

## **LEGISLATIVE COUNCIL BRIEF**

### **FREE TRADE AGREEMENT BETWEEN HONG KONG AND CHILE**

#### **INTRODUCTION**

At the meeting of the Executive Council on 28 August 2012, the Council ADVISED and the Chief Executive ORDERED that the outcome of the negotiations with Chile on a bilateral Free Trade Agreement (FTA) should be endorsed, the FTA plus the side instrument on labour should be signed, and formal notes should be exchanged with Chile on entering into negotiations on an agreement on investment.

#### **JUSTIFICATIONS**

##### **Key outcomes of the negotiations**

2. The FTA is comprehensive in scope and the commitments therein are of high quality. Some commitments go beyond those undertaken by Hong Kong and Chile under the World Trade Organization (WTO), granting more favourable market access or treatment to one another. Key outcomes of the negotiations and expected benefits to Hong Kong are summarised in paragraphs 3 to 19 below.

##### **(A) Trade in Services**

3. We have achieved a balanced outcome on trade in services, building on both sides' commitments under the WTO General Agreement on Trade in Services (GATS). Hong Kong service providers will enjoy legal certainty in market access and national treatment for a comprehensive range of services in the Chilean market under the four modes of supply<sup>1</sup>, namely cross-border supply (Mode 1), consumption abroad (Mode 2), commercial presence (Mode 3), and movement of natural persons (Mode 4). Many of these preferential arrangements go beyond those committed under the WTO (i.e. WTO-plus) by Chile.

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<sup>(1)</sup> Detailed explanations of the four modes of supply of services are provided in the **Annex**.

Some of them even go beyond Chile's offers under the on-going WTO Doha Round of negotiations (i.e. Doha-plus).

4. Chile's WTO-plus commitments in respect of Modes 1 – 3 encompass sectors where Hong Kong has traditional strengths or has potential for development. These include financial services, telecommunications services, various business services<sup>2</sup>, tourism and travel-related services, environmental services, and services related to innovation and technology. With the exception of financial services, Chile's commitments are essentially on par with its commitments under the Chile–China FTA<sup>3</sup>. Chile's commitments to Hong Kong on financial services are among the best for FTAs of a similar nature that Chile has concluded.

5. Hong Kong's commitments to Chile cover a wide variety of services, many of which are WTO-plus and in a few areas Doha-plus. These commitments address Chile's priority interests, such as in architectural services, engineering services, audiovisual services, and construction services. In respect of Mode 4, the commitments of the two sides are generally comparable and are WTO-plus. They cover the temporary entry and stay of business visitors (BV) as well as intra-corporate transferees (ICT) in a wide range of sectors.

6. Our commitments for Mode 4 by and large reflect Hong Kong's existing liberal regime on temporary entry of business persons. Similar to the commitments we made under the WTO and the FTAs with New Zealand (NZ) and the European Free Trade Association (EFTA)<sup>4</sup> States, Hong Kong will waive the economic needs test (ENT)<sup>5</sup> for entry into Hong Kong for employment in respect of ICT from Chile in specified sectors. Our commitments on ICT are confined to senior and high-skilled positions (i.e. Senior Manager and Specialist)<sup>6</sup> only.

7. Apart from market access commitments, the two sides have agreed on other general obligations to facilitate trade in services. In

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(2) For example, architectural services, integrated engineering services, computer and related services and services incidental to manufacturing.

(3) Chile's FTA with China does not cover financial services.

(4) EFTA Member States comprise Iceland, Liechtenstein, Norway and Switzerland.

(5) The test comprises the economic benefits test (i.e. whether the person can make a substantial contribution to Hong Kong's economy) and labour market test (i.e. whether the person possesses a skill, knowledge or expertise that is not readily available locally).

(6) Given that the commitments are confined to senior and high-skilled positions, we do not envisage the waiving of the economic needs test will have significant impact on Hong Kong's employment market, in particular the low-skilled sector.

particular, the rules and disciplines developed under the FTA will improve transparency of domestic regulations and ensure that they do not constitute unnecessary barriers to trade in services.

## **(B) Trade in Goods**

8. Upon the FTA entering into force, for goods originating from Hong Kong, Chile will abolish import tariffs on around 88 per cent of its tariff lines, and will phase out the tariffs on an additional 10 per cent over three years. The remaining 2 per cent, comprising, for example, cereals, sugars, articles of iron or steel, will continue to be subject to import tariff because of domestic sensitivity in Chile. On Hong Kong's part, we commit to binding our existing zero import tariff regime for all goods originating from Chile when the FTA takes effect.

9. For the purpose of Chile affording preferential tariff treatment to goods of Hong Kong origin, the two sides have formulated a set of preferential rules of origin which include certain "value-based" rules<sup>7</sup> for certain goods. These rules are among the most favourable that Chile has adopted under its FTAs with other economies. To enable Hong Kong traders to apply the rules of origin agreed in the FTA, the Secretary for Commerce and Economic Development will add the FTA to Schedule 1 of the Trade Descriptions Ordinance (TDO) (Cap. 362) by notice published in gazette.

10. The FTA includes an article on protection of geographical indication (GI). A GI is a name which identifies a product as originating in a particular territory or area, where a given quality, reputation or other characteristics of the product is essentially attributable to its geographical origin. Well-known examples of GI include "Champagne" and "Parma Ham". Hong Kong's commitments under this article are compatible with our domestic regime.

11. As regards the use of trade remedy measures<sup>8</sup>, the FTA includes disciplines additional to the relevant WTO Agreements, which will better safeguard Hong Kong's interest. As Hong Kong is not a user of trade

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<sup>(7)</sup> Under "Value-based" rules, goods may claim Hong Kong origin on the basis of the proportion (which may be different for different categories of goods) of either the value added to the goods in Hong Kong or the value of non-originating materials used in their manufacture, to the total value of the goods.

<sup>(8)</sup> Trade remedy measures refer to anti-dumping, countervailing and safeguard measures. Imposition of these measures by the importing economy could result in additional duties (being one of the usual forms) on top of tariffs and other charges or other import restrictions on certain imports.

remedy measures, the additional disciplines will not pose any problem to us.

12. Under the FTA, Hong Kong and Chile will co-operate in the areas of sanitary and phytosanitary measures<sup>9</sup> and technical barriers to trade<sup>10</sup>, with the objective of reducing trade barriers and facilitating bilateral trade as far as possible.

### **(C) Investment**

13. The FTA contains a chapter on Establishment<sup>11</sup>, which will provide investors of both sides with legal certainty on national treatment in respect of their investments in specified non-services sectors<sup>12</sup>. These commitments are WTO-plus and comparable.

14. To further enhance investment flows between Hong Kong and Chile, both sides have agreed to negotiate a separate agreement on investment. The negotiations will cover additional elements of investment promotion and protection, including but not limited to non-discrimination, minimum standard of treatment, protection from unlawful expropriation, and protection of transfers.

### **(D) Other Areas in the FTA**

15. The FTA contains provisions to promote competition, facilitate access to each other's government procurement market, enhance co-operation in customs procedures, and protect the environment. The two sides' commitments in these aspects are in line with relevant WTO Agreements. The FTA also provides for an effective, efficient and transparent process for consultations and for settlement of disputes in relation to the FTA.

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<sup>(9)</sup> Sanitary and phytosanitary measures are any measures applied: (i) to protect human or animal life from risks arising from additives, contaminants, toxins or disease-causing organisms in their food; (ii) to protect human life from plant- or animal-carried diseases; (iii) to protect animal or plant life from pests, diseases, or disease-causing organisms; and (iv) to prevent or limit other damage to a country from the entry, establishment or spread of pests.

<sup>(10)</sup> Technical barriers to trade include technical regulations, standards and conformity assessment procedures that may directly or indirectly affect trade in goods.

<sup>(11)</sup> "Establishment" refers to investments in the forms of (i) the constitution, acquisition or maintenance of a juridical person; or (ii) the creation or maintenance of a branch or a representation office, in non-services sectors, for the purpose of performing an economic activity.

<sup>(12)</sup> National treatment and other safeguards in respect of investments in services sectors are covered by the chapter on Trade in Services.

### **(E) Side Instrument on Labour**

16. Alongside but separate from the FTA, Hong Kong and Chile have concluded a Memorandum of Understanding (MOU) on Labour Co-operation. Whilst respecting each other's right to regulate and implement its own labour laws and policies, the MOU provides a formalised framework within which both sides can address labour matters of mutual interest or concern through dialogue and co-operation. The MOU also sets out the shared understanding of the two sides on not using labour laws and policies for trade protectionist purposes. The MOU will enter into force on the same date as that of the FTA.

### **Economic and Strategic Value of the FTA**

17. The FTA will help Hong Kong businesses tap the Chilean market, which offers potential opportunities as an emerging market in itself, as well as opportunities as a gateway to the South American region. In particular, the FTA will assist our service providers by providing secured market access and enhanced legal certainty of non-discrimination in Chile. The trade facilitation measures including transparency enhancing initiatives will help reduce transaction costs. Furthermore, the conclusion of the FTA will generate on the part of the Chilean business community greater interests in and a better understanding of the Hong Kong market, potentially attracting more investments from Chile to Hong Kong. The FTA will therefore enhance trade and investment flows between the two places, benefiting our economy.

18. We estimate that Chile's import tariff elimination commitments under the FTA, upon full implementation, will result in annual tariff savings for Hong Kong of about HK\$1.4 million. This is not substantial because the import tariffs currently imposed by Chile are already at a low level<sup>13</sup>, and bilateral trade between the two places is not significant at present.

19. Apart from direct economic benefits, the FTA also carries significant strategic value for Hong Kong. It will expand our free-trade network to the American region, in addition to our existing linkage with the Asia-Pacific and European regions through our FTAs with Mainland China, NZ and EFTA Member States. It will reinforce the signal to our trading partners that Hong Kong is ready to forge closer economic partnership through FTAs. This will facilitate our other bilateral and

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<sup>(13)</sup> The simple average applied tariff rate of Chile is 6 per cent in 2010.

regional FTA initiatives.

## **BASIC LAW IMPLICATIONS**

20. The proposal is in conformity with the Basic Law, including the provisions concerning human rights. Negotiations and conclusion of FTAs is within the high degree of autonomy of the Hong Kong Special Administrative Region (HKSAR) as provided for under Article 151 of the Basic Law. The Article provides, inter alia, that the HKSAR may on its own conclude and implement agreements with foreign states in the economic, trade and other appropriate fields.

## **FINANCIAL AND CIVIL SERVICE IMPLICATIONS**

21. Additional resources, if any, required for the implementation of the FTA, including that related to the relevant enforcement activities, will be absorbed by existing manpower resources of relevant bureaux/departments.

## **ECONOMIC IMPLICATIONS**

22. Signing the FTA with Chile has positive economic implications for Hong Kong as it will help foster closer economic ties between the two places. In broad terms, the FTA will provide Hong Kong with better access to the Chilean markets which may potentially serve as a gateway to the South American markets, and hence create more business opportunities beneficial to Hong Kong's long-term economic growth. It will also help strengthen Hong Kong's role as an international trade, commerce and investment centre.

## **SUSTAINABILITY IMPLICATIONS**

23. The FTA with Chile will bring more and better access to the Chilean markets, create more business opportunities for Hong Kong businessmen and increase trade and investment flows between Hong Kong and Chile. This will in turn bring benefits to other trade related sectors in the Hong Kong economy, including insurance, banking and securities and related services. All these would help to sustain the economic development of Hong Kong and reinforce Hong Kong's position as an international trade, economic and financial hub.

## **ENVIRONMENTAL IMPLICATIONS**

24. The Environment Chapter in the Agreement has positive environmental implications for Hong Kong. The Chapter seeks to enhance protection of environment through encouraging sound environmental policies and practices.

## **LEGISLATIVE IMPLICATIONS**

25. Implementation of the FTA would require legislative amendments as set out in paragraph 9 above.

## **PUBLIC CONSULTATION**

26. We conducted a public consultation exercise on the FTA negotiations between Hong Kong and Chile from December 2011 to January 2012 to help develop our negotiation positions and better gauge the local business community's areas of interest. We have sought views from major trade and industrial associations, professional bodies and the general public, and their feedback was positive.

## **PUBLICITY**

27. Details of the FTA will be made public after Hong Kong and Chile formally sign the FTA in September 2012. We will issue a press release after the signing of the FTA. A spokesperson will be available to answer media enquiries.

## **BACKGROUND**

28. In July 2009, Hong Kong and Chile completed a Joint Feasibility Study on the possibility of commencing FTA negotiations. The study concluded that the enhancement of the trade and economic relationships between Hong Kong and Chile would have a positive impact on the economic relationship between the two sides. Hong Kong and Chile commenced formal negotiations in January 2012. After three rounds of talks, the negotiations were concluded on 1 August 2012 in Hong Kong. The FTA will enter into force on a date to be mutually determined by Hong Kong and Chile.

29. Total merchandise trade between Hong Kong and Chile was HK\$7,058 million in 2011 while total service trade was HK\$950 million in 2010. On trade in goods, Chile ranked 29th<sup>14</sup> among Hong Kong's worldwide trading partners and 4th among those in Latin America in 2011. On trade in services, Chile ranked 32nd among Hong Kong's worldwide trading partners and 4th among those in Latin America in 2010.

## **ENQUIRIES**

30. For enquiries, please contact Mr Rick Chan, Assistant Director-General of Trade and Industry Department, at 2398 5309.

**Trade and Industry Department**  
**7 September 2012**

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<sup>(14)</sup> The European Union is counted as one single entity for the rankings.



## **EXPLANATIONS OF THE FOUR MODES OF SUPPLY FOR TRADE IN SERVICES**

### ***Cross Border Supply (Mode 1)***

The cross border mode of supply refers to the supply of service from the area of an FTA party into the area of the other FTA party. If Party A of an FTA makes commitment in respect of Mode 1, a service supplier of the other Party of the FTA (i.e. Party B) can supply the service within the area of Party B to service consumers in the area of Party A, without being physically present in the area of Party A. An example is the supply of service through telecommunications, fax or mail etc.

### ***Consumption Abroad (Mode 2)***

The consumption abroad mode of supply refers to the supply of service in the area of an FTA party to the service consumer of the other FTA party. If Party A of an FTA makes commitment in respect of Mode 2, a service supplier of Party B can, within the area of Party B, provide the service to consumers of Party A who are present in the area of Party B. An example is the supply of tourism services.

### ***Commercial Presence (Mode 3)***

The commercial presence mode of supply refers to the supply of a service by a service supplier of an FTA party, through commercial presence in the area of the other FTA party. If Party A of an FTA makes commitment in respect of Mode 3, a service supplier of Party B can provide the service within the area of Party A through commercial presence in the area of Party A. This covers the presence of juridical persons (e.g. corporations, joint ventures, partnership, sole proprietorship, trust, association) as well as representative offices, branches etc.

### ***Movement of Natural Person (Mode 4)***

The movement of natural person mode of supply refers to the supply of a service by a service supplier of an FTA party, through the presence of natural persons in the area of the other FTA party. If Party A of an FTA makes commitment in respect of Mode 4, service supplier of Party B can provide the service within the area of Party A through the presence of natural persons. This covers natural persons who are themselves service suppliers, as well as natural persons who are employees of service suppliers (e.g. accountants of accounting firms).