

CEPA Questions - I

Introduction

Although CEPA was concluded on June 29, 2003, much work still lies ahead in fine-tuning the Agreement, and details on various aspects needing to be filled in now that CEPA is to be implemented in January 2004. As we have done over the past 18 months, the Chamber would like to offer our full support to the government in the course of working out the details of CEPA. On our part, we have arranged a number of programs to explain CEPA, to collect questions, and to encourage the business sector to make use of the Agreement.

This submission sets out our thoughts on the immediate issues which we believe should be addressed as soon as possible during the months leading up to January 2004. We have presented these issues in the form of questions, for some of which we provide the Chamber's own comments as well.

Trade in goods

We would like to raise a number of questions relating to Origin of goods.

Determination of Rules of Origin for 273 products

The Chamber supports the government's stated intention to maintain, as much as possible, the status quo in determining ROO. On this basis, we would propose that the government consider two possible ways to broaden the benefit for Hong Kong manufacturers from the ROO negotiations:

(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?

It would be much flexible if 25% value added could be used as the ROO formula. In addition, if design or R&D cost can be calculated as the value added, it will definitely benefit Hong Kong to promote innovation and to develop into a design center.

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

The Chamber's view is to advocate as much flexibility as possible. As regards the combined-ROO concept, this was suggested by the Chamber in our previous submissions, and it could possibly offer further room to reduce Hong Kong's content, while at the same time benefiting the Mainland (for example, a combined minimum 40% ROO with minimum of 20% on either side).

Application procedure for zero-tariff products post-2006

CEPA Annex I will provide for accreditation for zero tariff and determination of ROO through application to "responsible department of the HKSAR government", and assessment by "designated agencies".

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

(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?

This may be important for new investment coming into Hong Kong. Manufacturers may not be willing to start up a new production plant in Hong Kong if the products they produced cannot enjoy the zero tariff benefits in a reasonably short period of time.

Although the zero-tariff will not apply until 2006, the manufacturers' preparation will have to start well before that, hence the details should be available as soon as possible.

(The Chamber would declare an interest, as a GACO, to be interested in being a designated agency.)

(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?

Chamber members are concerned that, for 2006 and beyond, China may be able to use arbitrary determination of ROO over products to effectively render the zero tariff concessions useless.

Certificate of Origin

Arrangements for certificates of origin are to be provided in Annex 3 of CEPA. We await details of the procedures for issuing certificates of origin. As the HKSAR and the Mainland side formulate these procedures, we would like to raise the question relating to Hong Kong's autonomy in certifying origin.

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

In our view, it is important for Hong Kong to retain autonomy in certifying origin, to reinforce Hong Kong's status as an independent customs territory. This will be beneficial for China too, as it would prevent a precedent from being created of another customs authority being allowed to certify origin in Hong Kong or China.

Trade in services

On trade in services, the most important question is that of definition of Hong Kong company. There are also a number of issues which require clarification or further elaboration with regard to individual service sectors.

Hong Kong company definition

The description of Hong Kong company definition in Annex 5 raises a few immediate questions that require clarification.

The most fundamental question relates to the precise meaning of "registered and established pursuant to the Companies Ordinance or other relevant ordinances of HKSAR", particularly in relation to the provision in the same paragraph that "Registered overseas companies and their offices in Hong Kong are not included." (Annex 5.2.(1).1) The following questions are immediate clarifications arising from the above wording.

(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?

(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"?

(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?

The answer to the above questions would appear to be yes, if one takes the plain wording of

CEPA, but this has to be confirmed.

A further complication will arise when one brings WTO principles into the consideration. GATS Article V para 6 states:

A service supplier of any other Member that is a juridical person constituted under the laws of a party to [the regional trade agreement]... shall be entitled to treatment granted under such agreements, provided that it engages in substantive business operations in the territory of the parties to such agreement.

Applying GATS Article V.6 to CEPA, it means that even if a company is an explicitly foreign company, it can still enjoy CEPA if it satisfies two tests, namely, that it is (i) a juridical person constituted under the laws of Hong Kong, and, (ii) it engages in substantive business.

The question becomes thus:

(10) Can a "Registered overseas companies and their offices in Hong Kong" (CEPA Annex 5.2.(l).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)?

If the answer is yes - as would appear from the plain wording, then it would not matter that a company is not a "Hong Kong company" under CEPA; it may still be eligible by the GATS principle of extension of benefits.

GATS Article XXVIII has further explained the meaning of "juridical person of another Member". The definition is that it is either

(i) constituted or otherwise organized under the laws of that other Member, and is engaged in substantive business operations in the territory of that Member or any other Member; or

(ii) in the case of the supply of a service through commercial presence, owned or controlled by:

1. natural persons of that Member; or
2. juridical persons of that other Member identified under subparagraph (i)

Article XXVIII(n) further defines what is "ownership" and control. Basically, it means majority equity or majority management control.

This WTO definition raises a question regarding interpretation of what is a "foreign company", for the purpose of commercial presence:

(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)?

If that is the case, then somewhere along the line "50% Hong Kong permanent residents" becomes a criteria for determining Hong Kong company, although it must be stressed that not being a Hong Kong company is not a big deal if the GATS V.6 "extension of benefits" provision applies.

In addition to the fundamental issue of "Hong Kong company" vs. foreign company posed above, there are additional questions on eligibility requiring clarification as follows.

(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.?

A plain reading would suggest that the employment should be 50% "in Hong Kong", not "of Hong Kong residents", i.e. non-Hong Kong permanent residents are included as long as they are not employed elsewhere and brought into Hong Kong. However, that needs to be verified.

(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?

It is not uncommon for a Hong Kong firm to have different branches of business all under the same incorporated company, for example, different divisions on trading, retail, distribution and consulting.

(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?

Circumstances do change and companies that may not qualify for CEPA initially may later become eligible; conversely, a company which is eligible now may not meet the same criteria later. The need or otherwise for some mechanism to review this should be clarified.

(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?

The plain answer to these two questions would appear to be yes, subject to confirmation.

Individual sectors

The "Hong Kong company" definition affects all service sectors. In addition, there are questions in respect of individual service sectors which vary from industry to industry:

Management consultants

For management consultancy, the question for clarification is:

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

Obviously, from the practitioners' point of view, a coverage that is as broad as possible should be sought.

Construction and engineering

The early liberalization of wholly-owned enterprises for engineering and surveying professional firms is welcomed. A closely related question is that of scope of operation.

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

This may appear to be a regulatory issue but in the view of the Hong Kong professions, the lack of stamping right can become a major barrier to market access.

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?

It has been reported - and not disputed by the government - that the Standard Chartered Bank, which is the oldest bank in territory and has been contributing substantially to Hong Kong for many decades, is not eligible for the CEPA benefits. This does not seem to be in line with a plain reading of the eligibility criteria for the banking sector under Annex 5.2.(II). The requirement in Annex 5 states that the bank must be (a) established pursuant to the Companies Ordinance, (b) authorized under the Banking Ordinance, and (c) authorized by the Hong Kong Monetary Authority to engage in banking business. Arguably, all duly-licensed foreign banks will satisfy these requirements. In Annex 4, however, the specific commitments for banking apply to "Hong Kong banks". It is not stated in Annex 4 whether the term "Hong Kong banks" refers only to Hong Kong local banks registered under the Banking Ordinance, or all banks with a presence in Hong Kong (thus including foreign banks). It would appear that the intention is to exclude foreign banks, but it has to be clarified whether this exclusion is undertaken by way of Annex 4 (specific commitments) or Annex 5 (definition of Hong Kong company).

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

For many sectors, Hong Kong companies are allowed to engage in wholly-owned business.

(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

Article 15 of CEPA's main text provides for mutual recognition of professional qualifications. A number of questions arise.

(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?

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

Further liberalization

The Chief Executive mentioned in his debriefing after his Beijing trip on July 19 that the Central government will agree to accelerate and expand the market opening for Hong Kong in areas such as value-added telecommunication, tourism and also financial services. The Chamber would like to submit the following 'wish list' - for the SAR government to consider proposing to the central government.

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?

Hong Kong operators would like to seek an understanding that management participation would be a matter for commercial negotiation and that a balance between the rights of shareholders and operational rights of management be maintained, so as to enable greater participation by management from Hong Kong side. This will be beneficial to China by enabling it to take advantage of Hong Kong expertise, such as technology operation, marketing, branding and other soft skills.

(36) Will the definition of value-added services be extended to cover Internet Protocol (IP) based services and resale-based services?

Specifically, these includes the following services:

- Simple resale of basic services e.g. leased circuits, long-distance voice telephony and International Direct Dial (IDD)
- Provision of voice and data services - such as Virtual Private Networks (VPN) and frame relay over circuits leased from basic service providers
- Provision of Internet access and IP-based services such as IP VPNs, voice over IP, intranet and virtual intranet services - over leased circuits and using technologies such as IP over Dense Wave Division Multiplexing (DWDM)
- Simple resale of mobile services, including voice and data services
- Offering mobile services as an Mobile Virtual Network Operator (MVNO) using a basic service provider network capacity

(37) Will Hong Kong operators be able to enjoy national treatment with regard to interconnection with public telecom operator?

One of the most critical issues in expanding telecom services in the Mainland is interconnection with public telecom operator. Hong Kong operators would benefit from more streamlined procedures in interconnection, but the criteria for interconnection is not entirely clear yet.

(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

A number of questions are relevant. This could be the most significant section of CEPA in the long run if it can deal with the numerous problems of "investment climate" in China, ranging from cumbersome procedures, to non-transparency, to rampant fee collection, to customs problems, to commercial disputes, to corruption, that plague almost all Hong Kong investments in China. Can there be a mechanism to address these issues? These would ultimately improve China's investment environment for investors from the whole world, and that would be good for China.

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

The present content of Annex 6 contains only scanty details of the seven trade and investment facilitation measures. More details will be needed.

(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?

The practical problems faced by many Hong Kong investors are regulatory in nature, rather than lack of promotional activities. For example, even if repatriation of profits is permissible, it is still hampered by regulations of an administrative and technical nature, which could become barriers to investors.

(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?

A number of public and private sector bodies, e.g. the Chamber and TDC, will have a stake in these measures. They are already promoting trade and investment and SME cooperation, with or without CEPA. They will benefit from a clarification of how their promotional work can relate to CEPA's implementation.

(47) On "transparency in laws and regulations", will the HKSAR government be providing support with regard to availability of information in the English language?

There is a demand from the international business community for more information, both on CEPA itself and on subsequent developments arising from CEPA. Specifically, for instance, there is the need for an official English text of CEPA to be available as soon as possible.

Institutional arrangements and procedures

CEPA Article 19 provides for the establishment of a Steering Committee. Questions regarding this Steering Committee include the following:

(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

As CEPA will be an ongoing process, it would appear appropriate for the bodies under CEPA to be of the nature of "standing committee" rather than "working group".

Besides the structure, there are a number of aspects in the working of the institutional structure which are of particular interest to the business sector.

(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 is particularly interested in the last issue, and would emphasize our view that active private sector participation is crucial to the continual success of CEPA.

Conclusion

This is the first submission of the Chamber after the conclusion of the CEPA detailing the outstanding issues and clarifications which the business sectors deem necessary. The

Chamber will continue our discussions with our members in specific sectors and will continue the private sector input to government on CEPA from time to time.