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# From special economic zones to greater special economic region – Hong Kong Special Administrative Region as a model for legal infrastructure design

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This article examines the key aspects of the legal infrastructure design of special economic zones (SEZs), with reference to the best practice of the Hong Kong Special Administrative Region (Hong Kong SAR) under “One Country, Two Systems” and the Basic Law. It discusses some recent initiatives of the Hong Kong SAR in respect of innovations in dispute resolution mechanisms and creative use of modern technology to illustrate how SEZs can respond to contemporary challenges and opportunities. In particular, this article discusses the Guangdong–Hong Kong–Macao Greater Bay Area, which sheds light on a new model of collaboration and partnership between SEZs, and explores the possibility and potential for SEZs to serve as the building blocks for the eventual establishment of a new paradigm of greater special economic region.

**Keywords:** special economic zone, legal infrastructure, Hong Kong Special Administrative Region, Greater Bay Area, greater special economic region

## 1. Introduction

The establishment of special economic zones (SEZs) has generated much interest in recent years, as the world is looking for catalysts for international trade and investment.<sup>1</sup> Although SEZs are economic policy tools with a very long history, they

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<sup>1</sup> As reported in UNCTAD's *World Investment Report 2019* (pp. 128–129), there are now estimates of nearly 5,400 SEZs worldwide. The author provided an overview on the historical development of SEZs, considerations on the legal infrastructure design of SEZs, and the major contemporary challenges and opportunities in relation to the development of SEZs in the article, “Special Economic Zones: A Catalyst for International Trade and Investment in Unsettling Times?” (2019).

are not always successful. Often the dividing line between an SEZ that can serve as a successful role model and one that ends up in disastrous failure hinges on whether the SEZ is supported by a solid legal infrastructure.

This article first considers best practice in the design of the legal infrastructure of an SEZ, with reference to insights from the Hong Kong Special Administrative Region (Hong Kong SAR) of the People's Republic of China. It then discusses various recent initiatives in the Hong Kong SAR that may address the contemporary challenges and build on opportunities in the development of SEZs.<sup>2</sup> In light of the Guangdong–Hong Kong–Macao Greater Bay Area (Greater Bay Area), this article also explores the possibility and potential for SEZs in different jurisdictions to collaborate innovatively and form a greater special economic region.

## **2. Best practice for the design of legal infrastructure – insights from the Hong Kong SAR**

The global experience with SEZs has shown that, apart from geographical location and supporting physical infrastructure, a well-designed legal infrastructure is crucial to success. Generally speaking, a well-designed legal infrastructure would be composed of SEZ laws that are sufficiently stable to ensure consistent, transparent and predictable implementation of SEZ policy, as well as SEZ regulations and SEZ operating procedures that are practical, flexible and responsive to the needs of investors (Gauthier, 2015, p. 10).

In considering the design of the legal infrastructure of an SEZ, the Hong Kong SAR provides an interesting case of reference. Under the unprecedented “One Country, Two Systems”, the Hong Kong SAR is a special administrative region of China, and exercises a high degree of autonomy and enjoys executive, legislative and independent judicial power, including that of final adjudication, in accordance with the Basic Law (Basic Law, art. 2).<sup>3</sup> In fact, the Hong Kong SAR exhibits a number

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<sup>2</sup> Major contemporary challenges and opportunities in relation to the development of SEZs include (i) innovations in dispute resolution mechanisms of SEZs, (ii) creation of synergy between SEZs and free trade agreement initiatives, (iii) making greater use of modern technology in SEZs, (iv) building a “green” model for SEZs to ensure sustainable development, and (v) enhancing collaboration and partnership among governments as well as international organizations on the development of SEZs (Cheng, 2019, pp. 56–66).

<sup>3</sup> The Basic Law, which came into effect on 1 July 1997, was adopted by the National People's Congress of China and promulgated by the then President of China on 4 April 1990 in accordance with the Constitution of China. The Basic Law sets out the high autonomy enjoyed by the Hong Kong SAR as well as the systems and policies practised in the special administrative region. Such systems include: the social and economic systems; the system for safeguarding the fundamental rights, freedoms and duties of its residents; the executive, legislative and judicial systems; and the relevant policies.

of characteristics of an SEZ,<sup>4</sup> such as having in place a regulatory regime different from that in the rest of the country. Further, the Hong Kong SAR practises the capitalist system instead of the socialist system practised in the rest of China (Basic Law, art. 5). Whereas the legal system of Mainland China is based on civil law, the legal system of the Hong Kong SAR is common law-based (Basic Law, art. 18).<sup>5</sup> It is also worth noting that the Basic Law requires the Hong Kong SAR to maintain the status of a free port (Basic Law, art. 114) and is widely acclaimed for that status. Moreover, it is well known in the international community that the Hong Kong SAR itself is a separate customs territory (Basic Law, art. 116) and a founding member of the World Trade Organization (WTO). With these features, the Hong Kong SAR can provide useful insights with respect to designing the legal infrastructure of modern SEZs.

The discussion in the following section focuses on six major elements in the legal infrastructure design of SEZs, namely (i) key principles and policies, (ii) the institutional framework, (iii) good governance and rule of law, (iv) fiscal incentives and tax administration, (v) an efficient and liberal regulatory regime for business activities in SEZs, and (vi) linkages and integration with national and global initiatives. It is also essential to ensure that the legal infrastructure of SEZs and their operations are compatible with the international trade rules of the WTO as well as the rules under applicable free trade agreements (FTAs) and international investment agreements.

## 2.1. Key principles and policies

It is important for the high-level design of the legal infrastructure of an SEZ to set out clearly its key principles and policies (Gauthier, 2015, p. 12) to, on one hand, guide the design of the features of the legal infrastructure and, on the other, signal the outside world about the underlying policies and objectives of the SEZ so as to attract the targeted foreign investments. In the Hong Kong SAR, high-level trade policy is set out in the provisions of the Basic Law. For example, the Hong Kong SAR shall pursue the policy of free trade and safeguard the free movement of

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<sup>4</sup> In a leading study conducted by the World Bank on SEZs (Farole, 2011, pp. 23–25), an attempt has been made to define SEZs broadly as “demarcated geographic areas contained within a country’s national boundaries where the rules of business are different from those that prevail in the national territory”. In the same study, the World Bank also observed that those differential rules “principally deal with investment conditions, international trade and customs, taxation, and the regulatory environment” and the determinant structural feature of an SEZ is that it “benefits from a different regulatory regime from that in the rest of the economy”.

<sup>5</sup> Art. 18 of the Basic Law provides that the national laws of China shall not be applied in the Hong Kong SAR except for those listed in Annex III of the Basic Law, which are confined to those relating to defence and foreign affairs as well as other matters outside the limits of the autonomy of the Hong Kong SAR as specified by the Basic Law.

goods, intangible assets and capital (Basic Law, art. 115), as well as maintaining its status as a free port (Basic Law, art. 114).

Protection of property rights is also a crucial component of the principles and policies of an SEZ because an obvious goal is to instil confidence in foreign investors about making investments in the zone. In this regard, ensuring adequate protection of property rights has always been high on the agenda of the Hong Kong SAR. The Basic Law expressly provides that the right of private ownership of property shall be protected (Basic Law, art. 6), and that the Hong Kong SAR shall protect the right of individuals and legal persons to the acquisition, use, disposal and inheritance of property and their right to compensation for lawful deprivation of their property (Basic Law, art. 105).<sup>6</sup> Moreover, given the status of the Hong Kong SAR as one of the leading global investment hubs, it has been made expressly clear in the Basic Law that the ownership of enterprises and the investments from outside the Hong Kong SAR shall be protected by law (Basic Law, art. 105).

In today's knowledge-driven economy, intellectual property can be a highly valuable investment. Under the Basic Law, the Hong Kong SAR protects by law achievements in scientific and technological research, patents, discoveries and inventions, as well as the achievements and the lawful rights and interests of authors in their literary and artistic creation (Basic Law, arts. 139 and 140). To ensure that the protection of intellectual property in the Hong Kong SAR meets the highest international standard, the Customs and Excise Department is tasked with helping rights-owners to enforce their rights in relation to copyright and trademark goods through border enforcement measures, in accordance with the Agreement on Trade-Related Aspects of Intellectual Property Rights of the WTO (Intellectual Property Department, 2019).

## 2.2. Institutional framework

The institutional framework of an SEZ serves as the backbone of the legal infrastructure and typically involves a number of key actors, namely government, regulator, owner, developer, operator and tenants of the SEZ (Farol, 2011, p. 171; ASEAN, 2016, p. 15).<sup>7</sup> In regard to the institutional role of the Government of the

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<sup>6</sup> Art. 105 of the Basic Law further provides that the compensation for lawful deprivation shall correspond to the real value of the property concerned at the time and shall be freely convertible and paid without undue delay.

<sup>7</sup> The government is generally responsible for the strategic planning, administration and regulation of an SEZ programme, selecting sites and developers, and providing offsite and connecting infrastructure. The regulator is often considered one of the most important actors in an SEZ. Its authority, quality and capacity will make or break an SEZ programme because the regulator plays a crucial role in monitoring the compliance and enforcement of the legal framework of the SEZ and in facilitating licensing and regulatory services within the SEZ (Farole, 2011, p. 182).

Hong Kong SAR, the Basic Law provides that it shall provide an economic and legal environment for the maintenance of the status of the Hong Kong SAR as an international financial centre and for encouraging investments, technological progress and the development of new industries (Basic Law, arts. 109 and 118).<sup>8</sup> The Basic Law further provides that the Government of the Hong Kong SAR shall formulate appropriate policies to promote and coordinate the development of various trades such as manufacturing, commerce, tourism, real estate, transport, public utilities, services, agriculture and fisheries (Basic Law, art. 119).

The Government of the Hong Kong SAR upholds the free market principle and at the same time seeks to play the role of a facilitator and a promoter to boost the economic vibrancy of the Hong Kong SAR through efforts in various areas, including land supply, talent, government-to-government business, policy directions, investment, business-friendly environment and taxation (Government of the Hong Kong Special Administrative Region, 2017, para. 3; Government of the Hong Kong Special Administrative Region, 2018b, para. 14).

In respect of the regulatory regime, it is worth mentioning that a number of regulatory bodies in the Hong Kong SAR, such as the Securities and Futures Commission,<sup>9</sup> the Competition Commission<sup>10</sup> and the Insurance Authority,<sup>11</sup> are independent statutory bodies.

The institutional structure of an SEZ can range from fully public, with the SEZ being operated, developed and regulated by the government, to fully private, with the SEZ being developed and operated privately.<sup>12</sup> In between the two extremes, there is also the public-private partnership (PPP) model.<sup>13</sup> The PPP model is becoming very important, especially for infrastructure works. In fact, during the early stage of the establishment of the Shenzhen SEZ in China, joint ventures and private developers from Hong Kong have provided significant contributions to the development of basic SEZ infrastructure through PPPs (Yeung et al., 2009, pp. 228–229).

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<sup>8</sup> Art. 128 of the Basic Law also provides that the Government of the Hong Kong SAR shall provide conditions and take measures for the maintenance of the status of the Hong Kong SAR as a centre of international and regional aviation.

<sup>9</sup> See the website of the Securities and Futures Commission at <https://www.sfc.hk/web/EN/>.

<sup>10</sup> See the website of the Competition Commission at <https://www.compcomm.hk/>.

<sup>11</sup> See the website of the Insurance Authority at <https://www.ia.org.hk/en/index.html>.

<sup>12</sup> Back in the 1980s, less than 25 per cent of zones worldwide were in private hands. However, by 2005, 62 per cent of the 2,301 zones in developing and transition countries were developed and operated by the private sector (Akinci et al., 2008, p. 2).

<sup>13</sup> The PPP model can take many forms, such as public provision of off-site infrastructure and facilities as an incentive for private funding of on-site infrastructure and facilities, government assembly of land parcels with secure title and development rights for lease to private zone development groups and build-operate-transfer and build-own-operate approaches to on-site and off-site zone infrastructure and facilities (Akinci et al., 2008, pp. 18–19).

With the increasing participation of private parties in the development and operation of SEZs, one must not overlook the risk that the acts of such private parties can potentially result in violations of the applicable international agreements and that such acts may be attributed to the relevant States under the rules on State responsibility.<sup>14</sup> As a result, one should be careful in the selection and vetting process for private parties' participation in the development, management and operation of SEZs. It would also be prudent to set up monitoring and coordination mechanisms to ensure that the conduct of such private parties does not breach the obligations under the relevant international investment agreements. Furthermore, the actions of private entities such as a private SEZ operator may give rise to concerns under the WTO disciplines if such entities are carrying out a governmental directive, or if the benefits of the WTO-inconsistent incentives provided through such entities are funded by the government (Creskoff et al., 2009, p. 30).

### **2.3. Good governance and rule of law**

In the design of the legal infrastructure of an SEZ, the importance of rule of law cannot be overemphasized. In the Hong Kong SAR, strong rule of law has always been its core value and such rule of law is supported by a robust legal and judicial system. It is worth noting that the Hong Kong SAR is vested with independent judicial power and that the courts of the Hong Kong SAR shall have jurisdiction over most cases in the special administrative region but not over acts of State such as defence and foreign affairs (Basic Law, art. 19).

Furthermore, the Basic Law has vested the power of final adjudication in the Court of Final Appeal of the Hong Kong SAR. A unique feature in the judicial system of the Hong Kong SAR is that the Court of Final Appeal may as required invite judges from other common law jurisdictions to sit on it as non-permanent judges (Basic Law, art. 82). More importantly, it is also expressly provided under the Basic Law

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<sup>14</sup> In the case of *Ampal-American Israel Corporation and others v Arab Republic of Egypt*, the investor's company was granted free zone privileges by Egypt and it entered into a contract with two State-owned corporations of Egypt. The company's free zone privileges were subsequently withdrawn by Egypt and its contract terminated by the two State-owned corporations. The tribunal of the International Centre for Settlement of Investment Disputes (ICSID) ruled in favour of the investor and held that the conduct of the two State-owned corporations, which amounted to expropriation, was attributable to Egypt (*Ampal-American Israel Corporation and others v. Arab Republic of Egypt*, ICSID Case No. ARB/12/11, Award, 21 February 2017, para. 354). In the proceeding that sought to set aside the arbitral award of *Lee John Beck and Central Asian Development Corporation v. Kyrgyz Republic*, made under the CIS Convention for the Protection of Investors Rights, although the Kyrgyz Republic argued that the SEZ in question was not a State organ, the Moscow Arbitration Court held that attribution was found because the management of the SEZ was an executive body established by the Prime Minister of Kyrgyzstan and the SEZ enjoyed the same executive status under the Kyrgyz legislation as a ministry within the Kyrgyz Government (Boltenko, 2018).

that the courts of the Hong Kong SAR shall exercise judicial power independently, free from any interference (Basic Law, art. 85).

The high degree of rule of law of the Hong Kong SAR is globally recognized. Insofar as judicial independence is concerned, the Hong Kong SAR ranked second among common law jurisdictions and eighth globally among 141 jurisdictions, according to the *Global Competitiveness Report 2019*, prepared by the World Economic Forum (WEF, 2019, p. 267). Moreover, the Hong Kong SAR ranked fourth among 126 jurisdictions with respect to the “order and security” in the Rule of Law Index 2019 of the World Justice Project (WJP, 2019, p. 84).

Good governance is also a crucial ingredient in the legal infrastructure of a successful SEZ. To achieve good governance, it is necessary to have in place an effective and efficient coordination mechanism for the various government agencies involved in the regulation of an SEZ. Under the Basic Law, the Chief Executive appoints members of the Executive Council of the Hong Kong SAR from among the principal officials of the executive authorities as well as members of the Legislative Council and other public figures (Basic Law, art. 55). The Chief Executive shall also consult the Executive Council before making important policy decisions and introducing bills to the Legislative Council (Basic Law, arts. 54 and 56). Such a mechanism is highly beneficial for effective policy coordination.<sup>15</sup>

Another facet of good governance is the absence of corruption, which is important for attracting foreign direct investment because foreign investors would clearly be reluctant to invest in a region where corruption and uneven enforcement of regulations are rampant (WJP, 2018, p. 11). In 2019, the Hong Kong SAR ranked ninth globally with respect to the “absence of corruption” in the Rule of Law Index 2019 of the World Justice Project (WJP, 2019, p. 84). This ranking can indeed be attributed to the effective functioning of the independent powers of the Independent Commission Against Corruption in investigation, the Department of Justice in prosecution and the Judiciary in adjudication to keep corruption under effective control (Independent Commission Against Corruption, 2019).

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<sup>15</sup> The Government of the Hong Kong SAR has also established the Policy Innovation and Co-ordination Office (PICO), which commenced operation in April 2018, to coordinate major cross-bureau policies selected by the chief executive and the secretaries of departments of the Government of the Hong Kong SAR to help achieve policy objectives and to provide “first-stop and one-stop” consultation and coordination services for innovative development projects that would bring broader public benefits (PICO, 2019).

## 2.4. Fiscal incentives and tax administration

Fiscal incentives are commonly featured in SEZs and may take the forms of corporate tax reduction or exemption; duty-free importation of raw materials, capital goods, and intermediate inputs; no restrictions or taxes on repatriation of capital and profits; exemption from foreign exchange controls; and exemption from most local and indirect taxes (Akinici et al., 2008, pp. 54–55).

Nevertheless, the policy of the Hong Kong SAR tends to focus on longer-term arrangements and relies on its track records, credibility and competitiveness to attract businesses and investments, instead of ad hoc short-term fiscal benefits. This policy has indeed contributed to attracting long-term, sustainable and profitable investments, as opposed to simply short-term entries that do not stay long in the markets.

Furthermore, one should bear in mind that some of the fiscal incentives may not necessarily sit well with the disciplines on subsidies under the Agreement on Subsidies and Countervailing Measures (SCM Agreement) of the WTO.<sup>16</sup> The provision of WTO-inconsistent fiscal incentives in SEZs may give rise to risks of dispute settlement actions under the WTO as well as the imposition of countervailing duties on the relevant products by other WTO members.

Fiscal incentives in SEZs, once imposed, are often difficult to remove and are described as being “sticky”. From the perspective of international investment law, investors may argue that withdrawal of fiscal incentives frustrates their legitimate expectation and gives rise to claims of violation of the fair and equitable treatment obligation and the like.<sup>17</sup> Whether such an argument would succeed depends on, inter alia, whether the cancellation and withdrawal of incentives are made in accordance with the laws related to SEZs in the host jurisdiction.

Research has revealed that successful zone programmes nowadays are moving increasingly toward the removal of fiscal incentives and toward the integration of

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<sup>16</sup> The SCM Agreement regulates two types of subsidies, namely prohibited subsidies and actionable subsidies. Prohibited subsidies are non-agricultural subsidies that are contingent on export performance, and subsidies that are contingent on the use of domestic goods in place of imported goods. As such, two kinds of subsidies could be considered prohibited: subsidies in the form of cash payments provided by the government on the basis of the export performance of SEZ tenants as well as subsidies that are contingent on the SEZ tenants' use of domestic over imported goods (Creskoff et al., 2009, pp. 31–33; Akinici et al., 2008, p. 55). Actionable subsidies, in contrast, are those that are granted by a WTO member that have “adverse effects” on international trade, because they cause injury to the domestic industry of another WTO member; nullify or impair WTO benefits; or cause “serious prejudice” to the interests of another WTO member (Akinici et al., 2008, p. 55).

<sup>17</sup> Withdrawals of free trade zone privileges have in the past given rise to a number of investor-State dispute actions, such as *Albacora S.A. v Republic of Ecuador*, PCA Case No 2016–11, and *Link-Trading Joint Stock Company v Department for Customs Control of the Republic of Moldova*.



zone tax regimes with those of the rest of the economy (Farole, 2011, pp. 178–179). Such integration should be orderly and gradual as well as predictable to minimize the risks of claims that may be brought by investors. One could also explore alternatives to fiscal incentives such as the enhancement of regulatory efficiency and greater emphasis on the business development service provided in the SEZ (Farole, 2011, pp. 178–179).

A simple tax regime and an efficient administration of the tax collection system in an SEZ would facilitate business activities and enhance the attractiveness of the SEZ as an investment location. Although tax rates offered in SEZs should be competitive in order to attract investment, SEZs should not be mistaken for tax heavens.

The Hong Kong SAR practises an independent taxation system separate from that of Mainland China and enacts its own laws on taxation. Under its tax regime, there are only three types of direct taxes, namely profits tax, salaries tax and property tax (Inland Revenue Ordinance (Cap. 112)). In the *Paying Taxes 2019* report prepared by the World Bank and PwC, the Hong Kong SAR was the top performer among the 190 economies in the overall ranking for ease of paying taxes. This high performance was attributed to the relative simplicity and stability of tax regulations as well as the digitalization of the entire tax work stream (World Bank and PwC, 2018, p. 15; 2019).

## **2.5. Efficient and liberal regulatory regime for business activities in SEZs**

Given that SEZs play the dual role of attracting investments and experimenting with regulatory reforms, they should have an efficient and liberal regulatory regime and allow the broadest possible business activities (Gauthier, 2015, p. 13). The Hong Kong SAR follows the economic policies of free enterprise and free trade. There are no import tariffs save for excise duties levied on a limited number of commodities such as liquors and tobacco (Government of the Hong Kong Special Administrative Region, 2018a). Moreover, the Government of the Hong Kong SAR shall, under the Basic Law, formulate its own monetary and financial policies, safeguard the free operation of financial business and financial markets, and regulate and supervise them in accordance with law (Basic Law, art. 110).

As compared with the situation of Mainland China in which certain measures of foreign exchange control are in place and full capital account convertibility has yet been achieved, the Basic Law provides that no foreign exchange control policies shall be applied in the Hong Kong SAR and that the Hong Kong dollar shall be freely convertible (Basic Law, art. 112). In addition, the Government of the Hong Kong SAR shall safeguard the free flow of capital within, into and out of the special administrative region (Basic Law, art. 112). Indeed, this feature has allowed the

Hong Kong SAR to perform the role of a global offshore renminbi business hub (Hong Kong Monetary Authority, 2016) and contribute to the internationalization of the renminbi.

In the Hong Kong SAR,<sup>18</sup> there is neither general foreign investment legislation governing the admission of foreign investments nor a general screening mechanism for such admission (The Heritage Foundation, 2018, p. 215). Licensing requirements exist in some industries (CAITEC, 2014), such as banking (Banking Ordinance (Cap. 155)), insurance (Insurance Ordinance (Cap. 41)), broadcasting (Broadcasting Ordinance (Cap. 562)) and telecommunication (Telecommunications Ordinance (Cap. 106)). Furthermore, in most cases, foreign investors can maintain 100 per cent ownership of their investments in the Hong Kong SAR (The Heritage Foundation, 2018, p. 215).

Effective customs facilitation measures are also an important facet of the legal infrastructure of successful SEZs. Under the framework of the WTO, there is the Trade Facilitation Agreement (WTO, 2019b), which entered into force on 22 February 2017. The Agreement is concerned with the simplification of import and export processes. It contains provisions related to expeditious release and clearance of goods as well as simplification of customs formalities and documentation requirements (Trade and Industry Department, 2019b). The Hong Kong SAR has been the global forerunner in the expeditious movement and release of goods and was the first WTO member to formally accept the Trade Facilitation Agreement in December 2014 (WTO, 2019a).

With respect to the legal system under which businesses operate, a flexible yet predictable system of law is often considered to be more business friendly. As mentioned above, the Hong Kong SAR practises a common law-based legal system (Basic Law, arts. 8 and 18),<sup>19</sup> which differs from the civil law-based legal system applicable to the rest of China. This model of an SEZ adopting a common law-based system that is different from the one practised in other parts of the country concerned is also found in a number of SEZs, such as the Qatar Financial

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<sup>18</sup> According to the report of the Heritage Foundation on its Index of Economic Freedom in 2019, the Hong Kong SAR ranked first among 180 economies in terms of economic freedom. The Hong Kong SAR has been ranked the world's freest economy for 25 consecutive years, since the Index was first published, in 1995.

<sup>19</sup> A common law system is often less prescriptive than a civil law system (providing for flexibility) and largely based on precedents, established by case law and follows the doctrine of judicial precedents (providing for predictability). However, it is by no means to say that a common law system is superior to that of civil law or other legal systems. Pejovic (2001) provides a useful comparison of common law and civil law systems and their respective advantages and limits.

Centre,<sup>20</sup> the Dubai International Financial Centre<sup>21</sup> and the Abu Dhabi Global Market in Dubai<sup>22</sup> as well as the Astana International Financial Centre in Kazakhstan.<sup>23</sup>

## 2.6. Linkages and integration with national and global initiatives

A very common pitfall in unsuccessful SEZ projects concerns the so-called “enclave syndrome”: SEZs established as isolated economic enclaves that do not have sufficient linkages with the rest of the country (Norman, 2018; UNESCAP, 2017, p. 155). Such SEZs would be unlikely to have a catalytic impact in most economies due to their isolation from the wider economic strategies of the relevant countries (Farole, 2011, pp. 9 and 25).

In the Hong Kong SAR, an economic system that is different from Mainland China is practised under the policy of “One Country, Two Systems” (Basic Law, art. 5). Yet the Hong Kong SAR also enjoys close linkages with Mainland China, in particular in relation to economic development. One of the most significant is the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA), which has very comprehensive coverage of trade in goods, trade in services, investment, and economic and technical cooperation (Trade and Industry Department, 2019a).

CEPA has been highly beneficial in strengthening the trade relationship in goods and services and fostering trade and investment between Mainland China and the Hong Kong SAR, as well as accelerating the economic integration and enhancing the long-term economic and trade development of both places (Trade and Industry Department, 2019a), thereby allowing the Hong Kong SAR to serve as a multilateral bridge or a springboard for inbound and outbound investments into or from Mainland China.

The Hong Kong SAR is also closely involved in various national initiatives such as the Belt and Road Initiative, as well as in the development of the Greater Bay Area (Government of the Hong Kong Special Administrative Region, 2018b, paras. 91–97). For the Belt and Road Initiative, a new model of trilateral cooperation featuring “Mainland China plus Hong Kong SAR plus a country along the Belt and Road” is being explored (OCMFA, 2017).

In today’s interconnected world, new developments in technology and an enabling policy environment have allowed businesses to internationalize their operations across the globe in order to improve efficiency, lower costs and accelerate production

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<sup>20</sup> See the website of the Qatar Financial Centre at <http://www.qfc.qa/en/Pages/default.aspx>.

<sup>21</sup> See the website of the Dubai International Financial Centre at <https://www.difc.ae/>.

<sup>22</sup> See the website of the Abu Dhabi Global Market of Dubai at <https://www.adgm.com/>.

<sup>23</sup> See the website of the Astana International Financial Centre of Kazakhstan at <https://aifc.kz/>.

(Fung, 2013, p. xix). As a result of the increasing connectivity and interdependence among different economies, it is important that SEZs are integrated not only with the rest of domestic economy but also with the global economy.

The Hong Kong SAR, acting under the general authorization of the Basic Law or the specific authorization of the Central People's Government of China, has been actively maintaining and developing relations with foreign States and regions, and has entered into a broad range of international agreements.<sup>24</sup> As of October 2019, the Hong Kong SAR has concluded six FTAs<sup>25</sup> and 21 investment promotion and protection agreements (IPPAs)<sup>26</sup> with foreign economies, and it is seeking further expansion of its network of trade and investment agreements to strengthen its economic connection with the rest of the world (Government of the Hong Kong Special Administrative Region, 2018b, paras. 82–85).

To craft a successful SEZ programme, policymakers should adopt an international mindset and pay close attention to the positioning of the SEZ in light of ongoing global initiatives. It is equally important to ensure that the policy design is compatible with international legal norms in relation to trade and investments, such as the principles of most-favoured-nation treatment and national treatment that are enshrined in the disciplines under the covered agreements of the WTO, such as the General Agreement on Tariffs and Trade 1994<sup>27</sup> and the General Agreement on Trade in Services, as well as under most international investment agreements.

### **3. Contemporary challenges and opportunities in the development of SEZs – Greater Bay Area and recent initiatives in the Hong Kong SAR**

Designing a solid legal infrastructure of an SEZ is already a daunting task, yet SEZs themselves are also an evolving subject. Apart from their catalytic potential for international trade and investment, SEZs can serve as part of broader economic

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<sup>24</sup> See e.g. arts. 96, 116, 133 and 151 of the Basic Law. For the list of bilateral international agreements of the Hong Kong SAR, please refer to the website of the Department of Justice of the Government of the Hong Kong SAR at <https://www.doj.gov.hk/eng/laws/treaties.html>.

<sup>25</sup> For the full list and the texts of the FTAs of the Hong Kong SAR, please refer to the website of the Trade and Industry Department of the Government of the Hong Kong SAR at <https://www.tid.gov.hk/english/ita/fta/index.html>.

<sup>26</sup> For the full list and the texts of the IPPAs of the Hong Kong SAR, please refer to the website of the Trade and Industry Department of the Government of the Hong Kong SAR at <https://www.tid.gov.hk/english/ita/ippa/index.html>.

<sup>27</sup> It should be noted that the principle of national treatment is also reflected in the disciplines of the Agreement on Trade-Related Investment Measures of the WTO, which govern the so-called "performance requirements".

reform strategies as well as laboratories for experimentation with innovative and forward-looking policies and regulatory practices (UNCTAD, 2019, p. 179).

There is currently a wide variety of SEZs, such as commercial free zones, export processing zones, single-unit free zones, wide-area SEZs (which operate similarly to cosmopolitan cities) and free trade ports.<sup>28</sup> Moreover, numerous new forms of SEZs continue to emerge (UNCTAD, 2018, p. 155).<sup>29</sup> For example, China Merchants Group, which is a Chinese State-owned corporation, has come up with the pioneering “Port-Park-City” (前港中區後城) model for SEZ development and sought to export such a model overseas on the basis of the very successful experience in Shekou of Shenzhen.<sup>30</sup>

To succeed in today’s world, modern SEZs need to respond to contemporary challenges and opportunities arising from the changing global trade and investment environment (Cheng, 2019, pp. 56–66). In this regard, the Great Bay Area and some recent initiatives of the Hong Kong SAR may provide useful insights into how SEZ policymakers can respond to such challenges and opportunities.

### **3.1. Innovations in dispute resolution mechanisms**

First, one must not overlook the fact that no matter how well an SEZ has been designed and operated, it is inevitable that for one reason or another, some of the investments in the SEZ may give rise to disputes between investors and between investors and the host government, as well as any other entities involved in the SEZ. On some occasions, even the establishment of an SEZ may give rise to disputes. A recent example is the high-profile legal dispute between a Djibouti port operator, which is a subsidiary of a global port operator owned by the United Arab Emirates,

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<sup>28</sup> In China, President Xi Jinping mentioned that more powers will be granted to pilot free trade zones to conduct reform, and the establishment of free trade ports is to be explored (Xi, 2017). At the 40<sup>th</sup> year following the launch of China’s economic reform in 1978, a plan was announced to explore the establishment of a free trade port with Chinese characteristics in Hainan, with reference to the experience of other well-established free trade ports in the world. Such a free trade port will move away from entrepôt trade, manufacturing and processing and focus on tourism, modern services industries and high-tech industries (Central Committee of the Communist Party of China and State Council of the People’s Republic of China, 2018).

<sup>29</sup> On 16 October 2018, the State Council also published the overall plan for the development of the Hainan Pilot Free Trade Zone (State Council of the People’s Republic of China, 2018).

<sup>30</sup> Under the “Port-Park-City” model, the “Park” element is concerned with the establishment of a free trade zone (Belt and Road Portal, 2019).

and the State of Djibouti, arising from the Djibouti International Free Trade Zone Project of the Djibouti Government and China Merchants Port Holdings.<sup>31</sup>

In light of the fact that different rules and regulatory approaches are adopted in SEZs as compared with the rest of the countries, a well-designed specialized dispute resolution mechanism for SEZs becomes even more important. Such specialized dispute resolution mechanism can, on one hand, ensure fair resolution of disputes and provide greater comfort for investors to make investments in the zones, and, on the other hand, prevent disputes in SEZs from being escalated to investor–State arbitration, which can result in substantial cost to the host jurisdictions (Dettoni, 2018).

The essential features of an effective specialized dispute resolution mechanism for SEZs are (i) clear and adequate scope of jurisdiction (Puig et al., 2017, pp. 689–690 and 700–703) and (ii) easy enforceability of judgments and arbitral awards delivered under such a mechanism outside the SEZs in the rest of the economy or in the other jurisdictions (Sharar et al., 2016, pp. 529–531 and 541).

The Hong Kong SAR has strived to fully capitalize on the unique arrangement under “One Country, Two Systems” to pursue the provision of effective, inclusive, efficient and affordable dispute resolution mechanisms for the benefit of all by way of various innovative initiatives.

On the international level, as the Hong Kong SAR is an inalienable part of China (Basic Law, art. 1), it is worth mentioning that the representatives of the Government of the Hong Kong SAR have, through the pioneering arrangement under the Basic Law, participated as members of the Chinese delegation in international organizations and conferences in appropriate fields limited to States (Basic Law, art. 152). In particular, the Judgments Project of the Hague Conference on Private International Law (HCCH), which has developed a new international convention (Judgments Convention) on the recognition and enforcement of foreign judgments in civil and commercial matters (HCCH, 2019), and Working Group III of the United Nations Commission on International Trade Law on the reform of investor–State dispute settlement (UNCITRAL, 2019), are two examples in which the Hong Kong SAR contributes to the international rule-making in dispute resolution under the aforesaid arrangement of the Basic Law.

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<sup>31</sup> In the ruling by a tribunal of the London Court of International Arbitration, the State of Djibouti was held liable for being in breach of the Djibouti port operator’s exclusivity rights under a concession agreement for a container terminal by pursuing the development of container port facilities with China Merchants Port Holdings (Jones et al., 2019). The parent company of that Djibouti port operator also brought a lawsuit in the High Court of the Hong Kong SAR against China Merchants Port for causing the Djibouti Government to revoke its exclusive right to run the port (South China Morning Post, 2019).

In the case of the Hong Kong SAR, whether before or after the resumption of the exercise of sovereignty by China on 1 July 1997, arbitral awards made within its jurisdiction can be enforced in all State parties to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.<sup>32</sup> Modelling on the regime under the New York Convention, the Hong Kong SAR has entered into two innovative arrangements, respectively with Mainland China and the Macao SAR, for reciprocal recognition and enforcement of arbitral awards.

Furthermore, in January 2019, taking reference from the Judgments Project of the HCCH, Mainland China and the Hong Kong SAR entered into a comprehensive arrangement on reciprocal recognition and enforcement of judgments in civil and commercial matters,<sup>33</sup> which will reduce the need for relitigation of the same disputes in both places and offer better protection of the disputing parties' interest.

In addition, in April 2019, Mainland China and the Hong Kong SAR entered into a ground-breaking arrangement concerning mutual assistance in court-ordered interim measures in aid of arbitral proceedings. This made the Hong Kong SAR the first and only jurisdiction outside Mainland China where, as a seat of arbitration, parties to arbitration proceedings administered by eligible arbitral institutions will be able to apply to the Mainland courts for interim measures.

To enhance the coordination and implementation of various initiatives on dispute avoidance and resolution, the Inclusive Dispute Avoidance and Resolution Office (IDAR Office) was established within the Department of Justice of the Hong Kong SAR to pursue and conclude cooperation or partnership arrangements with other jurisdictions and international organizations.<sup>34</sup> The IDAR Office strives to facilitate

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<sup>32</sup> Prior to 1 July 1997, the United Kingdom had extended the application of the New York Convention to Hong Kong, with effect from 21 April 1977, by way of a notification to the Secretary-General of the United Nations (received on 21 January 1977). See <https://treaties.un.org/doc/Publication/CN/1977/CN.27.1977-Eng.pdf>. China is a Contracting Party to the New York Convention and ratified the Convention on 22 January 1987. On 6 June 1997, China made a notification to the Secretary-General of the United Nations that China would resume the exercise of sovereignty over Hong Kong on 1 July 1997, and the New York Convention thus applies to the Hong Kong SAR with effect from that date as well. See <https://treaties.un.org/doc/Publication/CN/1997/CN.273.1997-Eng.pdf>.

<sup>33</sup> This arrangement will supersede the previous Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and of the Hong Kong Special Administrative Region pursuant to the Choice of Court Agreements between Parties Concerned (also known as the Choice of Court Arrangement).

<sup>34</sup> For example, the Department of Justice of the Hong Kong SAR and the Ministry of Justice of Japan signed a Memorandum of Cooperation in January 2019 to strengthen their collaboration on issues relating to international arbitration and mediation. The Department of Justice of the Hong Kong SAR and the Ministry of Justice of Korea also signed a Memorandum of Cooperation in September 2019 to provide a framework for the Hong Kong SAR and Korea to strengthen communication, collaboration and co-operation on issues relating to dispute avoidance and resolution. On 5 May 2017, the High Court of the Hong Kong SAR and Abu Dhabi Global Market Courts signed a Memorandum of Guidance as to Enforcement.

access to justice and provide equal opportunities for people from all walks of life and for all sectors of the economy without boundary, advancing Goal 16 (Peace, Justice and Strong Institutions) of the United Nations 2030 Sustainable Development Goals in the Hong Kong SAR and beyond.

Innovation with respect to legal cooperation arrangements capitalizing on “One Country, Two Systems” in relation to dispute resolution will continue to enhance the role of the Hong Kong SAR as a legal hub and dispute resolution centre.

### **3.2. Creative use of modern technology**

With respect to making greater use of modern technology in SEZs, the Government of the Hong Kong SAR has been very supportive of the development by non-governmental organizations of efficient and cost-effective online dispute resolution services and deal-making platforms, in order to enhance the use of LawTech in the Hong Kong SAR.<sup>35</sup> In particular, the non-governmental eBRAM Centre was established to develop an electronic business-related arbitration and mediation platform (eBRAM platform). The eBRAM platform is an internet-based online platform integrating state-of-the-art technologies such as neural machine learning on translation, artificial intelligence, the internet of things, blockchain and smart contracts, for facilitating the provision of a full spectrum of cross-border one-stop dispute resolution services ranging from negotiation, conciliation, mediation, to arbitration for enterprises worldwide (Department of Justice, 2019, pp. 3–4). The eBRAM Platform will also serve as a secure and user-friendly online platform to provide deal-making services.

### **3.3. Enhancing collaboration and partnership in the development of SEZs – the Greater Bay Area**

In today’s globalized world, collaboration and partnership are crucial to the development of SEZs. Goal 17 (Partnerships for the Goals) of the United Nations 2030 Sustainable Development Goals also places great emphasis on the revitalization of the global partnership for sustainable development.

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<sup>35</sup> In the 2018 Policy Address, the Chief Executive of the Hong Kong SAR indicated support for funding the cost of non-governmental development of an e-arbitration and e-mediation platform so that the Hong Kong SAR will be able to provide efficient and cost-effective online dispute resolution services. On 27 February 2019, the Financial Secretary of the Hong Kong SAR announced that in the 2019-20 Budget HK\$150 million will be provided for the development and initial operation of the online dispute resolution and deal making platform (Department of Justice, 2019).



Collaboration and partnership come in many forms. They may range from cooperation agreements between SEZs in different countries to the joint development of an SEZ by different governments. In this regard, the Greater Bay Area<sup>36</sup> sheds light on a new paradigm in the collaborative development of SEZs.

The Greater Bay Area consists of the Hong Kong SAR, the Macao Special Administrative Region (Macao SAR) and nine Pearl River Delta municipalities in Guangdong Province.<sup>37</sup> Similar to the situation in respect of collaboration among SEZs located in different jurisdictions, a unique challenge to the Great Bay Area is that it involves one country, two systems, three customs territories, three currencies and three legal jurisdictions. Given the differences in legal systems, social systems and regulatory policies practised in the Hong Kong SAR, the Macao SAR and the nine Pearl River Delta municipalities, innovative measures are necessary for fostering the flow of people, goods, capital and information.<sup>38</sup>

The Greater Bay Area, which is a key national strategy, aims at further deepening cooperation among Guangdong, the Hong Kong SAR and the Macao SAR, fully leveraging the composite advantages of these three places, facilitating in-depth

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<sup>36</sup> On 1 July, 2017, witnessed by President Xi Jinping, the National Development and Reform Commission and the Governments of Guangdong, the Hong Kong SAR and the Macao SAR signed the Framework Agreement on Deepening Guangdong–Hong Kong–Macao Cooperation in the Development of the Greater Bay Area in Hong Kong (深化粵港澳合作推進大灣區建設框架協議). On 18 February, 2019, the Outline Development Plan for the Guangdong–Hong Kong–Macao Greater Bay Area (粵港澳大灣區發展規劃綱要) was promulgated and signified a new milestone in the development of the Greater Bay Area.

<sup>37</sup> The Greater Bay Area covers an area of 56,000 square kilometres with a combined population of approximately 70 million at the end of 2017. The nine Pearl River Delta municipalities are those of Guangzhou, Shenzhen, Zhuhai, Foshan, Huizhou, Dongguan, Zhongshan, Jiangmen and Zhaoqing in Guangdong Province (Outline Development Plan, p. 1).

<sup>38</sup> On 1 March 2019, eight policy measures were promulgated for taking forward the development of the Greater Bay Area to facilitate Hong Kong residents to develop, work and reside in the Mainland cities of the Greater Bay Area, as well as strengthen the convenient flow of people and goods within the Greater Bay Area. The policy measures include: (i) clarifying the method for calculating the 183 days that trigger payment of individual income tax on the Mainland: any stay of less than 24 hours on the Mainland will not count as a day of presence; (ii) providing tax relief by municipal governments to non-Mainland (including Hong Kong) high-end talents and talents in short supply by offsetting the tax differential between the two places; (iii) supporting the open recruitment of Hong Kong and Macao residents by public institutions in the Greater Bay Area; (iv) encouraging innovation and entrepreneurship in the nine Mainland cities of the Greater Bay Area by the youth of the Hong Kong SAR and the Macao SAR; (v) supporting higher education institutions and scientific research institutes from the Hong Kong SAR and the Macao SAR in participating in projects under Guangdong technology programmes; (vi) introducing pilot schemes of immigration facilitation reform in the Greater Bay Area; (vii) facilitating the entry and exit of vehicles from the Hong Kong SAR and the Macao SAR at Mainland ports; and (viii) expanding the scope of implementation of connection to the Speedy Customs Clearance mechanism between Customs administrations. Other major facilitation policies and measures for the Greater Bay Area can be found on the website of the Constitutional and Mainland Affairs Bureau of the Government of the Hong Kong SAR, at <https://www.bayarea.gov.hk/en/facilitation/measures.html>.

integration within the region and promoting coordinated regional economic development, with a view to developing an international bay area (Outline Development Plan, p. 1). One of the six principles of the Greater Bay Area is to adhere to “One Country, Two Systems” and act in accordance with the law.<sup>39</sup>

The Greater Bay Area is instructive for the legal infrastructure design of SEZs because, apart from the Hong Kong SAR and the Macao SAR, the Greater Bay Area also encompasses a number of SEZs of Mainland China, such as Shenzhen (including Qianhai Shenzhen–the Hong Kong Modern Service Industry Cooperation Zone) and Zhuhai (including the Hengqin Free Trade Zone). In particular, “early and pilot implementation” (先行先試) of reform and opening-up is part of the guiding ideology in the development of the Greater Bay Area (Outline Development Plan, p. 6). This provides a valuable platform for experimenting with the specialization and synergy creation of SEZs. For example, the Hong Kong SAR, one of the four core cities in the Greater Bay Area, is positioned as the centre for international legal and dispute resolution services. This positioning allows the Hong Kong SAR to leverage its experience and expertise in dispute resolution and the legal profession to handle disputes and address the demand for high-quality legal services in the Greater Bay Area.<sup>40</sup> As for the other three core cities in the Greater Bay Area, the Macao SAR is positioned as a tourism and leisure centre, while Guangzhou and Shenzhen are respectively positioned as an integrated gateway city and a national innovation city (Outline Development Plan, p. 12). This arrangement allows the cities to specialize on the basis of their respective strengths, to complement each other to create synergy and to avoid unnecessary competition among them. For example, the Hong Kong SAR can “export” its legal and professional talents and services to other places in the Greater Bay Area and provide a platform for resolution of disputes in the Greater Bay Area. In fact, the Department of Justice of the Hong Kong SAR and the legal departments of Guangdong and the Macao SAR have established, in September 2019, a joint conference mechanism to discuss work progress on

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<sup>39</sup> The other five basic principles in the development of the Greater Bay Area are (i) to be driven by innovation and led by reform; (ii) to coordinate development and plan holistically; (iii) to pursue green development and ecological conservation; (iv) to open up and cooperate and achieve a win-win outcome; and (v) to share the benefits of development and improve people’s livelihood (Outline Development Plan, pp. 6–8).

<sup>40</sup> Under the Outline Development Plan for the Guangdong–Hong Kong–Macao Greater Bay Area, an objective is to consolidate and enhance the Hong Kong SAR’s status as an international financial, transportation and trade centre as well as an international aviation hub; strengthen its status as a global offshore renminbi business hub and its role as both an international asset management centre and a risk management centre; promote the development of high-end and high value added financial, commercial and trading, logistics and professional services, etc.; make great efforts to develop the innovation and technology industries; nurture emerging industries; establish itself as the centre for international legal and dispute resolution services in the Asia-Pacific region; and develop into an international metropolis with enhanced competitiveness (Outline Development Plan, pp. 11–12).

specific proposals, such as the establishment and implementation of a mediation platform in the Greater Bay Area, and research priorities on strengthening legal exchanges and collaboration, in accordance with the guiding directions set out in the Outline Development Plan for the Greater Bay Area.

#### **4. Conclusions and policy implications – from SEZs to the new paradigm of special economic region**

Despite the very long history and widespread use of SEZs in the world, the establishment of an SEZ does not necessarily guarantee success in boosting trade and investment. The performance of SEZs has so far been mixed (Zeng, 2015, p. 2), and many have not performed well for reasons such as poor site location, uncompetitive policies and lack of differentiation, poor zone development practices, cumbersome procedures and controls, and poorly designed administrative structure (Akinci et al., 2008, pp. 50–51). At the same time, there is no shortage of examples of SEZs that have proven to be highly successful in attracting foreign direct investment and supporting broader economic reform strategies of the host country.

This article highlights for policymakers that a well-designed legal infrastructure is essential to the successful development of an SEZ. In this regard, referring to the unprecedented and unique “One Country, Two Systems” policy and the experience of the Hong Kong SAR, it suggests that important features of a well-designed legal infrastructure of an SEZ are (i) key principles and policies that emphasize free trade and the protection of property rights; (ii) a solid institutional framework that can facilitate collaboration and coordination among the key actors of an SEZ and accommodate partnerships between public and private parties; (iii) good governance and strong rule of law supported by a robust legal and judicial system; (iv) policy incentives that aim to attract long-term, sustainable and profitable investments, and a simple and efficient tax regime; and (v) a liberal and efficient regulatory regime for business activities.

Furthermore, it underscores that policymakers should ensure an SEZ is linked with, and integrated into, national and global initiatives and should avoid the pitfall of turning an SEZ into an isolated economic enclave. Moreover, in light of the interconnectedness of today’s world, it is of paramount importance for the policies and practices in an SEZ to align with international legal norms in relation to trade and investments as enshrined in the rules of the WTO, FTAs and international investment agreements.

This article also provides some thoughts on how policymakers can address and capitalize on the contemporary challenges and opportunities in relation to

development of modern SEZs, with reference to recent initiatives of the Hong Kong SAR in respect of innovations in dispute resolution mechanisms and creative use of modern technology. In particular, it draws the attention of policymakers to the Greater Bay Area, which provides a valuable and timely opportunity to experiment with innovative policies, on the basis of “early and pilot implementation”, to facilitate the flow of people, goods, capital and information across places with different legal, economic and social systems as well as policy coordination among such places.

While the development of the Greater Bay Area is a national initiative of China, it is worth considering whether the Greater Bay Area model can be applied to collaboration efforts of SEZs in different countries for the establishment of a greater special economic region (SER). Much research will need to be conducted on the establishment of such greater SERs. Perhaps a new form of SEZ treaty or new best practice can be created to facilitate the implementation of such an arrangement. In this regard, the experience of the Hong Kong SAR – with respect to its legal infrastructure design, including its unique regime and status for entering into arrangements with foreign States and Mainland China – may shed light on how standalone SEZs can serve as the building blocks for the eventual establishment of a new paradigm of greater special economic region.

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