

This PDF is a selection from a published volume from the National Bureau of Economic Research

Volume Title: Trade in Services in the Asia Pacific Region, NBER East Asia Seminar on Economics (EASE), Volume 11

Volume Author/Editor: Takatoshi Ito and Anne O. Krueger, editors

Volume Publisher: University of Chicago Press

Volume ISBN: 0-226-38677-5

Volume URL: [http://www.nber.org/books/ito\\_03-1](http://www.nber.org/books/ito_03-1)

Conference Date: June 22-24, 2000

Publication Date: January 2003

Title: The Private Sector's View of Trade Liberalization in Services: A Hong Kong Perspective

Author: Clement Yuk Wong, Anming Zhang

URL: <http://www.nber.org/chapters/c10160>

---

# The Private Sector's View of Trade Liberalization in Services

## A Hong Kong Perspective

Clement Yuk Pang Wong and Anming Zhang

---

### 7.1 Introduction

Asia has long been the home of many world-class manufacturers as well as being a major manufacturing centre of the world. Its service industries, however, are still largely shielded from world competition. This is changing as the so-called "Services 2000" round of multilateral trade negotiations under the General Agreement of Trade in Services (GATS) proceeds in the new millennium. Two major recent events have had pronounced effects on service liberalization in Asia: the 1997 Asian currency crisis and China's imminent accession to the World Trade Organization (WTO). The former has led to realization on the part of policy makers that service liberalization will increase the competitiveness of the service sector, which in turn will strengthen the overall economy. As a result, significant additional liberalization has been achieved since the crisis started (*Business Asia*, "Asia's Crisis Reform," 22 February 1999). Commitments to the WTO have in fact been used by some governments as an instrument to lend credibility to domestic liberalization reforms, because failure to honor these commitments

Clement Yuk Pang Wong is an assistant professor at the Department of Economics and Finance, City University of Hong Kong. Anming Zhang is currently an associate professor at the Faculty of Commerce and Business Administration, University of British Columbia commerce department and an associate professor at the Department of Economics and Finance, City University of Hong Kong.

The authors would like to thank W. K. Chan, Steve Ching, Gregory Chow, David Dodwell, Robert Feenstra, Andrew Kao, Anne O. Krueger, W. F. Leung, Chong-Hyun Nam, Pin Ng, Eden Y. Woon, Chung-Shu Wu, participants of the Eleventh NBER Annual East Asian Seminar, and two anonymous referees for their helpful comments. Financial support from the Services Support Fund of the Industry Department of the Hong Kong SAR Government and the Research Grant Council (RGC) of Hong Kong (Competitive Earmarked Grant No. 9040320) is gratefully acknowledged.

would require that compensation be made to countries adversely affected (Mattoo 1999; Low and Mattoo 1998). China's accession to the WTO would create significant opportunities for foreign participation in its service industries and provide the catalyst for domestic liberalization both in China and in other Asian countries. Furthermore, China's accession will pave the way for Taiwan's.

Against this backdrop, multilateral liberalization of services has had an immense impact on the Hong Kong service sector. Hong Kong is not only the most service-oriented economy in the world, but also a "service hub" in the Asia-Pacific region, directing the flow of goods, information, and capital.<sup>1</sup> In 1999, Hong Kong's trade in services reached US\$57.53 billion, or 36.5 percent of gross domestic product. Not surprisingly, Hong Kong has evolved into a service hub because of its close proximity to China, excellent telecommunications infrastructure, laissez-faire policy, free flow of information, and the rule of law. As a service hub, Hong Kong plays a key role in providing so-called "trade services" (Deardorff 2001) in the region. Trade services are services, such as financial services, transportation, trading, telecommunications services, and professional services, that serve as inputs in the completion of international trade and investment.

Although the liberalization of services trade would provide substantial benefits for the global trading community, its effects on the Hong Kong economy in general and its service providers in particular are worth understanding. As China and other regional economies undertake service liberalization, Hong Kong's service sector faces both opportunities and challenges. On one hand, market liberalization in other countries, particularly in China, opens up new business opportunities for Hong Kong service providers to expand their operations beyond Hong Kong's boundary. The expanded market can, for example, improve their efficiency through the realization of economies of scale and scope. On the other hand, multilateral trade liberalization diminishes the attractiveness that Hong Kong used to enjoy. Some countries may now bypass Hong Kong, and this would endanger its traditional role as a middleman between east and west, particularly as the gateway to China (Hui et al. 2000; Feenstra and Hanson 2001). Perhaps Hong Kong needs to search for and bolster its identity as a service hub as in the new millennium. What role can the WTO trade forum play? We approach these questions by going directly to Hong Kong service providers themselves because they are the main group (besides consumers) that will be both affected by and affecting the process of service liberalization.

This paper reports the results of a project that studies the private sector's opinions and expectations of service liberalization. It has two objectives. First, it summarizes the project's findings and discusses the implications of

1. In 1999, the service sector accounted for 85 percent of Hong Kong's gross domestic product (93 percent if construction and utilities were also included) and 85 percent of employment.

these findings for the upcoming Services 2000 negotiations. Second, it examines the private sector's view of how to maintain and enhance Hong Kong's current status as a service hub in the region.

The rest of the paper is organized as follows. Section 7.2 describes the project's background and the methodology used. Section 7.3 provides an overview of the results of a large-scale questionnaire survey and a series of personal interviews with business leaders from Hong Kong service industries. It also discusses the implications of the findings on Services 2000 negotiations. Section 7.4 turns to the issue of how service liberalization can affect Hong Kong's position as a service hub. In this section, we focus on three major service sectors that help shape Hong Kong's position as a service hub—financial services, telecommunications, and transport services. Some concluding remarks are offered in section 7.5.

## 7.2 Methodology of Study

The main research techniques used in this study are a questionnaire survey and personal interviews. This research approach is quite different from the standard research procedure in economics, which involves theorizing the phenomenon and then subjecting the empirical implications to an actual data test. Economists' traditional skepticism on the usefulness of the survey methodology can be traced back to the famous "billiard player" analogy (Friedman and Savage 1948). However, as argued by Blinder (1991), results from a properly designed survey can provide valuable data that are unavailable to an econometrician.

The service providers covered by this study are members of the Hong Kong Coalition of Service Industries (HKCSI), which is the biggest and most representative association of the service industry in Hong Kong. The primary purpose of the study is to compile a private sector's "wish list" of issues that they would like to be addressed in the WTO negotiations.

### 7.2.1 Questionnaire Design

The most crucial step in designing the questionnaire was the construction of a proposed wish list for the respondents to choose from. We interviewed fourteen senior executives from leading services companies in Hong Kong. The interviews sought to identify the problems encountered by Hong Kong service providers in market access, the countries in which they would like to see liberalization, and the issues that they would like to be addressed in the Services 2000 Round negotiations.<sup>2</sup> Although the interviewees were from different service sectors and some of their concerns were quite sector-specific, they all alluded to several common concerns. These are restrictions on market access through various forms of establishment requirements, discrimina-

2. A summary of the interviews is published in "Barriers Hindering Trade in Services: 'Services 2000,' Preliminary Interview Results" (1999).

tory treatment of foreign service providers, difficulty in accessing trade regulation information, and complex domestic and trade regulations. The feedback collected from the interviews was used, along with our own research, as inputs to construct a proposed list.<sup>3</sup> The list was refined several times after consultations with the members of the HKCSI executive committee, which consisted of representatives from various service industries. The final wish list consists of thirty-eight wishes. Some of the wishes are general concerns (such as applying the same licensing requirements to both local and foreign firms), whereas others are quite specific (such as relaxing restriction on foreign equity ownership). The first thirty-six individual wishes can be classified into one of the following eight categories:

1. Establishment requirements (wishes 1–6)
2. Qualification of professional standard (wishes 7–8)
3. Immigration and visa (wishes 9–11)
4. National treatment (wishes 12–18)
5. Labor market regulations (wishes 19–23)
6. Information flow and transparency (wishes 24–27)
7. Market structure to promote competition (wishes 28–32)
8. Trade facilitation and removal of restrictions in other industries (wishes 33–36)

Wishes 37 and 38 are not classified under any category. They are “relax travel restrictions, durations of stay, and foreign currencies carried abroad” and “relax restrictions on foreign company’s profit repatriation.” The main parts of the survey are questions 3, 4, and 8 in the questionnaire. Question 3 provides a sector classification scheme for the respondents to indicate their current businesses (Q3) and to define up to two *composite* service sectors called “sector 1” and “sector 2” (Q4) that they want to see liberalized. Our sectoral classification in Q3 follows the GATS classification scheme with only minor adjustments. There are twelve main sectors: (a) business services; (b) telecommunications; (c) construction and related engineering; (d) distribution services; (e) environmental services; (f) educational services; (g) financial services; (h) health-related and social services; (i) tourism and travel and leisure services; (j) recreational, cultural, and sporting services; (k) transport services; and (l) information services. Each sector is further subdivided into subsectors. There are altogether seventy-two subsectors.<sup>4</sup> In defining the two composite sectors in Q4, the respondents

3. We have consulted the literature from United Nations Conference for Trade and Development (UNCTAD), the World Bank, Pacific Economic Co-operation Council (PECC), and Pacific Basic Economic Council (PBEC). See UNCTAD and the World Bank (1994), PECC (1995), and PBEC (1998). We also consulted some surveys that the HKCSI conducted on related topics.

4. If the respondent just selects a main sector without indicating the subsector, we treat this as a “general” subsector. Hence, there are twelve “general” subsectors. This, together with sixty “listed” subsectors, constitute the seventy-two subsectors.

could combine several subsectors from the seventy-two provided. Because the wishes are likely to be (in fact they all are) country-specific, the respondents were also asked in Q8 to identify up to five economies, Hong Kong and four foreign economies, that should undertake market-opening measures to fulfill their selected wishes. Then the respondents could simply build up their own "wish list" by checking the boxes next to the thirty-eight wishes or specifying other wishes in the spaces provided in the questionnaire.

In counting the number of wishes, one must bear in mind that each "wish" can be identified by three fields: a wish code, a subsector (out of the seventy-two subsectors), and an economy the wish is made for. For instance, suppose a respondent selected wish code number 7 in Q8 for "sector 1," which he defines in Q4 as "advertising" plus "public relations," and he put down country codes "A," "B," and "HK" next to the check. Then, this respondent has made a total of six (two subsectors  $\times$  three economies) wishes.

### 7.2.2 Background Statistics

In May 1999 we sent the questionnaire to 1,787 members of the HKCSI. A reminder letter followed this two weeks later. We also made random follow-up telephone calls to the respondents approximately one month after the questionnaire was sent out. The calls were made for two purposes. The first purpose was to encourage participation and answer any queries about the questionnaire. The second purpose was to adjust the "effective" size of the sample because the original mailing list might have overstated the effective sample for two reasons. First, it was at least two years old and many of the addresses might no longer have been valid. Second, some firms might not have been the intended targets because their businesses were unrelated to trade in services. Out of the 241 telephone calls made, we found in twenty cases (8.3 percent) the addresses were out of date and could not be updated. Another eighteen cases (7.5 percent) declined to participate in the study because their businesses were not related to trade, either directly or indirectly. Because the calls were made randomly, we project the same percentage of problem cases (15.8 percent) onto the whole sample. This reduced the effective sample size to 1,504 companies.

By August 1999, we had received 114 completed questionnaires; this implied an effective response rate of 7.6 percent. An obvious reason for the low response rate was that the questionnaire itself was lengthy. However, based on our experience from personal interviews, seminars, and follow-up telephone calls, there are also two other factors that we believe are more important explanations. First, there is a general feeling of apathy among business people, especially those from small and medium-sized enterprises, toward the WTO. This can be attributed to a lack of understanding of what the WTO is about or a lack of confidence in what it can do for them. The

common perception is that the WTO is too remote to be relevant to everyday business. Second, because market liberalization brings about more intense competition, it is inevitable that some service providers take a cautious attitude and are not keen to see the Hong Kong government open its domestic markets. This tends to discourage companies from making wishes for Hong Kong or even participating in the survey altogether. We would like to note that besides making those 241 calls, we also visited the chairmen of some trade associations, such as the Hong Kong Information Technology Federation and the Institute of Architects, to solicit their participation. We know some of the returned questionnaires came from these associations. This tends to raise the “effective” response rate, because those replies reflect the views of key members of the associations (i.e., from their executive committees).

Table 7.1 provides a summary of the service sectors of our respondents’ businesses. The majority of the respondents (38 percent) described the service they provided as “business services.” This is followed by financial services (27 percent), transport services (18 percent), distribution services (14 percent), information technology (which consists of telecommunications and information services) (14 percent), and construction and related engineering services (10 percent). Most respondents in our sample appear to be indigenous to Hong Kong. Among the 114 respondents, 75 replied that their parent company’s main place of operation was Hong Kong. For the other 39 respondents whose parent company’s main place of operation was outside Hong Kong, most are from the United States (10) and United Kingdom (9). Regarding head office locations, 69 of the respondents replied that

**Table 7.1** Main Services Provided by Respondents

Sector	No. of Companies	% of Companies
Business services	43	37.7
Financial services	31	27.2
Transport services	21	18.4
Distribution services	16	14.0
Information technology <sup>a</sup>	16	14.0
Construction and related engineering	12	10.5
Tourism, travel, and leisure services <sup>b</sup>	11	9.6
Environment services	8	7.0
Education services	8	7.0
Health-related and social services	2	1.8
Others	15	13.2
Total	114	100.0

<sup>a</sup>Eleven from information services and five from telecommunications.

<sup>b</sup>Nine from tourism and travel-related services and two from recreation, cultural, and sporting services.

their companies had a head office in the Asia-Pacific region, with a vast majority of them (59) located in Hong Kong.

Table 7.2 summarizes the distribution of firm size, based on the 1998 revenue. Most firms (twenty-six firms or 29.5 percent) recorded revenues of between HK\$10 and HK\$50 million. This, along with the nine cases in which revenues of HK\$10 million or below were reported, indicates that most of our respondents (around 40 percent) are relatively small companies. Another 43 percent (thirty-eight firms) are medium-sized companies with reported revenues between HK\$50 million and HK\$1 billion. Finally, 17 percent of the respondents (fifteen firms) are large firms, with revenue exceeding HK\$1 billion in 1998.

A legitimate concern is to what extent the “wishes” are realistic and do not represent wishful thinking. It is possible that a respondent may “wish” that it could access all markets by checking all thirty-eight wish codes in the questionnaire. We trust that the wish list compiled from our survey does represent a realistic picture. First, only two companies checked all thirty-eight wishes. Second, from our personal interactions with business people on various occasions (interviews, follow-up telephone conversations, and meetings), we observe that they are very realistic people. Most of them had strong opinions on certain issues that are related to their business experiences and future expansion plans. The wishes collected in our questionnaire should reflect (a) the business opportunities the targeted economies can offer and (b) the degree of difficulty of fulfilling those wishes. Companies are more likely to have wishes for promising markets and in measures that resolve the practical difficulties that they have encountered in the past. In this sense, the wishes collected from this survey are not “wishful” thinking and should be taken seriously because they are well-grounded in a firm’s business plans and past experiences. An indication of this conjecture is that 60 percent of the firms made thirty wishes or less and 75 percent made fifty wishes or less.

**Table 7.2 Business Revenues of Respondents in 1998 by Service**

Business revenues (HK\$ millions)	No. of Companies
Less than 10	9
10–50	26
51–100	3
101–200	12
210–500	9
501–1,000	14
1,001–10,000	10
Greater than 10,000	5
Total	88

*Note:* The total is less than 114 because not all respondents indicated their revenue.



### 7.3 Overall Results from the Questionnaire Survey and Interviews

The 114 companies that returned the questionnaire recorded a total of 5,555 wishes. Table 7.3 presents the breakdown of the wishes by main service sectors. Six main service sectors account for 88 percent of all wishes. These are, in descending order in terms of the number of wishes, the financial services, business services, distribution services, information technology (which is defined as information services plus telecommunication services), construction and related engineering services, and transport services. Basically, the pattern in this table is consistent with the sectoral distribution of the respondents' businesses depicted in Table 7.1.

Table 7.4 presents the breakdown of the wishes by economies of interest. Most wishes are directed toward Asian economies. The top eight econ-

**Table 7.3** Distribution of All Wishes by Sector

Sector	No. of Wishes	%
Financial services	1141	20.5
Business services	966	17.4
Distribution services	773	13.9
Information Technology <sup>a</sup>	759	13.7
Construction and related engineering	746	13.4
Transport services	489	8.8
Recreational, cultural, and sporting	174	3.1
Health-related and social services	154	2.8
Environmental services	144	2.6
Education services	137	2.5
Tourism and travel-related services	59	1.1
Others	13	0.2
Total	5555	100.0

<sup>a</sup>This sector consists of information services and telecommunications. There are 465 wishes for information services and 294 wishes for telecommunications services.

**Table 7.4** Distribution of All Wishes by Country

Country	No. of Wishes	%
China	2104	37.9
Hong Kong	636	11.5
Taiwan	530	9.5
Korea	364	6.6
Singapore	289	5.2
Malaysia	275	5.0
Japan	242	4.4
Thailand	168	3.0
Other countries	947	17.1
Total	5555	100.0

omies for which the respondents have wishes are all located in Asia, and together they account for 83 percent of all wishes. The top three economies are from the Greater China area (China, Hong Kong, and Taiwan) and they account for 59 percent of the wishes. China, in particular, accounts for 38 percent of the wishes. This underscores the role of Hong Kong as the gateway to China for many multinationals trying to gain a foothold there, especially in anticipation of its imminent entry to the WTO. Since Hong Kong is often heralded as one of the most open regimes in the world, it may perhaps be surprising to find that it is the second most mentioned economy in the private sector's wish list. The other one-quarter of the wishes are directed at Korea, Japan, and three Association of Southeast Asian Nations (ASEAN) countries: Singapore, Malaysia, and Thailand. The importance of Asian economies is consistent with our interview experiences and the fact that many multinationals use Hong Kong as a regional base to manage their businesses in the Asia-Pacific region. The notable absence of the U.S. and European Union (EU) economies might be due partly to the fact that many respondents originate from these two areas and therefore have no need to expand in their home markets.

The breakdown of the wishes by the eight wish categories mentioned earlier is provided in table 7.5, where the categories are ranked in descending order of an "adjusted response rate." The "adjusted" response rate controls for the fact that the categories have a different number of wishes.<sup>5</sup> The top ten most mentioned individual wishes are listed in table 7.6. Because the service providers we interviewed had very different wishes for Hong Kong as compared with other economies, we break down the results in tables 7.5 and 7.6 between those for Hong Kong and those for foreign economies. In order to have an idea of which issues should be dealt with in the Services 2000 Round, we also asked the respondents to name the most urgent issues from their wish lists, both for the Hong Kong economy and for foreign economies. The results are presented in table 7.7.

### 7.3.1 Wishes for Other Economies

The top three types of wishes that Hong Kong service providers demanded from other economies were (a) to relax establishment requirement restrictions, (b) to be accorded national treatment, and (c) to improve information transparency.

5. In comparing the relative importance of the eight wish categories, one must also take into account the number of wish items in each category. Everything else being the same, categories with more wish items would be selected more often than those with fewer items. In order to adjust for this bias, an *adjusted response rate* is computed in addition to the *raw response rate* that is simply the relative frequency. The adjusted response rate of an *i*th wish category is computed as follows. First, divide the number of votes for a category *i* by the number of wish items in the *i*th category. Second, repeat the first step for the other seven categories. Third, add up the answers from steps 1 and 2. Finally, "standardize" the answer in step 1 by dividing it by the answer from step 3.

**Table 7.5** Distribution of All Wishes by Wish Category

Category	No. of Wishes	Adjusted Response Rate <sup>a</sup> (%)
<i>A. For All Economies</i>		
Establishment requirement	1092	16.1
Information flow and transparency	689	15.2
Immigration and visas	447	13.2
Market infrastructure	688	12.2
Qualification of professional standard	272	12.0
National treatment	937	11.8
Trade facilitation	456	10.1
Labor market regulations	535	9.5
Total	5116 <sup>b</sup>	100.0
<i>B. For Foreign Economies</i>		
Establishment requirement	1032	17.4
Information flow and transparency	610	15.5
National treatment	886	12.8
Qualification of professional standard	241	12.2
Market infrastructure	599	12.1
Immigration and visas	318	10.7
Trade facilitation	391	9.9
Labor market regulations	459	9.3
Total	4536	100.0
<i>C. For Hong Kong Only</i>		
Immigration and visas	129	29.7
Information flow and transparency	79	13.6
Market infrastructure	89	12.3
Trade facilitation	65	11.2
Qualification of professional standard	31	10.7
Labor market regulations	76	10.5
Establishment requirement	60	6.9
National treatment	51	5.0
Total	580	100.0

<sup>a</sup>Adjusted response rate for category  $i$  ( $AR_i$ ) =  $R_i/(\sum R_k)$ , where  $k = 1, 2, 3, \dots, 8$  and  $R_i = X_i/N_i$ , where  $N_i$  is the number of wishes listed in category  $i$ . Note that the sum of all  $AR_i$  is equal to 100 percent by construction.

<sup>b</sup>The number of wishes is less than 5,555 because we exclude wishes that do not fall into any of the eight categories.

The use of establishment requirements as a way of restricting market access presents the biggest obstacle for Hong Kong service providers. Four of the wishes under this category are among the top ten wishes in this survey (table 7.7, section B). They are, starting with the most important,

1. Relax restrictions on the scope of business activities.
2. Relax restrictions on foreign equity ownership.
3. Relax restrictions on the number of operating licences.

**Table 7.6** Top Ten Individual Wishes For All Sectors

	No. of Wishes	%
<i>A. For All Economies</i>		
1. Relax restrictions on the scope of business activities	253	4.55
2. Apply same licensing requirement to local and foreign firms	213	3.83
3. Relax limit of foreign equity ownership	213	3.83
4. Set up inquiry points to disseminate information	210	3.78
5. Relax restrictions on profit repatriation	209	3.76
6. Improve transparency of court ruling	198	3.56
7. Relax restrictions on number of operating licenses	184	3.31
8. Streamline the procedures of obtaining foreign visas	176	3.17
9. Relax restrictions on the composition of local partners	172	3.10
10. Simplify customs clearance procedures	170	3.06
Total	1998	36.0
<i>B. For Foreign Economies</i>		
1. Relax restrictions on the scope of business activities	239	4.86
2. Relax limit of foreign equity ownership	207	4.21
3. Apply same licensing requirement to local and foreign firms	200	4.07
4. Relax restrictions on profit repatriation	199	4.05
5. Set up inquiry points to disseminate information	189	3.84
6. Improve transparency of court ruling	182	3.70
7. Relax restrictions on number of operating licenses	172	3.50
8. Relax restrictions on the composition of local partners	163	3.31
9. Relax discriminatory tax on foreign firms	155	3.15
10. Simplify customs clearance procedures	151	3.07
Total	1857	38.0
<i>C. For Hong Kong Only</i>		
1. Streamline the procedures for obtaining foreign visas	51	8.02
2. Increase the quota of foreign work visas	43	6.76
3. Set up regulations related to e-commerce	36	5.66
4. Increase the duration of stay of foreign workers	35	5.50
5. Set up the electronic data interchange facilities	35	5.50
6. Increase flexibility of hiring and dismissing workers	25	3.93
7. Relax travel restrictions (e.g., durations of stay, FX)	22	3.46
8. Set up inquiry points to disseminate information	21	3.30
9. Enforce intellectual property rights law impartially	19	2.99
10. Simplify customs clearance procedures	19	2.99
Total	306	48.0

*Note:* Percentage is with respect to the total number of wishes: 5,555.

4. Relax restrictions on the composition of local partners, agents, or board of directors.

In particular, relaxing restrictions on the scope of business activities stands out as the most popular wish in the entire survey. This underscores the structural changes taking place in the service industry. Technological in-

**Table 7.7** Most Urgent Wishes

	No. of Wishes
<i>A. For Foreign Economies</i>	
1. Relax restrictions on the scope of business activities	35
2. Apply the same licensing requirements for both local and foreign firms	24
3. Relax restrictions on foreign equity ownership	22
4. Simplify customs clearance procedures	14
5. Relax restrictions on profit repatriation	12
6. Others	150
Total	257
<i>B. For Hong Kong</i>	
1. Increase/eliminate the quota of foreign work visas	14
2. Streamline the procedures of obtaining visas	13
3. Set up e-commerce regulations	11
4. Set up electronic data interchange	8
5. Simplify customs clearance procedures	7
6. Others	74
Total	127

*Note:* Sixty-four companies responded to this question (Q11).

novations and market liberalization of service sectors have gradually weakened segmentation across service product lines. For example, banks and insurance companies are cross-selling each other products as “banca-asurance”; voice telephone service and facsimiles can now be provided as a package over the Internet; and mobile and fixed-line services are converging. As the product lines blur, the ability of service providers to offer a one-stop, total solution package of services to their customers is absolutely essential. This allows service providers not only to build up customer loyalty but also to benefit from economies of scale and scope. In this respect, restrictions on the scope of businesses would have a negative spillover effect on service sectors that are already open to foreign service providers.

The respondents’ second most important concern is to improve information flows and transparency. Two of the wishes in this category are among the top ten individual wishes of the survey. They are (a) to set up inquiry points for dissemination of trade related laws and regulations, and (b) to improve transparency of court rulings on business disputes.

Article III of GATS on transparency stipulates that “Each Member shall publish promptly and, except in emergency situations, at the latest by the time of their entry into force, all relevant measures of general applications which pertain to or affect the operation of this Agreement [i.e., GATS].” Apparently, this overriding principle has not been complied with by WTO member economies covered in this survey. (China, Taiwan, and Vietnam are yet to join the WTO.) Out of the 210 wishes on the establishment of inquiry points to disseminate trade-related laws and regulations, more than half are

directed to WTO member countries. Some interviewees stressed that the problem they faced was not so much whether the regulatory information was available but how government officials implemented it. It was also noted that some countries such as Japan and Korea have not translated all of their regulations in English, which put foreign firms at a disadvantage. The wishes to improve the transparency of court rulings on business disputes underscore another hazard of running a business in foreign economies. China alone accounts for 50 percent of these wishes. The result is consistent with the incidences of arbitrary imprisonment of Hong Kong businessmen in the mainland.

Another major concern is national treatment. This GATS principle is apparently not being followed by the main economies covered in this study. The two main complaints are (a) application of different licensing requirements for local and foreign service providers and (b) discriminatory taxes imposed on foreign firms. Demands to remove them are among the top ten wishes from the survey. In a broader sense, some wishes in other categories may constitute violation of national treatment.<sup>6</sup> For example, "Qualification of professional standard" is the fourth most important wish category in section B of table 7.5. Sectoral distribution shows that the use of unreasonable qualification standards unrelated to the quality of services provided (such as race and residency requirements) are commonly used against foreign professionals, especially in the business service sector. The establishment restrictions on the scope of business activities mentioned above are also a violation of national treatment as they are usually imposed on foreign service providers. For example, many interviewees from the financial service sector complained that foreign brokers are restricted to trading foreign-trenched stocks in many Asian economies. In the case of China, restrictions on renminbi business are a common complaint.

The interviewees also pointed out some measures that put foreign service providers at a disadvantaged position vis-à-vis domestic providers, hence violating the spirit behind national treatment. For example, Singapore requires foreign fund management companies to have a "full-fledged" position before they can bid for business. A full-fledged operation means that the company must establish an office with portfolio managers. This type of restriction discourages foreign fund management companies from operating there because the domestic market is too small to warrant setting up a full-fledged operation. Some interviewees in the courier service business said that many developing countries have laws that limit courier service to commercial documents or the weight of the item delivered. The primary purpose of this type of measure is to protect the local postal service provider.

6. Technically, national treatment is used in the context *after* a foreign service provider has gained market access to foreign markets. However, some measures, such as those on establishment requirements, also constitute unequal treatment although they operate *before* market access is achieved.

The other two wishes in the top ten list are (a) to simplify customs clearance procedure (tenth) and (b) to relax restrictions on profit repatriation (fourth). A cumbersome customs clearance procedure would raise transaction costs and discourage international trade of goods, which support service sectors such as transport and distribution. According to a study by Pacific Basin Economic Council (PBEC 1998), “excessive documentation” has been identified as one of the most reported administrative barriers to trade.

Section A of table 7.7 presents the distribution of the most urgent wishes for foreign economies. The five most urgent wishes are all among the top ten most mentioned wishes in section B of table 7.6 as well. In particular, the issue of capital controls was brought up many times in our interviews. In fact, “relax restrictions on profit repatriation” is the fourth most mentioned wish for foreign economies in this study.

### 7.3.2 Wishes for Hong Kong

As mentioned earlier, Hong Kong is the second most mentioned economy in the private sector’s wish list. Most wishes, including the four most urgent wishes, are targeted at relaxing immigration policy and promoting Hong Kong’s high-technology sector. Whether we use the raw or the adjusted response rates, the three main types of wish that Hong Kong service providers demanded from their own government were (a) to relax immigration and visa policy, (b) to improve market infrastructure to promote competition, and (c) to improve information transparency.

Although “immigration and visas” is a relatively small category with only three items, it accounts for one-fifth of all wishes for Hong Kong. Hong Kong also accounts for the lion’s share of wishes in this category. Out of the 447 wishes from all our respondents, 29 percent are directed at Hong Kong.<sup>7</sup> All three wishes in this category are among the ten most mentioned for Hong Kong (first, second, and fourth in section C of table 7.6). This result accords with the common complaint we heard from our interviewees. Service providers, especially those from the high-technology sector, are critical of the Hong Kong government’s immigration policy. Commercial presence and movement of personnel are the two main modes of supplying services to overseas customers. Both modes of supply, however, assume unrestricted flows of personnel across national borders. The industry practitioners that we interviewed stressed that the most crucial element of a business-friendly immigration policy is the flexibility for people to move in and out of national boundaries frequently with minimum administrative hassle. Employees of many multinational corporations and people working in the trade sector often need to travel to foreign countries frequently for

7. From table 7.5, there was a total 447 wishes in the category of “immigration and visas,” 318 for other economies and 129 for Hong Kong.

brief stays to attend a meeting or a training program or to meet with business partners. Therefore, being able to obtain a foreign visa quickly and inexpensively is very important. Issuing more foreign work visas with longer durations of stay, such as the Hong Kong special administrative region (SAR) policy of allowing in information technology professionals from China, would not be able to address this kind of "flow" need.

The wishes in the other two wish categories also strongly reflect concerns for the high-technology sector. In the "information flow and transparency" category, one of the most important concerns is "to set up electronic data interchange [EDI] facilities." Some interviewees suggested that Hong Kong needed to bolster its middleman role in the e-commerce age by offering other forms of e-middleman function. They argue that given Hong Kong's excellent telecommunications infrastructure, it can develop into a regional electronic catalog center and authentication center. Electronic catalog is a facility that translates buyers' and sellers' product information into a standardized electronic format understandable by both sides. For example, in the apparel industry, electronic catalogs can help a U.S. purchasing manager pass his product requirements to a supplier in China.

The respondents also wished to see travel restrictions relaxed (seventh in section C of table 7.6). This request is obviously motivated by the restrictions on mainland tourists' duration of stay and the complicated visa application procedures for Taiwanese tourists visiting Hong Kong and mainland China. Due to its excellent location, Hong Kong has the conditions to position itself as a hub destination. Hong Kong can be packaged as part of a China or South Asia itinerary. Another obstacle against Hong Kong's developing as a travel hub is its human resources. According to a recent government estimate ("Editorial: Immigration Policy and Economic Considerations," *Mingpao* 15 August 2000), the tourist and high-technology sectors are identified as the two sectors that are most affected by labor shortage.

Finally, as is the case for other countries, the respondents also recommended that Hong Kong should simplify its customs clearance procedures in order to facilitate trade. This wish is obviously important for Hong Kong to maintain and enhance its status as the major trading port in Asia. We elaborate on this point in section 7.4.

In terms of urgency, the two most immediate issues for Hong Kong (table 7.7, section B) are relaxing the quota of foreign work visas and streamlining the procedures for obtaining visas. The third and fourth most urgent wishes are to set up e-commerce regulations and electronic data interchange.

### 7.3.3 Implications for GATS Negotiations

Our results above may have some useful implications for GATS negotiations. First, there may be a need to deepen the meaning of transparency in Article III of GATS. This problem is borne out in our survey. "Set up in-



quiry points to disseminate trade information” and “improve the transparency of court rulings on business disputes” are the fourth and sixth most mentioned wishes in our survey. The feedback from practitioners raised our attention to two dimensions of transparency, namely, the interpretation and implementation of trade regulations. Foreign firms are often put in a disadvantaged position vis-à-vis local firms because the former are less familiar with how and in what context local laws and regulations are implemented or interpreted.

Another dimension of transparency is accountability—an element lacking in Article III of GATS. Because GATS members have no obligation to set up a special information agency to assist foreign companies to obtain trade-related information, it is more difficult to ensure their compliance with GATS Article III.

The importance our respondents assigned to a fair, open, and efficient court ruling procedure would help reduce their political risks. Because many countries are still in the process of adapting their laws and regulations to the requirements of WTO rules, trade disputes are bound to occur. From the service providers’ point of view, transparency in court rulings can provide more timely and relevant means to resolve business disputes than the WTO dispute settlement mechanism, which only operates at the country level. Perhaps specifying some minimum level of due process and diligence in trade-related court rulings in GATS Article III would help. For example, court rulings on business disputes involving foreign companies could be published and the rationale of the rulings explained.

Violation of the WTO’s national treatment principle is a major complaint in this survey. For example, nondiscriminatory licensing requirements are the second most mentioned wish. At present, GATS Article XVII governing national treatment does not oblige countries to state the public policy objectives behind exemptions from this principle and does not, as in the case of the most-favored nation (MFN) principle, impose a phase-out period on such exemptions.

#### **7.4 Sector-Specific Wishes**

In this section we examine the three sectors that make Hong Kong a service hub: financial services, information technology services, and transport services. These three sectors attracted 43 percent of the wishes from the private sector and nearly half of the wishes directed to the Hong Kong government. The hub status Hong Kong currently enjoys is, to a large extent, due to the fact that Hong Kong has adopted a free and open investment and trade policy whereas other Asian economies adopt restrictive policies (see appendix 7.1 for a theoretical analysis). However, as other countries in the region (especially Singapore) gradually open up their service sectors under multilateral liberalization, Hong Kong’s status as a hub will be challenged. As our

theoretical model in appendix 7.1 shows, competition among service hubs lies in the development of hub infrastructure that facilitates the movement of goods, people, capital, and information through a hub. This includes excellent facilities in container and airport terminals, an efficient and smooth customs clearing process, a flexible and open immigration policy, and a transparent flow of information. The private sector's wishes for these three pillars of hub services seem to strike the same chord as our theoretical model. In our discussion below, we try to minimize repetition by focusing on features unique to each sector. Results that are similar to the overall pattern will only be mentioned briefly.

#### 7.4.1 Financial Services

In the 1990s, the world's financial markets underwent several sweeping changes. The first structural change was large-scale privatization as governments tried to reduce their influence in economic activities. This weakens the segmentation of their financial services industries. Banks, insurance companies, securities brokers, and a new breed of nonfinancial institutions are invading each other's turf. The second phenomenon is an ongoing worldwide consolidation and restructuring of the financial services industries in the industrialized countries such as Japan and the EU as well as in developing economies. The latter also need badly foreign capital inflows to recapitalize their financial sectors. The third major force is Internet technology, which has had a major impact on financial services industries. Trading of financial assets can now be conducted around the clock from anywhere, breaking time and geographical constraints. On-line stockbrokers such as E\*Trade and the electronic communication networks are challenging the once-protected markets. These forces have created a stock-market culture among investors worldwide. In Asia, this culture is eroding the once-dominant position of the banking sector. Traditionally, Asian companies relied mainly on bank loans for financing. However, the currency crisis has changed this partnership. Asian companies have discovered that they cannot rely too much on bank loans for financing. To reduce their funding risks, they are gradually turning to the equity and bond markets. Across the region, corporate restructuring and bank recapitalization have accelerated the push to equity markets.

The financial service sector is the most important sector in our survey. There are 1,141 wishes for liberalization in the financial sector, representing 21 percent of the wishes from the private sector. Our questionnaire adopts the GATS classification under which the financial services sector is divided into three main subsectors: insurance, banking, and other financial services. Banking includes all traditional services such as deposits, lending, payment, and money transmission services. Other financial services are mostly fee-based services. These include trading of financial assets (e.g., foreign exchange, equities, and derivatives), underwriting, money broking,

financial advising, settlement and clearing, provision of financial information, and fund management.

When the distribution of financial-sector wishes by wish category is decomposed into Hong Kong and all other economies subsamples, we observe a couple of results that are the same as the overall results discussed in section 7.3. First, the top concern for Hong Kong remains “immigrations and visas” and that of foreign economies is “establishment requirements.” Four of the top five wishes for foreign economies fall into the establishment requirement category—scope of business activities, number of branches or offices, foreign equity ownership, and licensing requirements. Despite the significant progress made in the Financial Services Agreement, the financial service sector remains rather restrictive in Asia-Pacific economies. The results also shed light on the multitude of obstacles standing in the way of foreign financial institutions’ trying to gain a foothold in other Asian countries.

Second, as in the overall result case, both subsample groups continue to place great emphasis on “information flows and transparency” in their wishes. “Set up EDI facilities” is among the top ten wishes for both groups. Without a doubt, financial services are the main engine of growth in e-commerce because they are the most easily adaptable to Internet selling. On-line trading has caught on in Asia, particularly in Korea, Japan, and Australia. It is estimated that almost half of all stock market turnovers in Korea are transacted on-line. Hong Kong, Taiwan, and Singapore are the next biggest markets. One of the main obstacles to e-commerce is security concern. Facilities in public key infrastructure can foster an environment conducive to e-commerce. The introduction of e-certification by the Hong Kong Post in 1999 is a good example of this. The other wish in the category demands that inquiry points be set up for dissemination of trade-related laws and information. There is clearly a need to improve transparency in the financial services sector in the Asia-Pacific region. For example, the restructuring process of Daewoo of South Korea is neither open nor transparent. It neither includes the debts of Daewoo’s overseas subsidiaries nor properly addresses transactions between Daewoo’s affiliates. The plans were drafted without input from foreign creditors, who complained that they were not given enough access to Daewoo’s financial information. Another example of lack of transparency is the Guangdong International Trust and Investment Corporation (GITIC) incident in China, in which lack of communication has led to misunderstandings over the need to register the loans of its overseas subsidiaries with the State Administration of Foreign Exchange. Foreign acquisitions of local financial institutions have slowed down in some countries such as Korea because of the substandard level of disclosure in these economies.

The only result that differs from the overall pattern in section 7.3 is “qualification of professional standards,” which is relatively more important in financial services than in overall results. A common complaint from this

category is the use of unreasonable qualification requirements as a barrier to entry. These can take the form of requirements on language, race, and length of residency. These measures violate Article VI (4) of GATS (Domestic Regulation) that states that qualification requirements cannot constitute unnecessary barriers to trade in services.

The six main subsectors mentioned in the wish list are “trading of financial instruments,” “clearing, settlement, and custodial services,” “insurance services,” “fund management services,” “financial advisory services,” and “lending services.” With the exception of lending and insurance, the other four subsectors are all from “other financial services.” This may suggest that Hong Kong financial services providers have a comparative advantage in these value-added services.

The most important financial service our respondents would like to see liberalized is the trading of financial assets (e.g., securities, derivatives, foreign exchange, bullion). This subsector attracts far more wishes than the rest, accounting for more than one-third of the wishes for financial services. Given the trend of expansion of stock trading in the global financial markets as discussed above, restrictions in this subsector would have a dire consequence for the business opportunities of trade in financial services. In the case of China, this wish was most likely made in response to the restrictions that foreign investors could only trade B-shares. Many countries in Asia also impose similar forms of trading restrictions, such as the maximum foreign ownership of local shares and the prohibition on offering derivative or innovative financial products. Another 43 percent of the wishes requested that national treatment be granted to foreign firms trading financial assets, an improvement in financial market infrastructure to facilitate trading businesses, and a more transparent information disclosure standard. For example, the lack of reliable clearing and settlement services is often cited as one of the main reasons that discourage trading in emerging markets. The lack of information transparency such as lax accounting standards and rampant cross-ownership-motivated trading has also introduced excessive risk to emerging markets.

Given our discussion above, it is not surprising to find that the second most important financial service our respondents sought to liberalize is clearing, settlement, and custodial services (16 percent of the wishes). Other financial sectors that foreign financial institutions find it difficult to enter include insurance, lending, fund management, and financial advisory services. Note that these are all high profit margin businesses. Together, these four subsectors account for 37 percent of financial-sector wishes.

Our respondents also demand to be given national treatment in licensing requirements (fourth and sixth on the top-ten list of Hong Kong and foreign economies respectively). One solution is to require the licensing authority to publish the licensing requirements on the Internet in order to improve the transparency of the selection process. Another major concern in

the foreign economies subsample is capital controls. The private sector would like governments to reduce their limitations on the repatriation of profits. Article XI (Payments and Transfers) of GATS stipulates that, except under circumstances envisaged in Article XII (Restrictions to Safeguard the Balance of Payments), a member country shall not apply restrictions on international transfers and payments for current transactions related to its GATS commitments.

*Implications for Hong Kong as an International Financial Center*

Judging from many criteria, such as stock market capitalization as a percentage of gross domestic product (GDP) and the size of footloose international financial businesses such as foreign exchange and international banking it can attract, Hong Kong is one of the premier financial centers in the Asian time zone. The fact that the financial services sector attracts most of the wishes from the private-sector wish list reflects Hong Kong's competitive strength in this sector. Nevertheless, other Asian economies are embarking on a service liberalization program of their own. Furthermore, as mentioned above, technological innovation is shaking up the financial service industry. Internet technology has made physical distance less important and cross-border supply of services more feasible. As a consequence, financial centers such as Hong Kong, where the costs of doing business are high, will face the threat of being bypassed. As other economies open their financial sectors, some non-personal-intensive, administrative types of services, such as clearing and settlement, custodial services, back-office operations, and, to some extent, even asset trading as technology develops further, could be diverted to less costly countries.

Hong Kong can keep these businesses by, as suggested by our respondents and our theoretical model, improving services trade facilitation and further liberalizing its financial market to bring down the cost of trading. For example, in asset trading, abolishing the minimum brokerage commission and opening exchange floor seats are urgent policies in need of adoption. Hong Kong also badly needs to develop EDI facilities to enable on-line payment. The lack of a secured and cheap online payment technology is holding back the development of e-commerce. Some financial institutions have started to use the Internet as a tool to provide value-added services. For example, some banks offer electronic bill presentment services to enhance existing cash management services. Another natural extension of their cash management services is to facilitate payment and information flows of business-to-business (B2B) e-commerce.<sup>8</sup>

At the same time, as developing countries start to liberalize their financial markets, services that require close contact with clients such as fund management, insurance and lending may also move closer to the clients'

8. See Citibank's website: [<http://www.citibank.com/singapore/get/english>].

countries. Hence, commercial presence may be a preferable mode of supply to cross-border supply because it can provide more timely information. The relative importance of insurance, lending, and fund management in our wish list for financial services underscores the advantage of gaining better information by getting closer to the source.

Although we cannot deny that there is a substitution effect from trade liberalization, we believe that Hong Kong's status as an international financial center can be maintained. In fact, it is well placed to become the most important financial center in the Asian time zone, given the trends of consolidation we mentioned above. First, a relaxation of foreign equity ownership could bring opportunities to cross-border supply of financial services. In its recent WTO accession agreements with the United States and the European Union (EU), China has made substantial concessions on foreign investment in many sectors. Many mainland companies will seek to use Hong Kong as a base to tap foreign capital. This will bring export businesses by increasing the number of mainland firms listed in the local bourse. The demand for advice on mergers and acquisitions, syndicated bank loans, and related business services will also increase.

Second, as an international financial center, Hong Kong is endowed with a critical mass of talents from a wide range of financial and business services, owing partly to its earlier start as a financial hub. Such a clustering of people could create a pressure for innovation that is important for high valued-added services such as investment banking. This clustering also makes it possible for financial service providers to have access to talents from other related financial services themselves. This allows them to enjoy economies of scope from the input point of view. For example, some financial services such as merges and acquisitions and initial public offerings require talents from many financial services and related business services (e.g., accountants, bankers, and lawyers) to work closely with each other.

#### 7.4.2 Telecommunications and Information Services

In this paper, we use a broader definition of the "telecommunications" sector, which we call the "information technology" (IT) sector. Information technology consists of two related sectors: telecommunications and information services. The telecommunications sector includes basic telecom services (e.g., fax, fixed network, international telecom, mobile, and private leased circuit services) and some simple value-added services such as call waiting and e-mail. The information service sector consists of higher value-added products (e.g., EDI, Internet access, on-line information services), hardware installation and maintenance, and software development. The IT sector is the third most important sector in our survey, after financial and business services. A total of 759 wishes are recorded for this sector. Among them, about 40 percent are for telecommunications, and the remaining 60 percent aim at information services.

Hong Kong's role as a leading business center in the Asia-Pacific region owes much to its advanced telecommunications infrastructure. The role of telecommunications will be especially important to Hong Kong in the age of electronic commerce. Trade liberalization in telecommunications services would stimulate the growth of e-commerce and offer tremendous business opportunities for Hong Kong Internet service providers and software companies. Within the telecommunications sector, China and Taiwan account for 71 percent of the wishes. Such a high concentration of wishes arises from Hong Kong's role as the hub of trade and investment in the Greater China region. At the end of 1999, 50 percent of both Hong Kong's outgoing and incoming telecommunications traffic originated from these two economies. Both China and Taiwan are currently under pressure to open their telecommunications markets in their bids to enter the WTO. As the Greater China hub, Hong Kong stands to benefit, because competition would lower costs and, hence, increase telecommunications traffic in the region.

Hong Kong started to open its fixed telecom-network services (FTNS) market in 1995 by allowing three companies to compete with Cable and Wireless HKT (CWHKT). The number of such "cable-based" FTNS licences is frozen at four until 2003. In the mobile-phone sector, six companies are now competing to serve the city's 6.8 million people. Competition intensified further when number portability was introduced in 1999. In the international services market, CWHKT surrendered its exclusive licence at the beginning of 1999. Since then, seventy companies have entered this market using what is called international simple resale, whereby they lease lines from the CWHKT.

On 26 January 2000, seventeen new telecommunication licences were granted. Five of these are "wireless" FTNS licences that allow licensees to launch broadband Internet access and telephone services, and value-added services such as video conferencing and multimedia services. The other twelve licences are for external satellite-based services. These services allow licensees to bypass the undersea cable gateway of CWHKT. Two weeks later, the Hong Kong Government issued letters of intent to thirteen companies for cable-based external fixed telecom-network services licences. Companies can now build their own submarine cables, hence further eroding CWHKT's position.

Most of the wishes for Hong Kong (65 percent) are concentrated in the international telecom services (35 percent) and fixed telecom-network services (30 percent). For foreign economies, fixed telecom-network service dominates all others subsectors by attracting 40 percent of the wishes. The other 38 percent are roughly split between private-leased circuit services and international telecom services. Mobile services, on the other hand, attract very little attention.

The subsector distribution for information services highlights the importance of software development and implementation and the Internet ser-

vices markets. Together, they account for 60 percent (Hong Kong subsample) to 67 percent (foreign economies subsample) of the wishes for information services. Deregulation, corporate restructuring, and investment in technology have stimulated a strong demand for Internet services and software development. For example, deregulation of the financial services industry has created a huge market for equity-trading and trading-clearance systems. Another reason is the realization by corporate Asia that a huge profit potential arises from the so-called B2B e-commerce. As this form of business soars, many companies, especially small and medium-sized enterprises that cannot afford major capital investment, are outsourcing their Internet operations. A new breed of Web hosting service providers is springing up, providing business with the essential e-commerce tools from data storage, data management, and business applications software to supply chain management. This creates enormous business opportunities for software companies.

#### *Wishes for Hong Kong: IT Sector*

For the Hong Kong market, most of the wishes for telecommunications services are from the "immigration and visas" and "market infrastructure" categories. The concern for a more relaxed immigration regime reflects the extremely tight labor market for the high-tech industry reported by the Hong Kong Government ("Editorial: Immigration Policy and Economic Considerations," *Mingpao* 15 August 2000) and our interviewees. If this is not solved quickly, Hong Kong's lead as a telecommunications hub and its role as a middleman in e-commerce business will be at risk. No wonder our respondents rated "increase/eliminate the quota of foreign work visas" and "streamline the procedures for obtaining visas" as the two most urgent wishes in this survey. Some respondents are also concerned with the enforcement of intellectual property rights law and competition law. Hong Kong's image as an international city has been tarnished by rampant piracy of computer software and brand-name apparel products. Piracy does present a serious threat to Hong Kong's quest to become a high-tech hub. This is an implementation problem that some of our interviewees have raised.

As for competition law, Hong Kong does not have one. Instead, the government has adopted a moral persuasion approach. A policy statement on the objectives of promoting competition and discouraging various forms of anticompetitive practices was adopted in 1997.<sup>9</sup> However, the Hong Kong telecommunications liberalization experience suggests that the current policy leaves much to be desired. First, all six mobile operators raised their rates on the same day (1 January 2000) and by the same extent. The Telecommunications Authority (TA) ruled that there was enough evidence to suggest that the price hike was the result of a tacit agreement. The mo-

9. See Cheng and Wu (1998) for the status of competition policy in Hong Kong.



bile operators backed down and restored their original rates. This event has shown that self-regulation may not be enough to ensure that the six regulatory principles in the reference paper will be implemented effectively. Another issue is cross-ownership, which is common in many Asian economies, as illustrated by the *chaebol* in South Korea and the conglomerates in Hong Kong and Taiwan. Many telecom operators in Hong Kong have close ties with property developers, and some are even wholly owned by them. Therefore, there is a potential for collusion, and consumers might be forced to use the service provided by the fixed-network operator with close ties to developer of their housing units. It is important for the telecommunications authority to ensure that access to facilities must be granted in a nondiscriminatory manner.

For the information service sector, the most-demanded requests for Hong Kong are, as expected, to set up e-commerce regulation and EDI facilities and to streamline application procedure for foreign work visas.

#### *Wishes for Foreign Economies: IT Sector*

The biggest obstacles facing Hong Kong telecommunications companies seeking a foothold in foreign telecom markets are the restrictions on establishing a commercial presence. Five of the top six wishes in the telecommunications sector in foreign economies demanded fewer restrictions on establishment requirements. This underscores the fact that many Asian economies still cling to the idea that telecommunications is a strategic sector and various restrictions are imposed on foreign participation. It is interesting to observe that some economies are using the WTO forum as a channel to lend credibility to domestic reform, particularly for China and Taiwan—two economies that are not WTO members yet. For instance, China has agreed to let foreign investors hold 49 percent of telecommunications companies upon China's accession to the WTO; this limit will be raised to 50 percent two years later. At least this is on a par with the level of openness of other developing economies. Taiwan has also recently raised the ceiling of foreign ownership of fixed telecom companies substantially, from 20 percent to 60 percent, and is planning to increase the number of fixed telecom network operating licences.

Surprisingly, "immigration and visas" is also the second most important wish concern for foreign economies. "Streamline the procedure for obtaining foreign visas" is the fourth most mentioned wish. This indicates that restrictions on immigration and visa are fairly common problems in the telecommunications sector.

The main driving force behind government efforts to liberalize telecommunications is the desire to foster its development by attracting the transfer of foreign technological know-how and capital. To this end, relaxation of establishment requirements must be accompanied by a more liberal immigration regime. Although it is certainly desirable to increase foreign work visa

quotas and foreign employees' duration of stay, the IT industry practitioners that we interviewed stressed that the most crucial element of a business-friendly immigration policy is to offer the "flexibility" for people to move in and out of national boundaries with minimum administrative hassle.

As for the information service sector, the respondents are also keen to see, as they do for Hong Kong, foreign economies establish adequate e-commerce regulation. Although the lack of regulation is hailed as the main reason behind the phenomenal growth of e-commerce, the result here does not square with the common perception that the business sector does not want any regulation. Instead, the respondents in our survey demanded that such regulations be set up. Lack of a regulatory framework has been a drag on the development of e-commerce in Asia. Only Singapore and Hong Kong have introduced an electronic transaction bill to give electronic records and digital signatures the same legal status as that of their paper counterparts.

Besides the common concern for e-commerce regulation, our respondents do have many concerns when thinking about expanding into foreign economies. These are familiar concerns mentioned in section 7.3, such as improving the transparency of court rulings (most frequently mentioned) and setting up inquiry points to disseminate information.

Businesses would also like foreign governments to give them national treatment in the licensing applications and to relax local content rules on services. These wishes are borne out by experiences in some countries. For example, China and Singapore have set up government-backed Internet companies to compete with private firms. This poses the risk to foreign firms that they might not receive treatment equal to that of local government-backed companies—a violation of the national treatment principle of GATS. Another form of restriction on marketing channels is the high interconnect fee that Internet firms have to pay telecommunications operators for the "last mile" of connection.

#### 7.4.3 Transport Services

The transport service sector has been traditionally regulated at both national and international levels. There have been concerted efforts, and considerable progress, in deregulating and liberalizing transportation services over the last two decades. For example, countries such as the United States, Canada, the EU states, and Australia deregulated their internal markets (e.g., trucking, rail, and air). At the international level, the Uruguay Round succeeded in applying multilateral trade concepts to three ancillary areas of the air transport sector (aircraft repair and maintenance, the selling and marketing of air transport services, and computer reservation services). However, efforts to bring air carriers' traffic rights under the multilateral purview of GATS have failed. Plans are currently being laid to discuss the inclusion of aviation services within the Services 2000 negotiations.

Although the extended negotiations on maritime services lasted two years beyond the end of the Uruguay Round, they were finally laid to rest in June 1996 when WTO member delegations agreed to suspend negotiations. They deferred them again, this time until Services 2000.

A total of 489 wishes are directed to transport services, representing 9 percent of the entire wishes. The category of "services auxiliary to all modes of transport" receives 170 wishes, air transport 118, and maritime transport 102, whereas the other categories receive far fewer wishes. This is not surprising, given Hong Kong's status as a hub for both aviation and maritime transportation, and given the importance of services liberalization to both these modes of transport and to services auxiliary to them.

The most popular wishes for the transportation sector relate to immigration and visa policy. This is understandable given the nature of transport services, which require movement of personnel across national borders.

The second most popular wishes are concerned with facilitating trade: to simplify customs clearance procedures and to eliminate unnecessary practices for certification and testing of products. These are, in particular, the dominant wishes for the maritime, air cargo, and trucking industries. Currently, transshipments through Hong Kong are treated as imports and re-exports. As a consequence, carriers are required to lodge accurate and complete import and export declarations for transshipped cargo, thereby introducing unnecessary delay and costs in the process. On the other hand, in Singapore transshipped goods avoid customs by being held in a bonded zone during transfer. Companies within the zone can move, break down, store, consolidate, and repack cargo without documentation or incurring customs duties. In terms of our theoretical model in appendix 7.1,  $N_{AHB}$  equals to 4 for Hong Kong and 2 for Singapore. We believe that simplifying customs procedure for transshipment services will become increasingly important because of the global trend toward international fragmentation of production processes. More and more raw material and intermediate goods will be in transit from one location to the other to be further processed before reaching their final destinations. Jones and Kierzkowski (1999) argue that as trade liberalization reduces the cost of coordinating activities across national borders (such as transport and communications), it becomes easier for producers to outsource part of their production processes to foreign locales to take advantage of comparative advantages. More production fragmentation, in turn, stimulates more demand for these trade services. They also argue that these coordination costs tend to be relatively fixed in nature. Therefore, the scale of outsourcing tends to be large. Given this kind of dynamic relationship, Hong Kong stands to lose more transport service business to other competing hubs if it delays simplifying its customs procedures.

Other popular wishes relate to establishment requirements and market access. In many economies, current rules restrict both the types of goods that can be shipped and the points from and to which carriers can transport

them. The common barriers specific to the courier services industry, mainly found in developing countries, are laws and regulations limiting courier services to commercial documents or cargo below a certain value. The primary purpose of these restrictions is to protect local postal services. There are also cases in which domestic regulatory policies or restrictions are applied to other sectors (e.g., ground transport, telecommunications) that are ancillary to air transport but nonetheless critical to a foreign carrier's ability to provide competitive services in the host economy. In many economies considered in this study, for example, a host of local regulations (such as licensing and ownership restrictions) limits foreign participation in the trucking sector, with the sector sometimes being reserved for nationals. This means express carriers must obtain their road transport through local contracting. The fourth most popular wishes relate to information flow and transparency. In particular, our respondents ask for the establishment of EDI facilities.

### 7.5 Concluding Remarks

With a "first mover" advantage in adopting an open and free trade policy regime, Hong Kong has evolved to become an important trade services hub in the Asia-Pacific region. Our discussions in this paper show that further liberalization of trade in services by other economies has presented challenges as well as opportunities for Hong Kong in general and for its service providers in particular. There is a need to rethink the role that Hong Kong plays and will continue to play in view of trade liberalization. The fragmentation of supply chains will accelerate as technology improves and barriers to the flow of goods, information, capital, and even human resources are removed. Ironically, fragmentation of the supply chain can come with increased demand for a central location to organize and coordinate activities. These are the "hub" services that Hong Kong should provide. Our study shows that policies or services that can enhance this role, such as a more flexible immigration policy and a faster customs clearance system, are crucial for Hong Kong to continue its role as a service hub in the Asia-Pacific region.

A *flexible* immigration policy is also necessary for Hong Kong to continue to attract multinational corporations to use it as their head office in Asia. This is important for a knowledge-based economy and particularly so for Hong Kong, because its labor market is undergoing changes that might put its future as a service hub in jeopardy. Over the past decade, about 400,000 well-educated Hong Kong people with key skills have emigrated. At the same time, tens of thousands of poorly educated mainlanders with few skills have settled in the territory annually on family reunion grounds. The urgency of this issue is borne out in this survey by the concern about immigration policy from the private sector.

Finally, we reiterate the importance of promoting Hong Kong as a service

hub, that is, a concentration of those “hub” services such as project management, product development, risk management, and end-to-end supply chain management. All these activities require a clustering of a *critical mass* of inputs located at the hub. Because many hub services are high value-added outputs, their qualities are extremely dependent on a high level of performance from *all* inputs. The presence of any substandard inputs, no matter how small are their shares, can significantly lower the quality of the final output (Kremer 1993). A deeper question is what the factors are that draw these inputs to the hub in the first place. Further theoretical work is needed here, taking account of multilateral trade liberalization and IT-induced structural changes in the production process of goods and services. We believe that some of the empirical findings arising from our survey will be useful in developing such a theory.

## Appendix 7.1

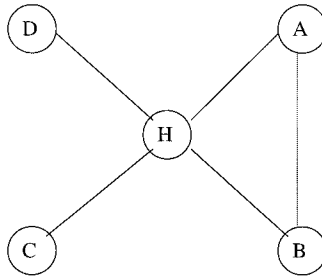
### *A Multilateral Model of Trade Services Hub*

Consider some services known as trade services, such as transportation and telecommunications, that are intermediate inputs to the completion of international trade of some underlying good. The provision of trade services involves three countries: the service provider’s country and the exporting and importing countries of the underlying good. If the trade service market is liberalized, the service provider can be from any country. If it is not, the service provider would come from either the exporting or the importing country, with a service provider from each country responsible for the part that falls within its own jurisdiction.

Let us examine the effect of liberalization of this trade service. Because our focus is on a service hub, we assume a *multilateral* setting where a hub country ( $H$ ) is surrounded by four spoke countries,  $A$ ,  $B$ ,  $C$ , and  $D$  (see figure 7.1). Let us first consider the case in which only country  $H$  has liberalized its trade service sector. Following Deardorff (2001), we cast the model in the context of a transport service for the sake of exposition, although the conceptual issues extend to other trade services as well. Let the total cost ( $S$ ) for a service provider from country  $J$  to transport a shipment of  $Q$  units from country  $A$  to country  $B$  be given by

$$(1) \quad S'_{AB} = c_0^J + c_1^J Q + c_2^J D_{AB} + c_3^J Q D_{AB} + c_4^J Q U_{AB} + c_5^J Q N_{AB}.$$

Because the service market is not liberalized in either country, the service will, as mentioned earlier, be provided by firms from both countries. For simplicity, we assume  $J = A$  or  $B$ .  $D_{AB}$  represents the travel distance between  $A$  and  $B$ ,  $U_{AB}$  is the number of loadings and unloadings, and  $N_{AB}$  is the num-



**Fig. 7.1 Country H as the trade services hub**

ber of customs crossings. The parameters  $c^J_i$  are functions of the technology and factor prices of country  $J$ , both of which are assumed to be exogenous. The fixed cost per shipment is  $c_0$ ,  $c_1$  is the cost per unit shipped,  $c_2$  is the cost per unit of distance,  $c_3$  is the cost that depends on both distance and quantity (such as the fuel cost),  $c_4$  is the cost that depends on both quantity and the number of loadings and unloadings, and  $c_5$  captures the cost associated with customs crossings that includes customs duties and the time delay. The last two terms in equation (1) add additional costs by reducing the speed of delivery. Note that  $U_{AB}$  and  $N_{AB}$  are equal to 2: one loading or customs crossing at  $A$  plus one unloading or customs crossing at  $B$ . The per-unit service cost is

$$(2) \quad s^J_{AB} = c^J_1 + \frac{c^J_0}{Q} + \frac{c^J_2 D_{AB}}{Q} + c^J_3 D_{AB} + 2c^J_4 + 2c^J_5.$$

On the other hand, the per-unit service cost for this shipment to go via  $H$  is

$$(3) \quad s^I_{AHB} = c^I_1 + \frac{c^I_0}{\hat{Q}} + \frac{c^I_2(D_{AH} + D_{HB})}{\hat{Q}} + c^I_3(D_{AH} + D_{HB}) + c^I_4 U_{AHB} + c^I_5 N_{AHB}.$$

Because country  $H$  has liberalized its trade service,  $I = H, A, B, C, D$ , or other countries in equation (3).  $\hat{Q} = Q + \bar{Q}$ , with  $\bar{Q}$  representing all other traffic carried on routes  $HA$  or  $HB$ . Potentially,  $\bar{Q}$  includes, on route  $HA$  for example, local traffic between  $A$  and  $H$ , or connecting traffic between  $A$  and  $C$  via  $H$ , etc. Taking the difference of equations (2) and (3), we obtain

$$(4) \quad s^I_{AHB} - s^J_{AB} = (c^I_1 - c^J_1) + \left( \frac{c^I_0}{\hat{Q}} - \frac{c^J_0}{Q} \right) + \left[ \frac{c^I_2(D_{AH} + D_{HB})}{\hat{Q}} - \frac{c^J_2 D_{AB}}{Q} \right] + [c^I_3(D_{AH} + D_{HB}) - c^J_3 D_{AB}] + (c^I_4 U_{AHB} - 2c^J_4) + (c^I_5 N_{AHB} - 2c^J_5).$$

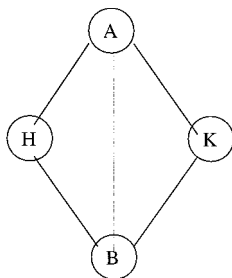
Equation (4) shows three principal sources of gain from routing the  $AB$  shipment through  $H$ . The first is comparative advantage: because  $J$  is a subset of  $I$ ,  $c_i^I \leq c_i^J$ . The second is economies of scale. Since  $AB$  goods will now be carried together with goods of other origin-destination pairs ( $\hat{Q} > Q$ ), the fixed cost associated with a shipment will be spread over more quantity. The third is economy of scope. This comes from two areas. First, a service hub has a critical mass of essential inputs for the certain related fragments of the trade service to be provided cost effectively—for example, the sorting, repackaging, and logistics facilities in transport service. The other is the cost saving through eliminating duplication of inputs. Note that as the number of spoke countries increases, the gain from economies of scale and scope will multiply. Equation (4) also illustrates three potential disadvantages of routing  $AB$  shipments via  $H$ : longer distance ( $D_{AH} + D_{HB} > D_{AB}$ ); additional loadings ( $U_{AHB} = 4$ ); and possibly additional customs crossings ( $N_{AHB} = 2$  or  $4$ ). All these would reduce the speed of delivery.

Now, consider the impacts on  $H$  if *all* countries liberalize their service sector. On the positive side, it allows service providers from  $H$  to expand their operations to other countries. The expanded market can, for example, improve efficiency through the realization of economies of scale and scope. Second, an increase in trade activities means more services opportunities for all countries, including  $H$ , especially if it could improve its hub infrastructure and remain a service hub. On the negative side, some traffic may be diverted away from  $H$  as the comparative advantage enjoyed by country  $H$  disappears, that is,  $c_i^I = c_i^J$ . Consequently, equation (4) becomes

$$(5) \quad s_{AHB}^I - s_{AB}^J = \left( \frac{c_0^I}{\hat{Q}} - \frac{c_0^I}{Q} \right) + \left[ \frac{c_2^I(D_{AH} + D_{HB})}{\hat{Q}} - \frac{c_2^I D_{AB}}{Q} \right] \\ + [c_3^I(D_{AH} + D_{HB}) - c_3^I D_{AB}] + (c_4^I U_{AHB} - 2c_4^I) \\ + (c_5^I N_{AHB} - 2c_5^I).$$

Equation (5) shows that now the trade route via  $H$  is less attractive than that under unilateral liberalization by  $H$ . The shipment may go directly between  $A$  and  $B$  if the extent of economies of scale and scope is weak, the delivery speed is important, and loading or unloading and customs procedures at  $H$  are costly and cumbersome. As long as the hub is well established due to its early liberalization, the benefits from economies of scale and scope at the hub will most likely offset the diversion effect. Furthermore, as discussed below, some activities can only be performed with a critical mass of essential inputs located at the hub.

Perhaps key competitive threats to  $H$  under multilateral liberalization come from other competing hubs that spring up after liberalization, such as  $K$  (see figure 7.2). The unit cost difference for an  $AB$  shipment going through  $H$  hub and  $K$  hub may be written as



**Fig. 7.2 Service liberalization and competing hubs**

$$\begin{aligned}
 (6) s_{AHB}^I - s_{AKB}^I &= \left( \frac{c_0^I}{Q_{AHB}} - \frac{c_0^I}{Q_{AKB}} \right) + \left[ \frac{c_2^I(D_{AH} + D_{HB})}{Q_{AHB}} - \frac{c_2^I(D_{AK} + D_{KB})}{Q_{AKB}} \right] \\
 &+ [c_3^I(D_{AH} + D_{HB}) - c_3^I(D_{AK} + D_{KB})] + c_4^I(U_{AHB} - U_{AKB}) \\
 &+ c_5^I(N_{AHB} - N_{AKB}).
 \end{aligned}$$

Equation (6) shows that, if both the distance and traffic density of the two routes are about the same, then the first three terms are negligible and the competition between the two hubs lies in the last two terms. They reflect the “frictions” of moving goods, people, capital, and information through a service hub. The more restrictions there are, the less competitive the service hub is. In the context of transport services, these frictions can arise from the fact that goods have to go through port and airport terminal services and customs-clearing procedures. In banking, the frictions can be capital controls. More generally, they can be caused by a restrictive immigration policy, because movement of personnel is often necessary in the provision of many services. Finally, many hub services such as banking and business services are knowledge intensive. A transparent environment for the free flow of information is essential for these services. Restrictions on information flows present another friction that can lower the quality of such services.

## References

- Barriers hindering trade in services: ‘Services 2000,’ preliminary interview results. 1999. *Service Economy*, August, 4.
- Blinder, A. S. 1991. Why are prices sticky? Preliminary results from an interview study. *American Economic Review* 81:89–100.
- Cheng, Leonard K., and Changqi Wu. 1998. *Competition policy and regulation of business*. Hong Kong: City University of Hong Kong Press.



- Deardorff, A. 2001. International provision of trade services, trade, and fragmentation. *Review of International Economics* 9 (2): 233–48.
- Feenstra, Robert, and Gordon Hanson. 2001. Intermediaries in entrepôt trade: Hong Kong re-exports of Chinese goods. NBER Working Paper no. 8808. Cambridge, Mass.: National Bureau of Economic Research.
- Friedman, M., and L. J. Savage. 1948. The utility analysis of choices involving risk. *Journal of Political Economy* 56:279–304.
- Hui, W., L. George, and Lawrence C. Leung. 2000. The trade of an entrepôt: Hong Kong 1978–1999. National University of Singapore, Department of Economics, and Chinese University of Hong Kong, Department of Decision Sciences and Managerial Economics. Unpublished Manuscript.
- Jones, Ronald, and Henry Kierzkowski. 1999. Horizontal aspects of vertical fragmentation. Paper presented at the International Conference on Global Production and Specialization and Trade. 25–27 October, Hong Kong.
- Kremer, Michael. 1993. The O-ring theory of economic development. *Quarterly Journal of Economics* 108 (3): 551–75.
- Low, Patrick, and Aaditya Mattoo. 1998. Reform in basic telecommunications and the WTO negotiations: The Asian experience. Working Paper no. ERAD9801. Geneva: World Trade Organization.
- Mattoo, Aaditya. 1999. Financial services and the WTO: Liberalization in the developing and transition economies. Working Paper no. 2184. Washington, D.C.: World Bank, September.
- Pacific Basin Economic Council (PBEC). 1998. Administrative Barrier to Trade. Hong Kong: PBEC.
- Pacific Economic Cooperation Council (PECC). 1995. *Survey of impediments to trade and investment in the APEC region*. Singapore: PECC.
- UNCTAD and the World Bank. 1994. *Liberalizing international transactions in services: A handbook*. New York: United Nations.

## **Comment**      Chong-Hyun Nam

I enjoyed reading the paper and learned a lot from it. The paper consists of two major parts, the first being a theoretical model part and the second an empirical survey part. The relation between these two parts, however, remains very thin.

The first part of the paper asks questions such as how Hong Kong has been able to evolve and thrive as a “regional service hub,” and whether Hong Kong can continue to be a regional service hub in the future as unilateral or multilateral liberalization in services trade proceeds. These questions were analyzed through a model, and the model suggests that Hong Kong’s geographical location, its ability to reap economies of scale and scope in services trade, and its relatively earlier liberalization in goods and services trade could be major factors behind Hong Kong’s success as a regional service hub.

The model also suggests that liberalization in services trade, at both unilateral and multilateral levels, can be a mixed blessing for Hong Kong's future as a regional service hub. Certainly, gains are to be made by liberalizing services trade, through expanded markets and a greater possibility of exploiting economies of scale and scope, and through speedier delivery and customs procedures. However, the same gains can accrue to other competing economies in the region, and some traffic can be taken away from Hong Kong.

This kind of model analysis, however, provides little guidance as to what actually might happen to Hong Kong vis-à-vis others in the region as a regional service hub. Some quantitative empirical work is desired to answer this question. The second part of the paper is not designed to answer this question, however.

The second part of the paper investigates what priority wishes Hong Kong's private companies may have in liberalizing services trade at home and abroad. A rather extensive survey was conducted over individual service companies in Hong Kong for that purpose. The survey results seem, indeed, very revealing and useful for policy makers, particularly in facing "Services 2000" negotiations, which were only recently under the auspices of the World Trade Organization (WTO).

I have a couple of questions and a couple of comments on the second part of the paper.

My first question is if there are any other similar surveys done in the past either on Hong Kong or on any other economies. If there is any, a comparative study seems quite interesting.

My second question is how the authors came up with the thirty-eight wishes they adopted in their survey. The thirty-eight wishes can be reclassified into eight more broad categories, including establishment requirements, national treatment, information flows and transparency, and so forth. I wonder how these classifications can square with the format used at the Uruguay Round when governments make their schedule of specific commitments on the General Agreement on Trade in Services. There they used four modes of service supply, namely, cross-border supply, consumption abroad, commercial presence, and presence of natural persons, and they used two types of trade restrictions, namely, restrictions on market access and restrictions on national treatment.

In any case, the thirty-eight wishes seem quite sensibly constructed in the study, and the survey results seem to provide very useful information, as I said before, for policy makers in particular.

Let me now make a couple of comments. My first comment is concerning the survey result that improving information flows and transparency turned out to be one of the most prevalent wishes among Hong Kong's service providers. Information gathering and its dissemination regarding individual countries' trade laws and regulations seem to be in high demand. Some-

one needs to do the job. In fact, the WTO is partly doing such a job at the moment through its Trade Policy Review Mechanism. Obviously, however, that is not sufficient. We may coerce the WTO into playing a greater role in that effort.

The authors argued that there is clearly a need to improve transparency, particularly in the Asia-Pacific region. I agree with that argument. They mentioned the recent case of Daewoo's restructuring process as an example. I may add to that. I believe transparency is badly in need in Korea not only for the business sector but also for the government sector. When the Korean government went for an International Monetary Fund rescue in late 1997, for example, nobody—even in the government circle, except for a very few persons—knew exactly what the actual reserve position at disposal was and what the foreign debt structure was at the time in Korea. The lack of information and transparency in accounting was surely one of the major causes of the recent financial crisis in Korea. Some systematic efforts need to be made on a global basis to improve information flows and transparency, I think.

My second comment is concerned with domestic regulations that may limit market access for many service providers. Such trade-impeding domestic regulations are often found to be country-specific and industry-specific. However, some common elements of trade barriers embodied in those domestic regulations may be drawn from cross-country studies or surveys, as was done in the present study. In the end, again, the WTO may need to be brought in to make something like what I would call a Trade-Related Domestic Regulations Review Mechanism.