**INTEGRATION IN THE PEARL RIVER DELTA AND IMPLICATIONS FOR THE EU**

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# Executive Summary

# Key points

* Hong Kong and Macao have long established division of labor in manufacturing with the PRD, but from the late 1990s integration has become increasingly more institutionalized and coordinated by central and local governments. Deeper socio-economic regional integration is now a priority in national strategy and a crucial means to boost the region’s competitiveness.
* If successful, the Greater PRD will serve as an exemplar of deepening market reforms in the rest of the country.
* Economic cooperation has been and continues to be the main driver, and the most successful aspect, of regional integration. Deepened trade and investment flows, largely thanks to a series of free trade agreements between Mainland China, Hong Kong and Macao, have benefitted all three sides. Huge infrastructural build up and relaxed borders have also brought the three sides closer together than ever.
* Yet regional integration has been far from smooth. Competing interests within the region as well as institutional obstacles, namely complex multi-layered decision-making systems and deepset differences in cross-border political and legal regimes, are some of the weaknesses that need to be addressed. Uneven intra-regional development and social problems including corruption have also posed challenges.
* Going forward, strategy plans for up to 2020 envision an even more integrated Greater PRD with less dependence on manufacturing and export-led growth. The region is expected to lead the rest of the country in indigenous innovative technology and transitioning to the services sector. Service industries are forecast to account for 60% of regional GDP growth by 2020.
* Further cooperation provides opportunities for the region to advance its technology and take a leading role in China’s financial liberalization process. But many obstacles, including the lack of open market competition for the private sector from home and abroad, an opaque financial system, and an inconsistent institutional environment, stand in the way. A lack of skilled labour and the uncertainty surrounding Hong Kong’s future also threaten successful integration and development.
* A more integrated Greater PRD presents many business opportunities for the EU and widens its scope for market access in the region and beyond. The EU should harness its existing relations with Hong Kong and Macao to gain up-to-date insight into the region’s developments and contribute know-how in regionalism, urbanization and managing cross-border issues where appropriate. It should draw relevant lessons from the challenges in regional economic cooperation and prepare for similar issues in negotiating a EU-China investment agreement.

# 1. INTRODUCTION

For decades, southern China’s Pearl River Delta Economic Zone has been the country’s leading export driver and one of the world’s foremost manufacturing hubs. Since 1978, when it was first established as China’s pioneering experimental ground for market reforms, the region has seen rapid urbanization and population growth. Foreign investment, mostly from the much wealthier Hong Kong and Macao across the border, led to unprecedented levels of economic growth and established the region as China’s manufacturing powerhouse.

In the late 1990s, the return of Hong Kong and Macao to Chinese rule, the implementation of a national “go global” strategy and China’s accession to the World Trade Organization (WTO) soon after triggered a new direction in the region’s development. Increasingly, policy makers began to prioritize more institutionalized integration of the two Special Administrative Regions with their neighboring cities across the border as part of a push to boost the region’s competitiveness and begin opening up its largely sheltered services sector. The pace of economic integration in what is now called the Greater Pearl River Delta (PRD) region – comprising Hong Kong, Macao, and the nine Guangdong cities in the delta region – quickened significantly through a series of preferential trade and investment agreements from 2004 onwards.

The Greater PRD is now in the midst of a new round of rapid transformation as China seeks to rebalance its economy, moving away from heavy reliance on exports, manufacturing and infrastructure and focusing on domestic consumption, expanding the services sector and technological advancement. As one of China’s most dynamic economic regions, the PRD has a leading role to play in further reforms. If successful, the developments within the region and its periphery in the next few years will serve as an exemplar of reform strategies in the rest of the country. The PRD’s strategic and symbolic importance was affirmed in December 2012, when President Xi Jinping chose to visit Shenzhen as the first stop in his southern tour.

China’s 12th Five Year Plan and other national directives dictate that deepening the regional integration within the PRD itself, and between the delta and Hong Kong and Macao, is a priority in national strategic policy. Such integration complements a second, equally important goal, which is to move the region’s industries up the value chain – especially with regard to the services sector – to promote more sustainable growth. Although the three sides have already become increasingly interdependent, the trend is for further ties in the next decade and beyond to fully tap the region’s potential. Integration is, for the most part, mutually beneficial for these economies. While the PRD provides Hong Kong and Macao with an important trading partner and a large and lucrative market to ensure their continuing prosperity, Hong Kong helps Mainland Chinese businesses internationalize and offers the recognized regimes and services expertise necessary to help Guangdong sustain its growth. Further integration would also serve as a base to help lift the economies and quality of life in the larger Pan-Pearl River Delta region, which includes a number of other less developed provinces close to the Pearl River upstream of Guangdong.

To date regional integration has focused overwhelmingly on economic matters, especially in trade and investment flows. Heavy investment in infrastructure building also means that the three sides are now more connected socially and politically than ever before in a sprawling urban “megalopolis” that matches the size of Los Angeles. Yet tremendous disparities still exist between the region’s cities in per capita income, GDP and their ability to attract foreign investment. Different legal and political systems, multiple layers of administrations, and intra-regional competition among the cities have hampered cooperation. Looking ahead, many unresolved issues could threaten regional integration. Among them are a persistent lack of a transparent and fair regulatory environment, competition from other provinces, the ability of the labor force to adapt to the transition, and the uncertain future of “One Country, Two Systems”. Cross-border pollution threatens to undermine the region’s competitiveness, especially among expatriates and foreign companies, and the levels of intense urbanization planned for the region will bring with it further environmental and social pressures.

For the EU, the developments in the Greater PRD not only provide a detailed snapshot of the wider political, social and economic strategies and policy trends in the rest of China. They also offer many opportunities for furthering EU-China economic and political exchanges for the mutual benefit of both sides. Businesses and officials based in the Greater PRD look to Europe as an important potential partner in the key high-end industries they need to develop in the coming years, while recession-hit European countries seeking to improve their finances could look to the Greater PRD as one of the best avenues into the Chinese market. Meanwhile, the EU has an abundance of experience to offer to PRD policy makers in terms of integrated approaches to dealing with urban development and cross-border cooperation.

This paper will first take stock of the development in the Greater Pearl River Delta, consider the extent of political, economic and social integration within the region, and cover the recent policy directives that will guide the region’s further development in the next decade. It will then examine the achievements and constraints in regional integration thus far, and outline what opportunities and risks the region faces going forward. Finally, it will provide an assessment of the developments’ potential benefits for the European Union, as well as what EU experience and institutions can offer.

# 2. DELIMITATION OF THE GREATER PEARL RIVER DELTA REGION

Delimitation of the Greater Pearl River Delta is key before undertaking further analysis of the cooperation and integration of the region. The administrative boundaries of the Pearl River Delta itself have not always been fixed. In 1988, for example, the PRD covered about 20,000 km2 (Luk et al., 1996, p. 306), while in 2013 the area more than doubled to 54,744 km2 (Xu 徐江 and Wang 王缉宪, 2012, p. 15).

Further, the Greater PRD not only include counties and municipalities but also two Special Administrative Regions and Special Economic Zones, all separately administered, adding to the complexity of regional cooperation and governance. For the purpose of this study we define the Pearl River Delta as including the following:

* In Guangdong province:
  + 2 provincial-level cities, Guangzhou and Shenzhen;
  + 7 prefectural-level cities: Foshan, Huizhou, Dongguan, Jiangmen, Zhaoqing, Zhongshan and Zhuhai; including
  + Two Special Economic Zones: Shenzhen Special Economic Zone and Zhuhai Special Economic Zone

The Greater Pearl River Delta refers to the above, in addition to the two neighboring Special Administrative Regions (SARs) of Hong Kong and Macao, which maintain semi-autonomous rule under the principle of “One country, Two systems”.



Figure 1. Greater Pearl River Delta region, 2013

**Table 1**

**Main cities in the PRD – population, 1990-2010**

|  |  |  |  |
| --- | --- | --- | --- |
| **City** | **1990** | **2000** | **2010** |
| Guangzhou | 3,918,010 | 8,524,826 | 11,070,654 |
| Shenzen | 875,176 | 7,008,831 | 10,357,938 |
| Dongguan | nd | 6,445,777 | 8,220,237 |
| Foshan | 429,410 | 5,337,709 | 7,194,311 |
| Shantou | 884,543 | 4,600,927 | 5,330,764 |
| Zhongshan | nd | 2,363,322 | 3,120,884 |
| Huizhou | 274,689 | 1,454,508 | 2,344,507 |
| Puning | nd | 1,856,402 | 2,054,703 |
| Jiangmen | 284,935 | 1,468,742 | 1,822,640 |
| Zhanjiang | 1,048,720 | 1,350,665 | 1,612,300 |
| Zhuhai | 331,065 | 1,235,437 | 1,560,229 |

Explanations: nd – no data

Source: Statistical Yearbooks of Guangdong Province.

# 3. BACKGROUND: REGIONAL DEVELOPMENT AND INTEGRATION TO DATE

## 3.1 Overview

After more than three decades of economic reforms, China has surpassed numerous developing countries in development and modernization, recording rapid economic growth and astonishing social change. As the world’s largest exporter and second-largest economy, China is now classified by the World Bank and United Nations Development Programme as a country of upper middle-income and medium human development, achieving higher than ever levels of life expectancy, literacy and income.

The transformation of Guangdong province, particularly its Pearl River Delta region, from farmland to national export engine has played a key role in the extraordinary rise of Chinese economy. Despite its relatively small geographical size and population, the PRD has made disproportionately large contributions to national output. As one of the most powerful economies in Mainland China and worldwide, the province recorded a gross domestic product of RMB 5,707 billion in 2012, the largest in China, accounting for about 11% of the national GDP and 28% of national exports[[1]](#footnote-1). Together with two other of the country’s most developed provinces, Jiangsu (10.4%) and Shandong (9.6%), Guangdong contributes to almost one third of the Chinese economy. The province also recorded some of the highest economic growth rates in the country in the past three decades. From 1978 to 2008, Guangdong’s economy grew at a rate of around 12% per annum, and in the peak years of 1992 to 1993 recorded a growth rate exceeding 22%[[2]](#footnote-2).

Foreign direct investment (FDI) in the region has played a crucial role in advancing its economic growth. Guangdong attracted 11.5% of national FDI inflows in 2010. Together with Jiangsu (16.2%) and Liaoning (11.8%), the three provinces drew 39.5% of Chinese FDI inflows. From the very start, Hong Kong, and to a lesser extent Macao, were integral in providing the investment necessary to build up the PRD region. Hong Kong is Mainland China’s largest source of realized foreign direct investment, and much of this has concentrated in Guangdong province. In 2012 the cumulative value of Hong Kong's realized direct investment in Guangdong was estimated at HK$1,431.5 billion (US$184.7 billion), accounting for 61.8% of Guangdong's total[[3]](#footnote-3).

The region’s leading position in the Chinese economy can be traced to 1978, when then leader Deng Xiaoping picked the nine Guangdong municipalities as a pioneering and experimental ground for economic reforms and opened them up to commerce and foreign investment. Shenzhen and Zhuhai in the PRD, together with Shantou, also in Guangdong province but outside the delta region, were designated the country’s first Special Economic Zones with less restrictive economic policies and liberal tax regimes. At a time when neighboring Hong Kong, a British colony, was a leading Asian financial hub with a world-class shipping industry and thriving manufacturing sector, these Guangdong municipalities were not much more than backward farmland and fishing villages. Macao, then still a Portuguese enclave, traded in and manufactured textiles but depended heavily on Hong Kong visitors to its legal gaming establishments for its income.

**Table 2**

**Greater PRD – main economic indicators, 2011**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Administrative unit | Area (km2) | Population (million) | GDP (RMB bn) | GDP growth (%) | Per Capita GDP (RMB) | Export (US$ bn) | Actual FDI (US$) |
| Guangzhou | 7,434 | 12.8 | 1242.3 | 11.3 | 97,588 | 56.5 | 4,271mn |
| Shenzhen | 1,953 | 10.5 | 1150.6 | 10.0 | 110,421 | 245.4 | 4,599 mn |
| Zhuhai | 1,688 | 1.6 | 140.5 | 11.3 | 89,794 | 24.0 | 1,338 mn |
| Foshan | 3,848 | 7.2 | 621.0 | 11.4 | 86,073 | 39.1 | 2,154 mn |
| Huizhou | 11,158 | 4.6 | 209.3 | 14.6 | 45,331 | 23.1 | 1,568 mn |
| Dongguan | 2,465 | 8.3 | 473.5 | 8.0 | 57,470 | 78.3 | 3,051mn |
| Zhonshan | 1,800 | 3.1 | 219.3 | 13.1 | 70,014 | 24.5 | 730 mn |
| Jiangmen | 9,541 | 4.5 | 183.1 | 13.0 | 41,062 | 12.3 | 789 mn |
| Zhaoqing | 14,856 | 3.9 | 132.4 | 14.7 | 33,642 | 3.3 | 1,029 mn |

Source: Guangdong Statistical Yearboook 2012.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Hong Kong | 1,104 | 7.1 | 1477 | 4.9 | 208,863 | 120.9 | 83 bn |
| Macao | 29.5 | 0.6 | 222 | 20.7 | 402,614 | 0.87 | 650 mn |

Source: Hong Kong and Macao government statistics, 2012

## 3.2 Integration through trade and investment

As industrialized economies that have enjoyed a long history of connections with the Western world, Macao and particularly Hong Kong had a substantial competitive edge over the PRD. It was thus natural that the municipalities that enjoy the closest geographical proximity to the two cities developed at the fastest pace. In 1980 Shenzhen and Zhuhai in the PRD were designated Special Economic Zones with looser regulation and taxation, so that they could attract foreign direct investment and expand China’s exports. Market-driven economic integration began to take shape as investment soon flowed from Hong Kong and Macao across the border. Many factories from Hong Kong began relocating to the PRD, taking advantage of the low wages and cheaper costs. Most produced labor-intensive goods including toys, footwear, garments, electronics and household appliances for export. The economies of Hong Kong and the PRD cities became increasingly interdependent, as a division of labor soon emerged in which Hong Kong served as the international service hub or “front shop” that did business with overseas buyers as supply chain managers, while working with the “back factories” over the mainland Chinese border.

That relationship began to evolve in the late 1980s and early 1990s, which saw the beginnings of a shift in investment in the PRD from light industries to heavier industries such as autos, machinery parts and petrochemicals. In 1992, Deng visited the region in his now famous southern tour to push for further economic reforms. Several events in the late ‘90s to early 2000s served to accelerate further restructure and trigger a more institutionalized drive to open up the region’s economy. First, the clarification of the political future of Hong Kong and Macao leading up to their handover to Chinese rule triggered an intensified push for regional integration, with a particular focus on how best to play up Hong Kong’s strength as an international financial center and logistics hub to the regional economy’s best advantage. Hong Kong returned to China in 1997 and Macao did the same in 1999. Both have been granted a high degree of autonomy under the “One Country, Two Systems” principle, which means that the cities came under Beijing’s sovereignty but retain their own elected legislatures, legal, financial and policing systems. Coincidentally, Hong Kong’s handover was almost immediately followed by the 1997-1998 Asian financial crisis, an event that prompted both businesses and policy makers to further rethink and redefine economic relations with the PRD. Finally, China’s accession to the WTO in 2001 triggered a further opening-up of the PRD’s industries to the rest of the world, especially in hitherto-restricted services industries including logistics, sales and marketing. As a developed service provider Hong Kong was to become a key factor in helping the PRD upgrade its economic development.

The main initiative in breaking down cross-border trade and investment barriers between Hong Kong and Guangdong has been the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA), a continuously expanded set of policies first signed by authorities in June 2003. CEPA allows zero-tariff treatment for the entry of over 1,000 categories of Hong Kong products to the Mainland and lowers the threshold for the entry of Hong Kong service suppliers to the Mainland market. The scheme was launched in January 2004, about two years ahead of China’s opening up in accordance with the WTO schedule. On the Mainland Chinese side, the arrangement enables local enterprises to capitalize on Hong Kong’s connections with the international market to realize China’s “go global” strategy, for example through listing on the Hong Kong Stock Exchange or raising capital there. The CEPA agreement has since been further broadened in eight batches and has granted more preferential treatment for almost all key service sectors in Hong Kong[[4]](#footnote-4). A similar set of partnership arrangements has also been implemented between Macao and the mainland since 2003.

The implementation of CEPA has provided huge economic boosts to all three sides in the Greater PRD. On the Hong Kong and Macao sides, thousands of goods and services providers were able to export to and set up operations in the mainland. Shenzhen became home to the highest concentration of Hong Kong banks in China; on the other hand, Chinese state-owned banks also began to list their shares in Hong Kong and expand their businesses there. Meanwhile, simplified investment application processes enabled some 3,615 Mainland Chinese enterprises to set up business in Hong Kong from 2004 to 2010, with a total investment value of over US$58.2 billion[[5]](#footnote-5). As mentioned in the introduction, investment from Hong Kong accounted for more than 60% of Guangdong’s realized direct investment in 2012.

## 3.3 Financial cooperation

In 2003 Hong Kong was allowed to trade in RMB, becoming the first market outside Mainland China to conduct offshore RMB business. It has since expanded its scope of business, and banks in Hong Kong now offer services including deposit-taking, loans, currency exchange and remittances, trade settlement and other related currency hedging services in RMB. In 2012, RMB trade settlement conducted through Hong Kong exceeded RMB2,600 billion, with settlement between Guangdong and Hong Kong accounting for one-fifth of the total[[6]](#footnote-6). In 2011, the first RMB-denominated initial public offering (IPO) was launched in Hong Kong. As at the end of 2012, five Hong Kong banks have set up branches in Guangdong, and a total of 136 Guangdong businesses have listed on the Hong Kong Stock Exchange[[7]](#footnote-7).

## 3.4 Integration through infrastructure

As the flow of investment and trade across the borders of the Greater PRD increased over time, policy makers were also investing heavily in infrastructure to boost the physical connectivity between the region’s cities. In the past decade Greater PRD region has been reshaped by a highly developed network of highways and rail links, with the most intense developments centering around provincial capital Guangzhou. Commuters can now travel by train from Hong Kong to Guangzhou in two hours; and in early 2013 a key new high-speed rail link, the Guangzhou-Zhuhai Intercity railway, opened to use, connecting most western PRD cities to each other and linking them up more directly with the national rail network. The high-speed link is part of a plan by the Guangdong provincial government to connect every major city in the PRD to the provincial capital of Guangzhou within one hour. It also holds particular benefits for Macao, which has become much more easily accessible to visitors from all over China.

Water infrastructure was crucial for the PRD’s early development and to this day still plays an important part in the region’s economy. The Greater PRD is currently home to three of the 15 largest seaports and container ports in the world (table 3). It also boasts a formidable air traffic capacity, with five international civil airports in a relatively concentrated area of 200 square kilometers. Three of them – Hong Kong, Guangzhou and Shenzhen – are among the largest cargo airports in the world, and Hong Kong and Guangzhou airports are also among the world’s busiest passenger airports (tables 4, 5).

**Table 3**

**Seaports and container ports of the world in the Greater PRD**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Rank | Name of sea port | Total Cargo (metric tons)  2010 | Rank | Name of container port | Total TEU (Twenty-Feet-Equivalent Units)  2010 |
| 6 | Guangzhou | 400,000,000 | 3 | Hong Kong | 23,699,000 |
| 9 | Hong Kong | 267,815,000 | 4 | Shenzhen | 22,510,000 |
| 14 | Shenzhen | 221,000,000 | 7 | Guangzhou | 12,550,000 |

Source: based on www.geohive.com/charts/ec\_ports.aspx

**Table 4**

**Largest cargo airports in the world in the Greater PRD**

|  |  |  |  |
| --- | --- | --- | --- |
| Rank | City | Airport code | Cargo (metric tons)  2010 |
| 1 | Hong Kong | Hong Kong International Airport | 4,165,852 |
| 21 | Guangzhou | Guangzhou Baiyun International Airport | 1,144,456 |
| 25 | Shenzhen | Shenzhen Bao’an International Airport | 809,125 |

Source: based on http://www.geohive.com/charts/ec\_airport2.aspx

**Table 5**

**Largest passenger airports of the world in the Greater PRD**

|  |  |  |  |
| --- | --- | --- | --- |
| Rank | City | Airport code | Passengers  2012 |
| 2 | Beijing | Beijing Capital International Airport | 81,307,596 |
| 12 | Hong Kong | Hong Kong International Airport | 55,718,301 |
| 18 | Guangzhou | Guangzhou Baiyun International Airport | 48,347,069 |

Source: based on http://www.geohive.com/charts/ec\_airport1.aspx

Although transport infrastructure has clearly been integral in linking up the Greater PRD cities, at times individual governments in the region got carried away with building ambitious new projects, resulting in unnecessarily overlapping facilities. A case in point is Zhuhai airport, which suffered from huge debts because demand for its services was extremely low. Despite ambitious plans by Zhuhai municipal authorities, Zhuhai airport achieved under 10 percent of capacity utilization shortly after it began operations in 2005, and its finances only improved after a joint venture with the Hong Kong Airport Authority in 2006.

Yet more rail and road construction aiming to facilitate deeper economic and social integration in the region has been earmarked or has begun. Landmark projects include the Guangdong-Shenzhen-Hong Kong Express Rail Link, due to be completed in 2015, and the US$ 11.5 billion Hong Kong-Zhuhai-Macao Bridge, expected to finish in 2016. Although initially delayed by a legal challenge over its environmental impact, the latter project is expected to produce the world’s longest cross-sea bridge, aiming to cut transportation time by up to 80 percent for both passengers and goods when it is completed. The travel time from Hong Kong to Macao and Zhuhai is expected to be completed in half an hour, down from 4.5 hours by road at present. The bridge is also expected to provide significant relief to the existing border crossings at Lo Wu and the Hong Kong-Shenzhen Western Corridor. The project is expected to be particularly useful in linking Hong Kong with the western PRD cities, which have lagged behind in the region’s overall development because of the remoteness of their location.

## 3.5 Socio-political integration

Since the early 1980s the PRD has been a gigantic hub attracting migrant workers from all over the country. By some estimates, about half of the PRD’s residents are migrant workers originating from other parts of China as part of the country’s massive rural-urban migration movement. Xu and Li (1988) estimated that on average, net migration in the PRD jumped from just 300,000 in 1979 to over 1 million in 1987. Throughout the ‘80s and ‘90s this population was, for the most part, barred from Hong Kong and Macao by strict border controls, although residents from the two cities could travel and work relatively easily in Mainland China.

Although Hong Kong and Macao were theoretically to maintain their own separate customs territory under “One Country, Two Systems” after returning to Chinese rule, in reality Beijing has gradually relaxed and simplified tourism regulations and travel procedures since the early 2000s to facilitate three-way people flows and encourage more economic activity within the Greater PRD’s borders. For example, increasing numbers of Hong Kong businessmen now reside and work in the mainland, and daily commutes between the two sides have become a part of life for thousands. The number of Mainland Chinese visitors to Hong Kong jumped sharply – and continues to grow – after the introduction in around 2003 of a policy called the Individual Visit Scheme, which meant that Mainland Chinese tourists no longer had to travel to the city in package tour groups. The policy, which has been of particular benefit to the retail and tourism sectors, has been progressively extended and a one-year multiple-entry permit is now available to most PRD residents. Mainland Chinese tourists to Hong Kong now overwhelmingly outnumber visitors from other countries; in 2011, an average of some 136,000 Mainland Chinese visited Hong Kong daily, more than three times the number in 2003[[8]](#footnote-8).

In urban development, planners in Guangdong, Hong Kong and Macao have coordinated in recent years on an integrated approach to urbanization that took the focus from individual cities to city clusters. Within the PRD, the first-tier cities Guangzhou and Shenzhen have served as the region’s main gateways to the rest of the world, while clusters of nearby mid-sized cities benefitted from expansion from the center[[9]](#footnote-9). The main metropolitan areas that have emerged under this process include the Guangzhou-Foshan-Zhaoqing metropolitan area, with Guangzhou as the center; the Shenzhen-Dongguang-Huizhou metropolitan area, with Shenzhen as the center; and Zhuhai-Zhongshan-Jiangmen, with Zhuhai as a center. Regional economic growth and development has been very much concentrated within these areas, as well as the corridors between Guangzhou and Shenzhen and Guangzhou and Zhuhai.

In addition, planners envision a hierarchical development framework in which the delta’s three most developed city clusters – the Hong Kong-Shenzhen cluster, the Macao-Zhuhai cluster, and the Guangzhou-Foshan cluster – are expected to lift the development level in their respective areas and together serve as the core urban space driving the development of the rest of the PRD[[10]](#footnote-10). Each of these megacities, or “Three Metropolitan Areas”, as Hong Kong planners call them, have pursued various bilateral dialogue frameworks in the past few years to coordinate local policies among themselves. Overall, the administrations of the PRD cities have had considerable flexibility to pursue such cooperation frameworks, with guidance and steering from Beijing. This applies particularly to urbanization and infrastructural issues that affect PRD cities jointly, including water and air pollution, water supply, and border traffic controls.

The most significant recent development in this regard was the 2009 agreement between the governments of Foshan and Guangzhou to merge the two cities’ urban planning and transport infrastructure. The two cities also said they would further collaborate on industrial development, particularly the auto manufacturing industry. By 2020, officials hope that residents from the two cities could have access to the same public services and goods.

Based on these developments, many observers predict the emergence of a so-called megalopolis encompassing the entire Greater PRD region in the near future, comparable to other Asian “megacities” including the Yangtze River Delta in China, the Tokaido (Tokyo-Osaka) metropolis belt of Japan, and the Greater Jakarta area of Indonesia[[11]](#footnote-11).

# 4. TOWARD FURTHER INTEGRATION: RECENT POLICIES

Since 2008 various economic challenges have prompted policy makers both on the central and local levels to rethink the PRD’s future. The aftermath of the global financial crisis and worldwide slowdown in demand highlighted the PRD’s dependence on exports and saw its competitiveness significantly decreased relative to other Chinese growth regions, especially inland cities such as Chongqing and Tianjin.

In 2012, the highest economic growth areas in China were inner cities (Tianjin, 13.8%, Guizhou 13.6%, Chongqing 13.6%), while that of Guangdong stood at just 8.2%[[12]](#footnote-12). Wage inflation in the PRD and rising overhead costs meant that many multinational business owners were moving their manufacturing bases to inland, less developed provinces, or even outside China to emerging manufacturing bases in Southeast Asia such as Vietnam and Bangladesh. At the same time, the PRD also faces multiple socio-economic challenges, namely a huge imbalance of development between the region’s areas and environmental problems resulting from overdevelopment.

Policy makers in Beijing and within the Greater PRD acknowledge that a more integrated approach to urbanization and a shift towards innovation, technology and a knowledge-based economy are imperative to sustain the delta’s competitiveness compared to other Chinese regions. In recent years a number of overlapping policy directives from both the national and provincial levels have set out strategies to address this and boost the Greater PRD region’s competitiveness to 2020 and beyond. A recurring theme in all of these forward-looking plans is that broader cooperation and economic integration within the Greater PRD is a key tool in achieving the transition to higher value-added industries and a more internationalized financial system – not only in Guangdong, but in the rest of China as well. In the same way that Guangdong was a pioneering force for Chinese export production and manufacturing in the 1980s, today the Greater PRD area is again touted as China’s pilot region for further reforms toward sustained growth and development.

## 4.1 The 12th Five Year Plan

The most important of these strategy documents, the current national 12th Five Year Plan (2011-2015), devoted a short chapter to the Greater PRD that spelt out Beijing’s emphasis on deeper regional cooperation between the three sides by “strengthening planning and coordination (and) improving the transportation system between PRD and Hong Kong/ Macao”. The plan also broadly described the particular roles that the three sides should each focus on developing under the closer cooperation framework. On Hong Kong, it outlined national backing for the city to develop its position as off-shore RMB business center and focus on its strength as a international finance, trade and shipping hub. On Macao, the plan dictated that the territory should focus on building itself up as a global tourism and leisure center. Finally on Guangdong province, it stipulated that the PRD should prioritize further opening up its service sectors and focus on advanced manufacturing, particularly next generation information technology, alternative energy, high-end equipment manufacturing, and clean energy vehicles. The outlined direction is in line with the plan’s wider strategy to rebalance the national economic focus from manufacturing to services and research and development in the next few years.

**Special Economic Zones**

One of the boldest national development strategies set out in the 12th Five Year Plan was the directive to set up three Special Economic Zones in the coastal areas of Guangdong Province, aimed at experimenting with new free-trade zone systems and to foster further economic integration, particularly in services sectors, between Hong Kong, Macao and Guangdong province. The three pilot zones are Hengqin in Zhuhai, a former oyster farming island; Nansha in Guangzhou; and Qianhai in western Shenzhen. In December 2011 Xi Jinping visited Qianhai and Hengqin during a trip to the PRD to stress his commitment to reform and deeper opening-up policies, underlining the importance of the initiative on a national level.

So far much of the media and market attention has focused on Qianhai, which has been earmarked to focus on banking, logistics and other professional services industries, with ambitions to become a financial hub modeled on Hong Kong. Policy makers want Qianhai to attract and trade in offshore RMB, most of which is deposited in Hong Kong accounts, and encourage the zone to conduct more cross-border RMB lending. Meanwhile, Hengqin is envisioned as a platform to promote cross-border coordinated development on the western shore of the Pearl River Estuary. A future tourism, business and culture zone, Hengqin has so far seen projects such as an ocean-themed amusement park and resort and the Macao-Guangdong Cooperation Industry Park, which includes facilities for developing Chinese medicine among other technology.

Officials have announced income tax subsidies and other incentives in a bid to attract foreign talent and businesses, especially tax and banking professionals from Hong Kong, to relocate to these SEZs. The extent to which non-mainlanders may benefit from these offers, however, is not yet clear. It appears that many restrictions are in place, and some reports have suggested that only a handful of non-mainlanders will be qualified to work in Qianhai[[13]](#footnote-13). Moreover, foreign invested projects will still be subject to industry restrictions.

## 4.2 Outline Plan for Reform and Development of the PRD, 2008-2020

The 12th Five Year Plan works in tandem with a longer-term development plan, the Outline Plan for the Reform and Development of the Pearl River Delta. Issued in December 2008 by the National Development and Reform Commission, it sets out much more detailed strategies for the PRD up to the year 2020.

The blueprint carries a similar message to the national 12th Five Year Plan, highlighting the need to deepen PRD regional integration with Hong Kong and Macao to “forge jointly the most dynamic and international competitive city cluster of the Asia-Pacific region.” To this end, the key objectives and strategies are as follows:

**Joint development of “modern services”.** Cooperation between Hong Kong, Macao and the PRD in developing more sophisticated industries and services is a key priority. New cooperation zones at Nansha, Qianhai and Hengqin are expected to help the three sides work together on opening up the region’s service sector industries, namely financial services, international service outsourcing, logistics, convention and exhibition, and tourism. Mutual recognition of professional qualifications in banking, law and other professional fields is to help pave the way for such services to develop. Service industries are forecast to account for 53% of regional GDP growth in 2012, and grow to 60% by 2020. The changes in the composition of GDP in PRD from 1980 to 2011 are presented in Table 6.

**Table 6**

**GDP constituent industries in the PRD (in %)**

|  |  |  |  |
| --- | --- | --- | --- |
|  | 1980 | 2008 | 2011 |
| Primary Industry | 25.8 | 2.4 | 2.1 |
| Secondary Industry | 45.3 | 49.9 | 47.9 |
| Tertiary Industry | 28.9 | 47.7 | 50.0 |

Source: Guangdong Statistical Yearbook 2012

**City specialization.** According to the blueprint, Guangzhou and Shenzhen are envisioned as the core regional centers, while the PRD’s eastern and western banks are expected to complement each other by focusing on existing strengths and select industries. While the more developed eastern PRD moves onto financial services, logistics, and convention and exhibition services, the western bank is expected to continue its focus on manufacturing.

**RMB business expansion in Hong Kong and Macao**. The state will continue to support the development of RMB businesses in the two SARs, and conduct further trials of RMB denomination and settlement for the trade with both cities.

**Converging infrastructure.** Emphasis is placed on further boosting the transport links between the east and west sides of the Pearl River estuary. Hong Kong, Macao and the Guangdong cities will become more connected with major new infrastructure projects, including the Hong Kong-Zhuhai-Macao Bridge, expressways and intercity trains, as well as coordinated urban planning and shared policies on water and energy supply. Strengthened coordination between the civil airports and port facilities on the three sides will create a mutually beneficial network. The Guangzhou-Foshan integration in 2009 will be a prototype for more intensified urban development for the whole area.

**Converging social administration.** Authorities on the three sides are to deepen cooperation in anti-smuggling and protecting intellectual property, and reforms will aim to make people movement between the three sides more convenient. Authorities are also to further cooperate on higher education, social insurance, environmental protection, water quality control and wastewater treatment, and epidemic prevention and control.

The Outline Plan also went to some lengths to detail the other economic and political priorities for the PRD region up to 2020. Some of the main themes included:

**Prioritizing advanced manufacturing.** The plan states that the PRD should pursue goals including the setting up of at least two “super automakers” and intensively develop petrochemicals, aircraft manufacturing and pharmaceuticals.

**Strong emphasis on science, technology, research and development.** Over the next decade, authorities hope to see the “Made in Guangdong” model transform to “Created in Guangdong.” Industries and universities in Hong Kong, Macao and Guangdong will strengthen research and innovation cooperation. By 2020, hi-tech industries, including biological research and development and electronics, are to account for 30 percent of overall industrial growth.

**Furthering the “go global” strategy.** The region is to encourage local businesses to internationalize by setting up facilities and resource bases overseas and purchasing small and medium enterprises abroad.

**Finance and enterprise reforms.** As part of the bid for further opening up the PRD, the plan pledges measures such as developing the venture capital sector and picking enterprises to experiment with RMB-denominated international settlement. State-owned enterprises may be reformed into joint-stock companies.

**Integration of rural-urban policies.** Rural infrastructure such as transportation and energy supply will be coordinated and linked up with those in urban areas, and resources will be allocated to raise the standards of basic public services including education and healthcare in rural areas.

**Moving low-value-added industries inland.** Labour-intensive industries will gradually transfer from the PRD to its surrounding areas, which can become the base for manufacturing accessories that support the heavy industries that will take their place in the PRD.

To help achieve these goals, the Outline Plan pledges to reform local administrative systems to make them more standardized across the region, as well as let the government stay out of the market as far as it’s practicable. To cut down on bureaucracy, selected towns with big enough populations and economic output will be assigned county-level authority for social and economic administration; cumbersome administrative fees will be reduced; and an electronic information network is promised so that different cities and towns can all share in the data.

## 4.3 Local policies

On the local level, Hong Kong, Macao and Guangdong provincial authorities have reiterated much the same messages in more detail. In Guangdong, the national 12th Five Year Plan is complemented with a similar Five Year Plan by the provincial government, issued in 2012, which sets out in more detail how the development of selected industries will be supported by local authorities. Some RMB 22 billion was to be allocated locally to invest in and subsidize so-called “strategic emerging industries”, which included biotechnology, new energy, electric cars, and high-end equipment manufacturing. The plan also outlined the establishment of joint research and development projects between selected Greater PRD cities, such as the “Guangzhou-Shenzhen Research and Innovation Axis” and the “Shenzhen-Hong Kong Innovation Circle.”

Hong Kong and Macao, meanwhile, each has parallel framework cooperation agreements in place with the Guangdong government to execute the integration priorities listed in the central government’s strategy plans. The main priority, in both SARs, has been on seeking deeper service trade liberalization between themselves and Guangdong under their respective Closer Economic Partnership Arrangements, although other specific areas of cooperation are also mentioned. In his 2013 policy address, Hong Kong Chief Executive Leung Chun-ying reiterated the strategic significance of enhancing the two sides’ cooperation, especially in finance and other service industries cited in the national 12th Five Year Plan. Leung also underlined the need to improve the access of Hong Kong’s service industries to the Mainland Chinese market, and to expand the city’s offshore RMB business, particularly in cross-border RMB settlement and issuing offshore RMB bonds and securities products. Finally, the leader positioned Hong Kong as a crucial player in the internationalization of China’s commodity futures market, in light of the country’s huge demand for commodities. In Macao, the government prioritizes working with Guangdong officials to expedite the development of Hengqin Free Trade Zone, while other topics on the agenda include coordinating in tourism services development and jointly promoting the Chinese medicine industry, among other tasks.

# 5. ANALYSIS: ACHIEVEMENTS AND WEAKNESSES OF REGIONAL INTEGRATION

## 5.1 Strengths

To date, economic cooperation has unquestionably been the driver and the most successful aspect of regional integration in the Greater PRD. While the process of integration began organically and was predominantly driven by Hong Kong businesses relocating their production chain to the PRD to take advantage of cheap labor and land, after 2003 economic integration became much more formalized and institutionalized under central and local government-supervised regimes such as CEPA.

### 5.1.1 Complementary economies and the “clustering effect”

The success of the PRD as an international manufacturing base needs little exposition, but it’s worth noting a number of factors that have contributed to its achievements. One of the PRD’s strongest assets is the geographical concentration of the supply chain, where clusters of plants involved in the upstream and downstream production of specialized industries operate close to and complement each other. This “clustering effect”, by which all parts and accessories required to assemble a product can be sourced within a relatively small region, has played a crucial role in reducing costs and increasing efficiency.

The advantages and complementarities brought about by the close proximity of Hong Kong and Macao cannot be overstated. The opening up of the PRD helped businesses from Hong Kong expand their production lines across the border, and enabled the city to focus on higher value-added services, especially finances, logistics and management – crucial fields that in turn supported the growth of the PRD. Hong Kong also was key in providing most of the investment, international connections and experiences, and business know-how. Hong Kong and Macao’s linguistic and cultural affinities with the mainland also contributed to the smooth integration. Governmental investment in highway, rail, water and air transport links over the past few decades have vastly improved the ease of goods and people movement within the area. Connectivity continues to improve on all levels – not only between the region’s cities, but also between the cities and their surrounding, less developed hinterlands, as well as with national rail and highway links.

Deepening the existing economic cooperation has largely been perceived as a win-win scenario for all parties due to the complementarity of the economies in the region. The removal of trade barriers has enabled the effective exploitation of the three sides’ resources and strengths. For the mainland, Hong Kong offers the strong regulatory environment, professional institutions and liquid capital markets to expedite the national strategy for businesses to move up the value chain and internationalize. Hong Kong and Macao, on the other hand, have been able to successfully harness the opening of the Chinese market and bounce back rapidly from the Asian financial crisis. For both cities, CEPA has created thousands of jobs and new business opportunities across the border, as well as bringing in huge numbers of affluent mainland tourists and new investments. Some Hong Kong companies have also taken advantage of CEPA to expand their operations beyond Guangdong to other parts of Mainland China, especially in service areas such as construction and real estate. Trade and investment cooperation between Hong Kong, Macao and the PRD has been strongly supported by the governments and business lobby groups in the three sides involved, but it would not have been so successful without support from Beijing, which continues to pay close attention to its implementation and expansion.

### 5.1.2 Administrative cooperation and socio-economic benefits

Somewhat as a side effect of the economic integration drive, closer cooperation between the mainland, Hong Kong and Macao on trade and investment matters have also encouraged deeper cross-border cooperation frameworks in a wide range of other social administrative areas. Notable examples include regional forums and meetings, mostly between the governments of Hong Kong, Guangdong and Macao, to address environmental problems that affect all sides, from water supply and wastewater disposal to pollution cause by industry and ocean-going vessels. Officials in Hong Kong and Guangdong have taken steps to coordinate their environmental policies since the early 1990s. In 2005 they established a regional air quality monitoring network to report a regional air quality index to the public daily; and in 2012, Hong Kong and Guangdong agreed on emission reduction targets in the PRD for 2015 and 2020. The agenda in the past two years have also featured a broad range of other issues, including cross-border exchanges on intellectual property, food safety, medical services, anti-corruption and anti-smuggling measures, though these were inevitably given less priority and assigned more modest targets than the economic and financial themes.

Economic integration also helped bring about an advanced infrastructure network that has been largely successful in lifting the development levels and living standards in the PRD’s second and third-tier cities. Policy makers hope that a more connected PRD will eventually help spread jobs, industrial development and public services more evenly across the region. Barring any major negative economic upsets, the improvement in overall living standards in the region that has been set in motion will continue in the next few years. According to the Outline Plan, by 2020 the region will see a services-dominated economy with an average per capita GDP of RMB 135,000, a more equitable distribution of income, and higher levels of social insurance. Some 85% of the region will be urbanized, and the energy consumption level per capital GDP will be on par with those in developed countries. Residents in the region will be able to easily travel from one PRD city to another within an hour by car or public transport.

## 5.2 Weaknesses

### 5.2.1 Competing interests and lack of overall coordination

Despite the Greater PRD’s many localization advantages and support from the local and central governments, regional integration has been hampered in many cases by numerous institutional obstacles. Competing interests between the region’s cities, local protectionism, multiple and overlapping layers of decision-making systems, and a lack of a transparent legal regime and standardized rules have all constrained cooperation.

Deciphering the layers of interaction and the share of resources and responsibilities between the main institutional actors in the Greater PRD can often be challenging. As we have seen, the central government in Beijing devises the broad national strategies and policies, with occasional specific references to regions such as the PRD. At the local level, the governments of the two SARs (Hong Kong and Macao) each works most closely with the provincial authorities of Guangdong to flesh out and implement these policies, but they must also lobby for the central government’s attention to ensure their interests are addressed - however briefly this may be - in the national planning documents. The two cities also each deals separately with individual municipalities: Hong Kong prioritizes connections with neighboring Shenzhen, while Macao does the same with Zhuhai. Meanwhile, several of the region’s “clustered” metropolitan areas, such as the Guangzhou-Foshan-Zhaoqing area, have their own forum and agenda. The third-tier cities and less developed areas of the PRD have a different set of needs.

Although the sheer number of parallel institutional cooperation frameworks isn’t necessarily in and of itself a constraint, they do highlight the differences in the interests, priorities and resources between the region’s actors. Hong Kong, Macao, Guangdong province and its cities, particularly the larger economies Guangzhou and Shenzhen, each have their own agenda; though they are complementary in many cases, they don’t always line up. For example, the development of Shenzhen’s Qianhai area is ostensibly a joint project to further Hong Kong-Shenzhen cooperation, but Shenzhen officials have been much more keen than their Hong Kong counterparts to push for the construction of a railway linking the zone with the Hong Kong International Airport.

Certainly, each city is eager to secure its own economic growth and focus on particular growth areas, and there is no discernable structure providing an overall, coordinated leadership among the cities. Competition is strong between all the parties involved in attracting FDI and industrial development resources to their destinations. In the Greater PRD, competition has been particularly strong in the fields of logistics and port services, particularly between Hong Kong and Shenzhen. Some of the more developed cities within the PRD itself have also sought to take a lead or outdo each other in regional development, creating challenges especially in infrastructure and urban planning. In some cases, lack of effective coordination has resulted in overinvestment and duplication of expensive infrastructure projects, including highways, sea and river ports, and airports, wasting precious time and resources. Some would argue that the investment in building five major international airports within such a short distance from each other was unnecessary; the initial failure of Zhuhai airport is a case in point. In the planning of other non-profitable infrastructure, such as wastewater treatment plants and other sustainable development measures, efforts were often not coordinated across administrative boundaries and there was no cohesive vision.

### 5.2.2 Institutional obstacles

On a more practical level, different laws and regulations between the three sides as well as local protectionism in various guises occasionally distort the market and hamper the free flow of labour, the division of labour and effective spill-overs of CEPA. Such challenges are particularly pronounced in the recent attempts to liberalize the services sector, which lags far behind liberalization in the trade of goods. The “One Country, Two Systems” principle means certain aspects of integration are inherently problematic; for example, the unification of fiscal or monetary policies or the occurrence of a common currency are unlikely to take place soon. Hong Kong, Macao and Guangdong not only each have their own legal systems, but also differ significantly in their economic structure and market maturity levels. Hong Kong regularly tops world rankings in economic freedom and competitiveness, in sharp contrast to Mainland China, which lacks transparency in its business environment and scores behind developing countries including India and Brazil[[14]](#footnote-14). In the World Bank’s most recent report on the ease of doing business around the world, Hong Kong ranked second behind Singapore, while China ranked 96th out of 189 economies. China did particularly poorly in the category “dealing with construction permits,” ranking among the worst. To the credit of PRD cities, Guangzhou ranked first in enforcing contracts, and third in starting a business, when compared with 30 other Chinese cities[[15]](#footnote-15).

Despite the expanding scope of CEPA, Chan and Zhao[[16]](#footnote-16) accurately point out that “while the main gateway has been opened, the small doors remain closed” for Hong Kong businesses entering the mainland market. This mainly refers to unfavourable institutional factors resulting from existing legal restrictions and regulations, or which are embedded in China’s socio-economic-political environment. The problematic regulations refer to the following specific dimensions:

* financial services,
* logistics,
* business services such as accounting and legal advice,
* non-regulation barriers.

In the financial sector, for example, businesses face a minimum capital requirement and regulations regarding branch networks. Difficult operating conditions and a lack of free market competition additionally intensify the existing bottlenecks. In logistics, service providers from Hong Kong are permitted to operate trucking, rail freight and warehousing business in China via the wholly foreign enterprise framework (WFOEs). Such service providers, however, may not own any air cargo business or hold more than 49% of a Chinese international shipping business, and they must acquire a license. In the legal sector, Hong Kong lawyers who had obtained qualifications to practice in Mainland China cannot take part in arbitration cases and anti-dumping lawsuits, and Hong Kong law firms face restrictions on forming joint ventures with Mainland Chinese firms. These are only a small sample of the obstacles imposed on non-mainland businesses. Other less tangible challenges to further integration of the services sector – as well as many other integration policies – include nepotism and the necessity of personal connections or “guanxi”, petty bureaucracy and poor streamlining of approval procedures, and bribery. Some, such as Chan and Zhao, have suggested that Hong Kong may do better simply focusing on services cooperation with Shenzhen instead of aiming to cooperate with the entire PRD, because the two cities are closest to each other and it would be easier to manage relations with just one entity[[17]](#footnote-17).

### 5.2.3 Unevenness of development pace and related social problems

As in the rest of China, disparity in wealth and income is a persistent trend in the Greater PRD region. Economic growth and development in the PRD has been intensely concentrated around Guangzhou and Shenzhen, while corridors connecting other, larger cities in the region with Hong Kong also benefitted to a lesser degree. The disparity in development level is especially evident between the region’s eastern and western halves, with Guangzhou, Shenzhen and Dongguan in the east far more advanced compared to Zhaoqing, Zhongshan and Jiangmen on the western bank. In 2011, actual FDI in Guangzhou and Shenzhen were US$4,271 million and US$4,599 million respectively, far ahead of the other seven municipalities, especially when compared with just US$730 million in Zhongshan and US$789 million in Jiangmen[[18]](#footnote-18). Income levels in different parts of the PRD are also diverse, especially when comparing a city like Shenzhen, which has the country’s highest minimum wage at RMB1,600 a month, with less developed areas in the far west of the region[[19]](#footnote-19). Despite increasing regional integration in trade, investment and infrastructure, access to basic urban services, education, social protection and welfare services in the region remains far from standardized.

Poor governance and corruption, especially among local officials, can be blamed for low levels of development in some areas. Rural villages that have been marginalized amid the region’s intense rate of industrialization and rapid transition to wealth remain one of the most difficult tasks facing policy makers in the PRD. In the past few years, rural villages in Guangdong have proved to be some of China’s most vulnerable to official abuses of power. Chinese authorities have cracked down on grassroots-level corruption, investigating 78 Guangdong village officials over corruption allegations in 2009[[20]](#footnote-20), but the problem is far from being completely rooted out. Although the Outline Plan of 2008 pledged to improve the coordination of urban and rural development and mentioned plans to secure a better system of social insurance for rural farmers, the lack of concrete measures and the numerous land-grab scandals and related village corruption cases that came to light in recent years give cause to doubt that urban-rural integration policies can run as smoothly as the policy documents describe. Further, the increase numbers of Mainland Chinese seeking to become residents in Hong Kong also suggests that the citizens themselves have more faith in social provisions – from hospitals to education to housing – across the border.

### 5.2.4 Environmental problems

The rapid industrialization and economic growth in the PRD has come at a high cost to the environment. The huge scale of infrastructure construction, including airports, sea and river ports, railways and highways, have brought about large scale loss of arable land and woodland and the creation of hazardous industrial waste. Industrial wastewater entering into the Pearl River has meant that it is no longer suitable for irrigation or recreational use. Cross-border smog pollution is a persistent problem and continues to negatively impact the region’s competitiveness, especially with regard to attracting overseas expatriates. From 2006 to 2012, the regional air pollution index recorded an increase of 13% in the annual ozone average[[21]](#footnote-21).

# 6. OPPORTUNITES AND RISKS

## 6.1 OPPORTUNITIES

The Greater PRD has many favorable factors that could enable the region to transition to the highly urbanized, middle-income and high value-added economy policy makers envision. As mentioned above, localization advantages – namely the complementarity of industries within the Greater PRD, the geographical proximity between the cities, its residents’ ethnic and cultural ties, and a relatively easy flow of people – all work in its favour. An impressive transportation network is already in place, and the region’s push for further development also has the support of the central government in Beijing.

Moving forward, the PRD’s cities could further capitalize on each other’s industrial strengths and take advantage of the favourable business environment offered by Hong Kong and Macao under the “One Country, Two Systems” principle. Hong Kong rightly positions itself as an ideal environment for Chinese enterprises to source capital and become familiar with international corporate practices, rigorous corporate governance and transparent regulatory frameworks – all essential for “going global”. Shenzhen and Guangzhou may be prosperous first-tier metropolises, but they do not come close to matching Hong Kong in its global outlook. In conducting closer economic and financial relationships with the mainland, Hong Kong and Macao businesses could help bring their business practices to their mainland counterparts. Such a process is already under way and will undoubtedly continue to bring benefits to the region and beyond in coming years. Hong Kong’s well-developed legal, financial and marketing sectors will also be particularly helpful to mainland businesses seeking to invest in services. While the services sector in Hong Kong constitutes more than 93% of GDP in 2012, the same indicator for China stands at just 44.6%, lagging far behind for a country with its level of economic development.[[22]](#footnote-22)

### 6.1.2 Qianhai: A potential role model

If the transition to a more services-based economy is successful, the PRD can become the country’s role model in pioneering development of industries such as financial services, insurance, commercial law, accountancy and advertising. In particular, Qianhai in Shenzhen and the other PRD experimental service cooperation zones proposed in the 12th Five Year Plan have great potential as a focal point enhancing Hong Kong-Guangdong integration, and could play a leading role for similar financial liberalization initiatives and reforms in the rest of the country.

For the mainland, the initiative will be a major first step in Guangdong’s drive to develop a cluster of financial, banking and taxation services in Shenzhen with support from Hong Kong. For Hong Kong, cheaper wages and lower office costs will offer relevant businesses the opportunity to relocate across the border. More importantly, Qianhai would likely also boost Hong Kong’s role as a major offshore RMB center and a key base for China to pave the way for the internationalization of the RMB. In January 2013, Hong Kong banks were authorized to offer a total of RMB 2 billion in loans to 15 Qianhai-based companies[[23]](#footnote-23). Qianhai is expected to continue providing further cross-border RMB business opportunities for Hong Kong banks. With their close proximity, the two sides could together form the core of an influential Asian financial services hub when the latter nears completion by 2020. It is important to point out that Qianhai is still in its early stages of development, and it is too early to predict the extent of its achievements. Regardless, there is no question that wider circulation of the RMB will present Hong Kong with huge opportunities for growth in the next decade and beyond.

### 6.1.3. Technological advancement through regional cooperation

Closer cooperation within the Greater PRD is indispensible in the region’s drive to move up the value chain, build a knowledge-based economy and address the region’s current over-specialization in the electronics and telecommunications industries. As mentioned above, officials have identified a plethora of new industries they hope the region can specialize in, from new energy resources development to hi-tech equipment manufacturing to Chinese medicine. Guangdong needs to adopt a much more diversified set of technologies, and deeper regional economic integration can address this in two ways. The relocation of higher value-added companies from Hong Kong and Macao could help provide the necessary technology transfer; more importantly, the region can make better progress toward innovative development by bringing together local governments, universities and the private sector from all sides.

Although so far the cooperation between academia, science and industry is limited, steps have already been taken to stimulate the collaboration of science and education, facilitate the mobility of highly skilled workforce and attract foreign scientists and qualified workers. The establishment of several joint research institutes and science parks, including the Hetao Innovation Park for Micro Electronics and the Nansha City-Guangdong-Hong Kong Science and Technology Innovation Park, will likely be followed by many more like them.

### 6.1.4. Opportunities for further integration and regional policy making

In terms of regional policy-making, the cooperation already in place between the local governments in Guangdong, Hong Kong and Macao has considerable room to expand to allow for greater flexibility and efficiency in the future. Some scholars have cited the initiation of economic reform and opening up in Guangdong and Fujian in the 1980s as typical examples of how the central government under Deng encouraged provinces to pilot reform measures for later adoption across the nation[[24]](#footnote-24). The process of regional cooperation is hence driven by a political process involving local governments serving as “policy entrepreneurs”, actively lobbying for preferential policy treatment with the central authorities in a hierarchical political system. Under such a system, local government actors define their regional strategies so that they are in line with central policy orientation, while attempting to maximize particular local interests in their policy considerations (ibid.). Similarly, others have noted that decentralization and dynamic interactions between the central and local levels of administration allows for policy making through experimentation because the process “gives room for local officials to develop models on their own, while ultimate control over confirming, revising, terminating, and spreading the model experiments rests with top-level decision makers.”[[25]](#footnote-25)

Within the context of the Greater PRD, it’s clear that policy makers at the local level need to find the right balance when negotiating with each other as well as with the central government to implement projects in numerous fields from infrastructure to resource allocation, attracting investment, and tackling environmental problems. Officials from Guangdong province and Hong Kong have had success in lobbying together for central government support for their development plans and subsequent reforms in the whole PRD region. In the future, they would need to do more to secure resources and attention from Beijing and position the region within the nation’s central vision, especially in light of competition from the central and western provinces. Some Hong Kong politicians and scholars have argued that the city has been overly passive in accepting regional integration plans and lack long-term vision; for example, the city does not put out five-year plans like those proposed by Guangdong and Beijing. The region will benefit if Hong Kong takes a more proactive role in devising and proposing social, political and economic policies that are advantageous both to the city and the Greater PRD.

Finally, successful integration in the Greater PRD could serve as a useful lesson and a foundation for a much larger-scale integration network extending to other provinces. A looser cooperation framework encompassing Hong Kong, Macao, Guangdong and eight other provinces called the Pan-Pearl River Delta (PPRD) Regional Cooperation and Development Forum already exists. Set up in 2004, the forum aims to stimulate the economy in the region and reaffirm Guangdong’s economic importance in south China amid the rise of other growth regions in the country. The forum, which includes the Greater PRD and Hainan, Yunnan, Hunan, Jiangxi, Fujian, Sichuan, Guizhou and Guangxi, has already seen some results and can be further formalized to achieve more. A total of 152 enterprises from the Pan-Pearl River Delta region were listed on the Hong Kong bourse in 2012, more than double from 71 companies in 2004.[[26]](#footnote-26) Although the Pan-PRD Forum faces many more challenges to cooperation compared to the Greater PRD, lessons learnt from the latter can potentially bring about wider regionalism within China and better utilization of member provinces’ existing capabilities. There is much potential for Hong Kong and the more developed cities in Guangdong to help mainland officials capitalize on the vast supplies of land, labor and natural resources in the Pan-PRD area. Further regional cooperation could tap the complementarities between the more advanced areas (Guangdong and the PRD) and the less-developed regional hinterland, and help level the bottlenecks in economic development in both the PRD and the rest of the forum’s member provinces.

### 6.1.5. Socio-political implications

In the socio-political realm, Hong Kong and Macao can potentially help Mainland China strengthen its rule of law, overall administrative efficiency, academic research capabilities and general development of civil society through closer cooperation in the Greater PRD. Hong Kong, in particular, prides itself on the many Western-style institutions that the mainland lacks, including the rule of law, an independent judiciary and media, transparent legislative processes and a well-regarded anti-corruption watchdog. Its universities also enjoy a much stronger international reputation and greater academic freedom than their counterparts across the border. As the three sides grow increasingly connected in all aspects of life, Hong Kong and Macao institutions will undoubtedly spread their norms to Guangdong and the rest of China. There is already some evidence that this is taking place. For example, anti-corruption agencies in Hong Kong and Macao have collaborated with their Guangdong counterparts to help small and medium enterprises that operate on both sides of the border understand the different legal requirements and strengthen their corporate governance. Conferences and exchanges between the legal and policy-making communities in Hong Kong and Guangdong also mean that certain legislative concepts, such as consultative processes before bills are put through, are learned across the border.

In wider civil society, political debates in Hong Kong about cross-border issues have provided opportunities for many in Mainland China to air discussions on sensitive topics. When a retiree in Hong Kong filed a legal challenge that halted the construction of the Hong Kong-Zhuhai-Macao Bridge in 2010, the news was positively reported in some mainland news outlets as an example of how ordinary citizens could successfully challenge the government. A major row over Beijing’s interpretation of Hong Kong’s Basic Law also sparked lively debate among scholars and citizens in the mainland. Despite the gradual spread of political discussion and norms across the border, however, one should not assume that regional integration could significantly impact China’s current political and legal institutions. Leaving aside the practical differences – Hong Kong practices Common Law, for example – the institutions as well as the scale and diversity of issues that politicians must respond to in Mainland China and Hong Kong are also completely different. Most politicians in Hong Kong believe it is highly unlikely that Beijing perceives, or will allow, the city to be a testing ground for democratic reforms in the rest of China.

### 6.1.6. The role of Macao

Within the Greater PRD, the role of Macao is one of the least addressed topics for various reasons. The territory’s small size (both geographically and economically) and its tiny population mean its contribution to the region’s economic integration is relatively insignificant. More importantly, perhaps, the unique and overwhelming dependence of Macao’s economy on gaming and tourism has made it difficult for policy makers to come up with a way to fit the territory into a coherent narrative of regional integration. As the only region in China where gambling is legal, Macao has enjoyed unprecedented economic growth in its GDP and tourism industry in particular since the liberalization of the gaming license in the territory in 2002. The territory also benefits from its status as one of the freest economies in the world. Its growth, however, is hugely dependent on visiting Mainland Chinese tourists, and Macao’s rosy development can easily be jeopardized by the prospect of legalized gaming in Mainland China. The territory’s economy also faces significant sustainability challenges, with its lack of land for expansion, heavy reliance on imported labour, and with the majority of jobs currently in relatively low-skilled service sectors.

So far, Macao and Guangdong authorities have focused on building up Macao’s tourism facilities beyond gaming, as well as proposing for the two sides to jointly develop the Chinese medicine industry. Officials are also exploring opportunities for Macao to harness its Portuguese history and serve as a gateway for more business opportunities between China and Portuguese-speaking countries. It is too early to tell whether these ventures will achieve substantial success. It could be argued, however, that despite the challenges it faces Macao will potentially become the biggest winner in the Greater PRD because the benefits it reaps from the region’s success far outweigh its contributions. The development of Zhuhai, the Hengqin economic zone and the completion of the Hong Kong-Zhuhai-Macao Bridge will almost certainly boost Macao’s attractiveness as a tourist destination, bring many more opportunities for growth and economic diversification for Macao. Without linkages to the PRD, Macao’s potential to develop on its own would be very limited indeed.

## 6.2 CHALLENGES AND THREATS

The vision for the Greater PRD in the next few years as projected by the 12th Five Year Plan and the Outline Plan for Reform and Development is clear: To achieve sustainable growth, the region needs to transition to a more value-added, services-oriented economy. Despite the ambition and optimistic tone of the policy plans, however, the Greater PRD clearly has some ways to go before it can realize that vision. The central and provincial governments are already trying to address some of the threats. For example, to address the PRD’s dependence on foreign investment, the Outline Plan proposed experimental Sino-foreign equity joint ventures as well as shifting the emphasis from foreign capital to technologies, managerial experience, and highly skilled workers. Yet there remains many more challenges and risks that could derail the region’s successful integration and restructure.

### 6.2.1 Regulatory environment

One of the biggest question marks going forward is whether the region (and the rest of China by extension) can become adequately equipped with the business environment and regulatory institutions to enable its transition from a manufacture-dominated economy to a more sophisticated one. A transparent judiciary framework and public service, as well as ample protection of intellectual property rights, are particularly vital to the development of the key industries – namely financial services, innovative technology, and research and development – projected to lead the region’s economy. Despite pledges by the central government and provincial authorities, there is little evidence that suggests a significant improvement is on its way in the next few years. Even the Outline Plan itself contains some contradictory statements in this regard. On the one hand, it makes various pledges to foster a more democratic and transparent government, to “cement [the] spirit of contract, the notion of rule of law… a sound legal system, a transparent and stable commercial system, and standardized mechanism for business dispute settlement”. Yet on the other hand, it also states that authorities would tighten supervision of the media and the Internet – measures that appear incompatible with more open and fair institutions.

Given China’s current low rankings in openness and ease of doing business, many are not optimistic. According to a recent report issued by the American Chamber of Commerce (AmCham) in South China, regulatory issues (including tax, customs and industry regulation) were perceived by foreign businesses to be the top challenge that would hinder their growth in the next few years. The report added that this has been the primary concern since 2006, suggesting that business confidence in China’s regulatory transparency has not improved since then[[27]](#footnote-27). Further, in 2012, a business confidence survey conducted by the European Chamber of Commerce in China stated that 40% of companies questioned believe that Chinese government policies toward foreign enterprises are less fair than they were two years ago. The survey further reveals that nearly a quarter of member companies are considering moving investments out of China[[28]](#footnote-28).

### 6.2.2 Competition from other provinces and urban clusters

The PRD region had a head start on economic development in 1979 and for years was the unrivaled leader in Chinese exports and manufacturing. That is no longer the case. In the past decade or so the PRD region’s competitiveness has decreased vis-à-vis other rapidly growing urban areas in the rest of China. As mentioned in the overview, several mega-city clusters – the Yangtze River Delta region led by Shanghai in the east, the Bohai Bay Economic Rim (Beijing-Tianjin and parts of surrounding provinces) in the north, and the inland Chengdu-Chongqing Area – have received significant stimulus measures by the central government. These regions have seen infrastructural integration similar to that in the PRD, expanded their export-oriented manufacturing capabilities, and have been catching up in terms of industrial output, foreign trade and investment. Most recently, the announcement of a pilot Shanghai Free Trade Zone in September 2013 has somewhat dampened the excitement surrounding the new PRD experimental zones, particularly Qianhai. It also raised some alarm bells among Hong Kong’s business sector, which has long voiced concerns that the city’s status as China’s foremost financial hub will be overtaken by Shanghai.

The extent of competition between China’s economic regions can often be exaggerated by the business sector and the media, though in some ways there are very real reasons to be concerned. Given limited resources, areas that fail to lobby their way into the national five-year plans do tend to suffer from a lack of central government attention and subsequently a lose of momentum for pushing through initiatives. Thus regional competition in China often looks for all intents and purposes like a zero-sum game. The PRD remains one of the most economically important and strategically crucial areas within China, but it would need to maintain its position of priority on the central government’s agenda in coming years.

### 6.2.3 Labour shortages

In addition, all the regions mentioned above are competing for human resources amid a labor shortage that has been affecting the country in the past few years. Within the PRD, rising minimum wages – especially in Shenzhen – and better welfare for migrant workers aim to attract and retain the labour force, but at the same time the measures (in addition to general inflation and increased costs of land resources) are also pushing many multinational companies to relocate to less developed inland cities and Southeast Asia in search of lower wages. In the long term, such low-waged labour isn’t what the PRD needs to sustain its restructuring plans, and rising wages may be a structural rebalancing process[[29]](#footnote-29). Looking ahead, a more pressing challenge is not the quantity of workers the PRD can attract but the right quality that can adapt to the needs of the planned transition. In the same AmCham report mentioned above, the lack of qualified professionals in the region, particularly managerial and specialist talent, was perceived by businesses as one of the top five challenges to growth in the next three years. Further integration within the Greater PRD will enable Guangdong to harness Hong Kong’s human resources, especially in fields such as banking, insurance, commercial law, advertising and accountancy. But Guangdong itself will need to strengthen policies to raise the overall education level in the province as well as attract and retain a highly skilled work force to the PRD in order to implement the transition to a more value-added economy.

### 6.2.4 The role of Hong Kong and the future of “One Country, Two Systems”

Taking a longer-term view, the uncertain future of “One Country, Two Systems” and Hong Kong’s changing role in the Greater PRD (and the rest of the country) poses some potential challenges. Historically, the city has been the unique gateway for international capital to enter Mainland China. But as cities across the border mirror Hong Kong’s development path, turning their backs to low value-added manufacturing and becoming more internationalized, Hong Kong will inevitably lose its competitive edge. The development of Shenzhen’s Qianhai area – envisioned to be, in essence, a “mini-Hong Kong” providing similar financial services and offshore RMB businesses – has prompted fears that this erosion is already starting to take place. Indeed, how the Greater PRD could “develop a system of service industries *to match Hong Kong* as an international financial center” but have a “*different positioning from Hong Kong and Macao*” (from the Outline Plan; emphasis added) is a question that has no easy answer.

“One Country, Two Systems” is Hong Kong’s biggest advantage and most important differentiator. Thanks to the principle, the city enjoys a reputation as the most cosmopolitan city in China, boasting a business and legal environment most friendly to overseas investors. Yet its autonomy is only guaranteed for 50 years, and there is no telling what lies in wait after 2047. This uncertainty does not affect the Greater PRD as a region as much as it impacts Hong Kong as an individual city. To avoid losing its competitive edge, Hong Kong’s government will need to develop longer-term strategies about its place in southern China, maintain the quality of the city’s services and upgrade its skills to differentiate itself from the rest of the PRD and the country at large.

### 6.2.5 Social and environmental challenges

Uncertainty about Hong Kong’s future isn’t only a potential destabilizer in economic terms; it has also prompted wider social unease as well as resistance to regional integration. An ongoing and increasingly vitriolic debate between those who support preserving Hong Kong’s unique assets and those pressing for further integration with China could slow down or threaten regional cooperation. In recent years Hong Kong civil society has seen a vocal anti-China backlash, with many residents and politicians expressing worries that prioritizing “One Country” would eventually erode the “Two Systems” principle. One of the main arguments is that deeper social, political and economic ties with the mainland risk undermining the autonomous aspects of government and democratic values that many in the SAR treasure, namely freedom of the press, freedom of speech and the right to gather for protests. For example, Hong Kong is the only place in China that holds annual protests against Beijing’s crackdown on Tiananmen protesters in 1989.

The governments of Guangdong and Hong Kong have been criticized for being slow to respond to a number of undesirable socio-economic side effects brought about by the increasing ease of cross-border movement in people and money in the past few years. Many in the SAR are concerned, for example, about pregnant women from the mainland crossing the border to give birth in Hong Kong because they drain local hospital resources. The inflow of new immigrant children is also perceived to be a threat to the city’s education system. Even as numerous businesses continue to benefit from the huge inflow of newly affluent Chinese consumers, many residents resent the way Mainland Chinese cash have distorted the Hong Kong economy – for example by investing in the city’s property and pushing up prices so that ordinary workers are priced out of the market. In 2012, Chief Executive Leung appeared to suggest that the buffer zone between Hong Kong and Shenzhen could be commercially developed, triggering fears that the two cities would merge at the borders – a prospect that many in Hong Kong would not relish. So far, it is unclear how the city – and Beijing – will deal with the dilemma between a desire to maintain separate cultural and political identity and the inevitable trend for close economic integration.

Further integration will likely bring about other negative social implications on the quality of life in the region. An even greater rate of urbanization, for example, will almost certainly bring about further environmental strains on all three sides. New solutions for coordinated urban planning must be implemented to sustainably and jointly share responsibilities for water, energy and transportation development. Collaboration is further necessary to prepare for non-traditional security issues, including risk control measures for natural disasters, diseases, and regional financial crises.

# 7. IMPLICATIONS FOR THE EU

For the EU, the Greater PRD offers a wealth of opportunities for economic and political exchange. A number of complementary factors mean that each side can benefit from exploring further ties. European countries are home to an abundance of creative industries, high technology companies and research and development resources that the Greater PRD, and the rest of China, needs and lacks. They have a long history of regional cooperation in dealing with cross-border issues such as transportation, urban sprawls and environmental protection, and also boast some of the world’s best enterprises in sustainable development. These experiences can provide invaluable help to the PRD. Meanwhile, many EU countries need Chinese investment to recover from the recession, and most will welcome increased access to the Chinese market.

Cooperation between Europe and the PRD on a city-to-city level has recently started to take place. On the initiative of former Premier Wen Jiabao and EU leaders at the 14th EU-China Summit in Beijing in February 2012, a new urbanization partnership was launched. The EU-China Mayors’ Forum was held for the first time alongside the 15th EU-China Summit in Brussels in 2012, providing an opportunity to discuss cooperation opportunities on sustainable urban development between Chinese and EU cities, including town twinning. This new form of dialogue and cooperation serves as a third pillar of institutional architecture between the EU and China, alongside the EU-China High Level Strategic Dialogue established in 2007 and the High Level Economic and Trade Dialogue, established in 2010.

## 7.1 Political and economic implications

As socio-economic and political integration in the Greater PRD region deepens, Hong Kong, Macao and Guangdong can no longer be treated as isolated entities. While EU officials should continue to maintain and build on their existing bilateral relations with Hong Kong, Macao and mainland China, it will become increasingly important to coordinate EU policies toward all three sides and take into account the interactions and interdependence of the administrations. This is important particularly with regard to cross-border issues in the Greater PRD such as cooperation in the trade, customs, financial and environmental areas. In the political realm, it would be impossible for the EU to devise policies and commentary on Hong Kong and Macao’s democratic development without giving significant consideration to Beijing’s interests in the subject.

In developing further trade and investment relations with China, the EU can draw some lessons from the challenges in implementing CEPA as outlined above. The latest EU-China Summit in November 2013 launched new negotiations between the two sides aimed at progressive liberalization of EU-China investment opportunities and boosting the two sides’ trade. The negotiations are expected to result in a deal that covers both investment protection and market access for both sides. Although it’s early days yet, it appears likely that many of the limitations in closer economic cooperation within the Greater PRD – in particular, the difficulties arising from deep-set legal and socio-economic structural differences, the multitude of restrictions and local protectionism measures, and the lack of a uniform and transparent regulatory environment within China - will repeat themselves on a larger scale in the EU-China context. EU officials should consider dialogue with the Hong Kong and Macao governments for the express purpose of sharing experience in this regard and, where appropriate, working together to cope with these potential obstacles.

## 7.2 Opportunities for the EU

There are several key take-away points for the EU with regard to opportunities provided by the development and integration of the Greater PRD. Firstly, EU policy makers should study and respond to China’s desire for its businesses to “go global” through joint ventures or buying up small to medium enterprises abroad. As many have pointed out[[30]](#footnote-30), Europe is overtaking Asia and developing countries as the foremost destination for Chinese overseas investment. Policy makers should note in particular that such direct investments are likely to focus on the key industries that China is looking to develop, as per national strategies mentioned earlier: financial services, innovative technologies, new energy, and advanced and high value-added manufacturing such as petrochemicals, biotechnology, autos and aviation. Secondly, given the importance placed on developing innovative technology and more knowledge-based industries in the region, there is high potential for growth in university and research collaborations between the EU and the Greater PRD. Many European academic institutions are held in high regard in China, and there is huge scope for more joint work in research and development, institution twinning programs, and other education exchanges.

Thirdly, EU companies in relevant fields seeking capital or expansion opportunities should actively look for opportunities for merger and acquisitions with Guangdong businesses. Such ventures could allow European businesses to grow their market in China through easier market access, distribution channels and networks, while the Chinese side can make use of the process to adopt international practices, acquire modern managerial skills and technical knowledge – all benefits that can be transferred to the domestic market and contribute to development at home. At the same time as identifying and attracting Chinese investment to individual countries, European countries will need to prioritize the coordination of their strategies toward China. As the ECFR’s Godement and Parello-Plesner argued, the EU needs to leverage its market size and take steps to ensure European companies can compete in China just as Chinese firms can in Europe[[31]](#footnote-31).

## 7.3 What can EU institutions offer?

Outside of economic and business exchanges, the EU has a wealth of history and experience to share with the Greater PRD regarding regional integration in general, and cross-border cooperation to tackle common issues such as urban sprawls, pollution, migrant integration and joint infrastructure projects. To be sure, the EU is hugely different to the PRD in a multitude of socio-political, historical and economic aspects, and lessons from the EU will often not be applicable in the Greater PRD. The Chinese political system is far from democratic; a common currency like the euro isn’t on the cards in the Greater PRD; and European-style common legal, fiscal or monetary policies are also highly unlikely as long as “One Country, Two Systems” exists.

Yet like the PRD, EU integration and expansion also began with economic cooperation – in its case through the European Economic Community (EEC), which established customs union and a common market through gradually reducing and eliminating existing barriers to the flow of goods, services, capital and labour between member countries. It was from that basis that institutions were built up to plan and establish a common currency, help even out regional wealth distribution by means of a development fund, iron out differences in national trade regulations, and devise common security policies. Common laws and a EU Parliament coexist with national laws and legislatures, and deeper political unification is discussed and considered. Despite its shortcomings, the EU is by most measures the most successful example of cross-border cooperation and multilateral governance in the world.

For policy makers in the PRD looking for strategies for deepening regional integration beyond trade and economic ties, the EU has much to offer. The two sides could build on dialogue forums such as the EU-China Mayors’ Forum and start by elaborating on some of the more practical and lower-level avenues of socio-political integration between regions and cities. On transportation and border controls, for example, the EU has some of the world’s best systems in easing the movement of tourists and commuters across borders, such as common train tickets and single visas for the whole Schengen region for non-EU visitors. Such lessons are relatively easy to apply to the context of the Greater PRD. Some of the EU’s cross-border city-level dialogue and policy integration frameworks can also serve as valuable case studies. The Eurocities project and CLIP (Cities for Local Integration Policies) enable multiple cities in different European countries to exchange experiences tackling urban issues such as urban regeneration, education and culture, and the integration of migrants. Such groupings have particularly highlighted issues unique to cities that are neglected by national governments, and they have allowed cities to jointly lobby EU institutions for more executive power and greater flexibility in budgeting and policies to safeguard their interests.

# 8. CONCLUSION

Driven by the central government’s opening up policies and market forces, Guangdong, Hong Kong and Macao took advantage of their proximity and began an organic form of economic integration in the 1980s. Together the three sides created China’s manufacturing and exports heartland. Today the Greater PRD region is not only highly economically interdependent, but is pursuing increasingly institutionalized initiatives to pursue further regional cooperation in the development of financial services, infrastructure projects, easier people flow and integrated social administration. Such strategies are integral to restructuring the region, which in turn enhances its competitiveness both within China and in the world. Closer and deeper integration is inevitable, and the economic future of Guangdong, Hong Kong and Macao all depend on it to a great extent.

On an economic level, closer integration within the Greater PRD should aid its transition to a more modernized, open and services-oriented economy. Such reforms, if successful, will serve as an exemplar and spread to the rest of the country, helping open and restructure the wider Chinese economy, especially the financial and services sectors. Pilot cooperation zones like Qianhai will enable Mainland China to further learn from Hong Kong’s internationalized business environment and tap its potential as a base for advancing RMB internationalization. These are all developments that have ramifications for EU-China economic policy and European businesses that have a stake in China. In socio-economic terms, the intense rate of urbanization and growth of metropolitan clusters in the PRD region should continue to lift living standards. The benefits of integration will spill over to larger regional groupings, such as the Pan-Pearl River Delta forum.

Some have optimistically compared the growth path of the PRD to that of South Korea, which evolved from advanced manufacturing to innovative technology and developing its own globally recognized super-brands. However, the PRD still has a long way to go, and its regulatory environment and labour force both have steep learning curves to adapt to the transition. More broadly, many weakness and challenges within the Greater PRD would need to be confronted and resolved before ambitious reforms and deeper integration can successfully take place. The uneven level of economic development, competing interests and the stark contrast between the legal and fiscal regimes between Mainland China and Hong Kong and Macao under “One Country, Two Systems” have hampered the creation of an effective cooperative framework. The region has also suffered at times from a lack of coherent policy and common vision. Going forward, the region needs a much stronger institutional framework to coordinate the priorities of the different parties involved, identify clear common goals and address the long-term implications of the changing roles of Hong Kong and Macao in relation to the mainland. Such a framework should include master plans for coordinated and sustainable urban planning and infrastructure building.

Taking a broader perspective, the Greater PRD illustrates the many challenges of balancing and managing intergovernmental interactions in an environment restricted by the role of the state in the Chinese economy and the executive supremacy of the central government. Despite these circumstances, the PRD must implement market reforms to facilitate genuine competition and a level playing field in order to move up the development ladder. By focusing on a region that is expected to take the lead role in national economic reforms, this paper has outlined some of the practical difficulties and factors to consider in carrying out lofty and ambitious national restructuring strategies. Cooperation and integration in the Greater PRD may serve as a small scale but valuable example of the opportunities that can be gained from such interactions.

Effective bilateral and multilateral relations at the provincial, sub-provincial, county, and municipality levels will be crucial for the sustainable development of China. In this regard, the EU has valuable lessons to share. As integration deepens in the Greater PRD, EU officials should leverage their existing bilateral relations with Hong Kong and Macao, which both share many of Europe’s values and institutional structures, to gain up-to-date insight on regional developments and contribute where appropriate. Such steps will strengthen the EU’s negotiating position not only in the region, but in the rest of China as well.

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# ANNEX





Figure 1

Greater PRD transportation plan – distribution of high speed rail stations, high speed railways, airports, roads highways

Source: extracted through Harvard Geospatial Library.

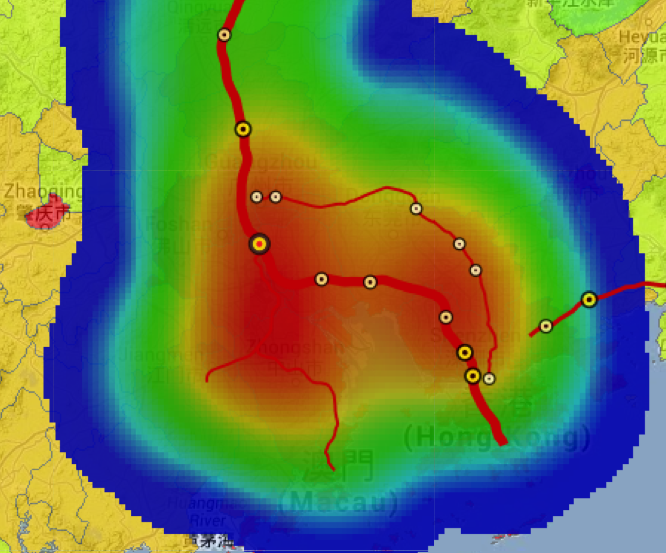




Figure 2

High speed train density and population density in the Greater PRD

Source: extracted through Harvard Geospatial Library.

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