

CROSS-BORDER CONNECTION BETWEEN HONG KONG AND MAINLAND CHINA UNDER 'TWO SYSTEMS' BEFORE AND BEYOND 1997

by
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ABSTRACT. Cross-border flows of people, goods and capital are fundamental forces triggering spatial and economic transformations in any cross-border regional production system. This study focuses on such cross-border links between Hong Kong and mainland China in the context of cross-border regional production systems. The paper examines first the close demographic ties and investment and trading relations between Hong Kong and mainland China before 1997. In terms of total direct and indirect trading, and outward investment, Hong Kong was the largest partner of mainland China and vice versa. The recent development in the cross-border development between Hong Kong and the mainland after 1997 is also analyzed. The political change, the return of Hong Kong to China in 1997, did not alter the demographic-economic linkages significantly as such connections had been well established during the period 1978 to 1997 after China's opening to the outside world. Hong Kong and mainland China are two independent economic entities practicing 'two systems' of capitalism and socialism respectively. Contrary to common expectation, the new government in Hong Kong only played a limited role after 1997. However, a bottom-up approach has been working spontaneously and the local people and businessmen in Hong Kong have been the primary force in establishing strong relations with the mainland facilitated by the close demographic-cultural ties both before and after 1997.

Introduction

Cross-border co-operation and development is a significant phenomenon in the globalizing world today (Ohmae, 1995). At least three cross-border regional production systems, Hong Kong–PRD (Pearl River Delta) region, Indonesia–Malaysia–Singapore growth triangle and the US–Mexico border, have emerged in the world, each involving a well-developed economy and one or several less developed economies (Chen and Ho, 1994; Kumer, 1994; Brown, 1997; Grundy-Warr *et al.* 1999; Shen, 2002).

The case of cross-border development between Hong Kong and mainland China is perhaps one of the most outstanding cases. By 1997, Hong Kong had become a well-established global city with GDP per capita higher than that of many developed countries. The success of Hong Kong depends on various

complementary factors. Indeed, a unique social-economic system has evolved in Hong Kong that emphasizes the rule of law, competition based on the free-market principle, and an efficient and clean government. However, the opening up of mainland China since 1978 has also been one of the crucial factors behind Hong Kong's rapid economic growth. This factor provides huge investment and trading opportunities for cross-border development, lifting Hong Kong's GDP per capita to a high level (Yeung, 1997a, 1999; Sung, 1998). Rapid cross-border development has caused profound de-industrialization in Hong Kong. But Hong Kong plays a significant role in the rapid industrialization on the mainland, especially the PRD (Sit, 1989, 1998; Berger and Lester, 1997; Shen, 2002). The connection with mainland China, the China factor, has benefited Hong Kong's economy significantly both before and after 1997. The main issue vital to Hong Kong's further prosperity is how to maintain Hong Kong's comparative advantage among the main competitors in the region including Singapore, Shanghai, Shenzhen and Taipei. The outcome depends not only on the political stability in Hong Kong, but also on timely response and adaptation to the changing economic and trading circumstances (Jessop and Sum, 1999; Yeung, 2000, 2001; Hong Kong Trade Development Council, 2001; Chu *et al.* 2002; Pun and Lee, 2002). Well-co-ordinated cross-border planning in the Hong Kong–PRD region has become an urgent matter for increasing the overall competitiveness of the region in the global economy.

The case of cross-border development between Hong Kong and mainland China was complicated by the return of Hong Kong to China in July 1997. There have been many questions and doubts about whether there would be a significant change in the relationship between Hong Kong and mainland China and whether Hong Kong's prosperity would continue after 1997 (Enright *et al.* 1997; Skeldon, 1997; Speak, 1997; Yeung, 1997a, 1997b). The basic law of the Hong Kong Special Administrative

Region (HKSAR) passed by the National Congress of the People's Republic of China in 1990 guarantees that there will be no change in the legal and social systems in Hong Kong after 1997.

Previous studies have focused on the mainland side of the cross-border development such as foreign investment, urbanization and development in the PRD under the influence of Hong Kong (Sit, 1991; Sung *et al.* 1995; Lin, 1997; Sit and Yang, 1997; Soulard, 1997; Yeung and Chu, 1998; Chan, 1998; Weng, 1998; Shen, 1999; Shen *et al.* 1999, 2000, 2002; Gu *et al.* 2001). Some recent studies examined the issues of regional co-operation and integration between Hong Kong and the PRD region indicating huge potentials and major challenges ahead (Li *et al.* 1996; Chu *et al.* 1997, 2002; Yeung, 1999; Hu and Chan, 2002; Shen, 2002).

However, few studies ever considered the impact of the cross-border development on the Hong Kong side systematically, with a few exceptions (Berger and Lester, 1997; Tsui-Auch, 1999; Loo, 2002). Even fewer studies ever considered the role of mainland China in the import/export trading of Hong Kong and vice-versa. Cross-border flows of people, goods and capital are fundamental forces triggering spatial and economic transformations in any cross-border regional production system. But no systematic study has focused on such cross-border flows in the literature.

The purpose of this paper is to examine the cross-border linkages between Hong Kong and mainland China both before and after 1997 from the perspective of cross-border regional production systems. This will help to assess whether there has been any significant change in the nature of cross-border development since 1997. Although Hong Kong has a close relationship with the PRD, complete data are available only for the linkages between Hong Kong and mainland China. On the other hand, the investors from Hong Kong have also reached other cities and regions all over the mainland. Broadly speaking, such investment activities are still a kind of cross-border co-operation and development under a large regional production system. Indeed, the so-called south China growth triangle covers a wider area than only Hong Kong and PRD. Focusing on the relationship between Hong Kong and mainland China is also appropriate since they represent two economies practicing capitalist and socialist systems respectively. Thus the cross-border development in this paper refers to both Hong Kong-PRD and Hong Kong-mainland China.

The rest of the paper is organized as follows. The

following two sections examine the concept of cross-border regional production systems and the Hong Kong-mainland China connection in the context of such cross-border systems. The demographic foundation for the cross-border development and the investment and trading relations between Hong Kong and mainland China are examined in the following two sections respectively. The recent development in the cross-border development between Hong Kong and the mainland after 1997 is then analyzed. Some conclusions are reached in the final section.

The emergence of cross-border regional production systems

Globalization has been advancing in the world in two main ways. First, various initiatives of institutional changes have been proposed and introduced at various spatial scales to abolish certain barriers and border controls to form 'borderless region states' such as the European Union to facilitate free movement of information, labour, goods, capital and technology. This conforms to a general shift towards a 'borderless world economy' as advocated by Ohmae (1995). WTO (World Trade Organization) and NAFTA (North American Free Trade Agreement) are also elements of such a global shift although they are focused more narrowly on the issues of free trade and capital movement.

Second, the international capital, via the transnational corporations (TNCs) especially, has engaged actively in the organization of new international/regional division of labour to make best use of worldwide resources, notably labour, land and capital, for maximum profit. The world economic system and the international division of labour have been remoulded under such globalizing forces. Most significant of all is the emergence of cross-border regional production systems in a number of regions in the world; for example the Hong Kong-PRD region, the Indonesia-Malaysia-Singapore growth triangle and the US-Mexico border (Chen and Ho, 1994; Kumer, 1994; Brown, 1997; Grundy-Warr *et al.* 1999; Shen, 2002). The cross-border regional production systems are known as 'growth triangles' in Asia that spread over well-defined, geographically proximate areas covering three or more countries (Tang and Thant, 1994). The cross-border regional production system is a more general and better term that can be applied to cases involving just two countries such as US-Mexico border. Even in the case of the Hong Kong-PRD re-

gion, only two systems, mainland China and Hong Kong, are really involved while Taiwan plays a much smaller role in Guangdong province.

A border has two functions: as a dividing line with a separation function and as a contact zone for exchange and co-operation (Ratti, 1993). During the time that the border is an underdeveloped frontier, it plays mainly a separation function. With the emergence of a cross-border production system, the border's function as a contact zone is greatly enhanced. But the two functions of the border may not be in conflict at all. While the function as a contact zone is enhanced by the institutional changes in one or both sides of the border, the separation function can still be maintained. This has been the case of the border between Hong Kong and mainland China. Tight border control has been maintained to monitor the movement of mainland people to Hong Kong while the border has been open to most residents in Hong Kong for free movement since 1978.

The emergence of a cross-border regional production system is the result of political-economic transformations in a border region initiated by the governments/businesses at one or both sides of the border recognizing the benefit of cross-border development. In the cases of the Indonesia–Malaysia–Singapore growth triangle and the US–Mexico border, the governments at both sides of the border have clearly been involved in legislation, while the less developed countries have also adopted incentive policies for foreign investment and attempted to improve the infrastructure (Kumer, 1994; Brown, 1997; Grundy-Warr *et al.* 1999).

The cross-border regional production system has two main characteristics. First, it often involves at least two economies, with one well developed and the other underdeveloped. Second, rapid development may take place in the border region of the less developed economy which may undergo a transition from a status of a less developed region to that of a more developed region in that economy. In other words, the border region becomes a new growth centre of the less developed economy with a higher growth rate than the rest of the economy. The cross-border development can thus significantly transform the spatial economic system of the less developed economy. This is often caused by the heavy concentration of foreign investment from the developed economy in the border region of the less developed economy due to their geographical proximity.

The two economies have different factor endowments, and abundant cheap land and labour are often available in the border region of the less developed

economy. The developed economy provides capital and technology for the development of the border region while retaining high value-added key functions such as designing, financing, co-ordination and marketing. As a result, a technical and spatial division of labour is developed. Looking beyond these comparative advantages for co-operation, it is interesting to ask whether demographic and cultural linkages, and political changes have any role to play in cross-border development. The case of Hong Kong–mainland China provides an excellent opportunity to examine this issue with the close demographic ties and the political change in 1997.

Hong Kong–mainland connection in the context of cross-border regional production systems

Among the three most significant cross-border regional production systems, the Hong Kong–PRD region is perhaps the most outstanding. The US–Mexico border has a long history of co-operation since 1942. It involves the largest and strongest American economy in the world and a developing country. The Indonesia–Malaysia–Singapore growth triangle involves one small but highly developed city state, Singapore, and two populous developing countries. This ambitious cross-border regional production system is still under development and has also faced increasing social and institutional problems (Grundy-Warr *et al.* 1999).

On the other hand, the Hong Kong–PRD region involves a small but well-developed economy of Hong Kong and a populous mainland China. But the populations on both sides of the border are mostly Chinese, sharing a common language and culture which has facilitated at least the initial cross-border investment especially by small investors.

Before 1997, Hong Kong was a British colony. The border between Hong Kong and mainland China was meant to separate Hong Kong from the mainland, and a frontier zone (called a closed boundary area) was created at the Hong Kong side of the border. There were two different systems, politically, economically and socially, across the border. Socialism/market socialism was practiced on the mainland and capitalism was practiced in Hong Kong. The border was used to protect the capitalist Hong Kong from the influence of the socialist mainland and to control migration from mainland China to Hong Kong. Before 1978, there were little population and goods movements across the border. Mainland China was closed to the outside

world. Few Hong Kong people wished to visit the mainland even though many originally came from there. The areas on both sides of the border were truly underdeveloped frontiers.

However, the mainland side of the border has changed significantly since 1978 when economic reforms and an open door policy were introduced. The open door policy of China has greatly facilitated and enhanced the border's function as a contact zone for massive cross-border investment and development since 1978 (Shen and Yeung, 2002). Similar to other cross-border regional production systems, major industrial development has taken place on the side of the less developed mainland. Due to economic complementarities and comparative advantages of Hong Kong and mainland China, a spatial division of labour has been established across the border which has been generally called 'front shop, back factory model' (Sit, 1989, 1998). Hong Kong has transferred the majority of its manufacturing to the PRD and itself has become a prominent service centre specializing in designing, marketing, co-ordination, trading, transport and communication, and financial services.

In contrast to the cases of the Indonesia–Malaysia–Singapore growth triangle and the US–Mexico border where the governments of both sides have been actively involved in stimulating cross-border development, the Hong Kong–PRD region has been initiated by the implementation of an open policy in mainland China with active participation of many investors from Hong Kong. The Hong Kong government generally took a non-intervention *laissez-faire* policy before 1997 (Yeung, 2000). This means that, on the Hong Kong side, the bottom-up forces represented by the businessmen were key to the success of the cross-border development in this case. A large amount of investment has been made on the mainland by Hong Kong investors. Most investment from Hong Kong has concentrated in Guangdong province, especially the PRD region (Shen *et al.* 2000). Consequently, a massive Hong Kong–PRD cross-border regional production system has emerged since 1978 and Hong Kong has contributed significantly to the rapid economic development in mainland China. Contrary to the conventional de-industrialization story of Hong Kong's economic transformation (Loo, 2002), some scholars argued that the manufacturing capacity controlled by Hong Kong has greatly expanded rather than shrunk since then (Berger and Lester, 1997). It is true that the amount of manufactured products 'made in Hong Kong' by the fac-

tories in the city has declined. But the amount of manufactured products 'made by Hong Kong' has increased significantly, as a labour force of over six million has been employed by Hong Kong investors in various enterprises in the PRD region. The labour force employed by Hong Kong investors in the mainland is about twice that of the local labour force in Hong Kong. It is typical that a Hong Kong-based company employs tens or a few hundred employees in its Hong Kong base but employs hundreds or thousands of migrant workers in mainland China (Tsui-Auch, 1999). This was evident during my various visits to the PRD.

The return of Hong Kong in 1997 has made this cross-border system even more significant politically and economically. The border between Hong Kong and mainland China continues to function and each remains an independent economic entity as before. The new HKSAR established in 1 July 1997 practices 'One country, two systems', which has long been laid down in the Sino–British Declaration of 1984 and also the Basic Law. HKSAR is an autonomous region of China. It has the full power to deal with all internal affairs from education to finance. It is a separate customs territory and has its own court of final appeal and currency that is linked to the US dollar (US\$1=HK\$7.8).

Thus the political change in Hong Kong in 1997 did not alter the configuration of the border in any real sense and was far less significant on the cross-border development than the effect of the open door policy introduced into China in 1978. Ironically, the frontier zone on the Hong Kong side continued to exist after 1997. Thus the political change, the return of Hong Kong to China in 1997, has had no dramatic impact on the cross-border regional system. In all practical terms, the cross-border regional production system has continued under 'two systems' in Hong Kong and mainland China. The following few sections will examine the cross-border linkages before 1997 and assess whether there has been any change since the handover of Hong Kong in 1997, especially the role of the HKSAR government.

Demographic foundation of the cross-border linkages between Hong Kong and mainland China

The demographic link between Hong Kong and mainland China makes their cross-border relationship significantly different from other cases. The majority of people on both sides of the border are

Table 1. Passengers travelling between Hong Kong and Shenzhen via Lowu and Lok Ma Chau 1991–2001 (two-way).

| Year | Lowu | | | Lok Ma Chau | | |
|------|-----------------|--------------------|---------------|-----------------|--------------------|---------------|
| | Total (million) | Share of Total (%) | Daily average | Total (million) | Share of Total (%) | Daily average |
| 1991 | 31.10 | 93.6 | 85205 | 0.19 | 0.6 | 521 |
| 1992 | 34.94 | 93.3 | 95726 | 0.69 | 1.9 | 1890 |
| 1993 | 37.56 | 92.8 | 102904 | 1.22 | 3.0 | 3342 |
| 1994 | 40.12 | 92.4 | 109918 | 1.61 | 3.7 | 4411 |
| 1995 | 43.31 | 90.7 | 118658 | 2.48 | 5.2 | 6795 |
| 1996 | 47.97 | 90.5 | 131425 | 3.09 | 5.8 | 8466 |
| 1997 | 56.29 | 88.9 | 154219 | 5.02 | 7.9 | 13753 |
| 1998 | 66.12 | 87.6 | 181151 | 7.42 | 9.8 | 20329 |
| 1999 | 77.20 | 87.3 | 211507 | 9.10 | 10.3 | 24932 |
| 2000 | 86.47 | 86.8 | 236900 | 10.93 | 11.0 | 29938 |
| 2001 | 89.50 | 85.7 | 245220 | 12.56 | 12.0 | 34401 |

Source: Territory Development Department, HKSAR; HKSAR Government (2001, 2002); Mak (2000)

Chinese and many Hong Kong residents came from Guangdong originally (Shen, 1997). It is not easy to find out the number of Chinese in Hong Kong from the official data that report people’s nationalities instead of ethnicity, but the 1996 by-census asked questions on birthplace and language which provided a clear clue. In 1996, 93.73% of the population in Hong Kong spoke Cantonese, 47.41% spoke English and 31.86% spoke Putonghua. Cantonese is the Chinese dialect popular in south China while Putonghua is the standard official language spoken on the mainland. In terms of birthplace, 60.28% of the population was born locally, 32.41% on the mainland, and less than 8% in other countries. Indeed, the percentage of people born on the mainland decreased from 50.5% in 1961.

However, during the period 1949 to 1978 there was little population interaction between Hong Kong and the mainland (Tsim, 1991). Many illegal and a few legal migrants settled in Hong Kong from the mainland during that period, but the movement was mainly one-way. Both new and old migrants rarely went back to visit the mainland. Hong Kong had better links with Europe, North America, Australia and Southeast Asia than with the mainland. Many Hong Kong people visited or emigrated to these regions each year.

The population exchange and interaction between Hong Kong and the mainland accelerated after the opening up of China to the outside world in 1978. Most Chinese people in Hong Kong could apply for a Home Visit Permit allowing them unlimited to travel to the mainland. Many businessmen also engaged in this newly expanded connection, resulting in huge investment and trading with the mainland. Personal and cultural ties resulting

from the demographic linkages contributed significantly to such outward investment in the mainland (Smart and Smart, 1991; Leung, 1993). During the holiday period, millions of people might leave Hong Kong; largely for mainland China. Lowu was the main exit that was linked by the Kowloon–Canton Railway from Hong Kong. Table 1 presents the number of passengers travelling to and from two main border crossings, Lowu and Lok Ma Chau, in the period 1991 to 2001. It is noted that mainland people could not travel freely to Hong Kong and thus the majority of cross-boundary passengers were Hong Kong people both before and after 1997. According to Table 1, the number of passengers leaving or entering Hong Kong via Lowu increased by 81% in the period 1991–1997 (from thirty-one million to fifty-six million). By 1997, an average person (child or adult) based in Hong Kong travelled five times to the mainland each year. On average, over 1% of Hong Kong’s population travelled through Lowu each day. This represents a high level of interaction between Hong Kong and the mainland.

Nevertheless, the border between Hong Kong and the mainland was used to control the travelling and migration of the population from the mainland to Hong Kong. The Hong Kong government introduced a tight migration policy directed at the migrants from the mainland in 1980. Due to the increased contact of Hong Kong people with those on the mainland, the number of cross-border marriages increased, but it was not easy for spouses and children of Hong Kong permanent residents on the mainland side to join their families in Hong Kong. Before 1997, spouses and direct descendants could apply to the government for one-way permits in the

mainland to migrate to Hong Kong. These one-way permits were granted according to a quota system that was introduced in October 1980. Initially, the quota for legal migrants was 150 a day but was reduced to seventy-five migrants a day in 1983. The basic law provided the right of abode to the children of Hong Kong permanent residents and it was expected that these children would join their families immediately after 1997. The quota of legal migrants was increased to 105 a day in November 1993 and to 150 a day in July 1995 to avoid a migration peak in 1997. Thus the number of legal migrants from mainland China increased from 26 782 in 1991 to 61 179 in 1996.

The migrant quota system dealt with the dependants of Hong Kong's permanent residents and these migrants became residents in Hong Kong after arrival. In the meantime, other migrants of Chinese nationality from the mainland or abroad were employed to work in Hong Kong, and their stay in Hong Kong was conditional upon their employment. These migrants were more likely, to be professionals. In 1996, there were 64 717 such migrants in Hong Kong.

There were also an increasing number of migrants from Hong Kong who moved to the mainland for retirement, housing and employment. Some people found it more economical to live on the mainland where the cost of living was low. Those who were working in Hong Kong, but could not afford the high housing cost, moved to live in Shenzhen and became commuters. The huge investment in mainland China by Hong Kong certainly generated many jobs for skilled people from Hong Kong. The number of Hong Kong residents who were working in the mainland increased from 52 000 in 1988 to 122 000 in 1996, according to the Census and Statistics Department (CSD, 1999). Many of them were managers looking after the enterprises established by Hong Kong's investors in the mainland.

The population in Hong Kong and that on the mainland shared the same culture. It was suggested that Hong Kong businessmen, especially small investors, had an advantage of doing business in mainland China compared to other foreign nationals (Sung, 1998). Hong Kong investors found it easier to cultivate a close relationship with local officials on the mainland through their relative networks (Smart and Smart, 1991; Leung, 1993). The close ethnic, cultural and migration links between Hong Kong and mainland China provided a strong foundation for the cross-border co-operation and

development in the region. The following section focuses on cross-border investment and trade between Hong Kong and mainland China.

Cross-border investment and trade relations between Hong Kong and mainland China

Investment and trading links are key in the operation of any cross-border regional production systems. This section examines the investment and trade relations between Hong Kong and the mainland. In 1997, Hong Kong was relatively small in terms of population. The economic scale of mainland China, in terms of GDP, was also 5.34 times larger than Hong Kong. However, in terms of GDP per capita, Hong Kong was comparable to the level in many advanced countries and much greater than that on the mainland. Hong Kong's particular strength was manifested by its larger volumes of import and export than those of the mainland in 1997. This reflects Hong Kong's role as an important trading centre.

Foreign direct investment (FDI) activities in the region, including those between Hong Kong and mainland China, accelerated after the opening up of China to the outside world. Hong Kong as an advanced economy and closest to the mainland took up this opportunity for intensive cross-border development. It is useful to note that a certain amount of FDI from Hong Kong to the mainland involved capital originally from the mainland for taking advantage of tax concessions for FDI. However, it is difficult to estimate the real scale of such 'return investment' to and from the mainland.

The large-scale investment from Hong Kong to the mainland made them among a few top origin and destination regions of FDI in the world respectively. The mainland became the second largest destination for FDI in the world, just after the USA, in 1993. In the same year, Hong Kong became the fourth largest FDI investor in the world, after the USA, UK and Germany. In 1996, the total FDI stocks in mainland China and Hong Kong were US\$175 billion and US\$79 billion respectively. Total FDI stocks originally from mainland China and Hong Kong were US\$18 billion and US\$112 billion respectively. Clearly, mainland China was a net major receiver of FDI. Out of the US\$175 billion FDI the mainland received, 56.8% came from Hong Kong which was the biggest investor in the mainland. Inside the mainland, 41% of Hong Kong's investment was concentrated in nearby

Guangdong province, PRD in particular (Yeung, 1999; Shen *et al.* 2000; Shen, 2002). Overall, Guangdong received 30% of FDI in mainland China but 80% of FDI in Guangdong came from Hong Kong. The total FDI stock originating in Hong Kong amounted to US\$112 billion, 88.5% of which went to the mainland in 1996.

In the meantime, total FDI stock in Hong Kong was US\$78.78 billion in 1996, 18.7% of which came from mainland China. Indeed, the mainland was the second largest investor in Hong Kong in terms of FDI stock, just after the UK. The mainland chose Hong Kong as the top place for investment. Hong Kong received 82% of FDI from mainland China (Sung, 1998). It was estimated that the shares of various economic activities owned and operated by the mainland enterprises were in the range of 10 to 30% in Hong Kong. By the end of 1996, a total of 13 970 mainland companies were operating in Hong Kong. It is clear that mainland China companies had penetrated Hong Kong's economy well before 1997.

The cross-border economic activities played a significant role in the rapid economic growth on mainland China (Eng, 1997; Shen *et al.* 2001; Shen, 2002), but such cross-border economic activities were also instrumental in sustaining the economic growth and transformation in Hong Kong especially in the 1980s and 1990s (Berger and Lester, 1997). Hong Kong has enjoyed a long period of economic growth in the past four decades. Its real annual GDP growth rate was 6% in the period 1965 to 1975, 8.5% in the period 1975 to 1985 and 6.1% in the period 1985 to 1997. The GDP per capita tripled during the period 1975 to 1997. Its real GDP per capita, adjusted by purchasing power, was US\$24 540, ranked fourth after Singapore, the USA and Switzerland in 1997 (World Bank, 1998).

Rapid economic growth in Hong Kong was based on the industrialization within Hong Kong before the 1970s when the China factor played almost no role. The share of the labour force employed in manufacturing was as high as 47% in 1971 and was still 41.3% in 1981 (Suen and Chan, 1997). Trading and re-exporting activities with the mainland were minor in the 1960s and 1970s before the boom of cross-border activities. During the period 1965 to 1979, the volume of direct export from the mainland to Hong Kong was larger than that of re-export via Hong Kong. Hong Kong was an important direct market of food and vegetables from the mainland. On the other hand, the mainland did rely on Hong Kong as an import agent during

the Cold War period. The volume of re-export to the mainland from Hong Kong was larger than the direct export from Hong Kong in that period. However, although Hong Kong did not play a major role as an export agent until 1979, it underwent a dramatic transition towards a service economy in the 1980s and 1990s when many manufacturing firms were relocated and extended across the border to mainland China. Hong Kong's economy experienced a significant de-industrialization process and trading with the mainland became very important to Hong Kong. By 1996, the share of labour force was only 18.9% in manufacturing in Hong Kong.

Among various economies in the World, Hong Kong ranked ninth, sixth and eighth in the export, import and total merchandise trade in 1997 respectively. These ranks still stood at tenth in 2001 after the Asian Financial Crisis (CSD, 2002a). One important role that Hong Kong plays is as a middleman, importing from and exporting to the rest of the world, especially for the mainland. According to Table 2, re-exports accounted for over 68% of the import or export of the economy and this share increased to over 84% in 2001. The majority of such re-export activities was related to the mainland which was the largest trading partner of Hong Kong. Table 3 presents the top four trading partners of Hong Kong in import, domestic export and re-export. According to Table 3, the mainland supplied 37.7% of total imports by Hong Kong in 1997 and this share increased to 43.5% in 2001. In terms of domestic export of products made in Hong Kong, the USA and mainland China were equally important destinations, each receiving over 23% of the domestic export. In terms of re-export, the mainland was the top destination, accounting for over 29% of the total re-export market from Hong Kong.

The re-export trading activities with mainland China brought huge profits to businesses in Hong Kong. According to the statistics of the Hong Kong government (Sung, 1998), the gross profit rate of exporting the mainland's product via Hong Kong increased from 13% in 1989 to a magnificent 34.4% in 1996 while that of exporting other products via Hong Kong declined from 11.5% to 6.6% over the same period. It could be estimated that Hong Kong made a gross profit of US\$21.82 billion by exporting the mainland's product in 1997. This profit was equivalent to 12.7% of the GDP in Hong Kong and was almost enough to cover Hong Kong's household expenditure on imported goods (equivalent to 13.5% of total private expenditure)

Table 2. Import and export in Hong Kong 1991 to 2001 (HK\$ billion)

| Year | Import | Domestic imports | Re-exports | Domestic Exports | Total exports | Re-exports share in imports (%) | Re-exports share in exports (%) |
|------|--------|------------------|------------|------------------|---------------|---------------------------------|---------------------------------|
| 1991 | 779.0 | 244.2 | 534.8 | 231.0 | 765.8 | 68.7 | 69.8 |
| 1992 | 955.3 | 264.5 | 690.8 | 234.1 | 924.9 | 72.3 | 74.7 |
| 1993 | 1072.6 | 249.4 | 823.2 | 223.0 | 1046.3 | 76.8 | 78.7 |
| 1994 | 1250.7 | 302.8 | 947.9 | 222.1 | 1170.0 | 75.8 | 81.0 |
| 1995 | 1491.1 | 378.7 | 1112.5 | 231.7 | 1344.1 | 74.6 | 82.8 |
| 1996 | 1535.6 | 349.8 | 1185.8 | 212.2 | 1397.9 | 77.2 | 84.8 |
| 1997 | 1615.1 | 370.6 | 1244.5 | 211.4 | 1455.9 | 77.1 | 85.5 |
| 1998 | 1429.1 | 269.9 | 1159.2 | 188.5 | 1347.6 | 81.1 | 86.0 |
| 1999 | 1392.7 | 214.3 | 1178.4 | 170.6 | 1349.0 | 84.6 | 87.4 |
| 2000 | 1658.0 | 266.3 | 1391.7 | 181.0 | 1572.7 | 83.9 | 88.5 |
| 2001 | 1568.2 | 240.7 | 1327.5 | 153.5 | 1481.0 | 84.7 | 89.6 |

Data Sources: CSD (2001d: 1; 2002b)

Note: It is important to distinguish domestic exports and re-exports in Hong Kong. Domestic exports are the natural produce of Hong Kong or the products of a manufacturing process in Hong Kong. Re-exports are products which have been imported previously and which are re-exported without having undergone a manufacturing process in Hong Kong (CSD, 2001d). Goods trans-shipment from one destination to another via Hong Kong is not counted in trade statistics as no trading company in Hong Kong is involved in importing or exporting such goods (Mainland Commission, 1995; Sung, 1998). A large amount of import and re-export between Hong Kong and mainland China involves outward processing trade (see Table 4).

Table 3. Main trading partners of Hong Kong 1991 to 2001 (HK\$ billion)

| Type of trade/Main country/Territory | 1991 | 1997 | 1999 | 2001 |
|--------------------------------------|-------|--------|--------|--------|
| Imports | 779.0 | 1615.1 | 1392.7 | 1568.2 |
| The mainland of China | 293.4 | 608.4 | 607.5 | 682.0 |
| Share of mainland China (%) | 37.7 | 37.7 | 43.6 | 43.5 |
| Japan | 127.4 | 221.6 | 162.7 | 176.6 |
| Taiwan | 74.6 | 124.6 | 100.4 | 107.9 |
| USA | 58.8 | 125.4 | 98.6 | 104.9 |
| Domestic exports | 231.0 | 211.4 | 170.6 | 153.5 |
| The mainland of China | 54.4 | 63.9 | 50.4 | 49.5 |
| Share of mainland China (%) | 23.5 | 30.2 | 29.5 | 32.3 |
| USA | 62.9 | 55.1 | 51.4 | 47.6 |
| United Kingdom | 13.7 | 10.7 | 10.4 | 8.6 |
| Germany | 19.3 | 10.3 | 8.5 | 5.9 |
| Re-exports | 534.8 | 1244.5 | 1178.4 | 1327.5 |
| The mainland of China | 153.3 | 443.9 | 399.2 | 496.6 |
| Share of mainland China (%) | 28.7 | 35.7 | 33.9 | 37.4 |
| USA | 110.8 | 261.4 | 269.4 | 282.2 |
| Japan | 29.6 | 77.7 | 67.5 | 83.6 |
| United Kingdom | 14.7 | 39.1 | 45.5 | 46.8 |

Data Sources: CSD (2001a: 52; 2002b)

Note: Japan ranked fourth in 1997 as the destination of domestic export from Hong Kong (HK\$10.6 billion); Germany ranked third as the destination of re-exports during 1991 to 1997 (HK\$46.3 billion in 1997).

or overseas expenditure by Hong Kong residents (equivalent to 10.9% of total private expenditure) (Heng Seng Bank, 1999). This clearly shows the importance of trading business to Hong Kong's foreign exchange balance.

The main reason for the high gross profit rate of trading with the mainland was the functioning of the cross-border regional production system. Many

manufacturing activities in the cross-border system were operated by Hong Kong investors or joint ventures on the mainland, particularly in Guangdong. Such FDI activities result in significant amounts of outward processing trade where raw materials or semi-manufactures are exported from or through Hong Kong to the mainland and the processed goods are then imported from the mainland to

Table 4. Outward processing trade and its share in total trade between mainland China and Hong Kong 1991–2000 (HK\$billion)

| Year | 1991 | 1995 | 1997 | 2001 |
|---|--------|--------|--------|--------|
| Mainland China direct import from Hong Kong | 40.4 | 43.9 | 47.1 | 35.2 |
| (Percentage share in total) | (76.5) | (71.4) | (76.1) | (71.0) |
| Mainland China import via Hong Kong | 73.6 | 173.7 | 197.81 | 224.4 |
| (Percentage share in total) | (48.2) | (45.4) | (44.7) | (45.2) |
| Subtotal | 113.9 | 217.6 | 244.9 | 259.6 |
| (Percentage share in total) | (55.5) | (49.0) | (48.6) | (47.2) |
| Mainland China export to Hong Kong | 197.4 | 399.6 | 491.1 | 532.0 |
| (Percentage share in total) | (67.6) | (74.4) | (81.2) | (78.0) |
| Guangdong export to Hong Kong | 186.6 | 379.6 | 430.8 | 529.5 |
| (Percentage share in total export involving outward processing from the mainland) | (94.5) | (95.0) | (95.1) | (97.9) |

Data source: CSD (1992, 1996, 1998, 2002c).

Hong Kong according to contractual arrangements. Table 4 shows that 44.7% of mainland imports from Hong Kong and 81.2% of mainland exports to Hong Kong resulted from such outward processing activities by Hong Kong investors in 1997. It is noticeable that 95.1% of total exports involving outward processing to Hong Kong from the mainland actually originated in Guangdong in 1997.

Indeed, Guangdong had become a manufacturing base of Hong Kong. In the PRD alone, over six million people were employed in firms owned or jointly owned by Hong Kong investors in 1997. In this sense, Hong Kong did not just play the role of a middleman, it was also an economic co-ordinator (Enright *et al.* 1997). According to the theory of cross-border regional production systems and Berger and Lester (1997), Hong Kong controlled a massive manufacturing capacity in the PRD. Taking the Hong Kong–PRD region as a whole, industrialization had intensified in the region. Thus the de-industrialization process in Hong Kong differed from that in Western developed economies where manufacturing declined and was detached from the economy. In Hong Kong, its economy benefited from its controlling and supporting roles to the expanding manufacturing capacity on the mainland. De-industrialization in Hong Kong reflected the division of labour between Hong Kong and the mainland in the regional production system which was under the control of the investors from Hong Kong. This differed from the case of the service sector on the mainland. Hong Kong’s investors faced tight regulations and strong competition from the local companies there and found it difficult to assume a dominating role. Transferring some parts of the service sector from Hong Kong to the mainland would pose a real challenge to Hong Kong’s eco-

nomy. This may call for a more active role of the government in Hong Kong which so far has been minimal.

Cross-border relations between Hong Kong and mainland China after 1997

The previous sections have shown that close relations had been well established between Hong Kong and mainland China by 1997. Before 1997, the population movement and trading relations were developed largely through the initiatives of local people and businessmen in Hong Kong. The then Hong Kong government took a policy of no intervention with a few exceptions. For example, a quota system was introduced in 1980 to allow 150 mainland people to migrate to Hong Kong each day. The Lok Ma Chau crossing was built and opened to the public in November 1994. To facilitate the return of Hong Kong to China in 1997, a limited number of subcommittees under the Sino–British Liaison Group were formed to deal with various matters after 1984 (Chu *et al.* 1997, 2002). The Hong Kong–Guangdong Environmental Liaison Group formed in July 1990 was the most successful before 1997. This committee met frequently and some fruitful outcomes were achieved, such as the straightening of the channel of the Shenzhen river along the Hong Kong–Shenzhen border.

As mentioned before, the return of Hong Kong to China in 1997 did not change the nature of the border between Hong Kong and the mainland dramatically. The new HKSAR practices ‘one country, two systems’ and the border continues to function to separate Hong Kong and the mainland as two independent economic entities. In all practical terms, the cross-border regional production system con-

tinues to operate under the 'two systems' in Hong Kong and the mainland respectively. Nevertheless, the HKSAR government has pledged to improve relations with the mainland and to strengthen co-operation on cross-border issues. It has also gradually recognized the importance for Hong Kong to be well integrated with the PRD, though much later than most businessmen in Hong Kong. The Commission on Strategic Development of HKSAR (2000) recognized that capitalizing on the links with the mainland and the PRD region in particular was one of the key strategies for the long-term development of HKSAR in the future.

Soon after 1997, the HKSAR government had to establish a legal basis to maintain its tight immigration policy on the dependent migrants from the mainland. The reunion of cross-border families, their spouses and children became the most debated and sensitive issue in the cross-border relations between Hong Kong and the mainland after 1997 (Lam and Liu, 1998). The Supreme Court in Hong Kong ruled on 29 January 1999 that all children of Hong Kong permanent residents who had the right of abode in Hong Kong should be allowed to come to Hong Kong. The HKSAR government argued that the basic law was not clear enough about the right of abode issue and proposed to seek an interpretation of the basic law on 18 May 1999. The People's Congress of the People's Republic of China interpreted the Basic Law on 26 June 1999 indicating that only children whose mothers or fathers were permanent residents of Hong Kong at the time of birth had the right of abode in Hong Kong. This interpretation was controversial in Hong Kong initially. Eventually, the Supreme Court of Hong Kong accepted the new interpretation and on 3 December 1999 ruled that the interpretation take effect from 1 July 1997.

On the other hand, to meet the increasing demand for skilled and professional migrants in Hong Kong, a new 'Admission of Talents Scheme' was adopted in January 2000 allowing skilled mainland people to work in Hong Kong. The Hong Kong employers have to prove that such skilled labourers are not available in Hong Kong and such persons are allowed to bring their spouses and children to Hong Kong. An 'Admission of Mainland Professionals Scheme' was introduced in June 2001, initially targeted at the information technology (IT) and financial services sectors. These two schemes had admitted 606 and 242 migrants respectively by the end of 2001. The mainland students graduating in Hong Kong's universities are also allowed to work

from Hong Kong if they are offered an employment contract of one year and over. The purpose of these measures is to strengthen the competitive edge of Hong Kong, especially in the mainland market.

Limited progress has also been achieved in the co-operation between HKSAR and Guangdong, in particular Shenzhen. The regular Hong Kong–Guangdong Cooperation Conference was inaugurated by the chief executive Chee-hwa Tung of the HKSAR and the Governor of Guangdong Ruihua Lu on 30 March 1998. This conference is to facilitate and expand co-operation in terms of the economy and infrastructure. The following examples illustrate limited progress at the governmental level.

1. Since mid-October 1998, the opening time of two main crossings at Lowu and Lok Ma Chau for passengers has been extended by one hour.
2. A decision was made to construct Lok Ma Chau spur line to link the Lok Ma Chau crossing with East Rail to relieve passenger congestion at Lowu. The spur line and the Lok Ma Chau/Huanggang railway passenger crossing will be completed by 2005.
3. According to the 'Railway Development Strategy 2000' (Transport Bureau, 2000), a Northern Link railway will be built in the period 2011 to 2016 to link West Rail at Kam Sheung Road and East Rail at Kwu Tung and to the boundary crossing point at Lok Ma Chau. A Regional Express Line (REL) was proposed for planning studies to link up the urban areas with the boundary.

However, it seems that the twenty-four hour operation of Lowu crossing is still off the agenda of the HKSAR authority. Another major project, the Lingdingyang Bridge, proposed by Shenzhen, Zhuhai and Macau, was not considered seriously by the government until 2002. The proposed Lingdingyang bridge linking Hong Kong with Zhuhai and/or Macau would be 41 km long, costing RMB 12 billion (US\$1 converted to RMB8.3 in 2001). The bridge would help to connect Hong Kong with the west side of the PRD. But HKSAR was not so enthusiastic about the project until 2002 (Li *et al.* 1996).

Generally, the HKSAR government is slow in taking actions, and the planning department has been blamed for not planning ahead to accommodate increasing flows of passenger/goods traffic across the Hong Kong–Shenzhen border. There are

two main reasons. First, the central government of China is committed to the implementation of 'one country, two systems' in Hong Kong and has instructed all provincial/regional governments on the mainland not to seek any official engagement with HKSAR, and that any relations with HKSAR need to be dealt with via the Hong Kong and Macau Office of the State Council in Beijing. This has the effect of cutting off relations between HKSAR and many regions on the mainland, including those in PRD and Shenzhen.

Second, a full regional integration of Hong Kong with the PRD region with a convenient twenty-four hour operation of border crossings has been considered by many not to benefit Hong Kong's economy, with a few exceptions (Kwong, 1999). Housing prices in PRD cities are only one-tenth to one-fifth of those in Hong Kong. Any significant improvement in the service of cross-boundary transport may induce many Hong Kong people to live in Shenzhen and work in Hong Kong. More residents, especially those who live in the New Territories, will go shopping in Shenzhen. These changes in the property and consumer markets will have negative effects on the real estate price and businesses in Hong Kong which has been affected by the Asian financial crisis already. Due to the crisis, Hong Kong registered a negative GDP growth rate of -5.3% in 1998. Hong Kong's economy was on its way to recovery with a positive GDP growth rate of 3% and 10.2% in 1999 and 2000 respectively (CSD, 2001a, 2002b). However, Hong Kong's economy worsened again after 11 September 2001. Expenditure-based GDP for the third and fourth quarters of 2001 declined by 0.3% and 0.9% respectively, in real terms over a year earlier. The GDP growth rate was only 0.6% in the year 2001 (CSD, 2002b). The housing price in Hong Kong has fallen by 30-50% on average since 1997. Stabilizing house prices in Hong Kong has been the consensus of the HKSAR government, property developers and homeowners. Therefore, the HKSAR government is hesitant to improve the cross-boundary facility speedily. Sung (2002) argued that it is ironic for Hong Kong, a champion for free trade, to be so hesitant in easing checkpoint congestion which acts as a trade barrier.

Comparing the limited progress in the regional co-operation and co-ordination between Hong Kong and PRD at government level, passenger movement, capital flow and trading volume between HKSAR and the mainland, driven by bottom-up forces, continued to rise even more rapidly

after 1997. These are the same forces which were working before 1997 which explains why the political change in 1997 had little impact on cross-border development so far. This is a multi-faceted process but a few examples could illustrate the point.

Cross-boundary passenger movement increased rapidly after 1997. According to Table 1, cross-boundary passenger traffic volume at Lok Ma Chau increased from 3.09 million in 1996 to 12.56 million by 2001. The volume of cross-boundary passenger traffic at Lowu speeded up after 1996, increasing from 47.97 million in 1996 to a massive 89.50 million in 2001. Passenger volume increased at 13% a year after 1996 in contrast with the annual growth rate of 9% in the period 1991 to 1996.

The Planning Department (2000) of HKSAR conducted a travel survey between 2 October and 2 November 1999, providing further information on the purposes and destinations of trips made by Hong Kong residents. It was estimated that 1.39 million Hong Kong residents travelled to the mainland during the survey period. Among them, 0.63 million Hong Kong residents travelled to the mainland at least once a month for three main purposes: business (40%), shopping/leisure (17%) and meeting with spouses or children (12%). Among 0.25 million frequent travellers for business, their main destinations were Shenzhen (38%), Dongguan (23%) and Guangzhou area (14%). Among 0.11 million frequent travellers for shopping and leisure, their main destination was Shenzhen (91%). Among 75 100 travellers to meet their spouses or children, their main destinations were Shenzhen (59%), Dongguan (14%) and Guangzhou area (8%).

The same survey also collected information on the commuting habits of Hong Kong residents living in Hong Kong or on the mainland. There were 14 600 Hong Kong residents who lived in Hong Kong but commuted to the mainland for work during the survey period. Some 51% of these were managers, executives and professionals. Their main destinations were Shenzhen (50%) and Dongguan (18%). Some 86% of them travelled to the mainland at least once every one or two weeks. These people were generally well paid. They were able to afford the high living costs in Hong Kong for a high quality of life since Hong Kong had excellent social and public services as a world city.

The survey found that 41 400 Hong Kong residents actually travelled to take vacations in their houses bought in the mainland during the survey

period. Main locations were Shenzhen (45%) and Dongguan (30%). Some 61% of them were full-time employed while 16% were retired. As many as 72% of them travelled to the mainland at least once every one or two weeks.

The survey also found that 51 300 Hong Kong residents who lived on the mainland travelled to Hong Kong during the survey period. Their main purposes were for meeting relatives (23%), work (22%) and business (19%). A total of 7 700 Hong Kong residents commuted to Hong Kong for work, most of whom lived in Shenzhen (86%) and Dongguan (8%). They were the most frequent travellers: at least four trips a week. Another survey on the aspiration and experience of taking up residence on the mainland found that 41 300 lived on the mainland in 2001 (CSD, 2001b). Among these people, 79.2% were males and 56.1% were aged 35 to 54. Only 12.4% had tertiary education, slightly lower than 16.4% of the total population in Hong Kong. The median monthly personal income was HK\$18 300, close to HK\$18 705 for all households in Hong Kong. Dongguan (33.5%), Shenzhen (19.7%) and Foshan (19.2%) were the main places of residence for Hong Kong people. The main reasons for living on the mainland (one person may give multiple reasons) were employment (77.5%), better living environment (19.2%), reunion with spouses/children/relatives (38.4%). Interestingly, only 1.5% of those living on the mainland considered low living cost to be a main factor. Clearly, Hong Kong residents were not simply looking for cheap housing in PRD. Employment, quality of life and social integration were much more important and were also the fundamental forces of regional integration among areas with similar levels of development.

The above survey also found that 163 900 households owned residential properties on the mainland in 2001 (CSD, 2001b). Most of these properties were located in Dongguan (23.9%), Shenzhen (19.7%) and Guangzhou (10.3%). Some 59.3% of these households also had private housing in Hong Kong while 20.3% owned flats sold by the government at a subsidized price and 30.2% lived in public rental housing. Only 8.8% of these households had a flat over 900ft² in Hong Kong while 47.1% had a flat over 1000ft² on the mainland. The size of a medium flat in the mainland was double that in Hong Kong. If convenient and economic cross-border transport services could be provided, cross-border suburbanization would take place so that many Hong Kong residents could improve their housing

and living standards dramatically at affordable cost. Conspicuously, the only Kowloon–Canton railway service to the border charged high fares for trips to and from Lowu. The extra income amounting to over HK\$1 billion a year was said to subsidize the internal rail service within Hong Kong, but such excessive profits might also be used to fund the lucrative salaries and welfare for the senior staff of the rail service. Such cross-border surcharge should have gone to the government treasury if it had to be levied at all.

It is interesting to note that some households with above-average income and education in Hong Kong made a rational choice for bigger properties on the mainland, most used currently as second homes. The median monthly household income of those owning flats on the mainland was HK\$22 400 and 17.2% of them had tertiary education. Both were greater than those of the total population in Hong Kong.

The above survey may have revealed only part of the reality. It has been reported that over 0.8 million housing units in the PRD region have been bought by Hong Kong residents as sole homes, second homes or holiday homes. One survey in 2000 found that more than 15% of 1121 respondents (41.4% with income under HK\$10 000 a month and 14.5% with income over HK\$30 000 a month) in Hong Kong would move to Shenzhen in the next ten years (Wong and No, 2000). This means that more than one million Hong Kong residents may move to live in Shenzhen and probably commute back to Hong Kong for work. Some low-income people in Hong Kong wanted to live on the mainland where living costs were substantially lower, while quite a few middle-income people were also interested in moving to Shenzhen for comfortable housing, currently mostly second holiday homes.

According to a separate household survey (CSD, 1999), the total number of Hong Kong residents working on the mainland increased further from 122 000 in 1996 to over 157 000 by 1998. This represents a 30% increase in two years and means that 5% of the Hong Kong labor force works regularly on the mainland. Among the total residents working on the mainland in 1998, 86.2% were males and 33.2% had tertiary education. In terms of employment status, 19.8% were employers and 7.5% were self-employed. In terms of occupation, 40.8% were managers and administrators, and 35.0% were professionals and associate professionals. These percentages were significantly higher than those in the total population of Hong Kong. Clearly, a quality

Table 5. Stock and flow of outward direct investment (DI) from Hong Kong by major country/territory in 2000.

| Major country/territory a) | DI stock (HK\$ billion) | Share (%) | DI outflow b) (HK\$ billion) | Share (%) |
|----------------------------|----------------------------|-----------|---------------------------------|-----------|
| British Virgin Islands | 1569.4 | 51.8 | 70.5 | 15.2 |
| Mainland of China | 1011.6 | 33.4 | 361.2 | 78.1 |
| Cayman Islands | 71.1 | 2.3 | -6.1 | -1.3 |
| Bermuda | 88.9 | 2.9 | 12.6 | 2.7 |
| New Zealand | 27.1 | 0.9 | -1.0 | -0.2 |
| Singapore | 25.9 | 0.9 | 3.5 | 0.8 |
| United States of America | 24.3 | 0.8 | 2.9 | 0.6 |
| United Kingdom | 23.5 | 0.8 | 4.6 | 1.0 |
| Panama | 23.5 | 0.8 | 2.5 | 0.5 |
| Japan | 18.3 | 0.6 | 3.2 | 0.7 |
| Others | 144.4 | 4.8 | 8.6 | 1.9 |
| Total | 3027.9 | 100.0 | 462.5 | 100.0 |

Data source: CSD (2001c).

Notes:

- a). Country/territory here refers to the immediate destination economy. It does not necessarily reflect the country/territory in which the funds are ultimately used. There is a significant circular flow of capital between Hong Kong and the tax-haven economies and between Hong Kong and mainland China.
- b). Negative outflows were mainly repayment of loans by non-resident affiliates.

Table 6. Stock and flow of inward direct investment (DI) to Hong Kong by major country/territory in 2000.

| Major country/territory a) | DI stock (HK\$ billion) | Share (%) | DI inflow b) (HK\$ billion) | Share (%) |
|----------------------------|-------------------------|-----------|-----------------------------|-----------|
| British Virgin Islands | 1131.4 | 31.9 | 238.4 | 49.4 |
| Mainland of China | 1112.2 | 31.3 | 110.7 | 23.0 |
| Bermuda | 340.4 | 9.6 | 36.9 | 7.7 |
| Netherlands | 224.8 | 6.3 | 7.4 | 1.5 |
| United States of America | 161.5 | 4.5 | 18.8 | 3.9 |
| Japan | 113.2 | 3.2 | 25.1 | 5.2 |
| Cayman Islands | 90.2 | 2.5 | 11.1 | 2.3 |
| Singapore | 98.3 | 2.8 | 60.2 | 12.5 |
| United Kingdom | 55.5 | 1.6 | -41.5 | -8.6 |
| Panama | 26.8 | 0.8 | 0.4 | 0.1 |
| Others | 196.9 | 5.5 | 14.7 | 3.0 |
| Total | 3551.3 | 100.0 | 482.2 | 100.0 |

Data source: CSD (2001c).

Notes:

- a). Country/territory here refers to the immediate source economy. It does not necessarily reflect the country/territory in which the funds are initially mobilized. There is significant circular flow of capital between Hong Kong and the tax haven economies and between Hong Kong and mainland China.
- b). Negative inflow from the United Kingdom in 2000 was attributable mainly to equity withdrawal arising from some large cross-border merger and acquisition activities.

population selected spontaneously from Hong Kong was involved in the cross-border employment on the mainland.

Import and export between Hong Kong and mainland China were affected by the Asian financial crisis after 1997 but the mainland remained the top trading partner of Hong Kong. The shares of the mainland in Hong Kong's total import, export and re-export market increased further to 43.5%, 32.2% and 37.4% respectively in 2001 (Table 3).

Guandong accounted for 97.9% of total export involving outward processing from the mainland to Hong Kong in 2001 (Table 4). FDI flow to and from Hong Kong clearly showed enhanced relations between Hong Kong and the mainland. Tables 5 and 6 present the recent estimation of outward and inward direct investment of Hong Kong by CSD (2001c) of HKSAR. As a major financial centre in the world, it is noted that a large amount of direct investment to and from Hong Kong involved non-

operating companies in tax haven economies such as the British Virgin Islands, Bermuda and the Cayman Islands. Large sums of money were moved from Hong Kong to these economies and then back to Hong Kong. It was estimated that 87.4% of inward direct investment stock in Hong Kong from these economies in 1998 originated from Hong Kong. Excluding these tax haven economies, mainland China stood as the largest source and destination of direct investment to and from Hong Kong. Among total outward direct investment from Hong Kong, the mainland received 33.4% of the total outward stock and 78.1% of new investment in 2000. Among total inward direct investment to Hong Kong, mainland China contributed 31.3% of total inward stock and 23.0% of new investment in 2000.

Conclusion

Cross-border co-operation and development between Hong Kong and mainland China is an outstanding case of the globalization process in the world. It has several distinguishing features from other regional production systems in terms of close demographic and cultural ties between the two sides of the border, the intensity of the cross-border interaction, the open door policy and significant political change on each side of the border in 1978 and 1997 respectively, and the transformative impacts of cross-border development on both sides of the border.

At least five groups of key actors may be identified in the cross-border development: local people, local investors and the government on the Hong Kong side and labour and the government on the mainland side. There are clear comparative advantages on both sides of the border. Hong Kong excels in marketing, financing and trading while there are abundant cheap labour and land resources on the mainland. Close demographic and cultural ties between Hong Kong and mainland China provide a firm foundation for intensive cross-border co-operation and development through a bottom-up approach while the government in Hong Kong has played a very limited role both before and after 1997.

Before 1978, mainland China was closed to the outside world and there was no possibility for any cross-border development without a fundamental institutional change in the mainland. Comparative advantages could be realized only once the border was opened to cross-border flows of people, goods and capital in 1978 when China adopted its open door policy. The then Hong Kong government

adopted a non-intervention policy, neither encouraging nor prohibiting such development while the central and local governments on mainland China introduced many measures and incentives to attract investment from Hong Kong. There have been relatively free movements of capital and goods between Hong Kong and the mainland since 1978. Hong Kong people and businessmen can travel to the mainland to do business freely but the movement of the mainland Chinese to Hong Kong remains tightly controlled. People and businessmen on the mainland participate in the cross-border development mainly on their own land with investment from Hong Kong. This case illustrates that a tight asymmetry immigration control can be achieved while there are free movement of capital, goods and investors in a cross-border regional development system. During the period 1978 to 1997, the rapid cross-border development between Hong Kong and the mainland was driven mainly by China's open door policy and the bottom-up forces involving local people and investors in Hong Kong.

After the return of Hong Kong to China in July 1997, many people expected that the new HKSAR government would play a much larger role than its predecessor and there would be dramatic changes in cross-border development. Nevertheless, the new HKSAR is a highly autonomous region of China which continues to practice capitalism under the principle of 'one country, two systems'. The Hong Kong-mainland border still has the function to separate the two economies on both sides of the border. To a large extent, the political change of 1997 has not made any dramatic impact on the cross-border development. Although the new HKSAR government takes a more positive attitude towards cross-border co-operation and development, the progress is still limited at government level. Nevertheless, the cross-border investment, trading and population movement continues to grow rapidly following up the momentum already built up in the period 1979 to 1997. More and more Hong Kong people have gone to the mainland for work, business, housing, shopping and travelling. Once again, it is the bottom-up forces which are driving the cross-border development. This also explains why the political change in 1997 has made no dramatic change to the cross-border development.

Cross-border flows of people, goods and capital are the fundamental forces of spatial and economic transformations in any cross-border regional production system. This study has focused on such cross-border links to illustrate that the close demo-

graphic and economic connections between Hong Kong and mainland China had been established well before 1997. A bottom-up approach has been working spontaneously and the local people and businessmen in Hong Kong have been the primary force in establishing strong relations with the mainland both before and after 1997. Hong Kong has played a pivotal role in the industrialization of south China.

Cross-border trading and investment have transformed Hong Kong's economy from manufacturing to a service centre. De-industrialization has happened within Hong Kong. But Hong Kong still controls a huge manufacturing base in PRD, employing over six million people. De-industrialization in Hong Kong reflects the division of labour between Hong Kong and the mainland in the regional production system which is still under the control of investors from Hong Kong. This differs from the case of the service sector on the mainland. Hong Kong's investors face tight regulation and strong competition from the local companies there and find it difficult to assume a dominating role. Transferring some parts of the service sector from Hong Kong to the mainland poses a real challenge to Hong Kong's economy. This may call for a more active role of the government in Hong Kong which is minimal so far. Hong Kong needs to redefine its role in the world economy after the entry of China into the WTO on 11 December 2001.

The connection with the mainland, the China factor, will continue to benefit Hong Kong's economy. The key issue crucial to Hong Kong's further prosperity is how to maintain Hong Kong's comparative advantage among main competitors in the region including Singapore, Shanghai, Shenzhen and Taipei. The outcome depends not only on the political stability in Hong Kong, but also on timely response and adaptation to the changing economic and trading circumstances. Enhancing regional competitiveness through closer regional integration in the Hong Kong-PRD region is an important strategy for both sides of the border. Whether the HKSAR government should confine itself to the same limited role in further cross-border development is being debated intensively in Hong Kong and will be tested as Hong Kong moves on towards the future.

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