

Beyond the Financial Crisis: Hong Kong-Metropolis' s Evolution and Economic Integration with China

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Abstract

This paper aims at studying Hong Kong' s evolution and progression from a city-state economy to a regional-metropolis and economic integration with China especially after the return of sovereignty in 1997 as well as the global financial crisis in 2008 by the examinations of (1) Hong Kong' s development as a regional metropolis upon China' s economic opening; (2) the formation of the HK-PRD economic region as induced by industrial and trade restructurings; (3) Hong Kong' s rise as a service-dominated city core of a core-periphery system by integrating economically with south China through the spatial expansion in the PRD and Pan-PRD common market; (4) Hong Kong' s dominant role as China' s most globally accessible core city and post-Asian financial crisis success by gaining international competitiveness; and (5) Hong Kong' s critical role in becoming the most competitive international financial center of China beyond the recent 2008-financial crisis. Further development and challenges ahead were also discussed.

Keywords: economic integration, competitiveness, FDI, financial crisis, Hong Kong, China

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1. Introduction

The economic success of Hong Kong had been built on its industrialization and trading relations with the rest of the world since 1950' s and enabled Hong Kong to transform from an entrepot to a manufacturing and export-oriented city-state during 1950s to 1970s. During this period, manufacturing served as the highest GDP and employment contributing sector with exports increased from only 15% of the total export in the early 1950s to more than 93% in 1970s. Rapid economic growth in terms of GDP and GDP per capita was observed during the period.

Other than export-led industrial strategy has been considered as the dominant factor to elucidate the post-war successful economic development and hence, the engine of growth, the "passive" industrial policy consciously adopted by the Hong Kong government since the 1970s to affect the industrial development is another major factor contributing to the growth pattern of the city-state economy (Tuan & Ng, 1995c). To avoid benefiting any particular industry, only improvement in infrastructure would be provided for to the manufacturing sector as a whole, that is, the Hong Kong government did not consider any prevalent strategy such as "public intervention in research and development at the private sector" as adopted by Japan and other Asian countries during

the same period (Tuan & Ng, 1995a). Hong Kong basically encouraged the restructuring of the city-state economy toward a mixed manufacturing-service dominated economy. Therefore, it is almost the consensus of the government and the local people that any development of the economy should be able to enhance Hong Kong's cosmopolitan orientation.

Given Hong Kong's economic integration with the Pearl River Delta (PRD) region in Guangdong in south China through manufacturing outward processing and relocation activities for more than three decades since China's economic opening in 1979 (Tuan & Ng, 1994; Ng & Tuan, 1996), the potential development of Hong Kong from a city-state economy into a regional metropolis particularly starting from the return of its sovereignty in 1997 could be well derived. Table 1 provides the statistics of some major economic indicators in terms of GDP, employment, price, and trade performance for selected period of 1961-2006. The growth of GDP, employment, prices, and trade by sub-period from a city state to a regional metropolis is shown in Table 2. Further, rapidly increasing cross-border economic activities derived from the evolving regional metropolis observed included increasing cross-border employment, cross-border living and home purchases, and cross-border consumption. A summary of the economic development of Hong Kong from a city-state to a regional-metropolis is depicted by a flow chart as shown in Figure 1.

This paper thus aims at studying Hong Kong's evolution and progression from a city-state economy to a regional-metropolis and economic integration with China especially after the return of its sovereignty in 1997 as well as the global financial crisis in 2008 by the examinations of (1) Hong Kong's development as a regional-metropolis upon China's economic opening; (2) the formation of the HK-PRD economic region as induced by industrial and trade restructurings; (3) Hong Kong's rise as a service-dominated city core of a core-periphery system by integrating economically with south China through the spatial expansion in the PRD and Pan-PRD common market; (4) Hong Kong's dominant role as China's most globally accessible core city and post-Asian financial crisis success by gaining international competitiveness; and (5) Hong Kong's critical role in becoming the most competitive international financial center of China beyond the recent 2008-financial crisis. Further development and challenges ahead were also discussed.

2. Hong Kong's Economic Integration with PRD since 1980

The manufacturing cross border operations (CBO) performed by Hong Kong investors in the nearby Guangdong province have ever since enhanced the economic integration and development between the two regions, Hong Kong and PRD, upon China's economic opening (Tuan & Ng, 1995a). Although the two regions remained institutionally and politically separated following the "One-Country Two-System" arrangement, from the perspectives of economic development and growth, Hong Kong and the nearby cities of Guangdong, including Shenzhen, Zuihai, and other PRD cities, had evolved toward a mega-city economy with Hong Kong as the (gravity) center core (Tuan & Ng, 1995b; 2001a; 2003a, b; Ng & Tuan, 2003). From a spatial point of view, the relocation of Hong Kong manufacturing firms to Guangdong by mainly concentrated

in the proximate PRD areas had not only facilitated the economic integration and the formation of a mega-economy between Hong Kong and PRD but also labor division between the two regions (Tuan & Ng, 2001b; c).¹

2. 1. HK-PRD Economic Integration: Formation of the HK-PRD Metropolis Regional Economy

2.1.1. Manufacturing Outward Processing in China

China's economic opening provided both cheap labor and land resources together with ample business opportunities and incentives to pull foreign investors especially Hong Kong manufacturers to invest in mainland China in order to save production costs and maximize profits (Tuan & Ng, 1995b; Ng & Tuan, 2004). Due to the push of high land and labor prices in Hong Kong and the pull of cheap resources in mainland China especially in PRD, Hong Kong's outward investment in the form of manufacturing outward processing had continued. Preferential governmental FDI policies in the economic opening China and the establishments of Special Economic Zones (SEZs) as well as preferential treatments and/or tax policies implemented by the China government (Ng & Tuan, 2001) and together with the "passive" industrial policies of the Hong Kong government (Tuan & Ng, 1995c) reinforced the pull and push factors for the relocations of Hong Kong manufacturing firms to Guangdong and especially in the nearby PRD (Figure 1).^{2, 3}

The production activities of Hong Kong manufacturing in the 1980s were mainly reflected by outward investment in the form of cross-border operations (CBO) in the proximate PRD and then further diffusion in the form of plant relocation with more service operations components (Tuan & Ng; 1994; 1995b; 2001b). Since 1992, the relocations of the whole manufacturing and more service-oriented operations (e.g., R&D, prototype manufacturing, quality control, and packaging) and by leaving behind Hong Kong the upper- and lower-streams production (e.g., order receiving, financing, management) had transformed Hong Kong's manufacturing into a sector mainly engaged in manufacturing management and services (Tuan & Ng, 2001c). The relocations of more manufacturing functions to PRD and eventually, the complete manufacturing processing and whole production plants deepened the region-wide division of labor in the management functions between the two regions of Hong Kong and PRD (Tuan & Ng, 2001c).

2.1.2. Industrial and Trade Structural Adjustments

(1) Industrial Restructuring between Manufacturing and Services

The decline of Hong Kong's manufacturing was marked by its industrial restructuring from 1987 in its input-output content and employment (Tuan & Ng, 1995d) and industrial concentration or entropy (Ng, 1995).⁴ A structural change was found to occur in both manufacturing and services in 1987 in that services achieved its expansion through the contraction of the manufacturing sector in terms of employment and establishments. The relocation of manufacturing firms to mainland China was considered

as a main source of such a change and thus retarded local manufacturing productivities (Ng & Tuan, 1997b; 2000). The manufacturing contribution to Hong Kong's GDP was declined from 23.7% in 1980 to 22.0% in 1987, 17.6% in 1990, 7.2% in 1996, and to 3.4% in 2006 with corresponding gradual expansion of services to account for more than 95% of GDP as of 2006. Some major statistics of GDP share by industrial sector are further presented in Table 3.

Two major service sub-sectors in services can be classified: (1) traditional services including trade-related and tourism-related industries and (2) newly-developed services including financing, real estates, and business services. In terms of value-added of the major service industries, import/export trade is still the most important industry sector among traditional services to provide 21.9% of GDP and 16.4% of total employment in 2006 (Table 3). The newly-developed service sub-sector showed increasing contributions to account for a total of 13.8% and 20.0% of GDP in 1987 and 1996, respectively, and had been expanding rapidly to become a significant sector contributed to the sustained growth of the economy (Tuan & Ng, 2001b).

(2) Cross Border Operations and Trade Evolution

Upon China's economic opening in 1979 and in order to maintain the competitiveness of labor-intensive manufacturing goods in the export market especially during the decade of 1980s, Hong Kong's manufacturing was forced to adopt a horizontal expansion of production without capital or technology deepening in the form of outward processing in the proximate PRD. Through such cross-border (outward) manufacturing processing of Hong Kong firms in PRD, trade activities particularly in the form of outward processing trade (OPT) between the two regions tremendously increased (Tuan & Ng, 1998). The economic opening of the "greater" PRD in 1987 further enhanced Hong Kong's re-export to exceed its domestic export. Both domestic export and re-export were observed to increase 11.2 and 6.1 times from 1980 to 1986, respectively, and 3.0 and 6.1 times, respectively, for the period of 1987-1991. China's reconfirmation of her open door policy in 1992 attracted huge FDI inflows and further relocations of Hong Kong manufacturing (Ng & Tuan, 2003) and hence, induced vigorous OPT. In 1992, it was estimated that 74.3% of domestic exports to China, 46.2% of the re-export, and 72.1% of imports from China were of that OPT in nature.

Further in 1992, the export values of Guangdong accounted for 32% of those of China while PRD constituted 74% of the export values of the whole Guangdong province derived mainly from the outward processing manufacturing of Hong Kong's firms as OPT. A long-run relation of trade by components in domestic exports and re-exports (secondary domestic exports) and output growth was observed for 1961-1995 (Tuan & Ng, 1998). Three stages of development of trade can be examined in response to the evolutions of Hong Kong's outward manufacturing processing and investment in PRD (Tuan & Ng, 2002b):

- (i) Rapid annual growth in domestic exports averaging 11% per annum from 1960s to 1987.

- (ii) Steady growth in re-exports (1988-1992) to be accompanied by a widening gap with domestic exports in terms of value.
- (iii) Re-exports growth started to decline since 1992 (averaged at 9.1% for 1993-1999) with a rise of off-shore trade including transshipments (or trade “derivatives”) and triangle trade (Tuan & Ng, 1998). The dominance of commodity trade from 1961-1987, re-exports trade from 1980-1992, and offshore trade from 1993-1999 (and now) explained the pattern of the trade evolution.

Strong relationships between manufacturing and trade loans/advances coupled with corresponding commodity trade and trade derivatives activities were observed while the weakening associations between the growth of manufacturing production (and trade) and the growth of institutional financing after 1987 illustrated the diminishing contributions of Hong Kong’s financial services to local manufacturing (Tuan & Ng, 1999). The evolving trade from conventional entrepot to domestic export-led dominance and then to re-export or outward-processing dominance provided great significance and impacts on GDP growth.

2.2. HK-PRD Metropolis Regional Economy as a Core-Periphery System

Krugman’s idea (1991, 1998) of a core-periphery system (CPS) has provided the HK-PRD regional relationship a theoretical stance. CPS can be considered as an economic entity where well-diversified, comprehensive and interrelated industries were developed and externalities in both production and consumption via agglomerative effects were generated (Quiley, 1998). In the HK-PRD economic integrated region, division of labor within the economic region between the core and the periphery was made possible while benefits such as scale economies, input sharing, etc., were also well generated (Tuan & Ng, 2001a, b). Hong Kong has become the major service provider of the HK-PRD CPS as well as the center core equipped with the unique function of high global accessibility (Tuan & Ng, 2003a; 2004b).⁵

The agglomeration effects derived from the HK-PRD economic integrated entity were organized as a three-tier agglomeration economy (Tuan & Ng, 2003b; 2004b) being empirically verified to include three types of agglomerative effects as (i) agglomeration of a core-peripheral system (CPS), (ii) the city as an agglomeration, and (iii) intra-city agglomeration (Ng and Tuan, 2006). Following this idea of the HK-PRD three-tier agglomeration economy and evolution during the three particular periods of economic integration since 1980s, deepening agglomeration effects since 1990s, and the period after Hong Kong’s handover in 1997, a new perspective of the “One-Country Two System” arrangement can be further elaborated from an economic point of view.

The HK-PRD economic growth can be well elucidated by the theories of city and regional growth with HK-PRD as an economic integrated entity being governed by two politically and legally separated local administrations needing close economic cooperation and partnerships between Hong Kong and PRD. This HK-PRD economic integrated region has functioned as a regional metropolis economy characterized by both

the agglomerations of production/consumption and the formation of effective city links within the economic region (Tuan & Ng, 2008) and has also become one of the two most Globalized Delta Economies (GDEs) in China (Tuan & Ng, 2007).⁶ Hong Kong, given the “One-Country-Two-System” arrangement, would remain as the most globalized city and globally accessible center core of this HK-PRD economic integrated economy and GDE.

2.3. Hong Kong as a Service-Dominated City-Core in GDE

Hong Kong has transformed from a manufacturing export enclaved into the hub of a fully-fledged, service-oriented cosmopolitan center (Tuan & Ng, 2001b, c; 2007). The cross-border manufacturing-led expansion of re-exports and transshipments has not only strengthened local trading industries but also nurtured the diversification and development of the service sector in the 1990s. Business view remained quite optimistic through the early 2000s even though the sovereignty transfer in 1997 inevitably affected the percepts of business on the investment environment and climate (Ng & Tuan, 1997). The government’s views on recognizing local comparative advantages and liberalization policy since the late 1980s have encouraged the formation of a regional financial center which further enhances the rapid rise and development of the newly-developed service industries (Tuan & Ng, 1999).

The evolution and growth of the city-state toward a service-dominated economy since 1980 and before the return of sovereign of Hong Kong to China in 1997 can be well characterized by its service-dominant economic activities as follows.

- (1) Sustained growth via spatial expansion in the proximate PRD.
- (2) Outward processing with scale economies production and trade expansion.
- (3) Stimulated growth of businesses/trade, finance/insurance, logistics, and business services.
- (4) Rapid growth of inward FDI, real-estate, and financing industries.
- (5) Expansion of higher education and rise of the middle-class.
- (6) Facing China.

After the return of sovereignty to China in 1997, two major financial turmoils, namely, the Asian Crisis in 1997 and the global crisis in 2008, and together with some untimely macroeconomic economic policies (such as housing) promoted by the Hong Kong government during 1997/98 strike the service-dominated economy in terms of growth. Unemployment and underemployment rates reached their all time high to almost 8% in 1998 (except in 1975) and 5.3% in 2009. Macroeconomic adjustments and problems during the post-1997 period were observed.

- (1) Burst of the economic bubble, high unemployment/underemployment, and deflation.
- (2) Deepening of services sector resulting in low productivity increase and biased opportunities toward high-end services employment.
- (3) Merging economic activities under two economic systems: a market-oriented economy needing cooperation with the planned economy in mainland China.

- (4) Macroeconomic restructuring: economic growth and employment creation in a service-oriented economy
- (5) Change in population structure including aging and immigration problems.

Even confronted by extensive outward investment to PRD, Hong Kong was able to maintain its sustained growth in the 1990s through the long-term growth of banking and finance, re-export trade, and induced “trade derivatives” (Tuan & Ng, 1998; 1999). The following rapid developments of the dominating service sector were observed.

- (1) Rapid development and integrations of banking, insurance, management of mutual funds, and financial derivatives industries; and preliminary tests in RMB handling and trading.
- (2) A center for regional MNCs headquarters promoted by tax-free preferential policies. The number of regional headquarters increased rapidly from 192 in 1980 to 924 in 1997 and 1,228 in 2006 representing a 6.4-fold increase from 1980 to 2006.
- (3) Import/export trade, transportation, storage, and supporting business services aided by information technology to form a supply chain of services, and hence, the formation of the “logistic” industry.
- (4) Tourism and regional tourism combining with international exhibitions and convention center provisions.

3. Economic Integration of Hong Kong-Metropolis after the Asian Crisis: From PRD to Pan-PRD

The favorable economic policies of China and the economic opening of PRD not only provided Hong Kong with opportunities to expand its manufacturing and other economic activities in terms of scale and space (Ng & Tuan, 2001; 2005), the subsequent economic integration of Hong Kong with its proximate PRD to form the HK-PRD regional-metropolis economy further ensured the region’s competitiveness and sustainable growth and development. The successful economic growth and competitive position of Hong Kong and her economic integration with Guangdong before the handover in 1997 can be attributable to major factors including effective government and government institutions; well-developed infrastructure and supporting facilities; good business culture and networkings; vital entrepreneurship; free port; and availability of a hinterland with close economic coordination and cooperation (Tuan & Ng, 2006).

After the financial crisis, there existed unique factors attributable to the continuous success and sustainable growth as well as regional competitiveness and further deepened the regional economic integration of Hong Kong with PRD and China. These factors included the preservation of the factors of success before the handover in 1997, rapid economic growth in China, continual openness of the economy in political and economic system, and continuous implementations of favorable economic policies or arrangements by China’s government to aid Hong Kong included Closer Economic Partnership Arrangements (CEPA) (2003), Pan-PRD Cooperation (2003), Individual Travel Scheme (2003), RMB handling by local Hong Kong banks (2005), and Qualified

Domestic Institution Investments (QDII) and Qualified Foreign Institution Investments (QFII) (2007), etc.

In the late 2003, the Guangdong government announced the Pan-PRD cooperation arrangement in the form of a common market to link up Hong Kong (and Macau) with nine provinces in south and southwest China in terms of economic and trading activities.⁶ Such an economic arrangement further expands the spatial context of Hong Kong from HK-PRD (9+1; that is, nine PRD cities plus Hong Kong) to HK-Pan-PRD (9+1; that is, nine Pan-PRD provinces plus Hong Kong/Macau) in terms of economic activities. The Pan-PRD (9+1) common market is intended to provide and/or facilitate the following competitive advantages targeting at mutual benefits and sustained growth of the Pan-PRD economic region:

- (1) Effective regional links: An effective regional free trade area to facilitate Hong Kong/Macau-PRD cities with Guangdong and the other eight provinces with better economic linkages, coordination, and cooperation particularly in terms of trade; that is, Hong Kong/Macau linking the global market and Guangdong linking the other eight Pan-PRD provinces.
- (2) Reduction of barriers and costs: With better linkages, barriers to investments and trade among the Pan-PRD provinces and the associated transaction costs can be much reduced.
- (3) Complementarities of Pan-PRD: The very different comparative advantages of the Pan-PRD members would complement each other and enhance regional competitiveness in that:
 - (a) Hong Kong/Macau to serve as (i) the contact point for international trade and financial networkings; and (ii) a source/gateway of FDI.
 - (b) Guangdong province to serve as (i) the demander for agricultural products and labor; (ii) the supplier of consumer-oriented industrial products; and (iii) a source equipped with pioneering experience for intra-regional investments.
 - (c) All the other eight Pan-PRD provinces, following their different stages of development and equipped endowments, to serve as (i) learners of the Hong Kong/Macau/Guangdong experiences in investing in foreign markets, advanced managerial experience, and production of high-end consumer products; (ii) suppliers of natural resources, labor, agricultural products, and contact points of overseas manpower networkings; and (iii) recipients of the relocations of more labor-intensive industries resulting from the industry up-grade in other more developed provinces/areas.

The formation of the HK-PRD metropolis regional economy and its subsequent extension to the Pan-PRD common market provided important implications to the distinct role and significance of Hong Kong-metropolis in China.

- (1) As the most globally accessible city in China: Hong Kong, as the most globalized and globally accessible city of China, will continue to provide Pan-

PRD and China with the highest global accessibility and enhance not only the metropolis economic growth but also that of PRD/Pan-PRD and China.

- (2) As a center core of CPS with effective city links: To serve as the facilitator in building the economic linkages between the HK-PRD metropolis region with Guangdong and Pan-PRD, and further with the global world.
- (3) As a core city of an efficient (Pan-PRD) common market: To be shared by PRD and the proximate Pan-PRD provinces.

A brief sketch of the HH-PRD-Pan-PRD common market relationships with global accessibility and the distinct role of Hong Kong played in this economic integrated region is depicted in Figure 2.

4. Beyond the Asian Crisis: Hong Kong International Competitiveness

4.1 Gaining International City Competitiveness: Some Opinion Survey Evidence

Given the mobilization of outward investment (FDI) from the core (Hong Kong) into its periphery (PRD), the HK-PRD economic entity has functioned as a regional metropolis economy in south China with Hong Kong remaining as the most globalized city and globally accessible center core in the HK-PRD. Hong Kong's international competitiveness has been largely enhanced by the regional economic preferential and cooperative policy measures implemented by China especially after the return of its sovereignty in 1997. In measuring international competitiveness, the Pyramid of International City Competitiveness (PCC) model (Tuan and Ng 2002a) depicts the competitiveness of an international city by three basic dimensions as: (i) Base for Sustainable Economic Growth (Dimension A), (ii) Investment Environment (Dimension B), and (iii) Image of Globalization (Dimension C).⁷

The opinions of CEOs/senior management of MNCs in both Hong Kong and Shanghai on the three basic dimensions of international competitiveness were collected by seven consecutive surveys conducted annually during 2001-2007.⁸ The survey results reported in Table 4 show that Hong Kong's overall international competitiveness had increased steadily from 3.75 in 2001 to 4.19 in 2007 representing a gain of 0.44 or 11.7%. By the three basic dimensions (A-C), Base for Economic Growth (Dimension A) increased from 3.56 to 4.12 representing a gain of 0.53 or 14.8%, Investment Environment (Dimension B) from 3.82 to 4.28 or a gain of 0.46 or 12.0%, and Image of Globalization (Dimension C) from 4.14 to 4.49 or a gain of 0.35 or 8.5% (Table 4).⁹

From the survey findings, Hong Kong earned the highest score in Dimension C to be followed by Dimensions B and A. However, Hong Kong gained most in Dimension A and followed by Dimension B and C. The same consistent results during the seven study periods were obtained. Such research findings of an international competitiveness progression may well reflect the continual success and further development of the economic integrated Hong Kong with China after the Asian financial crisis as a cosmopolitan and the center core (regional metropolis) of a core-periphery economy in the south China region through the spatial expansion of its production base into its proximate PRD and Pan-PRD regions and improvement of its investment environment.

4.2 Mobilization of International Investments: Evidence from MNCs Survey

In the mobilization of international investments in terms of direct investment flows, total direct inflows increased from HK\$423.9 billion in 2007 to HK\$464.3 billion in 2008 while total direct outflows decreased from HK\$476.5 billion to HK\$ 393.9 billion, respectively. China mainland remained the predominant partner in terms of Hong Kong's FDI mobilization. As of 2008, China shared a total of 36.5% of Hong Kong's outward FDI and in terms of flows, supplied HK\$179.7 billion or 38.7% of Hong Kong's FDI inflows and received HK\$215.2 billion or 54.6% of Hong Kong's FDI outflows reflecting the significance of China's direct investments as well as the China market. While China remained the top destination/recipient of Hong Kong's investment, Guangdong had been the most popular province to share 30.4% (or HK\$798.4 billion) of Hong Kong's total outward investment in 2008¹⁰

In order to study the strength and attractiveness of Hong Kong in mobilizing FDI in the region, the Hong Kong Government conducted a MNCs Survey (June, 2008) by investigating a sample of 6,612 MNCs of USA, Japan, UK, and China origins and conducting businesses in trading, business services, banking and finance, and transportation. The findings of the survey revealed the ten most important factors why MNCs chose Hong Kong as the base to set up their businesses and headquarters and/or regional offices.

These ten factors include (1) simple tax system and low tax rate, (2) free flow of information, (3) corruption free government, (4) political stability and security, (5) absence of exchange control, (6) rule of law and independent judiciary, (7) excellent infrastructure, (8) proficiency in English, (9) productivity of the staff, and (10) geographical location being a bridge of China and the rest of the world. Other factors that followed are free port, accessibility to business opportunity in China, and business friendly economic policy. This survey study reaffirmed the unique investment environment of Hong Kong in that its free market economy with ample business opportunities provided by the China hinterland and effective government are the key factors in enhancing the competitiveness of Hong Kong as a competitive international city particularly in FDI promotion and attraction

5. Beyond the 2008-Crisis: Hong Kong-Metropolis as an International Financial Center

Due to the fact that Hong Kong had evolved into a service-dominated economy with trading, finance, and transportation contributing to at least half of the economy's GDP, the recent global financial crisis in 2008 affected adversely its exports, GDP, and employment. Statistics from Tables 5-6 reveal the following impacts on the Hong Kong-metropolis due to the crisis.

- (1) Real GDP decreased by 2.6% in the 4th quarter of 2008 and -7.8%, -3.6%, and -2.4% during the first three quarters of 2009. Both private consumption and

private capital formation went down by three consecutive quarters until the 2^d quarter of 2009.

- (2) Commodity exports decreased by 4.9% in the last quarter of 2008, and then by -22.7%, -12.4%, and -13.2% during the first three quarters of 2009. Service exports also recorded negative growth rates of -6.3%, -5.2%, and -0.9%, respectively, during the same period.
- (3) Unemployment rate jumped from 3.8% (average of 9/2008-11/2008) to 4.1% (average of 10/2008-12/2008) and 5.4% (average of 4/2009-6/2009). However, unemployment improved in the fourth quarter 2009 to 4.9%.
- (4) During the 2008/09 period, CPI remained rather stable with only a mild deflation observed for the three consecutive months of June-August of 2009.

The statistics in Tables 5-6 also reveal the fact that the Hong Kong-metropolis is recovering rapidly from the 2008-Crisis given the strong economic performance and supports provided by its PRD hinterland as well as that of China. Since the Hong Kong economy has in fact integrated economically with PRD/Pan-PRD and China, business confidence has been upheld by China's impressive economic growth rate of 8.9% in 2009 even in the midst of the global crisis for the rest of the world. Observations show that:

- (1) Tourism services which accounted for 18% of the service exports in 2009 still recorded positive growth during the post-2008 crisis period. The number of incoming/outgoing passengers reached an all time high record of 220 million in 2009 due to China's policy in allowing residents of PRD and other major China cities to visit Hong Kong on individual basis (Individual Travel Scheme).
- (2) To take advantage of the HK-PRD core periphery system and Hong Kong's "free" market economy with high accessibility to the China mainland economy, capital inflows continued in 2009. According to the balance of payments figures, both current and capital accounts recorded significant surpluses during the first three consecutive quarters of 2009. The total capital inflows during the 2008/09 crisis period were HK\$147 billion representing 33.8% of Hong Kong's GDP in the 4th quarter of 2008 and HK\$109 billion or 25.3% of GDP in the 3rd quarter of 2009 (Table 5).
- (3) It is also expected that the ever growing China mainland market will stimulate commodity exports from Hong Kong by at least 5% in 2010 (HKTDC, 2010). The expected recovery in the rest the world will certainly reinforce the confidence of the territory in terms of economic growth.
- (4) Continuously improving bilateral trading environment with the mainland and other Asian countries, such as CEPA, ASEAN 10+1, seems also benefit Hong Kong in both the external trade of commodities and services in the long run.
- (5) The gradually opening China financial sector and the expanding cross border operations including services (CEPA I-VI, 2003-2008), in particular, will provide increasing opportunities for Hong Kong investors. Other than the two different systems, the necessary conditions for an international financial center, such as financial infrastructure and developments of high-end financial products/instruments, well-trained manpower, global accessibility, and business networkings, etc, are well provided for. Hong Kong is still well ahead of all

other major cities in the mainland including Shanghai in terms of global accessibility and international competitiveness (Ng, Tuan, and You, 2008).

It follows that being China's most internationalized city, Hong Kong definitely plays a predominant role by serving as a gateway to China as well as linking China with the rest of the global world. China's strong and impressive economic performance has also well preserved Hong Kong from the serious external shocks generated by the 2008-crisis. Hong Kong, China's most globally accessible core city/metropolis, will further strengthen its role as a dominated service-regional metropolis and become the top international financial center of China not only in banking/financial services provisions and as regional center for syndicate loans, but more importantly, in the mobilizations of China's inward/outward international investments with the global world. The recent delegations by allowing local Hong Kong banks to conduct more RMB business for corporate clients and local business firms to issue RMB corporate bonds, to apply for bank loans/credit lines in RMB to finance projects as well as to settle trade in RMB¹ would definitely facilitate Hong Kong as a testing ground for the internationalization and convertibility of the RMB currency and further, enhance the development of the critical role as an offshore RMB center.

6. Further Challenges

As far as sustainable growth is concerned, the impacts of the 2008-crisis upon Hong Kong may impose the following potential problems:

- (1) The trend of tightening regulations on the global financial market, such as institutional governance, operations, and innovations in products, will inevitably and adversely affect the financial sector. As a regional financial center, a major share of the sector is foreign owned. If global regulations were moving toward a conservative direction, contraction in business value of the financial market would eventually follow.
- (2) Increasing protectionism in commodity and service trade is expected for China's major trading partners in 2010 and the near future while its spillover effects upon Hong Kong is a major concern.
- (3) Rapid growth in the domestic market and expansion in private consumption in China have been well observed recently. However, the rise of private smaller enterprises in China will continue (Tuan & Ng, 2006). All these changes will exert enormous pressure on the needs of the Hong Kong's service economy to adjust its strategies both in terms of production and geographic marketing.

Within the Hong Kong-metropolis entity, the following development and challenges are of major concerns:

- (1) Development of infrastructural supports in transportation, environment protection, health care, social welfare, and education under the spirit of "One-Country-Two-System" for furthering the administrative coordination and cooperation between the two regions (the core Hong Kong and its periphery PRD townships) are called for.

- (2) Active participation and utilization of China's "Five Year Planning" in the PRD and Pan-PRD regional economies, and reductions of various forms of transaction costs generated from the two "different (political/economic) systems" are the priorities.
- (3) Problems arising from macro-economy restructuring, employment creation in a service-dominated economy, and balancing growth and environmental preservations.
- (4) Problems with income distribution and equity in a service-dominated economy in
 - medicare, social welfare, and minimum wage/maximum work hours
 - middle-class's expectations and frustrations
- (5) Keen demand for improving business environment for business operations, such as market competition policies and SMEs/industrial policies
- (6) Rising expectations on the performance of the Hong Kong Government and quality of civil servants
- (7) Balance of the rising political demand and economic growth
 - The rise of non-government organizations, e.g., Green Peace, Anti-WTO, and human rights organizations emphasizing on the goal of equity
 - The quest of administrative-led tradition and pursue of check-and-balance between administration and legislation; the trade-off between social-political and economic goals becomes a reality.

Given the above development and challenges, the confidence of the residents in Hong Kong toward the post-crisis development has been unfailing. As the core city in south China and being further enriched by the two "different (political/economic) systems", the next challenge faced by Hong Kong is how to better utilize its a unique role and positioning as China's gateway and the most international competitive city in the global world. Hong Kong is becoming the top international financial center of China with the leading role in directing China's international investment with the global world. Afterall, the economic success of the city has its unique formula by exploiting its comparative advantages including the three key elements of a business friendly investment environment,¹² an industrious quality labor force and human capital, and residents with pragmatic mentality and vital entrepreneurship, which have remained unaltered throughout Hong Kong's history of development and growth.

Notes

1. Following the theories of pattern of land use (Alonso, 1964) and the observations from the two decades of FDI diffusion process and pattern of geographical distribution, the nearby PRD areas have evolved as an integrated economic "sub-urban" of Hong Kong with the highway distance (or gravity) from the center core to serve as a friction of FDI diffusion (Tuan & Ng, 1995b; 2001a; 2003a, b; Ng & Tuan, 2003). The economic boundary of the HK-PRD economic integrated region coincides geographically within a radial distance of 196 kilometers from the center core (Tuan, Ng, & Wong, 1998) or approximately three hours of travel time by highway distance.

2. The accumulative total amount of realized foreign direct investment (FDI) from Hong Kong to China reached a record high of US\$259.7 billion for the period of 1979-2005 to account for an average of 42% of China's total national FDI receipts during the same period. In 1987, the recorded amount is US\$1.6 billion representing 69% of the national total and increased to US\$20.6 billion or 46% in 1997 and to US\$17.9 billion or 30% in 2005.
3. The HK-PRD economic region (with an area of 40,000 km²) or with the periphery area lying within the three-hours travel time zone by highway from Hong Kong can be quite different from that of Guangdong province (with an area of 179,000 km²) in terms of economic activities.
4. The year of 1987 is the economic opening of the PRD region in Guangdong PRD has nine cities including Shenzhen, Dongguan, Huizhou, Guangzhou, Foshan, Jiangmen, Zhongshan, Zhuhai, and Zhaoqing.
5. From an economic development point of view, the HK-PRD regional economy has become one of the two most globalized delta economies (GDEs) in steering the regional growth of China (Tuan & Ng, 2007; Tuan, Ng, & Zhao, 2009). The economic growth and potentials of GDEs can be inspected by some major economic and visualized indicators via the following website: www.jlgis.cuhk.edu.hk/business (Tuan, Ng, & Lin, 2006).
6. The nine Pan-PRD provinces included Guangdong, Guangxi, Fujian, Hainan, Guizhou, Yunnan, Sichuan, Hunan, and Jiangxi.
7. The PCC model has three major dimensions consisting of six components and 14 factors with 32 indicators in the measurement of international city competitiveness (Tuan & Ng, 2002a). The six components and 14 factors are: (1) Production Factors consisting of 3 factors, namely, Human capital, Technology base, and Environment for entrepreneurs (6 measuring items); (2) Existing Economic Base consisting of 3 factors, namely, Institutional infrastructure, Business culture, and Economic and industry structure (11 measuring items); (3) Policy for Social-Economic Development consisting of 1 factor, namely, Government and governance (3 measuring items); (4) Environment for Business Operations consisting of 4 factors, namely, Rule of law, Administration of economic affairs, Openness, and Labor (8 measuring items); (5) Environment for Living consisting of 2 factors, namely, Living facilities and Environment protection (2 measuring items); and (6) Image of Globalization consisting of 2 factors, namely, Acceptance of "foreignness" and Degree of globalization (2 measuring items).
8. Over 1,240 CEOs and senior management of MNEs in both Hong Kong and Shanghai were surveyed from 2001-2007 in order to understand their expert opinions regarding the international competitiveness of both cities. The CEOs and senior management were requested to rate the achievements of both Hong Kong and Shanghai by a structuralized questionnaire on international city competitiveness based on the Pyramid of International City Competitiveness (PCC) model (Tuan and Ng, 2002a). Respondents were asked to score from 5 (best) to 1 (worst) on the three basic dimensions with 32 measuring items.
9. Hong Kong was found to lead in all the three dimensions during the seven-year survey period (2001-2007) when compared with Shanghai which is the top international city in China mainland (Ng, Tuan, and You, 2008).

10. In 2008, other than China mainland, British Virgin Islands accounted for another 32.3% of Hong Kong's inward investment in stock and 23.8% in flow, and 43.8% of the outward investment in stock and 36.1% in flow. These two top FDI recipients and destinations together shared 88.2% of the total FDI outflows and 68.8% of the total inflows (in stock), and 90.7% and 62.5% (in flow), respectively, in 2008.
11. The new measures announced recently in February 2010 by Hong Kong Monetary Authority (HKMA) have two major restrictions: first, RMB raised in the bond issuance or trade settlement activities cannot flow back to China mainland unless given China's approval so as to eliminate any pressure on RMB appreciation and second, business must use the proceeds for trade settlements or to finance projects and not for speculations in stocks, bonds or property (SCMP, 2010).
12. Building a business friendly investment environment was found critical for the facilitation of FDI inflows (Ng & Tuan, 2002). Even though short-run investment decisions are more affected by profit expectations, post-ante investment experience on investment satisfaction/dissatisfaction and environmental and institutional determinants are the prime factors in determining long-run investment decisions (Ng & Tuan, 2004). Institutional determinants also affected the entry strategies of MNEs and hence, the FDI investment patterns at the destination (Lam, Ng, & Tuan, 2006).

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**Table 1 Hong Kong Macroeconomy from City-State to Regional Metropolis:
Selected Major Economic Indicators (1961-2006)**

Economic Indicators	1961	1981	1987	1997	2005	2006
Population (million)	3.13	5.00	5.58	6.49	6.81	6.86
Labor Force Participation Rate (%)	38.7	50.2	48.9	49.8	52.0	52.8
Unemployment Rate (%)	0.7	2.0	1.7	2.2	5.3	4.4
GDP (HK\$ billion) (2000 price)	-	48.21	73.31	121.61	162.35	173.43
Per Capita GDP (HK\$) (2000 price)	-	9,642	13,136	18,740	23,828	25,917
Per-Capita Real GDP Average Annual Growth Rate (%)	-	7.3 (61-81)	6.9 (81-06)	5.99 (87-97)	3.05 (97-05)	3.49 (97-06)
Commodity Trade (HK\$ billion)	0.99	26.14	75.60	307.10	436.72	506.08
Service Trade (HK\$ billion)	0.32	5.71	15.54	48.53	76.00	84.62

Notes: The period experiencing the city-state economy is defined as 1961-1981 and that of a regional metropolis economy as 1981-2006; the ten-year period before and after Hong Kong's handover in 1997 refer to 1987-1997 and 1997-2006, respectively.

**Table 2 The Hong Kong Macroeconomy from City-State to Regional Metropolis:
Selected Major Economic Indicators by Growth Period (1961-2006)**

Economic Indicators (Unit=%)	City-State Economy		City-Core Metropolis	
	1961-1970	1971-1980	1981-1997	1997-2006
GDP				
GDP (2000 price)	8.9 ^(a)	9.1	6.2	4.2
GDP Deflator (2000=100)	4.2 ^(a)	10.2	7.6	-2.2
Per Capital GDP (2000 price)	6.2 ^(a)	6.5	4.7	3.6
Prices and Unemployment				
CPI (1999/2000)=100	-	8.6 ^(b)	8.5	-0.4
Unemployment	-	4.6 ^(c)	2.5	5.6
Underemployment	-	-	1.4 ^(d)	2.7
Trade				
Domestic Exports	15.9	19.3	7.5	-4.1
Re-exports	10.8	27.8	25.3	7.3
Service Exports	12.2 ^(a)	16.9	14.5	7.4
Import of Commodities	13.0 ^(a)	21.0	17.5	5.9
Imports of Service	11.5 ^(a)	21.8	14.6	4.3

Notes: (a) 1962-1970 average; (b) 1976-1980 average; (c) 1975-1980 average; and (d) 1983-1997 average

Table 3 Hong Kong's Industrial Structure: Percentage Share in GDP by Industrial Sector (1981-2006)

Industry	1981	1987	1997	2006	
				(A)*	(B)
I. (Unit=%)					
II. Manufacturing Sector	21.8	21.1	6.0	3.4	5.1
Service Sector					
Import/Export Trade	8.7	13.0	16.1	21.9	16.4
Finance and Insurance	7.1	6.7	9.8	12.3	5.3 ^(a)
Transportation	6.7	7.9	8.1	9.8	9.4 ^(b)
Business Services**	2.2	3.0	4.2	4.6	-
Wholesale and Retail	5.0	4.8	3.5	3.4	10.5

Notes: Compiled by the authors; Column (A) represents market value and Column (B) represents employment percentage share; *2005 data; **excluding real estate; (a) financial services; (b) include storage.

Table 4 Hong Kong-Metropolis Competitiveness after the Asian Financial Crisis: Survey Results of MNEs (2001-2007)

PCC Dimension	2001	2002	2003	2004	2005	2006	2007	2001 vs 2007
Dimension A								
Base for Sustainable Growth	3.59	3.85	3.93	3.91	4.08	4.02	4.12	-
Δ	-	+0.26	+0.08	-0.02	+0.17	-0.06	+0.10	+0.53
$\% \Delta$	-	+7.24	+2.08	-0.51	4.35	-1.47	+2.49	+14.76
Dimension B								
Investment Environment	3.82	4.05	4.15	4.13	4.18	4.13	4.28	-
Δ	-	+0.23	+0.10	-0.02	+0.05	-0.05	+0.15	+0.46
$\% \Delta$	-	+6.02	+2.47	-0.48	+1.21	-0.29	+3.63	+12.04
Dimension C								
Image of Globalization	4.14	4.24	4.22	4.33	4.42	4.30	4.49	-
Δ	-	+0.10	-0.02	+0.11	+0.09	-0.12	+0.19	+0.35
$\% \Delta$	-	+2.42	-0.05	+2.61	+2.08	-2.71	+4.42	+8.45
Dimension A-C								
Average	3.75	3.93	4.02	4.00	4.12	4.08	4.19	-
Δ	-	+0.18	+0.09	-0.02	+0.12	-0.04	+0.11	+0.44
$\% \Delta$	-	+4.80	+2.29	-0.05	+3.00	-0.10	+2.70	+11.73

Notes: Δ and $\% \Delta$ denote year-on-year change and percentage change, respectively; a score of '5' represents 'best' and '1' represents 'worst'.

**Table 5 The Hong Kong-Metropolis Economy beyond the 2008-Crisis:
GDP, Aggregate Demand, Exports, and BOP (2006-2009)**

Year	GDP					Private C*	G*
	GDP*	GDP Deflator*		Per-capita GDP*			
	%D	2007=100	%D	HK\$	%D	%D	%D
2006	7.0	97.2	-0.3	221455	6.3	5.9	0.3
2007 ^T	6.4	100.0	2.9	233245	5.3	8.5	3.0
2008 ^T	2.4	101.4	1.4	236989	1.6	1.5	1.7
Year/Quarter							
2008Q3 ^T	1.5	101.7	2.0	n.a.	n.a.	-0.2	1.6
2008Q4 ^T	-2.6	102.5	-0.2	n.a.	n.a.	-4.1	1.8
2009Q1 ^T	-7.8	100.8	0.4	n.a.	n.a.	-6.0	1.4
2009Q2 ^T	-3.6	102.0	1.1	n.a.	n.a.	-1.1	1.7
2009Q3 ^P	-2.4	102.2	0.4	n.a.	n.a.	0.2	3.3
Private Investment		Exports			BOP Account		
Year	I*	Inventory Change*	Goods*	Services*	BOP Account		
	%D	HK\$mil	%D	%D	HK\$mil	% to GDP	
2006	7.1	-1429	9.3	10.1	46735	3.2	
2007 ^T	3.4	12841	7.0	14.1	114498	7.1	
2008 ^T	-0.5	9573	1.9	5.7	263869	15.7	
Year/Quarter							
2008Q3 ^T	2.9	2892	1.3	4.8	51259	11.9	
2008Q4 ^T	-17.8	4494	-4.9	0.4	147317	33.8	
2009Q1 ^T	-13.7	-4426	-22.7	-6.3	68900	18.2	
2009Q2 ^T	-13.6	-2286	-12.4	-5.2	143096	36.6	
2009Q3 ^P	1.4	21025	-13.2	-0.9	106625	25.3	

Notes: *2007=100; revised figures; preliminary figures.

Source: Hong Kong Census Statistics (November 2009), HKSAR

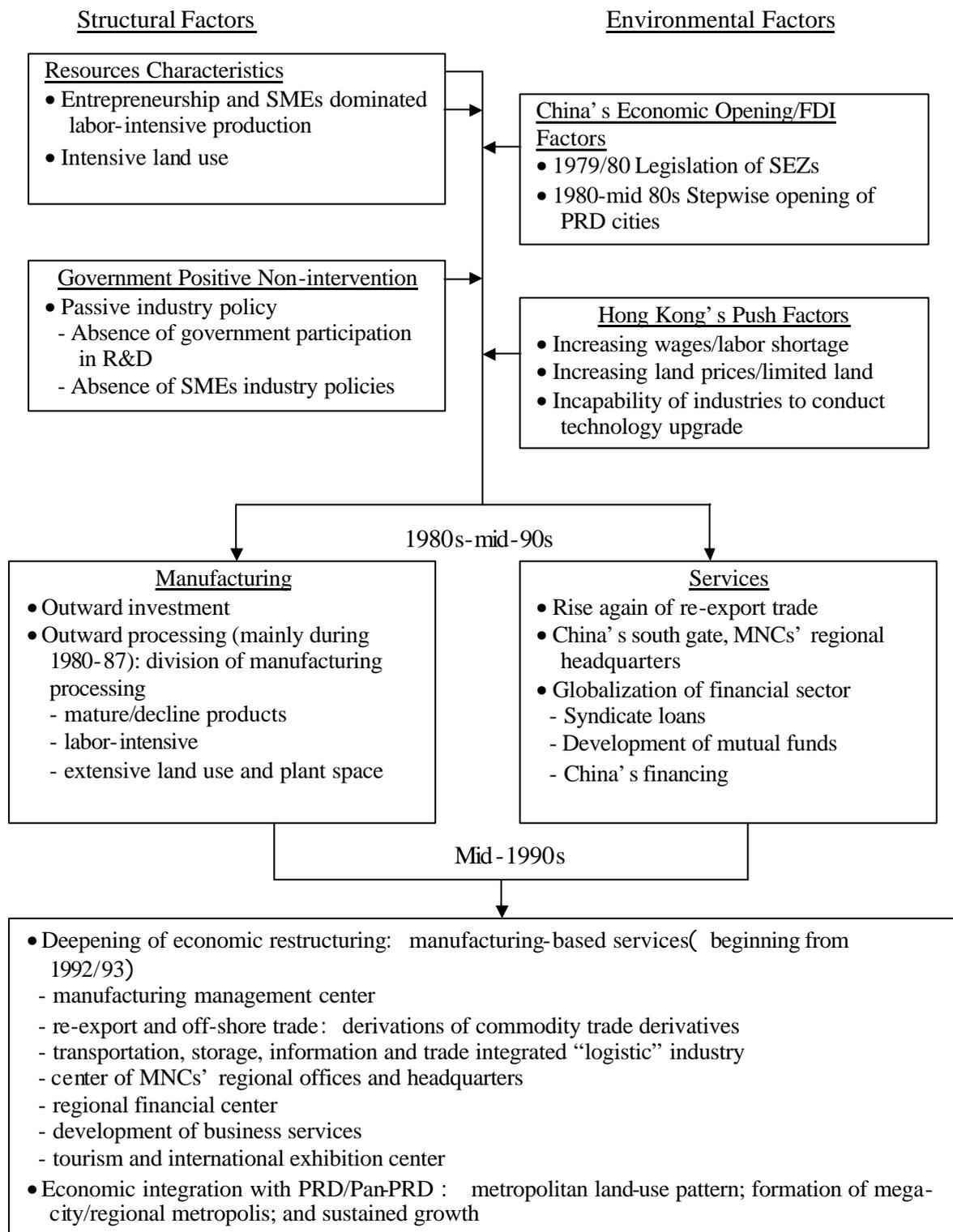
Table 6 The Hong Kong-Metropolis Economy beyond the 2008-Crisis: Prices and Unemployment (2007-2009)

Year	Composite CPI		Year/Month	Unemployment*	Under-employment
	CPI	%D			
2007	104.4	2.0	2007	n.a.	2.2
2008	108.9	4.3	2008	n.a.	1.9
2009	109.5	0.5	2009	5.3	2.3
Year/Month					
2008/10	108.1	1.8	2008/8-10	3.6	1.7
2008/11	110.0	3.1	2008/9-11	3.8	1.8
2008/12	109.6	2.1	2008/10-12	4.1	1.9
2009/1	110.0	3.2	2008/11-2009/1	4.6	2.1
2009/2	109.2	0.8	2008/12-2009/2	5.0	2.1
2009/3	109.5	1.2	2009/1-3	5.2	2.1
2009/4	109.6	0.6	2009/2-4	5.3	2.2
2009/5	109.3	0.0	2009/3-5	5.3	2.3
2009/6	109.1	-0.9	2009/4-6	5.4	2.3
2009/7	109.2	-1.5	2009/5-7	5.4	2.4
2009/8	107.4	-1.6	2009/6-8	5.4	2.4
2009/9	108.2	0.5	2009/7-9	5.3	2.4
2009/10	110.5	2.2	2009/8-10	5.2	2.4
2009/11	110.6	0.5	2009/9-11	5.1	2.5
2009/12	111.0	1.3	2009/10-12 [#]	4.9	2.3

Notes: *seasonal adjusted; [#]estimated figure;

Source: Hong Kong Census Statistics (2009), HKSAR

Figure 1 Evolution of Hong Kong from a City-State to a Regional Metropolis



Source: updated from Tuan & Ng (2003)

Figure 2 A Sketch of the Role of Hong Kong-Metropolis and Pan-PRD Common Market

