Hong Kong-Canada Economic Ties

A Supplemental Report to *China's Economic Impact on Canada*

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Executive Summary

Canada and Hong Kong's long-standing relationship is deeply rooted in shared history, common values, and strong commercial, political, and people-to-people ties. While Canada-China relations have been extensively discussed in our previous report, *China's Economic Impact on Canada: Trade, Investment, and Immigration*, Canada's relationship with Hong Kong is distinct, requiring its own consideration.

This report aims to provide a fact-based overview of Canada-Hong Kong trade, investment, and immigration relations while also discussing broader relevant trends and issues. Understanding the unique characteristics and contexts of the Canada-Hong Kong economic partnership is essential to develop strategies and policies that promote mutual prosperity. Despite political uncertainty and recent headwinds, economic and business opportunities between Canada and Hong Kong remain abundant and profitable.

Hong Kong is an important nexus of international trade due to its free port status and its special relationship with mainland China. Canada-Hong Kong merchandise trade totaled C$8 billion in 2019 and unwrought gold, which comes from Ontario, was by far Canada's most valuable export at C$2 billion. However, integrated circuits/microchips, ginseng, petroleum, navigational and medical instruments, fish and seafood, and transportation signaling systems are also pillars of Canada-Hong Kong merchandise trade. Notwithstanding the significance of these exchanges, Canadian exports make up only 0.2% of Hong Kong's total imported goods, about half of which are ultimately destined for mainland China.

Total Canada-Hong Kong services trade, dominated by transportation and commercial services, was C$6 billion in 2019. Port, shipping, management, and tourism services were the most significant components therein. Tourism, by the share of visitors from Asia that herald from Hong Kong relative to its small population, highlights the intensity of the Canada-Hong Kong relationship, particularly on the human side.

Hong Kong has also long served as the main avenue for international capital to flow into China, although evolving Chinese economic policy is opening up new financing opportunities. Nonetheless, Hong Kong's investment and business friendly environment makes it a relatively more accessible and secure destination than mainland China to many investors.

With strong per-capita domestic consumption, greater familiarity with western brands and media, and widespread English language proficiency, Hong Kong is a uniquely attractive place for Canadian businesses expanding in Asia. Additionally, the number of investments in Canada originating from Hong Kong surpassed those from mainland China in 2020 and 2021 for the first time since 2004. Hong Kong based enterprises invested in Canada also supported 22,295 jobs across the country and contributed C$4.2 billion to Canadian annual GDP as of 2018.

It is also particularly important to recognize the human side of Canada's relationship with Hong Kong given that, despite Hong Kong's size, it is home to one of the largest communities of Canadian citizens abroad, at an estimated 300,000. Conversely, there were already 500,000 Canadians of Hong Kong descent in Canada as of 2009. Of these, 215,775 were born in Hong Kong, while those remaining were descendants of earlier immigrants. For several reasons, including to support the bilateral relationship, Canada even has preferential immigration policies for Hongkongers. Inescapably, these connections forged not only in economic exchanges but in the flow of people and culture are crucial to building and preserving vibrant Canada-Hong Kong relations.

Finally, there are several important challenges and persistent opportunities to consider regarding Hong Kong. Considerable domestic and global crises have caused headwinds in Hong Kong and affected bilateral relations in recent years. Hong Kong's increasing integration with mainland China, the COVID-19 pandemic, heightening competition from other regional trade and finance hubs, and lingering impacts from the US-China trade war all affect Hong Kong's trade and investment environment. Nonetheless, Hong Kong's unique advantages and its efforts to diversify its economy while strengthening its finance and trade capacities stand to increase its resilience while growing its mutually prosperous relationship with Canada.

Introduction

New York, London, and Hong Kong are the three largest financial centres in the world. Hong Kong, the semi-autonomous city whose ownership has shifted many times over the years, became a global trade and financial centre in the late 1800s when it was the intermediary of East-West colonial trade under British rule. In large part, Hong Kong rose to wealth in the last few decades by taking full advantage of it's semi-autonomous status to benefit from China's rise. Under the "one country, two systems" framework, Hong Kong's semi-autonomous status grants it separate legal, judicial, and political apparatus and authorities from those of mainland China while leaving Beijing responsible for national defense and foreign relations. After China's "opening up" under Deng Xiaoping, Hong Kong's finance and banking centre was to China what Wall Street is to the United States. Hong Kong's GDP per capita, at over $46,000 USD, is over four times that of China as a whole and is even slightly ahead of Canada ($43,000 USD) in 2020.

Huawei, Alibaba, and Tencent have all partially financed their operations through public listings on the Hong Kong Stock Exchange (HKEx). Since Chinese financial markets have long been highly restricted to international investors, Hong Kong has served as the main avenue for international capital to flow into China. As we will explore later in this report, China's evolving economic policies are changing this dynamic.

Many of China's major state-owned enterprises (SOEs), including China Construction Bank, PetroChina, CNOOC, and China Mobile, are publicly listed in Hong Kong. By listing on the HKEx, Chinese companies may also foster international recognition and credibility. Some of this credibility derives from the HKEx's international portfolio, which includes western firms like Goldman Sachs, ExxonMobil, and AT&T. Additionally, Hong Kong banks have been prolific loan suppliers throughout China's economic explosion in the late 20th century.

Hong Kong has a highly open international trading system. Its port offers a trade barrier-free system which facilitates reliable access to international markets and keeps Hong Kong in the number one position on the *Freedom to Trade Internationally Index*.[1] This feature has made it an extremely important port for re-exports, exports derived from imported products. In fact, 99% of shipments from Hong Kong are re-exports.[2] Unsurprisingly, imports from mainland China make up slightly more than half of Hong Kong's re-exports. For Canada, this means that much of the goods imported from Hong Kong originate in mainland China. It also indicates that Hong Kong's trading system supports greater trade relations with other countries and regions, like South Korea and Taiwan, whose products are also widely re-exported from Hong Kong. This also works in reverse, wherein much of Canada's exports to Hong Kong are re-exported to mainland China and other nearby countries.

Altogether, Hong Kong is dominated by a financial sector that has reaped great dividends over its tenure. However, the pattern of this prosperity may be changing under pressure from shifting global and local factors. This is examined later in the report, where competition from emerging financial centres, trade disruptions, pandemic disruptions, and political and social tensions are discussed.

Because of Hong Kong's relatively high familiarity with western culture and paradigms, its free trade and investment policy, its high per-capita wealth, low tax rates, bilingual environment, intellectual property protection laws, high-skilled talent pool,[3] and strong people-to-people ties to Canada, Hong Kong is an ideal place for Canadian investors to get a foothold in Asia, for exporters to route trade through, and for migration between continents. This makes it very important for Canada to have good relations and a smart and fact-based strategy regarding Hong Kong. To this end, enclosed is an overview of the important areas of Canada-Hong Kong relations. The following three sections will examine key Canada-Hong Kong trade, investment, and immigration characteristics. Subsequently, a fourth section discusses Hong Kong's changing political and economic landscape to foreground important considerations for Canada and businesses in general.

1

Trade

Understanding Hong Kong's economy requires that we give special consideration to its deep interconnectedness with the world. Hong Kong used to be well known for its manufacturing, ornate porcelain in particular, even before "made in China" became ubiquitous. Subsequently, Hong Kong's economy shifted to finance, while manufacturing industries have largely moved to neighbouring Guangdong. However, Hong Kong remains an important player in international trade due to its free port status and its role facilitating trade between mainland China and other countries.

Although Hong Kong is a part of China, Statistics Canada records trade and investment data for Hong Kong separately. As seen in the table below, Canadian product exports to Hong Kong exceeded C$4 billion in 2019, dropping by more than half in 2020 due to the pandemic disruption. The decline in services exports was less significant, falling from nearly C$1.9 billion in 2019 to nearly C$1.4 billion in 2020. Hong Kong was the tenth and eighth largest recipient of Canadian merchandise and services exports in 2019, respectively.[4] If the effects of the pandemic disruption subside, 2019 figures may be more indicative of future Canada-Hong Kong trade relations.

CANADA-HONG KONG TRADE

2011-2020, BALANCE OF PAYMENTS, MILLIONS OF DOLLARS CAD

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Exports to Hong Kong (Goods)	**3,822**	**3,710**	**5,798**	**5,927**	**5,414**	**4,084**	**3,882**	**5,883**	**6,037**	**3,343**
Exports to Hong Kong (Goods)	2,917	2,553	4,551	4,623	4,025	2,378	2,308	4,067	4,162	1,949
Exports to Hong Kong (Services)	925	1,157	1,247	1,304	1,389	1,706	1,574	1,816	1,875	1,394
Imports from Hong Kong	**7,920**	**7,943**	**7,838**	**8,149**	**8,665**	**8,454**	**8,829**	**9,563**	**9,474**	**8,602**
Imports from Hong Kong (Goods)	4,689	4,594	4,149	4,169	4,421	4,116	4,120	4,248	4,179	4,149
Imports from Hong Kong (Services)	3,231	3,349	3,690	3,980	4,244	4,338	4,709	5,315	5,295	4,453

Source: Statistics Canada - Balance of Payments Data

1.1 MERCHANDISE TRADE

A handful of product categories dominate Canadian goods exports to Hong Kong, both for domestic consumption and re-export purposes, particularly to mainland China. The Hong Kong SAR government reported that, in 2020, about half of Canada-Hong Kong merchandise trade, about C$3 billion, was destined for or originated from mainland China.

While it is often highlighted that Hong Kong is Canada's fourth largest market for fish and seafood, the single largest export category to Hong Kong, by far, is unwrought (i.e. not fully processed) gold used for non-monetary purposes. Notably, all Canadian unwrought gold exports to Hong Kong came from Ontario, where 95.3% of all Canadian unwrought gold exports originated in 2019.[5]

In 2019, Statistics Canada reported unwrought gold exports to Hong Kong of C$2.07 billion, representing 51.5% of Canada's total exports to Hong Kong in 2019. This also represented 10% of Canada's overall unwrought gold exports in 2019, which totaled C$20.7 billion. Conversely, Canadian gold made up only 9% of Hong Kong's unwrought gold imports in 2019.[6]

Unwrought gold exports to Hong Kong declined dramatically in 2020, totaling only C$344 million; however, gold continued to be Canada's leading export category to Hong Kong and represented 18% of total exports to Hong Kong in 2020. Overall, Canadian exports of unwrought gold to other countries increased so that overall unwrought gold exports remained stable through 2020, totaling C$21.3 billion.

Hong Kong is a renowned jewelry producer and exporter, particularly gem-set gold jewelry and pure gold jewelry.[7] Some of this jewelry stays in Hong Kong for sale through luxury shops whose primary clientele are tourists, most of whom are mainland Chinese.[8] Gold holds special significance in Chinese culture and is a common gift at weddings, birthdays, and other special occasions.[9] Hence, pandemic related gathering restrictions and safety concerns collapsed gold demand in Hong Kong and mainland China.[10] Gold exports are thus likely to rebound as pandemic restrictions ease.[11]

While worth only about 30% the value of gold exports, animal and vegetable products, consisting mainly of fish and seafood products, were the second largest merchandise export category to Hong Kong in 2019, at nearly C$585 million. By value, the third largest export category, machinery and electrical equipment, was about half that, at C$220 million.

Despite decreases in most categories, several product exports to Hong Kong increased in 2020. Most notably, exports of circuits and microchips to Hong Kong exploded from C$7.6 million in 2019 to C$122 million in 2020, making it the second most valuable export product to Hong Kong in 2020. Canada's semiconductor industry has seen significant investment and growth in recent years.[12] Demand fueled by the global semiconductor shortage may explain the sudden spike in microchip exports to Hong Kong.

Likewise, ginseng root exports, which has consistently been a top export to Hong Kong, grew from C$108 million in 2019 to C$115 million in 2020. This is particularly interesting given that Hong Kong ginseng re-exports fell by more than half to only C$32 million in the same year.[13] Almost all of Canada's ginseng production is exported to Hong Kong, some of which is re-exported to China, although Hong Kong has its own considerable demand. Ginseng root was the third most exported product to Hong Kong by value in 2020.

Overall, the most important Canadian product exports to Hong Kong include unwrought gold, integrated circuits/microchips, ginseng, petroleum, navigational and medical instruments, and transportation signaling systems.[14] Notably, only 0.2% of Hong Kong's total imported goods were from Canada.

Canadian imports from Hong Kong were far more diverse. The largest product category, including pearls, precious stones and metals, coins, and jewelry, was worth $141 million in 2020. Machinery and electrical equipment were second in value at $84 million. Textiles ($51 million), knitted or crocheted clothing and apparel ($47 million), and industrial machinery ($35 million) rounded out the top five import product categories in 2020.[15]

Canada's imports from Hong Kong are also far more concentrated in final goods compared to imports from mainland China. This means that imports from Hong Kong contribute fewer intermediate and capital goods to Canadian supply chains relative to their total. Additionally, a greater share of imports from Hong Kong are not only final goods but luxury goods. Nonetheless, imports from Hong Kong are significant to those consumers that access them and do still comprise potential intermediate inputs such as base metals and animal products (C$16 million).[16]

1.2 SERVICES EXPORTS

Service trading makes up a significant part of Canada's economic relationship with Hong Kong. In 2018, the Government of Canada laid out a target of 50% export growth by 2025.[17] Services exports to Hong Kong peaked in 2019 at C$1.9 billion, before falling dramatically during the pandemic. Likewise, services imports from Hong Kong peaked in 2018 at C$5.3 billion.[18]

Canada has always run a significant trade deficit with Hong Kong in the services sector. While this has often been portrayed as a negative, it is not necessarily so.

Services trade is grouped into several categories: travel, which comprises education, tourism, and business travel, government services, transportation services, and commercial services, which encompasses an array of activities. In 2019, Canada exported C$1.86 Billion worth of services to Hong Kong, including transportation services totaling C$880 million, commercial services of C$791 million, and travel exports of C$382 million. Exports of government services to Hong Kong were negligible below C$5 million.[19]

The most significant commercial services exports from Canada to Hong Kong included management services, charges for Intellectual Property (IP), and financial services, which comprised C$591 million, or 75% of the commercial services total and 32% of total services exports. Trade related services and maintenance and repair services rounded out the top 5 commercial services exports to Hong Kong, with C$80 million and C$34 million in exports respectively. Notably, all major commercial services exports to Hong Kong increased in 2020, with the exception of maintenance and repair services. Despite an overall decline in services exports from 2019 to 2020, commercial services increased from 791 million to C$903 million, respectively. Broadly speaking, important areas to consider in this sector regarding Canada-Hong Kong trade include financial, engineering, information technology and professional services.[20]

Transportation exports fell from C$880 million to C$741 million between 2019 and 2020, putting it in the number two spot after commercial services. Transportation services are defined as any service that is rendered in the transportation of goods or individuals. Canada's definition of transportation services is more broad than international standards, including things not typically considered such as cruise fares, ship stores, which are grouped with port expenditures, rentals without crews, and freight insurance. Transportation services exports to Hong Kong are predominantly composed of port services for Canada bound Hong Kong air and sea shipments of merchandise exports, revenues earned by Canadian freight carriers from Hong Kong companies and residents, and as well as passenger revenues of Hong Kong citizens on Canadian carriers (mostly airlines).[21]

Finally, travel services exports, including education and tourism fell dramatically in 2020 to C$160 million from C$382 million in 2019.[22] However, travel remains a crucial element of the relationship between Canada and Hong Kong. In 2020 for example, 32,000 Hongkongers visited Canada, representing 8.6% of the 380,000 visitors that came from all of Asia.[23] While these figures are greatly reduced from previous years due to the pandemic, the share of visitors from Asia that herald from Hong Kong relative to its small population highlights the intensity of the Canada-Hong Kong relationship, particularly on the human side.

1.3 SERVICES IMPORTS

Conversely, Canadian imports of services from Hong Kong totaled C$5.47 billion in 2019, creating a C$3.41 billion deficit. Canada has always run a significant trade deficit with Hong Kong in the services sector, and this is not necessarily a negative for Canada.

In 2019, imports of transportation services totaled C$4.61 billion, commercial services amounted to C$520 million, and travel imports totaled C$318 million. Canadian transportation imports fell from C$4.61 billion in 2019 to C$3.71 billion in 2020, remaining the largest category in Canada-Hong Kong services trade and the reason for the services trade deficit.[24] Similar to exports, transportation service imports largely comprise freight carrier expenses, port services incurred by Canadian exporters, and payments made by Canadian travelers to Hong Kong airlines.[25] Hong Kong airlines connect Canadians travelling to Hong Kong and across Asia, while freight and port services enable Canadian exporters and multinational enterprises to conduct business throughout the region. The main reason transportation imports from Hong Kong are so high is precisely because of how important the semi-autonomous city is to the region as a business facilitator. Thus, while transportation service imports may cause Canada to run a service trade deficit with Hong Kong, the wider economic and cultural linkages brought on by transportation service are of great benefit to Canada.

Commercial services, the next most significant services import category, fell slightly from C$520 million in 2019 to C$494 million in 2020. The leading categories of commercial service imports from Hong Kong in 2019 were trade-related services ($139 million), management services ($101 million), and maintenance and repair services ($76 million). Financial services ($70 million) and research and development services ($65 million) round out the top five services imports from Hong Kong.[26]

Finally, travel imports from Hong Kong also fell dramatically, from C$318 million in 2019 to only C$78 million in 2020. Nonetheless, Hong Kong remains an important destination for Canadian travelers. The most recent available data shows that just over 236,000 Canadians took trips to Hong Kong in 2014, where they spent C$284 million CAD.[27] This put Hong Kong as the #13 destination for Canadians traveling abroad in 2014, beating out sunny destinations like the Bahamas; this once again highlights the personal and human dimension of the Canada-Hong Kong relationship.

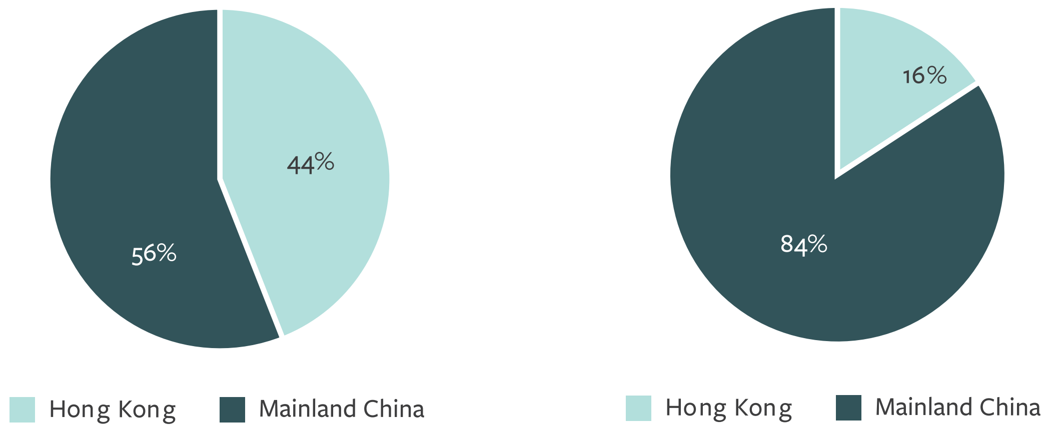
2 Investment

Hong Kong is a particularly important region when it comes to international investment. Its more relaxed regulatory system makes it an important avenue for many large Chinese companies investing globally. Its investment environment, similar to that of many Western countries, and with long-standing investment agreements with Canada, make it relatively more accessible than mainland China to many investors. Moreover, Hong Kong's strong per-capita domestic consumption, greater familiarity with western brands and media, and widespread English language proficiency make it a uniquely attractive place for Canadian businesses expanding into Asia. These are some of the reasons why Canada-Hong Kong investment makes up a much greater share of total Canada-China investment than does Canada-Hong Kong trade relative to total Canada-China trade. Since 2014, 44% of Chinese investment in Canada has originated from Hong Kong. Comparatively, only 16% of Canada-China trade involved Canada-Hong Kong shipments. 20% of all Chinese investment since 1993 has come from Hong Kong according to the China Institute's (CIUA) China-Canada Investment Tracker. Hong Kong was the second-largest destination worldwide for outbound flow of Canadian direct investment in 2020, behind only the US.[28] Hong Kong was also the third-largest destination of FDI flows overall, behind only the US and mainland China.[29]

FIGURE 1

CHINA TO CANADA INVESTMENT (2014-2021)

CANADA-CHINA TRADE (2019)



Source: China-Canada Investment Tracker, China Institute (CIUA); Statistics Canada - Balance of Payments Data

2.1 KEY STATISTICS

Statistics Canada reports that Canadian entities own C$32.5 billion in Hong Kong assets as of 2020. C$18 billion of this represents direct investment, and there are over 200 Canadian companies in Hong Kong.[30] Notably, Canadian direct investment in mainland China totals only C$13 billion, nearly C$5 billion less than in Hong Kong ($17.9 billion).[31] However, adding portfolio investment, Canadian investment in mainland China more than doubles that of Hong Kong at nearly C$70 billion total; Canadian investment in Hong Kong totals about $32 billion.[32] Comparatively, Hong Kong based entities have direct investments totaling C$22.2 billion in Canada. As is the case with trade, much of this is closely related to mainland Chinese enterprises.

The China Institute's China-Canada Investment Tracker records investment from Hong Kong at C$18.7 billion, and at C$75 billion from mainland China. Statistics Canada's record of mainland Chinese investment in Canada stands at only C$24.3 billion. The great difference in ratio of Hong Kong to mainland Chinese investment between Statistics Canada and the CIUA Investment Tracker is largely due to investors that ultimately reside on the mainland investing through Hong Kong enterprises.

Comparatively, Canadian direct investment in Singapore, which has almost the same GDP and GDP per capita as Hong Kong, totals only C$8 billion, and Canada has only received C$1.3 billion from the city state.[33] In part, this indicates the importance of Hong Kong's close relationship with mainland China in addition to its wealth and world class financial industry.

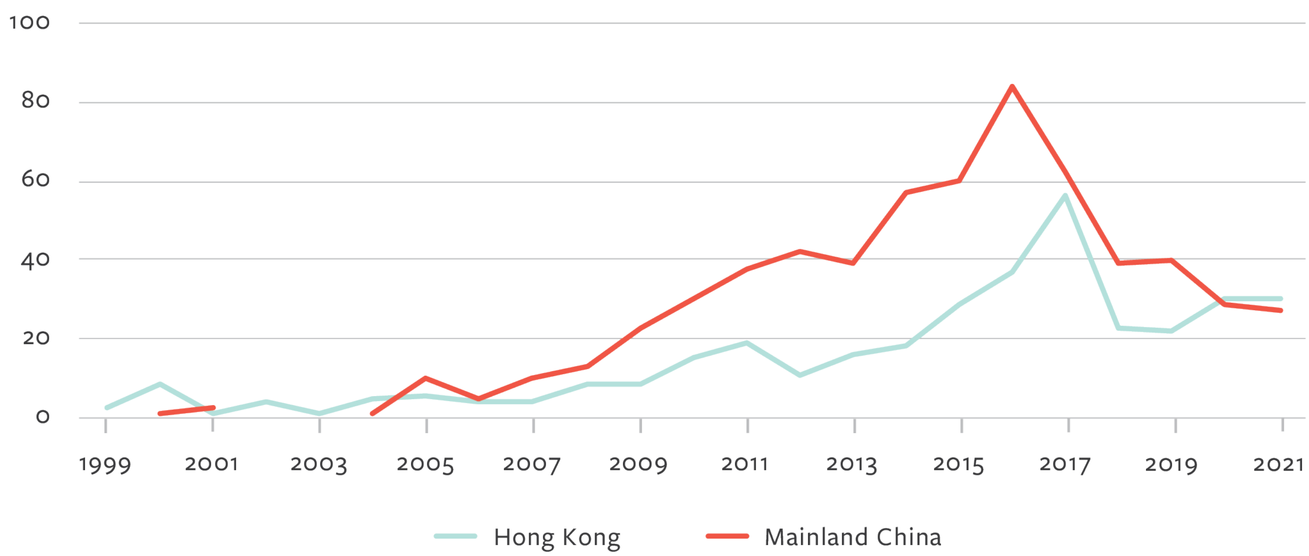
Although Canada has received far greater investment from mainland China than from Hong Kong in total, the discrepancy is less significant in recent years. Since 2014, Hong Kong enterprises have invested more than C$15 billion in Canada; mainland Chinese investors have been only slightly ahead, investing just less than C$20 billion over the same period. In fact, the number of investments originating from Hong Kong surpassed those from mainland China in 2020 and 2021 for the first time since 2004, as shown in Figure 2. As of 2018, Hong Kong based enterprises invested in Canada also supported 22,295 jobs across the country and contributed C$4.2 billion to Canadian GDP on an annual basis.[34]

Over half of all Chinese investment by value has flowed from Beijing, where many large State Owned Enterprises are headquartered; however, more than twice as many investment transactions (361) have come from Hong Kong since 1999. In part, this means that many of the small and medium-sized Chinese investments in Canada come from the semi-autonomous region. Consequently, while mainland China may have large investment interests in certain areas, Hong Kong investors are more greatly dispersed across Canada and invested in a more diverse portfolio of Canadian businesses.

FIGURE 2

NUMBER OF INVESTMENTS BY YEAR

MAINLAND CHINA VS. HONG KONG



Source: China-Canada Investment Tracker, China Institute (CIUA)

2.2 KEY POLICIES AND CHARACTERISTICS

Hong Kong's inviting investment policy taxes foreign corporations the same as Hong Kong based corporations, imposes no capital-gains tax, and has a robust foreign investor support system, InvestHK, to encourage inward investment. Of course, one of the main caveats to this openness is that the government owns all land and sells long-term leases without transferring title, as is the case in mainland China.[35]

Canada also signed an Investment Promotion and Protection Agreement (IPPA) with Hong Kong in 2016, enhancing assurance of protection for Canadian investors. The agreement creates obligations relating to transparency, non-discriminatory treatment, standard of treatment, taxation, and health and safety measures. It also provides settlement frameworks.

Though it is obvious that Hong Kong's investment policy greatly enables robust bilateral investment, several other factors further enhance its attractiveness to Canadian investors.

Comparing Hong Kong to its closest competitors helps illustrate this. Shanghai, Singapore, and Tokyo are all well positioned to take on business that may otherwise be conducted in Hong Kong. However, each falls short of Hong Kong in different ways. Shanghai enjoys direct access to mainland China, but its strict capital controls still pose a major impediment to international business. Singapore has a more similar business environment, rule of law, and English language prevalence to Hong Kong, but lacks a gateway to mainland China and its major companies, which largely explains why its stock exchange is only a quarter the size of the HKEx. Lastly, while Tokyo is home to a mind boggling 613 company headquarters, 51 of which are fortune 500 companies,[36] it has higher taxes, English is less commonly spoken,[37] and, of course, it is less integrated with mainland China, making it less attractive than Hong Kong to many Canadian investors on several fronts. This will be expanded upon in a following section.

Finally, it is worth noting that Canadian real estate is an important destination for Hong Kong's retail investors. Reuters reported that, in 2020, FINTRAC (Canada's anti-laundering agency) recorded Hongkongers shifting C$43.6 billion from Hong Kong to Canada, though actual wealth transfer could be higher.[38] Some of this transfer undoubtedly targeted real estate according to an investment report, stating that the first weeks of 2021 saw exhibitions of Canadian properties increase by a third in Hong Kong. Further, Canadian visa applications from Hong Kong rose by over 20%, reaching 10,819 in 2020, suggesting that further capital inflow is likely.[39] This may be contributed to by factors including political turmoil in Hong Kong, living standards in Canada, and established Hong Kong-Chinese communities. Moreover, it highlights the relationship between immigration and investment as well as the profound impact immigration from Hong Kong can have on Canada's economy in general.

3 Immigration

The ties that bind Canada and Hong Kong run deep. The first Hongkongers arrived in Canada over 150 years ago, and their communities have been making strong contributions to Canada ever since. The 2016 Canadian census reported that there were 500,000 citizens of Hong Kong descent in Canada as of February 2009, among which only 215,775 were born in Hong Kong.[40] Hence, while some of them may be temporary workers, the vast majority represents the generational legacy of Hong Kong immigrants in Canada. Meanwhile, there are an estimated 300,000 Canadians living in Hong Kong, which is one of the largest Canadian communities abroad.[41] This community, along with the significant number of Canadians of Hong Kong descent in Canada, plays an important role in building vibrant bilateral relations.[42]

In 1984, the British government agreed to hand the colony of Hong Kong to the government of China after 150 years of British rule. Sovereignty was to be handed over on July 1, 1997. Uncertainty over how this handover would affect the city prompted many wealthy Hongkongers to emmigrate to Canada during the 1980s and ’90s. In 1985, a whopping 43.5% of the 6,481 ″business immigrants″ to Canada were from Hong Kong (including entrepreneurs, the self-employed and investors as well as their dependents), up significantly from 19% in 1983. The immigration of Hongkongers to Canada peaked in 1994, with 44,271 Hongkongers migrating to the country in that year alone.[43] In total, approximately 335,646 Hongkongers moved to Canada between 1984 and 1997. The great majority of these people settled in the Toronto and Vancouver areas, as there were already well-established Hong Kong-Chinese communities there. After the handover, there was a sharp decline in emigration and some who came to Canada returned to Hong Kong having obtained the “safety” imparted by having a foreign (Canadian) passport.[44]

3.1 CANADA'S SPECIAL POLICIES TO FACILITATE HONG KONG IMMIGRATION

Hong Kong residents are now entitled to priority processing when applying for Canadian citizenship, permanent residency, work or study permits, visitor visa, electronic travel authorization, and family sponsorship.[45] Following the introduction of the controversial national security law in Hong Kong in June 2020, Canada committed to granting open work permits to Hong Kong's recent graduates, up to 5 years after their graduation.[46] This special measure took effect on February 8, 2021 and is set to expire on February 7, 2023. Unlike the original work permit that was limited to recent graduates from designated learning institutions in Canada and their spouses,[47] the new open permit does not require applicants to have a Labour Market Impact Assessment (LMIA) from Employment and Social Development Canada or an offer of employment.[48] The open work permit is valid for **up to 3 years** and allows entry to Canada regardless of employment status, which greatly reduces immigration impediments for graduates by allowing them to conduct their job search while already in Canada. In turn, this helps supply Canada with more educated workforce entrants and makes it easier for Hongkongers to eventually obtain permanent residency in Canada.

3.2 POST-NATIONAL SECURITY LAW IMMIGRATION

Hong Kong registered a net outflow of 89,000 people in the first half of 2021, the largest population drop recorded since 1961, according to government statistics. A poll released by the Hong Kong Institute of Asia-Pacific Studies suggested that 42% of residents would leave if they had the opportunity, with the U.K., Canada and Australia as the preferred destinations.[49] Consequently, fostered by Canada's preferential policies implemented at the height of political tensions and unrest in Hong Kong, Canada saw its visa applications from Hong Kong, excluding visitors' visas, rise by 10%, reaching 8,121, in 2020.[50]

More specifically, in the first four months after the programs were announced in February 2021, 3,481 people — not including dependents — had applied, said Nancy Caron, an Immigration Refugees and Citizenship Canada (IRCC) spokeswoman. Additionally, Ottawa also introduced two new pathways for recent Hong Kong residents in Canada to obtain expedited permanent residence status in Canada. The IRCC received 400 applications under those programs by July 31, less than two months after they were announced. However, regular applications from Hong Kong for permanent residence have not seen a marked jump. They totaled 1,826 in 2018, 2,207 in 2019, 2,105 in 2020 and 1,219 in the first seven months of 2021.[51]

4 Trends & Issues

This section focuses on recent trends and issues that may influence Hong Kong's future roles as an international financial and trade center and thus its relationships with its economic partners, including Canada. It aims to provide insight into the major areas that could impact Hong Kong's trajectory through an up-to-date overview of the economic, political, and business dynamics of recent years. We will also highlight several opportunities for Canadian and Hong Kong entities to identify common interests and gain a better understanding of the changing geopolitical conditions.

4.1 HONG KONG'S ECONOMIC CLIMATE

Hong Kong's role as a gateway between China and the rest of the world has been of tremendous strategic significance since China's opening up in the late 1970s. In 2020, Hong Kong was the sixth largest trading entity and the largest re-exporter in the world.[52] Hong Kong was also ranked 3rd in FDI inflow, nearly 30% of which was from Mainland China. Likewise, the city is the third most significant global financial centre according to the Global Financial Centres Index (GCFI) and the largest offshore Renminbi (RMB) hub.[53] Nevertheless, controversy has arisen over Hong Kong's economic downturn, focusing on its changing investment and business environments due to tapering economic freedom, increasing economic and political integration with mainland China, and its waning roles as an unparalleled international trading hub and financial centre in Asia. Some also argue that Hong Kong's importance to mainland China is dwindling. Hong Kong's share of China's GDP has shrunk from 18% in the mid-1990s to less than 3% in 2018, due to the fast growth of the Chinese economy.

As previously discussed, the economy of Hong Kong is a highly developed free-market economy, characterized by low taxation, duty-free trade, a thriving international financial market, and minimal government intervention. Hong Kong is notably a world-renowned free-trade hub with a high degree of economic freedom and was praised as an example of the free-market system by Milton Friedman.[54] Nonetheless, the economy of Hong Kong has faced mounting headwinds since 2019. Hong Kong's economic freedom is challenged by its ties to the mainland, which have been described as "increasingly forged in steel" by critics.[55] Hong Kong has topped the Heritage Foundation's economic freedom list for 25 years, from 1995 to 2019, but was removed from the list in 2021 due to tightening control from Beijing. Hong Kong's government has criticized this removal, pointing out that the HKSAR remains a separate customs territory and has separate World Trade Organization (WTO) and Asia-Pacific Economic Cooperation (APEC) memberships from mainland China.[56]

4.2 HONG KONG AS A FREE-TRADE PORT AND INTERNATIONAL FINANCIAL CENTRE

In recent years, Hong Kong has been facing heightened competition from regional competitors including Singapore in Southeast Asia and Shanghai, Shenzhen, and Hainan in mainland China, where the Chinese government has gradually eased some financial restrictions. The civil unrest in 2019 triggered debate over the city's future as Asia's preeminent global trade, investment, and financial hub.

Singapore grew to become a global trade and financial center in a similar fashion to Hong Kong. These two economies, sharing many characteristics such as transparent common law legal systems, low business tax, a world-class trading port, and a free-market financial system, are long-time rivals as competing regional financial centres. According to IMD's World Competitiveness Yearbook, Singapore scored better than Hong Kong in 1997 and from 2019 to 2021. Hong Kong slipped to 7th in 2021 from 1st in 2017 while Singapore usurped the number one position.[57]

In recent years, Shanghai and Shenzhen have realized strong growth in international trade, business, and finance through China's Pilot Free-trade Zones (FTZs) and Free-trade Port (FTP) programs. These Chinese mega cities have the potential to become competitive trade and financial hubs as well as investment destinations, which may increasingly challenge Hong Kong's role in Asia and the rest of the world. In 2020, Shanghai was 3rd on the GFCI, following New York and London, while Hong Kong was 4th, though Hong Kong regained the number three spot in 2021.[58] Likewise, Shenzhen, mainland China's high-tech hub, overtook Hong Kong in GDP terms in 2018. However, neither city matches Hong Kong's executive, legislative and judicial independence, economic and trade freedom, and well-established financial system, although Shanghai's stock exchange now exceeds the HKEx in sheer size. Importantly, Hong Kong is also the only market globally that can handle real-time settlement of HKD-RMB-USD-

EUR exchanges, which are major currencies for trade and investment.[59] Finally, Hainan, the mainland's free trade port, while not comparable to Hong Kong in all the above-mentioned respects, dwarfs Hong Kong's importance to China as a global free-trade port, seeing vastly more shipments.

4.3 POLITICAL INSTABILITY

Political uncertainty looms over Hong Kong's economic growth and social development and is a major concern for global investors who have invested in or are planning to expand business in Hong Kong. Hong Kong's 2019 protests ignited a long fight to maintain the city's eroding political freedom, autonomy, and distinctive political system from the rest of China. Even before the unrest in 2019 controversy persisted over China's gradual tightening grip on the peninsula. In response to the massive pro-democracy protests in 2019, China introduced the National Security Law (NSL) in Hong Kong, which drew widespread criticism that it violated the "one country, two systems" principle, while Beijing argued that the purpose of the law was to safeguard Hong Kong's security and stability. Many still fear the loss of Hong Kong's freedom and judicial independence. The impacts of the NSL are profound. It heightens uncertainty and spurs conflict surrounding Hong Kong's political and legislative environment; it worsens domestic and international sentiment about the city's investment and business environment which may decrease its attractiveness as an investment destination. Lastly, it could also impact Hong Kong's direct relations with other countries, particularly its economic partners. For example, the US revoked Hong Kong's special status as a separate customs and travel territory from the rest of China in May 2021.

One year after the implementation of the National Security Law, Hong Kong's political climate appears to have stabilized to some extent, although some have pointed out that this is in part because dissidents and activists are pressured to go underground or overseas to continue their protest activities. Hong Kong's economic and business environment is recovering and its GFCI ranking improved in 2020 and 2021. Nevertheless, the National Security Law is a fundamental course change in Hong Kong's political and legislative history and will impact its political system and social structure profoundly. These impacts are not easily quantifiable and will continue to develop over years.

Of course, Hong Kong's unique advantages and role continue to be an important part of China's overall economic wellbeing, and the semi-autonomous city will continue making every effort to maintain resiliency and prominence in global finance. The IMF's 2021 assessment report lauded Hong Kong's macroeconomic policy and regulatory frameworks, affirming Hong Kong's persistent role as a crucial global financial centre.[60]

4.4 THE ECONOMIC IMPACT OF THE US-CHINA TRADE WAR AND THE PANDEMIC

As the US-China trade war, political protests, and the COVID-19 pandemic hit the city, Hong Kong's economy recorded its longest-ever recession, spanning from the third quarter of 2019 to the last quarter of 2020. Its GDP growth registered a year-on-year contraction of 1.2% in 2019, the first contraction since 2009, and further declined by 6.1% in 2020. On top of Hong Kong's own domestic political instability, the US-China trade war and pandemic further contributed to its economic contraction. Given Hong Kong's key role as a re-exporting center, which ships goods made in mainland China to the US and vice versa, it was directly impacted by the tariffs and product bans imposed by both sides. China-US trade re-exported through Hong Kong fell 5.4% and 6.0% in 2019 and 2020, respectively, due largely to the trade war but also the pandemic.[61] Data shows that exports started to significantly decline in the last quarter of 2018, falling into negative growth numbers in the first quarter of 2019, which coincided with the peak of the trade war. Although tensions were eased by the Phase One agreement, Hong Kong exports to the US, including direct exports and re-exports, dropped by 24.6% from 2018 to 2019, and its total trade value with the US further plummeted by 38.8% in 2020.[62] While Hong Kong will inevitably be caught in crossfires should tensions occur between China and its major trading partners, like the US, its special economic and administrative status does provide it with the unique ability to mitigate negative impacts and help bridge business ties between China and other countries that could otherwise fall under greater strain.

The global repercussions of the COVID-19 pandemic have had an even more significant impact on Hong Kong's economy than the trade war. Hong Kong's recession highlights its economy's structural imbalance due to a high dependence on the service sector, including financial services, trade and transportation services, tourism, retail, real estate, and catering services. Hit particularly hard by the pandemic, the service sector dragged Hong Kong's economic growth and pushed the unemployment rate to 6% in 2020.[63] Income inequality, another challenge for Hong Kong's economy and society, was further widened by the pandemic. In the post-pandemic era, Hong Kong's growth is expected to be more diversified and innovation-driven, including upgrading traditional sectors via new technologies, advancing the digital economy sector, and improving its role as a global financial and trade center.[64]

4.5 OPPORTUNITIES FOR HONG KONG IN THE POST-PANDEMIC ERA

Hong Kong's economy began to recover in the first quarter of 2021. GDP growth stood at an annualized rate of 8%, 7.6%, and 5.4% over the first three quarters, respectively. The recovery has mainly been fueled by exports which jumped 30% year on year from January to June 2021, almost making up for its 2020 decline. Exports to its major trade partners, such as the mainland, the US, the EU and many other key Asian markets, all posted double-digit expansion. For the first nine months of 2021 combined, total merchandise trade value amounted to HK$7.4 trillion (just shy of US$ 1 trillion), up 13.2% compared to the same period of 2020.[65] Meanwhile, Hong Kong remained one of the hottest investment destinations in the world. In 2020, Hong Kong's FDI inflows soared by 61.7% year on year, overtaking Singapore to become the third largest recipient of FDI, after only the US and mainland China.[66]

As the economic recovery continues and its political environment starts to stabilize, Hong Kong is showing the world that it remains a vibrant financial center and offshore Renminbi (RMB) hub, acting as a key intermediary of RMB and other currency activities in Asia. Hong Kong remains the premier site of RMB business, which is the fifth most active currency in global payments, facilitating over 70% of the world's RMB offshore payments.[67] As China continues to push for RMB internationalization, Hong Kong's global financial center status will likely further improve.

Hong Kong outperforms other Asian competitors with respect to its stock market. Its stock market is ranked the third largest in Asia and the fifth largest in the world in terms of market value, with 2,538 listed companies. Additionally, in 2020, Hong Kong was the second largest IPO fundraising market in the world, with US$51.3 billion raised through IPO. Further contributing to Hong Kong's attractiveness to foreign investors is its connectivity with stock markets in mainland China through programs such as the Bond Connect, Stock Connect, and the more recent Cross-Border Wealth Management Connect, which allow banks in Hong Kong to connect wealth management products to the mainland.[68]

Although criticized for its increasing dependence on the mainland, Hong Kong also benefits from the intimate economic ties. The mainland is Hong Kong's number one export market, goods supplier, and investor. For example, the UNCTAD's report noted that Hong Kong's 2020 FDI surge was mainly driven by an increase in intra-company loans and reinvested earnings through corporate restructuring, particularly by Chinese multinational enterprises (MNEs).[69] The rebound in cross-border M&A sales also contributed to this rise, as Chinese MNEs consolidated affiliates in Hong Kong.

Importantly, Hong Kong remains a key component of China's national economic development strategy, given its unique role as a gateway to the rest of the world. China's two most important national economic plans, the 14th Five-year Plan (FYP) and the Greater Bay Area (GBA) Development Plan, both highlighted Hong Kong's importance to China. The 14th FYP, for the first time, outlined support for Hong Kong's "four emerging centres",[70,71] namely as an international aviation hub, an international innovation and technology centre, a regional intellectual property trading hub, and a hub for arts and cultural exchanges between China and the rest of the world. Likewise, the GBA plan specifies opportunities in innovation and technology, financial services, transportation and logistics, health care, and education by strengthening economic and cultural connectivity with the mainland.

Hong Kong is also now the 6th largest trading partner for the Association of Southeast Asian Nations (ASEAN), a market of 660 million people. In 2021, a Hong Kong-ASEAN FTA came into effect, which will accelerate their trading relationship. While Hong Kong has long connected international traders to mainland China, South Korea, and Japan through re-exports, it will now increasingly be able to provide similar connectivity with Southeast Asia.

As commented by the United Nations Conference on Trade and Development (UNCTAD), "Hong Kong will remain an important financial hub in Asia and a gateway to investing in China, because of its favourable tax regime, easy listing process, absence of capital controls and good regulatory framework," even though in the short-term, the stabilization of FDI will rest on "the resolution of conflicts arising from the implementation of the National Security Law (NSL), and the normalization of tensions between China and the United States."[72]

4.6 IMPLICATIONS FOR CANADA

As a vaccine-enhanced recovery progresses, economic and business cooperation between Canada and Hong Kong will eventually rebound. Trade between Canada and Hong Kong dropped by 24.9% from 2019 to 2020 amid the pandemic;[73] however, the recovery outlook is optimistic given the historic stability of previous trade and investment relations between the two partners. The Canadian government also led several efforts to promote trade and business cooperation throughout the pandemic. For example, the Canadian Consulate in Hong Kong has helped Canadian companies reach Hong Kong through trade events such as the "Cloud Expo Asia," "Asian Financial Forum," "Hong Kong International Medical and Healthcare Fair," and "Hong Kong Fintech Week." These are but some of many initiatives covering a wide range of sectors, from agri-food to life sciences, that support our enterprises in Hong Kong. Many Canadian companies have been able to leverage the virtual pivot, accelerated by the pandemic, to explore new markets like Hong Kong. This is particularly significant for small and medium-sized Canadian companies that have fewer resources to access market information for expansion in Asia.

As previously noted, Hong Kong was the second greatest destination for Canadian direct investment after the US in 2020. Canada and Hong Kong's future collaboration may lie increasingly in financial services, transportation, education, food and beverages (F&B), and arts and culture. Furthermore, both Canada and Hong Kong are renowned innovation hubs with mutual interest in and clustering around areas such as biotech, cleantech, AI, fintech, insutech (insurance technology), or edtech (education technology),[74] providing great opportunities for technology and research related cooperation. The advancement of digital technologies has facilitated new opportunities in Canada's emerging and traditional sectors such as agri-food, where cross-border e-commerce has great potential to connect businesses in Canada and Hong Kong. Additionally, the Canadian government has encouraged the formation of industry superclusters which greatly help industry leaders, SMEs, colleges and universities, accelerators, and incubators to benefit from collaboration and investment with Hong Kong.

Despite the effects of political uncertainty, there remain economic and business opportunities between Canada and Hong Kong, two entities that have long shared values and interests and that will continue to collaborate in the above-mentioned areas in the post-pandemic era. Hong Kong's ties to mainland China may be a double-edged sword, but its role as a gateway connecting the mainland to international markets, as an international financial, transportation, trade, and innovation hub has proved resilient to economic, political and social shocks. Canada's Fraser Institute recently ranked Hong Kong as the freest economy in the world, based on data collected in 2019.[75] Although concerns on the impact of the National Security Law remain, Hong Kong affirms its commitment to build a free economy is long-standing and steadfast.[76]

Hastily drawn conclusions regarding Hong Kong's decreasing political independence from mainland China may miss these resiliencies and the irreplaceable role Hong Kong plays for the Chinese economy. While a part of China, Hong Kong is influenced by many places and ideas relating to politics, law, economics, trade, and culture, which is not the case for other Chinese cities. Understanding the differences between Hong Kong and mainland China and their unique political and economic relationship is essential for Canada to develop a productive strategy that balances political and economic considerations and continues to maximize opportunities for future prosperity.

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