

Presentation at Hong Kong Airport Authority

What Is Special about HKSAR?

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America Miracle and China Puzzle

The Ten Leading Economies in 1820 and 1992				
Share in PPP-GDP	1820	1992	1992 Rank	Population*
1. China	28.7%	12.9%	2	20.9%
2. India	16.0%	4.2%	5	16.7%
3. France	5.4%	3.7%	6	1.1%
4. UK	5.2%	3.3%	8	1.1%
5. Russia	4.9%	2.9%	9	2.7%
6. Japan	3.1%	8.6%	3	2.3%
7. Austria	1.9%			
8. Spain	1.9%			
9. USA	1.8%	20.3%	1	4.7%
10. Prussia	1.7%			
10+ Germany		4.9%	4	2.3%
10+ Italy		3.4%	7	1.1%
10+ Brazil		2.7%	10	2.9%
Top Ten Total	70.50%	66.80%		54.9%

Source: Angus Maddison, 1995; *Share of population in the world total in 1992.

Competition on Institutions

- **Just a few hundred years ago China's feudalistic institutions achieved...**
 - Cheng Ho expeditions of the Ming to South-East Asia, Indian Ocean, Persian Gulf, the Red Sea and the east coast of Africa.
 - Grand Canal, Great Wall, Forbidden City and great tombs of emperors
 - Rapid increase in population and output

- **... but could not increase living standards of average individuals and national strength**

Competition on Institutions

- **However, Western capitalism, emerging in the same period, lifted dramatically living standards of everyone and national power of even small countries**

- **The central planning, tried in the last 50 years, also lost to the free market**

WTO Impact: Lower Transaction Costs

- ❑ With much higher costs of labor and land, why has Hong Kong been so much more competitive than the Mainland?
- ❑ **Competitiveness: Transaction costs + factor costs**
- ❑ **Transaction costs (or more accurately costs of inadequate institutions and incentives)** are broadly defined as any human-made costs that hinders mutually beneficial trade

WTO Impact: Lower Transaction Costs

- ❑ Hong Kong's low transaction costs have more than offset its high factor costs
- ❑ The impact of WTO accession on China will be reflected mainly in a rapid decline of artificially imposed transaction costs in
 - Distribution and producer services
 - Telecommunication
 - Law and accounting services
 - Banking and financial services

From Property Rights to Credit Culture

- ❑ **China needs the six positive property effects to build the credit culture already existing in Hong Kong:**
 - 1. Fixing the economic potential of assets
 - 2. Integrating dispersed information into one system
 - 3. Making people accountable
 - 4. Making assets fungible
 - 5. Networking people
 - 6. Protecting transactions

No property → not tractable, not accountable, not fungible, no network, no trading → no credit culture

Note: Six property effects articulated by Hernando de Soto in [The Mystery of Capital](#), 2000.

WTO Impact on Life Style in China

- ❑ **Contractual relations** protected by legal rules and enforcement will gradually but irreversibly govern business activities in China.
- ❑ **Free movement** of goods, services, people, capital, and information within China and across Chinese borders will become reality.

WTO Impact on Life Style in China

- **People's daily life** will depend more and more on the markets, domestic and international, with constant improvement in choices, quality, and quantity.
- **Knowledge and education** will be bench-marked with global standards.
- **Politics** will become more rational due to public pressure and less important to daily life of ordinary people.

Impact on the Rest of the World

- **The relative price** of manufacturing products will fall for a considerable period of time, especially against the price of education and localized knowledge
 - **One fifth** of the world population now joins the world market
 - **Expected returns** in the past investment need to be adjusted
 - **Shareholders** need to absorb losses
 - **Producers** need to adjust strategies
 - **Consumers** are enjoying cheaper and better products
 - **Economies** need to position itself properly in the value chain

Impact on the Rest of the World

- What is happening now?
 - China gains market shares in **exports and FDI**
 - However **capital** from Japan and Europe flow to U.S.
 - Hong Kong, Taiwan, Korea, and MNCs are all competing on **economic integration with China.**

China's Most Wanted List: All in HKSAR

- **Efficient and timely distribution networks**
 - With effective supply chain management that can guide China's manufacturing sector
 - Can sell Made-in-China products to anywhere in the world
- **Efficient and safe banks**
 - With low levels of non-performing loans
 - Strong capacity in channeling savings to quality investment
- **Efficient and robust capital markets**
 - Complement the banks in intermediating savings and investment
 - Facilitate corporate restructuring and corporate governance
 - Manage risks at individual, corporate, and national level

China's Most Wanted List: All in HKSAR

- ❑ **Efficient and reliable accounting services**
 - Make, protect and enforce contracts
 - Provide reliable information
- ❑ **Trusted and credible legal system**
 - Protect and fine-tune property rights
 - Reduce corruption
 - Cultivate credit culture

Strengths of HKSAR Economy

- ❑ **Low Transaction Costs**
 - Rule of law + property rights system
 - Free and open economy + world-class financial system
 - Low tax rate + simple tax system
- ❑ **Low Exchange Rate Risk and Uncertainty**
 - Fully convertible currency
 - Linked firmly to USD
 - Open and deep capital market

Strengths of HKSAR Economy

- **Next to Rapidly Growing Southern China** ® **strong potential for**
 - Lowering production costs
 - Expanding turnovers
 - Raising living standards in HKSAR

The Value of Hong Kong

- **Mini window** to the West under Chairman Mao
- **Huge options gain** with the early reform and opening under Deng Xiaoping
- **Eroding franchise value** as China's window to the West when Mainland cities are deepening their reform and opening

The Value of Hong Kong

- Could become a pioneer and a training ground for China in its course of catching up with the developed economies, breaking the glass-ceilings on Asian development

Hong Kong as Risk Manager

- One country, two systems
 - One country, two standards
 - Mainland: with WTO, moving towards international standards
 - Hong Kong: already international standards - important "pilot SAR" role in experimenting with risks of migration to international standards [no Hong Kong equivalent in Russia]
- Hong Kong, risk manager for Asia
 - Direct access to international expertise in risk management
 - Deep derivative markets that can help hedge risks
 - Training ground for Mainland managers in getting financial expertise and service sector skills to compete on international basis, with international salaries

Two Networks for China

- ❑ **Metcalf's Law** - *“The value of a network goes up as the square of the number of users”*
- ❑ **Shanghai Domestic Network**
- ❑ **HKSAR International Network**
- ❑ **The two networks will converge when RMB becomes fully convertible**

Two Networks for China

- ❑ **Shanghai and HKSAR are complementary** ® **help & learn a great deal from each other**
- ❑ **Cooperation between Shanghai & HKSAR will help the two networks to compete with other regional and global networks**

Network Economics

□ Economies of Scale

- The most competitive producers win ® become the biggest producers for the biggest markets
- The biggest volume consumers ® set standards and get best deals

Network Economics

□ Critical Mass

- Best combination and integration of local information, specific skills and global knowledge is an overhead with high fixed cost
- Critical Mass ® deliver the best ® achieve economies of scale ® get high return ® able to sustain high cost
- Where in the supply chain can we locate the real value added?

Liquidity & Friction Costs

- ❑ The greater the friction costs, the more important the geographical location
- ❑ The lower the friction costs, the higher the liquidity

Liquidity & Friction Costs

- ❑ Friction costs depend on the following:-
 - **Time** - speed to market and timing
 - **Factor costs** - labour, capital, land, & taxes
 - **Infrastructure constraints** - are physical utilities hindering movement of goods and people?
 - **“Government constraints”** - are rules & policies blocking efficient economic adjustments?
 - **Barriers to entry and exit** - competition policy right?

Competition & Co-operation

- **Kong Kong domestic market alone too small to maintain critical mass**
- **In areas where HK has critical mass, play dominant player strategy**
 - **eg financial services - improve quality to capture value in supply chain management**

Competition & Co-operation

- **In areas where HK has no critical mass, cooperate and affiliate**
 - **eg move manufacturing where there is cheap labour**
 - **eg cooperate with others to achieve economies of scale [airports, power, environment]**

Localization of Global Knowledge

- ❑ **HKSAR had premium as external window for China and East Asia, when access to markets and knowledge was poor**
- ❑ **Franchise is eroding when China gains access to WTO and through Web**

Localization of Global Knowledge

- ❑ **However, the biggest value added is “Localization of Global Knowledge” - add value by being:**
 - **Preferred financial centre in Asian Time Zone (ATZ)**
 - **Best logistics centre in ATZ**
 - **Importing and disseminating external skills [eg marketing, finance, technology and tailoring for local markets]**

Lessons from Neighbours

- **Lessons from Shanghai and Singapore:**
 - Clear vision, sound strategy and detailed blueprint
 - Effective coordination among local and central governments and business
 - No economic borders to residents or outsiders
- **Lessons from Japan, Taiwan and other Asian economies:**
 - Political stability key to stable growth
 - Protectionist policies only delay pain
 - People and capital move faster than policy changes

Lessons from Neighbours

- **Implications for HKSAR:**
 - Economic and financial integration of HKSAR (finance), Southern China (manufacturing) and Taiwan (technology).
 - HKSAR could provide the best of both HKSAR and Southern China for Mainland, Taiwan, Asia and international business

What Is Special about HKSAR?

- **A Chinese region backed by a huge hinterland and run by Chinese under fully functional western-style institutions**

- **One step ahead of the curve:**
 - One billion people were, are, and will be looking at the seven million people in Hong Kong for their puzzles, frustrations, and pride in interacting with the West

- **HKSAR needs only a little tune-up for its new journey in a new era**

Thank you very much