

HONG KONG'S TURBULENCE AND CHINA'S PROVINCES HORIZONTAL COMPETITION

Dominik Mierzejewski

October 2020

SUMMARY

The policy paper aims to discuss the role of Mainland China the provincial governments in shaping the central government's policy towards Hong Kong. The primary point discussed in here is that the Beijing's based government foreign and domestic policies are based on the bargaining process with the provincial-level governments and the conflict is further triggered by the horizontal competition between Guangdong, Hainan and the city of Shanghai. Guangdong with bringing Hong Kong under the joint project of the Greater Bay Area hopes to utilize the former British colony for own benefits. However, the ongoing turbulence limits the possible benefits. The second local player interested in minimizing the role of Hong Kong is Hainan. Being closely connected with the military and oil cycles in Beijing, the government in Haikou openly declared to take over Hong Kong. Finally, the city of Shanghai, with its historical legacy of being the financial centre of China playing the Hong Kong card to make Shanghai the city like in the 1920s. and 1930 s. before the Japanese invasion. Nevertheless, as discussed in the paper the limitation of the role of Hong Kong in China's financial system would not prevent the horizontal conflicts between provinces, and at the same time would intensify the contradictions among local governments in China.

The critical issue for the decision-makers in dealing with Mainland China is analyzing the real position of Hong Kong inside the political system of the People's Republic of China and monitor provincial level behaviour in the context of Beijing-Hong Kong relations.

This publications is part of the National Science Center research project "The Role of Local Governments in China's Foreign Policy" no. UMO2017/25/B/HS5/02117.

INTRODUCTION

In May 2020 the National People's Congress has passed a new security law for Hong Kong, which reduces the city's autonomy. Apart from the vast international reactions, e.g. in the White House or declarations by the Western countries, the less recognized territory is domestic outreach of Hong Kong's position. The situation shows that the hardliners in Beijing's decision-making cycles are taking the lead, while softeners more oriented at the economic interdependence are losing their grounds. But the critical thing is who stimulates the decision on the security law and whether the competing province Guangdong, Hainan or the city of Shanghai might push the central government into more tough policy towards Hong Kong? Looking into the microscale of Guangdong province, the core question discussed here is to what extent the newly implied policy of Beijing in Hong Kong will have an impact on the Greater Bay Area integration project? And whether the southern province will take the advantages from the situation or rather other domestic players will utilize the case to the fullest? Hainan's government is interested in taking the role of Hong Kong, similarly Shanghai that cherishes its financial histories hopes to be the number one financial hub in China. Once the situation worsens the domestic, horizontal competition over the financial resources and high ended technologies might be deepened. In other words, along with wolfing, Hong Kong Beijing government hopes to limit the historical continuation of fragmentation inside China. However, apparently might fail.



But the critical thing is who stimulates the decision on the security law and whether the competing province Guangdong, Hainan or the city of Shanghai might push the central government into more tough policy towards Hong Kong?



GUANGDONG: WITH OR WITHOUT HONG KONG?

After the BRI was announced as the next round of reform and opening up the integration with the global economy has been seen a necessary for China's technological rise. To this end, Guangdong hopes to regain its leading position in the country economic development. In this regard, close relations with the external world, its geographical location, and bordering Hong Kong, created strategic opportunities for the development of Guangdong's structures and economic power. Using its cultural proximity Guangdong quickly make the first usage, and Hong Kong became the most prominent investor in Mainland China while Guangdong is

becoming the most notable beneficiary, particularly in the Pearl River Delta area. By exercising its relations with the former British colony, Guangdong became a location that attracted foreign investment from the manufacturing sector, for example, the technology industry in Shenzhen (80%) as well as high-value-added agriculture, real estate, construction, transport, telecommunication and other sectors.

More to the point, Hong Kong is like the magnet concerning labour-power and the emerging Pan-Pearl River Delta bloc within the concept of nine provinces and Hong Kong with Macau. The project will facilitate Guangdong's access to cheap labour from more impoverished regions such as Guangxi, Guizhou, Yunnan, Hunan, Jiangxi and Sichuan and thereby strengthen Guangdong's economic status vis-à-vis its northern competitors. The poorer provinces hope to benefit economically by linking up with the more affluent coastal areas and Hong Kong, but in fact, dominant Guangdong takes the labour forces from the neighbouring regions and develop its own economy.

By the very active policy and its historical position as the gate to China, Guangdong secured the export market for its products; but this was made on the expense of Hong Kong. Since 2010, the markets in the USA, and the European Union, Japan and South Korea remain stable, while the ASEAN importance in the provincial export markets has been growing. At the same, the role of Hong Kong as the intermediary has been diminished and dropped down from 41% in 2014 to 25% in 2019.

But still, regardless of the situation in Hong Kong, the city is seen as the trampoline for Guangdong go global strategy and utilize the principle of "united go abroad". In other words, the role of Hong Kong, however in the short term, is auxiliary in the provincial go out strategy; the market information of the "going out" destination, related investment consultation and investment risk. Moreover, the mainland Cantonese companies might resolve many problems caused by overseas investment in the Hong Kong court. The companies from Mainland China might also use Hong Kong's international competitiveness in finance, commerce and other fields. But the tensions over Hong Kong in 2019 and 2020 resulted in the limitations of Chinese companies in Hong Kong stock exchange, where they



By the very active policy and its historical position as the gate to China, Guangdong secured the export market for its products; but this was made on the expense of Hong Kong.



acquire the greater portion capital resources from the United States and other countries. According to the Hong Kong Trade and Development Council, as of year-end 2018, 1,146 mainland companies were listed in Hong Kong, with a total market capitalization of USD 2.6 trillion (68 per cent of the market total) According to the SWIFT global payments processing service, in May 2019 over 75 per cent of offshore RMB-denominated payments were cleared in Hong Kong.

On the one hand, as discussed by Liang Ganghua (2019), the dependency on Hong Kong limits the potential of Guangdong province, and the government should terminate the cooperation as soon as possible. The "illness of dependence" limits Guangdong position vis a vis Shanghai, as well as independent provincial position in the global geo-economics. On the other hand, for the international financiers, Hong Kong, with the role of law works like the magnet for foreign capital. The ongoing limited role of Hong Kong in the trade and finances of Guangdong might have a negative impact over the Greater Bay Area project, and by triggering tensions undermined the integration programmed. In fact due to the based on export processing and labour-intensive manufacturing development model Guangdong faces limitation to build up their own capital intensive industrial base, given the importance of revenue and employment of traditional manufacturing for the local governments. The same time the government in Hong Kong seeks to foster an innovation and start-up environment. Moreover, since July 2017, the Hong Kong government has committed "over HKD 100 billion" to promote innovation in biotechnology, artificial intelligence, smart cities, and financial technology. This signals the competition with the inland cities of Guangdong province.

HAINAN: OFFICIAL DECLARATION TO TAKE OVER HONG KONG

In the 1980s. recognizing the problem of demarcation of sea border scholars from Hainan prosed "Pan South China Sea Community of Shared Interests". By attracting attention from Beijing with the national border questions, they hope to gain more incentives from the central government. The very first idea was to combine East and South China Seas as the core place, then Fujian and Guangdong province as the leading forces with a massive influence on Hainan, Guangxi, Hong Kong, Macau and Taiwan. But later the conceptual framework of two seas has been rejected, and the only the South China Sea remains as the critical part of the cooperation framework with Hainan as the core area and radiates towards 12 countries and regions in South China Sea region.

In this project, however, the closest province Guangdong has not been very much mentioned in the documents while with Guangxi AR Hainan Province has many synergies, and the construction of "two corridors and one ring" with Pan Beibu Gulf (Tonkin Gulf) illustrate this the most. Then, Hainan position itself as the intermediary for the development of the marine economy in Guangdong, Guangxi, Hong Kong, Macao and Taiwan, and by this means navigated the coordinated domestic integration in the South China Sea. Apart from the local outlook, Hainan serves China's all-round opening up and strengthens the regional economic integration between China and Southeast Asia.

The last point as advocated by Hainanese scholars when Hainan should be like a magnet for the international business and in the future should compete with Hong Kong over the centre for RMB internationalization. Then the province might serve as the bond market with RMB as the dominant currency, and find sufficient funds for the BRI projects. At the same time, Hainan FTA as part of the BRI strategy will be allocated more capital and resource both from the domestic and international scene and then utilize them for the BRI projects. In this particular area, the critical role was given to the Free Trade Zone when the majority of trade should be settled in the Chinese currency. The escaping from the currency risks is crucial for the further stable development of China's trade, and Hainan Province takes the advantages of the policy to invite foreign companies to establish offices and ship the country's goods to China. After obtaining the Renminbi, they can then purchase the commodities required by their country. By taking these measures, Hainan Province can secure more stable trade of the whole country. In this context, the Hainan's role is diminishing the role of Hong Kong in the island economic interactions. The ultimate goal for the government in Haikou, as said in official document Hainan is to build the position that in the future will allow the island to replace the intermediary roles of Hong Kong and Singapore and conduct more self-reliant policies. The local government repeated this promise in June 2020, when afraid of decoupling with the United States Hong Kong would lose its intermediary role in Hainan's trade. However this declaration was nothing new: in August 1988 the local



Hainan should be like a magnet for the international business and in the future should compete with Hong Kong over the centre for RMB internationalization.



government announced that the new provincial authorities were considering opening China's first "free port" in Yangpu similar to the free ports operating in Hong Kong and Singapore and the future overtook the position of both, respectively. This was a local government-fulfilling prophecy. In 1993, Hong Kong was the main export market, accounting for 50.1 per cent of exports and since then the role of Hong Kong drops down: in 2000 it counts 44 per cent of total export value; in 2005 Hong Kong only 31.4 per cent. Along with the BRI policy, Singapore became a more prominent partner, while Hong Kong's role decreased from 31% in 2012 to 13% in 2019. This clearly shows that Hainan, step by step, is limiting the role of Hong Kong in the island's foreign trade.

The decision of implementing the Security law in Hong Kong is in line with the recent decision announced in June 2020. Beijing declared to build the mega-project to build its largest-yet exclusive economic zone in South China's Hainan Province into a world-class free trade port, with one of its primary focuses on escalating the development of its financial market. This is targeted at Hong Kong previous status as the economic hub in China.

SHANGHAI: COMING BACK TO THE RIGHT PLACE

Needless to say that economic history speaks for Shanghai. Before the Japanese invasion in 1937, it was among the five most important ports in the world and was the industrial, commercial and financial metropolis of China. When the Communist Party of China took power in the city majority of business people left Shanghai and settled in Hong Kong. Partly the triumphant story of than the British colony was the driven factor. Paradoxically then Shanghai became the vanguard of the Cultural Revolution, and with the example of Shanghai commune based on the Paris commune example became the pioneer of the ultra-leftist movement. Nevertheless, the progressive nature of the city became famous when in early 1990s Pudong special zone was opened, the capitalistic nature of Shanghainese prevails.

Both business people and the policymakers have utilized this nature. Being the leader in the Yangtze River Delta and Lingang New Area, the city hopes to make its position great again. It is being part of the broader project of the economic concept of the Yangtze River Economic Belt (YREB) Shanghai integrating the arear closer to the city. It limits the unification to the Yangtze River Delta. The central government, while mentioning the division of labour between Shanghai, Nanjing, Wuhan and Chongqing, tried to reduce competition between local

governments and guide their future actions. But, along the domestic economic belt is hard to achieve. So the city will not care about the bigger picture of integration with the other inland province and will concentrate on how to utilize its comparative advantages to be the successor of Hong Kong and fulfil to its historical place.

Ever since Shanghai has its Free Trade Area, the first of this kind in China, the central government signals its support to Shanghai's ambitions to be the financial hub for the whole country. The Chinese and international commercial banks are now permitted to establish financial asset investment companies in the city. Such financial asset investment companies will be enabled to develop specialized investment subsidiaries in the city to invest in equities of crucial programs in the and the Yangtze River Delta. China's official statistics show that in 2019 Shanghai had 6,800 new foreign investment projects, growth 21.5 per cent on the previous year amounted to USD 50.25 billion, showing 7.1 per cent growth. More to the point, the Shanghai Stock Exchange is ranked seventh in the world, while Hong Kong the sixth. Having a quick look at the IPO at the stock market in Hong Kong and Shanghai Main Boards; the asymmetry is more than visible. While in 2015 Hong Kong 104 IPOs (amounted 33.5 bln USD) and Shanghai 89 (16.7 bln USD); respectively, in 2017 Shanghai with the amount of 21.2 bln USD overtook Hong Kong (16.4 bln USD) by 30 IPOs more; since 2018 the situation changed and in 2018 Shanghai had only 57 IPOs worthen 12.7 bln USD while Hong Kong 143 (36.6 bln USD) and in 2019 169 (40.7 bln USD) and 53 (27,1 bln USD) respectively. This ups and downs favour Hong Kong; the lucrative resources to take over by Mainland China. Relations with Hong Kong as the trade partner remains at the same level and Hong Kong occupies between 10%-11% as Shanghai's export market over the period between 2000 and 2018. From the Shanghai perspective, the best idea is to have Hong Kong within the People's Republic of China and exercises its superior position as the municipality governed by the State Council. From the central government, the position is also a beneficiary. Having two different financial hubs: Shanghai and Hong Kong with the minor role of Shenzhen the Beijing based government will enjoy its dominant position to judge



From the Shanghai perspective, the best idea is to have Hong Kong within the People's Republic of China and exercises its superior position as the municipality governed by the State Council.



both cities according to similar regulations. On the other hand, Beijing allows individuals cities to compete with each other and by stick and carrots will exercise its power. The city of Shanghai fits this role perfectly.

CONCLUSIONS

Implementing the National Security Law by Beijing is the first step to take over Hong Kong's resources. Now with the growing economic controversies with West China faces the dilemma of how to raise the capital for further economic growth as the competitor in the next industrial revolution. Looking inside China, as argued here, some of the domestic forces are particularly interested in diminishing the role of Hong Kong and ultimately takes over the former British colony place. As of now, it is hard to tell whether the local forces from Mainland lobbied the central government to take more active position vis a vis Hong Kong or the military people takes the initiative. But

one thing is for sure, the majority of local governments argue that Hong Kong while being part of the People's Republic of China should obey the Mainland regulations and creates its development on the equal footage as the provinces inside China. On the other, the lucrative business might be taken either by Hainan or Shanghai. Hainan has its military-oil lobby in Beijing; while Shanghai looks to be supported by people closer to Xi Jinping. From the growing tensions in Hong Kong, Guangdong has the most significant possible loser. However, the political centre needs to acknowledge that the power of Xi Jinping as the paramount leader comes from the Eastern part of China namely Fujian, Zhejiang and Shanghai and might play a role in supporting east coastal provinces. However, as the history of China illustrates the government and rightly argued by Sebastian Heilmann (2019) China's core executive, serves as the counterweight against centrifugal forces and particularistic forces and particularistic interests in the political-administrative system. By now, Hong Kong was the catalyst of the domestic horizontal competition. When the "resources' window" will be limited, it would broaden room for province-to-province competition inside China.



Hong Kong was the catalyst of the domestic horizontal competition. When the "resources' window" will be limited, it would broaden room for province-to-province competition inside China.





**CENTRE FOR
ASIAN AFFAIRS**
University of Lodz

RESEARCH OPINIONS ADVICE

FIRST OF THIS KIND UNIVERSITY BASED
THINK-TANK IN POLAND

OPINION-FORMING UNIT

POLITICAL AND BUSINESS ADVICES

ASIA EXPERIENCED TEAM

www.osa.uni.lodz.pl

