

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

Chyau Tuan and Linda F.Y. Ng
Department of Decision Sciences and Managerial Economics
Faculty of Business Administration
The Chinese University of Hong Kong

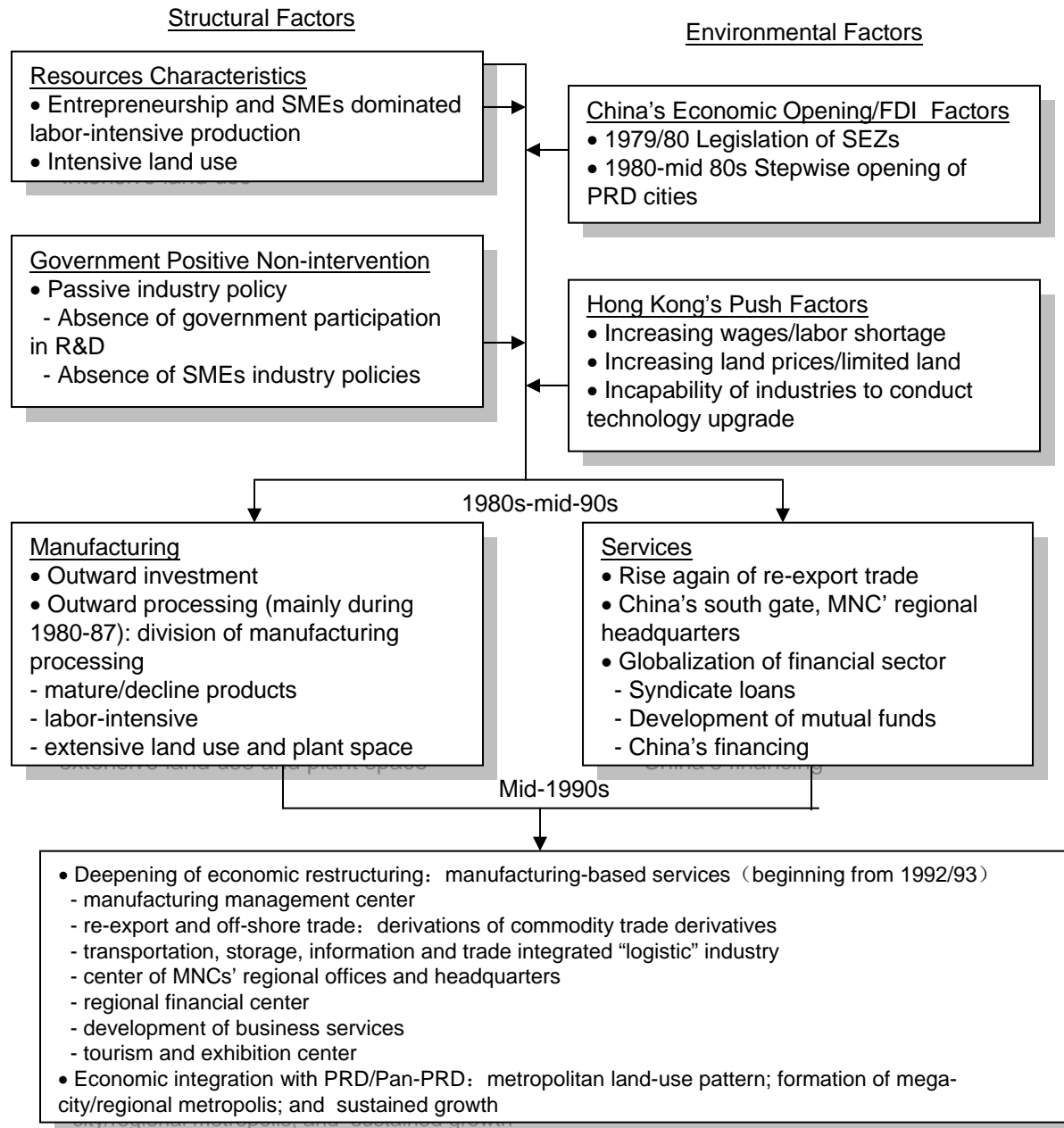
Asia after the Crisis

Jointly Organized by
ACAES and Doshisha University
Kyoto, Japan
March 4-6, 2010

Objectives

1. HK's development as a regional metropolis upon China's economic opening'
2. Formation of HK-PRD economic region as induced by industrial and trade restructuring
3. HK's rise as a dominated-service city-core of CPS through spatial expansion into PRD and Pan-PRD in China
4. HK's dominant role as China's most globally accessible city and gaining international competitiveness
5. HK's critical role in becoming China's most competitive international financial center

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



I. The City-State Economy (1961-1979)

- Positive non-intervention: market-oriented economy and passive role of the government
- Export-led strategy
- “Passive” industrial policies
- SMEs and labor-intensive manufacturing
- Period of rapid economic growth

Fig 2-7

Tables 1-2

II. HK's Economic integration with PRD: Regional Metropolis I (1980-1997)

China's economic opening and reform in 1979

- Stepwise openings of PRD: HK's expansion of economic space
- Manufacturing outward processing in PRD: scale expansion, outward processing trade (OPT)
- Sustained growth

HK-PRD (Pearl River Delta) as a Core Periphery System (CPS)

CPS (Krugman, 1991; 1998)

HK-PRD (9+1):

HK: Core city (gravity center)

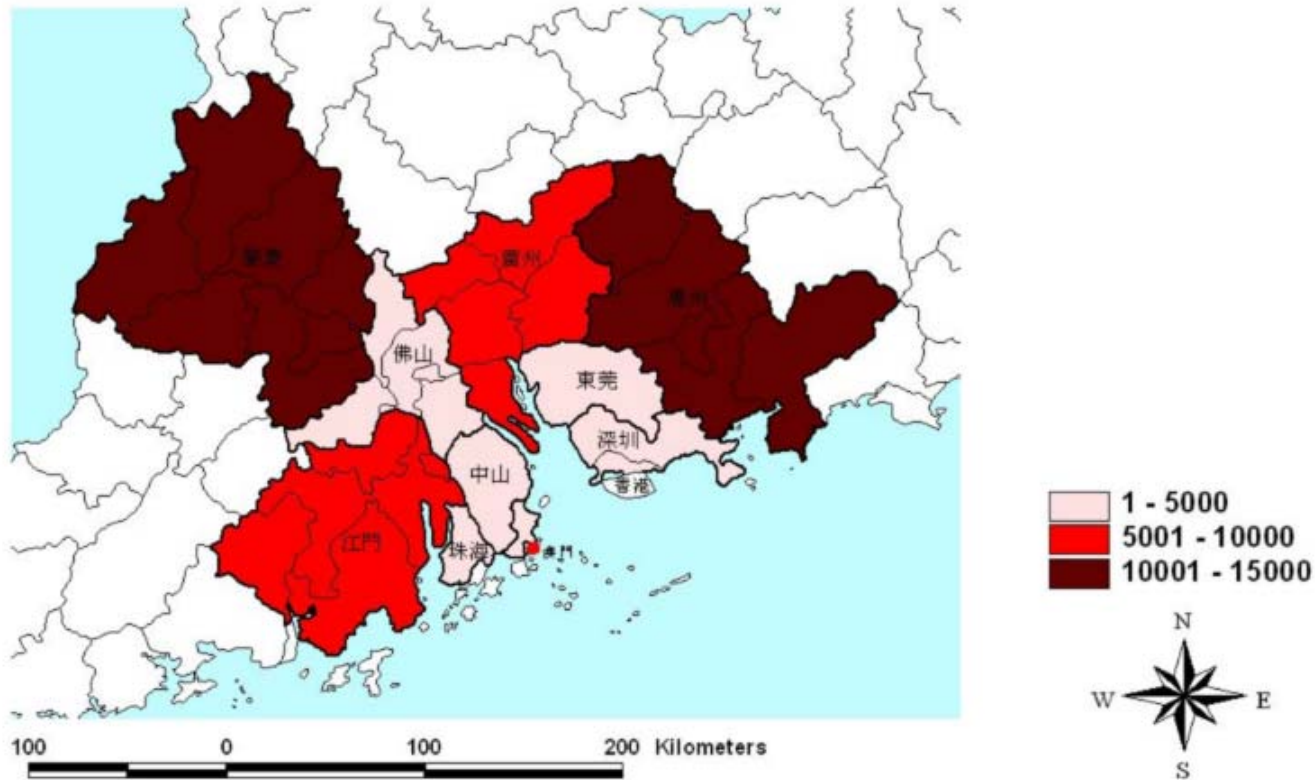
PRD: 9 PRD cities as periphery (Shenzhen, Dongguan, Huizhou, Guangzhou, Foshan, Jiangmen, Zhongshan, Zhuhai, and Zhaoqing)

Figure 8a A Map of China: Location of PRD in Guangdong



Figure 8b A Map of PRD: Area (Km²)

2003珠江三角洲面積 (平方公里)



Source: Tuan, Ng, & Lin (2006) (<http://www.jlgis.cuhk.edu.hk/business>)

Industrial restructuring between manufacturing and services

- Development of business & trade, finance, logistic, business services
- Rapid growth of FDI, real estate, and financial service
- Induced further outward processing trade (OPT)

Table 2 (1981-1997) vs (1997-2006)

**Table 1 From City-State to Regional Metropolis:
1961-81 vs 1981-06**

	1961	1981	2006
Population (Million)	3.13	5.00	6.86
Labor Force Participation	38.7%	50.2%	52.8%
Unemployment Rate	0.7%	2.0%	4.4%
Per Capita Real GDP Annual Growth Rate	-	7.3% (61-81)	6.9% (81-06)
Per Capita Real GDP (HK\$) (2000 price)	-	96,430	252,917
GDP (HK\$ Billion) (2000-price)	-	482.1	1734.3
Commodity Trade (HK\$Billion)	9.9	261.4	5060.8
Service Trade (HK\$Billion)	3.2	57.1	846.2

Table 2 Hong Kong Macroeconomy: Selected Major Economic Indicators by Sub-periods (1961-2006)

Economic Indicators (Unit=%)	City-State Economy		City-Core Metropolis	
	1961-1970	1971-1979	1980-1997	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

**Figure 2 Hong Kong's GDP at Constant 2000 Price
(1970-2006)**

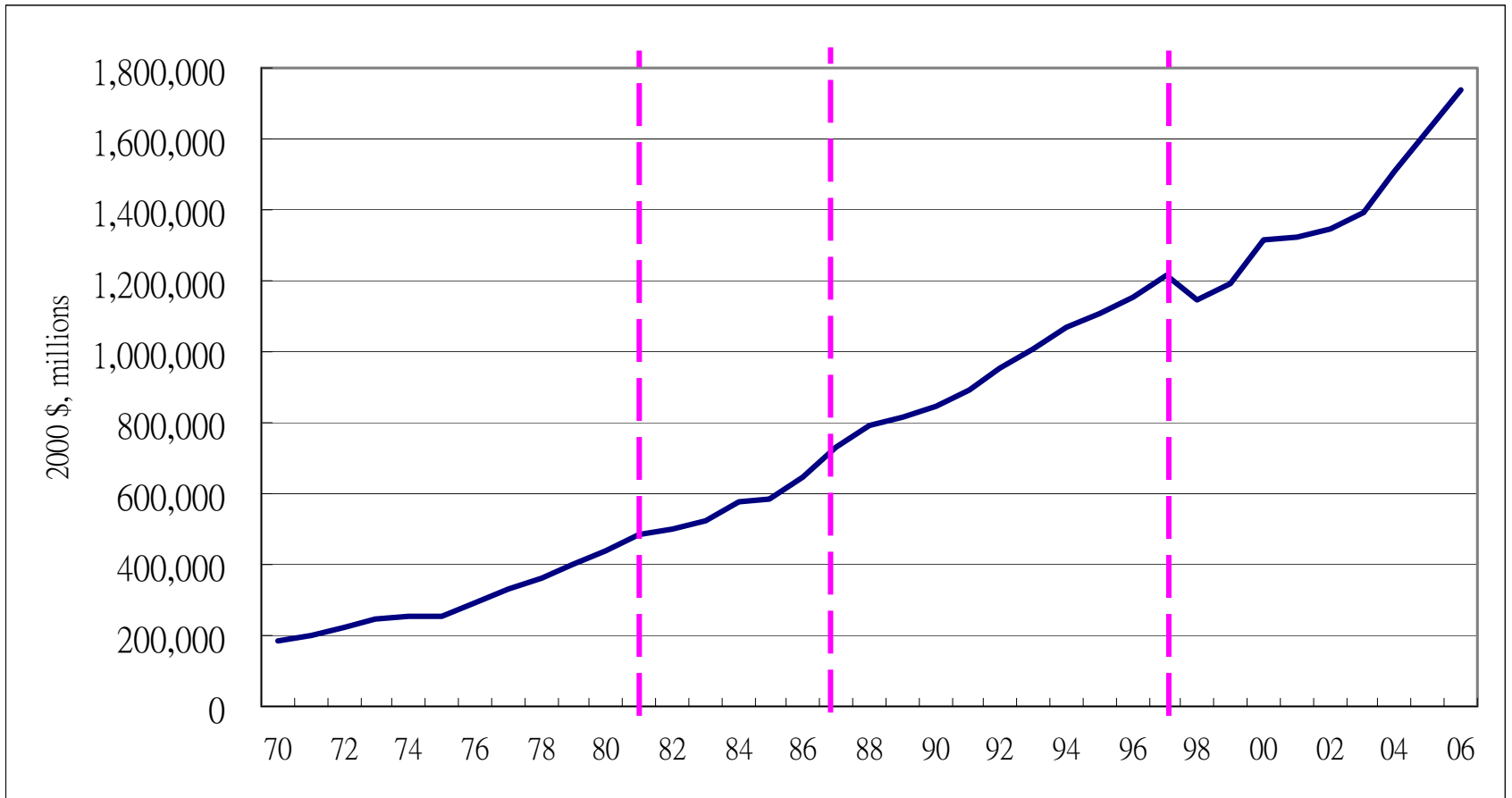


Figure 3 Hong Kong's Per Capita GDP at Constant 2000 price (1970-2006)

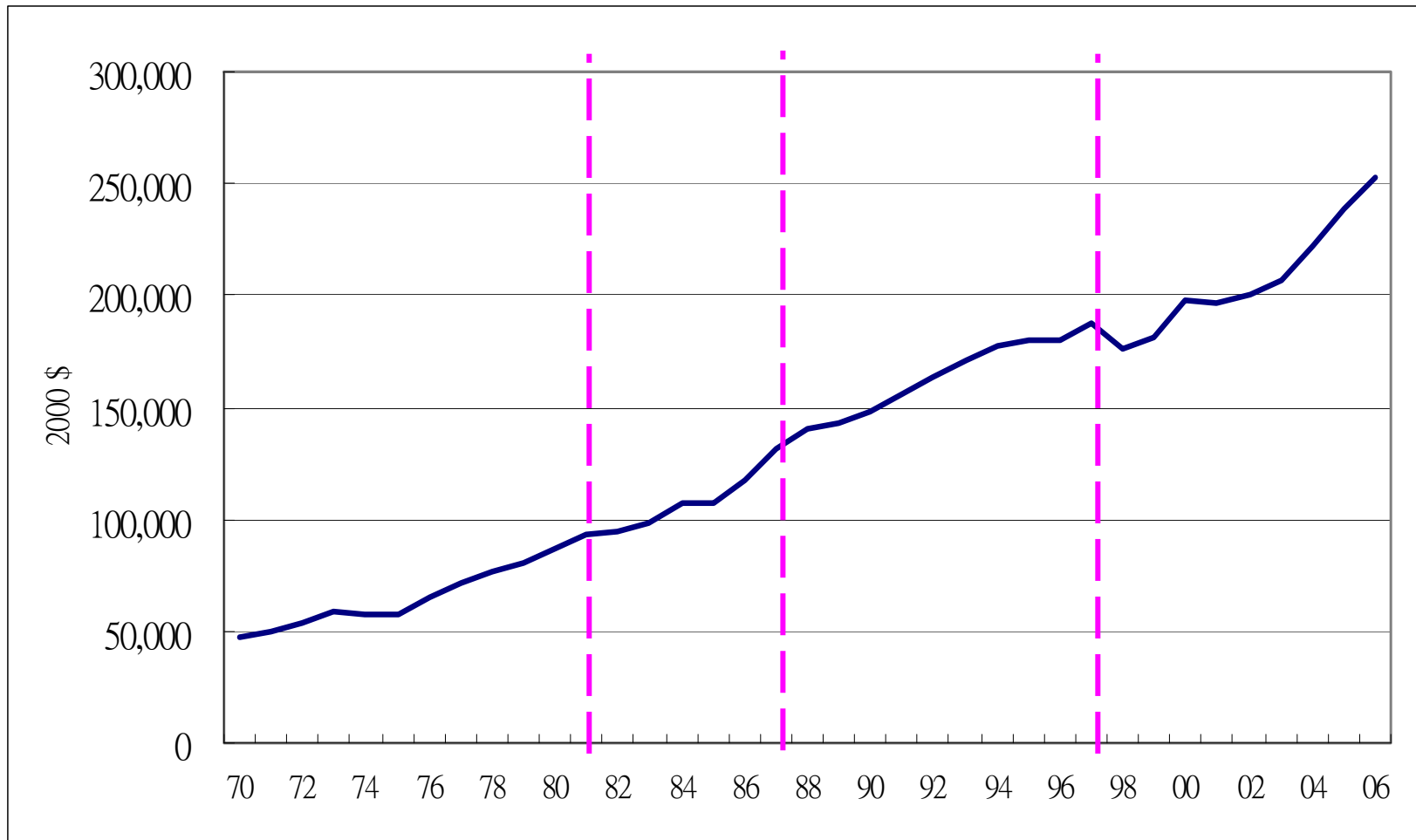


Figure 4 GDP Deflator and CPI in Hong Kong (1970-2006)

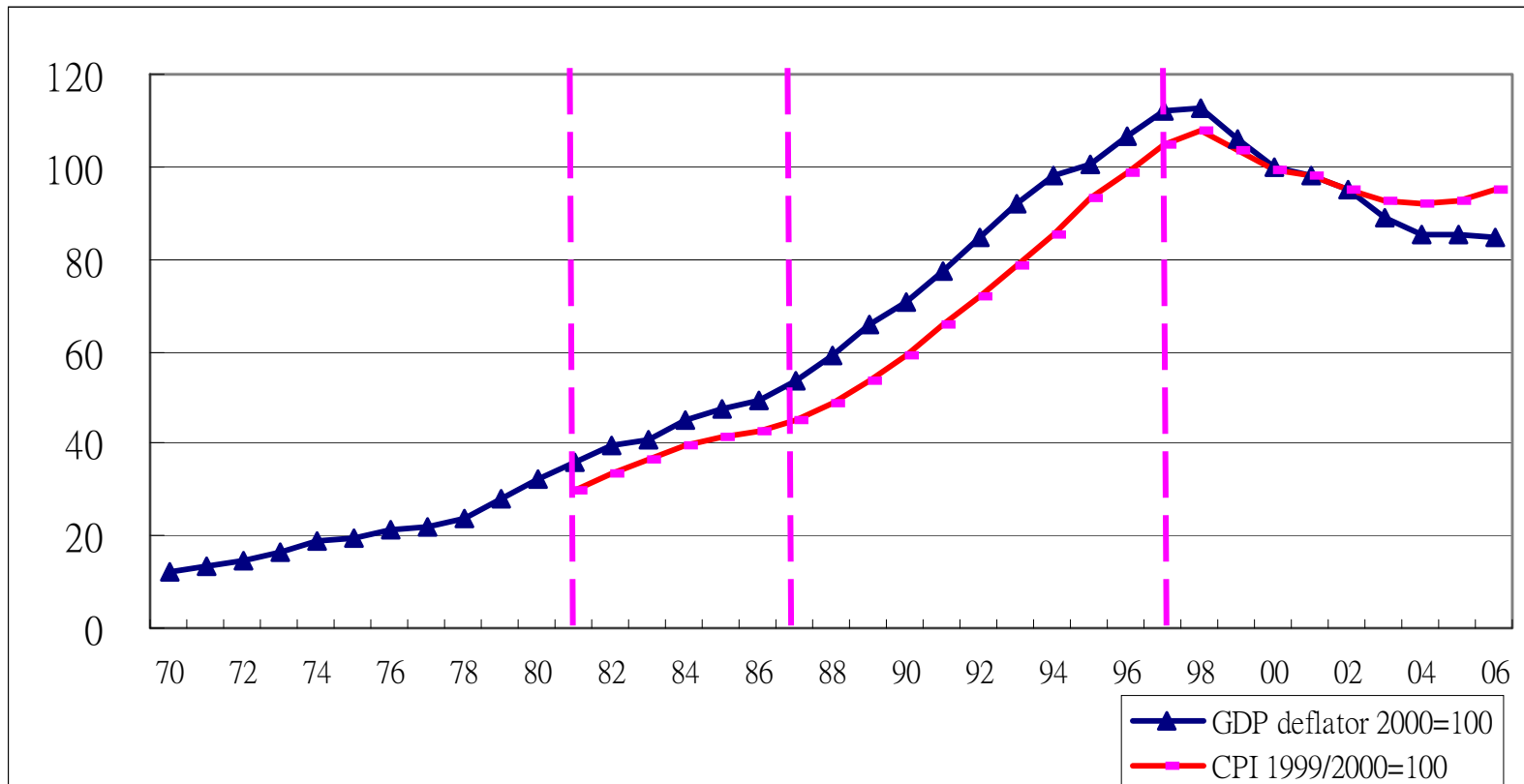


Figure 5 Unemployment and Underemployment Rates in Hong Kong (1970-2006)

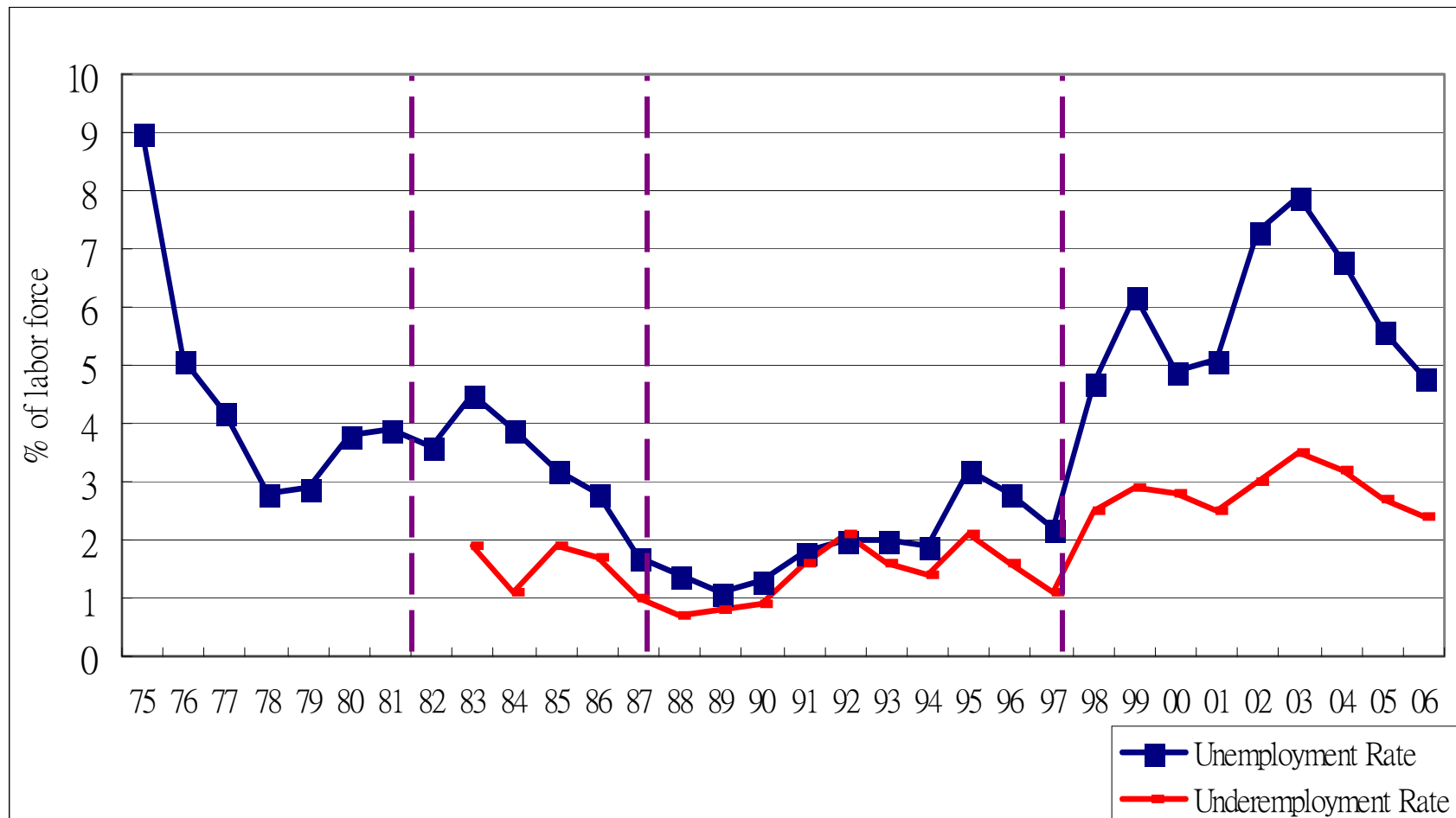


Figure 6 Domestic exports, Re-exports & Services Exports in Hong Kong (1961-1980)

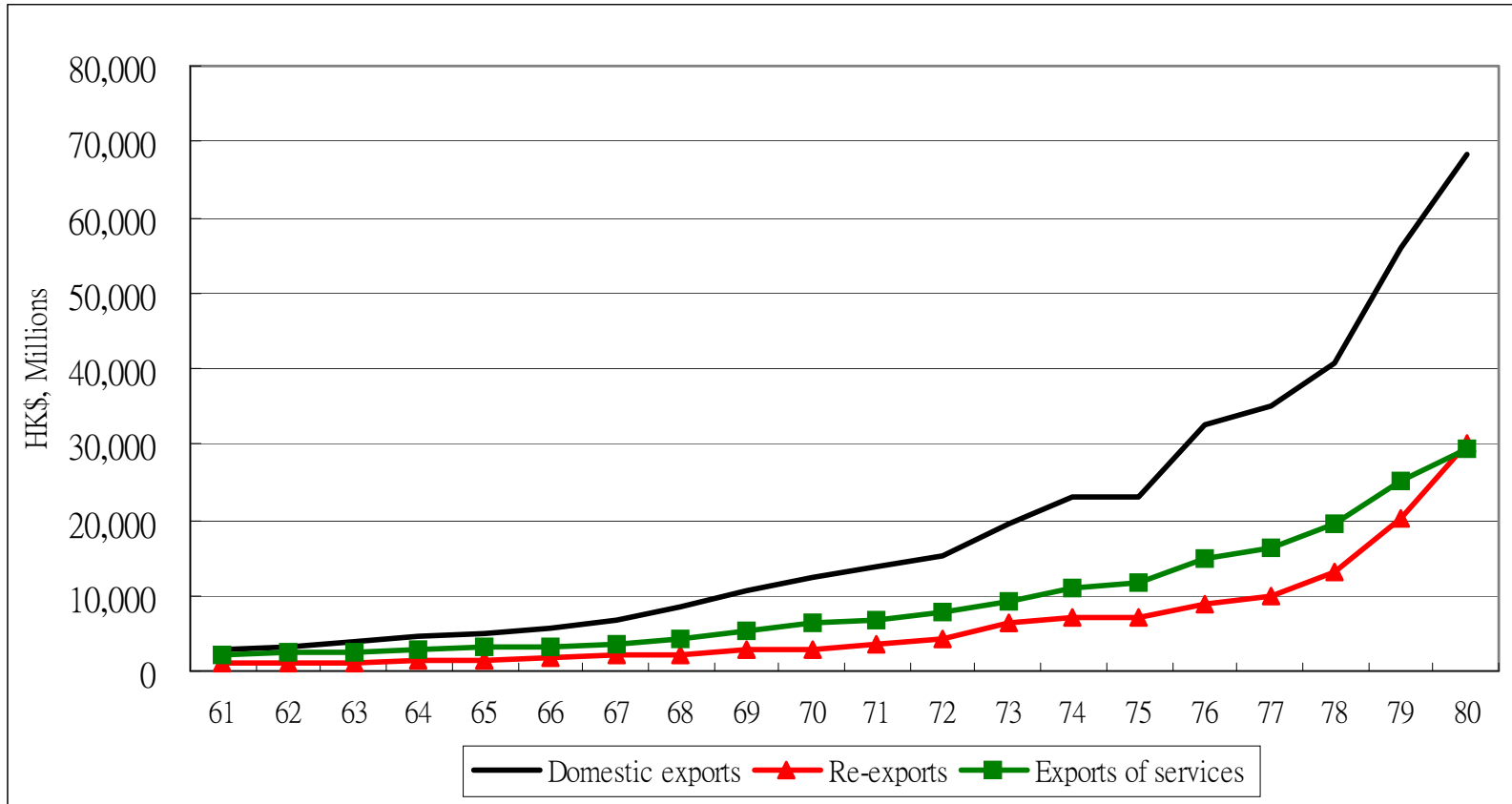
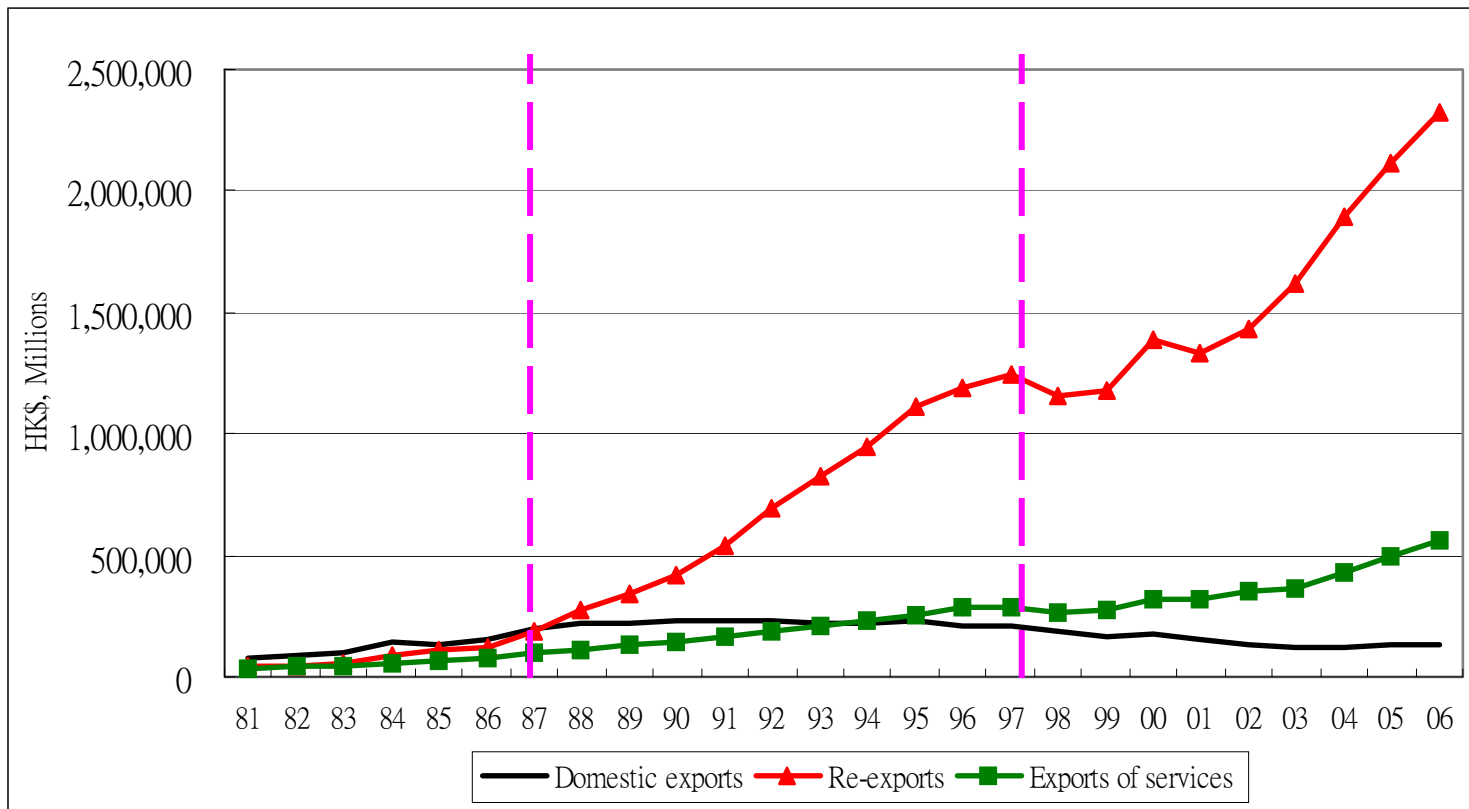
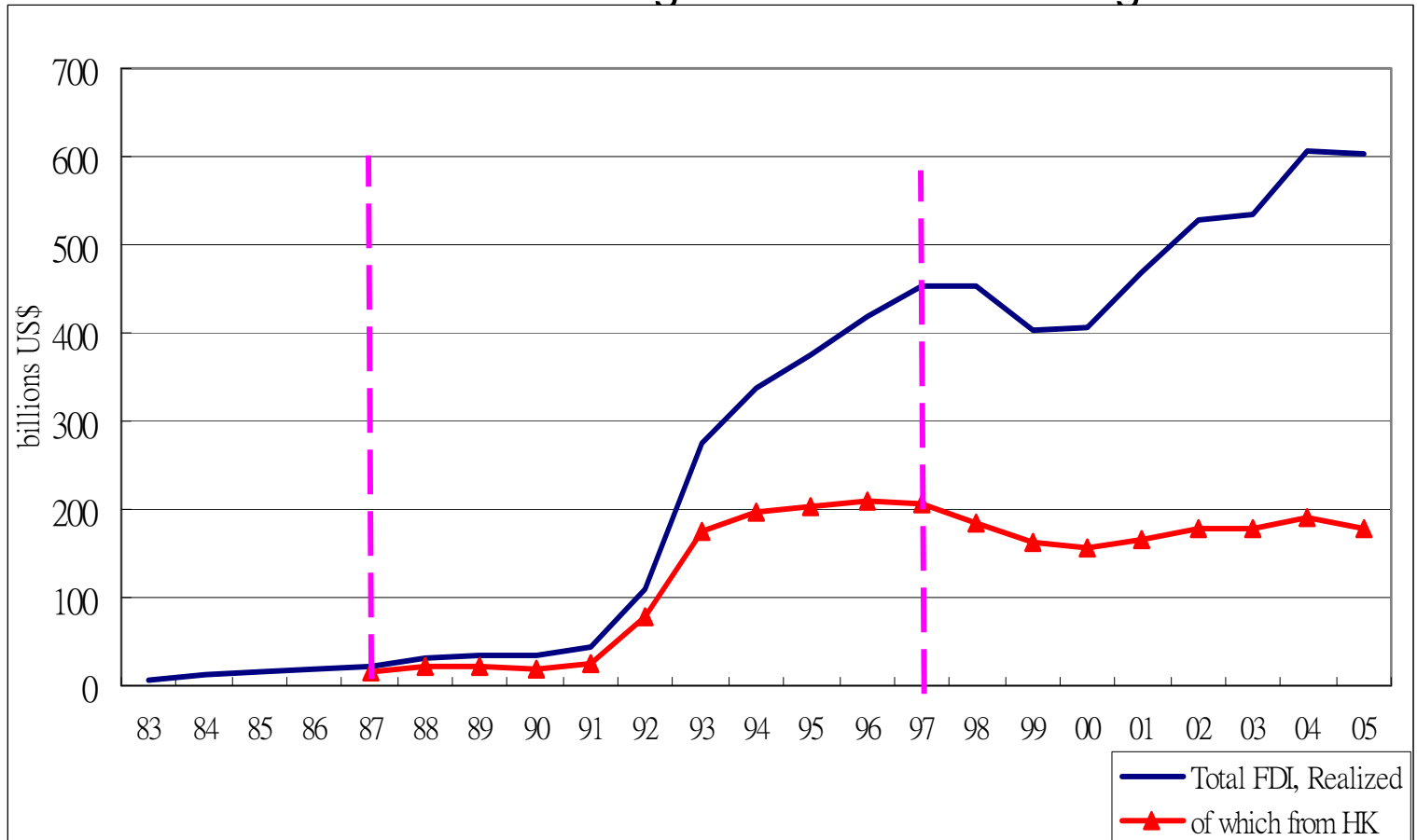


Figure 7 Domestic exports, Re-exports & Services Exports of Hong Kong (1981-2006)



**Figure 8 China's Realized FDI Inflows (1983-2005):
HK's Manufacturing Outward Processing/Relocations**



III. The Rise of a Service-Dominated Economy

HK: Service-dominated core city of GDE, most globally accessible city

HK-PRD: GDE (Globalized Delta Economy) in south China

Figure 8 China's Realized FDI Inflows (1983-2005): HK's Manufacturing Outward Processing/Relocations

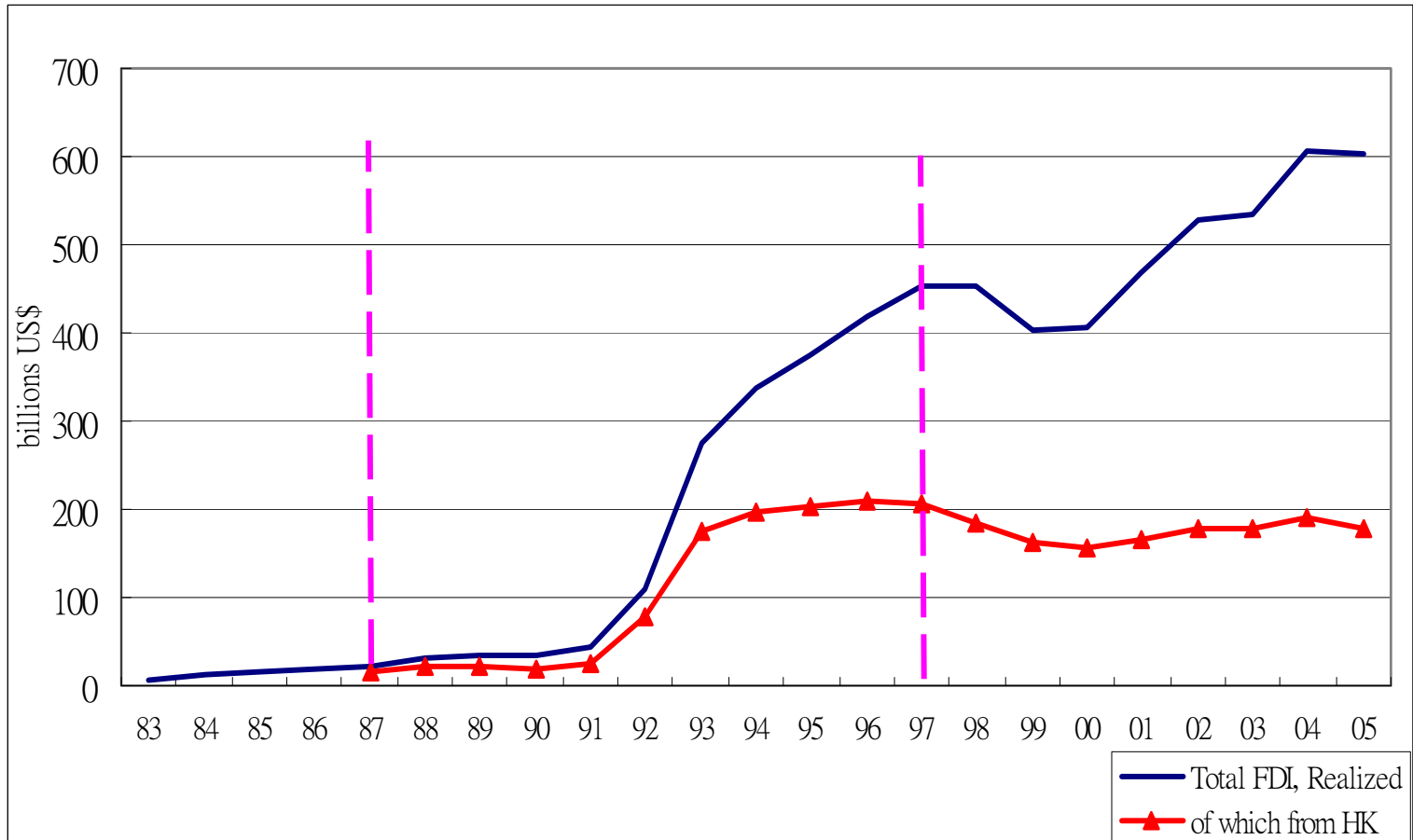


Figure 9 Manufacturing Employment and Share in GDP (1980-2005)

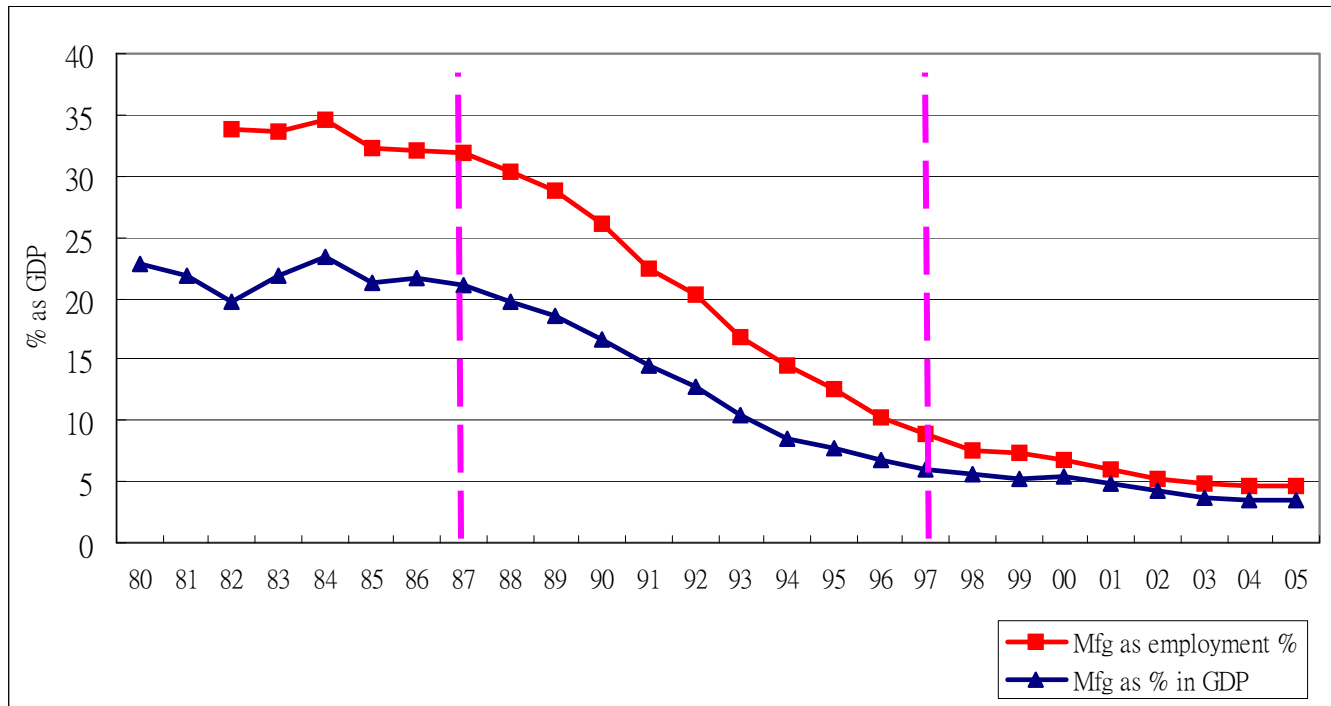


Figure 8 China's Realized FDI Inflows (1983-2005): HK's Manufacturing Outward Processing/Relocations

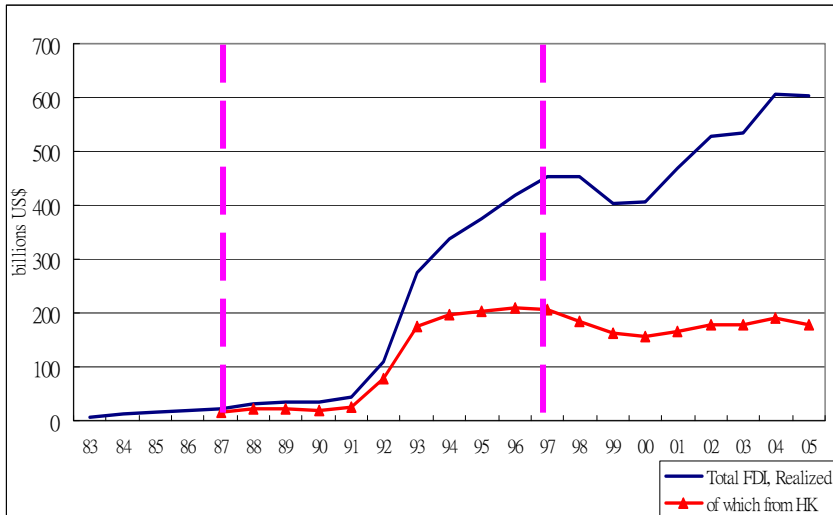
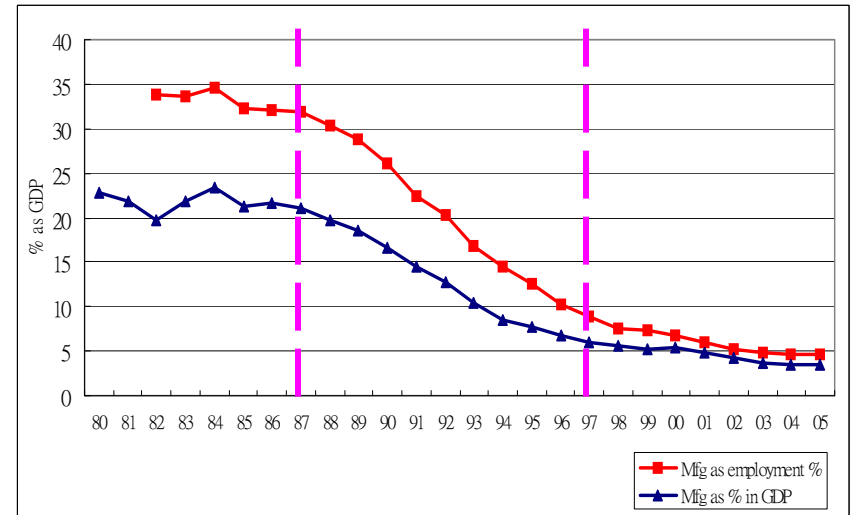


Figure 9 Manufacturing Employment and Share in GDP (1980-2005)



- **Banking/Finance:** Integration of banking, insurance, management of mutual funds, and financial derivatives
- **“Logistics” Services:** Import/export trade, transportation, storage, and supporting services to integrate as “logistic” industry
- **Tourism:** Tourism/regional tourism and international exhibition center
- **FDI:** Center for regional MNCs headquarters

1980: 192	1994: 714
1997: 924	1999: 840
2004: 1098	2006: 1228

Table 3 Hong Kong's Industrial Structure (% of GDP)

Industry	1981		1987		1997		2006	
	A	B	A	B	A	B	A*	B
Manufacturing	21.8		21.1	31.8	6.0	8.9	3.4	5.1
Import/Export	8.7		13.0		16.1		21.9	16.4
Fin/Insurance	7.1		6.7		9.8		12.3	5.3**
Transportation	6.7		7.9		8.1		9.8	9.4#
Bus. Services (exc. Real estate)	2.2		3.0		4.2		4.6	
Wholesale/Retail	5.0		4.8		3.5		3.4	10.5

A: % of GDP; * 2005 figure; # include storage; ** financial services; B: % of employment

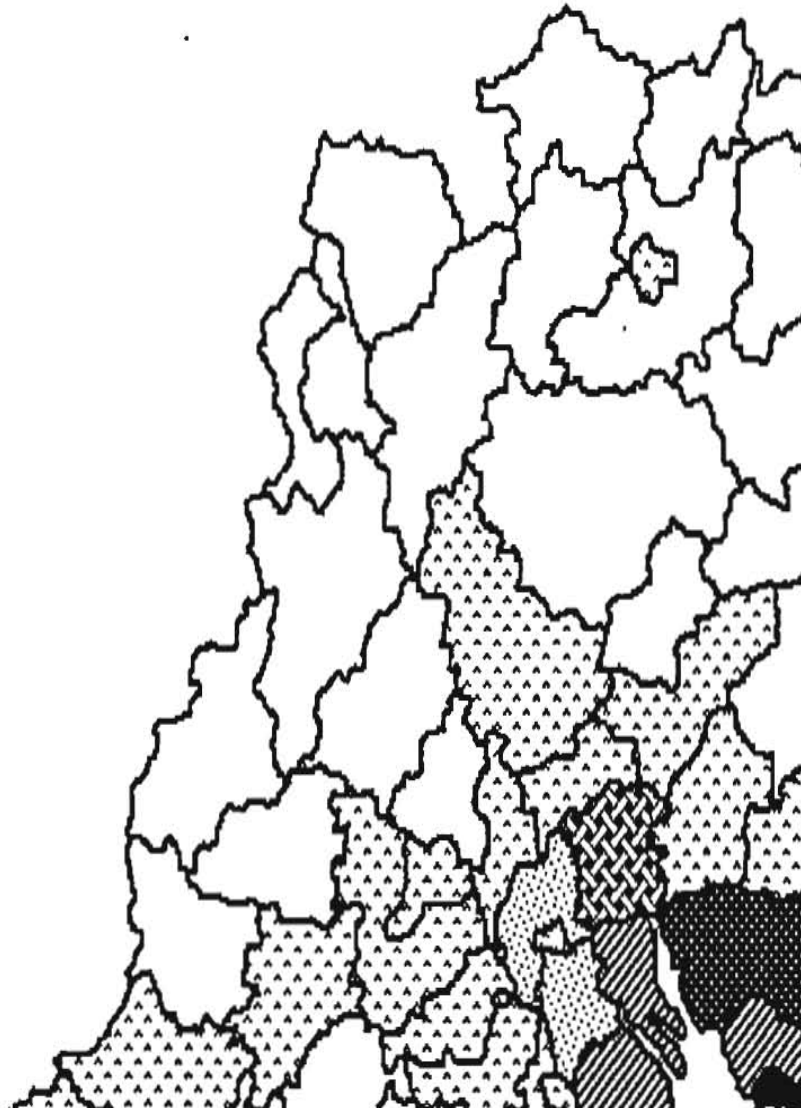
Source: compiled by the authors

Agglomerative implications of HK-PRD:

HK-PRD Three-tier Agglomerative economy:

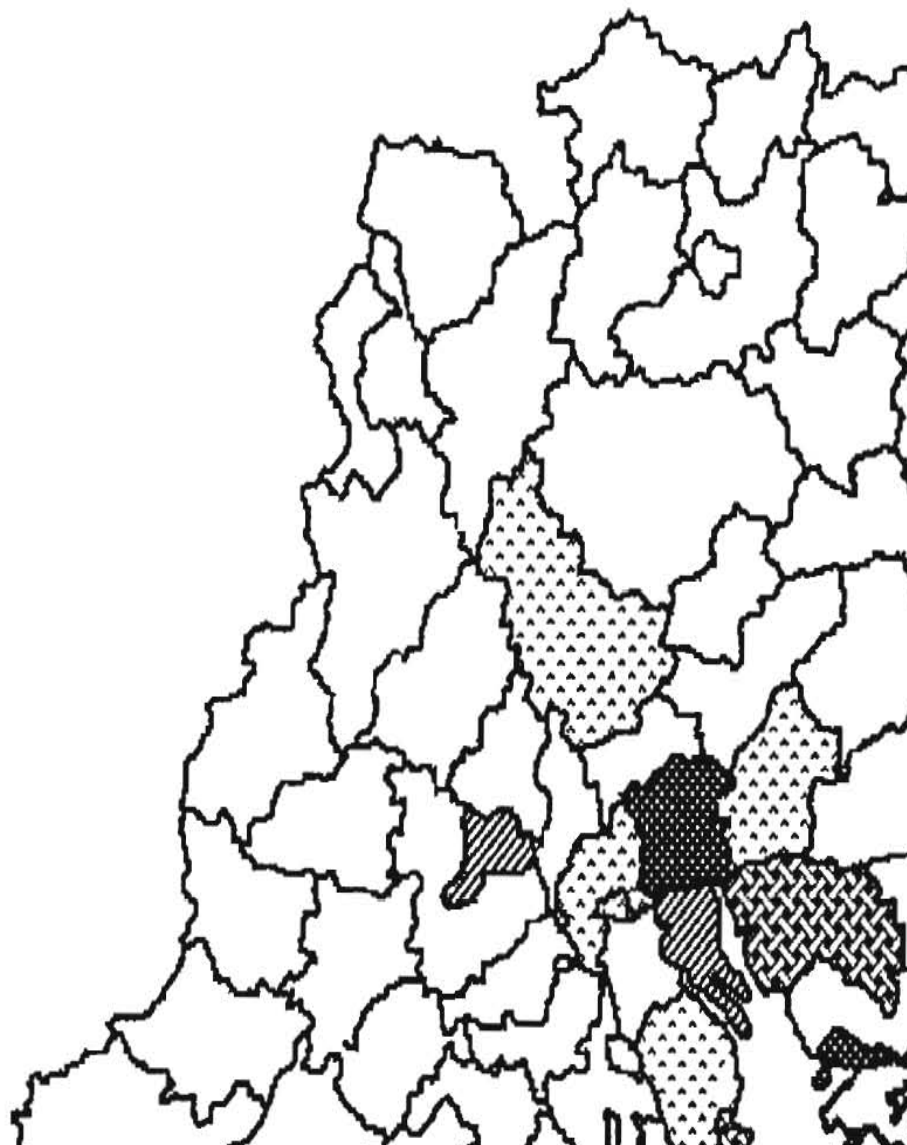
- (1) Agglomeration of CPS (HK-PRD): CPS agglomeration economies
- (2) The city as agglomeration: inter-industry agglomeration economies
- (3) Intra-city agglomeration: agglomeration economies among groups of firms (micro-level)

Fig. 10a



Source: C.Tuan, L.F.Y.Ng / FDI facilitated by agglomeration economies: evidence from manufacturing and services joint ventures in China, *Journal of Asian Economics*, 13 (2003) 749-765

Fig. 10b



Source: C.Tuan, L.F.Y.Ng / FDI facilitated by agglomeration economies: evidence from manufacturing and services joint ventures in China, *Journal of Asian Economics*, 13 (2003) 749-765

**IV. Beyond the Asian Crisis:
Economic Integration with
Pan-PRD:
Regional Metropolis II (1997-)**

In 1997: Asian Crisis & Return of Sovereignty to China

(1) External shocks

- 1997-Asian Financial Crisis
- (2003-SARS)

(2) Macroeconomic adjustments

- burst of economic bubble, high employment (~8%), underemployment (~3.5%)
- deflation
- deepening of services: low productivity increase and biased opportunities toward high-end services employment
- cooperation of two economies: market-oriented and planned economy
- further economic restructuring: industry & trade

Problems with economic growth and employment creation in a service-based economy

(3) Favorable China Policies and Measures to aid HK

- Pan-PRD Cooperation (2003)
- Closer Economic Partnership Arrangement
CEPA I-VI (2003-2009)
- Individual Travel Scheme (2003)
- RMB handling by local HK banks
- FDI flows: QDII/QFII (2007)

Economic Integration with Pan-PRD: The Pan-PRD Common Market

HK-PRD to HK-Pan-PRD (9+1):

HK: Core city (gravity center)

Pan-PRD: 9 Provinces (in South/Southwest China: Guangdong, Guangxi, Fujian, Hainan, Guizhou, Yunnan, Sichuan, Hunan, and Jiangxi)

Figure 10 A Map of China: Location of Pan-PRD Provinces



HK-Pan-PRD:

1. Effective regional links: free trade area
2. Costs reduction: removal of investment and trade barriers; transaction costs reduction
3. Complementarity of members' comparative advantages

HK/Macau:

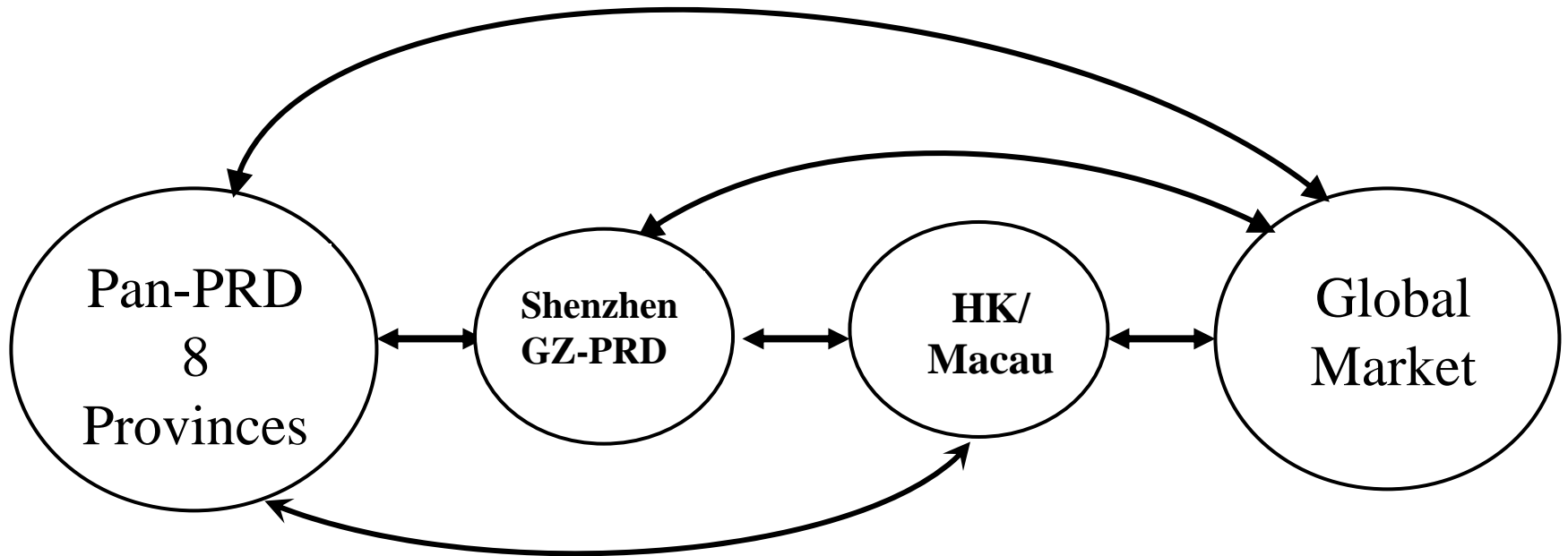
- center for international trade and financial/business networkings
- major source of FDI

HK's Role in Pan-PRD

- Center Core of an Effective Regional Link: as the core city of an efficient common market shared by HK-PRD-Pan-PRD
- Global Accessibility: as the most globally accessible core city; sustained increase in international competitiveness
- Gravity Core of CPS: building linkages between HK metropolis-PRD-GD-Pan-PRD and the global world

A brief sketch (Fig. 11)

Figure 11 A Sketch of the Role of Hong Kong-Metropolis-PRD and Pan-PRD Common Market



10 Years before and after Handover in 1997

	1987	1997	2005	2006
Population (million)	5.58	6.49	6.81	6.86
Labor Force Part. Rate	48.9%	49.8%	52.0%	52.8%
Unemployment Rate	1.7%	2.2%	5.3%	4.4%
Per Capita Real GDP Annual Growth Rate	-	5.99% (87-97)	-	3.49% (97-06)
Per Capita Real GDP (HK\$) (2000 price)	131,372	187,381	238,284	252,917
GDP (HK\$ Billion) (2000 price)	733.1	1216.1	1623.5	1734.3
Commodity Trade (HK\$Bil)	756.0	3071.0	4367.2	5060.8
Service Trade (HK\$Bil)	155.4	485.3	760.0	846.2

V. Beyond the 1997-Crisis: HK-International Competitiveness

(1) **HK International Competitiveness:**

Pyramid of International City Competitiveness (PCC) (Tuan & Ng, 2002c)

- Adopted and modified from **WEF & IMD (1999)**
- **Three Dimensions** (6 components/14 factors/32 items)

Dimension A: Base for sustainable economic growth

Dimension B: Investment environment

Dimension C: Image of globalization (1 components)

Opinion Surveys (2001-2007):

7 consecutive opinion surveys of MNCs in HK and Shanghai; a total of 1240+ CEOs/senior managers surveyed; structuralized questionnaire with 32 items on a 5-point scale (1=worst to 5=best)

HK's gain in international Competitiveness (2001-2007):

Dimension (A-C): 3.75 to 4.19 (+0.44; +11.73%)

Production Base (A):

3.59 to 4.12 (+0.53; +14.76%)***

Investment Environment (B):

3.82 to 4.28 (+0.46; +12.04%)**

Global Image (C): 4.14 to 4.49 (+0.35; +8.45%)*

Table 4

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'.

(2) Mobilization of International Investments

Total FDI inflows to HK: HK\$464.3 bil (2008)

Total FDI outflows from HK: HK\$393.9 bil (2008)

China remains the predominant partner:

China accounts for 36.5% of HK's DI; Guangdong is the most popular province (30.4% in 2008) (stock)

FDI inflows from China: 38.7% (HK\$179.7 bil) in 2008

FDI outflows to China: 54.6% (HK\$215.2 bil) in 2008

Evidence from MNCs Survey (HKSAR, 2008):

Sample: 6612 USA, Japan, UK, China firms

10 top factors why choosing HK as a base: (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.

In enhancing mobilization of DI/competitiveness:

1. Unique business environment; free market
2. China hinterland
3. Effective government

VI. Beyond the 2008-Crisis: HK-Metropolis as an International Financial Center

Adverse effects and rapid recovery:

- Real GDP: -2.6% (Q4/2008);
-7.8%, -3.6%, -2.4% (Q1-3/2009)
- Exports (goods): -4.9% (Q4/2008);
-22.7%, -12.4%, -13.2% (Q1-3/2009)
- Exports (services): +0.4% (Q4/2008);
-6.3%, -5.2%, -0.9% (Q1-3/2009)
- Unemployment: 3.8% (9-11/2008);
4.1 (10-12/2008); 5.4 (4-6/2009); 4.9%
(12/2009)
- CPI: rather stable; -2.6% (Q4/2008)

HK and China's 8.9% GDP growth (2009):

- **Tourism services:** account for 18% of service exports; '+' growth
- **Capital inflows:** HK\$147Bil or 33.8% of GDP in Q4/2008; HK\$109Bil or 25.3% of GDP in Q3/2009
- **Exports (commodity):** expected to +5% in 2010 as stimulated by China's growth
- **Business Environment:** continuously improving bilateral trade environment, CEPA, ASEAN+1, etc.
- **Financial market:** China's gradual opening financial/services market (CEPA V-VI 2008-9)

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

	GDP					C*	G*	
Year	GDP*	GDP Deflator*		Per-capita GDP*				
	%Δ	2007=100	%Δ	HK\$	%Δ	%Δ	%Δ	
2006	7.0	97.2	-0.3	221455	6.3	5.9	0.3	
2007 ^r	6.4	100.0	2.9	233245	5.3	8.5	3.0	
2008 ^r	2.4	101.4	1.4	236989	1.6	1.5	1.7	
Year/Quarter								
2008Q3	1.5	101.7	2.0	n.a.	n.a.	-0.2	1.6	
2008Q4	-2.6	102.5	-0.2	n.a.	n.a.	-4.1	1.8	
2009Q1	-7.8	100.8	0.4	n.a.	n.a.	-6.0	1.4	
2009Q2	-3.6	102.0	1.1	n.a.	n.a.	-1.1	1.7	
2009Q3	-2.4	102.2	0.4	n.a.	n.a.	0.2	3.3	

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

	Private Investment		Exports		BOP Account	
Year	I*	Inventory Change*	Goods*	Services*		
	%Δ	HK\$mil	%Δ	%Δ	HK\$mil	% to GDP
2006	7.1	-1429	9.3	10.1	46735	3.2
2007 ^r	3.4	12841	7.0	14.1	114498	7.1
2008 ^r	-0.5	9573	1.9	5.7	263869	15.7
Year/Quarter						
2008Q 3 ^r	2.9	2892	1.3	4.8	51259	11.9
2008Q 4 ^r	-17.8	4494	-4.9	0.4	147317	33.8
2009Q 1 ^r	-13.7	-4426	-22.7	-6.3	68900	18.2
2009Q 2 ^r	-13.6	-2286	-12.4	-5.2	143096	36.6
2009Q 3 ^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	%Δ			
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
2009/1	110.0	3.2	2008/11-2009/1	4.6	2.1
2009/3	109.5	1.2	2009/1-3	5.2	2.1
2009/5	109.3	0.0	2009/3-5	5.3	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

HK's role as China's most internationalized core city:

- **Gateway to China**
- **China's most globalized and globally accessible core city:** dominated-service-regional metropolis
- **China's top international financial center:** regional center of syndicate loans; in mobilization of China's inward/outward DI with the global world
- **RMB offshore center:** HK as a testing ground for the internalization & convertibility of RMB

A recent delegation (Feb 2010):

- HK banks to conduct more RMB businesses for corporate clients
- Local firms to issue RMB corporate bonds, to apply for bank loans/credit lines in RMB
- Trade settlements in RMB not only by trading firms

VI. Further Challenges

1. Development of infrastructural supports in transportation, environment protection, health care, social welfare, and education under the spirit of a “One-Country Two-System” economy with better economic linkages and cooperation between the two regions (HK and PRD)
2. Active participation and utilization of China’s Five Year Planning in the PRD/Pan-PRD regional economy; reduction of transaction costs generated by the “Two Systems”
3. Problems of macroeconomic restructuring and employment creation in a service-dominated economy; balancing growth and environmental preservations

4. Problems with income distribution and equity in a service-dominated economy
 - medicare, social welfare, min wage/max work hrs
 - middle-class's expectations and frustrations
5. Rising expectations on the performance of HK government and quality of the civil servants
6. Keen demand for improving business environment for business operations, such as market competition policies, SMEs and industrial policies
7. Balancing political demand and economic goals
 - rise of non-government organizations, e.g., Green Peace, Anti-WTO, human rights organizations
 - quest of colonial administrative-led tradition and demand for check-and-balance between administration and legislation; tradeoff between socio-political and economic goals

How to better utilize HK's unique role?

- Gateway to China
- China's most internationalized, globally accessible city
- China's top international financial center

Unique formula by exploiting its comparative advantages?

- Business friendly investment environment
- Industrious quality labor force/human capital
- Pragmatic mentality/vital entrepreneurs