



# China-US Trade Disputes (XXXIV)

FUNG BUSINESS INTELLIGENCE

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## China-US tensions heighten over national security legislation for Hong Kong

### **Key takeaways**

- *Responding to China's passage of a new national security law imposed on Hong Kong, the US has announced punitive measures against China, including visa restrictions on Chinese officials and ending 'controlled' defense exports to Hong Kong.*
- *In our view, the impact of the ban on sensitive exports to Hong Kong seems to be limited in scope. With the China-US tech war looming over the past two years, the US is likely to have controlled technology transfer and restricted technology exports to Hong Kong well before the ban was officially announced on 29 June.*
- *It is possible that the US uses provisions under the Hong Kong Human Rights and Democracy Act of 2019 to impose further actions/sanctions on Hong Kong, including termination of separate treatment of visa applications by Hong Kong residents and Mainland Chinese residents, and cessation on the recognition of Hong Kong as a separate customs territory.*

### **US criticism over national security legislation for Hong Kong**

The National People's Congress, China's top legislature, approved on 28 May a plan to draft a new national security law to be imposed on Hong Kong, which would ban any acts or activities that endanger China's national security, including separatism, subversion, terrorism and collusion with foreign forces. Since then, the US has repeatedly condemned the move as 'eroding Hong Kong's autonomy' and threatened to impose punitive measures against China. The law was subsequently passed on 30 June.

### [Visa restrictions on Chinese officials](#)

US Secretary of State Mike Pompeo announced last Friday (26 June) that the US would impose visa restrictions on current and former Chinese officials who are believed to be responsible for ‘undermining Hong Kong’s high degree of autonomy’, although he did not name any officials. The move followed Donald Trump’s earlier announcement to sanction Chinese and Hong Kong officials involved in ‘eroding Hong Kong’s autonomy’, and the passage of the *Hong Kong Autonomy Act* in the US Senate last Thursday (which still needs to be passed by the House, and we believe it will be passed).

Responding to the move, the Chinese embassy in the US said that China firmly opposes the US wrongful decision to impose visa restrictions on Chinese officials over Hong Kong-related issues, and urged the US to stop interfering in China’s internal affairs.

### [Ending ‘controlled’ defense exports to Hong Kong](#)

Hours before China’s National People’s Congress Standing Committee passed the national security law for Hong Kong on 30 June, the US government announced on 29 June that it would end the exports of US-origin defense equipment to Hong Kong, and take steps towards imposing the same restrictions on exports of US defense and dual-use technologies to Hong Kong as it does for China. Mike Pompeo said that the US was taking the measure as China moves forward with passing the national security law for Hong Kong.

### [US targets 20 Chinese tech firms for potential sanctions](#)

In addition to tensions over China’s new national security law for Hong Kong, the China-US tech war is also heating up. In letters to US lawmakers dated 24 June, the US government unveiled a list of 20 technology companies that it claims to be ‘either owned by or backed by the Chinese military’, including Huawei, Hikvision, China Mobile and China General Nuclear Power. A spokesperson for the US Department of Defense said that the list will be a useful tool for the US government and companies ‘to conduct due diligence with regard to partnerships with these entities’. Inclusion on the list does not come with immediate punishment, but it could open these companies up to increased scrutiny and potential sanctions.

## [Our assessments of potential changes in US policies towards Hong Kong and their impacts on Hong Kong's economy and trade](#)

The impact of the ban on sensitive exports to Hong Kong seems to be limited in scope. With the China-US tech war looming over the past two years, the US is likely to have controlled technology transfer and restricted technology exports to Hong Kong well before the ban was officially announced on 29 June.

However, now that China's National People's Congress Standing Committee has passed the national security law for Hong Kong, it is possible that the US uses provisions under the *Hong Kong Human Rights and Democracy Act of 2019* to impose further actions/sanctions on Hong Kong:

1. **Termination of separate treatment of visa applications by Hong Kong residents and Mainland Chinese residents:** US visa applications from Hong Kong residents currently enjoy separate consideration, which is generally believed to be more favorable than that faced by Mainland Chinese residents. The US may cease such separate treatment, making it more cumbersome for Hong Kong residents to undertake business or personal travels to the US.
2. **Cessation on the recognition of Hong Kong as a separate customs territory:** The US may place Hong Kong within the Chinese Mainland's customs territory for the purpose of bilateral trade and customs cooperation. The 'China Section 301 tariffs' could then be applied on Hong Kong as well. This will lead to tangible yet limited impact on Hong Kong's economy and trade.
  - Impact on Hong Kong's domestic exports to the US: The US will treat Hong Kong's domestic exports as exports from the Chinese Mainland. This possibly implies that certain Hong Kong exporters will face a jump in tariffs. While this may have been a considerable threat in 1992, when the *United States – Hong Kong Policy Act* was enacted, a change in tariff regime is much less of a concern to Hong Kong nowadays. Hong Kong's domestic exports to the US decreased from HK\$64.6 billion (8.29% of GDP) in 1992 to HK\$3.57 billion (0.13% of GDP) in 2018. The total economic impact of a tariff hike on domestic exports by the US is estimated to be less than HK\$1 billion.
  - Impact on re-exports through Hong Kong to the US: In 2018, Hong Kong's re-exports to the US amounted to HK\$353 billion, accounting for just 8.6% of Hong Kong's re-exports. Around 80% of these exports originated from the Chinese Mainland.
    - For goods transshipped through Hong Kong, or where processing does not lead to changes in the country of origin, there will be no implication on tariffs.
    - Even in cases where a US policy change leads to an increase in tariffs to the US market, it is likely that the Chinese Mainland and other countries will continue to use Hong

Kong as an entrepot because of the efficiency, economies of scale and flexibility offered by Hong Kong.

- However, in transactions where final processing in Hong Kong leads to changes in country of origin, the goods may be subject to higher tariffs. In such cases, whether enterprises will continue to use Hong Kong as a hub depends on whether the abovementioned benefits from re-exporting via Hong Kong outweigh the costs arising from higher tariffs.
- In the event that the US ceases to recognize Hong Kong as a separate customs territory, it is important to ensure that the final destinations of Hong Kong's re-export trade continue to recognize Hong Kong's customs supervision and the certificate of origins (COOs) issued by Hong Kong. The US's continued recognition of COOs issued by Hong Kong is set out in the *United States – Hong Kong Policy Act of 1992*. In an extreme scenario, the US could cease to recognize the COOs issued by Hong Kong, making it impossible to re-export goods via Hong Kong to the US.
- The US could also withdraw its recognition of Hong Kong as an independent member of international organizations such as the WTO and APEC.

## FUNG BUSINESS INTELLIGENCE

**Fung Business Intelligence** collects, analyses and interprets global market data on sourcing, supply chains, distribution, retail and technology.

Headquartered in Hong Kong, it leverages unique relationships and information networks to monitor, research and report on these global issues with a particular focus on business trends and developments in China. Fung Business Intelligence makes its data, impartial analysis and specialist knowledge available to businesses, scholars and governments through regular research reports and business publications.

As the knowledge bank and think tank for the Fung Group, a Hong Kong-based multinational corporation, Fung Business Intelligence also provides expertise, advice and consulting services to the Group and its business partners on issues related to doing business in China, ranging from market entry and company structure, to tax, licensing and other regulatory matters.

Fung Business Intelligence was established in the year 2000.

### About Fung Group

Fung Holdings (1937) Limited, a privately-held business entity headquartered in Hong Kong, is the major shareholder of the Fung Group of companies, whose core businesses operate across the entire global supply chain for consumer goods including sourcing, logistics, distribution and retail. The Fung Group comprises over 34,000 people working in more than 40 economies worldwide. We have a rich history and heritage in export trading and global supply chain management that dates back to 1906 and traces the story of how Hong Kong and the Pearl River Delta emerged as one of the world's foremost manufacturing and trading regions. We are focused on both creating the Supply Chain of the Future to help brands and retailers navigate the digital economy as well as creating new opportunities, product categories and market expansion for brands on a global scale.

For more information, please visit [www.fbicgroup.com](http://www.fbicgroup.com).

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