

ECONOMIC RELATIONS BETWEEN HONG KONG AND GUANGDONG PROVINCE

*Toyojiro Maruya**

INTRODUCTION

After the Second World War, the economic relationship between Hong Kong and China became more strained as a result of China being taken over by communist rule. However, since 1979 China has undertaken an open door policy which changed the fundamental economic relationship between Hong Kong and China. For example before 1979 the Chinese government had restricted its external trade to a minimal level. So when such restrictions were lifted, their trade relationship was revived. What particularly spurred the development was China's introduction of a policy to attract more foreign investment. With this policy, Hong Kong started to invest in China in order to take advantage of the abundant but cheap labour supply. To take advantage of these resources, Hong Kong enterprises moved their labour intensive manufacturing base to China while preserving the high value-added production in Hong Kong. Through such spatial division of labour in the manufacturing relationship between these economies, the Hong Kong manufacturing industry has been able to preserve its international competitiveness. This phenomenon has been termed the "spatial division of labour between Hong Kong and China". Not only has this change strengthened the economic relationship in manufacturing, but every economic aspect including finance, exchange of human resources, and information has been boosted. The horizontal division of labour between Hong Kong and China also induced many Hong Kong manufacturing industries to shift their labour-intensive production base to China. Since Guangdong Province is situated just next to Hong Kong, it is natural that Hong Kong-Guangdong economic relations would become mutually strengthened.

Although the purpose of this book is to focus on the economic dynamism of Guangdong Province, the author would like to point out that the development of Guangdong's economy cannot be isolated from its

*The author's thanks go to Miss May Wong at the City Polytechnic of Hong Kong, for her assistance in translating this paper.

relationship with Hong Kong and the integral relationship bonds the two economies. In this chapter, therefore the role of Hong Kong will be analyzed with respect to the integral nature of Hong Kong-Chinese economic relations. This chapter will focus on the economic shifts that have taken place between Hong Kong and China since the introduction of China's foreign investment policy. These trade shifts are as follows:

- trade structure with China
- direct investment in China
- division of labour
- triangular trade relationships

With result of this, since Hong Kong's economy is becoming more dependent on China, the service sector in Hong Kong will become more prominent.

1. A Changing Trade Structure

a. Revitalised Entrepot Trade

The open door policy of China has had great impact on the structure of Hong Kong trade. This policy not only reopens the trading relations between Hong Kong and China but it also revitalises Hong Kong's traditional entrepot trade which was once active thirty years ago.

When we examine the figures of Hong Kong's domestic export from 1978 to 1990, China's share extended from 0.2% in 1978 to 21.0% in 1990. The share of China related re-export (re-export to China and re-export of China-made products via Hong Kong) to the total amount of re-export extended from 29% in 1978 to 87% in 1990. With this expansion, the annual growth rate of the territory's domestic export, re-export and import increased at 15%, 33%, and 22% respectively in the past 12 years since 1978. It is important to point out that re-exports had the most distinctive result. In 1978, re-exports took less than 25% of the total amount of export but its share was increasing steadily ever since. In 1988, the growth rate of re-exports exceeded those of domestic exports and took 64% of the territory's total amount of export in 1990 (see Table 1).

As result of the increasing China-related re-export, it can be observed that Hong Kong's entrepot trade between China and the third world has been revitalised. Although Hong Kong's entrepot trade is prospering after China reopened its country, the nature and characteristics of its present entrepot

trade is very different from that of the 1950s. The underlying reason for Hong Kong's rapid growth in entrepot trade after 1980s cannot be contributed only to the prospering entrepot trade between China and the Asia Pacific region, but also to another factor, that is the raw materials and parts which are being sent into China by Hong Kong enterprises. After assembling these resources in China, Hong Kong enterprises re-export the products to other countries via Hong Kong.

Table 1
The Changes of Domestic, Re-export and China-related Export

	Domestic Export (A)		Re-export (B)				(A)	(B)
	HK\$1 billion	China's share (%)	HK\$1 billion	China-related's share (%)	Share to China	China-made products' share	(A) + (B) (%)	(A) + (B) (%)
1978	40.7	0.2	13.2	29.3	1.6	27.7	75.5	24.5
1979	55.9	1.1	20.0	34.9	6.6	28.3	73.6	26.4
1980	68.2	2.4	30.1	43.3	15.4	27.9	69.4	30.6
1981	80.4	3.6	41.7	50.0	19.3	30.7	65.8	34.2
1982	83.0	4.6	44.4	51.1	18.0	33.1	65.2	34.8
1983	104.4	6.0	56.3	56.6	21.6	35.0	65.0	35.0
1984	137.9	8.2	83.5	67.3	33.6	33.7	62.3	37.7
1985	129.9	11.7	105.3	76.6	43.7	32.9	55.2	44.8
1986	154.0	11.7	122.5	75.5	33.4	42.1	55.7	44.3
1987	195.3	14.3	182.8	79.0	32.9	46.1	51.6	48.4
1988	217.7	17.5	275.4	82.2	34.5	47.8	44.1	55.9
1989	224.1	19.3	346.4	84.2	29.9	54.3	39.3	60.7
1990	225.9	21.0	404.0	87.0	27.5	59.5	35.9	64.1
[Average growth p.a. (%)]								
(78-84)	(22.6)	(127.7)	(36.0)	(56.2)	(68.3)	(40.5)		
(84-90)	(8.6)	(27.1)	(30.1)	(35.7)	(125.4)	(43.0)		
(78-90)	(15.4)	(70.0)	(33.0)	(45.6)	(25.7)	(41.7)		

Source: Census and Statistics Department, *Hong Kong Annual Digest of Statistics*, various issues.

b. Situation of Outward Processing Trade

Outward processing trade between Hong Kong and China is a result of direct investment to China by Hong Kong enterprises. According to the Census and Statistics Department,¹ the projected values of outward processing trade in the territory's domestic export, re-export, and import with China

for each quarter from the third quarter of 1988 to the third quarter of 1991 are shown in Table 2. The Hong Kong's trade with China can be divided into the following types:

- i. outward processing trade, and
- ii. traditional China trade (export for China's domestic demand and import for territory's consumption and for re-export of China-made products).

It is shown in Table 2 that in 1990, the outward processing trade has exceeded the traditional China trade in terms of Hong Kong's domestic exports, re-exports, and imports. In this year, the export of raw material and parts related to outward processing production took 79.0% of the domestic export, 50.3% of re-export, and 58.8% of Hong Kong's total exports to China. On the other hand, the re-import of processed and assembled products by Hong Kong enterprises took 61.8% of total volume of re-imports from China.

Table 2

The Changes of Hong Kong-China Trade:
Outward Processing Trade and Traditional Trade

Unit: HK\$1 million, %

	Domestic Export to China			Re-export to China			Import from China		
	Trade	O.P.	T.T.	Trade	O.P.	T.T.	Trade	O.P.	T.T.
[Composition]									
88-III	10,687	73.5	26.5	26,007	37.0	63.0	40,292	58.5	41.5
89-I	8,984	72.1	27.9	25,132	35.5	64.5	53,241	57.8	42.2
89-III	11,101	77.2	22.8	25,658	46.3	53.7	45,674	57.3	42.7
90-I	8,993	77.3	22.7	22,349	47.5	52.5	62,963	62.3	37.7
90-III	12,468	77.9	22.1	27,811	52.6	47.4	56,847	67.0	33.0
91-I	9,931	79.4	20.6	28,685	47.5	52.5	79,288	68.2	31.8
91-III	14,188	77.0	23.0	40,984	49.4	50.6			
[Increase rate for the same quarter of previous year]									
89-III	3.9	9.2	-10.9	-1.3	23.4	-15.9	13.4	11.1	16.6
90-I	0.1	7.3	-18.6	-11.1	18.9	-27.6	18.3	27.4	5.8
90-III	12.3	13.3	8.9	8.4	23.1	-4.3	24.5	45.4	-3.6
91-I	10.4	13.3	0.5	28.4	28.3	28.4	25.9	37.9	6.1
91-II	13.8	12.5	18.3	47.4	38.5	37.1			

Notes: O.P. means outward processing trade
T.T. means traditional china trade

Source: Census and Statistics Department, *Hong Kong External Trade*, various issues.

Although the real picture of outward processing trade was unknown before 1988 owing to the lack of statistics before this year, it is certain that the outward processing trade has been increasing since Hong Kong enterprises have continued to invest. The average annual share of outward processing trade to domestic exports, re-exports, and imports have increased to 11.7%, 28.2%, and 35.6% respectively in the recent two or three years.² The share of outward processing trade in re-export and import have increased rapidly compared to its share of domestic exports. This is due to the fact that Hong Kong enterprises have shifted their manufacturing production bases from Hong Kong to China. On the other hand, as a result of the rectification of China's economy and the Tienanman Square Incident, the traditional China trade decreased until the latter half of 1990. Also its growth rate remained low in domestic exports which was 4.7%, 8.2% in re-exports and 5.9% in import respectively. During the period the share of outward processing trade increased to 4% in domestic exports, 12% in re-exports, and 5% in imports.

The composition of the outward processing trade is basically very similar to that of Hong Kong's export products. The export goods for outward processing production in China mainly include textile materials and articles, machinery and mechanical appliances, sound and television recorders reproducers, and plastic articles. The import of outward products processing mainly include textile garments, machinery and mechanical appliances, sound and television recorders and reproducers. On the other hand, the share of outward processing trade in the Hong Kong's trade with China has increased substantially on the following items:

- i. more than 95% for clocks and watches,
- ii. more than 85% for toys, sports requisites, garments, and sound and television recorders and reproducers.

It is, no exaggeration to say that the Hong Kong's trade with China of all the above items are nearly from outward processing trade which is managed by Hong Kong enterprises.

Since there is an investment boom from Hong Kong enterprises in China, outward processing trade has replaced traditional China trade. Therefore, the rapid increase of Hong Kong trade in recent years is mainly contributed to an intra-industrial trade of Hong Kong's enterprises in outward processing trade instead of traditional China trade.

Table 3

The Percentage of Outward Processing Trade in the Hong Kong-China Trade (1990)

Unit: %

	Domestic Export		Re-export		Import	
	(A)	(B)	(A)	(B)	(A)	(B)
Textile materials, fabrics	15.6	84.2	40.1	75.9	4.0	18.2
Apparel garments	4.8	87.9	1.7	86.5	27.7	87.4
Plastics products	13.6	86.1	10.5	68.7	2.9	78.0
Machinery, electrical appliances	13.5	62.2	11.9	31.2	11.7	73.3
Sound & TV recorders	20.7	94.4	6.5	52.9	15.4	88.7
Clocks & watches	7.7	97.3	4.3	96.9	4.9	94.9
Toys & sport requisites	4.0	96.9	0.8	73.2	9.7	94.8
Metal products	4.3	71.1	5.4	46.4	2.0	32.5
Others	15.8	62.9	18.7	30.7	21.7	43.7
Total Amount	100.0	79.0	100.0	50.3	100.0	61.8

Note: (A) The percentage of various industries in outward processing trade.

(B) The percentage of outward processing trade in the amount of domestic export, re-export, and import to outward processing trade.

c. Characteristics of Recent Trade Structure

The purpose of this section is to analyze whether there have been any recent changes in Hong Kong's trade structure recently. According to statistical data of the trade relations between Hong Kong and China in 1990, Hong Kong's roles in linking China and third countries are shown at Figure 1. In the figure, the upper part represents China, the lower part represents third countries excluding China, and the middle part represents Hong Kong. The arrows represent the direction of flow of trade. The figures within \circ , Δ , and \square represent the amount of trade from Hong Kong, China, and third countries respectively passing through Hong Kong's customs. Hong Kong's resources and products can pass through customs via three routes:

- i. *the channel of flow of Hong Kong's domestic export.*
In 1990, there were 48 units being exported to China out of 226 units of total export. The remaining 178 units are exported to third countries. (one unit represents HK\$ 1 billion)
- ii. *the channel of flow of resources from third countries.*
Among 406 units of import from third countries, 97 and 77 units are re-exported to China and third countries respectively, and the remaining 255 units are consumed in Hong Kong.
- iii. *the channel of import from China.*

Among 236 units of China import, 14 and 226 units are re-exported to China and third countries respectively, and the remaining 27 units are consumed in Hong Kong. The 14 units which are being re-exported to China are called "China-China trade".

There is a point in the statistical data on re-exports which deserves clarification. There is general estimation that 15% added value is placed on the re-export items. Therefore, in the second and the third channel of trade, the volume of imports are not equal to the summation of the volume of re-export plus the volume of domestic consumption.

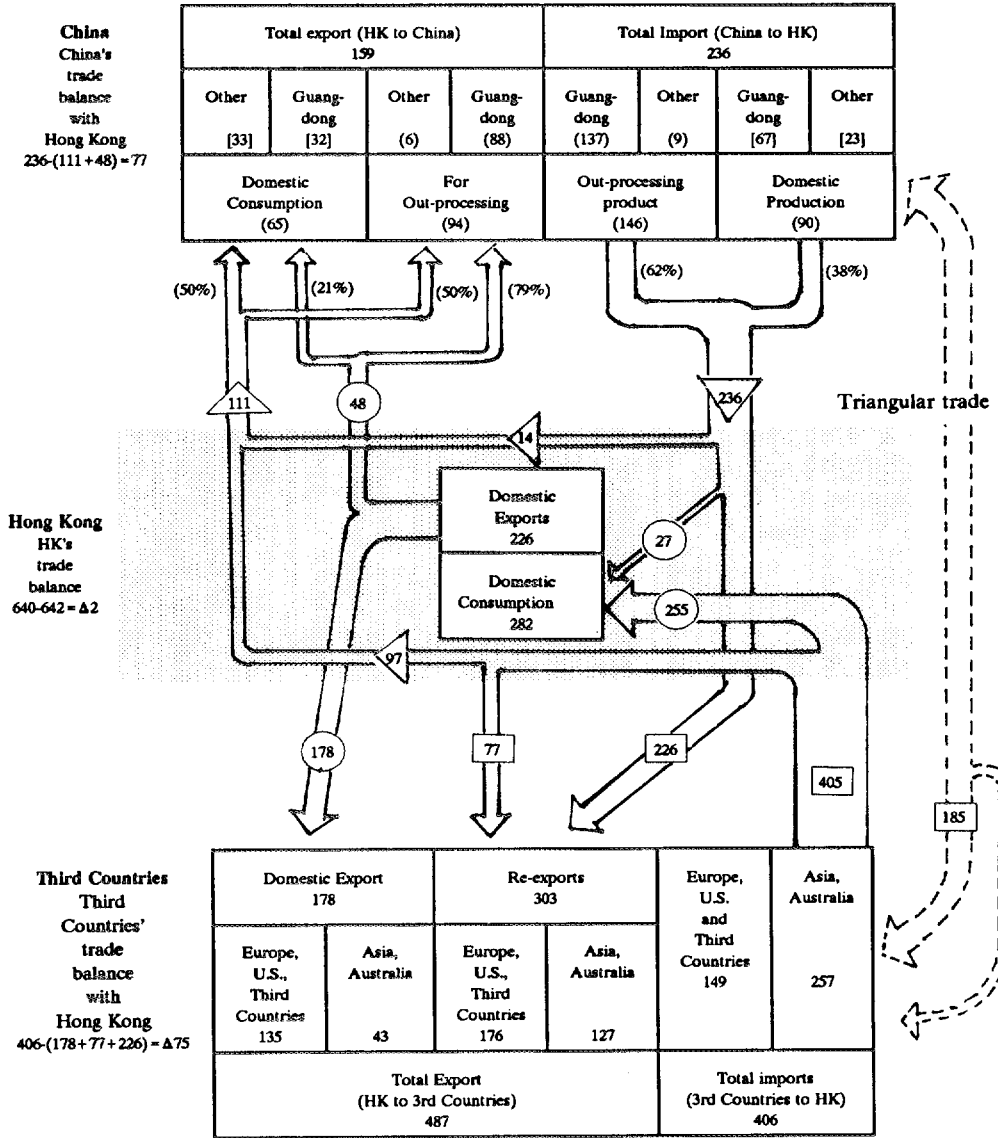
From Figure 1, the characteristics of the most recent trade structure can be observed and analyzed in three ways:

Firstly, there is an overall expansion of Hong Kong-China trade with respect to its functions and amount in monetary terms. The traditional Hong Kong-China trade used to function as an export from the territory for domestic consumption in China, and import of China-made products to Hong Kong only. Recently, in addition to the traditional trade, there is outward processing trade which has contributed to the increasing volume of Hong Kong-China trade. When the importance of outward processing trade takes over the traditional trade, Hong Kong's role has also been changed from a base of entrepot serving as a bridge for China and third countries to a control base in which Hong Kong has a leading role.

Secondly, Hong Kong has become increasingly reliant on the trade with China, especially with Guangdong Province. According to the Census and Statistics Department, among the imports of outward processing products, there is 94.4% being produced in Guangdong. Moreover, the share of Guangdong's traditional trade has also been increasing at a rapid pace. Although there is a discrepancy between the statistical data from Hong Kong and those from China, it is useful to make use of the data from Guangdong Province to verify the importance of Hong Kong's trade with Guangdong Province. Hong Kong exports 49% of its production to China and 74% of the territory's imports of China-made products are either for local consumption in Hong Kong or for re-export from Guangdong Province. When we examine the total trade volume by putting outward processing trade and traditional trade together, we find that 75% of the territory's exports are to China that 86% of imports are from China, and that a total of 82% of Hong Kong-China trade is actually trade with Guangdong Province. Furthermore, Guangdong is taking an increasing share in Hong Kong trade. Compared to last year, for example, there is an increase of 29.2% in the import of outward processing

Figure 1

Hong Kong's Trade Pattern in Relation to China and the Third countries, 1990 (in HK\$1 billion)



- Notes:
1. The figures in () are calculated from surveys of Hong Kong Census and Statistics Department.
 2. The figures in [] are calculated from the Trade Statistics of Guangdong Province.
 3. The amount of triangular trade are calculated from surveys of Hong Kong Trade Development Council.
- Sources:
1. Census and Statistic Department, *Hong Kong Annual Digest of Statistics 1991*.
 2. Annual Report of Guangdong Province's Statistics, 1991 (in Chinese).
 3. Hong Kong Trade Development Council, *Survey on Hong Kong Domestic Exports, Re-exports and Triangular Trade*.

products in Hong Kong. The share of Guangdong Province in outward processing imports to Hong Kong took 93% in 1989 which represents an increase of 1.4% from last year. With such huge trade volumes, the present Hong Kong-China trade can be re-stated as "Hong Kong-Guangdong trade."

Thirdly, when we focus on third countries' relations to Hong Kong trade, Hong Kong is becoming increasingly active in conducting trade with the Asian region. With the shifting of its production base to China, Hong Kong is more reliant on importing more machinery, raw materials, and parts which are of appropriate technology and suitable cost from Taiwan and Korea. Although more than half of the export market of Hong Kong is still reliant on the European and American markets, the markets of Asian countries are taking up greater importance.

The summary of the above is as follows: First Hong Kong imports capital, raw materials, and parts mainly from the Asian countries, then these resources are brought into Guangdong Province for assembling and processing, and finally the finished products are exported to European and American countries. The production bases of labour-intensive industries are shifted to China. The countries at different stages of development, such as Japan, Asian NIES, ASEAN, and China have progressed to a stage of international division of labour. This trend has resulted in a so called "Asian Extended Economic Circle" where Hong Kong has an important role in linking China, especially the Southern China, with the world economy.

2. *Direct Investment to China and Spatial Division of Labour Between Hong Kong and China*

a. Background of Direct Investment to China

Hong Kong enterprises tend to invest in the southern part of China and set up outward processing industry which leads to intra-enterprises specialization. The outward processing trade has also changed the trade structure of Hong Kong. After the Second World War, manufacturing industries had contributed to economic development in Hong Kong. However, Hong Kong lost its competitiveness in labour-intensive manufacturing industry to ASEAN countries in the 1970s. In order to survive, Hong Kong enterprises started to invest in facilities to produce high value-added products on the one hand, and also chose to invest in overseas countries for the labour-intensive manufacturing industry. After China opened its door, Hong Kong naturally chose to invest there for its cheap and abundant labour. With the improve-

ment of China's investment environment, Hong Kong enterprises formally invest in China. This change is especially noticeable after the Plaza Accord which changed the structure of world economy. As a result of the depreciation of Hong Kong dollar, Hong Kong products has become more competitive in the international market. With the increasing overseas demand for Hong Kong products, Hong Kong enterprises are urged to speed up their investment in China.

Table 4 shows the amount of Hong Kong's direct outward investment (on approval basis) to the major Asian countries in the 1980s. It can be seen that 80% of Hong Kong's direct investment was in China. Although there was a part of the investment being diverted to Thailand, Indonesia, the Philippines as a result of the Tiananman Square Incident in 1989, a majority of Hong Kong's direct investment was still in China, especially Guangdong Province. According to foreign investment data released by Chinese sources, 40-50% of Hong Kong's direct investment is concentrated in Guangdong Province.

Table 4
Hong Kong's Direct Outward Investment to Major Asian Countries

Approval Basis, US\$ million									
	China	Indonesia	Thailand	Taiwan	South Korea	Philippines	Malaysia	Japan	Total (excluding Japan)
1980	n.a.	n.a.	n.a.	40	0	n.a.	n.a.	n.a.	n.a.
1981	n.a.	n.a.	n.a.	35	34	0	15	n.a.	n.a.
1982	n.a.	195	n.a.	41	27	1	2	n.a.	n.a.
1983	642	126	n.a.	24	7	4	21	n.a.	n.a.
1984	2,175	706	n.a.	65	4	10	4	n.a.	n.a.
1985	4,134	53	n.a.	29	13	3	7	n.a.	n.a.
1986	1,449	10	127	76	13	7	11	57	1,693
1987	1,947	135	125	181	43	28	11	36	2,470
1988	3,466	240	451	157	14	27	50	44	4,405
1989	3,160	407	561	248	37	133	42	63	4,588
Total	20,651 (1979-89)	2,657 (1968-89)	1,264 (1986-89)	1,194 (1952-89)	225 (1962-89)	214 (1981-89)	163 (1987-89)	453 (1950-89)	26,368 (end 1989)

Notes: 1. Figures for Malaysia cover only manufacturing investment.
2. It is based on the approval basis from various countries.

Source: *Economic Report*, Hong Kong Bank, November 1990.

The main reason for Hong Kong enterprises to invest in China is the rising production cost in Hong Kong as a result of the labour shortage and its accompanied inflated labour cost, and the rising industrial rental cost. With the exception of 1983, the unemployment rate was below 4% throughout the

1980s. In 1986, the unemployment rate was 2.2%, and after 1987, it has remained at 1 to 2%. According to the Hang Seng Economic Monthly's survey in 1989, the monthly wage level of unskilled labour was US\$412 in Hong Kong, and US\$75 in Shenzhen making Hong Kong's labour at least 4 times as expensive as that in Shenzhen. Moreover, the monthly industrial rental cost per square foot in Hong Kong was HK\$8 compared to around HK\$1 in Shenzhen (Table 5). The production cost of China is much lower than that of the ASEAN countries. In fact the wage level and industrial rental cost in Shenzhen is comparable to those of Malaysia and the Philippines. Hong Kong enterprises have already proceeded to invest in the low-cost Pearl River Delta area which is one quarter to a half the cost of investing in Shenzhen.³ With such differences in the production cost between Hong Kong and her hinterland, Guangdong Province, Hong Kong enterprises are attracted to invest in China.

Table 5

Monthly Comparative Wage Level (Unskilled Worker) & Monthly Industrial Rental Comparing to ASEAN

	Monthly Wage Level of Unskilled Workers (US\$)	Monthly Industrial Rental (HK\$ per sq. ft)
Hong Kong	412 (5.5)	8 (New Kowloon)
Shenzhen	75 (1.0)	0.8-1.5
Thailand	90 (1.2)	1 (Chon Buri)
Malaysia	110 (1.5)	2 (Ipoh)
Indonesia	60 (0.8)	2 (Bonded Zone)
Philippines	—	1 (Cebu)

Note: The wage level in () is the indicator comparing to the base of 1.0 of Shenzhen.

Source: *Hang Seng Economic Monthly*, Hang Seng Bank, March 1990.

b. The Situation of Hong Kong's Investment in China

Two popular forms of direct investment in China by Hong Kong enterprises are:

- i. export processing, assembly, and manufacturing according to foreign materials, foreign design and foreign parts, and
- ii. compensation trade.

Among the above two forms of investment, the first one is the most common form. Hong Kong enterprises, as foreign investors, usually provide machinery, facilities, raw materials, parts, production manuals and product catalogues to the factories in China. The processing and manufacturing are to be done in China. When the products are finished, Hong Kong enterprises are responsible for exporting them and paying for all the process and assembly cost. This arrangement is based on a 3-5 year contract. Hong Kong enterprises can retreat any time and take back their machineries whenever the contract is expired. The classification of foreign investment by China is divided into:

- i. wholly foreign-owned enterprise,
- ii. equity joint venture enterprises,
- iii. contractual joint ventures,
- iv. low dimension cooperation which includes the above-mentioned export processing, assembling, and manufacturing according to foreign materials, designs and parts, and compensation trade

Although there is little difference between the first three forms (i) to (iii) of investment with the last one (iv) in respect of its characteristic of labour-intensive export, Hong Kong enterprises usually resort to the last form of investment in order to avoid taking risk in politically volatile countries. In terms of the data released from China, two-thirds of the last form of investment takes place in Guangdong Province. The most prosperous area for outward processing production is the Pearl River Delta area which is only a few hours driving distance from Hong Kong.

The outward processing production in Guangdong Province has been increasing steadily since 1980. By the end of June 1991, there were about 20,000 Hong Kong enterprises conducting the (iv) form of investment in Guangdong with more than 2,000,000 workers.⁴ The cost of processing and manufacturing paid by Hong Kong enterprises is increasing, about US\$660 million in 1990 and an aggregate amount of about US\$3.5 billion⁵ from 1979 to 1990. Until June 1991, Guangdong has approved a total of over 15,000 direct investment projects which are of the (i) to (iii) forms. The projects which are under operation include 7,000 enterprises with 1,000,000 workers. More than 98% of the foreign direct investment in 1990 was export-oriented industries. Foreign investors started a number of capital and technology-in-

tensive projects, including the production of chemicals, pharmaceuticals, and telecommunications equipment. More foreign investment also went into energy, transport, and raw materials projects.⁶

In the year 1991, 12 years after the implementation of open door policy in China, Hong Kong enterprises employ the 3,000,000 manufacturing workers in Guangdong Province which is 4 times more than that of Hong Kong.

c. People and Commodities which Go through the Border

The economic integration of Hong Kong and Guangdong has fostered human and material flow across the border. The flow of people between these two places after the opening of China is especially active since the majority of Hong Kong people's have their home towns in Guangdong. According to the data of Census and Statistics Department in 1977, the number of people going to China was 1,030,000 only less than half of those going to Macau which amounted to 2,000,000. However, the number of Hong Kong people going to China has increased dramatically to more than 10,000,000 in 1985 and 16,690,000 in 1990 (Table 6). Although there was a slight decrease of such flow in 1989 after the Tienanman Square Incident, it increased again in 1990. Within 13 years, the number of Hong Kong people going to China has increased 16 times, with an average of 46,000 people going to China daily. It is estimated that each Hong Kong resident goes to China as many as three times every year. About 90% of these people go to Guangdong by the Kowloon-Canton Railway.

As far as the cargo to China is concerned, it is as active as the flow of people. The major items of cargo to China are raw materials, parts, and finished products for outward processing production from Hong Kong to China and vice versa. Although in 1978 there were less than 1,000 trucks per day running from Hong Kong to Guangdong, there were more than 10,000 trucks per day in 1988, and about 12,000 per day in 1992.⁷ Trucking represents a 40% increase in the volume of loading and discharging annually in the past 10 years, and it is becoming the main means of commercial cargo to China. As for the railway, before the implementation of the open door policy it used to only perform discharging functions, particularly food from China, and export of raw materials to other countries through Hong Kong. However, after the open door policy, railways also took charge of loading as shown in the rapid increase in China's external trade.

Table 6
People and Commercial Cargo to China

	Hong Kong people going to China (10,000 person)	Commercial-Cargo to China (10,000 tons)			
		Land Transport		Railway	
		In	Out	In	Out
1980	391.7	13.0	17.8	115.7	1.5
1981	453.7	22.5	30.0	103.2	4.1
1982	461.6	39.4	44.7	103.6	3.4
1983	572.4	70.2	81.1	125.3	7.2
1984	803.6	113.4	106.1	134.3	10.4
1985	1096.1	143.6	124.9	138.4	20.3
1986	1186.8	212.5	170.3	180.5	36.7
1987	1408.9	296.7	244.0	189.0	37.5
1988	1630.7	352.5	321.6	172.9	48.4
1989	1520.7	410.3	385.8	174.5	45.3
1990	1668.8	456.5	449.6	185.0	36.7
[Average growth p.a. (%)]					
1980-85	22.9	61.7	47.7	3.6	67.6
1985-90	8.8	26.0	29.2	6.0	12.5
1980-90	15.6	42.8	38.1	4.8	37.3

Source: Census and Statistic Department, *Hong Kong Annual Digest of Statistics*, various issues.

3. *Revitalised Triangular Trade*

The open door policy has not only promoted Hong Kong enterprises to invest in China but also fostered Chinese and foreign enterprises to invest in Hong Kong. Before the open door policy, there were only about 10 companies operating with Chinese capital in Hong Kong. The number of Chinese companies has increased to 2,000 to 3,000 in recent years.⁸ In 1991, an association for Chinese enterprises was established. The source of capital of these Chinese enterprises not only come from the central government but also from other levels of local governments such as provinces, cities and districts. Furthermore, there is a lot of foreign enterprises like trading houses and banks which aim at opening China's markets by setting up branches in Hong Kong. It leads to an increase in business interaction between the branches of Chinese enterprises and the branches of foreign capital in Hong Kong. Therefore, Hong Kong not only plays an important

role of entrepot for South China, but also it acts as a base for Chinese businesses for the whole of China and the third world.

As a result, there is not only direct trade going through Hong Kong but also triangular trade. The products of triangular trade which are finished in China or third countries are exported overseas directly without going through Hong Kong. According to the surveys conducted by the Hong Kong Trade Development Council,⁹ triangular trade shared 18.7% and 19.8% in 1988 and 1991 respectively of the total Hong Kong transaction. From these ratios, it is estimated that the amount of triangular trade was HK\$113.2 billion in 1988 and HK\$189.4 billion in 1991 (Table 7). Looking at the growth rate of the past three years, there was an obvious increase in the triangular trade in which the average annual growth rate was 18.7%. Although such growth rate is not as high as the re-export rate which is of 24.8%, it is higher than the growth rate, 2.0% of domestic exports. Therefore, triangular trade increased from 52% to 82% of domestic exports. Although triangular trade does not pass through Hong Kong customs, it enhances not only Hong Kong's traditional trade and outward processing but also triangular trade.

Table 7

Average Annual Increase and the Changes in Triangular Trade

Unit: HK\$1 billion

	Domestic Export	Re-export	Triangular Trade
1988	217.7 (35.9)	275.4 (45.4)	113.2 (18.7)
1991	231.0 (24.2)	534.8 (56.0)	189.4 (19.8)
[Average annual increase rate] 1988-1991	2.0	24.8	18.7

Note: 1. Figures in () are the percentage to total including triangular trade.
2. It is calculated from the survey of triangular trade.

Source: Hong Kong Trade Development Council, *Survey on Hong Kong Domestic Export, Re-exports and Triangular Trade*, November 1991.

By analyzing recent trends in the triangular trade, it is predicted that it is only a matter of time for triangular trade will exceed domestic exports. According to the survey conducted by the Hong Kong Trade Development Council. Half of Hong Kong enterprises will be pessimistic about the prospect of domestic export, however, 80% of Hong Kong enterprises will be optimistic

about re-export and triangular trade (Table 8). Although triangular trade contribute less than re-export, it will play a greater role in contributing to Hong Kong economy.

Table 8

Mid to Long-term Trade prospect in Different Forms

Unit: %

	Rapid growth	Moderate growth	Sluggish	Slight recession	Extreme recession
Mid-term (91~97)	7	70	15	26	1
Long-term (99~2011)	7	58	19	14	3
<i>Forms of Trade:</i>					
Domestic Export	3	42	29	20	6
Re-export	21	65	10	4	0
Triangular Trade	18	63	15	3	0

Note: It is calculated based on the original data excluding the unanswered parts.

Sources: same as table 7.

4. *Hong Kong Economy Becomes More Reliant on Services Provided by China*

The changes in trading and investment structures of Hong Kong after the open door policy of China have generated a great impact on the industrial and employment structures in Hong Kong. The share of manufacturing industry to GDP and employment has been decreasing steadily since the 1980s but the share of service sectors such as commerce and trade, transport and communication, and finance has been increasing instead. The manufacturing industry which had occupied the first position in the share of GDP has dropped 7% in the past 10 years; with this shift manufacturing has taken third position after commerce & trade and finance & securities, and took only 17% of GDP in 1990. Although manufacturing still maintains its first position in the share of employment, its composition ratio has dropped 14%. On the other hand, commerce & trade and transport & communication increased the share of 4% and 2% to GDP and 7% and 2% to employment respectively. Although the share of finance to GDP has decreased in 1990 compared to those in 1980 owing to economic recession, its share of employment has increased 3% (Table 9).

Table 9

Composition of GDP and Employment and Contribution of GDP by Type of Industries

Unit: %

	1980	1985	1986	1987	1988	1989	1990	Contribution to GDP	
								1980-85	1985-90
Manufacturing Industry	23.8 (41.2)	21.9	22.3 (34.8)	21.7 (34.2)	20.1 (32.0)	18.9 (29.7)	16.7 (27.7)	19.8	12.4
Commerce & Trade	20.4 (19.2)	21.8	21.3 (23.0)	23.2 (23.4)	23.8 (24.3)	24.0 (24.9)	24.0 (25.9)	23.4	25.9
Transport & Communication	7.5 (7.5)	8.1	8.1 (8.3)	8.7 (8.5)	9.2 (9.0)	8.9 (9.6)	9.3 (9.9)	8.8	10.3
Finance & Securities	22.8 (4.8)	16.3	17.3 (6.1)	18.2 (6.4)	19.2 (6.8)	19.8 (7.4)	20.6 (7.7)	9.0	24.1
Others	25.8 (27.3)	68.1	31.0 (27.8)	28.2 (27.5)	27.7 (27.9)	28.4 (28.4)	29.4 (28.4)	39.0	27.3

Note: The figures at the upper line represent the percentage of GDP and the figures in () at lower line represent the percentage of employment.

- Sources:
1. Census and Statistics Department, *Estimates of Gross Domestic Product 1966 to 1991*, March 1992.
 2. Census and Statistics Department, *Hong Kong Annual Digest of Statistics*.

The restructuring of international currencies after the Plaza Accord has sped up the structural adjustment of the relations between Hong Kong and its neighbour, Guangdong in the latter half of 1980s. It also led to a change in the industrial structure in Hong Kong. When we look at such structural changes by examining the employment structure after 1986, the trade sector has absorbed more than 10% of labour for the same quarter of previous year from the first quarter of 1986 to the second quarter of 1991. In the other sector, the labour absorption rate of finance, transport, communication, and commerce is very high. The most rapid change in the Hong Kong industrial structure occurred in 1988 and 1989. On the other hand, the impact of the change of Hong Kong manufacturing base to China started to be felt when there was a negative growth in the labour absorption from the first quarter 1988. After that, the rate of negative growth is increasing steadily. As a result, the number of manufacturing employees decrease from a peak of 896,000 in the second quarter of 1987 to 700,000 in the first quarter of 1991. A decrease of 160,000 workers in manufacturing industry is offset by an increase of 410,000 employees in the trade, transport, finance and communications industries (Table 10).

Table 10
Changes of Employment in Various Industries

Unit: %, persons

	Manufacture	Commerce	Import/Export	Transport	Financing
[Increase rate for the same quarter of previous year]					
1986-I					
1986-II	3.0	3.8	10.4	2.2	8.2
1986-III	1.4	3.8	10.4	2.8	6.6
1986-IV	2.5	4.3	8.7	2.6	6.6
1987-I	2.1	3.3	14.1	3.5	7.4
1987-II	2.8	4.2	12.7	4.6	6.2
1987-III	1.1	6.2	12.4	4.5	8.1
1987-IV	0.6	5.3	15.4	6.5	9.8
1988-I	0.4	6.1	9.7	7.4	9.3
1988-II	-1.8	8.6	11.1	7.4	8.4
1988-III	-3.0	9.5	13.0	8.5	10.3
1988-IV	-3.5	7.9	16.9	9.0	9.9
1989-I	-3.6	8.1	16.3	9.0	10.9
1989-II	-4.1	5.0	12.4	8.9	12.7
1989-III	-5.1	5.1	9.6	12.7	12.2
1989-IV	-4.9	8.5	11.4	9.9	8.2
1990-I	-5.4	8.8	11.7	9.1	4.4
1990-II	-6.1	9.4	13.4	8.2	9.3
1990-III	-8.4	7.8	10.6	4.3	6.3
1990-IV	-9.1	7.5	10.4	4.3	9.5
1991-I	-9.6	7.2	9.8	5.4	12.5
1991-II	-8.9	10.3	13.6	3.4	5.1
	-9.8	8.7	11.6	2.1	5.3
[No. of employee]					
(86-I)	(841,485)	(595,278)	(195,389)	(95,670)	(185,702)
(91-II)	(681,085)	(874,343)	(367,772)	(131,658)	(283,603)

Source: Census and Statistics Department, *Monthly Digest of Statistics*, various issue.

It is clear that there is a rapid development of service economy in Hong Kong as a result of the economic integration between Hong Kong and Guangdong and it is believed that this developed will continue. According to a survey done by the Hong Kong Trade Development Council, Hong Kong enterprises will still maintain the status quo in manufacturing and trade within Hong Kong. However, there will be a steady increase in business and trade of China-manufactured products. Therefore, Hong Kong will become more important as an entrepot as well as a control base for China businesses in future.

Conclusion — the Trends in Future

In this chapter the structural changes in the Hong Kong economy as a result of the economic integration with Guangdong has been examined.

With the opening of China, the manufacturing industry in Hong Kong has not actively invested in plant and equipment; instead it has shifted to high-productivity service sector. As a result, Guangdong becomes the production base of an expanding labour-intensive manufacturing industry. Hong Kong not only plays a role in establishing relations of division of labour between itself and Guangdong, but it is becoming an entrepot and control base for Guangdong as well. Therefore, the Hong Kong-Guangdong integration is a result of the combination between Hong Kong's free economy, human resources and transport and communication infrastructure and the relatively inexpensive labour force and industrial rental in Guangdong. Furthermore, the industrialization of export-oriented industries in this region has been strengthened by the Hong Kong dollar by its linkage to the US dollar.

Since the Hong Kong economy relies on China, its economic barometer has become extremely sensitive to any changes in China's internal policy. Therefore, if one wants to predict Hong Kong's economy in the future, the stability of China's politics becomes a necessary factor to be considered. This situation also applies to Guangdong which is industrializing its export-oriented industries as a result of the economic integration with Hong Kong. It is obvious that political stability in China is becoming a prerequisite for the development of the coastal regions of China, including Guangdong. In 1991 the Chinese government decided to widen the open door policy by introducing a 10-year economic plan which will be carried out in 1993 in three southern provinces: Guangdong, Fukien, and Hainan. The Hong Kong economy should also benefit from such development in these other provinces.

Furthermore, the industrialization which has resulted from the economic integration between Hong Kong and Guangdong has created an obvious problem of developing infrastructure in both Hong Kong and Guangdong. That is to say that infrastructure development lags behind the speed of development in other sectors. Therefore, after obtaining the support from Chinese government, Hong Kong has started to carry out the Port and Airport Development Strategy (PADS) which is an essential project for the development of a control base for the flow of resources between Hong Kong and Southern China in future. However, the main problem remains insufficient infrastructure in Guangdong. This problem is not only with insufficient supply of electricity, transportation, and water, but also the lack of coordinated plans as a result of division of power within the governments. Moreover, Guangdong is unable to obtain any support for developing its resources from the central government and it also has to contribute a large sum of money to the central government.¹⁰ It is therefore, becoming more difficult for Guangdong to adjust the distribution of resources within the province, making

it more dependent on capital investment from Hong Kong for its infrastructural development.

Another issue which deserves consideration is Hong Kong's overheated economy. Hong Kong's active economy has resulted in inflation problems, labour shortages, and other supply problems in Hong Kong. Furthermore, there is three others problems are follows:

- 1) the destorted allocation of resources between labour and capital because of Hong Kong dollar linked with US dollar.
- 2) the steady continuation of China's open door policy.
- 3) the increasing political risk with the 1997 issue.

These factors make it more difficult for investors to confidently invest in plant and equipment in high value-added industries. Therefore, it is predicted that Hong Kong will only move its low-productivity manufacturing industry to China, and extend its service industry in Hong Kong.¹¹ It is believed that the servicing role that the Hong Kong economy developed in the 1980s will continue into the 1990s; and if present patterns continue, Hong Kong will become more reliant on china in the 1990s.

Notes

1. The data of the third quarter 1988's outward processing trade is extracted from: Census and Statistics Department, *Hong Kong External Trade*, Dec 1988. The data after that is a projection from its March, June, August and December issues.

2. It is the average annual increase rate of the combination of domestic export and re-export in outward processing trade from the period between the third quarter 1988 to the third quarter 1991, and the import of outward processing trade during the period of the third quarter 1989 to third quarter 1991.

3. Hong Kong Trade Development Council(HKTDC), *Recent Investment Environments of Guangdong, Fujian and Hainan (Second Edition)*, Trade Developments, Aug. 1991. pp. 3-4.

4. HKTDC, *Survey on Hong Kong Domestic Export, Re-export and Triangular Trade*, Nov. 1991. p. 3.

5. *Annual Statistics of Guangdong Province* (published in Chinese), 1991.

6. HKTDC, Aug.1991, p. 8.

7. Transport Branch, Government Secretariat, *Moving into the Twenty-first Century: the White Paper on Transport Policy in Hong Kong*, May 1989, p.6.
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