

Hong Kong: one country, two systems and a trade war

The U.S.-China Trade War has again placed Hong Kong in the role of middleman between the world's two largest economies. It is at once an enviable and unenviable position, juxtaposing opportunity and calamity. While Trump's trade war provides Hong Kong an opportunity to reprise its role as middleman to China, pressure from both Beijing and Washington threatens to slam the door on open trade.

By George Lauriat, AJOT

ONE PLUS TWO EQUALS...

“One Country, Two Systems” succinctly sums up the “Basic Law” under which Hong Kong SAR (Special Administrative Region) has existed within China since the 1997 handover. There is a system for mainland China and another system for Hong Kong. This arrangement, a communist-socialist China and a capitalist-quasi-democratic Hong Kong, is scheduled to last for fifty years – until 2047. At that time, the reunification is to be completed and Hong Kong will nominally be under Beijing’s political system and no longer “special”. For Hong Kong’s leadership balancing the socio-economic needs of Hong Kong against Beijing’s covets has been the primary challenge.

It’s a difficult juggling act on many counts. With over 7.3 million people crammed into just over 1,000 square miles, land is at a premium. Housing is a continual struggle. It is often said in Hong Kong buying a flat (apartment) – taking out a mortgage and paying the down payment - is the pinnacle of a Hongkongers’ life, a genuine coming of age moment. It’s well worth noting that the average price for a used Hong Kong flat in the first quarter of 2018 was US\$1.28 million, up 4.2% over the fourth quarter of 2017. New homes are going for just about double the used market price. Raymond Cheng, a director at CIMB Securities Hong Kong and China equity division, in an under-statement commented, “These home prices are definitely beyond the general public’s reach.”

The domestic real estate market for both domestic housing and business space is almost unique (Singapore is the only other similar market) – a roller coaster ride of boom and bust cycles that can make or lose fortunes in the time it takes to spin a roulette wheel.

Hong Kong has a near obsession with business and money. It’s one of the few places in the world where average people follow the stock market and race track results with equal intensity. But there is a significant social debate in the works in Hong Kong centering around the “One country, two systems” policy. In 2014 the pro-democracy movement

made headlines with the occupation of Central but now the arguments are more nuanced.

Even at this writing, a debate is unfolding as to whether Andy Chan Ho-tin, an advocate for an independent Hong Kong, should be allowed to give a presentation at the FCC (*Foreign Correspondence Club*) over the objections of China’s Ministry of Foreign Affairs and the local authorities. While the speech went ahead as planned, Hong Kong’s CE Carrie Lam Cheng Yuet-ngor said, the FCC allowing Chan’s speech was “deeply regrettable and inappropriate.”

THE DICHOTOMY

Ironically, while the nature of “freedom” for citizens is being debated, Hong Kong has regularly topped the “Freedom Index” which ranks economic freedom. In the 2018 rankings Hong Kong received a 90.2 rate, topping rival Singapore at 88.8. By way of comparison, the United States ranks 18th with a tally of only 75.7. More to the point, the PRC (People’s Republic of China) ranks 110th with a minuscule 57.8 – highlighting the importance of Hong Kong’s corporate environment to China’s.

This is not an unexpected result but the complexity of Hong Kong’s situation shouldn’t be understated.

The dichotomy of “One country, two systems” clearly creates confusion. Hong Kong based SCMP (*South China Morning Post*) columnist Philip Leung, probably expressed it best writing, “Twenty years after the handover, Hong Kong is still struggling with its political schizophrenia: while “one country” stipulates unity, “two systems” embraces diversity. Officials are getting jittery about singing Hong Kong’s uniqueness, as if it were a code for separateness.” To be clear, Leung’s remarks were on the selective use of English in official circles – since Britain handed back Hong Kong, English, still an official language has been on the decline -but it applies equally well to other aspects of Hong Kong life.

Hong Kong’s economic role within greater Chinese economy has always been the focus. Hong Kong’s no longer

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the entrepot for China but rather one port of many (excluding Hong Kong, six of the world's top ten container ports are in mainland China), with rival Shanghai clearly (over 40 million TEU) the hub-port for the country. Establishing a new role within the greater Chinese economic sphere has been the goal of Hong Kong's political and business leadership since 1997.

The post-1997 effort has been outward into the neighboring PRD (Pearl River Delta) Region. Hong Kong's expertise and capital have spread outward and the PRD has (along with the greater Shanghai region) shown the greatest growth in the PRC. A testament to that success is regional rival ports. Ports like Shenzhen, Guangdong and Nansha are thriving and in some ways eclipsing Hong Kong itself. Ironically, Hong Kong as a facilitator – with capital and expertise – is contributing to the City's demise as entrepot. Hong Kong, is becoming just another Chinese port, albeit a very large one with a throughput of around 20 million TEU.

TRADING PLACES

It takes a step back to understand how Hong Kong's role as the middleman in the China trade evolved...and it might help in the current circumstance.

Before the 1997 return, Hong Kong was a British Crown colony precariously perched at the end of a vast Chinese continent. What seemed the singular pursuit of Hong Kong and its populace was to be a middleman in the China trade – Hong Kong became a mercantile turnstile, moving goods, people and money between China and global markets. In doing so, Hong Kong became one of the most open free-trading places in the world, as acknowledged by the economic freedom ranking.

The system worked well up until the 1930s. By then rival city Shanghai had eclipsed Hong Kong as China's trading capital. However, after World War Two and the end of China's Revolution with the Fall of Shanghai and establishment of the PRC (People's Republic of China) in 1949, Hong Kong reprised its role as the middleman to a new middle kingdom.

Many of the Western companies domiciled in Shanghai moved to Hong Kong along with a wave of Shanghai businesses and business families following the fall in 1949. A good example is C.H. Tung. Hong Kong's first Chief Executive (CE) is the son of Shanghainese shipowner C.Y. Tung, founder of the Hong Kong-based shipping line OOCL – recently acquired by China's principal shipping line COSCO. The influx of talent and capital set off a boom and more importantly established a Hong Kong business community with an even greater reach into the China market. With the "reforms" of 1978 in China, culminating with the "rehabilitation" of Deng Xiaoping the country was poised for an economic awakening. And when China stirred, Hong Kong was well placed to be the entrepot for an unprecedented growth spurt. From 1978-1997 Hong Kong's GDP grew from US\$18.31million to US\$177.349 million. Beijing's entry into the WTO (World Trade Organization) in 2001 spurred on even more economic development

in China albeit with Hong Kong playing an increasingly different role in the post-1997, more facilitator and less entrepot.

SURVIVING A TRADE WAR

When President Trump unleashed the trade war with China, it also pushed Hong Kong within the crosshairs. Staying out of the economic crossfire between China and the United States is now an important economic goal for the Region – but can it be done?

Back in July with the trade war looming, Financial Secretary Paul Chan Mo-po was asked in an interview what Hong Kong could do to avoid becoming collateral damage in a trade war between the world's two largest economies, "As a small and open economy, there is not much we can proactively do. But we can monitor the situation very closely and make sure our financial and banking systems are operated in order without systematic risks," adding, "We stand ready to roll out support measures to enterprises if affected, especially for small and medium-sized businesses."

At least going into the war zone, Hong Kong is starting from a point of strength – the economy is solid. Overall Hong Kong's economic performance has been very good. In the 2nd quarter Hong Kong's economy expanded by 3.5% year-on-year in real terms after the growth of 4.6% in the preceding quarter, marking the seventh consecutive quarter of growth above the trend growth rate of 2.7% per annum in the past decade. Total exports of goods grew solidly by 4.6% year-on-year in real terms for the second quarter. Exports of services also expanded by 6.1% year-on-year in real terms. Unemployment rates are running at 2.8% while wages are near historic highs of HK\$15,897(roughly US\$2,025) a month for the 1st quarter of 2018. In 2017 the GDP per capita was US\$46,200, as compared to US\$43,500 in 2016.

Most observers believe the short-term impact of the trade war would be slight, a 0.1 to 0.2 drop in GDP growth. The actual flow through trade between China and the U.S. using Hong Kong is fairly small – a side result of the demise of the entrepot role and rise of the Port of Shanghai. Equally, Hong Kong has made a significant effort to diversify its economic base by reaching out to ASEAN nations.

However, as Financial Secretary Paul Chan intimated in his remarks, a strong economy might not be enough if the U.S.-China trade war becomes a slugfest.

And selling the U.S. officials on Hong Kong's autonomy is problematical, as by all appearances Beijing has stepped up its own efforts to bring the SAR into step with China's own aspirations.

With the U.S.-China trade war escalating with every new tweet, Hong Kong's hoping "one country, two systems" adds up to finding a third alternative.

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