



# Hong Kong: Challenges and Prospects as an International Financial Center

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**Abstract.** Hong Kong has long been recognized as a major international financial center, leveraging its strategic location, institutional advantages, and economic strengths. This study aims to analyze Hong Kong's development as a financial hub, compare its competitiveness with other major centers, identify challenges, and propose future prospects. The study employs a comparative analysis of Hong Kong and other major international financial centers, such as New York, London, and Tokyo, to identify Hong Kong's unique advantages and core competitiveness. It also examines the challenges faced by Hong Kong, including risks associated with its dual economic characteristics, short-term uncertainties, and the lack of market dominance by Chinese financial institutions. The analysis reveals that Hong Kong possesses distinct advantages and competitiveness in its financial market, despite facing various challenges. The study proposes policy recommendations, such as adjusting the dividend tax of Southbound Stock Connect, strengthening the development of the financial derivatives market, promoting the internationalization of the Renminbi, enhancing collaboration with mainland China and other regions, and fostering innovation in financial technology. Hong Kong's position as an international financial center remains strong, but it must address the challenges and seize opportunities for sustainable development. By implementing appropriate policies and strategies, Hong Kong can maintain its competitive edge and continue to thrive as a global financial hub.

**Keywords:** Gateway to China, Dual Economy, Fintech Innovation, Renminbi Internationalization, Regional Collaboration

## 1 Introduction

### 1.1 Overview of Hong Kong's Development as an International Financial Center

Hong Kong's transformation into a leading international financial center is a narrative of strategic positioning and adaptability, shaped by its unique geopolitical status and socio-economic policies. From its inception as a free port in the mid-19th century, which ignited trade and commerce, to its pivotal role post-Opium Wars, Hong Kong

has consistently leveraged its advantages. The establishment of HSBC in the early 20th century and post-World War II manufacturing boom, catalyzed by refugees and government investment, laid the groundwork for its financial ascendancy. The late 1960s and 1970s saw its formal emergence as a financial hub with the introduction of HIBOR and the Stock Exchange, symbolizing economic vitality. The 1984 Sino-British Joint Declaration, affirming "one country, two systems," reassured investors and solidified Hong Kong's financial stability amidst the 1997 handover. The 21st century has seen Hong Kong strengthen its bridge role between East and West through CEPA and embrace fintech innovations, reinforcing its financial market infrastructure and regulatory framework to attract global businesses and investors. Hong Kong's development reflects an enduring commitment to growth, resilience, and a business-friendly environment, securing its place as a vital financial hub in the global economy.

### **1.2 Key Factors Contributing to Hong Kong's Success as a Financial Hub**

Hong Kong's rise as a global financial hub is driven by its strategic location bridging East and West, a robust legal system inherited from its colonial past, a tax-friendly business environment, world-class infrastructure, and a highly skilled workforce. Its currency board system, pegged to the US dollar, ensures monetary stability, while a stringent yet adaptive regulatory framework supports financial innovation and risk management. The 'One Country, Two Systems' framework with Mainland China further integrates Hong Kong into China's economic policies, enhancing its role in cross-border trading and investment. These synergistic factors create a compelling financial ecosystem that cements Hong Kong's status on the world stage.

### **1.3 Objectives and Significance of the Study**

This study comprehensively examines Hong Kong's role as a leading international financial center, analyzing its robust regulatory environment, advanced infrastructure, and economic stability amidst global financial shifts and geopolitical dynamics. It explores the implications of its unique "One Country, Two Systems" status, which offers both autonomy and integration with Mainland China, and the challenges and opportunities this presents. The research aims to provide strategic insights for stakeholders and contribute to the global understanding of financial dynamics, positioning Hong Kong within the context of other major financial hubs and offering a holistic view of its financial landscape and potential future trajectory.

## **2 Comparative Analysis of Hong Kong and other Major International Financial Centers**

This section delves into a comparative analysis of Hong Kong's financial market with three key international financial centers: New York, London, and Tokyo. The selection of these cities is strategic, as each represents a distinct approach to financial market development and regulatory frameworks, offering valuable insights into Hong Kong's

unique position and challenges within the global financial landscape. By examining these contrasts, we gain a nuanced understanding of Hong Kong's strengths and areas for improvement, enabling the formulation of strategic recommendations to enhance its competitive edge and ensure sustainable growth as an international financial center.

## **2.1 Comparison with New York**

This section will compare Hong Kong's financial market with that of New York, focusing on factors such as market size, liquidity, and regulatory environment.

Hong Kong and New York stand out as two of the most prominent financial centers in the world. However, both markets exhibit distinct characteristics that set them apart in various domains.

1. One of the most significant factors in evaluating the financial markets is market size. The New York financial market, represented primarily by the New York Stock Exchange (NYSE) and NASDAQ, is often considered the largest in the world. This is attributed to its considerable market capitalization, which spans trillions of dollars. Hong Kong, represented by the Hong Kong Stock Exchange (HKEX), also commands a substantial market capitalization, but it is smaller in comparison to New York. Despite this, Hong Kong stands as one of the leading financial hubs in Asia and serves as a gateway for investment into the Chinese mainland and broader Asian markets.

2. Liquidity is another key factor in comparing these financial markets. Liquidity refers to the ability to buy or sell assets without causing significant changes in the asset's price. New York is renowned for its high liquidity due to the high volume of trades and the extensive presence of various market participants, including institutional investors, retail investors, and international investors. The depth of the market in New York means that it can accommodate large transactions with minimal impact on prices, making it an attractive market for traders and investors looking for efficient execution of trades.

Hong Kong's market also enjoys significant liquidity, though it is somewhat more susceptible to fluctuations due to its reliance on trade volumes from mainland China and regional players. The presence of many multinational corporations and the heavy influence of Chinese companies contribute to the market's liquidity. Nonetheless, in periods of economic uncertainty or geopolitical tensions, liquidity in the Hong Kong market can be more volatile compared to New York. The Initial Public Offerings (IPOs) in Hong Kong are a major focus, as the city often serves as a primary listing venue for Chinese companies seeking to raise capital. These IPOs can drive liquidity but also contribute to its variability.

3. The regulatory environment in both markets is a critical area of differentiation. New York's financial market operates under a robust regulatory framework established by entities such as the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA). The stringent regulatory environment is designed to protect investors, ensure market integrity, and maintain confidence in the financial system. This includes rigorous disclosure requirements for listed companies, stringent rules against market manipulation, insider trading, and other forms of

financial misconduct. The regulatory oversight in New York is widely respected and is a key factor in its reputation as a secure and reliable market.

By contrast, the regulatory environment in Hong Kong is governed by the Securities and Futures Commission (SFC) [7], which also maintains high standards of market integrity and investor protection. However, there are some differences in regulatory approaches and enforcement intensity compared to the United States. Hong Kong operates under a system influenced by both British common law and Chinese regulations due to its history and strategic position. This unique regulatory framework is designed to cater to both international investor expectations and the dynamics of the Chinese market. The SFC focuses on ensuring that the market operates transparently and fairly, but the proximity to China means that there can be specific challenges and opportunities that differ from those in New York. For instance, the Stock Connect program, which links the Hong Kong market with the mainland Chinese markets in Shanghai and Shenzhen, introduces an additional layer of regulatory complexity and coordination.

Both Hong Kong and New York serve as critical financial markets globally, each with its own strengths and challenges. New York's significant market size, high liquidity, and robust regulatory framework cement its position as a leading global financial hub. In contrast, Hong Kong's strategic location, significant liquidity, and unique regulatory environment make it a vital financial center in Asia, particularly in its role as a bridge to mainland China. This comparison underscores the distinctive characteristics that each market brings to the global financial ecosystem, catering to different investor needs and market dynamics.

## **2.2 Comparison with London**

This section will compare Hong Kong's financial market with that of London, examining similarities and differences in terms of market structure, financial products, and international connectivity. Market structures in both Hong Kong and London have evolved to support a robust and dynamic financial ecosystem. Hong Kong, often regarded as the financial gateway to China, boasts a well-developed market infrastructure that includes a variety of exchanges such as the Hong Kong Stock Exchange (HKEX). Similarly, London maintains its standing as a global financial hub through institutions like the London Stock Exchange (LSE) and alternative trading facilities.

1. Both financial markets are characterized by their strong regulatory frameworks aimed at ensuring market stability and investor protection. Hong Kong's regulatory environment is overseen by the Securities and Futures Commission (SFC), which enforces rules and regulations tailored to maintain order and transparency within the market. London's financial regulations, on the other hand, are shaped by entities such as the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA), focusing on both market conduct and the holistic prudential health of financial institutions.

2. When it comes to financial products, both markets offer a diverse range that caters to various investor needs. Hong Kong's financial market is known for its deep liquidity in equity trading, derivatives, and fixed-income products. The availability of products tailored to Chinese companies, including H-shares and red-chip stocks, represents a

significant facet of Hong Kong's product offerings. In London, the financial product landscape includes a wide spectrum of assets such as equities, bonds, foreign exchange, and complex derivatives. Notably, London's focus on international bonds and its role as a global leader in the Eurobond market underscores its prominence in fixed-income securities.

3. Furthermore, the role of futures and options is critical in both markets, facilitating risk management and speculative activities. Hong Kong's futures market includes products like index [8] futures (e.g., Hang Seng Index futures) and commodity futures linked to metals and energy sectors. London's derivatives market, particularly through platforms like the London Metal Exchange (LME) and ICE Futures Europe, provides significant hedging tools for commodities, financial indices, and other specialized contracts.

4. International connectivity is another dimension where both markets excel, though with distinct attributes. Hong Kong acts as a pivotal bridge for international capital flowing into Mainland China, supported by programs like Stock Connect, Bond Connect, and the Wealth Management Connect, which link Hong Kong's financial markets with those in China. These connectivity programs are instrumental in enhancing cross-border investment opportunities and fostering greater integration between Hong Kong and Mainland China.

London's international connectivity, bolstered by its historical legacy and geographical timezone advantages, allows it to serve as a key financial center spanning American, European, and Asian markets. Post-Brexit, London has continued to navigate new regulatory environments while maintaining its influence in global markets. Its significance in foreign exchange trading is unparalleled, with London accounting for a substantial portion of the global FX market turnover.

To summarize, both Hong Kong and London have market structures that support extensive financial activities, underpinned by robust regulatory frameworks. Their financial products cater to a wide range of investment needs, from equities to complex derivatives, ensuring liquidity and market depth. Each market's international connectivity, via targeted programs and historical positioning, reinforces their roles as leading global financial centers within the rapidly evolving economic landscape.

## **2.3 Comparison with Tokyo**

This section will compare Hong Kong's financial market with that of Tokyo, analyzing the strengths and weaknesses of each market in terms of investor base, financial innovation, and regional influence.

1. Hong Kong's financial market holds a prominent position within the global financial ecosystem, driven by its strategic location and robust regulatory framework. The investor base in Hong Kong is diversified, encompassing both local and international investors. This diverse base is a significant strength, as it provides liquidity and stability to the market. The presence of numerous multinational corporations and financial institutions also helps in maintaining a dynamic market environment. However, one weakness is the heavy reliance on mainland China's economy, exposing Hong Kong to

geopolitical risks and economic fluctuations that could potentially impact market stability.

The financial innovation landscape in Hong Kong is vibrant and continually evolving. The city is known for its fintech advancements and supportive regulatory environment, which fosters innovation and growth. Moreover, Hong Kong's well-established infrastructure facilitates the seamless integration of new financial technologies, allowing for a more efficient and inclusive financial system. Despite these strengths, there are challenges, such as regulatory constraints and intense competition from other financial hubs, which could potentially hinder further innovation.

In terms of regional influence, Hong Kong serves as a crucial gateway between East and West. Its free-market policies, coupled with a superior legal system based on common law, make it an attractive destination for international business and finance. Hong Kong's stock exchange is one of the largest in the world, further cementing its influence within the region. However, the growing influence of mainland China and the shift of economic power towards Shanghai have emerged as potential threats to Hong Kong's dominance in the region.

2. On the other hand, Tokyo maintains its status as one of the leading global financial centers, characterized by a mature and stable financial market. The investor base in Tokyo is somewhat different, with a significant proportion of institutional investors and a relatively smaller presence of retail investors compared to Hong Kong. This composition has both strengths and weaknesses. While the dominance of institutional investors ensures substantial market stability and liquidity, it also means that the market might not be as dynamic and diverse as Hong Kong's.

Tokyo is also a hub for financial innovation, particularly in fields such as artificial intelligence and blockchain technologies. The city's supportive regulatory environment and well-developed infrastructure foster a conducive environment for technological advancements in finance. Nevertheless, Tokyo faces challenges such as a rigid regulatory structure and cultural resistance to change, which can slow down the pace of financial innovation.

Regarding regional influence, Tokyo's financial market plays a critical role in the Asia-Pacific region. While it may not serve as a bridge between East and West like Hong Kong, Tokyo remains a vital financial center with significant influence over regional economic activities. The Tokyo Stock Exchange is one of the world's largest, providing a platform for investors and companies throughout the region. Nonetheless, Tokyo's regional influence is somewhat constrained by the limited internationalization of its corporate sector and the overarching focus on domestic economic issues.

In summary, both Hong Kong and Tokyo possess unique strengths and weaknesses in their financial markets. Hong Kong's diverse investor base, vibrant financial innovation, and strategic regional influence position it as a crucial global financial center. However, it faces challenges from its reliance on mainland China and the competitive pressures from other financial hubs. Tokyo, with its stable and mature market, substantial institutional investor presence, and strong regional influence, remains a key player in the global financial landscape. Yet, it must navigate challenges related to regulatory rigidity and domestic-focused economic policies to maintain its competitive edge.

## **2.4 Unique Advantages and Core Competitiveness of Hong Kong's Financial Market**

Hong Kong's financial market possesses a range of unique advantages that have established it as a formidable player on the global financial stage.

1. One of the primary elements of Hong Kong's financial ingenuity lies in its strategic position as a gateway to mainland China. This geographic and political proximity grants Hong Kong unparalleled access to one of the world's largest and fastest-growing economies. Investors worldwide find Hong Kong an attractive entry point to China due to the ease of conducting business, the familiarity of its financial infrastructure, and the extensive bilateral economic ties between the two regions.

2. Furthermore, Hong Kong's financial market benefits significantly from a well-established legal and regulatory framework that assures global investors of a high level of stability, transparency, and predictability. The region adheres to the common law legal system, distinguished by its independence and impartiality. This system is rooted in principles that ensure fair competition, protect property rights, and uphold contract enforceability. Such a robust legal environment is paramount for fostering investor confidence and ensuring sustained inflows of international capital.

3. Hong Kong's regulatory bodies, particularly the Securities and Futures Commission (SFC) and the Hong Kong Monetary Authority (HKMA) [3], play a crucial role in maintaining market integrity. The SFC oversees the securities and futures markets, ensuring that market activities are conducted smoothly and fairly. Additionally, the HKMA is responsible for maintaining the stability of the banking sector and managing the linked exchange rate system, where the Hong Kong dollar is pegged to the US dollar. This pegged exchange rate has provided a stable currency environment, eliminating the risks associated with exchange rate volatility and thereby attracting a steady stream of international business.[5]

4. Additionally, Hong Kong boasts a financial ecosystem that is well-connected and highly liquid. The presence of a large number of leading global banks [1, 10], investment firms, and insurance companies, along with a diverse array of financial products, positions Hong Kong as a comprehensive financial hub. The city's stock exchange, the Hong Kong Stock Exchange (HKEX), is one of the largest and most dynamic in the world, offering a platform for companies from around the globe to raise capital. This gateway for Initial Public Offerings (IPOs) sees significant activity, creating opportunities for diverse investment and trading.

5. Moreover, Hong Kong's free flow of capital is another vital advantage, allowing investors to move funds [4] in and out without restrictions. This level of accessibility is essential for fostering a competitive financial environment where market participants can freely engage in international trade and investment activities. The liberalized financial environment is underpinned by a sound infrastructure that facilitates efficient transaction processing and settlement.

6. The city's financial market is also supported by a well-educated and highly skilled workforce proficient in both local and international regulations, making it easier for global firms to operate within the region. With a diverse talent pool, financial institutions in Hong Kong can tap into a wealth of expertise across various financial services

[2] sectors. This access to a broad talent base ensures that Hong Kong remains at the cutting edge of financial innovation and services.

7. Technology adoption and innovation within Hong Kong's financial sector further drive its competitiveness. The city is a fertile ground for fintech startups, supported by government initiatives and investment in innovation. These startups contribute to the dynamic and evolving landscape of financial services by introducing new technologies that enhance efficiency and customer experiences.

In conclusion, Hong Kong's financial market is characterized by its strategic gateway position to mainland China, a robust and transparent legal and regulatory framework, high liquidity, free capital movement, a skilled workforce, technological innovation, and geographical advantage. These elements collectively underpin Hong Kong's unique advantages and core competitiveness, affirming its status as a leading global financial hub.

### **3 Challenges Faced by Hong Kong as an International Financial Center**

#### **3.1 Risks Associated with the Dual Characteristics of Hong Kong's Economy**

Hong Kong's dual economy presents a unique set of challenges and opportunities, intertwining a highly developed financial sector with a more traditional manufacturing and service sector. This hybrid economic model poses significant risks that merit closer examination. Understanding these risks is crucial for policymakers, investors, and business leaders who seek to navigate Hong Kong's complex economic landscape effectively.

The financial sector in Hong Kong is among the most advanced in the world, characterized by a robust banking system, a transparent regulatory environment, and a dynamic stock market. As a global financial hub, Hong Kong attracts immense capital flows, facilitating international business transactions and investments. The city's financial prowess is further bolstered by its strategic location, serving as a gateway between China and the rest of the world. Regulatory practices in Hong Kong's financial industry adhere to international standards, ensuring a high level of confidence and trust among global investors.

1. However, the prominence of the financial sector also introduces vulnerabilities. The economic stability of Hong Kong is closely tied to the performance of global financial markets. Any significant downturn or instability in international markets can have a ripple effect on Hong Kong's economy. For instance, a global financial crisis can lead to a sudden outflow of capital, causing liquidity issues and market disruptions. Furthermore, the over-reliance on the financial sector may result in economic imbalances, where other sectors of the economy, such as manufacturing and traditional services, do not receive adequate attention or investment. This disproportionate focus could exacerbate income inequality and limit economic diversification.

2. On the other hand, the traditional manufacturing and service sectors in Hong Kong have historically been the backbone of the local economy. These sectors encompass a

wide range of activities, including textile production, electronics manufacturing, tourism, retail, and hospitality services. While these industries contribute significantly to employment and GDP, they face intense competition from other economies in the region, such as mainland China, which offers lower labor costs and larger-scale production capabilities. The competitiveness of Hong Kong's traditional sectors is further challenged by rising labor costs, limited land availability, and stringent environmental regulations.

The manufacturing sector, in particular, has been significantly impacted by these pressures. Many manufacturing firms have relocated their production facilities to mainland China or Southeast Asia to take advantage of cost efficiencies. This migration has led to a hollowing-out effect, where high-value-added manufacturing activities remain in Hong Kong, but the mass production segment has shifted elsewhere. Consequently, the local manufacturing sector's contribution to the overall economy has declined over time, leading to concerns about sustainability and long-term growth prospects.

3. Simultaneously, the service sector remains resilient but is not immune to challenges. The tourism industry, a key component of the service sector, is sensitive to geopolitical tensions, public health issues, and changes in consumer behavior. Events such as protests, pandemics, or shifts in global travel trends can significantly impact tourism revenues and, by extension, the broader service economy. Retail businesses, heavily reliant on tourism, also face the brunt of such disruptions. The evolving nature of consumer preferences, with a growing emphasis on e-commerce and digital services, mandates a continuous adaptation to emerging trends and technologies.

4. Moreover, the dual economy structure can lead to policy dilemmas. Balancing the needs of a sophisticated financial sector with those of traditional industries requires nuanced and well-calibrated policy decisions. Policymakers must ensure that regulatory frameworks support innovation and growth in both domains while mitigating potential risks. There may be conflicting interests between different economic players, necessitating a strategic approach to governance that fosters inclusive growth and economic resilience.

In conclusion, Hong Kong's dual economy, characterized by a highly developed financial sector and a more traditional manufacturing and service sector, poses unique risks. The heavy reliance on the financial sector introduces vulnerabilities to global market fluctuations, while traditional industries face competitive pressures and evolving challenges. Addressing these risks requires a comprehensive strategy that balances the interests of both sectors, promotes economic diversification, and enhances resilience against external shocks. The future trajectory of Hong Kong's economy will depend on its ability to navigate these complexities and leverage its strengths in a rapidly changing global landscape [6].

### **3.2 Short-term Economic Risks and Uncertainties**

Hong Kong, a bustling metropolis known for its vibrant economy and strategic geographical position, has long been a focal point in global trade and finance. However, in recent times, this city has faced a constellation of short-term economic risks and uncertainties. Prominent among these challenges are the severe impacts of the COVID-19

pandemic and the persistently tense trade relations between China and the United States.

1. The COVID-19 pandemic has been a global disruptor, but its ramifications in Hong Kong have been particularly pronounced. As a densely populated urban area with a significant degree of international connectivity, Hong Kong was vulnerable to the swift spread of the virus. The government took swift but stringent measures, including social distancing mandates, travel bans, quarantine protocols, and widespread testing. While these measures were crucial for public health, they brought the city's economic activities to a grinding halt. Retail businesses, a cornerstone of Hong Kong's economy due to the city's status as a shopping hub for tourists, particularly from Mainland China, faced unprecedented challenges. With international travel restricted, tourism, which contributes a substantial portion of the city's GDP, plummeted, leading to sharp declines in revenue for hotels, restaurants, and retail outlets.

Moreover, the pandemic led to a significant slowdown in Hong Kong's financial services sector, which is another vital component of its economy. The stock market experienced volatility, investor confidence dwindled, and there was a noticeable contraction in financial transactions. The administration's fiscal response to the economic downturn included relief packages aimed at supporting the most affected sectors and safeguarding employment. However, these measures have also exerted pressure on the city's fiscal reserves, raising concerns about long-term fiscal sustainability.

2. At the same time, the ongoing trade tensions between China and the U.S. have cast a long shadow over the economic landscape of Hong Kong. As a Special Administrative Region (SAR) of China, Hong Kong has historically served as a bridge for trade between the East and the West. The escalating tariff wars, regulatory crackdowns, and geopolitical frictions have strained this intermediary role. The imposition of tariffs and trade barriers by both the U.S. and China has disrupted supply chains, exacerbated costs for businesses, and led to uncertainties in investment climates. Companies operating in Hong Kong, especially those involved in manufacturing, export-import businesses, and tech sectors, have found themselves entangled in a web of compliance complexities and shifting market dynamics.

Furthermore, the U.S. government's decision to revoke Hong Kong's special status, which provided favorable treatment under American law, has added layers of regulatory and economic challenges. This decision impacts tariffs, exports, visa protocols, and technology transfers, adding another layer of complexity for businesses operating in the region. This revocation has unsettled foreign investors, who question the long-term viability of using Hong Kong as a gateway for business operations in Asia. The potential realignment of global trade routes and focus away from Hong Kong could significantly alter the city's international business landscape.

Understanding and navigating these challenges is crucial for policymakers, businesses, and the general populace of Hong Kong. The interconnected nature of the city's economy with global trade networks makes it essential to adopt adaptive strategies that mitigate risks while capitalizing on emerging opportunities in a post-pandemic world. As Hong Kong looks to the future, efforts to bolster economic resilience and adaptability will be key determinants of its recovery trajectory and sustained economic health.

### 3.3 Lack of Market Dominance by Chinese Financial Institutions

This section will analyze the challenges posed by the lack of market dominance by Chinese financial institutions in Hong Kong, and the potential implications for the city's future as a financial center.

The landscape of Hong Kong's financial sector has historically been influenced by global institutions, with a significant presence of Western banks and financial entities. Despite Hong Kong's proximity to Mainland China and the increasing economic clout of Chinese financial entities globally, Chinese financial institutions have not yet achieved substantial market dominance in Hong Kong. The reasons behind this phenomenon are multifaceted and have significant implications for Hong Kong's future role as an international financial center.

1. One of the primary challenges faced by Chinese financial institutions in trying to establish market dominance in Hong Kong is the legacy of entrenched Western financial entities. These institutions, such as HSBC, Standard Chartered, and various American investment banks, have had a long-standing presence in Hong Kong and command a substantial share of the market. This historical presence is supported by strong client relationships, comprehensive service portfolios, and significant influence over regulatory frameworks that favor established players. For Chinese financial institutions, breaking into this tightly held market poses a considerable hurdle despite their growing capabilities and resources.

2. Additionally, the regulatory framework of Hong Kong, while robust, is heavily influenced by international standards and practices. The compliance and operational expectations set forth by entities such as the Hong Kong Monetary Authority (HKMA) are rigorous and align closely with Western regulatory approaches. As such, Chinese financial institutions may find it challenging to navigate these stringent requirements, which might differ significantly from those in Mainland China where they primarily operate. The need to adapt to these regulatory conditions can slow their expansion and limit their ability to compete head-to-head with established rivals.

3. Furthermore, there is an inherent perception and trust issue at play. Hong Kong's financial sector clients, including high-net-worth individuals and international corporations, have developed strong trust-based relationships with established Western financial institutions. Overcoming these deep-rooted preferences requires Chinese banks to not only match but exceed the service quality, reliability, and innovation traditionally provided by their Western counterparts. Building this level of trust and reshaping client perception is a time-intensive process and represents a significant barrier to achieving market dominance.

4. Adding to the complexity is the geopolitical dimension. The relationship between mainland China and Hong Kong has been a subject of significant political discourse, impacting the sentiment of international investors and stakeholders towards Chinese financial institutions. Political developments can create uncertainties and perceived risks that may deter clients from shifting their banking and investment relationships to entities perceived as closely aligned with Mainland China. This geopolitical backdrop can, therefore, be a deterrent to the growth aspirations of Chinese financial entities within Hong Kong's financial market.

Despite these challenges, there are potential pathways for Chinese financial institutions to enhance their presence and influence in Hong Kong. A strategic approach that involves partnerships and collaborations with established international financial entities could pave the way for a more gradual and accepted integration into the market. Additionally, leveraging technological advancements and financial innovations could provide a competitive edge to attract younger and more tech-savvy client segments, possibly altering market dynamics in favor of Chinese institutions over time.

Another potential approach is to align more closely with global regulatory practices and standards, ensuring compliance and enhancing their reputation in the international finance community. This could involve investing substantially in regulatory technology, compliance training, and risk management systems to meet and possibly exceed the expectations set by local regulators and international counterparts.

The implications of Chinese financial institutions either successfully navigating these challenges or failing to gain substantial market dominance are significant for Hong Kong's future as a financial center. Should they succeed, Hong Kong could see a more diversified and competitive financial market, bolstering its status as a dynamic conduit between East and West. On the other hand, if Chinese financial institutions fail to make meaningful inroads, Hong Kong risks retaining a status quo that might not fully leverage the economic potential of its strategic location next to Mainland China. This scenario could potentially limit Hong Kong's growth and innovation in a rapidly evolving global financial landscape.

### **3.4 Increasing Competition from other Emerging Financial Centers**

Hong Kong has long been recognized as a leading global financial hub, known for its robust infrastructure, business-friendly regulations, and strategic location that affords it easy access to major Asian markets. Its financial services sector has attracted businesses and investors from around the world and plays a crucial role in the global economy. However, this stellar reputation is increasingly being challenged by other emerging financial centers, such as Singapore and Shanghai, which are striving to claim a share of the financial services market and potentially undermine Hong Kong's status as a preeminent financial center.

1. One of the main competitors of Hong Kong in the region is Singapore. Known for its political stability, transparent regulations, and high-quality lifestyle, Singapore has been successfully positioning itself as an alternative hub for financial services in Asia. Over the past decade, Singapore has made substantial investments in its financial sector, bolstering its capabilities in banking, asset management, insurance, and financial technology. The Monetary Authority of Singapore (MAS) has implemented forward-thinking policies to attract international financial institutions, providing incentives such as tax benefits and streamlined regulatory processes. Moreover, Singapore has developed a comprehensive framework to support financial technology (fintech) innovation, further enhancing its attractiveness as a financial center. The city's strategic geographic location, strong legal infrastructure, and efforts towards diversifying its economy have made it a compelling choice for investors and financial firms seeking a stable and competitive environment.

2. Meanwhile, Shanghai has emerged as a formidable competitor largely due to the rapid economic growth of China and the Chinese government's concerted efforts to develop Shanghai into an international financial hub. The establishment of the Shanghai Free Trade Zone (SFTZ) has been a significant milestone, allowing for greater financial liberalization and integration with global markets. [9] This initiative includes policies aimed at attracting foreign investment, increasing the convertibility of the Chinese yuan, and facilitating cross-border trade and financing. Additionally, the Chinese financial market's gradual opening up has enabled Shanghai to attract a growing number of multinational financial institutions, eager to tap into the vast Chinese market. The Shanghai Stock Exchange, one of the largest in the world by market capitalization, continues to grow, further consolidating the city's position as a leading financial center. The Chinese government's support, coupled with Shanghai's burgeoning financial infrastructure, makes it a formidable rival to Hong Kong.

The intensifying competition from Singapore and Shanghai has significant implications for Hong Kong. While Hong Kong benefits from its long-standing reputation, established regulatory framework, and deep financial markets, it can no longer rest on its laurels. Political developments, particularly those related to the relationship between Hong Kong and mainland China, have also introduced an element of uncertainty that could impact investor confidence. As a response to these external pressures, Hong Kong must pursue strategies to reinforce its competitive edge. This could include investing in innovative financial technologies, expanding its role as a bridge between China and the global economy, and ensuring that its regulatory environment remains conducive to business.

In addition, the rise of alternative financial centers necessitates a focus on talent acquisition and retention. Hong Kong must continue to attract and develop a skilled workforce capable of driving financial innovation and maintaining high standards in financial services. Collaborations with academic and research institutions to foster a culture of continuous learning and development could further bolster the city's position. Additionally, enhancing infrastructure, such as ensuring cutting-edge digital platforms and cybersecurity measures, will be vital to sustaining Hong Kong's competitive advantage.

In summary, while Hong Kong remains a leading financial hub, the growing competition from Singapore and Shanghai poses a significant challenge. To maintain its preeminent status, Hong Kong must continue to innovate, adapt, and invest in its financial sector. This dynamic and evolving landscape of financial services underscores the importance of strategic foresight and proactive measures to sustain leadership in a competitive global market.

## **4 Policy Recommendations and Future Prospects**

### **4.1 Adjusting the Dividend Tax of Southbound Stock Connect**

This section will propose adjusting the dividend tax of Southbound Stock Connect to enhance the attractiveness of Hong Kong's stock market to mainland Chinese investors by outlining specific methods and potential benefits. Adjusting the dividend tax could

involve lowering the tax rate on dividends earned through the Southbound Stock Connect, which would directly impact the net returns of Chinese investors.

1. Lowering the dividend tax rate would increase the after-tax income for investors, thereby potentially making Hong Kong-listed stocks more appealing. For example, if the current dividend tax rate is 10%, reducing it to 5% could result in a 5% increase in net investment returns from dividends. This incremental gain could be substantial over time as dividends are often reinvested, leading to compounding returns. Furthermore, a more favorable tax regime can create a competitive edge for Hong Kong in attracting more Southbound investments compared to other international markets.

2. In addition to immediate tax savings, lowering the dividend tax could improve market liquidity. Increased participation by mainland investors can lead to higher trading volumes, which can enhance the price discovery process and reduce the bid-ask spread. This improvement in market efficiency is advantageous not only to the investors themselves but also to the overall health and stability of Hong Kong's financial markets. Higher liquidity tends to attract more market participants, creating a virtuous cycle of investment and growth.

3. Broadening the base of investors by making the tax environment more favorable can also lead to greater diversity in the investor pool. A diversified investor base can stabilize the market as it reduces the likelihood of synchronized trading behavior. High net worth individuals, institutional investors, and retail investors from mainland China might have different risk appetites and investment horizons, contributing to market resilience.

4. Moreover, adjusting the dividend tax to enhance Hong Kong's stock market attractiveness must consider the interplay with mainland China's capital controls. The Southbound Stock Connect is part of an overall strategy to internationalize the Renminbi (RMB) and integrate mainland Chinese financial markets with global economies. A lower dividend tax could facilitate a smoother flow of capital between the two regions, supporting these broader objectives. By demonstrating a commitment to creating a conducive investment environment, Hong Kong can reinforce its strategic position as a gateway for international investors looking to access China's vast economic landscape.

5. Finally, such an adjustment should also involve comprehensive policy and regulatory measures to ensure transparency and adherence to international standards. This includes clear guidelines on tax reporting, measures against tax evasion, and a streamlined process for tax refunds or credits that mainland investors might be eligible for. Clear and efficient regulatory frameworks can enhance investor confidence, further bolstering market participation.

In summary, adjusting the dividend tax for Southbound Stock Connect is aimed at making Hong Kong's stock market more attractive to mainland Chinese investors by increasing after-tax returns, improving market liquidity, broadening the investor base, and aligning with China's broader financial integration strategies. It serves as a strategic maneuver to solidify Hong Kong's status as a key financial hub and gateway for capital flowing between mainland China and the rest of the world.

## 4.2 Strengthening the Development of Financial Derivatives Market

The development of Hong Kong's financial derivatives market is crucial for enhancing its global competitiveness and drawing a higher number of international investors. Financial derivatives, which include instruments like options, futures, and swaps, offer valuable opportunities for hedging, speculation, and arbitrage. The robust performance of these instruments within a well-regulated market can substantially elevate investor confidence and market robustness.

Given Hong Kong's strategic location as a gateway between the East and the West, the deepening of its financial derivatives market aligns with its role as a preeminent international financial center. Developing a more advanced derivatives market will provide the necessary tools for risk management and investment diversification. It allows for more comprehensive and sophisticated financial planning, tailoring to the specific needs of various investors, ranging from individual retail investors to large institutional firms.

1. One of the primary steps towards strengthening this market is to enhance the regulatory framework governing the trading of financial derivatives. A robust regulatory environment ensures that all market participants operate on a level playing field, thereby reducing systemic risks and potential malpractices. Moreover, clear regulations can attract institutional investors who seek a stable and predictable investment environment. The establishment of transparent, stringent, and consistently enforced regulations can help promote Hong Kong as a trustworthy hub for financial derivatives trading.

2. Additionally, the implementation of technological advancements is essential in modernizing the trading platforms used for derivatives. Sophisticated trading technologies, such as blockchain and high-frequency trading algorithms, can enhance the efficiency, speed, and security of transactions. These technological improvements can lower transaction costs, increase liquidity, and improve the overall user experience for market participants. By investing in cutting-edge technology, Hong Kong can position itself as a leader in innovation within the financial sector.

3. Another pivotal area for development is to cultivate talent and expertise in the field of financial derivatives. Establishing specialized education programs and professional training courses can produce a skilled workforce capable of navigating and developing the complexities of the derivatives market. Creating partnerships between academic institutions, industry leaders, and government bodies can foster an ecosystem conducive to continuous learning and professional growth. A well-educated talent pool not only enhances the market's operational efficiency but also drives innovation, creating new derivatives products and investment strategies.

4. Promotion and marketing efforts aimed at global investors are equally important in amplifying Hong Kong's appeal as a financial derivatives hub. Strategic communication and outreach initiatives can highlight the unique advantages of investing in Hong Kong's derivatives market, including its regulatory environment, technological infrastructure, and skilled workforce. Hosting international conferences, seminars, and workshops on derivatives trading can also serve as platforms to showcase Hong Kong's market strengths and attract interest from international investors and financial institutions.

5. Collaborations with other major financial hubs can further enrich Hong Kong's derivatives market. Establishing mutual recognition agreements and collaborative frameworks with markets in the United States, Europe, and other parts of Asia can facilitate cross-border trading and increase global integration. These alliances can offer diversified investment opportunities and enhance market depth, appealing to a broader spectrum of global investors.

6. The evolution of Hong Kong's financial derivatives market must also keep pace with the evolving global economic landscape. This involves continuously monitoring and adapting to global trends, regulatory changes, and emerging risks. By staying agile and responsive to global market dynamics, Hong Kong can secure a competitive edge in the international financial arena.

In conclusion, strengthening the development of Hong Kong's financial derivatives market requires a multifaceted approach. Enhancing regulatory frameworks, leveraging technological advancements, cultivating specialized talent, engaging in strategic promotion, and fostering international collaborations are key strategies that can drive the market forward. Through these concerted efforts, Hong Kong can improve its competitiveness and attract a greater number of international investors, solidifying its status as a leading global financial center.

#### **4.3 Promoting the Internationalization of the Renminbi**

The internationalization of the Renminbi (RMB) is of paramount significance for several reasons, and Hong Kong occupies a unique and strategic position to facilitate this process effectively. The concept of the internationalization of a currency typically involves its acceptance and usage beyond the borders of its originating country, covering roles such as a medium of exchange, a unit of account, and a store of value. For the RMB, achieving this status not only aligns with China's economic aspirations but also enhances its influence in global financial markets.

One of the primary reasons for promoting the internationalization of the RMB is to reduce dependency on the US dollar. China, being the world's second-largest economy, conducts a significant portion of its trade in US dollars. This dependency subjects China to risks associated with fluctuations in the value of the dollar and geopolitical tensions with the United States. By internationalizing the RMB, China aims to mitigate these risks, facilitating more stable and predictable economic interactions on the global stage. This shift could potentially lead to a new financial order where the RMB stands as a significant global currency, thereby enhancing China's economic sovereignty and security.

Hong Kong's role in this transformative process cannot be overstated. Given its unique status as a Special Administrative Region of China with a high degree of autonomy, Hong Kong serves as a crucial bridge between Mainland China and the rest of the world. Its well-developed financial infrastructure, robust legal system, and deep capital markets make it an ideal testing ground for RMB internationalization initiatives. Furthermore, Hong Kong's strategic geographic location and historical role as a global financial hub position it uniquely to facilitate cross-border trade and investment using the RMB.

1. One of the key mechanisms by which Hong Kong can bolster the internationalization of the RMB is through its offshore RMB market. Hong Kong has already established itself as the leading offshore RMB center, providing a critical platform for various financial products and services denominated in RMB. These include Dim Sum bonds, RMB-denominated loans, and trade finance. The availability of these instruments allows international investors and businesses to access RMB-denominated assets, promoting liquidity and confidence in the RMB as a viable currency for global transactions.

2. Moreover, Hong Kong's financial regulatory framework plays a supportive role in this process. Its regulatory bodies maintain high standards of transparency and stability, which are essential for fostering trust among international investors. The regulatory environment in Hong Kong ensures that RMB products and transactions are conducted within a secure and predictable framework, thereby encouraging wider acceptance and usage of the currency. The Hong Kong Monetary Authority (HKMA), in collaboration with the People's Bank of China (PBOC), has been instrumental in implementing policies that facilitate smooth and efficient RMB transactions. Such collaboration underscores the synergistic relationship between Hong Kong and Mainland China in pursuing RMB internationalization.

Trade settlement using the RMB is another critical domain where Hong Kong can contribute significantly. Through the implementation of the RMB Cross-Border Trade Settlement Pilot Scheme, companies in Hong Kong have gained the ability to settle trades directly in RMB. This facility reduces transaction costs associated with currency conversion and hedging, making trade more efficient and cost-effective. As more enterprises adopt RMB for their international trade transactions, the demand and circulation of the currency will naturally increase, reinforcing its international status.

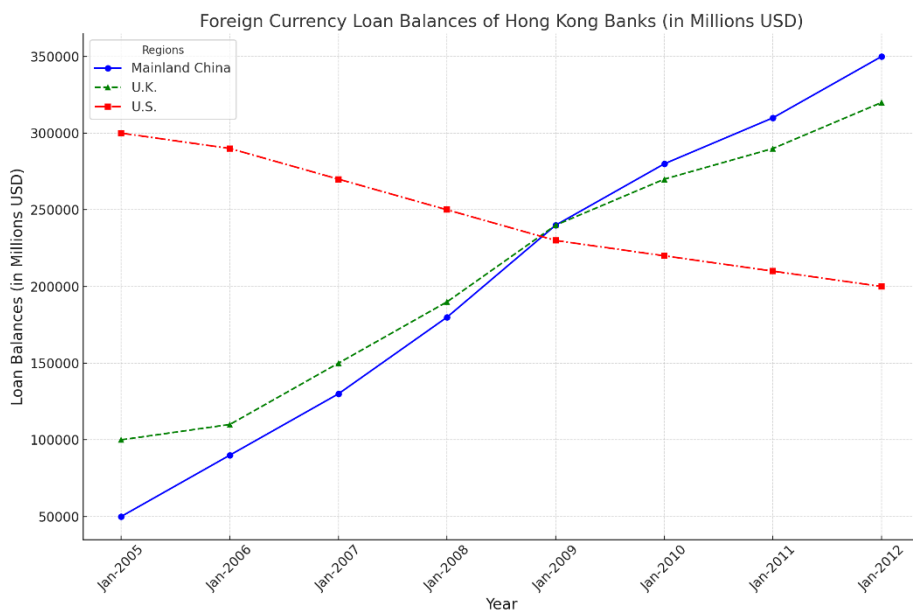
Hong Kong's vibrant financial ecosystem also supports a wide array of RMB-denominated investment products, ranging from equities to real estate investment trusts (REITs). By offering diversified RMB investment options, Hong Kong attracts global investors seeking to tap into China's growth story while utilizing a currency they trust. This influx of foreign capital into RMB assets further strengthens the currency's global presence and acceptance.

In conclusion, the internationalization of the Renminbi is a multifaceted endeavor that carries profound implications for China's economic positioning on the global stage. Hong Kong, with its sophisticated financial infrastructure, regulatory prowess, and strategic geographical and political positioning, plays an indispensable role in this ambitious project. By leveraging its unique advantages, Hong Kong not only facilitates the broader adoption of the RMB in international markets but also reinforces its own status as a premier global financial centre. The synergistic efforts between Hong Kong and Mainland China in promoting the RMB will likely pave the way for a more diversified and balanced global financial system.

#### **4.4 Enhancing Collaboration with Mainland China and other Regions**

As shown in Fig. 1, the graph depicts the foreign currency loan balances of Hong Kong banks to the U.S., Mainland China, and the U.K. from January 2005 to January 2012.

There is a notable upward trend in loan balances to Mainland China and the U.K., reaching peaks of approximately \$260 billion and \$280 billion respectively. In contrast, the loan balance to the U.S. remains relatively stable with a slight decline over the same period.



**Fig. 1.** Hong Kong has Been Buying Up China [11].

The collaborative efforts between Hong Kong and mainland China, along with other regions, present a dynamic opportunity to fortify Hong Kong's status as a premier international financial center. Central to this proposal is the integration of advanced financial technologies and regulatory frameworks that are congruent with the global financial ecosystem. Hong Kong's robust legal system, coupled with a transparent regulatory environment, makes it an attractive destination for global investors seeking to navigate the complexities of international finance.

1. Enhancing the synergy between Hong Kong and mainland China necessitates a multifaceted approach. One critical aspect is the alignment of financial policies and standards. Harmonizing these elements will facilitate smoother cross-border capital flow and amplify investor confidence. By adopting a cohesive regulatory framework, both regions can mitigate risks and ensure a stable financial environment conducive to growth. Additionally, leveraging Hong Kong's expertise in financial services and its strategic geographical location can serve as a conduit for mainland Chinese enterprises looking to expand their global footprint.

2. Another dimension of this enhanced collaboration involves embracing innovation within financial technologies. Fintech, blockchain, and artificial intelligence are revolutionizing the financial industry. By fostering a collaborative ecosystem that encourages the exchange of technological advancements, Hong Kong and mainland China can

jointly spearhead innovations that cater to the evolving needs of the global market. Collaboration in these areas can lead to the development of new financial products and services, thereby attracting a broader spectrum of international investors and firms.

3. The inclusion of other regions in this collaborative effort further diversifies and strengthens Hong Kong's position. For instance, engaging with financial centers in Europe and North America can introduce best practices and innovative financial products to the Hong Kong market. Likewise, exploring partnerships with emerging markets can open new avenues for investment and growth. The diversification of economic partnerships mitigates risks associated with overreliance on a limited number of markets, thus enhancing financial stability and resilience.

4. A key enabler of this collaboration is the development of a robust infrastructure that supports seamless financial transactions and communication. Building a sophisticated digital infrastructure that encompasses secure data exchange, real-time transaction processing, and advanced cybersecurity measures is imperative. Such an infrastructure will not only bolster investor confidence but also streamline operations across different financial jurisdictions.

5. Human capital is another crucial element in fortifying Hong Kong's financial leadership. By investing in education and professional development programs that focus on financial services, technology, and regulatory compliance, Hong Kong and mainland China can cultivate a talent pool equipped with the skills necessary to navigate and lead in the global financial landscape. Exchange programs, joint research initiatives, and cross-border internships can foster a culture of knowledge sharing and continuous improvement.

6. Moreover, fostering a culture of corporate governance and ethical financial practices is vital. Transparent and accountable business practices are the bedrock of sustained investor trust. Collaborative efforts to promote these principles can include joint regulatory oversight, adherence to international financial standards, and the implementation of rigorous compliance mechanisms.

In conclusion, the proposition of enhancing collaboration between Hong Kong and mainland China, along with other regions, aims to consolidate Hong Kong's role as a leading international financial center. This collaborative framework not only strengthens financial ties but also propels economic growth and stability, benefiting all participating regions and solidifying Hong Kong's strategic position in the international financial arena.

#### **4.5 Fostering Innovation and Embracing Financial Technology**

The landscape of global finance is undergoing a transformative phase, driven primarily by advancements in technology and innovation. In this dynamic and rapidly evolving environment, the need for Hong Kong to embrace financial technology and foster innovation cannot be overstated. Historical precedence highlights Hong Kong's exceptional ability to adapt and thrive amid changing economic conditions, but the current challenges are unprecedented in scope and scale, requiring a proactive and comprehensive strategy to maintain its competitive edge.

A pivotal aspect of this strategy involves creating an environment conducive to innovation, particularly in the realm of financial technology (FinTech). Innovation in FinTech encompasses a wide array of developments, from blockchain and cryptocurrency to artificial intelligence and machine learning in financial services. These advancements have the potential to revolutionize the way financial transactions are conducted, making them faster, more secure, and more efficient. Hong Kong, with its deep-rooted financial infrastructure and a globally recognized legal and regulatory framework, is uniquely positioned to become a global hub for FinTech innovation.

1. One of the primary steps in fostering innovation is the establishment of dedicated research and development (R&D) centers. By investing in R&D, Hong Kong can cultivate a pool of talented individuals adept at developing cutting-edge financial technologies. Partnerships between government bodies, educational institutions, and private enterprises can facilitate the creation of innovation clusters, where ideas can be rapidly transformed into market-ready products and services. Government incentives, such as tax breaks and grants for start-ups, can also play a crucial role in encouraging entrepreneurial ventures in the FinTech sector.

2. Moreover, regulatory frameworks must evolve in tandem with technological advancements. Regulatory sandboxes, which allow FinTech companies to test new products and services in a controlled environment with temporary regulatory exemptions, can spur innovation while ensuring consumer protection and financial stability. Hong Kong's regulators need to strike a balance between fostering innovation and maintaining the robustness of the financial system. Transparent and adaptive regulatory frameworks will not only encourage innovation but also attract international FinTech firms to establish bases in Hong Kong, thereby enhancing the city's global financial stature.

3. Another important facet of embracing financial technology is the integration of digital payment systems. Digital payments are becoming increasingly popular worldwide, driven by their convenience and efficiency. In order to stay competitive, Hong Kong must promote the widespread adoption of digital payment systems among businesses and consumers. This can be achieved through public-private partnerships that enhance the digital infrastructure while also ensuring cybersecurity and data protection. Efforts should be made to educate the public on the benefits of digital payments and to address any concerns related to digital security.

4. Additionally, the emphasis on big data analytics cannot be ignored. Big data analytics enable financial institutions to harness vast amounts of data to make more informed decisions, improve customer experiences, and enhance operational efficiency. By leveraging big data, Hong Kong's financial sector can gain deeper insights into market trends, customer preferences, and potential risks, thereby maintaining its competitive edge. Investment in technology that supports big data analytics, such as cloud computing and advanced data processing algorithms, is essential to fully realize the benefits of this approach.

5. Cybersecurity is another critical area that demands attention in the context of FinTech innovation. As financial transactions increasingly move online, the susceptibility to cyber-attacks also increases. Ensuring robust cybersecurity measures is paramount to maintaining trust in the financial system. Hong Kong must invest in state-of-the-art cybersecurity infrastructure and continuously update its protocols to counter

evolving cyber threats. Collaboration with international cybersecurity agencies and participation in global cybersecurity initiatives can provide valuable insights and resources to bolster Hong Kong's defense mechanisms.

6. Lastly, fostering a culture of innovation requires a shift in mindset across the financial sector. Traditional banking institutions must be encouraged to adopt agile methodologies and to be more open to collaboration with FinTech start-ups. This can be facilitated through innovation labs and incubators that bring together traditional financial experts and tech innovators to co-create groundbreaking solutions. Building a community that values experimentation and is not afraid to take calculated risks will be instrumental in driving the next wave of financial innovation in Hong Kong.

In conclusion, Hong Kong's commitment to fostering innovation and embracing financial technology is essential to sustaining its leadership in the global financial arena.

## 5 Conclusion

The study summarizes that Hong Kong's status as a premier international financial center is affirmed by its comprehensive legal framework, deep pool of financial professionals, and robust infrastructure. The balanced regulatory approach supports market integrity and innovation, while the strategic geographic location and time zone advantage bolster its role as an East-West market bridge. The financial markets' depth and liquidity, stringent listing requirements, and the presence of global financial institutions, particularly in banking and asset management, reinforce Hong Kong's financial hub status.

The study also notes the proactive integration of fintech, enhancing Hong Kong's competitive edge in innovation. The future outlook is promising, with initiatives like the Greater Bay Area and the Belt and Road Initiative offering opportunities for further integration and growth. However, challenges such as geopolitical dynamics and the need for economic diversification and environmental sustainability must be addressed to ensure sustainable development.

The research concludes by emphasizing the importance of a forward-looking approach to policymaking that balances growth with social equity and environmental considerations. It suggests that future studies should explore the emerging opportunities in fintech and the implications of global economic shifts for Hong Kong's continued relevance and competitiveness in the global financial landscape.

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