FAR EASTERN ECONOMIC REVIEW

Financial Center Pipedreams

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There is no denying that for financiers, Singapore has plenty of buzz these days. When a large European bank held a reception there recently for its prime brokers to meet potential hedge fund clients, it expected a couple hundred people. Instead more than 700 showed up. The influx of fund managers and private bankers has helped create a shortage of high-end housing, and as a result prices have risen 20% to 30% in the last year. Office rents just posted a 13% quarter-on-quarter rise, the highest ever, and are expected to break through their 1996 peak within the next couple years.

So is Singapore succeeding in its ambition to become a regional financial center? In some ways, yes. It has certainly enhanced its attractiveness to certain segments of the financial sector. But at the same time it seems to be falling further behind in the race to become the pre-eminent integrated hub. The analogy some use is that Singapore is becoming the Zurich to Hong Kong's London, or the Greenwich, Connecticut to Hong Kong's Manhattan.

For high net-worth individuals, Singapore's banking secrecy laws make it highly attractive as a place to stash funds out of sight of their own country's authorities-especially since some havens like Switzerland have recently watered down their guarantees of confidentiality. The super-rich of Southeast Asia have long used Singapore as a bolt-hole, both from political instability and the long arm of the law. Now new money is flowing in not only from Europe, but also from China. That's because since the 1997 handover, wealthy Chinese trust Hong Kong less as there is a perceived risk that mainland authorities will exert their authority there.
Meanwhile, Asia is in the middle of a hedge-fund boom, with assets flowing in at a rate of $12 billion to $15 billion per year. Singapore has offered tax breaks, simpler registration, and even mandates to manage some of its own massive pool of pension savings as enticements for fund managers to locate there. Since many of these individuals trade from wherever they happen to be and spend much time travelling around the region, they can essentially live wherever they want.
That means Singapore's clean environment and efficient urban planning come into play. With Hong Kong's air quality deteriorating rapidly and the government so weak it is unable to undertake the building of a cultural center in West Kowloon, it is no wonder that those who can move are doing so. Employers are beginning to rethink whether they need to pay Hong Kong's higher costs in order to be close to the market. The exodus looks much like the way U.S. hedge funds have moved out of New York City to the suburbs or other cities.

However, the appearance that everything is going Singapore's way is misleading. For one thing, the benefits of attracting fund managers are small. In this year's budget, the government announced preferential tax treatment, meaning that the local coffers will only get a small bite of this growing pie. The local market may also get a slight boost, but the biggest pluses is the extra consumption and employment in the local economy. In fact, the bid is reminiscent of Singapore's past efforts to attract targeted industries like the Internet or biotech. It usually ends up paying

top dollar, and then repenting at leisure as it turns out that it jumped on the bandwagon too late.
Meanwhile, Hong Kong is actually solidifying its position as the premier financial center for East Asia. Its stock market is outpacing rivals in the race to become large and liquid enough to intermediate the huge flows of capital needed to reform China's state-owned enterprises.

One proof of that should come later this month, when what could be the world's largest IPO is scheduled. Hong Kong retail investors are already lining up to buy into Industrial and Commercial Bank of China. With $815 billion in assets, the bank is the largest on the mainland, is expected to raise as much as $21 billion, about $17 billion of that in Hong Kong and the remainder in Shanghai.

A flood of IPOs-$21.2 billion worth last year-is fueling Hong Kong's self-confidence as the pre-eminent regional financial center. No longer does the city look over its shoulder at Shanghai. Instead it is Wall Street that it starting to get twitchy about the Hong Kong market's ability to handle such massive offerings.
Meanwhile, the Singapore exchange, with a total market capitalization about one-quarter the size of Hong Kong at the end of last year, gets a few smaller Chinese companies listing, and for a while local investor interest was keen in these shares. But a derivatives trading scandal involving China Aviation Oil in late 2004 nearly blew up the company, and also raised questions about whether the Singaporean regulators were lowering their standards to attract listings. Trust in Chinese companies coming to Singapore evaporated almost overnight, and oversight had to be tightened in order to rebuild it.

Even in terms of being a center for fund management, Hong Kong is arguably maintaining or enlarging its lead over Singapore. It still attracts the larger funds, which want to be physically close to the main market so they can have plenty of contact with the managers of companies. Singapore doesn't hold much appeal because its market is dominated by stodgy government-linked companies.
The real potential for a breakthrough lies in the development of an Asian bond market. The issuance of local currency bonds has more than quadrupled in the last 10 years from a very low base. Everyone agrees that the region would benefit hugely if it could reduce companies' reliance on bank debt by making bond issues more accessible. So can Singapore take the lead?

It seems unlikely however that Singapore could develop this market on its own. One hurdle is the lack of a benchmark government security issued in a convertible local currency. India and China are the two giant sovereign issuers with the potential to create a market. And both are going to want to create their own financial centers. Last March, India announced its intention to create a road map for convertibility of the rupee. Ultimately that will boost Mumbai's ability to cut out Singapore as a gateway to India.

And there is talk of Chinese companies being allowed to issue yuan-denominated bonds in Hong Kong. It is not inconceivable for Beijing to make a pragmatic decision to promote Hong Kong as a bond trading center. Already Hong Kong banks are beginning to conduct yuan-denominated business.

The other countries in Southeast Asia are hardly likely to welcome Singaporean control over their access to capital. While relations are stable, the recent outburst of public anger in Thailand at the sale of former Prime Minister Thaksin

Shinawatra's family stake in Shin Corp. to the Singaporean government holding company Temasek shows the depth of suspicion lurking beneath the surface. Effigies of Prime Minister Lee Hsien Loong and his wife Ho Ching, the head of Temasek, were burned in the streets of Bangkok. Temasek has repeatedly faced problems investing abroad because it is perceived as an agent of the government, with political as well as commercial motivations. The conflict with Malaysia over the trading of Malaysian shares in Singapore in the 1990s also shows the regional unwillingness to cede market leadership to the city state.

Singapore is thus paying a price for its government-led economic model, which is intertwined with its system of social control at home. Instead of nurturing a domestic entrepreneurial class with its own vested interests, it has kept the commanding heights of the economy under the control of Singapore Inc. Therefore its financial institutions have not been welcomed abroad in the way that Switzerland's have.

Individual institutions will also have to consider the political problems of doing business in Singapore. Market players were shocked this month by the sudden resignation of Morgan Stanley Asia economist Andy Xie, reportedly after he sent an internal email disparaging Singapore's financial center ambitions: "Actually, Singapore's success came mainly from being the money laundering centre for corrupt Indonesian businessmen and government officials. Indonesia has no money. So Singapore isn't doing well. To sustain its economy, Singapore is building casinos to attract corrupt money from China." Mr. Xie could not be reached to comment on his resignation.

Such undiplomatic remarks from an economist would never be welcomed by an investment bank. But Mr. Xie's resignation suggests just how sensitive the political climate there is for financial institutions. For hedge funds, then, the question is to what extent they could take bets against the Singapore economy or prominent Singaporean companies without wearing out their welcome. Such concerns don't enter the picture in Hong Kong, and indeed mainland China is not so thin-skinned. Ten years after the handover, Hong Kong's freedom of information has unexpectedly proved resilient, while Singapore has failed to liberalize.

So it is difficult to see Singapore continuing to enjoy its current success. Fund managers may be happy to receive tax breaks, but their mobility and fickleness means there is not much of a network effect to keep them in Singapore for the long term. Meanwhile Indonesia is exerting pressure to conclude an extradition treaty and amend its secrecy laws in order to stop the outflow of illicit funds.

Singapore deserves credit for financial market deregulation since 1998 and the opening of the local banking sector to foreign competition. But as long as it pursues a strategy that alienates its neighbors, it will be unable to realize its ambition of becoming a fully fledged financial hub. Ultimately such centers depend on cooperative relationships, while at the moment Singapore is still seen as an opportunistic player.

Mr. Restall is editor of the review.