2018.10.19 (No.19, 2018)

Newsletter

Institute for International Monetary Affairs
公益財団法人 国際通貨研究所

Hong Kong Economy in Closer Relationship with Mainland: Its Struggle for New Development

Naoki Umehara
Senior Economist
umehara@iima.or.jp
Emerging Economy Research Department
Institute for International Monetary Affairs (IIMA)

Currently, Hong Kong continues its development as a commercial city with two functions of a free-trade port and an international financial center. Under the British rule, it had enjoyed a free economy and a space of speech that were guaranteed by the British government. Then, in response to the Chinese policy change taken in December 1978, forty years ago, toward reforms and opening-up policies, Hong Kong started to play an important role as a window city for trade and investment of the Mainland. Even after its reversion (return) to China in July 1997 when a "One Country Two Systems formula"[1] started to be applied to Hong Kong, it has continued to develop as a free-trade port and an international financial center while maintaining a social system based on capitalism, common laws, and bilingualism of English and Chinese.

The Chinese government has actively supported the Hong Kong economy based on the "Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA)", which is explained below, while at the same time fully utilizing the function of Hong Kong as a highly developed international financial center. Going forward, Hong Kong will continue to strive to survive a global competition to grow as an international financial center. It is also expected to play a leading role in strengthening the relationship with its hinterland Mainland which has been becoming even closer recently.

In this article, I would like to overview, especially focusing on finance, the development of Hong Kong which has been playing an important role in connecting the Mainland and the global

[1] A system that China introduced as part of transition measures for a period of 50 years when it regained the sovereignty over Hong Kong (and Macao). Legally the system has been guaranteed by the Chinese Constitution and the Basic Law of the Hong Kong Special Administrative Region (Hong Kong Basic Law).

economy and look to its future.

1. Strengthened relationship between Hong Kong and the Mainland promoted around the CEPA after its return to China

The Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) was concluded in June 2003 as the first economic agreement after the return of Hong Kong to China in 1997[2]. CEPA covers all aspects of economic relations between the two regions including financial services.

The coverage of cooperation under CEPA was expanded since 2003 with the conclusion every year of ten supplement agreements until 2013. In 2014, an "Agreement between the Mainland and Hong Kong on Achieving Basic Liberalization of Trade in Services in Guangdong (Province)" was concluded based on CEPA. In a way to incorporate it, an agreement on services trade extending to the whole Mainland was concluded in the following year 2015. The newest agreement under the framework of CEPA is an "Investment Agreement and Agreement on Economic and Technical Cooperation" signed in June 2017[3], which have practically upgraded CEPA from Free Trade Agreement (FTA) to an Economic Partnership Agreement (EPA). In any case, it is believed that Hong Kong will continue to maintain its direction toward fostering closer economic ties with the Mainland based on CEPA under the assumption of continuation of "One Country Two Systems" formula.

---

[2] CEPA is expressed in Chinese as "內地與香港關於建立更緊密經貿關係的安排". It is comparable to a Free Trade Agreement, but since Hong Kong is not an independent country but a special administrative region (a local government with a special status), a word of arrangement is used instead of agreement. CEPA takes the form that the central government supports the local government of Hong Kong Special Administrative Region. The Chinese government also has concluded an agreement with Macao SAR which has almost the same content as that of Hong Kong and is also called CEPA. For the contents of CEPA for Hong Kong including Supplements, refer to the following URL. https://www.tid.gov.hk/english/cepa/legaltext/cepa_legaltext.html

[3] These agreements were implemented on January 2018. The "Agreement on Economic and Technical Cooperation" includes cooperation in economic and trade areas of the "Belt and Road" initiative. It also includes cooperation in the areas of finance, tourism, law, accounting, science and technological innovation, e-commerce transaction, and intellectual property rights; Moreover it includes promotion of cooperation between Hong Kong and the Pan-Pearl River Delta Region (泛珠江三角洲地区) comprising of eight Provinces, one Autonomous Region and two Special Administrative Regions, and China's Pilot Free Trade Zones as well as Qianhai of Shenzhen, Nansha of Guangzhou and Hengqin of Zhuhai. https://www.tid.gov.hk/english/cepa/legaltext/cepa1415_note.html

2. Hong Kong used as a hub for offshore transactions of the RMB to promote its internationalization

(1) Hong Kong's Relationship with the Mainland around the time of Hong Kong's return to China

When it moved to take reform and open-up policies in December 1978, China created a Special Economic Zone in Shenzhen and promoted to attract foreign investment centering on manufacturing. Under the continued severe foreign exchange controls, reform of foreign exchange system was made in the Mainland in January 1994, with the devaluation of the Renminbi (RMB or Chinese yuan) by almost 40% to push it toward a prevailing market rate and resolve dual exchange rates. The devaluation gave an enormous boost to inflows of foreign investment in the Mainland. In the meanwhile, Hong Kong adopted a currency board system in 1983, pegging the Hong Kong dollar (HK$) to the US dollar at a rate of HK$ 7.8 per US dollar, and the HK dollar came to be viewed as a quasi-hard currency. Against the background of these two currency regimes, inflow of Hong Kong capital and foreign capitals flowing through Hong Kong increased in South China (Hunan) led by Shenzhen, which promoted infiltration of the HK dollar in the region and the HK dollar came to circulate together with the Renminbi.

(2) Formation of the RMB Pool in Hong Kong

In 1997 when reversion of Hong Kong was realized, an Asian currency crisis took place and the Hong Kong economy was seriously hit[4]. The Hong Kong dollar was attacked by speculators, and the Hong Kong Monetary Authority (HKMA) managed to maintain the pegging system by taking emergency measures to cope with them that included purchases[5] of stocks listed on the Hong Kong Stock Exchange. On the other hand, the Mainland, which escaped the effect of the crisis owing to the capital controls, joined the World Trade Organization (WTO) [6] in December 2001, and began to maintain a trade surplus supported by the business advance of export-oriented foreign companies that were attracted by the low cost of production.

In the first half of the 2000s, the United States strongly demanded China to correct the exchange rate of the RMB on the ground that it had been undervalued to create a trade imbalance. The Chinese government resisted the pressure on a sharp revaluation of the RMB and in the reform of exchange rate system it implemented in July 2005 for the first time in

---

[4] The real growth rate fell from positive 5.1% in 1997 to negative 5.9% in 1998.

[5] For the intervention of the HK government into stock market and disposition of the purchased stocks, refer to "Composition of Exchange Traded Fund (ETF) by the HK Government", Nomura Institute of Capital Markets Research, *Capital Markets Quarterly*, Autumn 2001. (in Japanese) http://www.nicmr.com/nicmr/report/repo/2001/2001aut21.pdf

[6] Hong Kong became a member of the General Agreement on Tariffs and Trade (GATT) in 1985. It is an original member of the World Trade Organization (WTO) inaugurated in 1995 and it has continued its membership in the name of Chinese Hong Kong after its return to China in July 1997.

almost 10 years it chose instead a way to correct depreciation of the currency while taking time by introducing managed floating system with reference to a currency basket. The correction process of the depreciated yuan continued until it was suspended just before the Global Financial Crisis of 2008.

The Hong Kong economy suffered again from a rampage of Severe Acute Respiratory Syndrome (SARS) in 2003, at a time when Hong Kong was struggling to recover from the Asian Currency Crisis. However, as was shown above, it was underpinned by even closer economic relations with the Mainland, especially with Hunan region after the conclusion of CEPA in June of the same year. Around the same time, there had been an increasing call from business society in Hong Kong to remove the ban on opening deposit accounts in the RMB. In response the HKMA had consultation with the People's Bank of China (PBOC), the Chinese central bank, and eased the restrictions on the RMB so that the RMB that were brought from the Mainland to Hong Kong could be deposited in the banks in Hong Kong. At the same time the subsidiary of the Bank of China in Hong Kong was designated as a clearing bank of the RMB so as to recycle the RMB deposits to the Mainland. This arrangement later led to the formation of a pool of offshore RMB[7], which gave the foundation to the Chinese government to promote internationalization of the RMB after the Global Financial Crisis.

(3) After the Global Financial Crisis, China promoted internationalization of the RMB through Hong Kong

When the Global Financial Crisis occurred in 2008, China began to have a strong confidence in its development in an environment where the United States suffered serious damage by the crisis, and it started its way to internationalization of the RMB while taking note of the fact that the US dollar is used as a key currency. Against this backdrop, the PBOC liberalized the settlement of trade in RMB, and since then the scope of the RMB use in cross-border settlement has been gradually expanded.

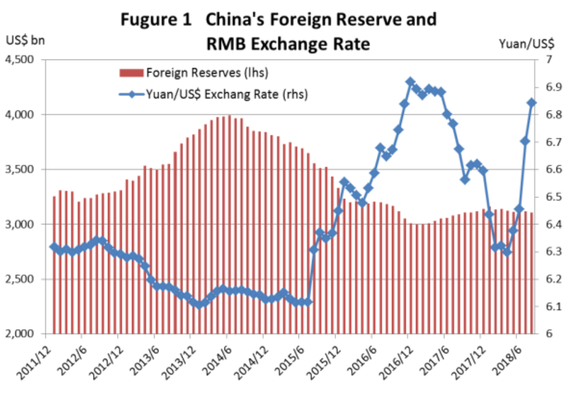
Yet until now the Chinese government has made it a rule to promote financial reforms progressively. On internationalization of the RMB, the government avoids an external opening in one stroke of its financial center Shanghai or making a bold experiment to liberalize financial business in its Pilot Free Trade Zones just established, and instead it has tried to take advantage of expertize of Hong Kong as an international financial center which Hong Kong has long accumulated. It is believed that China tries to maintain its framework of capital controls almost as they were without making any big changes, while avoiding a situation where the government loses control on the cross-border capital flows and in turn macroeconomic management of the

[7] To distinguish from the RMBs circulating domestically in China, the RMBs circulating outside the Mainland including Hong Kong is called offshore RMB.

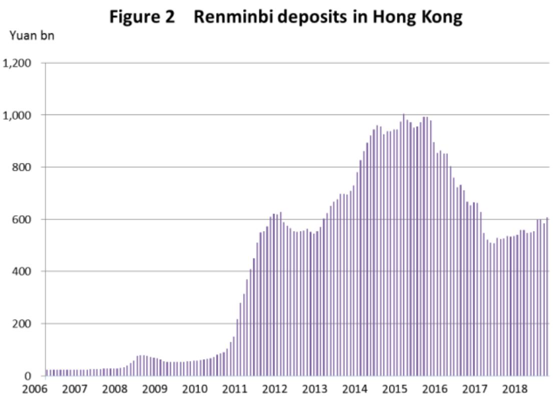
domestic economy at a time of financial turmoil in the international financial market.

Meanwhile, from around that time the interest of China came to be directed also toward improving its voice in the international organizations including the International Monetary Fund (IMF). That was an imperative from the top of the government and had a high priority. In early 2015, the Chinese government started to negotiate with the IMF to add the Chinese yuan as a fifth composing currency in the Special Drawing Rights (SDR) of the IMF. As a result, it succeeded in adding the RMB to the SDR basket in October 2016. It was at a bad timing, however, that China forced through exchange system reforms including a devaluation of the RMB in August 2015 since it was preceded by a plunge of stock prices in June, and therefore it triggered a sharp fall in the RMB exchange rate, inviting a capital outflow through 2016. The PBOC intervened in the market by selling the dollars and buying the yuan to stabilize the RMB rates, which resulted in the intermittent decrease of its foreign exchange reserves until the second half of 2016. It was in the autumn of 2016 when the IMF decided to add the RMB in the calculation of the SDR that the Chinese government made a shift in its policy priority earnestly toward preventing capital outflows (Figure 1).

In this context, a turning point came to the flows of the RMB which had continued to inflow from the Mainland to Hong Kong. In fact, the outstanding amount of the RMB deposits opened in Hong Kong, which increased rapidly from around 2011 pushed by the government policies, hit a peak in 2015 and continued to decrease to almost a half by early 2017 (Figure 2). A view that the exchange rate of the RMB had reached almost equilibrium level started to spread from around 2014, causing a shift in anticipation of its rise to a large fall in the summer of 2015. This also spurred the decrease in the RMB deposit outstanding[8].



Source: State Administraton of Foreign Exchange, China Foreign Exchange Trade System



Source: Hong Kong Monetary Authority

8 After the outstanding of the RMB deposit reached the bottom in March 2017, it is now on a mild rising trend.

3. Improvement of Infrastructures on Multi-currency Settlement and Securities Settlement in Hong Kong

(1) Improvement of multi-currency settlement infrastructure promoted since the early 2000s

Long before the Chinese government started to internationalize the RMB, Hong Kong had steadily promoted the improvement of financial infrastructure since it had been decided that the function of Hong Kong as an international financial center should be strengthened even after its return to China[9].

The HKMA had energetically worked on the improvement of fund settlement infrastructure since the middle of the 1990s, and as a result it realized the introduction of Real-Time Gross Settlement (RTGS[10]) system to its home currency (HK dollar)[11] ahead of Japan. Four years later in 2000, it started the operation of the RTGS for the US dollar transactions, followed by the euro transactions in 2003, and the RMB in 2007, achieving the introduction of a system that enabled the RTGS in four currencies in Hong Kong. Also PvP[12] was introduced in the exchange transactions among the four currencies to avoid the risk of delivery with a time lag. Thus the most advanced and unprecedented multi-currency settlement system in Asia was constructed in Hong Kong. Figure 2 shows the conceptual diagram of the current infrastructures of multi-currency settlement and securities settlement in Hong Kong, most of which had been constructed by the end of the 2000s. It may be said that the high strategic efforts of the HKMA enabled the improvement of these settlement infrastructures in less than ten years after the introduction of RGTS system for the HK dollar[13].

---

[9] It is clearly specified in the Basic Law of Hong Kong that it should go on developing as an international financial center.

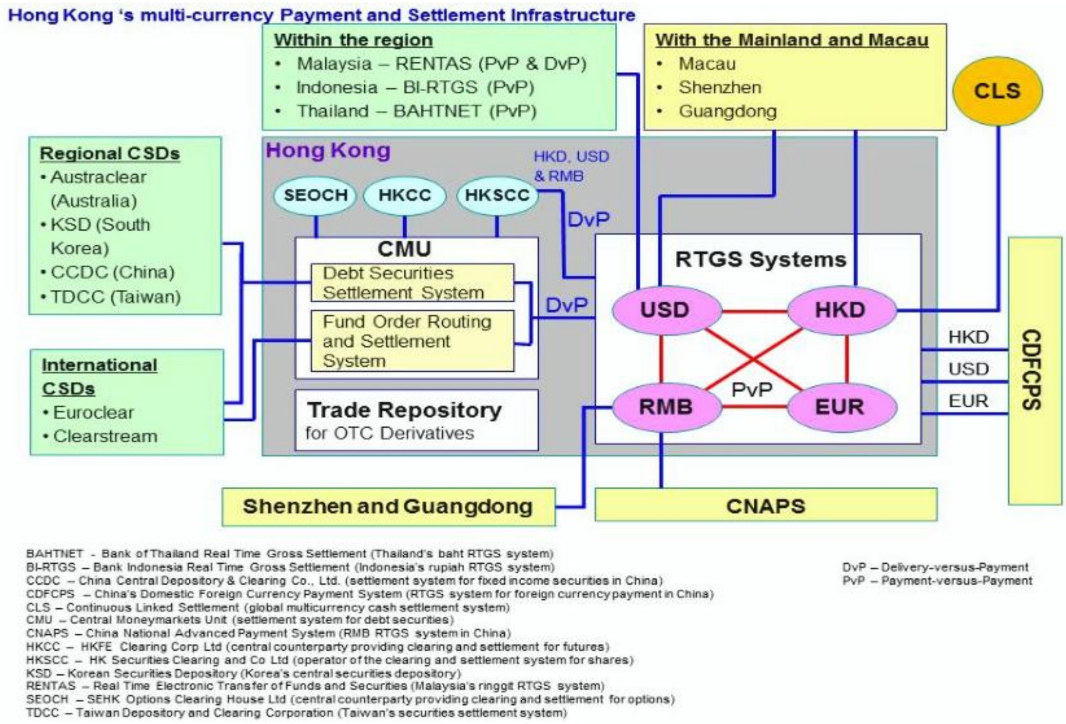
[10] RTGS differs from the Designated Time Net Settlement in that a failure in payment of a financial institution does not stop the settlements by the third party institutions in chain reaction, and it can sharply reduce the systemic risks.

[11] The connection of Central Moneymarkets Unit (CMU), a bond settlement system, and the RTGS of the HK dollar was realized in 1996. The RTGS system of the Bank of Japan for both current deposit settlements and JGB settlements was introduced in January 2001.

[12] It stands for Payment versus payment. It is a mechanism for settling a foreign exchange transaction where payments in the two currencies involved are settled simultaneously.

[13] The settlement of transactions made through the Hong Kong multi-currency RTGS systems is final and irrevocable (finality). This finality is legally protected by the Clearing and Settlement Systems Ordinance (CSSO) which came into effect in 2004.

Fugure 3 Hong Kong's multe-currency Payment and Settlement Infrastructure



Source: Hong Kong Monetary Authority

Note: "RTGS Systems" shown on the right side is a combined system of payment and settlement of currencies and foreign exchange transactions. Financial institutions for currency settlement are appointed by the HKMA: HKMA for Hong Kong Dollar, HSBC for US Dollar, Standard Chartered Bank Hong Kong for Euro and Bank of China (Hong Kong) for RMB.
Settlement system and services are provided by Hong Kong Interbank Clearing Limited (HKICL), a quasi-public corporation.
"CMU (Central Moneymarkets Unit)" shown on the left side is settlement platform of high-creditworthy bond including Government Bond, HKMA Exchange Fund Bills and Notes, financial institution bond, and so on. As shown above figure, CMU is connected with HKSE's clearing and settlement house, and central securities depositories (CSD) outside of Hong Kong like "Euroclear", "Clearstream" and so on.

(2) Hong Kong's Increased potential in line with the launch of the RMB settlement infrastructure

For a long time the RMB had been a currency severely controlled by the Mainland authorities. Before the Chinese government started the internationalization policy of the RMB after the Global Financial Crisis, the RMB was administered in principle as a currency to be circulated only within the country[14]. When the PBOC designated the locally incorporated company of the Bank of China (Bank of China Hong Kong) as a clearing bank for the RMB, it marked the first step for the internationalization of the RMB. At that time, however, it was regarded that the Chinese government had no intention to make the RMB a full-fledged international currency but rather considered it as a step to improve the convenience of business in Hong Kong. In other words, the focus was on how to recycle to the Mainland and administer the RMB that flowed out into Hong Kong.

However, in Hong Kong, as was seen above, construction of infrastructure for multi-currency

[14] As an exception, the Chinese government had introduced a system under which settlement can be made in the RMB or currencies of partner countries in addition to hard currencies in the frontier trade in along the borders to Mongolia, Russia, Vietnam, etc.

settlement had been promoted with the HKMA taking a lead. The RTGS funds settlement system had been expanded to include the Hong Kong dollar, US dollar, euro and in March 2006 it was extended to the RMB transactions with its RTGS achieved in October 2007. It was likely that in those days the HKMA promoted the sophistication of settlement infrastructure for the RMB in order to keep a lead as an international financial center while fully respecting the framework and thinking with which the PBOC designated the Bank of China (Hong Kong) as a clearing bank in 2003. The progress in the improvement of settlement infrastructure made by the Hong Kong authorities was ultimately highly evaluated by the Chinese government and it seems that the improvement contributed to the adoption of Chinese policies of fostering and utilizing Hong Kong as a global hub of offshore RMB transactions.

On the part of Hong Kong, becoming a settlement hub for the offshore RMB in the growing presence of the Chinese economy brought a virtuous cycle to further raise its position as an international financial center. Also in the Mainland, in addition to its high convenience in the funds settlement, based on the achievement of Hong Kong which set up infrastructure for highly advanced securities settlement system, there was a growing thinking that it should fully utilize Hong Kong when it took an opening policy of financial and capital market.

(3) Progressive opening of China's capital market using securities settlement infrastructure in Hong Kong

The Chinese government tried to steadily promote the reform and opening of its capital markets (stocks, bonds, etc.) while keeping its own schedule and pace of reform without being swayed by external factors. Especially it has cautiously promoted external opening while carefully watching the progress in the reform of domestic markets. In that process the Chinese government has actively utilized the securities settlement infrastructures in Hong Kong as is shown in Figure 3.

(i) Progressive opening of the Chinese capital market that started with QFII and RQFII systems

In 2002, the Chinese government introduced Qualified Foreign Institutional Investor (QFII) program[15] and allowed foreign investors to access the capital markets in the Mainland. The quotas initially granted totaled only $4 billion but they exceeded $100 billion as of August 2018[16].

In addition, the government started in March 2013 the operation of RMB Qualified Foreign Institutional Investor (RQFII) program that allowed foreign investors an access to the RMB-denominated capital markets[17]. As is shown in Table 1 below, the total quotas granted as

[15] "Foreign" in these programs means outside of the boarder of the Mainland China.
[16] There is a voice that the quotas are difficult to use and it is unclear to what extent they are actually utilized.
[17] QFII program grants only a quota to individual financial institutions while RQFII program grants both quotas by

of August 2018 amounted to RMB 627.5 billion (about $92 billion), almost the same size as the quotas for QFII, and with the quotas granted to Hong Kong accounting for 50% of the total. This seems to be reflecting, in addition to its already established position as an international financial center, Hong Kong's unrivaled superiority in providing, both in quantity and quality, information on investment in the Chinese markets and in its hub function for raising and managing the offshore RMB funds [18].

Table 1 RQFII Quota approved by Chinese Government and its utilization

(Unit: 100 million Yuan、as of August 2018)

Country or region	Quota approved	Utilized amount	Share	Reference
Hong Kong	5,000	3,146	50%	Enlarged from 2,700 in 2017
U.S.A.	2,500	204	3%	
Korea	1,200	754	12%	Enlarged from 800 in 2015
Singapore	1,000	747	12%	Enlarged from 500 in 2015
Taiwan	1,000	Nil	–	
U.K.	800	423	7%	
France	800	240	4%	
Germany	800	105	2%	
Australia	500	320	5%	
Switzerland	500	70	1%	
Canada	500	87	1%	
Luxemburg	500	152	2%	
Thailand	500	11	0%	
Malaysia	500	16	0%	
U.A.E.	500	Nil	–	
Qatar	300	Nil	–	
Japan	2,000 (forecast)	Nil	–	RMB Clearing bank to be appointed.
Total	18,900	6,275	100%	Quota for Japan (forecast) is included.

Source: State Administration of Foreign Exchange, Media news

(ii) Launch of Stock Connect and Bond Connect

In November 2014, the Hong Kong-Shanghai Stock Connect was launched, followed by the Hong Kong-Shenzhen Stock Connect launched two years later in December 2016. These systems enabled the investors outside the Mainland China to trade through Hong Kong the stocks listed on Exchanges in Shanghai and Shenzhen within a range of daily limits for net buying. Also they made it possible for the Mainland investors to transact stocks listed on the Hong Kong Stock Exchange. Both QFII and RQFII programs used to be based on a positive list

nation and quotas by individual financial institutions. The national quotas are determined by the intergovernmental negotiations which often include the designation of the RMB clearing banks and conclusion of currency swap arrangements as a package. This process indicates that the Chinese government has promoted the internationalization of the RMB as part of its economic and currency diplomacy.

[18] The Chinese government deregulated in June 2018 the QFII and RQFII program to improve the user convenience. However, the original institutional design had been made from administrator's point of view rather than the users' perspective and therefore it is unclear to what extent the deregulation effect can be felt in the environment where, as is touched later, Stock Connect and Bond Connect are more actively utilized in the transactions between Hong Kong and the Mainland China.

method under which nations and investors applied to the authorities should be granted a quota for trading, but with the Stock Connect, although securities companies and others are required to register in advance, they are not required to apply for quotas, which means that China has adopted a negative list method, breaking its own regulatory practices.

Moreover, in July 2017 Bond Connect was launched to allow investors outside the Mainland to trade Mainland bonds in the Chinese interbank bond market through the system of the Hong Kong Exchanges and Clearing (HKEX)[19].

This stream of market opening policy that developed from the launch of Stock Connect to Bond Connect was not disrupted although there was a temporary slowdown due to financial instabilities caused by fall of stock price, depreciation of the RMB against the dollar, and concerns over capital outflows that occurred from summer of 2015 to early 2016. Here can be seen a consistency in the policies of the Chinese government. It seems that the Chinese government has had a purpose to revitalize the Chinese economy by promoting the Chinese capital market through taking in the funds of foreign investors as part of promoting domestic financial reforms.

(iii) Inclusion of A-shares of Mainland-based companies in the MSCI Emerging Markets Index

Taking account of the launch of Stock Connect and Bond Connect by China, MSCI decided in June 2017 to incorporate Chinese shares into MSCI Emerging Markets Index that is used by global investors as a benchmark for investment in the emerging markets, and the inclusion was realized in June 2018. The Chinese government greatly welcomes the inflow into the Mainland stock markets of global investment funds in a form of passive investment. It is likely that the Chinese government has cooperated in a smooth launch of MSCI's operation in collaboration with the Hong Kong authorities.

(4) Hong Kong that functions as a buffer to international capital movements

Hong Kong plays a major role in the Chinese opening of its capital market to the world. China has continuously made efforts of financial reforms and market opening while maintaining a certain degree of capital controls. For these efforts Hong Kong has functioned as a kind of buffer zone, protecting China from destabilization of its domestic financial market and materialization of systemic risks associated with turmoil in international financial markets and market speculation by overseas investors. It functions as a buffer because Hong Kong has

[19] Currently Bond Connect is not operated in a two-way traffic but only Northbound Trading is available, allowing overseas investors from Hong Kong and other regions to invest in the China interbank bond market (CIBM). The Southbound Trading which allows Chinese investors to invest in overseas bonds through Hong Kong has not been allowed yet since it may accelerate capital flights from China. The latter is considered to be implemented after the government assesses the progress of reforms of financial and capital market when the deleveraging measure is progressed to a certain degree and domestic financial market is stabilized.

developed its financial system and financial regulations to meet the international standards as an international financial center and at the same time the Hong Kong government has a deep understanding about the financial reforms of the Chinese government and accordingly administers flexibly the flows of capitals between the Mainland and Hong Kong in accordance with the intention of the Chinese government.

The Chinese government embarked on a reduction of domestic excess debts in 2017 and put a certain brake on its expansion. Without the existence of Hong Kong as a buffer, it may not have succeeded in implementing this policy.

Much remains to be tackled in order to build a modern economic system in the Mainland China. They include the straightening of fiscal relations between central and local governments, improvement of relationship between local government finance and local financial institutions, coordination of relationship between state-owned enterprises and private companies, and implementation of restructuring the debts of local zombie corporations. All of these agendas require reforms in the financial field. Going forward, the Chinese government is expected to continue to promote these reforms while utilizing Hong Kong as a buffer against international capital movements.

4. Participation of Hong Kong in the "Belt and Road" Initiative and Construction of Greater Bay Area

(1) China's Publication of policy documents on the "Belt and Road" initiative and Hong Kong's Response

The Xi Jinping administration which took office in March 2013 showed a positive attitude to diplomacy and started to advocate a "Belt and Road" initiative in the autumn of the same year. The initiative was published in March 2015 as a policy document "Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road". In response, the Hong Kong government incorporated a series of contents on the construction related to the Belt and Road Initiative into the Economic and Technical Cooperation Arrangement under CEPA signed in June 2017[20].

Furthermore, in December 2017, a document on "Arrangement between NDRC and HKSAR Government on advancing Hong Kong's full participation in and contribution to Belt and Road Initiative" was signed under the leadership of Chief Executive Carrie Lam (林鄭月娥) who took office in July[21]. The major areas for cooperation included in the arrangement are shown in Table

[20] Refer to the footnote 3.

[21] In July 2017, when President Xi Jinping attended the 20th anniversary of Hong Kong's return to China and talked with the newly inaugurated Chief Executive Carrie Lam, the Belt and Road initiative became a hot topic and the Chief Executive lobbied the Chinese government to sign an agreement between the State Council Development and

2, which are designed so as for Hong Kong to be able to exert various advantages it has fostered as a free trade port. In addition to the actual benefit of getting continued support from the Chinese government by fully participating in the constructions related to "Belt and Road" Initiative, it seems that (by doing so) Hong Kong had a purpose to increase the confidence of the Chinese government in the Hong Kong government.

Table 2 Main area and contents of cooperation in Hong Kong regarding "Belt and Road" Initiative

Main area	Main contents
Finance and investment	Hong Kong provides with various financial channels to promote "Belt and Road" initiative (BRI) projects. A relevant division of HKMA plays a role in supporting financial arrangement in infrastructure projects. To develop a green bond market. Hong Kong provides with the function as the global off-shore RMB business hub and enhances cross-border RMB payment and settlement. More connection between capital markets in the Mainland and Hong Kong. More cooperation between financial institutions of the Mainland and Hong Kong. Integrated cooperation between enterprises and financial institutions in order for BRI construction.
Infrastructure and Maritime Services	Hong Kong provides with professional services for developing infrastructure construction and other BRI projects. Hong Kong develops high value-added services for marine transportation enterprises of the Mainland and strengthens the status of Hong Kong's important international maritime services hub.
Economic and Trade Facilitation	Hong Kong encourages both Mainland enterprises and BRI countries' enterprises to establish regional headquarters in Hong Kong, and further promote trade and investment with Mainland and BRI countries and regions.
People-to-People Bonds	Hong Kong attracts more students of related countries and regions to nurture talent in various areas. To increase opportunities for young people of Hong Kong for internship in Mainland enterprises in BRI countries and regions.
Taking Forward the Guangdong-Hong Kong-Macao Bay Area Development	Hong Kong plays an active role in participating in and taking forward the development of the Guangdong-Hong Kong-Macao Bay Area (Bay Area), deeply participating in building the Bay Area technology and innovation hub, and achieving synergy through complementary co-operation with other cities in the Bay Area.
Enhancing Collaboration in Project Interfacing and Dispute Resolution Services	To further improve the communication mechanism between the Mainland and Hong Kong on investment co-operation related to the BRI and to explore the setting up of a repository on BRI projects. To encourage enterprises and financial institutions in Hong Kong and the Mainland to leverage their respective advantages. Hong Kong establishes itself as a center for international legal and dispute resolution services in the Asia-Pacific region to provide relevant services for the BRI.

Source: Government of Hong Kong SAR

Reference: http://gia.info.gov.hk/general/201712/14/P2017121400551_274123_1_1513241987560.pdf

(2) Deepening Integration of the Hunan Region through the traffic infrastructure construction in the Greater Bay Area

In the 2010s, infrastructure constructions have gathered momentum in the Hunan Region, especially in the Greater Bay Area that covers Guangdong Province, Hong Kong and Macao. These projects are based on the initiatives that aim to accelerate the infrastructure construction in the region, enhance mutual connectivity among the cities, and promote the region-wide economic development thereof. They are also very compatible with the construction projects

---

Reform Committee and the government of Hong Kong Special Administrative Region. For English version refer to the Attachment in the following URL. https://www.info.gov.hk/gia/general/201712/14/P2017121400551.htm under the Belt and Road Initiative. The signing in the presence of President Xi Jinping of the "Framework Agreement on Deepening Guangdong-Hong Kong-Macao Cooperation in the Development of the Bay Area" further raised the local expectations[22]. The Greater Bay Area master plan is going to constitute a part of this comprehensive project but currently the announcement of it is still to be waited. Actually, however, in September 2018, an operation of a high-speed railway was launched to connect more than 20 Chinese cities starting from Hong Kong (West Kowloon) through Shenzhen and Guangzhou, and a sea bridge "the Hong Kong-Zhuhai-Macao Bridge" that connects Hong Kong with Macao and Zhuhai will be opened by the end of 2018[23].

When these infrastructures are completed, human exchange between Hong Kong and the Mainland China is expected to increase dramatically. This will mean a closer relationship on the side of the Mainland, and it will be welcomed without problems. On the Hong Kong side where the residents enjoy an affluent life with diversified values albeit tilting somewhat to conservatism, it is inducing a sense of caution. Specifically, it has raised concerns that a closer relationship with the Mainland will lead to social unrests, or real estate bubbles through inflow of speculative funds, making Hong Kong a tough place to live with higher prices. However, the improvement of the transportation infrastructure in the Greater Bay Area and higher connectivity in the region are highly likely to bring a positive effect to the economic development of Hong Kong, and at present expectations are exceeding concerns.

In the Mainland, on the other hand, a framework of cooperation was established in 2004 covering a wider region than the Greater Bay Area, comprising 8 provinces, one autonomous region, two special administrative regions of Hong Kong and Macao and called "Pan Pearl River Delta Regional Cooperation"[24]. This framework is a scheme with a great geographical scale that rivals the Yangtze River Economic Belt, Jing-Jin-Ji (Beijing-Tianjin-Hubei) Metropolitan regions, and Northeast 3 provinces.

The Greater Bay Area represents the most advanced development area in the megaproject of "Pan Pearl River Delta Regional Cooperation" with development of other regions somewhat lagging behind. It has been a big challenge to the central government how to narrow the regional development gaps. The detailed plan of the Greater Bay Area will be announced after

[22] The idea of the plan is believed to come from the experiences of such advanced bay areas as in Tokyo, New York and San Francisco and the plan is expected to realize a development cluster in the middle and downstream basin and delta area of the Pearl River that will exceed the precedent bay areas. In the background there is an existence of Shenzhen which attracted attention as an advanced area of innovation with an accumulation of electronic parts and IT industries, suggesting Silicon Valley in the US.

[23] On the side of the Mainland, constructions of an artificial island and highways are under way to connect cities of Shenzhen and Zhongshan through a sea bridge and a tunnel.

[24] It is reported that in November 2003, the idea was proposed by the then Secretary to the Guangdong Province Mr. Zhang Dejiang. The region is comprised of nine provinces of Guangdong, Guangxi, Hainan, Yunnan, Guizhou, Sichuan, Hunan, Jiangxi and Fujian (both a province and an autonomous region are regarded as an administrative unit on the same level) and two special administrative regions of Hong Kong and Macao. The idea is therefore commonly called 9＋2.

the policy coordination has been made on these challenges.

5. Toward the Future Development

In Hong Kong, Ms. Carrie Lam won the Chief Executive election held in March 2017 and her inaugural ceremony was held on July 1 2017. The day just fell on the 20th anniversary day of the Hong Kong's return to China.

Three years before, in the autumn of 2014, there occurred in Hong Kong a democratization movement over the reform plan for the next Chief Executive election, which destabilized the Hong Kong society. It was basically a contention over a "high level of autonomy" of Hong Kong, and young residents in Hong Kong wanted to elect by popular election a Chief Executive who can represent the wills of the people living in Hong Kong, but the Chinese government could not permit such reforms in the election system. The moves of the youth may also be attributed to the fact that there was an accumulated discontent with the Hong Kong government which had been unable to offer appropriate solutions despite sharp rises of real estate prices that were triggered by the inflow of speculative money coupled with a shortage of land supply. Although these issues cannot be solved easily in a short term, at least the current administration led by the Chief Executive Mme. Lam has shown its intention to face them seriously.

The integration of Hong Kong with the Mainland China is now going on through infrastructure constructions and the process is unlikely to be stopped. Yet, sometimes there seems to be a sway in its belief in the One Country Two Systems formula. The Chinese government once expressed its recognition that after two decades of Hong Kong's governance under the Chinese sovereignty, the Sino-British Joint Declaration of 1984 has become just a historical relic[25], with the "high level of autonomy" being only a privilege that the central government has temporarily given to the local government. In reality, however, common laws have been applied in Hong Kong, both English and Chinese are used, and the institutional systems like Basic Law of Hong Kong Special Administrative Region have been maintained and implemented. The Hong Kong government has no other choice but to continue to administer itself based on these realities and explore the ways for further development.

Meanwhile, the financial markets in the Mainland China are still very weak and vulnerable. The government does not seem to choose a rapid external opening or liberalization in a big bang style and therefore Hong Kong's position established as an international financial center will be very useful for the moment. The Hong Kong government will try to manage the economy

---

[25] A spokesman at the Chinese Ministry of Foreign Affairs told at a press conference on June 30 2017 that "it's been 20 years now since Hong Kong's return to the motherland, and the arrangements during the transitional period prescribed in the Sino-British Joint Declaration are now history and of no practical significance, nor are they binding on the Chinese central government's administration of the Hong Kong SAR.
https://www.fmprc.gov.cn/mfa_eng/xwfw_665399/s2510_665401/2511_665403/t1474637.shtml

steadily and stably, while maintaining a sound banking sector through the HKMA and with appropriate regulations over the financial innovation including fin-tech. It is believed that the policies for Hong Kong to keep surviving at least in the coming dozens of years lie in the maintenance and development of its position as an international financial center and a free port while maintaining the “high level of autonomy” in a form acceptable to the Chinese government and promoting social harmony in Hong Kong.

Address: 3-2, Nihombashi Hongokucho 1-Chome, Chuo-ku, Tokyo 103-0021, Japan
Telephone: 81-3-3245-6934, Facsimile: 81-3-3231-5422
〒103-0021　東京都中央区日本橋本石町 1-3-2
電話：03-3245-6934（代）ファックス：03-3231-5422
e-mail: admin@iima.or.jp　URL: https://www.iima.or.jp