Reform and Opening up in the New Era: Hong Kong's Changing Role and the Way Forward

Honourable guests, ladies and gentlemen, given the limited time available and the wide and deep expertise of the audience in this room, I will focus only in finance, on which I humbly wish to share my views.

To address the subject matter of this Session, there is of course the essential need to gain a full appreciation of the agenda for financial reform and opening up on the Mainland in the new era. There is a lot of information at the strategic level emanating from President Xi's Report at the 19th Party Congress in October last year. To translate his thoughts into a specific agenda for financial reform and opening up is obviously not an easy task and this is still very much work in progress for policy making on the Mainland. For us in Hong Kong we also need to study them and where appropriate offer our views based on our experience, and correspondingly position ourselves to play a meaningful role in the process.

In that spirit, I have identified from President Xi's Report four areas of emphasis in respect of financial development on the Mainland in the new era. They are:

First, to strengthen the ability of finance in serving the real economy;
(增強金融服務實體經濟能力)

Second, to promote the formation of a new framework for opening up on all fronts, (including) ... a large scale relaxation of market access, (and) ... the formation of ... an investment and fund raising ... network that is globally oriented;
(推動形成全面開放新格局。…大幅度放寬市場准入，…形成面向全球的…投融資…網路…)

Third, to deepen market reform of interest rate and exchange rate; and
(深化利率和匯率市場化改革)

Fourth, to refine the system of financial regulation to guard the bottom line of no outbreak of systemic financial risks.
(健全金融監管體系，守住不發生系統性金融風險的底線)

Having regard to these emphases on the Mainland, I have correspondingly identified for Hong Kong our own four enphases in financial development in the new era.

First is to reinforce the sustainable culture in finance of serving the economy through satisfying the needs of different users of financial services and, importantly, putting their interests, which collectively is very much in line with the public interest, on top of the private interests of financial intermediaries in profit maximization.

Finance is about the mobilization of money from those who have it to those in need of it, for whatever purposes, whether it is for production, investment or consumption. A financial system that is effective in the mobilization of money is thus essential for economic growth and development. In many developed jurisdictions, this fundamental purpose of finance has been very much ignored or taken for granted. Instead, there has developed a self-serving culture in finance, taking advantage of the strong political influence acquired through being in a position to determine where money comes and goes in the economy. The fact that Wall Street wields strong political power and makes enormous profit, paid for by users of financial services, is clear evidence of this self-serving culture. This self-serving culture is of course problematic and is the root cause of the debilitating international financial crises experienced in the last quarter of a century.

As an international financial centre and a jurisdiction with a reputation for respecting market freedom, Hong Kong constantly faces a dilemma in financial development. On the one hand, we would like to welcome financial institutions operating globally and embrace financial innovation. On the other hand, we are also concerned about the self-serving culture that these institutions represent, which may undermine financial stability and the interests of the many international users of financial services that we serve. Harnessing financial potency is a difficult task indeed. But we must strive to do better, if we aspire to be a meaningful international financial centre that plays a pivotal role in financial intermediation between the Mainland of China and the rest of the world.

Specifically, our financial authorities should be proactive in understanding and questioning the rationale behind the great variety of business models adopted by financial intermediaries, particularly those at the cutting edge of finance, and be prepared to veto self-serving activities. They should also recognize that they have the ultimate responsibility over the financial infrastructure, as indeed the government has responsibility over the physical infrastructure. For example, there is a need to ensure that operators of platforms for the transaction of risk assets, particularly those that are privately run, perform their roles in a manner that is undoubtedly oriented towards achieving the purpose of their existence, which is to provide liquidity and reliable price discovery in the secondary market in order to facilitate mobilization of money through the primary market, rather than profit maximization. I am glad that our HKEx passes this muster with flying colours. The fact that Hong Kong is the largest IPO centre in the world in five out of the last nine years (hopefully soon it will be six out of the last ten years) speaks for itself. But we must obviously not be complacent. In this and other areas of finance we should constantly question and satisfy ourselves that the economy is well served. For example, should the bread-and-butter banking business of deposit-taking and lending be subject to a regulatory framework designed principally for the Wall Street type of investment banking activities? Or should the mobilization of money within the non-bank sector be made safer and more efficient through introducing an independent, real-time payment platform, instead of providing a linkage for the great variety of bank-specific retail payment mechanisms, by limiting exposure to hacking risk to what is in the wallet rather than what is in the bank account?

My **second** area of emphasis for Hong Kong in financial development in the new era concerns the need further to strengthen the capability of Hong Kong in facilitating financial transactions involving the use of, or denominated in, the RMB. When first raising the need for Hong Kong to develop such capability with the People's Bank of China back in 2000, I took the view, correctly I hope, that for Hong Kong meaningfully to be an international financial centre, in accordance with article 109 of the Basic Law, we must be in a position to handle efficiently financial transactions denominated in the currency of (then soon to be and now is) the second largest economy in the world, which is also the currency of our country. The fact that we have our own currency under "one country, two systems" does not mean that the Hong Kong dollar should necessarily be the preferred currency for international financial transactions conducted in Hong Kong. Indeed, I have said many times since that it would be unrealistic for the Hong Kong dollar to play a meaningful role as the medium of transaction in international financial activities conducted in Hong Kong between the Mainland and the rest of the world. In the fullness of time, and this may not be so far off as to be ignored, the currency risk and the implications for monetary and financial stability of large capital flows in and out of our currency for an economy of seven million people may become matters of concern on different fronts. We therefore need to be prepared; and an obvious response is more proactively to promote the greater use of the RMB in the relevant international financial transactions conducted in Hong Kong, rather than to wait for the materialization of those concerns to trigger a relative shift in currency denomination, which may not be a benign process.

My **third** area of emphasis is the related one concerning the development of the RMB off-shore market and the internationalization of the RMB. Germane to this area of emphasis for finance in Hong Kong is of course the convertibility model adopted on the Mainland for the RMB. As an observer, my view is that free convertibility of the type characterized by the currencies of the developed economies is, perhaps for the foreseeable future, unsuitable for the RMB. The risk to exchange rate stability is high and difficult to manage, and there is genuine doubt on the ability of the foreign exchange market to discover a price, in other words an exchange rate, that reflects the basic economic fundamentals or that facilitates the necessary economic adjustments to redress any external imbalance. One just have to look at the behavior of the exchange rates of emerging market currencies in Asia in 1997-98 to appreciate how disorderly the foreign exchange market can be and how damaging it can be to the domestic economy. China must, therefore, retain the ability to deny convertibility to capital account transactions of doubtful utility in serving the economy or of an entirely speculative nature. China must ensure that it continues to be in a position confidently to maintain monetary and financial stability in the new era, notwithstanding unfair and politically motivated accusations of exchange rate manipulation.

Under this safe convertibility model, the RMB offshore market will continue to serve the rest of the world in their increasing demands for the RMB, as China gains relative economic weight in the global economy. I am glad that the off-shore RMB market in Hong Kong (the CNH market), which started in 2004 with a real time gross settlement payment system (subsequently introduced in 2006), has largely been functioning well. This is notwithstanding the occasional and temporary deviations in the RMB exchange rate and interest rates in our off-shore market from those in the on-shore market, due to differential shifts of sentiment in the two markets. Further, notwithstanding competition from other centres also allowed to operate off-shore RMB settlement systems, the market in Hong Kong now is where adequate RMB liquidity can be found off-shore. We need obviously to build on that enviable position, through enriching the availability of financial instruments to serve the needs of different legitimate users, remembering always that the objective is to facilitate and promote the greater use of the RMB off-shore, in other words, the orderly internationalization of the RMB, which also helps to diversify currency and credit risks assumed by the Mainland in its large holding of foreign reserves.

My **fourth** area of emphasis for financial development in Hong Kong in the new era concerns the Greater Bay Area initiative. The key is the mobility of capital within the Greater Bay Area, when the degree of openness of the capital account is different between the Mainland and Hong Kong, and when there are principally two currencies involved under "one country, two systems". It is obvious that, for the economy of the Greater Bay Area meaningfully to take-off as desired, not only is there a need for such strategic linkages in the physical infrastructure, such as the Hong Kong-Zhuhai-Macau Bridge and the High Speed Rail Link, to facilitate the greater mobility of people and goods, there is also the crucial need for much greater and convenient mobility of capital within the Area. After all, Deng Xiaoping did say that "finance is very important, it is the nucleus of the modern economy" (金融很重要，是現代經濟的核心). Capital mobility between the two systems within the Greater Bay Area should therefore be enhanced as a matter of priority.

There may, understandably, be concern over the risks to monetary and financial stability, particularly on the Mainland, associated with greater capital mobility within the Greater Bay Area. I am confident, however, that these risks can be effectively managed. It is for the financial authorities of the two financial systems of our country to work together earnestly to design a mechanism for capital mobility that is clearly oriented towards serving the economy. The mechanism should perhaps involve pre-approvals for capital mobility, including conversion, for well-defined activities conducted by well-defined institutions and individuals within the Greater Bay Area. This would also serve as a test case for similar capital mobility for other provinces on the Mainland as part of the safe convertibility model I mentioned earlier.

I should stop here, given the time constraint. Let me end by pointing out that there are other areas of emphasis for the financial development of Hong Kong in the new era that I have not touched upon, for example, the provision of a financial platform for infrastructure financing associated with the "One Belt, One Road" initiative, the application of modern information technology in the delivery of finance services, and the corresponding development of an effective regulatory framework, etc. But I shall leave these to other speakers.

Thank you.

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