Columbia Center on Sustainable Investment
A JOINT CENTER OF COLUMBIA LAW SCHOOL AND THE EARTH INSTITUTE, COLUMBIA UNIVERSITY

Columbia FDI Perspectives

Perspectives on topical foreign direct investment issues
No. 197 April 10, 2017
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FDI sectorial diversification: the trade-transport-tourism nexus*

by

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There is a long-standing debate about whether countries should actively seek to attract all types of inward FDI or adopt a sectoral approach. The latter view has been supported by academic evidence that suggests that host country benefits from inward investment are not the same across all industries. Moreover, a country cannot support the development of all industries nor can it have a comparative advantage in all areas. Therefore, a number of investment promotion agencies have focused on a handful of industries that they believe will meet their economic objectives, yet allow for sufficient inward FDI. However, the question of which industries to select for this purpose has been a troublesome issue for countries that want to use this approach. This challenge is even more complicated for small developing economies with few, if any, natural resources to attach. This *Perspective* examines the successful strategy used by Hong Kong, Singapore and Dubai and assesses how other governments can adopt their approach.

Small economies have tended to focus on tourism as its labor-intensive nature can absorb large quantities of relatively unskilled and usually young people. However, focusing on just tourism by itself can make a country prone to external events such as acts of terrorism, fluctuations in foreign exchange rates, etc. The cases of Hong Kong, Singapore and Dubai show that connecting trade, transport and tourism (the 3Ts), in that order or even simultaneously, can assist economic growth and diversification. For instance, Dubai in 1894 gave foreign traders full tax exemption; to support trade further, it dredged the creek in 1959 to allow for larger vessels. By 1970, the emirate had opened the Port Rashid to handle modern vessels and then, in 1979, opened Jebel Ali Port. In 1985, Emirates Airlines was established to support the trading sector but also to allow the tourism industry to develop. A similar chain of events took place in Hong Kong after the Treaty of Nanking in 1842, whereupon the colony focused on trading. Hong Kong then became a regional center for shipping. In 1957, the Hong Kong Tourism Association (HKTA) was established to develop tourism. From independence onwards, Singapore focused on exploiting its trading history and then became a center for shipping, followed by tourism.

Trade and transport have always been important to Hong Kong, contributing to a quarter of its GDP. It is now the world's seventh largest exporter of merchandise trade, and one of the top five re-export centers globally, with tourism contributing a further 5% of Hong Kong's GDP. A similar pattern exists in Singapore, with trade and transport contributing 23% of GDP and tourism providing a further 18%. For Dubai, trade and transport contribute 38% of GDP and tourism 5%. In all three economies, the 3Ts are an important contributor to GDP, and are also one where efficiencies have been obtained through building advanced infrastructure. Global rankings show that these three economies feature within the 20 best performers regarding trade, tourism and transport.

All three economies have the 3Ts firmly embedded in their national strategies supported by free zones or free ports allowing each to attract large inward FDI inflows. The 3Ts account for 21% for all inward investment into Singapore, 20% in Dubai and 13% in Hong Kong. In addition, the need to service the 3Ts implies that new and ancillary industries have developed, such as financial services and information technology, that have attracted further inward FDI.

While other countries cannot copy-and-paste what these three economies have done, particularly regarding migration, cultural change and government led-investment, they can still apply lessons derived from these governments' experiences. In particular, the geo-strategically located nations within the Caribbean can harness the power of the 3Ts. The region is at the crossroads of Latin America and can take advantage of the expansion of the Panama Canal. Countries such as Jamaica were once mercantile hubs and important ports. Some countries succeed, while others did not because there is a need to maintain the momentum of development that is illustrated by the case of Hong Kong, Singapore and Dubai.

These three economies have demonstrated that a targeted sectoral approach, integrated into an overall economic development strategy, is crucial not only for attracting FDI, but also for building a base to support other industries and for attracting a diversified range of inward FDI.

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