

# **The Role of Hong Kong in China's Transformation**

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## **I. Abandoning Economic Planning**

This paper examines the reason for the successful rise of markets in China's transformation since 1978. While I would not call the markets in China to be free markets, it is important to recognize that even fettered and regulated markets provide an incredibly large measure of freedom for individual choice that is unprecedented ever since Communist rule was imposed in China and this has contributed greatly to China's economic growth in the last 30 years. Two features are emphasized. First, how and why was it possible for a market economy to emerge when the state remains unwilling to support and commit to a system of private property rights essential for market capitalism to thrive? Second, how and why was it possible to sustain rapid economic growth together with political stability? Few observers and scholars were optimistic that China's economic transformation could be possible, not to mention sustained for almost 30 years. This was also achieved without too many convulsive political upheavals and instability that could have led to the collapse of the state.

What is the logic of China's economic transformation? The process was gradualist in the sense that it proceeded step by step. The sequencing of each step was not well thought out at the start and there was much experimentation to determine the way forward. The Chinese called it "crossing the river by feeling the pebbles". The experimental nature of the process meant that there were false starts and much back tracking. At every step both political and economic considerations were relevant in determining the next step. On the whole the reforms proceeded from the more easy reforms to the more difficult ones – the path of least resistance was often taken. In moving from the easier to the more difficult reform measures, it was possible for the benefits to be realized from the early reform measures. This strengthened the hands of the reformers politically and enlarged the constituents that supported the reforms.

Critics of the gradualist process pointed out that this could lead to a stiffening of resistance as old ones have time to mount a counter attack and new ones have time to emerge to stall the process altogether. Gradualist reform meant inevitably partial reforms leading to all kinds of inconsistencies that can be confusing and cause the reform to lose momentum and direction. The greatest challenge was to abandon central planning as an economic system and to reintroduce markets in the opposition of inevitable resistance and not knowing how to do so. To understand China's economic transformation it is useful to

understand the logic of the command economy that had to be abandoned and, in the Chinese case, this had to take place step by step.

I find it useful to start with an early conception of socialist planning as an economic system put forward by Oskar Lange. He proposed that socialist planning could in principle be efficient as an economic system through the use of shadow pricing based on detailed comprehensive calculations. Indeed one could even imagine that such calculations could correct or avoid failures that real markets could fall victim to due to the divergence of private and social costs or because of coordination failures. For Lange, solving the mathematical problem implied a solution for the economic resource allocation problem that can be implemented through the plan.

Real life socialist planning appeared to have little resemblance to Lange's ideal. Both the Soviet Union and China single mindedly pursued rapid industrialization based on the Stalinist model of emphasizing investment in heavy industries and collectivizing agriculture. Such an approach was followed by many former socialist command economies. The driving force was to catch up with the West, the developed capitalist economies, by accelerating economic growth through forced mobilization of savings to invest in heavy industries.

In developing economies by definition labor was abundant but capital was scarce. The Stalinist model meant that scarce and expensive capital had to be forcibly mobilized through credit rationing by a monopoly state banking sector to invest in capital intensive heavy industries where the rates of return are low. Labor intensive light industries that could possibly create more employment opportunities had to be discriminated against and denied scarce capital.

The logic of the Stalinist model was to purposefully pursue an economic policy that contradicted the laws of comparative advantage. In order for this to take place prices had to be controlled across the board and markets had to be suppressed. Vast bureaucracies at both the central and provincial/local levels had to be created as the institutional instruments to manage widespread shortages and impose full scale rationing. Coercion had to be a central feature of the system. Indeed the central command system was a more effective institutional mechanism for delivering Stalinist economic goals. The market system based on individual choice was not an advantage and could not deliver such goals. Total coercion under central planning made perfect sense for Stalinist goals aimed at defying the laws of comparative advantage. Nationalization provided a compelling institutional logic to achieve coercive developmental goals. Agricultural collectivization provided the institutional mechanism to extract the maximum possible surplus from labor that had to be forcibly employed in agriculture.

The bureaucracy that emerged was a necessary consequence of the full scale attempt to manage pervasive shortages in all markets. With China's size the bureaucracies comprised both massive central ministries that were national monopolies and regional-provincial-local bureaucracies that behaved as spatially based monopolies. Bureaucratic

planners became defenders of their own interests and those of their constituencies. Rents created had to be protected and led to further rent seeking activities.

Mao Zedong himself was at times abhorred by the vast bureaucratic empire that had emerged and perhaps felt powerless against the institutionalization and routinization of a bureaucracy dominated economy and society. The Cultural Revolution he unleashed can be seen as his attempt to rebel against bureaucratic institutionalization and routinization that he felt was sapping China of its revolutionary fervor and spontaneity. But he did not have an alternative to take its place beyond sheer charismatic cult for episodic periods. Perhaps by challenging the bureaucracy the way he did Mao succeeded in discrediting and weakening the bureaucracy, damaging the economy, and weakening the political authority of the state thereby preparing the ground for eventually finding a solution after his time.

It was not difficult to realize that the command planning system was not improving the livelihoods of the vast majority of the people. The incentives to perform and innovate were progressively removed and the problem with the system became more apparent over time. The bureaucracies at all levels of government had many specific vested interests to protect and resisted reform. Many well meaning efforts to decentralize decision making to restore incentives had failed. Whenever the Chinese planners sought to decentralize decision making authority, disorder emerged and stability was threatened. Re-centralization rapidly killed all incentives to perform and innovate. Allowing the market to emerge seemed impossible without risking disorder and chaos. Moreover, political resistance that were either ideologically motivated or interest driven threatened to overwhelm every reform effort.

Abandoning a command economy under the Stalinist mode implied reversing the emphasis on heavy industries and decollectivizing agriculture. Political resistance had to be overcome. China's reformers hit on two very important breakthroughs very early in the reform process. First, the agricultural reforms were initiated at an early stage by Zhao Ziyang in Szechuan Province, who later became Premier, but fell from power after the turmoil in Tiananmen Square 1989. The introduction of the contract responsibility system in agriculture rapidly restored incentives and provided the initial economic success and broad based political support that restored the political legitimacy of the state and gave impetus to pursue further reforms. While agricultural reforms in China remain incomplete in many ways, including the ownership of land and its transfer, nevertheless these early and subsequent reforms were relatively easy to undertake with huge benefits accruing to large numbers of individuals. Successful experimentation in one province could be rapidly emulated in other provinces and all over China. All this is well known to most students of China's agricultural reforms and I had discussed them in considerable detail at the Mont Pelerin Society Meetings in Vancouver in 1992 that it is no longer necessary to go over familiar ground again.

Second, the policy to open up China to the world was also adopted at an early stage because there was an obvious way to develop an important type of market activity where there was an opportunity of huge economic success without great political resistance.

The role of Hong Kong as an agent of China's opening to the world was embraced by the Chinese reformers. Two "special economic zones" – Shenzhen and Zhuhai – across the border from Hong Kong and Macau, respectively, were created and soon became the starting point of China's rapid expansion of foreign trade and investment activities. Foreign trade and investment became the catalyst of China's industrial reform. Industrial economic activity outside the state sector flourished and soon spread from the "special economic zones" to the entire coastal regions. Massive internal migration to the coastal regions and into urban areas soon followed. These workers took up jobs in the rapidly growing non-state owned industrial enterprises and in the construction and service sectors.

The Stalinist economy was rapidly replaced by economic activities outside the growing non-state sector. As state owned enterprises lost ground to non-state enterprises the pressure for fiscal and financial reform became eminent. The introduction of the fiscal system made clear what belonged to the state and what was due to enterprises and individuals. Land ownership remained public but user rights were beginning to be defined and proprietary ownership of structures had to be recognized in order for transactions to take place with mortgage loans provided by banks. Banking reforms were slow to start and this gave stock markets an opportunity to emerge to serve initially the state-owned enterprises and later the non-state enterprises. Hong Kong's role as a catalyst for industrial transformation is important but so is its role to continue to act as a model and agent to further China's economic transformation.

## **II. Hong Kong's Role**

How Hong Kong's institutions and experience as a free enterprise system founded on the rule of law contributed to China's rapid economic transformation and the gradual re-emergence of a civil society is much less known and I intend to cover this in much greater detail in this paper. The agents of change are the people, companies, and non-government organizations of Hong Kong and they have been helping to modernize China's workforce and institutions. They brought with them capital, managerial and professional talent, market networks, international best practices, and knowledge of Hong Kong's institutions and experience. These agents greatly facilitated China's opening up and connectivity with the world paving the ground for other investors to enter China for Chinese enterprises to enter the world market.

First, Hong Kong manufacturing companies began to invest in the Pearl River Delta and subsequently the Yangzi River Delta helping to create vast export oriented industrial bases in these regions. Aside from the enormous economic benefits mentioned in the vast literature on this subject, it also led to the early adoption and adaptation of Hong Kong's laws governing trade, commerce and investment and also company law on the Mainland and these became crucial for the development of market-oriented rules and institutions in China. The large volume of trade between Hong Kong and Mainland China provides a mechanism for some Mainland Chinese capital to do "round tripping"

activities through misinvoicing of exports and imports that indirectly improved the efficiency of capital utilization.

Second, Hong Kong prospered in the process and rapidly transformed itself into a producer services economy initially serving the manufacturing base across the border and increasingly a wider range of activities in China. The export of services to Mainland China was facilitated by China's entry into the WTO and the signing of CEPA<sup>1</sup>. Hong Kong investment in infrastructure and various service sectors grew rapidly across the border. The "transnationalization" of Hong Kong companies and professional services extended Hong Kong's influence and expertise into many reaches of the Chinese economy. The process created extensive training and education opportunities for China's managerial and professional workforce both in the workplace and in Hong Kong. Hong Kong's professional codes, regulatory rules, governance and management systems and procedures formed and adapted from international best practices are making an impact on China's economic system through the gradual transformation of legal and regulatory codes and behaviors. This is especially evident in the areas of banking, finance, land use, real estate, mortgage, transport infrastructure, and even selective media and entertainment sectors, where the influence of Hong Kong is dominant. It is important to point out that the dominance of Hong Kong's influence is not directly related to size of its economic contribution on the Mainland. Hong Kong is not a dominant player on the Mainland in many of these sectors in China. Hong Kong's influence stems from the relevance and usefulness of its rules and institutions.

Third, in the area of voluntary service, Hong Kong's non-government organizations and charities numbering in the thousands have contributed generously through donations, time and expertise to education, health, social services in care for the disadvantaged, disabled, elderly, sick, orphaned, emergency care and support during natural disasters, conservation and environmental protection, media reporting and advocacy of social injustices, labor conditions, and violation of human rights and property rights, and religious groups have together enriched and supported the re-emergence of a diverse and pluralistic civil society as the totalitarian state recedes. These organizations and the vast two-way cross-border flow of people between Hong Kong and the Mainland has been a major channel for people to people cross influence. Despite the opening of China to the world for the vast majority of the Chinese people Hong Kong continues to be their principal window and gateway to the world. Through these people to people and organization to organization encounters and engagements, Hong Kong contributes to the shaping of the culture, beliefs and habits of the Chinese people day after day.

In the subsequent sections I elaborate on these three themes through analyzing relevant data where possible and the use of anecdotal evidence where necessary and appropriate. The paper concludes that more than anyone realizes the world influences China as intermediated through agents in and from Hong Kong. And Hong Kong's experience with the free enterprise system exerts an enormous autonomous influence in shaping

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<sup>1</sup> CEPA stands for Closer Economic Partnership Arrangement is a bilateral free-trade arrangement between Hong Kong and Mainland China to facilitate entry of a range of services into the Mainland ahead of the timetable on liberalization as specified in the agreement on China's entry into the WTO.

China's emerging institutions in the market place. The dominant characteristic of non-governmental organizations in Hong Kong is its plurality and they have exerted their influence through meeting a diversity of growing social and other demands and address pressing needs in China's emerging civil society.

### **III. Trade and Investment**

Hong Kong's economic ties with the Mainland as an entrepot largely halted during the Korean War with the United Nations embargo against trade with China. The economic ties were rapidly revived after 1978 with the opening of China. Today Hong Kong is the most important trade, investment and international fund raising center for the Mainland.

Wong, Siu, Wong and Choi (2003) and Wong, Siu and Choi (2007) found that Hong Kong based manufacturing and import/export companies employ over 11 million workers on the Chinese Mainland, and is responsible for intermediating 15% of China's external trade and the source of one-third of total foreign direct investment flows into the Mainland in 2007.<sup>2</sup> Tao and Wong (2002, 2004) studied the transformation of Hong Kong from manufacturing to services as entirely explained by the rise of producer services. The export of services which accounts for 40% of Hong Kong's GDP is heavily composed of producer services that support of the export oriented manufacturing base in Guangdong Province and beyond.

Hong Kong is the most important source of international capital for the Mainland. Cumulative foreign direct investment (FDI) from Hong Kong is estimated at about US\$309 billion as of 2007, or about 40 percent of China's total FDI. Although the share of FDI flows from Hong Kong has decreased recently, it still accounts for more than one-third of total FDI flows to the Mainland in 2007. The Mainland has also become a major source of FDI in Hong Kong. By-end 2006, the Mainland had invested over US\$260 billion in Hong Kong (about 35.1% of total inward FDI). The Hong Kong Stock Exchange has been an important source of funds for China's listed companies. Between 1993 and 2007 a total of US\$410 billion has been raised through Hong Kong.

Hong Kong's significance as an international economic center for China goes far beyond the volume of trade and investment funding that it drives, mediates or raises in the marketplace. Given the size of the Chinese economy many major cities like, Beijing, Shanghai, and others will become major economic centers in their own right and will become even larger than Hong Kong economically. The distinctive role of Hong Kong is that it is the business and economic information hub for the whole of China and also about the rest of the world. If one wishes to know about economic developments in Eastern China one would go to Shanghai because it is the information hub of the region,

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<sup>2</sup> Hong Kong's labor force is only 3.5 million with less than 5% in manufacturing. Some of these Hong Kong based companies may not be owned by Hong Kong residents, who merely use Hong Kong as their base of operation and incorporation. Indeed it is possible that some of the owners might be from the Mainland itself. These possibilities do not change the key implications we draw about the role of Hong Kong in China's economic transformation.

but it is not an information hub for the whole of China. For the latter you have to come to Hong Kong whose residents have business in all parts of China and where businessmen from all over China convene. As the information hub for the whole of China it is also the natural center where businessmen from all over the world could first visit to explore and develop their opportunities. Everyone who comes to Hong Kong for information brings information and in so doing enhances the role of Hong Kong as the business and economic information hub. Hong Kong was able to acquire this unique role right at the very beginning of China's economic opening because of China's regionally fragmented markets and cellular economy. The first mover advantage obtained by Hong Kong as an information hub is not easily replaceable.

### Manufacturing Trade in the Pearl River Delta and the Yangzi River Delta

When China established the first two special economic zones in Shenzhen and Zhuhai across from Hong Kong and Macao, respectively, the entrepreneurial small and medium companies responded to the call. These two zones were given considerable flexibility to adopt economic policies that were outside the regulatory structure of the rest of the Mainland. The process later spread to other coastal regions.

Hong Kong with its labor intensive and export oriented manufacturing economy based on numerous highly entrepreneurial small and medium companies quickly exploited the opportunity to expand across the borders and scale up, some of which by 10 to 20 times. These agile entrepreneurs brought capital, knowledge of world markets, management know how, experience of world trading and regulatory practices, capacity to source materials, and ability to move goods to these literally barren special economic zones. Chinese authorities provided land, labor and a willingness to learn from these entrepreneurs. Together they created the vast manufacturing base in the Pearl River Delta (PRD)<sup>3</sup>, which by 1992 was already exporting more goods than Thailand known at that time as the fifth Asian Dragon after South Korea, Taiwan, Hong Kong and Singapore.

Given the primitive state of the banking sector in China at the start of the economic opening and their preference for lending only to state owned enterprises, these entrepreneurs had to rely on Hong Kong to fund the expansion of the manufacturing base across the border. Banks in Hong Kong were also unwilling to provide trade and financing for production activities across the border where contractual enforcement could not be performed. These entrepreneurs resorted to mortgaging their own property assets in Hong Kong to provide requisite financing. The process was further facilitated in the early 1990s by asset price inflation in Hong Kong precipitated by the weakening of the US Dollar, to which the Hong Kong currency was linked. This unusual role is no longer necessary with China's entry into the World Trade Organization and gradual

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<sup>3</sup> To be absolutely precise the PRD region dominated by Hong Kong and other foreign investors was for most of the period essentially a narrow corridor stretching from Hong Kong to Shenzhen and Dongguan connected by a highway constructed by a Hong Kong investor requiring less than 2-hours driving.

liberalization of banking and finance to allow foreign institutions to enter the Chinese market.

The army of small and medium companies from Hong Kong<sup>4</sup>, numbering as many as 65,000 showed the Mainland authorities how to establish the necessary market institutions to organize trade, production, taxation, land use, banking and finance, company and commercial law, labor laws, and so on. These institutional and infrastructure developments were essential to the sustained economic opening and development of China. These entrepreneurs were not merely investors who brought capital and management-marketing know how. They helped laid the foundations of a market economy and they brought with them the experience of market institutions learned in open and free markets. Unlike most foreign investors that invested in special economic zones elsewhere these small and medium companies did not build up enclave economies that had to be sustained by protective barriers.

The entrepreneurialism of the small and medium Hong Kong companies was critical to the economic opening of China. They were part of China's push towards market reform in the front lines, spearheading the drive into the world market, and laying the necessary institutional infrastructure for the process to be sustained both internationally and domestically. I have asked many individuals and experts whether and to what extent China's opening would have been negatively impacted if instead of situating Hong Kong at the estuary of the Pearl River Delta, we were to relocate Singapore from the Straits of Malacca there. This is not a rhetorical question, but a research problem in counterfactual history.

My working hypothesis is that the negative impact would be not only statistically significant but very substantial. Singapore does not have the army of small and medium entrepreneurs with relevant manufacturing experience geared towards serving an international market and accustomed to taking risks. The economic policies of the government of Hong Kong encouraged entrepreneurs to take their own risks rather than rely on the guidance of the state. Investing in the Mainland was a novel endeavor that hardly anyone and very few companies knew how to begin when China opened up. It is to the credit of these entrepreneurs that they were able to blaze a new trail.

As these entrepreneurs bring highly valued investment and trade opportunities across the border there was a pressing need to develop the basic rules of doing business so that things can proceed. These entrepreneurs introduced the very same way of doing business that they were familiar with in Hong Kong to the Mainland and in so doing they helped create essentially the same market institutions in China that they were familiar with in Hong Kong. This is not to say that the business environment on the Mainland is the same as that in Hong Kong, but the model from which the adaptations were made were certainly shaped by Hong Kong's experience.

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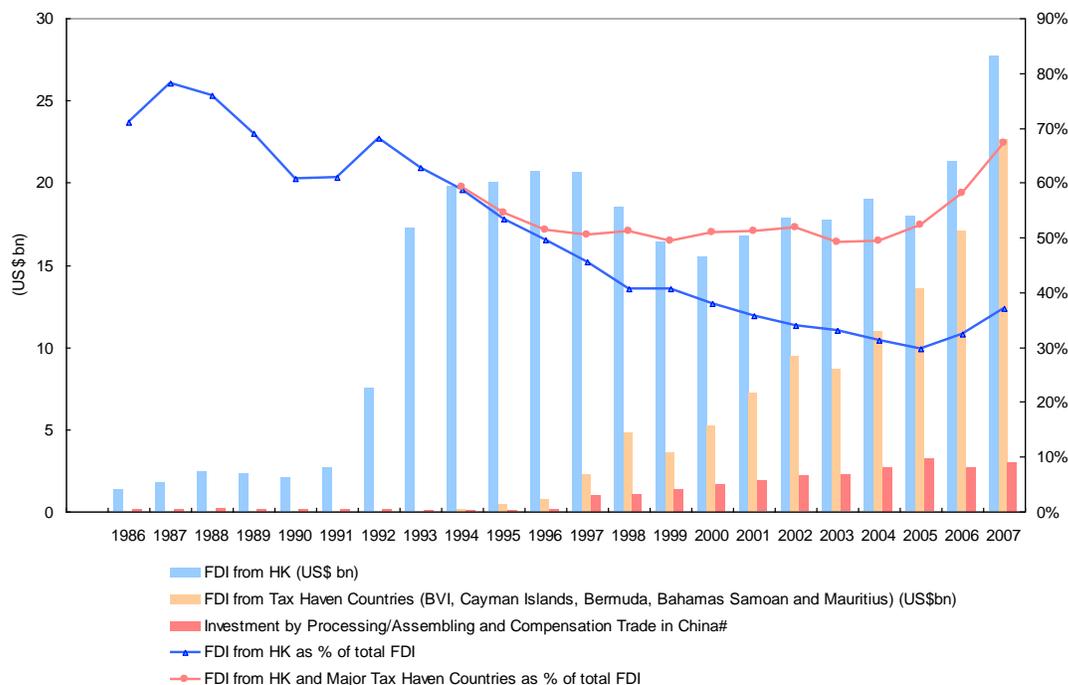
<sup>4</sup> Companies from Taiwan and to a lesser extent from other economies also participated in this process over time. Their role has grown over time, but the pioneering role of Hong Kong was critical especially at the beginning.

Within the Greater PRD economic region, Guangdong's economy is highly integrated with those of Hong Kong and Macao, primarily through the manufacturing industries and the production services. Producer services in Hong Kong provide essential support for the export-oriented manufacturing operations in Guangdong. Since the open door policy was adopted, the Greater PRD has become a rapidly growing economic region in China whose economic growth and industrialization owes much to the enterprising efforts of Hong Kong's businessmen and manufacturers from the very outset. At the same time, Hong Kong became the foreign trade outreach platform for these enterprises in Guangdong.

After 1997, the British Virgin Islands became the most important source of FDI in Hong Kong and Mainland China. It is well known that Hong Kong enterprises generally establish dormant companies in offshore financial centers such as the British Virgin Islands and the Bermuda Islands to transfer direct investment capital into Hong Kong or other places, and also allows as well foreign enterprises to transfer capital to Hong Kong indirectly. In 2006, these British Virgin Islands related investments accounted for 34% and 44% of the accumulated FDI to and from Hong Kong. Based on this inward and outward flow, we can infer that a substantial proportion of such capital is related to Hong Kong enterprises.

If we add these off-shore investments to the investments that Hong Kong enterprises are recorded to have made in China, we can derive an upper bound for the total amount of investments made in China with Hong Kong capital. Figure 1 provides upper and lower bound estimates of the band. After making such an adjustment, the downward trend probably still remains but the proportion is reduced considerably.

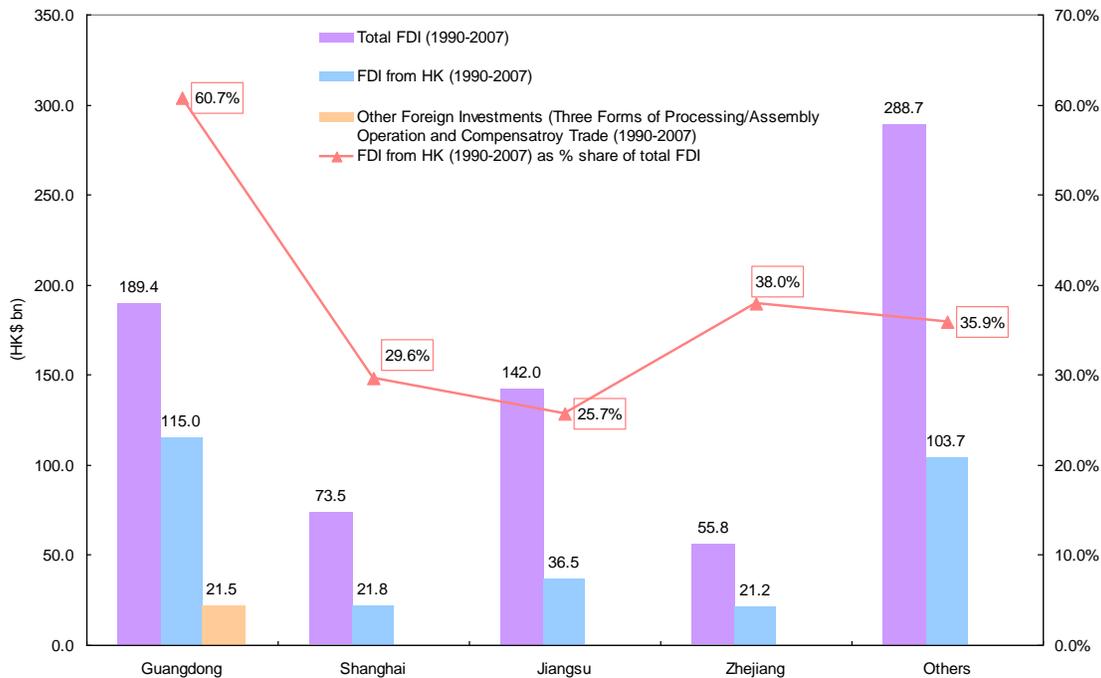
**Figure 1: FDI and Other Investments Made by  
Hong Kong in China, 1986-2007**



Source: China Statistical Yearbooks, Trade Office of the Economic Affairs Department of Liaison Office of the Central People’s Government in HKSAR

Since the mid-1990s, manufacturing enterprises based in Hong Kong and clustering in Guangdong have gradually moved to the Greater YRD, and this trend has accelerated after 2000 (see Wong, Lu, Tao, Jiang, Siu, and Sun, 2007). From 1990 to 2007, capital invested by Hong Kong in the Greater YRD accumulated to US\$79 billion, which was already 27% of its investment in China. Capital invested by Hong Kong in other regions cities of Mainland China accumulated to US\$104 billion, which was about 35% of its investment in China (See Table 2). With the continuing improvements in the business environment of the Greater YRD and other regions of Mainland China, the proportion of investments going there has been on the rise.

**Figure 2: FDI and Other Investments Made by Hong Kong in Guangdong, Shanghai, Jiangsu and Zhejiang, 1990-2007**



Source: Guangdong Statistical Yearbooks, Shanghai Statistical Yearbooks, Jiangsu Statistical Yearbooks, Zhejiang Statistical Yearbooks, China Statistical Yearbooks, Trade Office of the Economic Affairs Department of Liaison Office of the Central People's Government in HKSAR

These figures do not include capital managed in Hong Kong, registered in tax haven economies and invested in China. Hong Kong capital not only drives key elements of Guangdong's development, but is also actively utilized for the development of the Greater YRD, helping the latter to become another export-driven economic region. Due to the continuous growth of FDI, exports of FIEs in Greater YRD have exceeded that of FIEs in Guangdong in 2004 by as much as 18% in 2005, 22% in 2006 and 30% in 2007.

As manufacturing moved across the border to the Mainland and elsewhere in the region, Hong Kong shifted from export oriented manufactured production toward trade intermediation and producer services supporting the manufacturing base across the border and in the region. Hong Kong's re-exports trade in 2007, almost all related to the Mainland of China, is now larger than its GDP at 160%. At its peak Hong Kong in 1996 intermediated about 53% of China's external trade. In 2007, Hong Kong still intermediates 15% of China's external trade. Entrepot trade with the Mainland and related services are thus critically important to the Hong Kong economy and is also one of the most important contributions to China's economic opening and transformation to a market economy. With the Mainland economy opening up further following WTO accession, Hong Kong's integration with the Mainland will continue to broaden and deepen and further facilitate China's economic transformation.

## Foreign Trade, Foreign Investment and China's Transformation

China's exports account for a growing share of world trade rising from 1.1% in 1981 to 8.8% in 2007 (see Table 1), and has been forecasted to grow to 10 percent by 2020.

**Table 1: Selected Global Export Shares in Percentage, 2001-2007**

| Year           | 1981 | 1991 | 2001 | 2007 |
|----------------|------|------|------|------|
| China          | 1.1  | 2.0  | 4.3  | 8.8  |
| Japan          | 7.5  | 9.0  | 6.5  | 5.1  |
| Asia NIEs*     | 3.6  | 6.2  | 5.9  | 5.7  |
| France         | 5.3  | 6.2  | 5.2  | 4.0  |
| Germany        | 8.8  | 11.5 | 9.2  | 9.5  |
| United Kingdom | 5.1  | 5.3  | 4.4  | 3.1  |
| United States  | 11.9 | 12.0 | 11.8 | 8.4  |

Source: World Trade Organization

(\*): S. Korea, Singapore, Taiwan and Hong Kong. Re-exports from Hong Kong are excluded.

Hong Kong's efficient port facilities, trading experience, global network, and concentration of a full range of business and professional services are hard to rival in contributing to China's opening. Physical infrastructure like Mainland port facilities will continue to improve but soft infrastructure embracing legal, regulatory, market and human resources will take a much longer time to become fully market driven and oriented. Nonetheless, as China continues to liberalize its trade and investment, direct access between the Mainland and rest of the world will increase, potentially bypassing Hong Kong with the exception of trade and investment activities in the Pearl River Delta region. Hong Kong's role as a traditional "middleman" for Mainland trade will most likely diminish over time as entrepot trade increasingly shift to offshore trade or by-pass Hong Kong altogether.

Hong Kong's role in Mainland trade, however, goes far beyond entrepot trade as a traditional "middleman". Hong Kong companies are major investors in the manufacturing sector that played a critical role in China's export led development. Table 2 shows the relative contributions to exports from domestic enterprises and foreign invested enterprises (FIEs) in China. The share contributed by FIEs has continued to rise over time. The total value of exports produced by FIEs exceeded exports of the entire domestic industrial sector for the first time in 2001.

**Table 2: China's export value in billions, 1990-2007**

| Year | Domestic enterprises | Domestic share | Foreign-invested enterprises | Foreign share | Total |
|------|----------------------|----------------|------------------------------|---------------|-------|
| 1990 | 54.3                 | 87%            | 7.8                          | 13%           | 62.1  |

|                           |       |     |       |     |         |
|---------------------------|-------|-----|-------|-----|---------|
| 1995                      | 101.9 | 68% | 46.9  | 32% | 148.8   |
| 2000                      | 129.8 | 52% | 119.5 | 48% | 249.2   |
| 2005                      | 317.9 | 42% | 444.4 | 58% | 762.3   |
| 2006                      | 404.9 | 42% | 564.0 | 58% | 968.9   |
| 2007                      | 522.1 | 43% | 695.9 | 57% | 1,218.0 |
| <b>Annual growth rate</b> |       |     |       |     |         |
| (1991-2005)               | 12.5% |     | 30.9% |     | 18.2%   |
| (2006-2007)               | 28.1% |     | 25.1% |     | 26.4%   |
| (1991-2007)               | 14.2% |     | 30.2% |     | 19.1%   |

Source: Customs, China

What China's customs figures indicate is that the FIEs have become the most vibrant part of China's export oriented production capability with much of it concentrated in light industries. The largest numbers of investors in China's FIEs are from Hong Kong and they have contributed some US\$309 billion or 40% of China's total cumulative FDI in the period 1979-2007. A heavy concentration of this investment is to be found in the Pearl River Delta in Guangdong province. During 1979-2007, Guangdong received US\$119 billion in cumulative FDI, of which 61% was from Hong Kong. Even by 2007, as much as 42% of FDI investment in Guangdong came from Hong Kong.

Many of these FIEs are owned by Hong Kong and the overseas-Chinese community working as part of the global supply-chains that sell to the advanced economies notably in North America and Europe. To date, these FIEs have been able to grow without a "home market" – i.e., selling to the domestic Chinese markets - and they have had to deal with bureaucratic hassles as well as poor institutional infrastructure. In other words, the FIEs have been able to achieve dramatic growth despite China's inefficiencies, in part because they were able to circumvent those inefficiencies that domestic enterprises could not do so.

The FIEs have become the leading driving force in generating exports for China. The evidence shows that their exports have grown by 30.9% per annum on average between 1990 and 2005. Contrast this with domestic enterprises, whose compound growth rate of 12.5% during the same period. Since 2006, and probably in response to government policy to level the playing field between domestic enterprises and FIEs, the share of exports emanating from the FIEs has stabilized.

Huang (2003) and Sung (2007) have argued that such foreign investment is a second-best instrument that helps China to succeed in export-led growth by circumventing the many distortions that discriminate against domestic private enterprises, including discriminating income taxes and access to bank credit. They point to the low estimated value added of China's processing exports of foreign affiliates. These export activities have also produced huge current account surpluses for China and is often the source of misdirected political frictions with many trading partners.

Huang (2003) and Sung (2007) have observed that China is “over-dependent” on foreign investment to drive its exports. To a large extent the so-called “over-dependence” is a result of a domestic economic environment that discriminates against private domestic enterprises, often times buttressed by specific policy measures that favor foreign investors. China’s proper policy choice is to correct its own domestic distortions so that domestic companies can operate under the same constraints as foreign companies. For example, unifying tax arrangements for domestic and foreign companies would be a major step forward, relaxing credit discrimination against private domestic enterprises would create a more level playing field, and speeding up financial market and banking reforms would reduce “over-dependence” on foreign investments to drive exports.

The issue of “over-dependence” is sometimes confused with another issue concerning the low value-added nature of some of the investment driven exports in processing activities that provide far more benefits to foreign investors than they bring to the domestic economy. Attracting high-value added investments will not remove the distortions in the domestic economy that puts domestic enterprises at a disadvantage. It merely substitutes one form of investment for another and may not reduce “over-dependence” in itself. “Over-dependence” is rather the symptom of an uncompleted economic transformation in China’s reforming economy. As China’s market reforms deepen and broaden the problem would eventually fade away.

In order to attract foreign investments and export manufacturing, China had to make necessary accommodating market oriented institutional innovations for these activities to take off in the first place and to continue to grow over time. China had little choice but to transform progressively the institutional foundations of its economy. China had to learn the Hong Kong market experience from these small and medium entrepreneurs. The lesson was not to create an enclave economy, as is prevalent in many developing economies, but to sustain further openness that would spread to more and more special economic zones until the whole country progressively became a special economic zone – at which point there would be nothing special anymore.

The rapid growth of China’s exports testifies to the great strides made in its institutional reforms. A recent United Nations Study by Singh (2008) argues that China’s economy benefited more from the legal reforms than from foreign investments. Are these two factors really independent factors or are they parts of the same inevitable process? I think they are because China’s economic opening was not the result of a few large deals with a few large foreign investors that could be engineered through special bilateral arrangements and isolated from the rest of the economy. It was necessary to change rules and develop new institutions if the entrepreneurialism of 65,000 companies from Hong Kong were to be put into play.

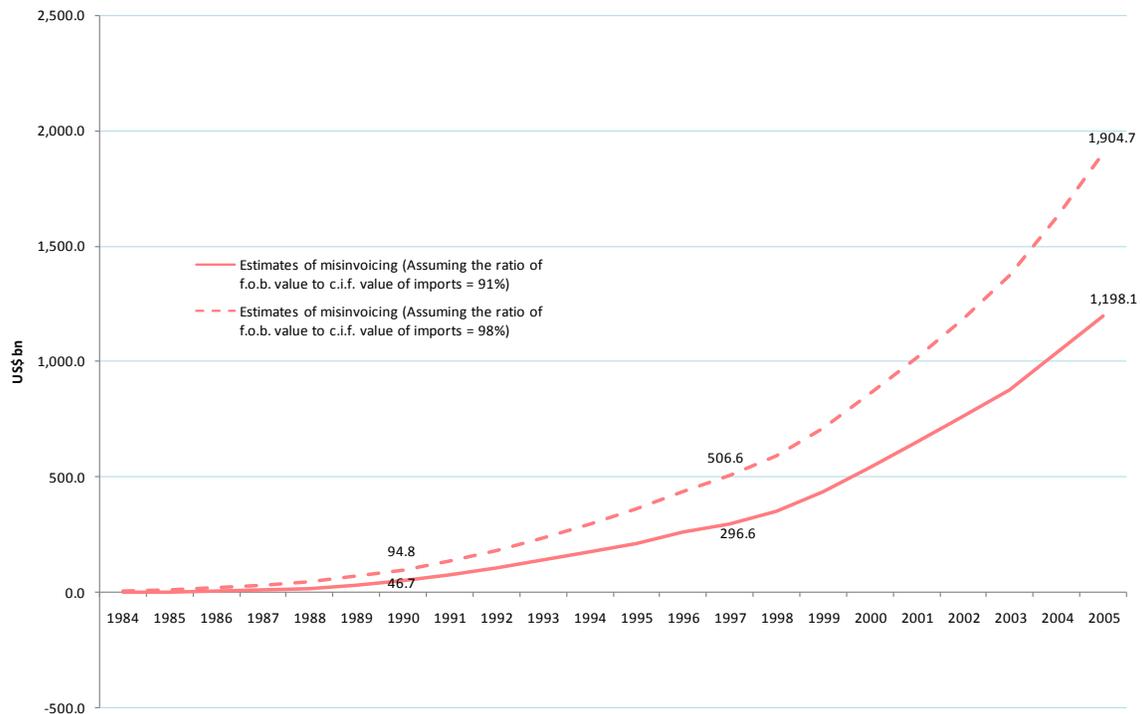
### Misinvoicing and Capital “Round Tripping”

Many countries have experienced capital flight defined as funds fleeing across national borders in search of sanctuary. Misinvoicing imports and exports is a well known

method for affecting capital flight. The large volume of trade that flows between Hong Kong and the Mainland provides ample opportunities for misinvoicing exports and imports. The question is whether this is indeed capital flight as is commonly understood.

Gunter (1996, 2004) apparently believes this to be the case. He made use of figures on balance of payments and residual measures for China and Hong Kong, adjusting for misinvoicing of China and Hong Kong trade with their major trading partners and estimated the amount of capital flight from the Mainland for the period 1984-2005. He assumed the ratio of f.o.b. value to c.i.f. value of imports to be 91% and used this as a basis for estimating capital flight. The solid line in Figure 3 below shows that between 1984 and 2005 the total cumulative value of misinvoiced value that might be used as a measure of capital flight amounted to US\$ 1196 billion. A figure that is higher than the accumulated foreign direct investment in China over the same period.

**Figure 3: China – Cumulative value of Misinvoicing 1984-2005**



Source: IMF, Direction of Trade Statistics, 1991, 1993, 2002, 2006, CEIC, Census and Statistics Department. (2004). Hong Kong's Imports Measured on Free on Board (F.O.B.) Basis 1998-2003.

Gunter's assumed ratio of f.o.b. value to c.i.f. value of imports is probably incorrect. In a special study issued by the Hong Kong Census and Statistics Department (2004) the estimated ratio of f.o.b. value to c.i.f. value of imports was 98%. Using this as a basis for estimating capital flight we can arrive at even larger estimates. The dotted line in Figure 3 above shows that between 1984 and 2005 the total cumulative value of misinvoiced value that might be used as a measure of capital flight amounted to US\$ 1905 billion.

I believe these estimates should not be interpreted as capital flight in the sense that it is money crossing national borders in search of sanctuary. Rather a large but unknown portion should be better understood as money leaving China and then re-entering again subsequently as foreign investment. In performing this “round-tripping” exercise money in China assumes a new identity that allows their owners-managers to use these funds more effectively to take advantage of China’s preferential treatment of foreign investments.

In a sense part of China’s foreign investment should be properly understood as domestic investment under the guise of foreign investment. The “round-tripping” exaggerates the true foreign sector. The role of Hong Kong here is to help facilitate the efficient reallocation of resources from a highly distorted domestic market economy to a less distorted part that is more closely integrated with the world economy. Hong Kong’s presence improves, albeit to a limited extent, the capital market imperfections on the Mainland’s – a financial market by proxy.

Interestingly, misinvoicing is now being used to facilitate speculative capital inflows into China betting on the appreciation of the Chinese currency widely believed to be undervalued. The issue is gaining attention from the Chinese authorities who are keen maintain the currency value and at the same time curb rapidly rising inflation due in part to the weak US Dollar and rising food and energy prices around the world.

#### Hong Kong as an International Financial Center for the Mainland

The growing presence of Mainland firms and capital raising activities has contributed to the development of Hong Kong's financial markets. The growing number of Mainland firms in the equity market has attracted an increasing amount of international funds to Hong Kong seeking better returns. Since 1993 a total of the 104 companies incorporated in the Mainland China have been listed on the Hong Kong Stock Exchange. These are the H-shares on the Hong Kong Stock Exchange. It is worth noting that every Mainland company that has been listed overseas has a listing in Hong Kong.

In 2006 and 2007, China-related companies, including both the "red-chip" and "H-shares" raised a record US\$45.5 and US\$25.7 billion, respectively, in the Hong Kong market.<sup>5</sup>

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<sup>5</sup> H-share companies refer to companies incorporated in Mainland China and approved by the China Securities Regulatory Commission for a listing in Hong Kong. The par value of the shares of these Chinese enterprises is denominated in RMB, and the shares are subscribed for and traded in HKD or other currencies. Red chip companies refer to companies which have at least 30% shareholding held in aggregate by Mainland China entities, and/or indirectly through companies controlled by them, with the Mainland China entities being the single largest shareholders in aggregate terms. Or if the shareholding of the company held in aggregate directly and/or indirectly by Mainland China entities is below 30% but is or above 20% and there is a strong influential presence, on a judgmental basis, of Mainland China-linked individuals on the company's board of directors. Mainland China entities include state-owned enterprises, and entities controlled by provincial and municipal authorities.

Altogether they have raised a cumulative amount of US\$102 billion (see Table 3). The combined trading value of China-related companies accounted for 66% of the total turnover and 52% of the total market capitalization in 2007.

**Table 3: China Enterprises Listed in Hong Kong Stock Exchange (Main Board), 1993-2007 (US\$ bn)**

|      | Number of Listed Companies      |          |           | Equities funds raised (US\$ bn) |          |           |
|------|---------------------------------|----------|-----------|---------------------------------|----------|-----------|
|      | Total                           | H shares | Red Chips | Total                           | H shares | Red Chips |
| 1993 | 477                             | 6        |           | 11.6                            | 1.1      | 1.9       |
| 1995 | 542                             | 17       |           | 5.1                             | 0.4      | 0.9       |
| 1997 | 658                             | 39       | 59        | 32.0                            | 4.3      | 10.5      |
| 1999 | 701                             | 44       | 67        | 19.1                            | 0.5      | 7.1       |
| 2001 | 756                             | 50       | 68        | 7.5                             | 0.8      | 2.4       |
| 2003 | 852                             | 64       | 72        | 26.9                            | 6.0      | 0.6       |
| 2005 | 934                             | 80       | 86        | 38.4                            | 20.4     | 2.9       |
| 2007 | 1048                            | 104      | 89        | 73.2                            | 11.0     | 14.7      |
|      | Market Capitalization (US\$ bn) |          |           | Turnover (US\$ bn)              |          |           |
|      | Total                           | H shares | Red Chips | Total                           | H shares | Red Chips |
| 1993 | 384.6                           | 2.4      | 16.0      | 141.7                           | 4.3      | 11.4      |
| 1995 | 303.6                           | 2.1      | 14.3      | 98.5                            | 2.2      | 5.9       |
| 1997 | 413.7                           | 6.3      | 61.1      | 453.7                           | 38.5     | 134.8     |
| 1999 | 609.4                           | 5.4      | 123.4     | 228.6                           | 13.3     | 45.7      |
| 2001 | 498.2                           | 12.8     | 116.5     | 233.5                           | 31.4     | 63.8      |
| 2003 | 703.5                           | 51.8     | 153.8     | 291.1                           | 64.4     | 63.4      |
| 2005 | 1,043.2                         | 164.6    | 219.9     | 461.3                           | 122.0    | 77.6      |
| 2007 | 2,632.4                         | 648.2    | 706.8     | 2,116.4                         | 993.3    | 349.4     |

Source: Hong Kong Exchange and Clearing Limited, Fact Books, various issues

These listings have enhanced Hong Kong's role as an international fund raising center for the Mainland. More importantly, through listing on the Hong Kong Stock Exchange, companies on the Mainland can learn directly from Hong Kong's capital market experience. Mainland companies have to comply with the rules and regulations of the capital market in Hong Kong. These companies had to strengthen their enterprise corporate governance, to readjust share owner and corporate governance structure, make necessary financial and accounting adjustment to ensure transparency and compliance with regulations regarding finances and taxes, implement thorough internal auditing procedures and systems.

Financial management and capital market operations are difficult to reform and put in place under a command economy. Implementation is particularly difficult to do well as reformers had to wrestle with both the old and new systems. The existence of the Hong Kong capital market on China's doorstep, its openness and maturity presented instant

listing opportunities that could facilitate reform and restructuring of its own industries. Through listing in Hong Kong, China gained direct access to an international capital market that it could not create quickly on its own and provided further impetus for its own financial reforms.

#### **IV. Institution Building**

The economic opening of China created a huge demand for professional knowledge that could not be rapidly met through investing in the human capital of its own residents. Moreover the knowledge set relevant to support a market economy was not available indigenously. Students sent abroad for education and training take time before they could return to help and not all of them returned home.

Many Hong Kong residents with the requisite expertise stepped in to fill a much needed gap drawing on their own experience from Hong Kong and also internationally. Many of these provided their service as a form of public service rather than as paid consultants. According to estimates made by the Hong Kong Census and Statistics Department in 2007 approximately 448,000 residents from Hong Kong live in the Mainland on a “long term” basis defined as staying in excess of one month in the past six months. Most are working in the Mainland in the manufacturing sector, but a growing proportion is now working in the service sectors.

In the area of infrastructure development Hong Kong companies and professionals have been active as both investors and managers and were the first to introduce the “build-operate-transfer” model for infrastructure investment in China. Hong Kong’s major companies have invested in container terminal ports and operations in Shanghai and Shenzhen, franchise bus services, tolled highways, subway systems, invested in and managed airport, power plants including the nuclear power plants, waste management facilities, and the list goes on.

The rapid growth of the Chinese economy has fuelled the most massive urban development and real estate construction boom in the post-war period. Hong Kong’s land ownership and lease system provided the ideal solution for China’s socialist requirement to have all land public owned. The colonial legacy of defining all land in Hong Kong as Crown land that could be leased for periods of 999 years provided the ideal combination that allowed land in China to be publicly owned and privately leased. The complete rules, codes and operations from planning and development, to urban design, to construction, to landscaping, to mortgage and finance, to real estate management and leasing, and sales and marketing of properties were modeled after Hong Kong’s planning codes and building codes. Even Hong Kong’s unique approach to finance property development using forward contracts to pre-sell properties before their completion was adopted. Here the contributions of bankers, lawyers, surveyors, real estate agents, insurers, developers and contractors and the experience they brought from Hong Kong were pivotal.

In the area of leisure and entertainment services, the influence of the Hong Kong lifestyle in areas like dining and cuisine culture, personal care, popular music, concerts, films and television have set standards and inspired new lifestyles in what was once a very barren and plain landscape. The Hong Kong brand is wildly associated throughout China as a sign of quality and modernity.

In professional services, the contributions of Hong Kong in the area of finance, social work, insurance, law, medicine and health, tourism, hotel management, convention and exhibition, advertising and design, logistics, accounting, have also set new standards of professionalism and quality benchmarks within China. Hong Kong benefitted from its knowledge and familiarity of international practices. As Hong Kong extended its services into China they were also able to serve a much larger market and in scaling up their activities they were able to take on projects that were not possible or even contemplated previously. This further enhanced the requirements for professionalism and higher standards that were beneficial to Hong Kong residents and companies as well as those on the Mainland.

The universities and other education institutions in Hong Kong were active in providing training and education services across the border. Business education, real estate management, urban planning, social work, law, public health, psychology programs were offered, including degree programs. Through these activities Hong Kong introduced completely new curricula that were both international and adapted to local conditions at the same time. They filled a huge knowledge and information gap and introduced new values, methods of thinking, behavioral patterns and different world views based on respect for the rule of law as an internalized culture that led people to compete within the law.

The professionals and executive from Hong Kong were like an army of ants bringing new ideas to the people on the Mainland, studying the problems there, devising solutions for the challenges and setting benchmarks for a new professionalism, inspiring change and emulation, and working on issues of mutual and common interest. They transformed China, participated in its transformation and together with their Mainland counterparts they learned to address the challenges of an economy in transition.

## **V. Population Flows, Integration and Civil Society**

The population of Hong Kong was 6.9 million in 2006. There is considerable diversity in the population body. The total number of resident “expatriates”, those traditionally associated with people of “white ethnicity”, was only 36,384, which is just over 0.5% of the resident population. But the number of foreign passport holders reported by the consulates of Britain, Canada, Australia, New Zealand, the United States, Germany, Italy France and South Africa, however, amounted to a total of some 600,000. It is believed that the vast majority are ethnic Chinese who had spent a considerable proportion of their time living abroad.

Combining maximum openness with vigorous upholding of institutional integrity means that both the local born and new comers enjoy a level playing field. Such an environment attracts those who appreciate Hong Kong's unique institutions, and rewards those who are competitive. The political implication of the continuous circulation of people through Hong Kong can be profound. The flexible and multi-layered process, intangible as it appears, help limit many entrenched local interests while providing a fair environment for a diverse range of people to contribute to Hong Kong as much as they may take from it over the course of their careers and sojourn. The real border is not constrained by physical boundaries, target populations, citizenships and the associated entitlements. The emerging metropolis combining Hong Kong and its immediate neighbors already interpenetrates beyond physical borders. They present new challenges for the spatiality of governance and are generating creative ways of cultivating social and cultural capital.

The role of Hong Kong residents as a catalyst of social and economic transformation on the Mainland is abundantly in evidence from news reports and numerous anecdotal and documentary reports, but the subject has yet to be systematically studied. Hong Kong's historical success relied on a border that was sufficiently porous for aspirations and skills to seep through and cross-fertilize. In doing so the territory is uniquely positioned to serve as a conduit of the world's best business, economic and technological ideas to enter the Mainland in support of its opening to the world. The Hong Kong resident as both Chinese national and world citizen is cultivating the social and cultural capital that is shaping the emergence of a civil society across the border through intensive and extensive interaction with residents from across the border.

### Population Flows

Hong Kong residents are a highly mobile population (see Table 4). Twenty five years ago in 1981 the total number of passenger arrivals in and departures from Hong Kong was 23.8 million person-trips (excluding transit and transfer passengers). The figure has increased to 202 million person-trips in 2006. The corresponding figures for Mainland China were 15.5 million person-trips in 1981 and 318 million person-trips in 2006. The growth in cross border person trips has grown by 9 times in Hong Kong and 20 times in Mainland China over the past 25 years. In 1981, the number of passengers crossing Hong Kong borders was 53.4% higher than those who crossed the border in Mainland China. In 2006, the number of passengers crossing the Mainland Chinese border was 57.3% higher than those who crossed the border in Hong Kong.

**Table 4: Population Cross Border Movements (million persons or person-trips)**

|   | 1981 | 1986 | 1991 | [1993] | 1996 | 2001  | 2006  |
|---|------|------|------|--------|------|-------|-------|
| (1) HK population   | 5.2  | 5.5  | 5.8  | 5.9    | 6.4  | 6.7   | 6.9   |
| (2) Total number of passenger arrivals in and departures from | 23.8 | 43.6 | 69.1 | 82.2   | 99.8 | 149.7 | 202.1 |

| HK   |        |       |       |       |       |       |       |
|--|--------|-------|-------|-------|-------|-------|-------|
| (3) Total number of passenger arrivals in and departures from Mainland China                 | 15.5   | 46.9  | 71.0  | 95.3  | 118.6 | 201.9 | 318.0 |
| (4) Total number of passengers crossing the Land-border between Hong Kong and Mainland China | 8.8    | 22.4  | 35.9  | 43.3  | 54.9  | 106.6 | 150.8 |
| (5) = (2) / (3) in %   | 153.4% | 93.0% | 97.4% | 86.3% | 84.1% | 74.1% | 63.6% |
| (6) = (4) / (3) in %   | 56.6%  | 47.9% | 50.6% | 45.4% | 46.3% | 52.8% | 47.4% |
|  |        |       |       |       |       |       |       |
| HK Resident departures -   | 8.6    | 16.8  | 26.3  | 30.7  | 37.1  | 61.1  | 75.8  |
| - to the Mainland  | 4.5    | 11.9  | 19.1  | 23.2  | 28.8  | 52.0  | 65.7  |
| - to Macao   | 3.0    | 3.7   | 5.2   | 5.0   | 4.9   | 4.3   | 4.4   |
| - to other countries/territories   | 1.1    | 1.2   | 2.1   | 2.5   | 3.4   | 4.8   | 5.7   |
| Average trips per Hong Kong Resident -   | 1.7    | 3.0   | 4.6   | 5.2   | 5.8   | 9.1   | 11.1  |
| - to the Mainland  | 0.9    | 2.1   | 3.3   | 3.9   | 4.5   | 7.7   | 9.6   |
| - to Macao   | 0.6    | 0.7   | 0.9   | 0.8   | 0.8   | 0.6   | 0.6   |
| - to other countries/territories   | 0.2    | 0.2   | 0.4   | 0.4   | 0.5   | 0.7   | 0.8   |
|  |        |       |       |       |       |       |       |
| Total number of outward bound person trips from the Mainland                                 | *      | 0.6   | 2.1   | 3.7   | 5.1   | 12.1  | 34.5  |
| - Mainland Chinese visitors who made trips to Hong Kong                                      | *      | 0.36  | 0.88  | 1.7   | 2.4   | 4.4   | 13.6  |

Source: HKSAR *Hong Kong Annual Digest*, various issues. China National Tourism Administration. *The Yearbook of China Tourism Statistics*, various issues. World Tourism Organization. *Chinese Outbound Tourism 2003*. Macao SAR Statistics and Census Service (DSEC). *Tourism Statistics 2007*.

As China prospers and opens up, its residents will benefit from direct travel to the rest of the world and the role of Hong Kong residents as a conveyor of information about the world may decline for the more mobile population in the Mainland. But given the size of the population in the Mainland, Hong Kong residents will still play an important role for reaching out to and engaging with the vast much less mobile population there.

In 1981, a total of 8.8 million person trips crossed the border between Hong Kong and Mainland China by land representing some 56.6% of the total number of person trips crossing the Mainland Chinese border in 1981. The number of passenger trips crossing this land had risen to a total of 151 million person trips in 2006. This represents some 47.5% of the 318 million person trips that crossed the Mainland Chinese border in 2006. The land border between Hong Kong and Shenzhen is the most popular land border crossing in China and probably in the world as well. People crossing the land border between Hong Kong and Mainland China are overwhelmingly residents in the Mainland and Hong Kong.

In 1981, Hong Kong residents made a total number of 8.6 million person trips out of Hong Kong of which 4.5 million trips was to the Mainland. By 2006, Hong Kong residents were making a total number of 75.8 million person trips out of Hong Kong with

65.8 person million trips to the Mainland. On average the number of trips Hong Kong residents were making to the Mainland had risen from 0.9 trips per year in 1981 to 9.6 trips per year in 2006; an increase of 10.7 times. In 2006, some 43.4 million trips were for personal reasons and 22.4 million were for business purposes. It is relevant to note that the number of outward bound trips to international destinations (excluding to Macao) had risen from 1.1 million in 1981 to 5.7 million in 2006. This amounts to 0.21 trips per person per year in 1981 and 0.83 trips per person per year in 2006; and increase of almost 4 times. Hong Kong residents are a very well traveled population not only to the Mainland but also internationally.

The number of outward bound person trips from the Mainland also grew dramatically from 0.6 million in 1986 to 34.5 million in 2006. Mainland Chinese visitors who made trips to Hong Kong rose from 0.36 million in 1986 to 13.6 million in 2006. The increase of Mainland Chinese visitors to Hong Kong grew dramatically when a more relaxed policy was introduced to allow travel on Individual Permits in 2003. Traveling to Hong Kong provide Mainlanders an opportunity to experience the city first-hand.

### Cross Border Marriages

An immediate consequence of the growing population flows between Hong Kong and the Mainland is the increase in cross border marriages. In the decade between 1986 and 1996 most of the cross border marriages took place in the Mainland. They were predominantly men from Hong Kong who married women across the border. These men often cluster at the low end of the socio-economic hierarchy had difficulties finding spouses in Hong Kong. Many decided to take rural brides from the relatively impoverished areas on the Mainland (see Siu, Wong and Faure 2006). Some of these marriages involve elderly men taking young rural brides. Local society has often singled out these brides and their rural cultural markers for discrimination.

In the recent decade, an increasing number of cross border marriages have taken place in Hong Kong. The marriages now involve a growing proportion of the better educated in the population. The numbers of the most rural and needy families have declined recently, and the geographical origin of Mainland spouses has shifted to more diverse and urban areas. In 2006, the total number of marriages registered in Hong Kong totaled 50,328 of which 21,259 involved at least a bridegroom or bride from Mainland China and only 25,682 were solely between residents from Hong Kong (see Table 5). The number has risen dramatically over time beginning with 782 in 1986, 680 in 1991, 2,484 in 1996, 5,892 in 2001 and 21259 in 2006.

**Table 5: Number of Marriages Registered and Certificate of Absence of Marriage Records Issued in Hong Kong**

| Year | Marriages Registered in Hong Kong | Estimate of Marriages Registered in China | Estimate of Bridegrooms/Brides from Mainland China |
|------|-----------------------------------|---|--|
|      |                                   |   |  |

|      | Total  | Bridegrooms/<br>Brides from<br>Mainland China | Certificate of<br>Absence of<br>Marriage<br>Records Issued | Estimate of<br>Marriages<br>Registered in<br>Hong Kong and<br>Mainland China | As % of Total<br>Marriages<br>Registered in<br>Hong Kong and<br>Mainland China |
|------|--------|---|--|--|--|
| 1986 | 43,300 | 782   | 15,669   | 16,451   | <b>27.9%</b>   |
| 1991 | 42,600 | 680   | 21,930   | 22,610   | <b>35.0%</b>   |
| 1996 | 37,045 | 2,484   | 23,901   | 26,385   | <b>43.3%</b>   |
| 2001 | 32,825 | 5,892   | 14,847   | 20,739   | <b>43.5%</b>   |
| 2006 | 50,328 | 21,259  | 13,369   | 34,628   | <b>54.4%</b>   |

Source: Demographic Statistics Section, HKSAR Census and Statistics Department, Talks on Specific Statistical Series (29 August 2007)

Note: Certificates of Absence of Marriage Records (CAMR) are issued By the Hong Kong Government for the purpose of those who intent to get married in Mainland China

Marriages registered in Hong Kong are a subset of all cross-border marriages that take place because some of the marriages take place on the Mainland and are registered there. An approximate estimate of the number of marriages in the Mainland can be indirectly deduced from the number of successful applicants for a Certificate of Absence of Marriage Records from the Hong Kong authorities for the purpose of getting married in the Mainland. As cross border travel into Hong Kong has become relaxed, the number has actually declined over time in recent years with 15,669 issued in 1986, 21,930 in 1991, 23,901 in 1996, 14,847 in 2001 and 13,369 in 2006.

Combining these two sets of figures we estimate that the percentage of cross-border marriages in all marriages involving Hong Kong residents was 27.9% in 1986, 35.0% in 1991, 43.3% in 1996, 43.5% in 2001 and 54.4% in 2006. Over a time span of two decades the percentage of cross border marriages with Mainlanders have more than doubled among Hong Kong residents. Using these estimates the cumulative number of registered marriages during the period 1986-2006 involving Hong Kong residents is 838,819 of which 478,458 or 39.5% are cross border marriages.

Judging from the trend and the growing interaction between Hong Kong and the Mainland these numbers are likely to accelerate over time. The population of Hong Kong is being gradually reconstituted through cross border marriages. Through this process many individuals, families and communities within the Mainland will be drawn progressively into engagement with the larger community beyond the Mainland. Unlike the local born in Hong Kong who grew up detached from any Mainland experiences, the newcomers, with their intimate social networks and experiences in China, can be effective brokers at a certain socio-economic level between Hong Kong and China, and in particular, the Pan Pearl River delta.

As they settle in Hong Kong or circulate back to the Mainland for career development, they would bring back their unique Hong Kong experience and enlarge Hong Kong's footprint on the Mainland. Their cross-border experiences are an important form of social capital to help the Mainland understand and reach out to Hong Kong and beyond.

Through these new residents, Hong Kong will acquire a deep and profound knowledge and understanding of the Mainland as it transforms. The concentration of a cross section of new Mainland residents in Hong Kong enhances the place as a center on what is happening in the community and society across the border. Hong Kong has become not merely an information hub for trade and investment as it did under 150 years of British rule, but also a network node and gateway to the Mainland's emerging new community and society. Time will tell how this process of what Karl Popper characterizes as "piecemeal social engineering" will ultimately shape the Mainland and with it also Hong Kong. The idea that the Mainland will become a more open society is not in doubt.

### The Silent Third Sector

The dislocations and social stresses created by market reforms on the Mainland and the inadequacies of the state machinery to respond effectively to these consequences created a huge gap in the supply and demand for social services. Hong Kong residents and many NGOs were able to bring in fresh ideas, expertise and funding, and even more importantly infectious enthusiasm.

Hong Kong has a vibrant Third Sector; a term often used to describe "non-profit" or "voluntary" institutions. A survey conducted in 2003 by the Central Policy Unit (2004) estimated that there were about 9,363 such organizations in Hong Kong of which about 6,785 or 72.5% were primarily organizations that served only their own members and 2,576 or 27.5% were primarily public serving organizations. A total of 49.8% of these organizations were formed during the period 1986-2002 and 42.5% were formed before 1986. About 70% reported that their main purpose was to serve Hong Kong, 12% reported that they served the Mainland, and 8% reported that they were serving the rest of the region or other parts of the world. The Third Sector is estimated to employ approximately 9% of the work force in Hong Kong on a full-time basis. The estimate is imprecise but provides an approximate order of magnitude. About 57% of these organizations use volunteers and the estimated number of volunteers that were involved amount to 8.2% of the population or 15.7% of the work force.

While 12% of the organizations reported that their purpose was to serve the Mainland is likely to be a gross underestimation because many organizations whose goal is not to serve the Mainland nevertheless have activities and programs that serve the Mainland or Mainlanders. Most religious groups serve the local Hong Kong community have activities and programs on the Mainland involving member volunteers. Many business social clubs like the Lions Club and the Rotary Club have projects for members on the Mainland. The true scale of volunteer activities on the Mainland is not known and has not been documented.

Extensive press reports<sup>6</sup> have been recorded on the role of non-government organizations from Hong Kong providing service in areas as diverse as the following:

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<sup>6</sup> See especially Yazhou Zhoukan (2007).

- education and training - providing teaching activities from primary to university levels and in professional subjects
- labor relations - performing advisory roles in labor disputes and unrests
- natural disasters - providing relief through donations, immediate support services and post-disaster services
- religion - religious service
- medical and health services – provision of free medical, surgical and health services to those who cannot afford it
- social outreach activities – reaching out to the most deprived groups in society in difficult to access rural and mountainous areas and urban slums to provide support for schooling, poverty alleviation, malnourishment, public health areas like AIDS, TB and sexually transmitted diseases, drug abuse, child abuse and protection
- food safety – testing for safety and provision of public information on unsafe foods, including genetically engineered foods
- environmental protection and conservation – public education and project initiation

The operational modes of these non-government organizations are to penetrate deeply into Chinese society, maintain flexibility, adapt to the local environment, meet specific local needs, readiness to customize their programs to fit the situation, stay independent, recruit university student volunteers both from Hong Kong and in the Mainland and provide them with training to carry on the work.

These non-government organizations perform a critical role in compensating for what the state has often neglected in the past and has failed to address. By addressing specific local needs they do not pose as threat to the state as such and is welcomed. Their work provides some mitigation of various conflicts and stresses building up in a rapidly changing society. Their work in solving specific needs encourage and facilitate self-examination and critical analysis of the social problems they face. As these organizations try to find client oriented solutions they create public social awareness of the problem, institutionalize the search for practical solutions through self-examination and critical analysis. Many non-government organizations are able to penetrate deep into the hinterland reaching as far as Yunnan, Guizhou, Inner Mongolia, Xinjiang and Tibet in the remote border regions.

Mainlanders are impressed by the continuous stream of volunteers from non-government organizations in Hong Kong. Their examples have inspired local residents to form their own non-government organizations. Through working together they are able to share common learning experiences.

The by-products of the work of the non-government organizations from Hong Kong is to raise professional standards, providing the means and the examples for mitigating many of the social stresses and dislocations in a transforming society, help usher in a new life style for its residents. The seriousness of purpose of the non-government organizations have provided the inspiration and the wherewithal for creating a new way of life on the

Mainland and the development of civic society as the state progressively withdraws its presence.

The entry of non-government organizations into the Mainland was not always a smooth process. They were suspicious of the intentions of these organizations. Lacking trust from the authorities these non-government organizations had to overcome many hurdles imposed by local and central authorities. Even to this date the non-government organizations have no legal status in China. But the value of the work they do, their focus of providing specific local solutions, and the absence of a larger social and political agenda have gone a long way to removing the early suspicions. The deep commitment, professionalism and personal examples of these individuals have been important elements in building the trust.

In the decades ahead the funding received by these non-government organizations will be growing as an increasingly prosperous community puts more emphasis on supporting specific causes in the Mainland. Sir Run Run Shaw the movie and television mogul has in the past quarter century donated at least HK\$100 million each year to universities on the Mainland. Mr. Shih Wing-Ching founder of the largest real estate agency in Hong Kong and the Mainland has pledged his entire estate to alleviating poverty on the Mainland. Hong Kong's baby boom generation born after the Second World War shortly after their parents arrived from the Mainland is entering the retirement years and this is an unusually well educated, skilled group of professionals and executives (see Siu, Wong and Faure, 2005). Many of them will no doubt volunteer their knowledge and skills to help the Mainland in their professional areas and to work for non-government organizations; some may even initiate new initiatives and organizations of their own.

The baby boom generation born in Hong Kong that had immigrated overseas will also be returning to Hong Kong to join the effort of others in the Third Sector to participate in and support China's social transformation. In a study of immigrant population by OECD (2008) initiated by J Dumont and G Lemaître the number of expatriates from Hong Kong working in OECD countries was estimated to be 388,400; the corresponding figure for Mainland China was 2,074,100. Dumont and Lemaître (2005) had earlier also estimated the percentage of this population that was highly skilled to be 42.8% and 39.6% for Hong Kong and Mainland China. These too would be skilled talent pools that could be drawn upon to serve the Mainland from Hong Kong.

Hong Kong's role as the catalyst for China's social transformation may be a very modest one observed on a day to day basis. But its armies of volunteers have quietly penetrated to remote corners of the vast rural and urban landscape and help inspired China's silent social transformation. The economic role of Hong Kong to support China's economic opening was probably fully envisaged by the Chinese leaders when they contemplated the opening of China and the setting up of the special economic zone in Shenzhen and other coastal areas. Deng Xiaoping must claim full credit for this piece of social engineering. Hong Kong's role in inspiring a silent social transformation on the Mainland could not have been even remotely foreseen. Deng Xiaoping's dismissive caricature that after the restoration of Chinese sovereignty in 1997, Hong Kong's capitalist life style of

indulgence in “horse racing and dancing” would be allowed to continue revealed the limits of what the Chinese leadership could have imagined possible. Time will tell whether Hong Kong’s role in the silent social transformation of the Mainland will prove to be as important as the economic transformation that has taken place.

## **VI. Conclusion**

From the start of Hong Kong’s existence, the territory has thrived on being simultaneously part of China and the world. Flexible positioning has been critical for Hong Kong to maintain a footprint that has reached far beyond the territory’s physical boundaries. When catering to the needs of world trading empires, Hong Kong has provided the environment for cultivating layers of China resources; when engaging China, its residents offer unique worldly institutions, social networks, cultural styles and business horizons.

Armed with strong institutional software in law, finance, communications networks, modern transport, and global connections, Hong Kong has facilitated China’s engagement with the world. It has also provided unique conduits for global interests heading towards China. Historical lessons tell us that when Hong Kong was but a barren rock, those who came to seek their livelihoods and to conduct business were not attracted by local social benefits but by competitive opportunities that extended beyond Hong Kong’s borders and reinforced by quality assurance, protection and professionalism that other regional nodes could not provide.

Its unique institutional resources and qualities remain, as it historically has been, a vibrant space of flow – of capital, goods, people, information, services, global cultural resources, creative aspirations and civic energies. In human resource terms, maximum circulation of a diverse range of talents through the territory has made the best use of the opportunities that could be harnessed from Hong Kong. With healthy institutions, those who enter and exit the territory during different phases of their education, lives and careers deposit value to Hong Kong society and to connect it to regional and global environments, making it the hub of hubs.

Hong Kong’s advantages are a combination of its proximity to China, its vibrant and luxurious urban culture, its globally recognized financial and legal institutions, and competitive opportunities for mobility and personal growth. From sustainable environment to professional ethics, institutional integrity and quality assurance, Hong Kong has been able to attract professionals and entrepreneurs by promising them that in coming to work, they can expect quality, level-playing fields. If they come to live and settle, their family and children can enjoy a healthy, civic environment and cosmopolitan educational facilities. With the opening of China, the territory has looked increasingly north to China. But Hong Kong’s global elements are equally necessary to make the territory culturally attractive to multi-ethnic talents.

## **Endnotes**

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