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WTO Trade Policy Review: Hong Kong, China*

Note: This text provides brief description of the conditions foreign business will encounter in trade with Hong Kong, China. It is based on a WTO Trade Policy Review for Hong Kong, China, early December 2010. Readers wishing for deeper analysis should turn to the original Trade Policy Review available on the WTO website. (www.wto.org/english/tratop_e/tp_r_e/tp341_e.htm)

Trade Policy Reviews are an exercise, mandated in the WTO agreements, in which member countries' trade and related policies are examined and evaluated at regular intervals.

Hong Kong, China remains one of the most market-oriented and open economies in the world (the ratio of trade in goods and non-factor services to GDP was 380% in 2009). It also has one of the world's most liberal and transparent foreign investment regimes.

Although Hong Kong, China's economy suffered a sharp contraction in early 2009 as a result of the global financial crisis, it has recovered fairly quickly owing mainly to its closer economic relationship with China and the latter's return to strong growth. The economy's resilience to external shocks is also underpinned by the flexibility of its wages and prices, which is especially important as the Hong Kong dollar remains pegged to the U.S. dollar (which reduces Hong Kong, China's scope for exchange rate flexibility and an independent monetary policy). Moreover, Hong Kong, China's prudent regulation of the financial markets has shielded it from the worst effects of the global financial crisis. Hong Kong, China has not adopted any protectionist measures in response to the crisis.

Hong Kong, China is facing a number of new challenges, as well as opportunities, as a result of the global financial crisis and the emergence of China as a major economic and trading power, as well as a competitor. Hong Kong, China's mainly services-oriented economy has traditionally been dominated by four pillar industries, i.e. financial

services, trading and logistics, tourism, and professional services, which account for roughly 55% of GDP and almost half of employment. As China is shifting its reliance from manufacturing to services, the challenge is to maintain these service industries and Hong Kong, China's position as a regional and global financial centre in the face of increased competition from such cities as Shanghai. Another major challenge is posed by improved cross-strait trade relations between China and Chinese Taipei, which reduces Hong Kong, China's intermediary role with regard to financial services, trade, and logistics.

While the Hong Kong, China Government remains committed to a free market philosophy, these new challenges have prompted a rethink of the role of government in promoting economic development. As a result of the recommendations by a major Task Force on Economic Challenges, six new industries have been identified in which the economy is believed to have "competitive advantages" (testing and certification; medical services; innovation and technology; cultural and creative industries; environmental services, and education services). Various new incentives are to be used to foster these new industries, including financial and regulatory incentives, access to land, as well as preferential access under the Closer Economic Partnership Arrangement with China (CEPA). The question arises as to whether this marks a shift in favour of a more interventionist policy.

Hong Kong, China's closer economic relationship with China under the CEPA offers an immense opportunity for it to exploit its comparative advantage. The depth and coverage of liberalizing measures has been further extended in the area of goods (via increasingly comprehensive CEPA rules of origin), and services. Preferential access to China's markets has been progressively extended to 44 service sectors (from January 2011). These market opportunities are available to companies of any nationality based in Hong Kong, China. Under CEPA's trade and investment facilitation agenda both sides have undertaken, inter alia, to improve the transparency of laws and regulations, and the protection of intellectual property rights. Therefore, CEPA may bring benefits to the broader WTO membership.

Hong Kong, China remains a staunch supporter of the multilateral trading system, with an excellent record of providing notifications, and a commitment to free and open trade. Nonetheless, the Hong Kong, China Govern-

* Extracted from WTO Secretariat Report on Trade Policy Review Hong Kong, China

ment has adopted a more active approach in pursuing FTAs with its trading partners in order to advance its economic and trade interests. A Closer Economic Partnership Agreement with New Zealand was concluded in 2010, while FTA negotiations with EFTA are under way.

One of the most significant developments in the direction of Hong Kong, China's trade policy is the shift towards cross sectoral competition legislation, which Hong Kong, China had previously eschewed on the grounds of the high degree of openness of its economy. The new Competition Bill, which was submitted to Hong Kong, China's legislature in July 2010, marks a major step forward. Under the proposed law, an independent Competition Commission will be responsible for enforcing the law and developing competition guidelines; and enforcement proceedings are to be adjudicated by a Competition Tribunal. The Bill's proposed content to prevent anti-competitive practices is broadly in line with the coverage of competition laws of other jurisdictions, although comprehensive regulation of mergers and acquisitions has been postponed. It remains to be seen what kind of agreements or conduct will be carved out from the law, and whether it will include statutory bodies, which play an important role in the economy.

While all applied MFN tariffs are zero, only slightly more than one third of the non-agricultural tariffs are subject to WTO bindings (all agricultural tariffs are bound), which imparts a certain degree of unpredictability to Hong Kong, China's tariff. However, Hong Kong, China's "mini-constitution", the Basic Law, guarantees the territory's status as a free port.

Hong Kong, China's customs procedures are simple owing to its duty-free tariff regime. Almost all trade documents can be lodged electronically (e-customs). Customs valuation, for purposes of levying excise duties, applies to only four products (liquor, tobacco, hydrocarbon oil, and methyl oil). Excise duties on wine have been eliminated to boost Hong Kong, China's ambitions of becoming a trading centre for fine wines.

There are few import and export restrictions, which are generally imposed for health, safety, security or environmental reasons (under international agreements). Imports and exports of textiles remain subject to special controls regarding their origin.

While Hong Kong, China ranks highly in terms of well-known indicators of economic freedom, competitiveness, and ease of doing business, there has been a gradual move towards more regulation of markets for social, health, environmental, and prudential reasons. For example, like other WTO Members, Hong Kong, China has introduced a new regulation for nutrition labelling and nutrition claims (such as "fat-free"). It has also drawn up a minimum wage law, whose effect on employment and the economy's competitiveness will depend on the minimum wage level implemented.

The regulatory framework for food safety and medicines has faced challenges following several incidents in and outside Hong Kong, China (such as the melamine incident). A new Food Safety Bill, which is pending, contains registration and record keeping requirements for operators to facilitate the traceability of (tainted) food.

Public procurement in Hong Kong, China is relatively small (about 4% of GDP in 2009), reflecting the commitment to "big market, small government". However, most contracts have been awarded through restricted and selective tendering procedures rather than more transparent open tenders. Hong Kong, China is party to the plurilateral WTO Agreement on Government Procurement.

Hong Kong, China is also a low-tax jurisdiction (with tax revenues accounting for about 13% of GDP in 2008-09) but the global financial crisis has exposed certain weaknesses of the tax structure. These include the volatility of revenues from the sale and lease of land (land premiums, stamp duties), which is largely state-owned, and the lack of revenues from other sources, such as indirect taxes, which are relatively non-distorting and stable during the business cycle. The proposal to broaden the tax base by introducing a goods and services tax was dropped as a result of public opposition.

Hong Kong, China has a relatively neutral direct tax system, but it is not entirely free of tax incentives, as there are tax allowances, for example, for environmental and intellectual property-related expenditures. Otherwise, the Government's limited assistance has mainly been in the form of grants, loans, or loan guarantees. Increased assistance has been provided notably for small and medium-sized enterprises (in response to the global financial crisis) and some of the six "new industries". Certain research and development is subsidized to foster an innova-

tion and research culture, as Hong Kong, China spends less on R&D (relative to the size of the economy) than China or other advanced economies.

In the area of intellectual property, Hong Kong, China has implemented the compulsory licensing scheme under Paragraph 6 of the Doha Declaration. It has modernized the protection of intellectual property to align it with technological developments and international standards, and is reviewing its legislative framework for copyright protection in the digital environment. Hong Kong, China has also taken steps to strengthen the enforcement of intellectual property rights.

The financial services industry remains the most important pillar of the economy. The Government has been keen to promote Hong Kong, China's role as a financial centre, notably through market access improvements in China for Hong Kong, China service suppliers (CEPA), and by broadening the opportunities for offshore business in renminbi. Major new developments in this regard include RMB bond issues in Hong Kong, China by China's financial institutions, and an RMB trade settlement pilot scheme (introduced in 2009), which offers Hong Kong, China new opportunities for financial intermediation between China and the rest of the world.

Both Hong Kong International Airport (HKIA) and Hong Kong Port are facing intense competition from neighbouring and other regional airports and seaports, such as Shenzhen in China. The authorities have reached a number of new or more liberal air services agreements with aviation partners, with a view to strengthening HKIA's position as an air hub and opening new opportunities for Hong Kong, China's airlines. Hong Kong, China has not pursued "open skies" (an exception to its otherwise liberal and open policies). HKIA is the world's leading airport in terms of cargo turnover, and the planned opening of a fourth private-sector-operated air cargo terminal is aimed at further enhancing its competitiveness.

To strengthen the airport and seaport's gateway position to China, Hong Kong, China has been developing its transport links to Mainland China. A major publicly financed infrastructure project, a landmark bridge linking Hong Kong, China with China and Macao, China, is expected to strengthen the economic relationship with Hong Kong, China's industrial hinterland in the western part of the Pearl River Delta region. There are also plans to build a

new terminal for mega cruise ships, with a view to positioning Hong Kong, China as a regional cruise hub. Travel arrangements for visitors from China have been further liberalized, greatly benefiting tourism in Hong Kong, China, another of its traditional pillar industries.

Hong Kong, China has taken further steps in deregulating the highly competitive telecommunications market. The regulatory intervention requiring mobile operators to pay fixed operators interconnection fees for traffic in both directions (the Mobile Party's Network Pays arrangement) was withdrawn to allow the market to determine the rates and the type of arrangements. As a result of facility-based competition among operators, about 85% of the territory's population has a choice between several fixed and wireless broadband networks. Telecommunications and broadcasting are the only sectors of the Hong Kong, China economy currently subject to competition rules.

The electricity market remains dominated by two private-sector territorial monopolies, which are controlled through tight regulation. The Government is currently undertaking preparatory work with a view to the possible liberalization of the electricity market, albeit not before 2018.

Hong Kong, China's agricultural base is very small and virtually all food is imported. In response to public health (H5N1 avian influenza) and environmental concerns, the Government intervened with Green Box-type resource retirement schemes to encourage pig and poultry farmers to abandon production. The incentive payments have resulted in a substantial drop in livestock output. For the staple food of rice, a number of control measures, including a reserve-stock scheme, remain in place. Rice stocks are maintained mainly to allay public concerns in the event of tight supplies or shortages, for example, as a result of restrictions imposed by rice-exporting countries.