

As China Surges, Hong Kong Holds its Own

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A little more than twelve years ago, in 1997, the British handover of Hong Kong to China was headline news. Concerns over the future of the former colony's free market economy and open society were addressed in the Basic Law that now governs the Hong Kong Special Administrative Region (SAR), with the core provision that the city-state would retain self-government in all areas except security—the so-called “one country, two systems” solution.

One doesn't hear much about Hong Kong these days, but that's largely good news, as the compromise embodied in the Basic Law seems to be working. Though not a pure democracy, political debate is lively, the judiciary remains independent, and the economy operates beyond the reach of Beijing's *diktats*. One suspects that there's some self-censorship at work, since Hong Kong's authorities have little interest in offending Beijing by straying too far from the reservation. But by and large, China's government has kept a low profile, ruling with a light hand and allowing Hong Kong to follow its own path.

Twelve years ago—when access to the mainland was more difficult—Hong Kong was positioned as the gateway to China. Today its future revolves around a new question: What role will it play in the new era when access to China and its markets is more open and Western companies are going there directly? This question becomes more telling in light of Beijing's push to promote Shanghai as a financial center.

For global business, Hong Kong continues to offer a distinct portfolio of asserts:

Rule of Law: In contrast to the mainland, Hong Kong continues to use the common law system inherited from the British, ensuring a transparent legal system that is largely free from politics. An established legal framework particularly helps in cases involving intellectual property, which is respected and protected.

Minimal Corruption: Hong Kong takes corruption seriously. Its 1300-employee Anti-Corruption Commission occupies a 27-story tower and aggressively pursues corruption through both education and enforcement.

Convertible Currency: While Shanghai will grow to become an important financial center, China's currency is not yet freely traded. Until that occurs, China's efforts to grow either Shanghai or Beijing into an international financial center will be hobbled. In the meantime, Hong Kong is the only place outside mainland China that is able to issue Renminbi (RMB) denominated bonds, handle RMB-denominated personal accounts, and act as a settlement center for RMB-denominated trade accounts.

Geography: Geography is still important. Hong Kong's central location between North-east and Southeast Asia, offers more convenient access to Asian markets (i.e., shorter flying time) than Shanghai or Singapore, its principal competitors.

Market Intelligence: Multinational business operations based in mainland China may be seen elsewhere as reflecting a primary focus on China, not Asia as a whole. As a city that is primarily identified as a regional hub, Hong Kong remains unsurpassed for its free flow of information and access to market intelligence on both China and Asia.

The Pearl River Delta: Hong Kong's ace in the hole may be its location in the Pearl River Delta, home to 65 million of China's wealthiest consumers, and the burgeoning technology and manufacturing center of Shenzhen (where much of Hong Kong's production is already located). A new high-speed rail line linking Hong Kong to Guangzhou and the rest of China, and a new 40 km cross-delta bridge to Zuhai will make that relationship stronger.

Hong Kong also has limitations. Its domestic market (7 million) is small, and its economy is largely focused on financial and professional services, trade and logistics, tourism, and real estate. Most manufacturing has moved across the border to China. Though its universities are excellent and efforts are underway to support science and innovation, it has yet to develop a science and technology (S&T) sector of any scale, and there are relatively few S&T jobs available for university graduates (most of whom choose to enter finance). This is a weak point in a region (Asia) that has built much of its success on production for the technology sector.

The government is currently focusing on six areas for priority development: educational services, health care services, testing and certification services, environmental technology,

and creative industries. Given how strongly the economy is anchored in finance and real estate, it's an open question how effective this strategy will be. A strong education system, access to an ageing population on the mainland, and an open political system with a well-established film industry suggests, however, that Hong Kong has a shot.

Hong Kong should continue to play a central role as a regional headquarters for multinational businesses, as an international financial center serving Asia, and as a capital market supporting both foreign investment in Chinese firms and Chinese capital flowing overseas (since Chinese firms' Hong Kong subsidiaries can deploy their capital with fewer political constraints). It may be able to parlay its management and IP strengths to attract more R&D, with manufacturing across the border in Shenzhen.

If in the future Hong Kong becomes just another big Chinese city competing for Beijing's attention, it will lose its distinctiveness and the game will be up. But for now, Hong Kong is likely to remain Asia's regional business center of choice.