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## INFORMATION NOTE

### Relocation of the Manufacturing Sector Outside Hong Kong in the 1980s and the early 1990s

#### 1. Figures About the Manufacturing Sector

1.1 It was clear from our brief study that there were signs of the manufacturing sector shrank in the 1980s and the early 1990s. We summarize the findings in the following tables and charts.

1.2 Statistical data on the development of the manufacturing sector from 1989 to 1992 clearly showed a certain reduction in the contribution that the manufacturing sector made to the Hong Kong economy. The number of establishments and the employment in the manufacturing sector are good indicators of this trend.

#### Annual Average Number of Establishments in the Manufacturing Sector

1.3 Table 1 and Chart 1 show that the annual average number of establishments in the manufacturing sector began to decrease in 1990. In the 1990 - 1992 period, the rates of reduction accelerated: 1990 (-2.1%), 1991 (-4.9%), and 1992 (-8.7%). The annual average number of establishments experienced a consistent downward trend in the 1990s. The rates of change are detailed in Chart 2.

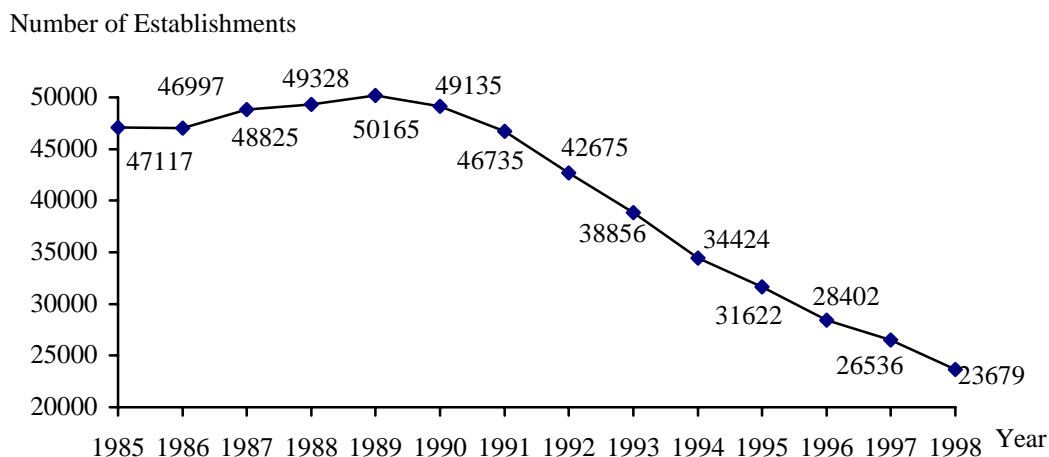
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**Table 1 - Annual Average Number of Establishments in the Manufacturing Sector**

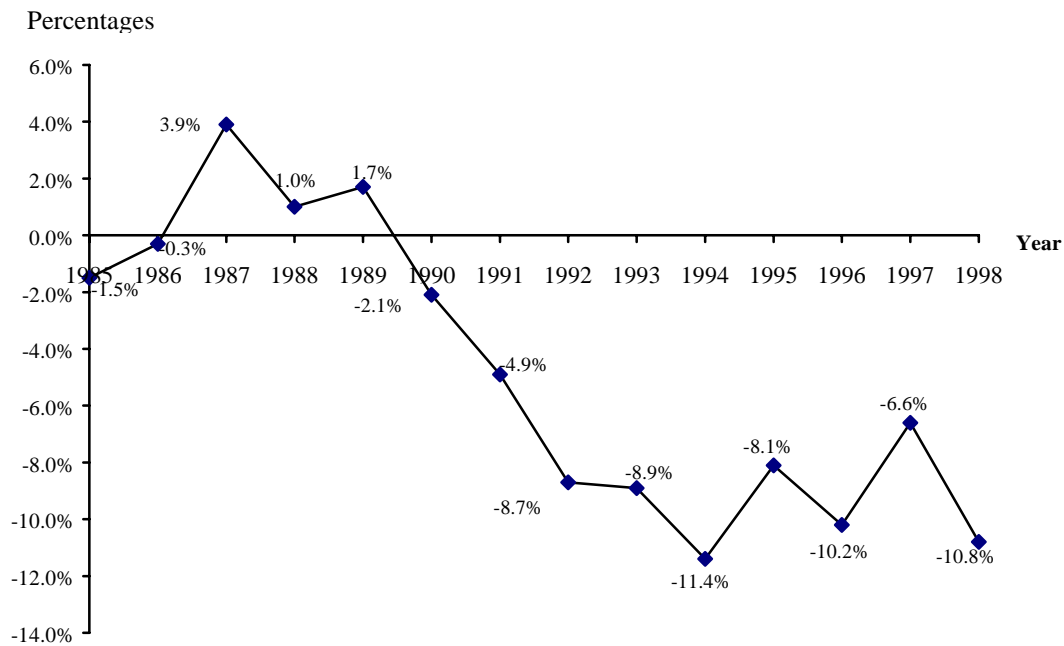
Year	Number of establishments	Change over Preceding year (%)
1985	47 117	-1.5
1986	46 997	-0.3
1987	48 825	3.9
1988	49 328	1.0
1989	50 165	1.7
1990	49 135	-2.1
1991	46 735	-4.9
1992	42 675	-8.7
1993	38 856	-8.9
1994	34 424	-11.4
1995	31 622	-8.1
1996	28 402	-10.2
1997	26 536	-6.6
1998	23 679	-10.8

Source: Financial Services Bureau

**Chart 1 - Annual Average Number of Establishments in the Manufacturing Sector**

Source: Financial Services Bureau

**Chart 2 - Rates of Change in Annual Average Number of Establishments in the Manufacturing Sector**



Source: Financial Services Bureau

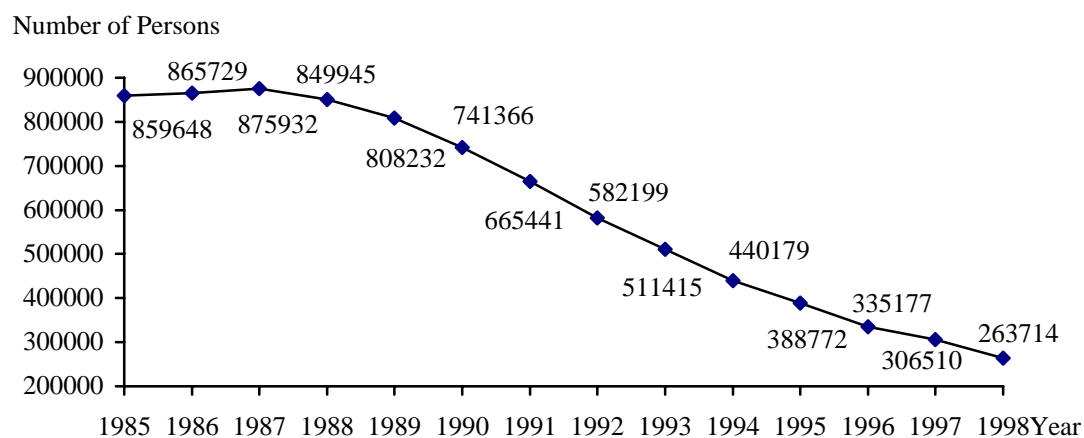
### Employment in the Manufacturing Sector

1.4 The pattern of change in the number of persons engaged in the manufacturing sector was similar to that for the annual average number of establishments in the manufacturing sector (see Table 2 and Chart 3). Employment in the manufacturing sector started to drop in 1988, and the rates of decrease accelerated annually in the 1989 - 1992 period. Chart 4 shows the rates of change of employment in the manufacturing sector.

**Table 2 - Employment in the Manufacturing Sector (Annual Average)**

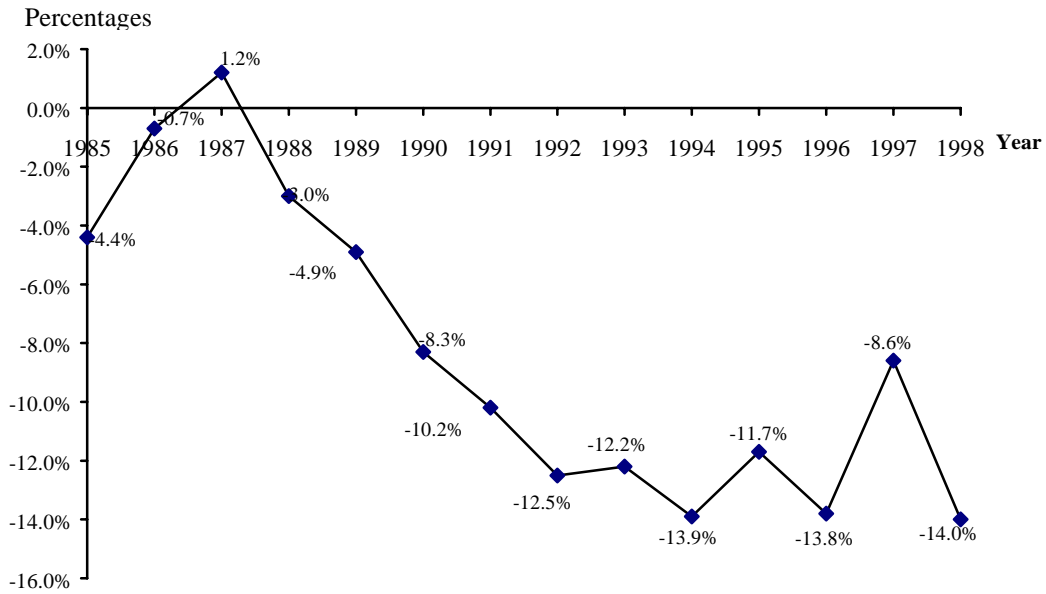
Year	Number of persons	Change over preceding year (%)
1985	859 648	-4.4
1986	865 729	0.7
1987	875 932	1.2
1988	849 945	-3.0
1989	808 232	-4.9
1990	741 366	-8.3
1991	665 441	-10.2
1992	582 199	-12.5
1993	511 415	-12.2
1994	440 179	-13.9
1995	388 772	-11.7
1996	335 177	-13.8
1997	306 510	-8.6
1998	263 714	-14.0

Source: Financial Services Bureau

**Chart 3 - Employment in the Manufacturing Sector (Annual Average)**

Source: Financial Services Bureau

**Chart 4 - Rates of Change of Employment in the Manufacturing Sector**



Source: Financial Services Bureau

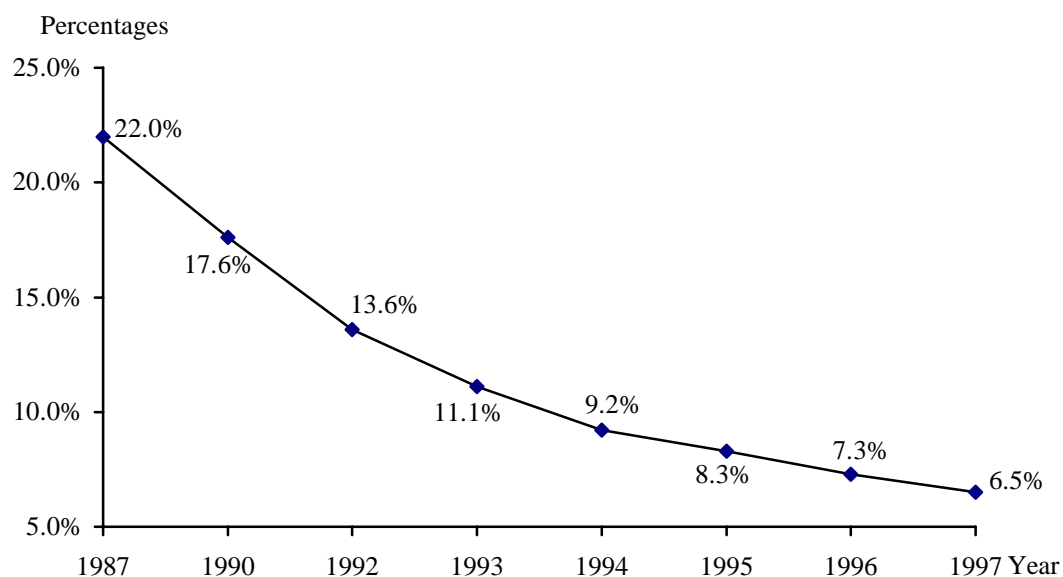
Contribution to Production-based Gross Domestic Product by the Manufacturing Sector

1.5 The percentage contribution to Gross Domestic Product (GDP) by manufacturing activities dropped since the mid-1980s, from 22.0% in 1987 to 13.6% in 1992 (see Table 3). It can be seen that the manufacturing sector lost its relative economic share during the period. Chart 5 provides the percentage shares of the manufacturing sector in production-based GDP at factor cost.

**Table 3 - Contribution to Production-based Gross Domestic Product at Factor Cost by the Manufacturing Sector**

Year	Value (in HK\$ Million)	Percentage share of the manufacturing sector in production-based Gross Domestic Product at factor cost (%)
1987	80,713	22.0
1990	98,352	17.6
1992	99,764	13.6
1993	92,582	11.1
1994	87,354	9.2
1995	84,770	8.3
1996	82,769	7.3
1997	82,156	6.5

Source : Census and Statistics Department, *Hong Kong Annual Digest of Statistics 1998* and *Hong Kong Monthly Digest of Statistics April 1999*.

**Chart 5 - Percentage Shares of the Manufacturing Sector in Production-based Gross Domestic Product at Factor Cost**

Source : Census and Statistics Department, *Hong Kong Annual Digest of Statistics 1998* and *Hong Kong Monthly Digest of Statistics April 1999*.

### Industrial Production

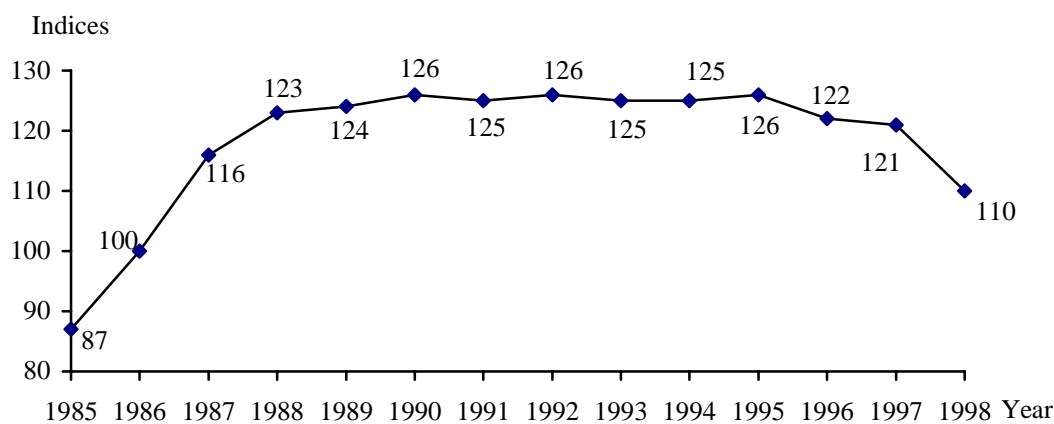
1.6 The index of industrial production is used to reflect the changes over time of local manufacturing output in real terms. As shown in Table 4 and Chart 6, the local manufacturing output increased considerably in the 1986 - 1988 period. However, the industrial production was slack in the 1989 - 1992 period. Chart 7 shows the rates of change of industrial production.

**Table 4 - Index of Industrial Production**

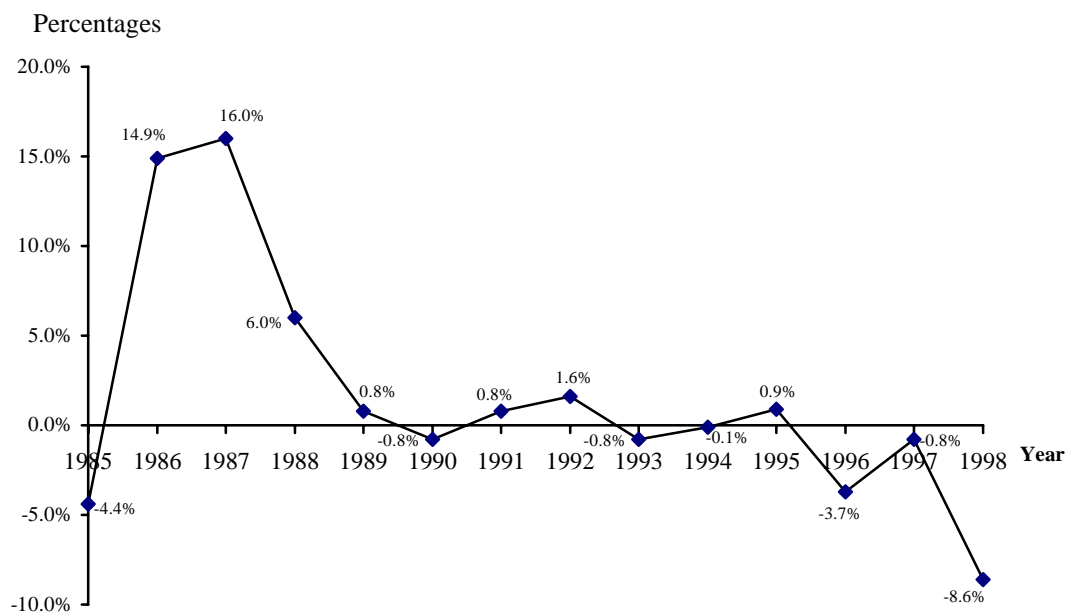
Year	Index (1986 = 100)	Change over preceding year (%)
1985	87	-4.4
1986	100	14.9
1987	116	16.0
1988	123	6.0
1989	124	0.8
1990	126	-0.8
1991	125	0.8
1992	126	1.6
1993	125	-0.8
1994	125	-0.1
1995	126	0.9
1996	122	-3.7
1997	121	-0.8
1998	110	-8.6

Source: Financial Services Bureau

**Chart 6 - Index of Industrial Production**



Source: Financial Services Bureau

**Chart 7 - Rates of Change of Index of Industrial Production**

Source: Financial Services Bureau

### Volume of Domestic Exports

1.7 In volume terms, domestic exports grew rapidly in the 1986 - 1988 period, but were slack between 1989 and 1992 (see Table 5 and Chart 8). Chart 9 shows the rates of change of volume of domestic exports.

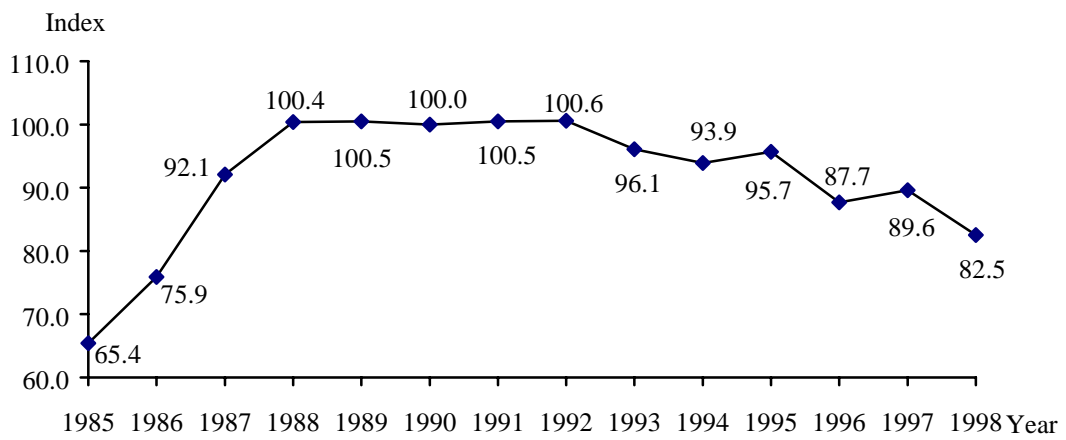
**Table 5 - Volume of Domestic Exports**

Year	Index (1990 = 100)	Change over preceding year (%)
1985	65.4	-5.4
1986	75.9	16.1
1987	92.1	21.3
1988	100.4	9.0
1989	100.5	0.1
1990	100.0	-0.5
1991	100.5	0.5
1992	100.6	0.1
1993	96.1	-4.5
1994	93.9	-2.3
1995	95.7	1.9
1996	87.7	-8.4
1997	89.6	2.2
1998	82.5	-7.9

Source: Financial Services Bureau

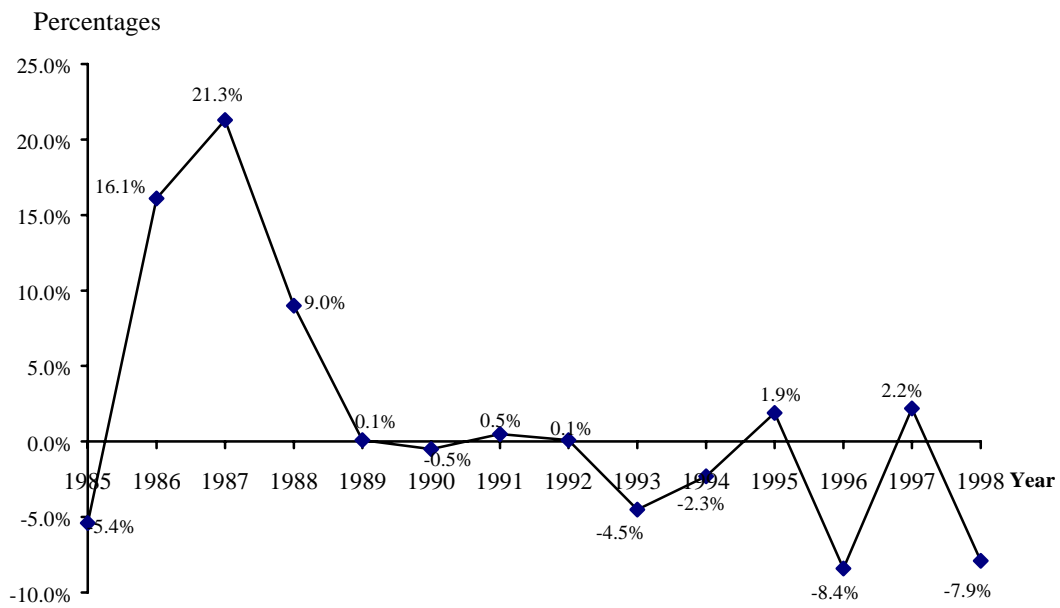


**Chart 8 - Volume of Domestic Exports**



Source: Financial Services Bureau

**Chart 9 - Rates of Change of Volume of Domestic Exports**



Source: Financial Services Bureau

## 2. China Light & Power Company, Limited Was Aware of the Relocation of Their Manufacturing Customers

2.1 China Light & Power Company, Limited (CLP) was aware of the relocation of the manufacturing sector outside Hong Kong: in 1988 it observed a slowdown in the growth in demand from the manufacturing sector and in 1990 it observed “migration” of manufacturing customers away from Hong Kong.

### CLP’s Sale of Electricity to the Manufacturing Sector

2.2 As shown in Table 6 and Chart 10, CLP’s electricity sales to the manufacturing sector increased remarkably in 1986 and 1987. The growth slowed down in 1988 (4.2%), and decreased in 1990 (-1.3%) and 1992 (-3.5%). Chart 11 shows the rates of change of CLP’s sales of electricity to the manufacturing sector.

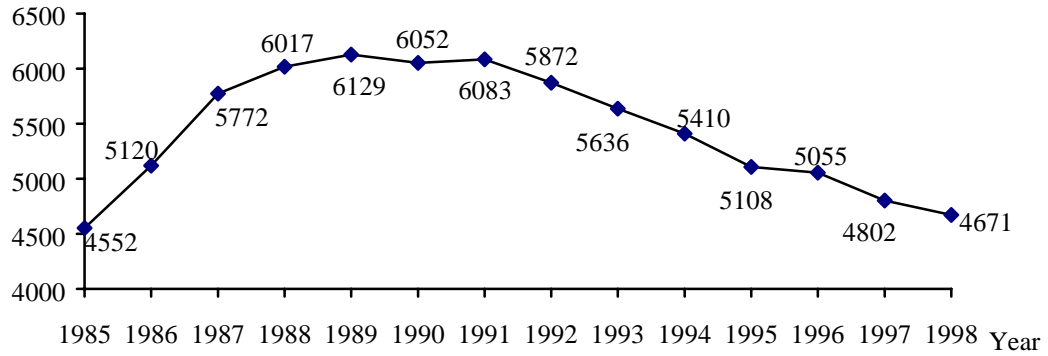
**Table 6 – CLP’s Sales of Electricity to the Manufacturing Sector**

Year	Sales of electricity to the manufacturing sector (GWh)	Change over preceding year (%)
1985	4 522	-0.2
1986	5 120	13.2
1987	5 772	12.7
1988	6 017	4.2
1989	6 129	1.9
1990	6 052	-1.3
1991	6 083	0.5
1992	5 872	-3.5
1993	5 636	-4.0
1994	5 410	-4.0
1995	5 108	-5.6
1996	5 055	-1.0
1997	4 802	-5.0
1998	4 671	-2.7

Source: Financial Services Bureau

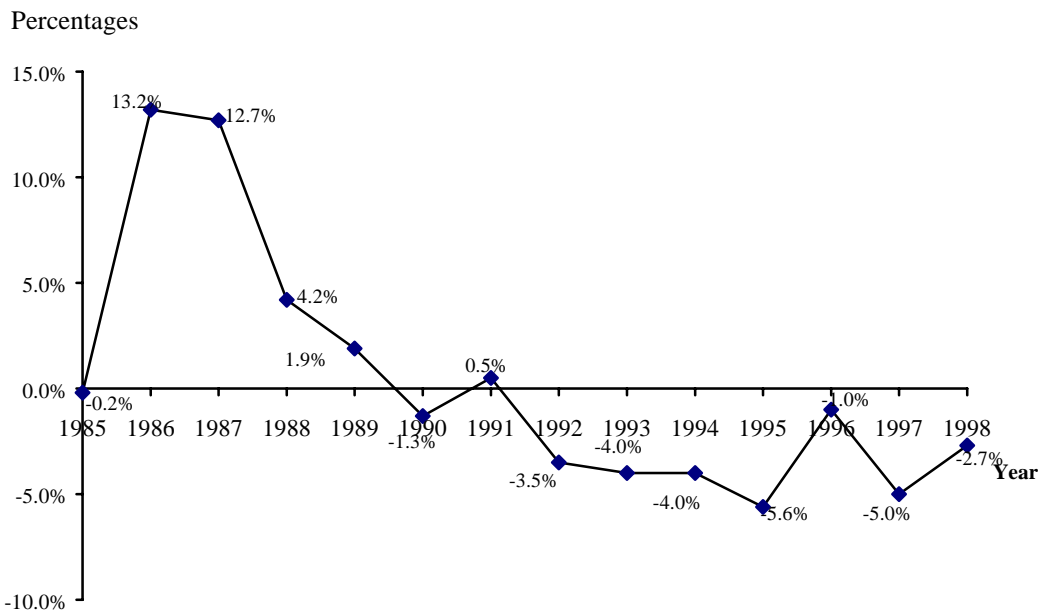
**Chart 10 – CLP’s Sales of Electricity to the Manufacturing Sector**

Sales of Electricity to the Manufacturing Sector (GWh)



Source: Financial Services Bureau

**Chart 11 - Rates of Change of CLP’s Sales of Electricity to the Manufacturing Sector**



Source: Financial Services Bureau

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### CLP's Comments on Sales of Electricity to the Manufacturing Sector

2.3 CLP's annual reports 1985 - 1992 indicate that it was fully aware of the trend of relocating manufacturing factories outside Hong Kong in the early-1990s. Relevant comments on sales of electricity to the manufacturing sector in the 1985 - 1992 annual reports are extracted below:

*"Sales to the manufacturing sector reflected a decrease of 0.5%. The principal cause of this reduction was the absence of growth in Hong Kong's exports due to weakening market demand in the United States."*

Source: CLP, *Annual Report 1985*, page 9.

*"Sales to the manufacturing sector rose by 11.8% for the year. Increased demand by this sector was largely attributable to a revival in exports to the OECD countries. This increase reflects the inherent strength of the Hong Kong economy."*

Source: CLP, *Annual Report 1986*, page 11.

*"Sales to the manufacturing sector rose by 14.7% for the year. This indicates sustained growth in manufacturing activity."*

Source: CLP, *Annual Report 1987*, page 10.

*"Sales to the manufacturing sector showed a smaller increase of 4.4%, reflecting the slowdown in manufacturing activities in the year."*

Source: CLP, *Annual Report 1988*, page 11.

*"A continuous slow-down in Hong Kong manufacturing activities has reduced the growth [sales of electricity] in this sector to 1.7%."*

Source: CLP, *Annual Report 1989*, page 11.

*"Sales [of electricity] to manufacturing customers declined by 1.6% due to difficult trading conditions and continuing migration to South China."*

Source: CLP, *Annual Report 1990*, page 11.

*"Reflecting the continuous shift of the local economic structure away from manufacturing, commercial sales are now the biggest single customer group of the Company. The manufacturing sector recorded a small decline of 0.4% [sales of electricity] in the year. However, this was not unexpected as it reflected the continuing migration of businesses to Shenzhen and the Pearl River Delta."*

Source: CLP, *Annual Report 1991*, pages 11 - 12.

*"The manufacturing sector recorded a decline of 3.0% [sales of electricity]. Sales to Skekou increased by 13.5% and to the rest of China by 81.1% ... This increase in sales is another symptom of the migration of manufacturing business into southern China ... In order to encourage the continuing sale to China of electricity surplus to requirements in Hong Kong, the Company and the associated generating company are now entitled to a 20% share of the marginal profit arising from such sales."*

Source: CLP, *Annual Report 1992*, page 14.

### **3. Discussions of the Relocation of the Manufacturing Sector Outside Hong Kong**

3.1 In the 1989 - 1992 period, there were discussions of the relocation of the manufacturing sector outside Hong Kong in various fora, including debates on the budgets, and *Economic Background* published by the Government. This trend has been observed by the Hong Kong Government and many who served the community. Relevant extracts are detailed below.

#### Budget Speech

3.2 *“Domestic exports will perform more moderately, with growth predicted at only 2%. This slower rate of expansion is not surprising. It reflects the success with which our manufacturers have relocated operations in Guangdong province in their search for growth. It also reflects the constraints on industrial growth in Hong Kong caused by the shortages of land and, more especially, of labour.”*

Source: *The 1992-93 Budget*, paragraph 18.

#### Debates on the Budgets

*1989 - 1990 Budget Debate (26 - 27 April 1989)*

3.3 The Hon Rosanna TAM said *“Hong Kong is no longer a manufacturing centre with low cost labour. Except for manufacturers which must operate in Hong Kong, a great majority have already moved into the Pearl River Delta.”*

3.4 The Hon Peter POON said *“The relief on the pressure of our workforce provided by Chinese workers in some of our labour-intensive industries which have been moved into China has also increased our competitiveness in the world market.”*

3.5 The Hon POON Chi-fai said *“Although there are many factors leading to the relocation of factories ... As labour and production costs and factory sites in our neighbouring area are comparatively lower than ours, more and more factories are moving out of Hong Kong. This has already become a trend which cannot be stopped.”*

3.6 The Hon Michael CHENG said *“The industries in Hong Kong can still manage to survive ... by taking advantage of the expanding back-up areas in cities along the Chinese coast, which serve them as workshops for their production and processing activities ... the industries and economic structure in Hong Kong are undergoing changes as a result of growing re-exports and the opening up of industrial back-up areas across the border.”*

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*1991 - 1992 Budget Debate (28 March 1991)*

3.7 The Hon LAU Wah-sum said *“As a result of the fall in business and relocation of production lines to China, the demand for labour in the garment and light metal industries has dropped.”*

3.8 The Hon Kingsley SIT said *“What we see is the Government’s high land price policy and unreasonable labour measures which have made it impossible for many factories of small and medium size to continue production in Hong Kong, thereby forcing the factory operators to relocate their factories to Shenzhen and Dongguan for reprocessing of products.”*

*1992 - 1993 Budget Debate (26 March 1992)*

3.9 Dr Hon HUANG Chen-ya said *“The manufacturing sector has continued to relocate to the north; and foreign investment in Hong Kong has continued to fall.”*

*Economic Background*

3.10 *“The marked deceleration in growth in 1989 was attributable to a number of factors: ... Also relevant was the continued relocation of production processes across the border, resulting in more finished products being shipped out as re-exports from China rather than as Hong Kong’s domestic exports.”*  
Source: *1989 Economic Background*, paragraph 2.1.

3.11 *“In September 1989, 803 000 persons were employed in the manufacturing sector ... Keen competition for labour from other sectors, release of production processes to China over the past years, and the moderation in manufacturing activity during 1989 had all contributed to this decline.”*  
Source: *1989 Economic Background*, paragraph 4.10.

3.12 *“Induced by the lower labour and land costs in South China, there has been a progressive relocation of production. Outward processing activities have continued to expand, along with a rapid increase in cross-border trade flows.”*  
Source: *1991 Economic Background*, paragraph 2.24.

3.13 *“Employment in the manufacturing sector dropped further, by 13% over a year earlier to 571 200 in September 1992 ... and progressive relocation of the more labour-intensive production process to China were the main factors underlying the persistent decline in manufacturing employment.”*  
Source: *1992 Economic Background*, paragraph 4.10.

#### 4. Hong Kong Government's Negotiation with CLP

4.1 Although the Government realized the relocation of the manufacturing sector, it did not apply such awareness in its negotiation with CLP on the latter's financing plans.

4.2 On 3 January 1985, the Executive Council approved CLP to purchase electricity from the Daya Bay Nuclear Power Plant Station *"to meet the increasing demand in Hong Kong in the 1990s."*

Source: *LegCo Brief encl. (1) in ESB CR 6/4576/79*, 15 April 1987.

4.3 On 7 April 1987, the Executive Council approved the 1986 Financing Plan (1986 - 1993) for CLP in which CLP again proposed its plan to purchase for the years of 1991 - 1993 electricity from the Daya Bay Nuclear Power Station *"to meet increasing demand."* The total capital expenditure was lower than the figure in the 1983 Financing Plan due to a lower assumption of inflation. The Government based its decision on the recommendation of an independent consultant, and it was not clear whether or not the Government made its own study of the overall demand for electricity in view of the economic development of Hong Kong. It considered that *"the generation development plan ... is considered to be adequate in ensuring supply being generated to meet the maximum demand and there is no excessive generating capacity."*

Source: *LegCo Brief encl. (1) in ESB CR6/4576/79*, 15 April 1987.

4.4 On 12 December 1989, the Executive Council approved CLP's 1988 Financing Plan (1988 - 1993) in which CLP identified a need for further generating capacity to cope with higher electricity demand in the future. There were plans, among others, to build a new 300 megawatts (MW) gas turbine power station locally [i.e. Black Point] *"to meet the anticipated peak demand for electricity in 1992 and thereafter."* Again, the Government relied on an independent consultant to conduct a reliability analysis study which confirmed that *"this additional capacity will be needed to meet the peak demand from 1992 onwards."* The Hong Kong Government considered CLP's proposals acceptable on two grounds<sup>1</sup>, amongst others:

- (a) the generation development proposals are appropriate for ensuring that sufficient supply is generated to meet the growing demand; and that
- (b) the gas turbine power station is required to meet the peak demand in 1992 and thereafter. The concern was disruptions to or shortfalls in the supply of electricity which would cause delays and losses in production.

Source: *LegCo Brief encl. (1) in ESB CR 6/4576/79*, 23 December 1989.

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<sup>1</sup> The other two grounds were the advantages of CLP participating in the Guangzhou Pumped Storage Power Station Project.

4.5 The Black Point large thermal power station was approved by the Executive Council on 1 October 1991. The justification of the proposal was maximum demand forecast which was measured by the peak electricity demand that the supply system must meet, namely, that which occurs in mid summer. The forecast published by CLP showed that if no new generating capacity were added to the CLP's system over and above that already approved, the reserve margin would begin to fall steadily from 1996 onwards. The Government's main concern at the time was "*meeting the continued growth in demand for electricity up to and beyond 2000*" and any possible decline in system reliability could put power supply at risk. The size of Black Point would be 6 000 MW, almost the same as CLP's existing capacity at the time. There was no mention about the fall in demand resulting from the relocation of the manufacturing sector from Hong Kong.

Source: *LegCo Brief encl. (5) in ESB CR 6/2061/90(91)II*, 8 October 1991.

#### Concern Expressed in the Legislative Council over the Operation of CLP

4.6 On 19 March 1986, the Hon Allen LEE asked whether the Financial Monitoring Unit of the Economic Services Branch was adequately staffed both in manpower and expertise to perform an effective monitoring function of public utilities companies under schemes of control. The Financial Secretary's reply was "*Yes, Sir, and I am sure if they were not, the Executive Council would have very strong views.*" At the same meeting, questions were asked on the issue of public scrutiny of CLP's performance, to which the Financial Secretary replied "*Confidential information cannot be made available to the public because it is share-price sensitive and is incidentally banned by the Securities Ordinance.*"

Source: Hong Kong Legislative Council, *Official Record of Proceedings*, 19 March 1986.

4.7 On 16 July 1986, the Legislative Council held an adjournment debate on Hong Kong and Daya Bay Nuclear Power Project. A total of 27 speeches were made on various aspects of the subject. Amongst them, the Hon Andrew WONG questioned whether power supply would be insufficient to meet the demand in the early 1990s: "*CLP says it won't be enough. The Government says it won't be enough. But both Friends of the Earth and the Conservancy Association in Hong Kong said that following the commencement of operation of the B Plant in Castle Peak, the power supply will be sufficient by the early 1990s.*"

Source: Hong Kong Legislative Council, *Official Record of Proceedings*, 16 July 1986.

4.8 At the meeting of the OMELCO Panel on Economic Services and Public Utilities held on 11 November 1991, Mr A J Deepröse, Head of the Financial Monitoring Unit, Economic Services Branch briefed Members on the performance of CLP. "*Demand forecast was close to actual demand and no excess generating plant had been built. Reserve generating plant capacity, on average about 30%, was adequate to ensure a reliable supply and in line with international standards.*"

Source: Minutes of meeting.



4.9 At LegCo meeting held on 13 November 1991, the Hon LAU Chin-shek moved a motion “*that this Council urges the Government to consult this Council and the public on profit control schemes and franchise agreements with public utility ... companies before entering into such schemes and renewing such franchise agreements with the companies.*” Members expressed their concern over the method of using fixed asset as the basis for calculating permitted returns and the consequent probable sharp increase in tariffs. The Secretary for Economic Services highlighted the Government’s priority was ensuring continued investment in the power supply industry given that “*demand continues to increase.*” No mention was made of excess capacity which could be caused by the relocation of the manufacturing sector outside Hong Kong.

Source: Hong Kong Legislative Council, *Official Record of Proceedings*, 13 November 1991.

4.10 At LegCo meeting held on 18 December 1991, the Hon TAM Yiu-chung asked whether CLP’s planned investment in Black Point would lead to increases in electricity charges. The Government’s response is extracted as follows:

*“ No Financing Review has yet been submitted by the Companies for the first phase of Black Point; therefore Government does not have any projections of future tariff levels. Tariff levels will be determined by the capital costs of the generating plants, the type and cost of fuel used, prevailing interest rates, inflation and unit sales.*

*It is too early to say whether or not the development of Black Point will lead to increased tariffs and if so by how much. It would, however, be unrealistic to expect the Companies’ [CLP’s] average basic tariffs to remain unchanged for a further eight years as they have done since 1983.*

*All proposals put forward by the Companies [CLP] will be subject to rigorous scrutiny by the Administration, with the assistance of international consultants, to ensure that consumers continue to receive an efficient and reliable electricity supply at a reasonable cost.”*

Source: Hong Kong Legislative Council, *Official Record of Proceedings*, 18 December 1991.

4.11 At the meeting of the OMELCO Panel on Economic Services and Public Utilities held on 16 March 1992, the Deputy Secretary for Economic Services assured Members that the CLP tariff increase which would come into effect on 1 April 1992 was not related to the building of the Black Point Power Station.

Source: Minutes of meeting.

4.12 At the meeting of the OMELCO Panel on Economic Service and Public Utilities held on 27 April 1992, the discrepancy between the rate of electricity demand projected by CLP and the rate of actual consumption over the past years was referred to. The Hon LAU Chin-shek expressed concern about excess generating capacity which would result in higher operating costs, thus affecting prices. Mr Alan Deeprise, Head of Financial Monitoring unit, Economic Services Branch, explained that *“Government always produced its own projections of electricity demand for cross-checking against CLP’s projections. The demand projected by CLP was seen as reasonably accurate and the difference between the installed capacity and total sales could be explained by the need to provide for additional capacity to meet peak demand.”*

Source: Minutes of meeting.

4.13 At a meeting of the OMELCO Panel on Economic Service and Public Utilities held on 2 June 1992, representatives from CLP explained how demand forecast was made. Reference was made to economic growth and usage pattern, but not to the relocation of the manufacturing sector outside Hong Kong.

Source: *OMELCO Paper No. 1625/91-92.*

4.14 At a meeting of the LegCo Panel on Economic Services held on 2 May 1995, representatives from CLP gave Members a briefing on electricity demand forecast and explained their methodology. Members specifically asked *“if the deferment of the 3<sup>rd</sup> and 4<sup>th</sup> blocks of the Black Point Power Station was a result of inaccurate forecast.”* CLP explained that *“CLP was not able to forecast accurately the drop in power consumption between 1990 and 1994 which was the result of an economic restructuring during that period, with 13 500 factories being moved to China. The restructuring had serious impact on CLP’s sales as the manufacturing sector had been one of its major customer groups.”*

Source: Minutes of Panel meeting.

## 5. Comments on Government's Current Explanation

5.1 The latest Government explanation on its ability to make an accurate economic forecast in 1991 is extracted below:

*“Although Hong Kong’s manufacturing activities might have already shown some signs of slowing down during 1989 to 1991, it would have been difficult at that time to associate this solely with the wave of industrial relocation which had become evident subsequently. This was in light of slower growth in the Hong Kong economy and the macroeconomic adjustment taking place in the Mainland during that period, as well as the Gulf war and the economic downturn in the United States in the early 1990s. For a long-term projection of electricity demand to be used for planning the provision of major electricity supply facilities, it would have not very prudent to extrapolate for eight years after 1991 mostly on the basis of the figures for the three-year period 1989 to 1991, which were subject to such varied and particular developments. Also, the substantial relocation of manufacturing activities across the border since 1992 was related in no small part to the strong push for further opening up of the Mainland some time after Mr Deng Xiaoping’s visit to Guangdong and his advocacy for more expeditious economic development in the Spring of 1992. Such a development did not come ahead of the Government’s forecasting exercise, which was carried out in early 1992.”*

Source: Letter dated 13 May 1999 from the Government Economist to the Public Accounts Committee.

5.2 Statistical data on the development of the manufacturing sector from 1989 to 1992 (Tables 1 to 6) clearly indicated a decline in the manufacturing activities in Hong Kong. Government’s awareness of the relocation of the manufacturing sector from Hong Kong was evident in its own publications ‘*Economic Background*’ from 1989 to 1992. CLP also indicated in its annual reports the loss suffered as a result of such relocation. Throughout the period, there was also discussion in Legislative Council on this relocation; at the same time, concern was also raised over excess capacity of CLP. It should have been clear from the decrease in the average number of manufacturing establishments and the reduction in the employment in the manufacturing sector that “peak demand” which would arise from industrial use would not be increasing in the 1990s. Government’s concern over “the continued growth in demand for electricity up to and beyond 2000” (paragraph 4.5 above) does not seem to have been based on a rigorous perception of statistical data.

5.3 With respect to the intensity of relocation of the manufacturing sector out of Hong Kong after 1992, we do not consider it possible to quantify the precise effect of Deng Xiaoping’s visit to Guangdong Province in 1992.