

GEOECONOMIC IMPLICATIONS OF CHINA'S EMERGENCE FOR EAST ASIA – WITH SPECIAL REFERENCE TO HONG KONG

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INTRODUCTION

Asia has been the most dynamic economic growth pole in the world for the past few decades. The Flying Geese Model has been used to describe Asia's regional growth pattern and explain why economic growth in Asia is faster than in other developing regions such as Latin America and Eastern and Central Europe. This model holds that Japan, the NIEs, and the ASEAN countries¹ are like a flock of flying geese, with Japan being the leader, the NIEs in the middle, and ASEAN countries in the rear. Japan is the most advanced economy in the region, and with its comparative advantage in technology, it relocates its manufacturing production to ASEAN countries where labor costs are the lowest. The levels of technology and labor costs in the NIEs are halfway between Japan and ASEAN countries. This model presents an orderly pattern of economic growth of the countries concerned. However, new development in the Asian region, especially the emergence of the Chinese economy, calls for an updated view of the growth pattern in Asia as well as of the interactions between its different members.

China played only a minor role in the Flying Geese Model in the earlier times. However, since the late 1990s, after nearly two decades' reform of its economic systems and opening-up to the outside world, China has become a non-negligible—or even formidable according to some—player in the world market. With its entry into the World Trade Organization in 2001, which implies more integration with the world economy, more and more voices are heard predicting China's impact in the international scene and in particular on the economy of other Asian countries. Some authors see more

¹ In this paper we mainly consider the ASEAN4, namely, Indonesia, Malaysia, Philippines and Thailand.

challenges while others see more opportunities for other Asian economies resulting from the emergence of the Chinese economy.

This paper intends to make a contribution to this literature by providing an updated analysis of China's role in Asia's economic growth. Below it gives more details about China's recent economic development and brings out some of the most salient impacts of China's emergence on other East Asian countries (which includes Southeast Asia), particularly on the ASEAN4 countries. Then it elaborates on a model called the Aerobatics Model, different from the Flying Geese Model, to take account of the current and future growth pattern among Asian countries, taking China's role in particular into account.

The paper also looks at the impact of Mainland China's economic emergence on the Hong Kong economy. The Mainland is by far Hong Kong's biggest import (supplier) source (with a value of imports by Hong Kong of HK\$717 billion in 2002, compared to HK\$182 billion from the second largest import source, Japan) and one of its two biggest export destinations (with a value of exports from Hong Kong of HK\$41.3 billion in 2002, compared to HK\$41.9 billion to the first largest export destination, CSY 2003). The Mainland is also by far Hong Kong's No. 1 re-export origin and destination, accounting for respectively 60% and 40% of the total value (CSY 2003). Hong Kong is the place where the impact of Mainland China's emergence is most felt.

Our concluding remarks suggest that the key to benefiting from China's emergence lies in the way each country adapts itself to the changes.

CHINA'S ECONOMIC EMERGENCE IN THE WORLD

In 2002 China's GDP reached RMB 10.35 trillion (CSY 2003) or US\$1.25 trillion, making it the world's sixth largest economy (World Bank 2003a). Its annual economic growth rate averaged 9.36% from 1978 to 2002 (calculation based on CSY 2003), the highest in the world. China's foreign trade reached USD 620 billion in 2002, ranking her the fifth biggest trader in the world, compared to thirty-second in 1978 (CSY 1979 and 2003), and is expecting to rank No. 4 in 2003.² Foreign direct investment inflows to China reached US\$52.7 billion in 2002 (CSY 2003), making her the largest FDI

² *China Daily*, Hong Kong edition, December 3, 2003.

recipient in the world.

And China is believed to be becoming a “world factory”. About 90% of China’s exports are manufactured goods (CSY 2003). China’s share in global output of textiles is 70%³, of cameras, over 50%, of air conditioners, 30%, washing machines, 25% and fridges, 20%⁴. Four hundred out of the world’s top 500 transnational corporations have entered China.

Fast economic growth rates and the WTO membership, which promises to promote further foreign trade and FDI inflows, set China under the limelight of the world economic scene. The rest of the world is sensing China’s emergence and reacting in different fashions. The United States threatened anti-dumping measures on Chinese garments at the end of 2003, a typical reaction from a country whose comparative advantage is not in competition with China’s but which is running large trade deficits with China. Another category of countries concerned about China’s emergence is those whose comparative advantage is in competition with China’s, and among them are a number of Asian economies. It is on the latter category of countries that this paper is focused, in particular on the ASEAN countries of Indonesia, Malaysia, Philippines, and Thailand. The paper also looks at a Newly Industrialized Economy, Hong Kong, for which Mainland China’s emergence may have the most significant implications due to the unique relationship and closeness between them.

CHINA’S IMPACT ON EAST ASIA

Does China Emerge at the Expense of Other Asian Countries?

Claims are often heard that China’s emergence poses threats to other Asian countries, especially to ASEAN countries. “Fears” from ASEAN countries result mainly from the fact that China has the advantage of low wage costs even compared to them, so that China’s further expansion of manufactured exports would imply export reduction for them, as they export similar products but at higher production costs. A second concern is the diversion of foreign direct investment (FDI) from ASEAN countries to China. We investigate below whether these fears are well grounded.

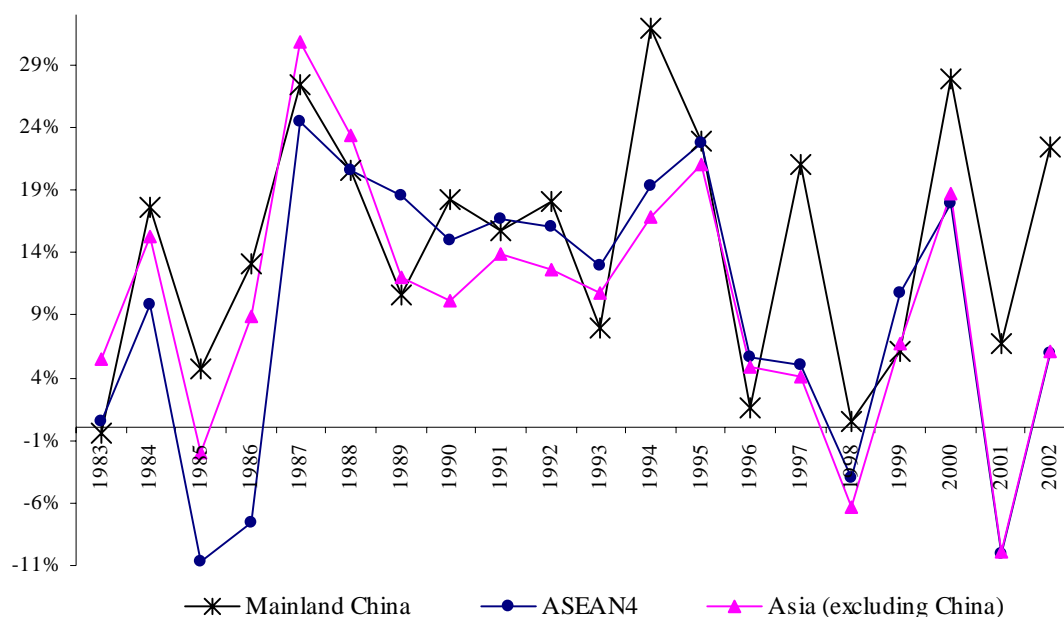
Figure 1 shows the annual growth rates of exports of Mainland China, ASEAN4 and Asia as a

³ News item on <http://www.chinainfobank.com> on November 21, 2002.

⁴ BBC News, November 22, 2002.

whole excluding Mainland China from 1983 to 2002. We can see that in general, China shared the same ups and downs as the ASEAN4 or the rest of Asia as a whole, the only difference being that in those “down” years, when growth rates slowed for China they were sometimes negative for the ASEAN4 or the rest of Asia. The main exception was only in the year of the Asian Financial Crisis, 1997, when China registered a 21% growth rate in exports while the ASEAN4 or the rest of Asia suffered already export slow-down. But the blame should not be put on competition from China.

Figure 1: Annual export growth rates of Mainland China and ASEAN



Source: IMF International Financial Statistics, 2002.

Special concerns are raised as to whether ASEAN countries and China are severely competing in their main export markets. But actually, calculations at the three-digit SITC level show that China and ASEAN countries have comparative advantages in different categories of products. Weiss and Gao (2002) show that concerning the U.S. market, at the three-digit SITC level⁵, ASEAN's biggest comparative advantages were first in the category of electronic and electrical products, with an RCA of 2.57 in 1995 and 2.79 in 2000, and secondly in the textile, garment and footwear category, with an RCA of 1.37 in 1995 and 1.39 in 2000. On the other hand, China's biggest comparative advantages in

⁵ At this level, trade products are divided into nine categories: Primary products, Resource-based manufactures, Textile, garment and footwear, Automobiles, Engineering, Electronic and electrical, Other low tech, Process, Other high tech (Weiss and Gao, 2002).

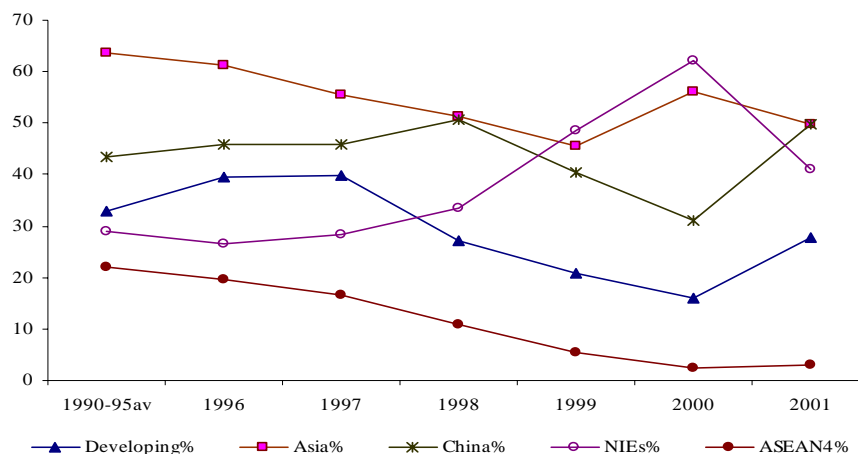
1995 were in the category of other low tech products (such as toys, furniture, plastics and steel), with RCA of 3.13, and in the textile, garment and footwear category, with RCA being 3.24. In 2000, China's biggest comparative advantages were in these same two categories with RCAs of 3.19 and 2.35. Concerning the Japanese market, both in 1995 and 2000, ASEAN mainly had advantage in electronic and electrical products, as well as in primary products, resource-based manufactures, and engineering products, while China had advantage, again, in textile, garment and footwear and other low-tech products. Actually, the complementarities between East Asia and China are even greater if we go into more finely detailed product classifications. For example, within electronic and electrical products, there is a sophisticated sub-regional division of labor among East and Southeast Asian economies including China.

In a broader, world-wide perspective, a noticeable pattern is that a big share of China's imports of machinery and transport equipment comes from other Asian countries, including ASEAN countries, and its major exports market is the United States (Ng and Yeats 2003; Lemoine and Unal-Kesenci 2002). This is suggesting a more interdependent sub-regional division of labor among Asian countries and a more integrated world economy, with China playing the pivotal role.

Concerning foreign direct investment, Figure 2 shows the shares of developing countries in the world total FDI inflows, of Asia in developing countries' total FDI inflows and of China, the NIEs and the ASEAN4 in total FDI inflows to South, East and Southeast Asia (SESE). We see that the ASEAN4's share of the SESE total is actually in decline since 1990 except for a very slight upturn in 2001, but the same trend was true for developing countries as a whole, including China. Contrarily, the share of the NIEs in the SESE total followed an upward trend from 1996 on, reaching a peak in 2000, and was only surpassed by China in 2001. Actually, in 1999 and 2000 it was the NIEs which drove up Asia's share of total FDI inflows to developing countries. It is thus an open question whether the fundamental issue for the ASEAN4 is China's emergence, or the need to better restructure and reform their domestic economies shaken by the 1997 crisis. Wu and Keong (2003) also show, by plotting FDI inflow volumes to China and ASEAN through 1989-2001 and finding similar up and down periods, that China is not really taking FDI away from ASEAN. Actually, source country FDI data (Wu and Keong 2003) show that developed countries had been investing more FDI in ASEAN than in China

through out the 1990s, even after the 1997 financial crisis. The recent decline in FDI in ASEAN was mainly due to a decline in FDI from other Asian countries after the 1997 crisis, and this decline did not go to China.

Figure 2: FDI inflows (%)



Notes: Developing% means the share of developing economies in world total. Asia% is Asia's share in developing economies' total. China%, NIEs% and ASEAN4% are respectively the shares of China, NIEs and ASEAN4 in the total South, East and Southeast Asia, which accounts for more than 90% of the total of whole Asia.

Source: *World Investment Report 2002*.

On the other hand, the expansion of production in China and the rising income of China's population create increasing demand for products from Asian economies. From 1995 to 2001, total exports from East Asia to China rose at an average annual rate of 11.5%, which is far above the corresponding 3.8% growth rate of world trade (Ng and Yeats 2003). China's economy is only one-third the size of Japan's, but its imports-to-GDP ratio is 2.5 times that of Japan. Table 1 shows that China has a trade deficit with the ASEAN4 countries. Given these trends, China's economic growth is beneficial to the expansion of exports of ASEAN countries. The China-ASEAN Free Trade Agreement that is to go into effect in 2010 will help to boost trade between China and ASEAN countries. An "early harvest" plan has already kicked off since January 1, 2004, aimed to gradually reduce the tariffs on more than 500 products, mostly agricultural, to zero by 2006.⁶

⁶ *China Daily*, Hong Kong Edition, December 18, 2003, page 5.

Table 1: China's trade deficit (exports minus imports) with ASEAN 4 countries

Units: USD 1 000

	1985	1995	2000	2001
Indonesia	2 932	-613 872	-1 340 060	-1 051 528
Malaysia	-88	-784 100	-2 914 962	-2 984 949
Philippines	15 645	754 379	-212 868	-324 910
Thailand	-5 980	140 973	-2 137 399	-2 375 409

Source: Yearbook of China's Foreign Economic Relations and Trade, various years.

With China's economic expansion, its investment outflow to other Asian countries will also grow. Increased tourism from China to other Asian countries is still another positive effect of China's economic growth on other Asian countries.

Given all of the above, we are not in agreement with such claims that China emerges at the expense of other Asian economies, or that the emergence of the Chinese economy and the development of other Asian countries is a zero-sum game. But China does cause changes in Asia's regional development pattern. The next section describes current and future growth pattern and interactions among different economies in the region through a model called the Aerobatics Model, different from the Flying Geese Model.

Aerobatics Model of Asia's Regional Growth Pattern

As mentioned above, the Flying Geese Model is widely recognized as an adequate account of the main economic development trend in Asia for the last few decades.⁷ This model is the analogue of a flock of geese flying in an orderly inverse "V" formation, to explain the phenomenon of sequential development of industries (Akamatsu 1962). In the flock of flying Asian "geese", Japan is the leader, followed by the four newly developed economies (NIEs) of Hong Kong, Singapore, South Korea and Taiwan, and then by the ASEAN4 countries of Indonesia, Malaysia, Philippines and Thailand.⁸ The basic idea is that Japan leads all the other Asian countries by its technological advantage, and it relocates its manufacturing industry to other Asian countries because of labor cost advantage in these countries. Through the interactions with the leading "goose"—mainly, trade, foreign direct investment, and to a lesser extent flows of people, which can result in technology transfer and spillover effects—

⁷ Meanwhile, controversy is not unheard. For instance, Bernard and Ravenhill (1995) pointed out that the affiliates of Japanese firms do not much help their host countries to achieve the same type of industrialization as Japan had, or delay the supply of new technologies, making other Asian countries dependent on Japanese technology and the gap between these countries and Japan widen.

⁸ Other Asian countries such as Vietnam and Laos are still further behind and often left out of the analysis.

the followers may move up the technological ladder.

China's recent emergence has called this model into reconsideration, however. China had a negligible role in the Flying Geese model, due to its isolation from the outside world and thus from the international division of labor before the late 1970s. But today, the development of this country has important implications for the development of other Asian countries, both at the low-skilled end and at the high-skilled/high-tech end of the production chain.

As mentioned above, China has a very sustainable surplus of low-cost labor—at least 100 million migrants from poor rural districts are seeking work in cities—constituting China's traditional, unshakable and undrainable comparative advantage, even compared to ASEAN countries. Developing the rural economy and reducing unemployment are high priorities of the Chinese government. Therefore, China will not discard low-skilled manufacturing, as it promises to provide millions of rural low-skilled people badly needed job opportunities.

But at the same time, at the high-skilled, high-tech end of the production chain, China is becoming more and more competitive through the years, developing comparative advantages that were not hers in the past. More and more people are getting better educated and becoming qualified for high-skilled and high-tech jobs. The number of scientific and technical personnel was 30.89 million by the end of 2002, all sectors taken together (CSY 2003). From 1996 to 2002, new postgraduate enrollment added up to 784,172 persons, graduates added up to 395,355 persons, and the number of students who returned to China after studying abroad totaled 68,136 persons (CSY 2003). Domestic high-tech R&D activities are more and more active, and the government is enthusiastically promoting the development of high-tech industries. By 2002 there were 28,338 high-tech enterprises across the country (CSY 2003). Technology transfer from FDI and learning-by-doing have, over time, greatly helped with technological capacity building. FDI to China concentrated mostly on labor-intensive industries in the 1980s, turned to capital-intensive industries in the early 1990s, and then more and more to technology-intensive industries in recent years (World Bank 2002). Large western high-tech giants are increasingly viewing China as a research lab: over 100 R&D centers have been set up by transnational enterprises; Motorola was investing \$1.3 billion in research programs in China, and Microsoft, \$750 million (World Bank 2002).

Therefore, China is likely to head for developing an extended, comprehensive manufacturing chain, comprising both low-skilled manufacturing and high-skilled, high-tech products. The low-skilled end of this chain is even lower than in the ASEAN countries, while the hi-tech end of this chain could reach countries such as Japan. Such industrial development in China injects powerful forces in Asia's industrial division of labor. In the Flying Geese Model, ASEAN countries' low-cost labor and Japan's advanced technology complemented each other finely, but now China's emergence seems to have come to cause "disorder".

The new situation would be better fitted into an "Aerobatics" Model—with a troop of aerial circus acrobats replacing the orderly flock of flying geese. In this model, the acrobats are always changing places, unlike geese flying in formation. The aerial acrobats change places every time the circus music changes. In other words, in this model, no country remains in one place for long.

Technological progress is the critical factor determining the music type and countries' places with respect to each other. And it is no longer true that technological breakthroughs always happen in advanced countries and to be later passed on to the next tier of countries. Rather, as different countries/economies specialize in the different sub-sectors of an industry, technological breakthrough may occur in any of these sub-sectors in any country or economy. When this happens, the breaking-through country/economy may become a leader of the region in that sub-sector and cause adaptation in other countries/economies. The domain of specialization of each country is not necessarily closely related to its level of economic development, that is, it is possible to technologically leapfrog in the *technology* cycle, a notion replacing that of a product cycle (Chen 1993). Each country looks for opportunities related to the introduction of a new technology and finds niches in accordance with its comparative edges.

With the emergence of the New Economy, which is brought about by the Information and Communications Technology (ICT) Revolution, the Aerobatics Model becomes more relevant. Nowadays, technological changes are no longer periodic and sporadic breakthroughs as they were in the past but pervasive, incremental and continuous. One country cannot dominate or monopolize a new technology for long. Each time a new technology emerges, new opportunities are created for all the economies in the "aerobatics troop", and new technologies emerge continuously. Countries are no

longer waiting for their turn in a prescribed order but just getting ready for the emergence of a new technology, which occurs all the time.

The Aerobatics Model provides, in fact, a more optimistic and flexible view of regional growth and interactions among the member countries/economies in a region. It highlights the competition among countries/economies, and may surpass the Flying Geese pattern, which is in essence a leader-follower relationship between countries/economies in regional development. Even though it may have a relatively low overall technology level, a follower can become a leader if it takes a stride in technological advancement in certain sub-sector(s) of an industry. Different countries can become leaders in different sub-sectors. No leader can afford to think that it will remain comfortably the leader without continuously striving for technological progress. Such regional interactions and competition should provide healthy drive for technological advancement to the region as a whole.

The implication of this scenario is that the emergence of China as an economic power should not be a threat to East Asia. Whenever a new technology emerges and a new industry is established, China will complement other East Asian economies, in the sense that China would at most be a pivot in the vertical and horizontal division of labor but not a monopolist of the technology and production. In the Flying Geese Model, a leader holds its position for a long time. In the Aerobatics Model, the leader keeps on changing with the emergence of different technologies.

This complementarity of production between China and other East Asian countries explains the desire of China and other East Asian countries to engage in closer economic cooperation. The new geoeconomics resulting from ASEAN plus One and ASEAN plus Three and other bilateral agreements deserves closer attention and deeper analysis.

IMPACT OF MAINLAND CHINA'S EMERGENCE ON HONG KONG

In the 1980s, during China's early opening-up and industrial development, Hong Kong's economy experienced a major transformation as its manufacturing firms relocated massively to the Mainland to take advantage of the low labor and land costs there. This may be called the "hollowing-out" of Hong

Kong's manufacturing, and, by releasing physical and human resources,⁹ it actually made a place for the subsequent fast growth of Hong Kong's services industries, including manufacturing-support industries and producer services, which have become the strengths of Hong Kong's economy today.

Hong Kong and the Pearl River Delta (PRD)

Hong Kong's economic integration with the Mainland was mainly through the Pearl River Delta (PRD). More than 90% of Hong Kong's FDI in the Mainland during 1980-90 went into the PRD (CSY). Of the 59,000 Mainland production facilities in which Hong Kong companies have equity, management, or operational control, 53,300 (90.3%) are located in Guangdong (Chen 2003). Actually, the development of Hong Kong and the PRD in the past two decades may be fitted into a small-scale Flying Geese Model framework, with Hong Kong being the leader goose and cities and counties in the PRD being the following geese. Hong Kong led in technology and relocated manufacturing to the PRD in much the same way that Japan led in technology and relocated manufacturing to ASEAN during the 1980s and 1990s.

Through the past two decades, however, the PRD has been developing comparative advantages in areas in which it depended on Hong Kong. For the time being, there is still much room for a complementary division of labor between Hong Kong and the PRD, with the latter becoming the heartland of the emerging "world factor" and the former providing production-supporting services. A world factory cannot function well without good supporting services in banking and finance, logistics, distribution, and transport. The PRD still lacks maturity and expertise in these areas, while Hong Kong is specialist in them. Together, they can become a highly competitive player in the world market. In a longer timeframe, an aerobatics pattern is also likely to set in between Hong Kong and PRD, with each able to become a leader in different sub-sectors of an industry. In particular, due to its small size, Hong Kong has indeed more interest to specialize in some key services sectors and to capitalize on the close ties with the Mainland's production base and huge consumer markets.

⁹ The Hong Kong Labor Department estimated that within a period of five years, from 1987 to 1992, almost 400,000 manufacturing jobs were lost in Hong Kong, whereas 450,000 jobs in the services sectors were created (Chen 2003).

Competition from the Yangtze River Delta?

With its more recent dramatic economic development is the Yangtze River Delta (YRD) becoming a competitor with the greater Pearl River Delta (Hong Kong and PRD)?¹⁰ In fact, these two economic blocs have different characteristics which allow complementarities to a great extent. Local government in the YRD is more involved in local economic activities, while the PRD, which was opened to outside investors much earlier, enjoys a relatively more autonomous and mature business environment. YRD has certain advantages in such industries as automobiles and medicine, while PRD has makers of famous national brands of home appliances such as Media, Kelon and Galanz, as well as food, daily chemical products, and the information-technology industry. With the interactions between PRD and Hong Kong, PRD has followed a path from initially developing labor-intensive manufacturing to developing more skill/technology-intensive products, while YRD has lacked such a systematic and dynamic growth path. The YRD does not have the international networks, legal and taxation systems, or many other services to rival those found in Hong Kong. Geographically, YRD is well situated to serve intensively China's central and northern inland provinces, while the greater PRD is well situated to serve southern China and the Asia-Pacific region. Shanghai plays a big role in mobilizing China's domestic capital, while Hong Kong is the preferred financial center for international capital. Hong Kong enjoys the most economic liberty, as shown by its number-one ranking on the Heritage Foundation's Index of Economic Freedom for the past ten years, compared to China's rank of 110 or higher. While the level of economic freedom in Shanghai itself may be higher than in China as a whole, it is still a far cry from the level in Hong Kong. Given the many areas in which their economies complement, rather than duplicate, each other there is much room for the two Deltas to seek cooperation and complementary specializations. Indeed, some manufacturing firms in PRD are already relocating to YRD to take advantage of the still lower labor costs there.

The emergence of China makes Hong Kong's geoeconomic position even more strategic today than before. Not only has Hong Kong not suffered from any hollowing out effect, but it has been able to capitalize on China's economic growth and development to transform its economy. With the

¹⁰ The Yangtze River Delta includes roughly Shanghai and its surrounding provinces of Zhejiang, Jiansu, Shangdong.

emerging China as its hinterland, Hong Kong has never had such an advantageous geoeconomics.

The Implications of the CEPA for Hong Kong

Hong Kong is headed toward integration with the Mainland economy further and faster than any other economy as a result of the Closer Economic Partnership Arrangement (CEPA) which goes into effect from January 1, 2004. The CEPA, China's first free trade agreement, provides Hong Kong greater advantages compared to its WTO commitment to other trading partners.

Under the CEPA, 273 types of goods of Hong Kong origin imported to Mainland have zero tariffs starting on January 1, 2004, and all goods of Hong Kong origin will have zero tariffs not later than January 1, 2006. These terms are more generous than China's WTO commitment. The CEPA will generate an estimated HK\$750 million per year in savings on tariffs (HKTDC). This will be translated into more price competitiveness of Hong Kong's exports to the Mainland. The elimination of tariffs under the CEPA will benefit mainly a few high value-added and high-fashion products. For example, makers of high-end fashion watches and jewelry for which the designation "made in Hong Kong" is highly valued, will be able to produce in Hong Kong and benefit from zero tariff when they export to the Mainland. For the majority of manufactured goods, however, production is likely to stay where it is, that is, in Mainland China, because of the sustainable advantage of low wages there. After all, manufacturing now accounts for only about 5.2% of Hong Kong's GDP and less than 6% of its total employment.¹¹ However, a good way for manufacturing-related Hong Kong enterprises to take advantage of the opportunities that the CEPA offers is to merge with Mainland manufacturing enterprises. In this way, the new entity gains a competitive edge both from the Mainland's low labor costs and from Hong Kong's production-related services expertise.

Concerning services, the CEPA offers Hong Kong firms access to Mainland markets in 18 sectors.¹² Advantageous arrangements include lowering the entry asset requirement and shortening the time requirement for services firms from Hong Kong to establish business in Mainland, and allowing Hong Kong professionals to take exams to qualify to conduct their profession in the Mainland. These

¹¹ HK Census and Statistics Department.

¹² These concern banking, securities, insurance, management consulting, convention and exhibition, advertising, accounting, real estate and construction, medical and dental, distribution, logistics, freight forwarding, storage and warehousing, transport, tourism, audiovisual and legal services (HKTDC 2003).

concessions enlarge significantly the potential market size for Hong Kong's services sector, which currently accounts for 87% of its economy (HKTDC).

The implications of the current transformation of Hong Kong's economy through services are different from those of the transformation through manufacturing in the 1980s. The earlier hollowing-out of Hong Kong's manufacturing industry to the Mainland would have caused unemployment problems at home if labor markets had initially been in equilibrium, but this was not the case. The excess labor force was actually absorbed into Hong Kong's fast-growing services sector. In addition, although the factories moved to the Mainland, production-supporting services such as marketing and product development remained dependent on Hong Kong. The picture was one of shops in the front (Hong Kong) and factories in the back (Mainland), and large portions of the profit actually went to the shops. The picture is changing. Hong Kong's economy does not stand to gain directly if service firms shut down in Hong Kong and people go to open businesses in Mainland, although there may be some linkage effects. Therefore there is fear for the hollowing-out of Hong Kong's services talent to the Mainland.

The scale of such movement is uncertain; it mainly depends on how fast the Mainland's human capital in these sectors develops and on how many Hong Kong business people are willing to cross the "border" to work in the Mainland, even on a commuting basis. The net effect on Hong Kong depends, in fact, on the unemployment situation in the services sectors in Hong Kong. The outcome would be a win-win situation if the service sector in the Mainland develops just enough to absorb all of those unemployed in Hong Kong's service sector. It would still be a win-win situation if it induces employed service workers to leave Hong Kong if, at the same time, some of the unemployed from Hong Kong's other sectors can be trained to replace them. If these conditions are not met, however, the outcome of the go-north movement may be the hollowing out of Hong Kong's services sector. So, one of the most important strategies for Hong Kong is to train more and more of the labor force to qualify for jobs in the dynamic service sectors, in preparation for a still more services-oriented Hong Kong economy. Indeed, becoming more integrated with the Mainland and becoming even more specialized in services may be the key to further economic development for Hong Kong, which is a small and open economy with an accumulation of important human capital in many services areas.

Hong Kong's role as a "window" to China will diminish as foreigners are increasingly able to conduct their business in China's provinces themselves as a result of China's greater openness and economic liberalization. Nevertheless, there is still room for Hong Kong to play the intermediate role. In 2002, Hong Kong's re-exports of electrical/electronics equipment and apparatus from Asian economies (South Korea, Taiwan, Singapore, Malaysia, the Philippines and Indonesia) to the Mainland surged 26%.¹³ Since Hong Kong's trade-related services exports are primarily related to offshore trading activities associated with moving goods to and from China, the Mainland's increasing external trade will surely fuel Hong Kong's role as a re-exporter. Moreover, companies from other Asian economies continue to need Hong Kong's bank, port, logistics, transport, finance services to support their Mainland operations.¹⁴

CONCLUDING REMARKS

Six years ago, during the Asian financial crisis, the answer to the question of what role China played would have been nearly unanimous: China contributed to the stabilization and recovery of the affected countries by not devaluing its currency. But today, viewpoints on the question of what impact a more developed, though still developing, China has are obviously divided. Some see mainly opportunities and others see more challenges or even threats. This paper tries to bring some more insight into this debate.

Our statistical analyses show that the claim that China's trade and FDI inflows expanded at the expense of other Asian economies should be taken with much caution and that the growth of China's economy indeed provides growth opportunities for other Asian economies.

But the emergence of China does cause changes in the former "orderly" growth pattern in the Asian region. Indeed, Asia may be in a period of adjustment to a new regime of regional development; the time for each country to find again its place relative to other countries may be short or long. Accordingly, the Flying Geese Model may need to be replaced by another more adapted model, the Aerobatics Model, to make an updated account of the current and future economic growth pattern in

¹³ Data from Hong Kong Trade Development Council.

¹⁴ For example, a survey conducted by Hong Kong Trade Development Council showed that Hong Kong remains the preferred service platform for about 80% of responding Taiwanese companies.

Asia. In this model, no country's place will any longer be as stable as in the Flying Geese Model. The circus music will be changing frequently, and when the music changes, the aerial acrobats will change places accordingly. Technological progress is a critical factor determining the music type. In particular, the order among ASEAN countries and China will be subject to frequent changes due to their similar levels of development. From the analyses in the text, important policy implications for ASEAN countries are to find their places in the new, more specialized, regional division of labor, and to speed up technological capacity building, especially indigenous ability to innovate. The right reaction is not to fear China's emergence as such, or to resort to protectionist actions. If China had emerged and opened to the outside world four decades earlier, that might have been a greater "threat" to the other Asian countries as such.

China's emergence and the passage of the CEPA should speed up Hong Kong's economic restructuring and growth through the expansion of the services sector. Making more people educated and qualified for services jobs should help taking advantage of the new opportunities. In China as a whole, and even in the Pearl River Delta in particular, there is a need for sustained and lengthy improvement in the supply of banking, finance, logistics, transport and distribution and other support services. Hong Kong can be actively involved during the period when China is developing these areas.

Competition is needed for progress. The positive reaction is not to fear and try to shield oneself from competition, but to strive to improve one's own competitiveness, as well as to seek cooperation possibilities for mutual benefit.

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