

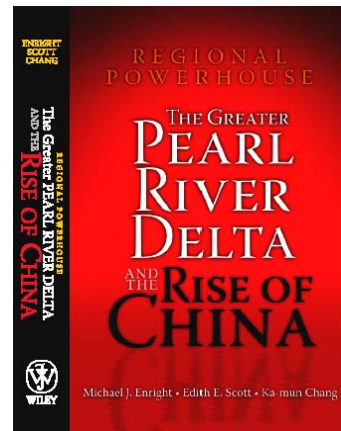
Regional Powerhouse: The Greater Pearl River Delta and the Rise of China

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Published May 2005 by
John Wiley & Sons (Asia) Inc.

<http://as.wiley.com/WileyCDA/WileyTitle/productCd-0470821736,descCd-description.html?print=true>

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EXECUTIVE SUMMARY

China, its Regions, and the Greater Pearl River Delta

Since the onset of its economic reform program in 1979, China has become the world's most dynamic large economy. It has gone from a nation cut off from the global economy to become one of the world's leading traders and destinations for foreign direct investment. Globally, China's economic rise has been viewed with a mixture of admiration and alarm. In industry after industry, China is gaining a substantial if not dominant share of world production. For many companies, China represents the single largest opportunity in the world today. For countries and governments, China represents an emerging tough competitor and an enormous potential market.

Most outsiders do not appreciate that China's economy is a series of loosely coupled regional economies, some driving China forward and others holding it back. Thus aggregate national numbers tend to mask the greatest challenges and the best opportunities to be found within China. The Greater Pearl River Delta, consisting of Hong Kong, Macao, and the Pearl River Delta Economic Zone of Guangdong Province, is easily the largest and most export-oriented of China's regions, a fact that might be news to those focused on political developments in Beijing and the gleaming skyscrapers of Shanghai. If it were a country, the Greater Pearl River Delta (with a GDP in excess of US\$270 billion) would be the world's sixteenth largest economy and its tenth leading exporter. Once heralded as the vanguard of China's reform program, the region has continued its spectacular development, almost under the radar screen, powered by foreign investment, trade, indigenous firms, and the unique combination of systems found in the region.

Hong Kong and the PRD: Combinations and Competitiveness

The Greater Pearl River Delta region has benefited from a unique set of interactions between Hong Kong and the Pearl River Delta Economic Zone. Hong Kong has evolved from an entrepôt; to a light manufacturing centre; to a leading centre for management, logistics, finance, and high-end business services. Hong Kong's influence in the global economy goes far beyond that one would expect due to its roles as a packager and integrator of economic activity, a foreign investor, a location for overseas firms, and a modernising and internationalising agent for the Chinese economy. Hong Kong has developed leading clusters of industries in financial and business services, infrastructure and development, transport and logistics, tourism and travel, and communication and media, most of which, like Hong Kong's economy as a whole, are tightly linked with, and gain strength from, the Pearl River Delta region.

The Pearl River Delta Economic Zone (PRD) has been the PRC's most dynamic economic region since the onset of the reform program. In just over two decades, the PRD was transformed from an agricultural backwater to one of the world's leading manufacturing areas. As the vanguard of China's reforms, the PRD used its Special Economic Zones and links with Hong Kong to attract firms, first from Hong Kong and Taiwan, next from the rest of Asia, and then from the rest of the world. Vibrant local companies also sprang up, buoyed by the relatively open economic environment, the opportunities to supply international firms, and the infrastructure that was rapidly created in the region. The PRD became home to world leading clusters in industries such as electronics, home appliances, telecommunications equipment, toys, autos, watches and clocks, garments, footwear, plastic products, and ceramics.

The economies of Hong Kong and the PRD have been inextricably intertwined. The vast majority of the external investment in the PRD has come from Hong Kong. We estimate that Hong Kong companies employ between 10 million and 11 million workers in the PRD, more than Hong Kong's total population of 6.8 million. Hong Kong also has served as an investment platform for foreign firms doing business in China. Proximity to Hong Kong has been a major reason foreign firms invest in the PRD. The vast majority of Hong Kong's trade involves re-exports from or to the PRD, while Hong Kong provides the main international inlet and outlet for the PRD. Hong Kong also has been a source of management and technology for burgeoning industries in the PRD. While linkages between Hong Kong and the PRD are extremely extensive in manufacturing, they have been limited in the service sector largely due to China's restrictions on foreign service firms. The value of tight links with Hong Kong for PRD jurisdictions is substantial. In 1980, for example, the two jurisdictions just north of Hong Kong, Shenzhen and Dongguan, had a combined GDP almost exactly equal to the combined GDP of the two jurisdictions just north of Macao, Zhuhai and Zhongshan. By 2002, the difference was RMB 210 billion (US\$25 billion) per year, driven by trade and investment facilitated by Hong Kong.

The combinations present in the Greater Pearl River Delta region have allowed it to become a world leader in many industries, with Hong Kong providing the high-end services and access to international capital and markets and the PRD providing the land, labour, and resources necessary to develop a light manufacturing juggernaut. In industries such as toys, garments, consumer electronics, watches, home appliances, and footwear, the combination allows the Greater Pearl River Delta region to be an important if not dominant player. In heavier manufacturing, on the other hand, the Greater Pearl River Delta has historically been weak. In services the picture is mixed. The Greater Pearl River Delta is home of two of the world's leading port cities (Hong Kong, the leader, and Shenzhen) and the world's leading international cargo airport (Hong Kong). Its world leading position in trading, transportation, and logistics is based on its role as the leading exporting region in China. In financial and business services, Hong Kong is a centre of global importance. While restrictions in the Chinese Mainland have not allowed Hong Kong firms and offices to serve the PRD freely, China's increasing openness is facilitating ever closer interaction.

Forces Shaping the Greater Pearl River Delta Region

There are several forces that will shape the economic future of the Greater Pearl River Delta. Further liberalisation and openness in China is manifested in China's accession to the World Trade Organisation (WTO) and the Closer Economic Partnership Arrangement (CEPA) between the Chinese Mainland and Hong Kong and Macao. Given the international orientation of the Greater Pearl River Delta region, and the fact that the region has been operating at world quality and cost standards for years, the region should receive a disproportionate boost from greater liberalisation and openness in China's economy. Greater openness to trade to and from China that comes with WTO accession should enhance the region's role as China's main exporter and transit point for trade. Greater openness in China's service sector will enhance Hong Kong's ability to act as a service centre for the PRD as well as the rest of the country. CEPA provides access to China's markets to Hong Kong and Macao firms and qualifying Hong Kong and Macao-based subsidiaries over and above that provided

in the WTO accession agreement. The result will be a reduction of barriers to operation across the region and much closer interaction between the different jurisdictions in the Greater Pearl River Delta.

Although serving China's 1.3 billion people has been only a dream for most companies, growth in China's "accessible market" due to greater purchasing power, urbanisation, improved transportation infrastructure, and greater market orientation favour the Greater Pearl River Delta region. So too will the new Pan-Pearl River Delta initiative that aims to create infrastructure, business, and governmental links between Guangdong Province, Hong Kong, Macao, and eight neighbouring Chinese provinces. The eight provinces will benefit from business spillovers and investment from the Greater Pearl River Delta region, while the Greater Pearl River Delta region benefits from a much broader hinterland. The Greater Pearl River Delta region also will lie at the centre of the world's most populous trading bloc (China-ASEAN) as of 2010.

Corporate strategic shifts, developments in costs and capabilities, and greater physical connectivity within the Greater Pearl River Delta region will also have an impact. Recognising that it is not possible to manage all of their Chinese Mainland businesses from a single location, major corporations are setting up regional centres in South China, East China, and North China, making the Greater Pearl River Delta region a focal point for China activities. Improvements in capabilities in the PRD are providing local and international firms with more options for the location of their activities in the region. In addition, improvements in infrastructure (particularly the Hong Kong-Macao-Zhuhai bridge) and streamlined procedures are creating an unprecedented fluidity of transit between Hong Kong, Macao, and the PRD. All of these should make the Greater Pearl River Delta region a more attractive location for local and international business.

Future Interactions, Combinations, and Competitiveness

These forces will have an important impact on the economic interaction within the Greater Pearl River Delta region. Greater openness and interaction will stimulate greater investment flows in both directions as Hong Kong and Macao firms and offices find it easier to operate in the PRD and as PRD firms come to Hong Kong and Macao to link with the global economy. Trade flows into and out of the region will expand dramatically, as will the transfer of technology, management capabilities, and market know-how. The result will be far greater interaction in goods and far greater interaction virtually across the board in the service sector. In essence, the Greater Pearl River Delta will be a fully integrated economic region for the first time.

As a result, the region will enhance and extend its business combinations to improve competitiveness in its traditional sectors, while greatly expanding in sectors in which the region has traditionally been weak. In light manufacturing, home appliances, and electronics, improvements in infrastructure will expand the region's manufacturing base as urbanisation provides an even more substantial workforce. The end of the quotas for garments and textiles will allow the region to leverage its competitiveness in these sectors as never before. A combination of business attraction policies and the development of consumer, urban, and industrial markets is fostering huge development in materials, metals, chemical, machinery, and equipment, sectors that were never particularly prominent in the region. The result will be a fully diversified manufacturing economy on par with any other region in China, or in the world. Linked to manufacturing will be a much more open and dynamic service sector driven by regional growth and by the skills and capabilities found in Hong Kong and eventually in Shenzhen, Guangzhou, and Macao.

As the region continues to develop, the emerging division of labour will provide more variety and more choice for investors, sourcing agents, and other firms. The overall picture is that of a region likely to retain its present advantages while adding new advantages and overcoming traditional obstacles.

Issues for the Greater Pearl River Delta Region

There is enormous potential for the Greater Pearl River Delta region to extend its position as one of the world's most dynamic economic regions. However, there are a number of issues that the region faces that could influence its future development. Rapid growth has placed strains on the infrastructure, the environment, public services, and quality of life. Many of these are best characterised as growing pains that create obstacles, but not insurmountable ones, for the region. Multiple jurisdictions, including two Special Administrative Regions, one province with a provincial capital, two Special Economic Zones, and nine municipalities, create issues associated with competing development plans and the need for cooperation on important issues. Competition with China's other major regions, such as the Yangtze River Delta and the Bohai region, and issues surrounding China's international links, such as potential trade protectionism and tensions over Taiwan or North Korea, are also concerns. Despite the importance of these issues, it is unlikely that they will derail the region's economy any time soon.

Perspectives

In the past it has been the combinations present in the Greater Pearl River Delta region, particularly the combination of Hong Kong with the PRD, that have allowed the region to become a major player on the world stage. For other places in the world, it has not been a matter of competing against 'China' if 'China' is framed as a third world nation with a low overall level of development. Instead, it has been a matter of competing against the resources and labour of China combined with first world-level knowledge of markets, finance, technology, and management based in Hong Kong. In industries in which this combination can be brought to bear, it is very difficult for others to compete. And when one realises that only half of the Greater Pearl River Delta region has been developed to any great extent, it clearly has the potential for substantial future development. It would not be surprising to see the emergence of a tightly integrated region of 70 million to 75 million people (up from 50 million or so in 2002) that is the most affluent in China.

The economy of the PRD will deepen and broaden as it moves further up the technology and skills ladder, while the Hong Kong economy will specialise more on providing high-level services for Hong Kong, foreign, and Chinese companies operating in the region, in China, in Asia, and the rest of the world. Macao, which is attracting massive investments in the tourism and gaming sectors, is likely to become the single largest destination resort area in Asia. At the same time, people in the different jurisdictions, who historically did not see themselves as part of a single integrated economic region, are changing mindsets rapidly, as government to government discussions, business to business discussions, academic exchanges, joint planning efforts, and joint promotional activities become the norm rather than the exception. The new mindset is being facilitated by China's WTO entry, CEPA, and easier travel, but is being powered by well-informed economic self-interest, which is why it will continue and grow.

Today, local companies are seeking out further Greater Pearl River Delta opportunities, placing different activities in different jurisdictions and tying them together through improved transportation and communication. Foreign companies are taking increasing notice as well, finding the region to be a production platform that they must use if they are not to be out competed by others that do, a market that cannot be ignored by any company serious about its China business, and a region in which they can manage from a place with world-class hard and soft infrastructure. Foreign governments are finding that detailed knowledge of the Greater Pearl River Delta region is essential if they are to understand China's rise and prepare their own economies to compete with China and sell into China.

What each is finding is that it is very difficult for other nations or regions to match the distinctive combinations and complementarities that have contributed to the growing competitiveness of the Greater Pearl River Delta region. It is these combinations and complementarities that are likely to continue to power the development of one of the world's most dynamic economic regions.