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HONG KONG REMAINS A DYNAMIC ECONOMY, CAPITALIZING ON AN OPEN TRADE REGIME - SAYS GATT

"Since its initial trade policy review in 1990, Hong Kong has continued to live up to its reputation as one of the world's most dynamic economies", says the GATT Secretariat's latest report on Hong Kong's trade policies and practices. "A business slowdown in 1989, attributable mainly to recession abroad and uncertainties ensuing from developments in Beijing, proved short-lived. Within three years, Hong Kong regained its trend growth rate of some 5.5 per cent, buoyed in particular by strong economic expansion in adjacent China and the resulting demand for core service and entrepôt activities."

Hong Kong's prosperity rests on a dynamic and flexible economy operating within an open environment, with no tariffs on imports or exports. Market forces apply across the full range of economic activities. There is no evidence of Government intervention to promote specific new industries, alleviate adjustment pressures on "sunset" activities or target individual business groups. Prices of goods and factors of production are the principal determinants of structural change. However, incentive schemes for technology- and skill-intensive activities appear to have gained in importance in the last few years: they may favour the development of certain sectors as against others.

Hong Kong considers ensuring liberal access conditions and preserving the integrity of a rule-based multilateral system top trade policy priorities. This has been translated into active participation in virtually all negotiating areas of the Uruguay Round, where Hong Kong's prime objectives were to roll back protectionism, improve market access, and strengthen GATT rules and disciplines, especially in the fields of safeguards, anti-dumping and rules of origin. In the tariff area, Hong Kong undertook to increase the level of bindings, presently less than one per cent, to some 34 per cent of its 6,000 tariff items. In services, it submitted a comprehensive schedule of commitments.

Hong Kong's trade pattern has changed significantly since the last review in 1990, mirroring the territory's rapidly growing rôle as a supplier of entrepôt and other business services. While domestic merchandise exports stagnated between 1990 and 1993, re-exports doubled and services exports increased by over 50 per cent. An increasing deficit in merchandise trade since 1990 has been more than offset by rising surpluses in the services area.

These developments are matched by rapidly expanding trade and investment links with adjacent regions in the Pearl River Delta. Reflecting the strong momentum of the Chinese economy, especially in the neighbouring Guangdong Province, and the lower costs of production in the Special Economic Zones across the border, China has become a core element in many investment strategies. In 1993, Hong Kong-based companies accounted for 83 per cent of the foreign direct investment in Guangdong Province. The relocation of many basic manufacturing activities across the border is reflected in an increasing concentration of skill-intensive functions within Hong Kong.

The report emphasizes that Hong Kong's continued expansion may be attributed both to its capacity for rapid adjustment and to a variety of positive external factors, including the presence on its doorstep of a large booming economy with an abundant resource base. "Swift structural change has been facilitated by small firm size, a highly motivated workforce, and the business synergies of regional economic co-operation. To bear fruit, however, it is essential for these factors to operate within a supportive institutional framework, based on an open, stable and non-discriminatory trade régime."

Notes to Editors

1. The GATT Secretariat's report, together with a report prepared by the Government of Hong Kong, will be discussed by the GATT Council on 5-6 October 1994 under the Trade Policy Review Mechanism (TPRM). This is the second review of Hong Kong since the launching of the TPRM in December 1989.

2. The TPRM enables the Council to conduct a collective evaluation of the full range of trade policies and practices of each GATT member at regular periodic intervals, to monitor significant trends and developments which may have an impact on the global trading system.

3. The two reports, together with a record of the Council's discussion and of the Chairman's summing up, will be published in due course as the complete trade policy review of Hong Kong and will be available from the GATT Secretariat, Centre William Rappard, 154 rue de Lausanne, 1211 Geneva 21.

4. The reports cover developments in all aspects of Hong Kong's trade policies, including domestic laws and regulations, the institutional framework, trade-related developments in the monetary and financial sphere, trade practices by measure and trade policies by sector. Attached are the summary extracts from these reports. Full reports will be available for journalists from the GATT Secretariat on request.

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5. Since December 1989, the following reviews have been completed: Argentina (1992), Australia (1989 & 1994), Austria (1992), Bangladesh (1992), Bolivia (1993), Brazil (1992), Canada (1990 & 1992), Chile (1991), Colombia (1990), Egypt (1992), the European Communities (1991 & 1993), Finland (1992), Ghana (1992), Hong Kong (1990), Hungary (1991), Iceland (1994), India (1993), Indonesia (1991), Japan (1990 & 1992), Kenya (1993), Korea, Rep. of (1992), Macau (1994), Malaysia (1993), Mexico (1993), Morocco (1989), New Zealand (1990), Nigeria (1991), Norway (1991), Peru (1994), the Philippines (1993), Poland (1993), Romania (1992), Senegal (1994), Singapore (1992), South Africa (1993), Sweden (1990), Switzerland (1991), Thailand (1991), Tunisia (1994), Turkey (1994), the United States (1989, 1992 and 1994), and Uruguay (1992).

TRADE POLICY REVIEW MECHANISM
HONG KONG

Report by the Secretariat - Summary Observations

Economic Environment

During the last four years, Hong Kong's economy has recovered rapidly from the steep downturn of 1989. Real GDP growth increased from 3.2 per cent in 1990 to 5.3 per cent in 1992 and 5.5 per cent in 1993. Hong Kong's economic strength has, during this period, been buoyed up by the dynamism of the Pearl River Delta region, for which it increasingly serves as a commercial centre and international gateway. Given its entrepôt functions, the territory stands to benefit from positive trade relations between China and main export markets. While the current weakness of the U.S. dollar, to which the Hong Kong dollar has been pegged for over a decade, may further stimulate business activity, there is a degree of caution relating mainly to the possible spillover from any economic tightening in China and uncertainties surrounding the transfer of sovereignty in 1997.

The Hong Kong dollar's exchange rate peg is intended to provide a monetary anchor in a politically and economically sensitive environment. However, nominal exchange rate stability has been accompanied by faster monetary growth and higher inflation than in the United States, leading to appreciation of the real exchange rate. Although inflation-induced speculation may have somewhat distorted investment patterns, in particular fuelling Hong Kong's recent real estate boom, the currency peg appears to have contributed to monetary stability and business confidence in recent years, thus living up to original expectations.

Institutional Framework

Legally, the United Kingdom has final responsibility for political developments in Hong Kong. However, the territory benefits from considerable autonomy, defining and pursuing its own policies in areas such as money and finance, production, employment, investment and trade. To enter into law, bills must be passed by the Legislative Council (LegCo) and approved by the Governor. Apart from three ex officio members, LegCo members are appointed by the Governor (18), elected directly by geographical constituencies (18) and indirectly by functional constituencies representing broadly-defined commercial, professional and social groups (21).

Most trade-related legislation is prepared and administered by the Trade Department, within the Trade and Industry Branch. Unlike many of their counterparts abroad, the sections responsible for industrial development and external trade are structured along functional, rather than sectoral lines. This may have helped to contain the influence of industry-specific interests on government regulation and, thus, on the territory's liberal trade and investment policies.

The Basic Law of the Hong Kong Special Administrative Region (HKSAR), which will come into effect from July 1997, provides for the continuation of the current economic, monetary and financial régime for 50 years. In particular, Hong Kong is to maintain the status of a free port, pursue a free trade policy and remain a separate customs territory. The future Government is to be free to conduct relations with States and international organizations on issues such as the economy, money and finance, shipping, communications, tourism, culture and sports. Using the name "Hong Kong, China", the HKSAR will be a member of the future World Trade Organization. A review and amendment process is now underway to ensure the compatibility of current legislation with the Basic Law.

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Trade Policy Features and Trends

Evolution since the initial review

Reflecting Hong Kong's growing rôle as a service centre for South China, transit trade has far outstripped domestic trade since the late 1980s. The ratio of re-exports to domestic exports increased from 1.3 in 1988 to 3.7 in 1993. Due to its re-export boom, Hong Kong remains the fifth largest merchandise exporter within the GATT system, after the European Union, the United States, Japan and Canada.

Economic integration with South China has been driven by growing investment - Hong Kong is the largest source of foreign direct investment in China - and the relocation of many manufacturing activities across the border, led by sectors such as leather, rubber, and electronic products, including watches. Their departure has freed resources for higher technology manufacturing and the rapid expansion of business services such as finance, marketing, design and logistics.

These locational adjustments and the concomitant changes in production and trade patterns have taken place without any significant government involvement. For example, Hong Kong has pursued no policies to ease adjustment pressures on individual sectors or to target growth industries. Rather, scarcity of land and labour has, in tandem with real currency appreciation, encouraged sectoral reorganization towards less labour-intensive and price-sensitive activities. The Government has assisted this process by promoting information and training, the development of infrastructure, including the ongoing construction of a new airport, and the gradual liberalization of some regulated services, such as voice transmission.

Type and incidence of trade policy instruments

Hong Kong's external trade régime is open and strictly m.f.n. based, with no tariffs on imports or exports. Procedures for government procurement appear streamlined, transparent and non-discriminatory. The authorities have not notified any State-trading activities under the relevant GATT provisions, nor are there government-sponsored countertrade arrangements. No legislation exists for safeguard actions in the event of import surges or for remedial measures against dumped or subsidized imports; and there is no evidence of any bilateral arrangements, apart from MFA-based restrictions, intended to influence trade flows. Hong Kong has no legislation relating to monopolies or other restrictive arrangements and, thus, no provisions to deter price maintenance, boycotts, bid-rigging or other collusive practices; to maintain competition it relies on the benefits of free trade and on the absence of regulatory barriers.

Apart from continuing restraints under MFA bilateral agreements, trade controls are maintained mainly on technical, environmental, health or security grounds. Changes since Hong Kong's initial Trade Policy Review in 1990 include the easing of restrictions on strategically sensitive products and the introduction of a Textiles Trader Registration Scheme intended to facilitate trade in non-restrained items and prevent fraudulent trans-shipments. Certain imported products frequently involved in smuggling activities, including high-powered outboard engines, have been made subject to licensing. Import controls on rice, frozen meat and poultry, intended to underpin domestic stockpiling obligations, have been maintained; the restrictions on frozen meat and poultry are, however, under review.

Trade-related fees, levies and charges generated revenue of less than US$200 million, or 1.2 per cent of total government income, in 1993-94. Some three-quarters of this sum resulted from

a charge relating to trade declarations, which applies to virtually all imports and exports but not to trans-shipments. While consignments of foodstuffs bear a flat rate, the charge on all other items is value-based.

Excise duties on fuels, alcoholic beverages and tobacco, and a tax on the first registration of motor vehicles, are important elements in Hong Kong's system of indirect taxation. Given the territory's economic structure, these duties and taxes apply almost exclusively to imports. Excise duties on non-alcoholic beverages and on cosmetics have been abolished recently, and the previous system of specific or compound duties on alcoholic beverages has been replaced by three levels of ad valorem taxation. While it does not differentiate between individual sources of supply, the new scheme results in widely differing rates for grape-based wine and Chinese-type beverages of similar alcoholic strength. Excise paid on production inputs can be reclaimed on exportation of the processed product.

Hong Kong's open import régime is matched by simple, streamlined internal regulations. Technical specifications and approval procedures focus essentially on user safety and do not further constrain consumer preference. For example, import, sale and use of simple telephone equipment are subject to no mandatory technical requirements; however, suppliers may opt for voluntary quality certification. The authorities rely on the robustness of existing network facilities to prevent deficient products from causing damage. Product admission for pharmaceuticals is in the hands of an independent statutory authority, the Pharmacy and Poisons Board. Its decisions are based on published material and information obtained from manufacturers; as a rule, products are cleared for use only if also admitted in the originating country. Apart from certain restrictions on distribution channels and advertisement, there are no regulations affecting prices, sales margins or other marketing parameters for medicines.

The limited government subsidies and other forms of industrial support are normally devoted to broadly defined purposes, including export promotion, technology enhancement and vocational training. There are no sector-specific schemes. However, certain programmes to encourage research, development and innovation may have selective effects, given sectoral differences in technology content. Such programmes, which generally provide for grants, subsidization of business services or preferential allocation of factory space, appear to have gained in importance.

Export-related assistance is essentially provided through the Hong Kong Trade Development Council, whose main activities focus on trade intelligence and promotional activities such as participation in trade fairs. In 1993-4, less than 30 per cent (about HK$570 million) of the Council's budget came from government funds. Export credit insurance, though in the hands of a government-owned body, is offered on commercial terms.

Basic utilities, such as public transport, telecommunications, electricity and water, are supplied either by State-owned companies or private franchised operators. Regulatory controls aim to ensure social policy objectives, including uniform supply conditions throughout the territory, and avoid the exploitation of monopoly power; there is no evidence of price differentiation for industrial policy purposes. While Hong Kong's local telephone company will face three competitors on the expiry of its franchise in mid-1995, the monopoly on a range of international telephone services is to remain until 2006. All markets for telecommunications equipment, as well as those for value-added, radio paging and cellular phone services, are liberalized.

All land is owned by the government; temporary leases are granted by auction, tender or private treaty grants. Under the Sino-British Joint Declaration of 1984, new land to be cleared for development purposes is limited, in principle, to 50 hectares per year.

Sectoral development patterns

Since the mid-1980s, Hong Kong has reduced its manufacturing workforce by 350,000, or about two-fifths, without any adverse impact on overall employment. Retrenched workers have largely been absorbed by, and helped the expansion of, the territory's booming services industries.

Textiles and clothing remains one of the few manufacturing industries with a strong domestic production base. In the early 1990s, it represented over one-third of manufacturing value-added, followed by electrical and electronic products with about one-quarter. The latter sector, particularly industrial machinery and equipment, performed relatively well in recent years, stimulated by the booming South Chinese economy. Growth has also been strong in paper and printing and in food production.

Hong Kong's clothing industry has lost ground in the import markets of the European Union and the United States, its dominant outlets. It currently supplies about 14 per cent of each market, respectively 5 and 10 percentage points less than ten years previously. In the European Union, the industry was not only outstripped by low-cost competitors, in particular from China, but also came under increasing pressure from suppliers benefiting from more favourable access conditions, such as Turkey and Tunisia.

It is generally acknowledged that the MFA quota régime has encouraged industrial congestion in Hong Kong and diverted scarce resources away from production alternatives with higher growth potential. Consonant with Hong Kong's basic policy stance, sectoral contraction is widely accepted, or even welcomed, as a necessary condition for strong overall expansion. In a booming environment, with lucrative new business opportunities just across the border, the consequent adjustments may be easier to accept, however, than in less dynamic economies.

Trade Policies and Foreign Trading Partners

As a small and open trading entity, Hong Kong's economic fate is closely entwined with that of the multilateral system. It has thus taken great interest in, and contributed intensively to, the Uruguay Round and the creation of the World Trade Organization. Hong Kong's commitments in the Round covered virtually all negotiating areas, including services, where it has submitted a comprehensive schedule. However, apparently with a view to retaining a degree of negotiating leverage, Hong Kong has agreed to bind in the GATT no more than one-quarter of its industrial tariffs at zero level.

Reflecting its unqualified support for an m.f.n. based trade régime, Hong Kong does not participate in any preferential trade agreements. While supportive of trade facilitation initiatives within the Asia Pacific Economic Co-operation (APEC) forum, of which it is a member, Hong Kong does not currently support the creation of formal structures or common institutions. Objecting to derogations from the principles of national and m.f.n. treatment introduced by some participants, it has refused to sign the new Agreement on Government Procurement negotiated in tandem with the Uruguay Round.

Hong Kong's continued expansion, particularly in the past four years, may be attributed both to its capacity for rapid adjustment and a variety of positive external factors, including the presence on its doorstep of a large, booming economy with an abundant resource base. Swift structural change has been facilitated by small firm size, a highly motivated workforce, and the business synergies of regional economic concentration. To bear fruit, however, it is essential for these factors to operate within a supportive institutional framework, based on an open, stable and non-discriminatory trade régime. Hong Kong, as a principal beneficiary of the multilateral trading system, has sought to ensure the resilience of basic GATT principles. Implementation of the Uruguay Round results will further improve the territory's locational attraction and help promote business confidence in its future.

TRADE POLICY REVIEW MECHANISM
HONG KONG

Report by the Government - Executive Summary

PART A: TRADE POLICY AND PRACTICES

Objectives of Trade Policies

Hong Kong's trade policy is to promote free and open trade within a stable and effective multilateral trading system. Now the world's eighth largest trader, and with a per capita GDP forecast to reach US$20,600 in 1994, Hong Kong is an economic miracle which owes its success to a large extent to the world trade liberalisation, and consequent economic expansion, brought about by the General Agreement on Tariffs & Trade (GATT). Hong Kong is one of the most open economies in the world, and the perfect example of GATT principles at work. There are no tariffs; no trade restrictions other than those required to protect health, safety, security and the environment and to discharge Hong Kong's obligations under bilateral and international agreements; and no unilateral 'trade policy instruments' to protect domestic industries or to promote exports.

Hong Kong's trade policy is distinguished by its firm commitment to the multilateral trading system as the best guarantee of free trade and economic expansion. Despite Hong Kong's active participation in the Asia Pacific Economic Cooperation (APEC) since becoming a member in 1991, Hong Kong's guiding principle in participating in such regional economic cooperation forum remains to promote free trade and to reinforce the multilateral trading system.

Hong Kong has participated actively and constructively in the GATT and the Uruguay Round (UR) of multilateral trade negotiations. Hong Kong strongly supports the early implementation of the UR agreements and the early establishment of the World Trade Organisation (WTO) on 1 January 1995. Hong Kong will ratify the WTO agreement and become an original member of the WTO. Hong Kong is a separate customs territory and will remain so after the change of sovereignty in 1997. Both the Sino-British Joint Declaration on the Question of Hong Kong and the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China (legislation promulgated by China setting out the systems in Hong Kong after 1997) provide for the continuation of Hong Kong's participation on its own in relevant international organisations and international trade agreements.

Description of the Import and Export System

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

Hong Kong is a party to the GATT Tokyo Round 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 as appropriate to recover the operating costs of import and export licensing systems, including relevant enforcement activities. Quantitative import restrictions apply to certain 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 Multi-Fibre Arrangement (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, 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.

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 and other government enforcement agencies give legal effect 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 and its subsidiary regulations are to enable Hong Kong to exercise its rights and meet its obligations under textiles agreements and to monitor and control the flow of strategic commodities into and out of Hong Kong.

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

The Export (Certificates of Origin) Regulations and the Protection of Non-Government Certificates of Origin Ordinance provide a system governing the issue of certificates of 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 affecting trade policy and is also Government's chief trade negotiator. The Commissioner of Customs and Excise is responsible to the Secretary for Trade and Industry in respect of trade-related enforcement activities. The Director of Intellectual Property reports to the Secretary for Trade and Industry on matters related to intellectual property protection.

The Administration also involves the private sector in the process of formulating, implementing and reviewing trade policy so as to ensure that proposals command a high degree of public support.

The Trade Advisory Board and the Textiles Advisory Board, which are advisory bodies chaired by the Secretary for Trade and Industry, advise the Administration on a wide range of trade policy issues.

Multilateral and Bilateral Trade Agreements

The 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 Union (EU), Finland, Norway and the United States (U.S.). 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 1993, the value of textiles and clothing exports covered by the six agreements amount to $60 billion, representing 69 per cent of Hong Kong's domestic exports of textiles and clothing and 27 per cent of all domestic exports.

The Implementation of Trade Policies

Trade Measures Used

Hong Kong's trading regime is marked by the absence of unilateral 'trade policy instruments' and minimum control. 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 control measures, including a rice control scheme; quantitative restrictions on the import of certain 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; rules of origin; 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 depend heavily on its ability to participate in world trade.

Hong Kong's developmental needs are basically twofold : the implementation of an ambitious social programme to improve the quality of life in a wide range of areas, including education, the environment, housing, and social welfare; and continuous investment in Hong Kong's physical infrastructure (such as airport and port facilities, road and sea links with China and the internal transport system) to remove the constraints on Hong Kong's growth. While expansion under the former category is funded largely by the Government, the Government encourages the private sector to invest in the

essential physical infrastructure that promotes economic growth by participating in design and development and by taking up Build, Operate and Transfer franchises.

In recent years, in view of the need for Hong Kong's industry to move into higher value-added, high technology production so as to maintain its competitive edge, the Hong Kong Government has launched various programmes to promote technological innovation, technology transfer and the undertaking of applied research and development.

The Hong Kong Government's economic philosophy is marked by minimum interference with the markets; keeping Government small and our systems open; keeping taxes low, simple and predictable and ensuring that Government expenditure does not outstrip the pace of economic expansion.

The External Economic Environment

Major Trends in Imports and Exports

Over 80 per cent 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 1983 and 1993 which had an average annual growth rate of 5, 27, 17, 17 per cent in real terms 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 overseas markets, as well as the opportunities created by China's open door polices. 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 1983 and 1993 was the emergence of China as the 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 considerably more from within the Asia-Pacific region in 1993 than in 1983. China has also become the largest supplier of Hong Kong's imports since the early 1980s.

Structural Changes of the Hong Kong Economy

The economic reform and open door policies adopted by China has led to the re-emergence of Hong Kong as the entrepôt for China trade and the relocation of the more land and labour-intensive industrial operations to China. This has accelerated the restructuring of Hong Kong's economy, with the result that manufacturing now accounts for only 13 per cent of the GDP, compared to 23 per cent in 1983, and Hong Kong now increasingly has the profile of a service-oriented economy. The growing importance of the services sector is consistent with Hong Kong's continuous development as an entrepôt serving not just China but the Asia Pacific region, and 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 1983 to 1993. 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

In so far as visible trade balance is concerned, Hong Kong is neither building up big surpluses nor incurring chronic unacceptable deficits. The visible trade deficits or surpluses, expressed as a percentage of the value of imports of goods, stabilised at low levels of zero to three per cent during the period 1984 to 1993. 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 arising from the flourishing entrepôt trade, such surpluses saw some increases in the last few years.

The Government has not incurred any external debts, and there are no official statistics on the external debts of the private sector.

The official foreign exchange reserves of Hong Kong are held by the Exchange Fund which is operated mainly for the purpose of maintaining exchange rate stability.

The Hong Kong dollar was linked to the U.S. 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 arising from political uncertainties connected with 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 under which business thrives. More importantly, it maintains confidence in Hong Kong dollars and in Hong Kong dollar-denominated 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 various Hong Kong dollar interest rates closely follow the corresponding U.S. dollar interest rates.

International Macroeconomic Situation Affecting the External Sector of Hong Kong

Given its externally-oriented nature, Hong Kong's economy is vulnerable to any adverse economic developments in its major markets. While reliance on the traditional markets has been reduced, they still remain as Hong Kong's top trading partners. Consequently, any significant unfavourable economic developments in these economies will have adverse implications for Hong Kong's external trade sector and thus overall economic growth.

The growing economic links with China represent both an opportunity and a risk. On the one hand, Hong Kong has benefitted from the phenomenal economic growth and opening up of China. On the other hand, Hong Kong's economic interdependence with China means that she is vulnerable to developments in China's economy.

Intra-regional trade with the economies in East Asia has increased significantly in recent years while trade with the Central and Eastern European countries has picked up, albeit from a small base.

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 changes in origin criteria which could be disruptive to trade.

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