



UNIVERSITAT DE  
BARCELONA

**Master Thesis**

**Master in Economic History UB-UAB**

**The impact of China's WTO accession (2001) on  
Hong Kong's trade development**

Zhibin Chen

NIUB:17893153

Supervisor: Anna Carrera

## **Abstract**

This paper sought to analyze the impact of China's accession to WTO (2001) on Hong Kong's trade development. Hong Kong, as a main financial center in Asia, also an important international port, plays an important role in the world economy and global trade market. Hong Kong achieved rapid trade expansion during the 1970s-1990s and remained the stable increase trend till today. As a bridge of communication and information exchange between overseas markets and Mainland China, Hong Kong gained numerous economic benefits through imports and exports trade, also promotes the economic expansion in Mainland China. Since China's entry into WTO, Mainland China obtains a noticeable trade increase and affects Hong Kong's commercial trade in a certain way.

To test the impact of China's accession to WTO (2001) on trade development in Hong Kong during 1970 to 2019, I argue that China's accession to WTO (2001) created a higher trade diversion in Hong Kong than trade creation; China's entry in WTO affects the shift of Hong Kong's total export composition: increasing its re-exports at the expense of domestic exports.

Key word: Hong Kong, Mainland China, WTO, trade, exports

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# 1. Introduction

Hong Kong is one of the most significant international financial hubs in the world, It, also, plays an important role in the international economy with its unreplacable geographical location as a natural port of Southeast China and connects the international market (Schenk, 2008). Hong Kong makes full use of the geographical advantage, undergoes numerous commercial and global trade between China and foreign countries. During the post-war period, Hong Kong gained economic development through industrialization, an increasing number of small and medium-sized firms (SMF) (Ngo, 1999), the inflow of international capitals, free trade, low taxes (Schenk, 2008), which laid a solid foundation for Hong Kong to obtain the further economic takeoff in the reintegration period (the 1970s-1990s). From the 1970s, a noticeable annual economic growth of around 8.9% (Hong Kong Census and Statistics Department, 2007), in the 1980s, stable growth was maintained. Since the open-door policy was announced in Mainland China, it brought Hong Kong a new economic stage. As a bridge to connect Mainland China and foreign countries, Hong Kong absorbed many international investments and capitals, transferred multiple information and technologies, and broaden the international market for China's mainland (Wong, 1991). Meanwhile, Hong Kong showed an upward trend in economic development, it became the world leader in total factor productivity growth between 1970-1989 (Husain, 1997). All the advanced conditions and foundations above have shaped Hong Kong, a well-known international hub, Hong Kong makes full use of its port advantages and obtains remarkable progress in external merchandise trade, Hong Kong remains its trade advantages since 2000 and continues to grow stably ((Hong Kong Census and Statistics Department, 2011). Nowadays, Hong Kong still plays an important role in global trading and commercial activities (Kong and Lim, 2018).

China is one of the most important economic units in the world, since the Chinese Economic Reform (1978), China's integration into the global economy has become more significant. Also, China's accession to WTO moves its economic evolution to a

more advanced level (Chen and Dong, 2012). In this study, I analyze the impact of China's entry to WTO on Hong Kong's long-run trade development.

In section 2, I develop the literature review in four parts: the impact of trade on Hong Kong's economy; the impact of China's accession to WTO (2001) on trade; the effect of trade creation and diversion between Hong Kong and Mainland China, and the overview of current studies. Hong Kong is featured as an outward merchandise economy, its external trade value is quite influential to the economic growth (Hong Kong Census and Statistics Department, 2011). The prosperous global trade affects Hong Kong's economic growth effectively via imports and exports (Chou and Wong, 2001). The excellent port facilities promote Hong Kong's participation in the international trade market (Enright et al. 1997). China's entry into WTO improves the overall trade increase and reinforces its GDP increase (Chen and Dong, 2012) and strengthens the collaboration with other trading partners, benefits the regional economy (Rumbaugh and Blancher, 2004)), enhances the bilateral and multilateral business cooperation (Garred, 2018). With the economic development in Mainland China, Hong Kong gained great benefits from the regional trade, however, the shift of high-cost production process to low-cost produced trade creation and diversion in both. Also, it brings competition in cargo ports and further development (Song and Sung, 1998) (Tian et al. 2015).

In section 3, I put hypotheses on China's accession to WTO (2001) created a higher trade diversion in Hong Kong than trade creation; China's entry in WTO affects the shift of Hong Kong's total export composition: increasing its re-exports at the expense of domestic exports.

In section 4, I describe the methodology plan into investigation plan and analysis plan. I collect data of total trade value, as well as total exports and imports value both in Hong Kong and Mainland China from 1970 to 2019, and Hong Kong's total export trade composition (domestic export value and re-export value) from 1970 to 2016, to calculate the share of domestic exports in total exports in Hong Kong and see how Hong Kong's domestic exports are related to China's total exports, and view the trade creation

and diversion effect in Hong Kong before and after China's accession to WTO in 2001. In section 5, I present results and further discussion. It demonstrates that the transformation of Hong Kong's total export composition started to present since the late eighties, well before China's entry into WTO (2001) by the significant drop of the share of domestic exports. And the trade creation effect can be observed in Hong Kong's re-exports, whereas the trade diversion effect in the case of domestic exports. In section 6, I conclude this study and mention the suggestion for further research.

## **2. Literature review**

### **2.1 The impact of trade on Hong Kong's economy**

Trade plays an important role in the world's economy nowadays, countries cooperate and negotiate with different trade partners to access more opportunities for resource exchange and to promote business collaboration, which furthermore strengthens the economic progress in the long term (Xi et al. 2020). Based on the previous studies, trade is believed to be linked closely with economic improvement (Ahmad et al. 2019; Dedeoglu and Kaya, 2013; Michelis and Zestos, 2004; Chen and Dong, 2012). Imports, exports, and international trade are highly associated with economic advancement through financial development (Shahbaz et al. 2013). Especially, plenty of researchers have tested the positive relationship between exports and economic growth (Azomahou et al. 2006; Su and Ullah, 2007, Henderson et al. 2008; Shan and Sun, 1998; Liu and Feng, 2007; Zhou, 2008).

The positive impact of trade on economic development can be observed in various industries and different countries, such as in the global mineral industry (Xi et al., 2020), the energy consumption in China (Shahbaz (2013), the expansion of financial activities (Baltagi et al. 2009) and economic rise in India (Kaushal and Pathak, 2015), the improvement of bank loan pricing system (Ashraf et al. 2021), and the bank-level evolution (Ashraf, 2018), through the labor market in the United Kingdom (Greenaway et al. 1999), etc. It is believed that trade volume, value, and relative policies can contribute to one nation's economy greatly.

International trade affects positively Hong Kong's economic growth through approaching foreign investment, import, and export volume (Chou and Wong, 2001). Hong Kong has excellent facilities to engage in international trade, like unbeatable natural geographic location, efficient port service with exceptional equipment, etc. (Enright et al. 1997). By developing international trade, Hong Kong stimulates domestic production, promotes the enterprises' productivity and innovation (Shu and

Steinwender, 2019), attracts a growing number of direct foreign capitals, which has a positive impact on economic expansion. Also, based on Lu (1997), Hong Kong is well-known as a re-export hub, reexport trade experienced a noticeable increase since the 1970s, it grew at an average annual rate of 22.28% throughout the 1970s with reaching HK\$13.197 billion in 1978 and HK\$20.022 billion in 1979. During the 1980s, Hong Kong's re-export trade rose at an incomparable high speed. In 1980, Hong Kong's re-export trade amounted to HK\$30.7 billion, which increased more than 50% than the previous year. In 1985, it surpassed the HK\$100 billion mark, by reaching HK\$105.27 billion. At the end of the 1980s, the re-export trade exceeded the HK\$300 billion record. Throughout the 1980s, Hong Kong's re-export trade grew nearly tenfold. The growing trend continued in the 1990s, by 1994, the value of Hong Kong's re-export trade was HK\$947.9 billion, which was more than three times in 1989 (Hong Kong Census and Statistics Department, 1995). The successful export industry contributed to Hong Kong's economic boom between the 1970s to 1990s by bringing numerous economic benefits like direct overseas investment, trade-over commission, etc.

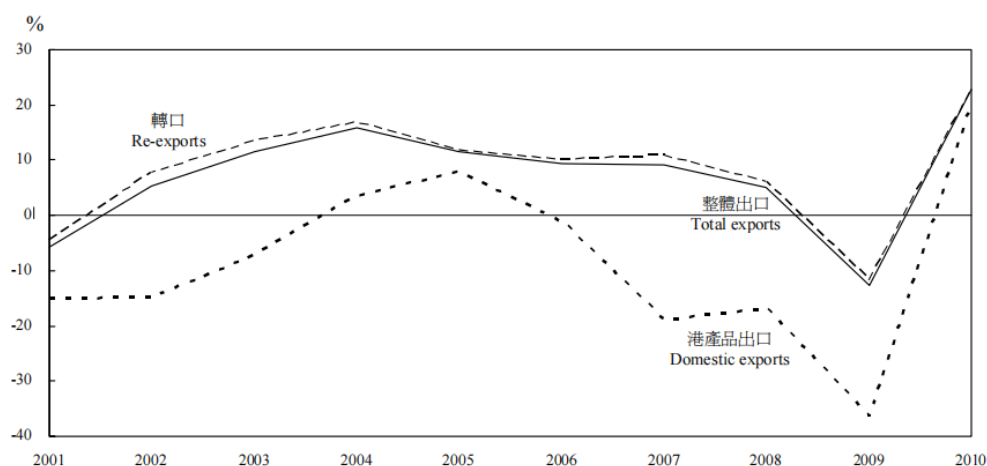
Since 1978 (Chinese economic reform and opening), China obtained better economic performance in the international market and attracted an increasing number of foreign investments and capitals from various counties and regions. Hong Kong naturally became China's front office due to its excellent commercial conditions and remarkable port equipment, it transferred large overseas investments and capitals for mainland China and gained a significant portion of their re-exports during this process. The mainland has become a crucial part of Hong Kong's re-export trade. According to the Hong Kong Trade Development Council (TDC), in 1994, 92% (US\$131.5 billion) of Hong Kong's total re-export trade (US\$121.5 billion) was related to mainland China.

Hong Kong is characteristic of its outwardly oriented economy; export performance plays a significant role in overall economic development. In recent years, with the expansion of the mainland's manufacturing industry and the advantage of a cheaper labor force, a growing number of resources relocations can be observed from Hong Kong to mainland China, which leads to the declining proportion of domestic product



exports in the total export commodities of Hong Kong (Hong Kong Census and Statistics Department, 2011). In Chart 1, we can notice that since 2001 the re-exports and total exports maintained the same increasing trend even though with a slight decrease in 2009, whereas the domestic exports of Hong Kong demonstrated more fluctuation with a significant decrease during this period.

Figure 1 Year-on-year Changes in Values of Hong Kong's Exports



Source: Hong Kong Census and Statistics Department (2011)

Also, Hong Kong experienced a change of principal export trading partners, mainland China and the United States became two main export trading partners of Hong Kong's total exports during the ten years' time (from 2000 to 2010). The number of total exports to the mainland continued increasing gradually, in 2010, more than half of the total export value of Hong Kong was towards mainland China (Hong Kong Census and Statistics Department, 2011). By the year 2017, mainland China is Hong Kong's most important and principal export trading destination with representing 54.1% of total exports, meanwhile, China becomes the most significant import trading partner of Hong Kong, which took up 44.6% of total imports value (The World Factbook, 2017).

Trade development has a fundamentally positive impact on Hong Kong's economic growth, especially through exports and external merchandise. As the front office of China, Hong Kong received numerous overseas investments and capitals, which lead

to the prosperity of re-exports trade and great economic benefits. However, in the recent few years, due to the resource relocation, Hong Kong witnessed a significant decline in domestic exports and a relatively slower economic increase.

## **2.2 The impact of China's accession to WTO on trade.**

To access the commodity and service markets better, reduce commercial costs (like tariffs and trade barriers), and obtain more advantages for future trading expansion, countries join World Trade Organization (WTO). Trade liberalization facilitates the competitiveness in international trade markets and promotes global transactions.

It has been tested that the WTO benefits trade in many aspects, strengthens the world trade value effectively, promotes resource exchange and mutual trade negotiation among various countries (Subramanian and Wei, 2007). Also, there is a tight connection between trade expansion and economic growth (Kneller et al. 2007). According to Winters (2004), trade openness and liberalization improve the domestic business and relative foundation, improve the stability of the local market, also, alleviate the corruption problems in a certain way, which is believed to improve the economic performance.

The fact of joining WTO brings member countries numerous benefits (such as tariff reduction, transparent trade regulations, etc.), also, WTO provides an open and free platform for them, which to some extent promotes the development of trade liberalization.

China's accession to WTO in 2001 reinforces its unification of the international market and gradually became a more significant export terminal by benefiting from tariff reduction and restriction lifts. Also, Chinese trade has been increasing noticeably since 2001 and has better performance in the global economy with the increasing integration. Imports, and exports, together with labor capital and stock investment impact productively on long-run economic expansion and GDP increase, also, with the positive influence of open and liberal trade policy during the period of 1997-2008 (Chen and Dong, 2012). It is believed that the accession of WTO will continually bring China

benefits in the long run, the more open trade policy improves the domestic business environment. More importantly, the growing development of China's role in the international market after it acceded to WTO positively affects the regional economy (mainly in Asia part) (Rumbaugh and Blancher, 2004).

The membership of WTO speeds up the Chinese procedure of economic globalization, supports the further open of the Chinese market to foreign investment and commerce, and widens the export channels for the global economy (Chow, 2003). The accession of WTO also shaped China's trade policy in many aspects, such as the raw material export rate. The adjustment of trade policy encourages business negotiation and the progress of bilateral and multilateral trade (Garred, 2018). The membership of WTO not only attracts international trade and investments for China but also forms a more open trade policy, which benefits China itself and its trading partners in the long term. Similarly, China enters the international market and build a long-term trade relationship with multiple countries through the membership of WTO. With the removal of trade restrictions, China's export volume and value experienced a significant boost (such as in the textile and clothing industry), and it allows China to participate in more trade-related activities (Ianchovichina, 2003). Besides, trade liberalization encourages domestic production and exports, stimulates internal demand and international trade, hence, promotes the Chinese integration of global economic development.

Also, apart from trade, the accession to WTO enhances the expansion of certain industries, such as the banking system (Chemmanur et al. 2020), firm-level up-gradation (Liu and Ma, 2020), and labor market condition (Dai et al. 2020). Also, it promotes the Chinese economy's structural change to some extent by leveling up the proportion of domestic production and exports (Bekkers et al. 2021).

China demonstrates better economic performance in global economic development and plays a growing significant role in the world economy with its integration. The accession of WTO positively enhances the trade development by establishing more trading partners, bringing overseas investment, and proceeding with business negotiation, to build a continuous and stable long-run bilateral or multilateral

cooperation. However, the growing trade evolution in China attracts multiple foreign capitals and encourages the relocation of manufacturing procedures, which were in Hong Kong during the 1970s-1990s. Does the upward trend of the Chinese economy lead to the declining importance of domestic exports in Hong Kong or affect the re-exports in Hong Kong to some extent? Is there any consequence between China's accession to WTO (trade increase) and Hong Kong's external merchandise performance (domestic exports drop)? China's integration of the global economy benefits itself in terms of trade creation?

### **2.3 Trade creation and trade diversion between Hong Kong and Mainland China**

With the development of regional integration, a growing number of trade agreements have been proceeded based on the WTO description. The unification promotes the expansion of bilateral and multilateral trade, trade liberalization and economic cooperation (Yang and Martinez, 2014). Similarly, among regions and countries, they reach an agreement to build a stable cooperative relation and achieve economic evolution together, and the effect of trade creation and diversion can be noticed through trade agreements. The transformation from high-cost to low-cost manufacturing process brings trade enlargement, whereas the shift from low-cost to high-cost manufacturing process produces trade decline. Hong Kong and China can be viewed as a good example concerning trade creation and diversion effect regarding ports competition and manufacturing relocation.

With the rise of the Four Asian Tiger, the global economy switches more on Asia by establishing a continuous relation between seaborne trade and economic growth. The increasing global trade is transmitted by sea transport, the advantages of geographic locations and port facilities have become more significant and noticeable since then. Hong Kong, as a front office and main transfer port of mainland China, obtains incomparable benefits and maintains the high-speed economic expansion since 1978 (Chinese economic reform) until the Asian Financial Crisis in 1997 (Song, 2002). Hong Kong achieved the economic boom like other “Asian Tigers” with the rapid expansion

of port facilities and equipment to adjust the regional economy, whereas mainland China did not have decent ports to take over container transport business back then due to its inferior facilities and equipment. Hence, the importance of Hong Kong ports has been upgraded as a territorial center. Also, Hong Kong could accomplish such economic progress because of its advanced banking and commerce system, excellent machinery, leading transportation facilities. Moreover, Hong Kong was considered the principal gateway to access the Chinese mainland market (Song and Sung, 1998).

At present, China has become the main trading partner for Hong Kong in both imports and exports. With the expansion of re-exports trade pattern, the significance of re-exports profit to Hong Kong's economy has becoming growing remarkably, whereas the amount of domestic export is decreasing apparently (Hong Kong Census and Statistics Department, 2011). Besides, since China has gradually developed into the world manufactory lead and manages numerous processing projects, Hong Kong operates the outward processing trade procedure for mainland China, for example, handling the cargo traffic and transferring raw materials or semi-finished products to China for additional processing. Consequently, Hong Kong's main trade patterns essential commercial movements are based on re-exports and outward processing procedures (Song, 2002).

However, Chinese southern ports have turned more modernized and forward in the past few decades, which has already made up for its insufficient port shortages. In particular, Shenzhen (a city in Guangdong province) ports have grown significantly and plays an important role among the world's dominant container ports, as well as Hong Kong port (Tian et al. 2015). Also, thanks to the port trade facilitation policy and the following system plus application, Shenzhen ports could upgrade to one of the most leading container ports in the world (Cheng et al. 2018). The import and export volume, trade value through southern ports have increased significantly in Yantian, Shekou, and Chiwan port in Shenzhen (Ministry of Transport, 1998), which has formed a competitive drive force for Hong Kong container ports development.

Figure 2 Port map of Hong Kong and Shenzhen



Source: A competitive analysis of port of Hong Kong: from external to internal. *Journal of Shipping and Trade* (Liu et al. 2020)

According to Do et al. (2015), the result of their application of game theory and uncertainty theory illustrates that Shenzhen port has a prevalent position in long-term scheme compared to Hong Kong port. Also, based on the research of Tian et al. (2015), Shenzhen port functions as a supplement of Hong Kong port, nevertheless, the two ports demonstrate active competition between them if the exclusion of demand impact is provided. Shenzhen ports have negative effects on re-exports and indirect shipment towards Hong Kong ports while showing positive effects on direct shipment and transportation for Hong Kong ports. Consequently, Shenzhen ports perform reasonably competitive to Hong Kong ports, whereas Hong Kong ports are not fairly influential for Shenzhen ports economically. Besides, due to the cheaper labor force, land rent and manufacturing cost in Mainland China, the relocation of resources and manufacturing process from Hong Kong to Mainland China (The shift from high-cost producer to low-cost producer) promotes trade creation in Mainland China and trade diversion in Hong Kong. Hong Kong's domestic exports demonstrate a noticeable decrease, while re-exports value has accounted for most of the total exports value, most importantly, Mainland China is the principal re-export destination. The shift from high-cost producer to low-cost producer benefits the trade growth, in this case, Mainland China

experiences significant trade expansion compared to Hong Kong.

All in all, Hong Kong serves as a regional center port of shipment and transportation, which cannot be viewed independently from South China or even Southeast Asia (Rimmer, 1996; Wong and Beresford, 1996; Bangsberg, 1998; Wong, 1999; Mooney, 2000). Hong Kong enjoyed great benefits from external merchandise and outward trade during a certain period because of “the special Chinese influence”. However, thanks to the growing advancement of infrastructure, facilities equipment, the cheaper labor force and manufacturing cost in Mainland China, the relocation of production process from Hong Kong to mainland has verified the trade creation and diversion effect between both to some extent.

#### **2.4 Overview of literature review**

Based on the current studies, trade plays a significant role in Hong Kong’s economic growth, especially through external merchandise and outward trade. As the front office of China, Hong Kong received numerous overseas investments and capitals, also, Hong Kong achieved a notable economic boom through cargo transportation due to its advanced port facilities, excellent finance and security system, sufficient telecommunication, etc. Since the accession of WTO (2001), China obtains increasing opportunities in the global trade market, enhances its banking and finance system, promotes the economic structural change, improves the proportion of domestic products exports, so that China gains better economic performance globally year by year. The effective impact of China joining WTO will continuously bring it trade increase (both volume and value) and economic growth.

With the rapid evolution of Chinese infrastructure and facilitation, the relocation of resources and manufacturing industry (The shift from high-cost producer to low-cost producer) becomes more common from Hong Kong to mainland China. Mainland China has experienced significant trade creation in exports generally, whereas Hong Kong has gone through trade diversion, especially in domestic exports. Re-exports show an important percentage of total exports in Hong Kong, while an obvious decline

of domestic product exports can be noticed. Also, Chinese ports (such as Shenzhen port) have become increasingly predominant in recent decades thanks to the enhancement of facilities and port construction, which have developed into a relevantly competitive force towards Hong Kong ports in terms of cargo transportation.

Does the growing economic importance of China cause Hong Kong's domestic exports to decrease? To what extent the accession of WTO of China shapes Hong Kong's exports in terms of two main trading patterns (re-exports and outward processing trade)?

Does the outcome (trade increase) of the accession of WTO in Mainland China change Hong Kong's export trading partners? Is there any consequence between China's accession to WTO (trade increase) and Hong Kong's external merchandise performance (domestic exports drop)? The effect of trade creation and diversion between Mainland China and Hong Kong will persist in a long term?

To my best knowledge, there is no previous study that mentions how much China's WTO accession affects Hong Kong's trade development in a long term. The current research neither compares the difference of trade patterns and the transformation of export composition in two periods (before and after the accession of WTO in 2001) in Hong Kong nor analyzes if China's entry to WTO has promoted trade diversion in Hong Kong rather than trade creation.



### 3. Hypotheses

Hong Kong is an outward-oriented economy, and its external merchandise trade plays a crucial role in its economy, mainly can be noticed in exports (Hong Kong Census and Statistics Department, 2011). China's entry into WTO (2001) significantly strengthens the trade development in the mainland by increasing domestic exports and total trade value. To explore more the impact of China's accession to WTO on Hong Kong's trade development in two periods (before and after 2001), the following hypotheses are proposed.

*H1: China's entry into WTO in 2001 created a higher trade diversion in Hong Kong than trade creation.*

Since the Chinese economic reform in 1978, the importance of China as an economic unit has become increasingly significant. Hong Kong, as mainland's front office, also, was viewed as the principal entrance for mainland market, took over numerous commercial business. The accession to WTO brings China a noticeable trade increase, also, due to the process of manufacturing and resource relocation from Hong Kong to mainland China, and the competitive force of Shenzhen ports, the effect of trade creation and diversion can be seen more obviously in between. Consequently, I assume that China's accession to WTO caused a higher trade diversion in Hong Kong than trade creation.

*H2: China's accession to WTO affects the shift of Hong Kong's total exports composition: increasing its re-exports at the expense of domestic exports.*

After China entered WTO in 2001, the significant trade increase can be observed both in imports and exports. Mainland China has become Hong Kong's most important trading partner, especially in re-exports. Hong Kong's re-exports increased notably in the past few decades and has accounted for most of the total exports value (trade creation) whereas domestic exports value dropped significantly because of the

relocation of manufacturing process (trade diversion effect). Hence, I assume that China's entry into WTO to some degree affects Hong Kong's total export structure and composition.

## **4. Methodology**

### **4.1 Investigation plan**

I divided the trade development of Hong Kong into two stages before and after China joined WTO (2001) during the given period. I collect data of Hong Kong's overseas merchandise trade during the period (1970 - 2019) from Hong Kong Annual Digest of Statistics. Meanwhile, Mainland China's overseas merchandise trade data is collected from China Statistical Yearbook in the same period, which includes total exports value, total imports value, and total trade value in two currencies (Hong Kong Dollars or Chinese RMB and US Dollar).

In Hong Kong Annual Digest of Statistics, the external merchandise trade statistics contain commodity flow in Hong Kong and its trading allies including land, air, and waterways and by mail. Exempted goods, gold, and gold coins. The import and export of gold and gold coins are not included. The statistical procedure is carried out based on the imports and exports declaration through customs. The imports cover commodities produced or manufactured outside Hong Kong, imported into Hong Kong for local use or re-export, and re-imported into Hong Kong. The value of import commodities is calculated on a freight-forwarding (C.I.F.) basis. Total exports include domestic exports and re-exports. Domestic exports refer to natural products and products that were manufactured and were altered in shape, character, and structure in Hong Kong, whereas re-exports stand for products that have been imported into Hong Kong from abroad and which have not been altered in the shape, character, structure. The value of export commodities is calculated under free-on-board regulation. Total trade value constitutes the total exports and imports value.

Based on the Hong Kong Annual Digest of Statistics, the trade value was recorded in Hong Kong Dollar by million. For further comparison between Mainland China, I transferred trade value in US Dollar by million according to the annual exchange rate between HKD and USD. Due to Hong Kong Dollars floating during 1975 to 1982, there is no reliable currency rate between Hong Kong Dollar and US Dollar. For comparative purposes, trade data from this period are not included in the comparison with Mainland China.

According to China Statistical Yearbook, the range of trade in goods statistics is developed following the United Nations principles of international trade statistics, that is, all import and export goods that can cause an increase or decrease in the stock of material resources in the customs territory of the People's Republic of China, unless otherwise specified in the system, are included in the statistics. The information of trade in goods statistics is recorded through the General Administration of Customs with the survey method is a comprehensive survey. China Statistical Yearbook provides the trade value in two currencies (Chinese RMB and US Dollar), in the following step, a comparison of trade value (total exports, imports, and total trade value) from 1970 to 2019 in USD/Million is carried out between Hong Kong and Mainland China.

## 4.2 Analysis plan

To test H1, through the comparison of Hong Kong's total trade value, total export value and total import value before and after China's accession to WTO (2001) during the period from 1970 to 2019 with the same trade data in Mainland China, we can notice if China's entry into WTO produces a higher trade diversion than trade creation.

To test H2, I calculate the share of domestic exports in Hong Kong by applying *Hong Kong's domestic export value (HK\$ Mn.) / Hong Kong's total export value (HK \$ Mn.) \* 100 = The share of domestic exports in Hong Kong*. And I measure Hong Kong's domestic export value (US \$ Mn.) through *the share of domestic exports in (Hong Kong / 100) \* Hong Kong's total export value (US \$ Mn.) = Hong Kong's domestic export value (US \$ Mn.)*. To further compare between Hong Kong and Mainland China, I set

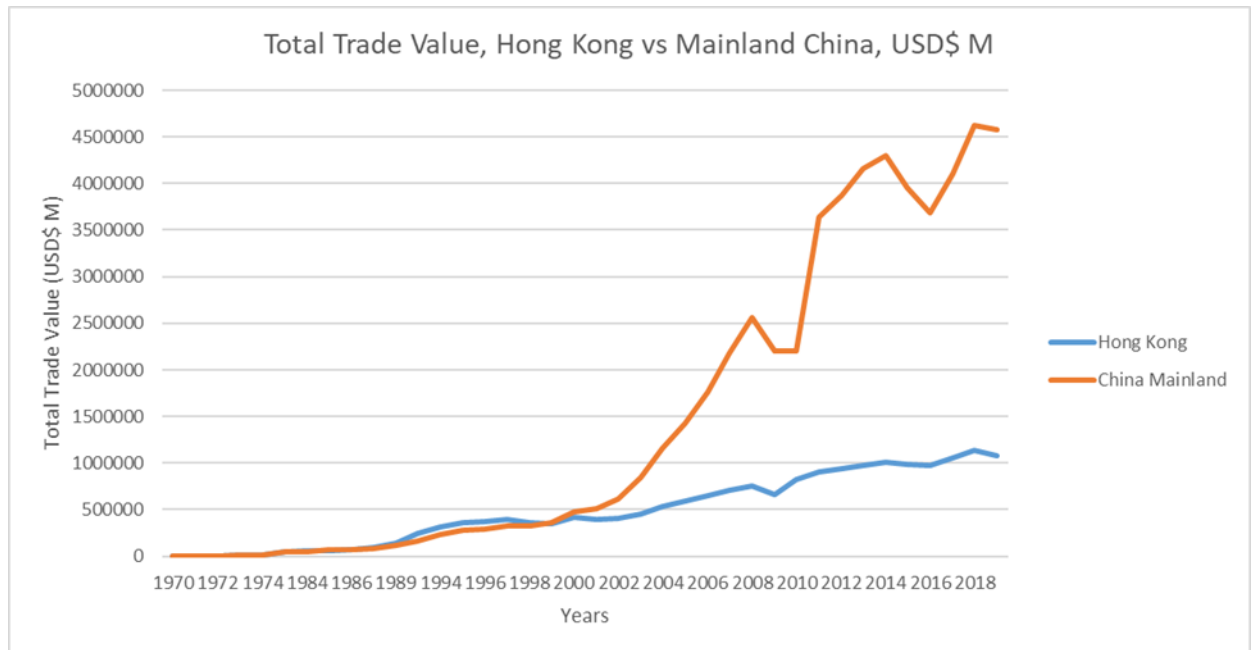
China=100 and recalculate Hong Kong's domestic export value through *Hong Kong's domestic export value (US \$ Mn.) \*100 / China's total export value (US \$ Mn.)* to see how Hong Kong domestic exports are related to China's total exports. Then, to compare if China's accession to WTO affects Hong Kong's total export composition through the changing proportion of domestic exports.

## 5. Results and discussion

### 5.1 Results

Based on Hong Kong overseas merchandise trade (Table 1, see appendix), we can observe a stable growing trend among total exports, imports, and total trade value since 1970 with a high speed of increase rate. Hong Kong has achieved remarkable total trade value from 1970 to 2019 and had advanced evolution on external merchandise trade as an important international hub. Compared to the overseas merchandise trade in Mainland China (Table 2, see appendix), China's total trade value started to become impressive since the 1980s and increased significantly after the entry to WTO in 2001.

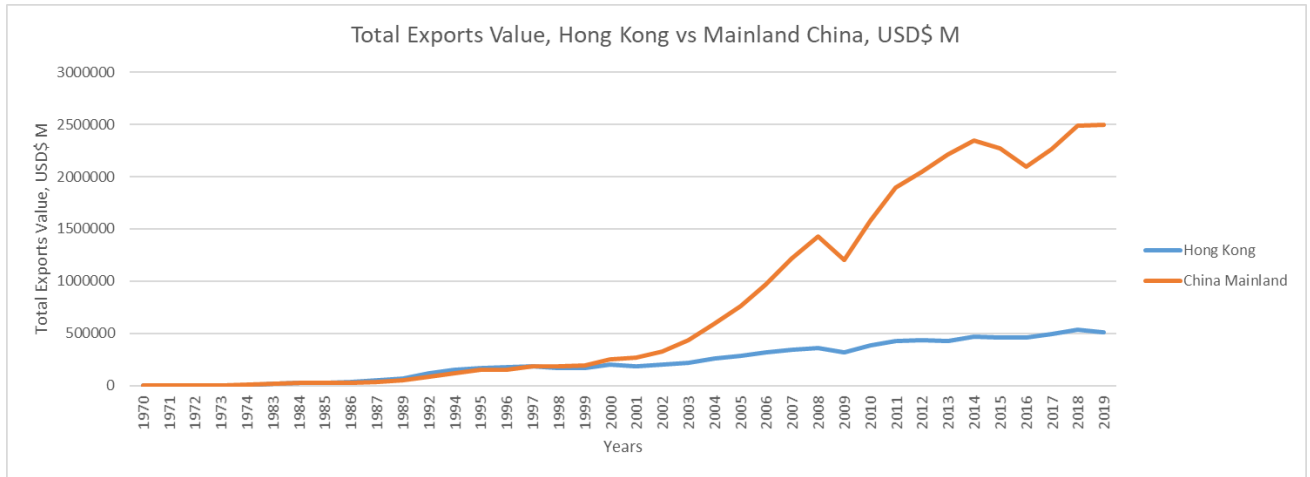
Graph 1 Total Trade Value (USD\$ Million) between Hong Kong and Mainland China (1970-2019)



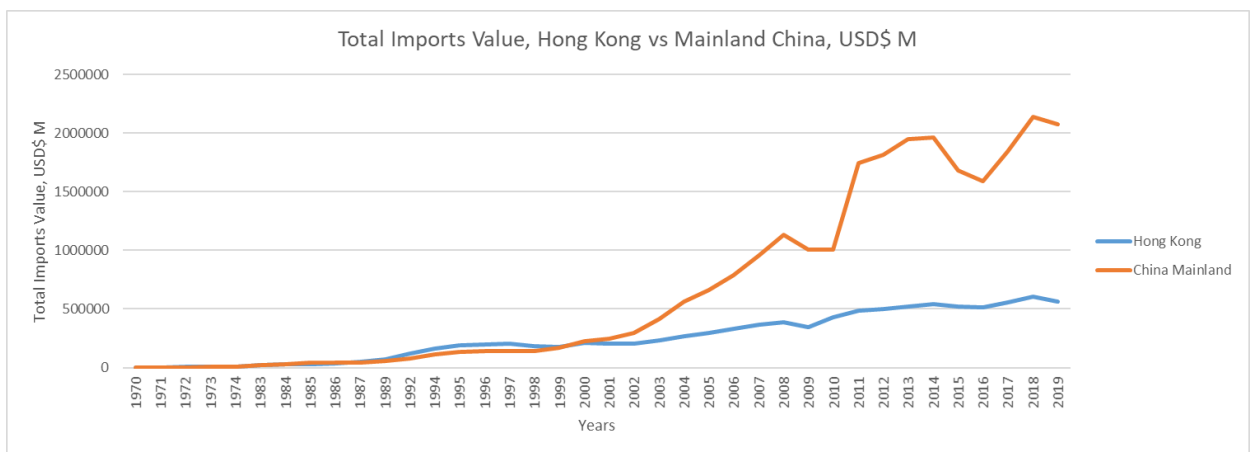
According to Graph 1, Hong Kong and Mainland China's total trade value both increased in the long term. Hong Kong maintained a stable tendency of total trade value increase before and after China's accession to WTO during the given period (1970-2019), even though the trade creation after China's entry to WTO was not that significant compared to Mainland China. Also, based on Graph 2 and Graph 3, we can

notice the trade enlargement in Hong Kong on both imports and exports before and after China entered WTO.

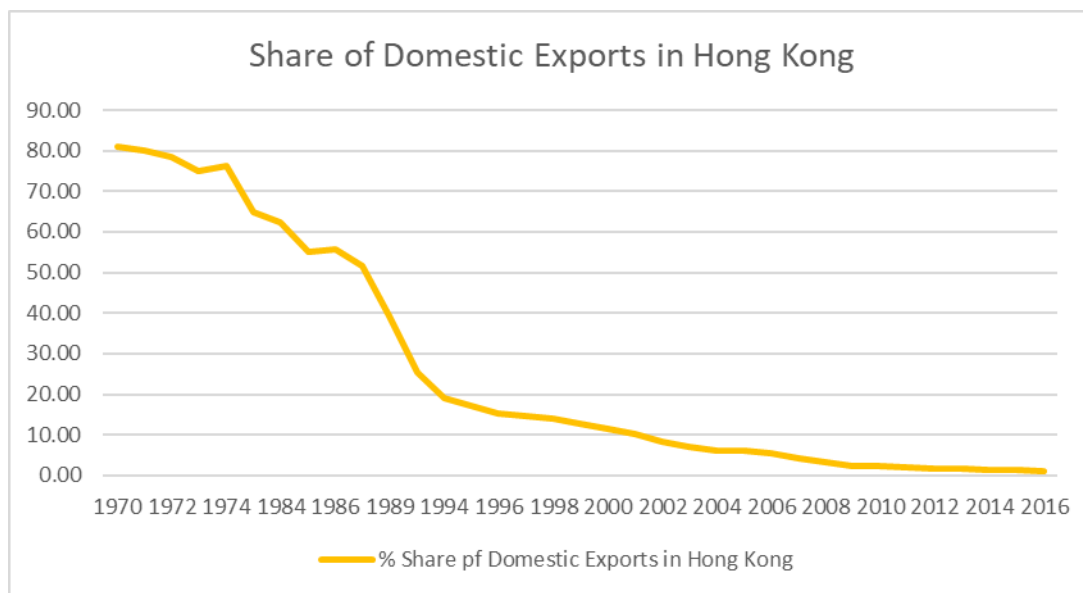
Graph 2 Total export value in Hong Kong and Mainland China (USD \$ Million)



Graph 3 Total import value in Hong Kong and Mainland China (USD \$ Million)



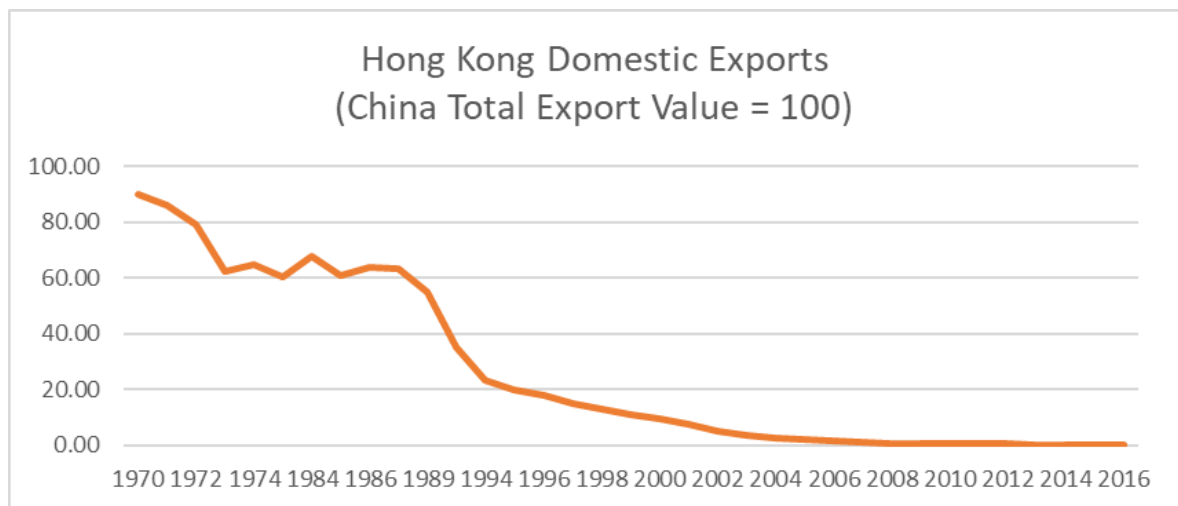
Graph 4. Domestic exports of Hong Kong as a share over total export



Total export value in Hong Kong contains domestic exports and re-exports (Total export value=domestic exports + re-exports). The shift in the share of domestic exports can demonstrate the transformation of total export composition. Based on Graph 4, we can observe that it is evident that the share of domestic exports in Hong Kong started to drop noticeably since the late years of 1980s, well before China's accession to WTO (2001), and continued with an obvious decline year by year. While, the share of re-exports value was much less than domestic exports value since 1970, but showed a stable growing trend and has represented the majority of total exports value. We can see that the development of re-export trade is almost representative of the total exports trade, yet the domestic exports only account for a very small percentage of total export trade. The share of domestic export started to decline significantly and re-export value started to present outstandly since late eighties. China's accession to WTO (2001) promotes the trade increase in Mainland China, also, Mainland is the most principal and important re-exports partner of Hong Kong. However, the shift of total export composition started to alter since late eighties, when re-export value has exceeded domestic export value. Hence, there is no clear evidente to illustrate that China's entry to WTO affects the transformation of Hong Kong's total export structure as the real change seems to have started in the eighties or even since end of the seventies.

Although Mainland China has become Hong Kong’s most significant trade partner, in particular, in re-exports, there is no proof to demonstrate that China’s entry into WTO affects the shift of Hong Kong’s total export composition in a certain way. Graph 5 points out how it was in the eighties when a remarkable shift on Hong Kong’s exportation did happen, and trade diversion can be an effect of the Chinese economic opening well before the official entry to the WTO (See appendix table 3 and table 4 for more details).

Graph 5. Hong Kong Domestic Exports related to China’s total exportation



Consequently, to answer H1, although the trade diversion in domestic exports and trade creation in re-exports can be both noticed in Hong Kong. In general, Hong Kong experienced trade increase both before and after China’s accession to WTO (2001). There is no clear proof to demonstrate that China’s entry into WTO created a higher trade diversion in Hong Kong than trade creation.

In terms of H2, the shift of Hong Kong’s total export composition started to show since late eighties through the declining share of domestic exports and increasing proportion of re-export. There is no evidence to illustrate that China’s entry into WTO (2001) can affect the change of Hong Kong’s total exports composition: increasing its reexports at the expense of domestic exports.



## 5.2 Discussion

Based on the results above, we can observe that China's accession to WTO (2001) did not create a higher trade diversion in Hong Kong than trade creation generally, even if there is a significant trade enlargement in re-exports and noticeable trade decline in domestic exports. Also, the shift of Hong Kong's total export composition started to occur well before China entered WTO. For years, Hong Kong was the principal entrance of foreign investments to Mainland China, Hong Kong achieved impressive trade incomes during 1970s to 1990s. Also, as an international port, Hong Kong's cargo business has been developing prosperously, thanks to its advanced port facilities, modern telecommunication skills and finance system. That also promoted the domestic export development in Hong Kong.

In contrast, thanks to Chinese economic reform (1978), China's integration to international market has become notable. The uprising Chinese economy and trade expansion also has brought trade creation for Hong Kong's re-exports particularly. China has become Hong Kong's principal trading partners both in imports and exports and the most important re-export destination, Hong Kong's main trading pattern has shifted to re-exports from domestic exports gradually since late eighties through a significant drop in domestic export proportion (see Graph 4) and re-exports value can nearly represent the total exports value. Moreover, the accession to WTO has brought Mainland China numerous trade opportunities, consequently, a remarkable trade increase can be viewed in both exports and imports value. And it continued to bring trade creation for Hong Kong's re-export by being the leading re-export destination for Hong Kong.

On the other hand, due to the low manufacturing cost, cheaper labor force and land rent in Mainland China, the production process relocation from Hong Kong to Mainland China occurred. Hong Kong's domestic commodities become less competitive and produced the decrease of domestic exports, which caused the trade diversion in Hong

Kong's domestic exports.

Apart from the reasons that I have discussed above, many more factors can affect the trade development in Hong Kong. Both the effect of Chinese economic reform (1978) and changing trade patterns should be viewed as significant factors to impact Hong Kong's trade evolution. Also, it gives a distinct perspective to regard the essence of the trade creation and diversion. Furthermore, it provides another way of thinking in terms of various extents of dependence, for example, Hong Kong relies on Mainland China more on both imports and exports industry at present, especially through re-exports. And Mainland China can continue bring trade creation to Hong Kong's re-exports by maintaining its trade increase trend.

## **6. Conclusion**

This study illustrates the impact of China's accession to WTO (2001) on Hong Kong's trade development. China's entry into WTO did not create a higher trade diversion in Hong Kong than trade creation, Hong Kong experienced trade increase generally during 1970 to 2019, even though with trade diversion in domestic exports and trade creation in re-exports. Also, Hong Kong's total export composition started to transform since late eighties through the significant drop in the share of domestic exports, which is well before China's accession to WTO in 2001.

The entry to WTO brings trade expansion to China significantly, and it continues to benefit Hong Kong's re-export evolution with Mainland China and bring trade creation to Hong Kong. Overall, Hong Kong's trade development is closely related to the economic advancement and commerce growth of mainland China.

Given the ongoing development of China's overseas trade market, Hong Kong can continue to leverage its trade advantages as an international port and develop its re-export trade in the long term, thus contributing to its economic growth.

For further research, more factors should be considered to affect Hong Kong's trade development, for instance, foreign investment (such as capital flow and foreign project) can be an important variable to measure the trade evolution, also, to analyze the regional development.

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## Appendix

**Table1 Hong Kong overseas merchandise trade (1970-2019)**

Year	Value (HKD \$ Million)			Value (USD \$ Million)			
	Total Exports	Total Imports	Total trade	Total Exports	Total Imports	Total trade	Trade balance (Exports-imports)
1970	15239	17607	32845	2515	2905	5420	-390
1971	17164	20256	37420	2832	3343	6175	-511
1972	19399	21764	41164	3454	3876	7330	-422
1973	25999	29005	55004	4844	5403	10247	-559
1974	30035	34120	64156	5907	6710	12617	-803
1983	160700	175442	336142	20603	22493	43095	-1890
1984	221440	223370	444811	28390	28637	57027	-247
1985	235152	231420	466572	30148	29669	59817	478
1986	276529	275955	552484	35452	35379	70831	74
1987	378034	377948	755982	48466	48455	96921	11
1989	570509	562781	1133291	73142	72151	145294	991
1992	924952	955295	1880248	118584	122474	241057	-3890
1994	1170004	1250709	2420722	150001	160347	310349	-10347
1995	1344127	1491121	2835248	172324	191169	363493	-18845
1996	1397917	1535582	2933499	179220	196869	376090	-17649
1997	1455950	1615090	3071040	186660	207063	393723	-20403
1998	1347649	1429092	2776741	172776	183217	355992	-10441
1999	1349000	1392718	2741717	172949	178554	351502	-5605
2000	1572689	1657962	3230652	201627	212559	414186	-10932
2001	1480987	1568194	3049181	189870	201051	390921	-11180
2002	1560517	1619419	3179936	200066	207618	407684	-7552

2003	1742436	1805770	3548206	223389	231509	454898	-8120
2004	2019114	2111123	4130237	258861	270657	529518	-11796
2005	2250174	2329469	4579643	288484	298650	587134	-10166
2006	2461027	2599804	5090831	315516	333308	652671	-17792
2007	2687513	2868011	5555524	344553	367694	712247	-23141
2008	2824151	3025288	5849439	362071	387857	749928	-25787
2009	2469089	2692356	5161445	316550	345174	661724	-28624
2010	3031019	3364840	6395859	388592	431390	819982	-42798
2011	3337253	3764596	7101849	427853	482641	910493	-54788
2012	3434346	3912163	7346509	440301	501559	941860	-61259
2013	3359686	4060717	7620404	430729	520605	976975	-89876
2014	3672751	4219046	7891798	470866	540903	1011769	-70038
2015	3605279	4046420	7651699	462215	518772	980987	-56557
2016	3588247	4009384	7596631	460032	514024	973927	-53992
2017	3875898	4357004	8232902	496910	558590	1055500	-61680
2018	4158106	4721399	8879505	533091	605308	1138398	-72217
2019	3988685	4415440	8404126	511370	566082	1077452	-54712

Source: Hong Kong Annual Digest of Statistics 1978, 73  
Hong Kong Annual Digest of Statistics 1981, 77  
Hong Kong Annual Digest of Statistics 1988, 95  
Hong Kong Annual Digest of Statistics 1999, 45  
Hong Kong Annual Digest of Statistics 2005, 50  
Hong Kong Annual Digest of Statistics 2010, 62  
Hong Kong Annual Digest of Statistics 2015, 64  
Hong Kong Annual Digest of Statistics 2020, 67  
By Trade Analysis Section, Hong Kong Census and Statistics

**Department**

Note: official currency rate between HKD and USD

1 January 1971 to 17 December 1971

US\$1 = HK\$6.06061

18 December 1971 to 5 July 1972

US\$1 = HK\$5.58213

6 July 1972 to 13 February 1973

US\$1 = HK\$5.65

14 February 1973 to 25 November 1974

US\$1 = HK\$5.085

26 November 1974 to 31 December 1980

Hong Kong dollars

floating

Since 17 October 1983, the Hong Kong dollar was linked to US dollar through a

new arrangement in the note-issue mechanism at a fixed exchange rate of US\$1.00= HK\$7.80.

**Table 2 China overseas merchandise trade (1971-2019)**

Year	Value (RMB ¥ Million)			Value (USD \$ Million)			
	Total Exports	Total Imports	Total trade	Total Exports	Total Imports	Total trade	Trade balance (Exports-imports)
1970	5680	5610	11290	2260	2330	4590	-70
1971	6850	5240	12090	2640	2200	4840	440
1972	8290	6400	14690	3440	2860	6300	580
1973	11690	10360	22050	5820	5160	10980	660
1974	13940	15280	29220	6950	7620	14570	-670
1983	43830	42180	86010	22230	21390	43620	840
1984	58060	62050	120110	26140	27410	53550	-1270
1985	80890	125780	206670	27350	42250	69600	-14900
1986	108210	149830	258040	30940	42910	73850	-11970
1987	147000	161420	308420	39440	43210	82650	-3770
1989	219990	195600	415590	52540	59140	111680	-6600
1992	467630	444330	911960	84940	80590	165530	4350
1994	1042180	996010	2038190	121010	115610	236620	5400
1995	1245180	1104810	2349990	148780	132080	280860	16700
1996	1257640	1155740	2413390	151050	138830	289880	12220
1997	1516070	1180660	2696720	182790	142370	325160	40420
1998	1522350	1162610	2684970	183710	140240	323950	43470
1999	1615980	1373650	2989620	194930	165700	360630	29230
2000	2063440	1863880	3927330	249200	225090	474300	24110
2001	2202440	2015920	4218360	266100	243550	509650	22550
2002	2694790	2443030	5137820	325600	295170	620770	30430
2003	3628790	3419560	7048350	438230	412760	850990	25470
2004	4910330	4643580	9553910	593330	561230	1154550	32100
2005	6264810	5427370	11692180	761950	659950	1421910	102000
2006	7759790	6337690	14097410	968080	791460	1760440	176620
2007	9362710	7329690	16692410	1220060	956120	2176180	263940
2008	10039490	7952650	17992150	1430690	1132560	2563260	298130
2009	8202970	6861840	15064810	1201610	1005920	2207540	195690
2010	10702280	9469950	20172230	1577750	1005920	2207540	571830
2011	12324060	11316140	23640200	1898380	1743480	3641860	154900
2012	12935930	11480100	24416020	2048710	1818410	3867120	230300
2013	13713140	12103750	25816890	2209000	1949990	4158990	259010

2014	14388380	12035800	26424180	2342290	1959240	4301530	383050
2015	14116680	10433610	24550290	2273470	1679560	3953030	593910
2016	13841930	10496720	24338650	2097630	1587930	3685560	509700
2017	15330940	12478980	27809920	2263350	1843790	4107140	419560
2018	16412780	14088030	30500810	2486680	2135730	4622420	350950
2019	17237360	14325370	31562730	2499480	2078410	4577890	421070

Source: China Statistical Yearbook 1981, 353, 2020 Chapter 11-2, by National Bureau of Statistics of China

Note: 1. This table before 1979 for foreign trade operations statistics, since 1980 for customs import and export statistics.

2. US dollar to RMB conversion 1970-1978 are calculated according to the ratio of US dollar to RMB as stipulated by the People's Bank of China in that year, 1979-2019 are calculated according to the ratio stipulated by the Bank of China.

**Table 3 Hong Kong's total exports value composition (HK \$ Million)**

Year	Domestic exports value (HK\$ Mn.)	Re-exports value (HK\$ Mn.)	Total exports value (HK\$ Mn.)
1970	12347	2892	15239
1971	13750	3414	17164
1972	15245	4154	19399
1973	19474	6525	25999
1974	22911	7124	30035
1975	22859	6973	29832
1976	32629	8928	41557
1977	35004	9829	44833
1978	40711	13197	53908
1979	55912	20022	75934
1980	68171	30072	98243
1981	80423	41739	122162
1982	83032	44353	127385
1983	104405	56294	160699
1984	137936	83504	221440
1985	129882	105270	235152
1986	153983	122546	276529
1987	195254	182780	378034
1989	224104	346405	570509
1992	234123	690829	924952
1994	222092	947921	1170013
1995	231657	1112470	1344127
1996	212160	1185758	1397918
1997	211410	1244539	1455949
1998	188454	1159195	1347649

1999	170600	1178400	1349000
2000	180967	1391722	1572689
2001	153520	1327467	1480987
2002	130926	1429590	1560516
2003	121687	1620749	1742436
2004	125982	1893132	2019114
2005	136030	2114143	2250173
2006	134527	2326500	2461027
2007	109122	2578392	2687514
2008	90757	2733394	2824151
2009	57742	2411347	2469089
2010	69512	2961507	3031019
2011	65662	3271592	3337254
2012	58830	3375516	3434346
2013	54364	3505322	3559686
2014	55283	3617468	3672751
2015	46861	3558418	3605279
2016	42875	3545372	3588247

**Table 4**

<b>Year</b>	<b>Domestic exports value (HK\$ Mn.)</b>	<b>Hong Kong Total Export Value (HK \$ Mn.)</b>	<b>Share of Domestic Exports</b>	<b>Hong Kong Total Export Value (US\$ Mn.)</b>	<b>China Total Export Value (US\$ Mn.)</b>	<b>Hong Kong Domestic Export Value (US\$ Mn.)</b>	<b>Hong Kong Domestic Exports Value (China = 100)</b>
1970	12347	15239	81.02	2515	2260	2038	90.16
1971	13750	17164	80.11	2832	2640	2269	85.94
1972	15245	19399	78.59	3454	3440	2714	78.91
1973	19474	25999	74.90	4844	5820	3628	62.34
1974	22911	30035	76.28	5907	6950	4506	64.83
1983	104405	160699	64.97	20603	22230	13386	60.21
1984	137936	221440	62.29	28390	26140	17684	67.65
1985	129882	235152	55.23	30148	27350	16652	60.88
1986	153983	276529	55.68	35452	30940	19741	63.80
1987	195254	378034	51.65	48466	39440	25033	63.47
1989	224104	570509	39.28	73142	52540	28731	54.68
1992	234123	924952	25.31	118584	84940	30016	35.34
1994	222092	1170013	18.98	150001	121010	28473	23.53
1995	231657	1344127	17.23	172324	148780	29700	19.96
1996	212160	1397918	15.18	179220	151050	27200	18.01

1997	211410	1455949	14.52	186660	182790	27104	14.83
1998	188454	1347649	13.98	172776	183710	24161	13.15
1999	170600	1349000	12.65	172949	194930	21872	11.22
2000	180967	1572689	11.51	201627	249200	23201	9.31
2001	153520	1480987	10.37	189870	266100	19682	7.40
2002	130926	1560516	8.39	200066	325600	16785	5.16
2003	121687	1742436	6.98	223389	438230	15601	3.56
2004	125982	2019114	6.24	258861	593330	16152	2.72
2005	136030	2250173	6.05	288484	761950	17440	2.29
2006	134527	2461027	5.47	315516	968080	17247	1.78
2007	109122	2687514	4.06	344553	1220060	13990	1.15
2008	90757	2824151	3.21	362071	1430690	11636	0.81
2009	57742	2469089	2.34	316550	1201610	7403	0.62
2010	69512	3031019	2.29	388592	1577750	8912	0.56
2011	65662	3337254	1.97	427853	1898380	8418	0.44
2012	58830	3434346	1.71	440301	2048710	7542	0.37
2013	54364	3559686	1.53	430729	2209000	6578	0.30
2014	55283	3672751	1.51	470866	2342290	7088	0.30
2015	46861	3605279	1.30	462215	2273470	6008	0.26
2016	42875	3588247	1.19	460032	2097630	5497	0.26