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## What's Next for Hong Kong

**Twenty years after the handover to China, the territory is faring better than critics will admit. But its biggest challenges are still to come.**

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By Fred Hu



Hong Kong's handover ceremony, June 30, 1997. Photo: AFP/Getty Images

As Hong Kong marks the 20th anniversary of its handover to China, a pessimistic mood hangs over the city. Some critics claim that the “one country, two systems” experiment has failed and as a Chinese territory Hong Kong has lost its competitiveness and economic vitality. Nothing could be further from the truth.

While its enormous economic lead over its sister cities in mainland China has narrowed, Hong Kong's global position has improved significantly since the handover. Its economy has matched or outperformed nearly all its traditional peers internationally.

Hong Kong achieved an annual real growth rate of 3.4% from 1997 to 2016, outperforming the average of 2% among advanced economies. Austria and Switzerland, comparable in population, grew 1.7% and 1.9%, respectively, during the same period. Only Singapore recorded a slightly better performance.

Hong Kong's feat is all the more remarkable considering it faced a series of shocks over the past two decades—starting with the Asian financial crisis, ignited by the devaluation of Thai baht on July 2, 1997, only a day after Hong Kong's handover.

That was followed by the SARS epidemic, severe deflationary pressures under the pegged exchange-rate system and the shocks of the global financial crisis in 2008-09. Time and again, Hong Kong demonstrated its stability and resilience.

As for the stunning development of mainland cities such as Shanghai and Shenzhen, Hong Kong should rightfully deserve some of the credit. It was the role model for Chinese cities since the start of the reform era.

Hong Kong's success story of achieving fabulous wealth and prosperity through a free-market economic system inspired mainland policy makers and entrepreneurs. Through its unique role in trade, direct investment and sophisticated services, Hong Kong has made crucial contributions to China's rise as a global economic powerhouse.

In return, Hong Kong has cemented its status as a leading international financial center. Among Hong Kong's salient advantages is a strong banking system, which has proved to be one of the best-managed, most-resilient, and most-profitable in the world.

Perhaps the most notable development since the handover is the rapid expansion of Hong Kong's stock market. The number of publicly listed companies on the exchange has increased three times since 1997 to just under 2,000, and market capitalization reached \$3.2 trillion by 2016, five times that of Singapore's market.

Hong Kong leads New York and London in initial public offerings. In terms of scale and importance in global capital markets, Hong Kong has left its chief regional rival Singapore in the dust.

But Hong Kong does face challenges. First and foremost is preserving the autonomy of Hong Kong with unfettered freedom, a strong rule of law and complete openness.

Under the "one country, two systems" formula designed by Deng Xiaoping, the city retains its freewheeling capitalist system with an independent judiciary and guaranteed individual rights.

While Hong Kong has benefited tremendously from the "one country" part over the past two decades, the "two systems" feature remains the crucial differentiator and cornerstone of its identity. That's mainly because political and legal developments on the mainland haven't kept pace with the remarkable economic progress there.

Worries about the gradual erosion of liberty in Hong Kong have increased in recent years. As Deng recognized, the freer Hong Kong remains, the more prosperous and dynamic it will be, and the more valuable a role it can play in China's modernization.

It is as vital as ever to uphold the "one country, two system" principle enshrined in Hong Kong's Basic Law. Beijing should cherish Hong Kong's uniqueness, and the local government should avoid becoming just another Chinese city. It is in Hong Kong's and China's best interest for Hong Kong to be a true global city under Chinese sovereignty.

Second, like other high-income societies, Hong Kong faces the challenge of widening inequality. The local housing market is the most expensive in the world, making affordability a hot-button issue for the low-income population and fueling discontent.

The city doesn't need a European-style social-welfare state, but it sorely needs a better housing policy to maintain social stability. That could be achieved mainly through increased supply of land for residential development and expansion of the existing public-housing program.

Third, Hong Kong must diversify its economy by nurturing new growth sectors. Today Hong Kong relies on finance, real estate, trade and other services exactly as it did 20 years ago, with few new industries in sight. Meanwhile its neighbor Shenzhen successfully transitioned from a labor-intensive manufacturing hub to a tech powerhouse, where global leaders such as DJI, Foxconn, Huawei, Ping An, Tencent and ZTE are based.

Hong Kong possesses many of the requisite factors for technological leadership, including world-class universities with top scientists in fields such as biotech and robotics. Yet it has failed to create a vibrant startup ecosystem. Beijing and Shanghai are in the top 10 of global startup rankings, while Hong Kong isn't even in the top 20.

Hong Kong spends just 0.7% of its gross domestic product on research and development, compared to 2% in Singapore, 3.1% in Taiwan and more than 4% in Israel and South Korea. The city enjoys a large budget surplus, and its medium-term fiscal outlook appears positive. It has the resources to rapidly close the R&D gap if it chooses to.

Hong Kong needs a strategic vision and strong action to transform the city into a 21st-century innovation leader. Building a startup ecosystem with rekindled entrepreneurial spirit holds the key to the city's future.

As new startups proliferate, more opportunities beyond traditional industries will become available to the younger generation, enhancing their prospects of finding jobs with avenues of advancement.

Despite missed opportunities and significant challenges, Hong Kong has been an unqualified success since its handover 20 years ago. Provided politics doesn't get in the way, the city is capable of reinventing itself and thriving.

*Mr. Hu is chairman of Primavera Capital Group.*