SUMMARY

1. Between 2010 and 2013 (the review period), the economy of Hong Kong, China (HKC) grew at an average annual rate of 3.1% (at 2012 prices), driven chiefly by solid domestic demand, amid a fragile global economic recovery. HKC is one of the world's most market-friendly and open economies, with a trade/GDP ratio of 458% in 2013, and some of the highest rankings in world indicators of economic freedom, competitiveness, and ease of doing business. It also has a very liberal foreign investment regime.

2. In the aftermath of the global financial turmoil (2008-09), the HKC Government implemented countercyclical measures to preserve financial stability and stimulate the local economy, affected by weak external demand. The economy quickly rebound in 2010 and 2011, and after a brief slowdown in 2012, grew by 2.9% in 2013. It is now forecast to expand by 3.75% in 2014.[1]

3. During the review period, HKC continued to strengthen its economic and financial ties with the People's Republic of China (Mainland China), in particular through their Closer Economic Partnership Arrangement (CEPA). The CEPA offers many trade opportunities for HKC's services suppliers and for the territory to consolidate itself as a key intermediary for Mainland China's external trade. The position of HKC as an international financial centre has also benefited from the gradual liberalization of Mainland China's capital account and the increasing international use of the Chinese renminbi. By the same token, closer financial integration has led to greater Mainland exposure of HKC's financial institutions. Overall, HKC's economic prospects are ever more intertwined with the economic performance of Mainland China.

4. Hong Kong, China's sound economic fundamentals, such as a healthy fiscal balance, a strong external financial position, flexible markets and a well regulated financial system, have enabled it to adjust swiftly to challenging external conditions and spared it from the destabilizing effects of the global financial crisis. Fiscal prudence, a key feature of its macroeconomic framework, allowed HKC to maintain a surplus in public finances throughout the review years (although it decreased over the period). Monetary policy continues to focus on currency stability, which has been achieved through a pegged exchange rate to the U.S. dollar since 1983.[2] Low interest rates have led to rapid credit expansion since 2010 and have helped boost domestic demand. After rising quickly in 2010-11, inflation was reduced to just over 4% in 2012 and 2013, thanks to prudential and demand-side measures implemented by the Government to cool off the property market as well as the easing of imported food prices. However, inflation remained higher than in the United States, leading to the real appreciation of the local currency *vis-à-vis* the U.S. dollar.

5. Notwithstanding its sound macroeconomic framework, HKC faces a number of policy challenges, including the need to: preserve fiscal sustainability in the face of an ageing population; address income inequalities and social welfare, health, and education needs; ensure appropriate and affordable housing supply as well as a stable property market; and keep inflation in check.

6. Services remain the dominant sector of the economy, accounting for 93% of GDP and 88% of total employment (2012). The most dynamic subsectors during the review years were wholesale and retail trade; accommodation and food services, which benefited from vibrant inbound tourism; and finance and insurance. Because of its services-orientation, HKC relies heavily on imports of goods to satisfy domestic consumption. This is reflected in a persistent deficit in the goods trade balance, which has been more than offset by large surpluses in services trade, mainly due to exports of transport, travel, and financial services. Given that HKC is the world's largest free zone, re-exports are the driving force of its goods trade, and Mainland China is its main trading partner, receiving 55% of HKC's re-exports and supplying 48% of HKC's merchandise imports (2013).

7. Hong Kong, China is a firm supporter of the multilateral trading system, the conclusion of the Doha Development Agenda, and the implementation of the Bali package. It has committed to

[1] IMF Press Release N° 14/238, 22 May, "Executive Board Concludes 2014 Article IV Consultation with People's Republic of China-Hong Kong Special Administrative Region". Viewed at: http://www.imf.org/external/np/sec/pr/2014/pr14238.htm.

[2] Recently, HKC's monetary authority intervened in the foreign exchange market to maintain the currency peg, as increased capital market activity (from new mergers and acquisitions) triggered the strengthening of the local currency.

implement the Trade Facilitation Agreement upon its entry into force, without using any flexibility. HKC is a party to the WTO Information Technology Agreement and the revised Government Procurement Agreement (GPA), and participates in other plurilateral initiatives such as the negotiations on the Trade in Services Agreement (TISA) and the recently-launched talks on environmental goods among WTO Members. Perhaps the most salient development in HKC's trade policy stance during the review period is its active engagement in free-trade agreements (FTAs). Since 2010, HKC has signed FTAs with New Zealand, the EFTA member states, and Chile (with the two former already in effect). It has also signed five supplements to the CEPA with Mainland China, and is currently negotiating an FTA with ASEAN countries. The HKC authorities have indicated that they are prepared to enter into bilateral, plurilateral, and regional free-trade agreements, as long as they are consistent with the WTO and can contribute to multilateral trade liberalization.

8. A landmark development in HKC's economic policy reform is the adoption of its first comprehensive competition law in 2012. The Competition Ordinance applies to all economic sectors, provides a legal framework to deal with different types of anti-competitive conduct and follows international best practices. However, merger control remains limited to the telecommunications sector, and statutory bodies are exempted from the Ordinance. A Competition Commission with ample investigative powers will be responsible for enforcing the law and developing competition guidelines, and a Competition Tribunal will adjudicate proceedings and grant remedies, including pecuniary penalties and relief.

9. HKC applies a duty-free tariff regime on an MFN-basis, but more than half of its tariff schedule remains unbound in the WTO. Given HKC's free-port status, customs procedures are among the easiest and fastest worldwide, with virtually all customs declarations and related documents processed electronically. Among the measures implemented by HKC in the past few years to facilitate trade and enhance its role as a transit hub are the formal introduction of an authorized economic operator programme, an intermodal transhipment facilitation scheme, and lower customs declaration fees. Customs valuation is only used for collecting excise duties on four products (liquor, tobacco, hydrocarbon oil, and methyl alcohol) and a first registration tax on motor vehicles.

10. Non-tariff measures are few, and import prohibitions and licensing are applied mostly on safety, health, and environmental grounds or to comply with international obligations. Licensing and notification requirements for textile trade with "non-sensitive markets" and for textiles transhipments were lifted in 2011, and there are plans to remove the remaining requirements on textile trade before the end of 2014, subject to the passage of the relevant legislative reforms. HKC has no legislation on contingency measures and safeguards.

11. The TBT and SPS systems are transparent and relatively simple. A new Food Safety Ordinance became effective in February 2012; it establishes a registration scheme for food importers and distributors, and requires food traders to maintain proper transaction records for a specified period in order to enhance food traceability.

12. No export taxes are applied. Goods subject to export prohibition and licensing are basically the same as those subject to import licences and are applied for the same reasons. An export licence for powder formula for infants and children under 36 months was introduced in March 2013 to ensure local supply of the product. Excise duties are refunded if the goods on which they were paid are exported. The Government supports exporters, mainly through export credit insurance and funding for export promotion activities. In June 2012, HKC established a Brand, Upgrade, and Development (BUD) fund to provide export assistance for locally registered SMEs to target Mainland China's market.

13. HKC maintains a simple tax structure with a narrow base and low rates. Nevertheless, several tax incentives are offered, including for the purchase of environmentally friendly commercial vehicles and for IPR-related expenditure. Non-tax incentives, mainly to support SMEs and R&D activities, are provided in the form of loans, loan guarantees, and cash grants, but the scale of assistance is modest.

14. Hong Kong, China was one of the first WTO Members to ratify the revised GPA, and improved its commitments by adding new government entities and types of services to its

schedule. The IP regime has remained largely unchanged, but there are important ongoing initiatives to amend legislation on copyrights and patents. HKC has gained international recognition for its actions to improve public awareness and enforcement of IPRs, and is taking active steps to fight against the new global challenges raised by IPR-infringing activities in the digital environment.

15. The agriculture and fisheries sector is very small, representing only 0.1% of GDP and total employment. The manufacturing sector continues to shrink and accounts for less than 2% of GDP. No direct policy instruments have been applied to reverse this trend. Mainland China is the largest market for manufactured exports from HKC, but "domestic merchandise exports" to Mainland China under CEPA account for less than 50% of total "domestic exports".

16. Hong Kong, China has consolidated itself as a regional or even global centre in sectors such as financial services, and maritime and air transport. HKC's GATS commitments are not always extensive, but the applied regime is quite liberal, as is reflected in the standstill-based, negative list in the HKC-EFTA States free-trade agreement. This contains very few reservations, notably for future measures, most of which are of a purely precautionary nature without effective application so far. The regime defined by this agreement is applied *erga omnes*.

17. The telecommunications regime was liberalized in 2003. The market is quite competitive judging by the number of operators, at least for fixed-telecom services, and by prices benchmarked on an international scale by the International Telecommunications Union. The mobile telephone market is dominated by three local firms that won a recent 4G/LTE international auction, as is the fixed-telecom market.

18. In financial services, HKC appears as a dynamic regional and global financial hub (e.g. for the IPO market). Three local banks dominate the domestic market but the largest part of the financial sector is devoted to offshore services, in particular towards Mainland China, and in which virtually all major global players are represented. The applied regime is quite liberal and has been further relaxed regarding establishment requirements for foreign banks to set up a locally incorporated fully licenced bank. Otherwise, the market access regime for financial services has not changed substantially and most of the measures taken since the last Review are of a domestic regulatory and prudential nature.

19. HKC is the 4th largest port in the world (after Shanghai, Singapore, and Shenzhen), and has the 4th largest registry (after Panama, Liberia, and the Marshall Islands). Favourable operating conditions and the cluster of maritime-related services offered by HKC have attracted investment from global shipowners, which explains why a very large part of the tonnage in the registry is owned by foreign interests. In addition, HKC shipowners own a sizable fleet under flags other than HKC's flag. The shipping policy is liberal with no restriction on onshore activities and establishment, and absence of or cargo-sharing regimes. There are no support or subsidy schemes but income derived from international activities under the HKC flag are exempt from profits tax. Most container terminals are managed privately, essentially by local firms but also with a significant foreign investment presence under lease agreements.

20. HKC has a relatively liberal regime for its bilateral air transport agreements. However, having the number one air-cargo airport in the world, considering this activity as strategic, and facing capacity and land constraints, HKC has a relatively less liberal regime for certain auxiliary services (e.g., cargo ground handling and maintenance services), which are subject to a limited number of licences. Computer reservation services, and selling and marketing services are fully liberalized.

21. Distribution is a major sector of the HKC economy, representing nearly 10% of employment and almost 5% of GDP. HKC's GATS commitments on distribution services are limited to retail services with a liberal regime (no restrictions for market access under mode 3). The free-trade agreements signed by HKC cover the totality of the sector with very limited reservations. The activity is essentially unregulated except for zoning and urban planning purposes. Numerous foreign distributors are present but the supermarket segment is largely dominated by local interests. Traditional open-air fresh food markets ("wet markets") remain an important component of HKC's distribution system.