



The Role of Hong Kong in China's Investment in the ASEAN Market

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After years of rapid economic growth, China's economy accumulated vast amounts of capital. Against this backdrop, Chinese enterprises face a rising need for opening new markets, raising earnings and performing asset allocation for risks diversification. These factors spurred a steep increase in the demand for outbound investment from China. During the process of Mainland enterprises' investing in the global market, Hong Kong has been playing an important middleperson role. Through a free and sound business environment, a well-established legal system and a highly effective financial market, Hong Kong serves as an ideal springboard for Mainland enterprises to expand their businesses overseas.

Amid the international cooperation under The Belt and Road Framework, the ten member states of ASEAN have considerable advantages in terms of their strategic location, low operating costs, and tremendous market size. And the ASEAN economy has continued to progress towards economic liberalization. With the establishment of China-ASEAN free trade zone, these advantages and economic policies have propelled a surge of Chinese outbound investment to the ASEAN market. At present, Hong Kong is an international financial and business hub in the region. The free trade agreement between Hong Kong and ASEAN is expected to be signed by the end of 2017, which will raise the competitiveness of Hong Kong companies in the ASEAN market. Hong Kong is well positioned to serve as the offshore regional base for Chinese enterprises in expanding and managing their businesses in the ASEAN market.

Hong Kong has always been the top destination for Chinese ODI

According to the "Report on Development of China's Outward Investment and Economic Cooperation 2016", Hong Kong remained the major destination for China's outbound direct investment (ODI). Counting by flows and positions, Hong Kong's relative weightings in China's overall ODI topped at 60% for both figures. Over the past 10 years, Hong Kong's share in China's overall ODI has remained high, reflecting the importance of Hong Kong in assisting Chinese enterprises to "go global".

Hong Kong is a highly efficient international metropolis with a high level of development in commerce and industry. Hong Kong's economy has a prevailing competitive edge in various aspects, including a low and simple tax regime, free and open trade policies, a just and equitable legal system, a well-developed financial market and advanced infrastructure facilities. These strengths allow Hong Kong to provide quality business services and assistance for Chinese enterprises in their global expansion. Moreover, Hong Kong companies have accumulated rich experiences in the international business market, trained up a pool of talented people with international perspectives and understood the management of international business operations.

Hence, Hong Kong companies could leverage these capabilities to help Mainland enterprises in coordinating their overseas operations as well as enhancing their internationalization.

Chinese investment to ASEAN driven by CAFTA

The ASEAN market accounted for a relatively small share of Chinese ODI. In 2015, only 6% of Chinese total ODI (positions) went into the ASEAN market. However, the growth of Chinese investment in ASEAN was hugely remarkable with ODI flows soaring from about US\$1 billion in 2007 to about US\$14.6 billion in 2015. The acceleration has been particularly notable since 2010, which is probably due to the full implementation of China-ASEAN Free Trade Area (CAFTA) in 2010. In 2015, China and ASEAN concluded an upgraded agreement on CAFTA, further enhancing greater liberalization and facilitation in areas of trade in goods, trade in services and investment promotion. The upgrade is expected to give a strong boost for investment activities between the two sides. In 2016, the total trade amount between China and ASEAN doubled from US\$ 203 billion in 2007 to about US\$460 billion, evidencing the buoyant economic activities in the two economies.

Furthermore, ASEAN is one of the fast growing regions in Asia with US\$2.55 trillion of GDP and over 600 million of population. ASEAN's economic growth is also forecast to stay at 4-5% level over the medium-term, which is much higher than many advanced economies. Thus, a considerable growth potential for Chinese investment in ASEAN is foreseeable in the future.

Strong demand from CAFTA stimulates Hong Kong's economic activities

Given the prospect of thriving bilateral trade and investment flows between China and ASEAN, Hong Kong will be able to benefit from stronger demand from the two economies. Upon the full implementation of CAFTA, Hong Kong's role as the entrepôt for merchandise trade between China and ASEAN diminished somewhat. However, through trade liberalization, both China and ASEAN enjoyed greater economic benefits, which in turn provided a boost to the demand for trade and logistics services in Hong Kong. In 2010-2016, Hong Kong's overall total trade values only grew at an annual rate of 2.9%, whereas Hong Kong's total trade with the ASEAN market outperformed the overall trade by growing at an annual rate of 3.9%. It suggested that Hong Kong's trade with ASEAN was not significantly dragged by the trade diversion effect of CAFTA. Instead, Hong Kong benefited from a bigger economic pie from its two major trading partners, bolstering the overall trade performance.

Similarly, with a growing trend of Chinese investment in ASEAN, more Mainland enterprises are expected to make good use of Hong Kong as a platform to invest in the ASEAN market.

Current landscape of Chinese enterprises investing in ASEAN through Hong Kong

Since the outward direct investment statistics compiled by the Census and Statistics Department of HKSAR only collect data on the immediate destination of investment, it does not necessarily reflect the ultimate destination country of the investment. Furthermore, Hong Kong's outward direct investments usually registered their companies in British Virgin Islands, Cayman Islands or Bermuda. The business operations of these investments were in fact conducted in Hong Kong. In this regard, the statistics of these investments would not be counted as originating from Hong Kong. Besides, the HKSAR Government did not publish any official statistics on the amount of Chinese

enterprises investing in ASEAN through Hong Kong.

Therefore, it is not an easy task to accurately understand Hong Kong's status as the operating base for investments in ASEAN by Chinese enterprises. This paper attempted to provide a rough estimation on the situation by analyzing data from different agencies. Comparing the investment figures from the Ministry of Commerce of PRC (MoC), Census and Statistics Department of HKSAR (C&SD), and the ASEAN Secretariat, this paper indirectly estimated that, between 2010 and 2015, Chinese capital accounted for about 27% of the total investments from Hong Kong to ASEAN, representing an average of US\$ 1.38 billion investment per year. Besides, both the figures from C&SD and the ASEAN Secretariat showed a noticeable surge in the investment flows from Hong Kong to ASEAN since the full implementation of CAFTA, indicating that part of the investment growth from Hong Kong to ASEAN was fuelled by the rising demand for outbound investments from Mainland enterprises.

From 2010 to 2015, MoC's data on the investment flows from Mainland China to ASEAN were significantly higher than the ASEAN Secretariat's data. On the other hand, C&SD's data on the investment flows from Hong Kong to ASEAN were considerably lower than the corresponding ASEAN Secretariat's data. As a portion of investment funds flowed into ASEAN via other territories, it was reasonable to have slightly smaller figures from C&SD. In addition, deviations on investment data could arise due to the differences in valuations, exchange rates and recording time.

If the investment figures to ASEAN from MoC and C&SD were summed up and compared against the sum of corresponding figures from the ASEAN Secretariat, deviations on the average annual investments to ASEAN from the two sets of statistics could be obviously reduced. Hence, it is believed that some of the Chinese investments in ASEAN through Hong Kong were treated as investments from Hong Kong in the statistics surveys conducted by the ASEAN Secretariat, leading to bigger deviations when comparing data from three agencies individually. In respect of this, subtracting the MoC's average annual investments to ASEAN from the corresponding figures provided by the ASEAN Secretariat for period from 2010 to 2015, it found an average of US\$ 1.38 billion Chinese capital flowing to ASEAN through Hong Kong each year, accounting for around 27% of total investments from Hong Kong to ASEAN.

Hong Kong as a regional base for Chinese investment in ASEAN

In recent years, Chinese FDI became more diversified with ownership positions across a wide array of sectors. There were also major changes for Chinese investment in ASEAN, as most projects were previously concentrated in three main industries, namely, resources infrastructure facilities, manufacturing, mining and quarrying, but their dominance has been gradually overtaken by the leasing and business services industry.

As an international financial center and business hub, Hong Kong is a preferred location for multinational corporations (MNCs) to set up their regional headquarters in Asia. According to the numbers of C&SD in 2016, Mainland enterprises had 137 regional headquarters and 174 regional offices in Hong Kong; ASEAN enterprises had 54 regional headquarters and 136 regional offices in Hong Kong. The presence of numerous MNCs' regional headquarters in Hong Kong allowed businesses to enjoy both cluster effect and economies of scale, raising their marketing effectiveness in the ASEAN market and their integrated management capability in the region.

Geographically, Hong Kong's location makes it an ideal place for Mainland enterprises to set up regional headquarters for managing their operations in ASEAN. Flights from Hong Kong to major ASEAN commercial cities take less than four-hour travelling time, and a wide-range of flight options are available. The aviation network in Hong Kong provides substantial convenience and facilitation for travels between Hong Kong and ASEAN.

Chinese investment in ASEAN has exhibited a rising trend in the services sector, which would bring new opportunities to Hong Kong's professional services. In choosing Hong Kong as a base for managing investments in ASEAN, Mainland enterprises can leverage Hong Kong's advantages in a variety of professional services such as due diligence, legal, accounting, management & operation integration, business consulting, sales & marketing, financing and cash management, etc. These professional services would help maximize the chance of success in their expansion into the ASEAN market. Also, the ten ASEAN member states have their own unique social and cultural backgrounds, where a high degree of localization is often needed for the services sector in these countries. Thus, it is anticipated that more Chinese enterprises will opt for entering the ASEAN market by means of mergers and acquisitions (M&A), in order to expedite the business integration process and enhance their market adaptability. The demand for these M&A transactions will generate new businesses for the legal sector and financial sector in Hong Kong.

As a summary of the factors mentioned above, Hong Kong is expected to have promising prospects to serve as a base for Chinese investment in ASEAN, considering the positive economic outlook of both the Mainland and ASEAN, the rising trend in investments from the Mainland to ASEAN, and Hong Kong's unique advantages in many aspects.

Opportunities from the Hong Kong - ASEAN Free Trade Agreement

The Hong Kong - ASEAN Free Trade Agreement (AHKFTA) is expected to be signed within 2017. The implementation of AHKFTA will facilitate trade and investment activities between Hong Kong and ASEAN, boosting the competitiveness of Hong Kong companies in the ASEAN market.

Currently, Mainland China and ASEAN are FTA signatories under CAFTA, so Mainland enterprises are given more preferential treatment than the WTO agreement in areas like market access, tariff reduction, and investment facilitation, when they trade and invest in the ASEAN market. Judging from market conditions, CAFTA will reduce incentives for Mainland enterprises to invest in ASEAN through Hong Kong.

If AHKFTA is in force, the policy discrepancies between Mainland and Hong Kong enterprises for investment in ASEAN will narrow. The full text of AHKFTA is yet to be published, but the trade pact will likely bring greater facilitations for Hong Kong's services trade and investment to enter the ASEAN market. It will also strengthen Hong Kong's functions as a platform for Chinese enterprises to invest in ASEAN.

From another perspective, ASEAN is negotiating the Regional Comprehensive Economic Partnership (RCEP) with China, India, Japan, Korea, Australia, and New Zealand. A deeper implication for concluding AHKFTA is to pave the way for Hong Kong to join RCEP. If Hong Kong is able to become a member of RCEP, which is a massive free trade zone in Asia, it will further cement Hong Kong's position as an international financial, shipping, trade and logistics center.