

Box 2.2**Impact of a regional trade agreement on Hong Kong
as a non-signatory: A case in ECFA**

Recognising the enormous challenge in reaching a wholesale agreement on trade liberalisation for the global economy (i.e. the Doha round of the World Trade Organization (WTO)), economies have increasingly focused on regional and sectoral trade agreements in recent years. According to the statistics from the WTO, 75 regional trade arrangements (RTAs), either bilateral or multilateral, notified the WTO from 1958 to 1999, while some 340 additional RTAs were formed since 2000, including the ASEAN - China Free Trade Area, Dominican Republic - Central America - United States Free Trade Agreement and EU - Colombia/Peru Free Trade Agreement, vividly reflecting the enthusiasm for RTAs in recent years across the globe.

Unlike a WTO agreement which would entail trade facilitation measures (e.g. lower tariffs, less non-tariff barriers, etc.) applicable to all of the 162 WTO members, a RTA would only lower the barriers for trade flows between the signatories. As a small, open economy and an international trading centre, it would be meaningful to look at the potential implications for Hong Kong when other economies sign a RTA.

Holistically speaking, the implications of a RTA can be categorised into three effects: (1) the trade creation effect, (2) the trade diversion effect, and (3) the spill-over effect.

The first two are usually referred as static effects. Loosely speaking, trade creation effect refers to the increase in trade flows between the signatories that is made possible by the RTA's realisation of each signatory's comparative advantage through lowering tariffs and non-tariff barriers among themselves. As a result, trade creation effect would be beneficial to all the signatories, but irrelevant to the non-signatories. As for trade diversion effect, it refers to the new trade flows between the signatories that are diverted from those between a signatory and a non-signatory, due to the newly introduced preferential treatment for trade between the signatories. As such, trade diversion effect could be beneficial to the signatories, to the detriment of the non-signatories.

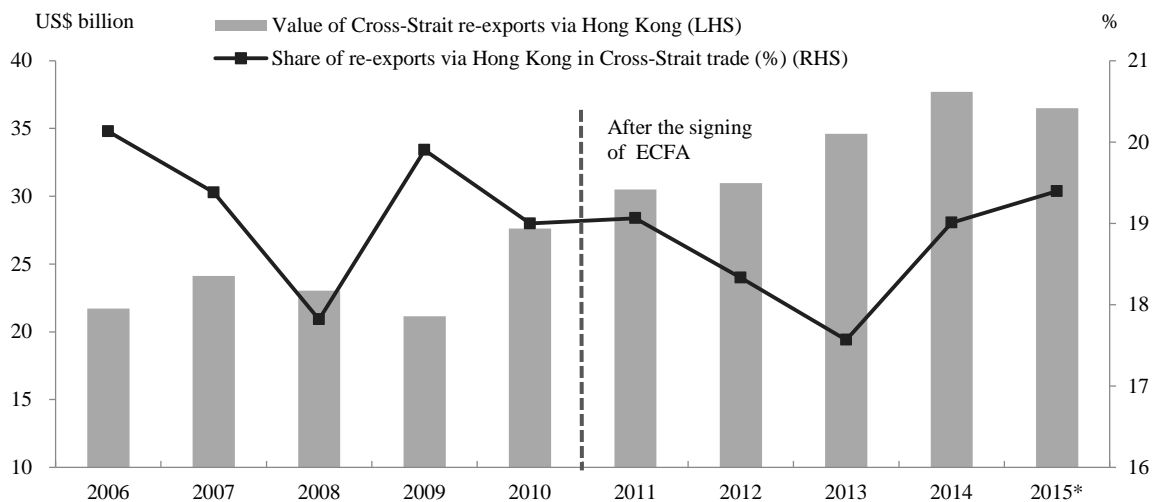
The spill-over effect comes in when the impact of a RTA is viewed dynamically. The relaxation of various trade restrictions among those signatories improves the resources allocation efficiency in these economies, thereby improving their income and production capacity. This in turn would lead to strengthening of import demand in these signatory economies and hence boosting trade flows worldwide.

An example to showcase a RTA's impact on Hong Kong as a non-signatory would be the signing of Economic Cooperation Framework Agreement (ECFA) between the Mainland and Taiwan in 2010, the first and the fourth largest trading partner of Hong Kong at that time. Since the implementation of ECFA, both the Mainland and Taiwan have lowered the import tariffs of more than 800 tariff items. Such reduction of tariffs has inevitably affected Hong Kong's re-exports of these goods due to the stronger price incentive for direct trade between the two economies. Specifically, the value of trade in items under the ECFA's tariff reduction list routing through Hong Kong as a share to the total Cross-Strait trade gradually fell from about 10% in 2010 to around 6% in 2014⁽¹⁾.

(1) Crude estimates only, based on the product codes on the ECFA's tariff reduction list.
(Source: http://fta.mofcom.gov.cn/cepa/annex/haixiaeran-xyfj01_cn.pdf)

Box 2.2 (Cont'd)

Despite so, since the signing of ECFA, the closer Cross-Strait economic relationship has benefited the Hong Kong's trade in overall terms. With the bilateral trade between the Mainland and Taiwan expanding notably by 29% from US\$145.4 billion in 2010 to US\$188.2 billion in 2015 (according to the China Customs Statistics), Hong Kong's re-exports between them also grew visibly over the same period, by 32% from US\$27.6 billion to US\$36.5 billion. Consequently, the share of Hong Kong's re-exports in the total Cross-Strait trade rose slightly from 19.0% to 19.4% over this period, despite a small drop in the early years of ECFA implementation. In fact, the 32% cumulative growth in Hong Kong's re-exports between the Mainland and Taiwan from 2010 to 2015 was even higher than the corresponding 20% growth in Hong Kong's overall re-exports. All these suggest that the positive spill-over effect should be even larger than the negative trade diversion effect, thanks to Hong Kong's close economic relations with the two economies and the competitive strength of Hong Kong as a regional trading hub.

Chart 1: Cross-Strait re-export trade via Hong Kong

Note: (*) Provisional figures.

Sources: China Customs Statistics and the Census and Statistics Department of HKSAR Government

The analysis above shows that, while a RTA would unavoidably divert some trade from a non-signatory, the increase in production capacity and demand thus entailed from the liberalisation measures of a RTA could have positive spill-over effect on a non-signatory, depending on its economic relationships with the signatories and the competitive strengths of its businesses. For Hong Kong in particular, this underlines the importance of continuously sharpening the competitiveness in our various services, and actively participating in co-operation projects in the region and beyond (e.g. the Hong Kong-ASEAN Free Trade Agreement and the WTO Trade Facilitation Agreement).