Chapter III Hong Kong: Growing Integration With the Chinese Economy and Issue Arising

権利	Copyrights 日本貿易振興機構（ジェトロ）アジア経済研究所 / Institute of Developing Economies, Japan External Trade Organization (IDE-JETRO) http://www.ide.go.jp
シリーズタイトル(英)	IDE Spot Survey
シリーズ番号	9
journal or publication title	Examining Asia's Tigers - Nine Economies Challenging Common Structural Problems-
page range	[20]-27
year	1997
URL	http://hdl.handle.net/2344/00010433

Chapter III

Hong Kong: Growing Integration With the Chinese Economy and Issues Arising

1. Sluggish 1996 Exports and Factors Behind These

Hong Kong's exports rose just 4% in 1996 – the lowest rate of growth since 1982. This sluggishness of exports in 1996 was due in part to the slowdown in exports of electronic components, as has occurred in other parts of East Asia, although in Hong Kong's case, the effects of this were smaller. Rather, it was caused by the change from goods to services in trade, the economic integration with China, the effects of the improved infrastructure in China, and other structural changes that were behind the export slowdown. Furthermore, structural problems can be said to have been clearly manifested in this sluggishness of exports and the changes in structure of the exports.

Hong Kong's export trade consists of domestic exports and re-exports, the latter being defined as the goods which have previously been imported into Hong Kong and subsequently exported without having undergone in Hong Kong any manufacturing processes which change permanently the shape, nature, form or utility of goods. Domestic exports have been declining as a general trend; in recent years, over 80% of the export trade has been reexports (see Table 3-1).

Total exports in 1996 reached HK$1,397.9 billion or 4.0% more than the previous year (same below). Of this, re-exports totaled HK$1,185.7 billion, up 6.6%, while domestic exports totaled HK$211.2 billion, down 8.4%. In 1995, total exports rose 14.9%, re-exports rose 17.4%, and even domestic exports rose 4.3%, so the slowdown in 1996 was all the more remarkable. Domestic exports began rising in the second half of 1994 and climbed 13% in the first quarter of 1995. However, the rate of growth began dropping in the second quarter, and exports declined in the fourth quarter. The shift of Hong Kong manufacturing industries to Guangdong province and to other parts of South China has led to a decline in domestic exports over the

Table 3-1 Trends in Hong Kong's Exports

(Unit: HK$ million)

	Domestic exports	Re-exports	Total exports
90	225,875	413,999	639,874
	0.8%	19.5%	12.2%
91	231,045	534,841	765,886
	2.3%	29.2%	19.7%
92	234,123	690,829	924,953
	1.3%	29.2%	20.8%
93	223,027	823,224	1,046,250
	-4.7%	19.2%	13.1%
94	222,092	947,921	1,170,013
	-0.4%	15.1%	11.8%
95	231,657	1,112,470	1,344,127
	4.3%	17.4%	14.9%
96	212,160	1,185,758	1,397,917
	-8.4%	6.6%	4.0%

Source: Census and Statistics Department, Hong Kong: Hong Kong External Trade, September 1996.

long term. The increase in domestic exports for the first time since 1992 was due to the depreciation of the Hong Kong dollar against the Japanese yen, major European currencies, the Taiwan dollar and the South Korean won, and to the large growth in exports of electronic components. Therefore, exports again began falling as the exchange rate advantage was lost. Viewing the trend in exports by major export destinations, the 12.1% decline in exports to the U.S., which account for a 25.4% share of exports, is particularly striking. By product, a 5.9% decline in the biggest item, apparel, was recorded, and over 10% declines were seen in office equipment and in telecommunications and audio equipment.

In exports to the U.S, a 13% decline was seen in apparel, which accounts for 60% of all exports to the U.S. The reasons for this were the sluggish growth in demand for imports in the U.S., the shift toward Mexican products resulting from the trade diversion effect caused by NAFTA, and the problems in application of the new rules relating to countries of origin for apparel. Exports to China, which fell 5.5%, dropped both in terms of goods for the domestic market and for outward processing trade. Exports for outward processing trade, which account for about 70% of the exports, were affected by both the large slowdown in Chinese exports and the changes in incentives relating to outward processing trade.

Re-exports recorded strong growth of 29.2% in both 1991 and 1992, and subsequently grew by 15% to 19%. In 1995 as well, growth of 17.4% was recorded. In 1996, however, the rate of growth suddenly dropped to just 6.6% compared with the previous year. In the fourth quarter of 1995, the growth rate fell to 12% and, in 1996, dropped to the single digit range (see Table 3-2). Viewing the trends in 1996 by destination, re-exports to the U.S., which account for 20.4% of the total, grew by only 4.9%, and re-exports to Taiwan and Canada dropped by 4.0% and 4.1%, respectively. On the other hand, re-exports to China, the biggest destination, increased by 8.8%. By main product, the biggest item, miscellaneous manufactured articles, fell in growth from 17.5% in 1995 to 5.1% in 1996, second-placed electrical machinery fell in growth from 44.0% to 8.0%, and telecommunications and audio equipment and plastics, which exhibited over 20% growth in the previous year, dropped 2.6% and 5.9%, respectively. By country, there was a large slump in reexports to the U.S. By product, the drop in telecommunications and audio equipment and in plastics, and the sluggish growth in textiles and travel goods were quite noticeable. The slump in re-exports to the U.S. was due to the slow growth in demand for imports in the U.S. and the effects of trade diversion due to NAFTA. Re-exports to China for outward processing trade remained at the same level as that of the previous year. The reasons for this included the slowdown in exports from China to the U.S., the reduction in the rate of rebates of the added value tax for exports, and the shift to transshipment. On the other hand, re-exports to the domestic Chinese market rose 14% to HK$114.0 billion in the first half of 1996 due to the growth of the domestic Chinese market and rising purchasing power.

Transshipments, that is, the shipment consigned on a through bill of lading or a through air waybill from a place outside Hong Kong to another place outside Hong Kong, rose by a strong 31% in 1994 and by 30% in 1995, but declined by 5% in the

Table 3-2 Quarterly Trends in Hong Kong Exports

(Unit: %)

	Domestic exports	Re-exports	Total exports
1995 as a whole	4	17	15
1st half	9	20	18
2nd half	*	15	12
1st quarter	13	22	20
2nd quarter	6	19	17
3rd quarter	4	18	15
4th quarter	-3	12	9
1996, 1st half	-8	7	4
1st to 3rd quarters	-9	7	4
1st quarter	-6	8	6
2nd quarter	-10	6	3
3rd quarter	-10	6	3

Note: Asterisks indicate a change of less than 0.5%

Source: Economic Analysis Division; Third Quarter Economic Report 1996.

January to September period of 1996. The reason for this decline was the reduced need for cargo from the north and central parts of China to go through Hong Kong due to the improved infrastructure in Shanghai, Tianjin, and other ports. Transshipment for China, which accounts for 30% of the total, fell from the 15% growth of 1995 to a 21% decline in the January to September period of 1996.

Next, outward processing trade, which accounted for 71% of the local exports to China, 46% of the re-exports, 80% of the imports from China, and 86% of the re-exports of Chinese-made goods in the first half of 1996, began declining. Outward processing trade with China had risen steadily by 13% in 1994 and by 20% in 1995, but dipped 0.7% in 1996. The reasons for this were the cut in value-added tax rebate on export items in China and the drop in exports from China caused by the slump in demand for imports from its major export markets.

The reasons for the fall in the rate of growth of Hong Kong's exports in 1996 have already been mentioned, and can be organized as follows: (a) the Hong Kong dollar, which is linked to the U.S. dollar, has been rising against the Japanese yen and the major European currencies since the second quarter of 1995, (b) the rate of growth is based on 1995 when the growth rate was high, (c) there was a slump in demand for imports by the two largest markets, that is, the U.S. and China, (d) there has been a shift from re-exports to transshipments and further to offshore trade, (e) tension was high across the Straits of Taiwan, (f) there were trade disputes between the U.S. and China, (g) the trade diversion effect due to NAFTA began to be felt, and (h) Chinese exports were poor due to the sluggish market for electronic components, the cut of the rebate of the value added tax for exports, (i) changes in incentives for outward processing trade, and other adjustments in China's trade and investment policies.

These factors can be grouped into short-term or cyclic factors (a, b, e and h), special factors (f), and long-term structural factors (d, g and i). In the next section, the long-term structural factors will be discussed. Note that the electronics industry entered a period of inventory adjustment in 1996 after the boom of 1995, so that many East Asian countries experienced sluggish growth in exports of electronic components, which in turn was the major reason for their export slowdown. Hong Kong was similarly affected, but relies less on electronic components than other East Asian suppliers and therefore was less affected.

2. Structural Shift Apparent in Export Trends

(1) Shift in Export Structure and Changes in Relay Trade Functions

First, mention should be made of the shift in the structure of Hong Kong export trade from domestic exports to re-exports, and from the re-exports to transshipments and offshore trade. In the 1960s, domestic exports accounted for over 70% of the exports, but re-exports grew to over 50% of exports in 1988 and reached 85% in the January to September period of 1996. This was due to the Hong Kong manufacturers moving production to the southern part of China through outward processing trade and other arrangements starting in the mid-1980s to avoid rising local costs and to take advantage of the open-door policy of China. The increase in transshipments was due mainly to improvements in the level of manufacturing technology in Chinese enterprises and to the consequent lack of need for stringent inspection or finishing in Hong Kong. While Hong Kong continues to be first in the world in container turnover, the rate of growth has dropped steadily from 20% in 1994 to 13% in 1995 and to a single-digit 6% in 1996. Offshore trade, on the other hand, has been rising due to improvements in the infrastructure of harbors in China and the increased globalization of networks for procurement and sales by Hong Kong businesses. At the same time, there has been a shift from exports of goods to exports of services. This shows that the function of Hong Kong in trade is changing from goods to services. The Hong Kong Trade Development Council conducted a survey on 2,500 companies in 1995 and found that 37% were handling exports of products from third countries other than China and that offshore trade accounted for 30% of the trade of those companies.

(2) Effect of the Trade Diversion Due to NAFTA and Changes in Consumption Patterns

U.S. imports rose 6% in 1996 and, therefore, slowed from the 11% gain of 1995. Another major reason for the sluggish growth in exports to the U.S. was the shift in consumer demand from items in which Hong Kong excels such as toys, watches, jewelry and other light industrial goods to big-ticket items like consumer durable goods. The shift in trade due to NAFTA is also affecting Hong Kong exports of apparel and sundry goods to the U.S. and Canada, but this is being overtaken by the changes in consumption patterns. Small volumes, diverse types of goods and quick delivery are being sought and, therefore, Mexican and other Central American suppliers which are geographically closer have the advantage. Another minus factor has been the textile negotiations between the U.S. and Hong Kong which began with changes in the U.S. rules of countries of origin. From June 1996 to April 1997, Hong Kong exports to U.S. of selected categories of textile products had to be accompanied by single-entry bonds, the original textile declaration and the U.S. importer's certification of authenticity for the textile declaration before U.S. Customs would release the shipment. This has resulted in a shift of procurement from Hong Kong to other regions. Hong Kong exporters, which were asked by U.S. customs authorities to allow inspection of their factories, have been moving their operations to Thailand and Cambodia as a result.

(3) Adjustments in China's Trade and Investment Policies and Growth of Chinese Enterprises

Much of the trade with China involves re-exports, so the slowdown in China's exports has been a major reason for the sluggish growth in exports to China. China's exports dropped 8.2% in the first half of the year and rose only 1.5% for the year as a whole. The main reasons for this slowdown in China's exports were the backlash after the rush of 'last-minute' exports in 1995 due to the cut of the rebate of the value added tax for exports from 17% to 14% in May 1995 and then further to 9% in October, and the waning enthusiasm for exports due to the lower rate of refund. Furthermore, articles imported for the outward processing trade all have to be exported after processing. To prevent their flowing illicitly into the domestic market, i.e. smuggled, the Chinese introduced the duty-security system for the export processing trade in November 1995 and announced strengthening supervision of cross customs district transfer of processing materials. This has stirred up considerable confusion and has become another reason for the drop in outward processing trade. Exports from Guangdong province, where Hong Kong companies do most of their outward processing, grew by only 0.01% in the January to September period, and exports from Shenzhen dropped 0.7%. The labor-intensive type of outward processing that utilizes cheap labor will no longer be welcomed. Furthermore, Chinese companies have been accumulating experience and catching up with Hong Kong firms, so have consequently been switching from outward processing to exporting their own products. The outward processing trade is therefore destined to decline.[1)]

3. Structural Changes in the Hong Kong Economy

(1) Growing Economic Integration with China

As can be seen in the previous section, 85% of Hong Kong's exports consist of re-exports, and of these re-exports, 58% originate in China and 35% are destined for China. In total, 83% therefore involves China. 28% of domestic exports also goes to China – a remarkable rise when considering the fact that China accounted for just 1.6% of domestic exports and 15.4% of re-exports in 1980. Furthermore, 71% of the domestic exports to China and 42% of the re-exports are for outward processing, so are susceptible to trends in China's export trade and changes in its trade and investment policies. 37% of imports also originate from China. In short, Hong Kong is extremely dependent on China for its trade. Hong Kong does not release its own statistics on outbound investment, but Chinese statistics indicate that Hong Kong provided 59.1% of the foreign investment (cumulative) in China up to 1995. China, therefore, is a large presence in Hong Kong's foreign investment as well. This economic reliance on China has grown rapidly since the start of the 1980s.

Hong Kong started to set up its own export industries in the 1950s to augment its functions as a port for the entrepot trade. The outbreak of the Korean War and the accompanying 1951 UN embargo on the export of strategic materials to China made exports to China difficult. At the same time, the civil war between the Kuomintang and the Communists and the establishment of the People's Republic of China in 1949 led to a flood of refugees and an influx of entrepreneurs, technicians and skilled labor to Hong Kong from Shanghai and elsewhere, thereby providing the enclave with the capital, entrepreneurs and labor for industrial development. Exports diversified from the previous spinning and other textile industries to apparel, plastic products, toys, watches and other light industrial goods. Starting in the 1970s, electronic products and components rose in share as well. Domestic exports, which had accounted for only a 12% share of exports in 1951, climbed to over 70% in the 1960s.

The Hong Kong economy enjoyed a high growth of an average 9.5% from 1950 to 1980. As a result, however, the export industries found labor, factory rents and other costs rising in the 1970s, and declined in competitiveness. China, on the other hand, took the decisive step of introducing reforms and an open-door policy in December 1978 and switched to promoting foreign investment and foreign trade. In 1980, it set up what it called 'special economic zones' in Shenzhen and three other locations and thereby opened up specific coastal areas to the outside world. These areas were subsequently steadily expanded. Even today, there is roughly a 10-fold difference between wages in Hong Kong and South China. Starting in the mid-1980s, Hong Kong-based manufacturers, including some Japanese affiliates, moved their production operations to Shenzhen and to other parts of the Pearl River delta. This was mostly done through outward processing arrangements by which the foreign company provides the machinery, equipment and technical knowhow and supplies the materials and parts, a Chinese factory supplies the buildings and workforce, and the foreign company takes back all of the production and pays the Chinese side for the processing work. The Hong Kong Trade Development Council reports that there are 38,000 Hong Kong companies operating in Guangdong and employing a total of over 5 million workers. As a result, a division of labor has been established between Hong Kong and South China, with Hong Kong providing the management, marketing, finance, product development and other knowhow, and South China providing an inexpensive, abundant workforce and land for performing the actual production work; this is referred to as a "qiandian houchang" or a "front company and rear factory" arrangement. In the process of this, re-exports began to increase. Re-exports surpassed domestic exports in 1988 and, since 1994, have accounted for over an 80% share of total exports.

In 1992, the late Deng Xiaoping made a well-publicized tour of South China to demonstrate his firm support for the economic reforms. This led to permission being granted for participation by foreign investors in the real estate, commercial and infrastructural sectors, the further opening up of 36 cities in the Yangtze River delta and inland regions, and the easing of restrictions on domestic sales. Hong Kong investment in China spread in both range and geographic area, the big financial giants in particular making huge investments in real estate and infrastructure.

China, on the other hand has been increasing its presence in Hong Kong. There are now 1756 Chinese enterprises approved by the State Council operating there and investment exceeds US$20 billion. Chinese companies now account for 22% of Hong Kong's trade, 25% of its bank deposits, 7-8% of its loans, 25% of its cargo shipments, 12% of its total building construction projects, and 6% of the value of the stocks on its stock market.[2)]

While Hong Kong and China have been growing economically closer in this way, as has been shown in the previous section, China's need for Hong Kong's infrastructure and Hong Kong's companies has been declining along with its own economic development: that is, the improvement of China's port infrastructure and the resultant increase in trade bypassing Hong Kong, the opening up of new areas to the outside and the resultant increase in investment bypassing Hong Kong, and the growing capabilities of Chinese enterprises with the resultant lack of need for final finishing work or inspection in Hong Kong and the switch from consignment processing to independent production.

(2) Growth of Service Industries

The movement of manufacturing operations to South China has re-aligned Hong Kong's industrial structure toward the service industries. Manufacturing's share of GDP fell from the 23.7% of 1980 to 9.3% in 1994, while manufacturing's share of employment dropped from the 46.0% of 1980 to 17.1% in 1994. Since the abolition of foreign exchange controls in 1973, foreign financial institutions have flocked to the enclave and made it an international financial center. The financial, trade, commercial, restaurant, business service, and other service industries have grown in size as a result. The tertiary industries have increased their share of GDP from 71.8% in 1980 to 85.9% in 1994. In export trade as well, exports of services grew steadily and exceeded domestic exports in 1994, reflecting the re-alignment to the service industries. In the process of converting to the service industries in the 1980s, Hong Kong has made good use of its superior infrastructure (i.e., port facilities, telecommunications networks and airport), its substantially unfettered business environment, its free-port status, its concentration of financial institutions, its pool of business experts, its location as a center for shipping in East Asia, and its functions as a base for doing business with China to successfully change from a base for export industries to a center for international business and finance.

The manufacturing industries sought to survive in this sea of change by moving their labor intensive production operations to South China. They have therefore been less concerned about shifting to high-technology fields and increasing added value. The government has also provided only limited support for this. Therefore, businesses have concentrated in the production of apparel, which is protected by quotas, and toys, watches and clocks, plastic products and the low end electronics, and lag behind Singapore and Taiwan when it comes to increasing their level of sophistication.

Turning to the real estate industry, despite the Hong Kong government being the sole supplier of land and oligopolistic real estate companies dominating development, a situation far from "laissez faire" management, the industry is becoming one of the leading sectors in the Hong Kong economy. Real estate, including construction, accounts for over a 15% share of GDP, with 70% of the companies listed on the stock exchange being real estate-related. The top companies are all real estate-based. During the boom in 1993 and 1994, real estate prices soared to the highest level in the world. While the government subsequently clamped down on this and prices have stabilized, an influx of Chinese funds has been causing the market to reheat, primarily in luxury condominiums, since the second half of 1996.

4. Medium-term Outlook and Issues

(1) 1997 Forecasts and Medium-term Outlook

The Hong Kong economy grew by an average of 5.7% from 1990 to 1994. Business with China, which had stagnated after the 1989 Tiananmen Square Incident and China's economic austerity policies, began recovering in 1991 and particularly picked up after Deng Xiaoping's 1992 tour of South China in support of economic reforms. Public investment, in a new airport for example, and private consumption both grew steadily. In 1995, however, while the economy grew by a steady 6.1% in the first quarter, growth slowed to 5.2% and then to 4.6% in the second quarter. In the third quarter, it dropped to 3.5% which is the lowest growth in six years. In 1995 as a whole, growth reached only 4.8%, failing to break the 5% level. In 1996, growth dropped further to 3.3% in the first quarter, but recovered to 4.3% in the second quarter and recorded 4.8% for whole the year. In 1995, due to the fall in stock and real estate prices and the consequent reverse asset effect and rise in unemployment. Private consumption expenditure, which accounts for 60% of GDP, rose only 1.3%, this being the lowest in 20 years. This was the main reason for the economic slump. Reductions in interest rates in December 1995 and in February 1996, rapid recovery of the real estate and stock markets, and a falling unemployment rate subsequently put private consumption expenditure on the road to recovery, although slowly. Exports, however, which had bolstered business in 1995, slowed in growth in 1996 and thereby hamstrung the recovery. In 1997, when Hong Kong reverts to China, most institutions project growth of 5-5.5%[3] due to continued steady growth of private consumption expenditure, activity in private construction projects, although the peak of public investment relating to the new airport has passed, increased capital investment in office automation equipment etc. and the resultant close to 10% increase that is expected in fixed capital formation, a recovery in exports, and a surge of tourists and other visitors.

The medium-term outlook differs according to how the effects of handover are viewed. While there are many elements for concern, China itself wants handover to be smooth and for Hong Kong to remain prosperous after handover, so most foreign business circles in Hong Kong are optimistic over changes in the business environment. Hong Kong government economists project an economic growth rate of 5% in the medium term (four years) after 1997. That is, they believe that the economy will perform fairly well for the first few years after revision, since the Hong Kong economy is a mature one and high growth cannot be expected.[4]

The structural changes now occurring in the Hong Kong economy will of course continue even after handover. Therefore, when making a medium-term projection, it will be necessary to consider the structural problems in the Hong Kong economy. First, mention may be made of the growing economic integration with China and the resultant vulnerability of the Hong Kong economy to changes in China's economic policies. As was seen in the previous section, one of the main reasons for the slowdown in Hong Kong's exports in 1996 was the slump in China's exports and the changes in its trade and investment policies. The financial austerity measures imposed by China since 1993 were prime factors in the economic slump in Hong Kong during 1995 and 1996 as well. China's impact on Hong Kong can only grow after handover. On the other hand, China's reliance on Hong Kong will decline due to improvements in China's infrastructure, a better business environment in different areas, and the growth of Chinese enterprises. Mention may also be made of a continued rise in real estate prices, already the highest in Asia, personnel costs, and the costs of business services due to the real estate roots of major businesses and inflationary pressures. The manufacturing sector managed to preserve its international competitiveness by moving operations to the lower-cost South China region, but the service industries will encounter problems holding on to their own competitiveness. Mention may also be made of a change in the former "laissez faire" approach to economic management, with the Federation of Hong Kong Industries and some sectors now calling for greater assistance in increasing the level of sophistication and with growing demands for improved social services through the directly elected Legislature.[5)]

(2) Issues

Hong Kong will revert to China on July 1, 1997. A high degree of autonomy is promised, except in defense and the foreign affairs, after handover under the Basic Law on the Hong Kong Special Administrative Region. The current capitalist system and way of life should remain unchanged for 50 years. Since Hong Kong will be under the sovereignty of China and will continue to be integrated further into the Chinese economy, the continued economic growth of Hong Kong will require the smooth development of and cooperation from China. In this sense, its autonomy in economic management will be limited to a degree. For example, the most important issue after reversion will be the maintenance of existing institutions in accordance with the provisions of the Basic Law; that is, the high level of autonomy, freedom of the press, and other democratic rights. This assumes however that the Chinese government will observe the Basic Law. The government of the 'Hong Kong Special Administrative Zone' will have to maintain the confidence of foreign investors. For this to occur, it will have to ensure that none of the various factors and conditions which have made the enclave a center of international business are tampered with. It will thus be asked to ensure that the specific interpretation of the "high degree of autonomy" promised in the Basic Law remains the same as that before handover and to prevent increased corruption and a change from the "rule of law" to the "rule of quanxi (human network)."[6)]

Next, maintaining and strengthening the competition of the service industries will be an important issue. The service industries are strongly reliant on such "human" factors as specialized knowledge, experience and knowhow. There is less room for improving productivity by investment in machinery and equipment than there is in the manufacturing sector. The Hong Kong Productivity Council reports that labor productivity rose annually by an average of 8% in the manufacturing sector from 1982 to 1992, but only by 2.3% in the service industries. Furthermore, with tradable goods, international competition can help cut costs and raise productivity, but the service industries normally require that the producers and consumers of services be in close proximity to each other, so replacement by the equivalent of lower-cost "imports" is difficult. Hong Kong's personnel costs and office rents are already the highest in East Asia. Rising business costs are the greatest cause for concern among foreign enterprises there. The general consensus in Hong Kong, however, is that prices are determined by supply and demand, that the quality of services is commensurate with the price, and that the service industries will not depart from Hong Kong as long as they remain profitable. Greater competition with other cities in Asia seeking status as international centers of business and finance is, however, certain and thought must be given to the inflated nature of the service industries as well. Note that the service industries are protected from competition by restrictions on entry etc., and the Consumer Council recommends that competitive policies be adopted.[7)]

A third issue is improving the sophistication of the manufacturing industries. With the economy becoming increasingly service oriented, the manufacturing industries account for only a 17% share of employment (1994). Domestic exports account for 28% of GDP (1995). Furthermore, the majority of outward processing trade, which constitutes a large part of the trade with China, is by Hong Kong manufacturers. The Hong Kong government has, through the Hong Kong Productivity Council and the Hong Kong Industrial Technology Centre, etc., been encouraging R&D, disseminating technical knowhow, and providing technical training. Hong

Kong's industrial policies, however, are widely judged to be "too late and too small." With the exception of securing foreign investment in industrial estates, no major successes have been recorded. At the present time, the Massachusetts Institute of Technology has been commissioned to conduct a survey on how to stimulate the manufacturing sector, and the construction of a science park is being planned. The idea of establishing a special zone at the border with China and of introducing labor from China there has been floated as well. Raising the level of sophistication of industry is becoming an issue due to the fact that costs are rising in Guangdong province to which Hong Kong manufacturers have been fleeing. Therefore, it will be necessary to consider raising the level of industry in Guangdong province too. Due to the high costs in Hong Kong and the orientation of the Hong Kong Chinese to the service industries, however, improving the level of sophistication of the manufacturing industries will not be an easy task. The most realistic approach will probably be to attract foreign investment.

Finally, it is necessary to develop the human resources needed to improve the efficiency of the service industries and to raise the degree of sophistication of the manufacturing industries. The Hong Kong government has been working to develop such human resources for more sophisticated manufacturing industries by offering technical training and by opening a science and technology university in 1991, but the manpower shortage continues. The increasing influx of foreign nationals is due to the lack of manpower in the financial, business services, and other high level service industries. Note that some are of the opinion that the manufacturing industries will be able to make greater use of Chinese manpower after handover.

Note:

1. Maruya, Toyojiro; "Henkan hikaeta Hong Kong keizai no genjo to tenbo" (Hong Kong economy on verge of handover – current state and outlook) in JETRO, *Chugoku Keizai (China's Economy)*, July 1996, pp. 29-30.
2. Statement by Vice Minister of Economy Qian Guoan at the Hong Kong branch of New China News Agency, Yazhou Zhoujian (Asia Weekly), September 8, 1996.
3. For example, the Hong Kong Shanghai Bank predicts it will be 5.2%, the Hangseng Bank, 5.4%, and the Bank of China, 5.5%.
4. A questionnaire survey conducted in 1995 and 1996 on members of the chambers of commerce of Japan, the U.S., and the U.K. in Hong Kong found that around 90% of companies considered that the environment for business after handover would be promising.
5. Since the Hong Kong dollar is linked with the U.S. dollar at a fixed rate, interest rates have to follow those in the U.S., making a flexible interest rate policy impossible. Furthermore, Hong Kong relies on China for its food supplies, so such "imports" are affected by China's inflation. In addition, a shortage of professionals has resulted in rising wage levels. As a result, Hong Kong has experienced inflation of about 8-12% in the 1990s.
6. The Japan Chamber of Commerce and Industry in Hong Kong found in a questionnaire survey conducted in July 1996 that over 80% of the responding members were concerned about maintaining the rule of law, corruption, and law and order.
7. This same above survey also found considerable dissatisfaction over the cost of housing, office rents, prices, the inflation rate, and labor costs. The Consumer Council released a report in November 1996 entitled *'Competition Policy: The Key to Hong Kong's Future Economic Success'*.