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How Hong Kong reinvigorate based on its "three-pronged economy"

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In recent years, the Hong Kong economic structure has undergone major changes due to many internal and external factors, exhibiting a very typical "three-pronged economy" characteristic. At this moment, after experiencing the most severe recession since World War II, analyzing the specific performance, inter-relationship, and impact of the "three-pronged economy" structure will allow us to accurately grasp the pulse of future changes in Hong Kong's economy, and to take effective measures to promote transformation and upgrading. Only in this way can Hong Kong fix its major issues and reinvigorate its economy.

1. "Three-pronged economy": features and influences

The first prong is the traditional sector that has almost stagnated. This sector includes trade, logistics, retail, manufacturing, construction, tourism, other business support services and social services industries, which are mainly the real economy. In terms of factor prices, the added value created by these industries together accounts for about 60% of GDP, which constitutes the main part of Hong Kong's economy. However, due to difficulties in business diversion, transfer or transformation, especially the delay in making breakthroughs in the innovation and technology industries, the overall development is slow and unable to become a driving force for economic growth. In the past five years (that is, during the national "13th Five-Year Plan" period), the average annual growth rate of the Mainland economy was 5.8%, while that of Hong Kong was only 0.2%. The average growth rate of the traditional sector as the mainstay of Hong Kong's economy was negative.

The stagnation of Hong Kong's traditional sector is first attributed to the relative decline of the trade and logistics industries. It is well known that Hong Kong is built up on trade. Trade and logistics have always been the primary economic pillar. At its peak, its added value accounted for 28.5% of GDP and provided 836,000 jobs. However, after the 2008 global financial tsunami, the growth rate of Hong Kong's foreign trade continued to slow down, coupled with the continuous decline in the gross profit margin of re-export trade and the stagnation of offshore trade. By 2019, the share of trade and logistics in GDP dropped sharply to 19.8%, giving the title of the first pillar industry to the financial industry; and the number of employed people dropped to 674,000, a sharp drop of 163,000 from the peak.

Tourism, another important pillar industry, has already peaked and fallen. Although the total number of tourists visiting Hong Kong before the occurrence of social events in 2019 is still increasing, Hong Kong's tourism service export value has been declining after reaching its peak in 2013, and has decreased by 14.3% in 2018, indicating that the tourism industry has indeed not as it seems in recent years. The increase in the number of tourists to Hong Kong cannot cover the sharp drop in the amount of tourists spending, and the contribution of tourism and related industries to the Hong Kong economy has also declined.

The second prong is the ascendant financial sector. Thanks to its own unique advantages and strong support from the country, Hong Kong's financial industry can be described as thriving, independently supporting local economic growth. Although Hong Kong is currently in recession, the financial market is still thriving. The Hang Seng Index broke 30,000 points at the beginning of the year, the strongest market in 12 years was opened on the fifth day of the Lunar New Year, and the bank deposits and loans also set a record high. This opposite trend has not only benefited from the stimulus of the ultra-loose monetary policies in Europe and the United States, but also reflected the global economic contrast of “sunrise in the east and rain in the west”, and let people see the unique advantages, historical opportunities, and huge development potential of Hong Kong as an international financial center.

From the perspective of national accounting, Hong Kong’s financial industry has created an average annual growth of 6.8% in real terms since the beginning of this century, which is twice as fast as GDP growth. Its share of GDP has increased from 12.8% in 2000 to 21.2% in 2019, and the contribution to economic growth reached 30%. In the past five years, Hong Kong’s overall economy has almost stagnated, but the financial industry’s average annual growth rate is still 4.2%, and its contribution to economic growth exceeds 100%. Financial industry is the only core engine of Hong Kong’s economy.

Of course, the actual function and role of a financial center cannot be covered by the above-mentioned national accounting figures. The scale of investment and financing driven by Hong Kong’s financial center ranks among the best in the Asia-Pacific region, and has grown rapidly. The total deposits in the banking system have increased from HK$3.22 trillion at the beginning of this century to HK$14.51 trillion at the end of last year, a sharp increase of 3.5 times in 20 years. The total loans in the banking system have also increased from HK$2.76 trillion to HK$10.5 trillion, a sharp increase of 2.8 times in 20 years. The capital market is even more spectacular. At the end of February this year, the total market value of Hong Kong stocks reached 6.7 trillion US dollars, ranking among the top five in the world. In the past ten years, the value of Hong Kong stocks IPOs has been among the top three in the world in seven years, providing large amounts of funds for Mainland Chinese companies.

It is worth mentioning that Hong Kong’s financial industry can basically operate independently from traditional local economic activities. A major sign is that in the Hong Kong stock market, the market value and trading volume of Chinese listed companies account for more than 80%. The Hong Kong stock market mainly reflects the performance of the Mainland economy, and is no longer a barometer of the Hong Kong economy. Another sign is that 45% of the total loans in the Hong Kong banking system are related to Mainland enterprises. Real estate-related loans, which account for more than 40% of local loans, are mainly affected by the US monetary policy. This is why Hong Kong’s economy has been in deep recession since last year, but the financial market has been relatively stable.

The third prong is the real estate sector under stagflation mode. This sector includes two attributes: one is of the real economy and the other of the virtual bubble, with the virtual bubble as a main attribute. From the perspective of the United Nations SNA, real estate in the real economy, including real estate development, real estate construction, and housing consumption services, can truly bring economic growth. In the 1980s and 1990s, Hong Kong built up 80,000 to 90,000 units each year, driving the rapid development of the real estate sector. By the beginning of this century, the value-added provided by Hong Kong’s real estate sector once accounted for 28% of GDP. Later, with the sharp decline in housing supply, the real contribution of real estate to Hong Kong’s economy also dropped sharply, and its current share of GDP has fallen below 20%. Hong Kong’s economic dilemma is really related to the features of its real estate sector.

Meanwhile, the market value of real estate, which is part of the virtual economy, is more than three times of the added value of real estate, because housing prices in Hong Kong have risen for more than 17 years since they bottomed out in 2003. At present, the price of private housing has soared 5.5 times from the bottom of SARS, and the accumulated real estate market value is equivalent to the total amount of Hong Kong's GDP in ten years, exceeding labor remuneration or operating surplus. The third income distribution and wealth effects driven by the real estate sector have long-term influence on and dominate the main economic activities of Hong Kong and are the source of deep social contradictions.

It can be seen from the above that in Hong Kong's "three-pronged economy", the traditional sector can no longer take the important task of promoting economic growth. Only breakthroughs in the innovation and technology can reverse the decline. Both the financial and real estate sectors can operate independently without relying on the support of the local economy, but their significance to Hong Kong's economic and social development is by no means the same: Hong Kong's real estate model with a virtual economy as the mainstay can bring temporary benefits to enterprises, individuals, and even fiscal revenues. However, it is not an ideal form of capitalism. Not only is it unable to improve living conditions and narrow the gap between the rich and the poor, but it has already become a burden on economic growth (according to the United Nations SNA standard, the Hong Kong real estate sector reduced GDP by at least 1 percentage point per year since this century). It also planted the seeds for financial crisis. Only by changing the development model can cultivate a way out. Only the financial industry is the most promising prong in Hong Kong. It can not only support Hong Kong's economic growth, but also be further upgraded to world-class standards and make greater contributions to the country's building of a financial power.

In other words, every sector in Hong Kong's "three-pronged economy" structure hides considerable development energy, and there is greater room for adjustment, transformation, improvement, and development, and it is imperative. Among them, the "first prong" focuses on innovation, the "second prong" must be improved, and the "third prong" is anxious for transformation. Specifically:

2. Innovate "first prong", break through scientific industry

After the relative decline of Hong Kong's trade and logistics industries, the key to launching traditional sector is the innovation and technology industry. South Korea has a long-standing precedent in this regard. The country's export volume in the 1980s was not as good as Hong Kong's. In order to transform into an innovative economy, South Korea moved its labor-intensive processing industries overseas and committed itself to the development of innovation and technology industries, and achieved great success. After that, not only the export value quickly caught up with Hong Kong, but also the value-added rate of export products based on local manufacturing was several times of that in Hong Kong, driving the rapid economic development. In the 1980s, Hong Kong also relocated low-cost processing procedures, but the local manufacturing industry did not undergo transformation and upgrading, and thus many opportunities for the development of high-value-added innovation and technology industries were lost.

Historically, Hong Kong does have some necessary conditions for the development of the innovation and technology industry, such as having the world's top basic scientific research capabilities, a highly open and international scientific research system, a world-class financial service industry, and a world-class business environment. And after its reunification, Hong Kong made every effort to develop innovation and technology industries. The government invested more than HK$100 billion, but with no good results. The key is not that there is insufficient R&D investment, nor is it that local universities have always had a tradition of focusing on academics and ignoring applications. Rather, they lack the overall innovation environment on which the innovation and technology industry depends, including mainstream innovation awareness, correct and effective innovation models, the guidance and promotion of government policies, the close connection between technology and industry, the eclectic innovative talents, the deep integration of innovative technology and innovative finance, and the relatively reasonable cost of innovation, which are very different from the business environment. In other words, the lack of a world-class innovation environment is the real reason for Hong Kong's innovation and technology industry to be unable to make breakthroughs.

According to figures from the Census and Statistics Department, the added value of Hong Kong's innovation and technology industry in 2019 was only HK$23.4 billion, accounting for only 0.86% of the local GDP. On the other hand, Shenzhen's strategic emerging industries have added value of RMB1,015.6 billion in 2019, which is about 50 times that of Hong Kong and accounted for 37.7% of its GDP. The main reason is that Shenzhen's innovation environment is first-class in the country and even in the world, supporting the innovation and technology industry to continuously climb to new levels. This shows that Hong Kong must first create a world-class innovation environment in order to achieve breakthroughs in the development of science and innovation industries. We will discuss the specific methods in a separate article.

Secondly, to make breakthroughs in technological innovation industries, we also need to strengthen cooperation with the Greater Bay Area. Technology application research and industrialization are just the strengths of the Greater Bay Area, which can completely make up for the shortcomings of Hong Kong. An important direction for future technology cooperation in the Greater Bay Area is to build on complementary shortcomings. On the one hand, Hong Kong's world-leading basic research capabilities will be used to make up for the lack of basic research in the Greater Bay Area. On the other hand, we use the Greater Bay Area's superb technology application research and industrialization standards to make up for Hong Kong's shortcomings, and try best to assist Hong Kong to realize the industrialization of scientific research results, especially in the areas of biomedicine, artificial intelligence, smart cities, and financial technology encouraged by the SAR government. In the future, if Hong Kong and the Greater Bay Area can work together to deepen their cooperation, they are fully equipped and capable of catching up with or surpassing Silicon Valley in the United States.

3. Improve "second prong", build a global financial center

Before detailing how to improve the finance industry, it is necessary to put forward a new method of classification of financial centers in response to the current problems in the evaluation of international financial centers that are out of touch with the actual situation. This new method is to first divide financial centers into domestic financial centers and international financial centers, and then divide international financial centers into regional international financial centers, characteristic international financial centers, and global financial centers according to their different functions and influences. The scope of influence of regional international financial centers is mainly regional, such as Hong Kong, Singapore, Shanghai, Tokyo, Frankfurt, etc.; characteristic international financial centers have global influence in specific financial fields, such as Chicago, which is good at futures trading; global financial centers are the highest-level financial center with global coverage, large scale, complete functions, and many talents, is a financial innovation and pricing center. At present, only New York and London meet these requirements.

There is still a gap between Hong Kong's financial center and that in New York and London, but the gap can be narrowed, and the goal of improvement is also very clear, that is, to build a global financial center comparable to New York and London. There are two key points to achieve this goal: opportunities and advantages. The former is exogenous and is a historic opportunity rare in a century. It is coming to Hong Kong now and bringing Hong Kong a good opportunity to build a global financial center.

Historically, the global financial center has always accompanied the economic center of gravity. The formation and development of financial centers in New York and London are the result of Western developed countries dominating the global economy. However, the situation has been reversed. During the global financial tsunami in 2009, economic growth in East Asia soared and East Asia became the main engine of global economic growth. By 2017, the total economic volume of East Asia began to surpass the North American Free Trade Zone and became the world's largest economic region; The COVID-19 epidemic has accelerated the eastward shift of the global economic center of gravity. In 2020, the total economic volume of East Asia accounted for more than 30% of the global economy. It is expected to increase to 40% by 2035, and will rise to about half by the middle of this century, officially open a new era of "East Asian Hemisphere".

If the economy of Europe and the United States have cultivated the two major global financial centers of New York and London, then the increasing importance of East Asia's economy and the continuous advancement of regional cooperation have released huge demand for financial services, which indicates that the financial centers in the region will have huge development, and eventually form a new financial layout dominated by two world-class financial centers and coordinated with other regional financial centers and professional financial centers. Among the cities in East Asia, Hong Kong and Shanghai have the best opportunities to become global financial centers.

To promote Hong Kong as a global financial center, it is necessary to focus on the development of five leading financial markets in Asia: (1) Through vigorously tapping the Mainland and Asian emerging market listing resources, building a world-class innovative financial platform, strengthening the connection between Hong Kong and the Mainland capital market, and developing the Asian bond trading market, etc., to elevate Hong Kong's capital market to a world-class level. (2) Strengthen RMB financing and transaction functions to better meet the various needs of market entities for investment and use of RMB, and enhance Hong Kong's position as a hub for offshore RMB business. (3) At least two-thirds of the global wealth growth in the next 20 years will come from Asia. If Hong Kong can effectively expand the Mainland and Asian markets, asset management can gradually reach a world-class scale similar to that of London. (4) Hong Kong is an international service hub for the "Belt and Road". It can provide project loans, syndicated loans, bond issuance and development funds through financial institutions and capital market financing, to become a major investment and financing platform for the "Belt and Road". (5) Hong Kong has the advantage of developing into a green financial hub in Asia. It should accelerate the development of green finance by strengthening domestic and foreign linkages, setting up "green channels" for overseas green bond issuance, and accelerating the process of unifying domestic and foreign green standards.

4. Adjust "third prong", transform the housing development model

The crux of the housing problem in Hong Kong lies in the inherent flaws in the housing development model. From the perspective of supply mode and value orientation, there are three main global housing development models: one is the market supply + tax regulation model in Europe and the United States; the second is the government supply model in Singapore; and the third is the investment/speculation-led model in Hong Kong. In terms of objective results, the European and American model is the best, followed by the Singapore model, and the Hong Kong model has the greatest sequelae. Because under the Hong Kong model, housing supply and demand are severely asymmetric. The demand mainly comes from three aspects: (1) the housing needs of local residents, (2) the investment needs of local residents and enterprises, and (3) the demand for overseas investment. Among them, only the housing needs of local residents correspond to the income of residents; however, as an international city, Hong Kong has an infinitely large investment demand. It has long dominated the Hong Kong property market, which has driven housing prices to skyrocket and greatly surpassed the growth of citizens' income.

We once invented an indicator—Living Burden Index (LBI), which is the ratio of housing price increase to income increase, (when the index is 1, the living conditions remain unchanged; when the index is greater than 1, the living conditions decrease; when the index is less than 1, the living conditions improve), to measure the changes in Hong Kong's living conditions. It is found that the price of private housing in Hong Kong from 1985 to 2020 soared by 21.2 times, the per capita income only increased by 6.5 times, and the housing burden index was as high as 3.3. In contrast, in developed economies such as the United States and some countries in Europe, it is only 0.7-1.0. Although the statistics are simple, the biggest secret of the deteriorating living conditions of Hong Kong citizens lies here.

Practically speaking, the long-term asymmetry of supply and demand has caused Hong Kong's real estate sector to be in a dilemma: on the one hand, housing prices have already far exceeded the purchasing power of the vast majority of citizens. To resolve social grievances, it is necessary to increase the housing supply to reduce property prices. On the other hand, high property prices have become the biggest support for Hong Kong's consumption, investment, public finance and employment. The sharp drop in property prices may trigger a series of serious consequences. At the same time, it should also be noted that the Hong Kong housing market is characterized by excessive volatility. The use of pure market means not only fails to effectively balance the relationship between supply and demand, but may also bring about new crises.

To break through this dilemma, we must introduce a new thinking: to get rid of the housing problem, we must first solve the problem of the asymmetry of housing supply and demand in Hong Kong. This requires starting with demand management, distinguishing housing demand and investment demand, and adopting different supply methods according to two different needs, namely implementing the real "dual housing system", and ensuring the housing of ordinary Hong Kong citizens with public housing and using private housing to meet local and overseas investment needs, forming two markets of different natures. On the one hand, it will ensure that citizens' housing rights are not corroded by market fluctuations, and on the other hand, domestic and foreign investment needs will not be excessively affected by policy controls, eventually forming a reasonable division of labor and efficient operation.

Based on this new thinking, we propose a policy concept with a long-term development strategy that takes into account the development of the economy, improving people's livelihood and social equity-the "New Home Ownership Project". The main idea is to more strictly divide public housing and private housing. To fully implement the "dual-track system" of public and private housing as a long-term development strategy. The new HOS model, which is different from the existing HOS, is the focus of future public housing construction. The price of the new HOS must be in line with the income of the middle class and the younger generation correspondingly, in order to assist them in buying homes more fairly and efficiently. This is the key to transforming the housing development model.

In a word, the "New Home Ownership Project" is mainly based on the current situation in Hong Kong, from the perspective of incremental adjustments, and strives to correct the direction of housing development in a gradual and gentle manner, and finally achieve the goal of changing the stagflation housing development model in Hong Kong. From an economic point of view, the "New Home Ownership Project" can effectively promote economic growth while solving the basic housing needs of most families in Hong Kong, including directly increasing the value-added of the real estate industry, expanding the value-added of the building construction industry and building ownership services. If things go on like this, the real estate industry will once again become the engine of Hong Kong's economic growth and provide more job opportunities for the public.

In conclusion, the in-depth deconstruction of the "three-pronged economy" not only allows us to find the crux of Hong Kong's economic problems, but also provides us with directions and strategies to facilitate economic transformation and upgrading. As long as Hong Kong works diligently in the three major areas of breaking through the innovation and technology industry, upgrading the financial center, and transforming the housing model, it will not be a problem for the GDP to grow by 3-4% annually in the next 20 years. Hong Kong needs to take a good headway, accelerate its integration into the overall national development, establish new concepts such as development first, people's livelihood first, effective market and effective government. Through global planning, strategic layout, and systematic promotion, to get Hong Kong's economy out of its predicament as soon as possible and sail again on a new national journey.

主要經濟指標 (Key Economic Indicators)

一. 本地生產總值 GDP	**2019**	**2020**	**2020/Q3**	**2020/Q4**
總量(億元) GDP($100 Million)	27,997	26,277	6,728	7,018
升幅(%) Change(%)	-1.2	-6.1	-3.6	-2.8
二. 對外貿易 External Trade			**2021/3**	**2021/1-3**
外貿總值(億元) Total trade($100 Million)				
總出口 Total exports	40,961	39,275	4,091	11,078
進　口 Total imports	45,714	42,698	4,361	11,748
貿易差額 Trade balance	-4,753	-3,422	-270	-670
年增長率(%) YOY Growth(%)				
總出口 Total exports	-5.6	-1.5	26.4	33.2
進　口 Imports	-8.1	-3.3	21.7	25.6
三. 消費物價 Consumer Price				
綜合消費物價升幅(%) Change in Composite CPI(%)	2.9	0.3	0.5	0.9
四. 樓宇買賣 Sale & Purchase of Building Units				
合約宗數(宗) No. of agreements	74,804	73,322	9,067	22,840
年升幅(%) Change(%)	-5.5	-2.0	99.1	79.2
五. 勞動就業 Employment			**2020/12-2021/2**	**2021/1-2021/3**
失業人數(萬人) Unemployed(ten thousands)	139	259.1	26.2	26.0
失業率(%) Unemployment rate(%)	2.9	5.5	7.2	6.8
就業不足率(%) Underemployment rate(%)	1.1	3.1	4.0	3.8
六. 零售市場 Retail Market			**2021/2**	**2021/1-2**
零售額升幅(%) Change in value of total sales(%)	-11.1	-24.3	30.0	2.7
零售量升幅(%) Change in volume of total sales(%)	-12.3	-25.5	31.7	2.5
七. 訪港遊客 Visitors			**2021/3**	**2021/1-3**
總人數(萬人次) arrivals (ten thousands)	5,590	356.9	0.7	1.7
年升幅(%) Change(%)	-14.2	-93.6	-91.9	-99.5
八. 金融市場 Financial Market			**2021/2**	**2021/3**
港幣匯價(US$100=HK$) H.K. Dollar Exchange Rate (US$100 = HK$)	779.3	775.2	775.7	777.5
貨幣供應量升幅(%) change in Money Supply(%)				
M1	2.6	30.1	39.8	29.5
M2	2.8	5.8	7.6	6.5
M3	2.7	5.8	7.6	6.4
存款升幅(%) Change in deposits(%)				
總存款 Total deposits	2.9	5.4	7.8	6.6
港元存款 In HK$	2.5	6.2	10.5	9.2
外幣存款 In foreign currency	3.2	4.6	5.1	4.0
放款升幅(%) in loans & advances(%)				
總放款 Total loans & advances	6.7	1.2	3.2	1.1
當地放款 use in HK	7.1	1.7	4.2	1.8
海外放款 use outside HK	5.8	0.1	0.8	-0.6
貿易有關放款 Trade financing	-0.7	-6.2	-4.3	-4.1
最優惠貸款利率(%) Best lending rate (%)	5.0000	5.0000	5.0000	5.0000
恒生指數 Hang Seng index	28,189	27,231	28,980	28,378