

Lecture 7. Hong Kong's Trade and Foreign Investment

1. Trade, foreign investment and economic development

(1) Trade and economic growth

The model of export-led growth of the Asian NICs: economic growth fueled by export growth and export growth follows closely to dynamic comparative advantage.

(2) Foreign investment and economic growth

Foreign (direct) investment (FDI) contributes to host countries' physical capital formation, human capital development, transfer of technology and know-how (managerial skills), and integration into the global market and foreign trade. FDI also benefits home countries through higher profits of MNCs and increased trade.

(3) The relationship between trade and FDI

There are strong evidences to show that FDI increases trade in both home and host countries. On the other hand, certain trade policies also trigger FDI.

Empirical evidence on the impact of trade and FDI on economic growth in HK can be found from the following article:

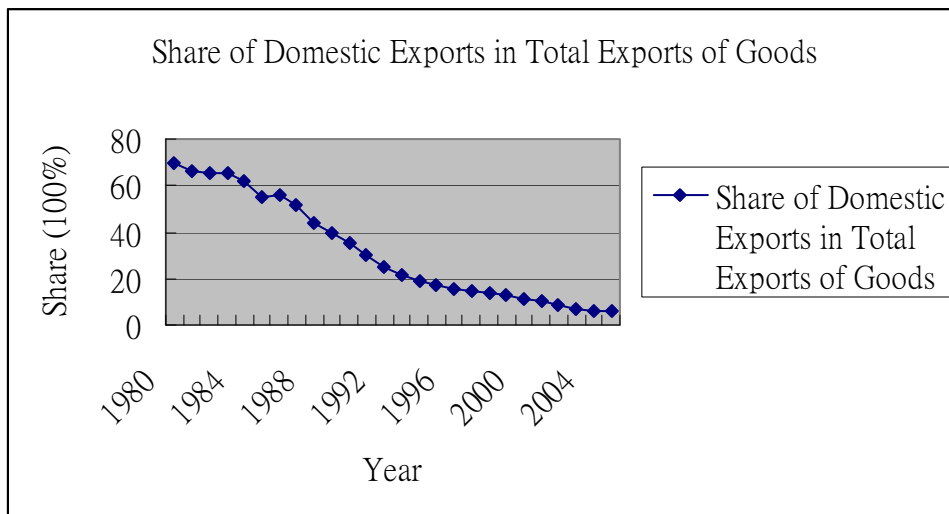
[Economic Growth and International Trade: The Case of Hong Kong](#). By: Chou, Win Lin; Wong, Kar-yiu. *Pacific Economic Review*, Oct2001, Vol. 6 Issue 3

Their main finding is that the estimated average contribution to growth of total factor productivity ranged from 3.86% to 5.86% per year between 1967 and 1996. However without trade and FDI, the corresponding rate ranges from 1.91% to 3.63%, i.e. a drop in the annual growth rate of HK by 1.78% to 2.37%.

1. The characteristics of HK's trade and foreign investment

(1) Trade

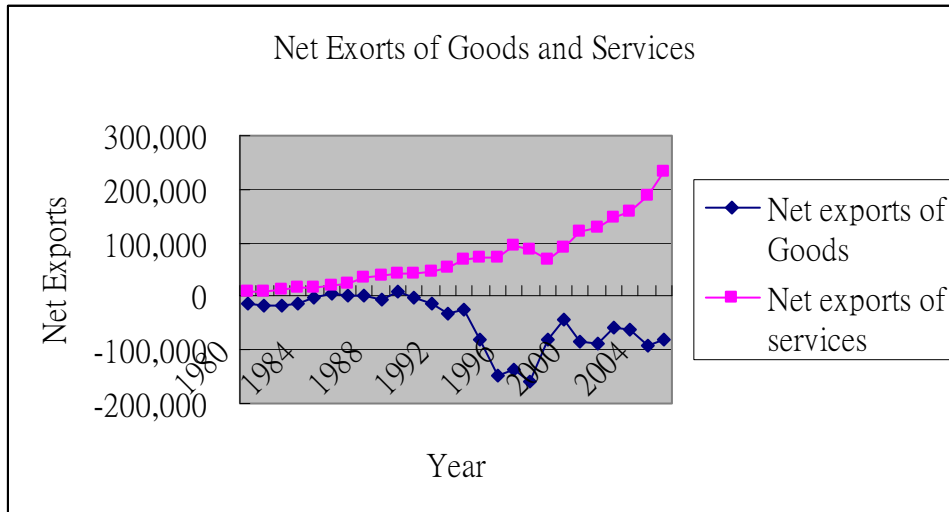
- With limited government interventions, the development of HK's exports have always been in line with its dynamic comparative advantage
- A large proportion of HK's exports are re-exports.



According to Young (1999), HK markups on re-exports totaled 10% of GDP.

Hong Kong's roles in re-exporting (see Hanson and Feenstra):

- a. middlemen --- earn informational rents
 - b. outward processing
 - c. circumventing trade barriers and hubbing in international shipping
- Exports of services are becoming increasingly important in HK's trade. Offshore trade takes a significant share of HK's exports of services.



- In value terms, offshore trade has exceeded re-export trade from 2002.

In offshore trade, goods do not enter Hong Kong. It covers services in merchanting and merchandizing. In merchanting, Hong Kong firms take the ownership of goods (buy from one party and sell to another and earn the price difference) while in merchandizing Hong Kong firms do not take the ownership of goods (facilitates the trade between two outside parties and earn commissions). However, the trade margin of merchanting (8.5% in 2003) was only about half of the rate of re-export margin (17.9% in 2003). The Commission rate of merchandising for offshore transactions was even smaller (3.4% in 2003).

Structural shift in Hong Kong's external trade
(change in real terms)

	<u>Re-exports</u> (%)	<u>Exports of trade-related services</u> <u>(comprising mainly offshore trade)</u> (%)
Average annual growth rate :		
1986-95 (10 years)	23.8	4.3
1996-04 (9 years)	8.1	15.3

**Value of goods involved in
re-export trade and offshore trade**

	<u>Re-export of goods</u> (HK\$ billion)	<u>Offshore trade</u> (HK\$ billion)
2002	1,430	1,458
2003	1,621	1,667

<http://www.gov.hk/hkecon/trade/index.htm>

<http://www.info.gov.hk/gia/general/200504/15/04150123.htm>

(2) Foreign investment

- HK has both a large inflow and a large outflow of FDI.
- The Chinese Mainland is both the major destination of HK's FDI and the major source of HK's FDI.
- HK's FDI is mainly in the service sector.

http://www.censtatd.gov.hk/hong_kong_statistics/statistics_by_subject/index.jsp

2. Issues related to HK's trade and foreign investment

3.1. The impacts of WTO accessions of Mainland China and Taiwan

For Mainland China, the accession to the WTO means that it has to lower its trade barriers and open up its service sector for foreign investors. So it will increase China's total trade with the rest of the world and attract more FDI to China. The impact on HK may be as follows:

- HK can get direct benefit from increased trade of the mainland with the rest of the world as Hong Kong currently serves as the mainland's major re-export centre.
- HK may be further de-industrialized as more local manufacturers will shift their production bases to China due to the further opening up of market there, specially the textile and apparel industries with full elimination of quota restriction on WTO members from 2005.
- There will be a new wave of investment in China by firms in the service sector (distributive, financial and telecommunication services) in HK. It will boost the income of the service sector
- The intermediate role of HK in the Cross Strait trade relations will deteriorate after both the mainland and Taiwan join the WTO.
- Hong Kong may attract more multinational companies to set up its regional headquarters here and so increase their FDI here, as more firms will increase their operations in China market.

3.2 Closer Economic Partnership Agreement (CEPA)

- Boost HK's export to the mainland
- Attract more foreign investment in HK
- HK's service sector can gain first-mover advantage in the mainland.

http://cepa.tdctrade.com/?w_sid=194&w_pid=703&w_nid=&w_ci_d=&w_idt=1900-01-01&w_oid=

3.3 Potential threats/problems

- Direct trade between Taiwan and the mainland
- Potential “trade wars” between China and its major trade partners
- Regional competition

Readings:

Hanson, Gordon and Feenstra, Robert, 2004. Intermediaries in Entrepôt Trade: Hong Kong Re-Exports of Chinese Goods. *Journal of Economic Management and Strategy* 13(1), pp. 3--35.

“China’s WTO accession and implications for Hong Kong”, Hong Kong: Research Department, Hong Kong Trade Development Council, 2001.

<http://www.tdctrade.com/econforum/tdc/tdc011101.htm>