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**Hong Kong and Shanghai: A Tale of Two Cities**

Annelise Preslan

**Introduction**

With a casual glance at Shanghai’s skyline, it would be difficult to determine whether this city was actually Shanghai or Hong Kong. Both cities possess the modern skyscrapers, elegant cafes, exclusive shopping boulevards, and glitzy nightlife that serve as requirements of major metropolises. (“Investment from Hong Kong…”) On the surface, Shanghai has many of the superficial aspects of another Hong Kong. The outer “hardware,” such as tall buildings, integrated road systems, and a well-educated workforce, is in place and working effectively. Internally, however, the “software” of governmental policies, lack of import restrictions, and personal liberties, is non-existent. Although the two cities may appear to be on an equal footing, that is not the case when their inner workings are examined.

In this article, I investigate several aspects of these two metropolises. First I examine their ports on the basis of their capacity, growth, and future plans. I then compare their markets, investments, and growth possibilities. Finally I analyze their governments with regard to public constraints, personal and economic freedoms, and legal frameworks. With all factors accounted for, there are two possible outcomes to the complementary competition between Hong Kong and Shanghai. According to the expansion model, Hong Kong’s ties to the mainland will increase, strengthening its role as Asia’s major services center. According to the substitution model, however, Hong Kong’s role as middleman will diminish and be replaced by other Asian cities, most notably Shanghai.
Background

In its current state, Hong Kong enjoys many advantages over its “competitor” to the northeast. Hong Kong is a free port with no import tariffs and a flat tax rate. Hong Kong is one of the largest recipients of foreign investment in the world, making it an international center of commerce. Hong Kong’s banking and financial facilities, independent currency, ready accessibility to information, cooperative government policies and services, favorable tax regime, and excellent natural harbor and geographical location combine to create a dynamic city.

Shanghai is not yet sufficiently equipped to function effectively in a global economy. To participate, Shanghai would require a legal system that is compatible with those of Western systems. Mainland China’s non-convertible currency, the gap in freedom of information, and the lack of capital mobility present great obstacles that must be overcome if Shanghai is to compete on Hong Kong’s global playing field. Yet, Shanghai does possess several advantages over Hong Kong – in particular, markedly lower labor costs and office/factory space. A recent awareness of vulnerability to terrorist attacks may also give Shanghai an advantage over Hong Kong. Hong Kong, a more densely populated island than Manhattan, is known as the “New York of Asia.” With numerous corporate headquarters, Hong Kong is a capitalist mecca and a vulnerable target for terrorists. Shanghai, while also a coastal port city, is surrounded and protected by great expanses of Mainland China.

Hong Kong is located on the southeastern tip of China. Its total land area is almost 1,100 square kilometers, including Hong Kong Island, Kowloon peninsula, the New Territories, and 235 small islands off the coast, most of which are uninhabited.
(Information Services Department) Hong Kong was under British rule for a 99-year lease period, after which it was handed back to the Chinese on July 1, 1997, when it became known as the Hong Kong Special Administrative Region of the People’s Republic of China, or the HKSAR. Along with the handover came a mandate that “the previous capitalist system and way of life shall remain unchanged for 50 years.”

Hong Kong is governed by a “One Country, Two Systems” model with a constitution, the “Basic Law,” that ensures that Hong Kong’s importance as a regional center will continue while it is under Chinese rule. The constitution ensures that “Hong Kong people run Hong Kong” with a “high degree of autonomy.” (Information Services Department) Foremost, Hong Kong will remain a free port and be allowed to continue its economic and trade systems in the capitalist manner under which they currently operate.

Shanghai, the largest city in China, is located just south of the mouth of the Yangtze River, on the eastern coast of China, centrally situated between China’s northern and southern borders. The city has a total land area of 6,184 square kilometers, with approximately 340 square kilometers constituting the city proper. (“Shanghai”) In its rich 6,000-year history, Shanghai has served as both a cultural and historical center for China. Over the past 20 years, the city has undergone sweeping reforms and has developed into an important economic base, housing much of China’s industry, foreign trade, and technology. The service sector of Shanghai’s economy is rapidly expanding with finance, insurance, commerce, real estate, tourism, and information being the key areas of development.
Shanghai’s goal is to become a regional economic trade center, as Hong Kong is
to the southwest. ("Economic Progress") Many advocates for Shanghai have set their
goal on regaining their spot as Asia’s premiere city, as Shanghai was prior to World War
II. They view Hong Kong as their primary rival. ("Investment from Hong Kong…")
Yet, many realize that this goal will not be achieved, at least not in the near future. As
Hong Kong’s Chief Executive Officer, Tung Chee Hwa (a Shanghai native), noted:
“There will be competition with Shanghai and there will be a complementary
relationship. One Hong Kong can hardly serve as the leader of China. We will need
many Hong Kongs and Shanghais. But I promise you one thing: Shanghai will never
catch up with Hong Kong.” ("Investment from Hong Kong…") The rivalry between
these two cities can, however, have a favorable effect upon both. Former U.S. Treasury
Secretary Robert Rubin has asserted that Hong Kong should not look upon Shanghai’s
resurgence unfavorably. He acknowledged that “Shanghai’s re-emergence as a financial
hub would be evidence that the mainland’s reforms were succeeding, which could only
benefit Hong Kong.” (Brooker)

The Ports

The port of Hong Kong is a natural deep-water, silt-free harbor lying at the mouth
of the Pearl River Delta, and is well known as an international shipping center. Hong
Kong services both the maritime traffic from the Pearl River and the larger ocean-going
trade vessels from the Pacific. Hong Kong does not have a port authority like most major
world ports, but utilizes a governmental Marine Department for port operations. This
system is advantageous for Hong Kong, as it keeps bureaucratic involvement to a
minimum. The government provides the port infrastructure through the building of roads and the dredging of channels, but the private sector provides the resources to sustain the facilities. Private parties take the risks, and they also take the profits. The port of Hong Kong is operated efficiently, which has helped to establish Hong Kong’s Kwai Chung as the busiest container port in the world.

Hong Kong is the base of all maritime trading activities in southern China, as it is the only port between Singapore and Shanghai able to handle such a tremendous throughput, both in terms of containers handled by sea-going vessels and by river-trade cargo vessels. Currently, Hong Kong handles 2.2 percent of total global port traffic. (“Top 25 World Port Calls…” December 1999 figures attributed the port of Hong Kong’s cargo throughput to be approximately 166.4 million tons and the container traffic to be 16.2 million TEUs (20-foot equivalent container units). This throughput translates into one vessel entering or leaving the port every 1.2 minutes with one TEU handled every two seconds. (“The Port and Harbour”) Ship turnaround time is most competitive: on an average day, 1,200 vessels will enter and leave the port, giving Hong Kong one of the largest cargo throughputs in the world. (The Port of Hong Kong…) The port system includes eight container terminals with a total of 18 berths and a holding capacity of 11.5 million TEUs. A ninth terminal is now under construction, and upon its completion Container Terminal Nine will contribute an additional six berths, further improving Kwai Chung’s efficiency and handling capacity by 2.6 million TEUs. In 1999 container throughput grew by 11.2 percent, reaching 16.2 million TEUs. Year 2000 throughput grew by 7 percent, and is expected to reach 24 million TEUs by 2006.
In addition to being the busiest container port in the world, the port of Hong Kong also offers mid-stream sites and a river trade terminal that serve as low-cost alternatives to directly loading or unloading at a container terminal. The mid-stream sites offer loading and unloading of cargo from ships moored at buoys and anchorages in the harbor and ship-to-shore transportation of the cargo, while the river trade terminal consolidates cargo brought down by small river-trade vessels before funneling it into the container terminals on larger vessels. The mid-stream sites handled 2.8 million TEUs in 1999, while the river trade terminal handled 3.1 million TEUs. The HKSAR is making plans to improve the competitiveness of the port by reducing border crossing time, adding pre-customs clearance, and refurbishing the existing rail and water passages to the port. (The Port of Hong Kong…)

Although it remains the dominant Chinese port, Hong Kong is feeling the pressure of competition. Year 2001 cargo traffic at Kwai Chung is moving at a slower tempo. In the first six months of 2001, cargo traffic fell by one percent. Although this decline is partly due to the global economic slowdown, a second cause is more sensitive to Hong Kong; rival shipping facilities along China’s eastern seaboard, most notably Shanghai, are diverting cargo volume from Hong Kong. (Chandler)

Shanghai is the largest port in Mainland China and the world’s fifth largest container port. It is ideally positioned along the Huangpu River, at the mouth of the Changjiang River, to service both river- and ocean-faring vessels of domestic and foreign origins. Shanghai is also an integral transport juncture between water and rail systems. Its central location along China’s east coast offers Shanghai easy access to coastal ports from the north and south, as well as access to inland provinces by way of the Changjiang
River. The key limiting factor of Shanghai’s port is its shallow water depth, which restricts access to shallow and moderate draft vessels.

In 1992 Shanghai approved a port restructuring and development project that will produce a deep-water terminal costing around 424 million dollars. The project goals are to provide the port with additional capacity, to increase efficiency through the introduction of modern methods of operational and financial management, and to gradually shift operations away from the city center. These goals will be realized through new cargo handling equipment for existing terminals, tariff restructuring to improve the Port Authority’s financial status, the construction of two new container terminals along the Yangtze River, and technical assistance and training. ("Shanghai Port Restructuring…") Within a few years, it is expected that this restructuring project will boost Shanghai to the number three position among the world’s busiest ports, lagging behind only Hong Kong and Singapore. (McGregor)

Because the port of Shanghai is growing quickly, improving capacity, and charging far less than Hong Kong, it is draining business away from Hong Kong. Foreign investment and industrial growth are gravitating towards the rapidly developing Shanghai. In 2000, Shanghai’s port trade reached an all-time high of $109.3 billion, with imports totaling $47.7 billion and exports totaling $61.6 billion. This figure represented a 43.5 percent increase over the 1999 totals. ("Shanghai Port Trade…") In 2000, Shanghai’s port handled 5.5 million TEUs, compared to the 18.1 million TEUs that Hong

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1 All dollar values are in US dollars.
Kong handled. Once the new facilities are completed, Shanghai’s port volume will be able to increase significantly.

**The Economies**

Hong Kong’s port plays a major role in its economy, which has long been known as the freest economy in the world. Its economy is highly dependent upon trade with the rest of the world, with a free trade policy applying to both merchandise trade as well as trade in services. Trade in the services sector is of foremost importance to Hong Kong’s economy, contributing 85 percent to Hong Kong’s GDP. As a member of the World Trade Organization (WTO), Hong Kong supports the multilateral trading system, which fosters global economic growth and stability and practices non-discrimination with respect to the treatment of foreign and domestic goods. Hong Kong does not impose tariffs. Excise duties apply only to tobacco and alcohol products, and to some hydrocarbon oils. Hong Kong treats domestic and foreign companies on an even playing field and has no trade barriers. (Trade and Industry Department)

Hong Kong is an entrepôt for China’s trade with the U.S. As an entrepôt, Hong Kong acts as an intermediary center for trade between these two countries, holding goods in transit before re-exportation. (“Introduction: Hong Kong…””) In 1999 the U.S. was the largest market for Hong Kong’s domestic exports, accounting for 30 percent of the total value, or $7 billion. (Trade and Industry Department) Most of Mainland China’s imports from the U.S. and exports to the U.S. are routed through Hong Kong.

Hong Kong’s minimal government intervention in business and economic practices plays an important role in its attractiveness to investors. Hong Kong has no
controls on foreign exchange nor restrictions on profit reparations. The simple tax
system is a key factor in Hong Kong’s success. A flat tax rate of 16 percent for corporate
profits and a 15 percent maximum tax for salaries attract many firms to conduct business
there. Also, Hong Kong’s extremely low level of political and financial corruption
further enhances its attractiveness. (Information Services Department)

The city is also a major financial center, with the Hong Kong Stock Exchange
being the second largest in Asia, behind the Tokyo Stock Exchange. About 500 banks
have offices there, including 78 of the world’s largest 100 banks, due partially to the fact
that Hong Kong holds the fifth largest volume of foreign exchange reserves in the world.
In terms of a trading entity, Hong Kong is the ninth largest merchandise trading economy
in the world and has an active insurance sector. Securities and commodity futures trading
is lively, as are the fields of investment advice and fund management. Hong Kong
attracts foreign investment because of its free flow of capital and return on investment
without exchange controls. Companies and capital are drawn to Hong Kong for its free
trade practices, efficient business environment, governmental policy of supporting
infrastructure, stable pegged currency free from exchange controls, low tax regime, and
established legal and judicial systems. (Trade and Industry Department)

Shanghai plays an integral role in China’s economic development. In the
beginning of the last decade, the Central Committee of the Communist Party of China
and the State Council decided to turn Shanghai into a “world economic, financial, and
trade center as soon as possible and to bring a new round of economic development to the
whole Yangtze River area.” (“Proportions in the Nation”) This city single-handedly
contributes one twelfth of the national industrial output value, one fourth of the nation’s
total exports, and one eighth of the national financial revenue to China. Shanghai maintains a high economic growth rate; during China’s previous five-year economic plan from 1996-2000, Shanghai’s total financial revenue grew at an annual rate of 20.1 percent.

China’s recent entry into the WTO will open the country further to outside influences. There will now be a significant rise in foreign direct investment (FDI) into China. One estimate predicts that FDI will increase from $40 billion in 1999 to $100 billion per year by 2005. Much of that money will be channeled through Hong Kong, as the number one foreign direct investor into China. The Mainland public economy’s monopolization of commercial activities has been broken up step-by-step, and a commodity market with the public ownership of commerce has been established. The supply and demand for most commodities are kept in balance in this buyer’s market. Shanghai’s intent to become a competitive international business center is also observed in the Shanghai Stock Exchange. The market has grown rapidly and aims to improve efficiency and services to customers. (“Socialist Market Economy”) With entry into the WTO, many markets will open up and grow, including the Mainland’s fund management and securities markets. (The Hong Kong General…)

The Chinese government has concentrated its efforts to accelerate the development of the western region of China through the Three Gorges Dam Project and a “Go West” strategy. The Three Gorges Dam Project will provide the western section of China with the largest dam and hydropower station in the world. The dam on the Yangtze River will control flooding, provide hydropower, and allow river navigation deep into China’s heartland. The power generated is needed to keep pace with China’s
increasing demand. (‘Three Gorges Dam’) The four key components of the “Go West” strategy are: increased capital investment in infrastructure development, favorable investment incentives, widened scope for foreign investment, and investment in human capital. If adopted, these components would create a more conducive investment environment in the western region. Foreign investment is “set to rise” (‘Opportunities for Hong Kong…’) and thus will lead to faster economic growth through favorable policies and increased access to the western region’s services sector and domestic market provided by the “Go West” strategy. Hong Kong companies have been alert in seizing investment and business opportunities on the Mainland during the reforms of the past 20 years. These companies will benefit from the new opportunities that are being created in the western area of China. As an international trade and financial center, Hong Kong can contribute to the development of western China, but can also reap the benefits of a more highly developed western China. This can be accomplished by providing comprehensive investment services to large projects in the western region, assisting western region enterprises in listings on the Hong Kong Stock Exchange, and helping the region attract the foreign direct investment and venture capital it urgently needs. (‘Opportunities for Hong Kong…’)

The Governments

Hong Kong’s government provides the perfect complement for its economic policies. Its constitution, the Basic Law, provides the legal framework to keep Hong Kong functioning as it was prior to the handover on July 1, 1997. The Basic Law mandates the principle of “One Country, Two Systems” and guarantees the people of
Hong Kong that unfettered capitalism will continue and the current way of life will remain unchanged for 50 years. Hong Kong will have independent executive, legislative, and judicial power, including that of adjudication. The Basic Law also states that the common law system will be retained, fundamental human rights will be protected, and there will be a right to free movement into and out of Hong Kong. Chinese and English will both be retained as official languages, and the readily convertible Hong Kong dollar will remain the official currency. Hong Kong will remain a free port, a separate customs territory, and an international financial center. Hong Kong will manage its own finances, trade, economy, external commercial relations, and all other matters, except for defense and foreign affairs. Finally, Hong Kong will remain a separate member of international organizations such as the WTO and the General Agreement on Tariffs and Trade (GATT). Thus, Hong Kong has been entrusted with a high degree of autonomy.

(Information Services Department)

Shanghai, in contrast, is directly controlled by the communist government of China. In 1978 China instituted a reform policy. Since this time, commodity, capital, labor service, and technology markets have appeared successively, transforming China into an “initial socialist market economy system” and resulting in a strengthened regulated market. (“Socialist Market Economy”) This was accomplished by reduction of state control over businesses and expansion of the rights of private enterprises. However, these reforms alone cannot bring Shanghai up to the free market level that Hong Kong enjoys. As James A. Dorn, an expert on China, has noted, “What China needs is not market socialism but market liberalism. In the long run, market socialism, like central planning, is bound to fail.” (“Cato Holds Second Conference…””) Adopting Hong
Kong’s unilateral free-trade policies would benefit China, and thus Shanghai, immeasurably. On June 16, 1997, at a conference in Shanghai, Ed Crane, another China expert, delivered an address titled “Civil Society versus Political Society: China at a Crossroads.” Crane explained that there are only two ways to organize society: through the coercion of the state, which he termed “political society,” or through the voluntary actions of individuals, businesses, and social organizations, which he termed “civil society.” Crane stated that “countries that have maximized the latter and minimized the former have flourished both economically and culturally; those that have done the opposite have stagnated. Your struggle in China is to create a constitution of liberty. Act for the people's benefit. Trust them. Leave them alone.” (“Cato Holds Second Conference…”) However, it is doubtful that this hands-off approach to governing will appear in China in the near future unless some radical governmental reforms are implemented. Until that time, Shanghai’s freedom will continue to be constrained under China’s heavy-handed rule. If the Chinese political system does not become more liberal, Shanghai will never achieve its true potential. “But the tide of democratization and liberty is powerful,” as journalist Dan Gillmor has noted, and Shanghai’s previous capitalistic ways may yet resurface. (Gillmor)

Other Factors

There are several other important factors contributing to Hong Kong’s success as an international business center, as I will briefly note below:
• Hong Kong respects intellectual property rights, including trademarks, patents, and designs. Penalties for trademark counterfeiting and copyright infringement are very strict.

• Hong Kong’s labor force is protected by legislation, including internationally recognized workers’ rights.

• Hong Kong is a major communications hub. Boasting the world’s first fully digital telephone system, Hong Kong also has satellite and fiber-optic communications links for instant, efficient, and cheap communications around the globe. Hong Kong has more than 130 Internet service providers and had the world’s first interactive TV network.

• Hong Kong is also a transport hub. The new airport, built on a man-made platform, opened in July 1998 with an initial annual capacity of 35 million passengers and three million tons of cargo.

• As a leader in education, housing, and social services, Hong Kong sets many global standards. Education, health, welfare, and housing account for 56 percent of the government’s total public expenditure, with education taking up the largest single share. Hong Kong provides comprehensive medical and health services either free of charge or at a nominal cost. Hong Kong also has one of the world’s lowest infant mortality rates and longest life expectancies.

Shanghai has important factors working to promote it as an international business center as well.
• Hong Kong’s pollution of both the air and water and high costs of living are driving people across the border to live and work on the Mainland. Shanghai has less pollution (so far), lower costs for office and factory space, and a lower cost of living. (Balfour and Clifford)

• Industrial giants in China are utilizing the Shanghai equities market instead of the Hong Kong Stock Exchange.

• Mainland salaries are lower than those in Hong Kong, encouraging businesses to relocate to the mainland.

• Shanghai is “closer to the action” of the capital city of Beijing, enticing many companies to move their operations out of Hong Kong.

• Shanghai is wooing foreign companies aggressively.

• Shanghai schools are turning out students who are dynamic and innovative thinkers with a firm mastery of the English language, whereas Hong Kong students are typically more pedantic and have poorer English language skills.

Thus, Hong Kong and Shanghai both have many enticing aspects that are encouraging growth. Yet, there remain many detrimental factors, hurdles even, which must be overcome in order for these cities to prosper to their fullest extents. Both the parallels and the contrasts of these cities will continue to influence the respective positions of Hong Kong and Shanghai in China in the future.

Conclusion

Hong Kong’s position as the premiere Greater China hub is experiencing increased competition. If Shanghai continues its current trend of rapid growth, Hong
Kong could find its role as middleman between China and the trade world greatly reduced. “Hong Kong is no longer the mandatory launching pad,” says Gordon Orr, a managing director of McKinsey & Co., who moved the consulting firm’s Greater China operations from Hong Kong to Shanghai last year. (Balfour and Clifford) Shanghai has become a magnet for the best and brightest in China, who see it as the place of greatest opportunity. (Gillmor) With its rapidly-growing port and competitive economy, Shanghai is draining business away from Hong Kong. Foreign investment and industrial growth are gravitating Shanghai’s way as well. The new logo and slogan – “Hong Kong: Asia’s World City” – seems more like a description of past glories to many Hong Kong citizens, and Hong Kong’s administration appears worried about the city losing its competitive advantage. Without incentives to stay, the trickle of corporate departures will continue. (Balfour and Clifford)

However, it is uncertain whether Shanghai’s draw is sufficient to overtake Hong Kong’s established position as a global business center. As journalist Mark Landler notes, “Hong Kong, with its robust press and reliable courts, remains indisputably freer than China.” (Landler) Hong Kong has several other advantages that Shanghai cannot imitate. “There are things we are doing that nobody can do [no red tape, no government interference] in raising or moving money around, and a corruption-free entrepôt where the rule of law, and contracts, is sacrosanct,” says Hong Kong’s Financial Secretary, Donald Tsang. (Cernetig) Hong Kong also has been and should continue to be a world-class center of entrepreneurial, financial, and market skills. While Shanghai’s current speed and scale of development are exciting, Hong Kong is a stable entity and is not likely to fall. Hong Kong journalist Simon Pritchard succinctly addressed the question of
Shanghai overshadowing Hong Kong by noting, “Hong Kong’s track record of re-invention and adaptation to adversity puts the onus on the accuser to make the 'eclipse' case stick.” (Pritchard) The competition between Shanghai and Hong Kong keeps both cities on their toes, and is beneficial to the larger entity, Greater China. The rivalry will force each city to perform to the maximum, thus ensuring these two titans a competitive edge in the global economy. Hong Kong and Shanghai are now playing for the same team, and as Shanghai’s mayor, Xu Kuangdi, has stated, “The better they play, the more prosperous China’s economy will become.” (“Opportunity amid Competition…””)
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