What Change in China Means For Trade in Hong Kong

By George D. Ferris

For well over a century, Hong Kong has been regarded as the gateway to China. During its history as a British colony, it experienced enormous economic development because of its location on the doorstep of China, its flexibility in working with several cultures and the virtual absence of trade barriers. The huge differences in import access, plus Hong Kong's strategic location, made it an irresistible environment for goods to be transshipped to China.

5051

Hong Kong's trade community has staunchly supported China's accession to the World Trade Organization (WTO), believing that it will lead to stronger economic growth. The Hong Kong government has also been a strong supporter, partly because it sees China's greater participation in the international trading community as further ensuring the continuation of Hong Kong's independence in the area of economic policymaking, and prosperous free-trade lifestyle. At the same time, the more progressive Hong Kong trading firms are considering what changes in their operations will enable them to remain an integral part of U.S.-China trade.

Many U.S. agricultural exports–mostly consumer-ready foods and commodities for further processing–make their way into China through Hong Kong. Its duty-free status and proximity to China have allowed Hong Kong to become the eighth-largest destination for U.S. agricultural exports, and fourth-largest for U.S. consumer-ready products.

In 2001, 47 percent of Hong Kong's agricultural imports from the United States were re-exported to China. Many observers believe that in the next three or four years, China's import liberalization will result in the rechanneling of an increasing share of imports directly to Chinese destinations. But while Hong Kong's share of this trade will likely decline as China becomes further integrated into the WTO, the absolute volume of China's imports should climb.

Since it rejoined China on July 1, 1997, Hong Kong has maintained a high degree of autonomy under the "one country, two systems" provisions of the Basic Law governing the reunification. The legislation is designed to safeguard Hong Kong's social and economic systems, rights and freedoms for at least 50 years. The Hong Kong government exerts its own authority on economic and international trade issues, while following Beijing's principles on foreign relations and national security.

Hong Kong maintains separate representation to several international organizations, including the WTO, the World Customs Organization and the Asian Development Bank. Although they may consult Beijing, Hong Kong representatives have on occasion adopted positions that are independent from, and significantly more supportive of, international cooperation than those of their Beijing counterparts.

Hong Kong retains its own import system. Most re-exports from Hong Kong to China are handled by Hong Kong transport companies that provide freight forwarding services to Hong Kong importers, moving their goods into China, taking care of documents and paying tariffs. These companies' fees reflect shipping conditions at mainland ports, and they typically rise when the Chinese government institutes crackdown measures, such as more stringent sanitary standards. The periodic crackdowns contribute to uncertainty about dependable access to China, thereby inhibiting the trade environment.

Commodity Breakdown

What China's WTO accession will mean varies by commodity. Here are analyses of the forthcoming dynamics in major categories:

Fresh fruits: The extensive distribution infrastructure in China's Guangdong Province–the Nanhai Lishui market and the transportation network that feeds into it from all over southern China–will keep Hong Kong actively involved in China's fresh fruit imports for the foreseeable future. However, Hong Kong companies handling this trade may be forced to move to, or at least expand their presence in, China to take on competition from mainland companies attempting to take over the trading, shipping and financing roles long performed by Hong Kong firms.

Over the longer term, as its agricultural sector evolves to counter stronger import competition, China can be expected to increase production of labor-intensive commodities, such as fresh produce, for which it has a competitive advantage. Because China is both a buyer and a growing competitor, U.S. suppliers must increase their emphasis on selling high-quality products in this market.

Tree Nuts: Infrastructural factors will likely keep a sizeable volume of China's tree nut imports coming through Hong Kong. For pistachios and to a lesser extent for almonds, Hong Kong trading companies have established cracking and slicing/roasting operations in Guangdong Province that rely on U.S. imports through Hong Kong. The processed products are distributed throughout China and also re-exported to Hong Kong.

Meats and Poultry: Almost 60 percent of U.S. frozen meat products going to China flow through Hong Kong, mostly in the form of poultry. Now that China has entered the WTO, reductions of duties and the easing of improper import restrictions will make Shanghai, Dalian, Tianjin and other mainland ports attractive entry

23216

points. For the foreseeable future, trade will continue through Hong Kong–but several major U.S. poultry firms are rapidly expanding distribution channels in China. A lot of the U.S. poultry exported to Hong Kong is handled by multi-national firms that are willing and able to relocate.

Financing will be slower to shift from Hong Kong companies because when sales slip, Chinese buyers simply may postpone paying for the goods ordered. Therefore, Hong Kong will continue to play a vital role in financing U.S. poultry meat shipments.

23069

Cotton: China's WTO accession will probably have diverse impacts on Hong Kong's cotton trade. Garment manufacturers with plants in China expect to benefit from better access to the U.S. apparel market. Demand for locally produced yarn will climb, boosting cotton consumption. China's imports of U.S. cotton will also rise.

On the other hand, Hong Kong traders could lose business to Chinese importers. And while Hong Kong spinning mills may have more business, their profit margin is likely to drop. Chinese yarn producers will be able to import raw materials at lower tariffs, reduce production costs and offer their goods at lower prices.

TR000668

Fish and Seafood: High demand for fresh seafood will necessitate increased shipments via air freight. Hong Kong will therefore remain an integral part of this trade because it has many more daily international flights than most major Chinese cities.

Hardwoods: Virtually 100 percent of U.S. hardwood lumber imported into Hong Kong is re-exported to China for further processing. U.S. exports are expected to grow to meet China's housing, furniture, paneling and flooring needs. Hong Kong will continue as a significant gateway to the Chinese market because of its traders' expertise in managing large, high-value shipments, and because Hong Kong is the major deepwater port serving Guangdong Province.

Financing Considerations

Many other factors will also influence trade flows among the United States, Hong Kong and China. One major consideration is the extent to which U.S. exporters are willing to make new contacts in China and assume additional risk in the area of payments. Their Hong Kong partners will seek to convince them to continue doing business through existing channels; on the other hand, potential partners in China could offer innovative pricing and distribution plans that deserve serious consideration.

Hong Kong will likely continue in its current financial role for at least another five years, for several reasons:

- It remains difficult for private companies in China to obtain letters of credit.
- Although larger Chinese importers may be able to pay in U.S. dollars, the majority cannot. Moreover, Chinese currency is not fully convertible outside China.
- With Hong Kong companies, U.S. exporters are reasonably assured of getting paid.
- Hong Kong has a Western-style legal system with the rule of law and enforceable contracts.

The Future of an Export Hub

Hong Kong continues to offer significant advantages as a trade entrepôt. As the world's largest container port, it can accommodate the very largest ships. Its size–and its location at the mouth of the Pearl River estuary–will keep Hong Kong involved in Southern China's trade, regardless of import policy changes.

Veteran Hong Kong traders estimate the share of China's agricultural imports coming through Hong Kong could drop to 30 percent. In years to come, 50-60 percent of U.S. shipments will go directly to Shanghai in Southern China, and 10-15 percent will go to Dalian in Northern China. However, China's total import volume will likely expand so much that Hong Kong's absolute volume of re-exports to China could remain near the current high levels for many years.

With the same ethnic makeup as its huge neighbor, a healthy average disposable income ($24,000 in 2000), demanding tastes and years of exposure to Western products, Hong Kong consumers are a leading indicator of potential consumer demand in China. Hong Kong should be viewed as an incubator or microcosm for long-term export projects in China–an easy-entry, exporter-friendly laboratory for the world's most populous country. These same factors will also sustain Hong Kong as a significant market in its own right.

In the short term (one to five years), Hong Kong traders will likely continue in their present role, with some modifications. Hong Kong traders are well positioned to benefit from increasing opportunities to provide such services as marketing, accounting, documentation, shipping, insurance and financing.

The more the Chinese market opens, the more challenging and competitive it will become. And although trade patterns will likely change markedly, the pace of change will be much slower than most people expect–at least 10 years. ■

The author is the deputy director of the Agricultural Trade Office, Hong Kong. Tel.: (011-852) 2841-2350; Fax: (011-852) 2845-0943; E-mail: atohongkong@fas.usda.gov

For details, see FAS Report HK1047. To find it on the Web, start at **www.fas.usda.gov,** select **Attaché Reports** and follow the prompts.