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The British Stake in Hong Kong: Trade in Goods

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For three decades Hong Kong's trade has grown consistently faster than any other territory's, latterly on the basis of re-exports to and from China as production has been re-located there. Britain is no longer Hong Kong's dominant European trading partner, although its share of Hong Kong's trade remains significant and vice-versa. The paper identifies the key features of British trade with Hong Kong in recent years. It compares British performance with the other major Europeans', and examines the reasons for data discrepancies, the extent to which Britain's falling trade share is due to changes in composition, and how far indirect trade through Hong Kong explains Britain's low market share in China.

This paper forms part of a broader study of Britain's economic relationship with Hong Kong, for which financial support from various sources is gratefully acknowledged. Comments are welcome.

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1. Introduction

The purpose of this paper is to examine Britain's visible trade with Hong Kong. It forms part of a study of the British stake in Hong Kong before the territory reverts to China in 1997. It is essentially descriptive and analytical. Policy implications are considered elsewhere.

Although both Britain and Hong Kong produce detailed trade figures, they are not mutually consistent. Section 2 therefore reviews these data to suggest the appropriate series to be used in analysis. Section 3 briefly describes the extraordinary growth and reorientation of Hong Kong's position in world trade in recent years. The key development has been the emergence of China as a major producer and market. Section 4 considers the main features of the British exports to Hong Kong, including the extent to which the UK's historically strong position has been eroded in recent years. Section 5 considers British imports from Hong Kong. Section 6 briefly discusses the extent to which the assessment of Britain's export performance in China should be modified to take account of trade involving Hong Kong, and Section 7 underlines the main results.

2. Basic data

Basis of measurement

For the purpose of the wider study of which this paper is part, trade in goods should be measured on a *balance of payments basis*, as defined in Table 2.1 of the *Pink Book* (ONS). The values of import exclude the cost of insurance and freight (cif) and should in theory be measured at the moment at which the goods concerned change ownership from the exporter. Any freight and insurance services purchased abroad are counted in Services.

Such figures are not published separately for British trade with individual countries, and have to be derived from the *Overseas Trade Statistics of the United Kingdom* (OTS) which are compiled on a slightly different basis from Customs documents as they are submitted. The OTS figures record imports on a *consignment* basis (ie the country from which they were last shipped); they exclude certain minor items (such as ships delivered abroad and gold bullion); they tend to under-record exports; they include items which do not change ownership; and, more important, include freight and insurance in the import figures. Exports are, in principle, compiled on the basis of country of final destination, but this is not always known, with the result that they tend to be attributed to intermediate destinations.

Table 2.1 of the *Pink Book* estimates the cif adjustment at about 3% for total British imports, on the basis of survey evidence for freight and a (low) fixed percentage for insurance. For the sub-category "Rest of World" of which Hong Kong is part the figure is nearly 5%. This is a slightly lower figure than that for other European countries' imports from East Asia collated by the IMF¹. The combined effect of other adjustments which cannot be specifically allocated reduce the OTS value of imports by a further 2-3% and of exports by 1-2%. The OTS figures can thus be adjusted by the percentages in Table 1 to put them on a balance of payments basis.

1. Direction of Trade Statistics.

Table 1 Adjustment factors for converting OTS values for trade with Hong Kong to a balance of payments basis

	Exports	Imports	<i>per cent</i>	
			<i>of which:</i> cif	other
1980	2.5	-8.4	-6.8	-1.6
1981	3.2	-8.6	-7.3	-1.2
1982	1.3	-9.2	-7.3	-1.9
1983	1.6	-6.7	-5.1	-1.6
1984	1.0	-5.8	-4.9	-0.9
1985	0.0	-7.5	-5.6	-1.9
1986	2.6	-2.0	-1.5	-0.5
1987	2.5	-4.5	-3.6	-0.9
1988	-3.8	-8.6	-5.7	-2.9
1989	-2.9	-6.9	-4.4	-2.4
1990	-4.1	-7.6	-4.8	-2.9
1991	-3.4	-7.8	-5.0	-2.8
1992	-2.1	-7.1	-4.5	-2.6
1993	2.2	-4.6	-5.0	0.4
1994	2.1	-4.8	-5.0	0.3
1995	-0.5	-6.1	-4.6	-1.5
Average	0.1	-6.6	-5.1	-1.5

Sources: Derived from ONS: *Monthly Review of External Trade Statistics*. ONS: *The Pink Book*, and data provided by ONS.

The results of these adjustments are set out in column 3 of Table 2. The remaining discussion refers to OTS data.

Reconciliation of British and Hong Kong data

The value of British exports to Hong Kong plus a margin for cif less an adjustment to take account of transit time should in principle equal the counterpart Hong Kong figures for imports from Britain in *Hong Kong Trade Statistics* (HKTS), and vice-versa. The estimated cif adjustment for Hong Kong's imports from Britain is 11%, double the figure in the opposite direction, with the difference attributed largely to insurance.

The adjustment for transit time arises from the fact that imports in one period are exports from a previous period. If trade is growing, the sum of the trade balance of any pair of countries will be positive. Synchronising the two sets of figures therefore requires the export figures to be reduced by the growth which takes place during the average transit period. For trade between Britain and Hong Kong this is taken to be 15% of the annual growth in exports each year (ie assumes an average transit time of 8 weeks).

Applying these adjustments to the bilateral trade figures converted to a common US dollar basis in the IMF's *Direction of Trade Statistics* (DOTS) reveals some striking discrepancies (Appendix 1, Table A1.1). British exports have been fairly consistently 25% higher than Hong Kong's imports, while Hong Kong's exports, which until the mid-1980s were about 10% below the corresponding British imports, have latterly exceeded them by a growing margin - some 7% by 1994. However, Hong Kong's *domestic* exports have always been lower than British imports - by a steadily widening

margin.

The explanation of these discrepancies is obvious enough in general terms. Some British exports to Hong Kong are not formally imported there (although they may be trans-shipped) but go straight to a final destination, mainly China. Moreover, some of Hong Kong's imports from Britain - a growing proportion - are re-exported to third countries, predominantly China. Thus a substantial proportion of British exports attributed in OTS to Hong Kong end up in China. The implications of this for recorded trade with China is discussed further in Section 6. Calculations of the proportion going to Hong Kong, based on HKTS, are set out in Appendix 1 and the results in Column 4 of Table 2. The balance go to China and other destinations.

There is a similar explanation for the discrepancies in the figures for imports from Hong Kong. Some imports originating in China are attributed to Hong Kong without being imported into Hong Kong; and latterly, some - but not all - of Hong Kong's re-exports originating in China are attributed in OTS to Hong Kong. Using Hong Kong data on the basis of the calculations in Appendix 1, Columns 4-6 distribute the figures in Column 3 between the value of goods originating in Hong Kong and re-exports from Hong Kong but originating elsewhere - mainly China. The latter is further subdivided into the value of goods attributable to the country of origin and the re-export margin in respect of value-added in Hong Kong. Strictly speaking this margin should not appear in the visible trade figures at all but as services supplied by Hong Kong.

Other adjustments

Although HKTS data is generally detailed, comprehensive and apparently reliable, and distinguishes between re-exports and domestic exports, one large and growing anomaly is Hong Kong's absorption of imports from China. Hong Kong Government analyses² calculate retained imports by subtracting re-exports (less a 14-16% mark-up³ for domestic value-added) from imports. For most countries this gives plausible results. In the case of China, re-exports now exceed imports, with the result that retained imports appear to be negative. The possible reasons for this are discussed in Section 3. The practical result is that the figures for domestic absorption of Chinese imports is manifestly understated and need to be adjusted, most obviously in the context of analysing country shares of the Hong Kong market. This can be done by adjusting the figures for Hong Kong's imports from China to be consistent with a declining share of Hong Kong's domestic demand from 1988. This is described in more detail in Appendix 2 and is included in the figures in Column 5 of Table 2. A consequence is to increase the value added attributable to Hong Kong in the import figures in Table 2.

Table 2. British Trade with Hong Kong

	<i>£ million</i>				
	On OTS basis	bop adjustment	On BoP basis	<i>of which</i>	
	(1)		(3)	Attributable to Hong Kong	
Exports	(1)		(3)	(4)	(5)
				(5)	(6)

2 e.g. successive Budget documents

3. Lardy (1994) p. 77

	(2)					
1980	559	14	573	412		
1981	619	20	638	472		
1982	731	9	740	533		
1983	727	12	739	542		
1984	897	9	907	672		
1985	949	0	949	611		
1986	961	25	986	621		
1987	1013	25	1038	708		
1988	1031	-39	992	630		
1989	1112	-32	1080	658		
1990	1238	-51	1187	628		
1991	1387	-48	1340	736		
1992	1613	-34	1579	840		
1993	2170	48	2218	1135		
1994	2298	47	2345	1382		
1995	2657	-15	2642	1576		
Imports						
				<i>Originating in:</i>		
				<u>Hong Kong</u>	<u>elsewhere</u>	
					<i>re-exp</i>	<i>margin</i>
						<i>goods</i>
			<i>value</i>			
1980	850	-72	778	559	8	211
1981	897	-77	820	676	10	134
1982	871	-80	791	676	8	107
1983	1177	-78	1099	754	8	337
1984	1266	-73	1193	979	11	203
1985	1176	-88	1087	854	15	218
1986	1537	-30	1507	839	27	641
1987	1532	-69	1463	943	42	478
1988	1792	-155	1637	1040	78	519
1989	2049	-140	1908	1106	144	659
1990	1972	-150	1822	928	189	705
1991	2148	-166	1981	957	242	782
1992	2397	-169	2228	876	371	981
1993	2998	-138	2859	923	556	1380
1994	3080	-147	2932	860	545	1527
1995	3542	-217	3325	865	592	1868
Balance						
1980	-291		-205	-147		
1981	-278		-181	-204		
1982	-140		-51	-143		
1983	-450		-360	-212		
1984	-369		-286	-307		
1985	-226		-138	-242		
1986	-576		-521	-218		
1987	-519		-424	-234		
1988	-761		-645	-410		
1989	-937		-828	-447		
1990	-734		-635	-300		
1991	-760		-641	-221		
1992	-784		-649	-35		
1993	-828		-642	212		
1994	-782		-587	522		
1995	-885		-682	711		

Source: see Appendix 1

The bilateral trade balance

While bilateral flows of imports and exports normally provide a good measure of the

strength of an economic relationship, bilateral surpluses and deficits are of little inherent economic significance in a multilateral trading system. Taking the broadest definition of UK trade with Hong Kong (ie Column 3 of Table 2) Britain could be said to have a visible trade deficit with Hong Kong of just under £0.7 billions - 0.14% of British GDP. After adjusting for trade which does not have Hong Kong as its eventual source or destination, it appears that the UK has a growing surplus (Column 4).

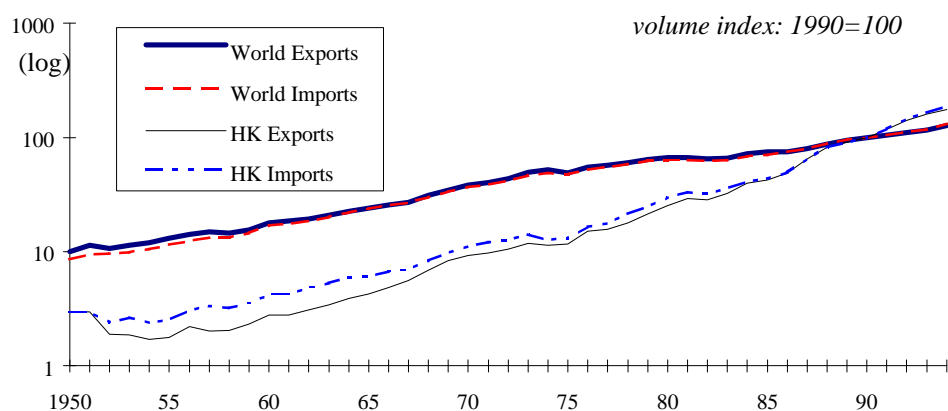
3. Hong Kong and World Trade

Rapid growth in Trade

The growth in Hong Kong's trade in the last two decades has been spectacular and unmatched elsewhere.

In the 1950s and 1960s, Hong Kong's trade grew in line with world trade, with 7-7.5% nominal growth and 6.5-7% volume. Since then, Hong Kong's trade has grown much faster. From 1971 to 1994 the value of Hong Kong's exports rose by 19.3% a year, twice the world figure, and export volume by 13.3% a year, three times the world rate. Unit values moved closely in line.

Figure 1 Growth in Trade: Hong Kong and the World



Sources: IFS; HK Trade Statistics

Table 3 Growth in Trade: Hong Kong and the World

	<i>average annual growth rate (% p.a.)</i>											
	Imports			Total			Exports			Re-exports		
	value	volume	UV	value	volume	UV	value	volume	UV	value	volume	UV
1949-70												
HK	7.5	7.3	0.1	7.5	6.9	0.7*						
World	7.3	7.1	0.1	7.2	6.4	0.7						
1971-94												
HK	18.7	12.4	6.2	19.3	13.3	6.0	13.6	7.7	5.9	25.8	19.3	6.5
World	9.6	4.7	4.9	9.6	4.4	5.2						

Sources: IMF; IFS, HK Trade Statistics.

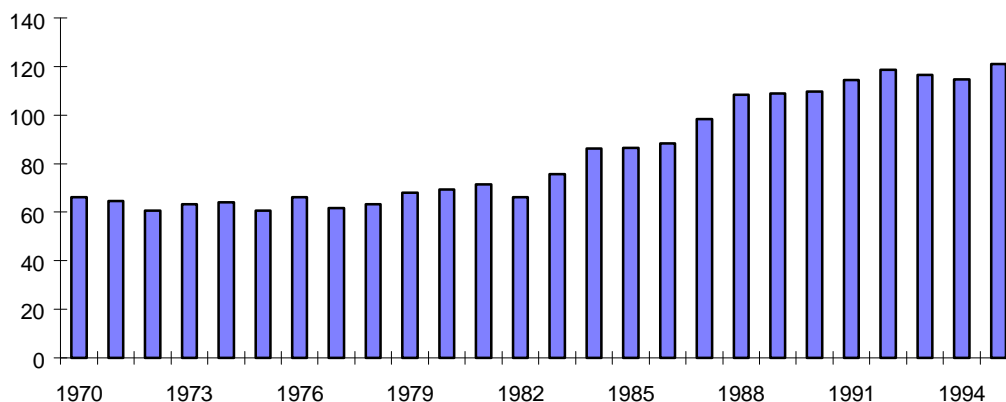
Unit values (UV) for HK are only available from 1971 onwards. Prior to that, volume figures assume that UVs in Hong Kong, a price taker, follow world UVs.

Hong Kong's trade ratio has also grown very fast, as Figure 2 shows. Exports were 121% of GDP in 1995 - the highest recorded ratio worldwide, and around four times

what might be expected for a country of Hong Kong's size and location.

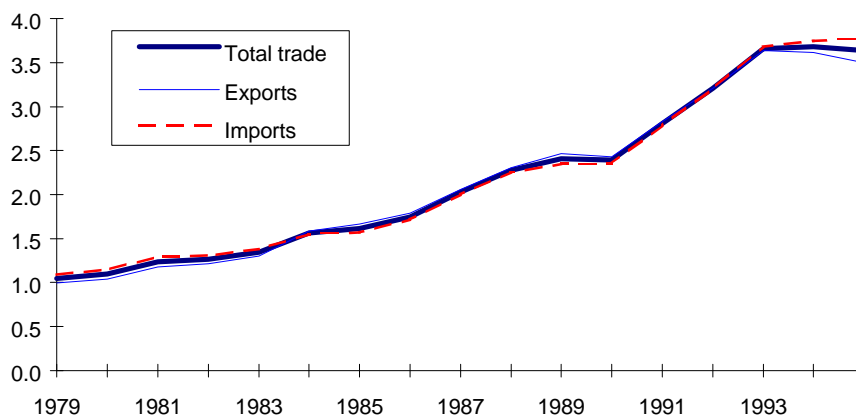
As a result of this growth, Hong Kong's share of world trade rose from about 1% in 1979 to 3.6% in 1995 (Figure 3) putting Hong Kong in eighth position among the trading countries of the world - behind only the G.7. This increase was greater than that of any single country; only Japan came close, with an increase in share from 6.6% to 8.5%.

Figure 2 Exports of goods as % of GDP: Hong Kong 1970-95



Source: HK C&SD: *Estimates of Gross Domestic Product*.

Figure 3 Hong Kong trade as % in the world: 1979-95

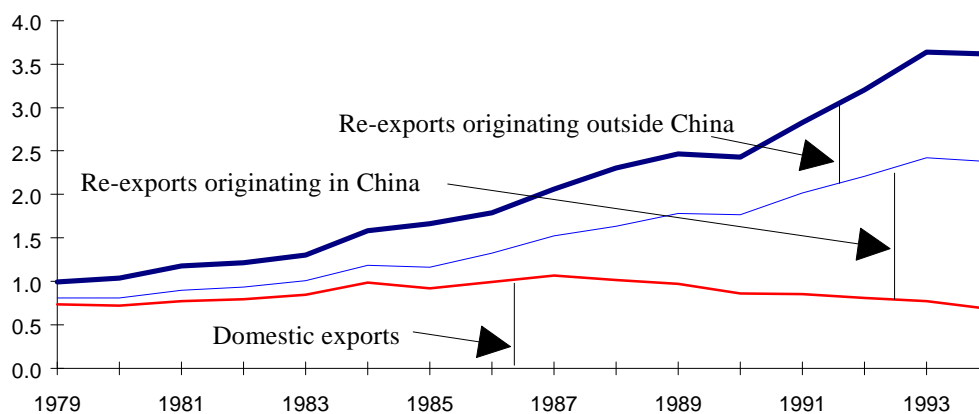


Source: IMF: DOTS.

Trade dominated by re-exports

More than four-fifths of Hong Kong's exports are re-exports - a far higher proportion than anywhere else. Re-exports have only become dominant in the 1980s - in 1979 they accounted for only 26% of total exports.

Figure 4 Hong Kong export components as % in the world: 1979-94



Sources: HK Trade Statistics. IMF: DOTS.

Virtually all of the increase in Hong Kong's share of world trade came from re-exports, which rose from 0.7% of world exports in 1979 to 2.9% in 1994 (Figure 4). However, domestic exports went on growing in line with world trade until 1987.

China trade the driving force

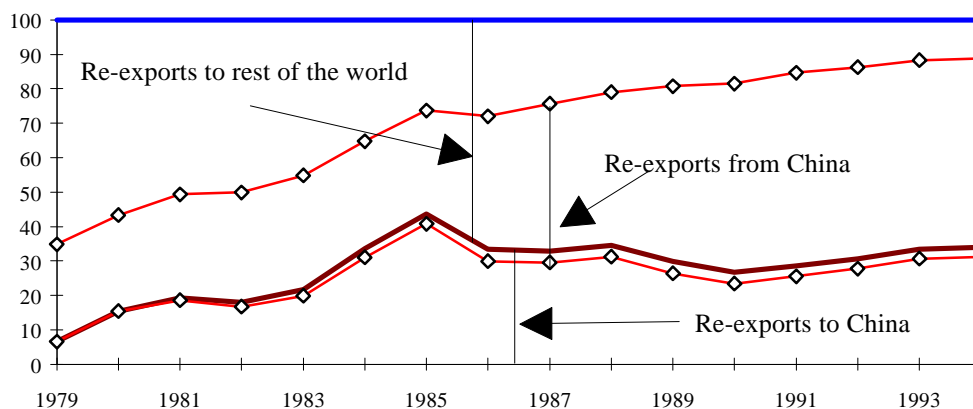
The reason for the extraordinary growth in Hong Kong's re-exports since 1979 is of course the emergence of China as a major producer and trader. During the 1920s China accounted for more than 2% of world trade, but years of autarkic policies in the previous two decades reduced this below 1% throughout the 1970s. Economic reforms in 1979, including the open door policy, the Special Economic Zones, and the transition to a market based system, created the conditions for China to become a major player in world trade. Hong Kong has from the start had a key role in this, relocating production to Southern China, orchestrating production there and marketing overseas, and transforming both Southern China's and Hong Kong's own economy in the process. The process is described in detail in Sung (1991) and Overholt (1993).

Most of Hong Kong's re-exports are consequently on their way to or from China (Figure 5). In 1995 a third of Hong Kong's re-exports went to China (of which a small proportion - just under a tenth - originated in China); these re-exports accounted for one third of China's total imports. 58% of Hong Kong's re-exports came *from* China and went to the rest of the world (again with a small proportion going back to China); these re-exports accounted for nearly half China's exports.

Hong Kong's trade figures thus pick up a very high proportion - over 40% - of China's trade and, in effect, count it twice. Chinese imports appear both as imports into and re-exports from Hong Kong, while China's exports also appear as imports into and re-exports from Hong Kong. That is why Hong Kong's share of world trade has grown even more than China's in recent years.

Discussion of Hong Kong's imports and re-exports should therefore distinguish carefully between flows *to* and *from* China.

Figure 5 Hong Kong re-exports: origins and destinations (%)



Source: HK Trade Statistics

Two other features of the re-export trade should also be noted. By 1994, half of Hong Kong's exports to China (and three-quarters of *domestic* exports) were the subject of Outward Processing Contracts (OPC) by which Hong Kong supplies materials for manufacture in China and then re-imports them for domestic use and for re-export elsewhere. Three-quarters of Hong Kong's imports from China and over 80% of re-exports originating in China were the product of OPCs.

A growing proportion of China trade passing through Hong Kong is now transhipped rather than being imported and then re-exported. In 1995, transshipment accounted for nearly half sea-borne exports and one fifth of imports⁴. Hong Kong benefits by supplying services such as shipping and marketing, but the goods in question do not appear in the trade figures.

Hong Kong's domestic exports to China grow while stagnating elsewhere

The relocation of much of Hong Kong's manufacturing capacity to Southern China has resulted in substantial changes in the pattern of Hong Kong's domestic exports. Exports to China, both of finished goods and of inputs for China's own production, have increased dramatically, while exports to the US and Europe have stagnated.

Table 4 Hong Kong Domestic Exports by destination

	% share					
	1979	1984	1988	1992	1995	% change 1995/1984
China	1	8	18	27	27	463
<i>of which OPC</i>				20	20	
Other countries	99	92	83	74	73	33
<i>of which</i>						
USA	34	45	34	28	26	0
Japan	5	4	5	5	5	131
West Europe	35	24	26	21	18	29
Others	26	20	18	20	23	93

Source: *Annual Review of Hong Kong External Trade*. Various years.

Although production of lower cost clothing has relocated to China, Hong Kong clothing production has moved upmarket with the result that it remains the dominant

4. *First Quarter Economic Report, 1996*, pp 34, 38.

domestic export. Three fast growing categories account for two thirds of domestic exports.

Table 5 Composition of Hong Kong's Domestic Exports to non-Chinese destinations

SITC	% share					% change 1995/1984
	1979	1984	1988	1992	1995	
75---Office machines & automatic data processing equipment	3	7	7	10	9	78
77--- Electrical machinery, apparatus & appliances n.e.s.	6	9	8	9	15	135
84--- Articles of apparel and clothing accessories	36	36	37	43	40	47
Total domestic exports						33

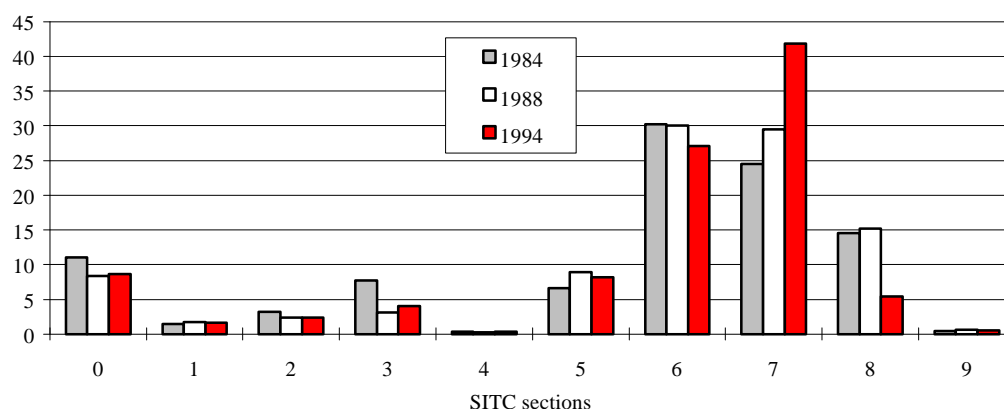
Source: HK Trade Statistics

Changing import structure

While Hong Kong's domestic exports of goods have fallen both as a share of total exports and of GDP, imports retained in Hong Kong have maintained a fairly stable relationship with GDP - around 50% - but represent a dwindling proportion of total imports - from 80% in 1979 to 34% in 1994. Of the remaining 66% of imports, more than half were from China and destined for re-export to third countries, a third were imports from third countries destined for re-export to China, and the remainder were from third countries for re-export to other third countries. This is demonstrated by Figure 5 above.

The commodity composition of Hong Kong's imports is the sum of these categories, and reflect the distinct and changing requirements of the various markets involved. The overall import structure has been a good deal more stable than that of each category.

Figure 6 Sectoral breakdown of Hong Kong's retained imports, 1984, 1988 and 1994 (%)



Source: HK Trade Statistics

The striking feature of *retained imports*, shown by Figure 6, is the sharp increase in the share of machinery and transport equipment imports (from 24% in 1984 to 42% in

1994), particularly vehicles (from 1.2% to 6%), telecommunications and electrical equipment (from 4.4% to 8%), and electrical machinery, apparatus & appliances (from 10% to 15%), and reflecting the consumption and investment needs of an increasingly affluent and sophisticated service economy.

Imports from China reflected the transformation of Hong Kong's relationship with Southern China and the transfer of Hong Kong's manufacturing capacity there. Thus imports used to consist of food, raw materials and semi-manufactures for use in Hong Kong and have been supplanted by clothing, toys and consumer goods for re-export.

Table 6 Imports from China: commodity distribution

SITC classification	<i>as % of total imports from China in the year</i>		
	1984	1988	1994
0---- Food and live animals	16.8	8.4	2.9
1---- Beverages and tobacco	0.9	0.8	1.0
2---- Crude materials, inedible, except fuels	6.9	4.7	1.1
3---- Mineral fuels, lubricants and related materials	4.7	1.1	1.0
4---- Animal and vegetable oils, fats and waxes	0.4	0.1	0.3
5---- Chemicals and related products, n.e.s.	3.8	4.2	2.2
6---- Manufactured goods classified chiefly by material	30.7	25.1	14.6
7---- Machinery and transport equipment	6.6	16.6	24.4
8---- Miscellaneous manufactured articles	28.8	38.5	52.1
9---- Commodities and transactions not elsewhere classified	0.4	0.6	0.5
Primary (0 - 4)	29.7	15.0	6.2
Manufactures (5 - 9)	70.3	85.0	93.8

Source: HK Trade Statistics.

Imports from elsewhere in the world, which consist of a large part for re-export to China, have grown rapidly but have not changed much in composition in recent years - dominated by capital equipment and raw materials for China's burgeoning manufacturing industry.

Table 7 Imports from areas outside China

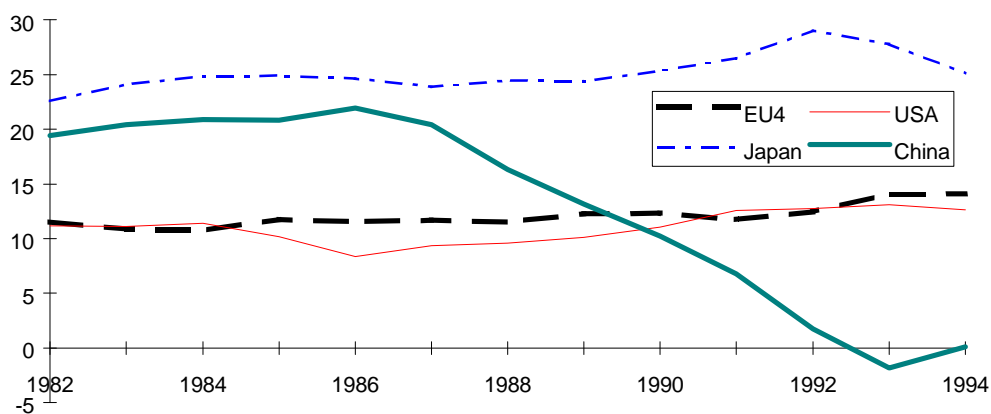
SITC classification	<i>as % of total imports (excl. China) in the year</i>		
	1984	1988	1994
0---- Food and live animals	6.4	5.3	4.7
1---- Beverages and tobacco	1.6	1.9	1.9
2---- Crude materials, inedible, except fuels	3.3	2.8	2.4
3---- Mineral fuels, lubricants and related materials	5.8	2.3	2.5
4---- Animal and vegetable oils, fats and waxes	0.3	0.2	0.2
5---- Chemicals and related products, n.e.s.	8.0	11.1	9.5
6---- Manufactured goods classified chiefly by material	27.9	27.0	24.5
7---- Machinery and transport equipment	32.3	34.4	42.1
8---- Miscellaneous manufactured articles	14.1	14.6	11.9
9---- Commodities and transactions not elsewhere classified	0.4	0.4	0.3
Primary (0 - 4)	17.4	12.5	11.8
Manufactures (5 - 9)	82.6	87.5	88.2

Source: HK Trade Statistics.

The puzzle of dwindling retained imports from China

Retained imports are the residual from imports less re-exports from which a (constant) re-export margin is deducted. A margin of 16% was suggested by a 1988 study by the Hong Kong Trade Development Council (Lardy (1994)). On this basis, Hong Kong's retained imports from China fell dramatically between 1987 and 1994 and apparently became negative in 1993, as shown in figure 7. This implies that, as a percentage of domestic demand (and of GDP) they fell sharply from the 12-13% to which they had risen in the mid-1980s.

Figure 7 Shares in Hong Kong total retained imports, %



Source: derived from HK Trade Statistics

The negative figures for China's retained imports should not happen, by definition. Although no detailed figures have been published for some years, the 1996 Hong Kong Budget documents suggested⁵ that China supplied 7% of retained imports in 1995.

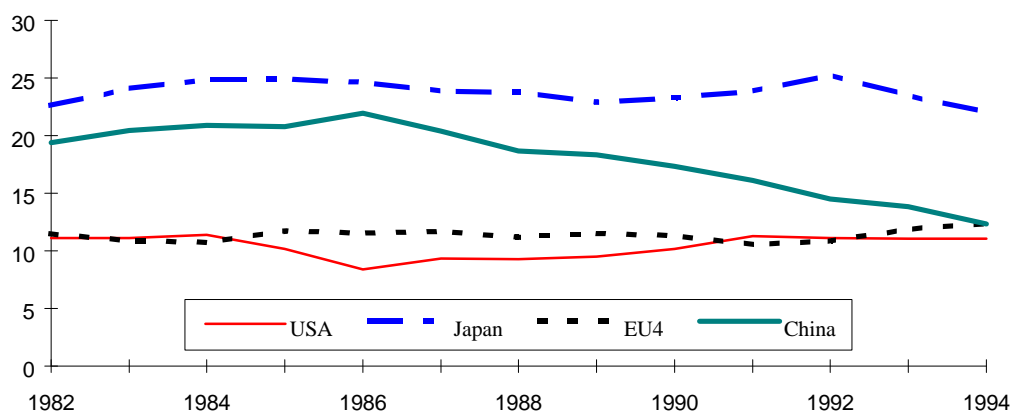
Negative figures could be explained for a time by a run down in stocks, but not on the scale and consistency that has occurred. Nor does the explanation lie in the time-lag between importing and re-exporting the goods in question. As with the timing adjustment discussed above, allowing for this would effectively reduce adjustment for the re-export margin by the growth rate of re-exports in the period during which the goods are handled in Hong Kong. With re-exports growing at 20-30% pa, the margin would have to be reduced by 2-3% for each month in which goods remained in Hong Kong. Recording error is another possibility which should not be ruled out; but there is nothing in the system to suggest why this should give the large and growing discrepancy observed.

The only other obvious possibility is that the re-export margin is much higher than 16%, possibly because the import figures systematically undervalue goods being imported into Hong Kong from China. The close relationship - often the same firm - between the Chinese exporter and the Hong Kong importer certainly makes transfer pricing of this sort a possibility and results in value added (and cash) accruing in Hong Kong rather than China. Financing capital needs in China by direct investment from Hong Kong would bring tax benefits compared with using domestically generated resources. Although the practice has not been much analysed, it appears to be a phenomenon that had been mentioned by some commentators in Hong Kong (e.g., Liu *et al* 1992).

⁵ *Economic Background 1996*, p.57.

Appendix 2 sets out the key figures and illustrates the possible extent of this apparent distortion. The tentative conclusion is that underpricing of imports might be about 20% assuming that the Chinese share of retained imports fell gradually from about 20% in 1987 to 12% in 1994. Other countries' shares would have to be correspondingly reduced, giving the results in Figure 8.

Figure 8 Share of Hong Kong's retained imports, after adjustment of imports from China (%)



Source: see Appendix 2.

Regional trade

Hong Kong's trade is becoming increasingly intra-regional. In 1994, 48% of Hong Kong's *domestic exports* went to Asian destinations, of which 58% (i.e., 27.5% of the Hong Kong's total domestic exports) went to China, largely under outward processing contracts.

Nearly 90% of Hong Kong's *re-exports* were to or from China. Of the 34% going to China, more than seven tenths came from Asian suppliers. Of the 58% coming from China, a quarter went to Asian destinations, about one fifth to Europe and more than a third to the USA.

Most of the remaining 11% of re-export trade was between Asian and non-Asian countries. Of this, about 30% (i.e., 3% of all Hong Kong's re-exports) was between non-Chinese Asian countries.

4. British exports to Hong Kong

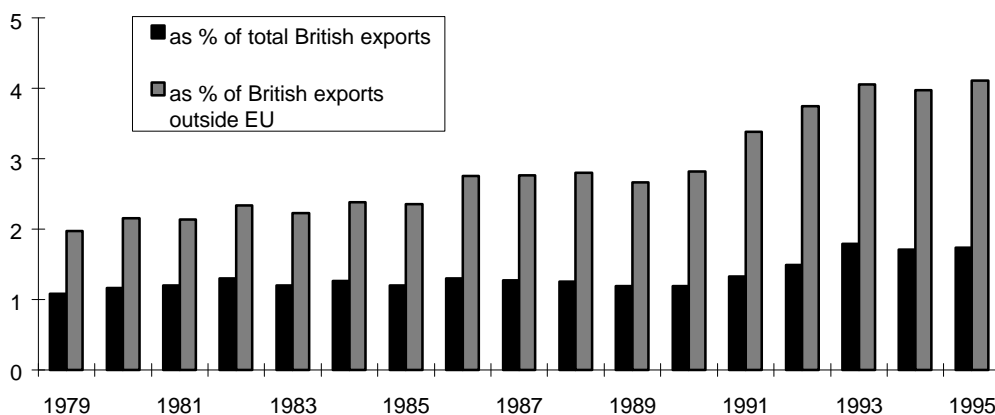
- Hong Kong is a significant and growing market for Britain
- Britain has been losing market share in Hong Kong but is still a leading supplier
- Contrasting performance in Hong Kong's domestic and re-export markets
- Composition of British exports to Hong Kong largely reflects the global pattern
- Declining British market share not the result of changing composition.

A significant market

According to UK figures, some £2.7 billions of British exports went to Hong Kong in 1995 - 1.7% of total exports. Hong Kong was thus Britain's fourth largest market outside the EU, after the USA, Japan and Switzerland, and the twelfth overall. Despite the explosive growth in Hong Kong's trade in the last two decades, this share

remained unchanged at around 1.2% throughout the 1980s and only started to rise in the 1990s - as figure 9 indicates. Also shown in the same chart is the percentage share of exports to Hong Kong in exports outside the EU - 4.1% in 1995.

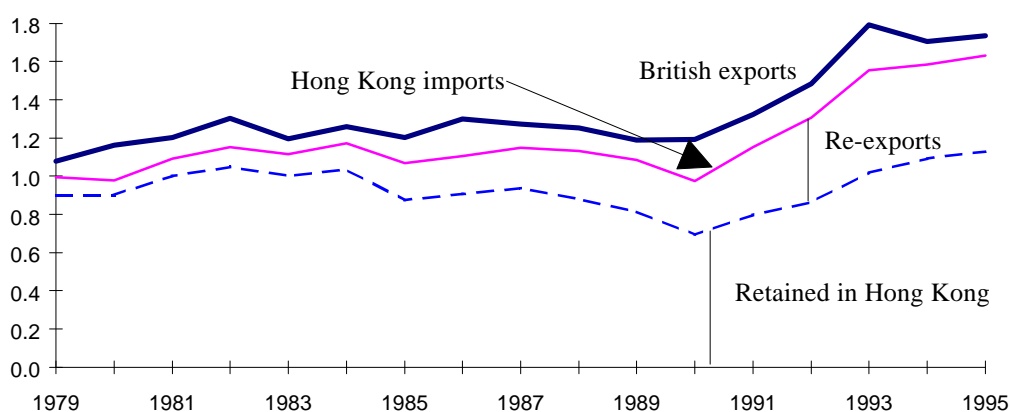
Figure 9 British exports to Hong Kong
as % of British exports



Source: UK OTS.

As Section 2 suggested, by no means all of British exports to Hong Kong end up there. In 1995, only £2.5 billions appear in the HKTS as imports to Hong Kong. Of these, £0.5 billions are re-exported to China, £0.3 billions elsewhere (largely in Asia) and £1.7 billions are retained in Hong Kong. The calculations are shown in Appendix 1 Table A1.2, and the figures are expressed as a percentage of British exports in Figure 10. As this chart makes clear, the reason for Hong Kong's increased importance as an export market since 1979 can be attributed largely to the re-export trade. Exports for retention in Hong Kong have only recently regained their share of the early 1980s.

Figure 10 British Exports to Hong Kong: local consumption and re-exports
as % of British exports



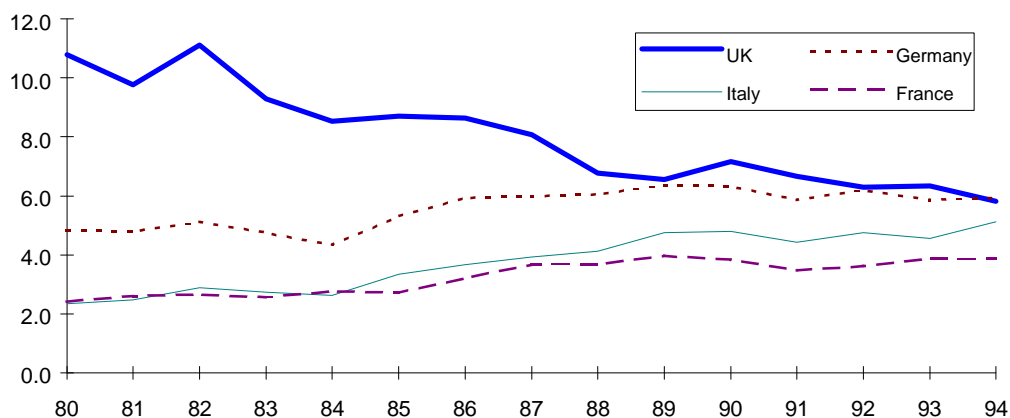
Sources: UK OTS ; HK Trade Statistics

Britain has been losing market share in Hong Kong but is still a leading supplier

OECD and EU figures, based on member countries' export data, suggest that Britain remains Europe's leading exporter to Hong Kong, shown in Figure 11. It is clear,

though that Britain's position has long since ceased to be dominant; as recently as 1982 British exports to Hong Kong were greater than those of Germany, France and Italy combined. They are now all fairly similar, and Germany overtook Britain in 1993.

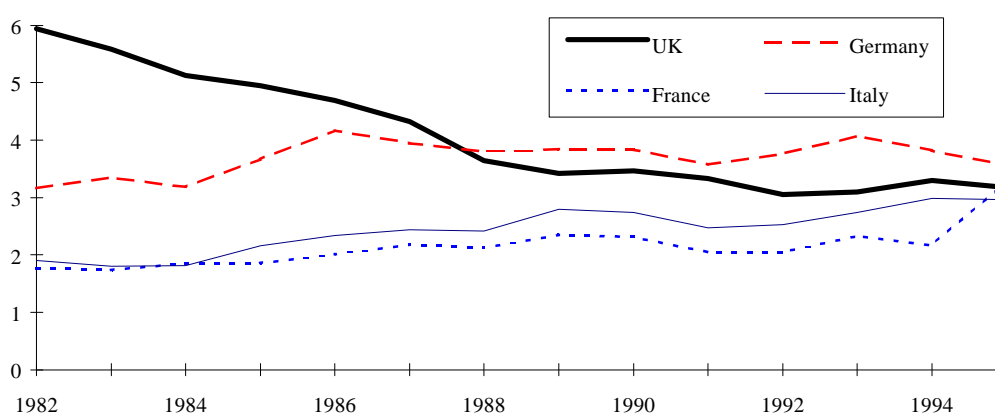
Figure 11 Share of OECD exports to Hong Kong: Major EU 1980-94 (%)



Source: OECD Foreign Trade Statistics

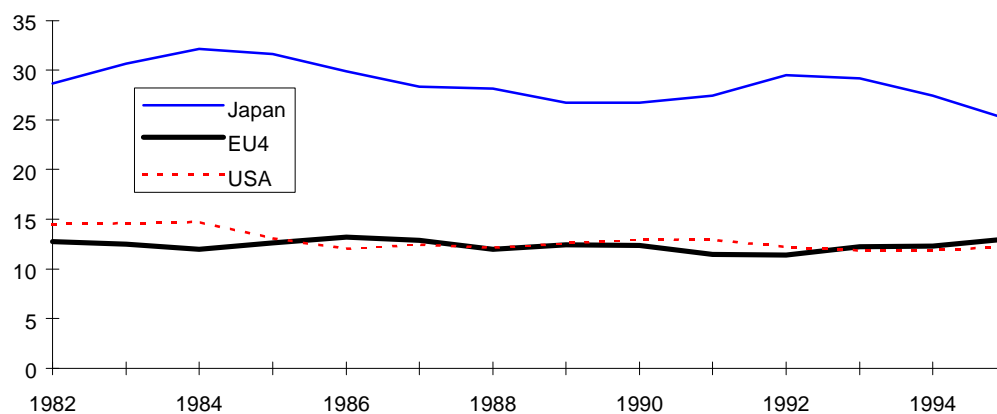
Hong Kong's import figures give a slightly different picture, as figure 12 shows. The same trends are apparent, but Hong Kong's imports from Germany have exceeded those from Britain since 1988. Britain accounted for 2% of Hong Kong's total imports (3.3% of non-Chinese imports), putting Britain in tenth position as a supplier to Hong Kong, well behind Japan (16%), Taiwan (8.6%), the United States (7.8%), Korea (5.1%), Singapore(4%), and Germany (2.3%), Malaysia(2.1%), France(2.1%), and of course China(35%). However, the French figure for 1995 was well above recent levels because of a large delivery of Airbuses in that year. The British content of these aircraft varies between 25 and 50%, but would normally appear in the statistics as British exports to France, underlining the limitations of bilateral trade figures.

Figure 12 Share in Hong Kong total imports (excluding China) (%)



Source: Hong Kong Trade Statistics

Figure 13 Share in Hong Kong total imports (excluding China) (%)



Source: Hong Kong Trade Statistics

As the charts show, most of the decline in the British share occurred in the 1980s and before. It was only in 1993 and 1994 that the decline stopped, with signs that the British share is being maintained just behind Germany (and ahead of France and Italy.)

It is of course hard to judge whether this represents a significantly stronger performance than elsewhere. The most obvious comparison is with other Asian markets:

Table 8 Shares of EU15 exports to selected countries, 1994

	UK	Germany	France	Italy	Others
Hong Kong	20	22	14	19	25
HK (retained imports) *	22	21	11	20	25
Singapore	23	24	13	12	28
China	8	38	13	14	27
India	23	23	10	8	36
Malaysia	28	28	14	8	23
Developing Countries	13	28	16	15	29
Japan	13	32	14	12	29
All countries outside EU	14	29	15	13	29

Sources: Eurostat: *External Trade*. OECD: *Monthly Statistics of Foreign Trade: Series A*.

HK C&SD: *Annual Review of Hong Kong External Trade, 1995*.

*Based on Hong Kong Statistics, excluding Greece, Ireland and Portugal.

It is clear that British trade performance is relatively stronger in Hong Kong than in non-EU markets as a whole, and in developing country markets as a whole. But it differs very little from that in other Commonwealth Asian countries, suggesting that the reason for the relatively high share of the Hong Kong market was long-established trading relationships rather than Hong Kong's colonial status.

An additional indication of the trade shares which might be expected in Hong Kong is provided by gravity model estimates predicting bilateral trade flows on the basis of output in the partner countries and their distance apart (Broadbent and Nishizowa (1996)). Although these estimates must be regarded as suspect in the case of Hong Kong because of its close integration with the Southern Chinese economy, they are suggestive:

Table 9 Expected and actual trade shares in Hong Kong for selected suppliers

	<i>as % of total OECD exports to HK</i>					
	1980		1985		1992	
	Expected	Actual	Expected	Actual	Expected	Actual
UK	5.1	10.8	4.2	8.7	3.6	6.3
Germany	9.0	4.8	6.3	5.3	7.2	6.2
France	6.7	2.4	4.7	2.7	4.6	3.6
Italy	3.8	2.3	3.4	3.3	4.1	4.7
Japan	33.7	41.5	39.0	47.2	51.2	47.2
US	28.9	22.4	30.3	18.8	18.9	17.3

Sources: OECD and Broadbent and Nishizowa (1996).

Contrasting performance in Hong Kong's domestic and re-export markets

Some 50% of Hong Kong's imports from sources other than China are retained for use in Hong Kong. The rest are re-exported, mostly to China. In the case of imports from Britain, retained imports account for an even higher proportion. There are significant differences in market shares between these two components. These are illustrated in Figures 14a and 14b.

Figure 14a Share in Hong Kong total re-exports (excluding China), %

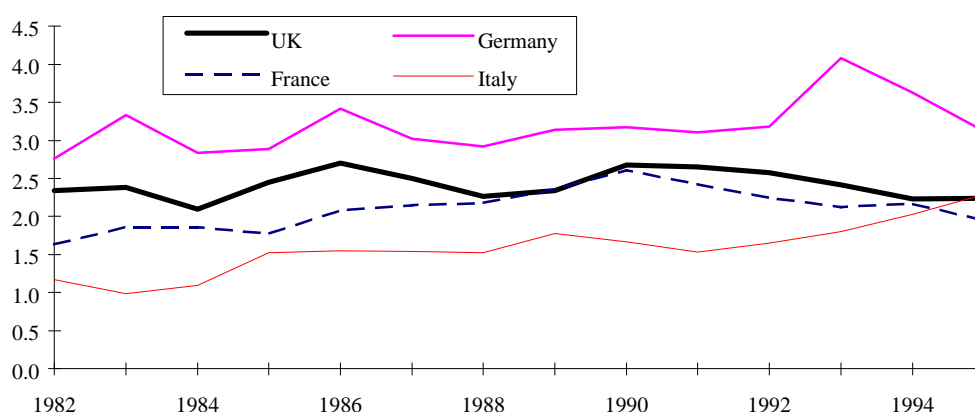
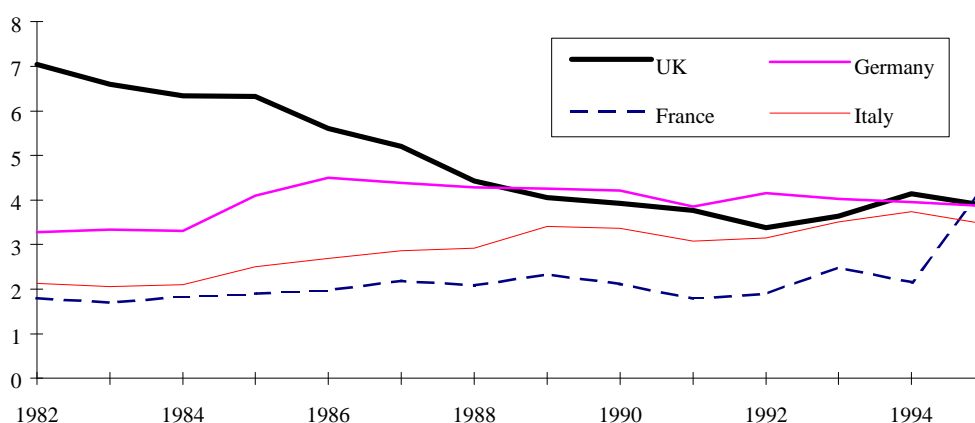


Figure 14b Share in Hong Kong's total retained imports (excluding China), %



Source: Hong Kong Trade Statistics.

The British share of retained imports fell sharply during the 1980s, before levelling off at around 3.5%: in 1994 Britain regained its position as the leading European supplier

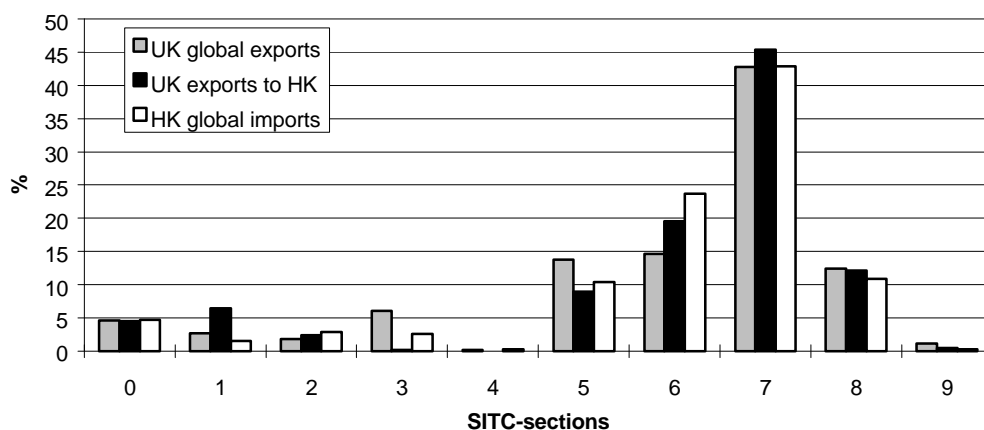
of retained imports, but lost that lead to France in 1995. By contrast the British share of the much faster growing (non-Chinese) imports for re-export has remained at around 2% for the past 15 years.

Thus although the British share of both retained imports and of re-exports has been more or less stable since 1990, Britain's overall share has contained to fall because of the growing relative importance of re-exports - in which the British share was stable and similar to that of the major European competitors.

Composition of British exports to Hong Kong

As might be expected, the pattern of British exports to Hong Kong reflects both the pattern of British output and exports as a whole and the pattern of demand in Hong Kong. This is dominated by machinery and transport equipment, which accounts for over 40% of each total (and, incidentally, nearly 40% of world trade).

Figure 15 Shares of UK exports, UK exports to HK and HK imports by SITC 1995



Source: UK ONS; HK Trade Statistics.

As the chart demonstrates, there are some exceptions. There is virtually no bilateral trade in oil, although it is a British export and a Hong Kong import; by contrast, bilateral trade in drink and tobacco is disproportionately large on both sides.

Table 10 lists the 16 largest categories (defined as SITC two-digit groups) of British exports to Hong Kong in 1995. Together they account for 74% of total exports. The first three columns of the data compare the shares of British exports to Hong Kong in 1994 and 1995 with those in 1984, before the expansion of re-export trade with China. The table also includes for each category a "specialisation ratio" relating the share of British exports to Hong Kong to the share in British exports as a whole and to the share in Hong Kong's imports as a whole. Finally the table shows the market share of British imports in each category in 1984 and 1995. It will be obvious that the second (Hong Kong) specialisation ratio for each category in 1995 is directly related to the UK's market share:

$$(\text{specialisation ratio for category}) = \frac{(\text{British market share in category})}{(\text{overall British market share})}$$

Thus the largest category - electrical machinery and components (SITC 77) - which is also one of the fastest growing, accounts for 12.4% of British exports to Hong Kong,

nearly double the share of this category in British exports as a whole. This is not, however, evidence of abnormal success in Hong Kong because this category accounts for an even higher share of Hong Kong's imports, and the British market share is only 2.9%. Much of the growth in this category is in fact concentrated in two much narrower sub-categories (SITC 772 electrical components) and 776 (valves etc), most of which are re-exported to China as inputs for China's burgeoning electrical goods and electronics industry.

The same tendencies are evident in another large and rapidly growing category, SITC 76 (telecommunications and sound recording apparatus), where its share in British exports to Hong Kong is more than double than in total British exports but a third less than its share in Hong Kong's total imports. One sub-category accounts for most of this trade - telecommunications equipment and parts (SITC 764) - which includes parts for radio and television assembly. Much of this is re-exported to China.

Table 10 Sectoral breakdown of British exports to Hong Kong and specialisation ratio in 1995

Commodity classification	Share of each commodity in UK's exports to HK (%)			Specialisation relative to		UK market share(%) in HK's non-Chinese imports	
	1984	1994	1995	British exports	HK imports ex.China	1984	1995
12---Tobacco and tobacco manufactures	1.6	6.7	5.1	6.9	6.2	7.9	19.7
53---Dyeing, tanning and colouring materials	2.4	2.6	2.0	1.9	2.7	13.7	8.6
65---Textile yarn, fabrics, made-up articles, related products	4.1	3.4	3.3	1.5	0.4	1.8	1.2
66---Non-metallic mineral manufactures, n.e.s.	2.9	3.1	3.5	1.2	0.9	3.3	2.9
67---Iron and steel	2.1	4.3	3.4	1.2	1.2	3.7	4.0
68---Non-ferrous metals	1.3	2.2	2.9	1.6	1.4	3.7	4.5
69---Manufactures of metal, n.e.s.	5.4	5.8	2.9	1.4	2.5	13.0	7.8
71---Power generating machinery and equipment	12.8	4.8	5.8	1.4	3.3	49.2	10.7
74---General industrial machinery & equipment, and parts	5.1	3.5	3.2	0.7	0.9	10.8	3.0
75---Office machines & automatic data processing equipment	3.6	3.0	2.7	0.4	0.5	4.4	1.7
76---Telecommunications & sound recording apparatus	1.8	6.6	12.2	2.9	1.4	1.7	4.4
77---Electrical machinery, apparatus & appliances n.e.s.	7.8	12.4	13.6	1.8	0.9	3.2	2.9
78---Road vehicles (including air-cushion vehicles)	4.2	5.3	4.6	0.6	1.1	8.2	3.4
84---Articles of apparel and clothing accessories	1.6	2.5	2.4	1.3	2.2	6.2	7.0
88---Photographic apparatus, optical goods, watches	1.8	2.1	2.1	1.7	0.5	1.4	1.5
89---Miscellaneous manufactured articles, n.e.s.	4.1	3.8	3.7	0.7	1.2	5.3	3.8

Sources: UK OTS and HKTS.

In only two other major categories do UK exports to Hong Kong take an abnormal share of the trade when compared both with British exports and Hong Kong's imports.

One of them is SITC 12 (almost entirely cigarettes). Around three quarters of Hong Kong's imports of cigarettes are later re-exported. China accounts for less than half of these re-exports, other major destinations being the Philippines and Korea.

By contrast, the other category in which the UK appears to be particularly strong, power-generating equipment, is far less significant as a proportion of the total than it was a decade earlier. This to some extent reflects relatively slow growth in Hong Kong's total imports and in re-exports to China; but it also reflects a decline in the UK's market share from 49% in 1984 to 11% in 1995.

Declining British market share not the result of changing composition.

As the previous section has indicated, the overall decline in the British market share in Hong Kong is reflected in a decline in market share in most categories of imports, albeit to a varying extent. However, part of the explanation for the change in overall market share may lie in changes in the *composition* of import demand. A supplier country which specialises in the production of goods for which demand is growing rapidly will tend to gain market share, other things being equal. In the case of Hong Kong, the composition of import demand has tended to favour Britain's output structure, and has gone some way towards offsetting a general decline in market share across the board.

The relative importance of these factors in a given period can be quantified by making two alternative assumptions:

- a. That British exports in each category grow at the same rate as Hong Kong's imports in that category. This is the same as saying that Britain maintains a constant market share in each category. Any resulting change in Britain's overall share in the market can be described as the *composition effect*.
- b. That Hong Kong's total imports in each category grow at the same rate, ie the rate at which total imports grow, but that Britain's share of any increment in each category's market (ie the elasticity of British exports to market size) is that which actually prevailed. Thus the structure of the market is unchanged. The resulting change in Britain's overall share in the market can be described as the *competitive effect*.

A detailed exposition of these calculations is set out in the Appendix 3. The key parameters and the results are set out in Table 11, where:

- f_1 = UK share of Hong Kong imports in 1984 (%)
- f_2 = share of category in HK market in 1984 (%)
- f_3 = elasticity of UK exports to HK imports 1984-94
- f_4 = elasticity of HK imports to total HK imports 1984-94

Values for f_3 above 1 indicate categories in which the UK gains market share, and values for f_4 above 1 indicate categories in which the market is growing faster than the overall market. Only in SITC 1- drink and tobacco- has this favourable combination for the UK.

Thus the overall loss of 2 percentage points in the UK's market share in the period is offset by a gain of about 0.6 percentage points resulting from favourable changes in the

composition of demand, but offset by a larger loss in general competitiveness.

The calculations can be repeated using the shares in the terminal date (1994) for f_1 and f_2 , or indeed for the average over the whole period: the result broadly the same.

Table 11 Contributions to changes in market share: Britain in Hong Kong 1984-94

SITC	Growth (% pa) in imports from		Changes in market shares (%) due to						
	UK	World					Total	Composition	
	\dot{b}_i	\dot{w}_i	f_1	f_2	f_3	f_4	Competitiveness Δk_i	Δk_i (H1)	Δk_i (H2)
0	12.2	13.3	2.9	6.4	0.9	0.8	-0.1	-0.1	0.0
1	24.9	18.8	8.9	1.6	1.3	1.1	0.1	0.0	0.1
2	13.9	13.3	1.9	3.3	1.0	0.8	0.0	0.0	0.0
3	17.8	6.4	0.1	5.8	2.8	0.4	0.0	0.0	0.0
4	8.0	13.9	0.3	0.3	0.6	0.8	0.0	0.0	0.0
5	8.6	20.0	8.9	8.0	0.4	1.2	-0.4	0.2	-0.4
6	9.9	15.5	4.8	27.9	0.6	0.9	-0.6	-0.2	-0.5
7	10.4	20.0	6.7	32.3	0.5	1.2	-0.9	0.6	-1.2
8	13.0	15.3	4.0	14.1	0.8	0.9	-0.2	-0.1	-0.1
9	15.3	13.4	5.7	0.4	1.1	0.8	0.0	0.0	0.0
Total	11.2	17.0	5.2	100	0.7	1.0	-2.0	0.6	-2.2

Source: see Appendix 3.

5. British imports from Hong Kong

- Hong Kong is a modest but increasingly significant supplier
- Most of Britain's imports from Hong Kong originate in China
- Britain still an important market for Hong Kong's domestic exports, but to a diminishing extent
- Britain takes a small but rising share of HK's fast-growing re-exports from China
- Concentrated on a narrow front, particularly clothing
- Large share of UK market for some products, mostly re-exports from China

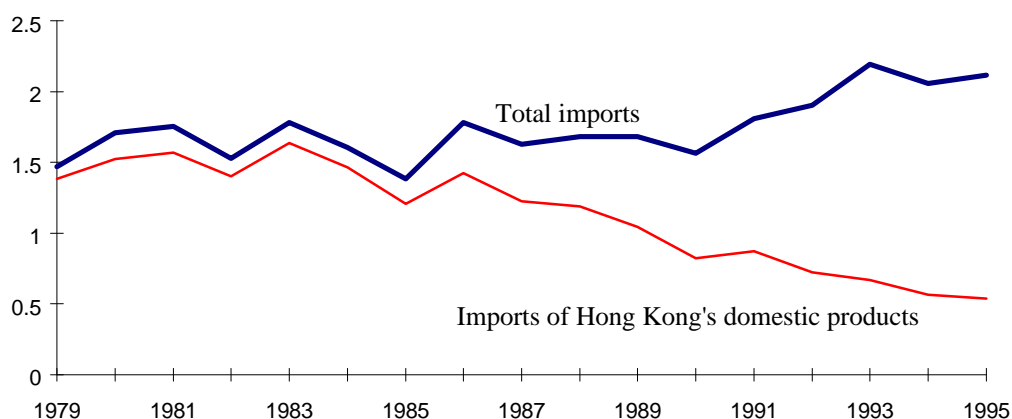
A modest but increasingly significant supplier

In 1995 Britain imported £3.5 billions of goods from Hong Kong, making Hong Kong its 13th largest supplier and the third outside Europe - behind only the United States (£20.3 billions) and Japan (£9.6 billions).

Imports from Hong Kong account for between 1.5 and 2% of Britain's total imports. This share fluctuated around 1.5% until 1990 when the trend turned upwards:

Figure 16 Hong Kong's share of British imports

as % of British imports



Sources: UK OTS. Ratio of HK's domestic and re-exports is based on HK statistics.

Most of Britain's imports from Hong Kong originate in China

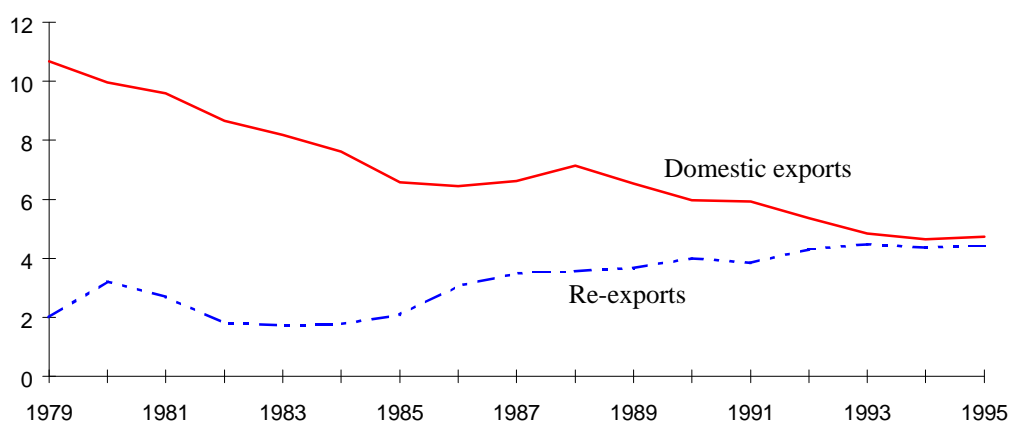
In the early 1980s domestic production accounted for some 90% of Hong Kong's exports to Britain. By the end of the decade re-exports had overtaken domestic production, and now account for over 70% of the total. More than 90% of these re-exports originate in China. Thus nearly 70% of Britain's imports from Hong Kong actually originate in China.

Britain still an important market for Hong Kong's domestic exports

From Hong Kong's point of view Britain remains a significant market, but its relative importance has been declining:

Figure 17 Hong Kong's exports to Britain

as % of HK's all exports in each category



Source: Hong Kong Trade Statistics.

Note: The chart shows Hong Kong's domestic exports to Britain as a percent of its total domestic exports, and Hong Kong's re-exports to Britain as a percent of its total re-exports excluding those to China.

In 1979 Britain took nearly 11% of Hong Kong's domestic exports; second only to the United States. By 1995 the figure had fallen to 5%. Even so, this means that Britain is

still the sixth largest market for Hong Kong's domestic exports, having been overtaken by China in 1984, by Germany in 1986, by Singapore in 1993 and Japan in 1994.

Re-exports from China

Britain is also a significant destination for Hong-Kong's fast-growing re-exports from China, well behind the United States, Japan and Germany but more than France or Italy. Britain is very nearly as reliant as the United States on this source of supply; taking re-exports to the value of 0.35% of GDP.

Table 12 Main markets for re-exports from China: Britain compared with others

	1990 % share	1995 % share	1995, as a % of	
			total imports	GDP
United Kingdom	4.5	4.7	1.5	0.35
Germany	8.9	6.7	1.3	0.23
France	2.4	2.6	0.8	0.14
Italy	(2.0)	1.9	0.8	0.14
Japan	6.7	9.3	2.3	0.16
United States	34.1	33.6	3.6	0.38

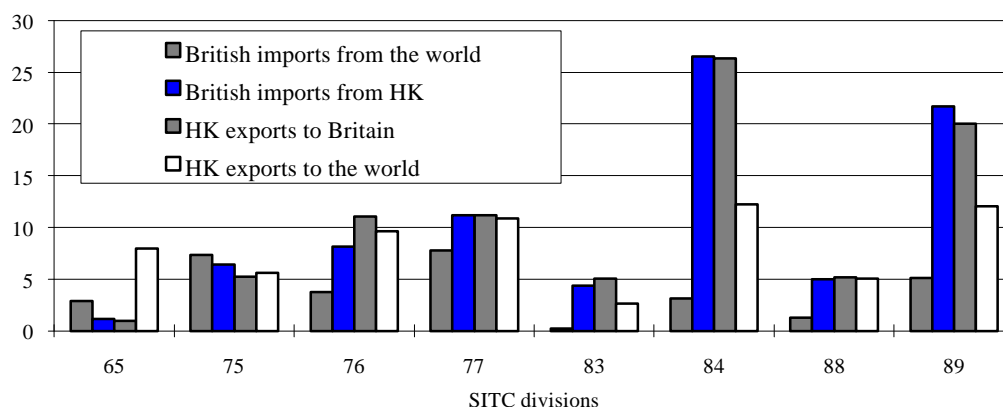
Source: *Annual Review of Hong Kong External Trade*

British imports from Hong Kong concentrated on a narrow front

British imports from Hong Kong broadly reflect the structure of Hong Kong's exports as a whole, but diverge from the pattern of British imports. 70% of the flow is concentrated in just four SITC two-digit sections (radios and televisions (76), electrical goods (77), clothing (84), and miscellaneous manufactures (89 - notably toys), with three others accounting for a further 15%.

Figure 18 Structure of Hong Kong's exports to Britain, 1995

% share of each SITC division in total



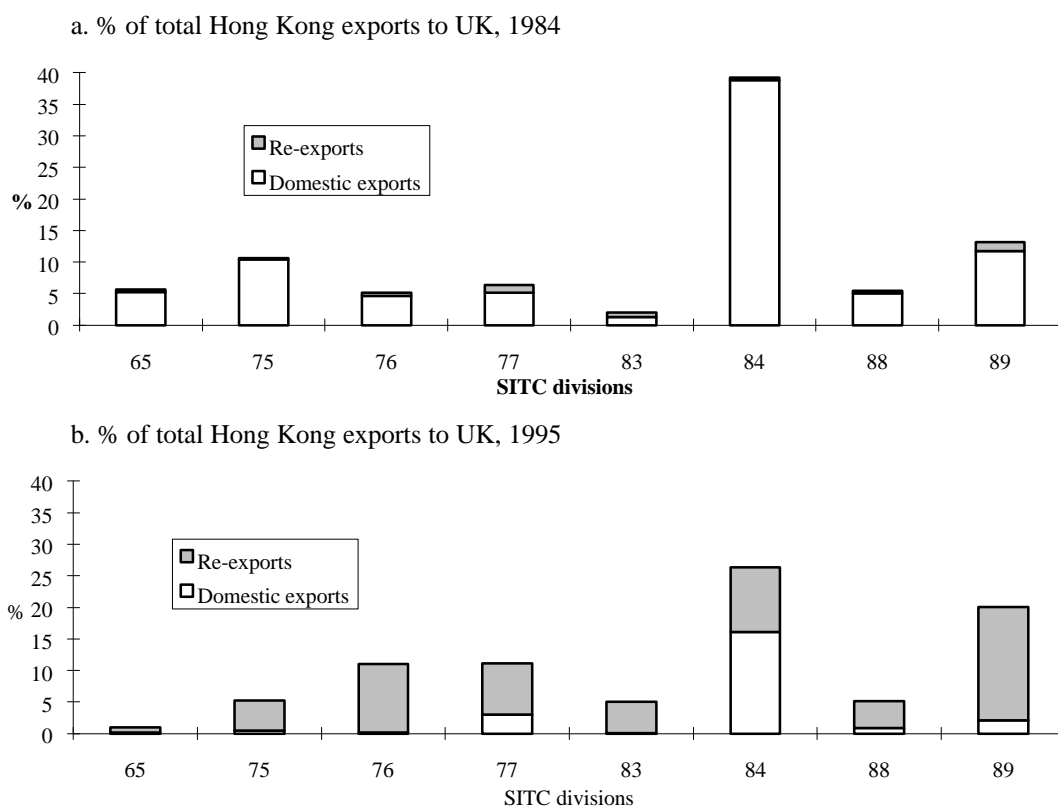
Sources: HK Trade Statistics; UK OTS.

As the discussion in Section 2 above indicates, British and Hong Kong figures give a slightly different picture because the former include some trade originating in China and not passing through Hong Kong. However, the figures are close enough for the

Hong Kong export figures to be used to identify whether particular categories of imports from Hong Kong originated in Hong Kong or China.

The same seven categories accounted for 82% of Hong Kong's exports in 1984, but the distribution was different. In 1984 the structure of total exports almost entirely reflected that of domestic exports, whilst a decade later it was more a reflection of the structure of re-exports.

Figure 19 Structure of Hong Kong's exports to Britain, 1984 and 1995



Source: HK Trade Statistics

Figure 19 underlines the extent to which production has been relocated from Hong Kong to China in most of these categories. It also gives an idea of the extent to which domestic exports to Britain became more concentrated. By 1995, clothing accounted for two thirds of the total, compared with 42% in 1984. It is also interesting to note that although the share of re-exports of clothing also increased in this period from 5 to 16% of all re-exports, the combined effect was a *fall* in the share of total clothing exports to Britain.

The concentration of Hong Kong's exports to Britain in a few categories means that Hong Kong is a major supplier in some categories of goods. Table 13 identifies categories of goods in which Hong Kong's share of British imports was more than 8% in 1992 (on the basis of British figures) and then, using Hong Kong's export figures, indicates how much of this share was attributable to *domestic* exports⁶.

Table 13 Hong Kong's share of British imports by commodity

SITC	% share			
	1984	1988	1992	1995 of which

6. As explained above, these estimates are approximations and represent an upper bound.

				Domestic Value (£m)			
6	Manufactured goods classified chiefly by material	1.0	0.7	0.7	0.7	0.1	21
7	Machinery and transport equipment	1.3	1.0	1.1	1.5	0.2	138
8	Miscellaneous manufactured articles	8.3	8.3	8.6	9.5	3.1	711
0-9	Total trade	1.6	1.7	1.9	2.1	0.5	896
76	Telecommunications & sound recording apparatus	3.8	5.3	4.6	4.6	0.1	5
83	Travel goods, handbags and similar containers <i>of which</i>	16.8	27.5	31.8	35.0	0.3	1
831	Travel goods, handbags, brief-cases, purses, sheaths	16.8	27.5	31.8	35.4	0.3	1
84	Articles of apparel and clothing accessories <i>of which</i>	23.2	21.1	17.5	17.7	10.9	575
842	Outer garments, men's, of textile fabrics	27.6	24.0	18.6	19.2	12.0	145
843	Outer garments, women's, of textile fabrics	23.4	19.6	17.7	17.4	5.5	16
844	Under garments of textile fabrics	39.3	40.7	37.5	15.5	5.7	21
845	Outer garments and other articles, knitted	20.6	19.4	17.4	19.9	12.7	192
846	Under garments, knitted or crocheted	15.6	20.0	13.7	5.1	2.4	7
848	Art. of apparel & clothing accessories, no textile	14.5	10.0	8.9	11.6	1.1	4
88	Photographic apparatus, optical goods, watches	5.6	7.2	6.6	8.1	1.4	31
89	Miscellaneous manufactured articles, n.e.s. <i>of which</i>	5.7	5.6	7.9	9.0	0.9	80
894	Baby carriages, toys, games and sporting goods	18.7	18.7	19.5	22.3	0.2	3
897	Jewellery, goldsmiths and other art. of precious m.	3.3	5.1	12.3	10.7	4.0	40

Sources: OECD, HK Trade Statistics

These figures do not, of course, represent shares of the total UK market, since they do not take account of domestic supplies. In several of the categories above, British domestic production has been losing share to imports. However, these figures show clearly that:

- (a) for goods in which Hong Kong appears to have large share of *imports*, this was generally established some time ago and in many cases is now in decline as other competitors have moved in;
- (b) in the cases in which Hong Kong's market share is increasing, re-exports rather than domestic exports are responsible;
- (c) domestic exports from Hong Kong are dominant in very few cases.

6. Trade between Britain and China: a reassessment

British trade statistics suggest that Hong Kong is a far more important trading partner for Britain than is China. In 1994 recorded exports to Hong Kong were three times those of China and imports from Hong Kong were nearly double those from Hong Kong.

As the above sections demonstrate, a substantial proportion of Britain's exports to Hong Kong end up elsewhere - mostly in China - while the bulk of British imports from Hong Kong originate in China. When recorded direct trade with China is included, British exports to China slightly exceed those to Hong Kong, while imports originating in China are more than double those from Hong Kong:

Table 14 British trade with Hong Kong and China, 1994

	<i>per cent</i>			
	China+Hong Kong	Hong Kong	China	other countries
exports:				
published UK data	100	73	27	0
after adjustment	88	43	45	12
imports:				
published UK data	100	65	35	0
after adjustment	97	26	71	3

Source: see Appendix 1

This should not of course be taken to imply that Hong Kong's role in generating trade is in any way diminished. Hong Kong is clearly the crucial bridge with China, and doubtless has a role in much of the trade which is recorded as direct trade with China.

The same adjustments can be applied to other countries' trade with Hong Kong and China. In the case of France, Germany and Italy, this effect is somewhat less pronounced than for Britain:

Table 15 EU4 exports to Hong Kong and China, 1994

	<i>US\$ m (per cent)</i>							
	China+Hong Kong		Hong Kong		China		other countries	
exports:								
published national data:								
UK	4814	(100)	3541	(73)	1273	(27)	0	(0)
Germany	9897	(100)	3586	(36)	6311	(64)	0	(0)
France	4491	(100)	2331	(52)	2160	(48)	0	(0)
Italy	5419	(100)	3141	(58)	2278	(42)	0	(0)
after adjustment:								
UK	4240	(88)	2062	(43)	2178	(45)	575	(12)
Germany	9457	(96)	1850	(19)	7607	(77)	441	(4)
France	3761	(84)	898	(20)	2863	(64)	730	(16)
Italy	4747	(88)	1822	(34)	2925	(54)	672	(12)

Source: see Appendix 1

Before these adjustments, Hong Kong appears to be a slightly more important export market than China for France and Italy. After the adjustment, the position is reversed. In the case of Germany, this further increases the relative importance of China.

These adjustments also allow a revised assessment of British export performance in Hong Kong and China compared with the other major EU economies. While the published figures (Table 8 above) suggest that the UK has a relatively high market share in Hong Kong, the share in China is far below that of the other major EU competitors and below the UK's share in developing country markets as a whole.

The adjusted figures indicate a somewhat stronger relative performance:

Table 16 Shares of EU4 exports to Hong Kong and China, adjusted, 1994

	<i>per cent</i>			
	UK	Germany	France	Italy
Hong Kong + China	20	40	18	22
Hong Kong (retained imports)	31	28	14	28
China	14	49	18	18
developing countries*	19	39	22	21

Source: see Appendix 1

*Shares in EU4 exports to non-OECD countries, based on exports data from OECD: *Monthly Statistics of Foreign Trade: Series A*.

7. Conclusion

For three decades Hong Kong's trade has grown consistently faster than any other territory's. With 3.6% of world trade, it has the eighth largest share. It is not surprising that Hong Kong is one of Britain's more significant trading partners, accounting for some 2% of the total. Outside Europe this is exceeded only by the US and Japan. British exports to Hong Kong were £2.7 billions in 1995, three times recorded exports to China, while imports of £3.4 billions were nearly twice those from China. However, the figures are somewhat misleading: more British exports ended up in China than in Hong Kong, and far more imports originated in China than in Hong Kong. After allowing for this indirect trade with China, Britain may actually be running a bilateral trade surplus with Hong Kong.

From the beginning of British administration, Hong Kong's *raison d'être* was as an entrepot for trade between China and the outside world. From the 1950s, growth was driven by exports of Hong Kong's own manufactures, particularly clothing and textiles, until the early 1980s, when economic reform opened China to foreign trade and investment. Hong Kong took the leading role in both, shifting much of its manufacturing to Southern China and concentrating on services. Between 1979 and 1995, the value of Hong Kong's trade grew by more than that of any single country. All of this growth came from re-exports to and from China. By 1995 these accounted for more than 70% of Hong Kong's trade.

Britain's position as Hong Kong's leading European trading partner eroded steadily throughout the 1980s, but has since been more stable and remains relatively strong. During this period the British share of Hong Kong's non-Chinese imports halved, to just over 3%. This decline comprised two elements - a fall in Britain's relatively high share of imports absorbed in Hong Kong, of which Britain remains the largest European source; and the growing importance of the re-export trade, in which the

more stable British share has been smaller but still respectable.

The changing composition of Hong Kong's import demand does not account for Britain's falling share but tends to increase it. The general tendency has been falling share across the board. A small but striking exception is tobacco.

Although British export performance in Hong Kong remains relatively strong, the figures suggest that it is weak in China. However, the contrast is slightly less pronounced when they are adjusted to take account of trade through Hong Kong. The combined performance is about what might be expected by comparison with France and Italy.

Hong Kong is of growing importance as a supplier for Britain, although most of the goods involved originate in China. On the other hand, Britain's relative importance as a market for Hong Kong has diminished. Even so, Britain lies just behind Germany as a destination for Hong Kong's domestic exports, taking just under 5%. Two thirds of these are clothing, but Hong Kong is not a dominant supplier in any sector.

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Appendix 1. Britain - Hong Kong bilateral trade data: discrepancy and reconciliation

Discrepancies in bilateral data

Comparison of UK and Hong Kong bilateral trade data on reveals considerable discrepancies between the two data sets. These are detailed in table A1.1 below.

As discussed in section 2 of the main text, a flow of exports, when adjusted to allow for the transit lag and the cif margin, should be equal to the import flow of the trading partner. Using the assumptions on transit lag and the derived c.i.f. adjustment factor for UK-Hong Kong trade described there, we get Table A1.1⁷.

Table A1.1, Part I **British exports to Hong Kong**

US\$ million

	UK's exports to HK	Allowing for time lag	Allowing for time lag&cif	HK's imports from UK	Diff	Diff%
	X	X_t	X_{tc}	M	$X_{tc} - M$	$X_{tc} / M - 1$
1980	1300	1229	1381	1094	287	26.3%
1981	1238	1247	1401	1125	276	24.5%
1982	1284	1277	1435	1136	299	26.3%
1983	1101	1125	1264	1027	237	23.1%
1984	1194	1179	1325	1113	212	19.0%
1985	1221	1217	1367	1084	283	26.1%
1986	1409	1377	1547	1198	349	29.2%
1987	1661	1618	1818	1502	316	21.0%
1988	1834	1806	2029	1655	374	22.6%
1989	1819	1821	2046	1662	384	23.1%
1990	2216	2146	2411	1812	599	33.1%
1991	2448	2410	2708	2129	579	27.2%
1992	2825	2761	3102	2483	619	24.9%
1993	3195	3133	3521	2771	750	27.1%
1994	3541	3484	3915	3287	628	19.1%
1995	4819	4572	5137	3936	1201	30.5%
<i>Average</i>					462	25.2%

Sources: Calculated from DOTS (IMF) data and *HK Trade Statistics*.

Table A1.1, Part II **British imports from Hong Kong**

US\$ million

UK's Imports from HK	HK's Exports to UK	Of which Domestic	Allowing for time lag	Allowing for time lag	Allowing for time lag&cif	Allowing for time lag&cif	Diff	Diff _d	Diff%	Diff _d %
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7. The formula is: $X_t = X/(1+g*0.15)$, $X_{tc} = X_t / (1+cif)$, where g is the annual growth rates of the original exports series X , $c.i.f.$ is the 3rd column in Table 1 of the main text for Hong Kong's exports to Britain and is -11% for UK's exports to Hong Kong, X_t is exports after adjustment for transit lag, further adjustment to include c.i.f results in X_{tc} .

	M	X	X_d	X_t	X_{dt}	X_{tc}	X_{dtc}	$X_{tc} - M$	$X_{dtc} - M$	$X_{tc} / M - 1$	$X_{dtc} / M - 1$
1980	1976	1527	1363	1481	1334	1590	1432	-386	-544	-19.5%	-27.5%
1981	1798	1537	1375	1535	1373	1657	1482	-141	-316	-7.8%	-17.6%
1982	1532	1293	1185	1325	1210	1429	1306	-103	-226	-6.7%	-14.8%
1983	1794	1269	1165	1273	1168	1341	1230	-453	-564	-25.3%	-31.4%
1984	1681	1467	1342	1433	1312	1507	1380	-174	-301	-10.3%	-17.9%
1985	1512	1255	1097	1283	1128	1358	1194	-154	-318	-10.2%	-21.0%
1986	2229	1590	1271	1529	1241	1552	1260	-677	-969	-30.4%	-43.5%
1987	2518	2202	1654	2082	1583	2160	1642	-358	-876	-14.2%	-34.8%
1988	3187	2811	1989	2699	1930	2864	2048	-323	-1139	-10.1%	-35.7%
1989	3352	3020	1877	2987	1893	3125	1980	-227	-1372	-6.8%	-40.9%
1990	3526	3287	1733	3244	1753	3406	1840	-120	-1686	-3.4%	-47.8%
1991	3780	3651	1764	3591	1759	3780	1851	0	-1929	0.0%	-51.0%
1992	4209	4281	1620	4173	1640	4370	1718	161	-2491	3.8%	-59.2%
1993	4498	4564	1392	4519	1422	4758	1498	260	-3000	5.8%	-66.7%
1994	4735	4866	1332	4818	1340	5074	1412	339	-3323	7.2%	-70.2%
1995	5578	5584	1414	5463	1401	5729	1470	151	-4108	2.7%	-73.7%
Average								-138	-1448	-7.8%	-40.9%

Sources: Calculated from DOTS (IMF) data and *HK Trade Statistics*.

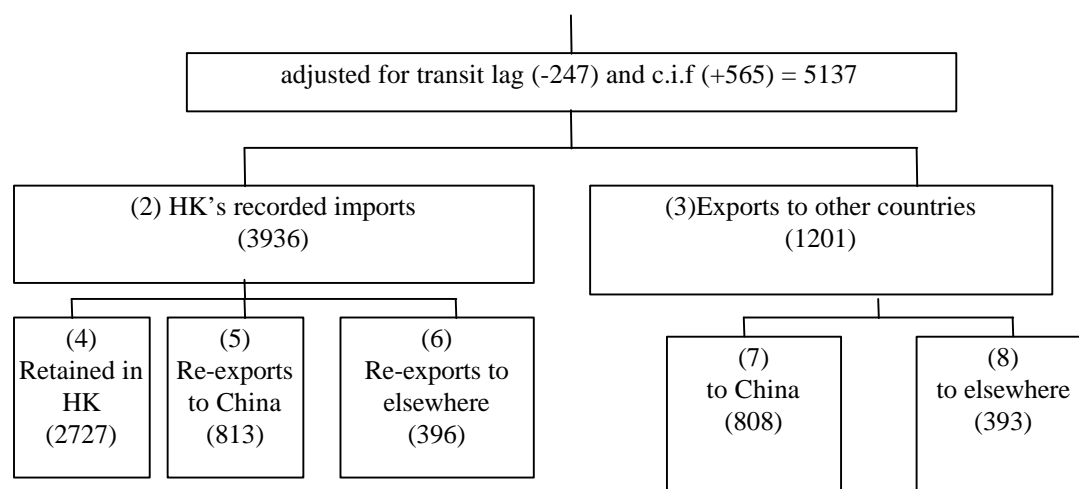
Adjustment of published data

The discrepancy arises because of Hong Kong's role as an entrepot and as a transshipment centre for the region, with the result that UK trade figures attributed too Hong Kong some trade with third countries, both direct and indirect. The approach adopted here is to use Hong Kong's trade statistics to reallocate part of the corresponding series of British data to sources and destinations other than Hong Kong, after allowing for the transit lag and c.i.f.. Furthermore, trade with Hong Kong's domestic economy and trade with other economies via Hong Kong are distinguished using Hong Kong's data.

a. British exports

The following scheme explains the adjustment procedure (illustrated with 1995 figures in US\$ million):

$\begin{matrix} (1) \\ 32 \\ \text{Recorded British exports to Hong Kong} \\ (4819) \end{matrix}$



Of the total exports to Hong Kong shown in British statistics (1), there is a counterpart in Hong Kong import data (2), and the residual (3) is attributed to transshipment elsewhere. Of Hong Kong's total imports from Britain (2), part are retained in Hong Kong (4)⁸; the rest are re-exported to China (5), and elsewhere (6). Finally, the total for transshipment to countries outside Hong Kong is split between China and elsewhere.

After the adjustment, British exports data comprises three components: exports ends up in Hong Kong (3), in China (4+7), and elsewhere (5+8). Table A1.2 gives the results.

Table A1.2 British exports to Hong Kong and China: before and after adjustment

<u>Published British Exports</u>				<u>After Adjustment</u>				
to Hong Kong		to China		Of the total British exports to HK & China				
£m	(%)	£m	elsewhere	Retained in HK	Ends up		Ends up in China	
(%)				£m	(%)	£m	(%)	£m

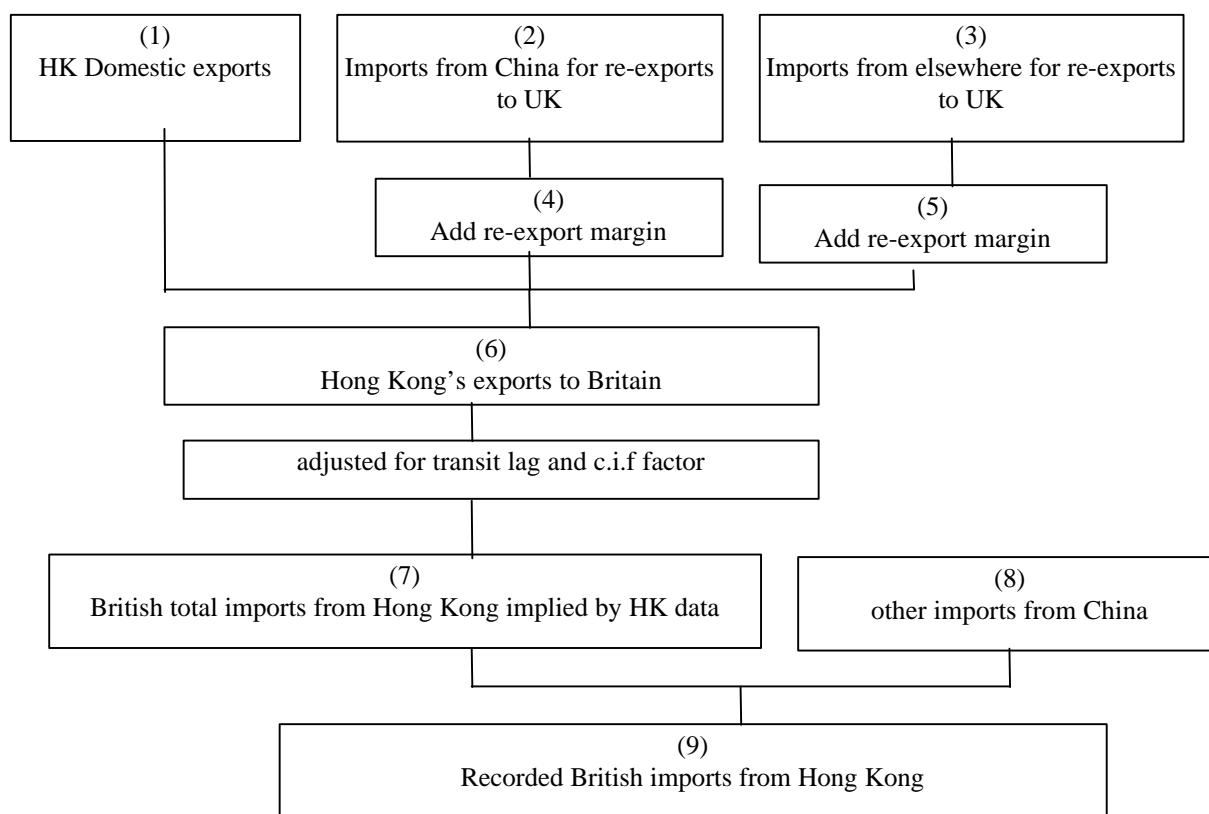
8. In practice, retained imports are calculated by deducting the value of re-exports (less a 14-16% re-export margin) from total imports.

	(%)				
1980	559 (77)	169 (23)	402 (55)	188 (26)	139 (19)
1981	619 (84)	120 (16)	457 (62)	153 (21)	129 (17)
1982	731 (88)	103 (12)	526 (63)	142 (17)	166 (20)
1983	727 (82)	160 (18)	534 (60)	203 (23)	151 (17)
1984	897 (74)	317 (26)	665 (55)	397 (33)	153 (13)
1985	949 (71)	397 (29)	611 (45)	581 (43)	154 (11)
1986	961 (64)	536 (36)	605 (40)	706 (47)	185 (12)
1987	1013 (71)	416 (29)	691 (48)	574 (40)	164 (11)
1988	1031 (71)	412 (29)	655 (45)	598 (41)	189 (13)
1989	1112 (73)	418 (27)	678 (44)	646 (42)	206 (13)
1990	1238 (72)	470 (28)	655 (38)	718 (42)	334 (20)
1991	1387 (81)	322 (19)	762 (45)	581 (34)	367 (21)
1992	1613 (79)	430 (21)	858 (42)	766 (38)	418 (20)
1993	2170 (75)	739 (25)	1111 (38)	1351 (46)	448 (15)
1994	2298 (73)	845 (27)	1354 (43)	1418 (45)	371 (12)
1995	2657 (76)	823 (24)	1585 (46)	1544 (44)	351 (10)

Source: OTS adjusted using HKTS figures.

b. British imports

As with exports data, the adjustment procedure can be explained by the following diagram.



There are three components in Hong Kong's total exports to Britain: domestic exports (1), re-exports originating in China (2) and elsewhere (3). Re-export margins on the last two components (4 and 5) represents Hong Kong's contribution and, strictly speaking, should be regarded as an import of services from Hong Kong. The margin is assumed to be 16% but, as discussed in appendix 2, higher figures for China, can be

used. Table 2 shows the margin separately. In the rest of the paper, including Table A1.3, it is attributed to Hong Kong.

British imports from Hong Kong therefore comprise three elements: imports originating from China ((2) with transit and cif adjustment), imports originating from elsewhere ((3) with transit and cif adjustment), and imports from Hong Kong itself ((1)+(4)+(5) with transit and cif adjustment).

The results are presented in table A1.3.

Table A1.3 British imports from Hong Kong and China: before and after adjustment

	<u>Published British Imports</u>		<i>After Adjustment</i>				
			<u>Of the total British imports from HK & China</u>				
	from Hong Kong	from China	Originate	Originate	Originate		
	£m	£m	in HK	in HK	in China		
(%)	(%)	£m	(%)	£m	(%)	£m	
		(%)					
1980	850 (85)	153 (15)	619 (62)	319 (32)	64 (6)		
1981	897 (83)	184 (17)	750 (69)	254 (24)	76 (7)		
1982	871 (82)	193 (18)	753 (71)	252 (24)	60 (6)		
1983	1177 (84)	231 (16)	817 (58)	529 (38)	63 (4)		
1984	1266 (82)	278 (18)	1051 (68)	409 (26)	85 (5)		
1985	1176 (79)	308 (21)	939 (63)	427 (29)	117 (8)		
1986	1537 (82)	327 (18)	883 (47)	884 (47)	96 (5)		
1987	1532 (80)	392 (20)	1031 (54)	800 (42)	93 (5)		
1988	1792 (80)	444 (20)	1202 (54)	947 (42)	86 (4)		
1989	2049 (79)	531 (21)	1285 (50)	1216 (47)	78 (3)		
1990	1972 (77)	583 (23)	1127 (44)	1343 (53)	86 (3)		
1991	2148 (75)	706 (25)	1189 (42)	1569 (55)	96 (3)		
1992	2397 (72)	954 (28)	1154 (34)	2099 (63)	98 (3)		
1993	2998 (69)	1327 (31)	1269 (29)	2927 (68)	129 (3)		
1994	3080 (65)	1642 (35)	1231 (26)	3347 (71)	143 (3)		
1995	3542 (65)	1938 (35)	1293 (24)	3999 (73)	188 (3)		

Source: OTS adjusted using HKTS figures.

Appendix 2. Hong Kong's retained imports from China

Table A2.1 shows alternative calculations of retained imports from China. Column 4 assumes a re-export margin of 16%, as in Figure 7.

Table A2.1 Hong Kong's total Imports and re-exports from China

<i>HK\$ million</i>										
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	
Imports from China	Re-exp from China	Fixed Re-exp margin	Ret-Imp based on 1,2,3	HK's domestic demand	First adjusted Ret-Imp	implied re-exp margin	Second adjusted Ret-Imp	implied re-exp margin	Adjust ment	
1979	15130	5663	16%	10248	110704	10248	16%	10248	16%	0
1980	21948	8394	16%	14712	143136	14712	16%	14712	16%	0
1981	29510	12834	16%	18446	174308	18446	16%	18446	16%	0
1982	32935	14694	16%	20268	192691	20268	16%	20268	16%	0
1983	42821	19680	16%	25855	210494	25855	16%	25855	16%	0
1984	55753	28107	16%	31523	237414	31523	16%	31523	16%	0
1985	58963	34628	16%	29111	246019	29111	16%	29111	16%	0
1986	81633	51597	16%	37153	285987	37153	16%	37153	16%	0
1987	117357	84266	16%	44714	346495	44714	16%	44714	16%	0
1988	155634	131525	16%	42250	414951	49794	24%	49794	24%	7544
1989	196676	188271	16%	34373	463597	55632	33%	50996	29%	16622
1990	236134	240410	16%	28884	533246	63990	40%	53325	32%	24441
1991	293356	315689	16%	21210	624395	74927	45%	56196	33%	34985
1992	354348	403782	16%	6260	737735	88528	52%	59019	37%	52759
1993	402161	474007	16%	-6466	834340	100121	57%	58404	38%	64870
1994	470876	545831	16%	332	999549	119946	56%	59973	33%	59640
1995	539480	636392	16%	-9134	1136627	136395	58%	56831	32%	65965

Sources: HK C&SD: *HK Trade Statistic; Estimates of Gross Domestic Product.*

- (1) total imports from China, published data, HK\$ million.
(2) total re-exports originated from China, published data, HK\$ million.
(3) the assumed re-exports margin on China-origin goods, based on a survey for 1988.
(4) retained imports from China, based on (1), (2) and (3).
(5) HK's domestic demand, published data, HK\$ million.
(6) the adjusted retained imports from China, equal to (4) before 1988, but is assumed to be 12% of (5) afterwards.
(7) the re-export margin implied by (1), (2) and (6).
(8) the 2nd adjusted retained imports from China, equal to (4) before 1988, but is assumed to be a declining fraction of (5) afterwards, with 12% in 1988 and one percentage point lower every year.
(9) the re-export margin implied by (1), (2) and (8).
(10) adjustment to be added to original retained imports from China. Equal to (8)-(4).

Illustrations of the degree to which the re-export margin may be inflated can be obtained by assuming that

- (a) the export value of re-exports is correctly recorded;
(b) the value of retained imports is better estimated by assuming a constant relationship with domestic demand, and that these values are in fact included in the import figures; and
(c) any under-recording of import values is confined to goods which are then re-exported.

Using these assumptions an imputed re-export margin is shown in column 7 and 9 on the basis of assuming that retained imports remained at 12% of domestic demand from 1988 and that they fell by one percentage point in each year from 1988 to 1994. The former assumption suggests margins that are improbably high. The latter assumption seems more plausible; relocation of Hong Kong production to China would have reduced the demand for Chinese inputs. It implies that underpricing of imports for re-

export might be around 20%.

The second assumption implies that retained imports from China are higher than recorded by the amounts in column 10 (i.e. some HK\$65 billions by 1995) and that total retained imports are higher by the same amount, giving China a share of 12% rather than zero, down from 20% in 1987. Other countries' shares have to be reduced correspondingly. This is shown in Figure 8.

Disaggregated data may provide further clues on the source of this distortion, Table 2.2 shows difference between imports and re-exports from China, for the main SITC divisions. It appears that the distortion occurred in all the main commodity groups, and implies high domestic value added and/or underpricing of imports from China for a wide range of commodity groups.

Table A2.2 Major groups of retained imports from China

	Imports <i>less</i> re-exports (HK\$m)			As % of imports		
	1992	1993	1994	1992	1993	1994
65--- Textile yarn, fabrics, made-up articles, related products	3543	690	4319	9.5	1.9	10.2
69--- Manufactures of metal, n.e.s.	-2643	-2952	-3467	-39.1	-35.6	-37.0
75--- Office machines & automatic data processing equipment	-2102	-5391	-7335	-26.3	-58.9	-54.5
76--- Telecommunications & sound recording apparatus	-8141	-10896	-16496	-25.8	-28.0	-32.4
77--- Electrical machinery, apparatus & appliances n.e.s.	-2867	-5317	-7611	-13.5	-20.3	-24.6
83--- Travel goods, handbags and similar containers	-6088	-6518	-7097	-38.4	-35.9	-33.4
84--- Articles of apparel and clothing accessories	-4196	-6380	-4180	-5.8	-7.7	-4.9
85--- Footwear	-6638	-9065	-9436	-24.1	-24.7	-22.2
88--- Photographic apparatus, optical goods, watches	1715	1098	289	12.7	7.0	1.6
89--- Miscellaneous manufactured articles, n.e.s.	-39722	-42840	-47608	-81.5	-76.6	-73.1

Source: HK Trade Statistics

Appendix 3. Explaining changes in market share

Between 1984 and 1994, Britain lost 2 percentage points of its share of Hong Kong's imports. To what extent is this attributable to changes in the composition of Hong Kong market?

Let B represent Hong Kong's imports from Britain,

$$B = b_1 + b_2 + \dots + b_n = \sum b_i \quad (i \text{ represents SITC groups})$$

W be Hong Kong's total imports from the world (excluding China),

$$W = w_1 + w_2 + \dots + w_n = \sum w_i$$

$K = B / W$ is UK's market share in Hong Kong.

Change in the UK's market share, ΔK , is given by

$$\Delta K = K^{94} - K^{84} = \frac{B^{94}}{W^{94}} - \frac{B^{84}}{W^{84}} = 3.3\% - 5.2\% = -1.9\%$$

This change can be decomposed into four factors f_1, f_2, f_3, f_4 ,

$$\Delta K = \sum \Delta k_i = \sum \Phi(f_1, f_2, f_3, f_4)$$

where $f_1 = \frac{b_i^{84}}{w_i^{84}}$, $f_2 = \frac{w_i^{84}}{W^{84}}$, are the UK's share in i th market and the relative size of

individual markets in 1984 respectively, $f_3 = \frac{\dot{b}_i}{\dot{w}_i}$ is the elasticity of the UK's exports to

changes in the Hong Kong market, $f_4 = \frac{\dot{W}}{W}$ the elasticity of Hong Kong's individual markets to changes in the Hong Kong total market.

Derivation of this relationship between ΔK and f_i is given below,

$$\begin{aligned} \Delta K &= K^{94} - K^{84} = \frac{B^{94}}{W^{94}} - \frac{B^{84}}{W^{84}} = \frac{\sum b_i^{94}}{W^{94}} - \frac{\sum b_i^{84}}{W^{84}} \\ &= \sum \frac{b_i^{94}}{w_i^{94}} \frac{w_i^{94}}{W^{94}} - \sum \frac{b_i^{84}}{w_i^{84}} \frac{w_i^{84}}{W^{84}} = \sum \left(\frac{b_i^{94}}{w_i^{94}} \frac{w_i^{94}}{W^{94}} - \frac{b_i^{84}}{w_i^{84}} \frac{w_i^{84}}{W^{84}} \right) \\ &= \sum \left(\frac{b_i^{84} (1 + \dot{b}_i)^{10}}{w_i^{84} (1 + \dot{w}_i)^{10}} \cdot \frac{w_i^{84} (1 + \dot{w}_i)^{10}}{W^{84} (1 + \dot{W})^{10}} - \frac{b_i^{84}}{w_i^{84}} \frac{w_i^{84}}{W^{84}} \right) \\ &= \sum \frac{b_i^{84}}{w_i^{84}} \frac{w_i^{84}}{W^{84}} \left[\left(\frac{1 + \dot{b}_i}{1 + \dot{w}_i} \right)^{10} \cdot \left(\frac{1 + \dot{w}_i}{1 + \dot{W}} \right)^{10} - 1 \right] \\ &= \sum \frac{b_i^{84}}{w_i^{84}} \frac{w_i^{84}}{W^{84}} \left[\left(\frac{1 + \frac{\dot{b}_i}{\dot{w}_i} \dot{w}_i}{1 + \dot{w}_i} \right)^{10} \cdot \left(\frac{1 + \frac{\dot{w}_i}{\dot{W}} \dot{W}}{1 + \dot{W}} \right)^{10} - 1 \right] \\ &= \sum f_1 \cdot f_2 \left[\left(\frac{1 + f_3 \dot{w}_i}{1 + \dot{w}_i} \right)^{10} \cdot \left(\frac{1 + f_4 \dot{W}}{1 + \dot{W}} \right)^{10} - 1 \right] \quad (1) \\ &= \sum \Phi(f_1, f_2, f_3, f_4) = \sum \Delta k_i \end{aligned}$$

where \dot{b}_i , \dot{w}_i and \dot{W} are average annual growth rates, $f_1 = \frac{b_i^{84}}{w_i^{84}}$, $f_2 = \frac{w_i^{84}}{W^{84}}$, $f_3 =$

$\frac{\dot{b}_i}{\dot{w}_i}$ and $f_4 = \frac{\dot{W}}{W}$.

Table 11 of the main text shows the size of these factors. In addition, to evaluate the effects of both the market changes in Hong Kong and the UK's own exporting performance, two simulations are considered.

In the first simulation, we assume that $f_3=1$, or $\dot{b}_i = \dot{w}_i$, so that the UK's exports in i th commodity to Hong Kong grew at the same rate as the i th market, and the UK maintained an unchanged share in each individual market. The result represents the pure effect of market changes in HK, or the *compositional* effects. This is given by the column Δk_i (H1) of the table. The overall effect is that changes in the Hong Kong market structure contribute positively to increase the UK's exports to Hong Kong.

In the second simulation, the assumption is $f_4=1$, or $\dot{w}_i = \dot{W}$. The market structure is assumed to remain unchanged and the exercise measures the UK's own export performance net of compositional effect. This can be termed the *competitiveness* effect. It suggests that competitiveness alone would result in a 2.2% loss in market share, as shown in Δk_i (H2) of the able.