

# TASKS FOR HONG KONG'S ECONOMY IN THE NEW ERA – SHIFT TO A SERVICE- ORIENTED ECONOMY AND INTRODUC- TION OF A COMPREHENSIVE COMPETITION POLICY

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In July 1, 1997, the sovereignty of Hong Kong has returned to mainland China. Since Hong Kong economy has long prepared itself for the handover, July 1, 1997 is simply a date for Hong Kong people. People's attention is now directed to the question: how will Hong Kong change in two to three years or in even five years? This paper examines the recent rapid structural changes of Hong Kong economy and the resulting problems in order to identify the necessary conditions for the continued prosperity and stability of Hong Kong after the handover.

In the account that follows, I will first analyze the rapid shift of Hong Kong from manufacturing to service-oriented economy, the changing business relationship between Hong Kong and China, and the resulting problems of these changes. Based on the result of this analysis, in the final section, I will suggest several concrete policies that may benefit the economic development of Hong Kong.

## **I. Rapid Shift to Service-Oriented Economy in Hong Kong**

Since the second half of the 1980's, Hong Kong has been undergoing a multi-faceted structural change together with notable economic growth. The speed of this structural change has gained further momentum in the 1990's. The most conspicuous aspect of the structural change in Hong Kong has been the shift to a service-oriented economy, commencing with (i) the restoration of entrepot trade, an original trade feature of Hong Kong, with the progressive opening of China to the rest of the world and (ii) the increased consignment processing production in Guangdong Province by Hong Kong manufacturers which had largely supported Hong Kong's economy upto the 1970's. The rapid improvement of the investment environment in China from the late 1980's, coupled with the loss of competitiveness of Hong Kong's manufacturing industry due to its neglect to equip itself with advanced technologies, accelerated the

relocation of manufacturing bases to Guangdong, further prompting Hong Kong's shift to a service-oriented economy. The GDP share by sector shown in Table 1 indicates that the share of the service sector in the nominal GDP increased from 70% in 1985 to 75% in 1990 and further to 84% in 1995. As far as Hong Kong's administrative area is concerned, the similar share of the manufacturing industry was below 10% in 1994 and it is no exaggeration to say that Hong Kong's economy has completely shifted to a service-oriented economy. The increasing speed of the structural change in Hong Kong is clearly indicated by the fact that the shift to a service-oriented economy advanced by 9.4% in the first half of the 1990's which was double the figure of 4.8% for the second half of the 1980's.

**Table 1**  
**Composition of and Contribution to GDP by**  
**Economic Activity: 1985-1995**

	Composition of GDP			Structural changes		Contribution to GDP	
	1985	1990	1995	1985-90	1990-95	1985-90	1990-95
<b>Agriculture &amp; Fishing</b>	<u>0.5</u>	<u>0.3</u>	<u>0.1</u>	<u>-0.2</u>	<u>-0.1</u>	<u>0.1</u>	<u>0.0</u>
<b>Industry</b>	<u>29.9</u>	<u>25.3</u>	<u>16.0</u>	<u>-4.6</u>	<u>-9.2</u>	<u>21.4</u>	<u>4.8</u>
Mining & quarrying	0.1	0.0	0.0	-0.1	0.0	0.0	0.0
Manufacturing	22.1	17.6	8.8	-4.6	-8.8	13.8	-1.9
Electricity, gas & water	2.6	2.3	2.3	-0.4	0.0	1.9	2.4
Construction	5.0	5.4	4.9	0.4	-0.5	5.7	4.3
<b>Services</b>	<u>69.6</u>	<u>74.5</u>	<u>83.8</u>	<u>4.8</u>	<u>9.4</u>	<u>78.5</u>	<u>95.2</u>
Commerce & trades	22.8	25.2	27.4	2.3	2.2	27.1	30.0
(Trade)	(12.6)	(15.3)	(17.1)	(2.7)	(1.8)	(17.5)	(19.6)
(Wholesale/retail)	(5.8)	(5.3)	(5.0)	(-0.5)	(-0.3)	(4.9)	(4.7)
(Restaurants/hotels)	(4.4)	(4.6)	(4.1)	(0.1)	(-0.5)	(4.7)	(3.5)
Transport & communication	8.1	9.5	9.8	1.3	0.4	10.6	10.3
Financing, real estate	16.0	20.2	24.9	4.2	4.7	23.7	30.6
(Real estate)	(6.6)	(9.7)	(12.4)	(3.1)	(2.7)	(12.2)	(16.3)
(Financing/insurance)	(6.4)	(7.0)	(10.6)	(0.6)	(3.6)	(7.5)	(15.7)
(Business services)	(3.0)	(3.6)	(3.8)	(0.5)	(0.2)	(4.0)	(4.1)
Community, social service	16.7	14.5	17.1	-2.2	2.6	12.7	20.3
Ownership of premises	10.5	10.6	12.7	0.1	2.1	10.7	15.2
Gross Domestic Product	100.0	100.0	100.0			100.0	100.0

Notes: Figures in 1995 in respect of Trades, Wholesale/retail, Restaurant/hotels, Real estate, Financing/insurance, Business services are for the year 1994. Consequently, Structural changes and Contribution to GDP each present for 1990-1996.

Source: Census and Statistical Department, Estimates of Gross Domestic Product 1961 to 1996, March 1997, Hong Kong.

The shift to a service-oriented economy in Hong Kong has been particularly accelerating in two areas in the 1990's. Firstly, among various service industries, the prime mover of the economy has been changing from trade to finance/insurance. Trade, which recorded conspicuous growth in the 1980's, is showing unmistakable signs of slowing down in the 1990's. The GDP share of trade increased by 2.7% from 12.6% to 15.3% in the second half of the 1980's but only increased by 1.8% in the first half of the 1990's. In contrast, finance/insurance which did not record any significant change in the 1980's has increased its combined share by 3.6% in the 1990's, out-pacing the growth of trade in the same period. In 1994, the share of trade actually declined on year-on-year basis while the share of finance/insurance further increased by 2%. Secondly, the real estate business is booming. In general, the term "real estate business" means real estate development, property rentals and building management by companies. In Hong Kong, however, property rentals involving houses/flats owned by individuals comprise a large part of the real estate business. There are many cases where the owner of a high class house, bought with a loan, rents the house to a foreigner while choosing to live in a small but inexpensive public housing unit. Reflecting the importance of private rentals, Hong Kong's GDP statistics list "the ownership of premises", which shows the income of individuals from housing rentals, separately from the real estate business run by companies. These two real estate business categories jointly accounted for as much as 25.1% of Hong Kong's nominal GDP in 1995, far exceeding trade (17.1%) and finance/insurance (10.6%) and establishing the real estate business as Hong Kong's largest industry today.

The rapid growth of the real estate business commenced in the second half of the 1980's in tandem with the shift of Hong Kong's economy to a service-oriented economy. Its share increased by 3.2% in the second half of the 1980's from 17.1% to 20.3% and by a further 4.8% in the first half of the 1990's. Accordingly, its contribution rate to the GDP annually increased to 23% through the second half of the 1980's and 32% in the first half of the 1990's. This trend has gained further momentum in recent years with the GDP contribution rate of the real estate business reaching 43% in 1994. Although development of the real estate business usually takes place as a derivative demand of economic growth, it is growing faster than trade and finance, both of which are figure heads of Hong Kong's economy. The reality of Hong Kong awaiting the return of sovereignty can, therefore, be described as an international real estate centre while pretending to act as an international financial business centre (see reference material 1).

## II. Changing Business Relationship of Hong Kong with China

### *Regional Trade and Manufacturing Centre Under Threat*

The recent rapid structural change clearly indicates the fact that Hong Kong's function has been changing in response to bewildering changes of the global business environment, particularly the economic growth and foreign policy changes of China. Following the reform and liberalisation of China's economy, Hong Kong has assumed the function of three economic centres through economic integration with China.

The first is the function of a regional trade centre, symbolised by entrepot trade and triangular trade. The second is the function of a manufacturing management centre, symbolised by consignment processing production by Hong Kong manufacturers in the South China Region, while the third is the function of an international finance centre based on the real demand provided by the other two functions. Since the adoption of a Open-door policy by China, Hong Kong has seen a rapid increase of entrepot trade as well as processing deal trade and, as a result, has experienced marked development as the key base for China trade and the manufacturing management base for the South China Region. Once Hong Kong was firmly established as a window for external trade for China, triangular trade between Chinese export-import corporations and foreign trading houses without passing through Hong Kong also prospered, making Hong Kong a regional trade centre with trade with China playing a central role.

Entrepot trade via Hong Kong, however, began to decline when China changed its external policy to open the entire country to foreign investment. A large number of foreign companies moved into major cities in China to take advantage of the new policy and the gradual infrastructure improvement in the coastal region diversified the trade channels with China. Table 2 reclassifies Hong Kong's trade statistics into exports by Hong Kong manufacturers and entrepot trade to show the changes of these categories in the 1990's. The year-on-year increase rate for entrepot trade with China declined by a half in 1994 and was down to a mere 1% in 1996 as trade with China suffered a major downturn. Meanwhile, such service trade as triangular trade and trans-shipment showed an increase. Triangular trade means the direct shipment of trade goods from a Chinese port to a foreign country (or vice-versa) without passing through Hong Kong although the trade agreement is made in Hong Kong. Trans-shipment means the transfer of Chinese goods off-shore of Hong Kong to a triangular without the goods landing in Hong

Kong. This illustrates the weakness of China's coastal provinces in that they still rely on the wide range of infrastructure in Hong Kong, which has prospered as a trade base with China, even though these provinces are actively trying to establish their own trade links. In short, Hong Kong's function as a regional trade centre is shifting from the trade of goods to the trade of services following the change of China's external policy to open the entire country. As the trade of services is marked by a lower rate of margin than the trade of goods, the total added value by trade appears to be suffering from slow growth.

Another major change in recent years is that production based on outward processing deals in the South China Region is showing signs of levelling off, presumably because of the policy change of the Chinese government to treat foreign companies as Chinese nationals and the catching up of Chinese companies with Hong Kong manufacturers who have neglected to transform their manufacturing base into a more advanced base (see reference material 2). As Table 2 shows, the exports of outward processing deal products by Hong Kong manufacturers began to slow down in 1993 and this trend was further intensified in 1996. As such, Hong Kong's economy has recently begun to see a dark cloud over two of its three functions which have sustained its development, i.e. that of a regional trade centre and that of a manufacturing management centre.

### *Thriving International Finance Centre*

Hong Kong's economy still maintains a GDP growth rate of almost 5% after reaching the level of advanced countries in terms of the GDP per capita as described earlier despite its worrying performance in some areas. This high growth has been backed by the notable growth of the financial and real estate businesses, over-shadowing the sluggish performance of trade and manufacturing. In particular, the finance/insurance business has been very active since 1993. Needless to say, financial trade in Hong Kong has been greatly boosted by full-scale investment by Hong Kong-based business groups in China and also by Overseas Chinese in Southeast Asia in China via Hong Kong, taking the opportunity which opened up after China's accelerated economic reform and opening up in 1992. In addition, the rapidly increasing presence of Chinese companies in Hong Kong has further boosted financial trade in Hong Kong.

Table 2

### Trends in Exports by Hong Kong Manufacturers and Entrepot Trades: 1978 to 1996

(Million HK\$,%)

	Exports of Hong Kong Manufacturers			Entrepot trades		
	(A)+(B)	Local exports (A)	Exports of consignment processing products (B)	(C)+(D)	China-related re-exports (C)	Other re- exports (D)
1978	40,700	40,700	0	13,200	3,868	9,332
	< 75.5% >	(100.0%)	(0.0%)	< 24.5% >	(29.3%)	(70.7%)
1991	411,189	189,426	221,763	239,179	156,931	82,248
	< 63.2% >	(46.1%)	(53.9%)	< 36.8% >	(65.6%)	(34.4%)
1992	488,428	188,087	300,341	292,496	197,349	95,147
	< 62.5% >	(38.5%)	(61.5%)	< 37.5% >	(67.5%)	(32.5%)
1993	541,489	176,135	365,354	342,280	245,787	96,493
	< 61.3% >	(32.5%)	(67.5%)	< 38.7% >	(71.8%)	(28.2%)
1994	603,957	178,532	425,425	382,708	276,434	106,274
	< 61.2% >	(29.6%)	(70.4%)	< 38.8% >	(72.2%)	(27.8%)
1995	679,698	186,279	493,419	444,695	316,535	128,160
	< 60.5% >	(27.4%)	(72.6%)	< 39.5% >	(71.2%)	(28.8%)
1996	721,465	167,177	554,287	443,482	319,996	123,486
	< 61.9% >	(23.2%)	(76.8%)	< 38.1% >	(72.2%)	(27.8%)
<b>(Rate of increase over previous year)</b>						
1978-91	19.5%	12.6%	-	25.0%	33.0%	18.2%
1992	18.8%	-0.7%	35.4%	22.3%	25.8%	15.7%
1993	10.9%	-6.4%	21.6%	17.0%	24.5%	1.4%
1994	11.5%	1.4%	16.4%	11.8%	12.5%	10.1%
1995	12.5%	4.3%	16.0%	16.2%	14.5%	20.6%
1996	6.1%	-10.3%	12.3%	-0.3%	1.1%	-3.6%

- Notes: 1. Re-exports of consignment processing products produced by Hong Kong companies in China included in exports of local manufacturers for adjustment of Hong Kong export statistics. Namely, (Exports of Hong Kong manufacturers) = (domestic exports) - (Domestic exports for consignment processing production) + (Re-export of consignment processing production in China)  
(Entrepot trade) = (re-exports) - (Re-exports of consignment processing production in China) - (Re-exports for consignment processing production)
2. Percents in parentheses below export figures represent shares. Figures in triangular brackets < >, however, represent shares of exports of domestic manufacturers and entrepot trade in total exports, while figures in parentheses ( ) represent shares of items in export of Hong Kong manufacturers or entrepot trade.

Source: Prepared from yearly editions of Census and Statistics Department, "Annual Review of Hong Kong External Trade."

Another important factor for the booming financial sector is that the recovery of profits by Hong Kong companies from past direct foreign investment has begun to have a positive impact on Hong Kong's

economy. Although the return of profits made by Hong Kong companies from direct foreign investment does not directly affect the GDP growth rate, it does act to increase the GNP, i.e. Hong Kong's total income. Hong Kong companies have actively expanded their direct foreign investment in the 1990's, mainly focusing on the development of infrastructure in China. As most cases of investment have taken the form of BOT, the recovery of profits has begun with those projects which are already at the operational stage. Hong Kong's outward investment, especially investment in China, has been rapidly growing since 1992, reaching US\$ 100 billion at the end of 1996 and almost equally the total amount of direct inward investment received by Hong Kong up to the end of 1995 (see Table 3).

Table 3

**Foreign Direct Investment in China and Hong Kong and Their  
Cross-investment in each economies: 1991 to 1997**

	1991	1992	1993	1994	1995	1996	Total
FDI in China	43.7	110.1	275.1	337.7	378.1	417.3	1,738.3
of which, from Hong Kong	24.1	75.1	172.7	198.2	201.9	206.8	984.8
(Hong Kong's Share, %)	(55.1%)	(68.2%)	(62.8%)	(58.7%)	(53.4%)	(49.6%)	(56.7%)
FDI in Hong Kong	n.a.	n.a.	n.a.	79.7	100.9	n.a.	1,006.2
of which, from China	n.a.	n.a.	n.a.	17.5	19.5	n.a.	192.9
(China's Share, %)	-	-	-	(22.0%)	(19.3%)	-	(19.2%)

Notes: 1. Figures in FDI in Hong Kong (1994,1995) are subject to the incremental amounts of Total Investments.

2. Total FDI in China summed up figures since 1984.

Sources: 1. *Zhongguo tongji nianjian*, various issues.

2. CSD, *External Investments in Hong Kong's Non-manufacturing Sectors*, 1993,1994,1996.

The returning flow of investment profits earned by Hong Kong companies through direct foreign investment is listed in the statistics under the heading of direct investment income inflow in the external factor income flows. The inflow total from direct investment income published by the Government of the Hong Kong SAR puts the figure at HK\$111.6 billion in 1994 which was a 38.2% increase on the figure for 1993. Unfortunately, GNP statistics were first introduced in Hong Kong in 1995 to indicate the nominal GNP data for 1993 and, therefore, the only statistical data is that for 1993 and 1994. Taking the increasing trend of Hong Kong's investment in China since 1992 into consideration, it can be easily imagined that the impact of the return flow of investment profits on Hong Kong's economy has been increasing every year. For example, as

Hong Kong companies have been investing an annual amount of some US\$ 20 billion in China since 1993, let us assume that projects with the same total amount of investment will commence commercial operation each year with a recovery of profits equivalent to 15% of the invested amount. The resulting return flow of investment profits will increase by US\$ 3 billion every year. This figure corresponds to 2.3% of the GDP in 1996. In other words, assuming that direct investment income is recovered rather than re-invested, Hong Kong has the potential to increase its GDP by 2% by the return flow of investment profits alone. This must be seen as a very positive factor when discussing the mid-term prospects for Hong Kong's economy.

As analysed so far, Hong Kong's economy has expanded its subject area from South China to entire China, taking the opportunity of the accelerated economic reform in China in 1992, and has become an integrated base for businesses with China, ranging from trade to investment. Following such development, the main function of Hong Kong has been shifting from that of a regional trade centre and manufacturing management centre to that of an international finance centre.

### III. Problems Resulting From Structural Change

#### *Widening of Income Gap*

It is also true that the rapid structural change in the 1990's has distorted Hong Kong's economy and society in many ways. Widening of the income gap typically symbolises such negative development. While the income gap has never been small in Hong Kong, the unequal distribution of income has been rapidly increasing in the 1990's. Indicating the unequal income distribution in Hong Kong, the Gini coefficient was 0.45 in the 1980's but has continually increased in the 1990's. Between 1986 and 1991, the Gini coefficient increased by 0.023 points, reaching the 0.5 mark in 1996 as it increased by a further 0.042 points. The Gini coefficient is said to be around 0.35 for countries with relatively fair income distribution and a level of more than 0.4 or 0.5 is said to indicate unfair or extremely unfair income distribution respectively. While the progress of globalisation since the second half of the 1980's has tended to widen inequality in many Asian countries, the Gini coefficient of 0.52 for Hong Kong, the economic size of which has already reached the level of advanced countries, is nevertheless particularly high (see Table 4).

Table 4

**Trends of Income Distribution of Households and  
Gini Coefficient: 1966 to 1996**

	1966	1971	1976	1981	1986	1991	1996
Lowest(20%)	6.0	6.0	5.5	4.4	5.0	4.3	3.7
Middle(60%)	36.5	44.0	45.9	44.4	44.3	42.9	40.0
Top(20%)	57.5	50.0	48.6	51.1	50.7	52.8	56.5
Gini Coefficient	0.50	0.43	0.425	0.451	0.453	0.476	0.518

Sources: CSD, *Hong Kong Population Census, Main Report*, Various issues.

There appear to be five factors which have contributed to the widening of the income gap in the 1990's. Firstly, there is a mismatch in terms of labour as a result of the rapid structural change in the 1990's. The major structural change from manufacturing and trade to finance has produced a large demand for professionals, management staff and engineers, resulting in a widening wage gap between them and ordinary workers with lesser knowledge and/or lower skills. Secondly, there has been an influx of "new immigrants". In order to supplement a long-term labour shortage, Hong Kong has set a daily quota of 150 new immigrants from China, totalling some 55,000 year which is slightly less than 1% of the total population. These new immigrants have found their way en masse to such low wage sectors as manufacturing and construction, forming a low income class. Thirdly, the structural change from trade to investment as gateway to China has caused a change in terms of the standard bearers of Hong Kong's economy from small manufacturers and traders to large corporations and financial groups. While large corporations have been making profits by advancing to new business fields, making the best use of globalisation and the accelerated economic reform in China, ordinary small manufacturers and traders have been struggling with sluggish exports. Fourthly, the finance/insurance, real estate, telecommunications, transport/warehousing and physical distribution markets, all of which are consolidating their positions as growth markets for the future of Hong Kong, form oligopolistic markets, preventing the full functioning of the principles of competition. This has led to a situation in which some large corporations make rather unfair profits in such oligopolistic markets while ordinary companies are prevented from entering these markets with the loss of opportunity of increasing their earnings. Fifthly and finally, there has been a tremendous price rise of such assets as real estate and stocks in the 1990's, further widening the gap between the haves and have nots.

A number of problems have manifested in Hong Kong as a result of the rapid structural change as described above and their combined effects have made the unequal income distribution acutely felt. While all of these are of a very serious nature, the first three factors are the result of dynamic development following the globalisation of the economy. To be more precise, these may be described as frictions of a transitional nature caused by the extremely fast structural change. If both the public and private sectors can successfully work together to produce the manpower required for an advanced economy or service-oriented economy, these problems can be solved rather quickly.

In contrast, the fourth and fifth factors are not direct results of structural change but are the results of the market structure of promising industries which are emerging in the aftermath of structural change. These factors have appeared as a result of the new economic reality where new entry to Hong Kong's growth markets has been blocked for one reason or another, depriving aspiring companies of the opportunity to earn new profits or to increase their earnings.

### *Shift to Service-Oriented Economy and Oligopolistic Markets*

It is natural for industrial organizations to undergo various transformations in the midst of conspicuous structural change. What is important here, however, is what is happening to the state of market competition. Manufacturing and trade led by small companies formed the mainstay of Hong Kong's economy upto the mid-1980's and the markets were very competitive. The subsequent change of the industrial structure from manufacturing and trade to finance, real estate and telecommunications, etc. has changed the standard bearers of Hong Kong's economy from small companies to large corporations, creating oligopolistic markets with less competition.

The Consumer Council published a report on the policy on competition in November, 1996, pointing out that, in Hong Kong, the main service industries are under an oligopolistic regime and that the level of market competition is low (see reference material 3). Oligopoly is particularly noticeable among service industries serving the local market. In the case of the finance sector for example, bank deposits in HK dollars are highly concentrated as deposits payable on demand and savings deposits are virtually in the hands of 10 and six banks respectively of the 182 licensed banks. In the case of term deposits, four banks with exclusive licenses share the market. There is a similar picture in the real estate market. In regard to private housing supplied from 1991 to 1994, one

developer accounted for 25% of the total supply while the combined market share of the top three, top five and top seven was 45%, 55% and 70% respectively. Telephone and gas are virtual monopolies. The top two supermarkets enjoy a combined market share of 70% and two local TV stations dominate the local market with a combined share of 94%.

The progress of oligopoly in local service industries with the insufficient functioning of the principles of competition will certainly have a significant impact on both the future growth and stability of Hong Kong's economy. Firstly, as pointed out by the said report, the lack of competition in local service industries could adversely affect the growth of the service trade, a sector with promising future growth prospects. In the case of highly concentrated and oligopolistic local service industries, oligopolistic large corporations exert their power of market control to set and maintain high prices to enjoy large profits. This practice has resulted in increasing direct and indirect costs for the trade or service trade sector. In particular, the pressure of the recent increase of real estate prices on Hong Kong's economy is strongly felt. In its report, the Consumer Council expressed strong suspicion that oligopolistic large corporations operating in the real estate business were maximising their profits through concerted actions (see reference material 4). Various questionnaire surveys and statistics make it clear that price increases in the service and non-trade goods sectors have worsened the investment environment in Hong Kong and have weakened the international competitiveness of the trade and service-trade sectors.

The market conditions where competition between growth industries is prevented poses a serious problem for the stability of Hong Kong's economy and society. As already described, while the insufficient functioning of the market mechanism in growth industries is a causative factor of the recent widening of the income gap, the problem is that the gap is widening through "unfair" means. According to the above-mentioned report, in the telecommunications sector, i.e. a growth industry, the Hong Kong government has given monopoly rights to the international telephone business to the HKTI until the year 2006. This monopoly policy has had a tangible effect on the domestic call competition with the price adjustment between international and domestic calls. In the case of the real estate business, the large size of plots sold by the government acts as a deterrent to the participation of smaller developers. Moreover, oligopolistic large developers have much land which they obtained cheaply in the past and can offer higher bidding prices in tenders for new land, successfully preventing the entry of newcomers into the market. If government policies and bureaucratic

formalism or high barriers are preventing newcomers to various sectors with the result of excessive profits or loss of new earning opportunities, in turn widening the income gap, the problem is truly serious.

In fact, the income gap has so far seldom been considered a problem in Hong Kong. Almost everyone entertains the Hong Kong dream, praising those who achieve the dream. However, it is now very difficult, if not impossible, for ordinary people to achieve the Hong Kong dream. If the recent widening of the income gap originates from unfair markets and systems, discontent among the people of Hong Kong will certainly become manifest in the form of political and social problems. The recent series of bomb explosions in Hong Kong is a protest against the housing policy of the government and is a manifestation of the public's dissatisfaction with the current reality that the high increase of housing prices has made it practically impossible for ordinary people to buy homes. The introduction of a policy of competition is urgently required to alleviate social discontent and to strengthen the international competitiveness of Hong Kong's service-oriented economy.

#### IV. Future Tasks

Hong Kong has maintained high economic growth in the 1990's through transformation from dependence on trade to the establishment of itself as a key base for businesses, including investment, with China. If the implications of the long-term growth potential of China as the hinterland of Hong Kong and the current economic gap between Hong Kong and China on the future prospects of Hong Kong's economy are considered, it is beyond doubt that Hong Kong has a relatively high growth potential among advanced countries. The recent commencement of the recovery of profits from past investment in China is one factor boosting the medium and long-term growth potential of Hong Kong. Nevertheless, if a situation arises in which the function of an international finance centre begins to suffer from the adverse effects of the declining competitiveness of service industries serving local markets, following the path of the regional trade centre and manufacturing management centre functions, the potential of Hong Kong's economy will be unable to sustain the strong growth performance recorded in the first half of the 1990's. Even though the Hong Kong government is confident of achieving a medium-term GDP growth rate in the region of 5%, it must realise that the singular growth of Hong Kong's economy has come to an end and has entered the world of a business cycle. Consequently, it must introduce not only a growth policy but also policies focusing on stabilisation and fair trading.

One concrete task for the Hong Kong government is further infrastructure development as part of the growth policy in response to the structural change of the local economy. As the hard aspect of such a policy, the port and airport development strategy has nearly reached completion and infrastructure development in the areas of information and telecommunications must be conducted in the coming years. Needless to say, the manpower to manage the service-oriented economy must be developed at the same time. The second requirement is the introduction of an industrial policy to achieve high added value in the manufacturing sector as part of the stabilisation policy. Even though the share of the manufacturing sector in Hong Kong's economy has declined, it still plays an important role, especially when outward processing deals in the South China Region are taken into consideration (see reference material 1). Revitalisation of the manufacturing sector is important as it will not only preserve the function of Hong Kong as the manufacturing management centre for the South China Region but will also support small manufacturers and traders operating in Hong Kong. Furthermore, the introduction of a fair trading policy is essential to maintain the growth and stability of Hong Kong's economy in the future. The introduction of competition principles in the service sector, Hong Kong's original growth sector, should restore the original advantages and strength of Hong Kong's economy. Active efforts must be made to introduce a competition policy, including the establishment of a fair trade commission.

When discussing the future of Hong Kong following the return of sovereignty, many concerns have been expressed in regard to possible problems arising from the change of the economic system from the British system to the Chinese system. However, a more important question is how to deal with problems originating from economic development and structural change.

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