

## CHINA-HK SAR FREE TRADE AGREEMENT

### –WHAT CAN IT LOOK LIKE?

China is finally an official member of the World Trade Organization (WTO). Now that the Hong Kong SAR Government has proposed to the Central Government the idea of a Hong Kong-Macao-China Free Trade Agreement, and given the positive reaction from the Central Government, we should concentrate on what this Agreement can look like.

Given that China and Hong Kong are two separate members of the WTO, the discussions between the SAR government and the Central government should be guided by these principles: (1) The Agreement must abide by WTO rules. (2) The Agreement should be beneficial to the economies of both Hong Kong and the Mainland. (3) The Agreement should be reached quickly—preferably before the end of 2002. Its content should be simple and its implementation transparent. (4) The Agreement should not bring additional difficulties to China in its implementation of WTO commitments and in its relationship with other WTO members.

Given these guiding principles, what should be explored? As proposed by the Chamber two years ago, an important element of any regional free trade agreement between Hong Kong SAR and China should be a time-advantage for Hong Kong companies. This means that while the market opening which China has committed to all WTO members will take effect three or five years after accession, Hong Kong companies may enjoy this opening earlier, say one year or eighteen months from accession. Let us look at this in more detail:

- (1) **Early Liberalization of Agreed Market Opening**—The liberalization will be implemented according to timetables for telecommunication, banking, insurance, distribution, retail, consulting, advertising, tourism, legal services, etc. These timetables cover forms of investment, percentage of investment, number of branches, licenses, areas of operation and others, and usually range from two to five years after accession. A FTA with China may, upon implementation, enable Hong Kong companies to obtain these same liberalizations earlier, say one year after accession, i.e. beginning 2003. For instance, according to China's WTO schedule for market access, by 2005, all restrictions on distribution auxiliary services – warehousing, advertising, technical testing and analysis, and packing services – will be phased out, wholly foreign-owned subsidiaries of freight forwarding company will be permitted. By 2007, China will release ownership limitations on foreign management consulting firms, and foreign retailers and chain store operators will no longer have equity limitations. Under a FTA, China may offer to fully open these sectors to Hong Kong investors in 2003 or 2004. This time advantage would allow Hong Kong companies to move into China quicker to look for the new opportunities in these sectors. China can benefit from having this “experimental” opening and by partnering with Hong Kong companies to get ready for the onslaught of companies from other WTO members at a later date.

- (2) **Further Lowering/Removal of Barriers**—In many sectors, there are barriers to investment or operation which are not covered by the current China WTO accession document. An example is the exhibition services sector, where wholly foreign owned operations are not allowed. Government procurement is not covered at all in the accession document. Another example is that of the asset barrier of USD20 billion for setting up foreign bank branches. A FTA with Hong Kong could open up a wide range of opportunities by lowering some of these barriers or removing prohibitions for Hong Kong companies. Obviously, any such additional opening may become the subject of future requests by other WTO members, so the Central Government will have to look very carefully before granting these to Hong Kong. But since China will be involved in the new round of trade liberalization anyway – the new Doha Round which was successfully launched a month ago – there will be room for additional, and previously not covered, liberalizations to be made available in the future. Even though those may eventually be enjoyed by all WTO members, Hong Kong will, again, gain a time advantage.
- (3) **Tariffs for Manufactured Goods**—The benefits described above for service sectors may also be applicable to industrial tariffs, that is, there may be an opportunity to seek early reduction or further reduction of certain tariffs. This could help attract some high value-added manufacturing operations to Hong Kong, especially those with a high design content, or others where the original components would encounter a stiff tariff in China or where technology transfer rules prohibit these components from entering China unassembled.

A free trade agreement by definition is two-way. The Central government appreciates that one benefit of the FTA is faster economic integration between Hong Kong and China in accordance with the “One Country Two Systems” principle. The “experimental” early opening described above can help China better prepare for the wider opening that it promised. Similarly, a FTA can be used to provide a framework for “pilot liberalization”, i.e. further liberalization on a voluntary and non-binding basis, thus enabling China to manage its own liberalization program. On our part, we shall have to be prepared to offer some specific benefits for Mainland businesses and professionals to enable them to access Hong Kong’s market more freely.

Finally, one can be sure that there will be many technical difficulties in reaching such an agreement – the question of what constitutes a “Hong Kong company”, for example. A definition which is too narrow undermines our international character, while a definition that is too all-encompassing may, by opening the door too wide and too quickly, render the time-advantage which we seek for Hong Kong SMEs less material. However, with over 150 WTO-permitted free trade agreements in existence for us to consult, surely the solution can be found satisfactorily in some of those agreements.

We hope that a successful FTA can be concluded quickly. We have not touched on Macao, but including Macao should be relatively simple. Including Taiwan would be a different story, and political problems are difficult to resolve in a short time. Let us work on a Hong Kong-Macao-China FTA first.

In conclusion, although much work needs to be done, we believe a free trade agreement with China by the end of next year is not beyond our reach. If we are to give Hong Kong as much time advantage as possible, we need to move fast with the negotiations. Now that Mr Tung Chee Hwa has put this proposal to Beijing, and now that the Central government is very interested, we hope that the open mind and the energy and the commitment on both sides will get us an agreement by the end of 2002, thus taking Hong Kong’s economy up to the next plateau.