

WTO: Hong Kong's Wake-up Call?

Hong Kong firms have consistently underestimated the strength of competition from Mainland firms. TDC Assistant Chief Economist Joseph Tsang believes China's WTO accession might provide them with a rude awakening



China's accession to the World Trade Organisation (WTO) has been 'imminent' for about 15 years now, so Hong Kong firms have had considerable time to mull over the likely impact of this perpetually postponed event. Finally, China's WTO bid has been approved. There's no question that the impact on Hong Kong's manufacturers and service providers will be enormous, as improved access to and from China will re-define Hong Kong's future role both as a gateway and an international metropolitan centre.

One of the main objectives of China's accession to the WTO is its increased participation in the globalisation of the world economy. The key feature of this will be the country's opening up of its various markets to foreign participants, plus the reduction in tariffs and elimination of non-tariff barriers to trade. According to the Hong Kong Trade Development Council (TDC) Assistant Chief Economist Joseph Tsang, the main benefit to the Mainland of WTO membership will be the largely symbolic fact that China, already a major economy, will become an official part of the world economic community.

Real benefits include China no longer being subject to ad hoc trade restrictions, such as having to go through the annual 'most favoured nation status' debate in the US. The country's exports should also no longer face the harsh quotas seen in the past. A key beneficiary of quota elimination will be the garment industry; under the terms of the WTO Agreement on Textiles and Clothing, all textile

quotas will be eliminated by 2005. As China starts to be treated the same as other exporters, clothing exports will expand – quite a prospect given that roughly one-third of the world's clothing exports already come from China and Hong Kong combined.

The TDC estimates that WTO entry will have a limited impact on China's growth, contributing to a forecast of 1 per cent increase in GDP. 'The real impact should come from rises in trading volumes,' Tsang explains. While the TDC forecasts that China's external trade will double over the next five years, this forecast includes estimated trade growth of 50 per cent even if China were not to be admitted to the WTO. So why the bother of going through these trade rounds? 'It all comes down to China being accepted as part of the world's official economic community,' Tsang says.

Regional Impact

Neighbouring countries have made some worried noises about the effect of China taking an increasingly authoritative position on the global trading stage. While the Mainland will always be in competition with its neighbours to some degree, Tsang points out that in trade terms, while countries such as Singapore and Taiwan produce high-tech and electronic goods, China has traditionally focused on the lighter end of the consumer product market.

He points out that Southeast Asian nations don't just worry about China's threat to their exports, but also that it will suck up all the foreign direct investment (FDI) targeted at the region. 'Many regional countries haven't fully recovered from the effects of the Asian financial crisis and now face a downturn in their major market, the US. China seems unscathed by these developments, even to the extent that Asian FDI is still flowing into the Mainland. In the foreseeable future, I think China will continue to compete with other Asian exporters and potential FDI recipients rather than export its growth to them.'

Hong Kong's prospects, however, are somewhat brighter. To gauge them better, Tsang says it is important to understand that the SAR's future economic relationship with China falls into two areas. The first and least controversial of these is whether Hong Kong companies can benefit from China's entry to the WTO. 'Many Hong Kong companies including those in the banking, manufacturing and freight forwarding sectors are already doing big business in China. When China becomes a regular member of the world economic community, these companies should be well-positioned to get a good share of the China market.'

A question mark hangs over the traditional role of the SAR itself as a hub through which foreign companies do business in China. Some commentators have advanced a rather gloomy prognosis, saying that China's entry to the WTO will be a 'nail in the coffin' of Hong Kong's role as an intermediary between China and the rest of the world.

Tsang disagrees with this extreme view. 'Even if you think that overseas companies won't need Hong Kong to be a trading intermediary, its economy won't simply wither away. The SAR's interdependence

with the Mainland means that Hong Kong will definitely share in the benefits of WTO entry.'

He admits that in the future foreign companies may decide that they don't need to use Hong Kong as their sole hub. To date, some companies have used the SAR for regional affairs while others have their China headquarters in Shanghai. However, Tsang says it's important to remember that Hong Kong is still *the* place from which to manage international business within this region. 'Companies may decide to co-ordinate their China operations from a base in the Mainland, but would still need to make use of Hong Kong's many services.'



He believes that second-tier multinational companies, which are relatively smaller groups with simple corporate structures that were born global, will still need a business-friendly location as a local base. 'There's real value to these groups in particular in using Hong Kong for regional headquarters, as it's still reasonably difficult for them to manage regionally from China.'

The Shanghai Question

In the medium term, Tsang believes Hong Kong and Shanghai will play mainly complementary roles. To start with, he reiterates that Shanghai will be an unlikely base for an overseas group's international operations. 'However, people also need to take into account the role that will be played by China's own megalithic companies. They want to expand overseas, so generally will set up in Hong Kong to tap international financial and trade markets,' he explains.

When it comes to financial services, Tsang says a city with a non-convertible currency cannot expect to become an international ►

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financial market. However, this should not be a barrier to companies doing domestic financial business. 'Shanghai has already seen its recognition as a local financial centre grow. Differences between the finance business in Hong Kong and Shanghai will become smaller over time as China tries to play the finance game according to international rules. However, remember that Hong Kong still has an absolute advantage in this field.'

When he presented the TDC's annual report to the Legislative Council, TDC Chairman Peter Woo talked about the five pillars on which Hong Kong's trade services platform rests: its marketing strengths, logistical strengths, 'first mover' advantage in China, institutional strengths and entrepreneurial economic and tax structure.

Tsang agrees with this list, and feels businesses should continue to play on these strengths. He adds that while common languages and culture are advantages in Hong Kong's relationship with China, these are given and cannot be depended upon in forging further into the Mainland market.

'Our real strength lies in taking this common bond and combining it with the fact that Hong Kong understands more about the China market than anyone else. If an overseas company wants to do business in China they can plough straight in or go into partnership with a Hong Kong entity, with people who really understand the market and who have been doing business in China since it first started to open up more than 20 years ago. This partnership idea adds value to the role Hong Kong companies can play. The idea of continuing to operate merely as a gateway is fairly passive; we would like to see Hong Kong companies taking on a more strategic role which they can do through the partnership formula.'

Despite the WTO, impediments to doing business in the Mainland still exist – the rule of law and enforceability of contracts are just two of the problems overseas businessmen face. Tsang maintains that China is constantly trying to improve its performance in non-business areas, and points to tangible and rapid improvements in its systems of corporate governance. 'Constraints because of ideology would have a big impact on how fast the government can change the way it plays the international game,' he says.

From a personal standpoint, he thinks that in the long term China's cities will follow the pattern shown in the US or EU where several cities act as important economic centres serving

a large population. 'A couple of places should stand out, but they will still be very much a part of the whole picture. When discussing Hong Kong's future, many people fall into drawing an all-or-nothing scenario. This is simply not the case in the real world.'

'Hong Kong has far higher living standards than southern China. This will change. We all hope that China's economy will continue to prosper and that in the long term the country will reach developed economy status. Hong Kong's standard of living may continue to stay slightly ahead, but the difference won't be as vast as it is today.'

Modernising Services

Service support is a vital factor in product globalisation. While services contribute more than 85 per cent of Hong Kong's GDP, they only account for around one-third of China's. Even in the major cities, services only contribute about 50 per cent of GDP. 'China's services industry lags behind the international standard as well as behind Hong Kong, which has arguably the best developed professional services in the region,' says Tsang.

In addition, China's services market is still relatively closed. 'There are a lot of restrictions on service providers that currently operate in China, especially in the telecommunication and Internet sectors. However, WTO will mean that foreign companies will be able to establish an operating presence in China and provide their services there.'

As China becomes increasingly integrated with the world economy, it will need far greater levels of services, opening up a myriad of opportunities for foreign service providers. Tsang cites the example of the legal profession. Although China has a large number of lawyers, few of them are experienced in business-related matters or in providing business advisory services. Until more local people are trained in international business and law, he says foreign lawyers will have a distinct advantage in this field.

He points out that as Shanghai develops as a financial centre, the demand for high-quality professional services will rocket. 'Businesses will demand standards that are commensurate with international standards. This opens up a whole host of opportunities for foreign lawyers.'

In the short- to medium-term, Tsang says demand for these services is unlikely to be matched by local supply, even after taking into account Chinese nationals who have trained overseas. Although the supply will increase over time, the gap will still have to be met by foreign market players.

A similar scenario exists in newer industries that China has embraced, such as IT. Although the Mainland has plenty of IT graduates with the requisite technology training and application, they often lack good business and marketing skills. 'China is very strong in strict technology areas such as research and development or programming. However, good business acumen and marketing skills are vital. What's needed is to develop people with a good combination of both the technical and business skills.'

For some years after China's markets started to open up to the outside world, the Mainland was seen as the El Dorado for service providers. However, more recently many Hong Kong professionals have been surprised at the pace at which their Mainland counterparts have caught up with international norms in respect of skills and knowledge. 'In the past, Hong Kong professionals

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thought they would only be competing with other foreign companies in the China market. They assumed that mainland Chinese companies would be no match for them. That assumption is dying fast,' says Tsang.


The gap between China's services and those of the developed world has closed rapidly in many areas, one of the most noticeable being the advertising industry. Ten years ago, Tsang says, people on the Mainland simply had no idea about how to handle modern advertising. 'Many expat managers were brought in to help bring Mainland creative advertising up to date. Today there is a lot more local talent being used in this business, even at the most senior levels,' he explains.

This trend is also visible in the legal and accounting communities and is slowly taking effect in the management consultancy field. Tsang says that while foreign companies can play a big role by opening up various markets for services, they would need to localise their operations quickly as the supply of local professionals grows.

He sees the same trend prevailing in manufacturing. 'Originally senior management of foreign invested companies was recruited

from overseas. Now many factory heads and middle managers are local people.' As a result Tsang feels that opportunities for Hong Kong professionals are perhaps less rosy than were forecast a few years ago. 'There are still big benefits to be had by companies, but when you look at individuals it's a different question.'

However, he emphasises that Hong Kong companies will only prosper – and perhaps even survive – by capturing the opportunities that arise from continued economic integration with China. 'We're at a turning point in China's economic development. Competition will be fierce, and there's no guarantee that foreign firms will continue to be successful in the Mainland's marketplace.'

'Hong Kong companies used to complain about barriers to doing business in China, and they maintained that once these were down they would be able to conquer markets there. Now it's clear that there are formidable competitors within China's walls. Hong Kong's businesses need to make a more realistic assessment of what they will encounter in China's marketplace. At the same time they should understand that the Mainland market is where Hong Kong's future lies.' 

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