

The Hong Kong economy: Structural transformation or dissolution?

[Tsang Shu-ki](#)

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The most frequently read and heard terms concerning the Hong Kong economy in the post-1997 era are “structural transformation” and “re-positioning”. They reflect the tension of an economy caught in turbulence and the spreading anxiety that the economy is entering uncharted waters with no clear outlet. Vibrant growth or irreversible decline might be awaiting somewhere ahead.

I have discussed extensively the major internal and external causes of the unfolding flux (Tsang, 2003a; 2003b). Internally, adjustments appeared to be inevitable after the imbalances, exuberance and short-sightedness built up in the pre-1997 period. The East Asian financial crisis in 1997-98 served as no more than an ignition. Externally, it has been the sea change in the Chinese economy and its amazingly speedy rise. The magnetic effects have been felt all around the world. Hong Kong is just fortunate (or unfortunate) enough to be closest to the magnet.

Three-fold doldrums

My idiosyncratic reading of the Hong Kong economic predicament now centres around three core problems:

1. Forming a *viable cluster* within a wide and unfamiliar terrain like Mainland China is inherently difficult. The “economic integration” between the Mainland and the HKSAR is by nature *asymmetrical*: the former large, diversified, and galloping, and the latter small, struggling and hollowing out. It is no easy task at all to re-define Hong Kong’s role in such a dynamic but lopsided context.
2. In any case, Hong Kong is confronted with several deep-seated and long-term problems in its own demographic changes, the low quality of its human capital, and the shortage of local R&D and innovative efforts. Its traditional dependence

on “locational advantage” is backfiring and its “quality advantage” does not seem to be a very dependable guarantee for its competitive position given the rapid reform progress in the Mainland.

3. To add to the woes in the SAR as a competitive cluster, the lack of *committed agents of structural transformation* to nurture, develop and maintain new advantage has transpired. Many of the biggest home-grown corporations, already gaining world-class status, seem to be more interested in their own cross-border, regional or global business strategies than in the coherence of the Hong Kong economy, while most of the medium and small-sized manufacturing enterprises in the Pearl River Delta are officially assessed there to be technologically outmoded and environmentally polluting. Politically sensitive government officials, although aware about the onerous tasks they have to face in guiding the SAR, are turning less interested in shouldering difficult responsibilities.

The net result is that the Hong Kong economy is heading towards structural dissolution more than structural transformation on a clearly identifiable new trajectory. It is probably not the intention of anyone. The SAR looks like a neglected child who everyone says would take care of. But who actually cares?

The two views again

In essence, Hong Kong’s economic development strategy has been caught in a dilemma, with two contesting “schools” of thoughts. I have labelled them as the “local advantage” view (「本地優勢論」) and the “resource flow” view (「要素流動論」). The former was the core of ideas in the mind of Tung Chee Hwa when he became CE in 1997, with the tacit blessings of the Mainland authorities. The latter, nevertheless, came to the forefront since 2003, driven on by CEPA, “9+2”, schemes for individual visitors, etc. At the moment, the “resource flow” view, under the banner of “big market, small government” is the accepted wisdom adopted by the SAR government, led by Donald Tsang, who took over the helm from Tung Chee Hwa in 2005.

In a number of recent articles (Tsang, 2003a; 2004b; 2004c), I put forth critical perspectives about the one-sided “resource flow” view because of the rapidly emerging competition among Chinese city economies. If not cast in the proper context, it is short-sighted as it fails to address the crucial point that the enhancement of the freedom and efficiency in the flows of factors of production across two economies is a “two-edged sword”. As Krugman (1991) puts it in *Geography and Trade*, under the trend of globalisation, high-grade factors would only converge to cores or centers with economies of scale, industrial concentration, and large and substitutable labour pools.

Of course, if Hong Kong and the Mainland cities strengthen their exchanges of resources, the SAR’s implicit and explicit costs of being “caged” under the “one country, two systems” framework could be reduced. Hong Kong may also benefit from an enlargement of business opportunities, just as CEPA, “9+2 Framework Agreement” and measures like relaxing restraints on Mainland tourism to Hong Kong are intended to generate. These developments should be welcome; although so far the short-term effects seem at best mixed, as will be discussed below. Moreover, increasing resource flows can be done with relative ease, in the sense that it basically involves policy changes that aim at removing existing barriers and constraints, largely by Mainland China (as Hong Kong has very few of those regarding external economic relations).

On the other hand, upgrading technology, developing frontier industries, and promoting competitiveness are much more demanding tasks. Hence in the longer run, the lopsided dependence on Mainland-Hong Kong economic integration may again soften Hong Kong’s resolve to tackle the crux of the problem, i.e. Hong Kong’s lack of cutting edge in the new situation. The disappearance of the economic boundary could in theory result in either a net inflow or a net outflow of resources of different qualities: so it is “a blessing or a curse”, depending on how the challenges are handled. Without persistent efforts in maintaining local advantage, the consequence could be the SAR’s secular decline, as a net load of low-quality factors precipitates in it. The brightest would find much greener pasture in the north.

Hong Kong must therefore reinvent its own niche in the new dynamic

circumstance. In my previous writings (e.g. Tsang 2003a), I made the distinction between locational and quality advantage. Hong Kong is losing its locational edge as China continues with its process of economic opening. Nevertheless, as shown in the outbreak of atypical pneumonia in 2003, and the ways with which Hong Kong handled the crisis, the SAR still holds quite a good deal of quality advantage, especially that related to professional credibility. There is as yet a marked “credibility asymmetry” between the Mainland and Hong Kong.

Ominously, the quality advantage is being eroded, not just by the rising standards in the Mainland as a result of multi-faceted reforms, but also because of Hong Kong’s own weaknesses. It has been trapped in internal politicking and few solutions seem to be on the horizon (Tsang, 2004d). The consequence is a continuous lack of social consensus on major policy moves. Moreover, more deep-seated problems are coming to the surface.

Hong Kong economy in quagmire

As I argued from a spatial economic perspective (Tsang, 2004a; 2004c), in order for a city economy to successfully join a regional bloc and continue to thrive, it must be able to form a “cluster” with special advantage and play a constructive role in the regional bloc, which may then perform better in an era of economic globalisation. Of course, if citizens in the city economy can freely move to other parts of the region and do not have any vested interests in promoting its relative “coherence” or continued prosperity, it would go into a secular, perhaps drawn out process of decline, ironically without doing much harm to the region. History is full of such examples: Yangzhou in China, Venice and Naples in Italy, Brugge in Belgium, just to name a few. As long as people involved are not too unhappy, why not?

The key difficulty for Hong Kong, unfortunately, is that in terms of both promoting itself as a cluster and carving out a constructive and important role in the PPRD regional bloc, there are deep-seated problems to be solved. Hence, the possibility of a secular decline for the SAR cannot be ruled out. The problems include:

A. Hong Kong's Demographic and Quality Worries: On its declining fertility rate and relatively low quality of human capital, see Tsang (2006).

B. Hong Kong's slipping advantage: In the era of globalisation, even China needs to rethink about its development strategy and open policies, which have been based significantly on “outward processing”. And Guangdong, the other core economy of PPRD, has been facing its own developmental problems in upgrading after more than 20 years of low-value-added and processing-driven growth and increasing competition from other regions in the country. 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 finally quickening up the development of Chinese medical treatment and pharmaceuticals.

It is apparent that most of Hong Kong's manufacturing industries relocated to the PRD in the past two decades belong to the “traditional sectors”, which are supposed to be “reformed and enhanced”. They are not “pillar”, “leading”, nor “strategic” in nature. Moreover, most of the 60,000 plus factories set up by Hong Kong businessmen in the core of PRD, unlike many of the Taiwanese, Japanese and other foreign plants, are small and medium in size, with diversified locations and showing a lack of economies of scale. In the increasingly land-scarce province, this is causing problems for meaningful consolidation, before genuine reform and enhancement can 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 (Tsang, 2006).

C. Increasing competition from “cooperative” neighbours and partners: 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 in 2003-2004, one would have thought that its position as the busiest port would be further enhanced.

However, the opposite seems to be happening. Hong Kong is now under tremendous competitive pressure from Shanghai and Shenzhen. As the following table clearly shows, if the relative growth trends persist, Hong Kong, and indeed, Singapore would be overtaken by the two Chinese ports in the rather near future. The reason: our high costs, of course (Tsang, 2006).

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-Jan-Sept		
Singapore	1,833.10	100.00	
Hong Kong	1,770.90	96.61	100.00
Shanghai	1,596.04	87.07	90.13
Shenzhen	1,341.09	73.16	75.73

Who are the social agents of transformation?

These problems are not yet fatal. Nevertheless, optimism needs to be justified. The local polity must overcome the obstacles of the underdevelopment of elite and the heterogeneity of ideologies, and release itself from the shackles of the past. Without a more popular and hence more stable vehicle of policy formulation and implementation, it will be very difficult for the local authorities to take a firm stance on long-term endeavour (Tsang, 2003b).

Moreover, who will be committed to develop a cluster of industries and services in Hong Kong which will facilitate the SAR in functioning as a genuine “dragon head” of PPRD with competitive advantage of its own? Those who are committed may not have the means; while those who have the means may not be committed, particularly if an alternative is to invest directly in other parts of PPRD, instead of doing so in Hong Kong. This is actually the dilemma facing any smaller economy under asymmetric integration. In many cases, the smaller economy needs to be more government-led, politically and socially coherent, and strategically clearer in its development. Otherwise, hollowing out, de-industrialisation, and structural dissolution (i.e. de-clustering) would become the inevitable fate. Taiwan, Singapore and South Korea are struggling to various extents. On the other hand, Switzerland, Norway, Denmark, Finland and Ireland are apparently prospering despite limited endowments, perhaps because their geo-political and geo-economic circumstances are less pressurising and their responses more coherent and effective.

Capital and labour are obviously the two most important factors of production in an economy. In contrast to the problems of labour supply and quality in Hong Kong, the SAR is extremely strong with regard to capital assets, but unfortunately rather weak as far as local commitments of the corporate sector are concerned.

According to the statistics on the “international investment position” (IIP) provided by the International Monetary Fund (IMF) in its *International Financial Statistics*, Hong Kong actually excels. The IIP refers to the amount of the member economy’s international assets minus its international liabilities, both of which cover direct investment, portfolio investment, other investment as well as financial

derivatives investment, by the public and the private sectors. In sum, it represents the financial prowess of an economy as a whole, vis-à-vis the rest of the world. The net amount can be positive or negative.

On the basis of the statistics, Hong Kong is abundant in capital. Japan has long been the largest exporter of capital in the world; and in 2005, its net IIP asset (at US\$1531.76 billion) was more than three times that of Hong Kong (at US\$449.120 billion). However, Hong Kong is a much smaller economy with only a 7-million population. Relative to GDP, Hong Kong's ratio (252.74%) was in fact 750% of Japan's (33.60%)!

Other anecdotal evidence of the world-class status of Hong Kong's business sector abounds. In the "2003 Global 1000 Scoreboard" compiled by the *BusinessWeek* on the basis of market value, for example, Hong Kong had 18 corporations in the list, ranging from Hutchison Whampoa (ranking 140) to Li & Fung (ranking 979), and including giants like Hang Seng Bank (178), Cheung Kong Holdings (266), Sun Hung Kai Properties (328), China Light and Power Holdings (382), Mass Transit Railway Corporation (646) and Wharf Holdings (787) (http://bwnt.businessweek.com/global_1000/2003/index.asp?country=HONG%20KONG).

Almost every businessman in Hong Kong is an "integrationist" regarding Mainland-Hong Kong economic relations. The key difference in business attitude lies rather in the emphasis on the pro-active role of the government. On this count, many of the industrialists in the manufacturing sector, some with large investments in the Mainland, are in favour of more involvement by the SAR Government in providing support measures for technological upgrading, R & D, and the promotion of new products etc.

The very big cross-sector groups, the property developers, and the financial corporations, on the other hand, are more likely "non-interventionist" except in wanting the SAR Government to help them in further opening up the Mainland markets. The top guns usually prefer "small government", especially relating to reducing government expenditure and, more importantly, taxes. Since they would feel

the hardest impact, they are also mostly against the establishment of a comprehensive competition law. This however is not necessarily true for the subsidiaries of multinational corporations not having dominant positions in Hong Kong. Some of them indeed prefer a competition law that may undermine the market power of domestic incumbents in fields which are “hard to break into”. Their parent companies have indeed sufficiently large legal teams and long experience in dealing with competition laws, which, according to a United Nations source, have been enacted by more than 100 countries and territories. See UNCTAD, *Directory of Competition Authorities*, January 2006, which is available online at http://www.unctad.org/en/docs/c2clpd51_en.pdf.

In sum, those with the greatest degrees of political influence in the SAR tend to behave more like international corporations, 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.

Structural transformation or dissolution?

Hong Kong’s economic experience has been an outstanding example of a society struggling, surviving and then prospering in historical cleavages. With virtually no natural resources except an excellent harbour, the former colony took off after the Second World War as a result of huge influx of capital and labour from Mainland China, as it served as a safety haven in the interface between the East and the West. Its economic miracle was as successful as it was astonishing.

History seems however to have turned a full circle. Now with the opening up and the unrelenting rise of the Mainland economy, the Hong Kong SAR is in danger of being “marginalised” under asymmetric integration. Theoretically, it has to undergo “structural transformation”. Yet in reality, another prospect is “structural dissolution” or “de-clustering” in a polarised society. Ironically, if that turns out to be the fate, it would be a consequence not of the lack of financial prowess, but of the paucity of political willpower and quality human agents.

Viewed from the grand perspective of the twists and turns in historical developments, the relative decline of Hong Kong in the context of a resurgent China represents a realignment in regional distribution of affluence. It should not engender lasting regret for any intelligent local resident, except that people in Hong Kong might be deemed, rightly or wrongly, by future generations as having wasted their stock of tangible and intangible assets accumulated over many decades, without sufficient far-sight and genuine efforts in putting up a decent fight against “fate”.

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