

At Risk: Hong Kong's Identity – and Prosperity

By Philip Bowring

Hong Kong's future prosperity, its assumed status as a world class city with living standards to match Tokyo, London or New York, is closely bound up with its sense of identity. Forty years from now, when the One Country, Two Systems formula and Special Administrative Region status will have expired, China as a whole may be as prosperous as Japan, Germany and the US. In which case there is no reason why Hong Kong should not be China's San Francisco. But, in the meantime, it has a struggle on its hands to retain an identity which allows it to follow policies to help sustain its position as one of the world's richest cities, which necessarily means revisiting pressures to force the pace of integration with a still much poorer mainland.

In turn that means focusing more on what makes Hong Kong different, emphasizing the positive aspects which no city in the mainland will be able to offer, at least in a medium term of at least a decade. By then, Hong Kong's promised 50 years of special status will be roughly at mid-point.

Failure to do so could easily have several negative results. The first is the blurring of the distinction between Hong Kong and its immediate neighbors, Shenzhen and Zhuhai. Another is the loss of medium- to high-value-added business to these neighbors. A third and perhaps less noticed danger is the loss of some of the very high value-added regional and international service business, not just to traditional rivals such as Singapore, Tokyo and Sydney but also to Taipei. The latter of course assumes that cross-straits commercial relations continue to be liberalized, which now looks more probability than possibility.

Yet in the face of these challenges to both its status and prosperity, the Hong Kong government seems unwilling to stand fair and square behind the territory's interest, instead following Beijing's desire to see integration with the mainland proceed as rapidly as can be done without too obviously compromising Hong Kong's position.

Another Bridge to Nowhere?

The latest example of officially driven integration is the decision of the central government to use some of its own funds, plus huge contributions from Hong Kong and Guangdong, to build a bridge linking Hong Kong with Macau and Zhuhai. Private money was originally supposed to finance a commercially viable bridge. But the project is no longer viewed commercially viable so has become a politically-driven one, and likely to be more useful to the neighbors than to Hong Kong.

The bridge probably would have made sense if Hong Kong's long promised Container Terminal 10 were being built on Hong Kong's Lantau island close to the airport, and including a rail link. But that is now most unlikely due to the massive and continuing increases in port facilities in and around Shenzhen. These port investments, coupled with the high costs of the local port duopoly and the curious lack of determination to build a rail link to the existing Kwaichung terminals, have assured that Hong Kong's importance as a port will continue to decline.

Hong Kong can probably afford to lose low value-added port business—but only so long as it does not lose all the shipping-related business such as ship-management, chartering and insurance. And that means offering quality of environment and supporting services, access to foreign expertise, complete freedom of movement of money, better security and a host of intangibles which compensate for higher costs.

But instead of seeing Hong Kong as a separate, unique place with special qualities derived from the accidents of geography and history, there is a growing vision in some quarters of the creation of a giant Hong Kong-Shenzhen-Macau-Zhuhai megalopolis. Politically-driven Hong Kong bureaucrats, aided and abetted by academics who are provided generous stipends for politically correct studies, have been promoting the idea of such a mega city, or at least a gradual merger of Hong Kong with Shenzhen. The latter now has a slightly bigger population than Hong Kong—though much of it is of migrant workers who have no permanent rights.

Bigger Is Not Always Better

Chief Executive Donald Tsang is apparently among those who believe that bigger is better, wanting a city of 10 million or more. Given Hong

Kong's fertility rate – the lowest in the world – this can only be achieved by massive mainland migration or at least partial integration with Shenzhen. Quite how this could be achieved other than over a very long period without affecting the living standards in Hong Kong has not been addressed. Hong Kong should be more welcoming of talent from everywhere, from the mainland, from India, from the West, but large scale migration can only add to Hong Kong's existing problems of rising income divides unless it is to follow the Dubai example (or indeed Shenzhen) of leaving a huge section its population as temporary low paid labor with few rights. That is a recipe for prosperity for the permanent citizens but carries a high social and ethical cost.

Hong Kong does not have too much to learn from Singapore, but Singapore does understand that its own political position and the economic policies flow from that very well. Of course, being a sovereign country gives it advantages which Hong Kong cannot copy. But it still has relevance. It engages in free trade with its much poorer neighbors, Indonesia and Malaysia, while using tax, infrastructure spending and immigration policies to maximize its own economic advantage. Singapore focuses on building high value added activities while retaining links to the lower value added ones which have migrated to its neighbors.

Hong Kong's private sector has of course been doing this for years, building export factories in the Pearl River delta but retaining corporate, design, marketing etc activities in Hong Kong. Hong Kong has evidently prospered from its PRD links and location. But there is no reason to force these with public spending and hidden subsidies. Nor is there any reason why immigration policy in Hong Kong should not be entirely in its own hands, not those of the mainland. As it is, the influx of mostly unskilled workers has added to existing problems of rising income differentials by creating areas, the most notorious of which is Tin Shui Wai, where unemployment and social problems are rampant.

Being a South China megalopolis is not the same thing as being a rich global city. Indeed, even in the specifically Chinese context it would be an also-ran. The Pearl River delta with its Hong Kong link may have been the birthplace of China's trade-based industrialization. But the focal point has moved northwards to the Shanghai area, to Shandong and now even to Liaoning. Even in the neighborhood, it is hard to see a combined Hong

Kong-Shenzhen overtaking Guangzhou as the lead city of southern China, of which the Pearl River valley and its tributaries are the core.

Hong Kong's long run advantage is not the Pearl River delta and the southern China hinterland. Those help its commerce immensely but what makes it unique are the international links, with overseas Chinese, with North America, with northeast and southeast Asia, and its the geographical position on the sea-trade routes.

Even the Two System interface with China and the outside world, Hong Kong could face challenges not just from Shanghai but, perhaps more importantly, from Taiwan. Taiwan already has a very developed stock market now on the threshold of opening up to two way investment traffic with the mainland. Its market is technically extremely efficient and has larger public participation than that of Hong Kong. It has a diverse range of industrial, shipping, finance and utility companies, including some of the world's leading IT companies. Meanwhile Hong Kong's Hang Seng index is becoming increasingly dominated by mainland H shares – now 21 of its 48 constituents and a higher proportion of the index weightings – leaving only a few mostly financial, property and utility and trading companies primarily reflecting Hong Kong itself.

Hong Kong has benefited immensely from listing of major mainland enterprise, particularly the banks. But there is no certainty that this will continue or that changes in rules relating to foreign investment in A shares will not sooner or later shift much of the trade in the major Chinese companies to Shanghai.

The Need to Look Abroad for Listings

By comparison with Hong Kong, Taiwan has had an insular exchange, with no foreign listings, strict controls on foreign ownership and foreign exchange and bans on mainland investment. Some of this has helped Hong Kong – for example, by forcing Taiwan companies such as electronics giant Foxconn to list their mainland activities in Hong Kong. But that is changing. Meanwhile, Hong Kong has belatedly awakened to the need to attract foreign rather than just mainland companies to its market. London now has dozens, most notably from Russia and other newcomers to the world of stock trading. Singapore has a handful. But thus far Hong Kong has none, and efforts to add them are running up against the global dearth of new

issues. It may need to wait till the next global bull market to make a big play for foreign listings.

Likewise an attempt to launch Hong Kong as an Islamic finance centre has been belated and may now be unrealistic, given the way Dubai, Kuala Lumpur, Singapore and London, all with more traditional links to the Islamic world, have all had success in developing products and trading.

Hong Kong for years has benefited from Taiwan's controls and isolation. Much Taiwanese money has been parked here for convenience and to avoid tax and exchange controls. In addition it has been booking centre for much Taiwan trade with the mainland. But a freer, more integrated Taiwan has advantages which could challenge not only some of Hong Kong's role as intermediary with the mainland but also some of its position as an international financial centre. That may never happen because Taiwan's bureaucracy still loves controls and rules. Several of its biggest banks remain government-controlled.

At present, Taiwan has a huge banking sector which at present is hopelessly fragmented, suffers from cut-throat competition and has no mainland access. But mergers are coming, and foreign banks with mainland business are growing their Taiwan operations. Taiwan has a strong independent currency, and massive private and government liquidity now mostly parked offshore.

Entrenched interests may prevent the mergers and freer competition needed to make Taiwan's service sector as dynamic as its IT sector. But the potential is there. And so too, if cross straits relations are eased, is the potential to re-generate Kaohsiung as a hub port, and for Shanghai-based business to use Taipei, which is closer, cleaner and speaks Putonghua, as their preferred offshore center. It is not difficult to see Taiwan offering to the mainland, and perhaps others, some of the things that Singapore offers Indonesia, such as top class medical services and private banking services more secure from prying mainland official eyes than those in Hong Kong. Taiwan also has close relations with Japan.

Taiwan's relations with the mainland may not prosper. Politics or its bureaucracy may prevent the liberalizations needed to make it a dynamic financial and other service centre, leaving its economy ever more dependent on thriving but narrow IT sector.

The Vision Thing Is Missing

But Hong Kong must raise its sights beyond the muddy waters of the Pearl River delta, and focus on its differences. Look at the challenges to its role vis-a`-vis both the mainland and the world at large. Look to fostering links to a southeast Asian Chinese community which once played a key role in its financial sector. Look to bolstering links with Japan and Korea. Be more open to Indians, Malaysians (not just ethnic Chinese). Clean up the environment – forget authoritarian Singapore; if Taipei and Seoul can do it why not Hong Kong? “Asia’s World City” is a fine idea but remains a self-deluding slogan.

It also needs to consider changing its currency system. The US dollar peg may have been useful but could well become a liability if its international role declines and Asian currencies in particular float against each other or use different benchmarks such as trade-weighted baskets. Hong Kong’s separate status and international role would be best served by a currency management system similar to that used by Singapore to maintain a strong and independent currency. But Beijing may well prefer that if there is to be a change it should be a peg to the Yuan. It is doubtful if a risk-averse Hong Kong government has the self confidence to develop and operate an independent monetary and exchange rate regime.

Hong Kong needs a degree of vision unlikely to be found in consultants’ reports or in the heads of career civil servants with scant international exposure and a level of self-esteem not necessarily shared by the community. And it needs political will. At the time of the handover I wrote that Hong Kong could well be better off if it had a Chief Executive from the mainland with political clout in Beijing. Mayors of Shanghai, Nanjing and Dalian have proven their worth by fighting not for vague notions of national solidarity but for the betterment of their cities. Hong Kong, on the other hand, was likely to end up with a local worthy acceptable to Beijing but with little political base either there or at home, and often beholden to vested business interests that remain a drag on still-flourishing real entrepreneurship. In that respect, Tsang is weaker than Tung Chee-hwa, his unsuccessful predecessor.

None of this is meant to write off Hong Kong, which still attracts talent and gives scope for new ideas. Self-improvement is still deeply

engrained and foreigners still have readier access than almost anywhere. But this is no time to be resting on laurels, or relying mainly on mainland success to pull Hong Kong along. Otherwise, historians will look back on the city in much the same way people today may look back on Trieste or Tangier, Lubeck or Weihai.

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