

Do Beijing's Capital Controls Bind Hong Kong? Reality or Illusion

Jiangyuan Fu* and Bryan Mercurio †

Abstract

The ongoing impact of COVID-19 on global economic growth is likely to result in a retreat from financial globalization, including restrictions on capital movements. This concern arises from the experience of short-term capital control policies being implemented by countries in past financial crisis. This trend, together with China's long history of using capital controls, has further sparked fears in Hong Kong regarding the extent to which the capital control restrictions from Beijing could impact Hong Kong's open financial policy on capital transfers. With this context, this article evaluates situations where concerns have been raised and seeks to ascertain whether Hong Kong could be legally liable for the implementation of capital controls in Beijing.

The COVID-19 pandemic has caused an unprecedented human and health crisis and severely impacted global economic growth. Countries have implemented drastic health and preventative measures including social distancing and lockdowns in an effort to contain the virus. Global travel has been effectively halted as societies seek to minimize the effects of the pandemic. The health crisis has also quickly morphed into an economic crisis. The world economy dipped into recession in 2020, and global growth is expected to remain stagnant for some time and take some time towards catching up to the path of economic activity for 2020–25 projected prior to the pandemic.¹

* Associate Professor, Huazhong University of Science and Technology, 3F School of Law, Hongshan, Wuhan, China. Email: jfu@hust.edu.cn. This research is supported by Hong Kong General Research Fund (GRF) Project No. 14613717, entitled, “When Regimes Clash on Capital Controls: Managing the Conflicting Norms and Standards of the IMF, WTO and International Investment Agreements”.

† Simon F.S. Li Professor of Law at The Chinese University of Hong Kong, 6/F Lee Shau Kee Building, Hong Kong. Email: b.mercurio@cuhk.edu.hk

¹ The International Monetary Fund (IMF) projected a negative 4.4 per cent growth in 2020. See IMF, ‘World Economic Outlook, October 2020: A Long and Difficult Ascent’ (October 2020) <<https://www.imf.org/en/Publications/WEO/Issues/2020/09/30/world-economic-outlook-october-2020#Full%20Report%20and%20Executive%20Summary>> accessed 26 April 2021.

Both advanced economies and emerging markets are being confronted with unprecedented financial shocks, and the magnitude of the collapse makes it the worst recession since the Great Depression—far worse than even the Global Financial Crisis (GFC) of 2008.² Government bond yields in advanced economies such as Germany and the USA have fallen sharply, and equity markets have experienced dramatic sell-offs since the advent of the crisis. While equities in advanced economies have recovered, they have remained extremely volatile, while emerging market equity prices remain about 20 per cent lower in mid-January.

Further harming recovery prospects is the fact that currencies of several commodity-producing economies tumbled by more than 20 per cent against the US dollar in the first quarter of 2020. Amid a surge in demand for hard currency, the pandemic has also led to dramatic outflows of capital. Portfolio investments from emerging economies have been particularly affected, with outflows already surpassing the levels seen during the GFC.³ Fluctuations in the global financial market and risk sentiment have led to significant governmental action being taken in order to stabilize the situation. Included among these are changes to fiscal, monetary, and exchange rate policies that have been introduced by numerous central banks in order to offset the tightening in financial conditions and reduce systemic stress.⁴

While capital controls have not yet featured in most policy responses to COVID-19,⁵ uncertainty related to the ongoing economic decline is likely to result in restrictions on capital movements in line with policy of retreat from financial globalization. This concern is based on past experience, as many countries have implemented capital controls to forestall or mitigate the impact of financial crises. For instance, in 1991, Chile imposed a one-year unremunerated reserve requirement of 20 per cent on foreign loans, while in the Asian Financial Crisis of 1998, Malaysia banned short-selling of the listed stocks and implemented a minimum stay period in portfolio investment of 12 months, subject to penalties for early withdrawal.⁶ More recently, Iceland and Greece have imposed a number of capital controls during the GFC in order to stabilize the economy in the wake of economic collapse. These examples have showcased possibilities of using restrictions on the withdrawal of existing foreign investment in response to a sudden reversal in capital flows during a retreat from globalization. Such

² IMF, 'World Economic Outlook: The Great Lockdown' (2020) <<https://www.imf.org/en/Publications/WEO/Issues/2020/04/14/weo-april-2020>> accessed 26 April 2021.

³ IMF, 'Global Financial Stability Report: Markets in the Time of COVID-19' (2020) <<https://www.imf.org/en/Publications/GFSR/Issues/2020/04/14/global-financial-stability-report-april-2020>> accessed 26 April 2021.

⁴ IMF (n 2) 3.

⁵ IMF, 'Policy Responses to COVID19' <<https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19>> accessed 29 May 2020.

⁶ For a detailed account of these situations, see Bryan Mercurio, Ross Buckley and Jiangyuan Fu, 'The Legitimacy of Controlling Capital Flows during a Retreat from Globalization' (2021) 70(1) *Intl & Comparative LQ* 59.

measures can aggravate the impact of financial crisis on foreign investors and exacerbate distorted incentives in the domestic financial system.

China's well-known use of long-term capital controls as a policy tool to control flows and maintain financial stability has sparked fears in Hong Kong regarding the extent to which capital control restrictions from Beijing will impact Hong Kong's financial policy on capital transfers. While these fears have always existed, they have become heightened in the midst of the COVID-19 pandemic and circulation of online rumours of further curbs following the controversial imposition of a national security law on Hong Kong.⁷

This brief article seeks to ascertain whether Hong Kong could be legally liable for the implementation of capital controls in Beijing. After introducing Hong Kong's long-standing policy of free capital movements in the first part, the article continues, in the second part, to discuss the territory's key role as a financial centre for China generally and for the Belt and Road Initiative (BRI). It is in this role where concerns have been raised regarding Hong Kong's potential liability for controls taken in Beijing. After finding little reason for genuine concern, the third part provides further comfort by describing how China is in the process of opening its financial markets. The fourth part concludes the article.

Hong Kong's policy on capital transfers

Hong Kong is a major international financial centre. Characterized by a transparent regulatory system and a *laissez-faire* type of openness to commerce, Hong Kong is home to many financial institutions providing a wide range of financial products and services to local and international investors. Hong Kong's financial industry features a high degree of liquidity and is widely viewed as a leading financial centre in Asia. Hong Kong's legal system is an important ingredient in the success of its financial services, with investors and businesses attracted by the security and predictability of the territory's strong adherence to the rule of law. Illustrating both of these points is Hong Kong's rating in the latest Heritage Foundation's Index of Economic Freedom (2020), which ranked the territory second among 186 economies in terms of economic freedom and fifteenth in the category 'Government Integrity', under the heading 'Rule of Law'.⁸

Financial services in Hong Kong are primarily regulated by the Hong Kong Monetary Authority (HKMA), the Securities and Future Commission, and the Office of the Commissioner of Insurance. The regulatory agencies operate within the framework of the Banking Ordinance, the Exchange Fund Ordinance, the Security and Futures Ordinance, and a number of other ordinances. With its free market approach, Hong Kong seeks to keep the involvement of its agencies in the financial system to a minimum while ensuring the maintenance, stability,

⁷ See eg Grace Tsoi, 'Hong Kong Security Law: What Is It and Is It Worrying?' *BBC News* (29 May 2020); Cannix Yau and Enoch Yiu, 'National Security Law: Hong Kong's Foreign Firms Eyeing Mitigation Plans' *South China Morning Post* (23 June 2020) <<https://www.scmp.com/news/hong-kong/hong-kong-economy/article/3090154/national-security-law-foreign-firms-hong-kong-look>> accessed 26 April 2021.

⁸ See 2020 Index of Economic Freedom <<https://www.heritage.org/index/>> accessed 8 July 2020.

and integrity of the monetary and financial systems.⁹ In this regard, Hong Kong does not impose any foreign exchange or capital movement controls, thus allowing capital to flow easily in and out of the territory without restriction.

Under 'one country, two systems', Hong Kong maintains its own economic, financial, and legal system.¹⁰ Hong Kong's mini-constitution, the 'Basic Law', enshrines free market principles for the monetary and financial systems, with Article 112 stating that:

[n]o foreign exchange control policies shall be applied in the Hong Kong Special Administrative Region. The Hong Kong dollar shall be freely convertible. Markets for foreign exchange, gold, securities, futures and the like shall continue.

The Government of the Hong Kong Special Administrative Region shall safeguard the free flow of capital within, into and out of the Region.¹¹

Article 112 is unequivocal in its commitment to free capital movements and prohibition of foreign exchange control policies from being applied in Hong Kong. Moreover, Hong Kong's policy on the free flow of capital and free convertibility of currency is also reflected in its trade and investment agreements. To date, Hong Kong has signed 22 international investment agreements (to which it refers as 'Investment Promotion and Protection Agreements' [IPPAs]) with foreign economies in order to enhance two-way investment flows, provide additional assurance to overseas investors that their investments in Hong Kong are protected, and protect the interests of Hong Kong investors overseas.¹² All 22 IPPAs provide for, *inter alia*, the free transfer of investments and returns across borders in any freely convertible currency.¹³ Most of the IPPAs that Hong Kong has signed contain largely blanket prohibitions on capital controls. As an illustration, Article 6 of the Hong Kong–UK IPPA reads:

Each Contracting Party shall in respect of investments guarantee to investors of the other Contracting Party the unrestricted transfer of their investments and returns abroad. Transfers

⁹ Hong Kong Monetary Authority (HKMA), 'Mandate and Governance of the Hong Kong Monetary Authority', HKMA Background Brief no 33 at 56 <<https://www.legco.gov.hk/yr06-07/english/panels/fa/papers/facb1-657-3-e.pdf>> accessed 26 April 2021; Hu Jiaxing, Matthias Vanhullebusch and Andrew Harding, *Finance, Rule of Law and Development in Asia: Perspectives from Singapore, Hong Kong and Mainland China* (Brill 2016) 60.

¹⁰ Joint Declaration of the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the People's Republic of China on the Question of Hong Kong, Annex I.

¹¹ Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China (1990) art 112 (Basic Law).

¹² 'Investment Promotion and Protection Agreements (IPPAs)', Trade and Industry Department Hong Kong <<https://www.tid.gov.hk/english/ita/ippa/index.html>> accessed 26 April 2021.

¹³ See eg Agreement between the Government of the Hong Kong Special Administrative Region of the People's Republic of China and the Government of the United Kingdom of Great Britain and Northern Ireland for the Promotion and Protection of Investments (12 April 1999), art 6; Agreement between the Government of Hong Kong and the Government of the Republic of Korea for the Promotion and Protection of Investments (30 July 1997), art 7; Agreement between the Government of Hong Kong and the Government of the Italian Republic for the Promotion and Protection of Investments (02 February 1998), art 6.

of currency shall be effected without delay in any convertible currency. Unless otherwise agreed by the investor transfers shall be made at the rate of exchange applicable on the date of transfer.¹⁴

Hong Kong's recent IPPAs have begun to contain General Agreement on Trade in Services-like exceptions to the above commitments,¹⁵ such as for balance of payments difficulties and prudential measures in the form of a prudential carve-out.¹⁶ For instance, while in the Association of Southeast Asian Nations (ASEAN)–Hong Kong IPPA Hong Kong undertakes commitment to allow all transfers relating to its investment commitments to be made freely and without delay into and outside of its territory, it includes both the balance of payments and prudential carve-out as exceptions to be used in exceptional circumstances when movements of capital cause serious difficulties for macroeconomic management and when requested by the International Monetary Fund (IMF). Likewise, the Australia–Hong Kong IPPA provides for the implementation of temporary safeguard measures in serious balance of payments and external financial difficulties if payments or transfers relating to capital movements cause serious difficulties for macroeconomic management.¹⁷ Thus, in all of Hong Kong's IPPAs, investors have the unrestricted right to transfer capital across borders except in certain envisaged circumstances and with strict conditions.

Hong Kong has also signed eight Free Trade Agreements (FTAs) that touch upon and impact the movement of capital. All of Hong Kong's FTAs contain a wide range of commitment relating to market access and national treatment liberalization, particularly in relation to financial services. Moreover, the starting point is that Hong Kong undertakes to not apply restrictions on capital flows in sectors where a specific liberalization commitment has been made. Among Hong Kong's FTAs, one-half include provisions on the free transfer of funds relating to covered services commitments.¹⁸ Again, the obligations are clear, and only in the circumstances prescribed in the carve-outs, exceptions, and safeguard clauses could Hong Kong apply restrictions to current payments and capital

¹⁴ Agreement between the Government of the Hong Kong Special Administrative Region of the People's Republic of China and the Government of the United Kingdom of Great Britain and Northern Ireland for the Promotion and Protection of Investments (12 April 1999), art 6.

¹⁵ Hong Kong's IPPAs containing such exceptions include those negotiated with the Association of Southeast Asian Nations (ASEAN), Australia, Chile and Canada. General Agreement on Trade in Services (15 April 1994, 1869 UNTS 183).

¹⁶ Para 2(a) of the General Agreement on Trade in Services Annex on Financial Services provides: 'Notwithstanding any other provisions of the Agreement, a Member shall not be prevented from taking measures for prudential reasons, including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system. Where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement.'

¹⁷ Agreement between the Government of Hong Kong and the Government of the Republic of Austria for the Promotion and Protection of Investments (1997), art 20.

¹⁸ Hong Kong's Free Trade Agreements (FTAs) containing provisions on the free transfer of funds include those negotiated with Australia, ASEAN, Georgia and New Zealand.

movements relating to the commercial presence or cross-border supply of the services pursuant to its commitments.¹⁹

In contrast to the open and free market in Hong Kong, Mainland China still has a long way to go before it fully liberalizes its capital market and makes the renminbi (RMB) fully convertible. In this regard, despite the fact that China has moved from a closed economy and has been gradually liberalizing its financial market for some time, the process of opening can be characterized as ‘gradual and cautious’,²⁰ and a multitude of capital controls remain. China’s current controls are generally ‘direct administrative restrictions’, such as authorization requirements, time requirements, and quantitative limits.

While China has not imposed restrictions suspending remittances by multinationals, more than 50 per cent of IMF members have done so over the past decades in response to global and regional financial crises.²¹ There is concern, however, that amid the rising tension in USA–China relations²² and prolonged global economic downturn as a result of COVID-19, Beijing may become more cautious with capital flows and impose greater restrictions. This leads to the question of whether China’s capital control policy (for instance, imposing additional barriers to profit repatriation and withdrawal of existing foreign investment) can potentially affect Hong Kong, creating a potential risk of retreat from its existing commitments to free capital movements and foreign exchange settlement, especially in the context of Hong Kong playing such a key role in the BRI in the areas of international project financing and offshore RMB business.

Hong Kong’s financial position on BRI: a safe harbour from capital controls?

The increasing financial integration between Hong Kong and China has become an important determinant of capital flows into and out of Hong Kong.²³ A host of factors—including the range of financial product on offer, open access for both Chinese and international issuers and investors, and its increasing significance as the largest offshore RMB business centre—make Hong Kong one of the most

¹⁹ For instance, art 10 of ch 8 of the Free Trade Agreement between Hong Kong, China and the Association of Southeast Asian Nations provides that ‘except under the circumstances envisaged in Article 11 (Restrictions to Safeguard the Balance of Payments), a Party shall not apply restrictions on international transfers and payments for current transactions relating to its specific commitments’.

²⁰ Yongding Yu, *The Management of Cross-border Capital Flows and Macroeconomic Stability in China* (TWN Global Economic Series 2009).

²¹ Jane Ihrig, ‘Multinationals’ Response to Repatriation Restrictions’ (2000) 24(9) *J Economic Dynamics & Control* 1345.

²² China is facing the threats of US sanctions against Chinese banks and delisting Chinese companies from the US stock markets. In Hong Kong, the primary renminbi exchange hub can be a potential battlefield in the US–China confrontation.

²³ Bank for International Settlements, ‘Financial Globalisation and Emerging Market Capital Flows’ (2008) BIS Papers no 44 at 207 <<http://www.ssrn.com/abstract=1339922>> accessed 26 April 2021.

attractive portfolio markets in Asia. Of significance to Chinese investors is the creation of mutual market access schemes such as Bond Connect, Stock Connect, and other listings structured via Hong Kong, which allow for eligible mainland investors to invest in stocks traded in Hong Kong with accounts remaining in mainland China to reduce the risk of capital flight. At the same time, such schemes enable global investors to tap into China's financial market through Hong Kong financial institutions without the need to open accounts in Mainland China and without being subject to China's exchange and capital controls. Such schemes have become popular choices for BRI countries to invest surplus RMB liquidity in a wide range of RMB-denominated products available in Hong Kong.²⁴

Since 2015, the Bank of China has issued BRI-themed bonds five times in seven currencies, with a total value of US \$15 billion. Most of the bonds issued are listed on the Hong Kong Exchanges and Clearing markets (HKEX), although some types of the bonds are listed on the China Europe International Exchange, the Frankfurt Stock Exchange, and the Luxembourg Stock Exchange.²⁵ As the bonds are issued by the Bank of China (Hong Kong) and are listed on the HKEX, the issuer is subject to scrutiny by the HKMA and the Securities and Future Commission.²⁶ In this regard, the investments bypass China's capital control in the offshore market via overseas subsidiaries of a Chinese financial institution. Thus, Chinese restrictions on daily and aggregate investment limits, fund remittance, and lock-up periods do not apply.

In addition, a pilot scheme launched in 2017 called 'Bond Connect' provides international investors 'northbound' access to trade BRI-themed corporate bonds and other bonds in the Chinese bond market. Investors can directly invest on the Chinese bond market through Hong Kong's Central Money-Markets Unit (CMU) system of the HKMA.²⁷ Since its establishment, Bond Connect has allowed multiple BRI countries to issue 'panda bonds' in China's Interbank Bond Market to both mainland and overseas investors.²⁸ While the legal structure of these instruments is complex and could be made clearer, it would appear that Bond Connect must abide by the relevant laws and regulations of the bond markets of both Hong Kong and China.²⁹ This should mean that an aggrieved investor can have recourse to both the Hong Kong and Chinese legal systems, depending on

²⁴ 'HKSARG's Work on the Belt and Road', Belt and Road Initiative Hong Kong <<https://www.beltandroad.gov.hk/work.html>> accessed 26 April 2021.

²⁵ See Bank of China Updates, '中国银行成功发行38亿美元“一带一路”主题债券' ['Bank of China Completed Issuance of \$3.8 Billion Belt and Road Bonds'] <https://www.bankofchina.com/about/boc/bi1/201904/t20190411_15096138.html> accessed 26 April 2021.

²⁶ Rules Governing the Listing of Securities on the Stock Exchange of Hong Limited.

²⁷ SFC, Notice of Authorization to Provide Automated Trading Services Issued to Bond Connect Company Limited (11 June 2019) <https://www.sfc.hk/-/media/EN/files/SOM/ATS/Notice-of-Authorization_BCCL.pdf> accessed 26 April 2021.

²⁸ HKEX, 'Bond Connect and Outlook for Further Opening up of the Mainland Bond Market' (January 2019) <https://www.hkex.com.hk/-/media/HKEX-Market/News/Research-Reports/HKEX-Research-Papers/2019/FIC_BondConnect_201901_e.pdf?la=en> accessed 26 April 2021.

²⁹ Notice on the Publication of the Bond Connect Provisional Measures (People's Bank of China 2017) art 3 (Bond Connect Provisional Measures).

the nature of the alleged breach. For instance, should the Chinese government exercise tight capital controls on the withdrawal of investments, eligible investors enrolled in the Bond Connect could have a legal remedy directly against the Hong Kong intermediaries without the need to bring a claim in China.

The system operates as follows: prior to issuance and distribution, overseas investors are required to sign a distribution agreement with mainland underwriters, specifying the business mode and the rights and obligations of both parties and stating that overseas investors shall invest in the bonds through the HKMA's CMU nominee account.³⁰ In addition to signing the distribution agreement, overseas investors are required to register and be recognized as an eligible foreign investor with the People's Bank of China and to open a trade account with the China Foreign Exchange Trade System via the Bond Connect Company.³¹

This 'northbound' trading is executed through a 'request for quotation' mechanism between an eligible foreign investor and a mainland underwriter at the China Foreign Exchange Trade System (see trading flow in blue).³² The settlement link facilitates the settlement and custody of the bonds between the CMU (offshore custodian and settlement agent for eligible offshore investors) and the Shanghai Clearing House (SCH) or the China Central Depository and Clearing Company (CCDC) (onshore clearing institutions) (see settlement flow in pink).³³ The bonds thus acquired are registered in the name of HKMA and held in the onshore nominee accounts opened by the CMU in the SCH or the CCDC. The CMU members then settle the bond transactions on behalf of offshore investors through the CMU.³⁴ The clear linkages built between foreign investors and mainland Chinese financial institutions (in particular, the contractual relationship in the trading link) through Bond Connect Company and HKMA allow foreign investors to bring a claim challenging the imposition of capital controls from Mainland China (Figure 1).

Overseas investors therefore do not need to open Chinese settlement and custody accounts. Instead, Bond Connect allows overseas investors to deploy their existing trading and settlement practices in Hong Kong with no further restrictions such as investment quotas, lock-up periods, and repatriation limits.³⁵ This also provides a slight uncertainty for investors, as the bonds are acquired through the custodian (the CMU), and the rights of eligible overseas investors must be enforced through the nominee holder CMU of the HKMA.³⁶ The

³⁰ Shanghai Clearing House Business Guidelines for Northbound Trading of Bond Connect art (30 June 2017) 3.1.

³¹ Bond Connect Company Limited Access Rule Book (28 March 2019) art 4.

³² Trading Rules of the National Interbank Funding Centre on the Bond Connect (for Trial Implementation), China Foreign Exchange Trade System (2017) ch 4.

³³ Bond Connect Provisional Measures (n 29) art 5.

³⁴ Ibid.

³⁵ HKEX, 'The Inclusion of China into Global Bond Indices: Current Status and Future Development' (2018) <https://www.hkex.com.hk/-/media/HKEX-Market/News/Research-Reports/HKEx-Research-Papers/2018/CCEO_BondIdx_201806_e.pdf?la=en> accessed 26 April 2021.

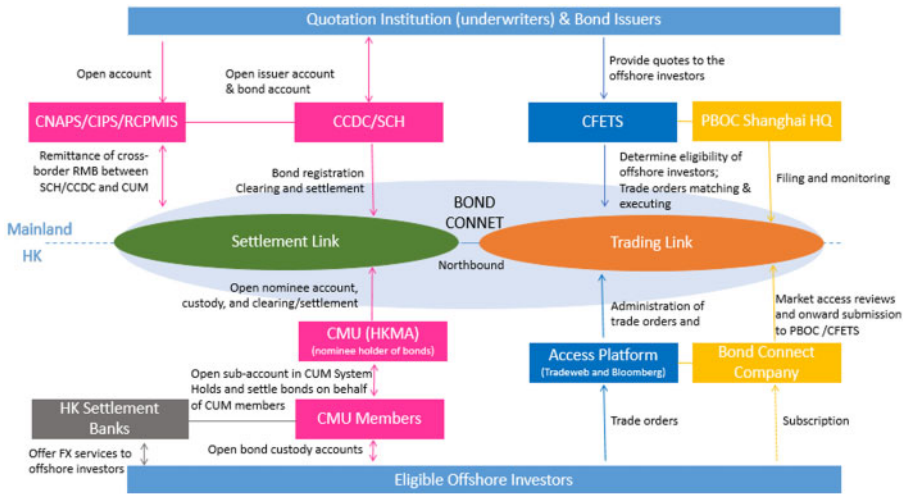


Figure 1. The process flowchart of Bond Connect.
Source: Authors' drawing based on applicable rules.

uncertainty stems from the loss of control in the legal process and the question as to what actions the investor would have should the CMU of the HKMA not pursue the legal claim. This being said, it does seem possible for overseas investors to bring a legal claim in their own name, as the ultimate beneficial owners of the bonds, in the courts in China.³⁷

Overseas investors in this scheme, likewise, should qualify as investors making an investment under China's bilateral investment treaties (BITs) should their country have a treaty with China. For instance, the term 'investment' is defined in the Investment Agreement of the Mainland and Hong Kong Closer Economic Partnership Agreement as meaning assets (including bonds) that an investor owns or controls, directly or indirectly.³⁸ The eligible foreign investors in Bond Connect directly control the trading of the bonds by placing trade orders through trading links provided by access platforms and conclude a bond trade with onshore market makers while also indirectly owning the bond as the investment is registered in the name of HKMA (in its custodian role) with the SCH or the CCDC.³⁹ This interpretation is confirmed by the Shanghai Clearing House Detailed Operation Rules for Registration, Custody, Clearing and Settlement of Bond Connect Cooperation between the Mainland and Hong Kong SAR, which

³⁶ People's Bank of China (PBOC), 'Q&A on the Bond Connect Provisional Measures' (22 June 2017) Q6.

³⁷ According to PRC law, the plaintiff to a legal claim is any citizen, legal person or any other organization with a direct interest in the claim. See Civil Procedure Law of the People's Republic of China (1991) art 119; see also PBOC (n 36) Q7.

³⁸ Mainland and Hong Kong Closer Economic Partnership Agreement (2003) art 2.1 (Mainland and Hong Kong Agreement).

³⁹ Bond Connect Provisional Measures (n 29) art 5.

recognizes investors' ultimate beneficial ownership by expressly providing for eligible investors to enjoy the rights and interests of the bonds.⁴⁰ Therefore, from the point of view of either trading or settlement practices, eligible foreign investors satisfy the definition of 'investors' in China's BITs.

Having established eligibility under a BIT, eligible foreign investors could likely succeed in a claim against China in an investor-State dispute settlement should Beijing impose controls on the withdrawal of the investment as the standard provision requires parties to permit all transfers relating to a covered investment to be made freely, and without delay, into and out of its area.⁴¹ It is worth stressing, however, that China's capital controls are not usually in the nature of repatriation restrictions and that China is unlikely to impose such measures in the foreseeable future.

The only question that remains to be answered is whether an investor can bring a claim against Hong Kong for such measures (should they be imposed). While an overseas investor would likely qualify as an investor under Hong Kong's IPPAs, a claim is unlikely to succeed for the simple reason that the control will have been initiated by the Chinese government and not Hong Kong. Hong Kong undertakes to protect and promote investments in its IPPAs and agrees not to take certain measures that restrict the outflow of capital—but, in our scenario, Hong Kong is not the responsible government restricting outflow: it is the government of China. Any such investor-State dispute settlement claim would thus be better placed to be filed against the government in Beijing. At the same time, should the CMU of the HKMA refuse to enforce the claims of eligible overseas investors, it would be reasonable for an aggrieved investor to access the Hong Kong courts to enforce the claims. But, here, liability for Hong Kong is not the result of any capital control being imposed by Beijing but, rather, through the lack of action of a Hong Kong governmental entity in enforcing the claims of an investor.

China accelerates the opening up of capital markets

Since 2016, China has attempted to strengthen capital controls with enhanced supervision on capital flights, including limitations on household residual foreign exchange and outward direct investment and portfolio investment. On the other hand, China has recently begun to accelerate the opening up of its capital markets to foreign investors. A special report from *The Economist* succinctly restates the situation: 'Domestic savers are still caged in, but foreign investors say they have no trouble getting money out, even during market routs.'⁴²

⁴⁰ Shanghai Clearing House Detailed Operation Rules for Registration, Custody, Clearing and Settlement of Bond Connect Cooperation between the Mainland and Hong Kong SAR (Trial Implementation) (23 June 2017) art 7.

⁴¹ Mainland and Hong Kong Agreement (n 38) art 14.

⁴² 'Can China Be Trusted to Be a Responsible Financial Power?' *The Economist* (7 May 2020) <<https://www.economist.com/special-report/2020/05/07/can-china-be-trusted-to-be-a-responsible-financial-power>> accessed 26 April 2021.

Thus, while still restrictive, China is making moves to liberalize the market. For instance, in 2015, China launched a reform of the RMB exchange rate to allow a greater role for market forces. This change marked a major improvement to the formation of the RMB's central parity rate against the US dollar and has been recognized by the IMF as an important step, building on the progress already made.⁴³ Since then, China has started to accelerate the liberalization of the capital markets in several ways. First, the government relaxed the requirements for the Qualified Foreign Institutional Investors (QFII) scheme (launched in 2006), which allowed licensed foreign investors to use offshore yuan to invest in China's capital with a combination of multi-tier and multi-stage approval procedures and a heavily regulated quota-based system.⁴⁴ In 2019, restrictions on the foreign investment quota of QFII were abolished. The new rules also removed the three-month lock-up period and the 20 per cent repatriation limit, allowing QFII investors to repatriate the principal and profits from their securities investments in China at any time.⁴⁵

Second, the launch of the Shanghai–Hong Kong Stock Connect in November 2014, and, later, the Shenzhen–Hong Kong Stock Connect in 2016, enabled mutual market access between China's Stock Exchange and the Stock Exchange of Hong Kong, allowing Hong Kong and international investors to access the mainland's stock market through trading and clearing facilities in Hong Kong.⁴⁶ In this regard, international investors can seek direct Shanghai/Shenzhen market access outside of the QFII. The annual aggregate quota for Shanghai Connect has been abolished since 2016, and no annual aggregate quota has been established for Shenzhen. In addition, the daily quota has been increased to allow a maximum 'net buy' value of cross-border trades to RMB 52 billion, with no limit on the withdrawal of the investment from Stock Connect.⁴⁷

⁴³ Sonali Das, 'China's Evolving Exchange Rate Regime' IMF Working Paper no 19/50 (2019) <<https://www.imf.org/en/Publications/WP/Issues/2019/03/07/Chinas-Evolving-Exchange-Rate-Regime-46649>> accessed 26 April 2021.

⁴⁴ 合格境外机构投资者境内证券投资管理办法 [Measures for the Administration of Securities Investment within the Borders of China by Qualified Foreign Institutional Investors], Consultation Paper, China Securities Regulatory Commission (CSRC), PBOC and State Administration of Foreign Exchange (SAFE) (2006) 36 Hao (24 August 2006).

⁴⁵ See 国家外汇管理局关于进一步促进跨境贸易投资便利化的通知 [Notice on Further Promoting the Convenience of Cross-border Trade and Investment] SAFE Hui Fa (2019) 28 Hao (25 October 2019).

⁴⁶ Securities and Future Commission, 'Joint Announcement of China Securities Regulatory Commission and Securities and Futures Commission' (10 November 2014) <<https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=14PR136>> accessed 26 April 2021. See also Securities and futures Commission, 'Joint Announcement of the China Securities Regulatory Commission and the Hong Kong Securities and Futures Commission' (25 November 2016) <<https://www.sfc.hk/web/EN/news-and-announcements/policy-statements-and-announcements/joint-announcement-of-the-china-securities-regulatory-commission-and-the-hong-kong-sfc.html>> accessed 26 April 2021.

⁴⁷ Daily Quota Balance = Daily Quota – Buy Orders + Sell Trades + Adjustments. See HKEX, 'Stock Connect Another Milestone Q&A' (31 March 2020); see also Notice on Abolition of Aggregate Quota for Shanghai–Hong Kong Stock Connect, [2016] no 40 SHEX; Measures of the Shanghai

Under this scheme, the Hong Kong Securities Clearing Company Limited is responsible for the clearing and delivery of shares and funds for eligible overseas investors with respect to the transactions concluded with Stock Connect.⁴⁸ Similar to the nominee holder account structure in Bond Connect, the 'nominee holder' and 'beneficial owner' in Stock Connect are recognized in Mainland China,⁴⁹ and, thus, the issues of legal liability outlined in the previous section would appear to be replicated here.

Third, in 2019, the Office of Financial Stability and Development Committee of the State Council announced the Relevant Measures for Future Opening Up of Financial Sector (11 Measures), covering a broad spectrum of financial service sectors.⁵⁰ By April 2020, foreign ownership limits for securities, fund management, and futures companies had been removed,⁵¹ and foreign financial companies are now allowed to establish wholly owned units in China. In the midst of a global health pandemic combined with deep economic uncertainty, these opening-up measures should alleviate concerns that China will retreat from the global system and boost confidence in the financial services industry.

In addition, amid the COVID-19 pandemic in May 2020, the People's Bank of China, the China Banking and Insurance Regulatory Commission, the China Securities Regulatory Commission, and the State Administration of Foreign Exchange jointly issued a financial support guideline for the development of the Greater Bay Area (GBA). The guideline put forward specific measures for expanding the liberalisation of the financial sector and promoting cross-border capital flows within the GBA.⁵² Notable measures include:

- facilitating banks with issuing more cross-border loans and easing the requirements for cross-border RMB;
- experimenting with the cross-border capital pooling of local and foreign currencies in the GBA;
- supporting residents of the GBA to purchase cross-border wealth management products;
- allowing overseas RMB investment to support cross-border investment and mergers, including projects along the BRI; and

Stock Exchange for the Pilot Program of Shanghai–Hong Kong Stock Connect (2016 Revision) art 39.

⁴⁸ See 沪港股票市场交易互联互通机制试点若干规定 [Rules on the Trial Implementation of Stock Connect between Chinese Mainland and Hong Kong] CSRC Order 101 (13 June 2014) art 14.

⁴⁹ CSRC, Clarification on Beneficial Ownership under SH–HK Stock Connect (2015).

⁵⁰ See State Council, 我国新推出11条金融业对外开放措施 [China Announced 11 Measures on Financial Sector Opening Up] (20 July 2019) <http://www.gov.cn/guowuyuan/2019-07/20/content_5412220.htm> accessed 26 April 2021.

⁵¹ See CSRC, 证监会明确取消证券公司外资股比限制 [CSRC abolished the restrictions on the foreign equity ratio of securities companies] (13 March 2020) <http://www.csrc.gov.cn/pub/news/ite/zjhxwfb/xwdd/202003/t20200313_372037.html> accessed 26 April 2021.

⁵² See 关于金融支持粤港澳大湾区建设的意见 [Financial Support Guideline for Greater Bay Area] PBoC, CBIRC, CSRC, SAFE Yin Fa (2020) 95 Hao (24 April 2020) <http://www.gov.cn/zhengce/zhengceku/2020-05/15/content_5511766.htm> accessed 26 April 2021.

- carrying out pilot projects for cross-border investment by private equity investment funds.

This guideline promotes various pilot operations of cross-border financial services and capital flows without reference to capital controls and demonstrates Beijing's determination to further promote opening-up from a financial point of view and to deepen financial cooperation within the GBA. As a result, the region is expected to receive more support for cross-border financial services and investment through the continued relaxation of restrictions.

A final point to make is that while China's investment climate has not always been friendly and stable, it is unlikely to backtrack, even in the face of COVID-19, when banking and capital markets have faced increased volatility recently. China realizes it must seek foreign investment to continue its robust economic growth and that uncertainty arises among investors if a government even hints at using capital controls to protect domestic capital markets. More importantly, at a press conference for the National People's Congress and the Chinese People's Political Consultative Conference Sessions held in May 2020, China's Premier Li Keqiang re-emphasized China's policy of opening-up against the background of global pandemic and its associated difficulties: 'it is impossible for any country to achieve development with its door closed or retreat back to the agrarian times and China will not waver in this commitment. Instead, China will further expand cooperation with the rest of the world and introduce more opening-up'.⁵³ While this declaration, of course, carries no legal force, it may provide additional comfort to foreign investors seeking market access to Chinese capital markets through Hong Kong.

Conclusion

Despite increasing concerns over the retreat from financial openness worldwide, capital controls have not yet featured in the policy responses of most governments. This article has provided an overview of Hong Kong's policy on capital flows, its commitment to capital transfers in related trade and investment agreements, and its financial positioning in relation to the BRI. The article also examined China's gradual and steady policy of liberalizing its capital markets in recent years. Combining these factors together, we conclude that it is unlikely that China's capital controls will legally bind Hong Kong. Moreover, this type of control is unlikely and would be unprecedented given Beijing's historical and continuing capital control practices and the trend towards opening up its capital markets.

It is worth concluding on the point that, although China has a long history of imposing capital controls on both outward and inward investment, thus far, none have had any impact on Hong Kong's financial policy or legal position. Going forward, the same will likely be the case, and any restrictions on capital

⁵³ Ministry of Foreign Affairs, 'Premier Li Keqiang Meets the Press: Full Transcript of Questions and Answers' (28 May 2020) <https://www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1783859.shtml> accessed 26 April 2021.

flows from Beijing, likewise, will not affect Hong Kong's legal commitments. For its part, China will likely continue with its opening up policy throughout and following the economic decline brought about by the COVID-19 pandemic. Hong Kong stands to benefit from continued liberalization, especially with increased regional unity stemming from the GBA, and can continue to capitalize on its unique advantages to connect China with other regions. Global investors can, likewise, continue to leverage Hong Kong's open market and robust legal system for their investment activities in both Hong Kong and China's capital markets.