

The Asymmetric Economic Integration between Hong Kong and Mainland China

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(1) Asymmetric economic structure

Mainland China: Socialist Market Economy

(Share of world output (non-PPP adjusted): > 5.0%; no.4, after US, Japan and Germany)

Per capita GDP: US\$2,500

Average growth rate: ~9%

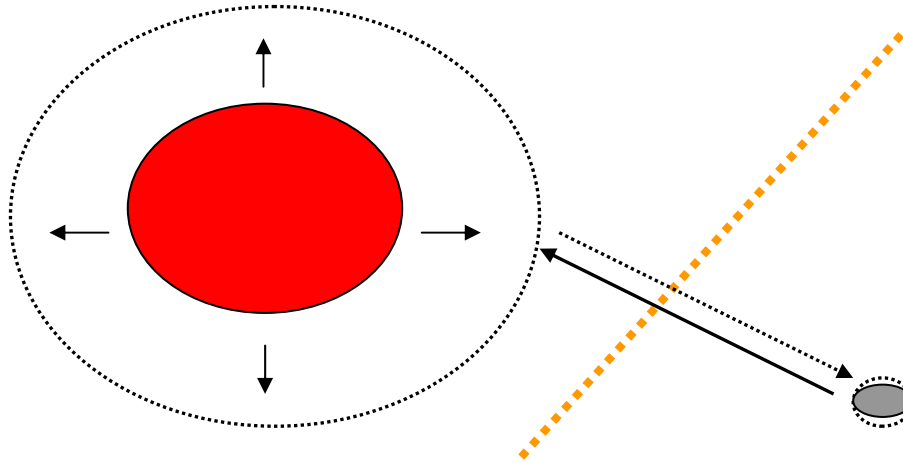
Population: 1.3 billion

Industrial upgrading

Large open economy

Financial and service bottlenecks

One Country, Two Systems
Political, economic and social boundaries



Increasingly permeable

Two-way resource flows

Net inflow/outflow
of high quality resources?

Hong Kong SAR
Freest Capitalist Economy
(Share of world output: >0.4%)

Per capita GDP: US\$29,000

Average growth rate: ~4%

Population: 7 million

Switzerland of Asia ?

Spain of Asia? Or something in between

Hollowing out? Marginalised?

(2) A brief chronology of HK's economic development

- 1950s-60s HK embarked on **export-oriented industrialisation** making low-end consumer products sold to the U.S. and Europe.
- 1970s Facing rising costs and challenges by other Asian competitors, the HK government set up the Committee on Industrial Diversification.
- 1979 China began its economic reforms and open policies, and HK's external economic environment saw a sea change.

(2) A brief chronology of HK's economic development

1980s

Structural transformation in HK's economy; massive relocation of manufacturing industries to south China; re-exports exceeding domestic exports again.

1990s

The de-industrialization and “Manhattanization” of HK. Transitional politics towards 1997 leading to “short-termism” in all parties. Financial and property bubbles.

1997-99

“One country, Two Systems”: **“The river water shall not intrude into the well water.”** The pre-1997 bubbles burst and deflation unfolded.

(2) A brief chronology of HK's economic development

2001-2003 SARS epidemics broke out.

2003 - Present **Mainland China coming to help**: Closer Economic Partnership Arrangement (CEPA), the “Individual Visit Scheme”, “Pan Pearl River Delta (PPRD) Regional Cooperation Framework Agreement” (the so-called “9+2 Agreement”). Amidst HK's internal political anomie, inter-city competition (with the Mainland counterparts) is on the rise.

Prospects “Resource flow” view versus “Local advantage” view: **Optimised “dual economy”**: with a “high value added, low employment” first sector and a “low value added, high employment” second sector to cater for a **polarising** society?

(2) A brief chronology of HK's economic development

Hong Kong's Economic Growth and Inflation

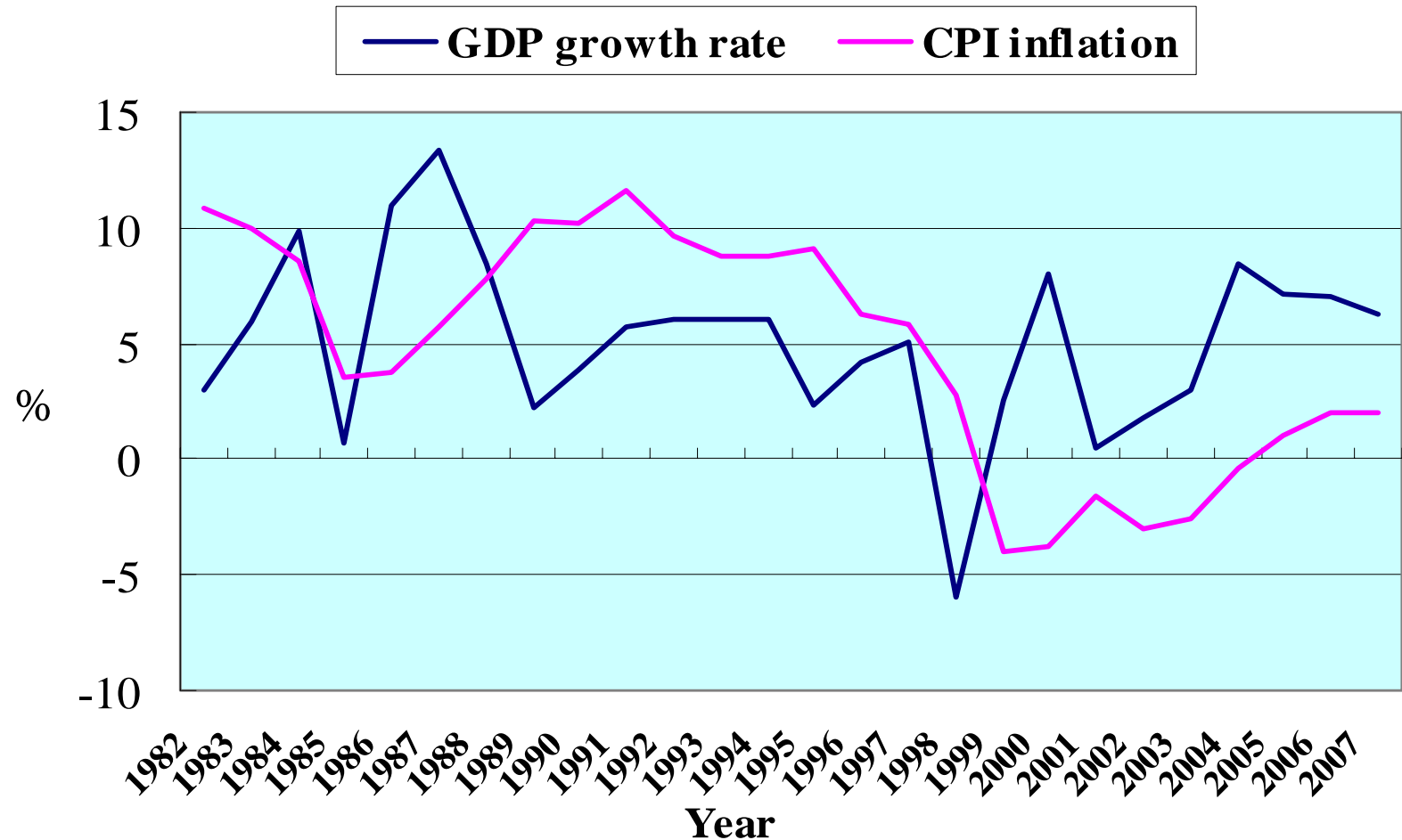


Table 1 : Hong Kong's GDP by Economic Activity (%)

Table 1: Hong Kong's GDP by Economic Activity at Current Prices (%)

Unit: %

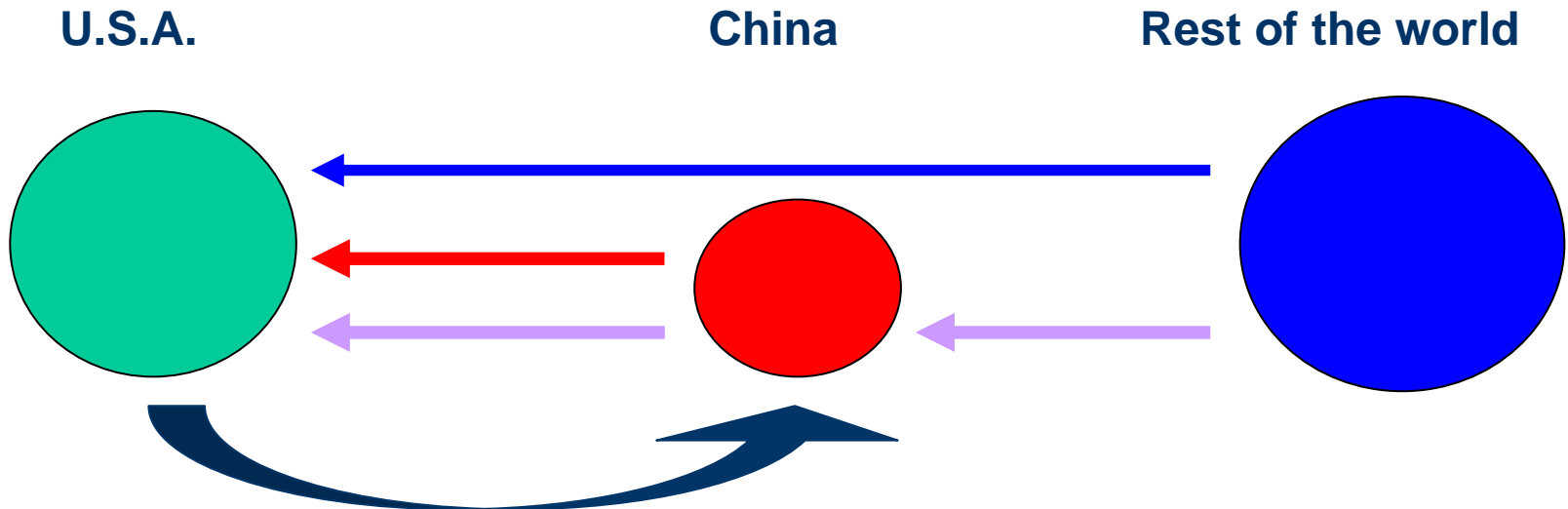
	1980	1990	2000	2006
Agriculture and fishing	0.8	0.2	0.1	0.1
Mining and quarrying	0.2	0.0	0.0	0.0
Manufacturing	22.8	16.7	5.4	3.2
Electricity, gas and water	1.5	2.4	2.9	2.8
Construction	6.5	5.2	4.9	2.7
Services	68.3	75.4	86.6	91.2
Wholesale, retail and import/export trades, restaurants and hotels	19.4	23.7	24.6	27.9
Transport, storage and communications	6.9	9.00	9.5	9.6
Financing, insurance, real estate and business services	21.7	18.9	21.4	25.0
Community, social and personal services	11.9	14.1	19.9	18.1
Ownership of premises	8.4	9.7	11.3	10.6
Total	100.0	100.0	100.0	100.0

Source: Census and Statistics Department, HKSAR Government

Note: The total is GDP at factor cost.

(3) China's reorientation and implications for HK

China as the manufacturing hub of the world



China needs to rethink about its development strategy and open policies, which have been based significantly on “outward processing”. They have given rise to increasing international trade frictions and pressures. There is a lack of significant improvement in domestic productive efficiency despite persistently high growth.

(3) China's reorientation and implications for HK

As an example particularly relevant to HK, Guangdong, the other core economy of PPRD, has been facing its own developmental problems of upgrading after more than 20 years of low-value-added and processing-driven growth and increasing competition from other regions in the country. Its rising costs and tightening resource constraints, like the energy shortage (in electricity and gasoline) and the drying up of the supply of cheap labour in the recent periods, are a testimony of the dilemma the province is confronted with. **Despite past linkages, Hong Kong as a service economy is not in much of a position to offer assistance to the development of high-tech industries and industrial upgrading in Guangdong. What it can offer are mainly “soft goods and services”.** Hence, there could be a lack of common interests further down the historical trajectory.

(3) China's reorientation and implications for HK

In Guangdong's Eleventh Five-Year Plan released in late 2005, the provincial authorities stressed the need to “adjust and optimise the economic structure” and to “comprehensively enhance the quality of industries”. It actually highlighted a number of key industries for promotion:

1. emphasising the need of strengthening the two **“pillar industries”** of electronic IT and petrol-chemical;
2. speeding up the development of the two **“leading sectors”** of automobile and equipment manufacturing;
3. actively nurturing the three **“strategic industries”** of bio-engineering, new materials, and new energy generation;
4. **reforming and enhancing the three “traditional sectors” of textile and garments, food and beverage, and construction materials;**
5. and quickening up the development of Chinese medical treatment and pharmaceuticals.

(3) China's reorientation and implications for HK

It is apparent that **most of Hong Kong's manufacturing industries relocated to the PRD belonged to the "traditional sectors"**, which were supposed to be reformed and enhanced. They did not qualify as "pillar", "leading", or "strategic". Moreover, most of the 60,000 plus factories set up by Hong Kong businessmen in the PRD, unlike many of the Taiwanese, Japanese and other foreign plants, were small and medium in size, with diversified locations and showing a lack of economies of scale. In the increasingly land-scarce province, this caused problems of consolidation, before genuine reform and enhancement could be implemented. The structural incongruence between the developmental directions of the two potential "dragon heads" of the PPRD might spell troubles for coordination in the future.

(4) Integration, coordination or competition?

Could the PPRD deteriorate into a talk show, because of a lack of persistence and implementation under a top-down approach given the diversities of the constituting members? Signs are that the authorities are trying a lot to avoid that prospect; but the outcome is far from certain.

A revealing speech was given by Donald Tsang, the CE of the Hong Kong SAR (who replaced Tung Chee Hwa) in the Second PPRD Economic Cooperation and Development Forum in Chengdu on 25 July 2005, in which he stressed the need of avoiding **“unnecessary competition” in infrastructure investments within the region**. That such a plea should have been made was in itself significant, and may point to the problems of designing such a regional economic bloc from day one.

(4) Integration, coordination or competition?

A sobering experience relating to this crucial point is Hong Kong's role as the logistics center of PPRD. **Hong Kong has been the number one container port in the world** since 1992, only once overtaken by Singapore in 1998. It regained the supremacy immediately in 1999. With CEPA and the "9+2" Framework Agreement, one would have thought that its position as the busiest port would be further enhanced. Unfortunately, that did not turn out to be the case.

For the year of 2005 as a whole, Hong Kong's container throughput rose merely 2% to 22.42 million TEUs, while **Singapore's** jumped 8.7% to 23.19 million TEUs, hence ***demoting* Hong Kong to the number two position in the world**. Hong Kong's growth rate of 2% was 5.5% lower than the 7.5% registered in 2004. Meanwhile, Shanghai and Shenzhen were catching up really fast. **The situation got worse for Hong Kong in 2006.**

(4) Integration, coordination or competition?

As number two in the world, Hong Kong is now under tremendous **competitive pressure from Shanghai and Shenzhen**, the third and fourth busiest container ports. Their businesses have been increasing at much higher rates than Hong Kong's. Many analysts are predicting that **Hong Kong, and indeed Singapore, would be challenged by the Shanghai and Shenzhen in the rather near future. Indeed Shanghai overtook Hong Kong in 2007.**

This phenomenon reflects on the one hand **the high operation costs of Hong Kong's container port.** Including land transport costs and port handling charges. A shipper had to pay about US\$250-300 more for a TEU of goods even after CEPA, compared with using Shenzhen.

(4) Integration, coordination or competition?

Container Throughput League

Port/Year	TEUs (millions)	Relative Ratio (%)	Relative Ratio (%)
	2003		
Singapore	1841.05	100.00	
Hong Kong	2044.90	111.07	100.00
Shanghai	1128.17	61.28	55.17
Shenzhen	1061.45	57.65	51.91
	2004		
Singapore	2,132.91	100.00	
Hong Kong	2,198.40	103.07	100.00
Shanghai	1,455.72	68.25	66.22
Shenzhen	1,361.52	63.83	61.93
	2005		
Singapore	2,319.22	100.00	
Hong Kong	2,260.20	97.46	100.00
Shanghai	1,808.40	77.97	80.01
Shenzhen	1,619.70	69.84	71.66
	2006		
Singapore	2,479.24	100.00	
Hong Kong	2,353.90	94.94	100.00
Shanghai	2,171.00	87.57	92.23
Shenzhen	1,846.89	74.49	78.46
	2007		
Singapore	2793.54	100.00	
Hong Kong	2388.10	85.49	100.00
Shanghai	2615.00	93.61	109.50
Shenzhen	2109.91	75.53	88.35

(4) Integration, coordination or competition?

Hong Kong's remaining advantages lie in its efficiency, reliability and international connections (with global reach). However, the high cost is increasingly becoming a drag.

On the other hand, in terms of **investment in infrastructure**, conflicts of interests are also rising. Guangdong and Shenzhen are in a frantic process of building ports and transportation networks, often under heavy government intervention. However, the Hong Kong SAR Administration still prides itself as practicing the principle of “**big market, small government**”. This reflects what the author has called “**asymmetry in government behaviour**”.

Regarding HK as a financial centre for China, though, it seems to be another story, as shown in the following table on the increasing importance of Mainland-related companies listed in HK's stock market (from the HKEx).

(4) Integration, coordination or competition?

Mainland Enterprises (Main Board and GEM)

	End 2007	End 2005
No. of H shares	146	120
No. of Red chips Stocks	93	89
No. of NHMPE*	200	126
Market capitalisation (% of market total)	58.2%	39.0%
Turnover value (% of equity turnover)	70.9%	45.9%

NHMPE = Non-H Share Mainland Private Enterprises

http://www.hkex.com.hk/data/markstat/markhighlight_c.htm

(5) HK's demographic and quality worries

Hong Kong has one of the **lowest fertility** rates in the world and population growth is increasingly dependent on immigration, mostly from the Mainland. **Aging** will become a socioeconomic headache for decades.

In **2006**, the **crude birth rate** in HK was only **0.984%**, far below the replenishment rate of about 2.1%. According to the forecast of the Census and Statistics Department, HK's average annual population growth rate **in 2007-2036** would only be 0.7% (rising from 6.86 million to 8.57 million). The growth of 1.71 million would actually be the result of **a natural increase of only 0.49 million** (indicating 0.16 million more deaths than births) and **a net in-movement** (i.e. inflow less outflow) **of 1.22 million**. Most of the in-movement is likely to be from Mainland China.

(5) HK's demographic and quality worries

In 2006, the number of **persons aged 65 and above** represented 12% of the total population. The ratio is forecast to rise to 15% in 2016, 22% in 2026, and **26% in 2036**.

Unfortunately, average educational level of HK's populace remains lamentably low. In 1991, 57.1% of those persons aged 15 and above had received **education only up to form 3 level or below**. The ratio stood at 47.8% in 2001 and **44.4% in 2006**. This kind of educational standard is quite incompatible with the supposed attributes of Hong Kong as an international financial center and a global service hub. The other side of the coin is the subdued degree of R&D in Hong Kong. The ratio of its **R&D expenditure to GDP** was 0.43% in 1998, 0.47% in 2000 and **0.69% in 2003**, compared with the averages of 1.85% for EU25 and 2.24% for OECD countries in 2003.

(6) HK's capital supremacy

On the other hand, though, the SAR is extremely strong with regard to capital assets. According to the statistics on the “international investment position” (IIP) of member economies of the IMF, **HK is the largest net owner of foreign assets as a ratio of its GDP.**

Japan has long been the largest exporter of capital in the world; and in 2006, its net IIP asset was more than three times that of Hong Kong. Nonetheless, Hong Kong is a much smaller economy with only a 7-million population. Relative to GDP, **Hong Kong's ratio (281.5%) was nearly 700% of Japan's (42.4%)!**

(6) HK's capital supremacy

Net International Assets of Hong Kong, Singapore and Japan

(Units: million US dollars; %)

Year	Hong Kong		Singapore		Japan	
	Net IIP	Net IIP/ GDP (%)	Net IIP	Net IIP/ GDP (%)	Net IIP	Net IIP/ GDP (%)
2000	221850.00	131.3			1157940	26.5
2001	265221.00	159.2	60990.00	73.7	1360090	36.0
2002	343337.00	209.6	81748.00	90.0	1462160	35.7
2003	394159.00	247.8	98212.00	103.8	1613620	35.2
2004	424752.00	255.6	108902.00	98.0	1784480	37.3
2005	439360.00	246.3	116371.00	99.7	1531760	36.0
2006	533910.00	281.5	129246.00	94.4	1808170	42.4

Source: International Monetary Fund

(6) HK's capital supremacy

Other anecdotal evidence of the world-class status of Hong Kong's business sector abounds.

Hence, those with the greatest degrees of political influence in the SAR tend to behave more like international corporations of wide vision, albeit with a “patriotic” bend. Growing out of a “lily pond” like Hong Kong and now becoming “elephants”, they are inclined to devising their business strategies from a “regional” or “global” perspective. The coherence of the local economy is of secondary concern to them.

Who really cares about HK? Those who care may not have the power. Those who have power may not care.

(7) The future

How should HK cope with these **structural problems** and the intensifying process of **integration/competition** with Chinese cities?

Should HK aim at becoming the “**Switzerland** of Asia” ? Or the “**Spain** of Asia?” Or something in between?

Or would **hollowing out** and **marginalisation** for HK in a resurgent China be an inevitable fate? A crucial factor is whether HK can muster sufficient “**quality premium**” to stay afloat, like some of the small open economies in Europe--- Switzerland, Finland, Denmark, Ireland....among the big EU.

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