

The Economic Relationship between the Mainland and Hong Kong

Lawrence J. Lau, Ph. D.

Ralph and Claire Landau Professor of Economics, The Chinese Univ. of Hong Kong
and

Kwoh-Ting Li Professor in Economic Development, Emeritus, Stanford University

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Tel: (852)3710-6888; Fax: (852)2104-6938

Email: lawrence@lawrencejlau.com; WebPages: www.igef.cuhk.edu.hk/ljl

Outline

- ◆ An Overview of the Mainland Chinese Economy
- ◆ Comparison of the Economies of Hong Kong and the Mainland
- ◆ Mainland-Hong Kong Economic Interactions
- ◆ Future Trends
- ◆ Concluding Remarks

An Overview of the Mainland Chinese Economy

- ◆ The Mainland has made tremendous progress in its economic development since it began its economic reform and opened to the World in 1978.
- ◆ The Mainland has made a smooth and successful transition from a centrally planned economic system to a market economic system.
- ◆ The Mainland of China is currently the fastest growing economy in the World—averaging 9.8% per annum over the past 33 years. It is historically unprecedented for an economy to grow at such a high rate over such a long period of time.

An Overview of the Mainland Chinese Economy

- ◆ A commonly used measure of the size of an economy is GDP, or Gross Domestic Product. It is defined as the total value of all goods and services produced within the geographical boundaries of an economy in a given period of time, for example, a year or a quarter. The value of a good or a service is defined as its price less the costs of all the intermediate goods and services used in its production, but not the costs of direct capital and labour services.

An Overview of the Mainland Chinese Economy

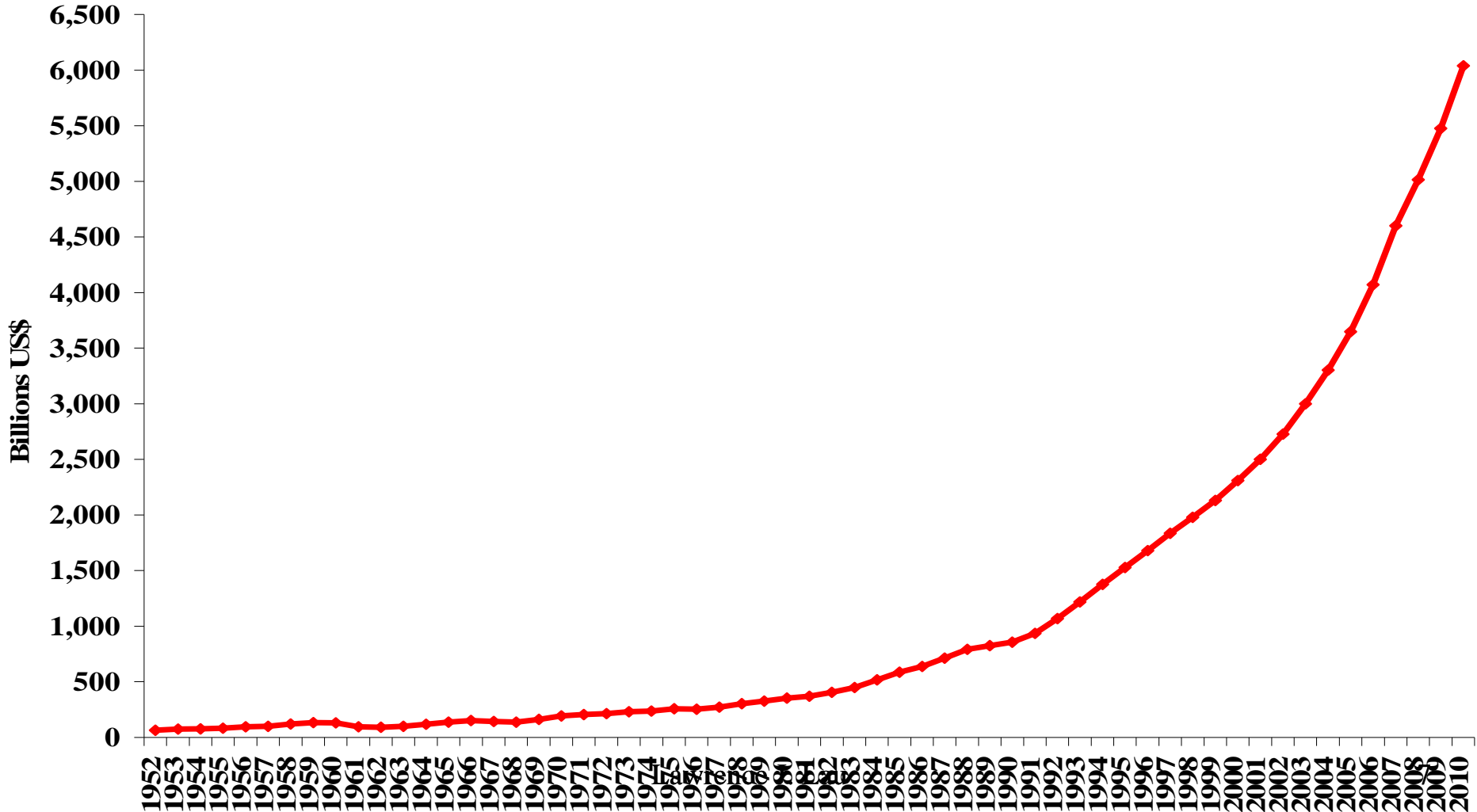
- ◆ Real GDP is a concept used to compare the values of GDP at different points of time that are net of the effects of the changes in the prices of goods and services. A change in the nominal value of GDP due solely to changes in prices is not “real” because in real terms no one has benefitted or lost out.
- ◆ Typically, real GDP is measured in terms of the fixed constant prices of a given period. We focus on real GDP because a change in the price of a good or a service, whether up or down, does not affect its utility to consumers.

An Overview of the Mainland Chinese Economy

- ◆ Between 1978 and 2010, Mainland Chinese annual real GDP grew more than 20 times, from US\$304 billion to more than US\$6.04 trillion (2010 prices) to become the second largest economy in the World, after the United States.
- ◆ By comparison, the U.S. GDP (approximately US\$14.66 trillion in 2010 prices) was 2.4 times the Mainland Chinese GDP in 2010.
- ◆ Hong Kong GDP in 2010 was only US\$225 billion, or 3.7% of the Mainland GDP.

Mainland Chinese Real GDP in US\$ since 1952 (2010 Prices)

Chinese Real GDP, in 2010 prices

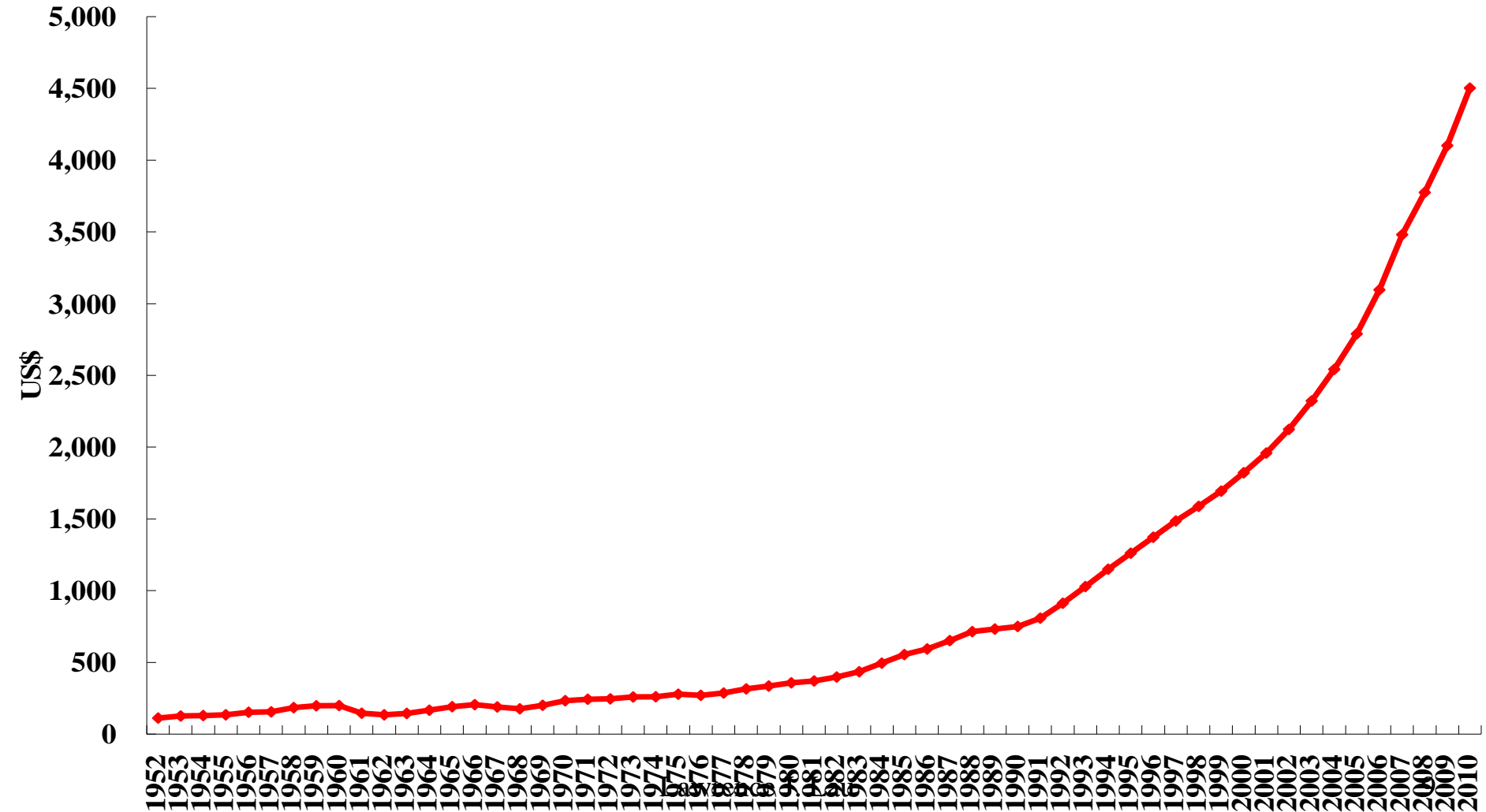


An Overview of the Mainland Chinese Economy

- ◆ Despite the rapid growth of the Mainland, in terms of real GDP per capita (that is, per person), it is still a developing economy.
- ◆ Between 1978 and 2010, Mainland Chinese real GDP per capita grew almost 15 times, from US\$316 to US\$4,503 (in 2010 prices). By comparison, the U.S. GDP per capita (approximately US\$47,274 in 2010 prices) was 10.5 times Mainland Chinese GDP per capita in 2010.
- ◆ Hong Kong GDP per capita in 2010 was US\$31,813, or 7 times the Mainland GDP per capita.
- ◆ Mainland GDP per capita ranks below 90th among all countries in the World.

Real Mainland Chinese GDP per Capita in US\$ since 1952 (2010 Prices)

Chinese Real GDP per Capita, in 2010 prices



An Overview of the Mainland Chinese Economy

- ◆ While many problems have arisen in the Mainland Chinese economy within the past decade—for example, increasing income disparity--both inter-regional and intra-regional--uneven access to basic education and health care, environmental degradation, inadequate infrastructure and corruption—it is fair to say that every Mainland Chinese citizen has benefited from the economic reform and opening since 1978, albeit to varying degrees, and few want to return to the central planning days.

An Overview of the Mainland Chinese Economy

- ◆ The Central Government leaders have also demonstrated their ability to confront important challenges and solve difficult problems, as for example, in maintaining Mainland Chinese economic growth during the 1997-1998 East Asian currency crisis and the 2007-2009 global financial crisis.
- ◆ The Mainland of China is one of the very few socialist economies that have made a smooth transition from a centrally planned to a market system. It is a model for other transition economies such as Vietnam and potential transition economies such as Cuba, Laos, and North Korea.

Economic Performance of the Mainland Before and After Economic Reform

	Growth Rates	
	percent per annum	
	Period I	Period II
	1952-1978	1978-2010
Real GDP	6.15	9.79
Real GDP per Capita	4.06	8.66
Exports	9.99	17.23
Imports	9.14	16.37
Inflation Rates (GDP deflator)	0.50	5.47
	1952-1978	1978-2009
Real Consumption	5.05	8.96₁₂
Real Consumption per Capita	2.99	7.79

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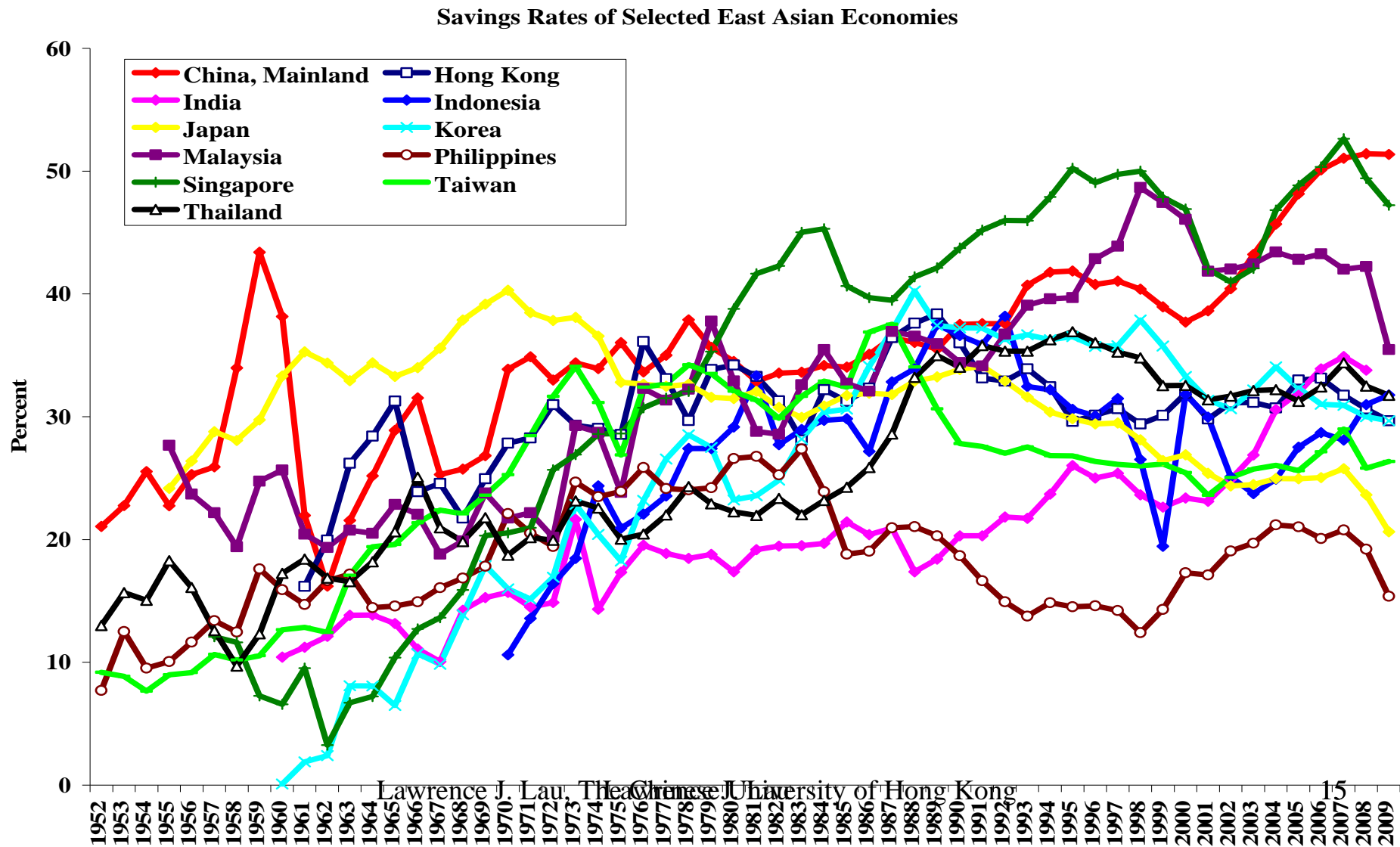
An Overview of the Mainland Chinese Economy

- ◆ The Mainland has consistently had a high national savings rate in excess of 30% which is more than adequate to finance all of its domestic investment needs. It does not need to depend on foreign direct investment, foreign portfolio investment, or foreign loans.
- ◆ The Mainland has an almost unlimited supply of surplus labour, ensuring that there will be little or no pressure on the real wage rate of unskilled, entry-level labour for decades to come.

An Overview of the Mainland Chinese Economy

- ◆ The huge potential domestic market of 1.34 billion consumers allows the economies of scale in production and in innovation to be easily realised on the Mainland.
- ◆ The Mainland also has a long tradition of emphasis on education and learning (human capital) and will be increasing its investment in human capital. The enrollment rate of tertiary education has been rising rapidly and stands at 24 percent today. It is expected to rise further over the next decades as private tertiary educational institutions become more numerous in response to demand and facilitated by government policy.

Savings Rates of Selected Asian Economies (1952-present)



An Overview of the Mainland Chinese Economy

- ◆ The huge domestic market of the Mainland greatly enhances the productivity of intangible capital (e.g., R&D capital, goodwill). The fixed research and development costs of a new product or process can be easily amortised over a large market. The benefits of investment in goodwill, e.g., brand-building, are also much greater in a large market.
- ◆ The huge domestic market also enables active Mainland Chinese participation in the setting of product and technology standards, for example, fourth-generation (4-G) standards for telecommunication, and sharing the benefits of such standard-setting.

An Overview of the Mainland Chinese Economy

- ◆ Brand-building is a pre-requisite for Mainland Chinese enterprises to re-orient themselves to take advantage of the huge domestic market. It is true that brand-building requires resources, but it also enables the owners of brand names to have much more pricing power and higher profit margins than enterprises that do only OEM (original equipment manufacturing) business. Examples of successful brand-building in the Mainland market include Haier, Kang Shifu and Wang Wang.

An Overview of the Mainland Chinese Economy

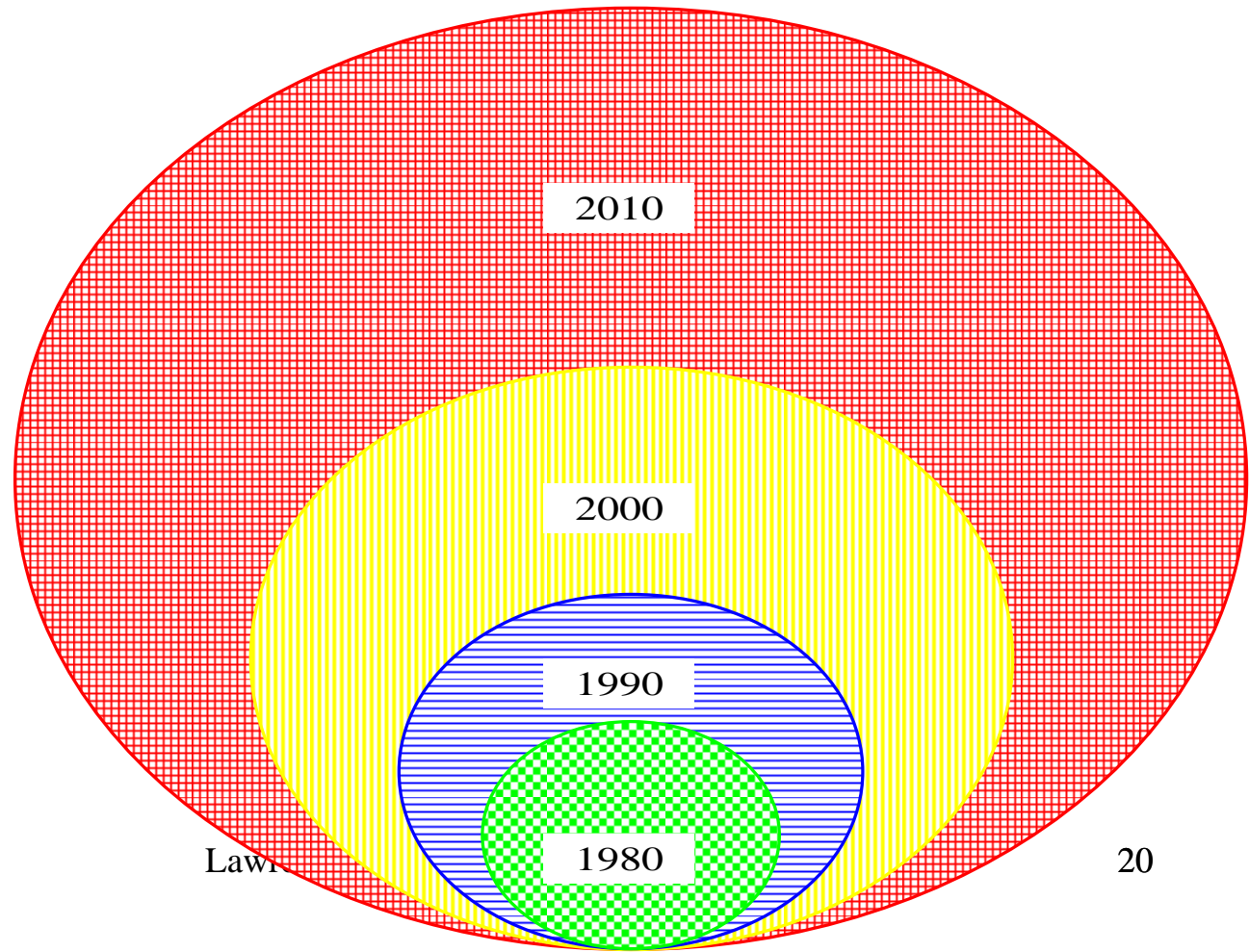
- ◆ In addition to a high national savings rate, a large pool of surplus labour, a huge domestic market, and rising investment in intangible capital (human capital and R&D capital), The Mainland also has the advantage of relative backwardness. It has:
 - ◆ The ability to learn from the experiences of successes and failures of other economies;
 - ◆ The ability to leap-frog and by-pass stages of development (e.g., the telex machine, the VHS video players, the fixed landline phones); and
 - ◆ The possibility of creation without destruction (e.g., online virtual bookstores like Amazon.com do not have to destroy brick and mortar bookstores which do not exist in the first place).
- ◆ The Mainland also possesses an abundance of scientific and technical manpower the cost of which is a fraction of the cost in developed economies.

Comparison of the Economies of Hong Kong and the Mainland

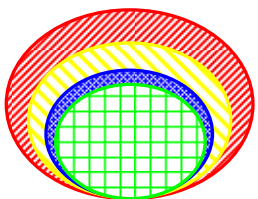
- ◆ It is useful to compare the economies of Hong Kong and the Mainland over time.
- ◆ Huge changes have occurred over the past 30 odd years.
- ◆ In 1980, the GDP of the Mainland economy is only 5 times that of Hong Kong. Today, it is more than 25 times.
- ◆ However, in terms of GDP per capita, Hong Kong still leads the Mainland at 7 times in 2010, but the gap has shrunk significantly from 45 times in 1980.

Comparison of the Real GDPs of Mainland and Hong Kong (2010 US\$)

China

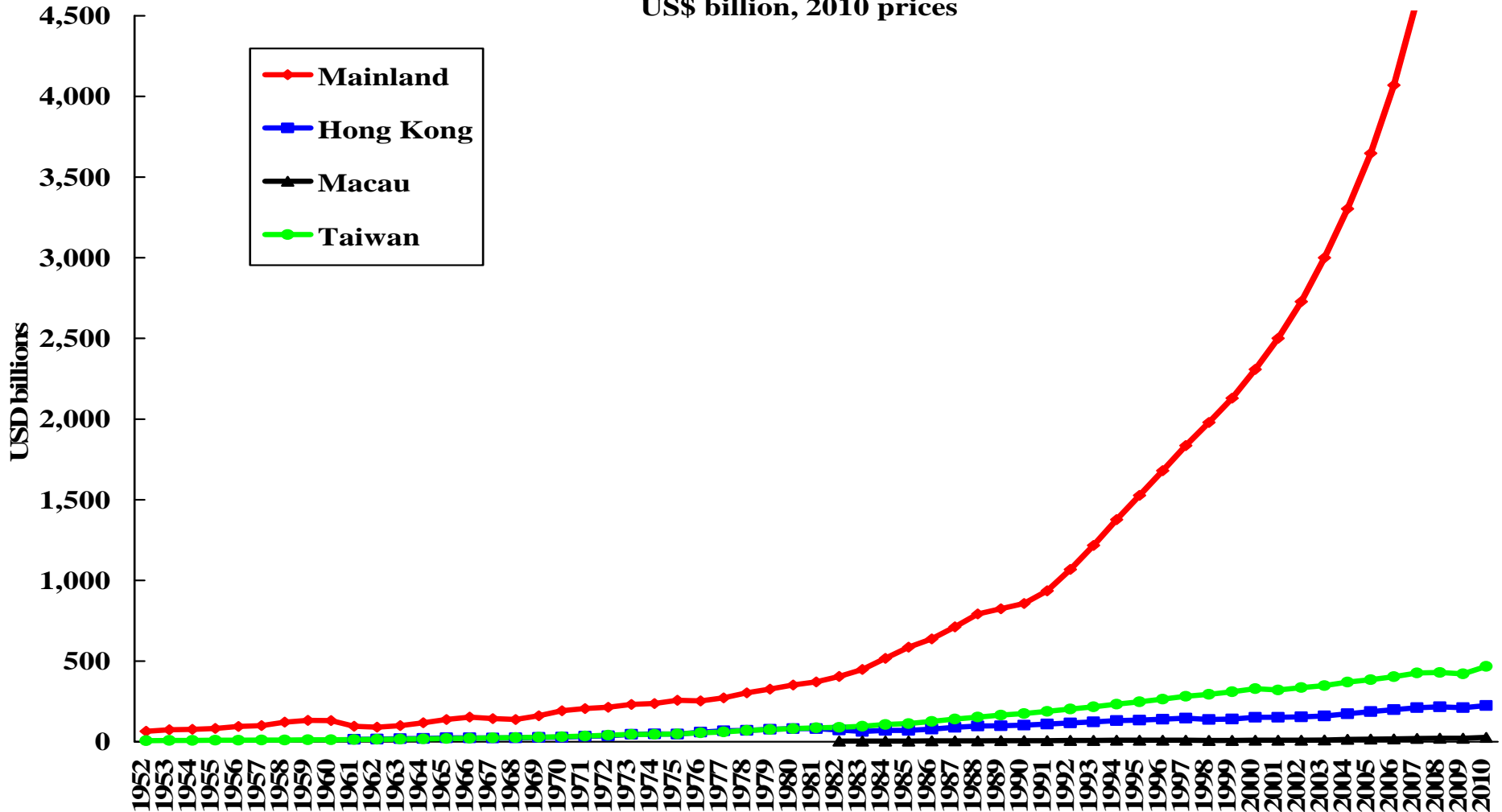


Hong Kong



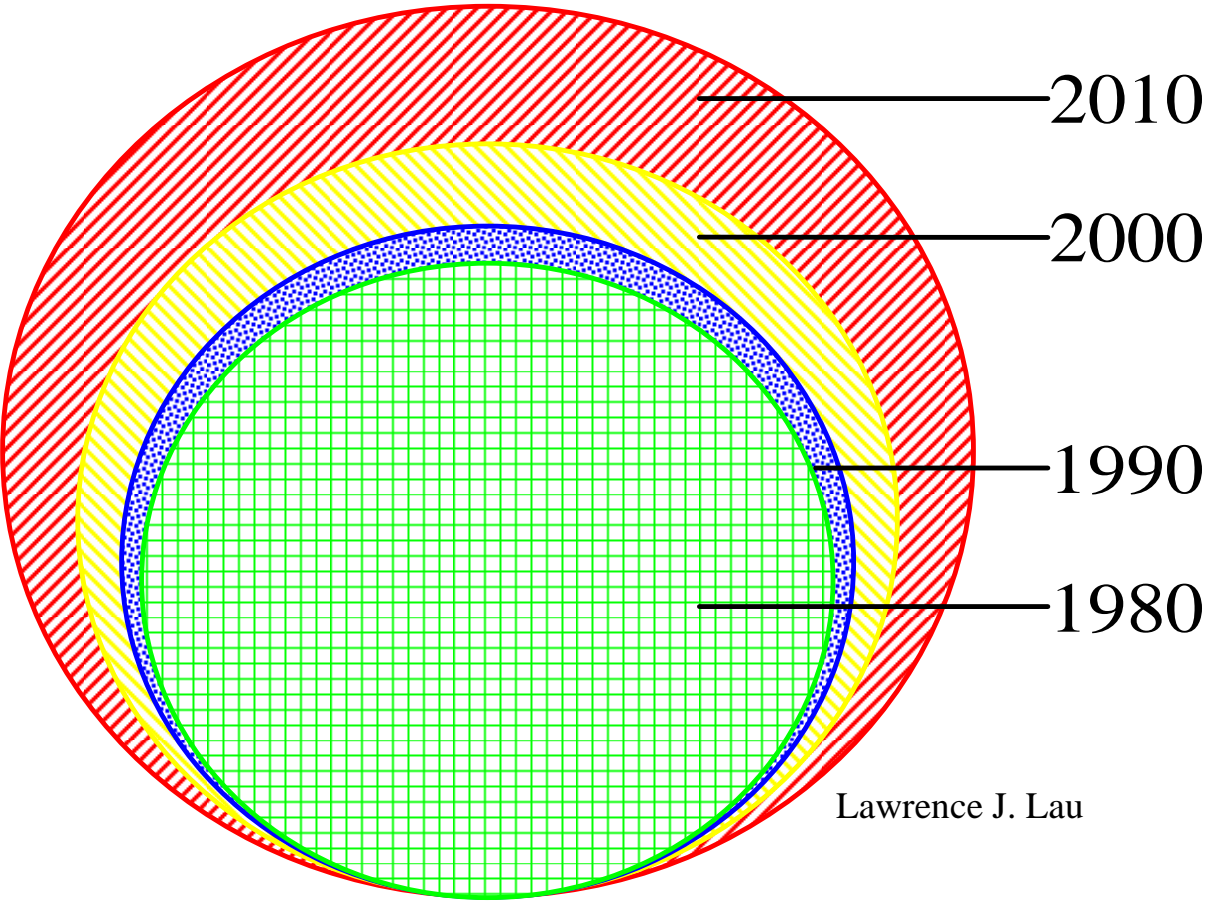
Comparison of the Real GDPs of Four Regions (2010 US\$)

Comparison of the Real GDPs of the Four Regions in the Greater Chinese Economy
US\$ billion, 2010 prices

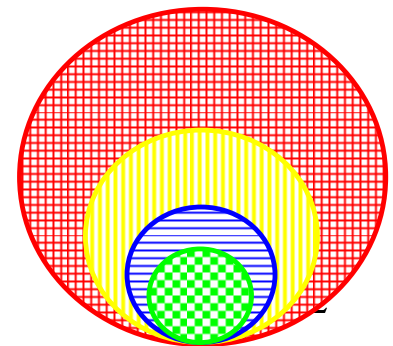


Comparison of the Real GDP-per-Capita's of Mainland and Hong Kong (2010 US\$)

Hong Kong



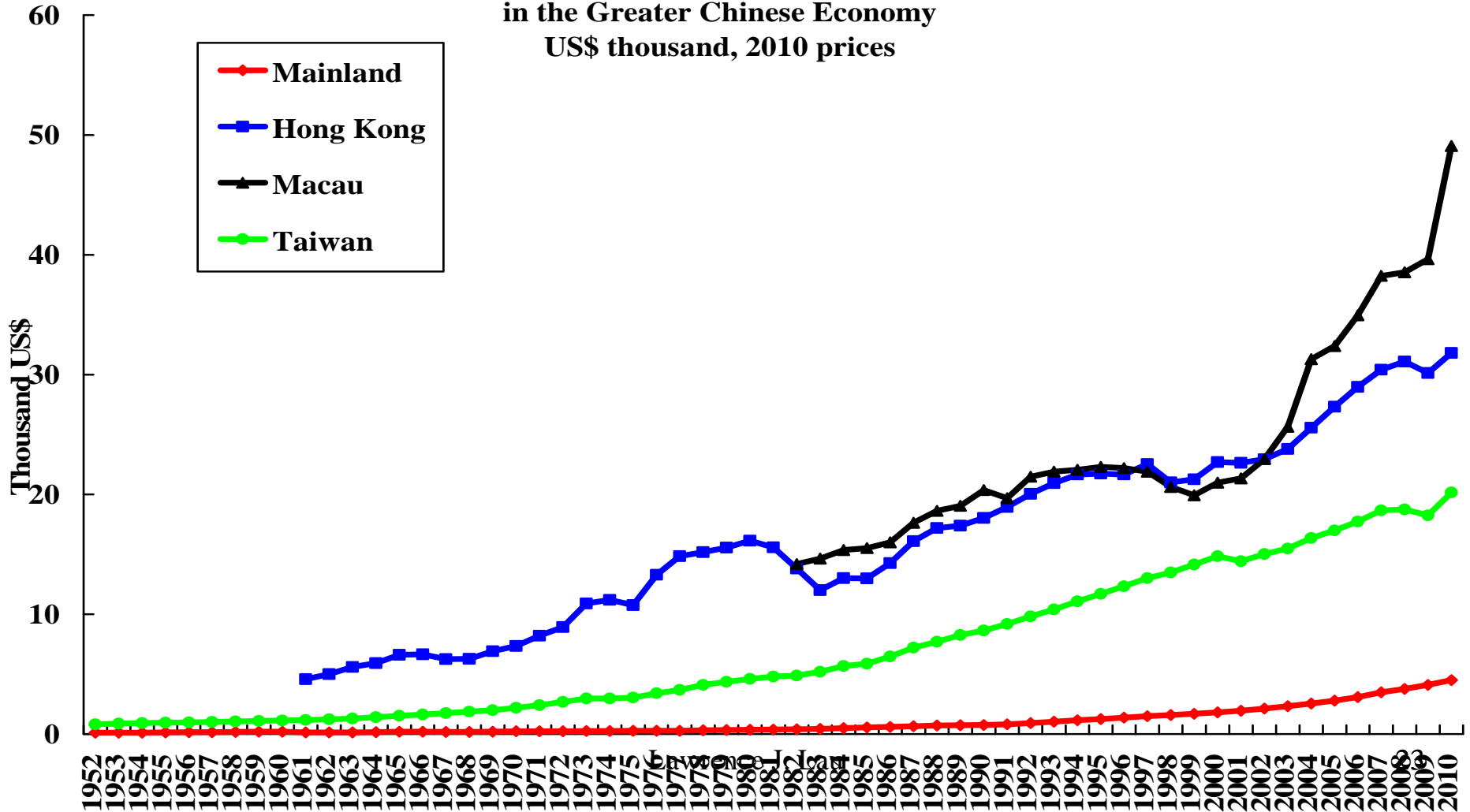
China



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Comparison of the Real GDP-per-Capita's of Four Regions (2010 US\$)

Comparison of the Real GDP per Capita's of the Four Regions
in the Greater Chinese Economy
US\$ thousand, 2010 prices

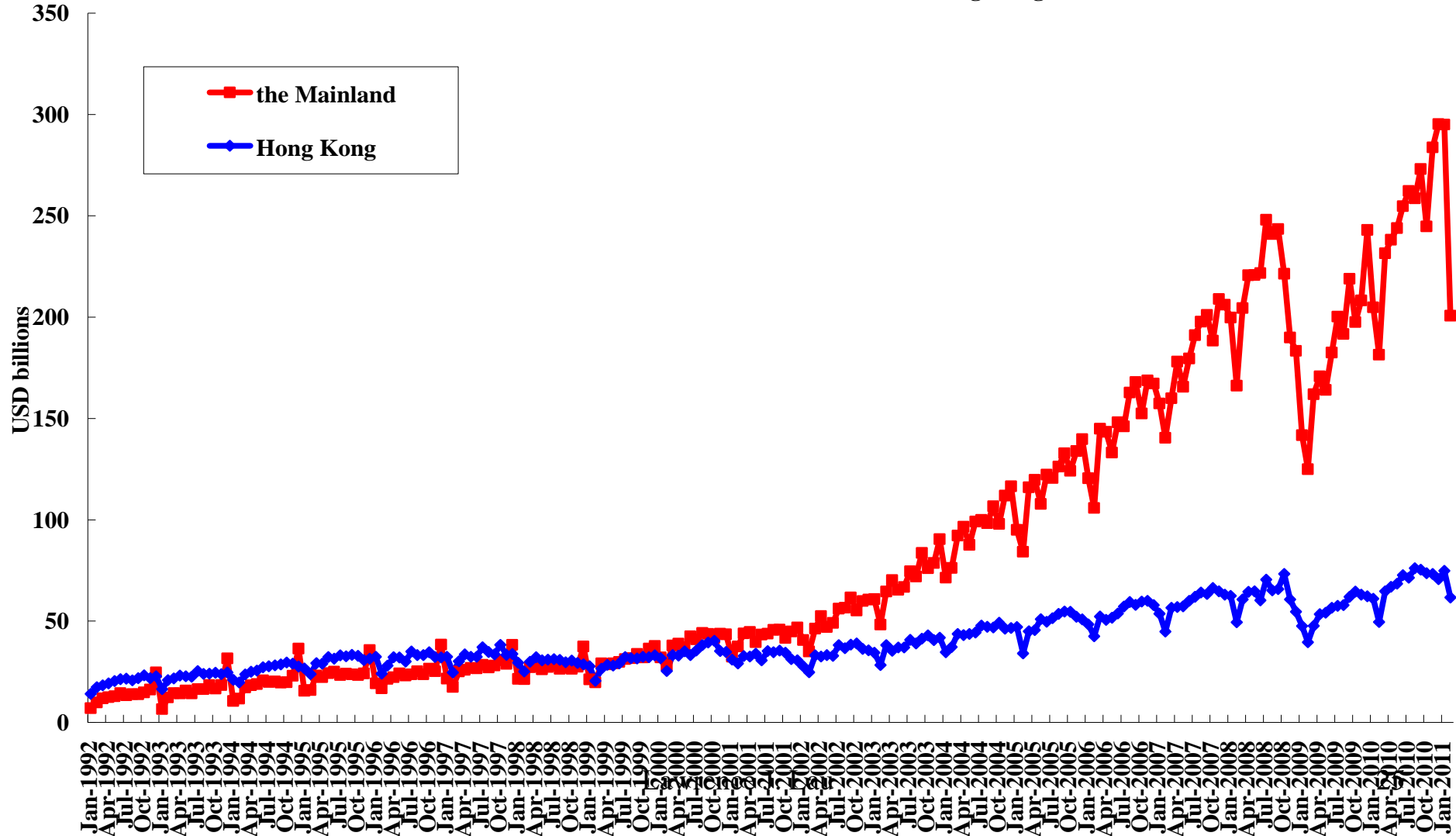


Comparison of the Economies of Hong Kong and the Mainland

- ◆ In terms of international trade, the Mainland, which started out at a very low level in 1978, overtook Hong Kong in the early 1990s and is now approximately 4 times as large as Hong Kong.
- ◆ The Mainland is the most important trading partner of Hong Kong.
- ◆ In terms of foreign direct investment (FDI), the Mainland has consistently attracted more direct investment than Hong Kong since it adopted the economic reform and opening policies.

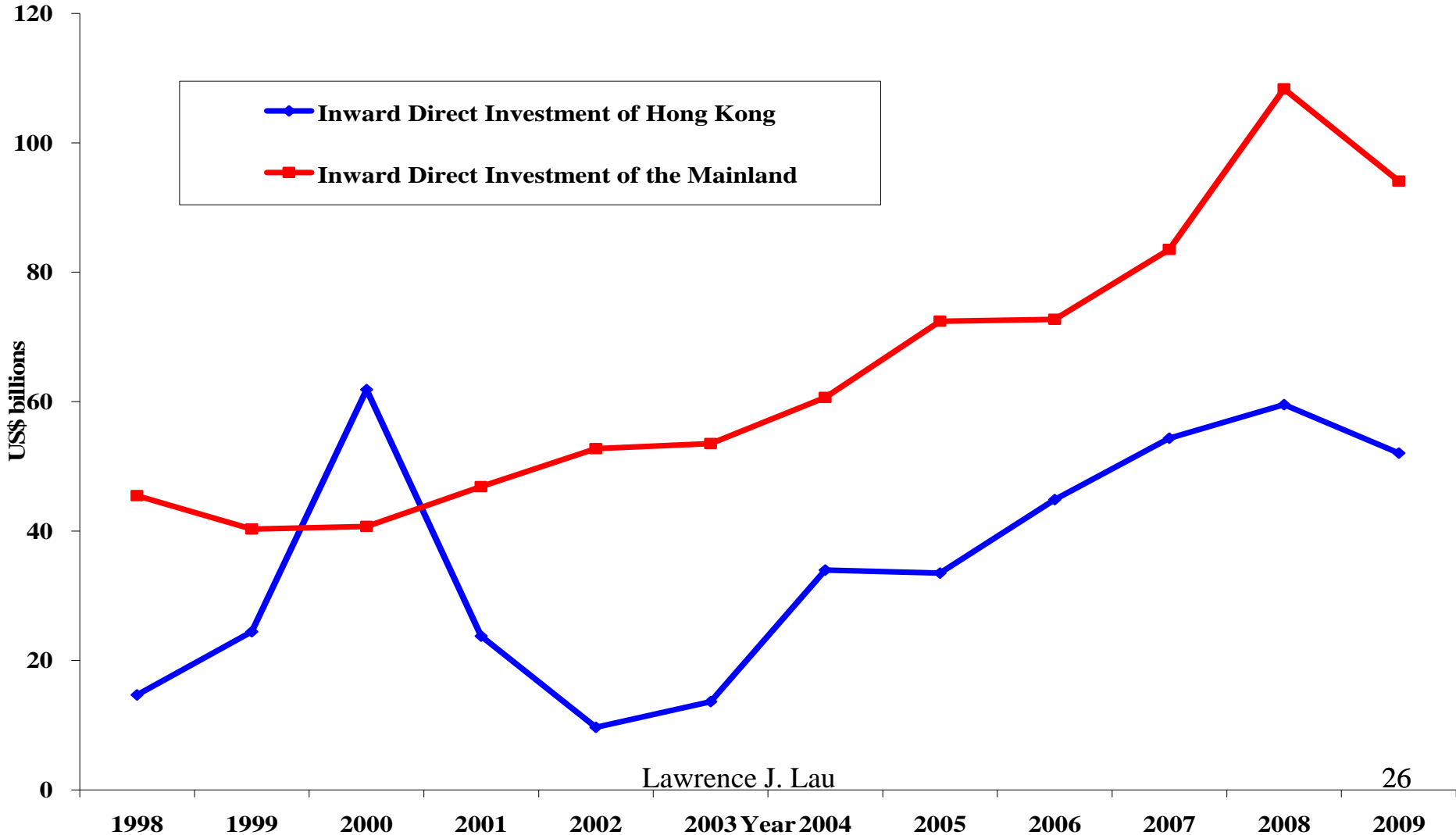
Comparison of the Total International Trade of the Mainland and Hong Kong

Total International Trade of the Mainland and Hong Kong



Comparison of the Inbound Foreign Direct Investment: Mainland and Hong Kong

Annual Inward Direct Investment of the Mainland and Hong Kong

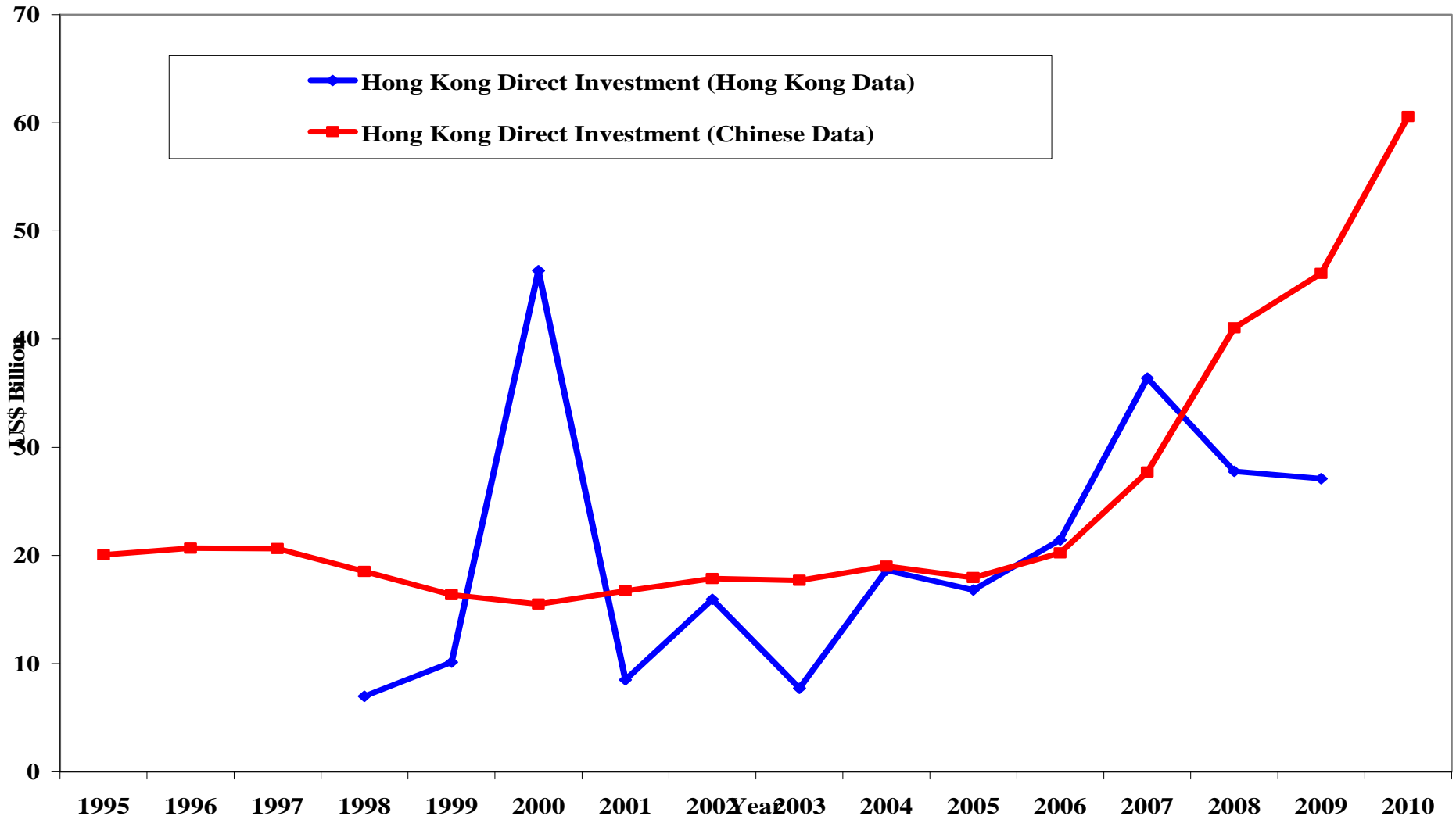


Mainland-Hong Kong Economic Interactions: Direct Investment

- ◆ Hong Kong data on direct investment by country or region of origin are not completely reliable. On the one hand, Hong Kong direct investment can include not only investment from Hong Kong firms and residents, but also investment from Taiwan and elsewhere routed through Hong Kong subsidiaries as well as round-tripped investment, that is, investment from Mainland firms and residents camouflaged as Hong Kong firms in order to enjoy certain special tariff and tax privileges.
- ◆ On the other hand, there is also Hong Kong direct investment that is routed through tax havens such as the British Virgin Islands, Cayman Islands and Netherland Antilles.
- ◆ Hong Kong data and Mainland data on FDI do not agree. Taking into consideration all of these data problems, Hong Kong is still the most important source of foreign direct investment into the Mainland, accounting for between 20% and 40% of total FDI.

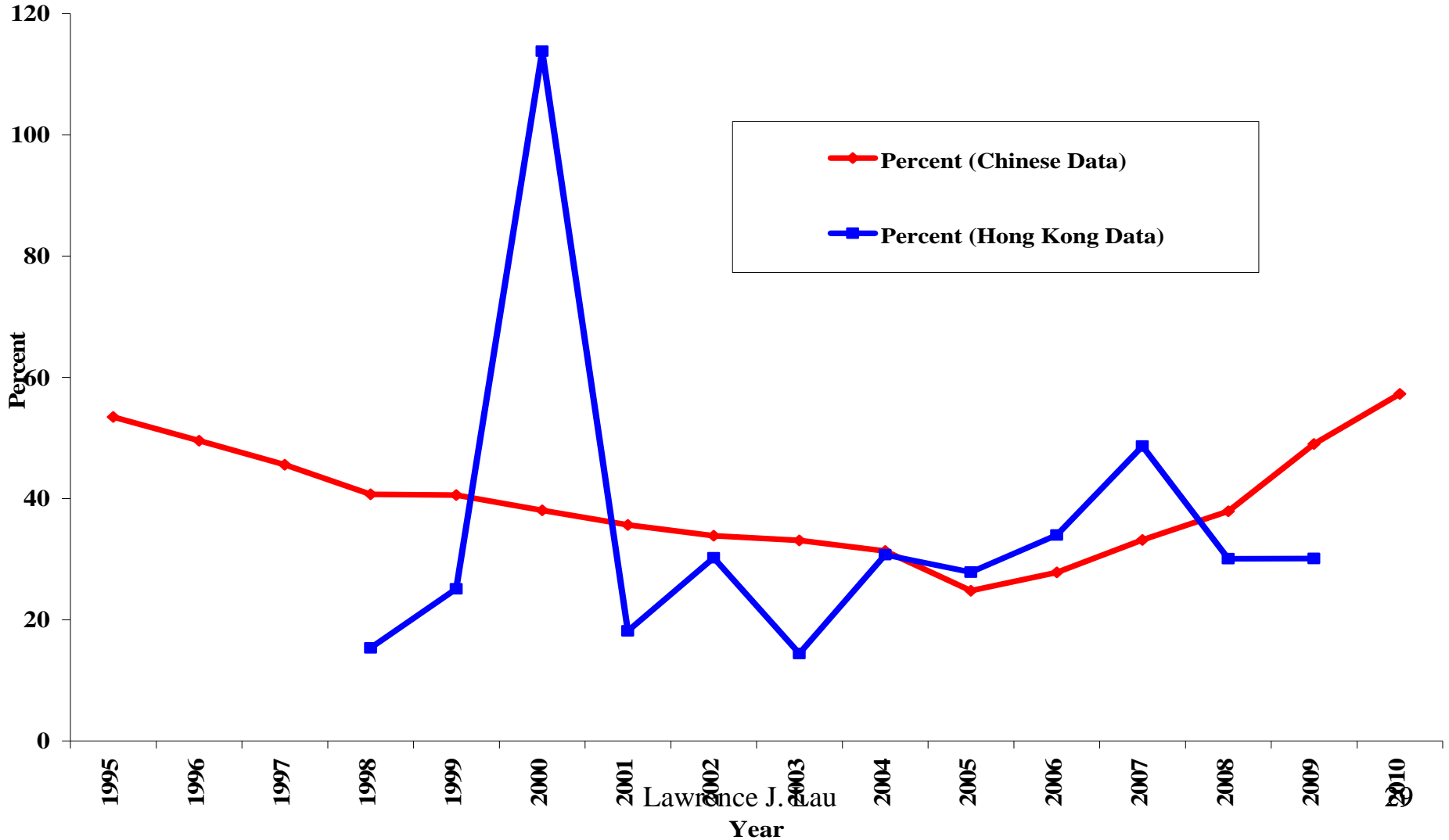
Annual Hong Kong Direct Investment to the Mainland (US\$)

Hong Kong Direct Investment into the Mainland



Hong Kong Direct Investment as a Percent of Total Inbound Direct Investment

Hong Kong Direct Investment as a Percent of Total Inbound Foreign Direct Investment into China

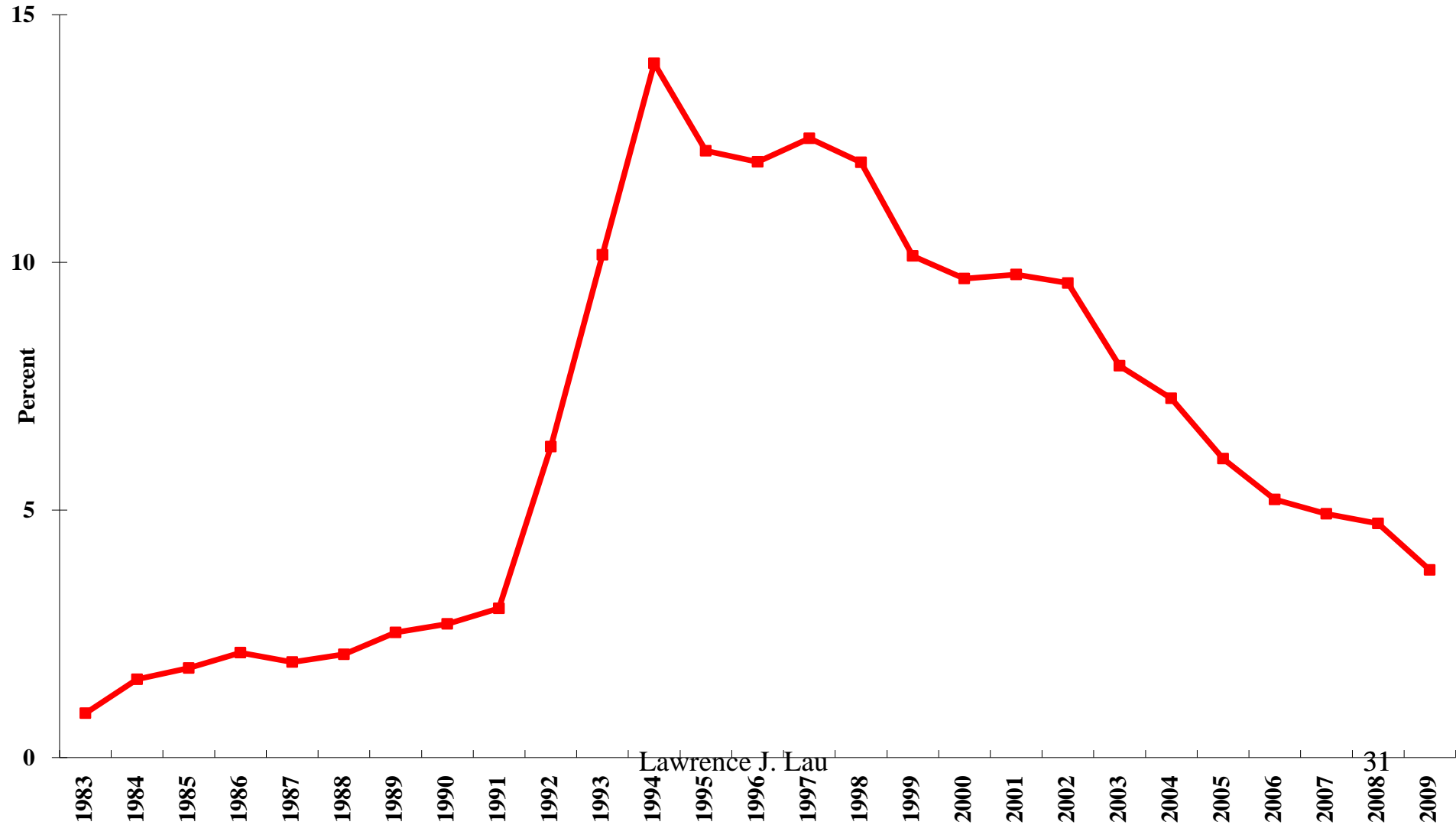


Mainland-Hong Kong Economic Interactions: Direct Investment

- ◆ Hong Kong investors were the first to invest in the Mainland when it first opened to the World and were instrumental for the successful development of the Special Economic Zones such as Shenzhen.
- ◆ It is fair to say that without Hong Kong, Shenzhen would probably not have been a success. The other Special Economic Zones have not been notably successful.
- ◆ But today, even total foreign direct investment, from all sources, constitutes only a very small and quantitatively unimportant percentage of total gross domestic investment on the Mainland (less than 5% in 2010).
- ◆ Mainland investment now constitutes almost 50% of all FDI into Hong Kong.

Foreign Direct Investment as a Percent of Total Mainland Domestic Investment

Foreign Direct Investment as a Percent of Total Mainland Gross Domestic Investment



Mainland Investment as a Percent of Total Inbound Direct Investment of Hong Kong

Mainland Investment as a Percent of Inbound Direct Investment of Hong Kong

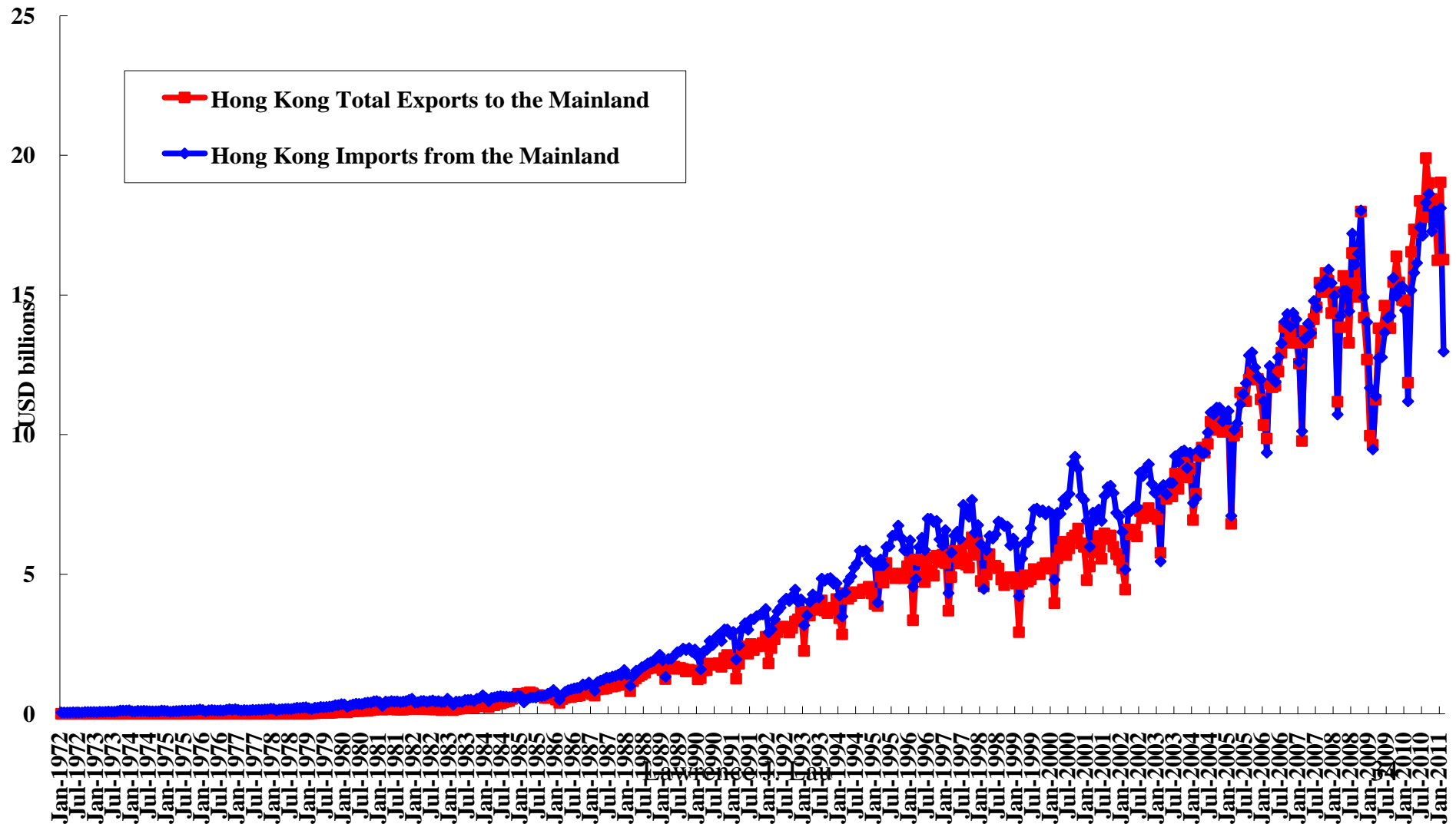


Mainland-Hong Kong Economic Interactions: International Trade

- ◆ Trade between Hong Kong and the Mainland has grown rapidly since 1978.
- ◆ The Mainland has become the most important trading partner of Hong Kong. It is the most important destination for Hong Kong exports as well as the most important source of Hong Kong imports.
- ◆ The Mainland has also become the most important source of visitors to Hong Kong, especially since the introduction of the “Individual Visit Scheme” in 2003. Mainland visitors constituted more than 60% of all visitors to Hong Kong in 2010.

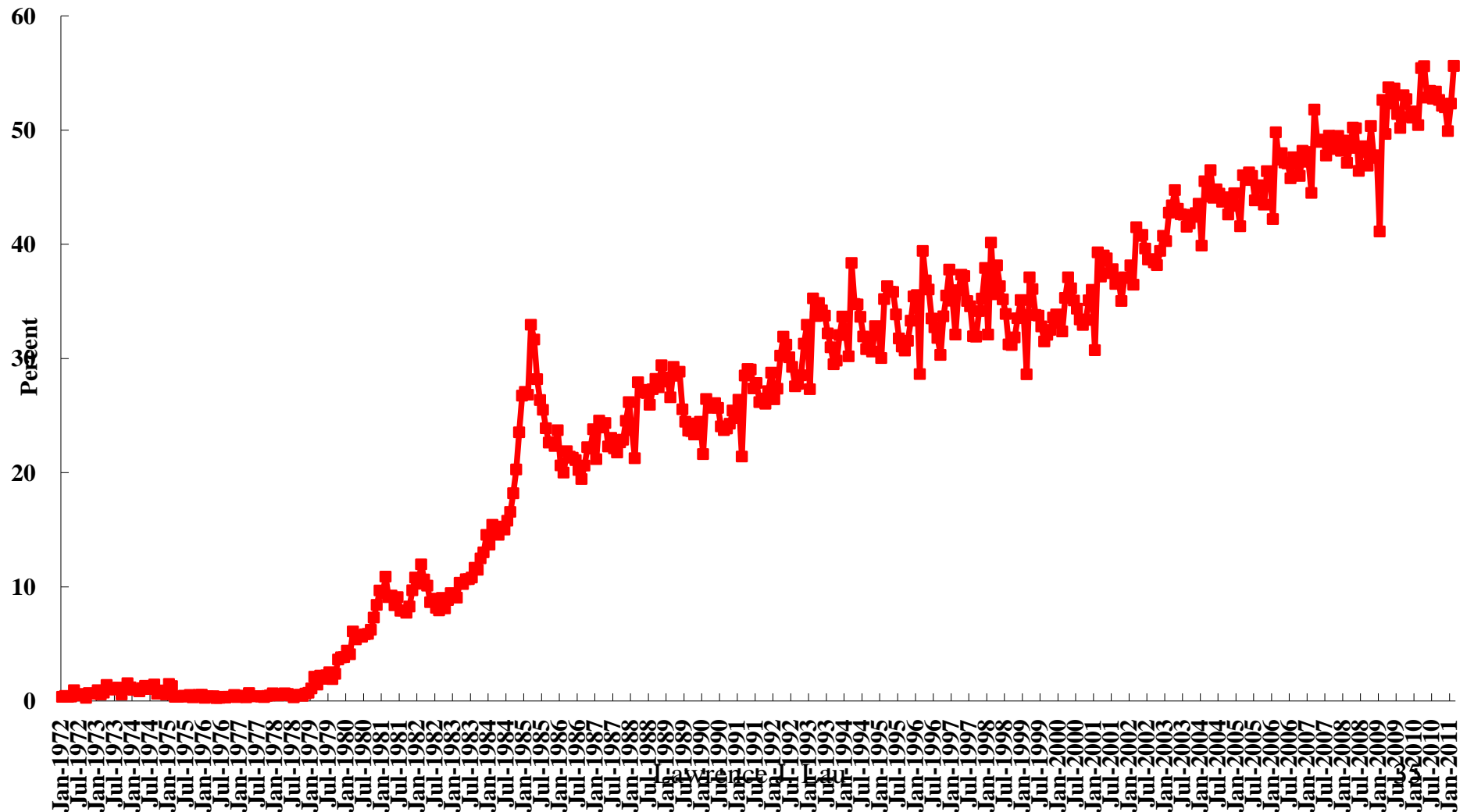
Total Hong Kong Exports to and Imports from the Mainland since 1972

Hong Kong Total Exports to and Imports from the Mainland



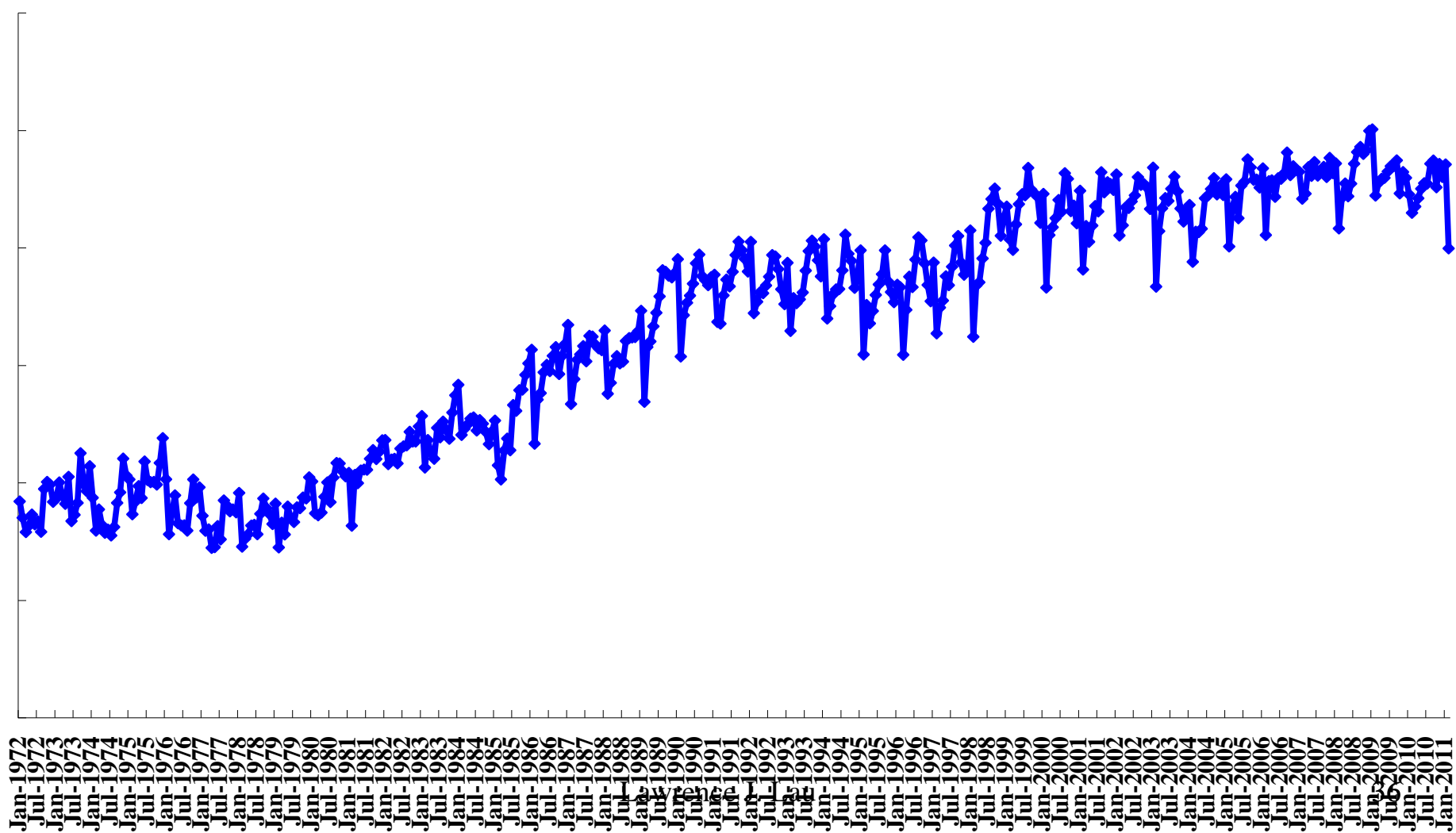
Hong Kong Exports to the Mainland as a Percent of Total Hong Kong Exports

Hong Kong Exports to the Mainland as a Percent of Total Hong Kong Exports



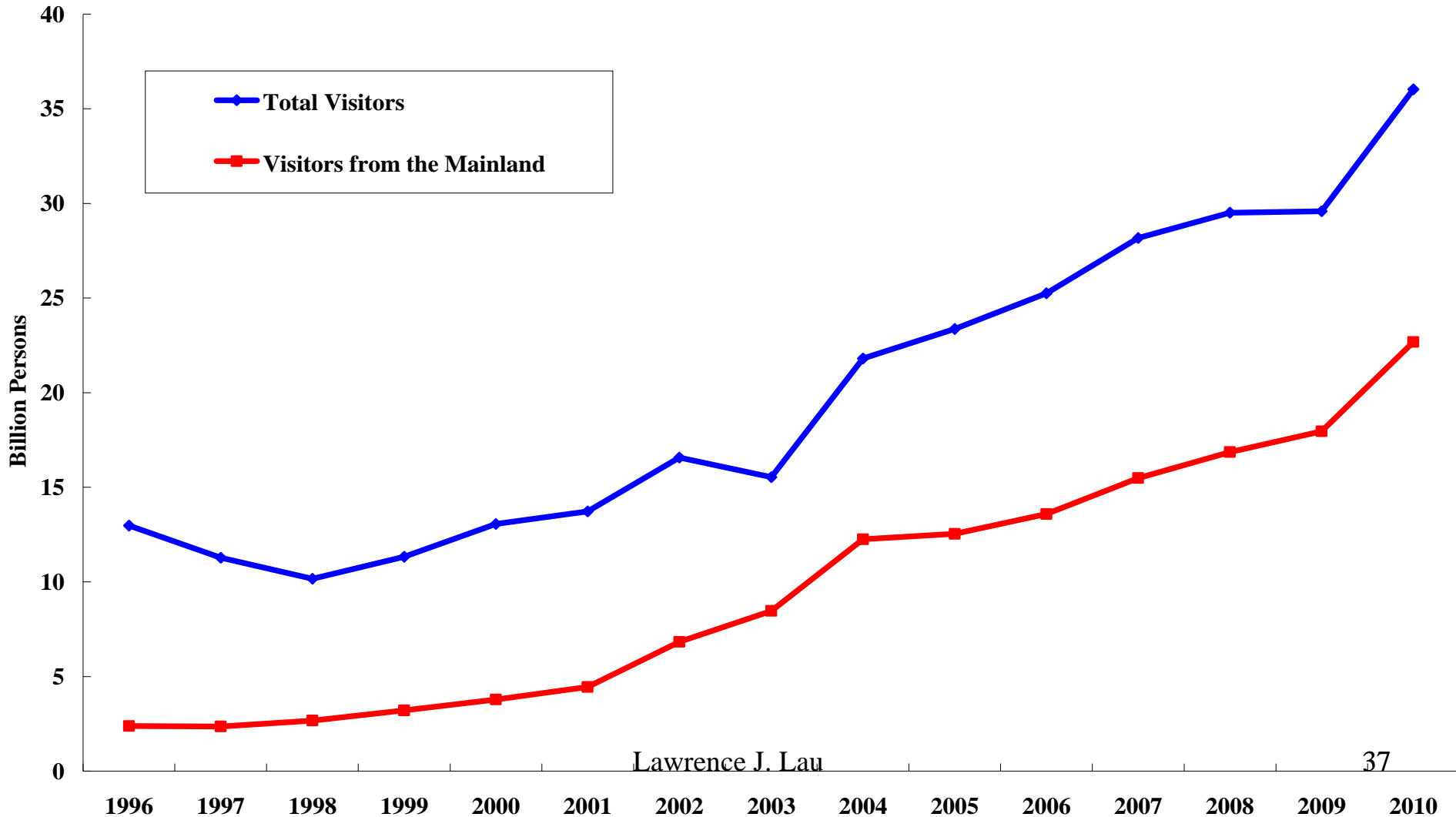
Hong Kong Imports from the Mainland as a Percent of Total Hong Kong Imports

Hong Kong Imports from the Mainland as a Percent of Total Hong Kong Imports



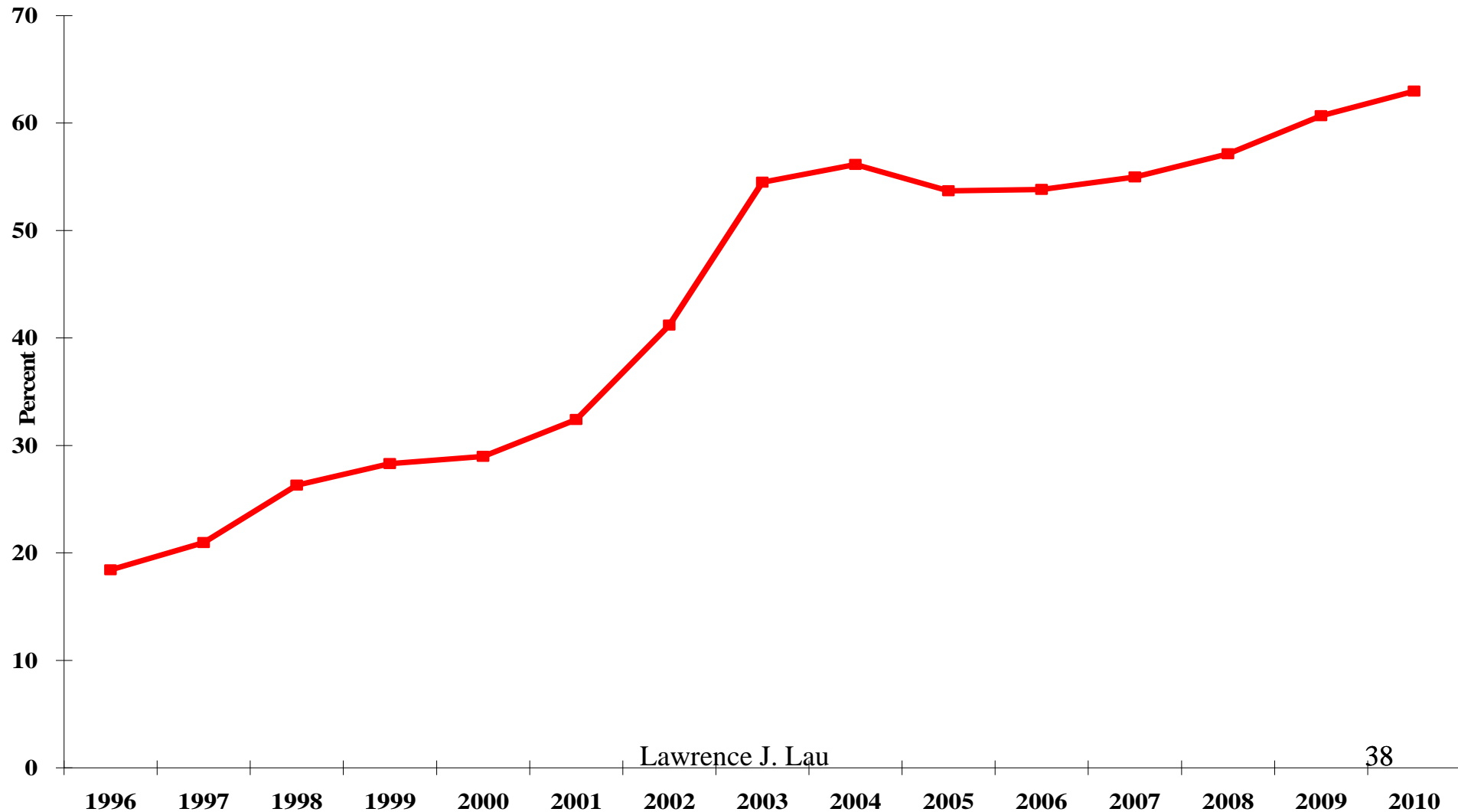
Annual Mainland and Total Visitors to Hong Kong since 1990

Annual Mainland and Total Visitors to Hong Kong



Visitors from the Mainland as a Percent of Total Visitors to Hong Kong

Visitors from the Mainland as a percent of Total Visitors



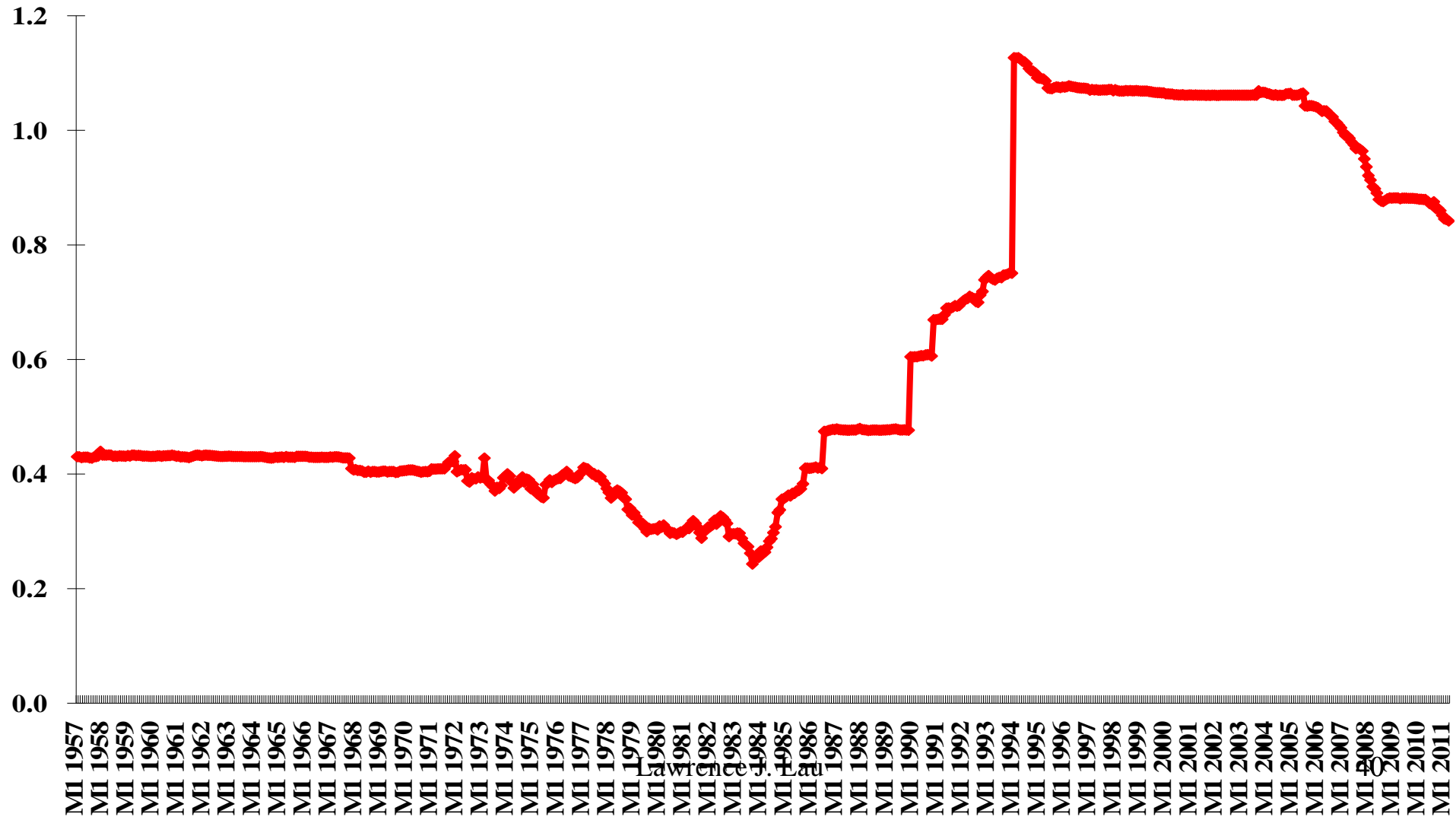
The Yuan-Hong Kong Dollar Exchange Rate

- ◆ The Yuan-Hong Kong Dollar exchange rate also reflected the relative fortunes of the Mainland and Hong Kong economies. The Hong Kong Dollar was worth less than the Yuan until 1994, when the Yuan became current accounts convertible. The Hong Kong Dollar then became worth more than the Yuan, until the Yuan began to appreciate in mid-2005. The Hong Kong Dollar is now worth approximately 0.83 Yuan.

The Yuan-HK\$ Exchange Rate

End of Month, Yuan/HK\$

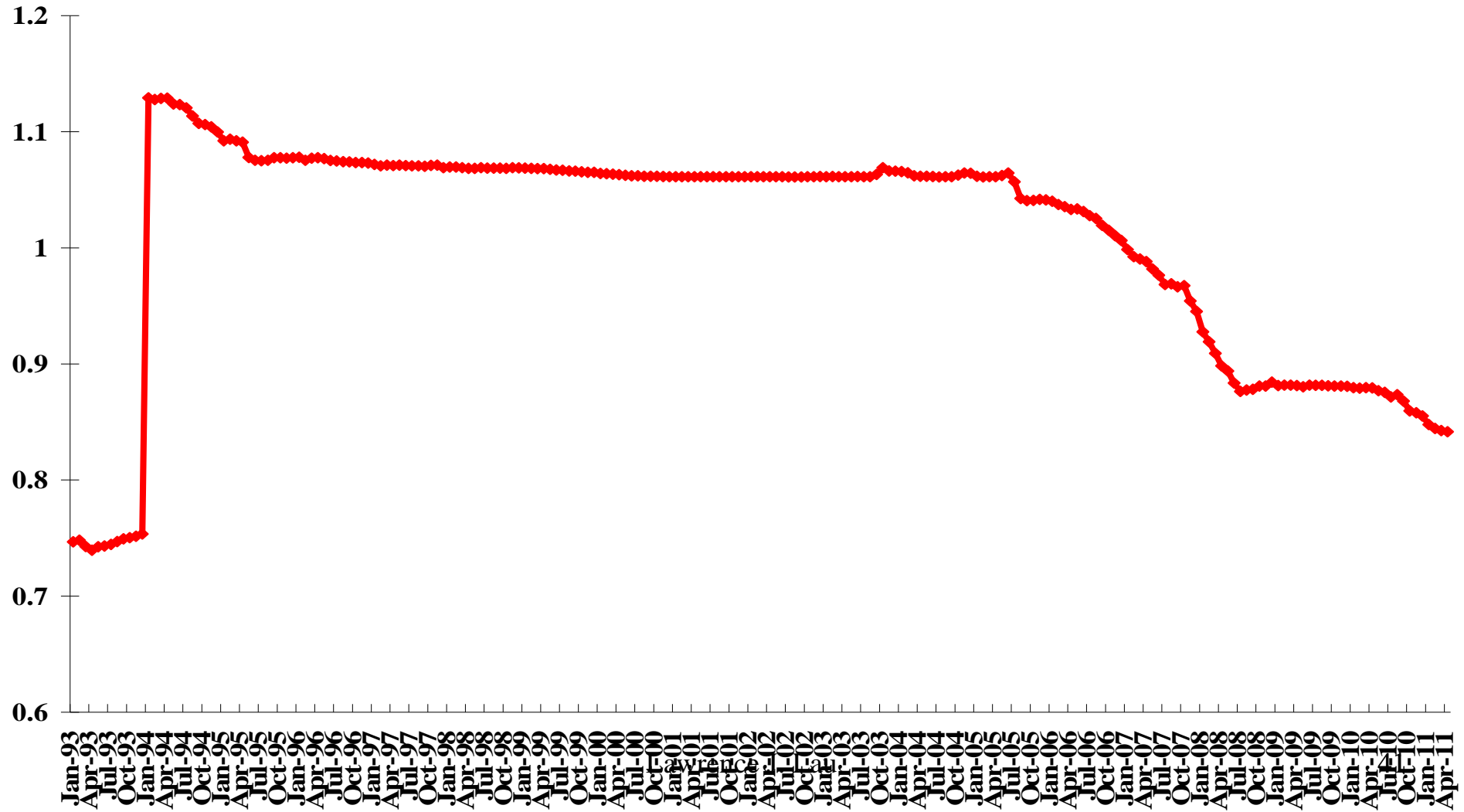
Yuan per Hong Kong Dollar at the End of the Month



The Yuan-HK\$ Exchange Rate

Monthly Average, Yuan/HK\$

Monthly Average Exchange Rate of Yuan per Hong Kong Dollar

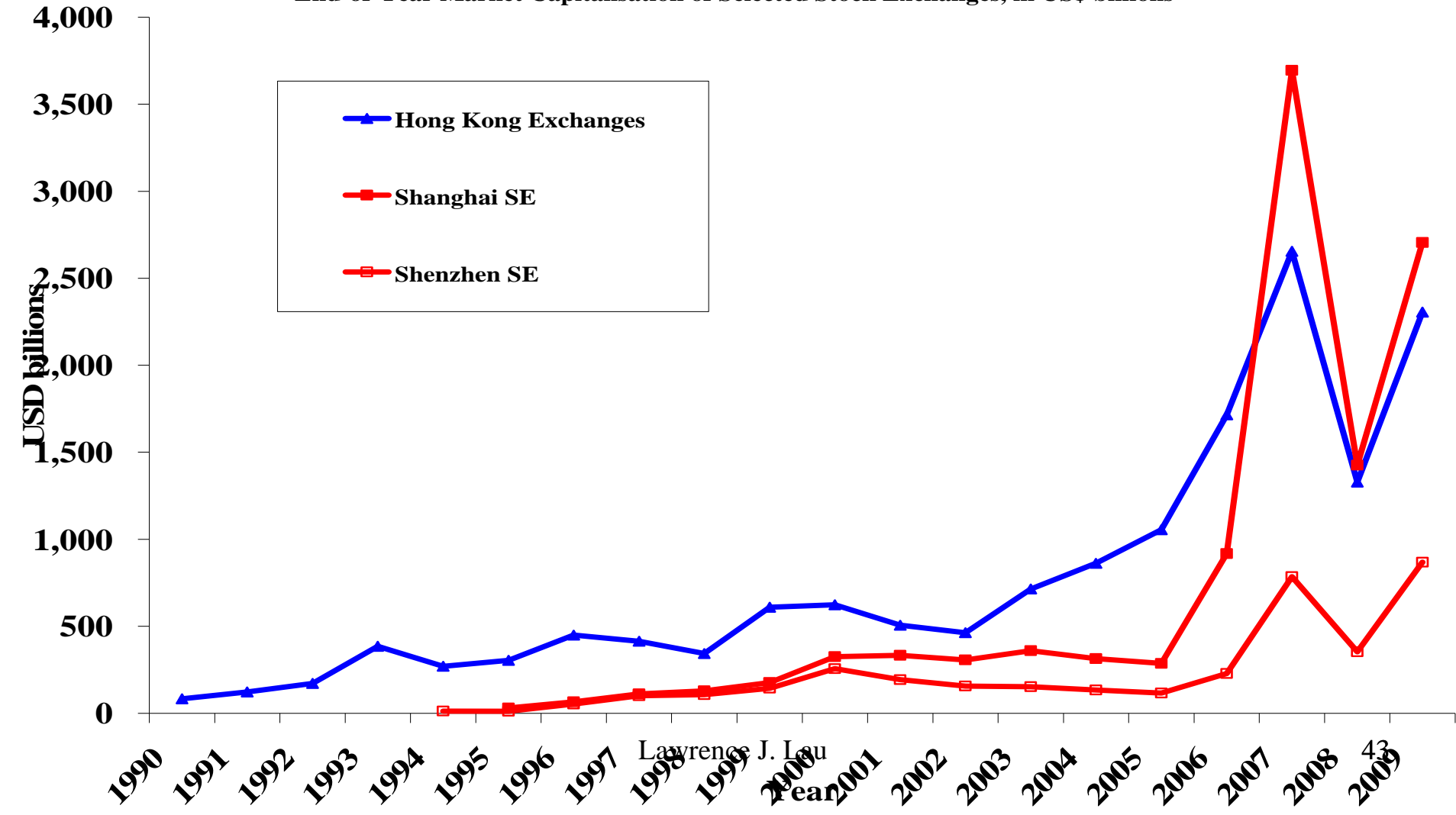


Mainland-Hong Kong Economic Interactions: The Stock Market

- ◆ Stock exchanges on the Mainland were first established in the early 1990s. In terms of market capitalisation—the total value of all the companies listed on the stock exchange at the prevailing share prices of the market—the Shanghai Stock Exchange alone now exceeds the Hong Kong Stock Exchange.
- ◆ Mainland firms now constitute more than 50% of the Hong Kong Stock Exchange by market capitalisation but less than 20% by the number of listed firms—indicating that the Mainland firms listed on the Hong Kong Stock Exchange are on average much bigger than the other firms listed there.

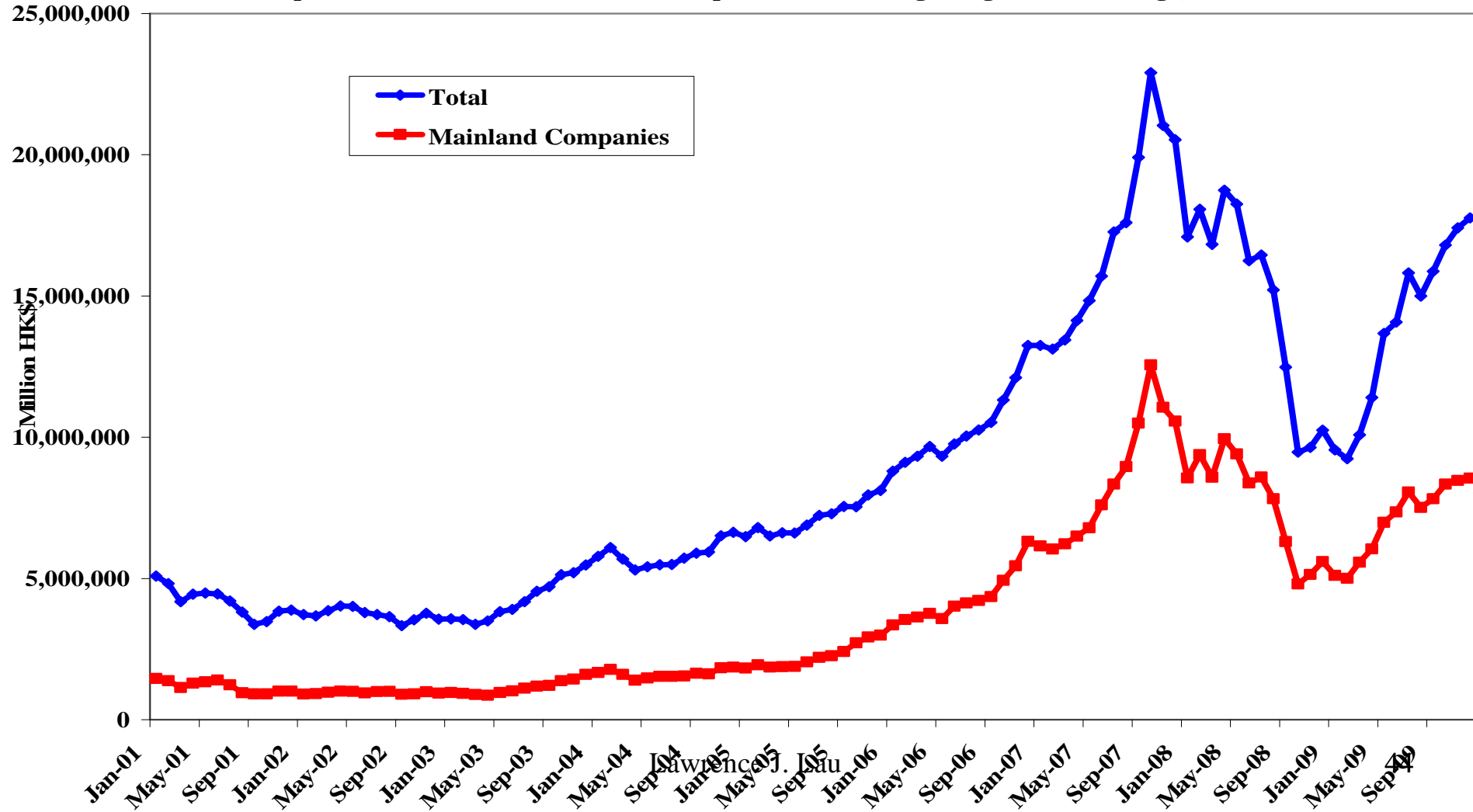
Comparison of Market Capitalisations of Mainland and Hong Kong Stock Exchanges

End-of-Year Market Capitalisation of Selected Stock Exchanges, in US\$ billions



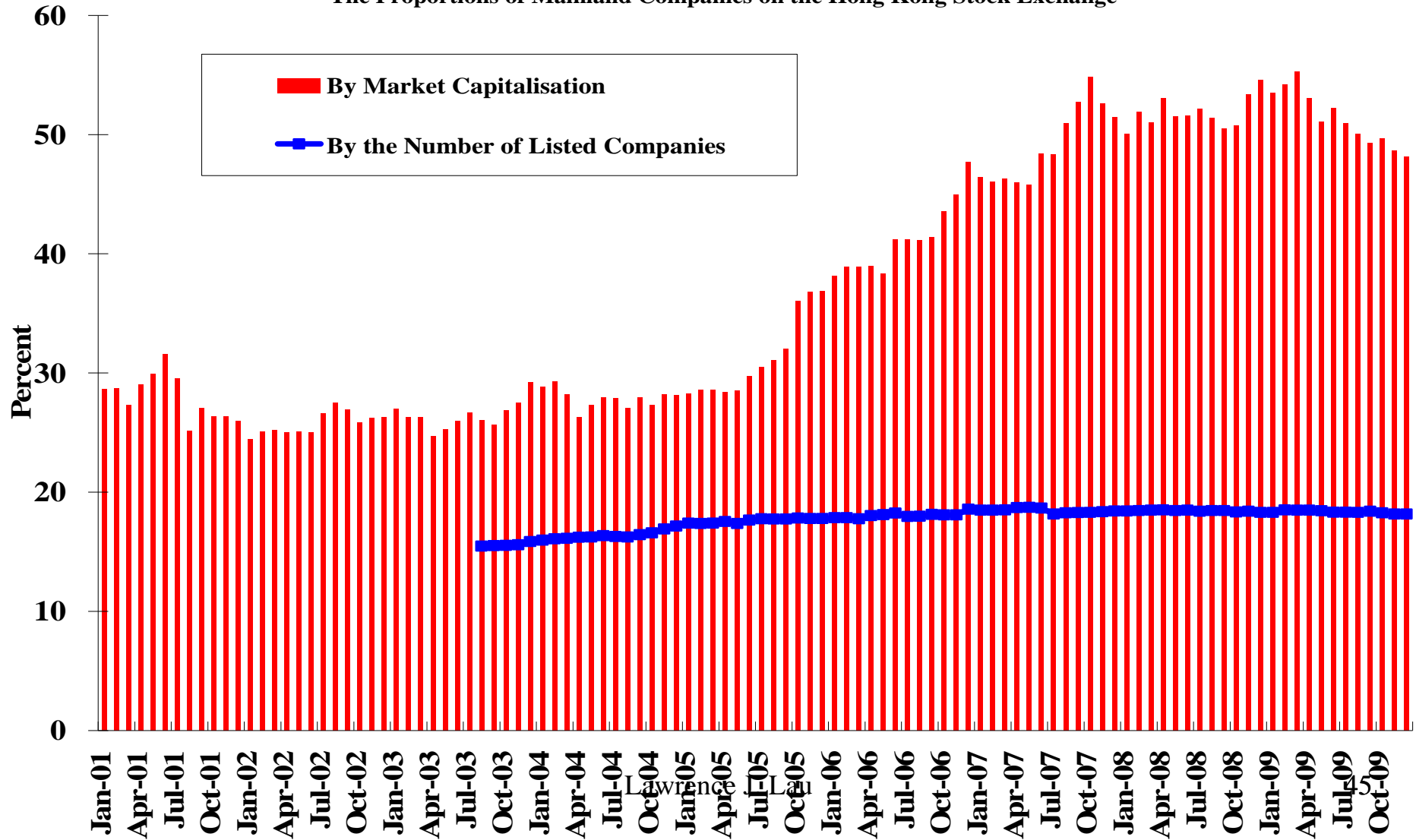
Year-End Market Capitalisation of Mainland and All Firms Listed on HKSE

Market Capitalisation of Mainland and All Companies on the Hong Kong Stock Exchange, million HK\$



Year-End Market Capitalisation of Mainland and All Firms Listed on HKSE

The Proportions of Mainland Companies on the Hong Kong Stock Exchange

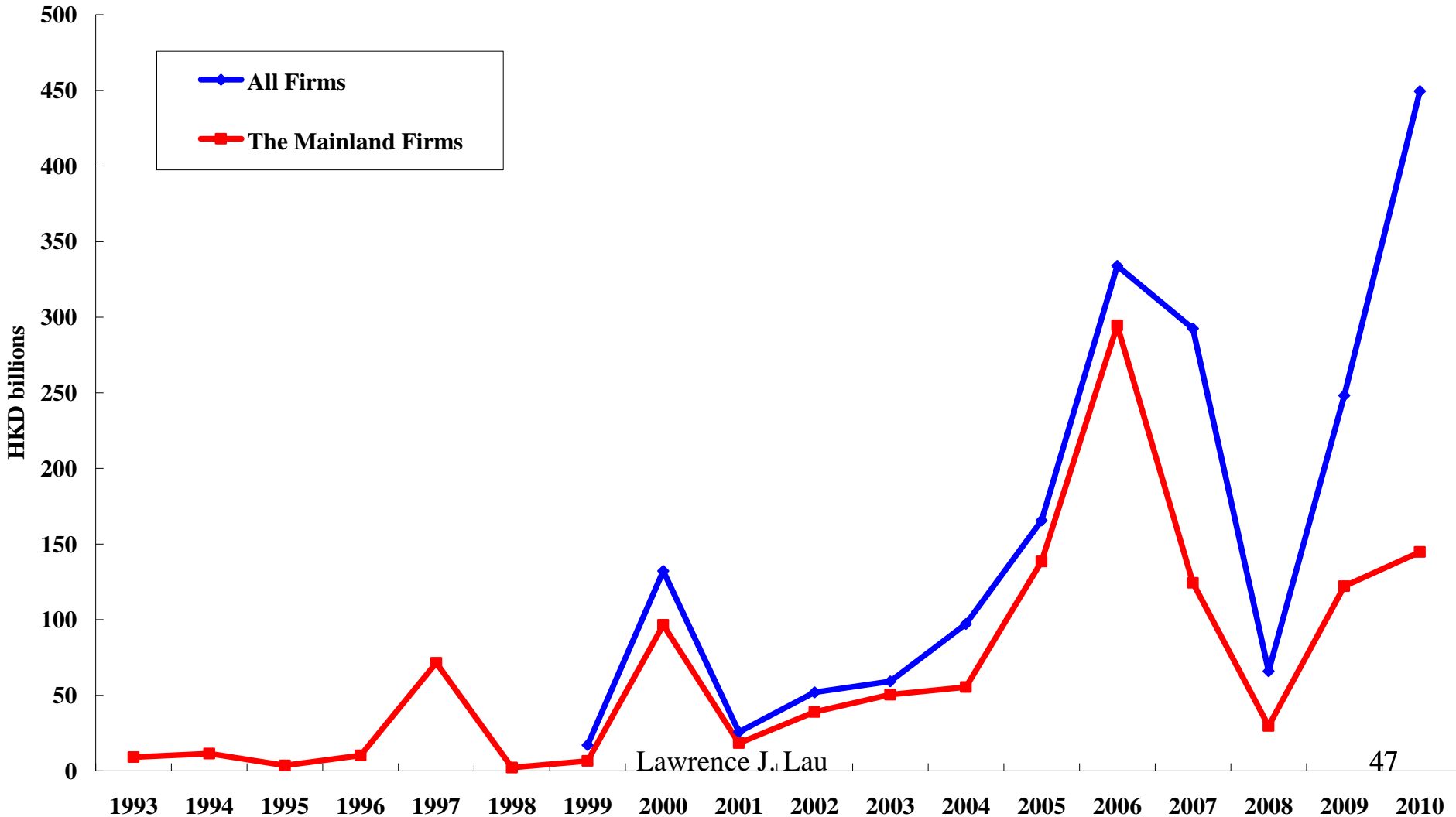


Mainland-Hong Kong Economic Interactions: The Stock Market

- ◆ In terms of initial public offerings (IPOs), that is, the first-time sales of shares by firms to public investors on the stock exchange, Mainland firms have been the mainstay of the Hong Kong Stock Exchange, accounting for most of the value of its IPOs, except in the global financial crisis years of 2009 and 2010 when firms from other countries came to Hong Kong to raise money because of the lack of activities in New York and London.
- ◆ Increasingly, however, Mainland firms find listing on the Shanghai Stock Exchange much more attractive because there is substantial domestic investor demand and the firms need to raise Renminbi rather than foreign exchange. The Mainland, with foreign exchange reserves exceeding US\$3 trillion, does not need any more inflow of foreign exchange.
- ◆ That is why Hong Kong has to seek firms from other countries and regions to list their shares on the Hong Kong Stock Exchange.

Annual IPO Value of Mainland and All Firms on Hong Kong Stock Exchange

Annual IPO Value of Mainland and All Firms on Hong Kong Stock Exchange

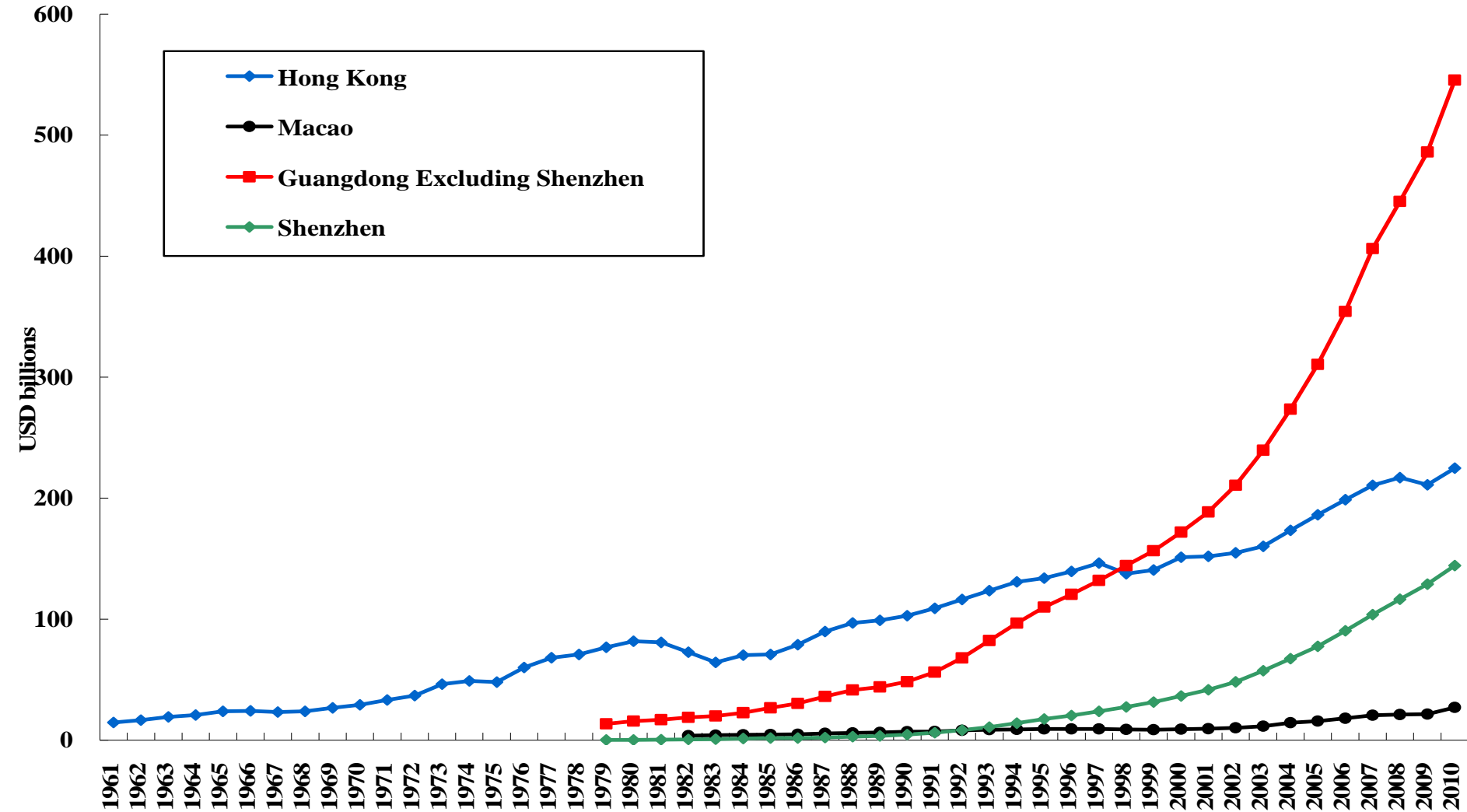


Mainland-Hong Kong Economic Interactions

- ◆ Hong Kong and its entrepreneurs were indispensable for the success of the economic reform and open-door policy on the Mainland, and in Guangdong and Shenzhen in particular.
- ◆ Hong Kong may not be the only gateway to the Mainland any more, but it can be the best gateway, or at least the best gateway to southern China.
- ◆ Hong Kong should capitalise on its geographical position to co-operate closely with Shenzhen, Pearl River Delta, Guangdong and southern China. Hong Kong can compete effectively with Shanghai as an international financial centre only if Hong Kong becomes more closely integrated economically with Guangdong (including Shenzhen).
- ◆ Guangdong, Hong Kong and Macau together can potentially become an economy as large as that of Japan today.

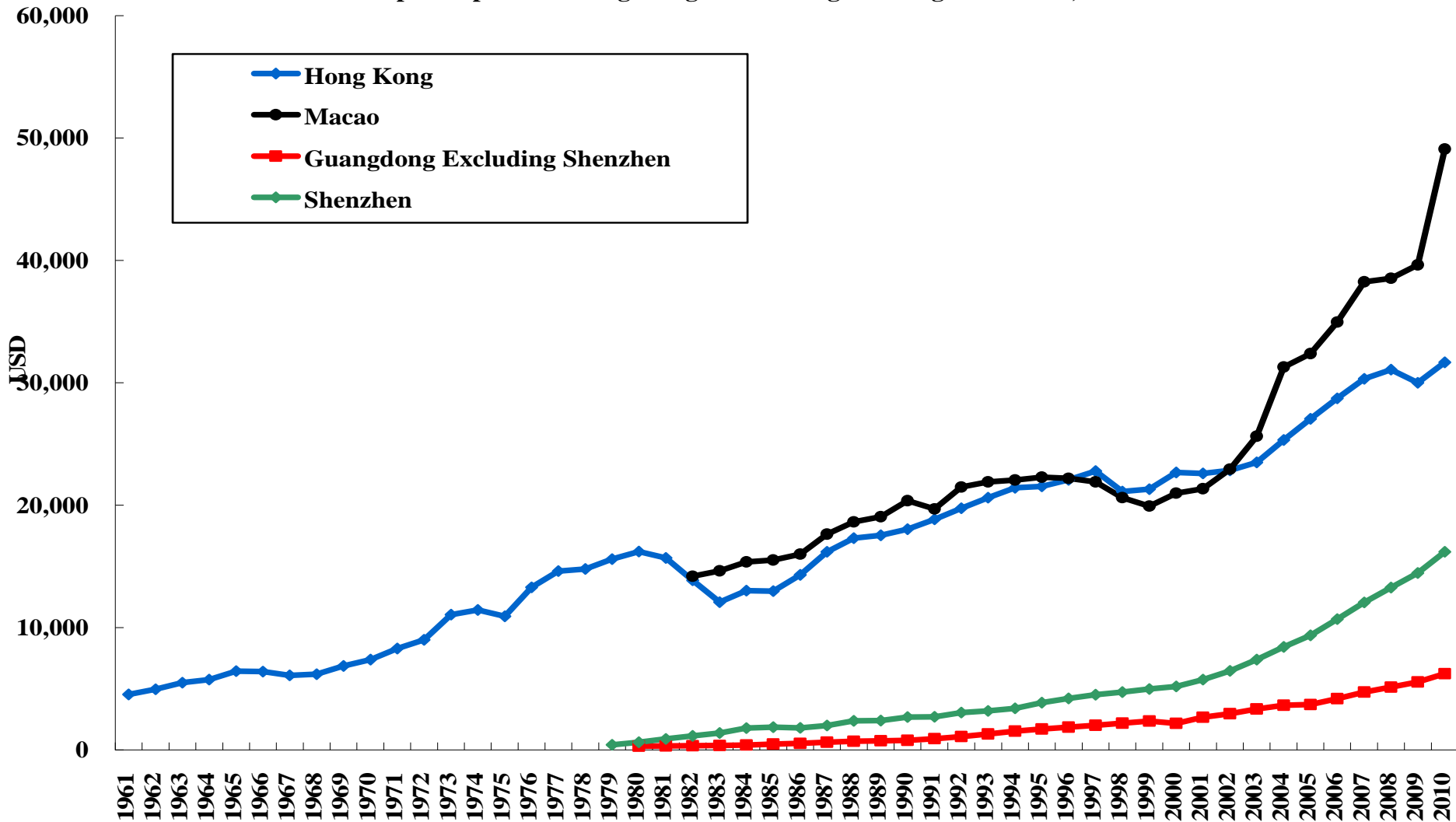
Real GDPs of Hong Kong and Its Neighbouring Economies, billion 2010US\$

Real GDPs of Hong Kong and Its Neighbouring Economies, billion 2010 US\$

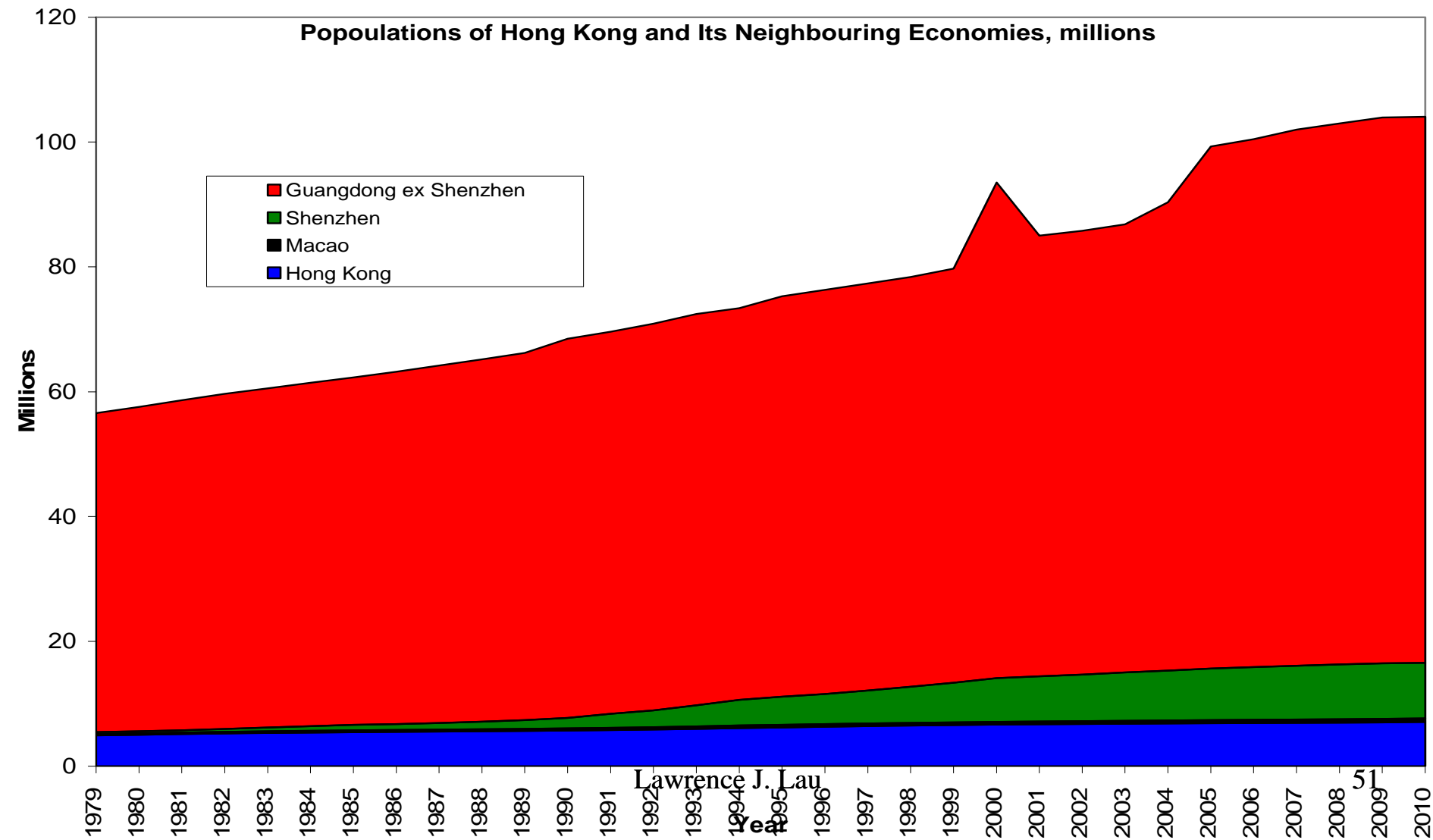


Real GDP-per-Capita's of Hong Kong and Its Neighbouring Economies, 2010 US\$

Real GDP per Capita's of Hong Kong and Its Neighbouring Economies, 2010 US\$



Populations of Hong Kong and Its Neighbouring Economies, millions



Mainland-Hong Kong Economic Interactions

- ◆ Guangdong has a permanent population of approximately 95 million, which together with Hong Kong and Macao is as large as Japan and almost half as large as the United States.
- ◆ Guangdong has a GDP in excess of US\$600 billion, approximately the same size as Taiwan, and a per capita GDP in excess of US\$6,500.

Mainland-Hong Kong Economic Interactions

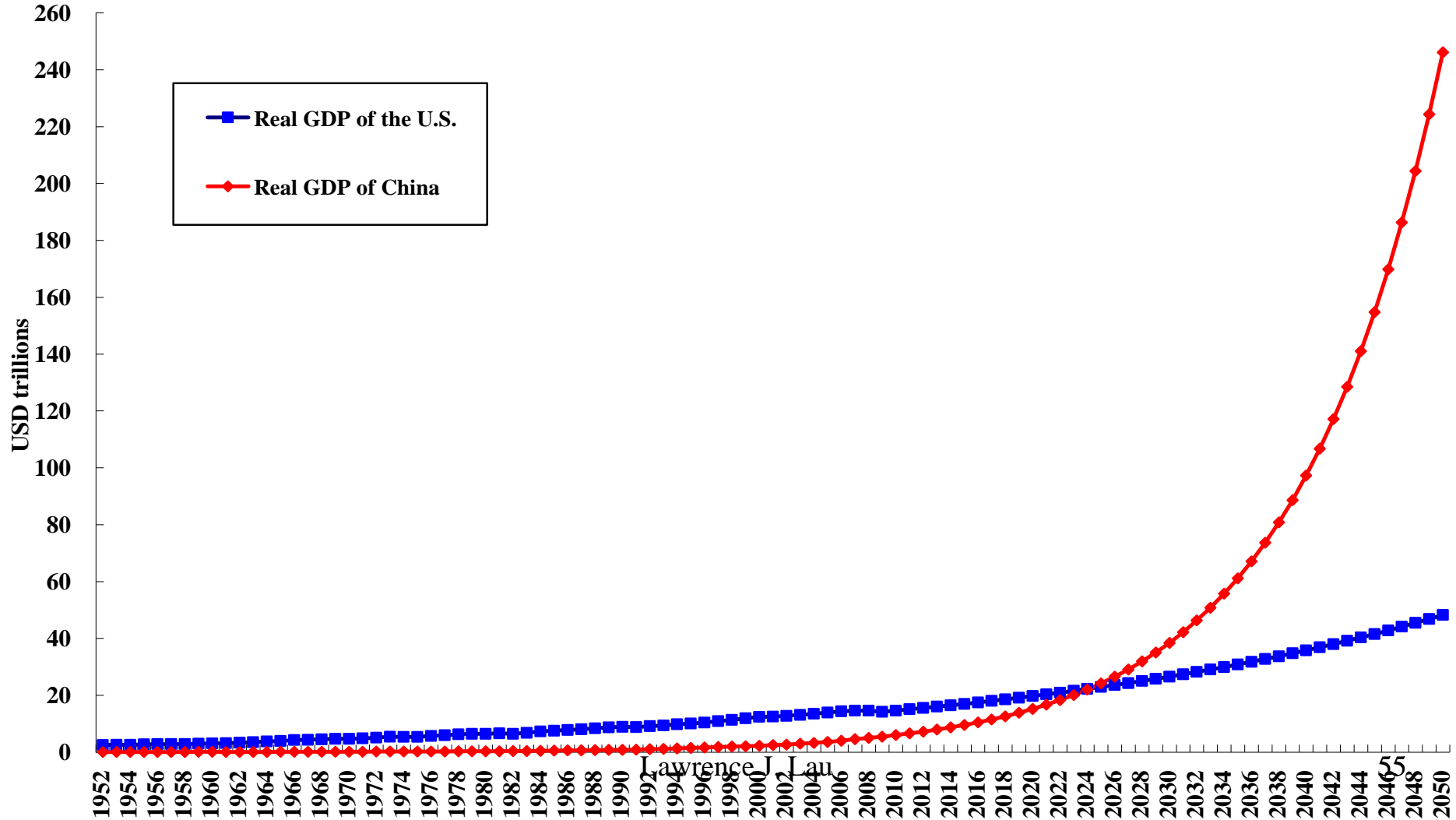
- ◆ Guangdong has a diversified industrial base—with light industry, heavy industry and high-technology industries. but is relatively weak in the higher education and research and development sectors. Hong Kong has little or no industry, especially high-technology industry, but has world-class research universities to provide scientific and technological manpower and R&D. There is therefore room for specialization and division of labor among Hong Kong, Guangdong and Shenzhen, which can be win-win for all.

Future Trends

- ◆ If current trends continue, Mainland Chinese real GDP will approach the level of U.S. real GDP in approximately 15 years' time--around 2025, at which time Mainland Chinese real GDP will exceed US\$20 trillion (in 2010 prices) and Mainland Chinese real GDP per capita will exceed US\$ 14,000.
- ◆ By that time, 2025, the Mainland and the U.S. will each account for approximately 15% of World GDP.

Actual and Projected Mainland Chinese and U.S. Real GDP (trillion 2010 US\$)

Actual and Projected Real GDP of China and the U.S., in 2010 prices

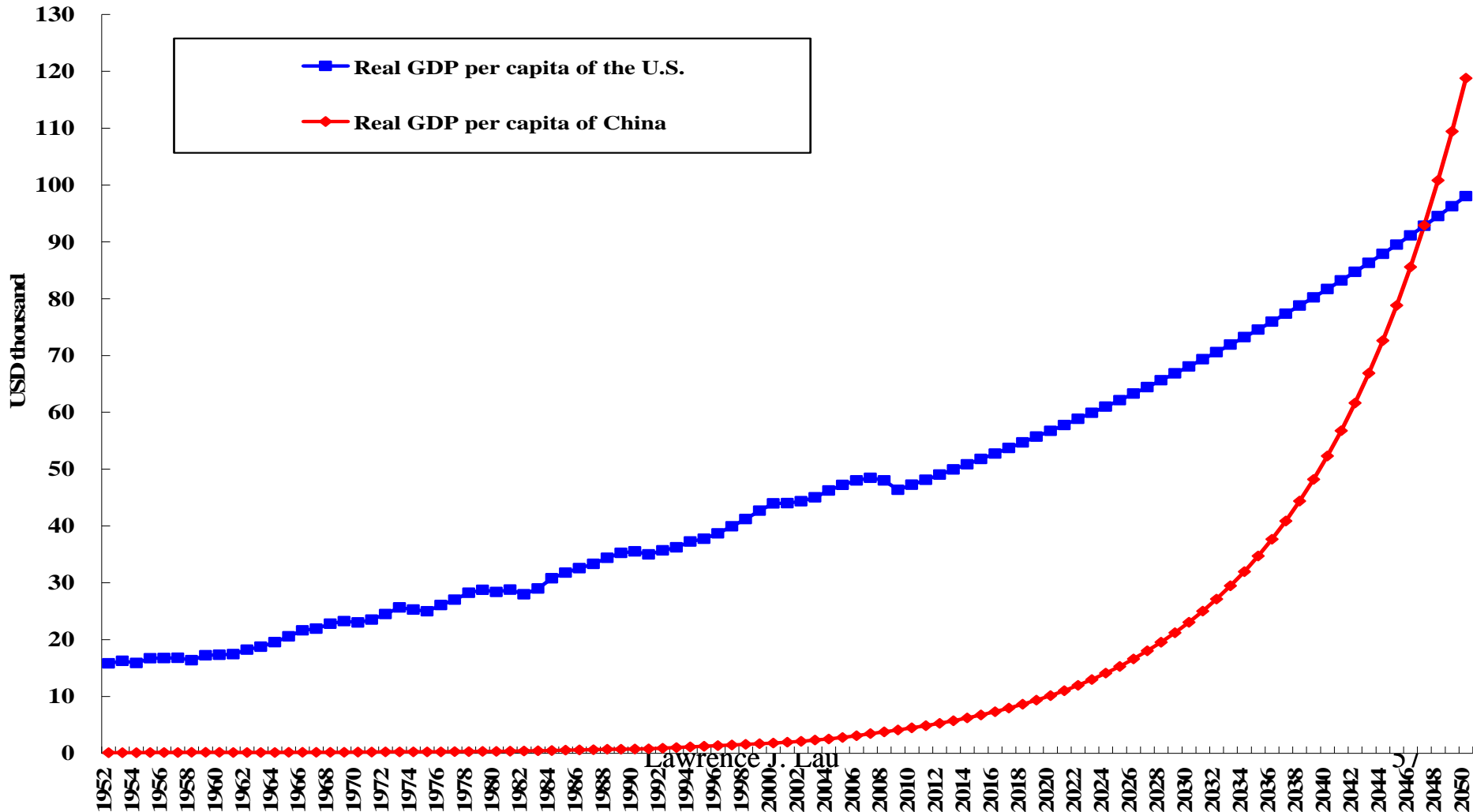


Future Trends

- ◆ It will take another 20-25 years, between 2045 and 2050, before the Mainland reaches the same level of real GDP per capita as the United States, at US\$90,000 in 2010 prices (bear in mind that in the meantime, the U.S. economy will also continue to grow, albeit at rates significantly lower than those of the Mainland Chinese economy and that the Mainland Chinese population will reach a peak around 2035 and then begin to decline slowly).
- ◆ By that time, Mainland Chinese GDP will be approximately 6 times the U.S. GDP, and will account for between a third and a half of World GDP (depending on the growth rates of other economies, especially the developing economies of today).

Actual and Projected Mainland Chinese and U.S. Real GDP per Capita (2010 US\$)

Actual and Projected Real GDP per capita of China and the U.S., in 2010 prices



Concluding Remarks

- ◆ Hong Kong was indispensable to the initial success of the Mainland's economic reform and opening to the World.
- ◆ However, with the success of the Mainland economy, the fate of the Hong Kong economy is now inextricably intertwined with that of the Mainland. The Mainland is now critically important to the Hong Kong economy. If the Mainland economy prospers, the Hong Kong economy will prosper. If the Mainland economy slows, the Hong Kong economy will slow.

Concluding Remarks

- ◆ It is because of the strength of the Mainland economy that Hong Kong has been able to survive the 2007-2009 global financial crisis relatively unscathed as well as the earlier East Asian currency crisis in 1997-1998.
- ◆ The “Individual Visit Scheme” has been instrumental in lowering the unemployment rate of Hong Kong down to its current 3.6%.
- ◆ Hong Kong must try to take full advantage of its Mainland opportunities so that its economy can continue to grow, especially given that the United States and European economies remain mired in recession and unlikely to resume normal growth any time soon.