

# 11 Industrial Environment

## 11.1 THE HONG KONG ECONOMY

Hong Kong began its "miracle" economic growth in the 1970s [1]. From 1965 to 1975, the GDP grew at an average 6.0 per cent per year; between 1975 and 1985, the growth rate was on average 8.5 per cent and between 1985 and 1995, the growth rate was 6.5 per cent [15]. The Hong Kong economy has been developed as an industrialized metropolitan economy in past decades. Its economic success is listed below:

### Scoreboard for the Economic Success of Hong Kong [2]

- General
  - The world's freest economy
  - The world's most service-oriented economy
  - The world's 2nd highest per capita holding of foreign exchange
  - Asia's 2nd least corrupted economy
  - Asia's 2nd largest source of foreign direct investment
  - The world's 3rd most competitive economy
  - The world's 9th largest trading economy (5th if EU regarded as one entity)
  - The world's 10th largest exporter of services
- Merchandise Trade
  - The world's largest exporter of clocks
  - The world's largest exporter of toys and games
  - The world's largest exporter of calculators
  - The world's largest exporter of radios
  - The world's largest exporter of electric, hair-dressing/hand-drying apparatus
  - The world's largest exporter of imitation jewellery
  - The world's largest exporter of travel goods & handbags
  - The world's largest exporter of umbrellas & sunshades
  - The world's largest exporter of artificial flowers
  - The world's largest exporter of textiles
  - The world's largest exporter of telephone sets

The world's 2nd largest exporter of electric food grinders, mixers & juicers  
The world's 2nd largest exporter of watches  
The world's 2nd largest exporter of footwear  
The world's 2nd largest exporter of clothing  
The world's 3rd largest exporter of fur clothing  
The world's 6th largest exporter of precious jewellery

- **Finance**

Asia's highest concentration of fund managers  
Asia's largest number of authorized insurance companies  
Asia's largest venture capital center  
Asia's 4th largest loan syndication center  
The world's 4th largest gold bullion market  
The world's 7th largest foreign exchange market  
The world's 9th largest banking center for external financial transactions  
The world's 10th largest stock market

- **Communications and Media**

The world's first major city to have a fully digitized telephone network  
Asia's busiest international telephone traffic  
Asia's highest rate of telephone penetration  
Asia's highest connection to optical fiber cables  
The world's highest per capita advertising expenditure  
The world's largest film producer (in terms of per capita production)  
The world's 2nd highest usage rate of facsimile  
The world's 4th largest printing center

- **Transportation**

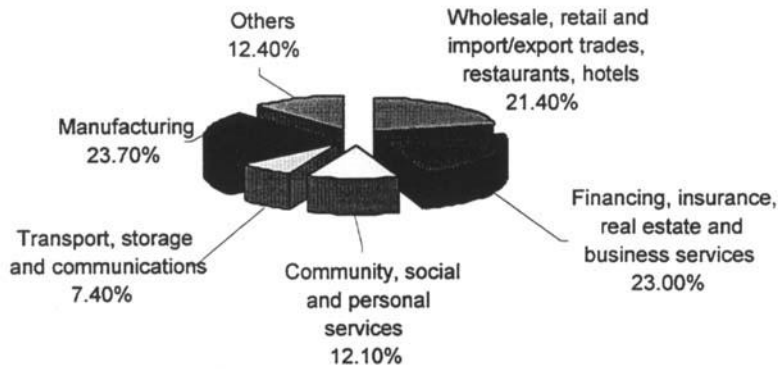
The world's busiest airport in terms of international cargoes  
The world's 2nd busiest container port  
The world's 4th busiest speedpost administration in terms of traffic volume  
The world's 5th busiest airport in terms of international passengers

The exchange rate was kept at a fixed rate of HK\$7.80 to US\$1.00 after a linked exchange rate system was introduced on October 17, 1983. Linking with one of the strongest currencies in the world helped Hong Kong to stabilize its economic development. However, in the period 1997 to 1998, when an Asian crisis loomed, the linked exchange rate penalised the export of Hong Kong manufactured products when faced by the devaluation of other countries.

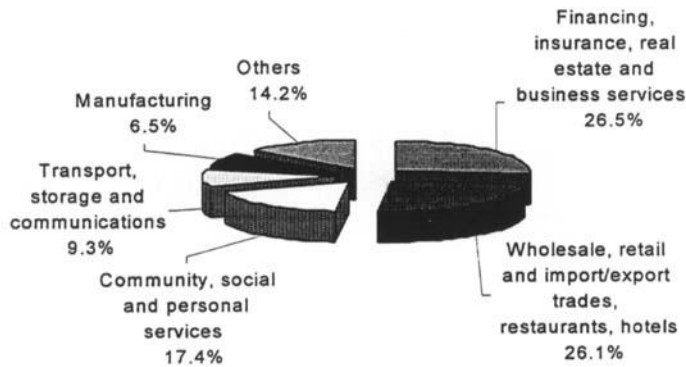
Hong Kong's interest rates move mostly in line with the US under the linked exchange rate system [3].

Since the late 1970's, the Hong Kong economic structure has transformed from a manufacturing-based economy to one that is mainly services-based. The biggest sector in Hong Kong's economy was manufacturing (accounting for 23.7 per cent of GDP) in 1980, but became one of the smallest sectors (6.2 per cent) in 1998 [4]. The biggest sector of the Hong Kong economy is now financing, insurance, real estate and business services, which account for 25.6 per cent of the Hong Kong GDP [4]. Hong Kong has become the world's most service dependent economy, with services contributing to 85.2 per cent of GDP in 1997. In the same year, the contribution from manufacturing dwindled down to 6.5 per cent [16].

### GDP by major economic activities 1980



### GDP by major economic activities 1997

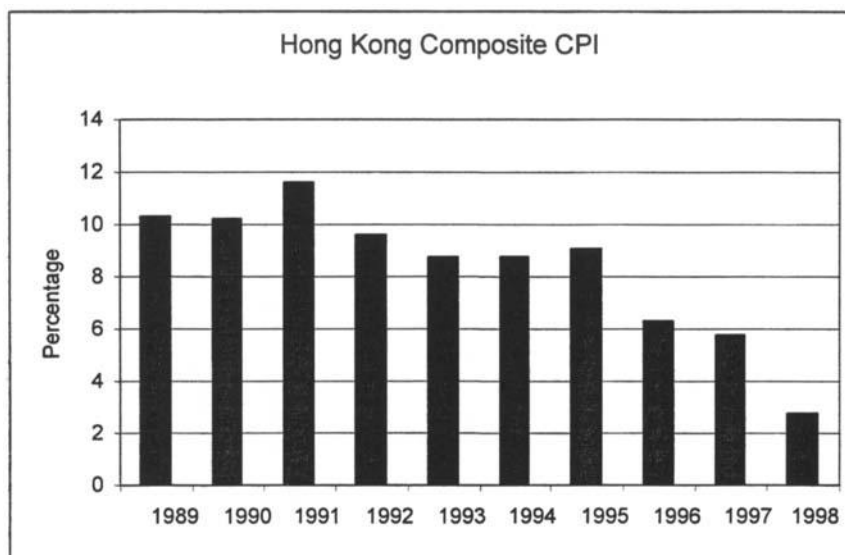


### 11.1 Service industry vs. manufacturing industry

The tax structure of Hong Kong is simple. The corporate tax rate is the lowest of any industrial country or developing country in the Asia and Pacific region. Although the fiscal reserves fell in the years 1998 and early 1999, Hong Kong still has a strong fiscal reserve. Hong Kong is now the world's 4th largest holder of foreign currency reserves, after Japan, the Chinese mainland and Taiwan [3].

The regional crisis that boomed in mid-1997 eroded confidence in Hong Kong's exchange rate and prompted a series of speculative attacks. The service industry, especially the financial industry, was heavily struck by the Asian turmoil. The wavering exchange rate led to sharply increased interest rates, weakened domestic demand, and clouded growth prospects for the following years. In 1998 and 1999, the unemployment rate was above 6 per cent, which was a record for the last few decades, and GDP grew negatively till the middle of 1999 [3].

The inflation in Hong Kong was kept low in past decades when its economy was developing at a high speed. Inflation declined in the 1990s (figure 11.2), and became negative in 1999. The deflationary pressure was felt in most items of consumer goods. The prices of clothing and footwear showed the most significant decrease, followed by durable goods, private housing and food. The deflationary pressure can partly be attributed to declining import prices and the substantial price discounts of recent months [3].



11.2 Hong Kong Composite Consumption Price Index  
Source: Hong Kong Census and Statistical Department [5]

A REER index based on unit labor costs in the Hong Kong's and trading partners' manufacturing sectors depreciated steadily during 1982 to 1997 and was researched by economists in the International Monetary Fund [6]. This study indicated that the productivity of Hong Kong's manufacturing sector has grown in that period. In the past decades, Hong Kong manufacturers have improved their competitiveness.

## 11.2 MANUFACTURING COSTS

### *Labor costs*

Hong Kong owns a pool of hard working labor, which has often been regarded as a unique Chinese quality which proved an asset in its rapid industrialization, especially in the labor intensive manufacturing industries [1].

From the 1970s, when the Hong Kong economy began its "miracle" growth, the labor costs increased quickly. Between 1974 and 1980, the wages for workers increased 103 percent in the six years [7]. From 1982 to 1990, the wage index for all Hong Kong workers grew at 13 per cent per year on average [7, 1978/88, 1980/90]. In the five years between 1993 and 1998, the average wage increase was 8 per cent per year on average [7, 1999].

In 1996, the labor costs in the Hong Kong textile industry were US\$4.9 per hour, higher than those paid by textile and clothing producers in other developing countries. The rate was 2.4 times that in Turkey, 3.2 times that in Mexico, 8.4 times that in Mainland China, 9.4 times that in Indonesia, 10.9 times that in Sri Lanka, and, 11.4 times that in Pakistan. Hong Kong had lost its advantage of low labor costs [8].

From the workers point of view, they would obviously like to work in a sector with high rates of pay. In the 1970s, the wage for a textiles worker was higher than the overall average wage, and the wage for garments workers was a little lower than the average wage [7]. In the 1990s, the Hong Kong economy became more and more service dependent. The salaries in the service sectors increased, but declined in the manufacturing sectors, including the textile and garment sectors [7, 1999]. The gap between the salaries for the service and manufacturing sectors increased, and younger

workers didn't like to work in the textile and garments sectors at the lower salary, and shifted to service sectors. The elder workers also worried about their future, that they wouldn't be able to find a new job after leaving the textile industry. Thus, few workers want to join the textile business currently.

In the 1980s, scholars suggested that Hong Kong's economic success hinged on its ability to maintain a high degree of competitiveness in its export trade [9].

#### *Fuel and wastage costs*

Fuel costs in Hong Kong are very high. The price of fuel in Hong Kong is the second highest in the world after the United Kingdom [10]. The Hong Kong oil market is monopolized by a few foreign oil companies, such as Shell, Mobil, Cax and Mefi. There is no Hong Kong domestic oil company working in this business. These few companies determine the price of oil in the Hong Kong market. On the other hand, Hong Kong applies high import taxes to oil products, and this is an important income to the Hong Kong government.

Some years ago, a waste discharge fee was introduced by the Hong Kong government. In the long term, the fee charged to the enterprises & households was unable balance the costs of government spending on the waste treatment. So the government is planning to increase the fee above the previous level. This will have an impact on the denim industry.

The above two factors greatly affect the denim industry's overheads, and the trend of increasing overhead costs pressures the industry to move their factories to lower costs countries (areas) and reduce the industry's competitive advantage of low costs.

### **11.3 INFRASTRUCTURE**

Hong Kong has a well-developed physical infrastructure, including its second busiest container seaport, busiest airport, and telecommunications system.[11].

Beside the well-developed physical infrastructure, Hong Kong has a sound legal system that has played a vital role in Hong Kong's past success. The rule of law begins with individuals and their right to seek the protection of the courts, in which justice is administered by impartial judges. It protects the freedom of individuals to manage their affairs without fear of arbitrary interference by the Government or the improper influence of the rich and powerful. Its starting point is the individual but it encompasses the whole of society. The existing Basic Law provides for the continuation of the rule of law and the judicial system beyond 1 July, 1997 with no fundamental changes, and will continue to be essential for Hong Kong's future. The common law and all the laws previously in force in Hong Kong, except for any that contravene the Basic Law, are maintained; the judicial system continues to operate fairly and independently as before [17].

Under the sound legal system, Hong Kong is an open market in which no concessions are offered to any investor or industry or company, but also no limitation on business forms. Foreign investment is not offered incentives, but the government makes efforts to improve investor protection. No duties are imposed on imported goods, except for a small number; no special legislation encourages export incentives. No specific incentives are offered to invest in other countries [11], and entry barriers for industry are really low.

The advanced infrastructure strengths make up for the weakness of Hong Kong domestic natural resources, high costs of land rent, etc. Furthermore, Hong Kong has an internationally recognized legal system, favorable corporate tax rates and an open market, which were untouched after its return to China, providing a sound foundation for the development of a garments cluster. The well-developed infrastructure is one of important elements in the Hong Kong garment cluster's competitiveness.

## **11.4 INSTITUTIONS**

On the institutional side, the government has established several organizations in an effort to promote Hong Kong's manufacturing and service industries, including the Hong Kong Productivity Council, the Hong Kong Trade Development Council, the Industry Department, the Hong Kong Export Credit Insurance Corporation, and the Business and Services Promotion Unit [11]. These institutions operated effectively and efficiently, to provide a service on enlarging trading space, vocational training, technological improvement, and productivity enhancement.

It is praiseworthy that the government and these institutes have built a set of public information networks to encourage information flow. For the textiles and garment sectors, some relative information resources in Hong Kong are listed in Table 11.1.

There are also several Hong Kong universities that are committed to textiles and garments development in different areas. The Institute of Textiles and Clothing in the Hong Kong Polytechnic University has maintained an exclusive role in the provision of textile and clothing education in the tertiary education sector. In addition to academic education at technician, technologist, and executive levels for the industries, the Institute also assists the industries by undertaking research and consultancy services. The Hong Kong University of Science and Technology (HKUST) is responsible for a 3D Garment Program and HKTAIGA (A communication infrastructure for Hong Kong textile and apparel industry global application). Three universities, the Hong Kong University of Science and Technology (HKUST), the Chinese University of Hong Kong (CUHK) and the Hong Kong Polytechnic University (POLYU), have cooperated to develop an Internet based system for sourcing and trading of fabrics. The City University of Hong Kong has developed a multimedia document and workflow management system to help industry improve productivity. The Chinese University of Hong Kong (CUHK) has developed an image database management system for textiles and clothing.

## **11.5 FOREIGN TRADE SYSTEMS**

The trading sector that has been developed since the middle of the nineteenth century has played a vital role in Hong Kong's economic history. Traditional intermediaries are complemented by Hong Kong firms, which match sources of supply with sources of demand on a global basis, and with trading volume of such magnitude handled by Hong Kong companies; Hong Kong has become a leading sourcing center of the Asia Pacific region. More than one in five employed people in Hong Kong are engaged in the import and export trade, a sector whose contribution to GDP is over 18 per cent [12].

Table 11.1 Textiles and garments information sources in Hong Kong

<b>GIC</b>	Hong Kong Government Information Center <a href="http://www.info.gov.hk/">http://www.info.gov.hk/</a>
<b>TDC</b>	Hong Kong Trade Development Council. <a href="http://www.tdc.org.hk/">http://www.tdc.org.hk/</a>
<b>ID</b>	Hong Kong Industry Department <a href="http://www.info.gov.hk/id/">http://www.info.gov.hk/id/</a>
<b>HKTAIGA</b>	Communication infrastructure for Hong Kong textile & apparel industry global application. Developed by the Industrial Engineering and Engineering Management Department of HKUST. <a href="http://hktaiga.ust.hk/">http://hktaiga.ust.hk/</a>
<b>HKCAINS</b>	Hong Kong Clothing Accessory Information Network System. Developed by the Industrial Engineering and Engineering Management Department of HKUST and the Clothing Industry Training Authority (CITA)
<b>IGS 2000</b>	Integrated garment system, IPC Information Processing Consultants Ltd.
<b>Prima Vision</b>	Color CAD systems for the garment and apparel industry. Prima design system Ltd. <a href="http://www.prima.com.hk/prima/main.htm">http://www.prima.com.hk/prima/main.htm</a>
<b>Gerber</b>	Product data management. Gerber Garment Technology. <a href="http://www.ggt.com/">http://www.ggt.com/</a>
<b>TP-CSS</b>	Three principle client/server solution garment system module. Three principles computer service Co. Ltd. HK

Table 11.2 Major textile and clothing related research projects in Hong Kong

<b>ASD (for textiles and garments)</b>	Part of Area of Strategy Development, focused on textiles and garments. Developed by Institution of Textiles and Clothing Department of Hong Kong Polytechnic University (One important aspect is a knowledge based information site for the denim industry) <a href="http://www.asd.polyu.edu.hk">http://www.asd.polyu.edu.hk</a>
<b>HKCAINS</b>	Hong Kong Accessory Information Network System. Developed by the Industrial Engineering and Engineering Management Department of HKUST and the Clothing Industry Training Authority (CITA)
<b>HKTAIGA</b>	Communication infrastructure for Hong Kong textile & apparel industry global application. Developed by the Industrial Engineering and Engineering Management Department of HKUST. <a href="http://hktaiga.ust.hk/">http://hktaiga.ust.hk/</a>
<b>HKfab</b>	An Internet based system for sourcing and trading of fabrics. Developed by HKUST, CUHK and HK POLYU.
<b>CityMerchant</b>	Multimedia document and workflow management system. Developed by MADLab, Dept. of CS, City University HK <a href="http://icg.cityu.edu.hk/madlab/citymerchant/">http://icg.cityu.edu.hk/madlab/citymerchant/</a>
<b>Montage</b>	Image Database Management System. Hong Kong Chinese University. <a href="http://www.cse.cuhk.edu.hk/~viplab/">http://www.cse.cuhk.edu.hk/~viplab/</a>

Because of the strong help from the government, Hong Kong trade jobber enjoyed a large trading space, as Hong Kong is a member of the WTO and a free port.

The Hong Kong import & export trading sector is active in sourcing garments. Three type of sourcing activities occur, namely sourcing goods produced in Hong Kong, sourcing goods from around the region for re-exports, and sourcing goods from one country to be shipped directly to a third country without touching Hong Kong ground [12]. The import business of Hong Kong trading firms is mainly generated by their distributing capabilities under the identity of agents or dealers [12]. Given Hong Kong's strategic location, advanced physical infrastructure, and well-established legal framework, trading through Hong Kong always provides convenience and certainty. Moreover, traders tend to agglomerate in a city.

The Hong Kong Trade Development Council (TDC), an agency of the Hong Kong government, is the statutory organization set up to promote Hong Kong's trade in goods and services. The agency has done much to develop and diversify markets for Hong Kong companies, with special reference to the needs of small and medium-sized enterprises (SMEs), enhancing the image and competitiveness of Hong Kong's products and services in world markets, strengthening Hong Kong's role as Asia's premier business and services hub, improving Hong Kong's image as an open market and good business partner, standing for free trade and the rule of law in global commerce.

As Hong Kong has a large number of trading firms and has acquired a comparative advantage in playing the middleman's role in international trade, such an advantage is expected to feed upon itself [12].

## 11.6 GOVERNMENT POLICIES

The government in Hong Kong has traditionally adopted a policy of nonintervention toward the regulation of private business and industry, and has actively promoted a free-enterprise, free-trade economy. In his first Policy Address, the Chief Executive of the Hong Kong SAR reiterated that Hong Kong's development strategy would continue to be based on the principles of a free-market economy, prudent fiscal policy, and maintaining a sound legal system [11]. In the policy address by the Chief Executive in 1998, he reiterated that the government would work on enhancing Hong Kong's economic vitality and promoting sustained economic growth; raising the quality of education, starting from basic education; leading the Civil Service in an open government and together building--a stable, free, democratic, equitable and compassionate society, a decent society with a level playing field and fair competition under the rule of law; a world class cultural, educational, and scientific research center; a society proud of its national identity and cultural heritage. Furthermore, he announced [13], on the basis of the recommendations from the Commission, that to realize this vision, Hong Kong needed to become:

- *a leading city in the world for the development and application of information technology;*
- *a world class design and fashion centre; ...*
- *a leading international supplier of high value-added products and components in the areas where Hong Kong already excels;*
- *a regional centre for supplying professional and technological talents and services; and*
- *a market place for technology transfer between the Mainland and the rest of the world.*

The tax structure in Hong Kong is simple, and the profit tax and salary tax rates are to remain unchanged despite a fiscal deficit. Moreover, to increase the attractiveness of Hong Kong as a business centre, the re-export declaration charges have been slashed by half, and merchant shipping registration fees have been reduced [14].

In response to the sluggish economic performance, the government put forward several measures to prop up the economy in late May 1998. In an effort to improve



the liquidity of the banking sector, the Hong Kong Mortgage Corporation has streamlined the purchase program for residential mortgages [14].

In June 1998, the government further announced another package of economic relief measures aimed at easing the credit crunch, stabilizing property prices and easing costs of families and businesses. These measures include exempting interest income earned locally from profits tax, and raising the size of the Credit Guarantee Scheme (CGS) in order to help small and medium enterprises (SMEs) to obtain loans from lending institutions [14].

According to the United Nations' World Investment Report, Hong Kong ranked the second largest source of outward foreign direct investment in Asia in 1998. Total investment outflows from Hong Kong stood at US\$18.8 billion in that year. Apart from the Chinese mainland, other Southeast Asia developing countries are major recipients of capital from Hong Kong. In terms of cumulative amounts on approval, Hong Kong is the largest investor in the Chinese mainland, and is among the leading investors in Indonesia, Taiwan, Thailand, Vietnam and the Philippines [3]. Hong Kong has continued to be the world's leading exporter of garments in 1999 [3].

However, a general pick-up in demand in Asian economies and a rebound in exports to the mainland supported a significant upturn in Hong Kong exports. Domestic consumer spending also increased. These factors encouraged the Hong Kong economy to be resuscitated [3].

Hong Kong remains a favorable business center for overseas investors despite its short-term economic weakness. It is also a regional center with the world's busiest airport in terms of international cargoes, the world's 2<sup>nd</sup> busiest container port, Asia's 2<sup>nd</sup> largest stock market, and Asia's 3<sup>rd</sup> foreign exchange market in terms of turnover.

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