

# **Hong Kong, Singapore and the East Asian Crisis: How Important were Trade Spillovers?**

August 2002

**Ramkishan S. Rajan**  
University of Adelaide  
Institute of Southeast Asian Studies

**Rahul Sen**  
National University of Singapore

and

**Reza Siregar**  
National University of Singapore

## **Summary**

Comparative studies between Hong Kong and Singapore have usually generated keen interest, both because of the obvious commonalities between the two economies, but also because of their pointed differences. Notwithstanding some concerns about longer term growth sustainability due to low total factor productivity (TFP) growth, especially in Singapore, it was generally acknowledged that both economies had in place strong macroeconomic fundamentals and robust financial systems with solid prudential regulations. Despite this, they both suffered from contagious fallout from the East Asian crisis of 1997-98.

This study examines Hong Kong's and Singapore's trade and investment linkages with the crisis-affected Asia-5 economies (Indonesia, Malaysia, the Philippines, Thailand and Korea). It then undertakes a formal empirical analysis to test the statistical and quantify the economic significance of the demand/export-induced trade spillover channel. Following this, attention is turned to the competitiveness-driven trade spillover channel, investigating the degree of similarity of comparative advantage and export structures of the regional economies.

The overall analyses of trade and direct investment links suggest that Singapore's web of close trade and investment complementarities with Malaysia in particular, but also the other regional economies, underpinned the transmission of the regional shocks from the Asia-5 economies to the city-state. Singapore's competitive export structures with the Asia-5 economies, especially in parts and components, may also have been an important factor in spreading the crisis to Singapore. In other words, Singapore was affected by trade linkages which operated through both an income effect mainly via falls in aggregate demand in other regional economies, but also due to a price or competitiveness effect via the appreciation of the Singapore dollar vis-à-vis regional

currencies. The deep but short-lived recession experienced by Hong Kong further exacerbated the recessionary impulses to Singapore.

The case of Hong Kong is less straightforward when seen through the lens of trade spillovers. Hong Kong has had very low trade and investment interdependencies with the Asia-5 economies, and while there is some evidence of export similarity with the crisis economies, this was far less than that of Singapore's. Hong Kong's trade, investment and other commercial links have been predominantly oriented towards Mainland China rather than the Asia-5 economies. In addition, the recessionary impulses from Hong Kong to Singapore were far more important than vice versa. This leads to the conclusion that one needs to look elsewhere for a rationalization of the transmission of the recessionary impulses of the East Asian crisis to Hong Kong. These include either trade spillovers for reasons not explored in this paper (due to data limitations), such as trade with Taiwan or services trade in general, or non-trade contagion channels, viz. financial spillovers, "pure contagion" or "common shocks".