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## *Development and Transformation of the Free Port of Hong Kong*

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## Introduction

Hong Kong has an area of 1,099 km<sup>2</sup> and a population of 6.82 million in 2002 (Hong Kong Government, 2003:418). Its territory consists mainly of hilly areas with almost no natural resources. Its major assets are a deep-water harbour and a resourceful population (Rimmer, 1992). It was only a tiny fishing village when it was seized by the British and made a colony in 1841. Since then, Hong Kong has acquired increasing significance as an entrepôt. Unlike Macao, which was under the exclusive rule of the Portuguese in early years, Hong Kong developed as a free port from the very beginning (Chiu, 1973:17; Meyer, 2000). The success of Hong Kong as a global city in Asia has much to do with its status as a free port and its role in international trade and re-exports.

In the process of its development, Hong Kong has gone through several stages due to changes in its external environment. Currently, Hong Kong is a Special Administrative Region of China. The arrangement of "one country, two systems" has been practised in Hong Kong since July 1997. Following the Asian financial crisis in late 1997, and the subsequent global economic slow-down, Hong Kong has been struggling to restructure its economy. Many questions have been raised about Hong Kong's future role in the development of mainland China and in Asia (Lo, 2004). The implementation of economic reforms and the open-door policy in the mainland since 1978 have brought many commercial opportunities to Hong Kong investors (Shen, 2002).

However, the increasing global integration of China's economy and its entry to the World Trade Organization (WTO) have raised questions about Hong Kong's role as a bridge between mainland China and the world. There have also been significant changes in Hong Kong's position on close cross-border integration with the Pearl River Delta (PRD) and the mainland in general (Shen, 2003). The debates on these issues involve both economic and political dimensions. The low production and living costs in the PRD are considered a threat to Hong Kong's competitiveness in terms of both the business market and housing market in the region. The stark differences in legal and institutional systems as well as in governance and business practices between Hong Kong and the mainland have alerted many Hong Kong people to the dangers of losing their legal and institutional advantages through close integration with the mainland (Rohlen, 2000). All of these considerations influence Hong Kong's strategy in coping with the restructuring of its economy.

Within the above context, this paper will first examine Hong Kong's free port policy and the government's approach of non-intervention in the economy. The paper will then examine Hong Kong's development and transformation in recent decades; its industrialization, de-industrialization and current transformation associated with China's open-door policy; the Asian financial crisis; and the closer economic partnership arrangement (CEPA) between Hong Kong and the mainland.

### **Free Port Policy and the Role of Government**

Hong Kong is a champion of free trade. It became a separate contracting party to the General Agreement on Tariffs and Trade (GATT) in 1986, and it is a founding member of the WTO, established in 1995. As a Special Administrative Region of China, the arrangement of "one country, two systems" has been practised in Hong Kong since July 1997, according to the Basic Law of the Hong Kong Special Administrative Region (HKSAR).

Hong Kong continues to be a full member of WTO using the name "Hong Kong, China." Within the WTO, Hong Kong is a separate customs territory that enjoys full autonomy in the conduct of its external commercial relations (Commerce and Industry Branch, no date). Hong Kong has continued to be a free port since 1997.

The success of Hong Kong as a global city in Asia has much to do with its status as free port and its role in international trade and re-exports. Hong Kong was ranked the freest economy in the world by the Heritage Foundation over the period 1995-2002 and by the Fraser Institute over the period 1970-2001 (O'Driscoll, Feulner and O'Grady, 2003; Gwartney, Lawson and Emerick, 2003). The current status of the free port policy and the government's approach of non-intervention in the economy can be summarized in what follows (Shen and Yeung, 2002).

Hong Kong follows the economic policy of free enterprise and free trade. No import tariffs are imposed and excise duties are levied only on four categories of goods, including locally manufactured or imported tobacco, alcoholic liquors, methyl alcohol and hydrocarbon oils. A tax is also payable on the first registration of motor vehicles. The Customs and Excise Department is assigned the tasks of fighting smuggling, collecting government revenues on dutiable goods, detecting and deterring the trafficking of narcotics and the abuse of controlled drugs, and the protection of intellectual property rights. In the year 2001/02, the excise duties collected amounted to HK\$6.98 billion (US\$1 = HK\$7.8), of which HK\$3.77 billion came from hydrocarbon oils, HK\$2.41 billion from tobacco, HK\$0.79 billion from alcoholic beverages and HK\$0.03 billion from other alcohol products, representing about 4% of the government's revenue (Treasury Branch, 2004). The tax on the first registration of motor vehicles amounted to HK\$2.68 billion in 2001/02.

For health and safety reasons, five kinds of commodities are subjected to the licensing control of the Director-General of Trade and Industry, according to the "Import and Export Ordinance," the "Reserved Commodities Ordinance," the

“Ozone Layer Protection Ordinance” and their subsidiary legislation. An import license is required for radioactive substances and irradiating apparatuses. Import and export licenses are required for the following commodities:

1. Pharmaceutical products, medicines and dangerous drugs,
2. Reserved commodities,
3. Strategic commodities, and
4. Ozone depleting substances.

Except for the above regulations, Hong Kong imposes no trade barriers. Any company, regardless of its ownership, can operate freely in Hong Kong. A new company can easily be set up in Hong Kong in six working days. Hong Kong has a simple tax system and profit taxes that are among the lowest in the world. In 2001/02, the profits of unincorporated businesses were taxed at 15% and the profits of corporations at 16% (Hong Kong Government, 2003:69). Hong Kong imposes no controls over the movement of foreign currencies. The Hong Kong dollar is currently pegged against the US dollar, which means that the exchange rate is extremely stable.

The Hong Kong government does not carry out any economic planning and does not protect or subsidize manufactures in Hong Kong. This is a distinctive departure from the foreign direct investment (FDI) policies in the mainland, which provide tax incentives and cheap land. Nevertheless, the Hong Kong government plays an important role in many aspects of society, including land ownership, education, public housing, water supply and health services. In addition, major utility services such as public transportation and the supply of electricity are also licensed to a few private companies. These companies set their prices mainly according to the value of their capital assets and to the ability of consumers to afford such services, with little fear of competitive pressure.

Generally, the government does not involve itself directly in economic activities; rather, it strives to provide a good physical, organizational and informational infrastructure so that Hong

Kong can serve as a hub-gateway and offer an excellent environment in which businesses can thrive. As mentioned above, the government has adopted policies of low and simple taxation, of Hong Kong as free port and possessing free trade status, anti-corruption and political stability. With a clean and efficient government, Hong Kong is an ideal place for business. The only concerns for business are the high property prices and labour costs, which were especially evident in the years prior to the Asian financial crisis in 1997.

In the period before 1997, the *laissez-faire* non-intervention policy of the government was the most famous feature of urban governance and considered one of the most important factors in the development of Hong Kong's economy (Enright, Scott and Dodwell, 1997). Such a policy of non-intervention largely continued in Hong Kong after 1997. However, Yeung (2000) argued that commercial and financial interests actually dominated Hong Kong's executive and legislative councils and had much influence on political affairs and government policy before 1997. The role of the Hong Kong government can best be interpreted as “a passive, reactive and *status quo* ‘intervention’ without intervention” (original emphasis, Yeung, 2000:138), possibly in conflict with the notion of neo-liberalism. Thus, government policy was rarely free from the influences of commercial and financial interests. Nevertheless, with a powerful Independent Commission Against Corruption (ICAC) that was set up in 1974, outright bribery and corruption in Hong Kong are also rare.

### **Industrialization, De-industrialization and Cross-border Development**

Hong Kong has enjoyed a long period of economic growth over the past four decades. According to the latest gross domestic product (GDP) estimates, its real annual GDP growth rate was 5.8% in the period 1965-1975, 8.5% in 1975-1985 and 6.1% in 1985-1997 (CSD, 2001a). The GDP per capita tripled during the period 1975-1997. In 1998, Hong Kong had a negative rate of



GDP growth of -5.0%, due to the Asian financial crisis. Its economy recovered in 2000 with a GDP growth rate of 10.2%, before again becoming stagnant. In 2002, after adjusting for purchasing power, the GDP per capita was US\$24,690, ranking Hong Kong 16th in the world (World Bank, 2004). With its airport and container port among the busiest in the world in 2002, Hong Kong is the world's tenth largest trading entity (CSD, 2003c).

Hong Kong's development is associated with its changing economic links with the mainland. The cross-border relationship between Hong Kong and the mainland from 1841 to 1949 can be characterized as one in which there was no government control of the border. Hong Kong's immigration laws prior to 1940 allowed Chinese to enter and leave Hong Kong freely, without the need to show documents or visas. Up to the early 1950s, Hong Kong's economy benefited from entrepôt trade with the mainland.

After 1950, Hong Kong's economic links with the mainland were severed following an embargo on China imposed by the United Nations. The embargo virtually put a stop to Hong Kong's entrepôt trade with the mainland.

From the 1950s to the 1970s, Hong Kong relied on industrialization for economic growth; the China factor played almost no role during that period. The share of the labour force employed in manufacturing was as high as 47% in 1971 and was still 41.3% in 1981 (Suen and Chan, 1997:37).

Since the introduction of an open door policy in the mainland in 1978, a spatial division of labour was gradually established, generally called the "front shop, back factory model." This occurred because of the economic complementarities and comparative advantages of Hong Kong and the mainland (Sit, 1989, 1998; Shen, 2003; Lo, 2004). Hong Kong has transferred the majority of its manufacturing to the PRD and has itself become a prominent service centre, specializing in trading, transport and communications, and financial services. Hong Kong's economy has gone through a

significant process of de-industrialization, and trading with the mainland and the United States has become very important to Hong Kong. By 2002, the share of the labour force in the tertiary sector was as high as 84.3%. The service sector accounted for 86.5% of the total GDP in 2001 (Hong Kong Government, 2003:42, 132).

One important role that Hong Kong plays is as a middleman between the rest of the world and mainland China. According to Table 1, re-exports accounted for over 68% of Hong Kong's imports or exports in 1991; by 2002, the figure had increased to as much as 88%. The majority of such re-exports are related to the mainland, Hong Kong's largest trading partner. Re-export trading activities with the mainland have brought huge profits to the business community in Hong Kong. According to the Hong Kong government's statistics (Sung, 1998), the gross profit rate from exporting products produced in the mainland via Hong Kong increased from 13% in 1989 to a magnificent 34.4% in 1996, while that of exports via Hong Kong of products produced in other countries declined from 11.5% to 6.6% over the same period. The main reason for a high gross profit rate from trading with the mainland is that, in the cross-border system, many manufacturing activities are operated by Hong Kong investors or by joint ventures with partners in the mainland, particularly in Guangdong. Table 2 shows that 47.2% of mainland imports from Hong Kong and 78.0% of mainland exports to Hong Kong in 2001 were the result of FDI activities by Hong Kong investors. It is notable that HK\$529.5 billion out of the HK\$532.0 billion in exports to Hong Kong from the mainland in 2001 induced by outward processing actually originated in Guangdong. In 2002, vehicular traffic movements through the three control points at Lok Ma Chau, Man Kam To and Sha Tau Kok reached 12.34 million, an increase of 9.0% from 2001 (Hong Kong Government, 2003:256). A cross-border production network between Hong Kong and the PRD has become well established, with exports of manufactured goods to world markets continuing to expand (Shen, 2003).

**Table 1** Imports and exports, Hong Kong, 1991-2002 (HK\$billion)

Year	Imports	Domestic imports	Re-exports	Domestic exports	Total exports	Share of re-exports in imports (%)	Share of re-exports in exports (%)
1991	779.0	244.2	534.8	231.0	765.8	68.7	69.8
1996	1,535.6	349.8	1,185.8	212.2	1,397.9	77.2	84.8
1997	1,615.1	370.6	1,244.5	211.4	1,455.9	77.1	85.5
1998	1,429.1	269.9	1,159.2	188.5	1,347.6	81.1	86.0
1999	1,392.7	214.3	1,178.4	170.6	1,349.0	84.6	87.4
2000	1,658.0	266.3	1,391.7	181.0	1,572.7	83.9	88.5
2001	1,568.2	240.7	1,327.5	153.5	1,481.0	84.7	89.6
2002	1,619.4	189.8	1,429.6	130.9	1,560.5	88.3	91.6

Sources: CSD (2001b:1, 2002b:1, 2003a).

**Table 2** The outward processing trade and its share in total trade between mainland China and Hong Kong, 1991-2001 (HK\$billion)

Item	1991	1997	2001
Mainland China's direct imports from Hong Kong (Percentage share of total)	40.4 (76.5)	47.1 (76.1)	35.2 (71.0)
Mainland China's imports via Hong Kong (Percentage share of total)	73.6 (48.2)	197.8 (44.7)	224.4 (45.2)
Subtotal (Percentage share of total)	113.9 (55.5)	244.9 (48.6)	259.6 (47.5)
Mainland China's export to Hong Kong (Percentage share of total)	197.4 (67.6)	491.1 (81.2)	532.0 (78.0)
Guangdong's export to Hong Kong (Percentage share of total exports involving outward processing from the mainland)	186.6 (94.5)	463.7 (94.4)	521.0 (97.9)

Sources: CSD (1992:170, 173; 1998:203, 207; 2002b:205, 209).

### Economic Restructuring and the Changing Role of Government in Cross-border Development

As a highly open economy, Hong Kong's development path has been shaped by the changing political, social and economic situations in the region and in the world. Hong Kong's economic position was adversely affected by the Asian financial crisis in 1997. Hong Kong has gone through a painful process of re-adjusting its cost of housing and labour. Conditions in mainland China and the United States have a tremendous economic impact on Hong Kong. The economic slowdown in the United States, worsened by the 9/11 tragedy in New York in 2001, had a dramatic effect on Hong Kong's export/re-export trade. China's entry to the WTO in 11 December 2001 has also brought a need for Hong Kong to adjust its role in the world economy.



The economic integration of Hong Kong with the PRD and the role of the Hong Kong government have become important issues since 1997. The previous section shows that a close economic relationship had been established between Hong Kong and the mainland by 1997. Such economic and trading relations had been developed mainly through the initiative of local people and businessmen in Hong Kong, through a bottom-up approach (Shen, 2003). At the time, the then Hong Kong government took the approach of non-intervention, neither prohibiting nor encouraging cross-border economic exchanges. To facilitate the return of Hong Kong to China in 1997, after 1984 a limited number of sub-committees were formed under the Sino-British Liaison Group to deal with various matters (Chu, Shen and Wong, 2002). Of these, prior to 1997 the Hong Kong-Guangdong Environmental Protection Liaison Group formed in July 1990 was the most successful.

The return of Hong Kong to China in 1997 did not bring dramatic change to the nature of the border between Hong Kong and the mainland. The new HKSAR practices "one country, two systems" and the border continues to function to separate Hong Kong and the mainland as two independent economic entities. In practical terms, the cross-border regional production system continues to operate under the "two systems" of Hong Kong and the mainland, respectively. Officially, the Hong Kong government has pledged to improve relations with the mainland and to strengthen cooperation on cross-border issues. The regular Hong Kong-Guangdong Cooperation Joint Conference was inaugurated by the Chief Executive of the HKSAR, Tung Chee-hwa, and the Governor of Guangdong, Lu Ruihua on 30 March 1998. But, in reality, little progress in cross-border development was achieved in the period 1997-2001. The frequent calls by the governments of PRD cities such as Shenzhen and Zhuhai for close economic integration were ignored. Sung (2002) has claimed that the Hong Kong government adopted a "fortress Hong Kong" policy towards the regional integration of the Hong Kong-PRD region, in stark contrast to its famous liberal policies and approach of "positive non-intervention" towards global capital and globalization.

The Hong Kong government was generally slow in taking action. The Planning Department was blamed for not planning ahead to accommodate increasing flows of passengers and goods across the Hong Kong-Shenzhen border. There are two main reasons for such a situation. First, the central government of China is committed to the implementation of "one country, two systems" in Hong Kong and has instructed all provincial/regional governments in the mainland not to seek any official engagements with the HKSAR. Any relations with HKSAR must be dealt with via the Hong Kong and Macao Affairs Office of the State Council in Beijing. This has had the effect of cutting off relations between the HKSAR and many cities and regions in the mainland, including those in the PRD and Shenzhen.

Second, many have considered the full integration of Hong Kong with the PRD region with convenient 24-hour border crossings as not to the benefit of Hong Kong's economy. Housing prices in PRD cities are only one-tenth to one-third of those in Hong Kong. Any significant improvements in cross-border transport could induce Hong Kong people to live in Shenzhen and work in Hong Kong. More residents, especially those living in the New Territories, would go shopping in Shenzhen. These changes in the property and consumer markets would have a negative effect on businesses and on the price of real estate in Hong Kong, which have already been affected by the Asian financial crisis.

The Asian financial crisis in October 1997 hit Hong Kong's economy hard, especially its stock and property markets. In the period 1997-2000, the price index of private housing dropped by 46.8%, and the rental index of private housing dropped by 27.1% (CSD, 2001c). The Hang Seng Index dropped from over 16,000 in 1997 to a low of 6,600 in August 1998. Hong Kong's domestic exports dropped from HK\$211.4 billion in 1997 to HK\$170.6 billion in 1999. With the fall in stock and property prices and the shrinking of the import/export trade, the consumption power of Hong Kong residents declined significantly. As a result, Hong Kong registered a negative GDP growth rate of -5.0% in 1998.

In 2000, Hong Kong's economy was on its way to recovery with a positive GDP growth rate of 10.2% (CSD, 2002a:xiii). However, Hong Kong's economy worsened again after the 9/11 event in New York. The value of domestic exports fell by 15.2% and 14.7% in 2001 and 2002, respectively. The value of re-exports dropped by 4.6% in 2001, but increased by 7.7% in 2002 due to the strong export performance of the mainland (CSD, 2003a). The GDP growth rate in real terms was only 0.5% and 2.3% in 2001 and 2002, respectively (CSD, 2003b).

The outbreak of Severe Acute Respiratory Syndrome (SARS) in March-June 2003 was another blow to Hong Kong's tourism industry and already weak internal consumption. The unemployment rate, a vital indicator of social well-being and stability, rose from only 2.2% in 1997 to 6.2% in 1999. It dropped to 5.1% in 2001 and rose again to 7.3% in 2002 due to the impact of 9/11 and the subsequent process of global adjustment (Table 3). The SARS outbreak pushed the seasonally adjusted unemployment rate to a peak of 8.7% in May-July of 2003 (CSD, 2003d). The number of unemployed reached 309,200.

The slowdown in the economy and the bursting of the bubble in the stock and housing markets have had a significant impact on the Hong Kong government's ability to balance its budget. Government revenues dropped from HK\$281.2 billion in 1997/98 to HK\$225.1 billion in 2000/01 and to HK\$177.5 billion in 2002/03, due to a significant loss in tax revenue from earnings and income, stamp duty and capital gains. The land premium dropped from a peak of HK\$63.6 billion in 1997/98 to HK\$29.5 billion in 2000/01 and HK\$11.5 billion in 2002/03 (CSD, 2001c; Legislative Council Panel on Financial Affairs, 2002; Leung, 2003; Treasury Branch, 2004). As a result, the Hong Kong government incurred a deficit of HK\$23.2 billion in 1998/99, HK\$7.8 billion in 2000/01, as much as HK\$63.3 billion in 2001/02 and HK\$61.7 billion in 2002/03. The government's fiscal reserves decreased from HK\$458 billion in 1997/98 to HK\$311 billion in 2002/03 and HK\$244 billion by 31 December 2003.

**Table 3** Numbers of unemployed and unemployment rate in Hong Kong, 1997-2003

	Unemployed (thousand)	Unemployment rate (%)
1997	71.2	2.2
1998	154.1	4.7
1999	207.5	6.2
2000	166.9	4.9
2001	174.8	5.1
2002	255.5	7.3
January - March 2003	259.8	7.5*
February - April 2003	273.7	7.8*
March - May 2003	287.3	8.3*
April - June 2003	300.0	8.6*
May - July 2003	309.2	8.7*
June - August 2003	309.4	8.6*

Note: \* Three months moving average, seasonally adjusted.

Source: CSD (2003d).

China's entry to the WTO in December 2001 provides opportunities and challenges to Hong Kong in its bridging role between mainland China and the outside world. It has marked a turning point in the Hong Kong government's policy from protectionism to closer economic integration with the PRD in particular and with the mainland in general. It seems that a consensus has been reached in Hong Kong on the desirability of a closer economic relationship with the PRD and the mainland. Previous reservations have been replaced by more active and enthusiastic moves to seek economic opportunities in the mainland. This was quite different from the years immediately following the handover. According to a survey conducted by the Hong Kong Institute of Asia-Pacific Studies of 1,004 residents of

Hong Kong in September 2002, 77.1% supported the construction of a bridge between Hong Kong, Zhuhai and Macao and 54.2% supported the operation of a 24-hour border crossing (Sung, 2003:14).

On the request of the Hong Kong government, the central government has been playing a coordinating and supporting role in fostering economic cooperation between the PRD region and Hong Kong. With the dramatic change in the Hong Kong government's position on the integration of Hong Kong with the PRD, significant progress has been made on cross-border issues. The following are some of the major developments since 2002:

1. The CEPA agreement was reached between the HKSAR and the mainland in June 2003.
2. The operation of a 24-hour border crossing for passengers was introduced at the Lok Ma Chau checkpoint on 27 January 2003 (*South China Morning Post*, 27 January 2003). This is an important step in Hong Kong's integration with the PRD region.
3. The quota on the number of tourists from the mainland to Hong Kong, 2,000 a day, was abolished on 1 January 2002. Individual tourists from cities in the PRD, Beijing and Shanghai have been allowed to apply for travel permits to visit Hong Kong since July 2003.
4. The issue of the Hong Kong-Zhuhai-Macao bridge (an alternative to the Lingdingyang bridge proposed by Zhuhai in 1997) was re-opened in 2002. Senior Hong Kong officials now support the idea that the bridge needs to be built well before 2016. The bridge, 41 km long and costing HK\$15 billion, would help connect Hong Kong with the western part of the PRD (Yeung, Shen and Zhang, 2003).

### **CEPA and Its Implications for Hong Kong**

The CEPA represents one major step in cross-border development between Hong Kong and the mainland. As a free

port, Hong Kong imposes no import taxes and has few constraints for foreign investors. However, other economies that are Hong Kong's trading partners have various measures to protect trade. Thus, it would be ideal for Hong Kong to seek the establishment of free trade arrangements with such trade partners. The CEPA agreement between Hong Kong and the mainland is one major development in this direction.

To be sure of securing business opportunities before China's full opening to the outside world after 2005, the Hong Kong government proposed to the central government, on 20 December 2001, that a closer economic partnership arrangement be established between the HKSAR and the mainland (*Ming Pao Daily News*, 21 December 2001). The CEPA agreement was officially signed on 29 June 2003. Although the mainland will not gain any direct benefit by lowering its tariffs and opening its domestic markets to Hong Kong companies, it has been argued that it will benefit indirectly. The CEPA will allow for the import of quality services from Hong Kong and this competitive pressure will help speed up the reform and restructuring of the domestic economy (Sung, 2003).

Starting January 2004, Hong Kong's business sector will benefit from zero customs duties for exporting 273 categories of products manufactured in Hong Kong to the mainland. These products account for 60% of Hong Kong's export value. Table 4 presents the list of categories of products on which the mainland currently imposes an import tariff of over 20% that will be reduced to zero for products from Hong Kong. This is in addition to products, making up 30% of Hong Kong's export value, that already enjoy zero customs duties (*Ming Pao Daily News*, 30 June 2003). Over 2,000 categories of goods from Hong Kong will also enjoy zero customs duties before January 2006, while the average customs duties for China's imports from the world will still be 8.9%. The mainland market will also be opened for 18 kinds of business and professional services from Hong Kong.

Agreements were reached regarding the definitions of Hong Kong products and Hong Kong companies on 29

**Table 4** List of Hong Kong origin products with an MFN tariff rate of over 20% in 2003 on which a zero import tariff will be implemented by the mainland

Serial number	Product description	MFN tariff rates
1	Ice cream and other edible ice, whether or not containing cocoa	24.2
19	Other mixtures of odoriferous substances and mixtures with a basis of one or more of these substances, of a kind used as raw materials in industry	21.7
23	Manicure or pedicure preparations	21.7
24	Other beauty or make-up preparations	22.3
110	Men's or boys' shirts, knitted or crocheted and of man-made fibres	21.3
111	Men's or boys' shirts, knitted or crocheted and of other textile materials	20.5
113	Women's or girls' blouses, shirts and shirt-blouses, knitted or crocheted and of man-made fibres	21.3
114	Women's or girls' blouses, shirts and shirt-blouses, knitted or crocheted and of other textile materials	20.5
132	Women's or girls' jackets, of synthetic fibres	21.3
135	Women's or girls' trousers, bib and brace overalls, etc., of synthetic fibres	21.3
137	Men's or boys' shirts, of man-made fibres	20.5
138	Men's or boys' shirts, of other textile materials	20.5
140	Women's or girls' blouses, shirts and shirt-blouses, of man-made fibres	21.3
141	Women's or girls' blouses, shirts and shirt-blouses, of other textile materials	20.5
149	Articles of jewellery and parts, of silver	26.7
150	Articles of jewellery and parts, of gold	26.7
151	Articles of jewellery and parts, of other precious metal	35.0
152	Articles of jewellery and parts, of base metal clad with precious metal	35.0

**Table 4** (Continued)

Serial number	Product description	MFN tariff rates
153	Articles of silversmiths' wares and parts	35.0
154	Articles of goldsmiths' and silversmiths' wares and parts, of precious metal	35.0
155	Articles of goldsmiths' and silversmiths' wares and parts, of base metal clad with precious metal	35.0
158	Articles of precious metal or of metal clad with precious metal, for other uses	35.0
159	Articles of natural or cultured pearls	35.0
160	Articles of precious or semi-precious stones	35.0
161	Cuff-links and studs of base metal	35.0
162	Other imitation jewellery of base metal	24.7
163	Other imitation jewellery of materials not specified elsewhere	35.0
190	Electric motors for use in toys, of an output not exceeding 37.5W	24.5
204	Primary cells and primary batteries of manganese dioxide	20.0
221	Pick-up cartridges	35.0
222	Parts and accessories for turntables (record decks) or record-players	27.0
223	Transport mechanisms of cassette recorders	27.0
224	Other parts and accessories for video recording or reproducing apparatus	30.0
225	Other parts of products within HS headings 85.19 to 85.21	20.0
260	Other electrically operated wrist-watches, with opto-electronic display	23.0
261	Electrically operated clocks with watch movements	23.0
262	Electrically operated alarm clocks	23.0
272	Slide fasteners fitted with chain scoops of base metal	21.0
273	Other slide fasteners	21.0

Source: CEPA (2003).

September 2003. To qualify as Hong Kong products under the CEPA, 187 categories of products, such as textiles and clothing, will use the existing Hong Kong definition based on the production process; 46 categories of products, such as chemical and metal products, will be defined according to the "Change in Tariff Heading" origin rule (meaning that the products were manufactured to the extent that their classification in the World Customs Organization Harmonized System falls in a different four-digit heading from the classification of the non-originating constituent materials used); 40 categories of products, such as clocks and watches, will be defined according to the production process and value, with the stipulation that at least 30% of the value must have been created in Hong Kong (Trade and Industry Department, 2003). The requirement of a 30% value creation in Hong Kong lies between the existing requirement of 20% and the 50% requested by the mainland (Sung, 2003:9).

To qualify as Hong Kong companies under the CEPA, companies must have been operated and registered for three to five years in Hong Kong and 50% of their employees must be Hong Kong permanent residents and holders of one-way permits. Such companies can engage in 18 kinds of services in the mainland. For example, the minimum asset requirement for a Hong Kong bank to be eligible to operate in the mainland was reduced from US\$20 billion to US\$6 billion. Eight more Hong Kong banks became eligible to provide banking services in the mainland (*Ming Pao Daily News*, 30 September 2003).

Based on figures for 2001, the CEPA could save HK\$750 million in customs duties on Hong Kong products. It is estimated that the CEPA will generate 10-50 thousand jobs in Hong Kong in the next five years. The agreement will also consolidate Hong Kong's status as an international financial centre. The central government supports the idea of state-owned commercial banks and certain joint-equity commercial banks relocating their international treasury and foreign exchange trading centres to Hong Kong. The central government also supports the listing in Hong Kong's stock market of eligible mainland insurance companies and other companies, including private enterprises (CEPA, 2003:Article 13).

The CEPA was well received by the business sector, and has had some positive impact on the economy. In August 2003, the total number of tourists visiting Hong Kong reached 1.64 million (*Ming Pao Daily News*, 1 October 2003). Those from the mainland reached 0.95 million, an increase of 43.3% from August 2002. The total number of job vacancies in the private sector registered with the Labour Department reached a historic high of 24,612 in August 2003. The Hang Seng Index rebounded to 11,229 on 30 September 2003. The housing market is also showing evidence that prices have stabilized.

## Conclusion

This paper has examined Hong Kong's free port policy and the government approach of non-intervention in the economy. Generally, as a free port, Hong Kong follows the policy of free enterprise and free trade.

Hong Kong has enjoyed a long period of economic growth over the past four decades, going through several stages of development. From the 1950s to the late 1970s, Hong Kong relied on industrialization for economic growth. From 1978 to 1997, Hong Kong transferred the majority of its manufacturing operations to the PRD and became a prominent service centre, following the implementation of economic reforms and open-door policies in the mainland (Shen, 2002).

In the period after 1997, the Asian financial crisis led to the bursting of the bubble in the stock and housing markets. Since then, with negative growth in GDP in 1998, Hong Kong has been struggling to restructure its economy.

Economic integration between Hong Kong and the mainland has been a key government policy. Although a cross-border network of production between Hong Kong and the PRD had been well established by 1997, Hong Kong had serious reservations about closer economic integration in the period 1997-2001. Sung (2002) claimed that the Hong Kong government adopted a "fortress Hong Kong" policy towards the regional

integration of the Hong Kong-PRD region. But after a series of crises such as 9/11 in 2001 and SARS in 2002, this policy has not been able to bring about an economic recovery in Hong Kong.

China's further integration into the global economy after its entry to the WTO raises the question of Hong Kong's role as a bridge between mainland China and the world. This issue has become the turning point in the Hong Kong government's policy on cross-border development. A consensus has been reached in Hong Kong for a closer economic relationship with the PRD and with the mainland in general. Previous reservations towards such a relationship have been replaced by more active and enthusiastic moves to seek economic opportunities in the mainland.

Responding to the needs of the HKSAR, the central government is also more than willing to support closer economic ties between Hong Kong and the mainland for political and economic reasons. The CEPA represents one major development between Hong Kong and the mainland. How successful the CEPA will be and how it can benefit Hong Kong will depend on the actions of the Hong Kong government and the business sector. Upgrading Hong Kong's human resources through education and training, consolidating advanced producer services, and enhancing Hong Kong's status as world city in Asia are some of the essential strategies to revive Hong Kong's economy.

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## **Development and Transformation of the Free Port of Hong Kong**

### **Abstract**

The territory of Hong Kong consists mainly of hilly areas and possesses almost no natural resources. Its major assets are a deep-water harbour and a resourceful population. Hong Kong was developed as a free port when the British assumed control over the territory. Currently, Hong Kong is a Special Administrative Region of China. "One country, two systems" has been practised in Hong Kong since July 1997. The success of Hong Kong as a global city in Asia has much to do with its status as a free port and its role in international trade and re-exports in a cross-border system of regional production.

This paper will first examine Hong Kong's free port policy and the government's approach of non-intervention in the economy. Generally, Hong Kong follows the economic policy of free enterprise and free trade. No import tariffs are imposed and there is only limited licensing control of a few commodities.

Hong Kong has gone through several stages of development due to changes in its external environment. This paper will examine Hong Kong's development and transformation in recent decades; its industrialization, de-industrialization and current transformation associated with China's open-door policy of 1978; the Asian financial crisis; and the closer economic partnership arrangement (CEPA) between Hong Kong and mainland China.

## 香港

### 一個自由港的發展與轉變

沈建法 楊汝萬

(中文摘要)

香港以山地為主，沒有什麼自然資源。深水良港與人力資源是香港的主要資產。成為英國殖民地之後，香港就定位為自由港，並由此而逐步發展起來。香港於 1997 年 7 月回歸中國，成為一個特別行政區，實施「一國兩制」。香港成功晉身為世界城市的因素包括其自由港的地位，以及在跨界區域生產系統中所扮演的國際貿易與轉口角色。

本文首先探討香港的自由港和政府不干預經濟的政策。一般來說，香港實行自由企業和自由貿易的經濟政策。香港沒有進口稅，只由海關對少數商品進行審批管制。

隨著外部自然環境的變化，香港已經經歷了幾個不同的發展階段。本文繼而探討香港幾十年來的發展與變化，包括工業化、逆工業化和近期的變遷，以及中國的開放政策、亞洲金融危機、香港與中國內地更緊密經貿關係安排的影響。