

# China Is Not Hong Kong's Only Worry

BY SIN-MING SHAW

**WHAT LIES AHEAD** for Hong Kong after 1997? Most pundits, in Hong Kong and abroad, have a pessimistic slant, focusing on the damage Beijing could inflict, not necessarily by design but because of China's imperial habits. In truth, no one really knows whether Beijing will have a negative impact on post-1997 Hong Kong and this column will not debate that. There are, however, sufficient grounds to believe Hong Kong's future is not bright simply because of economic factors.

Hong Kong's economy has been losing steam for three main reasons. Pegging the Hong Kong dollar at the rate of \$7.80 to the U.S. greenback has caused massive asset inflation, making Hong Kong's economy increasingly uncompetitive. Second, the economic liberalization of China and the growing sophistication among neighboring Southeast Asian countries are eroding the historically strategic and unique role played by Hong Kong's bilingual and bicultural community. Third, Hong Kong's labor force is not sufficiently skilled to meet the challenges of the 21st century.

The currency peg was instituted in 1983 to stabilize the Hong Kong dollar when Sino-British talks on the territory's future got off to a bad start, causing currency market volatility. The peg was considered a stroke of genius. Unfortunately the palliative was mistaken as a permanent cure.

The peg binds Hong Kong's interest rates to U.S. rates. Inflation in the territory since 1983 has grown at a compound annual rate of 7.8 percent versus 3.6 percent in the U.S. Put another way, from 1983 to 1995 prices in Hong Kong increased by 145 percent against 53 percent. Real interest rates between 1987 and now have been either negative or negligible. Asset inflation was inevitable.



*Hong Kong's U.S.-dollar currency peg has led to massive asset inflation, not just in real estate but in shares on the territory's stock exchange*

A typical 74-square-meter apartment in, say, Tai Koo Shing that cost US\$46,000 in 1984 is now US\$564,000, more than a 12-fold increase. Prime office rent then at HK\$18 per square foot is now nearly HK\$100, a rise of 5.5 times.

China is unlikely to change the peg for fear of "instability." The British government does not want to upset the peg. Big business, especially property developers prominently represented in the transition team, would not want the exchange rate changed because negative interest rates are good for

property sales. Home-owners, whose properties are now expensive by world standards, have a vested interest in seeing higher residential values. First-time home buyers are squeezed; naturally they demand higher wages.

So, what gives? Hong Kong is still too expensive for many businesses, small and big, even after the recent fall in property values. Many companies are expanding somewhere else or cutting back. Hong Kong's core rate of growth has fallen and will continue to do so. Real growth averaged 8.1 percent in 1978-1987, slowing to an estimated 4.8 percent in 1988-1997.

Meanwhile, Hong Kong is facing stiffer competition. Expatriate populations in Beijing and Shanghai are exploding as many foreign companies now find it more advantageous to have their principal Asian offices there. You can find a bilingual mainland Chinese with a Stanford degree who knows his way around the power corridors.

Elsewhere in Asia, Singapore and even Kuala Lumpur can boast many of the features that were once exclusive to Hong Kong. Malaysia has established Labuan, an offshore tax haven, to attract financial capital. The powerful Government of Singapore Investment Corp. has successfully persuaded blue-



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chip asset-management companies to set up in the city-state to help manage its wealth of funds. Now K.L. is doing the same.

Singaporean companies arguably are better positioned than Hong Kong's to serve as middlemen for the West. They are well-managed and many have the government as the single largest shareholder. When these companies do business in China, they have the backing of their government, a distinct advantage over Hong Kong companies that will be "domestic Chinese" post-1997. Also, Singapore's educational system has long emphasized Mandarin and English, which are spoken more adeptly there than in Hong Kong.

Hong Kong's deepwater port and container facilities are first class. However, Singapore — which is only just behind Hong Kong in terms of containers transhipped — is better situated to serve the booming ASEAN countries. And China is developing its own port facilities. Direct transportation links with Taiwan (a certainty) will further reduce the importance of Hong Kong as a transshipment port.

**FOR YEARS, CHINA** was happy to let Hong Kong turn its entrepôt role into a lucrative monopoly. No more. China's principal cities are increasingly taking over Hong Kong's function as the country opens up to foreign investment. Witness the explosive growth of Shanghai and Beijing, for instance. Even Shenzhen is now relegated to a bit part in China's grand scheme of economic liberalization because it has served its purpose. This leads me to the most serious problem Hong Kong faces: its limited ability to make itself invaluable to China's future.

China needs capital. Hong Kong has provided much. Between 1979 and 1994, US\$195 billion — or 64 percent of all direct foreign investment — came from the territory. In the future, China

PESSIMISTS ON

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ON POLITICS

increasingly will tap the only financial market that can satisfy its capital needs: Wall Street.

China needs technology and manufacturing know-how. Hong Kong's forte in that area is in very light manufacturing industries: toys, portable stereos, watches and the like. China now turns to Samsung, Toshiba, Motorola, Ericsson for what it wants. When the Taiwan situation cools down, companies in Hsinchu Science-Based Industrial Park will have far more to offer than any Hong Kong company I know.

There is not much more Hong Kong can do for China because the territory's expertise is too narrowly confined to financial services. The Hong Kong University of Science and Technology, established in 1991, is the only serious attempt the territory has made to educate larger numbers of engineers and scientists. Most of Hong Kong's best and brightest have gone into finance. Wall Street has plenty of financial engineers and China is likely to deal more directly with the Americans. Hong Kong is many decades behind Taiwan, Korea or even Singapore in scientific education.

Ronnie Chan, chairman of Hang Lung Development Co. in Hong Kong and one of the richest and smartest property scions, was eloquent on this topic: "All you have is money!" he snorted in reference to the bloated, self-important Hong Kong rich who do not appreciate sufficiently that Hong Kong has largely served its historical purpose for the motherland.

The pessimists on Hong Kong should concentrate more on economics, less on politics. Unfolding economic factors and a more congenial Shanghai or Beijing as a place to work and live will pose a greater threat to Hong Kong's future than any real or imagined political threat from Beijing after the clock strikes midnight, June 30, 1997. ■



*Technology, not toys, is what China now wants — like this Motorola pager plant in Tianjin*