

THE BROOKINGS INSTITUTION
IS FREE TRADE SILL ALIVE? HONG KONG'S PERSPECTIVE

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Introduction:

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Keynote:

THE HONORABLE EDWARD YAU TANG-WAH
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Discussion:

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P R O C E E D I N G S

MR. LI: Good afternoon and welcome. My name is Cheng Li. I'm the director of the John L. Thornton China Center here at Brookings. Thank you all for joining us today.

This event is very timely not only because of the ongoing trade tensions between the United States and China, but also because of the controversy over the proposed extradition bill in Hong Kong. The trade war between China and the United States has no doubt preoccupied many of us in this room. The dispute has squeezed economic partners in the region and has sparked a broader debate over the benefits and the prospects of free trade.

As we know, Hong Kong occupies a unique position the Asia Pacific. Known as "Asia's world city," Hong Kong is a key center for international business and finance. It holds a longstanding reputation as the freest economy in the world according to several authoritative studies, including the Heritage Foundation's 2019 Index of Economic Freedom.

This position stems in part from the city's multiple identities. It's a strong connection to the entire world and its roles as the gateway to markets in mainland China. Beijing also hopes to transform the Pearl River Delta as part of its Greater Bay Area plan and Hong Kong will play a critical, important role.

Hong Kong has been in the international spotlight these past few days. Residents have engaged in large-scale protests. They worry that the extradition bill will erode Hong Kong's traditional independence and undermine the rights and the freedoms that are stipulated by One Country, Two Systems and the city's special semiautonomous status.

Foreign NGOs and members of the business community, including American Chamber of Commerce, some of whose prominent members are with us today, have also expressed concern. They are anxious about the scope of the bill, the speed and

the lack of transparency in the deliberation process, and an active impact that it may have on business confidence.

I'm grateful that we have some excellent speakers with us today to help shed light on these important and timely issues and help identify more constructive paths forward. We are particularly privileged to be joined by Honorable Edward Yau, secretary for commerce and economic development in Hong Kong, and his delegation, despite an extremely busy schedule in Washington, D.C. It is also great to see you, Commissioner (inaudible), a wonderful, dear friend, and thank you for coming to Brookings.

Secretary Yau will deliver keynote remarks before answering a few questions from the audience. Secretary Yau is no stranger to many of us. He studied at Harvard University, worked as the director-general of the Hong Kong Economic and Trade Office in Washington, and has frequently visited this town. Secretary Yau's portfolio covers a range of policy areas, including trade, telecommunications, intellectual property, consumer protection, investment in Hong Kong, and tourism development.

Prior to his current position, Mr. Yau was director the Chief Executive's Office and the secretary for the environment. Secretary Yau, many thanks for joining us and for agreeing to answer questions, likely tough ones, at this very challenging time on all fronts.

Because the delegation from the American Chamber of Commerce, including panelist Robert Grieves, will have to leave for another event at 1:30, so we'll make some small change in terms of the schedule. We will hold the panel discussion before Secretary Yau's keynote remarks.

My Brookings colleague, Senior Fellow David Dollar, will moderate this discussion with our two distinguished panelists: Daniel Fung, chairman of International Bridges to Justice and former solicitor general for Hong Kong; and Robert Grieves, chairman of the American Chamber of Commerce in Hong Kong. And I just saw his bio. He went to Hamilton College, where I taught for 15 years, so it's so good to see you.

And the panel discussion will also include a Q&A. After that, David will moderate the keynote session with the Honorable Secretary Yau. The whole event will be on record.

Please join me in welcoming our moderator and the panelists to the stage.
Thank you. (Applause)

MR. DOLLAR: Good afternoon, ladies and gentlemen. I'm David Dollar. Great pleasure to be here. In the interest of time I want to jump right in. We had the introductions from my colleague, Cheng Li, so I don't need to say more.

I'm going to start with Daniel Fung. As Cheng suggested, you still, in the Heritage Foundation rankings, you still see Hong Kong as the freest economy in the world, very good institutions, property rights. But, frankly, there's a concern that the relationship with the mainland is starting to erode that in Hong Kong. You had such long experience as solicitor-general working on these issues, so how do you see investment climate, rule of law issues in China?

MR. FUNG: I think let's get things in perspective. The first point to remember is that our proudest legacy of 156 years of British rule is actually the rule of law. There's nothing more important than that. And that's a principle and value that we share with the United States because you yourselves underwent a very long period of, as it were, British Colonial tutelage. And for all the bad things that happened, we both emerged, I think U.S. and Hong Kong, with this extremely strong and deeply embedded principle and rule of law. And that is something that has been preserved constitutionally in Hong Kong in our basic law.

It's a process that involved a constitutional drafting, which took place between '85 and '90, in which I was part of the team that was involved. And then the actual constitution kicked into operation in '97 and became living law, which is something that did not happen in the U.K. because the U.K. is unique amongst the 196 nation states in the world, members of the U.N., without a written constitution. But here in Hong Kong, because

it was embedded into a written constitution, it became traditionally reviewable as a benchmark for executive action, legislative acts, and other acts of public authority, so we could measure whatever an institution does with a public remit by reference to the basic law.

And all the basic freedoms are protected, including every single freedom embedded in the International Covenant on Civil and Political Rights, which is part and parcel of our Chapter 3. That was a key element of our constitutional drafting process between '85 and '90. And we have built up, as you probably know, a huge body of case law since '97, 22 years, with input not just from Hong Kong judges, but from overseas judges of common law jurisdictions, including chief justices of Australia, chief justices of U.K., chief justices of Canada, chief justices of New Zealand. In other words, it really is, as it were, world class.

And today, within the Court of Final Appeal, which is in Hong Kong and not in mainland China -- everything stops, as it were, in Hong Kong -- of the 18 members of the Court, 14 are from overseas, from these jurisdictions I've talked about. We've not yet managed to persuade your chief justices to join us, but we're trying. (Laughter) We'll get there one day. So that's a very important point to remember. That's alive and well.

MR. DOLLAR: Okay, thank you, Daniel. So, Robert, you're here as part of an annual door-knock, talking to different stakeholders in Washington about relations with Hong Kong and the U.S. business community. What are the main messages that you're bringing on the door-knock and what are you hearing back?

MR. GRIEVES: Thank you, David. This is an annual event. We go to Washington every year from Hong Kong and then in the autumn we go to Beijing, so it's twice a year for us.

Obviously, we're very concerned about what's happening in Hong Kong right now. We are significant -- the American community employs 100,000 people in Hong Kong and that's direct employment. There's a multiplier in that. There are 85,000 Americans who live and work in Hong Kong. We are significant stakeholders in Hong Kong.

We care about the Hong Kong people, the people we work with, the people that we employ.

And so we are -- our message basically is we are going -- we are trying to find out and asking people on the Hill and the administration their views on what's going on, as well. And our message to them is, first, please, do no harm. If you're going to react, take a restrained, thoughtful, measured approach to Hong Kong because you do not want to hurt the people of Hong Kong. And Hong Kong remains a viable, as Daniel was saying, a viable business center for not just Americans, but a vibrant international business community. And you do not want to throw that vibrant business community under the bus, under the China bus.

MR. DOLLAR: Daniel, are you worried that this extradition law will harm U.S.-Hong Kong relations and might interfere with the special relationship that we have?

MR. FUNG: Well, I'll give you an honest answer because I don't speak for the Hong Kong government and I'm not longer with the government. So I think this is a very important and serious question which deserves a serious answer.

And I think there are issues at stake which require deep study. And I'm not in favor of ramrodding it through, pushing it through. I do think it requires deep thought and full consultation. Because, as you know, extradition is an issue, which is both legal as well as diplomatic. And normally, how these things are done is that you negotiate extradition treaties, if you can. Let's take yourself as one out of 196 sovereign states, members of the U.N. If you want to negotiate with, say, 120 of those 195 interlocutors, you spend a lot of time (inaudible) with them, looking into their systems. And if you succeed in having a treaty, you then draft domestic law. So it's a serious process and I do think it requires time. I don't want to say more because I think Hong Kong people actually deserve that deep thought and consideration, and I hope it'll happen.

I know the Hong Kong government has already made very substantial concessions right from the outset and taken out from the schedule of originally 38 offenses, various offenses, which give rise to concern. Because most people aren't that concerned

about let's say murders and rapes, right. But they are concerned in relation to white collar crime because we all know, and this country it's no different, that commercial disputes sometimes can shade off into regulatory disputes and into, as it were, criminal disputes, and that's where the concern lies.

And I think the Hong Kong government, to be fair our government, has taken substantial steps to address those concerns and removed many of those offenses from the schedule. But there's a range of other issues which remain to be discussed. And I'm the last person to advocate for ramrodding this thing through because it's a serious process and I think it deserves serious consideration.

MR. DOLLAR: Okay, thanks. Robert, the other hot topic in Washington is the U.S.-China trade conflict. You know, Hong Kong's not directly involved, but Hong Kong is an intermediary between the U.S. and China in many economic transactions. So can I ask you how the international business community in Hong Kong views the U.S.-China trade conflict? And are you optimistic about some kind of resolution or what are worst-case scenarios?

MR. GRIEVES: Well, it's a tale of a couple of AmChams in China. So AmCham China and AmCham Shanghai have very strong views about this. They're very upset. Forty percent of their membership, according to a poll that both of them released just recently, are considering moving their supply chains and their headquarters in some cases out of China. But the problem is, that's very destructive. That supply chain and those value chains have been put in place for over 30 years. They're talented people that have been trained that are running them. And then where do you go? Do you go to Vietnam? Do you go to the Philippines? Where do you go?

That's sort of their issue. We're in Hong Kong. We go into China, our members go into China, but we also go into ASEAN. We go as far as India. So we have slightly different concerns. And we agree with the Hong Kong government that if you incorporate in Hong Kong, that's a great launch pad to go into China.

We are doing a survey right now, it's not completed, where we're going to better, more methodically gauge how our members are feeling about that. But right now, we don't have -- I don't see a lot of evidence that our members are pulling out, leaving right now. Concern? Yes, there's a lot of concern.

And the second part of your question, what was that again?

MR. DOLLAR: Well, kind of what's worst-case scenario?

MR. GRIEVES: Well, the worst-case scenario is it just drags on and on and on. And I think the problem is it's becoming a larger confrontation. It's involving tech and it just seems to be getting wider and wider. It'd be great if there was some resolution reached earlier rather than later.

MR. DOLLAR: So I'm going to turn to the audience for questions in a second, but since this topic came up I want to just add my two cents on this.

So it's very easy to talk about value chains moving out of China and a little bit of that will happen, but these other economies that are being discussed, Vietnam or Bangladesh, they're tiny compared to China. So you're not going to have large-scale shifting of value chains out of China. You're more likely to have some of the labor-intensive activities at the end of the value chain. That's already been shifting to Vietnam, Bangladesh, other countries, Indonesia, because of wages. That'll accelerate a little bit, but China is going to be at the heart of a lot of these value chains, and that's not going to change because of this.

Okay, any questions from the audience? And if I don't see questions, I keep asking questions. (Laughter)

This woman here. Do we have a handheld mic? Yes, it's coming right to you.

SPEAKER: Thank you. Reporter from Voice America. I do have a question for Mr. Grievess.

You mentioned that you come here to ask the Congress to take a restricted

and measured approach to Hong Kong. So I'd like to hear your view on Speaker Pelosi's statement. She was saying that if the bill passed, the Congress is going to review the Hong Kong state (inaudible). Thank you.

MR. GRIEVES: Well, we can't really influence policy. We're not giving any policy prescriptions, per se. One of the things we are asking for, if you're asking what we're asking for, we'd like to see continued and increased involvement, engagement of the American government. We'd like to see more people coming out from the Hill to Hong Kong. We love the ship visits, that's great. That's not entirely in control of the U.S. Congress.

We'd also like to see some of the vacancies in the State Department filled so that there are officers involved in East Asia working on our behalf. Because there's a real -- it's sort of an intangible relationship. If those relationships, if those visits are happening, if people are looking over from the United States into East Asia, into Hong Kong, it helps business.

And let me make this point. Hong Kong's values are the values of the United States. And so we're very cognizant of that.

MR. DOLLAR: Other questions? This gentleman.

MR. LANGE: Yeah, hi. Jack Lange with AmCham. Daniel, I'll ask you this question in your capacity as one of Hong Kong's leading lights of the Hong Kong bar.

We heard recently that Taiwan has said that they really don't want Mr. Chan back under the framework of these amendments. In light of that and in light of the enormous importance that the Hong Kong government has put on making sure that Mr. Chan, the accused murderer, can be sent back to Taiwan to face justice. Is it a viable option, do you think --

MR. DOLLAR: I'm sorry. The mic went off.

MR. LANGE: Sorry, I'll try to speak up. Okay, thank you.

Is it a viable option, do you think, for the government now to split off the Chan case, deal with it through some ad hoc arrangement or ad hoc legislation that will

allow him to be sent to face justice under terms that will be acceptable to Taiwan? And then, at the same time, allow the amendments generally to be treated with the kind of thorough deliberation that the ordinarily would have been?

MR. FUNG: I think that option has always been available. And it's always possible to deal with things ad hoc without having a comprehensive, as it were, treaty or rendition arrangement or with comprehensive domestic legislation. I mean, it is an option; it's not ideal. It can be done. And I've actually said so in Beijing back in March because I sit on the CPPCC, so this is not something I'm just saying in the United States to make people feel good. But I've said it up in March during the (inaudible), so it's open. And I think there is an open debate, so it's not as if there's only one way to skin the cat.

And I do feel very strongly personally that this is such an important issue it deserves a comprehensive ventilation and because we know that people in Hong Kong want a full debate. I mean, that's pretty obvious from the numbers, so let's have a full debate. But in the meantime, we don't want to, as it were, let justice not be done. I mean, there has to be some process. And if Taiwan says, well, we don't want him back under that arrangement, we will take him under another arrangement, let that be looked at.

I mean, I don't want to say any more because this is a complicated issue and I don't want to, as it were, embarrass Hong Kong government officials, but I think it's always been an option. And as I've said, I've said so in Beijing myself.

MR. DOLLAR: Okay. If I don't see a hand I'm going to ask Robert one of my questions because another hot topic here in Washington concerned Huawei. You know, the U.S. has taken what are really two distinct actions: one preventing the sale of Huawei products into the U.S., particularly into the telecom infrastructure; and then the other there are 33 key American suppliers that sell to Huawei and Huawei's been put on what we call the "entity list," so that without special licenses those U.S. suppliers cannot sell to Huawei.

So do you have a view about this? Is this an interesting or discussed issue among the business community?

MR. GRIEVES: Well, it's a very --

MR. DOLLAR: And, Daniel, if you want to weigh in on this, too.

MR. GRIEVES: It's a very discussed issue. And there are entity lists in the U.S. and now there are entity lists in China. So this is another escalation in this continuous trade war spinoff.

I'm not prepared to tell you whether Huawei's engaged in spyware technology. Probably so, but I -- just what I read in the papers. Would I like Americans to sell, American suppliers to sell to Huawei? Yes, I think that would be great. Is that possible? Will the American government allow that? I'm not sure. And it seems like the position keeps changing a little bit. It's hard to know where we're going to stop in that process.

We have to figure out as a nation and as a global economy, if I can still refer to the economy as global, how we are going to deal with technology in various jurisdictions. Are we going to have two separate platforms, one based around China and one based around the United States? Are we going to Balkanize even further? We have got to get our heads around this because the way it's going right now is unsustainable in my opinion.

MR. DOLLAR: Daniel?

MR. FUNG: Yeah, I'm with Robert 100 percent on this because I think if you start quarantining the markets, it's a very unhealthy downward spiral. And we know that the rest of the world, particularly the European Union, is not going to boycott Huawei. We know that. And, therefore, what is the net result? The net result is the United States will be, as it were, walled off from the rest of the world. I mean, that's the real wall that's being built, not the one on the Mexican border.

Now, what happens there is really a very interesting proposition which Google raised. Right? Google's actually said if you stop us interacting with Huawei, it becomes a national security issue because we can't develop, as it were, without their input. They can't develop without ours. We've become two different systems. We're actually in

hostile competition. That is a national security issue.

So the Google position, which came out just two days ago, I think is enlightening. And I think it's well worth thinking about because this is such a complex issue. And the supply chains are so intertwined and the R&D is so intertwined, we truly live in a globalized world. Whether or not people accept it in this town, we are in a globalized world. The rest of the world thinks we are and, therefore, if there's a walling off, I think one of the main, as it were, unintended victims is the United States.

MR. GRIEVES: I just want to add to that. If we continue down this road, it's not only technology, but if we try to decouple completely from China, this is going to be disastrous for the world and for the American economy and for the Chinese economy.

MR. DOLLAR: Right, I definitely agree with you two about this. I like to point out that every country in Asia has more trade with China than with the United States with the exception of Afghanistan and Bhutan. So if we're going to divide up the world, we get Afghanistan and Bhutan, and China gets everybody else. So I think Daniel made a very important point.

I also want to ask you two about trade agreements. I mean, Hong Kong is a free trade economy, so in some ways it's not that relevant directly, but I would think indirectly the development of a Trans-Pacific Partnership, the Regional Comprehensive Economic Program, all of these are potentially important.

MR. FUNG: I would say we're highly irrelevant because actually we're a victim of the trade war and we're collateral damage. Because we have zero tariffs, right? I mean, this is a free port. So we don't have anything in our toolbox to retaliate against anybody putting tariffs against us. But we actually believe in the free trade we live in. And we talk the talk and we walk the walk. And, therefore, we're very much in favor of the WTO. I mean, we're a founding member of the WTO way before China joined in the year 2000. And we were a member of the GATT, right, since 1967. So we live this particular talk. And I think it's very, very important that that talk is realized and implemented and preserved and

nurtured.

Because if we go into some Balkanized world, we go back into the Dark Ages. I mean, this is the end of empire. We get sucked into a thousand years of Dark Age and medieval whatever. And I'm sure even the most atavistic policymaker in D.C. is not gunning for that outcome because that will not make America great again, for sure.

MR. DOLLAR: Right. Daniel, I'm going to take that as a very articulate final comment from you and ask Robert if you have any final comments before we move on.

MR. GRIEVES: Trade agreements impose discipline and discipline is good for trade. The TPP that you and I were discussing earlier was not perfect, but it was a very good agreement that was scuttled at the last minute. I noticed the Trump administration is now taking pieces of the TPP and putting them into their bilateral agreements, which his interesting.

MR. DOLLAR: Okay, thank you. So we're the warm-up band for the main attraction, so please let's have a nice round of applause for this. (Applause)

And now we're very happy to introduce Secretary Yau.

MR. YAU: Thank you, Cheng Li. Thank you, David. I'm happy to come back to Brookings because you are our neighbors. Our economic and trade office is just around the corner, so I remember my three years here. So this is the place we often combine in a lot of joint projects, so happy to be back.

And also, when I was invited to address this audience, David or Cheng asked about a topic, I came here last year to talk in a separate occasion using the topic is free trade free? Is fair trade fair? So that's record. But I think that's more sort of philosophical.

This year I'm talking about is free trade alive? I think this topic wouldn't attract much attention two years ago because I think we were all living a very happy life. Because as trade minister, when we rub shoulders, we think we are all free trade sort of advocates around the world. And so far, that has been part of the world, has been going

until almost 12 or 14 months ago. And also, the traditional concept of free trade, which is a middle school economics concept, is well understood whereas the new concept of fair trade, although it sounds sexy and sort of equitable, has, in fact, invited a lot of debate, even in trade fora, in particular APEC and WTO. Because, well, "fair," what does "fair" mean? But I think we are more imminently sort of affected by problems that we find between just two terms.

So back to the topic, is free trade still alive? So I think no better than sort of doing a health check on free trade. I wouldn't go back to the definition of free trade, but what does free trade mean or what does free trade bring to the global and national community? So I would start with sort of a health check by looking at certain figures, which are commonly found in a lot of websites, including those from WTO.

Now, look back. Daniel mentioned about GATT, 1967, and also thereafter WTO. Well, looking on this time horizon world trade actually increased substantially since the GATT days. So looking back since 1967, I think trade, global trade volume increased how much? Forty times, 4,018 percent. Forty times. And world trade value increased 2.8 times, almost 3 times. That means in this more than half a century actually traded more, just go around the world in substantial sort of quantity, although the price doesn't catch up with that. You can interpret this goods move around, but not necessarily more expensive. In fact, goods are with a quite reasonable price, as you can see today in the U.S.

Then the second health check factor is tariffs. Since WTO was founded in 1995 and the last one was more than 20 years, the average tariff actually cut by half from 15 percent to 8 percent. So that's the global average. And in they year 2018, around the world 60 percent of trade are actually on zero tariffs. So Hong Kong used to be the exception, but, in fact, is the norm. The majority of trade actually incurs no cost.

Another 20 percent, the tariff was below 5 percent. So in a way, 80 percent, a lion's share, of trade are, in fact, operating at very low cost or even zero tariff environment. Of course, things that happened in the last 12 months is another story. Twenty-five percent

isn't very huge, though, compared with the historical levels, be they the reasons sort of 20 years or even back the last 50 or 60 years.

Now, during this period global GDP increased substantially. Back in 1960, the global GDP was at a level of 11 trillion. It increased fourfold in 1995 to 42 trillion and then to year 2017, 80 trillion. So what do all these factors come into being? I think it portrays a very healthy (inaudible). On the one hand, trade increased; in parallel, GDP also increased; and at the same time, tariffs come down. So there at least would be strong correlation, if not causation, about those two factors.

But clearly, I think tariffs being (inaudible) from the toolbox as a very antiquated sort of trade weapon seems to be against this flow. So I think the question is, is this harmful, too, or is it really a cure for a trade problem that some pundits are trying to describe?

But the immediate symptoms that we have seen only in the last year or so are obvious. Well, in the last 12 months I've attended twice the World Economic Forum in Davos. I also came from three ministerial meetings only last month, one in Chile APEC ministerial meeting, OECD, and also WTO ministerial meeting. Well, among all these major organizations their projections for this year has been coming down constantly. IMF is just 3 times from 3.6 percent GDP growth globally down to 3.3 this year. OECD, the meeting I just attended, revised it downward 3.2. And, in fact, World Bank and WTO are less optimistic. They put the projection to 2.6 this year. Well, all these figures are, in fact, a projection of GDP, which is lowest since the last financial crisis back in 2009.

And in the discussion among ministers and also economic fora, they actually put all these sort of downward adjustments to one single thing: the trade war. So I think that's a symptom. When asked if free trade's still alive, I think that's a symptom of sickness that doesn't require a doctor to sort of confirm the diagnosis.

And, in fact, the Hong Kong case, as Daniel rightly mentioned, we suffer immediately from the collateral damage. Our first quarter GDP managed only to achieve 0.6

percent, it's almost down to 0, compared with 4.6 in the same quarter last year; Singapore similar, 1.2 against 4.7. And we are also seeing that that's a result of these sort of trade downward trends, which happened only in the last six months.

The initial six months when the trade war started because, well, knowing that the tariffs would be imposed, people were catching up and sort of rushing orders for export. But then we are seeing the immediate hit in the last six months. And I can tell you that while we won't be seeing any upward trend in the next two quarters because not only are the tariffs kicking in, but also we are measuring against a rushing out of exports. So we can foretell that, well, this will hard hit Hong Kong.

And in a way Hong Kong is suffering from three areas. One, of course, the collateral damages, although it's not directly hitting Hong Kong, but obviously we are feeling the heat. And secondly, it's the unintended consequences which a lot of people in the financial sectors are talking about because in this time and age it's not just trade alone on goods. It's also a fact of the global sort of financial market.

Obviously, Hong Kong traders know full well because in this supply chain a lot of Hong Kong investors invest in manufacturing on the mainland, exporting to the world, including the U.S. We know full well that while the profit margins are usually in the single digits and sometimes at the lower end of the digits, in fact, the American consumers are getting quite a good price from them. But as a result, barring any sort of currency adjustment, the 25 percent is unlikely to be foot by the producer because there's no way they can sort of swallow this. So they either sort of stop the order or move somewhere else, which might take time and some difficult decisions, or simply negotiate for another sort of price. That means the consumer end will be bearing the brunt and also corporate earnings will soon be reflected. I'm not sure whether that's directly or adequately reflected in that sense. Again, Hong Kong being a financial center with a lot of companies listed n Hong Kong, corporate earnings will also be reflected in our stock market. And, therefore, I think, well, in this time and age we are all sort of in the same boat.

Now, but more importantly, another sort of concern is the systemic concern that the symptom with trade being shocked in a very uncertain environment, it makes business decisions very difficult. Well, I echo perfectly David's point. Relocation is easier said than done because in the old days when we are talking about basic consumer goods, like textiles, what they needed was sewing machines and labor. It can easily take three months to establish a plant. But we are now talking about more sophisticated, sort of advanced manufacturing, which requires must closer connected component suppliers, skilled labor, quality (inaudible), and also ensuring a good logistic. So this is not simply the location of the plant, but also the entire sort of chain related to that, so with the uncertainty there.

And I will mention about why the relocation of industry may not necessarily be the answer. But this uncertainty alone is choking the industry and also sort of (inaudible) people, for instance, from investing, from expending, from upgrading, or even not sure whether they should take the American orders. But these are things that we heard in the last 12 months whenever I meet with the chambers in Hong Kong.

Finally, also our concern about this systemic sort of problem on the multilateral trading system, Daniel opened the topic that, well, Hong Kong being a founding of WTO, we're naturally concerned. Because actually with defenses, there is nothing in our toolbox called tariffs or duties where we can manipulate the trade. We are at the receiving end. It's the trading partner that picked Hong Kong. It's not Hong Kong picking the trading partners.

So all this looks like a very clear indication that if the global economy is one single body, the tariffs, the injection of this dosage, high dosage of tariffs, somehow it's making us a bit fragile, weak, and vulnerable. But I want to dig slightly deeper. Why there are great concerns about tariffs is, in fact, not the tariff level itself, but it's the reason behind this so-called weapon in the toolbox.

Because while if tariffs are being imposed for the reason of rebalancing the

trade, that means you're using the balance of trade as analysis, as the reason behind. And that brings in the concept of reciprocal trade or fair trade.

But if the balance of trade is any indicator, then around the world there won't be any place that is safe because I have tracked U.S. balance of trade among the world. There are only slightly over a dozen economies that are not having -- that the U.S. is not having a trade surplus. Sorry?

SPEAKER: Trade deficit.

MR. YAU: Trade deficit, sorry. Yeah, you know what I mean. I'm very poor in accounting, but. (Laughter)

And if the balance of trade is the reason behind, then I think Hong Kong would have nothing to worry about because Hong Kong topped the U.S. trade surplus list. Last year the U.S. enjoyed a trade surplus of 31.1 billion, topping the world, year after year, decade after decade. And, in fact, the U.S. trade surplus from Hong Kong increased in the last 25 years how many times? One hundred times and keeps on increasing.

But we have an exception. We're an exception if we are saying what China is having -- the U.S. is having a trade deficit with China, then all the relocating countries that we are talking about, for instance ASEAN, Vietnam in particular, they are the major beneficiary of this relocation. They're also having the same sort of trade pattern with mainland China. So in a way, the consequence, the ultimate end game would be U.S. would be -- well, Daniel used the term Dark Age, I would say Stone Age, where you hunt, you farm, and also you make your tools by yourself. Then, therefore, you restore the totally safe environment.

But even with the trade balance as a yardstick, Hong Kong sometimes is not spared. I hate to repeat this sort of minor, trivial example, but last February, we were one of the first economies being hit by Section 232. Carol is smiling. Because, well, somehow Hong Kong was subject to trade expansion acts in possession of 23.6 percent of tariffs for the single shipment from a company of steel -- I mean, aluminum sort of components. So

sometimes if non-trade factors being into this as a reason for tariffs, particularly those involving things beyond trade, for instance paying for construction and other things, then where do we draw the line?

So I think that comes back to the comments that tariffs are a very blunt sort of instrument. In medical terms it's very much like the chemo for the cancer treatment instead of the more sort of modern and preferred targeted therapy, because it basically hits everything. Now, I think before when we talked about the apparent sickness of the global economic system, we cannot stop sort of looking at the entire body, which is in the time of the (inaudible) trading system, which we are all part of it; in fact, more than 164 members of WTO, which account for 98 percent of total trade.

But admittedly, there is something wrong with this system, which Hong Kong as a member also admits. So in examining and diagnosis the problem encountered by this multilateral trading system we must go back to the three fundamental functions of the system, like the heart, the brain, the lung, or the arms and legs of this body, which includes three major functions of the WTO.

One is the rulemaking process. WTO is a legally binding multilateral organization. When rules are being made, they are being respected, they're being observed. If there is any departure from that, there will be processes to deal with it. That's a very important function, basically the entire sort of functioning of WTO.

The second one is the involvement of negotiation to change or to make rules. Because all these rules cannot be copied from textbooks. They are the result of bilateral, multilateral, or plurilateral discussion where by a consensus and also final agreement they are able to be entered into. And the process is, in fact, as important as the result. And I think, well, any trade talks will speak for that because in a negotiation you give and take. It's not never one side takes all. So the negotiation function is another one.

The third one is the safety valve, which is a dispute settlement. In the circumstances, rules are not being observed, then you have to, then you have a mechanism

like a court for you to appeal and also an appellate body to arbitrate and come to a final adjudication. But I think that's something at a time when we need this multilateral organization to function, in fact, this is the part that we are seeing the choking. Because in artificial terms the appointment of the appellate body are being held back until the end of the year, when this term of the appellate body appointment lapses. There will be no more, an insufficient appellate body.

So in a way, it's like sort of going into a game where you start a fight, but you're holding the referee on the side, not allowing him or her to make an adjudication. So I think that's a complicated matter. So if we were to sort of tackle the illness of the multilateral trading system or free trade, I think we must look back on this.

WTO has its limitations. The rulemaking process has been slowing down and the negotiation process got stopped. Therefore, there will be a lot of frustration, including the U.S., including EU, including many other jurisdictions. No one is entirely happy with WTO, that's for sure. But does that mean that, well, we need to sort of put WTO aside and start another thing or leaving or abandoning a ship when it's most needed, particularly when some big players have been assuming the role of the captain of the ship?

So that brings me to a side thought. Well, in this time and age a lot of people are talking about alternative medicine. Well, perhaps what Hong Kong, small Hong Kong can contribute maybe accounts for this kind of alternative treatment, so I will try to give it a go, see if that works.

Of course, Hong Kong believes in the multilateral trading system. We uphold a sort of rules-based system and we sort of will continue to be the very strong voice defending and guarding this principle of WTO. And, in fact, that's the major contention in the drafting session behind the APEC ministerial meeting, behind the leaders' declaration. Well, very often we are the lone voice in doing that.

But before the multilateral trading system could find sort of the solution, Hong Kong is not giving up. Hong Kong is not giving up on other means, like a free trade

agreement. Or someone might say that, well, while the multilateral trading system failed, would a bilateral arrangement work or not? I think the task is not whether there is a bilateral arrangement. It's what kind of bilateral agreement we're able to enter into.

If it's just sort of a kind of a side deal which undercuts the multilateral trading system, then in a way it's defeating. It's harming WTO. But if these sort of side deals on the bilateral basis or even on plurilateral basis, regional basis, contain content which may supplement or even sort of build up WTO, then I think it's worth trying at least.

And that's exactly what Hong Kong has been doing, in particular in our new current term of government. In the last 20 months, we have entered into four new free trade agreements, which doubles the number of agreements and also triples the market we are entering into, which includes ASEAN, the 10 emerging countries in our part of the world; also includes minor, small, but very open economies, like Georgia. Not the state of Georgia here, but the Georgia in Eurasia, which ranked number 16 in the Heritage Foundation's Freedom Index. And also includes one more recent one that we entered into is the FTA with Australia, focusing on services. And in particular, in this newest FTA we are talking about commitment well beyond our respective commitment to WTO. There are 40 more new commitments made to this agreement on top of what Australia and Hong Kong have put into it.

Last point, FTA, a lot of people overlooked, but FTA something like (inaudible) and then put it aside. But Hong Kong has a very different experience. In at least one of these FTA, the most alive document that we are having, it's interesting, the one with the mainland, which we give a term "Closer Economic Partnership Arrangement," CEPA. Actually this piece of agreement is never sort of signed and shelved. It's being taken out year after year.

It was signed 15 years ago. But during this period, we have made 10 supplements, which is updating and refining, adding on new clauses, allowing more, better market access, lowering of barriers. And, in fact, that's the FTA that allows American

companies, European companies to go into the mainland through Hong Kong. And I think that's the point that Bob mentioned, why some companies operating on the mainland through Hong Kong would be less unhappy than their counterparts in the mainland.

Well, for instance, in the area where a company qualifies to be a service supplier in Hong Kong into the mainland, they include very low-barrier conditions, such as the company registering in Hong Kong for three to five years, paying tax, having an office. And also, most important of all is nationality blind. We don't check your identity. So, in fact, among the 1,800 companies enjoying the CEPA entry, 5 percent of them are American companies. I believe they should be the happy ones.

So anyway, back to the topic, well, if small Hong Kong (inaudible) even on bilateral side deals I think, we hope, those would be areas that we can contribute. So if we see the multilateral trading system having some problems, first we have to admit it. We have to do the health check. We have to sort of find ways. But the therapy doesn't fall into just throwing some painkillers or sort of embarking on something you don't even know whether it's the right sort of therapeutic treatment. But most important of all, I think, we need to strengthen the body instead of weakening it. I think that's what Hong Kong has been doing.

So sorry, about a longwinded, but that's my starting point. I'm happy to take any questions on this topic. Thank you. (Applause)

MR. DOLLAR: Thank you very much. Thank you.

Secretary Yau has a hard stop in five minutes, but he's graciously agreed to answer a couple of questions. Same rules as before, if I don't see your hand, I start asking my questions. So the woman there.

SPEAKER: Hi, Secretary Yau. Thank you for your remarks. So my question is in terms of the extradition law. How do you respond to the rising concerns here in the U.S. among legislators and also businessmen in Hong Kong over the rising concerns and sort of fear that may harm the economy in Hong Kong and business ties with the U.S.?

MR. DOLLAR: Can you identify yourself?

SPEAKER: Oh, my name is Anna and I'm a reporter with Voice of America.

MR. YAU: Yeah, thank you. Well, first of all, in all my (inaudible) and also calling offices I tried to explain the cases, but I might be not be the most qualified person to answer that question because that's not my personal portfolio.

And also, I must say that while we are deeply concerned about things happening back home, and in the last two days I've been sort of contacting my colleagues and getting to know the current situation because the peaceful demonstration is, of course, part of Hong Kong's life, which government and the community fully respect. It's not how many people come out, but in general the peaceful process in force. And Hong Kong prides itself having that freedom being fully respected. But on the other hand, any sort of use of violence, attacking police and what you see on TV, is something that, well, I think no members of the community would condone.

Back to the question, I think if you read sometimes the headlines as if this extradition law is a big encroachment from the mainland, but if anyone would look at the details, the debut, the entire construction, it's quite the other way around. Because Daniel mentioned about this law which was inherent slightly before the handing over. The law was actually proposed and enacted of '96, '97, being the process of adaptation of the old law because in the old days it's part of the U.K. jurisdiction. We don't have this piece of law, so we have to take it.

But in that process, that vacuum, unless and until we enter into a long-term agreement, there are basically no arrangements, for instance, for this handing over a fugitive, which in Hong Kong and the mainland, which after 9-11 is one country, not even Macao, let alone Taiwan. So how to pluck this loophole.

We are in the process of doing the long-term agreement. At the same time, how do we deal with this case-to-case arrangement with all the countries that not yet are having this long-term arrangement, which, unfortunately, is the lion's share. Among the 190-

odd countries in the world, we only manage to have 20 long-term agreements, leaving a big sea of countries where we don't have an arrangement.

But in filling this gap, we do it in the typical One Country, Two Systems fashion. A, full local legislation. B, safeguards guarding against any sort of casual handing over. In fact, they need to go through three important stages: the CE, which is the head of the government; the court, which Daniel talked about, remains highly respected; and also, finally, if the court agrees, then the CE could then proceed to the third phase, consider areas beyond what the court considered. And all these processes will subject to (inaudible), as Daniel mentioned.

And also, we are hearing what the people (inaudible) and, therefore, there are additional safeguards being put in, including almost mirroring individual provisions in the ICCPR, including sort of -- we need to ensure that in handing over such a fugitive, we need to make sure that there will be open court; need to be having the legal representation; need to cover a lot of area that basically you find in the ICCPR.

So I think however detailed and meticulous we do, the process itself is difficult. A, that we're driven by the single case, the single case which triggers 20 years sort of lagging behind process with the clock ticking while people just ask about what if the Taiwan authorities say no. But I did ask the same question to my law enforcement colleagues. There remains a request from the Taiwan law enforcement agency asking us to hand this over. So it's a standing case, a life case with this suspect about to be released, so we have to do things within this timeframe.

And it's not helped by the truncated legislative process that a fraction of our legislature, they did not allow the government to go through the Appeals Committee. It took them three weeks in a kind of filibustering that not even the chairman for this committee could be elected, let alone sort of examining of the clause-by-clause arrangement. We tried to sort of replace it with other arrangements, but somehow a tough decision would have to be made.

But sorry, well, I thank you for giving me the chance of at least explaining the situation. But as to how things go, I need to go back and sort of -- I shouldn't be preempting my responsible colleagues on that particular area.

MR. DOLLAR: Secretary Yau, you made a very eloquent case for free trade, which resonates well with economists. But the striking thing today is in countries like the United States, the United Kingdom, you know, there's a lot of unhappiness about international trade. So do you have any thoughts about why we've got this anti-globalization backlash and any general advice for how we can deal with it?

MR. YAU: I think that was, in fact, the topic I covered last year, is free trade free? I think the answer that Hong Kong has is free trade, of course, is not entirely free, free trade meaning that we will remove barriers for trade in between countries and the economy. But as a result, globalization and global trade, of course, it will bring about the problems that you mentioned: disparity, distribution of income, job loss. So in a way, these are the consequences of trade, which has already foreseen in the concept of comparative advantage. Because by saying comparative advantage, you are better doing something, but you may not be doing as good as that.

And in the case of the (inaudible) sector being involved, there will be costs to pay. But come to think about it, that's the cost. That perhaps falls within the jurisdiction and responsibility of each and every trading nation or economy.

I remember my chief executive spoke at the WEF in Davos last year. She was saying that, well, yeah, Hong Kong actually pays a price for sort of enjoying this free trade while we earn income. But over the last sort of 10 to 20 years Hong Kong invested quite a lot in balancing that act, particularly in social services, in sort of a retraining of workers.

And, in fact, looking back we have been quite fortunate that -- well, a lot of people know that Hong Kong, in fact, moved into the mainland for manufacturing in 1977 -- 1978, but not many people realize that actually we have lost over a million jobs within a time

span of less than 10 to 15 years into the mainland. Because these were workers, factory workers, doing all the things, but all of a sudden they move -- jobs move north, but they remain in Hong Kong. And we have gone through this transition.

But, fortunately, I think the training of labor, retraining program, sort of a grooming of talent I think managed to sort of resolve this. And also, housing, which remains a big problem; social services. I think in a way that's the prime responsibility that we as a government should take on instead of just sort of passing it on to others.

But I think WTO also needs to address others. WTO, when I mentioned it in the negotiation process the rule-setting is slow and stagnant because there are still a lot of major issues to be dealt with, but increasingly, they were talking about, say, e-commerce, which goes beyond the boundaries, or environment, which is a social and economic cost that all trading partners will need to bear. So I think we need to work doubly hard on both fronts, but primarily I think with Hong Kong, for example, we take care of that in the first instance.

MR. DOLLAR: Okay, thank you very much. Please join me in giving a big round of applause to Secretary Yau.

MR. YAU: Thank you. Thank you. (Applause)

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