

# **Laissez-faireism and Export-oriented Industrialization:**

## **The Hong Kong Experience**

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### **Abstract**

Hong Kong is the earliest of the Asian Newly Developed Economies to have embarked on export-oriented industrialization. Its success has also been portrayed as the best example of a free-trade policy that leads to sustained development. The paper presents the factors leading to Hong Kong's post-Second World War industrialization, the characteristics of its industries as well as the related government policies. In the second half, the paper treats in detail how Hong Kong's industrial economy has been extended into neighbouring South China in a new cross-border system since the 1980s. The paper doubts the relevance of non-interventionist policies in the current situation of industrial growth based on cross-border co-operation and argues for more government input for sustaining Hong Kong's future industrial growth.

### **Introduction: Laissez-faireism and 'Transferred Industrialization'**

Many believe that Hong Kong's success stems from her policy of 'positive non-intervention', i.e. the government aims to pro-

vide a general conducive environment of excellent infrastructure and efficient bureaucracy with a minimum of red-tape, while shying away from a sectoral policy of active promotion or subsidy (Clark and Kim 1995; Chiu, Ho and Lui 1997). It is therefore important to understand the causes and nature of Hong Kong's post-Second World War industrialization. This is not only a prerequisite for studying the special features of the local industrial economy in order to draw lessons from the Hong Kong model of economic development, but also an indispensable foundation for debates on the prospects of Hong Kong's future potential growth.

For the entire period of 1842-1949, Hong Kong was mainly used by Britain as an entrepot in the 'Triangular Trade' between China, India and Britain. Some complementary industrial activities did develop to service the entrepôt, including ship-breaking and shipbuilding, the manufacture of ropes, sugar and matches, as well as some engineering and repair shops, which however had little direct impact on the local economy (Yu and Liu 1993; Davies 1949).

Hong Kong's dependence on entrepôt trade came to an end with the setting up of the People's Republic of China (PRC) in 1949 and the outbreak of the Korean War in 1952. The trade embargo imposed on China by the United Nations due to the Korean War forced Hong Kong to develop industries to support itself. The favourable infrastructure that Hong Kong possessed as well as the changed global supply and demand situation promoted the growth of these new industries, while immigrant Shanghai industrialists and the flight of capital into Hong Kong from politically unstable Southeast Asia also boosted growth there (Szczepanik 1958; Fan 1972). The 'old' industries of shipbuilding and ship-repairing declined rapidly as their total share in manufacturing employment dropped from 28 per cent in 1947 to 9 per cent in 1955, and the new textiles industry alone registered 28.4 per cent of the employment in 1955. Local manufacturing also quickly shifted towards export markets as their share in the total export value jumped from 10 per cent in 1947 to 30 per cent in 1953.

However, it needs to be stressed that most of the 'new' industries originated from Shanghai and its surrounding areas. The movement of Shanghaiese and Wuxi industrialists into Hong Kong with their capital, industrial know-how, market experience and information, as well as some engineers and key workers in 1949-1951, meant that Hong Kong's post-Second World War industrialization was not a conventional experience. It was almost a wholesale 'transfer' of industrialization from the long established and second largest Asian modern industrial base of 1920-1940. This happened more as a result of the new political realities of the Mainland and Hong Kong's geographical and ethnic proximity, rather than for economic reasons (Sit 1998).

Unlike many neighbouring governments in the 1950s and 1960s, the Hong Kong government at that time did not subsidize, protect or promote these new industries. Their rapid pace of growth and consistent success in export markets has thus been traditionally explained by laissez-faireism and market forces: the 'almost complete laissez-faireism' that 'unleashed human potentialities which in other countries have remained paralysed by elaborate control systems' (Szczepanik 1958). Despite this, the reality is that 'transferred industrialization' is due to historical specificity, though reinforced by other economic and policy factors. The latter includes the new external demand created by the temporary absence of competition from Japan and West European countries, a trade embargo by the UN on PRC exports, the new Commonwealth Preferential Tax arrangement, and Hong Kong's excellent infrastructure for facilitating international trade and export-oriented industries (Sit 1989a, 1998).

## **The Nature of Hong Kong Industries and Related Government Policy**

Experiences of post-Second World War industrialization in some less developed countries (LDCs) support a four-stage development path for a small to medium-sized Asian developing economy with little internal natural resources to attain an industrialized economy (see Figure 1 at the end of the article,

Chenery 1960; Ranis 1983; Sit 1991). It is an important basis for understanding the characteristics of Hong Kong industries and the reasons behind their success, especially regarding the relationship between these and the official attitude of 'positive non-intervention'. The four stages are:

1. **Import-substitute Phase I:** In a post-independent country/economy which has already attained political and social stability, early industrialization can be based on the domestic market and the absorption of foreign capital, imported matured technology and management skills. The government cradles such industries by setting up a tariff wall and stringent controls on foreign currency exchange while providing incentives to the 'infantile' or 'pioneer' industries. The latter are typically food, textiles and garment industries that require imported machinery and cheap, unskilled to semi-skilled local labour.
2. **Export-oriented Phase I:** With the success in Import-substitute Phase I industrialization, the local market will soon reach saturation. By then the quality and price-competitiveness of the new industries will have been so improved that they can compete in the international market. At this stage, the government turns to promote export as a means for continual industrial growth. Former tariff walls are taken down with the installation of a new regime of laissez-faireism in import-export, foreign currency exchange and credit, to encourage export. The industries, though similar in nature and type to Stage I, have become export-oriented.
3. **Import-substitute Phase II:** Continued growth of low skill and labour-intensive industries is frustrated by 'market protection' in major importing countries and increasing competition from lower-cost producers. Future industrial growth has to be led by diversification and the deepening of technology. The strategy at this stage is to introduce complementary

new industries that produce raw materials and intermediate inputs for existing industries, which up to now are imported, e.g. petro-chemicals, iron and steel making and machinery. Export-oriented light industries still maintain growth through upgrading quality and semi-automation. However, the new industries are heavy, capital- and technology-intensive in nature. They require tariff protection as well as government cradling through various forms of incentives and subsidies. Overall, therefore, the industrial structure as well as the related government policies have become more complicated.

4. **Export-oriented Phase II:** The new industries in stage (3) have become more mature in quality and price-competitiveness. At the same time they have espoused a host of Research and Development (R&D) activities and new product lines. Hence, they are ready to compete in the international market. For expanding exports of these industries, the tariff walls of relevant products are taken down, with a return to free trade and less government interference except more policy attention towards high-level human resource training and enhancement of R&D development.

Thus at different stages of development of the industrial economy, the government policy should vary to generate the most conducive environment and inducement for channelling resources towards targeted industries. Taiwan was in stage (1) (Import-substitute Phase I) in 1956-1966, and stage (2) (Export-oriented Phase I) since 1966-71. It entered the third stage in the mid-1970s with government assistance in technology, marketing, infrastructure and subsidized credit. In a few key heavy industry projects, e.g. iron and steel, shipbuilding and petro-chemicals, the government even participated in equity. South Korea had also a long phase of import-substitute Phase I and then entered Export-oriented Phase I in the early 1970s. Since the early 1970s she started stage (3) through heavy government subsidies in heavy industries. Both Malaysia and Thailand were

still in stage (1) at the beginning of the 1970s (Sit 1989b). Among these Asian NIEs or near-NIEs, Hong Kong is unique. It started off with stage (2), a consequence of the 'transferred industrialization' previously referred to. Its political system, the *laissez-faire* tradition, excellent infrastructure, as well as the large amount of export quotas it has maintained since the early 1960s, combined with a flexible system of production and entrepreneurship, enabled it to develop Export-oriented Phase I industries quickly in the 1950s and remain competitive in them for a much longer period than any other economies.

The Hong Kong government policy is indeed typical of what is required for promoting stage (2) industrialization. Put simply, a regime of *laissez-faireism* seems to provide the ideal environment for export-oriented light manufacturing. However, free trade alone would not be sufficient, as it only provides the micro business environment to unleash the potentials of entrepreneurs to enter into business and to efficiently manage their businesses without undue official interference. At the meso level, or industry level, a good infrastructure and sectoral support system for services, such as labour training, export credit and export insurance, quality testing, certification and productivity enhancement, etc., would be required to access, maintain and improve the quality and price-competitiveness of local products in export markets. In Hong Kong, such activities are adequately provided at cost through semi-official agents. At the macro level (strategic or economy-wide) the Hong Kong government had been very active in assuring market entry through bilateral government negotiations. Thus although it has not provided subsidy, incentives or protection (except a slight land price subsidy for selected industries located within the Industrial Estates since the 1970s), the Hong Kong government has devised an effective system of user-paid supporting infrastructure and quality assurance and enhancement programmes to facilitate trade and industries. This has been aptly described as 'positive non-interventionism' (Sit and Wong 1989).

## Characteristics of Hong Kong Industries

Hong Kong industries therefore demonstrate a number of features characteristic of stage (2) industrialization in the four-stage model shown in Figure 1 i.e.:

- 1 The products are light consumables of the mass market, fashion-oriented and highly 'perishable', e.g. garments and toys.
- 2 The markets are concentrated, mainly in the USA, Japan and West European countries.
- 3 Labour input is basically of low-skill and low-cost types.
- 4 Local value-added as a proportion of the total cost is small, as most equipment, intermediate products and raw materials are imported.
- 5 The factories are mainly small in scale and operate in an intensively linked and flexible subcontracting system.

With these features, the competitiveness of Hong Kong industries thus lie with low-cost, fast and timely delivery, and flexibility in meeting changing designs and size of the orders (Sit and Wong 1989).

Figure 2 shows Hong Kong's major domestic exports, over 95 per cent of which are manufactured products. Garments and textile persisted as the predominant items in 1970-1995. Consumer electronics (under items 3 and 4 in the figure), and watches and clocks (since 1980), have been of increasing significance. Garments and textiles, however, have maintained their position through quota protection while the latter have benefited from increasing automation as well as Hong Kong's excellent air transport and flexibility in its system of manufacturing.

Superficially, there have been changes in market concentration. The USA as the major market has slipped. Since many Hong Kong firms have transferred their production into the Pearl River Delta (the Delta) in the 1980s, although quite a lot of these firms still produce for the US market, their products are now being classified as Hong Kong re-exports. This also partly

explains the growing significance of China Mainland in Hong Kong's total trade, which became the largest export market of Hong Kong in the 1990s.

The local value-added ratio in Hong Kong industries dropped from 36.1 per cent in 1973 to 29.2 per cent in 1993 (Table 1). The drive in automation since the early 1980s simply means less man-hours rather than raising the local value-added content with more skill input. The average factory size, which has been consistently small, has also fallen further. In short, Hong Kong in the mid-1990s remained what it was in 1960-1980, i.e. in Export-oriented Phase I industrialization despite a prolonged growth of about four decades.

*Table 1: Manufacturing Features of Hong Kong*

Year	Number of Establishments	Number of Persons Engaged	Avg. Scale of Establishment (persons)
1973	30,542	713,688	23.4
1983	46,309	936,609	20.2
1993	34,382	504,888	14.7
Year	Ratio of Added-Value to Gross Output (%)	Gross Output (HK\$ Million)	Added-Value (HK\$ Million)
1973	36.1	31,961	11,544
1983	25.9	160,552	44,140
1993	29.2	311,816	91,151

*Sources: Hong Kong Social & Economic Trend, Hong Kong Government (various dates).*

## **Post-1978 Development of the Industrial Economy into a Cross-border System**

The Open and Reform of China since 1978 has created new opportunities for foreign investment in the Mainland. Hong Kong industrialists seized the chance to set up out-processing



facilities there, exploiting the Delta's lower cost in labour in forms of subcontracting, compensation trade, out-processing and joint-ventures. Later, they shifted the entire or most of their production facilities across the border. The success of the northward ventures has thus extended Hong Kong's lease of life of Export-oriented Phase I industrialization and generated a new spatial division of labour and co-operation with Guangdong. In the process, Hong Kong has also transformed itself into a tertiary economy based on an expanded cross-border industrial system of export-oriented light manufacturing.

**(a) The cross-border extension**

Since 1979, concrete measures in the form of infrastructural development, new laws and regulations have offered better surety of business environment, as well as incentives and opportunities to foreign direct investment (FDI) in the Delta (Hong Kong investment is regarded FDI by the PRC; see Zheng *et al.* 1997). The most popular form of industrial venture then was out-processing, known locally as 'projects of imported material processing'. The out-processing fees for the whole of China Mainland rapidly increased from only US\$27 million in 1979 to US\$340 million in 1986. Of the latter, Guangdong accounted for 79.4 per cent or US\$270 million. Later, out-processing took on more and more the form of 'co-operative enterprises' which became the predominant form since the mid-1980s. In 1979-1995, Hong Kong investors signed 23,605 'co-operative production' contracts with Guangdong, with an actual invested capital of US\$14 billion. The total investment in industrial projects accounted for 63 per cent (or a huge sum of US\$25.2 billion) of the FDI from Hong Kong into the province in the same period (Zheng *et al.* 1997).

Out-processing, which represents the northward shift of a major part of Hong Kong's manufacturing, is reflected in a new pattern of Hong Kong-Mainland trade. By June 1990, out-processing-related exports accounted for 78 per cent of Hong Kong's domestic exports to the Mainland, 49 per cent of its re-exports and 64 per cent of its imports to and from the Mainland (Sit 1995). Updated figures for 1995 show a stronger trend in the

growth of out-processing in 1989-1995. In 1995, of all Hong Kong exports to the Mainland, HK\$217.6 billion, or 49 per cent, was made up of raw materials or intermediate products for out-processing. After having been processed, these were shipped back to Hong Kong at a worth of HK\$400 billion, which accounted for 74 per cent of Hong Kong imports from the Mainland. Re-exports from the Mainland through Hong Kong was also made up of 82 per cent of these products (HK Trade Development Council 1997).

Clearly, out-processing is supported by trade and itself also creates trade, i.e. it is 'trade-creative'. It therefore has enhanced Hong Kong's overall trade. Hong Kong thus improved its ranking from the eleventh to the seventh largest trading economy in the world in 1988-1997. Its visible trade value was also raised to 232 per cent of its GDP in 1997, while it was only 148 per cent in 1980.

Using a broad definition for out-processing, i.e. embracing 'co-operative enterprises', joint-ventures and wholly foreign-owned industrial enterprises, at the end of 1995, the total number of persons directly employed by the northward-shifted Hong Kong-based industries may number 5.2 million persons and their total gross output value was ¥253 billion. The 'sam-zhi' (wholly foreign-owned, joint-venture and co-operative) enterprises portion alone contributed to about 30 per cent of the gross industrial output value and 71 per cent of total export (US\$39.5 billion) of the province (Zheng *et al.* 1997). In terms of employment and gross output by light industries, they represented 34.4 per cent and 68 per cent of the Delta's total respectively. Hong Kong's extended industrial economy has formed the backbone of the Delta's as well as Guangdong's economy. Compared to similar figures for Hong Kong at that time, the employment size is about 10 times, while the gross output value figure (though it may not be strictly comparable) is roughly the same as Hong Kong's domestic exports of HK\$231 billion.

**(b) *The cross-border co-operation***

By 1991, 75 per cent of Hong Kong's manufacturing firms had set up manufacturing facilities in China, and 62 per cent of Hong Kong exports were made in China Mainland. The made-in China Mainland proportion reached over 80 per cent in three major traditional Hong Kong products, i.e. toys, footwear, travel goods and handbags (Hong Kong Association of Industries, Commerce and Professionals 1993). Such an extension of Hong Kong's industrial economy is believed to benefit Hong Kong in two ways: (a) it has upgraded local skill demand in Hong Kong and (b) it has improved the gross operating profit of Hong Kong industries. However, the most significant consequences are the rapid expansion of Hong Kong's tertiary sector to serve the expanded industrial system and profits gained in the Delta portion of that system by Hong Kong investors.

Indeed, in 1978-1997 the industrial economy of Hong Kong effectively developed into a cross-border model of 'front shop: back factory' over an extended space that straddles across Hong Kong's northern border into the Pearl River Delta. Higher value-added and mostly non-productive functions of Export-oriented Phase I industries are localized or concentrated in Hong Kong, whereas the manufacturing processes have been dispersed into the Delta (see Figure 3). Thus to claim that Hong Kong has, in the past 15 years, successfully undergone a structural transformation to become a service-based economy is not exactly correct. 'Front shop' activities, which are tertiary in nature, would be healthy and expanding if the 'back factory' were healthy and expanding. A deeper examination of the source of GDP in Hong Kong may illustrate this point: manufacturing's contribution to GDP dropped from 24 per cent in 1980 to 6.5 per cent in 1997, whereas the tertiary sector's contribution increased from 63 to 85.2 per cent. Of the latter, 62.3 per cent is related to transport, trade and the servicing of out-processing in the Delta.

Employment in trade-related activities also grew from 123,000 persons in 1980 to 538,000 persons in 1996. At the same

time, the 1996 bi-census reported about 550,000 Hong Kong residents who claimed to be employed in manufacturing, while local manufacturing reported only 257,000 employees (in 1997). The difference is most likely made up of engineers, technicians, managers and skilled workers who serve out-processing plants and other Hong Kong industrial investments in the Mainland, a large part of which is located in the Delta. This may be supported by official figures from Guangdong which confirm that by the end of 1993, there were a total of 5.5 million persons, including 200,617 Hong Kong residents, employed in enterprises of foreign capital in the province (Zheng *et al.* 1997).

In short, Hong Kong at present is still, in practical terms, very much within the stage of Export-oriented Phase I industrialization, though in statistical terms, only the 'front shop' activities which are located within Hong Kong have been reported by local statistics. The other vital part of the Hong Kong's industrial economy – the 'back factory' has been excluded from Hong Kong's economic accounting because it is locationally outside the territory.

The pace of growth of these industries and their types in the Delta in 1985-1995 are illustrated in Table 2. Indeed, while Hong Kong industries were declining, the rate of growth of like industries in the Delta averaged 22 per cent per annum in 1985-1990 and 41 per cent in 1990-1995. The predominance of electronics and communication equipment, electrical, textiles, garments and food industries there also underlines the nature of Export-oriented Phase I industrialization.

Thus, in 1978-1997, Hong Kong's industrial economy, in theory and practice, should incorporate industries of the Delta. The spatial pattern of the 'back factory' in this extended industrial system, is shown in Figure 4. Shenzhen, being closest to Hong Kong, becomes the largest centre there, followed by Dongguan, which is also next in terms of geographic proximity. Both are well-served by transport and other infrastructure. Other major concentrations include Guangzhou (the Delta's primate city), Foshan and Zhuhai. These new industrial centres have grown from almost nothing (except Guangzhou) to significant centres of export-oriented industries.

**(c) Why does the new cross-border industrial system work?**

Hong Kong's developed expertise, large pool of capital, skilled labour and management personnel, and access to the most appropriate foreign equipment, technology and overseas markets, are critical factors that supported the expansion of this cross-border industrial economy. A benign government policy in Guangdong, especially in the Delta, and the rapidly improving infrastructure there are other positive factors.

Table 2: Growth of Industry in Pearl River Delta

Industry	Gross output value (¥ bil.)			Avg. growth rate (%)	
	1985	1990	1995	1985-90	1990-95
Electronic/ Com	3.25	12.5	72.1	31	42
Electrical	3.70	10.4	46.7	23	35
Textiles	3.33	8.5	31.5	20	30
Machinery	2.54	5.9	9.5	18	10
Food	2.73	4.6	45.6	11	58
Chemical	1.23	4.2	26.1	28	44
Garment	0.84	4.0	22.6	36	41
Metal	1.24	3.9	12.4	26	26
Plastics	1.09	3.5	19.7	26	41
Transport equipm	1.10	2.4	21.6	16	55
Medical drugs	1.16	3.2	8.5	22	22
Total	32.71	88.7	501.6	22	41

Sources: Economic Development of the Pearl River Delta, 1993: 30-31; Statistical Yearbook of Guangdong 1996.

Note: The table only includes major branches, hence the figures in each column do not add up to the total.

In the late 1980s, an additional factor had promoted Hong Kong's spatially extended Export-oriented Phase I industries, i.e. the peg between the Hong Kong and US dollar. It has boosted Hong Kong exports to markets in the US and Western Europe, as Hong Kong enjoys a currency advantage over its main competitors of Taiwan, South Korea and Malaysia. As the PRC currently, the Renminbei (RMB) has a stable exchange rate with the Hong Kong dollar, it means that such an edge is also shared by manufacturers of the Delta. However, it requires the co-existence and spatial proximity of the 'two systems' (i.e. Hong Kong's capitalist system, and China's socialist market system) and an effective border in between that allows the maximization of the complementary nature of the two systems to generate competitive products in the international market.

The processing nature of most Hong Kong investments that utilized most non-labour and non-land factors from imports, also allows the quick establishment of production units and the fast recycling of profits for expansion. These can be gleaned from a survey on foreign-invested industrial enterprises and out-processing facilities in Dongguan in 1990-1991 (Lu 1992). Among the 2,931 foreign-invested establishments there, their imported equipment was valued at HK\$3.77 billion, while domestic equipment was valued at RMB48 million only. The same applies to the 2,715 out-processing facilities: China-made equipment was only 7.2 per cent of all their equipment by value. Besides, the two types of enterprises consumed US\$2.6 billion worth of raw materials input in the year, of which only 4.6 per cent was purchased within the Mainland. From the point of view of Guangdong, it is a unique pattern of industrialization with 'two heads' on the outside, i.e. based on huge imports and huge exports, and very much 'foreign-induced' and market-responsive.

As a further explanation, Sit modified Chen's product cycle model (Sit 1989a; Chen 1988) to illustrate how Hong Kong has been able to maintain growth within Export-oriented Phase I industries. Products I, II, and III as shown in Figure 5, have different trajectories of profitability. When a product is just introduced into the market or is at the early market stage, its unit

profit margin is very high. However, as mass production and competitors appear, the unit profitability will decline from the respective ceilings of B, D and F (Figure 5). Although Hong Kong is not the developer of products A, B and C, it is able to enter into production of these products when the profitability curves are still on the rise, e.g. at AB or CD in the Figure, due to its fast and efficient international communication and information networks and its highly flexible system of production organization. By this, and by shifting to new products before the unit productivity of an established product declines, Hong Kong had been able to maintain success in her industries in spite always being a 'follower' rather than a 'leader' or 'developer' of new products. In the past 15 years, the same model has worked through bringing an additional dynamic, i.e. cheaper factor inputs of labour and land in the Delta. The latter has reinforced the efficiency and profitability of Hong Kong's traditional industrial system due to the spatial proximity of the two complementary though different economic systems, and accounts for its rapid expansion and extended duration.

### **Conclusion: Creating new Competitiveness in the Cross-border Industrial System**

However, it is commonly agreed that Export-oriented Phase I industries in the enlarged Hong Kong-Delta cross-border industrial system have become less competitive recently. This is due to rising costs in the Delta after two decades of continuous economic growth as well as the slashing of tax incentives forced onto it by the central government as China prepares itself for entry into the World Trade Organization (WTO), and it will not be the engine of growth for both Hong Kong and Guangdong in the future. This is especially so after the Asian Financial Crisis of 1997-1998. The pegging of Hong Kong and RMB to the strong US dollar against the devalued currencies (by 20-60 per cent) of most of Hong Kong's Asian competitors, has seriously weakened the price-competitiveness of the Hong Kong cross-border industrial system in its major export markets. The situation is

worsened by numerous export incentives adopted by these competitors in the wake of the Crisis. Since Hong Kong's present tertiary sector is related, to a large extent, to productive activities of the 'back factory', it cannot escape a decline if the latter goes down. Therefore, Hong Kong needs to strive for two new developments in order to improve the future performance of the cross-border industrial system, i.e.: (a) to deepen and diversify the present industrial system, and (b) to develop new growth branches in Hong Kong's tertiary sector.

The economic co-operation, and hence co-prosperity between Hong Kong and Guangdong in 1978-1997 has provided an important indicator of how Hong Kong could overcome existing economic pressures of increasing costs and other constraints such as inadequate land, natural resources and human resources for further growth. It is important for Hong Kong and the Delta to improve their common infrastructure and cross-border links to further raise efficiency and productivity as 'a system', and to co-operate more closely for advancing into the third stage of the industrialization path in Figure 1. In doing so, much more government input on both sides of the border would be required in order to minimize inefficiencies due to policy differences and the presence of a border with customs and excise hurdles under two socio-economic systems. Simultaneously, Hong Kong's 'front shop' role should be extended to a world city role to serve as the headquarters of international capital and multinational corporations (MNCs) for Asia Pacific and, in particular, for exploiting new trading opportunities when China enters the WTO. To achieve this will require a strong lead by the Hong Kong Special Administrative Region (SAR) government in the following areas:

- **Investment in cross-border infrastructure:** The Hong Kong SAR should invest in the Delta to improve the infrastructure there and to link it efficiently with Hong Kong to facilitate future economic growth through more effective exploitation of factor advantages in the Delta.
- **Investment to create new international competitiveness:** The Hong Kong SAR should take a lead in invest-



ing: (a) in R&D by setting up new product-incubating centres and to encourage investment in production ventures of new technology that may serve as catalysts for new industries in both Hong Kong and the Delta and (b) in new tourist facilities in the whole of the Hong Kong Extended Metropolitan Region, i.e. Hong Kong, Macau and the Delta.

Hong Kong should use wisely part of its accumulated budget surplus and land fund, which in 1997 totalled US\$70 billion, for the above purposes. Of course, there will be immense political and administrative reluctance to do this, as Hong Kong government's planning and expenditures have hitherto been restricted to Hong Kong's 1000 sq km territory as a matter of basic policy. As the real industrial geography and economic arena of Hong Kong have already embraced the entire Delta, its future will be closely tied up with how successful it is in incorporating this part of China into its future development planning. Thus a fundamental change in government attitude and principles in long-term economic development and spatial integration with the surrounding hinterland is a prerequisite for formulating Hong Kong's new strategy for future growth.

The Mainland has always been an important and sometimes crucial factor in Hong Kong's economic development, as illustrated by the 'transferred' industrialization of the 1950s and the 'extended' industrial economy of the present. Unlike Singapore, which has been cautiously following a strategy of economic extension and integration with its close neighbours of Bataam and Johore, as well as actively acquiring technology and market access through vigorous government-led planning and investment, Hong Kong's integration with South China under 'one-country; two systems' should be more logical and less riddled with political and policy hurdles. However, it requires first an understanding of our present cross-border relationship and its future potentials, besides a change of philosophy of the SAR government in becoming more proactive and entrepreneurial. Thus the Hong Kong experience and its present challenges serve to underline that any economic policy, including Hong Kong's version of positive non-intervention, is

time-bound. It should be compatible with changed circumstances through timely modifications.

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Figure 1 The Four Stages of Post WW II Industrialization

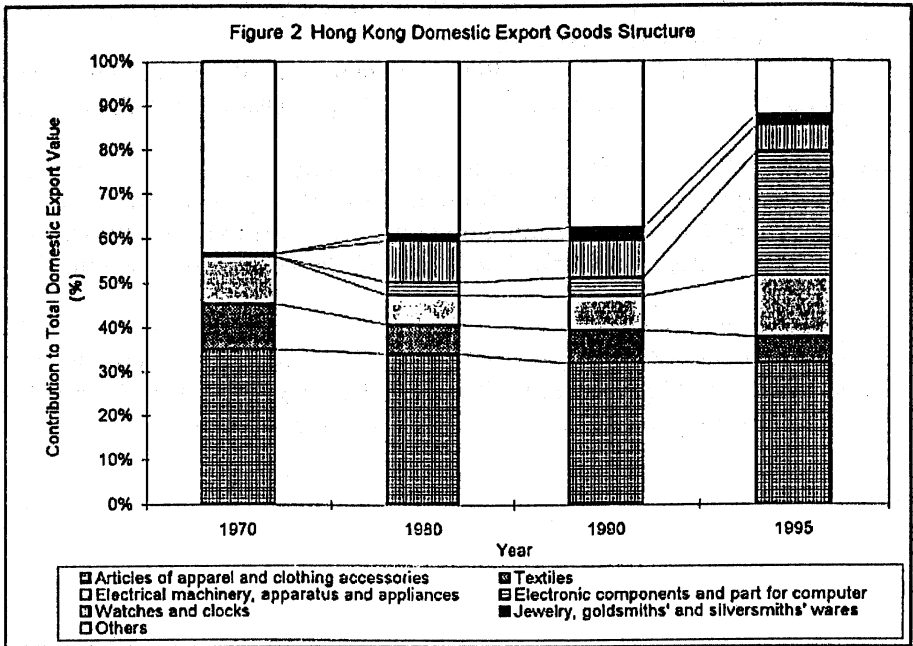
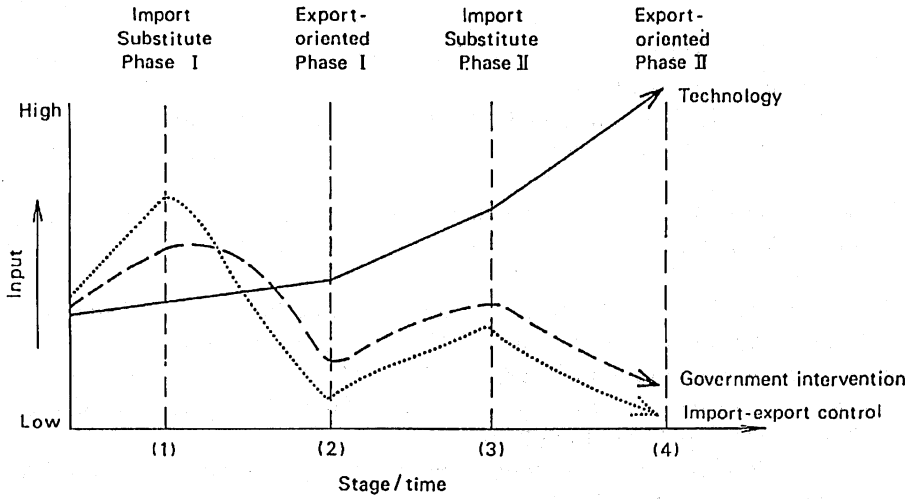


Figure 3 Hong Kong - Pearl River Delta Cross-border MNC Model

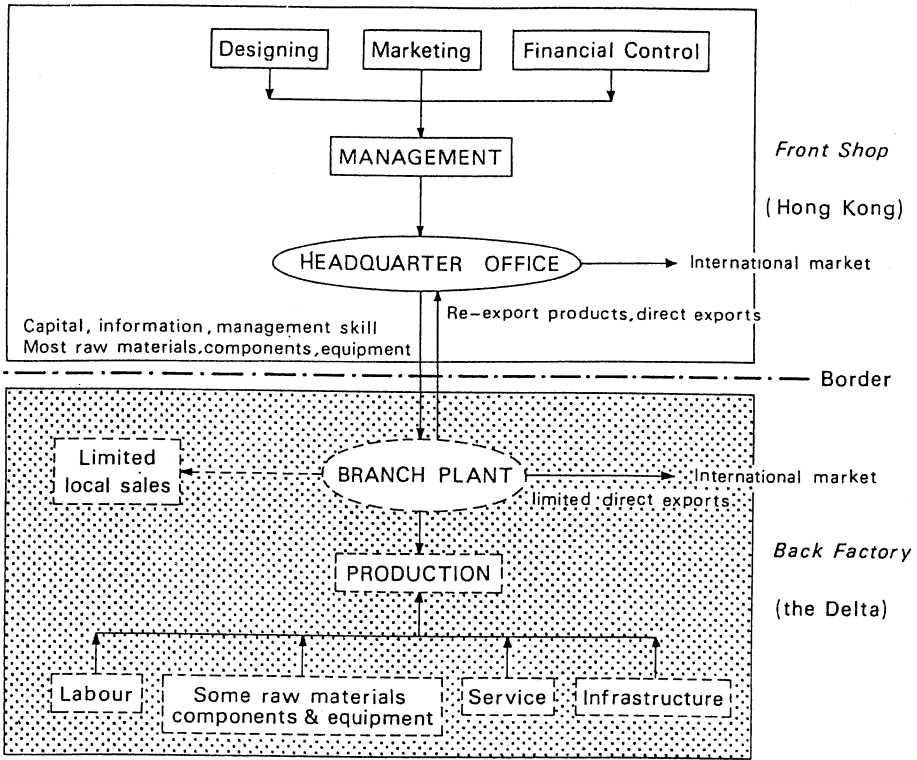
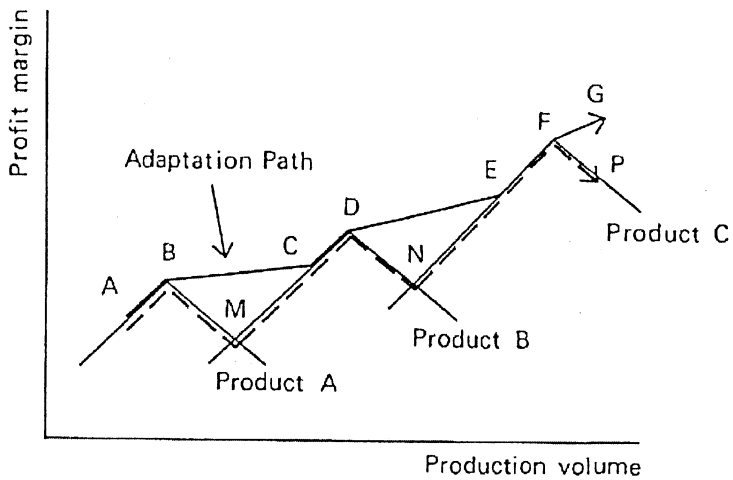


Figure 5 Product Cycle & Entrepreneur's Adaptation Path



Source: adapted from E Chen (1988)

Figure 4 Distribution of manufacturing in the Pearl River Delta (by 1996 output, 1993 employment)

