1988

Hong Kong's capabilities in international trade

Chi Keung Mak

The University of Montana

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HONG KONG'S CAPABILITIES IN INTERNATIONAL TRADE

By

CHI KEUNG, MAK

B.SC., University of Calgary, 1987

Presented in partial fulfilment of the requirements
for the degree of
Master of Business Administration
University of Montana
1988

Approved by:

Chairman, Board of Examiners

Dean, Graduate School

Date

December 9, 1988
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CHAPTER 1. HISTORY AND ECONOMIC SETTING OF HONG KONG

1.1. INTRODUCTION

The purpose of this paper is to review those factors contributing to Hong Kong's economic success in the past and then to examine the prospects for Hong Kong in the coming years. Two factors will be dominant in Hong Kong's economic future: (1) The increasing competitiveness of the other Newly Industrialized countries (NICs) and (2) The 1997 issue. Some proposals are suggested with the hope that, upon their implementation, Hong Kong's economic and political stability can be maintained and its competitiveness in the international market sustained. With this purpose in mind, the remainder of this chapter is devoted to the history and a description of the present status of Hong Kong and its economic setting. Chapter two describes the factors which contribute to Hong Kong's economic success while chapter three will discuss major economic threats to Hong Kong. Chapter four provides possible strategies to deal with the threats. The conclusion and summary is in chapter five.

1.2. HISTORY & PRESENT STATUS OF HONG KONG

Hong Kong is a British Crown Colony but has responsibility for its own internal affairs, including legislation and taxation. The Queen's appointed representative, the Governor, is the head of government and presides over the two main policy-making bodies: the
Executive and the Legislative Councils. At present, the Governor of Hong Kong is Sir David Wilson. He took office in April 1987.

Generally, the law of Hong Kong follows that of England and Wales. Specifically, Hong Kong law is a mixture of English Acts of Parliament, Hong Kong ordinances, and the common law of both England and Hong Kong. The courts of justice in Hong Kong include the Supreme Court (consisting of the Court of Appeal and the High Court), the District Court, the Magistrates' Courts, the Coroners' Court and the Juvenile Court. In addition, the Lands Tribunal, the Labor Tribunal and the Small Claims Tribunal have special responsibilities.

The British have administered Hong Kong since 1841, except for the four year Japanese occupation during World War II. Under the treaty of Nanking, the 1842 ceding of Hong Kong Island in perpetuity to British was negotiated in January 1841. In the same month, Hong Kong was proclaimed a British Colony. In 1860, another treaty, known as the Convention of Peking added Kowloon Peninsula to Hong Kong. In 1898, the 99 year lease of the New Territories was signed in Beijing.

Under the British administration, Hong Kong has been one of the fastest-growing economies in the world in the post-war period. Rapid economic growth in Hong Kong began with its transformation from an entrepot to an industrial
In the 1960s and early 1970s, Hong Kong experienced a process of rapid industrialization accompanied by a high rate of growth in incomes. Throughout this period and even until today, the Hong Kong Government's attitude towards the economy has been based on the philosophy of laissez-faire. Limited by its small domestic market, Hong Kong had to adopt an outward-looking policy of export-oriented industrialism from the very beginning. Today, Hong Kong, South Korea, Singapore and Taiwan, are newly-industrializing countries (NICs) which are receiving great attention in the study of economic development.

The efficient transport network in Hong Kong is an important reason for its success. At the end of 1987, a total of 1345 kilometers of roads were maintained by the government — 380 in Hong Kong Island, 359 in Kowloon and 606 in New Territories. Increasing traffic density is being met by constant improvements and new roads.

The port of Hong Kong is one of the most outstanding natural harbors in the world. It is also one of Hong Kong's rare natural resources. The harbour covers an area of 60 square kilometers. Its commercial wharves can accommodate vessels up to 14.6 meters. As one of the world's major ports, the port is equipped with modern handling equipment and an efficient labor force. Containerization is the major cargo method used in the
harbour. Hong Kong has recently overtaken Rotterdam as the world's busiest container port.

Since 1981, the question of the expiry of the lease on the New Territories in 1997 has become a major issue. An agreement of Joint Declaration on the future of Hong Kong was signed on December 19, 1984 by both the governments of China and Britain. Under this Joint Declaration, China will resume sovereignty over Hong Kong upon the expiry of the leases in 1997. Hong Kong will, from July 1, 1997, become a Special Administrative Region (SAR, also hereafter called the region) within the People's Republic of China, with a high degree of autonomy except in foreign and defense affairs. The policies expressed in the Joint Declaration are to remain unchanged for fifty years after 1997. Thus, the SAR may retain for the 50 year period its capitalistic system and lifestyle. The region will also have executive, legislative and independent judicial power.

The laws currently in force will remain basically unchanged. The region will continue to operate as an international financial center with a freely convertible currency, free flow of capital, a free government and a separate customs territory. Private property, the ownership of enterprise, the right of inheritance and foreign investment will be protected by law. Furthermore, the region will have independent finances. The Government of the People's Republic of China has agreed not to levy
taxes on the region. Land leases expiring in 1997 may be extended for another 50 years at the lessees' option without payment of an additional premium. However, they will be subject to an annual rent of three percent of rateable value. The intention of the above policies is to have the current social and economic systems in Hong Kong remain in place. Also, a Sino-British Joint Liaison Group (JLG) has been established to implement the Joint Declaration and supervise the smooth transfer of sovereignty in 1997.

Although authorities in China have always emphasized and made promises that the current social and economic system in Hong Kong will remain intact when sovereignty of Hong Kong reverts to China in 1997, there remains a certain degree of uncertainty regarding the future political and economic stability of Hong Kong under China's proposed "one country-two systems" policy. This cloud of uncertainty is surely detrimental to Hong Kong's future economic transformation which will require long-term political and economic stability.

1.3. ECONOMIC GROWTH & STRUCTURAL CHANGE

1.3.1. ECONOMIC HISTORY 1841-1941

Hong Kong, as a British colony since 1841, prospered as a free port trading post because it offered security and freedom from interference with trade. While the early Chinese inhabitants had little or no interest in politics,
the government was mainly concerned with providing a framework within which trade could flourish. As a gateway to China and located on the major sea route to and from the Far East, Hong Kong prospered as an entrepot, a market and storehouse for goods in transit to Asia and the West.

In keeping with Hong Kong's entrepot character, the first industrial venture was shipbuilding and repairing. Until World War One, the economic picture of the colony was that of enterprises linked with the operation of the port and a few cottage industries. Later, Hong Kong became the headquarters of the major merchant houses trading in the Far East and as a clearinghouse of trade between the East and the rest of the world. It soon developed specialized associated services such as banking, insurance, accountancy and legal services. Further special market facilities such as the gold market emerged to supplement shipping, and related industries. Although the entrepot trade with China declined after World War One, the area served by such trade grew to cover much of the Far East.

1.3.2. INDUSTRIALIZATION IN THE 1950'S

There are several factors that gave rise to the economic transformation of Hong Kong from a trading to an industrial economy. First, with the establishment of the Communist regime in China in 1949, there was a massive influx of refugees to Hong Kong during the period 1948-1951. This huge inflow of human and financial resources from China
formed the basis of subsequent industrialization. Second, Hong Kong’s entrepot trade declined after 1951 due to the Communist takeover in China and the outbreak of the Korean War in 1950 and the resulting the United Nations embargo on China. Thus, Hong Kong had to turn to industrialization for survival. Third, as a British colony, Hong Kong enjoyed the advantages of Commonwealth preference and membership of the Sterling Area. The Commonwealth Preference Scheme enabled Hong Kong’s products to be more competitive in overseas markets and Sterling Area membership helped Hong Kong have a stable currency. Lastly, Hong Kong followed the laissez-faire capitalism system with no foreign exchange control, few restrictions on the scope of private ownership and low tax rate on business profits. All these factors contributed to Hong Kong’s growing industrialization.

1.3.3. ECONOMIC GROWTH 1961-1986

Along with most of the NICs, Hong Kong continued to grow rapidly following 1960. Table 1 shows the average annual growth rates of Hong Kong’s GDP (Gross Domestic Product) and GDP per capita during the period 1961 to 1986. The average annual growth rate of the real GDP was 9.08%. Even in terms of GDP per capita, the growth rate was as high as 6.8% per annum on average.
Table 1. Average Annual Growth Rates of GDP and GDP Per Capita in Hong Kong (in percentages)

<table>
<thead>
<tr>
<th>Years</th>
<th>GDP</th>
<th>GDP per capita</th>
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</thead>
<tbody>
<tr>
<td>1961-66</td>
<td>10.9</td>
<td>8.0</td>
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<td>1966-71</td>
<td>7.6</td>
<td>5.4</td>
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<tr>
<td>1971-76</td>
<td>8.8</td>
<td>6.8</td>
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<tr>
<td>1976-81</td>
<td>12.4</td>
<td>9.5</td>
</tr>
<tr>
<td>1981-86</td>
<td>5.7</td>
<td>4.3</td>
</tr>
<tr>
<td>1961-86</td>
<td>9.1</td>
<td>6.8</td>
</tr>
</tbody>
</table>


Comparing the rate of economic growth in Hong Kong with some advanced countries and some developing countries in Asia shows that the economic growth of Hong Kong during the period 1960-1981 has been much faster than that of Western industrialized countries such as West Germany, the United States and the United Kingdom (See Table 2.) Among Asian

Table 2. Average Growth Rates of Real GDP and GDP Per Capita of Selected Economies (in percentages)

<table>
<thead>
<tr>
<th></th>
<th>GDP</th>
<th>GDP per capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>9.8</td>
<td>9.6</td>
</tr>
<tr>
<td>West Germany</td>
<td>4.4</td>
<td>2.2</td>
</tr>
<tr>
<td>United States</td>
<td>4.3</td>
<td>2.6</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>2.9</td>
<td>2.0</td>
</tr>
<tr>
<td>India</td>
<td>3.7</td>
<td>2.9</td>
</tr>
<tr>
<td>South Korea</td>
<td>8.6</td>
<td>7.0</td>
</tr>
<tr>
<td>Japan</td>
<td>10.5</td>
<td>4.6</td>
</tr>
<tr>
<td>Philippines</td>
<td>5.1</td>
<td>5.9</td>
</tr>
<tr>
<td>Taiwan</td>
<td>9.6</td>
<td>9.2</td>
</tr>
<tr>
<td>Singapore</td>
<td>7.9</td>
<td>9.8</td>
</tr>
<tr>
<td>Thailand</td>
<td>7.2</td>
<td>6.7</td>
</tr>
</tbody>
</table>

Source: Lethbridge, *The Business Environment In Hong Kong*, Oxford University Press, H.K., 1984, p. 6, Table 1.2.
countries, the economic growth of Hong Kong was slightly slower than that of Japan, but faster than all other Asian countries during the period 1960-70. In the 1970's Hong Kong's GDP growth was exceeded only by Singapore and then only by a very small margin.

1.3.4. STRUCTURAL CHANGES 1961-1986

Hong Kong's economic growth was accompanied by structural changes involving the inter-sectoral shift of resources, especially the movement of resources away from agriculture. More recently, there has been a shift towards more technology- and capital-intensive products. Table 3 shows the sectoral shares of the different economic activities in Hong Kong's GDP for the period 1961-1985. Since Hong Kong possesses no important natural resources other than an outstanding natural harbour, it has to import most of its food supply, virtually all raw materials and the fuels required by the various industrial activities. To pay for this huge volume of imports, the colony has actively engaged in export and re-export activities. Hong Kong's leading exports are in textile, clothing, electronics and plastic products.

The other important structural change, observed in the early 1970s was the development of Hong Kong as a financial center. This trend has been evidenced by the congregation
of a large number of international banks, representatives' offices, merchant banks, finance companies and other assorted financial intermediaries in Hong Kong. Added evidence of this change lies in the contribution of the financial services sector to GDP. This has grown from 14.5% in 1970 to 25.9% in 1980.

Table 3. GDP by Economic Activity in Hong Kong (in percentages)

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<tr>
<td>Agriculture</td>
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<td>1.8</td>
<td>1.6</td>
<td>1.6</td>
<td>1.3</td>
</tr>
<tr>
<td>Mining &amp; Quarrying</td>
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<td>0.2</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.2</td>
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<tr>
<td>Manufacturing</td>
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<td>28.0</td>
<td>25.0</td>
<td>27.4</td>
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<td>1.7</td>
<td>1.6</td>
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<td>1.4</td>
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<td>4.1</td>
<td>4.7</td>
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<td>Wholesale &amp; Retail Trade</td>
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<td>21.9</td>
<td>20.6</td>
<td>21.5</td>
<td>23.8</td>
<td>21.2</td>
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<tr>
<td>Transport &amp; Communication</td>
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<td>5.7</td>
<td>6.2</td>
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<td>7.2</td>
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<tr>
<td>Agriculture</td>
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<td>0.7</td>
<td>0.7</td>
<td>0.6</td>
<td>0.5</td>
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<tr>
<td>Mining &amp; Quarrying</td>
<td>0.2</td>
<td>0.2</td>
<td>0.2</td>
<td>0.2</td>
<td>0.1</td>
<td>0.2</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>25.1</td>
<td>23.6</td>
<td>21.6</td>
<td>24.1</td>
<td>25.6</td>
<td>23.0</td>
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<tr>
<td>Utilities</td>
<td>1.3</td>
<td>1.5</td>
<td>1.9</td>
<td>2.6</td>
<td>2.6</td>
<td>2.9</td>
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<tr>
<td>Construction</td>
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Source: Lethbridge, The Business Environment In Hong Kong, Oxford University Press, 1984, p.9, Table 1.4, and Hong Kong Social and Economic Trends 1976-1986, p.22, Table 3.4.

This chapter provides some background knowledge about the
history and economic setting of Hong Kong. The next chapter will discuss the factors contributing to Hong Kong's economic success.
FOOTNOTES

1. Moores, Alan (Editor), Living in Hong Kong, American Chamber of Commerce in Hong Kong, 1986, p.5.

2. Ismail Aladin (Editor), Hong Kong 1987 Yearbook, Hong Kong Government Information Services, 1987, p.34.


5. Ismail, Aladin (Editor), Hong Kong 1987 Yearbook, Hong Kong Government Information Services, 1987, p.185.

6. For a detail documentation and photographic presentation, refer to The Port Of Hong Kong, the Government Printer, H.K.


8. See Geiger, "Hong Kong and Singapore : An overview of their development progress and policies" in Tales Of Two City - States : The Development Progress Of Hong Kong And Singapore, and Rabushka, The Changing Face Of Hong Kong, Chapter two.


CHAPTER 2. FACTORS CONTRIBUTING TO HONG KONG'S ECONOMIC SUCCESS

In *Hong Kong: Borrowed Place - Borrowed Time*, Hughes commented that "The Hong Kong formula for success is just as simple and straightforward: low taxes, no controls, quick profits, hard work, laissez-faire."¹

2.1. GEOGRAPHICAL SETTING

Hong Kong is strategically located on the western rim of the Asian Pacific Region along the coast of China. The colony is a gateway to China and serves as a bridge between China and the rest of the world. Its proximity to the huge potential China market and the common language and culture attract a lot of investments.

2.2. LABOR FORCE

Though Hong Kong's economic success is traditionally attributed to its site and its natural harbor, the colony's success is undoubtedly due to the industrious nature and the high adaptability of its labor force. By Western standards, the Hong Kong worker is overworked and underpaid. Since unions are weak and there are no stringent labor laws regarding working hours and minimum wage, market forces of demand and supply are allowed to shape the labor market, to keep labor supply highly
competitive and thus labor cost low. In fact, the real level of wages is fairly flexible. Labor costs are also held down by the operation of round-the-clock shifts, so that machines can run more economically and efficiently. In recent years, as a result of education, industrial training and the use of modern technology, productivity of the labor force has increased rapidly. In addition, there exists a general belief among the workers in Hong Kong that hard work would eventually be rewarded. These elements together make Hong Kong manufacturers very competitive in the international market on the basis of least-cost production.

2.3. EFFICIENT TRANSPORTATION & COMMUNICATION NETWORK

Hong Kong has developed an advanced infrastructure. The government provides facilities such as roads, railway, water supply, port facilities, the airport and interurban transit. On the other hand, the container terminal, cross-tunnel and electricity are provided mostly by private capital. Efficient infrastructure is vital to economic success. A lot of foreign companies invest in Hong Kong to take advantage of the efficient transportation and communication network especially in areas such as telecommunication and computers.

With Hong Kong's export-oriented economy, it is especially important to make sure that internal and
external communications systems are keeping pace with the growth of the economy and the needs of customers. Therefore, the government is now seriously considering plans to construct a new airport as well as a new container port in order to maintain Hong Kong's long-term prosperity and stability.4

2.4. BRITISH ADMINISTRATION

As a British colony, Hong Kong enjoyed the advantages of Commonwealth preference and membership of the Sterling Area in its early stages of industrialization. These two factors though abolished later, enabled Hong Kong's products to be more competitive in the international market and Hong Kong currency to be stable. Since then, Hong Kong has established a strong foothold in overseas markets. In later years, as the United Kingdom has acceded to the General Agreement on Tariffs and Trade (GATT) on behalf of Hong Kong. The consequence is the colony's exports are given most-favored-nation tariff treatment in the majority of its overseas markets and are accorded a degree of protection against discriminatory import restrictions by members of GATT. Hong Kong is designated as a beneficiary of the various preference schemes established by the European Economic Community (EEC), Japan, Norway, New Zealand and Sweden.5

2.5. POLITICAL STABILITY

From the end of World War I through July 1982, Hong Kong
enjoyed remarkable political stability which fostered prosperity. An important element that contributes to this stability is found in Hong Kong’s political geography. Hong Kong’s prosperity has served the developmental interests of China. Entrepreneurs from Britain and other countries also benefit from commerce with Hong Kong. Finally, the local residents have found in Hong Kong an opportunity for personal economic improvement. Thus, a tripod of consent -- Britain, China and local population -- has fostered this haven of economic success.  

2.6. GOVERNMENT POLICIES

Hong Kong has an extremely liberal economic policy and there is very little government intervention in private business activities. Economic affairs in Hong Kong are conducted in a free enterprise environment where individual workers, businessmen and investors can pursue their own self-interest as they see fit. Hong Kong is a duty-free port and allows the entry and exit of most raw materials, consumer goods and commodities. This means that Hong Kong manufacturers can supply both local and foreign markets on the basis of low cost production. Free entry is permitted into almost every line of production and market forces are allowed to shape both the economic activities and the labor market.
This economic policy of non-intervention and minimal regulation is extended to its treatment of foreign investments. The colony’s economic and tax policy does not discriminate between domestic and foreign corporations. That is, all local and foreign corporations are registered under the same laws, subjected to the same set of business regulations and taxed at the same rate. Foreigners can invest in any business and own up to 100% of the equity. There is no limit on the repatriation of capital and remittances of earnings, interest and other income; nor are there any exchange controls. In addition, there is no capital gains tax, no sales tax, no corporate capital tax and the income tax is low. In contrast to Hong Kong, other countries of the Asian-Pacific region such as Singapore, Taiwan and South Korea have far more intricate policies towards foreign investments. Such policies might include official restrictions on foreign ownership, specific incentives granted to foreign investors and the like. Thus Hong Kong’s economic liberalism provides an excellent environment for foreign investment.

2.7. CHINA’S 'OPEN-DOOR' ECONOMIC POLICY

China’s open door policy, which started in 1978, is of great importance to Hong Kong. Under this policy, trade has increased tremendously, foreign investment in China was encouraged, four special economic zones have been
established in southern China, and in 1984, 14 coastal cities and Hainan Island were opened to foreign investment. It is expected that more cities along the coast will be opened up. In addition, China has adopted many of the tools commonly associated with capitalism such as increased emphasis on market forces and giving more independence to managers of enterprises.\textsuperscript{11}

One benefit that this open-door policy of China has brought to Hong Kong is the revival of the importance of entrepot trade in Hong Kong.\textsuperscript{12} Hong Kong's role as an entrepot declined after 1951. However, with China's open-door policy, Hong Kong's re-exports to China increased rapidly and amounted to more than 20 percent of its total re-export in 1983. In other words, Hong Kong has now recovered as a full-fledged entrepot with China as the leading trader.\textsuperscript{13}

China's open-door policy also brought other benefits to Hong Kong. China has provided crucial labor resources that have allowed Hong Kong to upgrade its economy, reducing the emphasis on low-value, labor intensive industries, and focusing more instead on sophisticated goods and services. Hong Kong manufacturers now employ more workers across the border, in neighboring Guangdong province than they do in the colony itself. One and a half million in the province were employed, directly or indirectly, by Hong Kong manufacturing companies in 1987. In Hong Kong itself,
900,000 people hold factory jobs. According to Alan McLean, Hong Kong government's chief economist, Hong Kong's future may be as a service center. Head offices, design and marketing work, insurance, financial and port facilities will be in Hong Kong while the actual manufacturing takes place across the border.¹⁴

By some estimates, China is likely to overtake U.S. as Hong Kong's biggest market in 1988. The projection is for Hong Kong's exports to China in 1988 to total HK$119 billion as compared with HK$116 billion to U.S.¹⁵ The big change in the China - Hong Kong relationship following the open-door policy has been positive for the Hong Kong economy.

This chapter summarized the factors contributing to the success of Hong Kong in the past. The next chapter will explore some of the problems facing Hong Kong internally and externally.


3. "Motorola Moves To 'Silicon Harbour'", AMCHAM, Journal Of The American Chamber Of Commerce In Hong Kong, March 1988, p. 35.


8. For a detail discussion on foreign investment in Hong Kong, see the chapter "Foreign Investment" by C.L. Hung, in Lethbridge (Ed.), The Business Environment In Hong Kong, Oxford University Press, H.K., 1984.


CHAPTER 3. MAJOR THREATS TO HONG KONG'S COMPETITIVENESS IN INTERNATIONAL TRADE

3.1. THE 1997 ISSUE

In September 1982, when Beijing first announced that China definitely intended to reclaim sovereignty over the whole of Hong Kong by 1997, political confidence in Hong Kong's economic future was shattered.¹ Despite promises by Chinese authorities that Hong Kong's free-wheeling economy would not be integrated into China's socialistic, state-directed system, the stock, property, and foreign exchange markets went into a virtual free-fall. Asset values on the stock exchanges fell by one-third within a few months, and land values in the choice sections of Hong Kong Island and Kowloon fell to as low as one-fifth of their pre-announcement prices. The floating exchange rate that had been in effect since 1974 fell from HK$6.2 to US$1 in mid-1982 to a low of HK$8.55 to US$1 on September 24, 1983 when the Government decided to peg the exchange rate at HK$7.8 to US$1.²

Over the past five years while authorities of both the Chinese and the British governments have been negotiating an agreement on the future of Hong Kong, the economy has stabilized and economic growth has been sustained. At the time of the signing of the Sino-British agreement in...
December, 1984, economic activity in Hong Kong slowed down. In 1986, the economy began to recover, achieving a real growth of around 8.7% while inflation fell to 2.8%. The upswing continued into 1987, with an overall growth for the year of over 12% while the inflation rate rose to 5.5%. The property and investment markets boomed and domestic exports were up 23% in real terms in 1987. The growth in exports to China reflects the increasing practice of sending raw materials and semi-manufactures to the mainland for finishing by China's cheap labor force. The U.S.A. remains the most important export market but rising U.S.A. protectionism has forced Hong Kong to turn to other markets, with notable success in Japan and West Germany.

Despite the economic recovery, there was a series of bombings in public places in Hong Kong in June and July 1987. These resulted in several injuries, but no deaths. The so-called Hong Kong Terrorist Association claimed responsibility and explained that the bombings were intended as a protest against the forthcoming Communist takeover. However, there is no evidence that the Association has widespread support and there have been no further similar incidents.

With regard to public attitudes towards the Sino-British agreement on Hong Kong's future after 1997, an independent survey revealed that most people "felt the agreement was not good but was the best that could be expected", but more
than 50% expressed concern that there were not enough safeguards against interference in Hong Kong's affairs by Beijing after 1997.

3.1.1. OUTFLOW OF HUMAN RESOURCES

Although the Hong Kong Government refuses to recognize that the problem of an outflow of human capital exists, the South China Morning Post, the Observer, the Financial Times and the Far Eastern Economic Review have been highlighting the problem. These sources note that confidence in the future of Hong Kong is not high and people are voting with their feet. A research conducted by the South China Morning Post based on a random selection of 1,000 persons in Hong Kong concluded that 27% of those interviewed expressed "no confidence" in the future of Hong Kong. This figure, when compared to those obtained in February 1987 and in September 1985 (23% and 14% respectively), showed that people's confidence in Hong Kong's future was heading downhill. Of the "no confidence" group, 17% said that they had at least one member of the family eligible to live abroad or trying to go. In this category, the higher income group showed a higher percentage of 23%. Based on present population statistics, such a proportion could amount to an exodus of 1.5 million people. This lack of confidence in the future of Hong Kong has been particularly prevalent among professionals and businessmen. Table 4 and
Table 5 shows some statistics reflecting the increasing seriousness of this "exodus" problem.

Table 4. Visas For Emigration From Hong Kong To Australia

<table>
<thead>
<tr>
<th></th>
<th>83-84</th>
<th>84-85</th>
<th>85-86</th>
<th>86-87</th>
<th>87-88*</th>
</tr>
</thead>
<tbody>
<tr>
<td>APPLICATIONS (CASES)</td>
<td>2621</td>
<td>2110</td>
<td>3755</td>
<td>6280</td>
<td>3639</td>
</tr>
<tr>
<td>VISAS ISSUED</td>
<td>3843</td>
<td>3997</td>
<td>4460</td>
<td>**</td>
<td>3258</td>
</tr>
<tr>
<td>BUSINESS MIGRATION</td>
<td>**</td>
<td>**</td>
<td>479</td>
<td>710</td>
<td>1113</td>
</tr>
</tbody>
</table>

* Last five months of 1987 only
** Data unavailable
Source: Executive, February 1988, p.22.

Table 5. Visas For Emigration From Hong Kong To Canada

<table>
<thead>
<tr>
<th></th>
<th>1986</th>
<th>1987</th>
</tr>
</thead>
<tbody>
<tr>
<td>FAMILY</td>
<td>1328</td>
<td>2231</td>
</tr>
<tr>
<td>ASSISTED RELATIVE</td>
<td>189</td>
<td>648</td>
</tr>
<tr>
<td>INDEPENDENT</td>
<td>3429</td>
<td>9918</td>
</tr>
<tr>
<td>BUSINESS</td>
<td>3857</td>
<td>3684</td>
</tr>
<tr>
<td>REFUGEE*</td>
<td>3857</td>
<td>3684</td>
</tr>
<tr>
<td>TOTAL</td>
<td>9948</td>
<td>17103</td>
</tr>
</tbody>
</table>

* All Vietnamese From Hong Kong
Source: Executive, February 1988, p.23.

The root of the problem is the distrust of China's intentions for Hong Kong and unease over Hong Kong's evolution during the transition to Chinese rule. According to Joseph Cheng, a political scientist at the Chinese University of Hong Kong, hopes were high after the signing of the 1984 Sino-British agreement that Hong Kong might be able to maintain its promised "high degree of
autonomy" after 1997. However, these hopes have been eroded over the past years by China's vocal objections to democratic reform in the colony ahead of 1997 and by Britain's backpedaling from widely expected reforms.\(^6\)

Reversing earlier government statements, Hong Kong's Governor Sir David Wilson, acknowledged that the number of middle-level managers leaving the colony is a problem. He admitted at a press conference earlier this year that more people from the key middle-management sector appear to be leaving now than in the past.\(^7\) In the private sector, businessmen say a brain drain has begun sapping the pool of their best and brightest employees and there is no viable way to cope with the problem. About half of those leaving came from professional, technical and management groups. As a result, the education, trade and financial sectors were hit hardest by the exodus.

The number of Hong Kong emigrants to Canada and Australia jumped sharply in 1987. Canada in particular, has attracted a large number of Hong Kong emigrants. About 500,000 Chinese, most of Hong Kong origin, live in Canada; and soon Toronto is expected to displace New York as the North American city with the largest Chinese population.\(^8\)

Most of those going to of Canada and Australia are from the "Independent" and "Business/Entrepreneur" categories. The chief characteristics of those in the "Independent" category are high educational attainment, skilled and aged
Those in the "Business/Entrepreneur" category are mostly businessmen.

Along with the exodus of these members of the business class is the huge capital outflow which might have been invested locally. These outflows of money and human resources impose a brake on Hong Kong's economic development because of shortages developing. Manpower costs will go up because of these shortages. Employees seeking short-term benefits over long-term career planning will cause higher turnover. More aggressive poaching of competitors' staff is anticipated and companies committed to training and development will suffer in the squeeze. Furthermore, it will be necessary to give younger, less skilled managers more responsibilities or bring in expertise from aboard -- either or both of which have cost and efficiency problems implications. Finally, replacements for those leaving for other countries are hard to find as more and more foreigners are working on short-term contracts.\(^9\) As a result, localization, the catchword of the early 1980's, is heard less often these days. Due to all these changes, a lot of the advantages that made Hong Kong attractive will no longer be available. The emigration pressure may cause some companies to look elsewhere.\(^10\)

3.1.2. OUTFLOW OF INVESTMENT

Corporate giants in Hong Kong have also shown their
deteriorating confidence in Hong Kong's future. Giants like Hutchinson Whampoa want to increase their investment overseas, while Jardine Matheson is already safely domiciled in Bermuda. The traditional Chinese families are also keen to pull their assets out of Hong Kong by increasing investment overseas.\textsuperscript{11}

3.1.3 INTERNAL POLITICAL CHANGE

According to the Sino-British Agreement, Hong Kong's people are supposed to run Hong Kong after 1997. This is, however, a formidable task. To forestall disruption in 1997, a predominantly local administration will have to be in place well before then. Political parties, or their equivalent are likely to emerge. An environment will have to be created so that indigenous leaders can develop. Unfortunately, this is easier said than done. For over 100 years, all political power in Hong Kong resided with the British, while Hong Kong's people channeled their energies into other activities, the most popular of which as making money.\textsuperscript{12} There is a danger that people with no previous government experience, in order to win voter support, will greatly expand social welfare programs that the government can hardly support. That might result in tax increases that will drive businesses away from Hong Kong. Also, there is a fear that pro-Communist or pro-Taiwan people will dominate the government, to the detriment of Hong Kong.\textsuperscript{13}
3.1.4. CHANGE IN INTERNATIONAL POLITICAL STATUS

In the post-1997 period, it is vital for the rest of the world to perceive Hong Kong as an entity which is different from the rest of China even though it is under Chinese sovereignty. However, there is a danger that Hong Kong's international standing may diminish. There are some consular and other official missions in Hong Kong that are from countries that China has no diplomatic relations with or that China does not recognize. Some of Hong Kong's most important trading partners fall into this category. The Joint Declaration suggests that such relation will be downgraded after 1997. This will definitely result in a decline in Hong Kong's international standing. Travel between Hong Kong and those places will become difficult. Besides, some Asian countries such as Indonesia, Malaysia and Singapore are suspicious of the communist Chinese. They will definitely reassess their relationship with Hong Kong after 1997. Such development will greatly hamper Hong Kong's ability to do business.14

Another question facing Hong Kong is its ability to remain a member of some international bodies and be a party to international agreements as a result of transfer of government authority to China. This issue involves about 300 international treaties and accords and about 160 bilateral agreements entered into by Britain that apply to Hong Kong. Hong Kong's role in certain international
activities may be terminated because China is not a participant. Membership in British Common-wealth organizations and agreements is an example. Hong Kong’s link with GATT would also be endangered. At present, China is not a member of GATT.

The problem is serious but not absolutely impossible to overcome. China is already a member of GATT’s textile committee and has been invited to take part in all meetings of the GATT Council. If China joins GATT before 1997, it can take over Britain’s role and provide for Hong Kong’s continued participation. Links with international organizations such as GATT, the Multifiber Agreement, and the International Monetary Fund are vital to Hong Kong’s economy and should be maintained. According to the Far Eastern Economic Review, progress has been made by Hong Kong in seeking independent membership in GATT.

3.2. HONG KONG’S COMPETITIVENESS WITH RESPECT TO OTHER NICs

Hong Kong’s economy is now facing the problem of severe competition from other Asian countries. Increasingly, Hong Kong’s major products for export, such as textile; electronic products and clothing, are facing strong competition from countries such as South Korea, Taiwan, and Singapore. In addition, other Asian countries such as Malaysia, Thailand, and Philippines have become competitors. These countries also compete with Hong Kong.
for foreign investment. To a certain extent, the keen competition that Hong Kong is now facing means that it is gradually losing some of its comparative advantage in the production of light manufactured products. In a lot of cases, these countries, in general, enjoy the advantage of lower wages, lower land values and greater government assistance. This signifies a trend that the late-comers in industrialization can take over some production previously undertaken by the older newly-industrialized countries.17

Besides facing competition in the manufacturing industry, Hong Kong is also facing competition in financial services from other Asian countries. As stated in The Economist, Singapore would like to balance its manufacturing growth with expansion in financial services. As a result, Singapore is now competing directly with Hong Kong in the area of financial services.18 Apart from Singapore, Taiwan has recently opened its financial market.

Table 6 presents the rough position of Hong Kong in comparison with a number of competing countries in Asia. From this table, it can be seen that Hong Kong's competitive position is still strong in certain areas due to low taxation and an efficient bureaucracy. Of course, Table 6 must be viewed dynamically. Some Asian countries such as Thailand are trying hard to remove their disadvantages.
TABLE 6. HONG KONG'S COMPARATIVE ADVANTAGE AGAINST SELECTED COUNTRIES IN GARMENTS, PLASTICS AND ELECTRONIC PRODUCTS.

<table>
<thead>
<tr>
<th></th>
<th>TAX</th>
<th>RED-TAPE</th>
<th>LABOR</th>
<th>RAW-MATERIAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>SINGAPORE</td>
<td>-</td>
<td>Ø</td>
<td>-</td>
<td>Ø</td>
</tr>
<tr>
<td>TAIWAN</td>
<td>-</td>
<td>-</td>
<td>+</td>
<td>Ø</td>
</tr>
<tr>
<td>THAILAND</td>
<td>-</td>
<td>-</td>
<td>+</td>
<td>-</td>
</tr>
<tr>
<td>SRI LANKA</td>
<td>Ø</td>
<td>-</td>
<td>+</td>
<td>-</td>
</tr>
<tr>
<td>PHILIPPINES</td>
<td>-</td>
<td>-</td>
<td>+</td>
<td>-</td>
</tr>
<tr>
<td>SOUTH KOREA</td>
<td>-</td>
<td>-</td>
<td>+</td>
<td>Ø</td>
</tr>
</tbody>
</table>

Ø = EQUAL TO HONG KONG  
- = LESS ADVANTAGEOUS THAN HONG KONG  
+ = MORE ADVANTAGEOUS THAN HONG KONG


The NICs and Asian countries are not equally attractive to business. To some people, such as Kunio Yoshihara, the author of Japanese Investment in Southeast Asia, Taiwan and South Korea have proven to be less desirable investment sites than either Singapore and Hong Kong. Customs procedures for the importation of raw materials and machinery are much more time consuming in South Korea and Taiwan. Besides, the administration of foreign investment laws are complex in these countries. In short, they seem to suffer from excessive "red-tape".19

Another weakness of Taiwan and South Korea is that their supporting industries are weaker and their transportation...
systems are much less developed. Moving goods from the inland transportation network and loading and unloading at piers is much less time consuming in Singapore and Hong Kong. Furthermore, Singapore and Hong Kong have far more developed financial institutions. That makes it possible for investors to gain access to low-interest loans.  

Although Singapore and Hong Kong have certain advantages over other Asian countries, they certainly have disadvantages as well. Singapore and Hong Kong have been relatively high-wage countries among the Asian countries ever since the middle of the 1960s. Besides, Hong Kong also suffers from a uncertain political future. Singapore differs from Hong Kong mainly in that its sovereignty provides Chinese Singaporeans with a degree of self-assurance and security which are absent in Hong Kong.  

In Singapore, not only is there internal stability but external security seems to be assured, since there is no particular country that is antagonistic. However, foreigners who would like to expand their business in Singapore have other complaints. Information flows poorly in Singapore compared with Hong Kong, which has a freer press. Businessmen also complain that the Singapore government is too suspicious of them or too restrictive, especially in control of companies.  

Finally, Hong Kong lacks national status and the ability to retaliate. Her bargaining power with the Western
countries in trade negotiations is weak. Therefore, Hong Kong is often forced to accept the restrictions imposed on her unconditionally. Also, Hong Kong’s economic performance has also been subjected to wide fluctuation because of her dependence on the export of a few commodities to a few countries.24

This chapter describes only the major threats to Hong Kong’s competitiveness in international trade. However, there are other minor problems facing Hong Kong in this area as well. To give an example, with the huge US trade deficits and the increasing Congressional pressure for protectionism, a slowdown in consumer demand in the U.S.A. is anticipated. This means competitive pressures will increase. The next chapter will provide some suggestions that might maintain Hong Kong’s economic and political stability.
FOOTNOTES

1. For a detail documentation on the process of negotiations, see Chapter 1 "The Negotiations" by Ching, Hong Kong and China -- For Better Or For Worse, published by the China Council of the Asia Society and the Foreign Policy Association, New York, 1985.


4. For a detail discussion on this topic, see Chapter 3 "The Future : View From Hong Kong", by Ching, Hong Kong and China -- For Better Or For Worse, China Council of The Asia Society and the Foreign Policy Association, New York, 1985.


12. Ching, Frank, Hong Kong And China -- For Better Or For Worse, published by the China Council of the Asia Society and Foreign Policy Association, New York, 1985, p.54.


CHAPTER 4. PROPOSED STRATEGIES

4.1. WHY THE STATUS QUO MAY BE MAINTAINED?

Although the spectre of 1997 has always loomed on the horizon, the live-and-let-live mutually profitable relationship between China and Hong Kong held out the possibility, however slight, that the status quo might be allowed to continue beyond 1997.\(^1\) Hong Kong has always been important to China in the post-war era. She has provided China with badly needed foreign exchange, a window to the West, access to modern technology and other economic benefits.

Since the mid 1960s, receipts from Hong Kong have accounted for 30-40% of China's total earnings of foreign exchange. In addition, Hong Kong is the clearinghouse for remittances to China. Local and overseas companies, and individuals remit to their relatives and business associates upwards of US$ 100 million a year.\(^2\)

Hong Kong's importance as an entrepot to China stems from its economy's worldwide marketing network and its effective transport and communications infrastructure. In recent years, the Colony's entrepot trade with China has been growing rapidly. The China's external trade has been constrained by its inadequate and outdated transport facilities. The cargo-handling capacities at the major ports of China have been strained and their ability to

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handle container cargoes is extremely limited. On the other hand, Hong Kong has the largest, deepest, and most modern port facilities along the China coast. Consequently, it is cheaper and faster for Chinese cargoes to be handled through Hong Kong. Even though China's takeover of Hong Kong would not eliminate this economic benefit, the pace of port modernization would likely ease.

As long as congestion and inefficient cargo handling at the ports of China remain, Hong Kong's role as an entrepot will continue to be indispensable for China as well as for other developed countries such as USA, Japan, Australia and West Germany. Furthermore, a fairly stable proportion of China's exports to nonsocialist countries is channelled through Hong Kong. The growth of the Taiwan-China trade flow through Hong Kong has been phenomenal. It was virtually nonexistent prior to 1977. Since 1980, however, Taiwan has become the leading source of Hong Kong re-exports to China. In 1987, indirect trade between China and Taiwan through Hong Kong rose 58.7%. Specifically, Taiwan's exports to China through Hong Kong had grown 51.2% while China's exports to Taiwan through Hong Kong had doubled.

Apart from quantifiable economic and financial benefits, Hong Kong provides China with indirect but tangible benefits in the form of access to Western technology and modes of business management, a convenient center for trade
contacts and financial negotiations, a training ground for thousands of Chinese technicians and service personnel, and the opportunity for first hand observation of the workings of a free market economy. Furthermore, the recent policy pronouncement by the Chairman of China, Teng Hsiaoping, emphasized the importance of continuing the development of foreign trade to increase foreign exchange earnings. He added that the development of industrial cooperation in its various forms should be continued because this constitutes an effective avenue for importing technical and managerial expertise, both of which are indispensable in expanding exports in the future.

Another element that helps enhance the possibility of Hong Kong maintaining the status quo beyond 1997 is that, by preserving the territory's capitalistic structure, China can create a model that one day may lure Taiwan back to "the embrace of the motherland". This political argument for keeping Hong Kong's status quo is likely to gain support from the aging Chinese leaders who dearly wish to see a reunified China in their lifetimes.

Both the economic and the political arguments for China to maintain Hong Kong as a capitalist enclave after 1997 are strong. From the economic viewpoint, the interests of China and Hong Kong coincide: if Hong Kong prospers, China will benefit, whereas if Hong Kong falls on hard times, it will only add to China's problems -- an additional 5.6
million people to feed. It is true that, as China continues to open up to the outside world, the role of Hong Kong may diminish in a relative sense. But Hong Kong's role as a financial, trade and transshipment center is unlikely to be taken over by any mainland Chinese city. In China's attempt to catch up with the rest of the world, it will certainly not be in its interest to turn one of its principal stepping-stones into a stumbling block.

From the political viewpoint, since China has pledged that the capitalist system will be maintained in Hong Kong, and that Beijing will not send officials to administer the territory so that Hong Kong is able to run its own economic affairs, Chinese officials have gone out of their way to show both to people in Hong Kong and to the international community at large, and to Taiwan in particular, that China fully intends to honor its commitments.

The publicity China has given to the agreement, both domestically and internationally, definitely indicates a willingness to abide by its terms. China has put its national reputation on the line. Failure to honor the agreement on China's part would not only lead to another crisis in Hong Kong but would also cause a severe decline in China's credibility with Britain as well as with the rest of the world. China's own major trading partners such as Western Europe, the United States and Japan all have a stake in Hong Kong's continued success. Beijing will
certainly not take any actions that will damage its carefully nurtured relations with the major countries of the non-Communist world. Not honoring the Hong Kong agreement will surely deter foreign investors from putting their money in China itself. 8

Closer to home, China is also aware of its Asian neighbor's view of Hong Kong as a test of whether China has really abandoned radical political objectives for economic development. Open intervention by Beijing in Hong Kong's affairs would be certain to backfire, reversing many years of diplomatic efforts.

Finally, China could have easily taken over or disrupted Hong Kong at any time since 1949. Except for relatively minor exceptional incidents in 1966–67, China's Hong Kong record is impeccable and there is no reason to think that it will not continue this way in the future. 9

4.2. WILL THE 1997 ISSUE DAMPEN INVESTMENT IN HONG KONG?

Although Hong Kong is to be returned to China in nine years, investment in Hong Kong has not yet been affected. In fact, the opposite is the case. The stock market is booming, property prices are soaring and outside investors are queuing up to move into Hong Kong. When Hong Kong's Financial Secretary, Piers Jacobs, made his budget speech in February 1987, he forecasted that the Crown Colony's economy would grow by 6.2 percent. He based that figure on the assumption that Hong Kong's domestic exports would rise
by 7 percent in 1987. But in the first half of 1987 domestic exports were up by 28 percent in real terms and now analysts believe that gross domestic product growth in 1987 would pass the 10 percent mark, well ahead of 1986's 8.7 percent. The export boom has carried over into virtually all areas of the economy. According to the Hongkong and Shanghai Bank's economics department, investment in plant and machinery was up 25 percent in the first half of 1987. Some investors invest in Hong Kong because of China and most appear to do so despite the 'China threat'. China's open door policy provides Hong Kong firms with an opportunity to establish their labor- and land-intensive industries in China to increase their productivity. Already there are factories in Guangdong province which are partly or wholly-owned by Hong Kong corporations. This rapid increase in investment in Hong Kong has led one observer to predict that there is an even chance of a four-fold increase in profitability of Hong Kong business in the next five years.

Reaction from members of the foreign business community so far has reflected a sense of confidence that they can continue to work in Hong Kong. Lawrence J. Toal, senior vice president of the Hong Kong branch of Chase Manhattan Bank, has been quoted as saying that the Sino-British agreement concerning Hong Kong, which is better than American businessmen in Hong Kong had expected, has
dispelled anxiety and uncertainty about Hong Kong's future.\textsuperscript{12} The total value of American investment at the end of 1986 showed an increase of 42\% over 1985. Of this total, 69\% was in the electronics industry.\textsuperscript{13}

Motorola, a major US-based electronics company, has recently invested several hundred million Hong Kong Dollars in a highly advanced three-story electronics plant, known as Motorola's "Silicon Harbour", located in the high technology zone of the Tai Po Industrial Estate in Hong Kong. This plant is scheduled to be completed by 1990. Semiconductors will be designed and produced utilizing computer-aided-design/computer-aided-manufacturing/computer-integrated-manufacturing (CAD/CAM/CIM) technologies. These technologies will represent the "state of the art" in the Hong Kong semiconductor industry and also will be one generation ahead of similar facilities now in USA and Europe. The emphasis is on producing high quality semiconductors of increasing complexity in the shortest possible cycle time to serve the electronic industry. The project will also help the local electronic industry move into the current generation of modern circuitry and product miniaturization. Hong Kong had been chosen as the location for Motorola's "Silicon Harbour" project mainly because of its advanced infrastructure support, its proximity to China and the common language and culture which will strategically help Motorola penetrate
the China market.\textsuperscript{14}

According to the \textit{Far Eastern Economic Review}, Japanese investment is pouring into Hong Kong at an unprecedented rate. Japanese investment in Hong Kong increased from US$131 million in 1986 to US$502 million in 1987 to over US$1 billion in 1988. The new influx of Japanese funds put Japan in a position to threaten the United States' traditional number one position in Hong Kong.

In a broader sense, the big increase in Hong Kong's share of Japanese investment indicates that Japanese businessmen and government officials' recognize Hong Kong's role as a regional financial, trade and manufacturing center. Few seem troubled by the shadow of 1997. "Now that the return of Hong Kong to China is a certainty, we feel the Hong Kong problem is already settled", said Masanori Okonogi, Consul for trade and industry at the Japanese Consulate in Hong Kong.\textsuperscript{15}

Certain elements necessary for an investment center such as the free market, free port, the well developed communication and transportation infrastructure have been present all along. Also, the high standard of living guarantees expatriates comfortable living conditions.\textsuperscript{16}

4.3. SHORT-TERM FORECAST

The day when Hong Kong is handed back to China is now less than ten years away, but there are few signs of panic
setting in. The economy is booming and achieved a 12% growth rate in 1987. Although the growth is anticipated to slow down in the coming years after two consecutive years of double-digit growth, the growth would still be moderate at an estimated rate of 6%. Inflation was up last year reaching 5.5% compared to 2.8% in 1986. It is predicted that inflation will continue to rise and reach 7% in 1988. This is due to domestic demand, low interest rates and the depreciation of the Hong Kong dollar against the yen and other European currencies, which has raised the prices of imports. Domestic exports, the economy's main driving force, are expected to grow 6% in 1988 after jumping 23% in 1987 and 16% in 1986. Re-exports, mostly goods from China, are projected to grow 12% in 1988. This follows a 46% surge in 1987 and a 16% rise in 1986. Imports are projected to grow 9.5% after increases of 32% in 1987 and 14% in 1986.

Despite the removal of Hong Kong from the United States' Generalized System of Preference, Hong Kong manufacturers will not lose a significant market share in the US since the other three Asian NICs receive the same treatment. Instead, the Colony's exporters recently have been increasing their penetration into other markets less subject to protectionist measures. Furthermore, the economy's textile and electrical appliance industries have strengthened their world market position through
improvements in product quality and design. Moreover, Hong Kong's growing commercial ties with southern China have given local industries access to an enormous pool of cheap labor. This greatly enhances Hong Kong's competitiveness among the NICs in the world market.17

4.4. PROPOSED STRATEGIES

The following section will provide some suggestions that might solve the economic problems facing Hong Kong.

4.4.1. RESTORE AND EXPAND HUMAN RESOURCES

There is a need to restore confidence since many people feel that if they do not leave Hong Kong now, the doors to future emigration will be closed. Pressure has to be brought to bear on the Hong Kong Government and the PRC for a better declaration of the right to leave after 1997. Efforts should be made to:

1) Improve human resources training and development.
2) Attract back from overseas those Hong Kong Chinese overseas who already have a second passport.
3) Urge government and private sector cooperation in education and training programs.

In order to achieve these objectives, universities and polytechnics in Hong Kong must expand capacity and make their curricula more relevant. Government must encourage excellence in management training by such obvious actions as establishing a Hong Kong Business School.
In the private sector, management training and development and career succession planning must become the norm to attract and hold managers. Smaller companies should encourage further education by employees if there are no other resources.

Both government and the private sector should make available enhanced specialist skill programs and consider granting aid to speed up management training and development programs.

4.4.2. DIVERSIFICATION

After two decades of rapid growth, the Hong Kong economy has now come to a point where its growth depends on the success of achieving some transformation within the economy. For the past two decades, Hong Kong’s growth has been based on the export of light manufactured goods which are generally labor-intensive. The possibility of maintaining a high growth rate of these traditional labor-intensive manufactured export is slight for two reasons. First, Hong Kong is encountering the problem of increasing trade restrictions imposed on the major items of her exports by the developed Western countries. Second, the Hong Kong economy is now facing the problem of severe competition from other Asian countries. Thus, economic transformation in the form of diversification is necessary for the Hong Kong economy to sustain its growth. But as a result of rapid economic development and in view of the
current need for diversification, laissez-faire capitalism may no longer be the best policy. A system with more central planning such as the one employed in Japan can be considered. It is appropriate for the government now to create an inductive environment in which resourceful entrepreneurs can diversify their activities.19

4.4.2.1 Diversification in the Economy

There are in fact different kinds of diversification. The first, and broadest, type is diversification of economic activities, say from manufacturing to financial service or from agriculture to industry. Continuing development as a financial center is critical for Hong Kong because the financial sector is a prominent part of its economy and could very well be the engine of its future growth. Hong Kong, with approximately 141 licensed banks from more than 23 nations, 20 has seen a significant expansion of its financial sector. Hong Kong's accomplishments over the last decade in becoming Asia's premier financial center are truly impressive. It is the third largest financial center in the world with a clear lead in Asia in loan syndication, foreign exchange and gold trading.21 Financial services, broadly defined, accounted for over 20 percent of GDP and 5 percent of employment. The government should focus on providing an attractive business environment and excellent infrastructure. Specifically, it needs to focus on:
1) **Regulation.** The policy of positive non-interventionism should continue as it has been healthy. But on the other hand, better qualitative supervision and more financial disclosure are important for longer-term stability.

2) **The Legal system.** This is probably very critical to the development of Hong Kong as a financial center. This issue can and should be addressed in the drafting of the Basic Law of Hong Kong.

3) **Currency.** The linked system is working well and has restored stability to the financial markets of Hong Kong. The currency system in Hong Kong may very well be a good model for use in the Special Economic Zones of China, if China wishes to develop an internationally tradable currency.

The banks and financial institutions should focus on:

1) **Investment.** There is a need to continue to invest in technology and communications which could provide a sustainable competitive edge.

2) **Innovation.** If syndicated loans are diminishing, there is a bewildering array of financial products that are entering the market everyday. Innovation in the financial industry is important and ought to be encouraged and promoted.

3) **Develop market niches.** Specifically, China is going to provide a large market and a competitive edge for
Hong Kong. Most successful financial centers build on a large and substantial economic base. China is a natural market for Hong Kong.\textsuperscript{22}

4.4.2.2. Diversification in Manufacturing Industry

Within manufacturing, new industries should be established in addition to existing industries and to replace those declining industries in which Hong Kong has lost its comparative advantage. Manufacturing industries cannot be completely replaced by financial service in Hong Kong for two reasons. First, Hong Kong has a comparative advantage in the development of technology-intensive industry with its plentiful supply of adaptable and dynamic entrepreneurs and workers. Second, manufacturing can create far more employment opportunities than financial services. Hong Kong still has a large labor force that can be absorbed.

In general, Hong Kong has the potential to diversify into sophisticated electronic products, telecommunication equipment, optical, scientific and medical instruments, ship building and repair, aircraft engineering and maintenance, oil refining, machinery and tools and light engineering products.\textsuperscript{23} It is necessary for the Hong Kong government to adopt some policy in order to provide cheaper, more suitable industrial land, more industrial training, and technology support so that industries can respond more rapidly and accurately to market changes. At
the same time, the expertise of Hong Kong industrialists in light manufactured products can play an important role in investing in China where the more labor-intensive production can take place.

Besides establishing new industries, Hong Kong should also attempt to diversify products in the existing industries. To give an example, the garment and textile industry will continue to remain in Hong Kong because of the quota system. The current trend is that process-based industries will remain in Hong Kong since they are management-intensive. The labor-intensive activities will be carried out in PRC. Design capabilities in Hong Kong should be expanded to facilitate more product diversification.24

The process of product diversification in existing industries has been very successfully undertaken in the past two decades in Hong Kong, particularly in the textile and electronic industries. Unfortunately, there is a limit to the extent to which product diversification can be undertaken. At a certain point, product diversification will become increasingly difficult. Hong Kong may have reached this point and so may now need to diversify in other ways.25

It is also important for Hong Kong to diversify its sources of supply. Hong Kong has very limited natural resources and most of the raw materials have to be
imported. To reduce over reliance on one source, Hong Kong must diversify its suppliers.

4.4.2.3. Diversification in Markets

The United States is Hong Kong’s largest export market. Forty-two percent of Hong Kong’s exports went to the United States in 1986. However, such heavy reliance on a single market might be unhealthy. Efforts to diversify into other markets are under way. Recently, there is a decrease in the relative importance of the United States as Hong Kong’s export market. The percentage of Hong Kong’s export going to the United States decreased to 37 percent in 1987, although the value of Hong Kong’s domestic exports rose 26.8 percent in 1987. The increase in domestic export to the United States was modest compared with the jump in sales to the Colony’s other major markets. Domestic exports to the United States rose 13 percent in 1987 while the increase in exports to China, Japan and West Germany were 55 percent, 53 percent and 35 percent respectively. Nevertheless, the United States still remains as the Colony’s largest export market.

Hong Kong exporters had made a particular strong effort in recent years to break into the Japanese market and this effort is beginning to bear fruit. Also, the relative importance of Australia as a trading partner of Hong Kong has been growing rapidly. Hong Kong investments represents approximately 4.5 percent of Australia’s overseas
investment and the Australian government encourages more Hong Kong investment. Australia is buying more from China in the form of re-exports through Hong Kong.

Companies with strong connections with China should benefit from the continuation of China's open door policy. Some noticeable successes are construction firms like Hopewell and New World Development, trading firms like Li Ka-Shing's Hutchinson, and Simon Keawick's Jardine Matheson, Hong Kong's airline, Cathay Pacific, and the utility firm, China Light & Power.

As the U.S. moves towards eliminating its huge trade and fiscal deficits, the trading partners of the Pacific Rim should expand two-way trade much more between themselves to remain the world's major economic growth region. To achieve this goal of more intra-regional trade and to promote world-wide trade and investment in the Pacific Rim region, a forum known as PacRim '88 will be held in Hong Kong in December.

4.4.3. IMPROVE RESEARCH CAPABILITY AND SUPPLY OF RAW MATERIAL

It has been recommended that Hong Kong should move towards a future path of industrial development with emphasis on higher technology. At present, two of the many vital elements for developing high technology industries are lacking in Hong Kong: research capability and local raw material. However, these deficiencies may possibly be
moderated if China is willing to cooperate and to participate.

The government has indicated that it will not finance the Electronic Technology Development Laboratory proposed by the Electronics Industry Report of 1982. However, such a facility is very important in the long run since it would help the traditional industries to move up the quality and technology ladder. It is possible that China will be willing to participate in this project in view of Hong Kong's new political status, and its closer ties with China. As China achieves steady progress in liberalizing its international economic relationships, Hong Kong can be utilized as a nodal point for the transfer of high-technology into China. To fulfil this role, Hong Kong can be developed into a high-tech center with China's support. Hong Kong's advantages in communication, and transport, and language, and its attractiveness as an international meeting place certainly provide some of the qualities for the development of such a center. Besides, a closer and new relationship with China may open up new sources of raw materials, based on which Hong Kong may develop new, heavy and capital intensive industries hitherto unimaginable.
FOOTNOTES


3. Hsia, The Entrepot Trade Of Hong Kong With Special Reference To Taiwan and The Chinese Mainland, published by Chung-Hua Institution for Economic Research, Taiwan, 1984, p.84.


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20. Moores, Alan (Editor), Living in Hong Kong, American Chamber of Commerce in Hong Kong, 1986, p.108.


22. Summarized from Victor Menezes, "Hong Kong -- Financial Center for The Future?" in Jao, Leung, Wesley-Smith and Wong (Editors), Hong Kong and 1997 -- Strategies for The Future, Center of Asian Studies, University of Hong Kong, 1985, pp. 355 to


CHAPTER 5. SUMMARY & CONCLUSION

5.1. SUMMARY

The purpose of this paper is to examine the factors contributing to Hong Kong’s historical success and to anticipate its future prospects. Chapter one describes the history and economic setting of Hong Kong. Obviously, the rapid industrialization following World War II is a major factor. Chapter two examines the factors leading to Hong Kong’s economic success. A noteworthy element has been the evolution of an infrastructure supporting the Colony’s rapid growth. Chapter three discusses the major threats to Hong Kong’s position in international trade. These are the 1997 issue and the competitive threats from the NICs. Suggested strategies to deal with future problems are provided in chapter four. This chapter will give a conclusion for the paper.

5.2. CONCLUSION

Hong Kong enjoys certain advantages such as location, a good natural harbour, an industrious labor force and a well developed and efficient infrastructure including an efficient bureaucracy. Today, Hong Kong is the center of communication in the Pacific and the ranking Asian financial center after Tokyo. If Hong Kong’s current status is maintained, continued prosperity seems assured, benefiting not only Hong Kong but the entire Pacific region. Should any setbacks to Hong Kong’s prosperity
occur, it would have ramifications extending well beyond the Colony. As Chalmers Johnson has noted, "The ending of Hong Kong to perform its true function will have enormous consequences not just for the people of Hong Kong but for the nations of the Pacific basin". Thus, the "China Factor" is critical in Hong Kong's future. China's willingness and ability to honor the Sino-British agreement can have a decisive impact on Hong Kong's future. Thus, the long-term stability of China's political system and its present outward-looking and pragmatic policies become even more important.

Outside Hong Kong's orbit, there is serious concern about the "China Factor". The U.S. Secretary of State, George P. Shultz, welcomed the Sino-British agreement and offered American cooperation. In his message to China's Foreign Minister Wu, Mr. Shultz said "The United States will provide any assistance it can, in close cooperation with the United Kingdom and the PRC to maintain Hong Kong's appropriate participation in international bodies". Support for the agreement also came from the Secretary General of the United Nations, Javier Perez de Cuellar, the 10 members of the European Economic Community (EEC), Japan, Singapore, Thailand, Portugal and even North Korea.

Among the actions that Hong Kong should pursue to insure its continued economic development are the following.

1) Devising new and strengthening existing programs tu
enhance the development of Hong Kong's already efficient human resources. This could include efforts to induce the return from overseas of Hong Kong citizens who live elsewhere.

2) Seek added economic diversification. In particular, Hong Kong should continue the trend away from light manufacturing and into financial and business services. Within manufacturing, however, there needs to be greater diversification. Further, Hong Kong should seek broader markets for its goods and services and more diverse sources of raw material.

3) Improve and expand research capabilities. This would feed on and in turn would support the human resource and economic diversification programs noted above.

Two conditions must be met if Hong Kong's future is to be realized. Hong Kong residents must not provoke China in any way. They must make sure that there is no excuse for Chinese intervention. Maintaining the economic prosperity of Hong Kong is more likely to keep China's hands off. Another important condition is that close cooperation between China and Britain must continue in order to work out a future government structure for Hong Kong and to draft a Basic Law that is acceptable to Hong Kong.

With good will and good sense on all sides, Hong Kong will continue to thrive as a major commercial, financial
and information center in the Asian-Pacific region beyond 1997.
FOOTNOTES


2. Ching, Frank, Hong Kong and China -- For Better Or For Worse, Published by the China Council of the Asian Society, the Foreign Policy Association, New York City, 1985, p.71.

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