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## Hong Kong's Business and Financial Hub Development:

### Factors, Challenges, and Policy Implications\*

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#### Abstract

This chapter comprehensively analyzes how Hong Kong developed to be a business and financial center, and its experience and implications. We come through the development history of Hong Kong to get a general idea of its development process. Key factors for Hong Kong's success include innovation and technology policies, industry promotion policies, free trade and free capital flow business environment, liberal and noninterventionist policy, well-established legal system, low taxation system, sophisticated physical infrastructure, educated workforce and professional talent, and close economic relations with mainland China. Innovation and industry policies are the most important factors. Hong Kong still faces challenges such as regional competition, changing trade mode, and comparatively slow economic growth. The main lessons learned from Hong Kong's development include innovation-led growth mechanism, free market environment, a sound legal system, and effective regulation policies. We discuss policy implications in the last part of the chapter.

**Keywords:** Hong Kong, Business Center, Financial Center

**JEL Classification:** G15, F23, G10

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## 1. Introduction

As an international financial center, Hong Kong has been ranked highly in statistics compiled by a variety of organizations. The International Monetary Fund and the World Bank ranked Hong Kong third in the world in 2015; in the same year, it ranked third in the Xinhua-Dow Jones IFC Development Index. In most of the statistics issued by international institutions, Hong Kong was typically ranked in the top five. It is fair to say that Hong Kong is one of the important business and financial centers in the world. Therefore, it is necessary to comprehensively survey Hong Kong's rise as a business and financial center, as well as analyze the main factors in its success.

We analyze Hong Kong's financial center development history since the 1950s and try to give a general idea of how it developed to be a global financial hub. We conclude that Hong Kong owes its success to three factors: policy, internal, and external. Policy factors are laws, rules, and measures taken by the government. Policy factors include innovation and technology policies, industry promotion policies, free trade and free capital flow environment, liberal and noninterventionist policy toward business, a well-established regulatory and legal system, and low and transparent taxation system. Internal factors relate to Hong Kong's domestic environment and conditions. They include sophisticated and extensive business and finance infrastructure, sustainable economic growth, political and social stability, an educated workforce and rich pool of professional talent, good physical infrastructure, and free press and transparent information. External factors relate to the surrounding environment and conditions that are exogenously given. For Hong Kong, we think that external factors include its central and convenient geographical location, close economic relations with mainland China, and fast-growing neighbors.

Hong Kong is not only an international financial center, but it is also an important business center. As a logistics core of East Asia, Hong Kong runs more than 400 airlines, operated by about 80 international container shipping companies, heading for more than 500 destinations every week.<sup>①</sup> Its container port is one of the busiest in the world and is known for its mature management experience; it also boasts a well-run airport and efficient clearance procedure that other countries would do well to study.

Hong Kong still faces challenges regarding its continued success. These challenges include regional competition from other business and financial hubs, changing trade modes and the prevalence of intra-firm trade, real industry hollowing, and comparatively slow economic growth.

From Hong Kong's success, we can find some experiences and lessons for building a business and financial hub: innovation and industry promotion policies, a free market environment, a sound legal system and effective regulation policies, fair competition, and skilled labor and talented professionals.

Hong Kong should take measures to further strengthen its business and financial center position. We propose five points: to further optimize the free market economic environment, promote development of the manufacturing sector, construct a politically stable society, strengthen economic relations with mainland China, and provide better physical infrastructure.

<sup>①</sup> <http://www.soft808.com/News/2016-2-18/8KBABC152796KK34639.html>



The contributions of this chapter are twofold. The first is that we focus our research on how Hong Kong developed into a business and financial center, as these factors have policy implications. The second is that we aim to describe for other cities that want to construct their own financial and business centers some policy implications and choices, which cannot be found in the literature.

This remaining parts of this chapter are organized as follows: section 2 outlines a profile of Hong Kong and proposes the basic concept of an international center or hub; section 3 studies in detail the development of Hong Kong's financial sectors; section 4 analyzes the key factors that led to Hong Kong's success; section 5 emphasizes the challenges that may affect its continued success; section 6 discusses what lessons other countries, especially Asian countries, can learn from Hong Kong's rising; and section 7 discusses the policy implication, i.e., what the government of Hong Kong should do to overcome the challenges it faces.

## 2. Profile of Hong Kong's Business and Financial Hub

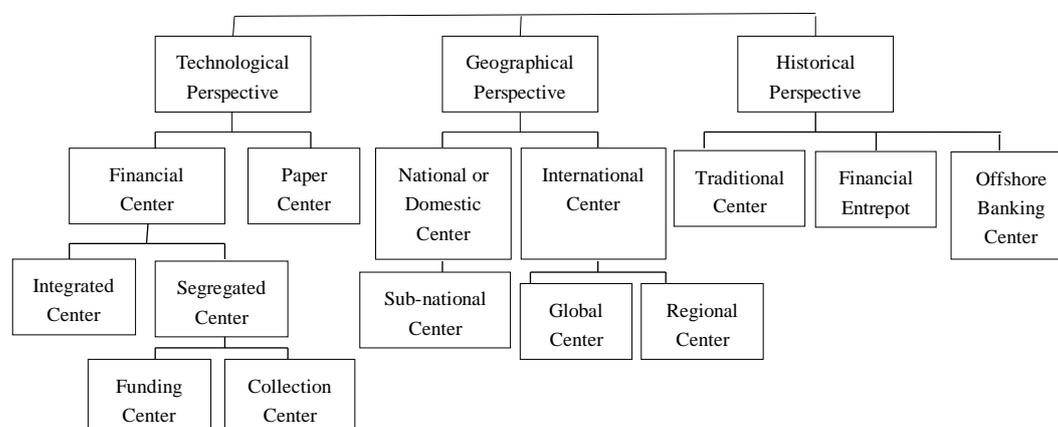
Technically, there is no universally accepted definition of the term “international financial center” or “business hub.” Intuitively, an “international financial hub” should be a place that affects the development of financial activities globally, that is to say that companies from all over the world are eager to be listed in its stock market; that its legal framework should be mature, which can guarantee that the financial activities in its market are orderly; that it has effective means to deal with a financial crisis, and so on. From this perspective, even though Hong Kong serves the whole world, it is more appropriately described as a regional financial center.

However, Hong Kong's postwar transformation from a transit trade harbor into an industrial powerhouse is worthy of study, especially considering that its rise took place over a rather short period. It is instructive to learn how a former tiny area colony was able to achieve this transformation. Under today's circumstances of the global economic structure changing enormously, Hong Kong's successful experience may lead the way for many other countries, especially those in Asia.

Hong Kong is indisputably one of the world's leading business and financial centers. It is not only a financial center but also a paper center<sup>②</sup> from the technological perspective, it is both a national and international center from the geographical perspective, and it is a traditional center, financial entre pot, and offshore banking center from the historical perspective (see Figure 1: Typologies of Business and Financial Center).

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<sup>②</sup> Paper center means information and communication center.

**Figure 1: Typologies of Business and Financial Center**

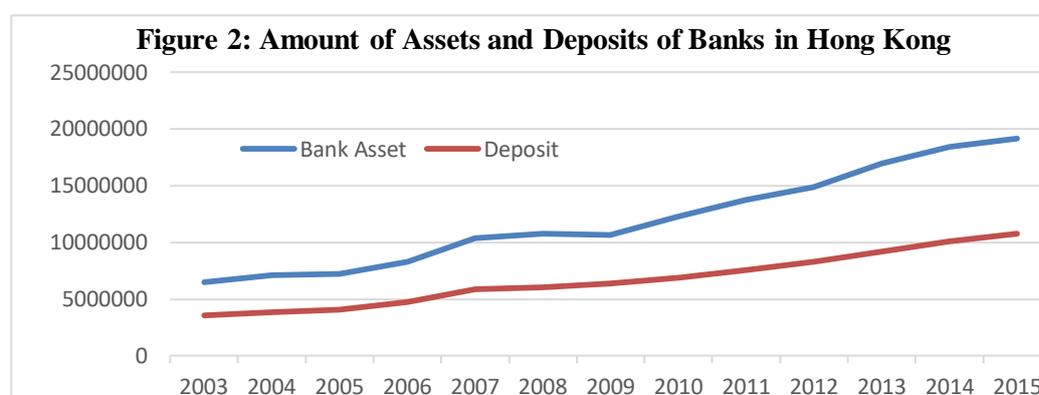
Source: Jao (2011), p4.

From the perspective of financial development, Hong Kong has performed perfectly in its free environment and steady legal system which deserves its reputation. Table 1 shows the number of banks in Hong Kong. From the table, we can see that for more than 10 years, the number of banks in Hong Kong has been stabilized at nearly 200, which indicates a high development level of the banking sector. As to the total assets of the banks, from 2013 to 2015, the trend of growth was stable (see Figure 2). In 2015, the total assets of banks in Hong Kong was HK\$19,180.6 million, which is about eight times Hong Kong's GDP.<sup>③</sup>The ability to attract deposits was also remarkable. In 2015, deposits in Hong Kong banks totaled HK\$10,749.8 million, about four times GDP.

**Table 1: Number of banks in Hong Kong (2003-2015)**

Year	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Number	215	208	199	202	200	200	199	193	198	200	201	203	199

Source: Wind.

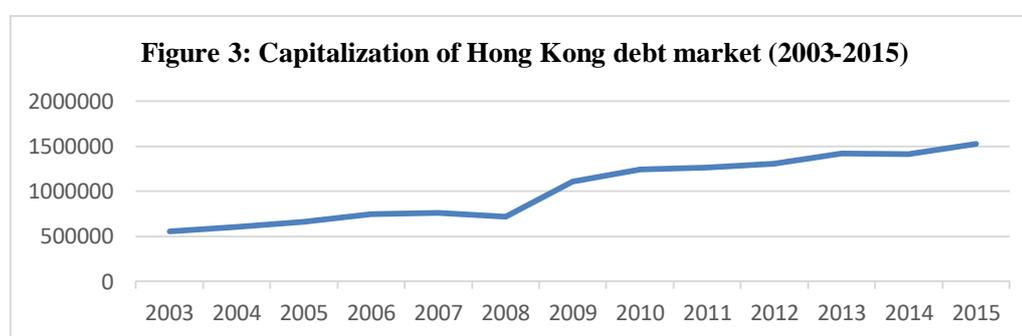


Source: Wind.

<sup>③</sup> [http://news.cnstock.com/news/sns\\_gg/201407/3107577.htm](http://news.cnstock.com/news/sns_gg/201407/3107577.htm)



Hong Kong owns a world-famous stock market and foreign exchange market, but its debt market, although relatively small, is not neglect table. In 2015, the capitalization of Hong Kong's debt market was HK\$1,524.6 million. Figure 3 shows that the debt market has been experiencing smooth and steady growth. From 2003 to 2015, the development of the debt market can be divided into two phases. The first phase was from 2003 to 2008, during which the growth rate was rather slow, in fact, it suffered a downturn in 2008 when the global crisis broke out. The capitalization in this phase grew from HK\$600 million to HK\$800 million, about a 33 percent growth over the six years. In the second phase, from 2008 to 2015, the growth rate was more rapid and the capitalization almost doubled from HK\$800 million to about HK\$1,600 million. All these facts explain Hong Kong's huge attraction to investors.



Source: Wind.

Hong Kong is more than a financial center. It is also one of the busiest and most efficient container service ports in the world. Hong Kong is an island, and the ports are spread all over its area (see Figure 4). According to Hong Kong Maritime and Port Board, Hong Kong handled 20.1 million TEUs (twenty-foot equivalent unit, the size of a standard container) in 2015. The Hong Kong port now provides about 340 container liner services per week connecting to about 450 destinations all over the world.<sup>④</sup> As shown in Figure 5: Commodities and Services Trade of Hong Kong, from 1957 to 2015, the amount of Hong Kong's commodities and services trade increased gradually until the mid-1990s, when the growth rate became much more rapid. Hong Kong's transfer trade is almost equal to the commodities and services trade, which indicates the importance of Hong Kong as a transit port.

<sup>④</sup> Hong Kong Maritime and Port Board, <http://www.hkmpb.gov.hk/en/port/port.html>



Figure 4: Hong Kong's Ports Are All Around the Island

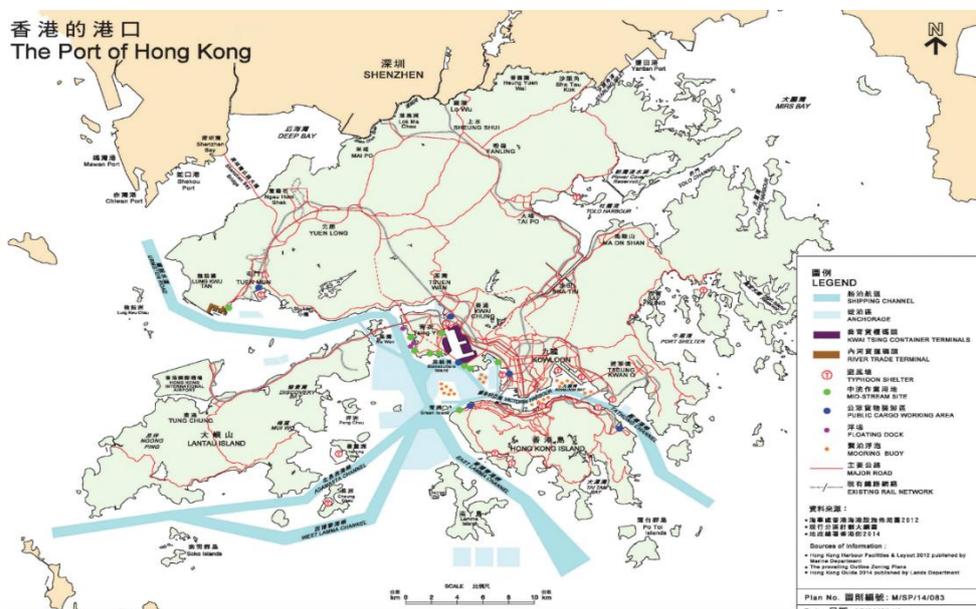
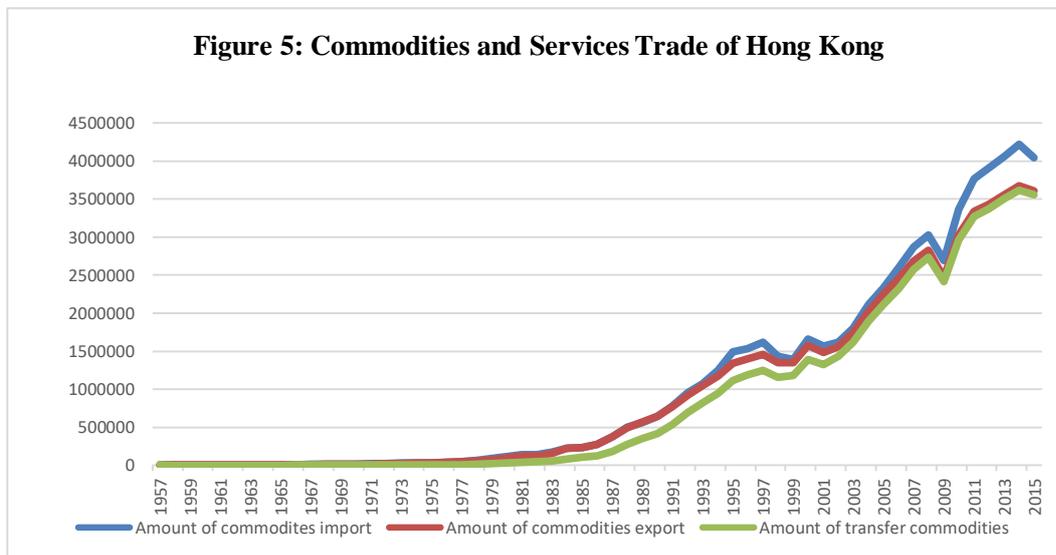


Figure 5: Commodities and Services Trade of Hong Kong



Source: Wind.

Hong Kong has become an international hub for business, trade and finance importers desirous of accessing the Chinese market. As such, the largest sector of the economy is services, which accounts for around 93 percent of GDP. Within services, the most important sectors are wholesale and retail trade (25 percent of GDP); public administration and social services (17 percent); finance and insurance (16 percent); real estate and business services (11 percent); ownership of premises (10 percent); and transportation and postal services (6 percent).



Information and communications and food and accommodation together account for 8 percent. Construction represents 3.5 percent of GDP, and electricity, water and gas supply, waste management and manufacturing account for 3.4 percent.<sup>⑤</sup>

Of the other financial and business hubs in the Asia area, Singapore is one of important competitor to Hong Kong. Although Hong Kong has a longer history as a center for business, Singapore has fast caught up, undermining Hong Kong's dominance in the region. Singapore has been quick and nimble in adopting business-friendly policies that continue to attract the bulk of foreign investors to establish their Asian presence on its shores. Some investors that choose Singapore are driven by lifestyle reasons or by the strength of its infrastructure and the quality of its service providers. Some choose Hong Kong mainly to get a foothold in the Chinese and North Asian markets. Smaller business often choose Singapore as it offers more attractive tax benefits and a lower cost environment when compared to its rival.

Compared with Singapore, Hong Kong now is no longer as attractive as it used to be. According to the Xinhua-Dow Jones IFC Development Index, Hong Kong scores low on quality of life and high on its cost of living, and qualified labor at affordable costs is no longer as easily available. Furthermore, English usage is declining, and the business community has concerns over the region's political stability in the future.

### 3. Hong Kong Financial Sector's Development History

This section examines in detail the development of Hong Kong's financial sector, from the time it opened for trade until the present day. The purpose is to provide an outline of Hong Kong's finance, emphasizing the major events that affected its development and the factors that caused Hong Kong's transformation.

The origin of Hong Kong's financial business, which is characterized by the rise of the banking sector, may be traced back to when it was opened for trade in the 19th century. At that time, foreign banks actively set up offices in Hong Kong, and their businesses were transferred to Hong Kong through this process. It was these offices that provided the necessary funds for countries that traded with China. At the early stage, the development of finance was mostly reflected by the increasing number of commercial banks, and the main business of these banks was to take deposits. Although its financial development followed this unitary pattern, Hong Kong's openness and its geographical advantages constantly attracted banks from all over the world to launch businesses on the island. The local banking sectors also benefited from this (Jao, 2003).

In 1950s the mode of Hong Kong's financial business started to change, and it gradually formed the embryo of modern finance. The reasons for this were both external and internal. First, the external reason was the establishing of People's Republic of China (PRC) in 1949. The central government of the PRC implemented strict monetary regulation under which only a few designated Chinese banks were allowed to conduct financial activities with Hong Kong. That led to a sharp decline in Hong Kong's trade volume. Also, considering the unstable situation of the PRC at that time, investors abroad worried about the investment environment in China.

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<sup>⑤</sup> See Trade Economics database: <http://www.tradingeconomics.com/hong-kong>.



Thus the funds that flowed into China through Hong Kong were stagnated. Second, the internal reason was the transformation of Hong Kong's economic structure. Hong Kong started to achieve industrialization in the 1950s. The population of Hong Kong boomed and then the government approved several policies to stimulate the development of real estate. That transformed the earlier banking mode of trade financing into one that was providing capital for manufacturing and real estate. This mode transformation was very important since it laid the groundwork for the diversification of Hong Kong's financial market and in turn promoted Hong Kong into an international financial center.

During the postwar recovery, innovation policy plays an important role. The Hong Kong government established some important institutional frameworks and organizations around the late 1960s, early 1970s and beyond. These institutions both supported innovative activity in Hong Kong and intervened in it to varying degrees. Primary among them was the Hong Kong Productivity Council, which was initially conceived by the Working Committee on Productivity in 1963 and was created in 1967. Another move in this direction was the Advisory Committee on Diversification, authorized in 1977, which recommended a more active role in finance for the government and greater support for the provision of technological infrastructure.<sup>⑥</sup>

One of main characteristics of a financial center is that it always has a stock market that performs well. The modern stock market of Hong Kong appeared in late 1960s and became widely recognized in the early 1970s.<sup>⑦</sup>

The stock market's prosperity was driven by several factors. First, Hong Kong's economy was booming, which brought strong demand from the market side. Manufacturing and merchant companies were urged to raise funds for their further development. As a result, more and more companies chose to be listed publicly while investors enticed by an optimistic economic outlook were also willing to invest. Furthermore, the international political environment—especially the relationship between China and United States in the Nixon era—gradually stabilized, which pushed investment interest to a rather high level. In addition, in the 1970s Western countries were going through a “stagflation” phase and were also under a severe monetary crisis. The unstable political environment in Middle East channeled the “hot money” to the Hong Kong stock market. More and more foreign financial institutions went to Hong Kong to acquire local companies and merchant banks and then invested in the stock market. The degree of internationalization of Hong Kong became higher day by day. All these factors jointly pushed the stock market into a fast-paced development.

In 1986, the Hong Kong Stock Exchange was approved for membership by the Federation International des Bourses de Valeurs (World Federation of Exchanges), a step that marked a high degree of internationalization. Since the 1980s, the Hong Kong Stock Market's status in the international securities market has dramatically improved. In 1976, the market capitalization of Hong Kong stock market accounted for 0.9 percent of the world market and was ranked 11th in the world. Five years later, in 1981, Hong Kong was ranked seventh in the world and second in Asia (all capitalization is calculated using current prices).

Today the Hong Kong Stock Exchange is the sixth-largest stock exchange in the world in terms of capitalization, and it is the third largest in Asia behind Tokyo and Shanghai. In total, as of August 2015, 1,810

<sup>⑥</sup>R. Ferguson, “From Ships to Chips: Research Issues Surrounding Hong Kong's Technology Policy” (Hong Kong: Hong Kong University of Science and Technology, 2001).

<sup>⑦</sup>The Hang Seng Index was publicly published on November 24, 1969.



companies were listed in the exchange: 920 from the mainland, 788 from Hong Kong, and 102 from abroad.<sup>⑧</sup> In addition to a prosperous stock market, Hong Kong owns a foremost foreign exchange market.

For decades, while Hong Kong was a British colony, its currency was pegged to the pound sterling. In the early stage of the postwar period, the Hong Kong government put strict controls on foreign exchange. During the strictest enforcement period, every trade deal required authorization. It was not until 1972 that the situation changed. It came when the British government was forced to announce the free floating of the pound sterling because of sustained depreciation pressure. The Hong Kong government thereupon announced that Hong Kong's currency would henceforth be pegged to the US dollar. But in the wake of the collapse of Bretton Woods system, the Hong Kong government soon announced it would stop pegging the currency to US dollar, and that instead the Hong Kong dollar would be freely floating with its exchange rate determined by demand and supply in the market.

The removal of controls over the foreign exchange and the formation of a floating rate regime promoted further development of Hong Kong's foreign exchange market. In 1978, the Hong Kong government relaxed the limitation on licenses for foreign banks, which led to 21 large foreign banks being granted full licenses to operate in Hong Kong. Most of these banks lacked a Hong Kong dollar. These banks had to use various means including selling foreign exchange in the market, borrowing funds through the interbank market and other schemes to get the assets they needed, but those assets profoundly improved Hong Kong's foreign exchange market, turning it into a modern and mature one.

In 1989, according to an investigation conducted by the Bank for International Settlements, in which Hong Kong participated for the first time, the average daily turnover in the foreign exchange market of Hong Kong has already exceeded US\$40 billion, ranking sixth in the world behind Britain, the United States, Japan, Switzerland, and Singapore. Today, Hong Kong's foreign exchange market is one of the most important in the world. In 2013, its average daily turnover of foreign exchange transactions was US\$274.6 billion dollars and it was ranked fifth in the global exchange market.<sup>⑨</sup>

As mentioned, the relaxation in the 1970s of limits allowing foreign banks to operate promoted Hong Kong into an international business hub. Further developments in the 1980s strengthened its base and made Hong Kong one of the world's major financial hubs.

In the late 1980s, after a couple of crises occurred in Hong Kong's finance industry, namely that a number of finance companies and banks went bankrupt in 1986 and the Hong Kong Futures Exchange went bankrupt the following year, the Hong Kong government realized that reform of the Hong Kong finance industries was urgently needed. The Bank Ordinance was amended and the Basel Accords were introduced in Hong Kong. The securities market also underwent reform. These reforms achieved the desired results and Hong Kong became the fourth-largest financial center in the world in terms of its number of foreign banks.

As an international financial center, Hong Kong performs various functions:

<sup>⑧</sup> See: [http://www.hkex.com.hk/eng/listing/listhk/our\\_markets.htm](http://www.hkex.com.hk/eng/listing/listhk/our_markets.htm).

<sup>⑨</sup> HKMA, <http://www.hkma.gov.hk/eng/key-information/press-releases/2013/20130905-3.shtml>



(1) As a center of capital export. According to the Hong Kong Monetary Authority (HKMA), the amount of foreign assets that banking sectors held has exceeded US\$100 billion, most of which was bank loans. The main sources were banks from Britain, Japan, and the United States. By the end of 2014, the amount of foreign assets was about US\$3trillion.<sup>⑩</sup>

(2) As a center of foreign exchange and stock. As noted, the Hong Kong foreign exchange market has developed at a rapid pace since the 1970s, mainly reflected in the fast growth of the average daily turnover of foreign exchange. By the 1980s, Hong Kong had already become a foreign exchange center. Today, after 30 years' development and perfection, it is one of the main foreign exchange centers in the world, especially in Asia along with Singapore and Japan.

Also, Hong Kong now has the biggest stock market in Asia with more than 1,800 companies from all over the world listed. The Hong Kong Stock Market has special implications for China. Among the companies listed in Hong Kong, more than half are from mainland China. For Chinese companies, Hong Kong has always been their first choice especially if their capital account is "closed." Hong Kong becomes a bridge that connects China with the world.

(3) As an international center of gold transaction. Hong Kong is also an important gold transaction market in the world. In 1974, the Hong Kong government removed limitations on exporting and importing gold, and since then the Hong Kong gold market entered a phase of fast growth. The main reason it has developed so fast is its geographical advantage: being between America and Europe, Hong Kong can perfectly supplement the time zone gap between the London market and New York or Chicago. Given this advantage, gold traders in London and Switzerland actively set up affiliates in Hong Kong, which turned Hong Kong into a main global gold transaction center. Another reason is that the Hong Kong gold market is not regulated by the government, plus there is no control over foreign exchange. Taken together, these qualities have made Hong Kong very attractive to global gold dealers. It is now the fourth-largest gold transaction market in the world, behind New York, London, and Zurich.

The Hong Kong financial market began taking shape in the 1980s, after which Hong Kong entered a phase of perfecting its financial system. By the late 1990s, Hong Kong's financial sector was basically mature. Meanwhile, a latent danger lurked in Hong Kong's economy, namely the unitary mode of its development mode. But when the economy underwent a slump, it would be a huge blow to the economy.

Hong Kong's finance business was affected profoundly by the Asian financial crisis in 1997, which weakened its status. Under the circumstances, the authority decided to further relax the financial limitation. Reform was enacted in the banking sector. In 1999, HKMA announced that the upper limit of interest rate on transaction accounts and deposits would be taken off starting in 2001, which made competition among banks more intense. It further improved the maturity of the derivative market. Meanwhile, modern finance tools, such as electronic business and use of the internet, were rapidly developing.

Since the late 1990s, the world financial pattern has been deeply changed, thanks to the development of

<sup>⑩</sup> HKMA, <http://www.hkma.gov.hk/eng/market-data-and-statistics/monetary-statistics/efbn/2015.shtml>



information technology. The world economy entered a phase of integration. Hong Kong's financial markets have become more globally integrated. In 2000, seven companies listed in NASDAQ were also listed in the Hong Kong exchange.<sup>11</sup> It was the first listed market for the companies. Also, by cooperating with security exchange in foreign countries, Hong Kong's "blue chip" stocks can be traded 24 hours a day in nine countries' stock exchanges.

Beyond the development of its financial services sectors, the Hong Kong government has participated even more actively and rapidly in the transformation of Hong Kong's innovation system so that it could identify a new role for itself as well as a new engine for its continued economic growth. This search culminated in the appointment of an Innovation and Technology Commission in March 1998. Members of the commission comprised mostly American-trained academics and professionals. In its report, the commission noted in its vision statement that "innovation and technology are vital to the future prosperity of Hong Kong."<sup>12</sup>

For the past few years, Hong Kong has extended its financial business to other areas, the most successful being the offshore renminbi business.

In recent years, China has quickened the pace of capital account liberalization. One important measure to achieve this goal is RMB internationalization, and China has launched a series of new policies to advance this process. Hong Kong has been a beneficiary of this process. It now has the largest RMB pool outside of China. The balance of RMB deposits in Hong Kong reached 900 billion in 2013 and is still growing rapidly. Hong Kong is now the most important offshore RMB center in the world.

#### 4. Key Factors for Success

What are main factors or elements for Hong Kong's successfully being a global business and financial center? This part will analyze these key reasons. We divide all key factors into three aspects: policy, internal, and external factors. Policy factors are laws, rules, and measures taken by the government, and we think of it as the most important factor. Internal factors relate to Hong Kong's domestic environment and conditions. External factors relate to the surrounding environment and conditions that are exogenously given. Factors for Hong Kong's success in constructing a business and financial hub are summarized in Table 2.

**Table 2: Factors of Hong Kong's status as a business and financial hub**

Type	Key Factors
Policy Factors	(1) Innovation and Technology Policies (2) Industry Promotion and Trade Policies (3) Free Trade and Free Capital Flow (4) Liberal and Noninterventionist Policy toward Business (5) Well-established Regulatory and Legal System (6) Low, Simple, and Transparent Taxation System
Internal Factors	(1) Sophisticated and Extensive Business and Finance Infrastructure

<sup>11</sup> The seven companies were Intel, Dell, Cisco, Microsoft, Amgen, Applied Materials, and Starbucks.

<sup>12</sup> HKSAR, "Commission on Innovation and Technology First Report"(Hong Kong, 1998).



	(2) Sustainable Economic Growth (3) Political and Social Stability (4) Educated Workforce and Rich Pool of Professional Talent (5) Good Physical Infrastructure (6) Free Press and Transparent Information
External Factors	(1) Central and Convenient Geographical Location (2) Close Economic Relations with Mainland China (3) Surrounded with Fast-growing Countries

Source: The authors.

## 4.1 Policy Factors

Policy factors are mainly government measures, rules, and laws. There are six specific points for this part, which are innovation and technology policies, industry promotion and trade policies, free trade and free capital flow, liberal and noninterventionist policy toward business, well-established regulatory and legal system, and low, simple, and transparent taxation system.

### (1) Innovation and Technology Policies

Hong Kong is an innovation-led economy. The government carries out a series of innovation and technology promotion policies to enhance the competitiveness of industries. The government set up the Innovation and Technology Commission (ITC) in 1998. The commission uses five main strategies to promote innovation and technology development: providing world-class technology infrastructure for enterprises, research institutions, and universities; offering financial support to stakeholders in the industry, academia, and research sector to develop and commercialize their R&D work; nurturing talent; strengthening science and technology collaboration with the mainland and other economies; and fostering a vibrant culture of innovation. ITC's achievements have been fruitful. As of 2016, there are more than 5,000 programs including innovation and technology support and university-industry collaboration programs approved by the ITC and supported by more than US\$11 billion in funding.

The Hong Kong government announced in 2015 that the Steering Committee on Innovation and Technology will be reorganized into the Advisory Committee on Innovation and Technology, to tender advice on the development of innovation and technology. The ITC manages the Innovation and Technology Fund to support projects that contribute to innovation and technology upgrading in industry. The Research and Development Cash Rebate Scheme was established in 2010 to reinforce the research culture among enterprises and encourage them to establish stronger partnerships with local research institutions. The ITC also helps to develop world-class support infrastructure to facilitate technological upgrading and development of the industry, such as Hong Kong Science and Technology Parks and Hong Kong Science Park.<sup>14</sup>

The ITC also works on fostering an innovation and technology culture, and it supports innovation- and technology-related competition such as the Hong Kong Student Science Project Competition and School Science Exhibition. These innovation policies help keep competition flourishing in Hong Kong.

<sup>14</sup>ITC, "Hong Kong: The Facts," Innovation and Technology Commission (2015), <http://www.itc.gov.hk>.



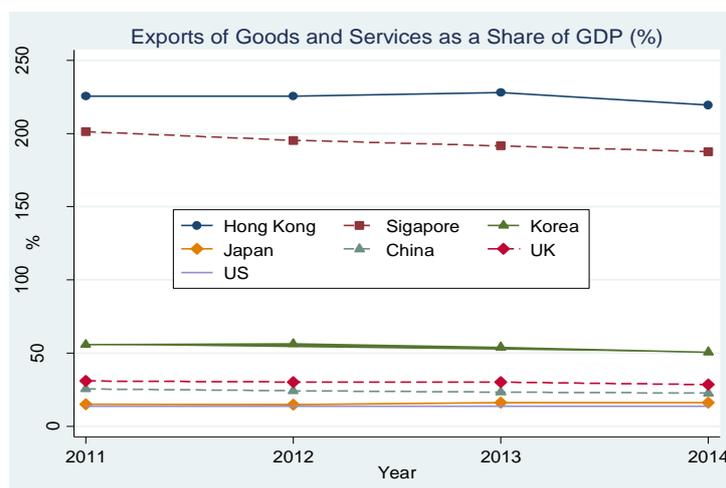
## (2) Industry Promotion and Trade Policies

The Hong Kong government tries to provide a friendly environment and maximum support for the development of industry and commerce in Hong Kong. The government encourages the industry sector to harness the forces of innovation and technology for improving productivity and adding value to products, provides world-class support infrastructure for industrial development, and helps address issues of concern to industry. The government supports small and medium-sized enterprises (SMEs). Through different agencies, the government provides a comprehensive range of services to meet the needs of SMEs. Nongovernmental bodies, such as the Hong Kong Trade Development Council, Hong Kong Productivity Council, and the Vocational Training Council, are also key SME service providers. The government also promotes inward investment. External direct investment brings in new technology and management culture, creates employment, and enriches Hong Kong as a cosmopolitan city.

## (3) Free Trade and Free Capital Flow

Hong Kong is built on a policy of free market, low taxation, and government nonintervention, and is best known for its capital economy and its popularity as an offshore center for business and individuals. Hong Kong's total trade exceeds its GDP as a transit trade center (see Figure 6). Hong Kong has been ranked for many years as the world's freest economy in the index of both Economic Freedom and Economic Freedom of World Report (see Table 3). Free trade and a free capital flow environment have largely promoted Hong Kong as a transit trade center and capital center, which are two of the most important factors in its success.

**Figure 6: Exports of goods and services as a share of GDP (%)**



Note: Korea in the figure are South Korea.

Source: World Bank Database.

## (4) Liberal and noninterventionist policy toward business

The Hong Kong Special Administrative Region government follows a liberal and noninterventionist policy toward business and the economy. Such a policy protects firms' interests and rights, which in turn attracts more firms to settle down in Hong Kong. The 2015 Global Financial Centers Index shows that Hong Kong is the third



best financial center in the world, trailing only London and New York. The World Competitiveness Yearbook of 2015 says that Hong Kong ranks second in the world as a competitive economic entity, behind the United States. The World Bank's 2015 Doing Business index shows that Hong Kong is ranked fifth. The Economic Freedom Index and Economic Freedom of the World both put Hong Kong at the top of their lists as the freest economic entity in the world.

**Table 3: Global rankings of Hong Kong in 2015**

Rank	Global Financial Centers 2015	World Competitiveness Yearbook 2015	World Bank Doing Business 2015	Economic Freedom Index 2015	Economic Freedom of the World 2015
1	London	United States	Singapore	<b>Hong Kong</b>	<b>Hong Kong</b>
2	New York	<b>Hong Kong</b>	New Zealand	Singapore	Singapore
3	<b>Hong Kong</b>	Singapore	Denmark	New Zealand	New Zealand
4	Singapore	Switzerland	Korea	Australia	Switzerland
5	Tokyo	Canada	<b>Hong Kong</b>	Switzerland	United Arab Emirates
6	Seoul	Luxembourg	United Kingdom	Canada	Mauritius
7	Zurich	Norway	United States	Chile	Jordan
8	Toronto	Denmark	Sweden	Estonia	Ireland
9	San Francisco	Sweden	Norway	Ireland	Canada
10	Washington DC	Germany	Finland	Mauritius	United Kingdom

Source: Global Financial Centers Index 2015, World Competitiveness Yearbook 2015, World Bank Doing Business 2015 Report, Economic Freedom Index 2015, and Economic Freedom of the World 2015 Report.

### (5) Well-established Regulatory and Legal System

Hong Kong has an effective and efficient regulatory and legal system that is of an international standard. The legal framework is well developed and comprehensive, and its trusted legal system is based on English common law and supplemented by locally enacted ordinances. The judicial system, which is firmly based on the impartial rule of law, operates on the principle of the independence of the judiciary from the executive and legislative branches of government. The World Bank Strength of Legal Rights Index shows that Hong Kong's legal rights strength is high (see Table 4). The respected rule of law and freedom of press are indispensable elements to the recognition of Hong Kong as a world-class business and financial center.<sup>15</sup>

**Table 4: Strength of legal rights index**

Strength of Legal Rights Index (0=Weak to 12=Strong)						
Country/Year	2010	2011	2012	2013	2014	2015
Hong Kong	7	7	7	7	7	8
Singapore	8	8	8	8	8	8
Korea	5	5	5	5	5	5
Japan	4	4	4	4	4	4
China	4	4	4	4	4	4
United States	11	11	11	11	11	11
United Kingdom	7	7	7	7	7	7

Source: World Bank data.

<sup>15</sup>FCLK, "Hong Kong as an Offshore Financial Center," Fairbairn Catley Low & Kong Report (2009), [www.fclklaw.com.hk/english/legal/update26.pdf](http://www.fclklaw.com.hk/english/legal/update26.pdf).



#### **(6) Low, Simple, and Transparent Taxation System**

Hong Kong has a low, simple, and transparent taxation system. The corporate tax rate is 16.5 percent, and personal income tax is capped at 15 percent. There is no sales tax, no withholding tax on dividends and interest, no capital gains tax, no value-added tax, and no estate duty. Hong Kong has a growing network of comprehensive double taxation agreements with major jurisdictions.

The uncomplicated, transparent, and low tax regime encourages entrepreneurial activity and contributes to a favorable business environment that attracts business and investment. It is especially attractive for those who wish to have efficient tax planning, all the more so for those companies that operate in a jurisdiction where the tax imposed on profits is higher than that of Hong Kong. Funds of investment companies set up in Hong Kong can be invested or deposited throughout the world and while generally returns or interest payable in respect of these funds will be subject to taxation by the applicable jurisdiction, funds placed in Hong Kong in bonds or as bank deposits are tax-free without any withholding tax. Therefore, a company incorporated in Hong Kong is a useful tax planning tool. Hong Kong also offers relief from double taxation through international tax treaties, thereby encouraging the free flow of international trade, international investment, and international transfer of technology.<sup>16</sup>

### **4.2 Internal Factors**

Internal factors are mainly the domestic environment and conditions. They comprise six aspects: sophisticated and extensive business and finance infrastructure, sustainable economic growth, political and social stability, educated workforce and rich pool of professional talent, good physical infrastructure, and free press and transparent information.

#### **(1) Sophisticated and Extensive Business and Finance Infrastructure**

Hong Kong is a developed special administrative region of China, with more than US\$40,000GDP per capita in 2014. It has advanced and convenient transportation, developed technological support for business, and good business services. Hong Kong owns a sound financial system. As of the end of 2014, the Hong Kong Stock Market was the world's sixth largest and Asia's second largest in terms of market capitalization. Hong Kong is one of the most active markets for raising initial public offering funds. It is also one of the most open insurance markets in the world. At the end of 2014, there were more than 150 authorized insurers in Hong Kong, more than 80 of which were incorporated in Hong Kong, while the remaining ones were from the mainland or overseas jurisdictions. Fourteen of the world's top 20 insurers conducted business in the city. Hong Kong is Asia's leading asset management center. At the end of 2014, more than 110 approved fund management groups were managing 2,000 unit trusts and mutual funds authorized by the Securities and Futures Commission.<sup>17</sup> This excellent and mature business and finance infrastructure forms a basic condition for Hong Kong as a business and financial center.

<sup>16</sup> Ibid.

<sup>17</sup> CEDB, "Hong Kong: Asia's World City," Commerce and Economic Development Bureau of Hong Kong Report (2014), <http://www.cedb.gov.hk/>.



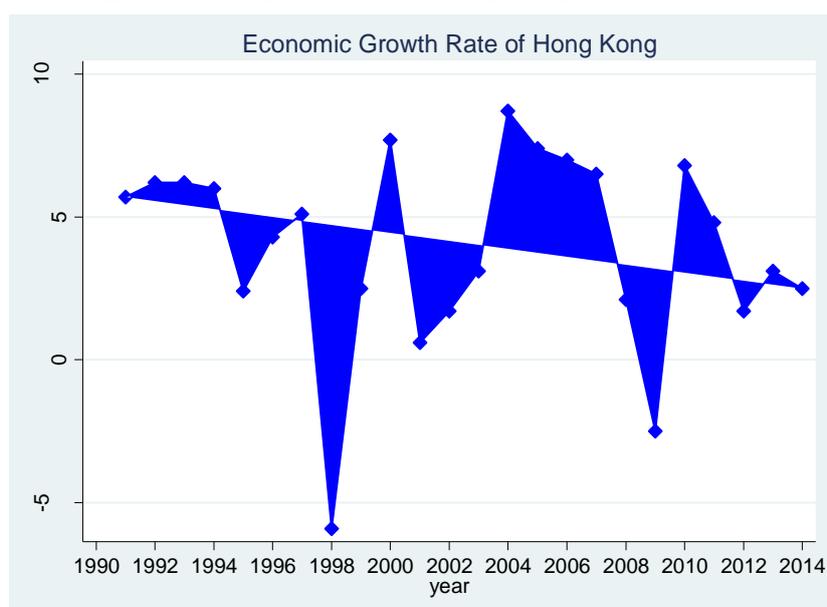
## (2) Sustainable Economic Growth

Hong Kong has a strong economic foundation. Its economic growth rates in the past few decades are higher than those of most developed economies (see Figure 7). GDP per capita of Hong Kong in 2014 is US\$40,169.6, more than in Japan or South Korea, and in fact is in the developed economy level (see Table 5).

**Table 5: GDP per capita of countries (US\$)**

Country/Year	2011	2012	2013	2014
Hong Kong	35,142.5	36,707.7	38,364.2	40,169.6
Singapore	53,122.2	54,578.2	55,979.8	56,286.8
South Korea	24,155.8	24,454.0	25,997.9	27,970.5
Japan	46,203.7	46,679.3	38,633.7	36,194.4
China	5,574.2	6,264.6	6,991.9	7,593.9
United States	49,781.4	51,456.7	52,980.0	54,629.5
United Kingdom	40,974.7	41,050.8	4,176.8	45,603.3

Source: World Bank Database.

**Figure 7: GDP growth rate of Hong Kong 1991-2014 (%)**

Source: World Bank Database.

Hong Kong is also a large trading entity whose total value of imports and exports exceeds its GDP. Having established extensive trade and investment ties, Hong Kong is the most attractive gateway for investments and resources to flow into the world's fastest-growing economy, mainland China. In general, Hong Kong's sustainable and economic foundation is the basis for its enviable business and financial hub position.

## (3) Political and Social Stability

Hong Kong was ceded to British control in the 19th century and reverted to Chinese sovereignty as a special administrative region of the People's Republic of China on July 1, 1997. The constitution of Hong Kong is known as the "Basic Law." It provides that Hong Kong shall operate under the "one country, two systems" mechanism.



Except for foreign and defense matters, Hong Kong shall enjoy a high degree autonomy for at least 50 years in all matters.<sup>18</sup> This political and social stability has attracted a wide variety of international and overseas firms to do business in Hong Kong and has made the city one of the most important business and financial hubs in the world.

#### **(4) Educated Workforce and Rich Pool of Professional Talent**

Hong Kong has a highly skilled workforce with world-class expertise in the financial sectors that is readily available to meet the needs of any business. It has several world-famous universities and research institutions, among them Hong Kong University, Hong Kong University of Science and Technology, Chinese University of Hong Kong, and City University of Hong Kong. Tertiary school enrollment rate of Hong Kong in 2013 is 67 percent, more than Japan with 61 percent and the United Kingdom with 60 percent<sup>19</sup> Meanwhile, Hong Kong people are flexible, accommodating, and adaptive to changes to suit the needs of enterprises. Additionally, Hong Kong is a gathering place for talented people and it boasts an educated workforce and professional talent.

#### **(5) Good Physical Infrastructure**

Hong Kong's economic development level is comparable to that of developed economies, with its living standard and physical infrastructure meeting high standards. This good physical infrastructure helps to keep entrepreneurs in Hong Kong and promotes high-class business and financial activities.

#### **(6) Free Press and Transparent Information**

Free press and transparent information are among the important factors for the development of a business and finance sector. One reason is that they help to construct a free society and environment and thus attract firms. Another reason is that business and finance development requires complete information, and transparent information is one of advantages that Hong Kong offers businesses. From getting a driving license to checking your Facebook account, reading the daily news, or researching potential business partners, Hong Kong is committed to transparent, timely, and reliable information.

### **4.3 External Factors**

External factors are mainly advantageous natural, geographical, and surrounding environments. We summarize three points: Hong Kong's central and convenient geographical location, strong economic ties with mainland China, and fast-growing neighbors.

#### **(1) Central and Convenient Geographical Location**

Hong Kong's location, time zone, and territorial openness to the movement of people have helped make it a clearinghouse for information and a powerful business and financial service center. With a landmass of more than 1,000 square kilometers, Hong Kong is situated at the southeastern tip of China, in the fastest-growing region in the world, and is the gateway to mainland China. Hong Kong is in the right time zone (UTC+8) to complement

<sup>18</sup>FCLK, "Hong Kong as an Offshore Financial Center," Fairbairn Catley Low & Kong Report (2009), [www.fclklaw.com.hk/english/legal/update26.pdf](http://www.fclklaw.com.hk/english/legal/update26.pdf).

<sup>19</sup> Data sourced from the World Bank database.



London and New York to form essentially a 24-hour stock market. Hong Kong's territorial openness makes it easy to gather goods, capital, and information, and it is convenient for transporting to any place.

### **(2) Strong Economic Ties with Mainland China**

Mainland China's support on trade, investment, and finance is one of important factors in Hong Kong's success. In addition, Hong Kong's transit trade has benefited from frequent interactions with mainland China. As an important transit harbor of mainland China, Hong Kong's economy is highly dependent on commercial trade. The Closer Economic Partnership Arrangement (CEPA) encourages mutual economic relations between Hong Kong and mainland China. Under the framework of CEPA, banks in the mainland could move their international capital and foreign exchange trading centers to Hong Kong for the purpose of using Hong Kong's financial resources. As a special administrative region of China, Hong Kong has benefited a great deal from mainland China's high economic growth and vast market.

China is the world's largest exporter and the second-largest economy. In recent years, it has promoted the internationalization of its currency, the renminbi (RMB). As the RMB is increasingly used outside mainland China, Hong Kong becomes China's testing ground for financial reform—the place where international use of the RMB as a settlement, investment, and funding currency is tested. In 2004, Hong Kong became the first market to conduct offshore RMB business and since then has expanded its scope of business. In 2007, Hong Kong became the first place outside mainland China to develop a RMB bond market. It is now the largest RMB trade settlement center and largest RMB funding center outside mainland China. Mainland China's development will benefit from Hong Kong's business and financial center construction.

### **(3) Surrounding Neighbors Are Mostly Fast-growing Countries**

Hong Kong's geographical neighbors in East Asia—mainland China, Taiwan China, India, and Singapore—all have high economic growth rates. Hong Kong's physical, human, and economic links with its neighbors have made it a natural center for trade in both goods and services and capital flow.

Meanwhile, Hong Kong has good relations with other main business and financial centers in developed countries. British rule set the policy and legal framework that still supports vibrant business networks with London, New York, and other leading global cities.<sup>20</sup>

## **5. Challenges Regarding Continued Success**

Although Hong Kong is already a well-recognized global business and financial center, and owns insurmountable advantages, it still faces challenges regarding continued success. These challenges include regional competition from other business and financial hubs, changing trade modes and the prevalence of intra-firm trade, and real industry hollowing and comparatively slow economic growth.

<sup>20</sup> L. W. Pauly, "Hong Kong Financial Center in a Regional and Global Context," *Hong Kong Journal* 22: 1–8 (2011).



### 5.1 Regional Competition from Other Business and Financial Hubs

Hong Kong plays a leading role across a range of regional business and financial markets, but it also is facing regional challenges. Challenges from abroad come from Singapore, Tokyo, and Seoul. Domestic challenges are mainly from fast-growing cities like Shanghai, Beijing, and Shenzhen.

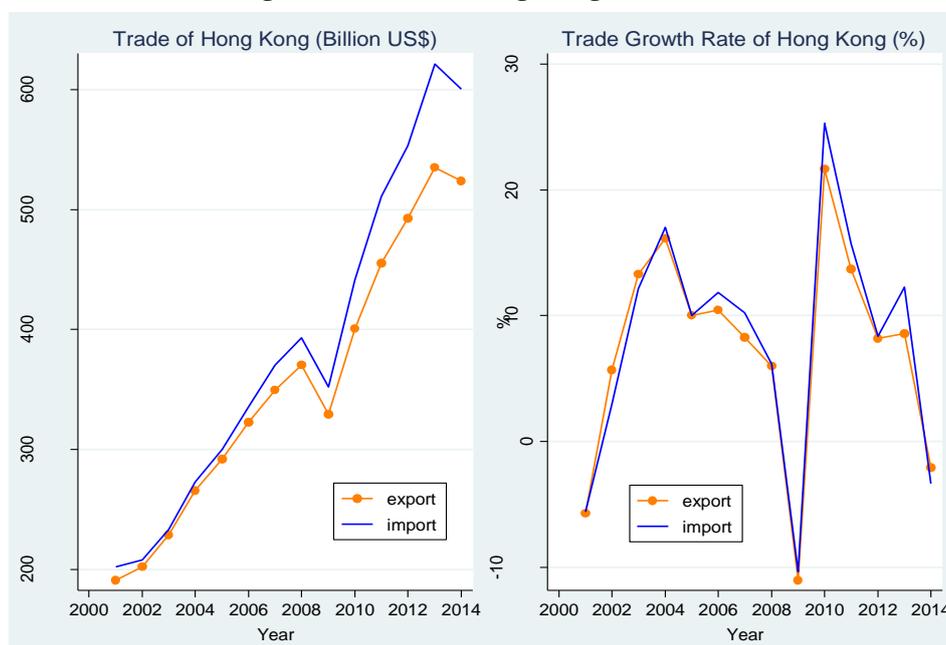
Of those, Hong Kong's main rival is Singapore, whose government quite clearly believes in and remains capable of implanting a coherent and effective industrial policy. The government in Hong Kong often served as a behind-the-sectors business facilitator and crisis manager. In Singapore, a centralized government promoted new industries and encouraged the development of a locally based "offshore" banking and bond market.<sup>21</sup> If Singapore is a continuing competitive challenge for Hong Kong, rapidly expanding business and financial centers in mainland China can be viewed as complements. Business and finance in Shanghai, Beijing, and Shenzhen is on the rise, and the three cities undoubtedly will challenge Hong Kong, but they mainly serve China's domestic market. Hong Kong's role, however, is viewed by the Chinese government as a gateway to the global economy, and in that sense mainland China's domestic cities cannot form significant challenges to Hong Kong.

### 5.2 Trade Modes Changing and Prevalent of Intra-firm Trade

With the development of multinational corporations and deepening global production networks, trade between nations mediated by merchant companies was largely transformed by the practice of intra-firm transfers within multinational firm networks. As a result, Hong Kong's function as an important transit trade center may gradually suffer. Meanwhile, mainland China's further reform and opening up will promote direct trade and that, too, could hurt transit trade from Hong Kong. As it is, Hong Kong's trade growth rate decreased sharply after the global financial crisis in 2008 (see Figure 8). Declining trade is one of Hong Kong's important challenges.

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<sup>21</sup> Ibid.

**Figure 8: Trade of Hong Kong 2001-2014**

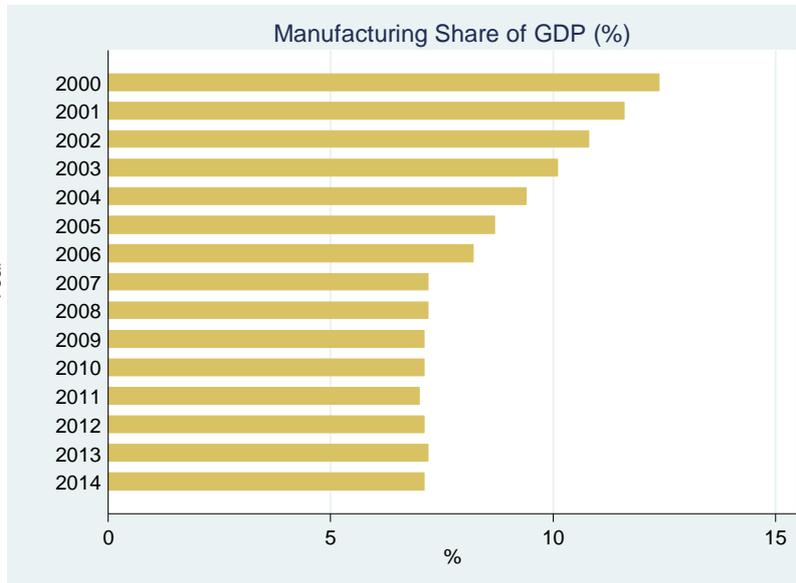
Source: WTO Statistics Database.

### 5.3 Industrial Hollowing and Comparatively Slow Economic Growth

The structure of the Hong Kong economy has shifted dramatically in the past several decades and has become extremely service-oriented. The massive relocation of the manufacturing industry to mainland China in the 1980s and early 1990s was largely responsible for this industrial hollowing out (see Figure 9). The manufacturing industry in Hong Kong was dominated by the production of light consumer goods with low technology content. Also, the small size of most firms in the industry kept them from conducting research and development or upgrading to high-technology activities. With local land and labor costs surging, manufacturing firms in Hong Kong took steps to restructure and relocate labor-intensive production processes across the border to mainland China. The low share of manufacturing sectors in GDP is a challenge to Hong Kong's sustainable economic growth.



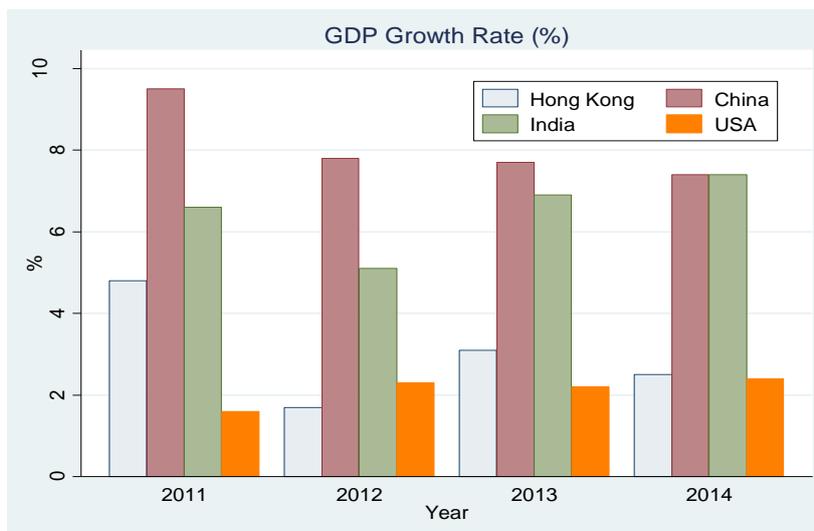
**Figure 9: Manufacturing sector share of GDP (%)**



Source: The World Bank Database.

Meanwhile, although Hong Kong's GDP growth rate is higher than that of most developed countries, it is lower than in the fast-growing economies of mainland China and India (see Figure 10). Compared to them, Hong Kong's economic growth rate is in the ranks of a low growth rate, which is disadvantageous for its business and financial center position.

**Figure 10: GDP growth rates of some countries (%)**



Source: The World Bank Database.



### 5.4 Economic Independence

As we have said, Hong Kong's economy is a small one from the perspective of size, and its development is easily affected by other economies, especially the gigantic economy of mainland China. According to a report by the International Monetary Fund in 2014, the claims of Hong Kong on the mainland had reached 1.6 times Hong Kong's GDP.<sup>22</sup> So if the mainland economy experienced a hard landing, the debt repayment ability of the borrowers would be highly affected and would seriously upset the order of Hong Kong's financial sector. Besides the mainland economy, any economic shock involving other countries in the world will also highly impede the development of Hong Kong's economy.

## 6. Key Lessons Learned

From the experience of Hong Kong's success, we can find some experience and lessons for building a business and financial hub. There are six key lessons: innovation and industry promotion policies, free market environment, a sound legal system and effective regulation policies, fair competition, skilled labor and talented professionals, and autonomy.

### 6.1 Innovation and Industry Promotion Policies are Important

Underlying Hong Kong's role as a dynamic business and financial center is its innovation and industry promotion policies. These policies are drivers of economic growth and are the key to enhancing the competitiveness of industries. The Hong Kong government has set up the Innovation and Technology Commission specifically to promote innovation. Hong Kong's industry policies include competition promotion policies, industry and business support, and inward investment support policies.

### 6.2 Free Market Environment Invigorates the Economy

As for the development process of Hong Kong to be a business and financial hub, a free market plays a key role, including a free trade system, free management of the private sector, free flow of capital, and free movement of people. The transparent and free market policies entrenched in Hong Kong have created a fair business environment and attracted a large amount of global capital to support economic growth.

A low tax burden helps to invigorate the private sector. Hong Kong's tax system follows the territorial principle, that is, for local people, only income that they earned in Hong Kong is taxed; they are not taxed on any foreign income. Hong Kong has been reducing the types of taxes it assesses since the 1990s, and today there are only three kinds of direct taxes and eight kinds of indirect taxes. Also, the tax rate is relatively low compared to other Asia-Pacific economies, with a standard corporate income tax rate of 15 percent. The tax deduction and return ratio in Hong Kong is high, which reduces the actual tax burden. Hong Kong's low tax rate and simple tax system are very attractive to investors from the mainland and elsewhere.

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<sup>22</sup> International Monetary Fund, People's Republic of China-Hong Kong Special Administrative Region: Financial System Stability Assessment (2014).



### **6.3 Sound Legal System and Effective Regulation Policies Should Be Adopted**

The legal system in Hong Kong is similar to that of other developed countries. As a result, investors from Europe and the United States are familiar with that kind of business and legal environment and find it easy to accept. This comfort level with the legal system has helped Hong Kong attract foreign direct investment and evolve into a center of multinational headquarters.

Regulation policies are an indispensable part in keeping the market system effective. Financial supervision in Hong Kong is similar to the level in other developed countries. This helps coordinate the development of the banking industry as well as fund management industry and the bond and stock market. “Principle-based supervision” is the core rule in Hong Kong’s financial supervision system.

Hong Kong uses English as its official language, and this makes it more effective when dealing with legal mediation or arbitration issues.

### **6.4 Fair Competition Is Embodied in Economic Policies**

Hong Kong insists on the principle of fair competition in making economic policies and rules, ensuring equal status to domestic and foreign companies. The FDI policies are highly transparent, consistent, and open. Hong Kong allows foreign investors to have 100 percent ownership of companies, and there is no control over the transfer of capital profit. There is little restriction to any specific industries, the public sector is not monopolized by state-owned enterprises, and cooperation between private and public entities is encouraged.

### **6.5 Skilled Labor and Talented Professionals Are Crucial to Industry Development**

Skilled labor and talented professionals have played an important part in Hong Kong’s evolution into a business and financial center. Nearly 200,000 people work in Hong Kong’s financial industry, most of whom are talented professionals. The high level of international expertise helps to improve the competitiveness of Hong Kong’s service industry.

A loose and open immigration policy encourages highly educated people to work in Hong Kong. And their expenditures on education, medical treatment, personal compensation, and the like are beneficial to the local people.

### **6.6 Improving the Autonomy of the Economy**

Hong Kong’s economy is highly related to other countries and areas in the world. Because the scale of its real economy is quite small, the degree of that Hong Kong’s economy is affected by other economies is very high. With the world economy becoming ever more globalized, the risk of a global crisis breaking out is increasing. Despite the good performance of Hong Kong’s financial center, the weakness of its economy will be infinitely amplified in the event of a global financial contagion. Thus, an urgent priority of Hong Kong is to find a sustainable point of growth.

## **7. Policy Implications**



This part discusses what Hong Kong should do to further strengthen its position as a business and financial center dynamo. We propose six points: to foster an innovation-led growth mechanism, further optimize a free market economic environment, promote manufacturing sector development, construct a politically stable society, strength economic relations with mainland China, and provide better physical infrastructure.

### **7.1 Foster an Innovation-led Growth Mechanism**

Innovation-led growth is what turned Hong Kong into a successful business and financial hub in Asia, but Hong Kong need to further improve its innovation and technology level. Over the past decade, Hong Kong has made attempts to improve its innovation and knowledge economy, but the outcomes have been modest. Hong Kong should further improve its innovation-led growth mechanism.

### **7.2 Further Optimize a Free Market Economic Environment**

As a small, open economy, Hong Kong benefits from free trade with other countries, while free capital flow and other open policies make Hong Kong more venerable to the external shocks. How to optimize the economic environment and reduce risks is an important challenge.

Also the complete free market economy induces market failure and the high degree of market monopoly in some areas results in the high cost of land and real estate, which deprived both consumer and producer surplus.

Historical experience shows that the standard of living of people is the rock of social stability and prosperity. The Hong Kong government needs to rethink its policy of idealism liberalism, and needs to take steps to improve the standard housing, education, and pension paradigm.

### **7.3 Promote Manufacturing Sector Development**

Hong Kong's economy is highly dependent on the service industry, which accounts for more than 90 percent of its GDP. In the service industry, the financial industry on the high level leads the economy growth, while the small retail business on the low level provides employment. Having an economic structure that relies too much on a single industry influences Hong Kong's economic growth potential. Hong Kong needs to broaden its base by promoting development of its manufacturing sector.

With the increasing of openness of mainland China, Hong Kong's traditional advantage as a transit trade hub and capital transfer hub is gradually being weakened and it may lose the competitive advantage. Hong Kong's government should become more active in directing industry development and upgrading.

### **7.4 Construct a Politically Stable Society**

The proportion of low-income groups is increasing, and social differentiation is intensified, which can affect the stability of the social situation. Hong Kong is now in a period of post-political reform, it is in the downside of economic cycle with a GDP growth rate of less than 2 percent, and as a result, fighting and conflict arises occasionally and is becoming the common social norm of Hong Kong. Public governance system innovation and the construction of civil society are important steps to under gird a stable society.

### **7.5 Strengthen Economic Relations with Mainland China**



Mainland China is Hong Kong's trade and capital origin, and it is also Hong Kong's direct investment destination. Mainland China's huge market and demand area basis for Hong Kong's development as a business and financial center. Therefore, Hong Kong should further enhance its economic relations with mainland China. CEPA is an important agreement, and it should be fully used to increase economic cooperation with the mainland. Along with the fast economic growth in the past 30 years, China harbors a goal of RMB internationalization. Setting up an offshore center in Hong Kong is under consideration. Hong Kong should take advantage of this good opportunity and promote Hong Kong as an offshore RMB financial center.

### **7.6 Provide Better Physical Infrastructure**

Having a welcoming physical infrastructure and environment for sophisticated financiers, top corporate decision makers such as regional headquarters and officers, and producer service providers from around the world will encourage them to base their businesses in Hong Kong. The government should pay more attention to building a beautiful environment with good facilities and excellent infrastructure.

### **7.7 Harmonize the Relationship Between Hong Kong, Shanghai, or Beijing**

For a few years, the Chinese government was trying to liberalize its capital account. As the best link between China and the world, Hong Kong has benefited enormously during this period. On the one hand, Hong Kong has geographical and historical advantages as said in previous sections. On the other hand, Hong Kong's economic structure is similar to that of the developed countries. As the main measures of capital account liberalization, the process of RMB internationalization could best be launched in Hong Kong.

However, China is not satisfied with merely a single offshore center even in its territory. Shanghai and Beijing are also important options for developing the RMB internationalization.

In Shanghai, the Shanghai Free Trade Zone was founded in 2013 and the one of its functions is to implement a high standard policy related to the openness of capital account. To a certain degree, Shanghai is very likely to replace Hong Kong in the future as a new and important international financial center.

Beijing is not only the political center of China, but it is also an important financial center. In 2015, the value added of financial sectors of Beijing was RMB 288.8 billion yuan, accounting for 18 percent of Beijing's GDP. Beijing is home to most of the national headquarters of the policy and commercial banks. There is no doubt that having the headquarters there is an advantage.

The relationship between Hong Kong and Shanghai and Beijing is more like operators than competitors. On the one hand, business regarding certain areas such as RMB internationalization is very similar. From this perspective, they compete with each other. But on the other hand, Shanghai and Beijing can learn a lot from the experience of Hong Kong's success, and the central government can also give Hong Kong certain privilege regarding its further development under the framework of "one country, two systems."



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