Competition among Financial Centres in Asia-Pacific

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Competition among Financial Centres in Asia-Pacific

Prospects, Benefits, Risks and Policy Challenges

EDITED BY
Soogil Young, Dosoung Choi, Jesús Seade and **Sayuri Shirai**

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Preface

The Korea National Committee for Pacific Economic Cooperation (KOPEC) convened, in collaboration with the Korea Securities Research Institute (KSRI), an International Conference on *Competition among Financial Centres in Asia-Pacific: Prospects, Benefits and Costs — Stumbling Blocks or Building Blocks towards a Regional Financial Community* in Seoul, Korea, on 15–16 October 2007 as part of its contribution to the work of the Pacific Economic Cooperation Council (PECC). Noting that several or more financial centres in Asia-Pacific were respectively engaged in efforts to become premier international financial centres in competition with one another, KOPEC organized this conference to examine the prospects for success for the respective financial centres, weigh the costs and benefits of such competition for local economies as well as the region as a whole, and derive implications of the ongoing competition for cooperation among the regional governments.

The conference examined the cases of seven financial centres in the region — Tokyo, Seoul, Shanghai, Hong Kong, Singapore, Sydney, and Wellington. The conference drew the participation of authoritative finance experts from the economies where these cities were located as case study authors and of a number of distinguished experts and practitioners from in and out of Korea as discussants. The conference was also attended by Mr Dominic Barton, Chairman, Asia McKinsey & Co., who gave the keynote address, as well as Messrs David Cowen, Jong-Wha Lee, and Masahiro Kawai, three senior officials respectively representing the International Monetary Fund (IMF), Asian Development Bank (ADB), and ADB Institute, who provided their insights on the subject matter. The conference drew an attentive audience of about 150 finance professionals and academics, both Korean and international.

The present book consists of papers and commentaries presented at the conference as well as a synthesis paper on the findings. The synthesis paper was jointly authored by Professor Sayuri Shirai of Japan, Professor Dosoung Choi of Korea, Professor Jesús Seade of Hong Kong, and myself, whose respective principal contributions constitute the report in the order listed here. The synthesis paper was publicly released in its preliminary version at the conference on *Global Financial Crisis and the International Financial Centre Competition in Asia-Pacific: Implications and Challenges for Asia and Korea* held in Seoul, Korea, on 4 November 2008, co-organized by KOPEC and the Seoul Financial Forum.

On behalf of KOPEC, I would like to thank all those experts who participated in the 2007 conference as presenters and discussants for their contributions. I also express my gratitude to Asia McKinsey & Co., the IMF, ADB, ADB Institute, the Singapore Committee for Pacific Economic Cooperation (SINCPEC), the Chinese Taipei Pacific Economic Cooperation Committee (CTPECC), Kookmin Bank, and UBS Hana Asset Management Korea for their generous support of the 2007 conference. I am also grateful to the *Financial Times* for its generous Media Partner support for the conference and to Mr John Burton, Singapore Bureau Chief of the *Financial Times*, for his participation in the conference as a panelist. I would like to thank Professors Dosoung Choi, Jesús Seade, and Sayuri Shirai for the honour and pleasure of collaborating with them in organizing the conference, writing the synthesis paper, and editing the conference volume. Finally, I would like to thank the staff of the KOPEC Secretariat for their dedication to the success of the present project.

Soogil Young
Chair
Korea National Committee for Pacific Economic Cooperation
(KOPEC)

Contributors

(In order of the contents)

Soogil Young, President of the National Strategy Institute, an independent think-tank in Seoul, has been serving as Chair of the Korea National Committee for Pacific Economic Cooperation (KOPEC) since November 2006. He served as a Senior Economist at four governmental economic research institutes during 1978–98, including the Korea Development Institute (KDI) as a Senior Fellow, Korea Transport Institute as President, and the Korea Institute for International Economic Policy (KIEP) as President. He served as Korea's Ambassador to the OECD in Paris during 1998-2001 where he concurrently served as Chairman of the Advisory Board on the Development Centre. He has been active on many blue-ribbon committees for the Korean government on economic policy matters since the early 1980s, including three Presidential Commissions. He was the founding Coordinator of the PECC Trade Policy Forum during 1983–86 and also of the PECC Finance Forum during 2001–05. He obtained his Ph.D. in Economics from the Johns Hopkins University in the United States. He was decorated with the Medal of National Service Merit of the Dongbaik Order for his contribution to Korea's epochal *Real-name Transactions Reform* in 1993. He has written extensively on trade, development, and international cooperation from Korea's perspective.

Dosoung Choi has been a member of the Monetary Policy Committee at the Bank of Korea since April 2008. He was a Professor of Finance at Seoul National University (SNU) during 1994–2008. He also served as President of Korea Securities Research Institute (KSRI) from 2005 to 2008 including at the time of his participation in the present project. Before joining SNU in 1994, he taught at the State University of New York at Buffalo and the University of Tennessee. He was a commissioner of the Securities and Futures Commission of Korea during 2001–04. He served as President of two academic societies, Korea Finance Association and Korea Securities Association. He received his B.A. in Business Administration (1974) and M.B.A. degree (1976) both from SNU. He earned his Ph.D. in Finance from the Pennsylvania State University (1980). Over the past three decades, he has published numerous articles in such fields as corporate finance, the market for corporate control, and capital markets in a number of prestigious journals including the *Journal of Finance* and *JFQA*. He has also authored a number of books on M&As, corporate bankruptcies and reorganizations, financial derivatives and risk management, and corporate finance.

Jesús Seade is the Vice-President of Lingnan University since September 2008. He joined Lingnan in January 2007 initially as Chair Professor of Economics. He has been a leading contributor to economic theory, policy and practice from a range of senior positions in academia, government, and international economic organizations. He was Chair of Public Economics at Warwick University in the United Kingdom whose Development Economics Research Centre he co-founded and headed, and was Director-founder of Mexico's leading Economics Department, El Colegio de Mexico's. He has been Mexico's GATT Ambassador and Chief Uruguay Round Negotiator; Deputy Director-General of the World Trade Organization (WTO); and Senior Adviser at the International Monetary Fund (IMF) where he led the internal review work on financial mega-crises cases Brazil, Turkey, and Argentina. Professor Seade's main research interests are in financial markets, fiscal analysis, and trade. At Lingnan, he teaches and leads a research programme on International Financial Centres and heads the Hong Kong APEC Study Centre, which is conducting research and preparing upcoming conferences on finance and trade integration in the region. He is an Honorary Professor at Warwick and Leicester Universities in the United Kingdom and senior advisory board member at Georgetown Law School in the United States.

Sayuri Shirai is a Professor of Economics at the Faculty of Policy Management, Keio University. She gave lectures on International Finance and Japanese Economy at the graduate and undergraduate schools of Sciences-Po, France as a Visiting Professor from 2007 to 2008. She graduated from Keio University and holds a Ph.D. in Economics from Columbia University. She was formerly an Economist at the International Monetary Fund (1993–98) and a Visiting Scholar at the ADBI Institute (2000–03). She also worked as a consultant for UN ESCAP and OECD and as a Visiting Scholar for JICA and Tokyo Foundation. She also participated in a number of committees and commissions organized by the Ministry of Finance (MOF), Cabinet Office, Ministry of Economy, Trade and Industry (METI) and other government institutions. Her research interests cover a wide range of areas, including international financial system, macroeconomic policy, economics of development, as well as global and Japanese economies. She is the author of numerous articles in professional journals. She has also published seven books in Japanese (all single authored) on China's exchange rate regime, Hong Kong's currency board system, IMF policy, economic crises, Japan's macroeconomic policy, and ODA policy. She also co-edited *How to Strengthen Banks and Develop Capital Markets in Post-crisis Asia* (Keio University Press, 2004).

Dominic Barton, McKinsey's Chairman of Asia, is a leading thinker on financial sector reform, sustainability, and corporate governance in both the public and private sector. His advisory in such areas as consumer finance, banking and securities, private equity, and insurance has helped to transform clients from local and regional players into global leaders and top performers. In the area of financial sector reform, his experience has been sought by such diverse audiences as the top government planning body in China, the National Development and Reform Commission, the Korean Financial Supervisory Commission, and the Monetary Authority of Singapore. He also serves on McKinsey's shareholder committee, the firm's senior governance body, and has been with the firm for twenty-one years. He is the author of *Dangerous Markets: Managing in Financial Crises* (2002) and *China Vignettes: An Inside Look at China* (2007). McKinsey & Company is a leading strategic management consultancy with more than 13,000 employees in its 83 offices across 45 countries.

Tan Khee Giap graduated with a Ph.D. from the University of East Anglia, England, U.K. in 1987. He has consulted extensively with the various government ministries, statutory boards and government-linked companies of the Singapore government, including the Ministry of Finance; Ministry of Trade and Industry; Ministry of Manpower; Housing and Development Board; Civil Aviation Authority of Singapore; Singapore Tourism Board; Trade Development Board; Maritime Port Authority; Ministry of Information, Communications and the Arts; Media Development Authority; Singapore Press Holdings; Mendaki; StarHub; and Capital Land, on policies concerning financial, fiscal, trade, tourism, public housing, labour, telecommunication, tourism, creative industry, media, airport and seaport activities. He has also served as a consultant to such international agencies as the Asian Development Bank; Asian Development Bank Institute; United Nations Industrial Development Group; World Gold Council; ASEAN Secretariat, Central Policy Unit, Hong Kong; Kerzner International; Las Vegas Sands; and other international financial institutions and multinational corporations. He has published in international refereed journals, including *Applied Economics, Asian Economic Papers, Review of Pacific Basin Financial Markets and Policies,* and *Competitiveness Review* in the areas of capital flows, economic forecasting, financial sector liberalization and macroeconomic competitiveness.

Masahiro Kawai joined the Asian Development Bank Institute (ADBI) in 2007 after serving as Head of the Asian Development Bank's Office of Regional Economic Integration (OREI) and Special Adviser to the ADB President in charge of regional economic cooperation and integration. Prior to his assumption as Head of OREI, ADB in October 2005, he was a Professor of Economics at the University of Tokyo's Institute of Social Science. He also served as Chief Economist for the World Bank's East Asia and the Pacific Region from 1998 to 2001, and as Deputy Vice-Minister of Finance for International Affairs at Japan's Ministry of Finance from 2001 to 2003. Kawai began his professional career as a Research Fellow at Brookings Institution (Washington, D.C.) from 1977 to 1978 and then as an Assistant and Associate Professor in the Department of Economics at Johns Hopkins University (Baltimore) from 1978 to 1986. Afterwards, he served as an Associate and Full Professor at the Institute of Social Science, University of Tokyo. He served as a consultant for the Board of Governors of the Federal Reserve System and the International Monetary Fund, both in Washington, D.C. He was also Special Research Adviser at the Institute of Fiscal and Monetary Policy (currently Policy Research Institute) in Japan's Ministry of Finance and a visiting researcher at the Bank of Japan's Institute for Monetary and Economic Studies and at the Economic Planning Agency's Economic Research Institute (currently the Cabinet Office's Economic and Social Research Institute). He has written books and numerous academic articles on international economics; economic globalization and regionalization; regional financial integration and cooperation in East Asia, including lessons from the Asian financial crisis; and the international currency system. He earned his B.A. and M.A. degrees in Economics from the University of Tokyo's Economics Department, and his M.S. in Statistics and Ph.D. in Economics from Stanford University.

Nicholas Gruen is trained in History, Statistics, Law and Economics and has published internationally on various issues including economic liberalization and fiscal policy architecture. He has qualifications in Law (Hons.), History (Hons. — First Class), and Education (Dip. Ed.), all from the University of Melbourne, and Economics and Public Policy (Ph.D.) from the Australian National University. He was adviser to Senator John Button on industry policy and to John Dawkins, both when he was Minister for Employment Education and Training and as Treasurer.

He was appointed to the Productivity Commission in 1994 and again in 1995 where he was Associate Commissioner on five inquiries and Presiding Commissioner on one inquiry and an industry study.

He joined the Business Council of Australia in 1997 where he directed the BCA's "New Directions" programme. In 2000, he founded <www.lateraleconomics.com.au> and <www.peaches.com.au>, a discount finance broker. He is Chairman of <www.onlineopinion.com.au>, Australia's eighteenth most popular Internet site — and a substantial contributor to Australia's thriving policy blog scene. He was a weekly columnist for the *Courier Mail* in 2005 and 2006 and still writes columns frequently for both *The Age* and the *Australian Financial Review*. Lateral Economics' report on making Australia an exporter of fund management services received a good deal of attention when it was published earlier this year. Lateral Economics has consulted to a wide variety of firms and governments both large and small in its seven-year existence. It has recently completed or is in the process of consultancies for the Victorian, South Australian, and New South Wales governments, all focusing on regulating more efficiently.

Xu Mingqi currently holds a full Professorship of International Economics at Shanghai Academy of Social Sciences and serves as the Deputy Director of the Institute of World Economy. He is an Executive Council Member and the Deputy Secretary-General of the Chinese Society for World Economy Studies and the Secretary-General of the Shanghai Society for World Economy Studies. He is also the Executive Director of the Shanghai Research Center for International Finance and a member of the Advisory Board to the Shanghai Municipal Government. He received his university education at Xiamen University and obtained his M.A. and Ph.D. degrees in Economics at Shanghai Academy of Social Sciences. He furthered his studies at the University of Western Ontario in Canada from 1987–88 and did postdoctoral research at Harvard University in the United States during 1995–96. He has frequently been invited to international conferences and has given public lectures both in China and abroad. He has published extensively in professional journals in the fields of international finance, trade, and open macroeconomics mainly in Chinese as well as in English. His most recent book is *Competition and Corporation: Foreign Capital in Yangtze Delta Region* (Shanghai University of Finance and Economics Press, 2008).

Roger Bowden is a Professor of Economics and Finance at the Victoria University of Wellington and director of Kiwicap Research Ltd. Prior to returning to his native New Zealand, he worked or researched at a number of offshore institutions, including the Universities of Manchester, Western Australia, and New South Wales as Professor of Finance and Foundation Director of the Asia-Pacific Centre for Banking and Capital Markets. In addition, he has been Visiting Professor of Economics at the Universities of California at Berkeley and British Columbia; held a Humboldt Foundation Senior Research Award (Forschungspreis) at Bonn University; and visiting fellowships or appointments at the Institute of Advanced Study in Vienna, CEPREMAP in Paris, and the IBRD Development Research Department in Washington D.C. He holds the degrees of B.A., B.Sc., M.A. (Auckland), and Ph.D. (Manchester). Bowden has published many research papers in international journals of finance, economics, econometrics, statistics, management science, and law. He has also been proactive in the development of instrumental or "learning by doing" financial education. He is co-originator of the Victoria International Applied Finance programme at Victoria University of Wellington and more recently has been a contributing author to the risk management and financial risk mathematics modules for the AMCT qualification of the London Association of Corporate Treasurers.

Hansoo Kim is a research fellow at Korea Securities Research Institute (KSRI). Prior to joining KSRI, he was a research fellow at Samsung Economic Research Institute. He holds a doctorate degree in Economics from Indiana University. His primary research interests are international finance and macroeconomics. He is particularly interested in bridging rigorous analysis and practical policy-making. Since joining KSRI in 2006, he has worked in many research projects, including "Importance of KORUS FTA: Financial Services Sector" (with Dr Pil Kyu Kim of KSRI), "Financial Reform in Australia and its Implications to Sydney's Competitiveness as an International Financial Centre" (with Dr Pil-Kyu

Kim), "Strategy to Develop Asset Management Sector in order to Build Financial Hub in Korea" (with Dr Jaechil Kim of KSRI).

Sang Kee Min has been a Professor of International Finance at Seoul National University since 1977. He is currently the Chairman of the Seoul Investment Banking Forum. He was previously the Executive Vice-Chancellor and Dean of the Graduate School at Seoul National University from 2000 to 2001. As Chairman of the Committee for Financial Development in the Ministry of Finance and Economy from 2001 to 2004, he was in charge of financial development and progress in Korea. He also assumed the role of Commissioner of the Korea Stock Exchange Commission in 1997. He was Chairman of the Korea Money and Finance Association from 2002 to 2003 and President of the Korean Academy of International Business from 1994 to 1995. He received his Ph.D. in International Business from the University of Michigan.

David Hong is the President and Senior Research Fellow of the Taiwan Institute of Economic Research, the first private economic think-tank in Chinese Taipei. Before taking the post, he had been Vice-President of the institute from 1997 to 2005. He was also the Director leading the institute's Energy and Environment Division before 1997. In 1993, Hong was named Director of the Bureau of Finance by the Taipei City government. He was the Financial Forecasting Manager of Northern States Power Company in Minneapolis, MN, U.S.A. (1984–93). He was an Adjunct Professor of St Thomas College in Minneapolis (1989–90). He also served as Economic Service Manager, Minnesota Department of Public Service, St Paul, MN, U.S.A. (1975–84). He holds a Ph.D. in Economics from the University of Minnesota.

Hong's research interests include industrial development, economic forecasting, and energy and environmental economic analysis. His recent studies comprise Promotion of New Industries and Technologies, Globalization, BOT, Environmental, Cross-strait Economics, Knowledge-based Economy, Financial Competitiveness, Fiscal Reform, Sustainable Development, Age Concerns, Unemployment, Privatization in general and Taiwan in particular. After being named the Director General of both the Chinese Taipei APEC Study Centre and CTPECC, he has further extended his research interests to APEC and PECC related issues.

Simon Cooper assumed the position of President and Chief Executive Officer of HSBC in Korea effective from 17 March 2006. HSBC employs some 1,250 staff and a further 800 contract workers in Korea and manages its business through eleven branches. Before moving to Korea, he was the Managing Director and Head of Corporate and Investment Banking in Singapore. As Head of Corporate and Investment Banking, he was responsible for the business activities of the Investment Banking Advisory, Investment Banking Financing (Debt Capital Markets, Project Finance, Structured Capital Markets), Transaction Banking, Securities Services (including Bank of Bermuda), and Corporate and Institutional Banking divisions of HSBC in Singapore.

Cooper was previously the Deputy Chief Executive and Head of Corporate and Investment Banking in HSBC Thailand from 2001 to 2003. Prior to his role in Thailand, he had twelve years of experience as a Director in corporate finance with the HSBC Group in London, Hong Kong, and Singapore. He is a graduate of the University of Cambridge and holds an M.A. in Law. He is an alumnus of Columbia Business School.

Hugh Patrick is Director of the Center on Japanese Economy and Business at Columbia Business School, a co-director of Columbia's APEC Study Center, and R.D. Calkins Professor of International Business Emeritus. He joined the Columbia faculty in 1984 after some years as Professor of Economics and Director of the Economic Growth Center at Yale University. He has been a Visiting Professor at Hitotsubashi University, University of Tokyo, and University of Bombay. He has been awarded the Guggenheim and Fulbright fellowships and the Ohira Prize. His professional publications include sixteen books and some sixty articles and essays. He is on the Board of Directors of the U.S. Asia-Pacific Council and is a member of the Council of Foreign Relations. In November 1994, the Government of Japan awarded him the Order of the Sacred Treasure, Gold and Silver Star (Kunnito Zuihosho). He completed his B.A. at Yale University in 1951, earned M.A. degrees in Japanese Studies (1955) and Economics (1957) and a Ph.D. in Economics at the University of Michigan in 1960.

Tan Teck Meng is an accountancy graduate of the University of Singapore and the University of New South Wales. He holds Fellowships in the Institute of Certified Public Accountants of Singapore, Australian Society of CPAs, Institute of Chartered Secretaries and Administrators, Chartered Management Institute, U.K. and The Association of Chartered Certified Accountants, U.K. In 1997, he became the first Singaporean to garner the U.S.-based Wilford L. White Award. He is currently a Professor of Accounting at Singapore Management University where he was the

Founding Deputy President and Provost from 1998 to 2001. Prior to joining SMU, he was Dean of the School of Accountancy and Business (SAB) at Nanyang Technological University (July 1990 to March 1998). Currently he chairs the Singapore National Council for Pacific Economic Cooperation (SINCPEC); the College Advisory Committee of the Meridian Junior College; Hospital Medifund, KK Women's & Children's Hospital; the Entrepreneurship Advisory Committee, National Youth Council; and the GST Board of Review. He serves on the Board of Directors of k1 Ventures Ltd, Kim Eng Holdings Limited, Oriental Century Limited, Raffles Education Corporation, Singapore Reinsurance Corporation Limited, Singapore Shipping Corporation Ltd, Hyflux Ltd, and China Auto Corporation Ltd.

James Rooney was born in Scotland, and he lived in the United States. He has been based in Seoul since 1996. He holds an M.B.A. from Harvard Business School, 1983, Boston. He is a well-known and respected investor, adviser, analyst, consultant and commentator on Korea's economy and financial sector, living in Northeast Asia since 1996, and published the One Million Jobs Report in 1998 focusing on critical policy measures for Korea's economic recovery. He has been participating in the healthy long-term development of the Northeast Asian economy as a market participant, investor, adviser, consultant, and catalyst for change. He also has been internationalizing the Northeast Asian economy to build its future strength by attracting FDI, foreign partners, and companies; by building strategic links to other economies and companies around the world; and by focusing on national and regional development opportunities and strategies. He is currently Chairman and CEO of Market Force Company. He serves as the Vice Chairman of Seoul Financial Forum, and is an outside director for Macquarie Korea Oportunities Management Company.

Sang Yong Park is a Professor of Finance and Dean of the School of Business at Yonsei University in Seoul, Korea. Dr Park received his M.B.A. and Ph.D. in Financial Economics from Stern School of Business at New York University and joined the faculty of Yonsei University in 1984 after an appointment at the University of Southern California. His major areas of research include corporate finance and capital markets. Dr Park has published articles widely in academic journals, including *Journal of Financial Economics*, *Journal of Business*, and other local journals in Korea. He has also participated in the numerous public research projects for reformation of the financial industry and corporate governance in Korea. For the past decade, he held various positions of public nature, including a non-standing Commissioner of the Financial Supervisory Commission, a member of the National Economic Advisory Council for the President of Korea, Treasurer of Yonsei University, the President of Korea Securities Research Institute, a member of the Public Funds Oversight Committee (PFOC) and the Chairman of Asset Disposal Sub-committee of PFOC, the President of Korea Money and Finance Association, and the President of Korea Institute of Directors (KIOD). Dr Park's current positions include a member of the Presidential Committee on Green Growth, an independent Director of POSCO and Shinhan Card, and the Chairman of the Asian Financial Regulatory Committee.

David Cowen is currently a Deputy Division Chief in the IMF's Asia and Pacific Department in Washington. Previously, he was in the IMF's Regional Office for Asia and the Pacific in Tokyo, where he covered regional capital market developments, including for the Fund's *Asia-Pacific Regional Economic Outlook*. He has also worked at IMF headquarters on the India desk. During this assignment, he co-edited a book on India's and China's experience with reform and growth (published in 2005), including comparative experiences with financial sector and capital account liberalization. He has also worked extensively on Vietnam, focusing on public finance and banking sector issues. A U.S. national, he holds a Ph.D. in Economics from the University of Texas at Austin.

Jong-Wha Lee is Head of the Asian Development Bank's (ADB) Office of Regional Economic Integration. He is also the Acting Chief Economist. He has over twenty years of professional experience as an economist and an academic. He worked as Economist at the International Monetary Fund and taught at Harvard University as a Visiting Professor. He had served as a consultant to the Asian Development Bank, the Harvard Institute for International Development, the Inter-American Development, the International Monetary Fund, and the United Nations Development Programme, and the World Bank. He also served as a member of the National Economic Advisory Council in the Republic of Korea. Prior to joining ADB, he was the Director of the International Center for Korean Studies and a Professor of Economics at Korea University. He has published numerous books and reviewed journal articles in English and Korean, especially on topics relating to human capital, growth, financial crisis, and economic integration. A national of the Republic of Korea, he obtained his

Ph.D. and Master's degrees in Economics from Harvard University, and his Master's and Bachelor's degrees in Economics from Korea University in Seoul.

John Walker is Executive Director of Macquarie Bank Limited and Chairman of Macquarie Group of Companies, Korea. He established Macquarie's Korean business in 2000 and it now comprises thirteen businesses. He has been responsible for leading major infrastructure projects and privatizations globally. John has also raised significant private equity and established Macquarie's first overseas-raised and -based investment funds in both infrastructure and general private equity. Prior to joining Macquarie, he was Executive Vice-President of Bankers Trust, Australia and earlier in his career was a very senior Australian Government Official holding a number of CEO posts. He was awarded the Honour of the Order of Australia in 1999. In Korea, he has received the President's citation as "Excellent Contributor in Foreign Direct Investment Inflow in 2005" encouraging Macquarie's contribution to Korea's financial sector. John was the first foreigner to be appointed as a director of the Korea Securities Dealers Association which recently changed into Korea Financial Investment Association. He is also a member of International Financial City Advisory Committee in Seoul Metropolitan Government and a member of Invest Korea Advisory Council which is part of Korea Trade-Investment Promotion Agency (KOTRA).

Kihwan Kim currently serves as Chair of the Seoul Financial Forum and an International Adviser to Goldman Sachs, Asia. His distinguished career bridges academia, public service, and the business world. Following his graduation from Grinnell College in 1957 with a B.A. in History, Kim earned an M.A., also in History, from Yale, and a Ph.D. in Economics from the University of California, Berkeley. Before his return to the Republic of Korea in 1976, Kim taught Economics at a number of universities in the United States, including the University of California, Berkeley.

Since his return to Korea, he has held many important positions in government, including Vice-Minister of Trade and Industry, Chief Trade Policy Coordinator and Negotiator, and Chief Delegate to the South-North Inter-Korean Economic Talks. During the 1997–98 Asian financial crisis, he served as Korea's Ambassador-at-Large for Economic Affairs, playing a key role in the resolution of the crisis. Other important positions he has held in the public sector include President of Korea Development

Institute (KDI) and a Member of the Monetary Policy Board. For most of the 1990s, he was a Senior Adviser at Kim and Chang, the largest and most prestigious law firm in Korea. From 1999 to 2002, Kim served as Chairman and CEO of Media Valley, Inc., a private-public sector initiative to accelerate the development of information-technology industries in Korea.

He served as Chair of the Korea National Committee for the Pacific Economic Cooperation Council (PECC) from 1992 to 2006, and International Chair of PECC from 2003 to 2005. He frequently contributes articles and columns to both domestic and international publications.

Yung-Chul Park is a Research Professor and Director of the Centre for International Commerce and Finance at the Graduate School of International Studies, Seoul National University. He was a member of the National Economic Advisory Council (2003–04), Ambassador for International Economy and Trade, Ministry of Foreign Affairs and Trade (2001–02), and Chairman of the Board at the Korea Exchange Bank (1999–2001). He previously served as the Chief Economic Adviser to the President (1987–88), President of the Korea Development Institute (1986–87), President of the Korea Institute of Finance (1992–98), and as a member of the Central Bank's Monetary Board (1984–86). He also worked for the International Monetary Fund (1968–74). He has written and edited several books, including Economic Liberalization and Integration in East Asia (Oxford, 2006), A New Financial Structure for East Asia (Edward Elgar, 2006) and Financial Development of Japan, Korea, and Taiwan: Growth, Repression, and Liberalization (Oxford, 1994).

John Burton has been the *Financial Times* correspondent in Singapore since 2001 and was previously the newspaper's correspondent in South Korea (1992–2001) and Sweden (1989–92). He also worked in Tokyo and Washington D.C. for several newspapers and business publications before joining the *Financial Times*. He attended George Washington University in Washington, D.C., with a B.A. major in East Asian Studies and a minor in journalism.

Executive Summary

1. THE LANDSCAPE — *POLICY COMPETITION WILL HELP SHAPE COMPARATIVE ADVANTAGES*

Competition among financial centres is intense globally but, in particular, in Asia-Pacific. There are many cities in the Asia-Pacific region that serve as financial centres in their respective jurisdictions or local areas. They do not just compete with one another. They also compete with many financial centres outside the region, especially with such global centres as London and New York.

Our examination of several representative financial centres in the region demonstrates that each of those centres has its unique set of SWOTs (strengths, weaknesses, opportunities, and threats). This means that while a financial centre may not excel in terms of the overall finance business performance, it may do so in specific lines of finance business in which it possesses a comparative advantage. Together with the dynamic nature of competition, it also means that the performance overall, or in specific lines of business, of a finance centre, five or ten years from now, may differ from what is today. The future shape and fortune of the individual financial centres will very much be the result of their policy efforts today. Policy competition matters and is thus quite intense.

2. PROSPECTS — *STRONG POTENTIAL FOR THE GROWTH OF FINANCIAL CENTRES IN THE REGION*

Asia-Pacific's strong macroeconomic fundamentals create a strong potential for the growth of its financial centres as a whole. The region continues to generate huge savings and accumulate wealth. Economic growth in the region will continue to remain high and account for increasing shares in the growth of the global economy. The region also has strengths in its financial industry that augur well for growth in the years ahead. With market economies and globalizing strategies firmly in place for several decades throughout the region, policies and frameworks are wholly supportive of efficiency and expansion. In addition, the Asian financial crisis a decade ago left in its wake a raft of improvements in financial policies and institutions that place these policies and institutions on a solid footing as the region moves on.

Specific policy and structural developments supportive of further growth of the region's financial centres include:

— deeper domestic financial markets;
— improvements in market infrastructure;
— continuing liberalization of trade in services, the capital account, and exchange restrictions;
— increased securitization of domestic assets; and
— rapid growth in Islamic finance.

3. INTERNATIONAL FINANCIAL CENTRE (IFC) COMPETITION — *BREEDS EFFICIENCY IN FINANCING AND INCREASES RETURNS ON INVESTMENT*

Not all financial centres may become internationally competitive, but efforts to compete will be beneficial to them all, enhancing efficiency and economic performance.

Competition breeds efficiency through a number of channels: It rewards excellence among firms; it changes the role and behaviour of regulators and supervisors from a culture of permits and enforcement to focus on quality and results. Competition requires and fosters fairer, more transparent, and, therefore, more reliable financial and capital markets in each jurisdiction. It leads to greater opportunities for profit from and confidence in using cross-border providers, thus expanding international financial business in the region as a whole. It will also promote financial integration among the regional economies with all the attendant benefits as argued below, including increased returns to savers and investors in the region. All this will lower the cost of financing and enhance the efficiency of operators and their ability to compete outside the region.

4. IFC COMPETITION — *MAY BRING INCREASED RISKS, ESPECIALLY INCREASED VOLATILITY, THUS POSING POLICY CHALLENGES*

4.1. Regional Market Fragmentation or Integration?

It is often argued that financial centre competition will lead to greater market fragmentation, and so it will if based on market closure or subsidies to secure the local champion. But IFC competition in the region is not of that persuasion: it consists of a relentless reduction of barriers to trade, to investment, and to movement of capital; and improvements in infrastructure and in legal and regulatory frameworks. All these expand trade, including in financial capital and services, without distorting it and increasingly allow the best player in any particular niche or sub-market to excel and grow. Integration should, if anything, increase.

Greater financial integration will bring many benefits to the regional economies, such as

— lower capital costs for investment;
— less scope for currency and maturity mismatches that underlay the Asian financial crisis in late 1990s and thereby enhance confidence in the system; and
— improve financial resource allocation in the region.

4.2. Increased Volatility from Market Integration?

The development of a financial centre tends to reduce volatility by developing the market and its diversity and liquidity, all of which are stabilizing buffers. But financial competition and integration may also increase exposure to volatility through greater transmission of risks across countries and regions of the world — a point that the U.S. subprime mortgage debacle illustrates. The question is: How best to protect my jurisdiction from potential shocks from abroad. The solution is not isolation, which makes you stable but poor, but a proper and constantly adapting regulatory framework and practice in the face of the constant flow of new financial products and problems. This requires cooperation across constituencies to exchange best practices and jointly address common problems.

4.3. Regulatory Laxity and Forbearance?

Could financial centre competition encourage regulatory laxity and forbearance, again contributing to increased financial risk contagion? The U.S. subprime mortgage crisis alerts us to the serious threat to financial and economic stability from lax oversight. Regulatory laxity and even failure to constantly improve and adapt to the cutting edge of new financial products and problems can pose serious financial risk. This is only a cautionary note for the region as there is no evidence that the problem is significant in Asia-Pacific, and, in fact, major financial markets in the region do have strong regulatory systems in place. Still, the regulatory authorities in the region need to be on a high level of alert to these risks as they try to update as well as internationalize their financial industries.

This task calls for a delicate balancing act on the part of the regulators. On the one hand, regulators need to allow market participants as much flexibility as possible in the provision and innovation of services, enhancing competitiveness of their financial industries. At the same time, they should seek to improve the transparency of the markets, strengthen financial and non-financial corporate governance, and ensure an effective management of systemic risks to the financial industry as a whole, especially as new financial techniques and products emerge over time.

With markets increasingly interdependent and problems intertwined, this again calls for coordinated international efforts to develop an effective yet flexible regulatory system — in short, a "good" regulatory system in each jurisdiction, with appropriate mechanisms for consultation and cooperation, at the regional level but also coordination of policies both in the Pacific region and at the global level.

4.4. Harmful Competition with Tax Incentives or Subsidized Facilities?

Competitive pressures may also make it attractive to use fiscal instruments to attract business or give domestic suppliers an edge in the competitive area through tax incentives or subsidized facilities or even broader reductions in tax levels. The issues are complex. The reality is that there are no best practices on the level of taxation. Still disparities can give rise to friction, particularly if they take the form of targeted tax or subsidy concessions, and create possibilities for investors to evade or avoid tax obligations utilizing those differences across jurisdictions. In the present WTO-compliant policy environment, there is less room for competition through targeted tax concessions or subsidies *per se*. But even those disciplines are less developed for service sectors than they are for goods. If deemed necessary by a number of regional governments, consultative dialogues should be held among the tax policy authorities of the regional governments on tax issues in the manner of the Organization for Economic Cooperation and Development (OECD) dialogue to avoid harmful tax competition.

4.5. Regional Integration — Too Low in Finance and Calls for Facilitation through Regional Cooperation

Integration of regional financial markets has been increasing but so slowly that the level of intra-regional financial flows has stayed very low. Less than 9 per cent of total foreign portfolio investment made by East Asia in 2003 was done within Asia. Why is regional integration so weak in Asia-Pacific? Why do users of financial services in the region choose to place only a markedly small proportion of their financial business in the region while taking most of it to the global financial centres outside the region? The following issues may be raised here:

First, Asian financial systems may have been carrying sustained perceptions of higher risk than those of Europe and North America, perhaps accentuated by the Asian financial crisis of the late 1990s.

Second, market participants seem to prefer established names across financial centres as much as among institutions. Breaking through is a major challenge. Distance in finance matters much less. Global players can be dominant in regional financial markets through branches and subsidiaries and also service customers from afar. The importance of incumbency and relative absence of transport costs create enormous economies of scale both among institutions and among supply centres. These economies of scale result in levels of concentration of world financial business that are ever increasing, creating a causal cycle where being large lowers costs, attracts business, renders it larger, and so on that make London and New York very difficult to contain let alone beat in the search for business, including Asia-Pacific related business.

Third, markets in Asia-Pacific remain segregated, divided into several separate smaller local markets; separate capital markets; separate trading markets in each sub-sector of finance; and separate legal systems, regulatory frameworks, and institutions. Most critically, there is no common, integrated regional payments system.

Fourth, financial centres in Asia have not been able to provide Asian investors and governments with ample, diverse financial products, like those present in London and New York.

Fifth, Asian countries continue to depend heavily on the U.S. dollar as an invoice currency, a foreign reserve currency, as well as an intermediary currency in the foreign exchange markets. As a result, demand for U.S. financial products tends to be greater than financial products denominated in regional currencies.

Lastly, the disclosure system (particularly, accounting and auditing of the financial statements of listed firms) is regarded more reliable in the United Kingdom and United States, as compared with Asian countries.

6. CONCLUSION — *COOPERATE TOWARDS AN INTEGRATED ASIA-PACIFIC IFC NETWORK*

Competition should be pursued alongside cooperation among the regional governments to manage the risks identified above as well as to foster and accelerate financial integration in Asia-Pacific. The ultimate aim in this cooperation should be to create a seamless, unified business area for finance in the region, linking the individual financial centres with one another in a regionwide network of integrated markets with financial institutions operating in those markets in competition and cooperation with one another as internationalized operators, thus forming an "Asia-Pacific IFC Network". This would enable regional financial centres to realize scale economies and compete with global financial centres effectively with consequent gains shared among them through the market competition process.

In a range of respects, having appropriate mechanisms for cooperation and consultation is much needed. To cope with the problem of the risk of volatility, which may be made worse by market integration or possible regulatory laxity attendant on the IFC competition in the region, the national governments should seek regional cooperation to:

— make coordinated efforts to make, and maintain, the national regulatory systems effective, flexible, and mutually consistent, through consultation and cooperation; and
— enhance the existing macroeconomic and financial policy dialogues for early warning signals of possible monetary and financial

instabilities, promoting close collaboration among the national early warning centres.

The mandate and agenda for ASEAN+3 (APT) Finance Ministers' Meeting and the EMEAP (Emerging Market Economies of Asia-Pacific Central Bankers) Meeting should be broadened and strengthened to meet those needs for cooperation.

In order to facilitate regional financial integration, the governments are also advised to pursue regional cooperation in the following four key areas:

— Move towards a seamless space for financial business in the region, starting with the payments system;
— Launch further initiatives towards the creation and expansion of regional bond markets in the Asia-Pacific along the lines of the Asian Bond Market Initiative, which seeks to develop local currency denominated bonds through promoting securitization, credit enhancement, bond settlement systems, and credit rating functions in the region; the Asian Bond Fund (ABF) initiatives, that is, ABF 1 (denominated in the U.S. dollar) and ABF 2 (denominated in local currencies) invested in by EMEAP; and expanding the scope of double listings and cross-listings in stock exchanges in the region;
— Launch ambitious in-region, WTO-consistent free-trade negotiations in financial services among the members of the ASEAN+3 or the ASEAN+6 as a first step towards a regionwide FTA;
— Create arbitration procedures at the regional level to greatly enhance legal comfort for cross-border co-investments and partnerships;
— Promote regulatory convergence in the disclosure systems of financial statements, for example, rule-based *versus* principle-based regulation, U.K.-based single *versus* U.S.-based multiple supervisory system, and regulations over mergers and acquisitions; and
— Further deepen the Chiang Mai Initiative as a mechanism to meet regional short-term liquidity shortages in the event of internationally systemic financial crises, such as the one currently unfolding globally.

In the wake of the Asian financial crisis, the East Asian countries launched a range of financial and monetary cooperation efforts in the context of the

APT Finance Ministers' Meeting Process in the form of the Chiang Mai Initiative, the Asian Bond Market Initiatives, and various policy dialogues. Such efforts should be further enhanced and accelerated, deepening their level of ambition as well as enlarging their scope and addressing the specific suggestions listed above and surely going beyond.

The present time is most opportune for rising to the challenge of regional cooperation for the initiatives listed here. In the wake of the current global financial crisis, there is an urgent need to critically reassess and reform the global financial regulatory system, as well as restructure the financial industry worldwide. Asia-Pacific can and should play a leading role in these processes. The global leadership for financial development coming from the existing global centres in New York and London has been impaired significantly by the crisis. The leadership now has to be repaired and enhanced with cooperation from the rest of the world. The financial centres in Asia-Pacific, and the national governments that regulate and promote them, are well prepared, with the reform and strengthening of their financial markets and industries since the Asian financial crisis of 1997–98 and with the parallel efforts to modernize them under the IFC drives, to contribute to this process collectively as new major participants.

They should contribute not so much with rhetoric but with actions — actions to strengthen themselves as a regional network of IFC and create the regional infrastructure to support this network. Specifically, they should continue their efforts to enhance and internationalize their national regulatory systems and financial industries, cooperating to strengthen both of these at the level of the region and to facilitate businesses across the region, thus progressing toward an integrated Asia-Pacific IFC network. These efforts will hopefully herald the emergence of an Asia-Pacific financial community as well as the ascendancy of a new global financial system with the Asia-Pacific financial centres as an IFC network joining the ranks of market leaders, such as London and New York, in a richer and more balanced array of international financial centres.

Keynote Address

International Financial Centres: The Terms of Competition and Prospects for the Asia-Pacific Region

Dominic Barton

The changing patterns in the global flow of capital are reshaping the world's economic system, and Asia's major financial centres are now poised to gain even greater prominence as hubs of commerce and creativity. As talent, technology and the drive for innovation speed the global mobility of capital, Asia's aspiring financial centres would be wise to examine the processes that have helped the world's leading financial centres to establish their track records of success. By applying those strategies for success, and understanding and anticipating the financial market deepening and shifts in Asia, the Asia-Pacific region's leading cities can seize the coming opportunity to be leading global financial centres.

In this paper, I would like to cover four topics:

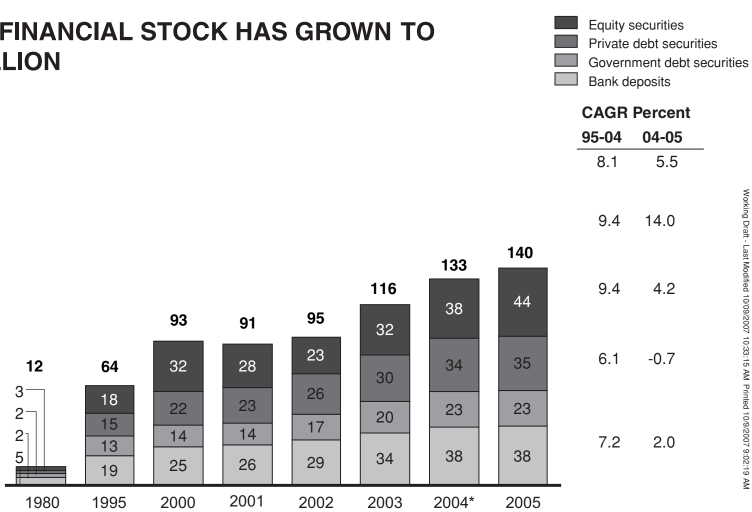
1. Context: Changes underway in the global financial system;
2. Overview of the financial centre strategic map;
3. Key criteria for success as an international finance centre;
4. Implications for cities in Asia-Pacific.

GLOBAL CONTEXT

The fall of the Berlin Wall in 1989 signalled the start of tremendous shifts in the world's financial flows and investment patterns. Since the historic moment when the Wall came down and a half-century of economic barriers dissolved, four forces have ultimately helped determine which cities and which countries would prosper as financial centres. First, liberalization — synonymous with each market's degree of deregulation — allowed capital to move more freely. Second, standardization — the gradual international convergence of the rules that apply to factors like corporate governance, accounting standards and regulatory oversight — clarified the relative merits of competing financial centres. Third, mobility — the easier flow of capital among financial venues — promoted the search for the best return on capital among an ever-wider array of global markets, beyond the traditional hubs of London and New York. Fourth, digitization — the improvement in the amount of information and the speed of its transfer around the world enabled capital to move very quickly (at the touch of a computer button) and allowed investors to

GLOBAL FINANCIAL STOCK HAS GROWN TO $140 TRILLION

$ Trillions



	1980	1995	2000	2001	2002	2003	2004*	2005	95-04	04-05
Nominal GDP $ Trillions	10.1	29.4	31.7	31.6	32.8	36.9	41.4	44.5	4.2	7.5
Depth (FS/GDP), %	109	218	292	289	290	315	322	316		

* 2004 figure dropped from $136 trillion to $133 trillion due to restatement of data by individual countries.

** Extrapolation off of 2005 base, with components grown at 2000-05 CAGRs

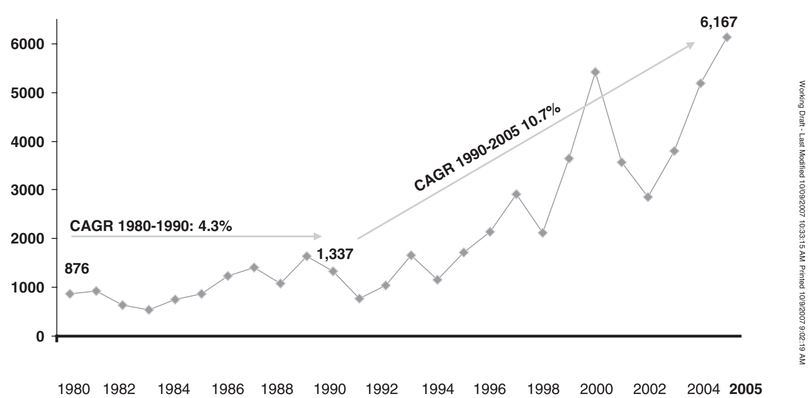
Source: McKinsey Global Institute Global Financial Stock Database speed the movement of capital toward the places where it would find its most productive uses and achieve the highest return. (Of course, as many investors have also come to learn, the increasing speed of capital mobility has a downside as well as an upside.)

These trends have converged to both increase the amount of stock and mobility of that financial capital. Financial stock has grown from roughly US$12 trillion in 1980 to about US$140 trillion in 2005. Leverage levels however, which have underpinned this growth, will not likely continue at the same rate.

Cross-border financial flows have seen a similarly dramatic increase since 1989: While those flows had been growing at 4.3 per cent per year in the 1980s, they are now growing at almost 11 per cent per year. With money able to move quickly across borders in search of higher returns, the world's stock exchanges have enjoyed unprecedented flows of funds — particularly those in Asia, where a significant proportion of investors now come from outside the region.

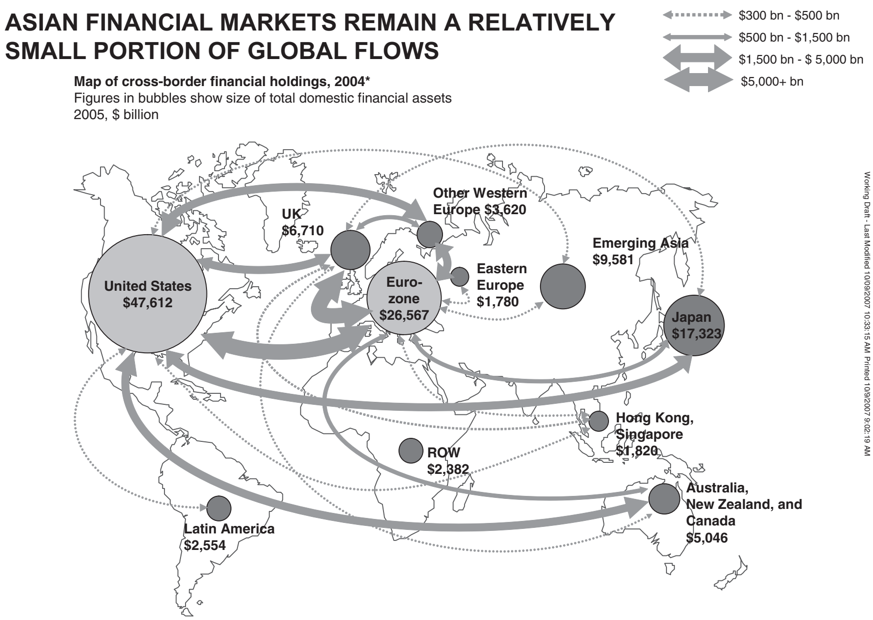
The map of the financial world has thus begun to change. The primary sources of capital remain the North America and the Eurozone of Europe (New York and London in particular), which are home to most of the

CROSS-BORDER CAPITAL FLOWS HAVE REACHED A NEW HIGH
Total cross-border capital inflows
$ Billions, 2005 constant $ and constant foreign exchange



Percent of global GDP	4.6	3.4	3.6	5.5	4.4	5.0	3.7	3.8	6.5	6.0	14.2	7.2	12.1	**13.9**

Source: McKinsey Global Institute Capital Flows Database world's financial stock. Yet as cross-border flows accelerate, other international financial centres are coming to the fore. Until recently, for example, Asia has been a relatively small part of the overall global financial system, and it has been a relatively modest source of funds. Analysis at McKinsey & Company, however, suggests that that old pattern is destined to change dramatically. The trends in Asia strongly suggest that there will be an astonishing increase in financial activity within this region — which leads us to argue that the time is now to establish a place in participating in this market.



* Includes cross-border equity, debt, lending and foreign direct investment.
Source: MGI Institute Capital Flows Database; McKinsey Global Institute analysis

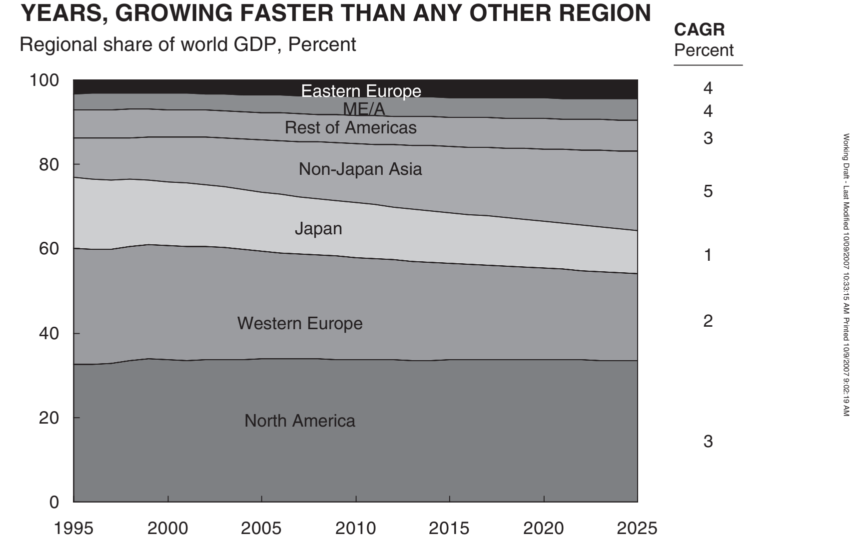
Asia's promise as an ever-stronger financial region becomes clear as we discern the six over-arching trends driving the rise of Asia. Those trends are:

1. The emergence of Asia as a global economic power — Asia has crossed a critical economic size threshold over the last five years;
2. The rise of a massive new Asian consumer class;
3. The increase of intra-Asian trade and integration;

4. The re-emergence of the historic Silk Road that once linked the great trading centres of Asia and the Middle East;
5. The evolution of Asia's financing and business ownership structures;
6. The prospect of an Asian merger-and-acquisition boom, in most sectors, accompanied by industry consolidation.

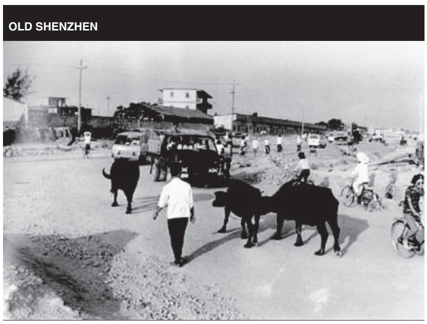
First, consider the emergence of Asia as a global economic power. As measured by its proportional share of the world's GDP, Asia (including Japan) will be more significant than Europe by 2018.

1 ASIA IS EMERGING AS A GROWTH ENGINE FOR THE NEXT TWENTY YEARS, GROWING FASTER THAN ANY OTHER REGION



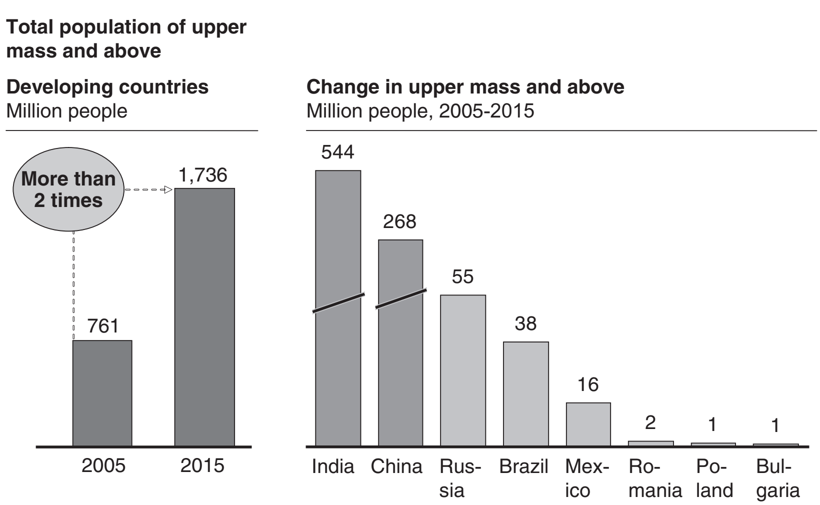
Source: Global insight

One example of this rapid growth is the city of Shenzhen — the site of the initial Chinese policy experiment of the economically liberalizing leader Deng Xiaoping, who famously said, "I don't care if the cat is black or white, so long as it catches mice." A photo taken in the same place in 1987 and 2004 illustrates this dramatic change in Shenzhen (See appendix). Shenzhen epitomizes the speed and scale of the change that is underway throughout the Asia region, where just the infrastructure expenditure may reach about US$2 trillion per year. The capital needs of the booming region — as nation after nation seeks investments in transportation, energy, and other infrastructure priorities — will bring opportunities on a vast scale for the region's financial players.



Second, consider the rise of a massive new consumer class in Asia. In China and India alone, roughly 800 million people will enter the middle class over the next ten years — historically, the world's largest single event in terms of economic upward mobility. (By "middle class" we mean US$5,000 GDP per capita, which may seen low but is the threshold at which major increases in consumption are realized.) Any financial-services company will benefit from this rising tide.

2 RAPID EMERGENCE OF A NEW CLASS OF CONSUMERS



The proportion of *Fortune Global 1000* corporations located in Asia will increase from about 18 per cent in 2004 to about 30 per cent 2010. Most of those leading companies had, in the past, been based in Japan — but now Chinese, Indian and Korean champions are entering the scene.

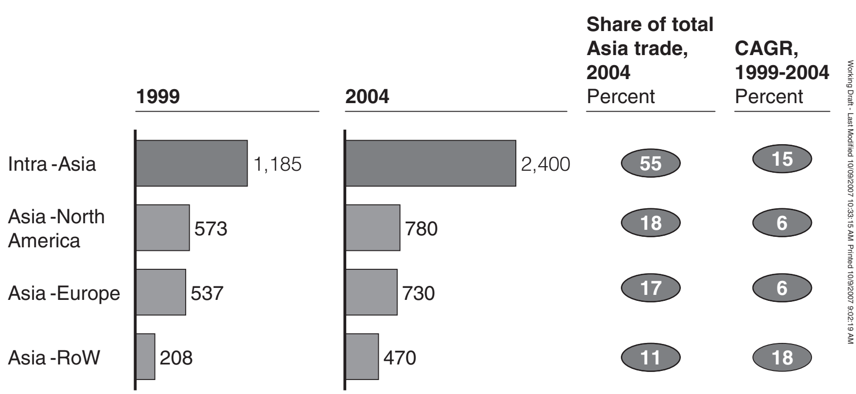
Source: Datastream, Bloomberg

Linked to that trend is the wave of fundamental transformations that are occurring — including changes that once might have seemed inconceivable. The world's largest financial institution — the US$2.7-trillion Japanese postal savings bank — is undergoing privatization, and that process will release the financial energy of a tsunami in the Japanese financial services sector. In addition, the growth of the region's sovereign wealth funds (SWFs) will change the way in which investments are made — both domestically and internationally — creating again new opportunities for financial services firms.

Third, consider the increase of intra-Asian trade, as Asia becomes a much more integrated region. When I first moved to Asia, about ten years ago, one of my Japanese colleagues told me that the idea of "Asia" was a Western invention. Historically, a united, uniform "Asia" has not actually existed, in terms of geography or culture or governance. Yet today Asia is indeed becoming much more closely integrated.

For example, the amount of trade within Asia dwarfs the amount of trade that Asia conducts beyond the region — and intra-Asia trade is increasing at a far faster rate than the region's trade beyond Asia (though much of that is destined for trade outside the region). In terms of financial service centres, intra-Asian linkages are becoming ever more important: It's not merely ensuring the centres' links to the traditional global hubs of New York and London, but creating and strengthening their relationships to other cities within Asia. There will surely be room, I believe, for a number of international financial centres in Asia, with each centre playing a different set of specialized roles.

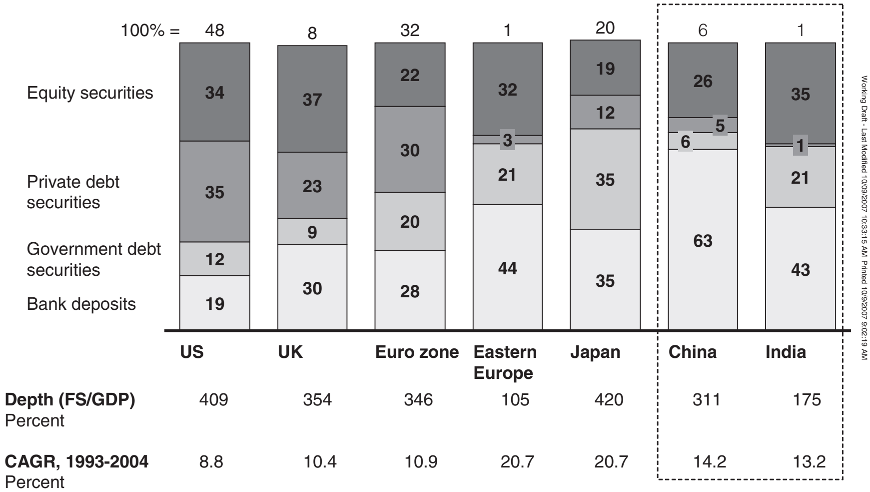
3 INCREASING INTRA-ASIA TRADE
USD billions



Fourth, consider how these forces have led to the re-emergence of the historic Silk Road — the trade route that, as far back as the twelfth century, linked the great trading centres of Asia, the Middle East and Europe. We believe that a New Silk Road has emerged. It was once the world's most significant trade route, and it is destined to be just as prominent again. The sources of so-called "petrodollars" in the Middle East, and the central banks of East Asia that have vast accumulations of

5 SHIFT FROM BANK-DOMINATED TO CAPITAL MARKETS-DOMINATED FINANCIAL SYSTEM

USD trillions, percent



Note: Some numbers do not add to 100% due to rounding error

Source: MGI Global Financial Stock Database; Global Insight

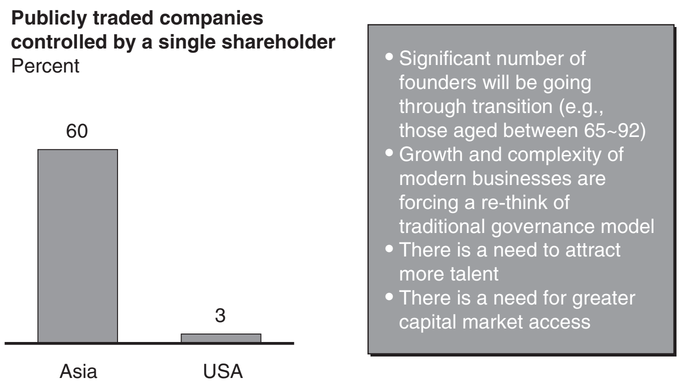
capital, are gradually shifting their investment ambitions from Europe and the United States towards Asia.

Fifth, these developments, in turn, have spurred a positive evolution of Asia's financing and business ownership structures. The financial markets themselves have been undergoing significant change, from bank-dominated systems to more capital-markets-oriented systems. That is creating a much more fluid, more dynamic Asian market, with the opportunity for flows of capital not just on a nation-by-nation basis but on a more regionwide scale.

Coupled with this is a shift in corporate ownership structures. Compare Asia to the United States, for example. About 60 per cent of publicly traded companies in Asia are controlled by a single shareholder — typically a family group — and many of those families are going through a demographic shift.

As the older generation ages, an inter-family demographic transition is destined to occur, and the new generation of leaders will rely more on the

ASIAN FAMILY-OWNED BUSINESSES WILL FACE IMPORTANT TRANSITIONS AND CHALLENGES



Source: Far Eastern Economic Review 8/14/03; World Bank;McKinsey analysis

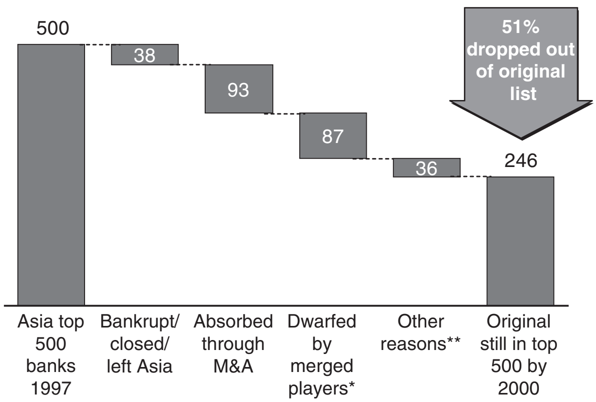
capital markets than on the old banking system — particularly as those companies have grown dramatically in size and complexity, and with the global education of the new generation of leaders.

Sixth and finally, consider how these trends, taken together, have reinforced the mergers and acquisition (M&As) boom and industry consolidation. This is happening and will accelerate in every sector in Asia. This will be a huge opportunity for financial service firms — which, themselves, will experience much more consolidation. After Asia's last period of financial crisis and consolidation a decade ago, about 50 per cent of the top 500 regional financial service players dropped out of existence (merged or went bankrupt), and another 50 per cent of this list will likely drop out over the coming five to seven years.

Taken together, these trends portend changes of historic proportions for the Asian financial sector. As the huge, rapidly moving financial market has truly become global in scope, there will be a dramatically changed role for Asia. Although Asia's financial centres have, in the

6 DISCONTINUITIES FROM CONSOLIDATION ACROSS INDUSTRIES, AS WAS THE CASE IN ASIAN BANKING

Increased consolidation and market exit in Asia



Key competitive trends

- Trends toward government bank deregulation expected to drive increased privatization and consolidation
- Foreign banks actively seeking M&A opportunities
- Privately owned market movers actively attacking assets of large state owned institutions

* Minimum asset value of USD2,235mn in 2000 compared to USD402mn in 1997
** Reclassification of entity by Bankscope to non-bank etc
Source: Bankscope

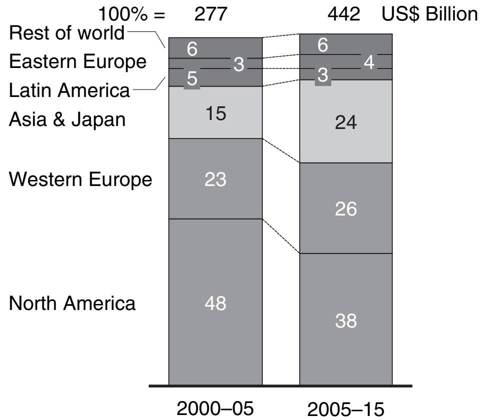
past, been a relatively small player on the global stage, the transformation of the international system means that Asia will over time see vast inflows of financial assets, as well as outflows — particularly with the sovereign wealth funds. Asia's contribution (including Japan) to the growth in financial services' profits can be conservatively expected to grow from about 15 per cent of the global total to about 25 per cent — and perhaps as much as 30 per cent, depending on the projections one makes about the economic activity among the upcoming 800 million new, middle-class, upwardly mobile consumers.

Today, three Asian banks now rank among the world's top ten, when measured by market capitalization, with Industrial and Commercial Bank of China (ICBC) now rated as the world's most valuable bank. In addition to today's powerful Chinese institutions, several Indian banks seem likely to join the list of top-ranking global financial institutions over the next five years, given their ambition and underlying growth.

These shifts in Asian banks' positions in the global rankings should give Korean institutions pause for serious reflection: Although Korean

IMPORTANCE OF ASIA IN FINANCIAL SERVICES PROFIT GROWTH WILL INCREASE DRAMATICALLY

Regional share of total banking profit growth; 2006–15; percent



Source: McKinsey analysis

ASIAN BANKS ARE RISING AS GLOBAL PLAYERS

US$ Billions

Based in Asia

2004 Market value	
1. Citigroup	259
2. HSBC	163
3. Bank of America	118
4. Wells Fargo	97
5. RBS	89
6. UBS	86
7. JP Morgan Chase	85
8. Mitsubishi Tokyo	63
9. Wachovia	61
10. Bank One	60

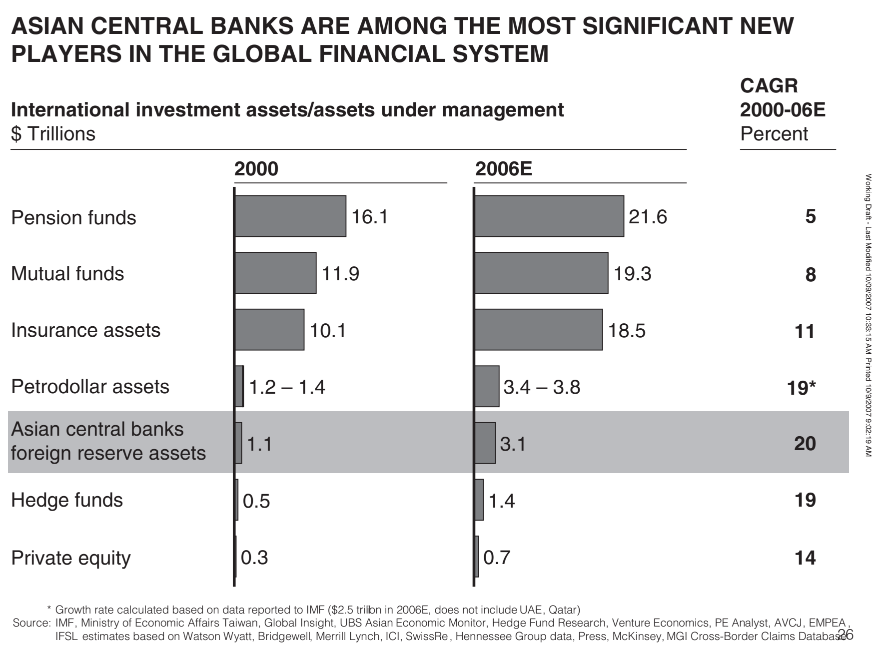
3rd September, 2007 Market value	
1. Ind & Com Bank of China	283
2. Citigroup	233
3. Bank of America	225
4. HSBC	213
5. China Construction Bank	186
6. Bank of China	183
7. JP Morgan Chase	151
8. Wells Fargo	122
9. Banco Santander	114
10.Royal Bank of Scotland	110

Source: Datastream, Bloomberg

banks are fairly large on a relative basis today in Asia, they are likely to be overshadowed within the next decade unless they think carefully about their growth and acquisition strategies, particularly on a regional basis.

Underscoring the changes underway throughout the financial system, McKinsey & Company recently released a report looking at some of the system's major new players or "power brokers". The Asian central banks and the utilization and investment of their large forex reserves are going to be much more of a force, with roughly US$3.1 trillion in accumulated assets, one of the international system's greatest shifts. And these players, including pension funds and sovereign wealth funds will need guidance and strategic counsel from financial service firms, representing a substantial opportunity. Their strategic decisions will help define the financial service landscape in the region.

For example: A major decision must soon be made in China about where to locate the various investment professionals within the China Investment Corporation (CIC) — the fund that will deal with the



foreign exchange reserves that China has amassed — perhaps as much as US$1.2 trillion eventually. The extent to which CIC bases its investment decisions in Beijing, Shanghai or Hong Kong makes a huge difference in terms of the future of each city as a financial centre.

Korea faces similar decisions. It must decide how best to leverage the many players handling significant pension fund assets.

Many issues arise from this discussion about the new Asian financial centres, and their role among the shifting global financial service landscape. Financial service leaders would be wise to consider the overarching trends that are destined to affect their entire sector. There will be more consolidation and convergence, so the size needed to rank among the top thirty players will continue to go up. There will be more dis-aggregation of the financial system, with more specialists coming in to deal with specific parts of the system. Leading firms will need ever-larger scale to do that, which means that they will need a regional footprint. Wholesale and personal financial service offerings are globalizing. Consumer needs in each market are becoming more similar, and the need for differentiation from nation to nation is no longer vital: Middle-class Koreans will increasingly seek the same products and services as their counterparts in, say, Singapore or China.

These trends have serious implications for financial centres. The rise of new global hubs is significant, because firms and individuals want to operate in one place, where they can get all of the critical mass of assets together. Dubai, for example, has literally come out of the desert and built itself as a financial centre with very strong ambitions. Mumbai, similarly, is driving forward. All aspiring financial centres must have a substantial number of foreign players in the market. Consider the experience of the United Kingdom, where "the Big Bang" of 1976 opened up the system and launched a new era of creativity in financial services. The Big Bang set an example, and other aspiring financial centres should draw a lesson from it: It does not really matter who owns the assets; the fundamental factor is that the people managing those assets must live in that centre. Governments and private sector participants must focus on overcoming that stumbling block.

Moreover, an aspiring global centre must adopt the common standards that prevail in the rest of the world's leading centres. If a nation has a different set of standards from the rest of the world, financial players simply will not do business there: They will not put up with multiple, differing regulatory regimes that impose starkly higher compliance costs and managerial burdens. That is one of the points of tension now between New York and London. To reiterate: financial centres need to move to global standards, away from local standards — and the longer that process is delayed, the further behind an aspiring centre will fall. Korea is among the players in the region that need to continue making progress in this area.

FINANCIAL CENTRE STRATEGIC MAP

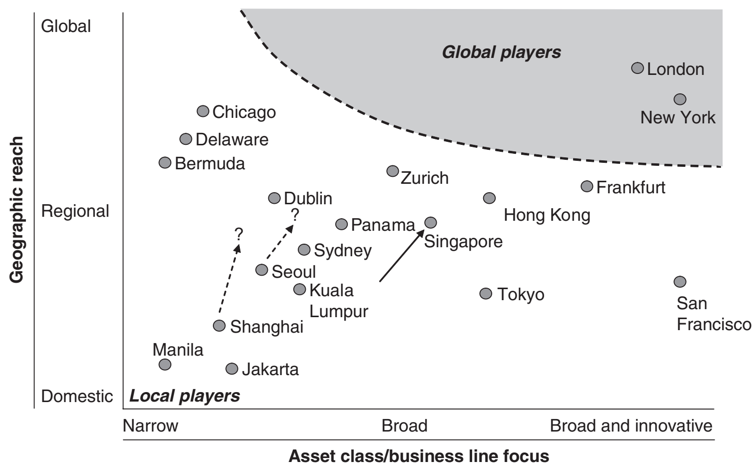
International competition among would-be global financial centres has been intensifying over the past ten years. A number of cities in both Europe and Asia have launched major initiatives, supported by their governments and private sector institutions, to build their stature as financial centres. In Europe, many would-be financial service centres are trying to figure out what their relative position is by comparison with London, gauging what role they might play and what niche they might fill. Since none of them can realistically overcome London's leading role — at least in the near-term — although Frankfurt in particular tried very hard, they must seek a role that is complementary to that of London.

Some cities have "punched well above their weight" in terms of significance. For example, in Central America, Panama has great ambition to become one of the pre-eminent financial centres of South America. For every would-be financial centre worldwide, it's well worth looking at what aspiring nations are doing to position themselves as future financial-services success stories.

Aspiring financial centres can gauge their chances of success by measuring along two dimensions. First, they should consider the breadth of "the offer" they make to investors, with London and New York at one end of the spectrum. Second, they should weigh how domestic, or how global, they can be.

In the Asian context, Singapore has made dramatic strides over the past seven years. Seoul is moving as well, although the scale of its future success remains uncertain. Shanghai is also developing very fast. Five years ago, when I was speaking at a financial services conference here, I was very bullish on Shanghai taking on the role immediately. Realistically, Shanghai has not moved quite as far or as fast as I said it would: I thought it might quickly overtake Hong Kong — but Hong Kong has retained its

FINANCIAL CENTRE POSITIONING NEEDS TO BE EVALUATED

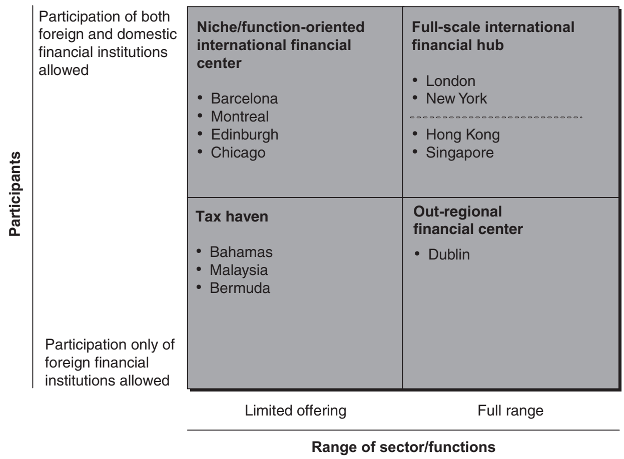


Source: McKinsey analysis

leading position. Nonetheless, I believe that Shanghai is poised to move forward again, with the right type of private–public leadership cooperation and with a critical mass of local players now located there.

In short, perhaps the essential factor working in Shanghai's favour, suggesting its success for the long term, is the size of the domestic market it serves and its rapidly concentrating group of asset managers. The banking market in China will be the second-largest in the world, in absolute size, within about seven years. With the number of institutions there in Shanghai, the city's infrastructure has, wisely, been improved significantly — and the local focus on quality-of-life concerns for expatriate executives has been intensified, as well. One of the major issues that Shanghai will face is whether foreign law firms will be permitted to play a significant role. Given the city's history and heritage — Shanghai, after all, was a major financial centre about seventy years ago, when the city gave birth to such firms as HSBC and AIG — the city's ambition to remain a major financial centre seems likely to be fulfilled.

FINANCIAL CENTRES MUST CHOOSE HOW BEST TO POSITION THEMSELVES FOR SUCCESS



Source: "The Money Market and its Institutions," 1955, Marcus Nadler et al., International Journal of Bank Marketing, Vol. 9; No. 5; 1991; Michael A. Goldberg,The Economist, June 27, 1992, "What Makes a Successful International Financial Center; Banking World; Vol. 11; No. 6, June 1993; McKinsey analysis

An additional question that aspiring financial centres might ask themselves is this: To what extent do you have a special zone for only foreign players, where you can open up the market to multiple players? This involves favourable tax treatment. In Dublin, for example, there are many back-office processing centres. There are, after all, many different types of financial centres. New York and London may have a wide lead over the rest of the world's financial centres, yet there are many niche players — for example, in areas such as derivatives, offshore tax havens, in asset management or in private banking. Each aspiring financial centre can seek to fill a particular role — and that is especially true for Asia, where there are many market niches still to be filled.

KEY SUCCESS CRITERIA

It is interesting to note that in the City of London financial-centres index (2007), four of the top ten institutions are in Asia. That number could increase over the next five to seven years, as Asia increases its role in the system.

There are several specific key factors to consider, as a would-be financial centre gauges its potential for success, including intrinsic factors like time zone, geography and underlying size of market. Among the most important is the cost and the ease of doing business. It is in this area that New York and London continue to manoeuvre to find an advantage over the other.

One other often overlooked but important factor is the attractiveness of the place to live. Financial professionals want to locate in a city that is environmentally livable, fun, intellectually stimulating and family-friendly. The City of London Global Financial Centres index, alongside a McKinsey survey of about 1,000 top global financial service companies, bears this out.

This factor directly affects a top criterion for success: The availability of professional workers — which is a particular challenge in many parts of Asia. The so-called "war for talent" is especially intense in financial services. Looking to the future, Chinese corporations will face a shortage of about 70,000 leaders. Ensuring the availability of highly skilled talent thus ranks alongside such factors as a fair and predictable legal environment and a responsive regulatory environment as absolutely critical.

Any city with ambitions to become a financial centre would be wise to look at New York and London — and at the healthy competition and rivalry between them. A major effort was launched last year when Mayor Bloomberg, Senator Schumer, and others realized that New York was beginning to decline relative to London. Although New York has many advantages over London — in terms of the depth and liquidity of the capital markets, as well as in its infrastructure — there were major legal and regulatory concerns that seemed to be making London relatively more business-friendly.

IMPLICATIONS FOR CITIES IN ASIA

A financial centre's strategy for success includes having a clear vision of what it wants to become and what deliberate process it will take to get there. In addition, these strategies must be simple. The United States is now trying to take action on this front: The Americans have realized that they have lost ground to their competitors in terms of such factors as the ease of doing business. The United States is thus wisely considering major initiatives to try to recapture its onetime advantages.

FOUR OF THE WORLD'S TOP TEN IFCs ARE BASED IN ASIA (1/2)

In Asia

Rank	Cities	Key features
1	**London**	• Most criteria are rated excellent – London is in the top quartile in over 80% of its instrumental factors. Especially strong on people, market access, and regulation. The main negative comments concern corporate tax rates, transport infrastructure, and operational costs
2	**New York**	• Most areas are very strong – New York is also in the top quartile in over 80% of its instrumental factors. People and market access are particular strengths. Respondents cited regulation (particularly Sarbanes-Oxley) as the main negative factor
3	**Hong Kong**	• Hong Kong is a thriving regional center. It performs well in all of the key competitive areas, especially in regulation. Headline costs are high but this does not detract from overall competitiveness. Hong Kong is a real contender to become a genuinely global financial center
4	**Singapore**	• Most areas are very good and banking regulation is often cited as being excellent. Has made major move on asset management and private banking. It performs well in 4 of the key competitive areas but falls to 9th place on general competitiveness factors alone. The 2nd Asian center just behind Hong Kong
5	**Zurich**	• A very strong niche center. Private banking and asset management provide a focus. Zurich performs well in 3 of the key competitiveness areas, but loses out slightly in people factors and in general competitiveness

Source: The City of London's Global Financial Centers Index

FOUR OF THE WORLD'S TOP TEN IFCs ARE BASED IN ASIA (2/2)

In Asia

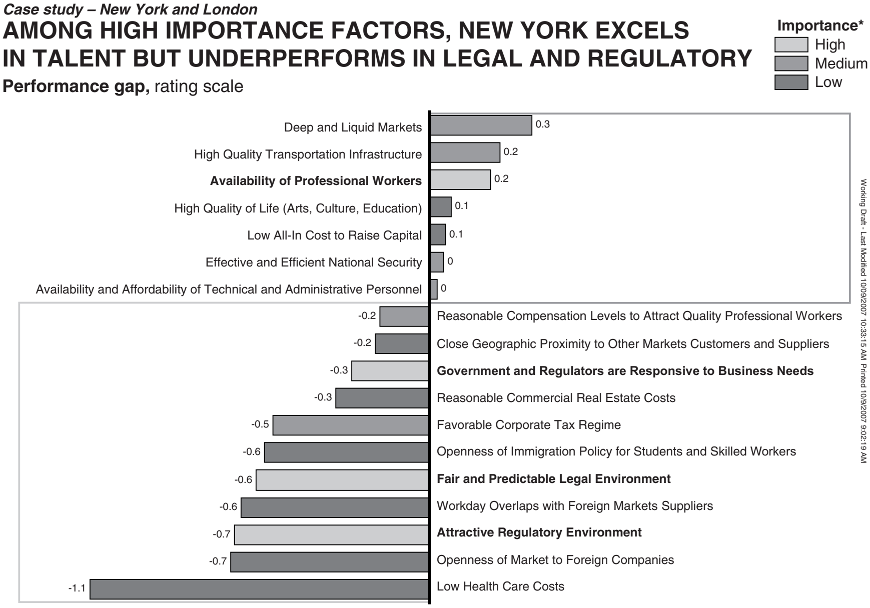
Rank	Cities	Key features
6	• **Frankfurt**	• Despite a strong banking focus, suffers from inflexible labor laws and skilled staff shortages. Market access, infrastructure, and business environment are strong, but Frankfurt falls outside the Top 10 GFCI rankings for people and general competitiveness. Has seen gains through derivative specialization
7	• **Sydney**	• A strong national center with good regulation, offering a particularly good quality of life. Sydney is strong in 4 of the key competitive areas, but falls outside the Top 10 for people – many financial professionals leave for larger English-speaking centers
8	• **Chicago**	• Number 2 center in the U.S. Hampered by the same regulatory regime as New York. It scores highly for people, but is let down by its infrastructure and market access rankings. Unlikely to overtake New York, it remains a powerful regional and specialist center
9	• **Tokyo**	• Does not fare well in terms of regulation and business environment, but the size of the Japanese economy means Tokyo has good liquidity. It fares poorly on people but has good infrastructure and market access
10	• **Geneva**	• A strong niche center similar to Zurich. Private banking and asset management continues to thrive. Geneva is strong in business environment and general competitiveness, but is let down by infrastructure

Source: The City of London's Global Financial Centers Index

Case study – New York and London

AMONG HIGH IMPORTANCE FACTORS, NEW YORK EXCELS IN TALENT BUT UNDERPERFORMS IN LEGAL AND REGULATORY

Performance gap, rating scale



* High importance factors were rated between 5.5-6.0 on a 7-point scale; medium between 5.0-5.4; low were less than 5.0

Source: McKinsey Financial Services Senior Executive Survey

Let me highlight the case of Singapore in this regard, and its success in strengthening its position as a leading financial centre. Maintaining a business-friendly environment remains an essential factor.

Notably, Singapore achieved the needed change as a public-sector/private-sector partnership — with private-sector working groups set up in seven key areas to solicit a wide range of viewpoints. That signalled that the government wanted the private sector to come up with ideas to try to make Singapore more of a financial centre. Once those ideas were evaluated, the government moved more to the regulatory front and examined the various actors that needed to change. The government again invited private-sector market participants — it also sought input from people in other regulatory environments, such as experts from the Bank of England and from the U.S. Federal Reserve.

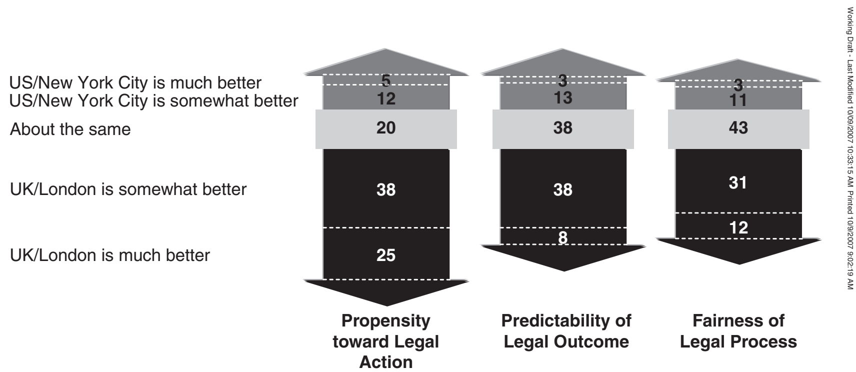
Many of Singapore's reform initiatives focused on adjusting its regulatory approach and on the liberalization of its financial-related services. It had been a highly controversial issue, for example, for foreign law firms to play a role in Singapore — yet this field was opened up.

Case study – New York and London

LONDON IS SEEN AS HAVING A MUCH BETTER LEGAL ENVIRONMENT, ESPECIALLY AS IT RELATES TO PROPENSITY TOWARD LEGAL ACTION

Ranking by response, percent

Which legal environment is more business-friendly?



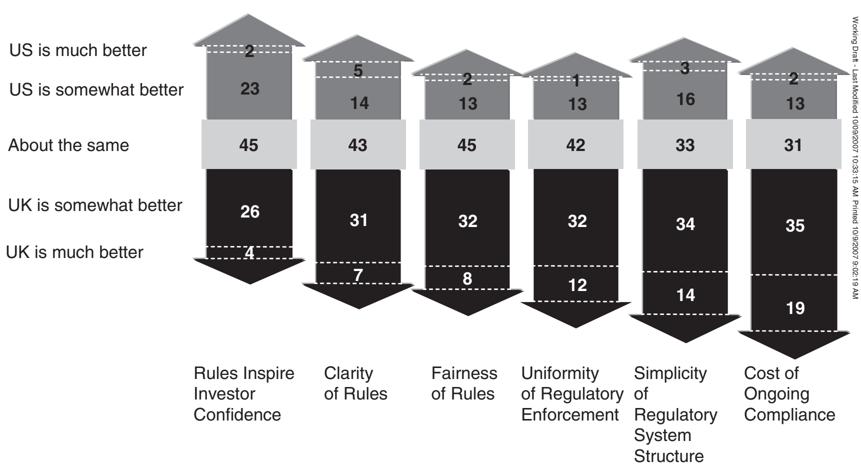
Source: McKinsey Financial Services Senior Executive Survey

Case study – New York and London

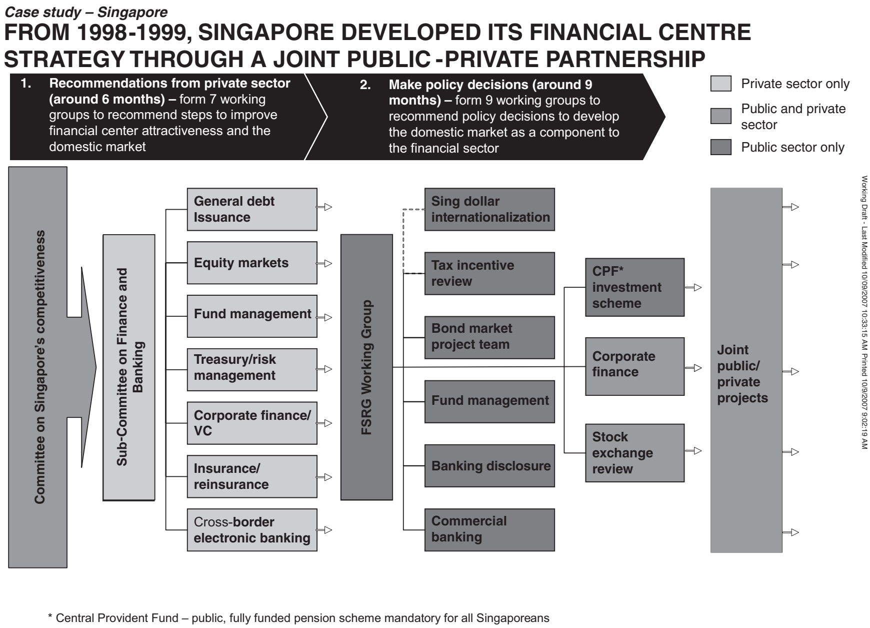
UK IS PREFERRED ACROSS MANY REGULATORY DIMENSIONS BUT IS MOST DISTINGUISHED IN COST AND SIMPLICITY OF REGULATIONS

Ranking by response, percent

Which regulatory environment is more business-friendly?

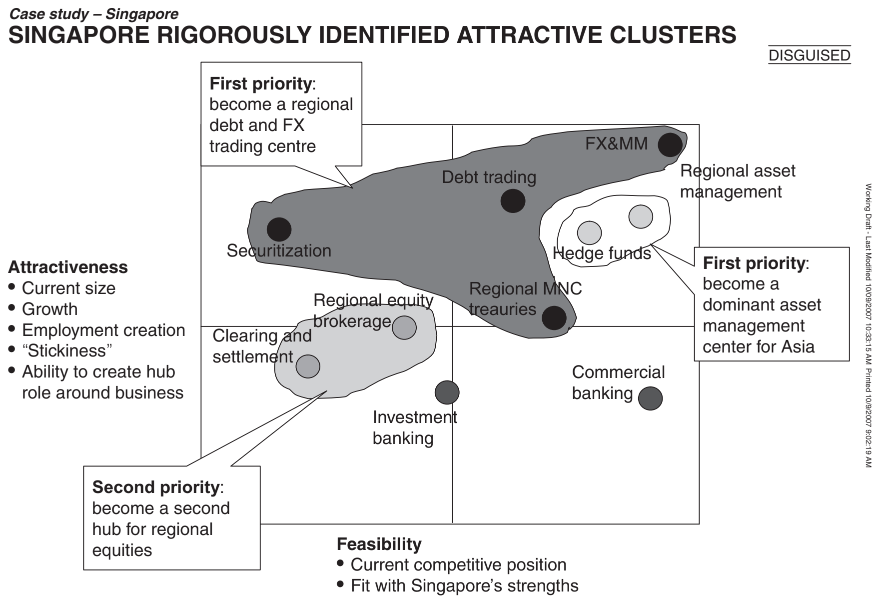


Source: McKinsey Financial Services Senior Executive Survey



Securities dealers were allowed to use more foreign and expatriate talent. Local asset management companies opened up their assets to foreign advisers. At about the same time, GIC — the government investment corporation of Singapore — was opening up significantly, allowing some proportion of its assets to be managed by foreigners. By making Singapore more attractive to highly skilled asset managers, Singapore helped secure its position as a financial centre — as a player that allowed for top-quality advice. That spirit of openness to talent of all nationalities is a factor that all aspiring financial centres should reflect on.

The case of Singapore also underscores the role of financial flexibility and the role of innovation. For example, ten years ago there was no significant debt market in Singapore. Sceptics often asked: Why would you want a debt market in Singapore, when the government there habitually ran a surplus rather than a deficit? Yet Singapore needed to have a mechanism that set a long-term yield curve, to allow other financial instruments to work. In meeting the need to create a debt market, Singapore



broke a lot of orthodoxies, and it was finally able to push through this innovation. It required a well-planned and coherent effort, but the initiative was, over time, successful in moving Singapore's market forward.

As we envision the future of Asian financial centres, there seems to be room for at least three, probably more, major centres in the region, given the growing size of the region's market. But to be successful, would-be financial centres need to have very specific aspirations about their role and their potential market share in such areas as debt markets, equity markets and asset management. Aspiring financial centres need to be specific about their market-share goals — much like a corporation — in order to move forward.

Looking at the factors that determine the success or failure of a would-be financial centre in Asia, I suggest that there are seven key criteria:

- First, a financial centre must have alignment with its national government, whose regulatory and compliance framework is critical. Outside of Hong Kong and Singapore, there has not been much progress here.

Case study – Singapore

SINGAPORE MOVED FAST TOWARDS INTERNATIONAL STANDARDS FOR OVERALL "MARKET INFRASTRUCTURE"

	From	To
1. Supervisory and regulatory approach	• Policy makers focused on regulation of individual components • Performance based regulation • Ad hoc national system	• Policy makers focused on market supervision and development in collaboration with market players • Reliant on self-regulated organizations and other market associations • Disclosure based regulation • Global standards
2. Legal frame-work and support	• Ill-defined legal framework • Lack of lawyers	• Conducive legal framework defined in close collaboration with market players and leveraging foreign country experience • Domestic and foreign law firms supporting market development
3. Transparency and information	• Ad hoc national accounting rules • Sketchy unreliable issuer information • Few rated issuers • Information asymmetry in the secondary market	• International GAAP • Standardized issuer information in line with international accounting standards • Majority of issuers seeking rating firm internationally recognized agency • Full transparency on price and volume information
4. Market mechanisms	• Ad hoc country specific mechanisms	• Market mechanisms in line with international practices and domestic characteristics
5. Settlement and clearing	• Lack of reliable electronic infrastructure	• Scripless markets • Settlement and clearing in line with international standards – e.g., Group of 30

Benefits of early adoption of global standards

- Implement capital markets reforms faster
- Ensure international credibility
- Avoid trial and error that could be harmful to the real economy and the financial system

Source: Interviews; McKinsey analysis

Case study – Singapore

SINGAPORE'S PUBLIC ACTIONS IN THE FIRST 18 MONTHS OF IMPLEMENTATION

Debt markets

SGS market	• Issue a 10-year instrument • Step up issuance level • Implement regular auction calendar • Appoint one more primary dealer • Appoint SGS brokers • Open Repo market to non resident investors
Corporate debt market	• Get government-linked companies to issue for funding • Organize seminar with large corporate CFOs
Securitization	• Review regulatory, legal and fiscal framework • Build information infrastructure for the primary mortgage market • Support private sector through MAS on a deal by deal basis
International S$ market	• Open S$ bond market to international issuers on a swap basis • Allow Singapore issuers to tap S$ bond market to fund projects abroad • Supranational aggressively tapping the market
"Infrastruc-ture"	• Gradually shift to fully scripless market • Move to international standard of disclosure

Source: Lit search

- Second, a financial centre must have a smooth-functioning public-private understanding and sense of collaboration. Private-sector players must do as much as they can, and they must work in harmony with public-sector regulators. In Korea, there are questions about whether the private-sector players are doing everything they can — an issue worth debating. Without the combination, very little can happen.
- Third, there must be a clear financial sector vision and strategy.
- Fourth, having senior government leadership that is capable of driving that vision and strategy is crucial. It is not sufficient to approach this on an *ad-hoc* basis, or to delegate this function to someone in the Ministry of Finance on a part-time basis. In Singapore the person who did this, who led this, is the current prime minister: He took on the challenge personally. Similarly, in Dubai, Sheik Mohammed Bin Rashid Al Maktoum drove the programme; and in New York, Mayor Bloomberg made sure there was very clear accountability.
- Fifth, adopting global standards. An aspiring financial centre must decide how it will move toward and adopt global standards — there is no alternative.
- Sixth, the ability to adapt and move. Global markets will continue to adapt, and any financial centre must be flexible enough to adapt along with them. Even a city as financially sophisticated as New York has had to re-evaluate its structures and processes, in order to keep up with the continuing threat to its pre-eminence posed by London. Interestingly, at the same time that the two cities are competing, they are engaged in a joint effort to improve both cities' roles as financial centres. They are both competing and cooperating — offering a good model for Asia, and other regions, by signalling that each financial centre does not have to look at each of its rivals necessarily only as a competitor.
- Seventh, the living environment and infrastructure. It bears repeating: This factor, over time, can prove to be crucial.

* * *

Asia's influence in global financial markets is destined to grow, and Asia's leading financial centres now seem poised to take their place on the global stage. Over the next ten years, Asia's prominence as a source of capital and as a destination for investment will grow quickly and present huge opportunities. There is no magic to success: If the leadership of both the public and private sectors in Asia exert determined effort and take far-sighted action, they can help ensure that Asia's financial centres will capitalize on the region's strong prospects for success.

CRITICAL FACTORS TO CONSIDER (1/3)

Today
Tomorrow

1. Capital. How attractive and welcoming is the capital and financial environment, including free flows, domestic and international?

Unattractive — Highly attractive

2. Ease of doing business. How easy is it to conduct business (incorporation, licensing, market conduct, competitiveness, M&A)?

Difficult — Very easy

3. Cost efficiency. How efficient is it to conduct business and is there a cost advantage?

Inefficient — Very efficient

4. Wiring. Are we adequately wired into the global financial system (culture, trade, infrastructure, location)?

Not wired — Highly wired

CRITICAL FACTORS TO CONSIDER (2/3)

Today
Tomorrow

5. Legal. How predictable balanced, and certain is the legal environment (contracts, rights, administration, adjudication)?

Unpredictable — Very predictable

6. Regulation. How attractive, effective, and efficient is financial regulation (principles-based, transparent, fairness, cost)?

Unattractive — Very attractive

7. Supervision. How effective and prudential is financial supervision (constructive engagement, prompt corrective action, enforcement)?

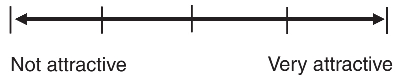
Ineffective — Very effective

CRITICAL FACTORS TO CONSIDER (3/3)

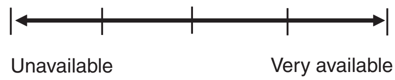
Today

Tomorrow

8. Tax. How attractive is the corporate and individual tax environment?



9. Skills. Are the necessary professional and technical skills readily available and easily acquired (education, immigration, employment laws)



10. Leadership. Is the necessary leadership available (private sector, public sector, public-private partnership)?