

# The Development of the Guangdong-Hong Kong-Macau Greater Bay Area 粵港澳大湾区的发展

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

# Outline 大纲

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- ◆ Introduction 引言
- ◆ Projections of the Mainland Economy 中国内地经济的预测
- ◆ The Guangdong-Hong Kong-Macau Greater Bay Area (GBA) Initiative 粤港澳大湾区倡议
- ◆ The Closer Economic Integration of the GBA 粤港澳大湾区的更紧密经济整合
- ◆ The Impacts of the Trade War 贸易战的影响
- ◆ Concluding Remarks 结语

# Introduction 引言

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- ◆ The GHKMGBA, or GBA for short, 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.
- ◆ The eastern half of the Pearl River Delta is currently much more developed than the western half as evident from the satellite photograph (courtesy of Mr. LEUNG Chun-Ying).
- ◆ However, with the completion of the Hong Kong-Zhuhai-Macau Bridge and several other east-west crossings, there will be significantly increased connectivity amongst these eleven cities, providing an engine of accelerated growth for the entire GBA. Increased connectivity can create trade in goods and services and direct investments that do not exist before, thus adding new value, increasing both GDP and employment. The western half of the Pearl River Delta region, which has lagged behind the eastern half, should begin to grow rapidly.

# The Guangdong-Hong Kong-Macau Greater Bay Area (GBA) Initiative 粵港澳大湾区倡议





# The Guangdong-Hong Kong-Macau Greater Bay Area (GBA) Initiative 粵港澳大湾区倡议

City/SAR	GDP ranking	GDP (US\$ billion)	GDP per capita ranking	GDP per capita (US\$)	End 2017 Population (million)
<b>Total</b>		<b>1,527</b>		<b>21,908</b>	<b>69.7</b>
<b>Hong Kong (香港)</b>	<b>1</b>	<b>342</b>	<b>2</b>	<b>46,196</b>	<b>7.4</b>
<b>Shenzhen (深圳)</b>	<b>2</b>	<b>339</b>	<b>3</b>	<b>27,123</b>	<b>12.5</b>
<b>Guangzhou (廣州)</b>	<b>3</b>	<b>324</b>	<b>4</b>	<b>22,317</b>	<b>14.5</b>
<b>Foshan (佛山)</b>	<b>4</b>	<b>141</b>	<b>6</b>	<b>18,374</b>	<b>7.7</b>
<b>Dongguan (東莞)</b>	<b>5</b>	<b>112</b>	<b>8</b>	<b>13,527</b>	<b>8.3</b>
<b>Huizhou (惠州)</b>	<b>6</b>	<b>57</b>	<b>9</b>	<b>11,879</b>	<b>4.8</b>
<b>Zhongshan (中山)</b>	<b>7</b>	<b>51</b>	<b>7</b>	<b>15,488</b>	<b>3.3</b>
<b>Macau (澳門)</b>	<b>8</b>	<b>50</b>	<b>1</b>	<b>71,623</b>	<b>0.7</b>
<b>Jiangmen (江門)</b>	<b>9</b>	<b>40</b>	<b>10</b>	<b>8,663</b>	<b>4.6</b>
<b>Zhuhai (珠海)</b>	<b>10</b>	<b>38</b>	<b>5</b>	<b>22,100</b>	<b>1.8<sub>6</sub></b>
<b>Zhaoqing (肇慶)</b>	<b>11</b>	<b>33</b>	<b>11</b>	<b>7,949</b>	<b>4.1</b>

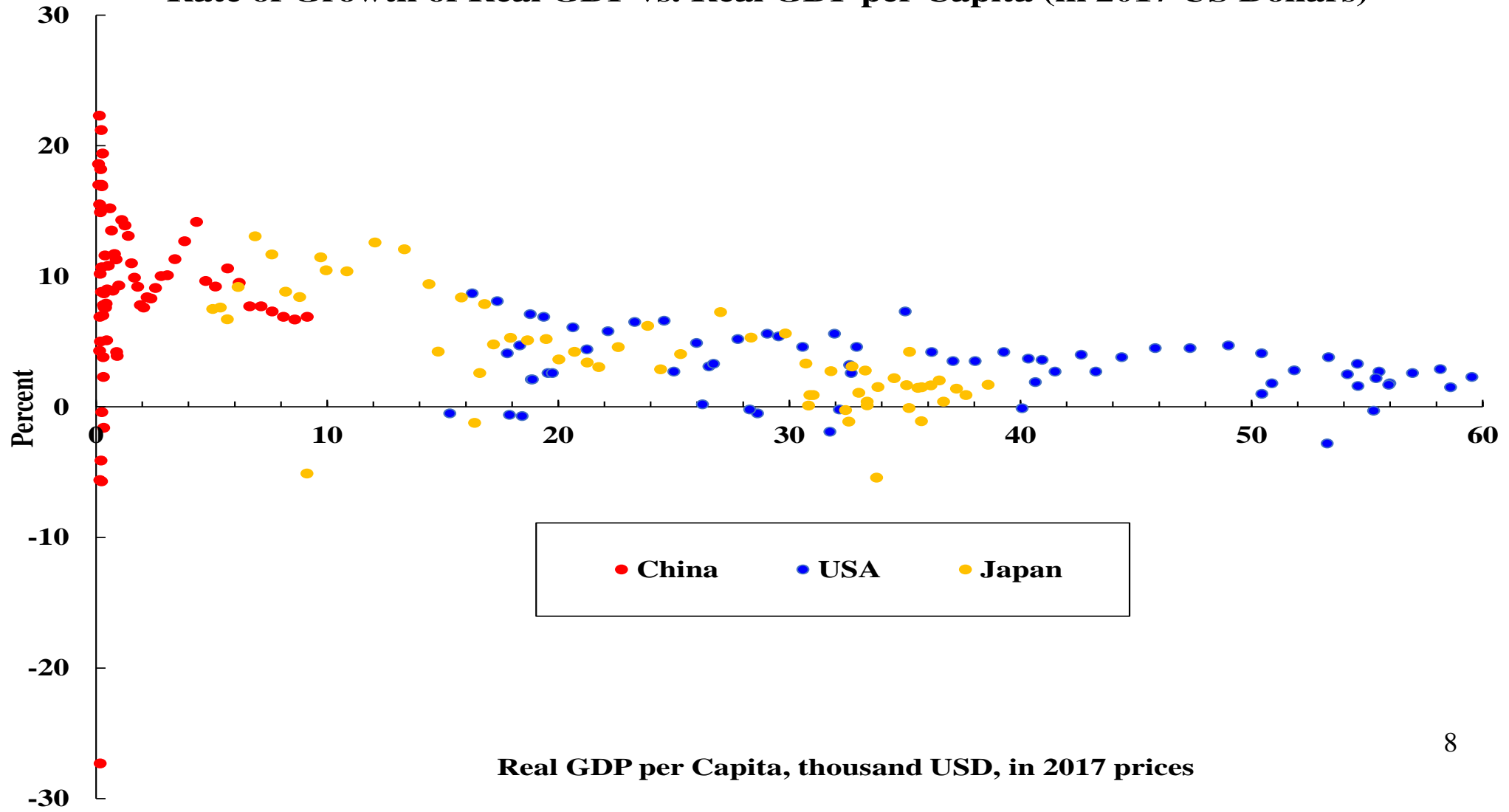
# Projections of the Mainland Economy 中國內地經濟的預測

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- ◆ It is assumed that the Chinese economy will continue to grow above 6% per annum for a few more 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 average annual rate of growth of between 5% and 6% for such a long time. Experience shows that the rate of growth of an economy declines as its real GDP per capita rises. But given the still relatively low level of real GDP per capita in China (US\$9,137) in 2017, and the low level of its tangible capital per unit labour compared to the U.S. and Japan, such a rate of growth should still be possible for at least several decades (see the following chart in which the experiences of China, Japan and the U.S. are compared.)
- ◆ In addition, there is still significant surplus labour in the Chinese economy. The share of total Mainland employment in the primary sector is around 30% whereas the share of Mainland GDP originating from the primary sector is below 10%.
- ◆ These projections presented here were made without taking into account the impacts of the China-U.S. trade war which erupted in 2018. However, as we shall show below, the real effect of the trade war on Mainland GDP is at most a reduction of 1.12 percent.

# Growth Rate vs. Level of Real GDP per Capita (2017 tril. US\$): China, Japan and the U.S.

Rate of Growth of Real GDP vs. Real GDP per Capita (in 2017 US Dollars)





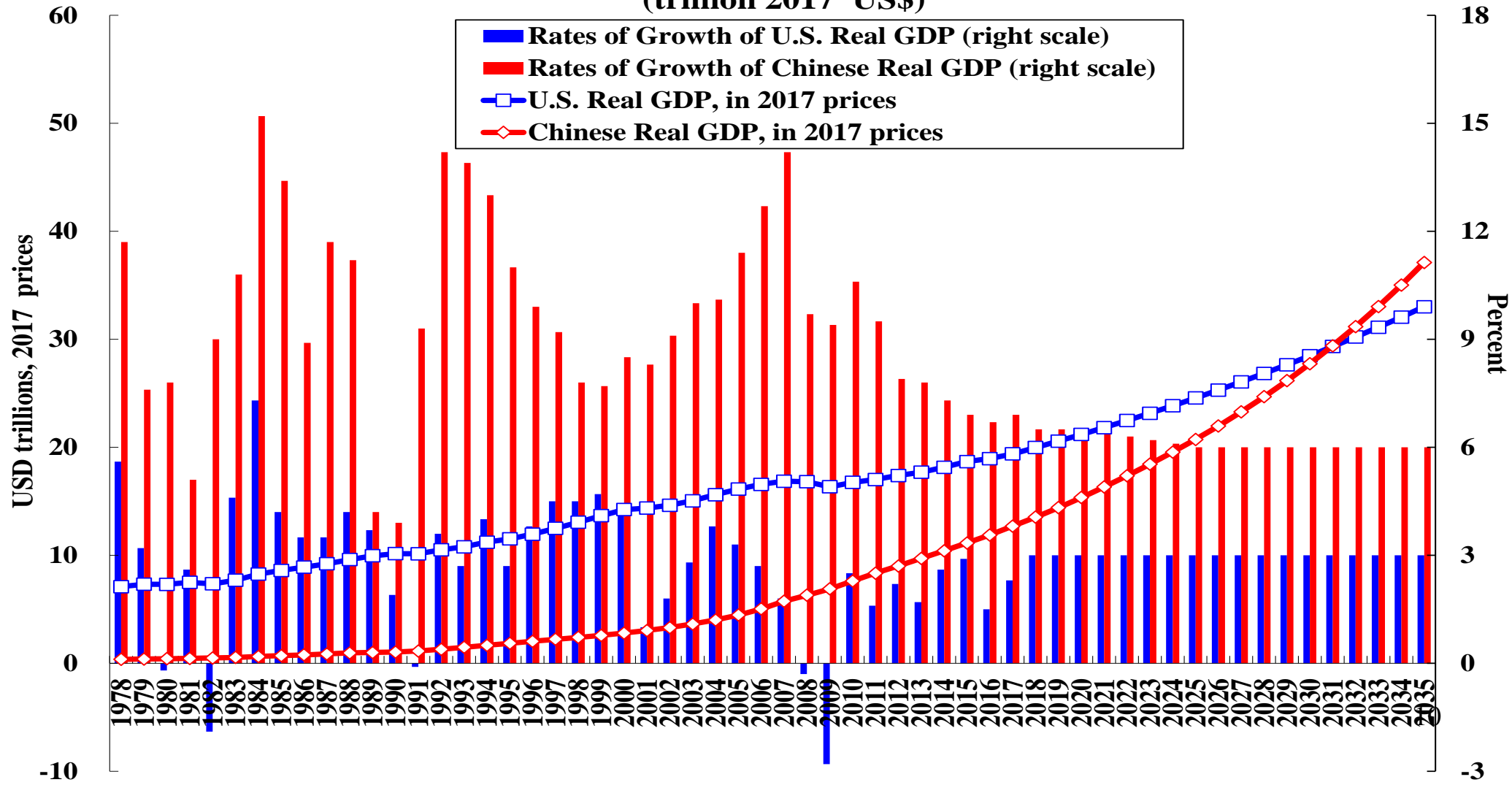
# Projections of the Chinese and the U.S. Economies

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- ◆ In his work report to the Nineteenth National Congress of the Communist Party of China, President XI Jinping identified several Chinese development milestones 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 2017 prices) will exceed US\$10,898 (compared to US\$63,703 for the U.S.).
- ◆ Our projections also show that by 2031, Chinese real GDP will surpass U.S. real GDP (US\$29.4 trillion versus US\$29.3 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\$20,009 compared to US\$82,502 for the U.S.
- ◆ By 2050, Chinese real GDP will reach US\$82.6 trillion compared to US\$51.4 trillion for the U.S. In terms of real GDP per capita, China will reach US\$52,870, slightly less than the current level of U.S. real GDP per capita, compared to US\$134,071 for the U.S.
- ◆ The Chinese real GDP per capita will not catch up with the U.S. real GDP per capita until near the end of the 21st Century.

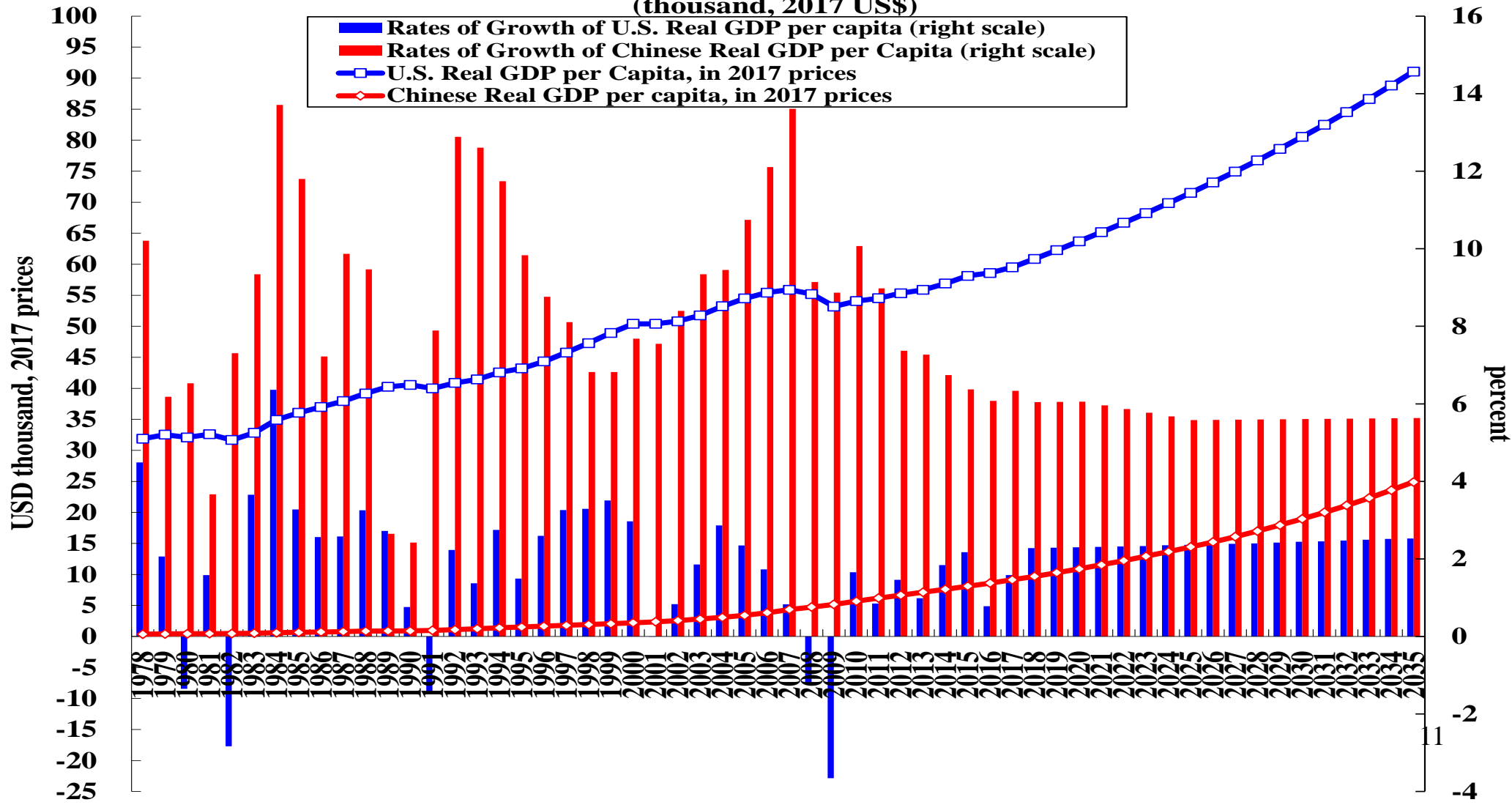
# Actual and Projected Levels and Growth Rates of Chinese and U.S. Real GDP (2017 tril. US\$)

**Actual and Projected Chinese and U.S. Real GDPs and Their Rates of Growth  
(trillion 2017 US\$)**



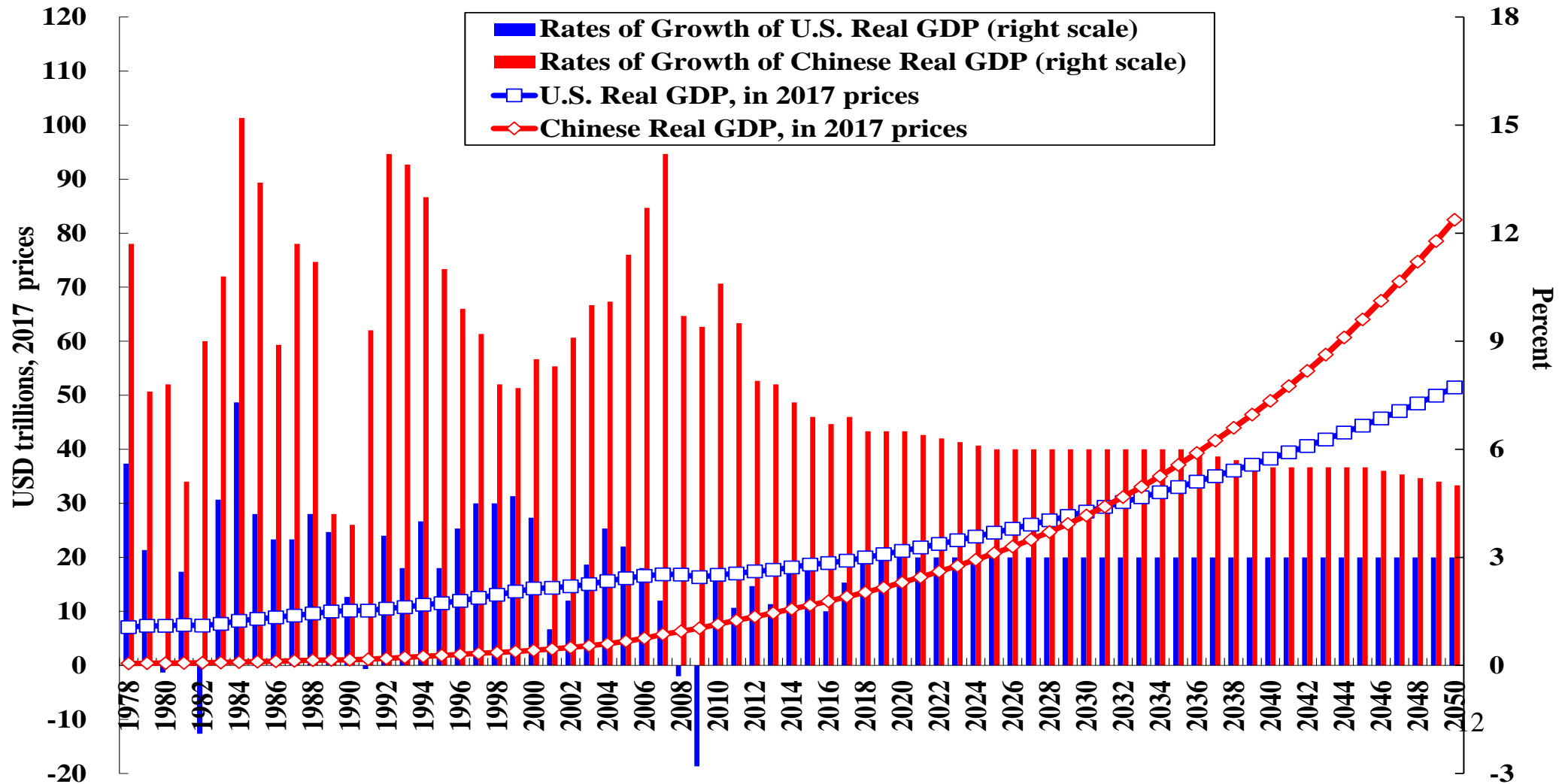
# Actual and Projected Chinese and U.S. Real GDP/ Capita and Their Rates of Growth (1,000 2017 US\$)

Actual and Projected Chinese and U.S. Real GDP per Capita and Their Rates of Growth  
(thousand, 2017 US\$)



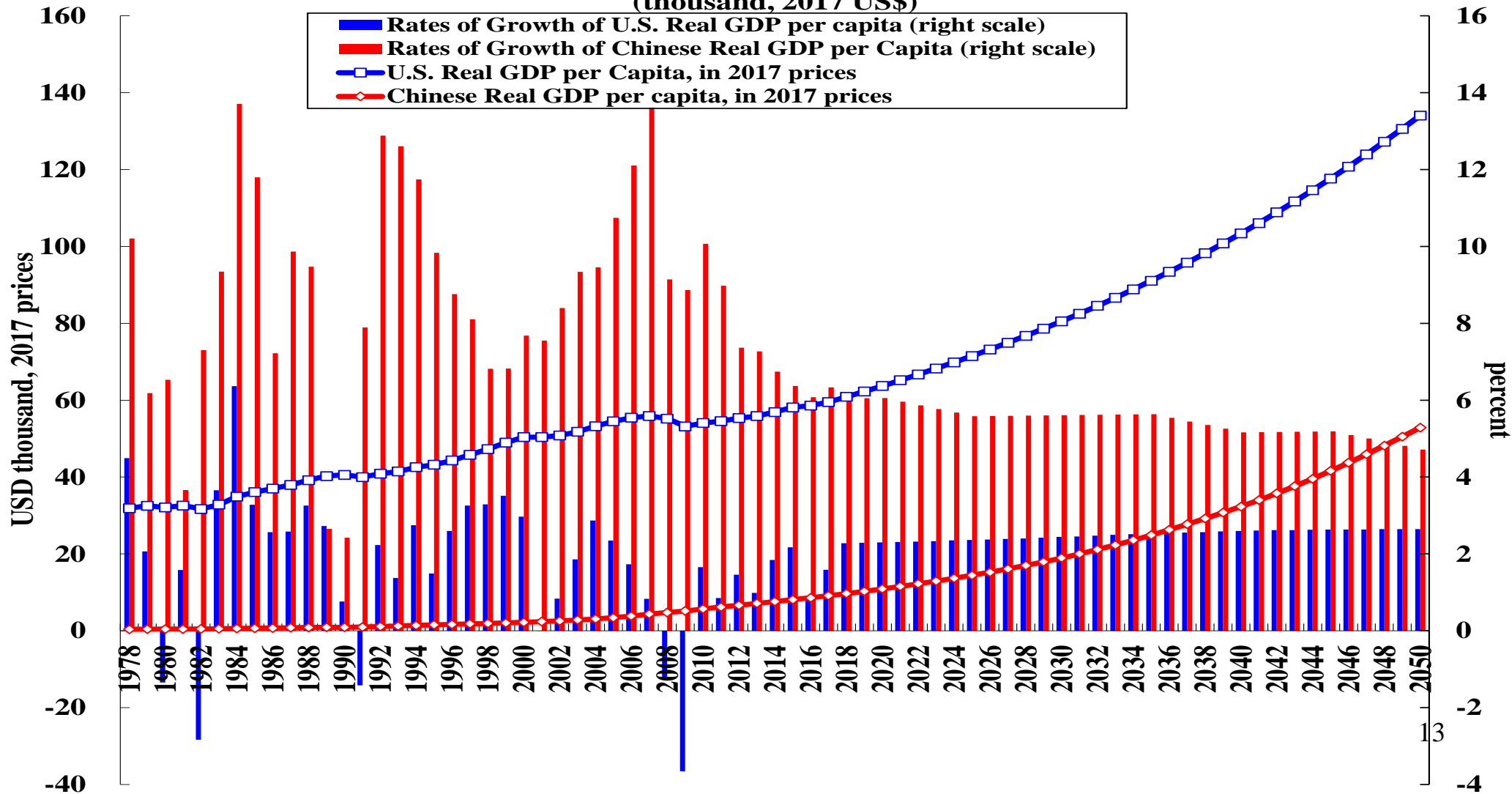
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# Actual and Projected Chinese and U.S. Real GDP/ Capita and Their Rates of Growth (1,000 2017 US\$)

Actual and Projected Chinese and U.S. Real GDP per Capita and Their Rates of Growth (thousand, 2017 US\$)



# The Guangdong-Hong Kong-Macau Greater Bay Area (GBA) Initiative 粤港澳大湾区倡议

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- ◆ The vision 愿景
- ◆ The opportunities and challenges 机遇与挑战

# The Greater Bay Area Initiative 大湾区倡议: The Vision 愿景

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- ◆ In 2017, the total population of the eleven cities within the GBA were 69.7 million, with a combined GDP of US\$ 1.53 trillion and an average GDP per capita of US\$ 21,908, exceeding the threshold for a developed economy. Nowadays, many people are worried whether China can avoid the so-called middle-income trap, but in fact the GBA has already far exceeded the threshold GDP per capita for middle-income economies of US\$12,000.
- ◆ The U.K., the world's fifth-largest economy in 2017, had a population of 66 million, a GDP of US\$ 2.63 trillion and a GDP per capita of US\$ 39,848.
- ◆ Although these two regions have similar sizes of population, the GDP of the U.K. is 70 percent higher than that of the GBA.
- ◆ However, based on the current average real rate of growth of **the GBA** of over 7% per annum and its potential for acceleration because of the closer economic integration of the GBA, its economy **will likely overtake that of the U.K. by 2028 to become the world's fifth-largest economy**, especially since the U.K. economy has slowed down and will be negatively affected by Brexit, however it turns out.
- ◆ The GBA has the potential to eventually become an enormous cosmopolitan metropolis, **with an average GDP per capita exceeding US\$ 40,000 in 2017 prices.**

# The Greater Bay Area Initiative 大湾区倡议: The Opportunities and Challenges 机遇与挑战

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- ◆ The eleven cities within the GBA should move towards closer economic integration to make more efficient use of their resources, give full play to their complementary economic structures, realise the benefits of economies of scale in production, distribution, brand-building and R&D, and specialise in accordance with their respective comparative advantages.
- ◆ **The sum is greater than its parts.  $9+1+1 > 11$ .** This is not a zero-sum game; but there will definitely be a positive and multilaterally beneficial outcome for all.
- ◆ Why is the sum always greater than 11? The closer economic integration of the GBA works like a mini version of economic globalisation. Every city will be better off with the new opportunities because each city can always continue to choose the status quo ante and hence cannot be worse off. If any city does anything different from before, it must be better off.
- ◆ The key is to understand that the increased economic connectivity, whether due to improvements in the inter-city basic infrastructure or to the elimination of legal and other barriers, makes possible new economic activities, such as trade and direct investment, that are not possible previously, thus adding new value and increasing GDP and employment.



# The Greater Bay Area Initiative 大湾区倡议: The Opportunities and Challenges 机遇与挑战

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- ◆ **The challenge to the closer economic integration of the Greater Bay Area lies in the need for the regulation of the flows of the four major factors--goods and services, people, capital and information --between the Guangdong part of the GBA and the rest of Guangdong Province and the Mainland.**
- ◆ Presumably it is possible to achieve free flows of the major factors between the Hong Kong and Macau SARs and the other nine cities in the Pearl River Delta region, especially if the GBA becomes a pilot Free Trade Zone. However, if there continues to be free flows of the major factors between the nine Guangdong cities and the rest of Mainland China, then there will effectively be free flows between all of Mainland China and the rest of the world through Hong Kong and Macau, because the latter are free ports.
- ◆ Moreover, even though closer economic integration, just like economic globalisation, will make every city in the GBA better off as a whole, it will also create both winners and losers in each city. The free market system will not compensate the losers in each city automatically, it is up to the governments of the respective cities to compensate any losers created by the closer economic integration.

# The Closer Economic Integration of the GBA

## 粤港澳大湾区的更紧密经济整合

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- ◆ The free flow of the four major factors 四种主要要素的自由流通
- ◆ The inter-connection and sharing of infrastructural facilities 基础设施互联互通
- ◆ Collaboration, cooperation, coordination, division of labour and specialisation 共營，合作，协调，分工与专门化

# The Free Flows of the Four Major Factors 四种主要要素的自由流通

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- ◆ The effectiveness of closer economic integration depends on the free flows of the four major factors within the GBA: (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, all of which allow the free flows of the four major factors within them. To be successful, the GHKMGBA has to achieve the same, but it cannot and will not occur overnight. It will require adaptations and a fairly lengthy transition period.
- ◆ The establishment of a pilot GBA free trade zone (GBAFTZ) comprising the eleven cities can facilitate and enable the free flows of the four factors within the GBA.
- ◆ However, this requires the agreement and support of the Central Government as well as the Guangdong Provincial Government and the Governments of the Hong Kong and Macau Special Administrative Regions.

# Establishment of the Pilot GBA Free Trade Zone 打造大湾区试点自由贸易区

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- ◆ With the appropriate basic communication and transportation infrastructure and the use of technology, free flows of the four major factors within the GBA can be effectively achieved (without the free flows, the inter-city basic infrastructure of the GBA will be underutilised and largely wasted).
- ◆ Again, the challenge to the establishment of the Pilot Greater Bay Area Free Trade Zone lies in the regulation of the flows of goods and services, people, capital and information between the Guangdong part of the GBAFTZ and the rest of Guangdong Province and the Mainland. If these flows are not regulated at all, then essentially there will be free flows of goods and services, people, capital and information between the entire Mainland economy on the one hand and the Hong Kong and Macau SARs on the other, and through Hong Kong and Macau, the entire rest of the world.

# Free Flow of Goods within the GBA

## 商品自由流通

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- ◆ The first condition for the free flow of goods in the GBA is **zero import tariff**, as multiple inspection and customs procedures will greatly increase transaction costs and reduce efficiency. Hong Kong and Macau are already free ports and do not have customs duties except on alcohol and tobacco.
- ◆ On a macroeconomic level, it will be most convenient if the Central Government lowers the tariff rates on imports to zero. Customs revenue is already a very small percentage of total Central Government revenue (260 billion compared to 16 trillion, or 1.6% in 2016). If the Central Government adopts zero import tariff for the country as a whole, customs inspections will no longer be necessary and imported goods can be shipped directly and freely to the Guangdong part of the GBA.
- ◆ However, even if the Central Government continues to maintain import tariffs, they can be exempt within the GBA itself.
- ◆ Alcohol and tobacco can be taxed through licensing the sellers. Thus, it is possible for both locally produced and imported goods to flow freely within the GBA.

# Free Flow of Goods within the GBA

## 商品自由流通

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- ◆ The second condition is **product (including food, beverage and medicine) quality and safety assurance**. If there is a system of credible product quality assurance, then goods can flow much more readily and freely within the entire GBA. One possible solution for quality assurance is to make use of advanced technology. Goods that have been inspected and are found to satisfy quality standards can be labelled with an **RFID (“Radio Frequency Identification”) tag**. This electronic tag can be attached to a commodity or product to indicate its place of origin and satisfactory quality inspection. The RFID may also include other information, such as the price of the good, production date, expiration date, composition, date of inspection and whether taxes have been properly paid or not.
- ◆ It is important to have an established and trusted authority within the GBA to certify as to the quality and safety of the goods being sold, to provide a seal of approval for the protection of all the consumers in the GBA. Hong Kong has the reputation and experience to establish a quality assurance organisation in cooperation with the other cities within the GBA. It can also function as a quality-assurance agency for both exports from and imports into the GBA.
- ◆ The inspection of the locally produced goods can be conducted on the actual production site, with the costs borne by the producers.

# Free Flow of Goods within the GBA

## 商品自由流通

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- ◆ Under a GBAAFTZ, the nine Guangdong cities together will constitute a giant bonded region (大保稅區), just like other bonded economic zones and districts, into which goods can flow from abroad without the payment of customs duties. Goods can also flow out of the bonded region overseas directly without customs inspection. However, in order for goods to flow from the bonded region to the rest of Mainland China outside of the nine cities, or vice versa, they will need to go through customs inspection.
- ◆ It may be necessary to do something about the value-added tax, which is levied in Mainland China but not in Hong Kong or Macau, so that the same good will sell for more or less the same price in all cities within the GBA.

# Free Flow of Goods within the GBA

## 商品自由流通

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- ◆ Goods which are to be transported from Hong Kong or Macau to a place outside the GBA but on the Mainland can be inspected, with the Mainland tariffs paid in advance, in Hong Kong or Macau, and affixed with an RFID tag as proof. These goods can then be transported directly to a place on the Mainland outside the GBA in a bonded transportation vehicle.
- ◆ Goods without RFID tags to show that the goods have been inspected and that tariffs have been prepaid will be subject to inspection and tariffs when they arrive at any destination outside the GBA on the Mainland.
- ◆ Goods which are transported from a place outside the GBA on the Mainland to Hong Kong or Macau can also be similarly provided with an RFID tag to show that they have been satisfactorily inspected and the required statutory taxes paid in advance on the Mainland before transportation into Hong Kong or Macau.



# Free Flow of Goods within the GBA

## 商品自由流通

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- ◆ What about Value-Added taxes? The value-added tax is a very significant source of tax revenue for China and for many European Union countries.
- ◆ The best way to proceed is to have an agreement among all countries with the value-added tax not to reimburse the value-added tax on goods exported and at the same time not to collect value-added tax on goods imported from countries that do not reimburse value-added tax on goods exported.
- ◆ For example, China and Germany can agree not to reimburse value-added taxes paid when they export to each other and not to impose value-added tax when they import from each other. The resulting price of German exports in China and Chinese exports in Germany will be the same (if the value-added tax rates are the same in China and Germany).
- ◆ This will simplify everything and the playing field will remain level.<sup>25</sup>

# Free Flow of Services within the GBA

## 服務自由流通

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- ◆ In addition to the free flow of goods, the GBAFTZ can also facilitate the free flow of services within the GBA. Qualified service providers in each GBA city should be able to apply for registration in the other cities within the GBA to provide the same services. However, they should fully comply with the eligibility requirements of the respective cities in which they plan to operate and strictly abide by the relevant laws and regulations.
- ◆ One service that should definitely be opened across the entire GBA is the courier delivery service. Courier services in the Guangdong GBA cities, Hong Kong and Macau should all be allowed to operate in all the other cities within the GBA upon appropriate registration and qualification. Internet customers who have purchased goods anywhere within the GBA can expect prompt deliveries no matter where they buy and where they live.

# Free Flow of People within the GBA

## 人員自由流通

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- ◆ First, there should be a significant simplification and automation of the entry/exit and customs formalities. A Chinese citizen with an official permanent resident status (according to the household registration) in a GBA city on the Mainland (for, say, the past seven years) and no prior criminal record can submit an application to the Hong Kong or Macau SAR Government respectively for a Hong Kong or Macau multiple entry-exit permit with validity up to ten years, and upon approval, he or she can travel freely to and from Hong Kong or Macau at any time, which is similar to the current arrangement under which Chinese citizens who are permanent residents of Hong Kong or Macau can apply for a permit to travel freely to the Mainland.
- ◆ However, the entry-exit permit does not entitle the holder to a long-term stay in either Hong Kong and Macau, and is not a work permit, both of which must be applied for separately. This is also the same as the current entry-exit permit (tongxingzheng) issued to Chinese citizens who are permanent residents in Hong Kong or Macau.

# Free Flow of People within the GBA

## 人員自由流通

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- ◆ Second, professional qualifications that are “mobile”, that is, acceptable to all cities in the GBA, should be based on mutually agreed standards, with the assessment criteria being set at the highest standards among the currently prevailing standards within the GBA. Once these qualifications are reached, a given professional can provide services in all the GBA cities. Such professions may include accounting, design, engineering, healthcare, legal practice, and teaching, to name only a few. (It may be most difficult for legal professionals to meet the highest standards in the Mainland, Hong Kong and Macau because of the significant differences in the three legal systems.) Similarly, university degrees and other qualifications can also be mutually recognised based on mutually agreed common standards among all the GBA cities.
- ◆ In order to facilitate the flow of people, the relevant authorities may also consider allowing Hong Kong and Macau permanent residents who live on the Mainland to establish schools for their children in the GBA cities, and GBA city permanent residents to establish schools for their children in Hong Kong or Macau. The schools established by businessmen from Taiwan for their children on the Mainland (台商子弟学校) provide precedents and examples.

# Free Flow of People within the GBA

## 人員自由流通

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- ◆ Third, individual income tax liabilities should be rationalised for the cross-border employment of permanent residents of Hong Kong or Macau in the Guangdong cities of the GBA or vice versa. We can take a page from the tax treatment of border-town residents in Europe with regard to the taxation of neighbouring cross-border employment. (This is suggested by my wife, Ayesha Macpherson Lau.) For example, a German citizen living on the German side of a border town on the Franco-German border but working on the French side of the border town will pay only German individual income taxes and no French income taxes and vice versa. This applies only to individuals physically living in the border area. Since this will have only limited application in China (to border areas only), other countries cannot demand equal treatment for their citizens. This arrangement is sometimes referred to as the “frontier tax” treatment.
- ◆ While double taxation should and can be avoided through this arrangement, double non-taxation should also be avoided. Under the “frontier tax” arrangement, a resident will have to pay the income tax of at least one side of the border.

# Free Flow of People within the GBA

## 人員自由流通

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- ◆ The border-town treatment should apply to not only individual income taxes but also to other employment-related payments such as the “Mandatory Provident Fund (MPF)” in Hong Kong and the “Four Insurances and One Fund (四險一金)” on the Mainland in accordance with the rules and regulations of the permanent place of residence of the employee.
- ◆ For example, when a Hong Kong permanent resident is employed in the Guangdong part of the GBA, his employer on the Mainland may make contributions to the MPF scheme in Hong Kong instead of the “Four Insurances and One Fund” at the place of employment. When a permanent resident of a GBA city on the Mainland is employed in Hong Kong or Macau, his or her employer may make contributions to the mandatory “Four Insurances and One Fund” in his or her permanent place of residence, instead of the MPF or other pension scheme in Hong Kong or Macau or other forms of insurance that are not statutorily required.

# Free Flow of People within the GBA

## 人員自由流通

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- ◆ In order to encourage the exchange of academic and research personnel within the GBA and promote cooperation and innovation, when any such personnel who have official resident status in a GBA city work cross-border in other GBA cities, they should be exempt from local (including the Central Government and Hong Kong and Macau) personal income taxes for up to three years and subject only to personal income tax of their place of permanent residence.
- ◆ The Central Government and the Macau SAR Government have already included in their tax agreement a provision for such an arrangement, but not so the Hong Kong SAR Government. Before such an agreement is signed, the local governments of the Guangdong GBA cities may need to make temporary provisions to exempt visiting academic and research personnel from Hong Kong from having to pay the Mainland individual income tax for up to three years.

# Free Flow of People within the GBA

## 人員自由流通

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- ◆ Fourth, it is great news that the so-called “co-location” arrangement for the clearing of immigration and customs for the passengers of the high speed train between Hong Kong and the Mainland will now be implemented later this month. This will assure the smooth and efficient flow of people across the border within the GBA. “Co-location” arrangements or pre-crossing border controls are not new to the world: Joint US-Canada border checks are conducted in Canada when travelers go to the U.S. from Canada; joint checkpoints are also used when one is travelling from Switzerland to France or from Europe to London via the Eurostar train (all inspections are done in the St. Pancras railway station in London). Currently, when travelling to Shenzhen from Hong Kong via the Shenzhen Bay crossing, the Hong Kong immigration control check point is actually located on the Shenzhen side.
- ◆ Without co-location arrangements for the immigration and customs inspections, the efficiency of all cross-border infrastructure projects connecting Hong Kong and the rest of the GBA, including the high-speed railroads, will be significantly reduced, resulting in a huge waste of resources. It will greatly reduce Hong Kong’s competitiveness as an international financial centre for the Mainland, especially the southern part. The beneficiaries will be the competitors to Hong Kong which may aspire to provide financial services within the GBA such as Guangzhou and Shenzhen.



# Free Flow of People within the GBA

## 人員自由流通

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- ◆ In fact, the principal beneficiaries of the “co-location” arrangements are Hong Kong residents. Under the “co-location” arrangements, Hong Kong residents can travel directly to major cities in the Mainland via the high-speed rail link without being subject to immigration and customs control during their journey. Otherwise, they are likely to have to disembark in Shenzhen for the inspections. The same applies on their return trip to Hong Kong.
- ◆ The service providers in Hong Kong will also benefit as their clients and potential clients can come directly to Hong Kong from their home bases on the Mainland.
- ◆ Moreover, even though in principle, “co-location” arrangements can be implemented on the Mainland rather than in Hong Kong, but it will require Hong Kong immigration and customs officials to be stationed at the high speed railroad stations in all the major Mainland cities to conduct checks before a traveller can board a direct high speed train ride to Hong Kong. Under the current proposed arrangements, the Hong Kong officials only need to be posted at the Hong Kong high-speed train terminal.
- ◆ “Co-location” arrangements also make it much more convenient for business travellers or tourists from major Mainland cities to visit Hong Kong. Encouraging more Mainland visitors to Hong Kong for both business and pleasure can help ensure the continued economic prosperity of Hong Kong.

# Free Flow of People within the GBA

## 人員自由流通

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- ◆ Fifth, it is also good news that Chinese citizens who are also permanent residents of Hong Kong can now apply for Mainland residence permits. This will allow them to open bank accounts, buy high-speed train tickets and enjoy various privileges previously only available to Chinese citizens with a permanent residence in the Mainland.
- ◆ This is also the time to review the “one visit per week (一週一行)” regulation for Mainland visitors, which does not make any sense and works against the best interests of Hong Kong. It has not solved the “water goods (水貨)” problem, which it is supposed to solve, as most of the “water goods” carriers are Hong Kong permanent residents. The principal beneficiaries of “one visit per week” are Hong Kong drivers who now monopolise the driving of cross-border vehicles. Consideration should be given to allow GBA residents with a good business or personal reason to have multiple-entry visas to Hong Kong. “One visit per week” will discourage many Mainland businesses from using Hong Kong services, such as advisory, financial and legal services.

# Free Flow of Capital within the GBA

## 資金自由流通

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- ◆ Three currencies, the Renminbi, the Hong Kong Dollar, and the Macanese Pataca, are used in the GBA. They can be allowed to circulate in parallel within all the GBA cities on an informal basis (the legal tender in each city will continue to be its local currency). One or more commercial banks can commit to the merchants accepting a non-local currency a preferential rate of exchange into the local currency. WeChat Pay and other electronic payment mechanisms as well as programmed cash registers can make the parallel use of three currencies possible and almost completely painless.
- ◆ It is also important to enable Hong Kong and Macau permanent residents to open bank accounts that will allow them to use their WeChat or other payment accounts on the Mainland (or at least in the rest of the GBA). In principle, it is not necessary that the bank account be established with a bank on the Mainland. An account with multiple-currency facilities with any commercial bank that operates in both Hong Kong (or Macau) and the Mainland should be able to provide such services.

# Free Flow of Capital within the GBA

## 資金自由流通

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- ◆ The movement of funds within the GBA, in whatever currency-- RMB, HKD, MOP, USD, EUR, JPY or any other currency—and under both current and capital accounts, should be totally free and unlimited.
- ◆ As for direct investments, national treatment should be fully enabled within the GBA so that cross-city direct investments and local intra-city investments should be treated equally as long as they abide by local laws and regulations (which may include restrictions or taxes on non-residents purchasing local real estate).

# Free Flow of Capital within the GBA

## 資金自由流通

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- ◆ Currently there are no restrictions on the transfer of funds, whether under current account or capital account, from a non-GBA city on the Mainland to a GBA city on the Mainland. However, funds on the Mainland cannot be directly transferred offshore under the capital account without approval. Otherwise it will violate the existing capital controls on the Mainland.
- ◆ With the establishment of the GBAFTZ, and before capital controls are completely lifted on the Mainland, there will have to be some restrictions on the onward transfer abroad under the capital account, even to Hong Kong and Macau, of funds originated from the non-GBA part of the Mainland, from the Guangdong part of the GBA. In the absence of such restrictions, the Mainland capital accounts will become de facto completely open to outflows from the entire Mainland economy. Similarly, there will have to be some restrictions on the inward transfer of funds originated from abroad, including Hong Kong and Macau, under the capital account into the non-GBA part of the Mainland.

# Free Flow of Capital within the GBA

## 資金自由流通

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- ◆ One possibility is to impose a waiting period of one year on these funds during which they are placed in commercial bank accounts and are subject to approval before being transferred either abroad or further inward. That is, funds transferred from a non-GBA city in the Mainland to a GBA city should be placed in bank accounts in the GBA city for at least one year before they can be transferred offshore, and similarly for inward transfers to the non-GBA part of the Mainland. This is an expedient approach that avoids having the outflow of funds under capital accounts from China to become totally unregulated.
- ◆ In order to avoid attempts to obscure the true nature of such funds on deposit at the commercial banks or to engage in money laundering, deposits or withdrawals of cash from banks of over RMB 100,000 or equivalent should require full and proper records including the date of deposit or withdrawal, amount, prior source and ultimate usage of the funds.

# Free Flow of Capital within the GBA

## 資金自由流通

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- ◆ The enforcement of the proposed regulation above relies mainly on the use of advanced technology: digital records should be created for each bank deposit, detailing the original source of the fund, and the date of deposit, and any subsequent transfer and withdrawal. The distributed ledger technology, also known as the block-chain technology, can be used to achieve this purpose. It will allow all fund flows to be tracked and traced continuously. (The block-chain technology is also used in bitcoins and other similar virtual currencies. Bitcoins and other crypto-currencies are a threat to a country's monetary system and should be banned.)
- ◆ Finally, another alternative is to impose a Tobin tax of say 1% on any capital accounts transfer between a non-GBA city on the Mainland and a GBA city on the Mainland, both inward and outward. It will discourage short-term speculative capital flows but pose no obstacle to truly long-term inbound or outbound capital flows for the purpose of long-term direct investment or portfolio investment.

# Free Flow of Information within the GBA

## 信息自由流通

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- ◆ Uniform and timely access to the correct information on the part of all participants in a market is crucial for the efficiency of the market system. If the market were to play the decisive role, the correct information must be available in a timely manner to all the market participants. This means they must have ready access to the internet.
- ◆ How can this be achieved, when access to the internet is restricted within the Mainland? We propose that the Central Government consider fully opening up information access on the internet within the Guangdong part of the GBA to all users who (1) use verified up-to-date real name registration and (2) also agree to multiple online real-time biometric authentications including fingerprint, facial and retina recognition, and voice authentication. (This should prevent an internet user from using the identity of another person.) Anyone caught using another person's identity for internet access will have his or her internet access revoked permanently. A similar penalty will apply to anyone caught letting another person use his or her identity for internet access.



# Free Flow of Information within the GBA

## 信息自由流通

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- ◆ As the activities of the internet users can be fully tracked on the various servers, and if necessary monitored on a real-time basis, users who are found to access forbidden websites do so at their own peril and will have to accept whatever penalties meted out by the government including permanent revocation of their internet access privileges.
- ◆ If this approach proves successful, it will be a big step forward for ensuring full information symmetry within the entire GBA and residents in the Mainland cities of the GBA will no longer be put at a disadvantage in terms of information access.
- ◆ Such an arrangement can be gradually extended to the rest of the country if it is found to work well.

# Free Flow of Information within the GBA

## 信息自由流通

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- ◆ The Central Government can also consider fully opening up radio and television broadcasts within the GBA (including news reports, weather forecasts, events, situation comedies, soap operas, other programmes and even advertisements) so that GBA residents inside the Guangdong Province can have access to the same programmes available in Hong Kong and Macau. This will be subject to the condition that the real responsible person for the broadcaster is willing to (1) step forward to be registered, (2) post a performance bond, and (3) commit to respect the laws on the Mainland. Any violation of Mainland law will result in revocation of the broadcast privileges, the forfeiture of the bond and possibly other additional penalties.
- ◆ Other social media, books and other cultural products such as films and video-discs can also be allowed to flow freely into the Guangdong part of the GBA from Hong Kong and Macau, subject to the prior review and approval of the material by the relevant government authorities and the registration of the real author, publisher and beneficial owner and the posting of a bond.

# The Inter-Connection and Sharing of Infrastructural Facilities 基础设施互联互通

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- ◆ The infrastructural facilities within the GBA should be inter-connected and shared among the GBA cities. The different GBA cities should coordinate among themselves their development plans, promote the division of labour and specialisation, and avoid wasteful duplication of infrastructure and misuse of resources.
- ◆ For example, they can all participate in the China Southern Power Grid, and jointly own and operate the electricity generation plants within the GBA, taking advantage of the significant economies of scale in electricity generation.
- ◆ For another example, they can also try to inter-connect one another's intra-city transit systems, which should greatly facilitate their closer economic integration. For example, it should be possible to ride the Hong Kong MTR and the Shenzhen subway lines to travel from Central in Hong Kong to the Longgang District in Shenzhen by transferring between trains at the intermediate stations and vice versa. The border crossings can be automated for frequent travellers within in the GBA.

# The Inter-Connection and Sharing of Infrastructural Facilities 基础设施互联互通

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- ◆ The GBA can maximise the usage of its airports by following the example of New York and New Jersey. The Port Authority of New York and New Jersey, formed 97 years ago, operates and maintains the John F. Kennedy, LaGuardia and the Newark, N.J. Airports on behalf of both the states of New York and New Jersey (as well as other surface and seaborne transportation facilities). The GBA can establish a GBA (or initially Hong Kong-Shenzhen) Airport Authority to manage all the civil airports (or just Hong Kong and Shenzhen airports) in the area.
- ◆ As a first step, the Hong Kong International Airport and the Shenzhen Baoan International Airport should consider operating jointly, through linkage by high speed trains, to achieve a division of labour. Hong Kong and Shenzhen will jointly share the revenues (landing fees, user fees and retail franchise fees) from the two airports according to a pre-agreed formula.

# The Inter-Connection and Sharing of Infrastructural Facilities 基础设施互联互通

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- ◆ Flights between Hong Kong/Shenzhen and Mainland cities can take off and land in the Shenzhen Baoan International Airport, while international overseas flights from Hong Kong/Shenzhen can take off and land in the Hong Kong International Airport. As part of this arrangement, Air China should be allowed to enjoy Hong Kong's air traffic rights, while Cathay Pacific (and Cathay Dragon) should be allowed to enjoy Shenzhen's air traffic rights. Better still, traffic rights at Hong Kong/Shenzhen International Airports can be governed by a joint Hong Kong-Shenzhen governmental authority, with approval from the central government.
- ◆ This arrangement can shorten the flight time between Mainland cities and Hong Kong/Shenzhen and result in significant fuel savings for the airlines, in addition to easing the congestion at the Hong Kong and Shenzhen airports.

# The Inter-Connection and Sharing of Infrastructural Facilities 基础设施互联互通

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- ◆ Prior to the joint operation of the Hong Kong and Shenzhen International Airports under one authority, a really productive reform is to move the invisible air wall between the Mainland and Hong Kong air spaces to the external border of Hong Kong. This would shorten the flight times between Hong Kong and all Mainland cities as they do not have to cross the invisible air wall at an altitude of 10,000 feet, saving considerable amounts of fuel and aircraft operating hours for the airlines and time for the passengers.
- ◆ The relocation of the invisible air wall will require coordination with and approval of the People's Liberation Army.
- ◆ However, once relocated, it is possible to establish a GBA air traffic control district to manage all the civil aviation control tower activities within the GBA. With the agreement of the PLA, cross-border civil helicopter flights within the GBA can be opened up so as to strengthen ties and facilitate travel among the GBA cities. One possible arrangement is to put all cross-border helicopter flights within the GBA under the control of the air control tower of either Guangzhou or Shenzhen.

# The Inter-Connection and Sharing of Infrastructural Facilities 基础设施互联互通

- ◆ After the opening of the Hong Kong-Zhuhai-Macau Bridge in 2018, the Macau International Airport will be readily accessible by automobile from Hong Kong and Shenzhen. It can then be used exclusively for serving private and business aircrafts in the GBA, so that the landing and taking-off of private and business aircrafts will be shifted from Hong Kong International Airport to the Macau International Airport. The demand of private jets has increased by leaps and bounds, far beyond what the Hong Kong International Airport is able to handle. The Macau International Airport has significant underutilised capacity. So this arrangement should be win-win.
- ◆ There will need to be some arrangements for special one-time automobile access to the Macau International Airport for passengers of private and business aircrafts from Hong Kong and the rest of the GBA.
- ◆ Zhuhai International Airport, which is also underutilised currently, can be developed into a transnational air cargo express delivery hub within the East Asian region (similar to the Federal Express America Center in Memphis, Tennessee, U.S.A.) for serving Northeast and Southeast Asia and even South Asia and the Middle East.

# The Inter-Connection and Sharing of Infrastructural Facilities 基础设施互联互通共享

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- ◆ The public tertiary educational institutions and research institutions in the GBA cities can be open to the permanent residents of the other cities in the GBA on a reciprocal basis with the payment of contributions from the other cities, subject to pre-agreed quotas and appropriate non-resident fees.
- ◆ Similar arrangements can be made for public libraries and museums.
- ◆ At some future date, perhaps even access to public hospitals can be arranged, subject to pre-agreed quotas and appropriate non-resident fees.



# The Inter-Connection and Sharing of Infrastructural Facilities 基础设施互联互通

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- ◆ In addition, after the opening of the Hong Kong-Zhuhai-Macau Bridge, the authorities can consider “cross-border vehicles” for all three places. Vehicles which have a Guangdong and a Hong Kong license plate can apply to the Macau SAR Government for a Macau license plate if necessary; vehicles which have a Guangdong and a Macau license plate can also apply to the Hong Kong SAR Government for a Hong Kong license plate if necessary.
- ◆ The authorities can adjust the cross-border license plate fees to control the volume of cross-border vehicular traffic flow and give priority to those vehicles that are most needed (such as large coaches) by travellers in Guangdong, Hong Kong and Macau to obtain cross-border license plates. They may also consider making available a temporary cross-border permit for a single one-time use within a short timeframe.

# The Inter-Connection and Sharing of Infrastructural Facilities 基础设施互联互通共享

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- ◆ It is also time to consider making the Hong Kong-Shenzhen cross-border arrangements more flexible. At the present time, vehicles with cross-border licenses are restricted to specific crossings. In this day and age of the information and communication technology revolution, there is really no reason not to remove these restrictions altogether, so that any vehicle licensed to cross the Hong Kong-Shenzhen border can use whichever crossing that is open. The customs inspection can remain the same.

# The Inter-Connection and Sharing of Infrastructural Facilities 基础设施互联互通

- ◆ However, one of the first order of business for the cities of the GBA is to jointly draw up a long-term (between ten and twenty years) comprehensive development plan for the entire GBA that benefits everyone.
- ◆ The eventual goal should be to make any two locations within the GBA accessible within an hour of travel time, using a combination of high-speed trains and convenient interconnected inter-city and intra-city transit systems. This puts the entire GBA into an one-hour quality living circle. Such inter-connection and sharing of infrastructural facilities can change residential patterns, commuting patterns, consumption patterns, shopping patterns, leisure activity patterns and life styles, creating huge new demands for goods and services for the entire GBA.
- ◆ Each pair of cities in the GBA should explore seriously with each other their bilateral economic complementarities. Thus, for example, Hong Kong and Zhaoqing should establish a joint committee of their distinguished citizens to explore the opportunities for collaboration and cooperation, making use of their existing bilateral ties.

# Collaboration, Cooperation, Coordination, Division of Labour and Specialisation

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- ◆ For example, Hong Kong and Shenzhen together can form a global innovation, venture investment, start-up and financing hub in the GBA, combining the Silicon Valley, Route 128, New York Stock Exchange and NASDAQ into one, serving not just the GBA but the entire Mainland and also the whole Belt and Road (including East Asia) region.
- ◆ Hong Kong can be further developed into a hub for venture capital, while Shenzhen is already 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 equity funds or issue corporate bonds on the Hong Kong Stock Exchange at a later stage.
- ◆ Perhaps ultimately the Hong Kong and Shenzhen Stock Exchanges can even be merged into a single one.

# The GBA as a Global Innovation Hub

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- ◆ The hub will specialise in the creation of intangible capital and the capitalisation of its commercial value through “Venture Capital”, “Initial Public Offerings (IPOs)” and “Mergers and Acquisitions (M&As)”.
- ◆ This will require a four-pronged approach: (1) increasing investment in human capital, specifically, in tertiary and research-based postgraduate education; (2) increasing investment in research and development (R&D) (in this regard Hong Kong is woefully inadequate); (3) creating a nurturing eco-system for venture capital; and (4) facilitating the IPO and M&A markets for successful start-up firms.
- ◆ The ultimate objective is to make Hong Kong-Shenzhen a global innovation hub, attracting inventors, entrepreneurs, venture capitalists and investment bankers to congregate, to innovate, to raise capital as well as to invest.

# Collaboration, Cooperation, Coordination, Division of Labour and Specialisation

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- ◆ The excess savings of Mainland China and the East Asian economies can provide the sources of the risk capital for the venture investments in the GBA. In particular, the excess savings of the GBA can be deployed in the Hong Kong-Shenzhen capital markets.
- ◆ Other Belt and Road countries can also provide the venture capital as well as the new markets for innovative products, supporting the GBA's development into a global innovation hub.

# The GBA as a Global Innovation Hub

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- ◆ Universities in Hong Kong and Shenzhen, as well as those in Guangzhou, can focus on basic research, while enterprises, especially those in Shenzhen, can focus on applied research, development, pilot manufacturing and commercialisation.
- ◆ The Central Government has recently announced that the tertiary educational institutions and research institutions in Hong Kong can apply for and receive grants directly from the Central Government. This should provide a great boost to R&D in Hong Kong. However, Hong Kong needs to spend much more on Research and Development (R&D) and in particular on basic research, which is best carried out at universities, free from the pressure of short-term returns.
- ◆ Break-through research discoveries and inventions can only come from sustained investment in basic research.

# Collaboration, Cooperation, Coordination, Division of Labour and Specialisation

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- ◆ Because of rising costs of operation and the opportunity costs of the land on which Hong Kong's current port facilities sit (Kwai-Chung), the Hong Kong container ports will eventually be supplanted by ports at Yantian in Shenzhen and Nansha in Guangzhou. Hong Kong will gradually withdraw from providing port facilities for container ships with cargo destined for the rest of the Mainland. Cargo destined for Hong Kong itself may still use Hong Kong ports. However, most of the traffic volume of the Hong Kong ports consists of cargo to be trans-shipped to the Mainland.



# Collaboration, Cooperation, Coordination, Division of Labour and Specialisation

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- ◆ Macau's economy is dominated by gaming (casinos) and tourism, including the convention and exhibition industries. Macau can develop into the national centre for Portuguese studies, capitalising on its more than 400 years of affiliation with Portugal, and taking advantage of the fact that Portuguese is one of Macau's official languages. It can help train Portuguese speakers in China to deal with business in Lusophone countries.
- ◆ Macau can also provide the platform for linking with countries in the world with linguistic and cultural associations with Portugal such as Angola, Brazil, Cape Verde, Guinea-Bissau, Mozambique and São Tomé and Príncipe, in which Portuguese is the official language. Portuguese also has co-official language status in East Timor, Equatorial Guinea (and of course Macau). Altogether 220 million people in the world have Portuguese as their first language. Another 45 million people have Portuguese as their second language.
- ◆ Some of these countries are important trading partners of China. For example, Angola was the largest oil exporter to China in the first quarter of 2018. Brazil is also an important exporter to China of natural resources including iron ore. It is also a participant in the BRICS Development Bank.

# Collaboration, Cooperation, Coordination, Division of Labour and Specialisation

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- ◆ Macau does not have onerous restrictions on physicians and surgeons trained elsewhere to practice in Macau, unlike Hong Kong. It can therefore try to develop into an offshore international medical services centre for all of East Asia by attracting skilled medical practitioners from all over the world. The University of Macau can establish a medical school that is open to faculty members and students around the world. Its hospital can also specialise in the provision of the best private medical care in Asia.
- ◆ Hong Kong does not have enough medical personnel because of its highly protectionist policy towards medical doctors not trained in one of Hong Kong's own medical schools. Hong Kong's doctors, while excellent, are also not exposed to a sufficient diversity of diseases and illnesses.

# Collaboration, Cooperation, Coordination, Division of Labour and Specialisation

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- ◆ Guangzhou has a most important role within the GBA. It is the capital and the administrative and political centre of the entire Guangdong Province. The Provincial Party Committee and Government in Guangzhou can decide what the nine cities in the Guangdong part of the GBA will or will not do.
- ◆ Guangzhou is also the centre of a huge market and sets the fashion and style in the Province.
- ◆ Before 1949, Guangdong-Hong Kong-Macau (省港澳) together were considered to be a single market—many common brands were popular in the entire region and were promoted simultaneously. A formal visa was not required then for cross-border travel as long as the traveler could speak Cantonese without an accent. This was because of a clause in the Treaty of Nanking that allowed free transit of the Chinese people between Hong Kong and the surrounding Chinese territory. In a sense, the GBA can be viewed as a return to the old days.

# Collaboration, Cooperation, Coordination, Division of Labour and Specialisation

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- ◆ Guangzhou will be responsible for the long-term development planning in the Guangdong part of the GBA, especially the inter-connecting and sharing of the basic infrastructure. It will oversee the coordination, the division of labor, and the apportionment and sharing of the financing of the infrastructural projects, with the possible exception of Shenzhen, which is financially independent of Guangdong Province.
- ◆ Guangzhou has a good balance between heavy industries (such as automobile manufacturing and ship-building), light industries and service industries.
- ◆ There are several first-class universities in the city, including the Sun Yat-sen University (中山大学) and the South China University of Technology (华南理工大学).
- ◆ It is also a transportation hub for the rest of Guangdong Province. For example, the high-speed train runs through Guangzhou.

# Collaboration, Cooperation, Coordination, Division of Labour and Specialisation

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- ◆ 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 effective openness through connectivity.
- ◆ Inter-connecting and building infrastructure in the GBA requires long-term financing, through development banks and bonds. This is also true of the Belt and Road Initiative. Within the GBA, Hong Kong is already an international financial centre, through which much of the financing of the infrastructural projects will need to be raised.

# Collaboration, Cooperation, Coordination, Division of Labour and Specialisation

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- ◆ 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 “B&R” Initiative is a serious long-term commitment of China that has been written into the Charter of the Communist Party of China at its Nineteenth National Congress held in October 2017, indicating that it will remain a focus for China’s foreign policy and its international economic outreach for a long time to come.

# The GBA and the “Belt and Road” Initiative

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- ◆ The Silk Road Economic Belt, as the Old Silk Road which existed more than two millennia ago, 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. For both routes, the GBA is a natural eastern terminus in China.
- ◆ The GBA, as a eastern terminus of the “Belt and Road”, and with its well-developed financial, international trade and service sectors, will have an important role to play in the B&R Initiative. The GBA can become a financial, trading and logistics hub for the entire Belt and Road region.

# Collaboration, Cooperation, Coordination, Division of Labour and Specialisation

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- ◆ Within the GBA, Hong Kong is already an international financial centre, through which much of the financing of the infrastructural projects will need to be raised.
- ◆ However, Hong Kong does not currently 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.
- ◆ Thus, unless this deficiency can be corrected soon, it makes Hong Kong unsuitable as a location for raising long-term debt and asset management operations, including those of fixed income funds, insurance companies, money market funds, pension funds, sovereign wealth funds and treasuries of multinational corporations. (This is in addition to impediments raised by Hong Kong tax rules.)



# The GBA as a Full-Service International Financial Centre: The Intern'l Bond Market

- ◆ The financing of the Guangdong-Hong Kong-Macau Greater Bay Area and Belt and Road 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.
- ◆ The financing can also be done in multiple currencies, for example, the U.S. Dollar and the Renminbi. Since the revenue for most infrastructure projects is in local currencies, to the extent that there is demand for local currency-denominated bonds, either in the host country or internationally, they should be used. However, local currency-denominated bonds may have to be enhanced through indexing the rate of interest to the rate of inflation of the host country.
- ◆ Alternatively, for foreign currency-denominated debt, they may need to be secured with the expected proceeds of exportables—for example, oil and gas and iron ore.
- ◆ Hong Kong is uniquely able to put together a complex financing package that includes both equity and debt and short-and long-term bonds and notes and possibly in multiple currencies.

# The GBA as a Full-Service International Financial Centre: The Intern'l Stock Market

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- ◆ Once the GBAAFTZ is formed, residents within the GBA should be free to invest in the shares of the Hong Kong Stock Exchange and the Shenzhen Stock Exchange without any restrictions. This should add a significant demand and transaction volume on both stock exchanges.
- ◆ 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 stock exchange where they can buy and sell the equity and debt of all the blue chip East Asian enterprises (e.g., the MSCI Far East Index components) in US\$ or eventually in Renminbi, and without having to worry about foreign exchange conversions and restrictions on capital inflows and outflows.

# The GBA as a Full-Service International Financial Centre: The Intern'l Stock Market

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- ◆ 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 they begin to re-balance their portfolios once capital controls are lifted on the Mainland. (Right now we already have Shanghai-Hong Kong Connect and Shenzhen-Hong Kong Connect as well as the Bond-Connect.)
- ◆ It therefore behooves Hong Kong to encourage and solicit blue-chip enterprises around the world to do secondary listings on the Hong Kong Stock Exchange as Hong Kong Depositary Receipts (HDRs).
- ◆ In addition, both Hong Kong and Shenzhen should encourage the listing of the shares of successful local enterprises in the GBA.<sup>67</sup>

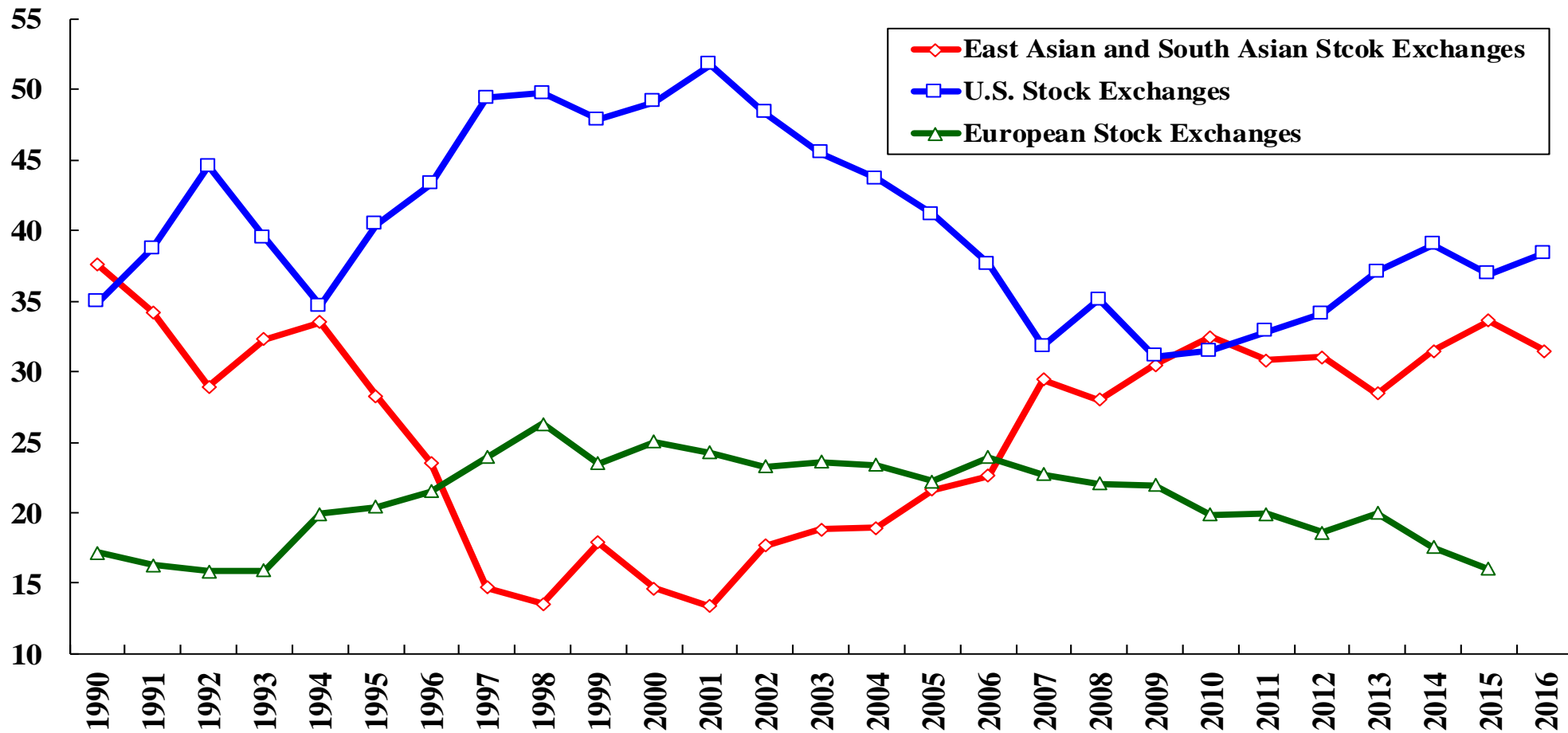
# The GBA as a Full-Service International Financial Centre: The Intern'l Stock Market

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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 capitalisation stood above 35% in 2016, compared to 38% for the U.S. and 17% for Europe.
- ◆ The 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 annual 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 international stock market in Hong Kong to succeed, the buying power of the Mainland investors must be harnessed in addition to attracting the Mainland enterprises to list their shares in Hong Kong.
- ◆ Asian household wealth is projected to exceed European wealth within the next five years.

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

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



# The GBA as a Full-Service International Financial Centre: The Intern'l Stock Market

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- ◆ Hong Kong is an ideal location for the establishment of an East Asian region-wide and eventually Belt-and-Road-wide international 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 interest, stock dividends and capital gains.
- ◆ Trading can be done in Renminbi and in U.S. Dollars in addition to Hong Kong Dollars. There is no need to convert. Thus, Mainland investors can purchase Hong Kong shares in Renminbi.

# The GBA as a Full-Service International Financial Centre: The Intern'l Stock Market

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- ◆ 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 has recently amended its listing rules to allow differential voting rights with appropriate safeguards to attract the listing of private Mainland enterprises still actively managed by their founders. Such safeguards include the possible sunset of the super-voting rights, restrictions on the transfer of such super-voting rights upon sale or transfer of the super-voting shares and advance notice of the sales of the super-voting shares.

# Collaboration, Cooperation, Coordination, Division of Labour and Specialisation

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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. Similarly, the demands for insurance and hence for re-insurance will also grow in both the GBA and the other Belt and Road countries.
- ◆ In addition, the Mainland, the other East Asian and the oil-rich Middle Eastern economies, with their high saving rates, are potentially major sources of risk capital for the re-insurance business.
- ◆ Re-insurance, like insurance, is a scale business, China and the East Asian economies have now grown sufficiently large to realise the economies of scale of re-insurance based on their own demands alone.
- ◆ Moreover, once sufficient scale and expertise are achieved, insurance companies worldwide will also want to re-insure with re-insurance companies in the GBA, so as to diversity and share the risks.



# The GBA as a Full-Service International Financial Centre: The Re-Insurance Market

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- ◆ The four necessary requirements for an international re-insurance market is:
- ◆ 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 complete freedom of capital flows to and from everywhere, so that insurance premia can be received and claims can be paid expeditiously worldwide. The insurance policies themselves can be denominated in different currencies so as to match those of the insured and re-insured assets.

# The GBA as a Full-Service International Financial Centre: The Re-Insurance Market

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- ◆ 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.
- ◆ The GBA (Hong Kong together with Qianhai in Shenzhen) is uniquely suited to become an international re-insurance centre for the Asian region, including all the Belt and Road countries. What is needed is some concerted governmental action to encourage and facilitate the establishment of one or more large re-insurance companies that are licensed to do business everywhere in China and East Asia and in the Belt and Road countries.

# Collaboration, Cooperation, Coordination, Division of Labour and Specialisation

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- ◆ The GBA can develop into the leading Renminbi centre, both onshore and offshore, taking advantage of the unique position of Hong Kong and Macau's "One country, two systems". With the Renminbi expected to become increasingly internationalised during the next decade or two, this will turn out to be a huge advantage.
- ◆ Hong Kong is currently by far the largest and most active offshore centre for Renminbi clearing, settlement, trading and financing, with an average daily volume of transactions approaching 1 trillion Yuan.
- ◆ One may ask: When the Yuan becomes completely freely convertible, would an offshore Renminbi centre still be needed?
- ◆ One only has to look at the Euro Dollar market in London to realise that an offshore Renminbi market can continue to prosper even after all capital controls are lifted on the Mainland. Hong Kong would continue to be an important Renminbi centre, perhaps even more important, for tax and many other reasons.

# Collaboration, Cooperation, Coordination, Division of Labour and Specialisation

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- ◆ The GBA, with its great diversity, can develop into an international art, convention and exhibition, cultural, educational, film, leisure, performing arts, recreational and tourism centre, attracting people from not only China but all over the world.
- ◆ The GBA can also develop into an international professional services centre, serving China, the Belt and Road countries, and the rest of the world.

# The Impacts of the China-U.S. Trade War

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- ◆ The impacts on the Mainland economy
- ◆ The impacts on the economy of Guangdong Province
- ◆ The impacts on the economy of Shenzhen
- ◆ The impacts on the economy of Hong Kong

# The Impacts of the Trade War on the Mainland Economy

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- ◆ The early impacts are psychological: they affect the prices of Chinese shares on the Chinese stock exchanges and the Renminbi exchange rate.
- ◆ However, the real impacts on the economy are relatively small and manageable for the Mainland economy as a whole.

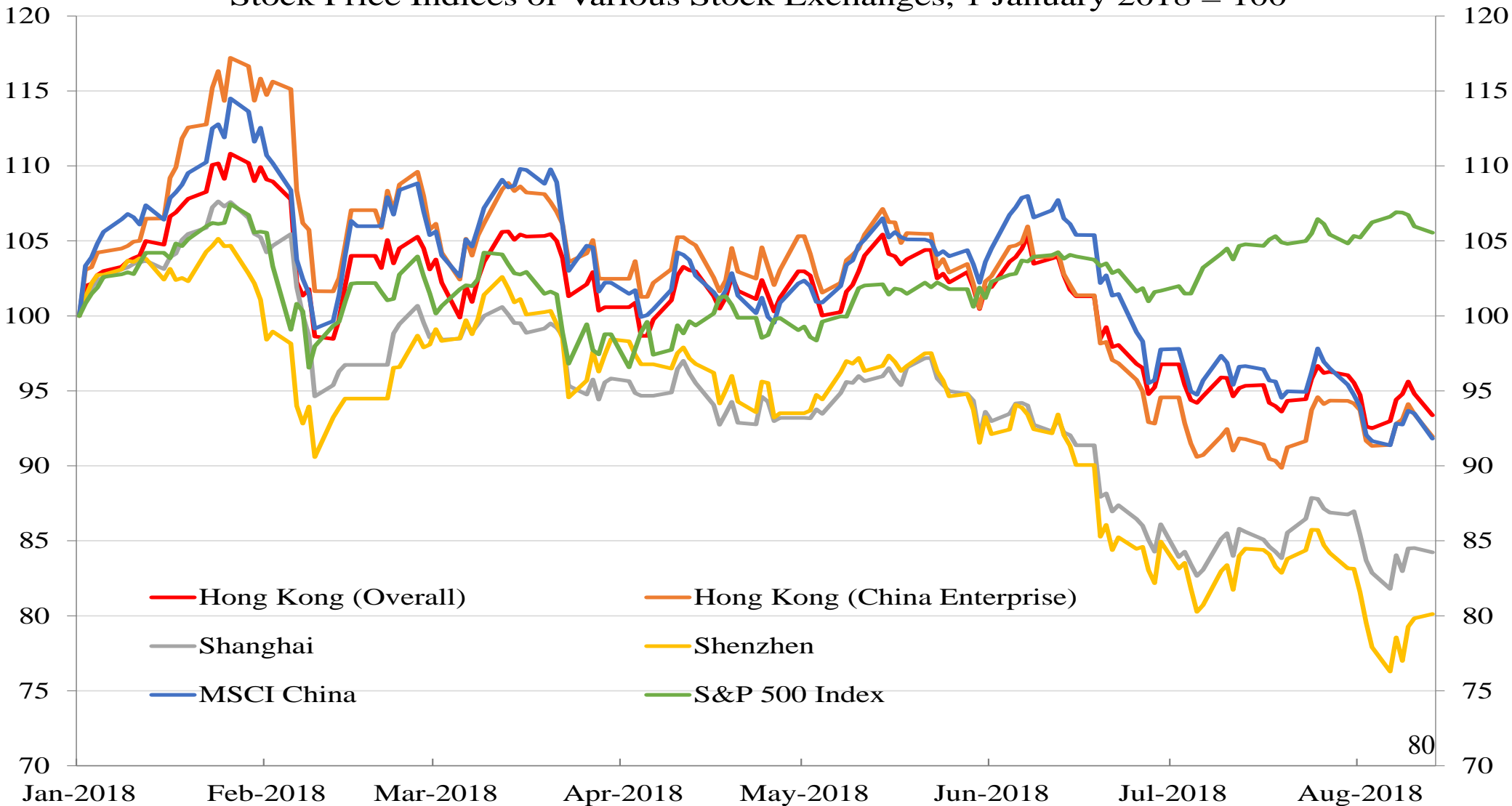
# Immediate Impacts

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- ◆ Stock markets abhor uncertainty. Any uncertainty will lead to a decline. The Chinese stock markets—Shanghai and Shenzhen, and even Hong Kong—have taken a direct hit from the start of the trade war (see the following Chart). The Shenzhen Stock Exchange has seen its average stock price decline by approximately 20 percent since the beginning of 2018. Similarly, the average price level of the Shanghai Stock Exchange has declined 15 percent. Hong Kong overall has declined more than 5 percent, but Mainland Chinese enterprises listed there have declined by approximately 8 percent.
- ◆ By comparison, the S&P 500 has gained 5 percent since the beginning of 2018. However, not all of the declines in the Chinese stock markets can or should be attributed to the trade war. The actual and expected increase in the rate of interest in the U.S. by the U.S. Federal Reserve Board also had a role in the falling prices of assets and exchange rates vis-a-vis the U.S. Dollar in emerging markets.

# The Chinese, Hong Kong and U.S. Stock Market Indexes, Year to Date

Stock Price Indices of Various Stock Exchanges, 1 January 2018 = 100





# Immediate Impacts

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- ◆ However, the performance of the Shanghai and Shenzhen stock markets is not a reliable barometer of the state of the Chinese economy. Rather, it is a measure of the degree of “irrational exuberance”, to use a phrase coined by Dr. Alan Greenspan, the former Chairman of the U.S. Federal Reserve Board, or the opposite, “irrational gloom”.
- ◆ This is because most of the investors on the Mainland Chinese stock exchanges are individuals looking for a quick profit through frequent trading. The average holding period of individual Chinese common stock investors is less than 20 trading days and that of institutional investors is between 30 and 40 trading days. Since the trade war looks like it will last much longer, at least until the mid-term elections in the U.S. to be held on 6 November of this year, most Mainland Chinese investors have elected to bail out and stay on the sidelines for now.

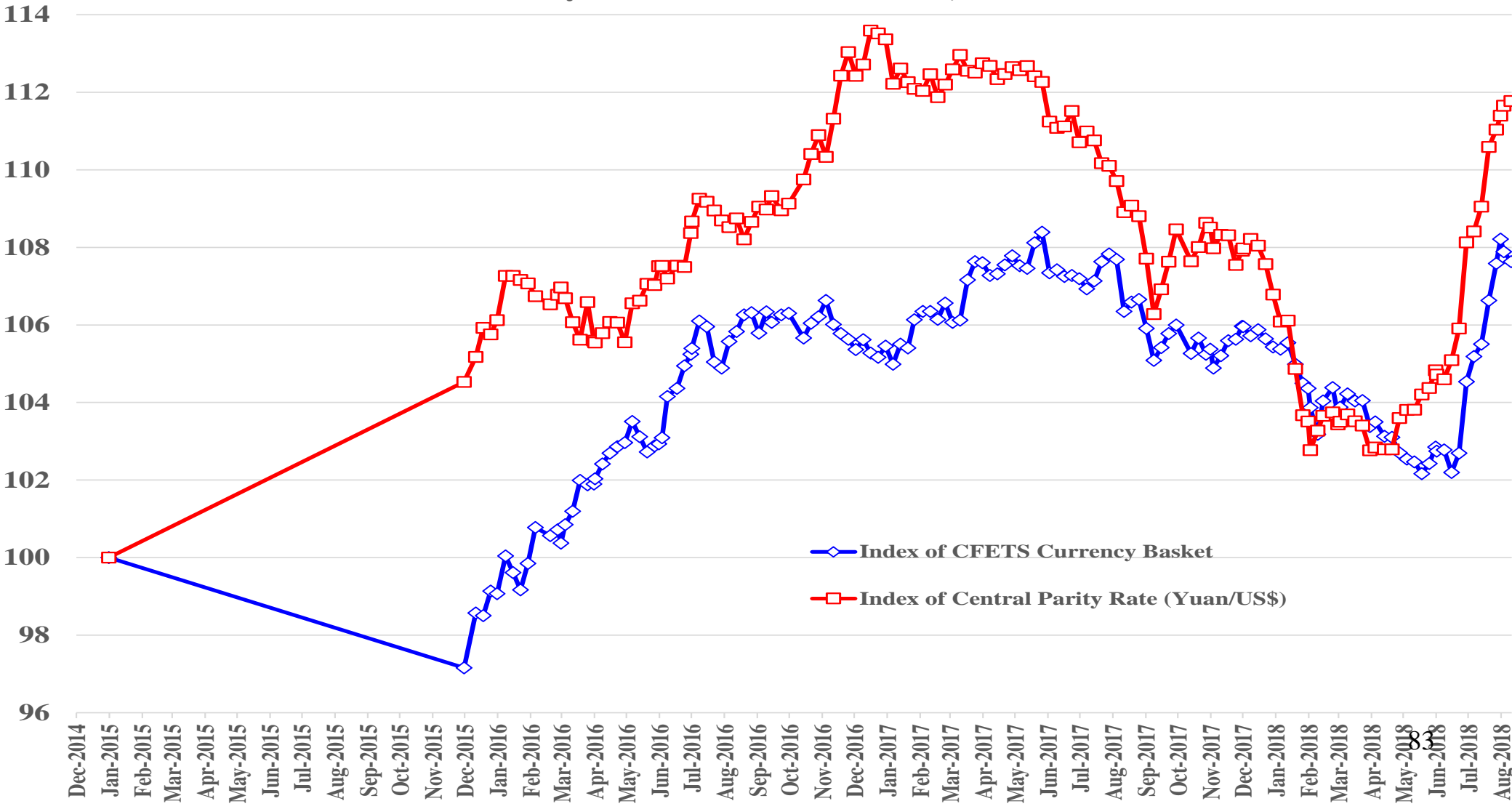
# Immediate Impacts

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- ◆ Similarly, the Renminbi exchange rate has also been negatively affected, but also in part because of the actual and expected increases in the U.S. rate of interest. In the following charts, the Renminbi central parity rate, the rate set by the People's Bank of China (the central bank of China) at the beginning of each daily trading session of the onshore Renminbi, is compared to the China Foreign Exchange Trade System (CFETS) Index, an index of the exchange rate changes of a Chinese trade-weighted basket of currencies, for the period since 2015.
- ◆ While there was wide divergence at the beginning, they began to move in tandem with each other in the second half of 2017. More recently, while the Renminbi has devalued vis-a-vis the U.S. Dollar by almost 9 percent since the end of January 2018, the deviation of the central parity rate from the CFETS Index has not widened beyond 3 percent.

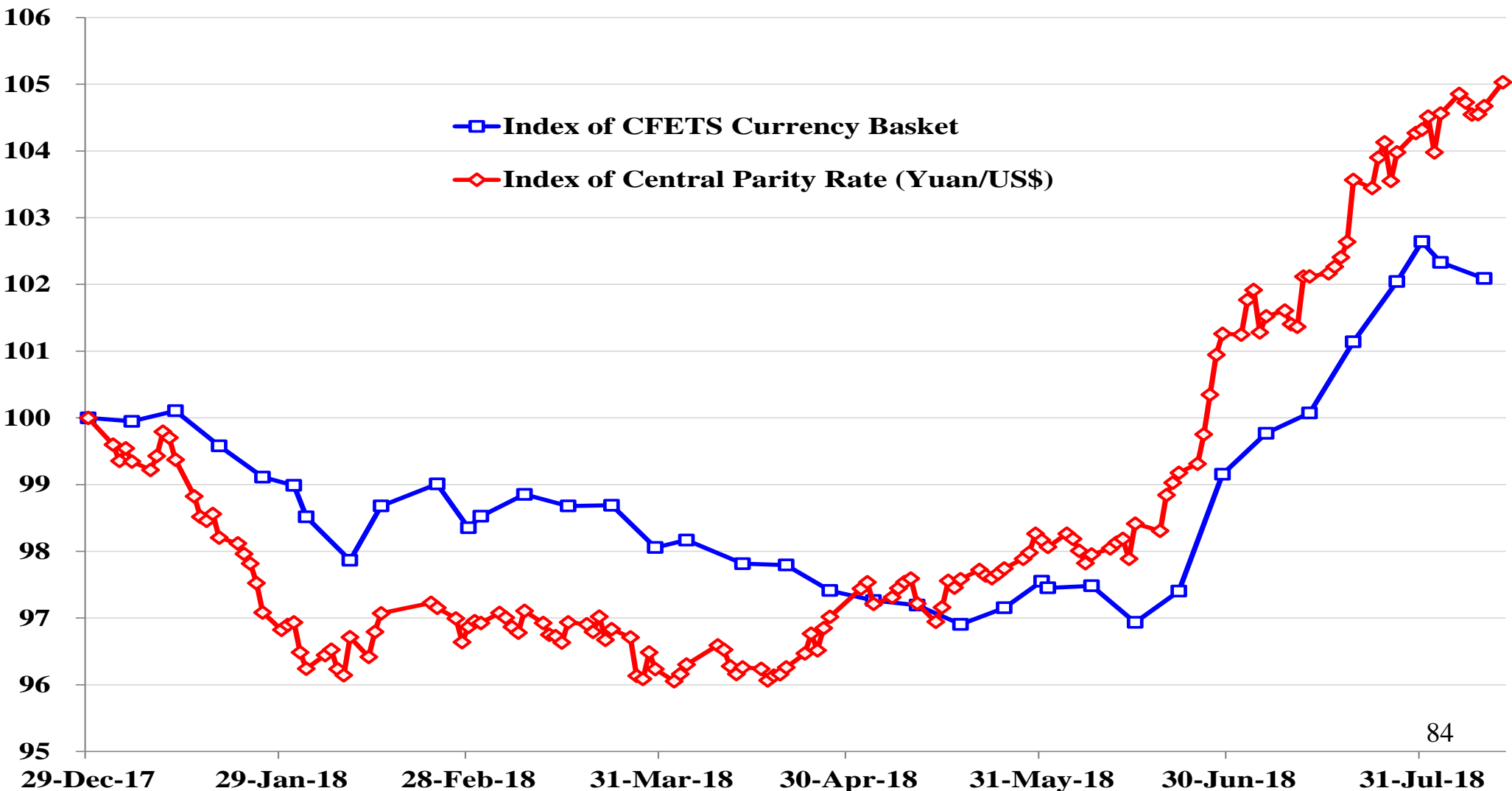
# The Renminbi Central Parity Exchange Rate and the CFETS Index

The Central Parity Rate and the CFETS Index, 12/31/2014 = 100



# The Renminbi Central Parity Exchange Rate and the CFETS Index

The Central Parity Rate and the CFETS Index, 29 Dec 2017 = 100



# Immediate Impacts

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- ◆ One way to interpret the CFETS Index is that it measures the weighted average of the percentage changes in the exchange rates of China's trading partners, with the weights given by each trading partner country's share in the total international trade of China. For example, the U.S. share of China's total international trade is approximately 25 percent, thus the U.S. Dollar should have a weight of approximately 25 percent.
- ◆ If the percentage change of the central parity rate is the same as the CFETS Index, it means that the Renminbi exchange rate is unchanged for China's average trading partner country, even though the Renminbi may have appreciated or devalued vis-a-vis the U.S. Dollar. Thus, for the Renminbi exchange rate to follow the CFETS Index amounts to keeping the Renminbi exchange rate constant for the average trading partner country of China.
- ◆ It is in China's interests to maintain a relatively stable Renminbi exchange rate. It is the only way for the internationalisation of the Renminbi to become a reality.

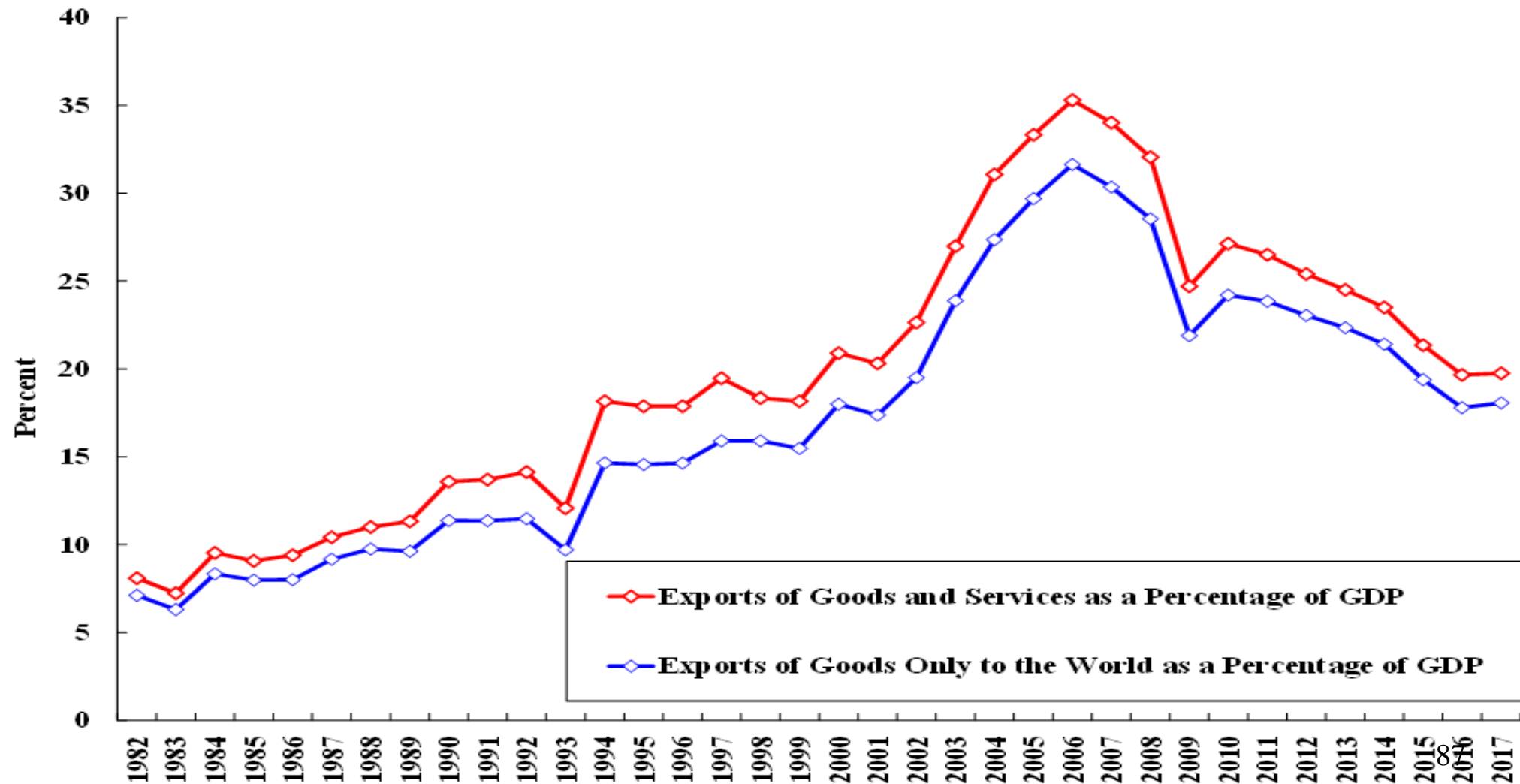
# The Real Impacts of the Trade War on the Mainland Economy

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- ◆ Chinese dependence on exports has been declining over the past decade. The share of exports of goods in Chinese GDP has fallen from a peak of 35.3% in 2006 to 18.1% in 2017.
- ◆ The share of exports of goods to the U.S. in Chinese GDP has also fallen by more than half, from a peak of 7.2% in 2006 to 3.4% in 2017.
- ◆ During this same period, the growth of Chinese exports to the world and to the U.S. has also slowed significantly (see the following charts). Chinese exports to the world grew at an average annual rate of 22.6% in the decade 1998-2007, but slowed to only 7.9% in the following decade, 2008-2017. Similarly, exports to the U.S. grew at 22% per annum in the decade 1998-2007, but slowed to less than 7% per annum in the most recent decade. Exports is no longer the engine of Chinese economic growth.

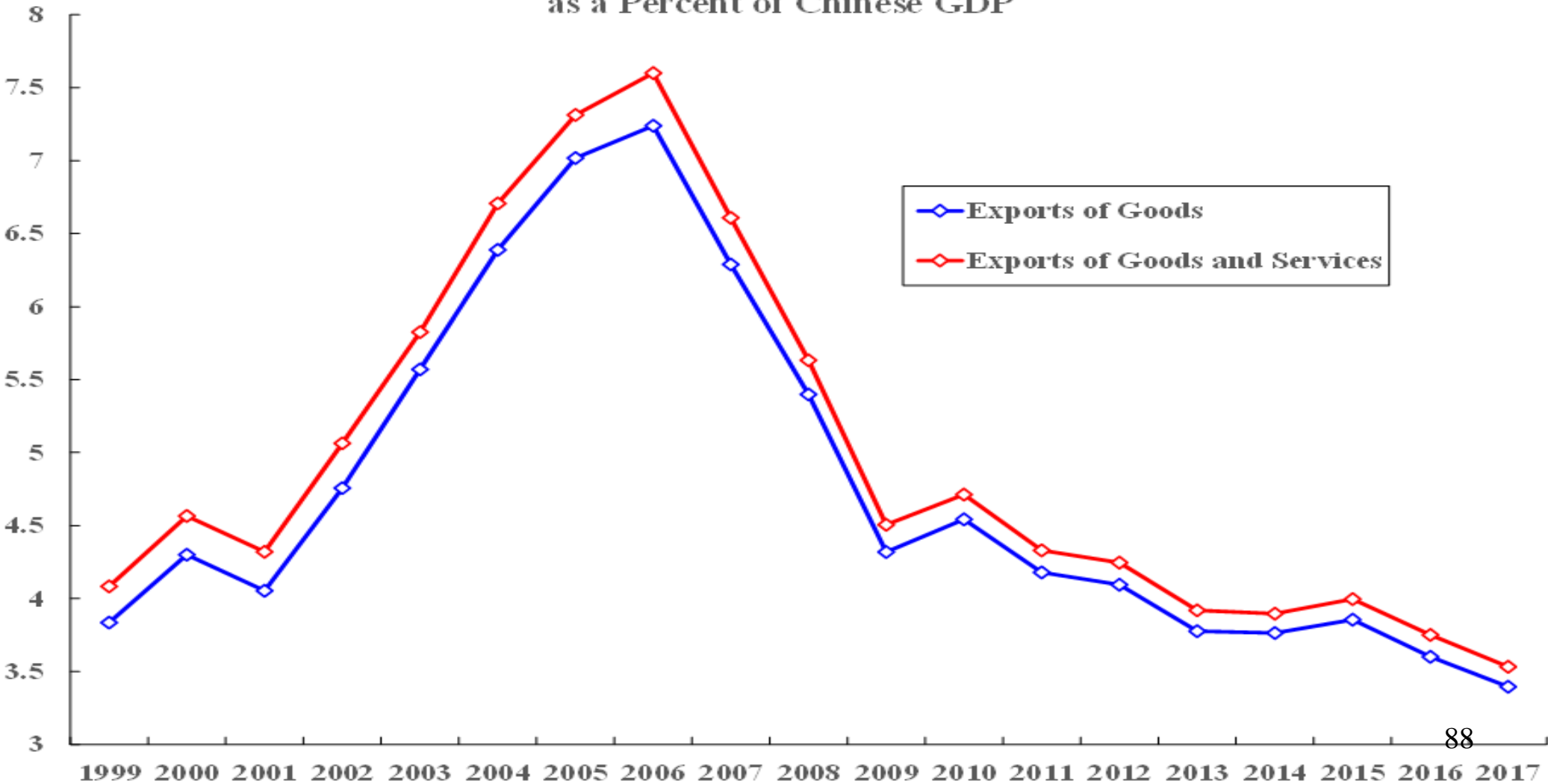
# Chinese Exports of Goods and Services and Goods Only as a Percent of Chinese GDP

Exports of Goods & Services and of Goods as a Percent of Chinese GDP



# Chinese Exports of Goods and Services to the U.S. as a Percent of Chinese GDP

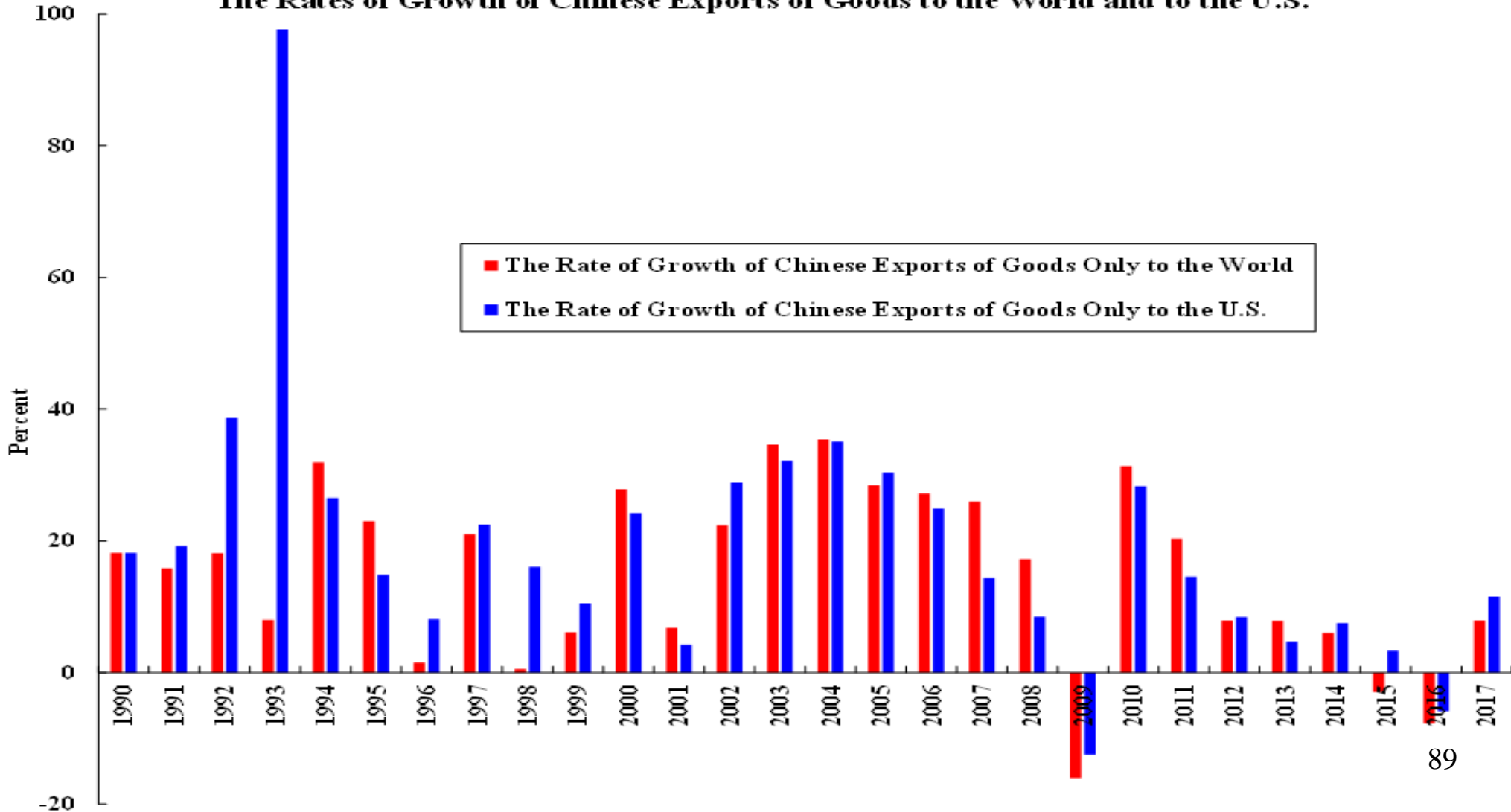
Chinese Exports of Goods and Services and Goods Only to the U.S. as a Percent of Chinese GDP





# The Annual Rates of Growth of Chinese Exports of Goods to the World and to the U.S.

The Rates of Growth of Chinese Exports of Goods to the World and to the U.S.



# The Real Impacts of the Trade War on the Mainland Economy

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- ◆ New U.S. tariffs are expected to eventually affect up to US\$250 billion of U.S. imports of goods from China (approximately equal to US\$227 ( $250 \times 10/11$ ) billion of Chinese exports of goods to the U.S., f.o.b.) or approximately half of Chinese exports of goods to the U.S.
- ◆ Thus, Chinese exports of goods amounting to approximately 1.7% ( $3.4\%/2$ ) of Chinese GDP will eventually be affected.
- ◆ The U.S. tariff rates will range from 10% to 25% on the value of the imports from China. These rates will be prohibitive for most of the goods imported from China as neither the Chinese exporters nor the U.S. importers have the kind of profit margins that can afford these tariffs.

# The Real Impacts of the Trade War on the Mainland Economy

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- ◆ However, the direct domestic value-added content of Chinese exports to the U.S. is less than 25%. Thus, assuming that half of the exports to the U.S. is completely halted, the maximum loss in Chinese GDP in the first instance, may be estimated at 0.43% ( $1.7\% \times 0.25$ ), a tolerable level, especially for an economy growing at an average annual real rate of 6.5 percent and with a per capita GDP of US\$9,137 in 2017, which is way over the subsistence level.
- ◆ With the indirect, that is, second-, third-, fourth- and higher-round effects of the reduction of Chinese exports kicking in, the total domestic value-added content affected increases eventually to 66 percent. This implies ultimately a total loss in Chinese GDP of 1.12% ( $1.7\% \times 0.66$ ). In absolute terms, this amounts to US\$137 billion in 2017 prices.

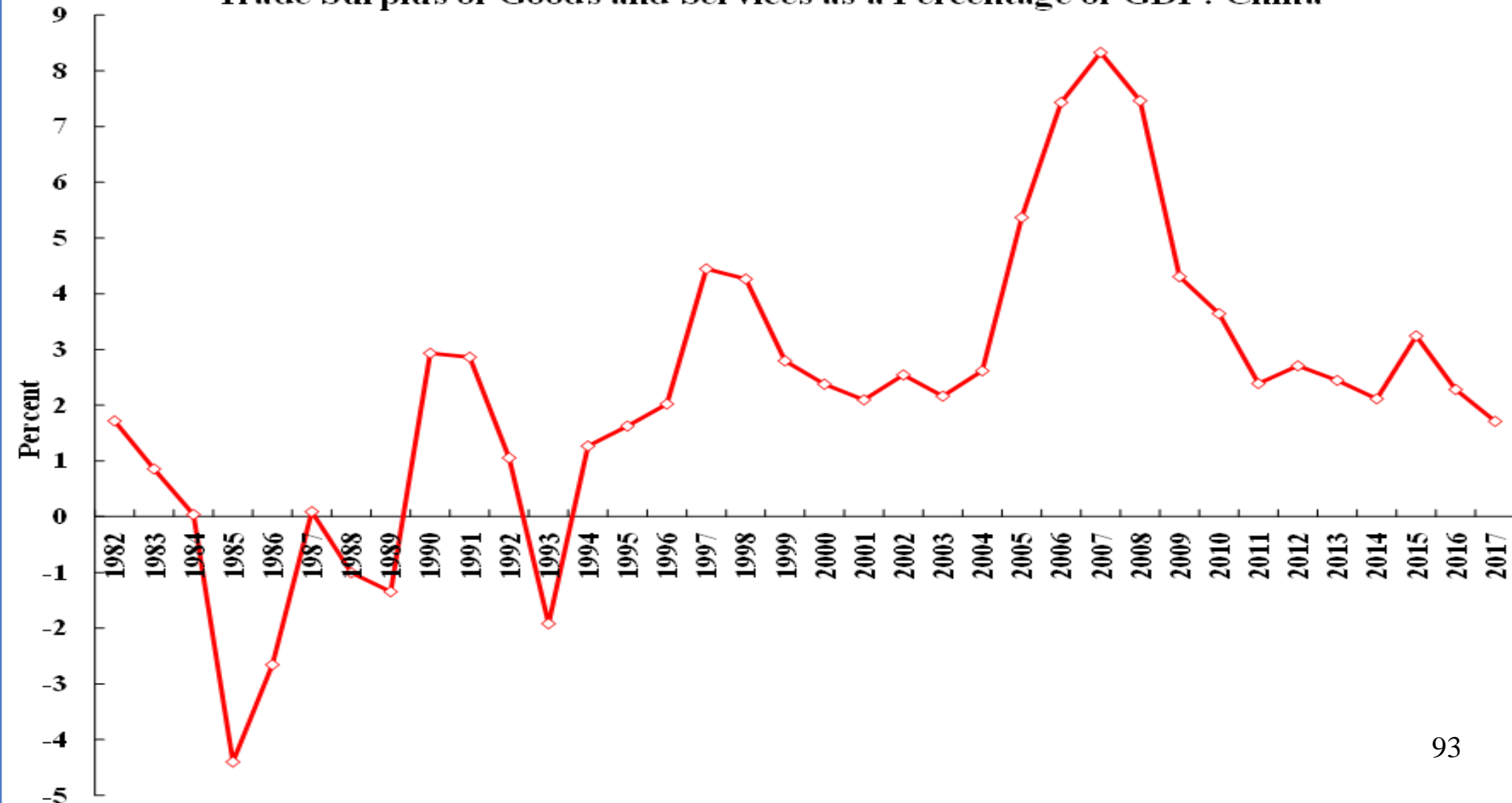
# The Real Impacts of the Trade War on the Mainland Economy

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- ◆ A reduction of 1.1% from an expected annual growth rate of 6.5% leaves 5.4%, still a very respectable rate compared to the average of 3.9% for the world in 2018 projected by the International Monetary Fund.
- ◆ Moreover, even with the reduction of Chinese exports of goods amounting to 1.7% of GDP, the Chinese trade in goods and services, which had a surplus of 1.71% of GDP in 2017, will still remain in balance, without taking into account any potential reduction of Chinese imports from the U.S. Thus, there should be little pressure for the Renminbi to devalue.
- ◆ In fact, it is probably in the best interests of the Chinese economy to maintain a relatively stable Renminbi exchange rate. By following the CFETS Index, an index of a trade-weighted basket of currencies, the Renminbi exchange rate will have a lower volatility than the U.S. Dollar exchange rate because it will move, in general, in the same direction as the U.S. Dollar but by a smaller amount. This means when the U.S. Dollar appreciates with respect to other currencies, the Renminbi will devalue relative to the U.S. Dollar, and when the U.S. Dollar devalues with respect to other currencies, the Renminbi will appreciate relative to the U.S. Dollar. The Renminbi exchange rate will be less volatile than the U.S. Dollar exchange rate.

# Chinese Trade Surplus in Goods and Services as a Percent of GDP

Trade Surplus of Goods and Services as a Percentage of GDP: China



# The Real Impacts of the Trade War on the Mainland Economy

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- ◆ In the longer run, assuming that the tariffs continue on both sides, the U.S. importers will begin to replace Chinese imports by imports from other Asian countries such as Vietnam, Cambodia and Bangladesh, and eventually perhaps even North Korea.
- ◆ But the shift in the sourcing of imports away from China has already been occurring since 2010, because of the rise in labour costs in China and because of the appreciation of the Renminbi. This is similar to the earlier shift of the sources of U.S. imports of apparel from Hong Kong, South Korea and Taiwan to Mainland China. The new U.S. tariffs will accelerate this process.
- ◆ The ASEAN and South Asian countries may benefit, but it is really hard to predict by how much because the supply chains today are so internationalised. However, it is unlikely, in most cases, that the tariffs will stimulate new domestic production in the U.S.

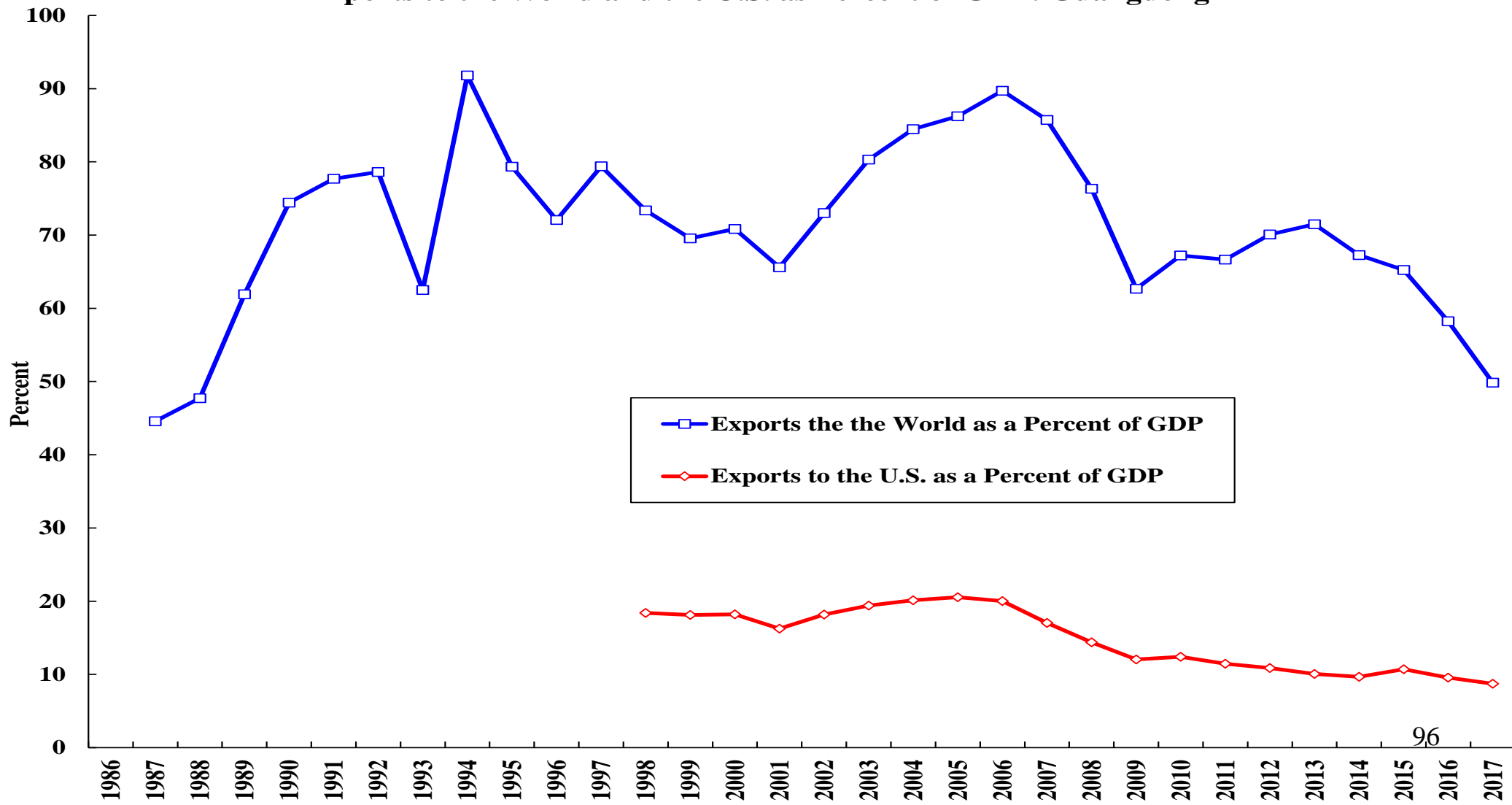
# Real Impacts on the Chinese Economy: Specific Regional Impacts

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- ◆ Even though the real impacts on the Chinese economy in the aggregate are relatively small, they can be more significant for individual specific municipalities and provinces, especially those oriented towards exports.
- ◆ Guangdong, including Shenzhen, is the largest exporting region in China, followed by Shanghai and then Zhejiang. Exports as a percent of its GDP was just below 50% in 2017, compared to a national average of 18%, and exports to the U.S. was 8.7%.

# Exports to the World and the U.S. as Percent of GDP: Guangdong

Exports to the World and the U.S. as Percent of GDP: Guangdong





# The Impacts of the Trade War on the Economy of the Guangdong Province

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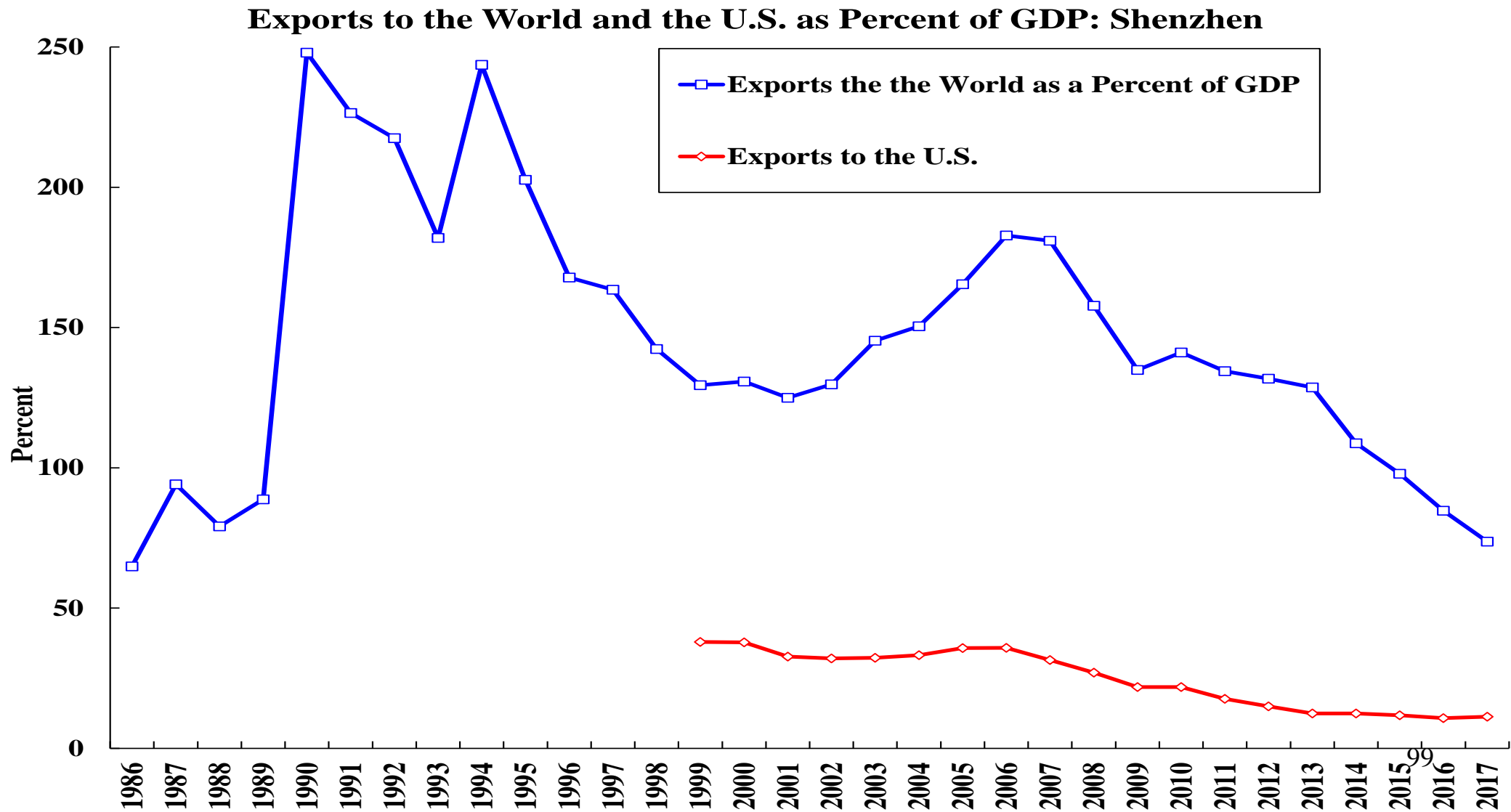
- ◆ Assuming the direct domestic value-added content of Guangdong exports to the U.S. is the same as that of Chinese exports as a whole, that is, 25%, the maximum loss in Guangdong GDP, assuming that half of the exports to the U.S. is completely halted, in the first instance may be estimated at 1.09% ( $4.35\% \times 0.25$ ). Such a decline in GDP is perfectly manageable by Guangdong as the real rate of growth of its GDP was 10.2% and its GDP per capita was US\$12,909 in 2017.
- ◆ Taking into account the indirect, that is, second-, third-, fourth- and higher-round effects of the reduction of exports from Guangdong, the total domestic value-added content affected increases to 66 percent. This implies ultimately a total loss in Guangdong GDP of 2.87% ( $4.35\% \times 0.66$ ). This will represent a significant slowdown in the real rate of growth of the Guangdong economy. Even then, the Guangdong economy will still be growing at more than 7% per annum.

# The Impacts of the Trade War on the Economy of the Shenzhen Municipality

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- ◆ Exports as a percent of GDP in Shenzhen was 73.7% in 2017, and exports to the U.S. was 11.3%, all higher than those of Guangdong.
- ◆ Assuming the direct domestic value-added content of Shenzhen exports to the U.S. is the same as that of China as a whole, that is, 25%, the maximum loss in Shenzhen GDP, assuming that half of the exports to the U.S. is completely halted, in the first instance may be estimated at 1.41% ( $5.65\% \times 0.25$ ). However, for the Shenzhen economy, which grew at 8.8% in 2017, a decline of this magnitude would still be manageable.
- ◆ Taking into account the indirect, that is, second-, third-, fourth- and higher-round effects of the reduction of exports, the total domestic value-added content affected increases to 66 percent. This implies ultimately a total loss in Shenzhen GDP of 3.7% ( $5.65\% \times 0.66$ ), still leaving Shenzhen with a rate of growth of 5.1%, significantly higher than the average rate of growth of the world economy of 3.9% and that of neighbouring Hong Kong in 2018 which is expected to be between 3 and 4 percent.

# Exports to the World and the U.S. as Percent of GDP: Shenzhen



# The Impacts of the Trade War on the Economy of Hong Kong

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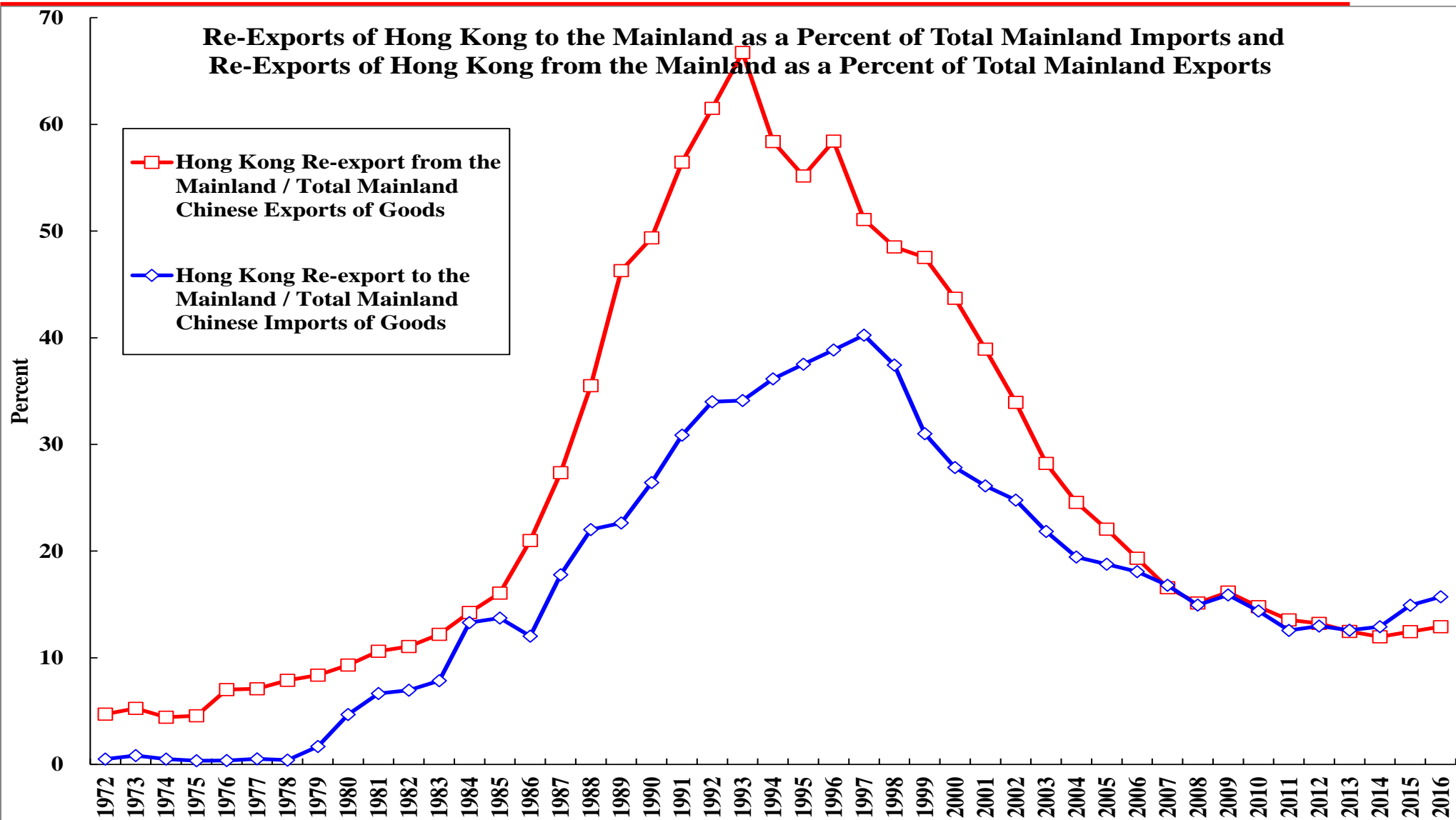
- ◆ In 2017, Hong Kong domestic exports (excluding re-exports) to the world and to the U.S. amounted to US\$ 5.6 billion and US\$ 0.45 billion respectively, representing 1.6 percent and 0.13 percent of Hong Kong GDP in 2017. We do not know the domestic value-added content of Hong Kong domestic exports, but it is unlikely to be higher than that of the Mainland, which is 25 percent in the first instance and 66 percent after all second- and higher-round effects are included. Thus even if all Hong Kong domestic exports to the U.S. are halted, the real impact will be quite small. Moreover, the U.S. tariffs are not targeted against Hong Kong domestic exports.

# The Impacts of the Trade War on the Economy of Hong Kong

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- ◆ More problematic is what happens to the volume of re-exports of Chinese goods to the U.S. through Hong Kong. The following Chart shows that re-exports through Hong Kong is now just slightly more than 10 percent of total Mainland exports. Re-exports to the U.S. amounted to 12.3 percent of Hong Kong GDP. However, the value-added in Hong Kong on re-exports of Chinese goods cannot be very high, probably no more than a couple of percentage points.
- ◆ Assuming that one-half of the re-exports of Chinese goods to the U.S. is halted because of the trade war, the net effect on Hong Kong GDP is given by  $12.3/2 \times 0.02 = 0.12$  percent, which is also a very small number.

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



# The Impacts of the Trade War on the Economy of Hong Kong

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- ◆ What might affect Hong Kong more are the indirect impacts.
- ◆ One source of indirect impact is the reduction of the profits from operations that Hong Kong entrepreneurs and direct investors have in Guangdong.
- ◆ There will be a direct impact on the prices and transaction volumes on Hong Kong Stock Exchange.
- ◆ There will be an impact on the number of Mainland tourists visiting Hong Kong.
- ◆ Finally there may be an impact on the price of residential housing in Hong Kong as fewer Mainlanders may buy because of the uncertainty. Hopefully this will prove positive for the Hong Kong permanent residents in the residential housing market.

# The Impacts of the Trade War on the Economy of Hong Kong

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- ◆ Even though the overall direct effect of the trade war on Hong Kong is likely to be small, I believe the Government can consider, as a possible mitigation measure, a reduction of taxes through adopting full expensing of new investments in machinery and equipment in the first year (as already adopted in the U.S.). A slightly more ambitious plan is to extend the allowed expensing to apply to all Hong Kong direct investments in machinery and equipment (and in R&D) in the Greater Bay Area (GBA).
- ◆ This is slightly revolutionary as at this time even depreciation of Hong Kong-owned machinery and equipment on the Mainland is not allowed, but we should consider this in the broader context of the promotion of GBA and as a mitigation measure in view of the negative impact of the trade war on Hong Kong and the GBA. Hong Kong investment in the GBA can create employment for Hong Kong people in Hong Kong as well as in the GBA.



# Concluding Remarks 結語

- ◆ The GBA can definitely become the world's leading international financial centre, where all of East Asia's stocks and bonds are available and traded in multiple currencies. Once the GBA achieves this status, it cannot be easily displaced or replaced.
- ◆ In order to become an international financial centre serving all East Asian countries, it must be prepared to collaborate and cooperate and share profits with the financial sectors of other economies, so that they will be pleased to have their blue-chip stocks offered as Hong Kong Depositary Receipts (HDRs) on the Hong Kong Stock Exchange.
- ◆ The GBA or Hong Kong can also become the world's leading asset (including private wealth) management centre if appropriate tax-exempt treatment for non-GBA or Hong Kong-sourced incomes of non-GBA or Hong Kong asset management clients can be arranged.
- ◆ If the Mainland can adopt the territorial principle of income taxation rather than the global principle of income taxation, it will greatly facilitate the GBA or Hong Kong being the world's leading international financial centre to eventually rival New York.

# Concluding Remarks 結語

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- ◆ The GBA definitely has the potential to become the world's leading innovation, venture capital, start-up and financing hub. Once the GBA achieves this status, it cannot be easily displaced or replaced.
- ◆ In order to become a global innovation hub, the GBA must vigorously promote higher education, R&D and venture capital within the GBA.
- ◆ The GBA is also uniquely able to support the “B&R” Initiative, in addition to its own infrastructural needs, as an international financial centre. However, it must work hard to develop an active and liquid long-term bond market (including Islamic bonds) as well as an international equity market, serving the entire Belt and Road region.
- ◆ The GBA can also become one of the world's leading international re-insurance centres, like London and Zurich.
- ◆ However, realising these goals requires the all the GBA governments, the enterprises and the public to work together. Moreover, they must also seek the help and support of the Central Government.

# Concluding Remarks 結語

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- ◆ It is necessary to promote the freer flow of goods and services, people, capital and information among the 11 cities of the GBA. There should be a pilot Guangdong-Hong Kong-Macau Greater Bay Area Free Trade Zone, within which experiments of the freer flows can be conducted.
- ◆ To the rest of the Mainland, the pilot Guangdong-Hong Kong-Macau Greater Bay Area Free Trade Zone will function as a giant bonded region. Flows between the GBAFTZ and the rest of the Mainland will be subject to immigration and customs inspections, tariffs, and in the case of inbound or outbound fund flows under capital accounts, approvals.
- ◆ To the rest of the world, the pilot GBAFTZ will function as a free port, a larger version of today's Hong Kong and Macau.
- ◆ If the pilot GBA free trade zone proves to be successful, it can be eventually expanded to include the entire Guangdong Province and ultimately perhaps even to the entire country.