

Hong Kong: Challenges and Opportunities of a Rising China

(A talk given by Mr Andrew Leung, Director-General, London, of the Hong Kong Special Administrative Region Government, to the Institute of Economic Affairs on 19 January, 2003)

The convergence of internal and external developments

Never before in the history of China has there been such a convergence of favourable forces spearheading its rapid growth in the world economy:

Externally,

- International and regional market barriers are coming down everywhere with China joining the World Trade Organisation, a vastly expanded European Union and closer economic cooperation amongst Asian nations. This enables a more efficient international division of labour with China becoming the Factory of the World with the best comparative advantage in terms of the quality/cost ratio. It has already overtaken France as the world's fourth largest manufacturing exporting country and is still growing rapidly.
- The world's container shipping has also been noticeably shifting to Asia as a whole, with the top six of the world's container ports all located in Asia (i.e. Hong Kong, Singapore, Pusan, Shanghai, Kaohsiung, and Shenzhen with Rotterdam dropping to No.7).
- With more developing countries pursuing pro-economic development policies, the world has recently witnessed a rapid growth of the middle class across the continents in Eastern Europe, Asia and Latin America. This has contributed to a greater variety of markets for consumer goods in which China has maintained a leading manufacturing position.
- With general deflation and sluggish performance in the world's major markets including the US, EU and Japan, international corporations are increasingly mesmerized by the potential of the China market. This is exemplified by the surge of Foreign Direct Investment in China in 2002 when with over US\$50 billion FDI it overtook the US as the world's foremost FDI recipient. Pledged FDI swelled by 38% during the first 10 months in 2002 and

China's exports and imports respectively increased by over 30% in September/October.

Internally,

- With nearly a quarter century of Open Door policies, China, especially the Pearl River Delta, has now developed the knowledge and skills necessary to produce consumer products that can match the best in the world. The Made in China label is now commonplace in high quality and higher-priced goods in the leading department stores around the world. Increasingly, such exports are also fast moving up the technology ladder. For example, China's IT hardware output of US\$35 billion in 2002 overtook Japan's US\$31 billion as the world's second largest electronics producer after the US. China's IT sector is growing at a rate of 25% p.a. and is accounting for over 85% of China's export growth.
- Increasingly, the buyers of the leading supermarket chains in the world are flocking into China with Shenzhen fast turning into a leading sourcing centre of the world. Walmart is said to be buying from China annually about US\$10 billion worth of goods for the supply of its stores throughout the world.
- A critical mass of a middle-class has been formed with over 200 million people in the Pearl River Delta, the Yangtze River Delta and the coastal cities in China. The consumer market is estimated at over US\$560 billion, attracting the presence of such international household names as Walmart, Carrefour, B & Q, Ikea, Kentucky Fried Chicken, McDonald's, Starbucks, and TGIF.
- Supported by China's continuous economic growth, infrastructural projects of historic proportions are being implemented, including the largest water resources projects the world has ever known, i.e. the Three Gorges Dam and three 1,300 km long man-made canals in three stages over the next 50 years at a cost of US\$60 billion connecting the Yangtze to the Yellow River as a means of solving the drought problem in the latter area; an oil/gas supply line from the Western region to the East; a similar electric power supply line from the West to the East; and a Tsinghai-Tibet Railway.

- The growth of highways and expressways has been phenomenal, increasing from just over 500 km to some 20,000 km in 10 years, leading to a rapid development of more townships and small cities. Coupled with the rise of disposable income, this has led to an unprecedented expansion of over 40% in 2002 of the saloon-car market, which has caught off guard even some the world's leading automobile manufacturers with a presence in China.
- China has secured a number of significant international recognitions, including WTO entry, the hosting of the Olympics in Beijing in 2008 and the World Expo in Shanghai in 2010. There has never been a more gung-ho national mood, supported by China's ascendance in international political, sports and scientific arenas, including making the World Cup Finals, the launch of Yao Ming in the NBA league, and the recently announced plan for a soon-to-happen manned space flight. In particular this national spirit is encapsulated in Shanghai, a showcase attracting the eyes and minds of the world, with its impressive skyline, the world's only commercially-run Maglev high speed train and courting such brand names as Vivienne Westwood, Formula One, and Universal Theme Parks.
- China's WTO membership has meant not only a massive lowering of tariffs, but the imposition of a much more transparent and level-playing economic and trading system subject to international enforcement. Already China has amended or abolished 2,200 laws and over 1,000 departmental regulations in compliance with WTO standards.

The Challenges of transition

- Continuous high economic growth is necessary to generate sufficient resources not only for the many infrastructural developments but also for the many new jobs required for the multitude of displaced workers resulting from the post-WTO restructuring of State Owned Enterprises and from the development of the countryside.
- The eye-catching rapid development of the two Deltas and the coastal region contrasts sharply with the much less developed interior, including the Western Region, leading to observations of the 'many different China's' on the Mainland and concerns with social and economic polarisation.

- There has been a substantial legacy of non-performing loans linked up with non-competitive State Owned Enterprises and a banking and financial system still open to significant improvements. The problem is accentuated by an increasing burden of social protection and an ageing population. As public revenue still lags behind international norms despite a tightened taxation system, the challenge is to maintain financial stability while the reform process and economic development are catching up.
- Despite the booming Factory of the World and the shine of Shanghai, there is a need for better transparency, level-playing field, and corporate governance in order to achieve long-term growth. In view of China's size and socio-economic complexity and diversity, the transition into international norms of rule by law and rule of law will be a continuing and arduous process.

A coordinated development blueprint

- The development strategy is characterised by the following:
 - Spurring China's manufacturing advantage, the growth of a home economy, its global economic integration, and the development of more orderly market forces and a greater rule-based system through the WTO;
 - More rigorous reform of the banking and financial systems through re-structuring the machinery of prudential supervision, including the formation of a new Banking Commission;
 - Continued reliance on Foreign Direct Investment for technology and skill transfer, including re-vitalising the stock market through such schemes as Qualified Foreign Institutional Investor (QFII);
 - Tapping the huge reservoir of domestic savings through such schemes as Qualified Domestic Institutional Investor (QDII);
 - Leveraging the rapid development of the two Deltas and the coastal region;
 - Maintaining the momentum of investment in education and technology, including turning out over 2 million qualified engineers a year;
 - Minimizing polarisation through capitalising on regional imbalances e.g. a West to East energy transfer; a South to

- North water transfer, and the spreading of economic development further inland especially the Western Region;
- Fostering the gradual development of a more transparent and law-based society with greater public participation through such measures as encouraging the media to monitor consumer protection and the day-to-day delivery of public services; fostering greater public representation at the village level (which accounts for the majority of China's population); and recently reported plans to experiment in Shenzhen the separation of the functions of the Party, the Executive and the Legislature and to set up a think-tank on political reform at the Central Party School in Beijing;
- In short, sustained long term economic growth based on stability.
- The national drive to long-term economic growth has recently been enshrined by the adoption of national strategies, directives and policies at the 16th Party Congress, which embraces the target of development of a 'middle income' society, the emphasis on productivity, and the creation of a more law-based social and economic framework.

Salient Business Opportunities in China

- The following are some of the more obvious possibilities and are by no means exhaustive:
 - Corporate restructuring, re-marketing, refinancing and equity investment in the wake of WTO entry.
 - Beijing Olympics 2008, including supporting services and merchandising.
 - Shanghai World Expo 2010, including consultancies, project development and commercial propositions.
 - Other major Shanghai projects including Universal Theme Park, Formula One, and deep-water port development.
 - Manufacturing, including light manufacturing in the Pearl River Delta and automobile components and accessories manufacturing.
 - Logistics services and management.
 - Transport and air services.

- Targeted research and development.
- Supermarket and other chain stores.
- National marketing and distribution for branded products including mid-range apparel and premium consumables as well as services in such areas as health, insurance, leisure, beauty (toiletries and treatment), specialized clinical services and retirement homes.
- Educational services, including One Stop Service preparing for entry into western universities and English language training.
- National and provincial infrastructural developments, including power, energy, environmental, transport, and urban development.
- Property development in leading cities.

The driver role of city-hubs (Shanghai and Hong Kong)

- The grid of North-South and East-West national trunk roads and railways has been planned and constructed over the past decades with Shanghai as the radiating hub. This is being further augmented by major railways and expressways linking neighbouring cities like Nanjing and Wuxi. Zhu Rongji has recently advocated the extension of the new high speed Maglev train to other cities. Apart from a brand-new international airport, Shanghai is building a world class deep-water port. With a population of 16 million, it is attracting some of the best talents in the country and an increasing multitude of the world's largest multi-national corporations. Its leading economic influence is undisputed in the Yangtze River Delta extending all the way from Wuhan to Chengdo and in the adjacent provinces, covering a total population of over 120 million and such fields as heavy industries, trading, marketing and distribution, finance, and research and development.
- The story of Hong Kong has been legendary. Under the One Country Two Systems formula, its free economy, its internationally convertible currency backed by the world's 5th largest foreign currency reserve (US\$ 112 Billion) and its Rule of Law represented in its robust legal, economic and financial systems continue to attract a lion's share (47%) of Foreign Direct Investment in China. Moreover, it strategically drives the light manufacturing powerhouse (Factory of the World) located in the Pearl River Delta (the fastest growing area in the fastest growing

Province), where Hong Kong entrepreneurs either own, in joint venture or contracting arrangements with over 90% of the enterprises there, employing over 11 million workers, according to the latest Chamber of Commerce assessment. With the support of the Central Government, a vigorous infrastructural and administrative initiatives, including 24-hour border crossings, streamlined visit procedures, and plans for the construction of a Hong Kong-Macao-Zhuhai bridge, are being put in place to promote a freer flow of goods, people, capital and information and to leverage Hong Kong's economic integration with the Delta. Additionally, Hong Kong remains a world-class international city and a leading financial centre in the whole Asia Pacific, servicing for example over 90% of the syndicated loans for the whole of China and a One-Stop hub for the multifarious financial, trade, logistics, as well as for the managerial and professional services and network required for the development of the entire China market.

Hong Kong's Challenges

- Economic re-structuring
 - Hong Kong recovered remarkably well from the post-1997 Asian Financial Storm with GDP growth bouncing back to 10.4% in 2000. However, this soon dropped to slow growth against a global recession and deflationary trend. Its current economic gloom is manifested largely by a record-high budget deficit of 5% of GDP; high level of unemployment of over 7%; the bursting of a property bubble with prices down by 65%; factor price equalisation with the neighbouring Guangdong Province; and weak consumer sentiments amidst cumulative deflation of some 13% since 1998.
 - There are still concerns with Hong Kong's supply of technologists, its standard of English and the quality of its environment.
 - On the other hand, November export figure was up 17.3 % year-on-year and tourism totalling 16.5 million visitors last year, represented a record-high growth of 50% over the 1997 level. 6 million of these were high-spending Mainland visitors (an increase of 52% over 2001).
 - Fitch's January rating maintains HK's long term foreign and local currency rating at AA- and AA+, on account of HK's absence of

external debt; foreign currency reserve of 3.5 times monetary cover; fiscal reserve of 20% of GDP; current account surplus of 8% GDP; and net external claims at 90% GDP. All these deemed to be supported by a robust banking system and a generally working One Country Two Systems.

- The latest Policy Address focuses on (a) Cutting the budget deficit, initially through a more vigorous control of public expenditure to cap it to no more than 20% of GDP by 2006-7; (b) Forging Closer Economic Cooperation with the Mainland, particularly the Pearl River Delta; and (c) Promoting economic recovery especially in our core industries of finance, trade, logistics, IT and tourism, including enhancing the business environment and human resource development.
- There are concerns of diminishing Mainland dependence on Hong Kong as a locomotive for attracting foreign businesses. On the other hand, while there are ample areas for economic cooperation, there is also increasing competition between Mainland regions and cities. The politics and economics of regional development have become increasingly important.
- While the recently introduced 'Ministerial System' has enhanced Hong Kong's governance, the challenge remains to demonstrate that under the existing political structure, Hong Kong is able to re-galvanize and re-invest itself to leverage the full potential of Hong Kong's strategic position in capturing the dynamisms of a Rising China.

Hong Kong's Strategic Role

- Mainland China is still relatively new to the global business environment. In particular, while its technical know-how is advancing rapidly by the day, its rule of law, its international business exposure and network as well as its professional and managerial skills still leave room for enhancement, especially in the light of the vastness and diversity of China and its breathless pace of economic development following WTO entry.
- With its international experience and network, its excellent business infrastructure, its unbiased legal system and its internationally convertible currency, the Hong Kong advantage, its current economic challenges notwithstanding, is there to be tapped to unlock the full

potential of this greatest market frontier of the 21st Century. Indeed, for a long time to come, especially for the uninitiated, this advantage remains crucial for a company's balance sheet in the sometimes still uncertain and diverse China market.

- Like other large world markets such as the US and the EU, China, with its geographical spread and diversity, requires more than a single business hub.
- International trade is not a zero-sum game. Hong Kong accounts for some 40% investment in Shanghai and many China-based businesses, those from Shanghai included, continue to maintain a presence in Hong Kong in order to take advantage of Hong Kong's sophisticated international business capabilities and separate status under the One Country Two Systems formula. The twin city hubs interact to create a greater potential for the China market.
- Hong Kong is becoming -
 - Entrepreneur for the Factory of the World in the Pearl River Delta;
 - Window to the World for Chinese enterprises to 'walk out';
 - Supply chain and logistic hub for China;
 - Financial centre for China's international businesses, including SOE re-structuring;
 - Integrator of best-practice professional services for the whole of China;
 - A hub for regional headquarters for international corporations;
 - A regional centre for science and technology;
 - A regional telecommunication hub;
 - A regional media and press centre;
 - A tourism centre for SE Asia.

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