

# Hong Kong as a Global Hub

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# A Preview

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- ◆ What does it mean to be a global hub?
- ◆ The flow of people
- ◆ The flow of goods
- ◆ The flow of capital
- ◆ The role of the Hong Kong SAR Government
- ◆ Concluding remarks

# What Does It Mean to be a Global Hub?

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- ◆ A hub consists of a wheel (core) and spokes, a place where everything has to go through between every pair of points A and B.
- ◆ The everything includes people, goods and capital.
- ◆ Global means the hub draws users from all over the world.
- ◆ The hub (the core) can add value by simply being the hub, for example, by consolidating traffic and thereby achieving efficiency, and by bringing together both the suppliers and the consumers/users. (Investors come to Hong Kong to seek deals, and entrepreneurs come to Hong Kong to seek financing.)
- ◆ But the hub can also add value itself locally.

# What Does It Mean to be a Global Hub?

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- ◆ There is a difference between being a hub and a gateway—a hub can add significant **value**.
- ◆ The value of a hub increases more than proportionately with the number of people using it as a hub. There are network externalities.
- ◆ Why is London's Heathrow Airport a major aviation hub despite its dilapidated conditions? Because a large number of airlines in the world consider it to be a hub and expect it to continue to be a hub. An airline wants to fly into an airport which provides the arriving passenger the largest possible choices of onward destinations and which also has the largest number of potential departing passengers from elsewhere.
- ◆ Thus, success as a hub builds on success. The more traffic a hub has, the more traffic it will be able to generate in the future.

# The Flow of People

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- ◆ Hong Kong is often the last stop for travellers before they enter Mainland China. It is also often the first stop for Chinese travellers going overseas. It is therefore a major hub for the flow of people.
- ◆ Visitors arriving from China now constitute more than half of visitors arriving in Hong Kong, thanks largely to the “individual visit scheme.”
- ◆ However, the number of visitors from elsewhere has also continued to grow.

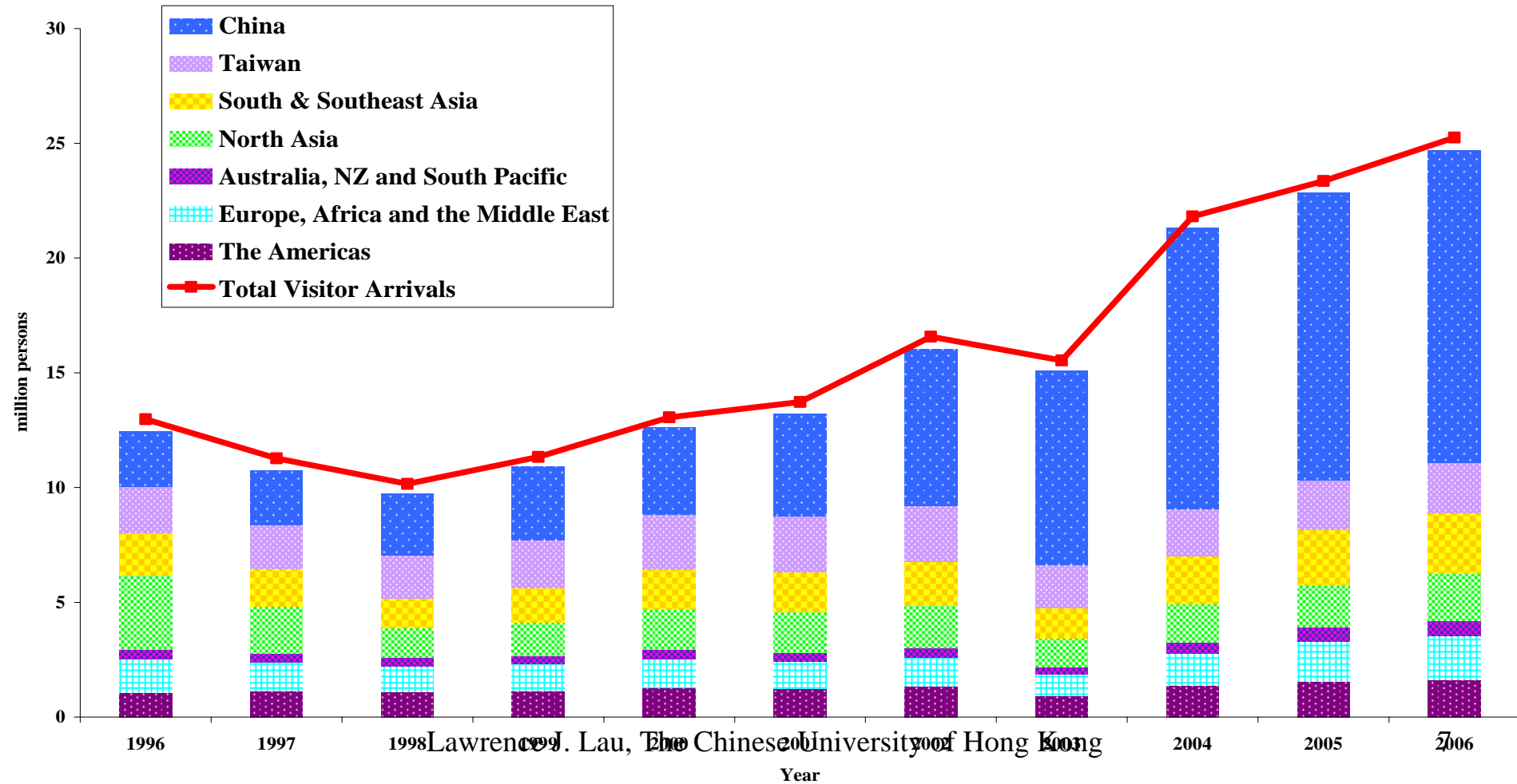
# The Flow of People

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- ◆ To consolidate its status as a transportation hub for people, Hong Kong should consider the following:
  - ◆ (1) An “open skies” agreement with Mainland China, the U.S., and any other countries/regions that are interested (The more people come through Hong Kong, the better for Hong Kong—it does not matter as much whether they travel to and from Hong Kong in Hong Kong carriers. Moreover, the more open skies agreements there are, the more potential destinations Hong Kong carriers can reach.);
  - ◆ (2) A fast rail link between Hong Kong and Shenzhen/Guangzhou (Hong Kong should be put at the doorsteps of Shenzhen and Guangzhou);
  - ◆ (3) A fast rail link between the Hong Kong International Airport and the Shenzhen International Airport, so that the two Airports can complement rather than compete with each other and perhaps operate jointly and share revenue and profit. (Passengers travelling from Shenzhen International Airport to elsewhere via Hong Kong and passengers travelling via Hong Kong International Airport to Shenzhen should not have to go through immigration and customs formalities until they arrive at their respective final destinations.)

# The Flow of People: Visitor Arrivals

The Number of Visitor Arrivals, including via Macau



# Hong Kong Should Aim at Becoming an Education Hub for the Region

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- ◆ By aiming to become an education hub, Hong Kong will also be able to
  - ◆ Enhance its internationalisation
  - ◆ Promote knowledge economy
  - ◆ Upgrade the local labour force through education and training and attracting non-local talents
  - ◆ Maintain stable and full employment (higher education can become a major industry with significant private (non-profit) sector participation)
  - ◆ Increase the quality of its jobs over time
  - ◆ Improve the environmental quality of Hong Kong
  - ◆ Train the future elite of the region
- ◆ And thereby maintain its competitiveness as Asia's World City

# Long-Term Benefits of an Education Hub

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- ◆ By attracting non-local, including Mainland, students to become full-time students in Hong Kong, they are exposed to Hong Kong's way of life and are likely to develop an appreciation and understanding and hopefully affection for Hong Kong.
- ◆ This can only rebound to the benefits of Hong Kong, regardless of whether they decide to stay here or to return to China or their home countries upon graduation.
- ◆ Exposure to multiple cultures is beneficial to Hong Kong's own students in an increasingly globalised world.
- ◆ Hong Kong can leverage the higher education sector to develop and deepen its knowledge economy and to become a centre for R&D-based economic activities such as design.

# Hong Kong Should Also Aim at Becoming a Health Care Hub for the Region

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- ◆ By aiming to become a health care hub, Hong Kong will also be able to
  - ◆ Enhance its internationalisation
  - ◆ Promote the growth of health care services and related research and development
  - ◆ Attract tourists who come to Hong Kong for health care
  - ◆ Maintain stable and full employment (health care can also become a major industry with significant private (non-profit) sector participation)
  - ◆ Combine and capitalize on the best that Western medicine and traditional Chinese medicine can offer
- ◆ Patients from the region will come to Hong Kong for treatment in the same way that Hong Kong patients will go to the U.S. for treatment.

# The Natural Advantages of Hong Kong as a Global Hub

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- ◆ Hong Kong is an ideal place to capitalize on the World's interest in the Chinese economy and other East Asian economies in general. It is an excellent place to learn about China and the Chinese economy.
- ◆ In addition, it has the following advantages as a global hub:
  - ◆ A non-Chinese speaker can live, study and work in Hong Kong using only English without any problem.
  - ◆ There is complete freedom, including academic freedom, in Hong Kong.
  - ◆ There is also complete freedom of access to information—the internet is entirely open and the press is among the freest in the world.
  - ◆ There is also easy access to China and to other parts of East Asia.

# Attracting Talents to Hong Kong

- ◆ Hong Kong must work harder to attract talents to Hong Kong by improving the quality of life and the environment (tax treaties?).
- ◆ There are already schemes in place in Hong Kong to attract the best professional talents but they can be improved. (For example, Singapore gives seven permanent residence visas to every approved immigrant for the use of the family members.)
- ◆ Hong Kong is actually already quite generous in terms of allowing post-graduation job-seeking and employment on the part of Mainland students. Hong Kong can consider extending these privileges to non-local students in general.
- ◆ Hong Kong already has generous provisions for graduates of Hong Kong tertiary educational institutions for obtaining permanent residency—basically, the time spent as a full-time student will count towards the seven years required.

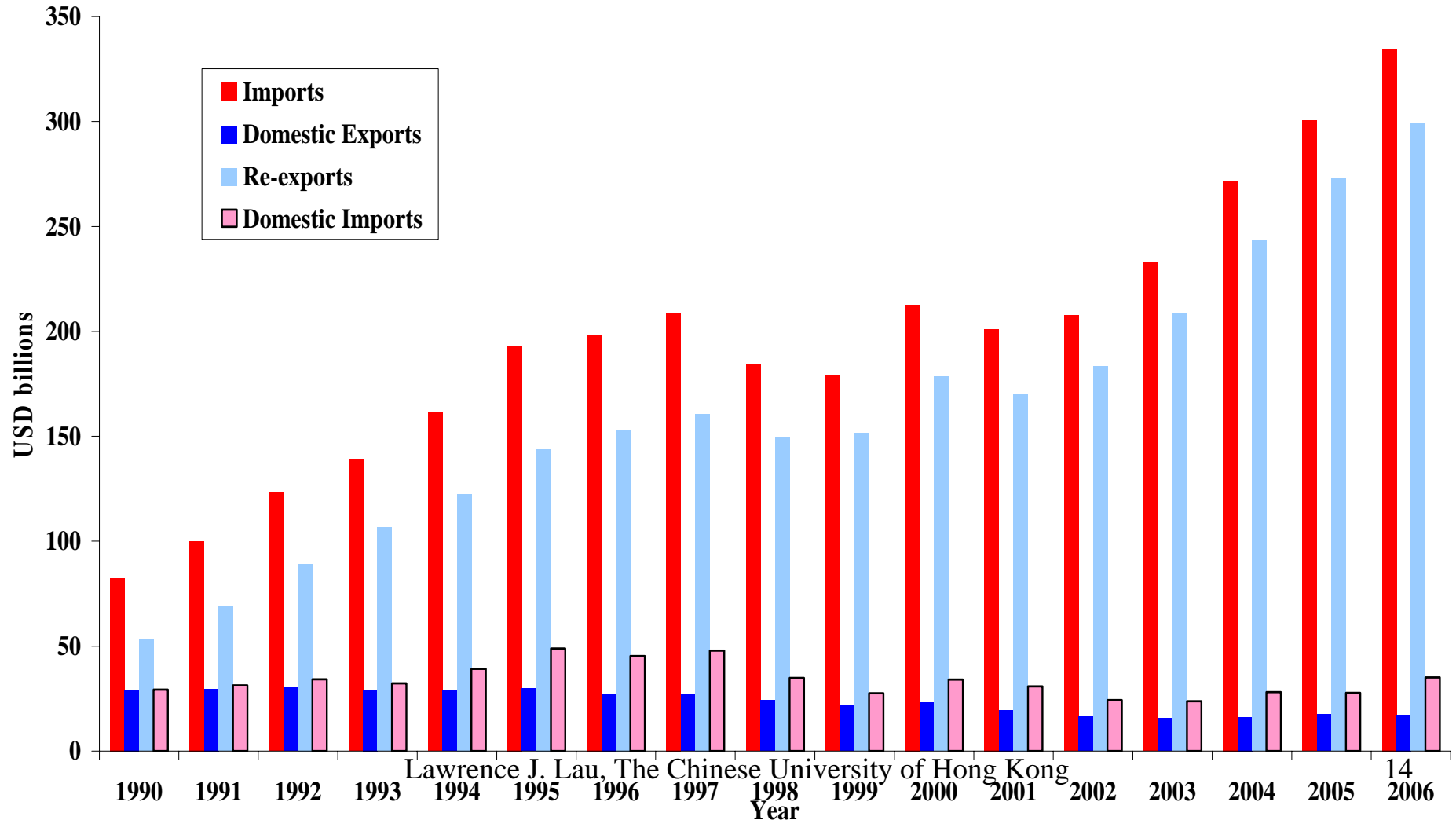
# The Flow of Goods

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- ◆ Hong Kong is already a major hub for the flow of goods.
- ◆ Re-exports to and from Mainland China constitute a major proportion of the total exports and imports of Hong Kong.
- ◆ Domestic exports and domestic imports (i.e., imports for domestic consumption) are both small relative to total exports and imports. (Our estimates of domestic imports assumes that there is no mark-up on re-exports. To the extent that there is a mark-up on re-exports, our estimates of domestic imports are biased downwards. Re-export mark-ups are no greater than 25 percent at a maximum.)
- ◆ Hong Kong is also a major headquarters city for shipping, transportation, logistics and trading companies.

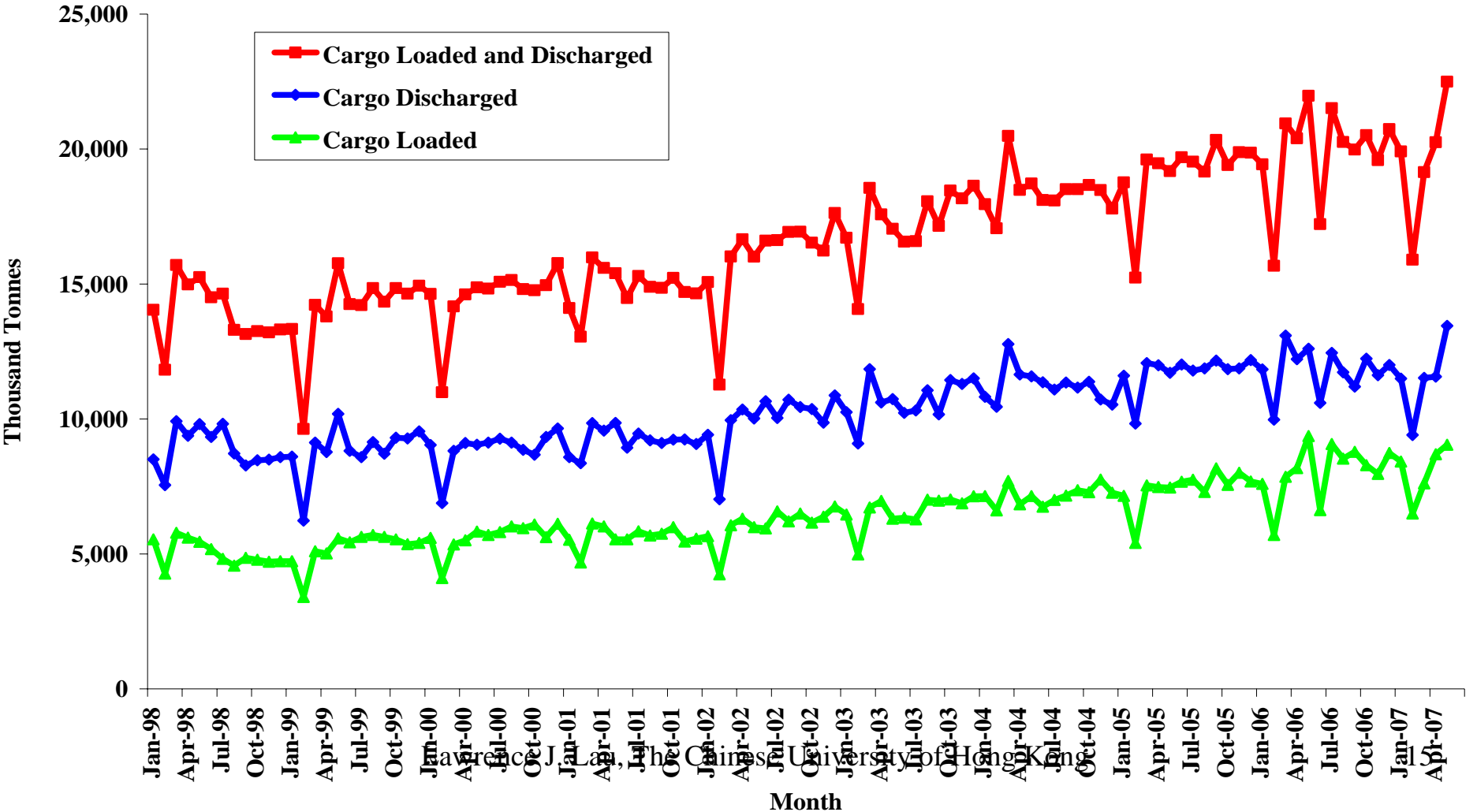
# The Flow of Goods: Imports, Domestic Exports, Re-Exports and Domestic Imports

Imports, Domestic Exports, Re-exports and Domestic Imports of Hong Kong



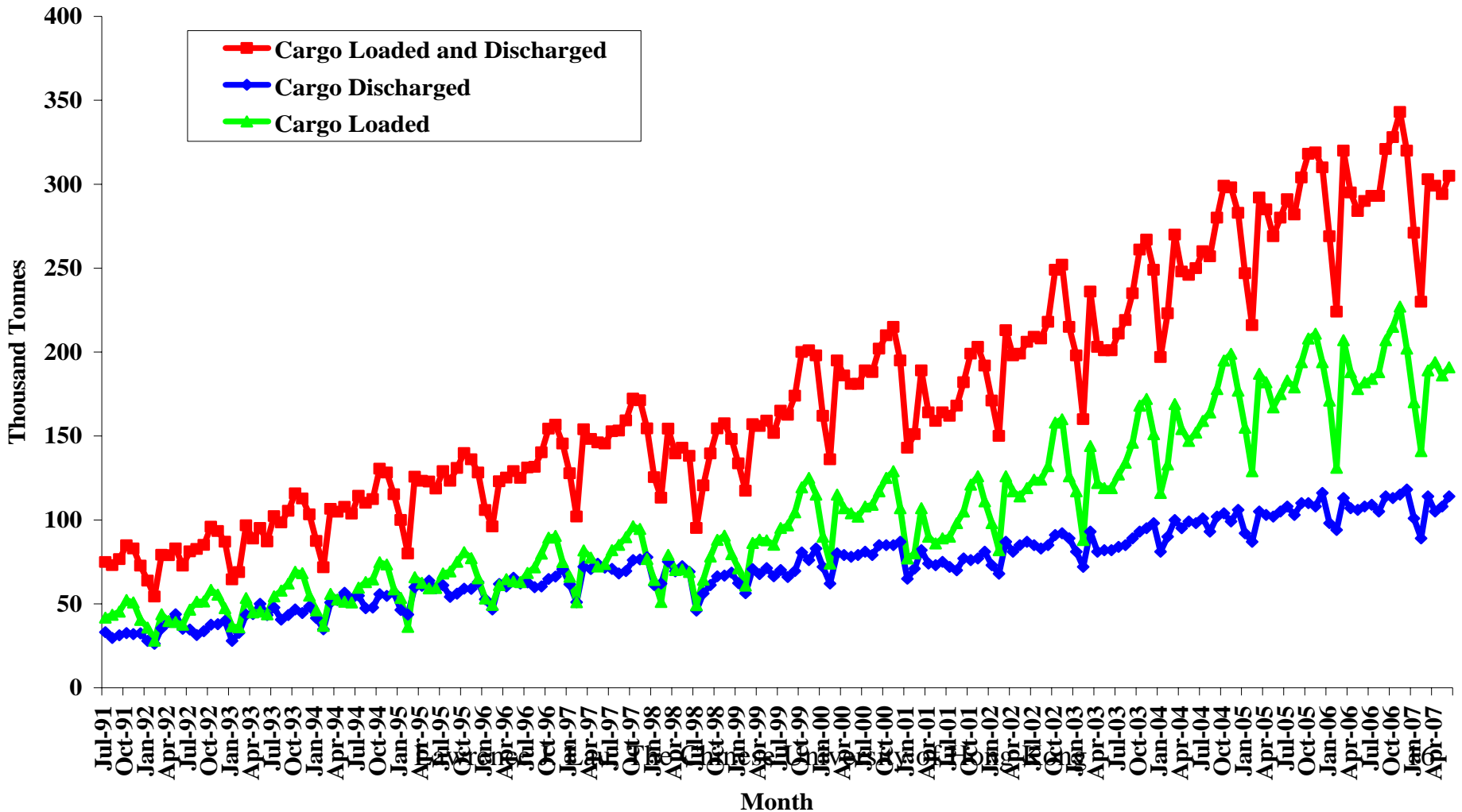
# The Flow of Goods: Waterborne Commerce

Total Tonnage through the Hong Kong Ports, by Water



# The Flow of Goods: Airborne Commerce

Total Tonnage through the Hong Kong Ports, by Air



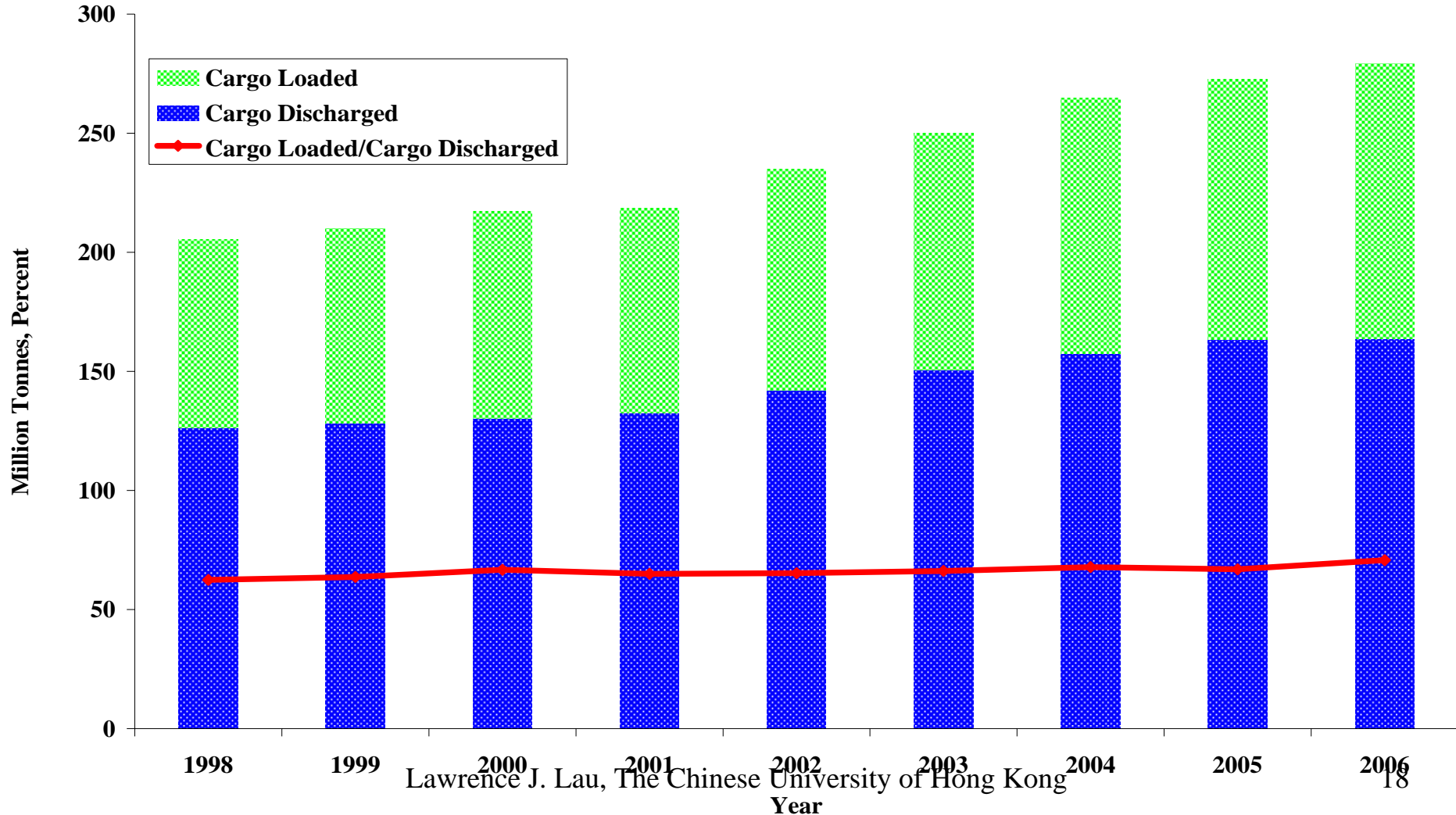
# The Flow of Goods

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- ◆ We note that for waterborne commerce, the inbound tonnage is much higher than the outbound tonnage, whereas on airborne commerce, the inbound tonnage is much less than the outbound tonnage.
- ◆ Tonnage data, unlike export and import data, are independent of the declared valuation of the exports and imports, and hence are not subject to biases due to over- and under-invoicing for transfer pricing, tariff, and/or currency revaluation/devaluation considerations.
- ◆ What do these data tell us?
  - ◆ That a significant proportion of inbound waterborne tonnage is retained for domestic Hong Kong consumption, but the proportion appears to be falling.
  - ◆ That Hong Kong contributes significantly to airborne exports either through domestic manufacturing in Hong Kong or re-processing of semi-finished goods imported from elsewhere. In any case, the domestic value-added proportion is significant and rising. Airborne exports normally consist of high-value-added goods.

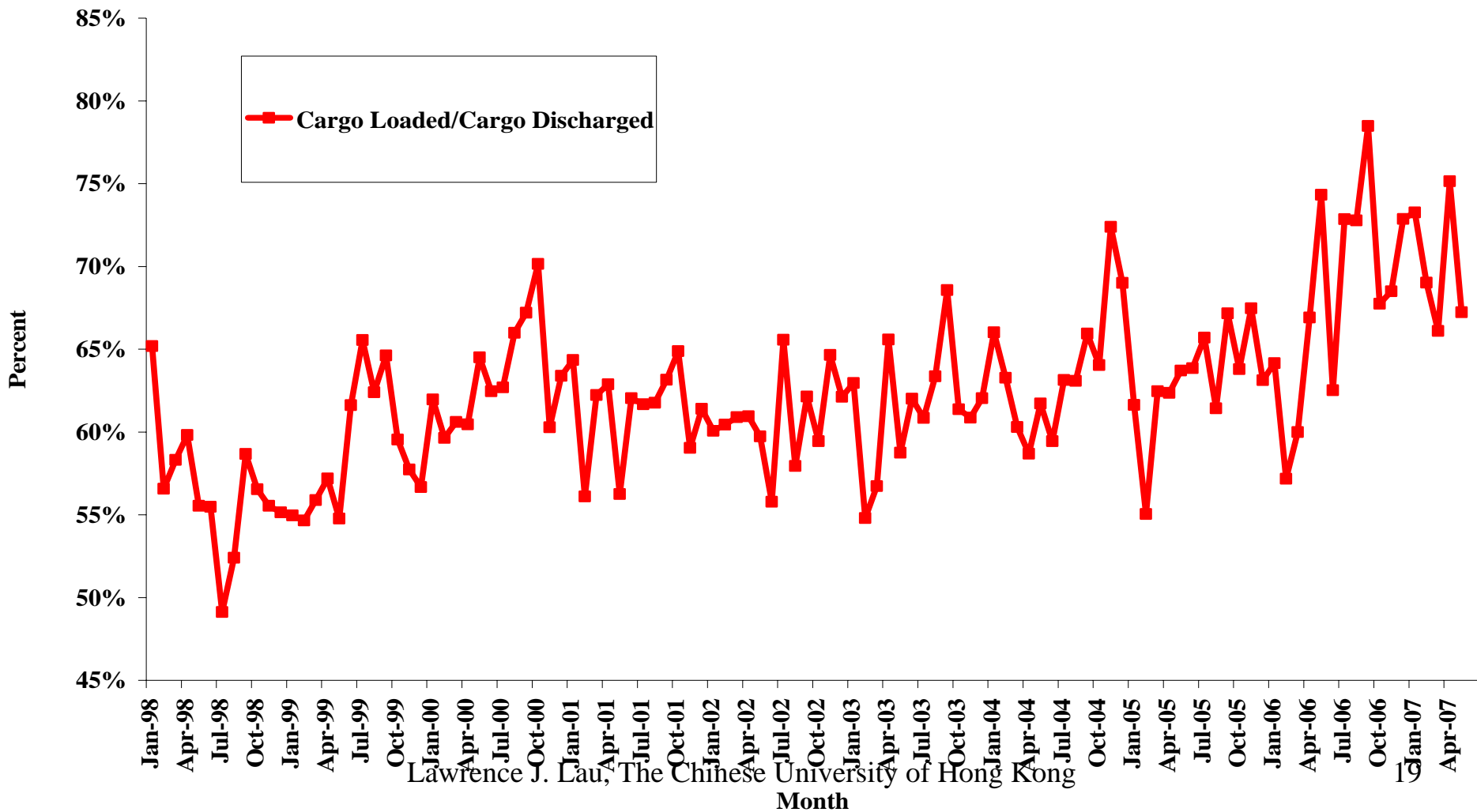
# The Flow of Goods: Percentage Cargo Loaded/Cargo Discharged

Total Tonnage through the Hong Kong Ports, by Air, Water and Land



# The Flow of Goods: Cargo Loaded/Cargo Discharged, Waterborne Commerce

The Ratio of Cargo Loaded to Cargo Discharged, Waterborne Commerce



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# The Flow of Goods

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- ◆ We note that overall, cargo discharged has always exceeded cargo loaded by a wide margin, indicating that on average, one-third of the imports, by tonnage, is retained for domestic consumption or use in Hong Kong, but the percentage has been declining steadily to below 30 percent in 2006.
- ◆ This also means the “hub” function of Hong Kong as a shipping and trans-shipment center has been rising.
- ◆ For waterborne commerce alone, the proportion retained for domestic consumption or use, by tonnage, has also declined to below 30 percent in recent years.
- ◆ All of these statistics are consistent with Hong Kong being a trading and shipping hub.

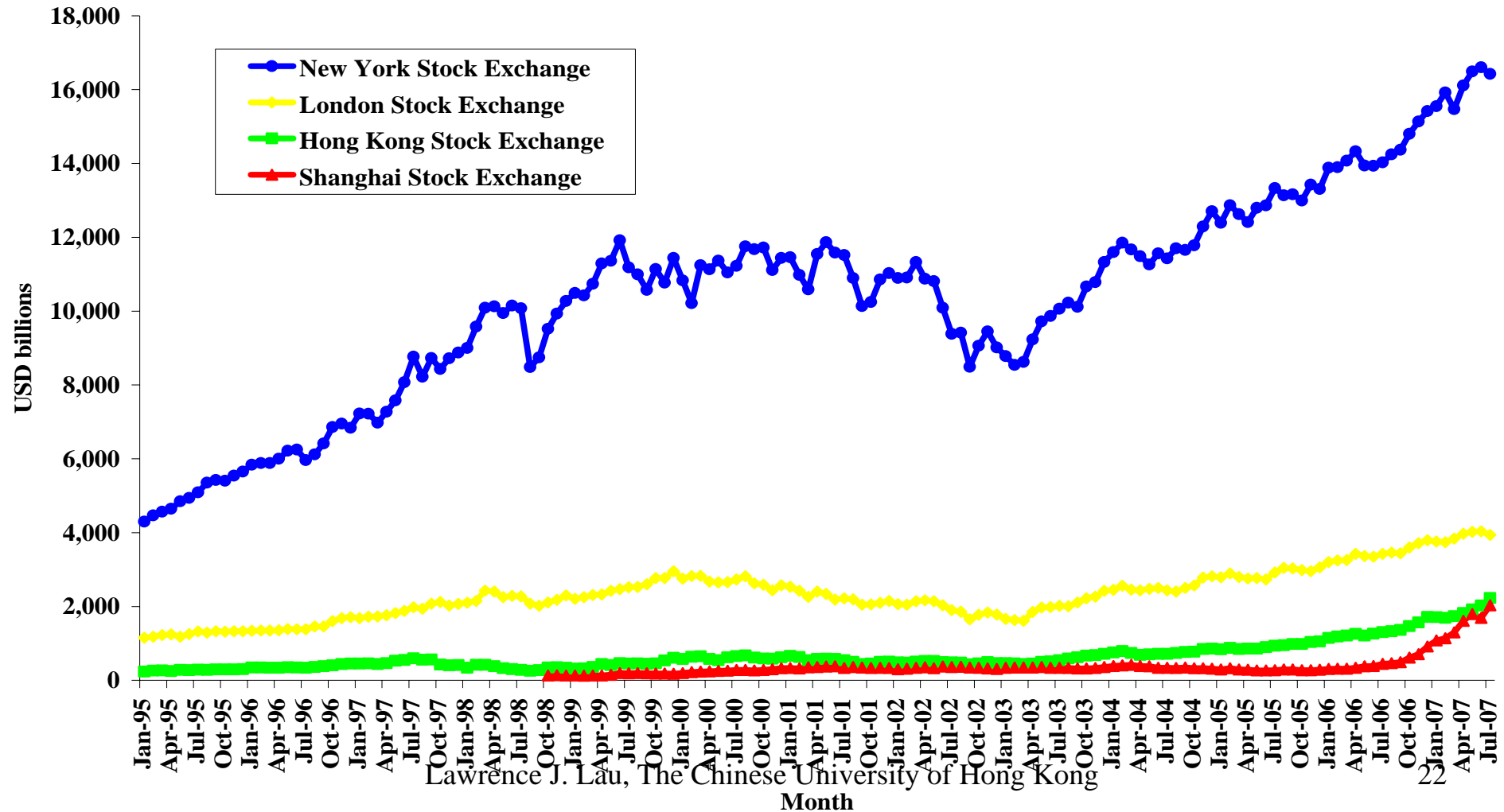
# The Flow of Capital

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- ◆ Hong Kong is the financial centre for the region. It played a pivotal role in the attraction of foreign direct investment into Mainland China.
- ◆ However, it faces potential competition from Shanghai, and particularly if the Renminbi becomes fully convertible, which can be expected within a decade.
- ◆ There is sufficient business for both Hong Kong and Shanghai to prosper, and it is not a zero sum game.
- ◆ But there can be some specialization and division of labour.

# The Flow of Capital: Market Capitalization of Stock Exchanges

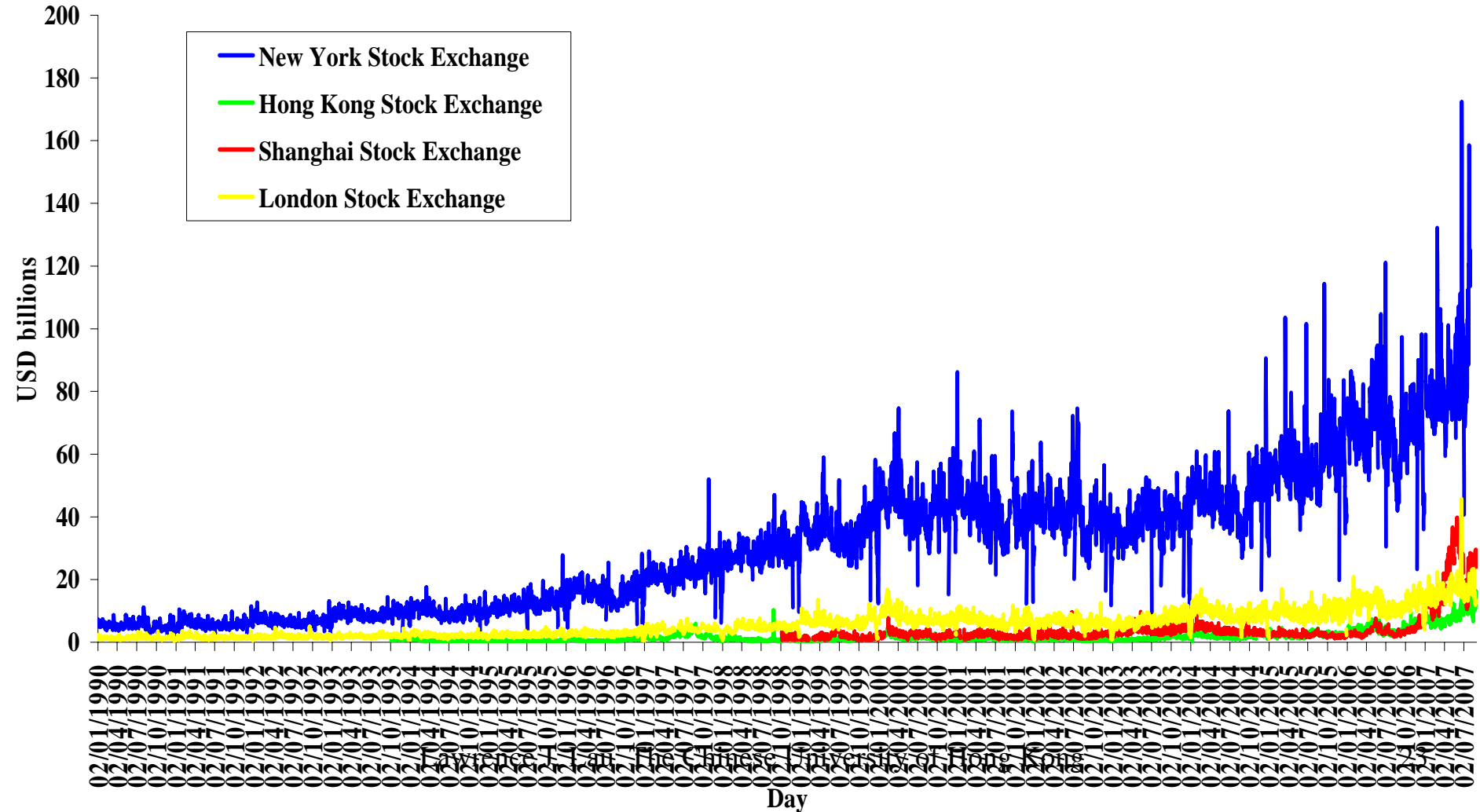
Market Capitalization of Four Stock Exchanges



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# The Flow of Capital: Daily Turnover of Stock Exchanges

Comparison of The Daily Turnovers of Four Stock Exchanges



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# The Flow of Capital: Division of Labour between Hong Kong and Shanghai

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- ◆ The sources of capital coming through Hong Kong are undergoing a structural shift. Mainland China will increasingly be a source of net capital, whereas the U.S. is no longer a source of net capital but a sink of net capital, although the U.S. still earns more on its foreign investments than foreigners earn on their U.S. investments.
- ◆ With Mainland China rapidly becoming the dominant source of net capital, it increasingly does not make sense for Chinese enterprises to raise capital in Hong Kong and bring it back to be used in Mainland China. Mainland China and the Chinese enterprises are better off, in the long run, to raise capital that is to be used in Mainland China in the Mainland itself. Hong Kong is not really functioning as a hub if the capital is simply round-tripped between Mainland China and Hong Kong.

# The Flow of Capital: Division of Labour between Hong Kong and Shanghai

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- ◆ Listing on the Hong Kong Stock Exchange does add value by providing the “seal of approval” by the Hong Kong Stock Exchange and the Securities and Futures Commission of Hong Kong. However, the same advantage can be obtained through a dual listing in both Hong Kong and Shanghai but with the bulk of shares offered in Shanghai.
- ◆ The problem is that Mainland China does not need any more foreign exchange—in fact, it has far too much foreign exchange, and with its own high savings rate it also does not really need foreign capital. It still welcomes foreign direct investment (FDI) but only because FDI brings with it technology, know-how, designs, markets, business models and methods that China does not have.
- ◆ Besides, the price/earnings ratio is higher in Shanghai than Hong Kong, so that it makes more sense for enterprises wanting to go public to offer their shares initially in Shanghai.

# The Flow of Capital: Division of Labour between Hong Kong and Shanghai

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- ◆ The Hong Kong stock market can differentiate itself from the Shanghai stock market by:
  - ◆ (1) having a more vigorous regulatory regime—be more demanding on governance and more alert to insider trading and market manipulation;
  - ◆ (2) listing blue-chip enterprises from all over East Asia, e.g., Samsung, Sony, Taiwan Semiconductor Manufacturing Company, San Miguel, Siam Cement, in addition to Mainland Chinese and Hong Kong enterprises, on the Hong Kong Stock Exchange, as HDRs (Hong Kong depositary receipts) but with trading conducted in U.S. Dollars (and perhaps at some point, in Renminbi). This provides one stop shopping in Hong Kong in a secured, transparent, and well regulated environment for asset managers interested in investing in East Asia, and at the same time provides additional sources of capital for successful East Asian enterprises).
- ◆ Once Hong Kong is established as an international market for securities, with both investors and users of capital coming to Hong Kong from all over the world, it will be difficult for another city to try to take over.

# The Flow of Capital: Hong Kong as an Insurance and Re-Insurance Hub

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- ◆ Hong Kong also has the potential of becoming an Insurance/Re-Insurance Hub for the region.
- ◆ The two most important insurance/re-insurance centers in the world are London and Zurich.
- ◆ There are three necessary conditions for becoming a global insurance/re-insurance center:
  - ◆ (1) The availability of risk capital--there must be an abundance of investors and capital willing and able to assume risks; both London (through its highly liquid and freely mobile capital markets) and Zurich (through its management of a large proportion of the world's private wealth);
  - ◆ (2) There must be political stability, foreigner-friendliness, and a credible, fair, and transparent legal system that is ready to adjudicate and enforce insurance contracts and claims in a timely manner;
  - ◆ (3) There must be expertise in actuarial sciences and risk assessment.

# The Flow of Capital: Hong Kong as an Insurance and Re-Insurance Hub

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- ◆ The capital is certainly available here and the appetite for risks is clearly demonstrated by the booming casino business in Macau and the A-share markets in Shanghai and Shenzhen.
- ◆ Hong Kong has a legal system that can be relied on to settle commercial disputes in an objective, fair, transparent and timely manner, without any favoritism, local or otherwise.
- ◆ Hong Kong can certainly attract as well as train locally the expertise required for the insurance/re-insurance business. The Chinese University of Hong Kong has an insurance and actuarial science specialization that attracts the best students from Hong Kong and overseas.
- ◆ There is a sufficiently large volume of business transactions that go through Hong Kong—shipping, transportation, storage—that there is a natural local and regional demand for insurance and re-insurance as well as insurance syndication.
- ◆ Large Chinese insurance companies already operate in Hong Kong. Some are listed on the Hong Kong Stock Exchange.

# The Role of the Hong Kong Government: Enhancing Internationalisation

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- ◆ Hong Kong must maintain and even enhance its degree of internationalisation at the same time that it strengthens its ties to and understanding of Mainland China.
- ◆ The standard of English, which has deteriorated in recent years, and that of Putonghua must be improved.
- ◆ However, internationalisation does not refer to the use of languages alone, but also to the outlook and interest of its citizens, and to the creation and maintenance of networks of international ties. If Hong Kong becomes insular and inward looking, it will lose its competitive advantage over other Chinese cities.
- ◆ Hong Kong must also renew and strengthen its ties to other East Asian (Japan, Republic of Korea) and Southeast Asian (ASEAN) countries. It should try to become a financial centre not only for Mainland China, but also for Southeast Asia as well, as it once was a decade or two ago.

# The Role of the Hong Kong Government: Supporting an Infrastructure

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- ◆ The cost of land is prohibitive in Hong Kong. Thus, new (private) tertiary educational and health care institutions are possible only if the Government is willing to lease land to these institutions to build their facilities at purely nominal rates (e.g., \$1 a year). In order to avoid diversion to commercial use, the lease should include strict prohibitions on changes of use of the land to any other purposes and on transfers of the lease without prior permission of the Government, which the Government has the sole discretion to grant or not to grant and to impose a land premium at a level that eliminates any advantage the lessee may have over other potential users of the same land.

# The Role of the Hong Kong Government: Cooperation with Shenzhen & Guangdong

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- ◆ The Government can also take the lead in collaborating and cooperating with the Municipality of Shenzhen and mobilize its resources, public and private, to jointly develop Hong Kong-Shenzhen as a global hub.
- ◆ It is important to make sure that long-term development projects create win-win solutions for Hong Kong, Shenzhen and Guangzhou.

# Concluding Remarks

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- ◆ Development of Hong Kong as a global hub for flows in people, goods and capital is a long-term undertaking and will require the long-term commitment of the Hong Kong Government, its citizens, its corporations, and public and private institutions engaged in education and health care.
- ◆ Hong Kong has natural comparative advantages to develop into a global hub for the region and for Asia.
- ◆ It will require the concerted and sustained efforts of not only the Hong Kong SAR Government, but also its citizens, corporations, etc. to invest in the long-term future of Hong Kong.
- ◆ The “Three Links” between Mainland and Taiwan, if they materialize, can in the short run reduce the flow of people, goods and capital through Hong Kong but in the long run should be beneficial to Hong Kong. By enhancing the stability of the region, it should allow the economies of Greater China to grow even faster. What is good for the Mainland Chinese economy is good for the Hong Kong economy in the long run.