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How Far Will Hong Kong's Accession to ACFTA Impact its Trade in Goods?

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Abstract: Hong Kong proposed its possible accession to the ASEAN-China Free Trade Area (ACFTA) in November 2011. This report examines how much Hong Kong's accession to ACFTA will impact on the trade in goods between ASEAN and China. It is likely that the direct impact of Hong Kong's accession will be minimal on the trade in goods since re-exports account for 96.3% of Hong Kong's total exports, indicating that the value of Hong Kong-origin products is marginal. However stock operations using movement certificates (MCs) in Hong Kong, which cannot be carried out in non-members of ACFTA, will facilitate the trade in goods between China and ASEAN. As such stock operations are generally carried out in places located near to final destinations, Hong Kong's accession will facilitate further ASEAN exports to China.

Keywords: Free trade area (FTA); ASEAN; China; Trade facilitation; Intermediary trade

JEL Classification: F15

1. Trade structure and the comparative advantages of Hong Kong

The ASEAN-China Free Trade Area (ACFTA) came into effect in January 2004, consisting of 10 ASEAN member states and China. Hong Kong is currently not a member of ACFTA and would be the 12th member if its accession were to be accepted by the existing member states.

The purpose of enlargement of an FTA's membership is to create increased trade in goods through the custom duties elimination effect. This literally means that Hong Kong's accession to ACFTA would increase the price competitiveness of Hong Kong-origin products by a value equivalent to the tariffs eliminated in China and ASEAN.

There would be no trade creation effect on exports to Hong Kong from ASEAN and China since Hong Kong does not impose any customs duties on imported goods, on a Most Favored Nation (MFN) basis. A trade creation effect from Hong Kong to China is unlikely because customs duties on certain Hong Kong-origin products have already been eliminated under the existing Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA), which came into effect in January 2004.

On the other hand, there would be an impact on exports to ASEAN from Hong Kong arising from ASEAN's elimination of customs duties on goods manufactured in Hong Kong. This is, however, likely to be limited. While Hong Kong's total exports in 2011 amounted to US\$ 456 billion, which is more than the total exports of Thailand and Malaysia, the share of its domestic exports,¹ i.e., exports of Hong Kong-origin products, accounts for merely 3.7% (US\$ 16.8 billion), which is equivalent to the total exports of Cambodia, Lao PDR and Myanmar (see Table 1).

This shows that re-exports account for 96.3% of the total, with a value of US\$ 439 billion. Re-exports are exports of foreign-origin goods which were previously imported into Hong Kong for transshipment or breaking bulk in stock for onward shipment to other destinations. Re-exported goods are not able to meet the rules of origin under ACFTA. However, goods imported originally from ASEAN and China may meet the ACFTA rules of origin, but these goods are eligible for preferential tariffs already, even before Hong Kong joins ACFTA, as long as they do not violate the direct consignment rule.²

Hong Kong and Singapore work as hub ports in the Asian region, but their trade structures differ in terms of their shares of domestic exports. While the total exports of Singapore are almost the same as Hong Kong, its share of domestic exports is 54.7% in comparison with 3.7% in Hong Kong. The Singapore government adheres to a policy of keeping the share of its manufacturing sector at around 20% of GDP,³ and there are manufacturing centers in Singapore for major industries, such as petrochemicals, IT products and pharmaceuticals. The share of the manufacturing sector in Hong Kong's GDP was 1.7% in 2011, in comparison with 19.6% in Singapore, indicating that the Hong Kong economy mainly relies on service sectors such as wholesale/retail (25.0%), financial/insurance (16.2%), and real estate/professional business services (11.1%).

**Table 1: Value of exports between ACFTA member countries and Hong Kong
(2011)**

(Unit: US\$ million)

Exporting Countries	Total	To ASEAN	To China
Hong Kong (Total)	455,663	30,185	246,592
Hong Kong (Domestic)	16,845	1,906	9,107
China	1,899,281	169,860	-
Exporting Countries	Total	To Hong Kong	To China
ASEAN	1,046,550	52,264	121,687
Singapore (Total)	409,722	45,174	42,685
Singapore (Domestic)	224,030	20,990	22,646
Thailand	220,373	11,834	25,987
Malaysia	228,290	10,229	29,953
Philippines	48,042	3,699	6,102
Indonesia	203,497	3,215	22,941
Vietnam	92,881	2,206	11,125
Myanmar	8,315	43	1,525
Cambodia	6,517	39	168
Brunei	11,487	5	511
Lao PDR	3,120	4	729

Note: Domestic Exports of Singapore are used for the total value of ASEAN exports.

Source: Trade statistics of countries/regions, CEIC database (DOT(IMF)).

Turning to the domestic exports from Hong Kong by country and region, its value of exports to China is US\$ 9.1 billion or 3.7% of total exports, while the value of its exports to ASEAN is US\$ 1.9 billion (6.3%). In ASEAN, Singapore ranks first with US\$ 686m (9.0% of the total), followed by Thailand with US\$ 526 m (8.4%) and Vietnam with US\$ 217 m (3.6%) (see Table 2). The value of domestic exports of Hong Kong to Indonesia is US\$100 m or 3.3% of Hong Kong's total, ranked lowest among the ASEAN 6 member states.

Table 2: Domestic export ratio of Hong Kong, by county/region

(Unit: US\$ million, %)

	Total Exports	Domestic Exports	Ratio
China	246,592	9,107	3.7
ASEAN	30,185	1,906	6.3
Singapore	7,659	686	9.0
Thailand	6,224	526	8.4
Vietnam	6,002	217	3.6
Malaysia	3,808	205	5.4
Philippines	2,653	155	5.8
Indonesia	3,037	100	3.3
Cambodia	700	16	2.2
Lao PDR	29	1	3.2
Brunei	13	1	7.0
Myanmar	59	1	0.9
Total	455,663	16,845	3.7

Source: Hong Kong trade statistics.

Table 3 shows the domestic exports of Hong Kong by product to the world, China and the ASEAN countries. Hong Kong's trade in goods is mainly dominated by chemicals, IT equipment such as telecommunication equipment, machines and apparatus for the manufacture of semiconductor devices, processed food products and clothing.

Table 3: Domestic export of Hong Kong by product (2011)

(Unit: US\$ million)

	World	China	ASEAN	Singapore	Thailand	Vietnam	Malaysia	Philippines	Indonesia	Cambodia	Lao PDR	Brunei	Myanmar
General equipment	889	441	100	17	15	4	40	22	2	0	0	0	0
Air conditioner	0	0	0	0	0	0	0	0	0	0	0	0	0
Machine tools	0	0	0	0	0	0	0	0	0	0	0	0	0
Electrical equipment	955	381	111	20	18	7	50	14	2	0	0	0	0
IT equipment	1,667	700	189	31	29	10	83	34	2	0	0	0	0
Finished IT products	894	361	90	18	15	3	33	19	1	0	0	0	0
Telecommunications equipment	317	166	40	4	2	4	20	9	1	0	0	0	0
IT parts	773	339	99	13	14	7	49	15	2	0	0	0	0
Machines and apparatus for the manufacture of semiconductor devices	444	275	74	10	12	3	32	17	0	0	0	0	0
Other electric and electronic components	271	125	46	3	11	2	26	4	1	0	0	0	0
Precision instruments	159	83	10	2	0	0	2	5	1	0	0	0	0
Transport equipment	1	0	0	0	0	0	0	0	0	0	0	0	0
Passenger cars	0	0	0	0	0	0	0	0	0	0	0	0	0
Automotive parts	0	0	0	0	0	0	0	0	0	0	0	0	0
Chemicals	1,757	1,331	241	128	39	17	26	13	15	3	0	0	0
Industrial chemicals	686	397	202	126	35	6	16	7	10	2	0	0	0
Pharmaceuticals and medical supplies	323	274	20	6	2	1	5	0	4	2	0	0	0
Plastic/rubber	1,702	933	39	2	4	11	9	6	5	1	0	0	0
Foodstuffs	688	192	186	88	6	56	5	20	3	5	1	1	0
Processed food products	671	191	185	88	6	56	5	20	3	5	1	1	0
Petrochemical products	145	133	1	0	0	0	0	0	1	0	0	0	0
Textiles and Clothing	545	277	36	2	3	13	3	4	7	4	0	0	0
Textiles	8	5	1	0	0	0	0	0	0	0	0	0	0
Clothing	351	160	4	2	0	0	1	0	1	0	0	0	0
Base metal/base metal products	789	320	102	6	49	23	16	1	7	0	0	0	0
Total	16,845	9,107	1,906	686	526	217	205	155	100	16	1	1	1

Source: Hong Kong trade statistics.

Table 4 shows Revealed Comparative Advantage (RCA) in Hong Kong, China and major ASEAN countries, which roughly captures the comparative advantages of Hong Kong by industry as compared with those of ASEAN and China. It compares the years 2000 and 2011. RCA is calculated by the simple formula below, using export statistics. Hong Kong's international trade statistics are based on domestic exports.

$$RCA = (EX_{ij}/EX_j)/(EX_{iw}/EX_w) - 1$$

where EX = value of exports, i = item i, j = country j, w=world

RCA > 0 comparative advantage, RCA < 0 comparative disadvantage

Based on this formula, if RCA of item i is above 0, indicating the share of export of item i of Hong Kong as a share of total exports of Hong Kong is higher than that of item i of the world as a share of world exports, it can be taken that Hong Kong has a comparative advantage in item i, because the share of the item's export compared to the total value of exports is higher than the world average.

As shown in the table, Hong Kong has comparative advantages in processed food products and plastic and has less comparative disadvantage in clothing and IT finished products. Compared with its comparative advantages in 2000, processed food products and plastics manufactured in Hong Kong have increased their comparative advantages by 0.9 and 0.8 index points respectively. Joining an FTA will have the effect of creating trade flows from countries with higher comparative advantages to countries with lower advantages, or comparative disadvantage. However, owing to the Information Technology Agreement (ITA) under the World Trade Organization (WTO), customs duties on IT products have already been eliminated on an MFN basis in major countries.⁴ On the other hand, as processed

food products and plastics are dutiable items in most ASEAN countries and China, Hong Kong's accession to ACFTA may increase the competitiveness of Hong Kong-origin processed foods and plastics.

The number of certificates of Hong Kong Origin under CEPA, as of 31 December 2012, is shown in Table 5. Food/beverages, textiles and clothing and plastics are major products exported with preferential tariff under CEPA, accounting for 67.1% of the cumulative number of Certificates of Origin approved.

Table 4: RCA by industry in Hong Kong, China and major ASEAN Countries

(Unit : %)

	Hong Kong		Singapore		Thailand		Malaysia		Indonesia		Philippines		Vietnam		China	
	RCA (2011)	Compared with 2000	RCA (2011)	Compared with 2000	RCA (2011)	Compared with 2000	RCA (2011)	Compared with 2000	RCA (2011)	Compared with 2000	RCA (2011)	Compared with 2000	RCA (2009)	Compared with 2000	RCA (2011)	Compared with 2000
General equipment	-0.5	0.2	0.0	-1.1	0.3	0.1	-0.1	-0.6	-0.8	-0.2	-0.1	-0.5	-0.7	0.2	0.6	0.9
Air Conditioner	-1.0	-0.2	-0.9	-0.3	6.7	0.5	1.4	0.2	-1.0	-0.4	0.8	1.3	-0.8	0.1	2.0	1.3
Machine tools	-1.0	-0.1	-0.2	0.4	-0.3	0.2	-0.8	0.0	-1.0	-0.0	-1.0	-0.0	-0.8	0.0	-0.6	0.1
Electrical equipment	-0.5	-0.8	0.6	-0.5	0.1	-0.3	1.2	-0.2	-0.5	-0.2	1.0	-1.4	-0.4	0.3	0.9	0.8
IT equipment	-0.3	-0.4	0.9	-1.0	0.3	-0.3	1.5	-0.4	-0.7	-0.3	1.3	-1.3	-0.6	0.1	1.2	1.2
Finished IT products	-0.2	0.3	-0.0	-1.7	0.3	0.3	0.6	-0.5	-0.7	-0.4	0.0	-0.7	-0.6	0.4	1.8	1.6
IT parts	-0.3	-0.9	2.0	-0.2	0.4	-0.8	2.5	-0.0	-0.7	-0.2	2.7	-1.4	-0.6	-0.1	0.5	0.6
Precision instruments	-0.7	-2.2	0.0	0.3	-0.4	-0.0	-0.2	0.3	-0.9	-0.1	-0.6	0.0	-0.6	0.3	0.0	0.1
Transport equipment	-1.0	-0.0	-0.6	0.3	-0.1	0.6	-0.9	0.1	-0.8	0.2	-0.4	0.4	-0.9	0.1	-0.4	0.3
Passenger cars	-1.0	0.0	-1.0	0.0	-0.2	0.7	-1.0	0.0	-0.8	0.2	-1.0	0.0	-1.0	0.0	-0.9	0.1
Automotive parts	-1.0	-0.0	-0.8	0.2	0.0	0.8	-0.8	0.1	-0.7	0.1	1.0	1.4	-0.7	0.3	-0.5	0.3
Chemicals	-0.2	0.4	0.3	0.5	0.5	0.6	-0.0	0.4	0.0	0.3	-0.6	0.3	-0.6	0.2	-0.4	-0.0
Industrial chemicals	-0.5	0.2	0.5	0.7	-0.4	0.2	-0.4	0.2	-0.4	0.1	-0.6	0.3	-0.9	0.0	-0.4	-0.1
Pharmaceuticals and medical supplies	-0.3	0.4	-0.1	0.8	-0.9	-0.0	-1.0	-0.0	-0.9	-0.0	-1.0	0.0	-1.0	-0.0	-0.9	-0.1
Plastic/rubber	0.4	0.8	-0.1	0.2	2.4	1.4	0.7	0.7	0.9	0.8	-0.6	0.2	0.1	0.6	-0.2	-0.0
Foodstuffs	-0.4	0.4	-0.8	0.1	1.1	-0.2	-0.5	0.2	-0.2	-0.2	0.1	0.5	1.9	-1.0	-0.6	-0.4
Processed food products	0.4	0.9	-0.5	0.2	1.7	0.2	-0.2	0.4	-0.1	0.2	0.4	0.8	-0.2	0.3	-0.6	-0.3
Petrochemical products	-0.9	0.1	0.8	0.3	-0.6	0.1	-0.3	-0.0	-0.3	-0.9	-0.8	0.0	0.2	-2.0	-0.9	-0.1
Textiles and Clothing	-0.2	-7.1	-1.0	-0.1	-0.1	-0.5	-0.6	-0.1	0.5	-0.7	-0.2	-0.4	3.0	1.6	2.0	-0.3
Textiles	-0.9	-0.2	-0.9	-0.1	1.2	0.4	0.0	0.1	2.8	-0.2	-0.8	-0.1	1.4	1.7	1.6	0.8
Clothing	-0.1	-12.5	-1.0	-0.2	-0.4	-0.9	-0.8	-0.2	0.6	-0.7	0.3	-0.8	4.6	1.6	2.3	-0.9
Base metal/base metal products	-0.4	0.3	-0.8	-0.0	-0.4	-0.0	-0.3	0.3	-0.2	0.2	-0.4	0.3	-0.6	0.2	0.0	-0.1

Source: Relevant trade statistics.

Table 5: Number of certificate of Hong Kong origin under CEPA (as at 31 December 2012)

(Unit: Number, %)

Product Types	Cumulative No. of COs Approved	Share
Food and Beverages	22,863	24.7
Textiles and Clothing	21,601	23.3
Plastics and Plastic Articles	17,683	19.1
Pharmaceutical Products	10,516	11.4
Chemical Products	5,371	5.8
Base Metal Products	4,296	4.6
Colouring Matters	2,987	3.2
Paper and Printed Articles	2,858	3.1
Electrical and Electronic Products	1,535	1.7
Clocks and Watches and Parts Thereof	771	0.8
Jewelry and Precious Metals	637	0.7
Optical, Photographic and Cinematographic Instruments & Parts	432	0.5
Leather and Furskin Articles	367	0.4
Machinery and Mechanical Appliances	292	0.3
Food Residues and Animal Fodder	188	0.2
Cosmetics	151	0.2
Measuring and Checking Instruments and Parts	61	0.1
Miscellaneous	5	0.0
Medical Instruments and Massage Apparatus	4	0.0
Furniture	1	0.0
Toys and Games or Sports Requisites	1	0.0
Mineral Products	-	-
Glass and Glassware	-	-
Total	92,620	100.0

Source: Trade and Industry Department, The government of the Hong Kong Special Administration region.

2. Outward processing on commission between Hong Kong and China

Hong Kong acts as a gateway to the global market for Chinese-origin products, as products manufactured in China are exported to foreign markets through Hong Kong. It is partly supported by a unique trade relationship between Hong Kong and the southern part of China, particularly the province of Guangzhou. “Outward processing on commission” is widely carried out between Hong Kong and this area in China, under which corporations in Hong Kong provide raw materials and components without any charge, and under customs bonded arrangements, to factories located in China for assembling/processing. Processed goods are purchased back by the same corporations in Hong Kong mainly for export to global markets. Factories in China do receive commission for processing, but payments for imported materials and components are not necessarily made. Those products are likely to be exported as Hong Kong-origin products, as explained below.

Hong Kong takes advantage of the abundant labor in China by relocating manufacturing processes for labor-intensive products to China. Outward processing on commission is unique, in that the factories in China⁵ have no juridical personality, i.e., are not legal entities under Chinese law. It is believed that these products are currently imported into ASEAN countries without enjoying preferential tariffs under ACFTA, as factories without juridical personality are not eligible to apply to the Chinese government for certificates of origin for ACFTA. This is because ACFTA requires applicants to be exporters in final exporting countries,⁶ and the revised operational certification procedures for the rules of origin of ACFTA define exporters as natural or juridical persons located in the territory of a party from where a product

is exported by such a person.

Moreover, corporations in Hong Kong enjoy corporate tax concessions of 50%, with an effective rate of 8.25% in Hong Kong, on income derived from outward processing.⁷ This works as an incentive to promote this type of trade between Hong Kong and China.

There may be a concern that the accession of Hong Kong to ACFTA may increase imports of goods manufactured under outward processing on commission to ASEAN countries. However, this should not be of any concern because those products cannot meet the rules of origin under ACFTA. Rules 4⁸ and 7⁹ of the rules of origin for ACFTA require substantial alteration, such as a 40% of value added content criterion in the final exporting countries, Hong Kong in this case.

The accumulation clause is another important feature of any enlargement of ACFTA. Accumulation means that originating materials of other member states used in the production of a good in another member state shall be considered as originating materials of a member state. This would lead to increasing the number of qualified goods meeting relevant rules of origin, such as the regional value added content criterion, through the enlargement of the regional accumulation basis. However, the accumulation clause cannot be applied to goods manufactured under outward processing on commission, because rule 5¹⁰ of the rules of origin for ACFTA requires final work or processing of the finished products to have taken place in the final exporting countries. It is therefore not possible to accumulate value added in China into value added in Hong Kong when applying for a certificate of origin as Hong Kong originating goods.

Hong Kong accession to ACFTA will not therefore increase the volume of Chinese origin products exported through Hong Kong. However, since outward

processing on commission between Hong Kong and the southern part of China is a unique trade pattern, it is worth consideration by policy makers to make provisions clearer so as to exclude minimal operations and to define non-qualifying operations in relation to final work or processing.

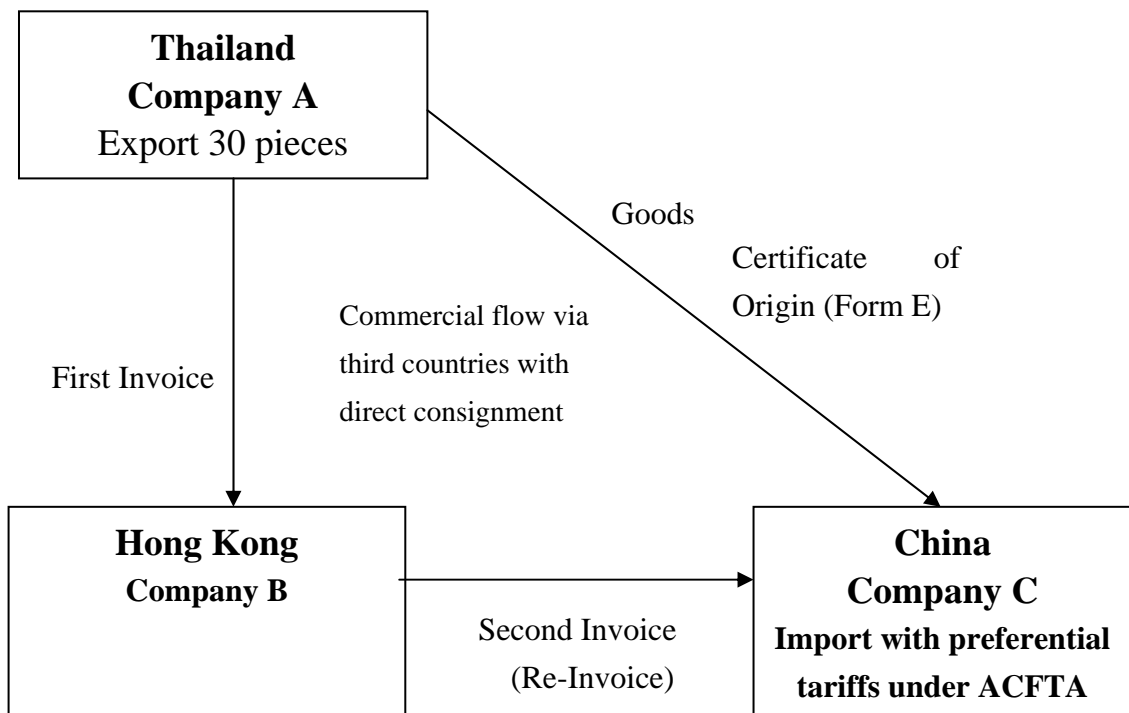
3. Possible third country invoicing through Hong Kong under ACFTA

Another important feature to be brought by Hong Kong accession to ACFTA is the intermediary trade through Hong Kong. Intermediary trade is defined as an international trade going through third countries, consisting of 1) third country invoicing (re-invoicing) and 2) stock operations utilizing movement certificates (back to back certificates). This is widely carried out in international trade in the Asia Pacific region, particularly by multinational corporations (MNCs) having regional headquarters (RHQs) in countries like Hong Kong or Singapore.

As seen in Figure 1, third country invoicing means a mode of transaction where commercial flows go through third countries, while exported goods are consigned directly between exporting member states and importing member states. Taking ACFTA for instance, it could be the case that company B in a third country like Hong Kong or Singapore purchases products manufactured/exported by company A in a member state such as Thailand and sells them to company C (the final customer) in another member state, e.g., China, while the exported goods are directly consigned from the exporting member state (Thailand) to the importing member state (China). In this case, the first invoice is issued by company A (the manufacture/exporter) in the exporting member state (Thailand) to company B in a third country (Hong Kong

or Singapore), and subsequently the second invoice is issued by company B in the third country to company C in the importing member state (China). This is called third country invoicing/re-invoicing because the second invoices are issued by corporations in third countries. As for a certificate of origin (C/O), company A applies for it to the issuing authority in the exporting member state (Thailand), and the CO is to be sent directly to company C in the importing member state (China).

Figure 1: Third country invoicing under ASEAN-China FTA



Hong Kong is currently not a member of ACFTA, but third country invoicing going through corporations in Hong Kong must be accepted by customs authorities of the ACFTA member states. This is because the agreement¹¹ states that “the customs authority of the importing party shall accept a certificate of origin (Form E) in cases where the sales invoice is issued either by a company located in a third country or by an ACFTA exporter for the account of the said company”, indicating

clearly that third country invoicing via non-members is accepted by importing member states. FTAs recently concluded in the Asia Pacific region generally incorporate the same or similar clauses in their agreements.

However, third country invoicing had not been acceptable in some member states up to the end of 2010. It was one of the serious issues for ACFTA users that some member states refused to apply preferential ACFTA tariffs when using third country invoicing, and there were actually some cases where firms gave up utilizing ACFTA because the benefit of preferential tariffs was smaller than costs of altering existing commercial flows. The ACFTA did not clearly state whether it would accept third country invoicing, and thus its acceptance used to depend on interpretations of the agreement by each customs authority. After the revised operation certification procedures (OCP) involving the above-mentioned article reached an agreement in October 2010 and came into effect in January 2011, third country invoicing has been accepted by all member states.¹²

The reason why MNCs utilize third county invoicing is that they seek to maximize the financial efficiencies of group companies through concentrating commercial flows of not only bilateral transactions but also transactions between third countries. One of the frequent functions in attaining financial efficiencies is to control foreign exchange risks generated from international trade transactions. For instance, corporations in third countries, such as those with RHQs in Hong Kong or Singapore, undertake foreign exchange risks by purchasing products in local currencies from their affiliated corporations and selling them to customers in US dollars, hedging their risks by purchasing future contracts. Another important function is 'netting' which leads to saving costs on remittances and foreign exchange transactions through reducing the total volume of transactions by means of

countervailing credits and liabilities between corporations. The simplest netting is made bilaterally between two corporations, but there is also multilateral netting which is carried out between more than three corporations. Furthermore, cash flows of group companies can also be improved by means of making payments of accounts receivable to group companies in the short term while RHQs take risks in inventories or sell products to customers with longer term payment terms.

In this regard, since third country invoicing going through non-members, including Hong Kong, may currently be carried out under ACFTA, Hong Kong's accession to ACFTA is not likely to create any additional impacts on commercial flows.

4. Stock operations utilizing MCs in Hong Kong will become possible

Stock operations utilizing movement certificates (MCs) may not currently be carried out in Hong Kong. This is a mode of transaction whereby consignments of exported goods and commercial flows pass through third countries.

It should be noted that this is different from transshipment of containers/goods at ports in third countries, which is consistent with the direct consignment clause. Goods are considered under ACFTA as being consigned directly from exporting member states to importing member states, as long as 1) the products have been kept in a customs bonded area in the third country, and 2) the products have not undergone any operation other than unloading and reloading or any operation required to keep them in good condition.

A stock operation, on the other hand, is a mode of transaction in which goods manufactured in exporting member states are held in stock at warehouses in third countries and part of the stock is re-exported to final importing member states or distributed to the domestic market of the third country. Forwarding part of a stock out of goods imported from the first exporting member state violates the direct consignment clause of ACFTA, making the first certificate of origin, issued by the authorities in the first exporting member state, invalid. Hence in order to apply preferential tariffs at the importing member states under ACFTA, it is required that exporters acquire a second certificate of origin from the authorities in the third country (an intermediate exporting member state), based on the first original certificate of origin (Form E) issued by the first exporting member state.

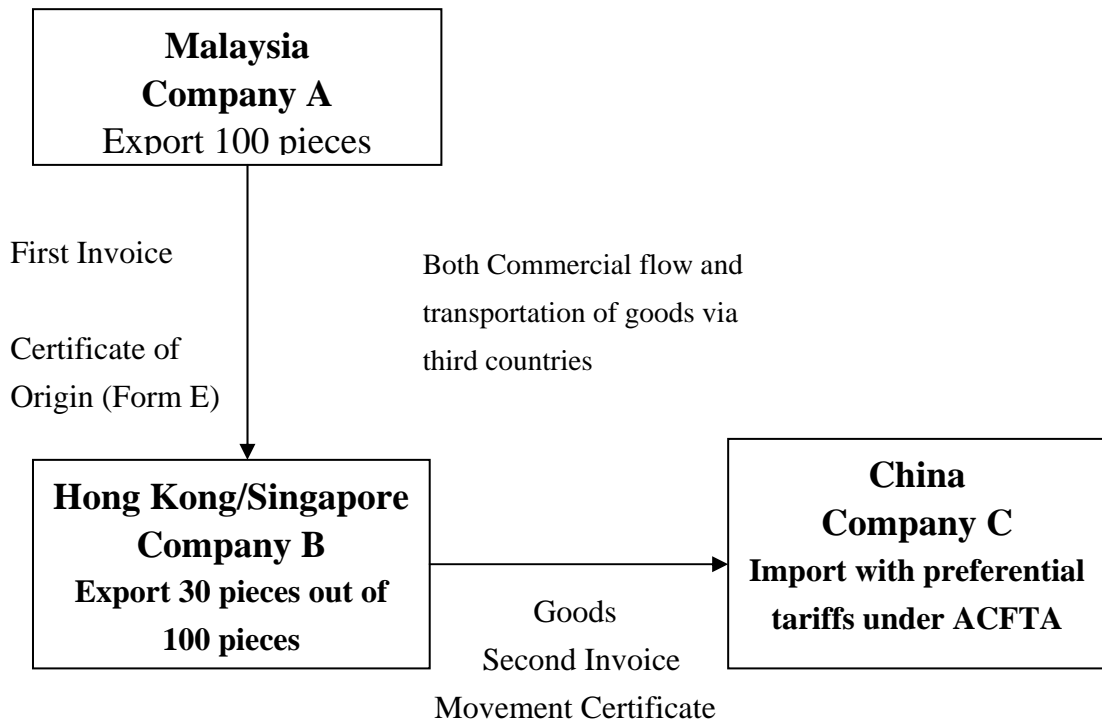
For instance, as seen in Figure 2, 100 pieces of a product exported on a certain day by company A in the first exporting member state (Malaysia) are kept in stock at bonded warehouses in Hong Kong or Singapore, with final purchases yet to be fixed. At this stage, the first certificate of origin issued by the relevant authority in the first exporting member state (Malaysia) is sent to company B in the third country (Hong Kong/Singapore) by company A, together with the first invoice. Since Company C in China, the final purchaser, places an order for 30 pieces of the product with company B, after, say, one month, company B re-exports them into China with a second certificate of origin issued by the relevant authority in Hong Kong or Singapore and with the second invoice issued by company B. The second certificate of origin is called a Movement Certificate under ACFTA, although other major FTAs in the Asia Pacific region call it a 'Back to Back' certificate of origin.

However, this operation cannot currently be carried out in Hong Kong, because the Hong Kong government, a non-member of ACTFA, is not eligible to issue

movement certificates under ACFTA. Rule 12 of the revised operational certification procedures (OCP) for the rules of origin of the ASEAN-China free trade area states that “the issuing authorities of the intermediate party within the ACFTA may issue a movement certificate (MC), if an application is made by the exporter while the product is passing through the territory”, indicating that MC can be issued only by intermediating member states of ACFTA. Thus the operation seen in Figure 2 can be carried out only if company B is located in either one of the ASEAN countries.

Singapore currently has an advantage in terms of stock operations utilizing FTAs, compared with Hong Kong. Since Singapore is a member state of ACFTA as well as other major FTAs such as AFTA and other ASEAN+1 FTAs, and has highly efficient port infrastructure, MNCs use Singapore as a hub port and a base for stock operations. Unlike the third country invoicing situation, stock operations using MCs in Hong Kong will be something new for FTA users to benefit from after Hong Kong accedes to ACFTA.

Figure 2: Movement certificate under ASEAN-China FTA



What are the aims of stock operations for exporters? In addition to attaining financial efficiencies through third country invoicing as mentioned earlier, it is of great importance to deliver goods to customers in the shortest possible period of time. In other words, the significant advantage of stock operations is that they lead to reduced lead times to customers from manufactures/exporters. By keeping inventories at the most convenient place, instead of in the countries in which products are manufactured, goods can reach to customers in an effective manner. For instance, it will take, approximately, a week or more from Tanjung Priok port in Jakarta to Guangzhou in China by ship, while it will take a day from Hong Kong to Guangzhou by truck.

According to interviews with some logistics firms in Singapore, stock operations generally take place where the stock is located near to its final destination. In this

regard, making stock operations possible in Hong Kong will tend to facilitate trade in goods to China rather than to ASEAN, from China. For those intending to streamline logistics in China, Singapore may not be the ideal place for stock operations as it may be better suited to streamlining logistics in the direction of Indonesia or Malaysia. Therefore, Hong Kong's accession to ACFTA may facilitate ASEAN's exports to China rather than China's exports to ASEAN.

Turning to the value of re-exports from Hong Kong and Singapore, as seen in Table 6, the value of re-exports from Singapore to China is US\$ 20 billion, accounting for 10.8% of the total re-exports of Singapore (US\$ 186 billion), while the value of re-exports from Hong Kong to China is US\$ 237 billion, accounting for 54.1% of the total re-exports of Hong Kong (US\$ 439 billion).¹³ In the same way, Singapore works as a base for re-exports to ASEAN countries, as its value of re-exports to ASEAN is US\$ 70 billion (37.8% of the total re-exports of Singapore) compared with US\$ 28 billion (6.4% of the total re-exports of Hong Kong). In particular, for re-exports to Indonesia and Malaysia which are neighboring countries of Singapore, Singapore's values and shares are much larger than those of Hong Kong. This indicates that stock operations tend to be carried out at places which are located not far from the area of final destination.

Table 6: Re-exports of Hong Kong and Singapore (2011)

(Unit: US\$ million, %)

		Total	China	Hong Kong	ASEAN	Singapore	Thailand	Vietnam	Malaysia	Philippines	Indonesia	Cambodia	Myanmar	Lao PDR	Brunei
From Hong Kong	Re-export	438,818	237,485 (134,786)	-	28,278	6,973	5,698	5,785	3,603	2,498	2,937	684	58	29	12
	Share	100.0	54.1	-	6.4	1.6	1.3	1.3	0.8	0.6	0.7	0.2	0.0	0.0	0.0
From Singapore	Re-export	185,693	20,039	24,184	70,219	-	7,641	5,876	24,784	3,357	26,765	462	677	29	628
	Share	100.0	10.8	13.0	37.8	-	4.1	3.2	13.3	1.8	14.4	0.2	0.4	0.0	0.3

Hong Kong's export to China; in parentheses is the data of Hong Kong's re-exports to China excluding Chinese origin products.

Source: Hong Kong and Singapore trade statistics.

However, there is an exception for products transported by air. In this case the lead time to final customers is hardly affected by distances between warehouses and final customers. Popular items transported by air include IT parts such as semiconductors, and diminutive medical appliances. Stock operations for these products can be carried out intensively at fewer places.

What kinds of products are likely to utilize stock operation in FTAs? There are no statistics correctly representing international trade using stock operations.¹⁴ According to interviews with trading and logistics firms in Singapore, products which tend to have a necessity for stock operation are bulky items, and materials used in supply chain networks. One of the typical items is chemicals. As chemicals are bulky, they need to be transported by ship, requiring longer lead times, while customers tend to purchase goods with short lead time.

In addition, there are other major ports in China such as Shanghai and Shenzhen which can work as hubs for stock operations using FTAs. There are also options for firms to choose other ports in China hubs for stock operation. However there are cases where preferential tariffs under ACFTA are not applied when part of a stockholding is imported to the domestic market from bonded warehouses in China. If this application of the rules continues in China,¹⁵ it will give more incentives for MNCs to use Hong Kong as a hub for stock operations using FTAs, after Hong Kong's accession to ACFTA.

5. Conclusion

Hong Kong's accession to ACFTA will be of minimal impact on trade in goods, as the value of Hong Kong's domestic exports is marginal. The provisions stipulating rules of origin under ACFTA will prevent Chinese-origin products from enjoying preferential tariffs as Hong Kong-origin products. On the other hand, stock operations using movement certificates in Hong Kong will facilitate trade in goods between China and ASEAN, particularly ASEAN's exports to China. As stock operations tend to be carried out near to the final destination of the goods, Hong Kong's accession to ACFTA may strengthen the role of Hong Kong as a distribution hub for ASEAN exports into China.

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ENDNOTES

¹ According to “Hong Kong Merchandise Trade Statistics Domestic Exports and Re-exports”, domestic exports are defined as “the natural produce of Hong Kong or the products of a manufacturing process in Hong Kong which has changed permanently the shape, nature, form or utility of the basic materials used in manufacture. Processes such as simple diluting, packing, bottling, drying, simple assembling, sorting, decorating, etc., do not confer Hong Kong origin”.

² It is stipulated by Rule 8 of Annex 3, Rules of Origin for the ACFTA under ACFTA.

³ Report of the Economic Strategies Committee (ESC) published by the Government of Singapore in February 2010 states that “the ESC recommends the following: retain a globally competitive manufacturing sector at between 20 to 25 percent of the economy”. (see the website of Ministry of Finance, Singapore at:

<http://app.mof.gov.sg/data/cmsresource/ESC%20Report/ESC%20Full%20Report.pdf>)

⁴ Of the ACFTA member states, China, Thailand, Malaysia, Indonesia, Philippines, Vietnam, Singapore are signatories of the ITA.

⁵ The Chinese government is trying to apply the policy to make those factories have juridical personality.

⁶ The Rule 5 (Applications) of the revised operational certification procedures for the rules of origin of ACFTA stipulates that “the exporter and/or the manufacturer of the products qualified for preferential treatment shall apply in writing to the Issuing Authorities requesting for the pre-exportation verification of the origin of the products”.

⁷ Hashimoto (2006), Ito (2010).

⁸ Rule 4 (not wholly produced or obtained) of the rules of origin for the ACFTA says that “(a) for the purposes of Rule 2(b), a product shall be deemed to be originating if (i) not less than 40% of its content originates from any party; or (ii) the total value of the materials, parts or produce originating from outside of the territory of a Party (i.e. non-ACFTA) does not exceed 60% of the FOB value of the product so produced or obtained provided that the final process of the manufacture is performed within the territory of the Party”.

⁹ Rule 7 (Minimal Operations and Processes) of rules of origin for the ACFTA says that operations or processes undertaken, by themselves or in combination with each other, for the purposes listed below, are considered to be minimal and shall not be taken into account in

determining whether a good has been wholly obtained in one country:

(a) ensuring preservation of goods in good condition for the purposes of transport or storage; (b) facilitating shipment or transportation; (c) packaging or presenting goods for sale.

¹⁰ Rule 5 (Cumulative Rule of Origin) says that “Unless otherwise provided for, products which comply with origin requirements provided for in Rule 2 and which are used in the territory of a party as materials for a finished product eligible for preferential treatment under the Agreement shall be considered as products originating in the territory of the party where working or processing of the finished product has taken place provided that the aggregate ACFTA content (i.e. full cumulation, applicable among all Parties) on the final product is not less than 40%”.

¹¹ See rule 23 of the revised operations certification procedures (OCP) for the rules of origin of the ASEAN-China free trade area.

¹² Precisely speaking, the revised agreement was ratified by member states in stages after completing their domestic ratification procedures. All member states have now ratified the revised OCP.

¹³ The value of re-exports of Hong Kong to China includes re-exports of Chinese origin products, e.g. trade between Guangzhou and Shanghai via Hong Kong, which reached 103 billion US dollars. The total value of re-exports to China is US\$ 135 billion, if it is regarded as domestic trade and excluded from the total value of re-exports to China.

¹⁴ Re-exports shall correlate it but include not only international trade using stock operation but transshipments of goods.

¹⁵ It is not clear that all of ports apply the same application of the rule. Some ports might have different applications.

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