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The Hong Kong Economy under Asymmetric Integration: Structural Transformation or Dissolution?

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Abstract

Terms such as "structural transformation" and "re-positioning" have almost become clichés when applied to Hong Kong in the post-1997 era. They reflect the tension of an economy entering uncharted waters with no clear outlet. This paper analyses the three-fold doldrums in which it has been caught: (1) the difficulties of forming a viable cluster in an asymmetrical integration process with mainland China; (2) deep-seated problems in the Special Administrative Region (SAR)'s demographic trends and manpower quality; and (3) the lack of capable and committed parties of change to nurture, develop and maintain local competitive advantage.

The Hong Kong economy seems to be heading towards structural dissolution rather than structural transformation. Viewed from the perspective of the twists and turns of history, the relative decline of Hong Kong under a resurgent China represents a regional redistribution of affluence and a shift in geopolitical gravity. It has probably not been the intention of anyone that this should happen. Nevertheless, if structural

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dissolution turns out to be the fate of the SAR, it would be a consequence not of the shortage of financial prowess, but of the paucity of political will power and committed quality agents.

Introduction

The terms most frequently read and heard 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 widespread anxiety that the economy is entering uncharted waters with no clear outlet. Either vibrant growth or irreversible decline might be waiting somewhere ahead.

The unfolding flux has two major observable causes. Internally, there have been the adjustments that appeared to be inevitable after the imbalances, exuberance and short-sightedness built up in the pre-1997 period. The East Asian financial crisis in 1997–1998 and the dramatic impact on the HKSAR (Hong Kong Special Administrative Region) served as little more than the spark to ignite the blaze. Externally, there has been the sea change in the Chinese economy and its amazingly rapid rise. The allure of this has been felt all around the world. Hong Kong is just fortunate (or unfortunate) enough to be closest to the magnet.

To presage my perhaps idiosyncratic perspective and conclusion about the present state of the Hong Kong economy, its core troubles can be regarded as three-fold:

1. Forming a *viable cluster* within a wide and unfamiliar terrain like mainland China is inherently difficult. Being both "a blessing and a curse," the "economic integration" between the mainland and the HKSAR is by nature *asymmetrical*: the former large, diversified, and forging ahead, and the latter small, struggling and "hollowing out." Re-defining Hong Kong's role in such a dynamic but lopsided context turns out to be a great challenge.
2. In any case, Hong Kong is confronted with several deep-seated and long-term problems in its demographic changes, the low average quality of human capital, and the shortage of local R&D and innovative efforts. The traditional reliance on "locational advantage" has been backfiring and a pillar of its "quality advantage," which arose from the western traditions of law and order and civil service, does not provide a dependable guarantee for its competitive position given the rapid reform progress in the mainland.

3. To add to the woes of the SAR as a competitive cluster, there is a lack of *committed and capable agents of structural transformation* to nurture, develop and maintain new advantage. 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 maintaining the coherence of the Hong Kong economy, while most of the medium and small-sized manufacturing enterprises in the core of the Pearl River Delta have been officially assessed there to be excessively based on processing and technologically outmoded. Politically sensitive government officials, although aware of the onerous tasks they have to face in guiding the SAR, are becoming less interested in shouldering difficult responsibilities. In the meantime, playing an essentially opposition role in the ill thought-out "democratic" system, local politicians of "progressive" inclinations are becoming myopic and narrow in their visions relating to popular elections and universal suffrage, as more of the common people, especially those in the lower social strata, are tempted or forced to resort to opportunistic behaviour to stay afloat.

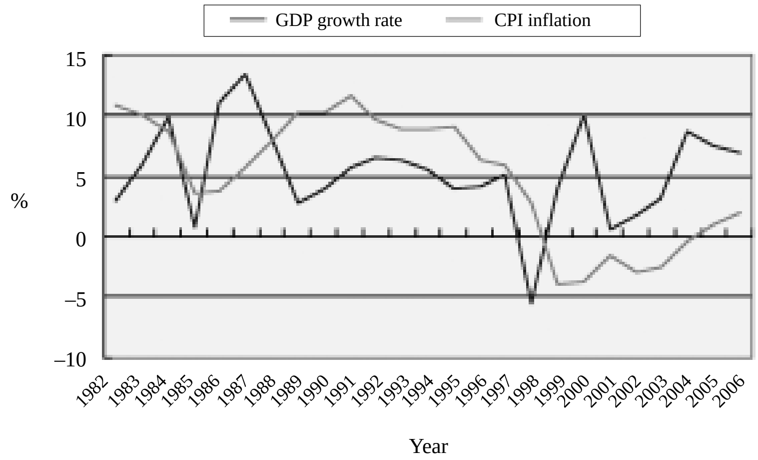
The net result is that the Hong Kong economy is on a clearly identifiable new trajectory heading towards structural dissolution rather than structural transformation. This is probably not what anyone intended. The SAR looks like a neglected child whom everyone says they will take care of. But who really cares? The rest of this paper represents an attempt to substantiate these admittedly controversial claims.

The Road to the Present Dilemma

The Hong Kong economy has been on a roller-coaster with a prolonged episode of demoralizing deflation since the political transition in 1997, as testified by Chart 1. That, among other factors, evidently cost the job of the first Chief Executive of the SAR, Tung Chee-hwa. A major force behind this is the widely publicized "structural transformation," as shown in Table 1. On the surface, Hong Kong has morphed, reluctantly or otherwise, from a manufacturing hub into a service- and "knowledge-based" economy.

Hong Kong's post-1997 crisis has its historical roots. As I have argued earlier, constraints that were inevitably imposed on the former colony —

Chart 1. Hong Kong's Economic Growth and Inflation



Source: Census and Statistics Department, HKSAR Government.

Table 1. Hong Kong's GDP by Economic Activity at Current Prices Unit: %

	1980	1990	2000	2005#
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	3.4
Electricity, gas and water	1.5	2.4	2.9	3.0
Construction	6.5	5.2	4.9	2.9
Services	68.3	75.4	86.6	90.7
Wholesale, retail and import/ export trades, restaurants and hotels	19.4	23.7	24.6	28.8
Transport, storage and communications	6.9	9.0	9.5	10.1
Financing, insurance, real estate and business services	21.7	18.9	21.4	21.9
Community, social and personal services	11.9	14.1	19.9	19.2
Ownership of premises	8.4	9.7	11.3	10.7
Total	100.0	100.0	100.0	100.0

Source: Census and Statistics Department, HKSAR Government.

Note: The total is GDP at factor cost.

Figures are subject to revision.

including the "transition syndrome" in the run-up to 1997, and the influence of western neo-conservative ideologies which formed a convenient countervailing force against Chinese "communism," albeit a reforming regime, have combined to generate short-termism and minimalism in politics and economics.[1] These inclinations joined force with two other major developments, which had been driving the local economy since the early 1980s. The first was the "China factor": Hong Kong's "integration" with mainland China. The second was the escalating dominance of the property and financial sectors. Both pushed Hong Kong down the path of what I described as "Manhattanization."[2] Between 1980 and 1997, the share of manufacturing industries in GDP dropped from 22. 8% to less than 7.0%, while the number of manufacturing workers fell from over 900,000 to below 300,000. During the same period, employment in major service sectors more than doubled.

Such a process not only brought significant adjustment costs to a large number of local labourers. It was in my view not consistent with the framework of "one country, two systems," under which Hong Kong is not supposed to "merge" itself into the mainland economy and become "just another Chinese city."[3] As stipulated in the Basic Law, the mini-constitution governing the SAR, Hong Kong is to take care of its own fiscal, monetary and manpower problems. Hong Kong is not supposed to expediently "export" difficulties such as unemployment or the lack of demand for its goods and services to mainland China, as New York in the US or London in the UK can to the rest of the country. Hence the Hong Kong economy should maintain some "coherence" of its own and keep a "healthy distance" from the mainland.[4]

Unfortunately, these economic constraints of "one country, two systems" were not well understood before 1997. The market was having a "free run." Worse still, the Chinese and the British sides were engaging in hostile politics. The consequence was a paralysis of initiatives which could have facilitated re-structuring in the appropriate direction. The failure by the Hong Kong government to build up a land bank and to provide an adequate supply of land to the market, as a result of political constraints and the lack of coordinated efforts, was particularly destabilizing.[5]

Even without the East Asian financial crisis of 1997–1998, the mode of growth in the Hong Kong economy was not sustainable. The crisis only aggravated the unavoidable corrective downturn, exposing all the problems that had accumulated since the mid-1980s.[6]

The Failed Attempts of Tung Chee-hwa and Antony Leung

In many ways, the developments in the Hong Kong economy over the past decade have been driven by two different policy perspectives. Initially, the first Chief Executive of the SAR, Tung Chee-hwa, wanted to overcome colonial inertia and carve out a new direction. The various long-term and short-term problems did not escape his attention. A new mood, which was more pro-active than the minimalist attitude of the pre-1997 years, emerged. Shortly after taking over, Tung vowed to find lasting solutions to the problems of housing, education and poverty, and to be more supportive to attempts at industrial upgrading in Hong Kong. In his Policy Address delivered on 8 October 1997, he announced a package largely dominated by economic measures.[7] It appears that Tung intended to rectify some of the key structural problems that had accumulated in Hong Kong. However, the package fell short of a systematic revamp. There were grey areas that cast doubts on its ultimate effectiveness.[8] In any case, in his speech at the ceremony marking the first anniversary of the establishment of the Hong Kong Special Administrative Region, he declared:

> The SAR Government has drawn up long-term plans to enhance Hong Kong's competitiveness and maintain its economic vitality. The Asian financial turmoil has exposed the weaknesses of our rather narrow economic structure. Therefore, while we are committed to the strengthening and reinforcing of our major economic pillars, such as finance, property development, tourism, shipping and trade, we have to promote actively the growth of our economy by strengthening and developing further our cooperation with the mainland, especially our cooperation with Guangdong; reviving small and medium businesses; developing high value-added and high technology industries; and developing such new and integrated industries as information technology, telecommunication, filming and television.[9]

Regrettably, Hong Kong was plunged into the East Asian financial crisis from late 1997 onwards. There was very little to cheer about; and local citizens had already seen two economic downturns before the severe acute respiratory syndrome (SARS) epidemic struck in the spring of 2003. Their tolerance was tested to the limit: and the result was the historic rally on 1 July when half a million people took to the streets. It served as a very clear expression of frustration with an inept government. Further political instability has only been avoided since mid-2003 by the central government's economic support measures.

The last attempt at a more proactive approach was that of Antony

Leung, the Financial Secretary who succeeded Donald Tsang, in his 2002–03 budget, in which he argued:

> Some may have the impression that, to maintain Hong Kong's economic freedom, the Government should be passive and distance itself from the economy. I disagree. I am of the view that the Government should have a clear vision of the direction of economic development and be a proactive market enabler.[10]

Leung said that the economic role of the government included "considering the need to take appropriate measures to secure projects beneficial to our economy as a whole when the private sector is not ready to invest in them."

Nevertheless, the post-1997 reality turned out to be much harsher than reformers and innovators of all shades had anticipated. Having suffered economic and then political setbacks, Tung Chee-hwa changed his stance and his Policy Address at the beginning of 2003 marked a watershed where ambitions began to be abandoned. Like his inaugural address in 1997, this was in essence an economic manifesto, albeit in the opposite direction. The new motto was "big market, small government." "Hong Kong is a free market economy, and the prime mover of economic restructuring rests mainly with the private sector." As a way out of the doldrums, Hong Kong should "capitalise on the rapid development of our Motherland to hasten our economic restructuring."[11] In particular, Hong Kong needed to strengthen its ties with the Pearl River Delta. What the government could do was to concentrate on reducing the barriers to cross-border flows of resources, and to open up circulation within the network, so to speak.

Then Henry Tang, the Financial Secretary who succeeded Antony Leung, marked the change in even clearer language in his 2004–05 Budget Speech: "A free market economy is the bedrock of Hong Kong's success. I firmly believe that our guiding principle in fostering economic development should be 'market leads and government facilitates'. Having come from the business sector, I am keenly aware that the essential ingredients for the success of an enterprise are flexibility, a quick response and the ability to see where the market is heading. The Government's principal role is to create the best possible environment for business and to facilitate the market's operation and promote its development."[12]

The Mainland Comes to the Rescue

The year 2003 was a critical one. The Hong Kong economy struggled desperately under the tremendous pressures of the post-1997 bubble burst, the SARS epidemic and the enormously unpopular political move of the SAR government to enact laws relating to state security. The mainland Chinese authorities, which initially adopted a hands-off attitude epitomized by the analogy that "River water shall not intrude into well water" (*heshui bu fan jingshui*), apparently decided to change course. A "Closer Economic Partnership Arrangement" (CEPA) was conceived; and up to mid-2007, four stages of a bilateral free trade and market access agreement had been concluded with the HKSAR. On the other hand, the widening schemes for "individual visitors" from major mainland regions and cities to Hong Kong are meant to boost tourism in the SAR.

In addition, in June 2004, nine provinces in the mainland — Guangdong, Fujian, Jiangxi, Guizhou, Sichuan, Yunnan, Hunan, Hainan and Guangxi, together with the Hong Kong and Macao SARs, signed the "Pan Pearl River Delta (Pan-PRD) Regional Cooperation Framework Agreement" (the so-called "9+2 Agreement"). Both CEPA and the "9+2 Agreement" were arrangements aiming at trade liberalization and economic integration at different levels, initiated mainly by government authorities. The operational targets were the reduction in tariff and non-tariff barriers to trade, enhanced investment and efficient flows of resources, as well as the strengthening of regional cooperation in various aspects of development.

Liberalization measures have also been extended to the financial sector. Banks in Hong Kong were allowed to conduct *Renminbi* banking business in early 2004, and the scope of this was enlarged in 2005 and 2006; and the China Development Bank, one of the three policy banks in the Mainland, issued *Renminbi* bonds in the SAR for the first time in July 2007. On the other hand, the QDII ("Qualified Domestic Institutional Investors") Scheme was launched in April 2006, paving the way for Chinese portfolio investments in the securities markets in Hong Kong. All these moves represented a U-turn from the original hands-off stance, but they fitted the morphing geopolitical and geoeconomic environment that both China and Hong Kong were confronted with.

In essence, Hong Kong's economic development strategy has been caught in a dilemma, with two contesting schools of thought. I have labelled them the "local advantage view" and the "resource flow view."[13] The former was at the core of ideas influencing Tung Chee-hwa when he became the Chief Executive of the SAR in 1997, with the tacit blessing of the mainland authorities. The central proposition was to develop a coherent economic entity in Hong Kong, one which was not reliant on integration with the mainland. After all, the framework of “one country, two systems” was not supposed to be only political, but also economic in nature.

The latter, “resource flow view,” has nevertheless come to the forefront since 2003. It takes as a starting point the inevitable economic integration between Hong Kong and the mainland, advocates the removal of artificial barriers to such a process and calls for facilitating its realization. We have already discussed the problems confronting the local economy, given obstacles and hurdles to resource flows between the two sides and the fact that Hong Kong was “caged.”[14] As we have said, Hong Kong in China is rather different from New York in the US or London in the UK. Our key conclusion was the necessity to cultivate Hong Kong’s own coherence and competitive niche rather than prompt integration with the mainland.

Given China’s phenomenal rise in the twenty-first century, the general mood has changed dramatically and the integrationists have gained ascendancy. The “resource flow view,” under the banner of “big market, small government,” has turned out to be the accepted wisdom of the SAR government, led by Donald Tsang, who took over the helm from Tung Chee-hwa in 2005. Flows of resources are taken to cover not only goods and services, but also factors of production (capital, labour and expertise etc.). Moreover, the constraints so far have not really been “one-sided” or “Gore-tex,” as some commentators would have it. For some elements, the flows (barriers) were in one direction; but for others, they were in the opposite direction. For example, Hong Kong’s capital, but not labour (surplus or otherwise), has been flowing more fluidly into the mainland; while for goods, the smoother traffic has been from the mainland to the territory. As to services such as transportation, banking and tourism, the stories have again been varied. In general, major policy barriers, both inward and outward, have usually been imposed by the Chinese authorities, rather than by Hong Kong as the “freest” economy in the world, with the exception of migration and labour movement, on which bilateral restrictions are the norm, largely out of socio-political concerns. Moreover, some important “barriers” or “hurdles” are simply “economic” as a result of uneven developments on both sides of the border or the lack of necessary hardware and software, and have nothing to do with policies.[15]

In several recent articles, I have made critical comments about a development strategy based primarily on the “resource flow view” because of the rapidly emerging competition among Chinese city economies.[16] If not cast in the proper context, such a strategy is short-sighted, as it fails to address the crucial point that the enhancement of freedom and efficiency in the flows of factors of production and goods and services across two economies is a "two-edged sword." As Krugman puts it in *Geography and Trade*, with the trend towards globalization, high-grade factors will only converge to cores or centres with economies of scale and industrial concentration, as well as large and substitutable labour pools.[17]

Of course, if Hong Kong and mainland cities strengthen their exchanges of factors and outputs, the SAR's implicit and explicit costs of being "caged" because of the "one country, two systems" framework could be reduced. Hong Kong may also benefit from an enlargement of business opportunities, of the sort which CEPA, "9+2" and measures like relaxing restraints on mainland tourism to Hong Kong have been intended to engender. These possibilities should be welcome; although so far the actual short-term effects seem at best mixed. In any case, to many believers in "big market, small government," increasing resource flows can ostensibly be done with relative ease, in the sense that it involves only policy changes that aim at removing existing barriers and constraints.[18]

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. its lack of cutting edge in the new situation. The disappearance of economic boundaries 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 to maintain local advantage, the consequence could be the SAR's secular decline, as a net load of low-quality factors precipitates in it. The brightest people would find much greener pastures in the north.

Hong Kong must therefore reinvent its own niche in the new dynamic circumstances. In my previous writings, I made the distinction between locational and quality advantage.[19] 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 in which Hong Kong handled the crisis, the SAR still holds 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. That is why tourists and businessmen from the north have preferred purchasing gold and jewellery, cosmetics and expensive drugs etc. in the SAR.

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 appear on the horizon.[20] The consequence is a continuous lack of social consensus on major policy moves which are necessary for enhancing the SAR's competitiveness. At the same time, more deep-seated problems are coming to the surface.

Why Clustering Is Needed in Open Regionalism

Why should one be bothered with these issues? Why not let the market decide the ultimate allocation of resources and investments across regions and cities? There are indeed many commentators who think that the market mechanism plus free trade would allocate factors of production and outputs in the most optimal way. The idea that Hong Kong should make special efforts to maintain a coherent "cluster" of economic activities is to them nonsense. Just open up the economic border and everything will be fine, eventually. Moreover, in a world of instant Internet connections and communications, there is no need for any cluster. R&D could be done in India, with software designed in Ireland and manufactured in Brazil!

This sort of ideology flies in the face of economic reality, in particular the utterly uneven spatial distribution of resources, wealth and activities over the globe. Other than "path dependence," which implies that serious researchers have to study history in some detail, a spatial perspective is necessary in meaningful developmental models.

Factors of production, especially high quality labour, will never be fully mobile, because pooling is an important prerequisite to achieving economies of scale and economies of scope. Hence they tend to gather in "clusters." This concept can be traced back to the writings of the classical economist Alfred Marshall on industrial districts; and the "central place theory" of Walter Christaller. Modern theoretical developments have had impetus provided by Krugman and Porter.[21]

In the new era of global sourcing and supply chain management clusters might be dismissed as unnecessary. And there are economists and geographers who doubt the wisdom of Krugman and Porter as well as the research they sparked off. For example, Beugelsdijk and Cornet argue in an empirical piece that "a far friend may be worth more than a good neighbour"; and Lagendijk has serious theoretical reservations about the so-called "New Regionalism" approach that underlies various studies.[22]

In any case, the strongest argument that supports the continued, and perhaps increasing, relevance of clusters goes back to Marshall's concepts of localized knowledge and industrial agglomerations. The notion of tacit knowledge, explored by economists of the Austrian School such as Friedrich Hayek, was a central pillar of the thinking of the scientist-philosopher Michael Polanyi. In our modern context, what can be dispatched through e-mails and discussed in attachments are essentially explicit or denotative information and ideas, which may be readily transmittable through electronic means. But in the hierarchy of knowledge, the most subtle and creative elements are usually tacit and connotative. That is why it is always enriching to follow a great teacher, no matter how idiosyncratic she or he personally is, because understanding can never be fully codified or digitalized through web-based learning.

Relating to industrial activities, face-to-face dialogue in an intelligent community is critical to extending the frontier of R&D; so is "praxis" (informed and committed action) by a group of co-researchers. Hence high-quality human capital has to stay in clusters to produce synergy. In the terminology with a socio-technological touch, this is called "embeddedness," a theory initially nurtured by economic sociologists. The innovation process is often "embedded" in specific institutions and cultures that foster creative thinking and interactions.[23]

From a practical perspective, this kind of observation borders on the common sense. Every successful manager or businessman knows the importance of networking. Personal trust is crucial in building constructive and enduring relations: and face-to-face contacts are essential. Social networks are important for extracting "non-redundant" information, as well as launching and sustaining organizational innovation.[24] To push the analysis further, networks can facilitate "knowledge spillovers." However, these networks have to be engaged in "associational activity," resulting in the production and the accumulation of "social capital" which lubricates entrepreneurial behaviour so that economic benefits may actually be reaped.[25]

There is no doubting that globalization has made international division of labour more pervasive. But in any case, this does not negate the need for innovation based on tacit knowledge; and institutional embeddedness becomes crucial for success, especially at the high value-added end of production and service. The new qualification is that the process is becoming less predictable and more competitive. As Fritsch has said:

> … innovation processes are characterized by an intensive division of labor that has a pronounced spatial dimension.… If the current trend continues, we should expect a further increase in labor division, regional specialization, and clustering of innovation activity in the future. The emerging spatial pattern will then be characterized by only a few regional centers of excellence throughout the world for each technological field in which the main market players have to be present in order to monitor technological developments and absorb relevant knowledge.[26]

The policy implications of these observations are profound. It is no longer very meaningful to think of economic development as simply either government-led or market-driven, the worn out ideological dichotomy that so many are still fond of debating. Innovation is a highly complex process; and as I have argued elsewhere, a "triangular strategic alliance" between the government, the business sector, and academia is required in the HKSAR to foster an operating environment that is conducive to the formation of a core with suitable peripheries, as well as the propagation of the proper dynamics.[27] The mere setting up of a science park with physical infrastructure and investment benefits, plus measures of grouping companies and experts together, are not sufficient, as Phillips and Yeung's analysis shows in the case of Singapore.[28] Indeed, "institutional thickness" and "local embeddedness" are essential, and they need the right types of networks, enabling conditions and interactive dynamics. Unfortunately, for Hong Kong, even the appropriate infrastructure and incentives have not yet been put in place.

The Complexity of Regional Economic Cooperation and Competition

Taking into account the above detour of considerations, let us go back to regional economic cooperation in the Pan-PRD. Globalization and regional integration appear to be the current historical trends, but their interactions are complex. Neither is irreversible and they do not provide guarantees for success. The Pan-PRD is a regional bloc within the Chinese economy. It is also part of the global economic network. Hence, economic integration is a two-pronged process. Attention must be paid to both internal consolidation and promotion (i.e. clustering) on the one hand, and external extension on the other. In so far as a region can attain economies of scale and scope through meaningful consolidation, it will be a more powerful competitor in the international and global arena — an example of this is the European Union.[29]

Why should regional economic blocs be formed and how does the Pan-PRD region fit into the patterns? In the recent literature on development economics and international political economy, regionalism can be viewed from both the positive and the negative angles. Positively, it can be a way of gaining economies of scale and scope so as to more effectively engage and participate in globalized production and competition. It is often termed "new regionalism" or "open regionalism."[30] In contrast, regionalization can also be a fallback position or a viable retreat from over-extended globalization. The "resistance model" is often not purely economic in perspective. It emphasizes the difficulties of maintaining local economic and social institutions and arrangements in the face of globalization and the importance of regional collective action to act as a safeguard.[31]

Although these two "schools" are often contrasted as promoting opposing approaches to super-national economic development, empirical evidence is much more mixed. Wei and Frenkel, for example, confirm that East Asia indeed practised open regionalism during 1970–1992, and that this was "Pareto-improving for world welfare." But so did Western Europe, albeit to a much lesser extent.[32]

In view of increasingly globalized production and marketing, a region needs to facilitate a certain degree of vertical segmentation of the production process. Some areas within it should be richly endowed with natural resources, others with efficient or quality labourers, and yet others with entrepreneurial, capital, or financial prowess. On the other hand, in order for the vertical division to be viable, resources must flow across different parts with relative ease and lower costs. Therefore, a "free trade area" (FTA) involving countries and territories with various endowments at different stages of development, yet with appropriate proximity and affinity, may become an ideal economic region in an era of globalization.

In this context, the recent literature has focused on the discussion of the so-called "old versus new regionalism." Questions have been raised as to (1) shallow versus deep integration; and (2) extension to regional trade agreements (RTAs) between developing and developed countries etc.[33]

However, regional multilateralism or multiple regionalism could backfire and it has its critics. Okfen, for example, argues that organizations such as APEC and Asia-Europe Meeting (ASEM) are too loose to be effective, and ASEAN's norms of "voluntarism, consent, non-interference and informality" do not always generate positive attitudes towards the formation of "community spirit."[34] One might wonder whether many of the members signing up to RTAs are "natural trading partners." Practically, if member countries of an RTA are involved with multiple RTAs, which involve countries outside the RTA, the costs of implementing restrictive rules of origin will increase, hence reducing the trade creation benefits of the arrangement.

Given the revealed national developmental priorities, the design of the Pan-PRD under CEPA is as yet still rather outward-oriented. Not enough attention has been paid to the promotion of internal developments and interactions. While this may remain optimal for the PRD (Guangdong, Hong Kong and Macao), it is probably problematic for the whole Pan-PRD to follow the lead of the core economies. Even Guangdong has been reconsidering its strategy of "shops at the front, factories at the back" and is keen to have serious industrial upgrading.

Deep-seated Troubles Confronting the Hong Kong Economy

In the light of the general analyses in the previous two sections on clustering and spatial economics, one may arrive at the tentative conclusion that 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 advantages and play a constructive role in the regional bloc, which may then perform better in an era of economic globalization. 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 persistent prosperity, it will fall 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, Brugge in Belgium, Venice and Naples in Italy, to name just a few. Provided that parties directly involved are not too unhappy about it and the wider region actually benefits from the disintegration of a former "core," 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 Pan-PRD regional bloc, there are deep-seated problems to be solved. Hence, the possibility of a secular but unwelcome decline for the SAR itself (albeit not for the region) cannot be ruled out.

Hong Kong's Demographic and Quality Worries

Hong Kong has one of the lowest fertility rates in the world; population growth is increasingly dependent on immigration, mostly from the mainland. At the same time aging will become a socioeconomic headache for decades to come.

The total fertility rate in Hong Kong has experienced a continuous decline in the past two decades. It fell from 1,367 live births per 1,000 women in 1986 to 901 in 2003, and then rebounded mildly to 984 in 2006, which was still far below the replenishment rate. According to the Census and Statistics Department,[35] Hong Kong's average annual population growth rate between 2007 and 2036 is likely to be only 0.7% (with the absolute size rising from 6.86 million to 8.57 million). The growth of 1.71 million would actually be the result of a natural increase (i.e. births less deaths) of only 0.49 million and a much larger net in-movement (i.e. inflow less outflow) of 1.22 million.

In mid-2006, the number of persons aged 65 and above was estimated to represent 12% of the total population. This ratio was forecast to rise to 15% in mid-2016, 22% in mid-2026, and 26% in mid-2036.

Partly because of the net immigration from the mainland, the average educational level of Hong Kong's populace has remained lamentably low. In 1991, 57.1% of those persons aged 15 and above had received education only up to form 3 level or below. In 2001, despite a decade of promotional efforts, the ratio stood at 47.8%. According to the *Summary Results* of *the 2006 Population By-census* released in early 2007,[36] it was still as high as 44.4% in 2006. This kind of educational standard is quite incompatible with the supposed attributes of Hong Kong as an international financial centre 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,[37] compared with the average of 2.24% for OECD countries in 2003.[38]

Hong Kong's Slipping Advantage

With the commodity and energy price shocks of 2004–2005, it has become a widely shared view on the mainland that China needs to rethink its development strategy and open policies, which have been based significantly on "outward processing." They have given rise to increasing international trade friction and pressures, even as there is a lack of significant improvement in domestic productive and energy utilization efficiency despite persistently high growth. The Eleventh Five-Year Plan (2006–2010) was a clear indication of an attempt to shift track; and the restructuring process involves efforts at every level of government.

As an example particularly relevant to Hong Kong, Guangdong, the other core economy of the Pan-PRD, 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 of the country. Rising costs and tightening resource constraints, such as energy shortages (in electricity and gasoline) and the drying up of the supply of cheap labour from inland provinces in recent years, are symptoms of the dilemma now worrying Guangdong as an economic spearhead of the mainland. Past linkages notwithstanding, Hong Kong as a service economy is not in much of a position to provide assistance to the development of high-tech industries and structural advancement 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.

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." The Plan actually highlighted efforts to promote a number of key industries:

(1) emphasizing the need to strengthen the two "pillar industries" of electronic IT and petrol-chemicals;
(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, speeding up the development of Chinese medical treatment and pharmaceuticals.[39]

It is obvious that most of Hong Kong's manufacturing industries which relocated to the PRD in the past two decades belonged to the "traditional sectors," which were supposed to be "reformed and enhanced." They were not "pillar," "leading," or "strategic" in nature.

Moreover, most of the 60,000-plus factories set up by Hong Kong businessmen in the core of the PRD, unlike many of the Japanese, Taiwanese 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 for meaningful consolidation, before genuine reform and enhancement could be implemented. The structural incongruence between the developmental directions of the two potential "dragon heads" of the Pan-PRD might spell trouble for coordination in the times ahead.

Increasing Competition from "Cooperative" Neighbours and Partners

Could the "9+2" Framework Agreement reached in 2004 deteriorate into a talking shop, because of a lack of persistence and implementation in a top-down approach and given the diversities of the constituent members? There are signs that the authorities have been doing a a great deal to avoid that prospect, but the future outcome is far from certain.

A revealing speech was given by Donald Tsang, who replaced Tung Chee-hwa as the Chief Executive of the Hong Kong SAR, at the Second Pan-PRD Economic Cooperation and Development Forum in Chengdu on 25 July 2005. In the speech he stressed the need to avoid "unnecessary competition" in infrastructure investments within the region.[40] That such a plea should have been made was in itself significant, and might point to the inherent difficulties of designing a regional economic bloc encompassing such a diverse range of economies.

A sobering experience relating to this crucial point is Hong Kong's declining importance as the logistics centre of the Pan-PRD. 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. Unfortunately, that did not turn out to be the case.

For the year 2005, Hong Kong's container throughput rose merely 2.8% to 22.60 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.

Moreover, Hong Kong has been under tremendous competitive pressure from Shanghai and Shenzhen. In 2003, the throughputs of

Shanghai and Shenzhen were only 55% and 52% of Hong Kong's, respectively. By the end of 2006, the ratios climbed to 92% and 79% because of their much higher annual rates of increase. As Table 2 so clearly shows, if the relative growth trends persist, Hong Kong, and Singapore as well, will be overtaken by Shanghai and closely challenged by Shenzhen in the rather near future. Indeed, Shanghai's traffic volume already surpassed Hong Kong's in the first half of 2007.

This paradoxical phenomenon reflects the high operation costs of Hong Kong's container port. Including land transport costs and port handling charges, in 2005 a shipper there had to pay about US$250–300 more for a TEU of goods than it would have cost in Shenzhen. Hong Kong's remaining advantages lie in its efficiency, reliability and international connections (with global reach), but the high cost is increasingly becoming a drag as globalized production is very much characterized by efforts to economize expense.

In addition, in terms of infrastructure, conflicts of interest are arising. Guangdong and Shenzhen have been frantically building ports and transportation networks, often in projects with heavy government intervention. In contrast, the Hong Kong SAR administration still prides itself on practising the principle of "big market, small government." This highlights what I have called "asymmetry in government behaviour"[41] and throws into doubt the so-called coordination in infrastructure and Donald Tsang's plea to avoid "unnecessary competition."

Committed and Capable Agents of Transformation?

The above problems are not at all easy to solve. Nevertheless, if there is a consensus in Hong Kong and enough committed agents of transformation can be found and organized, the problems may yet turn out not to be fatal. On this count, though, optimism could be elusive, as the prerequisites for a vibrant future are not simply economic in nature. The local polity must overcome the obstacles of the underdevelopment of its elite and the heterogeneity of ideologies among its citizens, and free itself from the shackles of the past. Without a more popularly supported and therefore more stable vehicle of policy formulation and implementation, it will be hard for the SAR authorities to take a firm stance on long-term endeavour.[42]

To start with a deliberately agitating question: Who would be committed to developing a cluster of industries and services within Hong

Table 2. Container Throughput League

	TEUs (millions)	Relative ratio (%)	Relative ratio (%)
Port /Year	**2003**		
Singapore	1841.05	100.0	
Hong Kong	2044.90	111.1	100.0
Shanghai	1128.17	61.3	55.2
Shenzhen	1061.45	57.7	51.9
	2004		
Singapore	2,132.91	100.0	
Hong Kong	2,198.40	103.1	100.0
Shanghai	1,455.72	68.3	66.2
Shenzhen	1,361.52	63.8	61.9
	2005		
Singapore	2,319.22	100.0	
Hong Kong	2,260.20	97.5	100.0
Shanghai	1,808.40	78.0	80.0
Shenzhen	1,619.70	69.8	71.7
	2006		
Singapore	2,479.24	100.0	
Hong Kong	2,353.90	94.9	100.0
Shanghai	2,171.00	87.6	92.2
Shenzhen	1,846.89	74.5	78.5
	Jan–Jun 2007		
Singapore	1347.02	100.0	
Hong Kong	1150.40	85.4	100.0
Shanghai	1251.49	92.9	108.8
Shenzhen	918.23	68.2	79.8

Sources: Websites of various port authorities/operators
http://www.mpa.gov.sg/infocentre/pdfs/container-throughput.pdf
http://www.pdc.gov.hk/eng/statistics/docs/Hkport.pdf
http://www.portcontainer.com/index.asp

Note: Figures for the first half of 2007 contain preliminary estimates.

Kong which facilitates the functioning of the SAR as a genuine "dragon head" of the Pan-PRD, with distinct competitive advantage? And why would they do this?

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 the Pan-PRD, instead of in Hong Kong.

This is actually the dilemma facing any smaller economy under asymmetric integration. In many cases, the smaller economy needs to be politically and socially more coherent and strategically clearer in its development, with the government taking a relatively proactive role. Otherwise, the magnetic effects of the bigger economic "partner" will set in; and hollowing out, de-industrialization, and structural dissolution (i.e. de-clustering) will become the inevitable fate for the junior partner.

Taiwan, Singapore and South Korea are struggling to various degrees, in the face of the rapid resurgence of mainland China. On the other hand, Switzerland, Norway, Denmark, Finland and Ireland are apparently prospering despite limited endowments, perhaps because their geopolitical and geoeconomic circumstances are less pressurizing and their public and private responses to the domination of the EU more coherent and effective.

Hong Kong's Irony: Strong Financial Capital versus Weak Human Capital

Capital and labour are obviously the two most important factors of production in an economy. We have explored above the problems concerning the supply and quality of labour in Hong Kong. The SAR is extremely strong with regard to capital assets, however, but unfortunately rather weak as far as local commitments of the corporate sector, which has the controlling say on those assets, are concerned.

Table 3 gives a clear indication of Hong Kong's abundance of capital. The table is based on the statistics on the "international investment position" (IIP) of member economies provided by the International Monetary Fund (IMF) in its *International Financial Statistics*. The IIP refers to the amount of a member economy's international assets minus its international liabilities, both of which cover direct investment, portfolio investment, other investment and 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. Here, three of the most outstanding examples with positive IIP are listed.

As can be observed from the table, 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 was more than three times that of Hong Kong. Nonetheless, Hong Kong is a much smaller economy with a population of only seven million. Relative to GDP, Hong Kong's ratio (252.7%) was in fact 750% of Japan's (33.6%)!

Table 3. 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	131.5			1157940	24.9
2001	265221	159.3	60888.00	71.1	1360090	33.3
2002	343337	209.7	81638.00	92.3	1462160	37.4
2003	394159	248.7	93900.00	101.3	1613620	38.1
2004	424752	256.1	102607.00	95.4	1784480	38.9
2005	449120	252.7	104507.00	89.5	1531760	33.6

Source: International Monetary Fund.

Other anecdotal evidence of the world-class status of Hong Kong's business sector abounds. In the "2003 Global 1000 Scoreboard" compiled by the *Business Week* 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 the 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).[43]

At least this point did not escape the attention of the Chief Executive of the SAR, Donald Tsang, in his inaugural Policy Address in October 2005, when he discussed the *prima facie* need for considering a comprehensive competition law in Hong Kong:

> A level playing field that allows enterprising people to start and run their own businesses is important for sustaining the vitality and harmony of society. Hong Kong has long been recognised as the world's freest economy. The international community has commented very favourably about the upholding of fair competition in Hong Kong. However, as Hong Kong enterprises grow in strength, with some acquiring world-class status, coupled with an increased presence of multinational enterprises, it is possible that forces capable of cornering the market may emerge in Hong Kong.[44]

Capital as Social Agent

In his discussion of the policy inclinations of different domestic business groups (traditional exporters and merchants, new industrialists, and subsidiaries of multinational corporations) in Latin America, Fischer links their interests to the unfolding globalization efforts of multinational corporations and the political institutions in which they operate:

> The Latin American business community is a heterogeneous lot, and its members' origins, interests, and politics can and do vary substantially.… The Latin American business community is much more politicized than its North American counterpart…. In fact, different business interests often have their own separate organizations, adopt opposing positions on issues of national interest, and align themselves with different political parties. The roots of these contradictions lie in the origins of these companies and the markets they serve.[45]

Fischer then comes up with various "models of integration" and a three-fold classification of "currents": (1) the "secessionist-protectionist" model; (2) the "integrationist-protectionist" model; and (3) the "integrationist-competitive" model.

This is not the place for me to attempt to perform a similar classification of the business groups and their policy tendencies in Hong Kong. Suffice it to say that, first, they are much less politicized than their Latin American counterparts; second, at least the top ones are economically more powerful; and third, very few enterprises in Hong Kong, including those of medium and small size, are outwardly "protectionist," given the asymmetric nature of the integration process between mainland China and the SAR.

So in a general sense, every businessman in Hong Kong is an "integrationist." The difference lies rather in the emphasis on the proactive role of the government. On this count, quite a few 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, e.g. the leading property developers and the financial giants, on the other hand, are more likely to be "non-interventionist" except in wanting the SAR government to help them in further opening up the mainland markets. The leaders of such groups usually prefer "small government," especially relating to reducing government expenditure and, more importantly, cutting taxes. Since they would feel the hardest impact, they are also mostly against the establishment of a comprehensive competition law.[46]

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" bent. 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.[47]

Identity Crisis and Opportunistic Behaviour of the Common People

A comprehensive review of a territory will not be complete without looking at the behaviour of the common people. Concurrent with the demographic, geopolitical and economic changes in the SAR, the blurring of identity appears to be a spreading experience among local residents. This could have profound consequences.

Of course, Hong Kong has never been free of an identity crisis. One can say that its history is indeed a record of social confusions: from being a colonial backwater to a roaring tiger to an international financial centre with below-par human capital quality, self-image for most in Hong Kong was always far from clear and firm. Nonetheless, what could be new is perhaps a rather pervasive sense of inability or even helplessness, at least for those trapped in the lower social strata. This subjective impression of theirs has probably been reinforced by the reported reappearance of absolute poverty and widening income inequality.[48] Into the new era characterized by a strong China without identifiable and manifest ideals besides "patriotism" and "social harmony," and in an SAR where upward mobility is constrained by powerful incumbents in almost every imaginable institution, a non-complacent person may be tempted to resort to opportunism as a way out.

This spells trouble for a "knowledge-based" society that prides itself on quality advantage. The bad press concerning tourism in the years since 2005, cumulating in mainland tourists being subjected to unscrupulous practices by local travel agencies and retail shops, has been a lamentable testimony to the erosion of the credibility edge of the SAR at the grassroots level, for which there are very few short-term remedial measures.

Concluding Remarks

Hong Kong's economic experience has been an outstanding example of a society struggling, surviving and then prospering in historical cleverages.

With virtually no natural resources except an excellent harbour, the former colony prospered after the Second World War as a result of a huge influx of capital and labour from mainland China, because it served as a safe haven in the interface between the East and the West. Its economic miracle was as successful as it was astonishing.

Nonetheless, history has turned a full circle. Into the twenty-first century, with the opening up and the unrelenting rise of the mainland economy, the Hong Kong SAR is in danger of being "marginalized" under asymmetric integration. Theoretically, it needs to undergo the much heralded process of "structural transformation." Yet in reality, as its fundamental weaknesses and troubles are coming to the surface, there looms the daunting prospect of "structural dissolution" or "de-clustering" in a polarized society. Ironically, if that turns out to be its fate, it would be a consequence not of a lack of financial prowess, but of the paucity of political willpower and committed quality agents.

Viewed from the grand perspective of the twists and turns in historical development, the relative decline of Hong Kong in the context of a resurgent China represents a realignment in regional distribution of affluence and a shift in geopolitical gravity. It should not engender lasting regret for conscientious local citizens, except that people in Hong Kong might be deemed, rightly or wrongly, by future generations to have wasted their awesome stock of tangible and intangible assets accumulated over decades, without sufficient far-sightedness and genuine efforts to put up a decent fight against "fate." In fairness, the burden of guilt should not be evenly shared by everyone, just as the stock of assets is not.

Notes

1. Tsang Shu-ki, "Hong Kong of China, Hong Kong of the World," 15 September 2003, Conference on "Hong Kong's Past, Hong Kong's Future: More Than an Economic City," organized by Hong Kong Policy Research Institute, Civic Exchange and SynergyNet; conference report posted at: http://www.civic-exchange.org/publications/2004/915Full%20Report.pdf., pp. 62–73.
2. See Tsang Shu-ki, "The Economy," in *The Other Hong Kong Report 1994*, edited by Donald H. McMillen (Hong Kong: Chinese University Press, 1994), pp. 125–48.
3. Tsang Shu-ki, "The Hong Kong Economy in the Midst of the Financial Crisis," keynote speech, Regional Conference on the Financial Crisis, Hong Kong Journalists Association, 26 September 1998; article posted on author's website: www.hkbu.edu.hk/~sktsang/web9810.html.

4. For a critical discussion of the "integration" between Hong Kong and southern China in the pre-1997 era, see Tsang Shu-ki and Cheng Yuk-shing, "The Economic Link-up of Hong Kong and Guangdong: Structural and Developmental Problems," in *China and the Asian Pacific Economy*, edited by Joseph C. H. Chai, Y. Y. Kueh and Clement A. Tisdell (New York: Nova Science Publishers, 1997), pp. 51–74. In this paper, we argued that "while better coordination should be pursued to ensure mutually beneficial developments and to avoid duplication in efforts and undesirable convergence in industrial structures, the future trajectories of the two economies will not and cannot be identical. Hong Kong and Guangdong are different in size and endowments, and face dissimilar political and economic frameworks. Independent policies and measures to nurture specific advantages and to solve internal problems have to be made. Indeed, a certain distancing in economic relations between the two economies will be healthy."
5. Tsang Shu-ki, "Handling Credit Crunch under Hong Kong's Currency Board System," 6 August 1998, article posted on author's website: www.hkbu.edu.hk/~econ/web987.html.
6. Tsang Shu-ki, "The Hong Kong Economy: Opportunities out of the Crisis?" *Journal of Contemporary China*, vol. 8, no. 20 (1999), pp. 29–45.
7. Tung Chee-hwa, *Building Hong Kong for a New Era*, Policy Address at the Provisional Legislative Council, 8 October 1997.
8. See Note 6.
9. The speech is downloadable from the HKSAR Government website: http://sc.info.gov.hk/gb/www.ceo.gov.hk/archive/97-05/speech/cesp.htm.
10. The speech is accessible at the HKSAR Government website: http://www.budget.gov.hk/fb/2002/budget/english/ebudget.zip.
11. The speech is downloadable from the HKSAR Government website: http://www.policyaddress.gov.hk/pa03/eng/policy.htm.
12. The speech is accessible at the HKSAR Government website: http://www.budget.gov.hk/2004/eng/budget.htm
13. See Tsang Shu-ki, "Hong Kong's Economic Strategy Reconsidered," 7 April 2003, article posted on author's website: www.hkbu.edu.hk/~sktsang/Devt_Strategy(e).pdf); and Note 1.
14. See Notes 2 and 4.
15. In short, my investigative angle is different from those of writers who debate whether the economic border between Hong Kong and the mainland has been "Gore-tex" (i.e. one-sided) or not, and from the comments by an anonymous referee to this article who opines that the concept of "resource" that I use is too general. The "resource flow view," as I define it, does not cover just goods and services, nor does it argue that the economic border was "Gore-tex" at the beginning (as articulated by K. C. Kwok and Tai Hui, "Antony Leung's Economic Vision: Another Important Milestone in HK's Strategic

Re-positioning," article originally published by the Standard Chartered Bank in March 2002 and posted subsequently at: http://www.tdctrade.com/econforum/sc/sc020303.htm). Such a line of analysis was criticized, albeit from an even more integrationist position, by Sung Yun-wing (*Hong Kong's Economic Integration with the Pearl River Delta: Quantifying the Benefits and Costs —Final Report*, Central Policy Unit, HKSAR Government, February 2004; posted at www.cpu.gov.hk/english/documents/new/press/200404%20 PRD% 20report.pdf). The crux of the matter to me is simply policy and developmental barriers, either way, to the cross-border flows of factors of production and outputs. Subscribers to the "resource flow view" hence advocate the prompt removal of artificial barriers and the promotion of freer flows as a top priority. More broadly, my examination of asymmetric integration focuses on relative size, strength and dynamism, not on the direction of the permeability of the economic border.

16. See for example Tsang Shu-ki, "Te qu de jingji fazhan celüe yu caizheng yusuan" (The Economic Development Strategy and Fiscal Budget of the SAR), *Hong Kong Economic Journal Monthly*, April 2004; and Tsang Shu-ki, "Fanzhusanjiao jingji zhenghe: Jiyu hai shi tiaozhan?" (Pan-PRD Economic Integration: Opportunities or Challenges?), *Hong Kong Economic Journal Monthly*, October 2004.
17. Paul Krugman, *Geography and Trade* (Leuven University Press and MIT Press, 1991).
18. This in itself is a deceptive vision, because, as has been said, some important barriers are not policy-induced but the result of uneven development, which changes over time.
19. See Notes 13 and 16.
20. Tsang Shu-ki, "From Heterogeneity to Plurality?" 5 October 2004, article posted on author's website: www.hkbu.edu.hk/~sktsang/From heterogeneity to plurality.pdf,.
21. See Note 17 and Michael Porter, *The Competitive Advantage of Nations* (New York: The Free Press, 1990).
22. Sjoerd Beugelsdijk and Maarten Cornet, "How Far Do They Reach? The Localization of Industrial and Academic Knowledge Spillovers in the Netherlands," 2002, article posted at www.eco.rug.nl/~los/TEG2002Pap/Cornet.pdf; and Arnould Lagendijk, "Will New Regionalism Survive? Tracing Dominant Concepts in Economic Geography," *EUNIT Discussion paper series*, 1997, no. 10.
23. For a literature review and an empirical study, see Meric S Gertler, David A. Wolfe and David Garkut, "No Place Like Home? The Embeddedness of Innovation in a Regional Economy," *Review of International Political Economy*, Vol. 7, No. 4 (Winter 2000), pp. 688–718.
24. See Martin Ruef, "Strong Ties, Weak Ties and Islands: Structural and Cultural

Predictors of Organizational Innovation," *Industry and Corporate Change*, Vol. 11, No. 3 (2002), pp. 427–49.

25. See Sjoerd Beugelsdijk, and Ton van Schaik, "Social Capital and Regional Economic Growth," 2003, article posted at www.jyu.fi/ersa2003/cdrom/papers/518.pdf.
26. Michael Fritsch, "Do Regional Systems of Innovation Matter?" *Freiberg Working Paper*, #3/2003, p. 14.
27. See Note 16.
28. Su-Ann Mae Phillips, and Henry Wai-chung Yeung, "A Place for R&D? The Singapore Science Park," *Urban Studies*, Vol. 40, No. 4 (2003), pp. 707–32.
29. The following discussion draws on Tsang Shu-ki, "The Economic Basis of Regionalisation," in *The Pan Pearl River Delta*, edited by Yeung Yue-man (Hong Kong: Chinese University Press, forthcoming) .
30. See C. Fred Bergsten, "Open Regionalism," Working Paper 97-3, US, Washington DC: Institute for International Economics, 1997.
31. See P. Kurzar, *Business and Banking: Political Change and Economic Integration in Western Europe* (Ithaca, NY: Cornell University Press, 1993).
32. Shang-Jin Wei and Jeffrey A. Frenkel, "Open Regionalism in a World of Continental Trade Blocs," NBER Working Paper 5272, September 1995, pp. 23–24 and p. 27.
33. See Mary E. Burfisher, Sherman Robinson and Karen Thierfelder, "Regionalism: Old and New, Theory and Practice," paper presented at the International Agricultural Trade Research Consortium Conference, Capri, Italy, May 2003, posted at www.ifpri.org/pubs/confpapers/2003/burfisherrobinsonthierfelder.pdf.
34. Nuria Okfen, , "Towards an East Asian Community? What ASEM and APEC Can Tell Us," Working Paper No. 117/03, Centre for the Study of Globalisation and Regionalisation, Warwick University, June 2003.
35. See Census and Statistics Department, Hong Kong SAR Government, "Hong Kong Population Projections 2007–2036," press release (http://www.censtatd.gov.hk/press_release/other_press_releases/index.jsp?sID=1943&sSUBID=9302&displayMode=D).
36. See Census and Statistics Department, HKSAR Government (2007), *Hong Kong 2006 Population By-census–Summary Results*, February 2007 (www.bycensus2006.gov.hk/FileManager/EN/Content_962/06bc_summary_results.pdf), p. 42.
37. See Table 6.1, Census and Statistics Department, Hong Kong SAR Government, *Hong Kong Annual Digest of Statistics 2005*, p. 127.
38. See the table on "Research and Development, 2003 (Table I)," in *OECD in Figures—2005 Edition*, which is available online from the OECD website as: http://213.253.134.43/oecd/pdfs/browseit/0105061E.PDF.
39. See the proposed plan approved by the Guangdong Party Committee of the

Communist Party of China in late October 2005. It is cited as: http://finance.dayoo.com/gb/content/2005-11/01/content_2280599.htm (in Chinese).

40. The speech, in Chinese only, is available on the website of the Hong Kong SAR Government: www.info.gov.hk/gia/general/200507/25/07250107.htm.
41. See Note 16.
42. See Note 1.
43. The list is accessible online at: http://bwnt.businessweek.com/global_1000/2003/index.asp?country=HONG%20KONG.
44. The speech is downloadable from the HKSAR government website: http://www.policyaddress.gov.hk/05-06/eng/p35.htm. The words cited are from paragraph 35. Subsequently, the government has embarked on a consultative process on the establishment of a competition law which binds all economic sectors in Hong Kong.
45. Klaus Peter Fischer, "Business and Integration in the Americas: Competing Points of View," in Gordon Mace, Louis Bélanger, and contributors, *The Americas in Transition: The Contours of Regionalism* (Lynne Rienner Publishers, Inc., 1999). The part cited is available from the online version of Fischer's chapter in the book at: http://www.ciaonet.org/book/mace/mace10.html.
46. This 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 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*, February 2007, which is available online at: http://www.unctad.org/en/docs/c2clpd56_en.pdf.
47. For example, two of the biggest corporations in Hong Kong, Hutchison Whampoa and Wharf Holdings, have invested heavily in the ports in Southern China. Hence whether the container port in the SAR is overtaken by Shanghai, Shenzhen and other Chinese cities or not should not be a crucial issue for them.
48. See Legislative Council Secretariat, "Causes of Poverty in Hong Kong: A Literature Review," *Information Note*, HKSAR Government, 2004; posted at www.legco.gov.hk/yr04-05/english/sec/library/0405in16e.pdf; Xiaobin Zhao, Li Zhang and Tak O Kelvin Sit, "Income Inequalities under Economic Restructuring in Hong Kong," *Asian Survey*, Vol. 44, No. 3 (2004), pp. 442–73; and Census and Statistics Department, HKSAR Government, *Hong Kong 2006 Population By-census — Summary Results*, February 2007, (www.bycensus2006.gov.hk/FileManager/EN/Content_962/06bc_summary_results.pdf), p. 62.