

# From “One Country, Two Systems” to Monetary Integration?

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## Summary

Since October 1983, the Hong Kong dollar has been pegged to the US dollar under the linked exchange rate system. The rapid economic integration between Mainland China and Hong Kong in recent years has nevertheless raised concern about the continuing optimality of the link. Officially, the Hong Kong Special Administrative Region (HKSAR) is to operate under the framework of “one country, two systems” and “one country, two currencies”. Hence monetary integration was and is not planned. However, one is entitled to ask whether the existence of separate currencies is consistent with the fast changing economic reality.

Would a re-peg with the Renminbi, the Chinese currency, or even a monetary union with Mainland China, be viable and desirable, particularly if the Renminbi becomes fully convertible in the future? Four options are explored in the paper.

- I. The *status quo*;
- II. The pegging of the Hong Kong dollar to the Renminbi instead of the US dollar;
- III. A new national “Chino” is launched, and the currency of Hong Kong as well as those of Mainland China, Macau and perhaps Taiwan are pegged to it at agreed fixed rates; and
- IV. The abolition of the Hong Kong dollar and the other currencies: i.e. Renminbi-zation or Chino-ization for Hong Kong and the others.

What are the preconditions for the options? What needs to be done to prepare for them? Which of them is the most suitable for Hong Kong? Taking clues from the theoretical literature on monetary integration and union and the evolving experience in Europe, this paper addresses these interesting choices by going through the complicated issues of trade and invoicing, real versus nominal convergence, risk sharing through public and market-based mechanisms, and labour mobility. It emerges that the *status quo*, i.e. option I, is optimal for the HKSAR in the foreseeable future.