Written Views on the Governance of the HKMA

1. I would like to begin by reviewing HKMA's performance according to its own objectives and criteria. The first one, monetary stability, undoubtedly has been achieved. In particular, the HKMA successfully defeated speculators during the Asian crisis of 1997-98. However, some of its tactics and measures, such as threatening the banks with punitive rates in October 1997, and the massive intervention in the stock market in August 1998, were extremely controversial. More important from my point of view, the HKMA, while successful in defending the linked exchange rate, a variant of the Currency Board Arrangement (CBA), has had also to pay a high price in the form of prolonged deflation and stagnation.

2. The HKMA often talks as though the linked rate is the be-all and end-all of monetary and financial policies, and therefore the maintenance of the peg is regarded as a supreme achievement. This view, to put it mildly, is hardly shared by the majority of professional economists. Indeed, the over-whelming majority of them take the view that no single exchange rate regime is right for all countries and at all times. An exchange rate regime is at best a means, not an end in itself. At the end of the day, it is economic welfare that really counts. After all, what is the point of a permanently fixed exchange rate with the USD if the economy is dead?

3. Given Hong Kong's ultra-sensitive forex market, and the very nature of the peg as a sitting duck, no public review of the linked rate can be held without causing the professional speculators to make some moves, as evidenced by the volatility in the forward premium on the USD. The Legco itself had the unhappy experience of cancelling a debate on the linked rate some months ago. Right now, both America and Hong Kong are in the downswing phase of the cycle, so the Fed's low-interest policy suits Hong Kong fine. But the Fed never takes into consideration Hong Kong's interests in formulating its policy. Should the Fed one day decide to raise interest rates vigorously while the Hong Kong economy is still in the doldrums, the consequences could well be catastrophic or

even fatal for Hong Kong. Also, many economists are afraid that any "regime change" at this time might trigger a confidence crisis. So for the time being, they are resigned to an attitude of "if it isn't broke, don't fix it". But this is far from being supportive of the HKMA's dogma that the linked rate is the best for Hong Kong at all times.

4. The HKMA can claim unambiguous success in banking supervision and financial infrastructure. Hong Kong's banking system is one of the best managed and supervised in the world, by international standards. Not one single licensed bank failed during the past decade, even at the height of the Asian crisis. The system's average capital adequacy ratio (CAR) declined marginally to 15.8% at the end of 2002, but it was still one of the highest in the world, in any case much higher than the minimum 8% agreed in the Basel Accord. Its average classified loan ratio was also relatively low at 5.05%. Hong Kong has also one of the most modern and sophisticated payments and settlements system in the world. A USD clearing system has already been in operation, and plans are being made to link up with the Euro clearing system.

5. As to reserve management, although the rate of return in recent years has been disappointing, the worsening investment environment, both locally and abroad, are largely beyond HKMA's control. In any case, a large part of the reserves have already been under outside professional management, so little will be gained by taking reserve management out of the hands of the HKMA.

6. The HKMA shares the task of maintaining and promoting Hong Kong as an international financial centre (IFC) with other government agencies such as the Financial Services Bureau, and statutory bodies such as the Securities and Futures Commission. In reading the International Financial Centre section of the HKMA's latest annual report for 2002, I get the impression that the HKMA has overstated its claims by equating the promotion of its own standing and prestige with the promotion of Hong Kong as an IFC. For instance, the offer of training services for the staff of the People's Bank of China was mentioned as an achievement. Such services, however, have been routinely offered by universities, or professional bodies such as the Hong Kong Institute of Bankers. They may enhance the reputation of the institution concerned, but they have nothing to do with Hong Kong as an IFC. Similarly, participation in various regional central banks meetings and forums was listed as an achievement under International Financial Centre. But even Indonesia's central bank, not noted for

its brilliant performance, also participates in such meetings and forums. So what is so extraordinary about such "achievement"? In my opinion, only objective criteria, such as the quality and quantity of banks and other financial institutions, the volume of financial transactions, the depth and diversity of financial markets, the efficiency and sophistication of payments and settlements systems etc., not public relations exercises, are the real indicators of IFC. Moreover, there are many factors responsible for Hong Kong's status as an IFC, such as economic freedom, national treatment, freedom of information flow, rule of law, business-friendly tax regime etc., which form part and parcel of the Government's traditional policies which had been in operation long before the HKMA was established. So the HKMA should be more modest and not claim too much for its contributions to Hong Kong's position as an IFC.

7. I have also scrutinized the many searching questions which the Legco has posed, and the HKMA's responses to them. The impression is a mixed one. While some answers are reasonably adequate, others are not. For instance, one question is (p. 13) "Why is the remuneration of the Chief Executive of HKMA so much higher than the Governor of the Bank of England, Chairman of the Federal (sic) Services Authority, UK, and the Chairman of the US Federal Reserve System?" Whether the HKMA likes it or not, this is surely the most frequently asked question, both inside and outside Hong Kong, about the HKMA. The HKMA's answer to this question is, not to put too fine a point upon it, both evasive and disingenuous. No one really believes that the job of the Governor of the Bank of England, the Chairman of the Financial Services Authority, UK, and the Chairman of the US Federal Reserve System is any less complex, demanding, and challenging that that of the Chief Executive of the HKMA.

The HKMA argues that its pay packages for senior staff are total cash packages. Presumably this means that there are no separate housing benefits. However, even if housing benefits are taken into consideration, the HKMA pay packages are still much higher than those for the civil service.

In 2002, despite some minor downward adjustments, one Chief Executive had a total package of HK$8.88 million, 3 Deputy Chief Executives had HK$6.056 million each, and 9 Executive Directors had HK$3.505 million each. Together these 13 persons alone cost some HK$58.6 million for the taxpayers.

The HKMA claims that its pay packages are pitched so that they are comparable to, and competitive with, pay for comparable positions in the private sector". This argument is rather self-serving, for the same reasoning can be applied to the civil service. Moreover, it is hypocritical for the HKMA to demand privileged pay packages for its staff while at the same time repeatedly warning the Government that fiscal deficit will threaten the linked exchange rate, the be-all and end-all of its policy.

8. I also share the concerns of the Legco members (paras. 12.3 to 12.13 of the Main Report), about the purchase of new premises at a cost of some HK$3.7 billion. The argument by the HKMA that it needed more space as it might take on new duties concerning consumer protection, supervision of deposit insurance, and the Credit Reference Agency etc. not only is presumptuous, but also give people the unsavory impression of over-eager "empire building". It is by no means certain that these new duties must be taken over by the HKMA. They can be administered by the civil service agencies with much lower costs to the tax-payers. Indeed, the insistence of the HKMA on a privileged pay packages disqualifies it, in my view, from expanding its jurisdiction. Unfortunately, the said purchase has been approved by the CE of the HKSAR, and is therefore a *fait accompli*. However, the Legco is right to insist that in future, all capital expenditure of the HKMA must be scrutinized and approved by it.

9. The HKMA has also many public relations activities which are largely self-promotional. For instance, it has a large External Department, and offices in London and New York. One wonders whether such a large bureaucratic set-up is really necessary or useful to Hong Kong. Another example is that, apart from a Research Department, it also has a Hong Kong Institute for Monetary Research (HKIMR). This is an excursion into academia. But while a research institute in a university, even when under-funded, enjoys high credibility, because it is regarded by the public as independent of the Government, the same cannot be said of HKIMR. It is widely perceived as an instrument or mouthpiece of the HKMA. The HKMA often invites foreign experts to serve as Visiting Fellows at the HKIMR, who may not have deep knowledge of Hong Kong, and whose research may not concern Hong Kong. So what is the rationale for such an expensive undertaking? In short, a lot of self-promotional activities may make the HKMA "feel good", but they may not be useful to or necessary for Hong Kong. It cannot be emphasized strongly enough that the HKMA is not equal to Hong Kong!

10. My written views may be summarized as follows:

(a) The HKMA should be allowed to retain its original portfolios of monetary policy, banking supervision, financial infrastructure, and reserve management. It should also continue to share the responsibility for maintaining and promoting Hong Kong as an IFC with the Financial Services Bureau and the Securities and Futures Commission.

(b) But there should definitely be a limit to the HKMA's jurisdiction. It must not be allowed to engage further in "empire-building" at the expense of the people of Hong Kong. Given the HKMA's insistence that it must enjoy a privileged pay package, the new duties of customer protection, deposit insurance, and Credit Reference Agency etc. can be administered by the civil service at much lower costs.

(c) There is no sound basis for the contention that the HKMA should enjoy a much higher pay package than the civil service. The existing gap between the pay packages of the HKMA and the civil service should be reduced as much as possible.

(d) I support the idea that in future, all capital expenditure of the HKMA must be scrutinized and approved by the Legislative Council.

(e) The HKMA has a lot of public relations activities which are self-promotional, and which can be cut back without hurting Hong Kong.

Y. C. Jao
Honorary Professor and
Honorary University Fellow
（饒餘慶教授）

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