

HONG KONG

TRADE SUMMARY

The U.S. trade surplus with Hong Kong was \$3.3 billion in 2002, a decrease of \$1.1 billion from 2001. U.S. goods exports in 2002 were \$12.6 billion, down 10.1 percent from the previous year. Corresponding U.S. imports from Hong Kong were \$9.3 billion, down 3.3 percent. Hong Kong is currently the 14th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Hong Kong were \$3.4 billion in 2001 (latest data available), and U.S. imports were \$3.7 billion. Sales of services in Hong Kong by majority U.S.-owned affiliates were \$9.3 billion in 2000 (latest data available), while sales of services in the United States by majority Hong Kong-owned firms were \$1.3 billion.

The stock of U.S. foreign direct investment (FDI) in Hong Kong in 2001 was \$29.4 billion, up from \$26.6 billion in 2000. U.S. FDI in Hong Kong is concentrated largely in finance, wholesale and manufacturing sectors.

Under the terms by which Hong Kong became a Special Administrative Region (SAR) of the People's Republic of China in 1997, Hong Kong retains a high degree of autonomy in all areas except foreign affairs and defense. As a separate customs territory with autonomy in the conduct of its economic, trade, and financial policies, Hong Kong retains independent membership in economic organizations such as the World Trade Organization and Asia-Pacific Economic Cooperation.

Hong Kong's economy strengthened moderately in the second and third quarters of 2002, after receding in the previous three quarters. Consumer demand has been undermined by falling asset prices and uncertainty over employment. The unemployment rate hit a record high of 7.8 percent in July 2002 and stood at 7.1 percent in November 2002. Hong Kong has suffered from deflation for the past four years. In November 2002, the Hong Kong Government announced measures aimed at stopping the decline in property prices. These measures included the halting of land auctions and government property sales. Hong Kong registered a full year real growth rate of 2.0 percent for 2002. Hong Kong recorded a fiscal

deficit of \$8.4 billion (approximately 6 percent of GDP) for the 2001-2002 fiscal year. The deficit for 2002-2003 is likely to be higher. The Hong Kong Government is considering a range of measures to reduce the budget shortfall, including cutting expenditures, raising taxes, and stimulating economic growth.

Hong Kong faces the need to restructure its high-cost, service-based economy while also addressing growing competition in the years ahead to its traditional role of *entrepot* to the Chinese mainland. Despite these challenges and the recent slowdown, Hong Kong enjoys a number of long-term economic advantages, including a large market and base of production in the Chinese mainland, massive fiscal and foreign exchange reserves, virtually no public debt, a strong legal and banking system, and a rigorously-enforced anti-corruption regime. In addition, Hong Kong is well-positioned to continue to benefit from growth in trade as a result of China's WTO accession.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Hong Kong continues to make good progress in IPR protection. Hong Kong's judicial system supports enforcement efforts by sentencing those convicted of IPR violations with jail time. Further, Hong Kong has sustained efforts to combat Internet piracy and to educate its public about the negative repercussions of all types of piracy.

Despite strong IPR legislation and sustained enforcement efforts, the U.S. Government continues to monitor the IPR situation in Hong Kong to ensure that such efforts are not weakened. The unauthorized copying of computer programs, movies, music, television programs, and music remains illegal; but in June 2001, the Legislative Council (LegCo) suspended the criminal provision for unauthorized copying of publications. The Hong Kong Government prepared a bill in late 2002 for consideration by the LegCo in early 2003 to refine the "fair use" rules for copyright publications and to create new provisions to crack down on illicit copy shops. An amendment before LegCo will liberalize the parallel import of computer software, while maintaining criminal penalties for the parallel importation of "entertainment" copyrighted products like movies and music. U.S. industry

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has expressed some concern about the adequacy of new legislation and continues to push for even stronger enforcement.

Sale of pirated discs at retail shopping arcades has decreased but remains a problem. The United States has urged the Hong Kong Government at senior levels to crack down on this retail trade and related distributors and manufacturers of illegal product. Hong Kong has responded by conducting more aggressive raids at the retail level and engaging in public education efforts to encourage respect for intellectual property rights. In the first nine months of 2002, there were 1,099 piracy-related arrests. The judiciary has also increased sentences and fines for copyright piracy, handing down 1,434 copyright and trade convictions in the first nine months of 2002, the majority of which brought prison sentences of six to twelve months. Hong Kong Customs intelligence operations and raids on underground production facilities have shut down most pirate manufacturing and have forced retailers to rely increasingly on smuggled products. Optical disc pirates have switched to computers or CD-burners to produce illicit copies.

Despite Hong Kong's efforts, the software industry estimated that their total losses increased from \$86.2 million to \$164 million in 2001 (latest data available). However, Hong Kong's IPR enforcement effort has helped reduce estimated losses to U.S. film and music companies. While pirated U.S. film and music remain prevalent, legitimate distributors report increasing levels of legitimate sales in Hong Kong.

The prevalence of IPR counterfeiting and piracy elsewhere in the region makes Hong Kong vulnerable to a resurgence if Customs' enforcement effort is relaxed. Handbags and apparel are top targets for counterfeiting for the retail market. U.S. officials have encouraged Hong Kong authorities to sustain the pace of street-level enforcement and to ensure that Hong Kong's very large optical disc production capacity is used only for legitimate products.

U.S. companies are concerned that approvals of generic pharmaceutical products by the Hong Kong Department of Health may infringe upon existing patents. In addition, the industry believes that certain pirated pharmaceuticals enter Hong Kong and then are repackaged as

legitimate products for sale.

SERVICES BARRIERS

Hong Kong completed its liberalization of the local fixed telecommunications network services (FTNS) market on January 1, 2003. Some U.S. companies are considering applying for full fixed licenses, but remain concerned about how interaction with the incumbent carriers will be regulated. There will be no pre-set limit on the number of licenses to be issued and there is no time limit for license applications.

In May 2002, the Hong Kong Monetary Authority replaced a requirement for foreign banks to have a minimum of \$16 billion in assets with a requirement that foreign banks maintain at least \$513 million in assets and \$385 million in deposits. With this change, the same entry criteria are applied to foreign banks and locally incorporated banks.

An October 2002 Civil Aviation Agreement between the Hong Kong and U.S. Governments significantly expands opportunities for U.S. carriers. The agreement allows deeper cooperative relationships between U.S. and Hong Kong carriers (codesharing) and also increases the ability of U.S. carriers to operate cargo and passenger services between Hong Kong and third countries, though some restrictions on frequencies and routes for these services remain.

Foreign lawyers may not practice Hong Kong law, but Hong Kong solicitors of associated firms or branch offices converted into a local firm may practice Hong Kong law. The number of registered foreign lawyers may not exceed the number of Hong Kong solicitors in an associated or local firm; only Hong Kong solicitors may be partners of a local firm, and at least one partner of a local firm must be a partner in the foreign firm.

ELECTRONIC COMMERCE

Hong Kong continues to place great importance on its role as an information technology and electronic commerce hub. In July 2002, the LegCo passed a bill to enable carriers to use Electronic Data Interchange in submitting cargo manifests to the Hong Kong Government. This will improve efficiency and promote the development of electronic commerce. Hong

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Kong also is encouraging software and content developers to use Hong Kong as a base for regional operations and is investing heavily in technology parks.

OTHER BARRIERS

Pharmaceuticals

U.S. industry has expressed concerns about lengthy approval procedures for new pharmaceuticals, which shorten the effective patent life of new products by six months. In addition, the U.S. industry is concerned with non-transparency in the Hong Kong Hospital Authority's approval process for new drugs. These cumbersome procedures also inhibit patent owners' ability to market their products on a timely basis.