As a businessman based in Asia, I have personally witnessed and participated in the tremendous growth of the Greater Pearl River Delta region over the last few decades. Since the onset of China's economic reform programme, the Greater Pearl River Delta region, which includes Hong Kong, Macao, Guangzhou, Shenzhen and the surrounding region of 40 million people, has emerged as one of the world's economic powerhouses. It has been, and will continue to be, one of the most important drivers of China's economy and the key area in China for investment, manufacturing and trading by Hong Kong companies. Despite this unprecedented development, it seems that the region remains one of the world's best-kept commercial secrets. Its story is not well-known outside of China and, perhaps even within Hong Kong and other parts of China, not everyone seem to grasp fully the region's enormous potential. The resumption of Chinese administration in Hong Kong in 1997 and Macao in 1999, and the entry of the Chinese Mainland into the World Trade Organisation have provided additional impetus and opportunity for closer economic interaction and development. Hong Kong, the Pearl River Delta, and China as a whole will benefit from a greater understanding of the potential of the Greater Pearl River Delta region to extend its already crucial role as a major production, trade, and commercial platform for China's burgeoning economy.

This study fills an important gap in information and analysis of the Greater Pearl River Delta region. The study also is notable in that it draws upon the work of researchers in Hong Kong as well as in Guangdong Province to provide a balanced perspective. It explores in details the complex interaction and division of labour that have shaped the region's development. It notes that many of the comparisons between the Greater Pearl River Delta region and other regions are inadequate and piecemeal and tend to understate the strength of the Greater Pearl River Delta region. It traces the economic trajectories that will influence future economic interaction within the Greater Pearl River Delta region and the issues that might stand in the way of greater interaction in the future. Finally, it develops useful guidelines for future development in the region. Already, some of the analysis and conclusions have found their way into strategy and policy formulation in the public and private sectors.

The research was sponsored by the 2022 Foundation, a non-profit foundation dedicated to improving understanding of Hong Kong in its long-term economic trajectories. As an initial focus, the Foundation has funded studies of the environmental linkages between Hong Kong and the Pearl River Delta, as well as a study of transportation linkages between Hong Kong and the Pearl River Delta region. The present study represents precisely the type of detailed, independent research that the members of the Foundation envisioned.
when its predecessor, Project 2022 was started in 1999. On behalf of the Foundation, I would like to thank Michael Enright, Chang Ka Mun, Edith Scott, Zhu Wenhui, Jo Wilson, Helen Chin, Flash Ng, Xu Zhihua, and their collaborators for their dedicated efforts.

For those of us that live within the Greater Pearl River Delta region, the present study serves as a timely reminder of the respective capabilities and economic roles of the various cities within the region. The complementarities that exist within the region have allowed all its jurisdictions to prosper. They provide favourable opportunities for Hong Kong, Guangzhou, Macao, Shenzhen, and other cities in the region to pursue win-win strategies in the future. Although there will inevitably be some competition among cities in the Greater Pearl River Delta region, this competition should not become a counter-productive, zero sum game with each jurisdiction exactly duplicating others' capacities/infrastructures. Instead, each of the jurisdictions in the region needs to see that it is in its own self-interest to harness the complementarities that make the region far more than the sum of its parts. I have no doubt, given the goodwill on all sides, that the Greater Pearl River Delta region will continue to be the most vibrant economic region in China, the Asia-Pacific, and indeed the world, a position that will contribute greatly to the well-being of China and the rest of the Asia-Pacific.

The present study should show all of us that live in the Greater Pearl River Delta region that the region has several different centres of excellence that contribute to a complementary whole. We all need to develop a greater understanding of the capabilities of other jurisdictions in the region and to forsake outmoded notions of what goes on in other jurisdictions. In Hong Kong, we must understand that the Pearl River Delta is a dynamic place with high levels of productivity and an increasingly sophisticated economy, not just a place with low land and labour costs. In the Pearl River Delta, it should be understood that Hong Kong is an advanced centre for management, coordination, finance, and commercialisation on a global scale, not just a bridge between China and the rest of the world. It is the combination of Hong Kong and the Pearl River Delta region that has allowed China to emerge as one of the world's leading trading nations in such a short time. It is this combination that will foster further growth in the future. Better understanding, mutual respect, and enlightened self-interest within the region should be the basis of joint promotion of the Greater Pearl River Delta region on the world stage and the starting point for other new cooperative initiatives within the region.

For people who live outside the region, the present study provides a valuable introduction to the region, its economic development, the various attributes that have spurred its rapid growth, and the region's future development potential. Today, China's economy is best
understood not as a monolith, but as a collection of regional economies, each with its own characteristics. The economy of the Greater Pearl River Delta region in recent times has been driven by a unique confluence of forces and actors. Important roles have been played by firms and individuals firstly from Hong Kong, the Pearl River Delta region, and then from the rest of the Chinese Mainland, Taiwan, the rest of Asia, and the West.

While the Greater Pearl River Delta region has demonstrated its ability to attract foreign investment to China and thousands of foreign firms operate successfully and profitably in the region, the region should seek to capture an even greater level of press and analyst coverage. The region provides a base for literally thousands of foreign firms that have placed manufacturing, purchasing, finance, management, and supply chain management activities into the various jurisdictions in the region. The study provides analysis and insights that should be of interest to any firm interested in or already investing in China.

I have no doubt that the further development of the Greater Pearl River Delta region as a platform for commerce and industry will be the source of new competitive advantages for Hong Kong and will enhance the prosperity of our people in Hong Kong as well as the prosperity of our neighbours within the Greater Pearl River Delta region.

Dr. Victor K. Fung
The 2022 Foundation
January 2003
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China's emergence on the world stage was one of the most important stories in the world economy in the latter portion of the 20th century and promises to continue to be one of the most important stories in the 21st century. China's development since the onset of its economic reform programme in 1979 has lifted more people out of poverty than in any other place over a comparable period of time. One of the most important parts of the story has been the contribution of the Pearl River Delta region. The Pearl River Delta region of China's Guangdong Province has been a leader in terms of China's economic reforms, its overall development, its emergence as an export powerhouse, and its ability to attract foreign capital.

The story of the Pearl River Delta region is not one of the Chinese Mainland alone. Hong Kong and Macao also have played crucial roles, so much so that we should really consider a "Greater Pearl River Delta region" that incorporates Hong Kong and Macao, as well as the Pearl River Delta portion of Guangdong Province. Hong Kong has been particularly important to this larger region as a source of capital, management, technology, international market knowledge, and access to international markets. The Hong Kong-Pearl River Delta region combination has allowed the Greater Pearl River Delta region to become a world leader in an increasing range of light-manufactured and technology-based goods.

With the return of Hong Kong to Chinese administration in 1997, and China's entry into the World Trade Organisation (WTO), the economic interaction between Hong Kong and the Pearl River Delta region has grown and is likely to expand enormously in the future. This expansion is likely to result in substantial additional economic opportunities for firms and individuals in the relevant jurisdictions. Despite this fact, the Greater Pearl River Delta region has not received much attention from the international press. In many ways, the Greater Pearl River Delta region has become the great, untold success story of China's economic reform era.

**The Project**

In order to understand the economic potential of the Greater Pearl River Delta region, we decided to focus on the present and future economic interaction between Hong Kong and the Pearl River Delta region. In addition to reviewing primary and secondary data, some 250 interviews were carried out with government officials, managers, academics, and other experts in Hong Kong, the Pearl River Delta region, Beijing, and elsewhere. The idea was to understand the nature of the economic interaction between Hong Kong and the Pearl River Delta region industry-by-industry and jurisdiction-by-jurisdiction. The overall picture of the economic interaction and how it might evolve in the future was built up from this detailed research. The research for the project took place from February to December of 2002.
The project has been a true team effort. Professor Michael Enright and Chang Ka Mun provided overall direction and coordination for the project as a whole and for the development of the final document. Edith Scott, Jo Wilson, and Flash Ng were primarily responsible for interviews, data collection and analysis, and drafting for the Hong Kong side of the project. Dr. Zhu Wenhui, Helen Chin, and Xu Zhuhua were primarily responsible for interviews, data collection and analysis, and drafting for the Pearl River Delta region part of the project. In addition, important support was provided by the Centre for Urban and Regional Studies at Zhongshan University in Guangzhou, which contributed key background pieces for the project.

**Defining the Regions**

In order to address the economic interaction between Hong Kong and the Pearl River Delta region, it is necessary to develop definitions of the relevant regions. The Pearl River Delta Economic Zone, as specified by Guangdong Province, includes Guangzhou, Shenzhen, Dongguan, Foshan, Jiangmen, Zhongshan, Zhuhai, and the urban areas of Huizhou and Zhaoqing. The Pearl River Delta Economic Zone was first defined by Guangdong Province in 1984 and was expanded to its present dimensions in 1987 (see Figure 1.1). In this report, we will use this official definition for what we will call the "Pearl River Delta region". We will define the "Greater Pearl River Delta region" to include the "Pearl River Delta region" plus the Hong Kong Special Administrative Region and the Macao Special Administrative Region (see Figure 1.2). We will argue later that given the high levels of interaction within the "Greater Pearl River Delta region" that this is the region that should be compared to other regions in China and elsewhere in the world.

**Figure 1.1** The Pearl River Delta Economic Zone in Guangdong Province
Key Findings

There are several key findings and conclusions that have emerged from our research that will be described in detail in later chapters of this report. These include the following:

- The economic interaction between Hong Kong and the Pearl River Delta region has been critical to the development of both economies. It has allowed the Greater Pearl River Delta region to become an economic powerhouse, whose strength vastly exceeds that which would have been possible for each jurisdiction in isolation. The Greater Pearl River Delta region has become the home for many internationally successful regional clusters of industries that will be difficult to displace.

- Despite the importance of the economic interaction between Hong Kong and the Pearl River Delta region, there are many cases in which opportunities are being missed due to a lack of understanding in the region and due to barriers that exist to further economic interaction. The result is that a great deal of money is being left on the table in the Greater Pearl River Delta region.

- The economic interaction between Hong Kong and the Pearl River Delta region has been growing substantially and will continue to grow with greater experience with "one country, two systems," with China’s entry into the WTO, with improved transportation and communication, and with an increased understanding throughout the "Greater Pearl River Delta region." Natural economic forces will create both opportunity and pressure for further interaction.
A complex division of labour has developed in which the Pearl River Delta region performs a wide range of manufacturing-related activities while Hong Kong performs management, logistics, finance, and other activities related to manufacturing, as well as a range of high-level professional services for the region. This division of labour has allowed the different economies in the region to focus on what they do best, contributing to the prosperity of the entire region.

While the development of Hong Kong and the Pearl River Delta region has been largely complementary, there are several areas in which competition among jurisdictions in the Greater Pearl River Delta region takes place. The most obvious areas include port and logistics services, activities supporting manufacturing, and some retailing.

The future economic interaction, division of labour, and competition between Hong Kong and the Pearl River Delta region will be influenced by the overall economic trajectories of the different jurisdictions. In particular, they will be affected by the natural deepening and broadening of the economy in the Pearl River Delta region and the high-value service orientation of Hong Kong. Understanding the natural economic trajectories of the economies in the region will be crucial to firms and governments as they develop strategies to benefit from the interaction in the future.

Overall, the economy of the Pearl River Delta region will become deeper and broader as the region produces more of the components and capital goods to supply its growing manufacturing base; as urbanisation, infrastructure investments, and transportation systems continue to grow; and as the rise of the service sector contributes to the region's growth. Hong Kong's economy, on the other hand, is likely to become even more specialised in providing high-value managerial, financial, information, and coordination activities, albeit for a broader range of industries and types of companies. This implies that the economic interaction between Hong Kong and the Pearl River Delta region will become even more important to overall prosperity in the Greater Pearl River Delta region than has been the case in the past.

Most of the existing comparisons between the Pearl River Delta region and other regions of China are at best misleading. In particular, comparisons with the Yangtze River Delta region often involve comparing an overly broad definition of the Yangtze River Delta that encompasses Shanghai, all of Jiangsu Province, and all of Zhejiang Provinces with an overly narrow definition of the Pearl River Delta region that encompasses only a portion of Guangdong Province, and excludes Hong Kong and
Macao. False comparisons give misleading results that have the potential to influence investment decisions.

There are several issues that need to be addressed if both Hong Kong and the Pearl River Delta region are to take full advantage of their economic interaction in the future. There are misperceptions and misunderstandings about the Greater Pearl River Delta region that exist both inside and outside the region. The region has multiple jurisdictions and complex decision making that can hinder beneficial interaction. These jurisdictions tend to have a limited view of cooperation in the region and tend to go their own ways without thinking through the overall regional impact of their actions. There is limited understanding of the implications of the fact that the Greater Pearl River Delta region has more than one centre. Limits to connectivity between Hong Kong and Shenzhen, between Hong Kong and the western part of the Pearl River Delta region, and around the region in general provide barriers to business. Regulations on export processing facilities and international service firms in the Chinese Mainland hurt the economies on both sides of the Hong Kong-Pearl River Delta region boundary. Finally, competition with other parts of China, most notably the Yangtze River Delta, will shape the region's economy in the future.

The Greater Pearl River Delta region also has the potential to benefit from enormous opportunities. The region is very well-positioned to benefit from eventual recovery in global markets. It is well-situated to benefit from growing affluence and the eventual emergence of a single national market in the Chinese Mainland. As the most trade-oriented part of China, the Greater Pearl River Delta region will benefit from China's accession into the World Trade Organisation. It also will benefit from the development of South-western China and from closer economic ties between Hong Kong and the Chinese Mainland as a whole.

There are several implications that arise from our analysis of the economic interaction between Hong Kong and the Pearl River Delta region. The region needs to build off of past success, including the presence of small and medium-sized firms, market-orientation, and international linkages. It needs to foster more of a regional identity, so that people within the region think more in terms of "us and us" rather than "us and them". Development planning needs to be improved to include cost-benefit analyses of major developments. Connectivity within the Greater Pearl River Delta region should be improved so that all main cities in the region can be reached from each other by land within the "magic three hours" that tends to govern the locations of investments, management, service provision, and purchasing. Streamlined border
operations and a direct link between Hong Kong and the western part of the Pearl River Delta region would be particularly beneficial.

- There also is a need to develop the right interaction among the different actors in the region. Often the right interaction to foster business activity is between local government or Party officials in the Pearl River Delta and private business people from Hong Kong. There is ample scope for far greater cooperation in terms of information sharing and promotion of trade, investment, and tourism in the region. There also is scope to enhance the region's international linkages, one of its main advantages over other parts of China.

- While greater cooperation among jurisdictions in the region would be beneficial to all, in reality it will be difficult to obtain widespread agreement and cooperation on all issues. This implies that the various jurisdictions in the region should seek out some of the more obvious and easier avenues of cooperation in order to build understanding and trust. It also implies that each jurisdiction should try to identify natural allies on particular issues. It also implies that even in areas in which cooperation might not be immediately forthcoming, the creation of an environment in which jurisdictions at least take into account the strategies and advantages of other jurisdictions would benefit the region as a whole.

- Finally, while greater economic interaction between Hong Kong and the Pearl River Delta region will foster additional development in both locations, both Hong Kong and the Pearl River Delta region face other issues that arguably are as important, if not more important, to their economic future. The key to productive interaction between Hong Kong and the Pearl River Delta region will be the extent to which the interaction will enable the individual jurisdictions to overcome their own challenges and ensure their prosperity.

Acknowledgements

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We would like to thank the professors and Ph.D. students from Zhongshan University who assisted us in obtaining data and background information, in arranging interviews with scholars and officials in the Chinese Mainland, and in reviewing the results of the project. We also would also like to thank the following scholars from Guangdong: Zheng Tianxiang, Chen Guanghan, Yan Xiaopei, Lin Jiang, Feng Xiaoyun, and Feng Bangyan for reviewing results of the project and providing their insights. We also would like to thank Invest Hong Kong for support for some of the cross-regional comparisons and the Hong Kong Trade Development Council for useful discussions and insights.

Finally, we owe a particular debt of gratitude to all of the officials, managers, business people, academics, and experts from Hong Kong, Guangdong, and Beijing that generously provided information and consented to be interviewed. This project could not have been completed without their cooperation.
The economies of Hong Kong and the Pearl River Delta region have developed rapidly in the last two decades. China’s economic opening and reform programme has allowed the economies to develop in different, but closely related ways. While Hong Kong has emerged as a leading centre for management, coordination, finance, information, and business services, the Pearl River Delta region has developed into a manufacturing powerhouse with few rivals worldwide. This chapter will sketch some of the major developments in the economies of Hong Kong and the Pearl River Delta region over the last few decades.

**The Economic Development of Hong Kong**

Hong Kong’s economic development has been influenced by its unique history. For over one hundred and forty years, Hong Kong was under British administration. During this time, it became a free port, an international financial centre, a regional centre for Asia and the leading location where the economies of the East and the West came together. Although it was under British administration, Hong Kong had its own unique set of economic policies and attributes. Hong Kong’s unique position has continued after China resumed administration in 1997. Under the “one country, two systems” mechanism, Hong Kong retains its separate economic system and autonomy in nearly all areas that influence the economy.

**Historical development**

Hong Kong’s economy has gone through several distinct stages. Initially, Hong Kong acted as an entrepot for trade into and out of China. In the 1950s and 1960s, it became a business service and light-manufacturing centre. In the 1980s, Hong Kong firms shifted production into the Chinese Mainland and focused the knowledge-intensive management, coordination, and information-related activities in Hong Kong. They were joined by hundreds of foreign multinationals that set up regional management centres in the territory. These activities have formed the basis of Hong Kong’s knowledge economy.

*From entrepot to business service and manufacturing centre*

For over a hundred years, Hong Kong’s main economic role was as an entrepot for trade into and out of China. This was the original purpose for which the British took over administration of Hong Kong in the 19th century. In the 1950s, as the Chinese Mainland became isolated from the rest of the world economy, Hong Kong’s entrepot role for China faded. Instead, it became a maritime and trade centre for Asia. Over time, its position as a free port, its openness, and its legal and administrative systems allowed Hong Kong to develop into a business service centre for a growing Asian region.
In addition, numerous refugees from the Chinese Mainland provided both the know-how and the cheap labour that allowed Hong Kong to obtain a strong position in a range of light-manufacturing industries. Hong Kong became a leading exporter in garments, textiles, footwear, plastic products, simple electronics goods, and related products. Hong Kong’s economy in the 1960s and 1970s was based largely on labour-intensive light manufacturing and the services directly related to trade and transportation. These had grown to supplement Hong Kong’s traditional role as a maritime centre. By the late 1970s, rising wages and land costs were rapidly making Hong Kong uncompetitive as a manufacturing location.

**From manual to knowledge economy**

The opening of the Chinese economy, and particularly the ability of Hong Kong firms to move their manufacturing activities into the Pearl River Delta region, meant that Hong Kong firms could concentrate the knowledge-intensive activities associated with manufacturing in Hong Kong. The knowledge worker portion of Hong Kong’s workforce (represented by “managers and administrators,” “professionals and related”, and “clerical”) has increased from 21 percent in 1981, to 46 percent in 1996, and to well over 50 percent today.\(^1\) Hong Kong firms found it far more valuable to manage and coordinate from Hong Kong than to actually produce in Hong Kong.

The knowledge economy in Hong Kong also is represented by the large numbers of regional headquarters of multinational firms found in Hong Kong. Hong Kong is by far the leading centre in the Asia-Pacific for such headquarters. The activities that major multinationals perform in Hong Kong, largely management, coordination, financial activities, and market development, are in fact very similar to those carried out by Hong Kong firms in Hong Kong.\(^2\) These activities are particularly important because they tend to be the highest value-added activities that these firms perform in the region. They also have substantial spillover effects through their demand for skilled personnel and advanced professional services. The knowledge economy in Hong Kong is also represented by the large number of firms in knowledge-intensive professional service industries that use Hong Kong as a base to serve Hong Kong, China, and the rest of Asia.

**Economic development**

Hong Kong experienced rapid economic growth in the years 1950 to 1995. Real GDP growth averaged 8.5 percent per year from 1975 to 1985 and 6.5 percent per year from

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2 Research by Michael Enright, University of Hong Kong School of Business.
1985 to 1995. In the years from 1975 to 1995, Hong Kong’s real GDP quadrupled, and its real GDP per capita tripled. In the run-up to the return of administration to China, Hong Kong’s economy grew at a real rate of 4.5 percent in 1996 and five percent in 1997. The Asian Economic Crisis, which started in the middle of 1997, hit Hong Kong in 1998 when its real GDP fell by 5.3 percent. GDP growth rebounded to 3.4 percent in 1999 and surged to 10.2 percent in 2000 before falling to 0.6 percent in 2001 (see Table 2.1). Hong Kong’s unemployment, which had been 2.2 percent in 1997, reached 7.6 percent in mid-2002.

**Table 2.1**  Major Economic Indicators for Hong Kong, 1999-2001

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<tr>
<th></th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
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<tr>
<td>Real GDP growth (%)</td>
<td>3.4</td>
<td>10.2</td>
<td>0.6</td>
</tr>
<tr>
<td>Inflation (%)</td>
<td>-4.0</td>
<td>-3.8</td>
<td>-1.6</td>
</tr>
<tr>
<td>Unemployment rate (%)</td>
<td>6.2</td>
<td>4.9</td>
<td>5.1</td>
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Source: Hong Kong Trade Development Council, *Major Economic Indicators*, November 29, 2002

Hong Kong has been going through a period of economic adjustment since the onset of the Asian Economic Crisis. Many people underestimated the links between Hong Kong’s economy and that of Southeast Asia. As a result, many underestimated the negative impact that economic stagnation in Southeast Asia would have on Hong Kong’s economy. In addition, Hong Kong went through the bursting of its own asset price bubble. Like many economies in Asia, Hong Kong saw its property prices and stock market index increase dramatically in the early and mid-1990s. Both increased in the order of 50 percent in 1996 and 1997 alone. As prices fell throughout Asia, they could not be maintained in Hong Kong, particularly as business throughout the region suffered. Even though property prices fell by 50 percent or more, attempts to prop them up only prolonged Hong Kong’s period of deflation, which reached four years in mid-2002.

As of the middle of 2002, Hong Kong was still facing adjustments due to the aftermath of the Asian Crisis, China’s accession to the World Trade Organisation, the rise of other cities in China, and the improvement of skills and capabilities in the Chinese Mainland. These adjustments are likely to continue for some time. In addition to affecting the economy as a whole, the downturn faced in Hong Kong, and structural changes in the economy have contributed to government budget deficits and the need to rethink government finances. Even so, Hong Kong’s economic development over the last two decades has been remarkable and Hong Kong remains an extremely wealthy economy, with per capita income in excess of US$24,000 (see Table 2.2).
Table 2.2 Economic Indicators for Hong Kong, 1980-2001

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<tr>
<td>Population (million)</td>
<td>5.039</td>
<td>5.456</td>
<td>5.705</td>
<td>6.156</td>
<td>6.665</td>
<td>6.725</td>
</tr>
<tr>
<td>GDP, at factor cost (HK$ billion)</td>
<td>135.04</td>
<td>255.42</td>
<td>563.52</td>
<td>1,041.07</td>
<td>1,228.90</td>
<td>1,211.65</td>
</tr>
<tr>
<td>- Primary (%)</td>
<td>1.0%</td>
<td>0.6%</td>
<td>0.3%</td>
<td>0.2%</td>
<td>0.1%</td>
<td>0.1%</td>
</tr>
<tr>
<td>- Secondary (%)</td>
<td>31.7%</td>
<td>29.9%</td>
<td>25.3%</td>
<td>16.1%</td>
<td>14.2%</td>
<td>13.4%</td>
</tr>
<tr>
<td>- Tertiary (%)</td>
<td>67.3%</td>
<td>69.5%</td>
<td>74.4%</td>
<td>83.7%</td>
<td>85.7%</td>
<td>86.5%</td>
</tr>
<tr>
<td>Per capita GDP (US$)</td>
<td>5,268</td>
<td>6,134</td>
<td>13,092</td>
<td>22,831</td>
<td>24,782</td>
<td>24,383</td>
</tr>
<tr>
<td>Exports (US$ billion)</td>
<td>19.10</td>
<td>30.15</td>
<td>82.04</td>
<td>172.32</td>
<td>201.63</td>
<td>189.87</td>
</tr>
<tr>
<td>Total Trade (US$ billion)</td>
<td>40.80</td>
<td>59.82</td>
<td>164.41</td>
<td>363.49</td>
<td>414.19</td>
<td>390.92</td>
</tr>
</tbody>
</table>

Sources: Hong Kong Government Census and Statistics Department

Composition of the economy

Hong Kong’s economy has always been dominated by the service sector. In the 1950s, 1960s, and 1970s, Hong Kong’s central location in Asia, its open economy, and its transparent business environment helped attract financial and business service activities. Hong Kong also grew as a tourism centre with its unique blend of Eastern and Western cultures. Even at the height of the importance of Hong Kong’s manufacturing sector, services still accounted for more than two-thirds of GDP. As China began to open its economy and as the manufacturing activities of Hong Kong firms were moved into the Pearl River Delta region, the portion of Hong Kong’s GDP in the service sector increased to over 85 percent, a figure typical of major city economies like London and New York (see Tables 2.2 and 2.3).

Particularly noteworthy is the prominence of producer services in Hong Kong’s economy. Transportation, tourism, trading, and other trade-related services represent important parts of Hong Kong’s economy. The import-export trading sector alone employs more than 500,000 people out of a workforce of just over three million.3 Hong Kong is one of the world’s leading international financial centres. In addition, Hong Kong has become a leading hub for business services, including law, accountancy, advertising, engineering, and consulting. The leading international firms in these and other service sectors have a strong presence in Hong Kong. Many, if not most, of the foreign firms in these industries that have a regional headquarters in Asia have their headquarters in Hong Kong.

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Table 2.3 Composition of Hong Kong’s Economy, 2001

<table>
<thead>
<tr>
<th>Industry or Sector</th>
<th>Percentage of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary</td>
<td>0.09</td>
</tr>
<tr>
<td>Secondary</td>
<td>13.37</td>
</tr>
<tr>
<td>- Manufacturing</td>
<td>5.12</td>
</tr>
<tr>
<td>- Construction</td>
<td>4.94</td>
</tr>
<tr>
<td>- Electricity, gas and water</td>
<td>3.31</td>
</tr>
<tr>
<td>Services</td>
<td>86.54</td>
</tr>
<tr>
<td>- Wholesale, retail, import-export trade, restaurants, hotels</td>
<td>26.08</td>
</tr>
<tr>
<td>- Transportation, storage, communications</td>
<td>10.51</td>
</tr>
<tr>
<td>- Financing, insurance, real estate, business services</td>
<td>11.96</td>
</tr>
<tr>
<td>- Community, social, and personal services</td>
<td>21.88</td>
</tr>
<tr>
<td>- Ownership of premises</td>
<td>13.31</td>
</tr>
<tr>
<td>Less: adjustment for financial intermediation services indirectly measured</td>
<td>7.72</td>
</tr>
</tbody>
</table>

Source: Hong Kong Government Census and Statistics Department.

Hong Kong is one of the most trade-dependent economies in the world. In 2001, Hong Kong’s total trade equalled 238 percent of its GDP. The vast majority of Hong Kong’s trade involves re-export trade with China. In recent years, Hong Kong’s re-exports have been in the range of seven to 10.5 times its domestic exports (see Table 2.4). Most of this trade involves manufactured goods that are imported into Hong Kong from the Chinese Mainland and then re-exported, or industrial inputs imported into Hong Kong and then re-exported to factories in the Chinese Mainland. Hong Kong’s leading manufactured goods are mostly produced for export. In 2000, these included electronics and electrical goods, garments, machinery, toys and games, footwear, watches and clocks, travel goods and handbags, and plastic articles.

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4 Hong Kong Trade Development Council, *Economic and Trade Information on Hong Kong, November 2002.*
5 Hong Kong Trade Development Council, *Hong Kong’s External Trade Performance - Statistical Highlight*
### Table 2.4 Hong Kong’s Trade Performance, 2000 - 2002, US$ billion

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>January- May 2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total exports</td>
<td>201.6</td>
<td>189.9</td>
<td>73.7</td>
</tr>
<tr>
<td>- Domestic exports</td>
<td>23.2</td>
<td>19.7</td>
<td>6.4</td>
</tr>
<tr>
<td>- Re-exports</td>
<td>178.4</td>
<td>170.2</td>
<td>67.3</td>
</tr>
<tr>
<td>Imports</td>
<td>212.6</td>
<td>201.1</td>
<td>77.4</td>
</tr>
<tr>
<td>Total trade</td>
<td>414.2</td>
<td>390.9</td>
<td>151.3</td>
</tr>
<tr>
<td>Trade balance</td>
<td>-10.9</td>
<td>-11.2</td>
<td>-4.0</td>
</tr>
</tbody>
</table>

Source: Hong Kong Trade Development Council, *Economic and Trade Information on Hong Kong, November 2002*.

### Market

Hong Kong is a sizeable market in its own right. Hong Kong’s per capita income of US$24,383 in 2001 exceeded that of all but a few countries. Hong Kong has been known as a relatively sophisticated market, and as a relatively large market for luxury goods and other consumer products. In 2001, Hong Kong, with a population of 6.7 million people, had a GDP that was substantially larger than that of Guangdong Province, which had a population in excess of 86 million people. Per capita income in Hong Kong was more than ten times that of Guangdong Province. Hong Kong also has had a history as a substantial market in a variety of industries. In the mid-1990s, for example, when the Hong Kong International Airport and related projects were underway, Hong Kong had more major infrastructure construction in process than most large countries. Hong Kong’s position as a trade and transportation centre makes it a very large market for goods and services related to these industries. Hong Kong’s position as a major financial centre also makes its markets for financial services and related items substantially larger than one might expect given its small population.

### Economic decision making in Hong Kong

The most salient feature of Hong Kong’s economy is its traditional market orientation. Hong Kong has repeatedly topped lists of the world’s freest economies put together by organisations such as the Heritage Foundation and Canada’s Fraser Institute. Hong Kong has prided itself on its low tax rates, light-handed regulation and entrepreneurial culture. In addition, many of the activities typically taken on by governments in other jurisdictions, such as container ports and tunnels, are taken on by the private sector in Hong Kong. Hong Kong’s system, in which government generally acts as a neutral party that sets and enforces rules of the economic game comparable with those in many other advanced economies,
Economic Development of Hong Kong and the Pearl River Delta Region

Economic Development of Hong Kong and the Pearl River Delta Region has been one of its critical strengths. For most types of economic decisions, Hong Kong relies on private actors operating within a framework set by government policy.

Policy making in Hong Kong can be rather messy and accountability for policy successes and failures is difficult to assess. According to Hong Kong’s Basic Law, most governmental power lies in the office of the Chief Executive. This mirrored the situation in the British colonial administration in which the Governor exercised executive and administrative authority. Historically, the Governor was to be supported by a politically neutral civil service, which over the years had taken on a major role in generating policy options and deciding policy issues. As of July 1, 1997, Hong Kong’s Chief Executive was at the top of a similar system. This system proved cumbersome after 1997 and was replaced in July 2002 by a ministerial system in which ministers, appointed by the Chief Executive, are supposed to share responsibility with the Chief Executive for decisions and are to be responsible for particular portfolios. The goal of this system is to create a more politically aligned decision making body and to separate policy decisions from implementation. Although Hong Kong’s Legislative Council has certain powers in economic affairs, such as the right to approve or disapprove the government’s budget, in reality its lack of power means that it tends only to react to initiatives from the government or from the general public.

One shortcoming of the system is the lack of sufficient analytical firepower to support the decisions of the Chief Executive and the ministers. As a result, the civil service policy bureau and departments retain substantial power to shape governmental options and agendas. One mechanism for dealing with this shortcoming that has developed over the years is a series of advisory committees and commissions, mostly staffed with people from the private sector and other groups on a pro-bono basis with government officials participating in an ex-officio manner. While such bodies are useful to gain input and opinions from selected members of the general public, they are less useful in providing independent, creative, analytical work. In order to meet this shortfall, the Hong Kong government makes extensive use of consultants, both from Hong Kong and abroad.

Once policies are generated in Hong Kong, there often is a lengthy consultation process in which the government solicits views from members of the public on specific initiatives. The tradition of consultation was initiated by the colonial administration as a means of vetting initiatives that were generated by a non-representative government. The process has evolved into one that tries to take various views into account and to build acquiescence, if not support, for government initiatives. While this process can be effective in obtaining
views and opinions, it can also be used by special interests to try to obstruct, delay or change proposed actions.

Hong Kong’s complex decision making process can result in decisions being drawn out as special interests either are accommodated or attempts are made to use political influence to delay or reverse unpopular decisions. For instance, the Hong Kong government delayed the institution of a pension programme for years due to opposition from business interests. Hong Kong’s environment still suffers from years of delay in developing and implementing measures for environmental protection. Several years after the decision to abolish the minimum commissions in Hong Kong was made, minimum commissions for the stock market remain in place, despite the fact that they were abolished 16 years ago in the United Kingdom. Once decisions are made, bureaucratic inertia can make it difficult to change tack, even when circumstances change. This is particularly true in infrastructure planning and land usage, where it can take years for changes to be made, and where numerous departments and bureaus can be involved in a single decision. In some cases, it appears to outsiders that several departments can prevent something from happening, but few can make things happen.

Hong Kong’s complex decision-making process has caused some frustration in its relations with jurisdictions in the Pearl River Delta region. Twenty-four hour border crossing, a potential land link between Hong Kong and the western portion of the Pearl River Delta region, and other administrative and infrastructural matters are areas in which officials in Pearl River Delta jurisdictions have been frustrated by slow decision making in Hong Kong. Another source of frustration for Pearl River Delta region officials has been the fact that the emphasis on private sector decision making in Hong Kong means that the Hong Kong government cannot commit local companies and does not even have the ability to bring the “Hong Kong private sector” to the table in the same way that Pearl River Delta region jurisdictions can.

**The Economic Development of the Pearl River Delta Region**

The Pearl River Delta region of the People’s Republic of China has been perhaps China’s most economically dynamic region since the onset of China’s reform programme in 1979. Since then, the region has become a leader in terms of development, exports, and attracting foreign investment. It also has served as a test bed for China’s reform programme and has provided numerous lessons for other jurisdictions in China.
Historical development

The development of the Pearl River Delta region, and Guangdong Province as a whole, took a marked turn with the onset of China’s economic opening and reform programme. Guangdong Province was largely an economic backwater in the years 1949 to 1979. It was with China’s economic opening and reform starting in 1979 that the province in general, and the Pearl River Delta region in particular, gained national prominence. Today, the region is one of the most dynamic in all of the Chinese Mainland.

Economic backwater

Before the onset of China’s economic reform programme, the Pearl River Delta region, and Guangdong Province as a whole, was not very important in China’s overall economy. Guangdong’s geographic position as a peripheral province on the southern coast meant that it was far from China’s industrial heartland. Guangdong’s lack of natural resources limited the ability of the province to contribute to the development of heavy industries, which were the focal points of China’s five-year plans in the 1950s, 1960s, and 1970s. The lack of convenient transportation links with the rest of China also hindered Guangdong’s development, as did an emphasis on development of industrial facilities in the interior of China. All of these compounded Guangdong’s historical position as something of an agricultural backwater.

As Table 2.5 indicates, Guangdong’s population in 1978 was 5.3 percent of that of the People’s Republic of China. Its percentage of GDP and GDP in primary, secondary, and tertiary industries was also around five percent. Guangdong lagged behind in terms of gross industrial output, capital construction, and investments in innovation. On the other hand, its share of agricultural output and retail sales exceeded its share of population. The most outstanding feature of the Guangdong economy was its relatively high share (7.7 percent) of China’s trade. Much of this was due to Guangdong’s proximity to Hong Kong and the fact that the province exported agricultural produce to Hong Kong.
Table 2.5  Major Indicators of Guangdong’s Economic Development in 1978

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Guangdong</th>
<th>National total</th>
<th>Proportion of Guangdong in the PRC (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population (million persons)</td>
<td>50.64</td>
<td>962.59</td>
<td>5.3</td>
</tr>
<tr>
<td>Employment (million persons)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Employment</td>
<td>22.76</td>
<td>401.52</td>
<td>5.7</td>
</tr>
<tr>
<td>- Staff and workers</td>
<td>5.16</td>
<td>94.99</td>
<td>5.4</td>
</tr>
<tr>
<td>National accounting at current prices (RMB billion)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Gross domestic product</td>
<td>18.59</td>
<td>362.41</td>
<td>5.1</td>
</tr>
<tr>
<td>- Primary industry</td>
<td>5.53</td>
<td>101.84</td>
<td>5.4</td>
</tr>
<tr>
<td>- Secondary industry</td>
<td>8.66</td>
<td>174.52</td>
<td>5.0</td>
</tr>
<tr>
<td>- Tertiary industry</td>
<td>4.39</td>
<td>86.05</td>
<td>5.1</td>
</tr>
<tr>
<td>Investment in fixed assets (RMB billion)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Capital construction</td>
<td>1.79</td>
<td>50.10</td>
<td>3.6</td>
</tr>
<tr>
<td>- Investment in innovation</td>
<td>0.22</td>
<td>16.77</td>
<td>1.3</td>
</tr>
<tr>
<td>Government revenue (RMB billion)</td>
<td>3.95</td>
<td>95.65</td>
<td>4.1</td>
</tr>
<tr>
<td>Government expenditures (RMB billion)</td>
<td>2.703</td>
<td>59.00</td>
<td>4.6</td>
</tr>
<tr>
<td>Gross output value of agriculture at current price (RMB billion)</td>
<td>8.59</td>
<td>139.70</td>
<td>6.1</td>
</tr>
<tr>
<td>Gross output value of industry at current price (RMB billion)</td>
<td>20.03</td>
<td>423.70</td>
<td>4.7</td>
</tr>
<tr>
<td>Total retail sales of consumer goods (US$ billion)</td>
<td>7.72</td>
<td>126.49</td>
<td>6.1</td>
</tr>
<tr>
<td>Total value of imports and exports (US$ billion)</td>
<td>1.59</td>
<td>20.64</td>
<td>7.7</td>
</tr>
</tbody>
</table>

China’s economic reform programme placed Guangdong Province in the vanguard of reform. Guangdong was chosen for special treatment due to its proximity to Hong Kong and Macao, its distance from the heartland of the Chinese Mainland, and the fact that it was lagging behind other provinces in the Chinese Mainland in economic terms. In 1979, the Central Government announced that Guangdong and Fujian provinces would be allowed to follow less restrictive economic policies and would be allowed to create Special Economic Zones (SEZs) in Shenzhen, Zhuhai, Shantou, and Xiamen. The Special Economic Zones were formalised in a set of regulations promulgated in 1980. The Shenzhen SEZ comprised an area of 327.5 square kilometres just north of Hong Kong. The Zhuhai SEZ, initially only 6.81 square kilometres adjacent to Macao, was eventually expanded to 121 square kilometres. Preferential policies in the SEZs included a 15 percent corporate tax rate, tax holidays of up to five years, the ability to repatriate corporate profits, the ability to repatriate capital investments after a contracted period, duty-free imports on raw materials and intermediate goods destined for exported products, no export taxes, and a limited ability to sell into the domestic market.

The SEZs also were given greater political and economic autonomy than other jurisdictions in the Chinese Mainland. The main areas of greater autonomy were finance and fiscal matters, foreign trade and investment, commerce and distribution, allocation of materials and resources, the labour system, and prices. Guangdong was allowed to keep a larger share of its output and foreign exchange than other provinces and it was required to be self-sufficient in terms of capital investment. The province was given greater control over economic planning, approval of foreign investments and foreign trade. Guangdong also took over control of several state-owned enterprises located in the province. After Deng Xiaoping’s southern tour of 1984, Guangzhou, along with 13 other coastal cities, was given greater autonomy in foreign trade and investment. In 1988, Guangdong asked for, and received, expanded powers to set its own economic direction and the designation as a “comprehensive economic reform area.” Included in these policies were the privatisation of some housing, the development of a land lease system, the creation of the Guangdong Development Bank, and the creation of the Shenzhen Stock Exchange. A second southern tour by Deng Xiaoping in 1992 reaffirmed Guangdong’s role as a leader in China’s economic reform process. Deng suggested that the province accelerate its reforms in order to catch up with other developing Asian economies.

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The local governments in Guangdong took advantage of their greater autonomy to run a number of experiments that were eventually repeated elsewhere. Control over trade was devolved to local levels, control over land was devolved to local communities or households, prices were freed, toll roads were built, and bonds issued. By allowing foreign banks to operate, Shenzhen became a leader in terms of foreign exchange markets. Shenzhen also took the lead in terms of land reform and stock market development. Entrepreneurial local governments have been credited with accelerating this reform process in the Pearl River Delta region.

Despite the overall direction of reform, the process has been anything but smooth. There have been several cycles of reform and retrenchment in the Pearl River Delta region since 1979, mostly due to local abuses and changes in national government policy. Gradually, preferential policies have spread to other parts of the Chinese Mainland, reducing Guangdong’s policy advantages. However, Guangdong’s early experience with reform has allowed a market-oriented culture to develop earlier than in other places in the Chinese Mainland and has allowed the province to develop a variety of mechanisms to deal with greater opportunity and greater competition.

**Economic development**

The economic development of Guangdong Province took off after the reform programme was instituted. Most of this development took place in the Pearl River Delta region, the area immediately north of Hong Kong and Macao and surrounding the Pearl River. From 1979 to 1984, the industrial development of the Pearl River Delta region was mainly geared toward the domestic market. Years of a command economy had left enormous pent up demand for a wide range of consumer products, particularly for light-manufactured goods. Much of the development in the region took place in Guangzhou and in nearby areas, such as Foshan, Nanhai, and Shunde. In the latter part of the 1980s, there was substantial growth in the production of home appliances. Export processing began to develop in the late 1970s in the eastern part of the Pearl River Delta region and accelerated substantially in the late 1980s when the Chinese Government relaxed restrictions on foreign direct investment. The eastern part of the Delta soon became a manufacturing powerhouse, which became largely responsible for China’s emergence on export markets.

The GDP of the Pearl River Delta region grew from just under RMB 12 billion in 1980 to over RMB 836 billion in the year 2001 (see Table 2.6 for a summary of the major economic indicators of the Pearl River Delta). During that period, the average real rate of GDP growth in the Pearl River Delta region was 16.2 percent per year, well above that of Guangdong Province (13.5 percent), and the People’s Republic of China as a whole (9.6 percent). In 1980, the Pearl River Delta region accounted for 47.7 percent of Guangdong’s
GDP and 2.6 percent of the Chinese Mainland’s GDP. By 2001, the Pearl River Delta region accounted for 78.6 percent of Guangdong’s GDP and 8.7 percent of the Chinese Mainland’s GDP. In 1980, the Pearl River Delta region accounted for 3.4 percent of the Chinese Mainland’s exports and 3.3 percent of realised inward investment. In 2001, the Pearl River Delta region accounted for 34.1 percent of the Chinese Mainland’s exports and 28.6 percent of the realised foreign direct investment in the Mainland, despite having only 3.3 percent of the Mainland’s population (See Table 2.7). Over the entire period from 1980 to 2001, the Pearl River Delta region was the fastest growing portion of the fastest growing province in the fastest growing large economy in the world.

Table 2.6  Pearl River Delta Region Major Economic Indicators (at current prices)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Registered Population (million persons)</td>
<td>16.27</td>
<td>17.57</td>
<td>19.28</td>
<td>21.38</td>
<td>23.07</td>
<td>23.37</td>
</tr>
<tr>
<td>Gross domestic product (RMB billion)</td>
<td>11.92</td>
<td>30.39</td>
<td>87.22</td>
<td>389.97</td>
<td>737.86</td>
<td>836.39</td>
</tr>
<tr>
<td>Primary industry (RMB billion)</td>
<td>3.07</td>
<td>5.73</td>
<td>12.94</td>
<td>31.49</td>
<td>42.85</td>
<td>44.52</td>
</tr>
<tr>
<td>Secondary industry (RMB billion)</td>
<td>5.40</td>
<td>14.87</td>
<td>40.46</td>
<td>195.71</td>
<td>365.73</td>
<td>413.90</td>
</tr>
<tr>
<td>Tertiary industry (RMB billion)</td>
<td>3.45</td>
<td>9.79</td>
<td>33.82</td>
<td>162.77</td>
<td>329.29</td>
<td>377.98</td>
</tr>
<tr>
<td>Total amount of investment in fixed assets (RMB billion)</td>
<td>1.66</td>
<td>12.84</td>
<td>23.14</td>
<td>149.10</td>
<td>229.16</td>
<td>256.68</td>
</tr>
<tr>
<td>Total amount of retail sales of consumer goods (RMB billion)</td>
<td>7.07</td>
<td>19.80</td>
<td>44.57</td>
<td>154.47</td>
<td>278.14</td>
<td>312.01</td>
</tr>
<tr>
<td>Total amount of exports (US$ billion)</td>
<td>0.62</td>
<td>1.63</td>
<td>8.14</td>
<td>46.11</td>
<td>84.74</td>
<td>90.83</td>
</tr>
<tr>
<td>Amount of foreign capital actually utilised (US$ billion)</td>
<td>0.10</td>
<td>0.74</td>
<td>1.54</td>
<td>8.58</td>
<td>12.54</td>
<td>14.19</td>
</tr>
<tr>
<td>Government revenue (RMB billion)</td>
<td>2.34</td>
<td>4.99</td>
<td>9.59</td>
<td>31.53</td>
<td>59.91</td>
<td>74.57</td>
</tr>
<tr>
<td>Government expenditure (RMB billion)</td>
<td>0.82</td>
<td>2.61</td>
<td>7.64</td>
<td>31.66</td>
<td>68.54</td>
<td>82.27</td>
</tr>
<tr>
<td>Savings deposits by urban and rural residents at year-end (RMB billion)</td>
<td>2.10</td>
<td>11.20</td>
<td>55.27</td>
<td>281.04</td>
<td>664.10</td>
<td>767.06</td>
</tr>
</tbody>
</table>

Table 2.7 The Relative Importance of the Pearl River Delta Region in Guangdong Province and in the PRC, 1980 - 2000

<table>
<thead>
<tr>
<th>Year</th>
<th>PRD Proportion of the Guangdong total (%)</th>
<th>PRD Proportion of the PRC total (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>GDP</td>
<td>Exports</td>
</tr>
<tr>
<td>1980</td>
<td>47.7</td>
<td>28.4*</td>
</tr>
<tr>
<td>1985</td>
<td>52.6</td>
<td>55.2*</td>
</tr>
<tr>
<td>1990</td>
<td>55.9</td>
<td>76.7*</td>
</tr>
<tr>
<td>1995</td>
<td>68.0</td>
<td>81.5</td>
</tr>
<tr>
<td>2000</td>
<td>76.4</td>
<td>92.2</td>
</tr>
<tr>
<td>2001</td>
<td>78.6</td>
<td>95.2</td>
</tr>
</tbody>
</table>


Composition of economy

The composition of the Pearl River Delta region’s economy has changed substantially since the onset of China’s reform programme. In 1978, the relative proportions of agriculture, industry, and services in the Pearl River Delta region economy were 30 percent, 47 percent, and 23 percent. By 2000, the figures were six percent, 50 percent, and 45 percent, respectively. Ownership also has been evolving. In 1978, state-operated and collective enterprises respectively accounted for 64 percent and 36 percent of the total gross industrial output in the region. By 1991, state-operated enterprises and collective enterprises accounted for 31 percent and 33 percent of Pearl River Delta region enterprises. By 2000, the figures were seven percent and ten percent for wholly owned state and collective enterprises, though enterprises with some kind of state-owned or state-controlled shareholding amounted to 23 percent of the region’s enterprises. Firms with investments from Hong Kong, Macao, and Taiwan ranked first in importance in the region followed by those with investments from non-Chinese locations.7

After 2000, the development of privately owned enterprises has been even faster. Privately owned enterprises have become the major force behind economic growth. As Jiang Zemin proposed in his “Three Representatives” (a guiding policy whereby the Communist Party...
should represent advanced production systems, advanced culture, and the best interests of the people of China), the development environment for privately owned enterprises has been greatly relaxed. Many enterprises, which once were listed as collectives, have been revealing their privately owned status, especially in the Pearl River Delta region. In this regard Shenzhen, Dongguan, Nanhai, and other portions of the region have been at the forefront in China. It is foreseeable that privately owned enterprises will play an even more important role in the economy of the Pearl River Delta region in future.

The composition of trade of the Pearl River Delta region has also changed substantially over time. In 1980, for example, agricultural products accounted for nearly 40 percent of the region’s exports. Manufactured goods, mainly low value-added textile, garment, and other light-industrial products, accounted for some 60 percent. By 1999, manufactured goods accounted for 96.1 percent of the Pearl River Delta region’s exports, and primary goods only around four percent. Electronics, electrical goods, and machinery accounted for 49.7 percent of total exports. Nearly half of this portion consisted of electrical equipment and machinery, television sets, and audio-visual apparatus. The aggregate composition of the Pearl River Delta region’s imports remained roughly similar over the period. Primary goods accounted for 8.5 percent of imports in 1990 and 10.3 percent of imports in 1999. Manufactured goods accounted for 91.5 percent of the region’s imports in 1990 and 89.7 percent of its imports in 1999.\(^8\)

\(^8\) The Centre for Urban and Regional Studies, Zhongshan University, “Zhujiang sanjiao zhou fazhan licheng yanjiu” (“A Study of the Development Trajectory of the Pearl River Delta,” August 30, 2001) in Xianggang yu Zhujiang sanjiao jingji hudong yanjiu (Hong Kong and the Pearl River Delta: a study of their economic interactions), 2002, p. 36.

**Market**

As one of the most dynamic economic regions in the Chinese Mainland, the Pearl River Delta region is increasingly important as a market. The region is clearly important as an industrial market for all sorts of inputs, materials, and capital goods. It also is a major market for transportation and trade-related services. Rapid urbanisation in the Pearl River Delta region has created demand for infrastructure, building materials, transportation services, housing, and other goods and services associated with urban development.

Increasingly, the region is becoming an attractive consumer market as well. According to the 2000 National Census, the Pearl River Delta Economic Zone had a population of 40.8 million people. This contrasts with the official registered population of 23.1 million that is usually cited for the region. As a result of this difference, actual per capita income (using the Census figures) for the region was RMB 18,098 (US$2,186) as opposed to the “official” figure of RMB 31,983 (US$3,863). Regardless of the figure used, per capita income has
been growing substantially in recent years, as have consumer expenditures. A survey by the Guangdong Provincial Statistical Bureau shows that residents in eight cities in the Pearl River Delta region (Shenzhen, Dongguan, Zhuhai, Shunde, Guangzhou, Foshan, Zhongshan, and Huizhou) are at the stage of “relatively comfortable living standards.” Average per capita consumption expenditures surpassed RMB 10,000 in seven cities in 2001 (see Table 2.8). In one measure of consumption, the number of registered cars per 100 households is Dongguan (20), Shunde (14), Shenzhen (13), and Zhongshan (10).  

### Table 2.8 Living Standards of Local Residents in Major Cities of the Pearl River Delta, 2001, RMB

<table>
<thead>
<tr>
<th>City</th>
<th>Disposable income</th>
<th>Annual consumption per capita</th>
<th>Food consumption expenditure / total consumption expenditure (%)</th>
<th>Annual accommodation expenses (including rent, and utilities)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shenzhen</td>
<td>23,544</td>
<td>17,809</td>
<td>27.1</td>
<td>2,335</td>
</tr>
<tr>
<td>Dongguan</td>
<td>16,938</td>
<td>14,669</td>
<td>31.2</td>
<td>1,173</td>
</tr>
<tr>
<td>Zhuhai</td>
<td>15,870</td>
<td>11,562</td>
<td>37.1</td>
<td>1,823</td>
</tr>
<tr>
<td>Guangzhou</td>
<td>14,694</td>
<td>11,467</td>
<td>40.0</td>
<td>1,540</td>
</tr>
<tr>
<td>Foshan</td>
<td>13,600</td>
<td>10,327</td>
<td>34.5</td>
<td>1,191</td>
</tr>
<tr>
<td>Zhongshan</td>
<td>12,803</td>
<td>10,626</td>
<td>39.6</td>
<td>1,082</td>
</tr>
<tr>
<td>Huizhou</td>
<td>10,551</td>
<td>8,878</td>
<td>37.3</td>
<td>1,175</td>
</tr>
</tbody>
</table>

Note: The bold figures provide data for the urban area instead of the whole city. For Dongguan, Zhuhai, Foshan, Zhongshan, and Huizhou in the respective surveys of household living conditions, they report urban and rural areas separately. No average of the whole city is available in the respective statistical yearbooks.


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9 *Ming Pao,* “Zhu sanjiao ba shi bi bing Shenzhen zui fu” (A Comparison of eight cities in the Pearl River Delta: Shenzhen is the richest”), April 18, 2002.
Jurisdictions in the Pearl River Delta region

Since 1979, there have been tremendous advances in the economy of the Pearl River Delta region. Different parts of the region, however, have emerged as leaders in different categories of economic activity as can be seen in Tables 2.9 and 2.10.

Table 2.9  Selected Economic Statistics, Pearl River Delta Region Cities, 2001

<table>
<thead>
<tr>
<th>City</th>
<th>Census population 2000 (000)</th>
<th>GDP (RMB billion)</th>
<th>GDP in industry (RMB billion)</th>
<th>GDP in services (RMB billion)</th>
<th>Retail sales (RMB billion)</th>
<th>Utilised FDI (US$ million)</th>
<th>Exports (US$ billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guangzhou</td>
<td>9,943</td>
<td>268.6</td>
<td>97.0</td>
<td>146.3</td>
<td>124.4</td>
<td>3,001</td>
<td>11.6</td>
</tr>
<tr>
<td>Shenzhen</td>
<td>7,008</td>
<td>195.5</td>
<td>90.5</td>
<td>88.1</td>
<td>60.9</td>
<td>2,591</td>
<td>37.5</td>
</tr>
<tr>
<td>Zhuhai</td>
<td>1,236</td>
<td>36.7</td>
<td>17.3</td>
<td>14.9</td>
<td>12.8</td>
<td>865</td>
<td>3.8</td>
</tr>
<tr>
<td>Huizhou</td>
<td>3,216</td>
<td>48.0</td>
<td>25.9</td>
<td>13.4</td>
<td>14.5</td>
<td>96</td>
<td>4.9</td>
</tr>
<tr>
<td>Dongguan</td>
<td>6,446</td>
<td>57.9</td>
<td>29.5</td>
<td>23.2</td>
<td>19.6</td>
<td>1,147</td>
<td>19.0</td>
</tr>
<tr>
<td>Zhongshan</td>
<td>2,364</td>
<td>36.3</td>
<td>19.0</td>
<td>13.1</td>
<td>12.0</td>
<td>643</td>
<td>4.4</td>
</tr>
<tr>
<td>Jiangmen</td>
<td>3,950</td>
<td>61.5</td>
<td>28.5</td>
<td>25.4</td>
<td>22.3</td>
<td>827</td>
<td>2.6</td>
</tr>
<tr>
<td>Foshan</td>
<td>5,338</td>
<td>106.8</td>
<td>53.8</td>
<td>43.4</td>
<td>37.5</td>
<td>99</td>
<td>6.4</td>
</tr>
<tr>
<td>Shunde</td>
<td>NA</td>
<td>39.2</td>
<td>20.7</td>
<td>15.5</td>
<td>6.5</td>
<td>280</td>
<td>2.1</td>
</tr>
<tr>
<td>Zhaoqing</td>
<td>3,371</td>
<td>41.1</td>
<td>13.3</td>
<td>14.6</td>
<td>14.0</td>
<td>471</td>
<td>0.8</td>
</tr>
</tbody>
</table>


Table 2.10  Gross Industrial Output, Selected Industries, Pearl River Delta Region Cities, 2001, RMB billion

<table>
<thead>
<tr>
<th>City</th>
<th>Textiles</th>
<th>Garments</th>
<th>Chemicals</th>
<th>Plastic products</th>
<th>Iron / steel</th>
<th>Transport equipment</th>
<th>Electrical / machinery</th>
<th>Electronics / telecom equipment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guangzhou</td>
<td>8,969</td>
<td>13,838</td>
<td>30,293</td>
<td>9,654</td>
<td>9,127</td>
<td>34,026</td>
<td>20,023</td>
<td>20,693</td>
</tr>
<tr>
<td>Shenzhen</td>
<td>4,366</td>
<td>4,218</td>
<td>5,077</td>
<td>10,055</td>
<td>1,510</td>
<td>4,050</td>
<td>18,681</td>
<td>157,357</td>
</tr>
<tr>
<td>Zhuhai</td>
<td>2,016</td>
<td>3,250</td>
<td>2,421</td>
<td>2,313</td>
<td>73</td>
<td>997</td>
<td>12,986</td>
<td>12,874</td>
</tr>
<tr>
<td>Huizhou</td>
<td>8,435</td>
<td>6,244</td>
<td>4,596</td>
<td>9,714</td>
<td>601</td>
<td>3,949</td>
<td>47,475</td>
<td>14,346</td>
</tr>
<tr>
<td>Dongguan</td>
<td>1,308</td>
<td>2,004</td>
<td>1,263</td>
<td>3,765</td>
<td>673</td>
<td>2,475</td>
<td>5,860</td>
<td>41,174</td>
</tr>
<tr>
<td>Zhongshan</td>
<td>3,197</td>
<td>2,705</td>
<td>2,602</td>
<td>768</td>
<td>87</td>
<td>939</td>
<td>722</td>
<td>5,597</td>
</tr>
<tr>
<td>Jiangmen</td>
<td>7,924</td>
<td>6,666</td>
<td>6,808</td>
<td>3,488</td>
<td>1,239</td>
<td>4,348</td>
<td>11,342</td>
<td>5,781</td>
</tr>
<tr>
<td>Foshan</td>
<td>8,411</td>
<td>4,223</td>
<td>3,157</td>
<td>4,460</td>
<td>258</td>
<td>664</td>
<td>7,480</td>
<td>35,059</td>
</tr>
<tr>
<td>Zhaoqing</td>
<td>3,469</td>
<td>5,203</td>
<td>3,812</td>
<td>5,214</td>
<td>522</td>
<td>439</td>
<td>8,289</td>
<td>11,632</td>
</tr>
<tr>
<td>Guangdong Province</td>
<td>58,299</td>
<td>60,220</td>
<td>67,811</td>
<td>56,483</td>
<td>19,898</td>
<td>54,461</td>
<td>138,637</td>
<td>310,991</td>
</tr>
</tbody>
</table>

Guangzhou

Guangzhou, located at the apex of the Pearl River Delta, is the capital of Guangdong Province, as well as the political and economic centre of the Pearl River Delta region. In the period from 1949 to 1979, Guangzhou was easily the leading city in Guangdong Province. Guangzhou, and nearby Foshan and Nanhai, were home to much of the manufacturing that existed in the province. The most significant function that Guangzhou played for the entire People's Republic of China was related to the “Chinese Export Commodities Fair,” also known as the “Canton Fair,” which was held in Guangzhou. In the decades following 1949, this trade fair was the only real link between China’s economy and that of the rest of the world. Guangzhou was chosen for this fair due to its proximity to Hong Kong, as well as its traditional role, dating back to the Qing Dynasty, as being China’s only officially sanctioned trading port.

In the years following China’s initial opening, Guangzhou and its immediate surroundings continued to play a leadership role in traditional industries, with much of the output geared toward the domestic market. However, the city began to fall behind Shenzhen in the 1980s, particularly in export-oriented manufacturing and development of the electronics sector. In the 1980s and 1990s, Guangzhou attracted substantial foreign investment from companies looking to serve the South China market. Companies like Honda, Procter and Gamble, Colgate Palmolive, and AIA are prominent investors. The city also saw a large influx in investment in the real estate sector, as new office complexes were built in the city centre and residential communities were developed on its outskirts. Today, Guangzhou has the largest population and the largest and most diversified economy of any city in the Pearl River Delta region. In addition to its manufacturing districts, Guangzhou is also the leading service centre in Guangdong Province for a range of services, including knowledge-intensive services like software, and is the leading domestic logistics and distribution centre in Southern China. A large number of infrastructure and industrial projects have been completed or set in motion in and around the city as well. Although its private sector is thriving, a larger percentage of the Guangzhou economy is state-owned than is the case in most other cities in the Pearl River Delta region. Overall, Guangzhou is ranked third among Mainland Chinese cities (behind Shanghai and Beijing) in terms of its overall economic strength. In the year 2001, Guangzhou led the cities of the Pearl River Delta region in population, GDP, GDP in industry, GDP in the tertiary sector, retail sales, and utilised foreign direct investment.

In many ways, Guangzhou has been trying to re-establish its leading economic position in the Greater Pearl River Delta region. Guangzhou officials believe that historical
circumstances allowed first Hong Kong and then Shenzhen to take away part of its leadership role. In recent years, substantial provincial and city funds have been invested in Guangzhou, resulting in large infrastructure projects, as well as completely new developments in Nansha and elsewhere around the city. The successful Ninth National Games held in Guangzhou in the autumn of 2001, further strengthened Guangzhou’s position as the leading city in the Pearl River Delta region and a leading city in China. Investments in port facilities, a new airport, completely new urban districts, and new industrial and science parks are being made in an attempt to extend this position.

Shenzhen

Shenzhen, the jurisdiction just north of Hong Kong, was designated as a Special Economic Zone in 1979. This designation allowed Shenzhen to enjoy preferential policies and made it relatively independent of the Guangdong provincial government both politically and economically. Shenzhen emerged rapidly in the years following 1979. Its population went from 321,000 in 1980 to more than seven million in 2000. Most of the newcomers were immigrants from other parts of China who came to work in Shenzhen’s burgeoning factories. As a result of immigration, the most common language spoken in Shenzhen is Mandarin (not Cantonese), its residents have the highest average educational achievement in the Chinese Mainland, and the portion of the population below 14 years of age and above 65 years of age is far smaller than anywhere else Guangdong Province and in the Chinese Mainland, with the exception of Dongguan, which approaches similar demographics (see Table 2.11).
Table 2.11 Age Distribution of Populations Living in Major Cities in Guangdong
According to the Fifth National Census, 2000

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Total population (0000 persons)</th>
<th>Proportion of population aged 14 or below (%)</th>
<th>Proportion of population aged 65 or over (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guangdong Province</td>
<td>86,421.70</td>
<td>24.17</td>
<td>6.06</td>
</tr>
<tr>
<td>Guangzhou</td>
<td>9,943.00</td>
<td>16.44</td>
<td>6.02</td>
</tr>
<tr>
<td>Shenzhen</td>
<td>7,008.40</td>
<td>8.5</td>
<td>1.11</td>
</tr>
<tr>
<td>Dongguan</td>
<td>6,445.70</td>
<td>8.68</td>
<td>2.0</td>
</tr>
<tr>
<td>Zhanjiang</td>
<td>6,072.90</td>
<td>34.72</td>
<td>6.98</td>
</tr>
<tr>
<td>Foshan</td>
<td>5,337.90</td>
<td>16.4</td>
<td>4.85</td>
</tr>
<tr>
<td>Maoming</td>
<td>5,239.70</td>
<td>36.26</td>
<td>7.44</td>
</tr>
<tr>
<td>Jieyang</td>
<td>5,237.40</td>
<td>34.11</td>
<td>6.5</td>
</tr>
<tr>
<td>Shantou</td>
<td>4,671.10</td>
<td>31.18</td>
<td>6.55</td>
</tr>
<tr>
<td>Jiangmen</td>
<td>3,950.30</td>
<td>22.6</td>
<td>8.52</td>
</tr>
<tr>
<td>Meizhou</td>
<td>3,802.00</td>
<td>30.86</td>
<td>9.11</td>
</tr>
<tr>
<td>Zhaoqing</td>
<td>3,371.40</td>
<td>29.59</td>
<td>7.67</td>
</tr>
<tr>
<td>Huizhou</td>
<td>3,216.30</td>
<td>23.13</td>
<td>6.1</td>
</tr>
<tr>
<td>Qingyuan</td>
<td>3,147.70</td>
<td>30.36</td>
<td>8.24</td>
</tr>
<tr>
<td>Shaoguan</td>
<td>2,735.10</td>
<td>25.75</td>
<td>7.37</td>
</tr>
<tr>
<td>Shanwei</td>
<td>2,453.10</td>
<td>37.72</td>
<td>5.87</td>
</tr>
<tr>
<td>Chaozhou</td>
<td>2,402.20</td>
<td>27.02</td>
<td>7.79</td>
</tr>
<tr>
<td>Zhongshan</td>
<td>2,363.50</td>
<td>16.15</td>
<td>4.54</td>
</tr>
<tr>
<td>Heyuan</td>
<td>2,265.20</td>
<td>32.19</td>
<td>8.66</td>
</tr>
<tr>
<td>Yangjiang</td>
<td>2,170.40</td>
<td>28.23</td>
<td>8.43</td>
</tr>
<tr>
<td>Yunfu</td>
<td>2,152.90</td>
<td>32.43</td>
<td>8.1</td>
</tr>
<tr>
<td>Zhuhai</td>
<td>1,235.60</td>
<td>17.38</td>
<td>3.92</td>
</tr>
</tbody>
</table>


In the 1980s, a large number of foreign-invested export processing enterprises were attracted to Shenzhen. In fact over the reform period, Shenzhen has had the highest cumulative utilised foreign direct investment among Pearl River Delta region cities. Leading investors by 2001 included IBM, Epson, Samsung, and Wal-mart. The initial investments were mostly in traditional industries, such as garments, textiles, footwear, plastic products, and other labour-intensive industries. However, due to rising land and labour costs after 1990, Shenzhen began to put great emphasis on developing what it called its “hi-tech” industries, mostly the relatively simple assembly manufacturing of electronics products. From 1992 to 2000, Shenzhen’s output in such “hi-tech” industries grew at an annual rate of 53.2
percent per year, reaching almost RMB 106.5 billion, or 42.3 percent of Shenzhen’s total industrial output value. In 1999, Shenzhen hosted China’s first Hi-Tech Fair, China’s leading exhibition of electronics and related products. Shenzhen’s technology-based investment initially came from Hong Kong, Taiwan, Japan, Europe, and the United States. Over time, these companies have moved more and more sophisticated activities into Shenzhen. In addition, in recent years, local companies, such as Huawei Technologies and ZTE Corporation, have become some of the leading technology-based companies in China. Huawei Technologies, for example, a leading producer of telecommunications equipment, was established in 1988. By 2000, the company had sales of RMB 25.5 billion, research and development expenditures in excess of RMB 3 billion, and a staff of 22,000 (85 percent of whom were university graduates and 10,000 of whom were researchers). Huawei, whose major product lines included fixed networks, mobile network equipment, data communications, and optical networks, has set up over 40 sales offices and customer support centres worldwide as well as research centres in places including Silicon Valley, Bangalore, Stockholm, Moscow, Beijing, and Shanghai.

Shenzhen is the most export-oriented city in the Chinese Mainland and, in 2000, exported goods worth US$34.6 billion. In that year, Shenzhen was second to Guangzhou among cities in the Pearl River Delta region in most economic aggregates. Shenzhen also has emerged as a leading transportation and logistics centre. The port of Yantian has become one of the leading ports in the Chinese Mainland and numerous major companies have set up buying offices in the city. Shenzhen has one of the two major stock exchanges in the Chinese Mainland and has been a leader, along with Shanghai, in terms of opening in the financial sector.

**Dongguan**

Dongguan, just north of Shenzhen, has become the leading centre for export processing in labour-intensive, light-manufacturing industries in the Chinese Mainland. Since the early 1980s, Dongguan’s industrialisation has been dominated by foreign investment and exports. Utilised foreign investment in Dongguan increased from US$1.7 million in 1979 to US$1.5 billion in 1998. Over that time period, the total amount of foreign capital actually used in Dongguan was US$9.6 billion. In 1998, foreign-invested enterprises accounted for 77.5 percent of all industrial enterprises and 74.5 percent of total industrial output value in Dongguan. A study by the Dongguan government shows that, from 1978 to 1995, foreign capital actually used in Dongguan amounted to US$5.1 billion, of which 80 percent was

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10 Guangdong Statistical Yearbook, 2001, p.34
11 See [www.huawei.com](http://www.huawei.com)
12 Thomas Chan and Zhu Wen Hui, *Industrial Clusters and Regional Concentration, the Changes of Investment Behaviours of Taiwanese in the Chinese Mainland at the Turn of the Century*, China Business Centre, Hong Kong Polytechnic University, 2000.
from Hong Kong.\textsuperscript{13} Dongguan had a total export value of US$18.99 billion in 2001, which ranked third in the Chinese Mainland behind Shenzhen (US$37.48 billion) and Shanghai (US$27.63 billion).\textsuperscript{14}

In the early 1980s, Dongguan’s foreign-invested facilities (largely involving Hong Kong investment) were mainly engaged in labour-intensive processing industries such as textiles, clothing, and plastic products. As Shenzhen began to move up the technology ladder in the early 1990s, many facilities that focused on lower value-added activities moved to Dongguan. In the mid-1990s, traditional foreign-invested processing facilities in Dongguan were joined by newer facilities that focused on electronics, telecommunications equipment, electrical equipment, and machinery, largely involving Taiwanese and then Japanese investment. In 1998, electronic and telecommunications equipment accounted for 29.1 percent of Dongguan’s industrial output, while electrical equipment and machinery accounted for another 8.2 percent.\textsuperscript{15} Although Dongguan’s output in textiles, clothing, and plastic products industries continued to increase in absolute terms, they lost ground in relative terms. Even so, Dongguan and some parts of neighbouring Huizhou remain one of the world’s major production bases for labour-intensive products.

Since the mid-1990s, Dongguan has also become a base for operations selling to the Chinese domestic market. Dongguan’s Humen, for example, has developed into a national wholesale centre for garments and textiles. More importantly, Dongguan has become home to thousands of component and input suppliers for the city’s electronics industry. Taiwanese and local component firms in particular have become major component and input suppliers to the Dongguan-based facilities of Mainland Chinese, Taiwanese, Japanese, and North American computer and electronics companies. This has facilitated the development of dense clusters of electronics firms and industries in Dongguan in particular, and the Pearl River Delta region in general.

\textit{The Western Delta}

The western part of the Pearl River Delta region, encompassing areas such as Zhuhai, Zhongshan, Jiangmen, Foshan, Shunde, and Nanhai, has had a distinctly different economic profile than the eastern part of the region, which includes Shenzhen, Dongguan, and Huizhou. In the early days of China’s economic reform programme, the major driving force of industrial development in the Pearl River Delta region came from Guangzhou and areas on the western bank of the Pearl River such as Nanhai, Shunde, and Zhongshan.

\begin{thebibliography}{9}
\bibitem{14} Guangdong Statistical Yearbook, 2002.
\bibitem{15} Thomas Chan and Zhu Wen Hui, \textit{Industrial Clusters and Regional Concentration, the Changes of Investment Behaviours of Taiwanese in the Chinese Mainland at the Turn of the Century}, China Business Centre, Hong Kong Polytechnic University, 2000.
\end{thebibliography}
These areas, which benefitted from some pre-existing industrial development, focused on production for the Chinese domestic market. Factories in the western part of the Pearl River Delta region soon began selling products to meet growing demand in other provinces. The area took advantage of access to raw materials, equipment, parts, and product designs through Hong Kong, as well as preferential foreign exchange policies that allowed the import of needed equipment, inputs, and components. Collectively owned firms in the area were able to establish large-scale production lines for the import substitution of light-manufactured goods and home appliances. Shunde, for example, which did not have much of an industrial base before, became an important production site for a wide range of home appliances.

Starting in the mid-1980s, goods from the Pearl River Delta region, such as drinks, packaged foods, clothes, and appliances, began to penetrate Mainland Chinese markets. Retailers from as far away as Northeast China and Inner Mongolia would drive their cars to the Pearl River Delta region in order to buy goods in bulk. A study by the Guangdong Economic and Trade Commission in April 1997 found that 25.3 percent of the sales of Guangdong’s products were inside Guangdong Province, while 43 percent of the sales were to other provinces in the Chinese Mainland, and 31.7 percent were to other countries or regions.16 As other areas of the Chinese Mainland opened up, however, the growth of sales of Pearl River Delta-based facilities in other provinces slowed. As a result, in recent years, Western Pearl River Delta region jurisdictions such as Shunde and Nanhui have accelerated changes in the management and ownership structures of local firms, employing consultants and professionally trained staff, and privatising enterprises by listing them on the domestic stock exchanges. Zhongshan, on the other hand, had a higher proportion of state-owned firms, and reforms have been relatively slow.

In the late-1990s, the western part of the Pearl River began to participate actively in international markets. Shunde’s appliance manufacturers, such as Midea, Kelon, and Galanz, for example, have used their capabilities to seek out foreign customers. Shunde’s total exports rose by 69.5 percent between 1999 and 2001. Zhuhai and Foshan also registered substantial export growth in the late 1990s, though not as great as Shunde.17 Jurisdictions in the western part of the Pearl River Delta region have also increasingly sought out investment from Hong Kong and Taiwan. These developments indicate that there is substantial scope for the development of the international economy of the western part of the Pearl River Delta region.

17 Guangdong Statistical Yearbook, various years.
Economic decision making in the Pearl River Delta region

The existence of multiple, sometimes overlapping jurisdictions in the Pearl River Delta region can create a tangled web of economic decision making. At the Guangdong provincial level, there are departments involved in economic strategy and planning, departments that monitor and examine operations, and departments that focus on specific industries. The Development and Planning Commission is responsible for annual economic plans, as well as plans for the province’s medium and long-term social and economic development. This remit includes the formulation of industrial policies, budgeting for fixed asset investments, and planning large-scale infrastructure projects. The Economy and Trade Commission manages the provincial economy, including industrial and transportation policies, as well as general rules and regulations. It also participates in macroeconomic forecasting and monitoring, in formulating and monitoring economic plans, and in developing solutions to economic problems. The Department of Finance sets and manages the provincial budget, tax policies, and accounting rules. It also monitors government revenue and expenditures. General monitoring functions are carried out by the Provincial Department of Auditing, the Administration of Industry and Commerce, the Bureau of Prices, the Bureau of Local Taxation, and the Bureau of the State-Owned Property of China, among others. Provincial departments concerned with specific sectors include the Department of Construction, the Department of Water Resources, the Department of Agriculture, the Department of Trade and Economic Cooperation, the Department of Information Industry, and the Provincial Tourism Administration.

Guangdong also is the home of numerous lower level jurisdictions. As of the end of 2001, it contained three Special Economic Zones (in Shenzhen, Zhuhai, and Shantou), all of which have the right to develop their own economic plans; one provincial capital, Guangzhou; 21 prefecture-level cities; 31 county-level cities; 42 counties; 48 districts; three autonomous counties; and 1,529 towns. Instead of a top-down process, development throughout much of the Pearl River Delta region is more bottom-up, with local jurisdictions developing their own plans and seeking to expand their rights of approval and economic reach. The Guangdong government has usually been supportive of such efforts, often lobbying the Beijing government on behalf of greater flexibility and autonomy in economic policy making. The bottom-up, decentralised decision-making process has proven a benefit to the province as a whole. However, such a process leaves open the possibility that local jurisdictions will engage in destructive competition for the same or similar types of industries. This seems to be the case in the Pearl River Delta region where multiple jurisdictions all seem to make the same investments in pursuit of the same industries, without regard to the plans of neighbouring jurisdictions or a clear sense of specialisation and division of labour. In addition, devolution of authority to lower levels of government
creates challenges in terms of governmental capacity to plan, to provide social security and public safety, or to implement strategies.

The roles of different economic actors are changing in the Pearl River Delta region. Local government and party officials increasingly are taking on the role of facilitators for private and collective firms, rather than acting as managers of state-owned enterprises. They often act to develop infrastructure, attract foreign investment, seek out business advice, and negotiate with other levels of government on behalf of local firms. The Central Government’s State Planning and Development Commission is much more a gatekeeper, passing judgement on plans from below, than a proactive decision maker for local level activities.

The Competitiveness of the Greater Pearl River Delta Region

The competitiveness of the combined “Greater Pearl River Delta region” consisting of the Pearl River Delta Economic Zone, Hong Kong, and Macao, has achieved a high level of international competitiveness in light manufacturing, trade-related services, transportation, and logistics. In these industries, the region is a world leader. The region also has a strong and growing position as a manufacturing centre for technology-based products. On the other hand, the region has not been very competitive in heavy industry, such as chemicals, steel or heavy machinery. Its competitiveness in business services is uneven, with some world-class services available in Hong Kong, but less extensive offerings available in the Pearl River Delta region. Many of the internationally competitive industries also tend to cluster geographically into relatively small areas within the region. This geographic clustering phenomenon is found in many if not most economies around the world. Such clustering tends to foster the development of skills and capabilities that can embed a given industry or set of industries firmly into a particular location.

Light manufacturing

The Greater Pearl River Delta region has become perhaps the world’s leading centre for a wide range of light-manufactured goods and one of the leading locations for assembly manufacturing of higher technology electronics products. The region is a world leader in the production of garments, textiles, footwear, toys, plastic products, travel goods, handbags, umbrellas, artificial flowers, and imitation jewellery. It is a leader in the production of games, electric hairdressing / hand-drying apparatus, electric food grinders, electrical mixers and juicers, clocks, watches, calculators, radios, and audio-visual equipment. It also is a
leader within China for a wide range of home appliances, such as refrigerators, air-conditioners, and electric fans and heaters.

The Greater Pearl River Delta region’s greatest strengths in these industries include a low-cost and productive workforce, relatively inexpensive land, reasonable infrastructure, improving technical skills, and a supportive policy regime. The industries also benefit from the investment, management, market knowledge, technology, and international connections obtained through Hong Kong. Labour costs for assembly labour have stayed relatively low in the Pearl River Delta region because the bulk of the workforce in the manufacturing facilities, at least in the export-oriented industries on the eastern side of the Pearl River Delta region, is made up of migrant workers from the inner provinces. Many of these workers come into the region for one or two years, make some money, and then return to their home provinces. One result is that labour costs are kept surprisingly low (see Table 2.12). Managers in some industries report that wages for assembly labour have not changed much in real terms for nearly a decade. Despite rising land costs in Shenzhen, the cost of industrial land is still relatively low elsewhere in the Pearl River Delta region. The Greater Pearl River Delta region also benefits from infrastructure that is generally far better than that found in economies at similar levels of development. The combination of Hong Kong and the Pearl River Delta region means that Third World level costs are combined with First World calibre management, infrastructure, and market knowledge. This combination has proven to be virtually unbeatable in any industry in which it can be brought to bear.

One of the weaknesses of the Greater Pearl River Delta region in light-manufactured goods involves the export processing regulations under which many of the factories of the region were established. These regulations generally did not foresee that the region would progress beyond simple one-step export processing into multi-stage export processing. As a result, many companies in the region ship goods back and forth across the Shenzhen-Hong Kong border to satisfy export processing regulations, or face time-consuming customs procedures.
### Table 2.12 Factory Costs in Selected Pearl River Delta Region Cities, 2002

<table>
<thead>
<tr>
<th></th>
<th>Shenzhen</th>
<th>Dongguan</th>
<th>Huizhou</th>
<th>Guangzhou</th>
<th>Foshan</th>
<th>Jiangmen</th>
<th>Zhongshan</th>
<th>Zhuhai</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monthly salaries and wages (RMB)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Middle manager</td>
<td>3,000-5,000</td>
<td>3,000-5,000</td>
<td>2,000-3,000</td>
<td>3,000-5,000</td>
<td>3,000-5,000</td>
<td>3,000-5,000</td>
<td>3,000-5,000</td>
<td>3,000-5,000</td>
</tr>
<tr>
<td>- Supervisor</td>
<td>2,000-3,000</td>
<td>2,000-3,000</td>
<td>1,500-2,000</td>
<td>1,500-2,000</td>
<td>1,500-2,000</td>
<td>1,500-2,000</td>
<td>1,500-2,000</td>
<td>1,500-2,000</td>
</tr>
<tr>
<td>- Skilled labour</td>
<td>1,500-2,000</td>
<td>800-1,500</td>
<td>1,000-1,500</td>
<td>1,000-1,400</td>
<td>800-1,200</td>
<td>1,000-1,500</td>
<td>1,000-1,500</td>
<td>800-1,500</td>
</tr>
<tr>
<td>- Unskilled labour</td>
<td>800-900</td>
<td>500-800</td>
<td>500-700</td>
<td>600-800</td>
<td>400-800</td>
<td>600-800</td>
<td>600-800</td>
<td>400-600</td>
</tr>
<tr>
<td>Social charges</td>
<td>18.0-19.0%</td>
<td>15.5-16.5%</td>
<td>15.5-16.5%</td>
<td>31.2-32.2%</td>
<td>21.5%</td>
<td>21.5%</td>
<td>21.5%</td>
<td>12.0%</td>
</tr>
<tr>
<td>Factory and running costs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Monthly factory rental (RMB/sq.m.)</td>
<td>11-14</td>
<td>8-9</td>
<td>8-10</td>
<td>12-25</td>
<td>8-10</td>
<td>8-10</td>
<td>12-13</td>
<td>6-12</td>
</tr>
<tr>
<td>- Electricity (RMB/KW/hr.)</td>
<td>0.61-0.93</td>
<td>1.08</td>
<td>0.62</td>
<td>0.70</td>
<td>0.69</td>
<td>0.76</td>
<td>0.80</td>
<td>0.68-0.78</td>
</tr>
<tr>
<td>- Water (RMB/cu.m.)</td>
<td>1.75</td>
<td>1.16</td>
<td>1.90</td>
<td>1.05</td>
<td>1.05</td>
<td>1.25</td>
<td>1.16</td>
<td>1.18</td>
</tr>
<tr>
<td>- Waste discharge fee (RMB/cu.m.)</td>
<td>0.34</td>
<td>0.33</td>
<td>0.30</td>
<td>0.30</td>
<td>0.30</td>
<td>Exempt</td>
<td>Exempt</td>
<td>0.18</td>
</tr>
<tr>
<td>Taxation (a)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Maximum corporate income tax</td>
<td>15%</td>
<td>33%</td>
<td>33%</td>
<td>33%</td>
<td>24%</td>
<td>24%</td>
<td>24%</td>
<td>15%</td>
</tr>
<tr>
<td>- VAT</td>
<td>17%</td>
<td>17%</td>
<td>17%</td>
<td>17%</td>
<td>17%</td>
<td>17%</td>
<td>17%</td>
<td>17%</td>
</tr>
<tr>
<td>- Personal income tax</td>
<td>5-45%</td>
<td>5-45%</td>
<td>5-45%</td>
<td>5-45%</td>
<td>5-45%</td>
<td>5-45%</td>
<td>5-45%</td>
<td>5-45%</td>
</tr>
</tbody>
</table>

Note: (a) There are additional taxes and fees, such as inspection taxes and fees, real estate taxes, and others not included in this table.
Source: The Dutch Chamber of Commerce in Guangzhou
Technology-based manufacturing

The Greater Pearl River Delta region has become a world leader in the production of a range of technology-based products, including telephones, facsimile machines, computers, computer peripherals, and other advanced electronics products. It should be noted that the region is a leader in terms of production, not in terms of technology development. While many of the world’s leading technology-based companies manufacture in the Pearl River Delta region, and many are placing increasingly challenging activities in the region, they still do the vast majority of their technology development elsewhere. The region’s local technology-based companies are improving, but still cannot compare with leading companies from the United States, Europe, Japan, Korea, or Taiwan in terms of their technology development capabilities. On the other hand, the Pearl River Delta region compares quite well to other locations in the Chinese Mainland across a range of technology-based activities. Table 2.13 shows the Guangdong government’s estimate of the share of China’s output accounted for by the Pearl River Delta region in selected industries.

Table 2.13 The Pearl River Delta Region’s Share of PRC Output, Selected Industries, 2000

<table>
<thead>
<tr>
<th>IT and Electronics</th>
<th>Electrical Appliances</th>
</tr>
</thead>
<tbody>
<tr>
<td>78.8% Telephones</td>
<td>88.2% Electrical fans</td>
</tr>
<tr>
<td>60.2% Printers</td>
<td>80.4% Hi-fi equipment</td>
</tr>
<tr>
<td>55.8% Fax machines</td>
<td>79.0% Electric rice cookers</td>
</tr>
<tr>
<td>50.7% Digital switches</td>
<td>72.1% Microwave ovens</td>
</tr>
<tr>
<td>43.6% Video recorders</td>
<td>64.3% Cameras</td>
</tr>
<tr>
<td>35.5% VCD players</td>
<td>58.4% Gas water heaters</td>
</tr>
<tr>
<td>31.1% LS Semiconductors</td>
<td>37.5% Air-conditioners</td>
</tr>
<tr>
<td>24.3% Cathode ray tubes</td>
<td>34.8% Colour televisions</td>
</tr>
<tr>
<td>23.0% Personal computers</td>
<td>25.1% Refrigerators</td>
</tr>
<tr>
<td>19.1% Mobile phones</td>
<td>24.9% Vacuum cleaners</td>
</tr>
</tbody>
</table>


The region’s advantages as a production base mirror those listed above. Although the production process for electronics goods requires greater precision in order to meet tolerances, in general assembly manufacturing is still a relatively labour-intensive activity that benefits from low-cost, productive labour, relatively well-organised and managed facilities, and access to the infrastructure required to ship components and finished goods.
quickly and accurately. Again, it has been the combination of the land, labour and regulations found in the Pearl River Delta with technology and commercialisation skills imported from other places through Hong Kong that has proven to be a strong combination. The region also has benefitted from the relative openness of places like Shenzhen, which has attracted technological workers from all over the Chinese Mainland.

Weaknesses in the Greater Pearl River Delta region have included a lack of local technological development capabilities, a lack of leading universities to train technology-based workers, and the fact that foreign companies have been increasingly going to other places in the Chinese Mainland. The region also suffers from intellectual property protection that is considered not only well behind international standards, but behind other areas in the Chinese Mainland as well.\textsuperscript{18}

Heavy manufacturing

The Greater Pearl River Delta region has generally not been strong in heavy manufacturing in international or national terms. The Pearl River Delta region is far from China’s traditional industrial heartland in the north and the east. It did not benefit from policies to decentralise industrial development into the interior in the 1950s and 1960s. It lacked easy access to the natural resources necessary for heavy industry, as the region was largely cut off from trade and the internal transportation system left much to be desired. Proximity to Hong Kong did not help the Pearl River Delta region much in this regard, given Hong Kong’s own lack of a heavy industrial base.

One emerging real strength that the Greater Pearl River Delta region has in terms of heavy industry is growing demand for heavy industrial products. This demand is related to the growth in export-oriented manufacturing and urbanisation in the Pearl River Delta region. Guangdong-based planners believe that this demand eventually will be sufficient to justify heavy industrial production in the region. Perversely, the lack of a history in heavy industry also could eventually turn into a benefit for the Greater Pearl River Delta region, since the region is less encumbered by the traditional, inefficient facilities of the northern and eastern portions of the Chinese Mainland.

Trade-related services

The Greater Pearl River Delta region is a world leader in terms of trade-related services. Hong Kong has the world’s busiest container port and the world’s busiest airport for

\textsuperscript{18} Authors’ interviews.
international airfreight. The ports in Shenzhen are rapidly assuming a leadership position, not just in the Chinese Mainland, but in international terms as well. The massive export surge of the Greater Pearl River Delta region over the last two decades also has created enormous demand for trading, sourcing, freight-forwarding, logistics, trade finance, legal, and other related services in the region. The Pearl River Delta region, as China’s leading trading region, also leads in terms of its importance in such trade-related services in the Chinese Mainland.

The region is strong in terms of trade-related services. The region’s light-manufacturing base has created the demand and the impetus for growth in trade-related services. The massive infrastructure investments made in Hong Kong and in the Pearl River Delta region have created some of the world’s finest facilities. The region’s tradition of trading and the large local trading community have clearly contributed to its competitiveness, as has the international market know-how and access provided by Hong Kong. Hong Kong’s separate legal, financial, and administrative system has proven a magnet to the buying and sourcing offices of multinational companies, as well as to the logistical, information, and other services related to trade. Increasingly, these are being linked to similar services that are developing in the Pearl River Delta region.

Despite its strengths, the Greater Pearl River Delta region has some disadvantages when it comes to trade-related services. The existence of a border, with the accompanying customs checks and transportation bottlenecks, is a clear disadvantage compared to other regions in which goods and people can flow more freely. In addition, the existence of multiple jurisdictions in the Greater Pearl River Delta region, each with its own development plans, has resulted in duplicative investments that can reduce the potential for the sort of hub and spoke system that would maximise efficiency.

Business services

Due to restrictions on the operations of foreign service providers on the Chinese Mainland, the business service sectors of the Greater Pearl River Delta region are less integrated than many other sectors of the economy. Thus, the competitiveness of Hong Kong and of the Pearl River Delta region in business services has to be treated separately. Hong Kong is an international business service centre of regional importance. This can be seen by Hong Kong’s position as the leading centre for the regional headquarters of multinational firms in Asia, its position as a leading financial centre in Asia, and the breadth and depth of Hong Kong’s professional and business service sectors. The main cities in the Pearl River Delta region, Guangzhou and Shenzhen, in comparison, lag behind both Shanghai and Beijing in terms of their prominence as business service centres.
Hong Kong has benefitted from its years as an international centre and its legal, financial, and administrative systems. Hong Kong’s free flows of capital, light-handed but international calibre regulatory system, and skilled professionals from all over the world have greatly contributed to its position as a business service centre. This has been accentuated by its trading roles. On the Chinese Mainland, on the other hand, Shanghai and Beijing have been the traditional centres for commerce and government relations. As a result, a denser set of business services has grown in these cities to serve both domestic and international clients. The lead of these cities has been influenced by restrictions on foreign firms that allow them to have only one or a few offices in the Chinese Mainland. Of the 96 representative offices of foreign law firms in the Chinese Mainland, in 2002, for example, only three were in Guangzhou. Of the 37 representative offices of Hong Kong law firms in the Chinese Mainland, nine had offices in Guangzhou and three in Shenzhen. In both cases, the vast majority of offices were in Shanghai and Beijing.19

Competitive clusters

National and regional clusters tend to be competitive, not in isolated industries, but in clusters of industries related by buyer-supplier links, common technologies, common channels or common customers.20 The economies of the Greater Pearl River Delta region are no exceptions. The region is extremely competitive in a broad range of light-manufactured and electronics goods as indicated above. Figures 2.1, 2.2, 2.3, and 2.4 show some of these clusters. Figure 2.1 represents only some of the inputs and components sourced in the Greater Pearl River Delta region that support its world-leading toy industry. Figure 2.2 shows a range of inputs and components available in the region that supports its footwear industry. Figure 2.3 shows a number of electrical and electronics industries in which the region is a leader in the world or in Asia. Figure 2.4 shows some of the components and inputs that can be sourced from highly competitive suppliers in the region. Given the importance of participation of Hong Kong firms and Hong Kong investment, these clusters can be considered to require the participation of both Hong Kong and the Pearl River Delta region.

The production for many of these clusters can be found in relatively small geographic areas. Figure 2.5 shows a wide range of industries in which there is a strong geographic concentration in individual cities or towns in the Pearl River Delta region. Whereas some of these industries have emerged relatively recently, others date back hundreds of years. Figure 2.6 shows a number of the clusters and industries in which Hong Kong is a leader on an international or global scale.

**Figure 2.1** The Greater Pearl River Delta Region Toy Cluster

**Figure 2.2** The Greater Pearl River Delta Region Footwear Cluster
Figure 2.3 The Greater Pearl River Delta Region Electronics Cluster, End Products

Figure 2.4 The Greater Pearl River Delta Region Electronics Cluster, Inputs and Components
Figure 2.5 Localised Industries in the Pearl River Delta Region

Figure 2.6 Localised Industries in Hong Kong
The Interaction Between Hong Kong and the Pearl River Delta Region

The above discussion indicates that the economies of Hong Kong and the Pearl River Delta region have become inextricably intertwined. It is difficult to even discuss the economy of Hong Kong without discussing that of the Pearl River Delta region and it is difficult to discuss the economy of the Pearl River Delta region without discussing that of Hong Kong. The next two chapters will focus on the details of the economic interaction between Hong Kong and the Pearl River Delta region, as well as the division of labour and competition between the two.
The economic interaction between Hong Kong and the Pearl River Delta region has been an important contributor to the economic development of both areas. This interaction also has evolved substantially over time. Before China’s opening, the interaction was rather limited. Hong Kong received water and staples from the Pearl River Delta region and provided limited services linked with China’s imports and exports. In the late 1970s and early 1980s, as China began to open, Hong Kong investors and businesses began to explore possibilities in the Pearl River Delta region. As of the mid-1980s, Hong Kong investment in the Pearl River Delta region grew dramatically and it could be said that Hong Kong was the leader of Pearl River Delta development at least in terms of burgeoning foreign investment and exports. By the mid to late 1990s, Hong Kong was playing more of a strong supporting role in the region’s development. In the 2000s, the prospects are for a much more even-handed and integrated development.

There are numerous areas of economic interaction between Hong Kong and the Pearl River Delta region, including investment, trade, technology, management, transportation and travel, tourism, retail shopping, and real estate.

**Hong Kong Investment in the Pearl River Delta Region**

Hong Kong investment has been a particularly important part of the interaction between Hong Kong and the Pearl River Delta region. This investment has evolved substantially over time. Hong Kong investors were the earliest of the external investors in the Pearl River Delta region. Today, they still provide the majority of foreign investment into the region. In addition to capital, this investment has brought along with it management, technology, and access to markets.

**Historical development**

Hong Kong investment into the Pearl River Delta region has undergone a substantial evolution since the late 1970s. This evolution can be described in three broad stages, each characterised by a somewhat different mix of investments and each corresponding to different roles played by Hong Kong and the Pearl River Delta region for the companies in question. The three broad stages included a start-up stage, which lasted from 1979 until approximately 1984, a rapid growth stage, which lasted from approximately 1985 to 1992, and a steady development stage from roughly 1995 to 2002.

**Start-up: 1979-1984**

The Pearl River Delta began opening to outside investors for the first time in decades in
1979. At this time, there was a great deal of uncertainty about the rules governing such investment and how the Pearl River Delta’s economy would evolve. From 1979 to 1984, much of the investment from Hong Kong into the Pearl River Delta region relied on family ties as Hong Kong business people invested in their ancestral hometowns. One reason for this focus was a sense of “going home” or contributing to the development of the ancestral hometown. A less prosaic reason was that many Hong Kong entrepreneurs still had family or friends in these towns that could help reduce the uncertainty and risk associated with the investments.

Most of the investment was in labour-intensive export processing facilities attracted by very low prices for land and labour. Industrial investment was concentrated in the Shenzhen Special Economic Zone and areas along the Guangzhou-Shenzhen railway line, especially in the Dongguan area. This minimised the travel times from Hong Kong at a time when travelling to adjacent cities in the Pearl River Delta region could take hours or more. Investment in the service sector was mainly in the urban centres of Guangzhou and Shenzhen, in part because these cities were more open than others to such investment and in part because these cities were the natural places to set up service activities due to links with Hong Kong (Shenzhen) or position as a provincial centre (Guangzhou). In this period, Hong Kong investors signed more than 49,000 investment contracts, with contractual funds of US$6.408 billion, and the actual use of funds was US$1.809 billion.¹

**Rapid growth: 1985-1992**

After the first few years of the opening of the Pearl River Delta region, Hong Kong-based investors became more familiar with and comfortable with operating in the region. The success of some earlier investments had a demonstration effect with others proving eager to follow. This was facilitated by the development of several infrastructure projects that allowed for easier transportation from Hong Kong to the eastern portion of the Pearl River Delta region. During this period, investment from Hong Kong into the Pearl River Delta region increased rapidly. Hong Kong investors signed 70,800 investment contracts, with a contract value of US$34.145 billion. The average investment rose from US$36,800 during the period from 1979 to 1984 to US$177,000 between 1985 and 1992, reflecting an improved investment and regulatory climate for investment.² In the Pearl River Delta region, direct investment accounted for 71 percent of the total actual use of Hong Kong-invested funds, while indirect investment was 20 percent of the total.³

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¹ The Centre for Urban and Regional Studies, Zhongshan University, “Xianggang yu zhujiang sanjiao zhou jingji guanxi yanjiu” (“A Study of the Economic Relationship between Hong Kong and the Pearl River Delta”) in Xianggang yu zhujiang sanjiao zhou jingji hudong yanjiu (A Study of the Hong Kong - Pearl River Delta Economic Interaction), April 2002, p.7.
² Ibid. p.7.
³ Ibid. p.8.
investment was concentrated in the secondary sector (69 percent of the total), the tertiary sector (28 percent of the total), and the primary sector (2.4 percent). 4

The investment in this stage was expanded from areas neighbouring Hong Kong further into the Pearl River Delta region. The bulk of the investments were still made in export-oriented processing facilities. By the end of 1992, two thirds of the exports from the Pearl River Delta had direct links to Hong Kong-invested enterprises. 5 Many of these enterprises had initially moved their existing production into the Pearl River Delta, but then found that they could greatly expand their production and sales from a Pearl River Delta production base. Companies began to employ many times the number of workers in the Pearl River Delta region than they had in Hong Kong previously.

**Steady development: 1993-2002**

After Deng Xiaoping’s 1992 South China tour, China launched a second round of reform and economic opening. This in turn stimulated a new round of inward investments from Hong Kong. Investments from Hong Kong into the Pearl River Delta region grew at an average rate of around 15 percent annually in this period. The scale of Hong Kong investments increased from an average utilised investment of US$177,000 from 1985 to 1992, to US$811,000 dollars between 1993 and 2002. In 1996, the average investment per project reached US$2 million for the very first time. The proportion of direct investment grew to 88 percent of the total of actual investment, while indirect investment and other forms of investment fell to eight percent and four percent, respectively. 6

Deng’s tour and subsequent developments heralded greater opening in the service sector within the Pearl River Delta region. Hong Kong investment also became more diversified, with Hong Kong firms investing in finance, insurance, real estate, and other services. Although the geographic focus remained in the eastern portion of the Pearl River Delta region, investments also started to be made in the western portion of the Delta and in the mountainous areas of Guangdong. At the same time, various localities have adopted a cautious attitude toward investment by pollution-making enterprises in order to maintain a sustainable development. The jurisdictions on the eastern side of the Delta have pushed to increase the technology level of the investments they accept.

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4 Ibid.
5 Ibid, p.9.
The importance of Hong Kong investment

Hong Kong has been the dominant source of foreign capital in the Pearl River Delta region. According to figures built up from the statistical yearbooks of different jurisdictions in the Pearl River Delta region, Hong Kong and Macao were the source of 90.82 percent of the total foreign capital used in the Pearl River Delta region in 1985, 73.6 percent from 1986 to 1990, 74.5 percent from 1991 to 1995, and 67.55 percent from 1996 to 1999 (see Table 3.1). The last figure was probably understated given the fact that much of the capital recorded as coming from the Virgin Islands was probably due to Hong Kong firms routing capital through corporate entities in the Virgin Islands. Despite the diversification of investment sources, Hong Kong (which represented nearly all of the investment in the Hong Kong and Macao category) remained the dominant source of foreign capital.

Table 3.1 Main Sources of Foreign Funds in the Pearl River Delta Region, US$ million

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<tr>
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<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>%</td>
<td>Amount</td>
<td>%</td>
<td>Amount</td>
</tr>
<tr>
<td>Total</td>
<td>738.95</td>
<td>100</td>
<td>80,473.82</td>
<td>100</td>
<td>6,133.61</td>
</tr>
<tr>
<td>Hong Kong and Macao</td>
<td>671.14</td>
<td>90.82</td>
<td>56,941.10</td>
<td>70.76</td>
<td>4,514.79</td>
</tr>
<tr>
<td>Southeast Asia</td>
<td>7.83</td>
<td>1.06</td>
<td>1,846.89</td>
<td>2.30</td>
<td>48.20</td>
</tr>
<tr>
<td>Taiwan, China</td>
<td>0</td>
<td>0</td>
<td>2,662.99</td>
<td>3.31</td>
<td>75.62</td>
</tr>
<tr>
<td>Japan</td>
<td>31.33</td>
<td>0.42</td>
<td>4,758.73</td>
<td>5.91</td>
<td>789.75</td>
</tr>
<tr>
<td>Korea</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Europe</td>
<td>6.57</td>
<td>0.89</td>
<td>4,122.97</td>
<td>5.12</td>
<td>299.96</td>
</tr>
<tr>
<td>North America</td>
<td>20.08</td>
<td>2.72</td>
<td>2,955.22</td>
<td>3.67</td>
<td>374.66</td>
</tr>
<tr>
<td>Australasia</td>
<td>0.5</td>
<td>0.07</td>
<td>356.97</td>
<td>0.44</td>
<td>34.79</td>
</tr>
</tbody>
</table>

Sources: Derived from Guangdong Statistical Yearbooks and the statistical yearbooks of different Pearl River Delta region cities.

The figures above more or less agree with other official sources that have quoted figures for Hong Kong investment into Guangdong Province. In June 2002, Lu Ruihua, Governor of Guangdong, claimed that Guangdong had used US$120 billion in foreign investment and that 70 percent (yielding a figure of US$84 billion) had come from Hong Kong. In April 2002, Huang Ziqiang, Director of the Guangdong Provincial Foreign Affairs Office, said Guangdong had used US$78.9 billion in investment from Hong Kong, representing 70 percent of the total Hong Kong investment in the Chinese Mainland. It has been reported,

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7 Hong Kong Commercial Daily, “Lu Ruihua expects Guangdong’s exports to increase 10% this year,” June 6, 2002.
8 Ta Kung Pao, “Trade between Hong Kong and Guangdong reached US$38.7 billion last year, April 10, 2002.
however, that Hong Kong businesses had made actual investments of US$183.3 billion in the Chinese Mainland by October of 2001 with the vast majority of this invested in Guangdong Province. The discrepancy is most likely due to the fact that most of the machinery and equipment, which typically represents the largest investment in export processing facilities and that enters China duty-free under export processing regulations, has not been included in the official foreign investment statistics. In fact, by 2000, the Guangdong Statistical Yearbook showed the accumulative value of imported processing and assembly equipment between 1979 and 2000 to amount to only US$5.64 billion, of which less than one-fifth were subject to tax. 

The Pearl River Delta region boasts a natural advantage in attracting funds from Hong Kong. It borders on Hong Kong and has relatively easy accesses to transportation between the two sides. Hong Kong and the Pearl River Delta region share a long history, family ties, and close relations among residents. Since the onset of China’s reform programme, the economic contacts and cooperation between Hong Kong and the Pearl River Delta region have become closer and closer, fostering a relationship of mutual dependence and mutual support. The Pearl River Delta region has become the first choice for Hong Kong investors, while Hong Kong has become a showcase for the Pearl River Delta region’s efforts to open to the outside and to attract overseas funds.

Many of the Hong Kong companies interviewed for this study indicated that they employed far more people in the Pearl River Delta region than in Hong Kong. The ratios ranged from 1 to 6 in the software industry to 1 to 55 in the toy industry. Based on figures like these, and those we have obtained for other industries in the course of hundreds of interviews, we estimate that Hong Kong manufacturing and trading companies employ on the order of 10 million to 11 million people in the Pearl River Delta region. Roughly 25 percent of these people are employed by firms classified as manufacturing firms in Hong Kong and 75 percent are employed by firms classified as trading companies in Hong Kong. This shows that firms that no longer do sufficient manufacturing in Hong Kong to be classified as manufacturers in the Hong Kong SAR are the major employers of manufacturing workers in the Pearl River Delta region. The 10 million to 11 million figure is similar to that estimated by the Hong Kong Federation of industries for the employment of Hong Kong manufacturing and trading firms in Guangdong Province in a different study.

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Table 3.2  Ratios of Hong Kong Firm Employment in Hong Kong and the PRD

<table>
<thead>
<tr>
<th>Industry</th>
<th>HK :PRD Employment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Toys</td>
<td>1 : 55</td>
</tr>
<tr>
<td>Electronics</td>
<td>1 : 50</td>
</tr>
<tr>
<td>Giftware</td>
<td>1 : 30</td>
</tr>
<tr>
<td>Plastics</td>
<td>1 : 27</td>
</tr>
<tr>
<td>Printing</td>
<td>1 : 24</td>
</tr>
<tr>
<td>Garments</td>
<td>1 : 15</td>
</tr>
<tr>
<td>Watches and Clocks</td>
<td>1 : 9</td>
</tr>
<tr>
<td>Software</td>
<td>1 : 6</td>
</tr>
<tr>
<td>Simple Average</td>
<td>1 : 26</td>
</tr>
</tbody>
</table>

Source: Project interviews

Other investors use Hong Kong as a base of operations. A recent Hong Kong Trade Development Council survey indicated that 87 percent of the Japanese companies with investments in the Pearl River Delta region said those investments had strong links to Hong Kong.\(^\text{12}\) In fact, proximity to Hong Kong was listed as the number one factor that influenced the firms to invest in the Pearl River Delta region as opposed to other locations. The companies claimed Hong Kong’s financial services, location, tax system, information flows, and legal system were strong reasons for using Hong Kong as a base for investing in the Pearl River Delta. The Dutch Camber of Commerce in Guangzhou reports that accessibility to Hong Kong is one of the most important factors associated with foreign investments in the Pearl River Delta region.\(^\text{13}\) Interviews with the managers of Western multinationals tell a similar story. In many cases, their investments in the Pearl River Delta region are managed or supported from a Hong Kong base. In addition, the managers responsible for the Pearl River Delta region investments of many Western and Japanese companies live in Hong Kong and commute into the Pearl River Delta region to oversee operations. It is less likely that the companies would have made these investments if it were not possible to do so.

The absence of direct links between Taiwan and the Chinese Mainland means that nearly all of the Taiwanese firms active in the Pearl River Delta region use Hong Kong to facilitate their investments and to gain access to the Chinese Mainland. A survey of Taiwanese enterprises in Hong Kong conducted by the China Business Centre of the Hong Kong Polytechnic University shows that Taiwanese firms use Hong Kong to support their operations.


\(^{13}\) Dutch Chamber of Commerce in Guangzhou, “Industrial Zone Survey in the Pearl River Delta,” September 2002.
Mainland operations, using their Hong Kong branches to market their products, receive orders, procure raw material and parts, coordinate production in the Chinese Mainland, arrange for transportation, collect money, and operate their financial activities. Many Taiwanese enterprises use Hong Kong as a financial base to avoid risks on the Chinese Mainland and regulations in Taiwan. Since the renminbi is not freely convertible and Taiwanese authorities intentionally restrict Taiwanese investment on the Chinese Mainland, Hong Kong has become the prime facilitator for Taiwanese businesses on the Chinese Mainland.

**Trade between Hong Kong and the Pearl River Delta region**

Hong Kong investment in the Pearl River Delta region has largely determined the patterns of trade between the two sides. Although the statistics show a decrease in the relative importance of Hong Kong to the exports of the Pearl River Delta region (see Table 3.3), a large amount of exported goods still rely on ports, infrastructure, and services from Hong Kong. In particular, the Pearl River Delta region relies on Hong Kong trading companies to set up marketing channels and other support services in Hong Kong.

**Table 3.3** Guangdong-Hong Kong Trade in 1995-2000, US$ million

<table>
<thead>
<tr>
<th>Year</th>
<th>Total value of Guangdong exports</th>
<th>Exports to Hong Kong</th>
<th>Total value of Guangdong imports</th>
<th>Imports from Hong Kong</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Value</td>
<td>(%)</td>
<td>Value</td>
<td>(%)</td>
</tr>
<tr>
<td>1995</td>
<td>56,592</td>
<td>22,255</td>
<td>47,380</td>
<td>6,055</td>
</tr>
<tr>
<td>1999</td>
<td>77,705</td>
<td>26,891</td>
<td>62,663</td>
<td>4,139</td>
</tr>
<tr>
<td>2000</td>
<td>91,919</td>
<td>32,105</td>
<td>78,187</td>
<td>5,335</td>
</tr>
</tbody>
</table>

Source: Guangdong Statistical Yearbook, 2001

Much of the trade between Hong Kong and the Pearl River Delta region has been prompted by Hong Kong investment in export processing activities in the Pearl River Delta region. Hong Kong firms export semi-finished products and raw materials made locally or purchased on the international market to the Pearl River Delta region. After they are processed in Hong Kong-invested enterprises in the Pearl River Delta region, Hong Kong companies export the products to various parts of the world. This has greatly increased the volume of entrepot trade between Hong Kong and the Pearl River Delta region, as well as the export of semi-finished products and raw materials made locally. According to Hong Kong statistics, the majority of Hong Kong’s trade with the Chinese Mainland involves export processing (see Table 3.4). It should be noted that the largest part of the outward processing trade generated by Hong Kong-invested enterprises is concentrated in the Pearl

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River Delta region. According to Guangdong statistics, export processing represented 3.75 percent of provincial exports in 1980, 72.04 percent in 1990, 78.09 percent in 2000, and 80.17 percent in 2001. Export processing also accounted for 62.23 percent of provincial imports in 2001 (see Table 3.5).

Table 3.4  Hong Kong’s Trade Involving Outward Processing in the Chinese Mainland, 1991-2000

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Estimated value of outward processing (HK$ million)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Domestic exports to the Mainland of China</td>
<td>40,369</td>
<td>41,959</td>
<td>43,089</td>
<td>47,078</td>
<td>42,184</td>
<td>37,696</td>
<td>39,304</td>
</tr>
<tr>
<td>Re-exports to the Mainland of China</td>
<td>73,562</td>
<td>139,221</td>
<td>179,235</td>
<td>197,809</td>
<td>197,089</td>
<td>197,890</td>
<td>242,929</td>
</tr>
<tr>
<td>Total exports to the Mainland of China</td>
<td>113,931</td>
<td>181,179</td>
<td>222,324</td>
<td>244,886</td>
<td>221,273</td>
<td>235,586</td>
<td>282,233</td>
</tr>
<tr>
<td>Imports from the Mainland of China</td>
<td>197,384</td>
<td>354,912</td>
<td>452,890</td>
<td>491,142</td>
<td>477,743</td>
<td>487,507</td>
<td>567,000</td>
</tr>
<tr>
<td>Re-exports of the Mainland of China origin to other places</td>
<td>221,450</td>
<td>422,544</td>
<td>552,822</td>
<td>595,511</td>
<td>559,726</td>
<td>570,126</td>
<td>647,338</td>
</tr>
<tr>
<td><strong>Estimated proportion of outward processing trade (%)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Domestic exports to the Mainland of China</td>
<td>76.5</td>
<td>71.4</td>
<td>72.8</td>
<td>76.1</td>
<td>77.4</td>
<td>75.9</td>
<td>72.7</td>
</tr>
<tr>
<td>Re-exports to the Mainland of China</td>
<td>48.2</td>
<td>43.3</td>
<td>43.2</td>
<td>44.7</td>
<td>44.1</td>
<td>49.7</td>
<td>49.7</td>
</tr>
<tr>
<td>Total exports to the Mainland of China</td>
<td>55.5</td>
<td>47.7</td>
<td>46.9</td>
<td>48.6</td>
<td>48.1</td>
<td>52.6</td>
<td>52.0</td>
</tr>
<tr>
<td>Imports from the Mainland of China</td>
<td>67.6</td>
<td>75.9</td>
<td>79.9</td>
<td>81.2</td>
<td>82.7</td>
<td>80.5</td>
<td>79.3</td>
</tr>
<tr>
<td>Re-exports of the Mainland of China origin to other places</td>
<td>74.1</td>
<td>82.0</td>
<td>86.0</td>
<td>88.4</td>
<td>87.6</td>
<td>86.6</td>
<td>85.1</td>
</tr>
</tbody>
</table>

Source: Hong Kong Government Census and Statistics Department, 2001

Trade between the Pearl River Delta region and Hong Kong (including re-export via Hong Kong) accounts for the vast majority of the total trade of the Pearl River Delta region. The main form of trade between the Pearl River Delta region and Hong Kong is import and re-export. Only a small portion is produced in or consumed in Hong Kong. According to a survey by the Hong Kong Trade Development Council, 86.9 percent of the products exported by Hong Kong business people engaged in export activity in the Chinese Mainland were manufactured all or in part in Guangdong Province. More than 90 percent of Hong Kong’s imports from the Pearl River Delta region are reshipped to a third economy. The
main destinations of re-exported commodities are the United States, Japan, EU countries, and Canada. About 70 to 80 percent of export products from the Pearl River Delta region are sold in international markets via Hong Kong, and about 80 percent of the imports to the Pearl River Delta region go through Hong Kong.\textsuperscript{17}

Table 3.5 Imports and Exports of Guangdong by Forms of Trade and by Types of Economic Units

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>General Trade</th>
<th>Export Processing Trade</th>
<th>Others</th>
<th>State-owned Units</th>
<th>Collective-owned units</th>
<th>Private-owned Units</th>
<th>Foreign funded units</th>
<th>Other types of ownership</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>100</td>
<td>95.94</td>
<td>3.75</td>
<td>0.30</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1985</td>
<td>100</td>
<td>82.99</td>
<td>16.72</td>
<td>0.29</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1988</td>
<td>100</td>
<td>32.89</td>
<td>66.05</td>
<td>1.06</td>
<td>87.22</td>
<td></td>
<td>12.27</td>
<td>0.51</td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>100</td>
<td>26.79</td>
<td>72.04</td>
<td>1.17</td>
<td>74.91</td>
<td></td>
<td>24.67</td>
<td>0.43</td>
<td></td>
</tr>
<tr>
<td>1993</td>
<td>100</td>
<td>20.90</td>
<td>77.92</td>
<td>1.18</td>
<td>60.10</td>
<td>1.05</td>
<td>0.00</td>
<td>38.42</td>
<td>0.43</td>
</tr>
<tr>
<td>1995</td>
<td>100</td>
<td>24.03</td>
<td>74.70</td>
<td>1.26</td>
<td>52.42</td>
<td>1.62</td>
<td>0.01</td>
<td>45.52</td>
<td>0.43</td>
</tr>
<tr>
<td>1997</td>
<td>100</td>
<td>24.07</td>
<td>73.54</td>
<td>2.39</td>
<td>47.93</td>
<td>2.27</td>
<td>0.01</td>
<td>49.35</td>
<td>0.44</td>
</tr>
<tr>
<td>1999</td>
<td>100</td>
<td>19.84</td>
<td>77.73</td>
<td>2.44</td>
<td>46.02</td>
<td>2.63</td>
<td>0.22</td>
<td>50.73</td>
<td>0.41</td>
</tr>
<tr>
<td>2000</td>
<td>100</td>
<td>18.97</td>
<td>78.09</td>
<td>2.94</td>
<td>42.39</td>
<td>2.75</td>
<td>0.67</td>
<td>53.86</td>
<td>0.33</td>
</tr>
<tr>
<td>2001</td>
<td>100</td>
<td>17.29</td>
<td>80.17</td>
<td>2.54</td>
<td>37.86</td>
<td>3.61</td>
<td>1.48</td>
<td>56.98</td>
<td>0.08</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>General Trade</th>
<th>Export Processing Trade</th>
<th>Imports of equipment</th>
<th>Others</th>
<th>State-owned Units</th>
<th>Collective-owned units</th>
<th>Private-owned Units</th>
<th>Foreign funded units</th>
<th>Other types of ownership</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>100</td>
<td>27.76</td>
<td>61.31</td>
<td>6.30</td>
<td>4.64</td>
<td>79.79</td>
<td></td>
<td>18.13</td>
<td>2.09</td>
<td></td>
</tr>
<tr>
<td>1985</td>
<td>100</td>
<td>17.54</td>
<td>64.85</td>
<td>14.66</td>
<td>2.95</td>
<td>63.08</td>
<td></td>
<td>36.01</td>
<td>0.90</td>
<td></td>
</tr>
<tr>
<td>1988</td>
<td>100</td>
<td>16.67</td>
<td>57.33</td>
<td>19.55</td>
<td>6.46</td>
<td>48.90</td>
<td>0.93</td>
<td>0.00</td>
<td>48.39</td>
<td>1.78</td>
</tr>
<tr>
<td>1990</td>
<td>100</td>
<td>9.80</td>
<td>68.37</td>
<td>14.51</td>
<td>7.33</td>
<td>38.21</td>
<td>1.73</td>
<td>0.00</td>
<td>57.94</td>
<td>2.11</td>
</tr>
<tr>
<td>1993</td>
<td>100</td>
<td>11.16</td>
<td>70.11</td>
<td>11.35</td>
<td>7.39</td>
<td>37.55</td>
<td>1.99</td>
<td>0.00</td>
<td>58.95</td>
<td>1.52</td>
</tr>
<tr>
<td>1995</td>
<td>100</td>
<td>22.12</td>
<td>67.10</td>
<td>6.71</td>
<td>4.07</td>
<td>41.50</td>
<td>2.91</td>
<td>0.29</td>
<td>54.13</td>
<td>1.18</td>
</tr>
<tr>
<td>1997</td>
<td>100</td>
<td>26.67</td>
<td>63.14</td>
<td>6.37</td>
<td>3.82</td>
<td>40.16</td>
<td>3.28</td>
<td>0.71</td>
<td>54.39</td>
<td>1.01</td>
</tr>
<tr>
<td>2000</td>
<td>100</td>
<td>28.34</td>
<td>62.23</td>
<td>5.81</td>
<td>3.62</td>
<td>38.38</td>
<td>4.04</td>
<td>1.89</td>
<td>54.59</td>
<td>1.09</td>
</tr>
</tbody>
</table>

Notes: Processing trade includes processing with supplied and imported materials. Import of equipment includes processing equipment and equipment needed by foreign-funded enterprises.

Source: Guangdong Statistical Yearbook, various years


\textsuperscript{16} The Centre for Urban and Regional Studies, Zhongshan University, “Xianggang yu zhuhai sanjiao zhou jingji guanxi yanjiu” (“A Study of the Economic Relationship between Hong Kong and the Pearl River Delta”) in Xianggang yu zhuhai sanjiao zhou jingji hudong yanjiu (A Study of the Hong Kong - Pearl River Delta Economic Interaction), April 2002, p.21.

\textsuperscript{17} Authors interviews and Hong Kong Trade Development Council and Edith E. Scott, \textit{Hong Kong Plus: Your Global Platform for Sourcing, Producing and Selling in China}, October 2002, p.22.
Technology transfer and interaction in technology

Since the onset of China’s reform programme, Hong Kong has been instrumental in the transfer of technology to the Pearl River Delta region. This transfer has come about largely through the direct transfer accompanying investments by Hong Kong firms, the copying of Hong Kong sourced technology by facilities in the Pearl River Delta region, and by Hong Kong acting as a technology intermediary for Pearl River Delta region entities.

A substantial amount of technology transfer has been coupled with the investments of Hong Kong firms. In the early years of the reform process, much of the technology that was transferred was embodied in imported capital equipment. After 30 years of a planned and closed economy, China had limited capacity for commercial research and development, or even the direct purchase or absorption of modern technologies. Foreign technology was needed if China were to start to meet domestic demand, as well as to produce for export markets. Technology transfer brought about by Hong Kong investments into the Pearl River Delta region at the time had an enormous impact, in part because the investment brought with it modern product design, production equipment, production management, quality control, packaging expertise, and marketing knowledge. Hong Kong-invested facilities generally exhibited large quality advantages over local firms in the Pearl River Delta region, even in labour-intensive products that could be made on equipment from the Chinese Mainland. This form of technology transfer continued into the late 1990s, by which time many facilities in the Pearl River Delta region had developed their own technological capabilities and the ability to absorb or copy foreign technology. By the late 1990s, direct technological transfer from Hong Kong firms to the Pearl River Delta region had diminished in importance.

Almost as soon as Hong Kong companies began to transfer technology into the Pearl River Delta region, there were firms that began to copy the technology and even in some cases the products themselves. A large number of Pearl River Delta region enterprises participated in outward processing for Hong Kong firms. Some of these companies simply produced beyond the agreed upon amount and sold the rest on the domestic market. Other firms fulfilled their processing contracts and then kept the equipment. Many other companies in the region reverse engineered the products of Hong Kong-invested outward processing enterprises from elsewhere in the Pearl River Delta region and then started producing similar products for the domestic market. Hong Kong companies usually found it fruitless to try to counteract such behaviour.
Hong Kong also has played an important intermediary role in technology transfer to the Pearl River Delta region. Since the mid-1990s, the role of Hong Kong in technology transfer to the Pearl River Delta region has shifted from that of direct provider more to that of intermediary. Increasingly, the most advanced technology introduced into the Pearl River Delta region comes from Taiwanese, Japanese or Western firms that use Hong Kong as a base of operations. In addition, Hong Kong-invested enterprises in the Pearl River Delta region play an intermediary role when they source technology on international markets and introduce it into the Pearl River Delta region. With a strong market sense and a better understanding of world markets, Hong Kong enterprises have played an important role in technology sourcing, a role that could become increasingly important in the future. However, it should be noted that more and more companies from the Pearl River Delta region are starting to source technology on world markets themselves without Hong Kong or Hong Kong-based entities acting as intermediaries. Given the trends over the last two decades, it is not surprising that direct technology transfer from Hong Kong to the Pearl River Delta region would become less important. Direct investments of leading edge foreign firms coupled with increasing capabilities in the Pearl River Delta region are creating their own dynamic.

Management transfers and interaction

Transfer and exchange of management experience often is even more important than to a developing region than technology transfer. China entered its reform period severely lacking in experience in modern management of market-oriented enterprises. For example, China only started its trial MBA programmes at Qinghua University, Beijing University, and the People’s University of China in 1991. At the onset of China’s reform programme, the Pearl River Delta region was more backward from a managerial standpoint than other regions of the country. At the time, Hong Kong-invested enterprises in the Pearl River Delta region mainly relied on Hong Kong people in management. Hong Kong managers, technicians, and some senior workers became management staff in Hong Kong-invested joint ventures and wholly owned companies, managing a large local workforce engaged in relatively simple activities.

In the 1990s, this situation began to change as the human resource pool in the Pearl River Delta region improved. University education improved and more and more university students began to seek jobs in the economically developed Pearl River Delta region. At the same time, people from the Pearl River Delta region began to use their accumulated experience to master modern management methods. This led to a division of labour in Hong Kong-invested enterprises in Pearl River Delta region, with the Hong Kong investors making policy decisions and taking up senior management posts, and their organisations
or management personnel in Hong Kong doing international market development, accepting orders, coordinating transportation, and engaging in international finance. Increasingly, people in internal management, accounting, technology, and quality control were recruited from elsewhere in the Chinese Mainland. Hong Kong management personnel gradually withdrew from first-line management and even parts of second-line management. Some Hong Kong-invested enterprises began to recruit university graduates and to give them the appropriate training. Others tended to attract people with practical experience from relatively less-developed areas in Central China, Northwest China, and Southwest China by offering higher pay. These people increasingly are populating the middle ranks of management in Hong Kong and foreign invested-enterprises. In addition to managing within Hong Kong-invested enterprises, many of the Mainland managers developed or recruited by Hong Kong firms have become the entrepreneurs that are now developing the Pearl River Delta region’s own private economy.

For firms from Taiwan, the rest of Asia, and the rest of the world, Hong Kong plays a management intermediary role. Hong Kong is the Asia-Pacific headquarters location for numerous multinational corporations. It also serves as a springboard for enterprises in Taiwan and Southeast Asian countries to invest in China, especially in South China. These enterprises have employed a large number of Hong Kong people to help manage their Pearl River Delta operations. Several also have expatriate managers who live in Hong Kong and commute to facilities in the Pearl River Delta region. Since there are no direct linkages across the Taiwan Straits, the exchange of personnel and goods for Taiwanese enterprises are mostly conducted through Hong Kong. The development of Taiwanese enterprises in Pearl River Delta has, therefore, created many new business and managerial opportunities for Hong Kong. Taiwanese enterprises use not just the physical infrastructure of Hong Kong, but also financial and other support services. Taiwanese enterprises, for example, often prefer to have financial trading in Hong Kong and take delivery on the Chinese Mainland, thus effectively avoiding risks associated with transacting on the Chinese Mainland.

As the non-governmental local sector of the Pearl River Delta region economy has developed, many of these companies have started to recruit management and professional people from Hong Kong, especially those with experience in international marketing, financial services, and human resource management. A number of Pearl River Delta region enterprises have put advertisements in Hong Kong newspapers or have held conferences in Hong Kong to recruit professional personnel resulting in a new type of managerial interaction between Hong Kong and the Pearl River Delta region.
Transportation and travel

Transportation linkages between Hong Kong and the Pearl River Delta region have expanded enormously over the last two decades. From 1980 to 1999, the GDP of the Pearl River Delta region and Hong Kong increased 15 times and five times, respectively, and the shipment of cargo between the two surged 103 times. According to industry sources, highway transport accounted for 84 percent of the freight transit into Hong Kong in 2001, with waterways accounting for 15 percent, and rail only one percent. The three-highway border crossing points between Hong Kong and Shenzhen account for the transit of some 360,000 TEUs of cargo each month. By far the busiest crossing point for truck traffic is at Lok Ma Chau, which handles 75 percent of the overland cargo flows into Hong Kong.18

There are 27 water routes for passenger ships going from the Pearl River Delta to Hong Kong and Macao and four railway ports leading to Hong Kong. In 2000, Guangdong dispatched 16,090 passenger ships and 119,180 cargo vessels to Hong Kong, 4,688,700 cargo vehicles with Hong Kong as the destination, and 922,100 passenger buses with Hong Kong as the destination. Guangdong received 4,691,100 cargo vehicles and 924,300 passenger vehicles from Hong Kong. At present, there are direct bus services between Hong Kong and major cities of the Pearl River Delta, greatly improving the land transportation conditions. For example, there were 229,700 passenger vehicle trips between Guangdong and Hong Kong in 1991. By 2000, this figure had increased to 1,846,400, or eight times the figure of ten years before.19

In November 2001, the Hong Kong government performed a survey of cross-boundary travel between Hong Kong and the Chinese Mainland at eight locations: Hong Kong International Airport, Lo Wu Terminus, Hung Hom Station, China Ferry Terminal, Macao Ferry Terminal, Lok Ma Chau Control Point, Man Kam To Control Point, and Sha Tau Kok Control Point. The 333,000 cross-boundary passenger trips per day uncovered represented a 17 percent increase from 1999. Roughly 83 percent of the passengers lived in Hong Kong, 10 percent were Hong Kong residents living in the Chinese Mainland, and five percent were others living in the Chinese Mainland. Of the trips to the Chinese Mainland, 42 percent were for leisure, 31 percent for business, 20 percent to visit friends or relatives, and four percent for travel to work in the Chinese Mainland. Of the trips to Hong Kong, 32 percent involved trips for work in Hong Kong, 23 percent for business, and 21 percent for leisure. The survey indicated that there were in the order of 31,300

vehicle trips per day, an increase of 9.7 percent over 1999. The vast majority of the vehicle trips across the border were made by container trucks (40 percent) or other goods vehicles (39 percent). Private cars accounted for 17 percent of the vehicle trips, coaches three percent, and shuttle buses one percent. Empty containers accounted for 23 percent of the container truck traffic to Hong Kong and 71 percent of the container truck traffic to the Chinese Mainland.

Tourism interaction

Close geographic, cultural, and family links between Hong Kong and the Pearl River Delta region provide a solid foundation for tourism. The process of reform and opening up fostered both business and leisure travel. Over 90 percent of the foreign tourists to the Pearl River Delta region come from Hong Kong.\(^{20}\) According to the Hong Kong Government Census and Statistics Department and the Hong Kong Retail Management Association, in 2000, Hong Kong residents spent an estimated HK$20.3 billion in Guangdong Province on personal travel, with 36 percent of this spent in Shenzhen. Of the total Guangdong expenditure, HK$10.6 billion went for lodging and meals, HK$5.7 billion for entertainment, transportation, and other services, and HK$2.1 billion for shopping.\(^{21}\) Hong Kong tourists constitute a major source of foreign exchange earnings for the Pearl River Delta region while the rapid growth of tourism in Pearl River Delta region has also injected new factors for further development of tourism in Hong Kong.

Tourism from the Chinese Mainland has become increasingly important to Hong Kong. In August 2002, 44 percent of the tourists that arrived in Hong Kong were from the Chinese Mainland.\(^{22}\) More than 80 percent of these came from Guangdong Province. In 2001, tourism receipts from visitors from the Chinese Mainland to Hong Kong reached HK$22.99 billion. Visitors from the Chinese Mainland spent an average of HK$5,169 per trip to Hong Kong, the highest among any visitor group.\(^{23}\) Tourism from the Chinese Mainland was one of the bright spots in an otherwise lacklustre economy in Hong Kong in 2002.

Several steps have been made to facilitate tourism in the Greater Pearl River Delta region. In 1993, the Pearl River Delta Tourism Marketing Organisation was set up by the Hong Kong Tourism Board, the Guangdong Provincial Tourism Bureau, and the Macao Government Tourism Office. This organisation has acted to promote tourism in Hong Kong, Macao, and the Pearl River Delta region, focusing on the exchange of tourists between the Pearl River Delta region and Hong Kong, and on marketing the Greater Pearl

\(^{20}\) The Centre for Urban and Regional Studies, Zhongshan University, “Xianggang yu zhujiang sanjiao zhou jingji guanxi yanjiu” (“A Study of the Economic Relationship between Hong Kong and the Pearl River Delta”) in Xianggang yu zhujiang sanjiao zhou jingji hudong yanjiu (A Study of the Hong Kong - Pearl River Delta Economic Interaction), April 2002, p. 23.


\(^{22}\) Hong Kong Tourism Board News, “More records set as August visitor arrivals pass 1.5 million,” September 26, 2002.

\(^{23}\) Hong Kong Tourism Board News, “Mainland visitors now top spenders as tourism receipts grow to HK$64 billion,” March 5, 2002.
River Delta region as an integrated tourist destination. In 1998, the number of overseas tourists that travelled to Hong Kong or Macao and Guangdong on the same tour reached nearly 3 million, some 40 percent more than in 1991.\textsuperscript{24} In order to facilitate Hong Kong tourist travel to Shenzhen, Shenzhen City introduced 72-hour convenience visa measures. In 2000, the granting of arrival visas for foreign tourists to Shenzhen and Zhuhai was extended to nine cities in the Pearl River Delta and the time limit was extended from 72 hours to 120 hours. In 2000, the Guangdong government also relaxed the control over tours to Hong Kong and Macao.

Some Hong Kong firms provide foreign tourism services for residents in the Pearl River Delta region. The practice of “receiving orders on the Mainland and carrying out operations in Hong Kong” is the main way that Hong Kong tourism service providers get involved in the Mainland tourism market. Some residents of the Pearl River Delta region find it more convenient and less expensive to participate in foreign tours or business tours organised by Hong Kong travel services than by domestic travel services. Many of the foreign tours by local government officials are arranged by Hong Kong travel service companies. It has become a common practice for the Shenzhen government, for example, to use Hong Kong-based service providers.

Retail shopping

Linked with increases in travel and tourism between Hong Kong and the Pearl River Delta region has been an increase in cross-border shopping. Although Hong Kong might not be considered the shopping paradise it once was, the availability of goods is still much wider than that found in the Chinese Mainland. As incomes rise in the Pearl River Delta region, more and more people from the region use their leisure, business, or official trips to shop in Hong Kong. In 2000, visitors from the Chinese Mainland to Hong Kong spent 65 percent of their total Hong Kong expenditures on shopping, making their per capita retail shopping expenditures in Hong Kong the highest of any visitor group.\textsuperscript{25} People from the Pearl River Delta region tend to shop in Hong Kong for foreign name brand products, such Japanese electronics and electrical goods, and luxury goods, such as French perfume, Italian shoes, and European garments. In the Chinese Mainland import duties on luxury consumer goods are high, distribution is inefficient, and imported goods are mostly sold in high-grade shopping centres. As a result, the prices of many branded products are far higher in the Pearl River Delta region than they are in Hong Kong. Demand generated by visitors from the Chinese Mainland also has become a mainstay of Hong Kong’s gold and jewellery

\textsuperscript{24} Ibid, p. 24.
industries, which benefit from higher standards of purity and authenticity than those found in the Chinese Mainland.

As the ease of crossing the boundary has increased, more and more low and middle-income people from Hong Kong have started to go to Shenzhen and other places in the Pearl River Delta region to shop. The border crossing areas in Shenzhen are filled with shops that cater to cross-border trade. Whereas at one time the traffic across the boundary from Hong Kong was dominated by business trips and family visits, increasingly leisure and shopping trips are becoming more important. Despite the concerns of Hong Kong retailers that such shopping was hurting their Hong Kong business, the Hong Kong Business Professionals Federation concluded that Hong Kong expenditures on the Chinese Mainland did not contribute greatly to the downturn in Hong Kong’s retail sales in 1999 and 2000. Instead, they attributed the decline to Hong Kong’s own economic circumstances. Analysts at Credit Lyonnais, on the other hand, indicated that the price differentials between goods in Hong Kong and Shenzhen would continue to fall as cross-border travel increased. The analysts believed that this would exert deflationary pressure on Hong Kong retail sales until prices came closer into line.26

Residential real estate

There is some question about the extent to which the residential property markets in Hong Kong and the Pearl River Delta region are linked. More and more people in Hong Kong are buying holiday homes or even primary residences in the Pearl River Delta region, especially in Shenzhen, Dongguan, Shunde, and Panyu. The Bank of China’s Shenzhen branch indicated that Hong Kong people bought 6.10 million square feet of housing worth RMB 2.8 billion in Shenzhen in 2001. The Bank of China launched a special mortgage scheme in 2002 to allow Hong Kong people to pay their mortgages in Hong Kong dollars in Hong Kong.27 Hong Kong people were expected to buy 19,500 to 21,400 property units in 2002 and 50 percent of these units were expected to be purchased in Shenzhen.28

The Pearl River Delta region does provide an ample supply of land suitable for residential use at prices affordable to Hong Kong residents. In addition, several housing estates in the Pearl River Delta region provide direct bus services to Hong Kong. In practice, the Pearl River Delta region residential property market serves several distinct categories of Hong Kong-based demand. These include weekend and holiday homes; residences that serve dual business and residential purposes, doubling as office premises and short-term overnight

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26 CLSA, Bridget Wong’s Diary: Hong Kong Property and the Shenzhen Effect, January 2002.
accommodation; residences for the elderly, including group retirement housing and nursing homes; and, to a limited extent, primary residences, largely for childless couples commuting to Hong Kong for work.

There is substantial variation in residential property prices by geographic location within the Pearl River Delta region. According to DTZ Research, in the first half of 2001, Shenzhen residential prices were the highest in the Pearl River Delta region, at HK$640 per square foot, followed by Guangzhou at HK$600 per square foot, on par with Macao. Zhuhai and Zhongshan were in the mid-range, at HK$430 and HK$400 per square foot, respectively. At the low end were Jiangmen and Huizhou, both at HK$230 per square foot. The price differential between high-end residential property in Shenzhen, near the HKSAR border, and comparable property in Hong Kong is substantial. As of June 2002, new prime residential property in Hong Kong was selling at between HK$3,000 and HK$4,000 per square foot, while in Shenzhen, HK$1,000 bought a “very nice” property, according to a leading Hong Kong realtor. For Hong Kong residents interested in vacation homes, such a home in Panyu can cost far less than membership in one of Hong Kong’s clubs, the site of weekend leisure activities for many well-off Hong Kong people.

Factor price equalisation between the Hong Kong and Shenzhen residential property markets has not occurred due to several factors. One reason is the travel time to get to jobs in Hong Kong. The purchase of real property is a purchase of intangible, as well as tangible assets, and Hong Kong purchasers are willing to pay a premium for the intangibles attached to purchases of property located within the HKSAR. These include secure title to property, political rights, and neighbourhood-specific public services in the areas of security, education, and medical services. A survey carried out for the Hong Kong Business Professionals Federation in 2001 indicated that 1.4 percent of the people living in Hong Kong had purchased a property in Shenzhen. Only 8.3 percent of the general public surveyed indicated that they would consider living in Shenzhen, if there were 24-hour-a-day border crossing and a reduction in border crossing time to 15 minutes or less. This indicated that property in Shenzhen was not viewed as a direct substitute to property in Hong Kong. Analysis by CLSA indicated that any cost savings a Hong Kong family could obtain by living in Shenzhen would be dissipated by higher taxes, higher mortgage rates, and higher commuting costs.

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**Hong Kong Investments in the Pearl River Delta by Sector**

Hong Kong firms have invested in a wide range of sectors in the Pearl River Delta region. Most of the analysis of Hong Kong investment in the Pearl River Delta region focuses on manufacturing investment (as for the analysis above, for example). In this section, we will focus more attention on the lesser-known investments in the services sector.

Table 3.6 shows the industrial structure of the utilisation of foreign capital in the Pearl River Delta region from all sources from 1979 to 1999. It shows that secondary industries, including manufacturing, accounted for the lion’s share of investment, followed by the tertiary sector. Only a small portion of the investment has been in the primary sector. Although precise figures are not available, experts estimate that the importance of Hong Kong investment has meant that the Hong Kong investment into the region has followed a similar pattern.
Table 3.6  Used Foreign Funds in the Pearl River Delta Region by Industry, percent

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>100.00</td>
<td>100.00</td>
<td>100.00</td>
<td>100.00</td>
<td>100.00</td>
<td>100.00</td>
<td>100.00</td>
</tr>
<tr>
<td><strong>Primary Industry Total</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Farming, forestry, animal husbandry, and fisheries</td>
<td>1.32</td>
<td>3.33</td>
<td>2.68</td>
<td>1.87</td>
<td>0.88</td>
<td>1.29</td>
<td>1.45</td>
</tr>
<tr>
<td><strong>Secondary Industry Total</strong></td>
<td>71.43</td>
<td>41.19</td>
<td>66.21</td>
<td>77.58</td>
<td>69.29</td>
<td>73.81</td>
<td>75.28</td>
</tr>
<tr>
<td>Mining and quarrying</td>
<td>0.14</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>0.13</td>
<td>0.21</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>64.98</td>
<td>41.19*</td>
<td>61.16*</td>
<td>77.54*</td>
<td>65.71</td>
<td>64.56</td>
<td>61.46</td>
</tr>
<tr>
<td>Production &amp; supply of electricity, gas, and water</td>
<td>3.15</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>5.60</td>
<td>10.94</td>
</tr>
<tr>
<td>Construction</td>
<td>3.16</td>
<td>—</td>
<td>5.05</td>
<td>0.04</td>
<td>3.58</td>
<td>3.52</td>
<td>2.67</td>
</tr>
<tr>
<td><strong>Tertiary Industry Total</strong></td>
<td>27.25</td>
<td>55.46</td>
<td>31.12</td>
<td>20.56</td>
<td>29.85</td>
<td>24.89</td>
<td>23.28</td>
</tr>
<tr>
<td>Geological prospecting and water conservancy</td>
<td>0.01</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>0.08</td>
<td>—</td>
</tr>
<tr>
<td>Transport, storage, post, and telecommunication services</td>
<td>4.37</td>
<td>13.84</td>
<td>4.14</td>
<td>1.69</td>
<td>4.43</td>
<td>7.39</td>
<td>4.46</td>
</tr>
<tr>
<td>Wholesale, retail, trade, and catering services</td>
<td>2.10</td>
<td>4.95</td>
<td>3.87</td>
<td>2.03</td>
<td>2.37</td>
<td>1.38</td>
<td>1.95</td>
</tr>
<tr>
<td>Finance and insurance</td>
<td>1.01</td>
<td>—</td>
<td>—</td>
<td>2.92</td>
<td>0.39</td>
<td>0.91</td>
<td>0.02</td>
</tr>
<tr>
<td>Real estate</td>
<td>1.27</td>
<td>25.31**</td>
<td>22.381**</td>
<td>4.531**</td>
<td>13.46</td>
<td>7.34</td>
<td>11.20</td>
</tr>
<tr>
<td>Social services</td>
<td>1.18</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>2.72</td>
<td>3.06</td>
</tr>
<tr>
<td>Health care, sports, and social welfare</td>
<td>0.51</td>
<td>0.00</td>
<td>0.05</td>
<td>—</td>
<td>1.29</td>
<td>0.75</td>
<td>0.98</td>
</tr>
<tr>
<td>Education, culture, arts, radio, film, and television</td>
<td>0.21</td>
<td>0.05</td>
<td>0.11</td>
<td>0.34</td>
<td>0.37</td>
<td>0.08</td>
<td></td>
</tr>
<tr>
<td>Scientific research and polytechnic services</td>
<td>0.06</td>
<td>0.01</td>
<td>—</td>
<td>0.04</td>
<td>0.00</td>
<td>0.24</td>
<td></td>
</tr>
<tr>
<td>Government agencies, Party agencies, and social organisations</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td>6.53</td>
<td>11.36</td>
<td>0.62</td>
<td>9.28</td>
<td>7.53</td>
<td>3.95</td>
<td>1.29</td>
</tr>
</tbody>
</table>

Note:  * including water conservancy  
** including electricity, gas, and water, production & supply, as well as social service trade  
# including mining and excavating sector  
Investment in primary industry

By the end of 1999, actual investment in the primary sector in the Pearl River Delta region accounted for less than two percent of the total Hong Kong investment in the region. The focus of this investment has been on the development of high-yielding agriculture, export-oriented agriculture, and forestry. In recent years, the Pearl River Delta region has attempted to attract foreign funds to agriculture. Forestry projects also have become a new attraction for investment from Hong Kong in Guangdong Province, making the province the biggest destination of Hong Kong investment in forestry, though again total investment in this area remains small. Other areas of interest include Guangzhou’s plans to create an organic food production centre and one of the largest botanical gardens in Asia, the latter representing an expected investment of RMB 100 million.

Investment in secondary industry

Hong Kong investment in the secondary industry was concentrated in manufacturing, with focus on export-oriented processing of a wide range of products, including electronic products, textiles, garments, plastics, machinery, and household electric appliances. In 2000, foreign-funded enterprises, including Hong Kong-invested enterprises, generated RMB 730.829 billion in total output value, accounting for 59.46 percent of the total of RMB 1228.924 billion of the gross industrial output value of Guangdong Province. The top 12 sectors in terms of output value in Guangdong were electronics and telecommunication equipment, electric machinery and appliances, textiles, garment and fibre products, leather, fur and down products, chemical raw materials and chemical products, metal products, plastic products, transportation equipment, food processing, non-metallic mineral products, instruments and meters, and office and other equipment. These were precisely the areas that attracted the largest amounts of foreign investments. With the exception of chemicals, transportation equipment, metals, and mineral products, the bulk of the external investment in these sectors has come from Hong Kong.

Hong Kong firms first moved their factories from Hong Kong to the Pearl River Delta region and then expanded and upgraded their production bases in the Delta region. In the early 1980s, Hong Kong-invested enterprises were mostly engaged in labour-intensive processing of such products as toys, garments, plastic products, and hardware. In the late 1980s, new investments deepened and broadened the Hong Kong-controlled production

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base. Production in traditional industries was deepened to include a variety of inputs, components, and sub-assemblies. The industrial base was broadened to include household electric appliances and electronic products. In the 1990s, the production base was further expanded into more technology-intensive industries, including: computers, computer parts and components, telecommunications equipment, precision instruments and appliances, intelligent toys, and fine chemicals.

By 2000, some 70 percent of the Hong Kong-invested enterprises in the Pearl River Delta region were engaged in production of textiles, garments, electronics, toys, metal products, plastics, and other labour-intensive light industrial products. Some 80 to 90 percent of Hong Kong’s plastic industry, roughly 85 percent of its electronic industry, and 90 percent of its watch and toy industries had moved to the Pearl River Delta region. The vast majority of these facilities were engaged in export activities in export processing OEM or ODM arrangements.\(^{32}\) The Hong Kong Chinese Manufacturers Association estimated that 86.1 percent of its members had set up factories in the Chinese Mainland by October 2001 and that the total number of Hong Kong-invested entities in the Chinese Mainland was 198,188, most of these in manufacturing and most of those in Guangdong Province.\(^{33}\)

In general, the Hong Kong companies kept their pre-production and post-production activities, including design, development, marketing, sales, and logistics in Hong Kong, along with senior management and finance, while decentralising production and activities closely related to production. In 1981, Hong Kong manufacturing firms employed roughly 870,000 manufacturing workers in Hong Kong and few elsewhere. By 2001, they employed only around 230,000 manufacturing workers in Hong Kong.\(^{34}\) By our estimates, by 2002, Hong Kong firms employed up to 10 million to 11 million (directly or indirectly) in the Pearl River Delta region and between 500,000 and one million elsewhere in Asia. In the process, the Hong Kong firms greatly expanded their global presence by leveraging their Pearl River Delta region facilities to grow from small firms to large, international enterprises.

**Export processing investment**

Of particular note is the investment made by Hong Kong firms in export processing. Export processing was one of the earliest forms of investment into the Pearl River Delta region and it remains prominent today. Hong Kong companies often contracted with township or village enterprises that supplied land and workshops, while the Hong Kong entity organised production and logistics. As long as the products were exported, inputs and capital goods

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\(^{32}\) The Centre for Urban and Regional Studies, Zhongshan University, “Xianggang yu zhujiang sanjiao zhou jingji guanxi yanjiu” (“A Study of the Economic Relationship between Hong Kong and the Pearl River Delta”) in Xianggang yu zhujiang sanjiao zhou jingji hudong yanjiu (A Study of the Hong Kong - Pearl River Delta Economic Interaction), April 2002, p.10.

\(^{33}\) Ta Kung Pao, “Hong Kong businesses prepare domestic sales,” January 22, 2002.

\(^{34}\) Hong Kong Census and Statistics Department, 2002.
could enter China duty-free. Most of the arrangements were for “single step” processing, in which a single production step, usually assembly, took place in the Pearl River Delta workshop. Processing contracts were typically of three-year duration. This system is still in place today and roughly 80 percent of the manufacturing investments of Hong Kong firms in the Chinese Mainland fall under the export processing regulations.

The export processing regime created a number of challenges for customs administration as smuggling and illicit sales on the domestic market became problems. Tougher enforcement in the late 1990s cut down on these activities, but also complicated operations for export processing activities. This is particularly true given the rise of China’s domestic market and the desire of many firms to use their export-oriented factories to supply the domestic market as well. In order to do so, the export processing operations have to be reclassified as foreign-funded enterprises. The question of how to evaluate capital goods that entered China duty-free and need to be assessed a duty before they can be used for goods sold on the domestic market has yet to be resolved.

The export processing regime was developed at a time when the Pearl River Delta region had a limited supplier base. As this supplier base and capabilities in the Pearl River Delta region improves, it is more and more desirable for export processing facilities to purchase local inputs and engage in multi-stage or complex processing. The mix of foreign and local inputs, however, creates further customs challenges. To reduce the coordination requirements with customs officials, many firms ship partially processed goods to Hong Kong to ensure they clear customs and then re-import the same goods for further processing. Needless to say, this creates inefficiencies, delays, and additional costs. Furthermore, customs officials usually demand that firms completely separate the production lines and inventory stocks associated with production of goods destined for the local market as opposed to the foreign markets.

All of these issues have made it difficult for many Hong Kong firms to upgrade their manufacturing base in the Pearl River Delta region.

**Investment in the service sector**

The Pearl River Delta region was the first region in the Chinese Mainland to begin opening its service sector. Overseas investment started to find its way into the hotel business in 1979, banking in 1982, and retailing in 1984. Over time, more and more Hong Kong service companies and foreign companies with Hong Kong bases have become active in the Pearl River Delta region. Today most services in the Pearl River Delta region have some external investment. Restrictions on foreign entry into the service sector, however,
have resulted in a slower penetration than in manufacturing or trade. In many service sectors, there are outright bans on foreign investments, while in others, there are strict regulations about which customers foreign service companies can serve and where they can serve them.

As there are threshold restrictions on foreign investors in the service industries in terms of assets, sales revenue, and registered capital, many overseas enterprises in the service industries in the Pearl River Delta region are large multinational corporations. Some of the world’s largest retailers, banks, shipping companies, trading firms, and professional services companies have entered the Pearl River Delta region. Many of these firms have entered to serve multinational manufacturing clients that are also active in the region. In fact, according to Chinese regulations, most foreign service providers can only serve foreign enterprises. Foreign service providers in the Pearl River Delta region are mainly concentrated in Guangzhou and Shenzhen. Although most of the largest foreign companies active in the service sector in the Pearl River Delta region are not from Hong Kong, most of these have regional activities in Hong Kong and coordinate or staff part of their Pearl River Delta activities from Hong Kong. In addition, despite size restrictions, small and medium-sized firms from Hong Kong have become active in the region.

According to statistics from the Ministry of Foreign Trade and Economic Cooperation of Guangdong Province, from 1979 to 2000, the number of foreign investment projects in service industries totalled 12,539, accounting for 14.98 percent of the total number of foreign investment contracts, involving contractual foreign investment of US$58.309 billion, or 34.22 percent of the total contracted foreign investment, and the utilised foreign investment reached US$24.4 billion, accounting for 24.70 percent of the total utilised foreign investment (see Table 3.7). As investment in the service trade mainly comes from Hong Kong firms, or through Hong Kong offices, Table 3.7 largely reflects the investment of Hong Kong entities in the service industry in the Pearl River Delta region. Leading sectors include real estate (accounting for 13.86 percent of the total foreign investment in Guangdong from 1979 to 2000), goods distribution, and the hotel business. This pattern has reflected the relative openness of the different service sectors to foreign investments.
Table 3.7  Total Overseas Investment in Guangdong’s Service Sectors, 1979-2000, US$ million

<table>
<thead>
<tr>
<th>Industries</th>
<th>Number of projects</th>
<th>Percentage of total</th>
<th>Contracted foreign direct investment</th>
<th>Percentage of total</th>
<th>Actual foreign direct investment</th>
<th>Percentage of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Geological prospecting and water conservancy</td>
<td>6</td>
<td>0.01</td>
<td>11</td>
<td>0.01</td>
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</tr>
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<td>Transport, storage, post, and telecommunication</td>
<td>803</td>
<td>0.96</td>
<td>5,569</td>
<td>3.27</td>
<td>3,789</td>
<td>3.83</td>
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<td>Wholesale, retail trade, and catering services</td>
<td>3,371</td>
<td>4.02</td>
<td>6,663</td>
<td>3.91</td>
<td>2,256</td>
<td>2.28</td>
</tr>
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<td>Finance and insurance</td>
<td>9</td>
<td>0.01</td>
<td>52</td>
<td>0.03</td>
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<td>0.07</td>
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<td>Real estate</td>
<td>4,948</td>
<td>5.91</td>
<td>40,113</td>
<td>23.53</td>
<td>13,693</td>
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<td>Social services</td>
<td>1,427</td>
<td>1.70</td>
<td>1,851</td>
<td>1.09</td>
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<td>1.83</td>
</tr>
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<td>Public health, sports, and welfare</td>
<td>173</td>
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<td>916</td>
<td>0.54</td>
<td>638</td>
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<td>Education, arts, film, and television</td>
<td>262</td>
<td>0.31</td>
<td>606</td>
<td>0.36</td>
<td>239</td>
<td>0.24</td>
</tr>
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<td>Scientific research and polytechnic services</td>
<td>459</td>
<td>0.56</td>
<td>272</td>
<td>0.16</td>
<td>80</td>
<td>0.08</td>
</tr>
<tr>
<td>Government agencies, Party agencies, and social organisations</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Others</td>
<td>1,081</td>
<td>1.29</td>
<td>2,256</td>
<td>1.32</td>
<td>1,837</td>
<td>1.86</td>
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<tr>
<td><strong>TOTAL</strong></td>
<td><strong>12,539</strong></td>
<td><strong>14.98</strong></td>
<td><strong>58,309</strong></td>
<td><strong>34.22</strong></td>
<td><strong>24,409</strong></td>
<td><strong>24.70</strong></td>
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</tbody>
</table>

Note: The percentages are of total foreign investments (the sum of primary, secondary, and tertiary industry investments)


### Real estate and hotels

As indicated, Hong Kong investors and developers have made substantial investments in real estate and hotels. Most of Hong Kong’s major developers, and several minor developers, are active in the Pearl River Delta region. Hong Kong developers have created entire office complexes and residential estates. These include New World (New World Garden in Dongguan and Ersha Island villas in Guangzhou), Changjiang Industry (Haiyi Golf Links...
and villas in Dongguan), New Honji Real Estate (Jincheng Garden in Guangzhou), and Lixin Group (Dongfeng Plaza in Guangzhou). One early example is Clifford Gardens, a complete residential and vacation home community located in Panyu and developed by Hong Kong interests. The area of this development, which includes schools, shopping, a farm, a hotel, a lake, and a full-time security staff, has expanded from its original 120 mu to nearly 10,000 mu. In the period 1991 to 1999, Hong Kong interests supplied 43 percent of the funds (and 90 percent of the foreign funds) invested in Guangzhou’s real estate industry.

Hong Kong developers have brought Hong Kong capital, Hong Kong designs, and construction techniques into the region. There was a great deal of speculative activity by Hong Kong firms in the Pearl River Delta real estate market in the 1996 to 1997 period. Though that activity cooled, Hong Kong interests are still very active in real estate in the region. In Guangzhou, Hong Kong developers are participating in the redevelopment of central Guangzhou, as well as developing several of the large residential estates along the new Guangzhou mass transit system. These investments will help transform land usage in and around the city. Hong Kong developers are also quite active in Shenzhen and the other cities of the region. Hong Kong investors also built the first high-grade hotels in the Pearl River Delta region, such as the White Swan Hotel and the Garden Hotel in Guangzhou. This helped establish standards for the hospitality industry in the region, improved the availability of accommodation for business and leisure travellers, and provided support for further economic interaction.

**Commerce and retail sales**

In June 1992, the Chinese government decided to open the retail sector to foreign investors gradually, starting with the special economic zones. This policy change stimulated investment activity by Hong Kong firms in the retail sector in the Pearl River Delta region. In 1993, China Resources of Hong Kong opened a supermarket in Shenzhen, signalling the onset of entry of Hong Kong retail enterprises into the region. Hong Kong-invested chain stores and franchised shops soon began to spread through the cities in the region. ParknShop, Giordano, Theme, Bossini, U2, Baleno, Free Bird, Seven-Eleven, Circle K, Watson’s, Jusco, TrustMart, Tianmao Group, Wanja, and the brand shops represented by Hong Kong’s Dickson Group are only some of the Hong Kong-invested entities operating in the Pearl River Delta region’s retail sector.

In Guangzhou, one of the top three cities in the Chinese Mainland in terms of retail sales,
there are more than 500 wholesale, retail sales, and catering enterprises financed by Hong Kong investment. The foreign investment in the retail sector in the Pearl River Delta region has run substantially ahead of what was provided for in China’s WTO accession agreement. Most of the investment has been allowed by local governments using flexible interpretations of Central Government policies or with the tacit consent of Central Government. Restrictions on wholly foreign-owned enterprises in the retail sector have meant that the Hong Kong investment has entered mostly through joint ventures.

Land transportation

Hong Kong enterprises have made substantial investments in land transportation in the Pearl River Delta region. The Guangzhou-Shenzhen expressway, the most important road link between Hong Kong and the Pearl River Delta region was developed by Hong Kong-based Hopewell Holdings, New World Infrastructure and Cheung Kong, along with the Guangdong Expressway Corporation. The Humen Bridge, which links the Guangzhou-Shenzhen expressway with the Guangzhou-Zhuhai expressway, was jointly built by Hopewell, GZI Transport (a subsidiary of Yue Xiu Enterprise) and the Guangdong Provincial Bureau of Transport. Hong Kong’s Wai Kee Holdings teamed up with the Shenzhen City Expressway Development Corporation to construct and operate the Shenzhen-Meiguan expressway, and has stakes in other highways in the area, such as those linking, Foshan/Guangzhou to Sanshui and Zhongshan to Jiangmen. Hong Kong businessman Henry Fok has invested in several bridges, a ferry and roads in and around Panyu in conjunction with local firms. The same group also has built several roads in and around Panyu. Hong Kong businesses also participated in the construction of many roads and bridges such as the Panyu Bridge, four new roads in Zengcheng and the expansion of the No. 106 national road.

Hong Kong investment in the Pearl River Delta has brought not only capital, but also new concepts, such as toll highways. The Hong Kong-invested Guangzhou-Foshan expressway was the first road to levy tolls in China. Since 1992, the inflow of funds from Hong Kong has helped make the Pearl River Delta region the leader in the Chinese Mainland in terms of density of expressways. With the improved land transportation facilities, the Pearl River Delta area now has much better road transportation and access to Hong Kong than before.

37 Ibid, p.11.
Sea transportation

Hong Kong firms have played an important role in the development of port facilities in the Pearl River Delta region. The port of Yantian, the most important container port in the Pearl River Delta region, was jointly developed by Shenzhen Dongpeng Holdings and Hong Kong-based Hutchison Port Holdings (HPH), under a cooperation term of 50 years. The Communications Group of Nanhai and HPH have collaborated in the construction of the Sanshan Port International Terminal. The port will have six berths during the first phase of construction and three 50,000-ton terminals in the second phase. HPH and the Zhuhai Jiuzhou Port Administration Group jointly constructed a deep-water port with a handling capacity of 4 million tons. HPH also controls 51 percent of the shares of two 20,000-ton berths of the Zhuhai Gaolan Port and controls the port at Jiangmen. Other Hong Kong-invested port facilities can be found in Shekou (Swire Pacific), Chiwan (Swire Pacific), and Nansha (Henry Ying Tung Fok). Hong Kong entities have been also active in providing ferry service throughout the Greater Pearl River Delta region. The Humen Ferry, for example, a joint investment of a company controlled by Henry Fok and four Panyu companies, carries some 15,000 vehicles a day.

In addition to investment, Hong Kong firms provide management and expertise. This has allowed the ports of the Pearl River Delta region to register impressive gains in efficiency in recent years. The joint management of ports in Hong Kong and the Pearl River Delta also has created an issue raised in a report from CLSA of whether the Hong Kong firms are using their positions in both Hong Kong and Shenzhen to artificially keep prices high in both locations.38

Market Access by Informal Means in the Service Sector

Official data on the penetration of Hong Kong and other foreign-invested service firms in the Pearl River Delta region tell only a small part of the story. In particular, they do not reflect service activities that have developed through informal mechanisms used to bypass official restrictions. In addition to outright prohibitions on foreign investment in many of China’s service sectors, there are stringent restrictions even in areas in which foreign investment is allowed. For example, in many sectors there are restrictions on the size of the companies that may operate in the Chinese Mainland. Another restriction involves the portion of shares that may be controlled by a foreign entity. In usual circumstances, only joint ventures are allowed in the service sector, with the shares of

38 CLSA and Christine Loh, Ports, airports and bureaucrats - Restructuring Hong Kong and Guangdong, October 2002, p.23.
overseas partners not exceeding 50 percent and overseas partners not acting as the legal representatives.

There are several ways that foreign capital can enter the Pearl River Delta region through informal means. The first is capital that is foreign in origin, but registered under names of local people or hidden in other ways. The second is capital that has entered openly and legally, but has been used beyond a strict service or geographic mandate. The third occurs when foreign firms officially enter joint ventures as the non-controlling party, but in fact control the venture. This might happen, for example, when overseas investors lend money to the domestic partners for their share of investment. The fourth mechanism occurs when foreign investment is introduced by local government modifications of Central Government policy or with Central Government consent, either explicit or tacit. Since the Pearl River Delta region is an area approved by the Central Government for experiments in opening up the service sector, local governments have a certain degree of autonomy and often introduce projects that are restricted according to the policies of the Central Government.

In addition to the investments that formally comply with regulations on the Chinese Mainland, there are several industries in which informal mechanisms to obtain access have been used. Foreign investment in most consumer services is prohibited by Chinese government policy, but Luohu Business Town and Dongmen Commercial Street in Shenzhen are full of enterprises in which foreign capital has funded companies registered under the names of locals. Import and export services in China have been off limits to foreign companies, but foreign investors have been known to register in the name of a domestic company with businesses affiliated to a state-owned specialised foreign trade company, which is paid a management fee. Although there are tight restrictions on foreign insurance providers in the Pearl River Delta region, some companies market to customers in the Pearl River Delta region and then sign them up in when they travel to Hong Kong or Macao. In printing, the Shenzhen City Cultural Bureau opened the industry in the name of introducing advanced equipment and technology. In print media, foreign investors can participate by focusing on operations, such as advertising, distribution, and printing, but not by being involved in the editorial aspects of the business. Foreign real estate agencies have formed joint ventures registered as domestic enterprises to enter the industry. Difficulties in defining the services that are closed have opened loopholes that some have exploited. Foreign advertising firms are restricted to serving foreign-invested enterprises, but some have developed local customers by launching joint ventures with domestic firms.

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In some restricted professions, Hong Kong-based professionals have been invited to provide specialist services or advice by government agencies in the Chinese Mainland.

The Spatial Profile of Hong Kong-Pearl River Delta Region Interaction

Hong Kong’s interaction with the Pearl River Delta region is highly location specific. The vast majority of the interaction is with the eastern and central parts of the Delta. This is true of investment links, trade links, service links, travel links, and passenger links. There are many results of this location specificity. When people in Hong Kong tend to think of the Pearl River Delta region, they tend to just focus on the eastern side. In addition, differences in links with Hong Kong have had a demonstrable influence on the development of different parts of the Pearl River Delta region.

The main reason for the differences in the density of links between Hong Kong and various parts of the Pearl River Delta region is connectivity. The vast majority of the Hong Kong-based company owners and senior managers that we interviewed indicated that their firms would only invest in facilities that could be reasonably reached in three hours by automobile from Hong Kong. They wanted to ensure that it was possible to leave Hong Kong in the morning, visit the factory, and then return to Hong Kong the same day. This roughly translates to a trip of three hours or less. For most firms this precluded locations other than the eastern and central portions of the Pearl River Delta from Shenzhen to Guangzhou. The same “magic three hours” was cited by Hong Kong-based service providers, who indicated that they generally would not try to serve clients more than a three-hour automobile trip from Hong Kong. It also was cited by foreign buyers, who want to be able to visit the factories where their products are made within a three-hour trip of Hong Kong. These owners, managers, service providers, and buyers did not want to be restricted to ferries and ferry timetables.

According to the Hong Kong government’s 2001 survey of cross-border travel, the vast majority of passenger trips and vehicle trips that connected Hong Kong with the Chinese Mainland actually linked Hong Kong to the eastern or central portion of the Pearl River Delta region. Of the passengers crossing from Hong Kong into the Chinese Mainland, 61 percent had Shenzhen as their destination, 14 percent had Dongguan as their destination, eight percent had Guangzhou as their destination, and 17 percent were going to other

destinations. The sources or destinations of cross-border passenger car trips between Hong Kong and the Chinese Mainland were: Shenzhen 64 percent, Dongguan 17 percent, Guangzhou four percent, Huizhou three percent, and “Other” 12 percent. Passenger cars are important because they are the preferred means of travel of factory owners, foreign investors, and senior managers. Of the container trucks and goods vehicles crossing the boundary, the sources or destinations in the Chinese Mainland were: Shenzhen 52 percent, Dongguan 34 percent, Huizhou five percent, and “Other” nine percent. According to industry sources, only one-third of the container throughput for the port of Hong Kong comes from the western part of the Pearl River Delta region, with two-thirds coming from the eastern portion of the Delta. The simple conclusion from these results is that the connectivity between Hong Kong and the eastern portion of the Pearl River Delta region is far greater than that between Hong Kong and the western portion of the Pearl River Delta region.

The value of this connectivity can be seen by tracing the differences in development between the eastern portion of the Pearl River Delta region and the western part of the region. According to the Guangdong Statistical Bureau, in 1980, for example, Zhuhai and Zhongshan, the two jurisdictions immediately north of Macao on the western side of the Delta had registered populations of 365,000 and 1,010,000 respectively. Shenzhen and Dongguan had populations of 321,000 and 1,127,000 respectively. The GDP of Zhuhai and Zhongshan were RMB 375 million and RMB 635 million respectively, while those of Shenzhen and Dongguan were RMB 270 million and RMB 704 million respectively. In other words, in 1980 the combination of Zhuhai and Zhongshan was nearly identical to the combination of Shenzhen and Dongguan in terms of population and economic output. By 1990, the combined Census population of Shenzhen and Dongguan (1.66 million and 1.74 million) had outpaced that of Zhuhai and Zhongshan (635,500 and 1.24 million). The combined GDP of Shenzhen and Dongguan (RMB 13.59 billion and RMB 6.46 billion) was more than twice that of Zhuhai and Zhongshan (RMB 4.11 billion and RMB 4.35 billion). By 2000, the Census populations of Shenzhen and Dongguan were 7.01 million and 6.45 million, while those of Zhuhai and Zhongshan were 1.24 million and 2.36 million. In 2001, the combined GDP of Shenzhen and Dongguan (RMB 195.5 billion and RMB 57.89 billion) were now more than three times that of Zhuhai and Zhongshan (RMB 36.66 billion and RMB 36.25 billion). From a virtual dead heat in 1980, the combination of Shenzhen and Dongguan had grown to three times the population and economic output of their western counterparts.\footnote{Numbers taken from \textit{Guangdong Statistical Yearbook}, various years.}

Why did the two portions of the Pearl River Delta region that started with virtually identical populations and economic outputs diverge so dramatically? Both are in the Pearl River
Delta region. Both have a Special Economic Zone (Shenzhen and Zhuhai). The main difference has been the connectivity of the eastern portion of the Delta with Hong Kong. The result has been a huge influx of investment, technology, and management from Hong Kong firms and foreign firms with Hong Kong offices into the eastern portion of the Delta. This investment, in turn, powered the development of an export economy in Shenzhen and Dongguan that allowed those two jurisdictions to leave their western Delta counterparts far behind.

The Importance of the Interaction

The interaction of Hong Kong and the Pearl River Delta region has been crucial to the prosperity that both have enjoyed over the last two decades. In the Pearl River Delta region, Hong Kong firms have helped develop a world-class manufacturing base that has greatly improved their ability to serve world markets. This base has allowed the port of Hong Kong to become the world’s busiest container port and the world’s busiest international cargo airport. It has enhanced Hong Kong’s role as a centre for finance, management, coordination, and communication. Increasingly it also is developing into a critical market for Hong Kong firms and the Hong Kong offices of foreign firms.

Despite these clear benefits, Hong Kong people at times appear ambivalent in their attitudes toward the Pearl River Delta region. Often they fail to grasp the advances that have been made within the Pearl River Delta region and fail to understand the roles that firms from other locations and indigenous enterprises are increasingly playing in the region. They tend to still believe that Hong Kong is in some ways leading the development of the Pearl River Delta region, rather than participating in development that is based on the resources, capabilities, and enterprise found throughout the Greater Pearl River Delta region.

At the same time, some people in the Pearl River Delta region claim that Hong Kong is less important to the development of the Pearl River Delta region today than it was in the past. They point out that the portion of external investment coming from Hong Kong has diminished in recent years and that the most advanced technology today comes from Taiwanese, Japanese, and Western companies, not Hong Kong companies. It is undoubtedly true that Hong Kong provides a lower percentage of the inward investment, handles a smaller percentage of the cargo flows, and provides a smaller percentage of the technology transfer and management capabilities for the Pearl River Delta region than was once the case.

However, the view that Hong Kong is less important to the Pearl River Delta region today is at best partial. It overlooks the fact that pre-existing investments still produce goods, still employ people, and still contribute to the region’s prosperity. Hong Kong’s share of
cumulative external investment in the Pearl River Delta region still exceeds 70 percent and its share of present output of foreign firms is likely to be far higher than that. It overlooks the role that Hong Kong plays in facilitating the external investments from other economies. Interviews with managers from numerous multinational firms indicate that without Hong Kong, they never would have invested in the Pearl River Delta region in the first place. It overlooks the fact that the bulk of the exports of the Pearl River Delta region still flow through Hong Kong’s port and airport. It also overlooks the substantial differences in development between areas in the region that have good connections to Hong Kong and those that do not.

Over the last two decades the economic interaction between Hong Kong and the Pearl River Delta region has grown and deepened to the point where it is impossible to seriously discuss the development of one without also discussing the development of the other. It is the interaction that has improved the competitiveness of the Greater Pearl River Delta region. The interaction also has fostered a division of labour and competition between Hong Kong and the Pearl River Delta region. It is this division of labour and competition to which we turn next.
4. Division of Labour and Competition in the Greater Pearl River Delta Region

Over the years, a strong division of labour has developed between Hong Kong and the Pearl River Delta region. This division of labour has been driven by differences in systems, costs, skills, and capabilities, market knowledge, linkages with the rest of China, linkages with the rest of the world, the nature of the workforce, and so on. One key aspect of the division of labour is that it has been good for both sides. In other words, the economies of Hong Kong and the Pearl River Delta region are for the most part complementary. This complementarity has been a great advantage and source of development. At the same time, there is an increasing sense of competition between Hong Kong and the Pearl River Delta region in a range of activities and industries. Some of this is due to the natural development of the Pearl River Delta region, while other aspects seem to be driven by the sizeable cost differential between Hong Kong and the Pearl River Delta region.

Manufacturing Industries

In the 1980s, many Hong Kong firms started their migration into the Pearl River Delta region by moving relatively simple assembly activities in a search for lower costs. Over time, more and more extensive manufacturing activities were moved out of Hong Kong or built up for the first time in the Pearl River Delta region. As the Pearl River Delta region continued to grow, Hong Kong firms and firms from Taiwan and elsewhere began to place other activities related to logistics, quality control, sourcing and packaging into the region. Today, these and more activities are being built up in the Pearl River Delta region. At the same time, Hong Kong still retains many of the highest value-added activities.

As the division of labour between Hong Kong and the Pearl River Delta region has evolved in manufacturing industries, so too has competition between firms from Hong Kong and those from the Pearl River Delta region. In many instances, the competitors use similar manufacturing capabilities that are now available in the Pearl River Delta region. Increasingly, the Pearl River Delta firms are able to set out on their own without the direct aid of Hong Kong firms, sometimes using Hong Kong as a channel to international markets.

Division of labour in manufacturing industries

Within the manufacturing and manufacturing-related trading industries, the division of labour within the Greater Pearl River Delta region is evolving over time. Perhaps the current division of labour can be best seen in the evolution of the activities of Hong Kong-owned or invested manufacturing and related trading companies in the region. Results of
two surveys carried out by the Hong Kong Trade Development Council\(^1\) are portrayed in Figures 4.1, 4.2, and 4.3. In these surveys, Hong Kong companies were asked about the future locations of their various activities. In 1997, well over 90 percent of the firms expected that their trade documentation and finance would be located in Hong Kong the future. At the other extreme, fewer than 20 percent expected any of their manufacturing activities to be located in Hong Kong (see Figure 4.1). In general, the higher value added the activity, the greater the expectation that it would be performed in Hong Kong in the future.

**Figure 4.1.** Hong Kong Manufacturing and Trading Companies
Activities Expected to be Performed in Hong Kong in the Future

Source: Created from data from the Hong Kong Trade Development Council

In 1997, the same companies exhibited the opposite expectations about the location of their activities in the Chinese Mainland (see Figure 4.2). In fact, the two figures show the almost pure complementarity between Hong Kong and the Chinese Mainland. Since the

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vast majority of the activities of the Hong Kong firms in the Chinese Mainland were in, and were expected to be in the Pearl River Delta region, the figures show the complementarity between Hong Kong and the Pearl River Delta region for manufacturing and related trading companies. The year 2000 results in Figures 4.1 and 4.2 show the expectation of an almost across the board decrease in activities to be located in Hong Kong and a similar increase in the activities to be performed in the Chinese Mainland. Figure 4.3 shows that some activities (such as market research, marketing, and promotion) were expected to be expanded in third economies (neither Hong Kong nor the Chinese Mainland) and other activities (mostly linked to manufacturing and logistics) were expected to contract in third economies.

**Figure 4.2.** Hong Kong Manufacturing and Trading Companies

Activities Expected to be Performed in the Chinese Mainland in the Future

Source: Created from data from the Hong Kong Trade Development Council

To a certain extent these results are to be expected given the rapid development of the Pearl River Delta region and the increasing number of activities that can be performed there. The most dramatic movements out of Hong Kong were expected in some areas related to business negotiation, marketing, freight forwarding, and consolidation, material
sourcing, and warehousing and inventory. Some of these expected movements out of Hong Kong represented movements of marketing-related activities closer to customers in China and in third economies. Some of the movements represented the further consolidation of manufacturing and closely related activities into the Chinese Mainland from both Hong Kong and third economies. Others represented an increased focus on performing logistics and sourcing activities in the Chinese Mainland.

**Figure 4.3. Hong Kong Manufacturing and Trading Companies**

Activities Expected to be Performed in Third Economies in the Future

Source: Created from data from the Hong Kong Trade Development Council

Our own interviews indicated a similar pattern. For Hong Kong firms with activities in the Pearl River Delta region, a small number of senior-level staff in Hong Kong generally oversees a much larger staff based in the Pearl River Delta region. Although top management is based in Hong Kong, it is not uncommon for top managers to spend four out of five days per week on site in the Pearl River Delta region. Hong Kong is still the preferred location due to family and lifestyle considerations. Many senior managers would not consider moving away from Hong Kong’s housing, schooling, medical facilities, cultural amenities,
and other support services. Many Hong Kong-based senior managers have mixed feelings about localising upper level management in the Pearl River Delta region. While they appreciate the rising skill levels and wage advantages they could obtain in the Pearl River Delta region, they are less comfortable about the loyalty and specialist expertise of managers from the Chinese Mainland. The corporate communications and finance functions for the Hong Kong firms tend to be kept in Hong Kong in close proximity to the seat of senior management.

The managers told us not only that the vast majority of production had moved out of Hong Kong, but that some Hong Kong firms have exited manufacturing altogether to focus on supply chain management. Purchasing departments of Hong Kong firms that purchase inputs primarily from within the Chinese Mainland are increasingly moving to the Pearl River Delta region, while Hong Kong remains the dominant location for purchasing offices for Hong Kong firms that purchase inputs from international markets. Technological development is often split, with research, customer-oriented design, and fine-tuning being carried out in Hong Kong and the bulk of the basic application development undertaken by technical staff in the Pearl River Delta region. Quality control increasingly is performed in the Pearl River Delta region, though Hong Kong retains a role. Routine bookkeeping associated with production has often been moved to the Pearl River Delta region (though often performed by Hong Kong people), while senior level accounting remains in Hong Kong.

For many internationally oriented firms, the sales and marketing teams tend to be based in Hong Kong, where the knowledge of international markets is far superior to that found in the Pearl River Delta region. On the other hand, in some industries, notably toys, international buyers already have set up offices in the Pearl River Delta region, forcing Hong Kong-based firms to move their sales teams into the Pearl River Delta region as well. In general, however, the activities associated with commercialisation of the products for the international markets take place in Hong Kong to take advantage of the knowledge and expertise of international and individual markets. Although many Hong Kong firms still use Hong Kong as a base for commercialising their products for the Chinese Mainland, increasingly they are looking to locations in the Pearl River Delta region to perform this role.

**Competition in manufacturing industries**

In several light manufacturing industries, the competition in the Greater Pearl River Delta region is between Hong Kong producers with Pearl River Delta facilities and Chinese Mainland companies with facilities in the Pearl River Delta region. Hong Kong companies that once were virtually unrivalled in the low-priced segments of their industries, now
face stiff competition from Pearl River Delta region counterparts. Hong Kong firms have retained strong positions in mid-priced segments through the development of strategies that add value through design, technology, systems integration, marketing, or developing novel channels and specialist capabilities.

A recent study by the Trade Development Council of Hong Kong companies’ participation in Mainland markets found that the extent of that participation varied greatly by product due to “keen competition from indigenous Chinese enterprises,” as well as copyright/trademark infringement. Goods manufactured by Hong Kong companies facing competition from indigenous Mainland firms include watches, toys, and electronics, as well as clothing, luggage, and handbags.

In the watch industry, for example, Hong Kong firms in the low end of the market are faced with increased competition from firms from the Chinese Mainland, mostly run by former employees of the Hong Kong firms. They reverse engineer Hong Kong products and offer their goods to foreign buyers at steep discounts, often 50 percent or more. Industry sources estimate that Mainland firms already have obtained 10 percent of the market. On the other hand, Hong Kong firms continue to dominate the OEM, ODM, and premium (watches used as premiums, not premium-priced watches) segments. Here their abilities in design, ability to deliver large quantities with short lead times, knowledge of international markets, reputation for reliability, and financial strength are key advantages.

In the toy sector, Hong Kong-owned firms face strong competition from Chinese Mainland-owned firms in the lower end of the market. The Mainland firms tend to sell to the developing markets and to European nations where distribution is still relatively fragmented. They tend to reverse engineer products developed by Hong Kong firms, and their cost structures are lower because they do not spend on Hong Kong marketing offices or on research and development. In the middle tier of the market, Hong Kong firms stay ahead by constantly developing new products in a segment where the shelf life of a new product often is six months. Hong Kong companies report less competition from Pearl River Delta region firms in the OEM, ODM, and branded market segments. The Hong Kong firms in these segments take advantage of their reputation, design capabilities, financial strength, logistics capabilities, and knowledge of international markets. Even if they are not direct competitors, firms from the Pearl River Delta region still exert a negative influence on price in these segments due to their presence in lower-priced segments.

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3 Authors’ interviews and Hong Kong Trade Development Council, *Hong Kong’s Trade and Trade Supporting Services: New Developments and Prospects*, January 2002, p. 25.
In the electronics sector, many Hong Kong firms have found that today’s partner from the Pearl River Delta region is tomorrow’s competitor. In low-end consumer electronics, a partnership of two years can provide enough technology transfer for the recipient to set up as a direct competitor. At that point, the Pearl River Delta competitor will typically look to compete in both domestic and international markets. Many Pearl River Delta firms are able to make incremental upgrades on the products of Hong Kong firms. At the higher end, firms like Huawei and TCL are capable of competing with the leading Hong Kong and international firms. They are rapidly assimilating advanced business concepts and are starting to rely on subcontracting networks themselves. Many managers of Hong Kong-owned electronics firms believe that companies from the Chinese Mainland are better equipped to sell into the Mainland markets than the Hong Kong firms. Several of the Mainland firms have the financial and marketing backing of local or national government and have developed distribution systems throughout the Chinese Mainland.

**Trade-Related Services**

The international orientation of the economies of the Greater Pearl River Delta region has made trade-related services absolutely critical to the region. Historically, Hong Kong has been the major source of trade-related services for the entire region. In recent years, however, there has been an emerging division of labour between Hong Kong and the Pearl River Delta region and even competition between Hong Kong trading entities and firms based in the Pearl River Delta region.

**Division of labour in trade-related services**

Hong Kong plays a major role in providing access to foreign markets for production originating in the Pearl River Delta region. Hong Kong’s import and export trade sector employed 500,719 people in 98,339 establishments as of December 2001. Its exports of trade-related services reached HK$97.6 billion in 2000, or 30.7 percent of Hong Kong’s service exports. Hong Kong’s trading role is supported by Hong Kong’s strengths as a city centre for trading and commercial activities for the region, and by the strategic strengths of Hong Kong-based traders and suppliers. For Western buyers, Hong Kong is the preferred destination for sourcing product. Hong Kong is “where the foreign buyers like to come” because it offers a critical mass of sales representatives conveniently located within a small area that allows foreign buyers to meet with large numbers of sales representatives without having to travel to the factories. For those who do wish to visit the factories, the
dense concentration of factories nearby in the Pearl River Delta region permits buyers to make selective visits to factories if required. Hong Kong offers world-class hard and soft infrastructure, including airport facilities and air flight connections, communications, ports and logistics, and professional support services.

Hong Kong provides direct access to foreign markets because of the differentiated strategies of Hong Kong-based traders and suppliers. At the high-end, Hong Kong traders and suppliers mastermind the supply chain linking the Pearl River Delta region’s manufacturing base with the world’s largest consumer markets. These supply chain masters have become active in the OEM, ODM, “branded” and “premium” lines of business by building up a respected profile, building a position of trust with the world’s largest buyers and delivering goods to customer shelves via a process that is “trouble free”.

Compared to Mainland counterparts, Hong Kong traders and suppliers are viewed as having superior knowledge of foreign markets, deeper understanding of customer needs, a higher degree of responsiveness to customers and greater attention to detail. Hong Kong traders and suppliers also play a pivotal role in translating the requirements of Western customers into precise technical specifications for relay to manufacturing teams in the Pearl River Delta region. Hong Kong firms can martial the production capabilities of thousands of factories in the Pearl River Delta and oversee the completion of mega-orders. They provide selective screening of those production facilities in the Pearl River Delta region capable of performing to specification. Avoidance of product defects that could cause a recall is a major concern to Western buyers. The factories that are chosen for meeting large orders tend to be Hong Kong-owned, not Mainland-owned.

**Competition in trade-related services**

Although Hong Kong still plays a major role in trade-related services for the Greater Pearl River Delta region, competition from Pearl River Delta-owned firms is rising. Some Pearl River Delta-based manufacturers are becoming proactive in accessing foreign markets directly. Some choose to set up marketing offices in Hong Kong, while others use the Canton Fair (which tends to attract buyers from Latin America, the Middle East, and other third world markets, as well as buyers from major markets operating in cut-rate segments), foreign trade fairs overseas, or even marketing offices overseas. Some Mainland garment firms have set up sales offices in New York and London, for example, to solicit potential clients. Many small and medium-sized Hong Kong traders voiced the opinion that the Internet is permitting Mainland firms and foreign buyers to interact directly. Though both large and small Hong Kong trading companies acknowledged the Internet as a force driving
change in their sector, small and medium-sized enterprises were more likely to view it as a direct threat to their “niche” as a Hong Kong trader. They point out that major Western buyers now have websites that permit Mainland firms to study their product specifications first-hand and initiate direct contact.

Some foreign buyers in price-sensitive markets and segments are seeking direct contact with Pearl River Delta firms to access lower-priced product, through trade fairs including the Canton Fair, Hong Kong-based buying offices, or direct visits to the Pearl River Delta region. In addition, major Western buyers are setting up sourcing centres in Shenzhen, supported by Shenzhen-based freight consolidation warehouses to permit export direct from Shenzhen ports. However, they have not shifted entirely to sourcing directly from Mainland-owned factories. Interviews suggest that Wal-Mart and other major buyers now based in Shenzhen are still relying on Hong Kong “supply chain masters” to manage design and production activities in Hong Kong and the Pearl River Delta region, in sectors such as electronics and toys.

Overall, the impact of competition with direct sales or Pearl River Delta based traders appears to be limited to Hong Kong’s small and medium-sized traders. There was little or no evidence that Hong Kong’s supply chain masters are being bypassed at present. The larger Hong Kong firms are taking measures to strengthen their direct contacts with foreign buyers through their own overseas marketing and sales offices. However, one area of concern for the large firms was the move by Wal-Mart and other major buyers to set up large sourcing centres in Shenzhen, and the potential implications of this development for future sourcing patterns.

**Sea Cargo**

Given the growing prominence of the Greater Pearl River region as one of the world’s great manufacturing and export bases, it is not surprising that the region also is one of the largest markets for sea cargo services in the world. Again, this is an area in which Hong Kong’s position was once by far the dominant one in the Pearl River Delta region. However, as the ports of the Pearl River Delta region improve along several dimensions and costs in Hong Kong stay high, the Pearl River Delta region ports, particularly those in Shenzhen, are attracting a larger and larger share of the business. It must be said, however, that the main ports in the Pearl River Delta region are at least partially owned and managed by Hong Kong companies that have transferred capital, knowledge, and reputation into the new ports. Thus the competition is largely among the Hong Kong operations and the Pearl River Delta operations of the same Hong Kong firms.
Division of labour in container ports

Hong Kong is the world’s busiest and most efficient maritime container port, visited by more than 36,000 vessels each year. Hong Kong is also a major shipping hub for the Asia Pacific region and for China, handling approximately 40 percent of China’s exports, compared to 10 percent through Shanghai. Hong Kong is the principal sea transport hub for the Pearl River Delta. An estimated 80 percent of the exports and imports of Guangdong Province pass through Hong Kong. In terms of volume, Hong Kong’s eight container terminals at Kwai Chung/Stonecutters Island handled 11.3 million TEUs in 2001. Hong Kong’s mid-stream and river trade operations handled 3.0 million TEUs and 3.5 million TEUs, respectively, in 2001, bringing Hong Kong’s total container traffic to 17.8 million TEUs.\(^5\) Hong Kong’s sea transport role is supported by world class capabilities in communications, logistics and freight forwarding, trade documentation, and trade-related services, as well as Hong Kong’s status as a free port and its highly developed judicial, legal, and regulatory regimes. In addition to physical infrastructure, Hong Kong offers world-class efficiency in container handling, customs administration, and logistics support. It also offers the highest frequency of shipping line visits and the densest route network of any seaport handling China trade.

Shenzhen’s container ports handle approximately 20 percent of the exports and imports of Guangdong Province. The leading container ports in the Pearl River Delta region are the Shenzhen ports of Yantian, Shekou, and Chiwan. Buoyed by the Pearl River Delta’s rapid export growth, Shenzhen’s overall container throughput achieved an average annual growth rate of 73.9 percent between 1991 and 2001.\(^6\) In 2001, the Shenzhen ports overall handled 5.04 million container TEUs. Their total container throughput for 2002 was 7.5 million TEUs.\(^7\) The Shenzhen seaports provide a lower-priced alternative to Kwai Chung for product originating in many areas of the Pearl River Delta region. Land-haulage costs from factory gate to seaport are lower, as are the handling charges imposed at the ports. As of November 2002, terminal handling charges in Shenzhen were between 21 and 49 percent lower than in Hong Kong depending on the destination and container size.\(^8\) Overall, shipping schedules are less frequent (though this is improving), and cargo handling and customs clearance are viewed as less efficient than at Kwai Chung.

Yantian, located 23 nautical miles northeast of Hong Kong, is the principal deep-water alternative to Kwai Chung. Yantian provides deep-water access, low-cost back-up land,
and a rail connection to the Guangzhou-Shenzhen main line. Compared to Yantian, Shekou provides lower-cost shipping but less frequent vessel schedules and can be a logical choice for low-priced product that is not time-sensitive. In terms of destination, there is a split in the major trade lanes, with United States services tending to ship out of Yantian and European services out of Shekou. Yantian receives shipments originating throughout the Pearl River Delta and is often favoured for product originating in the Eastern part of the Delta. Shekou is comparatively well positioned for flows out of Guangzhou and Zhuhai. Outside of Shenzhen, Guangzhou has a river port at Huangpu and is planning a new port complex to be located at Nansha.

Table 4.1 Comparative Statistics on Container Throughput of Hong Kong and Shenzhen

<table>
<thead>
<tr>
<th></th>
<th>Kwai Chung terminals</th>
<th>Overall ports</th>
<th>Shenzhen Major terminals*</th>
<th>Shenzhen Overall ports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Period</td>
<td>0000 TEUs</td>
<td>Growth</td>
<td>0000 TEUs</td>
<td>Growth</td>
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<td>1997</td>
<td>956.4</td>
<td>9.3%</td>
<td>1,438.6</td>
<td>8.2%</td>
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<td>955.5</td>
<td>-0.1%</td>
<td>1,458.2</td>
<td>1.4%</td>
</tr>
<tr>
<td>1999</td>
<td>1,029.5</td>
<td>7.7%</td>
<td>1,621.1</td>
<td>11.2%</td>
</tr>
<tr>
<td>2000</td>
<td>1,160.3</td>
<td>12.7%</td>
<td>1,809.8</td>
<td>11.6%</td>
</tr>
<tr>
<td>2001</td>
<td>1,128.5</td>
<td>-2.7%</td>
<td>1,782.6</td>
<td>-1.5%</td>
</tr>
</tbody>
</table>

*Shenzhen Major Terminals refer to Shekou Container Terminals, Chiwan Container Terminals and Yantian International Container Terminals

Source: Hong Kong Shippers’ Council, citing Hong Kong Government Census and Statistics Department, Marine Department, Port and Maritime Board, Shenzhen Municipal Transport Bureau, and the Shenzhen Municipal Port Authority

Competition in sea cargo

Hong Kong and the Shenzhen ports compete directly for cargo flowing from the Pearl River Delta. Figures for 2001 show that, Hong Kong handled container throughput of 17.8 million TEUs and growth was generally flat, while Shenzhen handled around 5 million TEUs and grew at an annual rate of 27 percent. In 2002, monthly throughput through Shenzhen’s major terminals grew on average by 50 percent compared with the same month in 2001, while Kwai Chung’s year-on-year throughput growth was negative for the first three months of the year, rising to 13.8 percent in September, before declining to 2.5 percent in October. The choice of port is determined by several factors, including cost considerations, border crossing delays, license terms, buyer practices and preferences, frequency of sailings, customs clearances, and quality of support services.
The shift of product flows in favour of the Shenzhen ports is driven primarily by costs. The major drivers of cost are land-haulage (trucking) charges from the factory gate to the pier and terminal handling charges (THCs). The cost of trucking from factories in the Pearl River Delta to the Shenzhen ports is reported to be half that of trucking to Hong Kong and THCs in Shenzhen can be 21 percent to 49 percent lower than in Kwai Chung. Overall, exporters reported that they can save 50 percent shipping out of the Shenzhen ports in land haulage and THCs, but ocean freight costs, according to some exporters, can be higher out of the Shenzhen ports. The net savings resulting from use of the Shenzhen ports was reported to be in the range of 20 percent to 33 percent. The cost calculation varies case by case and is influenced by factors including the precise location of the factory, and whether the load reaching the port is a whole or partial container load. Exporters are generally of the view that if they are not shipping full containers, consolidation is done better in Hong Kong. With respect to the Shenzhen ports, exporters noted minimum customer charges regardless of size of load, delays in filling up containers, and delays in customs clearance caused by unrelated merchandise sharing a container.

Trucking cargo into Hong Kong via the Shenzhen-Hong Kong border control points is seen as a major inconvenience. Overall, the average waiting time for goods vehicles at the border control points is between two and four hours, but at peak times it can be considerably longer. As one garment manufacturer explained, driving straight through from Hong Kong to his factory in Dongguan takes only 1.5 hours, but delays affecting trucks at the border can turn it into a six-hour trip. Despite the recent opening of the Lok Ma Chau “border port” to cargo on a 24-hour basis, most exporters do not regard late-night crossings as a viable option because only one kiosk is open, resulting in undesirable queues. Most drivers prefer to wait till the morning to cross through. In contrast, factories located in the Pearl River Delta can truck cargo to the Shenzhen ports on a 24-hour basis.

License or customer requirements also can influence the choice of port. Some exporters reported that the sole reason for their continued shipping out of Kwai Chung relates to the terms of their export processing licenses. Their licenses require goods processed in the Pearl River Delta to be exported back across the Hong Kong-Shenzhen boundary prior to re-export overseas. Other customers are able to specify the port they wish to use. While in the past most of these customers would specify Hong Kong due to its efficiency and reliability, increasingly buyers in some categories are specifying Shenzhen ports. This is particularly true of some large US distributors, like Wal-Mart, that have set up their own consolidation centres in Shenzhen to take advantage of lower costs. Some exporters report that, in a new development, shipping companies in the United States and Europe are also asking them to ship directly from Shenzhen.
One of the big advantages of Kwai Chung over the Shenzhen ports is the frequency of vessel arrivals at port. In interviews, exporters estimated the length of the delay that Yantian represented over Kwai Chung from three days to one or two weeks. However, the exporters also noted that the frequency of vessel arrivals continues to improve at the Shenzhen ports. A few even claimed that for their business needs, frequencies were actually superior out of Yantian than Kwai Chung.

Hong Kong Customs provide world-class efficiency, transparency, and predictability, at “international standards.” Cargo passes through Hong Kong Customs faster and with far more certainty and security, reflecting superior systems, procedures, and technical know-how. Cargo shipped out through the Shenzhen ports must undergo China Customs clearance, which has traditionally entailed extensive paperwork and the presentation of physical accounting records on a shipment-specific basis. Transition to an electronic system is currently under way, but exporters still report onerous information requirements, lack of predictability, unanticipated cargo detentions, and lengthy sampling procedures. In interviews, exporters also noted the superiority of supporting services in Hong Kong, including export finance, trade documentation, and logistics. Exporters are generally of the opinion that if they route cargo through Hong Kong, they pay higher prices for higher efficiency. Some are willing to pay this price, while others as one exporter told us were “willing to lose sleep the night before shipment from Yantian, in order to save the money.”

**Competition by product type**

Our interviews suggest that low-price cargos are increasingly routing through the Shenzhen ports. Toys and rattan furniture are examples of product that often route through the Shenzhen ports because of the paramount importance of cost considerations in their supply chain equation. Shipping costs represent a relatively high proportion of total retail price in end markets and there is a strong incentive to minimise land-haulage costs by off-loading trucks short of the border. For products flowing to giant retail chain stores in the US, such as toys, the location of consolidation centres in Shenzhen is another factor weighing heavily in favour of the Shenzhen ports. Yantian was reported by most toy exporters in our interviews to be the main exporting terminal for toys from China to the US or Europe. One shipping executive estimated that as much as 90 percent of the toys produced for export in the Pearl River Delta region now ship out of the Shenzhen ports. An exception is toys with high “cut-and-sewn” content, which are subject to quota.

Hong Kong remains the port of choice for high-value products. For these products, the cost of shipment is secondary to security, speed or reliability. High-end electronics, like
computer peripherals and mobile phones, where shipment time is critical, are usually shipped out of Hong Kong. Watches are a highly seasonal fashion item and are quite time sensitive in terms of shipping speed to the end customer. Buyer power in the United States is less concentrated in the watch sector than in the toy sector. For these reasons, Hong Kong-owned output of watches produced in the Pearl River Delta region usually ships out of Kwai Chung, though company executives mentioned that they were actively looking into moving a portion of their shipments over to the Shenzhen ports. These results are consistent with the results of the Trade Development Council’s most recent survey on Hong Kong’s offshore trade, which also concluded that lower value cargoes are shifting to Pearl River Delta region ports, while high value products still use the port of Hong Kong.9

**Air Cargo**

There are five principal airports within a 50-kilometre radius in the Greater Pearl River Delta region, in Guangzhou, Hong Kong, Macao, Shenzhen, and Zhuhai. Of total export cargo shipped from Hong Kong, 99 percent (by volume) ships via maritime container transport, with one percent travelling via airfreight. Nevertheless, airfreight represents 27 percent of all cargo moves.10

**Division of labour in air cargo**

The Hong Kong International Airport is one of the world’s foremost airports and ranks first worldwide in air cargo throughput. It far outstrips the Pearl River Delta region airports on all parameters, including international passenger flows, freight tonnage, and passenger and freight destinations. The Hong Kong International Airport handled 33 million passengers and 2.1 million tones of cargo in 2001.11 It offers services to 135 cities worldwide (95 international destinations and 40 in China), with about 3,300 passenger flights and nearly 400 cargo flights weekly. The Hong Kong International Airport has an air cargo capacity of three million tonnes per year. Two air cargo terminals are in operation at the airport. Hong Kong Air Cargo Terminals Limited (HACTL) operates the Super Terminal 1 Building, which is the world’s largest stand-alone air cargo facility with an initial capacity of up to 2.6 million tons of freight per year. Asia Airfreight Terminal Company Limited (AAT) operates the second air cargo terminal, with an annual handling capacity of 0.4 million tons.12

Guangzhou’s existing (and soon to be superseded) airport, Guangzhou Baiyun, is presently oriented primarily towards destinations on the Chinese Mainland. Guangzhou Baiyun is

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10 *South China Morning Post*, “Technology holds the key to keep cargo moving,” July 5, 2002.
11 Hong Kong International Airport Annual Report, 2002.
China Southern Airline’s hub. The airport serves approximately 70 domestic and 17 international destinations.\textsuperscript{13} It handled 13.8 million passengers and 531,565 tonnes of cargo in 2001.\textsuperscript{14} Guangzhou’s new airport, Baiyun International Airport, which is costing an estimated RMB 20 billion, is scheduled to begin operation in 2003. Baiyun International Airport is being promoted as “China’s largest and most advanced international airport.”\textsuperscript{15} It is projected to have a capacity of 25 million passengers and 1 million tonnes of cargo by 2010.\textsuperscript{16}

Shenzhen’s Bao’an International Airport is growing in importance as a feeder for Mainland domestic passengers and for freight. Bao’an International Airport currently has 60 domestic routes to other destinations in the Chinese Mainland. In 2001, it handled 7.78 million passengers and 247,000 tonnes of cargo.\textsuperscript{17} US-based air express carrier Federal Express started to run flights from Shenzhen to Europe and to North America in November 1999. Zhuhai Airport does not make an appreciable contribution at present. It has been disadvantaged by the disapproval expressed by the Civil Aviation Administration of China (CAAC) to its construction, and its subsequent exclusion from official Chinese air route planning. In 2001, Zhuhai handled only 637,000 passengers and 11,000 tonnes of cargo.\textsuperscript{18}

In contrast to Zhuhai Airport, Macao International Airport is a player of some substance, particularly for traffic connecting Taiwan with the Chinese Mainland. There are 142 flights per week between Macao and 13 cities in the Mainland, and 248 flights per week between Macao and Taiwan. In 2001, the Macao Airport handled 3.8 million passengers and 76,076 tonnes of cargo.\textsuperscript{19}

\section*{Competition in air cargo}

At present, Guangzhou Airport is not affecting passenger throughput at Hong Kong International Airport to any measurable degree. However, with the opening of the new Baiyun Airport in 2003, Guangzhou aims to enhance its international services, thus increasing competition with Hong Kong. Shenzhen’s Bao’an International Airport is already having an effect on air passenger flows through Hong Kong, both in terms of supplying passengers from the Mainland that use Hong Kong via Shenzhen to connect to international destinations, and in terms of diverting traffic from Hong Kong to Shenzhen for destinations within China. Though Guangzhou and Shenzhen airports currently have little impact on cargo flows from Hong Kong International Airport, both airports are presenting themselves as viable alternatives and this could have a demonstrable effect on Hong Kong’s freight

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{13} \textit{South China Morning Post}, “Rival airports pose a threat to Chek Lap Kok,” May 14, 2002.
\item \textsuperscript{14} Guangdong Statistical Yearbook 2002, p.380.
\item \textsuperscript{15} \textit{South China Morning Post}, “Shenzhen tie-up poses more problems than solutions,” July 2, 2002.
\item \textsuperscript{16} Guangzhou City Government, \texttt{www.gzcity.gov.cn/english/2001mainindexes/keyindex2002.htm}.
\item \textsuperscript{17} Guangzhou Statistical Yearbook, 2002, p.109.
\item \textsuperscript{18} \textit{Hong Kong Economic Times}, “Zhuhai Airport to shift to cargo transportation,” May 25, 2002.
\item \textsuperscript{19} Macao International Airport, \texttt{www.macau-airport.gov.mo}.
\end{itemize}
\end{footnotesize}
traffic in future. Some industry analysts, for example, believe that the Fed-Ex presence could eventually make Shenzhen a major cargo airport, possibly at the expense of Hong Kong. There is no appreciable bypass of either passenger or freight traffic via Zhuhai Airport, though Zhuhai-related traffic can sometimes be bothersome for Hong Kong air traffic control. Macao International Airport, in contrast, does impact on Hong Kong with respect to passengers transiting to and from Taipei and the Chinese Mainland.

In addition to competition, the duplication of airport resources creates a number of working problems. As indicated above, the Greater Pearl River Delta region is home to five airports all in close proximity to each other. Divisions of airspace, air traffic control responsibilities, and communications requirements result in inefficient flight patterns and delays in takeoffs and landings.

**Logistics**

Logistics encompasses several activities associated with the transportation and distribution of goods. As firms focus more and more on developing efficient supply chains, logistics activities are viewed as important potential sources of advantage and disadvantage. In addition to the physical flows, today many logistics firms are equally concerned about the flows of information related to the goods. Numerous specialist suppliers have emerged to serve customers in the Greater Pearl River Delta region and elsewhere. Hong Kong historically has been a logistics centre for China and the rest of Asia. Increasingly, however, Shenzhen is emerging as a centre for logistics for the export industries of the Pearl River Delta. In addition, as the economies of the Greater Pearl River Delta become more intertwined, the role of Guangzhou, the traditional centre for logistics for South China, is becoming more important.

**Division of labour**

Hong Kong is a leading logistics hub for the Asia Pacific region. Local and international companies use Hong Kong as a location to coordinate product flows encompassing China, Japan, South Korea, Taiwan, and even Singapore. Logistics services provided in Hong Kong include a variety of value-adding services, such as assembly, mix and match, and packaging. Hong Kong is also home to providers of supporting services to the logistics industry, including operating software and strategic input. Hong Kong’s logistics industry is viewed as a “high-end, low-end business.” At the high end, the world’s leading multinational logistics firms are present in Hong Kong. These firms often use Hong Kong as headquarters for managing all of Greater China or South China. They tend to view Hong Kong and the Pearl River Delta as a single region, with large flows into and out of
Hong Kong. At the low end, many smaller, Hong Kong-owned logistics providers serve Hong Kong’s small and medium-sized export traders. Many of the smaller logistics firms are family-run businesses that offer trucking-oriented services to a relatively narrow customer base.

The Pearl River Delta does not yet offer a level playing field for foreign investors in logistics. In general, foreign shareholders cannot have more than 49 percent equity ownership. Forging a successful relationship with a Mainland partner is a major challenge for many Hong Kong firms trying to expand into the Pearl River Delta region. Hong Kong logistics firms with minority stakes in Pearl River Delta operations still try to maintain their headquarters in Hong Kong. However, the exigencies of this location-dependent business are forcing many logistics providers to spend more and more time in the Pearl River Delta region. As a result, the proprietors of family-run logistics firms are beginning to develop a “dual lifestyle,” to the detriment of their families in Hong Kong.

While Hong Kong has remained dominant as a location for managing international logistics activities for the Greater Pearl River Delta region, Shenzhen has emerged as a secondary centre for logistics for export-oriented industries based in the Pearl River Delta region. Shenzhen provides a low-cost location for consolidators close to the Shenzhen ports. As the Shenzhen ports have grown and the number of foreign buying offices in Shenzhen has increased, more and more logistics companies are setting up to meet the demand.

Guangzhou has been the traditional logistics centre for domestic cargo in the Pearl River Delta region. Guangzhou is at the heart of the region’s transportation systems and provides the main links between the Pearl River Delta region and China’s national road, rail, and air networks. Guangzhou and its surrounding communities also are home to literally hundreds of markets for goods ranging from building materials, to light consumer goods, to consumer durables, to industrial inputs, and to machinery. In a region where distribution has historically been limited, these markets play a crucial role in the distribution system for all of South China. In some products, the clientele of the markets is even national in scope.

Competition in logistics services

According to interviewees, Hong Kong’s advantages in logistics over the Pearl River Delta jurisdictions include its world-class transportation, financial, and legal infrastructure, plus a much broader base of experience and technological expertise. In addition, Hong Kong’s free flows of merchandise make it a highly convenient location for receiving products from different factories in the Pearl River Delta region or elsewhere, mixing them, and re-
packing them as a single item for export prior to shipping. Restrictions on export processing activities hinder the combined re-packaging of products from different factories, in places like Shenzhen, Dongguan, or Guangzhou.

The logistics industry executives we interviewed were in agreement that the labour costs involved in running consolidation and warehousing facilities in Shenzhen are much lower than in Hong Kong. For example, clerical staff for the manual inputting of information can be hired in Shenzhen for the equivalent of HK$1,200 per month, or one-tenth the salary of someone doing the same job in Hong Kong. Pearl River Delta warehouse workers are reported to offer the same set of skills as their counterparts in Hong Kong, at substantially lower prices. In addition, some Hong Kong-based managers of logistics firms claim that the Pearl River Delta region workforce is far more motivated than their Hong Kong workforce.

Interviewees also reported that many logistics firms, ranging from large multinationals to the smallest of firms, have moved from Hong Kong into the Pearl River Delta region, mostly into Guangzhou and Shenzhen. For consolidators, for example, it is advantageous to have a single operation in close proximity to the port of shipment. Starting in the mid-1990s, Hong Kong-based consolidators started moving from Hong Kong into Shenzhen, attracted by lower costs and by the growth of the port at Yantian. This movement accelerated in the later 1990s. By 2002, many consolidation operations had relocated to Shenzhen, mostly near Yantian. A wide range of activities are performed in these consolidation centres, including packing, mix and match, labelling, and the affixing of bar codes to help direct product to its destination.

Many Hong Kong-owned logistics firms that have entered the Pearl River Delta occupy niches tied to a distinct manufacturing and foreign customer base. Their niche positions cushion them from direct rivalry with counterparts from the Chinese Mainland. Nevertheless, competition within the sector is heated as a result of firms from the Chinese Mainland entering in large numbers. The fees charged by Mainland-based trucking firms, for example, are falling rapidly and Hong Kong end-users of transport services noted that this dynamic is also driving down fees charged by Hong Kong-owned trucking firms.

**Software**

Increasingly software development is being treated almost like a manufacturing industry, with specific development and design activities often separated from implementation steps like coding. This allows for the development of a division of labour between locations within software firms that was not so common a decade ago. Historically, the software
industries of Hong Kong and the Pearl River Delta region were relatively underdeveloped compared to many other places in the world. However, growing demand for software and software applications in the region, as well as improving skills and capabilities hold out the promise that software will be a more and more significant industry in the region in the future. In this industry, the division of labour between Hong Kong and the Pearl River Delta region is just evolving, as is competition between firms from the different jurisdictions.

**Division of labour in software**

Hong Kong is home to approximately 700 to 1,000 indigenous software firms, the vast majority of which are small and medium-sized enterprises. Most of these players provide software for particular applications, customised software for specific clients, or systems integration software rather than packaged software. Hong Kong also has design and development facilities for some of the world’s leading software companies, although these firms tend to do localisation and customisation rather than basic design in Hong Kong. In software, Hong Kong is usually the place where new software and software technology comes first to be tried and tested before it filters into China. In addition, there are many Hong Kong people in senior positions in software operations based in the Chinese Mainland. Many of these people are trained in Hong Kong before taking up their positions in the Pearl River Delta region or elsewhere in the Chinese Mainland.

In recent years, Hong Kong companies and multinational companies with offices in Hong Kong have begun to set up software activities in the Pearl River Delta region. Hong Kong is used for high-level design, coming up with the concept and then planning it through. Hong Kong is used as the base for project resources, the people that interact with the customer, write up proposals, develop the projects, and lay out the overall scheme. The Pearl River Delta region is then used for application development out-sourcing and implementation. Software experts claimed that the Pearl River Delta region did not have the high-level design capability and understanding of international customers that only comes from decades of exposure to the international market. While software industry executives praised the level of research being done in the Chinese Mainland, they claimed that Mainland programmers lacked applied knowledge. Industry experts claimed that much of the advanced software and software technology comes from the United States and Hong Kong is in a far better position to access that type of knowledge than the Pearl River Delta region.

The local market for software in the Pearl River Delta region is mostly met from imports or from within the region itself. Hong Kong firms are starting to penetrate the markets,
though this can be challenging. Guangzhou and Shenzhen, for example, are beginning to develop into software centres. Many software firms in these cities were set up by people from other places in China who have come to the Pearl River Delta region to seek opportunity; others have been set up by Chinese nationals returning to China after stints in the United States. Pearl River Delta firms were considered strong on word processing and low value systems integration and customisation geared toward the manufacturing sector and relatively weak on mass market software and in specialist applications. Guangzhou and Shenzhen are regarded as having a plentiful supply of reasonable quality software developers. However, Pearl River Delta firms are not generally considered innovators. Managers indicated that Pearl River Delta firms often caught on quickly, but that the ideas and technology often came through Hong Kong.

**Competition in software**

In software, Hong Kong firms face competition at the high-end from big Mainland firms such as Legend, and at the medium to low-end from numerous small firms. The small Mainland software firms focus primarily on word processing applications and systems integration, and less on functional software. While Legend and a few other large Mainland software houses sell to overseas markets, the small Mainland software houses focus primarily on Mainland markets.

Software-related business in the Pearl River Delta has proven very difficult for Hong Kong small and medium-sized firms because innovations are easily and quickly copied by local rivals. The smallest of innovations, including source codes, are routinely appropriated by Mainland employees of Hong Kong firms and either sold to existing rivals or used as the basis for a new start-up. One large Hong Kong software developer has responded to this challenge by cumulating expertise as well as capital, and developing a management system to differentiate it from Mainland rivals. For many smaller firms, this is not feasible.

Fierce rivalry from Pearl River Delta-based programmers, combined with inadequate intellectual property protection, make the Pearl River Delta region an inhospitable environment for many. Several Hong Kong firms have concluded that moving programming operations to the Pearl River Delta region is a mistake. Many advise other software companies to move out of the Pearl River Delta region.

**Business and Professional Services**

Economic interaction between Hong Kong and the Pearl River Delta has brought about a steady increase in the demand for business services on both sides of the border. This
demand has been driven on three levels. The movement of manufacturers from Hong Kong into the Pearl River Delta region has led to an increase in demand for cross border support services, whilst the growth in multinational concerns in the region has fuelled demand for high quality services, particularly in the legal and financial sectors. The emergence of the Pearl River Delta region as a manufacturing powerhouse has also increased the demand for services from local producers in the Pearl River Delta region who seek to upgrade their systems and processes in order to compete on a global scale.

Division of labour in business services

The division of labour in business services within the Pearl River Delta region is influenced by restrictions on the activities of foreign firms in the Chinese Mainland and on the ownership of the companies involved in the service transactions, and subsequently, the source of investment flows into the Pearl River Delta region.

Current barriers to entry for Hong Kong-based service providers

Hong Kong is regarded as a foreign country when it comes to the provision of services in the Mainland, and as such, Hong Kong service providers currently face a number of government restrictions when doing business in China. For many, licensing is the first obstacle. Some interviewees described the various regulations as being “overwhelming”. They found that restrictions were not always apparent, that there were often differences between different townships and provinces and that rules were not consistently predictive of outcomes.

There are also a number of informal barriers facing Hong Kong or multinational service companies in entering the Pearl River Delta region. Those interviewed highlighted language and cultural barriers as being significant. Many interviewees stressed the importance of being able to communicate effectively using the particular local dialect of their clients. Local knowledge was also seen as a vital factor in the service sector. However, as several of the interviewees explained, a gap sometimes exists between the services offered by Hong Kong-based providers and the needs of local clients. This gap was seen as being difficult to close. The existence of “regionalism” in China, which stresses local connections and expels outsiders, including those from other provinces, was seen as one cause. On the other hand, a number of respondents stated that they felt some reluctance from Hong Kong service providers in learning from their Pearl River Delta region counterparts. Adequate experience of servicing local needs was seen as important to the success of Hong Kong-based service providers in the Pearl River Delta region.
These barriers differ by sector. While in areas such as recruitment, management consultancy, and advertising, the institutional barriers are not insurmountable; the legal and accountancy sectors are much more constrained. In legal services, the foundations of Hong Kong and Mainland legal systems are different. Hong Kong operates under the British common law system, whereas the system in the Mainland is founded on principles of continental law. This has repercussions on the range of services that Hong Kong-based lawyers are able to provide to companies in China. Hong Kong lawyers are considered “foreign” service providers and as such are not allowed to practice Chinese law, are prohibited from forming joint ventures or partnerships with Mainland lawyers, and are restricted by the “one office one location” rule. Other barriers to entry concern the disparity in legal fees between Hong Kong and the Pearl River Delta region and the scarcity of human resources on the other side of the border. Lawyers in Hong Kong command much higher fees than their opposite numbers in the Pearl River Delta region, whilst top-tier Mainland lawyers with overseas training often opt for positions in Beijing or Shanghai rather than in Guangzhou or Shenzhen.

Similarly, Hong Kong-based accountancy firms face special restrictions when operating in China. Though there are differences in accounting systems between Hong Kong and the Pearl River Delta region, dual reports are not as yet allowed. The criterion that accountancy firms should have “international status” is an obstacle to the many small accountancy firms in Hong Kong. The fact that they have to show paid up capital of US$20 million to register a company in China prevents these firms from expanding their offices into the Pearl River Delta region. Hong Kong and foreign-owned firms in the accountancy field also complain about the difficulty of finding suitably qualified staff in the Pearl River Delta region and the lack of mutually recognised qualifications in this area. Even where relevant certification is produced, it is often difficult to verify the qualifications of Mainland accountants.

There are also tax and currency implications for Hong Kong-based service firms doing business in the Pearl River Delta region. Local Pearl River Delta region companies are discouraged from engaging the services of firms from Hong Kong if bills would have to be settled in Hong Kong dollars. Hong Kong service providers are, however, reluctant to bill their Pearl River Delta region clients locally in renminbi, as the rate of tax payable is double that of Hong Kong.
**Ownership and markets**

For business services that are not covered by restrictions, Hong Kong business service companies tend to be the providers of choice for Hong Kong-invested companies in the Pearl River Delta region. Smaller foreign-invested companies also tend to use Hong Kong service providers. Large multinationals tend to have global agreements with international service firms with branches in Hong Kong and elsewhere in China. Large Mainland firms that are aiming at overseas expansion tend to draw on the experience of multinational service firms, whereas local, Mainland focused businesses tend to source their service providers from within the Pearl River Delta region. Many of the international companies will tend to have in-house service expertise imported from their respective countries. Smaller Hong Kong and Pearl River Delta region companies tend to outsource service functions to small-scale operators, the majority of which have just a handful of clients. Relationships and trust figure strongly in such service provision.

Depending on the ownership of the service firm, providers display different market orientations. For Hong Kong-owned service firms, the majority of their business is firmly rooted in Hong Kong, or with Hong Kong-owned firms in the Pearl River Delta region. An emerging area for such companies is in meeting the requirements of foreign small and medium-sized companies with operations in the Pearl River Delta region. Local service providers in the Delta are generally of such small scale that they do not pursue business much beyond their immediate locality. For multinational firms, their main business remains in Hong Kong, with a strong focus on Beijing and Shanghai for their China expansion strategy. For such firms, particularly in the financial, legal, and accounting sectors, the Pearl River Delta region is not considered a significant market.

**Competition in business services**

In general, Hong Kong and Mainland service providers in the Pearl River Delta serve distinct market segments and perform different functions. The result is a lesser degree of head-to-head competition than in many manufacturing industries. The expertise of Hong Kong solicitors and accountants differs substantively from that of their Mainland counterparts in terms of applicable accounting and legal standards and practices. Hong Kong-based solicitors are equipped to handle matters arising under Hong Kong and foreign laws, cross-border and trans-national legal issues, and the requirements of firms from the Chinese Mainland seeking access to foreign capital and commercial markets. Hong Kong-based accountants are equipped to handle consulting, auditing, tax, and accounting work under international standards. Both sectors would encounter strong competition in the Pearl River Delta region in fields traditionally the province of local firms, either through
restrictions or capabilities, including legal matters arising solely under Mainland laws or routine bookkeeping, where Mainland firms enjoy a distinct cost advantage. On the other hand, Hong Kong firms tend to enjoy a powerful and enduring competitive advantage in their respective fields of expertise. Competition is fierce among the 70,000 advertising agencies active in the Chinese Mainland. At the high-end, multinational firms and Hong Kong’s leading advertising firms are already in China. Small and medium-sized Hong Kong advertising firms are generally viewed as having limited competitive prospects in the Mainland because they lack in-depth understanding of local markets, advantages of scale, and Mainland-specific skill sets.

To sum up, Hong Kong-based service providers and Pearl River Delta region service firms are currently servicing different market segments or are finding ways to operate in partnership. Due to the “one office, one location” restriction in some fields, multinational companies have tended to focus more on clients in Shanghai or Beijing. These firms may also draw on their Mainland or Hong Kong offices to service large-scale projects for international clients in the Pearl River Delta region. For Hong Kong-owned service providers, the Pearl River Delta region is seen as a very important market. The existence of a large number of Hong Kong-owned companies in the light-manufacturing sector has created an abundance of work for these small service firms, though again, most of the clients are serviced from Hong Kong. Local Pearl River Delta firms, in general, do not provide services to firms in Hong Kong, unless they are Hong Kong companies with a physical presence in the Pearl River Delta region. Even then, the services provided are for clients requiring low-cost basic services, or a high degree of local knowledge. For top-tier services requiring Western applications, Hong Kong-based service providers have an absolute advantage over their Mainland counterparts. Their superior international exposure, professional standards, and management practices mean that clients tend to have confidence in their services. For the time being at least, local service firms in the Pearl River Delta region do not generally reach these standards.

Many small Hong Kong service providers felt that the chances for widening their client base beyond servicing the needs of Hong Kong-owned manufacturers in the Pearl River Delta region were slim. Most felt that they lacked the investment needed to expand their businesses into the Delta region and pointed out that, at the present time, all large-scale projects were generally handled by multinational firms. Nevertheless, recent initiatives by the Hong Kong Trade Development Council to provide marketing platforms for Hong Kong legal service providers within the Pearl River Delta region have met with an enthusiastic response among Hong Kong small and medium-sized enterprises. In addition, such initiatives have attracted large audiences of business representatives from the Chinese Mainland eager for knowledge on how to build an international business through Hong Kong.
**Figure 4.4** Service Demand Derived from Inward and Outbound Investment Flows to and from the Pearl River Delta region

<table>
<thead>
<tr>
<th>INVESTMENT FLOW</th>
<th>PREFERRED SERVICE PROVIDER</th>
<th>OWNERSHIP OF SERVICE FIRM</th>
<th>MARKET ORIENTATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>HK SME investment in the PRD</td>
<td>Tend to use local HK service providers, or keep the service in-house and are therefore not a primary target for international service firms. May use local firms for low-level routine work as they are cheaper, but have raised the issue of trust and usually have well-established relationships with HK service providers.</td>
<td>Hong Kong-Owned Service Providers</td>
<td>HK</td>
</tr>
<tr>
<td>Foreign SME investment in the PRD</td>
<td>HK-owned service providers see this as a growth area, particularly for legal, accounting and advisory services. HK service providers have a better reputation for quality than their mainland counterparts. They also have substantially more experience of dealing with foreign firms.</td>
<td>Local PRD Service Providers</td>
<td>PRD</td>
</tr>
<tr>
<td>MNC investment in the PRD</td>
<td>MNCs tend to bring their own service professionals with them, or employ multinational service firms with which they have international contracts to do their China-based work. For work requiring local knowledge (e.g., some advertising, junior-level recruitment) or for routine work (e.g., bookkeeping) local service firms may be used.</td>
<td>Multinational Service Firms</td>
<td></td>
</tr>
<tr>
<td>Outbound investment from the PRD</td>
<td>This is regarded as being the greatest potential area for Hong Kong’s local and international service providers, particularly in the banking, legal and advisory sectors. Hong Kong will act as ‘broker’ for these investment flows.</td>
<td>In-house Service Providers</td>
<td>Shanghai / Beijing</td>
</tr>
</tbody>
</table>
Division of Labour and Competition

Hong Kong and the Pearl River Delta region have developed a deep division of labour over the last two decades. This division of labour has allowed the different jurisdictions to specialise in activities in which they have had comparative and competitive advantages, while linking with activities that were better performed in other places in the Greater Pearl River Delta region. The division of labour allowed both Hong Kong and the Pearl River Delta region to undertake activities that they would not have been able to undertake otherwise. The interaction and mutual support has allowed both sides to develop further. As the economy of the Pearl River Delta region has grown in size and sophistication, it has been able to take on more and more activities. This is to be expected from an economy that had been isolated for so long and has been opened gradually in only the last two decades. It also is to be expected that activities would decentralise out of Hong Kong, a city with some of the world’s highest costs, as soon as it was feasible.

It also is to be expected that in addition to a division of labour that has benefitted individual firms, there will be growing competition between Hong Kong and the Pearl River Delta region in a number of activities and industries. This is only natural since they both have the manufacturing base of the Pearl River Delta region and the service base (at least significant parts of the service base) of Hong Kong available for their use. It is this competition that is likely to force greater efficiency in both Hong Kong and the Pearl River Delta region, efficiency that is likely to benefit the region as a whole going forward. The precise nature of this competition and division of labour will determine which parts of the Greater Pearl River Delta region capture which activities and industries in the future.
In order to have a reasonable view of the likely future economic interaction between Hong Kong and the Pearl River Delta region, it is necessary to understand the development trajectories of both. These trajectories will determine the type of interaction that will be possible and the type of interaction that will be beneficial. They will determine what opportunities exist and how these opportunities can be developed and exploited. Of course, the economic trajectories of Hong Kong and the Pearl River Delta region will influence each other as they have in the past. However, it is useful to understand where each is going before trying to forecast the nature of the interaction. In this chapter, we will look at the development planning and likely development patterns of the Pearl River Delta region and Hong Kong going forward. We then will take a very brief view of the future competitiveness and development potential of the Greater Pearl River Delta region.

**Development Plans in the Pearl River Delta Region**

The future economic trajectory of the Pearl River Delta region will be strongly influenced by the national, provincial, and local development plans. Although the economy of the Chinese Mainland has become much more market-oriented in recent years, there is still a strong planning component to China’s development. Development plans set forth overall goals, identify key government infrastructure and development investments, and provide an overall framework within which both state and non-state enterprises operate. In many localities within the region, local government officials remain very influential, regardless of whether the dominant forms of ownership are private or collective.

**National plans**

China’s Tenth Five-Year Plan (2001 to 2005) calls for the implementation of the nation’s World Trade Organisation (WTO) accession agreement, a further modernisation of the economy, a greater role for private enterprise, and enhanced development of the central and western provinces. The more developed areas along the coast, particularly the Bohai Rim region, the Yangtze River Delta region, and the Pearl River Delta region, in the face of greater market competition at home and abroad, are to speed up technological development and innovation, and develop their high-tech and export-oriented industries. These regions are supposed to lead China’s economic development and work to strengthen cooperation with, and the development of, less economically advanced regions. The Pearl River Delta region is supposed to upgrade its manufacturing industries, expand its technology-based industries, and develop a more modern service sector. The goals are to improve the region’s ability to succeed in international competition and to provide space for lesser-developed areas to take on lower value-added activities.
Guangdong’s provincial plan

The Tenth Five-Year Plan of Guangdong Province (2001 to 2005) calls for provincial GDP to increase by nine percent per year to reach RMB 1,630 billion by 2005. The primary, secondary, and tertiary sectors are expected to grow by three percent, 9.5 percent, and 9.5 percent respectively. The province hopes to upgrade traditional industries, such as garments and textiles, food and beverages, and construction materials; expand the newer “pillar industries” of electronics and IT equipment, electrical appliances and machinery, and petrochemicals; and develop new strengths in the automobile, pharmaceutical, paper product, and environmental industries. In the service sector, the province plans to improve the conditions for market access, break down industry monopolies, and actively develop a modern service sector in order to meet the conditions of the WTO accession agreement. The plan indicates that the Pearl River Delta region is to lead the further modernisation of the provincial economy by linking the urban and rural economies, modernising infrastructure, becoming a high technology zone, promoting the region as an important base for international trade, and pioneering a sustainable market-oriented economic system.

Local and municipality plans

Each local and municipal government in the Pearl River Delta region also develops its own economic plan. These plans are supposed to be consistent with the national and provincial plans. In recent years, as decision making in economic affairs and government finance has become more and more decentralised, the local plans have taken on increased importance. In addition, these plans can change substantially when new local leaders take office. We will focus on the plans of Guangzhou, Shenzhen, Dongguan and Zhuhai, four cities that account for more than 70 percent of the GDP of the Pearl River Delta region.

Guangzhou

Guangzhou’s Tenth Five-Year Plan targets an average growth rate of 12 percent per year in GDP and ten percent per year in per capita income. The plan prioritises the development of the “pillar industries” of information technology, automotives, and petrochemicals. Several technology and industrial parks have been designed to take a leading role in these industries. In the service sector, priority has been given to developing Guangzhou into the leading service centre for the Pearl River Delta region, into an international transport and logistics centre, and into a distribution centre for South China. The idea is to build the financial, commercial, transportation, information, science and technology, human resources, and education and training systems necessary to attract large firms from China and from abroad to set up factories, research and development centres, headquarters, and offices in Guangzhou.
In November 2001, after the promulgation of Guangzhou’s Tenth Five-Year Plan, the city announced ambitious plans to develop Nansha, an area south of Guangzhou proper, into a heavy industrial and logistics centre. The main thrust is in the development of steel, chemical, and heavy industrial facilities, and of the bulk port required for industrial materials. The goal is to provide materials for the automotive and machinery industries developing in Guangzhou and to supply the growing South China market with heavy industrial products. If successful, the Nansha development would provide South China with the sort of heavy industrial base it has traditionally lacked. Other components of the Nansha development plan include container port facilities, a logistics centre, and a high technology zone. Guangzhou planners expect that much of the manufacturing that takes place in Guangzhou will migrate south toward Nansha. This in turn will free up land in Guangzhou proper for the development of a modern commercial city. They expect that the economy of Nansha will eventually equal that of Guangzhou.

Guangzhou shows every intention of attempting to regain the economic primacy in the Pearl River Delta region that some people believe has been temporarily usurped by Hong Kong and Shenzhen due to historical circumstances. Provincial and provincial capital resources provides Guangzhou with ample funds to carry out its plans, which it is doing without too much regard to neighbouring jurisdictions. Aside from the lack of consultation with neighbouring areas, there are a number of reasons why the Nansha development plan has become a cause for concern within the Pearl River Delta region and Hong Kong. These include the short time period between initial planning and the onset of construction, the lack of cost-benefit analysis, plans that seem to fly in the face of logic (such as deepwater port facilities in a location subject to substantial silting and a high-tech zone just across from chemical storage facilities), and the potential for duplication of investments made by other jurisdictions. Guangzhou’s response to these concerns has been that these plans are set and there is no need to revisit them.

**Shenzhen**

Shenzhen’s Tenth Five-Year Plan calls for GDP growth of 12 percent a year from 2001 to 2005. Priority is being given to a range of high technology industries, including computers, integrated circuits, telecommunications equipment, digitally controlled appliances, and biomedical products. Shenzhen plans to focus its efforts on education and on the promotion of these and other high technology industries. Shenzhen also aims to become a leading international logistics centre, leveraging off its location at the heart of one of the world’s leading manufacturing regions. According to the Five-Year Plan, by 2005, Shenzhen expects its seaports to have a cargo handling capacity of 70 million tonnes, to reach 6.5 million
TEUs in container capacity and to operate more than 100 international shipping routes. It is likely, however, that these expectations will be surpassed as container capacity has already approached the 2005 target by the end of 2002. Shenzhen also hopes to improve customs and administrative systems in order to streamline the passage of cargo into and out of the city. In order to enhance its position as a logistics and commercial hub, Shenzhen has approached numerous major multinational companies to see if the firms would place buying or sourcing offices in Shenzhen.

Shenzhen plans to push for substantial economic integration with Hong Kong, with particular regard to cooperation in science, technology, ports, infrastructure, tourism, and environmental protection. Shenzhen also wishes to continue to capture manufacturing and service industries from Hong Kong, as well as to become a place for Hong Kong people to live, work, and shop. Shenzhen also plans to enhance its service sector through the early liberalisation of certain sectors in order to attract increased service activities and persuade multinational headquarters and offices to relocate to Shenzhen from Hong Kong. The city also plans to help other parts of the Pearl River Delta region develop through use of its financial, logistics, technology, and infrastructure.

**Dongguan**

Dongguan’s Tenth Five-Year Plan calls for an average annual GDP growth of 12 percent and a doubling of most economic aggregates from 2001 to 2005. Dongguan is to be built into an international industrial, trade, and port city based on its manufacturing capabilities, high technology research and development, and foreign trade. The city’s plan emphasises cooperation with Hong Kong and Taiwan in finance, trade, technology, and manufacturing. The goal is to deepen and upgrade traditional industries, to expand in high technology industries, and to attract suitable foreign investments. The electronics and information technology equipment industries are slated to be the focal points of development. To support this development, the Dongguan city government is setting up a 72 square kilometre science, technology, and industrial park at Songshan Lake. The park will focus on knowledge-intensive industries and is planned to become a centre for innovation, technology, education, and culture. The lakeside setting is designed to be an attractive place for professionals to live and work.

**Zhuhai**

Zhuhai has suffered from its relative isolation in the southwestern portion of the Pearl River Delta region. Its proximity to Macao has not proven nearly as beneficial as proximity to Hong Kong has been for jurisdictions in the eastern part of the Delta. Zhuhai has also
suffered from investments in airports, ports, and roads that go far beyond what has been needed. “White elephant” investments, such as the vastly under-utilised Zhuhai Airport, lost the city credibility with national officials. In 2000, the new leadership started drafting new plans for the city. These plans call for GDP growth of 14.9 percent for the period 2001 to 2005. The city plans to develop strong positions in electronics, information technology equipment, research and development, and education. Zhuhai has set out to attract leading Chinese and foreign companies and universities to join in its development. It also hopes to use its relatively unspoiled environment to attract mobile professionals for technology-based industries and activities.

Pearl River Delta region development plans in perspective

One striking feature of the development plans in the Pearl River Delta region is their similarity. All of the plans call for “high technology” without much of a sense of what that means or of what levels of technology are appropriate for the next stage of development in the region. The result tends to be a focus in which simple export processing of “higher technology” products is favoured over the deepening of existing industries into components, capital goods, and related services, a typical path of development for economies that start with export processing. The plans also tend to neglect references to the soft infrastructure and administrative capacity necessary to underpin a modern economy. Some of the jurisdictions that are investing enormous amounts of money in showplace technology parks might be better off investing in transportation infrastructure, public services, public safety, and improving administrative systems.

The similarity between plans means that most of the jurisdictions in the Pearl River Delta region appear to be targeting the same industries with little real regard for the potential wastefulness of duplicative investments and with little regard to the potential gains from specialisation. Each jurisdiction appears to develop its own plans with little notice of the plans of neighbouring jurisdictions. As a result, each appears to be more anxious to steal business from its neighbours than to develop distinctive industries and capabilities of its own. The main exception to this trend is Guangzhou’s plans in heavy manufacturing that are not found in other jurisdictions. Even so, Guangzhou’s other plans do seem to imply a desire to take business from other cities in the Greater Pearl River Delta region. In addition, much of the planning that has gone on in Guangzhou, as well as in other jurisdictions in the region, takes place with little or no cost-benefit analysis that might point towards more efficient uses of funds.

The shortcomings of the planning processes in the Pearl River Delta region are nothing new. In the past, one of the saving graces of the region has been that plans have been
viewed as indicative rather than overly directive. That is, developments that did not happen to coincide with the plans in terms of industries were not prevented. As a result, much of the development that has taken place in the Pearl River Delta region has not been the result of blindly following plans. As the economy of the Pearl River Delta region has become more market-oriented, the plans have become more goals and predictions than directive plans. Of course the exceptions to this are infrastructure investments and other government investments that tend to more or less follow the plans.

Development Plans in Hong Kong

Hong Kong’s traditional development approach had been characterised as “positive non-intervention.” This in essence meant that the Hong Kong government would create an environment within which the private sector would prosper. As a result, the government focused on setting and enforcing clear rules of the economic game, making sure that the administrative and regulatory system was simple and conducive to business, limiting taxation and government expenditures, and allowing the private sector to take on economic activities, such as tunnels and other infrastructure, that would be taken on by government in many other places. Direct government intervention and involvement in the economy tended to be limited to infrastructure, education, some public utilities, and other support activities. Housing was the main sector in which the government intervened directly. The Hong Kong government became a major housing provider, as Hong Kong welcomed hundreds of thousands of refugees in the 1950s and 1960s, and by 2001 provided housing for approximately half of Hong Kong’s population.

Since 1997, the Hong Kong government has become more active in economic affairs while retaining its overall philosophy of private sector-led development. In recent years, the government has become more proactive in promoting Hong Kong products and companies, as well as Hong Kong as a place to do business, through the Hong Kong Trade Development Council and a new investment promotion agency, Invest Hong Kong. It has created a series of support programmes to provide loans and other support to small businesses and to initiatives designed to improve businesses within Hong Kong. It has even become an investor in commercial ventures itself. The Hong Kong government is the local partner, for example, in the Hong Kong Disneyland project, which is expected to open its doors in 2005. The government also has become an important player in the commercial real estate market with its Cyberport and other developments.

The Hong Kong government has supported a number of initiatives that it hopes will improve Hong Kong’s position as a technology centre. The Science Park has provided heavily subsidised land in an attempt to lure technology-based manufacturing facilities into Hong
The Cyberport is providing heavily subsidised office space for companies that fall within its “information technology” mandate. ASTRI, a mid-stream or applied research and development programme, was introduced to support Hong Kong industry. The Hong Kong government also created a venture capital fund to be administered by private sector firms. Many of these initiatives have met with criticism. Although the original idea of the Cyberport was to attract new investments in technology development into Hong Kong, in practice it has attracted activities and offices that were already in Hong Kong at the expense of private sector office developments. The companies initially enlisted to manage the government’s venture capital fund eventually returned the money to the government.

In 2000, the Hong Kong Chief Executive’s Commission on Strategic Development put forth the notion of Hong Kong becoming “Asia’s World City”, an international city that could eventually perform for Asia roles similar to those performed by New York and London for North America and Europe respectively. The Commission focused on four principal themes: strengthening links with the Chinese Mainland, enhancing competitiveness, improving quality of life, and reinforcing identity and image. Several specific sectors were identified as crucial to Hong Kong’s development. These included financial and business services; tourism; regional headquarters for multinational companies; information services and technology; and trade, transportation, and logistics.

In the 2002 budget address, Hong Kong’s Financial Secretary recast the traditional Hong Kong government approach to the economy from “positive non-intervention” to “proactive market enabling”, a sign that the Hong Kong government would take a more active role in performing tasks it deemed beneficial to Hong Kong if the private sector was not ready to take up the tasks. The Financial Secretary also identified four sectors that would receive special attention due to Hong Kong’s competitive strengths and business opportunities. These were financial services, logistics, tourism, and producer and professional services. Several measures were announced to facilitate the development of these sectors. The Budget Address also highlighted the need for Hong Kong to foster greater interaction with its Pearl River Delta region neighbours.

**Hong Kong development plans in perspective**

Hong Kong does not have formal development plans as found in the Chinese Mainland. As a result, its plans tend to represent areas in which government chooses to invest in infrastructure, education, and support programmes. The government’s control of zoning and land supply, however, actually give it a tool with which it can try to micromanage development should it choose to do so. Increasingly, it has shown a tendency to do so. From the Cyberport to the Science Park, to instances in which firms are told they will not
have access to land because their applications are not “high-tech enough,” the Hong Kong government shows signs of greater intervention. The government claims that it does not grant subsidies, but this is true only in a narrow sense. Instead of cash subsidies, the Hong Kong government has provided subsidised land for selected projects. The tendency to try to exert greater direction and control also can be seen in numerous support funds, which try to channel research and other efforts into a limited number of government-defined target areas. This creeping process has not been the focus of any serious public discussion or debate.

Despite these tendencies, the Hong Kong government is still far less directive than most governments in Asian when it comes to economic development. Much of its planning focuses on how to support what it sees as Hong Kong’s development, with the government trying to anticipate demand for infrastructure, land, housing, and government services, and then focusing most of its efforts on meeting the forecasted demand. This remains a fundamental difference in philosophy with Pearl River Delta region jurisdictions. This difference, in turn, can create some misunderstanding and frustration on the part of Pearl River Delta region officials who find that the Hong Kong government cannot commit Hong Kong or Hong Kong firms to commercial deals in the same way that governments on the Chinese Mainland can.

**Economic Development Trajectory of the Pearl River Delta Region**

The Pearl River Delta region economy is expected to grow at a real rate of 12 percent per year from 2001 to 2005 according to Guangdong officials. If current trends continue, the overall percentages of primary, secondary, and tertiary sectors in the Pearl River Delta region’s GDP will shift from 5.6 percent, 52.0 percent, and 42.4 percent in 2001 to around 5 percent, 50 percent, and 45 percent by 2006. Table 5.1 shows the trend in gross industrial output for the major industries in the region and the likely composition of gross industrial output by the year 2006 should trends over 1999 to 2001 continue. The table shows that the electronics and telecommunications sectors and the electrical appliances and machinery sectors will continue to lead, but that the chemicals and transportation equipment sectors are growing rapidly. As we will see below, these latter two sectors are likely to become even more important in the future than the table would suggest. Traditional industries, such as garments and textiles are losing share at present. Again, however, these sectors are likely to get an extra impetus from the abolition of garment and textile quotas later in the

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1 Calculated from data found in Guangdong Statistical Yearbook, various years.
decade. The table also shows that the leading manufacturing industries in the Pearl River Delta region have a relatively low value-added portion of gross industrial output.

Table 5.1  Gross Industrial Output (GIO), Selected Industries, Pearl River Delta Region

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<tbody>
<tr>
<td>Electronics / telecom equipment</td>
<td>304.51</td>
<td>21.0%</td>
<td>25.3%</td>
<td>30.7%</td>
<td>41.8%</td>
</tr>
<tr>
<td>Electrical appliances and machinery</td>
<td>132.76</td>
<td>25.1%</td>
<td>11.1%</td>
<td>23.1%</td>
<td>13.5%</td>
</tr>
<tr>
<td>Metal products</td>
<td>60.21</td>
<td>24.6%</td>
<td>5.0%</td>
<td>16.1%</td>
<td>4.6%</td>
</tr>
<tr>
<td>Chemicals and chemical products</td>
<td>58.28</td>
<td>27.8%</td>
<td>4.9%</td>
<td>30.8%</td>
<td>8.0%</td>
</tr>
<tr>
<td>Transportation equipment</td>
<td>51.43</td>
<td>24.5%</td>
<td>4.3%</td>
<td>23.8%</td>
<td>5.4%</td>
</tr>
<tr>
<td>Plastic products</td>
<td>49.23</td>
<td>24.9%</td>
<td>4.1%</td>
<td>15.4%</td>
<td>3.6%</td>
</tr>
<tr>
<td>Garments and fibre products</td>
<td>47.43</td>
<td>26.2%</td>
<td>3.9%</td>
<td>8.8%</td>
<td>2.6%</td>
</tr>
<tr>
<td>Textiles</td>
<td>46.91</td>
<td>24.7%</td>
<td>3.9%</td>
<td>5.8%</td>
<td>2.2%</td>
</tr>
<tr>
<td>Non-metal mineral products</td>
<td>42.47</td>
<td>29.0%</td>
<td>3.5%</td>
<td>5.5%</td>
<td>2.0%</td>
</tr>
<tr>
<td>SUBTOTAL</td>
<td>793.23</td>
<td>23.9%</td>
<td>66.0%</td>
<td>21.6%</td>
<td>75.8%</td>
</tr>
<tr>
<td>Other</td>
<td>408.00</td>
<td>31.0%</td>
<td>34.0%</td>
<td>10.5%</td>
<td>24.2%</td>
</tr>
<tr>
<td>TOTAL</td>
<td>1201.23</td>
<td>26.3%</td>
<td>100.0%</td>
<td>17.4%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Source: Based on *Guangdong Statistical Yearbook, various years.*

Table 5.2 shows the current composition of the Pearl River Delta region’s service sector. The largest service sectors are the transportation, storage, post, and telecommunications sector and the wholesale, retail, and catering sector. The fastest growing service sectors are scientific research, polytechnic services; social services; healthcare, sports and social welfare; and education, culture, arts, broadcasting, film, and television. If the 1999 to 2001 growth rates for the different sectors continue into the future, then by 2006, the composition of the service sector would be as indicated in the table.
Table 5.2  Service Sector Composition, Pearl River Delta region

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Services for agriculture, forestry, animal husbandry and fisheries</td>
<td>0.3%</td>
<td>8.2</td>
<td>0.2%</td>
</tr>
<tr>
<td>Geology and water conservancy</td>
<td>0.5%</td>
<td>7.6%</td>
<td>0.4%</td>
</tr>
<tr>
<td>Transportation, storage, post, telecommunications</td>
<td>24.4%</td>
<td>20.0%</td>
<td>26.0%</td>
</tr>
<tr>
<td>Wholesale, retail, catering</td>
<td>21.7%</td>
<td>11.4%</td>
<td>18.2%</td>
</tr>
<tr>
<td>Finance, insurance</td>
<td>13.8%</td>
<td>9.9%</td>
<td>11.1%</td>
</tr>
<tr>
<td>Real estate</td>
<td>8.9%</td>
<td>12.4%</td>
<td>7.7%</td>
</tr>
<tr>
<td>Social services</td>
<td>14.9%</td>
<td>24.9%</td>
<td>18.1%</td>
</tr>
<tr>
<td>Healthcare, sports, social welfare</td>
<td>3.6%</td>
<td>24.1%</td>
<td>4.3%</td>
</tr>
<tr>
<td>Education, culture, arts, broadcasting, film, TV</td>
<td>5.1%</td>
<td>24.5%</td>
<td>6.1%</td>
</tr>
<tr>
<td>Scientific research and polytechnic services</td>
<td>1.2%</td>
<td>30.2%</td>
<td>1.6%</td>
</tr>
<tr>
<td>Government and Party agencies, social organisations</td>
<td>5.0%</td>
<td>22.9%</td>
<td>5.8%</td>
</tr>
<tr>
<td>Other</td>
<td>0.6%</td>
<td>10.7%</td>
<td>0.5%</td>
</tr>
<tr>
<td>TOTAL</td>
<td>100.0%</td>
<td>16.7%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Source: Based on *Guangdong Statistical Yearbook*, various years.

While simple projections tell an interesting story, there is far more going on in the Pearl River Delta region than these simple projections might indicate. The economic trajectory of the Pearl River Delta region over the next decade will be characterised by modernisation, deepening and broadening of the industrial base, urbanisation, and greater openness. Modernisation will take place across several dimensions. Traditional industries will see an upgrading based on the incorporation of modern technologies into the design and production process. Guangdong has set up seven science and technology centres to support the incorporation of advanced technology into traditional industries. These are located in Nanhai’s Xijiao Town (textiles and garments), Zhongshan’s Guzhen Town (lighting and lamps), Zhongshan’s Xiaolan Town (hardware), Dongguan’s Shilong Town (electronic products), Dongguan’s Humen Town (garments), Nanhai’s Dali Town (aluminium products), and Shunde’s Lunjiao Town (woodworks). Individual towns also have invested in enhancing the technology content of traditional industries. The Yanbu Township of Nanhai, known for its women’s underwear production, has set up the China Underwear Innovation Science and Technology Centre and imported a three dimensional full-body...
scanner for clothing design. This apparatus is the only one in China and one of only twenty in operation worldwide.

Modernisation also will take place in management and commercial activities. Despite the region’s impressive development, management and business practices are still somewhat backward. Management, strategic planning, control, accounting, and financial systems within many, if not most, Pearl River Delta region companies still leave a great deal to be desired. Improved management education, recruitment of professional managers, improvements in professional services and a more modern regulatory system are all likely to contribute to better practices in the future. So too will competition among local firms and between local and foreign firms. Links with Hong Kong, with its relatively advanced management capabilities, could be crucial in upgrading the management systems found in the region.

We would expect to see a further deepening of the economy of the Pearl River Delta region. As skills and capabilities improve in the region, more and more corporate activities will be shifted in. In addition, we would expect the supply base for inputs and components to expand substantially and to see far more in the way of capital goods for industry being produced in the Pearl River Delta region. The idea is that, as the local industrial base reaches a critical mass, it will become economically feasible to start producing capital equipment close to the customers. This has been the trend in all of the Asian economies that have started with relatively simple export processing. As a result, we would expect value added in industry to increase substantially over the next decade. The Pearl River Delta region’s logistics and trade-related service industries will also deepen with substantial new investments in ports, airports, transportation networks, and logistics centres.

Along with the deepening of the Pearl River Delta region economy, we would also expect to see a broadening as well. As the industrial markets of the region grow, there will be demand for a higher volume and greater variety of materials and heavy industrial goods. The development in Nansha is supposed to provide a spearhead for heavy industrial development. The main thrust of the Nansha development will be integrated steel and chemical facilities designed to supply the markets of South China. Of particular importance in this regard is the region’s growing automotive industry. The chemical industry also will be expanded through the further development of the Guangzhou ethylene facility, which eventually was turned over to Sinopec, and a massive petrochemical complex in Huizhou to be developed by Shell and CNOOC. This complex, which is expected to require an investment of US$4.3 billion, will be the largest single foreign investment in China’s history. Guangzhou’s automotive sector in the region is expected to grow substantially in
the next few years. Fengshen, a joint venture between Nissan, Dongfeng, and Yulon is expected to produce 35,000 units in 2002 and 240,000 units by 2007. Bao Long is building a new plant that is expected to produce 50,000 vehicles by 2005. Honda plans to produce 60,000 autos in 2002 in Guangzhou and plans a new facility in for a joint venture with Guangzhou Automobile Industry Group and Dongfeng Motors that will produce 300,000 units per year. Total auto production in Guangzhou is expected to increase from 100,000 units in 2002 to between 400,000 and 500,000 in 2005, and eventually to 800,000. Hundreds of suppliers to the auto firms already have located in Guangzhou and many more are expected.²

Urbanisation is a strong trend in the Pearl River Delta region. China as a whole still has vast numbers of people living in rural settings and depending on agriculture for their living. Most of these people eventually will move into the manufacturing and services sectors in urban settings. Guangdong Province has the highest percentage of urban dwellers of all the provinces of the Chinese Mainland (50.5 percent in 2000), with the exception of the provincial level cities Beijing, Shanghai, and Tianjin. At the same time, the urban populations in Shenzhen (92.4 percent), Zhuhai (85.5 percent), Guangzhou (83.8 percent), Foshan (75.1 percent), Zhongshan (60.1 percent), and Dongguan (60.0 percent) all exceeded the provincial average.³ In the 2001 to 2005 period, Guangdong officials believe that urbanisation in the province will increase by 40 percent. The expectation is that eventually there will be a virtual urban continuum that runs from Hong Kong up through Guangzhou and around to Macao. This would represent a vast expansion of the urban population from 40 million to perhaps 60 million. It would also represent huge potential demand for goods and services required by cities and city dwellers. In addition, some cities in the Pearl River Delta region will see extensive development or redevelopment. Guangzhou, for instance, is developing a completely new urban system by creating industrial locations and residential communities outside the traditional city centre and then rebuilding the centre as a modern commercial metropolis. The total area under development or redevelopment is equal to roughly half the size of Tokyo’s 23 wards. In the coming ten years, Guangzhou will undertake projects that will result in the transformation of the city, much in the way that Shanghai has been transformed in the last ten years. Shenzhen is building a new city centre and undergoing dramatic development and redevelopment as well. Other cities all around the Pearl River Delta region are doing the same.

One concern that arises in the Pearl River Delta region is that urbanisation is outstripping the capacity of local jurisdictions. In China, the level of government and, therefore, government resources and government services is determined by registered population. In the Pearl River Delta region, it is common for the floating population to outstrip the registered population by a wide margin. The floating population in Shenzhen is roughly six times the registered population; in Dongguan it is five times the registered population; and in Guangzhou it is comparable to the registered population. Government services, amenities and resources devoted to public safety are underfunded in many locations in the Pearl River Delta region.

China’s accession into the WTO will substantially increase the openness of the Pearl River Delta region’s economy. Given its proximity to Hong Kong, and what that implies in terms of access to international trade and spillover of tastes, one would expect that imports would rise in the Pearl River Delta region faster than in most other regions of the Chinese Mainland. Many companies will find it worthwhile to extend their sales and distribution networks from Hong Kong into the region and many Hong Kong firms are already entering the region. In addition, the WTO accession agreement should greatly open China’s markets to foreign service providers. Given Hong Kong’s position as a major international service centre, one would expect that the Pearl River Delta region would become an early entry point for foreign service firms. This latter point emphasises the fact that one important aspect of the economic trajectory of the Pearl River Delta region will be much greater economic interaction with Hong Kong.

**Economic Development Trajectory of Hong Kong**

As indicated earlier, Hong Kong’s economic growth rate has fluctuated substantially in recent years. Hong Kong’s overall economic growth was forecast at 3.0 percent real growth per year from 2002 to 2006 in Hong Kong’s 2002/03 budget.\(^4\) In mid-2002, Goldman Sachs forecast that Hong Kong’s economy would grow at a real rate of 4.0 percent per year from 2002 to 2006 and at a nominal rate of 3.5 percent (assuming 0.5 percent deflation per year).\(^5\) The Goldman Sachs forecasts are shown in Table 5.3. The investment bank forecasts rapid growth in tourism, given Hong Kong’s investments in Hong Kong Disneyland and increasing tourism from the Chinese Mainland. Strong growth was also forecast in offshore trade (trade controlled by

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4 Hong Kong Special Administrative Region Government, *Budget 2002/03.*

Hong Kong entities that does not enter Hong Kong’s Customs statistics) and finance. Goldman Sachs predicts a continued decline of manufacturing in Hong Kong itself, but foresees that growth related to manufacturing in the Pearl River Delta region would more than offset this decline.

Table 5.3 Historical Economic Growth Rates and Future Projection, Hong Kong

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Nominal GDP</td>
<td>0.8</td>
<td>3.5</td>
</tr>
<tr>
<td>Real GDP</td>
<td>1.5</td>
<td>4.0</td>
</tr>
<tr>
<td><strong>Assumptions</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Throughput</td>
<td>4.9</td>
<td>3.2</td>
</tr>
<tr>
<td>- Finance</td>
<td>1.7</td>
<td>6.6</td>
</tr>
<tr>
<td>- Offshore trade</td>
<td>8.2</td>
<td>8.0</td>
</tr>
<tr>
<td>- Manufacturing</td>
<td>-4.2</td>
<td>-4.0</td>
</tr>
<tr>
<td>- Tourism</td>
<td>2.4</td>
<td>9.0</td>
</tr>
<tr>
<td>- Property sector</td>
<td>-3.2</td>
<td>1.5</td>
</tr>
<tr>
<td>- Other non-traded</td>
<td>1.9</td>
<td>2.2</td>
</tr>
</tbody>
</table>


A mechanistic approach to projecting the composition of Hong Kong’s economy over the period 2000 to 2005 can be found in Table 5.4. In this table, the growth rates for the components of Hong Kong’s GDP were calculated for the 1995 to 2000 period and then similar rates projected forward from 2000 to 2005. The table shows that if the 1995 to 2000 trends continued that Hong Kong’s service sector would expand in relative terms, as the primary and manufacturing sectors decline in relative terms. The most rapidly growing sectors over the 1995 to 2000 period were electricity, gas, and water; community, social, and personal services; and finance and insurance. The largest sectors in Hong Kong’s economy are projected to be community, social, and personal services; import and export trade; and finance and insurance.
### Table 5.4 GDP Components, Hong Kong

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture and fishing</td>
<td>920</td>
<td>0.1%</td>
<td>-7.3%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Mining and quarrying</td>
<td>241</td>
<td>0.0%</td>
<td>-4.8%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>71,655</td>
<td>5.8%</td>
<td>-3.4%</td>
<td>4.1%</td>
</tr>
<tr>
<td>Electricity, gas and water</td>
<td>38,853</td>
<td>3.2%</td>
<td>9.4%</td>
<td>4.2%</td>
</tr>
<tr>
<td>Construction</td>
<td>64,026</td>
<td>5.2%</td>
<td>3.2%</td>
<td>5.1%</td>
</tr>
<tr>
<td><strong>Services</strong></td>
<td><strong>1,053,202</strong></td>
<td><strong>85.7%</strong></td>
<td><strong>4.2%</strong></td>
<td><strong>88.0%</strong></td>
</tr>
<tr>
<td>- Wholesale and retail trades</td>
<td>45,505</td>
<td>3.7%</td>
<td>-1.1%</td>
<td>2.9%</td>
</tr>
<tr>
<td>- Import/export trade</td>
<td>240,521</td>
<td>19.6%</td>
<td>5.2%</td>
<td>21.1%</td>
</tr>
<tr>
<td>- Restaurants and hotels</td>
<td>38,596</td>
<td>3.1%</td>
<td>-0.6%</td>
<td>2.6%</td>
</tr>
<tr>
<td>- Transport and storage</td>
<td>98,298</td>
<td>8.0%</td>
<td>5.5%</td>
<td>8.7%</td>
</tr>
<tr>
<td>- Communications</td>
<td>27,426</td>
<td>2.2%</td>
<td>0.3%</td>
<td>1.9%</td>
</tr>
<tr>
<td>- Financing and insurance</td>
<td>156,258</td>
<td>12.7%</td>
<td>8.3%</td>
<td>15.9%</td>
</tr>
<tr>
<td>- Real estate</td>
<td>77,652</td>
<td>6.3%</td>
<td>-4.8%</td>
<td>4.1%</td>
</tr>
<tr>
<td>- Business services</td>
<td>57,152</td>
<td>4.7%</td>
<td>5.1%</td>
<td>5.0%</td>
</tr>
<tr>
<td>- Community, social and personal services</td>
<td>252,435</td>
<td>20.5%</td>
<td>8.7%</td>
<td>26.1%</td>
</tr>
<tr>
<td>- Ownership of premises</td>
<td>155,303</td>
<td>12.6%</td>
<td>3.0%</td>
<td>12.3%</td>
</tr>
<tr>
<td><strong>Less: Adjustment for financial intermediation indirectly measured</strong></td>
<td><strong>95,945</strong></td>
<td><strong>7.8%</strong></td>
<td><strong>3.9%</strong></td>
<td><strong>7.9%</strong></td>
</tr>
<tr>
<td><strong>GDP at factor cost</strong></td>
<td><strong>1,228,897</strong></td>
<td><strong>100.0%</strong></td>
<td><strong>3.6%</strong></td>
<td><strong>100.0%</strong></td>
</tr>
</tbody>
</table>


Behind these figures and forecasts has been a process of evolution in Hong Kong’s economy. Increasingly, Hong Kong’s economy is focused on high value-added, knowledge-intensive activities involving management, coordination, finance, information, market development, and business services. These activities return more per person and more per square metre than other corporate activities. This is why they tend to be concentrated in the centres of major cities, particularly those that are relatively expensive in terms of wages and land costs. In essence, these are the activities that can justify the highest costs and the activities that tend to crowd out other activities (such as manufacturing) that do not return the same value per person or per square metre. These activities are consistent with Hong Kong’s
goal to become Asia’s world city, a city that has regional or even global reach. Other world cities, such as New York and London, have overall economic profiles similar to that of Hong Kong. They are also consistent with a cost gradient between Hong Kong and its surroundings that is substantially greater than that found in other major commercial cities.

Thus, Hong Kong’s economic trajectory is likely to include an extension of its position as a regional base for multinational firms. Hong Kong has long been the leading centre for regional headquarters of multinational firms. In one survey encompassing 1,100 North American, European, and Japanese multinationals, Hong Kong was a regional headquarters for 35 percent of the firms. Singapore was second at 30 percent. Tokyo was third with nine percent of the Western multinationals reporting a regional headquarters in that city. The main shift since 2000 has been Hong Kong gaining share at the expense of Singapore. This has been due to the shift of investment and interest from Southeast Asia to Northeast Asia, the continued superiority of Hong Kong in infrastructure, clear and transparent rules and regulations, international access, and proximity to large markets. Since the Asian Crisis, major international financial service firms increasingly are concentrating Asian regional activities into Hong Kong. The main activities that foreign multinationals undertake and plan to undertake in Hong Kong reflect the managerial, financial, information, coordination, and market development activities that Hong Kong firms also perform in Hong Kong. As indicated earlier, Hong Kong companies tend to perform the highest value-added activities in Hong Kong and expect to continue to do so in the future.

The emergence of the Pearl River Delta region has allowed Hong Kong companies to decentralise many activities out of the Hong Kong SAR and into the surrounding areas. This is exactly the type of development that one would expect once the economies of Hong Kong and the Pearl River Delta region were allowed to interact. The result has been a narrowing of the activity base of Hong Kong’s economy even as the economy has grown and prospered. While the activity base of Hong Kong’s economy is likely to continue to narrow, it is likely to perform high value-added activities for a wider range of industries than has been the case in the past. Despite the extensive interaction between Hong Kong and the Chinese Mainland in general, and the Pearl River Delta region in particular, what is striking is how limited this interaction is when compared to that between other major economic cities and their surroundings. China’s entry into the WTO and the development of the Pearl River Delta region into a wider range of industries, including not just light manufacturing, but also heavier industries and services, will provide greater scope for

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high-value activities linking these industries to the rest of the world through Hong Kong. They also will provide additional impetus for foreign investment and the location of management activities for a wider range of multinational companies in Hong Kong. Thus Hong Kong is likely to perform high value-added managerial, financial, coordination, and information activities across more industries. It also is likely to perform these activities for a wider range of firms, including foreign multinationals interested in accessing the region and Chinese firms seeking to access international markets.

The high cost base found in Hong Kong also will serve to limit the range of corporate activities and employment opportunities in Hong Kong. Hong Kong is showing a tendency toward developing a “high-low” economy in which high value-added activities and the lower level maintenance and support activities are found in Hong Kong and middle-level activities of the sort that employ middle or lower middle class employment may be increasingly located outside of the city. Hong Kong-based managers in manufacturing firms and trade-related services firms interviewed for this study indicated that they are relocating as many jobs as they can out of Hong Kong and into the Pearl River Delta region due to cost considerations. Other service providers predict that they will move many back office jobs out of Hong Kong. The question is whether Hong Kong will be able to attract sufficient numbers of jobs in high-value management activities and follow-on employment to compensate for the jobs that leave for the Pearl River Delta region. If so, then it will be a matter of higher value-added activities crowding out lower value-added activities. While this would bring difficulties for those displaced from the workforce, it should help Hong Kong’s overall economic development and prosperity.

The inescapable conclusion is that Hong Kong’s economy will narrow in terms of the activities that it performs. This is not necessarily good or bad. In many ways, as the Chinese Mainland in general and the Pearl River Delta region in particular progress and open, Hong Kong’s economy will start to look more and more like that of other major economic cities around the world. These cities, be they New York, London, Chicago, Zurich, or Tokyo grow prosperous through their ability to be the nodes at which economic activities are managed, coordinated, and financed. Major economic cities thrive on controlling or handling flows of knowledge, information, goods, and finance. China’s opening allows Hong Kong a much greater scope to perform precisely these activities. The question is whether Hong Kong will perform these activities for a large enough number of local, Chinese, and multinational firms to offset the employment impact of the loss of middle class jobs. While the vast potential of the Pearl River Delta region, China, and Asia as a whole, would seem to indicate that this is a distinct possibility, ultimately it will be an empirical question whose answer will only become clear over time.
Although concerns have been voiced about the impact of the Pearl River Delta region on Hong Kong, the region’s dynamism should represent more of an opportunity than a threat to the future development of Hong Kong’s economy. Hong Kong is well positioned to benefit from the region’s burgeoning and diversifying trade. Hong Kong’s financial system and financial strength are well matched to the substantial investment requirements of the region. Hong Kong-based professionals are well placed to help meet the region’s growing demand for management, accounting, marketing, and consulting expertise. Hong Kong’s developers and infrastructure companies are likely to take leadership roles in several of the large-scale development projects in the region. Hong Kong-based distribution, logistics, and retailing companies will benefit from a rapid expansion in consumer demand.

To take full advantage of these opportunities, however, many in Hong Kong will need to expand their horizons. Hong Kong and Hong Kong firms have played a crucial role in the Pearl River Delta region’s development to date. Hong Kong firms and professionals have provided manufacturing investment and expertise, and have provided advanced support services for Hong Kong firms and foreign firms accessing the region. Increasingly, they are helping firms from the Pearl River Delta region become international players themselves. Today, however, the Pearl River Delta region has become a force to be reckoned with in its own right. This implies that the development of Hong Kong and the Pearl River Delta region will be far more interactive and even-handed in the future than in the past. The companies that will be winners in the Pearl River Delta region will be those that understand the region’s development trajectory and then find ways to take advantage of, and contribute to, that development trajectory.

**Future Competitiveness and Development Potential of the Greater Pearl River Delta Region**

An understanding of the present position of the Greater Pearl River Delta region (defined as the Pearl River Economic Development Zone, the Hong Kong SAR, and the Macao SAR) and the future economic trajectories of both the Pearl River Delta region and Hong Kong allow us to make some projections about the future competitiveness and development potential of the Greater Pearl River Delta region as a whole.

**Light-manufacturing industries**

The Greater Pearl River Delta region is poised to expand its position in light-manufactured goods. Despite increases in land costs within the Pearl River Delta region, most experts interviewed for this project indicated that the region would retain and expand its position as a light-manufacturing base. The region will continue to benefit from relatively low
assembly manufacturing wages, high quality infrastructure, improving capabilities, access to international markets through Hong Kong and the presence of a wide range of supplier and supporting industries. At the same time, China’s WTO accession and growing importance as an investment location will further enhance the Pearl River Delta’s position.

Wage rates for assembly manufacturing will continue to be low in parts of the Pearl River Delta region since most of this labour comes from China’s inner provinces, such as Hunan, Guizhou, Jiangxi, Sichuan, Hubei, Henan, and Anhui. The opening of the Beijing-Kowloon Railway has made it far easier for migrant workers from Central China to come to Guangdong. The result has been a situation in which real wages in assembly manufacturing have been remarkably stable and low in the Pearl River Delta region. Some managers indicate that these wages are lower than can be found in the Yangtze River Delta region or in Northern China. Access to labour from all over China allows the Pearl River Delta region to keep wages relatively low. Only in the garment sector did Hong Kong-based managers indicate that lower wages might give other parts of China an advantage over the Pearl River Delta region.

The eastern part of the Pearl River Delta region and Hong Kong have infrastructure that is better than elsewhere in China. The eastern part of the Pearl River Delta region has better highway access than other places in the Chinese Mainland. Planned investments in the region should make transportation around the Pearl River Delta region far better than is the case today. In the ports of Shenzhen and Hong Kong, the Greater Pearl River Delta region has ports that are more efficient than elsewhere in China and less subject to silting and other difficulties than new ports in Shanghai. New investments in the region’s ports are likely to continue to enhance the Greater Pearl River Delta’s relative position. The Greater Pearl River Delta region has more international air cargo and air transport capacity than anywhere else in China. The combination of Hong Kong’s international routes and Guangzhou’s domestic network is likely to continue to be an advantage well into the future. The new airport in Guangzhou and Hong Kong’s new air service agreement with the United States should enhance the region’s position further.

All of these developments combined with an increasing importance of short cycle times for supply chain management means that the Pearl River Delta’s light-manufacturing base is not likely to move far from its ports and airports. This is particularly true since the unwritten rule for foreign invested facilities engaging in labour intensive production is that the factories should be no more than a three-hour drive from the customs facilities heading to Hong Kong. Any further and the goods risk not being able to get to the port within one day, therefore involving storage and uncertainty in getting on board the
appropriate ship. Locations beyond the three-hour travel time, such as those in the western part of the Pearl River Delta region, are less favourable.

China’s accession into the WTO and its increasing exports might provide a further impetus to the Pearl River Delta’s light-manufacturing base. Accession to the WTO and the phasing out of garment and textile quotas are expected to increase China’s share of world trade in garments from under 30 percent to around 50 percent or more over the next several years. WTO entry also has ended the need to renew China’s Normal Trade Relations status in the United States and other industrial economies. As a result, investors can be more confident that their Chinese facilities will continue to have access to important markets. China’s growth as an export base also is fuelling additional investment in light manufacturing at the expense of other countries, mostly in Southeast Asia.

Industry participants across a range of industries claim that the combination of Pearl River Delta manufacturing and Hong Kong management and capital is not likely to be seriously challenged in the near future. In garments, while some experts believe that the Pearl River Delta region may lose some share to other regions in China, the overall growth of China’s position in the garment industry is likely to ensure that the sales volume of Pearl River Delta region factories will increase substantially. Managers in the watch industry believe that the Greater Pearl River Delta region will remain one of the world’s leading manufacturing locations in the industry. Outside of Switzerland, the major competitors in the watch industry, from Hong Kong, the Chinese Mainland, South Korea, and Japan, are all doing much if not all of their manufacturing in the Pearl River Delta region. The presence of a dense supply base, market knowledge largely based in Hong Kong, easy access to buyers through Hong Kong, and rapid cargo shipments through Hong Kong are viewed as likely to keep watch manufacturing in the region.

Technology-based industries

The Pearl River Delta region has been the leading producer of technology-based products in the Chinese Mainland. Shenzhen, for example, has a highest proportion of technology-based products in its economy among cities in the Chinese Mainland. The Shenzhen High Technology fair, first held in 1999, has made Shenzhen a showcase for the technology sector for the entire Chinese Mainland. In 2000, some US$2.4 billion in transactions occurred at the fair. Guangzhou, Shenzhen, and Zhuhai have become centres for the software industry in the Chinese Mainland. Dongguan has become a centre for the production of desktop computers and computer peripherals. According to the Guangdong government, the main focal points for technology-based development in the Pearl River Delta region are to include Foshan (audio-visual products), Guangzhou (software and
telecommunications products), Shenzhen (electronics, computers, peripherals, software, and telecommunications products), Dongguan (computers and electronics), and Huizhou (audio-visual and telecommunications products). In addition, Guangzhou and Zhongshan are slated to lead development in biotechnology.

Numerous foreign companies continue to set up production and development activities in the region. IBM and HP are active producers in the region. IBM’s wholly owned enterprise in Shenzhen, represents an investment of over RMB 7.3 billion. Dongguan’s position in computers and peripherals is largely due to Taiwanese investments. Leading Asian electronics companies, such as Canon and LG, and European companies such as Nokia and Ericsson, also have major production facilities in the Pearl River Delta region. The supplier base for electronics companies in the Pearl River Delta region continues to grow, with literally thousands of producers supplying a broad range of components and inputs. Industry experts claim that the Pearl River Delta region will soon be attracting additional facilities to produce semiconductors and other advanced components for the production base in the region.

The Pearl River Delta region also is the home of an increasing number of Chinese technology-based firms. More than half of the “high-technology” products (usually defined as electronics, information technology equipment, electrical appliances, and electrical machinery) produced in Shenzhen in 2001 were based on indigenous intellectual property. More than 30 universities have set up research and development activities in Shenzhen in order to take advantage of the city’s technical workforce and access to commercialisation capabilities and finance from Hong Kong. Zhuhai has set up a university city to which it plans to attract branch facilities from leading Chinese and foreign universities. Hong Kong universities also have set up research operations in the Pearl River Delta region, and increasingly are cooperating with Pearl River Delta-based universities. Even so, the universities of the Pearl River Delta region are not considered on par with those in Eastern or Northern China when it comes to research capabilities or in the training of a technological workforce. The continuing ability of Shenzhen to attract highly educated people from elsewhere in China will be critical to the further development of its technology-based industries. While it is becoming difficult for Shenzhen to attract qualified people from Shanghai and Beijing, it is still able to attract people from universities in the north and central parts of the country.

One critical issue for technology-based industries and companies is finance. The emerging technology-based firms in the Pearl River Delta region require venture capital and follow-on financing if they are to succeed. Many of these companies obtain finance from the
Shenzhen Stock Exchange. Others seek finance from Hong Kong-based firms, financial institutions, venture capitalists or from Hong Kong’s GEM board. There is substantial potential for Hong Kong to become the main base for financing the growing companies of the Pearl River Delta region. To do so, it will need to expand its knowledge of the local company base in the region, enhance the sophistication of the local venture capital industry, attract the Asian activities of foreign venture capitalists, and make listing in Hong Kong an even more attractive option for new firms and for investors.

**Heavy industry**

Historically, the Pearl River Delta region in particular and South China in general have been under-represented in heavy industries. The region lacked the natural resources, human resources, and demand present in the industrialised north. Development of heavier industry has long been a priority of the Guangdong Provincial government, but several efforts, such as the Peugeot auto joint venture and an ethylene facility built by the city of Guangzhou, have proved to be failures. However, over the last two decades, the growth of industry, urban centres, and purchases of consumer durables has created substantial demand for autos, steel, chemicals, building materials, heavy machinery, and other heavy industrial products, as well as renewed interest in heavier industry. New investments are scheduled to expand these industries substantially in the future.

In the late 1990s, Honda took over the failed Peugeot venture and began to turn it around. As indicated above, Honda is scheduled to vastly increase its capacity, as are other auto producers and suppliers in the region. These investments are likely to make Guangzhou the fourth leading auto producer among Chinese cities. Honda, whose new plant will be geared towards export markets, obviously believes that China in general and Guangzhou in particular, will be able to build to world quality and cost standards. The attraction of foreign auto parts suppliers will dramatically improve the sophistication of these businesses as well.

As indicated above, the main thrust of the Nansha development is to bring heavy industry to South China. South China has historically lacked the natural resources and human resources considered necessary to compete in these industries, nor is there much experience in these industries in the region. The key question is what will happen when South China demand is coupled with imported raw materials, foreign investment and technology, and a Chinese workforce. Much of the technology and know-how in heavy industries is embodied in equipment. The Nansha development could try to do what Korea’s POSCO did two decades ago; invest in modern equipment and bypass many traditional players. Certainly South China is not encumbered by the inefficient and outdated facilities that are endemic
in the more traditional heavy industrial zones of China’s north. In chemicals, the question will be exactly where large investments, such as the Shell-CNOOC complex in Huizhou, place the Pearl River Delta region on the national and international stage. Certainly, there is ample evidence in this industry around the world of large investments bringing in world-class technology that allows plants to compete effectively.

Hong Kong, with an economy based on services, light industry, and electronics, has never had much of a position in heavier industries. Hong Kong’s contribution is likely to be much more on making the Pearl River Delta region more accessible to international firms, linking Pearl River Delta region production to international markets, linking foreign suppliers of inputs and capital goods to the region, and investing in new entities that might arise.

Services

The service sectors of the Greater Pearl River Delta region also will see substantial growth and development. For some service sectors, this will involve the extension of existing competitive positions. In others, it will involve the development of new industries and new markets. One important distinction among service sectors will be those in which Hong Kong and the Pearl River Delta region will increasingly become integrated and those that are likely to continue to be more or less separate.

*Trade-related services*

The Greater Pearl River Delta region shows every indication of extending its position in trade-related services. The deepening and broadening of the industrial base of the region will create substantial new demand for trade-related services in the region. Investments in ports, airports, highways, and railways will bring the region closer together and will enhance its efficiency. This will be combined with the expertise found in Hong Kong and increasingly in the Pearl River Delta region. Buying offices and traders will continue to benefit from the dense network of support services found in Hong Kong. The Greater Pearl River Delta region also will continue to benefit as the home of China’s two most important trade fairs, the traditional “Canton Fair” in Guangzhou and the High Technology Fair in Shenzhen. It also will benefit from the large number of leading international trade fairs held each year in Hong Kong.
**Business and professional services**

The business and professional service markets in the Greater Pearl River Delta region are likely to remain distinct. Hong Kong will retain a very strong position in internationally related services, such as international finance, and as a hub location for professional services, such as accounting, advertising, consulting, and legal services. As indicated above, Hong Kong’s position as a regional headquarters for multinational firms is improving, as is its position as a management and coordination centre for business into and out of China. All of these generate substantial demand for high-level professional services. Hong Kong’s role as a regional hub also has meant that many international professional service firms themselves use Hong Kong as a base to serve the rest of the region. Hong Kong’s advantages in terms of legal and administrative systems, communications network, history as a cosmopolitan city, and international linkages continue to make it the city of choice for the regional activities of professional service firms. In several professional services, the Pearl River Delta region is not on the map for international firms. Neither Guangzhou, nor Shenzhen, has potential or pretensions to be an international financial centre. International legal firms see their business prospects more in other cities in the Chinese Mainland than in those of the Pearl River Delta region.

The business service sectors of the Pearl River Delta region will need to grow substantially just to satisfy the demand of its growing industrial base. In addition, the plans of Guangdong Province, Guangzhou, and Shenzhen all call for a dramatic expansion of the business service sector. Most interviewees, however, indicated that the Pearl River Delta region cities would remain well behind Beijing and Shanghai in the depth and breadth of their business service offerings. Beijing and Shanghai are both far more important as domestic financial service centres than the Pearl River Delta region cities. Beijing is the centre for state-owned financial service providers and Shanghai has been designated as China’s domestic financial centre. Shenzhen, despite its relatively early opening in some financial services and the presence of the Chinese Mainland’s second leading stock exchange, remains behind. Should Shenzhen get the approval of the Central Government to set up a second board, the city could become an important centre for financing growth companies. As for other business services, the market is likely to develop further as large local and foreign companies begin to demand more advanced services in the region. The more integrated the business service sectors of Hong Kong and the Pearl River Delta become, the better it is likely to be for both. In such integration is the best hope that the Pearl River Delta region can close the gap with other Mainland Chinese cities.
Tourism

Tourism in the Greater Pearl River Delta region also is expected to grow substantially. Hong Kong is a major international tourist destination, as well as an increasingly popular location for visitors from the Chinese Mainland. Hong Kong attracts many visitors interested in a modern, metropolitan, East-meets-West setting. Macao builds off its history and its European links. It also will receive substantial new investments that could make it a tourism and gaming centre for the entire Asian region. The Pearl River Delta region has numerous attractions that make it attractive for a Chinese Mainland clientele, though not as of yet to the international tourism market. Attractions include a variety of theme parks, several golf resorts, two major nature parks, and attractive natural locations. Should the jurisdictions in the Greater Pearl River Delta region make further efforts to pool their marketing and link their attractions, they could offer combined tours and promotions that might enhance their overall positions. Even so, they are unlikely to compete successfully for visitors more interested in the history and culture of the Chinese Mainland, which is better represented by locations such as Beijing, Shanghai and Xi’an.

Future Trajectories and Economic Interaction

The future trajectories of the economies of the Pearl River Delta region and Hong Kong will set the background for their future economic interaction. The Pearl River Delta region is likely to have a much deeper and broader economy in the future as input, component, capital goods, and service industries rise to serve its industrial base. We also would expect to see substantial opportunities linked to urbanisation and the further development of consumer markets. Hong Kong, on the other hand, is likely to see the range of activities that it performs narrow to many of the highest value-added management, coordination, financial, and information activities, but the number of firms and the number of types of firms performing such activities is likely to expand significantly. The most beneficial types of economic interaction between Hong Kong and the Pearl River Delta region are likely to be those that build upon, facilitate, and accelerate these trajectories. The nature of the future economic interaction between Hong Kong and the Pearl River Delta region, as well as the division of labour and competition between Hong Kong and the Pearl River Delta region will be the subjects of the next chapters.
The economic interaction between Hong Kong and the Pearl River Delta region has had a profound impact on the development of both economies. The future economic interaction between the two areas is likely to have an equally profound impact going forward. There are several driving forces that promise to make the interaction closer, more challenging, and potentially more rewarding in future. These will change the nature of the economic interaction between Hong Kong and the Pearl River Delta region in significant ways. Understanding these driving forces and their likely impact on the economic interaction is critical to our understanding the future of the Greater Pearl River Delta region economies.

**Driving Forces**

There are several forces that are driving the changes in the economic interaction between Hong Kong and the Pearl River Delta region. These include the growth and development of the Pearl River Delta region, the experience that both sides have with “one country, two systems”, greater communication across the boundary, China’s accession into the World Trade Organisation, Hong Kong’s economic conditions, and competition with the Yangtze River Delta region.

**The growth and development of the Pearl River Delta region**

The Pearl River Delta region has had one of the world’s fastest growing regional economies for over two decades. This growth has allowed the region to support levels of development and living standards that are well beyond those found in most of China. The Pearl River Delta region is becoming increasingly self-sufficient in economic matters as the skills and capabilities in the region grow. A broader, more diversified Pearl River Delta region economy provides substantial additional potential for interaction with the Hong Kong economy. The development of the Pearl River Delta region is still dependent on Hong Kong, but not as dependent as it was in the past. At the same time, there is a sense in the Pearl River Delta region that it might be losing out to other areas in China, notably the Yangtze River Delta region, for some types of development. Thus, the different jurisdictions within the Pearl River Delta region are trying to redefine their economic roles in the national and global economies. Many in the region look to further interaction with Hong Kong to help them in this endeavour.

**Experience with “one country, two systems”**

The “one country, two systems” formula under which China reasserted administration of Hong Kong on 1 July 1997 has been more successful than many people had imagined. Many of the fears about the possibility of Mainland intrusion into day-to-day life in Hong
Kong have receded substantially since 1997. The international business community in Hong Kong generally sees very little difference in how they do business in Hong Kong since the transition. The experience with the formula over the last five years has given people in Hong Kong more confidence that further interaction with the Pearl River Delta region will not lead to an erosion of Hong Kong’s separate system. As a result, of the change of administration, a great deal of learning has occurred in both Hong Kong and the Pearl River Delta region. This experience and learning will foster closer interaction going forward.

Greater communication

At the same time, five years of experience has changed the way the governments and the general public view the interaction as well. For much of the period immediately following 1 July 1997, the focus was on ensuring that the “two systems” portion of “one country, two systems” was essentially in place. This was quite natural given the concerns at the time. As those concerns began to recede, it was natural that governments and business people on both sides of the Hong Kong-Pearl River Delta region boundary would try to develop the potential benefits of “one country”. Thus there has been a significant upswing in terms of the numbers of government-to-government meetings, seminars, cooperative research undertakings, and other signs of interaction. There has also been an increase in the interaction between professional associations and Chambers of Commerce on both sides of the boundary. Many more communications channels are open today than was the case even two years ago. The result will be a much more fluid interaction that allows for discussion of joint issues and joint undertakings.

China’s accession to the World Trade Organisation

China’s accession to the World Trade Organisation (WTO) also is driving further economic interaction between Hong Kong and the Pearl River Delta region. WTO entry will mean a substantial opening of the economy of the Chinese Mainland, and therefore the Pearl River Delta region, to international trade and investment. Industries in which foreign investment was limited or forbidden, such as banking, insurance, commerce, trade, telecommunications, railways, civil aviation, distribution, and others will open to foreign investment. Many Hong Kong-based businesses, and the Hong Kong offices of foreign multinationals, will be able serve customers in the Pearl River Delta region that they have never been able to serve before. WTO accession, and China’s general opening, should stimulate substantial growth in trade and investment in the Pearl River Delta region. Much of this trade and investment will involve Hong Kong. Hong Kong will start to provide far more of the services to the Pearl River Delta region that major economic cities around the world provide to their surrounding areas than has been the case to date.
Hong Kong’s economic conditions

The economic downturn that Hong Kong has experienced over the last five years has created a strong impetus for greater economic interaction with the economy of the Chinese Mainland in general, and the Pearl River Delta region in particular. Hong Kong’s economy slowed dramatically in 1998 as the impact of the Asian Crisis and Hong Kong’s own asset price bubble began to be felt. Despite a strong rebound in 2000, in which Hong Kong experienced 10.5 percent real annual growth in GDP, the overall story of Hong Kong’s economy since 1997 has been a weakening of economic figures, deflation, and rising unemployment. While some in Hong Kong seem to think that closer links with the Pearl River Delta region will be some magic bullet that will save Hong Kong’s economy, more thoughtful business people, analysts, and policy makers, view closer interaction with the Pearl River Delta region as a way to help Hong Kong reposition itself as part of one of the world’s most dynamic economic regions while retaining its role as a major management, financial, and coordination centre for Asia.

Competition with the Yangtze River Delta

Competition between the Pearl River Delta region and the Yangtze River Delta region is becoming more direct in some areas. This competition is highlighted in Chapter 8. Competition among regions may well change the interaction within the Greater Pearl River Delta region. In particular, it should provide a strong impetus for the different jurisdictions and interests in the Greater Pearl River Delta region to find ways of identifying and developing joint gains and of jointly facing future competition. It is not necessarily clear that the jurisdictions will do so without an external stimulus.

The Future Economic Interaction

These driving forces will have an important impact on several dimensions of the economic interaction, including investment, trade, transportation and travel, tourism, technology, management, real estate, and retail shopping. The future interaction of the service sectors, particularly given the strength of Hong Kong’s service sectors and gaps in those of the Pearl River Delta region, will also be influenced by these forces.

Investment

Hong Kong has been the dominant source of international investment into the Pearl River Delta region since the region began to open in the late 1970s. Official estimates indicate that roughly 70,000 Hong Kong firms had invested nearly US$80 billion in Guangdong
Province through 2001. In recent years, however, Hong Kong’s share of inward investment into the region has been declining. There are a number of reasons for this relative decline. The vast majority of Hong Kong manufacturing firms already have shifted their manufacturing facilities into the Pearl River Delta region. As of 2000, for example, some 86.1 percent of the members surveyed by the Hong Kong Chinese Manufacturers’ Association had already set up facilities in the Chinese Mainland, largely in the Pearl River Delta region. They claim that as of 2001 there were 198,188 Hong Kong invested-entities in the Chinese Mainland, again mostly in the Pearl River Delta region. Hong Kong service sector companies have been limited by restrictions on activities of foreign firms in the service sector. As firms from Taiwan, Japan, and the West have become more familiar with the Pearl River Delta region and more comfortable in investing there, they make up an increasing portion of the companies investing the Pearl River Delta region. In addition, these companies tend to make much larger investments on average than their Hong Kong counterparts. There will be greater openness to investment as China follows its WTO accession agreement and as investments are sought in the automotive sector, in heavy industries associated with the Nansha development programme, and in other industries that favour Western and Japanese firms. Foreign service firms will also take advantage of their size and international status to extend their positions in retailing and business services. For these reasons, the share of Hong Kong investment into the Pearl River Delta region is likely to decrease.

Even with a decline in share, however, Hong Kong investment should retain a leading share well the in foreseeable future and the absolute value of Hong Kong investment into the region will grow. Hong Kong investment should continue to climb for several reasons. Many investments are already on the drawing boards. According to the Hong Kong Chinese Manufacturers’ Association, members have invested only around half of the amount that they have contracted to invest in the Chinese Mainland. Hong Kong firms will invest to expand existing facilities and activities as manufacturing firms are allowed to distribute more freely in the Chinese Mainland. Hong Kong firms are also likely to be major participants in the infrastructure, real estate, and retail development opportunities that are rapidly expanding in the Pearl River Delta region. Some of the industries that will be opened under China’s WTO accession agreement, such as telecommunications, banking, transportation, wholesaling, and distribution, are industries in which Hong Kong firms are likely to take on major positions in the Pearl River Delta region. Finally, greater openness

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1 Ta Kung Pao, “Trade between Hong Kong and Guangdong reaches US$38.7 billion, April 10, 2002.
2 Hong Kong Chinese Manufacturers’ Association, 2000 Survey on Members’ Investment in Mainland China.
in the service sectors will allow many Hong Kong firms to formalise and expand their informal investments in the Pearl River Delta region and allow other Hong Kong firms to enter the region for the first time.

Hong Kong’s position as a base for foreign multinationals to make and manage investments in the Pearl River Delta region should grow substantially. As indicated above, the thousands of firms that use Hong Kong as a base for the Pearl River Delta region will increase. The number of Taiwanese firms active in Guangdong, for example, estimated at 14,000, is likely to increase substantially. These firms tend to use Hong Kong as a base for their Pearl River Delta operations. Increasing openness and economic development will bring greater investment in a wider range of industries than has been the case before. In addition, as foreign firms develop their businesses in the Chinese Mainland, firms that chose to place their first operations in the eastern or northern part of the Chinese Mainland eventually will place operations in the south as well. Hong Kong retains its advantages as a location for foreign firms to place their management, financial, logistics, and international market-related activities. Improved transportation within the Greater Pearl River Delta region and improved border-crossing efficiency will make it easier to travel from Hong Kong to facilities or operations in the Pearl River Delta region.

The number of firms from the Pearl River Delta region that invest in offices in Hong Kong is likely to increase substantially. According to a survey carried out by the Hong Kong Trade Development Council in 2002 among private sector firms in the Chinese Mainland, 19.7 percent of the responding firms from the Pearl River Delta region already had an office in Hong Kong, 14.5 percent already had plans to place an office in Hong Kong, and 49.3 percent indicated that they might place an office in Hong Kong in the future. Only 16.6 percent indicated that they had no plans to place an office in Hong Kong. Responding managers indicated that no other city could replace Hong Kong as an international commercial and financial centre. Some 81.0 percent of the Pearl River Delta-based managers indicated that it was easy to manage regional business activities from Hong Kong. The managers also viewed Hong Kong as superior to cities in the Chinese Mainland and elsewhere on a variety of attributes (see Table 6.1). All of this promises a substantial increase in the number of Pearl River Delta region companies investing in Hong Kong.

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4 Hong Kong Trade Development Council, Hong Kong as an International Commercial and Financial Centre — From the Perspective of Mainland Private Enterprises, June 2002.
### Table 6.1  PRD-based Private Sector Manager’s Comparisons of Hong Kong with the Chinese Mainland and Other Cities, 2002

<table>
<thead>
<tr>
<th>Attribute</th>
<th>Percentage of PRD respondents claiming Hong Kong is superior to Chinese Mainland and other cities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Concentration of foreign business associations and multination companies</td>
<td>85.5</td>
</tr>
<tr>
<td>Ready access to market intelligence</td>
<td>82.6</td>
</tr>
<tr>
<td>Easy to locate agents and do sourcing</td>
<td>66.0</td>
</tr>
<tr>
<td>Base for developing world markets</td>
<td>65.9</td>
</tr>
<tr>
<td>Platform for seeking foreign capital and business partners</td>
<td>52.6</td>
</tr>
<tr>
<td>Human resources</td>
<td>58.0</td>
</tr>
</tbody>
</table>

Source: Hong Kong Trade Development Council

#### Trade

Most of the present trade between Hong Kong and the Pearl River Delta region, some 80 percent by some estimates, relates to export processing by facilities in the Pearl River Delta region.\(^5\) Since these types of exports are expected to increase substantially over time, the volume of this trade is expected to grow as well. One feature that will influence this trade is the nature of export processing regulations, which are relatively restrictive in terms of requiring single-step processing, in which only companies performing a single production step are able to take advantage of the tax and duty breaks associated with export processing.

Although there is little doubt that the volume of trade and trade interaction between Hong Kong and the Pearl River Delta region will grow, one major influence on the future trade relations between Hong Kong and the Pearl River Delta region is whether Hong Kong-funded enterprises in the Pearl River Delta region will still use Hong Kong for trade-related services and as a transit point for goods. According to the Hong Kong Trade Development Council, offshore trade (trade that is transhipped through Hong Kong without even entering its customs statistics or shipped directly to third markets without ever touching Hong Kong) of Hong Kong-invested or Hong Kong-controlled enterprises has been growing dramatically. Although re-exports are still the dominant mode of exports for Hong Kong

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firms from the Chinese Mainland, transhipments and direct shipments represented a total of 32.9 percent of the exports of Hong Kong related firms from the Chinese Mainland in 2000, up from 28.2 percent in 1997.6

The future form of this trade depends on many factors, such as the division of labour and competition between Hong Kong and Pearl River Delta region in port services and trade-related services. This in turn will be influenced by the ease of transportation and customs clearances between Hong Kong and the Pearl River Delta region. Plans to dramatically improve the situation with respect to border crossing by increasing the number of checkpoints, expanding opening hours, and using more advanced technology to streamline procedures are not expected to come to fruition for a few years. Once these problems are overcome, one would expect a substantial increase in cross-border trade flows. Until then, trade within the Greater Pearl River Delta region will be hindered. The Greater Pearl River Delta region could, therefore, benefit enormously from an integrated trade communication system that would allow for more efficient transportation and customs procedures.

As China opens its markets under its WTO accession agreement, or even earlier if there is a successful completion of discussions for a Closer Economic Partnership Arrangement (CEPA) between Hong Kong and the Chinese Mainland, there is far greater opportunity for Hong Kong firms to sell their Hong Kong production and their Pearl River Delta region production into the Chinese Mainland. A survey by the Hong Kong Trade Development Council in 2001 indicated that only 27.5 percent of the Hong Kong manufacturing and trading companies surveyed had sales in the Chinese Mainland. Of the firms that did not sell into the Chinese Mainland, only 17.2 percent had plans to enter the market, while 31.0 percent had no plans to enter the market, and 51.8 percent were taking a wait and see attitude.7 This indicates that a large number of Hong Kong-based firms are not seriously exploring what should be an important growth opportunity, particularly given the rapid increase in incomes in the Pearl River Delta region and the cultural and linguistic similarities of that region with Hong Kong. Thus we would expect that the growth of Hong Kong domestic exports to the Chinese Mainland would not grow as much as they might given the new openness. Many Hong Kong firms are concerned about collecting payments, capital flows, competition with local enterprises, import duties, and ambiguous laws, regulations, and customs treatments. Many believe they will need to partner with Pearl River Delta firms in order to sell successfully into the Pearl River Delta region. In

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addition, many firms will have to transform their status from export processing firms to foreign-owned enterprises.

The exports of the Pearl River Delta region are still largely tied to foreign-invested or contracted firms. While many local firms in the Pearl River Delta region have begun to export, for the most part they still focus on the domestic market. Many firms located on the Western side of the Pearl River Delta region that produce international quality products have found it too difficult or expensive to set up their own international marketing and sales channels. Ironically, these are precisely functions that Hong Kong-based firms and offices excel at providing. In the future, it is expected that many Pearl River Delta firms would seek out Hong Kong partners or set up Hong Kong offices in order to access international markets. At the same time, more and more Hong Kong firms will seek out Pearl River Delta sources of supply for an expanding range of international markets. This should result in an additional trade flow involving Hong Kong and the Pearl River Delta region.

Finally, China’s opening under its WTO accession agreement should result in substantial increases in imports of all types into the Pearl River Delta region. Hong Kong and Hong Kong firms are well positioned to act in an intermediary role for much of this trade, linking the Pearl River Delta region to international sources of industrial and consumer goods on a large scale. This implies that Hong Kong import traders will be able to expand their businesses in the future; just as the Hong Kong export traders have done in the past.

Transportation and travel

The interaction between Hong Kong and the Pearl River Delta region in transportation and travel will be critical to the future of the entire Greater Pearl River Delta region. Many efforts are now in process to handle what is expected to be a surge in cross-boundary transportation and travel involving all means of transport.

*Land transport by road and rail*

Passenger and passenger vehicle flows between Hong Kong and the Pearl River Delta region are likely to grow strongly in coming years. Passenger traffic across the Hong Kong/Shenzhen boundary has been growing at double-digit rates and is likely to continue to do so. According to the Hong Kong Immigration Department, for example, over the 12-day holiday period from December 21, 2001 to January 1, 2002, more than 1.65 million Hong Kong people crossed into the Chinese Mainland via the Lowu Crossing. The number of private cars and coach crossings surged by 18.7 percent in 2000 and by 22 percent in
This has implications for the kinds of vehicle flows to be accommodated by future land links between Hong Kong and the Pearl River Delta region.

As for projected cross-border cargo flows, the Hong Kong Port and Maritime Board predicts that by the year 2015, Hong Kong’s seaports will be handling between 2 and 2.5 times today’s cargo volumes as a result of the projected growth in production in South China. The 32,500 trucks that cross the border each day at present already represent a fourfold increase since 1994. Since trucking remains by far the preferred method for transporting goods from factories in the Pearl River Delta region to port facilities in Hong Kong, demand for cross-border truck transportation is likely to continue to increase substantially.

Passenger and cargo-related demand have already resulted in numerous efforts to improve the infrastructure and procedures necessary to facilitate cross-border movements and transportation around the Greater Pearl River Delta region. The “Western Corridor”, linking Yuen Long in Hong Kong to Shekou in Shenzhen by bridge, due for completion in 2005/2006, is expected to accommodate 2.5 times the number of present border crossings between Hong Kong and Shenzhen. New expressways or highways are being built or planned between Guangzhou and Zhuhai, between Guangzhou and Shenzhen, from Guangzhou to Boluo and Huizhou, between Huizhou and the Shenzhen-Hong Kong border, and between Zhuhai and Yangjiang. There are several proposals for links between the Western and Eastern sides of the Pearl River Delta region, including proposals to connect Zhuhai and Macao to Lantau by bridge, a route that would connect Zhuhai to Hong Kong and Shenzhen by bridge, and a bridge or tunnel from Zhuhai that would connect to Shenzhen north of Hong Kong.

With respect to railway transport, the Hong Kong SAR Government plans to alleviate congestion at the KCRC-Lowu crossing with a KCRC spur line to Lok Ma Chau on the Hong Kong side of the Shenzhen River, across from the Shenzhen Underground Railway. The Lok Ma Chau spur line is expected to begin operation by 2007/2008. Shenzhen’s expansion of its urban rail network will continue to take shape, with lines 1 and 4 scheduled to open in 2003 or 2004. Shenzhen Station already serves as a transfer terminal for Hong Kong passengers travelling by rail to Guangzhou and other Mainland cities. Guangdong and Hong Kong authorities have announced plans to study a High Speed Rail (HSR) link between Guangzhou and Hong Kong, which according to some estimates could cut travel times between the two cities to as little as 30 to 40 minutes. The HSR link could potentially

8 Samuel Lam, Orient Trucking Hong Kong Ltd., “Cross Border Trucking,” Presentation to Hong Kong AmCham Transport and Logistics Committee, May 29, 2002.
9 Hong Kong Port and Maritime Board, Hong Kong Port Cargo Forecasts 2000/2001.
connect with the Regional Express Line proposed by Hong Kong’s Railway Development Strategy 2000.

With respect to rail freight, KCRC has undertaken feasibility studies on a Port Rail Line to provide container shuttle services between Kwai Chung and a rail freight centre at Pinghu in Shenzhen. The freight distribution centre, already the largest marshalling yard in South China, would provide back up consolidation and distribution capacity for Kwai Chung. Also envisioned is on-site Mainland Customs at Pinghu to facilitate cargo runs and trucking flows.11

**Sea Links**

There already are numerous sea links between Hong Kong and the Pearl River Delta region. Several of the region’s ports, particularly those on the western side of the Pearl River Delta region, are feeder ports to Hong Kong. As trade into and out of the Greater Pearl River Delta region grows, this interaction should continue to expand. A new Marine Cargo Terminal at the Hong Kong International airport that will handle barge traffic will facilitate intermodal transportation. As with the land transport routes, Hong Kong and Pearl River Delta region authorities have been taking initiatives to drastically reduce the customs procedures for container ships between the two jurisdictions. Customs at the river trade post at Dachan Island on the western side of the Pearl River Delta have recently started to accept documentation electronically and conduct random checks rather than comprehensive inspections of every vessel.12 To help improve the cross border movement of people between Hong Kong and the Pearl River Delta region, there are proposals underway for new high-speed ferry links between Hong Kong’s Chek Lap Kok airport and major destinations in the Pearl River Delta region. Investment by Hong Kong firms in the ports of the Pearl River Delta region is also expected to grow.

**Air transport**

There will be increasing interaction among the airports in the Greater Pearl River Delta region. The Hong Kong Airport Authority has already commissioned feasibility studies into the possibility of Chek Lap Kok using Zhuhai as a twin hub for cargo and Mainland connections. The recently established A5 group, a cooperative group of representatives from the Greater Pearl River Delta Region’s five main airports, has also started to undertake joint studies with the aim of easing passenger and cargo flows and attracting more business into the region.13 Another possible source of future interaction between Hong Kong and

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11 Ian Petersen, KCRC, Presentation to the Hong Kong AmCham Transportation and Logistics Committee, April 24, 2002.
the Pearl River Delta region might be in the provision of helicopter commuter flights between Hong Kong and locations in the Pearl River Delta region. In March 2002, permission was granted to Hong Kong’s first helicopter service to the Pearl River Delta region. Such a service can shorten the journey time between Hong Kong and Zhuhai, for example, to 17 minutes. Current licensing only extends to Zhuhai and Macao. Whether helicopter service providers can overcome licensing restrictions and extend their services to other locations in the Pearl River Delta region remains to be seen. However, an extension of helicopter licensing to locations such as Foshan, Zhongshan, Shunde, Panyu, Nanhai, and Dongguan would not only improve the mobility of senior business executives between the Hong Kong and Pearl River Delta region cities, but would also be useful in increasing connectivity between the Greater Pearl River Delta Region’s tourist sites and numerous golf courses.

**Customs**

With the closer economic relations between Hong Kong and the Pearl River Delta region, improved cargo transportation efficiency across the boundary between Hong Kong and Shenzhen has become a major issue. One focal point has been customs procedures. Hong Kong and Pearl River Delta region authorities are working on plans for the co-location of customs facilities at the border crossing, so that goods vehicles need only pass through one set of procedures. To improve customs facilities for passenger and goods vehicles, a new automatic vehicle registration system has been installed at Lok Ma Chau, which will come into operation by the end of 2002. In addition, the opening of border checkpoints on a 24-hour basis has been raised, but as yet to hold favour with the authorities who are cautious about the effects of such a move on the “one country, two systems” arrangement. Hong Kong-based Hutchison Whampoa has recently been in discussions with the Hong Kong and Pearl River Delta authorities to relocate customs checks away from the border to seaport terminals. This type of bonded service has been in place for the last 18 months for shipments between Hong Kong’s air cargo terminal and three main air cargo destinations in the Pearl River Delta - Guangzhou’s Baiyun Airport, bonded warehouse facilities in Dongguan, and Bao’an Airport in Shenzhen. It is likely that the network of Pearl River Delta destinations covered by this kind of service will increase in the future, thus easing the time needed to clear customs at border checkpoints between Hong Kong and Shenzhen.

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14 *South China Morning Post,* “Helicopter service offers Zhuhai in 17 minutes,” March 20, 2002.
15 *The Standard,* “Hutchinson has plan to beat border jam,” July 4, 2002.
16 *South China Morning Post,* “Hactl to improve cargo flows,” March 29, 2002.
Tourism

Tourism linkages within the Greater Pearl River Delta region also will expand dramatically in the future. Growing incomes in the Pearl River Delta region have resulted in sharp increases in people from this region travelling to Hong Kong and Macao. The Pearl River Delta region already is Hong Kong’s largest source of tourists. In the first five months of 2002, the number of tourists from the Chinese Mainland (most of which came from the Pearl River Delta region) to Hong Kong totalled 544,163, an increase of 42.8 percent from a year before.\(^{17}\) Industry experts project that inbound tourist flows into Hong Kong from the Chinese Mainland as a whole will reach five million in 2002 and 14 million annually by 2012. These flows will include very significant movement of increasing affluent visitors from the Pearl River Delta region.

Despite this growth of tourism from the Chinese Mainland, in general, people from the Chinese Mainland still find it difficult to go to Hong Kong. This limits the numbers that enter Hong Kong to attend meetings, sponsor exhibitions, go shopping, and engage business activities. The governments of Hong Kong and Guangdong are working to streamline procedures and to boost the exchange of tourism, business, meetings, exhibitions, sightseeing, and shopping between the two areas. On June 13, 2002, the Hong Kong Business News reported that the Hong Kong government had reached an agreement with the Chinese State Travel Bureau and Ministry of Public Security on improving the service for Mainland tourists to Hong Kong, including machine-readable travel certificates, accelerated transit procedures, and better monitoring of service offered by travel agencies.

According to officials and scholars from the Pearl River Delta region, there is substantial scope for cooperation between Hong Kong, Macao, and Guangdong to develop the Greater Pearl River Delta region as a tourist destination. The idea would be to jointly develop tourism resources and promotion programmes of the various jurisdictions to attract tourists from the rest of China and elsewhere. Coordination of tourism planning would be strengthened, particular spots of tourism interest identified, a common image developed, redundant investments avoided, and some common products would be put together. Guangdong-Hong Kong tours would be planned and arranged for tourists from the Chinese Mainland and Hong Kong-Guangdong tours would be planned and arranged for international tourists. Tourism research would be shared among the jurisdictions. Joint promotion programmes would be developed. Hong Kong, Macao, and Guangdong could even cooperate to sponsor international conferences, sports events, summer camps, student

\(^{17}\) Hong Kong Tourism Board, “Mainland arrivals hit further new heights as momentum maintained in May,” June 27, 2002.
events, festivals, and environmental initiatives. Hong Kong firms will be encouraged to invest in tourism facilities in the Pearl River Delta region and transportation facilities linked to tourism are likely to be improved. Hong Kong and Shenzhen have reached agreements to cooperate in training tourism professionals, sharing tourism related information, promoting each other as a destination, and improving the environment for tourism in the region.

Whatever the form of cooperation, it is clear that the Greater Pearl River Delta region has substantial tourism resources. Hong Kong already is a major destination for international tourism, a situation that experts expect to be enhanced by the completion of Hong Kong Disneyland in 2005. The Shenzhen Tourism Bureau already has indicated that Shenzhen would act as a “promotion and reception spot” for Hong Kong Disneyland when it opens, a position backed by Prime Minister Zhu Rongji. The recent granting of gaming licenses in Macao to incumbent Sociedade de Tourismo e Diverseos de Macau, and Las Vegas investors Wynn Resorts (run by Steve Wynn, builder of the Mirage and Treasure Island Casinos in Las Vegas), and Las Vegas Sands, Inc. (developer of the Venetian Hotel in Las Vegas), is expected to result in hundreds of millions of dollars in new investments slated to make Macao an Asian version of Las Vegas. Shenzhen’s theme parks have made it a major tourism destination for tourists from the Chinese Mainland. The Pearl River Delta region as a whole has between 50 and 60 theme parks and 50 golf courses. The western side of the Pearl River Delta region is viewed as an area with significant upside potential in tourism. Moreover, if the Greater Pearl River Delta region were to upgrade its “quality of life” ratings, it would benefit from the further development of recreational facilities in the region. The western side of the Pearl River Delta region, with its low-cost land, golf facilities, and natural hot spring resources, is well situated to fulfil this need. Better linkages between Hong Kong and the western side of the Delta would be necessary to realise this potential.

The region’s tourism sector should benefit from China’s WTO membership. China’s liberalisation under WTO is expected to bring more foreign business people and investors into the region. It also is expected to have a positive impact on flows of Hong Kong tourists into the Pearl River Delta region and Pearl River Delta region people into Hong Kong. Hong Kong tour operators are hopeful that they will have a greater share of flows of travellers into and out of Hong Kong from the Chinese Mainland. Eventually, under WTO, Hong Kong travel agents should be able to handle Mainland tours in China, a potentially

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lucrative area for expansion. Indeed, China has promised to allow foreign-invested tourism firms to offer travel agency services in the Chinese domestic market. It is expected that Hong Kong travel agencies would have a unique advantage in competing for this market. Many Hong Kong travel agencies have expressed their intentions of entering the tourism market in the Pearl River Delta region in the form of joint ventures. Guangdong officials claim that they will allow Hong Kong travel agencies to compete with state travel agencies in the province.

Technology

The Pearl River Delta region already is a leader in terms of production of technology-intensive products in the Chinese Mainland. Guangdong accounts for more than 30 percent of electronics output, 50 percent of biomedical output, 50 percent of advanced ceramic components, and 68 percent of China’s medical electronics output.20 According to the plans of the Guangdong Provincial Government, the Pearl River Delta will focus on six high-technology industries, electronics, biotechnology, new materials, opto-mechanical-electronic devices, environmental technologies, and oceanic technologies. The technology base of the Pearl River Delta region is expected to expand substantially, particularly given the large investments that local governments and foreign companies are expected to make in the region.

The interaction between Hong Kong and the Pearl River Delta region in technology is likely to change substantially in the future. When China began its reform process, it was behind in virtually all areas of technology. The Pearl River Delta region was behind several other places in the Chinese Mainland in terms of its technological development. Hong Kong firms, the first outside firms to enter the Pearl River Delta region, initially brought in the technologies associated with the production of light-manufactured goods. Much of this technology was embedded in the capital goods that were imported into the region. As the transfer of manufacturing to the Pearl River Delta region continued, Hong Kong shifted from being a supplier of technology to one of technology intermediary, bringing in advanced technology developed elsewhere into the region.

Hong Kong firms are expected to continue to perform design and development activities in Hong Kong and then transfer ideas into production facilities in the Pearl River Delta region. Hong Kong will continue to operate as a technological intermediary given its

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20 Hong Kong Economic Journal, “Pearl River Delta becomes the biggest hi-tech industry base in China,” June 20, 2002.
superior knowledge and access to international information networks. This role includes the ability to forecast trends in consumer demand and end products in the world’s leading markets, identify pertinent, cutting-edge technologies, and translate them into new applications. At the medium to low-end, Hong Kong’s small and medium-sized firms will continue to adapt medium to low-level technology for use in the world’s largest consumer markets and to excel in commercially-driven systems integration. Prospects for this role are good, as technological change driven by consumer demand is predicted to continue into the foreseeable future. As the Pearl River Delta region’s high-tech production base develops, locally owned firms will become more sophisticated customers and innovators in their own right, giving rise to prospects for mutually beneficial collaboration.

For Hong Kong high-tech firms with activities on both sides of the border, Hong Kong will continue to play a central strategy-setting and marketing role for day-to-day activities and for overall company direction. It will remain the location for customer-related activities directed at overseas markets, and for defining new products aimed at those markets. Hong Kong also will remain the lead location for collecting new technology and information related to overseas consumer requirements. In this respect, Hong Kong’s “free flows” of people and ideas will be an enduring source of advantage. Technology will continue to flow into Hong Kong through person-to-person relationships that are contact-based. As one Hong Kong executive explained, “as a systems integrator, we don’t own the technology, we just buy it, so we are talking about the relationship. It’s not likely that companies in the PRD can make such close relationships.”

While Hong Kong firms will continue to be active in developing and transferring technology into the Pearl River Delta region, the bulk of the most advanced technological development in the region is likely to come from the research and development facilities that are being set up in the Pearl River Delta region by foreign multinational firms and by firms from the Chinese Mainland. The most advanced technology in the Pearl River Delta region already comes from Western, Japanese, and Taiwanese firms active in the region. The combination of cutting-edge science and technology from the multinational companies with the burgeoning technical workforce of the Chinese Mainland is likely to prove to be a very difficult combination to beat.

Several jurisdictions in the Pearl River Delta region plan to improve their university bases. Shenzhen, Dongguan, and Zhuhai are all planning university towns or developments to attract major universities to set up educational and research facilities. The idea is to overcome the traditional shortages in locally produced scientists, engineers, and technicians that have required firms to bring people with the appropriate skills in from other places in the Chinese Mainland. Several Hong Kong universities are also involved in research and
programmes in the Pearl River Delta region with an eye toward providing technological capabilities to the region. In addition, several local jurisdictions in the Pearl River Delta region have come to agreements for the Hong Kong Productivity Council to provide services in the Pearl River Delta region. The Productivity Council is setting up industrial development centres in conjunction with Pearl River Delta region jurisdictions to introduce business support and commercialisation activities into the region. The net effect will be to help support Hong Kong-invested enterprises in the Pearl River Delta and to contribute to the training of technicians and managers in the Pearl River Delta region. The Productivity Council also has cooperated with agencies of China’s Ministry of Science to promote science-based industrialisation. The Productivity Council plans to have offices in Guangzhou, Foshan, Zhongshan, Zhaoqing, Jiangmen, Dongguan, Zhuhai and Shenzhen. Even so, it is unlikely to be able to meet the demand for technology oriented support and training in the region.

Hong Kong has the potential to play an important role in the financing and commercialisation of breakthroughs made in the Pearl River Delta region. Hong Kong has a critical mass of venture capitalists and links to the international capital markets that can aid in the identification and financing of technology based start-up companies and eventually list these companies on the Hong Kong stock exchange. Proximity to Hong Kong already has caused a number of firms from elsewhere in the Chinese Mainland to set up operations in the Pearl River Delta region. The idea is to get access to the market knowledge, information flows and experience available in Hong Kong and the Pearl River Delta region.

Significant corporate research and development facilities are far more likely to locate in Shenzhen or Guangzhou than in Hong Kong in the future. In most major cities around the world, the main types of research and development that are performed inside the cities are university research and medical research linked to teaching hospitals. Most corporate research and development is priced out of the cities and into the surrounding areas. Thus the corporate research and development takes place in Silicon Valley, not in San Francisco; along the M4, not in London; in the crescents around Paris, not in Paris; along Routes 128 and 495, not in Boston. Hong Kong, with fewer scientific and technological resources, and with a much greater cost differential with the surrounding areas, is actually less promising than these other cities. It simply is not cost effective for most corporations to perform significant corporate research and development in Hong Kong. The research and development activities most likely to take place in Hong Kong are those that do not require large amounts of land or large numbers of people and where the intellectual property is particularly important and portable, the latter being features that might discourage investments in the Chinese Mainland.
Management

The interaction between Hong Kong and the Pearl River Delta in terms of management should become much more fluid over the next several years. The source of managerial talent in a given firm will depend a great deal on the home nation or region of the firm involved and their managerial requirements. For Hong Kong firms, one important question is the extent to which they will localise the management of their activities. The vast majority of these companies will keep their head office in Hong Kong, and so the key decision makers will continue to be based in the territory. Hong Kong managers also will continue to play a lead role in the Pearl River Delta region activities of Hong Kong firms.

The consensus from the Hong Kong managers we interviewed was that Hong Kong managers will command lead roles at senior-most levels and in specialised roles involving supply chain management, finance, and accounting. Hong Kong managers will keep on leveraging their years of experience in dealing with the local production base, overseas consumer markets, multinational firms, international logistics, and international trade regimes. Managerial positions that can be filled by local Pearl River Delta managers, or managers from other parts of the Chinese Mainland, will be general management type positions at the junior to mid-level. The trend towards localisation will continue, particularly in more mature companies, and there will be an increasing pool of local talent available as access to education and opportunities increases for Mainland managers both within China and abroad. However, a number of factors stand in the way of localisation, including perceptions that Hong Kong managers will be more trustworthy and loyal than managers from the Chinese Mainland.

Top management positions within multinationals operating in China are overwhelmingly staffed by Hong Kong or overseas nationals. When dealing with service providers, multinational executives want to be able to communicate effectively. This is why, for example, advertising executives claimed that 90 percent of senior talent in foreign firms operating in the Chinese Mainland is imported. As a number of Hong Kong directors pointed out, though there are now some excellent foreign-educated managers from the Chinese Mainland in the Pearl River Delta region, these are still a minority. For managers from the Chinese Mainland to really take the lead in operating in a multinational environment, there really needs to be a dramatic shift in mindset. While some individuals have achieved this, it was felt that it would take a generation or two for a critical mass of Mainland talent with the appropriate mentality to become available in the Pearl River Delta region. On the other hand, most junior management and many middle level managers in the multinational’s Pearl River Delta facilities would be from the Chinese Mainland. Some companies, particularly certain multinational corporations, have made localisation
an overriding goal. The senior expatriate manager’s task is to develop local talent to take
over as many challenging jobs as possible in as short a time as possible.

Most of the managers that we interviewed, both in Hong Kong and the Pearl River Delta
region, indicated that while management talent is converging between Hong Kong and the
Pearl River Delta region, that this convergence would take time. The Pearl River Delta
region has been developing a market-oriented economy for a much shorter time than Hong
Kong and the business and market sense that comes with this development is very hard to
obtain overnight. Several interviewees expected it to be another decade or more before
management capabilities in the Pearl River Delta region would be what they are in Hong
Kong today. Whilst some people point to imminent localisation as rendering Hong Kong
managers redundant in the Pearl River Delta region, complete localisation is likely to be a
lengthy process

One reason that localisation might take place well before equalisation of skills and
capabilities is cost. Our interviewees indicated that there was a huge gap in the salaries
paid to low and middle-level managers from Hong Kong and those from the Pearl River Delta
region, with the Hong Kong person earning four to six times what their Pearl River Delta
counterpart would earn. While many managers claimed that their Hong Kong staff
was more efficient, many also indicated that the difference in efficiency did not make up
for that type of salary differential. Salary levels, in fact, form a possible barrier to the
potential for Hong Kong managers to take up positions in the Pearl River Delta region.
Hong Kong people often have financial commitments such as children’s schooling, care
of elderly parents, mortgage payments, or even just the expense of maintaining a household
in Hong Kong. There is a perception among recruiters that Hong Kong people are unwilling
to move their jobs into the Pearl River Delta region. Competition is driving down wages,
while family relocation is often not an option as it is often difficult for the spouse to find
suitably paid work. Tax is another problem. If a Hong Kong manager works for more than
180 days in the Chinese Mainland, then he or she is liable to be charged Chinese tax at
double the level of Hong Kong taxation. On the social side, working away from home can
place pressure on family life. Many Hong Kong managers are reluctant to take that risk
with their spouse and children.

The management practices of Hong Kong companies in the Pearl River Delta region may
be fostering the development of an entrepreneurial class in the region. On the one hand,
many workers and managers from the Chinese Mainland use their time working for Hong
Kong or foreign-invested firms to learn as much as they can before setting up a business of
their own. This creates a dynamic where the firms do not necessarily wish to promote
local workers or managers to high positions. This “glass ceiling”, in turn, creates a dynamic where some of the most capable people will leave because they cannot rise to the top of the organisation. In either case, eventually the worker or manager sets out on his or her own. The implications of this phenomenon may mean that, for Hong Kong firms, there will be a long-term strategic imperative to keep Hong Kong managers in positions of trust within Pearl River Delta region operations. Alternatively, there may also be a need for Hong Kong companies to incorporate more management practices aimed at the selective inclusion and development of talented local personnel.

Another feature of the interaction in management between Hong Kong and the Pearl River Delta region that has emerged in recent years is the recruitment of people from Hong Kong to work in a managerial capacity for Pearl River Delta firms. Hong Kong-based recruitment firms are helping Pearl River Delta region firms attract management talent and jobs fairs held in Hong Kong by Pearl River Delta organisations are attracting significant interest. There are three basic reasons for this phenomenon. The first is the conclusion that many Pearl River Delta firms have reached that they could benefit from bringing talented Hong Kong individuals into the organisation. The second is that, with so many Hong Kong people already working in the Pearl River Delta region for Hong Kong firms and foreign multinationals, the uncertainties and fears of working in the region have diminished. Finally, with Hong Kong’s economy in the doldrums, Pearl River Delta region firms can provide an attractive employment opportunity for many people from Hong Kong. Some Pearl River Delta region enterprises are even willing to offer salaries that are becoming comparable to salaries in Hong Kong, with some companies offering up to a million renminbi per year for senior managers and 200,000 to 300,000 for middle-level managers.

Real estate

The interaction between Hong Kong and the Pearl River Delta region in terms of real estate is multifaceted. An increasing number of Hong Kong people are buying real estate in the Pearl River Delta region and an increasing number of people from the Pearl River Delta region are buying real estate in Hong Kong. Although the property markets of Hong Kong and the Pearl River Delta region are more closely coupled than they were in the past, the property markets in Hong Kong and in the Pearl River Delta region are not expected to converge completely in the foreseeable future. The “two systems” part of “one country, two systems” means that Hong Kong will remain a distinct region with its own system until at least 2047. The different systems imply different attributes for real estate in the different jurisdictions. Thus we would expect that the coupling of the Hong Kong and Pearl River Delta real estate markets would be weaker than that found in most major cities.
and their surroundings elsewhere in the world. Hong Kong should be able to support a significant gradient in residential real estate due to its affluence and social amenities, and in commercial real estate by its distinct positioning as one of the world’s leading business cities.

Although the number of Hong Kong residents that are buying real estate in the Pearl River Delta region is increasing, the majority of these purchases appear to be of vacation or secondary homes, rather than primary homes. Hong Kong residents will remain willing to pay a premium for residential real estate within Hong Kong. As one Hong Kong realtor explained, “property is not just a purchase of physical real estate: you are also buying the social services.” Hong Kong residency entails entitlements to state-funded educational, medical, and social benefits that are not transferable across the Shenzhen boundary. The Shenzhen authorities are unlikely within the next ten years to reach a comparable level of social benefits. Indeed, their level of public spending is unlikely to approach Hong Kong’s present levels within ten years’ time. Although authorities in the Pearl River Delta are opening up grass roots politics, neighbourhood-based lobbying is unlikely to result in social benefits anywhere near Hong Kong levels. In addition, Hong Kong may well attract upscale homebuyers from the Chinese Mainland. Looking at the Greater Pearl River Delta region as an extended urban area, the prime residential areas in Hong Kong, such as the Peak, Mid-Levels, and the South Side, may well develop into the “Gross Pointe” of the entire area, catering to the most affluent on both sides of the border. Demand for high-end residences for the families of multinational executives is also expected to remain concentrated in those areas.

Greater fluidity of movement between Hong Kong and the Pearl River Delta region is not expected to have a significant impact on the price differentials in real property on either side of the border. A survey released in January 2002 by the Business and Professionals Federation of Hong Kong shows that travelling time between home and work is a minor factor to Hong Kong people in deciding where to live. Efforts now under way to facilitate cross border flows at Shenzhen, including the Western crossing from O Hom Shek in Yuen Long to Shekou (the Shenzhen Bay Bridge) and the KCR Lok Ma Chau spur line, will not induce Hong Kong people to relocate across the border in substantial numbers. Similarly, a bridge connecting Hong Kong to Zhuhai or Macau is not expected to affect residential land prices in Hong Kong, despite Zhuhai’s attractive urban layout. As one real estate expert observed, “no matter how attractive the layout is of the garden city [of Zhuhai], legal and social factors will remain, and they are more important to Hong Kong people than the quality of the urban environment.”
In commercial real estate, convergence between Hong Kong and Shenzhen is not expected to occur within ten years. Indeed, some interviewees viewed convergence in prime commercial property values to be even less likely than in residential property. As a general rule, in developed countries around the world, the truly premium sites are located in the prime business areas in the key cities. Hong Kong’s high-end financial service providers are expected to remain in Central, including financiers, bankers, lawyers, accountants, and management consultants, along with the high-end retail establishments that cater to them. Multinational firms basing regional headquarters in Hong Kong are seen as another source of future demand that is unlikely to migrate en masse across the border. At the same time, Grade B commercial properties in Guangzhou (currently the high-end of the market) are expected to experience growing demand, fed by a gradual increase in the operations of multinational firms in Guangzhou. For example, multinational consumer firms well established in Guangdong continue to attract the offices of multinational advertising firms. If barriers to entry are lifted in the legal and accounting sectors, this segment of commercial property will benefit.

A number of Hong Kong property developers and real estate agencies already have a well-established presence in localities across the Pearl River Delta region, and are looking to expand their presence post-WTO. In the year 2000, in Shenzhen alone, residential transactions reached a volume of 66 million square feet, and the market is expected to grow. At present, Mainland authorities are treating Hong Kong investment as “overseas investment.” This can result in a good deal of red tape, especially for small and medium-sized Hong Kong firms. Joint venture requirements, in particular, make it difficult for Hong Kong small and medium-sized enterprises to enter the Pearl River Delta property markets, because joint venture arrangements often give rise to disputes, regardless of whether the business is a success or failure. Hong Kong firms are hoping that an “open door” policy under WTO will generate very substantial opportunities.

There are some that have suggested that housing policy not be limited by the border between Hong Kong and Shenzhen. The Hong Kong Policy Research Institute has suggested the Hong Kong government should consider the option of Hong Kong people living in Shenzhen or elsewhere in the Pearl River Delta region in its housing plans. They suggested that government supported housing, welfare, and old-age pension programmes should not necessarily be limited to those who live in Hong Kong. The rationale was that it might be far more cost effective to provide such services in the Pearl River Delta region than in

Hong Kong. Any plans by the Hong Kong Housing Authority or Housing Society to operate in the Pearl River Delta region is bound to be heavily criticised as spending Hong Kong resources outside of Hong Kong, as is any active encouragement of low income Hong Kong people to move across into Shenzhen in search of more affordable living arrangements.

**Retail shopping**

The interaction between Hong Kong and the Pearl River Delta region in retail shopping is also slated to increase substantially in the future. This is in part a natural consequence of easier cross-border travel, in part a natural division of labour in terms of the retailing sectors of different parts of the region, and in part due to relatively high costs in Hong Kong. Easier cross-border travel means that more and more people will travel to shop and more and more people will shop in new locations because they travel. In terms of a division of labour, we would expect that luxury goods retailing would tend to concentrate in Hong Kong due to its affluence and position in the international distribution network of luxury goods companies. Large superstores will tend to be located in jurisdictions where land costs are cheap enough to support that form of mass retailing. High costs in Hong Kong will exert continuing pressure for low and medium-income people in the New Territories to seek other locations in which to purchase goods.

In terms of cross-boundary shopping, Hong Kong is likely to attract growing numbers of tourist shoppers from the Pearl River Delta region and other areas in the Chinese Mainland. Hong Kong’s retail attraction for this segment of customer lies in products and services differentiated by high quality, high business standards, and a reputation for fair dealing (though this latter reputation can be damaged by some Hong Kong retailers serving the tourist trade). These “soft” aspects will be difficult for retailers inside the Pearl River Delta region to replicate in the near future. Product areas to benefit will include jewellery, high-end consumer electronics, Western pharmaceuticals, and fashion apparel, including foreign-branded items. Pearl River Delta shoppers are also attracted to Hong Kong because of Hong Kong’s leadership in setting consumer trends and tastes for the region, and because shopping in Hong Kong is perceived as a “fun, international experience”. Both factors should endure. Hong Kong’s affluence means that it is likely to remain a trendsetter for the foreseeable future. Meanwhile, rising tourist flows will bring larger number of Pearl River Delta region-based shoppers into Hong Kong.

Hong Kong people will continue to shop in the Pearl River Delta region, in particular Shenzhen, attracted by low-priced goods and services in general and the rise of modern-scale “hypermarkets” and suburban shopping centres. Improvements in border crossing
points and supporting infrastructure will greatly reduce travel time from Hong Kong to Shenzhen. Nevertheless, the Guangzhou-Hong Kong-Shenzhen corridor is unlikely to become a unified retail shopping area within the next five to ten years. This is due to the fact that in urban areas around the world, daily shopping tends to be located in close proximity to place of residence. To date, only small numbers of Hong Kong people have relocated their permanent residence across the border into Shenzhen. An estimated 12,500 people commute daily from Shenzhen into Hong Kong for work purposes, which constitutes a tiny fraction of Hong Kong’s workforce. Preferences for Hong Kong’s societal infrastructure, including civil, educational, and medical benefits, militate against large-scale relocation of Hong Kong people into the Pearl River Delta region. Thus, except for residents of areas of the New Territories adjacent to the border crossing points, Hong Kong people will continue to meet their daily retail needs inside Hong Kong. Restrictions prohibiting free movement of Hong Kong-registered private vehicles across the border into Shenzhen further restrict the ability of Hong Kong shoppers to access Shenzhen’s retail sector, in particular the large-scale hypermarkets that offer items in bulk quantities.

The retail business in the Pearl River Delta region is likely to emerge along differentiated lines from the Hong Kong retail sector. The development of retail “hyperstores,” already evident along the highways of Shenzhen, is likely to accelerate with the Pearl River Delta region, while smaller urban supermarkets and other retail outlets will prevail within Hong Kong. Similar differentiation has occurred between downtown urban areas and their suburban counterparts across the United States. At the high end, Hong Kong will continue its hold on the luxury segment catering to the most affluent spenders, including Hong Kong locals and expatriates, because of the enduring gap in consumer spending power between Hong Kong and the Pearl River Delta region.

There will certainly be increased competition between mid-tier consumer malls in Hong Kong, especially the New Territories, and their counterparts in Shenzhen and Guangzhou, driven by weekend shoppers from Hong Kong. Hong Kong’s proactive retailers view competition with retail outlets across the border as healthy for Hong Kong business. In response to developments in Shenzhen, Hong Kong-based consumers are demanding better prices, selection, and service from Hong Kong’s retailers. Competitive pressures of this nature are encouraging Hong Kong retailers to innovate. In the words of a Hong Kong-based fashion retailer, “the competitive pressure from across the border is positive because it puts pressure on us to differentiate,” in such areas as assortment of goods, end-use of the store, and visual presentation of product.
China’s liberalisation under WTO is likely to boost competition between Hong Kong retailers and Shenzhen-based retail outlets. These outlets will be able to offer a broader selection of products at lower prices, as tariff and non-tariff barriers are lowered. Hypermarkets such as Sam’s Club in Shenzhen already offer a variety of products at prices not seen in Hong Kong. Hong Kong consumers, in response, may be expected to make more demands on Hong Kong-based retailers. Hong Kong’s relatively high prices are attributed to oligopolistic practices in certain areas of retail and distribution, which may give rise to greater dissatisfaction among Hong Kong consumers as the Pearl River Delta modernises its retail sector.

**Future Interaction in the Service Sectors**

The interaction between Hong Kong and the Pearl River Delta region in the manufacturing sector already is quite extensive. Although it will continue to develop over time, the course of further decentralisation of manufacturing from Hong Kong and further deepening and broadening of manufacturing in the Pearl River Delta region seems clear. The future division of labour and competition between Hong Kong and the Pearl River Delta region will be covered in the next chapter. On the other hand, China’s WTO accession agreement promises to open a range of service industries to foreign investors and competitors. These will represent substantial new opportunities for Hong Kong firms and the Hong Kong offices of foreign multinationals. At the same time, this will benefit Pearl River Delta region producers and consumers by introducing a wider range of high value services into the Pearl River Delta region. This section will trace some of the future interaction that is likely to take place between Hong Kong and the Pearl River Delta region in the service sectors.

The demand for high quality services from Hong Kong-based service providers will continue to grow in the Pearl River Delta region. Hong Kong-based service providers report that expanding Hong Kong investments should result in additional demand for related services. This demand will flow in large measure to Hong Kong-owned firms. Multinational investment in the Pearl River Delta is also projected to grow at a healthy rate post-WTO, again generating demand for services. This demand will be met in a variety of ways. Taiwanese investors will rely directly on Taipei based providers to the extent possible. Japanese investors will send some work directly to Tokyo and other work to Japanese service providers based in Hong Kong or in the Pearl River Delta region. Hong Kong’s status as the regional headquarters’ capital in the Asia Pacific for Western multinationals ensures that Hong Kong-based multinational service providers will capture a significant portion of the demand for services generated by Western multinational activities in the Pearl River Delta. Though some multinational firms view opportunities for service-oriented work inside the Pearl River Delta region to be relatively small scale compared to areas
such as Beijing and Shanghai, others see the Pearl River Delta region, with its large number of private enterprises and its affluent urban consumers as a region meriting focused attention.

Firms from the Chinese Mainland with activities in the Pearl River Delta region are focusing to an increasing extent on accessing foreign capital and international markets. This outward push may well prove a strong new opportunity for Hong Kong-based service providers. This demand will probably be serviced by a combination of local providers, Pearl River Delta region offices of Hong Kong and multinational service providers, and Hong Kong offices of Hong Kong and multinational service providers. The high-end work is likely to be done in or through Hong Kong. At the same time, more and more Pearl River Delta enterprises will set up offices in Hong Kong to access the information flows and service providers located in Hong Kong. As a result, Hong Kong will play a pivotal role in the mediation of outbound investments from the Pearl River Delta region, just as it has for inbound investments into the Pearl River Delta region. With the ongoing increase in these capital flows, Hong Kong will remain the place to draft contracts and manage the risk. This will create a host of opportunities for Hong Kong-based service firms, particularly for legal, accountancy, and management consultancy business. Overseas firms looking to gain a foothold in the China market will continue to engage the services of Hong Kong-based companies. Increasingly, Mainland firms will also come to Hong Kong to form joint ventures, register companies, and raise capital.

Within the Delta region, the general pattern of multinational, and Hong Kong-based companies providing high-end, value-added services, with local service firms carrying out a growing portion of the ongoing service activities. The opportunities for Hong Kong and multinational service providers in the Pearl River Delta region will continue to be limited by restrictions imposed by the Chinese government on participation in the service sector. Though China’s entry into the WTO has created huge potential for Hong Kong and foreign service providers, it remains to be seen how fast the restrictions that are limiting the growth of this sector will be lifted. The majority of participants to this study agreed that restrictions on foreign service firms are lifting slowly. Their own firms, however, are adopting a “wait and see” attitude when it comes to service sector reform in China and the opportunities these might create for their own companies.

As Hong Kong manufacturers moved production to the Pearl River Delta region, it was natural for some services to migrate as well. However, due to restrictions on the Chinese Mainland, Hong Kong’s service sector has not been able to move into the Pearl River Delta region nearly as easily as its manufacturing did. In addition to formal, approved entry, Hong Kong firms also have found a number of informal means of entering the service sector in the
Pearl River Delta region. China’s entry into the WTO provides a substantial opportunity for greater interaction between the service sectors in Hong Kong and the Pearl River Delta region. According to Liao Guoji, Deputy Director of the Guangdong Provincial Bureau of Foreign Trade and Economic Cooperation, although China has a timetable for opening its service sector after its WTO entry, Guangdong is studying how to encourage Hong Kong’s service enterprises to enter Guangdong as quickly as possible. Liao noted that the service cooperation between Guangdong and Hong Kong could be carried out in many ways. First of all is cooperation in international and domestic markets with Hong Kong’s internationally-oriented service sector bringing Guangdong’s products to the international market and Hong Kong’s service sector combining its marketing and service management capabilities with Guangdong’s products to jointly develop the domestic market. In addition, Guangdong is studying the possibility of opening the logistics, tourism, banking, insurance, and other fields to Hong Kong firms on a trial basis.

According to Ye Minhui, Director of the Shenzhen Bureau of Foreign Trade and Economic Cooperation, before China reached its WTO accession agreement, Shenzhen had already opened 20 industries, including banking, insurance, retailing, and investment funds, to joint ventures, foreign-holding companies, and wholly owned foreign companies on a trial basis. However, the Central Government still needed to examine and approve enterprises one by one. Ye noted that the Central Government would move to a system that would allow several foreign companies to operate on a trial basis. The Shenzhen city government is also studying a plan to allow people with Hong Kong identification cards to operate private companies in Shenzhen, something the Luohu Commercial Town (in Shenzhen) did years ago. In March 2002, Shenzhen city officially issued the “Implementation Measures for External People to Apply for Temporary Licenses of Private Industrial and Commercial Businesses in Luohu” and encouraged Hong Kong people to register and open businesses.

A survey on “producer services required by enterprises” in Dongguan by Guangzhou’s Zhongshan University indicated that Hong Kong was a substantial source of productive services for Dongguan facilities, particularly trade and trade-related services (see Table 6.2). What was also striking, however, was the scope for additional service provision for Hong Kong service providers, should the markets be opened. In particular, the share of Hong Kong providers in professional, information, intermediary, and financial services was far lower than that in trade and trade-related services and far lower than might be expected given the skills and capabilities that can be found in Hong Kong in these sectors. Thus, one should turn to the potential for these and other sectors to be opened to Hong Kong or Hong Kong-based service providers in the future.
Table 6.2  Sources of Producer Services Used by Surveyed Enterprises, percent

<table>
<thead>
<tr>
<th>Service</th>
<th>Hong Kong</th>
<th>PRD</th>
<th>Mainland China</th>
<th>Asia</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Professional services</td>
<td>11.3</td>
<td>13.5</td>
<td>27.8</td>
<td>2.3</td>
<td>3.4</td>
</tr>
<tr>
<td>Information and intermediary services</td>
<td>4.5</td>
<td>6.9</td>
<td>17.4</td>
<td>3.1</td>
<td>4.3</td>
</tr>
<tr>
<td>Financial services</td>
<td>7.8</td>
<td>11.2</td>
<td>23.7</td>
<td>1.8</td>
<td>2.6</td>
</tr>
<tr>
<td>Trade and trade-related services</td>
<td>19.6</td>
<td>9.7</td>
<td>15.1</td>
<td>2.9</td>
<td>3.5</td>
</tr>
</tbody>
</table>

Source: The Centre for Urban and Regional Studies, Zhongshan University, “Xianggang yu zhujiang sanjiao zhou jingji guanxi yanjiu” (“A Study of the Economic Relationship between Hong Kong and the Pearl River Delta”) in Xianggang yu zhujiang sanjiao zhou jingji hudong yanjiu (A Study of the Hong Kong - Pearl River Delta Economic Interaction), April 2002, p.37.

In a survey by the Hong Kong Trade Development Council of private sector firms in the Chinese Mainland (see Table 6.3), a far higher percentage of Pearl River Delta respondents indicated that Hong Kong-based services meet the needs of Mainland enterprises. The mismatch indicates that there should be a greater opportunity for Hong Kong and Hong Kong firms to service Pearl River Delta firms in the future than appears to be the case today.

Table 6.3  Hong Kong Services that Meet Mainland Enterprises’ Needs in 2002, percent

<table>
<thead>
<tr>
<th>Service</th>
<th>Percentage of Pearl River Delta private sector respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking</td>
<td>50.1</td>
</tr>
<tr>
<td>Accounting and finance</td>
<td>46.2</td>
</tr>
<tr>
<td>Business consultancy</td>
<td>41.6</td>
</tr>
<tr>
<td>Logistics and transportation</td>
<td>52.3</td>
</tr>
<tr>
<td>Legal and administration</td>
<td>36.9</td>
</tr>
</tbody>
</table>

Source: Hong Kong Trade Development Council
Finance

There will continue to be an interaction between Hong Kong and the Pearl River Delta region in terms of financing. Given China’s closed capital account and Hong Kong’s open economic system, financial sector expertise, legal system, and regulatory environment, Hong Kong will continue to act as an international financial centre for China. In the last nine years, 150 H share and red chip enterprises have already gone public on Hong Kong’s two boards. These firms represent roughly 25 percent of the market capitalisation of Hong Kong’s security markets. The initial public offerings (IPOs) of these firms totalled HK$700 billion, or 64 percent of the capital raised on the markets in that period. According to industry sources, as of June 2002, there were more than 40 Chinese enterprises that had received approval from the Chinese government were waiting to be listed in Hong Kong. Another 60 firms were waiting for approval from the Chinese government to list in Hong Kong. Numerous Pearl River Delta companies would list on the Hong Kong exchanges if they could. It is expected that Hong Kong’s role as a funding centre for companies from the Chinese Mainland would expand, though not at a dramatic rate, at least not in the near term. The Hong Kong financial sector has the knowledge, facilities, human resources, and global reputations to handle such deals. However, growth in this area is hampered by the need for major structural reform in China. It remains uncertain how long these reforms will take and how far they will go, as China opens up its equity markets following WTO entry. The prediction from the investment banking community in Hong Kong is that, for the foreseeable future at least, Beijing bureaucracy will provide Hong Kong with a trickle of deals rather than a flood.

Future interaction between Hong Kong and the Pearl River Delta region in the securities and fund management sectors also will be very much tied to issues of national policy. There will need to be more stringent controls on speculation in place investors from the Chinese Mainland are granted access to the Hong Kong stock market. This has been raised as being on the agenda of the Central Government, but in the eyes of Hong Kong institutional investors this could push up the value of Mainland firms in Hong Kong to unrealistic levels. In fund management, there is a proposal in the pipeline by the Hong Kong Investment Funds Association to allow SAR-based funds to be sold to Mainland investors. This would boost Hong Kong’s fund management business, solidify Hong Kong’s role as a financial hub, and increase the attractiveness of Hong Kong as a location for the regional headquarters of fund management firms. The measure would also benefit the Mainland, as it would offer greater diversification for Mainland investors. What is not clear is the likely timetable.

22 Hong Kong Commercial Daily News, “Mainland companies go public in Hong Kong create a win-win situation says Hong Kong Exchange Chairman,” June 1, 2002.
for such liberalisation. One measure that is causing much interest amongst Hong Kong’s investment banking community is new legislation, from July 1, 2002, allowing foreign companies to apply for licenses to set up joint venture securities and fund management companies in China. Hong Kong firms can now buy a 33 percent stake in a Mainland fund management firm and this will be increased to 49 percent in three years. Hong Kong firms are now publicly looking for Mainland partners. There are concerns again, however, that the implementation of this directive will hit a number of stumbling blocks before it is effectively realised.

Venture capitalists spent only around US$500 million of the total US$40 billion in foreign investment in the Chinese Mainland in 2001. This too is seen as an area of potential growth in interaction between Hong Kong and the Pearl River Delta region. Part of the reason is that investment opportunities in Hong Kong alone are regarded as limited, as many potential high-value sectors, such as telecommunications, are already saturated. However, professionals in the field claim that the lack of a unified code of practice to regulate the venture capital industry in China is a major barrier to entry for the Hong Kong venture capital sector.

The push for liberalisation in China’s financial service sector is by no means driven exclusively by Hong Kong-based firms. Shenzhen is actively lobbying Beijing to lower the legal restrictions on overseas lenders in an attempt to attract Hong Kong’s small banks to invest in the area. Shenzhen authorities have been very vocal in the press on Hong Kong’s potentially instrumental role in helping firms from the Chinese Mainland raise the funds they need to finance their development and the need to attract world-class insurance, financial service, and securities firms to Shenzhen to further the growth of the Pearl River Delta region.

Moves to allow Mainland investors access to the Hong Kong stock market and to attract more foreign firms to list in Shenzhen have tremendous potential for Hong Kong investment houses and related service providers, such as lawyers and electronic trading systems support firms, to manage these investment flows, though according to the planning horizon of the investment banks surveyed, most of this work would be carried out in Hong Kong, Beijing, or Shanghai. Hong Kong’s well-developed expertise in management and capital markets operations means that the territory is ideally positioned to act as a bridge between the Chinese Mainland and the world’s capital markets. At the same time, Hong Kong financial firms have a leading role to play in helping the Mainland to upgrade its financial systems.

23 South China Morning Post, “Funds forming group to boost bargaining power,” May 2, 2002.
24 At time of writing, Mainland regulations dictate that banks must have assets of at least US$20 billion to open branches on the Chinese Mainland and have operating capital of RMB 600 million to accept local currency deposits and provide services to customers from the Chinese Mainland. These restrictions make it too expensive for smaller banks to enter the Chinese market.
Commercial banking

While some Hong Kong banks have been reported to take strategic stakes in banks from the Chinese Mainland, the general approach to expansion in China from the banking community in the territory is one of caution. The preliminary wave of banking reform in China will increase business for Hong Kong and foreign commercial banks through their Hong Kong branches. Guangdong business people have recently been allowed to conduct business transactions using Hong Kong dollar denomination cheques. Soon Guangdong residents visiting Hong Kong and holding Union Pay credit cards will be allowed to withdraw foreign currency through the territory’s ATMs and within two years, foreign banks will become able to offer renminbi currency business to corporate clients. These measures may seem like small steps in themselves, but they hold potential for greater interaction with Hong Kong banks given the increase in the number of people from the Chinese Mainland that are visiting Hong Kong.

Shenzhen leads most Mainland cities in many aspects of finance and banking, having more foreign and overseas banks than any other Chinese Mainland city apart from Shanghai. Guangzhou and Shenzhen together have around 10 million Jetco cardholders and around 900 ATMs. The growth of these ATM networks is seen as providing opportunities for payment system operators. However, the lack of a unified credit rating system in China is making it very difficult for potential customers to obtain credit cards and also provides an obstacle to credit card operators in developing business in China, as it is difficult for them to manage the risk effectively. Shenzhen-based China Merchants Bank has used Hong Kong as a base to for international activities, targeting customer requirements for cross-border banking. This represents only one example of an increasing trend of financial institutions from the Chinese Mainland setting up offices in Hong Kong to make and manage their international banking investments.

Under China’s WTO accession agreement, all current restrictions on the commercial banking sector are due to be dismantled by 2005. Thereafter, fierce competition is predicted between banks from the Chinese Mainland and their foreign counterparts. Again, Hong Kong has a pivotal role to play in this process. The Hong Kong / Pearl River Delta combination, in particular, has great potential as a testing ground for China’s future reform of the banking sector.

Insurance

China’s insurance sector is set to liberalise under China’s WTO accession agreement. However, it is likely to take some time before Hong Kong-based insurance companies or the Hong Kong offices of foreign insurance companies are able to profit from developments in the Pearl River Delta region. One estimate reported that it would perhaps take 20 years for foreign companies to reach a 50 percent share of the insurance market in the Chinese Mainland. Given the fact that over 100 foreign insurance companies operate in Hong Kong, it would not be surprising that they would use Hong Kong as a base from which to access the Pearl River Delta region’s insurance market. As in many other areas, the likely result is that the Pearl River Delta region will be ahead of most of the rest of China in the reform and opening process. Given the vast insurance needs in a country where many types of insurance typically found in market economies did not exist just a few years ago, the potential for Hong Kong and foreign insurance companies to provide needed services in the Pearl River Delta region is substantial.

Law

Opportunities for more extensive interaction between Hong Kong and the Pearl River Delta region in legal services should grow substantially. As more Hong Kong firms and foreign firms use Hong Kong to access the Pearl River Delta region, there will be substantial additional demand for legal services geared to the Chinese Mainland. This will provide work for the growing number of highly capable lawyers in the Pearl River Delta region. These people, who are being graduated in increasing numbers by Chinese universities, are seen as better equipped to deal with the legal, political, and bureaucratic aspects of Chinese law than foreigners. There will also be demand in Hong Kong for lawyers trained in Chinese law to advise Hong Kong and foreign companies with Hong Kong offices on the law of the Chinese Mainland.

Inside the Pearl River Delta region, the development of Hong Kong-based legal services will remain tied to the pace at which China’s restrictions on the scope of practice for foreign lawyers are eased. The prohibition on foreign lawyers providing “Chinese legal practices” was amended on April 1, 2002 to allow foreign lawyers to provide information on the “impact of the Chinese legal environment”. However, Hong Kong law firms and the Hong Kong offices of multinational law firms remain cautious about what this will mean in terms of future business opportunities. In addition, eventually the restrictions that prevent foreign legal firms from opening multiple offices in the Chinese Mainland will be eased under China’s WTO accession agreement. Furthermore, negotiations between Hong Kong and Central Government authorities on CEPA (Closer Economic Partnership
Arrangement) are forging the way for Hong Kong lawyers to sit the national lawyers’ exams on a predictable basis, domestic law firms to hire foreign law firms, and for Hong Kong to be the training ground for Mainland lawyers to enable them to compete in the international arena.

The smaller Hong Kong-owned law firms saw good potential in servicing the needs of both Hong Kong and foreign-owned small and medium-sized enterprises in the Pearl River Delta region. In particular, Hong Kong-owned providers of legal and accounting services expected a rise in the number of foreign small and medium-sized enterprises launching operations in the Pearl River Delta region. This factor, coupled with a need to keep up-to-date with changing regulations are increasing demand for quality legal advice, especially when it comes to managing investment flows, overseeing a workforce, and obtaining patents and licenses. Again, Shenzhen’s relatively liberal economy and history as a trial area for Mainland reforms were seen as advantageous to Hong Kong law firms hoping to develop their China business. Larger, multinational law firms with Hong Kong offices believe that even when they are able to open additional offices in the Chinese Mainland that their principal focus will continue to be Beijing. Multinational law firms general regard the Pearl River Delta region as a “manufacturing hinterland” and see limited opportunities for future business in the area.

A key driver of future demand for Hong Kong’s legal sector is the projected inflow of firms from the Chinese Mainland into Hong Kong. Many of these firms, a significant portion of which will be from the Pearl River Delta region, will use Hong Kong as a platform for accessing international capital and foreign markets. Thus they will need legal services from those knowledgeable in Hong Kong and international law. Future growth is expected in work related to Hong Kong IPOs, anti-dumping, shipping and banking law, and where Hong Kong-based expertise is unmatched in the region. These Mainland-owned firms are increasingly relying on Hong Kong as an international arbitration centre. Multinational firms based in Hong Kong are well equipped to provide world-class legal expertise in these practice areas. However, Hong Kong legal firms will need to move away from traditional areas such as conveyance to focus on areas of business that are in high demand.

**Accounting**

Opportunities for quality accountancy services in the Pearl River Delta region will continue to grow. With China’s entry into the WTO and with an increasing number of Mainland firms seeking external investment, tightening accounting procedures and reporting methods is seen as an absolute necessity. There is likely to be increased interaction in this area
given the need for the experience and expertise found in the accountancy sector in Hong Kong. Recently, international audit firms from Hong Kong have been used to audit major state-owned enterprises in Shenzhen in readiness for company sell-offs, as Mainland authorities increasingly demand that international firms audit corporate statements. At the same time, Hong Kong-owned accounting firms plan to target small and medium-sized enterprises in the Pearl River Delta region.26

Hong Kong interviewees expressed guarded optimism at the pace at which the Mainland’s legal restrictions on entry by foreign accountants are being relaxed. Progress in the area of accounting is viewed as superior to that in the legal sector, for example. Nevertheless, with uncertainty over when current restrictions on accountancy firms would be liberalised, a number of Hong Kong accountants interviewed saw potential in diversifying into consultancy services for Pearl River Delta firms wishing to target overseas markets, and for small foreign-owned companies wishing to set up operations in the Pearl River Delta region.

Activities within the Pearl River Delta region are also likely to drive demand for accountancy services within Hong Kong. The continued strength of small and medium-sized companies within the Pearl River Delta region will create ample opportunity for Hong Kong-owned service providers. Some small legal and accountancy firms in Hong Kong are already planning to relocate their offices to Kwun Tong or Tsuen Wan to target the returning business traveller. At the same time, the increase in firms from the Chinese Mainland using Hong Kong as a springboard for international expansion and accessing capital markets will create work for the international accountancy firms based in Hong Kong.

Advertising

Market liberalisation and growing demand suggest future opportunities in the Pearl River Delta region for the Hong Kong offices of the top global advertising agencies. The advertising industry is expected to feel the effects of China’s WTO membership, as foreign advertising firms will be able to have a majority stake in joint ventures in 2004, and in 2006, they will be able to set up wholly foreign-owned enterprises. A significant increase in work is expected, as brand equity becomes an increasingly important competitive weapon in China and as firms from the Chinese Mainland aim to promote their products abroad and at home on a national scale. Urbanisation in the Pearl River Delta region will continue

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26 Authors’ interviews
to drive the growth of the advertising sector in the region. For Hong Kong’s small and medium-sized enterprises in advertising, prospects in the Pearl River Delta will be limited largely to specialised areas. A new generation of locally owned Mainland firms has become skilled in advertising, promotion sampling, and on-ground support. They know their market, charge lower fees than Hong Kong firms, and their quality of service is improving. Specialty areas where Hong Kong firms will maintain an advantage include film production, post-production services, and packaging design for export markets.

There may also be an increase in firms from the Pearl River Delta region coming to Hong Kong to promote their products as a test-bed for further expansion overseas. For example, Huizhou-based TCL has recently committed HK$15 million this year to advertising its household electronics products in Hong Kong. This trend is likely to increase as more Pearl River Delta region firms target Hong Kong for their products. Given the fact that Hong Kong television programmes are received in Guangdong Province, people from the region are likely to have a good idea of the lifestyles, tastes, and fashions of Hong Kong consumers. Coupled with linguistic and cultural similarities, this should help Pearl River Delta firms penetrate Hong Kong markets in the future.

Recruitment

The demand for skilled and professional talent in the Pearl River Delta region will continue to grow as the economy grows, as Pearl River Delta firms begin to expand into international markets and as China’s entry into the WTO spawns tougher competition in the Chinese domestic market. This will create demand for management talent from Hong Kong, as well as from the Pearl River Delta region. This in turn, will create demand for the services of recruitment agencies. More than 12,000 people in Hong Kong recently attended a job fair that was organised to fill around 1,000 jobs at 70 state-owned enterprises and private firms in the Pearl River Delta region. Companies within the Pearl River Delta region routinely report 1,000 applicants for a single advertised position. The amount of resources needed to handle this process means that such recruitment cannot be effectively managed in-house. This creates opportunities form both Hong Kong and Pearl River Delta region recruitment agencies and suggests the potential for significant collaboration to match jobs and personnel across the border.

Though the recruitment industry is not subject to the same stringent regulations as the finance, banking, legal, and accounting sectors, there are still some restrictions, which

will inhibit the interaction between Hong Kong and the Pearl River Delta region in the future. For example, Hong Kong is home to a number of agencies that specialise in the effective management of temporary staff. Given the need of many manufacturers in the Pearl River Delta region to take on seasonal staff to meet fluctuating demand, the expertise of these temping agencies would certainly add value to businesses in the Delta region. At present, however, foreign companies are not able to provide this service, as legally they are not allowed to manage the payroll for third party businesses. At the top end of the range, headhunting firms are also subject to changing legislation that could impair their ability to compete in the Pearl River Delta region. For example, Guangdong province has recently prohibited the “poaching” of senior-level staff from its state-owned enterprises. The issue for Hong Kong recruiters looking to expand their business over the border is the unpredictability of these changes in regulations. As one recruitment consultant complained, “The rules differ by province and even by city. Even when they announce a new regulation, you never know if it is going to be enforced. Often they change the rules on you without notice. It’s difficult to keep up and future plans for Mainland business always carry a high degree of risk because of this.”

Consultancy

Demand should continue to be strong for business consultancy services in the Pearl River Delta region. International consultancy firms continue to report double-digit growth in China as a whole. The drivers for this growth are tied to both inbound and outbound investment. Excellent potential is seen to be in assisting firms from the Pearl River Delta region to achieve their development goals. For instance, Chinese companies seeking to issue new shares are increasing demanding quality consultancy services in areas such as restructuring and corporate governance. Multinationals expanding their investments in the region will also drive demand.

Promising areas include marketing, human resources, and workplace safety. Given the fragmented nature of China’s markets, marketing-related services, such as data analysis and customer relationship management (CRM), will be critical to successful market penetration in the Chinese Mainland in general and the Pearl River Delta region in particular. Hong Kong companies are ideally positioned to fill a two-way function. Hong Kong is home to a critical mass of consultancy firms, ranging from global consultancies to high-end “boutique” firms, with deep expertise in China markets. These firms will continue to assist foreign companies in gaining access to the Chinese Mainland. They are well positioned to help Mainland companies commercialise their products for the global market, as more firms from the Chinese Mainland choose Hong Kong as their international platform.
Companies from the Pearl River Delta are increasingly looking to Hong Kong-based business consultants to help them position their products for Hong Kong or international markets, or to establish offices in Hong Kong or overseas. Many of these firms are successful private enterprises that often have scant English ability and little or no experience of overseas markets. While major international business consultancies have established a presence in the Chinese Mainland, these firms tend to work on the restructuring of major state-owned enterprises, focusing on Beijing or Shanghai as locations to develop their China business. Enterprises from the Pearl River Delta often look for small ‘boutique’ business consultancies or individuals in Hong Kong to help them with their restructuring or expansion plans. Frequently, the interaction will be based on personal relationships with Hong Kong-based recruiters, accountants or advertisers expanding the scope of their business to provide business advisory services to Pearl River Delta companies.

Consumer services

Developments in the Pearl River Delta region are fuelling demand for consumer services. Already there is a substantial amount of informal interaction through the operations of Hong Kong-based firms in some parts of the Pearl River Delta region. In the future, we would expect to see far more interaction in education, training, and perhaps elderly care. Hong Kong universities have already set up research and training centres in the Pearl River Delta region and are increasingly involved in joint research projects and exchanges. The flow of students is starting to go in both directions, with some Pearl River Delta region students coming to Hong Kong and a small, but growing number of Hong Kong students electing to go to university in the Pearl River Delta region. One of the most common reasons that both Hong Kong and foreign business people cite for not relocating their families to the Pearl River Delta is the lack of adequate schooling for their children. As an increasing number of Hong Kong and expatriate staff find work in the Delta region, opportunities for providers of private schools and day-care facilities should increase.

The proportion of Hong Kong’s population aged 65 and over is projected to rise from 11 percent in 2001 to 24 percent in 2031. Hong Kong retirees are increasingly looking to settle in the Pearl River Delta region, attracted by its lower costs and attractive and roomier housing stock. This trend may well continue, driving up demand inside the Pearl River Delta for private housing, nursing, and medical services. On the other hand, the population of the Pearl River Delta region is skewed toward younger people of employment age. Thus, it is less likely that Pearl River Delta jurisdictions will be providing such facilities in large quantities in the near future.
The Future Economic Interaction

Developments in Hong Kong and the Pearl River Delta region are generally regarded as advantageous for increased interaction in both manufacturing and services. The manufacturing sector already is tightly integrated and promises to be more so going forward. In the service sector, the nature of China’s economic opening under its WTO accession agreement and China’s own efforts to develop and stimulate its economy should enhance the interaction as well. The precise nature of the interaction, particularly in the service sector, is uncertain in that it depends greatly on the extent and timing of regulatory changes and the ability of firms from Hong Kong, the rest of China, and the rest of the world to deal with these changes.

As the economic interaction between the Hong Kong and the Pearl River Delta region increases, there should be ample opportunities for Hong Kong firms, for Pearl River Delta region firms, and for foreign multinationals to benefit. The interaction, however, will take on different forms as the economies develop. The future interaction will create new dynamics involving new divisions of labour and new competition between Hong Kong and the Pearl River Delta region. These, in turn, will be influenced by the relative strengths and weaknesses of the economies in question and the opportunities that companies of all types see in the future, subjects that will be taken up in the next chapter.
7. Future Division of Labour and Competition in the Greater Pearl River Delta Region

The division of labour that has emerged in the Greater Pearl River Delta region has allowed a certain amount of specialisation to take place among the jurisdictions of the region. This division of labour has allowed the Pearl River Delta region to use its land, resources, and low cost labour to penetrate international markets in conjunction with investment, management, technology, and market knowledge from Hong Kong. It is this combination that has allowed the Greater Pearl River Delta region to become one of the world’s economic success stories. For the most part, the development of the economies of Hong Kong and the Pearl River Delta region have been complementary, with relatively little overlap and, therefore, relatively little direct competition. The forces identified above, however, are causing a shift in both the division of labour and the competition between Hong Kong and the Pearl River Delta region. Although the interaction between the two areas will become more complex and in some senses more difficult, the future division of labour and competition among jurisdictions could well create even further benefits for the Greater Pearl River Delta region as a whole going forward.

Manufacturing Industries

The initial economic interaction between Hong Kong and the Pearl River Delta region was based on the decentralisation of Hong Kong’s manufacturing activities to the Pearl River Delta region. Over time, however, this interaction has taken on many new facets. Today, the range of activities of manufacturing companies performed in the Pearl River Delta region is expanding. The interaction today involves not just Hong Kong-owned enterprises, but also enterprises owned or operated by Taiwanese, Japanese, Korean, and Western companies. The interaction also involves a much wider range of industries than those involved in the initial shifts into the Pearl River Delta region. The development of the Pearl River Delta region and Hong Kong economies will influence both the division of labour and competitive balance between Hong Kong and the Pearl River Delta region in the future.

Future division of labour in manufacturing industries

As indicated above, the bulk of the manufacturing in the Greater Pearl River Delta region takes place in the Chinese Mainland. This is true for Hong Kong firms, for Pearl River Delta region firms and for foreign multinationals. Hong Kong exporters predict that their operations in the Pearl River Delta region will continue to grow in size, in the quest to achieve greater scale economies. Hong Kong firms, as well as foreign multinationals, are likely to move more and more of their activities directly related to manufacturing, such as sourcing, packaging, quality control, and warehousing, directly into the Pearl River Delta region. Procurement offices will migrate into the Pearl River Delta region, as the region becomes a more and more important source of components and inputs.
Most commercialising activities aimed at international markets are expected to remain in Hong Kong. Most Hong Kong exporters expect their marketing and sales activities for overseas markets to remain in Hong Kong. A common theme is Hong Kong’s enduring superiority as a platform for communicating with and responding to foreign clients. On the other hand, a vocal minority of firms predict that most of their marketing activities directed at overseas customers would move into the Pearl River Delta, facilitated by e-mail, the Internet, and video e-conferencing. For these firms, the cost savings to be afforded by either completely closing down the sales office in Kowloon, for example, or reducing it to a minimum, more than justify the loss of other location-related conveniences. In addition, the location of some commercialisation activities will continue to be influenced by the location of a firm’s customers. The presence of giant distributors such as Wal-Mart and Levis in Shenzhen is likely to induce their suppliers in Hong Kong to relocate customer-specific sales and service activities across the border.

Marketing and sales activities for the markets of the Chinese Mainland will continue to move from Hong Kong into the Pearl River Delta region, with measures to “safeguard” sensitive company information in the Mainland business environment. One electronics firm, for example, is relocating a trusted Hong Kong employee into the Pearl River Delta region for exclusive access to the firm’s own pricing structures, disclosure of which to the Mainland staff would “give away the game.” Another firm reported that a past effort to set up a sales office in the Pearl River Delta region backfired when the Mainland sales staff took away the firm’s clients. Fears of this type of behaviour will serve to limit the activities that Hong Kong firms and foreign multinationals place in the Pearl River Delta region for a considerable period of time.

Hong Kong-based firms that source technology from the United States, Europe, and other foreign markets report that Hong Kong will continue to play a valuable role as a “window” open to overseas technology. In addition to technology “sourcing,” high-tech firms will continue to use Hong Kong as corporate headquarters, as well as the location of overseas sales and customer service activities and banking. Hong Kong is also expected to remain an important market for software and other high-tech services provision within the Asia Pacific region, due to its high, and growing, concentration of the regional headquarters and offices of multinational firms. As discussed earlier, intellectual property-related concerns keep many Hong-based firms, especially small and medium-sized firms, from relocating technology-related activities across the border. Hong Kong firms generally do not foresee significant improvements in the Mainland’s intellectual property regime under WTO.
As to the coordination of shipping and other export-related activities, reports were mixed. Some firms intend to move the control of logistics and shipping into the Pearl River Delta to take advantage of the low-cost shipping and logistics base in Shenzhen. Others expect their coordination of shipping and related activities to remain in Hong Kong because of fuller service provision by Hong Kong banks and shipping companies. Firms with marketing and sales operations in Hong Kong are better equipped to respond to client needs if issues arise with the shipment or with product returns. As one Hong Kong-based toy designer explained, “What happens if there is more than a two percent defect rate, or we need to recall the product? This is where...the Hong Kong arm of a Mainland-based factory is essential.”

A trend that we expect to gather momentum in the future is that of firms from the Pearl River Delta region setting up offices in Hong Kong to access the international market and the information sources that are available in Hong Kong. According to the Hong Kong Trade Development Council, 19.7 percent of private sector firms surveyed in the Pearl River Delta region already had a Hong Kong office. The survey indicated that the number of such firms with a Hong Kong office is bound to increase dramatically. In addition, the participation of Pearl River Delta companies in the trade fairs and exhibitions held in Hong Kong has risen sharply over the past few years, and this is projected to continue. Hong Kong is far ahead of every other city centre in the region as a hub for international trade fairs and exhibitions that attract the world’s major buyers.

Future competition in manufacturing industries

In light manufactures, Hong Kong-owned small and medium-sized firms active in low-end and OEM segments will face head-on competition from Pearl River Delta region firms in local and overseas markets. Competition will continue to be price-based and will heat up as Pearl River Delta-owned firms further expand their direct contacts with foreign buyers. They will gain position vis-a-vis Hong Kong-owned firms through continued reliance on existing strategies, copying Hong Kong-designed products, minimising labour and overhead costs, accepting lower profit margins, and reducing price to the extent possible. Industry leaders expect this competitive pressure to have a dramatic impact on Hong Kong-owned firms in the low to mid tiers of the market. A commonly heard prediction is that half or more of Hong Kong firms in the toy and watch sectors will go out of business within ten years. The consensus among industry leaders is that cost-cutting measures, the most common strategic response to date among Hong Kong-owned firms, will be insufficient.

1 Hong Kong Trade Development Council, Hong Kong as an International Commercial and Financial Centre— from the perspective of Mainland Private Enterprises, June 2002.
The strategies of Hong Kong and Mainland-owned firms will converge in OEM to an increasing extent, unless Hong Kong-owned firms take immediate steps to stay ahead of the game. Managers of Hong Kong companies believe that OEM production will become more and more difficult for Hong Kong firms, which will be forced to move into ODM, branded manufacturing, or specialised segments if they are to succeed in the future. According to several managers, Hong Kong firms that do not adjust and reposition may not survive. This will require managers of Hong Kong firms to be forward looking in order to take advantage of technological change and the emergence of new markets to address new product applications and, perhaps, entire new categories of products. This may enable Hong Kong firms to move from toys, for example, into new categories of consumer products incorporating robotics. Another trend is the shortening life-cycles of consumer products, which will require Hong Kong-owned firms to move more quickly in identifying upcoming trends, adapting fast-breaking technologies, and updating their supply chain management. Strategies that address these trends include investing in continuous improvements and in more sophisticated, high-end products.

Another area of future convergence will be in markets across the Chinese Mainland. Many small and medium-sized Hong Kong firms are responding to heightened competition from counterparts from the Chinese Mainland in overseas markets by placing greater emphasis on selling into China. The dilemma, as they see it, is that their Pearl River Delta region competitors are already active in these markets and in some senses are better positioned. They generally have lower overhead costs and can often, by virtue of connections or shared ownership, source locally produced components at lower prices and on better terms than Hong Kong-owned firms. Within the Pearl River Delta, they operate free of the regulatory constraints and duties imposed on Hong Kong-based firms with export processing licenses. They also excel at cultivating close relationships with local officials, an advantage that some see as growing in importance as the Pearl River Delta’s business environment becomes more highly regulated. The frequent conclusion reached by Hong Kong managers is that “cooperation” or “partnership” with Mainland firms in Mainland markets is the best, and indeed the only, “way ahead.”

Hong Kong-based firms have a number of strengths that Pearl River Delta firms cannot yet replicate. Enduring advantages, in addition to those related to marketing and sales, include experience with quality control, product safety, and post-sales service, which is based on an understanding of buyers’ needs after they receive the product and it is on the shelf. Good business sense was widely identified as another enduring source of advantage. Hong Kong people are expected to be better “business analysts” for the foreseeable future, in part because they operate in an open business environment. In high-tech, Hong Kong
people are predicted to remain better at interacting with the customer with respect to the design process and systems to meet the needs of customers.

The most innovative of Hong Kong’s small and medium-sized trading companies continue to show remarkable creativity in designing strategies to keep them head of the competition. An example is the “as seen on TV” merchandising strategy, where one Hong Kong-based trader buys airtime on US television stations, advertises directly to consumers, sources product from the Chinese Mainland and elsewhere, and manages the supply chain to the end customer. In watches and clocks, some Hong Kong firms have found a niche that focuses on transforming product “from engineered product to fashion item, at the best quality for the lowest price.” Other Hong Kong traders focus on systematically transforming their experience base into formidable barriers to entry. One trader, for example, has built up over time a cumulative computer database of 100,000 specific colour matches for a specific item of fabric. Others invest heavily in client relationships and achieve such close customer relationships that their overseas clients report back any overtures from Mainland firms.

Marketing, design, and branding have strong potential as sources of future competitive strength. Hong Kong’s superior marketing acumen is expected to remain a competitive edge, based on a deep understanding of overseas consumers. It is the ability to sense what the markets will look like next year or in five years that is the key advantage of Hong Kong firms. Market knowledge is supported by competitive advantages in design. Hong Kong’s design capability is seen as a potential source of enduring advantage, especially if it is cultivated. There will be a greater strategic premium in future on Hong Kong-owned firms building their own brands. This will require Hong Kong-owned firms to invest more heavily in promotion. As one garment manufacturer explained, design is the more readily grasped concept. In many respects, success is determined more by marketing and branding. “It’s about creating a phenomenon. It’s not the designers that create this, it is the promoters.”

In manufacturing, WTO accession is expected to compel China to modernise the regulatory foundation on which to build future business. The resulting upgrading in regulatory environment will drive Mainland firms, including Pearl River Delta firms, to upgrade their basic business practices, which in turn will narrow the gap between Mainland and Hong Kong firms at the low and mid-tiers of the market. In addition, increased competition from imports, and the exigencies of foreign clients, will drive Mainland-owned firms to improve their product and process quality standards. Larger numbers of factories will qualify for ISO and other standard certifications. The anticipated result is fiercer competition on quality with Hong Kong-owned factories.
Trade-related Services

The interaction between Hong Kong and the Pearl River Delta region in trade-related services has been extensive. As the Pearl River Delta region has become one of the world’s leading manufacturing locations, Hong Kong has become one of the world’s leading centres for trade and trade-related services. As the Pearl River Delta region expands its role in manufacturing and deepens its production base, the demand for trade-related services will expand further. In addition, as China’s economy opens under its WTO accession agreement, there will be an entire new dynamic, in which import trading will rise to take its place alongside export trading as critical activities for the Greater Pearl River Delta region.

Future division of labour

Hong Kong should continue to play the lead role in providing overseas market access for the Pearl River Delta region over the next ten years. Hong Kong’s strengths as a region-wide hub for trading and commercial activities rest on powerful hard and soft infrastructure advantages and “cluster strengths” that will not be replicated by any Pearl River Delta city anytime soon. The strategic strengths of Hong Kong-based traders and exporters should generally endure because they rest on capabilities that will prove difficult for Mainland-based competitors to replicate — in part because they lack Hong Kong’s first-world business environment.

Hong Kong will continue to play the role of “nerve centre” for global trade flows involving the Pearl River Delta production base. Hong Kong’s highly developed capabilities in trading, business services (including trade finance and documentation), and transport (including logistics management) reinforce themselves in a virtuous circle. In addition, Hong Kong’s unique soft infrastructure advantages, including the rule of law, first-world judicial and legal system, enforceability of contracts, level playing field, political stability, security, transparency, and intellectual property protection, are of inestimable value to the foreign market access function. With respect to hard infrastructure, Hong Kong will continue to lead the region in sea and air transport, communication, and other areas of hard infrastructure indispensable to the provision of foreign market access.

When we consider Hong Kong’s future positioning, it is important to consider these strengths in combination. Interviewees tended to give great weight to progress by cities in the Chinese Mainland in one or two areas while overlooking the systemic aspects of Hong Kong’s overall leadership. There is no city in the Chinese Mainland that will replicate Hong Kong’s powerful constellation of trade-related strengths over the next ten years. Shenzhen and Guangzhou lack the critical mass and overall systems, while Shanghai is too far away to
act as a hub for the Pearl River Delta region. Soft infrastructure advantages, including free
flows of capital, goods, people, and information, lie firmly with Hong Kong for the foreseeable future.

On the strategy side, Hong Kong’s traders and exporters enjoy strategic advantages in relation to their competitors from the Chinese Mainland that the latter will find difficult to replicate in the short term. Specific skills include the ability to deliver on time, to meet stringent quality requirements, to communicate with foreign buyers, to understand overseas markets, and to coordinate complex commercial practices. In the ODM and “branded” segments, the control of Hong Kong firms over production and supply chain management is essentially unchallenged across a wide spectrum of light manufactures.

Future competition in trade-related services

Many Hong Kong traders express concern that their Mainland-owned counterparts will proceed up the learning curve in international marketing at the same rate of progress as Hong Kong’s trading community has achieved. The logic, commonly expressed, is that Hong Kong firms have had thirty years’ experience in foreign markets, Mainland firms have had twenty years’ experience, and that in ten years, they will catch up. Many interviewees from small and medium-sized Hong Kong firms predicted that their strategic advantages in “foreign market access” would last only three to five years. Others indicate that this logic is flawed and that any catching up would take far longer and assumes that Hong Kong firms stand still.

It is important to distinguish between areas where progress by Mainland traders will be relatively rapid, and areas where change will be slower. The former include making direct contact with foreign buyers, through the Internet, the Canton Trade Fair or trade fairs overseas, the backward engineering of commodity products, and improved English language and marketing skills. The latter include areas of deep-seated business culture where changes in business practices would require a shift in underlying values. Hong Kong’s business culture has been informed by a unique combination of factors, including a British-based system of commercial law and enforceability of contracts, transparent regulation, and free flows of information. For example, the concept of payment in fair consideration of value delivered is a fundamental precept of British common law. Hong Kong’s business standards have been enriched by contributions by major Hong Kong firms as well as Hong Kong’s large and well-established community of international firms. These business standards have been developed and enforced for decades by the courts and by a well-developed community of professional service providers operating at international standard. In contrast,
within the Pearl River Delta region, the need to capture foreign currency earnings is very great and the mechanisms to enforce contracts are weak.

Compared to Hong Kong, the notion of fair payment in exchange for value delivered in the Chinese Mainland is relatively weak. Many Hong Kong interviewees identified this as a major obstacle to doing business in the Pearl River Delta region. For example, Pearl River Delta firms will often undertake to meet higher quality standards in exchange for a higher price, and then substitute lower-quality inputs in an effort to boost their profit margin without understanding that the substitution goes to the “heart” of the contract. Collection of payment is notoriously difficult, not just for Hong Kong firms within the Mainland, but also for multinationals of every nationality and no quick progress is foreseen on this front. Against this background, Hong Kong’s leadership in overseas markets with respect to business values and business standards is likely to endure. It should play an important role in preserving Hong Kong’s “foreign market access” function into the foreseeable future.

Despite Hong Kong’s overall leadership, there are specific areas in which Hong Kong is being bypassed, at least to a limited extent. Some of the world’s major distribution chains, such as Levis and Wal-Mart, have relocated their buying operations for South China into the Pearl River Delta region, and this type of relocation may gain in momentum. These firms are perceived as having sufficient clout with officials in the Chinese Mainland to strike favourable deals. The very large firms may also enjoy sufficiently deep professional service support to navigate the operating environment in the Pearl River Delta region without reliance on Hong Kong’s soft infrastructure and professional service clusters. They increasingly have the financial clout to subcontract the establishment of dedicated consolidation centres convenient to the maritime port facilities in Shenzhen, which in turn are sufficiently developed to accommodate their shipping requirements.

Hong Kong importers and producers continue to play value-adding roles in the strategies of these “giant” multinational buyers despite their physical relocation into the Pearl River Delta region. Hong Kong executives report that in a variety of light-manufactured goods, these buyers continue to buy almost exclusively from Hong Kong-owned firms with production capacity inside the Pearl River Delta region, rather than from Mainland-owned firms. The Hong Kong-owned factories continue to dominate by virtue of their ability to deliver on time and to high specification within acceptable product defect parameters. The large buyers also continue to rely on Hong Kong-based traders to design products and mastermind their outsourcing within the Pearl River Delta region. It is doubtful that large buyers will be able to internalise the “packaging and integrating” function still performed by Hong Kong-based traders, except perhaps in very basic commodity-type goods. In
other product lines, including toys, the depth of specialised expertise required suggests a continuing role for Hong Kong traders. Some Hong Kong traders express concern that as more multinational firms set up production bases in the Chinese Mainland, they “will start to look for agents in the Mainland sooner or later.” As a result, there may be fewer opportunities for Hong Kong firms to act as agents.

The cities of Guangzhou, Shenzhen, and Dongguan have encouraged foreign investment in purchasing centres. With the approval of the Central Government, Shenzhen has asked the world’s 500 top enterprises to set up their own purchasing centres and to engage in import and export business. At present, more than 20 have applied to set up purchasing centres in the city, and at least ten of them were approved in 2002. According to Shenzhen’s Foreign Trade Director, foreign-funded enterprises, which set up purchasing centres in Shenzhen, will enjoy preferential tax treatment whether the products exported are made by themselves or by others. Different localities in the Pearl River Delta region are also sponsoring more and more trade fairs to attract overseas investors. These represent the strong interest of locations in the Pearl River Delta region to establish their own connections that would bypass Hong Kong in trade relations. While these cities are improving, they are unlikely to capture Hong Kong’s “foreign market access function” to any appreciable extent over the next ten years. They cannot match the depth of Hong Kong’s clusters in this area, and they suffer quite basically from physical proximity to the Hong Kong SAR, since what can be done with respect to trade-related services in the Pearl River Delta region can usually be done better in Hong Kong.

In terms of bypassing Hong Kong, the largest impact in the next ten years is likely to be felt at the low-end of light manufactures. Mainland-based traders are increasingly targeting buyers in third world markets and mid-tier markets in Europe, for example, where numerous actors still prevail in distribution. The mechanisms for bypass include the Canton Fair, the Internet, and direct participation by Mainland-owned firms in overseas trade fairs and exhibitions. The Indian trading community in Hong Kong, for example, is increasingly encountering Mainland traders in third world markets for basic commodity goods, such as footwear, where the Mainland traders are competing very aggressively on price.

On the export side, competition from Mainland-owned traders and exporters is expected to intensify following China’s WTO accession. Some Hong Kong-based traders predict that the liberalisation of foreign trade under WTO will enable Mainland-owned firms to do their own international marketing and that during this process they will evolve from partners to competitors. Certainly, concerns of this nature were widespread among the interviewees, many of whom predicted that WTO would “reduce” Hong Kong’s export-
related functions for China. A related concern is that WTO will facilitate the entry of multinationals into the Mainland, where they will set up more facilities, develop first-hand knowledge of doing business inside the Mainland, and directly take over trade functions previously handled through Hong Kong.

In other respects, the impact of the WTO may act to strengthen Hong Kong’s hand. Mainland-owned firms should place a premium on the services and expertise of Hong Kong as a trading hub and on Hong Kong service providers. Hong Kong should attract growing flows of firms from China eager to tap into and learn from Hong Kong’s extensive base of experience. Some interviewees acknowledged this potential while voicing concern that in this process Hong Kong would be teaching Mainland firms to compete independently. However, it remains the case (as discussed above) that “foreign market access” is a function that concentrates in “hub” cities and that there is no other city in China positioned to take over Hong Kong’s role as export hub. Hong Kong’s soft infrastructure and “business value” advantages will contribute very significant and enduring value to this equation.

In terms of import flows, China under WTO is expected to become more open, and more shipments will flow direct to their destinations on the Mainland. The pace of change will depend in large part on the ability of Mainland locations to resolve internal disputes over jurisdiction and streamline their customs procedures. Meaningful progress on this front may well require another five to ten years. In terms of upside for Hong Kong, China’s WTO membership should provide Hong Kong firms with a more level playing field inside the Mainland, while lower import tariffs should boost overall trade flows and yield a larger pie for everyone. In the words of one logistics provider, “China’s imports will jump and Hong Kong will benefit.”

In trading, China’s WTO accession is expected to make it easier for overseas firms to sell direct into the Mainland, eroding the import role of Hong Kong’s small and medium-sized traders. Some Hong Kong exporters foresee a time, in the near future, when Mainland MBAs across China will set up offices and work with overseas sellers to sell directly into the supermarkets and shopping centres in their localities. Other Hong Kong traders predict that the moment the Central Government announces free convertibility of the yuan (albeit in the distant future), new Mainland traders will spring into existence in large numbers. These trends underscore how important it is for Hong Kong’s small and medium-sized traders to explore value-adding strategies for this changing environment.

Many Hong Kong firms prefer to locate sales and marketing activities targeting Mainland markets within those markets themselves. As Mainland markets are highly localised, and
are expected to remain so, Hong Kong firms often field marketing and sales staff in multiple Mainland locations. They expect to continue to hire sales personnel locally. Activities that are expected to remain in Hong Kong include overall formulation and coordination of sales strategy, and the drafting of training manuals for Mainland sales personnel.

**Sea Cargo**

The sea cargo industry is slated to grow dramatically in the Greater Pearl River Delta region, as the region’s export base continues to expand and as China’s accession into the WTO results in increased imports. Although the cargo throughput for the whole region is expected to grow, the precise division of labour and the outcome of competition between ports in the region remain uncertain. Hong Kong is expected to remain for the foreseeable future the main contributor of capital and management to the export processing base of the Pearl River Delta region. However, there are disagreements about how much capacity should be added in Hong Kong and in other ports around the region. In some quarters there are fears that investments made on a non-commercial basis will drive out investments made on a commercial basis. This is an area in which cooperation around the region would probably be beneficial, but seems unlikely to occur in reality given the desire of several jurisdictions to have their own ports.

**Future division of labour in sea cargo**

The Tenth Five-Year Plan (2001-2005) forecasts Guangdong’s foreign trade value to grow at an average annual rate of 8.5 percent. On this trajectory, the containerised cargo throughput originating in Guangdong will reach between 22 million and 24 million TEUs by 2005. According to forecasts by the Hong Kong Port and Maritime Board, the port throughput of Hong Kong will rise from 18.1 million TEUs in 2001 to 30 million TEUs in 2010 and 40 million TEUs in 2020.\(^2\) According to Guangdong officials, on the other hand, Guangdong’s sea-borne trade will equal 40 million TEUs. Of this total, 10 million TEUs are expected to be handled by Yantian and 30 million by other Pearl River Delta ports. Half of this latter total would be shipped to Hong Kong for transhipment and another 10 million would be trucked by highway to Hong Kong, leaving Hong Kong handling on the order of 25 million TEUs.

Hong Kong will contribute significant additional port capacity at Container Terminal 9, which is being commissioned in stages between 2002 and 2004, and will add six berths to

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\(^2\) Alex Fong, “Port Planning for the Pearl River Delta Region: A Hong Kong Perspective,” in Anthony Yeh, ed., *Building a Competitive Pearl River Delta Region*, p. 123.
the existing 18 berths at Kwai Chung Port. Beyond this, the future expansion of Hong Kong’s port capacity is uncertain. Diversion of cargo to the Shenzhen ports has created divergence of opinion within the planning, policy, and investment communities over the need for Container Terminal 10. Some industry participants believe that Hong Kong’s ports will continue to capture robust and growing levels of container throughput, as forecast by the Port Cargo Forecasts 2000/2001. Others, in contrast, wonder if Hong Kong should use its high-priced land for other purposes, noting that Tai Koo Shing was erected on land previously used for port facilities, and speculating whether Kwai Chung might eventually go the way of London’s Docklands.

Ports in Guangzhou, Nansha, Shekou, Yantian, Chiwan, and Zhuhai are also being built or expanded. Guangzhou plans to add four berths in the Xinshagang district. Nansha has three berths at present and plans to add 40 more. Some 31 berths are being added to the Shenzhen ports of Shekou, Chiwan, and Yantian. Zhuhai’s Gaolan Port has built a coal wharf, a petroleum wharf, and an ore wharf. It will add 16 additional berths by 2010. There are plans to accelerate port development in Zhongshan, Foshan, Jiangmen, Shunde, Dongguan, Panyu, Xinhui, Sanbu, Huizhou, and Taizhou. Many experts expect that the Shenzhen ports will eventually outstrip that in Hong Kong in terms of container throughput.

The Hong Kong Port and Maritime Board forecasts that the Shenzhen ports will exceed Hong Kong’s container throughput by the year 2015.³ An important factor is the future capacity at Shenzhen. As of 2001, the container throughput of the Shenzhen ports had already reached 5 million TEUs, with an annual growth rate of around 30 percent per year.⁴ It is expected that Shenzhen’s seaports will continue to experience strong growth over the long-term. The Shenzhen seaports are currently projected to bring on-stream additional capacity of two million TEUs by 2005.⁵ Beyond this, the potential for additional expansion, particularly at Yantian, will come into play. Yantian’s future expansion potential has become a contentious issue. Views range from a likelihood of no additional capacity (absent costly land reclamation) to essentially unlimited deep-water capacity along the adjacent coastline, outside the jurisdiction of Yantian’s private terminal operators. Shenzhen authorities are minority holders in the existing Shenzhen ports but they do control adjacent land, and they are highly ambitious. Shenzhen officials recently have been overheard to discuss how soon Shenzhen will overtake Shanghai as China’s largest port.

³ Hong Kong Port and Maritime Board, *Hong Kong Port Cargo Forecasts 2000/2001*.
⁴ Research and Statistics Team, *Hong Kong Shippers’ Council*.
In contrast, the port planned by Guangzhou authorities at Nansha is not expected to divert cargo originating in the eastern side of the Pearl River Delta region. Part of the port plan in Nansha is for bulk terminals to handle raw materials destined for the heavy manufacturing base planned for the area. According to local officials, the container port in the Nansha plans will only be built if sufficient foreign capital can be attracted. The impact of a major container port in Nansha on the container ports in Hong Kong and Shenzhen depend on the future connectivity between the western part of the Pearl River Delta region and the existing ports in Hong Kong and Shenzhen. Nevertheless, some industry members fear that Nansha might hinder the future development of other ports in the region by adding capacity that will limit the attractiveness of investments elsewhere in the region.

China’s WTO regime is expected to boost both import and export trade through Hong Kong. This growth in demand will dovetail with the overall growth in volumes to be handled by the global shipping industry, which in turn is driving new generations of supertankers. The world is moving to fourth generation ships with 5,000-container load capacity. The minimum clearance for these vessels, when fully laden, will be 15 metres of water, plus two metres from the keel to the seabed. The deepest of the Pearl River Delta ports, Yantian, has a depth of 12 metres. Fourth generation vessels will be likely to ply direct long distance routes between Hong Kong and Europe or the U.S. and their economics will discourage multiple stops. Under this scenario, Hong Kong would play the role of central hub for South China, with Shenzhen also heavily involved with smaller vessels. Other ports in the Pearl River Delta region would provide feeder services to Hong Kong and regional services.

It is expected that Hong Kong will remain the nerve centre for the port operations in the Greater Pearl River Delta region. The port of Hong Kong will also retain a strong position for high value and rapid turnaround cargo due to its efficiency, simple customs procedures, and dense shipping network. Yantian will continue to emerge as a strong port for lesser value and time sensitive cargo, as well as cargo linked to consolidation centres in Shenzhen. As sailing frequencies and customs procedures improve, Yantian is expected to move into higher value cargo as well. Most of the other ports in the region are likely to service bulk cargo or act as feeder ports to the major hubs.

**Future competition in sea cargo**

Competition among ports in the Greater Pearl River Delta region is driven by costs and capacity investments. At present, terminal handling charges in Shenzhen are between 16 percent and 46 percent lower than those in Hong Kong, depending on the size and destination.
of the shipment. However, there is some evidence that pricing in the ports in Hong Kong and Shenzhen is not completely competitive. According to a report by CLSA, Hong Kong has the highest terminal handling charges in the world. This has long been a bone of contention between shippers and the port operators. The port operators have claimed that high costs in Hong Kong justify the high terminal handling charges. Data from the Hong Kong Shippers’ Council, however, shows that the terminal handling changes in Shenzhen are among the highest in Asia. CLSA claims that costs cannot be the reason for such high charges and that the Hong Kong-based operators, which operate the container ports in both Hong Kong and Shenzhen, essentially use an oligopolistic pricing structure to maximise profits across the ports in both Hong Kong and Shenzhen.

Another form of competition in port services takes place through capacity investments. If investors in port facilities operate on a commercial basis, they will take the capacity of other competing locations into account before making their own investments. In particular, if there is overcapacity in nearby jurisdictions, commercial investors could be deterred from making new investments. There is a fear on the part of some that investments in the Pearl River Delta region will be made without reference to commercial criteria. The resulting capacity could deter commercial investments in other locations, even if those other locations are superior for port activities. The large number of jurisdictions in the Greater Pearl River Delta region would seem to indicate that at least some of the investments are not based on detailed commercial analysis.

**Air Transportation**

According to the Guangdong government, there will be 18 airports in Guangdong, Hong Kong, and Macao by the end of 2010. These will include the international airports in Guangzhou, Hong Kong, Macao, and Shenzhen, and five local airports. The Guangdong government estimates that international passenger traffic into and out of all the airports will reach 240 million from the present 50 million by 2010.

**Future division of labour in air transportation**

The four international airports in the Greater Pearl River Delta region will handle the international passenger and cargo traffic in the region in the foreseeable future. Of these, the Hong Kong International Airport is likely to continue to be the principal access point for international passenger and freight traffic into and out of the region. The ultimate

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6 Research and Statistics Team, Hong Kong Shippers’ Council.
8 The Centre for Urban and Regional Studies, Zhongshan University, “Xianggang yu zhujiang sanjiao zhou jingji guanxi yanjiu” (“A Study of the Economic Relationship between Hong Kong and the Pearl River Delta”) in Xianggang yu zhujiang sanjiao zhou jingji hudong yanjiu (A Study of the Hong Kong - Pearl River Delta Economic Interaction), April 2002, p.32.
design capacity of the Hong Kong International Airport is 87 million passengers and nine million tonnes of cargo. The Hong Kong International Airport’s dense network of international flights is unlikely to be matched any time soon by any other airport in the region, especially given the strength of local carriers Cathay Pacific and Dragonair, and the liberalised air services agreement reached with the United States in 2002. Hong Kong and Chinese Mainland carriers also are actively seeking to serve more destinations in the Chinese Mainland. The Hong Kong Airport Authority expects passenger and cargo throughput in Hong Kong to grow at an average annual rate of around 6 percent over the next twenty years.9

The ultimate design capacity of the new Baiyun Airport in Guangzhou is planned to be 80 million passengers and 2.5 million tonnes of cargo. Guangzhou has been designated as one of the top three domestic hubs and international airports in the Chinese Mainland (the others are in Beijing and Shanghai). As such, it is expected to dominate domestic air transportation between the Pearl River Delta region and the rest of the Chinese Mainland. Guangzhou is aggressively building up its flight network, extending fifth freedoms to foreign carriers in an effort to become a major international hub connecting South China to Southeast Asia and beyond. Although it is likely to make significant inroads, it seems unlikely to displace Hong Kong’s position as an international hub.

Shenzhen’s Bao’an Airport has plans to accommodate 25 million passengers per year. Bao’an would seem to be well situated to become a major airport for air cargo, given its position in the heart of the Pearl River Delta’s export base. It is also likely to grow in stature as an express cargo-forwarding centre, as Federal Express builds up its base of operations at Shenzhen. Shenzhen is also likely to expand its position as a hub for domestic travel within China, though this will depend on its ability to obtain permission to fly to more domestic destinations. It is not clear that such permission will be forthcoming given the hub status of Guangzhou and the plans of domestic airlines.

In addition to serving Macao itself, Macao Airport has carved out a niche connecting passengers from Taiwan through to the Chinese Mainland. This niche, of course, would be made obsolete should direct links between the Chinese Mainland and Taiwan be established. It is not clear that Zhuhai Airport has a niche. It handled only 23,000 flights and 637,000 passengers in 2001 despite a capacity of 12 million passengers.10 Some have suggested that the relative emptiness of Zhuhai Airport could make it suitable for aircraft maintenance,

9 Hong Kong Airport Authority, *Hong Kong International Airport Master Plan 2020*, October 2001, p.3.
10 *Hong Kong Economic Times*, “Zhuhai Airport to shift to cargo transportation,” May 25, 2002.
or as a satellite cargo facility affiliated with the Hong Kong Airport. However, this appears to be a plan to bail out Zhuhai Airport rather than a commercially based proposal. Zhuhai is on the wrong side of the Pearl River Delta to have access to the Delta’s export base and does not have sufficient flight frequency to justify the costs associated with operating a major airport.

Future competition in air transportation

Hong Kong has dominated the international passenger and cargo flow in the Greater Pearl River Delta region, but the emergence of other airports in the region could reduce this dominance to a certain extent. Recent press reports have focused on the future possibility of increased competition between Hong Kong’s Chek Lap Kok airport and the four other major airports in the Pearl River Delta. It was reported that Chep Lap Kok lost an estimated HK$25 million in revenue in 2001, as a result of Hong Kong-based passengers opting to fly from Shenzhen.\(^\text{11}\) Demand for air shipment is less sensitive than demand for sea shipment to differentials in land haulage costs from factory gate to point of outward shipping point. External trends are strengthening the demand for airfreight of high-value consumer goods. International distributors are reducing risk by minimising the time that goods spend in inventory and show willingness to pay a premium for “just in time” air shipment. Nevertheless, over the longer term, as the airports at Guangzhou (Baiyun) and Shenzhen (Bao’an) develop denser air networks and more sophisticated cargo handling capabilities, there is the potential for significant diversion of airfreight away from Hong Kong International Airport.

However, as Lin Shusen, the Mayor of Guangzhou has said, Guangzhou and Hong Kong are likely to retain their strong positions in the domestic and international arenas, respectively, with neither airport able to displace the other. He suggested that connections between the two airports be made easier so that they could better complement each other.\(^\text{12}\) The Mayor of Shenzhen, Yu Youjun, on the other hand, has encouraged the Hong Kong airport to take shares in Shenzhen airport and to forge connections that use Shenzhen airport’s domestic connections and Hong Kong airport’s international connections.\(^\text{13}\) Huang Longyun, Secretary of the Zhuhai Committee of the Chinese Communist Party has indicated that the Zhuhai government will try to promote cooperation between the Hong Kong and Zhuhai airports. The manoeuvring would appear to give the Hong Kong Airport Authority some choices of how it manages cooperation and competition among the airports in the region.\(^\text{14}\)

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14 *Hong Kong Economic Times*, “Zhuhai Airport to shift to cargo transportation,” May 25, 2002.
The potential for air transportation in the region, as well as competition between airports, will be strongly influenced by air service rights. Historically, Hong Kong has had a less open air services regime than other airports in Asia. As a result, it had lost some of the hubbing activities of companies like Federal Express and UPS. The air services agreement that Hong Kong reached with the United States in October 2002, which enhanced fifth freedom rights for US carriers in Hong Kong and allowed Cathay Pacific to serve additional cities in the United States and to code share with American Airlines, appears to show that the Hong Kong government was becoming concerned about the potential loss of Hong Kong’s hub status. At the same time, Hong Kong carriers are seeking expanded landing rights in the Chinese Mainland, something that would naturally extend Hong Kong’s position as a regional hub. The gradual erosion of the “one route, one airline” policy in Hong Kong indicates that Hong Kong also is starting to take competition in air services more seriously.

With respect to Mainland tourists bypassing Hong Kong in future, the principal concern lies with potential competition from Guangzhou and Shenzhen airports for Mainland traveller flows. Guangzhou’s new Baiyun Airport, in particular, is said to harbour ambitions to become a major regional hub for Mainland travellers to Southeast Asian destinations, as well as the leading domestic hub in South China. Hong Kong-based travel agency operators worry that the rise of Guangzhou Airport will divert large numbers of Mainland passengers from Hong Kong and cut into Hong Kong’s outbound fare business catering to Mainland travellers. They report that rising numbers of charter flights leaving out of Guangzhou and Shenzhen for Southeast Asia are already having a negative impact on the number of Chinese Mainland visitors coming through Hong Kong. This is of particular concern because a significant percentage of Mainland visitors to Hong Kong are in transit to other destinations.

One aspect of air transportation services that is often overlooked in the Greater Pearl River Delta region is the potential impact of large express cargo carriers. Federal Express has single-handedly made its main US hub airport, in Memphis, the busiest air cargo airport in the world. Should Federal Express receive sufficient air rights to turn Shenzhen into a real hub, it could shift the balance in the region. On the other hand, DHL’s express cargo facility to be build in Hong Kong could also help to lock in Hong Kong’s position as the leading air express cargo airport in the Greater Pearl River Delta region.

Logistics

Logistics is increasingly becoming a focus of companies and of regions. Companies are realising that managing their supply chains well is critical to competitive success in the marketplace. Regions are realising that logistics is rapidly becoming an attractive, high value-added industry that can add substantially to local wealth. Advances in information
and communication technology are revolutionising the logistics business, allowing the companies and centres that are able to handle vast information and product flows to have substantial advantages over competitors. The rise of third party and even fourth party logistics providers has increased specialisation and levels of expertise in the industry. It also has made customers increasingly more demanding of the logistics companies and the logistics centres that they employ. The future division of labour and competition in logistics services in the Greater Pearl River Delta region will depend on a number of factors including the networks of each of the major hubs, the availability and quality of advanced services, the information handling capability of the hubs, costs, and the ability to provide integrated management for flows of information and goods.

Future division of labour in logistics services

The division of labour between the locations will probably involve Hong Kong and Shenzhen as hubs for international logistics activities. Hong Kong will remain an important regional hub for managing and coordinating multidirectional flows of products and components within the Asia-Pacific region and between the Asia-Pacific and the rest of the world. Its world-class hard and soft infrastructure, and supporting services, are without par in the Chinese Mainland. Hong Kong will attract and retain regional and sub-regional operations of multinational logistics firms. Shenzhen will provide a low-cost alternative to Hong Kong for logistics provision proximate to the Pearl River Delta’s export processing base and the Shenzhen ports. It will continue to attract and retain consolidation centres serving export flows to the ports. Shenzhen’s cost advantage relative to Hong Kong will lessen somewhat over time, because rental costs of warehouse space in Shenzhen are rising. Wage differentials, on the other hand, are expected to remain significant for at least another ten years.

In fact, there is a possibility that Hong Kong and Shenzhen might become almost a single hub with warehousing and consolidation activities taking place in Shenzhen for physical flows through Hong Kong and Shenzhen and with logistics companies setting up a single management structure to manage the flows of goods through Hong Kong and Shenzhen in an integrated manner. The various options for physical goods flow through Hong Kong or Shenzhen would become a portfolio of choices managed in an integrated fashion by logistics companies. In all likelihood, this integrated management for many companies would be based in Hong Kong to take advantage of the Hong Kong SAR’s network of key decision makers and access to international market information. This integration of hubs would require significant improvements in the cross-border transport of goods. In order to truly operate as a single hub, there must be flexibility in terms of moving goods back and forth
depending on what is optimal at the moment. Failing such flexibility, Hong Kong and Shenzhen still could be viewed by logistics companies as linked, but without such immediate flexibility.

Guangzhou, on the other hand, will continue to be a hub for domestically oriented logistics activities. As China opens its distribution and transportation industries under its WTO accession agreement, it is likely that Hong Kong and foreign companies that wish to be active in the Pearl River Delta region, and South China in general, will place significant activities into Guangzhou. This is likely to be the best place to deal with customers and to deal with the myriad of transportation, warehousing, and consolidation activities geared toward the domestic market. Here the Hong Kong and foreign providers will meet indigenous companies that will provide support services and competition. The new Baiyun Airport will give Guangzhou a strengthened role as an air hub for domestically oriented logistics as well. The new airport, coupled with plans for port development at Nansha could put Guangzhou on the map as a centre for internationally-oriented logistics activities, though these are still likely to be dominated by Hong Kong and Shenzhen.

This would indicate that it is important that the logistics hubs of Guangzhou and Hong Kong-Shenzhen should be linked as tightly as possible. For goods imported into the Pearl River Delta region, the goal would be a seamless transit from the international logistics hub to the domestic logistics hub and then on into the domestic distribution system. In addition, export cargo originating from Guangzhou and surrounding areas could be funnelled into the domestic hub and then linked seamlessly to the international hub for export. Such a division of labour would probably optimise the entire logistics system for the Greater Pearl River Delta region.

Future competition in logistics services

There will be more intense competition in logistics services between the various jurisdictions in the Greater Pearl River Delta region in the future. Hong Kong, Guangzhou, and Shenzhen all have made logistics services a cornerstone of their future development plans. The question is whether this competition will be direct head-to-head competition or more differentiated competition, with the different jurisdictions performing mostly different functions and thus limiting direct competition to a limited range of activities in which there is direct overlap. In addition, in the context of the expected growth of trade and distribution in the region, the competition will be for pieces of a much larger pie than is available as present. This limits the potential for destructive competition between jurisdictions going forward.
Interviewees agreed with the concept that Hong Kong should differentiate its logistics sector by concentrating on high value-added services. One main dimension over which the competition will take place involves the existing networks and systems of the different centres. Hong Kong’s linkages with the rest of the world through its port and airport should enable its logistics providers to maintain a strong if not dominant position in high-end logistics services, particularly those associated with goods moving by air. Even so, in the future, shippers looking at air shipment into China will “cost compare” entering through Hong Kong or going direct to their Mainland destination. The final result will be dictated by the frequency, cost, and reliability of the various air cargo platforms. The systems developed by Hong Kong providers and the Hong Kong offices of foreign providers to manage complete supply chains should also hold Hong Kong in good stead for supply chain management activities, not just with respect to the Greater Pearl River Delta region, but also for trade in and around Asia and between Asia and the rest of the world. The legal, financial, communications, and business systems in Hong Kong should also leave the Hong Kong SAR in a good position for providing services associated with logistics, including real time tracking, financing, settlement, and advisory services.

As China’s trade with the rest of the world grows, an increasing portion will go into and out of the Pearl River Delta without intermediation from Hong Kong. As the services in the Pearl River Delta region improve, logistics services linked closely to the physical flows of goods, such as transportation and freight forwarding, will locate near the shipping point. For these types of services, cost is likely to be an important factor. For logistics services associated with international trade, Shenzhen is likely to become a strong competitor on the back of its growth in port services. Transport bottlenecks at the Hong Kong-Shenzhen border crossing points could continue to shift shipping activities to Shenzhen along with associated logistics activities. One concern voiced in Hong Kong is that cargo, and logistics activities diverted to Shenzhen are highly unlikely to revert back into the HKSAR. As one interviewee observed, “cargo diverted is cargo permanently lost to Hong Kong.”

Guangzhou has been the historical centre of logistics for domestic flows of goods in the region. Competition in logistics services for the Pearl River Delta and South China markets will be heavily influenced by cost, geographic position, and connections to the rest of the region. It is hard to imagine that either Hong Kong or Shenzhen could compete successfully with Guangzhou along these dimensions. Even with a link between Hong Kong and / or Shenzhen and the western part of the Pearl River Delta region, Guangzhou’s location with respect to the population centres in the Pearl River Delta region and in the regional transportation network should ensure its position. The only competition could come from
a combination of Hong Kong and Shenzhen should the international portion of the logistics industry become so prominent that it absorbs the domestic system into a single hub. Given the disparate nature of the goods that are involved in the export trade and those involved in domestic shipments in the Pearl River Delta region, this is unlikely to take place.

**Business Services**

Business services have become the main driving force of Hong Kong’s economy. At the same time, the demand for business services in the Pearl River Delta region is slated to grow substantially. The division of labour and nature of competition between Hong Kong and the Pearl River Delta region in business services will influence the development of both areas. Business services also will be the test case for the opening of China’s economy under its WTO accession agreement. While some in the Chinese Mainland seem to believe that an opening to Hong Kong firms and the Hong Kong offices of foreign firms is in some way a concession, many officials in the Pearl River Delta region have been seeking to open the sectors to facilitate the development of the Pearl River Delta economies.

**Future division of labour in business services**

In business services, the division of labour is likely to be rather different in the future than it is today. The main reasons will be the opening of the Chinese market under the WTO accession agreement, greater development in the Pearl River Delta region, and greater knowledge of the Pearl River Delta market on the part of Hong Kong firms. In essence, the market for business services is likely to become much more integrated. The natural result should be an expansion of the high-end service sectors in financial and professional services in Hong Kong, an increasing sophistication of service offerings in the Pearl River Delta region by both Hong Kong and Pearl River Delta firms and offices, and a shift of backroom type activities out of Hong Kong and into the Pearl River Delta region. On the latter point, companies like HSBC, PCCW, and others have moved substantial portions of their back office and supporting activities to the Pearl River Delta region in search of lower costs.

In financial services, Hong Kong will remain the major international financial centre in the Greater Pearl River Delta region. As Chinese restrictions on Mainland companies listing in Hong Kong are eased, we should expect that many Pearl River Delta-based companies will prefer to list in Hong Kong to obtain access to international capital flows, or on a second board in Shenzhen which would be closer to their business base than Shanghai. The main investment banking, fund raising, project finance, and other “big ticket” financial services will largely be provided out of Hong Kong. Guangzhou and Shenzhen will provide much of the retail and corporate banking activities for consumers and businesses in the
Pearl River Delta region. The movement by large service providers of back-end support operations from Hong Kong into the Pearl River Delta region is expected to continue and perhaps accelerate. The salary differentials between clerical and support workers in Hong Kong and the Pearl River Delta region are projected to continue for at least another fifteen years. As a result, data processing, customer call centres, bill processing, and other backroom activities of Hong Kong-based financial institutions increasingly will be moved to centres across the boundary in the Pearl River Delta region.

For professional services, we would expect a similar trend of Hong Kong offices providing high-level services and specialist expertise for Hong Kong firms, foreign multinational firms, and even the larger Pearl River Delta companies. Hong Kong-invested facilities will continue to favour Hong Kong-based providers and easing of border crossing and entry will make it easier for many Hong Kong firms to service Hong Kong-invested operations in the Pearl River Delta region. At the same time, a growing sophistication in the service sector of the Pearl River Delta region will provide Pearl River Delta firms with an expanding choice of capable local service providers. Hong Kong companies also will try to crack this market as the imperative to learn to serve Pearl River Delta customers outweighs their traditional lack of knowledge of the Pearl River Delta firms. In addition, we would expect that major multinational service providers would move a good part of the execution of service provision to Pearl River Delta entities into the Delta, even if the projects were managed from Hong Kong.

Senior managers of Hong Kong-based service firms were split on the question of whether they would consider locating an office in the Pearl River Delta region if allowed to under current Chinese legislation. Those that thought this would help improve their operations pointed to the advantages of being close to their client base. These include lower travel time, a higher ability to establish closer ties with their clients, greater access to local market research, and the decided advantage of being able to learn ‘normal practice’ by being immersed in the local environment. Those that were opposed to the establishment of a branch office in the Pearl River Delta region found that the proximity of Hong Kong and the current volume of business did not justify the cost. The growing convenience of the land and rail links between Hong Kong and major locations within the Pearl River Delta region means that, for these companies, the majority of clients could be adequately serviced from Hong Kong. Clearly each firm will have to do its own analysis of its business and client base in order to make an intelligent decision.

Future competition in professional services

There will be keener competition in business services among the jurisdictions of the Greater
Pearl River Delta region in the future. The development plans of Shenzhen and Guangzhou are directly targeting the service sector as a means to move into higher value activities and as a means to improve performance of the local manufacturing sectors. The past view of the service sector as “unproductive” or “parasitic” is falling away faster in the Pearl River Delta region than anywhere else in the Chinese Mainland. While some of the plans in local jurisdictions in the Pearl River Delta region call for cooperation with Hong Kong and Hong Kong service providers to upgrade the capabilities of the local service sector, other plans, such as Shenzhen’s plan to attract multinational regional headquarters away from Hong Kong, are less cooperative in nature. At the same time, greater openness under China’s WTO accession agreement will allow Hong Kong firms to compete in sectors that once were protected, placing further pressure on Pearl River Delta-based firms and offices.

In some service areas, such as high-end financial services, consulting, accounting, and engineering, experts based in Hong Kong are likely to be called in to deal with particular projects or large-scale undertakings in the Pearl River Delta region. In such areas, it is the access to particular expertise, the ability to draw upon an Asian or global organisation, and deep experience that will determine the choice and location of service provider. For more routine and ongoing work, the right qualification, knowledge of the specific market and practices and price will be major considerations. Companies from some countries or regions will continue to prefer to deal with service providers from their own country or region. This again could favour Hong Kong-based offices of these firms. In any case, the specific project or job, the price sensitivity of the buyer, and the nationality of the client will continue to have an important influence on the choice and location of service provider.

The Future Division of Labour and Competition Within the Greater Pearl River Delta Region

The nature of the division of labour and competition between Hong Kong and the Pearl River Delta region will evolve considerably in the future. The Pearl River Delta region is likely to take on far more activities than has been the case to date. Hong Kong, on the other hand, is likely to deepen in particular activities. The competition between Hong Kong and jurisdictions in the Pearl River Delta region is likely to become much more even handed than has been the case. The competition will become tougher in some senses as the Pearl River Delta region’s economy develops and as Hong Kong firms and the Hong Kong offices of foreign firms gain entry into the Pearl River Delta market. The result of this competition should be a sharpening of competitive advantages, greater specialisation within a number of jurisdictions and greater efficiency within the Greater Pearl River Delta region. Of course, there are a number of issues that will need to be addressed if this evolution is to create additional benefits for the entire Greater Pearl River Delta region.
The Greater Pearl River Delta region has emerged as an important economic region in its own right. Yet the development of the region cannot be viewed in isolation from the wider context of China’s economic reform and development. In this context, the Greater Pearl River Delta region is only one of several economic regions within China, and the Pearl River Delta Economic Zone is only one of several regions within the Chinese Mainland. Indeed, one of the more important aspects of China’s economic development over the last two decades has been its regional flavour. The Chinese Mainland is not as much a national market as it is a series of regional markets. Decentralisation of governance of many corporations and financial responsibility to local governments has led to a certain amount of competition between different regions. There are huge disparities in regional development, with the coastal regions far more affluent than the regions of the interior. These disparities have become a major social and policy issue for the Chinese Government. Clearly, the relationship between the Pearl River Delta region and other regions of China will be crucial to the development prospects for the regions and for the Chinese Mainland as a whole.

The rise of the “other” regions of China

As was indicated earlier, the Pearl River Delta region was historically one of China’s relatively backward regions. It was only with the economic reform process that started in the late 1970s and picked up momentum in the 1980s that the Pearl River Delta region emerged as an economic powerhouse. The success of the Pearl River Delta region inspired further change and reform that spread to other areas of the Chinese Mainland. Shanghai in the early 1990s, the western provinces in the late 1990s, and Beijing in the early 2000s became new focal points for China’s development. The result has been an inevitable decline in the share of the Pearl River Delta region in some of China’s economic aggregates over the last few years, while its absolute position remains very strong.

Shanghai and the Yangtze River Delta region

In the 1980s, as the Pearl River Delta region was in the vanguard of China’s economic development, the Yangtze River Delta region exhibited uneven growth. Suzhou and Wuxi in southern Jiangsu grew rapidly through the development of collective township enterprises, while growth in northern Zhejiang was fuelled by collective-based private enterprise. Officials from jurisdictions in the Yangtze River Delta region, including Shanghai, travelled to the Pearl River Delta to learn from that region’s development.

Shanghai began to attract international attention in the early 1990s. The traditional commercial areas around the Bund and along Nanjing and Huaihai Roads became focal
points of development. With this development as well as the opening of the Pudong area in Shanghai starting in 1991, the Yangtze River Delta region emerged as one of the fastest growing regions in China. The Pudong development consisted of four main development zones, the Lujiazui Finance and Trade Zone, the Jinqiao Export Processing Zone, the Waigaoqiao Free Trade Zone, and the Zhangjiang Hi-Tech Park. A mix of concessions and influence drew many investors to Shanghai. Along with the development of Pudong, there has also been a massive redevelopment of parts the city centre on the western side of the Huangpu River. Some RMB 62 billion was spent on infrastructure over a nine-year period throughout Shanghai. The years 1990 to 1995 saw the construction of the Nanpu Bridge, the Yangpu Bridge, the Yanggao Road Extension, the Shanghai Inner-Ring Road, and the harbour at Waigaoqiao, as well as gas works, water treatment facilities, and telecommunications infrastructure. The second round of infrastructure investments from 1996 to 2000 included the Pudong International Airport; the Pudong Deep-Water Harbour (Phase I); the Pudong International Info-Port; the #2 Metro Line (Phase I); the Outer Ring Road; and additional rail, water, gas, and power facilities. The development in Shanghai included the building of a new museum, arts complexes, and shopping centres. Provinces from around China and ministries from the Central Government were asked to contribute by building skyscrapers in Pudong.

The Central Government also designated Shanghai to be the main financial centre for the Chinese Mainland. Chinese banks were urged to move some of their businesses to Shanghai (a move that some resisted) and some foreign financial institutions were allowed limited access to the Shanghai market. In several instances, foreign financial institutions were told that they had to set up in the new financial district in Pudong in order to receive licenses. The Shanghai Stock Exchange became the largest stock exchange on the Chinese Mainland and the trading home of many of China’s largest publicly traded companies.

The Yangtze River Delta region benefits from a large and, by Chinese Mainland standards, affluent population. It is the home of some of China’s leading universities, such as Fudan University and Jiaotong University. The region is geographically close to Korea, Japan, and Taiwan, and has good connections to other Chinese cities and other countries through Shanghai. Shanghai also has received both political and financial support from the Central Government. In recent years, the “Shanghai faction” has dominated China’s politics and Pudong, in particular, has received a massive infusion of money from the Chinese Government. In addition, Shanghai was nominated by China to host major international meetings such as the Fortune Forum in 1999, the APEC summit in 2001, and the World Expo in 2010. This support has helped Shanghai bill itself as a window into China and has allowed the city to recapture some of its lustre from the 1920s and 1930s, when Shanghai
was the leading economic city in Asia. Shanghai also has become a prime destination for foreign investment and a major commercial and business centre.

Beijing and the Bohai Rim region

The Bohai Rim region, which includes Beijing (the capital of the People’s Republic of China), Tianjin, and the provinces of Hebei, Shandong, and Liaoning, was historically an important part of China’s industrial heartland. This relatively resource-rich region received substantial emphasis as a heavy industrial centre in the Mao era. In the early years of China’s economic opening, the economy of Beijing and the Bohai Rim region continued to be dominated by the state sector. During that period, however, Beijing was still the economic centre for northern China and the leading centre for finance, education, and tourism for the entire PRC. Meanwhile, Tianjin developed into a leading centre for the petrochemical, automotive, electronics, and metal industries.

Beijing has received support from the Central Government to modernise its infrastructure in recent years. As the political and cultural centre of China, it clearly has the opportunity to benefit from national policies. Beijing boasts several of China’s top universities. In fact, the Chinese Government plans to invest in three Beijing universities (Beijing University, Qinghua University, and the People’s University of China) in an attempt to make them three of the world’s leading universities. The key universities, as well as the research institutes of the Chinese Academy of Sciences and Social Sciences, further add to the technological base in the Beijing area, as does the development of several industrial and technology parks (most notably Zhongguancun in the northwest part of Beijing, the home of China’s leading computer brands, Founder, Stone, and Legend) in the area. Beijing also has a relatively high quality local workforce, good transportation infrastructure, and proximity to China’s decision makers. International investors often cite this latter point as being of prime importance for developing business in China.

In anticipation of the Summer Olympic Games to be held in Beijing in 2008, there will be massive infrastructure and facilities expenditures in and around Beijing. Many observers believe that Beijing will use the Olympic Games and associated investments to transform the city, much as was the case with Tokyo in 1964 and Barcelona in 1992. The city also plans to substantially upgrade its environment in anticipation of the Games. The Olympics also has created an impetus for trying to make Beijing more accessible to the increased number of foreign travellers and business people that are expected to come to the capital at that time.
Tianjin also has developed into a centre for local and foreign industry. More than 3,400 foreign companies have invested a total of more than US$16 billion in the Tianjin Economic Development Area. Tianjin is less expensive than Beijing (with commercial rents roughly half of the level in Beijing and residential rents only a third of Beijing levels) and is connected to the capital by a good transportation system. However, local transportation can be difficult and the local government has been described as less forward looking by some business people.¹

“Go West” and new regional developments

In June 1999, the Chinese Government announced its “Go West” policy in an attempt to foster development in some of China’s poor, western provinces. Since the early 1980s, the development in the coastal regions has created a noticeable and growing income gap that left much of the interior behind. The “Go West” initiative, therefore, provides preferential treatment in terms of tax policy, enterprise development, and use of foreign funds in an effort to let the West catch up. The Central Government has also undertaken a massive spending programme to improve the region’s infrastructure, education, and environment. These efforts, which were underwritten through the issuance of state government bonds, included electricity transmission lines, a gas pipeline, and water projects. In addition, the government sought to improve an environment that had been neglected for decades, resulting in pollution, desertification, and loss of productivity.

Given the sparse population, backward economies and limited market prospects of the regions involved, the “Go West” policy has not generated too much interest among private sector firms. As a result, the Central Government itself has decided to pay the price of building the infrastructure necessary for development. This means that more and more Central Government resources have been earmarked for the West. As a result, other areas have been forced to rely more on their own means and on private investors to fund urban construction and infrastructure. Local jurisdictions throughout the Chinese Mainland have competed fiercely with each other to attract foreign investors to fund infrastructure and industrial development. This competition can be seen between provinces and even within provinces, as evidenced by the rivalry that takes place within the Pearl River Delta region and within other regions of the Chinese Mainland.

¹ Economist Intelligence Unit, China Hand, May 2002.
Provincial Comparisons

Table 8.1 provides a comparison of the economies of the provinces of the Chinese Mainland. Guangdong Province had the largest economy in 2001, followed by Jiangsu and Shandong provinces. As can be seen in the table, the economies of the Northeast, East-Central, and Southeast provinces are dominant, while those of the Central, Southwest, and Far West lag behind. The Northeast, East-Central, and Southeast provinces also dominate trade and inward investment in the Chinese Mainland. The table clearly shows the uneven development that has become a major issue for China’s economy.
Table 8.1  Economic Aggregates for Provinces in the Chinese Mainland

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<tr>
<td>National total</td>
<td>1,265.83</td>
<td>9,593.33</td>
<td>266.15</td>
<td>243.61</td>
<td>46.88</td>
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<td><strong>Far Northeast</strong></td>
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<tr>
<td>Liaoning</td>
<td>41.82</td>
<td>503.31</td>
<td>11.01</td>
<td>8.80</td>
<td>2.52</td>
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<tr>
<td>Jilin</td>
<td>26.80</td>
<td>203.25</td>
<td>1.46</td>
<td>1.75</td>
<td>0.34</td>
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<tr>
<td>Heilongjiang</td>
<td>36.24</td>
<td>356.10</td>
<td>1.61</td>
<td>1.77</td>
<td>0.34</td>
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<td><strong>Northeast</strong></td>
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<tr>
<td>Beijing</td>
<td>13.57</td>
<td>284.57</td>
<td>11.79</td>
<td>39.75</td>
<td>1.77</td>
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<tr>
<td>Tianjin</td>
<td>9.85</td>
<td>184.01</td>
<td>9.49</td>
<td>8.68</td>
<td>2.13</td>
</tr>
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<td>Hebei</td>
<td>66.68</td>
<td>557.78</td>
<td>3.96</td>
<td>1.78</td>
<td>0.67</td>
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<td>Shanxi</td>
<td>32.47</td>
<td>178.00</td>
<td>1.47</td>
<td>0.47</td>
<td>0.23</td>
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<td>Inner Mongolia</td>
<td>23.32</td>
<td>154.58</td>
<td>0.63</td>
<td>1.41</td>
<td>0.11</td>
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<td>Shandong</td>
<td>89.97</td>
<td>943.83</td>
<td>18.12</td>
<td>10.83</td>
<td>3.52</td>
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<td><strong>East-Central</strong></td>
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<td>Shanghai</td>
<td>16.41</td>
<td>495.08</td>
<td>27.62</td>
<td>33.27</td>
<td>4.29</td>
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<td>Jiangsu</td>
<td>73.04</td>
<td>951.19</td>
<td>28.87</td>
<td>22.48</td>
<td>6.91</td>
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<tr>
<td>Zhejiang</td>
<td>45.93</td>
<td>674.82</td>
<td>22.98</td>
<td>9.82</td>
<td>2.21</td>
</tr>
<tr>
<td>Anhui</td>
<td>59.00</td>
<td>329.01</td>
<td>2.28</td>
<td>1.34</td>
<td>0.34</td>
</tr>
<tr>
<td>Henan</td>
<td>91.24</td>
<td>564.01</td>
<td>1.70</td>
<td>1.08</td>
<td>0.46</td>
</tr>
<tr>
<td>Hubei</td>
<td>59.51</td>
<td>466.23</td>
<td>1.80</td>
<td>1.78</td>
<td>1.19</td>
</tr>
<tr>
<td><strong>Central</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chongqing</td>
<td>30.51</td>
<td>174.98</td>
<td>1.10</td>
<td>0.73</td>
<td>0.26</td>
</tr>
<tr>
<td>Sichuan</td>
<td>82.35</td>
<td>442.18</td>
<td>1.58</td>
<td>1.52</td>
<td>0.58</td>
</tr>
<tr>
<td>Shaanxi</td>
<td>35.37</td>
<td>184.43</td>
<td>1.11</td>
<td>0.95</td>
<td>0.35</td>
</tr>
<tr>
<td>Ningxia</td>
<td>5.49</td>
<td>29.84</td>
<td>0.35</td>
<td>0.18</td>
<td>0.02</td>
</tr>
<tr>
<td>Gansu</td>
<td>25.12</td>
<td>107.25</td>
<td>0.48</td>
<td>0.30</td>
<td>0.07</td>
</tr>
<tr>
<td><strong>Southeast</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fujian</td>
<td>34.10</td>
<td>425.37</td>
<td>13.93</td>
<td>8.70</td>
<td>3.92</td>
</tr>
<tr>
<td>Jiangxi</td>
<td>40.40</td>
<td>217.57</td>
<td>1.04</td>
<td>0.49</td>
<td>0.40</td>
</tr>
<tr>
<td>Hunan</td>
<td>63.27</td>
<td>398.30</td>
<td>1.75</td>
<td>1.00</td>
<td>0.81</td>
</tr>
<tr>
<td>Guangdong</td>
<td>85.23</td>
<td>1,064.77</td>
<td>95.43</td>
<td>81.07</td>
<td>11.93</td>
</tr>
<tr>
<td>Hainan</td>
<td>7.56</td>
<td>54.60</td>
<td>0.80</td>
<td>0.95</td>
<td>0.47</td>
</tr>
<tr>
<td><strong>Southwest</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Guangxi</td>
<td>43.85</td>
<td>223.12</td>
<td>1.24</td>
<td>0.56</td>
<td>0.38</td>
</tr>
<tr>
<td>Guizhou</td>
<td>35.25</td>
<td>108.49</td>
<td>0.42</td>
<td>0.22</td>
<td>0.03</td>
</tr>
<tr>
<td>Yunnan</td>
<td>42.36</td>
<td>207.47</td>
<td>1.24</td>
<td>0.74</td>
<td>0.06</td>
</tr>
<tr>
<td><strong>Far West</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Qinghai</td>
<td>4.82</td>
<td>30.10</td>
<td>0.15</td>
<td>0.06</td>
<td>0.04</td>
</tr>
<tr>
<td>Xinjiang</td>
<td>18.46</td>
<td>148.55</td>
<td>0.67</td>
<td>1.10</td>
<td>0.02</td>
</tr>
<tr>
<td>Tibet</td>
<td>2.62</td>
<td>13.87</td>
<td>0.08</td>
<td>0.01</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: *China Statistical Yearbook 2002.*
The Pearl River Delta and Yangtze River Delta Regions

Today, the region most often compared with the Pearl River Delta region is the Yangtze River Delta region. The growth of Shanghai and surrounding cities has created a new focal point for a significant portion of China’s development. While the development of the Yangtze River Delta region has been extremely impressive over the last decade, many of the comparisons that are generally made between the Yangtze River Delta region and the Pearl River Delta region are flawed. There are a number of factors that must be considered in constructing an accurate picture of the relative economic strengths of these two regions. These will be explored below. We will also examine the relative advantages of the Yangtze River Delta Region and the Pearl River Delta region, as well as the challenges faced by the latter in the face of increased competition from the Yangtze River Delta region.

In comparing the Pearl River Delta region with the Yangtze River Delta region, many observers lump together Shanghai plus all of Jiangsu and Zhejiang Provinces as part of the “Yangtze River Delta Region”. One of the main reasons for this comparison is that data for Shanghai and all of Jiangsu and Zhejiang Provinces are readily available. As can be seen in Figure 8.1, however, it is clear that such a definition includes far more than just the Yangtze River Delta.

Figure 8.1 The Pearl River Delta Region and the Yangtze River Delta Region

Source: Hong Kong Trade Development Council
A more precise definition of the Yangtze River Delta region has been identified in a number of publications. This definition includes Shanghai plus 14 other cities in the southern part of Jiangsu Province and the northern part of Zhejiang Province closest to the actual river delta. As can be seen in Table 8.2, this definition of the Yangtze River Delta region represents 60.8 percent of the population, 80.1 percent of the GDP, 94.6 percent of the trade and 83.3 percent of the utilised foreign capital into the ‘Shanghai + Jiangsu + Zhejiang’ combination.

Table 8.2 Defined Yangtze River Delta vs. Summation of Shanghai Municipality, Jiangsu Province, and Zhejiang Province

<table>
<thead>
<tr>
<th></th>
<th>Yangtze River Delta Region (YRD)</th>
<th>Sum of Shanghai Municipality, Jiangsu Province, and Zhejiang Province</th>
<th>YRD % of Sum of City and Two Provinces</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land area (square kilometres)</td>
<td>100,113</td>
<td>210,741</td>
<td>47.5%</td>
</tr>
<tr>
<td>Population - Census total, 2000 (million)</td>
<td>82.28</td>
<td>135.38</td>
<td>60.8%</td>
</tr>
<tr>
<td>Population - Registered, 2001 (million)</td>
<td>74.94</td>
<td>132.02</td>
<td>56.8%</td>
</tr>
<tr>
<td>GDP total (RMB billion)</td>
<td>1,698.10</td>
<td>2,121.09</td>
<td>80.1%</td>
</tr>
<tr>
<td>Gross industrial output, of enterprises with above RMB 5 million in sales (RMB billion)</td>
<td>2,322.96</td>
<td>2,689.95</td>
<td>86.4%</td>
</tr>
<tr>
<td>Total Trade, imports + exports (US$ billion)</td>
<td>137.15</td>
<td>145.05</td>
<td>94.6%</td>
</tr>
<tr>
<td>Imports (US$ billion)</td>
<td>63.54</td>
<td>65.57</td>
<td>96.9%</td>
</tr>
<tr>
<td>Exports (US$ billion)</td>
<td>73.60</td>
<td>79.49</td>
<td>92.6%</td>
</tr>
<tr>
<td>Utilised foreign capital (US$ billion)</td>
<td>16.06</td>
<td>19.28</td>
<td>83.3%</td>
</tr>
<tr>
<td>Retail sales of consumer goods (RMB billion)</td>
<td>560.98</td>
<td>728.58</td>
<td>77.0%</td>
</tr>
</tbody>
</table>


---

2 Included are the cities of Shanghai; the Jiangsu Province cities of Nanjing, Zhenjiang, Yangzhou, Suzhou, Wuxi, Changzhou, Nantong, and Taizhou; and the Zhejiang Province cities of Hangzhou, Jiaxing, Huzhou, Ningbo, Shaoxing, and Zhoushan. See, for example, Chinese Statistics Press, China’s Yangtze River Economic Belt, 2001.
A more accurate comparison, therefore, would be between a properly defined Yangtze River Delta region and the Pearl River Delta region as shown in Table 8.3. As this table shows, the Census population, GDP, and gross industrial output of the Yangtze River Delta region are roughly twice that of the Pearl River Delta region. Although the “official” statistics for per capita income would indicate a significant lead for the Pearl River Delta region, the per capita figures based on 2001 GDP and Census population from the year 2000 are nearly identical. The Pearl River Delta region’s trade was substantially greater than that of the Yangtze River Delta region in 2001, while the latter obtained more foreign capital. The Pearl River Delta region’s economy is somewhat more service-oriented than that of the Yangtze River Delta region. The Pearl River Delta region’s economy grew significantly faster than that of the Yangtze River Delta region in the periods 1980 to 1990, and 1990 to 2000, showing that even as the Yangtze River Delta region economy took off in the 1990s, the Pearl River Delta region’s economy was just as dynamic.
Table 8.3  Main Indicators of the Pearl River Delta Region (PRD) and the Yangtze River Delta Region (YRD), 2001

<table>
<thead>
<tr>
<th></th>
<th>PRD</th>
<th>YRD</th>
<th>Chinese Mainland</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land area (square kilometres)</td>
<td>41,698</td>
<td>100,113</td>
<td>9,597,000</td>
</tr>
<tr>
<td>Population (million)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Registered, 2001</td>
<td>23.37</td>
<td>74.94</td>
<td>1,276.27</td>
</tr>
<tr>
<td>- Census, 2000</td>
<td>40.77</td>
<td>82.28</td>
<td>1,265.83</td>
</tr>
<tr>
<td>GDP (2001)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Total (RMB billion)</td>
<td>836.39</td>
<td>1,698.10</td>
<td>9,593.30</td>
</tr>
<tr>
<td>- % in primary industry</td>
<td>5.3%</td>
<td>6.4%</td>
<td>15.2%</td>
</tr>
<tr>
<td>- % in secondary industry</td>
<td>49.5%</td>
<td>51.5%</td>
<td>51.1%</td>
</tr>
<tr>
<td>- % in tertiary industry</td>
<td>45.2%</td>
<td>42.2%</td>
<td>33.6%</td>
</tr>
<tr>
<td>Annual average GDP growth</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- 1980-1990 current prices</td>
<td>22.0%</td>
<td>13.0%</td>
<td>15.2%</td>
</tr>
<tr>
<td>- 1990-2000 current prices</td>
<td>23.8%</td>
<td>15.5%</td>
<td>9.3%</td>
</tr>
<tr>
<td>- 1980-1990 constant prices</td>
<td>14.0%</td>
<td>8.3%</td>
<td>10.1%</td>
</tr>
<tr>
<td>- 1990-2000 constant prices</td>
<td>17.5%</td>
<td>15.5%</td>
<td>9.6%</td>
</tr>
<tr>
<td>Retail sales of consumer goods (RMB billion)</td>
<td>312.01</td>
<td>560.98</td>
<td>3,759.52</td>
</tr>
<tr>
<td>Gross industrial output, of enterprises with above RMB 5 million in sales (RMB billion)</td>
<td>(a) 1,201.2</td>
<td>2,323.0</td>
<td>9,544.9</td>
</tr>
<tr>
<td>(b) 1,108.1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Value added % of gross industrial output, 2001</td>
<td>26.29%</td>
<td>28.92%</td>
<td>29.68%</td>
</tr>
<tr>
<td>Total trade, 2001 (US$ billion)</td>
<td>(a) 168.46</td>
<td>137.15</td>
<td>509.80</td>
</tr>
<tr>
<td>(b) 167.04</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Exports (US$ billion)</td>
<td>(a) 90.83</td>
<td>73.60</td>
<td>266.2</td>
</tr>
<tr>
<td>(b) 90.02</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Imports (US$ billion)</td>
<td>(a) 77.63</td>
<td>63.54</td>
<td>243.6</td>
</tr>
<tr>
<td>(b) 77.02</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Utilised foreign capital, 2001 (US$ billion)</td>
<td>(a) 14.19</td>
<td>16.06</td>
<td>46.8</td>
</tr>
<tr>
<td>(b) 13.66</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Notes: (a) Figures as reported in Guangdong Statistical Yearbook 2002. Analysis of the reported figures shows that they include all of Huizhou and Zhaoqing and therefore overstate the Pearl River Delta region totals. (b) Authors’ computation of actual Pearl River Delta figures based on local sources. (c) US$1 = RMB 8.28.

Even this comparison, however, does not tell the true picture of the relative economic strength of the two regions. In particular, this comparison includes the leading economic city in the Yangtze River Delta region, but it does not include the major economic city in the Greater Pearl River Delta region. For example, when Hong Kong and Macao are included, the “Greater Pearl River Delta region” has a GDP that is more than 25 percent higher than the Yangtze River Delta region (see Table 8.4). While it is difficult to reverse engineer all the Hong Kong-Pearl River Delta regional trade and investment flows to get the totals for a unified region, the exports of the Greater Pearl River Delta region are roughly two and a half times those of the Yangtze River Delta region. When Hong Kong’s inward foreign direct investment is included, the Greater Pearl River Delta region dwarfs the Yangtze River Delta region on this measure.¹

The use of a properly defined Yangtze River Delta region and the inclusion of Hong Kong (in particular) and Macao into a Greater Pearl River Delta region provide a much more defensible comparison than that between an overly large region to another region without its major economic city. This comparison yields a picture that is substantially different from that usually described by analysts. Given the importance of Hong Kong and Macao to the economic system of the Greater Pearl River Delta region, excluding them from the mix would be similar to excluding Shanghai from the Yangtze River Delta region.

³ The export figure for the Greater Pearl River Delta region was obtained by adding together the exports of the Pearl River Delta Region, Hong Kong and Macao; then subtracting a figure equal to 80 percent of Hong Kong’s total imports from the Chinese Mainland under the assumption that this roughly equalled the value of imports from the Pearl River Delta region that were subsequently re-exported; then subtracting out the Pearl River Delta region’s imports from Hong Kong. This provides an estimate of the exports of the region. The utilised foreign capital figure for the Greater Pearl River Delta region was obtained by adding the utilised foreign capital for the Pearl River Delta region and the inward foreign investment figures for Hong Kong and Macao and then subtracting out the utilised foreign capital into the Pearl River Delta region from Hong Kong. Again, this provides an estimate of the utilised foreign capital in the region.
Table 8.4  Comparisons of the Greater Pearl River Delta region and the Yangtze River Delta region

<table>
<thead>
<tr>
<th></th>
<th>Yangtze River Delta Region</th>
<th>Greater Pearl River Delta Region</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land mass (1,000 square km)</td>
<td>100.113</td>
<td>42.798</td>
</tr>
<tr>
<td>Population, 2000 (million)</td>
<td>82.28</td>
<td>47.54</td>
</tr>
<tr>
<td>GDP, 2001 (US$ billion)</td>
<td>205.13</td>
<td>267.18</td>
</tr>
<tr>
<td>Exports, 2001 (US$ billion)</td>
<td>73.60</td>
<td>(a) 194.79</td>
</tr>
<tr>
<td>Utilised foreign capital (US$ billion)</td>
<td>16.06</td>
<td>(b) 67.86</td>
</tr>
</tbody>
</table>

Notes: (a) Pearl River Delta exports + Hong Kong exports + Macao exports - 80% of Hong Kong imports from the Chinese Mainland - Pearl River Delta imports from Hong Kong. (b) Pearl River Delta utilised foreign capital (2001) - Pearl River Delta utilised foreign capital from Hong Kong (2001) + inward foreign investment into Hong Kong (2000) + inward foreign investment into Macao (2000)

Sources: Based on data from the Statistical Bureaus of Guangdong, Shanghai, Jiangsu, Zhejiang, Hong Kong, and Macao.

Similar issues arise for a number of other comparisons between the Pearl River Delta region and the Yangtze River Delta region. The tonnage passing through the ports of Shanghai and Ningbo, the two leading ports in the Yangtze River Delta region, for example, dramatically outstrip that through the ports of the Pearl River Delta region, until Hong Kong is added to the mix. In terms of container throughput, Shanghai was substantially ahead of any of the Pearl River Delta region ports, but was only around a third of that of Hong Kong (see Tables 8.5 and 8.6). In terms of air transport, Shanghai actually handled more passengers and more air cargo than Guangzhou in 2001, However when Hong Kong is added to mix, the Greater Pearl River Delta region dominates (see Table 8.7). The Pearl River Delta region dominates in terms of international tourism. Again, when Hong Kong is included, the Greater Pearl River Delta region’s domination is that much greater, though for a fair comparison, the tourism between Hong Kong and the Pearl River Delta region should be subtracted out (see Table 8.8).
### Table 8.5  Port Throughput, Selected Cities, 2001

<table>
<thead>
<tr>
<th>Cities</th>
<th>Throughput (million tonnes)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guangzhou</td>
<td>128.23</td>
</tr>
<tr>
<td>Shenzhen</td>
<td>51.16</td>
</tr>
<tr>
<td>Foshan</td>
<td>23.29</td>
</tr>
<tr>
<td>Zhuhai</td>
<td>19.98</td>
</tr>
<tr>
<td>Jiangmen</td>
<td>10.72</td>
</tr>
<tr>
<td>Dongguan</td>
<td>8.83</td>
</tr>
<tr>
<td>Huizhou (a)</td>
<td>8.34</td>
</tr>
<tr>
<td>Zhongshan</td>
<td>6.77</td>
</tr>
<tr>
<td>Zhaoqing (a)</td>
<td>1.35</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>178.21</td>
</tr>
<tr>
<td>Shanghai</td>
<td>220.99</td>
</tr>
<tr>
<td>Ningbo</td>
<td>128.58</td>
</tr>
</tbody>
</table>

Note: (a) Figures for Huizhou and Zhaoqing include some areas outside the Pearl River Delta region.

Sources: Statistical yearbooks and bureaus from Guangdong, Foshan, Zhuhai, Jiangmen, Dongguan, Huizhou, Zhongshan, Zhaoqing, and Shanghai, as well as data from the Hong Kong Port and Maritime Board.

### Table 8.6  Port Container Throughput, Selected Cities, 2001

<table>
<thead>
<tr>
<th>Cities</th>
<th>Throughput (million TEUs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shenzhen</td>
<td>4.98</td>
</tr>
<tr>
<td>Guangzhou</td>
<td>1.74</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>17.83</td>
</tr>
<tr>
<td>Shanghai</td>
<td>6.34</td>
</tr>
</tbody>
</table>

Sources: Statistical yearbooks of Guangdong and Shanghai, and the Hong Kong Port and Maritime Board.
Table 8.7  Air Traffic, Selected Airports, 2001

<table>
<thead>
<tr>
<th>Airport</th>
<th>Passengers (million)</th>
<th>Cargo (000 tonnes)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guangzhou</td>
<td>13.80</td>
<td>531.57</td>
</tr>
<tr>
<td>Shenzhen</td>
<td>7.78</td>
<td>247.00</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>32.12</td>
<td>2,119.62</td>
</tr>
<tr>
<td>Macao (2000)</td>
<td>3.24</td>
<td>56.92</td>
</tr>
<tr>
<td>Shanghai</td>
<td>20.66</td>
<td>1,000.05</td>
</tr>
</tbody>
</table>

Sources: Statistical yearbooks of Guangzhou and Shenzhen; Shanghai Airport Authority; Hong Kong Civil Aviation Department; and Macao International Airport.

Table 8.8  International Tourism Statistics, 2001

<table>
<thead>
<tr>
<th></th>
<th>Pearl River Delta Region</th>
<th>Yangtze River Delta Region</th>
<th>Hong Kong</th>
</tr>
</thead>
<tbody>
<tr>
<td>International Tourists Staying Overnight (million persons)</td>
<td>(a) 12.32</td>
<td>5.06</td>
<td>13.73</td>
</tr>
<tr>
<td>Revenue from International Tourists (US$ billion)</td>
<td>(a) 4.24</td>
<td>3.15</td>
<td>64.28</td>
</tr>
</tbody>
</table>

Notes: (a) includes all of Huizhou and Zhaoqing and thus overstates the Pearl River Delta region slightly

Sources: Statistical yearbooks of Guangdong, Shanghai, Jiangsu, and Zhejiang, as well as data from the Hong Kong Tourism Board.

Shanghai is regarded as the main financial centre in the Chinese Mainland, but few observers seem to discuss the fact that, on some measures, Shenzhen is nearly as important. In terms of number of foreign financial institutions present and stock market turnover, Shenzhen compares well with Shanghai. Both cities actually have had greater average stock market turnovers in recent times than Hong Kong. Hong Kong still leads both Mainland cities in terms of numbers of foreign financial institutions, numbers of listed companies, and stock market capitalisation (see Table 8.9).
Table 8.9  Selected Financial Markets, 2001

<table>
<thead>
<tr>
<th></th>
<th>Number of foreign financial institutions</th>
<th>Number of listed companies, as of June 28, 2002</th>
<th>Stock market capitalisation, as of June 28, 2002 (RMB billion)</th>
<th>Daily turnover, average of June 2002 for stocks (RMB billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shenzhen</td>
<td>54</td>
<td>545</td>
<td>1,675.8</td>
<td>8.55</td>
</tr>
<tr>
<td>Shanghai</td>
<td>53</td>
<td>675</td>
<td>3,097.8</td>
<td>11.80</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>219</td>
<td>787</td>
<td>4,025.0</td>
<td>7.02</td>
</tr>
</tbody>
</table>

Note: Hong Kong figures converted for comparison. Exchange rate HK$1 = RMB 1.0615

Sources: Shenzhen Securities Information Co. Ltd; CEIC; Hong Kong Monetary Authority Annual Report 2001; China Daily, ‘Foreign financial institutions thrive in Chinese market,’ December 16, 2001; Hong Kong Exchange and Clearing Ltd.; and Shanghai Stock Exchange (SSE).

Advantages of the Yangtze River Delta region

In recent years, there has emerged some competition between the Pearl River Delta region and the Yangtze River Delta region. The two are seen as alternatives for multinational investments, for locations of important meetings, for certain manufacturing industries and for service sector development. There are several actual or perceived advantages of the Yangtze River Delta region versus the Pearl River Delta region. These include: the size of population and economy, location, linkages between the region’s main economic city and its hinterland, workforce capabilities, government support, business tradition, perceptions of the region, and the region’s apparently unified development.

Size of population and economy

Common comparisons of the Yangtze River Delta region and the Pearl River Delta show that the population and economy of the Yangtze River Delta are both substantially larger than those of the Pearl River Delta. The Yangtze River Delta region has nearly twice the population of the Pearl River Delta Economic Zone. The GDP of the Yangtze River Delta region is more than twice that of the Pearl River Delta Economic Zone. Companies looking to sell into China markets might be naturally attracted to the larger population and economic base. However, the comparison is a bit suspect in that it is usually made with Shanghai included in the Yangtze River Delta region, but with Hong Kong and Macao excluded from the Pearl River Delta region. When Hong Kong and Macao are added to the Greater
Pearl River Delta region, the population comparison does not change much, but the economic weight of the Pearl River Delta region exceeds that of the Yangtze River Delta region by roughly 25 percent.

**Location**

The Yangtze River Delta is viewed as being in the heart of the Chinese Mainland and, therefore, as providing easy access not only to the Yangtze River Delta’s 78 million people and the Yangtze Basin’s 360 million people, but also to the entire Chinese market of 1.3 billion people. The Pearl River Delta region is viewed as peripheral by comparison. In reality, however, China is not a single national market, but a series of regional markets. Transportation challenges, regional differences, and inter-provincial barriers to trade and investment prevent a single location from providing optimal access to the entire country. For example, it is just as easy to reach central provinces such as Sichuan from the Pearl River Delta region as from the Yangtze River Delta region. As China’s national rail and road networks are further developed, both delta regions will be able to access large parts of the Chinese Mainland.

**Linkages between city and hinterland**

The Yangtze River Delta region is often considered to have superior linkages between the main economic city and neighbouring jurisdictions when compared to the Pearl River Delta region. Travelling between Shanghai and its neighbouring cities and towns does not require going through immigration or customs checks. Improving infrastructure allows for relatively easy transportation around the region. In the Pearl River Delta region, the city with the best international access, Hong Kong, is separated from the rest of the region by a border involving immigration and customs checks that can result in substantial waits. In addition, the Yangtze River Delta region benefits from relatively easy transportation between Shanghai and Suzhou, Wuxi, and other industrial areas around Shanghai. Some interviewees even indicated that it was easier to go from Hong Kong to Shanghai by air, than from Hong Kong across the land border and on to Foshan.

**Workforce capabilities**

The technical capabilities in the Yangtze River Delta region are considered to be superior to those of the Pearl River Delta region. This is due in part to the history of the Yangtze River Delta region as the industrial centre of China. It is also due to the relative newness of the development of the Pearl River Delta region and the fact that much of the workforce in the Pearl River Delta region consists of relatively unskilled labour that comes from inland and northern provinces. The Yangtze River Delta region is home to several of China’s
leading universities. As a result, people from all over China come to the region for education. Many then stay on to work in the region. Research institutes in Shanghai are deepening their talent pools and international access and the days are long gone when Beijing and Shanghai relied on Hong Kong as a conduit for high-end technology. As for multinational firms, the growth of Mainland-based research facilities linked directly into global corporate networks suggests that technology flows may bypass Hong Kong and the Pearl River Delta region. Shanghai’s history as a commercial centre also has given it a reputation as being a commercially savvy place and a centre for high-calibre professional services. The workforce is reported to have improving standards of English, which will allow it improved access to the international business community.

Central Government backing

The Pearl River Delta region benefitted from its position as the vanguard of China’s reform programme in the 1970s and 1980s. During this period, the Central Government’s policies favoured development in the region. In recent years, however, the Yangtze River Delta has benefitted from substantial backing from the Chinese Central Government. Many of the present leaders of the People’s Republic of China came from posts in Shanghai. Since 1990, Shanghai has been the showcase of China’s development. Billions of dollars have been poured into Shanghai by the national government, by the Shanghai government and by other governments in China to aid in its development. Massive investments and support from national and local governments have attracted thousands of foreign firms to set up facilities in and around Shanghai. Prevailing sentiment is that today the Pearl River Delta region receives far less direct support from the Chinese government than the Yangtze River Delta region and that the rules and regulations governing investments are more favourable in the Yangtze River Delta region than in the Pearl River Delta region.

Local government support

The Yangtze River Delta region is also credited by interviewees as being particularly forward looking and supportive of development. The local governments in the region are seen as particularly aggressive and anxious to bring in business. They are also seen as running more efficient administrations compared with many other places in China. Our interviews with business people in both regions indicated that intellectual property protection and controls over smuggling in the Yangtze River Delta region are considered superior to those of the Pearl River Delta region.
Business tradition

In the 1920s and 1930s, the Yangtze River Delta was one of the leading business and commercial regions in Asia. Shanghai was Asia’s leading centre for business and commerce. To many people, Shanghai and the Yangtze River Delta region are simply reasserting their historical role as the leading centre for business in China. Many point out that the Pearl River Delta region was until recently an economic backwater and that it does not have the same business tradition as the Yangtze River Delta region. However, these views tend to ignore the importance of recent history and the fact that the history of China over the last two decades has been that of the emergence of both the Pearl River Delta and Yangtze River Delta regions as leaders of China’s economic development.

View of the Yangtze River Delta as “first tier”

Increasingly, the Yangtze River Delta region in general, and Shanghai in particular, are being viewed as “first tier” locations, while the Pearl River Delta region and its cities are viewed as “second tier”. It is the Yangtze River Delta region that is viewed as “hot” and “the place to be”. As a result, it is easier to attract mobile professionals to Shanghai than it is to most of the cities of the Pearl River Delta region. In addition, for foreign companies in businesses that are restricted to one or two locations in the Chinese Mainland, Shanghai and Beijing seem to be more natural choices than Guangzhou or Shenzhen. This is despite the fact that for some businesses, the Pearl River Delta region has been in many ways an equally attractive place.

Unified development

A final advantage of the Yangtze River Delta region has been a more unified development than has been the case in the Pearl River Delta region. While the development in the Pearl River Delta region has been beset by a lack of coordination and duplicative investment, that of the Yangtze River Delta has been less subject to competition among jurisdictions. One reason is that the dominance of Shanghai means that its development plans take priority over those of the rest of the Yangtze River Delta region. The development of the new port and the new airport in Shanghai can hardly be viewed as taking into account the interests of the rest of the Yangtze River Delta region. The former, which is currently under construction at Yangsham, is on land that once was under the administration of Zhejiang Province, but is now under the jurisdiction of Shanghai. The latter, located in Pudong, probably would have served the region better if it had been constructed to the west of the centre of Shanghai rather than to the east.
Advantages of the Pearl River Delta Region

At the same time, the Pearl River Delta region has several advantages of its own. These include its links with Hong Kong; its position in international trade and investment; its earlier experience with reform and development; its relatively flexible business environment and local government administration; the ability to attract skills and resources from around China; and the presence of embedded clusters of internationally successful industries.

Links with Hong Kong

One of the primary advantages that the Pearl River Delta region has over the Yangtze River Delta region is its links with Hong Kong. Hong Kong has been a source of investment, technology, information, management, international linkages, access to foreign companies, and market knowledge. These links have allowed the export-oriented firms in the Pearl River Delta region to operate at world quality and cost standards for most of the last two decades. Through its links with Hong Kong, the Pearl River Delta region has superior linkages to international business and the international community. Hong Kong, for example, is far better connected to the rest of the world by air and sea than Shanghai. In addition, the entrepreneurship that has been commonplace in Hong Kong has spilled over with a vengeance in the Pearl River Delta region, making it perhaps the most entrepreneurial region in all of the Chinese Mainland. As one executive explained, “I am amazed at how many successful private companies are now based in Shenzhen. Yes, the government is influential, but part of it is because of people coming into Shenzhen and getting ideas from Hong Kong entrepreneurs. I do not downplay Shanghai, but there is no place next to Shanghai called Hong Kong.”

Position in international trade and investment

Although the Pearl River Delta’s portion of China’s international trade and foreign direct investment is declining, the Pearl River Delta region is still a leader within the Chinese Mainland. The Greater Pearl River Delta region has the infrastructure, the business climate, and the international connections to make its economy one of the most internationally oriented regional economies in the world. This strong position is not going to deteriorate soon. China’s accession into the World Trade Organisation (WTO) might mean that the Pearl River Delta region’s share of international trade and investment will go down, but the absolute magnitude of the trade and investment should show sharp increases in the coming years. Although the volume of foreign investment may be growing more rapidly in the Yangtze River Delta region, interviewees indicate that the number of foreign investors that seem to be making good profits from their Pearl River Delta region investments seems to be far larger than those making money on their investments in other regions of China.
Earlier reform and development

The Pearl River Delta region’s earlier reform has made it far more familiar with market-oriented development than the Yangtze River Delta region. The economy of the Pearl River Delta region is more influenced by foreign investment and more influenced by private sector development than the economy of any other region in China. The economies of most other parts of the Chinese Mainland are still driven by state enterprises and/or state planning. The Pearl River Delta region, on the other hand, has been forced to make its way by developing enterprises that are strong competitors without state support. As a result, businesses in the Pearl River Delta region are more used to dealing with customer requirements, business competition, and international standards of practice than is the case in most other parts of the Chinese Mainland. As the Chinese economy opens up under the WTO accession agreement, the longer experience with reform and market forces is likely to be a strong advantage for the Pearl River Delta region.

Flexible business environment and administration

One advantage that the Pearl River Delta region has had historically is that of flexibility. The development of the Pearl River Delta region has benefitted from its five year plans over the last two decades, but what is striking is the ability of the region to grow “off plan,” to allow experimentation and new ideas, and then to incorporate those that work into future plans. The ability of individual jurisdictions to do their own deals and foster their own type of economic development also has contributed to the region’s development. Pragmatic leadership has allowed many actors in the region to learn quickly, to adjust to markets and to find profitable niches in the marketplace. At the same time, the Pearl River Delta region has developed large numbers of market-oriented, foreign-invested, and privately owned firms. Many of these firms are used to dealing with customers from around the world and to meeting world quality and cost standards. Their flexibility has been one of the hallmarks of the Pearl River Delta region’s development.

Attraction of skills and resources from around China

The Pearl River Delta region has shown itself able to attract skills and resources from around China. Most of the workforce in Pearl River Delta factories actually comes from other places in China. So too do most of the highly educated scientists and engineers that work in the research facilities in the region. The tertiary institutions in the Pearl River Delta region are viewed as lacking the expertise and financial resources required for world-class technological innovation. However, technical talent is expected to continue to flow into the Pearl River Delta, and into Shenzhen in particular, drawn largely by the commercial magnetism of Hong Kong. The Pearl River Delta region has been substantially more open.
to people from the rest of China than the Yangtze River Delta. The prevailing language in Shenzhen, for example, is Putonghua (Mandarin), not Cantonese. The registered populations of Shenzhen and Dongguan are far lower than the population figures obtained by China’s National Census. Although foreign direct investment has been rising in the Yangtze River Delta region, the Pearl River Delta region still dominates in terms of foreign investment stocks, particularly those from Hong Kong and Taiwan.

**Embedded clusters**

The last two decades of development in the Pearl River Delta region have resulted in the emergence of several industry clusters in the region. These clusters include not only groups of related end-product industries, but components, materials, inputs, and some equipment as well. The development of clusters such as these tends to embed the industries into a particular location. It is not simple to relocate or attract away entire sets of industries. At the same time, such clusters tend to foster the development of skills and capabilities that can be difficult to match in other places. As a result, while the Yangtze River Delta region is likely to be a strong competitor in some industries, the Pearl River Delta region is likely to retain strong positions in the clusters that have emerged over the last two decades.

**Pearl River Delta Challenges**

There are a number of challenges that the Pearl River Delta region faces with respect to the Yangtze River Delta region. These include competition for light-manufacturing exports; competition in light manufacturing for the domestic market; competition in electronics and telecommunications products; competition in heavier industries; competition in service industries; competition for foreign direct investment; and competition for the “upgrading” and diversifying of investments.

**Competition for light-manufacturing exports**

Overall, the light-manufacturing industries in the Pearl River Delta region seem to be well prepared to meet competition from the Yangtze River Delta region in their traditional export markets. According to Table 8.3, the Pearl River Delta’s exports still exceed those of the Yangtze River Delta region by a significant margin. However, the light-manufacturing industries of Zhejiang and Jiangsu provinces in particular have emerged as strong competitors in some third world export markets. They have tended to avoid direct competition with Hong Kong-funded enterprises in the Pearl River Delta region by exporting products to the Middle East, Eastern Europe, Latin America, and South Africa. These producers have formed their own sales networks to export to these areas. The Pearl River Delta region and Hong Kong continue to win in their traditional markets, as well as in the Indian subcontinent.
In addition, a number of international buyers are starting to set up buying and sourcing offices in Shanghai. This will give the manufacturers in the Yangtze River Delta region significantly better access to some of the world’s major markets than they have had to date. We would expect the Pearl River Delta and Yangtze River Delta regions to emerge as leaders within the Chinese Mainland for both domestic production and exports. In some individual industries, such as watches, the position of the Pearl River Delta region appears to be unassailable. The Pearl River Delta region accounts for an overwhelming majority of the output of the Chinese Mainland and has a dense network of supplier and support industries that will be difficult to duplicate. In others, such as garments, we might expect there to be a more even balance between the two regions in the future.

**Competition for light manufacturing for the Chinese domestic market**

The western portion of the Pearl River Delta region has a strong position in light-manufactured goods for the markets of the Chinese Mainland. The region has a leadership position in garments, shoes, travel goods, construction materials, and electrical household appliances. In recent years, the Pearl River Delta region has begun to face competition in the domestic market in garments and travel goods from Zhejiang Province, in shoes from Fujian Province, and in appliances from Sichuan and Shandong. As these other regions have developed, they have used their locations and their local sales networks to become significant competitors.

**Competition in electronics and telecommunications products**

Shenzhen has become the leading Pearl River Delta location for electronics and telecommunications products. The city leads the Chinese Mainland in terms of the average educational level of its population, most of which originated from other areas in China, and in its market orientation. Shenzhen has proven to be one of the leading bases for technology and technology-based industry in the Chinese Mainland. In addition to developments in Shenzhen itself, the city has formed links with leading universities all over China to commercialise the products of their research. In recent years, however, several foreign companies have placed production and research activities for high-technology industries in the Yangtze River Delta region in order to take advantage of the presence of some of China’s leading universities and a technically competent workforce.

The Yangtze River Delta region, for example, is the home of most foreign investments to produce notebook computers and several of the major investments in integrated circuits. However, in the integrated circuits sector, the Pearl River Delta region stands out as the one geographic area in China where we are likely to see both components and end product
activity, thanks to the unique role performed by Hong Kong firms in translating end product developments into commercial applications. In this respect, Hong Kong and the Pearl River Delta region should have a powerful, enduring advantage. As one Hong Kong-headquartered integrated circuit designer explained, “Shanghai is and will be more focused on the process of going from the wafer to the end product, while in the Pearl River Delta, we will be working in the opposite direction. In this industry, our direction is the most important.” The location of foreign investment in these industries is likely to be an important factor in determining which region comes out ahead in the long run.

**Competition in heavier industries, machinery, and chemicals**

Historically, the Pearl River Delta region has been relatively weak in terms of heavy industry, machinery, and chemicals when compared to other parts of China. The Pearl River Delta region lacks the raw materials (coal and iron ore) used in the steel industry. Historically, as an underpopulated agrarian area, there was little heavy industry, machinery, or chemical production in the region. These industries traditionally were centred in the industrialised north, and they are still centred in the north today. While light industry, which needs relatively little capital investment and limited capabilities, can grow rapidly in a region, the experience of Japan, Korea, and Taiwan suggests that heavier industries take much more capital and a longer time to develop. In recent years, the growth of the Pearl River Delta region’s light industrial base has increased both consumer and industrial demand for the products of heavier industry. The development of the auto industry and the heavy industrial facilities planned for Nansha could be very influential in the development of these industries in the Pearl River Delta region. One advantage that the Pearl River Delta region might have is that it is relatively unencumbered by history in these industries and does not have to worry about large numbers of inefficient facilities. Even with such significant investments as the Honda and Nissan automotive investments in Guangzhou, the Shell-CNOOC joint venture in Huizhou, and the eventual Nansha steel and chemical facilities, the Pearl River Delta will lag behind the Yangtze River Delta region in these industries.

**Competition in service industries**

The Pearl River Delta region does quite well in international transport and other trade-related services industries when compared to most of the Chinese Mainland, including the Yangtze River Delta region. Shenzhen’s ports compare favourably in terms of growth and throughput with those of Shanghai, and no other part of China has a port to rival Hong Kong. Purchasing, freight forwarding, shipping, and other related services have exhibited strong growth in the Pearl River Delta region. Shanghai was awarded its own international
trade fair that competes with the Canton Fair in Guangzhou, after Guangzhou officials complained about plans to move its fair to Shanghai. Shenzhen and Guangzhou are emerging as logistics and distribution centres that are likely to be complementary to each other and complementary to Hong Kong.

In financial services, the Central Government has designated Shanghai as the main financial centre in the Chinese Mainland and until recently had suspended new listings on the main board of the Shenzhen Stock Exchange. At the same time, the second board that was promised to Shenzhen has been postponed. The result has been a relative diminution of Shenzhen’s role as a national financial centre. As China opens the financial sector under its WTO accession agreement, more foreign firms are likely to try to tap markets in the Yangtze River Delta region than in the Pearl River Delta region. In professional services, such as the legal and banking sectors, there is a view that Guangzhou and Shenzhen do not compare well with Shanghai and Beijing. On the other hand, greater openness will allow firms that have set up offices in Beijing or Shanghai to also serve Guangzhou or Shenzhen. Shanghai is viewed as relatively strong as a commercial centre, particularly for companies looking to develop the markets of the Chinese Mainland, while Beijing is preferred by companies that require a high degree of official approval in their Chinese operations.

**Competition for foreign direct investment**

In general, foreign direct investment oriented toward the export market still favours the Pearl River Delta region with its linkages to Hong Kong. On the other hand, foreign direct investment geared toward selling into Chinese domestic markets is starting to favour the Yangtze River Delta region. As Table 8.3 indicates, foreign investment into the Yangtze River Delta region has begun to exceed that into the Pearl River Delta region. It is not a matter of existing investments moving out of the Pearl River Delta region. Instead, it is a matter of where the newer investments will go. In addition, as companies enter Chinese markets, they have to choose somewhere as their first major location. As they grow and become more experienced in China, it is likely that most significant foreign companies selling into China will have operations in both the Yangtze River Delta region and the Pearl River Delta region. Thus, over the medium term, it is likely that the foreign companies will not be investing in just the Pearl River Delta region or the Yangtze River Delta region, but in both, with the only questions being those of relative timing and magnitude. At the same time, Hong Kong still appears to be in the best position to host the Asia and Asia-Pacific regional headquarters of major multinational firms.
Competition for the “upgrading” and diversifying of investments

As indicated, there is little sign that existing activities are moving from the Pearl River Delta region to the Yangtze River Delta region. The issue, therefore, is not the potential to lose existing investments so much as which region will get the investments that will foster upgrading and diversification. One natural progression for the Pearl River Delta economy would be to expand by deepening its production into more advanced components, inputs, capital goods, and support services linked with its export-oriented assembly industries. Another would be to develop a more diversified economy with heavy industry taking its place alongside light industry. Indeed, such development is already occurring in the region. However, there is a danger that some of the components, inputs, capital goods, and support services will actually be provided by the Yangtze River Delta region, particularly given its reputation as a centre for technology and for capital goods industries. If this occurs, the development potential of the Pearl River Delta region might be blunted. The Yangtze River Delta region, for example, has been attracting more IC investment and more facilities for notebook computers (considered more sophisticated than the desktop computers produced in the Pearl River Delta region) than the Pearl River Delta region.

WTO, Market Development, Infrastructure, and China’s Regions

There are a number of features that will have dramatic impacts on China’s regional economies. These include further market development in China, China’s accession into the WTO, and the development of the national highway and railway systems. Each is likely to contribute to the development of a single national market within China. The speed of this development could have a profound impact on the relative position of the Pearl River Delta region and the position of the Greater Pearl River Delta region in China’s economy.

As China’s economy develops further, more and more purchases will be made on the basis of the quality and price of the goods and services and less and less on the basis of influence and local pressure. In addition, as local governments face harder and harder budget constraints, they will be less able to subsidise money-losing local enterprises. The likely result is a rise in the importance of market forces and a reduction in local barriers to trade. At the same time, the development of the national highway and railway systems should substantially ease the transportation of goods around China, thus expanding the ability of factories to serve national markets. In addition, WTO entry is likely to result in further pressure to reduce inter-provincial barriers to trade and investment within China. While such barriers might be an annoyance to local Chinese firms, when used against foreign
firms investing elsewhere in China, they are likely to precipitate WTO disputes. All of these features would serve to move China from a group of segregated regional markets more toward a single national market.

The speed with which China develops a single national market will influence the relative position of the Pearl River Delta in the future. The export-oriented industries of the Pearl River Delta have been meeting world quality and cost standards for nearly two decades. If the Chinese market becomes a single national market before some of the other areas in China can develop a real sense of satisfying customers and serving the market, then companies from the Pearl River Delta could well become entrenched as leaders across a substantial range of industries for the entire Chinese domestic market. If on the other hand, it takes a long time before the Chinese Mainland becomes anything like a single national market, then one might expect that other places in China will have sufficient time to learn more about the market before faced with direct competition from the Pearl River Delta region.

China has several regions that will be important contributors to the national economy. The Pearl River Delta region is well positioned to continue as a leader in terms of China’s export economy. As for which regions will do the best in the Chinese domestic market in the future, it is hard to bet against the Pearl River Delta region, particularly given its linkages with the rest of the Greater Pearl River Delta region. At the end of the day, one is left with the question: Which region will respond best to the development of a single national market in China, a region that has been meeting world quality and cost standards for nearly two decades, or a region that has not? The obvious answer to this question should indicate that the Pearl River Delta region is likely to be an economic force to be reckoned with in both the domestic and export markets well into the future.
The economic interaction between Hong Kong and the Pearl River Delta region has become increasingly extensive since the onset of China’s reform programme. This interaction has benefitted development in all parts of the Greater Pearl River Delta region. However, while the interaction has become more extensive, what is striking is how limited the interaction actually is when compared to that between other major commercial cities and their surroundings around the world. The “one country, two systems” framework will always provide some hindrance to fluid interaction across the border. However, this means that the region should be diligent in identifying the numerous issues that affect economic interaction and should be creative in finding ways of dealing with these issues. We highlight just a few of the major issues below.

Misperceptions and Misunderstandings

There are many misperceptions and misunderstandings about the Greater Pearl River Delta region both inside and outside the region. Most people in the region do not have a firm grasp of the roles that different actors play in the different jurisdictions of the region. For example, the governments of the Pearl River Delta region have been far more directive in their approach to the economy than the Hong Kong government. The result is a mismatch in styles that can be difficult to understand and can create frustration. While the governments within the Pearl River Delta region often have the ability to commit state-owned firms or other government-linked or government-influenced firms to action, the Hong Kong government generally cannot commit Hong Kong firms to particular actions. Leaders from the Pearl River Delta region looking for the Hong Kong government to be an enterprise partner or to broker specific commercial deals are likely to be disappointed. Instead, often it is up to them to identify the right private sector firm from Hong Kong to deal with.

In Hong Kong, there is a tendency to think of the Chinese Mainland as a monolith run in detailed fashion from Beijing. In reality, the last several years have seen a dramatic increase in the ability of local governments to make decisions for themselves. This is due in part to the ongoing reform process, in part to the devolution of some economic decision making to lower levels, and in part to the fact that more local governments in the nation now have the resources to make sizeable investments without the need for Central Government funding. Thus, some critical discussions might sometimes need to take place with provincial government officials and other critical discussions with local government officials. Understanding the nature of decision making in the Pearl River Delta region is crucial for any Hong Kong-based firm wishing to do business in the region. There also is a tendency for many in Hong Kong to underrate the skills and capabilities in both the public and
private sectors in the Pearl River Delta region. This limits the range of business deals and opportunities that many Hong Kong-based business people seek out.

While there is a considerable amount of information available in Hong Kong on the Pearl River Delta region and in the Pearl River Delta region on Hong Kong, this does not appear to have been translated into the deep understanding that might be necessary for improved interaction. The sources of information that do exist often are not shared widely, or are not known by people seeking opportunities in the region. For example, the lack of reliable and up-to-date information sources on all of the jurisdictions of the Greater Pearl River Delta region that are open to the public on both sides of the boundary is a hindrance to further development in the region.

Multiple Jurisdictions and Complex Decision-Making

The Greater Pearl River Delta region contains one province, one provincial capital, two special administrative regions, two special economic zones, many cities, and multiple development areas. To the uninitiated, the multiple jurisdictions present in the Greater Pearl River Delta region can make identifying the right potential partner or even regulator difficult. Even in Hong Kong, a single jurisdiction, decision making can be complex and cumbersome. Infrastructure development projects, for example, go through several departments and bureaus. In some instances, multiple departments will claim jurisdiction. In others, no department will claim responsibility. The result is a process that can take 10 to 15 years in many cases, even when the case for a given project is clear.

One manifestation of the multiple jurisdictions within the Greater Pearl River Delta region is the duplication of investments and infrastructure. The region has five major airports, in Guangzhou, Hong Kong, Macao, Shenzhen, and Zhuhai. The result has been dramatically unused capacity, particularly at Zhuhai airport. Another manifestation has been the potential conflicting development of multiple ports around the region, and the multiple ports already operating around the region in Chiwan, Gaolan, Guangzhou, Hong Kong, Shekou, and Yantian. Another manifestation is duplicative investments in science and technology parks in nearly every major jurisdiction in the Greater Pearl River Delta region.

Multiple jurisdictions make coordinating planning around the Greater Pearl River Delta region extremely difficult. There have been a number of meetings between officials from the region and China’s State Development Planning Commission (SDPC) on coordinating infrastructure development in order to reduce duplication of investments. The goal is to
take full advantage of existing infrastructure. The SDPC also has committees studying coordination among the ports, airports, and other infrastructure development. Despite the involvement of the SDPC, it remains difficult to coordinate activities in the Greater Pearl River Delta region. Although in theory the SDPC must approve large projects that involve the Chinese Mainland, in reality the decentralisation programme has moved much infrastructure planning to provincial or local governments. The SDPC does act as a gatekeeper, but one that hesitates to intervene too heavily in local plans.

A Limited View of Cooperation

In Hong Kong, cooperation with the Pearl River Delta region is often couched in terms that seem designed to benefit Hong Kong without too much regard for the benefits that might accrue to the rest of the region. Hong Kong entities want access to the Pearl River Delta for themselves and for their firms, but do not seem to want the same access to Hong Kong for people and firms from the Pearl River Delta region. Some people in Hong Kong want easy flows across the border to Shenzhen in order to capture a greater portion of goods transport and logistics, but seem not to want easy flows of people across the border that might create some downward pressure on property prices in parts of Hong Kong. In a number of instances, Hong Kong people have sought Central Government intervention or policies for the “good of Hong Kong” rather than for the good of the Greater Pearl River Delta region. There have even been reports of Hong Kong companies lobbying officials in Beijing to slow or stop some of the development plans of other jurisdictions within the Greater Pearl River Delta region.

In the Pearl River Delta region, the view of cooperation with Hong Kong tends to be equally limited. Pearl River Delta region jurisdictions want Hong Kong to contribute to the jurisdiction’s plans, often with little concern as to whether this contribution makes sense for Hong Kong. While some jurisdictions are seeking cooperation with Hong Kong that would benefit all sides, others have a more parochial view. Some jurisdictions in the Pearl River Delta region hope that Hong Kong and Hong Kong entities will teach them about international markets, in part so that they can displace Hong Kong and bypass Hong Kong for the activities that the Hong Kong SAR performs. Other jurisdictions hope that Hong Kong or Hong Kong entities will bail them out of bad investments that have been made in the past. Some individuals seem surprised or even insulted when Hong Kong and Hong Kong officials do not respond to proposals of questionable benefit to Hong Kong.

If there is to be true cooperation within the Greater Pearl River Delta region, then people from the different jurisdictions will have to take into account the interests of others when
they propose cooperative ventures. Lack of understanding at this points limits this potential. There also has to be a sense of there being positive sum rather than negative sum outcomes if there is to be true cooperation. Particularly aggressive actions on the part of one jurisdiction in one area will have an impact on willingness to cooperate in other areas. When Guangzhou decides to go ahead with a major investment with important ramifications for the rest of the region without warning or consultation, when Shenzhen plans to lure thousands of multinational headquarters and offices away from Hong Kong, and when Hong Kong interests lobby against the interests of other jurisdictions, it is hard to find common ground in other areas, even if there is the potential for positive sum, win-win outcomes.

The Implications of a Polycentric Region

The Greater Pearl River Delta region is a polycentric region. There are multiple centres in the region and each have their strong points and weak points. The unique political and historical circumstances in the Greater Pearl River Delta region means that no single centre will dominate, as is the case in the Yangtze River Delta region. Guangzhou, with its provincial political, administrative and distribution roles, will always be an important centre. Hong Kong, with its wealth, international linkages, and special status also will be an important centre. Shenzhen also has emerged as a strong centre in its own right, as will other cities in the Greater Pearl River Delta region. In essence, the Pearl River Delta region is more like the Randstadt region of the Netherlands, in which there is a political centre (The Hague), a business and commercial centre (Amsterdam), a port and logistics centre (Rotterdam), and an education centre (Utrecht), among others. In fact, the greater Pearl River Delta region is far more fragmented than the Randstadt, since different jurisdictions are not so closely controlled by the national government.

Given the historical circumstances of the Greater Pearl River Delta region, the major centres are used to having pretty much their own way without having to worry too much about their neighbours. Hong Kong and Macao were under foreign administration until 1997 and 1999 respectively, while the Special Economic Zone status of Shenzhen and Zhuhai gave them a great deal of autonomy. The fact that foreign investment drove the economies of Shenzhen and Dongguan meant that they were not so much in the orbit of Guangzhou or even the Guangdong Provincial Government. For many years, the interactions within the Greater Pearl River Delta region occurred in a decentralised fashion, with linkages developing based on family, cultural or business ties. While these linkages have allowed the Greater Pearl River Delta region to flourish, this very success has resulted in a situation in which each jurisdiction in the region will perhaps be more dependent on the other jurisdictions in the region than it has been in the past. Given the newness of this situation,
it is not surprising that it will take time for the relations between different jurisdictions to be worked out.

**Connectivity Between Hong Kong and Shenzhen**

One of the major issues affecting greater economic interaction between Hong Kong and the Pearl River Delta region is connectivity across the boundary between Hong Kong and Shenzhen. This was the number one issue identified by Hong Kong interviewees for the present project. In fact, many stated that if this problem were solved, many of the other issues regarding further economic interaction between Hong Kong and the Pearl River Delta region could more or less solve themselves. Since the value of the interaction within the Greater Pearl River Delta region depends on connectivity, this is a major issue.

The existing crossings between Hong Kong and Shenzhen often get swamped with travellers. Delays in the order of two hours or more are common for passengers crossing the border. The One Country Two Systems Research Institute estimated that the equivalent of more than 2 million working days was lost in 1999 through border-crossing delays. Given the rise in cross-border traffic since then the figure must be much higher today. Trucks trying to cross the border often have to wait four hours or more. The wait virtually doubles the cost of trucking goods from the Pearl River Delta region to Hong Kong, since the trucks generally can make only one trip, rather than two trips per day. The delay adds costs and reduces efficiency throughout the entire system and may push some shippers to choose Pearl River Delta region ports even if their first choice would normally be Hong Kong. In addition, given that according to industry sources roughly 25,000 goods vehicles cross the boundary every day, an average wait of four hours translates into more than 100,000 hours of idling engines polluting the atmosphere every day due to delays at the border.\(^1\)

Delays at the border can put the entire Greater Pearl River Delta region production chain at risk. In addition to the costs associated with inefficiency and lost time, there are potentially much larger costs involved. International buyers have reported that it can sometimes take less time to fly from Hong Kong to Shanghai and reach factories in the Yangtze River Delta than it takes to go from Hong Kong to parts of the Pearl River Delta region. If this is the case, the buyers say, then why not source in the Yangtze River Delta region and locate buying offices in Shanghai? One of the key disadvantages that the Greater Pearl River Delta region has with respect to the Yangtze River Delta region is delay at the border. This prevents the Greater Pearl River Delta region from taking full advantage of the synergies present in the region.

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In response to increasing cross-border flows of goods and people, officials from Guangdong Province and Hong Kong have met to develop plans to improve the flows. The hours of the Lowu and Huanggang checkpoints were extended in 1998. Those of the Sha Tau Kok and Man Kam Do checkpoints were extended in 1999. Although many in the business community in Hong Kong called for 24-hour-per-day border crossing, the two governments announced that 24-hour crossing would be a “long-term goal.” This was most likely in response to fears in Hong Kong that 24-hour border crossing would result in a decline of Hong Kong real estate prices and retail sales. Although studies of the issue indicate that the likely effect would be small, the governments have chosen to be cautious.

The main sentiment that we heard from business people from the Greater Pearl River Delta region is that the border crossing issue needs to be dealt with immediately. They were not content to wait years until solutions could be planned, developed and implemented. Instead, several claimed that if it took that long to solve the issue, they or their business would be long gone by then.

**Connectivity Between Hong Kong and the Western Pearl River Delta**

Connectivity between Hong Kong and the western part of the Pearl River Delta region has arisen as a topic of great interest recently. The Pearl River Delta and Hong Kong highway transport grid lack a link south of the Humen Bridge between the western and eastern shores of the Delta. Such a link would complete a transport circuit facilitating circular cargo and people flows within the Greater Pearl River Delta region. In Hong Kong, there have been debates over the merits of a bridge between Hong Kong and Zhuhai and Macao. In the Pearl River Delta region there have been plans mooted for links between Zhuhai and Shenzhen. We believe that much of the public discussion has been limited in terms of its outlook and level of implied analysis.

Much of the public discussion and analysis that has been done appears to focus on the movement of containers and the potential impact of a link on the volume and distribution of container port activities around the Greater Pearl River Delta region. Our research indicates that the focus of analysis needs to be much broader than container traffic. The key issues for links between the eastern and western sides of the Pearl River Delta region do not have to do so much with container traffic as with flows of investment, expertise, management, knowledge, service provision, and people. Much of the development of the eastern part of the Pearl River Delta region has been linked to Hong Kong in one way or another. As we have indicated earlier, there is a “magic three hours” that limits the preferred scope of Hong Kong-based owners, investors, service providers, and buyers. The huge
disparities in terms of the passenger flows, goods flows, investment flows, and trade flows between the eastern and western sides of the Delta can be explained by the fact that this three-hour radius currently includes the eastern and central parts of the Delta.

The discussion should focus on the potential economic development benefits for both Hong Kong and the Pearl River Delta region of an east-west link. One thing that is clear is that one traditional method of assessing the need for infrastructure, identifying the present traffic between two locations, calculating the past growth in this traffic, and then projecting the same growth rate into the future to assess when some threshold level of demand would be reached, is completely inappropriate for looking at proposals for connectivity between the eastern and western sides of the Pearl River Delta region. It is completely inappropriate because in the case of the eastern side of the Delta the links have created their own demand that has been far more than any traditional projection mechanism would have indicated.

As was indicated in Chapter 3, in 1980, Shenzhen and Dongguan (the two jurisdictions just north of Hong Kong on the eastern side of the Pearl River Delta) had a combined GDP that was nearly identical to the combined GDP of Zhuhai and Zhongshan (the two jurisdictions just north of Macao on the western side of the Pearl River Delta). By 2001, the combined GDP of Shenzhen and Dongguan, RMB 253.36 billion, was more than three times that of Zhuhai and Zhongshan, at RMB 72.91 billion. Much of this difference could be ascribed to the difference in exports and foreign investment. In 2001, the combined exports of Shenzhen and Dongguan, RMB US$56.46 billion, were nearly seven times those of Zhuhai and Zhongshan, at US$8.15 billion. The combined utilised inward investment of Shenzhen and Dongguan in 2001, US$5.42 billion, was more than twice that of Zhuhai and Zhongshan, at US$1.94 billion. Much of the difference in performance could be attributed to the eastern side’s better linkages with Hong Kong and the capital, management, technology, services, and other benefits resulting from those linkages.

If a direct link between Hong Kong and the western part of the Delta allowed Zhuhai and Zhongshan to close the development gap with Shenzhen and Dongguan by even a fraction, the result could be a benefit to the western part of the Delta of hundreds of billions of renminbi in GDP, tens of billions of US dollars in exports, and billions of US dollars in foreign investment per year. It should be noted that in this regard a link between the western part of the Delta and Shenzhen is not nearly a good substitute for a link with Hong Kong. After all, it was not capital and expertise from Shenzhen or Guangzhou that helped develop Dongguan, it was capital and expertise from Hong Kong. While a link to Shenzhen would facilitate cargo flows to Shenzhen’s ports and maybe to the port of Hong Kong, it would be less likely to foster as direct links for owners, investors, service providers, and buyers.
For Hong Kong, a bridge would bring much of the western Delta area into easy contact for all types of businesses, investments, and services. If a bridge were to allow the Hong Kong SAR to expand its exports of trade-related services and transportation services by just ten percent, it could mean nearly 56,000 jobs and HK$20 billion in additional service exports per year (using year 2000 figures for employment and trade in services). When we realise that a bridge would be a long-lived investment, with a life of 30 years, 40 years, or more, we see that the value of a bridge to the region is likely to dwarf all the figures that have been estimated as the costs of such an undertaking (which have ranged from HK$16 billion to HK$29 billion, depending on the source and route).

**Export Processing Regulation**

One of the striking features of most of the manufacturing in the Pearl River Delta region is the low percentage of value added in the region’s industrial output. Local value added equalled 27.2 percent of gross manufacturing output in the PRD in 2000. For the largest of the region’s manufacturing industries, the figure was even lower. If the Pearl River Delta region could reach a local value added of 35 percent of gross industrial output, it would add over RMB 80 billion per year to the GDP of the region. This means that adding more value in the Pearl River Delta region could be of great economic benefit. While the percentage of value added has been on the rise, China’s existing export processing regulations are hindering the deepening and upgrading of portions of the Pearl River Delta region’s manufacturing base. The regulations were developed at a time when virtually all components and inputs had to be imported. These components and inputs were imported and assembled in the Pearl River Delta region and were then exported. Components and capital goods used in such “one-step” or “simple” processing were allowed into China on a duty-free basis.

Today, however, supplier networks have developed for many of the components and inputs needed by Pearl River Delta manufacturing locations. This makes it possible to engage in “multi-step” or “deep” processing with several production steps and a mix of imported and locally produced components. For many firms, however, the customs treatment of this type of manufacturing is so uncertain and complex that either they do not perform multi-step operations in the Pearl River Delta, or they wind up sending semi-finished goods to Hong Kong only to re-import them into the Pearl River Delta region to use as inputs to final production. This adds to cost and reduces the value added in manufacturing industries in the Delta. In addition, it creates an obstacle to further development into components and inputs in the Pearl River Delta region.
The export processing regulations did not foresee a time when the Pearl River Delta region would possess the skills and capabilities to supply components and inputs to export industries. They also did not foresee that China would eventually open its markets and that many of the export-oriented factories would wish to sell into the domestic market. Selling into the domestic and international markets clearly raises issues about duty-free entrance for components. It also raises issues about duty-free entrance for capital goods. If a factory that imported its capital goods on a duty-free basis wishes to sell into the Chinese Mainland, Chinese Customs authorities often levy duties on the original purchase price of the equipment rather than its depreciated value. Such levies can make it non-economical to sell in the domestic market for many firms. The absence of clear standards and regulations concerning such equipment prevents many firms from exploring Mainland markets.

The thousands of small and medium-sized Hong Kong invested firms that run into these issues often do not have the resources or influence to ensure a reasonable outcome. Nor is the professional expertise necessary to deal with the customs issues widespread in the Pearl River Delta region. This is an area in which Hong Kong-based expertise could identify and apply international standards to develop reasonable standards for the depreciation of fixed assets and treatment of imported components and inputs. Then the Hong Kong government should be able to work with local governments in the Pearl River Delta region to bring proposed solutions to the attention of the Central Government and the Guangdong government.

**The Producer Services Gap**

The Pearl River Delta region has large unmet demand for a wide range of producer services. Historically, the service sector has been looked down upon or even frowned upon in the People’s Republic of China. In the 1950s, 1960s, and 1970s, the focus always was on agricultural and industrial development. Many of the services that were necessary to keep production going were simply provided in-house by state enterprises. The service sector was viewed as unproductive or even parasitic in some quarters. Although these attitudes have changed since China began its reform programme, a planning mentality run by people with engineering and production backgrounds has left the nation ill-equipped to provide high-level services. Historically, the Pearl River Delta region was perhaps even more backward than most other parts of the Chinese Mainland when it came to the service sector.

The growth of the region’s manufacturing base and the subsequent diversification of the economy have given rise to tremendous demand for producer services of all kinds. At the
same time, the rise in consumer incomes and the withdrawal of state enterprises from providing many social services, such as housing, education, healthcare, and social security, has dramatically increased demand for consumer services. Despite this rise in demand, the development of the service sector in the Pearl River Delta region remains slow. In 2000, for example, the tertiary industry accounted for 39.3 percent of Guangdong’s GDP, 46.5 percent of Shenzhen’s GDP, and 52.6 percent of Guangzhou’s GDP. The typical advanced national economy has a service sector that accounts for more than 70 or 75 percent of GDP. Leading commercial cities in such economies typically have more than 80 or 85 percent of their GDP in the service sector. In Hong Kong, for example, the service sector accounts for 86 percent of GDP. Roughly three quarters of Hong Kong’s service GDP was in producer services, while less than one half of Guangzhou’s service GDP was in producer services. Thus producer services equal roughly three-fifths of Hong Kong’s GDP and only around one-quarter of Guangzhou’s GDP. When we realise that Guangzhou has the most producer service-intensive economy in the Pearl River Delta region, we can see the magnitude of the gap. ²

Ironically, the types of producer services that are needed most in the Pearl River Delta region, transportation services, trade-related services, accounting, advertising, consulting, and financial services, are precisely those that Hong Kong specialises in. On the surface, there would appear to be massive scope for Hong Kong service firms to contribute to the further development of the Pearl River Delta region. However, there are numerous barriers to Hong Kong service providers actually providing their services in the region. As indicated above, there are several service sectors in which foreign firms are excluded from the market of the Chinese Mainland and there are others where regulations sharply limit the activities that foreign service companies can provide. Although many of these will open substantially under China’s WTO accession agreement, such opening in China seems to be considered a concession to foreign governments more than an important means of accelerating China’s own economic development.

The Pearl River Delta region may be affected disproportionately by restrictions on foreign service sector firms. One reason is that the economy in the Pearl River Delta region is in many ways more advanced than the economies in most other places in China. As a result there is greater demand for more advanced services, and service restrictions represent a more immediate constraint to development. In addition, given its relatively recent development, the Pearl River Delta region has less of a legacy of service sector firms that

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² Numbers taken from statistical yearbooks of Hong Kong, Guangzhou, and Guangdong. Professor Anthony Yeh of the University of Hong Kong has reached similar conclusions. See Anthony Yeh, “The Hong Kong-Pearl River Delta Producer Services Linkages,” CUPEM, University of Hong Kong, 2002.
might be hurt by foreign competition. A third reason is that in some service industries, such as legal services, foreign companies are restricted to a single office. In such cases, many foreign firms choose Beijing or Shanghai rather than Guangzhou or Shenzhen, and thus do not have a presence in Pearl River Delta region cities that could use their services equally well. On the other hand, the Pearl River Delta region has been given more flexibility to experiment with service sector openness than other parts of the Chinese Mainland. Shenzhen and Guangzhou have been opened relatively early to foreign service providers in some sectors.

Finally, a further barrier to greater participation by Hong Kong firms or offices in the Pearl River Delta region is the lack of market knowledge of the Hong Kong firms themselves. Many firms based in Hong Kong, particularly small and medium-sized firms, do not have sufficient knowledge of the Pearl River Delta region markets to sell successfully. While many Hong Kong firms have educated themselves about business in the region, many other firms have not. They will need a substantially more aggressive attitude if they are to compete and succeed in the Chinese Mainland. In any case, if greater interaction between Hong Kong and the Pearl River Delta region, perhaps through an easing of restrictions on Hong Kong service providers in the Pearl River Delta region, allows to increase the portion of the region’s GDP in the service sector by five percent, it could result in an additional RMB 35 billion to RMB 40 billion in GDP per year. This clearly is a substantial addition to the local economy.

The Potential for a Single Market within the Chinese Mainland

China today is not a single national economy, but a series of sub-national regional economies. This is due to support of provincial governments for local firms and resulting trade barriers; a transportation system that historically has faced many challenges; and a lack of national companies with advanced distribution capabilities. The combination of infrastructure development, greater market orientation, and WTO accession could make the market of the Chinese Mainland much more unified. In a more unified market, it will be possible for some areas to extend their positions in domestic competition beyond what has been the case to date.

The development of the national highway, railway, and inland waterway systems should substantially improve the flow of goods in China, dramatically expand the efficient catchment area for China’s ports, expand the use of multi-modal transportation, and contribute to the eventual creation of a single national market. In addition, such
developments could foster the emergence of a small number of cities that develop as the logistics and transportation centres for the entire Chinese Mainland. The Pearl River Delta region, with its advanced logistics capabilities and international linkages, is likely to play a strong role in the future as a centre for South and West China, and as a link between China and the rest of the world.

WTO accession will create pressure to reduce the barriers to trade between Chinese provinces. Discriminating against a Chinese company from another province is one thing, discriminating against a foreign company producing in another province in China is a WTO dispute in the making. The foreign logistics and distribution companies that will be able to operate in the Chinese Mainland under the WTO agreement will prove far better at setting up efficient national distribution systems than have been in place in China to date. WTO entry will also enhance the push toward a market economy in which underlying competitiveness and efficiency will become increasingly important in determining business outcomes. As market orientation progresses, it will be more and more difficult for local governments to support or subsidise money-losing enterprises. Each of these features should further the trend towards a national market.

A single national market will mean that the competitiveness of different regions will determine where most production takes place. China’s regions vary enormously in terms of their competitiveness. The Pearl River Delta region has literally tens of thousands of firms and facilities that have been operating at world quality and cost standards for a long time. As China becomes more of a single national market, producers from the region should have an easier time selling throughout the Chinese Mainland. Given the state of reform and of market-oriented development, it is probably in the Greater Pearl River Delta region’s best interest for the Chinese Mainland to develop a single national market as soon as possible.

**Potential for South and Southwest China**

There is a potential for the Greater Pearl River Delta region to become more integrated with the rest of South and Southwest China. Improvements in transportation within the Greater Pearl River Delta region along with the railway and highway development in Western Guangdong has the potential to link the Greater Pearl River Delta region directly into Guangxi Province and then into the Southwest Chinese provinces of Yunnan, Guizhou, and Sichuan. In 2001, the GDP of Guangdong was RMB 1064.8 billion, that of Guangxi RMB 223.1 billion, Yunnan RMB 207.8 billion, Guizhou RMB 108.2 billion, Sichuan RMB 442.2 billion, and Chongqing RMB 175.0 billion. The total GDP of these southwestern
In addition, these areas lack a major seaport, as well as international linkages. It is also hard for the influence of other major Chinese cities, such as Shanghai, to reach there. The advantages of the highly externally oriented Hong Kong and the Pearl River Delta region economies could therefore be brought into full play.

In addition, if China and Southeast Asia are to establish a “10 plus 1 Free Trade Area” in the future, Southwest China could become the centre of the world’s biggest free trade area. The Pearl River Delta region in general, and Hong Kong and Guangzhou in particular, could benefit from a wide range of activities linking China with Southeast Asia. As an internationally oriented economy with close links to Southeast Asia, Hong Kong is positioned to become the bridgehead for investors from the Chinese Mainland to invest in Southeast Asia. Of course all of this depends on the ability of the Greater Pearl River Delta region to form close links with Southeast Asia and Southwest China.

**Competition Between the Greater Pearl River Delta Region and the Yangtze River Delta Region**

Although a large portion of the economies of the Greater Pearl River Delta region and the Yangtze River Delta region do not compete directly, in recent years, there has emerged increasing competition between the two regions. There are several aspects to this competition. One is competition for foreign direct investment. The general perception these days in the international investment community is that the Yangtze River Delta region has several advantages over the Pearl River Delta region. These include: the size of population and economy, location, linkages between city and hinterland, workforce capabilities, government support, business tradition, the perception of the Yangtze River Delta as “first tier” and the Pearl River Delta as “second tier”, and the more unified development of the Yangtze River Delta region. In contrast, the Pearl River Delta region benefits from links with Hong Kong, its strong position in international trade and investment, its history of reform and development, flexibility, attraction of skills and resources from around China, and embedded clusters of internationally successful industries.

Another aspect of the competition between the regions is competition in the export markets and in the domestic market. To date, producers in the Greater Pearl River Delta region have obtained strong positions in the major advanced country markets. In contrast, the

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Yangtze River Delta region has been building up exports to developing nations. Increasingly, the two regions are beginning to compete in export markets. The two regions also have become the major producers for many manufactured goods for the entire Chinese Mainland. As a result, they face increasing competition in the burgeoning local market as well. Hong Kong and Shanghai may see additional competition over the location of China management centres, as well as buying offices and logistics activities.

There are several keys to this competition for the Greater Pearl River Delta region. One is the need to draw on regional strengths to combat regional competition. It is far more likely that the Greater Pearl River Delta region will prosper if it finds ways to coordinate sufficient activities in order to meet the competition from the Yangtze River Delta region. This could include joint promotion, cooperation on infrastructure and the environment, the development of collaborative organisations across the Greater Pearl River Delta region and a greater sense of regional identity.

The Environment

The environment is another important issue facing the Greater Pearl River Delta region. Rapid growth and development has created substantial demands for environmental resources and substantial pollution problems. Despite growing environmental degradation, it is only recently that the environment has obtained a place on the agenda in the jurisdictions of the Greater Pearl River Delta region. One problem has been the sheer pace of development that has left the infrastructure for water treatment lagging behind in some jurisdictions. Another problem has been that of fragmentation of jurisdiction. The pollution created in one jurisdiction might have much of its impact in another jurisdiction, for example. This creates two counterproductive dynamics. The first is the idea that it does not make sense to crack down on local pollution, because the effect might appear elsewhere. The second is the idea that much of the pollution comes from somewhere else so that it doesn’t matter if a jurisdiction adds to pollution at home. Another issue is the apparent lack of initiative on the part of governments in the region to make enforcement of environmental regulations a high priority. In some jurisdictions fines are levied, but the practices are not curtailed. As a result, factories and vehicles are left to pollute more or less at will. Since it often is cheaper to pay the fines than to fix the problem, they continue to do so.

In recent years, the governments in the region have become more active in trying to control pollution. In Hong Kong, the government realises that its efforts to make Hong Kong “Asia’s World City” could be hindered by an environment that mobile professionals find unattractive. Shenzhen has declared its intention to have a modern, clean, sustainable
economy. The Guangdong government has announced efforts to decrease or clean up water pollution in the region. The environment has been one issue on which there has been significant cross-boundary discussion. Recently, an emissions trading system has been discussed for the region. After virtually no cooperation on environmental issues prior to 1997, in recent years the Hong Kong and Guangdong governments have reached agreements to study air pollution, to protect common waterways, to establish a forestry and conservation group, to strengthen cooperation in improving the quality of water from the Dongjiang River, and to strengthen cooperation and communication on urban planning and related environmental issues.

Of particular interest, at least to Hong Kong, have been efforts focused on the Dongjiang River and on air pollution. The Dongjiang River is the main source of water for both Hong Kong and Shenzhen. The rise of local industry and local population growth have put strains on this water source both in terms of quality and quantity. In Hong Kong, unhealthy air pollution levels have resulted in calls for cooperation with the Pearl River Delta region to reduce emissions from the Delta’s factories.

Whatever steps are taken, the Greater Pearl River Delta region will continue to face environmental challenges. Further economic growth is likely to attract more factories and more people, and therefore, generate more pollution. In addition, as the Pearl River Delta region becomes more affluent, the growth in automobile traffic is likely to cause even more air pollution. Even if individual factories, plants, or vehicles become cleaner, an expansion in their numbers may result in worse pollution than has been the case to date. This makes education about the detrimental impact of environmental degradation and enforcement of environmental legislation even more important than it might be otherwise.

**Challenges Associated with “One Country, Two Systems”**

The “one country, two systems” formula under which Hong Kong was returned to Chinese administration has generally been considered a success by the local and international business communities. In the first years after the transition, the focus was mostly on establishing the “two systems” component of the arrangement. More recently, local and foreign business people have begun to focus more on the potential advantages of the “one country” component.

In this regard, the “two systems” component clearly creates some obstacles. The formula involves border crossings, customs checks, and the inconvenience involved in dealing
with both. It involves treating Hong Kong firms and the Hong Kong offices of foreign multinationals as foreign firms in the Chinese Mainland. This reduces their ability to participate in some sectors of the Pearl River Delta region economy and entails restrictions in other sectors. Notably, it makes it difficult for Hong Kong-based firms or offices to provide services to the surrounding area the way most major commercial cities elsewhere in the world do.

In addition, the “two systems” formula makes it difficult for highly skilled or qualified people from the Chinese Mainland to come to Hong Kong to work. This limits Hong Kong’s ability to attract the senior management activities of firms from the Pearl River Delta region and makes it difficult, though not impossible, for Pearl River Delta firms to use Hong Kong as a base for international operations. On the other hand, the “two systems” formula also makes it less likely that Hong Kong people will move to the Pearl River Delta region to take up jobs that might be appropriate to their skill levels. Although in recent years there has been much more flexibility in this regard, and Hong Kong’s Census and Statistics Department estimates that 190,800 Hong Kong residents now live and work in the Chinese Mainland, mostly in the Pearl River Delta region, the different systems result in a far less fluid situation than is the case in most cities.

Despite the difficulties created by the “two systems” aspect of “one country, two systems”, it should be remembered that this formula was designed for very specific purposes. One purpose was to allow Hong Kong to preserve a system that had benefitted not just Hong Kong, but the Pearl River Delta region (and the rest of the Chinese Mainland as well). Until the Chinese Mainland has a completely open economy, and even beyond, it will benefit from the more open system in Hong Kong. Many of the advantages of Hong Kong that contribute to its competitiveness, as well as the competitiveness of the entire Greater Pearl River Delta region, are rooted in its separate system. Thus, the vast majority of our interviewees in Hong Kong and in the Pearl River Delta region supported the continuation of the two systems. The challenge faced by Hong Kong is how to promote greater economic interaction with the Pearl River Delta, while maintaining the integrity of its separate system and minimising the obstacles to further economic interaction.

The Closer Economic Partnership Arrangement (CEPA)

In late 2001, the Foreign Trade Minister of the People’s Republic of China, Long Yongtu indicated that the Central Government was actively considering the establishment of a “Free Trade Area” including Hong Kong and the Chinese Mainland. After several discussions, the target has been set at a “Closer Economic Partnership Arrangement” (CEPA)
between the HKSAR and the PRC. The premise for CEPA would be that Hong Kong should be allowed, without violating the WTO rules, to enjoy the benefits of further opening up of the Chinese economy before other jurisdictions. At the same time, the Chinese Mainland could use entry by Hong Kong businesses as a test and a way to gain experience before opening to other economies. This would make it possible for the Mainland to gain ground while opening up the financial and other sectors, and to extend the opening-up policies to other countries and regions only after gaining experience in Hong Kong.

While in theory CEPA seems simple, in reality there are a number of practical problems associated with the negotiation and implementation of such an agreement. Progress on promoting “zero-tariffs” for commodity trade between Hong Kong and the Chinese Mainland has been relatively fast. The implications, however, are in practice not that far-reaching. After all, Hong Kong already is a free port with few duties on imports and Hong Kong’s domestic exports to the Chinese Mainland are not that significant.

Opening up to Hong Kong service providers, however, is potentially more problematic. Hong Kong has prided itself in treating all companies in most sectors the same, regardless of whether their original place of incorporation is Hong Kong or elsewhere. Since many of the world’s leading service multinationals have operations in Hong Kong, opening to “Hong Kong firms” (as traditionally defined in Hong Kong) would potentially open China’s service sectors to the rest of the world in advance of the WTO timetable. A restrictive definition of “Hong Kong firms”, on the other hand, could put an end to equal treatment of firms in Hong Kong. Another issue is that the WTO agreement included threshold levels (in terms of assets, sales, or capitalisation) for the size of firms that would be allowed to enter the Chinese market. Since most of Hong Kong’s service providers are small or medium-sized firms, a lower threshold level might be required if Hong Kong firms were actually to enter the market.

**The Impact of China’s Entry into the WTO**

Last but certainly not least, in terms of issues that will affect the economic interaction between Hong Kong and the Pearl River Delta region, is China’s entry into the WTO. Entry into the WTO will have different impacts on different industries. In garments and textiles, entry will allow China access to larger quotas in foreign markets and will allow it to participate when the quota regime is phased out in the future. In electronics goods, Chinese producers have had relatively free access to international markets, but membership in the WTO will allow producers active in China a greater comfort level that this market access will be extended and that China has a means of combating protectionism in other
markets. In heavy industries, like steel and chemicals, WTO membership is likely to open China up to much tougher competition from imports than has been the case in the past. In other industries, such as automobiles, WTO entry has provided a stimulus for foreign firms to invest into an industry in which domestic producers were mostly inefficient. In parts of agriculture, WTO entry could create tremendous difficulties as China struggles to improve productivity in order to keep pace with imported goods. In general, in goods markets, WTO entry will allow the export-oriented firms of the Pearl River Delta region to perhaps expand their markets, while the industries that will be hardest hit are not generally found in the Pearl River Delta region.

Entry into the WTO also will have far-reaching implications for the service sector in China. Under its WTO accession agreement, China has promised a substantial liberalisation in a wide range of service industries. In general, this should benefit the parts of China that are best able to attract foreign investment in the service sector and are best able to use this investment to help develop the local economies. In this regard, the Pearl River Delta region, with its proximity to world-class service providers based in Hong Kong, should be a strong beneficiary. The question will be how far and how fast the various sectors will open and how creative Hong Kong and Pearl River Delta region-based providers will be in developing the opportunities.

The Issues in Perspective

There are clearly several issues that will influence the way in which Hong Kong interacts with the Pearl River Delta region in the future. How the issues are dealt with will determine whether the Greater Pearl River Delta region as a whole, as well as its constituent parts, is able to progress. The issues addressed here give rise to a series of implications that will be addressed in the next chapter.
The Greater Pearl River Delta region has been one of the world’s economic success stories in the past two decades. The region also is poised to take advantage of China’s growth, opening, and entry into the World Trade Organisation (WTO). The economic trajectory of the region as a whole, as well as individual jurisdictions within the region, shows substantial promise. The level of economic interaction within the region will undoubtedly grow significantly. Greater openness in the region and economic forces will bring about additional interaction, even if no specific steps are taken. However, there are several implications that can be drawn from the above analysis as jurisdictions in the region seek further benefits through greater interaction. In particular, there are a number of lessons from past successes and current bottlenecks that should be learned and used to formulate policies and strategies that maximise the benefits of economic interaction within the Greater Pearl River Delta region.

**Build off Past Success**

The success of the economies of the Greater Pearl River Delta region over the last few decades would indicate that strategies, programmes, and policies in the future should build off this success. This means that sources of past success should be understood, extended, and built upon rather than discarded.

**Value both “on plan” and “off plan” development in the Pearl River Delta**

The various Five Year Plans of Guangdong Province and the various jurisdictions within the Pearl River Delta have sent strong signals that have influenced development in the region. At the same time, part of the genius of development and development planning in the Pearl River Delta region has been the fact that top-down plans have been enforced only loosely. The result has been a flexibility that has allowed investors to invest and businesses to grow even if they were not necessarily within the official plans. In recent years, planning in the region has become more indicative than directive. The ability to build businesses both “on plan” and “off plan” will continue to be critical to the Pearl River Delta's development. This requires a continuing flexibility in policies and administration that will allow firms the opportunity to adjust to market conditions and to develop new opportunities regardless of whether they are specified in any economic development plan.
Small and medium-sized enterprises have powered growth in the region

In some parts of the Greater Pearl River Delta region, there is a tendency to claim that development through the growth of small and medium-sized enterprises is disorderly and inefficient. As a result, there are plans to try to consolidate industries and support the development of larger companies. This approach flies in the face of a reality in which small and medium-sized firms have been major engines of development in the Greater Pearl River Delta region. While the region can and will be the home of a number of large firms, this need not be at the expense of small and medium-sized companies. The natural mechanism for large firms to develop is to have an environment that supports entrepreneurship and then allows access to capital markets for the companies that are the most effective and efficient. This allows successful firms to grow to become strong large firms. Any policy regime that hinders the ability of small firms to get started and then to grow will hinder the ability of a region to foster larger efficient firms.

Phased development is key

One of the striking aspects of the development of the economies of the Greater Pearl River Delta region has been their evolution and phased development. Even the fastest growing economies in the region have gone through processes of transformation that have taken time to evolve. While there is a natural desire to upgrade the economic base in every jurisdiction in the region, it is not possible to do so overnight. In particular, the development of parts of the Pearl River Delta from export processing, to broadening and deepening of the manufacturing base, to becoming centres of technological development will take time. Thus, while pressure to upgrade and enhance the value added in any local economy is to be welcomed, it would be unwise to push out “lower value-added” activities prematurely. This is due in part to the fact that these activities often provide a basis for further development and growth. In several Asian economies, for example, export processing in traditional industries provided an initial impetus that helped develop the skills, capabilities, markets, and environments necessary to support the development of export processing in high value-added industries, the development of higher value-added components, and higher value-added capital goods. This, in turn, helped foster the development of advanced support services and technological capabilities. There is no reason that the same should not happen in the Greater Pearl River Delta region. The fact that this process is occurring will be a strong positive factor for the region’s economy going forward.
Market orientation has benefitted the region

The growth of the Greater Pearl River Delta region has been remarkable in the contribution made by market forces. This has been true in Hong Kong, but it also has been true in the Pearl River Delta region of the Chinese Mainland. Foreign investment created facilities that have had to succeed in tough international market conditions. Local companies have emerged to take advantage of the opportunities afforded by local and international markets. The private sector contribution to the Pearl River Delta region economy has been unmatched by other locations in the Chinese Mainland. This has been one of the features that has allowed the Pearl River Delta region to be “one step ahead” of other parts of the Chinese Mainland in terms of economic reform and development for most of the last two decades.

In Hong Kong, the government has been distinctive in that outside of a small number of sectors, it has generally left economic development to the private sector and to market forces. This system allowed Hong Kong to have one of the world’s most entrepreneurial economies for decades. Given China’s growth and accession to the WTO, Hong Kong would do well to concentrate on what makes it a good environment for the senior management, information, coordination, and international linkages for any business and then let investors and markets determine the right opportunities to pursue.

A strong division of labour has developed in the region

One of the reasons for the success of the Greater Pearl River Delta region has been the development of a strong division of labour among the different jurisdictions. This division of labour has allowed different places to do what they do best and has contributed to the overall efficiency of the region. In recent years, however, there has been a tendency for different jurisdictions to desire what others in the region have. Manufacturing centres want to become service centres. Service centres want to become manufacturing centres. Every jurisdiction wants to be a technology and transportation centre. Business people and policy makers in the region should understand that each part of the region has its own advantages and disadvantages, and that the region as a whole, as well as the individual jurisdictions, would be better off if the jurisdictions developed their own specialisations and complementarities. The idea should be for each jurisdiction to develop what it can uniquely develop that contributes to local and regional prosperity. This type of development holds the opportunity of a region that is more than the sum of its parts, rather than one beset by too much imitation and duplication.
Implications for the Greater Pearl River Delta Region

**Foster a Regional Identity**

If the Greater Pearl River Delta region is to achieve the maximum benefits from economic interaction, there is a need for a greater sense of regional identity and greater sharing of information around the region. The lack of such an identity today allows the persistence of prejudices and limits the ability of people from various places in the Greater Pearl River Delta to work with each other. There are, however, a variety of ways in which a regional identity can be fostered.

**Need for a regional identity**

One of the obstacles to greater interaction between Hong Kong and the Pearl River Delta region is the absence of a regional identity. Despite the fact that most people in Hong Kong have strong ancestral or family ties to the Pearl River Delta region, and despite the extensive business and commercial links between Hong Kong and the Pearl River Delta region, there is little sense of identity and community than spans the entire area. Without such a sense, it is difficult to identify common interests, common opportunities or common challenges. A regional identity that includes both Hong Kong and the Pearl River Delta region is vital to achieving the greater levels of interaction that could benefit both sides. Such an identity must be the result of a process whereby people from different jurisdictions learn more about each other and think more in terms of regional interest than strictly local interests. The idea is to foster more of an “us with us” mentality in which joint benefits are identified and achieved, rather than an “us versus them mentality” in which parochial interests result in destructive competition.

**Need for a common name**

In order to facilitate the development of a regional identity, there should be a common name that encompasses the different jurisdictions in the area. The “Greater Pearl River Delta region” would be one such name. This region is defined to include Hong Kong, Macao, and the Pearl River Delta Economic Zone (as defined by Guangdong Province in 1994). Use of “Pearl River Delta” would create confusion between the “Pearl River Delta Economic Zone” and the wider region. Any hyphenated name, such as “Hong Kong-Macao-Pearl River Delta region” fails the test of simplicity. It also would emphasise the separateness of jurisdictions rather than the development of a single economic region. A single name for the region should highlight unities rather than separations. Although it may seem a small step, creating a name that encompasses the region, emphasises its connections rather than separations, and is simple to use, is a first step toward changing attitudes toward interaction around the region. Such a name also will make it far easier to market the region to foreign business, investors, and travellers.
Fostering exchange

In order to increase understanding within the region, exchanges, and cooperative projects of several types should be encouraged. Government to government exchanges, student exchanges, academic exchanges, social and cultural exchanges, and business exchanges could all serve to foster greater understanding within the region. Cooperative research projects designed to foster greater knowledge within the Greater Pearl River Delta region also should be encouraged as mechanisms to further understanding. Ironically, some institutions and organisations in Hong Kong seem to have more exchanges with other parts of the Chinese Mainland than with other parts of the Greater Pearl River Delta region. Exchange promotes understanding and understanding is what is needed in order for the region to maximise its potential.

Information and education

Throughout the Greater Pearl River Delta region, there is a need for information and education on a number of levels. Many people do not know the basics of the administrative, governmental, and business structures that exist in other jurisdictions in the region. As a result, there is a lack of understanding about the roles that different actors play in their respective jurisdictions and, therefore, the roles that they are able to play in joint or cooperative efforts. Many people do not know the advantages that the Greater Pearl River Delta has as a location for production, management, services, and related economic activities. Nor do many people in the region have a clear sense of all the advantages present in the region’s various jurisdictions, or how they can be combined. The compilation and dissemination of even basic information in this area would go a long way toward improving understanding around the region. This includes relatively basic information, such as demographic and economic information, as well as more complex information on the locations of specific industries, specific pockets of expertise, and specific channels that can be used for those interested in further interaction. While a number of sources put together their own information on the region, there tends to be limited information sharing. As a result, each entity seems to reinvent the wheel, putting together relatively simple information, and not going much beyond the basics. Clearly there is scope for cooperation among the governments in the region to make at least the basic information easily accessible to local and international audiences.

Don’t forget Macao

There is a tendency in Hong Kong and in other parts of the Greater Pearl River Delta region to forget about Macao. Given its small size, Macao is unlikely to be a major driving force in the overall economy of the Greater Pearl River Delta region. However, Macao
Implications for the Greater Pearl River Delta Region

brings several things to the region that could be very important in a number of industries. New investments in the gaming and tourism industry could make Macao the Las Vegas of Asia. The potential for closer linkages between Hong Kong and the eastern part of the Pearl River Delta, on the one hand, and Macao and the western part of the Pearl River Delta, on the other, could have an important impact on flows of goods, investment, and people. This could greatly expand business prospects in Macao and substantially raise Macao’s profile in the region. The present study has focused on the economic interaction between Hong Kong and the Pearl River Delta region. Given this focus, Macao is seen as part of the Greater Pearl River Delta region, but external to the core of the analysis. Our research suggests that this approach should be broadened to explicitly focus greater attention on Macao in the future.

Make the right comparisons

The Pearl River Delta suffers at present from inappropriate comparisons, particularly with the Yangtze River Delta. Often a portion of Guangdong province is compared to Shanghai, plus all of Jiangsu and all of Zhejiang. A more appropriate comparison would be between the Greater Pearl River Delta region as defined above and the 15-city definition of the Yangtze River Delta. Note also that no one else will make this comparison if people within the Greater Pearl River Delta region do not. Other regions in China will not view it as in their interest. The attentions of China’s Central Government tend to be elsewhere and many elements of the international press or business community either do not know or do not care. Some people in the Greater Pearl River Delta region seem hesitant to put the statistics of the whole region together because it makes their own jurisdiction look less important in comparison. This is the attitude that thinking more as a region would hopefully overcome.

Improve Connectivity

Connectivity is a critical issue for the Greater Pearl River Delta region. Connections within the region have been critical to its economic success over the last two decades. Greater connectivity within the region holds the promise of easier interaction and greater prosperity in the future. This is particularly important as the Greater Pearl River Delta region competes more and more with other regions inside and outside of China. The region also benefits from connectivity to the rest of China and the rest of the world. In fact, this connectivity with the rest of the world has been one of the major advantages of the Greater Pearl River Delta region. This connectivity also should be enhanced if the region is to maximise its prosperity.
Connectivity around the Greater Pearl River Delta region

The Greater Pearl River Delta region has seen substantial investments in infrastructure over the last several years, investments that have improved the connectivity around the region substantially. However, connectivity around the region is not as good as it could be. While the highway system planned for the region will improve matters, an integrated approach to the highway, rail, water, and air transportation systems around the region will be needed if connections are to be made in a seamless fashion. The overall goal should be the ability to reach any major city in the Greater Pearl River Delta region from any other major city in the region within three hours by land, including border-crossing times. This would bring the entire region into the reach of local and international investors based in the region. It would make the Greater Pearl River Delta region much more of a single region for logistics and distribution purposes, and would create a true regional market of significant size. There also is ample scope for exploring additional ferry, and even helicopter, links in order to facilitate travel around the region.

Connectivity across the Hong Kong-Shenzhen border

Connectivity across the border was the number one issue identified by Hong Kong interviewees as an obstacle to greater interaction with the Greater Pearl River Delta region. Representatives from international companies also indicated that delays at the border were a strong disincentive to invest in the Pearl River Delta. Business people did not emphasise any single solution over others, but instead emphasised the importance of action now rather than in a year, or two years, or three years. Recent announcements of a move to 24-hour a day border crossing have been welcomed by the local and international business communities, as has the recent move to open a special lane for foreign passport holders. Special lanes for people working for companies registered on either side of the border (Hong Kong residents working for companies with a registered facility in the Pearl River Delta region and Pearl River Delta region residents working for companies with a registered facility in Hong Kong) would be a logical next step.

Connectivity between Hong Kong and the western side of the Delta

Connectivity between Hong Kong and the western side of the Delta is equally important. Much of the disparity in economic development between the east and west sides of the Delta can be attributed to the fact that the former is directly linked with Hong Kong and the latter is not. The result is that around 90 percent of all people and vehicle flows between Hong Kong and the Pearl River Delta region are with the eastern and central portions of the Delta. The impact can be seen in the substantial differences in the levels of development
found in Shenzhen and Dongguan when compared with Zhuhai and Zhongshan. Hong Kong investors, foreign investors that use Hong Kong as a base, and Hong Kong-based service providers tend only to deal with the eastern part of the Delta, largely because these are the only portions that can be accessed reliably within three hours from Hong Kong. Connectivity between Hong Kong and the western part of the Delta should be a high priority. In this regard, the announcement that there is support in Hong Kong, in the Pearl River Delta region, and in Beijing for a bridge between Hong Kong and the western portion of the Pearl River Delta region is to be welcomed. Our analysis indicates that such an effort should go forward expeditiously.

**Connectivity between the eastern and western portions of the Delta**

Better connectivity between the eastern and western portions of the Pearl River Delta region should also be a priority. In this way, supply and distribution networks could be combined in a way that would enhance productivity on both sides of the Delta. Jurisdictions on the eastern side of the Delta, such as Shenzhen and Dongguan, would be able to shift some assembly activities to the western part of the Delta while retaining some of the components and capital goods. This would allow for an accelerated development of the western part of the Delta, while providing the eastern part of the Delta with the space to move up the ladder in terms of technological and industrial sophistication. It should be noted, however, that links between the eastern and western parts of the Delta are not a good substitute for links between the western part of the Delta and Hong Kong. After all, it has been investment from Hong Kong and from foreign companies using Hong Kong as a base that has contributed most to the development of Dongguan, not Dongguan’s links to Shenzhen or Guangzhou. While a bridge between Hong Kong and the western part of the Pearl River Delta region would solve some of this problem, there may be a need for additional linkages as well.

**Connectivity between the Greater Pearl River Delta region and the rest of China**

The development of China’s highway and rail networks, growing port services, and expanded flight schedules promise to bring the Greater Pearl River Delta region into much closer contact to the rest of China. Travel times by land from China’s interior to the Greater Pearl River Delta region could be cut by days, while development of the region’s aviation industry could dramatically increase the number of cities reachable from the region’s major airports. One of the important roles that the Greater Pearl River Delta region can play is to link China’s prosperous coastal regions with the less prosperous interior and western
provinces. One order of business is to ensure that the needed infrastructure and regulations to facilitate these connections is put in place. Another is to find ways of taking advantage of better connections to expand business prospects. Greater connectivity with the rest of China should allow the ports and airports of the Greater Pearl River Delta region to expand their catchment areas substantially. In addition, logistics operators should be able to increase the use of logistics hubs in the Greater Pearl River Delta region.

Connectivity between the Greater Pearl River Delta region and the rest of the world

The Greater Pearl River Delta region has benefitted substantially from its links to the rest of the world. With China’s opening and accession into the WTO, the region will lose some of its exclusivity as a link between China and the global economy. If it is to continue to be a leader in terms of international trade, international investment, and development in China, the region will have to ensure that its connections with the rest of the world are first-rate. It needs to ensure that its air connections, sea connections, and information connections are second to none. The region cannot simply focus in on itself or in on the Chinese domestic economy. It needs to continue to develop and exploit its ability to attract individuals, visitors, and companies into the region.

Develop the Right Interaction Within the Greater Pearl River Delta

One factor that holds back development in the Greater Pearl River Delta region is that often the interaction that does take place is not between individuals that can directly foster business development. In particular, while government-to-government interaction is extremely important when it comes to issues concerning infrastructure, the environment, and border crossing, it is less useful when it comes to developing specific business relationships. One reason is the mismatch between the roles of government in Hong Kong, where government tends to be a neutral facilitator of business, and in much of the rest of region, where government takes on a much more active business role. The right interaction to foster direct business linkages often is between local governments in the Pearl River Delta region and private sector companies in Hong Kong. The creation of forums in which there can be informal interaction between these and other related parties should be a high priority for the Greater Pearl River Delta region. Otherwise numerous opportunities will continue to be missed in the region.
Database on areas in the Pearl River Delta and companies in Hong Kong

It has become clear in our research that there are opportunities that are being left unfulfilled due to the lack of information that can lead to useful business linkages. Many companies in Hong Kong that might have the ability to bring the products of Pearl River Delta firms to international markets do not know where to seek out sources of supply in the Pearl River Delta region. Attempts to match companies on a company-by-company basis are complicated and have a place in fostering pan-regional interaction. However, it is likely to be far more useful to supply trading companies and buying offices in Hong Kong with detailed information on the different locations within the Pearl River Delta and their industrial profiles. This would reduce the search costs for Hong Kong trading companies and buying offices in finding sources of supply. In addition, a database of Hong Kong traders and buying offices, along with their major specialties, provided to each local jurisdiction in the Pearl River Delta region would reduce the search costs for local officials and managers who wish to find a means of expanding their international sales. Such databases would not be difficult to compile and the information could prove quite valuable. This should be a high priority project for governments throughout the region and could prove an important cooperative undertaking.

Greater Pearl River Delta Chamber of Commerce

Another mechanism for fostering greater business interaction around the Greater Pearl River Delta region would be the creation of a Greater Pearl River Delta Chamber of Commerce. Such a Chamber would have both public sector and private sector members from throughout the region. In addition to providing a mechanism for business people to meet to discuss issues common to the region, such a Chamber would provide an opportunity for the type of informal contacts that often are the most fruitful in developing new contacts and business leads. The Chamber could sponsor a variety of events around the region and could act as an important player in providing input on the economic development of the region. Chamber meetings could take place in the various cities of the region. Committees and working groups could focus on a range of specific issues of interest to the business community in the region. In particular, such a Chamber could become a focal point for discussion and development of ideas to reduce bottlenecks within the region and to further the region’s development in terms of infrastructure, manpower and other critical issues.

Greater Pearl River Delta Council

Another mechanism for creating greater business interaction around the Greater Pearl River Delta region could be the development of a Greater Pearl River Delta Council. Such
a Council would have a more limited membership than a Chamber of Commerce, but should include members from the region’s various governments, local companies, and foreign multinationals. Its roles could include the fostering of greater understanding within the Greater Pearl River Delta region, the promotion of the region to the rest of the world, advising on development strategies within the region, organising or promoting international events in the region, and so on. It also could help organise exchanges, collaborative research projects, and other undertakings designed to contribute to greater knowledge in and of the region. It also could be a high-level group that could have an important influence within the region, an important role in organising large-scale cooperative efforts and projects in the region, and could be important in presenting the views of the Greater Pearl River Delta region to officials in Beijing and elsewhere in China.

**Exploit and Foster International Linkages**

The economies of the Greater Pearl River Delta region are reliant on international trade and investment. Anything that fosters better linkages between the region and the rest of the world is likely to result in enhanced business prospects for the region. Right now, many of the international links are through Hong Kong or Macao. However, both Guangzhou and Shenzhen are expanding their international linkages. There is a need to foster better linkages, not just in terms of transportation, communication, and infrastructure, but also in the way firms and governmental organisations do business or operate.

**Hong Kong offices**

Many local jurisdictions in the Pearl River Delta region are trying to help their firms enter international markets, or acquire international class technology or inputs. These jurisdictions are finding it difficult to help their firms create the international sales, distribution systems, and buying networks necessary to reach those markets. One way to foster such development is for the jurisdictions to use offices in Hong Kong to find partners to help them in international markets. Hong Kong’s local trading companies, offices of international trading companies, buying and sourcing offices, and professional service providers could prove extremely helpful to Pearl River Delta companies trying to address international markets as suppliers or buyers. They could provide international experience and far quicker and less expensive access to international marketing and sales networks. The local jurisdictions in the Pearl River Delta should seriously consider setting up Hong Kong offices that would help their companies find the appropriate Hong Kong-based partners. These offices could act as business conduits and matchmakers to create beneficial business relationships that might not be created otherwise.
Seeking out Pearl River Delta opportunities from Hong Kong

There are many Hong Kong companies that have good international connections and access that could further develop business opportunities in the Pearl River Delta. As indicated above, there are many firms in the Delta that provide high quality goods that have not yet penetrated international markets. There are opportunities for Hong Kong firms to seek out these firms from the Pearl River Delta region and help bring them to international markets. In addition, as China’s WTO accession process proceeds, there will be ample opportunity for Hong Kong firms and multinational firms with Hong Kong offices to seek out further opportunities to link the Pearl River Delta region with the rest of the world. While there already is a huge trading community in Hong Kong, consisting of over 80,000 firms and employing in excess of 500,000 people, our research indicates that there are still opportunities that are being missed simply because it can be difficult to know where to look for the right supplier or buyer in the region. In other cases, opportunities are being missed because the industry involved might not be one in which Hong Kong historically has participated. It will be necessary for Hong Kong and its companies to expand their horizons if they are to serve a rapidly expanding and diversifying region.

Create showcases for the region

The Greater Pearl River Delta region has several existing and potential showcases for its firms. Such showcases bring the products of the region to the attention of national and international buyers. The Canton Fair, still the most important trade fair in the Chinese Mainland, is a showcase for manufacturers from all over China. The Shenzhen High-Tech Fair is the most important trade fair for high-tech products in China. Hong Kong is the site of numerous trade fairs that highlight the productive capabilities of the Pearl River Delta region. Given the importance of international trade and investment to the Greater Pearl River Delta region, it would be useful to set up one or more permanent showcases for the region’s products. These showcases, probably linked to convention or exhibition centres, could host rotating or permanent displays for different companies and industries. Given its position as an international business centre, Hong Kong would be a natural choice for one such showcase. Guangzhou could be another. The idea would be to provide easier access to the region’s products and services for international buyers and customers.

Develop Mechanisms for Regional Promotion

To date, the Greater Pearl River Delta region has been singularly poor at promoting itself as a region. This is due in large part to the fact that most people in the region have not adopted a regional identity. This is true despite the deep family, cultural, linguistic, and business ties found within the region. As a greater sense of regional identity develops, it
should be possible to develop mechanisms to promote what has been one of the world’s most dynamic economic regions. This will take a level of understanding and cooperation that has appeared on the scene only recently.

**Trade and investment promotion**

Trade and investment promotion would appear to be natural avenues for cooperation between Hong Kong and the Pearl River Delta region. The importance of the logistics, transportation, manufacturing, and trade-related service industries in the Greater Pearl River Delta region make regional trade promotion a win-win proposition. Given the fact that Hong Kong has an extensive trade promotion network, but very little manufacturing, and the Pearl River Delta has a tremendous amount of manufacturing, but limited trade promotion networks, such cooperation would appear to be natural. In fact, promotion of Hong Kong exports, by agencies such as the Hong Kong Trade Development Council, already is more or less promotion of Pearl River Delta exports as well. It should be relatively easy to have significantly more coordination of export promotion across the Greater Pearl River Delta region. Potential targets of such promotional efforts would include buying offices of major companies, retail chains, and other distributors. Issues such as where the funding for such promotion should come from will need to be worked out, but it would seem that these problems are relatively minor compared with the potential benefits of greater cooperation in trade promotion.

Given the strong complementarity between Hong Kong and the Pearl River Delta region, it should be natural to promote the “Hong Kong-Pearl River Delta Combination” to multinational firms. In using the combination, multinationals can set up regional management, coordination, financial, and information centres in Hong Kong while performing their manufacturing and technical activities in the Pearl River Delta region, and performing logistics and related activities in both places. Many firms are already using the Hong Kong- Pearl River Delta combination to great effect, despite the fact that the combination is usually not marketed as such. Others choose to invest elsewhere, in part because the benefits of operating in the region are not well known or publicised in the international business community. Managers from firms already operating both in Hong Kong and in the Pearl River Delta region should be natural allies in any joint promotional efforts. They also can be important sources of information on what the various jurisdictions can do to facilitate the development of a stronger Hong Kong-Pearl River Delta region combination.
Tourism promotion

The Greater Pearl River Delta region has unique opportunities to engage in joint tourism promotion. Nowhere else in China is there such a combination of different histories, heritages, cultures, and attributes. The Pearl River Delta region has natural and urban sites, golf courses, and tourist attractions. Hong Kong has its hypermodern, cosmopolitan attributes. Macao too promises to become a world-class tourist destination. However, at present, visa issues, regulations governing tour operators, and the lack of integrated promotion efforts mean that this combination goes unrealised. China is expected to become the single most important destination for international tourism early in the 21st century. A real integrated tourism promotion effort could attract a significant portion of these travellers to the Greater Pearl River Delta region. As people from around China travel more and more, an integrated tourism promotion effort also could draw even more travellers from elsewhere in China. What would be required is a willingness to overcome the bureaucratic barriers to develop integrated packages that could supplement the tourism offerings of each of the jurisdictions.

Overcome Hurdles to Closer Interaction

Although there is a relatively widespread belief that there are potential benefits to increased economic interaction between Hong Kong and the Pearl River Delta region, there are several hurdles that stand in the way of closer interaction within the region. These include, among others, red tape and bureaucracy, export processing regulations, and restrictions in the service sector. Clearly, these will have to be dealt with if the steps suggested above are to be taken or if the region is going to optimise its interactions going forward.

Reducing red tape and bureaucracy

Throughout all the major jurisdictions of the Pearl River Delta, there can be lengthy and costly approval processes for business start-ups and for new investments. Even Hong Kong, reputed to be modest in terms of regulatory requirements, has extensive approval processes for anything that involves land use. The entire region could benefit from a reduction in bureaucracy and approvals necessary for the normal conduct of business. While there are a number of issues on which progress has been made recently, such as border crossing and connectivity issues, there is still a need for further concerted efforts around the region to identify and reduce the red tape and bureaucracy involved in doing business around the region. Although the region benefits from having separate systems, it also needs to make sure that it does not lose the potential benefits of being part of one country.
Export processing regulations

Present export processing regulations in the Pearl River Delta region can make it difficult for firms to deepen their productive activities without shipping goods into and out of the Delta, or undergoing cumbersome customs examinations. In addition, if some facilities that formerly were export-oriented wish to sell in the domestic market, they may face customs duties on the original value of imported equipment, even if that equipment normally would have been fully depreciated. This is an area in which international best practice and experience could perhaps be brought to bear on an issue that hinders the expansion of Pearl River Delta region-based manufacturing. The idea would be to come up with standard treatments for this situation that can be decided once and for all and then implemented, rather than each one of several thousand different cases having its own decision making process with all the potential for delays, uncertainties, and varied outcomes.

Overcoming restrictions in the service sector

The service sector remains relatively underdeveloped in the Pearl River Delta region, while Hong Kong has one of the more extensive service sectors among major cities in Asia. In fact, the types of services, particularly business and producer services, which are most needed in the Pearl River Delta region, are precisely those that Hong Kong tends to supply. It will be critical for officials in the Chinese Mainland to understand that opening up the Pearl River Delta region for Hong Kong-based service providers, both locally owned and foreign owned, is not “giving something away” to the outsiders. Instead, it is a way to enhance the Pearl River Delta’s own development and a way to supercharge the development of its own service sector. This is especially true given the fact that most services are performed locally. Thus Hong Kong and other “outside” firms typically will invest into the Pearl River Delta jurisdictions in order to provide services there. Recent announcements that Shenzhen will open a number of its service industries in advance of the rest of the China is a strong step in the right direction.

Understand the Realities of the Present Situation

Many analysts have described the multiple jurisdictions that exist in the Greater Pearl River Delta region and the lack of cooperation that has fostered overlapping and potentially counterproductive investments. The analysts then tend to go on to state that the different jurisdictions must find a way to reach some grand cooperation if the region is to reach its optimal performance. Such observations are right as far as they go, but in reality not very useful. While there is great potential for further cooperation between the different
jurisdictions of the Greater Pearl River Delta region, expectations for trouble-free, universal cooperation around the region should not be raised too high. Instead, each jurisdiction should understand that the realities of the present situation imply that achieving cooperation on major issues will take time and will have to be based on a series of interactions that foster communication and trust over time.

Conflicting interests

There are a number of cases in which special and parochial interests of different jurisdictions in the Greater Pearl River Delta region will conflict. Large infrastructure projects that go into one location within the region will not go into others. Factories built in one city will not be built in another. Distribution or logistics centres that go to one location will not go to others. Headquarters activities that go into one location cannot go into another. Thus, there always will be some competition between jurisdictions. China’s history, which suggests that we should expect competition rather than cooperation among jurisdictions, indicates that this situation will persist into the future. It is important for the different jurisdictions to recognise when their interests might conflict with others. Such issues are perhaps better left for future negotiations or for a time when multiple issues can be addressed at the same time, with each jurisdiction giving a little on some issues to get a little on others. The point is that conflicts of interest on one issue should not be allowed to hinder cooperation and understanding on other issues.

Different priorities

In addition, there will be some initiatives that interest or excite some jurisdictions more than others. The environment is one example where differences in levels of development are likely to result in different jurisdictions placing different levels of importance on an issue. In most countries in the world, environmental concerns increase with rising income levels. It is hard to imagine that jurisdictions with a per capita income of between US$2,000 and US$5,000 per year will have the same interest in the environment as jurisdictions with a per capita income in excess of US$24,000 per year. Jurisdictions with the lower income levels are far more likely to focus on basic economic development than are more economically advanced jurisdictions. One point of frustration for many of the jurisdictions in the Greater Pearl River Delta region is that other jurisdictions in the region do not seem to share their priorities. It is necessary for each jurisdiction to understand the priorities of others if it is to try to develop approaches that will capture the interests of the other jurisdictions in the region. Each jurisdiction should not assume that all others share its priorities.
Different decision-making regimes

The different decision-making regimes in the region also need to be understood. The different jurisdictions have different decision-making systems. Some systems can be quite simple, while others are quite complex. Some jurisdictions have top-down decision making. Others have bottom-up decision making. Yet others have consultative decision making. The political, economic, and social interests vary in terms of their strength and their ability to influence the political process. All this means that the decision makers from different jurisdictions face different pressures and must satisfy different constituencies. In order for the Greater Pearl River Delta region to find ways of cooperating on important issues, different actors need to understand the pressures that their counterparts face. This is perhaps easier said than done given the stark differences among systems in the region and what appears to be a general lack of appreciation for the nuances of getting things done in other jurisdictions in the region.

Overcoming the narrowness of “cooperation”

As we indicated earlier, many people in the Greater Pearl River Delta region seem to define regional cooperation as every other jurisdiction in the region doing exactly what people in the first jurisdiction want. This approach will not go particularly far in a complex region with multiple jurisdictions. Instead, the individual jurisdictions, and people within the jurisdictions, need to understand what drives people in the other jurisdictions, what areas are open to discussion and compromise and what areas are not. Some jurisdictions in the region suggest “cooperation” that has nothing to offer other jurisdictions and then seem disappointed or even offended when the other jurisdictions do not respond. Again, a far better understanding of the differences among jurisdictions will be necessary to overcome this problem. The first step is to admit that it exists and then to develop means of sharing sufficient information to allow areas in which joint benefits can be more easily obtained.

The search for a viable strategy

What this implies is that those who stop at suggesting some grand cooperation around the region are likely to be waiting for a long time and at the same time missing the opportunities that can be developed if a realistic view of the situation is employed. The search for grand cooperation should most naturally focus on areas in which there are not direct conflicts of interest between different jurisdictions in the region. Experience in working on such areas can then be used to develop the working relationships necessary to tackle more difficult issues on a regional basis. In the meantime, each jurisdiction will need to try to identify
areas in which it might benefit from pan-regional cooperation and seek to realise its goals. In other areas, including the areas that are likely to be the most contentious, each jurisdiction will have to identify its own interests, seek out those with common interests in the region and then work with those entities to bring about positive solutions. Understanding that tough negotiations and unilateral and competitive actions are more likely in some areas than pan-regional cooperation will probably allow more progress to be made than assuming or hoping otherwise.

The situation is one that economists might recognise from game theory. One might see the present circumstance in the Greater Pearl River Delta region with multiple jurisdictions as representing a repeated, non-cooperative, but non-zero sum game. The game is repeated, because the different jurisdictions will be dealing with each other on many issues over an extended period of time. It is non-cooperative, because each jurisdiction seems to be trying to optimise its own position rather than trying to identify the best outcomes for the entire region. It is non-zero sum, because there are some clear benefits that can be had through interaction and that prosperity in part of the region should benefit other parts of the region.

In such circumstances, the best approach is not to hope that somehow cooperation will suddenly appear. Instead, it is to assume that the other players will act in accordance to what they view as their self-interest, and then to act accordingly. One problem from the standpoint of the region is that jurisdictions might not always see what is in their real long-term interest. If all the jurisdictions did so, they already would take into account the moves of other jurisdictions in their own economic development plans, something that does not appear to be the case today. In addition, it is hard to imagine that the duplication of plans around the region comes from a process in which a rational long-term view is taken. In this regard, it might be necessary for jurisdictions to become more educated about the costs and consequences of their choices. The repeated, long-term nature of the game means that it makes sense to give on some issues in the hope of building trust and cooperation that will help on other issues. It also makes it important that there be some mechanism to discuss and hopefully resolve differences when there are direct conflicts, or the ability to agree to disagree on some issues while making progress on others.

**Pressing Issues for Hong Kong and the Pearl River Delta**

Although greater interaction between Hong Kong and the Pearl River Delta region holds the promise of greater prosperity throughout the Greater Pearl River Delta region, there are a number of other issues that both Hong Kong and the Pearl River Delta region face. Some of these issues are actually more pressing than Hong Kong-Pearl River Delta
interaction. It is beyond the scope of this report to go into these issues in detail, but it is important to at least identify some of these issues to place the Hong Kong-Pearl River Delta region interaction into an appropriate context.

Pressing issues for Hong Kong

An increased focus on the Pearl River Delta region should not obscure the fact that Hong Kong faces several issues that are as pressing or even more pressing than its interaction with the Pearl River Delta region. Among the major issues that Hong Kong faces, regardless of its interaction with the Pearl River Delta, are issues concerning leadership and accountability on economic issues, the high prices found in Hong Kong, the development of a corporate handout mentality, pressures for protectionism throughout Hong Kong’s economy, the need for the right preparation for the knowledge economy, and Hong Kong’s ability to retain its standing as an international centre.

There has been rather substantial confusion about leadership and accountability on economic issues in Hong Kong. When asked about who was responsible for Hong Kong’s economic policies, Hong Kong-based interviewees, including some very senior business leaders, generally responded that they did not know. Even though prices in Hong Kong have fallen since the onset of the Asian Crisis, the combination of steeper price falls in other Asian cities and improvements in skills and capabilities in the Chinese Mainland are causing many companies to push jobs out of Hong Kong as fast as they can.

Perhaps the biggest difference between the Hong Kong business people interviewed in 1995-1997 when preparing The Hong Kong Advantage and today is that far more business people in Hong Kong seem to believe that government should solve their problems for them. Interviewees called for government support for their industry (though not for other industries) despite their own statements that support programmes were cumbersome and not very useful. Along with the emergence of a corporate handout mentality is increasing protectionist pressure among special interests. Instead of focusing on adjustment and building for a challenging future, many groups in Hong Kong seem to prefer to resist change and to seek protection for their present existence.

Although many in Hong Kong have indicated that Hong Kong needs to become more of a knowledge economy, fewer seem to understand that the knowledge economy of any major

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1 Michael J. Enright, Edith E. Scott, and David Dodwell, *The Hong Kong Advantage*. (Hong Kong: Oxford University Press, 1997).
city is driven by the strategy setting, information, coordination, communication, and financial activities that take place in the city. These are the activities that support the highest salaries and the highest rents. One critical source of knowledge economy activities in Hong Kong involves its international linkages. Several interviewees, including Hong Kong-Chinese interviewees, indicated that they feared that a greater focus on China might result in Hong Kong failing to maintain its lead as an international centre. This was viewed as particularly serious given the fact that Hong Kong’s main value to the Pearl River Delta region in economic terms was seen as its international linkages.

Pressing issues for the Pearl River Delta region

Similarly, an increased focus on interaction with Hong Kong should not obscure the fact that the Pearl River Delta region faces several issues that are more pressing than its interaction with Hong Kong. Among the major issues that the Pearl River Delta region faces regardless of its interaction with Hong Kong are the development of hard and soft infrastructure, more sophisticated development planning, better links with the rest of the world, emerging competition with the Yangtze River Delta region, and competition among jurisdictions within the Pearl River Delta.

The Pearl River Delta region has benefitted from improving hard infrastructure and has ambitious plans for future investments for infrastructure within and between cities in the region. However, these plans need to be funded and implemented if they are to facilitate business development in the region. Although there is much attention focused on hard infrastructure in the region, there is less focused on soft infrastructure. Many interviewees on both sides of the boundary indicated that there is substantial opportunity for improvement in public services, including public safety, healthcare, and education. Improvements in these areas would make the Pearl River Delta region in general, and individual jurisdictions, much more attractive for foreign investors and for professionals from elsewhere in the Chinese Mainland. For some jurisdictions in the region, investments in these areas would yield far greater benefits than other investments that are in the planning stages.

There also is a need for more sophisticated development planning in some of the jurisdictions of the Pearl River Delta region. There is a tendency for different jurisdictions in the Pearl River Delta region to simply copy each other’s strategies regardless of their initial conditions. Much of the planning is done without any sense of return on investment or cost-benefit analysis. In some jurisdictions, investments are made if they can be made, not only if they are the best investment that can be made. The result, on occasion, is duplicative investment and unnecessary competition among jurisdictions. While some competition is
Within the Pearl River Delta region, there is a tendency to downplay the competition with the Yangtze River Delta region. Much of the economic development in the Pearl River Delta region has been the result of foreign direct investment. Today, however, some foreign investors opt to locate in the Yangtze River Delta region without even exploring the potential of the Pearl River Delta region. In addition, the domestically oriented manufacturers in the Pearl River Delta region increasingly face competition from suppliers in Zhejiang and Jiangsu provinces. As the domestic market of the Chinese Mainland becomes more unified, such competition will be extremely important in determining which areas will capture the lion’s share of the domestic market. The Pearl River Delta region has not captured the attention of some international audiences nearly as much as the Yangtze River Delta.

**A Means not an End**

There is tremendous potential to foster greater interaction between Hong Kong and the Pearl River Delta region. Such interaction is necessary if the “Greater Pearl River Delta region” is to maximise its future prosperity. There are a number of concrete steps that can and should be taken to enhance this interaction going forward. These steps include building off past success, fostering a regional identity, improving connectivity, developing the right interaction, exploiting and fostering international linkages, developing mechanisms for regional promotion, overcoming the hurdles to closer interaction, and understanding the realities of the present situation.

However, greater interaction is not a panacea that will solve all the issues in the Greater Pearl River Delta. The above discussion indicates that greater interaction between Hong Kong and the Pearl River Delta region should be seen as a means rather than an end. In particular, it should be viewed as a means to help each jurisdiction meet its own challenges and optimise its development. A focus just on interaction is likely to result in talk, but not much action. On the other hand, interaction that is focused on solving issues that are critical to the jurisdictions in the region is more likely to lead to positive action. Without such a focus, it is likely that players on both sides would eventually tire of discussion.

The importance of greater interaction, at least in the short and medium-term, will be in its ability to help the various jurisdictions in the Greater Pearl River Delta region address their own priority issues and it is here that present efforts should focus, in part because it is the...
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best way to achieve greater benefits through interaction today, and in part because it is the best way to ensure that the various jurisdictions in the region develop the understanding and common ground necessary to achieve even larger benefits through interaction in the future.