

For Information

Legislative Council Panel on Trade and Industry

China's Accession to the World Trade Organisation (WTO) :
Opportunities and Challenges

The attached paper sets out the Government's latest assessment of the implications of China's accession to the WTO, in particular for Hong Kong. A related issue is the granting of Permanent Normal Trade Relations status by the United State to China. Members may wish to refer to the Legislative Council brief we issued on 5 January 2000 for our assessment of the current situation regarding this latter issue.

Trade and Industry Bureau
5 January 2000

China's Accession to the World Trade Organisation :
Opportunities and Challenges

Content	Paragraph
Summary	
Background	1 - 3
Global significance of China's WTO accession	4
Implications for China's economy	5
(a) The multitude of benefits	6 - 12
(b) Opportunities and challenges	13 - 18
(c) Absorbing the WTO shock	19 - 21
(d) Overall impact on China's economy	22 - 23
Implications for the Hong Kong economy	24
(a) Opportunities	25 - 29
(b) Challenges	30 - 35
(c) Hong Kong's positioning	36 - 40
(d) Overall impact on the Hong Kong economy	41 - 43
Annexes I and II	

China's Accession to the World Trade Organisation :

Opportunities and Challenges

Summary

- *The progressive integration of China into the world economy will have significant global ramifications. It will lead to fuller realisation of comparative advantage amongst the world trading entities in the conduct of trade, and through this process induces a broad re-alignment of output and trade pattern, change in investment mix, and shift in financial flows.*
- *It will also have profound influence on China's own economic and social development for many years to come. Trade liberalisation will reduce distortions and raise efficiency and overall well-being in its economy. Existing business culture and people's mindset will however have to adjust to keep up with the times. This will not take place overnight. Firm determination and perseverance is required to turn challenges into opportunities.*
- *The substantial benefits in store for China will include a fairer and more certain trading environment, wider market access, more foreign capital inflow, expedited revamping of the state-owned enterprises (SOEs), accelerated transformation into a market-driven economy, and enhanced consumer and producer surpluses giving better economic welfare.*
- *China has already developed significant comparative advantage in the light manufacturing industries such as textiles and garment, toys, plastics, and consumer electrical and electronic products. Wider market access will expand the export potential of these industries and raise their employment creation over time. What matters is whether the gain in these industries can more than offset the loss in the currently less competitive industries such as automobile, chemicals and pharmaceutical products.*

- *In China's service sectors, banking, insurance and telecommunications will face greater competition from foreign operators. However, foreign banks without an extensive retail network are unlikely to run into direct competition across the full spectrum of financial services with the domestic commercial banks. Foreign banks at least initially are thus likely to concentrate more on trade financing and corporate banking activities such as loan syndication.*
- *The insurance market in China is relatively untapped. The World Bank has estimated that China's pension assets will reach US\$2 trillion by 2030, and that its insurance market will be valued at US\$25 billion in premium income in 2000. Meanwhile, foreign operators can be expected to erode the present duopoly in telecommunications.*
- *Viewed positively, foreign companies will bring in capital, technology and management know-how, foster competition, raise business standards, and generally lift quality in China's service sectors.*
- *In the more recent years, the Chinese government has gone through with much vigour and success the reforms of SOEs and banks. There are also reforms to monetise the housing, medical and education benefits, thereby helping to reduce the financial burden of SOEs. In addition, there are reforms of the employment and social security systems, for minimising the risk of social instability in face of greater retrenchment from SOEs. On this track record, China should be able to withstand the disruptions likely to be brought about by its entry into WTO.*
- *As the Mainland economy transforms into a more liberalised and transparent regime, the Hong Kong economy will be able to benefit from reduced transaction cost and expanded trade and investment potential. There can be expected to be greater business opportunities notably in the distributive trades, banking, finance, insurance, telecommunications and tourism sectors.*
- *In general, the gateway value of Hong Kong is expected to be sustained. While competition in the Mainland market will no doubt be more intense, for the operators involved it will be on a more even keel. Nevertheless, Hong Kong will have to position itself, identify its niche, enhance its infrastructure, and sharpen the capability of*

its workforce. Hong Kong's profound trading experience, extensive business network, and close cultural and language semblance with the Mainland will help secure a good slice of the emerging economic opportunities. Moreover, Hong Kong's professionals can contribute to strengthening the Mainland's business and legal systems further.

- *There has yet been few, if any, in-depth quantitative assessment of the impact of WTO accession for China's economy. As China has still to complete bilateral negotiations with some other WTO members involved, there has yet been fuller disclosure of details on the accession conditions to enable such quantitative assessment to be made more thoroughly.*

- *From various economic research sources, it is estimated that the Mainland's GDP will be 13% higher with than without WTO accession by 2010 (implying an additional growth averaging at 1 percentage point per annum over the period). Its exports will be higher by 22% (averaging at 1.7 percentage points per annum) and its imports by 17% (averaging at 1.3 percentage points per annum). Using these as key input, it is crudely estimated that by 2010 Hong Kong's exports involving the Mainland will be raised by 15% (averaging at 1.3 percentage points per annum) and its GDP by 5.5% (averaging at 0.5 of a percentage point per annum). In the earlier years up to 2005, allowing for possible disruptions brought about by adaptation and adjustment, the incremental growth in trade and GDP could be relatively less.*

- *It should be noted that the quantification of impact done for the Mainland economy is basically confined to the more specific effects of tariff cuts and non-tariff barrier relaxation, including notably the phasing out of quota restrictions on its textiles and clothing exports. The wider impact on development of its service sectors at large is not yet incorporated. Moreover, there are bound to be further influences of an intangible nature which are not easily quantifiable. A similar caveat applies to the quantification of impact done for the Hong Kong economy.*

China's Accession to the World Trade Organisation :

Opportunities and Challenges

Background

After 13 years of protracted negotiations, China has achieved a breakthrough in recent months in its bid for accession to the World Trade Organisation (WTO). On 15 November 1999, China concluded a bilateral agreement with the United States (US), clearing a key hurdle in the process. Encouraged by the China-US accord, it has become increasingly hopeful that China will be able to enter WTO in the early part of 2000.

2. Earlier in July 1999, China concluded an agreement with Japan on services (the agreement on goods was reached in September 1997). Lately, China and the European Union (EU) are in bilateral talks to strike a deal. As at end-December 1999, China has yet to conclude bilateral negotiations with 20 WTO members, out of 36 members who have requested such negotiations with China. US and Japan together accounted for slightly over 35% of China's overall trade in the first ten months of 1999, while EU accounted for another 15%.

3. This paper assesses in broad terms the implications of China's accession to WTO for both the Mainland and the Hong Kong economies. The assessment is based on information reported in the media so far, specifically the summary account of the China-US bilateral agreement as released by the US government on 16 November 1999 which contains the most details (*Annex I*)⁽¹⁾. An attempt is made to quantify crudely the possible impact on Hong Kong's trade and overall economic growth.

(1) Upon completion of all bilateral negotiations with those WTO members who have requested such negotiations, China will compile consolidated schedules of concessions (for the goods area and mainly covering tariffs) and specific commitments (for the services area). These schedules will form part of the documents the Working Party on China's Accession will submit to the WTO General Council with which the accession decision rests. In addition, the Working Party will produce a Protocol of Accession setting out the terms of China's accession, including any special provisions that will apply to China, e.g. those on special safeguards.

Global significance of China's WTO accession

4. The progressive integration of China into the global economy will have significant ramifications not only for China, but also for the rest of the world. China is now the world's sixth largest trading entity (with EU being treated as a single entity). Its incorporation into the world trading system will drive a fuller realisation of comparative advantage amongst the world trading entities in the conduct of trade. The consequential gain in efficiency and expansion in trade will promote a broad re-alignment of output composition, change in trade pattern, and shift in financial flows.

Implications for China's economy

5. China's accession to WTO will have profound influence on its economic and social development in many years to come. Trade liberalisation will reduce external and internal market distortions in China. It will also expose inefficient state-owned enterprises (SOEs) to greater foreign competition. Existing business culture and people's mindset will have to adjust to cope with an increasingly transparent and ruled-based market economy. These changes will not take place overnight. Firm determination and perseverance is required to turn challenges into opportunities.

(a) The multitude of benefits

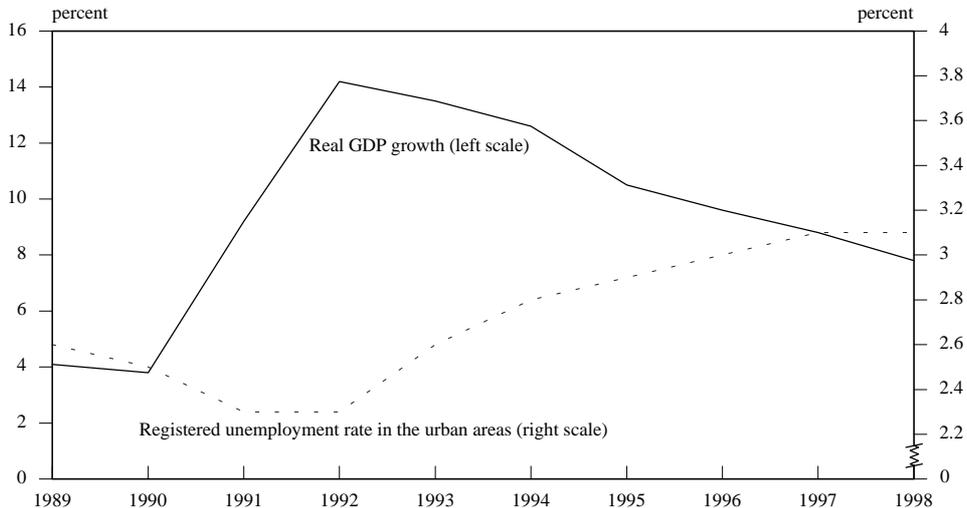
6. ***Fairer and more certain trading environment:*** The WTO rules and disciplines offer a consistent and transparent framework within which China can conduct trade with other members. After accession, China can have recourse to the WTO dispute settlement mechanism that provides effective and objective redress to trade disputes within a defined framework, thereby adding certainty to its trading environment.

7. ***Wider market access for China's goods:*** Once China becomes a WTO member, it will be able to enjoy the right of most favoured nation (MFN) treatment by other WTO members. In the recently concluded bilateral agreement with US, the US Administration promises to make an all out effort to ensure that the Congress grants permanent normal trade relations (NTR) status to China. It also agrees to allow the quotas for China's textiles exports to US to expire in 2005, in accordance with the WTO Agreement on Textiles and Clothing (although it will still maintain a special anti-surge safeguard mechanism applicable

only to the textiles and clothing sector for four more years after 2005 to ensure an orderly transition).

8. ***Affirmation of the Chinese government's commitment to economic reform:*** There is concern amongst some overseas observers that China's reform pace may be retarded, in face of the recently slower economic growth and increased unemployment caused in part by retrenchment from SOEs. A firm commitment to comply with the binding WTO rules should help forestall backsliding and enhance others' confidence in China's commitment to continued reform.

Chart 1 : China's real GDP growth and registered unemployment rate in the urban areas



9. ***Re-invigorating foreign capital inflow:*** Another more recent concern is that foreign direct investment inflow into China has been slowing down, more noticeably in the wake of the Asia financial crisis. In general, while state investment contributes the bulk of fixed asset investment in the past two years, non-state investment is slack. A more certain trading environment, wider market access, and a firm commitment to transform the economy on the basis of a set of binding and internationally recognised trading rules will encourage inward foreign investment. More pertinently, the opening up of the service sectors, which so far have been relatively untapped, will offer huge investment potential. There can be expected to be a relative shift in composition of investment flow from manufacturing more towards services over time.

Table 1 : China's realised foreign direct investment

	<u>1997</u> (US\$Bn)	<u>1998</u> (US\$Bn)	<u>Jan-Sep 1999</u> (US\$Bn)
Manufacturing	28.12 [62.1]	25.58 [56.1]	16.63 [56.9]
<i>of which:</i>			
- textiles	N.A.	1.53 [3.4]	0.88 [3.0]
- machinery and equipment	N.A.	1.47 [3.4]	0.88 [3.0]
- electronic and communications equipment	N.A.	2.43 [5.3]	2.12 [7.3]
Real estate	5.17 [11.4]	6.41 [14.1]	4.03 [13.8]
Construction	1.44 [3.2]	2.06 [4.5]	0.57 [2.0]
Transportation, storage, postal and telecommunications services	1.66 [3.7]	1.65 [3.6]	1.06 [3.6]
Others	8.87 [19.6]	4.45 [9.8]	2.83 [9.7]
Total	45.26 [100.0]	45.58 [100.0]	29.23 [100.0]

Notes: N.A. Not available.

[] % share in total foreign direct investment.

10. ***Expediting the SOE reform process and accelerating transformation of China into a market-driven economy:*** Liberalisation of imports and opening up of the service sectors in China are bound to exert pressure for its entire economy to rationalise and restructure in a much quicker pace. SOEs that remain uncompetitive will perish. There will be more bankruptcies and mergers, and in the end the fit ones will survive and flourish.

11. From a dynamic point of view, the penetration of imported goods and of foreign operators will inject competition into the domestic market, thereby providing impetus and demonstration effect for local operators to raise efficiency and productivity. Greater inflow of foreign capital will bring with it more up-to-date technology and better management know-how, particularly into the previously closed sectors. All these will help upgrade the respective operations and in turn lift the overall growth potential of the economy.

12. ***Enhanced consumer and producer benefits:*** Over the longer term, a freer and more open external trade regime should help bring out distinctly the genuine comparative advantage of different industries in China. A more transparent, fair-play and market-driven economic system will lower transaction cost, reduce distortion in the allocation of resources, and raise overall efficiency and productivity. Consumers will benefit from having greater choice of cheaper and better quality goods. Producers will gain from having cheaper inputs and hence greater competitiveness in both the domestic and overseas markets.

(b) Opportunities and challenges

13. ***Manufacturing Industries:*** Over the years, China has developed strong comparative advantage in the light manufacturing industries like textiles and garment, toys, plastics, consumer electrical appliances and consumer electronic products. Wider market access accorded by WTO accession will benefit these industries with expanded potential for export and larger creation of employment opportunities. Increasingly, China has diversified its exports in recent years. Between 1993 and 1998, the share of textiles and garment exports in China's total exports fell from 28% to 22%, while that of consumer electrical and electronic products rose from 11% to 15%. This trend of diversification can be expected to continue. Yet, the phasing out of textiles quotas in 2005 can also be expected to boost significantly further China's textiles and garment exports. Some analysts envisage that China's textiles exports will surge by over 60% and garment exports by more than two times from now to 2005.

Table 2 : China's exports of selected industrial products

	<u>Total exports</u> (US\$Bn)		<i>of which:</i> <u>Textiles and garment</u> (US\$Bn)		<u>Electrical machinery, and consumer electrical and electronic products</u> (US\$Bn)	
1993	91.8	(N.A.)	26.1 [28.4]	(N.A.)	10.0 [10.6]	(N.A.)
1994	121.0	(31.9)	34.2 [28.3]	(26.5)	14.1 [11.7]	(45.5)
1995	148.8	(22.9)	35.9 [24.1]	(15.1)	19.0 [12.8]	(34.6)
1996	151.1	(1.5)	35.0 [23.1]	(8.0)	20.2 [13.4]	(6.2)
1997	182.7	(20.6)	43.2 [23.6]	(22.5)	24.6 [13.4]	(21.7)
1998	183.8	(0.6)	40.5 [22.0]	(16.2)	27.0 [14.7]	(9.8)

Notes: [] Share in total exports (%).

() Annual growth rate (%).

N.A. Growth rates cannot be derived due to revision to the statistical series as from 1993.

14. However, other industries like automobile, chemical and related products, and pharmaceutical products where China is less competitive will suffer. Many of these industries are run by heavily subsidised SOEs that are already under strain. While WTO accession will benefit consumers of these products with greater choice of cheaper and better quality goods, the weaker domestic local producers will be forced to restructure, merge or even go out of business. Overall, changes will be induced to the composition of output and pattern of trade to reflect more closely the comparative advantage of different industries in China. In the end, what matters is whether the gain in employment opportunities in the stronger industries can more than absorb the lay-offs from the less competitive industries.

15. **Agriculture:** While the agricultural sector employs a major portion of the total workforce in China, its per capita output is low. WTO membership will facilitate the import of more resource-intensive products like wheat, rice, cotton and soybean, and the export of more labour-intensive products like fruits, vegetables, livestock and aquatics. Moreover, the food processing and other industries relying on the agricultural sector for raw materials will benefit, as the prices of their inputs can be expected to decline. There will be accelerated development of township enterprises to cope with the rural-urban labour migration.

16. **Banking, finance and insurance:** The banking, finance and insurance sectors will face greater competition from foreign operators. The Research Institute of the Ministry of Foreign Trade and Economic Cooperation forecasts that in three years following WTO accession, the number of foreign bank branches in China will rise from 153 to 279, while deposits with these banks will double. Yet in the absence of an extensive retail network now possessed by the domestic commercial banks, foreign banks at least initially are likely to concentrate more on trade financing and corporate banking activities such as loan syndication.

17. China offers potentially the world's largest untapped market for insurance. Opportunities for both local and foreign insurers will be enormous as the government progressively unloads its welfare burden through implementation of social security reform. Foreign financial concerns are hopeful that they can participate in the management of China's growing retirement funds. A World Bank study has projected that China's pension assets will reach US\$2 trillion by 2030, and that its insurance market will be valued at around US\$25 billion in premium income in 2000. According to China's Insurance Regulatory Commission, foreign insurers now only have a 1% share of the domestic market, and they have potential to grow into a 10% share. Overall, the presence of foreign companies will foster competition, drive domestic companies to raise business standards and improve service quality, help tighten the legal and regulatory framework, and advance manpower training and productivity consciousness.

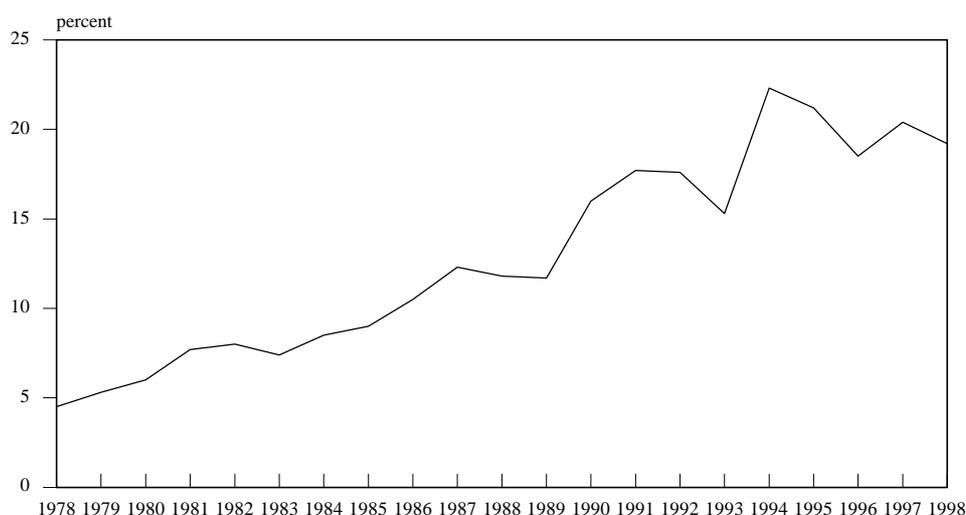
18. **Telecommunications:** The potential for expansion of telecommunications in China is substantial, given the prevalent low penetration rate. The opening up of the market to foreign operators will bring in foreign capital, technology and expertise to expedite development of the telecommunications sector in China, and reduce the

market share of the present duopoly there.

(c) Absorbing the WTO shock

19. Over the past two decades, China's economy has been growing by leaps and bounds, as it became progressively open to external trade and foreign investment (*Annex II*). Between 1978 and 1998, China's exports grew strongly, by an average of 15.8% per annum in US dollar terms, while its imports likewise showed a robust increase, by an average of 14.5% per annum in US dollar terms. Substantial inflow of foreign direct investment was also recorded, amounting to a cumulative total of US\$266 billion on a realised basis at end-1998. Over the period, China's real GDP grew at an average annual rate of 7.8%. The ratio of visible trade to GDP rose markedly, from 10% in 1978 to 34% in 1998. External trade and inward foreign direct investment have been providing a key driving force for China's industrialisation, which is a crucial part of its entire economic reform and modernisation programme. China's industrial value-added hence rose by an annual average of 11.8% in real terms, even faster than the overall growth of the economy. In recent years, the Chinese government has been taking significant strides to reduce import tariffs in its move towards trade liberalisation. The impact of this move on the domestic industries has apparently been well-contained so far.

Chart 2 : Share of exports of goods in China's GDP



20. The concessions made by China in its bid to join WTO will exert pressure on its economy to adjust and adapt to the new environment. Nevertheless, over the years the Chinese government has gone through with much vigour and success substantial economic reform to improve the overall efficiency of the economy. In the banking sector, apart from bringing in risk management techniques, a further strategic step has been taken recently with the setting up of four asset management companies to resolve the huge non-performing loans of the four state-owned commercial banks. For SOEs, rationalisation and restructuring is complemented by a series of housing, medical, and education reforms thereby helping to reduce the financial burden of SOEs, and by reforms of the employment and social security systems for minimising the risk of social instability in face of greater retrenchment from SOEs.

21. The Chinese government has also placed strong emphasis on the development of technology and its utilisation in economic development. This should help raise the long-term competitiveness of China's enterprises in face of the influx of foreign competitors. The stepping up of effort on training and retraining should also help the workers adapt better to the structural change induced by the WTO accession, thereby reducing the difficulty of adjustment.

(d) Overall impact on China's economy

22. As China has still to complete bilateral negotiations with the remaining 20 WTO members who have requested such negotiations, there has yet been fuller disclosure of details on the terms and conditions of China's accession, not to mention any official estimates of the impact of WTO accession on China's trade, overall economic growth and employment. An earlier study conducted by the State Council Research Development Centre (SCRDC) in 1998 gave some crude indications of the possible impact of WTO accession on China's economy, by reference to the information available at that time. The assessment covered only the more specific effect of tariff cuts and non-tariff barrier relaxation, including the phasing out of quotas on textiles and clothing exports. Lately upon announcement of the China-US accord, certain broad appraisals are done by some private sector analysts.

Table 3 : SCRDC's assessment of the impact of WTO accession on China's economy

	<u>Real GDP</u>	<u>Exports in US dollar terms</u>	<u>Imports in US dollar terms</u>
Increase in level by 2010 (%)	13	22	17
Implied additional average annual growth, 1997 - 2010 (in % point)	1.0	1.7	1.3

Table 4 : Private sector appraisals of the impact of WTO accession on China's economy

	<u>Incremental impact on real GDP growth rate (% point)</u>	<u>Increase in 2005:</u>		<u>Foreign direct investment in 2005 (US\$Bn)</u>
		<u>Exports (US\$Bn)</u>	<u>Imports (US\$Bn)</u>	
Goldman Sachs	0.5 in 2005	50	115	50
Merill Lynch	N.A.	100 (in 2004)	120 (in 2004)	55 (in 2004)
BNP Prime Peregrine	0.5 - 1.0 p.a.	Total trade doubles to US\$600 billion.		

Note : N.A. Not available.

23. As to employment, SCRDC has estimated that retrenchment in the agricultural sector may reach 9.6 million from now to 2005, and that the automobile industry is likely to shed about half a million jobs. These will nevertheless be offset by large increases in job creation in the textiles and garment industries (5.4 million), commerce and other services (2.7 million), and construction and infrastructure (1.3 million).

Implications for the Hong Kong economy

24. As the Mainland economy transforms into a more liberalised and transparent regime, Hong Kong will be able to benefit from reduced transaction cost and expanded trade potential, given the highly intimate and mutually beneficial economic links between the two places all along. Hong Kong is the most important entrepôt as well as the largest source of foreign direct investment for the Mainland, accounting for 12% of its overall trade and 52% of its cumulative investment inflow. Hong Kong will have much to gain from the spurring effect of China's WTO membership, stemming from its ascending trade and investment relations with the rest of the world. Moreover, with greater protection accorded against unilateral trade actions by others, China's WTO membership will help reduce the adverse ripple effect on Hong Kong arising from its trade disputes with other trading partners. According to a recent survey conducted by the Hong Kong Policy Research Institute, 41% of the respondents feel that China's accession to WTO will raise their confidence in the Hong Kong economy.

Chart 3 : Hong Kong's total exports to the Mainland

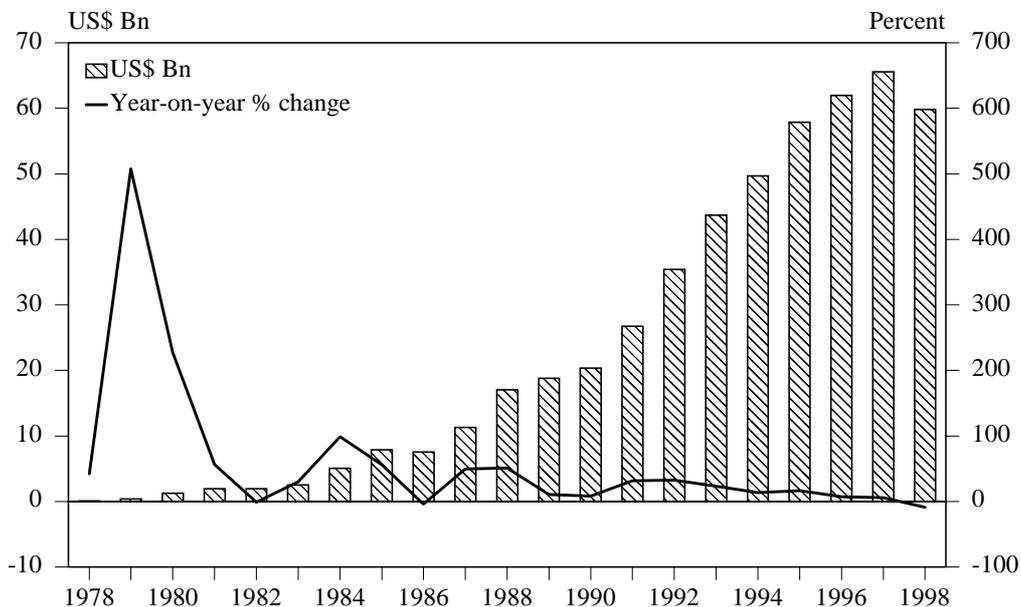


Chart 4 : Hong Kong's exports to the Mainland involving outward processing

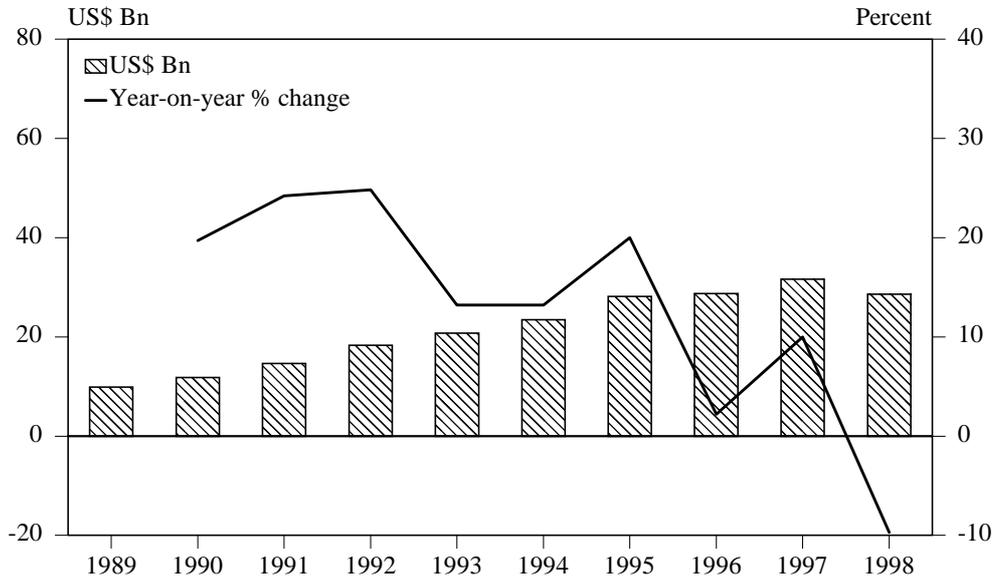


Chart 5 : Hong Kong's imports from the Mainland

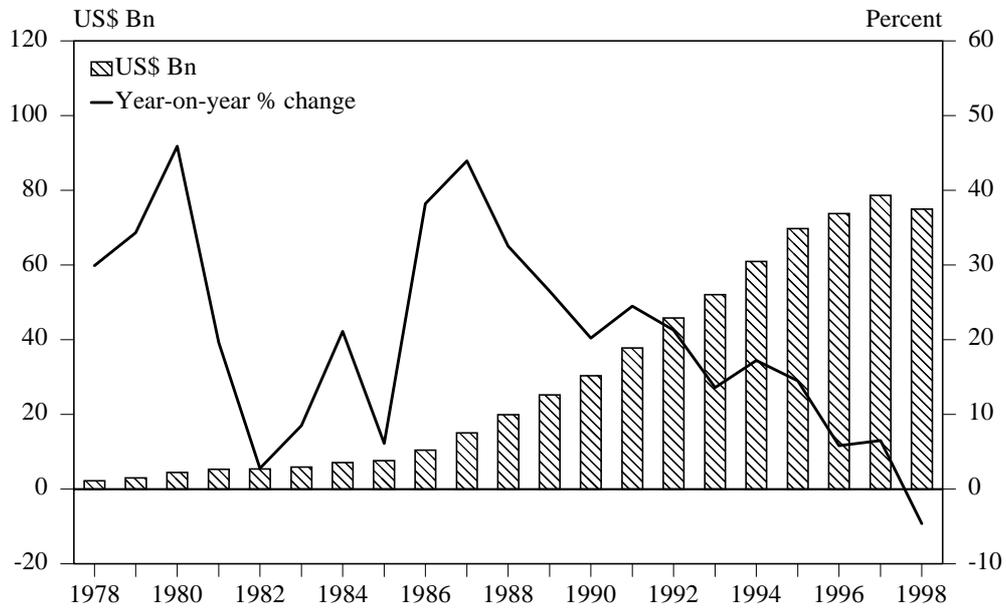
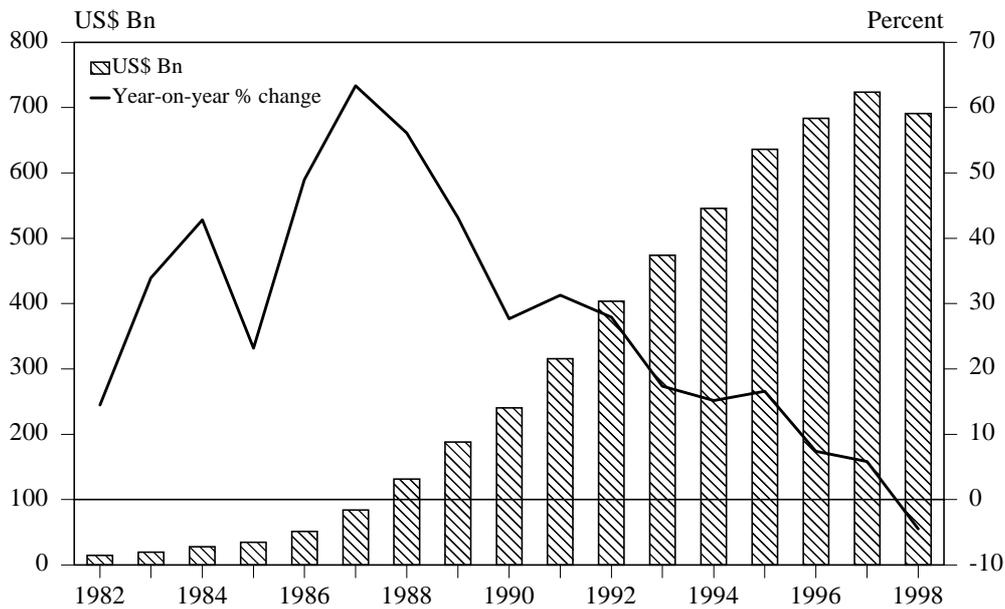


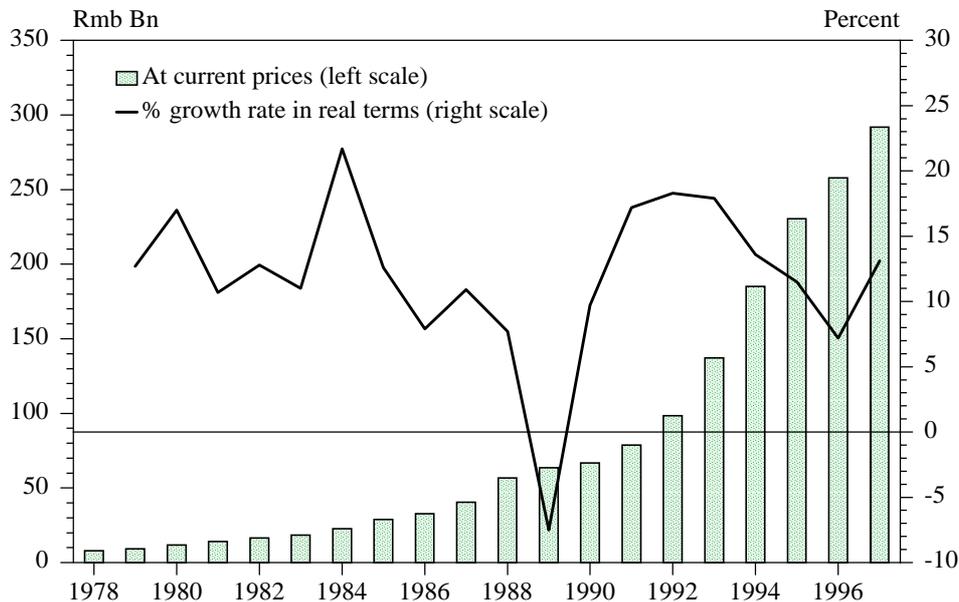
Chart 6 : Hong Kong's re-exports of China origin



(a) Opportunities

25. **Distributive trades:** The opening up of the Mainland's service sectors will provide ample business opportunities for Hong Kong. An obvious promising growth area is in the distributive trades. For instance, in Guangdong Province, which is the province closest to Hong Kong and has the highest per capita income amongst all provinces in the Mainland, retail sales have been rising substantially in recent years. Similar impressive growth in retail sales is recorded in other major cities in the Mainland. The business acumen and sales promotion skills of Hong Kong's retailers can be put to profitable use.

Chart 7 : Guangdong's retail sales



26. **Banking and finance:** China's WTO accession will greatly expand the business scope for foreign banks. Foreign currency and Renminbi deposits by both Chinese enterprises and individuals, as well as consumer credit, should offer abundant business opportunities. At present, consumer credit takes up less than 1% of the total outstanding bank credit in the Mainland, much smaller than the share of over 20% in the industrialised economies. Over the past five years, the number of foreign banking branches in the Mainland almost doubled, from 80 to 153. Of this total, the number of Hong Kong banking branches also increased, from 27 to 34. Further inroads by Hong Kong's banks will however depend on the Mainland being willing to lower its minimum asset requirement for foreign banks to set up branches there, which is currently set at US\$20 billion.

27. **Insurance:** As the Mainland economy continues to grow in scope and increase in complexity, the need for various insurance services, including life insurance, medical insurance, property insurance and pension products, will surge. Currently the insurance industry in the Mainland is still at a rudimentary stage, with total insurance premium amounting to only 1.5% of GDP in 1998 and per capita insurance premium less than Rmb 100. Following China's accession to WTO, foreign insurers interested in the Mainland market may be attracted by the availability of modern infrastructure, advanced communications

network and broad insurance expertise in Hong Kong and hence choose Hong Kong as their regional management base. There are already reports of certain multinational companies planning to team up with Hong Kong insurers in their bid to enter the Mainland market.

28. ***Telecommunications:*** Between 1994 and 1998, the number of urban telephone subscribers in the Mainland was larger by almost three-fold, from 22 million to 63 million, and the number of mobile telephone subscribers increased even more rapidly, from 1.6 million to 24 million. Over the same period, the number of long-distance telephone calls more than doubled, from 8 billion to 18 billion. As the penetration rate for these telecommunications services in the Mainland is still very low, the potential for further expansion is substantial. According to news reports, several overseas companies have already been siding with Hong Kong companies with a view to developing further telecommunications business in the Mainland.

29. ***Tourism:*** A total of 58 million foreign visitors went to the Mainland in 1997, of whom 48 million were from Hong Kong and Macau. In the first three quarters of 1999, the number of Hong Kong residents travelling to the Mainland reached 33 million, representing an increase of 17% over the same period in 1998. As Hong Kong's travel agencies are well acquainted with the interests and requirements of foreign visitors, as well as the domestic situation in the Mainland, they should have an edge over their foreign counterparts in conducting tour business there, the more so if they enter into joint venture with domestic partners.

(b) Challenges

30. ***Greater competition from foreign companies:*** Following China's accession to WTO, Hong Kong companies will face competition from a far greater number of foreign companies, very often with much greater financial strength and operational capability, in the full stretch of the Mainland market. This is particularly so in high value-added activities like information technology and banking, where Hong Kong companies face keen competition from the major foreign companies even within Hong Kong. Thus the Hong Kong companies involved will have to devise appropriate strategies to cope.

31. ***Implications for Hong Kong's gateway role:*** Some observers are wary that as the Mainland opens up more to foreign companies with its rules and regulations becoming more transparent and more consistent with international practice, the value of Hong Kong as a gateway to the Mainland may diminish.

32. Compared with their Mainland counterparts, Hong Kong companies have more efficient operations, richer experience in the import/export and distributive trades, and better business networking with the rest of the world. Compared with foreigners, Hong Kong people have much closer cultural and language semblance with Mainland people and better knowledge of the Mainland environment. These entrenched advantages should enable Hong Kong companies to secure a significant share of the liberalised trade in the Mainland. Also, Hong Kong companies can capitalise on their well-established business network in the Mainland to help facilitate foreign direct investment inflows into the Mainland, including through joint ventures. Moreover, Hong Kong's professionals can contribute to the further strengthening of the Mainland's business and legal systems.

33. Overall, Hong Kong can be expected to remain a major gateway to the Mainland. While it is not surprising that Hong Kong's role for the Mainland as an intermediary will tend to decline somewhat, due to the greater direct interface between the Mainland and other economies in due course, the profound business creation effect of China's accession to WTO should ensure still further growth in Hong Kong's business involving the Mainland.

34. ***Implications for local employment:*** There is a further concern that greater competition and on-going transformation in the Hong Kong economy caused by further opening up of the Mainland market to trade and investment will lead to increasing structural unemployment in Hong Kong. Yet judging from past experience, at every round of economic transformation, new jobs are created and the workforce at large benefits with greater employment opportunities at better conditions. China's accession to WTO will accord Hong Kong with new business ventures and along with that more jobs, particularly in the distributive trades, communications, tourism, accounting, auditing, advertising, computer applications, management systems, and finance (including fund raising, share listing and securities dealing).

35. On the other hand, as the structural transformation proceeds, there are bound to be some workers who due to their own individual conditions will face greater difficulties than others in adapting to the change. These are mostly the older workers with lower education and lesser skills, and hence are often confined to rather narrow job perspectives. They will require more focused effort on retraining and re-equipping to enable them to tide over the change and re-orient towards the new job prospects arising.

(c) *Hong Kong's positioning*

36. In turning challenges into opportunities, Hong Kong companies must strive to maintain and wherever possible lift their competitive edge in the Mainland. China's accession to WTO will lead to keener yet fairer competition in the Mainland market. Hong Kong will have to position itself, identify its niche, enhance its infrastructure, and sharpen the capability of its workforce so as to be able to secure a good slice of the emerging economic opportunities.

37. In the distribution sector, notwithstanding the current restrictions to business, some Hong Kong companies have already established a foothold in the Mainland through setting up retail outlets selling their own products there. They should increase their market penetration further, by setting up joint ventures with certain domestic entities, and continue to strengthen their business network, in anticipation of such restrictions being relaxed in the near future.

38. Against the likelihood of diversion of trading and other business activities, Hong Kong companies will have to actively seek new areas that can contribute to development of the Mainland economy whilst offering satisfactory business rewards. For example, on the transition from entrepôt trade to offshore trade, although the goods involved do not cross the Hong Kong border, the transactions are conducted by Hong Kong businessmen, with profits ploughing back to Hong Kong. Currently, the goods involved are mostly products of Hong Kong's industrial ventures in the Mainland, as well as material inputs for their production. More could be done along this track. Also, as a natural extension, Hong Kong businessmen could in due course go more into trading in goods produced by domestic enterprises or required by domestic users in the Mainland.

39. Even in areas where Hong Kong companies do not have a clear edge vis-à-vis their foreign counterparts, for example in banking and finance, Hong Kong people could still benefit. For example, over the past years a number of foreign financial institutions have set up branches and representative offices in the Mainland. Hong Kong people are often hired to senior positions in these offices, due to their professional skills and more importantly their better knowledge of the place. Moreover, the business activities of these offices usually need substantial support from their Hong Kong offices, which often serve as their functional headquarters. This in turn reflects Hong Kong's continuing role as a professional services hub for the Mainland.

40. In general, continuation and expansion of Hong Kong's hub function for the Mainland, and indeed for the region as a whole, calls for strong drive and determination for betterment on the part of Hong Kong companies and their workforce. For small and medium-sized enterprises in particular, this is no small urge. As to the Government, it should strive to persistently upgrade the physical infrastructure and human resources in the economy, so as to raise its efficiency and capability, and henceforth its overall competitiveness in catering for such a hub function.

(d) Overall impact on the Hong Kong economy

41. Applying regression technique, the estimated impact of WTO accession on the Mainland's trade and real GDP growth (as shown in paragraph 22 and Table 3) is used as key input to assess the possible impact on Hong Kong's exports and real GDP growth⁽²⁾. It is crudely estimated that by 2010, Hong Kong's exports involving the Mainland will be raised by 15% (averaging at 1.3 percentage points per annum) and its GDP by 5.5% (averaging at 0.5 of a percentage point per annum).

(2) The following regression equations are formulated for the assessment:

	<u>Constant</u>	<u>Mainland's GDP</u>	<u>Mainland's exports</u>	<u>Mainland's imports</u>	<u>Rmb exchange rate</u>	<u>Share of HK's manufacturing output to GDP</u>	<u>Lag(1)</u>	<u>Dum</u>	<u>\bar{R}^2</u>	<u>DW</u>
HK's domestic exports to the Mainland	-3.2327 (-1.69)		1.2037 (4.70)		-0.7062 (-3.99)	1.3062 (6.48)			0.9736	2.134
HK's re-exports to the Mainland	0.7554 (0.37)	1.1796 (2.91)		0.6508 (2.10)	-0.8196 (-3.72)		-0.3672 (-1.68)		0.9872	2.097
HK's re-exports of Mainland origin	-2.3535 (-2.96)	1.2661 (2.94)			-1.2405 (-4.86)			-0.3709 (-2.04)	0.9794	1.628

Notes : All variables are in logarithm form.

Lag(1) : The value of the dependent variable with a one-year lag.

Dum : Dummy variable to take account of the structural shift brought about by the operation of the Yantian Port since 1994.

Table 5 : Impact of China's accession to WTO on Hong Kong's exports and GDP up to 2010

	Increase in exports in 2010 (%)	Implied additional average annual growth in exports between 1978 and 2010 (in % point)	Contributions to GDP as increase in GDP level by 2010 ⁺ (%)	Contribution to GDP as implied additional average annual growth in GDP between 1978 and 2010 (in % point)
HK's domestic exports to China	22.9	1.8	0.7	0.1
HK's re-exports to China	16.6	1.4	1.6	0.1
HK's re-exports of Mainland origin	13.7	1.2	3.2	0.3
HK's exports involving the Mainland (as weighted average of the constituent increases above)	15.0	1.3		
Summed total of contributions to HK's GDP			5.5	0.5

Note : (+) Estimated on the basis of the overall domestic exports and re-exports multipliers reckoned for the Hong Kong economy. In the case of Hong Kong's re-exports of Mainland origin, the re-exports multiplier has been adjusted by making reference to re-export trade margin data.

42. However, the boost on China's exports and GDP in the earlier years is likely to be less than the average increment per annum as assessed for the period up to 2010. Understandably as China's economy adjusts to the WTO shock in the earlier years, the gains from the stronger sectors will be offset in part by losses in the weaker sectors. For this reason, some analysts have trimmed the projected incremental GDP growth for the Mainland to 0.3-0.4 of a percentage point per annum,

instead of 1 percentage point per annum, up to 2005. If so, the projected incremental GDP growth for Hong Kong in the earlier years could be relatively less.

43. It should be noted that the quantification of impact done for China's economy is basically confined to the more specific effects of tariff cut and non-tariff barrier relaxation, including notably the phasing out of quota restrictions on its textiles and clothing exports. The wider impact on development of its service sectors at large is not yet incorporated. This part of the impact is difficult to gauge at this stage, as many of the changes that will take place after China's accession to WTO are unprecedented. Moreover, there are bound to be further influences of an intangible nature which are not easily quantifiable. A similar caveat applies to the quantification of impact done for the Hong Kong economy.

Economic Analysis Division
Financial Services Bureau
Government Secretariat
3 January 2000

China-US bilateral agreement*

	Tariffs	Non-Tariffs
I. China's offer:		
(a) Agriculture	<ul style="list-style-type: none"> - reduce tariff on agricultural products from an average of 31.5% to 17% (14.5% of US priority products) by January 2004. 	<ul style="list-style-type: none"> - eliminate export subsidies; - set significant and growing tariff-rate quota (TRQ) for bulk commodities like wheat, corn and cotton, and provide a share of the TRQ for private traders; - lift ban on US meat products, citrus and wheat based on sanitary and phytosanitary standards.
(b) Industrial goods	<ul style="list-style-type: none"> - reduce tariffs to an average of 9.4% (7.1% for US priority products), with the majority of the tariff cuts implemented by 2003 and the rest by 2005; - cut tariffs on automobile from the current 80-100% to 25% by 2006; - cut tariffs on auto parts to an average of 10%; - significant cuts in tariffs in the wood and paper sectors. 	<ul style="list-style-type: none"> - eliminate existing quotas for the top US priorities upon accession, and phase out the remaining quotas generally by 2002, and no later than 2005; - participation in the Information Technology Agreement and the APEC Accelerated Tariff Liberalisation initiative; - implementation of the vast majority of the chemical harmonisation initiative.
(c) Trading and distribution services		<ul style="list-style-type: none"> - provide trading and distribution (including wholesaling, sales away from a fixed location, retailing, maintenance and repair, and transportation) rights to US firms in 3 years; - all restrictions on services auxiliary to distribution (including

	Tariffs	Non-Tariffs
		rental and leasing, air courier, freight forwarding, storage and warehousing, advertising, technical testing and analysis, and packaging) will be phased out in 3 to 4 years.
(d) Telecommunications services		<ul style="list-style-type: none"> - open all telecommunications services in Beijing, Shanghai and Guangzhou upon accession; - phase out all geographical restrictions on different telecommunications services in 3 to 6 years; - allow 49% foreign ownership in all services in the first year of accession, and 50% foreign ownership in value-added services in 2 years; - liberalise internet services at the same rate as other key telecommunications services; - agrees to implement the pro-competitive regulatory principles embodied in the Basic Telecommunications Agreement and agrees to technology-neutral scheduling.
(e) Banking services		<ul style="list-style-type: none"> - allow foreign banks to conduct renminbi business with Chinese enterprises 2 years after accession, and with Chinese individuals 5 years after accession; - foreign banks will have same rights as Chinese banks within designated geographical areas, and both geographical and customer restrictions will be removed in 5 years.
(f) Securities		<ul style="list-style-type: none"> - permit minority foreign owned joint ventures to engage in fund management on the same terms as Chinese firms;

	Tariffs	Non-Tariffs
		<ul style="list-style-type: none"> - allow minority joint ventures to underwrite domestic securities issues, and to underwrite and trade in foreign currency denominated securities, including debt and equity.
(g) Insurance services		<ul style="list-style-type: none"> - for life insurance, allow 50% foreign ownership upon accession; - for non-life insurance, allow branching or 51% ownership upon accession and wholly owned subsidiaries in 2 years; - for reinsurance, no restrictions upon accession; - expand the scope of activities for foreign insurers to include group, health and pension lines of insurance; - eliminate all geographical limitation over 5 years, and allowing access to the key cities of priority US interest in 2 to 3 years.
(h) Audio-visual services		<ul style="list-style-type: none"> - allow 49% foreign participation in the distribution of video and sound recordings; - import 40 foreign films per year after accession, growing to 50 films in 3 years, of which 20 films will be revenue sharing.
(i) Professional services		<ul style="list-style-type: none"> - open market for legal, accountancy, taxation, management consultancy, architecture, engineering, urban planning, medical and dental, computer-related services; - allow majority foreign control except for practising Chinese law; - eliminate mandatory localisation for accountancy.

	Tariffs	Non-Tariffs
(j) Travel and tourism		<ul style="list-style-type: none"> - allow majority foreign ownership for hotels upon accession and 100% ownership in 3 years; - allow foreign travel agents to provide full range of travel agency services and full access to government resorts.
(k) Protocol/rules issues		<ul style="list-style-type: none"> - implement the TRIMs Agreement upon accession; - eliminate and cease enforcing trade and foreign exchange balancing requirements and local content requirements; - impose or enforce laws or other provisions relating to the transfer of technology only if they are in accordance with the relevant WTO agreements; - agrees that the US can maintain their current anti-dumping methodology for 15 years, and their product specific safeguard for 12 years; - ensure that state-owned enterprises will make purchases and sales based solely on commercial considerations.
II. US's offer:		
(a) Textiles		<ul style="list-style-type: none"> - allow textile quotas for Chinese goods to expire in 2005. But there will be an additional 4 years after that of a special anti-surge safeguard mechanism to insure a more orderly transition.
(b) Normal trading relations		<ul style="list-style-type: none"> - the US administration promises to put out an all out effort to pass permanent normal trading relations (NTR) status for China through the Congress.

* Based on the summary report issued by the US government on 16 November 1999.

China's major economic indicators

	<u>Real GDP growth</u> (%)	<u>Real industrial output growth</u> (%)	<u>Inflation</u> (%)	<u>Annual realised inward foreign direct investment</u> (US\$ Bn)	<u>Exports</u> (US\$ Bn)	<u>Imports</u> (US\$ Bn)
1978	11.7	13.6	0.7	N.A.	9.8	10.9
1980	7.8	9.3	6.0	N.A.	18.1	20.0
1985	13.5	21.4	8.8	2.0	27.4	42.3
1990	3.8	7.8	2.1	3.5	62.1	53.3
1995	10.5	20.3	14.8	37.5	148.8	132.1
1998	7.8	10.7	(2.6)	45.6	183.8	140.2
Average annual % growth rate during 1978-1998 (20 years)	9.7	15.4	6.8	N.A.	15.8	13.6
Average annual % growth rate during 1990-1998 (8 years)	13.8	19.9	7.8	37.9	14.5	12.8

Sources : China Statistical Yearbook, various issues.
China's Customs Statistics, December 1998.