The Possible Economic Initiatives for Hong Kong in the Aftermath of the Failure of Its Political Reform

by

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Lawrence J. Lau[1]

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Abstract: In the aftermath of the failure of political reform, Hong Kong needs to try to mitigate the negative long-term economic consequences of the failure and launch new initiatives that will ensure its long-term economic prosperity. Hong Kong was at one time indispensable to the Mainland economy, but this is no longer the case. Hong Kong must try to launch new economic initiatives, including developing itself into an innovation hub, establishing itself as a securities market for the entire East Asian region, becoming the reinsurance centre for the East Asian region, adopting a "Serve Thy Neighbour" strategy and cooperating closely with the Province of Guangdong, including Shenzhen, and Macau, and finally trying the "Super-Coordinator" strategy. The people of Hong Kong must put aside their differences and move forward together!

1. Introduction

In June 2015, the proposed political reform package was voted down in the Legislative Council. Hong Kong missed a real opportunity to improve its governance and enhance the livelihood of its people. What Hong Kong needs to do now is to try to mitigate the negative long-term economic consequences of the failure to implement the proposed economic reform and launch new initiatives that will help to ensure its long-term economic prosperity.

These negative economic consequences will not be felt immediately. However, since the development of an economy is basically driven by expectations about the future, the failure of political reform will cast a dark shadow on the economy of Hong Kong. Doubts

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will be raised on our ability to govern ourselves effectively, to manage our own affairs well, and to solve our urgent livelihood problems in a timely manner. And the perceptions of the economic roles we can play going forward by the Mainland and the rest of the world will be significantly affected. These negative consequences will manifest themselves gradually but unavoidably over time, unless active steps are taken to reverse them.

What needs to be done is the rebuilding of mutual trust, first of all, among the people of Hong Kong and between the Government and the people. Secondly, mutual trust must be rebuilt between Hong Kong and the Mainland and between their peoples. Without such trust, nothing can be accomplished. What also needs to be restored is confidence: confidence on the part of the Hong Kong Government that it can continue to serve the people effectively, confidence on the part of the people of Hong Kong in the ability of the Government to deliver on its policies, confidence of the Central Government in Hong Kong's ability to manage its own affairs, and confidence of the rest of the world in Hong Kong's continued prosperity and stability. Hopefully, in the aftermath of the failure of the proposed political reform, there is a new sense of urgency among the people of Hong Kong—that "business as usual" will no longer suffice, that this is the time to consider and launch new economic initiatives that will assure Hong Kong's continuing economic prosperity in the future.

2. The Negative Impact on Hong Kong

The rejection of the political reform package will be taken as a sign, a signal about the future, and an indicator of our inability to govern ourselves, to come together, to compromise and act in our collective best interests. It will definitely lower expectations about the future of Hong Kong.

First, domestically, the important livelihood issues faced by Hong Kong, such as access to health care, affordable housing, and provision for retirement, cannot be satisfactorily addressed and resolved, as their resolution will require bold actions as well as wise compromises. The reform of the Legislative Council will be delayed. It portends more gridlock, which Hong Kong can ill afford, certainly not another seven years of unnecessary internal squabbling that solves none of the critical problems.

Second, no new economic initiatives will be possible without an effective Hong Kong SAR Government. The success of all of the new economic initiatives proposed below requires a stable economy, an effective government and a harmonious society. Instability and contentiousness drive businesses and investors away.

Third, the success of all these new initiatives also depends critically on cooperation with and support from the Mainland. For example, commercially successful innovation is just a pipe dream without access to the huge Mainland market. (The huge size of the U.S. market has been one of the most important factors for the U.S. to be such a successful innovator.) Success in organising an East Asian region-wide securities market in Hong Kong will also be unlikely without the active support of the Central Government.

3. The View from the Mainland

The failure of political reform implies an erosion of mutual trust between Hong Kong and the Mainland. Can Hong Kong be relied on to act in the interests of the nation as a whole in a time of crisis? If Hong Kong is perceived to be not completely reliable, the Mainland will have to begin to hedge and to diversify away from Hong Kong. The Mainland will come to the conclusion that it cannot afford to put all of its eggs in the Hong Kong basket and must plan to be able to do without Hong Kong if and when necessary.

The people on the Mainland already feel that they are not welcome in Hong Kong for various reasons. They also increasingly feel that they are being taken for granted. The failure of the political reform, rightly or wrongly, will discourage them even more from visiting Hong Kong. It will definitely accelerate the decline in investment from the Mainland as well as the number of Mainland tourists. Any perception by the Mainland public of Hong Kong’s unfriendliness and lack of patriotism will discourage closer cooperation in the future.

Different commentators have advanced different arguments of why the Mainland must continue to be “nice” to Hong Kong. These arguments range from the supposed importance of the role Hong Kong plays in the Mainland’s international economic exchanges, to the need to demonstrate to Taiwan the benefits of “One Country, Two Systems”, and to the reluctance of incurring the displeasure of the Western powers. However, the times have changed. Hong Kong is no longer indispensable to the Mainland economy, as it once was. Realistically speaking, whatever happens in Hong Kong is hardly relevant to the future development of cross-strait relations any more. And the leverage of the Western powers on the Mainland is low or almost non-existent. The entry of the U.K. as a Founding Member of the Asian Infrastructure Investment Bank is an example of how much the situation has turned around. The Mainland's goodwill for Hong Kong can no longer be taken for granted, and the failure of the political reform cannot but make the relation between Hong Kong and the Mainland more strained, regardless of what is being said publicly.

The people of Hong Kong must realise that Hong Kong is now an inseparable part of the Chinese nation. There are benefits and there are costs for Hong Kong being part of China. But it is not a choice for Hong Kong. The best way forward for Hong Kong is to try to craft win-win strategies with regard to its relations with the Mainland. Strategies that only benefit one side are never viable or sustainable in the long run. Hong Kong should also realise that the Central Government also has many pressing problems to solve itself. It is therefore best for Hong Kong to try to solve all of its own domestic problems internally insofar as possible, without having to bring them to the attention of the Central Government.

4. The View from the Rest of the World

As expected, Hong Kong did not get anything more than a pat on the back from the so-called foreign "friends" who encouraged the pan-democrats in their obstruction of political reform. These "friends" will also be the last to lend a helping hand if the economy of Hong Kong ever falters. However, concern by foreign investors about the possibility of interruption of their continuing operations in Hong Kong will come to the fore, similar to the way in which the earthquakes in Japan and Taiwan caused their customers to think about second-sourcing, to think about the geographical diversification of suppliers and service providers.

For a potential foreign investor considering Hong Kong as a possible investment destination, there will be doubts about our ability to manage our own affairs, to resolve our own problems, and to act in our own long-term best interests. Investors around the world are used to dealing with other people who act in their own self-interest, even those who act solely in their own self-interest, but will be at a loss dealing with people who do not and cannot act in their own manifest self-interest. Such people will be perceived to be irrational and unpredictable and best to be avoided.

Questions will also arise as to whether Hong Kong will continue to be able to play the role of a coordinator/intermediary in the economic exchanges between the Mainland and the rest of the world, especially if the relations between Hong Kong and the Mainland turn sour. Will the Hong Kong SAR Government, plagued by continuing political gridlock, be up to promoting this role? Will Hong Kong enterprises and entrepreneurs continue to be viewed as worthy of trust on the Mainland? Would collaboration with a Hong Kong enterprise or entrepreneur in pursuit of Mainland business be a net plus or a net minus for a foreign investor planning to invest on the Mainland? Doubts and questions such as these will over time contribute to the gradual marginalisation of the economy of Hong Kong.

It is not a coincidence that the consul generals of almost all major countries in Hong Kong have supported the passage of the political reform package. They realise the importance of political reform to the future of Hong Kong. They also understand how Hong Kong can be most useful to the businesses and investors from their respective countries in the future. Hong Kong must therefore make a real effort, not only by words, but also by deeds, to reassure our foreign friends that Hong Kong is still alive and well and a good place to do business and in particular continues to be a good gateway to as well as from the Mainland.

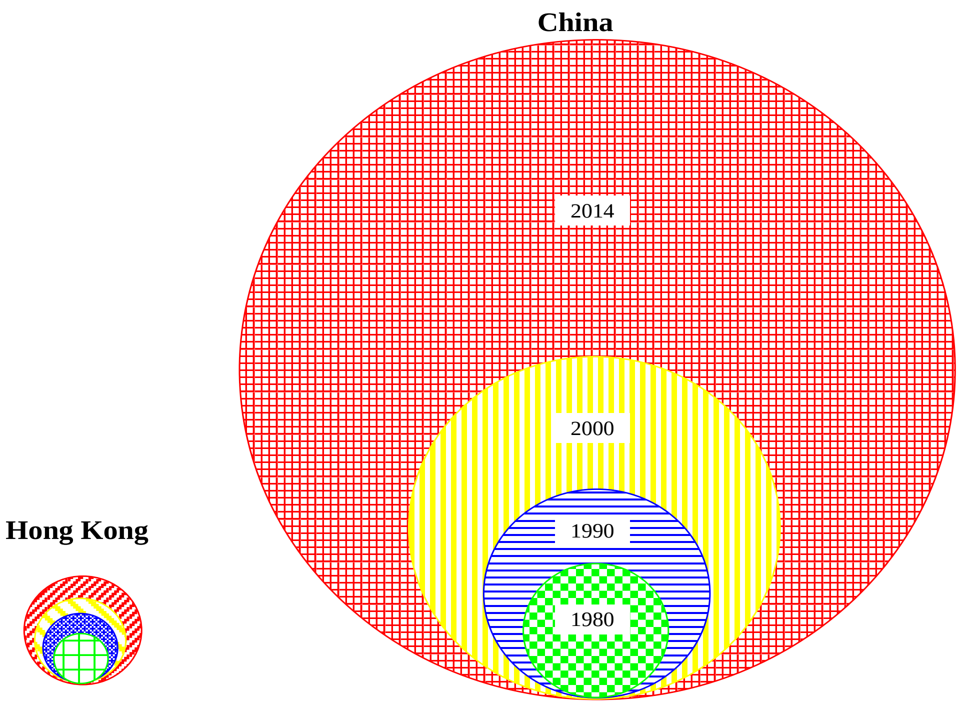
5. The Economic Relationship between Hong Kong and the Mainland—Then and Now

To understand why the failure of the political reform has such negative economic consequences for Hong Kong, we need to take a realistic look at the current state of the Hong Kong economy and the evolution of its relationship with the Mainland economy. Huge changes have occurred since the Mainland began its economic reform and opened to the world in 1978. The Mainland economy has made tremendous progress. It is currently the fastest growing economy in the world—averaging 9.7% per annum over the past 37 years. Even though it has begun to slow down, it is still expected to achieve an average annual rate of growth of around 7%. In contrast, the rate of growth of the real GDP of Hong Kong was 3.1% in 2013 and 2.5% in 2014, slowing to 2.1% in the first quarter of 2015 but rising to 2.8% in the second quarter on a year-over-year basis. The Hong Kong SAR Government has forecast a range of 1%–3% per annum for the rate of growth of the Hong Kong real GDP in

2015.[2] This range is likely to apply to the future rates of growth of the real GDP of Hong Kong in the medium term as well.

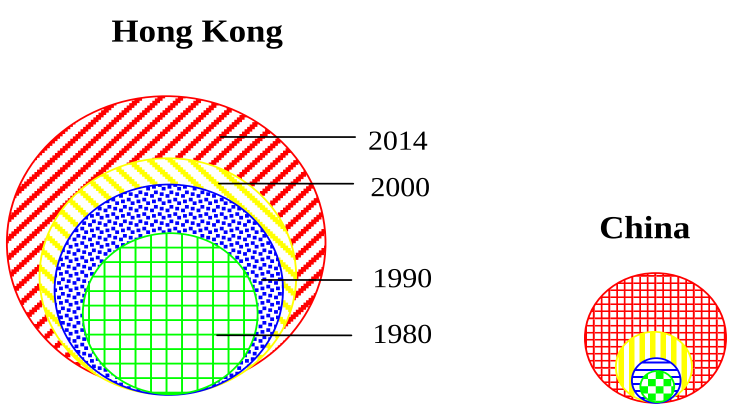
In 1980, the real GDP of Hong Kong was as large as one-seventh of that of the Mainland economy. In 2014, it was not quite 2.8 percent (USUS290 billion versus US$10.4 trillion). In 1980, real GDP per capita of Hong Kong was 28 times that of the Mainland. In 2014, the real GDP per capita of Hong Kong was still ahead, but only by a little more than five times (US$39,986 versus US$7,604). (See Charts 1 and 2.)

Chart 1: Comparison of the Real GDPs of Mainland and Hong Kong (2014 US$)



[2] Both the Asian Development Bank and the International Monetary Fund have forecast a rate of growth of 2.8% for Hong Kong in 2015 and slightly higher rates in 2016.

Chart 2: Comparison of the Real GDP per Capita of Mainland and Hong Kong (2014 US$)



The bulk of Mainland's international trade, including both exports and imports, used to be trans-shipped through Hong Kong between 1978 and 2000. However, since the Mainland acceded to the World Trade Organization (WTO) in 2001, direct Mainland international trade has grown rapidly, and total Mainland trade is now approximately four times as large as Hong Kong's.[3] (See Chart 3.) The Mainland has become the most important trading partner of Hong Kong. It is the most important destination for Hong Kong exports as well as the most important origin of Hong Kong imports, accounting for respectively 52.9% and 48.2% in 2014[4]. (See Charts 4 and 5.) The water that Hong Kong uses and the bulk of the food that Hong Kong eats come from the Mainland. Mainland direct investment now constitutes almost 50% of all foreign direct investment (FDI) into Hong Kong.

[3] However, Chinese international trade measured in U.S. Dollars has not been growing recently because of the appreciation of the Renminbi and because of the significant declines in the prices of oil and other natural resources which constitute the bulk of Chinese imports. In quantity rather than value terms, Chinese imports have continued to grow.
[4] Data are from Table 057 and Table 061 of "Merchandise Trade" from Census and Statistics Department.

Chart 3: Comparison of the Total International Trade of the Mainland and Hong Kong

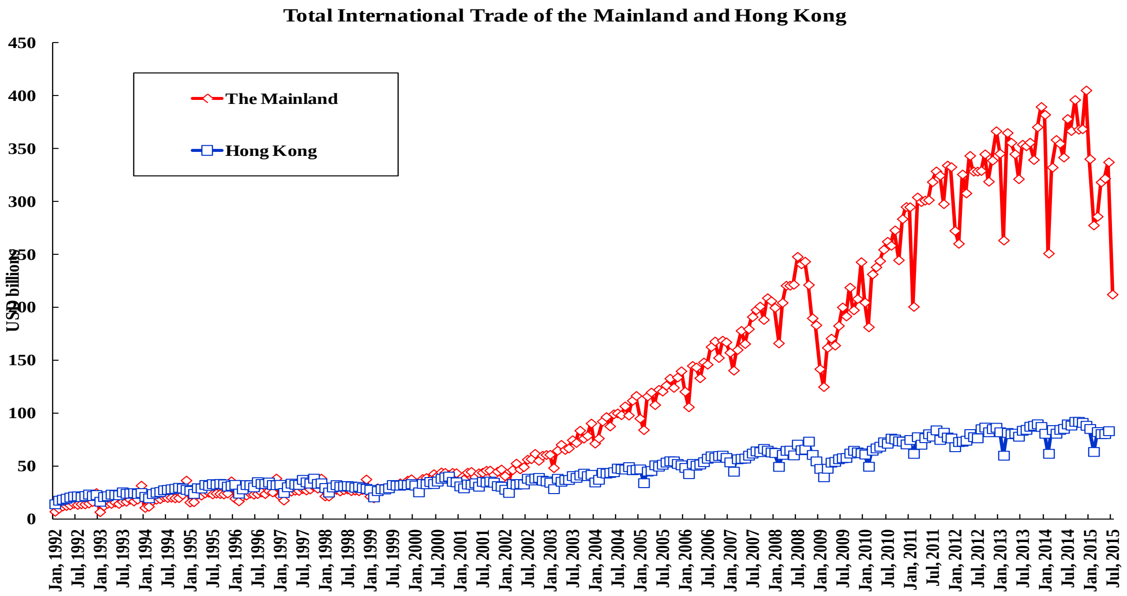


Chart 4: Hong Kong Exports to the Mainland as a Percent of Total Hong Kong Exports

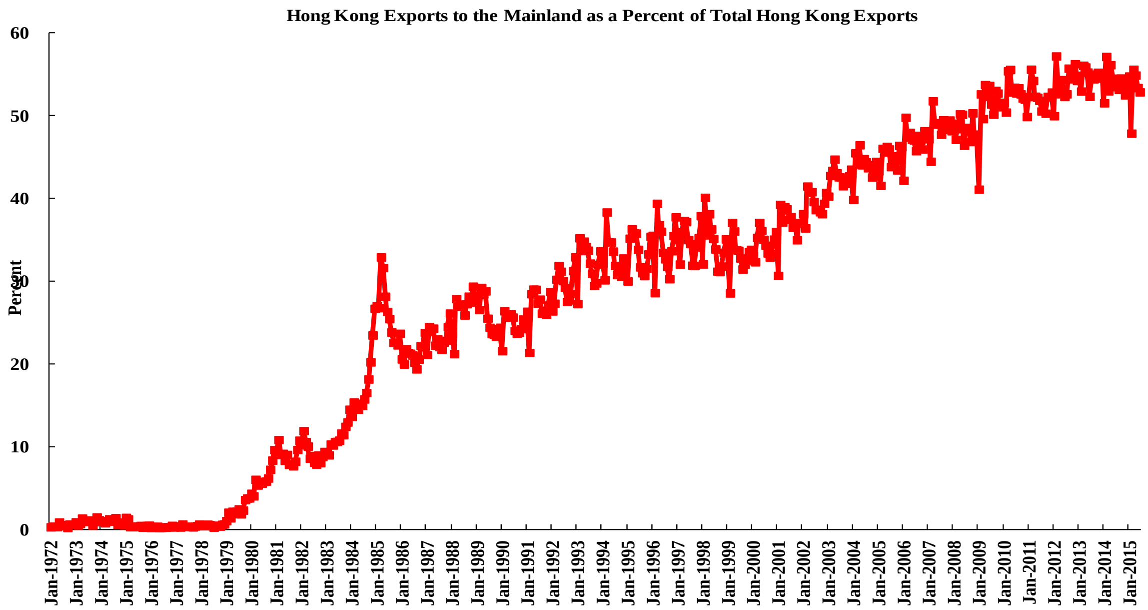
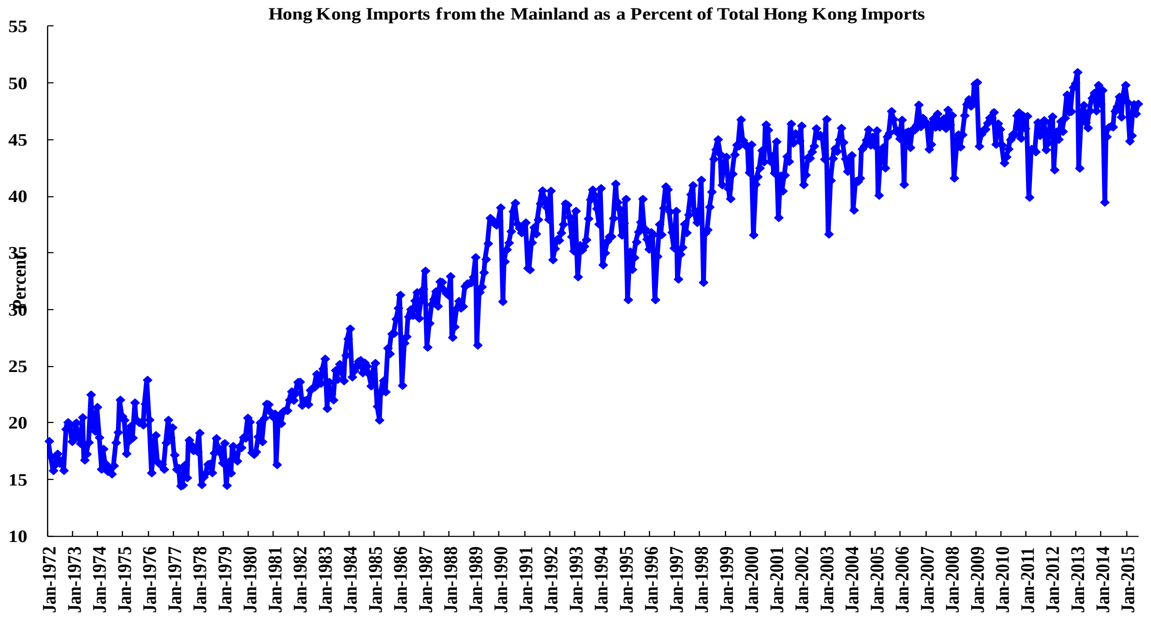


Chart 5: Hong Kong Imports from the Mainland as a Percent of Total Hong Kong Imports



We pride ourselves to be an international financial centre, ranking just after New York and London. However, our ability to continue as a major international financial centre depends very much on the Mainland. Even though the present-day stock exchanges in Shanghai and Shenzhen were established only in the early 1990s, much later than the Hong Kong Stock Exchange, which dates back to 1891, their combined market capitalisation at year-end 2014 was already almost twice as large as that of the Hong Kong Stock Exchange[5]. (See Chart 6.) The current market capitalisation of the Mainland Chinese stock exchanges is the second largest in the world, after the U.S. Despite recent setbacks in the Mainland stock markets, the prospect is that the gap between the Chinese and Hong Kong stock markets will become even bigger over time because of the enormously greater aggregate wealth and hence buying power of the existing and potential Mainland investors. Moreover, Mainland enterprises now constitute more than 50 percent of the Hong Kong Stock Exchange by market capitalisation, and they are by far the largest listed firms. (See Chart 7.)

[5] Data on market capitalisation have been collected from the World Federation of Exchanges.

Chart 6: Comparison of Market Capitalisation of Mainland and Hong Kong Stock Exchanges

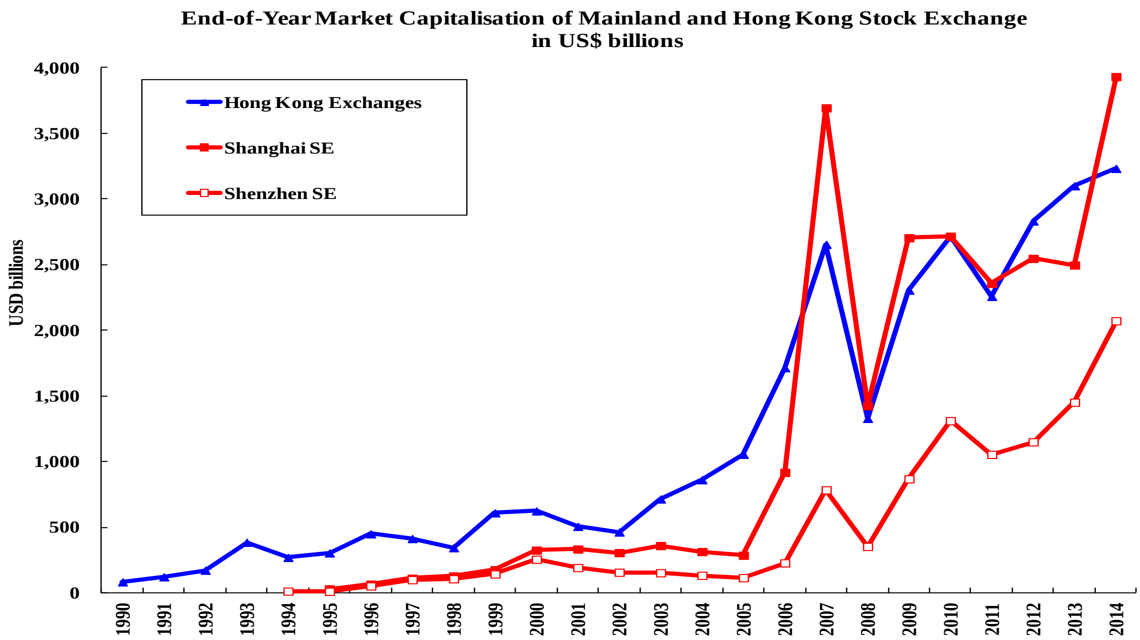
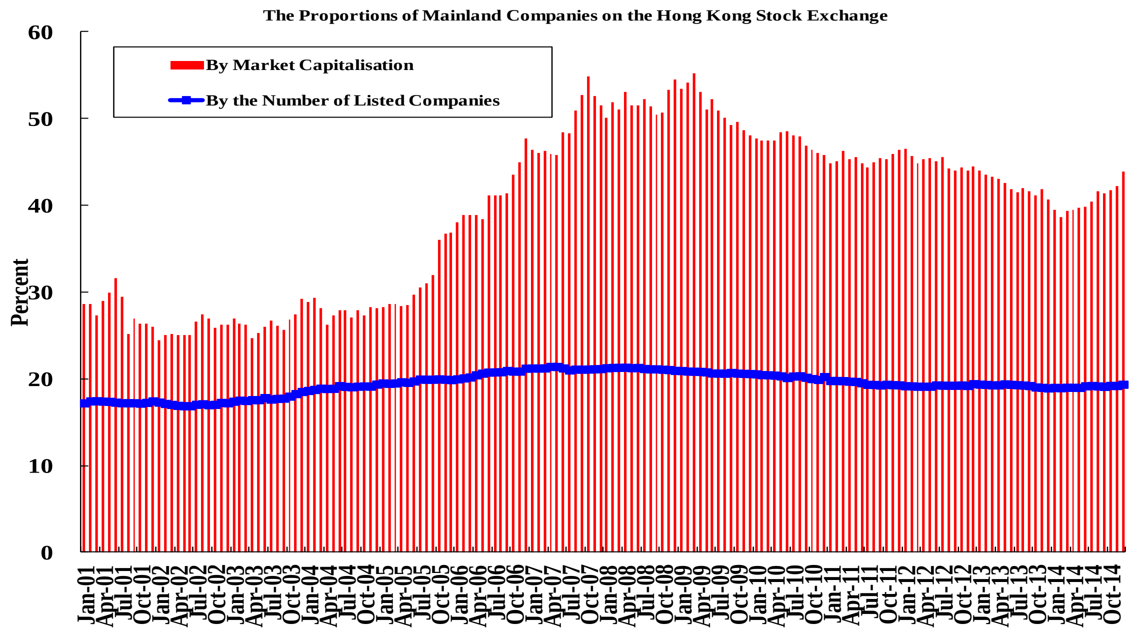
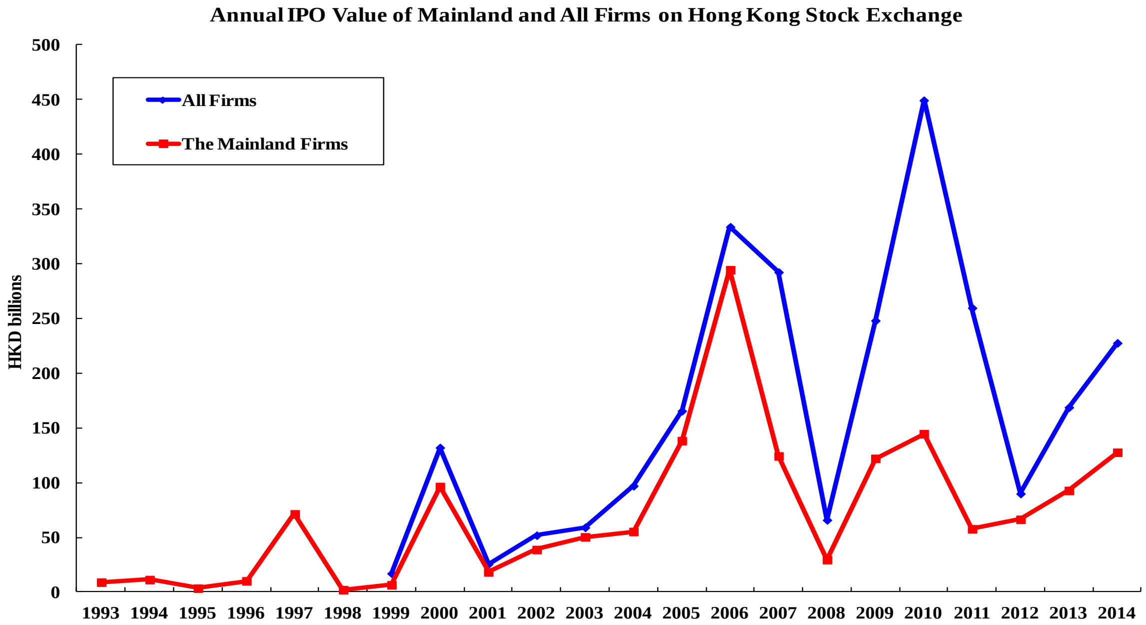


Chart 7: Year-End Market Capitalisation of Mainland and All Firms Listed on the Hong Kong Stock Exchange



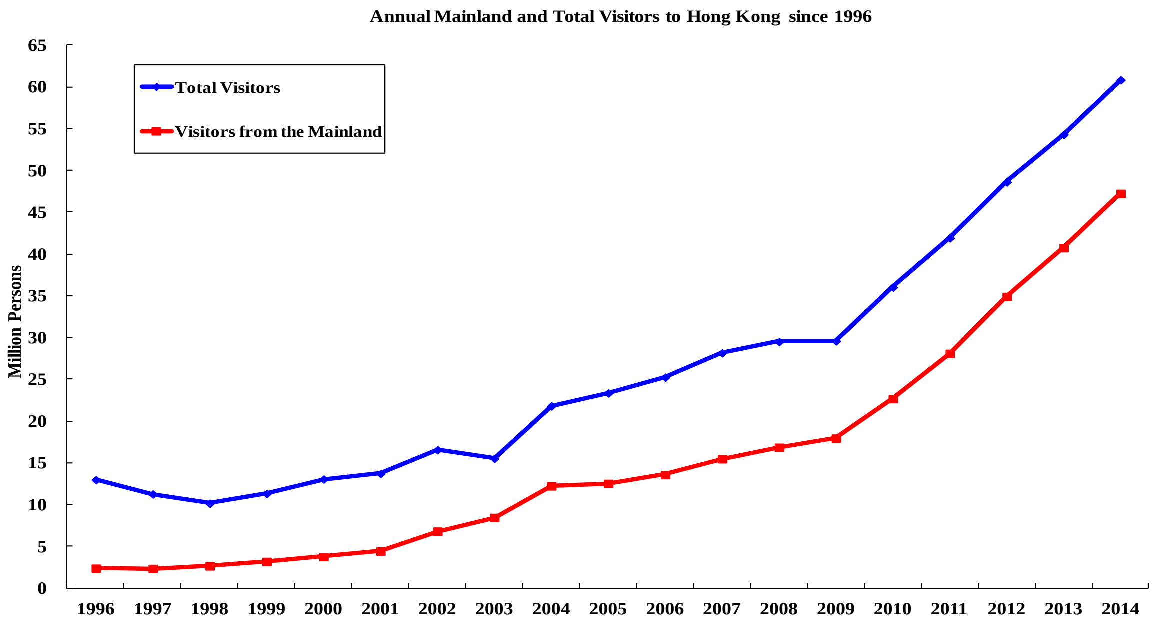
For the longest time, the Hong Kong Stock Exchange has been the primary stock market for Mainland enterprises to have their “initial public offerings (IPOs)”, because of its perceived better supervision and regulation and hence access to foreign investors and because of the need for foreign exchange on the part of the Mainland enterprises. (See Chart 8.) However, this situation has begun to change, as the Mainland becomes an increasingly important source of investment funds itself, and because the need of the Mainland and its enterprises has shifted from foreign exchange to Renminbi. The Shanghai-Hong Kong Stock Connect and the potential Shenzhen-Hong Kong Stock Connect have the potential of increasing the demand on the Hong Kong Stock Exchange. And Hong Kong will benefit from the temporary suspension of IPOs on the Mainland stock exchanges. However, the fundamentals still indicate that Shanghai will ultimately become a more preferred place for Mainland enterprises to raise capital than Hong Kong.

Chart 8: Annual IPO Value of Mainland and All Firms on the Hong Kong Stock Exchange



The Mainland has also become the most important source of visitors to Hong Kong, especially since the introduction of the “Individual Visit Scheme” in 2003 at the request of the Hong Kong SAR Government. (See Chart 9.) Mainland visitors constituted 77.7% of all visitors to Hong Kong in 2014. The total number of visitors from the Mainland to Hong Kong is currently running at the rate of approximately 50 million a year, not including day visitors. These visitors generate demands for hotels, restaurants, retail, and transportation and through these demands create many job opportunities that cannot be moved away from Hong Kong. The “Individual Visit Scheme” has been instrumental in lowering the unemployment rate of Hong Kong down to its recent low of 3.2%.[6] Unfortunately, for various reasons, the number of Mainland visitors to Hong Kong appears to have peaked and is likely to decline gradually in the future.

Chart 9: Annual Mainland and Total Visitors to Hong Kong since 1996



Thus, the economy of Hong Kong today is very much dependent on the Mainland economy. This has not always been the case. Hong Kong was effectively the only gateway to and from the Mainland for international trade and direct investment when China began its economic reform and opened to the world in 1978. Hong Kong investors were the first to invest in the Mainland then. The light manufacturers in Hong Kong were given a second wind from the economic reform and opening of the Mainland, making use of the abundant labour and inexpensive land on the Mainland. Hong Kong and its entrepreneurs were indispensable for the success of the economic reform and open-door policy on the Mainland, and in Guangdong and Shenzhen in particular. However, the direction of dependence has reversed with the highly successful development of the Mainland economy. Today, Hong Kong is no longer indispensable to the Mainland economy. Nor is direct investment from

[6] However, it is believed that this would be as low as it would become, and that the unemployment rate is expected to rise gradually over the next several quarters.

Hong Kong that important any more—even total foreign direct investment from all sources constitutes only a very small and quantitatively unimportant percentage of total gross domestic investment on the Mainland (less than 3% in 2014).

The fate of the Hong Kong economy is now inextricably intertwined with and dependent on that of the Mainland. And the Mainland has thus far been a consistent and unwavering supporter of the Hong Kong economy, enabling Hong Kong to survive the 1997–1998 East Asian currency crisis, the 2003 "Severe Acute Respiratory Syndrome (SARS)" crisis, the 2007–2009 global financial crisis, and the European sovereign debt crisis. The Mainland has always tried to be supportive of the economic well-being of the people of Hong Kong: from the sale of water from the East River (Dong Jiang), to delaying the Shanghai Disneyland project and the international board of the Shanghai Stock Exchange, to the launch of the "Individual Visit Scheme", the establishment of the first offshore Renminbi centre, and now the Shanghai-Hong Kong and the Shenzhen-Hong Kong Stock Connects. The Hong Kong economy benefits from being part of China, but it pays no tax of any kind to the Central Government. It does not even have to pay for the Chinese garrison in Hong Kong, as it had to do for the British garrison prior to 1997.

Looking ahead, the Mainland economy is expected to grow at an average annual rate of around 7 percent over the next five to ten years, between two and three times higher than the likely average annual rate of growth of the Hong Kong economy during the same period. The Mainland economy will become even more critically important to the Hong Kong economy. If the Mainland economy prospers, the Hong Kong economy will prosper. If the Mainland economy slows, the Hong Kong economy will slow. The challenge for Hong Kong is how to take full advantage of the growth of the Mainland economy to advance the economic well-being of its own people in Hong Kong.

6. The Hong Kong Economy at a Turning Point

The world economy today is very different from what it was ten years ago. The world has changed, with the developed economies growing much more slowly and world trade as a whole growing at its lowest rate in decades. The Mainland has changed—and its economy is in the process of adjusting to a "new normal"—a lower rate of growth, more environmentally conscious, less export-oriented, and more service-sector focused. The rate of growth of the Chinese economy has slowed down to around 7% from double-digit rates, with even greater declines in the rates of growth of its exports and imports. Light manufacturing has become less and less competitive on the Mainland because of the rising domestic wage rates and the appreciating Renminbi. The global supply chains are beginning to migrate away from the Mainland and Hong Kong. The Hong Kong economy cannot afford "business as usual". It must try to find a new role to play in the transformed Chinese and world economies.

As we all know, Hong Kong has no natural resources. Its geographical location has been and still is one of its most important comparative advantages. Before 1949, Shanghai was much more prosperous than Hong Kong. Hong Kong has played an indispensable role in the successful rise of the Chinese economy since 1978. However, now that the Chinese economy itself is in transition to a "new normal", how should the Hong Kong economy adjust to its own "new normal"? Hong Kong needs to try to make itself indispensable once again, based on new comparative advantages that it creates, and not only on monopolies granted to Hong Kong by the Central Government. It is up to Hong Kong to create value, to align the interests of both Hong Kong and the Mainland, and to pursue strategies that are potentially win-win and not just only to Hong Kong's advantage.

Hong Kong will within the next five to ten years lose its advantage of the Hong Kong Dollar over the Renminbi as a fully convertible currency—the Renminbi is certain to become capital account convertible during this period (perhaps with some residual controls over short-term capital inflows); and when it does, it will substantially displace and replace the Hong Kong Dollar, both as a medium of exchange and as a store of value, even as the Hong Kong Dollar remains the legal tender as provided in the Basic Law. Paradoxically, the rising acceptance and use of the Renminbi, including its eventual full convertibility, can be a great opportunity for Hong Kong as a centre not only for clearing and settling Renminbi transactions but also for Renminbi-denominated financing. That is why the ability to conduct domestic and international transactions and hence to clear and settle in Renminbi is so important for Hong Kong.

However, with the Renminbi fully convertible, the justification for Mainland enterprises listing on the Hong Kong Stock Exchange and for foreign investors purchasing securities issued by Mainland enterprises here will be significantly weakened, especially given that most Mainland enterprises need Renminbi rather than foreign exchange for their domestic expansion in China. The Mainland, with foreign exchange reserves in excess of US$3.6 trillion, does not need any more inflow of foreign exchange. Thus, Hong Kong must try to make its stock exchange serve more than just the Mainland enterprises and seek enterprises from other countries and regions to raise capital in Hong Kong.

Hong Kong will also lose much of its advantage of a free trade port/low tariff on account of Chinese accession to the WTO and its continuing reduction of its tariffs as well as non-tariff trade barriers. In any case, growth of Chinese exports and imports will slow as the Mainland economy further reorients itself to its own huge domestic market. Hong Kong will therefore have to rely on other activities than being a conduit for Chinese international trade. Related to this is the gradual decline of Hong Kong’s attractiveness as a shopping centre to Mainland and other tourists on account of the tariff reductions and increased availability of imported goods on the Mainland. The perceived unfriendliness of Hong Kong people to Mainland tourists is also a factor. Tourist arrivals from the Mainland have already peaked. Hong Kong retail sales have also begun to decline, leading to significant reductions in retail rents.

Today, Hong Kong’s most important comparative advantage is probably its human capital. But human capital, like physical capital, also depreciates unless it is continuously replenished and upgraded. Moreover, it is not just how much human capital there is but how much there is relative to the current and potential competition. The Mainland will also catch up quickly on Hong Kong’s comparative advantage in human capital as its economy continues to be globalised, its institutions of higher learning continue to improve, and the use of the English language becomes more and more widespread, at least in its major cities. Moreover, one needs to bear in mind that in this age of globalisation, any job that can be moved away will be moved away. Hong Kong must try to create jobs that can and will stay in Hong Kong.

Going forward, the Hong Kong economy needs a new plan, a new strategy. Hong Kong also needs to transition to its own "new normal". Such a plan can only be drawn up, and such a strategy can only be implemented, by an effective government with a mandate from the public, by a government that can fashion a broad consensus and mobilise the people into action. This will require the close cooperation between the executive and the legislative branches of the Hong Kong Government.

7. Possible New Initiatives for Hong Kong

However, the Hong Kong economy still has significant potential for future growth. Geographically, Hong Kong cannot be better located, right next to the Mainland, a huge market and a huge source of savings, and right at the junction between Mainland China and the huge emerging ASEAN region, also a huge market with rising demands for capital investments. Hong Kong should take full advantage of the opportunities actively.

First, Hong Kong can try to develop into an innovation hub for the East Asian region, specialising in the creation of intangible capital. This is the Silicon Valley/Route 128 (a freeway surrounding the Greater Boston area) strategy. This will involve a three-pronged complementary approach: increase investment in human capital, specifically tertiary education; increase investment in research and development (R&D); and create the ecology and environment that can nurture venture capital. Hong Kong must try to increase its tertiary education enrolment rate substantially from its current 20 percent and attract the best students from the entire East Asian region to study in Hong Kong. Hong Kong must try to increase its investment in R&D—which is indispensable for innovation. Currently, Hong Kong invests only 0.7% of its GDP in R&D, compared to 2.2% for the Mainland as a whole, over 4% for South Korea, and 7% for Shenzhen. The Hong Kong SAR Government does not have to finance all of this investment, but it should enable and facilitate the private and non-profit sectors to do so through its land and tax policies. Similarly, it should also encourage the development of Hong Kong as the venture capital centre of the East Asian region by providing the appropriate incentives and facilitating the operation of private equity firms and the listing of successful start-up firms on Hong Kong stock exchanges. Note that ultimately, human capital, R&D capital, and venture capital combined can create great value for the Hong Kong economy.

Second, Hong Kong can try to pursue a serious New-Lon-Kong[7] strategy by establishing itself as a securities (both bonds and stocks) market for the entire East Asian region, so that East Asian governments and firms can all come to Hong Kong to raise capital, and investors worldwide only need to come to Hong Kong to invest in all of the East Asian economies, in bonds, stocks, and private equity (including venture capital). This strategy is possible but requires a proactive government with the ability to plan long-term and to get everyone in Hong Kong working together to make it happen. This will also require the support of the Central Government, not only because the Mainland investors will be supplying much of the investment funds, but also because the Central Government can also help to persuade the other East Asian economies to come along. Hong Kong, by becoming an East Asian region-wide securities market, will achieve a suitable division of labour with Shanghai, and the two cities can cooperate rather than compete. Moreover, once established as the home of the East Asian region-wide securities market, it will be hard for Hong Kong to be displaced or replaced. The establishment of an East Asian region-wide securities market in Hong Kong also fits it with the "One Belt, One Road" and the Asian Infrastructure Investment Bank (AIIB) strategies of the Central Government.

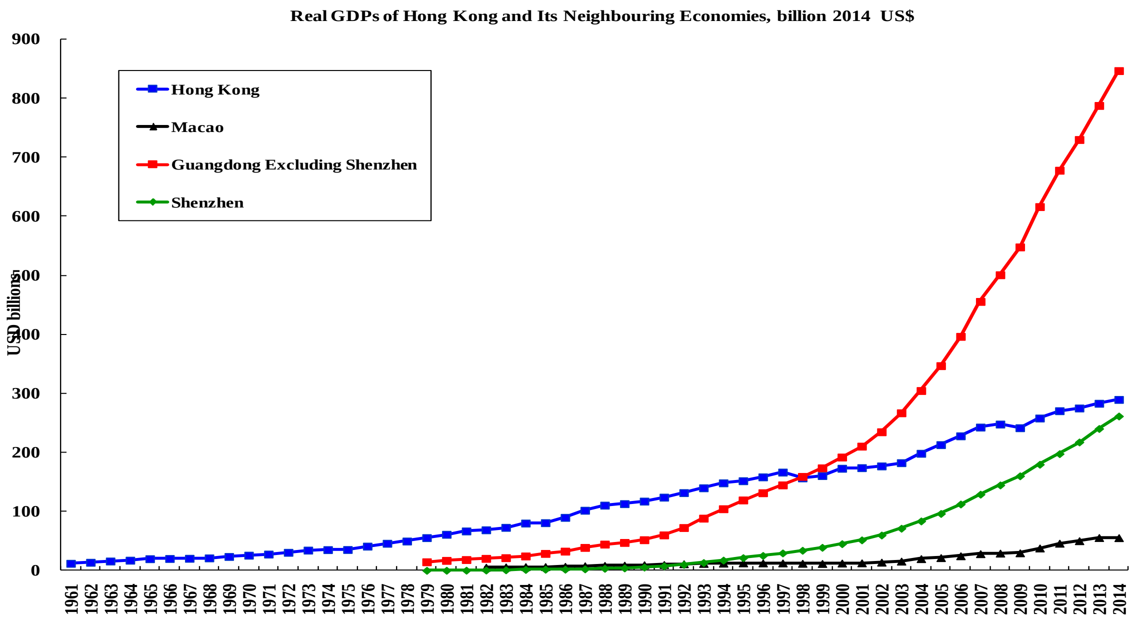
Third, Hong Kong can also try to become the reinsurance centre for the East Asian region. As the demand for property, casualty, and life insurance rises rapidly in the East Asian region, so is the demand for reinsurance. Insurance is a scale business, and East Asia now has the scale. Thus, there is no reason to continue to let most of the reinsurance business go to London and Zurich, as it does now. Hong Kong, because of its complete freedom of capital flows, its tradition of rule of law and efficient and fair judicial system, and its supply of highly seasoned professional manpower, is an ideal place to become the East Asian reinsurance centre. In addition, the Mainland is potentially a major source of risk capital. A significant proportion of the reinsurance business can thus stay in Hong Kong. Moreover, once Hong Kong can be established as a reinsurance centre, insurance companies worldwide will also come to Hong Kong for part of their reinsurance so as to diversify their risks.

Fourth, Hong Kong can also try a "Serve Thy Neighbour" strategy. The Province of Guangdong, including Shenzhen, had a population of 107.24 million in 2014, and is the most populous province on the Mainland. If the populations of Hong Kong (7.2348 million) and Macau (0.6362 million) are added to that of Guangdong, the total population of the combined

[7] New York-London-Hong Kong

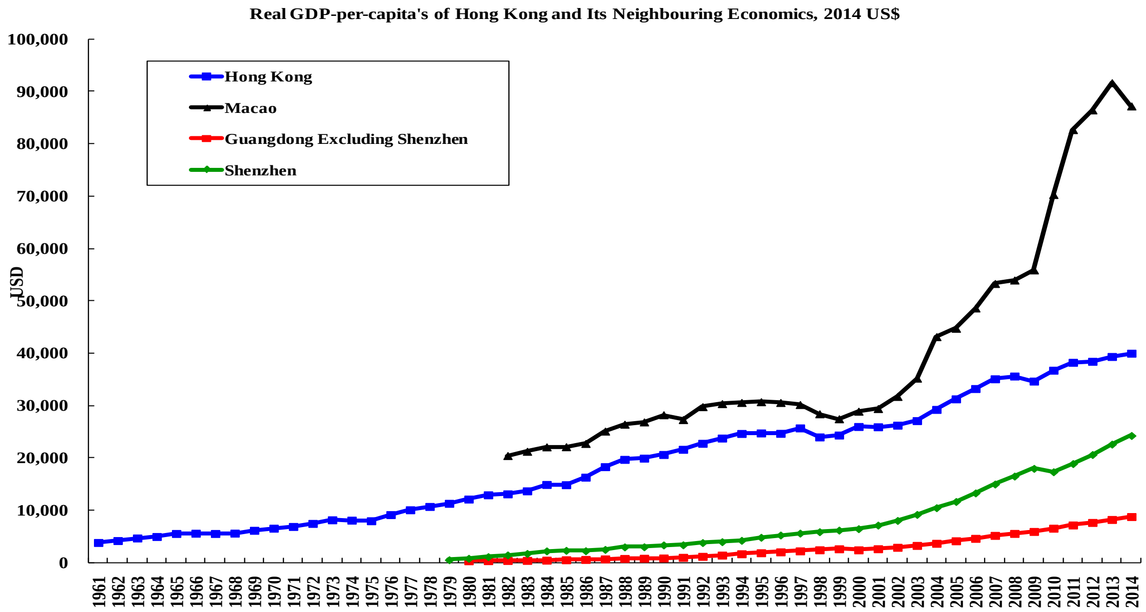
region would become 115.11 million, more than that of Germany (81.0836 million[8]) and almost equal to that of Japan (126.91 million[9]). The GDP of the Province of Guangdong, including Shenzhen, was US$1,108 billion in 2014, 3.8 times the Hong Kong GDP of US$290 billion. It is also the province with the largest GDP on the Mainland, constituting 11% of the Mainland GDP. The GDP of Macau was US$55.48 billion. The GDP of Guangdong, Hong Kong, and Macau combined was US$1.453 trillion in 2014, almost 14% of the Mainland GDP. (See Chart 10.) The GDP per capita of the Province of Guangdong in 2014 was US$10,331, compared to Hong Kong's US$39,986 and Macau's US$87,208. The GDP per capita of the combined region was US$12,622[10]. (See Chart 11.) Hong Kong should capitalise on its geographical proximity to cooperate closely with Guangdong as well as other provinces and autonomous regions in southern China. Hong Kong can compete effectively with Shanghai as an international financial centre only if Hong Kong becomes more closely integrated economically with Guangdong (including Shenzhen), which is its natural hinterland. Guangdong, Hong Kong, and Macau together constitute a region with the potential of eventually surpassing Japan to become the third largest economy in the world.

Chart 10: Real GDPs of Hong Kong and Its Neighbouring Economies, billion 2014 US$



[8] German Federal Statistical Office
[9] Statistics Bureau of Japan
[10] Data on Guangdong, Hong Kong, Macau, and Shenzhen are from their respective government statistical agencies.

Chart 11: Real GDP per Capita of Hong Kong and Its Neighbouring Economies, 2014 US$



Guangdong has a diversified industrial base—with light, heavy, and high-technology industries—but is relatively weak in the higher education and R&D sectors. Hong Kong has little or no industry, especially high-technology industry, but has world-class research universities to supply scientific and technological manpower and R&D. There is therefore room for specialisation and division of labour between Hong Kong and Guangdong, which can be win-win for all. Moreover, if Hong Kong were to become an international financial centre for China, it must begin by first providing the enterprises and households in its immediate hinterland with the best financial services possible, so that they do not need to go to Shanghai or develop their own international financial centre(s). If Hong Kong cannot even hold on to these potential customers, it can never become a financial centre for China.

Fifth, Hong Kong can also try the "Super-Coordinator" strategy. Hong Kong can be a springboard for outbound Mainland Chinese direct investment because of its international network and highly developed professional service sector. It can provide the necessary accounting, financial, legal, logistic, and other services and the infrastructural support for Mainland enterprises investing abroad (through their Hong Kong subsidiaries).

However, the implementation of any or all of these strategies requires the leadership of and planning by the Hong Kong SAR Government, as well as the strong support of the Central Government. It is not possible for Hong Kong to succeed by going alone.

8. Concluding Remarks

While it is not possible to put a figure on the size of the impact on the GDP of Hong Kong as a result of the negative economic consequences, it is clear that continuing economic progress in Hong Kong will be stalled. Can Hong Kong launch these new economic initiatives by itself alone? The answer is clearly no. Support by the Central Government is critical for the success of these new initiatives. As the Mainland economy continues to grow much faster than Hong Kong, the relative bargaining power of Hong Kong can only decline over time. Moreover, an increasingly wealthier and more confident and most likely more populist China is unlikely to be kinder to Hong Kong. It is therefore time to mend fences, to try to identify and implement win-win strategies in our relations with the Mainland.

Moreover, the people of Hong Kong should put aside their differences, shelve the unproductive disputes among themselves, and try to solve the many urgent livelihood problems. If the two sides of the Taiwan Strait can agree on a moratorium on inducing foreign countries to switch their recognition from one side to the other, why can't our legislators in the Legislative Council cooperate to focus on the people's business at hand? Being obstructionist does not do anyone any good, even to the obstructionists themselves, but is definitely detrimental to the best interests of the people of Hong Kong. The people of Hong Kong must move forward together!