for China as well.

Q. But there are reports of thousands of factories closing, especially nearby in China, that are owned by companies in Hong Kong and Taiwan. Are you seeing effects here?

A. I'm sure there will be. It is something which exercises our minds seriously at the moment because we have thousands of factories in the Pearl

River Delta that are owned by Hong Kong people. These factories have their managing offices in Hong Kong, so the closing down of any factory will have an effect here as well. So we are helping our manufacturers as much as we can by a number of ways. For instance, we provide a large pool of money for export credits, exports beyond Hong Kong boundaries....We also provide extra help for them for funding purposes by putting money through the local banks, specifically for giving loans to small and medium-sized enterprises operating in the mainland in this moment of stress. And, inevitably, the weaker ones will fail to obtain further orders while their goods for various developed markets in Europe and the United States will face a tough time, and some of them might have to close down.

But I just hope this is a phase we have to go through, Darwinism will reign, and the stronger ones will survive and the weaker ones will be shaken out....On the whole, it wouldn't be a totally lost cause in that we are already seeing a restructuring of the industrial configuration of the Delta by having fewer...polluting industries which impact on the environment or those that are not producing high value-added [goods] for the economy. So there [is] a natural evolution already which will then, of course, be exaggerated by what is happening in their sales markets.

Q. You mentioned two or three years. Is that the timeframe you expect?

A. I really don't know....For me, I would be a very happy man if this particular crisis comes to an end by the close of 2009. But much depends upon the recovery process, and in particular the redress measures which the United States will take in the coming year under the new administration. If [it] adopts a protectionist mode, or extreme measures to salvage uncompetitive industries, then it will be a very, very slow recovery as we have seen in Japan.

Q. Turning to politics, there is a timetable that requires some political reforms for the next elections. What do you have in mind?

A. We have no fixed positions at the moment. One thing I know is that we have to advance the present electoral arrangements for both the election of the next Chief Executive and for the legislature. That is for the next set of elections in 2012 that will then pave the way for elections in 2017 with a universal suffrage system.

The question really is whether we have to come to a consensus what those arrangements for 2017 would be when designing the 2012 arrangements. I'm not optimistic. At the moment, the active politicians on this subject are miles apart on what they want. Some would want a pure one-man, one-vote single chamber solution which I have not seen anywhere else in the world. Some others want full retention of all the functional constituencies, reconstituted to meet the universal suffrage criteria. So we have no meeting point yet. But I'm not despondent at all. I do believe that for the elections of 2012, particularly the positions on these arrangements that come within my term of office, I'm sure will be a significant advancement over the arrangements that we have now.

Q. Do you have any more specific thoughts about what those might be?

A. I do not want to go into specifics. I believe it would be premature. What we will do is that early next year is that we will have a consultation, another consultation specifically on 2012, in light of the discussions we have held in various forums on the subject. And there will be a very noisy debate, typical of Hong Kong, which ends up with a proposition on my part—and that is it. We then have to put it to a test in the legislature, [to see] whether it is likely to win the two-thirds majority required under law for its passage.

Q. Looking ahead, would you see a system in which a majority party would form the government, but perhaps later lose an election with a different party then forming the government? That is, the ruling party changing from time to time over one policy or another?

A. Well, that is a very conventional way of looking at things from an American point of view, with the Republicans and Democrats switching positions [also] the European parliamentary system is something that is not prescribed in the present Basic Law [Hong Kong's de facto constitution]....If we want to adopt the Westminster model, which is a legislature-led government, then we have to rewrite the Basic Law. But I'm sure the party system will grow and we will have some alignment of political philosophy between the executive arm of the government and the legislative arm of government, as in the United States. But it will...not be a tight union...a unified structure as we have seen in London.

Q. My real question is: do you think Beijing would allow a ruling party it favors to lose an election?

A. Beijing has not ruled out anything. But it must be something that can work to produce good results. First of all, it must produce a result that will somehow give stability and prosperity to Hong Kong people as an international financial center and a center of trade as described in the Basic Law. Second, it must work harmoniously and accept fully the central government as the sovereign power, and the chief executive is ultimately, wholly acceptable to the National People's Congress in the mainland. There is no escaping this. We are not a sovereign territory, and we are given universal suffrage—but we have to think carefully about what we need to do.

How the American style and the Westminster style have been practiced in Asia [offers] some good lessons, some necessarily not-so-good lessons. We have seen...in Japan, though it has a multi-party system, that the [Liberal Democratic Party] seems to be able to sustain itself all these years by self-rejuvenation or self-assassination, whatever you call it, by having changes of leadership in rapid succession. We have the American-style congressional system operating in The Philippines, and that doesn't seem to produce the economic goodies that we have. I am saying that we have to find a way that suits Hong Kong, and what is happening in Korea, Taiwan, Thailand and elsewhere we have to study [to see] why it is not working well. So it might be a very good time for us to think all these things through.

At the same time, we are not starting with a clean slate. All I am saying is that I have no fixed position, and while I'm here I hope I can bring people together to find a consensus that would meet the criteria of universal suffrage and at the same time meet those [other] criteria which I mentioned. At the end of the day, we must have a system with which Hong Kong people feel comfortable and particularly one which would help them upgrade their standard of living.

Q. Mention of the standard of living raises the quality of life, the environment.

A. I'm not complacent at all, and this is an area in which we are working very hard, not only here but also in the mainland—particularly in the Pearl River Delta. All I can say is a few things to you: I am not complacent; there is a lot of work yet to be done. I know it is part and parcel

of our claim to be a world city, and we must not only sustain but we must improve. A few things to bear in mind: First of all, in my last policy address...we have formally adopted the World Health Organization's standards. Of course, it will take time but we must move towards these for air quality measurements. Secondly, we intend to import a lot more gas for power generation and we have now signed an agreement with the mainland that will guarantee the supply. This gives us a very good chance to increase the proportion of gas used for power generation purposes from 25%, or 20%, up to 50% if we want to. At the same time, we are taking very active measures here locally on replacing our vehicles with greener vehicles, and we adopting the highest standards in terms of fuel quality...standards similar to California, particularly Los Angeles. We are working hard with the Guangdong authorities on new targets going beyond achievements that we hope to make in any case for 2010—for what we are going to do beyond that, and we are now working on those targets. There are active measures now being taking in Guangdong Province following the national determination to upgrade air quality throughout the country.

Q. But is Guangdong ready to move from the rhetorical to the practical?

A. They are, they are, in terms of enforcing cleaner power generation. [They are] putting a lot of money into various gadgets to take out the sulfur from the effluent of power generation plants, closing down dirty industries including fertilizer plants and so forth, closing down all illegal private power generators...which use dirty fuel....These are measures which they actually do, and they also look at the standards of fuel used by vehicles. Now with the global recession in place, they are also looking at the industrial and manufacturing targets for automobiles. So all these things will help.

....As I have said, I am moving to adopt the WHO standards and these will be institutionalized. I think no country on earth has done that yet; the WHO has been crying like a little lone wolf at the moment and we embrace it, though of course it will take time in terms of compliance.
