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INSTITUTE FOR EMERGING MARKET STUDIES
POLICY BRIEF
IEMS.UST.HK
NO.4
SPRING 2021

A Tale of Two Cities: Implications from Singapore & Hong Kong for Asian Emerging Markets

By David Skilling

Key Points

- Hong Kong and Singapore have increasingly divergent economic models, although they continue to share some common features such as significant FDI inflows. Hong Kong is focused on its position as a global hub, acting as a gateway into mainland China, whereas Singapore is building positions of competitive advantage based on domestic strengths and capabilities.
- These models have different exposures to changing patterns of globalisation. As cross-border global flows of people and physical trade reduce in intensity, and supply chains become more regional in nature, being a global hub is a riskier proposition. In contrast, developing domestic capabilities means that more domestic value can be captured from globalisation even with growing global frictions. The recent economic performance of Singapore and Hong Kong provide a measure of this.
- This experience has relevant insights for other emerging markets in Asia as they seek to position themselves for Covid-19. Asian emerging markets will need to deliberately build competitive advantage through an active process of investment in building strengths and capabilities. They cannot rely on the same patterns of globalisation as previously.

Issue

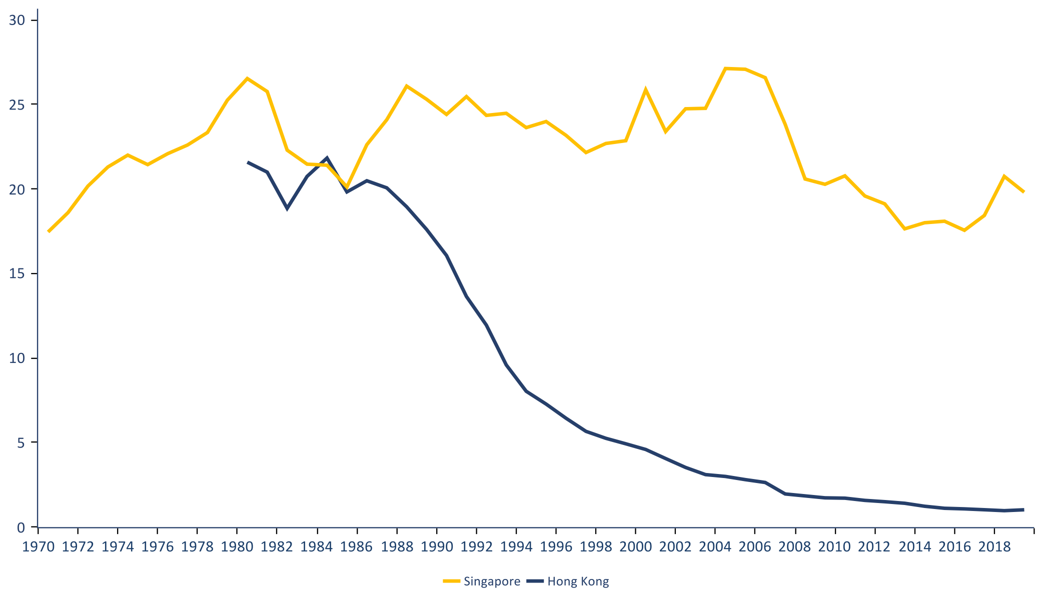
Singapore and Hong Kong have much in common and are frequently compared against each other. Both city states enjoyed rapid growth from the 1960s, on the back of active international engagement, the associated rapid productivity catch-up gains, and favourable demographics.

Both have similarities in their economic models; attracting substantial FDI by providing a high-quality business environment, low tax rates, world-class infrastructure, and proximity to Asian markets; serving as transport and financial hubs; and very high shares of exports and inward and outward investment.

However, it is increasingly apparent that these two economies are following diverging economic paths, due both to policy choices as well their different political and geographic contexts.

Consider, for example, the differences in their respective economic structures. Hong Kong's manufacturing share of GDP has reduced from a peak of just over 20% of GDP in the 1980s to less than 1% of GDP today (see Chart 1). Domestic exports of goods reduced from around 70% of total exports in the 1980s, to 20% in 1995, and to less than 1% when the last data was reported.

Figure 1: Manufacturing, % of GDP, 1970 - 2019



Hong Kong is an important financial and business services hub, as well as a logistics hub, with a focus on mainland China. Its growth model is heavily leveraged to integration into China. In contrast, Singapore's manufacturing share of GDP has been relatively stable at about 20% of GDP over the past few decades. And non-oil domestic exports (NODX) are 40% of GDP, with exports of services of another 50% of GDP.

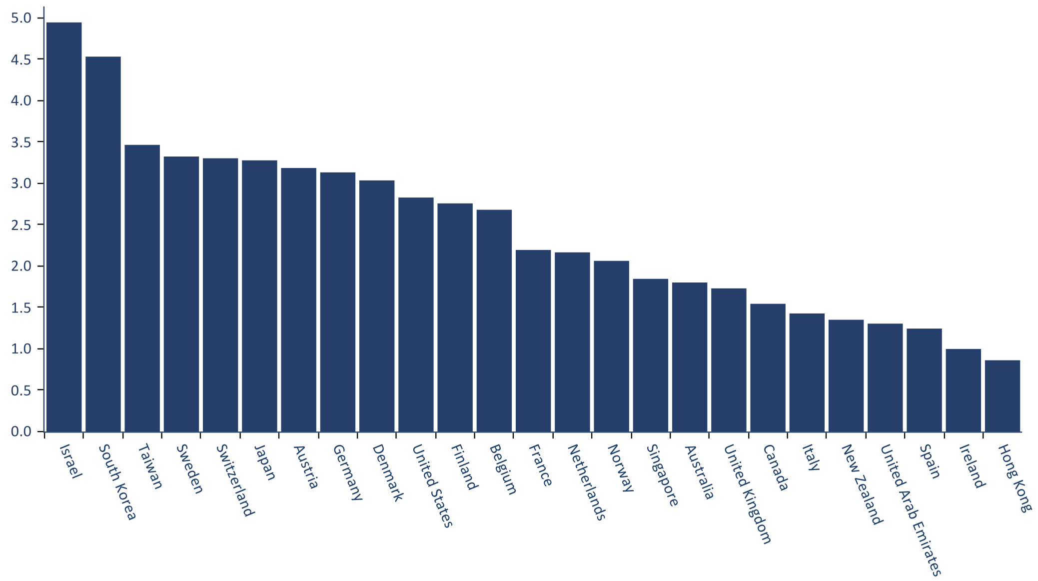
MNCs make a substantial contribution to Singapore's economy. But these activities broaden out the range of growth drivers and providing a broader range of opportunities than would be available otherwise.

Part of these experiences reflects comparative advantage at work. As Hong Kong has become an increasingly knowledge intensive economy, with a rising wage and cost profile, it has focused on financial and business services as well as logistics rather than manufacturing. Manufacturing activity has moved across the border into the Greater Bay Area, often financed by substantial Hong Kong investment.

But policy choices have also played an important role. Hong Kong's policy statements over the past few years have consistently emphasised deeper integration into China, with relatively limited investment in domestic strengths. Hong Kong is positioned as an intermediary between mainland China and the rest of the world in both directions.

In contrast, Singapore has chosen to develop a more diversified economic structure that is not overly concentrated on financial and professional services. In addition, Singapore has invested heavily in research, innovation and human capital to attract and retain firms, capital and people – and to provide the basis for new growth engines, from fintech to pharmaceuticals.

Figure 2: R&D spending, % of GDP in advanced economies



Assessment

In the context of changing globalisation (further reinforced by Covid-19) these differing models position Hong Kong and Singapore quite differently – and afford them different strategic options.

Hong Kong has a less diversified economy, focused narrowly on its areas of comparative advantage. Hong Kong's hub-based model is much more exposed to the intensity of regional and global trade and capital flows – and is exposed to international competition from other locations for capital, talent, and firms.

Being a hub for flows is an activity that other locations can also deliver; for example, several mainland Chinese cities also offer strong infrastructure and connectivity as well as increasingly high quality professional and finance services. The value proposition increasingly revolves around the quality of infrastructure and the wage and cost structure. Over time, these are likely to be subject to intense competition.

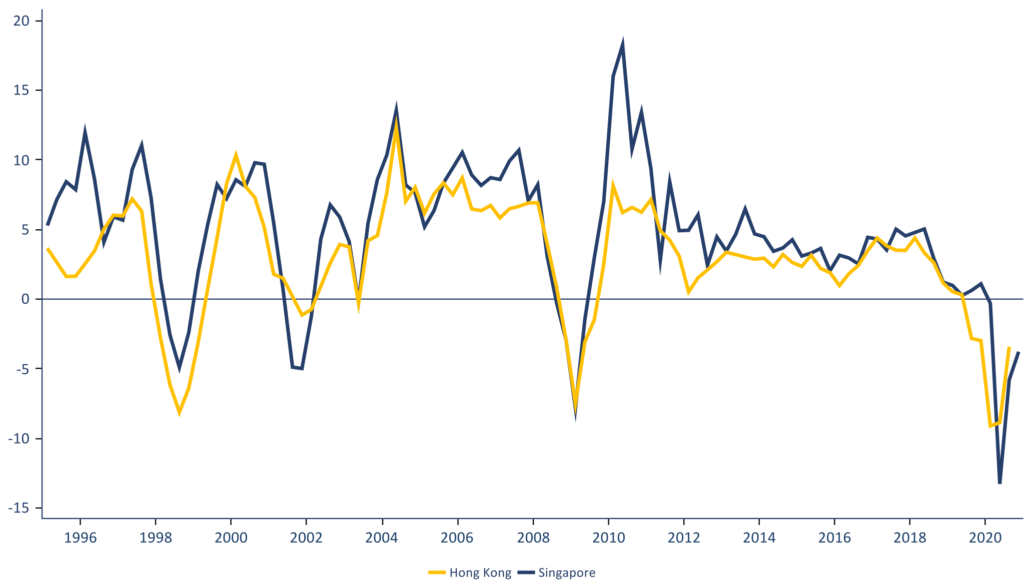
Hong Kong has doubled down in its policy focus on integration, acting as a hub. Hong Kong clearly has strengths in this area, and it is a source of significant economic value. But it leaves Hong Kong exposed to changes in globalisation as well as competition – notably from mainland Chinese cities.

In contrast, Singapore is better able to deliberately push back against forces of agglomeration because of distinctive, hard-to-replicate features of its economy. The sustained investment in domestic strengths and capabilities (skills, innovation, clusters) are a source of significant economic value (see Chart 2). The broader set of strengths in Singapore generates a greater degree of economic resilience, as they are hard to replicate elsewhere, and allow for a greater measure of value capture.

Singapore is also better positioned to respond to changing patterns of globalisation. Indeed, despite the slowdown in globalisation over the past few years, Singapore has continued to receive record amounts of FDI – in activities as diverse as electronics, chemicals, and R&D.

Side-by-side GDP growth comparisons can sometimes mislead. But it is instructive that Singapore has out-performed Hong Kong in terms of GDP growth over the past several years (see Chart 3). And although Singapore was hit hard by border restrictions and domestic lockdown measures in 2020, it is expected to recover strongly through 2021.

Figure 3: Real GDP growth, %, compared to previous quarter, Q1 1995 – Q4 2020



Recommendations

As two highly open city states, Hong Kong and Singapore are idiosyncratic examples. But the insights from these experiences have implications for other Asian economies as they respond to the challenges and opportunities of globalisation in a post-Covid world. Asian emerging markets will be dealing with a world in which globalisation is likely to be less intense and where emerging markets can no longer rely as heavily on the rising tide of inward FDI.

As I noted in a recent Policy Brief, growth models will need to be changed across many parts of emerging Asia in a post-Covid world.[1] Economies will need to upgrade domestic capabilities, and form a view as to where they can fit into the Asian regional economy – and where they can compete.

[1] https://iems.ust.hk/publications/policy-briefs/skilling-emerging-markets-in-asia-need-to-adapt-their-growth-model-in-a-post-covid-world-pb3

The Hong Kong model has worked well for Hong Kong, but it does not generalise well to other economies in the region. Particularly given the challenges ahead, being a hub for cross-border flows is not likely to work well. The Singapore experience of building a more diversified economic structure, which focuses on building domestic strengths and capabilities in addition to being a hub for regional and global flows (supply chains, FDI, logistics) is more useful.

Many Asian emerging markets have successfully deployed export-oriented growth models, often supported by substantial inflows of FDI with deep integration into global supply chains. As globalisation changes, with increasing sophistication in production and competition, economies will need to upgrade in order to sustain performance.

In particular, they will need to invest behind distinctive competitive advantage, with a focus on skills and innovation. Additional growth engines are required, grounded on domestic strengths and capabilities. This will increase their resilience to changes in the prevailing model of globalisation – competing more on the basis of domestic strengths rather than cost and less reliant on decisions by MNCs.

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