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Triangular Trade and Economic Integration into
Guangdong**

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Abstract

In Hong Kong, two tremendous changes have occurred in the past decade. One is the rise of the re-export/total export ratio to more than 90 percent, which reflects the rapid expansion of triangular trade between China, Hong Kong, and other countries. Another is the drastic decline of manufacturing's share of GDP from around 20-22 percent (1980-1988) to an extremely low level of 5.6 percent in 2000, which resulted from the massive transfer of manufacturing plants to China and the integration of the Hong Kong and Guangdong economies. This paper explores these phenomena statistically, detailing trends by size of establishments in manufacturing and by industries, a topic which has generally been neglected among economists.

1. An Overview of Hong Kong's Economy

Hong Kong has been called “the Hong Kong special administrative district”, since the sovereignty of Hong Kong was returned to China in 1997. It consists of three parts: (1) Hong Kong island (80.28 km²), (2) the tip of the Kowloon Peninsula (46.85 km²), and (3) the New Territories (a large part of the Kowloon Peninsula), Landau island, and other islands (970.99 km²). Parts (1) and (2) were ceded to Britain in the middle of 19th century and called “crown land”. However, the New Territories and other islands were leased by Britain from the first of July in 1898 to the 30th of June in 1997 on the terms established in the “lease treaty” of June 1896. Even though cession and lease are very different legal concepts, the three parts of Hong Kong are now economically inseparable. For example, an enormous number of people commute from the New Territories to Hong Kong island. Therefore, it is easy to see how people could consider the destinies of the New Territories and Hong Kong to be intrinsically linked.

Hong Kong is a small economy like Singapore, but it is also a rich economy. Its per capita GDP was US\$24,814 in 2000, much higher than Taiwan's US\$13,926 and Korea's US\$9,183 (International Centre for the Study of East Asian Development 2003). In addition, Hong Kong's per capita gross national income at purchasing power parity was estimated to be US\$25,660, which is rather close to the \$26,460 estimate for Japan (World Bank 2002). It is for this reason that Hong Kong has been dubbed a small but rich economy. However, Hong Kong's economy has been dominated by service industries, in particular trade, transport, finance and insurance. This is different from most other late developing, industrial countries, in which industrialization has mainly resulted from the expansion of manufacturing sector.

There are several distinctive features of the economy. First, according to estimates from Jao (1998), Hong Kong is the fourth or fifth biggest international financial center in the world (Table 1). The actual number of international banks in Hong Kong is the second highest in the world, but this is in large part due to the fact that many of them are small representative offices. According to Jao (1997), Hong Kong ranks fourth in the world in terms of foreign credits in deposit banks, fifth in terms of foreign debts in deposit banks and net turnover on foreign exchange and derivatives' markets, and ninth to eleventh in terms of stock market indicators. Hong Kong is also a major source of capital for surrounding economies. For example, Hong Kong's share of annual inward direct investment flows in China was 57 percent 1990 (Table 2). Although this share declined to 36 percent in 2001, it was still quite large. For the decade of the 1990s, Hong Kong's average share was 50 percent. In 2001, the combined share of the United Kingdom, United States, and Germany in total was 13 percent and Japan's share was 9 percent, while Taiwan, Korea and Singapore combined to account for another 15 percent of the total.

Secondly, Hong Kong is one of the typical “free trade ports” in the world for four reasons listed below.

(1) Hong Kong has a free business system, which is characterized by affirmative anti-intervention. There is no discrimination between local companies and foreign companies. There are also no capital or foreign exchange controls and foreign currency exchange is completely free. There is no other country in the world with such a consistent

Table 1: Hong Kong's Rankings Among World Financial Centers, 1994-1995

Indicator	Hong Kong's Ranking	Cities or Countries with Higher Rankings
Banking		
Number of Foreign Banks	2	1-London
Foreign Claims of Deposit Banks	4	1-U.K., 2-Japan, 3-U.S.A.
Foreign Debts of Deposit Banks	5	1-U.K., 2-U.S.A., 3-Japan, 4-France
Foreign Exchange Markets		
Daily Net Turnover	5	1-U.K., 2-U.S.A., 3-Japan, 4-Singapore
Derivatives' Markets		
Daily Net Turnover of Foreign Currency Contracts	5	1-U.K., 2-U.S.A., 3-Japan, 4-Singapore
Stock Markets		
Trading Value of Stocks	9	1-U.S.A., 2-Japan, 3-U.K., 4-Germany, 5-France, 6-Switzerland, 7-Canada, 8-Netherlands
Trading Volume of Stocks	11	1-U.S.A., 2-Japan, 3-Germany, 4-U.K., 5-France, 6-Taiwan, 7-Switzerland, 8-Netherlands, 9-Korea, 10-Canada

Source: Jao (1997)

Table 2: Foreign Direct Investment in China by Country
(US\$100 millions; percentage shares of total in parentheses)

Year	Hong Kong	Japan	Singapore, Taiwan, Korea	United Kingdom, United States, Germany	Total (including others)
1990	21.2 (56.5)	5.2 (13.9)	2.7 (7.2)	4.8 (12.8)	37.5 (100.0)
1992	77.1 (68.3)	7.5 (6.6)	12.9 (11.4)	5.6 (5.0)	112.9 (100.0)
1994	198.2 (58.4)	20.9 (6.2)	53.0 (15.6)	35.7 (10.5)	339.5 (100.0)
1996	208.5 (49.5)	36.9 (8.8)	64.8 (15.4)	52.6 (12.5)	421.4 (100.0)
1998	194.0 (40.8)	34.4 (7.2)	82.5 (17.3)	60.8 (12.8)	475.6 (100.0)
2000	174.0 (35.3)	30.6 (6.2)	62.0 (12.6)	65.9 (13.4)	493.6 (100.0)
2001	179.4 (36.1)	45.1 (9.1)	76.7 (15.4)	68.0 (13.7)	496.7 (100.0)

Source: China Statistical Publishing House (various years a).

policy of national treatment, which guarantees the same degree of access to imports from any country as to domestic products.

(2) The tax ratio is very low. The standard income tax rate is 15 percent, and 1.5 percent is added to this for corporate incomes. In addition, Hong Kong implements the principle of taxing income at the source, and there is no taxation on the income from dividends, interest, or capital gains.

(3) In principle, there is no fiscal deficit. The ratio of public expenditure to GDP is about 10 to 12 percent, which is low compared to other nations. It is noteworthy that Hong Kong has maintained a fiscal surplus for a long period.

(4) Hong Kong has a highly trained specialized workforce. There is a free flow of information and English is used as an official language. In addition there is an effective international financial infrastructure and a Central Money Market Unit is being developed. In recent years, Hong Kong's economic relations with China have become increasingly close. Within one country, a socialistic economy and a typical free economy have coexisted, which has given China great economic strength. Correspondingly, it is often said that Hong Kong's role in the Chinese economy is similar to the role of the *sogo shosha* or general trading companies like Mitsui & Co. Mitsubishi Corporation in Japan.

2. A Macroeconomic Sketch of Hong Kong

This section sketches the macroeconomic performance of Hong Kong's small but rich economy over the last 20 years, focusing on the role of exports. In order for such a small economy to grow, imports and exports have to become as the size of big as its GDP. This is the first point to be confirmed.

Table 3 compares Hong Kong's nominal GDP from national accounts data with estimates of merchandise trade flows from customs' statistics. The value of both imports and exports exceeded GDP since 1988, with the ratio of exports to GDP increasing sharply from 69 percent in 1980 to 86 percent in 1985, 109 percent in 1990 and 123 percent in 1995 before falling slightly to 122 percent in 2000. Similarly, the ratio of imports to GDP increased from 79 percent in 1980 to 86 percent in 1985, 109 percent in 1990, and 136 percent in 1995, before falling back to 129 percent in 2000. In other words, although GDP grew more than 9 fold in 1980-2000, exports and imports grew much more rapidly, 16 fold and 15 fold, respectively. Notably, the ratio of exports and imports to GDP did not increase during the banking crisis of 1982 or in the few years after 1997, when Hong Kong reverted to Chinese rule and the region-wide financial crisis began in Thailand. However, apart from those periods, ratios of exports and imports to GDP have increased continually.

Although the preceding discussion highlights the important role of merchandise trade, trade in services has also been significant in Hong Kong. According to the new national income statistics, which were comprehensively revised in 2000, the ratio of service exports to total exports reached 17 percent in 2000 (Table 4). Moreover, the balance of trade in services has always been positive and increased 15 fold between 1980 and 2000, from HK\$8.6 billion to HK\$126 billion. In contrast, the balance of merchandise trade has generally been negative. In most years the positive services' balance was larger than the negative merchandise balance. The combined balance on goods and services was therefore positive and tended to increase over time. Accordingly, the total balance of payments, aided by a positive balance of capital, has also been in healthy surplus for most years.

Among services' exports, exports of transportation services were largest, though the share of this item declined from over two-fifths in 1980 to less than one-third in 2000 (Table 5). In 1980-1995, tourism was the second largest item but the share of trade-related services became larger in 2000-2001 and as large as the share of transportation services. Adding exports of finance and insurance services, the top five categories combined to account for

Table 3: Transit Port Hong Kong: The High Dependence on Trade in Goods

Year	GDP HK\$billions (a)	Merchandise Trade (HK\$billions)		Exports/GDP (%) [b/a]	Imports/GDP (%) [c/a]
		Exports (FOB) (b)	Imports (CIF) (c)		
1980	142.2	98.3	111.7	69.1	78.6
1981	171.2	122.1	138.4	71.3	80.8
1982	193.1	127.4	142.9	66.0	74.0
1983	213.5	160.7	175.4	75.3	82.2
1984	257.5	221.4	223.4	86.0	86.8
1985	272.9	235.2	231.4	86.2	86.2
1986	314.0	276.5	276.0	88.1	87.9
1987	386.3	378.0	377.9	97.9	97.8
1988	457.2	493.1	498.8	107.9	109.1
1989	527.1	570.5	562.8	108.2	106.8
1990	587.6	639.9	642.5	108.9	109.3
1991	677.2	765.8	779.0	113.1	115.0
1992	791.3	925.0	655.3	116.9	120.7
1993	912.8	1,046.2	1,072.6	114.6	117.5
1994	1,029.8	1,170.0	1,250.7	113.6	121.5
1995	1,096.2	1,344.1	1,491.1	122.6	136.0
1996	1,210.9	1,397.9	1,535.6	115.4	126.8
1997	1,344.5	1,455.9	1,615.1	108.3	120.1
1998	1,279.9	1,347.6	1,429.1	108.1	111.7
1999	1,246.1	1,349.0	1,392.7	108.3	111.8
2000	1,288.3	1,572.7	1,658.8	122.1	128.8
2001	1,279.0	1,481.0	1,568.2	115.8	122.6

Source: Hong Kong Census and Statistics Department (2002, various years b).

about 90 percent of all service exports in all years.¹

Since 1980, the balance of merchandise trade with China and Japan has continuously been in deficit. The deficit with China grew rapidly from HK\$22 billion in 1985 to HK\$172 billion in 2000 and HK\$136 billion in 2001 (Figure 1). One cause of the deficit with China was the continuous devaluation of the yuan through the mid-1990s, which promoted China's exports to Hong Kong and other countries. Increases in China's total exports naturally led to increases in China's exports to Hong Kong because 20-40 percent of China's total exports are sent through Hong Kong. A large portion of the imports from China go to the U.S. market and merchandise trade surpluses with the United States were very large, peaking at HK\$253 billion in 2000 and the deficit with Mainland China was 68 percent of the surplus with the United States in 2000. Hong Kong also ran a large deficit with Japan, which reached HK\$112 billion in 2000. Here again a large portion of the imports from Japan are reexported, though the destination of these reexports is not clear. However, in 2000 a little over one half of the deficit with Japan was equivalent to the sur-

¹ Although the data are not shown here, shares of these items in the imports of services were similar to shares of exports (Hong Kong Census and Statistics Department 2002).

Table 4: Hong Kong's Trade in Services and Merchandise (HK\$ billions)

Year	Service Exports a	Service Imports b	Service Balance [a-b]	Goods Exports A	Goods Imports B	Goods Balance [A-B]	Combined Balance [a-b]+[A-B]
1961	2.3	1.1	1.2	3.9	5.7	-1.7	-0.6
1965	3.1	1.5	1.5	6.5	8.6	-2.0	-0.5
1970	6.3	2.9	3.4	15.2	16.9	-1.7	1.8
1975	11.4	6.3	5.1	29.8	32.3	-2.4	2.7
1979	24.6	16.0	8.6	75.9	83.4	-7.5	1.1
1980	28.5	19.9	8.6	98.2	108.1	-9.9	-1.3
1985	59.7	43.1	16.6	235.2	226.0	9.2	25.8
1990	139.3	99.6	39.7	639.9	629.8	10.1	49.8
1995	255.6	178.7	76.9	1,344.1	1,466.8	-122.7	-45.8
2000	317.6	191.5	126.1	1,572.7	1,636.7	-64.0	62.1
2001	323.1	189.6	133.5	1,481.0	1,549.2	-68.2	65.3

Source: Hong Kong Census and Statistics Department (2002).

Table 5: Hong Kong's Exports of Services by Industry (HK\$ millions)

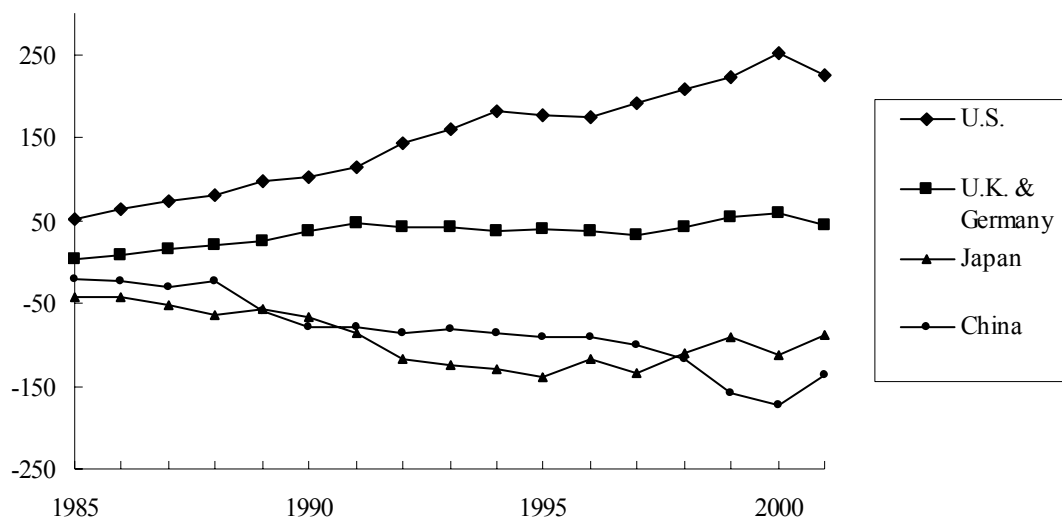
Year	Services, total	Transportation	Tourism	Trade-related	Insurance	Finance	Others
1980	28,486 (100.0)	12,325 (43.3)	6,529 (22.9)	5,618 (19.7)	582 (2.0)	520 (1.8)	2911 (10.2)
1985	59,735 (100.0)	22,967 (38.4)	15,003 (25.1)	11,932 (20.0)	870 (1.5)	2,727 (4.6)	6237 (10.4)
1990	139,324 (100.0)	50,760 (36.4)	41,473 (29.8)	26,431 (19.0)	1,299 (0.9)	5,570 (4.0)	13,791 (9.9)
1995	255,553 (100.0)	84,937 (33.2)	74,997 (29.3)	49,032 (19.2)	3,617 (1.4)	15,568 (6.1)	27,402 (10.7)
2000	317,580 (100.0)	99,513 (31.3)	61,786 (19.5)	97,616 (30.7)	3,452 (1.1)	20,859 (6.6)	34,355 (10.8)
2001	323,087 (100.0)	101,815 (31.5)	64,594 (20.0)	99,323 (30.7)	3,942 (1.2)	19,739 (6.1)	33,674 (10.4)

Source: Hong Kong Census and Statistics Department (2002).

plus with Germany and the United Kingdom, and the remaining half was equivalent to about one-fifth of the surplus with the United States. The sharp increase in the ratio of reexports to total exports, from 31 percent in 1980 to 65 percent in 1990 and 89-91 percent in 2000-2002, has been an important factor affecting the evolution of bilateral trade balances.² In short, Hong Kong's trade has become increasingly dominated by triangular trade, in which Hong Kong serves as intermediary between China, the United States, Europe and Japan.

² More precisely, reexports accounted for 89 percent of all exports in 2000, 90 percent in 2001, and 91 percent in 2002.

Figure 1: The Balance of Hong Kong's Merchandise Trade by Country (HK\$ billions)



Note: Germany before 1990 is West Germany.

Source: Hong Kong Census and Statistics Department (various years b).

3. The Structure of Triangular Trade in the Era of Large Reexports

The structure of this triangular trade can be revealed by examination of Hong Kong's trade statistics, which disaggregates reexports by origin, destination, and product. Table 6 shows total reexports to four major destinations, the United States, China, Japan, and Taiwan, by major sources for every five years from 1980 to 2000, as well as 2001 and 2002. Reexports to the United States have always originated mainly from China and these exports increased rapidly from HK\$1.7 billion or 55 percent of the total in 1980 to HK\$268 billion in 2002 or 92 percent of the total. In other words, these data reveal the surprising fact that the vast majority of reexports from Hong Kong to the United States have originated in China in recent years. Put another way, reexports to the United States originating accounted for 37 percent of the HK\$717 billion in total imports from China in 2002. In contrast, reexports from Hong Kong to the United States which originate in Japan or the United States itself were surprisingly much smaller.

The share of goods originating in China in total reexports to China fluctuated between 6 and 13 percent in 1985-1995, but then increased rapidly to a peak of 25 percent in 2002 (Table 6). The share of goods originating in Japan was somewhat larger than the share of goods originating in China between 1980 and 2000 (20-32 percent) as was the share of goods originating in Taiwan between 1980 and 1995 (17-26 percent). However, the shares of goods originating both from Japan and from Taiwan have fallen some in subsequent years.

Reexports to Japan and Taiwan are much smaller than reexports to the United States and China (Table 6). China has always been the largest origin of reexports bound for Japan,

Table 6: Hong Kong's Reexports by Main Destination by Main Origin

A. Reexports whose main destination is the United States by main origin								
Year	All regions		China		United States		Japan	
	HK\$mil	(%)	HK\$mil	(%)	HK\$mil	(%)	HK\$mil	(%)
1980	3,085	(100.0)	1,690	(54.8)	158	(5.1)	301	(9.8)
1985	14,705	(100.0)	11,256	(76.5)	766	(5.2)	983	(6.7)
1990	87,753	(100.0)	81,645	(92.6)	949	(1.1)	1,796	(2.0)
1995	230,997	(100.0)	213,545	(92.4)	6,363	(2.8)	3,084	(1.3)
2000	311,047	(100.0)	283,781	(91.2)	7,321	(2.4)	3,983	(1.3)
2001	282,189	(100.0)	259,326	(91.9)	6,127	(2.2)	3,272	(1.2)
2002	291,043	(100.0)	267,607	(91.9)	5,639	(1.9)	3,054	(1.0)
B. Reexports whose main destination is China by main origin								
Year	All regions		China		Japan		Taiwan	
	HK\$mil	(%)	HK\$mil	(%)	HK\$mil	(%)	HK\$mil	(%)
1980	4,642	(100.0)	NA		904	(19.5)	1,205	(26.0)
1985	46,023	(100.0)	3,076	(6.7)	14,544	(31.6)	7,697	(16.7)
1990	110,908	(100.0)	14,046	(12.7)	24,886	(22.4)	25,570	(23.1)
1995	384,043	(100.0)	36,125	(9.4)	93,037	(24.2)	77,086	(20.1)
2000	488,823	(100.0)	89,697	(18.3)	104,605	(21.4)	74,826	(15.3)
2001	496,574	(100.0)	105,269	(21.2)	97,731	(19.7)	68,730	(13.8)
2002	571,870	(100.0)	143,689	(25.1)	109,050	(19.1)	80,432	(14.1)
C. Reexports whose main destination is Japan by main origin								
Year	All regions		China		Japan		United States	
	HK\$mil	(%)	HK\$mil	(%)	HK\$mil	(%)	HK\$mil	(%)
1980	2,201	(100.0)	588	(26.7)	3	(0.1)	344	(15.6)
1985	5,486	(100.0)	2,879	(52.5)	672	(12.2)	467	(8.5)
1990	24,376	(100.0)	16,019	(65.7)	1,329	(5.5)	1,296	(5.3)
1995	70,081	(100.0)	59,120	(84.4)	2,578	(3.7)	1,369	(2.0)
2000	82,050	(100.0)	72,286	(88.1)	2,967	(3.6)	616	(0.8)
2001	83,551	(100.0)	74,927	(89.7)	2,689	(3.2)	769	(0.9)
2002	80,743	(100.0)	72,502	(89.8)	2,500	(3.1)	757	(0.9)
D. Reexports whose main destination is Taiwan by main origin								
Year	All regions		China		Japan		United States	
	HK\$mil	(%)	HK\$mil	(%)	HK\$mil	(%)	HK\$mil	(%)
1980	2,229	(100.0)	391	(17.5)	434	(19.5)	493	(22.1)
1985	4,325	(100.0)	904	(20.9)	645	(14.9)	801	(18.5)
1990	21,248	(100.0)	5,970	(28.1)	2,823	(13.3)	4,835	(22.8)
1995	27,758	(100.0)	12,279	(44.2)	3,504	(12.6)	2,190	(7.9)
2000	33,696	(100.0)	15,448	(45.8)	3,100	(9.2)	2,901	(8.6)
2001	30,021	(100.0)	13,208	(44.0)	2,304	(7.7)	2,168	(7.2)
2002	30,193	(100.0)	13,326	(44.1)	2,240	(7.4)	1,757	(5.8)

Source: Hong Kong Census and Statistics Department (various years b).

and the Chinese share of these exports increased rapidly to very high levels in recent years (e.g., 90 percent in 2002) from much more modest levels in the past (e.g., 27 percent in 1980 and 32 percent in 1982; Hong Kong Census and Statistics Department, various years b). The Chinese share of reexports to Taiwan also grew markedly from 21 percent in 1985 to 44 percent in 2002.

The patterns identified above contrast in many important respects with pattern observed when reexports are classified first by origin and then by destination as depicted in Table 7. First, China has become the largest destination for reexports originating in the United States, with the Chinese share of the total rising gradually from 11 percent in 1980 to 77 percent in 2002. However, very few of these reexports return to the United States or go to Japan. Second, between 1980 and 2001, about one third of reexports originating in China were destined for the United States. In addition, the combined share of China and Japan in these reexports was only one fourth or less, indicating that a substantial portion of reexports originating in China were bound for Europe and other East Asian countries. Third, the share of reexports originating in Japan and sold in China also rose from 15 percent in 1980 to 80 percent in 2002. Fourth, China was always the largest market for reexports originating in Taiwan and China's share of these reexports rose from 57 percent in 1980 to between 84 and 93 percent after 1990.³

4. The Massive Entry of Hong Kong's Manufacturing Plants into Guangdong

Two significant features of Hong Kong's economy emerged in the 1990's. The first was the rapid development of processing trade between Hong Kong and Guangdong and the second was the shift of Hong Kong's manufacturing plants to Guangdong. This relocation was carried out on an extraordinarily large scale, which could even have been detrimental to economic growth in other countries.

4a. The Development of Processing Trade between Hong Kong and Guangdong

Every year since 1989, Hong Kong has estimated processing imports from and processing exports to mainland China (Table 8). Processing imports are defined as Hong Kong's imports which were processed in China with parts and materials that were primarily provided by Hong Kong. These processing imports grew over 4.6 fold in 1989-2002, from HK\$114 billion to HK\$525 billion. Processing exports are then defined as Hong Kong's exports to China which consist of goods processed in Hong Kong using parts and materials that are imported from China. Processing exports were smaller than processing imports and grew less rapidly in 1989-2002, only 3.6 fold from HK\$77 billion to HK\$274 billion. Moreover, the share of processing exports in total exports to China was somewhat smaller in 2002, 45 percent, than in 1989, 53 percent. In contrast, the ratio of Hong Kong's processing imports to total imports from China increased from 58 percent in 1989 to 72-76 percent in 1992-1995, and 78-83 percent in 1996-2000, before falling off some to 74 percent in 2002. Thus, in recent years processing imports have amounted to about four-

³ Annual calculations and further analysis are provided in Shinohara (2002).

Table 7: Hong Kong's Reexports by Main Origin by Main Destination

A. Reexports whose main origin is the United States by main destination								
Year	All regions		China		United States		Japan	
	HK\$mil	(%)	HK\$mil	(%)	HK\$mil	(%)	HK\$mil	(%)
1980	3,157	(100.0)	337	(10.7)	301	(9.5)	344	(10.9)
1985	9,474	(100.0)	4,476	(47.2)	983	(10.4)	467	(4.9)
1990	24,490	(100.0)	10,283	(42.0)	1,796	(7.3)	1,296	(5.3)
1995	55,635	(100.0)	38,544	(69.3)	3,084	(5.5)	1,369	(2.5)
2000	65,465	(100.0)	47,592	(72.7)	3,983	(6.1)	616	(0.9)
2001	65,193	(100.0)	50,429	(77.4)	3,272	(5.0)	769	(1.2)
2002	62,900	(100.0)	48,334	(76.8)	3,054	(4.9)	757	(1.2)
B. Reexports whose main origin is China by main destination								
Year	All regions		United States		China		Japan	
	HK\$mil	(%)	HK\$mil	(%)	HK\$mil	(%)	HK\$mil	(%)
1980	8,394	(100.0)	1,690	(20.1)	NA		588	(7.0)
1985	34,628	(100.0)	11,256	(32.5)	3,076	(8.9)	2,879	(8.3)
1990	240,410	(100.0)	81,645	(34.0)	14,046	(5.8)	16,019	(6.7)
1995	636,392	(100.0)	213,545	(33.6)	36,125	(5.7)	59,120	(9.3)
2000	849,517	(100.0)	283,781	(33.4)	89,697	(10.6)	72,283	(8.5)
2001	808,370	(100.0)	259,321	(32.1)	105,269	(13.0)	74,927	(9.3)
2002	863,967	(100.0)	267,607	(31.0)	143,689	(16.6)	72,502	(8.4)
C. Reexports whose main origin is Japan by main destination								
Year	All regions		China		United States		Taiwan	
	HK\$mil	(%)	HK\$mil	(%)	HK\$mil	(%)	HK\$mil	(%)
1980	5,885	(100.0)	904	(15.4)	158	(2.7)	434	(7.4)
1985	22,504	(100.0)	14,544	(64.6)	766	(3.4)	645	(2.9)
1990	42,280	(100.0)	24,886	(58.9)	949	(2.2)	2,823	(6.7)
1995	130,512	(100.0)	93,037	(71.3)	6,363	(4.9)	3,504	(2.7)
2000	137,338	(100.0)	104,605	(76.2)	7,321	(5.3)	3,100	(2.3)
2001	125,649	(100.0)	97,731	(77.8)	6,127	(4.9)	2,304	(1.8)
2002	135,793	(100.0)	109,050	(80.3)	5,639	(4.2)	2,240	(1.6)
D. Reexports whose main origin is Taiwan by main destination								
Year	All regions		China		Taiwan		United States	
	HK\$mil	(%)	HK\$mil	(%)	HK\$mil	(%)	HK\$mil	(%)
1980	2,134	(100.0)	1,205	(56.5)	NA		44	(2.1)
1985	9,561	(100.0)	7,697	(80.5)	205	(2.1)	175	(1.8)
1990	30,283	(100.0)	25,570	(84.4)	655	(2.2)	358	(1.2)
1995	83,307	(100.0)	77,086	(92.5)	1,728	(2.1)	748	(0.9)
2000	87,943	(100.0)	74,826	(85.1)	3,737	(4.2)	2,499	(2.8)
2001	80,321	(100.0)	68,730	(85.6)	5,128	(6.3)	1,528	(1.9)
2002	94,275	(100.0)	80,432	(85.3)	4,624	(4.9)	1,795	(1.9)

Source: Hong Kong Census and Statistics Department (various years b).

Table 8: Hong Kong's Processing Trade with China

Year	Processing Trade with China				Reexports originating in China to other regions
	Total exports	Domestic exports	Reexports	Imports	
Values in HK\$ billions					
1989	76.8	32.0	44.9	113.6	-
1990	91.9	36.4	55.5	145.1	-
1991	113.9	40.4	73.6	197.4	221.5
1992	141.6	44.3	97.4	254.0	299.8
1993	160.2	45.1	115.0	295.2	364.5
1994	181.2	42.0	139.2	354.9	422.5
1995	217.6	43.9	173.7	399.6	492.5
1996	222.3	43.1	179.2	452.9	552.8
1997	244.9	47.1	197.8	491.1	595.5
1998	221.3	42.2	179.1	477.7	559.7
1999	235.6	37.7	197.9	487.5	570.1
2000	282.2	39.3	242.9	567.0	647.3
2001	259.6	35.2	224.4	532.6	578.3
2002	274.3	28.6	245.7	525.3	590.8
Share of Above Processing Trade Estimates in Total Trade with China (%)					
1989	53.0	76.0	43.6	58.1	-
1990	58.8	79.0	50.3	61.8	-
1991	55.5	76.5	48.2	67.6	74.1
1992	52.4	74.3	46.2	72.1	78.3
1993	47.9	74.0	42.1	73.8	80.8
1994	47.7	71.4	43.3	75.9	82.0
1995	49.0	71.4	45.4	74.4	82.2
1996	46.9	72.8	43.2	79.9	86.0
1997	48.6	76.1	44.7	81.2	88.4
1998	48.1	77.4	44.1	82.7	87.6
1999	52.6	75.9	49.7	80.5	86.6
2000	52.0	72.7	49.7	79.3	85.1
2001	47.5	71.0	45.2	78.0	82.2
2002	45.1	69.7	43.3	73.8	82.5

Source: Hong Kong Census and Statistics Department (various years b).

fifths of total imports from China. These figures on processing trade clearly indicate the need for Hong Kong firms to move their plants to the Pearl River Delta in order to facilitate better access to relatively cheap processing imports and cope with labor shortage and high wages in Hong Kong.

Table 9 shows Guangdong estimates of processing exports from the province. Most of Guangdong's processing exports are destined for Hong Kong, though a small amount of these processing exports are also sent to Macao. In 2000, Guangdong's processing exports

Table 9: Guangdong's Estimates of Processing Exports

Year	Guandong Processing Exports to Hong Kong						Exports of foreign-funded enterprises D
	Consign-ment processing A	Complex processing B	Total in US\$ A+B	Ratio B/A	Exchange rate HK\$/US\$	Total in HK\$ C	
	unit US\$ bil.	unit US\$ bil.	unit US\$ bil.	Percent	unit HK\$/US\$	unit HK\$ bil.	
1984	0.257	0.073	0.330	28.40	7.82	2.6	0.073
1985	0.273	0.221	0.494	80.95	7.79	3.8	0.221
1986	0.351	0.387	0.738	110.26	7.80	5.8	0.387
1987	5.186	1.565	6.751	30.18	7.80	52.7	1.565
1988	7.110	2.676	9.786	37.64	7.81	76.4	1.818
1989	8.250	4.560	12.810	55.27	7.79	99.8	3.581
1990	9.165	6.842	16.007	74.65	7.79	124.7	5.481
1991	11.087	9.357	20.444	84.40	7.77	158.8	7.925
1992	13.147	12.115	25.262	92.15	7.74	195.5	10.787
1993	13.649	15.487	29.136	113.47	7.73	225.2	14.366
1994	15.078	21.136	36.214	140.18	7.73	279.9	19.814
1995	15.936	26.340	42.276	165.29	7.74	327.2	25.759
1996	16.858	30.298	47.156	179.72	7.73	479.3	30.692
1997	19.257	35.574	54.831	184.73	7.74	424.4	36.794
1998	20.255	38.106	58.361	188.13	7.75	452.3	39.176
1999	23.603	36.795	60.398	155.89	7.76	468.7	39.418
2000	26.580	45.200	71.780	170.05	7.79	559.2	49.509
2001	27.489	49.013	76.502	178.30	7.80	596.7	54.372

Note: Exports of foreign-funded enterprises are not reported for 1987. However, the figure for exports under complex processing and exports by foreign-funded enterprises were equal in 1984-1986, so the two figures are assumed to be the same for 1987 as well.

Sources: A, B, D from China Statistical Publishing House (various years a, various years b); C from Hong Kong Census and Statistics Department (various years a and various years c)

amounted to US\$72 billion, which was 78 percent of the US\$92 billion in total exports from the province in that year (total from China Statistical Publishing House various years b). If these estimates of Guangdong's processing exports are converted to Hong Kong dollars and compared with Hong Kong's estimates of processing imports from China, the two sets of figures are generally very close, especially in recent years.⁴

In recent years, most of Guangdong's processing exports, US\$45 billion in 2000, result from complex processing arrangements in which firms move their production facilities from Hong Kong to Guangdong and import necessary materials and parts from Hong Kong and other countries (Table 9). Because China has foreign exchange and import controls which are often relaxed for foreign firms operating in the country, eased access to foreign exchange and imports is one important benefit of the direct investment involved in complex

⁴ The ratio of Guangdong's estimates of processing exports in Table 9 to Hong Kong's estimates of processing imports in Table 8 varied between 76 and 88 percent in 1989-1995 and between 86 and 112 percent in 1996-2001. These two sets of estimates differ partially because Hong Kong estimates include processing imports from other regions of China (e.g., Shanghai).

processing arrangements. The rest of these exports are produced under traditional Guangdong-style consignment processing arrangements, where for example firms in Hong Kong provide parts and materials to firms in Guangdong and commission them to produce goods which are then sent back to Hong Kong. Guangdong's exports under these consignment processing arrangements are now relatively small but they were much larger in past years. For example, the ratio of exports under complex processing arrangements to exports under consignment processing was only 75 percent in 1990 and below 100 percent through 1992, indicating that consignment processing exports were larger. However, the ratio increased to 170 percent in 2000 and even higher levels in 1996-1998 and 2001, indicating that exports under complex processing arrangements has become far larger in recent years.

In addition to classifying trade by form, for example by the type of processing in Table 9, Guangdong's statistics also make it possible to classify trade by ownership of the enterprise conducting the trade.⁵ Because foreign direct investment increased rapidly and foreign-funded enterprises account for a large portion of the growth of Guangdong's processing exports, the exports of foreign-funded enterprises are included in column D of Table 9. Interestingly, exports of foreign-funded enterprises were exactly equal to exports under complex processing arrangements and values of the two types of exports were also very similar thereafter. For example, exports of foreign-funded enterprises grew from US\$5.5 billion in 1990 to US\$26 billion in 1995 and US\$50 billion in 2000, while exports under complex processing arrangements grew from US\$6.8 billion to US\$26 billion and US\$45 billion, respectively. The extremely high correlations between values and trends in these two types of exports suggests that exports foreign-funded enterprises consisted primarily of exports under complex processing arrangements and conversely that foreign-funded enterprises accounted for the vast majority of all exports under complex processing arrangements.

4b. Hong Kong's Economy and the Sudden Decline of Manufacturing

In the 1990s, Hong Kong's manufacturing industry experienced large structural changes at an extremely rapid pace. For example, manufacturing's share of GDP at factor cost declined only gradually in the 1980s, from 24 percent in 1980 to 22 percent in 1985 and 18 percent in 1990, but then plunged to only 6 percent in 2000 and 5 percent in 2001 (Hong Kong Census and Statistics Department 2002, various years a, various years b). The rapid pace of this change led some to worry that Hong Kong's economy was hollowing out, but the validity of these concerns is questionable.

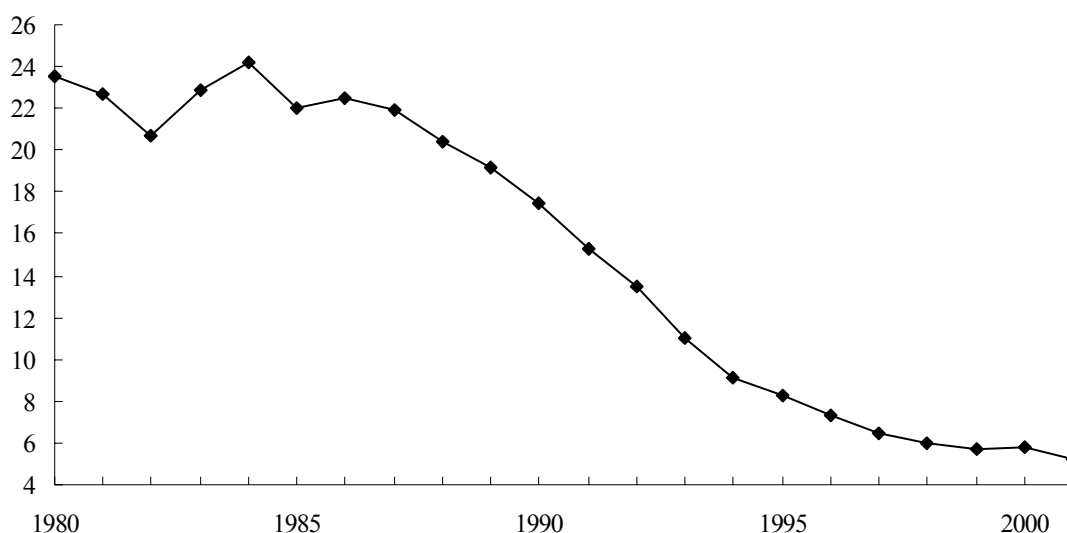
The growth of Hong Kong's real GDP averaged 5.6 percent annually between 1981 and 1985 and 7.6 percent between 1986 and 1990 (Hong Kong Census and Statistics Department 2002). Although annual average growth fell to only 3.6 percent between 1996 and 2000, this average becomes 5.8 percent if 1998 (the year most affected by the Asian financial crisis) is removed from the calculation. Thus, Hong Kong maintained an

⁵ Five ownership categories are identified, (1) state-owned enterprises, (2) collective-owned enterprises, (3) private enterprises, (4) foreign-funded enterprises, and (5) other enterprises.

economic growth rate of 5 to 7 percent for most years in the 1980's and 1990's. Considering this growth performance into account, which is comparable to growth performance in the other Asian NIEs (Newly Industrialized Economies), it does not seem appropriate to describe Hong Kong's economic performance as hollowing out.

Nevertheless, it is clear that the decline in manufacturing activity has been extremely rapid in the 1990s. For example, Figure 2 shows that share of manufacturing in GDP at factor cost was more than 20 percent until 1988 but then it dropped sharply to under 9 percent in 1994 and then under 6 percent in 1999-2001. It is thus important to address the question of why manufacturing's has contracted so rapidly despite relatively rapid growth of overall GDP.

Figure 2: Manufacturing's Shares of Hong Kong's GDP at Factor Cost (percent)



Source: Hong Kong Census and Statistics Department (2002; various years a).

According to establishment statistics, there were 908 thousand employees in Hong Kong's manufacturing industries in 1980 but this number decreased to only 226 thousand in 2000 or about one-fourth of the 1980 level (Table 10). In contrast, during the same period, the number of employees increased 4.5 fold in the trade sector, 3.3 fold in finance, insurance, and real estate, and 2.3 fold in transport, communication, and storage. These comparisons underscore the fact that Hong Kong's employment grew quite rapidly in the service industries, while the number of employees in the manufacturing sector decreased dramatically. Another point highlighted in Table 10 is the decline in the average number of employees per business establishment. The decline was relatively rapid in manufacturing where average employment size fell from 22 in 1980 to 16 in 1989, and only 11 in 2000. However, as will be seen below, changes in average scale in manufacturing depend heavily on the size of establishment.

Table 10: The Number of Private Business Establishments in Hong Kong and Their Employees by Industry

Year	Establishments		Employees		Employees/establishments	
	thousands	index 1980=100	thousands	index 1980=100	number	index 1980=100
Manufacturing						
1980	45.0	(100.0)	907.5	(100.0)	20.2	(100.0)
1985	45.9	(102.0)	847.6	(93.0)	18.5	(92.0)
1990	49.4	(110.0)	715.6	(79.0)	14.5	(72.0)
1995	30.8	(68.0)	375.8	(41.0)	12.2	(60.0)
2000	21.2	(47.0)	226.2	(25.0)	10.7	(53.0)
Trade						
1980	17.5	(100.0)	113.8	(100.0)	6.5	(100.0)
1985	32.9	(188.0)	191.9	(169.0)	5.8	(89.0)
1990	62.7	(358.3)	341.6	(300.0)	5.4	(83.0)
1995	105.7	(604.0)	519.9	(457.0)	4.9	(75.0)
2000	101.6	(580.6)	509.4	(448.0)	5.0	(77.0)
Finance, Insurance, Real Estate						
1980	10.9	(100.0)	131.6	(100.0)	12.1	(100.0)
1985	15.7	(144.0)	180.9	(137.5)	11.5	(95.0)
1990	30.1	(276.1)	276.6	(210.2)	9.2	(76.0)
1995	46.9	(430.3)	378.2	(287.4)	8.1	(66.9)
2000	51.9	(476.1)	434.1	(329.9)	8.4	(69.4)
Transportation, Communication, Storage						
1980	2.8	(100.0)	77.3	(100.0)	27.6	(100.0)
1985	3.6	(128.6)	95.4	(123.4)	26.5	(96.0)
1990	6.1	(217.9)	132.8	(171.8)	21.8	(79.0)
1995	9.2	(328.6)	172.2	(222.8)	18.7	(67.8)
2000	10.4	(371.4)	176.9	(228.8)	17.0	(61.6)

Sources: Hong Kong Census and Statistics Department (various years a, various years c).

4c. Analysis of the Manufacturing Industry by Scale of Establishment

In 1975 there were 484 large establishments with 200 or more employees, and in 1980 and 1984 this number increased to more than 560 (Table 11). The annual average number of large establishments over the 1975-1984 period was 531 and there were still 538 large establishments in 1986 (Figure 3). However, the number of large establishments then began to decrease, first gradually to 450 in 1989, but then very rapidly to 185 in 1995 and 118 in 2000. Therefore the number of large establishments in 2000 was only 26 percent of the 1989 level. The number of medium-sized establishments with 50-199 employees increased

Table 11: The Number of Establishments and Employees in Hong Kong's Manufacturing by Number of Employees per Plant

Year	1-49		50-199		200 or more		Total	
	number	index 1989=100	number	index 1989=100	number	index 1989=100	number	index 1989=100
Number of Establishments								
1975	28,331	(59.8)	2,219	(81.4)	484	(107.6)	31,034	(61.4)
1980	41,836	(88.3)	3,006	(110.2)	567	(126.0)	45,409	(89.8)
1984	45,392	(95.8)	3,037	(111.4)	563	(125.1)	48,992	(96.9)
1989	47,388	(100.0)	2,727	(100.0)	450	(100.0)	50,566	(100.0)
1995	29,518	(62.3)	1,058	(38.8)	185	(41.1)	30,761	(60.8)
2000	20,566	(43.4)	564	(20.7)	118	(26.2)	21,248	(42.0)
Thousands of Employees								
1975	249.5	(67.9)	205.4	(98.3)	234.0	(120.6)	688.5	(87.0)
1980	368.2	(100.3)	267.6	(116.3)	256.2	(132.0)	892.1	(112.7)
1984	383.2	(104.4)	271.0	(117.8)	250.5	(129.1)	904.7	(114.3)
1989	367.2	(100.0)	230.1	(100.0)	194.1	(100.0)	791.5	(100.0)
1995	191.6	(52.2)	93.3	(40.5)	90.9	(46.8)	375.8	(47.5)
2000	115.5	(31.5)	49.5	(21.5)	61.3	(31.6)	226.2	(28.6)
Average Number of Employees per Establishment								
1975	8.81	(113.7)	92.56	(109.7)	483.47	(112.1)	22.19	(141.8)
1980	8.80	(113.5)	89.02	(105.5)	451.85	(104.8)	19.65	(125.6)
1984	8.44	(108.9)	89.23	(105.7)	444.93	(103.2)	18.47	(118.0)
1989	7.75	(100.0)	84.38	(100.0)	435.33	(100.0)	15.65	(100.0)
1995	6.49	(83.7)	88.19	(104.5)	491.35	(113.9)	12.22	(78.1)
2000	5.62	(72.5)	87.77	(104.0)	519.49	(120.4)	10.65	(68.1)

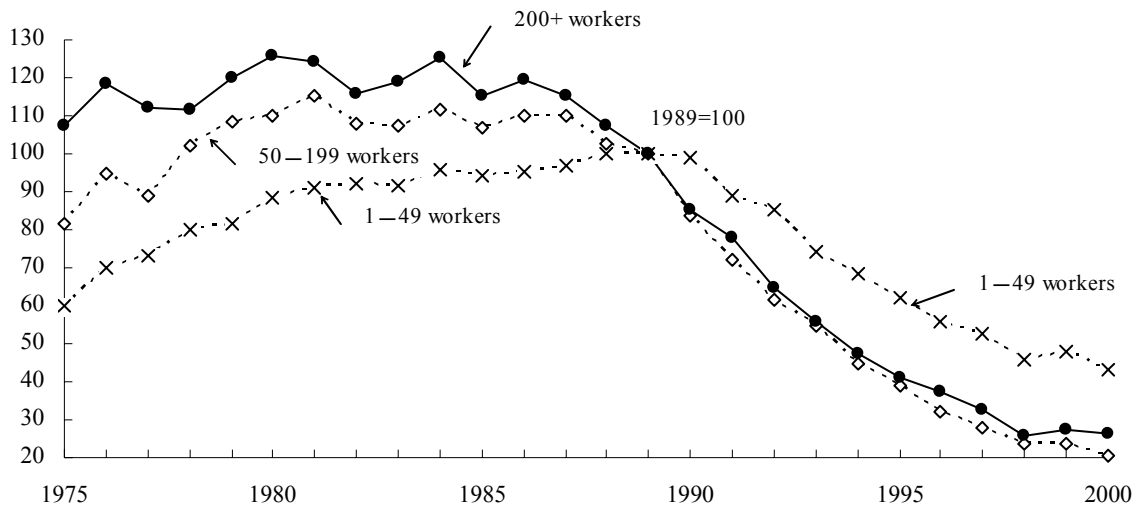
Notes: Figures refer to 30 September in 1975, 1980 and 1984 and 31 December in 1989, 1995 and 2000. 1989 is chosen as the base year (1989=100) because Hong Kong began estimating processing trade with China in 1989.

Sources: Hong Kong Census and Statistics Department (various years a, various years c).

constantly through 1981 but then declined slowly through 1989 and then very rapidly. In 2000 there were only 564 medium-sized establishments or 21 percent of the 1989 level. In contrast, the number of small establishments with 49 or fewer employees increased rather steadily in the 1980s to a peak of 47,388 in 1989. Although this number then fell markedly, the decline was slower than in the other groups and there were 20,566 small establishments in 2000 or 43 percent of the 1989. Because the number of small establishments has always been far larger than the number of establishments in the other size groups, overall trends in number of manufacturing establishments was highly correlated with trends in the number of small establishments.

Employment of large establishments followed trends similar to the number of establishments. The average number employees in large establishments declining from an

Figure 3: The Number of Manufacturing Establishments in Hong Kong by Size of Establishment (1989=100)

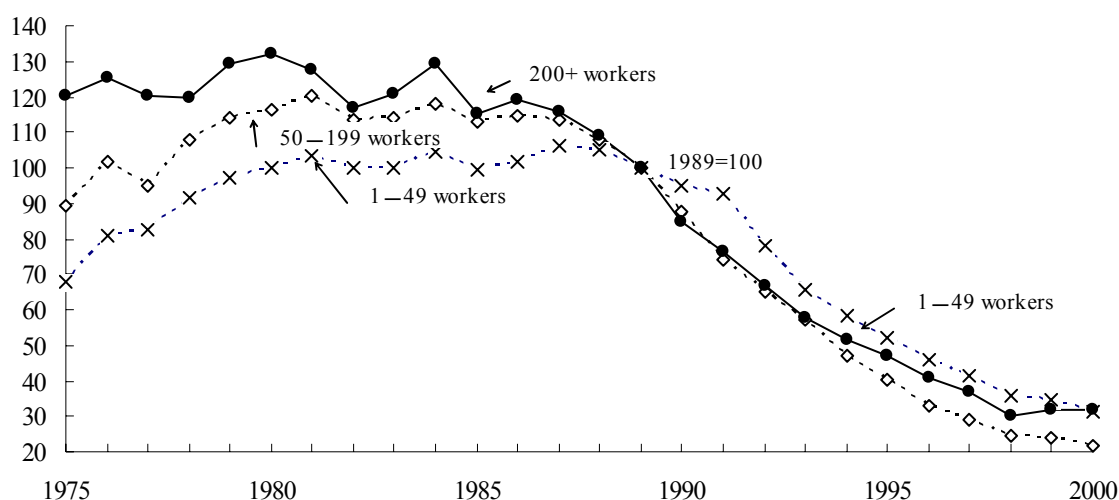


Sources: Hong Kong Census and Statistics Department (various years a, various years c).

average of 239 thousand per year in 1975-1986 to 194 thousand in 1989, 91 thousand 1995, and 61 thousand in 2000 (Table 11, Figure 4). Thus, in 2000, large employment in large establishments was only 31 percent of the 1989 level. In medium-sized establishments the number of employees generally declined more slowly in the 1980s but much more rapidly thereafter from 230 thousand in 1989 to 50 thousand in 2000 or only 22 percent of the 1989 level. In small establishments, employment continued to grow for most of the 1980s, peaking at 389 thousand in 1987 and remaining at 367 thousand in 1989. However, the decline accelerated rapidly in the 1990s and employment in small establishments was only 115 thousand in 2000 or 31 percent of 1989 levels, the same ratio as for large establishments. Nevertheless, the large number of small establishments and the relatively rapid growth of their employment in the 1980s means the development of small sized industries was an integral part of Hong Kong's economic expansion during this period.

Table 11 also shows that the number of employees per business establishment in the manufacturing industry as a whole decreased from 22 in 1980 to 11 in 2000. This could imply that average establishment size also became much smaller in most of Hong Kong manufacturing. However, when trends in average size among large establishments with more than 200 employees are examined, a very different conclusion emerges. Among these large establishments, the number of employees per establishment was 483 in 1975, 452 in 1980, 445 in 1984, 435 in 1989, 491 in 1995, 519 in 2000. Thus, average establishment size was actually increasing slightly in the late 1990s and there is no indication of shrinking factory size in this group. Likewise, there is relatively little decline in the average size of medium-size establishments with 50-199 employees. Thus, the only group with declining average factory size was small establishments with 49 or fewer workers, which saw aver-

Figure 4: The Number of Employees in Hong Kong's Manufacturing by Size of Establishment (1989=100)



Sources: Hong Kong Census and Statistics Department (various years a, various years c).

age size fall from 8.8 in 1980 to 7.8 in 1989 and then 5.6 in 2000. The decline in average size in manufacturing overall resulted partially because this group was by far the largest of the size groups as mentioned above and partially because the relative size of this group increased over time, from 92 percent of all establishments in 1980 to 94 percent in 1989, and 97 percent in 2000.

It is also important to stress that two important factors underlying the sharp decline in the number of business establishments and employees in the 1990s were the rapid growth of complex processing trade with mainland China and the transfer of many manufacturing operations to the Pearl River Delta area by Hong Kong companies. It is also likely that the rapid transfer of manufacturing to the Pearl River Delta is closely related to the especially rapid declines in the number of large and medium-sized establishments in Hong Kong.

4d. Analysis by Manufacturing Industry

Table 12 and Figures 5 and 6 show the number of business establishments and employees, in eight manufacturing industries, highlighting several important points. First, in seven of the eight industries examined (printing and publishing was the exception), there were sharp declines in both the number of establishments and in their employment levels in the 1990s. It is important to note that these declines coincided with the increase of the complex processing imports from China.

Second, through 1989 there were relatively few printing and publishing establishments, an even smaller number than in textile products and plastics, for example (Table 12, Figures 5, 6). However, this was reversed in the 1990s when the printing and publishing industry grew to have the largest number of establishments, even more than in the metal and machinery sector for the first time. This means that the printing and publishing industry was

Table 12: The Number of Business Establishments and Employees in Hong Kong's Manufacturing by Industry

Industry	(1976. 9.)			(1989. 12.)		
	Plants A ₁	Employees B ₁	Employees /plants B ₁ /A ₁	Plants A ₂	Employees B ₂	Employees /plants B ₂ /A ₂
Manufacturing total	36,303	773,746	21.3	50,566	791,519	15.7
8 selected industries	27,386	669,430	24.4	39,626	669,754	16.9
(% of manuf. total)	(75.4)	(86.5)	-	(78.4)	(84.6)	-
Apparel	7,946	244,510	30.8	9,116	237,345	26.0
Textile products	4,578	137,315	30.0	5,366	113,487	21.1
Printing, publishing	1,881	22,353	11.9	3,998	35,351	8.8
Plastics	3,844	76,994	20.0	5,553	59,248	10.7
Metal products	6,113	69,781	11.4	6,497	54,670	8.4
General machinery	1,354	11,971	8.8	5,392	29,621	5.5
Electric machinery	1,228	88,057	71.7	2,135	105,985	49.6
Precision & office mach.	442	18,449	41.7	1,569	34,047	21.7

Industry	(2000. 12.)			Changes in Employment, 1989-2000	
	Plants A ₃	Employees B ₃	Employees /plants B ₃ /A ₃	[B ₃ - B ₂]	% of total
Manufacturing total	21,248	226,205	10.6	-565,314	(100.0)
8 selected industries	15,995	168,723	10.5	-501,031	(88.6)
(% of manuf. total)	(75.3)	(74.6)	-	-	-
Apparel	1,953	36,330	18.6	-201,015	(35.6)
Textile products	2,077	27,489	13.2	-85,998	(15.2)
Printing, publishing	4,785	43,849	9.2	8,498	(-1.5)
Plastics	1,171	7,108	6.1	-52,176	(9.2)
Metal products	2,293	11,185	4.9	-43,485	(7.7)
General machinery	2,678	14,901	5.6	-14,720	(2.6)
Electric machinery	339	20,943	61.8	-85,042	(15.0)
Precision & office mach.	699	6,918	9.9	-27,129	(4.8)

Note: Selected industries are relatively large industries in terms of establishments and employment.

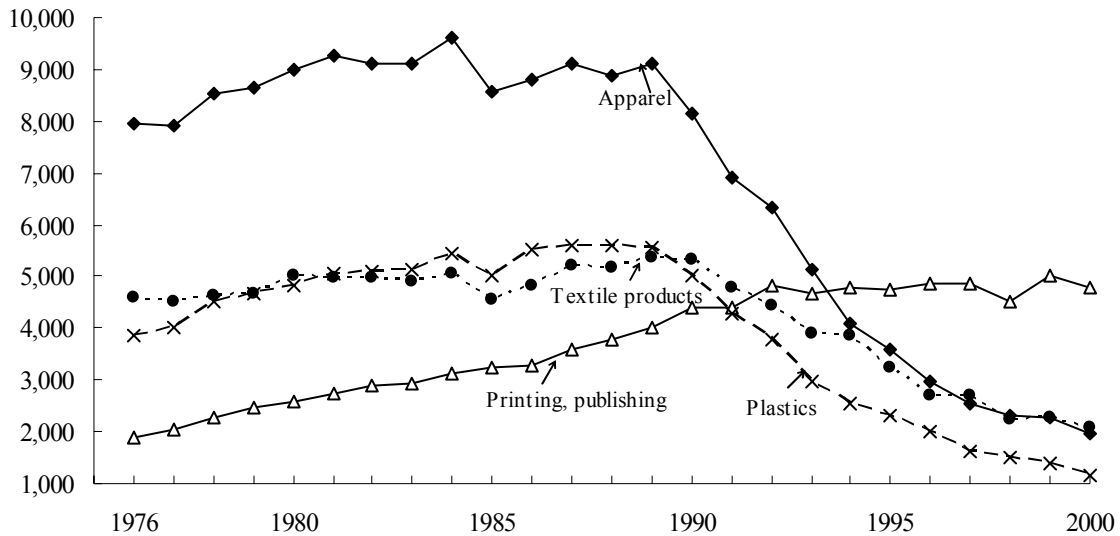
Sources: Hong Kong Census and Statistics Department (various years a, various years c).

not affected by the phenomenal shift of Hong Kong's manufacturing to China. The growth of this industry is also related to the emergence of a large number of academic publishers in Hong Kong (e.g. Oxford University Press).

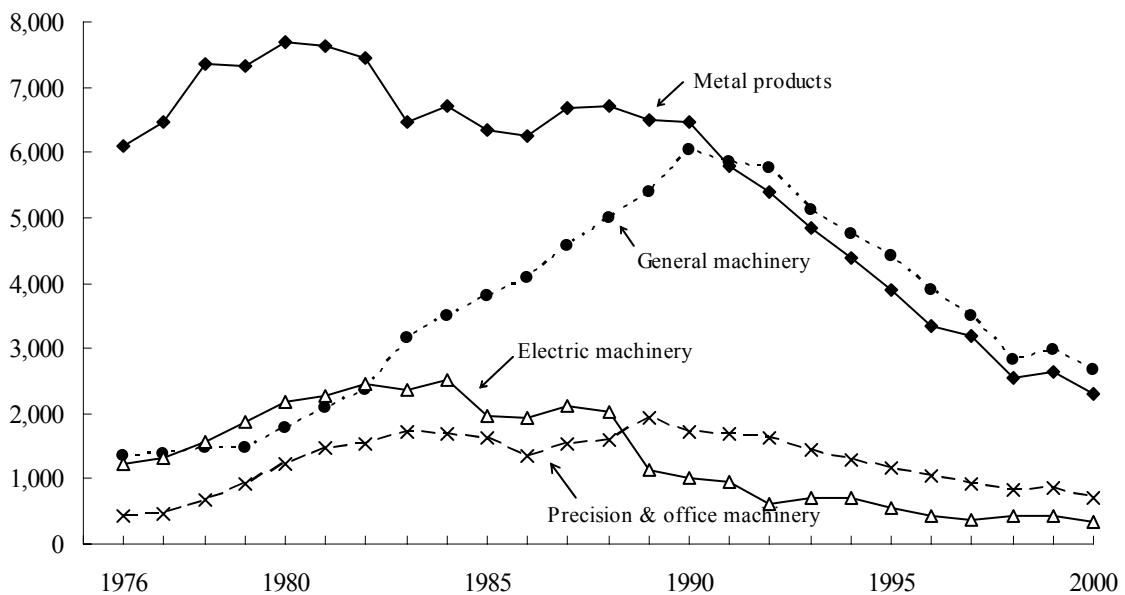
Third, in the 1980's, there were 8,000-9,000 establishments in the apparel industry, 4,000-5,000 each in textile products and plastics, and 6,000 to 7,000 in metal products (Figure 5). There were also about 250,000 employees in the apparel industry,

Figure 5: The Number of Manufacturing Establishments in Hong Kong by Industry

[A] Light industry and Printing, Publishing Industry



[B] Machinery and Metal Products



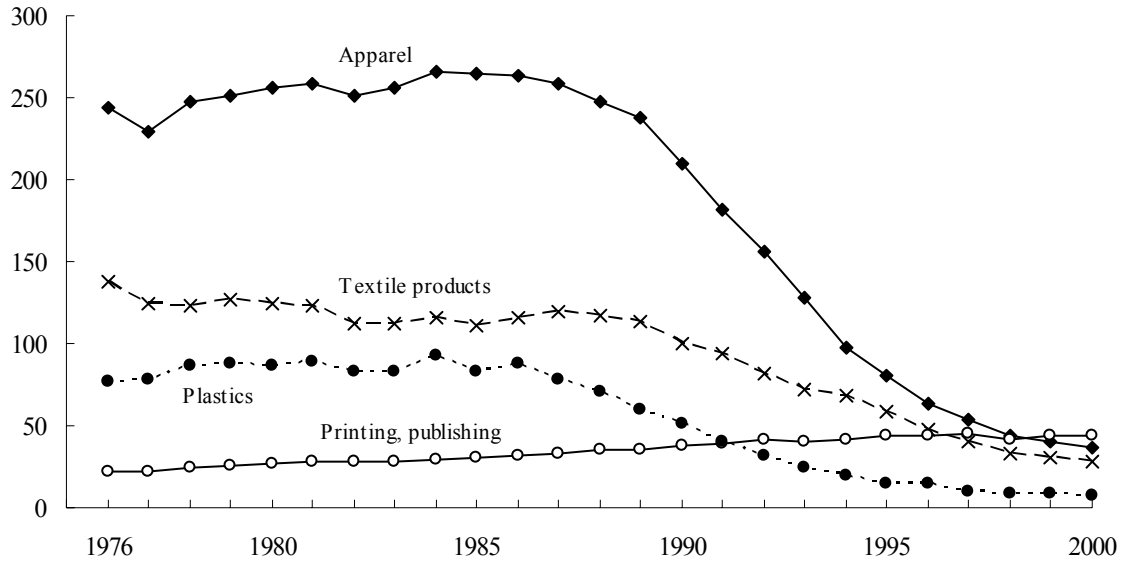
Sources: Hong Kong Census and Statistics Department (various years a, various years c).

110,000-120,000 employees in textile products, and about 120,000 in electric machinery (Figure 6). However, both the numbers of establishments and the number of workers fell sharply in these industries during the 1990s. These declines result largely from the relocation of related activities to Guangdong.

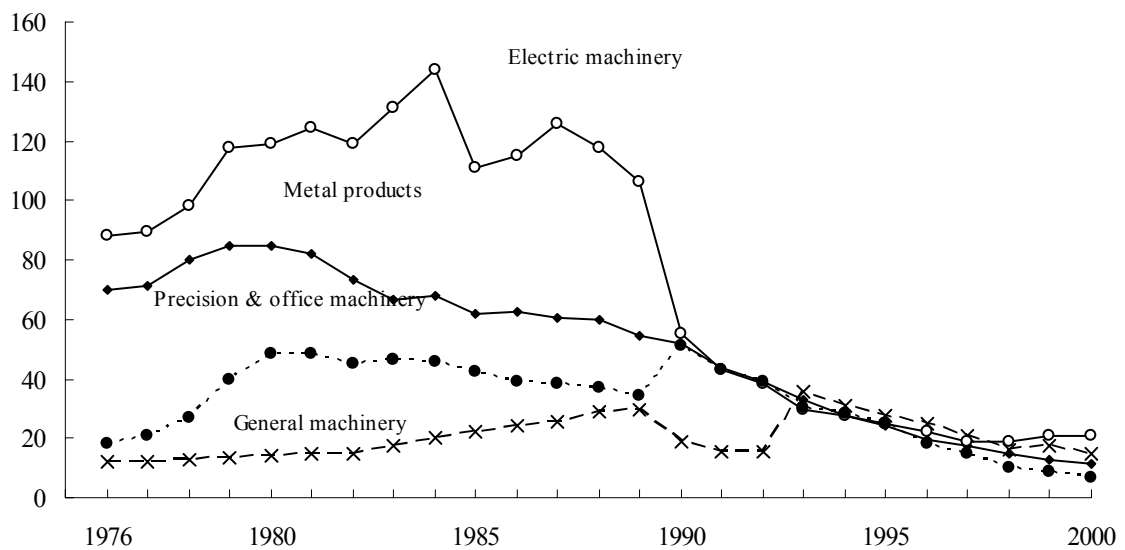
Fourth, in the 1990s, the number of establishments declined most rapidly in electric ma-

**Figure 6: Manufacturing Employment in Hong Kong
by Industry (thousands)**

[A] Light Industry and Printing, Publishing Industry



[B] Machinery and Metal Products



Sources: Hong Kong Census and Statistics Department (various years a, various years c).

chinery to 339 in 2000 or only 16 percent of the 1989 number. Declines were also very rapid in apparel and plastics where the number of establishments fell to only 21 percent of 1989 levels in 2000. Ratios of employment in 2000 to employment in 1989, 12 percent in plastics, 15 percent in apparel, and 20 percent each in electric machinery, precision machinery, and metal products, indicate similarly rapid declines in employment. Here again these figures highlight the effects of the dramatic shift of manufacturing to The Pearl River

Delta.

Fifth, between 1989 and 2000, total employment decreased 565 thousand in the manufacturing industry as a whole. Apparel accounted for 36 percent of this total (a decline of 201 thousand), textile products for 15 percent (a decline of 86 thousand), while the four metals and machinery industries combined to account for another 30 percent (170 thousand). This underscores the fact that the shift to the Pearl River Delta occurred in all areas of the manufacturing industry except printing and publishing.

Sixth, the patterns observed in employment trends above generally pertain to the 1989-2000 period. During 1976-1989, which could be characterized as a period of normal growth, some very different patterns were observed. Most fundamentally, there was an increase of 17,773 employees in total manufacturing during this 13-year period. Although there was a decline of 30,993 employees (-174 percent) in apparel products and textiles combined and another decrease of 32,821 employees (-185 percent) in plastics and metal products combined, but these were largely offset by a large increase of 51,176 employees (288 percent) in the three machinery industries (general machinery, precision and office machinery, and electric machinery) combined. This large increase in the three machinery industries increased their combined share of manufacturing employment from 15 percent in 1976 to 21 percent in 1989 and a trend contrasts starkly with trends observed between 1989 and 2000.

Seventh, the contrast between patterns observed before 1989 and afterwards can be understood as inevitable changes in the industrial structure resulting from the integration of the Guangdong and Hong Kong economies and Hong Kong's increased utilization of the cheap labor available in the Pearl River Delta area. Correspondingly, Hong Kong's trade and finance industries have grown rapidly but in the manufacturing sector only printing and publishing that continued grew. The patterns of growth observed in these tumultuous times are very different from the more normal pattern observed in the past. The normal pattern consisted of gradual decreases in the shares of apparel and textile products and contrasting constant increases in the shares of machinery industries. However, hollowing out is not an appropriate way of describing the special growth patterns observed in the 1990s. Rather, these patterns reflect desirable phase of the process that Hong Kong's economy has to undergo as a result of the economic integration with the Pearl River Delta area. In short, Hong Kong simply underwent a rational and inevitable process, and together with the Yangtze delta area, which has Shanghai at its head, the Pearl River Delta area with Hong Kong at its head has become an important element of China's revitalized seaboard.

5. A Short Summary

In the 1990s, Hong Kong's economy has undergone dramatic restructuring. Three aspects are particularly important. First, the ratio of reexports to exports grew rapidly from under one-third in 1980 to over 90 percent in recent years, indicating the peaking of so-called triangular trade. It is particularly interesting that the vast majority of reexports to the United States (over 90 percent in 1990, 1995, and 2000-2002) originate in China. The large volume of reexports originating in China also highlights Hong Kong's important role as an intermediary of Chinese exports. Second, there has been a rapid expansion of Guangdong's

exports to Hong Kong that involve complex processing, the share of this trade in Guangdong's exports to Hong Kong rising rapidly. In contrast, the volume of exports through traditional consignment processing has stagnated and the share of these exports has fallen.

Third, there was a dramatic shift of manufacturing plants from Hong Kong into Guangdong in the 1990s which corresponded to the changing nature of Guangdong's exports to Hong Kong. This shift also corresponded to an astonishingly rapid decline in the share of manufacturing in the Hong Kong economy. If the Japanese economy had experienced a similarly rapid decline of manufacturing, it may have collapsed entirely. However, although the growth rate did decline some, there was no such collapse in Hong Kong because of strong growth in service industries, mostly centered on the foreign trade and finance. This shows to the remarkable extent to which Hong Kong's service industries have been strengthened by the intense competition resulted from its highly internationalized free trade and its role as the world's fifth largest international financial center.

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