

"HONG KONG'S COMPETITIVE EDGE"
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Chairman, Ladies and Gentlemen, it is a great pleasure for me to be here to share with you some of my views about Hong Kong's competitive edge at this time, when we are in the midst of a rather severe economic downturn.

It is worthwhile to reflect on our past achievements and to consider what the past can tell us of our future. Our past economic performance has been outstanding. Our GDP in the last 20 to 30 years has grown at about 7.5 percent, which is a phenomenal achievement. Our per capita income in purchasing power parity terms, until the recent downturn, was the fifth highest in the world. We have had low rates of unemployment of around 2 to 3 per cent. We are the second most externally oriented economy in the world, and the eighth largest trading economy. All these achievements are well known. Perhaps what is less well known is that we are the fourth largest source of foreign direct investment in the world. We generate capital to invest around the world, and we are among the top four investors, where the top three include the two leading economic powers in the world; the United States and Japan.

This success has been based on Hong Kong's ability to compete in the world economy. It is important to also recognize that we have a cluster of economic sectors which are internationally highly competitive and it is useful to outline them. The most important are light manufacturing and trading. The two go very much hand in hand in Hong Kong and have been the traditional source of our economic strength. But there are others - transportation, financial and business services, tourism and travel services, communications and media and infrastructure and real-estate development. These are some of Hong Kong's most competitive sectors in the world economy. Our very open economy does not allow them room to be less than internationally competitive.

One of the key elements in Hong Kong's competitive edge is its ability to adapt. Hong Kong's economy has been transformed in the past decade. We have heard much about Hong Kong's rapid transformation into a service economy. It is correct to say that Hong Kong has always been service economy and that even at its lowest point in 1984 the services sector still accounted for some 65% of the economy. Today the figure is 85%. So when we talk about Hong Kong's transformation to a services economy the most significant point is not its dominance, but its rapid growth. It is about a 20% increase in the service sector share of the economy over a mere 15-year period is historically unprecedented anywhere in the world.

To a greater or lesser degree, the Hong Kong economy has always been a service economy. Today, this predominance is even greater. For instance, over 92% of inbound foreign direct investment is in services. However, it is producer services, i.e., services provided to business, rather than consumer or personal services, that dominate our services sector. Hence, the economy of Hong Kong rises and falls with business activity both in Hong Kong, the Chinese Mainland and the rest of the region. Therefore, unlike the past when export-oriented manufactured products dominated the Hong Kong economy, we are now far less likely to be the first to recover from the recession that is affecting the region, since the services we provide depend on the economic activity such as manufacturing, trade and investment, in the region. This

does not necessarily mean that we are less competitive, but it does mean that we are even more dependant than before on the external environment in Asia.

We should also note that Hong Kong's economic transformation since the 1980s is better characterized in my view not as simply one from manufacturing to services, although this is the usual way of looking at it, but as a transformation from what may be viewed as an “enclave-like” economy towards a “metropolitan” economy. An “enclave” economy is an economy that operates more or less in isolation from its immediate environment or neighbors, but would often have economic ties to distant markets. An obvious example is the export processing zones established in many highly regulated developing economies. Before the 1980s and the opening of China, Hong Kong's economy heavily dependent on the export of domestically produced light manufacturing goods. These activities were carried out with very limited interaction with the Mainland, or even with other economies in the region. Hong Kong was an “enclave-like” economy that existed apart from even its immediate hinterland. But today Hong Kong is more like a metropolitan economy, which has close links around the region and with the Chinese hinterland.

This has come about primarily as manufacturing has moved out of Hong Kong. In 1980, 100% of Hong Kong's manufacturing was carried out in Hong Kong. By 1997, 10% of the production was in Hong Kong, 60% of the production was in the Chinese Mainland, but a full 30% was elsewhere in the world. The economic integration that has taken place, however, is not only with the Chinese hinterland but there are good reasons why the Hong Kong economy is linked very closely to the Chinese hinterland: it is geographically close, transportation links are convenient and there are language and other ties. The shift from an “enclave-like” to a “metropolitan” economy has enabled industries, and the Hong Kong economy in general, to remain competitive when it would have otherwise declined.

In this respect, Hong Kong's economic structure today is closer to that of New York, London and Tokyo than to a typical national economy. Thus, Hong Kong has emerged as a major business center that serves the region in which it is located. However, Hong Kong is unique in some ways in the sense that the manufacturing sector in Hong Kong has not declined, but has actually expanded by relocating itself to the Chinese hinterland.

An important characteristic of the Hong Kong metropolitan economy and its Chinese hinterland is that the cost structure is very different to other examples of such economies. In the cost structure of most other metropolitan/hinterland economies the cost differential is about 20 to 30 percent. New York, for instance is about 20-30 percent more expensive than the rest of the United States. But in the case of Hong Kong and the Chinese Mainland, the cost differential is more like 10 to 1. This obviously is an enormous advantage, Hong Kong companies have access to a cost base that is much lower than that within Hong Kong itself.

In this “metropolitan” economy production is decentralized to offshore locations. Hong Kong concentrates on management and coordination, and financial and other professional services, not the actual production of goods. As we know, the transformation of Hong Kong into this type of producers' services based economy took place in a decade. In New York, the process occurred over a 40 year period. In comparison, the adjustment here was very dramatic and very rapid. This shift not only implies the change from an “enclave-like” to a “metropolitan” economy, but also a transformation to a knowledge based economy.

The change is most obviously reflected in the proportion of employees in the labor force. In 1981, managers and administrators constituted 3% of employees. In 1996 they constituted

12% of employees. Professional and related workers constituted 6% of employees in 1981; in 1996 they constituted 17%. As you can see, at the higher end of this managerial coordination function shown by these figures the transformation is dramatic while at the clerical end, there is also change but less dramatic. In 1981 we had 11% of our labor force doing clerical functions, while today the figure is 17%. I once joked that many high school graduates that would be employed as clerks in the 1970s are now enrolled as university graduates, many of whom in the current economic recession are now seeking employment as clerks. If we look at the totals for all these of managerial service functions, which are essential to the performance of business services and headquarters functions, we can see that in Hong Kong the percentage of the labor force who work in these functions increased from 21% in 1981 to about 46% in 1996. These changes show how the nature of work has changed as the economy has been transformed; we are now providing managerial coordination, professional, financial, other business related services. These services are knowledge intensive. Being knowledge intensive does not necessarily mean knowing any specific specialized body of knowledge such as physics and chemistry. It can mean the ability to think, to organize, to plan, to handle people, handle modern equipment, all of which is very knowledge intensive. You can put a peasant in the factory and the peasant is at a loss how to operate the various machines. You put a factory worker in an office and he does not know how to handle most office routines. Education and training therefore becomes the key to competitiveness.

If the previous trend continues, and there is little doubt that it will, the importance of the performance of these functions to the Hong Kong economy can only increase. Indeed, a recent survey of manufacturing and trading firms showed that 95% of them want to retain their controlling headquarters in Hong Kong and that 90% of them intend to increase or maintain their headquarter management functions in Hong Kong. However, all the companies surveyed wish to decentralize other production functions out of Hong Kong. The continued importance of the headquarters role of Hong Kong can be seen from the fact that multi-nationals continue to put their regional headquarters and regional offices in Hong Kong and that the concentration of these headquarters and regional offices in Hong Kong is several times that of any other center in the region.

The knowledge intensive economy is anchored in activities, not industries. The key activities are management and coordination, it does not matter what you manage. Management skills are to a large measure transferable: the chairman of a beverage company can be the chairman of a media company.

The knowledge intensive economy, therefore, is anchored in activities, not industries. The primary jobs are management, coordination, finance, strategy formulation, product development, advanced marketing and the generation of vital information that will allow managers to manage their enterprises effectively. Such an economy, this type of activity and knowledge based economy, is much more immune to the change in the fortunes of any particular industry or particular sector than is a manufacturing economy. But it is very sensitive to a general business downturn, which is what we are experiencing today. Because almost every sector in the whole region is doing badly Hong Kong in turn suffers.

For this reason, Hong Kong's competitiveness and the Asian crisis is particularly interesting to observe. The competitiveness of a metropolitan and knowledge based economy is based on its dynamic private sector, its clean and supportive government, very strong local firms and a significant presence of overseas firms. Part of this competitiveness comes from smaller entrepreneurial firms that are hustling every single deal. These firms, there are some 200,000 of

them in Hong Kong, enable a quick response and rapid adjustment to the changing business environment. Some trading firms are minimalist companies with just a mobile phone and a briefcase. These competitive advantages that I have mentioned have not changed in Hong Kong. I think Hong Kong has even strengthened itself vis a vis the rest of the region after this crisis because we did not experience a financial meltdown like some of our neighbors. As a consequence the vast majority of our firms have continued to operate. The destruction of valuable entrepreneurial and organizational capital have been kept to a minimum.

As we debate Hong Kong's economic future we must therefore not lose sight of our existing competitive advantages. Hong Kong should not be benchmarked against national economies but against other metropolitan centers. The relationship of the metropolitan center to its hinterland is of critical concern. I will not discuss this because the most important hinterland is, of course, the Chinese hinterland, and Mr. Kwok will talk about it later. But I wish to emphasize that China is not only our production base where we can locate our factories and support services but it is also a market for our goods and services.

Hong Kong's major long run constraint is its human resources. The education and training required to extend its role as a management, coordination and financial center is a major issue, and Antony Leung our distinguished banker and moderator of this forum is handling that problem with all his skill and experience.

But aside from the question of education and training, the provision of human resources requires immigration to replenish Hong Kong's entrepreneurial and risk taking spirit and to provide the skills we cannot supply ourselves. This is essential. It is inconceivable that New York would be New York if all New Yorkers were born in New York. Similarly, it would be inconceivable that Hong Kong would be the Hong Kong we know and hope to become if all Hong Kongers have to be born here. It is a very important that we adopt an attitude of openness to immigration as being vital to our future economic success.

There are other factors which impact on our competitiveness. The quality of life and physical environment must be enhanced to retain and attract the highly mobile, knowledge intensive work force. Workers who are knowledge intensive can pack their bags and go somewhere else if you cannot provide a congenial environment for them to work and live. They are not the traditional blue-collar workers who have limited skills and little mobility.

These days we hear a great deal about Hong Kong's cost structure as being too high. But it is important to make a distinction between traded and non-traded goods. In the traded sector our cost structure cannot be too high, otherwise our industries could not survive. But this is not necessarily the case in the non-traded sector. I think the real policy issue here is not about lowering costs and prices across the board but in making the non-traded sector more competitive in a global environment. These would include many of the professional and technical services. Wages and prices in this sector must not be so high as to price itself out of the global market place. This would entail reducing artificial barriers to entry in this sector and making it more tradable in the world market so that it too will be subject to the same market forces as the traded sector. The increased competition facing the non-traded sector, which traditionally has not had to face external competition is also an important policy issue for Hong Kong.

My conclusion is there are certain things that Hong Kong should be doing for the long term, I think we are beginning to recognize them and are starting to address them. Although we are still in the middle of a severe economic crisis, I think we should take heart that we do have a lot of long term competitive advantages that we can continue to build on. We should not lose sight of them. Thank you very much