Hong Kong and Macau — Two Worlds but One Destiny

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at

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Ladies and Gentlemen, my dear friends,

We are gathered here in beautiful, peaceful, and prosperous Macau, in a conference initially scheduled to take place in Hong Kong. All places which have survived and prospered have been the beneficiaries of history. The critical question we have to explore today is whether history will continue to be beneficial to both these places.

Macau is a city reverberating with history. Its history as a City is nearly three centuries longer than that of Hong Kong. It started as the first Western foreign trading port in China. Because of this unique position, it became an important trading post for the Portuguese and a place from where modern Western ideas were first introduced into China through Roman Catholic Missionaries, principally the Jesuits. Macau's importance in trade was not lost in the eyes of its then contending Western power, the Dutch. In 1622, Macau repelled the Fleet of the Dutch East Indies Company, with cannons forged with new technology brought in by the Jesuits. As the Canton trading system flourished, Macau became a vital way station for foreign vessels on their way to Canton. But all this changed in 1841, after the First Opium War when Hong Kong was ceded by China to the British and Hong Kong became the way station. Macau then quickly reinvented itself by legalising gambling in 1849. Macau later became a backwater and would have been a just a footnote to history had it not been that history itself took another fateful turn at the beginning of the 2nd World War.

The Japanese occupation of Hong Kong on Christmas Day 1941 brought to Macau, not only refugees but also vast flight capital. After the 2nd World War, this connection with Hong Kong literally turned to gold. After the Bretton Woods Agreement, private sales of gold 99.99 fineness were banned, such sales being legal only between IMF Member Central Banks. Macau (because Portugal was not a signatory to the IMF Articles of Agreement) became the centre for import, reprocessing and then re-export of gold into lesser fineness (99.45 fineness) so that private sales and trading of gold may continue in Hong Kong and Southeast Asia. In 1962, the economy of Macau went up another notch by the granting the gambling franchise to a consortium (STDM) which revitalised gambling by importing Monte Carlo style gaming and revamped transportation from HK to Macau. After the return of Macau to the PRC, the monopoly was broken up and granted to some eight international franchisees, and Macau is what it is today, the Las Vegas of the Far East! Gambling taxes now command slightly over 80% of Macau's tax income. Macau has the world's highest per capita GDP.

History also took another fateful turn for Hong Kong after the Second World War. Hong Kong became a magnet for people from China escaping the ravages of the civil war and after the founding of the People's Republic, from the ravages of the drastic changes taking place when large numbers of people were displaced from their land, wealth or positions. Hong Kong's population grew from 600,000 at the end of the Second World War, quickly to 1.8 million by the end of 1947, 2.5 million in 1956, 4.25 million in 1974, 5 million in 1980, 6.5 million in 1997 and 7.6 Million today. This explosion of population enabled Hong Kong to industrialize, capitalising from the human resources and capital flowing from China and of course, the inventions of the 2nd Industrial Revolution. Hong Kong became first as a centre for textiles, and then a powerhouse for light industry, enabling it to become one of the four dragons of Asia.

Then, in the early 1980s, history took another turn. China began to open up to the world. This event coincided with the age of automation, often cited as the 3rd Industrial Revolution, and Hong Kong's industrialists began to take advantage of this as well as the less expensive workforce and a plentiful supply of land in the Guangdong Province. Hong Kong then began its transformation into a service economy and in the process, played an important part in the modernisation of the Chinese economy by starting the movement in China for export-driven high volume manufacturing and playing the role of the most important conduit for foreign capital into China.

Hong Kong's role as China's most important importer of capital did not come about by chance. Hong Kong played a critical role as the most important foreign exchange conduit to China after the war in the Korean Peninsula, when China was closed to the financial markets of the Western World. As a result, Hong Kong's banking system became closely linked with that of China from the 1950s onwards. From the early 1980s, Hong Kong entrepreneurs began the movement of foreign direct investment into China. From the early 1990s, with the listing of H shares, Hong Kong became the most important market for portfolio investment into China.

We are now in the cusp of the 4th Industrial Revolution, the age of information technology, 5G communications, and the Internet of Things. Before we ponder Hong Kong's future, let us first take a look at the probable future for China.

China is known as the factory of the world. But as automation continues to improve productivity in manufacturing, employment opportunities have become fewer in the traditional industries, though new opportunities are opening up in the high technology sectors. Recent research shows that in addition to improvements in productivity, there has also been innovation. This trend has resulted in China climbing the export value chain. Only 13% of the manufactured goods exported from China today need to have imported intermediate components. In other words, 87% of the goods exported from China are totally produced within China, with no need for imported intermediate goods, with value-added to the raw materials completely implemented within China. China is thus, the world's most self-sufficient manufacturing economy, and a manufacturing force in its own right and no longer, just a processing or assembly economy. But the most tantalizing opportunities lie in the bridges being built between the manufacturing and service sectors of the economy.

The service sector in China takes up about 50% of the GDP, but it is growing strongly,

particularly in coastal cities such as Shenzhen, where this percentage is coming close to 60%. A potent force behind the growth of the service industry is that China has embraced the 4th Industrial Revolution, the age of information technology and artificial intelligence, much earlier than most economies. The financial system is now mostly linked to the cell phone, and the People's Bank of China is likely to start digital currency issue within the next two years. As of September 2019, there are 1.6 billion registered cell phone users in China, and by the end of this year, China expects to have over 100 Million 5G users and in 2025, over 600 million 5G (and possibly 5G+) users. People nowadays hardly use cash in China; nearly all payments are made through cell phones. 95% of the daily transactions of all major Chinese banks come from cell phone users. A Chinese person can access most of what he needs with his cell phone, literally from the cradle to the grave. The same is happening with manufacturing, commerce, and agriculture. China has the largest group of artificial intelligence and big data developers in the world. This group is continuously being refreshed by an annual addition of 5 million+ STEM graduates out of a cohort of 8 million+ higher education (universities and post-secondary technical institutes) graduates each year. The Ministry of Education encourages universities in China to partner in education and research with other universities. China now has the most significant number of cited reviewed scientific research papers in the world.

One cannot expect an economy with a population of 1.4 billion, which has gone through one of the most rapid periods of economic development in history, to be without problems. China's GDP per capita has grown 50 times in 40 years, touching US $10,000 GDP per capita, reaching its goal of a moderately prosperous country this year. It has an unemployment rate of 3.61% in mid-2019, and over 800 million people have been lifted out of poverty (no one in China today is without food or shelter), But, China has built up a national debt of 55% of its GDP by the end of 2019, that is USD 5 Trillion. The rapid economic development has built up a corporate debt of just above 150% of GDP, and the economic downturn has exacerbated this problem. Household Debt is about 53% of GDP by the end of 2019.

The financial system in China has gone through 40 years of development, but it is still mostly debt-driven. Although China has two of the largest stock markets in the world in both market capitalization and turnover, equity financing accounts for less than 20% of overall social financing. There is a tiny securitization market of only RMB 5 Trillion out of a pool of over RMB 140 Trillion in total bank debt. The shadow banking market, which caters mainly to the smaller players in the private sector is collapsing due to lack of regulation and the trade war which has mostly affected the private sector (the private sector accounting for 87% of total external merchandise trade). The laws which regulate the financial system were enacted in the 1990s when the financial system was still in its early stages of development. Although there were a few band-aid amendments over time, they need an overhaul. The judicial system is playing catch-up due to enormous caseloads and difficulties in recruitment. But it is improving with better transparency and technical ability through extensive use of information technology. Governance is also playing catch up again through better transparency and predictability, also through extensive use of information technology.

All of the above problems are capable of a solution. China has a stable and effective government, with a successful track record to date. Its population has one of the world's highest savings rate (about 45% of GDP) and yet are developing into a middle class with the consumption habits of middle-class people everywhere. They are spending on both

domestic and imported goods, and they travel the world. Last year 166 million Chinese tourists left China to travel the world spending US$130 Billion. 143 million tourists came to China and also spent US $130 Billion. Internal tourists spent RMB 5.6 Trillion (equivalent to USD 800 Billion). China has a 99.5% literacy rate in a population of 1.4 Billion. Education expenditure is presently at about 2% GDP, lagging much behind OECD countries (at 4.5% of GDP) and will increase in the coming years. China has some of the best universities in the world. Although its population is shrinking due to an aging demographic, it is no longer pursuing the one-child policy. China is also pursuing a flexible immigration policy for returning ethnic Chinese and others with the necessary qualifications for the continuing development taking place. China has a clear path to growth for the next 30 years, in fact to 2049, the 100th anniversary of the People's Republic, reaping the dividends of the 4th Industrial Revolution.

All of the above developments point to exciting possibilities for China!

All this seems to leave Hong Kong and Macau in the dust. But let me assure you that this is not the case, and will not be the case!

Macau is the only city in China capable of granting gambling franchises. With some 20 locations of great historical interest, it ranks as one of the world's top UNESCO World Heritage Sites. It is also a place where gastronomes go. And of course, it is the Las Vegas of the East! Macau is a place for a great vacation, satisfaction guaranteed! But that is not all! It has links to Portugal and hence Europe and former colonies of Portugal, including Brazil and many African countries. Its population is small, but it is receptive to the employment of people from around the world who have the qualifications to advance its economic development. Soon Macau will develop its stock market for companies in Macau and the Greater Bay Area (a conurbation of 9 cities, at the core of which are Guangzhou, Shenzhen, Macau, and Hong Kong). The stock market will also cater to companies in Portuguese speaking countries who have business interests in Macau and Mainland China. Macau may not have the human resources to pull this off. But there are many people in Mainland China and Hong Kong with the right experience to enable Macau to make a success of this venture. Indeed, far from competing with Hong Kong, Macau's future stock market will be an excellent complement to the capital markets of the Greater Bay Area.

What about Hong Kong? 93% of the GDP of Hong Kong is made up of the service industry, of which 20% is taken up by the Insurance and Financial Sector. It has a service economy with the world's third most important international financial centre with the human resources to boot!

As a founding member of the WTO, Hong Kong preceded China to join the organization as a member in its own right. It is a free port with no trade tariffs, and it is the only place in China where there is no currency restriction. Capital can flow freely in and out of Hong Kong so long as international norms against money-laundering are observed. Hong Kong also has a highly respected legal and financial regulatory system, and one of the best-regulated banking system and securities market in the world. Both the banking system and securities markets serve Mainland China. The Banking System is one of China's most crucial financial window to the world, and thus, play the role of the largest RMB offshore market in the world. Since the founding of the People's Republic, Hong Kong has played the role of international banker to China. With China's likely

development trajectory for the next 20 years, China will continue to need Hong Kong, as its international banker. China will need to keep a highly restricted capital account for the foreseeable future. Hong Kong, with no capital controls, and a currency board that ensures a stable Hong Kong dollar linked to the US Dollar, will continue to a critical buffer for China's financial system with the rest of the world. The Stock Market plays host to a large number of Mainland Chinese companies. It is China's third-largest trading partner and the largest single provider of foreign direct investment into Mainland China. In the last forty years since China's opening to the world, Hong Kong has been the place for financial flows and innovation into and out of China. It will continue to do so for at least the next twenty years, in helping the People's Republic attain its Centennial development goals.

Macau and Hong Kong are cities with different histories and characters, but they both share their future with that of China's. All the evidence indicates that China is destined for a bright future. Hong Kong and Macau are well-positioned to share this same destiny if they should so choose to share it.