

The Economic Relationship between the Mainland and Hong Kong

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

Introduction

- ◆ The most important development in the global economy during the last three and a half decades is the opening of the Chinese economy and its participation in the World.
- ◆ As a result, the centre of gravity of the World economy, in terms of both GDP and international trade, has been shifting gradually from North America and Western Europe to East Asia, and within East Asia from Japan to China.

Introduction

- ◆ Mainland China has made tremendous progress in its economic development since it began its economic reform and opened to the World in 1978.
- ◆ Mainland China has become the second largest economy by GDP as well as the second largest trading nation by value of total trade in goods and services in the World.

Introduction

- ◆ The Mainland Chinese economy has also been growing and continues to grow at much higher rates than North American and European economies and Japan.
- ◆ Mainland China, with a saving rate in excess of 40%, is a potential large foreign direct and portfolio investor to the rest of the World.

An Overview of the Mainland Chinese Economy

- ◆ The Mainland of China is one of the very few socialist economies that have made a smooth and successful transition from a centrally planned economic system to a market economic system without a massive decline in their real GDPs, as were the cases of the former Soviet Union and the formerly socialist countries of Eastern Europe.
- ◆ It is a model for other transition economies such as Vietnam and potential transition economies such as Cuba, Laos and North Korea.

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.
- ◆ The pure appreciation in value of an asset, such as a piece of unimproved land, a security, or an antique, is not considered an addition to GDP as no new goods are produced and no new services are performed (and as a result no new direct employment is generated).

An Overview of the Mainland Chinese Economy

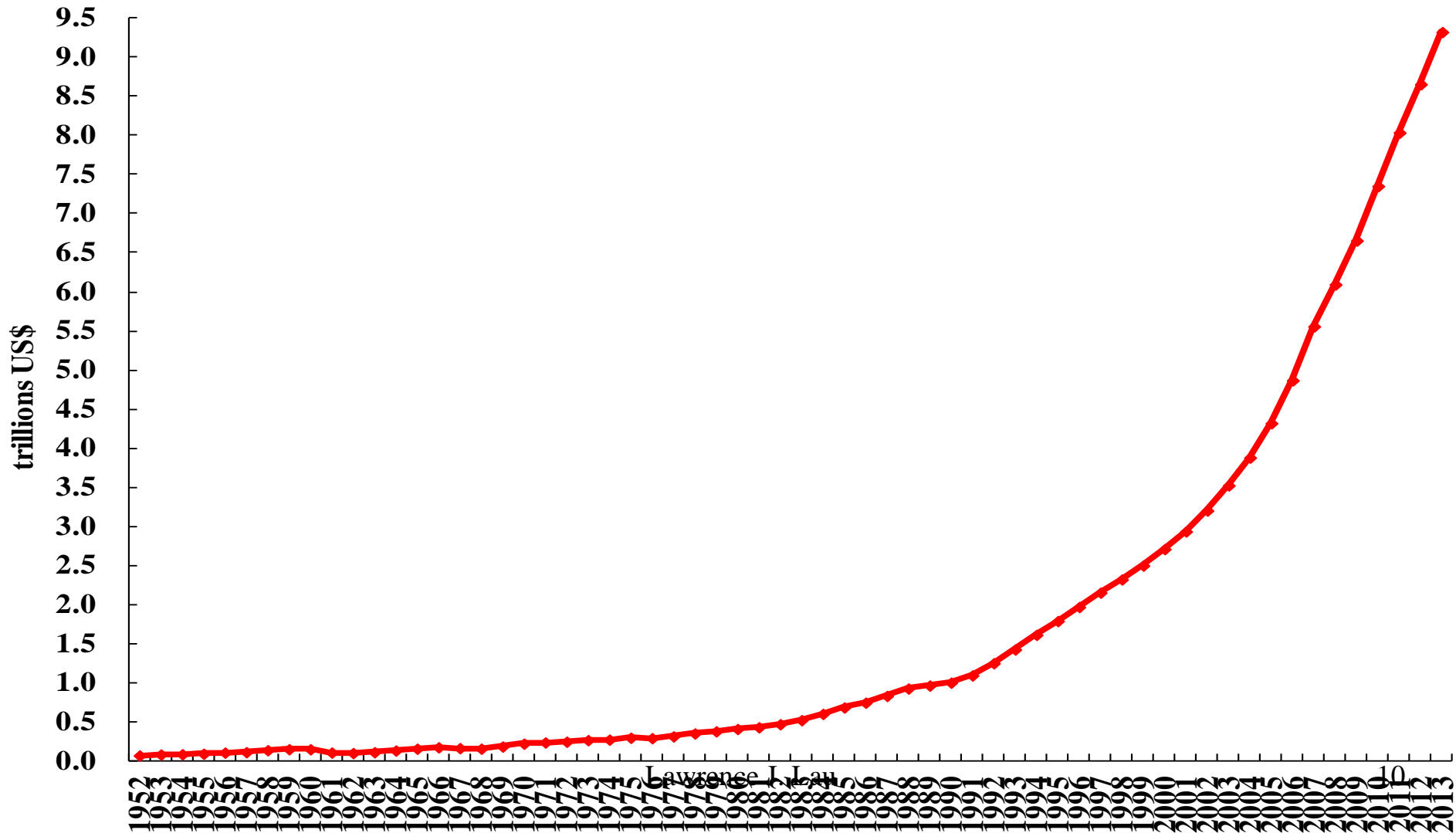
- ◆ **Real GDP** is a concept used to compare the values of GDP at different points of time that are net of the effects of the changes in the prices of goods and services. A change in the nominal value of GDP due solely to changes in prices is not “real” because in real terms no more goods and services have been produced.
- ◆ 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.
- ◆ Comparison of real GDPs across economies can be done by converting the real GDPs at the market exchange rates at one point in time.

An Overview of the Mainland Chinese Economy

- ◆ The Mainland is currently the fastest growing economy in the World—averaging 9.8% per annum over the past 36 years (1978-2013). It is historically unprecedented for an economy to grow at such a high rate over such a long period of time.
- ◆ Between 1978 and 2013, Chinese real GDP grew more than 26 times, from US\$357 billion to nearly US\$9.32 trillion (2013 prices), to become the second largest economy in the World, after the U.S.
- ◆ By comparison, the U.S. GDP (approx. US\$16.8 trillion) was slightly less than 2 times Chinese GDP in 2013.
- ◆ Hong Kong GDP in 2013 was only US\$274 billion, or 2.9% of the Mainland GDP.

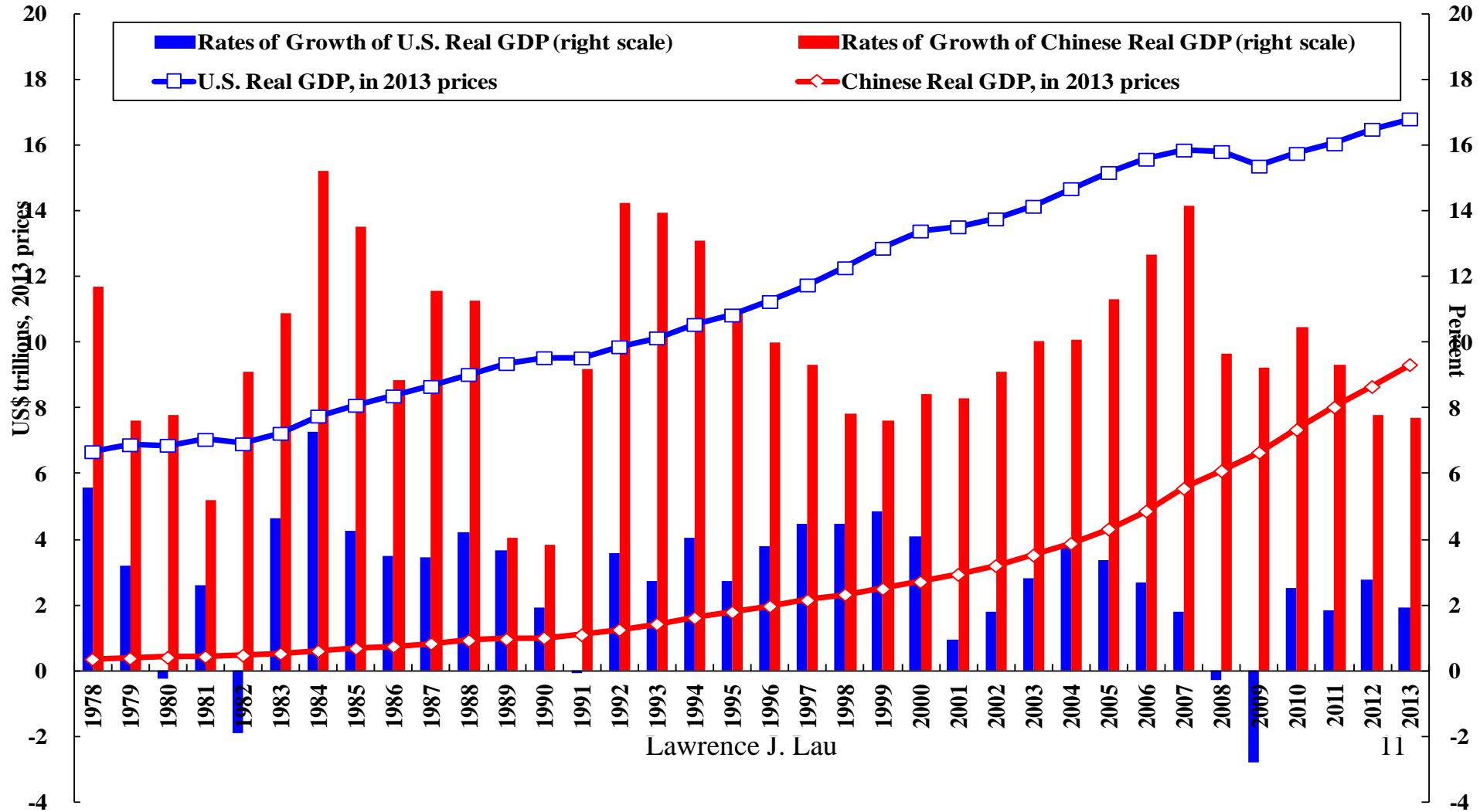
Chinese Real GDP in US\$ Since 1952 (2013 Prices)

Chinese Real GDP since 1952, in 2013 prices



Real GDPs and Their Annual Rates of Growth: China & the U.S. (2013 US\$)

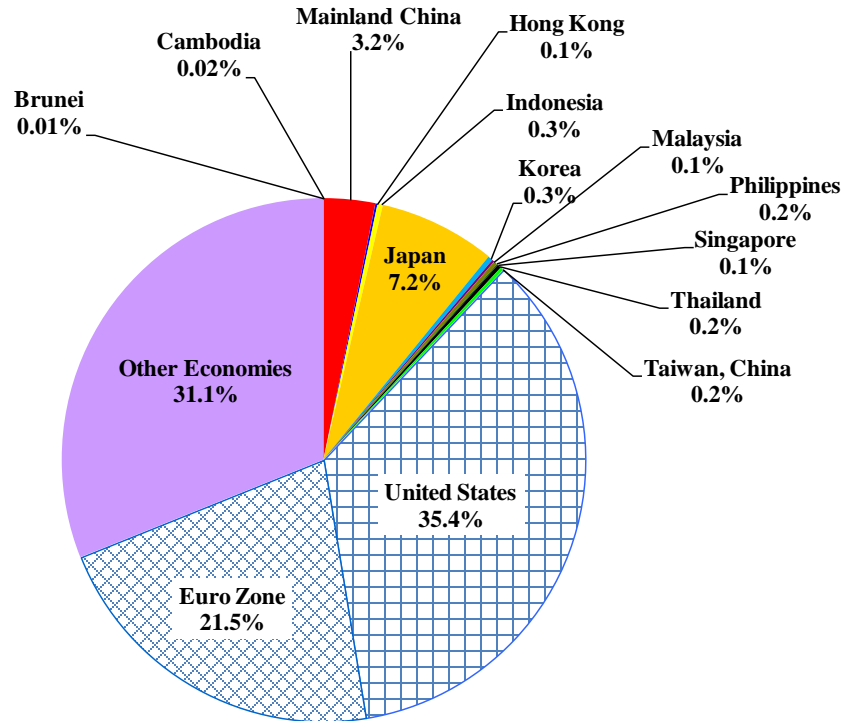
The Real GDP and Its Annual Rates of Growth of China and the U.S.
(trillion 2013 US\$)



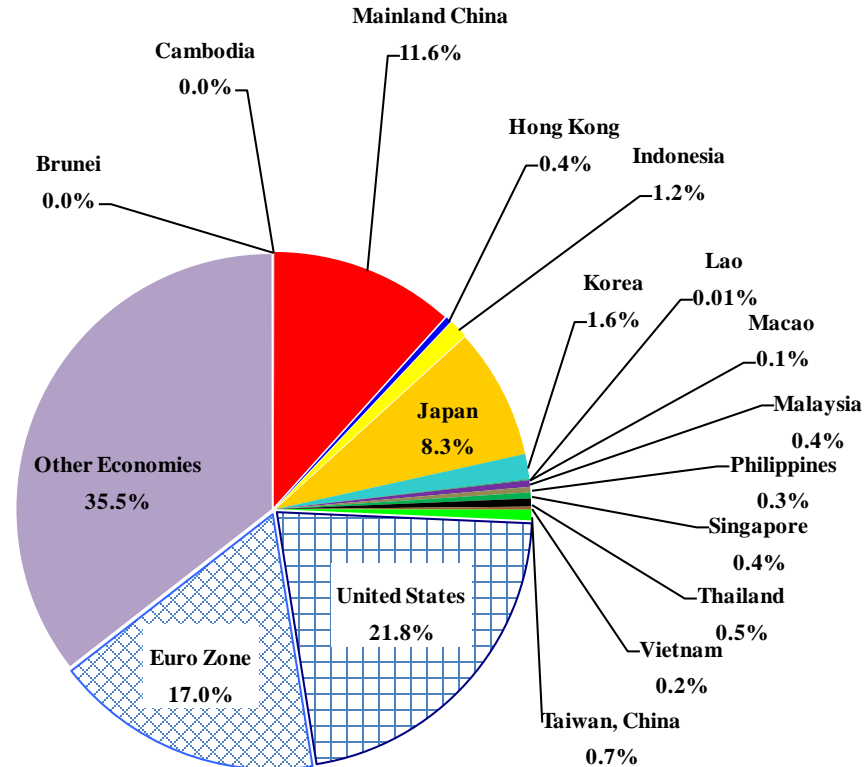
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The Distribution of World GDP, 1970 and 2012, US\$

The Distribution of World GDP in 1970

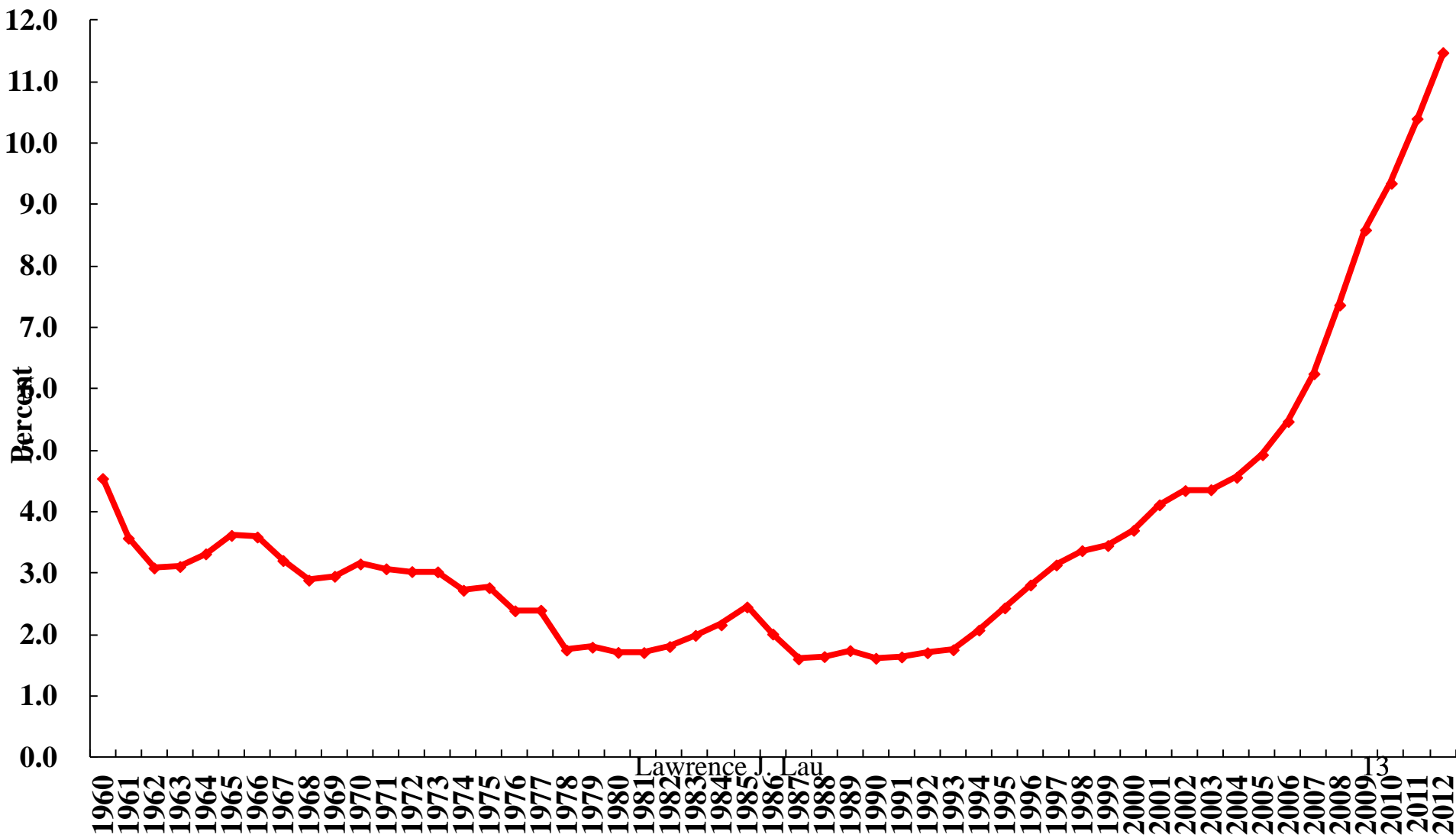


The Distribution of World GDP in 2012



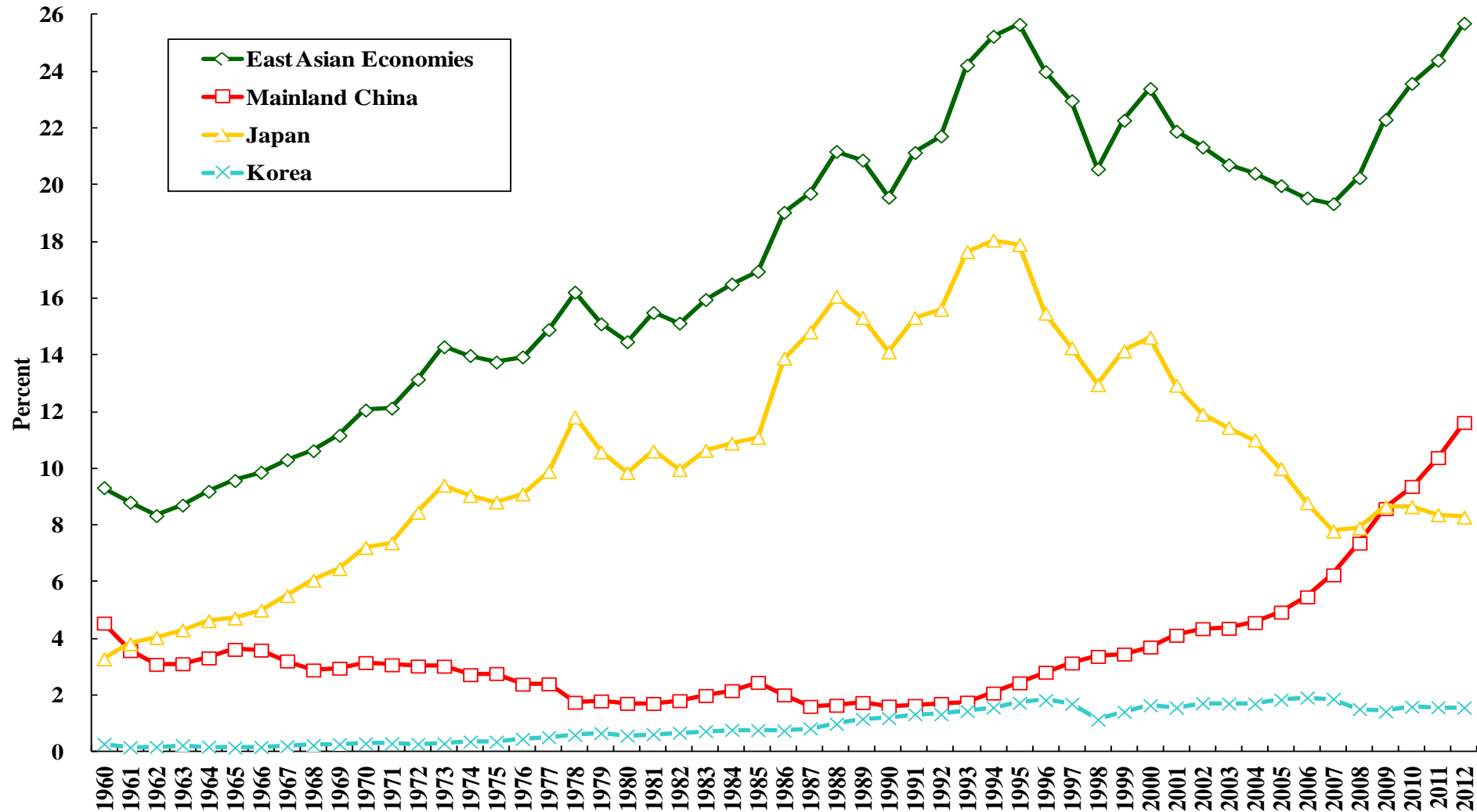
Mainland China's Share of World GDP, current prices, 1960-present

China's GDP as a Percentage of World GDP, 1960-present



The Shares of East Asia, China, Japan and South Korea in World GDP, 1960-present

The Shares of East Asia, China, Japan and South Korea in World GDP, 1960-present

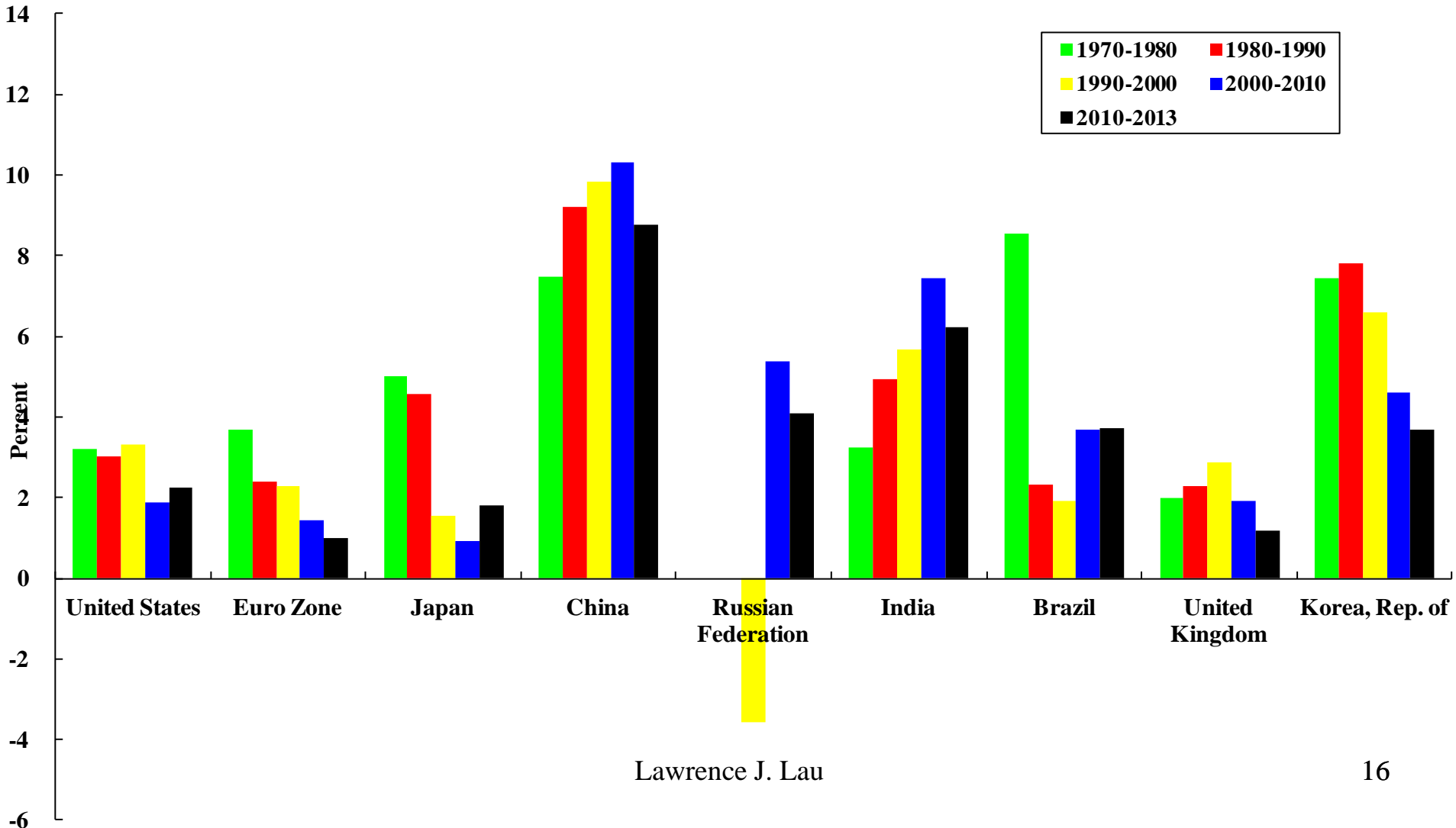


An Overview of the Mainland Chinese Economy: Economic Growth

- ◆ China, India and South Korea are among the fastest growing economies during the past four decades.
- ◆ Russia grew at a very high rate during the past decade because of its significant oil production and high oil prices but has begun to slow down.
- ◆ Brazil also grew very fast during the past decade because of the world natural resource boom but has also begun to slow down.
- ◆ However, all the developed economies—the U.S., Euro Zone, Japan, and the U.K.—had relatively low and declining growth rates during the past decades. Even though there are now early signs of a steady economic recovery, the rates of growth have remained low by the historical standards of these economies.

Average Annual Rates of Growth of Real GDP of Selected Economies

Average Annual Rates of Growth of Real GDP of Selected Economies

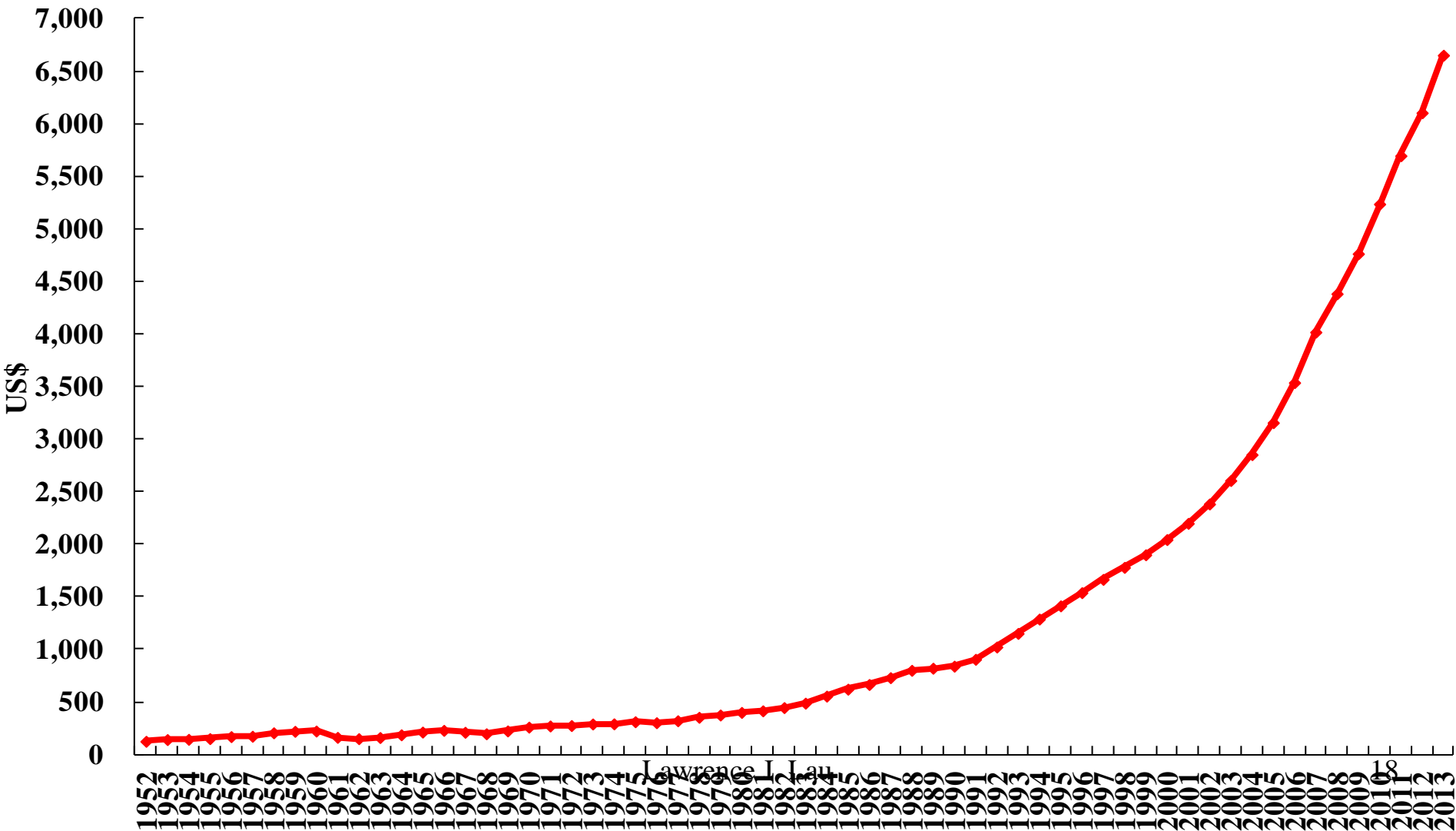


An Overview of the Mainland Chinese Economy: GDP per Capita

- ◆ Despite its rapid growth, in terms of its real GDP per capita, Mainland China is still a developing economy.
- ◆ Between 1978 and 2013, Chinese real GDP per capita grew 18.5 times, from US\$371 to US\$6,850.5 (in 2013 prices).
- ◆ By comparison, the U.S. GDP per capita of approximately US\$53,069 was 7.7 times Chinese GDP per capita in 2013.
- ◆ Hong Kong GDP per capita in 2013 was US\$38,086, or 5.6 times the Mainland GDP per capita.
- ◆ Mainland GDP per capita ranks below the 90th among all countries in the World.

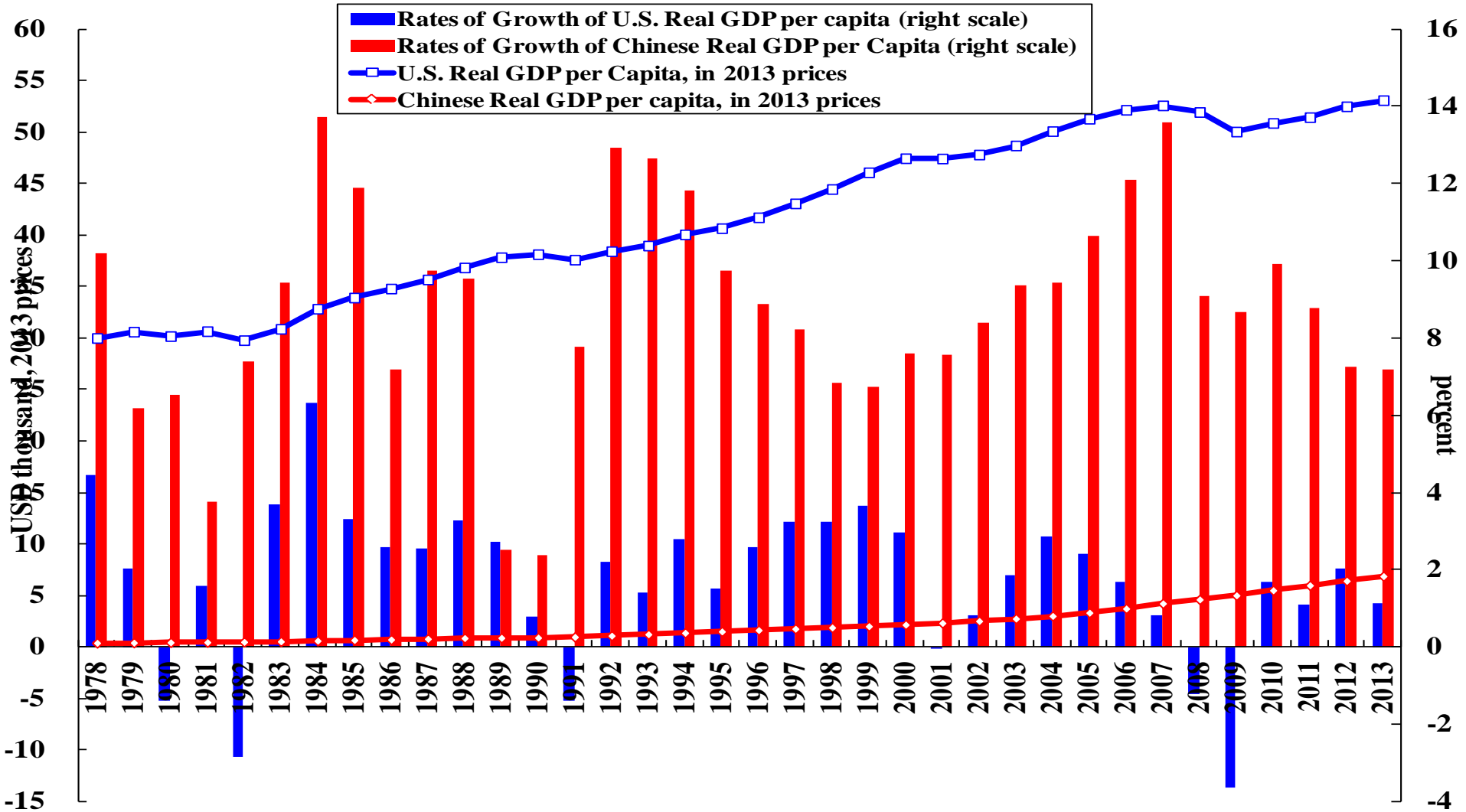
Real Chinese GDP per Capita in US\$ Since 1952 (2013 Prices)

Real Chinese GDP per Capita since 1952, in 2013 prices



Real Chinese and U.S. GDP per Capita in US\$ Since 1978 (2013 Prices)

Real GDP per Capita and their Annual Rates of Growth of China and the U.S.,
(thousand, 2013 US\$)



An Overview of the Mainland Chinese Economy: International Trade

- ◆ Chinese international trade has grown very rapidly, especially after it acceded to the World Trade Organisation (WTO) in 2001.
- ◆ China has also grown into the second largest trading nation in the World in terms of the total value of international trade in goods and services (US\$4.61 trillion in 2013), just after the U.S. (US\$5.02 trillion).
- ◆ While China is the largest exporting nation in terms of goods and services (US\$ 2.425 trillion in 2013), followed by the U.S. (US\$2.271 trillion), the U.S. is the largest importing nation in terms of goods and services (US\$2.75 trillion), followed by China (US\$2.19 trillion). China is also the largest exporting nation in terms of goods alone, followed by the U.S. The U.S. is the largest exporting as well as importing nation in terms of services, followed by respectively the United Kingdom and Germany.

International Trade & Its Rate of Growth: A Comparison of China and the U.S.

The Value of International Trade and Its Rate of Growth:
A Comparison of China and the U.S.

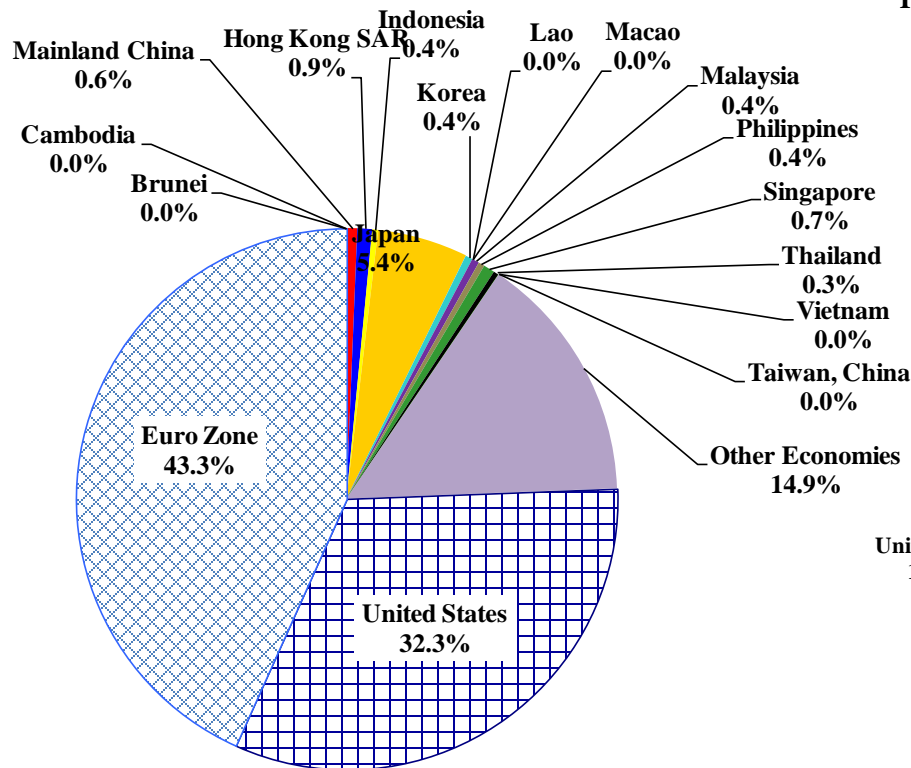


The Chinese Economy in the Global Context: International Trade

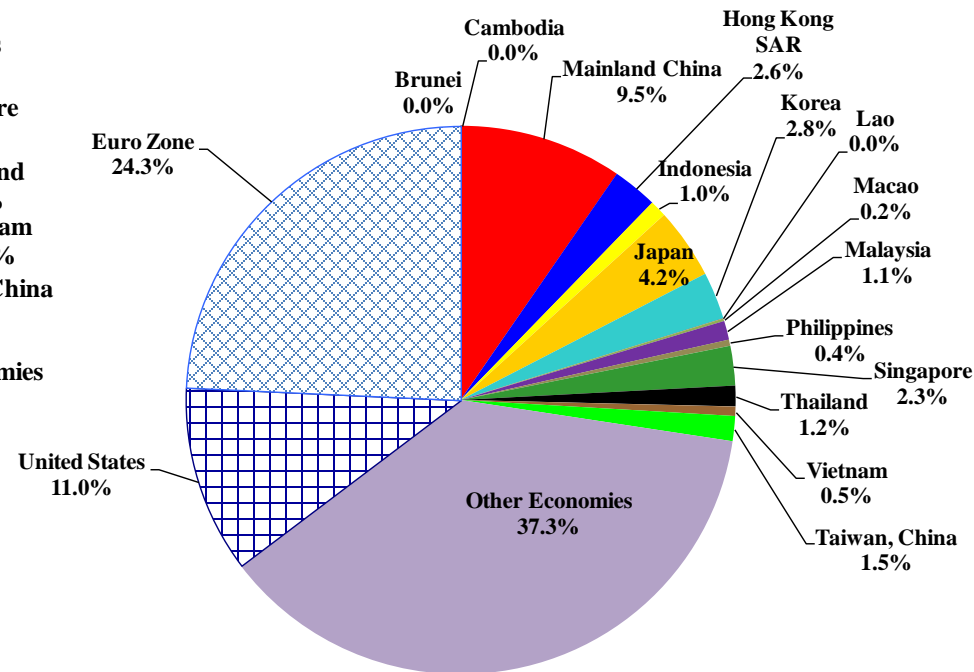
- ◆ In 1970, the United States and Western Europe together accounted for over 60% of World trade. By comparison, East Asia accounted for less than 10% of World trade.
- ◆ In 1990, the United States and Western Europe together still accounted for approximately 55% of World trade while East Asia and South Asia combined accounted for just over 10% of World trade.
- ◆ By 2012, the share of United States and Western Europe in World trade has declined to below 45% whereas the share of East Asia has risen to 30%.
- ◆ The regional distribution of international trade parallels approximately the regional distribution of GDP.

The Distribution of Total International Trade in Goods and Services, 1970 and 2012

The Distribution of Total International Trade in Goods and Services in 1970



The Distribution of Total International Trade in Goods and Services in 2012

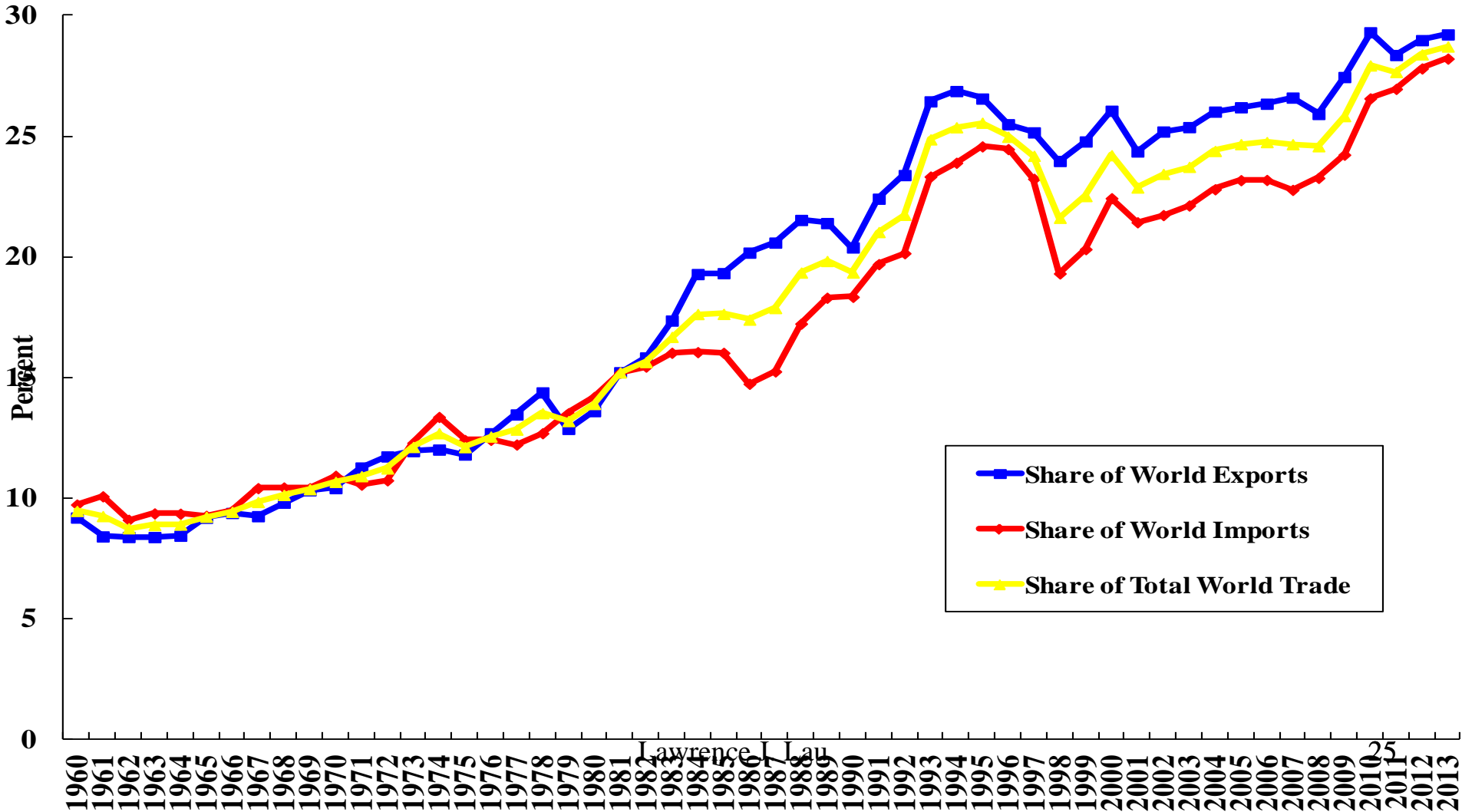


An Overview of the Mainland Chinese Economy: International Trade

- ◆ The East Asian (defined as the 10 Association of Southeast Asian Nations (ASEAN) + 3 (China, Japan and the Republic of Korea) share of World GDP rose from just above 10% in 1970 to 25% in 2012.
- ◆ Similarly, East Asian share of World trade rose from approximately 10% in 1970 to almost 30% in 2013.
- ◆ The Chinese share of World trade rose from 0.7% in 1970 to 11.4% in 2013.
- ◆ Chinese international trade accounted for 39.5% of East Asian international trade in 2013.

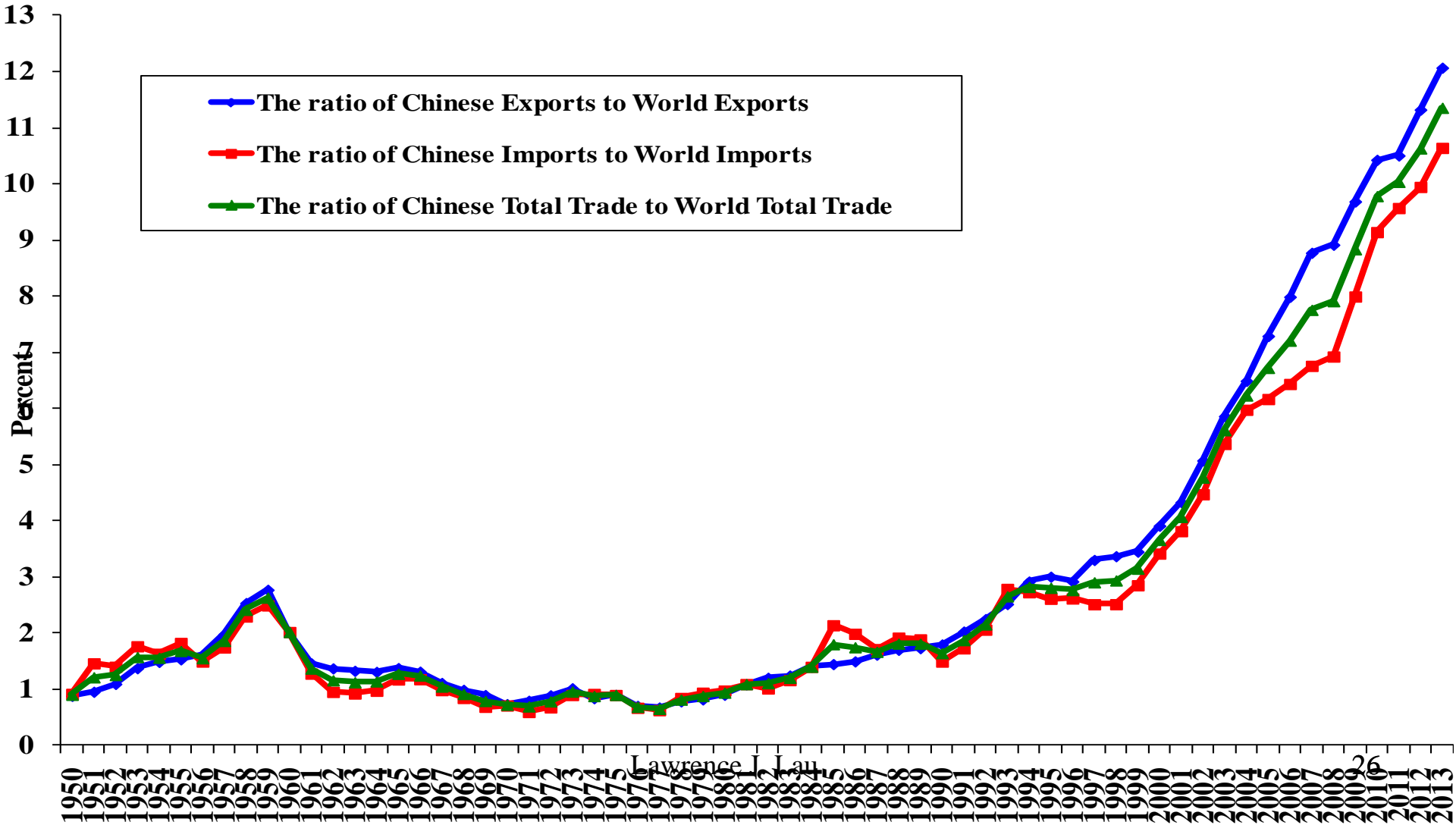
The Rising Share of East Asian Trade in Total World Trade, 1960-present

The Rising Share of East Asian Trade in Total World Trade, 1960-present



The Share of Chinese Trade in Total World Trade, 1950-present

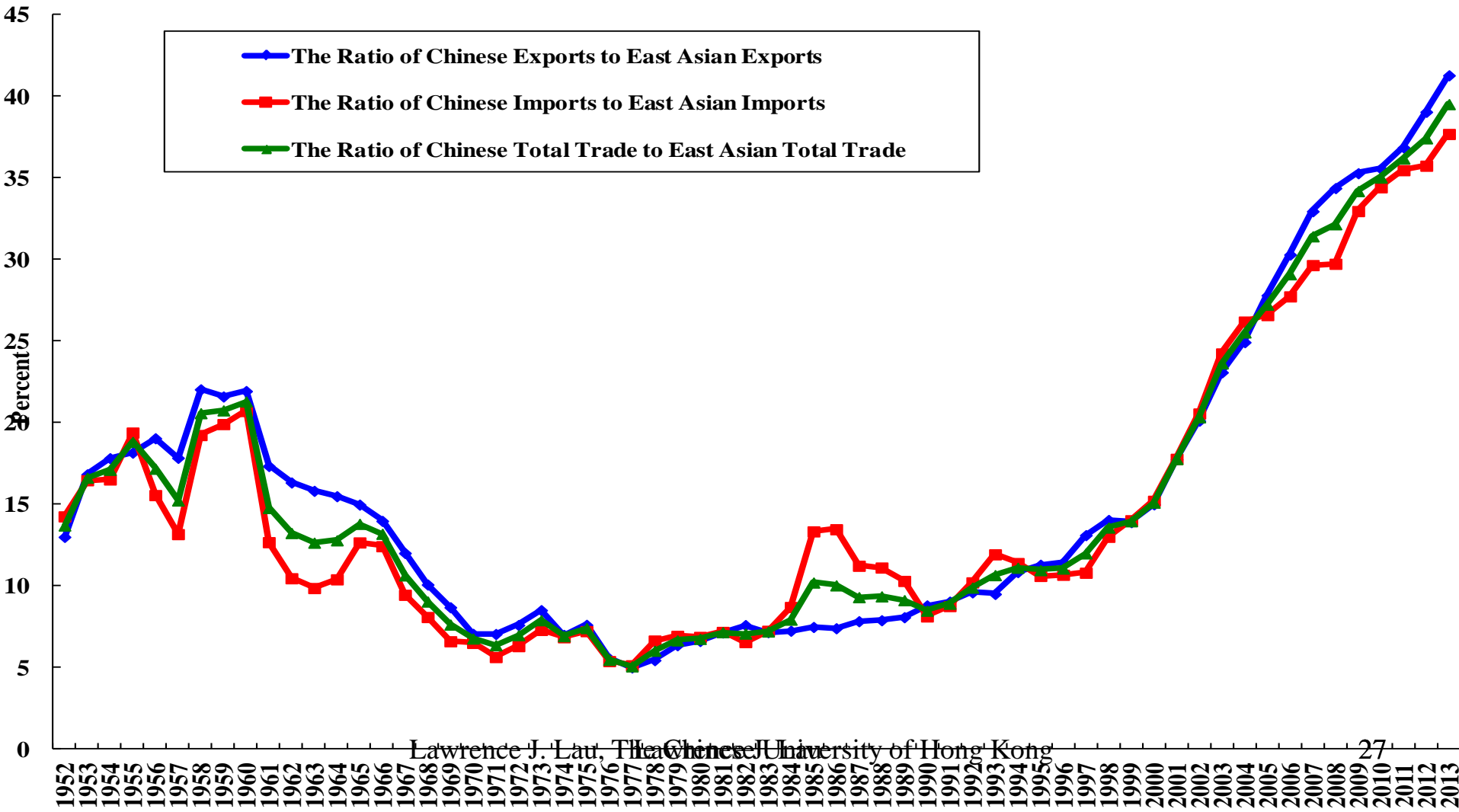
The Share of Chinese Trade in Total World Trade, 1950-present



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The Share of Chinese Trade in Total East Asian Trade, 1952-present

The Share of Chinese Trade in Total East Asian Trade, 1952-present

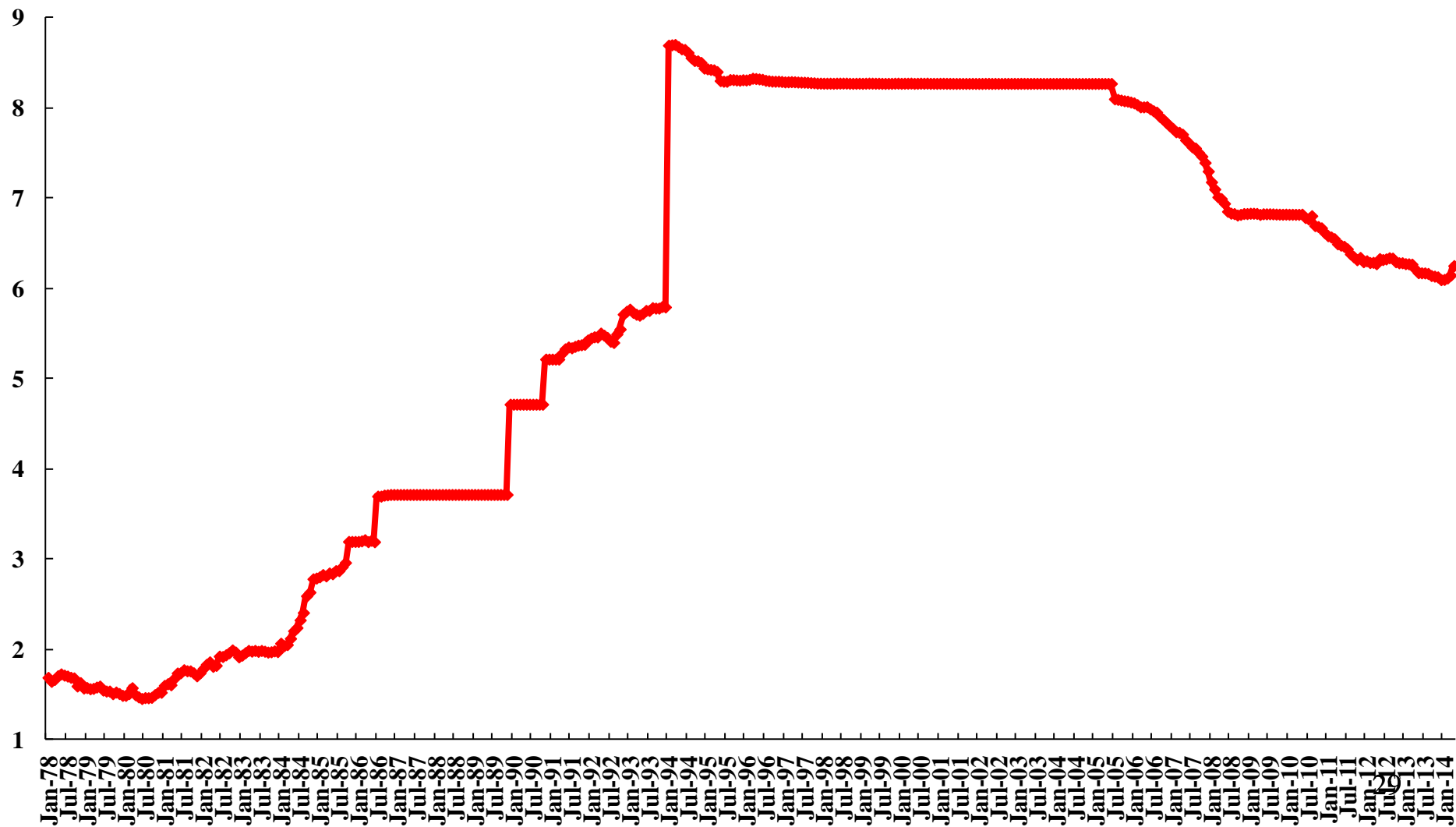


An Overview of the Mainland Chinese Economy: The Renminbi

- ◆ The Renminbi was over-valued in 1978. (For quite a few years, Mainland China maintained dual exchange rates and foreign visitors used “Foreign Exchange Certificates” rather than Renminbi.) It devalued continuously until 1994.
- ◆ The dual exchange rates were unified in 1994 when the Renminbi became current-accounts convertible, that is, exporters are free to sell their foreign exchange proceeds for Renminbi and importers are free to purchase foreign exchange with Renminbi to pay for their imports.
- ◆ Since 1994, the Renminbi has been appreciating with respect to the U.S. Dollar, from 8.7 Yuan/US\$ in 1994 to 6.2 Yuan/US\$ today.

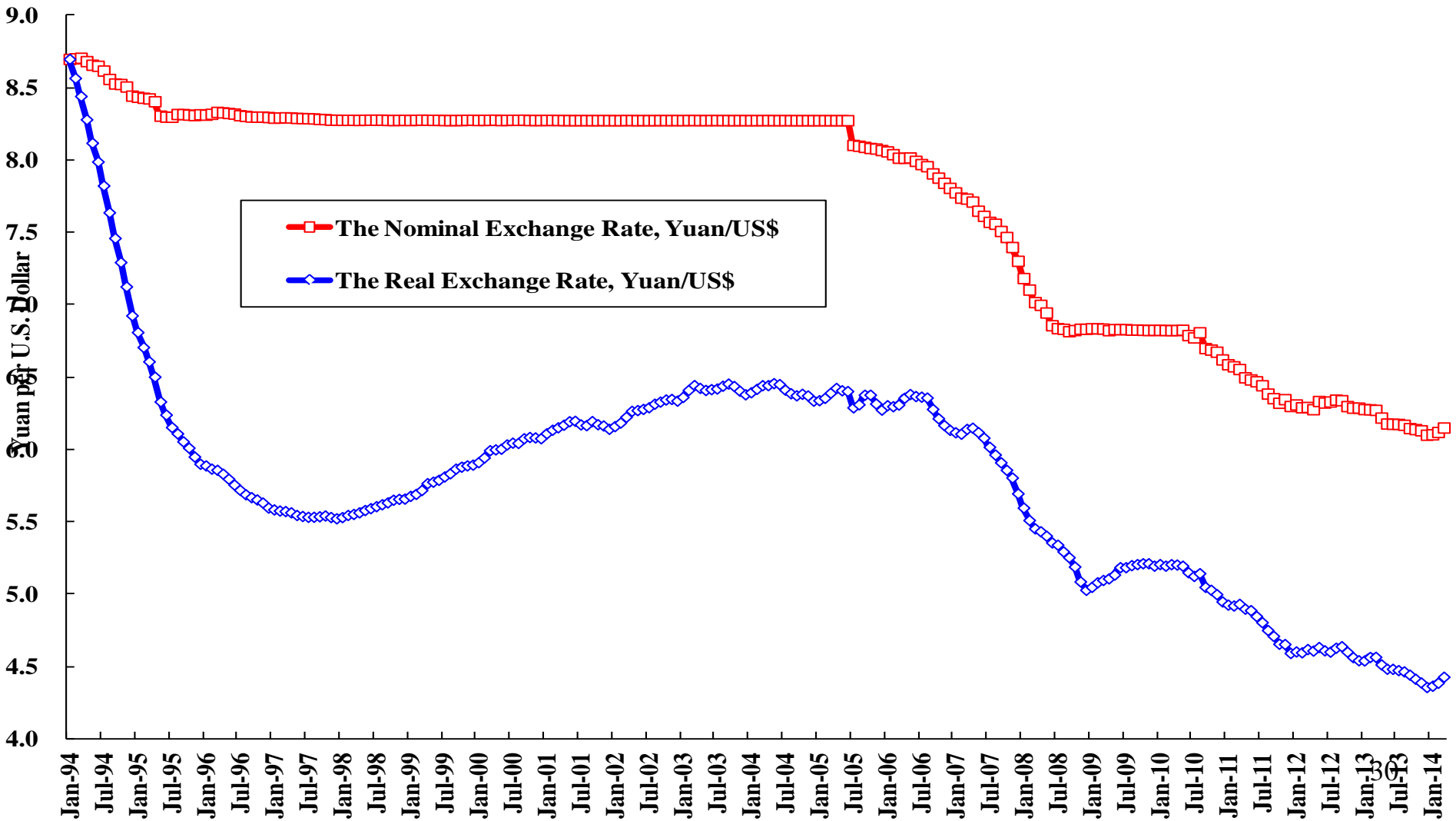
Nominal Exchange Rate of the Renminbi, Yuan/US\$, 1978-present

Nominal Exchange Rate of the Renminbi, Yuan/US\$, 1978-present



The Nominal and Real Yuan/US\$ Exchange Rates (1994 prices)

The Nominal and Real Yuan/US\$ Exchange Rates (1994 prices)



An Overview of the Mainland Chinese Economy

- ◆ While many problems have arisen in the 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 benefitted from the economic reform and opening since 1978, albeit to varying degrees, and few want to return to the central planning days.
- ◆ An estimated 500 million people in Mainland China have been lifted out of poverty during the past 36 years.

An Overview of the Mainland Chinese Economy

- ◆ The Central Government leaders have also amply demonstrated their ability to confront important challenges and solve difficult problems over the past 35 years, surviving various economic and financial crises such as the 1997-1998 East Asian currency crisis, the 2007-2009 global financial crisis, the European sovereign debt crisis and more recently the anticipated tapering and winding down of QEIII.

An Overview of the Mainland Chinese Economy

- ◆ In the following table, the key performance indicators of the Chinese economy before and after the initiation of the economic reform and opening policy in 1978 are compared. It is readily apparent that there has been a huge improvement in every aspect of the economy—rates of growth of GDP, consumption, and international trade, on both an aggregate and per capita basis—except the average rate of inflation, which has become considerably higher in the period since 1978.
- ◆ One important factor for the improvement of the per capita performance indicators is the “one-child policy”, which applies to the 94% Han majority in China, adopted in 1979. This policy is in the process of being relaxed.

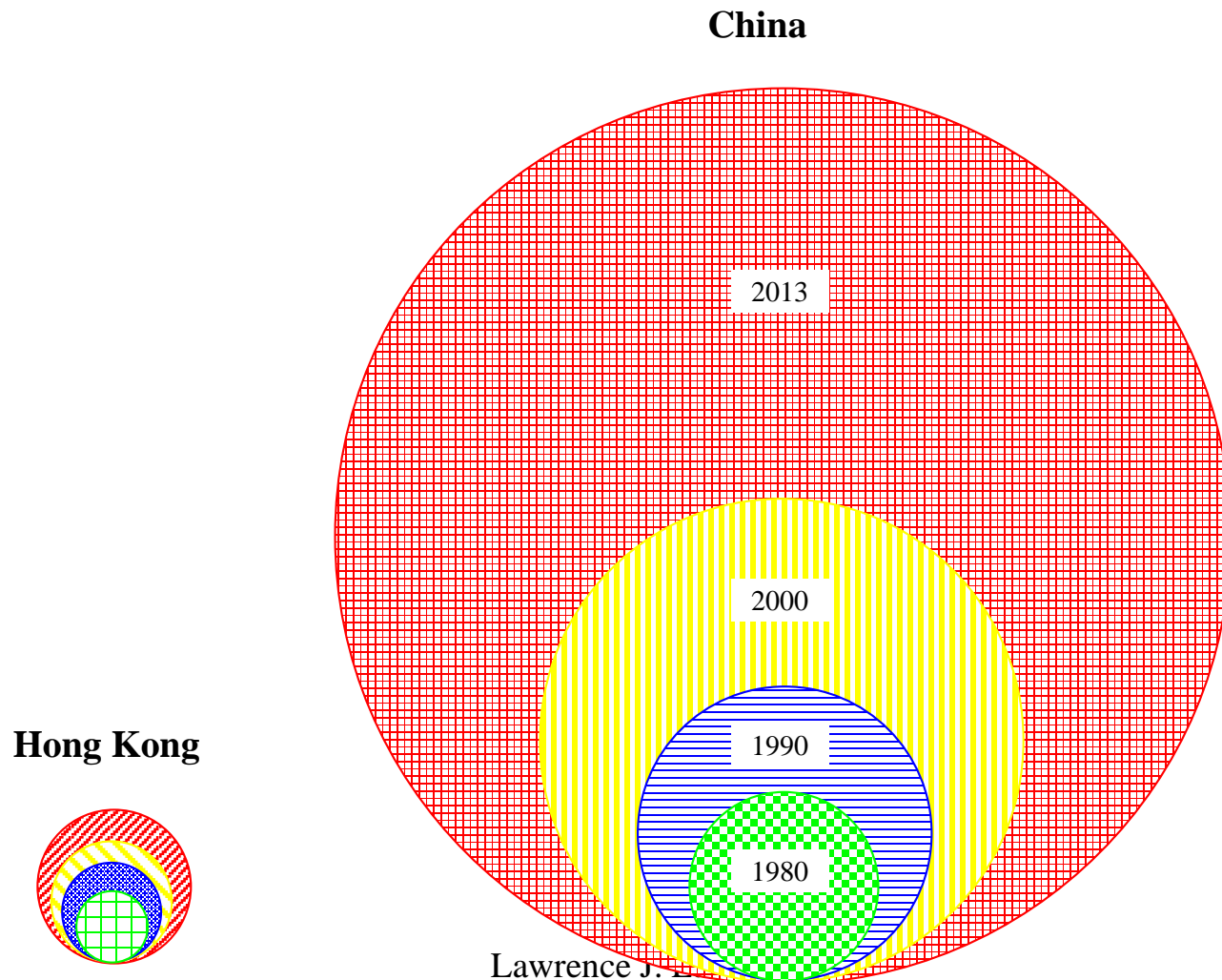
Key Performance Indicators Before and After Chinese Economic Reform

	Growth Rates	
	percent per annum	
	Period I	Period II
	1952-1978	1978-2013
Real GDP	6.15	9.82
Real GDP per Capita	4.06	8.74
Exports	9.99	16.76
Imports	9.14	15.98
Inflation Rates (GDP deflator)	0.50	5.19
	1952-1978	1978-2012
Real Consumption	5.05	9.17
Real Consumption per Capita	2.99	8.08

Comparison of the Economies of Hong Kong and the Mainland

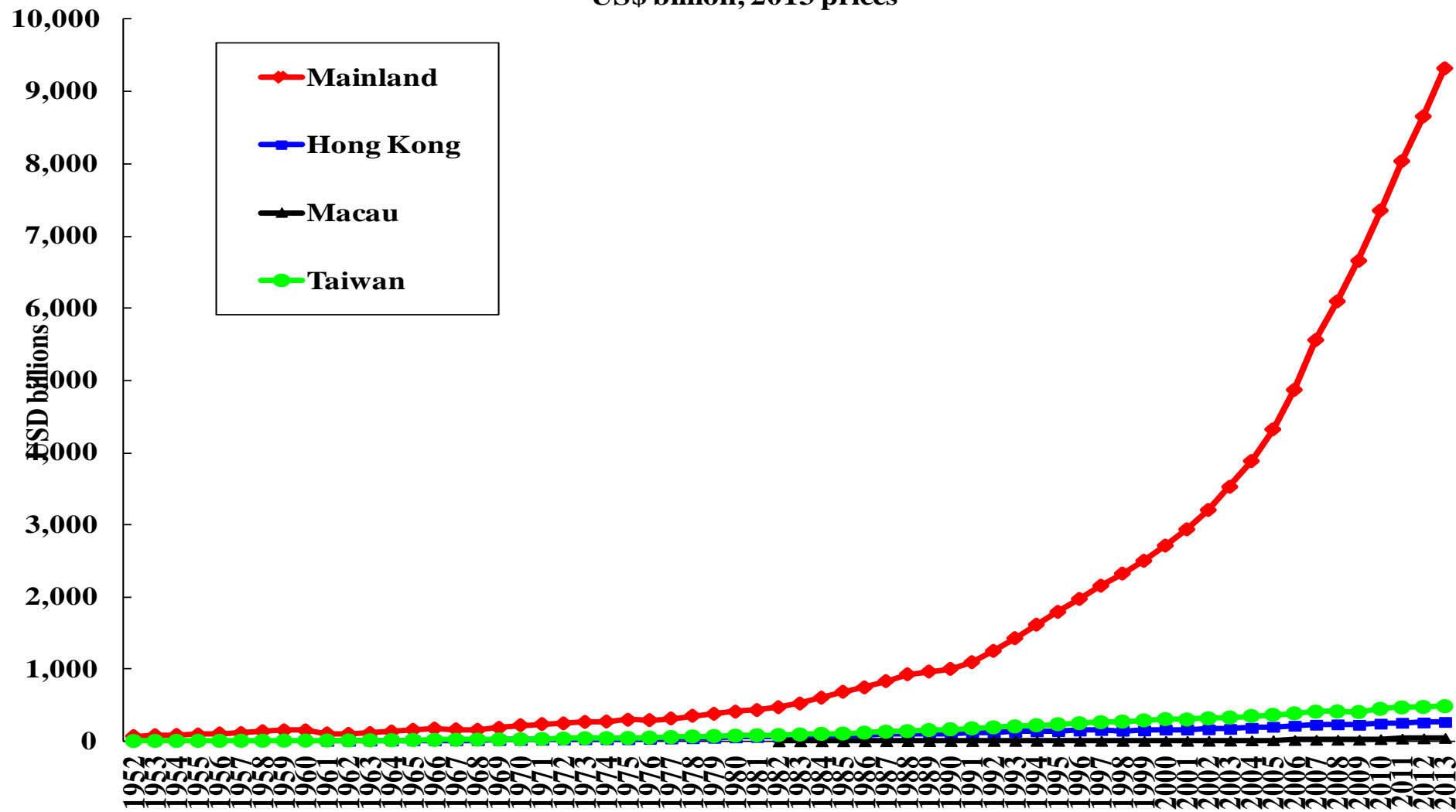
- ◆ It is useful to compare the economies of Hong Kong and the Mainland over time.
- ◆ Huge changes have occurred over the past 30 odd years.
- ◆ In 1980, the real GDP of the Mainland economy is only 7 times that of Hong Kong. Today, it is 34.1 times (US\$9.32 trillion versus US\$274 billion).
- ◆ However, in terms of real GDP per capita, Hong Kong still leads the Mainland at 5.6 times in 2013 (US\$38,086 versus US\$6,851), but the gap has shrunk significantly from 28 times in 1980.

Comparison of the Real GDPs of Mainland and Hong Kong (2013 USD Billions)



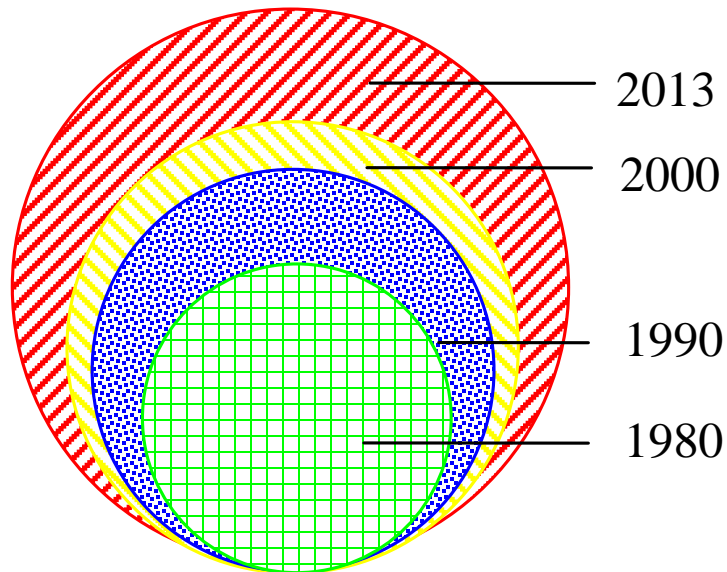
Comparison of the Real GDPs of Four Regions (2013 US\$)

Comparison of the Real GDPs of Four Regions in the Greater Chinese Economy
US\$ billion, 2013 prices

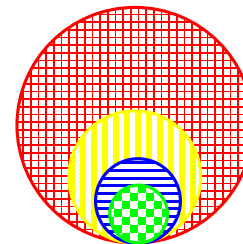


Comparison of the Real GDP per Capita's of Mainland and Hong Kong (2013 US\$)

Hong Kong

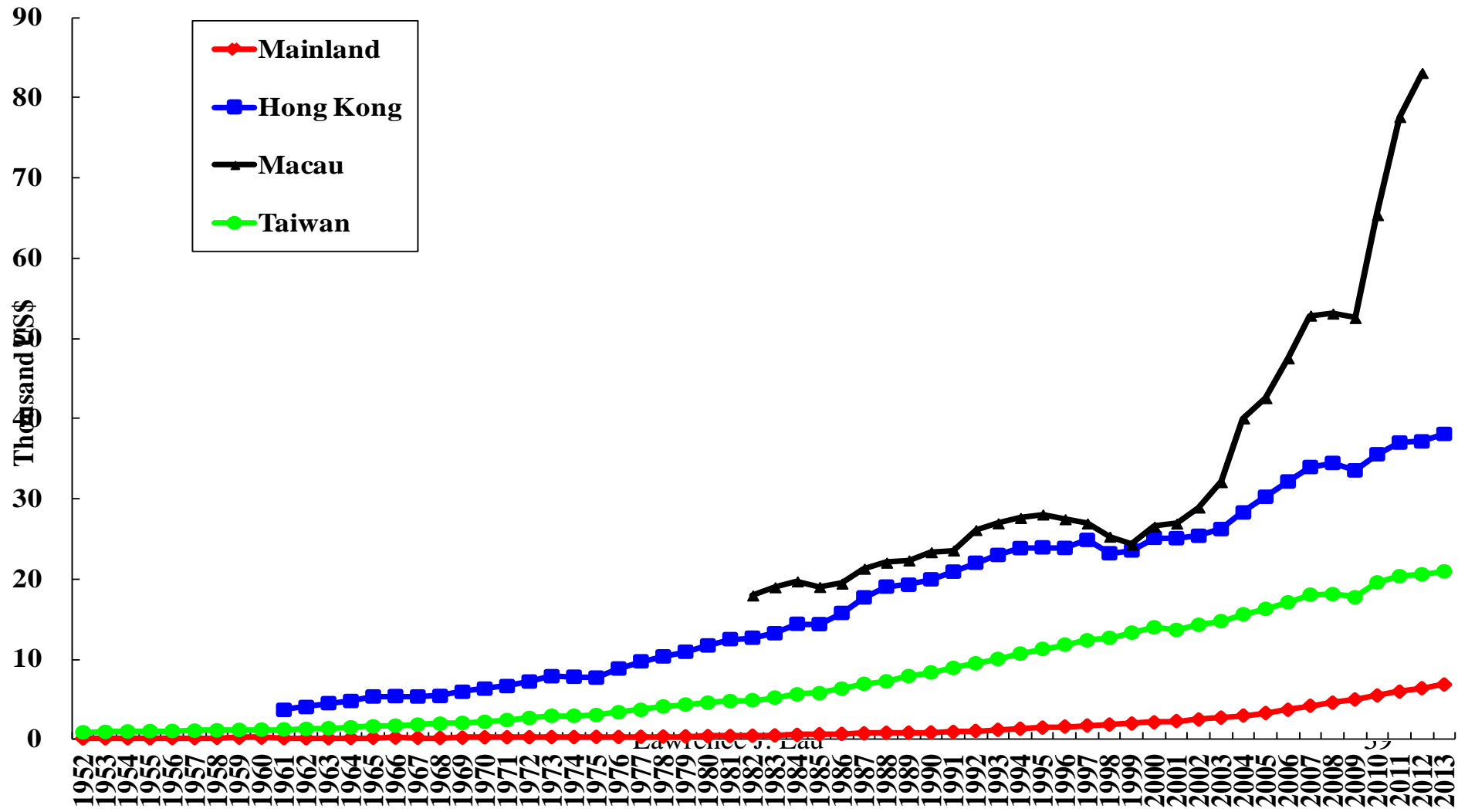


China



Comparison of the Real GDP-per-Capita's of Four Regions (2013 US\$)

Comparison of the Real GDP-per-Capita's of Four Regions in the Greater Chinese Economy
US\$ thousand, 2013 prices

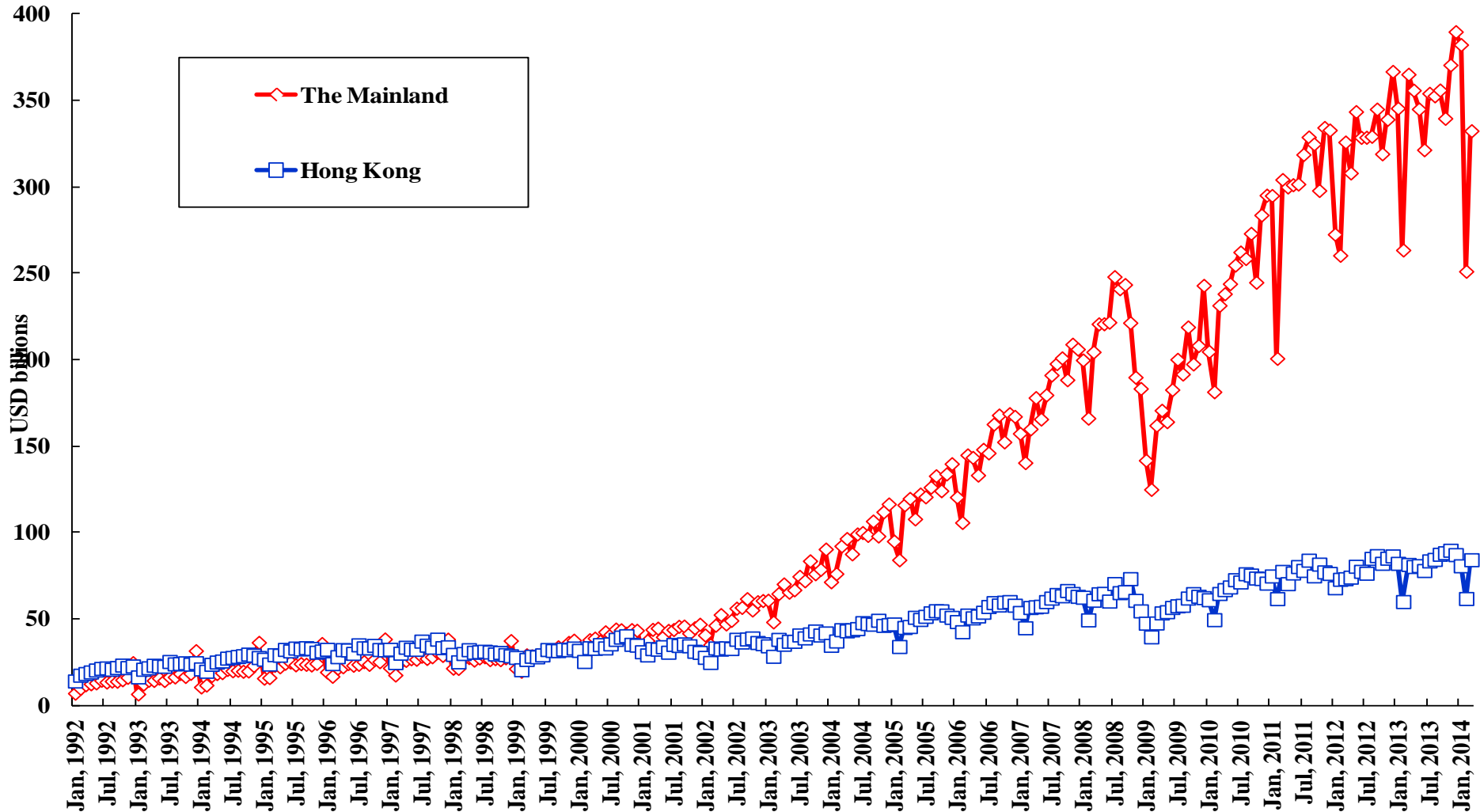


Comparison of the Economies of Hong Kong and the Mainland

- ◆ In terms of international trade, the Mainland, which started out at a very low level in 1978, reached approximately the same level as Hong Kong in the early 1990s . This is because the bulk of the Mainland international trade, whether exports or imports, was trans-shipped through Hong Kong. Hong Kong's domestic exports and imports, by comparison, were quite low.
- ◆ However, since the Mainland acceded to the World Trade Organisation (WTO) in 2000, direct Mainland international trade grew rapidly and total Mainland trade is now approximately 4 times as large as Hong Kong's.

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

Total International Trade of the Mainland and Hong Kong

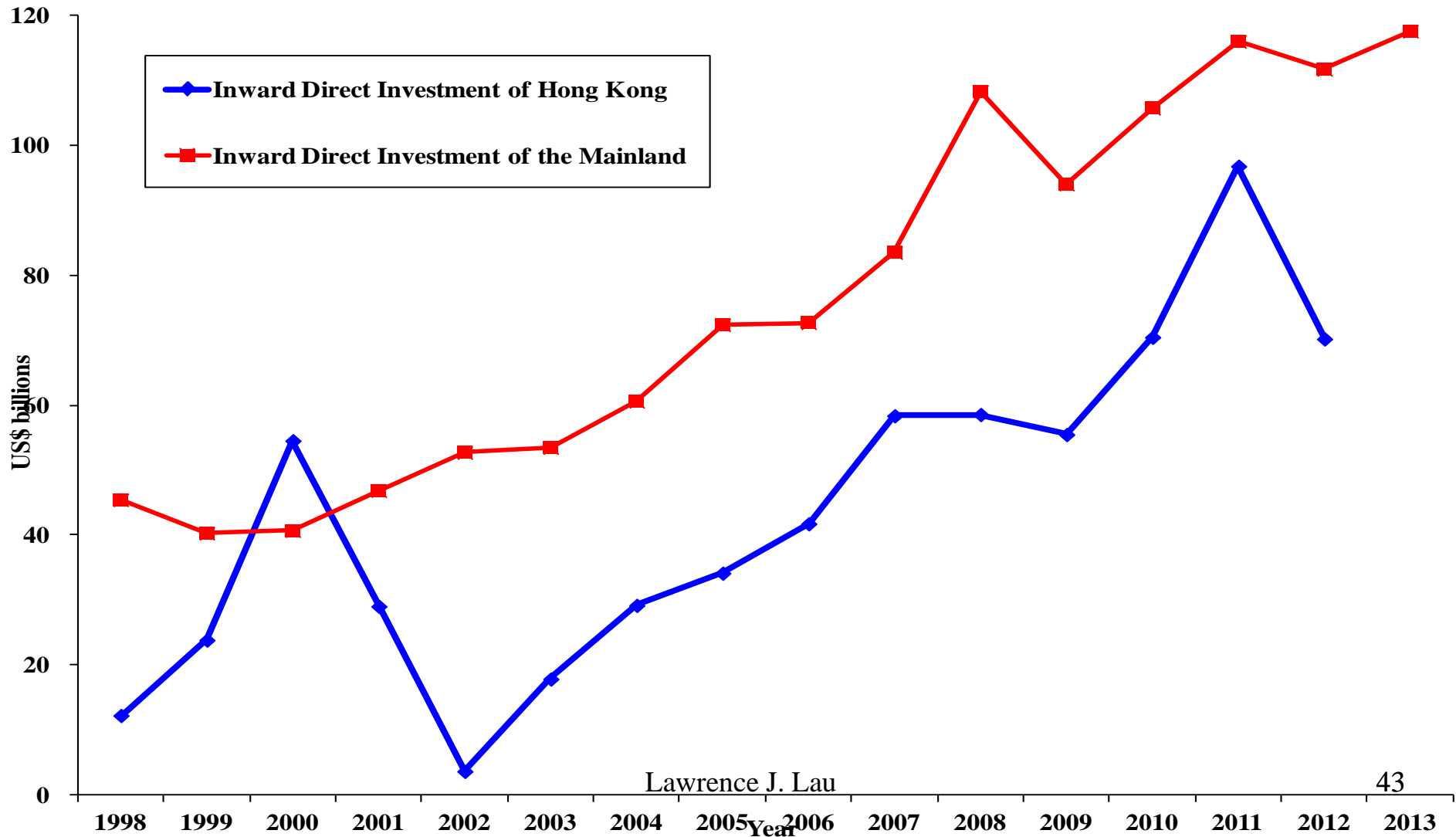


Comparison of the Economies of Hong Kong and the Mainland

- ◆ 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 in 1978.

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: International Trade

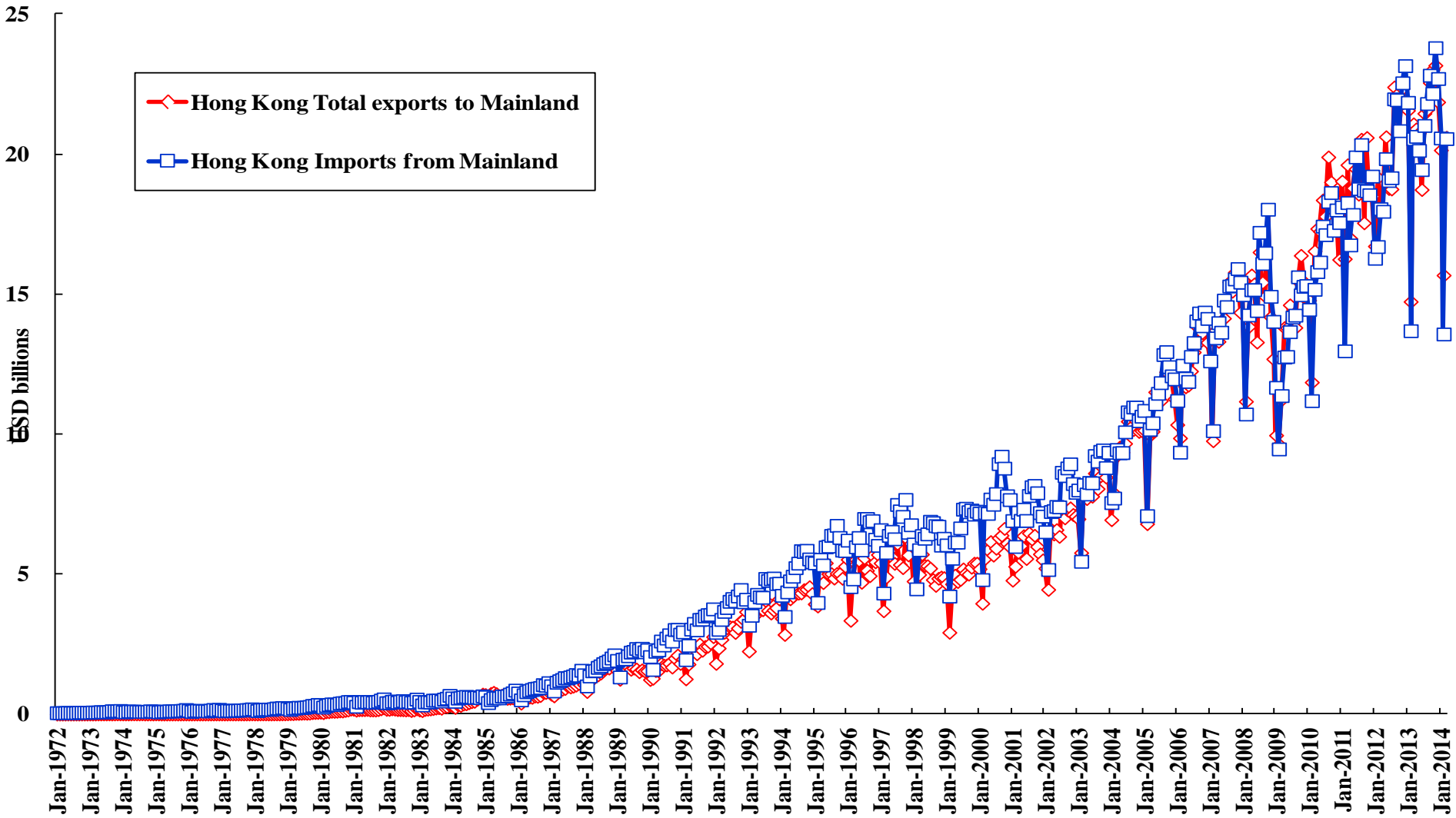
- ◆ Hong Kong was effectively the only gateway to the Mainland for international trade and direct investment when China began its economic reform and opened to the World in 1978.
- ◆ Most of the early international trade between the Mainland and the rest of the World was routed through Hong Kong. Hong Kong provided the financing, logistics and port facilities for the trade. Later on, the Mainland developed its own facilities at Shanghai, Shenzhen and other ports.
- ◆ Trade between Hong Kong and the Mainland has grown rapidly since 1978, with most of it being re-exports from and to the Mainland. Re-exports still constitute the major proportion of total Hong Kong exports today.

Mainland-Hong Kong Economic Interactions: International Trade

- ◆ 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, accounting for respectively 54.8% and 47.8% in 2013.
- ◆ Since 2008, the Mainland has become even more important to the Hong Kong economy because of the economic problems in the United States and Europe.
- ◆ The advances in information and communication technology and globalisation have also meant that all jobs that can be moved away to a lower-cost location will be moved away. This has happened to the U.S., Japan, Taiwan, Hong Kong and even the Mainland.

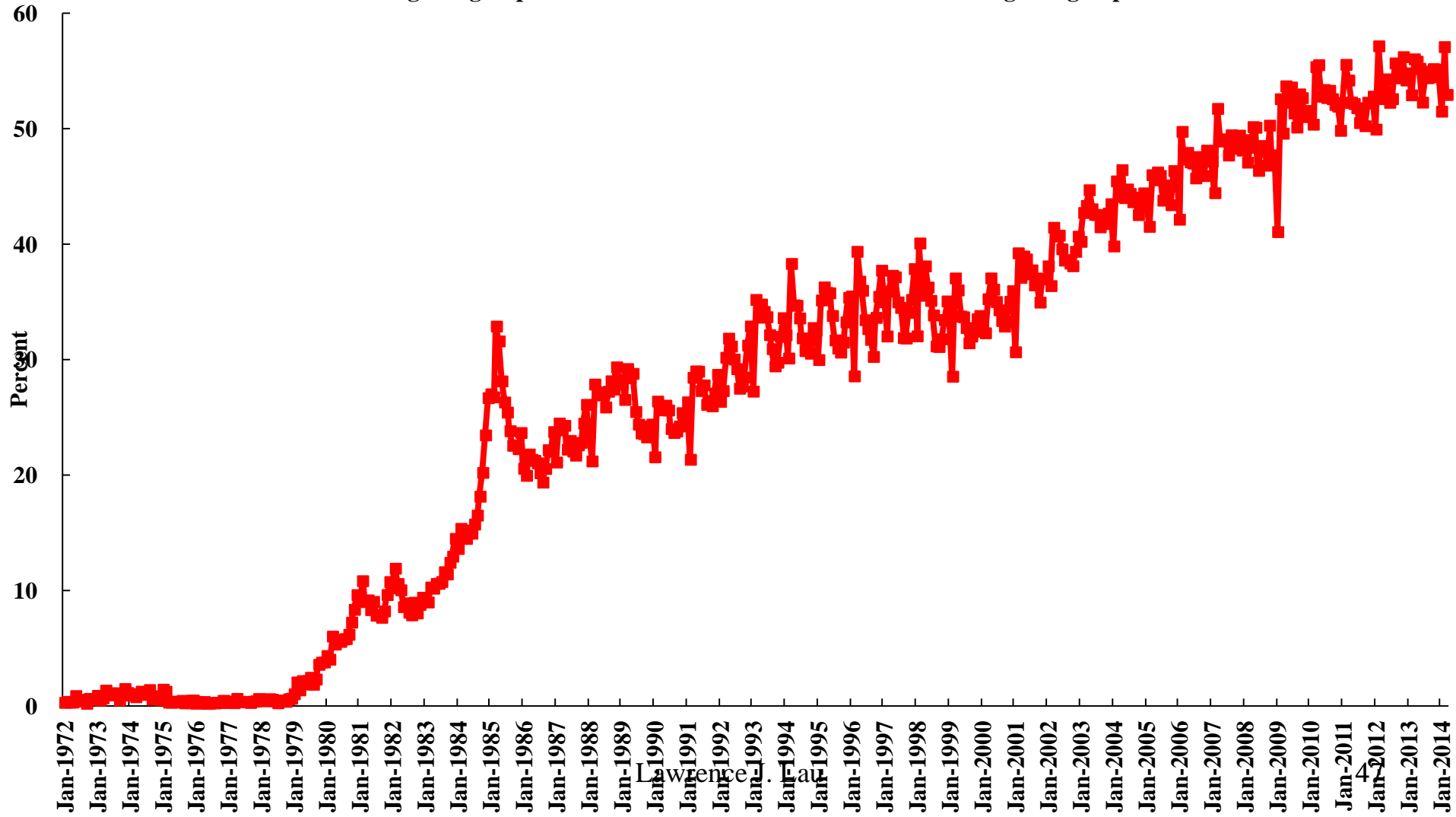
Total Hong Kong Exports to and Imports from the Mainland since 1972

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



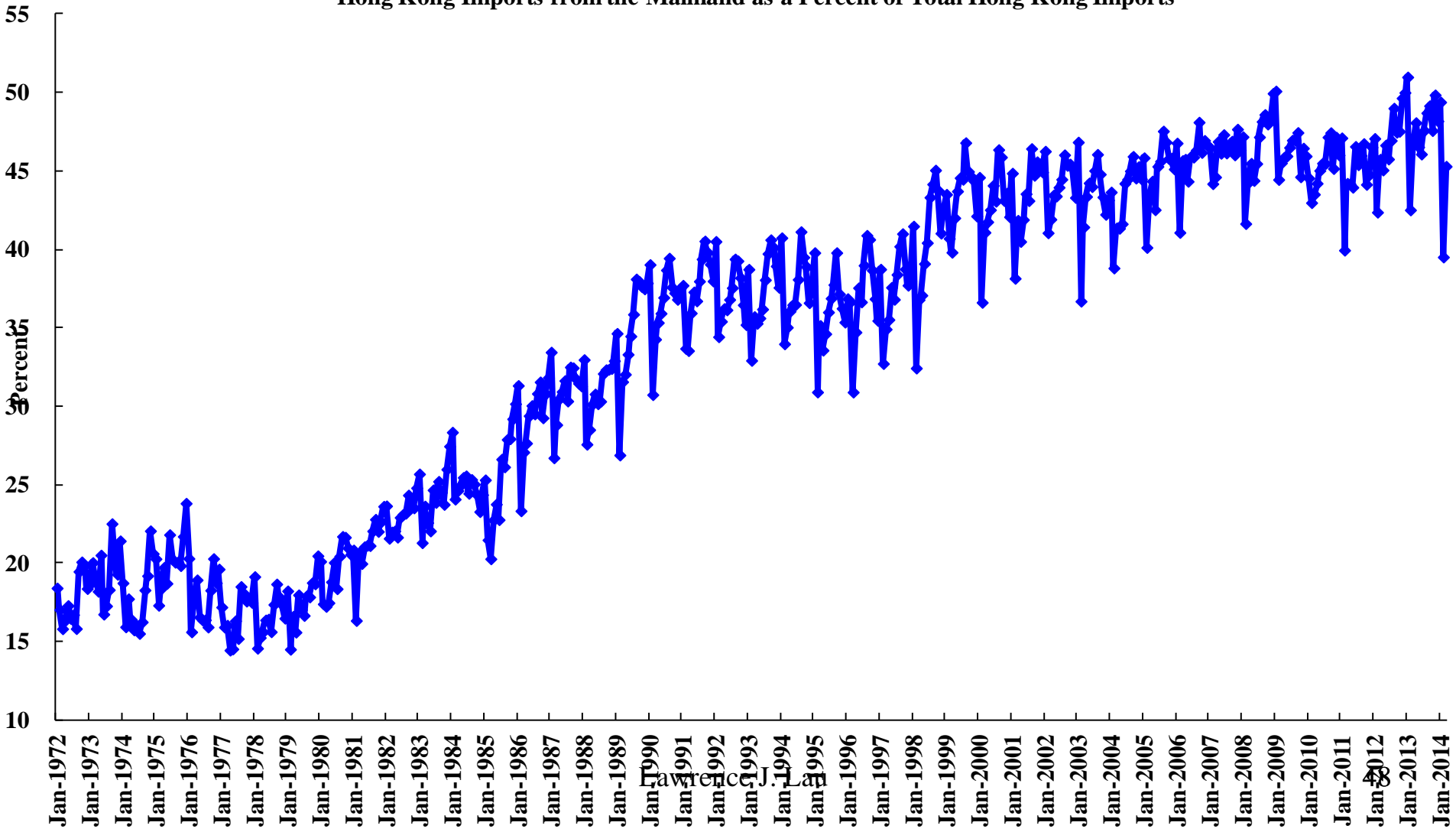
Hong Kong Exports to the Mainland as a Percent of Total Hong Kong Exports

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

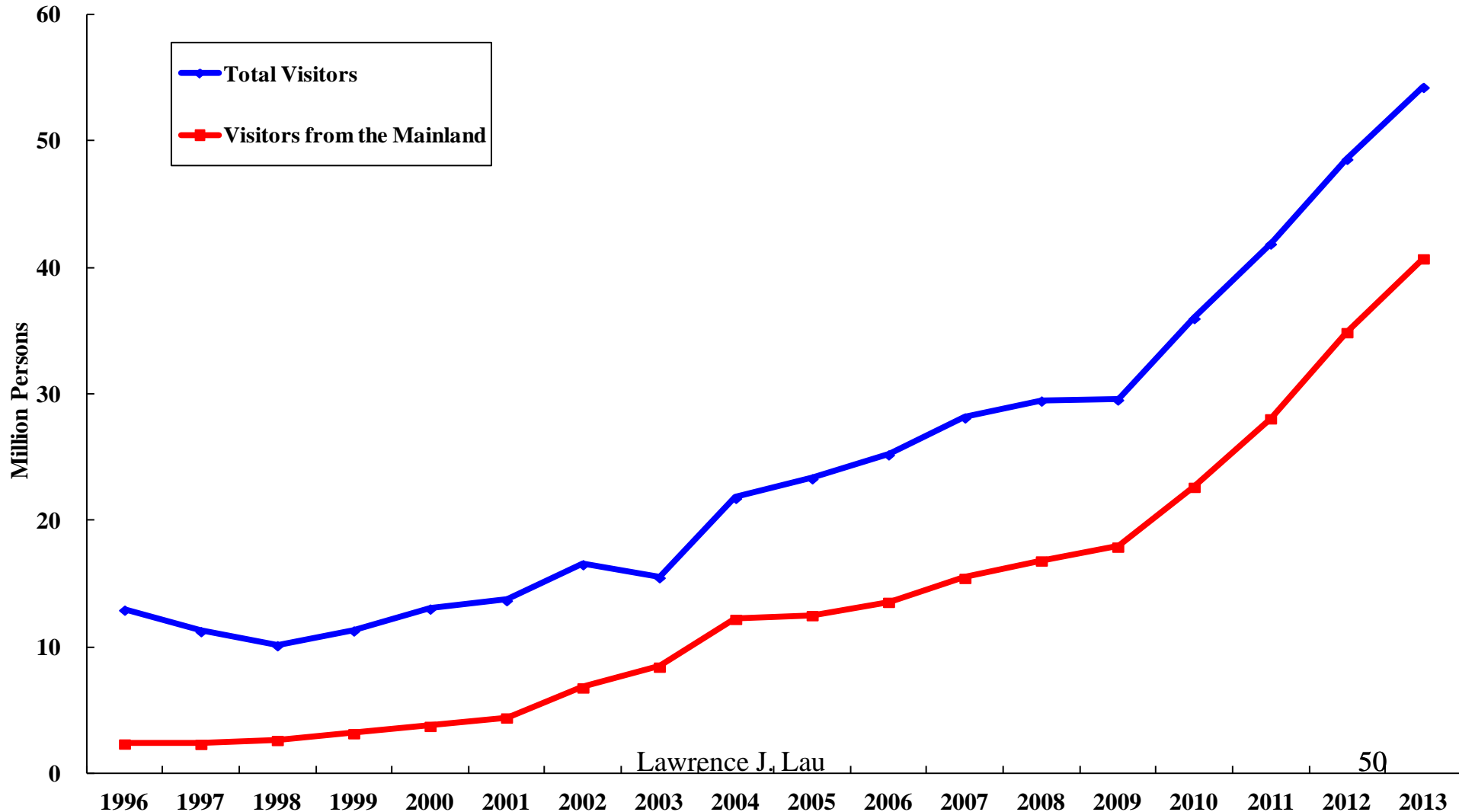


Mainland-Hong Kong Economic Interactions: International Trade

- ◆ 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 75% of all visitors to Hong Kong in 2013. Mainland visitors spend on average 3 days in Hong Kong and US\$750 per day.
- ◆ The total number of visitors from the Mainland to Hong Kong is currently running at the rate of approximately 41 million a year, not including day visitors.
- ◆ These visitors generate demands for hotels, restaurants, retail, and transportation and through these demands create many job opportunities that cannot be moved away. It is fair to say that without the Mainland visitors, the unemployment rate in Hong Kong would have been at least two percentage points higher.

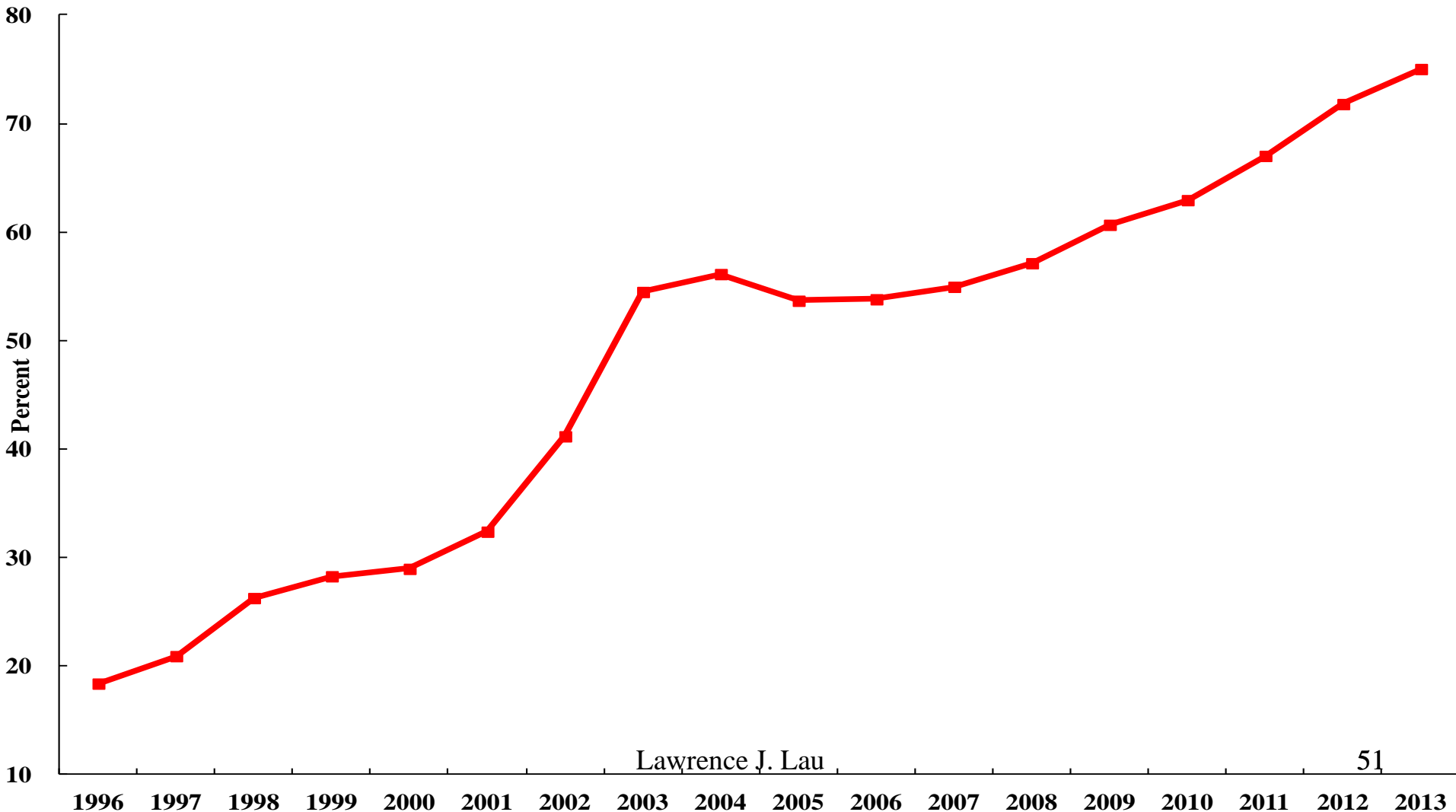
Annual Mainland and Total Visitors to Hong Kong since 1996

Annual Mainland and Total Visitors to Hong Kong since 1996



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

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

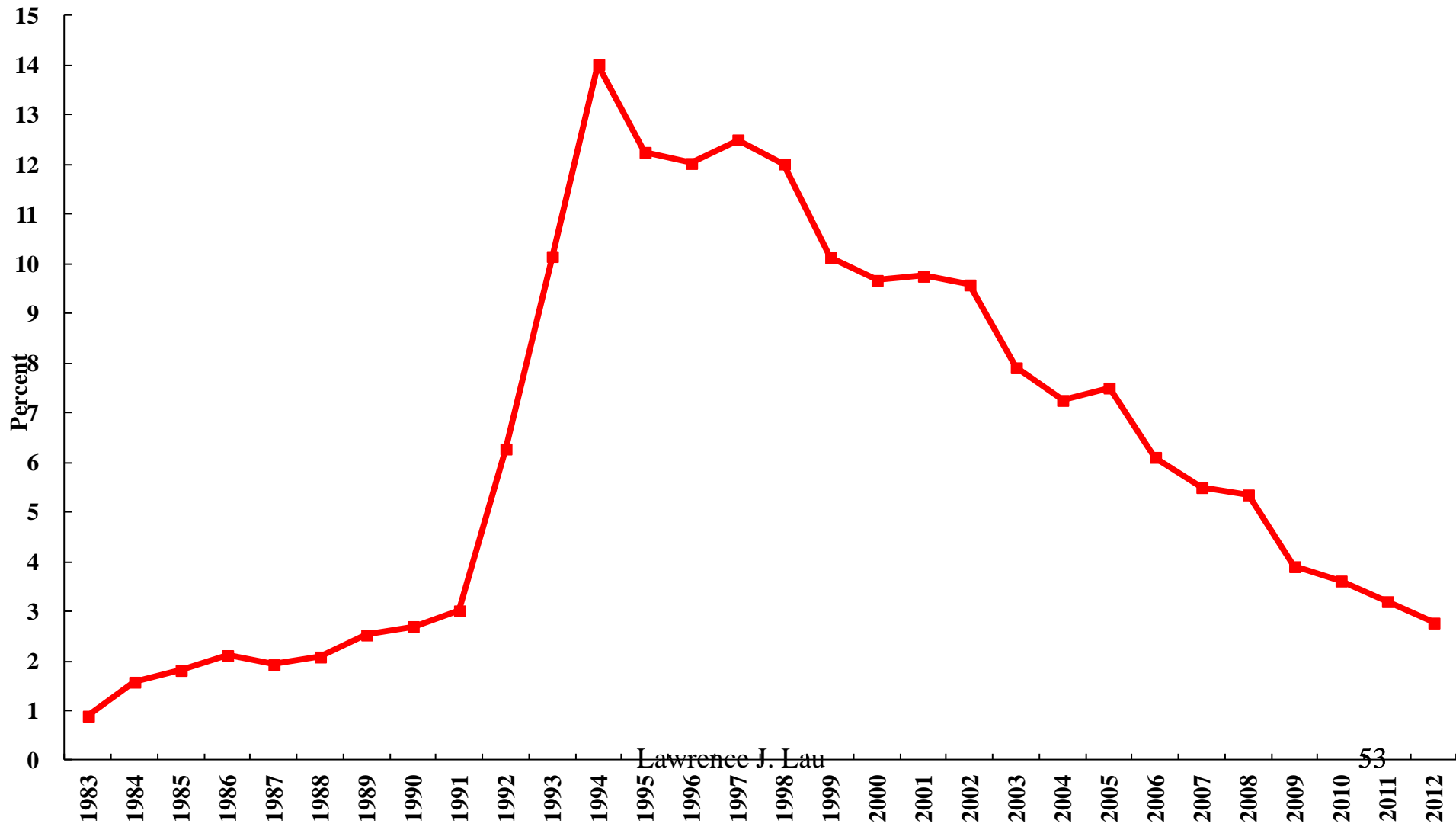


Mainland-Hong Kong Economic Interactions: Direct Investment

- ◆ Hong Kong investors were the first to invest in the Mainland when it first opened to the World in 1978 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 as successful. The other Special Economic Zones (Shantou, Zhuhai, Xiamen and the entire island province of Hainan) 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 2012).
- ◆ Mainland investment now constitutes almost 50% of all FDI into Hong Kong.

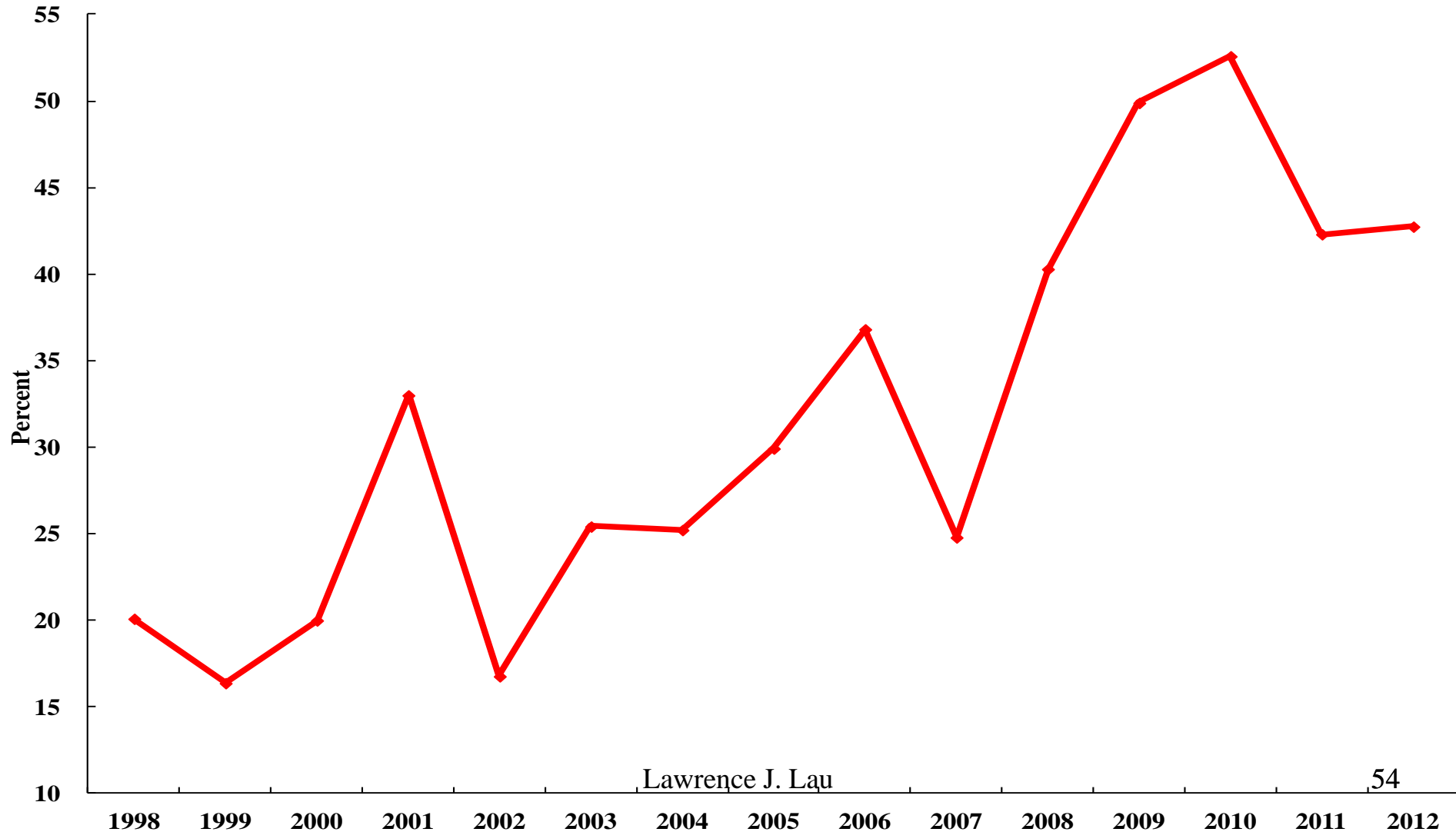
Foreign Direct Investment as a Percent of Total Mainland Domestic Investment

Foreign Direct Investment as a Percent of Total Mainland Domestic Investment



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

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

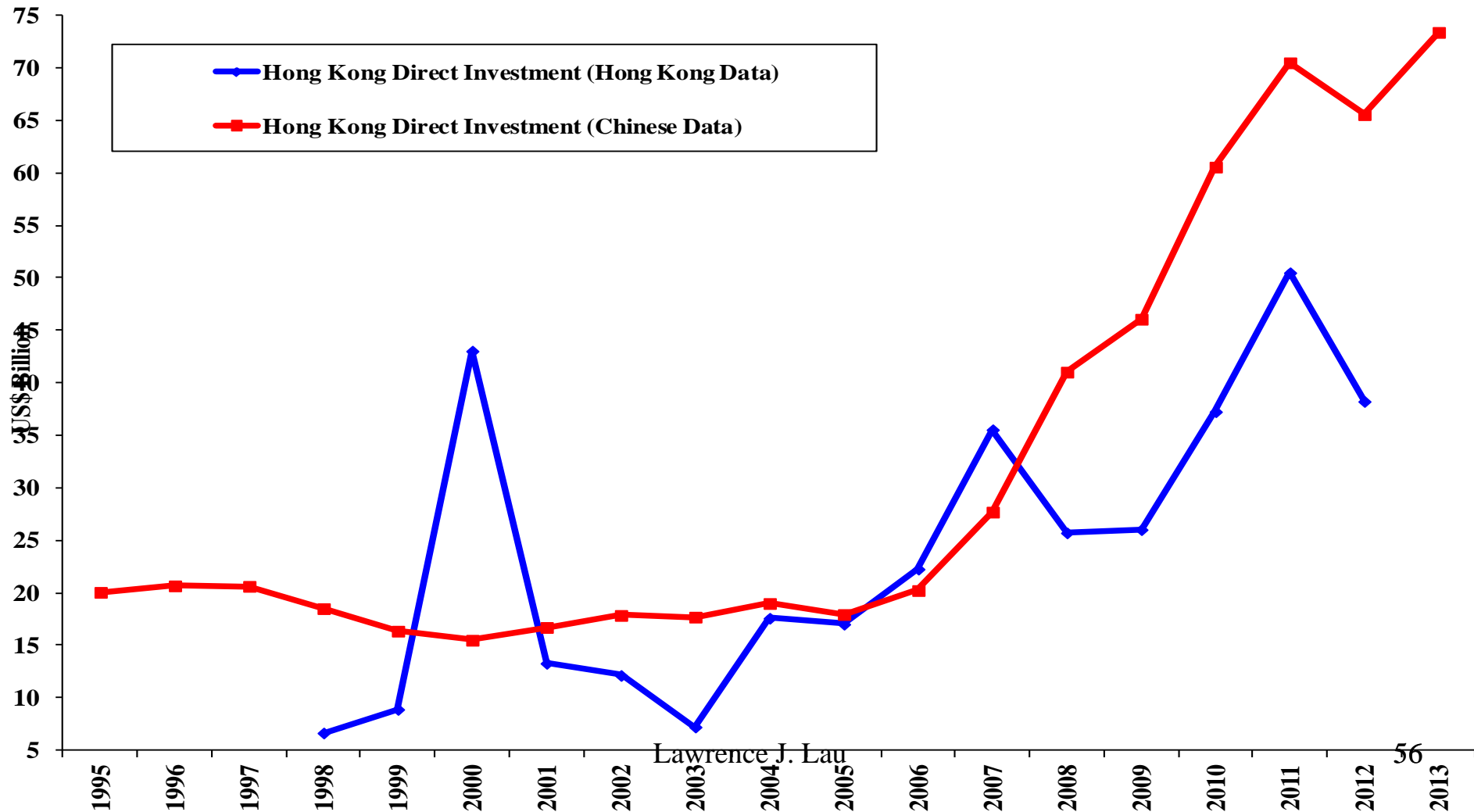


Mainland-Hong Kong Economic Interactions: Direct Investment

- ◆ 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, taking advantage of the Closer Economic Partnership Agreement (CEPA) between the Mainland and Hong Kong, 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 and hence is not counted as Hong Kong investment.
- ◆ 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.

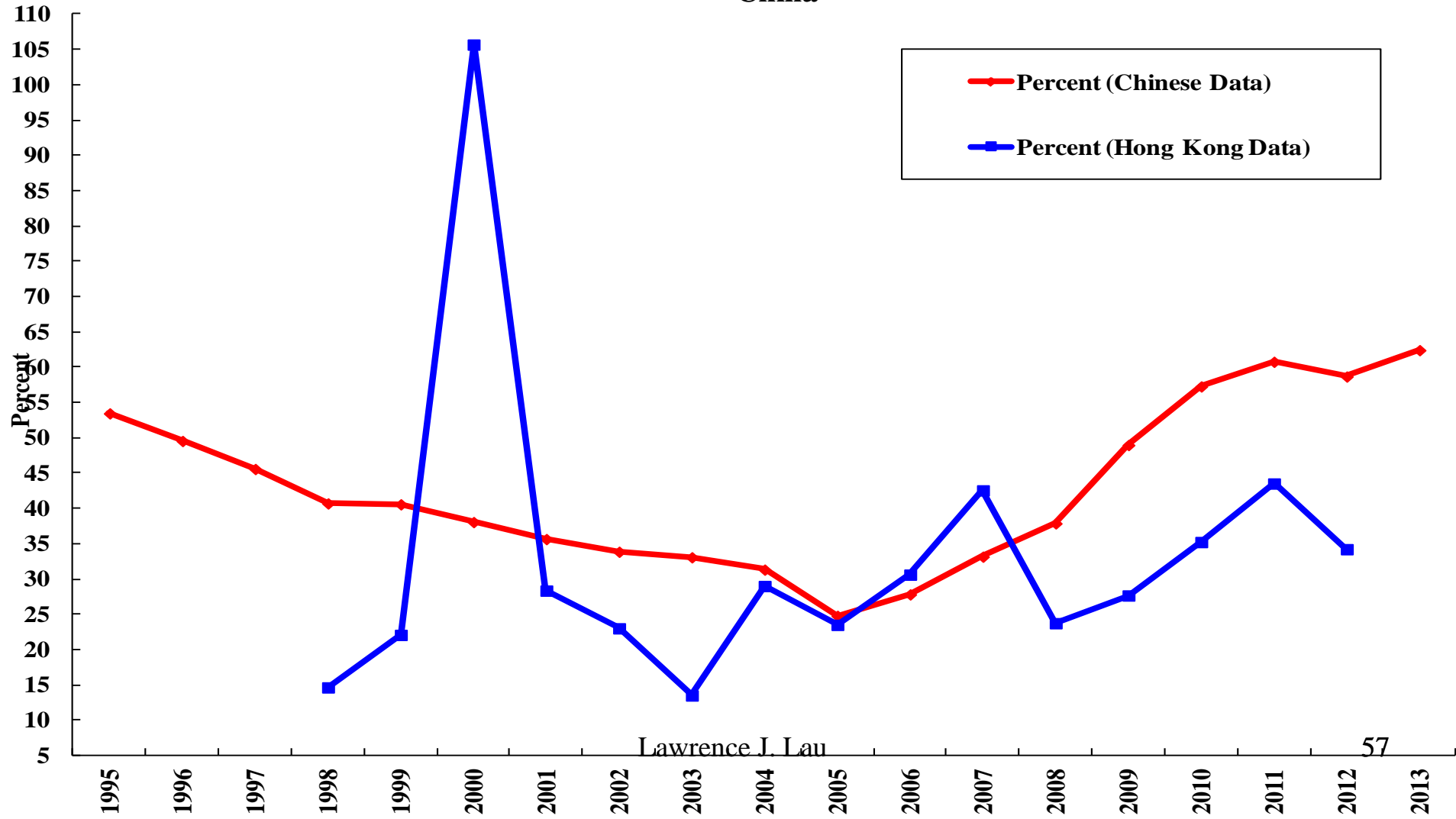
Annual Hong Kong Direct Investment to the Mainland (US\$)

Annual Hong Kong Direct Investment to the Mainland, USD billions



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

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



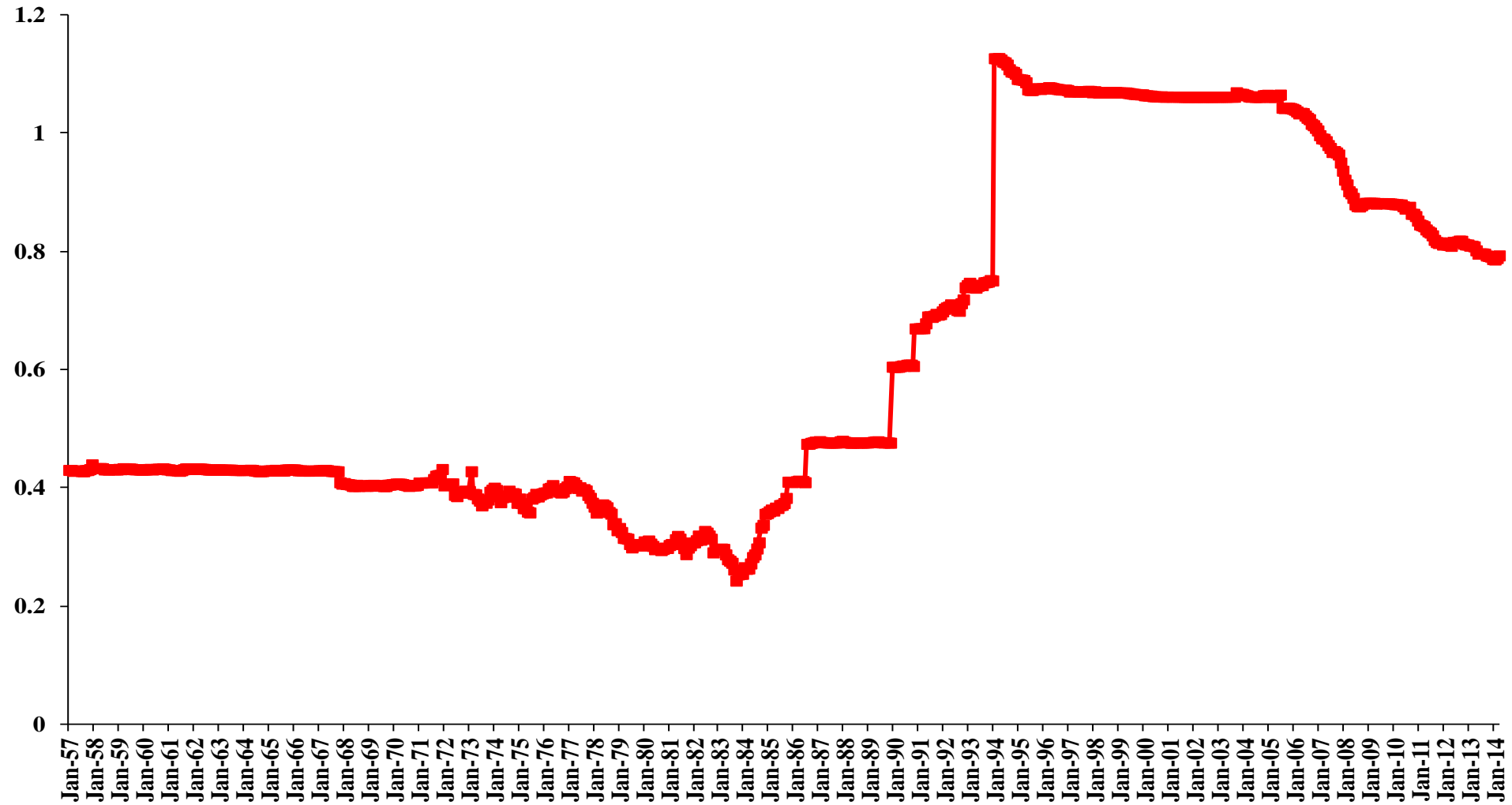
The Yuan-Hong Kong Dollar Exchange Rate

- ◆ 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 slightly more than 0.4 Yuan/HK\$ in 1957, fell to a low of less than 0.3 Yuan/HK\$ in 1984, and rose to a peak of 1.12 Yuan/HK\$ in 1994, when the Yuan became current accounts convertible. The value of the Hong Kong Dollar then remained higher than the Yuan until the Yuan began to appreciate in mid-2005. The Hong Kong Dollar is now worth approximately 0.80 Yuan/HK\$.
- ◆ In the foreseeable future, the Yuan is not expected to devalue vis-a-vis the U.S. Dollar and hence the Hong Kong Dollar as long as the linked exchange rate system of Hong Kong remains unchanged. It may continue to appreciate relative to the U. S. Dollar on a long-term trend basis, but the degree of appreciation will likely be small.

The Yuan-HK\$ Exchange Rate

End of Month, Yuan/HK\$

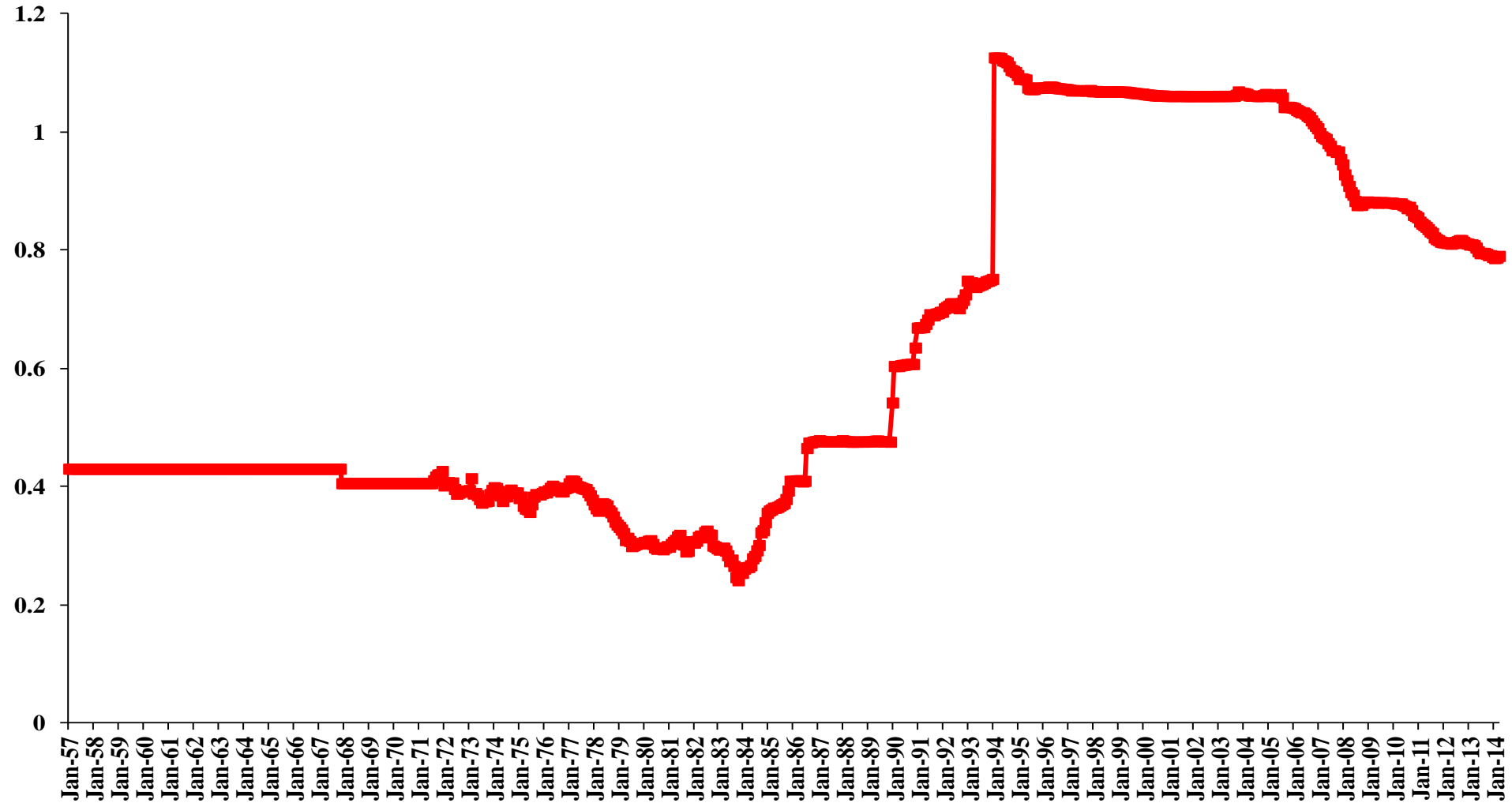
The Yuan-HK\$ Exchange Rate, End of Month, Yuan/HK\$



The Yuan-HK\$ Exchange Rate

Monthly Average, Yuan/HK\$

The Yuan-HK\$ Exchange Rate, Monthly Average, Yuan/HK\$



Mainland-Hong Kong Economic Interactions: The Stock Market

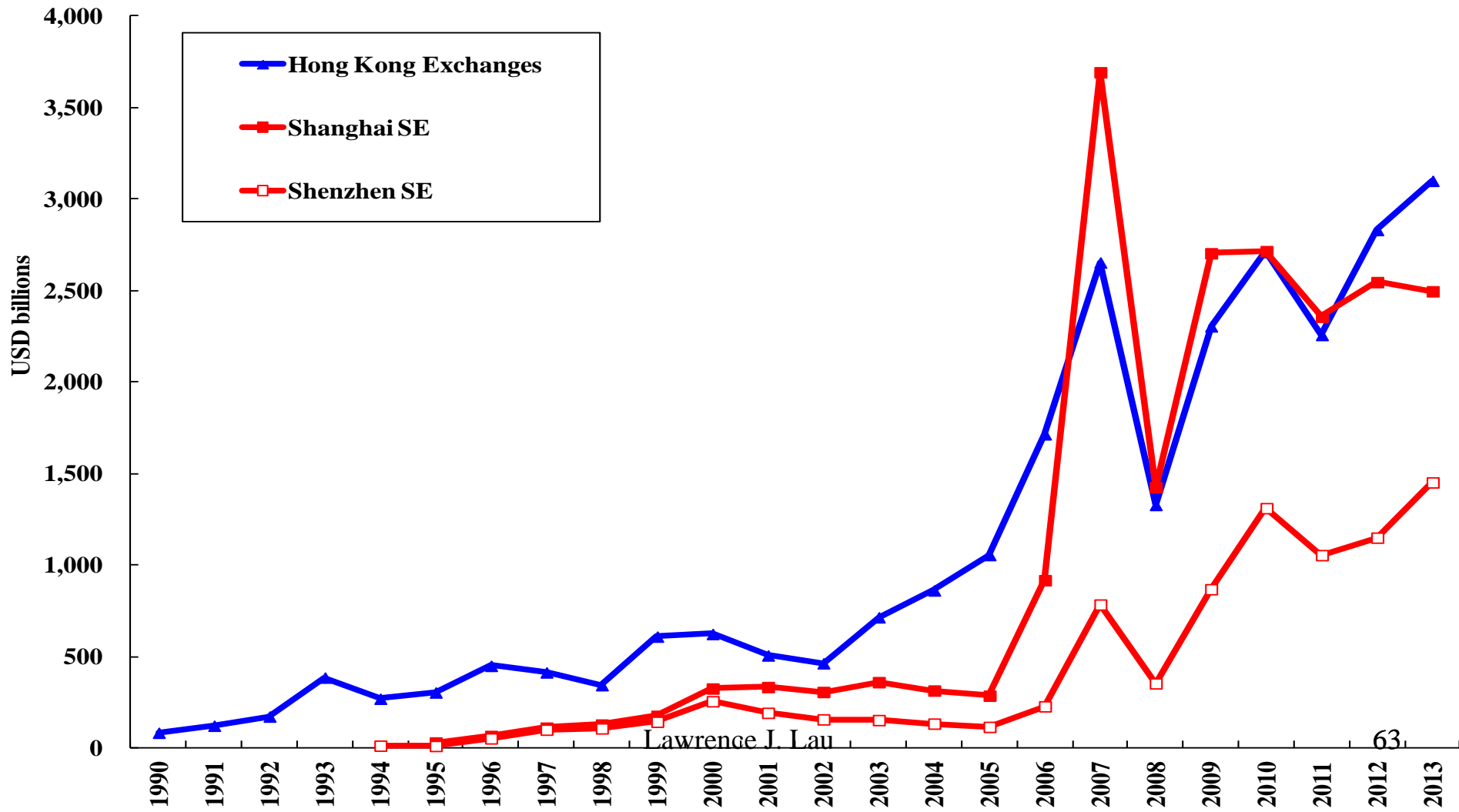
- ◆ Stock exchanges on the Mainland were first established in the early 1990s, much later than the Hong Kong Stock Exchange. However, in terms of total market capitalisation—the total value of all the companies listed on the stock exchange at the prevailing share prices of the market—the Shanghai Stock Exchange alone is now comparable to the Hong Kong Stock Exchange. The Shanghai and Shenzhen Stock Exchanges combined have a total market capitalisation that exceeds Hong Kong's.
- ◆ 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.

Mainland-Hong Kong Economic Interactions: The Stock Market

- ◆ However, the Hong Kong Stock Exchange was also instrumental in attracting foreign portfolio investors to invest in the shares of Mainland Chinese enterprises at the start of the Mainland stock exchanges in the early 1990s through the listing of their shares as H-shares. The Hong Kong Stock Exchange provided the easy access, the liquidity and the strict regulation expected by the foreign portfolio investors. Listing of Mainland enterprises on the Hong Kong Stock Exchange also helped to bring in foreign exchange, which was needed by Mainland enterprises at the time.

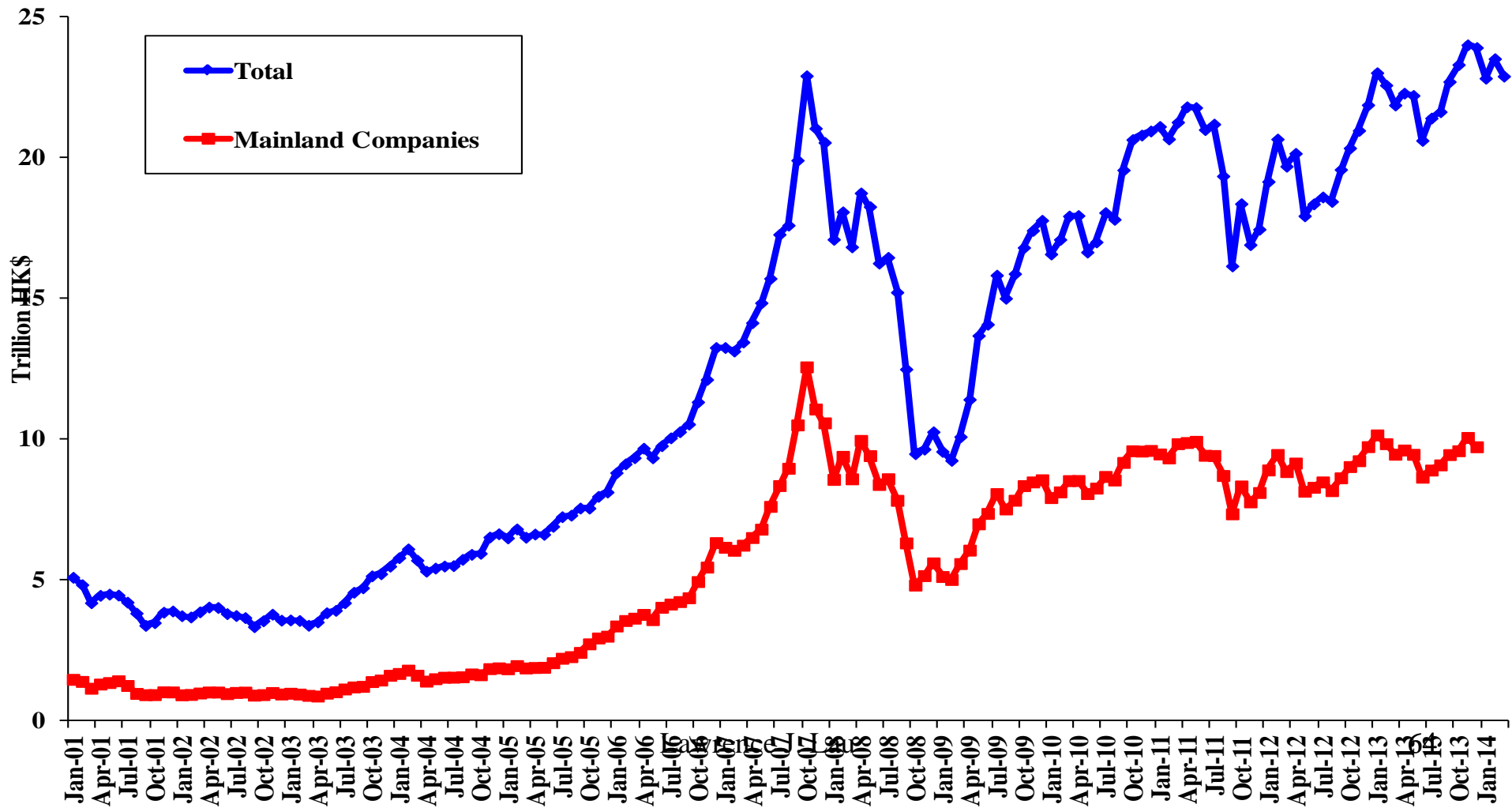
Comparison of Market Capitalisations of Mainland and Hong Kong Stock Exchanges

End-of-Year Market Capitalisation of Mainland and Hong Kong Stock Exchange in US\$ billions



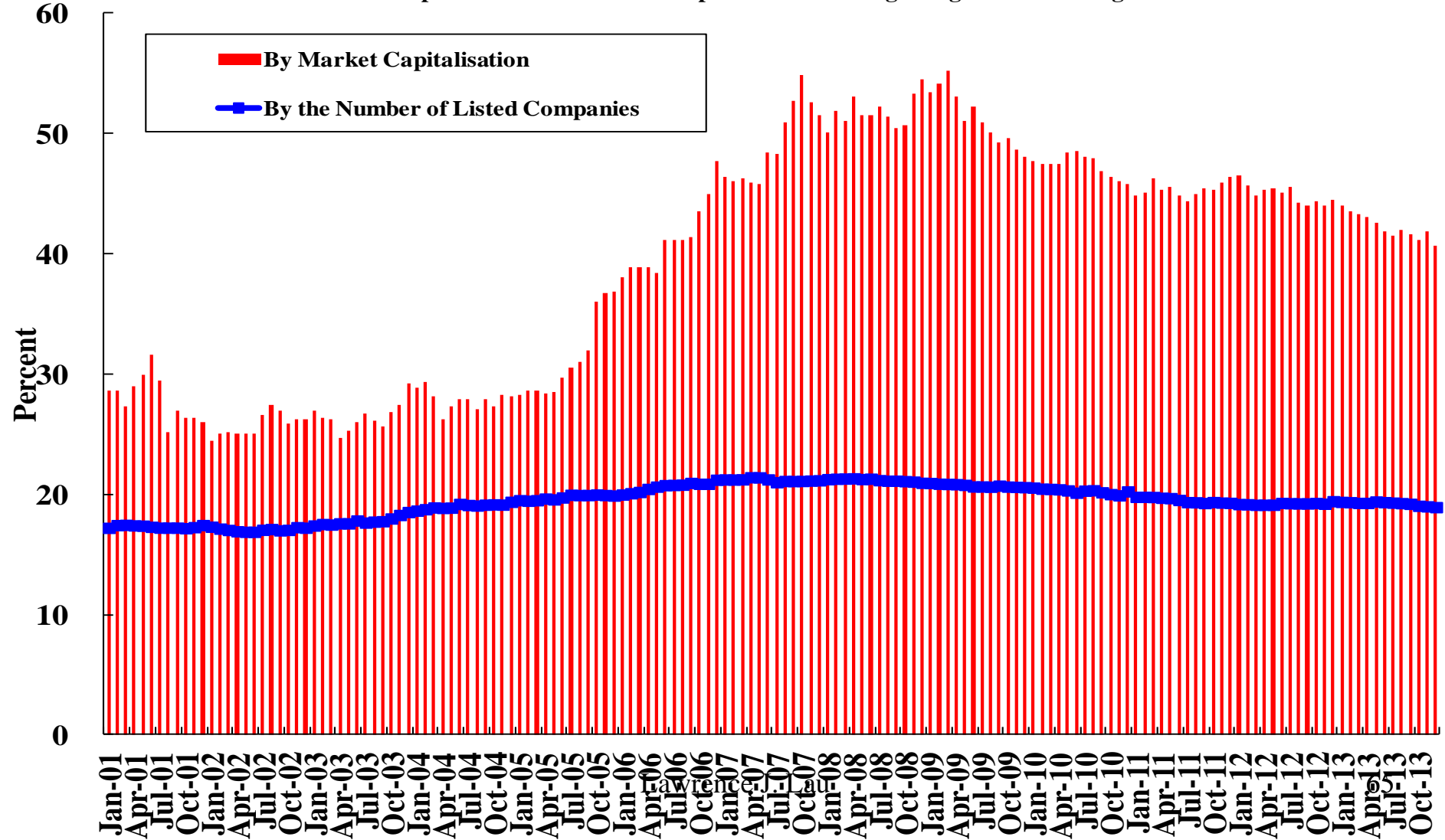
Year-End Market Capitalisation of Mainland and All Firms Listed on HKSE

Market Capitalisation of Mainland and All Firms Listed on Hong Kong Stock Exchange, HK\$ trillions



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

The Proportions of Mainland Companies on the Hong Kong Stock Exchange

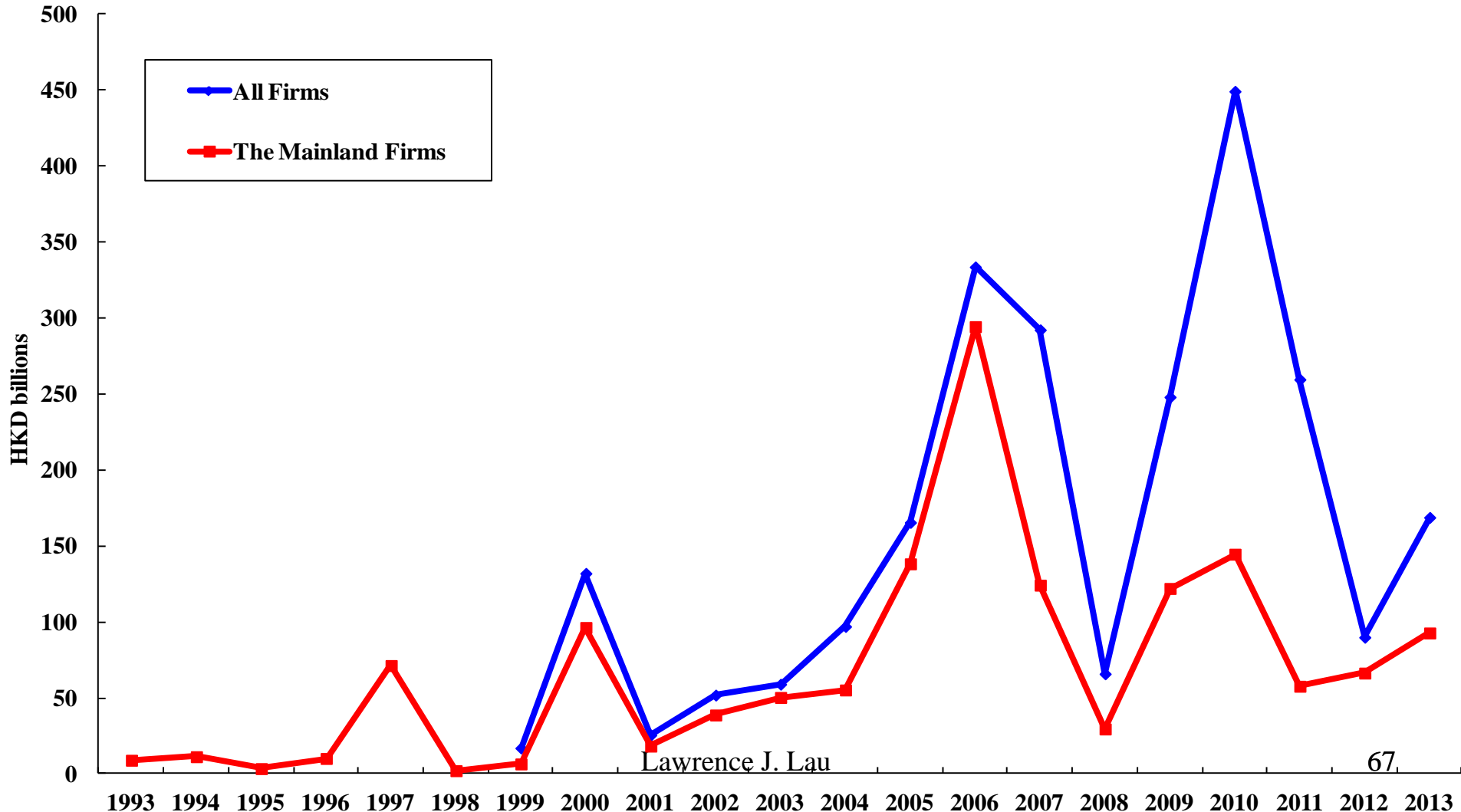


Mainland-Hong Kong Economic Interactions: The Stock Market

- ◆ 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 2009-2011 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 enterprises may find listing on the Shanghai Stock Exchange much more attractive because there is substantial domestic investor demand and the enterprises need to raise Renminbi rather than foreign exchange. The Mainland, with foreign exchange reserves exceeding US\$4 trillion, does not need any more inflow of foreign exchange. Moreover, funds raised offshore cannot be automatically remitted to the Mainland for use on the Mainland. Specific approval from the People's Bank of China is required. However, there is a long queue at the Shanghai Stock Exchange.
- ◆ That is also why Hong Kong has to seek firms from other countries and regions to list their shares on the Hong Kong Stock Exchange.⁶⁶

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



Lawrence J. Lau

Mainland-Hong Kong Economic Interactions

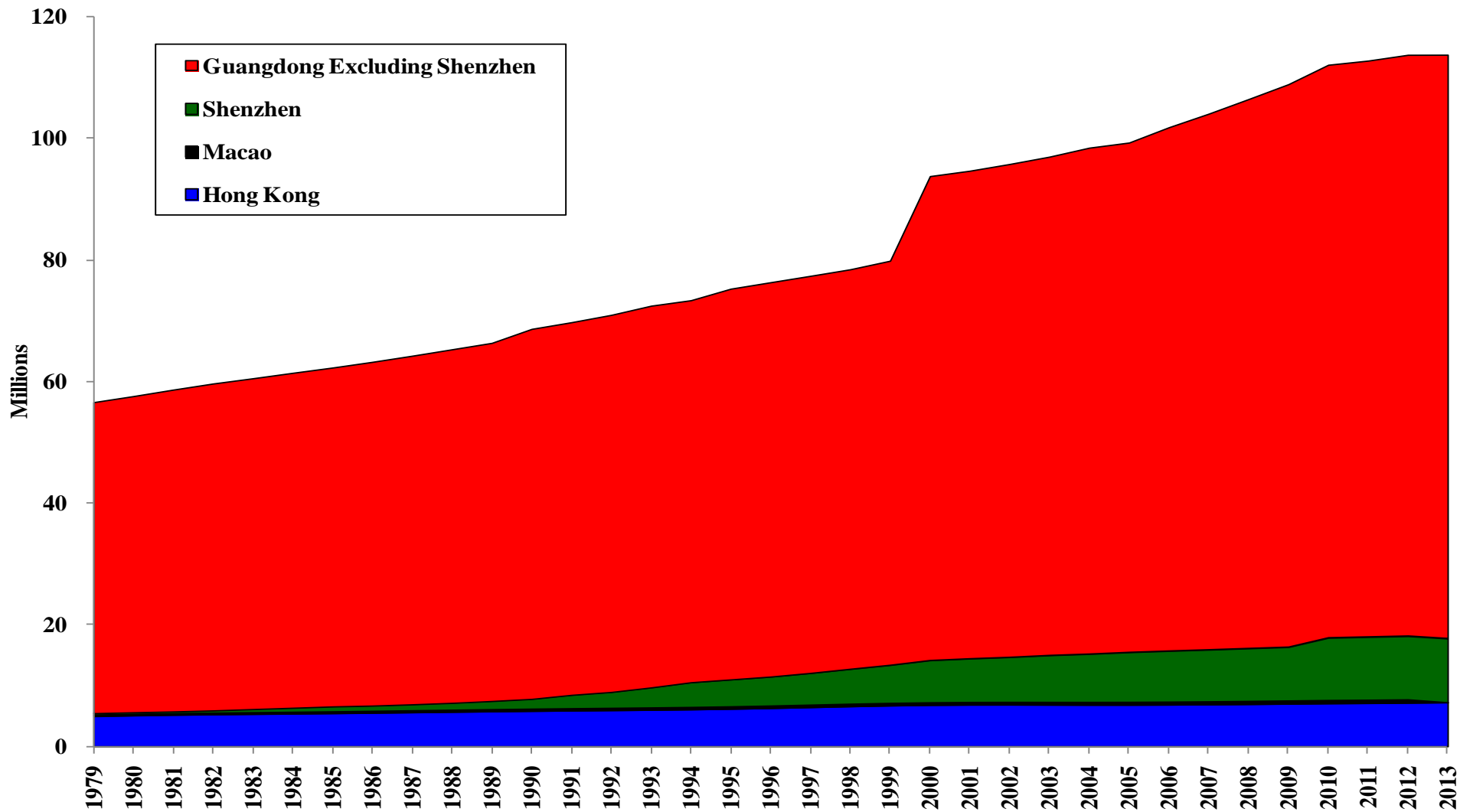
- ◆ Hong Kong and its entrepreneurs were indispensable for the success of the economic reform and open-door policy on the Mainland, and in Guangdong and Shenzhen in particular.
- ◆ Hong Kong may not be the only gateway to the Mainland for international trade and investment any more, but it can be the 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.

Economic Cooperation between Hong Kong and Guangdong

- ◆ The Province of Guangdong, including Shenzhen, has a population of 105.94 million, and is the most populous province on the Mainland.
- ◆ If the populations of Hong Kong (7.15 million) and Macau (0.56 million) are added to that of Guangdong, the total population becomes 113.65 million, more than that of Germany (82 million) and almost equal to that of Japan (128 million).

Populations of Hong Kong and Its Neighbouring Economies, millions

Populations of Hong Kong and Its Neighbouring Economies, millions

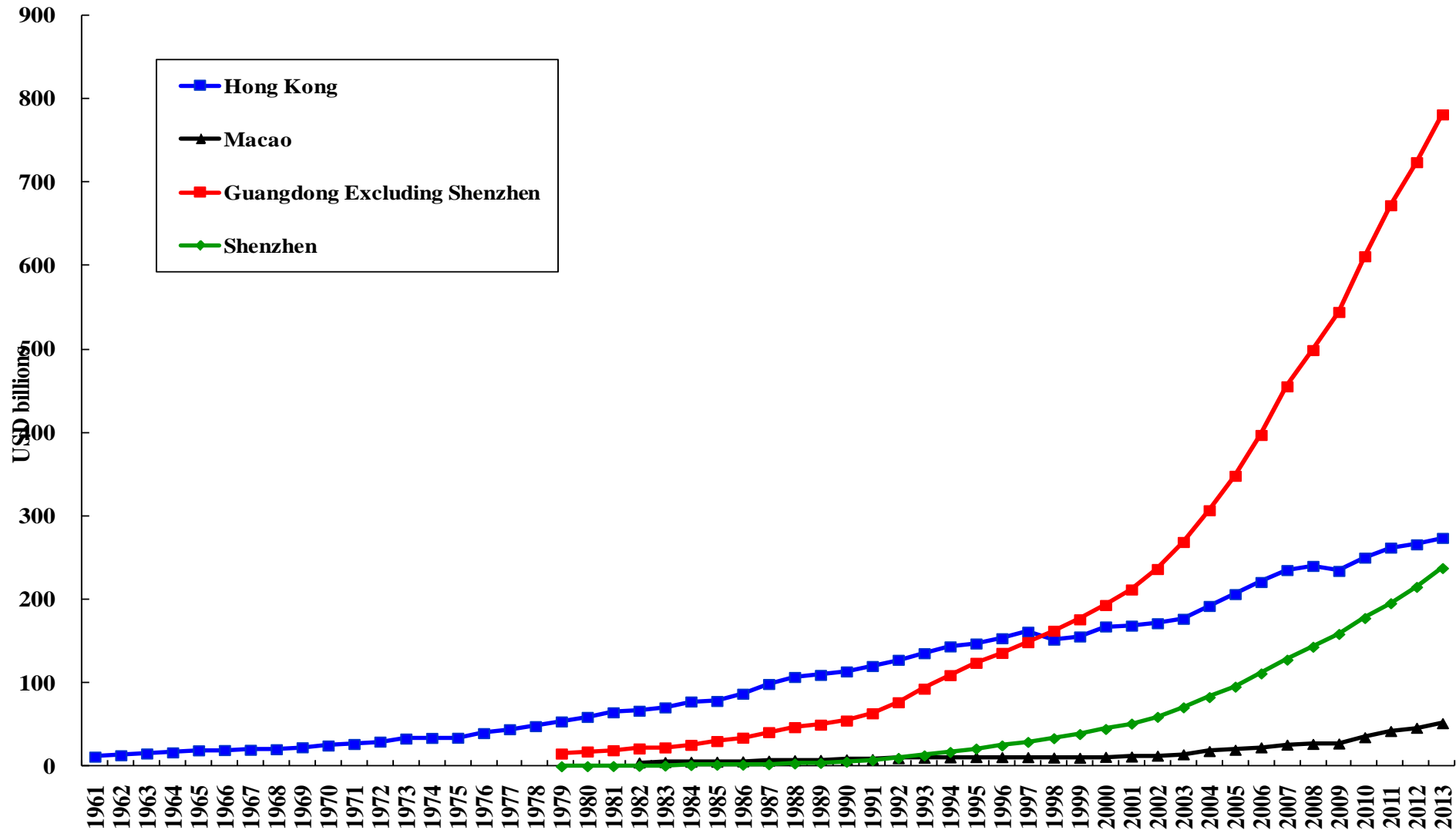


Economic Cooperation between Hong Kong and Guangdong

- ◆ The GDP of the Province of Guangdong, including Shenzhen, was US\$1,019 billion in 2013, 3.7 times the Hong Kong GDP of US\$274 billion. It is also the province with the largest GDP on the Mainland, constituting 11% of the Mainland GDP. The GDP of Guangdong and Hong Kong combined was US\$1.29 trillion in 2013, about 1/7th of the Chinese GDP.
- ◆ The GDP per capita of the Province of Guangdong in 2013 was US\$9,570, compared to Hong Kong's US\$38,086. The GDP per capita of the combined region was US\$11,371.
- ◆ Thus, together, there is a huge consumer market with ample labour force, and the region has the potential of eventually surpassing Japan to become the third largest economy in the World.

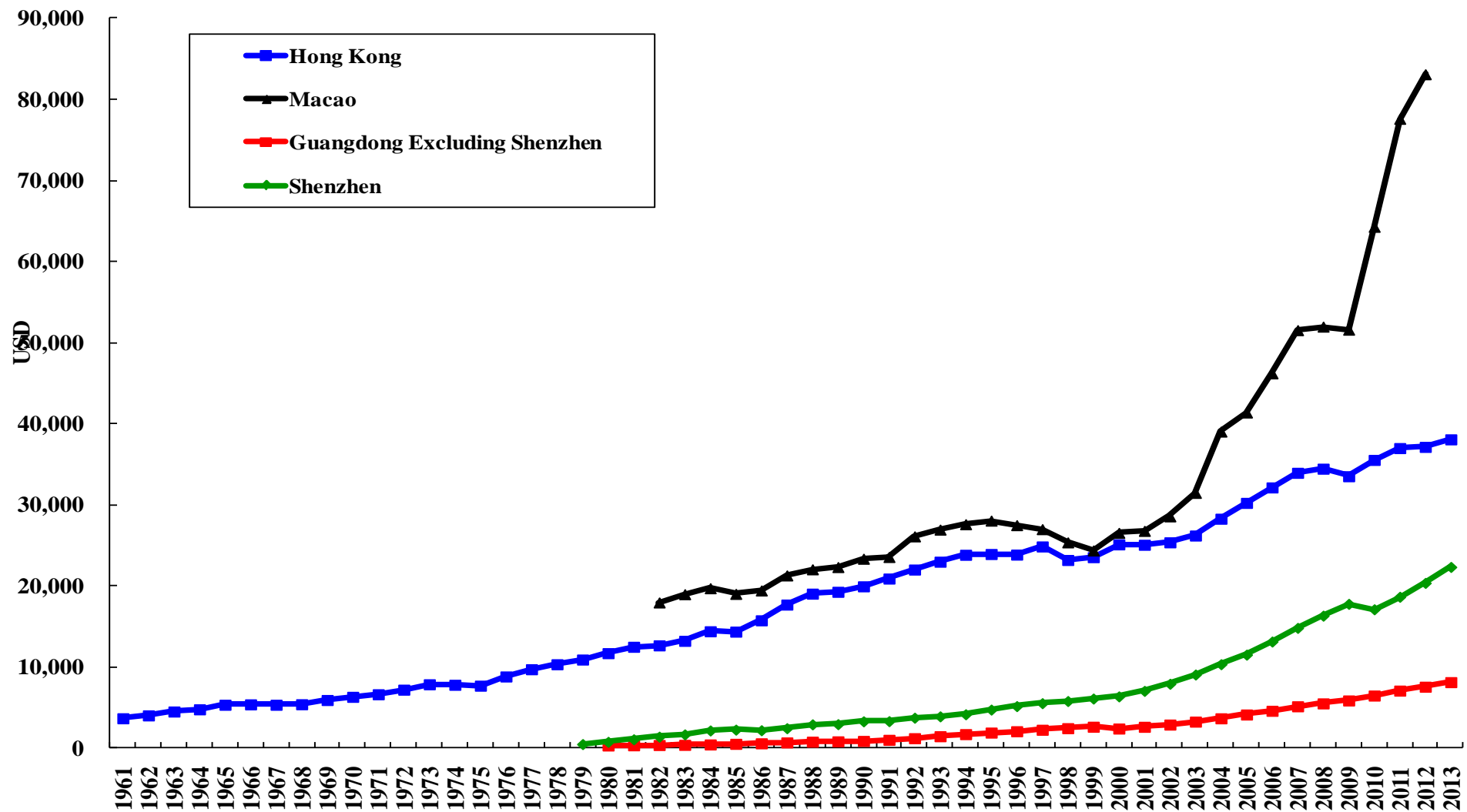
Real GDPs of Hong Kong and Its Neighbouring Economies, billion 2013US\$

Real GDPs of Hong Kong and Its Neighbouring Economies, billion 2013 US\$



Real GDP-per-Capita's of Hong Kong and Its Neighbouring Economies, 2013 US\$

Real GDP-per-capita's of Hong Kong and Its Neighbouring Economies, 2013US\$



The Comparative Advantages of Hong Kong

- ◆ A tradition of capitalist free market economy—the flows of people, goods and capital into and out of Hong Kong have always been free and open.
- ◆ A cosmopolitan international metropolis that is bilingual (Chinese and English) and bicultural, and closely connected to both China and the rest of the World
- ◆ Stable exchange rate, freely convertible currency, full capital mobility and free trade
- ◆ A well-developed financial market with close links to the other international financial centres
- ◆ Low corporate and individual income tax rates
- ◆ Rule of law, effective regulation and supervision of financial markets, transparent governance, and civil liberties comparable to the most developed countries in the World
- ◆ An environment hospitable to entrepreneurs and potential entrepreneurs

The Comparative Advantages of Hong Kong

- ◆ The favourable commercial reputations of Hong Kong and its firms
- ◆ Academic freedom, freedom of speech and real-time full access to information everywhere—the internet is entirely open and the press is among the freest in the World
- ◆ A well-educated and experienced professional labour force
- ◆ World-class, research-oriented universities
- ◆ Geographically well located--proximity to the Mainland, a huge market and a huge source of savings, and right at the junction between the Mainland China and the emerging ASEAN region

The Comparative Vulnerabilities of Hong Kong

- ◆ High cost structure for both local and international businesses, especially the cost of land (and hence the costs of office space and housing)
- ◆ The lack of a large domestic market
- ◆ A narrow tax base, and over-dependence of government revenue on land sales, resulting in its excessive volatility and also high and rising land prices
- ◆ The lack of double-tax agreements (DTAs) with many countries and regions (a problem that is in the process of being corrected)
- ◆ Insufficient support for higher education and for R&D, hindering Hong Kong's transformation into an innovation-based economy

The Comparative Vulnerabilities of Hong Kong

- ◆ Local protectionism of many service professions such as the legal and the medical
- ◆ Declining English proficiency and an increasingly inward-looking mentality
- ◆ Lack of a long-term plan and strategy
- ◆ Lack of unity of purpose (and a sense of urgency)

The Opportunities and Challenges for Hong Kong

- ◆ Hong Kong will within the next ten years lose its advantage of the Hong Kong Dollar over the Renminbi as a convertible currency—the Renminbi is certain to become capital accounts convertible during this period (perhaps with some residual controls over short-term capital inflows); and when it does, it will substantially displace and replace the Hong Kong Dollar both as a medium of exchange and as a store of value even as the Hong Kong Dollar remains the legal tender as provided in the Basic Law.
- ◆ Paradoxically, the rising acceptance and use of the Renminbi, including its eventual full convertibility, can be a great opportunity for Hong Kong as a centre for Renminbi-denominated financing. That is why the ability to conduct domestic and international transactions and hence to clear and settle in Renminbi is so important for Hong Kong.

The Opportunities and Challenges for Hong Kong

- ◆ Hong Kong will also lose much of its advantage of a free trade port/low tariff on account of Chinese accession to the WTO. In any case, growth of Chinese exports and imports will slow as the Mainland economy further reorients itself to its own huge domestic market. Hong Kong will therefore have to rely on its other comparative advantages.
- ◆ The Mainland will catch up quickly on Hong Kong's comparative advantage in human capital as its economy continues to be globalised, its institutions of higher learning continue to improve, and the use of English becomes more and more common, at least in its major cities.

The Opportunities and Challenges for Hong Kong

- ◆ Hong Kong can also be a springboard for outbound Chinese direct investment because of its international links and highly developed service sector. It can provide the necessary accounting, legal and other services and the infrastructural support for Chinese enterprises investing abroad (through Hong Kong subsidiaries).
- ◆ The Hong Kong capital market can also provide Chinese enterprises the ability to use “natural” hedges for their outbound foreign direct investments (by, say borrowing the foreign currency in Hong Kong to fund the outbound investment thus balancing the foreign-currency assets with foreign-currency liabilities).
- ◆ In the transition, policy support from the Hong Kong SAR Government is crucial (e.g., concluding double-tax agreements with foreign tax jurisdictions).

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 specialisation and division of labor between Hong Kong and Guangdong, which can be win-win for all.

The Opportunities and Challenges for Hong Kong

- ◆ If Hong Kong were to become an international financial centre for China, it must begin by trying to provide the firms and households in its potential hinterland with the best financial service possible, so that they do not need to go to Shanghai or develop their own international financial centre(s). If Hong Kong cannot hold on to these potential customers, it can never compete with Shanghai.

Concluding Remarks

- ◆ It is because of the strength of the Mainland economy that Hong Kong has been able to survive the current European sovereign debt crisis as well as the earlier 2007-2009 global financial crisis and the 1997-1998 East Asian currency crisis relatively unscathed.
- ◆ The “Individual Visit Scheme” has been instrumental in lowering the unemployment rate of Hong Kong down to its current 3.2%.
- ◆ Hong Kong must try to take full advantage of its Mainland opportunities, such as those offered by CEPA, 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.

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

- ◆ The economies of Hong Kong and Guangdong are complementary to each other. What Hong Kong lacks, Guangdong can provide; and vice versa. Their economic cooperation can be win-win; it can benefit both places.
- ◆ Hong Kong should therefore intensify its economic cooperation with Guangdong (and Shenzhen). Guangdong is Hong Kong's natural economic hinterland. Hong Kong cannot compete with Shanghai if it is unable to hold on to Guangdong.

Concluding Remarks

- ◆ It is necessary to promote the freer flow of goods and services between Guangdong and Hong Kong. There should be a pilot programme for a Guangdong-Hong Kong Pilot Free Trade Zone.
- ◆ It is also necessary to promote the freer flow of people—the simplification of entry/exit and customs formalities, the mutual selective recognition of academic degrees and professional qualifications between Guangdong and Hong Kong.
- ◆ Finally, it is necessary to promote the financial cooperation between Guangdong and Hong Kong and to facilitate the cross-border flow of capital.