

Mr. Yam talks about the implementation of financial policies in the HKSAR.

Address by the Chief Executive of the Hong Kong Monetary Authority, Mr. Joseph Yam, at a symposium in commemoration of the 9th anniversary of the promulgation of the Basic Law of the HKSAR in Hong Kong on 10 April 1999.

Ms Ko, Ladies and Gentlemen,

1. I am very honoured to be invited today to address this Seminar. The Basic Law is the constitutional instrument of the Hong Kong Special Administrative Region (HKSAR). The legal protection offered by the Basic Law has, to a very great extent, contributed to Hong Kong's monetary stability during the political transition and has enabled Hong Kong to withstand the severe challenges brought about by the unprecedented financial crisis. I would like to take this opportunity to examine the implementation of financial policies in the HKSAR. I shall discuss with you the two main areas relating to financial policies under the concepts of "one country, two systems" and "Hong Kong people ruling Hong Kong" as well as the legal protection offered by the Basic Law. The first of these is the monetary autonomy enjoyed by the HKSAR. The second is the monetary relationship between Hong Kong and the Mainland. I should stress that the experience of the HKSAR Government since its establishment shows that Hong Kong not only enjoys an even higher degree of monetary autonomy after the transfer of sovereignty, but also that its monetary relationship with the Mainland has been handled strictly in accordance with the "one country, two systems" principle. I hope that this will also be your conclusion at the end of this seminar.

Hong Kong's autonomy in formulating its own financial and monetary policies

2. First, let me talk about Hong Kong's monetary autonomy. Prior to the handover, some people feared that Hong Kong's monetary autonomy would be eroded. This was quite understandable, since the "one country, two systems" principle was a completely novel concept. However, a comparison between the relevant provisions in the two constitutional instruments applied to Hong Kong before and after the transfer of sovereignty respectively, i.e. the Royal Instructions to the Governor of Hong Kong and the Basic Law, illustrates that Hong Kong's monetary autonomy has not and will not be eroded. In fact, Hong Kong has enjoyed an even higher degree of monetary autonomy after the transfer of sovereignty.

3. Under the Royal Instructions, the Governor could not assent to "any Bill affecting the Currency of the Colony or relating to the issue of Bank notes", or "any Bill establishing any Banking Association, or amending or altering the constitution, powers, or privileges of any Banking Association" without previously obtained the approval of the Secretary of State. Under the Basic Law, however, there appears only a corresponding general requirement. Article 76 states that once a bill has been passed by the Legislative Council, all that is required for it to take effect is signing and promulgation by the Chief Executive. In addition, Article 17 states that "laws enacted by the legislature of the Hong Kong Special Administrative Region must be reported to the Standing Committee of the National People's Congress for the record." But this article also states that "the reporting for record shall not affect the entry into force of such laws."

4. On the other hand, unlike the Royal Instructions, the Basic Law also prescribes in considerable detail the financial systems to be practised in the HKSAR. For example, Article 109 provides that the HKSAR government shall maintain the status of Hong Kong as an international financial centre. Article 110 provides that the HKSAR government shall, on its own, formulate monetary and financial policies. Article 111 prescribes that the Hong Kong dollar, as the legal tender in the HKSAR, shall continue to circulate. Article 112 states that no foreign exchange control policies shall be applied in the HKSAR and that the Hong Kong dollar shall be freely convertible. Article 113 stipulates that the Exchange Fund of the HKSAR shall be managed and controlled by the government of the HKSAR. It is unusual to have such detailed specifications in a constitutional law, but the transfer of sovereignty is a significant change and it is helpful to retain those effective features that contribute to Hong

Kong's success as an international financial centre in the form of constitutional law. These provisions have, of course, provided adequate safeguards for Hong Kong's monetary autonomy. The reliability, credibility and transparency of our monetary policies are also greatly enhanced. The efficiency of market operations, which may be required from time to time for achieving our monetary policy objectives, has also been improved. As a result, our efforts to maintain monetary stability have become more effective. We should also note, however, that, theoretically, when monetary policies are constitutionalised, the flexibility in addressing problems, especially the unpredictable ones, will be reduced. Nevertheless, during the 20 months or so after the transfer of sovereignty when we have seen extreme conditions of the financial environment, we have not experienced any constraints in our handling of monetary issues. This serves as evidence of the success of the Basic Law in the area of monetary affairs.

5. The higher degree of monetary autonomy that Hong Kong enjoys is also reflected in the changes to Hong Kong's monetary legislation over the past nine years. To ensure that Hong Kong's monetary legislation is in full compliance with the Basic Law, we carried out, where necessary, adaptation and localisation of relevant monetary legislation prior to the transfer of sovereignty. For example, amendments were introduced to the Exchange Fund Ordinance and the Bank Notes Issue Ordinance in 1995. The Coinage Order was revoked and the Coinage Ordinance was promulgated in 1994. One significant amendment common to this exercise was the removal of the need to refer matters to the Secretary of State. Let me give a few examples:

(a) the investment of the Exchange Fund in securities; (b) the determination of the limit for borrowing using the assets of the Exchange Fund or fiscal revenue as security; (c) the transfer of assets from the Exchange Fund to the fiscal and other government accounts; (d) the authority to appoint note issuing banks; and (e) the authority to proclaim coins as legal tender, mint coins and appoint minting agencies were all subject to the prior approval of the Secretary of State before amendment of the relevant ordinances.

6. After amendment, these powers formerly rested in the Secretary of State are now rested in the Chief Executive in Council or the Financial Secretary. This means that, in terms of the management of monetary and financial affairs, Hong Kong enjoys even greater autonomy after the transfer of sovereignty.

7. The high level of monetary autonomy enjoyed by Hong Kong, as provided in the Basic Law and the monetary legislation, is not just something written into laws: it is also realised in our actual implementation of monetary policies. The financial turmoil that erupted just after the transfer of sovereignty has subjected Hong Kong's monetary autonomy to a rigorous testing. Yet, even when the Hong Kong dollar and the financial markets were under great pressure, and the economic and monetary conditions were extremely difficult, all the measures to address the financial crisis, including the market operation undertaken last August for the purpose of preserving order in our financial markets, were entirely formulated by the government of the HKSAR on its own. During this period of financial turmoil, the Central Government has strictly adhered to the provisions of the Basic Law. The Central Government has shown confidence in the ability of the HKSAR government and has not interfered in Hong Kong's monetary affairs. Furthermore, the success of the HKSAR government in addressing the financial turmoil has fully demonstrated the effectiveness of "Hong Kong people ruling Hong Kong". The confidence of the international financial community and the Central Government in the ability of Hong Kong to maintain monetary stability and to continue the development of Hong Kong as an international financial centre have also been enhanced.

The Monetary relationship between Hong Kong and the Mainland

8. An issue related to monetary autonomy is the handling of the monetary relationship between Hong Kong and the Mainland under the "one country, two systems" principle, especially given that the economic relationship between the two places has become increasingly close. A precise and clear approach to the monetary relationship between both places is one of the key factors in maintaining Hong Kong's status as a financial centre. At the same time, it will enable Hong Kong to give full play to its status as an international financial centre, and enable it to play a role in the promotion of reform and liberalisation, and the development of economic infrastructure on the Mainland.

9. Prior to the transfer of sovereignty, there were many doubts and myths surrounding this subject. The popular myths were: that the Hong Kong dollar would be replaced by the Renminbi; that Hong Kong's foreign reserves would be absorbed by the Mainland; that the PBOC would replace the HKMA or would interfere in the operation of the HKMA; or that Hong Kong's regulatory standards would deteriorate as a result of the need to grant special privileges to influential interests from the Mainland. Of course, those who believed these myths would have done well to have familiarized themselves with the Basic Law. But even those who were familiar with the Basic Law had other concerns to raise. For example, under the "one country, two systems" arrangement, there are two monetary systems within one country. Which monetary system should be more important from the nation's perspective? Since this is not answered in the Basic Law, should we apply the relationship between the Central Government and the local government, that is, a local government subordinate to the Central Government, when we study the two monetary systems? Obviously, Hong Kong and its status as an international financial centre would be adversely affected were this the case. In order to address these myths and remove investors' doubts and anxiety, the PBOC, clearly stated in 1996 the monetary relationship between Hong Kong and the Mainland. The relationship can be best summarised as "one country, two currencies, two monetary systems and two mutually independent monetary authorities".

10. The "mutually independent monetary systems" of Hong Kong and the Mainland reflect the differences in economic and financial developments between the two places. The two systems operate in a mutually independent manner. One does not precede or follow the other. Their relationship is different from the administrative relationship between the Central Government and the local government. In my view, the basic principles and policies governing the monetary relationship between Hong Kong and the Mainland can be summarized in the following ways.

(A) Laws, regulations, policies and management rules relating to monetary affairs promulgated on the Mainland are not applicable to Hong Kong. The HKSAR government, on its own, formulates monetary legislation and regulations as well as draws up and implements financial and monetary policies.

11. The fact that mainland monetary laws and regulations are not applicable in Hong Kong mainly reflects the difference in social and economic systems, economic and financial developments and regulatory standards between the two. The Mainland is in transition from a planned economy to a market-oriented economy. The legal framework relating to monetary affairs is still being modified. There are still a lot of restrictions in respect of monetary and financial issues. As for Hong Kong, our main task is to maintain the various monetary and financial laws that have been put in place before July 1997. Of course, we need to review and improve the legal framework in the light of the developments in the financial markets. The formulation and amendment of monetary laws are proposed by the executive body of the HKSAR and passed by the legislature.

(B) Mainland authorities do not interfere in the monetary affairs of the HKSAR. The monetary authorities of the Mainland and the HKSAR are mutually independent and one is not subordinate to the other. The monetary authority in the Mainland does not set up any office in Hong Kong to exercise monetary management.

12. Under the Exchange Fund Ordinance, the Chief Executive of the HKMA, i.e. the Monetary Authority, is accountable to the Financial Secretary of the HKSAR government. According to the Law of the People's Bank of China, the PBOC is accountable to the State Council and the branches of the PBOC are accountable to the headquarters. As mentioned earlier, although Hong Kong has been subject to a severe ordeal during the financial turmoil, the PBOC and other Mainland government departments have not interfered in Hong Kong's monetary affairs. Furthermore, our autonomy in the management of Hong Kong's foreign reserves is an important element in the mutual independence between the two monetary authorities.

13. While maintaining a mutually independent relationship, the two monetary authorities will continue to maintain and strengthen further the existing sound co-operation between the two places. Both parties have held several regular and ad hoc discussions about monetary management, cross-border supervision of financial institutions and linkages between payment and settlement systems, and the achievements in these fields have been many. The mutual trust between the HKMA and the PBOC has contributed to exchanges and co-operation between the two places in relation to monetary affairs.

(C) Financial business between the Mainland and Hong Kong are treated as international financial affairs and are conducted in accordance with the rules and practices of international financial activities.

14. All financial transactions between the two places after the handover have been conducted according to the rules and practices of international financial activities. Claims and liabilities between banks and companies from the mainland and those in Hong Kong are regarded as external claims and liabilities. Investment by Hong Kong companies in the mainland is regarded as foreign investment. When raising funds in Hong Kong, mainland entities are treated as other international and local market participants. Mainland companies listed in Hong Kong are required to abide by security laws of Hong Kong and are regulated by the relevant regulatory authorities in Hong Kong. Disputes relating to financial transactions are handled in accordance with international practice. Where China's Arbitration Law and other relevant laws and regulations are applicable according to the terms of a contract, the provisions relating to arbitration involving foreign parties are applied.

(D) The HKSAR maintains its existing system of currency issuance and management. The Hong Kong dollar and the Renminbi continue to circulate as legal tender in Hong Kong and the mainland respectively. The Hong Kong dollar is treated as a foreign currency in the mainland. Likewise, the Renminbi is treated as a foreign currency in Hong Kong.

15. The Basic Law has provided for the legal status of the Hong Kong dollar. The Renminbi is still not yet freely convertible. However, even if it becomes freely convertible, it will only be one of the many foreign currencies traded in Hong Kong's forex market. As for the cross-border circulation of the banknotes of the Hong Kong dollar and the Renminbi, this is a natural consequences of the close relationship between the two places. This phenomenon was in existence long before the handover. The legal status of the Hong Kong dollar will not be affected and the Hong Kong dollar will not be replaced as a result.

16. The issuance arrangements for the Hong Kong dollar remain independent. Hong Kong dollar bank notes continue to be issued by the three note-issuing banks under the authorisation of the HKSAR government. Under the linked exchange rate system, the note-issuing banks provide 100% backing in US dollar according to the fixed rate of US\$1 to HK\$7.80. In order to ensure that all the Hong Kong dollar notes and coins in circulation comply with the monetary rule of the Currency Board System, we have improved our coins issuance mechanism so that it operates in exactly the same way as the notes issuance mechanism. From 1 April onwards, all coins issued are 100% backed by US dollar.

17. Before China's resumption of the exercise of sovereignty over Hong Kong, the PBOC and the HKMA reached the following consensus on licensing procedures and supervision for each other's financial institutions:

- Financial institutions based on the Mainland or Hong Kong that set up offices in each other's territory shall be approved on the same basis as foreign financial institutions.
- The mainland offices of Hong Kong-based financial institutions shall continue to enjoy the same preferential treatment in the Mainland as other foreign financial institutions.
- Mainland financial institutions in Hong Kong shall be regulated by the HKMA in accordance with the same set of requirements; they shall not enjoy any privileges.

18. Following the handover, the HKMA has followed the Banking Ordinance and international standards in ensuring a high degree of professional and prudential supervision of authorized institutions. We are pleased that various international credit rating agencies have, in their recent reports, continued to commend Hong Kong's banking system as being the safest and most stable in the region. The hardest financial turmoil in decades has not imperiled the stable foundation of our banking sector. During a process of market adjustments and recession, and under a harder operating environment, in which banks' bad debts increase and profits drop, Hong Kong still boasts one of the world's safest and most stable banking systems. To further enhance the competitiveness of our banks and step up our supervisory efforts, the HKMA commissioned a large-scale consultancy study of the local banking sector. The study was completed in 1998 and the recommendations contained in it are being carefully considered by the HKMA.

(E) Hong Kong continues its participation in international financial activities in accordance with the provisions in the Basic Law

19. The Basic Law provides that the HKSAR may, using the name of “Hong Kong, China”, maintain and develop financial ties with different countries and regions. This includes entering into and implementing multilateral and bilateral financial agreements, setting up overseas official and quasi-official financial representative offices, and handling external financial relations.

20. Following the handover, Hong Kong has become even more active in the international financial scene. In addition to further developing co-operation with regional central banks, the HKMA has strengthened its ties with multilateral and international financial institutions. In September 1997 the Annual Meetings of the International Monetary Fund/World Bank were staged with great success. As the first major international event in Hong Kong after the handover, the Meetings became an important landmark in Hong Kong’s financial history. In 1996 both HKMA and the PBOC were admitted to the Bank for International Settlements (BIS) in their own right. Since then, Hong Kong has begun to play an active role in the activities of the BIS, including attending its regular meetings and participating in committees focusing on global financial issues, in particular, the Committee on Banking Supervision and the Committee on Payment and Settlement Systems. In July 1998, the BIS established in Hong Kong its Asia Pacific office, which is also the Bank’s first overseas office. In addition, Hong Kong continued to attend the annual meetings of the Asian Development Bank, International Monetary Fund and World Bank, as well as maintaining close technical co-operation with these bodies. Since the outbreak of the Asian financial turmoil, the issues of financial stability and new global financial architecture have become increasingly important. In addition to voicing our views on these topical issues under the name of “Hong Kong, China”, Hong Kong has also actively participated in the lending arrangements organised by international financial agencies. In 1998, we co-chaired the G22 Working Group on Transparency and Accountability and actively promoted the disclosure standards in both public and private sectors. At present we have been invited to attend the BIS Committee on Global Financial System and its working group meetings. While the above underscore Hong Kong’s status as an international financial centre, it also demonstrates to the international financial community the successful implementation of the “one country, two systems” principle.

Conclusion

21. Time flies. Nine years have passed since the Basic Law was promulgated. Some 600 days have also passed since the establishment of the HKSAR government and the Basic Law came into effect. During this period we encountered the severest financial crisis in many years, sustaining the great pain brought on by the economic adjustments. Nevertheless we are also pleased that with the smooth implementation of the Basic Law, the “one country, two systems” principle has gained recognition not only from the local public, but also the international community and overseas investors. This constitutes an essential basis for Hong Kong’s continued prosperity and stability as well as our status as an international financial centre. The Chinese government has also gained extensive recognition for its firm commitment to the “one country, two systems” policy for Hong Kong.

22. The Basic Law ensures that Hong Kong will enjoy financial autonomy. Article 109 of the Basic Law further requires that the HKSAR government should provide a suitable economic and legal environment in order to maintain Hong Kong’s status as an international financial centre. Within these two broad guidelines, we shall continue to make efforts in the following tasks:

(a) implementing credible financial and monetary policies and further strengthening the linked exchange rate system; (b) engaging in market operations and managing Hong Kong’s reserves with a high level of transparency and accountancy; (c) further improving the banking supervision system, ensuring the integrity, and increasing the competitiveness, of the banking sector; (d) promoting the development of the financial infrastructure, including the debt market and payment systems, heightening Hong Kong’s status as an international financial centre; (e) actively participating in international co-operation and seek to improve the international financial architecture; and (f) discharging our duties with a high degree of professionalism to gain confidence from both the public and international community.

23. The 21st century is fast approaching, with just some 200 days to go. The financial sector will then also embark on a new era. All that we have done in the past and are working on now, including

organising this seminar on the Basic Law, will help prepare us with a firm foundation for taking on the next century's challenges. I strongly believe that the "one country, two systems" principle will continue to play an important role in the 21st century, and that both the Mainland, one of the world's largest economies, and Hong Kong, one the world's freest and most open economies, stand to reap immense benefits from it.

Thank you.