China-US Trade Disputes (XXXV)

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Trump ends Hong Kong's special status with US

Key takeaways

- *On Tuesday, US President Donald Trump took two actions against China, signing an executive order ending Hong Kong's special treatment, and enacting the Hong Kong Autonomy Act that would impose sanctions against foreign individuals who 'undermine Hong Kong's autonomy' and banks that do business with them.*
- *Of all the announced actions against Hong Kong, the most significant one is the revocation of license exceptions for high-tech and defence-related exports to Hong Kong. In our view, the impact of the move on Hong Kong is 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.*
- *However, with China-US relations still deteriorating, it is likely that the US will use provisions under the Hong Kong Human Rights and Democracy Act of 2019 to impose further actions/sanctions on Hong Kong, including cessation on the recognition of Hong Kong as a separate customs territory.*

Donald Trump signs executive order to end Hong Kong's special status with the US

On Tuesday (14 July), US President Donald Trump signed an executive order ending Hong Kong's different treatment from the Chinese Mainland.[1] Trump said in the executive order that Hong Kong 'is no longer sufficiently autonomous to justify differential treatment' in relation to China.

[1] https://www.whitehouse.gov/presidential-actions/presidents-executive-order-hong-kong-normalization/

Under the *United States – Hong Kong Policy Act of 1992*, the US treats Hong Kong differently from the Chinese Mainland in trade and other areas. The executive order signed by Trump has revoked several of those provisions, including:

- Eliminate preference for Hong Kong passport holders as compared with China passport holders
- Revoke license exceptions for certain exports (mainly high-tech and defence-related) to Hong Kong
- Suspend the US's extradition agreement with Hong Kong
- End the provision of training for members of the Hong Kong police and security services
- Terminate the Fulbright scholar exchange program
- Reallocate refugee admissions to Hong Kong residents

The executive order also threatens to impose sanctions against individuals involved in developing or implementing China's national security law on Hong Kong, and those 'involved in undermining the democracy and autonomy of Hong Kong'.

Trump decided against a more extreme move to strike against the Hong Kong dollar's longstanding peg to the US dollar, according to persons familiar with the matter.

Donald Trump signs Hong Kong Autonomy Act

Also on Tuesday, Trump signed into law the *Hong Kong Autonomy Act* which was earlier passed by the Congress. The Act directs the US government to impose sanctions against any foreign individuals for 'contributing to the violation of China's commitments to Hong Kong', and against any foreign financial institutions that conduct business with those individuals.

Within 90 days, the US Secretary of State will identify individuals and entities (if any) for sanctions. Individuals identified would be barred from entering the US and lose control over any US-based assets. In addition to losing control of US-based assets, sanctioned banks would also be subject to other punitive measures, including being prohibited from receiving loans from US institutions.

Responding to the enactment of the Act, China vowed to take countermeasures and sanction US officials and entities. It also urged the US to 'correct its wrongdoings' and to stop interfering in China's internal affairs. 'To safeguard China's legitimate interests, we will take necessary measures and impose sanctions on relevant individuals and entities from the US,' China's Ministry of Foreign Affairs said in a statement on 15 July.[2]

[2] https://www.fmprc.gov.cn/web/zyxw/t1797796.shtml

Our assessments of potential changes in US policies towards Hong Kong and their impacts on Hong Kong's economy and trade

Of all the announced actions against Hong Kong, the most significant one is the revocation of license exceptions for high-tech and defence-related exports to Hong Kong, which would effectively ban the exports of those goods to Hong Kong. The impact of the move on 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.

However, with China-US relations still deteriorating, it is likely that the US will use provisions under the *Hong Kong Human Rights and Democracy Act of 2019* to impose further actions/sanctions on Hong Kong, including 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.

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