# CONTENT



8th December, 2011

# 1: Summary: Hong Kong faces a Binary outcome in the Golden 5 Years – Invest, Reach Up, Re-model and become a World City, or get Sidelined

This is the second report by HKGolden50, an independent, non-political and non-profit research organization whose mission is to illustrate through hard facts and figures the significant tasks the community and government of Hong Kong must undertake in order to convert the tremendous inflows of opportunities and talents into the city during 2010-2014, the "Golden 5 Years" as we characterise it, into a foundation for a more prosperous, vibrant and compassionate metropolitan for the next generation. HKGolden50 has two core beliefs: (1) the best 50 years of Hong Kong are ahead of us, and not behind us (2) taking over the baton to make Hong Kong a better place is the post-80's, Hong Kong's most-educated generation.

*Situating at the heart of a fast-growing Asia, Hong Kong can service a combined GDP of US$14trn — it has all the potential of joining London and New York to become a World City*

"How to Become a World City, Lessons from London" does not pose London as an opponent to Hong Kong. The two cities operate in time zones and neighbourhoods too widely different for direct competition to occur. Rather, our research regards London, the longer standing of the two World Cities, as the "model" for Hong Kong and ascertains the many shortcomings the territory must strive to put right. Adding to Hong Kong's positive momentum are the unprecedented inflows of opportunities and talents in the Golden 5 Years and its unique setting of being the freest city in China and its situating at the ecomomic heart of a fast-growing Asia. Within four hours flight from the city, Hong Kong can service a combined GDP of US$14trn, similar to that of London and New York City but seven times that of Singapore's. We conclude that Hong Kong has all the potential of joining London and New York City to become a World City.

A World City attracts talents of every discipline and wealth from all parts of the globe. It is a city in which the global citizen has a business and emotional stake and where people from other places want to spend a lot of their time enjoying it. In a nutshell, a World City needs to have all the ingredients of "**IFC-BEST**":
It must be

*World City – Your pulse races and your pace quickens when you are in one…*

(1) **I**nspiring and imaginative, fun, exciting, confident, capable, purposeful and young in spirit;

(2) **F**ree, open and welcoming to all cultures and beliefs;

(3) **C**onvenient such that its people are not bogged down by chores and inefficiencies, leaving more time for life;

(4) **B**usiness-friendly, providing a myriad of opportunities to support talents from all around to congregate and develop their careers in diverse areas, from arts, culture and culinary skills to high finance and technology;

(5) **E**nergetic and self-critical but also capable of re-inventing itself so that it is always up-to-date with global values and ideas;

(6) **S**afe and friendly so that its inhabitants can enjoy the city without fear or inhibition; and last but not least;

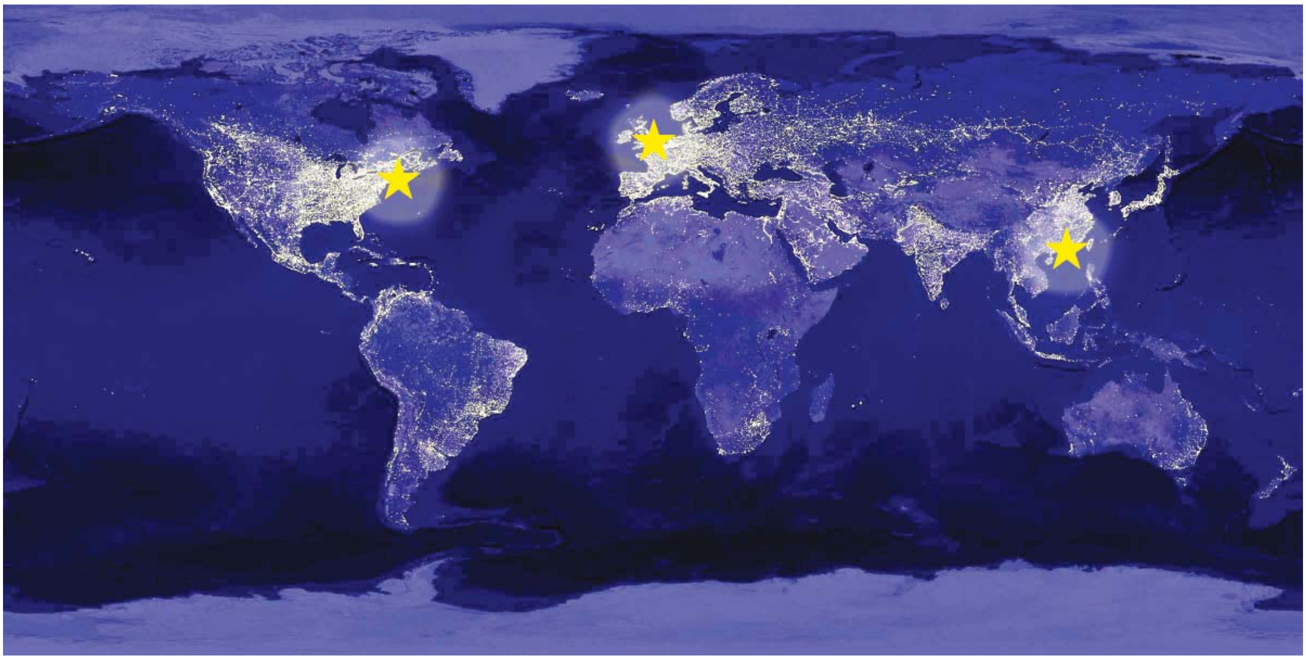
(7) **T**rustworthy so that businesses and consumers know they will get what they pay for, so that no effort, cost or time needs to be wasted on verification or seeking recourse.

### (1) It takes an International Finance Centre to make a World City

*An IFC is the standard bearer and pace setter for a World City*

In section 2, we provide a comparison of top-down statistics of the two cities to establish basic understanding of the economies and set the landscape for our research. We then turn to assessing the finance industry and social features of Hong Kong and London as well as those of New York City and Singapore. We elaborate on the role of finance as a highly effective enabler of efficient economic activity by virtue of its requiring extremely high standards of performance (precision and urgency) and conclude that it is not a coincidence that both London and New York City, the two acknowledged World Cities, are International Finance Centres (IFCs) and Hong Kong should learn from their evolution and widen and deepen its IFC capacity and capabilities in order to hasten its rise as the next World City.

Great cities of manufacturing, culture, trading of goods, agriculture, never became World Cities. An IFC, on the other hand, is a city with an attitude – it does not accept compromise or mediocrity and aspires for excellence and perfection. It has to be a top performer because its key product is ideas and its markets move at the speed of thought and re-price every second. In all, an IFC is the standard bearer and pace setter for a World City.



### (2) World City creates Prosperity for All – but future prosperity requires quickly improving Service Standards via Investing in bigger and better Hardware and Software

This insistence of services of the highest quality attracts both (1) talents and corporates that believe they can provide such level of services and (2) consumers of such services, including the wealthiest individuals and the largest corporates from around the world. This exacting standard of performance requires the orchestration of an intricate web of support services, eg an efficient legal system and the rule of law (which provides predictability and independent recourse), education, healthcare, freedom of movement of ideas, capital and goods (thus minimizing friction and costs while maximizing speed of delivery of services). Hence, an ecosystem of employment and prosperity across all sectors would rise with the emergence of an IFC. Hong Kong is an open economy that has no natural resources and has to pay for everything it imports and consumes. This is done mostly by its workforce "exporting" its services. Hence, the main means to growing this economy is to procure more customers to use Hong Kong services.

*Build the best, then talents and the well-to-do will come, helping to create further jobs and wealth for Hong Kong citizens*

We argue that the task of "exporting services" is amongst the most difficult ways of "making a living". Unlike mercantile trade, where goods can be manufactured locally and exported, most of Hong Kong services are not "shipped out". For instance, the production of a bowl of won-ton noodles for the consumption by a Japanese tourist does not involve packing the bowl of fresh noodles and sending it to Japan. Rather, the "exporting" of this culinary service involves the Japanese tourist taking a holiday break from his or her work, paying for air travel to Hong Kong, shouldering the expense of staying in a hotel and lastly, the actual consumption, in Hong Kong, of the bowl of won-ton noodles. To earn this income by "exporting a service", Hong Kong must physically "import" a customer!

*Hong Kong does not "export services", it "imports customers" who have to incur hefty time and travel expense to come to Hong Kong to consume the services the city produces*

The quality of this "exportable" service has to be very high in order to justify the significant time and travel expenses incurred by the consumer to come to Hong Kong. To perform a service, we need both hardware (office, shop, hotel, dealing rooms, hospital, school etc) and software (professionals, salespersons, chefs, waiters, fund managers and traders, doctors and nurses, teachers and lecturers etc). In order to produce more service exports and grow incomes, Hong Kong must quickly step up its investment in property and training of people, in the face of unprecedented influx of business opportunities and talents into Hong Kong, so as to maintain and improve the quality of its services. For a more detailed discussion, please refer to our first report "Hong Kong – The Golden 5 Years (2010 – 2014) and the Decline that may follow…?".

*Hong Kong must quickly invest in its service hardware and software to ensure a world-class service sector and to capitalise on unprecedented inflows of opportunities in these Golden 5 Years*

In that piece of research, we highlighted the significant hurdles in Hong Kong's path as (1) its hardware is heavily strained, with space utilization standing at historic high levels and which has led to double-digit rent rises, stoking inflation, and (2) its software stressed as its workforce is at the highest level of employment since the handover and, to make matters worse, the workforce will start to decline when more and more people retire in the next two years.

A visiting customer will be disappointed when shops/offices/hospitals are packed and there is not enough staff to serve him or her. International customers have a wide choice of cities competing for their money. For Hong Kong to continue to earn money from exporting its services, their quality has to be excellent and they have to offer good value.

*Hong Kong will easily lose visiting customers if it allows its service standards to drop*

### (3) Hong Kong must improve on both
### (i) very significant income underperformance relative to peers
### (ii) inequality in domestic income

*A context to recent discussion about Hong Kong's income distribution*

Recently the subject of income inequality attracted much public discussion in Hong Kong. We hope our study of the two existing World Cities should put a wider context to this discussion. In London, the top 10% and 20% of income earners receive 39% and 54% of the total income of the city respectively, while the second half of the population account for 17% of total income. Hong Kong's income dispersion is similar to London's, with top 10% and 20% of Hong Kong households earning 41% and 57% of the city's income respectively, while the second half of the population sharing 16% of the income pie. The figures for New York City paint a similar picture.

#### Distribution Across Three Household Income Groups

| Household Income Group | Top 10% | Top 20% | Bottom 50% |
|---|---|---|---|
| **Hong Kong, 2006** | 41% | 57% | 16% |
| **New York City, 2010** | 40% | 56% | 15% |
| **London, 2009** | 39% | 54% | 17% |
| **Singapore, 2010** | 37% | 53% | 19% |

Source: HK CSD, US Census Bureau, New Policy Institute, Trust for London, Singapore Dept. of Statistics, HKGolden50

*It appears that most top international cities have uneven income distribution*

In fact, Hong Kong's income distribution as measured by the Gini Coefficient (0 being the most equal and 1 the most unequal) is also in line with those of the two World Cities and that of Singapore.

## Gini Coefficients

| | Gini Coefficients |
|---|---|
| **New York City, 2010** | 0.54 |
| **Hong Kong, 2006** | 0.53 |
| **London, 2009** | 0.52 |
| **Singapore, 2010** | 0.48 |

Source: US Census Bureau, HK CSD, New Policy Institute, Trust for London, Singapore Dept. of Statistics, HKGolden50

These top-down statistics seem to suggest that disparity of income is common amongst most successful cities. The main reason this is so is not that successful cities tend to produce more poor people but quite the contrary, these cities are of such high quality that talented and well-off people from all around the world will want to work and live in these places, adding to the band of high income earners, thus widening the gap.

*Top cities that attract the clustering of the talented and well-to-do, thereby skewing income distribution*

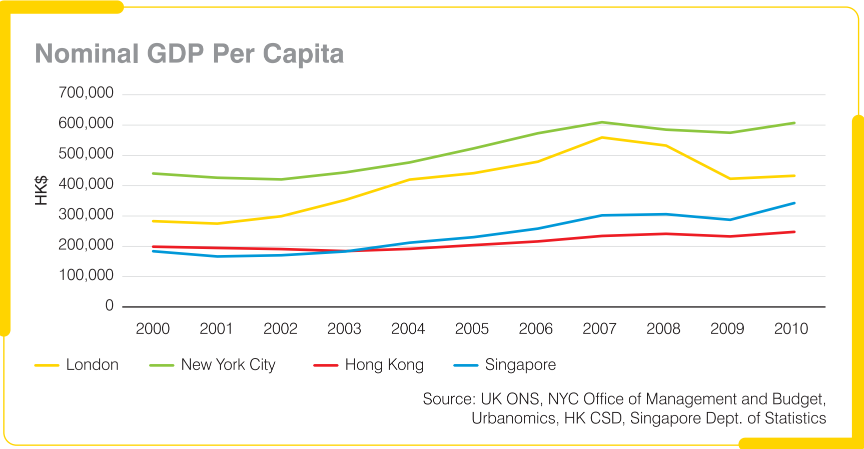
While Hong Kong should continue to enhance social mobility especially through providing subsidised education and other means of self-improvement so that those who put in the effort can have a better chance of advancing in society, it is even more important, we argue, that the entire community should focus on the substantial gains that Hong Kong can reap, when its citizens, businesses, public bodies and its motherland work together and walk that "extra mile" to bridge the significant income gaps with the two existing World Cities. With the capturing of further business opportunities come new jobs, better social mobility and improved means to provide for the less fortunate in society.

*Given the significant underperformance of Hong Kong economy over the past decade, the city should put heavy emphasis on advancing GDP – without new wealth, the scope for general prosperity is limited*

**Hong Kong has underperformed very badly for the past decade — time to chart a Better Course!**

The per capita incomes of London and New York City at the end of 2010 were some 75% and 146% above Hong Kong's HK$247,000. The gap remains high, at some 20-70%, even after adjusting for purchasing power parity or cost of living. A study of the value-added and employment composition shows that proportionally, Hong Kong has only a third of the size of London's business activities/service sector and a slightly smaller finance sector of around 17% and ever allowing for differences in classifications, still these must be some of the key high-skill/high-income areas that Hong Kong should focus on to add to jobs and GDP.

*Per capita incomes of London and New York City were some 75% and 146% above Hong Kong in 2010*




Turning to the Asia time zone, important lessons on economic development can be learnt from the significant underperformance of Hong Kong vis-à-vis Singapore over the past decade. Despite a population only 72% of Hong Kong's and a land area 35% smaller, Singapore managed to grow its nominal GDP at a robust 9% per annum (as opposed to Hong Kong's 2.8%) from 2000 to 2010 and caught up with Hong Kong's GDP of HK$1.7trn by the end of that period.

*Singaporeans' income per capita is 40% higher than Hong Kong's and Singaporeans are 100% wealthier*

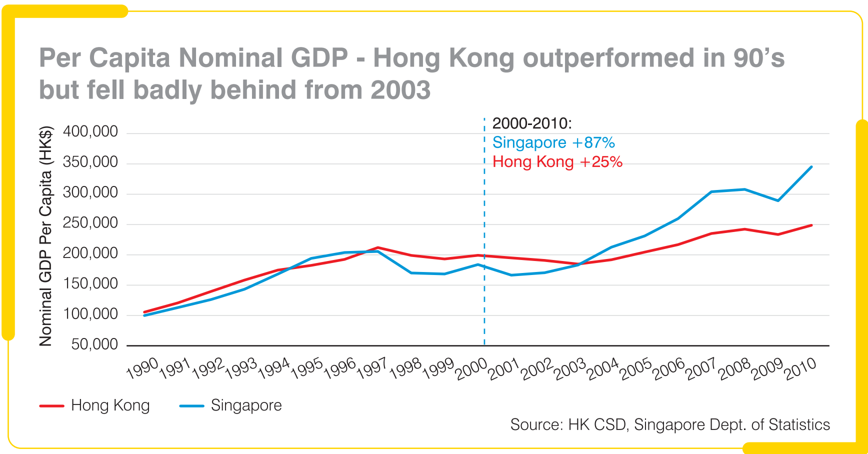
It is important to remember that measured by income per capita, Hong Kong was ahead of Singapore for most of the 90's and the earlier part of 2000's. However, the tide turned from 2003 onwards when Singapore overtook Hong Kong and opened a significant lead since. Standing at HK$342,000, the Lion City's per capita income is almost 40% above Hong Kong's with its average wealth per capita weighing in at twice that of its northern peer. In the decade 2000-2010, Singapore's nominal GDP per capita surged 87% while that of Hong Kong rose only 25%, off overall GDP growth of 136% and 32% respectively, over that period.

*Hong Kong was ahead of Singapore for most of 1990 – 2003, but has fallen badly behind since*

The extent of Hong Kong's economic underperformance is all the more disappointing against the backdrop of the robust growth of its Chinese hinterland which posted a nominal GDP growth and per capita growth of 294% and 278% respectively over the past decade. In other words, despite its (1) exposure to finance, one of the fastest-growing industries in the world in the last ten years and (2) proximity to the surging Chinese economy, Hong Kong has only managed to return a nominal GDP per capita growth of around 2% p.a..

*Despite its near-perfect positioning in fast-growing (1) finance industry and (2) the Chinese economy, Hong Kong only managed to eke out 2% nominal growth of GDP per capita per annum over 2000-2010*

From a separate angle, over this decade, Hong Kong's nominal GDP per capita grew 25%, against London's 53%, New York City's 38%, Singapore's 87% and China's 278%.




Helping to propel Singapore forward so strongly was a deliberate but judicious use of an immigration policy that enabled it to absorb some 380,000 as Permanent Residents ("PR") and 110,000 as citizens, skilled/educated (75% have post-secondary education versus overall Singapore 48% and Hong Kong around 23%) and/or well-to-do individuals from 2004 to 2010. This significant source of economic and cultural enrichment has added 490,000 or 15% to Singapore's mid-2004 resident population of 3.37m. While some social discomfort must arise when almost one-sixth more people were added to the population over six years, the result is far from disruptive and for a sophisticated society that Singapore is, the social adjustment to the new immigrants is not likely to be long.

*Income/wealth-accretive immigration scheme – an accelerant to boosting diversity/quality of economy*

In stark contrast to Singapore's clear socio-economic development strategy, and proving heavily dilutive to per capita GDP growth, Hong Kong's policy of taking in, under a daily quota of 150, residents from the mainland to join their families in the SAR since the handover, accounted for the bulk of the 685,000 new immigrants to Hong Kong from 1997 to 2010. Clearly this is primarily a social policy which might not have taken seriously into account the economic implications in both the short and long term; it nevertheless has led to the consequence of adding a highly significant 11% to Hong Kong's population of 6.49m at the handover and this issue should be explicitly assessed and publicly discussed.

*While Singapore has added 490,000 (15%) socio-economically strong (75% have post-secondary education) to its citizenry, Hong Kong has added 685,000 (11%) low-skilled (8% have post-secondary education) to its population*

Data from Hong Kong 2006 Population By-census show that 54% of those in working-age who had settled in Hong Kong for less than seven years were not economically active (ie. not contributing to GDP), comprising mostly housewives and students. By skill level, 7.9% of those in working-age had received post-secondary education, as opposed to 23% for Hong Kong as a whole.

Using the data above and making simplistic assumptions, we have performed a simulation to work out, very roughly, the effects on total and per capita incomes an immigration policy that targets high-earners against one that does not.

*A simplistic simulation to estimate effects on per capita income is performed*

Assume Singapore and Hong Kong each to have a population of 100 and GDP per capita of $10, hence an overall GDP of $1,000. Further assume that Singapore and Hong Kong each to add immigrants amounting to 15% and 11% of the original populations respectively so the new populations of the cities become 115 and 111 (please refer to the two tables below). Based on government and publicly available survey figures and after making assumptions and adjustments to aid comparability, we have roughly estimated that the contribution to GDP per immigrant to Singapore is twice that of the average citizen while each immigrant to in Hong Kong contributes only 45% of average income - thus in the tables below, $20 and $4.5 for Singapore and Hong Kong, respectively.

### Simulation of the Effect of Immigration Policies

| Immigration Policy Simulation | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Singapore Before and After Immigration** | | | | **Hong Kong Before and After Immigration** | | | |
| | Before | Immigrants | After | | Before | Immigrants | After |
| **Population** | 100 | 15 | 115 | **Population** | 100 | 11 | 111 |
| **GDP Per Capita** | **10.0** | **20.0** | **11.3** | **GDP Per Capita** | **10.0** | **4.5** | **9.5** |
| **Total GDP** | 1,000 | 300 | 1,300 | **Total GDP** | 1,000 | 50 | 1,050 |
| **Increase in Total GDP** | | | 30% | **Increase in Total GDP** | | | 5% |
| **Change in GDP Per Capita** | | | +13% | **Change in GDP Per Capita** | | | -5% |

The result of the simulation shows that a policy that targets high-output immigrants has added 13% to per capita income while a social policy that does not carry a skill threshold has led to a 5% drop in per capita income. In terms of total GDP, the former policy has added 30% to incomes while the latter only 5%. It is likely that over the longer term, this divergence in income performance will widen as the latter policy is likely to lead to slower output growth and higher welfare costs and, within Hong Kong, further disparity in incomes between the high- and low-income earners. Professor Francis Liu of the University of Science and Technology Department of Economics has observed that one year of study in university could add 15-18% to earnings whereas an extra year's study in lower level education would add only 4-5%.

*Roughly estimated, an accretive versus a dilutive immigration policy has led to a 18% underperformance in Hong Kong per capita income in the short term and probably further divergence in the longer term*

In charting the way forward and creating job opportunities for the young and its most educated generation, Hong Kong must, as a top priority, diligently deliberate on the existing population policy which has contributed to the formation of an immigrant "underclass".

*Hong Kong must have a pro-income, pro-jobs, pro-education, pro-diversity population policy*

It is estimated that there are some 1million poor people in Hong Kong. It is not difficult to expect that the 700,000 new immigrants since the handover now form a significant part of this group and have accentuated income inequality. They form an integral part of the Hong Kong community and affirmative action should be taken to strengthen the weaker-skilled groups and to help the underprivileged immigrant children so that they can have the full resources to attain as high a level of education as they are capable of achieving. If Hong Kong invests in putting up new hardware, so that the inflow of business opportunities in the Golden 5 Years can be properly accommodated, there should be plentiful new jobs for every segment of society and means for individuals to improve their lot.

*Must undertake Affirmative Action to help the under-privileged groups to improve social mobility*

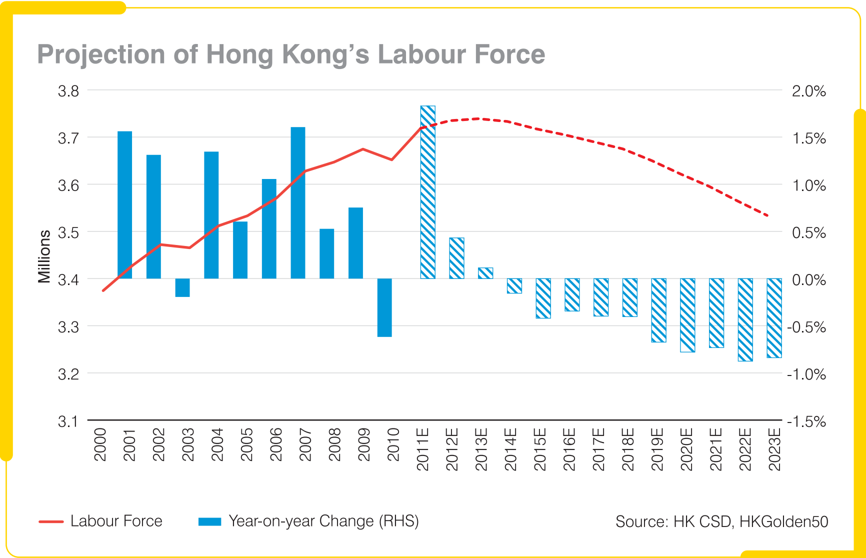
Faced with a workforce that will start to shrink 0.4-0.8% or some 20,000-40,000 each year, from 2012/2013, one of the fastest declines in the world, Hong Kong will struggle to keep up its service standards. A significant stepping up of investment in university education, including offering scholarships to talents from the mainland and on-the-job training of the existing workforce, should help improve labour productivity and keep Hong Kong competitive. Furthermore, as Hong Kong is likely to lose over 200,000 workers over the next ten years or so, it is imperative that a highly selective new programme to attract global talents and the well-to-do's, assured by the Singapore experience in this area, should be adopted. This should accelerate Hong Kong ascent to become a World City.

*Hong Kong must (1) explore the merits of Singapore's high income/wealth-accretive immigration policy to accelerate its ascent to a World City, and (2) step up investment in university education, on-the-job training and take affirmative action to help underprivileged immigrant children, to counter the rapid decline in its workforce and add to its service capability in the Golden 5 Years*

The flow of talents and the well-to-do from the rest of China into Hong Kong is a natural process. This clustering effect has led to congregation of talents and well-to-do's to key nodal cities and contributed to the growth of Beijing and Shanghai. In Section 5, we set out the findings of a survey we conducted on a group of mainland graduates of the University of Hong Kong (HKU). HKU has the longest history amongst the local universities in admitting mainland students and our survey found that, encouragingly, 88% of respondents believed education at HKU had offered them advantage over mainland degrees. Another key finding is that some 83% of respondents would like to obtain Permanent Resident status. These two results suggest that a policy to attract and retain talents will be effective. The two measures above aimed at enhancing labour and service quality are two essential public policies for Hong Kong to enact in the Golden 5 Years.

*The flow of mainland talents and the well-to-dos is a natural process. Both China and Hong Kong should not hinder this*

*Our own survey on HKU mainland students, set out in Section 5, affirms potential for inflow of talents from this source*




## (4) Creating a World City is Herculean task

Four centuries of capitalism and pursuit of human freedoms have managed to produce only two acknowledged World Cities, firstly London, then later came New York City.

For the past two centuries, London has been the true World City – a highly successful meeting place of commerce and depository of wealth from all corners of the world, a trendsetter of global culture, a place where commercial and social ideas flow together, become refined by enterprise and discourse, and impact the world. While there have been many great cities rising and fading in modern history, few, if any, rival London when it comes to the degree of internationalization and the extent its systems of organizing business, law, knowledge, values and language have influenced the world.

*London – a World City that has stood the test of time because it has built a value system and code of practice the world has grown to trust*

This has remained so despite the rise of the US as the largest economy in the world in 1870 (Cassis, Youssef. "Capitals of capital: the rise and fall of international financial centres, 1780-2005". Pages 80-86, 110-116), overtaking the UK which at the time, provided nearly one-third of global production. New York City, as the commercial and financial capital of the US, ascended into the ranks of an IFC largely through the sheer scale of its economic growth. By 1914, the US GDP was already the total of UK, Germany and France, the next three largest economic powers of the day.

*New York City – the World City of a superpower*

Having come under British rule for 155 years, one of the longest periods of colonial histories in the world, Hong Kong has inherited a comprehensive system of Common Law and some of the best values and market practices of the developed West. It therefore shares the same international system of business conduct with the developed world and should head the race as the preeminent hub of financial and high credibility business (eg healthcare, product certification, valuable goods) in Asia, where service standards are often lower. For example, while the service sector accounts for some 93% of Hong Kong's GDP, the highest in the world, it is only 43% in China and around 60% in Shanghai and 72% in Singapore.

*Hong Kong shares the best practices of UK/the West and is the service capital of the World*

Recognising these positive qualities of Hong Kong, Time Magazine coined “Nylonkong” to describe the tripodal links between the three IFC’s. We have taken excerpts from Time Magazine’s “A Tale Of Three Cities” 18th January 2008 to show perceived strengths of Hong Kong:


- “Connected by long-haul jets and fiber-optic cable, and spaced neatly around the globe, [New York City, London and Hong Kong] have created a financial network that has been able to lubricate the global economy, and, critically, ease the entry into the modern world of China, the giant child of our century. Understand this network of cities – Nylonkong, we call it – and you understand our time.”
- “…even in the darkest times, the Nylonkong cities had the sort of hidden strengths that would be their salvation. All had a certain adaptability hardwired into their people.”
- “… the sense of being a blue-water place … has made them open to trade, with all the transformative capacity that trade has to shake up established orders and make the exotic familiar.”
- “Hong Kong, which barely existed 150 years ago, has always been a haven for migrants fleeing trouble in China. Even in these prosperous times for the mainland, it still has pull… And increasingly, it is a magnet also for Chinese whose families have lived for generations in Canada, the US and the U.K.”
- “Great cities, of course, are about more than money and finance. They are messy agglomerations of talent and culture. That is how they attract men and women in the financial sector who could choose to live anywhere.”
- “Hong Kong, for its part, has gotten rich on the back of China. But … the mainland has scores of other rising cities, all ambitious for their moment on the world stage. Hong Kong must continually raise its game to maintain its relevance to the burgeoning Chinese economy.”
- “… these are places that **know how to meet a challenge**. They’ve done it before. **From being dismissed as long past their prime a quarter of a century ago, New York, London and Hong Kong have gone on to extraordinary heights.**”

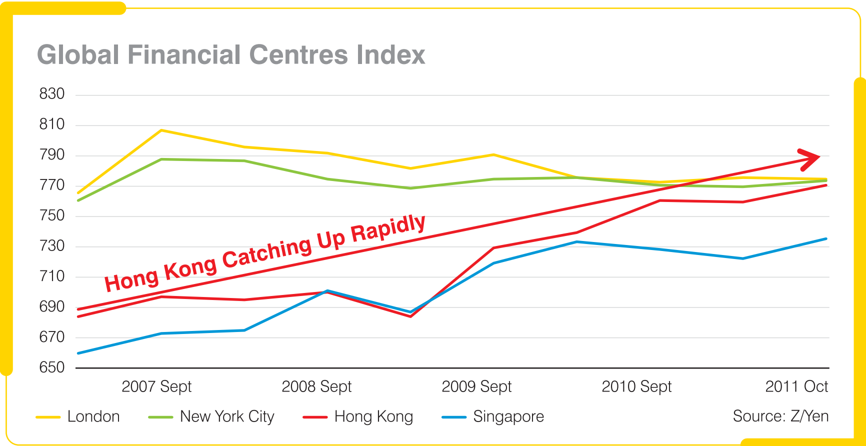
In Section 2, we will assess whether Hong Kong has the essential skills (technology) to be the preeminent IFC in Asia and whether the city has the "Deepcraft," as Professor W. Brian Arthur of Stanford University described, to sustain its leadership position. In "The nature of technology: what it is and how it evolves" 2009, he says "One thing very noticeable about the buildout of new bodies of technology is that *their leading edge is highly concentrated in one country or region…*" (Pages 156-165) "Real advanced technology *…issues not from knowledge but from something I will call* **deepcraft… it is a set of knowings. Knowing what is likely to work and what not to work**. Knowing what methods to use, what principles are likely to succeed, what parameter values to use in a given technique. Knowing whom to talk to down the corridor to get things working, how to fix things that go wrong, what to ignore, what theories to look to. *This sort of craft-knowing takes science for granted and mere knowledge for granted*. And **it derives collectively from a shared culture of beliefs, an unspoken culture of common experience…A knowing that again becomes part of a shared culture…To any problem or difficulty … there would surely be an answer somewhere in the [location].**"

*"Knowing" what works and what does not is second nature to Hong Kong IFC*

## (5) Third-Parties Have Vouched for Hong Kong's Excellence as an IFC

There is growing recognition of Hong Kong's growing importance as a top IFC. In addition to Fortune Magazine's cover article in 2008, this May, KPMG, one of the "Big Four" global accountancy firms, relocated its International Chairman's Office to Hong Kong. This September, Z/Yen, the consultant that compiles the Global Financial Centres Index (GFCI) and ranks 75 centres around the world, further narrowed the gap in ratings between third-placed Hong Kong and two leading IFCs, commenting that "There is no significant difference between London, New York and Hong Kong".

*"There is no significant difference between London, New York and Hong Kong"*




From a range of independent studies, it seems clear that the city is already the premier IFC in Asia and for the past four years, Hong Kong has been rapidly closing the gap with London. The significant business opportunities opened by China's 12th Five Year Plan (FYP) and in particular, the beginning of the development of an offshore Rmb market in Hong Kong, will only add further momentum to the IFC's capabilities and scale. Hence, there is little reason to doubt Z/Yen's comment that "Hong Kong is now just three points behind New York and four points behind London. These three centres control a large proportion of financial transactions (approximately 70% of equity trading) and are likely to remain powerful financial centres for the foreseeable future."

*"These three centres (Nylonkong) control a large proportion of financial transactions (approximately 70% of equity trading) and are likely to remain powerful financial centres for the foreseeable future"*

## (6) Hong Kong - China's World City in the making?

*Gaining the Trust of the World – takes more than having laws and codes, but having "time-tested" laws and codes*

We outlined previously the huge efforts and time involved in the making of a World City. London is the product of a business empire that spanned the globe for over two centuries and a system of laws and business practices that has been adopted across the western world and the Commonwealth nations. The predictability and protection of business and individual rights stemming from these laws and codes have given people from all around the world the confidence to invest/live/study/play in the UK, and its capital city, London, has become the focal attraction. New York City arose from the rapid ascent of the US in the past century to become the biggest economy of the world and the rapid pace of growth of the finance industry in the past 50 years.

*Confidence from the rest of the world in the World Cities builds up as their fairness systems are observed to yield consistent results for well over a century.*

Both cities attained their cosmopolitan flavour because people from all around the world trust their systems of fairness and protection of business and individual rights as they have an independent judiciary as final recourse. They have become cities the world as a whole has a stake in.

*Hong Kong has all the software to be World City, but it needs the Bulk of Hinterland to reach that status*

In theory, Hong Kong has all the potential to become the next World City – by virtue of its 155-years of colonial history, it shares the same legal and business DNA of the capitalistic west and talks the same language when it comes to organizing business and personal matters. A key customer to Hong Kong services is China, the second largest economy of the world. It takes bigger demand to lever the already excellent service platform of Hong Kong to become a World City.

The question remains if China wishes, in its many strategic considerations, to have a World City. The lack of an independent judiciary and the rule of law that the world can trust to the same extent as found in the western world, and the lesser state of economic development compared with the US, suggest that the pre-conditions to a London and New York City are not met by any mainland city. The one city that offers a more realistic chance of reaching World City status is Hong Kong but it cannot get there without the full support of its hinterland. China should consider the desirability of having a World City and if it decides that it is so, focus its resources on the city's development as history has shown it is a Herculean task to grow even a single World City. A strategy of having many IFCs is likely to diffuse and defeat an effort to have a financial centre that can influence the world.

*The one city in China that can reach World City status is Hong Kong but it cannot get there without the full support of China*

Extracts from the 12th Five-year Plan show that China would "(continue) to support Hong Kong in developing its financial services,…tourism, professional services,…and other high-value-added services; (support) Hong Kong to develop into an offshore Renminbi (Rmb) business centre and an international asset management centre…reinforcing and enhancing Hong Kong's status as an international centre for financial services… and strengthening the global influence of its financial centre." The opening of China Development Bank International Holdings in Hong Kong on 7th December 2011 was a significant milestone marking the state sector's endorsement of Hong Kong. This company will form the platform for the state bank to invest outside of China and to attract overseas investment into China.

*The 12$^{th}$ FYP shows China's commitment to support Hong Kong as an IFC, but it has to make significantly more use of this service platform for it to live up to its potential of a World City*

While China's intentions are clearly supportive, the conceptualizing and implementation of such an effort has remained problematic, in our opinion. Please refer to pages 8 to 12 of our first report for a discussion of the development handicap to Hong Kong as it remains easier for Hong Kong people and businesses to "go North" than it is for mainland people and businesses to "come South". Insofar as the porosity of the economic border with the city remains less than that between Hong Kong and most of its trading partners, "One-Country, One-Market" is not working out and this will continue to cap Hong Kong's development. While the two sides should continue to work on CEPA, we argue it is significantly more important for both to "level the playing field" so that the flow of talents, customers and businesses from the mainland is made easier so that they can freely utilise the world-class service platform of Hong Kong.

*One-Country, One-Market – yet to work out fully*

*While the two sides should continue to work on CEPA, we argue it is even more important to facilitate the natural flows of talents and businesses into Hong Kong*

A lesson we learn from the emergence of the two World Cities is that it is extremely difficult and takes over a century and a solid track record to gain the trust of the world. An example of this trust is provided by the public listing of Prada shares in Hong Kong this year. While the company can raise capital from its home market Italy or either of the two World Cities, London or New York City, it chose Hong Kong. A skeptic can argue it matters little where the money is raised if the exercise is simply to extract capital from investors and since there is an abundance of savings in Asia, taking money from Hong Kong makes sense. More importantly, however, it is likely that the largest asset in the Prada family, after the listing, is its holding of Hong Kong-dollar denominated shares tradeable only in this Asian IFC. This demonstrates the high level of trust Prada has placed in Hong Kong.

*Trusting Hong Kong with one's family wealth – lesson from Prada*

The Prada IPO symbolises the trust a foreign citizen group has invested in Hong Kong and it is doubtful if the owners of these overseas enterprises would be as confident in listing their core wealth in a mainland market, should the avenue be open in future. The press has reported that Graff Diamonds, the international jewelers and Ferrari, the sports car company, are planning to list in Hong Kong soon, adding momentum to Hong Kong's growing credibility as a city in which the world trusts and has an emotional and financial stake.

This stream of listings also demonstrates that the concept of "One-Country, Two-Systems" is highly credible in the eyes of the world and the mainland should leverage on this unique and valuable situation to further the development options of its enterprises, for instance, by allowing the efficiencies and the value systems of global enterprises to flow through mainland enterprises via their mutual exposure to Hong Kong.

*The world's trust in "One-Country, Two-Systems" is a valuable tool to improve efficiencies and value systems for mainland and overseas enterprises but more companies must be allowed to come south*

Trust in mainland cities by China's Asian neighbours may be difficult to earn when a string of countries along the East Asia coast, including Japan, the Philippines, Vietnam, Malaysia, Brunei and India, dispute its oil and gas exploration rights and some of which were at war with China within living memory. A recent increase in military interest by the US in East Asia, stepped up by the announcement in mid-November of a new US military base in Northern Australia, may add to threats of encirclement.

*War wounds may still be too sore for complete trust?*

Freedom and fairness endear global citizens but the opposite and arbitrariness do not. Articles like the one on the Financial Times 29th November, that "China has banned advertisements during dramas and films on television in the Communist party's latest move to assert control over the country's increasingly commercial media industry" and comments by the media regulator after forcing Supergirl, the nation's first and most successful talent show, off air, that entertainment should take a back seat to "values, responsibility and quality" and that it wanted to "fully utilize the TV networks to build a public cultural service system, raise the quality of public cultural services and guarantee the people's basic cultural rights" deter global citizens.

*Hong Kong – a free and fair Chinese city that endears global citizens*

A considered decision and a new commitment by China to let Hong Kong become a World City by allowing it the economic freedom of "One-Country, One-Market" is critical for Hong Kong to extend its Golden 5 Years. With 93% of its GDP earned by servicing global needs, this world-class IFC is capable of taking on far more load from its hinterland. The more that Chinese enterprises bring their domestic business networks to hook up with the world through Hong Kong, the more overseas enterprises will come to Hong Kong to connect with China.

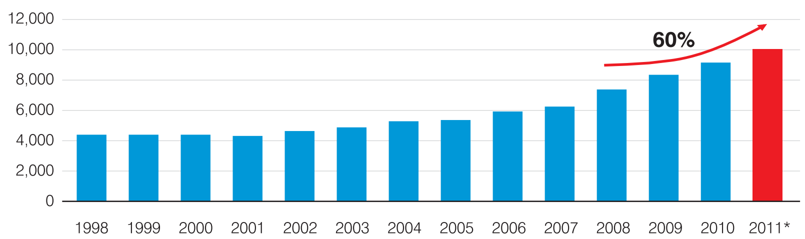
*Hong Kong service industry and global connections are world class, but it needs the mass of its hinterland to make a World City*

Without the stepping up of business quantum, Hong Kong's ascent to World City will be frustrated and there may not be a World City in Asia for quite some time to come. The rise of New York City was hastened by the size of the US economy. It remains to be seen if key decision makers in Beijing can rise above the clamour from domestic cities, which are far more politically powerful than Hong Kong, to be IFC's and recognise the strategic development options on the table. China can have one IFC or none at all.

*The more the flows from China into Hong Kong, the more the flows the rest of the world into Hong Kong*

One such example of how the natural and uninduced inflow of people and opportunities from China has triggered global inflow of talents into Hong Kong is provided by the influx of French nationals. On 18th November, the French consulate celebrated the registration of the 10,000th French national arrival to Hong Kong. It reckons that this latest number represents a 60% rise in residents from France since 2008. Evidencing Hong Kong's World City flavour, Hong Kong now has the biggest French community in Asia, accounting for two-thirds of the total of some 15,000 French nationals. Anecdotal comments from contacts in other consulates suggest similar uptrend.

*Free flow of talents/customers/businesses southwards will draw talents/customers/businesses from the rest of the world to Hong Kong*




* As of 2011 Nov; all other figures are as at year-end

Source: French consulate

A lesson can be learned from Tokyo. Japan was the second biggest economy in the world for many years until China surpassed it last year. Despite its size, Japan did not invest enough efforts to open up its markets, adopt global best practices or focus on internationalising its largest city, Tokyo, with a population of 13 million.

*Japan was second largest economy until last year, yet, Tokyo never rose to the ranks of London and New York City. Without "One-Country, One-Market", Hong Kong will likely meet with the same fate.*

As a result, Tokyo never rose to the ranks of London or New York City. With an extensive network with the world but without the free-flow of capital/talents/opportunities from the mainland, Hong Kong is likely to meet the same fate.

*A huge economy, without globally accepted laws and systems, will not be enough to produce a World City*

### (7) Hong Kong is already World-Class on many fronts

There are so many world-class attributes to Hong Kong that make the city uniquely competitive even against the two World Cities; the two most important factors being convenience and safety. In Section 2, we elaborate on the strengths of Hong Kong's finance sector. In Section 3, we explore the strengths of the non-financial services sectors and find that the physical and informational connectivity of Hong Kong is unmatched by most cities and that it is much safer to live in Hong Kong than London. Hong Kong has the most efficient transportation system (only 0.3% journey delays on the MTR) and the geographical advantage of being positioned in the centre of Asia. Access to internet and mobile network is also one of the cheapest in the world.

*Hong Kong already has the building blocks of becoming a World City*

Services in Hong Kong are of such high standards that its tourist numbers are surging year after year without fail. There are plenty of choices for tourists but they like to visit Hong Kong because the city is a culinary capital and a shopping paradise. Food is amazing in Hong Kong because people are very particular about it; for instance, Hong Kong boasts the cheapest Michelin star restaurant in the world and has the only Italian restaurant with three Michelin stars that is outside of Italy. The restaurant business is extremely competitive, a total of 14,000 restaurants, 1.8 times London's despite having a size of population 10% smaller. People also wait in line to be served in luxury good shops such as Louis Vuitton and Chanel. This is a real testament to the service quality and value for money of Hong Kong.

*Hong Kong is a city full of critics, but critics are the reason why its service standards are so high*

Perhaps the most surprising trend is the emergence of the art and culture industry due to increased patronage in the city. Christie's and Sotheby's are reporting unprecedented revenues. ART HK has surpassed Art Basel as one of the most attended art fair in the world in its number of attendees; If trends continue, other creative industries such as music, theatre and ballet will also bump up to world-class status. We eagerly await for rock festivals (Rockit failed due to difficulties in securing necessary permissions from the government) and the return of Music Matters. The only missing ingredient seems to be more government support for talent development and providing talents with space to perform and practice.

*ART HK started only four years ago, and already surpassed the attendance for the two largest art fairs in London in 2011 to become the largest in the world*

Combined with developing the MICE industry, Hong Kong could win back the events business it loses to Singapore and Macau. The international business visitors are already in Hong Kong; with the boost of cultural offerings and additional venues, little can stop Hong Kong from capitalizing on its opportunities.

*There is obvious demand for more art and the government should facilitate the supply of venues, subsidies and easier procedures*

Entrepreneurship continues to thrive and aided by business-friendly practices. The only major limitation is high rent. However, Singapore has caught up; so although Hong Kong is still the preferred destination for starting SMEs and setting the Asia headquarters of MNCs, other things being equal, the lack of office, retail and residential space etc is pushing businesses to Singapore. Hong Kong has a fantastic start but like the story of the Tortoise and the Hare, Hong Kong has been sleeping for the past decade and now competing cities are catching up. In Sections 2 and 6, we elaborate more on the situation of the race in the finance sector.

*Entrepreneurship is alive and well and ensures competitive quality and prices*

*Singapore, despite less favourable surroundings, has caught up and even exceeded Hong Kong in some areas*

### (8) Building Hong Kong into a World City

Hong Kong certainly has the potential and momentum to become a World City if the many mind-set, institutional and infrastructural obstacles that are holding back its development are removed quickly.

*Hong Kong stands at the crossroads of either reaching up and become a World City, or standing idly by, allowing its lesser brethren overtake it*

We set out in Section 4 ("Call for Action"…) our recommendations, targeted to enlarge and improve both the city's hardware and software, in the hope that the entire community can reach up, invest its collective energy into devising public and private sector plans, and turn Hong Kong into an even more prosperous, vibrant, and compassionate World City for this and next generation.

*Turn Hong Kong into an even more prosperous, vibrant and compassionate World City*

**Action 1: Build Consensus – "Hong Kong, the World City"**

All segments of the community in Hong Kong and the leadership in China should appreciate the processes leading to the formation of a high calibre society which excels in services and a civic value system and in which the world has an emotional and economic stake. Future is very promising, but Hong Kong, as a community, must invest to expand service capacity and capability in the Golden 5 Years and China must allow "One-country, One-market" to evolve smoothly. Symptoms of shortage of hardware (rents and prices of most types of property) and software (full employment in most job sectors) are everywhere – there is a clear call for community to act. Considering the binary outcome facing Hong Kong in the Golden 5 Years, there already exists a common purpose for all segments of the community to "invest and become a World City"

*All segments of the community in Hong Kong and the leadership in China should understand what it takes to make a World City*

**Action 2: Build World-class Hardware**

(1) Increase Land Supply – and build better (environment-friendly and efficient) hotels, offices, shopping places, public and private housing, hospitals, universities, local and international schools, public amenities (sports facilities, libraries and study centres etc)… creating the space for new and better jobs and better environment for everyone. Hong Kong is turning customers away because (1) it simply does not have the space for them or (2) rents for the available spaces are prohibitive – good jobs, skills and business networks are denied to the young and best educated generation.

*More land, more hardware for new and better jobs and better environment for everyone*

If we use rent levels as objective indicators of tightness of supply Vs demand in the market, priorities for the government to produce developable land seem mis-placed. While housing rents have barely returned to their peak levels in 1997, rents for shops and offices are already doubled their elevated levels 14 years ago. Yet the bulk of this October's Policy Address was devoted to public Home Ownership Scheme (HOS).

*While home rentals only reached their 1997 levels, commercial rentals have doubled their 1997 highs*

The community should support the government's new initiative to create new land and land reserve (available in around five years' time at the earliest) and also encourage its faster implementation. Furthermore, the government should quicken approvals for projects already in the pipleline so that existing sites can be quickly developed to provide relief to current shortages. The University of Hong Kong School of Economics and Finance Professor Richard Wong's suggestions on "liquefying" the entire stock of HOS units are clearly workable and will add significantly to economic efficiency as thousands of households can regain mobility and move to the districts they want instead of getting "stuck" in a place they were allocated units many years ago. This will also quickly free up many units for first time buyers.

*Support the government's new initiative to create new land and land reserve and encourage its faster implementation*

*Follow Professor Richard Wong's suggestions and "liquefy" the stock of HOS flats*

We outline North Lantau and West Kowloon Reclamation for potential large scale projects to help with short to medium term supply of commercial hardware. Briefly, North Lantau includes sites owned by Hong Kong International Airport (HKIA) at Chek Lap Kok (we term "Gateway to the World" or "GTTW") and "Greater Tung Chung". GTTW's 57ha site is capable of supporting a huge 11m sf commercial development.

*Build "Gateway to the World" and "Greater Tung Chung"*

(2) Boost Hong Kong's Appeal as Travel Destination

*Tourists love to shop but we have no new destination malls. Hong Kong should look underground – WKCD looks promising location for new malls*

Hong Kong is one of the second most-visited city in the world and will likely surpass New York City, in another two to three years, as the most popular city-destination, hosting 58m visitors a year. While most visitors love the shoppers' paradise, hardware is increasingly inadequate and scenes of customers queuing outside shops are getting more common. Hong Kong has no new "destination" mall (sized 1m sf+) on its drawing board. To cater for the rising customer stream, new spaces have to be built. Professor Kwok-pun Cheung of The University of Hong Kong delivered a report to the Legislative Council in March 2011, suggesting the use of underground space (total estimated 15m sf) in West Kowloon Cultural Development (WKCD). In our third report we will explore using 2m sf of this space for retail use. We also suggest a range of measures to improve cultural and artistic contents for tourists.

**Action 3: Build World-class Software**

(1) Reinvigorate the city's medical capacity and unleash its potential

*Hong Kong built zero hospitals 2000 to 2010 Vs eight 1990 – 1999; Hong Kong must make up for the missing capacity in these few years, and as medical demand will rise with ageing population*

It is difficult to understand how no hospitals were established in the 2000s at all when eight were built simultaneously during the 1990s. Since the establishment of the Tseung Kwan O Hospital in 1999, the only new hospital still undergoing construction is the one in Northern Lantau that is now estimated to be in limited operation in 2013, which is 14 years after the start of the project.

Increasing reports of sentinel events is a clear reflection that the shortage of medical staff acts as a huge constraint for quality healthcare provision. There are currently some 12,000 doctors in the city at a ratio of 1.8 doctors per 1,000 population, much less than the average of 3.3 doctors per 1,000 population that OECD countries enjoy. Even with an efficient team of well-trained professionals, the demanding workload of over 60 hours per week on average lowers the service standard that a doctor provides. Our fourth report on how to create a World-class medical system highlights solutions to this burning issue.

(2) Enhance tertiary education attainment

*More educated/productive students are needed to offset falling workforce and rising demand for Hong Kong skills*

Grooming a World City depends much upon the talent pool of the city. Given the importance of knowledge in today's economy, one should expect that nowadays most talents have significant exposure to tertiary education. Hong Kong currently only has 18% of its population graduated from universities, much lower than that of many other developed regions in the world. In contrast, Singapore has 23% university graduates out of its population, and the United Kingdom at 24%; leading Hong Kong by 5-6 percentage points.

*Hong Kong produces 14,000 fewer university graduates than London*

Compared with London, Hong Kong falls behind by around 14,000 university first-year first-degree places per year. Hong Kong should therefore raise its university enrolment rate. Given that London receives students from the entire UK and the world, Hong Kong should look to its hinterland. The number of government-subsidised university places should be increased to enhance local educational attainment as well as more students from the mainland.

(3) Make Hong Kong a "magnet" to mainland talents

The development of Hong Kong into a World City requires free two-way flows of talents and businesses between the mainland and Hong Kong, so that the most efficient allocation of resources within One-country can result. This will likely result in a significant inflow of talents and capital into the southern city and Hong Kong should accommodate this natural flow because this will create jobs for the young generation.

(4) Attract and retain international talents

*More international talents, more international schools*

A world city cannot be truly international without expatriates adding colour to its cosmopolitan nature. However, recent developments have showcased some glaring deficiencies that critically undermine Hong Kong's attractiveness to overseas talents. The shortage of quality international schools in Hong Kong is a major inconvenience for expat parents, driving experienced talents out of the city: 75% of the British Chamber of Commerce's members reflected their businesses in Hong Kong are detrimentally affected by the lack of international school places.

Surveys carried out by the American, British and Canadian chambers show similar conclusions that expats are moving to other cities such as Singapore for they cannot secure a place for their children at an international school. Famous investor Jim Rogers is a real life example who chose to relocate to Singapore over Hong Kong because it offered a better environment for his children.

(5) Freshen Hong Kong's air

A long-time complaint by locals and expatriates alike. While concrete steps have been taken by the government, there is still significant room for improvement.

(6) Promote the city's art scene

This is an area where quality and quantity of both audience and professional art talents in are found wanting. This is not to say Hong Kong does not have discerning connoisseurs and great artists, but they are few in number when compared to London and New York City.  Hong Kong needs to groom its art and culture scene towards maturity and recognition to gain an equal standing with other World Cities. Offerings in Hong Kong are less diverse than other cultural hubs mainly due to two reasons: audience's unresponsiveness and limited venue availability. As an illustration of the matter, the Hong Kong Cultural Centre is fully booked two years in advance, but only 12% of performances there are from international groups. The first reason has been gone through above, sufficient to add that internationally renowned music performers and groups have increasingly bypassed Hong Kong to give concerts in Shenzhen or Guangzhou (let alone Tianjin, Shanghai or Beijing), citing declining attendance as one cause. For the second reason, both the quality and quantity of cultural hardware in Hong Kong are in severe shortage, which cannot even satisfy local need.

*WKCD – Proceed with all haste and make sure phase 1 is >25% of entire project*

Locating performing venues in Hong Kong has been based on needs of local districts, thus neglecting the clustering effect that could be created by location proximity of different art facilities. This is why the WKCD can be an enabling factor for Hong Kong's art and culture development. Baby boomers' imminent retirement boosts demand in art and culture activities, thus spurring corresponding development. In order to catch the rising tide of retirements, the Legislative Council should approve whatever request for extra funding so that the project can proceed at the fastest pace possible.

*A successful debut of WKCD phase 1 is a prerequisite to a sustainable arts and cultural hub in the future*

If we are going to tread the path as the WKCD Authority drew, the 9%-opened "cultural district" is likely to disappoint on its phase 1 debut 2015. No matter how ingenious the planning of the first phase is, a fragmented conception of WKCD can never blossom into the splendor originally intended. The 700,000sf composite phase simply is too small to draw crowds even if it is used entirely as a shopping centre. Public disappointment at the completion of 9% will snuff any rosy vision of the remaining 91% and WKDC will be stillborn. To improve the chances of success and to ensure sustained support by the public, WKDC should significantly increase the size of phase 1 to at least 25% of the project.

*Art – the quiet boom*

Following the gradual rise of China, worldwide attention has increasingly turned to Oriental art, and the centre of gravity of art and cultural activities has been moving from the West to the East. Nowadays more and more local and international art connoisseurs gather together in Hong Kong, which we expect to increase further in parallel with the increase in corresponding demand. This is not wistful optimism: record-breaking art fair auction (ART HK) this year and the rapid expansion of the number of top galleries in Hong Kong are just tips of the iceberg.

The reality is that art and cultural activities in Hong Kong grow with the size of their attendees. It suffices just to give a few examples: attendance of the Hong Kong Art Festival was well over 90% in past few years; contemporary art festivals and the artwork they exhibit (a significant portion is local), especially visual art like film, painting and photographing, have been enjoying international critical acclaim for decades.

In Section 4, we have identified the actions the community must take in order to take advantage of the inflow of opportunities in the Golden 5 Years and propel Hong Kong to a better future. One of the keys to success involves your participation, thus we would be grateful if you could disseminate our reports which explain the Hong Kong situation and our call for improvement to other Hong Kong stakeholders.

We sincerely hope that you find this report informative and valuable. Feel free to send us your comments and suggestions by emailing friends@hkgolden50.org and please stay in touch through our website www.hkgolden50.org.

*Boom in Hong Kong art fair / auctions / galleries shall diffuse to all walks of art*