HKGCC

Mainland / Hong Kong Closer Economic Partnership Arrangement (CEPA)

Hong Kong General Chamber of Commerce

July 2003

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Background

Nov 11, 2001 - China signed WTO Protocol of Accession at Doha

End Nov 2001 - CE proposed to the Central Government regarding a RTA between Mainland China and Hong Kong

Mid Dec 2001 - Central leadership formally agreed to move forward on a RTA between Mainland China and Hong Kong

January 25, 2002 - First meeting on RTA between MOFTEC Vice Minister An Min and HK Financial Secretary Antony Leung. This RTA to be called CEPA

June 29, 2003 - CEPA signed

2001 **2002** **2003**

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What HKGCC has done?

Jan 2000	Submission of the Chamber report on "China's Entry into the WTO and the Impact on Hong Kong Business" to Chief Executive CH Tung first proposing the RTA concept
Mar 2000	Letter to the CE with a more detailed analysis on the feasibility of a RTA between Mainland China and Hong Kong
Jun 2000	Letter to the CE reporting on the result of the HKGCC General Committee mission to Beijing. During the visit, the Chamber was told by Central government leaders that the concept of a RTA between Mainland China and Hong Kong was worth further study
Oct 2001	Letter to Financial Secretary Antony Leung clarifying the misunderstanding over "preferential treatment" at a speech giving by the then Mayor of Beijing, Liu Qi
Nov 2001	Letter to the CE again proposing the RTA between Mainland China and Hong Kong
Dec 2001	Letter to the CE welcoming the formal agreement by the Central leadership regarding the RTA between Mainland China and Hong Kong
Jan 2002	Letter to the FS submitting HKGCC's preliminary idea of the contents of the RTA between Mainland China and Hong Kong, first raising the concern of the definition of Hong Kong company
Mar 2002	Letter to FS with a 70-page comprehensive submission on CEPA
May 2002	Further submission to FS re CEPA
Jun 2002	Letter to the FS after the HKGCC General Committee mission to Beijing, emphasizing the benefits to HK's service industry with a timely concluded CEPA
Jun 2002	Submission to the Industry and Trade Department regarding "Rules of Origin"
Aug 2002	Letter to the FS regarding "The Impact of Zero Tariff on employment in Hong Kong"
Jan 2003	Letter to FS giving our latest situation-analysis on CEPA
Feb 2003	Letter to CE on the benefits of CEPA to Hong Kong and China and urging the government to conclude CEPA as soon as possible

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CEPA - Principles and Contents

- **Principles**
  - WTO, 1C2S
  - Mutual benefit
  - Progressive, easy-first
  - Wide consultation
  - Continuous progress
- **Contents**
  - Trade in Goods
  - Trade in Services
  - Trade and Investment Facilitation

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Trade in Goods

- **Zero tariff on 273 Mainland product codes from 1 January 2004**
  - Rules of origin requirement
  - Total tariff of exports to the Mainland will be reduced by HK$750 million annually
- **Zero tariff on other products not later than 1 January 2006**
  - From 1 Jan 2004, manufacturers can submit applications to the responsible department
  - From 2005 onward, not later than **1 Jun** each year, HKSARG will submit a consolidated product list to the responsible authorities of the Mainland
  - Before **1 Oct** each year, both sides will complete the ratification and consultations on the origin rules and tariff reduction program and announce the consensus
  - From **1 Jan** each year, the Mainland will apply zero tariff to the projects ratified in the preceding year

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Trade in Goods

- **The 273 Mainland product codes include:**
  - Some electrical and electronics products
  - Plastic articles
  - Paper articles
  - Textile and clothing
  - Chemical products
  - Pharmaceutical products
  - Clocks and watches
  - Jewelry
  - Cosmetics
  - Metal products
- Coverage of zero tariff by 1 January 2004: 60+% of the value of Hong Kong's domestic export to China; 90% if including China's commitments upon accession to the WTO.

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Trade in Goods

- **Examples:**
  - Ice cream and other edible ice (24.2%)
  - Other beauty or make-up preparations (22.3%)
  - Men's or boys' shirts, knitted or crocheted and of man-made fibers (21.3%)
  - Women's or girls' blouses, shirts and shirt-blouses, knitted or crocheted and of man-made fibers (21.3%)
  - Articles of jewelry and parts, goldsmiths' and silversmiths' wares and parts, of other precious metal, or base metal clad with precious metal, of precious metal (35%)
  - Articles of natural or cultured pearls, precious or semi-precious stones (35%)
  - Electric motors for use in toys, of an output not exceeding 37.5W (24.5%)
  - Pick-up cartridges (35%)
  - Other parts and accessories for video recording or reproducing apparatus (30%)
  - Electrically operated clocks with watch movements (23%)
  - Electrically operated alarm clocks (23%)

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Trade in Goods

- **Rules of origin**
  - Negotiations still ongoing, agreement likely to be reached in October
  - Currently 3 ways to determine ROO:
    - **Substantial transformation**: some "principal processes" have to take place
    - **Content requirement**: % value-added
    - **Change of tariff heading**: after addition manufacturing process, the product undertakes a "new tariff heading", i.e. becomes a different product
  - The "principal processes" criterion applies for the great majority of products under Hong Kong's current ROO regime. For the rest, mostly electronic products, content requirement applies at 25% value-added.

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Trade in Goods

- **Rules of origin**
  - In other RTA negotiations it is not uncommon for contracting parties to tighten ROO. This is because under the free trade area arrangement, goods originating from the FTA will enjoy zero-tariff as compared to goods coming from outside the FTA. If ROO criteria are not tightened, it may result in trade diversion which may hurt the importing party within the FTA.
  - The Chamber has advocated that the status quo should be retained for the ROO regime.

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Trade in Goods

- **Benefits of zero tariff**
  - Revenue effect
    - If the price of the commodity exported remains unchanged, the tariff saving will go directly to the manufacturer or exporter as additional revenue from an expanded profit margin
  - Price effect
    - The tariff saving offers the manufacturer/exporter a margin to reduce prices to make their products more competitive. A reduction in price will induce a bigger demand on HK products and enable HK manufacturers to expand their market share.
  - Substitution effect
    - Manufacturers may shift production from low-tariff categories to high-tariff categories to take advantage of the high tariff saving.
  - Investment effect
    - More direct investment into products for which production is hitherto curtailed by high tariff.

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Trade in Goods

- **Industries to benefit in January 2004**
  - Substantial tariff saving
    - For some products, there will be substantial tariff saving. For the following products, for instance, a tariff saving in excess of HK$10 million may be achieved if zero tariff is applied:
      - Polystyrene in primary forms
      - Other paper and articles of paper
      - Other medicaments put up in measured doses
      - Plates, sheets, film, foil and strip, of flexible polymers of vinyl chloride
      - Parts of machines or instruments, of plastics
      - Parts for micro-motors for use in toys
      - Parts and accessories for instant print cameras
      - Other clock or watch parts
      - Slide fasteners fitted with chain scoops of base metal

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Trade in Goods

- **Industries to benefit in January 2004**
  - A surge in production and export for China market
    - Among the 273 categories, around 160 have bound tariff rates of more than 10%, 24 products have tariff of more than 20%, 12 products carry final bound rates of more than 30%. For example:
      - Jewelry
      - Pick-up cartridges
      - Other parts and accessories for video recording or reproducing apparatus
      - Parts and accessories for turntables (record decks) or record-players
  - To take advantage of the HK brand name
    - focusing on the design content and high-value processes. For example:
      - Some textiles products
      - Wrist-watches
      - Electrically operated clocks (include alarm clocks)

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Trade in Goods

- **Looking forward to 2006 - other potential products**
  - Product currently with high-tariff rate for import into China
    - Spectacles, goggles and the like (16-20%)
    - Sun glasses (20%)
    - Hats and other headgear, knitted or crocheted (20%)
    - Artificial flowers (20%)
  - Products which HK may not previously have comparative advantage
    - With restructuring that is expected, HK's comparative advantage may change, some new industries may be attractive to investors
    - Photographic/cinematographic films (20-47%)
    - Glassware for table and office (24.5%)

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Trade in Goods

- **Looking forward to 2006 - other potential products**
  - Products that have high design content and where IPR is an important issue
    - High-end apparel and clothing accessories of leather, of fur (10-20%) - high design content, import tariff of raw material into China is high
    - High-end bicycles (racing bicycles, mountain bicycles) and baby carriages (13-20%) - aluminum alloy is very light and expensive, final bound rate is 8%, but it may be restricted to export to China. China produces a lot of bicycles, but not very high class
    - Massage apparatus (15%) - high technology
    - Chandeliers and other electrical ceiling or wall lighting fittings (10%) - high design content
    - Designed pencil, pen (21%) - high design content, high final bound rate

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Trade in Services

- **Liberalization in 17 sectors**
  - Management Consulting Services
  - Convention services
  - Advertising services
  - Accounting services
  - Construction and real estate services
  - Medical and dental services
  - Distribution services
  - Logistics services
  - Freight forwarding agency services
  - Storage and warehousing services
  - Transport services
  - Tourism services
  - Audiovisual services
  - Legal services
  - Banking services
  - Securities services
  - Insurance services

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Trade in Services

- **Early liberalization**
  - Management consulting Services, Convention and exhibition services, Advertising services, Construction and real estate services, Distribution services, Freight forwarding agency services, Transport services, Tourism services
- **Lowering of threshold**
  - Distribution services, Freight forwarding agency services, Storage and warehousing services, Banking services
- **Mutual recognition and relaxation of regulations on HK service suppliers**
  - Accounting services, Legal services, Insurance services, Medical and dental services
- **Additional liberalization**
  - Convention and exhibition services, Construction and real estate services, Distribution services, Logistics services, Transport services, Audiovisual services, Legal services

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Trade in Services

- **Preliminary assessment:**

	Sectors	Time advantage	Lower requirements	Additional liberalisation
Very good	Real estate services	✓✓		✓✓
	Distribution: Retail	✓	✓	✓✓
	Banking		✓✓	✓✓
Good	Convention and exhibition		✓	✓✓
	Legal services		✓	✓✓
Quite good	Management consulting	✓✓		
	Construction			✓✓
	Medical and dental			✓✓
	Distribution: general	✓	✓	
	Freight forwarding	✓	✓	
	Storage and warehousing	✓	✓	
	Land transport	✓		✓
	Maritime transport			✓✓
	Tourism: travel agents			✓✓
	Audiovisual			✓✓
	Insurance		✓	✓
Fair	Advertising	✓		
	Accounting			✓
	Logistics			✓
	Tourism: hotel	✓		
	Securities			✓

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Trade in Services

- **Examples - Real estate services**
  - **China WTO**
    - Wholly owned not permitted for high standard real estate projects, such as apartments and office buildings, but excluding luxury hotels.
    - Engineering services wholly owned 5 years after accession
  - **CEPA**
    - Wholly-owned operations to engage in activities relating to self-owned or leased properties for high standard real estate.
    - Wholly owned consultancy firms *(3-year time advantage)*

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Trade in Services

- **Examples - Distribution services**
  - **China WTO**
    - Retailing services no shareholding or geographic restrictions 3 years after accession.
  - **CEPA**
    - HK companies allow to establish wholly-owned retail commercial enterprises in all cities at prefecture level, and cities at county level in Guangdong.
    - Minimum average annual sales value requirement is lowered from the current requirement of US$ 2 billion to US$ 100 million. The minimum asset requirement is lowered from the current requirement of not lower than US$ 200 million to US $ 10 million. The minimum registered capital requirement is lowered from RMB 50 million (RMB 30 million for Central and Western Region) to RMB 20 million (RMB 6 million for Central and Western Region).

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Trade in Services

- **Examples - Banking services**
  - **China WTO**
    - Asset requirement for establishment of a subsidiary of a foreign bank or a foreign finance company is US$10 billion.
    - Asset requirement for establishment of a branch of a foreign bank is US$20 billion.
  - **CEPA**
    - Asset requirement for HK banks and finance companies to enter the Mainland market, and to set up branches and body corporates, is reduced to US$ 6 billion.
    - Mainland branches of HK banks enjoy a reduced minimum prior business operation from three years to two year.
    - Profitability assessment will be based on the overall profitability situation of all branches instead of the profitability situation of an individual branch.

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Trade in Services

- **Examples - Convention services**
  - **China WTO**
    - Joint Venture with foreign majority ownership permitted for convention services.
    - No mention of exhibition in China's WTO commitment. Foreign exhibition companies are not allowed to operate independently in China.
  - **CEPA**
    - Convention and exhibition services on a wholly owned basis

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Trade in Services

- **Examples - Legal services**
  - **China WTO**
    - All representatives shall be resident in China no less then 6 months each year.
    - Foreign law firms can provide legal services only in the form of representative offices.
  - **CEPA**
    - Minimum residency requirement for HK representatives is 2 months each year. No restrictions for HK representatives stationed in representative offices in Shenzhen and Guangzhou.
    - HK permanent residents of Chinese nationality are permitted to sit the legal qualifying examination in the Mainland, and once qualified, are permitted to engage in non-litigation legal work.
    - HK law firms with representative offices in Mainland can run business jointly with Mainland law firms, except in the form of partnership.

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Trade in Services

- **Examples - Transport services**
  - **China WTO**
    - Freight transportation by road wholly owned 3 years after accession.
    - International maritime transport, joint venture with foreign investment not exceed 49%. Maritime cargo-handling, customs clearance services, joint venture with foreign majority ownership. Maritime container station and depot, joint venture with no more than 49% foreign ownership.
  - **CEPA**
    - Wholly-owned road freight transport services enterprises *(1 year time advantage)*.
    - Non-stop road freight transport services between HK and each province.
    - Wholly-owned road passenger transport enterprises in the Western Region.
    - Wholly-owned enterprises to operate international ship management services, storage and warehousing for international maritime freight, container station and depot services, non-vessel operating common carrying services.

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Trade in Services

- **Implications of the services commitments**
  - Sectoral linkages within Hong Kong
    - Many companies in Hong Kong do not offer a "pure" service in any single sector. The existing sectoral linkages among the various service sectors of HK will enable CEPA's benefits to multiply, through the "producer chain". This will reinforce the industrial clustering of HK's service sectors and reinforce the comparative advantage of our pillar industries, i.e. the financial, logistics, professional, and tourism service sectors.
  - Competition in the Mainland
    - The WTO-plus concessions are what China may be ready eventually to give to another WTO member. Therefore, HK service providers should always regard them as time-advantages only and be prepared for competition to increase. Tougher competition will also come from China's own players.

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Trade in Services

- **Implications of the services commitments**
  - External investment
    - CEPA will have the effect of attracting foreign investment from the outside into our service industries. It will reinforce Hong Kong's status as the business headquarter of multinational companies. Even if a multinational cannot become a "Hong Kong company" in time to enjoy CEPA benefits, it pays to be close to the heart of the world's "China service center", a position of Hong Kong which will be reinforced with CEPA. Or it could buy a CEPA-qualified company in Hong Kong.

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Trade in Services

- **Definition of HK Company**
  - Incorporated under the laws of the HKSAR
  - Pay profits tax in the HKSAR (or be exempted by law from paying such tax)
  - The length of the company's substantive business operations in the HKSAR;
  - The size and nature of business activity of the company's office in the HKSAR; and
  - The proportion of the company's staff force employed in the HKSAR.
- The two sides agree to adopt a "sectoral" approach to take into account the unique characteristics of each individual service sector. *(In fact, HKGCC in its January 2002 submission asked the government to consider the sectoral approach as an option for "Hong Kong company".)*

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Trade in Services

- **Definition of HK Company**
  - There are still many legitimate questions:
    - The term 'service provider' is used sometimes in the CEPA document, what does that mean?
    - What exactly is "a juridical person" of another country constituted under the laws of Hong Kong, which should be able to enjoy CEPA's benefits according to GATS Article V?
    - Will there be a situation where a branch office in Hong Kong can have more liberalization in China than the parent company based elsewhere?
    - How is the 50% employment criteria enforced in practice?

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Trade in Services

- **Further liberalization**
  - Either side can request consultation on further liberalization on trade in services. The absence of a sector from the current schedule does not mean it will never be covered.
  - Some of the possible candidates from the Chamber's "wish list" include the following:
    - Information technology services such as software and database services: business scope, wholly-owned subsidiaries.
    - Financial services: expanded business scope, e.g. possibility of opening up of qualified domestic institutional investors (QDII) services.
    - Telecommunications: great degree of market access for value-added services.
    - Air transport: network for Hong Kong airlines, and expanded scope for support services.
    - Tourism: expanding scope to service outbound travelers from the Mainland.

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Trade and investment facilitation

- Trade and investment promotion
- Customs clearance
- Quarantine and inspection of commodities, food safety and quality assurance
- Electronic commerce
- Transparency in law and regulations
- Small and medium-sized enterprises
- Chinese medicine and medical products

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Trade and investment facilitation

- It is interesting to note the specific reference to e-commerce, SMEs and Chinese medicine.
- While details in the yet-to-be-finished Annex 6 are scanty, their inclusion in CEPA is significant in that they are an indication for genuine actionable progress to be made in Hong Kong-Mainland cooperation.
- Their specific nature also implies that it is possible to include other specific areas of cooperation under CEPA, for example, infrastructure coordination, or government procurement.
- Further progress in trade and investment facilitation can be agreed and added to CEPA, in the same way that negotiations on further liberalization on trade in services can be undertaken.

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Benefits for China

- **Trade and investment benefits**
  - By opening the market further to Hong Kong service suppliers, the Mainland will gain more foreign direct investment from Hong Kong, especially from SMEs in the service sectors.
- **Capacity-building benefits**
  - CEPA will help China adjust to the challenges of WTO implementation, through pilot-testing market openings, and gaining regulatory experience. CEPA will help expose domestic enterprises to outside competition, and hence build up the capacity of China's own industry in preparation for foreign competition.

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Benefits for China

- **WTO benefits**
  - In the WTO context, there will be increasing pressure on China for further concessions over and above its commitments in the Protocol of Accession. CEPA will open an avenue for China to use HK companies as test entries to prepare it for possible further concessions for the Doha Round of negotiations.
  - CEPA helps China to send a message to other WTO's members that it is ready to open itself up to another trading partner *which is willing to be as open to China as Hong Kong is.* It is unlikely that China will be besieged by other WTO members for concessions, as few would be willing to be as open as Hong Kong multilaterally. Alternatively, they may negotiate with China through a bilateral free trade agreement, which gives China much more control over what concessions it is willing to offer.
  - CEPA helps China position itself in negotiations over other possible regional trade agreements, whether with the ASEAN countries or with other trading partners.

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Benefits for China

- **Central leadership's motivation**
  - CEPA can help to boost Hong Kong's economy, especially after the devastation that SARS has wrought.
  - The opening up of Hong Kong's service sector for qualified Mainland companies and professionals.
  - Cheaper goods for Chinese citizens when tariff-free Hong Kong goods come into the Mainland.
  - CEPA can improve China's competitiveness - the same reason why former Premier Zhu Rongji was so interested in China getting into the WTO several years ago.
  - It would be awkward for China to have a FTA with ASEAN without having one with Hong Kong first. Now including Hong Kong in any future FTA that China signs will be relatively easy.

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Benefits for China

- **Central leadership's motivation**
  - Macao will be included in our CEPA soon, and Taiwan could eventually be included in a future date in this CEPA. Korea and Japan already expressed interest to join in an FTA with China. Having one FTA for all of Asia with China as the prime driver will not be that far-fetched.
  - This new look would make the PRD integration smoother, as Guangdong will now see a clear advantage in working with Hong Kong that brings new values to the table. CEPA would further integrate Hong Kong's economy with that of the Mainland, and that is good for China.

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Thank You

Questions & Answers

HKGCC Website CEPA page :

www.chamber.org.hk/wto/content/rta_main.asp