

Chamber Questions on CEPA – A Preliminary Update

On 25 July the Chamber submitted a 10-page paper to the Hong Kong SAR government detailing more than 50 outstanding issues and clarifications which the business sectors deem necessary on the CEPA provisions. The Chamber has had some discussion with the SAR government, and this paper provides some answers to the questions, clarifications, and contains some further comments. It is presented here to update members interested in more clarifications on CEPA. The following comments have been arranged in order of the 51 questions in the original paper. The questions are presented in bold.

The full text of the original paper can be retrieved from the following:

http://www.chamber.org.hk/memberarea/chamber_view/policy_statement_template.asp?id=839

Please be advised that the Chamber is only providing its interpretation, analysis, and comments for reference purposes. These by no means constitute either a legal or a final, official interpretation of the terms and provisions of the CEPA agreement. Therefore, the Chamber bears no legal responsibility for the contents in this paper.

Trade in goods

Determination of Rules of Origin for 273 products

- (1) Can flexibility be built into the ROO formula so that content requirement (25%) can also be used as an alternative, for products where ROO is presently determined by “principal processes”? If that can be done, will design or R&D cost be calculated as the value added?**

The HKSAR government has committed to agree with the Mainland side on the ROO for the 273 products by 30 September. This is a tough deadline to meet. In line with the Chamber’s recommendation, the Hong Kong government will endeavour to maintain the status quo for ROO. Thus alternative ROO will not be actively pursued for the time being. In practice, this means that for most products the “substantive transformation (principal processes)” rule will continue to apply, not the value content (% value added), although that cannot be ruled out in future.

For products currently using value content to determine ROO, status quo means applying the current percentage. In addition, there may be a small number of other products for which % content may be used for ROO. For these cases, the government is aware that the private sector would like to have design and R&D included in the calculation.

- (2) Can the “Combined ROO” (percentage in Mainland; percentage in Hong Kong) concept be discussed and negotiated with the Mainland side?**

This is recognised as a useful concept, but because of other priorities (to meet the immediate deadline for the 273 products), at this stage it will not be actively pursued. But the Chamber will continue to keep this concept alive. It may become useful in subsequent negotiations.

Application procedure for zero-tariff products post-2006

- (3) When will details of the information required on “description of products, productive capacity, export capacity” be known?**

This should be known well before June 2005 to give time for industry to prepare. Once the current, immediate round of negotiations is over, the Chamber will explore the possibility of bringing the whole process forward earlier.

- (4) If a manufacturer would like to set up a new production plant in Hong Kong after 2004, there will not be information on existing production capacity and export capacity of the products to be produced. Under this situation, can the manufacturer still benefit from CEPA and submit application without the above-mentioned information?**

The detailed rules are not yet available, hence the situation is not clear yet. However, in principle these companies must be able to apply, because that is part of the spirit of CEPA.

- (5) Can Hong Kong seek a “binding” on ROO determination for both the 273 items now and any further items, so as to prevent any changes in future?**

The spirit of a free trade agreement is that one can only liberalise further, not go backwards, (except in cases of “anti-surge” where “safeguard measures” can be used). Thus there is no need to bind ROO for that reason. On the other hand, further liberalisation can always be sought.

Certificate of Origin

- (6) Is extra-territorial inspection or certification possible between the two sides?**

We believe the likelihood is not high of Mainland custom being involved in signing Hong Kong CO.

Trade in services

Hong Kong company definition

When CEPA comes into effect, there will need to be a process to certify “Hong Kong companies”, like the certification of origin for goods. There are a number of relevant considerations.

- Based on the concept of CO, a company seeking to claim CEPA benefits will need to go through a certification process.
- In designing the certification process, the principle must be that it is as simple as possible. One model is to have a simple declaration plus submission of basic supporting documents.
- Supporting documents may include tax return, office rental contract, MPF record, business registration paper etc. It is reasonable for these to undergo a basic checking process.
- For certain cases, an independent third party report by professional agencies may be required to support the application.
- Unlike CO which is consignment-specific, the CEPA certificate of “Hong Kong company” will be more like a certificate to operate in the Mainland. The role of Hong Kong government and the Mainland authorities in the certification will need to be further discussed. It is felt that for the purpose of certifying Hong Kong company, Ministry of Commerce’s role could be to act as endorser.
- The qualified applicant will thus get a certificate to go to the Mainland to claim CEPA benefits.

- (7) Does it mean that if a company is a “registered overseas company”, say in Cayman Islands, then it is not considered a Hong Kong company, however substantive its business is in Hong Kong?

That is right, the company must be incorporated in Hong Kong.

- (8) Does it mean that the 100% subsidiary of a foreign company will be eligible as long as it is “registered and established pursuant to the Companies Ordinance”?

That is right, a subsidiary is “Hong Kong company” if it meets the requirements. But the branch that is not incorporated as a company here is not a “Hong Kong company”.

- (9) Arising from the above, would that imply the 100%-owned subsidiary of a foreign company may get greater market access into China than the parent company?

That is right.

- (10) Can a “Registered overseas companies and their offices in Hong Kong” (CEPA Annex 5.2.(I).1), which are not included as “Hong Kong companies”, still enjoy CEPA benefits as “a juridical person constituted under the laws of” Hong Kong (GATS Article V.6) with substantive business?
- (11) Will such classification of a “juridical person” be clarified by the definition of “services suppliers” as stated in Annex 5 (Annex 5.1)?
- (12) Would GATS Article V.6 and XXVIII(n) combine to mean that Hong Kong companies that are majority-owned or controlled by non-residents of Hong Kong will be treated as foreign companies? (Even they may still benefit from CEPA according to GATS Article V.6)?

The relationship between GATS Article V and Article XXVIII has yet to be clarified. There are two possible interpretations:

- (a) If a company does not meet the definition of “Hong Kong company” in CEPA Annex 5, then it is not a “Hong Kong company” and cannot enjoy CEPA benefits. This is consistent with GATS Article V, which is the overriding provision in respect of regional trade agreements.
- (b) Notwithstanding CEPA Annex 5, foreign companies will have the right to enjoy CEPA by the principle of “extension of benefits” implied by GATS Article V together with GATS Article XXVIII.

- (13) How would the 50%-employment criteria be enforced? What will be the treatment of other forms of employment like part-time workers, interns, piece-work, contract workers, secondment, free-lancer, etc.?

We believe a common-sense interpretation should be adopted, i.e. all employment by the company in Hong Kong should be counted (including non-residents, temporary workers, part time workers, but not including sub-contractors, secondments and free-lancers who cannot be regarded as “employed by” the Hong Kong company). However, the decision has yet to be made, pending negotiations with MOC.

- (14) In regard to “similar business”, in assessing eligibility in accordance with the quantitative criteria, how would a company with a diversified business (e.g. a conglomerate) be treated? For the purpose of evaluating the years of establishment

and employment (the quantitative criteria), would the company as a whole be considered, or only the relevant division?

Our assessment is that as long as the CEPA Annex 5 criteria are satisfied, diversity of business is not a concern. In the case of employment, however, the whole company will have to be accounted for, not just the relevant division.

(15) Will there be a review mechanism on the status of a company as a “Hong Kong service supplier”? Can an eligible company become “disqualified” later?

Whether the “CEPA Hong Kong company” certificate, once obtained, needs to be renewed, is an important question that needs to be resolved. One rationale for renewal is that the business nature of a company may change, e.g. its Hong Kong operation may cease altogether after it enters China, rendering it no longer a “Hong Kong company” in accordance with CEPA’s criteria. In any case, the authorities may want to retain the right to conduct investigations on a company’s eligibility and to revoke the certification if necessary to maintain the integrity of the system. The question is how actively this should be pursued – should reviews be conducted regularly, or should government stay away until a problem arises? The Chamber is inclined to support the latter, more hands-off approach, but we would welcome comments from our members.

(16) Where Chinese nationality is mentioned (e.g. in the case of lawyers), does that mean Chinese nationality defined under the country’s national laws, in addition to permanent residency of HKSAR?

Yes, “Chinese nationals” means Chinese nationals from the Mainland point of view. For legal services, for instance, mere Hong Kong permanent residency is not enough.

Individual sectors

Most of the sectoral issues below reflect the private sector’s “wish list” for liberalisation, rather than questions for clarification. As the negotiations will be ongoing, the Chamber will continue to monitor progress in these sectors.

Management consultants

(17) What is the scope of services covered, e.g. is management consultancy for IT, education, training, employment, or financial services companies included?

Construction and engineering

(18) Will wholly-owned firms in engineering or surveying be able to have stamping rights, like their counterpart design institutes in the Mainland?

Distribution

(19) According to China’s WTO commitment, trading right will be granted to all foreign companies within three years after China’s WTO accession. Does that mean Hong Kong retailers, even under CEPA, still need to wait for one more year before they can have the trading rights to import their inventories by themselves rather than going through a local trading partner?

(20) Will the retail and distribution license be granted at State level, with the same license applicable to all provinces and cities in China? Or do retailers and wholesalers need to apply for license from each province and city?

(21) Is there any way that Hong Kong manufacturers with factories in China can set up retail outlets in Mainland cities selling their own products? What if the manufacturer does not have retail business in Hong Kong?

Franchising

(22) When will the “relevant regulations” be announced?

(23) For retail-type franchising, will the provision to allow retail operations at prefecture and county levels apply to them as well?

Logistics

(24) Is there a definition for “logistics operation”, or is it just a general term to describe the collection of logistics-related services in transport and distribution?

Land Transportation

(25) Hong Kong companies are permitted to operate road transport services in the Mainland on a joint-venture basis. Does that include domestic land transportation? For non-stop road freight transport services, does that mean the cargo will only go through one customs through-check and no need to stop at each and every customs checkpoints?

(26) What is the procedure for wholly-owned road transport services to obtain vehicle licenses in Mainland China? Will that be national treatment on license issuance?

Motion pictures

(27) With regard to the regulations listed in Annex 4 para 3.(XIII).2.(3), on the conditions defining “motion pictures produced jointly by Hong Kong and the Mainland”, is there a regulatory authority to decide its compliance, or will this be necessary only when a problem arises?

Banking

(28) Are the liberalization measures on banking in Annex 4 applicable only to Hong Kong local banks registered under the Banking Ordinance?

For banks, the conditions in both Annex 4 (sectoral liberalisation and conditions) and Annex 5 (Hong Kong company) apply. The net effect is that only banks registered as Hong Kong banks will be qualified. Thus a registered foreign bank does not qualify, however substantial its business in Hong Kong is. The detailed relationship between the Companies Ordinance and the Banking Ordinance has yet to be studied but it is believed that there should not be any conflict between the two, i.e. there should not be a bank which is registered as foreign company under Companies Ordinance and yet gets a local bank license.

Securities

- (29) What is the coverage of “Hong Kong professionals” who are permitted to apply to practice?

Insurance

- (30) Apart from actuarial science, it is not clearly stated what the “insurance qualifications” refer to. Are brokers and agents covered?

All sectors: where wholly-owned business is allowed

- (31) Will the concessions also applied if a Hong Kong company choose to engage in a joint-venture business instead? To be more specific, if in any particular sector, the current policy does not allow majority foreign ownership but CEPA allows wholly-owned business, can a Hong Kong company set up a majority foreign-owned joint venture in that sector? Or, in any particular sector that enjoyed lowered entry requirement under CEPA, can a Hong Kong company set up a majority foreign-owned joint venture in that sector and still enjoy the lowered threshold?

Professional services: mutual recognition

- (32) Does “professional bodies” apply only to statutorily recognized bodies in Hong Kong?
- (33) Is the Memorandum of Understanding signed by some professional bodies with their counterparts in Shanghai CEPA-compliant? If so, can it be a prototype of similar MOUs with other bodies in the Mainland?

Presumably Hong Kong professional bodies will want mutual recognition with central rather than provincial bodies, and the latter will not enter into MOUs that conflict with national regulations. In reality, however, the possibility of conflict between provincial and national regulations cannot be ruled out. Hence, a judgement on whether say a HK-SH MOU is acceptable to the Central Government is useful.

- (34) Will CEPA Article 15 make it easier for Mainland professionals to come to practice in Hong Kong?

Telecommunications

- (35) For value added services, can Hong Kong companies gain permission for majority ownership or even set up wholly-owned company? If not, in the 50-50 joint venture company, can the Hong Kong partner have management participation?
- (36) Will the definition of value-added services be extended to cover Internet Protocol (IP) based services and resale-based services?
- (37) Will Hong Kong operators be able to enjoy national treatment with regard to interconnection with public telecom operator?
- (38) Will there be early liberalization in mobile voice and data services, which include domestics or international voice services?

Travel and tourism

- (39) Under the current CEPA concessions, Hong Kong companies are allowed to establish joint-venture travel agencies in China. How will the joint-venture travel agencies be regulated? Specifically, will it receive national treatment, including provision of outbound travel services for PRC citizens?
- (40) Will there be any possibility for wholly-owned travel agencies in China?
- (41) Will there be any specific commitment to allow Hong Kong tourist guides to work in the Mainland?

Financial Services

- (42) Will Hong Kong financial services companies be allowed to conduct offshore RMB business in Hong Kong? Hong Kong can serve as an offshore RMB center.
- (43) Will QDII be included in the first phase of CEPA?

Trade and investment facilitation

- (44) Will more details be provided in the final text of Annex 6 on the content of the seven facilitation measures?

We believe more will be provided in the final CEPA document, but details will be limited in view of the lack of time.

Investment facilitation measures will be of practical benefits for Hong Kong investors. In general, the goal should be to simplify regulations to achieve national treatment. It will be extremely difficult, and not entirely in accordance with multilateral principles, to seek “national treatment plus”, i.e. better treatment for Hong Kong than mainland’s own investors.

- (45) Does “trade and investment promotion” cover only “promotional activities” (exhibitions, trade shows, business matching etc), or can its meaning be extended to include investment deregulation so as to encourage and “promote” trade and investment?
- (46) A number of the measures listed are promotional in nature, e.g. general trade and investment promotion, SMEs and Chinese medicine. What are the implementation agencies for these measures?
- (47) On “transparency in laws and regulations”, will the HKSAR government be providing support with regard to availability of information in the English language?

Institutional arrangements and procedures

(48) Article 19 enables working groups to be set up under the Steering Committee. Will these working groups be like standing committees of the WTO? Specifically, will a working group or committee be established for each of the following areas:

- **Further consultation on trade in goods**
- **Further consultation trade in services**
- **Trade and investment facilitation**
- **Rules of Origin determination**
- **Definition of Hong Kong companies**
- **Dispute settlement**

The Steering committee will probably be set up in and serviced by Commerce, Industry and Technology Bureau.

(49) What would be the enforcement, appeal, and dispute settlement mechanism? When will details be worked out?

(50) How would further negotiation be activated and taken forward?

(51) How would the private sector be involved in CEPA? Would a mechanism be established to coordinate private sector input, as in the case of the “Japan-Singapore Economic Partnership Agreement”, with its bilateral and tripartite Japan-Singapore Free Trade Agreement Joint Study Group?

The Chamber will examine further possible options to involve the private sector, e.g. the concept of a PECC-like body (Pacific Economic Cooperation Conference, a tripartite advisory body to APEC) for CEPA.