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GATT TRADE POLICY REVIEW

**HONG KONG**

On 31 July-1 August 1990, the GATT Council will consider reports on the trade policies of Hong Kong, prepared by the Hong Kong Government and the GATT Secretariat. The reports will form the basis of a comprehensive examination of the trade policies of Hong Kong.

The reports cover all aspects of Hong Kong's trade policy, including domestic laws and regulations; the institutional framework; bilateral, regional and other preferential agreements; and wider economic questions.

The trade policy review mechanism was launched in December 1989 as one of the early results of the Uruguay Round to enable a regular collective evaluation by the GATT council of the full range of trade policies of individual GATT members.

Attached are summary sections of the reports prepared respectively by the GATT Secretariat and the Hong Kong Government. Full reports are available for journalists from the GATT Secretariat on request.

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The complete trade policy review of Hong Kong, including these two reports together with a record of the Council's discussion and of the Chairman's summing-up, is expected to be published in October 1990, and will be available from the GATT Secretariat, Centre William Rappard, 154 rue de Lausanne, 1211 Geneva 21, Switzerland.

Since December 1989, reviews of the following countries have been completed and are available from the GATT Secretariat: Australia, Morocco and the United States.

TRADE POLICY REVIEW

HONG KONG

**Report by the GATT Secretariat - Summary Observations**

(1) Hong Kong in World Trade

Hong Kong, despite its small size in geography and population, is the eleventh largest trading entity among contracting parties, with 2.2 per cent of total world merchandise trade. The share of external trade in gross domestic product has grown rapidly. Merchandise trade was equal to 230 per cent of GDP in 1989, up from 144 per cent in 1979 (263 and 192 per cent for trade in goods and services).

During the 1980s, Hong Kong's economy evolved considerably in the context of fluctuating, but rapid economic growth (7 per cent annually). The services sector grew markedly in importance to almost three-quarters of total value added, while output of manufacturing expanded less and its share in total GDP declined from one-quarter to one-fifth. However, the manufacturing sector has developed up-market and diversified.

As with manufacturing output, Hong Kong's domestic exports are still heavily concentrated in clothing and textiles, but the importance of other sectors, particularly electronic equipment and components, watches and printing is growing. Machinery and equipment now account for around one-quarter of domestic exports. The technological and design content of exports has increased.

Some of these developments were linked to the opening up of the Chinese economy. Many labour-intensive operations have been moved to mainland China. In line with this development, Hong Kong's historical entrepôt rôle has grown in importance. Re-exports have increased from 26 to over 60 per cent of total exports, with China as Hong Kong's largest market and supplier.

The smooth development of external trade is crucial to Hong Kong's economic well-being. In the last three years, economic growth in Hong Kong has slowed down considerably as the labour market became tight, and capacity constraints resulted in accelerated inflation. Economic activity in Hong Kong was particularly affected by the austerity measures taken by China since 1987 and the events of June 1989. In the first months of 1990, the economy stagnated.

(2) Institutional Framework

Hong Kong's trade policies are formulated and implemented on the basis of a clear and transparent legal framework of Ordinances (laws) and regulations. Ordinances are passed by the Legislative Council and

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promulgated by the Governor in Council. The Executive Council advises the Governor on all important policy formulation questions. The Trade and Industry Branch is the main trade policy making body in the administration. The Trade Department administers trade policy and contributes to its formulation. The Industry Department advises on industrial development policies, which are closely related to trade.

Consultations with private sector manufacturers, service providers and traders on trade-related policy questions are extensive. The highest level institutional linkages are through the Trade and Textiles Advisory Boards and the Industry Development Board. These are official bodies, which include senior public and private sector representatives. Chambers of Commerce and industrial associations, many of which are also represented in Government committees or in the Legislative Council, provide further channels of communication between the Government and the private sector. Informal contacts between the Government and the private sector are frequent.

There is therefore a substantial system of co-ordination and consultation, but Hong Kong's small size and close-knit trading community implies a relatively streamlined process of policy formulation. Foreign firms established in Hong Kong are part of the Chambers of Commerce and hence participate in the consultative process. The representation of the consumer interest is less well developed.

No independent bodies, statutory or private, exist to review trade policies in Hong Kong. However, since February 1989, members of the public have had the possibility of addressing complaints regarding any Government department to the Commissioner for Administrative Complaints (ombudsman), through members of the Legislative Council. So far, the Commissioner has not received any trade-related administrative complaints.

### (3) Trade Policy Features and Trends

Hong Kong has been a contracting party to GATT in its own right since April 1986. Hong Kong is a party to all the Tokyo Round codes, except those relating to meat and dairy products and the Agreement on Trade in Civil Aircraft.

Hong Kong's trade policies are based on GATT principles. All imports are granted m.f.n. treatment. Hong Kong does not participate in any customs-union or free-trade area arrangements. It has taken an active part in discussions relating to trade with OECD countries and to regional issues, including the development of trade in the Pacific area.

The evolution of Hong Kong's trade is also linked to its policy, since October 1983, of maintaining a fixed nominal exchange rate against the US dollar. The real effective exchange rate is estimated to have depreciated markedly between 1985 and 1987, but has appreciated since. This is reflected in Hong Kong's export volume and GDP growth rates.

(i) Recent evolution

Traditionally, the Hong Kong Government has intervened little in import flows. On the export side, however, a considerable share of domestic exports is subject to management. This is generally linked with international arrangements to which Hong Kong is party, in particular the MFA for textiles and clothing, and to export restriction provisions for strategic goods. No major changes have taken place in this general policy orientation in recent years.

Hong Kong devotes public resources and policies towards encouraging and facilitating industrial development through the provision of infrastructure (land, public works), training and technology development facilities. Government policies aimed at improving the framework for industrial development have expanded in scope. The Government plans to increase Hong Kong's economic and trading capacity through a major programme of public works (new airport, port expansion) and of training and education. These initiatives, in particular the extension of the container port, involve substantial participation of the private sector.

(ii) Type and incidence of trade policy instruments

Relatively few import measures are applied by Hong Kong. All goods enter Hong Kong duty-free. Tariff bindings, most of which are at zero rates, currently cover a limited number of items. Domestic indirect taxation, although applied equally to domestic and imported products, falls to a large extent on imported goods. Excise duties are applied to hydrocarbon oils, liquor, methyl alcohol, tobacco, non-alcoholic beverages and cosmetics. Motor vehicles, all of which are imported, are subject to a first registration tax.

Import licensing controls are applied for purposes of strategic control, public health, reserve stocks, surveillance, environmental protection and safeguarding of threatened species. The Trade Department is the central body issuing import licences. A number of other departments are involved in issuing or approving applications in particular cases. Most import licences are approved within one to three working days.

Rice and ozone-depleting substances are the only products subject to import quotas. Rice quotas are maintained for reserve stock purposes. Importers are required to import fixed amounts determined by the Trade Department and to maintain minimum stocks.

In respect of standards, Hong Kong does not apply mandatory technical regulations for goods imported for domestic consumption. All proposed technical regulations or standards are published. The Industry Department provides services to manufactures and traders concerning standards in overseas markets, as well as calibration and laboratory services.

In Government purchasing, no preferences are given to imports from any source. Purchasing is either by open, selective or single tender. While procedures for open tender are transparent, the criteria for selective or

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single tendering are less clear, and their importance in overall Government purchasing may be considerable.

Hong Kong applies COCOM rules to imports and exports of strategic commodities, including many electronic products. Export authorisations for such products depend on vetting by the Strategic Commodities Section of the Trade Department.

Export licences are also required for rice, frozen meat and poultry, ozone depleting substances, chemical weapon precursors, acetylating substances, pesticides, pharmaceuticals and dangerous drugs, products of endangered species, radio transmitters, and textiles and clothing.

The export licensing system for textiles and clothing is particularly elaborate to ensure Hong Kong's observance of its bilateral agreements under the MFA. For products under restraint, quotas are allocated to registered quota-holders in relation to past performance. Quotas may be traded among firms and unused quotas may be surrendered to the Trade Department for re-allocation to new exporters. A considerable trade in quotas exists. Several empirical studies show that substantial quota rents accrue to Hong Kong traders and manufacturers, and thus create some vested interest in the management of world trade in textiles and clothing.

Hong Kong has specific legal provisions, based on the Kyoto Convention, for defining local origin for many products. On this basis, the Government and a number of approved certifying organizations issue certificates of origin for exported goods. Special origin rules apply to textiles and clothing exported to the European Communities.

Although the Hong Kong Government does not maintain any direct export or production subsidies, as noted above, substantial public resources are devoted to efforts to facilitate industrial and trade development. The Industry Department works closely with other governmental and academic institutions to assist in improving the competitiveness of industry through the introduction of new techniques, provision of infrastructural support and the development of skills. It carries out regular studies of Hong Kong's industrial base and provides assistance through its links with other statutory bodies. The Hong Kong Trade Development Council seeks to develop all aspects of external trade through consultancies, fairs, exhibitions and the provision of information.

Official export credit insurance is provided on commercial terms by a statutory corporation which competes in the market with private insurers. Other statutory bodies involved in industrial promotion include the Hong Kong Industrial Estates Corporation and the Hong Kong Productivity Council. These bodies are closely linked to the Industry Department and to the Government's overall efforts for industrial promotion. In their different ways, they provide support and facilities for the establishment or development of new industries and new skills in Hong Kong.

Hong Kong attaches great importance to the protection of intellectual property. It has taken considerable steps to ensure the enforcement of its domestic legislation.

(iii) Temporary measures

Hong Kong has never taken safeguard action under Article XIX of GATT, nor recourse to anti-dumping measures, countervailing measures or trade measures related to balance of payments considerations (indeed, it does not maintain official statistics on the balance of payments). No domestic legislation exists on which such actions could be based.

(iv) New initiatives

Recent Budget changes have brought about increases in rates of excise duties and motor vehicle registration taxes more than proportionate to the rate of inflation. The aim is to provide higher Government revenue and contribute to changing the taxation pattern towards greater reliance on indirect taxation.

(4) Trade Policies and Foreign Trading Partners

Hong Kong's economy remains almost completely reliant on trade. It is thus heavily dependent on developments in its main foreign trading partners, and their trade policies have a strong impact on Hong Kong's overall prosperity. Restraint agreements and regulations maintained under the Multi-Fibre Arrangement have influenced the long-term development of the clothing and textiles industries in the territory, inter alia, by tying production patterns to the availability of quotas for different categories of textiles and clothing. More recently anti-dumping measures by trading partners have given rise to considerable concern.

Serious efforts are being made to broaden the range of export destinations for Hong Kong's goods, and to lessen the reliance on products which have traditionally been subject to import restrictions or export restraint agreements. Some success is being achieved in both these aims, but more evidently, to date, in product diversification. Hong Kong's manufactured exports have become less labour-intensive and more technologically sophisticated.

Hong Kong's trade with China has expanded particularly rapidly over the past decade. The growth of total exports, including re-exports, hides a considerable relative decline in domestic manufactured exports. To some extent, domestic exports of labour-intensive products have been replaced by re-exports of goods from China. Overall, the economy is now considerably more dependent on, and integrated with, that of South China than ten or even five years ago, and is thus more influenced by economic and political developments in China. Hong Kong will retain its present status of contracting party to GATT after becoming a Special Administrative Region of China in 1997.

For an outward-oriented economy like Hong Kong, a well functioning multilateral trading system is of evident importance. The Uruguay Round offers a particular opportunity for promoting its interests in the growth and diversification of trade in goods and services. Hong Kong participates actively in the Round particularly in such subject areas as rules of origin, textiles and clothing, negotiating rights on tariffs, safeguards, anti-dumping procedures, intellectual property and services. Improvements in these areas and, more generally, success in the Round in liberalizing market access worldwide and clarifying multilateral trade rules will help Hong Kong maintain its economic progress and prosperity.

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TRADE POLICY REVIEW

HONG KONG

**Report by the Hong Kong Government - Summary**

**Objectives of trade policies**

Hong Kong's trade policy seeks to promote a free, open and stable multilateral trading system; to safeguard Hong Kong's rights and fulfil its obligations as a contracting party to the General Agreement on Tariffs and Trade (GATT) and a party to the Multi Fibre Arrangement (MFA); within the context of the GATT, to secure, maintain and improve access for Hong Kong's exports and to ensure and maintain the integrity of all measures adopted by Hong Kong to meet its obligations under multilateral and bilateral trade or trade-related agreements.

**Description of the import and export system**

Hong Kong's import and export system is characterized by minimum controls, zero tariff and no subsidies or assistance to exports.

Hong Kong is a party to the GATT Agreement on Import Licensing Procedures. Import and export controls are kept to a minimum, and either stem from obligations under various international undertakings, or are applied for health, safety or security reasons.

Import and export licensing requirements are maintained under the Laws of Hong Kong. Such requirements are administered by the relevant government departments. Fees are charged to recover the operational costs of import and export licensing systems, including relevant enforcement activities. Quantitative import restrictions apply to ozone depleting substances. Imports of rice must meet, but may not exceed, minimum levels prescribed by the Director-General of Trade. Exports of a wide range of textiles and clothing are subject to quantitative restraints under agreements concluded under the MFA.

Imports into Hong Kong are not required to be accompanied by certificates of origin issued by the exporting countries concerned. In regard to its exports, Hong Kong provides origin certification services as necessary to facilitate the trade in meeting requirements at the importing end.

Any person or firm who imports, exports or re-exports any article other than an exempted article (e.g. personal baggage) is required, under the Import and Export Ordinance (Cap. 60), to lodge with the Customs and Excise Department an import or export declaration which is used to compile statistics on Hong Kong's merchandise trade. A charge is payable on each declaration. Such charges constitute part of the Government's general revenue.

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## **The trade policy framework**

### Domestic laws and regulations governing the application of trade policies

The statutory provisions under the purview of the Director-General of Trade give legal backing to the control of imports and/or exports to enable Hong Kong to fulfil international/bilateral obligations or to meet Hong Kong's requirements on health, safety and security grounds.

The main purposes of the provisions of the Import and Export Ordinance (Cap 60) and its subsidiary regulations are to enable Hong Kong to exercise its rights and meet its obligations under textiles agreements, to prevent the proliferation of chemical weapons, and monitor and control the flow of strategic commodities into and out of Hong Kong in accordance with requirements of the Co-ordinating Committee for Multilateral Export Controls.

The purpose of the Reserved Commodities Ordinance (Cap 296) is to ensure the availability of certain essential foodstuffs for emergency situations.

The Export (Certificates of Origin and Commonwealth Preference Certificates) Regulations and the Protection of Non-Government Certificates of Origin Ordinance (Cap 324) provide a system governing the issue of certificates of Hong Kong origin for goods.

### Summary description of the process of trade policy formulation and review

Trade policy formulation involves the Governor, the Executive Council, the Legislative Council, the Administration and advisory boards and committees.

The Administration is organised into branches and departments. The branches, each headed by a secretary, collectively form the Government Secretariat. The Trade and Industry Branch, headed by the Secretary for Trade and Industry is the policy branch in the Government Secretariat responsible for trade policy formulation and review. The Trade Department, headed by the Director-General of Trade, is responsible for the implementation of trade policy. The Director-General of Trade also advises the Secretary for Trade and Industry on matters of policy affecting trade. The Commissioner of Customs and Excise is responsible to the Secretary for Trade and Industry in respect of trade-related enforcement activities.

The Administration also involves the private sector to the widest possible extent in the process of formulating, implementing and reviewing trade policy so as to ensure that any proposal will command a high degree of public support. The Trade Advisory Board, the Textiles Advisory Board and the Free Trade Committee, which are advisory bodies chaired by the Secretary for Trade and Industry, advise the Administration on a wide range of trade policy issues.

Bilateral, multilateral, regional or preferential trading agreement, their scope, duration and goal

The General Agreement on Tariffs and Trade (GATT) is the cornerstone of Hong Kong's trade policy. Hong Kong acquired separate contracting party status in April 1986. Hong Kong is a party to six Tokyo Round Agreements. It has participated fully in the MFA since its inception. Hong Kong at present has bilateral textiles agreements with Austria, Canada, the European Economic Community (EEC), Finland, Norway, Sweden and the US. These agreements have been concluded under the MFA, and cover a wide range of textiles and clothing products of cotton, wool, man-made fibre, silk blend and other vegetable fibres. In 1989, the value of textiles and clothing exports covered by the seven agreements amounted to \$59,610 million, representing 67.2% of Hong Kong's domestic exports of textiles and clothing and 26.6% of all domestic exports.

**The implementation of trade policies**

Trade policy measures used

Hong Kong applies zero tariff on all imports from all sources. Hong Kong does not maintain any tariff quotas or surcharges, safeguards, anti-dumping or countervailing actions, concessionary export financing, export taxes or government-mandated countertrade. Hong Kong offers neither subsidies nor tax exemptions. It does not operate any state-trading enterprises, and has no foreign exchange controls.

Hong Kong maintains a number of trade policy measures, including tariff bindings of certain products at zero rate; rice control scheme; quantitative restriction on the import of ozone depleting substances into Hong Kong; licensing controls which either stem from obligations under international undertakings or are applied for health, safety and security reasons; excise duties; rules of origin; government procurement provisions, and export restrictions on textiles and clothing.

Prospective changes in trade policies and practices

Hong Kong does not have any prospective changes in its trade policies and practices.

**PART B : BACKGROUND AGAINST WHICH THE ASSESSMENT OF TRADE POLICIES IS CARRIED OUT**

**Wider economic and developmental needs, policies and practices**

Given its small size and lack of natural resources, Hong Kong has to be externally oriented. Hong Kong's economic growth and prosperity are built upon its ability to participate in world trade.

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Hong Kong advocates and practises free trade. There is no foreign exchange control, and free movements of funds across the territorial boundary are assured. The Hong Kong dollar is freely convertible against all currencies.

Unless there are sound social or economic reasons suggesting otherwise, the Government normally does not interfere with the operations of the economy, particularly activities of the private sector. The Government does not provide subsidy to any particular economic sector or industry.

The role of the Government in the economic development process is one of facilitation. The Government seeks to ensure a socio-economic environment which is conducive to economic growth and development, such as the provision of the necessary infrastructural facilities, a sound legal and institutional framework as well as an efficient administrative machinery. Business decisions are left entirely to the private sector.

Pragmatism, adaptability and resilience, coupled with a strong sense of business enterprise and hard work, are key ingredients of the development of the Hong Kong economy.

#### **The external economic environment**

##### Major trends in imports and exports

Some 80% of the manufactured products of Hong Kong are for export, while most of the foodstuffs and consumer goods, as well as raw materials and capital goods for production, are imported.

Hong Kong's domestic exports, re-exports, total exports and imports increased rapidly during the ten years between 1979 and 1989 which had an average annual growth rate of 14.9%, 33.0%, 22.3% and 20.7% respectively.

Hong Kong has been diversifying its export markets over the past decade. This was largely due to the initiatives taken by Hong Kong businessmen in tapping the global and regional markets, as well as the opportunities created by China's open door policy. Apart from a decrease in shares attributable to the United States, the Federal Republic of Germany and the United Kingdom, the most significant change between 1979 and 1989 was the emergence of China as the second largest market for Hong Kong's domestic exports. China also emerged as the largest market for Hong Kong's re-exports. As for sources of imports, Hong Kong imported more from within the Asia-Pacific region in 1989 than in 1979. China has also become the largest supplier of Hong Kong's imports since the early 1980s.

##### Structural changes of the Hong Kong economy

In line with changes in both the pattern of overseas demand and Hong Kong's own industrial structure, the local manufacturing sector was oriented to producing goods of a higher quality and of greater skill and design content. With the opening up of China's economy, Hong Kong

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businessmen set up production facilities and established outward processing arrangements in China, mostly in Guangdong Province, to engage in the more labour-intensive production processes. The local base is likely to concentrate more on strategic activities which relate to the service component of manufacturing production.

Besides moving up-market in the manufacturing sector, development of the Hong Kong economy is also characterized by a relative shift to the service sectors. In 1988, 67% of the GDP was attributed to trading and services. This matches with the re-emergence of Hong Kong's role as an entrepot serving the Asia-Pacific region generally and China in particular, and the increasing importance of Hong Kong as a regional financial and business services centre.

#### Developments in the terms of trade and commodity prices

The prices of Hong Kong's domestic exports, re-exports and imports increased by broadly similar magnitudes over the period 1979 to 1989. This has resulted in generally stable terms of trade for Hong Kong.

#### Important trends in the balance of payment, reserves, debt, exchange and interest rates

Hong Kong does not compile balance of payment statistics in view of the reporting burden this would impose on respondents.

In so far as visible trade balance is concerned, Hong Kong is neither building up big surpluses nor incurring chronic deficits. The visible trade deficits or surpluses, expressed as a percentage of the value of imports of goods, stabilized at low levels of -1.6% to 1.1% during the period 1984 to 1989. This suggests that in this free market economy with no major structural rigidities, the adjustment mechanism to changes in the external environment has been operating well.

Hong Kong has traditionally been running surpluses in the invisible trade account. Reflecting the buoyant tourist sector and the expansion of trade-related services in connection with the flourishing entrepot trade, such surpluses saw some increases in the last few years.

Putting the visible and invisible trade figures together and considering a probable deficit in net investment income from abroad, Hong Kong's current account may come up to a rough balance or even a small deficit.

There are no official statistics on the external debts of the private sector. The Government, on the other hand, has not incurred any external debts.

The official foreign exchange reserves of Hong Kong are held by the Exchange Fund which is operated mainly for the purpose of maintaining a stable rate of exchange between the Hong Kong dollar and the US dollar.

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The Hong Kong dollar was linked to the US dollar at the rate of HK\$7.80 to US\$1 in October 1983, after a period of much instability in the exchange rate of the Hong Kong dollar owing to political uncertainties arising from the Sino-British negotiations on Hong Kong's future.

The linked exchange rate system has provided a stable monetary system for Hong Kong. It helps to ensure orderly economic and financial conditions upon which business thrives. More importantly, it maintains confidence in Hong Kong dollars and in Hong Kong dollar assets. Hong Kong does not maintain the linked exchange rate to gain a competitive advantage or to build up trade surpluses.

Under the linked exchange rate system, the movements of Hong Kong dollar interbank interest rates follow closely those of US dollar interest rates. Deposit rates on most types of Hong Kong dollar deposits are set by the Hong Kong Association of Banks, normally with regard to the movements of interbank interest rates.

#### International macroeconomic situation affecting the external sector of Hong Kong

The threat of protectionism remains Hong Kong's key concern. Protectionist measures are detrimental to the expansion of world trade and particularly to the growth prospects of small, export-oriented economies like Hong Kong.

As a regional financial centre, Hong Kong is affected by developments in major overseas financial markets. Under the linked exchange rate system, monetary developments in the United States are of particular relevance to Hong Kong.

#### **Problems in external markets**

Hong Kong's exports face a range of trade barriers maintained by the importing countries. Such trade barriers include quantitative restrictions on textiles and clothing products maintained under MFA bilateral agreements, anti-dumping actions against Hong Kong products, and introduction of more stringent rules of origin criteria.