

# The Irreplaceable Financial Free Hub -- Hong Kong

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**ABSTRACT.** *Hong Kong's financial free hut ranking dropped from Top 3 to Top 6 in the world due to the anti-amendment incident in the second half of 2019 and the COVID-19 epidemic in the first half of 2020. With the enactment of the National Security Law, many people around the world have raised doubts that Hong Kong has been marginalized by China's central government. This article will further analyze the impact of Hong Kong's situation in China from the perspective of China's mainland cities, including Hainan free trade zone, that is Hong Kong is the irreplaceable financial free hub. Meanwhile, Mundellian Trilemma theory will be used in analyzing the influence of exchange rate on Hong Kong and Mainland China.*

**KEYWORDS:** *Mundellian trilemma, The importance of hong kong to china*

## 1. Introduction

Hong Kong, officially the Hong Kong Special Administrative Region of the People's Republic of China (HKSAR), is a highly prosperous free hub and an international metropolis. As a place where Chinese and Western cultures meet, Hong Kong enjoys the reputation of “pearl of the Orient”. However, influenced by the global COVID-19, Hong Kong's total GDP in the first quarter fell by more than 9% compared with the previous quarter, breaking the record of decline since 1968 (Lee, 2020). After months of “Anti-Extradition Law Amendment Bill Movement”, the “*the Law of the People's Republic of China on Safeguarding National Security in the Hong Kong Special Administrative Region on the Maintenance of National Security Law*” was legislated, which also aroused the public opinion and concern worldwide (Fan et al., 2020). Mainland China has introduced a series of supportive policies to other cities, such as building Hainan into a free trade hub (State Council, 2020), which has been interpreted by public opinion as a forceful action to “replace” Hong Kong (Wyzxwk.com, 2019). According to the latest Global Financial Centers Index (GFCI), Hong Kong was once the third largest global financial center in the

world after New York and London, and the largest international financial center in Asia, surpassing Singapore, Tokyo, Shanghai, etc., but now it has fallen to the fourth place in Asia (“The Global Financial Centers Index - Long Finance”, 2020)... Against such an unpredictable background, Hong Kong is facing the biggest crisis in its social and international status since its return to China. Some commentators in mainland China, Hong Kong and even the international community should put forward the assertion of “Hong Kong is useless”, questioning that Hong Kong’s status as a “financial free hub” is being threatened and replaced (Hong Kong second most competitive Chinese city for fourth consecutive year, 2020). However, Hong Kong, as the essential window of communication between China and the world, its role in China will never be copied by any city, and its status as a world financial free hub will also not be replaced.

## **2. Freedom of Foreign Exchange is the Biggest Highlight of Hong Kong**

With the rapid development of other cities in Mainland China, such as the capital Beijing, the international metropolis--Shanghai, and Hainan Island, which has just implemented the construction of a free trade hub, many people believe that the rapid implementation of the Chinese central government’s economic support plan for inland cities has diminished Hong Kong’s importance to the mainland (Wyzxwk.com, 2019). It may be that the tourism industry has been affected by the epidemic, leading to a decrease in the number of visits between the mainland and Hong Kong, which cause a misconception to people that “the central government has lost confidence in Hong Kong.” However, from the perspective of finance, Hong Kong’s status as an “international financial center” will not be marginalized due to the rise of other cities in the mainland.

On June 1, 2020, the Central Committee and the State Council jointly released *Overall Plan for the Construction of Hainan Free Trade Hub* (“the Masterplan”), which indicates that Hainan will enjoy the same free trade and import tariff exemption policies as Hong Kong (State Council, 2020). However, it is inadvisable to think that Hong Kong’s future development situation will be decentralized just because of the implementation of this plan. Hong Kong has two core foundations, respectively namely “zero-tariff free hub” and “financial free hub”, while Hainan is only a zero-tariff free hub rather than a financial free hub.

American economist Paul Krugman, stated in his Mundellian Trilemma that the relationship between the free flow of capital, independence of currency policy and exchange stability cannot be established simultaneously (UKEssays, 2018). As is known to all, China is a country of exchange controls, in order to ensure the stability of exchange rate, China gives up the free flow of capital, so the RMB cannot be freely converted into foreign currency, which also brought serious investment obstacles to many foreign businessmen (Lee, 2020). Foreign businessmen investing in the mainland mean that they must face the challenge of restricted convertibility and flow of funds. As for Hong Kong, where foreign currency can be exchanged at will, it owns highly developed financial institutions and professional commercial service institutions that can efficiently provide foreign currency exchange services to

foreign tradesman (Lee, 2020). According to the latest data from the Bank for International Settlements (2019), Hong Kong is the world's largest RMB foreign exchange market. According to data compiled by the Bank for International Settlements released every three years, the average daily value of such transactions has increased 39.6% from USD 77.1 billion in April 2016 to USD 107.6 billion in April 2019, which provides Hong Kong a unique advantage over other major financial centers such as Singapore and Tokyo in attracting investors who wish to trade RMB (BIS.org, 2019). Therefore, Hong Kong has been the first choice for many foreign investors to invest in China.

### **3. The Irreplaceable “Transit Hub”**

With the gradual opening of China's door to the world, China's international status in the world is no longer what it used to be. Both the G20 summit and China's important role in the WTO demonstrate China's resolve to develop the “global economic community”. However, a country's development road is always bumpy, and the Sino-US trade war has also been a topic of global concern in recent years. Both sides have raised their respective tariffs, which causes the transactions are hindered (Usha & Neha, 2019). But Hong Kong, which operates under the principle of “one country, two systems”, has become an economic detente in the trade war. Iris Pang, chief economist of ING, Greater China at ABN AMRO, believes that due to the “First Sale Rule” imposed by the United States on imported goods, it means that Hong Kong could act as an intermediary for smooth trade between Mainland China and the US (Lee, 2020). If the products exported from China are sold to a businessman in Hong Kong at a low price, who in turn sells the products to a businessman in the United States, the United States only charges tariffs on transactions between the American businessman and the Hong Kong businessman, which also allows the two countries to still save tax during a trade war. In this case, the two countries can save taxes in this way during the trade war, which is far from possible to realize in Beijing, Shanghai and Hainan.

### **4. Hong Kong National Security Law: Strengthens Hong Kong's Social Status**

The status of Hong Kong as a free trade hub was established under the joint action of many factors, which is equipped with a diversified economic structure and its perfect relevant policies and systems guarantee it to maintain the dominant position as a free hub, thereby maintaining Hong Kong's indispensability to a certain extent. The promulgation of the *Law of the People's Republic of China on Safeguarding National Security in the Hong Kong Special Administrative Region on the Maintenance of National Security Law* (hereinafter referred to as the “*Hong Kong National Security Law*”) focuses on combating separatist forces in the country, thereby safeguarding Hong Kong's security and the integrity of China's sovereignty, and further to provide the free trade hub of Hong Kong of the national security law guarantee, rather than a fundamentally reconstruction of the Hong Kong economic

and trade system and policy.

First, the legislation of *Hong Kong's National Security Law* complies with *the Constitution* and *the provisions of Article 18 of the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China* (hereinafter referred to as the "*Hong Kong Basic Law*"), and is listed in Annex III of the Hong Kong Basic Law (Li, 2020). The riots in Hong Kong after the storm of the amendment, which advocated "Hong Kong independence", attempting to subvert the state power and split the country, had gone beyond the jurisdiction of the SAR. In this case, the National People's Congress has the right to formulate national laws, namely the *National Security Law* against such incidents, which directly addresses the long-stalled issue of Hong Kong's national security legislation, and truly began to promote the localization of national security laws in Hong Kong.

Secondly, although the *Hong Kong National Security Law* was enacted by the National People's Congress, it did not weaken the legislative power of the Legislative Council of the local legislature of Hong Kong, as claimed by outsiders, impair Hong Kong's high degree of autonomy, and threaten Hong Kong's status as a free trade hub. With regard to the issue of national security in the Hong Kong Special Administrative Region, Article 23 of the Hong Kong Basic Law serves as an authorization clause that authorizes Hong Kong to legislate on its own for ACTS endangering national security, such as subversion of state power (Li, 2020). However, Hong Kong's national security legislation has been obstructed and shelved until now since the former Chief Executive Tung Chee-Hwa's submission of the national security legislation to the Hong Kong Legislative Council in 2003 (Li, 2020). Objectively, the fundamental legal loopholes in Hong Kong have not been filled yet, and the establishment of the *National Security Law* has a cross-cutting and complementary relationship with Article 23 of the legislation, completing the legal loopholes and providing a solid guarantee for Hong Kong's status as a free trade hub.

In fact, this authorization clause is not an absolute authorization clause but a limited one, that is, when the authorized party fails to fully implement the authorization, the Central government has the right to withdraw the authorization (Fan et al., 2020). Today, as the authorizing party, the National People's Congress authorized the NPC Standing Committee to legislate, which is just a legitimate response to the failure of the Hong Kong Legislative Council to fulfill its constitutional responsibilities for more than ten years. Therefore, the amendment of the *National Security Law* did not diminish the legislative power of the Hong Kong Legislative Council, but positively proved that the legislative power of which has been respected by the National People's Congress for a long time (Fan et al., 2020). It can be seen that the Hong Kong Legislative Council will still enjoy extensive legislative powers in the future and will continue to make amendments and enact laws to safeguard and enhance Hong Kong's status as a free trade hub.

Finally, the *National Security Law* maintains a safe, free and efficient business environment in Hong Kong. During the Anti-Extradition Law Amendment Bill Movement and the riot movement, extreme terrorist ACTS such as deliberately

blocking roads, paralyzing tunnels and destroying the MTR actions caused huge obstacles to the normal economic and trade activities of Hong Kong, brought huge economic losses, and damaged the reputation and status of Hong Kong as a free trade hub. By criminalizing such ACTS, *the National Security Law* is conducive to deter terrorists and further to provide legal protection for the efficiency and safety of Hong Kong's traffic order that is closely related to economic and trade activities, and effectively strengthen and restore the confidence from international community in Hong Kong's free and stable business environment.

## 5. Conclusion

Today's Hong Kong is indeed facing a huge test: Shenzhen's construction of a pilot demonstration zone for socialism with Chinese characteristics approved by the State Council, which is expected to become a "business card" of reform and opening up. The central government aims to build a free trade hub in Hainan, which is expected to make up for the mainland's restrictions on "capital freedom", thus leading some could not help thinking about whether it will replace Hong Kong as China's hub city to the world. Of course, these answers are naturally "No". Hong Kong is far ahead of inland cities at all levels, including Beijing and Shanghai, in terms of monetary freedom and the number of professionals. Even if Hong Kong's status is crushed by the mainland, the next city with the same advantage in the East is not other cities in China, but Singapore or Tokyo whose financial positions are closely to Hong Kong, which is clearly not beneficial to China. The Anti-Extradition Law Amendment Bill Movement and the COVID-19 epidemic have made Hong Kong the "mask capital" and the focus of attention and the center of public opinion in the Western world. Hong Kong is now an orderly place, and it will still be shining in the future. At present, solving local problems should be put in the first place, actively organizing epidemic prevention and release control work to ensure the safety of local citizens and demonstrate the execution power of the SAR government. At the same time, the Hong Kong Special Administrative Region Government should correctly guide and effectively implement the *National Security Law*, so that to maintain social stability and consolidate its status as a world financial center. Opening-up is the symbol of Hong Kong, which is an indispensable approach for the world to see China, and also a bridge linking the mainland and the outside world. Hong Kong, with free trade, with financial freedom and with the function of accessing to the world from the mainland, will continue to show the world its social status and value named after "freedom" through the baptism of the storm.

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