DGL's speech to the LSE

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Following is the full text of the speech by the Director-General of the Hong Kong Economic and Trade Office, London, Mr Andrew Leung, at a seminar organised by the London School of Economics and Political Science on July 3, 2002:

Hong Kong: Beyond the Clouds

Hong Kong has always been a place full of wonder and paradox. A place of contrasts and rapid change. A place susceptible to the vagaries of world markets and the developments in Mainland China. It is not surprising that in spite of being proved far off the mark from time to time, various commentators, interlocutors and research agencies continue with their speculations on the fortune of Hong Kong. A good example is Fortune Magazine, famous with that short-lived prediction of "Death of Hong Kong" in 1995, followed by their proclamation in November 2000 that Hong Kong was the best business location in the Asia Pacific. Their latest critique is "Who Needs Hong Kong?"

Over the past 5 years, Hong Kong's successful implementation of the unique One Country Two Systems formula has been internationally acknowledged. Our economy recovered better than our neighbours from the Asian financial storm with GDP growth rate picking up at 10.4% in 2000.

However, clouds are indeed appearing on Hong Kong's horizon. With the onset of world economic slowdown, we registered a 0.1% growth rate in 2001 and expect a forecast growth rate of only 1% for 2002. In spite of some signs of recovery, our economy on the whole is not completely out of the woods. Internal consumption remains sluggish in a period of continued deflation and wage reduction. Property prices, historically a mainstay of Hong Kong's economy, have nose-dived resulting in negative equity and have remained generally depressed, as the inflated asset bubble had burst. With continued down-sizing, unemployment has reached a historical level of 7.4% and personal bankruptcies are on the rise. We have a sizeable budget deficit (estimated at about 5% of GDP). There is increasing talk of China-related businesses beginning to bypass Hong Kong. Our long-term competition is questioned, as are our standards of English, our air quality and indeed, the general mood of the community.

Can Hong Kong's fortune again change so drastically? In face of these uncertainties it would be educative to examine Hong Kong's fundamentals, including our innate strengths and weaknesses.

First, no economy in the world, including China, is able to sustain double-digit growth rates forever. Hong Kong has become a mature economy with 85% of our GDP in services. A more sustainable long-term growth rate can be expected.

Secondly, we are a highly externally dependent economy, with external trade representing 220% and net external financial assets 168% of our GDP. So we are relatively more susceptible to outside influences such as the Asian financial storm and the world economic recession.

Thirdly, with factor-price equalisation with a rapidly developing China market, it will take sometime and some pain for Hong Kong to complete the necessary re-structuring into a knowledge-based economy.

Accordingly to the IMF and the Economist Intelligence Unit, our economy is set to grow by 3.2% and 3.3% respectively for 2002-6, in line with our own conservative forecast of 3%.

On the other hand, over the past two years, at a time of continuing global economic downturn, the number of new US companies set up in Hong Kong (mostly as regional headquarters) had grown by 33%, Japanese companies by 44%, Australian by 53% and European by 23%. To mention just a few examples, in 2001, Boeing decided to establish its regional HQ in Hong Kong; Eli Lily merged its Asia Pacific centres from Singapore and Shanghai into Hong Kong; Swiss Re, the world's second largest reinsurance firm, relocated its Asian Division from Zurich to Hong Kong, to cover Beijing and Shanghai as well.

Why do all these companies need Hong Kong? They are unlikely to be in Hong Kong just for the short haul. The developments which I have outlined obviously represent the outcome of some hard corporate soul-searching.

There is no doubt that these companies are there because of the bigger picture - Hong Kong's synergism with an enormous Mainland China market. The size of the China market is estimated at US$1.2 trillion, growing at 7% p.a., and is set to grow to one third of Japan's projected GDP by 2005, the size of Germany by 2010, and probably the world's second largest economy by 2020 using PPP measurements. These forecasts are made plausible as China is becoming the Factory of the World from garments to integrated electronics, including such latest gadgets as flat-screen television. For example, it already accounts for 29% of the world's production of colour TVs, 32% of air conditioners, 50% of photocopiers and 21% of personal computers, with rising levels of quality and sophistication.

This Factory of the World is in the Guangdong Province's Pearl River Delta (PRD) (1) where Hong Kong supplies over 70% of Foreign Direct Investment (FDI) (2), and employs more than 5 million workers in some 40,000 enterprises with 25,000 outward processing arrangements. Over 80% of South China's cargoes are exported through Hong Kong - the busiest container port in the world. Indeed, Guangdong's share of China's total imports rose from 14% in 1992 to 39% in 1997, manifested largely as Hong Kong's re-exports to the Mainland. Every year, there are about 120 million pedestrian and 10 million vehicle crossings across the boundary.

With the international convertibility of the Hong Kong Dollar, Hong Kong remains highly attractive as a leading financial centre for Mainland related businesses. Since the 1980's, 90% of the syndicated loans in the Mainland was arranged with Hong Kong financial institutions as lead managers. Since the late 1990s, there have been increasing floatation by Chinese 'red-chip' companies and H-share listings in Hong Kong (3). In 2000 and 2001 alone, the total capital raised by Mainland enterprises in Hong Kong reached US$68 billion. In addition, ideas are being floated to tap the huge reservoir of public savings on the Mainland through such vehicles as Qualified Foreign Institutional Investors (QFII) and Qualified Domestic Institutional Investors (QDII), including the handling of RMB-denominated deposits in Hong Kong.

So Hong Kong is already the dynamo behind the PRD powerhouse; a key logistics portal for the flow of its multifarious goods and services; and a leading international banker to the entire China market.

Further momentous economic changes are taking place in Mainland China. The critical mass of an accelerating huge internal market has taken shape with the rapid growth of a middle class. The demand seems insatiable (4) in the main cities for newer and better consumer products and services taken for granted in the West. Although the Mainland market for domestic goods is still dominated by local brands, global brand names are beginning to establish bridgeheads in key Chinese cities, such as Starbucks and TGIF in Beijing, Ikea in Shanghai and Walmart in Shenzhen. Meanwhile, China has outnumbered the USA as the country with the most mobile phone subscribers - 160 million, still adding over 4 million more a month.

There have been marked shifts in consumption patterns towards higher quality imports (5) as well as such services as chain store and distribution centres, travel, leisure, physical well-being, education, insurance and advertising. (6) Moreover, concomitant with the development of China's role as Factory of the World, capital and intermediate goods are accounting for a growing proportion of China's imports. (7) According to President Jiang Zemin at the Hong Kong World Economic Forum in October 2001, China was to import US1400 billion worth of facilities, products, equipment and expertise for the next 5 years. (8)

These developments are integrated in one way or another with Hong Kong, including capital and trade finance, freight and transportation, supply chain management, professional, marketing and other services. More Hong Kong companies are already expanding their Mainland production for sales within the China market.

What is more, the truly private sector only accounts for about one-third of China's economy. The remainder, including many large State-Owned Enterprises (SOEs), urgently need to be reformed, re-engineered and re-marketed, both to grapple with an increasingly competitive environment in China and to 'walk out' (9) into the global market-place. It is estimated (10) that additional investment capital of some US$210 billion and a multitude of international corporate skills will be required to re-vitalize the state sector. As an externally oriented economy, Hong Kong is well poised as China's 'Window to the World' to service this transformation of stupendous proportions as we continue to capitalize on our excellent financial, logistics, legal, accounting, management, marketing and other professional expertise as well as our international connections.

The above developments are set to accelerate now that China has joined the WTO, as tariffs are drastically cut; procedures made more streamlined, consistent and transparent; and international monitoring and enforcement mechanisms put in place.

Already, in line with its urbanisation strategies, China has been adding more than 230 cities/towns and over 1.65 billion square metres of non-subsidized middle-income housing during the past 4-6 years.

Let me hasten to add that such developments are by no means a bed of roses. China is such a huge and diverse market. China's WTO accession has accentuated the problems of non-competitive SOE's, including large portfolios of non-performing loans; mounting public debt; a sizable pension deficit; regional polarities with rising unemployment and labour redundancies; continued efforts in strengthening a law-based business environment with a higher level of consistency and corporate governance; the demand for more investment capital; and the need for more training and re-training in the skills and expertise for international businesses. All these challenges will become even more urgent if the economy continues to grow at 7% p.a., if China's Factory of the World continues to expand its global reach, and if more and more SOEs can be turned around to compete in the market place both internally (11) and internationally.

Nevertheless, China's dynamic growth means that these 'ifs' are looking like more than mere assumptions. And Hong Kong, as explained above, is fulfilling our two-way bridging role both as a pivot and a catalyst to leverage the China market for international investors and to help enterprises in China to take part in global competition.

Here I feel obliged to address some 'Frequently Asked Questions': Has Hong Kong lost its exclusive franchise, for doing business in the Mainland, with a booming Shanghai in the north; a high growth Yantian container port right next door to Hong Kong; and Taiwan trading more directly with the Mainland? My reaction is that Hong Kong's unique blend of rule of law, transparency, freedoms, financial sophistication and business efficiency (12), concentration of over 100,000 companies proficient in China trade, coupled with a multitude of fully networked multinational companies and Mainland enterprises, cannot be easily replaced. Moreover, international trade and business are not always a zero-sum game. Hong Kong's synergy with the Mainland market could only result in further market expansion for all players. In any case, vast markets such as the US, EU and China need more than one single business and logistic hub.

Does increasing integration with the Mainland mean gradual erosion of Hong Kong's autonomy? The remarkable paradox is that the integration has happened because of the usefulness of our autonomy, not in spite of it. Why should businesses both inside the Mainland and abroad seek out Hong Kong if we are just another Chinese city? Indeed, our autonomy is our most precious asset which would become even more precious by being used to expand and leverage the Mainland market.

But how well are we equipped to realise our destiny? The latest Budget has laid all the cards on the table - a direction to tackle the budget deficit, to re-hone our competitive edge by what the Financial Secretary calls the "3Rs and 1M" - Re-prioritising, Re-organising, Re-engineering and Market-enabling, promoting more corporatisation, privatisation and outsourcing and to provide more room for the private sector. A recent corollary was a decision to reduce significantly Government's supply of Home Ownership flats with greater emphasis instead on housing loans. This has been followed by a vigorous revamping of the Government's authorities on housing policies and their implementation.

Public expenditure will be capped at half (1.5%) of our trend GDP growth rate. Emphasis is laid on more broad-based growth including logistics and tourism, away from a dependence on land revenue. 25% of Government expenditure will be invested in education, including programmes to improve our standard of English and to increase post-secondary education opportunities to 60% of school leavers, within 10 years.

There will be gathered momentum to reinforce Hong Kong's culture of service, technology and entrepreneurship. More corporations will be encouraged to take part in applied research and development in collaboration with our universities. New institutions (13) have been set up to foster greater design creativity including integrated circuits, production technologies (14), and brand name development (15).

Over the next 10 years, US$75 billion will be invested in some 1,600 rail and infrastructure projects to further enhance our infrastructural environment and economic links with the Mainland, including a high speed train cutting journey time to Guangzhou to 30 minutes. The Hong Kong SAR Government has recently opened an Economic and Trade Office in Guangzhou and the Hong Kong Productively Council is setting up 9 centres in the Pearl River Delta to serve Hong Kong entrepreneurs. In addition, consistent with WTO rules, a closer Economic Partnership Agreement between Hong Kong and Mainland China is being pursued.

Meanwhile, a new 'ministerial' system has just been introduced, with politically appointed and accountable non-civil service 'ministers', including those drawn from business and professional sectors as well as the leading political parties, forming a new cabinet to support a coordinated and focussed government agenda. These new-styled 'ministers' will be much more proactive and better placed in winning the support of the community and the legislature.

In spite of September 11, visitors to Hong Kong in 2001 registered a 5.1% increase with a 7.9% increase expected this year. One third of these are business travellers, and half of these are holiday makers. What is more significant, Mainlanders account for 32% of these visitors, with a 17% increase year on year and 48% for the first four months. (16) These numbers are bound to increase further following the opening of Hong Kong's Disneyland in 2005 and the development of a Las Vegas-type entertainment resort in neighbouring Macao.

In brief, a clearer picture is emerging, as 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' to the global market-place

* Supply chain and logistic hub for the China market

* Financial centre for China's international

businesses, including the re-structuring of SOEs

* Integrator of best-practice professional services

for the whole of China

* A hub for regional headquarters for

international corporations

*„hA regional centre for science and technology

* A regional telecommunication hub

* A regional media and press centre

* A tourism centre for SE Asia

With Mainland China requiring all the help it can get to continue to transform and to realise the full potential of its huge economy, Hong Kong's strategic role can hardly be overestimated.

True, we are still in the throes of economic re-structuring as we try to make up for deficiencies and re-double our efforts to take advantage of the momentous economic developments in China. Yes, we sometimes err. But we always try and do better. Furthermore, our system remains free, open and flexible. We are still voted the freest economy in the world by such respectable organisations as the Heritage Foundation, the Cato Institute and the Fraser Institute. (17) Even Fortune Magazine (which, incidentally, maintains its Asia Pacific headquarter in Hong Kong) (18) said in the same article 'Who Needs Hong Kong' that "Hong Kong is still a better, easier, safer, more honest place to do business anywhere in Asia."

As quoted elsewhere, we can't prevent the dusk from falling. But after midnight, a new dawn will come: and with a new day, sunshine is just behind the clouds.

Thank you.

Footnotes:

(1) With a population of 48 million and a GDP of some US$258 billion, more than Switzerland, Sweden or Austria

(2) Hong Kong accounts for nearly 50% of total FDI in the whole of Mainland China

(3) The combined market capitalisation of red-chips and H-shares in Hong Kong rose from 3.5% of Hong Kong's total market capitalisation in 1994 to 16% by mid-1998. Transaction of red-chip and H-shares also expanded from 5% of total turnover to 23% during the same period

(4) Total retail sales of consumer goods in China are estimated at US$560 billion in 2000 and are expected to increase by 9-10% p.a. in real terms up to 2010

(5) China's imports of manufactured articles including travel goods, handbags, clothes, shoes and watches increased more than 3 times from US$1.9 billion in 1986 to US$8.6 billion in 1997

(6) At the end of 1997, China signed a total of US$190 billion (36.3% of total) foreign investment contracts in the services sector. Between 1994-1996, billing of international advertising agencies in China grew on average by 110% with their market share rising from 10% to 21%. Between 1994-96, China's tourism business recorded an average growth of 44.2% p.a.. The World Tourist Organisation expects China to be the world's most popular tourist destination by 2020 with the number of tourist visiting China increasing by 9% p.a. to over 137 million

(7) In 1997, industrial and office machinery accounted for 19.1% of China's total imports, followed by chemicals and plastic materials (13.5%), electrical apparatus and parts (9.1%) and textile yarns and fabrics (8.6%)

(8) China plans to build 10,000 km of railways; 170,000 km of roads; more ports with a daily cargo handling capacity of at least 1000 tons; and plans to improve telecommunications, power supplies, flood controls and sewage

(9) 'China's Foreign Economic Trade in the 21st Century', - Shi Guangsheng, Minister of Foreign Trade and Economic Corporation, in 'China's Century', by Laurence J Braham

(10) China's State Council study report "Strategic Restructuring the State Economy", 1997

(11) SOE's with good recognition and sales channels could become strategic partners in widening distribution in the China market

(12) For example, at Hong Kong's Kwai Chung container port, the typical turnaround time is within the same day, compared with at least double the time in a Mainland port. Moreover, with computerised management, Hong Kong routinely handles fractionalised container bookings, not yet possible in Mainland ports. The paperwork in Hong Kong is much simpler and straightforward. Moreover, land and air cargo transport to and from Hong Kong have posted buoyant growth trends at over 7% and 10% p.a., as more and more international electronics producers are taking advantage of the Factory of the World in the Pearl River Delta.

(13) Such as the Cyberport; the Hong Kong Science and Technology Parks Corporation; the Applied Science and Technology Research Institute; and a new Hong Kong Design Centre (in September 2002)

(14) This complements China's strong technology research base with some 5.7 million engineers and technologists. In 1996, China developed some 31,000 technology-based products. For example, China Changfeng Service and Technology Industry Group's micro-fabrication technology has been adopted by Motorola for its mobile phone manufacturing

(15) Successful Hong Kong brands include Giordano, Baleno and Jeanswest.

(16) Following a recent relaxation of restrictions on tour groups from the Mainland

(17) Published by the US-based Cato Institute and Canada's Fraser Institute and Institutes from 54 other countries, the sixth annual report of the Economic Freedom of the World 2002, released in late June 2002, continued to rate Hong Kong as the freest economy in the world, followed by Singapore, US and the UK

(18) Hong Kong also has the highest number of daily newspapers (800) per 1000 population: The Economist Pocket World in Figures 2001

End/Thursday, July 4, 2002

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