The Economic Relations between the Mainland and Hong Kong

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Introduction

- Before 1949, Hong Kong was an entrepot port, serving mainly Southern China. There were many other competing ports in China, most notably Shanghai but also Shantou and Xiamen.
- After the establishment of the People's Republic of China and the outbreak of the Korean War, entrepot activities essentially stopped, and there was a large influx of people, capital and human capital into Hong Kong.
- Hong Kong began to develop light manufacturing industries such as wigs, plastic flowers, textiles, electronic assembly and a real estate development industry and gradually prospered.

Introduction

- However, by the 1970s, Hong Kong faced rising labor wages, competition from Taiwan and then South Korea and was also hit with quota restrictions from the U.S. and other countries.
- The reform and opening of the Mainland economy and its participation in the world since 1978 gave Hong Kong entrepreneurs a second wind. Many of them moved their operations to Shenzhen, Dongguan and other parts of the Pearl River Delta, taking advantage of the inexpensive labor and land. Hong Kong also served as the primary gateway for Mainland trade and inward foreign direct investment.
- It is fair to say that without the contribution of Hong Kong's entrepreneurship, capital and international connections, the Mainland economic reform would not have been nearly as successful.
- However, as the Mainland economy continues to grow, its reliance on the Hong Kong economy has diminished. Today, the Hong Kong economy is more dependent on the Mainland economy than the other way around.
- Looking forward, what is the future of the Hong Kong economy?

Global and Chinese Economic Trends

- The shifting center of gravity of the world economy
- The historically unprecedented rapid growth of the Mainland economy
- The slowdown of the growth of world real GDP, international trade and direct investment
- The transition of the Mainland economy to a "new normal"
- The geo-political uncertainties

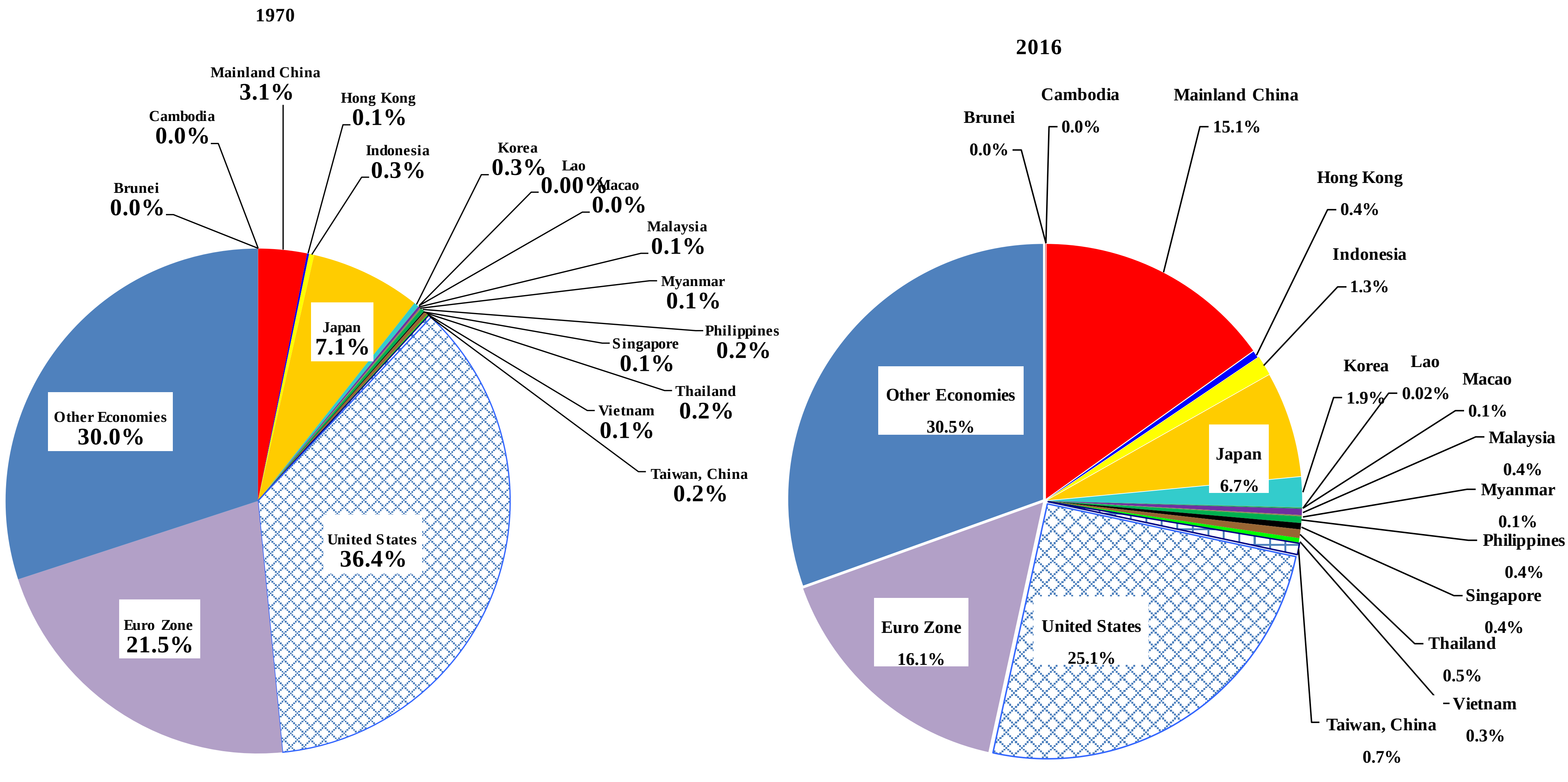
The Shifting Center of Gravity of the Global Economy

- In 1970, the United States and Western Europe together accounted for almost 60% of world GDP. By comparison, East Asia (defined as the 10 Association of Southeast Asian Nations (ASEAN)--Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam--+ 3 (China including Hong Kong, Macau and Taiwan, Japan and the Republic of Korea)) accounted for only approximately 10% of world GDP.
- Hong Kong, Republic of Korea, Singapore and Taiwan are also known collectively as the East Asian "Newly Industrialized Economies (NIEs)".

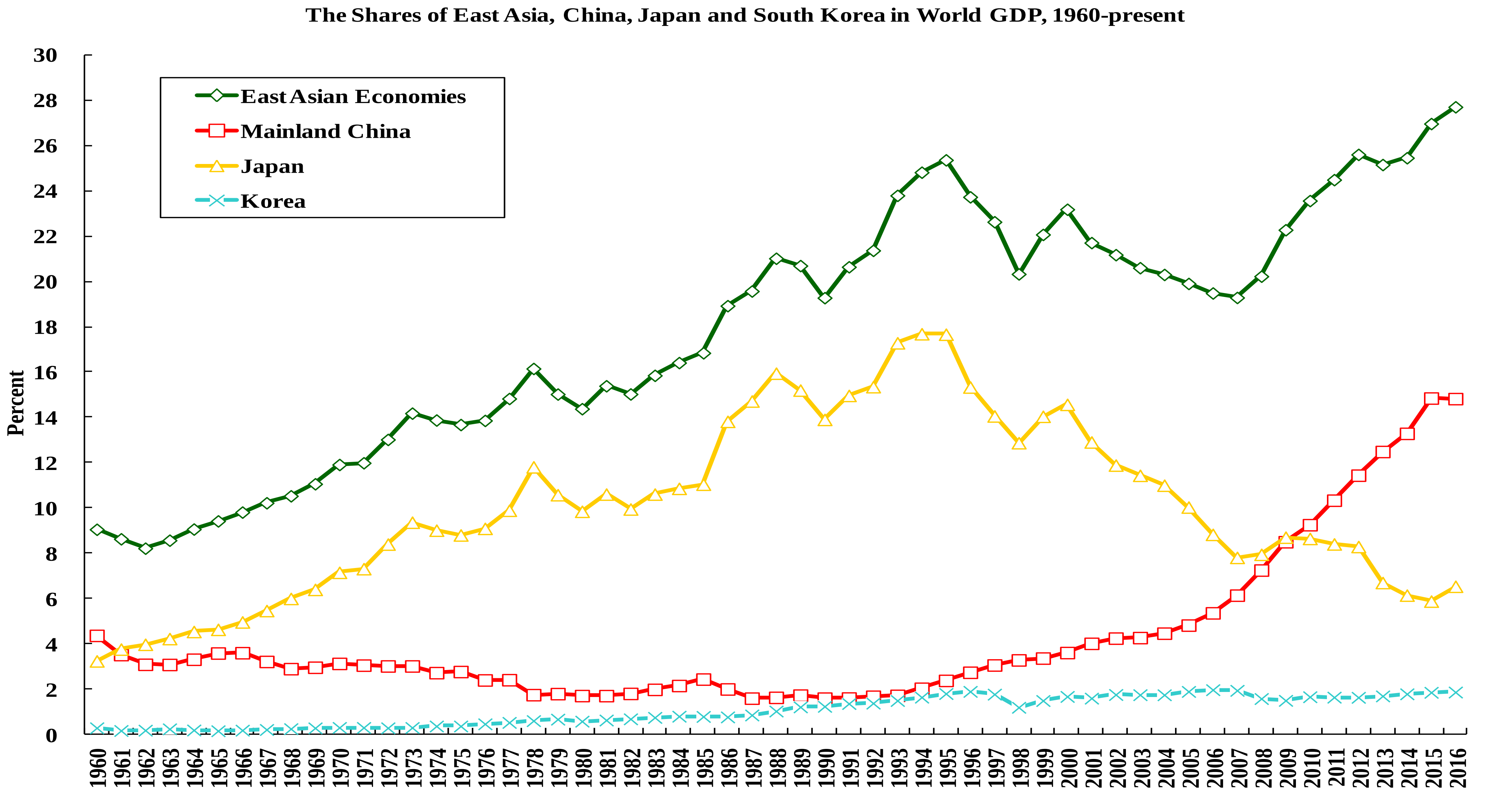
The Shifting Center of Gravity of the Global Economy

- By 2016, the share of United States and Western Europe combined in world GDP has declined to approximately 41% whereas the share of East Asia has risen to around 28%.
- The Japanese share of world GDP declined from a peak of almost 18% in the mid-1990s to 6.7% in 2016 while the Mainland Chinese share of world GDP rose from 3.1% in 1970 and less than 4% in 2000 to over 15.1% in 2016.

The Distribution of World GDP, 1970 and 2016, US$



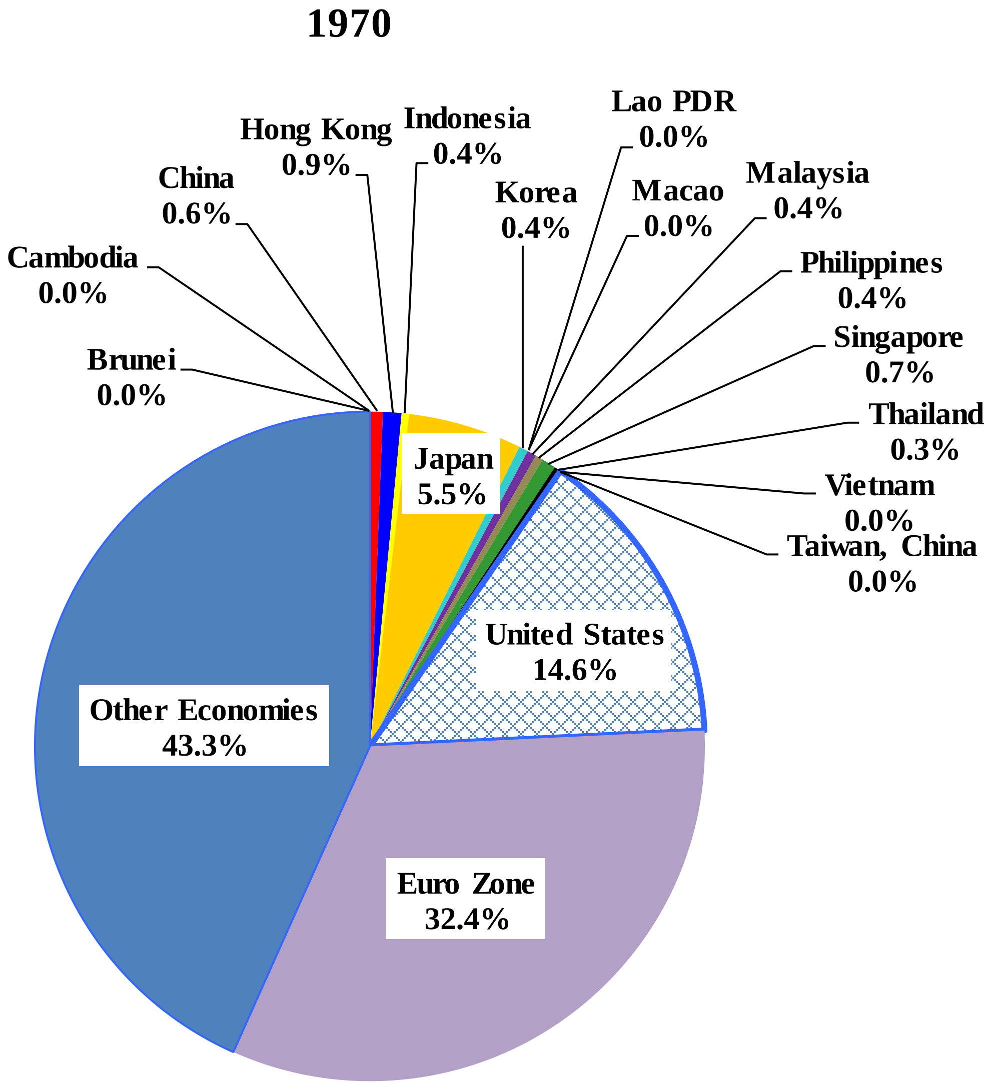
The Shares of East Asia, China, Japan and South Korea in World GDP, 1960-present

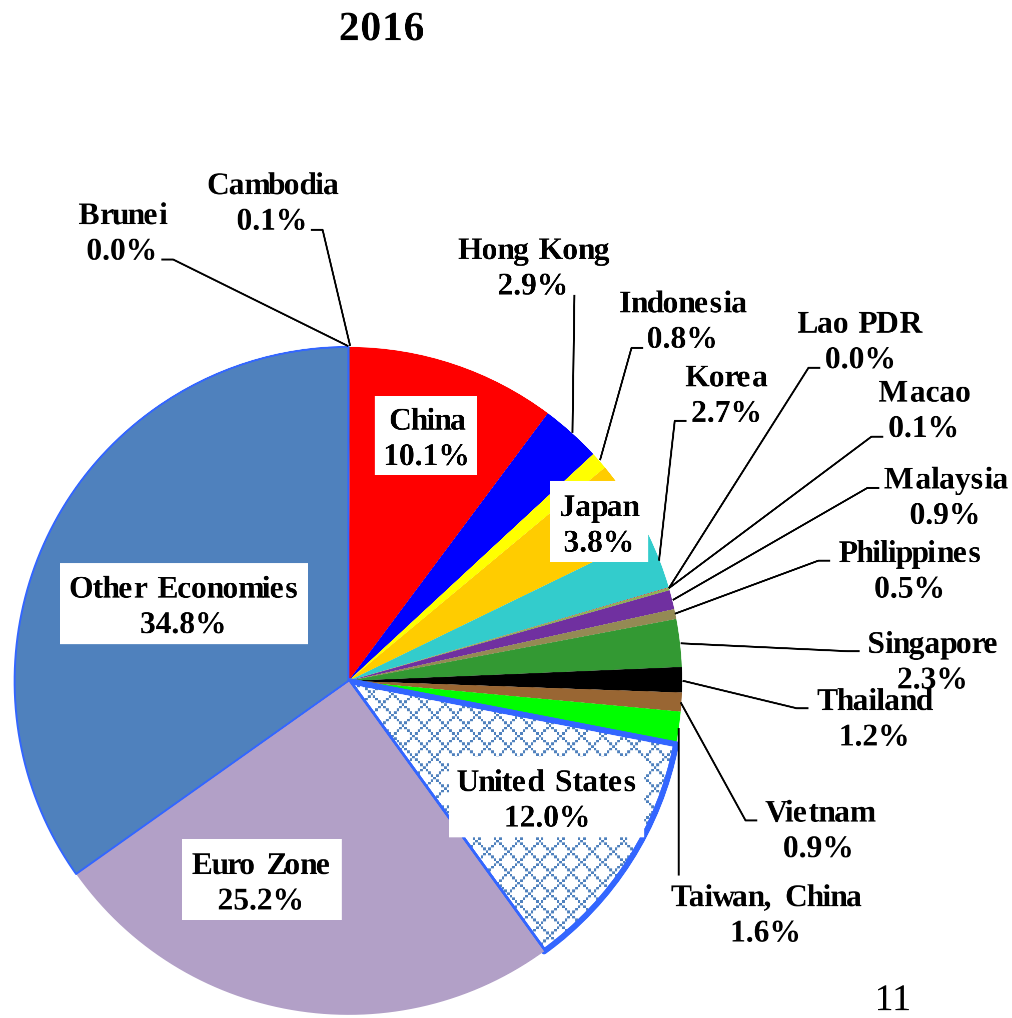


The Shifting Center of Gravity of the Global Economy

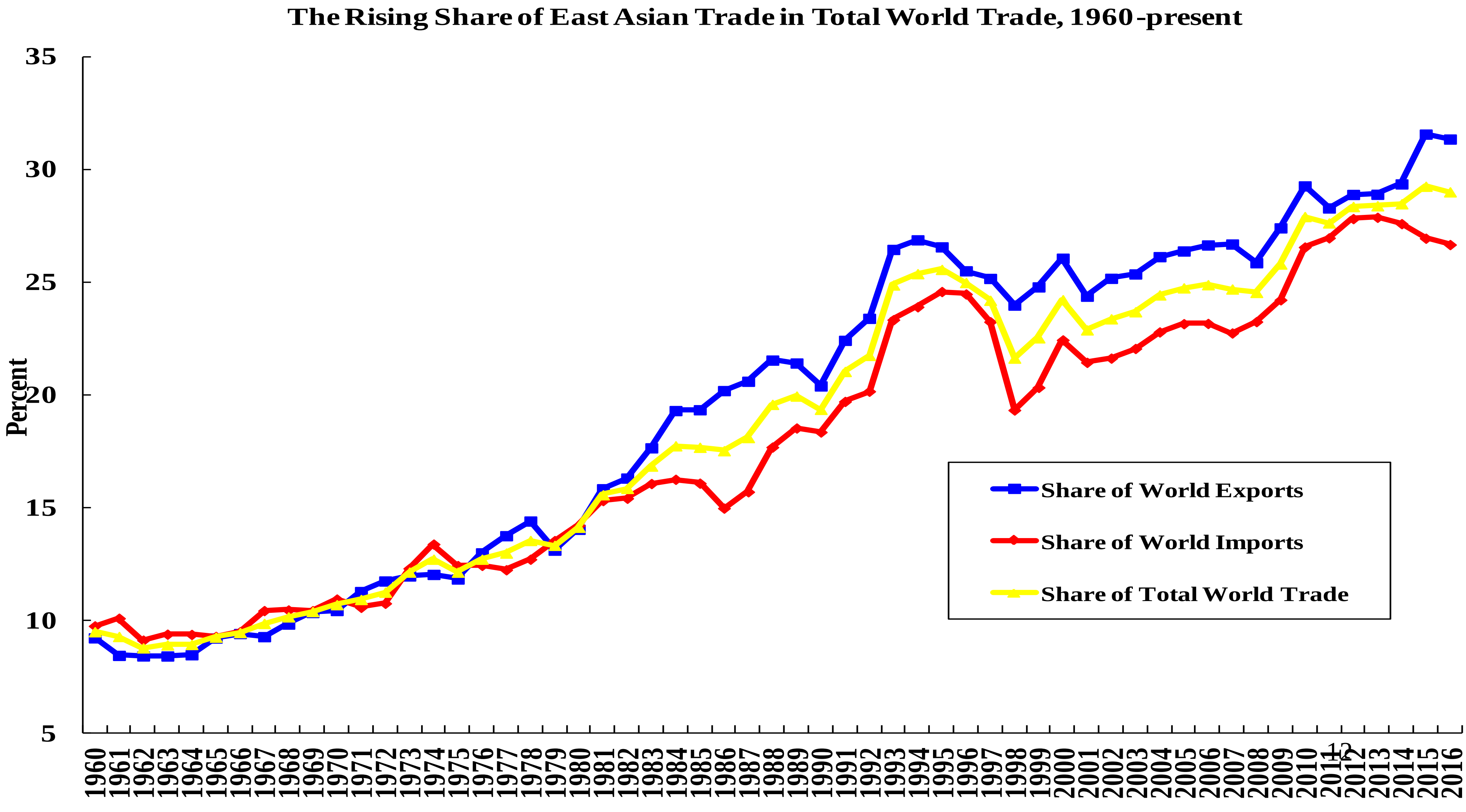
- In 1970, the United States and Western Europe together accounted for almost 47% of world trade in goods and services. By comparison, East Asia accounted for 9.6% of world trade.
- By 2016, the share of United States and Western Europe combined in world trade has declined to 37.1% whereas the share of East Asia has risen to almost 28.1%.
- The Mainland Chinese share of world trade rose from 0.6% in 1970 to 10.1% in 2016. The growth in Chinese international trade may be attributed in part to adoption of current-account convertibility of the Renminbi by China in 1994, accompanied by a significant devaluation of the Renminbi, and to Chinese accession to the World Trade Organisation in 2001.
- Since 2015, Mainland China has also been the largest trading-partner country of the U.S., surpassing Canada.

The Distribution of International Trade in Goods and Services, 1970 and 2016

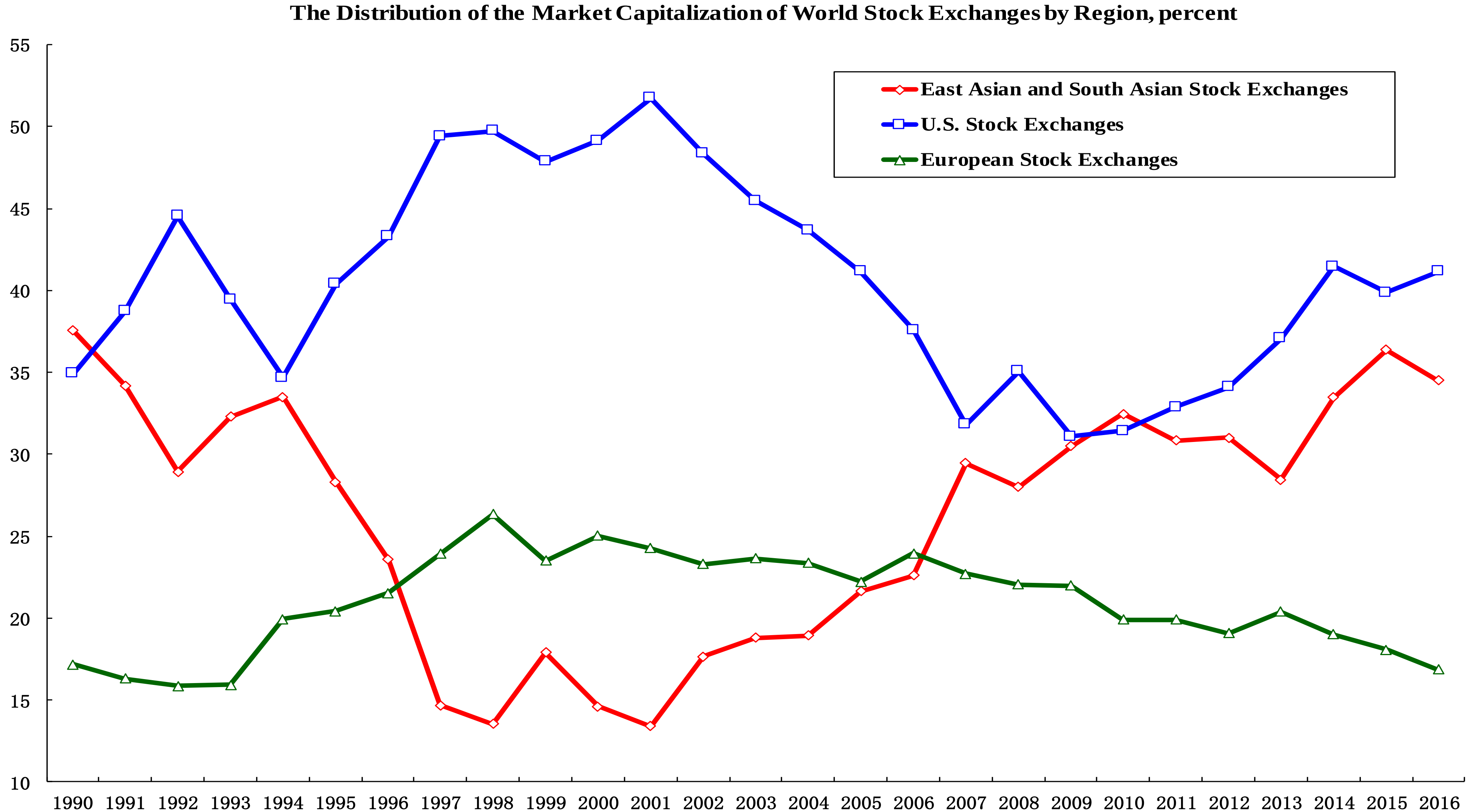




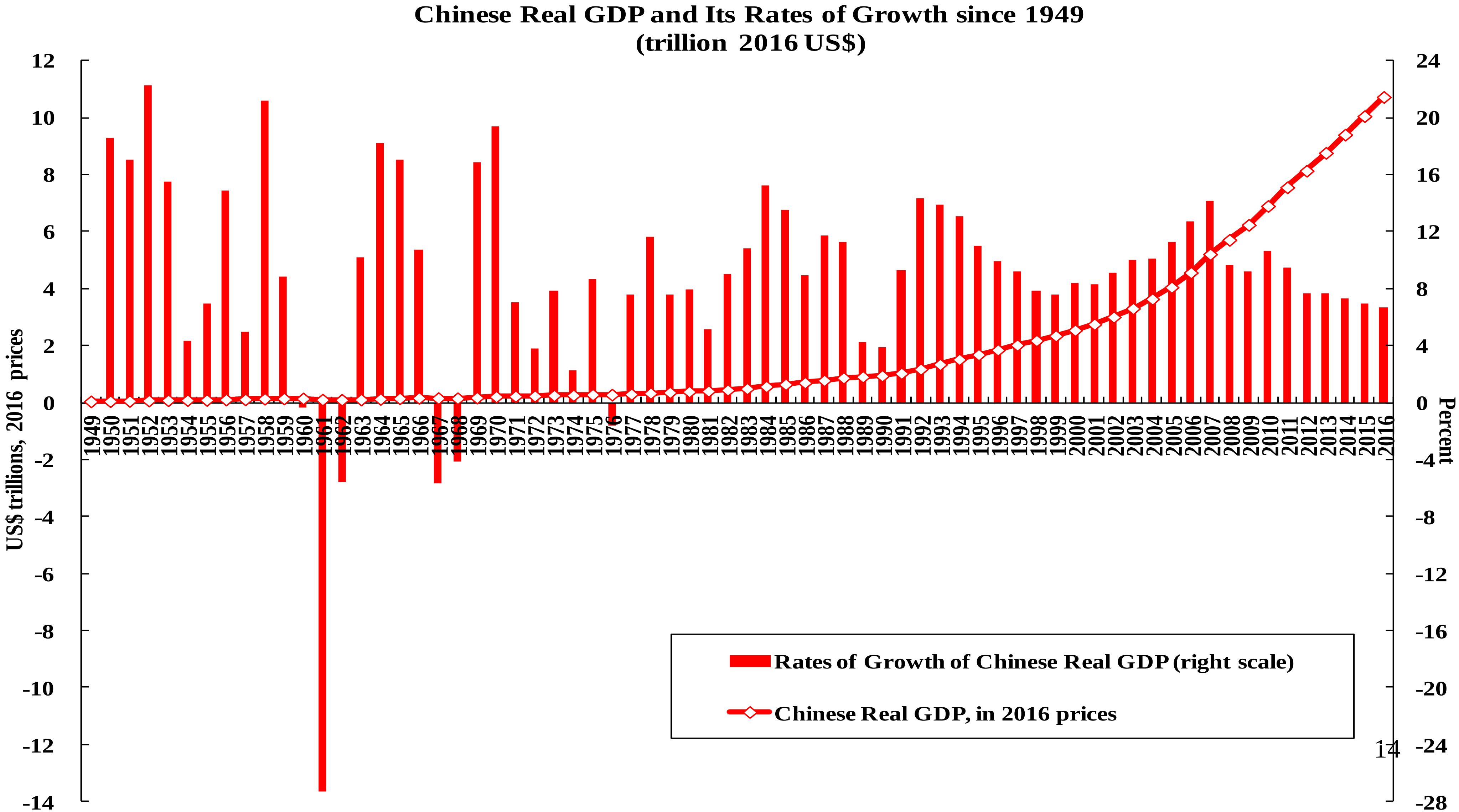
The Rising Share of East Asian Trade in Total World Trade, 1960-present



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



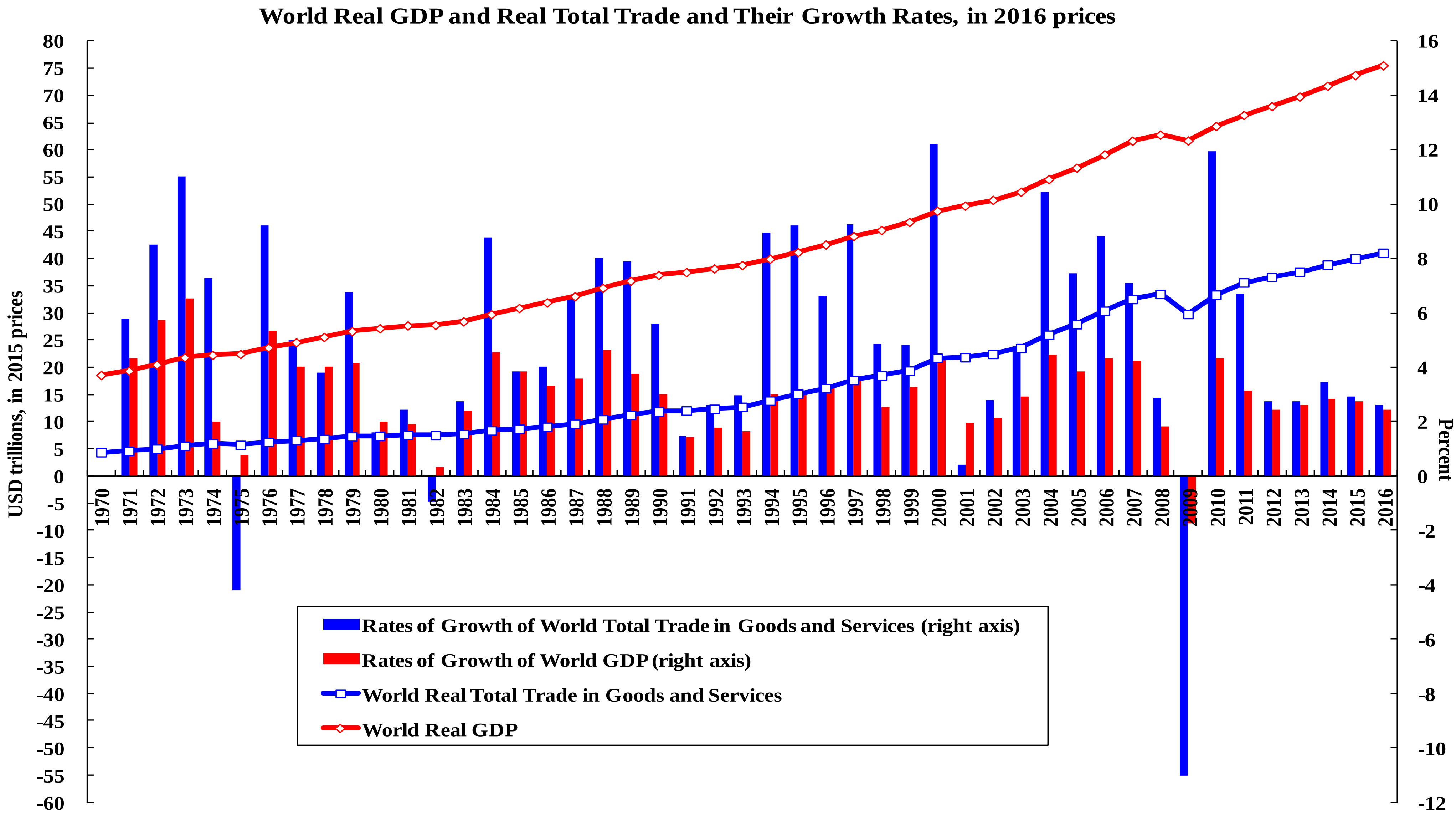
The Historically Unprecedented Rates of Growth of the Mainland Economy



The Slowdown of the Growth of World Real GDP, Intern' l Trade and Direct Investment

- Both total real world trade and total world foreign direct investment have grown much faster than total real world GDP since 1970. Between 1970 and 2008, the beginning of the most recent global financial crisis, total real world GDP grew at an average annual rate of 3.3% while total real world trade grew at an average annual rate of 5.5%.
- However, since the global financial crisis that began with the U.S. sub-prime loan crisis in 2007, the average annual rates of growth of real world GDP and real world trade have declined to 2.2% and 2.5% respectively. The recent fall in the nominal value of total world trade is due in part to the fall in the world price of oil.
- 2017 turned out to be the best year for the developed economies—the U.S., the European Union and Japan—in a decade.

Real World GDP and Trade in Goods and Services and Their Growth Rates (2016 prices)



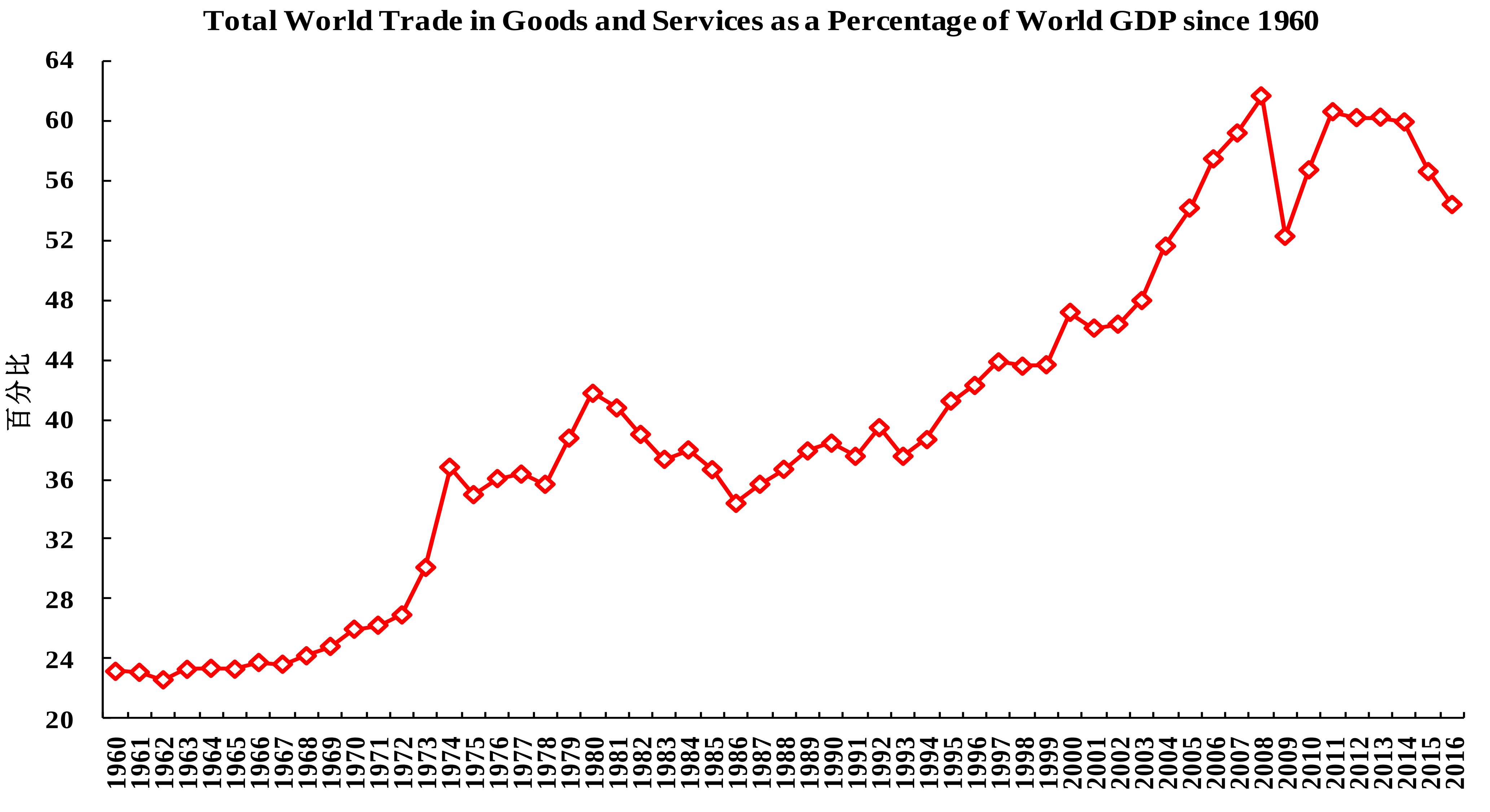
The Slowdown of the Growth of World Real GDP, Intern' l Trade and Direct Investment

- Even though the International Monetary Fund recently raised its projected rates of global economic growth to 3.9% in 2018 and 2019, it is unlikely that the world economy as a whole would resume its heady rates of growth in GDP and trade that it achieved prior to the global financial crisis of 2008 in a sustained manner.
- Cross-border trade and direct investment are no longer the major drivers of world economic growth.
- Protectionism, isolationism and populism are rearing their heads and the entire world faces the risks of trade wars and economic de-globalization.

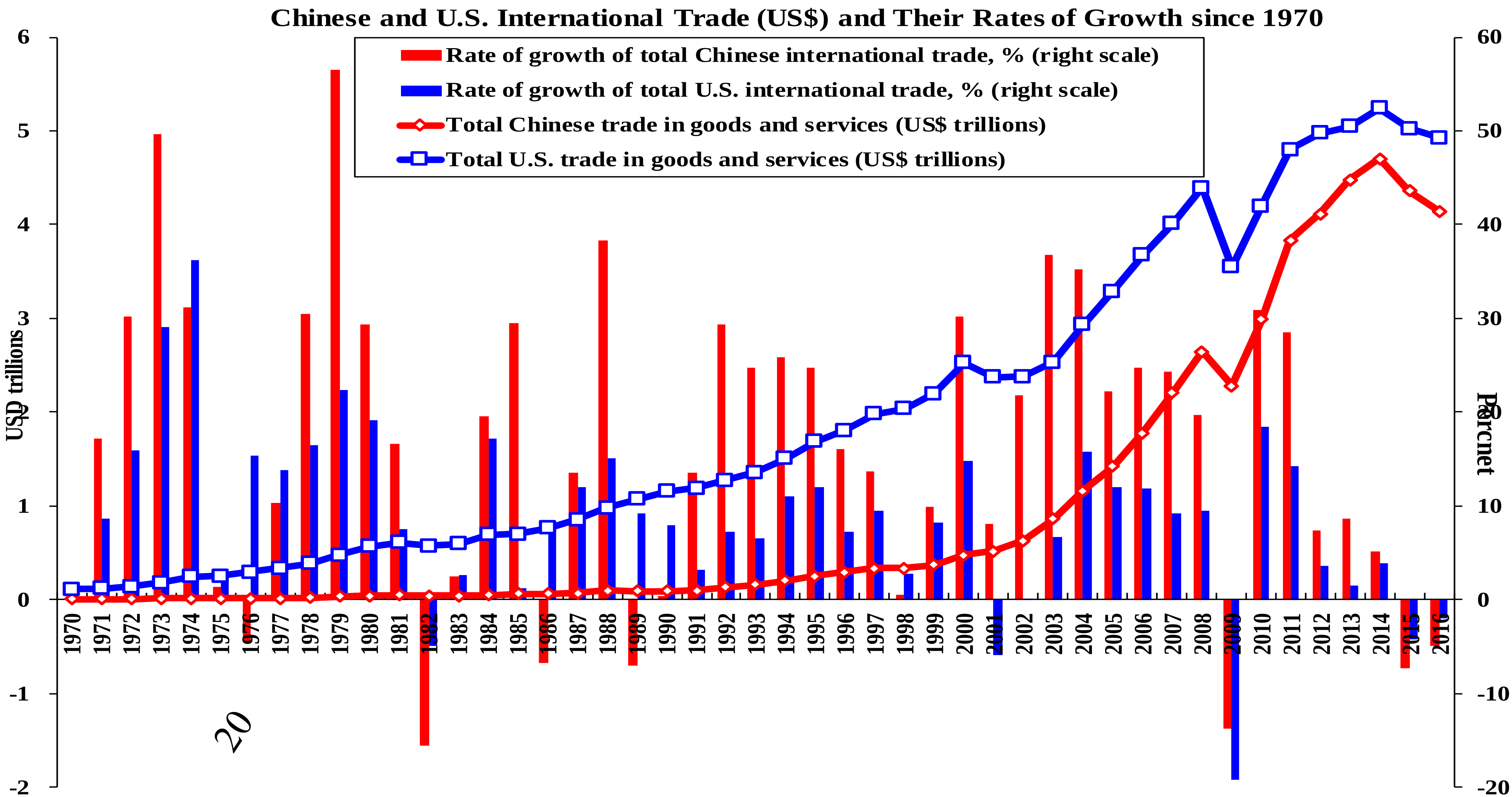
The Slowdown of the Growth of World Real GDP, Intern' l Trade and Direct Investment

- Total world trade as a percent of total world GDP increased from 26% in 1970 to 62% in 2008, but it has since stalled and has begun a gradual decline.
- The total values of international trade of the United States and China, the two largest economies and also the two largest trading economies in the world, have declined in both 2015 and 2016.
- However, 2017 saw a rebound in the growth of world trade, but it was probably due, in part, to the recovery from a low base.
- Economic globalization has reached a turning point. Is it likely to be reversed in the future?

Total World Trade in Goods and Services as a Percentage of World GDP since 1960



Chinese and U.S. International Trade and Their Respective Rates of Growth since 1970 (US$)



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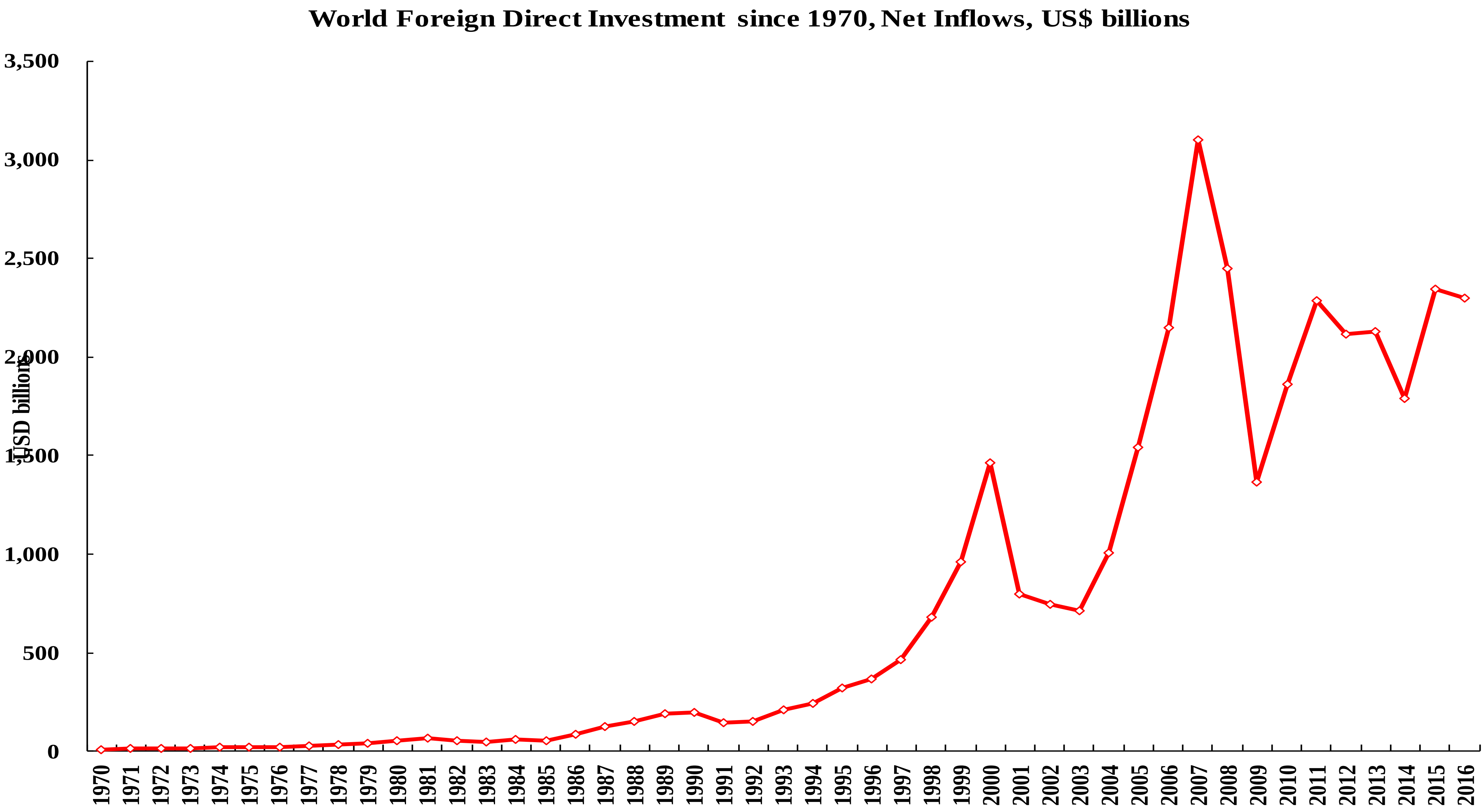
The Slowdown of the Growth of World Real GDP, Intern' l Trade and Direct Investment

- Falling barriers to as well as incentives for foreign direct investment (FDI) provided by investee countries have also greatly increased cross-border direct investment. National treatment for foreign direct investment is becoming increasingly standard under the World Trade Organisation (WTO) and similar agreements.
- Data from the United Nations Commission for Trade and Development (UNCTAD) show that total world FDI increased at the average annual rate of 14% between 1970 and 2007, the beginning of the global financial crisis. Annual total world FDI may be estimated at approximately US$1.9 trillion in 2007. Since 2007 total world FDI has been declining by 1% per year.
- The U.S. and Mainland China are the world's top two leading recipients of foreign direct investment (FDI) with an annual average of approximately US$100 billion currently. They are also the top two outbound direct investors.
- Foreign direct investments (FDI) often follow trade—e.g., to secure long-term supply of raw materials and natural resources; and trade often follows foreign direct investments—e.g., production by captive subsidiaries in foreign markets. A large proportion of world trade consists of intra-industry and intra-firm trade.
- International capital flows also include portfolio investment, foreign aid, foreign loans and short-term capital flows such as "hot money".

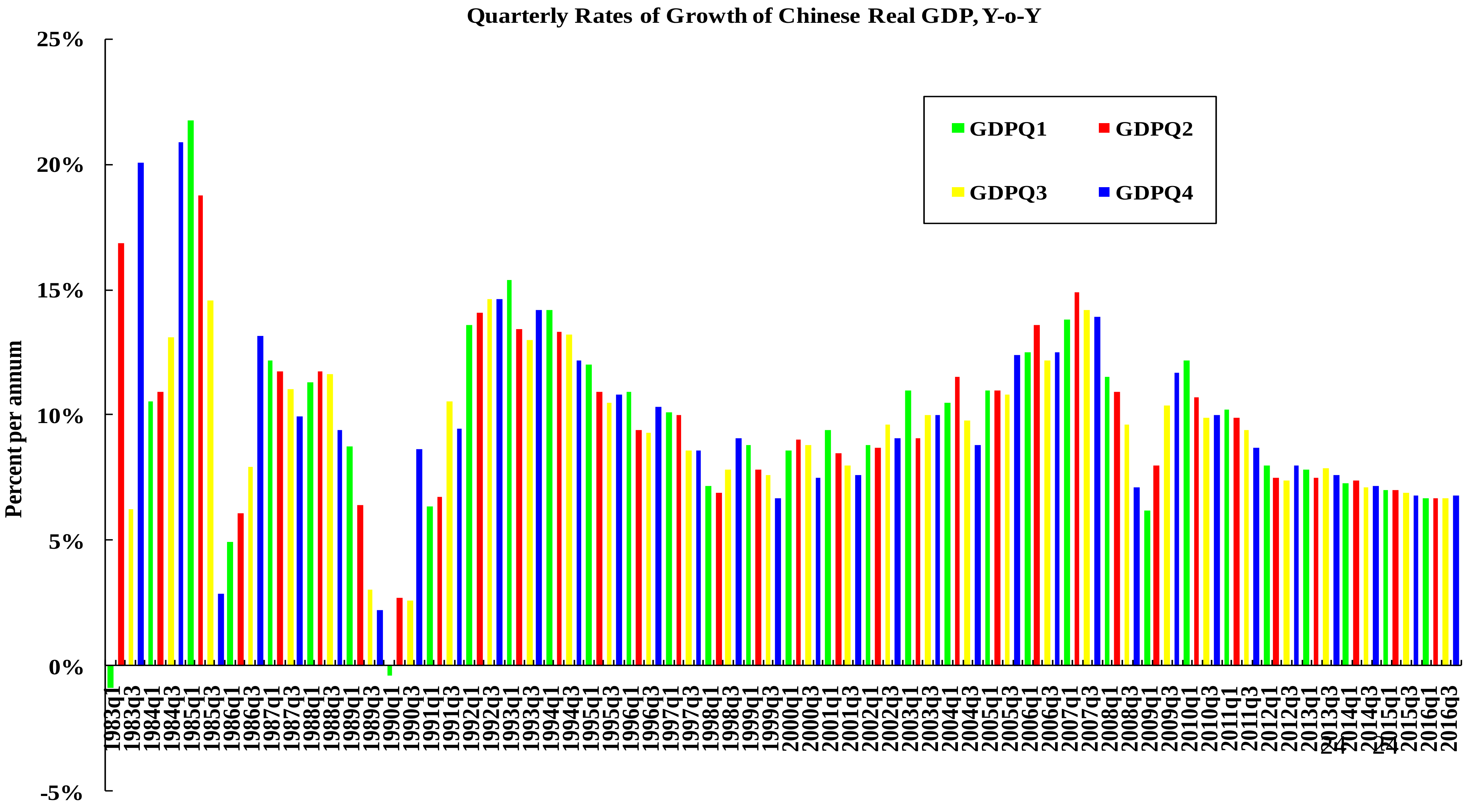
Total World Foreign Direct Investment (FDI), US$ since 1970



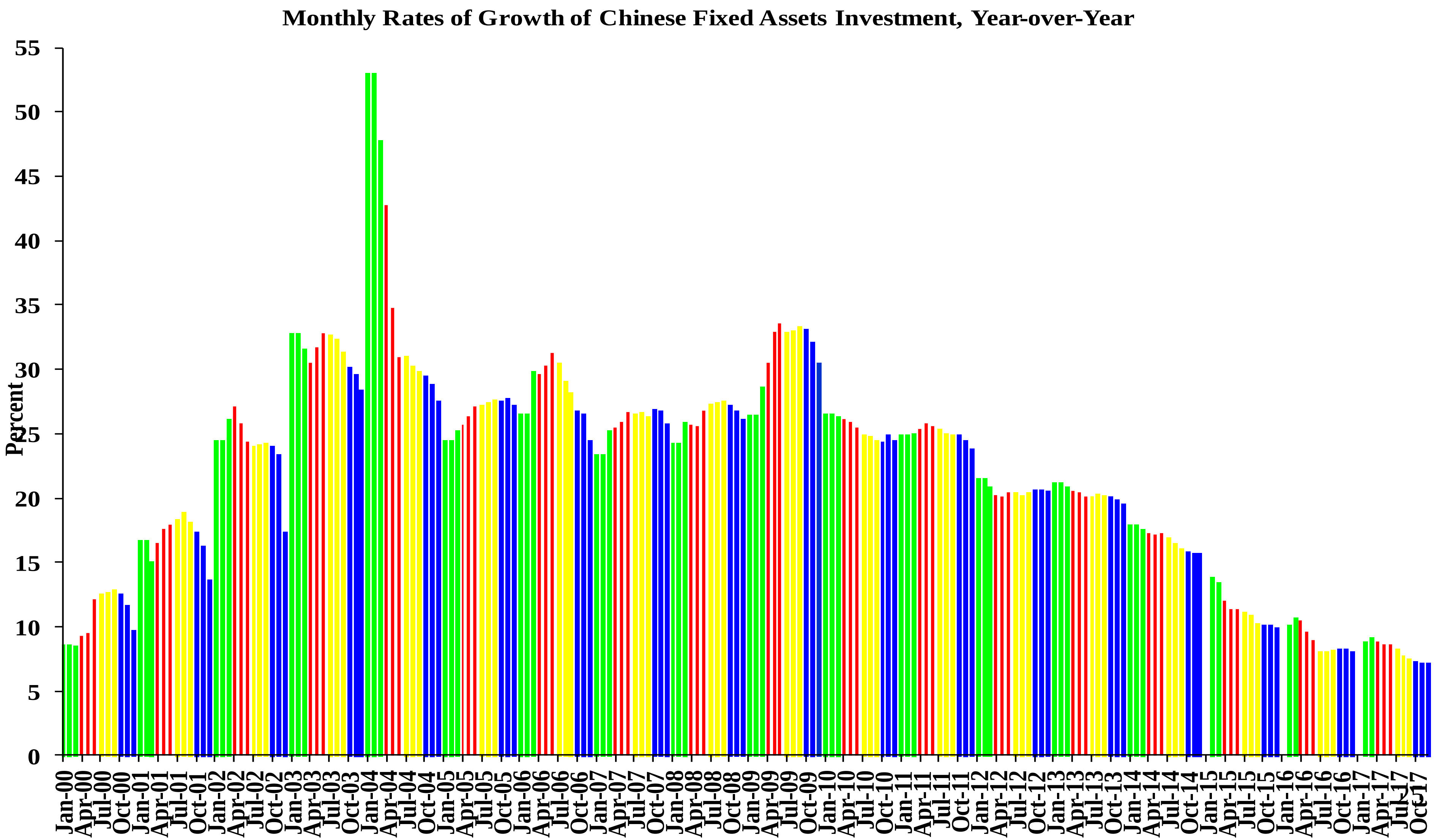
The Transition of the Mainland Economy to a New Normal

- The Mainland economy has transitioned to a “new normal”, with a rate of growth stabilized around 6.5%. It no longer relies on export growth, but has shifted towards internal demand as the principal economic driver.
- However, the national saving rate remains high. But because of the on-going supply side structural reform and the serious excess production capacities in many industries, the rate of growth of fixed assets investment has been declining, resulting in significant excess domestic savings which need to be deployed abroad.
- Today, foreign direct investment (FDI) into the Mainland constitutes only approximately 2.5% of total gross domestic investment on the Mainland and is quantitatively no longer important.

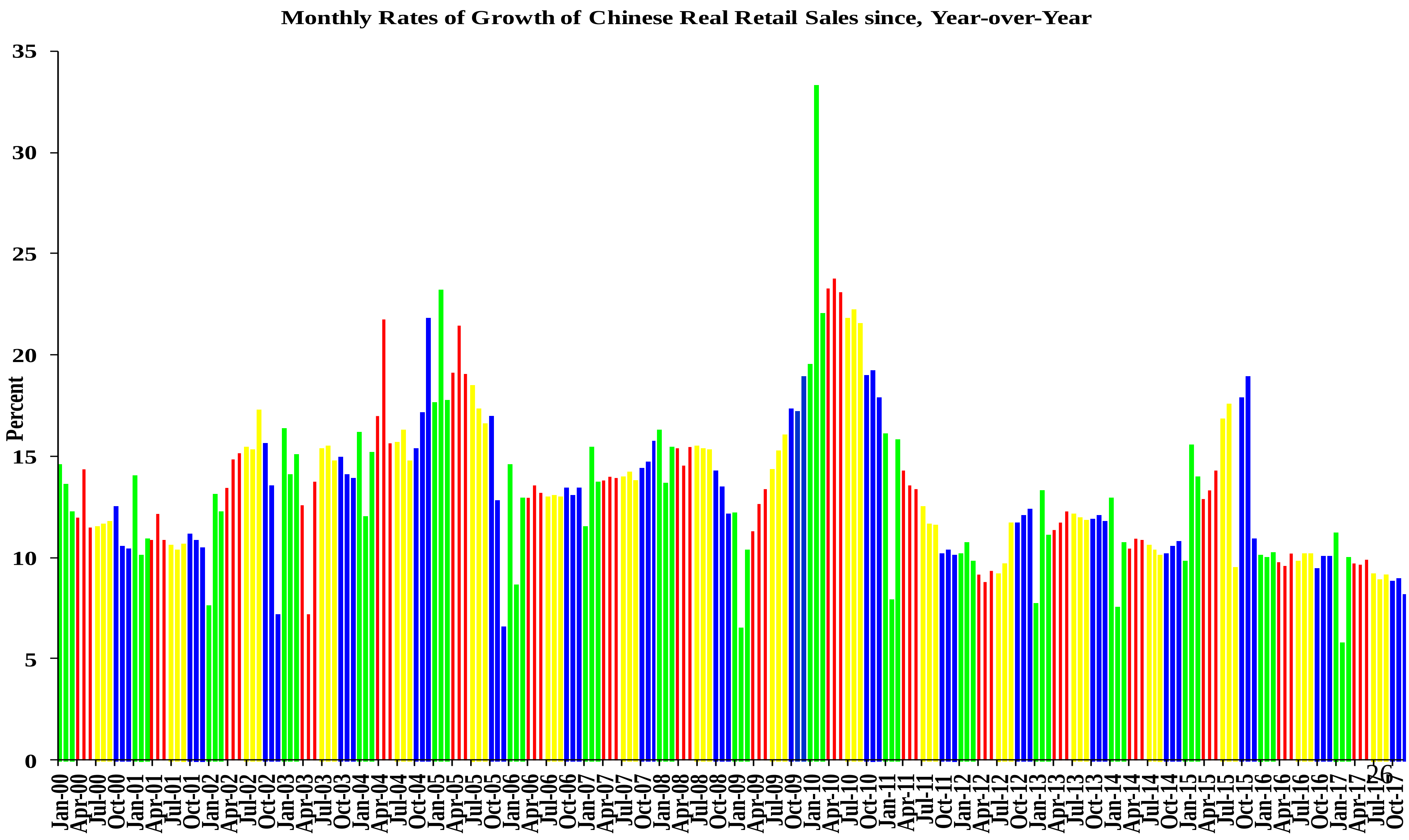
Quarterly Rates of Growth of Chinese Real GDP, Y-o-Y



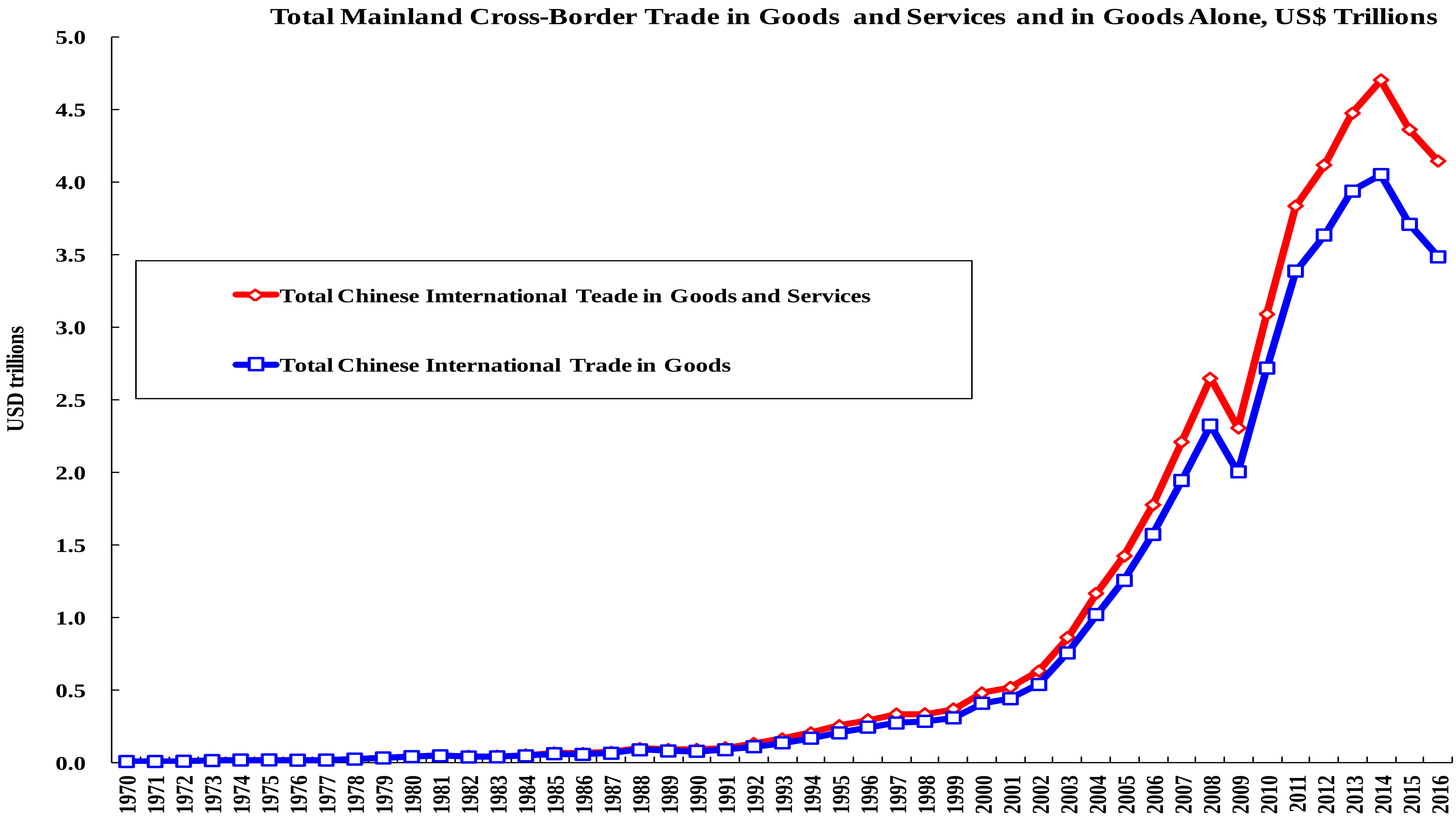
Monthly Rates of Growth of Chinese Fixed Assets Investment, Y-o-Y



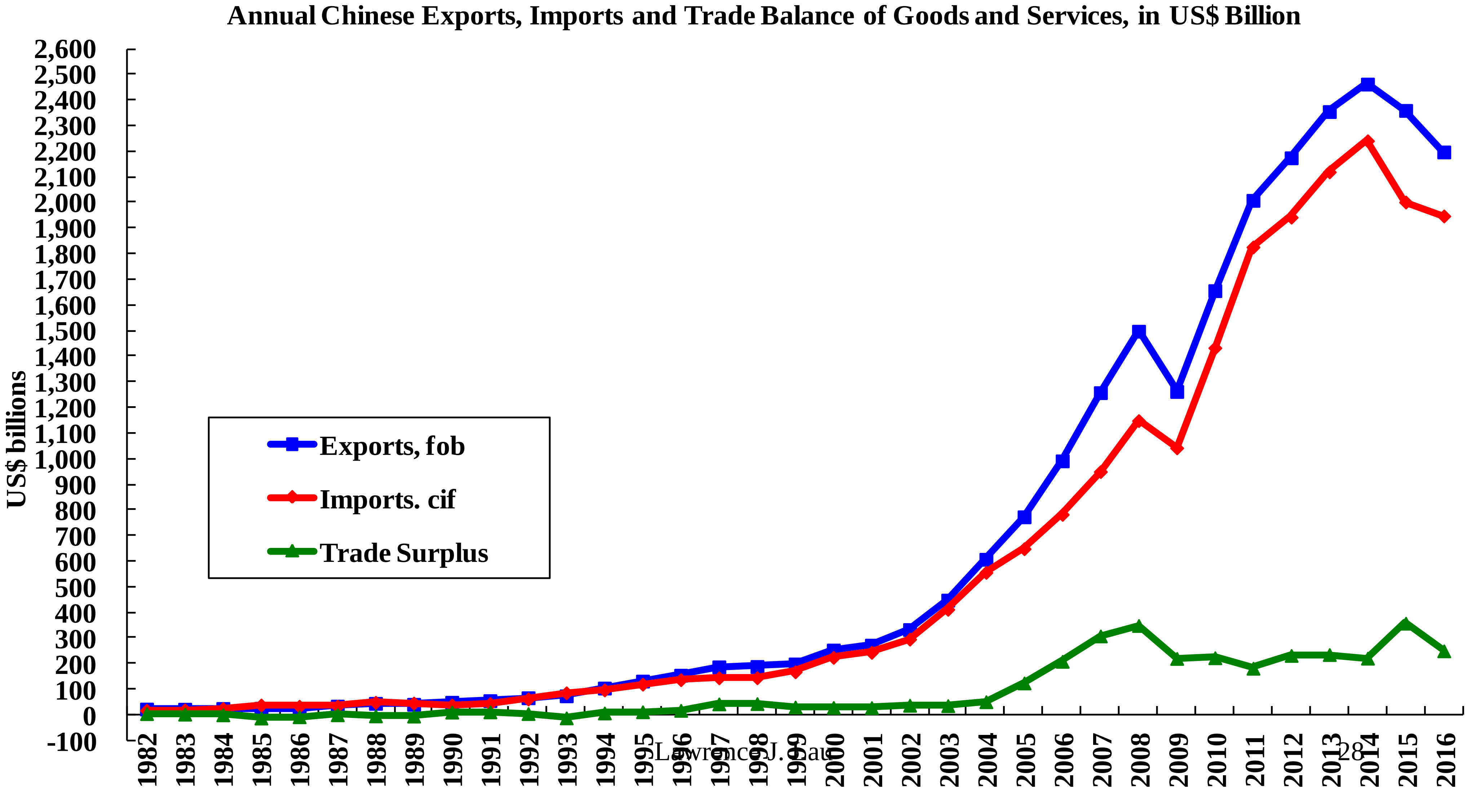
Monthly Rates of Growth of Chinese Real Retail Sales, Y-o-Y



Total Mainland Cross-Border Trade in Goods and Services and in Goods Alone, US$ trillions



Annual Chinese Exports, Imports and Trade Balance of Goods and Services



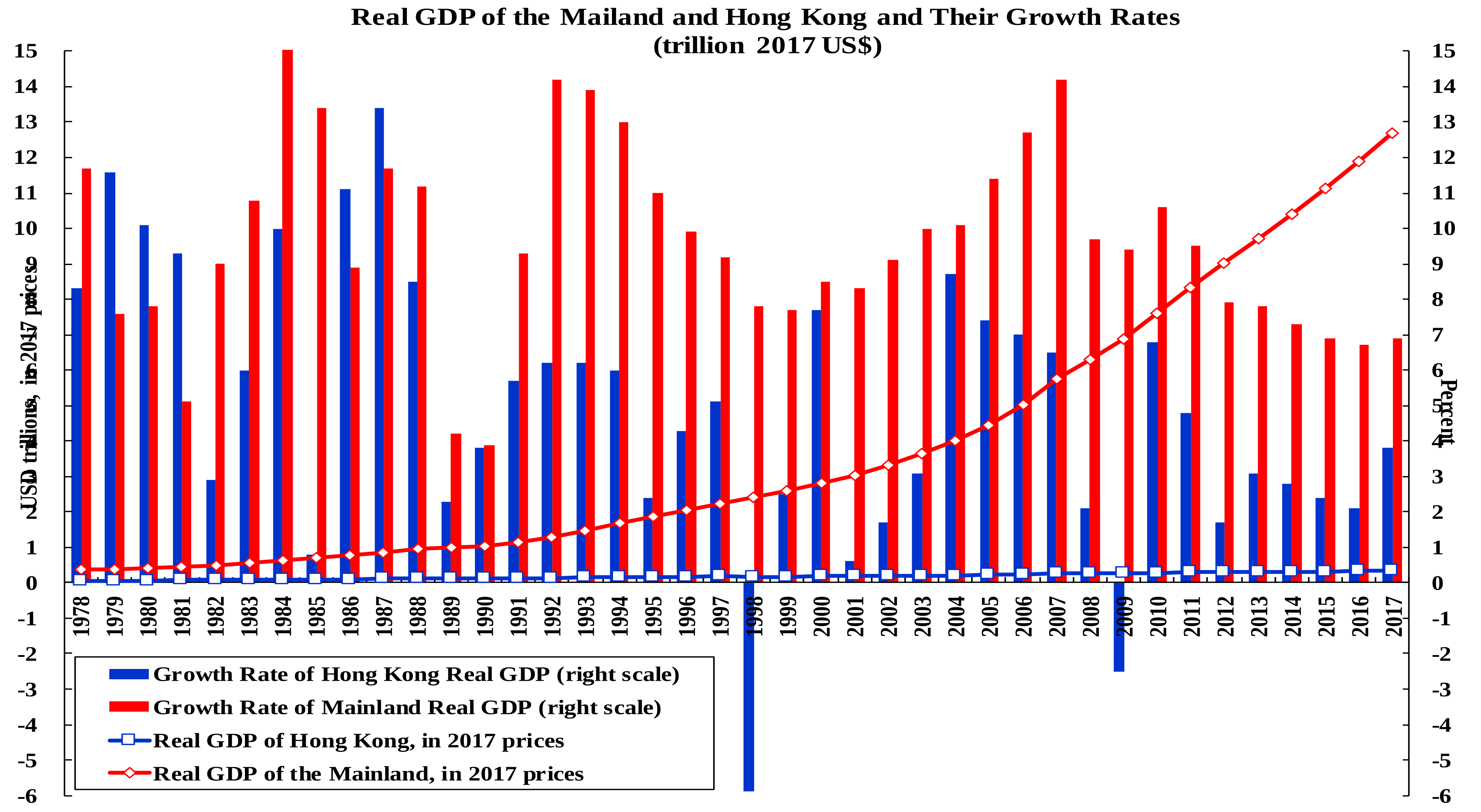
Global Economic Trends: The Geo-Political Uncertainties

- There are currently many major geo-political uncertainties. What are the real effects of Brexit on the U.K., on the European Union and on the rest of the world? What policies will a new German Government pursue?
- The possibility of trade wars with the United States—across the Pacific (China and Japan) and the Atlantic (Germany) and within North America (Canada and Mexico).
- The risks of isolationism, protectionism and populism.
- And then there is the continuing North Korean crisis.
- Other potential hot spots include the South China Sea, the East China Sea, the Middle East, Africa and possibly the Taiwan Straits.

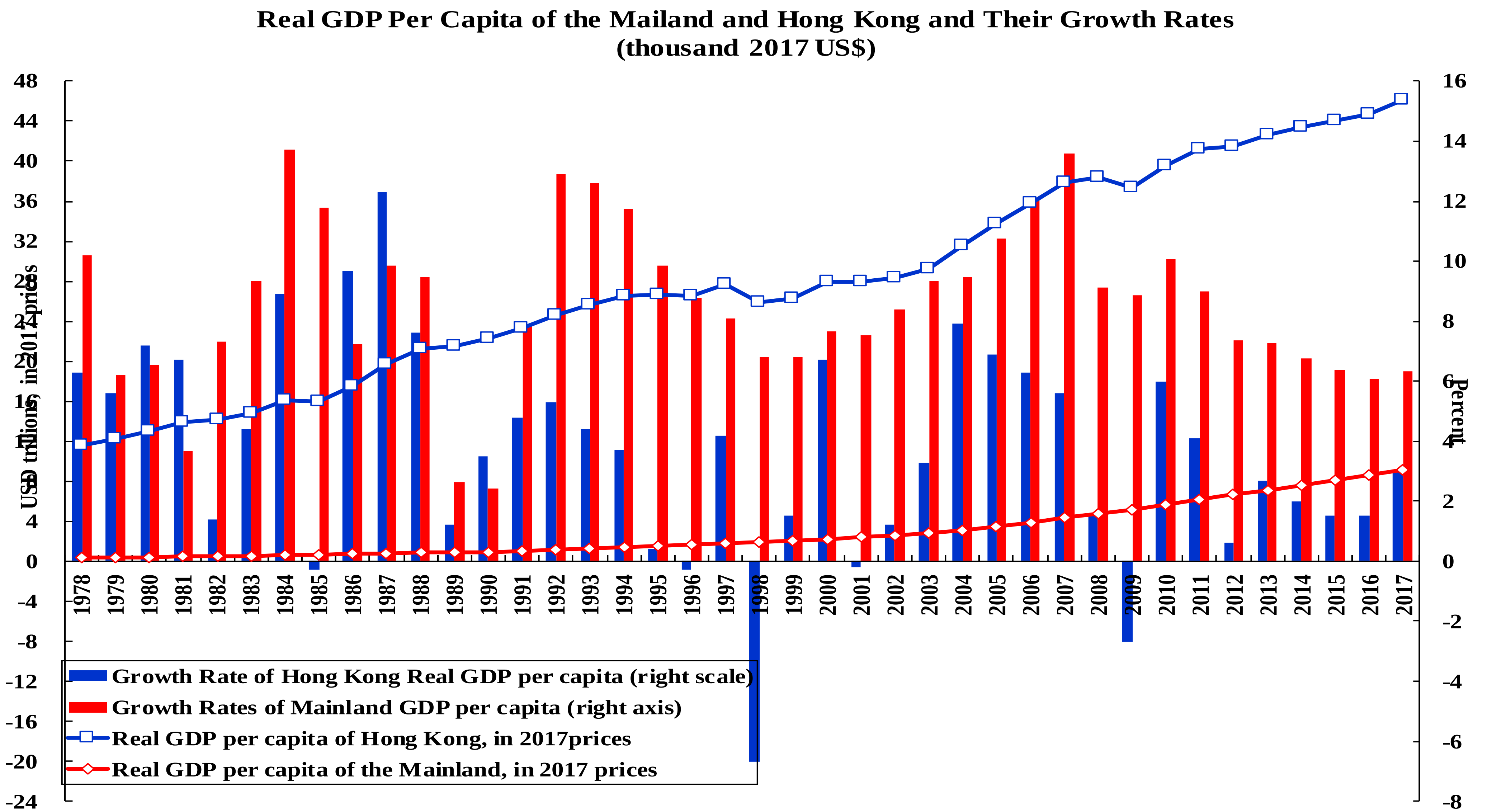
The Hong Kong Economy at a Turning Point

- It is useful to compare the economies of Hong Kong and the Mainland over time. Huge changes have occurred since 1978 when the Mainland began its economic reform and opened its economy to the world.
- The relative economic sizes of Hong Kong and the Mainland have changed significantly. In 1978, the real GDP (2017 prices) of Hong Kong was one-seventh that of the Mainland (US$53.6 billion versus US$368.6 billion). In 2017, the real GDP of Hong Kong was only 2.7 percent of that of the Mainland (US$340.8 billion versus US$12.7 trillion).
- The real GDP per capita of Hong Kong was 30 times that of the Mainland in 1978 and still 4.9 times in 2017 (US$46,099 versus US$9,138).
- Since 1991, the rates of growth of Mainland real GDP and real GDP per capita have exceeded those of Hong Kong in every single year, often by large margins. The respective Mainland rates average 9.7% and 9.0% annually over this period, compared to Hong Kong's 3.7% and 2.7%.
- Even then, it will probably take another half-a-century before the level of Mainland real GDP per capita exceeds that of Hong Kong.

Mainland and Hong Kong Real GDPs and Their Rate of Growth (trillion 2017 US$)



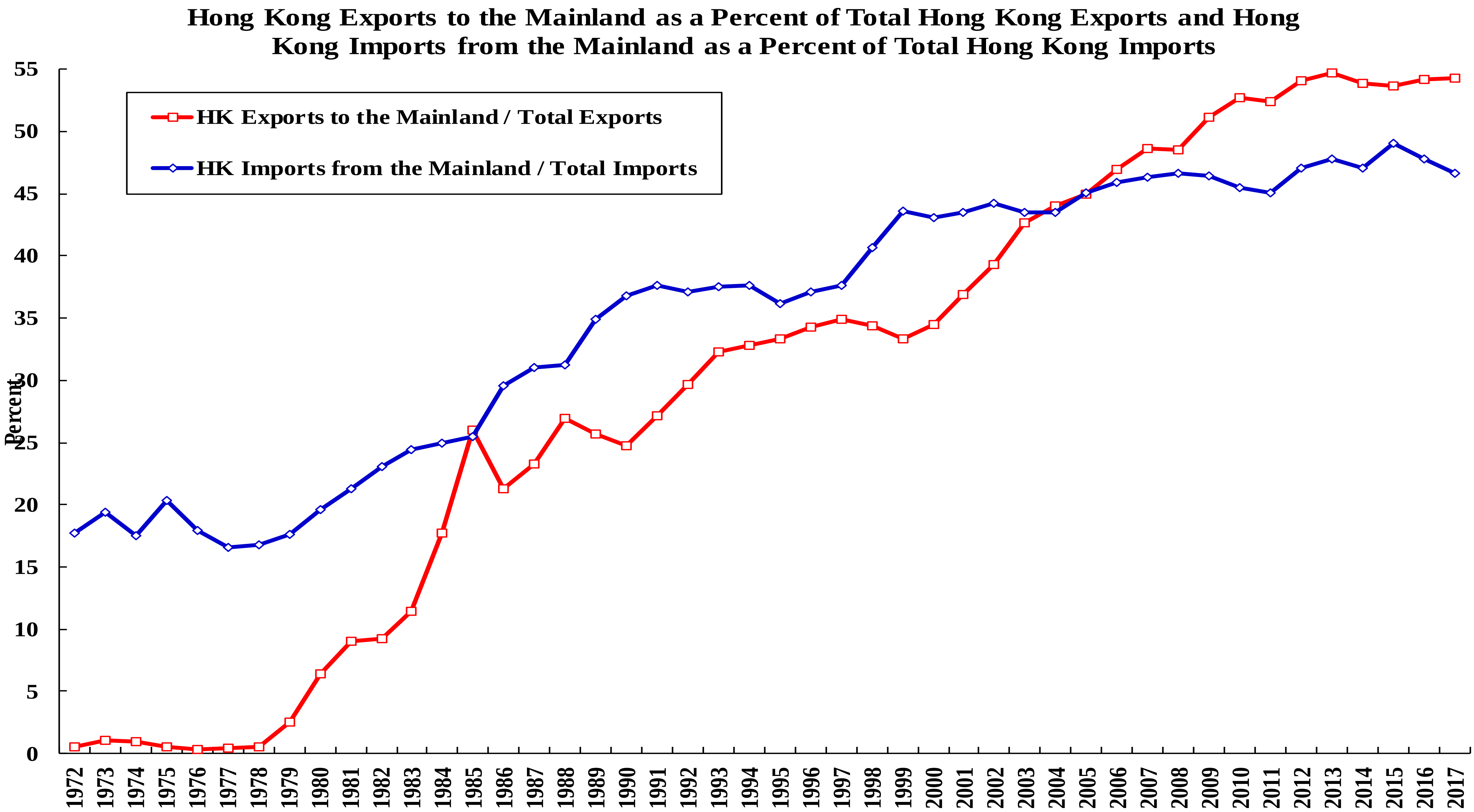
Mainland and Hong Kong Real GDPs per Cap. and Their Rates of Growth (thou. 2017 US$)



The Hong Kong Economy at a Turning Point

- The Mainland is Hong Kong's most important export destination and the most important import origin (accounting for 54.7% and 47.2% respectively as of January 2018).
- Mainland annual direct investment in Hong Kong constitutes approximately half of annual total foreign direct investment in Hong Kong.
- The Mainland is the most important source of tourists to Hong Kong, accounting for more than 70%.
- Mainland enterprises are the mainstay of the Hong Kong Stock Exchange.

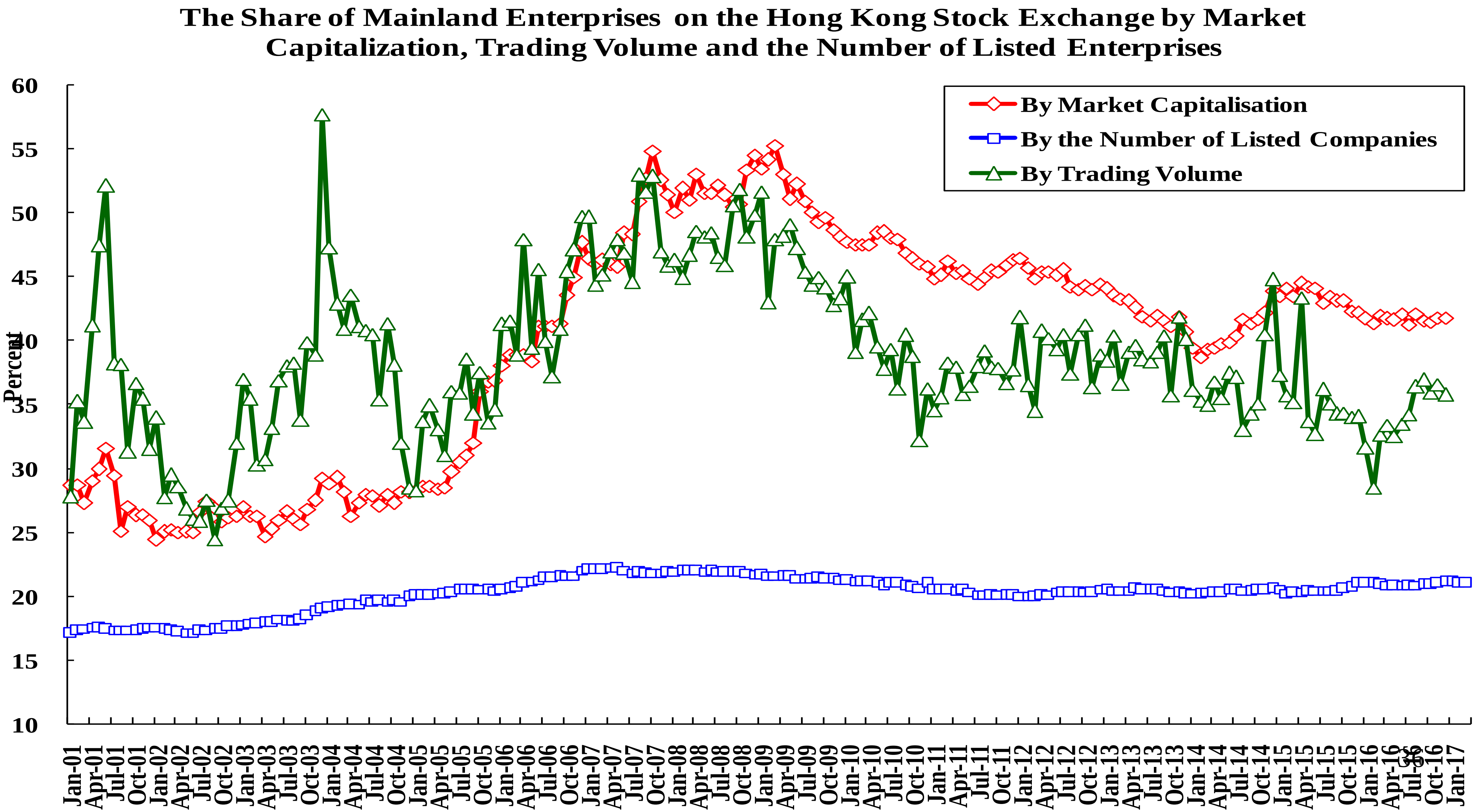
Hong Kong Exports to and Imports from the M'land as % of Total HK Exports and Imports



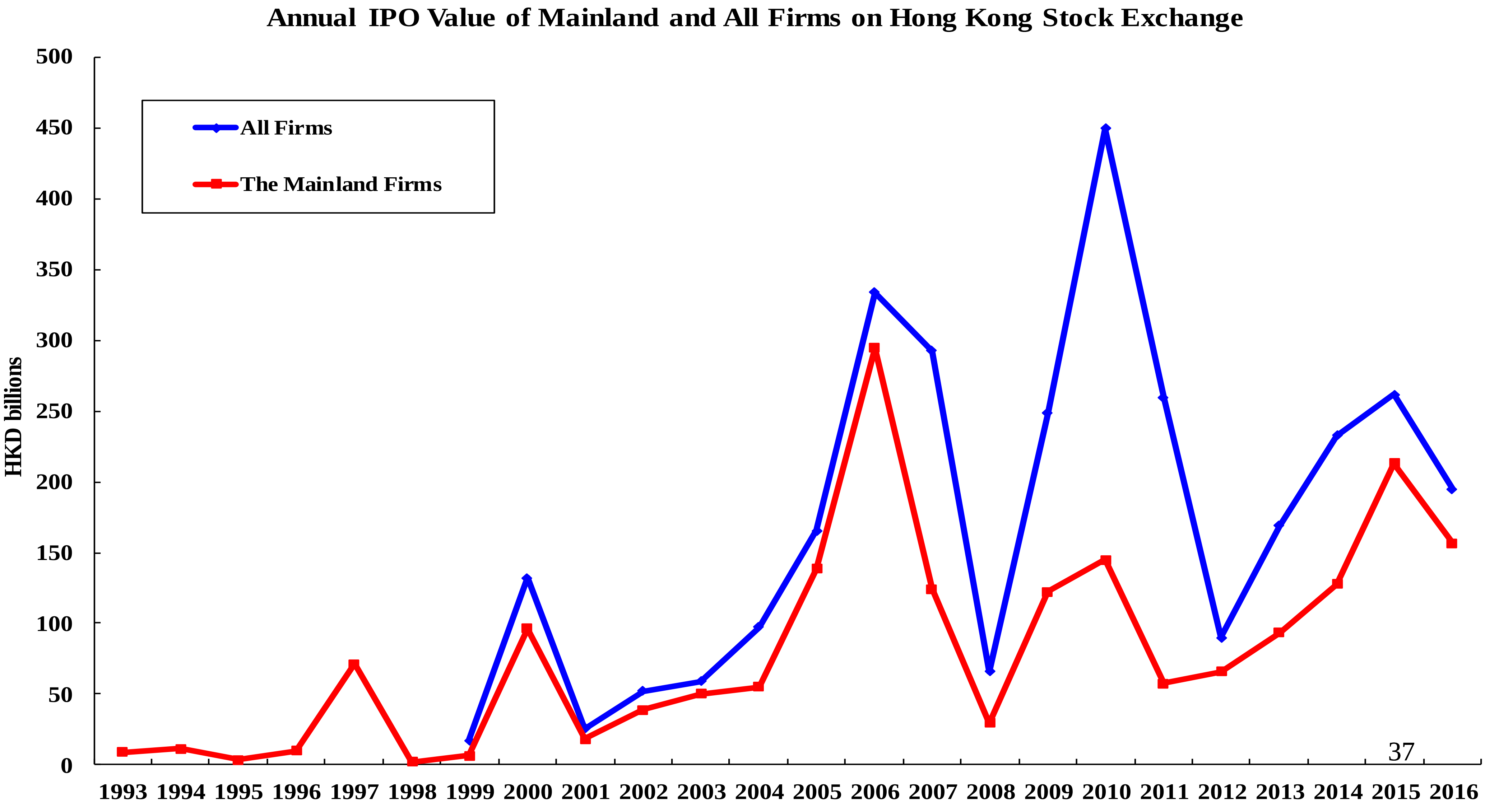
The Hong Kong Economy at a Turning Point

- Although Mainland enterprises constitute only 20% of the listed enterprises on the Hong Kong Stock Exchange by number, they constitute over 35% of the daily turnover on average and over 40% by market capitalization.
- They also account for and constitute half of the 50 enterprises included in the Hang Seng Index.
- From the point of view of IPO volume at the Hong Kong Stock Exchange, with the exception of the years of the Global Financial Crisis, Mainland enterprises account for way over 50%.

The Share of Mainland Enterprises on the Hong Kong Stock Exchange



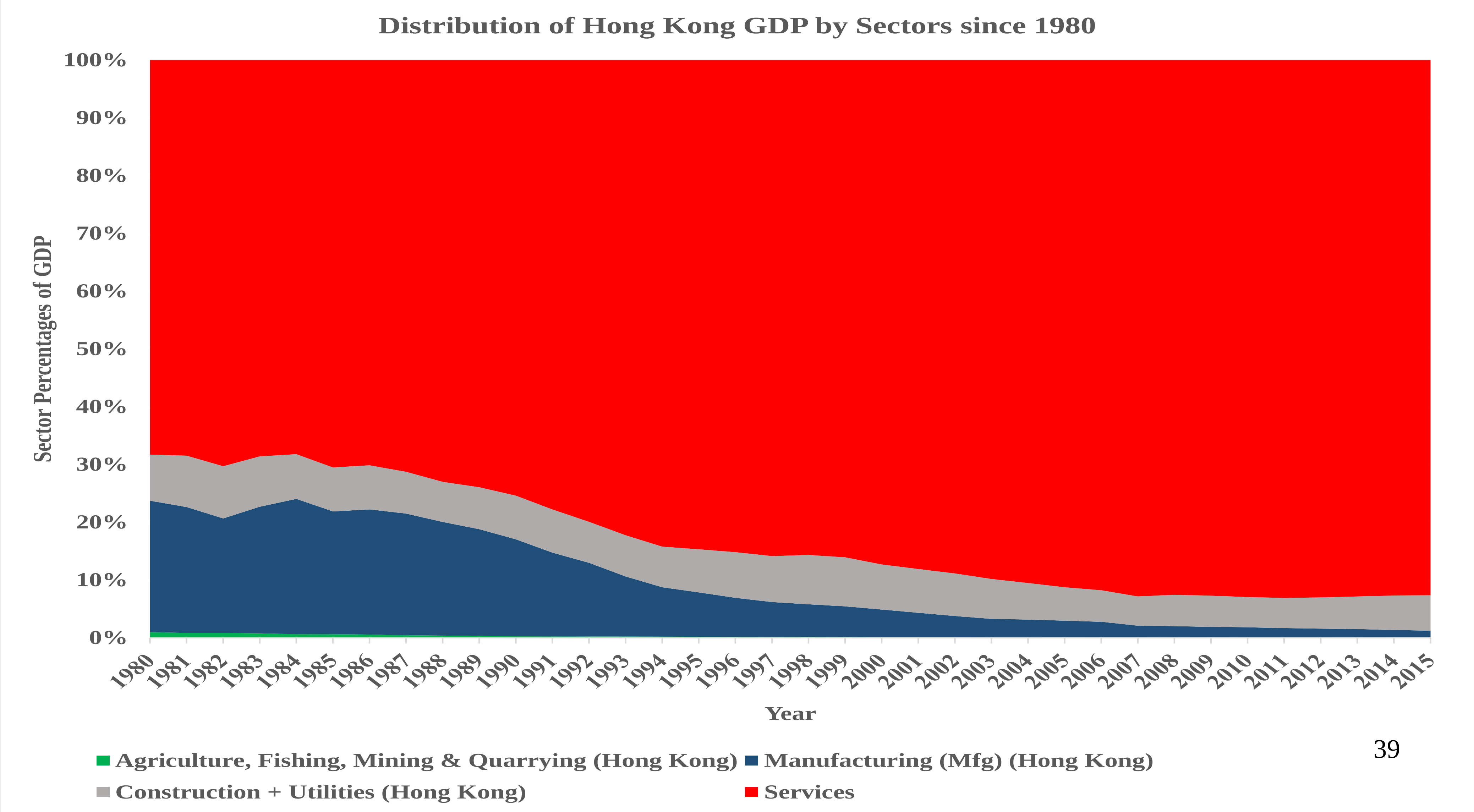
Annual IPO Value of Mainland and All Firms on Hong Kong Stock Exchange



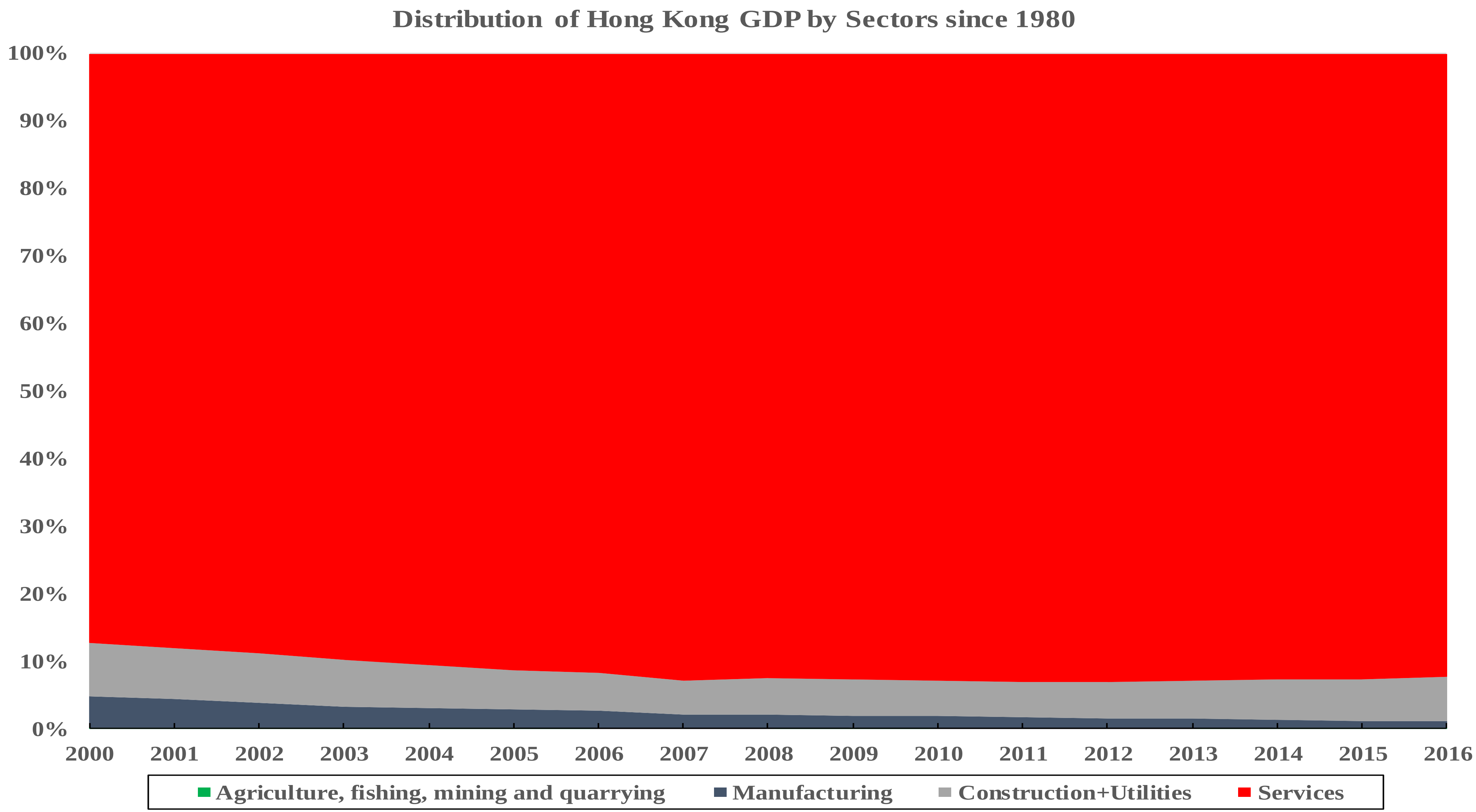
The Hong Kong Economy at a Turning Point

- The share of manufacturing in GDP has declined from 22.4% in 1980 to 1.1% in 2016. Basically manufacturing has left Hong Kong. Hong Kong direct investments in light manufacturing on the Mainland also face the twin challenges of rising real wage rate and Renminbi exchange rate.
- The share of the service sector already exceeds 92%.
- The four traditional key industries in Hong Kong--financial services, tourism, trading and logistics and professional services—have been providing the main support for Hong Kong's economic development and employment. However, their combined share in GDP has declined from its peak of 60.3% in 2007 to 56.6% in 2016 and their share of employment has not been growing in recent years.

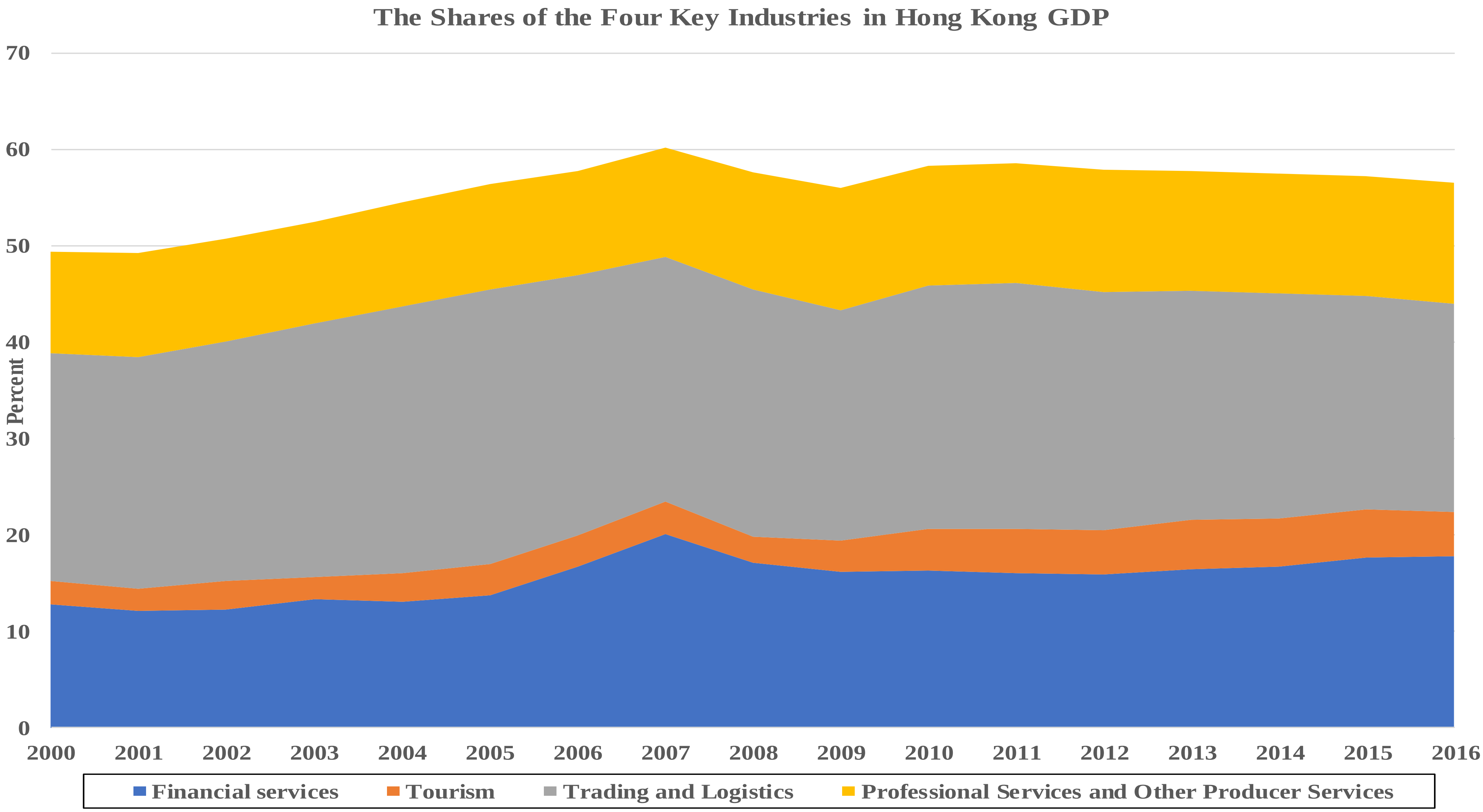
The Shares of the Four Production Sectors in Hong Kong GDP since 1980



The Shares of the Four Production Sectors in Hong Kong GDP since 2000



The Shares of the Four Key Industries in Hong Kong GDP



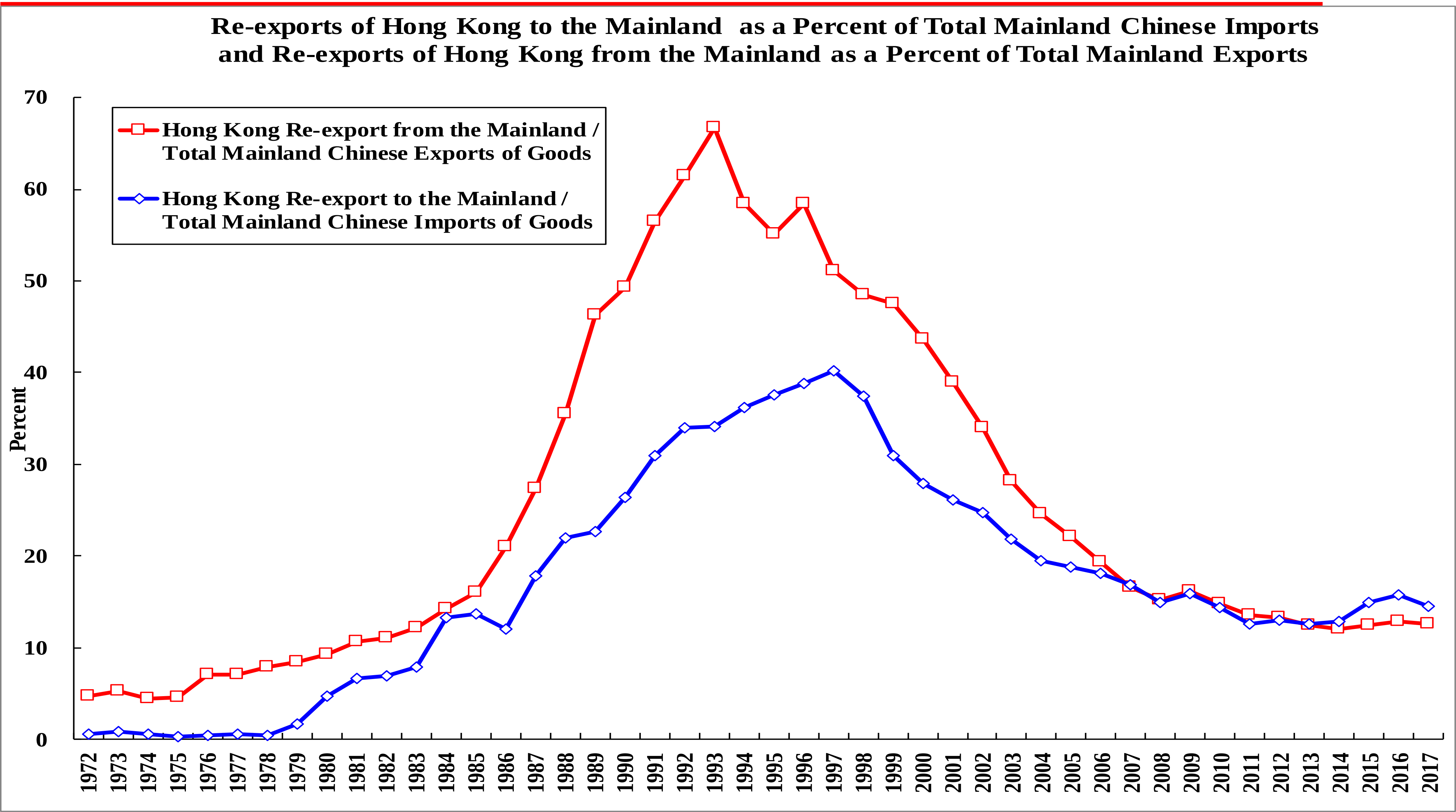
The Hong Kong Economy at a Turning Point

- Of the four traditional key industries, financial services and professional services still have growth potential. But Hong Kong must enhance its role as a conduit for the Mainland's outbound investments, to provide financial and professional services for the Mainland's growing direct and portfolio investments abroad.
- The six other selected industries are 1.Cultural and creative industries; 2.Medical services; 3.Educational services; 4.Innovation and technology; 5.Testing and certification; and 6.Environmental industries. In 2015, the shares of cultural and creative industries in GDP and employment reached 4.7% and 5.7% respectively, close to the shares of tourism (5% and 7% respectively), and it has significant growth potential. Educational and medical services, with their huge domestic demands, have also been growing fast. Innovation and technology will require government policy support before it can achieve a high rate of growth.

The Hong Kong Economy at a Turning Point

- For various reasons, the incentive for Mainland enterprises to list their shares in Hong Kong has diminished. That is why Hong Kong has to try to attract potential listings from other economies.
- The tourist arrivals from the Mainland have already peaked. The value-added of trading and logistics as a percent of GDP has been declining since 2005.
- The competition from Mainland ports, in addition to the slowdown in the growth of world trade, has caused the proportion of re-exports through Hong Kong in total Mainland trade to decline substantially.
- Hong Kong must embark on new directions in order to continue to grow and prosper, developing new industries to provide high value-added employment opportunities. It must further diversify its economy to reduce the over-dependence on any one particular sector or region. Above all, it cannot afford to turn inward and must remain internationalized.

HK Re-Exports to and from the Mainland as a Percent of Mainland Imports and Exports



The Hong Kong Economy at a Turning Point: 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 centers
- Low corporate and individual income tax rates with exemption for income generated outside the HKSAR
- 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 established international arbitration and mediation center

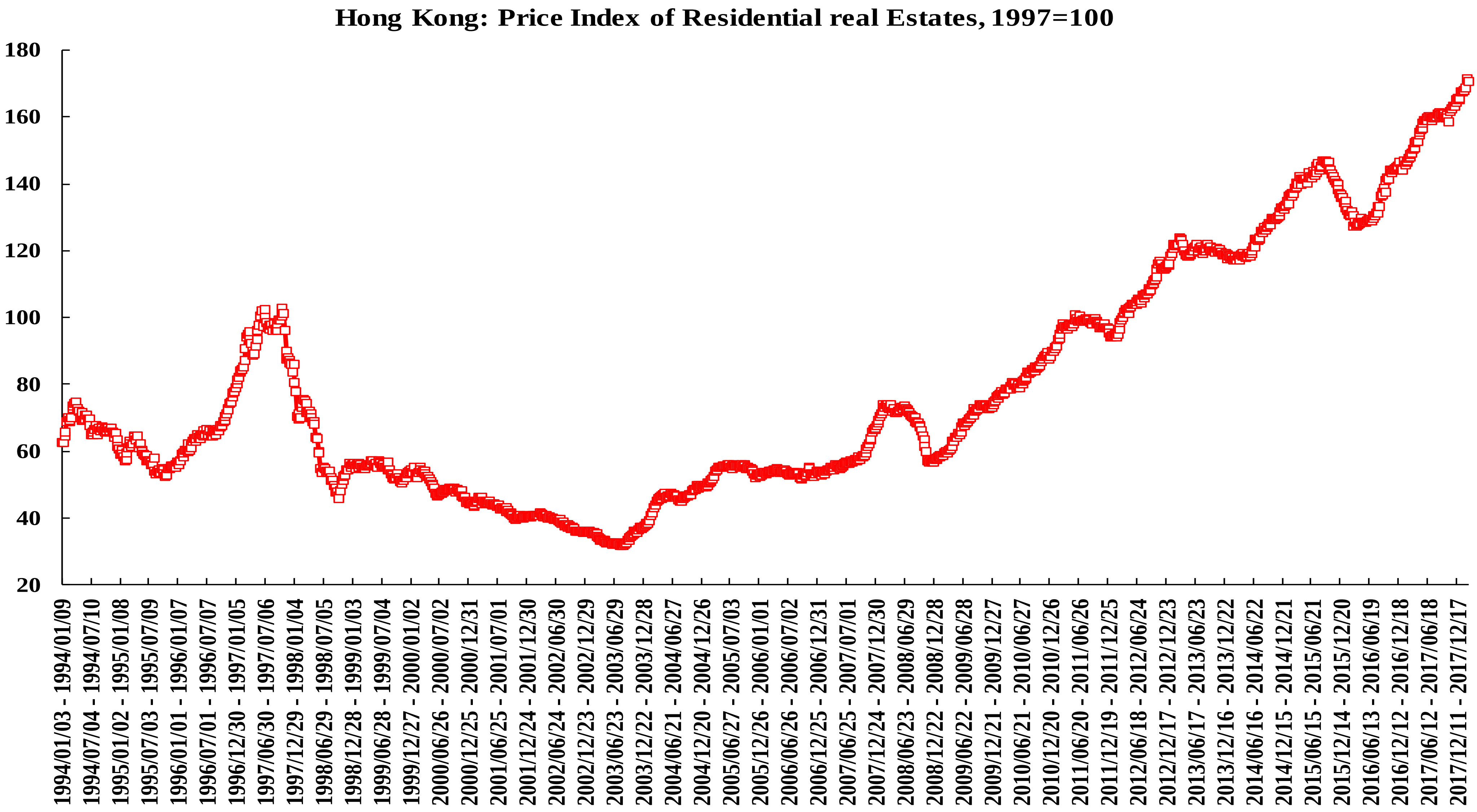
The Hong Kong Economy at a Turning Point: The Comparative Advantages of Hong Kong

- An environment hospitable to entrepreneurs and potential entrepreneurs
- The favorable 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 labor force
- An internet-savvy population
- World-class, research-oriented universities
- Geographically well located--proximity to the Mainland, a huge market and a huge source of savings, right at the junction between the Mainland China and the emerging ASEAN region and a terminus of the Belt and Road.
- 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).
- A supportive central government.

The Hong Kong Economy at a Turning Point: The 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
- The lack of an economic hinterland, which New York, London, Tokyo and Shanghai all have. (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.)
- 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)

Price Index of Residential Real Estate, Hong Kong: Centa-City Leading Index (1997=100)



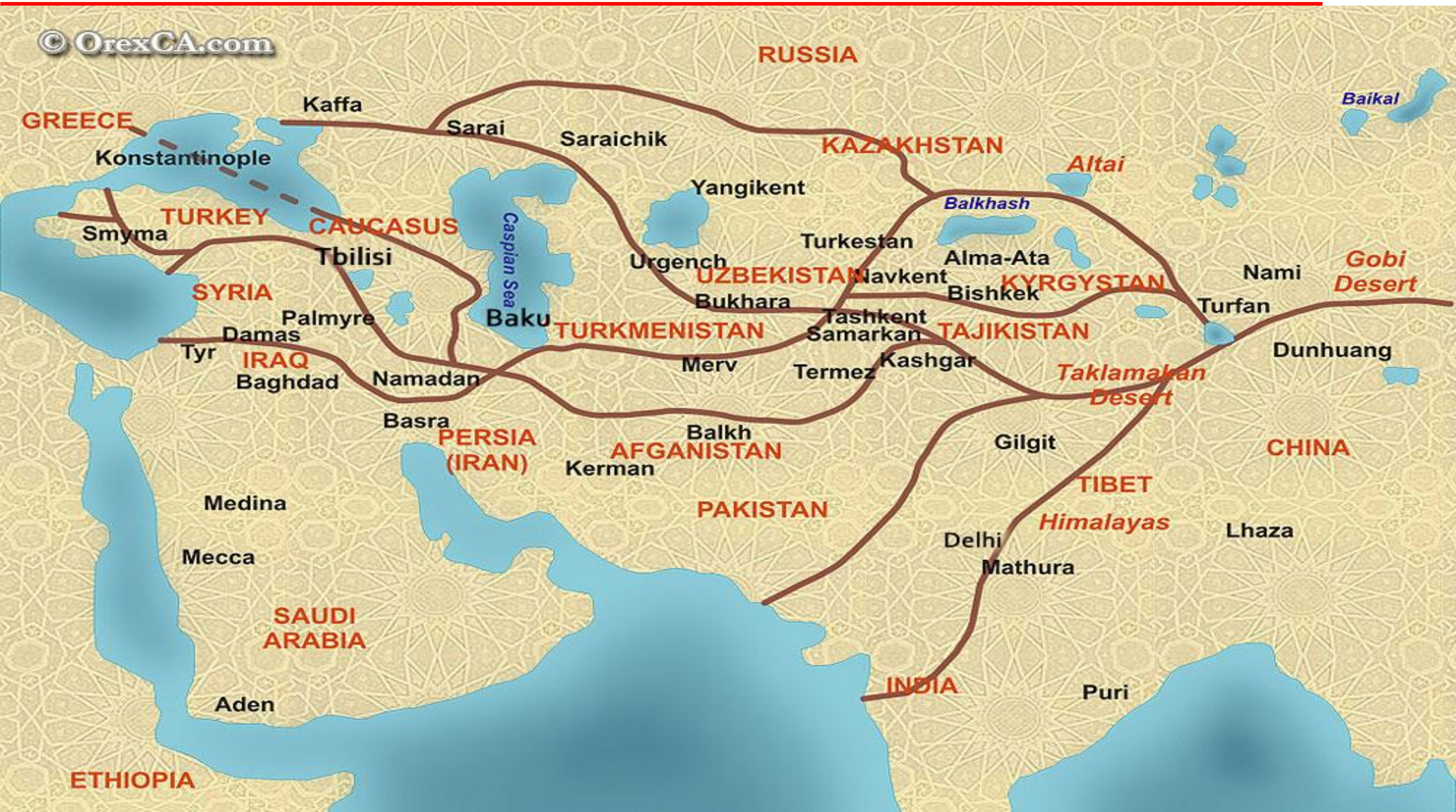
The Hong Kong Economy at a Turning Point: The Vulnerabilities of Hong Kong

- Insufficient support for higher education and for R&D, hindering Hong Kong's transformation into an innovation-based economy (Tertiary education enrolment rate is around 20% compared to almost 50% for the Mainland and 100% for Taiwan; R&D expenditure is only 0.73% of Hong Kong's GDP, compared to 3% or above for Japan and the U.S., 4.15% for South Korea and 4% for Shenzhen).
- Local protectionism of many service professions such as the legal and the medical
- Declining English proficiency and an increasingly inward-looking mentality
- Adverse demographic development
- Lack of a long-term plan and strategy
- Lack of unity of purpose and a sense of urgency

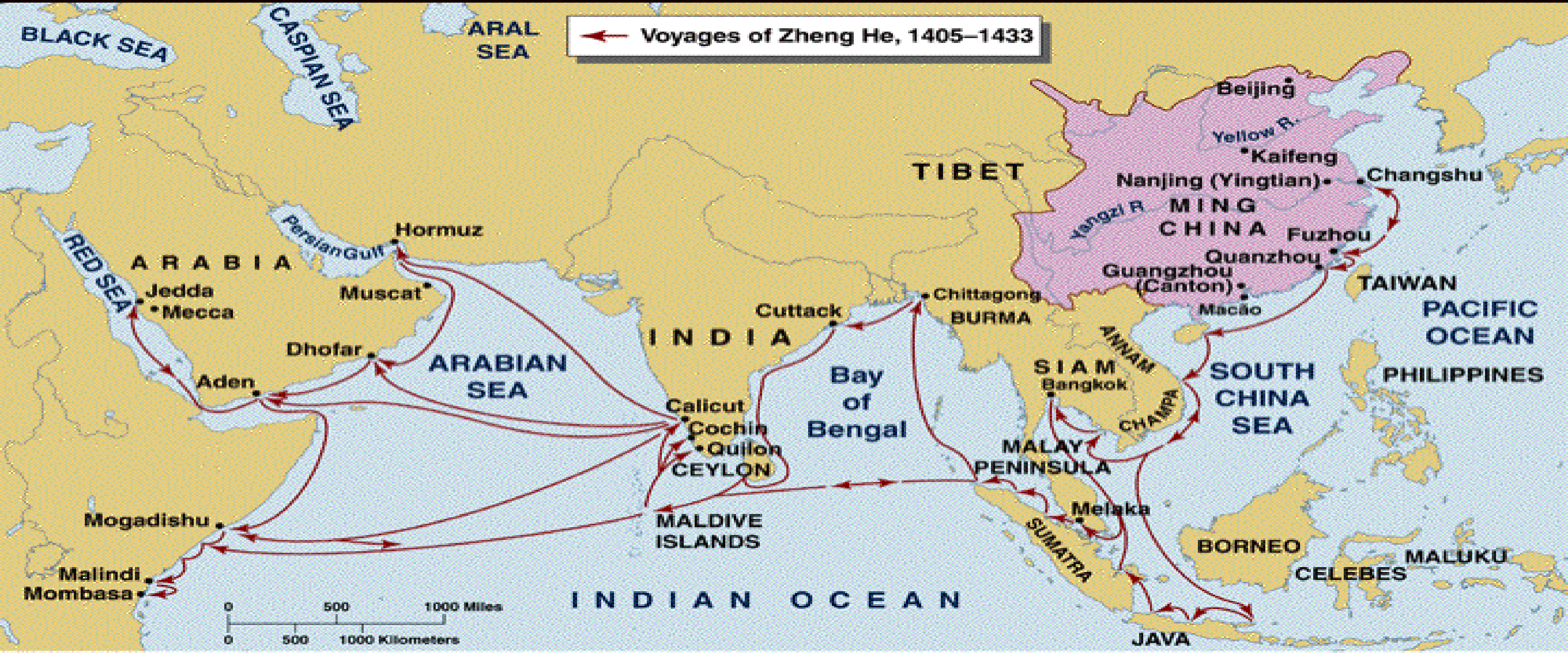
The Belt and Road (B&R) Initiative

- The "Belt and Road" (B&R) Initiative, consisting of the Silk Road Economic Belt and the 21st Century Maritime Silk Road, was launched by President XI Jinping in September 2013. It is a grand, multi-country (72 by last count), multi-decade development plan with the objective of linking and transforming the economies of Asia, Europe, Africa and Oceania.
- The Silk Road Economic Belt, as the Old Silk Road, links the continents of Asia, Europe and Africa together. It brings together China, Central Asia, West Asia, Middle East, North Africa, Russia and Europe. In particular, it will encompass new Eurasian Land Bridges.
- The 21st-Century Maritime Silk Road is designed to connect China's coastal regions to Europe through the South China Sea and the Indian Ocean in one route, and through the South China Sea to the South Pacific and Oceania in the other. However, the "Northern Passage", through the Bering Strait and down to Northern Europe, has also been proposed to be part of the 21st-Century Maritime Silk Road as global warming makes the route navigable year round.

The Belt and Road (B&R) Initiative: The Old Silk Roads



Voyages of Admiral ZHENG He (1405-1433) (map from www.history.ubc.ca)



MAP 2-6 VOYAGES OF ZHENG HE, 1405–1433

The Belt and Road (B&R) Initiative

- The Belt and Road (B&R) Initiative is a serious long-term commitment of China that has been written into the Charter of the Communist Party of China.
- It aims to create a peaceful and secure environment for joint development by building a trade, investment and infrastructure network connecting all B&R nations.
- It emphasizes the nurturing of mutual understanding and trust and the formation of durable relationships through cultural and educational exchanges as well as industrial cooperation.
- It promotes open, inclusive, balanced and green economic globalization through enhanced regional interconnectivity.
- But above all, it seeks to stimulate and create sustainable trade and investment exchanges where none exist before, thus benefitting every Belt and Road country and accelerating economic development for all.

The Belt and Road (B&R) Initiative: The Financing of Infrastructure Projects

- China's own economic development experience confirms that both reform and openness are necessary for success. And infrastructure building is the indispensable first step for achieving real effective openness.
- This is true of the B&R Initiative. The Asian Development Bank (ADB) estimated that emerging Asian economies would need infrastructure investment totaling US$1.7 trillion a year in order to maintain economic growth, but only about half the amount would be available. Finding ways to finance the infrastructure needs is the first priority. The B&R Initiative is an attempt to fill the gap.
- The more cynical observers may suggest that the B&R initiative is only a Chinese ploy to create the demand to solve its excess capacity problem. However, one should note that B&R is a multi-decade plan whereas the Chinese excess capacity is at most an intermediate-term (five-year) problem. Moreover, it is actually win-win for both China and the host country of the infrastructure project if a Chinese contractor is the successful bidder because it is likely to imply a lower construction cost.

The Development of a Belt-and-Road-Wide Long-Term Bond Market

- The B&R projects require private investment in both equity and debt.
- The buying power of Asian investors, which 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, can and should be marshalled to supply the demand for both equity and debt.
- The average annual turnover of the Shanghai and Shenzhen Stock Exchanges combined was more than US$41 trillion, higher than that of the New York Stock Exchange of US$30 trillion in 2016. In contrast, the average daily turnover of the Hong Kong Stock Exchange was only US$2 trillion. The potential stock-buying power of the Mainland investors is what will attract the non-Mainland enterprises to list their shares on the Hong Kong Stock Exchange.
- Sooner or later, the investment portfolios of Mainland investors will have to be diversified into investments outside the Mainland. Hong Kong is the ideal place to provide a channel for such investments.

The Development of a Belt-and-Road-Wide Stock Market

- At present, there is no single market in which the stocks of all major enterprises in East Asia (let alone the stocks of enterprises in the other Asian Belt and Road countries) are traded. Investors both inside and outside 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$ or eventually the Renminbi, 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 attract, encourage and solicit blue-chip enterprises around the world to do secondary listings in Hong Kong as Hong Kong Depositary Receipts (HDRs).
- The size of the buying power and the liquidity will decide which capital market will dominate. Ultimately, there will be only one such market in East Asia that can attract international investors worldwide.

The Guangdong-Hong Kong-Macau Greater Bay Area (GBA) Initiative

- The GBA consists of nine contiguous cities in the Pearl River Delta region of the Guangdong Province--Guangzhou, Shenzhen, Dongguan, Foshan, Huizhou, Jiangmen, Zhaoqing, Zhongshan, and Zhuhai, and the Hong Kong and Macau Special Administrative Regions.
- There will be increasing connectivity amongst these eleven cities with the completion of additional infrastructural facilities.
- Increased connectivity can create trade in goods and services and investment that do not exist before.

The Guangdong-Hong Kong-Macau Greater Bay Area (GBA) Initiative

The Guangdong-Hong Kong-Macau Greater Bay Area (GBA) Initiative: The Vision

- In 2016, the total population of the eleven cities within the GBA were 68 million, with a combined GDP of US$ 1.39 trillion and an average GDP per capita of US$ 20,412. The U.K., which was the world's fifth-largest economy in 2016, had a population of 65.1 million, a GDP of US$ 2.63 trillion and a GDP per capita of US$ 40,399.
- Although these two regions share similar size of population, the GDP and GDP per capital of the U.K. are almost twice that of the GBA.
- However, based on the current growth rate of the GBA, its economy will at least double in size after a decade. As the U.K. economy has slowed down, and taking into account the negative impact of Brexit, it seems likely that the GBA will overtake the U.K. by 2027 to become the world's fifth-largest economy.
- The GBA has the potential to eventually become an enormous international metropolis, with an average GDP per capita exceeding US$ 40,000, achieving a top rank amongst the developed economies.

The Guangdong-Hong Kong-Macau GBA Initiative: Opportunities and Challenges

- The cities within the GBA should move towards economic integration to make more efficient use of their resources, giving full play to their potential and complementary economic structures and realizing the advantage of economies of scale, specialization and division of labor.
- In order to integrate the economic activities in the GBA, it is imperative to consider establishing a pilot GBA free trade zone for trial implementation.
- Economic integration of the GBA requires the free flow of four major elements within: (1) goods and services; (2) people; (3) capital; and (4) information.
- The role models for the GBA are the bay areas of San Francisco, New York and Tokyo, which all have the free flow of the four major elements within them.

The GDHKM Greater Bay Area (GBA) Initiative: Sharing of Infrastructure Facilities

- The infrastructure facilities within the GBA should be shared among the GBA cities. Different GBA cities should coordinate among one another in their development plans, specialize in their respective areas of expertise and promote the division of labor to avoid duplication, mismatch and waste of resources.
- For example, the GBA can follow the example of New York and New Jersey to establish a GBA or HK-Shenzhen Airport Authority to manage all the civilian airports in the area. As a first step, the Hong Kong International Airport should consider cooperating with the Shenzhen Baoan International Airport, through the linkage of a high-speed railroad between the two airports, so that flights between Hong Kong/Shenzhen and Mainland cities take off and land in the Baoan Airport and international (overseas) flights take off and land in the Hong Kong Airport. The revenue of the two airports will be shared by Hong Kong and Shenzhen.
- Guangdong, Hong Kong and Macau may also consider coordinating with the military and starting a GBA cross-border civilian helicopter business to strengthen ties and facilitate exchanges among the GBA cities.

The GDHKM GBA Initiative: Specialization, Division of Labor and Coordination

- For example, after the opening of the Hong Kong-Zhuhai-Macau Bridge, the Macau Airport can be used exclusively for serving private and business aircrafts in the GBA, so that the landing and taking-off of private aircrafts will be shifted from Hong Kong International Airport to the Macau Airport.
- Zhuhai International Airport can be developed into a transnational air cargo express delivery hub within the Eastern Asian region (similar to the FedEx America Centre in Memphis, Tennessee, U.S.) for serving Northeast and Southeast Asia.

The GDHKM GBA Initiative: Specialization, Division of Labor and Coordination

- Hong Kong and Shenzhen can join forces in building the GBA into a global innovation, venture investment and financing center, which combines the Silicon Valley, Route 128, New York Stock Exchange and NASDAQ exchange into one.
- Hong Kong and Shenzhen should each specialize based on their respective comparative advantages: Universities in Hong Kong may focus on fundamental research, while Shenzhen, and in particular Shenzhen enterprises, may focus on application and development research, pilot manufacturing and commercialization.
- Hong Kong can be developed into a hub of venture capital, while Shenzhen a hub of start-up enterprises to attract inventors, entrepreneurs and venture investors.
- The Hong Kong and Shenzhen Stock Exchanges together can fulfil the function of the NASDAQ exchange in the U.S. capital market for new enterprises in the GBA seeking an initial public offering (IPO). Successful enterprises can obtain a listing to raise equity funds or issue corporate bonds on the Hong Kong Stock Exchange at a later stage.
- Hong Kong and Shenzhen together can become a regional merger and acquisition (M&A) center.

Projections of the Future: Near-Term Forecasts by International Organizations

	The World Bank			The IMF	
	Real GDP Growth Forecasts			Real GDP Growth Projections	
	2018	2019	2020	2018	2019
World	3.1	3	2.9	3.9	3.9
China	6.4	6.3	6.2	6.6	6.4
The U.S.	2.5	2.2	2	2.7	2.5
EU	2.1	1.7	1.5	2.2	2
Japan	1.3	0.8	0.5	1.2	0.9
India	7.3	7.5	7.5	7.4	7.8

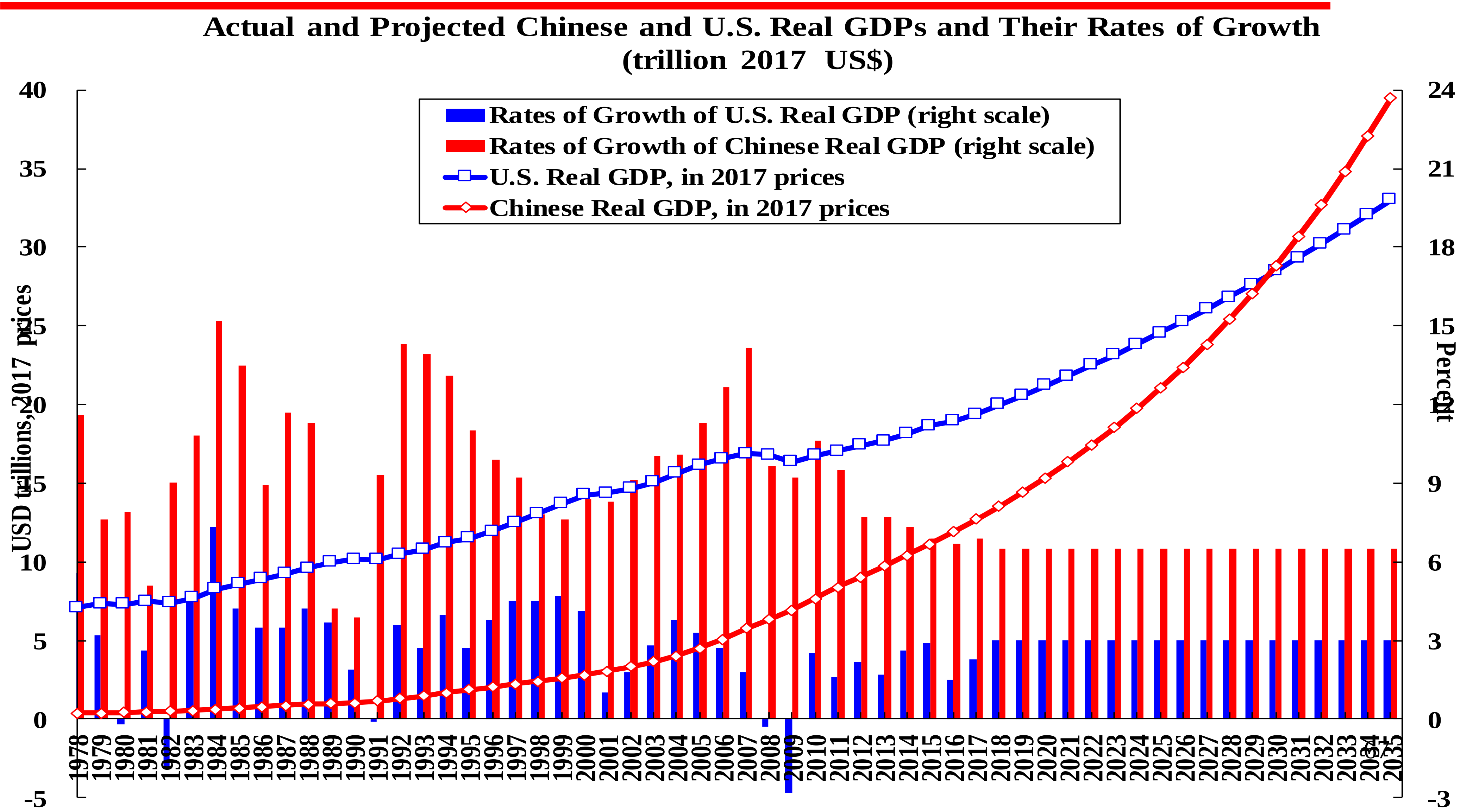
Projections of the Future: Long-Term Forecasts of the Chinese and the U.S. Economies

- It is assumed that the Chinese economy will continue to grow above 6% per annum for a few years, declining gradually to between 5% and 6%, and that the U.S. economy will grow at an average rate of 3% per annum between now and 2050.
- It may be thought that the Chinese economy will be unable to sustain an approximately 6% average annual rate of growth for such a long time. But given the still relatively low level of real GDP per capita in China, such a rate of growth should be possible for at least several decades (see the following chart in which the experiences of China, Japan and the U.S. are compared.)
- The projections of Chinses and U.S. real GDP and real GDP per capita between now and 2050 are presented in the following charts.

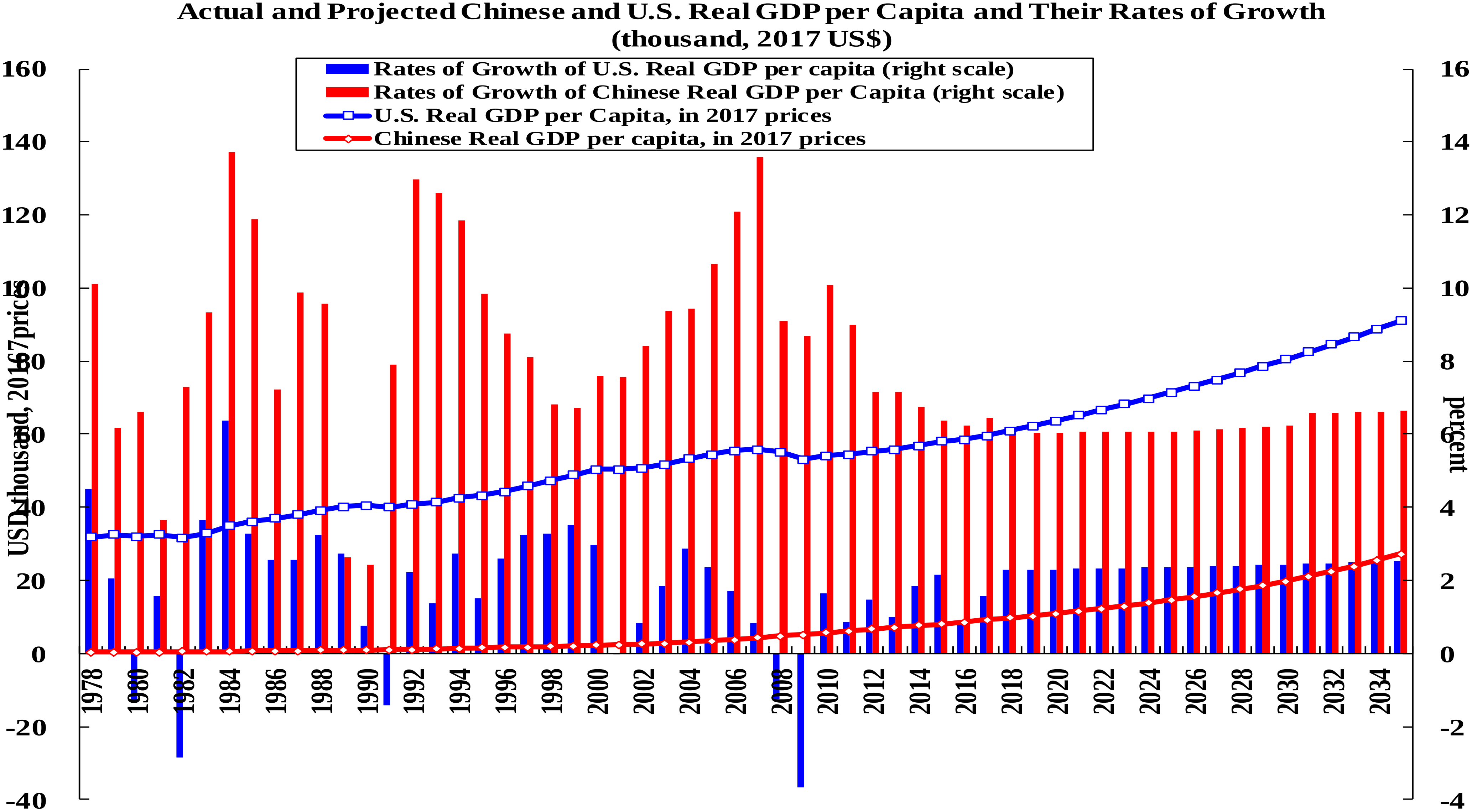
Projections of the Chinese and the U.S. Economies

- In his work report to the Nineteenth National Congress of the Communist Party of China, President XI Jinping identified several milestones in his speech at the Nineteenth Party Congress at 2020, 2035 and 2050.
- The first milestone is to become a moderately well-off society by 2020. Our projections show that by 2020, Chinese real GDP per capita (in 2016 prices) will exceed US$9,800 (compared to US$62,600 for the U.S.).
- Our projections also show that by 2033, Chinese real GDP will surpass U.S. real GDP (US$31.3 trillion versus US$30.6 trillion), making China the largest economy in the world. However, in terms of real GDP per capita, China will still lag behind significantly, with US$21,000 compared to US$84,000 for the U.S.
- By 2050, Chinese real GDP will reach US$86 trillion compared to US$50 trillion for the U.S. In terms of real GDP per capita, China will reach US$54,000, approximately the current level of U.S real GDP per capita, compared to US$123,500 for the U.S.

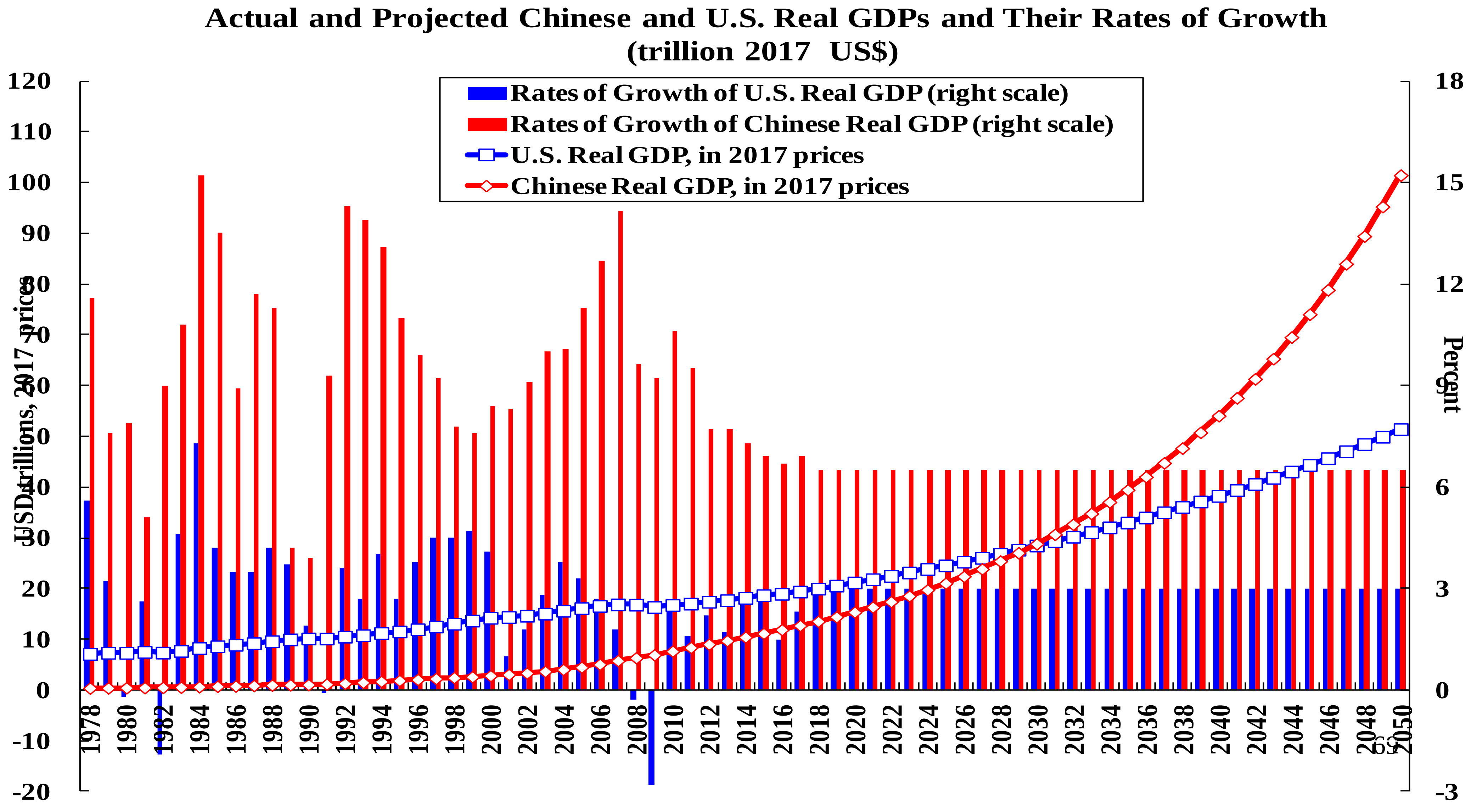
Actual and Projected Levels and Growth Rates of Chinese and U.S. Real GDP (2017 tril. US$)



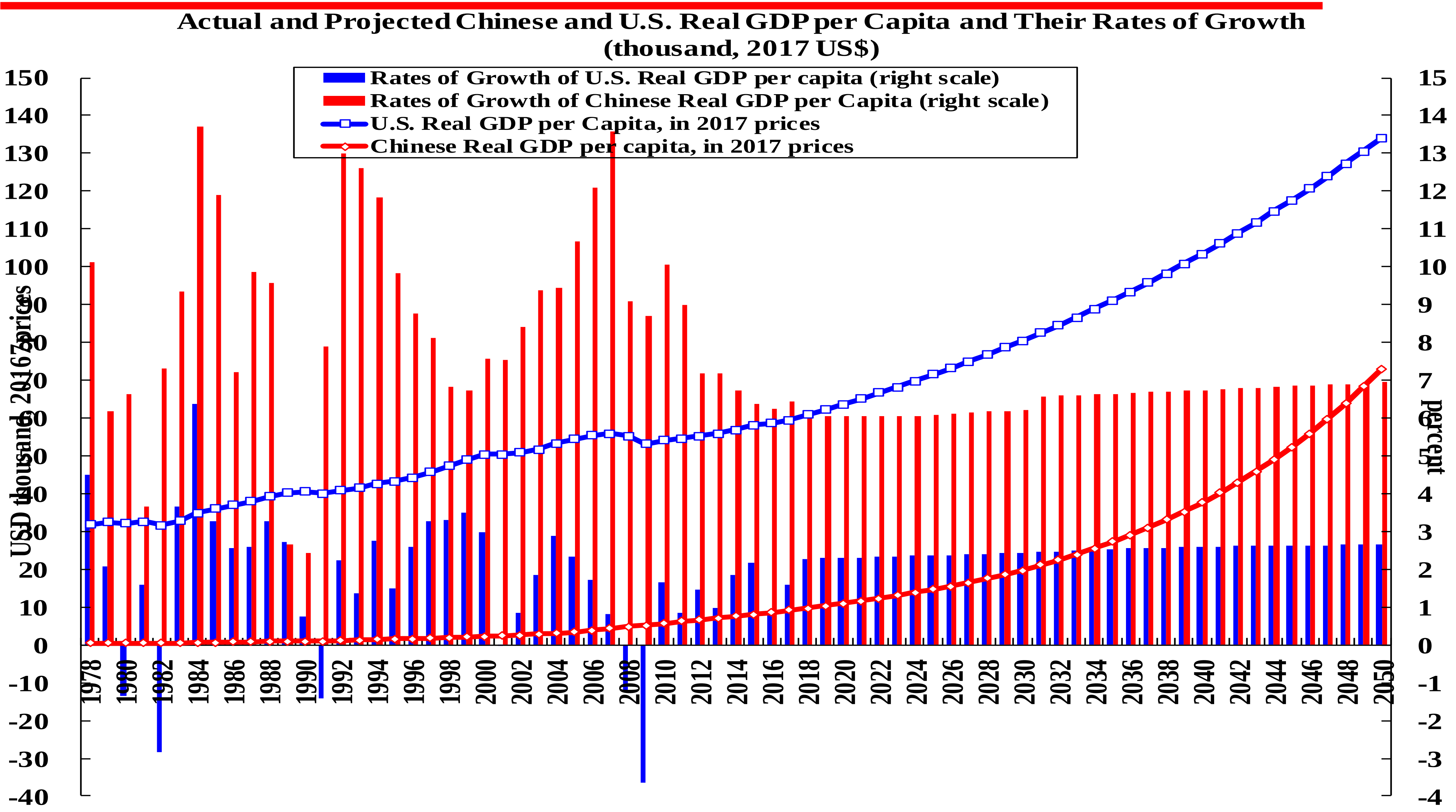
Actual and Projected Chinese and U.S. Real GDP/ Capita and Their Rates of Growth (1,000 2017 US$)



Actual and Projected Levels and Growth Rates of Chinese and U.S. Real GDP (2017 tril. US$)



Actual and Projected Chinese and U.S. Real GDP/ Capita and Their Rates of Growth (1,000 2017 US$)



The Future of the Hong Kong Economy

- (1) Make Hong Kong into a comprehensive, full-service and one-stop international financial center;
- (2) Together with Shenzhen, build Hong Kong into an all-encompassing international hub for innovation;
- (3) Develop the cultural and creative arts industry; and
- (4) Grasp the opportunities presented by the "Belt and Road" and the "Guangdong-Hong Kong-Macau Greater Bay Area" initiatives.
- This should usher in a third spring for the Hong Kong economy.

The Future of the Hong Kong Economy

- Hong Kong has many comparative advantages over other cities, some of which it will, unfortunately, begin to lose over time.
- The Belt and Road and Greater Bay Area Initiatives should bring great opportunities to the Hong Kong economy and to its financial sector in particular. It will usher in a "third spring" for the Hong Kong economy.
- Hong Kong should take maximum advantage of the opportunities offered by the Belt and Road and the Guangdong-Hong Kong-Macau Greater Bay Area initiatives.
- However, it will require the concerted efforts of business, government and academia to realize the full potentials of the B&R and GBA initiatives.
- Hong Kong must do its part in devising implementable plans and strategies and in addition coordinate and 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 try to make itself indispensable once again, as it was during the early days of the Chinese economic reform and opening to the world.

Hong Kong as a One-Stop, Full-Service International Financial Center

- Hong Kong is ideal as a center for the financing of the "B&R" projects. It has the advantages of not only complete capital mobility, full currency convertibility, a stable exchange rate and low taxes, but also ready access to the huge market, the excess savings pool, and the support of the governmental institutions in China, the principal sponsor of B&R.
- However, this will require the development of an active and liquid bond market for both short and long maturities in Hong Kong.
- The financing and the related transactions can also be done in multiple currencies, for example, in U.S. Dollars and Renminbi in addition to the Hong Kong Dollars.

Hong Kong as a One-Stop, Full-Service International Financial Center

- Hong Kong is also an ideal location for the establishment of a Belt-and-Road (which includes East Asia)-wide stock market. because of its location and time zone, efficiency, free mobility of capital, rule of law, stable currency (fixed peg to the U.S. Dollar), and no tax on dividends and capital gains.
- International institutional investors will also be attracted to Hong Kong by newly listed Mainland enterprises, especially the private ones, as well as the Belt-and-Road enterprises.
- Once such an international 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.
- Hong Kong should allow differential voting rights for new listing enterprises as long as there is full disclosure and adequate protection for the minority shareholders.

Hong Kong as the Belt and Road Capital Market

- The B&R initiative is especially important now because the growth of both world GDP and world trade has stalled since the 2008 global financial crisis due to insufficient aggregate demand. B&R, by creating new demands and new supplies, can propel the world economy forward. And economic development will in turn foster peace, security and harmony among the B&R nations.
- In order for Hong Kong to succeed in becoming the leading international financial center for the Belt and Road countries, including 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. (Already an Infrastructure Financing Facilitation Office (IFFO) has been established within the Hong Kong Monetary Authority (the central bank of Hong Kong).)
- It will also need the support of the Central Government.
- Once Hong Kong is established as the home of the Belt and Road region-wide equity and debt securities market, it will be almost impossible for it to be displaced or replaced.

The Future of the Hong Kong Economy

- In order to become an international innovation hub, Hong Kong must vigorously promote higher education, especially post-graduate education, R&D and venture capital in Hong Kong and its surrounding areas.
- Hong Kong must increase its land supply in order to reduce the high cost of office space and housing.
- Fiscal, taxation and regulatory policies should be used as tools for adjusting and re-directing the development of the economy so that it is sustainable in the long run. Appropriate tax policies can facilitate Hong Kong's efforts to become a comprehensive, full-service international financial center, an international innovation hub, and a regional international center for the cultural and creative arts industry.

The Future of the Hong Kong Economy

- The Government of the HKSAR is already actively promoting double-tax treaties with countries on the Belt and Road so as to facilitate investment by Hong Kong entities as well as subsidiaries of Chinese and multinational corporations established in Hong Kong to do Belt and Road related business in the countries concerned.

Make Hong Kong into a Comprehensive, Full-Service, One-Stop Intern’l Financial Center

- In addition to the Mainland, Hong Kong must also grasp opportunities to provide financial services to Belt and Road, including East Asian, countries.
- Hong Kong should develop the ability to trade on its markets in Hong Kong Dollar, U.S. Dollar and the Renminbi.
- Hong Kong must develop an active, broad, deep and liquid bond market for both long- and short-term bonds (including Islamic bonds), starting with sovereign and quasi-sovereign bonds (e.g., bonds issued by the Hong Kong Mortgage Corporation), with maturities ranging up to 50 years.
- Hong Kong should become a capital hub attracting simultaneously fund-raisers, investors and asset managers worldwide.
- Hong Kong is ideally placed to provide related professional services.

Make Hong Kong into a Comprehensive, Full-Service, One-Stop Intern'l Financial Center

- Develop infrastructure financing services to support Belt and Road infrastructure development. The financing of the Belt and Road and Guangdong-Hong Kong-Macau Greater Bay Area projects can help create an ample supply of different types of sovereign and quasi-sovereign as well as non-sovereign bonds for the Hong Kong bond market.
- Attract listing of companies of the Belt and Road, including East Asian, countries, possibly as secondary listings, on the Hong Kong Stock Exchange.
- The huge buying power of the Mainland investors can provide the potential backing and attract these cross-border listings. In 2015, the annual transaction volume of the Mainland stock exchanges reached US$41 trillion, exceeding the combined volume of New York Stock Exchange and NASDAQ of US$30 trillion.
- Once Hong Kong succeeds in attracting listings of companies from different countries, it will be difficult for a stock exchange of another country or region to replace Hong Kong's.

Build Hong Kong-Shenzhen into an All-Encompassing Int’l Hub for Innovation

- Hong Kong and Shenzhen can join forces in building the GBA into a global innovation, venture investment and financing hub, combining the Silicon Valley, Route 128, NYSE and NASDAQ exchanges into one, serving not just Hong Kong and the Mainland but also the entire Belt and Road region.
- Hong Kong and Shenzhen should each specialize based on their respective comparative advantages: Universities in Hong Kong may focus on fundamental research, while Shenzhen, and in particular Shenzhen enterprises, may focus on application and development research, pilot manufacturing and commercialization.
- Hong Kong can be developed into a hub of venture capital, while Shenzhen a hub of start-up businesses to attract inventors, entrepreneurs and venture investors. The Hong Kong and Shenzhen Stock Exchanges together can fulfil the function of the NASDAQ exchange in the U.S. capital market for new enterprises in the GBA seeking an initial public offering (IPO). Successful enterprises can obtain a listing to raise funds or issue corporate bonds in HKEx at a later stage.

Concluding Remarks

- The economic prospects for the Mainland are very good. The Mainland economy should be able to continue to grow at an average rate of around 6% per annum for the next several decades.
- The Mainland has become a surplus economy—there is excessive production capacity in almost every traditional industry. As long as there is aggregate demand, the supply will be forthcoming.
- The economic fundamentals for the Mainland continue to be strong: the high national saving rate ensures the ample supply of new investment; and while the society is ageing, there is still significant surplus labor in the rural areas and by lifting the existing too low retirement ages (50 or 55 for women and 60 for men), coupled with the recent abolition of the "one child" policy, there should be no serious labor shortage. Investment in intangible capital, education and R&D, has been increasing rapidly.
- The Belt and Road (B&R) Initiative should provide an engine for economic growth not only for the Mainland but for all of the Belt and Road countries, including European and African countries.

Concluding Remarks

- The economic prospects for Hong Kong are potentially equally good. If the Mainland prospers, Hong Kong can also prosper. Moreover, both the Belt and Road and the Guangdong-Hong Kong-Macau Initiatives open up unique opportunities for the financial and professional services sectors of Hong Kong. It will usher in a "third spring" for the Hong Kong economy.
- Hong Kong definitely has the potential to become the world's leading international financial centre. Together with Shenzhen, Hong Kong also has the potential to become an international innovation hub comparable to the Silicon Valley and NASDAQ combined. Once Hong Kong achieves these positions, it can use its first-mover advantage to remain in them indefinitely.
- However, achieving these goals requires the HKSAR Government, business, academia and the public to work together. Medium- to long-term strategies and pragmatic implementation plans must be put in place. Moreover, the HKSAR Government must also seek the help and support of the Central Government. The time for "laissez faire" or "positive non-interventionism" of the government is over.