

# Yes, Hong Kong CAN!

## 發揮香港潛力、再創經濟奇蹟

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**The Chinese University of Hong Kong, Our Hong Kong Foundation and Southeast University**

Policy Summit

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\*All opinions expressed herein are the authors' own and do not necessarily reflect the views of any of the organisations with which the authors are affiliated.

# Outline

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- ◆ Introduction
- ◆ How Does Hong Kong Compare with New York and London?
- ◆ Hong Kong as a Leading International Financial Center
- ◆ Hong Kong as East Asia's International Innovation and Venture Capital Center
- ◆ Hong Kong as an International Professional Services Center
- ◆ Pearl River Delta (PRD) Economic Cooperation
- ◆ The Role of Hong Kong in the “Belt and Road” National Initiative
- ◆ Concluding Remarks

# Introduction

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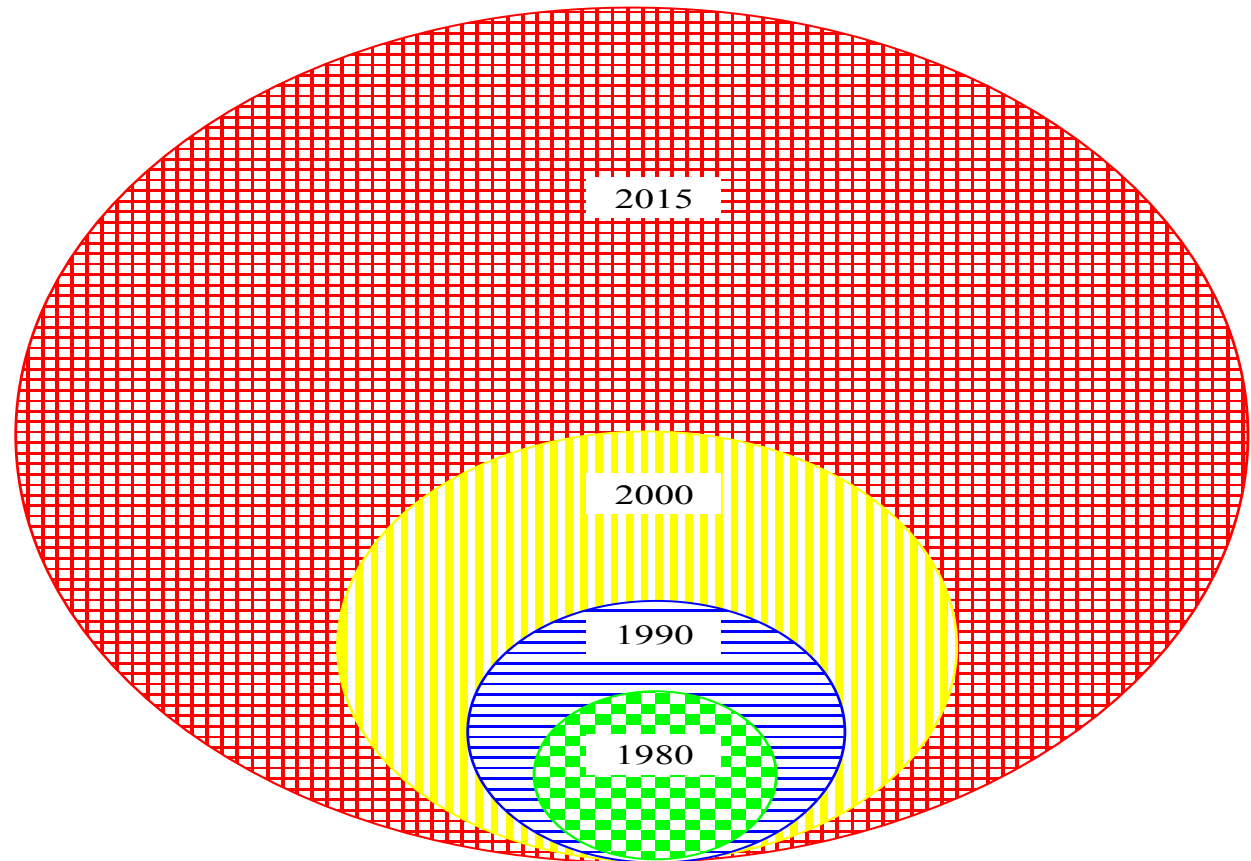
- ◆ The purpose of our report, “Yes, Hong Kong CAN!”, is epitomized by the Chinese saying, “Tossing a brick to attract the jade (拋磚引玉)”.
- ◆ It is important to note that the relative economic sizes of Hong Kong and the Mainland have changed significantly over time. In 1980, the GDP of Hong Kong was one-seventh of that of the Mainland. In 2015, the GDP of Hong Kong was less than 3 percent of that of the Mainland. In per capita terms, the GDP of Hong Kong was 28 times that of the Mainland in 1980 and is still more than 5 times that of the Mainland today.
- ◆ Given the slowdown in the economies of the Mainland and the world, and in the growth of world trade, the economy of Hong Kong is now at a turning point.
- ◆ Hong Kong must embark on new directions in order to continue to grow and prosper. It must further diversify its economy to reduce the over-dependence on any one particular sector. The report is a catalog, a menu of the available possibilities.

# Comparison of the Real GDPs of Mainland and Hong Kong (2015 USD Billions)

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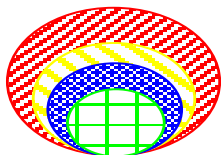
**Mainland**

大陸



**Hong Kong**

香港

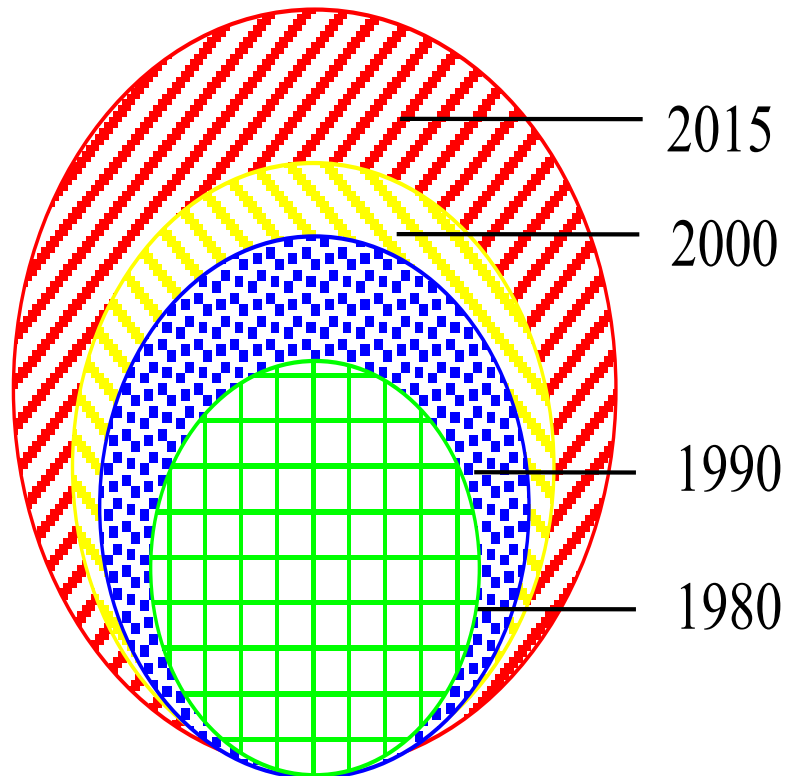


# Comparison of the Real GDP per Capita's of Mainland and Hong Kong (2015 US\$)

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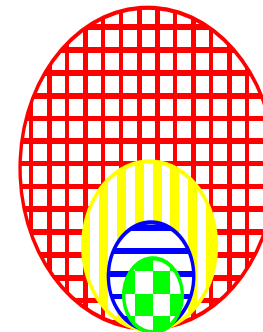
**Hong Kong**

香港



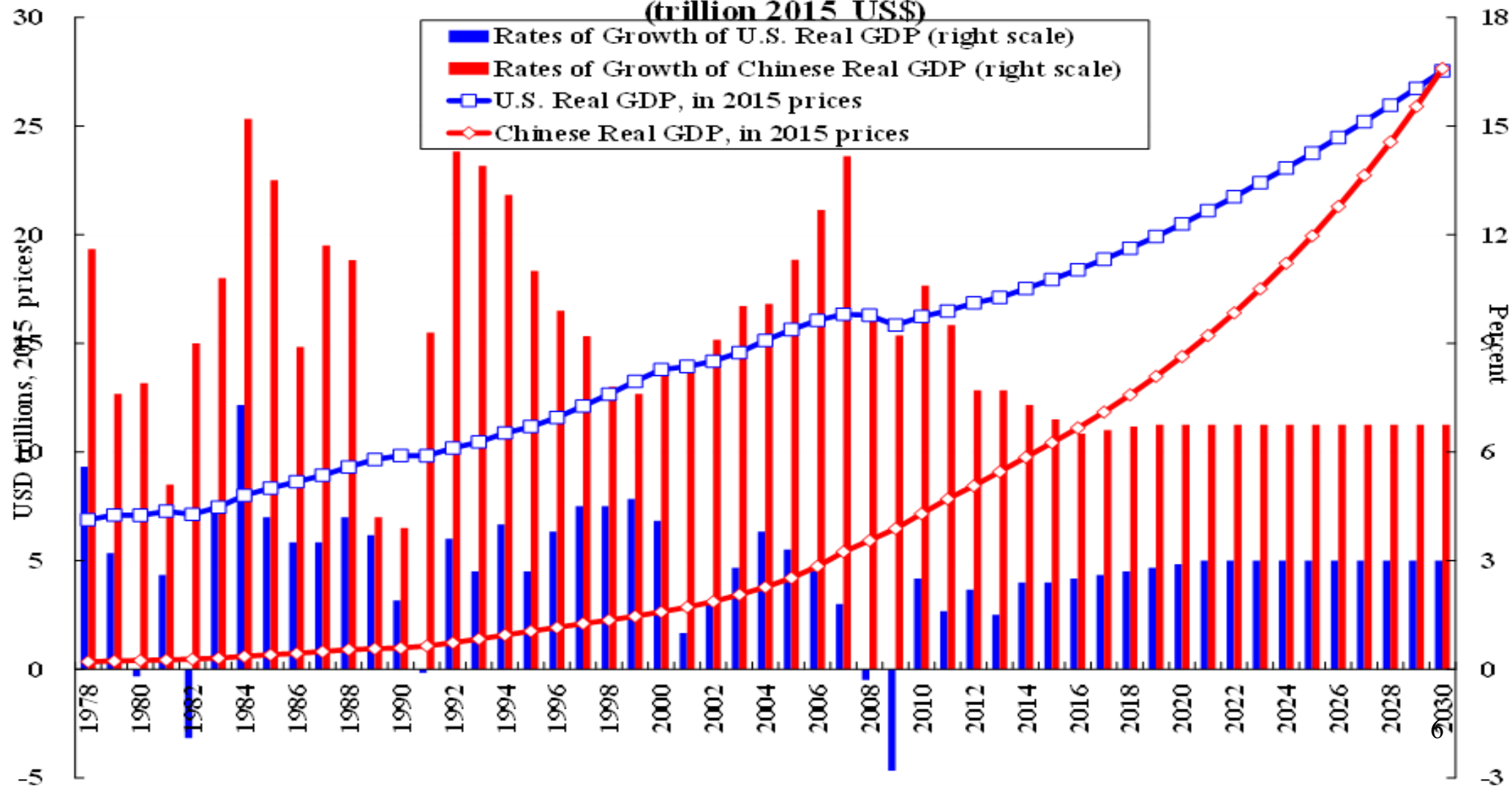
**Mainland**

大陸



# The Actual and Projected Level and Annual Rate of Growth of Chinese and U. S. Real GDP

**Actual and Projected Chinese and U.S. Real GDPs and Their Rates of Growth  
(trillion 2015 US\$)**



# How Does Hong Kong Compare with New York and London?

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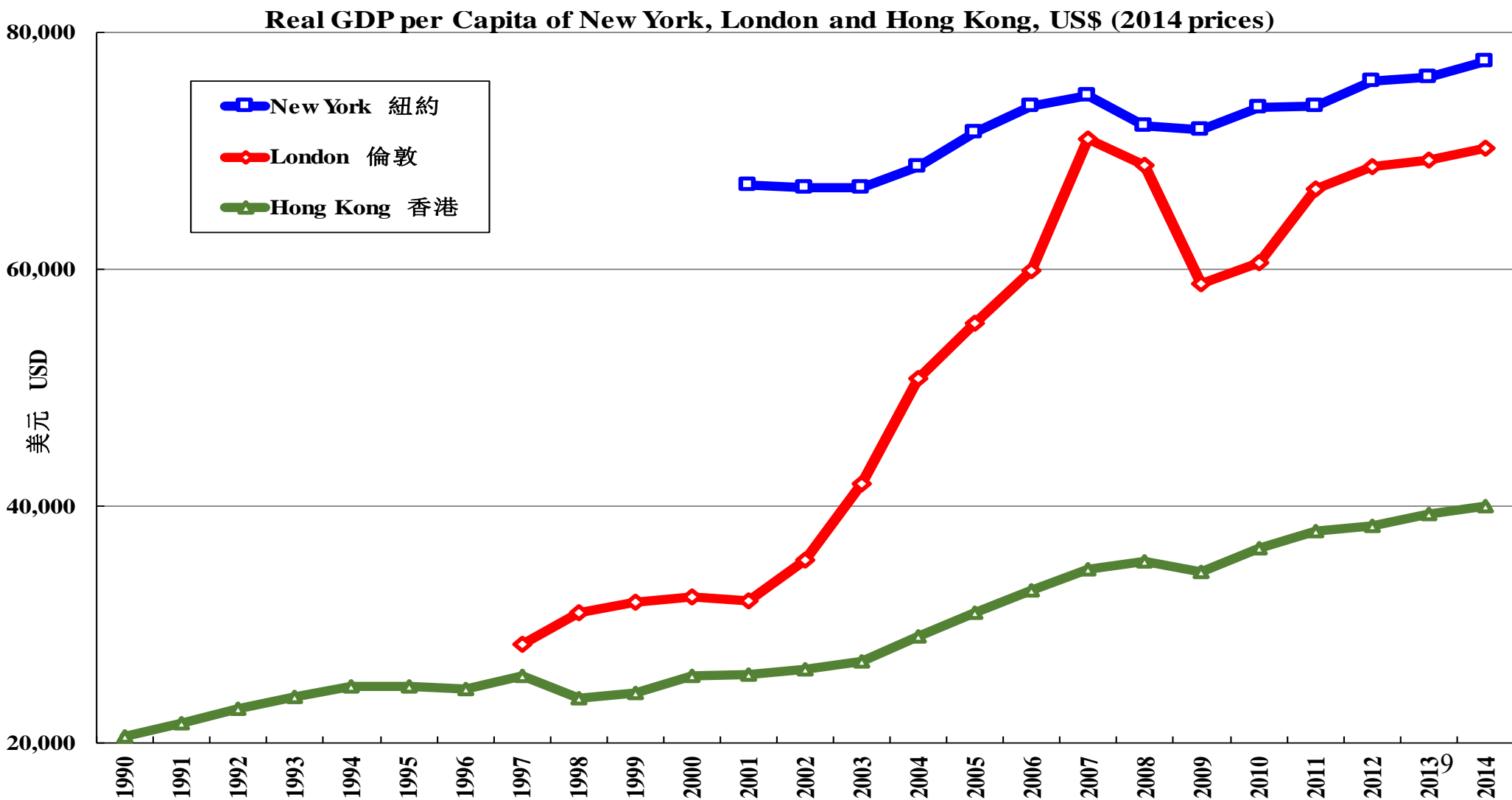
- ◆ New York and London have as their natural economic hinterlands the entire United States and the entire U.K. and the European Union (this is now in doubt because of Brexit) respectively. However, Hong Kong does not have its own economic hinterland. Nevertheless, under the “one country, two systems” arrangement, the Mainland can and should function as Hong Kong’s economic hinterland, much as the European Union has been for the U.K.
- ◆ The Mainland can be a source of huge securities buying power as well as huge demands for capital, both equity and debt, by its enterprises as its GDP and wealth continue to grow. (Even 6.5 percent is a very high rate of growth of real GDP).

# How Does Hong Kong Compare with New York and London?

- ◆ At present, Hong Kong's adult population has an average of only 10 years of schooling, much lower than those of both the United States (12.9) and the United Kingdom (12.3). Taking into account that New York and London are able to attract the best educated people in their respective countries, the human capital gap between Hong Kong and its two competitors is probably even bigger. This is one important reason why the GDP per capita of Hong Kong is significantly lower than those of New York and London.
- ◆ Moreover, while New York and London can readily augment their human-resource pools by attracting talents from the rest of their respective countries and regions, Hong Kong can do so only on a case-by-case application basis. This puts Hong Kong at a potential disadvantage compared to New York (but perhaps not so much compared to London any more). Hong Kong can reduce this disadvantage by expanding its own tertiary education sector and by simplifying the process of recruitment of qualified professionals from the Mainland and the rest of the world.

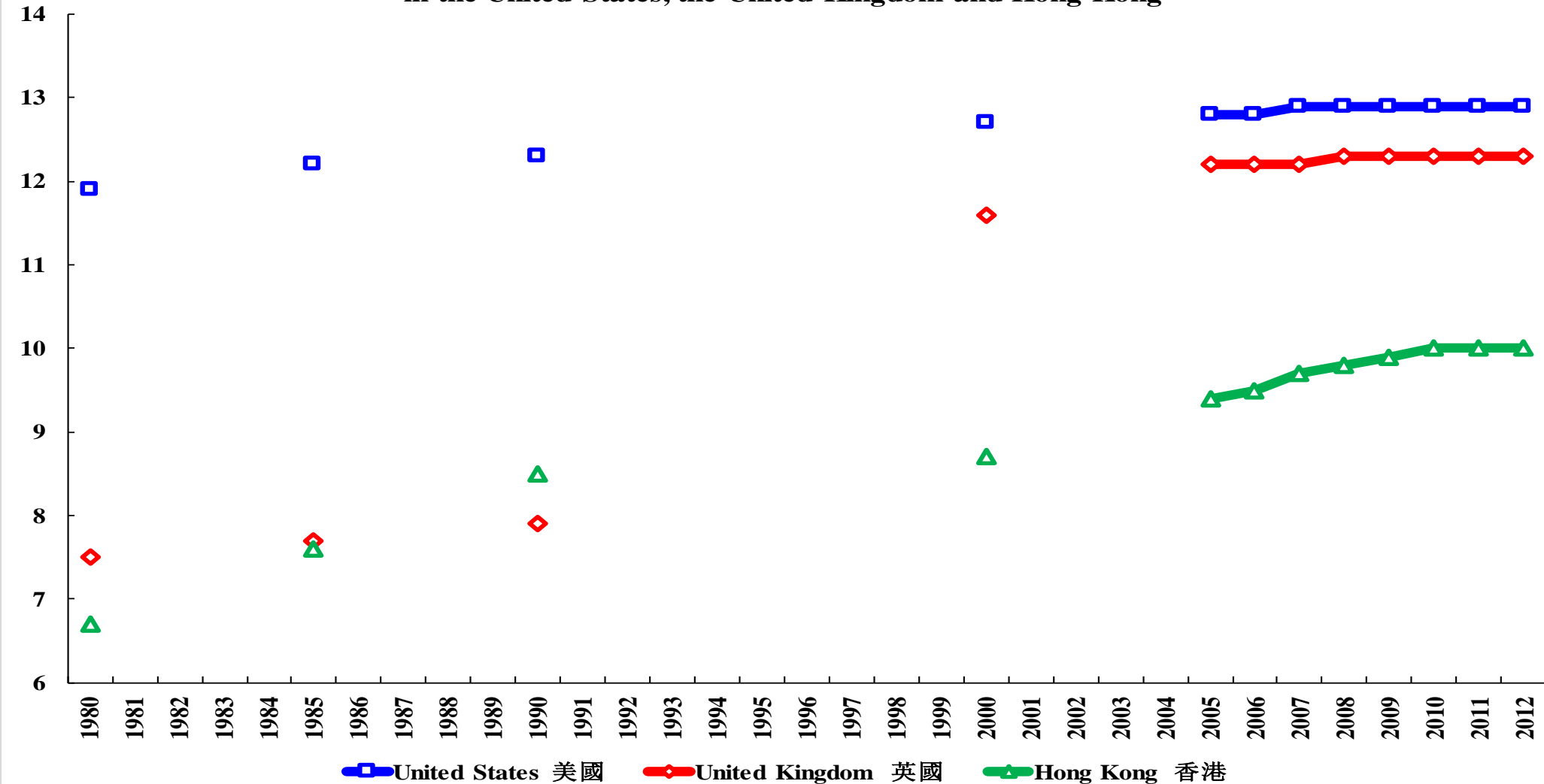


# The Real GDP per Capita of New York, London and Hong Kong, US\$ (2014 prices)



# The Average Number of Years of Schooling of Adults in the U.S., the U.K. and Hong Kong

The Average Number of Years of Schooling of Adults  
in the United States, the United Kingdom and Hong Kong



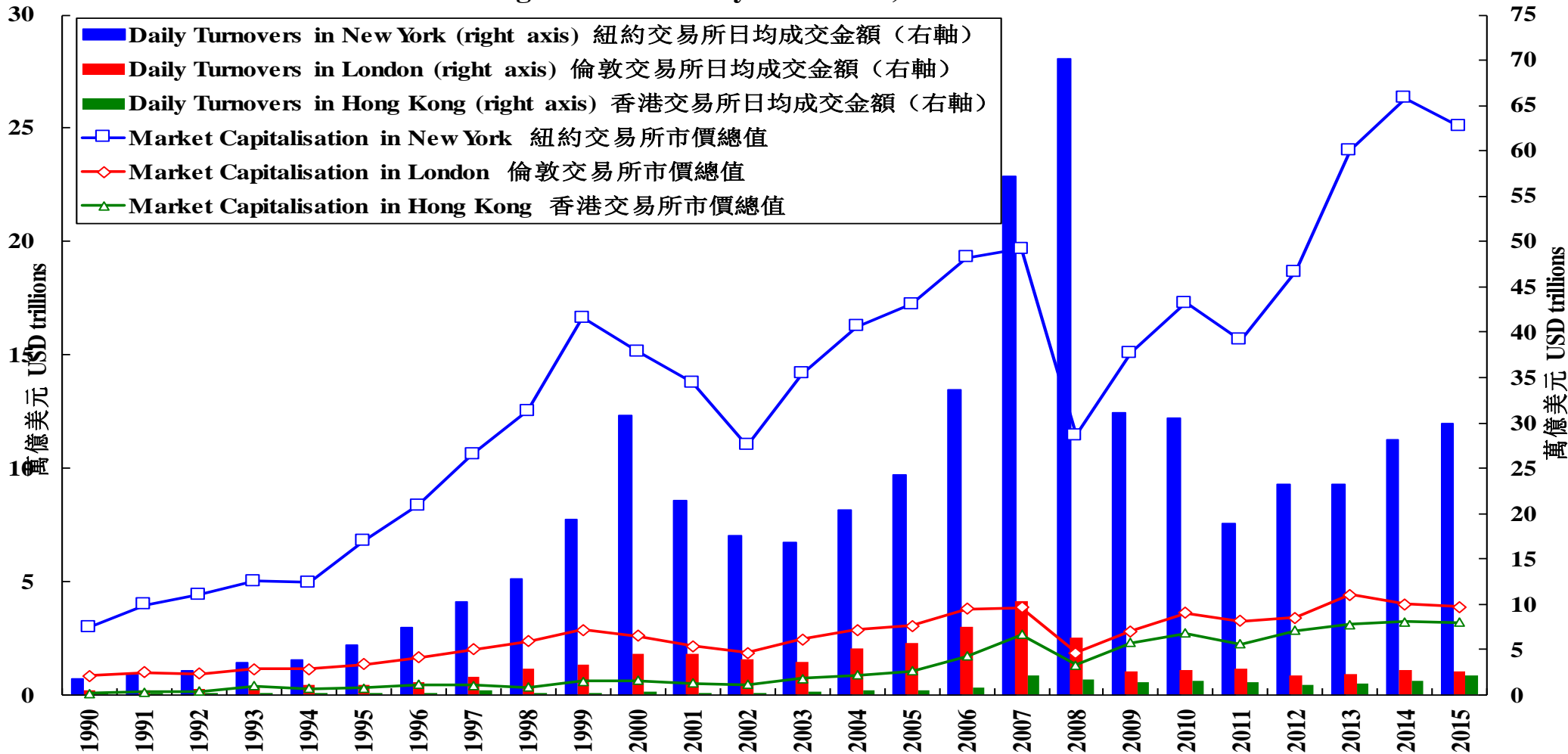
# How Does Hong Kong Compare with New York and London?

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- ◆ Although Hong Kong is behind New York and London in terms of many metrics, it has the potential of overtaking both New York and London to become the premier international financial center of the world in a couple of decades.
- ◆ There is now an opportunity for Hong Kong—with the center of gravity of the world economy shifting from North America and Europe to East Asia, and within East Asia from Japan to China, the continual rapid economic growth of the Mainland, and the savings and wealth that it has generated for its enterprises and households.
- ◆ The unwillingness and inability of Tokyo to become more internationalized, the inability of Shanghai at the present time, and the recent Brexit by the U.K. all provide a unique opportunity for Hong Kong.
- ◆ Singapore has many of the same advantages that Hong Kong has, but it lacks one important thing—a large and supportive potential economic hinterland.

# The Total Market Capitalization of New York, London and Hong Kong and Daily Turnovers

The Total Market Capitalisation of the Stock Exchanges in New York, London and Hong Kong and Their Daily Turnovers, in USD trillions



# The Development of an East-Asia-Wide Bond Market in Hong Kong

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- ◆ Hong Kong does not have an active, deep and liquid sovereign and corporate bond (fixed income) market with both short and long maturities that both New York and London have. In fact, Hong Kong does not at the present time have much of an active bond market at all. This makes Hong Kong unsuitable as a location for many asset managers, including fixed income funds, insurance companies, money market funds, pension funds, sovereign wealth funds and treasury operations of multinational corporations.
- ◆ One reason suggested for the lack of an active bond market in Hong Kong is the fact that the Government of HKSAR habitually runs budget surpluses and hence has no need to borrow from the market through the issuance of bonds. This makes it difficult to establish a (sovereign) benchmark risk-free rate and a long enough yield curve for the Hong Kong bond market. However, this can be readily remedied by the issuance of project bonds by the Government of the HKSAR for the financing of such infrastructural projects as the Third Runway.

# The Development of an East-Asia-Wide Bond Market in Hong Kong

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- ◆ But these projects are one-off. A steady flow of mortgage bonds can also be issued by the Hong Kong Mortgage Corporation (HKMC) for the financing of long-term, say thirty-five-year, fixed-rate, owner-occupied mortgage loans for lower-income households (because of the ceiling on the amount of the loan).
- ◆ The Government of the HKSAR should be able to command a rate of interest on its bonds as good as the U.S. Treasury because of the very low public debt to GDP ratio of Hong Kong compared to the U.S.
- ◆ By buying qualified mortgage loans, the HKMC can bring down significantly the monthly payments for the borrowers (both because of the lower rate enjoyed by HKMC as a quasi-sovereign issuer and because of the longer maturity) and eliminate their interest-rate risks, thus making home ownership more affordable and less risky.

# The Development of an East-Asia-Wide Bond Market in Hong Kong

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- ◆ Commercial banks in Hong Kong and for that matter anywhere else are unable to offer fixed-rate mortgage loans of long maturity because they do not have fixed-rate deposits of similar maturity. If they offer long-term fixed-rate mortgage loans on their own, it will result in a serious maturity-mismatch between their assets and liabilities, with potentially disastrous consequences. However, they can originate these mortgage loans, sell them to HKMC, and service them for fees.
- ◆ With a risk-free rate and a full yield curve established, other HK\$-denominated bonds such as “green” bonds and corporate bonds can be issued based on their own individual credit ratings.
- ◆ US\$-denominated bonds and Renminbi-denominated bonds can follow. Issuers can include sovereign governments, quasi-sovereign institutions, multilateral organizations and corporations from all over East Asia and beyond.

# The Development of an East-Asia-Wide Stock Market in Hong Kong

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- ◆ At present, there is no single market in which the stocks of all major enterprises in East Asia are traded. Investors both inside and out of East Asia would welcome a single exchange where they can buy and sell the equity and debt of blue chip East Asian enterprises (e.g., the MSCI Far East Index components) in US\$ or HK\$ (which is pegged to the US\$), and without having to worry about foreign exchange conversions and restrictions on capital inflows and outflows.
- ◆ In addition, Mainland investors would also welcome the convenience of being able to buy and sell the equity and debt of blue-chip enterprises in developed economies (e.g., the Dow Jones 30 companies), in a single market, if and when capital controls are lifted on the Mainland.
- ◆ It therefore behooves Hong Kong to solicit, encourage and solicit blue-chip enterprises around the world to do secondary listings in Hong Kong as Hong Kong Depositary Receipts (HDRs).



# The Development of an East-Asia-Wide Stock Market in Hong Kong

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- ◆ Why would enterprises listed elsewhere want to have a secondary listing in Hong Kong? One of the attractions is the current and future buying power of Mainland investors and potentially of other East Asian investors as well. (The geographical and time-zone proximity also makes a difference.) Another is the expectation that institutional investors from developed economies also prefer to be able to buy and sell East Asian blue-chip securities in one place and one currency, without any red tape. Thus, a secondary listing in Hong Kong for an enterprise listed elsewhere will increase the potential demand and liquidity for both its equity and its debt securities.

# The Development of an East-Asia-Wide Stock Market in Hong Kong

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- ◆ International institutional investors will also be attracted to Hong Kong by new listed Chinese enterprises, especially the private ones.
- ◆ Hong Kong is an ideal location for the establishment of an East Asian region-wide stock market because of its location and time zone, its efficiency, its free mobility of capital, rule of law, stable currency (fixed peg to the U.S. Dollar), and no tax on dividends and capital gains.
- ◆ Once an East-Asia-wide securities market gets going, it should start a virtuous cycle of more trading volume leading to more listing, and more listing in turn leading to more trading volume, thus feeding on each other.

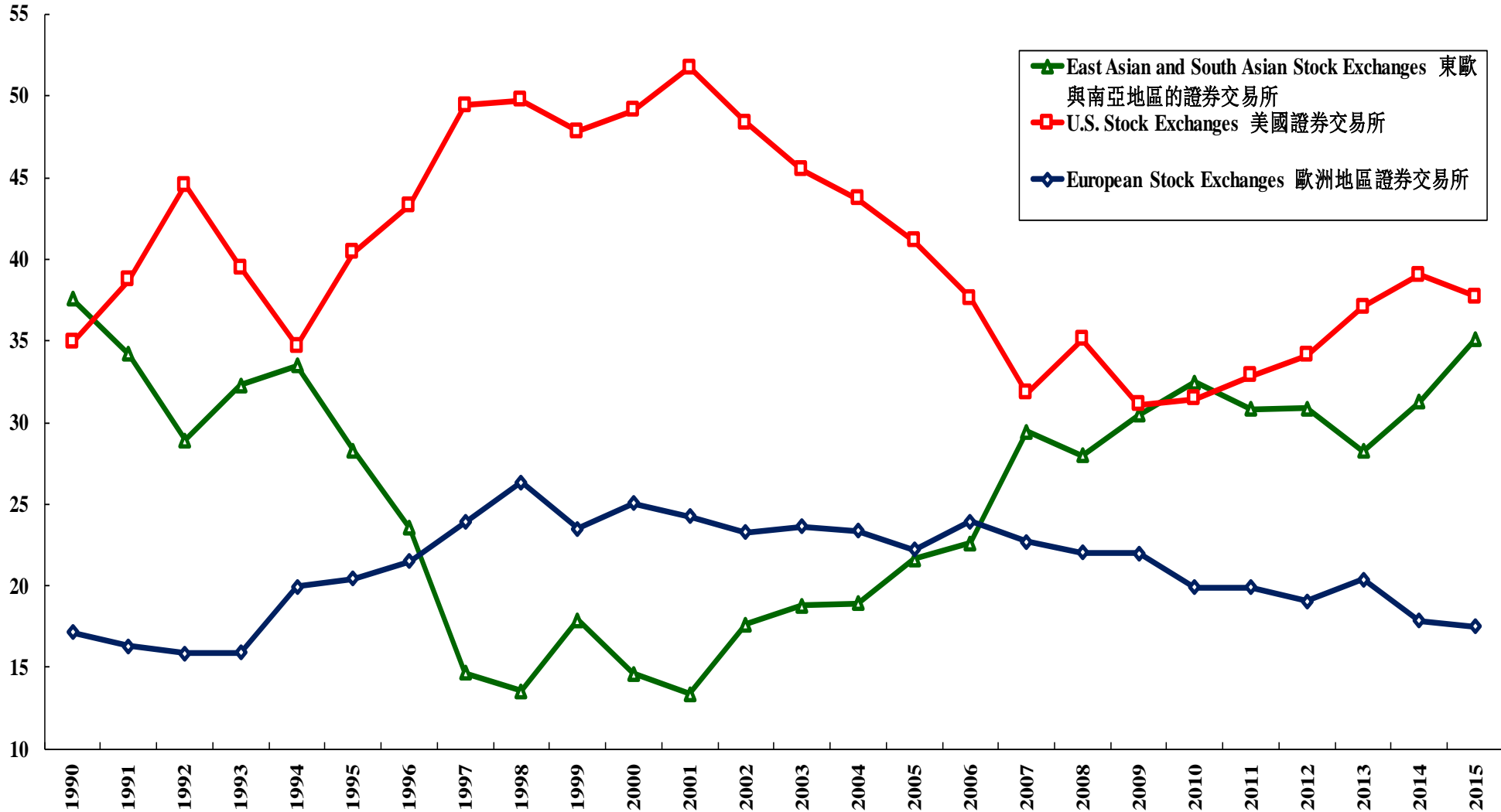
# The Development of an East-Asia-Wide Stock Market in Hong Kong

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- ◆ The buying power of Asian investors has been growing very rapidly since 2000, driven by the rapid rate of growth of their GDPs and wealth as well as the high saving rates.
- ◆ The share of East Asian and South Asian stock exchanges in the total world market capitalization stood above 35% in 2015, compared to 38% for the U.S. and 17% for Europe.
- ◆ The average daily turnover of the Shanghai and Shenzhen Stock Exchanges combined was more than UD\$41 trillion, higher than that of the New York Stock Exchange of UD\$30 trillion in 2015. In contrast, the average daily turnover of the Hong Kong Stock Exchange was only US\$2 trillion. This demonstrates the potential stock-buying power of the Mainland investors. For the East-Asia-wide stock market in Hong Kong to succeed, Hong Kong must harness the buying power of the Mainland investors in addition to attracting the Mainland enterprises to list their shares in Hong Kong.

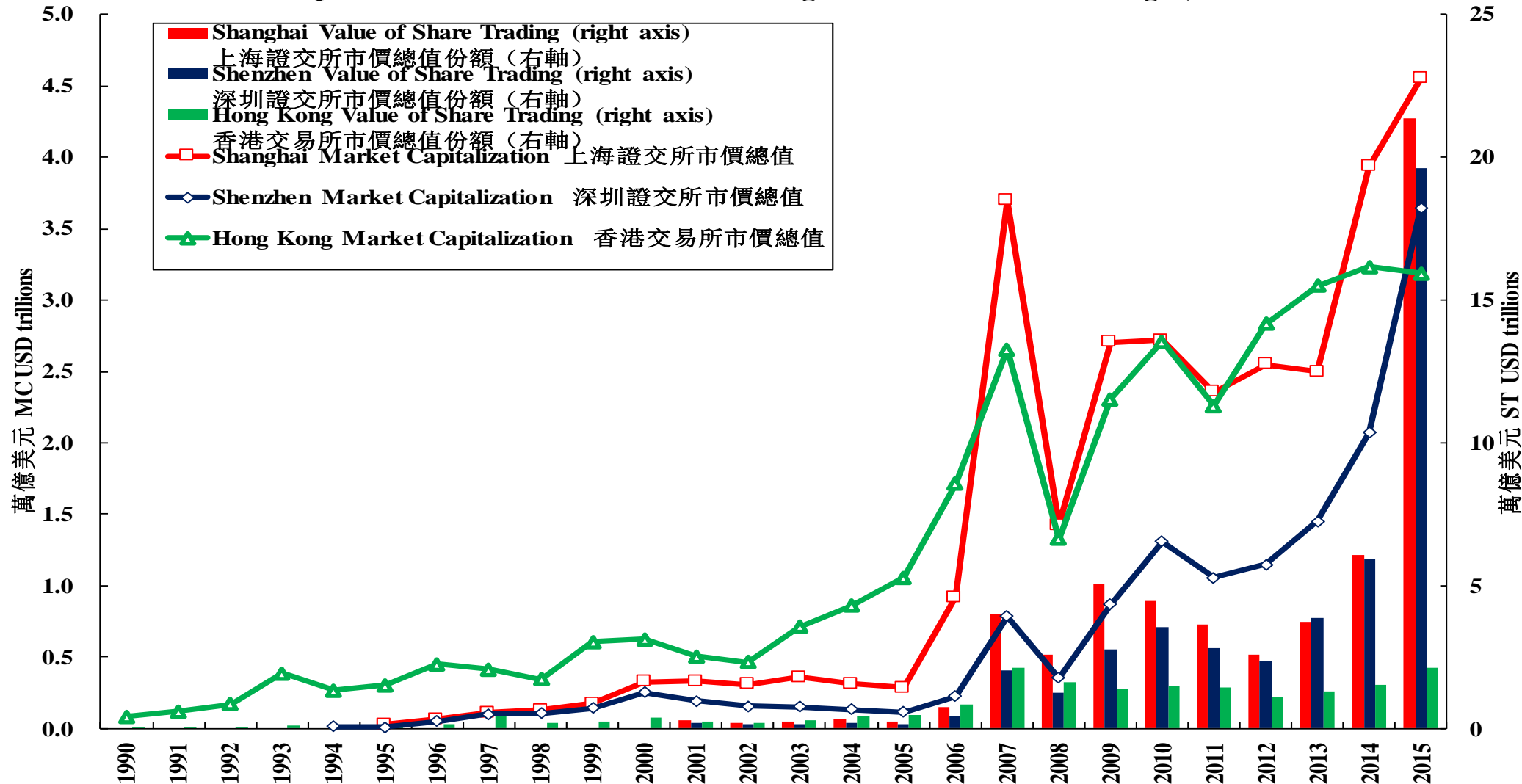
# The Distribution of the Market Capitalization of World Stock Exchanges by Region, percent

The Distribution of the Market Capitalization of World Stock Exchanges by Region, percent



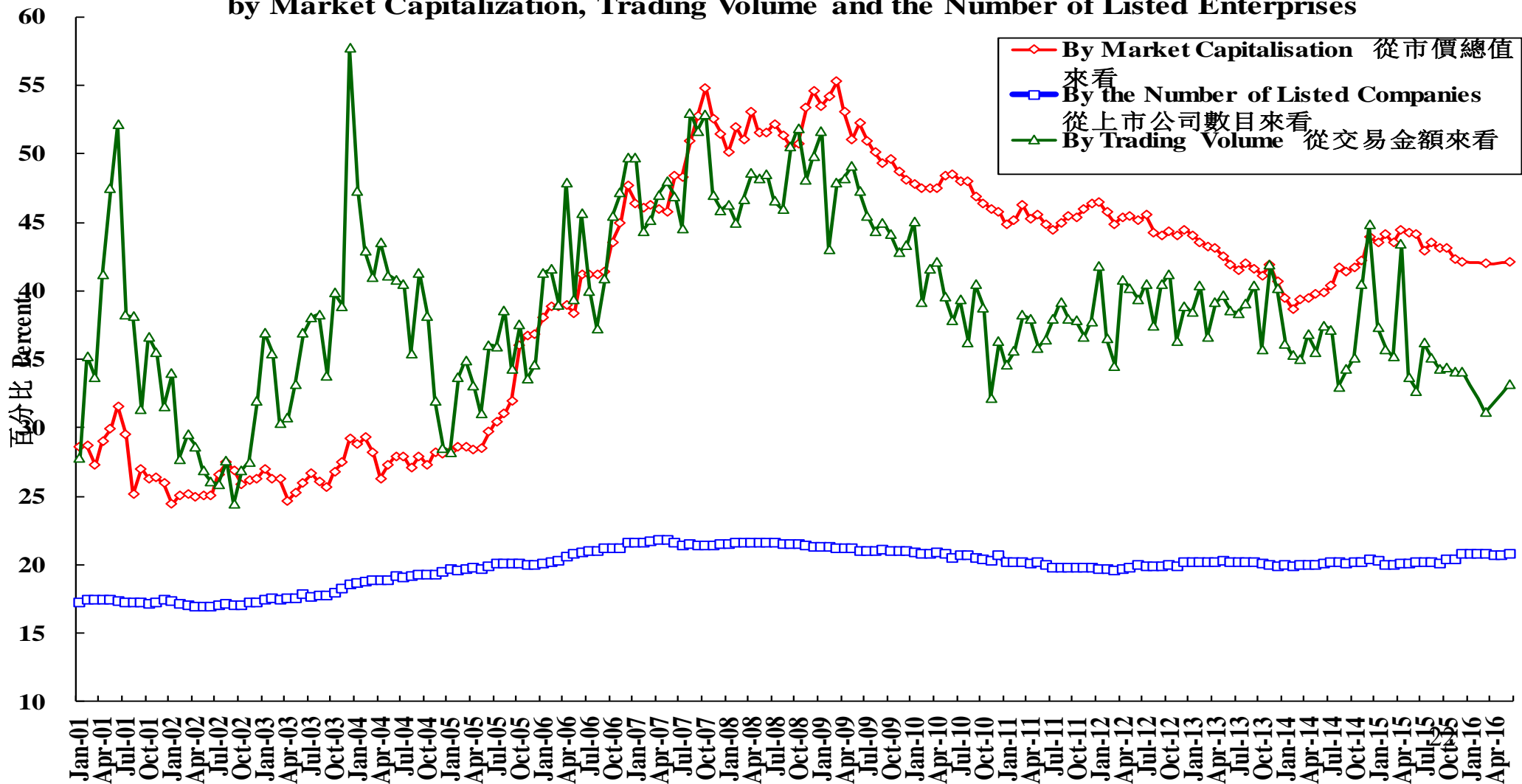
# The Market Capitalization and Value of Share Trading of Chinese Stock Exchanges, US\$ tril.

Market Capitalisation and Value of Share Trading of Chinese Stock Exchanges, US\$ trillions



# The Share of Mainland Enterprises on the Hong Kong Stock Exchange

The Share of Mainland Enterprises on the Hong Kong Stock Exchange  
by Market Capitalization, Trading Volume and the Number of Listed Enterprises

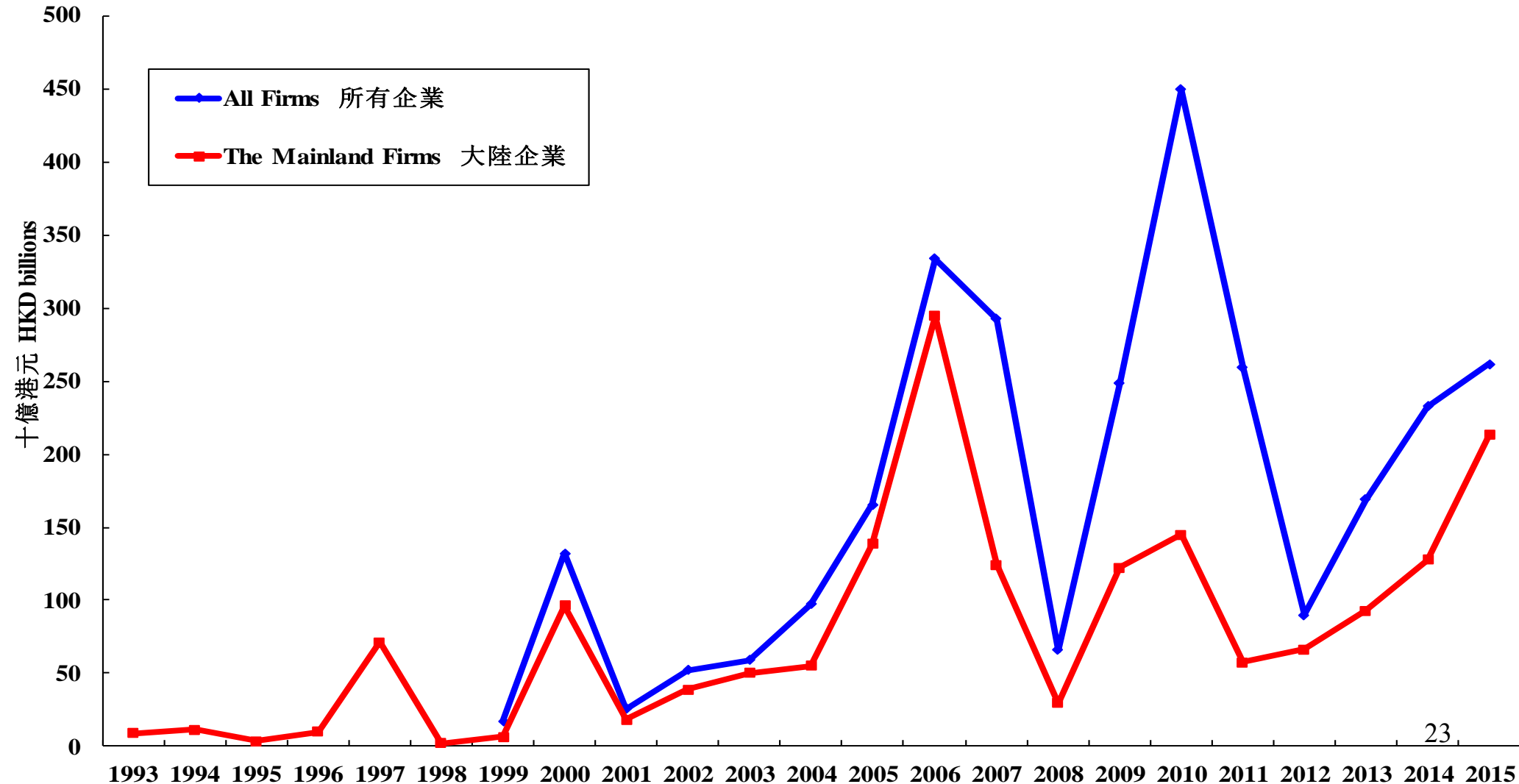


Note: The 2016 market capitalisation and trading volume data were only available quarterly.

Source: HKEx, Bloomberg

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

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



# The Development of an East-Asia-Wide Stock Market in Hong Kong

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- ◆ In 2014, the Hong Kong Stock Exchange lost the IPO of Alibaba, the largest global IPO ever, because it would not allow any shareholder for any new enterprise to be listed in Hong Kong to have “super voting rights”.
- ◆ However, many prosperous private Mainland enterprises are still run by their relatively young founder-owners, and quite a few of them may wish to continue to control and manage them even after their IPOs. In fact, potential investors may also prefer that these founder-owners continue to hold their stakes and remain in charge after IPO. Hong Kong cannot afford to lose all of these potential listings to other stock exchanges.
- ◆ One possible compromise is to grant “super-voting rights” to the “controlling shareholder” and at the same time impose additional obligations on him or her, such as the non-transferability of the “super-voting rights”, and a required prior notification of any sale of shares by the controlling shareholder for a certain fixed period, say between three and six months, so as to allow the other shareholders an opportunity to exit first if they choose to do so.
- ◆ Then with full pre-IPO disclosure of the super-voting rights and the additional obligations of the “controlling shareholder”, as long as the investors are still willing to buy the shares at the IPO, it should not be considered unfair.



# The Development of an East-Asia-Wide Stock Market in Hong Kong

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- ◆ A consultation is underway on possible reforms of the listing procedures and requirements on the Hong Kong Stock Exchange (HKEx).
- ◆ One of the proposals is to establish two new committees to advise on the listing of new enterprises: a listing policy committee and a listing regulatory committee, in addition to the existing listing committee of the HKEx.
- ◆ While this structure may seem cumbersome, it is quite necessary. First, the listing policy committee will be able to consider such issues as “super-voting rights” and “Hong Kong Depositary Receipts” on a generic level, that is, without reference to particular enterprises. Second, the listing regulatory committee will consider the suitability of an enterprise to be listed, presumably after the existing listing committee of the HKEx has approved it. This double vetting makes sense because of the potential conflict of interest on the part of the listing committee of the HKEx.
- ◆ Just as an association of pharmacy owners and managers or even pharmacists cannot substitute for the Food and Drug Administration in the approval of new drugs, the Securities and Futures Commission (SFC), the regulator, should not allow the HKEx to be the sole arbiter of the listing decisions.
- ◆ The SFC has the responsibility of protecting the rights of investors, especially the small investors, and by so doing ultimately enhance and protect the reputation of Hong Kong as an efficient and fair securities market.

# Hong Kong as East Asia's Leading Int'l Asset Management and Headquarters Center

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- ◆ Once an active and thriving East-Asia-wide capital market in both stocks and bonds is successfully established in Hong Kong, it will greatly enhance the attractiveness of the Hong Kong market to not only bond and stock issuers and investors worldwide but also to treasury operations of major multinational financial and non-financial corporations.
- ◆ Global and regional financial institutions such as banks, insurance companies and asset management companies will be more likely to establish their headquarters in Hong Kong, thus further strengthening Hong Kong's position as East Asia's leading international financial center.
- ◆ The Asian Infrastructural Investment Bank (AIIB) and the New Development Bank BRICS should be encouraged to establish branch operations in Hong Kong (just like the China Development Bank) to facilitate raising capital for themselves as well as financing activities for their Mainland and foreign borrowers.

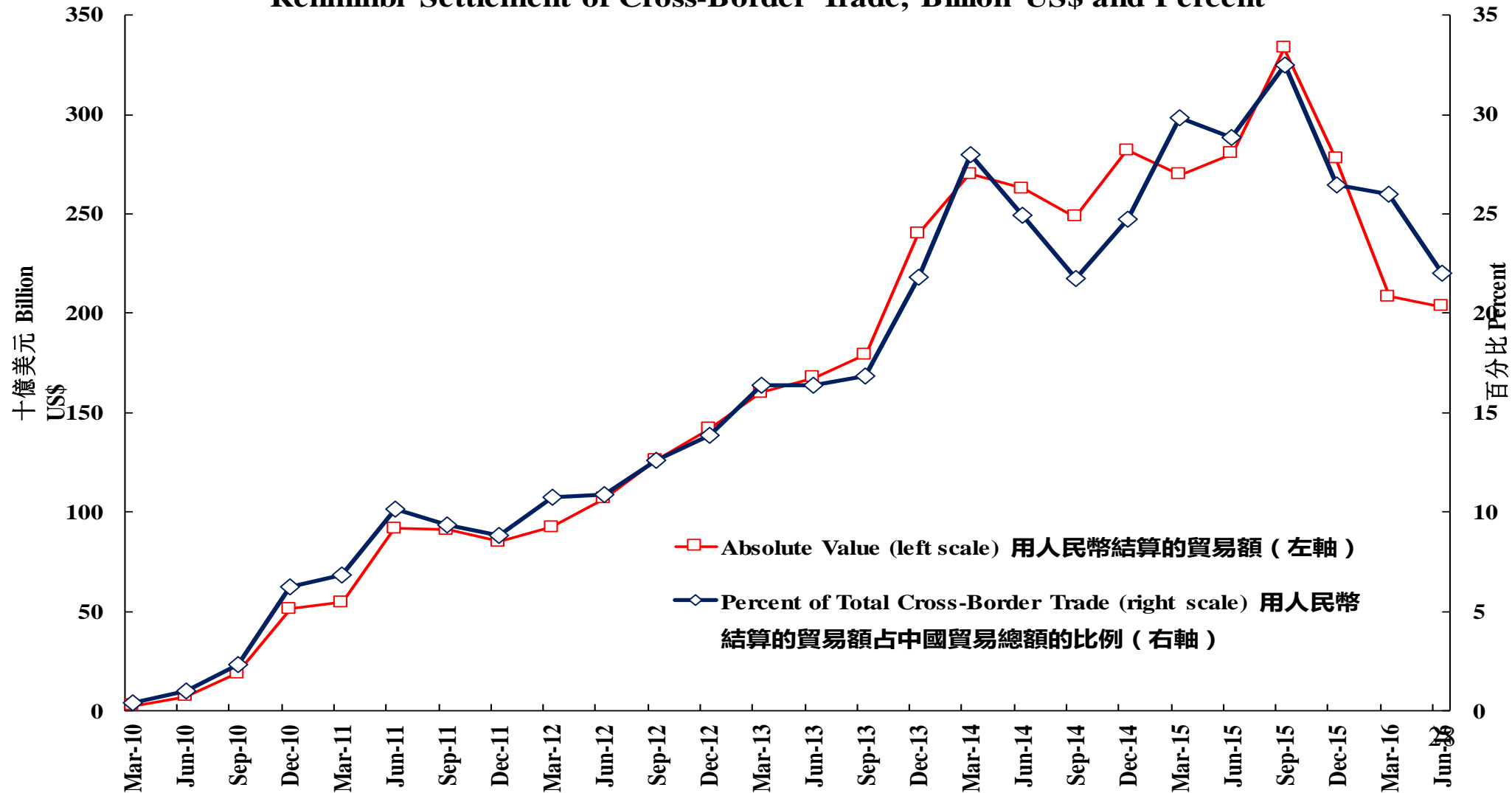
# Hong Kong as the Premier Offshore Renminbi Center

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- ◆ Mainland cross-border trade used to be all settled in U.S. Dollars. However, since 2010, it has been increasingly denominated and settled in Renminbi. As of 2016Q2, almost one quarter (22 percent, or at an annualized rate of more than US\$800 billion) of total Mainland trade was settled in Renminbi, compared to almost nothing in 2010Q1.
- ◆ Hong Kong is currently by far the largest and most active offshore center for Renminbi clearing, settlement, trading and financing, with an average daily volume of transactions approaching 1 trillion Yuan.
- ◆ It is likely to continue to be the leading offshore Renminbi center. With the Renminbi expected to become increasingly internationalized during the next decade or two, this will turn out to be a huge advantage for Hong Kong.

# Renminbi Settlement of Chinese Cross-Border Trade, Billion US\$ and Percent

Renminbi Settlement of Cross-Border Trade, Billion US\$ and Percent



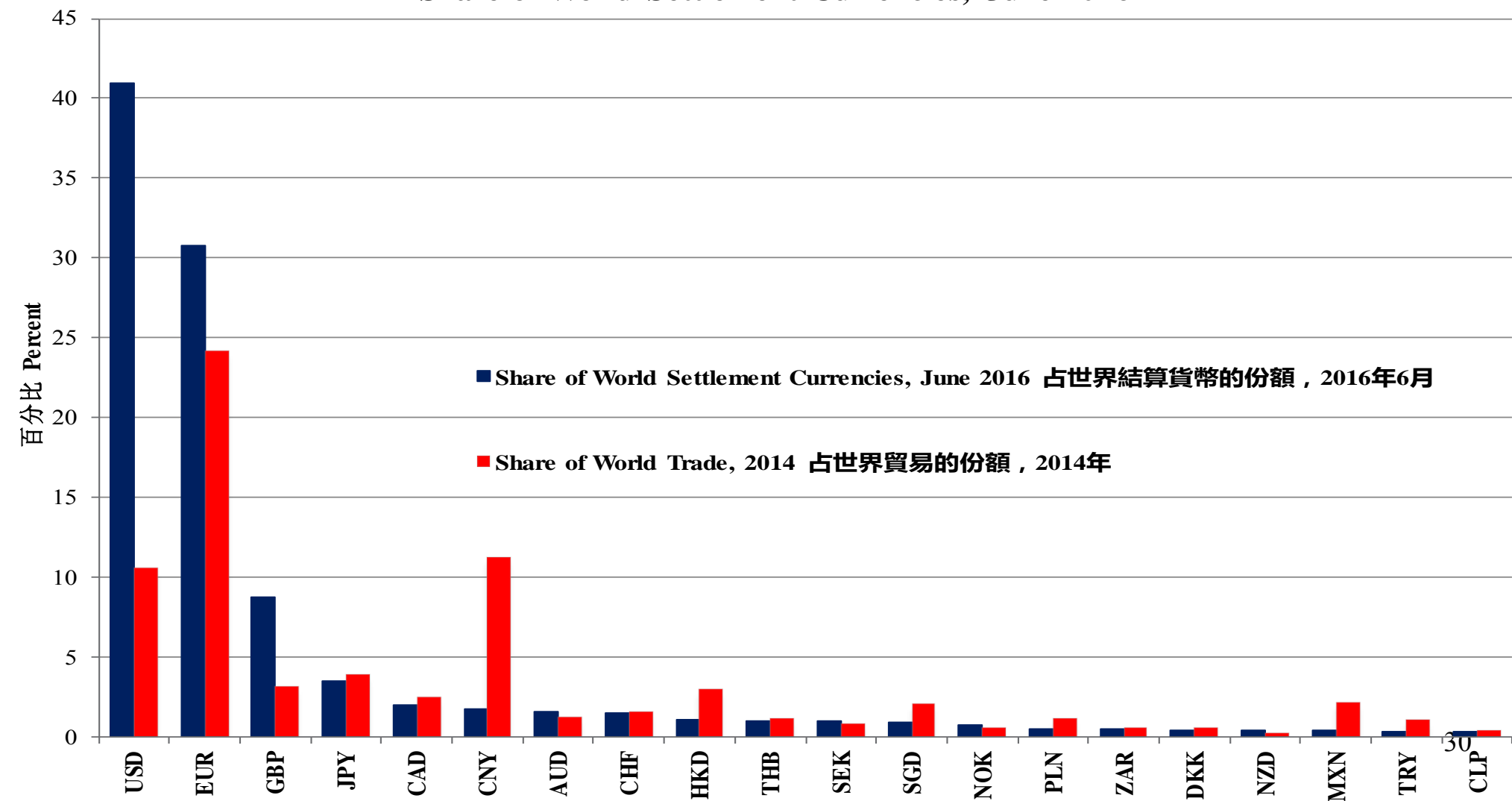
# Hong Kong as the Premier Offshore Renminbi Center

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- ◆ At present, the Renminbi is used for the settlement of international transactions to a much lesser extent than warranted by the Mainland share in world trade. In the following Chart, the world currencies are ranked from left to right in descending order of the sizes of their respective shares in world settlement as of June 2016. The U.S. Dollar was the undisputed champion, accounting for 41% of world settlement, even though the U.S. itself accounted for not quite 11% of world trade in 2014, followed by the Euro, which accounted for 31% of world settlement (with the Euro Area accounting for more than 24% of world trade). The Chinese Yuan, with not quite 2%, was in the sixth place in terms of world settlement, while the Mainland also accounted for more than 10% of world trade.

# The Share of World Settlement of a Country's Currency and Its Share of World Trade

Share of World Settlement Currencies, June 2016



# Hong Kong as the Premier Offshore Renminbi Center

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- ◆ This shows that there is still a great deal of room for the Renminbi to grow in terms of its share of world settlement. This would mean even more business for Hong Kong as the leading offshore Renminbi center, and even less need for the People's Bank of China to maintain a high level of official foreign exchange reserves.
- ◆ Hong Kong has a great advantage over other cities in being the premier offshore Renminbi Center because of its “one country, two systems” arrangement with the Mainland. But Hong Kong should realize that it has to take into account not only its own interests but also the Mainland's interests in order to maintain its position as the premier offshore Renminbi center in the long run.

# Hong Kong as East Asia's International Re-Insurance Market

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- ◆ As the demands for casualty, property and life insurance have been increasing by leaps and bounds in the East Asian region, including the Mainland, so do the derivative demands for re-insurance—all insurance companies need re-insurance so as to diversify and share their risks.
- ◆ Re-insurance, like insurance, is a scale business, and the East Asian economies have now grown sufficiently large to realize the economies of scale of re-insurance based on their own demands.
- ◆ In addition, the Mainland and the other East Asian economies, with their high saving rates, are potentially major sources of risk capital for the re-insurance business. An international re-insurance center can be developed right here in East Asia. What is needed is some concerted governmental action to establish one or more East-Asia-wide re-insurance companies that are licensed to do business everywhere in East Asia and which ideally should have multinational ownership.



# Hong Kong as East Asia's International Re-Insurance Market

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- ◆ There are four necessary requirements for an international re-insurance center:
- ◆ First, there must be an abundance of investors and capital willing and able to assume risks. The appetite for risks in East Asia is clearly demonstrated by the booming casino business in Macau and the A-share markets in Shanghai and Shenzhen.
- ◆ Second, there must be a stable currency and complete freedom of capital flows to and from everywhere, so that insurance premia can be received and claims can be paid expeditiously worldwide.
- ◆ Third, there must be political stability, a tradition of adherence to the rule of law, and a credible, efficient, fair and transparent judicial system that is ready to adjudicate and enforce insurance contracts and claims in a timely manner.
- ◆ Finally, there must be a large supply of highly seasoned professional expertise in accounting, actuarial sciences, law and risk assessment.
- ◆ Hong Kong is uniquely suited to become an international re-insurance center for the East Asian region.

# Hong Kong as East Asia's Leading International Financial Center

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- ◆ In order for Hong Kong to succeed in becoming the leading international financial center for East Asia, a pro-active Government of the HKSAR is needed to plan a long-term strategy and to rally everyone in Hong Kong, including its major enterprises, to work together to make it happen.
- ◆ It will also need the support of the Central Government.
- ◆ Once Hong Kong is established as the home of the East Asian region-wide securities market, it will be almost impossible for it to be displaced or replaced.

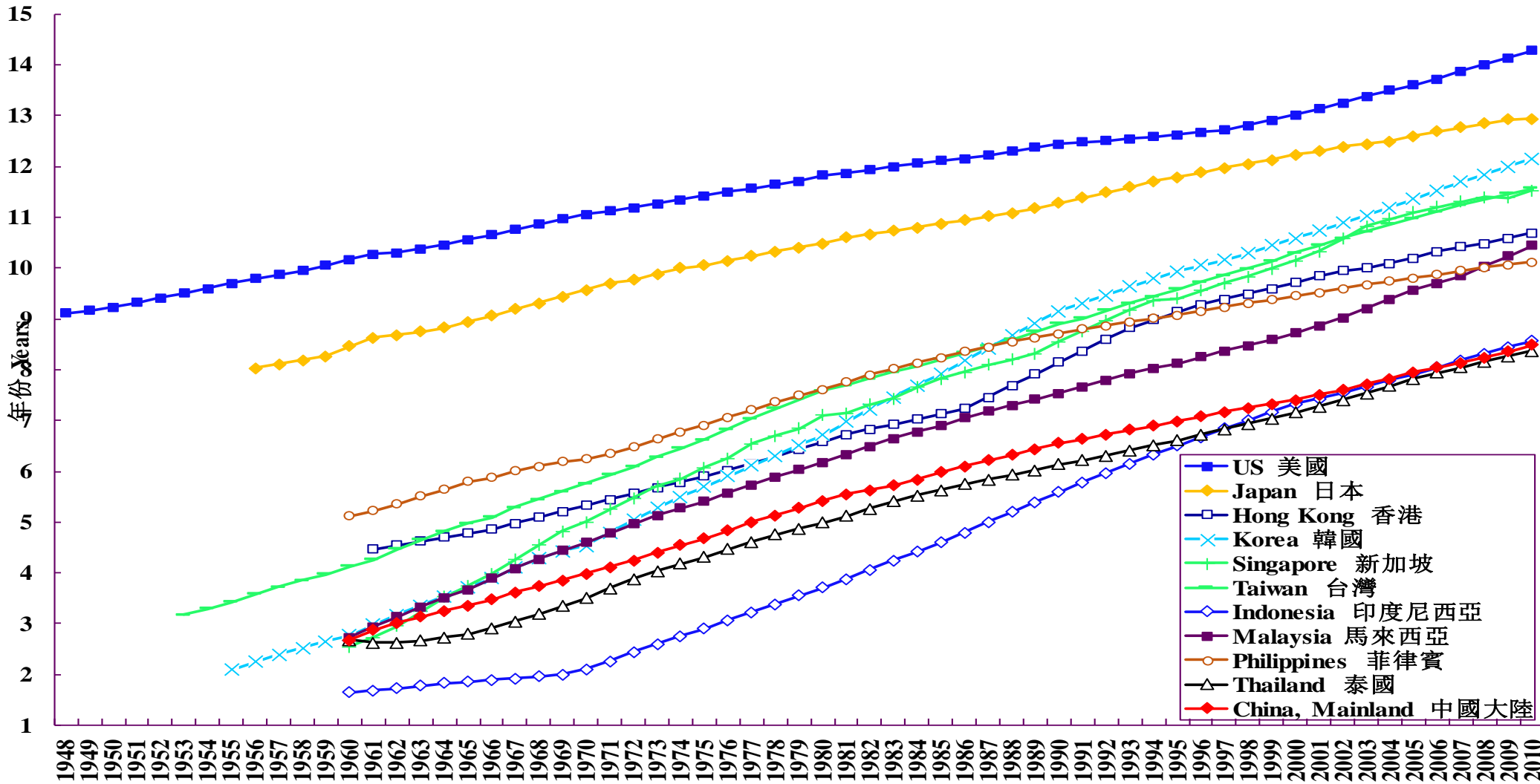
# Hong Kong as East Asia's International Innovation and Venture Capital Center

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- ◆ Hong Kong can also develop into an international center for innovation and venture capital, a “Silicon Valley/Route 128 ” cum NASDAQ for the entire East Asian region, specializing in the creation of intangible capital (human capital, R&D capital, goodwill, intellectual property, and knowledge capital) and the capitalization of its commercial value through “Initial Public Offerings (IPOs)” and “Mergers and Acquisitions (M&As)”.
- ◆ This will involve a four-pronged complementary approach: increasing investment in human capital, specifically in tertiary and post-graduate education; increasing investment in research and development (R&D); creating a nurturing eco-system for venture capital; and facilitating the IPO and M&A markets for successful start-up firms so that they can raise the additional capital needed.
- ◆ However, Hong Kong lags significantly behind New York and London in terms of human capital. It also lags behind other developed and developing economies. In 2010, the average number of years of schooling of the working-age population in Hong Kong was 10.7 years, behind those of the other East Asian NIEs of South Korea, Taiwan and Singapore, and still substantially below those of the U.S. and Japan.

# Average No. of Years of Schooling per Person in the Working Age Pop., Selected Economies

Average Number of Years of Schooling of Selected Economies (1945-present)



# Hong Kong as East Asia's International Innovation and Venture Capital Center

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- ◆ To augment its human capital, Hong Kong must try to increase its own tertiary education (bachelor-degree) enrolment rate substantially from its current 32 percent (2014-15 figure) . By comparison, the corresponding tertiary education enrolment rates are over 30 percent on the Mainland, over 90 percent in South Korea, and over 100 percent in Taiwan.
- ◆ In Hong Kong, many graduates of secondary schools are actually enrolled in two-year sub-degree programs, including associate-degree programs. These associate-degree programs are similar to those offered by junior colleges or community colleges in the U.S. and essentially cover the first two years of a conventional bachelor-degree curriculum. They are socially desirable because they provide students who for one reason or another have not done well in secondary schools a second chance.
- ◆ However, as implemented in Hong Kong, they have two basic problems. First, they are too expensive (in the U.S., such programs are virtually free). Second, the graduates from the associate-degree programs do not have a ready career or education advancement path in Hong Kong.

# Hong Kong as East Asia's International Innovation and Venture Capital Center

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- ◆ The Government of the HKSAR should subsidize the tuition fees of Hong Kong citizens or permanent residents enrolled in qualified associate-degree programs in the same way that public primary and secondary education are subsidized. The publicly funded universities in Hong Kong should allocate more places for entry in the third year by applicants with associate degrees.
- ◆ However, this alone is not likely to be sufficient to accommodate all of the annual associate-degree graduates. As there are more than two thousand tertiary educational institutions on the Mainland, the Government of the Hong Kong SAR can negotiate with the Ministry of Education of the Central Government to allow selected universities on the Mainland to each allocate 50 or 100 student places annually to be open to application by associate-degree holders from Hong Kong for admission to the third year. The Government of HKSAR can also provide a tuition grant to any such Hong Kong citizen or permanent resident admitted.
- ◆ An important necessary government commitment is that the graduates from these Mainland universities under this articulation program will be eligible to apply for government civil-service or government-funded public-service positions after receiving their bachelor degrees and returning to Hong Kong.

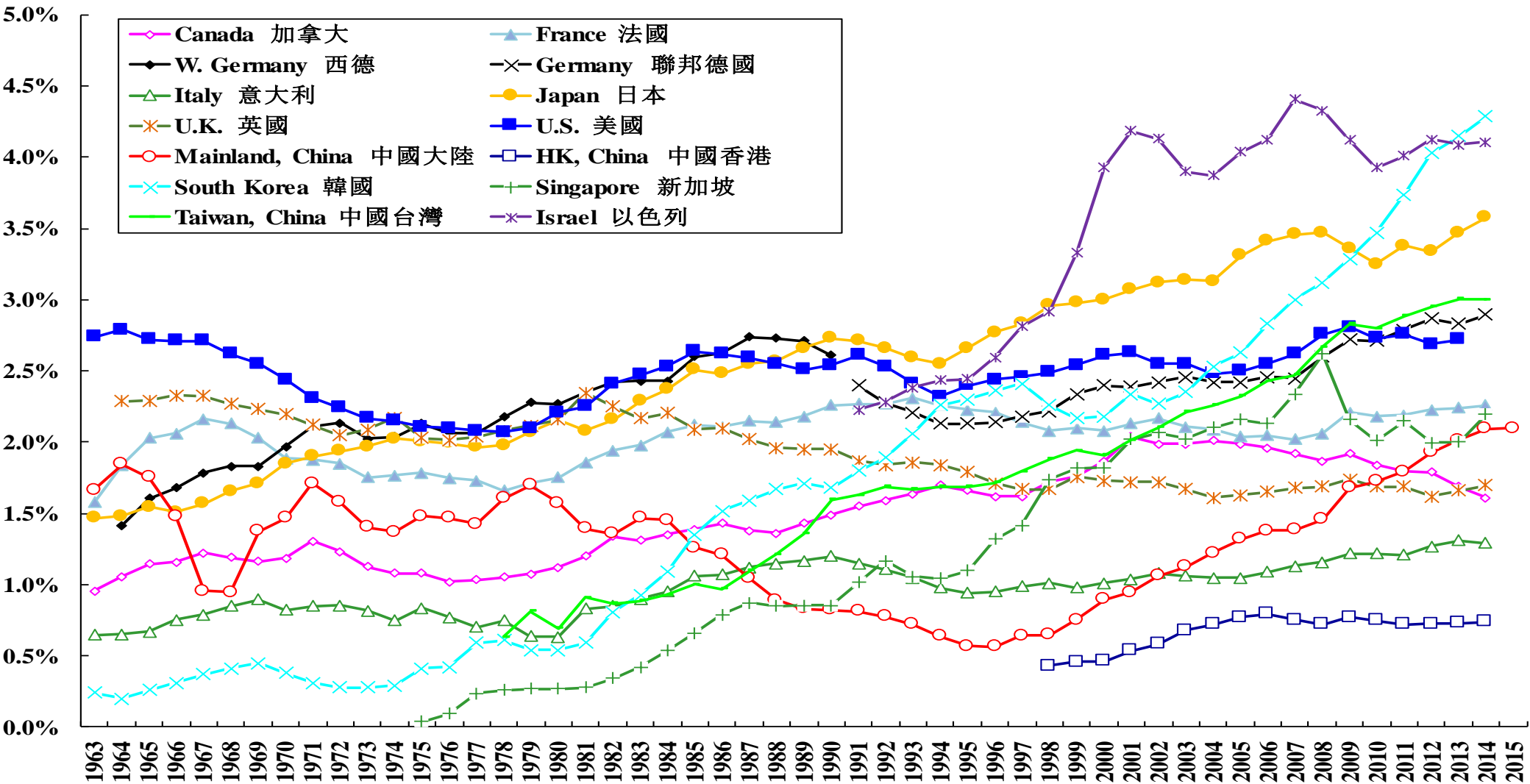
# Hong Kong as East Asia's International Innovation and Venture Capital Center

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- ◆ Investment in R&D capital is also important for promoting innovation (technical progress) in an economy. Hong Kong's R&D expenditure as a percent of GDP has been persistently and pitifully low. It invested only 0.73% of its GDP in R&D in 2015. By comparison, the R&D Expenditure-GDP ratio was around 2% for Singapore, 3% for Taiwan and over 4% for South Korea. Hong Kong's ratio is also significantly below the historical averages of 2.5% for the U.S. and 3% for Japan, and the 4% of Hong Kong's closest neighbor, Shenzhen, and 6% of Beijing.
- ◆ We recommend that the Government of HKSAR should set a long-term target for overall expenditure on R&D at 4% of GDP over the next decade or two, comparable to the current ratios of Israel, South Korea and Shenzhen and that of government-funded R&D to 1.6% of GDP from its current 0.4%. It is only through continuous innovation that Hong Kong can create more higher-paying jobs and thus increase both the level and the rate of growth of real disposable income per capita in Hong Kong in a sustainable manner.

# R&D Expenditures as a Ratio of GDP: G-7 Countries, 4 East Asian NIES, China & Israel

R&D Expenditure as a Percent of GDP: G-7 Countries, 4 East Asian NIES, China & Israel





# Hong Kong as East Asia's International Innovation and Venture Capital Center

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- ◆ However, this also means that the non-Hong Kong Government-funded R&D expenditure should increase from 0.33% of GDP to 2.4% of GDP over the next couple of decades. It is essential for the Government to encourage the private sector to increase its investment in R&D by providing the enabling conditions, environment and incentives for the private sector to support R&D.
- ◆ It can do so via its land, tax and intellectual property registration and protection policies. In particular, Hong Kong should consider allowing corporations to deduct twice their current R&D expenditure against their revenues for profits tax purposes.
- ◆ The government can strengthen the protection of intellectual property such as patents, copyrights, trademarks, trade secrets and know-how.
- ◆ The government can also try to provide the incentives for domestic and foreign private equity and venture capital firms to locate their global or regional headquarters in Hong Kong and to invest in Hong Kong-based start-up enterprises. It can also facilitate the listing of successful invested enterprises on the Hong Kong stock exchanges or other means of exit for the venture investors.

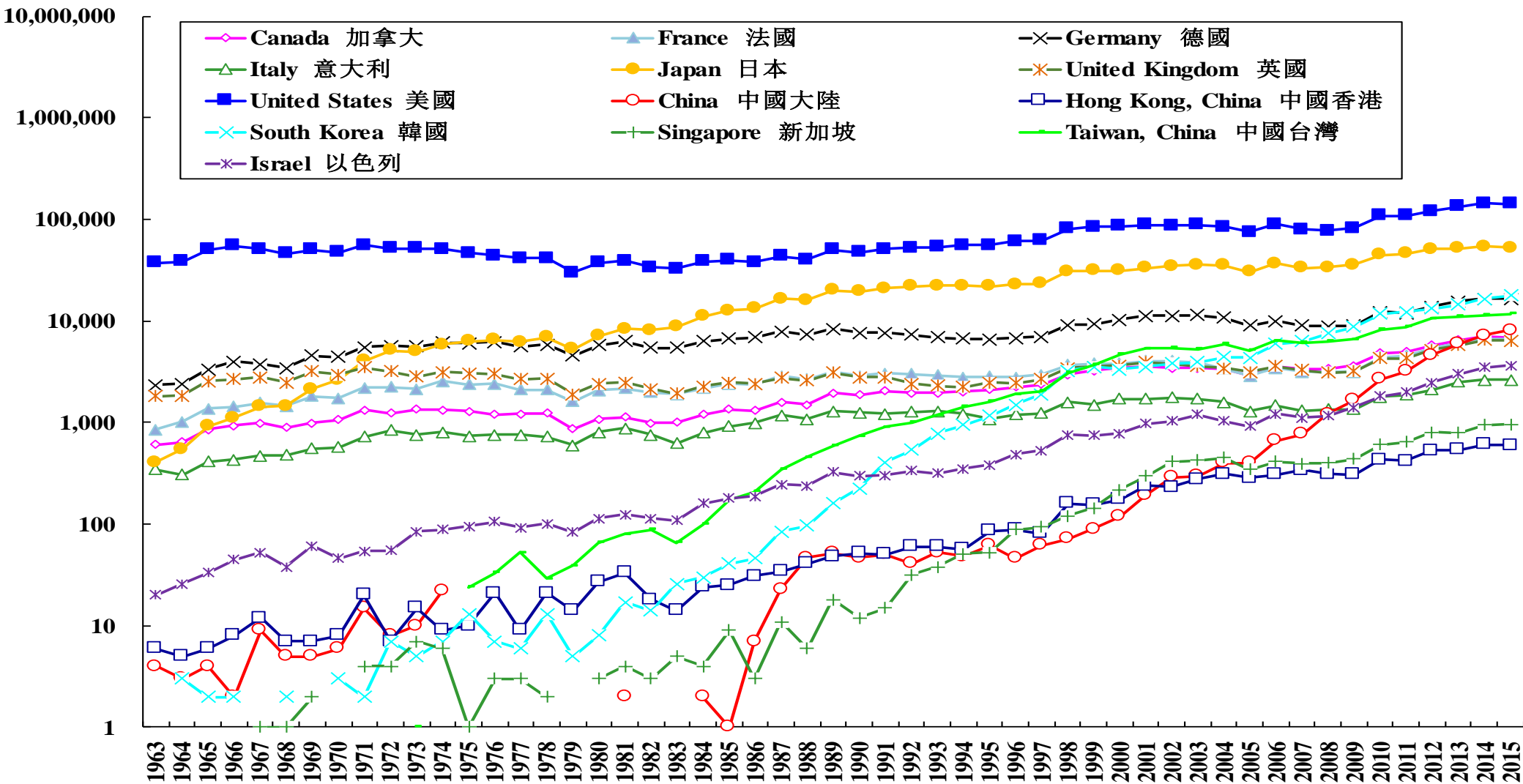
# Hong Kong as East Asia's International Innovation and Venture Capital Center

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- ◆ A useful comparative indicator of the national potential for innovation (national innovative capacity) is the number of patents granted each year. In the following Chart, the annual number of patents granted in the United States each year to the nationals of different countries, including the U.S. itself, over time is presented. It shows that the U.S. has been the undisputed champion over the past forty years, with 140,969 patents awarded in 2015, followed by Japan, with 52,409. (Since these are patents granted in the U.S., the U.S. may have a home advantage; however, for all the other countries and regions, the comparison across them should be valid and fair.)
- ◆ Hong Kong ranked the lowest among the four East Asian NIEs with 601 patents in 2015. (In terms of the number of domestic patents, Hong Kong is even lower.)
- ◆ There is a positive relationship between the number of patents granted to each economy and its stock of R&D capital (defined as cumulative real expenditure on R&D less an annual depreciation of 10%)—the higher the capital stock, the higher the total number of patents.
- ◆ Human capital, R&D capital and venture capital are complementary to one another.

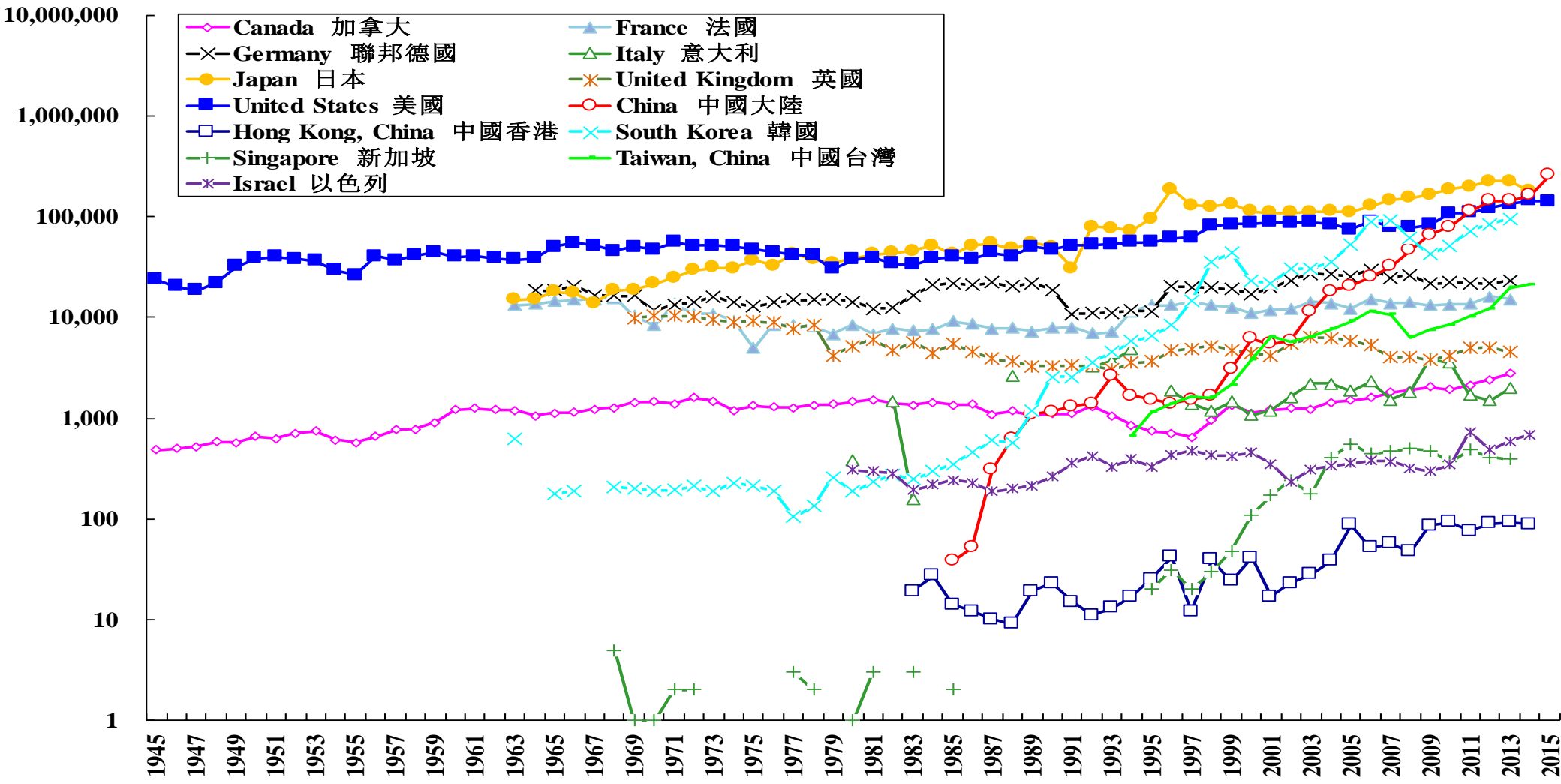
# Patents Granted in the United States: G-7 Countries, 4 East Asian NIEs, China & Israel

Patents Granted in the United States: G-7 Countries, 4 East Asian NIEs, China & Israel



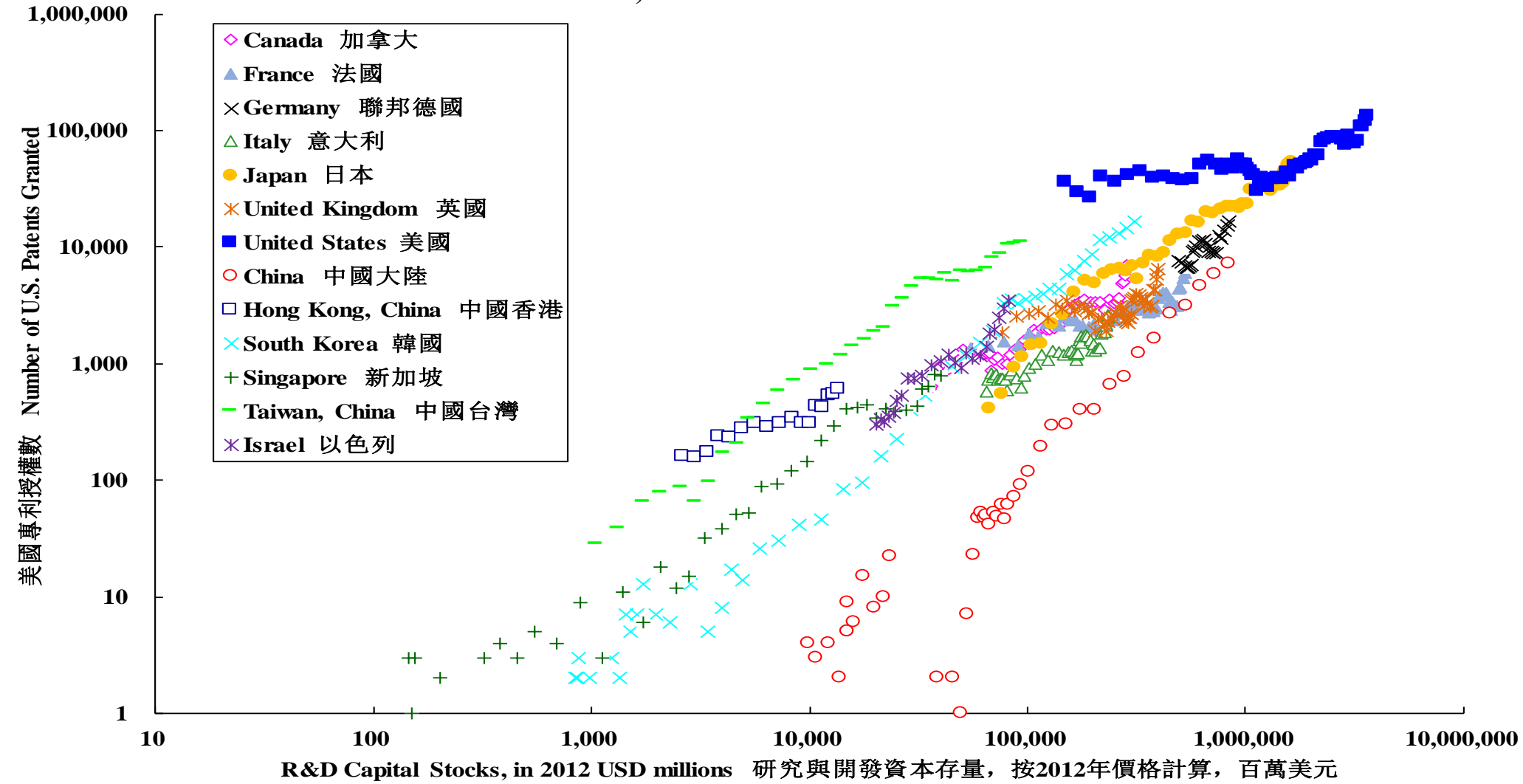
# Domestic Patents Granted Annually: G-7 Countries, 4 East Asian NIEs, China and Israel

Domestic Patent Granted to Domestic Applicants Annually:  
G-7 Countries, 4 East Asian NIEs, China and Israel



# U.S. Patents Granted and R&D Capital Stocks: G-7 Countries, 4 East Asian NIEs and China

U.S. Patents Granted and R&D Capital Stocks:  
G-7 Countries, 4 East Asian NIEs and China



# Hong Kong as an International Professional Services Center

- ◆ The service sector in Hong Kong should be developed in such a way to enable Hong Kong to become a “destination” itself rather than simply a transit/trans-shipment point. Jobs will be much easier to retain in Hong Kong if Hong Kong itself is the “destination” or the “hub”.
- ◆ Expectations are critical to the success of a hub—if potential suppliers expect to find demand at the hub and potential demanders also expect to find supply at the hub, they will both show up at the hub, and transactions will result, making the hub a success. A successful hub also depends on the quantity of traffic, and the quantity of traffic depends on the prior expectations, which can be self-fulfilling.
- ◆ One of the consequences of globalization is that any job that can be moved away to a lower-cost location will be moved away. Most low-skilled jobs have already migrated away from Hong Kong. The only low-skilled jobs that are left are the jobs needed to provide services to people who are physically in Hong Kong, whether on a permanent or a transient basis, such as tourists. These jobs will not migrate away, as long as tourists keep coming to Hong Kong, but they do not pay well enough.
- ◆ The challenge is to create better-paying jobs that are also not so dependent on tourism, which can be quite fickle, and at the same time upgrade the skill levels of the workers so that they can take on the new, better-paying jobs.

# Hong Kong as an International Education Hub

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- ◆ Hong Kong should aspire to develop into an international education (as well as R&D) hub, like Boston, for the East Asian region. Within a 50-mile radius of Boston, there are probably close to a hundred tertiary educational institutions, with most of them private but non-profit. Together they form an international education hub that attracts accomplished scholars as well as novice students from all over the United States and the world. These tertiary educational (and R&D) institutions as a group are major employers in the area, as are the high-technology companies that they help to spawn, generating many jobs that cannot move away.
- ◆ It is possible for Hong Kong to emulate Boston's success as an international education hub, but it will take perhaps a decade or longer, as well as persistent and dedicated efforts. There are two principal factors that account for Boston's success: first, Harvard and MIT, because of their world-class status, act as magnets to talented individuals with academic aspirations everywhere; and second, the large number of diverse tertiary educational institutions in the area allows the realization of the economies of scale (some would say the "economies of agglomeration") in the Greater Boston "market" for tertiary education: a potential professor can always find a position and a potential student can always find a place.

# Hong Kong as an International Education Hub

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- ◆ In order to become the Boston of East Asia, Hong Kong will need to try to raise one or two of its comprehensive research-based universities to the highest international standards of academic excellence, by committing additional long-term resources to it, so that Hong Kong can be put on the world tertiary education map. This will help to attract the best professors and students to Hong Kong from around the world.
- ◆ The Government of the HKSAR should put into practice the concept of “role differentiation”, and focus its support for basic and applied research and research postgraduate students on one or two leading tertiary educational institutions, and encourage the private sector to do the same, for example, through matching grants.
- ◆ However, only a very strong government can manage to direct additional research resources to only one or two public universities.



# Hong Kong as an International Education Hub

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- ◆ It is politically untenable for Hong Kong to try to become an international education hub if it cannot even satisfy the needs of its own permanent residents. Hong Kong should therefore plan for an eventual increase of its local enrolment rate to at least 40 percent. The expansion can come from both an increase in the enrolment per existing tertiary educational institution, public and private, and an increase in the number of such institutions.
- ◆ However, it is not possible for the entire expansion of tertiary enrolment to be financed by the Government of the HKSAR alone. The expansion in the number of tertiary educational institutions in Hong Kong can be more easily accomplished through the establishment of new private, non-profit universities and colleges. Potential sources of financing can include private individuals, foundations, religious institutions, and even non-local academic institutions.
- ◆ The government should encourage and support these initiatives and also explore high-technology alternatives for the tertiary education sector that make use of distance-learning and the internet, such as the operations of the Open University here in Hong Kong and the University of Phoenix in the U.S., as well as “massive open online courses (MOOCs)”.<sup>49</sup>

# Hong Kong as an International Education Hub: The Potential Benefits

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- ◆ First of all, the expansion of the tertiary education sector will help to attract talents and retain them in Hong Kong. It will also enhance and upgrade the quality of its labor force at all levels, and hence maintain its competitiveness.
- ◆ Second, it can create many permanent jobs of varying skill requirements that cannot be moved away, are more stable and permanent, and not so cyclical or fickle. In addition, a non-local student population also creates derived tourism on the part of their parents, family members, relatives and friends. A successful education hub generates an annually renewable demand for services.
- ◆ Third, Hong Kong will be training the future elite of the East Asian region. If the non-local students decide to stay in Hong Kong after graduation, they will augment the talent pool; if they return to their home countries and regions, they can become goodwill ambassadors for Hong Kong.
- ◆ Fourth, the opportunities for Hong Kong's own students to be exposed to multiple different cultures can be beneficial to them in this increasingly globalized world.
- ◆ Finally, the expansion of the tertiary education sector will facilitate the gradual transformation of Hong Kong to a knowledge-based economy, which will also help Hong Kong to maintain its competitive advantage over Mainland and Southeast Asian cities with their lower costs of labor and land.

# Hong Kong as an International Health Care Hub

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- ◆ Hong Kong also has the potential to become an international health care hub for the East Asian region. It should aim to be the place where patients with difficult cases within the region will be sent for further examination, testing, diagnosis and treatment. There is a great deal of such potential demand for medical treatment by patients from the Mainland and Southeast Asia, for reasons of both the quality of the health care generally available in their home countries and the relatively restricted access to the best available care there even for those patients who can afford it.
- ◆ However, in order for Hong Kong to become such a health care hub, it also needs to increase its capacity for the provision of health care significantly—it will need more doctors, more nurses, and more hospital beds. Hong Kong cannot aspire to becoming an international health care hub if it cannot adequately care for the local patients in a timely manner.
- ◆ Hong Kong has a unique advantage as a health care hub because its health care professionals are able to combine the best that Western medicine and traditional Chinese medicine have to offer. And the growth in health care services can in turn spur related research and development in Hong Kong.

# Hong Kong as an International Legal Services Hub

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- ◆ Hong Kong has always been and continues to be a common-law jurisdiction. Because of its long tradition of rule of law, its efficient and fair judicial system, and its abundance of professional legal manpower, Hong Kong can serve as a center for international legal, arbitration, dispute mediation and settlement services for the East Asian region.
- ◆ It can provide the necessary legal and other services, and the infrastructural support for Mainland enterprises investing overseas and foreign enterprises seeking to invest on the Mainland. In particular, it can serve all of the parties involved in the “Belt and Road” projects. Of course, if the proposed East-Asia-wide securities market comes to fruition, a great deal of recurrent demand for legal services, by Hong Kong, Mainland and foreign clients, will be generated in Hong Kong.

# Pearl River Delta (PRD) Economic Cooperation

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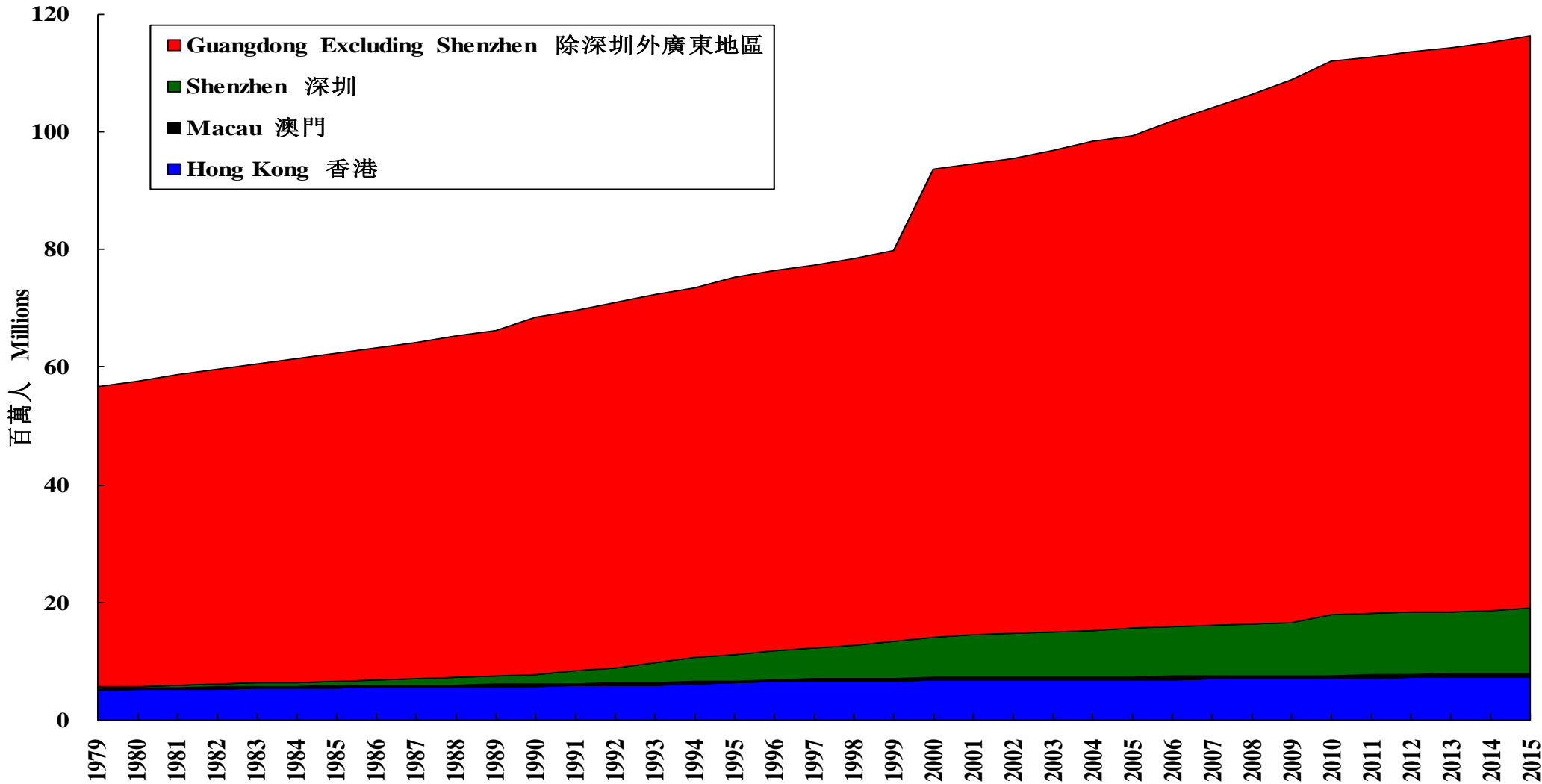
- ◆ Hong Kong can become the vanguard of the Pearl River Delta Economic Zone, which comprises the nine municipalities of Guangdong--Dongguan, Foshan, Guangzhou, Huizhou, Jiangmen, Shenzhen, Zhaoqing, Zhongshan and Zhuhai--plus Hong Kong and Macau. It will constitute a giant metropolis, with a population of almost 67 million and a GDP over US\$1.32 trillion in 2015.
- ◆ Guangdong, including Shenzhen, had a population of 108.49 million in 2015, and is the most populous province on the Mainland. Including Hong Kong (7.32 million) and Macau (0.65 million), the total population of the combined region becomes 116.46 million, more than that of Germany (83 million) and almost equal to that of Japan (127 million).
- ◆ The GDP of Guangdong was US\$1.122 trillion in 2015, compared to Hong Kong's US\$310 billion. The GDP of Guangdong, Hong Kong and Macau combined was US\$1.48 trillion in 2015, almost 14.2% of the Mainland GDP.
- ◆ The GDP per capita of the Guangdong in 2015 was US\$10,339, compared to Hong Kong's US\$42,430 and Macau's US\$71,984. The GDP per capita of the combined region was US\$13,541, comfortably exceeding the threshold for developed economy status of US\$10,000.

# Hong Kong as Part of the Pearl River Delta Metropolis



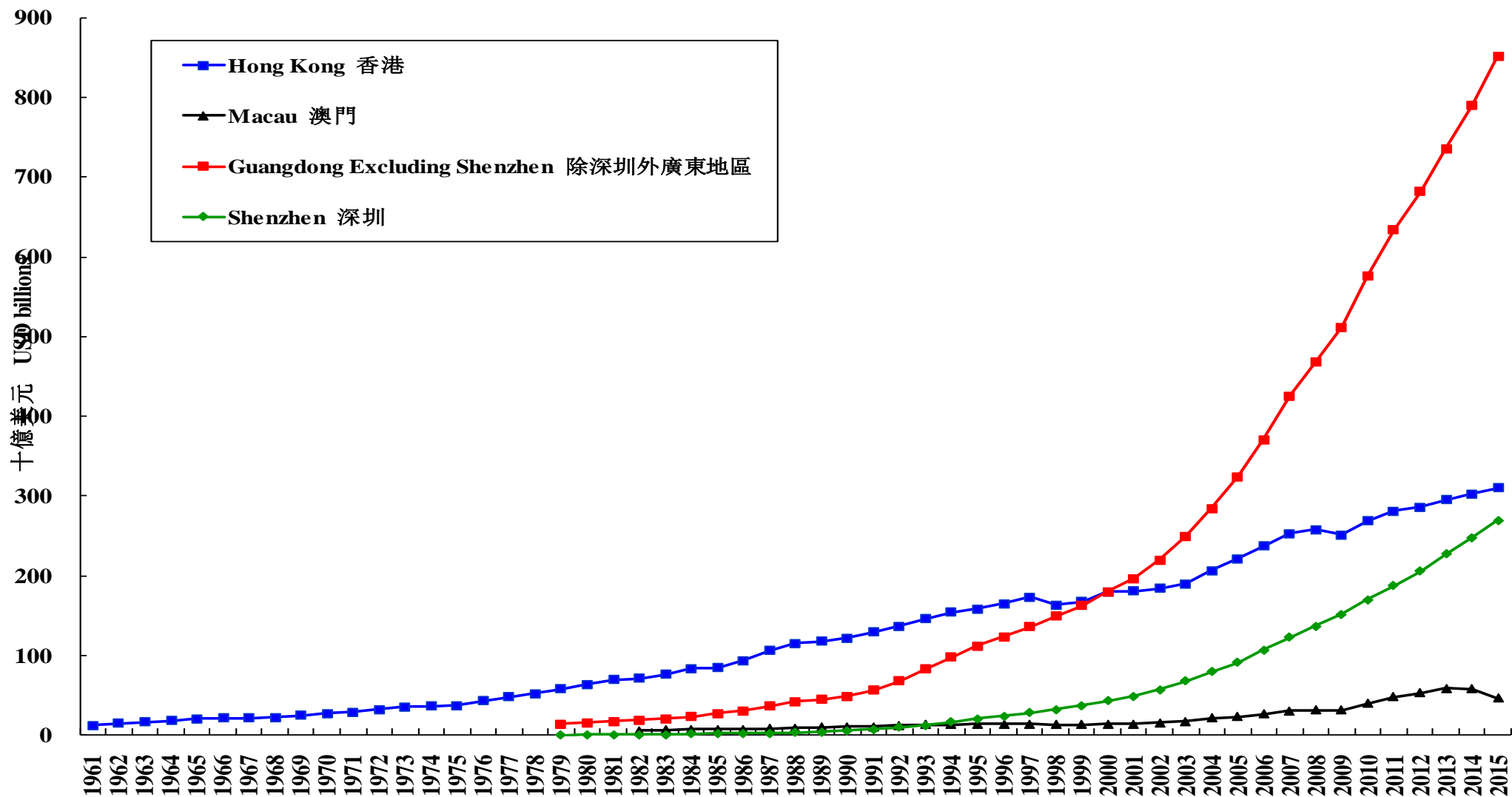
# The Populations of Hong Kong and Its Neighboring Economies, millions

Populations of Hong Kong and Its Neighbouring Economies, millions



# Real GDPs of Hong Kong and Its Neighboring Economies, billion 2015 US\$

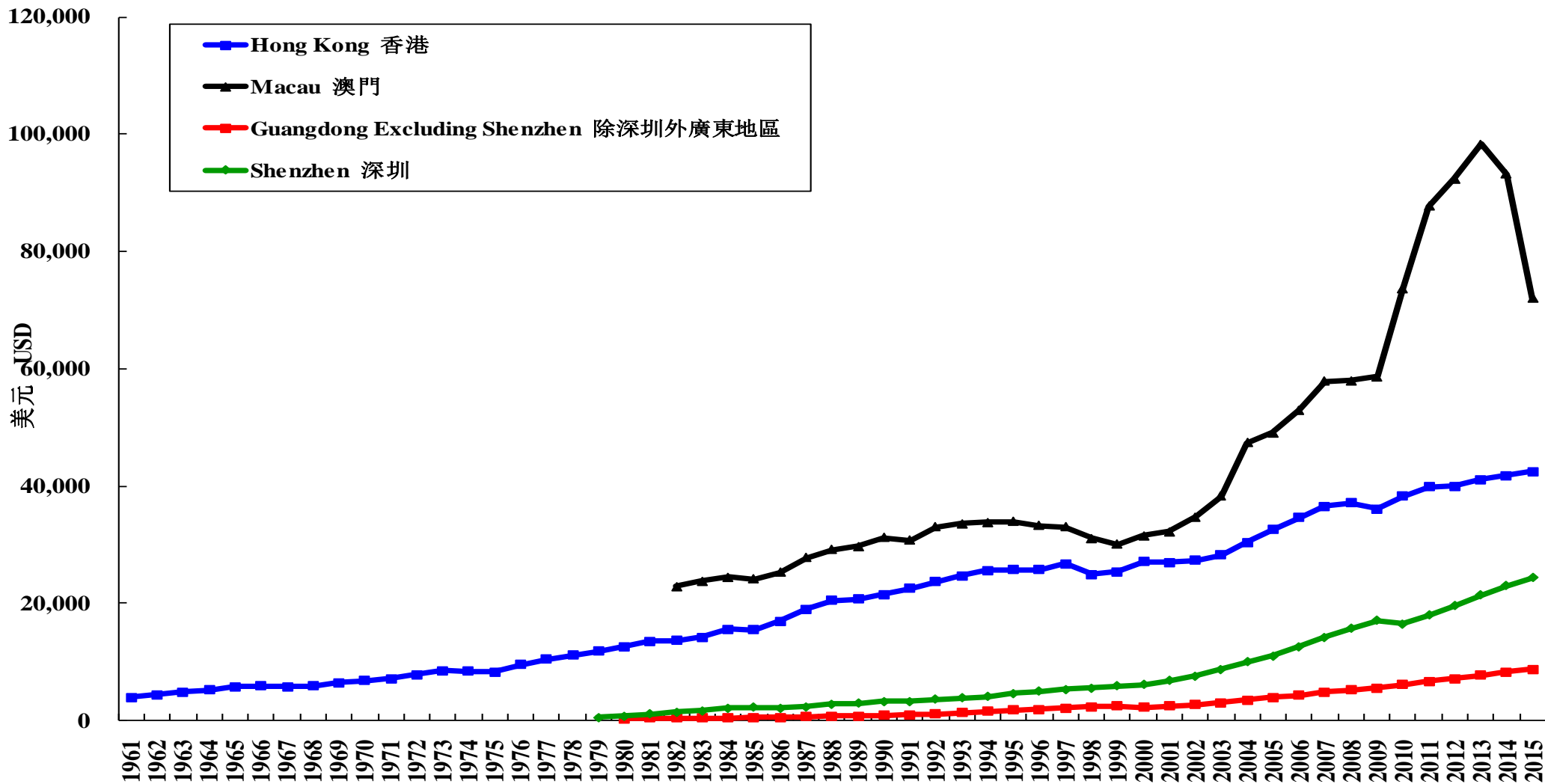
Real GDPs of Hong Kong and Its Neighbouring Economies, billion 2015 US\$





# Real GDP-per-Capita's of Hong Kong and Its Neighboring Economies, 2015 US\$

Real GDP-per-capita's of Hong Kong and Its Neighbouring Economics, 2015 US\$



# Pearl River Delta (PRD) Economic Cooperation

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- ◆ Economically, Guangdong, Shenzhen, Hong Kong and Macau are complementary to one another. Guangdong (including Shenzhen) has a diversified industrial base—with light, heavy and high-technology industries (Shenzhen has very successful high-technology firms such as Huawei, ZTE, BYD and BGI)--but is relatively weak in higher education, healthcare and R&D sectors. Hong Kong has little or no industry any more, especially high-technology industry, but it has world-class research-based universities to supply scientific, technological and medical manpower and R&D. The strong and seasoned financial sector of Hong Kong can also help the enterprises and provincial and local governments of Guangdong to raise both equity and debt capital in Hong Kong. Guangdong-Hong Kong economic cooperation makes sense not only because of geographical proximity, but also because of linguistic as well as cultural and kinship affinity.

# Pearl River Delta (PRD) Economic Cooperation

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- ◆ The forthcoming Shenzhen-Hong Kong Stock Connect is a live demonstration of mutually beneficial win-win economic cooperation. There can also be other possible forms of regional cooperation in the future, such as a region-wide joint airport authority, with high-speed railroad links among all of the airports in the region.
- ◆ There is a great deal of room for economic cooperation among Hong Kong, Macau and Guangdong (including Shenzhen) through specialization, division of labor, realization of economies of scale and reduction of duplicative and wasteful competition.
- ◆ At their current rates of economic growth, Hong Kong, Macau and Guangdong (including Shenzhen) together constitute a region with the potential of eventually surpassing Japan, which has been economically stagnant, to become the third largest economy in the world in a decade or so.
- ◆ However, in order for this four-way economic cooperation to be successful, it is necessary to promote the free flow of goods and services, people and capital and the sharing of basic infrastructural facilities among them. The plan for a Guangdong-Shenzhen-Hong Kong-Macau Pilot Free Trade Zone should be actively developed and pursued.

# The Role of Hong Kong in the “Belt and Road” National Initiative

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- ◆ Hong Kong can serve as an international financial center for the arrangement of the financing of the “Belt and Road” infrastructural projects through a combination of both public and private equity and debt, direct commercial loans as well as development loans. For example, Hong Kong can develop into an international center for “Sukuk” or “Sharia (Islamic Law)-compliant” bonds.
- ◆ Hong Kong can also try to provide a secondary market for these equity and debt securities to ensure some liquidity for the investors. Hong Kong can add significant value, if it is able to maintain an active and liquid stock and bond market for the East Asian region as a whole.
- ◆ As one terminus of the “Belt and Road” is Europe, Hong Kong, with its long tradition of close economic relations with Europe, can also play an important role in involving European businesses in the “Belt and Road” projects. The “Belt and Road” initiative, especially the maritime portion of the “New Silk Road”, will also cover the ASEAN region, where Hong Kong traditionally has strong ties.

# The Role of Hong Kong in the “Belt and Road” National Initiative

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- ◆ In addition to helping with infrastructural project financing, Hong Kong can also provide various types of insurance as well as re-insurance for the infrastructural projects.
- ◆ It can also provide many one-off services, such as architectural, design, engineering and project management as well as more recurrent services such as accounting and legal services.
- ◆ Moreover, Hong Kong, because of its long tradition of rule of law and abundance of seasoned professional talents, can also be used as a center for arbitration, dispute settlement and mediation services in relation to the “Belt and Road” projects.

# Concluding Remarks

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- ◆ We have tried to suggest some feasible directions of significant potential in which the economy of Hong Kong can aspire to develop. The goals may appear ambitious, but in our opinion, they are all achievable with sufficient commitment and resolve. In diversifying its economy in these various directions, Hong Kong can also reduce the risks of over-dependence on any one particular sector.
- ◆ It is essential to try to make Hong Kong more competitive once again. This means trying to do something to the high price of land, and the resulting high office space and housing costs.
- ◆ Hong Kong indeed has the potential of surpassing both New York and London to become the leading international financial center in the world. However, the development of Hong Kong as an international hub for flows of people, goods and services, and capital is a long-term undertaking and will require the long-term commitment of the Government of the HKSAR, its citizens, and its public and private institutions.

# Concluding Remarks

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- ◆ Hong Kong must do its part in devising implementable plans and strategies and in addition seek assistance and support from the Central Government on the basis that these initiatives are win-win for both Hong Kong and the Mainland. It is up to Hong Kong to make itself indispensable once again, as it was during the early days of the Chinese economic reform and opening to the world.
- ◆ There is clearly still great potential for the economy of Hong Kong! It will require the united efforts of everyone in Hong Kong to fully realize this potential. Yes. Hong Kong CAN create yet another economic miracle! However, time is of the essence. The time to act is NOW.