Economist Corporate Network China Meeting

- Hong Kong & Shanghai: Competing Centres?

Hong Kong & Shanghai: Competing Globally

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Ladies and gentlemen,

I am delighted to have the opportunity to speak at this China Meeting organized by Economist Corporate Network. It is heart-warming to see that Hong Kong businessmen (and businesswomen!) are willing to set aside this morning to explore the changing role of Hong Kong.

These days in Hong Kong, figures and statistics in our newspapers are mostly depressing. For instance, our unemployment rate has mounted to an unprecedented level; our economic growth for last quarter was only 0.5% after experiencing negative growth for 3 consecutive quarters; and our exports declined for the past 4 quarters. Whilst a city just 1,400km away from us is going through a totally different transformation: it has double digit GDP growth for 10 consecutive years; its development of Pudong New Area was a big success; its stock exchange, if combined with that of Shenzhen, has become the second largest in the region (except Japan); and it is endowed with solid growth prospects where the availability of land and talents makes it a cheaper place to operate. In one of its report, Hong Kong Trade Development Council estimated that Shanghai would catch up with Hong Kong in terms of the total size of the economy in about 15 years, given that both economies would continue to grow at their respective average growth rates.

In the face of this rising star, some of us lose heart. The belief that the rise of Shanghai means the doom of Hong Kong is not uncommon. These people think that our economy has yet to revive from the downturn since the Asian Financial Crisis because Shanghai, or broadly speaking, the Mainland, has robbed businesses from us. So, these people believe that we are competing with Shanghai because of our similarities. Competition and complementary of course exist between the two financial and commercial centres striving to serve China. The competition, however, is not just between the two, but on a much grander scale. These two cities try their best to attract the best talents and the most foreign investment by offering the best services in financing, logistics, legal, accounting, consulting and management. They have to fight for these limited resources in the open global economy, with competitors from everywhere.

Hong Kong and the Pearl River Delta

Throughout the 1980s, Guangdong Province and the Shenzhen Special Economic Zone were the primary beneficiaries of China's open door policy. Its proximity to Hong Kong combined with strong governmental support enabled Southern China to capture the lion's share of foreign direct investment to the Mainland. At the same time, our labour-intensive industries such as manufacturing and back-office operations started migrating across the border to take advantage of the cheap labour and low operation cost over there. Hong Kong, on the other hand, has become the centre of value-added trade services and financial services, and has established itself as a natural gateway to China for traders and financiers.

This model has served Hong Kong very well for the past decades, and we keep perfecting our system in order to enhance its competency over the years. Last year, the Heritage Foundation ranked us as the world's freest economy for the eighth year in a row. The Fraser Institute echoed this recognition at about the same time. This kind of recognition confirms the value of our system, rule of law, high quality supervision and regulation, clean civil service, sophisticated financial infrastructure and free flow of capital and information. Though The Economist pointed out in the Briefing Paper that "the number of lists at which Hong Kong is at the top is diminishing", we still have the edge. This however, also means that competition waged by cities in the region and globally is getting tougher.

Attracted by our system advantage, lots of MNCs have flocked to Hong Kong to establish regional headquarters. Hong Kong became their stepping stone to China, as well as the main window to the world for Mainland enterprises.

Shanghai and the Yangtze River Delta

The growth of Shanghai was kick-started by the launch of the Pudong New Area in 1990. Shanghai is rapidly internationalising its economy and has been capturing a rising share of trade and investment to China, from 15% of the country's foreign trade 10 years ago to the current level of 23%, while FDI in 2000 was up 56% to USD6.4 billion, accounting for 15% of China's total.

Hong Kong is not unfamiliar with this kind of growth, as we have seen this happened to Guangdong before. However, China's entry into WTO allows direct foreign participation in many sectors, and this further enhances the attractiveness of Shanghai to foreign investment.

This gives rise to the concern that the middleman role of Hong Kong may diminish.

I am afraid that our sight may have been clouded by the depressing economic situation in Hong Kong and this refrains us from seeing our value. Interestingly, our Mainland friends see it much more clearly. A TDC survey in June this year reveals that Mainland private enterprises consider that no other city can replace Hong Kong as an international commercial and financial centre, and our fair and transparent legal system wins the highest recognition. We are also told that regional headquarters set up in Hong Kong have regional responsibilities with a wider network, while Shanghai is mainly for setting up “China headquarters”. It is therefore not difficult to see that Hong Kong and Shanghai have two different roles to play, because of their differences in geographical location, historical background, and level of development etc. By serving different purposes and functions, they both aim for playing an influential role in the global economy.

Hong Kong is at Southern China and has long been the economic locomotive in the PRD as detailed above. The PRD consists of 14 Mainland cities, with a per capita GDP of USD2,850 in 1999, which was higher than any other region in China. On the other hand, Shanghai is in the Yangtze River Delta, which comprises 15 cities, with a per capita GDP of USD2,264 in 1999. This Delta locates in the middle of China’s coastline, and its population of 77 million already represents a significant domestic market, not to mention the 360 million residents in the Yangtze Basin.

China has a vast territory, it would take more than one city to drive the national development process: Shanghai is the gateway to central and northern China as Hong Kong is to the PRD. In the past 20 years, Hong Kong investors brought capital, production and management skills, and technology into the PRD. Its position is so well established that cannot be replaced easily.

Moreover, PRD is gradually leaving the low value-added production procedures to its northern region, and upgrading itself to do the high value-added procedures. Technology, research and R&D centres are clustering in the region. Goldman Sachs stated in a recent report that the next Silicon Valley would not be in the United States, nor Japan, but in Guangdong. As the PRD advances its technology industry in full speed, Hong Kong is the ideal platform for seeking foreign capital and commercialising new technology. As long as the integration between Hong Kong and the PRD is properly managed, this supply chain will be a significant player in the international market.

International financial center Vs domestic financial market

Hong Kong's financial market is well established; it will remain a regional financial centre for Asia and as a conduit for foreign capital into the mainland. The sophistication and integration of services offered is vital to the success of a financial centre. Hong Kong is posed to benefit most from the mainland's liberalization with its massive and liquid capital markets, excellent financial infrastructure, availability of talent, and concentration of institutional investors.

As China is still developing its regulatory systems and institutional framework, and has yet to set any agenda for free convertibility of the currency, the main role of Shanghai will for the time being remain in mobilizing domestic funds to fuel the mainland's economic reforms.

Middleman's role

It is unambiguous that the traditional role of Hong Kong as middleman in trade is diminishing, as direct links between Mainland and foreign firms can be established under a more liberal and transparent trade regime. However, as Mainland private enterprises go to explore the international market and foreign enterprises enter the unfamiliar Mainland market, they both need an agent who has connections and knowledge of their respective target markets. Armed with the 20 years of experience of doing business in the Mainland and the international network established over the years, Hong Kong is the prime candidate to play such a middleman role.

Transportation and logistics hub

Shanghai's impressive development in sea and air transport intensifies the anxiety in Hong Kong. Located at the mouth of Yangtze River, Shanghai is the principal gateway to inland cities such as Wuhan and Chongqing. It has quickly emerged as a major port in Asia thanks to China's expanding external trade. Though the relatively unfavourable natural environment of the existing port hampers its further development, the planned development of Da Yang Shan and Xiao Yang Shan shipping zone can help to shape Shanghai as a transportation and logistic centre. This is important for the development of Shanghai as the gateway to central and northern China. As for air transport, Shanghai is the only city that possesses two international designations. It is keen to build itself into an aviation centre.

On the other hand, Hong Kong's air network has a worldwide coverage, and links to about 40 Mainland cities. Its dominance in air route networks, air cargo handling and supporting services, better inter-modal transportation links and logistics facilities is expected to be unmatched in the region in the foreseeable future. Though Hong Kong's sea cargo business may be less promising, we all know that our container business flows to those ports in southern China such as Yantian and Shekou, not Shanghai. In order to draw business to our port, we have to improve its efficiency and competitiveness, and simultaneously seek to improve its accessibility and permeability by joining the superhighway network in the Mainland, such as the Wuhan-Zhuhai highway. This will enable Hong Kong to provide logistic services to a wider region in China and to take full advantage of the development of the PRD.

Hong Kong and Shanghai are two cities with their own unique role to play. They are engines for growth in the Asia Pacific region and gateways to China. Both of them would have to upgrade their infrastructure facilities and service standards incessantly in order to remain competitive in the global economy. While in many of the traditional economic roles played by Hong Kong we still have a competitive advantage over Shanghai, it is foreseeable that the gap would continue to narrow. But this is true in relation to other cities in the rest of the world because of improved communications and information accessibility and the existence of virtual services. Hong Kong and Shanghai would both do well if they could see each other more as strategic partners striving to excel in the global economy and together create a bigger pie for China economically.