

DRAFT RESEARCH OUTLINE

Views of Experts and Academics on the Linked Exchange Rate System

1. Background

1.1 At its meeting on 19 July 2002, the Panel on Financial Affairs (the Panel) requested the Research and Library Services Division (RLSD) to conduct research on the Linked Exchange Rate system. Concerns were raised as to whether there would be benefits for Hong Kong if the Government were to change, or even abolish, the linked exchange rate system. The Hong Kong economy has not performed well in recent years. Gross Domestic Product (GDP) only managed to grow by 0.5% in real terms in the second quarter of 2002, after consecutive declines in the previous three quarters. The unemployment rate was 7.6% in June - August 2002.

1.2 RLSD has conducted some preliminary research on the linked exchange rate issue. The findings show that only Hong Kong and a number of smaller economies, including Djibouti, Brunei, Estonia, Lithuania, Bulgaria, Bosnia and Herzegovina, are operating a linked exchange rate system. Except for Hong Kong, these economies are relatively small and are not considered as international financial centres. Consequently, the experience of their exchange rate policies may not be relevant to that of Hong Kong.

1.3 Therefore, RLSD proposes to perform a literature review of relevant studies and papers, and invite representatives of the local financial services industry and relevant business associations and academics to express their views on the linked exchange rate system. The research paper will summarize the views expressed.

2. Research Outline

2.1 RLSD proposes the following outline for the research:

Part 1 — Introduction

2.2 This part provides the background information of the research.

Part 2 -- Advantages and Disadvantages of the Linked Exchange Rate System

2.3 This part discusses the advantages and disadvantages of the linked exchange rate system. In particular, both the literature review and expert opinions will be focused on the relationship between the linked exchange rate system and Hong Kong's economic development, competitiveness and the current deflation situation.

Part 3 -- Whether the Linked Exchange Rate System Should be Maintained, Adjusted or Abolished

2.4 This part presents the views of the experts on whether the linked exchange rate system should be maintained, adjusted or abolished. RLSD will solicit their views on the following areas:

- (a) Circumstances to be considered in making the decision
- (b) Alternatives to the Linked Exchange Rate System
 - to revert to a free floating system
 - to link the Hong Kong dollar to the US dollar at another exchange rate
 - to link Hong Kong dollar with another currency
 - to link the Hong Kong dollar to a basket of currencies
 - to substitute the Hong Kong dollar by the US dollar
 - to replace the Hong Kong dollar by the Renminbi
 - others
- (c) Whether the economy of Hong Kong would be benefited if the Linked Exchange Rate is maintained, adjusted or abolished

3. Proposed Completion Date

3.1 RLSD proposes to complete the research by December 2002.