

The Impacts of China's New Free-Trade Zones on Hong Kong Tourism

ABSTRACT

In the face of an increasingly integrated global economy the Chinese government has progressively upgraded the so-called Free Trade Zones (FTZs) to attract greater foreign investment. While the relationship between international trade and tourism development is widely acknowledged, the impacts of trade on the latter have rarely been quantified. This Regional Spotlight discusses the impacts of the Shanghai FTZ on tourism in Hong Kong. The micro level impacts on tourism are considered in the macro context of FTZ developments. The authors suggest that Hong Kong should seek closer integration within the Chinese developments, diversify its current tourism products and export its tourism-related expertise in areas that support the economic development of FTZs.

Key words: Free-Trade Zone, Shanghai, Hong Kong, tourism impacts

In the face of an increasingly integrated global economy, nations and territories have increasingly acknowledged the potential for foreign investment to energize the growth of domestic employment, technology and trade (Borensztein, De Gregorio, & Lee, 1998). In the case of countries where less liberal economic and trade systems prevail, establishing free-trade zones (FTZs) has been a popular approach to pilot economic reforms through the offer of a combination of tax-and-tariff incentives, streamlined customs procedures and reduced regulation. There are about 4,300 FTZs worldwide (The Economist, 2015). With the global economy now characterized by the “Asia Pacific era”, China, which was previously one of the most closed

economies, has accelerated the reform process since 2013 by launching new types of FTZ. While the relationship between international trade and tourism development is widely acknowledged (Gray, 1970; Kulendran & Wilson, 2000; Turner & Witt, 2001), the impacts of international trade on the latter have seldom been quantified. This Regional Spotlight explores the establishment of China's FTZs and provides insights into their potential effects on tourism in Hong Kong with reference to the prototype Shanghai FTZ (SFTZ). The study provides a timely reflection for Hong Kong tourism policy makers and practitioners as well as for destination managers elsewhere in Asia.

The first of China's FTZs were established in the 1980s with a manufacturing export orientation (Pak, 1997). During the subsequent period the manufacturing edge has been progressively lost to lower cost competitors in Southeast Asia (The Economist, 2013). China must offer new FDI related incentives if the momentum of economic reform is to continue. Following China's admission to the World Trade Organization in 2001, the formation of the SFTZ (in September 2013) has solidified China's efforts to eliminate restrictions on foreign entry and ownership within the services sector. This initiative is expected to force domestically-protected service sector businesses to modernize (The Economist, 2013). The SFTZ represents a new type of services-oriented FTZ. The pilot has a special focus on reforming financial, shipping, trading and professional services, cultural services, and public services (China Shanghai Pilot Free Trade Zone, 2013). The SFTZ has also conducted trials on expediting the functional transformation of government and exploring administrative innovation for international trade and investment (China Shanghai Pilot Free Trade Zone, 2013). As shown in Figure 1, SFTZ has provided a prototype for the more recently established Guangdong, Fujian and Tianjin FTZs

(Lau, 2015). Though in their early formative stage, these zones have a particular emphasis on service sector reforms.

There is a close parallel with Hong Kong's prevalent free-trade model and its financial services and trade focus. Given the link between international trade and tourism (Gray, 1970; Kulendran & Wilson, 2000; Turner & Witt, 2001), we suggest that one of the Hong Kong SAR's four local economic pillars – the tourism industry – may be negatively affected.

Hong Kong's fledgling cruise tourism sector may be the first to be affected. The Ministry of Transport of China and the Municipal Government of Shanghai are committed to expanding the Shanghai International Shipping Center in SFTZ with a view to developing cruise tourism in China (PRNewswire, 2013). At the time of writing Shanghai accommodates more than 10 international cruise liners which travel to Hong Kong, Taiwan, Korea and Japan. As recently as five years ago, there was only a single foreign-owned cruise company in Shanghai. With more ports opening and with "visa on arrival" for Chinese nationals, Shanghai is posed to divert Chinese tourists travelling on cruise ships to places other than Hong Kong. Furthermore, Shanghai's "Wusongkou" port authority has proposed the development of its own cruise brand and intends to offer cruise management services through collaborations with international cruise companies and tour agencies covering issues such as cruise staff recruitment and training, and materials supplies (PRNewswire, 2013). Hong Kong is also committed to development as a leading regional cruise hub (Hong Kong Tourism Board [HKTb], 2013), though the number of cruise liners and cruise destinations is modest.

A second area of potential impact is Hong Kong's medical tourism. China has been interested in developing medical tourism and the SFTZ provides an opportunity to progress this agenda by allowing the establishment of wholly foreign-owned medical institutions. With the

presence of such institutions, there is a prospect to improve the quality of China's medical services and of communication with patients from overseas. Hong Kong has been recognized as Asia's hub for cancer treatments and is also keen to develop medical tourism. Although it is unclear whether cancer treatment will be the focus of medical tourism in Shanghai, the Chinese government's enthusiasm for developing medical tourism and its rapid development cannot be overlooked.

Stimulated by lower tariffs and by the establishment of duty-free retail hubs, the prices will drop for imported goods in Shanghai. Hong Kong has an established reputation as a "shopping paradise" for Mainland Chinese visitors, offering a range of duty-free shopping opportunities from luxury goods to daily necessities. Retail spending by Mainland Chinese visitors contributes 60% of Hong Kong's tourism income (HKTB, 2013). When duty-free retail hubs in Shanghai offer duty-free goods, consumers from affluent Yangtze River regions will be attracted to shop in the SFTZ rather than in Hong Kong (He, 2013; Gao, 2013). This may have a dampening effect on Hong Kong's retail sector. The effect may be accelerated by the recent Hong Kong protests against "parallel trading" activities and by the imposition of multiple entry visa restrictions on Shenzhen citizens which followed (Chen, 2015).

Shanghai's trade in artworks is likely to be revitalized thanks to the low consumption taxes prevailing in SFTZ (Siu, 2014). The construction of the International Artwork Trade Centre is preparing Shanghai to become a leading platform for Asia Pacific artwork trade. The Center provides services such as storage, trading, logistics, insurance, jewelry quality assurance, financing and leasing service. The inaugural tax-free artwork warehouse in China stores over 2,000 international artworks from more than 100 countries (Sinanews, 2014). The SFTZ exploits

the favorable tax regime and can accelerate the development of the artwork trade relative to Hong Kong.

Shanghai's exhibition services are another domain that competes with Hong Kong. The SFTZ is building China's National Exhibition and Trading Center (NETC). In its capacity as a founding member, Australia has established the Australian National Exhibition and Trading Centre (ANETC), an entire floor that exhibits Australian products and services (Riley, 2013). This permanent exhibition will become a centralized trading venue for wholesalers to source genuine Australian products from all regions of China, particularly in the case of wine (Riley, 2013). ANETC will also organize in-house trade fairs and road shows around China (Riley, 2013). International companies that are interested in conducting business between the two countries may be lured to Shanghai by NETC.

The influx of FDI will be accompanied by increased demand for hotel accommodation. The current range of high-end hotels in SFTZ is limited to the Sheraton and Crowne Plaza in Waigaoqiao Free Trade Zone and to Crowne Plaza and Ramada at Pudong Airport Free Trade Zone (Li, 2013). The occupancy rate achieved by Sheraton Waigaoqiao jumped by 20% to 30% over a three-month period to more than 80%, following inauguration of the SFTZ (Li, 2013). The future expansion of high-end hotels will enhance the luxury image of Shanghai.

A range of entertainment facilities that offer visitors enhanced excitement will appear in Shanghai because of the complete opening of the sector to foreign ownership. After a lengthy incubation, Shanghai's "Disneyland" theme park will open in 2016. When this development is considered, along with the expanded provision of duty-free retail hubs, exhibition centers, state-of-art hotels and entertainment facilities can make the SFTZ an enhanced integrated tourism

destination for Mainland tourists. The SFTZ may lure potential visitors within the region who would otherwise have visited Hong Kong.

There is a bright side to the FTZs for Hong Kong. The FTZs in general and Guangdong FTZ in particular will offer potential business opportunities. To date, Hong Kong has mainly capitalized on CEPA's (Mainland and Hong Kong Closer Economic Partnership Arrangement) zero tariff preferential treatment to access the mainland market (for certain services) ahead of other foreign countries. The Guangdong FTZ will provide an alternative channel for Hong Kong by introducing facilitation measures and bonded arrangements for cross-border e-commerce operators (HKTDC Research, 2015). An additional range of new services will be made available to Hong Kong service providers in the FTZ, including wholly Hong Kong-owned international shipping enterprises, intermediary service institutions for self-financed overseas study, travel agencies providing overseas group travel services (with the exception of Taiwan), and high-end medical services (Yao, 2015). Guangdong FTZ also aims to develop international trade ties amongst the economies located along the nascent Maritime Silk Road. If Hong Kong participates, this should consolidate its position as an Asia-Pacific trade and shipping hub (Yao, 2015).

Confronted by the various challenges and opportunities of the FTZs, how should Hong Kong react? Firstly, the authors suggest that Hong Kong should adopt a co-operative attitude towards the mainland in order to secure the new opportunities. In the earlier period Hong Kong was the greatest single contributor to foreign direct investment in the PRD, leading to the employment of some 10-11 million workers (Enright, Scott, & Chang, 2005). The offshore services that Hong Kong offered also played an effective role in attracting foreign investment to the mainland. However, the newer FTZs are more reliant on stimulating domestic consumption to sustain growth. For this reason, Hong Kong has increasingly played a support role through

China's recent economic reforms. On this basis, Hong Kong should adopt a philosophy of *cooperation*, rather *leadership* in various business and political matters towards the mainland. Adopting a co-operative attitude should help Hong Kong to integrate itself within China's economic development and secure new opportunities. This is also a potential foundation for counteracting any negative impacts of the FTZs.

As a result of the consequences arising from the FTZs, it is suggested that Hong Kong should consider strategies to counteract the negatives by diversifying its range of products/services, enhancing the process of serving, creating resources from existing assets, and offering primacy to intangibles in the tourism market (Lusch, Vargo, & Tanniru, 2010). In so doing, destination marketers may highlight Hong Kong's unique cultural resources, such as "Lingnan" Chinese culture, British colonial legacy, and film history. Such initiatives can help diversification from an over-reliance on long established tourism products. Hong Kong could also export its tourism-related expertise in areas that support the economic development of FTZs, such as MICE management, travel agency services, transportation management, medical expertise and service management standards. In domains where direct competition is evident, such as retail services, cruise management and art trading, Hong Kong may seek closer integration within the Chinese developments. Such prospective strategies do however raise questions about whether the Hong Kong government and especially local residents are ready to pursue closer integration into China's agenda of social and political development.

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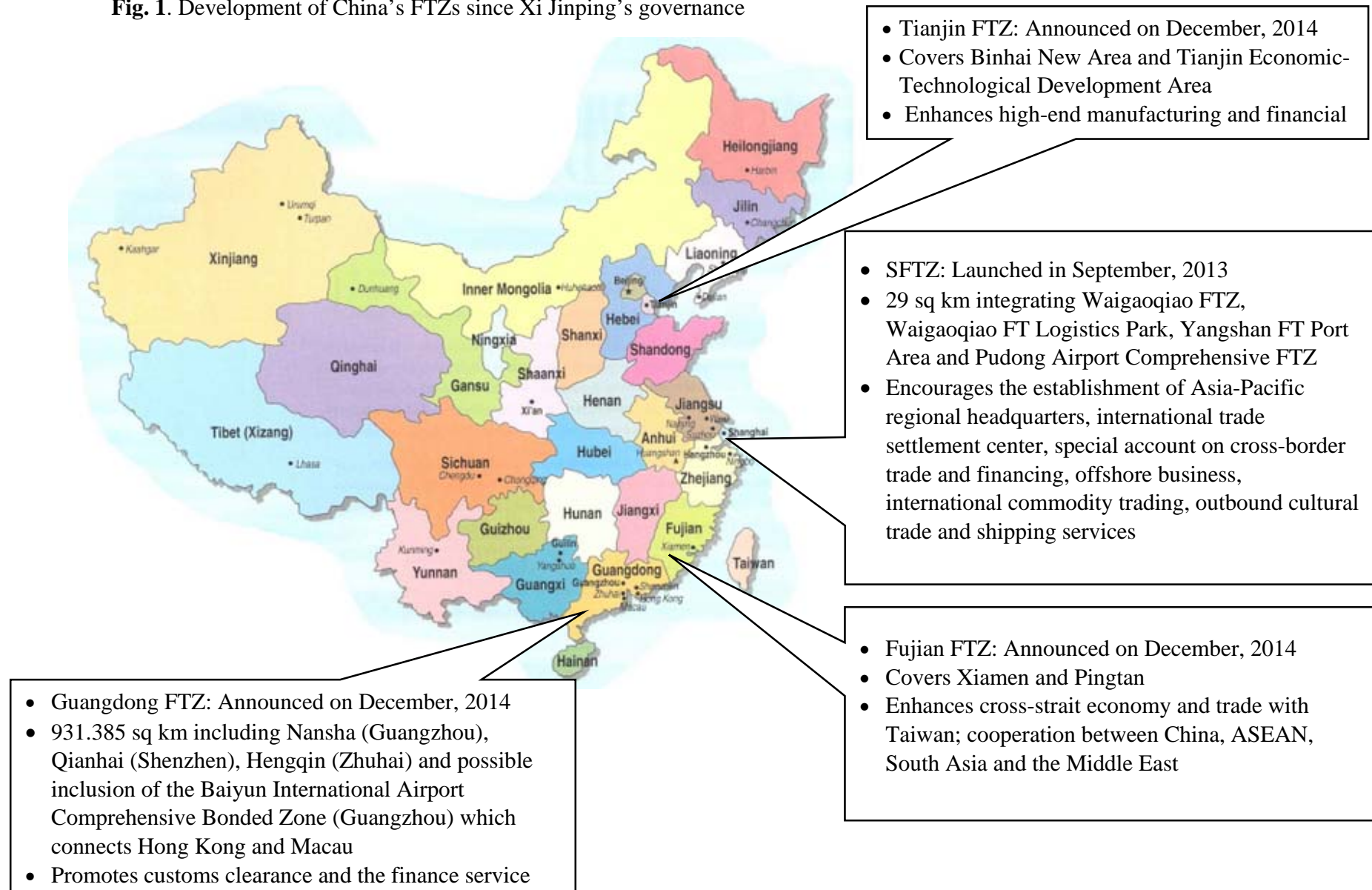
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Fig. 1. Development of China's FTZs since Xi Jinping's governance



Note: The above information is based on Gao (2013), Shi (2013), HKTDC Research (2015), Yao (2015) and Lau (2015).