

## Australia – Hong Kong FTA not a secondary priority

As late as May last year, the Australian government was bluntly ignoring requests from the government of Hong Kong's requests to explore possibilities of a free trade agreement (FTA) and dual taxation agreement (DTA) between the two regions. Since taking the reins of a new government, Tony Abbott has been enthusiastically flagging an FTA with the People's Republic of China as a key foreign policy initiative. There is little guidance, however, as to whether these talks will take place alongside similar negotiations with Hong Kong. There is a strong case for ensuring that they do.

Australia and Hong Kong share deep economic and cultural connections. There are 90 000 Australian citizens in Hong Kong,<sup>1</sup> and 88 500 Hong Kong-born people living in Australia.<sup>2</sup> A more telling statistic is the fact that there are 252 000 Cantonese speakers in Australia, accounting for subsequent generations with a potential cultural connection to Hong Kong and nearby provinces.<sup>3</sup> A not-dissimilar legal system descended from British roots, and shared economic values further cement the strength of relations between the two. Both regions value liberalised trade and economic freedom, and seek to position themselves as world leaders in international trade policy.

Why are these agreements necessary?

Some variables suggest that the SAR ought to be a higher priority than the mainland. Investment flows between Australia and Hong Kong are massive but tend to be combined into a single figure with mainland investment. Investment flows between Australia and Hong Kong are actually two-thirds larger<sup>4</sup> than that with China (excluding the SARs) and many Chinese firms conduct trade with Australia through Hong Kong subsidiaries to take advantage of better trade conditions. Hong Kong is our sixth-largest source of inbound investment, and maintaining this relationship is crucial to future growth. Merchandise and services trade with Hong Kong contains significant opportunities for Australian businesses, and should not be taken lightly.

Dual taxation agreements prevent the double recovery of taxation revenue for entities operating in foreign jurisdictions and are regarded as an important addition to most FTAs. Hong Kong has expressed interest in negotiating both an FTA and DTA.

Free trade agreements enable and safeguard international trade. They mitigate the avoidable risk that arises from differences in jurisdiction, and encourages local businesses to look overseas for new opportunities. DFAT recognises the emphatic success of free trade agreements, citing "greater certainty for Australian service suppliers and investors, including through certain legal protections for investment" and the provision of "a platform for ongoing economic engagement with [other signatories] through a range of built-in agendas, economic

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<sup>1</sup> Callick, Rowan. 'Hong Kong snubbed on FTA and tax deals', *The Australian*, Sydney, May 30 2012

<sup>2</sup> 2009 Census Data, from Australian Consulate-General, Hong Kong, China.

<sup>3</sup> Australian Bureau of Statistics, 2011

<sup>4</sup> Representative from "Invest Hong Kong for Australia and New Zealand," quoted in Callick, Rowan. 'Hong Kong snubbed on FTA and tax deals', *The Australian*, Sydney, May 30 2012

cooperation projects and business outreach activities” as key results of the ASEAN-Australia-New Zealand Free Trade Agreement.<sup>5</sup>

The presence of the *Hǎiwài Huárén* or the Chinese diaspora in Australia further reinforces the case for liberalised trade with both China and Hong Kong. Reportedly a feature of the New Zealand experience, a critical mass of foreign-born citizens above a certain income level is said to foster trade connections with their home country.

Australia is signatory to seven bilateral free trade agreements, covering important trade partners such as the United States, Singapore and most recently South Korea. As the only multilateral agreement, the ASEAN-Australia-New Zealand pact bucks the trend, and represents \$112.9 billion of Australian trade alone.<sup>6</sup>

The ASEAN-Australia-New Zealand exception aside, the world is heading in the direction of bilaterally negotiated free trade agreements rather than free trade zones, as governments increasingly recognise the hidden costs of protectionism. While debating the costs implementing of each individual free trade agreement, policymakers must acknowledge the alternative – being left behind as second-priority trade partner. Australia’s economy must already overcome geographical distance, high taxation and an expensive labour force to promote its goods and services overseas. As regional competition intensifies with growth and further trade liberalisation, it would be foolish not to seek out potential areas of improvement.

Why is there reluctance on the Australian side?

As sovereign wealth funds and other sources of foreign capital diversify into wider interests and multinationals begin to wield more influence than nation-states, questions about the appropriate level of foreign control of domestic commerce arise. Australians have little to fear while they retain full control over a robust domestic legal system that is not undermined by the graft that plagues some of our trading partners. Liberalised trade does not bring the same risks as less restrictive foreign investment regimes, and should not be treated as such.

Legitimate concerns about the undermining of sovereignty aside, the electorate may fear risks flowing from foreign-owned companies operating in Australia. Though this argument might find less traction among economists, it nonetheless must find its way into the political calculus for leaders of Australian government. In liberalising trade, the market influence of Chinese firms operating in Australia increases. Attaining the benefits of such an agreement would require Australian voters will have to overcome any lingering distaste for Chinese owned firms, and the goods and services they provide.

The composition Hong Kong economy means that Australia could see greater opportunities through access to services than it will lose through competition. For the most part, protectionist sentiment is rapidly disappearing from political rhetoric. A key justification for

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<sup>5</sup> Australian Government, Department of Foreign Affairs and Trade, ASEAN-Australia-New Zealand Free Trade Agreement – Snapshot [<http://www.dfat.gov.au/fta/aanzfta/>] accessed October 8

<sup>6</sup> Australian Government, Department of Foreign Affairs and Trade, ASEAN-Australia-New Zealand Free Trade Agreement – Snapshot [<http://www.dfat.gov.au/fta/aanzfta/>] accessed October 8

the Hong Kong – New Zealand FTA was increased certainty “of access to Hong Kong’s services market, [ensuring] that New Zealand services providers will benefit from future liberalisation by Hong Kong in particular sectors”. What previously might have been viewed as adversarial competition was acknowledged to be a source of opportunity. The New Zealand government noted that its FTAs with other nations meant that domestic industries were becoming increasingly able to deal with foreign competition anyway. As with any FTA, both states parties to an Australia – Hong Kong FTA would necessarily lose trade excise as a source of income but stand to gain from increased economic activity. Modelling from 2005 suggests that Australia could see over \$1 billion added to domestic GDP figures from an Australia – China FTA.<sup>7</sup> Hong Kong’s role as a gateway to the region, alongside its commercial hub more generally, indicate that significant growth gains would make reform worthwhile.

Depending on the content of any FTA, such an agreement could mean that Australian businesses are more vulnerable to international law suits. International dispute settlement mechanisms are important features of the legal environment in many trade-friendly jurisdictions, though Australian governments have displayed varying degrees of hesitation when considering them.<sup>8</sup> Allowing the legitimate recovery of losses incurred is a necessary aspect of maturing to a global economy and increases commercial certainty.<sup>9</sup>

Finally, there is the chance that any gains will undershoot expected levels. Though lower-than-anticipated returns do not necessarily mitigate the benefits of trade liberalisation, policymakers should be cautious with forecasts. The Hong Kong – China FTA (Closer Economic Partnership Agreement or ‘Cepa’) is one such agreement that did not provide benefits to the extent anticipated when it was signed.<sup>10</sup>

## Implementation

Economic concerns have not necessarily been the driver behind the signing of FTAs across the Pacific Rim.<sup>11</sup> Alongside the growth and trade benefits, nations have signed preferential FTAs to galvanise strategic relationships. The link between increased trade liberalisation, deeper economic linkages and the reduction of the possibility of war is well-explored.<sup>12</sup> It is unlikely that relations with Hong Kong (given its status as a Special Administrative Region) could create the same strategic benefits and tensions as negotiations with larger Asian neighbours. The shadow of the proposed China – Australia FTA, particularly in an

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<sup>7</sup> Adams, Philip, et al. *Modelling the Potential Benefits of an Australia-China Free Trade Agreement*. Canberra: Department of Foreign Affairs and Trade, 2005.

<sup>8</sup> See Secombe, Mike. *Abbott Open for Business and Multinational Lawsuits*, The Global Mail, Sydney, May 20 2013

<sup>9</sup> Secombe, Mike. *Abbott Open for Business and Multinational Lawsuits*, The Global Mail, Sydney, May 20 2013

<sup>10</sup> Cheung, Gary. *Beijing fails to win hearts and minds of Hongkongers with Cepa trade pact*, South China Morning Post, Hong Kong, July 5 2013

<sup>11</sup> Capling, Ann. "Preferential trade agreements as instruments of foreign policy: an Australia–Japan free trade agreement and its implications for the Asia Pacific region." *The Pacific Review* 21.1 (2008): 27-43.

<sup>12</sup> Taylor, Brendan and Luckham, Bruce. “Economics and security”. In *Strategy and Security in the Asia-Pacific*, Edited by Ayson, Robert and Ball, Desmond. 131–51. Sydney: Allen & Unwin, 2006.

environment of increased trade liberalisation, is likely to negate any perceived security risks flowing from a Hong Kong agreement.

### The New Zealand Experience

The strongest assurance of success of a proposed agreement is the result of the Hong Kong – New Zealand agreement. Journalists note the economic benefit that has flowed to New Zealand following the conclusion of the agreement, and highlight the benefits of the agreement working in tandem with agreements with the Mainland and Taiwan.<sup>13</sup> Cross-border trade has not only increased, but accelerated, and continues to grow. The Hong Kong, China–New Zealand Closer Economic Partnership Agreement entered into force on 1 January 2011<sup>14</sup> and was said to complement the bilateral agreements already signed by New Zealand and Hong Kong with the Mainland.<sup>15</sup>

The average annual growth rate in bilateral trade between Hong Kong and New Zealand was 4% in the five years up to 2012. Bilateral trade volume by increased by 7% in 2012, an indication of the effectiveness of this form of co-operation. There is nothing to suggest that Australia would not experience every benefit that unshackled trade with Hong Kong brought to New Zealand.

### Conclusion

The new Australian government has many priorities. As impressive and ambitious statements are made about the prospect of an Australia – China FTA, Hong Kong should not be relegated to an afterthought.

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<sup>13</sup> Fallow, Brian. *When the Chinese trade wall came down*, The New Zealand Herald, Auckland, October 4 2013

<sup>14</sup> Hong Kong Economic and Trade Office, Sydney. *Hong Kong-New Zealand Trade Relations*, Government of Hong Kong Special Administrative Region [<http://www.hketosydney.gov.hk/hknztraderel.php> accessed October 8 2013]

<sup>15</sup> Ministry of Foreign Affairs and Trade. *New Zealand – Hong Kong – China Closer Economic Partnership – National Interest Analysis*. Government of New Zealand, Auckland, 2010. [<http://www.mfat.govt.nz/downloads/trade-agreement/hongkong/hk-cep-nia.pdf> accessed October 8 2013]