

Crimea 2.0: China Preps ‘Soft’ Annexation of Hong Kong

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On November 27, US President Trump approved the Hong Kong Human Rights and Democracy Act (HKHRDA), which seeks to punish China and its officials for failing to treat Hong Kong as a semi-autonomous Western styled liberal democratic enclave under the ‘One-China-Two-Systems’ model.

The announcement of the new US law was met with apathy from investors, anger in Beijing and complacency by EM portfolio managers. However, this lackadaisical reaction belies the increasing likelihood that China is prepping a ‘soft’ annexation of Hong Kong, much like Russia did to Crimea in 2014.

The new US law threatens the peaceful continuation of the ‘One Country, Two Systems’ formula which has been the cornerstone Chinese economic growth since 2000. This model helped China’s economy to grow by an incredible factor of 10x from a GDP of \$1.3tn in 2001 to \$13.4tn in 2018.

Against the backdrop of continued Hong Kong demonstrations and overwhelming local political support (recent local district council saw pro-democracy/anti-China candidates win in 17 of 18 councils), China is caught between a rock and a hard place: accede and risk looking weak with potential of spill-over into domestic politics; or risk a confrontation and eventual direct intervention/annexation in Hong Kong, triggering a show-down with Washington DC. There is NO easy middle ground. China has rejected the new extraterritorial US law, thus paving the way for an eventual forced military-backed

de jure and *de facto* annexation and absorption of Hong Kong into China. The current disequilibrium cannot long endure despite the current seeming peaceful posture of Beijing.

On November 19, Zang Tiewei, a Chinese representative for the National People's Congress Standing Committee (NSPC) Legislative Affairs Commission stated that, "Whether Hong Kong's laws are consistent with the Basic Law [Hong Kong's legal system] can only be judged and decided by the NPCSC. No other authority has the right to make judgments and decisions."

If Hong Kong is annexed, many US corporations, employees and states would have to fundamentally re-assess their operations and presence there. The capital flight that will ensue will also cause a dramatic devaluation of the Hong Kong-US dollar fixed currency peg.

US companies and nationals domiciled in Hong Kong could become pawns in any hard bargain between Beijing and Washington.

- ✓ US nationals represent one of the most significant foreign presence in Hong Kong. As at the end of December 2018, there were around 20, 758 US nationals residing in Hong Kong and 1.3 million US visitor arrivals to Hong Kong.
- ✓ As at 1 June 2018, there were 290 regional headquarters, 434 regional offices and 627 local offices in Hong Kong with parent companies located in the US.
- ✓ Notable US companies represented in Hong Kong include: 3M, Amazon, Apple, AT&T, Bloomberg, Chevron, Cisco, Dell Technologies, Deloitte, Dow Chemical, eBay, Estee Lauder, Expedia, ExxonMobil, Facebook, FedEx, Gap, General Electric, General Mills, Google, HP Inc., IBM, Johnson & Johnson, LinkedIn, Marriott, Microsoft, MIT Hong Kong Innovation, Nike, Oracle, PayPal, Pfizer, Procter & Gamble, Ralph Lauren, Skechers, Stripe, Under Armour, Walt Disney, WeWork and Yahoo! Etc
- ✓ Several states, including Florida and North Carolina have set up representative offices in Hong Kong. In addition, several port authorities from US cities and states maintain a presence in Hong Kong.
- ✓ As at end-2018, nine out of the 152 licensed banks, and five out of the 18 restricted license banks and one out of 48 local representative offices in Hong Kong were owned by US interests. The total assets of and customer deposits with US banks were around US\$148 billion and US\$79 billion respectively, representing around 5% of the total of Hong Kong's banking sector.
- ✓ US banks in Hong Kong include: Bank of America, Cathay Bank, Citibank, East West Bank, JPMorgan Chase Bank, State Street Bank and Trust Company, The Bank of New York Mellon, Wells Fargo Bank, Morgan Stanley and Goldman Sachs.
- ✓ In the insurance sector, US companies rank 3rd in number among foreign insurers operating in Hong Kong. Of the 161 insurance companies authorized in Hong Kong, 10 are US companies. Another 12 are known to be controlled by US interests.
- ✓ US insurers in Hong Kong include members of the American International Group, the Chubb Group and the MetLife Group.
- ✓ US companies also participate actively in securities and futures trading, investment advice, fund management and credit rating in Hong Kong. These companies includes: Citigroup, Fidelity,

Franklin Templeton, Goldman Sachs, J.P. Morgan, Bank of America Merrill Lynch, Morgan Stanley, Standard & Poor's, State Street Bank and Trust Company, and Moody's.

- ✓ Hong Kong is home to the fifth Disney themed resort. The Hong Kong Disneyland Resort is owned by a joint venture company set up by the HKSAR Government and The Walt Disney Company. Since its opening in September 2005, the Hong Kong Disneyland Park has received over 77 million visitors.

Under-appreciated economic impact of annexation

Firstly, the service sector accounts for 92% of Hong Kong's GDP and nearly 80% of the employment. Surely a breach of the US act would have a severe impact on this sector, which is likely to be accentuated by other developed countries mirroring the actions of the US. Already jittery Hong Kong hotels and airlines have shown extreme sensitivity to political comments by staff.

Secondly, Hong Kong is one of the most open economies in the world where merchandise trade accounts for 312% of GDP. Two-third of the merchandise trade is in form of electronics products, of which majority is being re-exported to China at zero tariffs and used in inputs in manufacturing high-tech products such as telecom equipment, semiconductors and computer items.

According to HK government data, Hong Kong is the world's largest exporter of electronic integrated circuits; the second largest exporter of computer parts/accessories and video recording apparatus; and the world's third largest exporter of telephones/mobile phones in value terms in 2017.

The ability for Hong Kong to act as a middleman for China's technology industry would be severely challenged or curtailed if China annexes Hong Kong and the US and EU levy sanctions on China.

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