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Problems of Hong Kong's Monetary System

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I. Introduction

The Sterling Exchange Standard was introduced in 1935 when Hong Kong, following China, gave up its traditional silver standard and since then linked the Hong Kong Dollar to Sterling. But since the floating of Sterling on 23rd June, 1972, this link has been broken. Instead, the Hong Kong Dollar has been pegged to the U.S. Dollar for the first time in the monetary history of Hong Kong[1]. The link with the U.S. Dollar was an interim measure as the Hong Kong Government made it clear that as soon as the British Government refixes the exchange value of Sterling, the link between Sterling and the Hong Kong Dollar will be restored. In view of the fact that Hong Kong is a British Crown Colony[2] a close link of the Hong Kong Dollar with Sterling is desirable for obvious political and economic reasons. But because of the deteriorating position of Sterling in the international exchange markets in the last five years this link has created considerable difficulties for Hong Kong and other Sterling Area Countries as well. The devaluation of Sterling in 1967 costed Hong Kong al loss of HK$450 million and the floating of the Sterling in 1972 a loss of some HK$890 million which meant a loss of around HK$220 for each Hong Kong resident. These figures indicate clearly the difficulties which arise from the link of the Hong Kong Dollar with Sterling. The difficulties are applicable to all members of the Sterling Area, although they are particularly severe for Hong Kong. The floating of Sterling evoked again our concern about the future of the Hong Kong currency system and the time is ripe to review the present system.

II. Historical Background of Hong Kong's Currency System

In the Hong Kong's history of 132 years since 1841, when Hong Kong became a British Crown Colony, the currency system can be roughly divided into the following five eras[3]:

[1] More exactly, the linking of the Hong Kong Dollar with the U.S. Dollar was officially announced on 6th July, 1972.

[2] Legally, Hong Kong (and Macau) had been removed from the list of U.N. Colonies in 1972 at the request of the People's Republic of China. Yet this legal action does not change at all Hong Kong's actual status of being a British Crown Colony.

[3] See T. B. Lin, Das monetäre System und das Verhalten des Angebotes an und der Nachfrage nach Geld in Hong Kong, Freiburg 1969, pp. 13–17.

1. The Era of Dual-Standards (1842–1844)

In this period transaction was divided into "local transaction" and the so-called "mercantile transaction" (this is in effect the foreign trade). The legal tender for the former was composed of the Spanish and Mexican Silver Dollars, the Rupees of the "East India Company" and the Chinese Copper coins, while the legal tender for the mercantile transaction was the British Sterling.

The Dual-Standards had the difficulty of determining the conversion rate between the Silver-Dollar or rupee and the Sterling. So soon after this system was introduced the then colonial government announced a new Proclamation which made the Spanish and Mexican Dollar the legal tender both for the local and for the mercantile transactions.

2. The Era of the British-Pound-Sterling Standard (1844–1863)

As far back as 1704 the Britains tried to impose the Sterling Standard on all their Colonial Territories. This attempt had also been made in Hong Kong. In 1844 the Sterling Standard was introduced in this colony and the Sterling therefore became the sole legal tender and the value standard. The attempt was, however, not successful because the Hong Kong Chinese residents were rather sceptical with the token money, the British Silver- and Gold-coins.

3. The Era of the Silver-Dollar-Standard (1863–1935)

Since the British Sterling Standard was not conformable to the traditional Chinese custom, the standard was given up 19 years after its introduction. In 1863 this system was replaced by the Silver-Dollar Standard und thus Hong Kong was no more a member of the Sterling Area. In 1866 a mint was set up to produce the Silver coins, which was called "Hong Kong Dollar". The Hong Kong Dollar circulated until 1895 and then was substituted by the so-called "British-Dollar" as legal tender, which was coined in India.

4. Issue of the Bank Notes

The bank notes became legal tender in 1935. But the issue and circulation of the bank notes went back to 1845 when the "Oriental Bank" was for the first time granted the right to issue the bank notes. Altogether, there have been six banks which obtained the right of issuing bank notes. For the time being, only three of the six banks still exist and continue to issue bank notes. Among the three, the Hongkong and Shanghai Banking Corporation, which is indeed the quasi Central Bank of Hong Kong, issues more than 90 per cent of the total bank notes in Hong Kong. The bank notes were so liked by the public that since 1890 they had become the practical media of payments. Especially since 1920 the local banks refused to accept the Silver-Dollar, although it was legally regarded as legal tender until 1935.

5. The Era of the Sterling-Exchange-Standard (since 1935)

Because Hong Kong is economically and geographically closely linked with China, its currency system could not break with that of China's. The introduction of the Silver-Standard in 1863 was an acknowledgement of this situation. Before 1935 China adopted a Silver-Dollar Standard. But between 1920–30 there was a great amount of silver outflow from China despite the fact that the raw silver price in the international market fell constantly during this period (this meant a depreciation of China's Silver-Dollar against those currencies on Gold Standard). The silver outflow was intensified through the "London Silver Agreement" in 1933 and the U.S. "Silver Purchase Act" in 1934. Both were aimed at increasing the silver price with the consequence that Chinese commodity exports became more and more difficult. So in 1935 China gave up its traditional Silver-Dollar Standard and adopted a "Managed Exchange Standard Currency". The Hong Kong currency system was directly affected by the Chinese measure. In 1935 the Hong Kong Government announced a Currency Ordinance, which was the legal foundation for the present Hong Kong currency system of the so-called Sterling-Exchange-Standard.

II. Mechanism of the Sterling-Exchange-Standard

Under the Sterling-Exchange-Standard the currency is backed 100 per cent by sterling. The currency in the Colony consists of bank and government issue. The latter is made up of $1 and smaller coins and notes; and the former of all larger notes which are issued jointly by the three private commercial banks: The Hongkong and Shanghai Bank, the Chartered Bank and the Mercantile Bank. (Over 90 per cent of the notes, however, are issued by the Hongkong and Shanghai Bank.)

Apart from a small fraction of the notes, which is covered by sterling securities deposited by the notes-issuing banks with the Crown Agents, all these bank notes are secured by the assets of the Exchange Fund. In order to issue notes, the banks must first pay the equivalent in sterling into the Fund in exchange for Certificates of Indebtedness (CI), expressed in Hong Kong Dollars, at a fixed rate[4]. Conversely, the Certificates can be redeemed by the Fund by paying the sterling equivalent in value to the banks which surrender the Certificates. The CIs are non-interest bearing and are issued or redeemed at the discretion of the Financial Secretary.

Although there is no statutory requirement that Certificates be covered exclusively by Sterling (they may, for example, be backed by Hong Kong Dollars, which would take the form of a bank balance or, subject to the approval of the Secretary of State, Hong Kong Government stocks), in practice the Exchange Fund invests the sterling so received mainly in U.K. Government Securities[5]. Therefore, the Exchange Fund – its original function was designed to maintain the value of the Hong Kong Dollar relative to Pound-Sterling – functions virtually in the same manner as an ordinary Currency Board does in other Colonial Territories.

The sterling backing of notes is in reality considerably above 100 per cent. This

[4] The official rate before the Pound devaluation on 19th November, 1967 was HK$16 = £1 and since then it has been HK$14.54 = £1.

[5] Hong Kong Annual Registrar (1960), by Nigel Ruscoe, Hong Kong 1964, p. 56.

is due to the fact that the note-issuing banks have to maintain a certain level of sterling reserve in excess of the amount required to cover the notes outstanding as a security margin against an eventual depreciation of their sterling securities. Since the nominal value of the sterling securities varies inversely with changes in interest rate, the percentage of the actual backing increased steadily from 134.8 per cent in 1960 to 143.2 per cent in 1963, the period during which the London Bank rate was decreasing from 6 per cent to about 4 per cent[6]. To avoid the excessive accumulation of assets in the Fund, it was proposed that the Financial Secretary be authorized to transfer from the Fund to the general revenue of the Colony any sum in excess of the amount required to maintain the assets of the Fund at 105 per cent of the aggregate of the face value of the CIs outstanding. Although the percentage of the actual backing decreased slowly after 1964, it is still well above the 105 per cent level[7].

III. The Devaluations of Sterling

As mentioned above, the exchange value of the Hong Kong Dollar was fixed at a rate of HK$16 to the £ Sterling since 1935 until 1967, and, with the setting up of the International Monetary Fund after the War, the Hong Kong Dollar was given a gold parity which reflected this rate. In 1949, when the Sterling was devalued against the U.S. Dollar, Hong Kong followed Britain to devalue its currency. This strengthened the view widely held in commercial and financial circles that the link of the Hong Kong Dollar to Sterling should be fixed, as the local importers and exporters as well as the so-called "authorized banks"[8], which were required by the exchange control rules of the Sterling area to hold their excess liquidity in Sterling, did not envisage any risk of exchange rate. It is important to know that the relationship between the Hong Kong Dollar and Sterling was not statutory one, but one that was established and maintained by the operations of the Exchange Fund. Yet, the Hong Kong Dollar has always been regarded as an extension of Sterling.

In November 1967 when Sterling was devalued by 14.3 per cent against the U.S. Dollar only few of the currencies in the Sterling-area countries followed suit. Because at the time of the devaluation Hong Kong's recorded Sterling assets amounted to as high as £350 million, Hong Kong was then faced with the dilemma of either again following Sterling down and thereby letting the internal price/cost structure adjust to the new rate through inflation or of maintaining the cross exchange rate with the U.S. Dollar and incurring a heavy loss in the Hong Kong

[6] For Sterling reserve, see Digest of Colonial Statistics, Quarterly Digest of Colonial Statistics and Digest of Statistics, London. Hong Kong Annual Reports, Hong Kong Monthly Digest of Statistics, Hong Kong. For a detailed Currency / Reserve ratio, see my paper on "Monetary Behavior Under The Sterling Exchange Standard – Hong Kong as a Case Study", Occasional Paper 1, Hong Kong Series, Economic Research Centre, The Chinese University of Hong Kong, 1971, p. 2.

[7] For the merits and demerits of the Sterling Exchange Standard, see my paper on "A Theoretical Assessment of the Monetary System of Hong Kong", New Asia College Academic Annual, Hong Kong, September, 1970.

[8] The functions of the "authorized banks" were clearly described by F. H. H. King in his book "The Monetary System of Hong Kong", Hong Kong 1953.

Dollar value of its Sterling reserves held both by the government and by the banking system. At first the government decided to follow Britain to devalue the Hong Kong Dollar against the U.S. Dollar at the same rate, But, as it turned out, the reaction from the public to this inflationary measure was so intense that the general price level increased by more than 20 per cent within a few days after the Hong Kong Dollar devaluation was announced. So the government reviewed the situation and decided at last to appreciate the devalued Hong Kong Dollar. The final solution was that the Hong Kong Dollar was devalued by 5.7 per cent in terms of the U.S. Dollar. This meant that the old rate of HK$16 to the £ Sterling was changed to HK$14.54. The revaluation of the Hong Kong Dollar against Sterling costed Hong Kong public funds about HK$450 million, including, of course, adjustment payments from the Exchange Fund to the commercial banks to compensate them for their losses.

After the devaluation of Sterling, Hong Kong should have tried to diversify its external assets. This was, however, limited by the existing exchange control rules imposed on all Sterling-area countries, including Hong Kong. Moreover, in view of the facts that Hong Kong's imports are equal to about 100 per cent of the Gross Domestic Product and exports to about 85 per cent a change in the rate of exchange may not be a desirable way to deal with the problem of the balance of payments. Therefore, it is very unlikely that Hong Kong would wish to follow suit if Sterling were to be devalued again in the near future. As a devaluation of the Hong Kong Dollar is not desirable for Hong Kong's economy due to its highly export-oriented character, something else must be done to prevent Hong Kong from incurring further loss in its Sterling asset through another Sterling devaluation.

IV. The Sterling Guarantee Agreement and the Exchange Fund Guarantee Scheme

In order to protect their Sterling assets, the Sterling-area countries since 1967 have been constantly trying to switch their Sterling reserves into other hard currencies and the Sterling-area was faced with a possible break-up. Yet, because of Britain's own depleted foreign reserves the British Government was unable to finance this switching. So in the so-called Basle Agreement a credit of US$2,000 million was negotiated with the Group of Ten which in turn made possible a guarantee of the U.S. Dollar value of their official Sterling reserves to be offered by the British Government to all members of the Sterling-area. This arrangement was now known as Sterling Guarantee Agreement (SGA). The guarantee was offered subject to the condition that each country should maintain a minimum proportion of its total official external reserves in Sterling (M. S. P.), roughly the proportion in Sterling when the offer was made. For some countries the guarantee was for three years and for others it was for five years effective from 25th September, 1968. (Hong Kong is in the latter category.)

The Hong Kong's S. G. A. provides that part of the banking system's Sterling reserves are counted as official reserves for the purpose of the guarantee. Since there are great differences between the Sterling assets held by the government and those held by the banking system in their purposes, a system called Exchange Fund Guarantee Scheme (EFGS) was devised to tackle this difficulty. Under the scheme the (Hong Kong) Exchange Fund signed a series of guarantee agreements with the local banks which wished to participate. The scheme and the exchange control restrictions on the Authorized Banks made sure that the banking system put a very high proportion of its external assets in form of Sterling.

While under the S. G. A. Britain guarantees the U.S. Dollar value of 90 per cent of the eligible Sterling assets held by the Hong Kong Government, including those owned by the banks and brought into official accounts through the EFGS, the (Hong Kong) Exchange Fund guarantees, under the EFGS, to the local banks the Hong Kong Dollar value of 100 per cent of the Sterling covered under the scheme.

The S. G. A. is first implemented if the Sterling/U.S. Dollar rate falls below US$2.40 by more than 1 per cent for a continous period of 30 days. As 1 per cent of US$2.40 is equal to 0.026, US$2.376 (= 2.40 − 0.026) is the trigger point for the 30-day period to start. Then the British Government is obligated to pay to the (Hong Kong) Exchange Fund sufficient Sterling to restore the U.S. Dollar value of the guaranteed part of its official Sterling reserves. If the Sterling/U.S. Dollar rate declines further, then subsequent compensation payments will be implemented. On the other hand, the EFGS is implemented in respect of any fall in the fixed rate between the Hong Kong Dollar and Sterling. Compensation payments have to be made from the Hong Kong Government to the banks to restore the Hong Kong Dollar value of their Sterling assets.

In 1971 a general lowering of the M. S. Ps. by 10 per cent was offered by the British Government to negotiate for a two-year extension of the three-year S. G. A. from 25th September, 1971 to 24th September, 1973. This concession was also extended to those countries with five-year agreements, including Hong Kong. So the new M. S. Ps. for Hong Kong is 89 per cent, compared with the original one of 99 per cent[9].

V. The Floating of Sterling and the Break of the Link

After the S. G. A. the Hong Kong Dollar was still linked with Sterling, and the Hong Kong Sterling reserves increased rapidly since ever. On the one hand, the Sterling assets of the Hong Kong banking system increased by £160 million, from about £200 million at the end of March 1969 to around £360 million by the end of March 1972; on the other hand, the Sterling assets owned by the government grew by £218 million, from £190 million to £408 million during the same period. These figures indicate that the Hong Kong Government did not take the advantage of the lowering of the M. S. Ps. offered by the British Government at all. One of the main reasons for this was that in the autumn of 1971 the U.S. Dollar's position in the international exchange markets came under pressure.

The U.S. Dollar crisis was settled by the Smithsonian rate of 8.57 per cent devaluation of the U.S. Dollar announced on 19th December, 1971. Following the announcement, the Hong Kong Government decided to maintain the gold parity and thus the Sterling parity of the Hong Kong Dollar, thereby revaluing the Hong Kong Dollar against the U.S. Dollar by 8.57 per cent. The new Sterling/U.S. Dollar parity is £1 = US$2.6057 as compared with the old rate of US$2.40. However, the

[9] No details of the SGA and EFGS have been revealed. The above account is based on a speech by the Financial Secretary, Mr. Philip Hadden-Cave, in the Legislative Council on Wednesday, 13th December, 1972.

British Government insisted that the Sterling assets of all countries in the S. G. A. remained guaranteed at the old rate of US$2.40. In other words, the new rate of US$2.6057 was not applicable. This was the origin of many subsequent controversies.

In the meantime, the Sterling reserves held by Hong Kong increased further. By the end of May, 1972 Hong Kong's total Sterling reserves stood at £803 million (£418 million belonged to the Government, the rest to the banking system). With the increasing Sterling reserves, the risk which Hong Kong had to take became higher and higher. For the banks which entered into the EFGS, there was always a risk of incurring the loss caused by the fall of Sterling's rate from 2.6057 to 2.40 (a further fall of the Sterling below this level would mean no additional risk for the banks because they were hundred per cent guaranteed by the Hong Kong Government under the EFGS). For the Hong Kong Government (and thus for the public funds), the risk was two-fold. Firstly, if the Sterling's rate falls from 2.6057 to 2.40, the Sterling reserves owned by the Hong Kong Government were subject to the same exchange rate risk as was just mentioned for the Sterling assets owned by the banks. Secondly, if the exchange rate for Sterling declines further, the Hong Kong Government, through the Exchange Fund, has to make compensation payments to restore the Hong Kong Dollar value of 10 per cent of the banking system's Sterling reserves because under the SGA the British Government guaranteed only 90 per cent of the official Sterling reserves, including those which were owned by the banks but were counted as official Sterling reserves under the arrangement of the EFGS. The Hong Kong Government realised this risk. So at the beginning of 1972 it tried to switch 10 per cent of the official Sterling reserves. However, before it had been done, the British Government suddenly announced to allow Sterling to float on 23rd June, 1972.

With the floating of Sterling the Sterling area broke down. Previously, the Sterling funds held by residents of Overseas Sterling Area Countries could not be switched into foreign currencies except for the genuine purpose of foreign trade. Since the floating of Sterling, residents of Overseas Sterling Area Countries are allowed to transfer their Sterling funds into any currency for any purpose. Although the free convertibility did not directly affect Hong Kong's exchange markets as there is always a free exchange market in Hong Kong operated by the non-authorized banks, the "authorized banks" now have the choice as to whether they will continue to keep their external assets in Sterling or not.

A serious question caused by the Sterling floating and to be answered by the Hong Kong Government was what measure should be taken as a response to the Sterling floating. As pointed out by the Financial Secretary in his December speech, there were three options opened to Hong Kong (as well as to other O. S. A. countries) namely:

a) to remain linked to Sterling at the then prevailing rate of HK$14.54 and thereby float with Sterling;
b) to give up the link with Sterling and instead set up a direct link with the U.S. Dollar;
c) to let the Hong Kong Dollar temporarily float independently in order to determine the true market rate of the Hong Kong Dollar in relation to other currencies.

As mentioned earlier, Hong Kong's economic growth depends primarily on its foreign trade. A floating of the Hong Kong Dollar would inevitably disturb its trade flow and thus impede its economic growth. It was due to this consideration that the Hong Kong Government decided, as an interim measure, to establish a direct link with the U.S. Dollar at a cross rate (the rate is maintained within the $4^{1}/_{2}$ per cent band of HK$5.5229 – HK$5.7771) slightly lower than that prevailing in December, 1971. With this decision the traditional direct link of the Hong Kong Dollar with Sterling had been broken for the first time since 1935 and the impact of the floating of Sterling on Hong Kong's economy was thereby staved off.

VI. Implementation of Sterling Guarantee Agreement and Loss in the Public Funds

After the floating of Sterling the Sterling/U.S. Dollar rate declined steadily, –first fluctuating around US$2.45 for about ten weeks and then plunging irreversibly since the end of September, 1972 until it reached the trigger point of $2.376 on 24th October, 1972 for the first time. The rate remained below the trigger point for a continous period of 30 days. So on 23rd November, 1972 the British Government announced that the S. G. A. would be implemented.

The exact amount of the loss in the Hong Kong public funds is not yet known because the Exchange Fund Guarantee Scheme with the local banks could not be implemented as long as the floating of Sterling continues. But with the Sterling/U.S. Dollar rate at around US$2.35 the loss amounts to about HK$890 million. Of this, about HK$478 million is to be paid by the (Hong Kong) Exchange Fund to local banks to restore the Hong Kong dollar value of the banks' Sterling assets under the EFGS and the rest (HK$412 million) is a loss in the Hong Kong Dollar value of the Sterling assets used to cover the bank note issue and the loss in the Hong Kong Dollar value of the Sterling assets belonging to the General Account and other government accounts.

In the meantime, the Hong Kong Sterling reserves increased constantly due to an increased demand for cover from the banks. Since the Sterling assets held by the Hong Kong banks are hundred per cent guaranteed by the Hong Kong Government under the EFGS, a further accrual of the bank's Sterling assets will mean no additional risk for the banks concerned. But this accumulation of banks' reserves would always put additional burden on the public funds. Therefore, the banks were now told by the government that further accruals would not be accepted for cover under the EFGS. The British Government agreed that, in the new situation, the Hong Kong Government was no more obliged to add further bank funds to the official external reserves and with it to maintain a M. S. Ps. of 89 per cent of such further accumulation of Sterling.

The loss of HK$890 in the public funds indicated that the government's surplus funds available for future development projects was reduced for two reasons. Firstly, the excess surplus in the Exchange Fund (i. e. the amount in excess of 105 per cent of the note issue) will decrease due to the pending adjustment payments to the banks whose Sterling assets were fully guaranteed by the Hong Kong Government under the EFGS and so the ability of the Exchange Fund to regulate the exchange value of the Hong Kong dollar will be substantially limited. Secondly, the Hong Kong Dollar value of the Sterling reserves held on the government's General Account has to be reduced. According to an estimate made by the

Financial Secretary, Hong Kong's fiscal surplus at the end of the year 1972 was about HK$3,000 million, compared with HK$3,900 million at 31st March of the same year. In other words, the government's funds have to suffer a nominal loss of around HK$900 million[10].

VII. Concluding Remarks

The traditional link of the Hong Kong Dollar to Sterling had its political and economic reasons. Politically, Hong Kong is still a British Crown Colony (although since 1972 Hong Kong has been removed from the list of colonies in the U.N. at the request of the People's Republic of China); no fundamental monetary reform, such as the proposal of a complete independent currency, will be approved by London. Economically, under the present system Hong Kong has the advantages of enjoying stable currency internally and having free access to an international currency, namely Sterling, as well as to the London capital market. Furthermore, the banks and the Exchange Fund had no difficulty in determining what rate of exchange should be. They simply looked to London for directions.

The present link of the Hong Kong Dollar with the U.S. Dollar is an interim measure. The Financial Secreatry made it clear that the U.S. Dollar/Hong Kong Dollar link would be valid only during the period of the floating of Sterling. Once London refixes Sterling's parity with the U.S. Dollar, the Hong Kong Dollar will be linked to Sterling again, perhaps at a rate different from that prevailing before the floating of Sterling.

In view of the economic and political reasons a direct link of the Hong Kong Dollar to Sterling is in the long-run desirable. But a direct link needs not to mean that all of our external reserves must be held in Sterling. This principle had been realised by the British Government and so the M. S. Ps. for Hong Kong was reduced from 99 per cent to 89 per cent in 1971. Unfortunately, the Hong Kong Government reacted too slowly to take the advantages of this facility. The present actual M. S. Ps. for Hong Kong is still near 99 per cent. If the Hong Kong's official Sterling reserves were cut down to 89 per cent before the floating of Sterling, the loss in the public funds would be substantially lower than HK$890. We can find quite a few reasons for the Government to justify its inertia (some of them were pointed out by the Financial Secretary in replying a question raised by Legislative Councillor Mr. P. C. Woo concerning this point[11]):

1. The interest rates in London have been higher than in other capital markets by around 1 per cent. Thus the interest earnings from our investment in Sterling have been higher than otherwise and thereby offset partly the capital loss that Hong Kong has now to suffer due to the devaluation of Sterling.
2. A switching of the Hong Kong external reserves from Sterling into the U.S. Dollar was definitely not a good solution because the U.S. Dollar itself experienced a devaluation of 8.57 per cent as recently as in December 1971; and such holders have no guarantee against further loss.

[10] I call it nominal loss because part of this will be compensated for by the British Government under the arrangement of S. G. A.

[11] See Hong Kong Standard and South China Morning Post (the two leading English newspapers in Hong Kong), December 14, 1972.

3. Though it is reasonable to deposit our external assets in a currency that is rather undervalued and thus seems more likely to appreciate than depreciate in the near future, the Government, however, tends to invest its liquidity assets in the medium- and long-term in order to maximise its long-run earnings, and what may appear correct in the short term may turn out to be wrong in the longer term.
4. Most governments of the hard currencies impose restrictions to deter overseas investment in their currencies as part and parcel of their anti-inflation policies.
5. In view of the fact that the London securities market has been weak large-scale sales of gilt-edged securities by the Hong Kong Government would not be possible without incurring a considerable capital loss.
6. While the Sterling/U.S. Dollar rate remains below US$2.40 we would run the risk of taking a further loss in our external reserves if our Sterling assets were switched into other currencies for which no guarantee is provided.

Although these reasons may justify the Hong Kong Government's decision to slow down the diversification process after 25th October, 1972, the date the Sterling/U.S. Dollar rate fell below the trigger point of US$2.376 for the first time since the floating of Sterling, the Hong Kong Government can, however, hardly disclaim the responsibility for not taking the full advantage of the 10 per cent lowering of our M. S. Ps. from 99 per cent to 89 per cent during the period between autumn of 1971, when the offer was made by the British Government, and 23rd June 1972, when the floating of Sterling was announced. If our Sterling assets had been successfully reduced to 89 per cent of our total external reserves before the floating of Sterling, the loss in the Hong Kong Dollar (or in the U.S. Dollar) value of our external assets would be substantially lower than the estimated amount of HK$890 million.

In the future, as its Sterling fixed deposits and other investments mature, Hong Kong will definitely switch these into other foreign currencies. But with the M. S. Ps. remaining as high as 89 per cent and the currency still on the Sterling-Exchange-Standard the room for this kind of manoeuvering is rather limited. To protect Hong Kong's public interest best the time to open a renegotiation between Hong Kong and London for a further lowering of its M. S. Ps., say from 89 per cent to 80 per cent, has been ripe. Some government officials may argue that this proposal will unlikely be accepted by the British Government because along with Australia and Kuwait, Hong Kong is the most important contributing member in the Sterling Area and a further lowering of its M. S. Ps. will appreciably reduce the ability of the Sterling Area Organisation to deal with international monetary problems. But money is too important to be left to a handful of government officials alone.

As experiences told us, concessions from the British Government can be obtained only with intensive discussions in academic circles and massive pressure from business sectors. I hope that this short paper will make the public pay more attention to the "liver" of Hong Kong's economy[12].

[12] "Ein monetäres System funktioniert wie die Leber im Menschenkörper: sie findet kaum unsere Aufmerksamkeit, wenn sie richtig funktioniert; aber sie wird uns große Sorge bereiten, wenn sie nicht in Ordnung ist." See: Das monetäre System und das Verhalten, op. cit., p. 11.