

# Hong Kong's Economic Future: Is a Currency Board the Answer?

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## Introduction

Outside of Tokyo, Hong Kong is the largest financial center in East Asia, attracting investors, businessmen, and economists worldwide with its rule of law, its extraordinarily low tax regime, and its well-developed infrastructure. (Hu) Hong Kong has also played an important part in China's economic success, acting as a middleman for the mainland's trade and investments. However, China's accession into the World Trade Organization on November 11, 2001, poses a potential threat to the future economic success of Hong Kong. The region's role as the "gateway" for China to the rest of the world comes into question. With reduced tariffs and the elimination of many trade barriers, China no longer needs to depend on Hong Kong as its economic liaison. Even more importantly, due to a surplus of labor China will emerge as a new low-cost manufacturer and will become a more attractive place for business. The large supply of workers available helps to keep wages down, while allowing for increases in the nation's consumption because of lower prices. ("Panda Breaks...") Furthermore, 2001 resulted in an economic setback for Hong Kong, and the region is still struggling to recover from the recession.<sup>1</sup> Even as of April 2002, the threat facing Hong Kong remains formidable, as is evident in the following quote from an article in *The Economist*:

While the former British colony still teeters on the brink of recession, the Chinese mainland's economy grew by 7.3% last year, and Shanghai's by more than 10%. If average growth rates over the past decade continue, Shanghai's GDP will match Hong Kong's in 15 years. In 20 years, its GDP per person will catch up too. ("Rivals More...")

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<sup>1</sup> Some economic indicators from the end of 2001: Hong Kong's overall GDP fell by \$US700 million from 2000, the unemployment rate rose to 6.1 percent, real GDP growth was -1.6 percent, and GDP per capita fell by \$US700.

Hong Kong needs to reexamine its monetary policy and the role the Hong Kong Monetary Authority plays in affecting the economy. An examination of the current exchange rate system of the region is a crucial step in attempting to determine what lies ahead for Hong Kong's economy.

Hong Kong's linked exchange rate system, known as a currency board system, has become a major subject of criticism and has led to numerous speculative attacks against the HK dollar. The system was created in October 1983 in response to a series of financial crises following the start of Sino-British negotiations. Since its establishment, many changes have been made to the system, so many, in fact, that the credibility of the entire arrangement is now doubted by economists and businessmen worldwide.

In this article, I discuss the creation of the currency board system some 18 years ago, as well as its main functions before any changes were implemented. Next, I describe the modifications that have been made to the currency board, the reasons behind each change, and how these changes affect the system as a whole. Finally, I analyze four alternatives to the arrangement Hong Kong currently has in place, with the intention of determining which system is the most feasible for the future economic success of the region.

### **Currency Board System**

In September 1982, while Hong Kong was under a free-floating system, officials began to plan for the region's future after its return to China. As a result, confidence in the HK dollar and economy began to diminish. That year, the stock market dropped more than 50 percent, the property market took a sharp downturn, and there were several runs on the small banks that had loaned money to the property market. The value of the HK dollar continued to decrease throughout the next year and on September 24, 1983, reached an all-time low of HK\$9.55 per US dollar. In less than a month, following a proposal made by Hong Kong business economist

John Greenwood, the government announced that it would return to a currency board system, which would pursue an anti-inflationary policy and promote currency stability<sup>2</sup>. (Schuler, “Currency Boards”)

A currency board traditionally is a domestic institution that issues coins and notes of a foreign currency upon demand at a fixed rate. This foreign (reserve) currency is established by the government and tends to be the currency of a major trading partner.<sup>3</sup> The reserve currency also tends to be an extremely stable one, thus helping to keep the anti-inflationary and stability goals of the domestic currency board system within reach. The fixed rate is determined at a time when the two economies are at fairly “calm” periods and neither of the exchange rates seems undervalued or overvalued relative to the other. The actual rate is determined by analyzing the purchasing power of each currency.<sup>4</sup> Typically, in order to be able to exchange the domestic currency for the foreign currency (and vice versa), at least one hundred percent of the monetary base (the currency in circulation plus demand deposits) must be backed by the reserve currency. Therefore, the domestic currency cannot be issued unless an equal amount of the reserve currency is deposited into the currency board. In addition, when a country or region puts a currency board regime into operation, it generally sacrifices its ability to engage in discretionary monetary policy. In other words, the domestic monetary authority sacrifices its control over the money supply to allow for automatic processes to control it.

A currency board generally has two automatically-adjusting mechanisms that work to control the monetary base. First is the “specie flow” mechanism. When there is a speculative

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<sup>2</sup> Hong Kong operated under a currency board system, linked to sterling, from 1935 to 1972. Then, between 1972 and 1974, the HK dollar was set at a fixed rate to the US dollar. From November of 1974 until the return of the currency board in 1983, the HK dollar floated freely against the US dollar.

<sup>3</sup> This helps to lower transaction costs for international trade; there is no real cost for the domestic trading partners to convert their currency into that of the reserve country when a currency board system is in place. The United States accounts for 22 percent of the Hong Kong’s exports.

<sup>4</sup> For example, if it costs an American importer \$US 100 (excluding taxes, duties, etc.) to purchase a good from Hong Kong which domestically costs \$HK 500, the exchange rate at that point in time would be \$HK 5 to \$US 1.

attack against the local currency and consequently a large outflow of capital, the amount of foreign exchange reserves falls. Since the foreign reserves are being removed from the currency board, note-issuing banks cannot issue more local currency without proper backing. This causes the monetary base, as well as the money supply, to shrink. As a result, domestic prices fall and interest rates rise. Once interest rates rise, it becomes attractive for investors to hold the local currency again; as the demand increases, so do the money supply and the monetary base, allowing for exchange rate stabilization. (Hanke) Arbitrage is the second mechanism that works in a similar way to automatically adjust the monetary base as well as the market exchange rate. This mechanism works when the market rate of the local currency falls (rises) far from the fixed exchange rate. In this case, arbitrageurs will buy (sell) the currency at the lower (higher) market rate and then sell (buy) it back to (from) the currency board at the fixed exchange rate for a profit. The increased demand for the local currency when the market rate is lower drives that rate up, causing it to converge with the fixed rate and adjusting the monetary base accordingly.

Hong Kong's currency board system, however, is far from traditional. First, Hong Kong's currency board, the Exchange Fund, is not the institution that issues reserve currency upon demand. There are actually three note-issuing banks responsible for the issuance of Hong Kong dollars (at the fixed rate of  $\text{HK\$}7.8 = \text{US\$}1$ ). They function in the same manner, nevertheless, as a traditional currency board. They submit US dollars to the Exchange Fund in return for "certificates of indebtedness," which can be sold back at any time to obtain US dollars at the fixed rate. These certificates are required by law in order to provide the one-hundred-percent backing of the domestic currency. (Jones) The accumulated reserves do not just remain dormant in the Exchange Fund; they are invested mostly in interest-bearing US government securities, which are highly liquid in case of a surge in demand for US dollars.

In addition to the note-issuing banks, Hong Kong has also implemented a series of reforms that have moved its currency board system even further from the “orthodox” regime. In 1988 the Accounting Arrangements were formulated, which in essence gave the Exchange Fund (EF) power to conduct open-market operations. Two years later, the EF began issuing Exchange Fund Bills (much like short-term Treasury bills), which became the instrument through which the open-market operations were carried out. In 1992 the Liquidity Adjustment Facility was established by the government as a discount window to provide banks short of HK dollars with overnight funds. Later on that year, the Hong Kong Monetary Authority (HKMA) was created by merging the Exchange Fund Office with the Office of the Commissioner of Banking.<sup>5</sup> Since then, the HKMA has worked to narrow the spread between Hong Kong and US dollars through open-market operations, with the main goal of maintaining exchange-rate stability. The HKMA has also been responsible for adjusting interbank liquidity and consequently acting as a lender of last resort. These actions by the HKMA contradict the traditional belief of how a currency board should act, as mentioned earlier in the article; the right to conduct discretionary monetary policy (including the role as lender of last resort) is forfeited upon the creation of a currency board. This is a clear example of how far Hong Kong has actually moved from the “orthodox” system. (Kwan and Lui, “Hong Kong’s...”)

The currency board arrangement, though far from the traditional system, has promoted monetary stability in Hong Kong. It has allowed the HK dollar-interest rate to closely follow the stable path of the US dollar-interest rate. In addition, there has been less fluctuation in monetary growth within Hong Kong since the establishment of the currency board system. The system operates under a fixed exchange rate, which is extremely advantageous because is not influenced

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<sup>5</sup> Before merging with the Exchange Fund, the role of the Commissioner of Banking was to supervise the region’s banks.

by any type of political or technical manipulation. This provides the people of Hong Kong with a sense of security and stability with respect to their monetary policy. (Greenwood) With the currency board system in place, Hong Kong has also been able to withstand the world-wide stock market crash in October of 1987, the effects of the Gulf War in 1990, the European currency crisis from 1992 to 1993, the Mexican currency crisis in 1994, and, most importantly, the Asian Financial Crisis in July of 1997. With the discount window employed and liquidity readily available for banks facing shortages, the HKMA has played a significant role in smoothing interest rates and consequently has helped to maintain economic stability and success.

Although these changes seem to have been extremely beneficial to the Hong Kong economy in the past, doubt is now growing about the *future* effectiveness of the currency board system. Since the establishment of these reforms, the powers of the HKMA have become very similar to those of a central bank. As a result, the ability of the Hong Kong economy to continue to thrive under this “unorthodox” currency board is now coming under closer scrutiny, as can be seen in the following quotation by economist Matthew Jones:

Monetary authorities in Hong Kong have modified the original currency board arrangement to permit limited discretionary policy. This institutional reform creates a potential conflict of interest between maintaining the linked exchange rate mechanism and maintaining monetary stability. Such a potential for conflict may increase the volatility and uncertainty of the exchange rate, negating some of the benefits of the currency board regime. (Jones)

In response to the reforms of the currency board system, speculators are expecting the HKMA to act like a central bank and devalue the currency. These expectations are, in part, due to Hong Kong’s declining balance-of-payments (BOP) surplus. According to Hong Kong’s Census and Statistics Department, between 1997 and 2001 the overall BOP surplus decreased from

HK\$95,087 to HK\$36,350. More specifically, in 2001 alone the BOP changed from a surplus of HK\$60,958 in the first quarter to a deficit of HK\$8,032 in the fourth quarter. Some speculators are anticipating a continuation of this trend; and if Hong Kong does begin to run a deficit, a devaluation of the HK dollar would be necessary to eliminate the deficit. Devaluation would make Hong Kong's goods more competitive internationally (assuming Hong Kong doesn't experience excessive inflation.) This would result in an increase in exports, a decrease in imports, and a consequent shrinking, perhaps even the elimination, of the BOP deficit. In reality, however, the HKMA is *not* a central bank and will not devalue the HK dollar. As long as Hong Kong remains under a currency board system, the HKMA will not interfere and alter the rate. The currency board mechanism is what actually works to change interest rates to maintain stability.

These speculative attacks against the HK dollar, however, are pushing interest rates up and contributing to the recession Hong Kong is facing. Confidence in the HK dollar is diminishing as well with the growing number of modifications being made to the system, including the Accounting Arrangements and the establishment of the Liquidity Adjustment Facility. Another flaw in the current arrangement is that it lacks substantial legal support. The Basic Law does not commit Hong Kong to any one monetary system, foreign currency, or exchange rate for that matter<sup>6</sup>. At any point in time, the HK government could step in and devalue the currency, or it could choose to abandon the currency board system altogether. Such actions would not even require approval by the Legislative Council (Hong Kong's legislature.) The uncertainty presented by the current arrangement leads one to search for alternatives to the currency board system that may help to solve Hong Kong's monetary problems. In the following

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<sup>6</sup> The Basic Law is Hong Kong's mini-constitution. See Rees Hawkins's article in this volume for further information on the Basic Law.

sections, I will discuss four different alternatives to the current system: a flexible exchange rate, a link to the renminbi, a basket currency, and dollarization.

## **Alternatives to the Current System**

### **Flexible Exchange Rate**

One alternative to the current system that has been proposed is to adopt a flexible exchange rate regime. The HK dollar floated once before against the US dollar in 1974, but was replaced by the currency board system in 1983 because of financial crises. Currently, economists are looking back to that regime in order to solve many of Hong Kong's economic problems. They do not see another crisis destroying the float if it were implemented now because the circumstances that ended the float in 1983 were unique – the start of discussions concerning the handover of Hong Kong from Britain to China. Priscilla Chiu, the Head of the Economic Research Division of the Hong Kong Monetary Authority, clearly explains this: “The immediate cause precipitating the meltdown of the floating exchange rate regime was the confidence crisis arising out of uncertainties surrounding Hong Kong's political transition.” (Chiu, p. 3) If a floating regime were established now, many feel that this would allow the HK dollar to depreciate against the US dollar, for the same reasons mentioned previously. Supporters claim that economic competitiveness would be restored, helping Hong Kong recover from the recession.

However, according to David Webb, a researcher of Hong Kong markets, a floating rate would not be feasible for an economy as open as Hong Kong's:

Hong Kong is not a normal economy. In nautical terms, Hong Kong is like [what] the Straights of Gibraltar are to the Mediterranean. We are a narrow bottleneck for massive flows of import and export finances in and out of the [People's Republic of China.] (Webb)

Hong Kong experiences high volumes of foreign currencies flowing through its banking system; it is an extremely “open” economy. (Trade in Hong Kong accounts for 393 percent of the region’s GDP, as compared to the US, where trade accounts for only 23 percent of GDP.) It tends to run a balance-of-payments surplus, and a slight change in the balance of trade can have a significant impact. In particular, with a floating exchange rate, a slight change in the overall balance of payments could seriously alter the value of the currency. This would create uncertainty in the value of the HK dollar and the risk involved in trading with Hong Kong. (Appleyard and Field, p. 267) The more volatile a currency becomes, the more risky it is to enter into business transactions involving such a currency. This volatility would further damage the economy of Hong Kong, rather than helping it to move out of the recession.

There are several other risks in adopting a floating exchange rate regime. One substantial risk is that of a run on the Hong Kong dollar if it is believed that the value of the currency will fall substantially. One of the main reasons the currency was fixed in the first place was to avoid another serious run. If this were to happen again, people would convert their local currency as quickly as possible to foreign currency. This would cause a serious imbalance in the banking system because foreign currency liabilities would far outweigh the assets of the banks. This type of situation is never desirable and often leads to default and/or bankruptcy of banks.

Another risk involved in the movement to a flexible exchange rate system is that the HKMA would have to be transformed into a fully functional central bank. In order to control the money supply, the HKMA would need to have all the monetary policy tools necessary to adjust liquidity, similar to those of the US Federal Reserve. This would include bank reserve requirements, a discount window, and open market operations, two of which the HKMA lacks. Hong Kong banks do not have reserve requirements. As a result, the HKMA cannot influence the money supply in the banking system because it has no direct control over the behavior of

banks. Additionally, although the HKMA has been conducting open market operations since 1988, it has never had to do so with the intention of controlling the money supply; open market operations in Hong Kong have only been used to provide interbank liquidity. Furthermore, open market operations are generally comprised of the purchase and sale of government debt securities. According to University of Hong Kong Professor George Yu, Hong Kong does not have a very large market for these securities: “The meager size of Hong Kong’s government debt market makes the intervention by the HKMA less effective in affecting real economic activity and inflation” and “impedes the HKMA’s ability to implement an effective monetary policy tool at this stage.” (Yu) For all of the reasons above, a floating exchange rate seems extremely impractical, unless the HKMA intends to implement many more measures to better manage the money supply. Another option, however, to the current linked exchange rate may be to make a less drastic change. Rather than move from one extreme to another (fixed to float), perhaps a change in the reserve currency may be a more feasible solution to Hong Kong’s economic problems. This option is examined in the following section.

### **Link to the Renminbi**

The economies of Hong Kong and China are tied very closely. In fact, their economic cycles have been more strongly integrated than those of Hong Kong and the US in recent years. When business cycles are moving in opposite directions, the effects can be destabilizing. In the early 1990s the US was experiencing a recession. Hong Kong was not at the same point in its business cycle yet still suffered from the US’s low interest rates. This was due to the forced integration of the two economies, which was a result of the fixed exchange rate. Some have suggested that a change in the anchor currency to the Chinese renminbi (RMB) would be a better alternative than the current link to the US dollar. The first important thing to note is that China is Hong Kong’s largest trading partner. Hong Kong’s monetary policy therefore greatly affects the

transactions made between the two regions. According to Chi Lo, Chief Economist (NE Asia) of Chartered Bank Global Markets in Hong Kong, China is working to implement a program (the Qualified Domestic Institutional Investor Program) that will promote mainland investment in Hong Kong. (Lo) In this case, the capital flows between China and Hong Kong will become even more integrated, and a link to the renminbi would facilitate these transactions. This would help to increase the economic development of both regions. A renminbi link would also eliminate the uncertainty related to exchange rate fluctuations that have hindered cross-border business transactions in the past. (Yam)

However, there are several reasons why these benefits might not be sufficient to justify a change from the current linkage of the HK to the US dollar. Currently, the main goals for Hong Kong are to rise out of the recession and maintain its position as one of Asia's largest financial centers. Simply improving its relations with China will not help to achieve these goals. Re-pegging the HK dollar may also threaten the region's stability with the risk of financial chaos. In the case of Hong Kong, abandoning its link with the US dollar would not necessarily reduce the volatility of the HK dollar. The US dollar has experienced unprecedented stability in recent years, and departing from a link to it may cause a shock to the HK economy and lead to a crisis similar to what Mexico experienced in 1994.<sup>7</sup>

Another reason a link to the renminbi may not be feasible pertains to an article in Hong Kong's Basic Law. Article 122 states the following: "The Hong Kong dollar shall be freely convertible." As of April 2002, the renminbi is not yet fully convertible, which is made clear in the following quote from one of China's largest circulating newspapers:

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<sup>7</sup> The Mexican currency crisis occurred when the Mexican peso was converted from a linked rate with the US dollar to a freely floating rate. This movement to a floating peso was an attempt to stabilize the peso after political and economic shocks led to speculative attacks against it. The peso depreciated drastically, dropping from 3.5 to 7.3 pesos per US dollar. The resulting financial chaos led to a severe contraction in Mexican GDP, as well as a banking crisis that forced government bailouts. (Hosomi)

The renminbi is convertible for current accounts, which mainly cover foreign trade and foreign companies' conversion of profits to their home country currencies. But under capital accounts, which cover the investment in securities market, it is not convertible. (“Bank: Renminbi...”)

Therefore, by law a link to the renminbi is not yet feasible. However, the option of a link to several different currencies may be a more realistic alternative, and I discuss this in the next section.

### **Basket Currency**

Instead of linking the HK dollar to one currency, such as the US dollar or the Chinese renminbi, a better alternative might be a link to a basket of currencies. The exchange rate would then be calculated as the total value, in US dollars, of the particular amounts of currencies in the basket. For instance, instead of backing up every 1 Hong Kong dollar with .128 US dollars, (12.8 cents<sup>8</sup>), many economists have proposed a basket of currencies based on trade percentages. That is, the HK dollar would be backed by the currencies of its three largest trading partners, with trade percentages determining the weights that the currencies have in the basket. In Hong Kong's case, China is its largest trading partner, followed by the US and the European Union. Under this proposal, the renminbi would make up the largest percentage of the HK dollar basket, with the US dollar and the euro as the remaining components. This type of link has three major advantages. First, it incorporates Hong Kong's largest trading partners into the valuation of its currency, thus facilitating transactions between the regions. Second, it allows for more stability in the Hong Kong exchange rate. A sudden change in the value of one of these three currencies would not have as severe an effect on Hong Kong's rate as when it is linked to only one currency. Hong Kong would be better protected against major shocks in the economies of the

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<sup>8</sup> 12.8 cents per HK\$1 is simply the reciprocal of the \$HK7.8 per \$US1.

basket currency countries. Finally, there would be more stability in the Hong Kong dollar interest rate. The reason is that the HK dollar interest rate, just as the exchange rate, would simply be a weighted average of the interest rates of the currencies in the basket.

However, the basket currency option also has some shortcomings. As mentioned earlier, the renminbi is still not fully convertible and cannot legally be used as a link for the Hong Kong dollar, even if it only comprises a fraction of the HK dollar's backing. Removing the renminbi from the basket altogether may seem like a solution to this problem. However, the advantage of facilitating transactions between China and Hong Kong would be lost. Considering that China composes almost 40 percent of Hong Kong's global trade, this loss-of-ease in trading with China would be quite significant. Second, if trade percentages were not used as a guide, determining which currencies to use as the basket components would become problematical. The matter would become subject to political pressures, and the results may not provide Hong Kong with the desired exchange rate stability. In order to provide this stability, adopting a stricter, more rule-bound regime such as dollarization may be a wiser choice.

### **Dollarization**

As Hong Kong's currency board becomes more like a central bank, speculative attacks against the HK dollar are causing its value to fall. A final alternative to the current system is to make the currency board more orthodox, or rule-bound, and actually go as far as "dollarization." By dollarizing, Hong Kong in effect would be replacing its dollar with the US dollar at the current fixed rate. The US dollar would then serve the textbook functions of money: a medium of exchange, a store of value, and a unit of account. Hong Kong dollar assets, such as bank deposits, would be replaced with equivalent US dollar deposits. However, not all deposits need to be converted; Hong Kong already has an enormous amount of US dollars in its reserves, and

converting all Hong Kong dollars into US dollars seems almost unnecessary (if not impractical). Hong Kong dollars can remain in coinage form, to avoid having to transfer massive amounts of US coins half-way around the world. Furthermore, Article 111 of Hong Kong's Basic Law states that "the Hong Kong dollar, as the legal tender, shall continue to circulate" and must be backed by a "100% reserve fund." Therefore, converting all of the Hong Kong dollars into US dollars would again violate the Basic Law.

Dollarizing would reap many benefits for Hong Kong. As opposed to operating under a central bank or an unorthodox currency board for that matter, dollarization is a much more efficient way of adjusting money supply to money demand. A central bank, or currency board, has the ability to engage in intervention that may cause an imbalance in the supply and demand of the monetary base; dollarization would eliminate this problem. Furthermore, by dollarizing exchange rate risk would no longer be an issue. This would enable banks that are short of reserves to borrow funds internationally at the same costs that they face within Hong Kong. The risk premium that lenders would normally charge borrowers to protect themselves against a change in the currency's value would no longer be present; the elimination of risk would remove the cost of borrowing. Furthermore, as the senior economist of the Joint Economic Committee of the U.S. Congress, Kurt Schuler, emphasizes: "The US dollar has been considered among the best-performing currencies in the world for more than 200 years, despite occasional periods of trouble." (Schuler, "A Contingency...") Therefore, dollarization would increase confidence in Hong Kong as a sound market for investment, thus strengthening Hong Kong's position in the financial world.

Dollarization is not without its costs, however. The first problem that arises is of a political nature. The Hong Kong dollar is often seen as "an essential symbol of Hong Kong." (Schuler, "A Contingency...") By replacing it with the US dollar, people within Hong Kong

may see the move as a blow to the region's pride and even as an infringement on their sovereignty. Many also see dollarization as an option only if Hong Kong's economy enters a state of emergency; and since it is not currently in such a state, dollarization would not be widely accepted. Another concern is related to the future of the US dollar. If for some reason the US dollar becomes an unstable currency, Hong Kong would be in serious trouble. Dollarization ties the economies of these regions so closely that any US shocks would have a harsh impact on Hong Kong's economy. This option would thus deprive Hong Kong of its ability to deal with external shocks and would lower the flexibility of the HKMA with respect to its discretionary monetary policy. Additionally, Hong Kong currently earns interest on the deposits of US dollars in the Exchange Fund. If these reserves were to be converted into use for circulation, Hong Kong would lose their interest earnings. The interest earned by producing Hong Kong dollars with 100 percent backing of US dollars is known as "seigniorage."<sup>9</sup> If dollarization were implemented, seigniorage would be passed to the US Federal Reserve. As of 1998, seigniorage accounted for HK\$5.1 billion a year, or about 0.6 percent of Hong Kong's GDP. Therefore, dollarization would be an extremely costly option.

## **Conclusion**

As the previous sections have indicated, finding a feasible alternative to the current system is a daunting task. However, after carefully analyzing the four options, it is clear that the implementation of a basket currency would provide Hong Kong with the strongest foundation upon which future economic success can be built. This type of regime would not only facilitate

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<sup>9</sup> Seigniorage, by definition, is the value of money less the cost of printing/manufacturing it. In Hong Kong's case, every time they issue new HK dollars, the equivalent in interest-earning US dollar-denominated securities is placed in their reserves. Therefore, the seigniorage on every HK dollar includes the interest earned on their reserves.

transactions among Hong Kong's largest trading partners, but would also stabilize Hong Kong dollar exchange and interest rates, as well as protect the region from major external shocks.

Though ideal in theory, a basket currency simply cannot be executed while the Chinese renminbi remains non-convertible. Until China allows its currency to become fully convertible, the best option for Hong Kong is to maintain the currency board system it has now. The Hong Kong Monetary Authority, however, must make more of an effort to concentrate solely on maintaining the fixed exchange rate. This will return the currency board to its traditional roots, and will decrease the uncertainty and financial instability associated with the system. By following this path towards orthodoxy and subsequently implementing a basket currency regime upon renminbi convertibility, Hong Kong will no longer be threatened by China's emergence into the "free-trade" world, and will be sowing the seeds for years of future economic success.

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