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Wider Implications of CEPA

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Now that the Free Trade Agreement (FTA) between the Mainland and Hong Kong, called the Closer Economic Partnership Arrangement or CEPA for short, has been signed, businessmen from Hong Kong, and indeed from around the world, are stepping forward to pore through the agreement to see if there are new opportunities for them. But let us step backward and analyze the wider implications of CEPA for both the Mainland and Hong Kong.

Let us look beyond the immediate dollars-and-cents, jobs-created, and GDP growth figures that the Hong Kong press loves to focus on. Let us look at what is in the agreement for Hong Kong's economic development as a whole, and more intriguingly, what is in the agreement for China.

For Hong Kong, zero tariff on 273 key items on January 1, 2004 is something not given to any other WTO member under China's WTO commitments. The further promise to widen the list by January 1, 2006 enhances the long-term benefits. The first action on zero tariff next year provides not only an opportunity for traditional industries such as watch making or jewelry making to bring some specialized processes back to Hong Kong, it also gives an opportunity for local or foreign or Mainland investors to consider investing in some "niche" manufacturing requiring a low number of workers with perhaps high intellectual content.

The zero tariff consideration for all other imported goods into China on January 1st, 2006 opens up an even broader horizon of possible manufacturing here. While all this will not make Hong Kong into a manufacturing powerhouse, it will put Hong Kong on the map when it comes to investment decisions for certain types of manufacturing. And that, while it will not reverse the trend of Hong Kong being mainly a value-added service economy, will bring some interesting manufacturing development to the city.

As for the service sector benefits, what should be noted is that some of the agreements are above and beyond China's WTO commitments and are more long-lasting than "early liberalization" type benefits. But whether it is early liberalization or further liberalization or lowering of thresholds, they will reaffirm Hong Kong's position as a platform to enter the China market, even though China is now in the WTO. It will also integrate Hong Kong's service sector closer with our manufacturing base in Guangdong which is the most likely immediate beneficiary of Hong Kong service sector investments under CEPA.

We may see foreign invested firms who satisfy everything but the "percentage-of-employment" criterion readjusting their employment rolls if they want to earnestly take advantage of the benefits. We may see firms looking to increase their presence in Hong Kong and in China to take care of the expanded business. We may see multinationals strengthening their CEPA-qualified subsidiaries here. We may even see purchases of companies that satisfy requirements of CEPA by foreign partners. All in all, there may be some very interesting corporate maneuvering in Hong Kong in the next couple of years.

And if future CEPA provisions could include QDII or Renminbi deposits in Hong Kong, then all these added up will give a new look to Hong Kong post-CEPA. This is a re-vitalization that goes well beyond jobs and statistics. It gives Hong Kong's middleman role life for at least another decade--with a fresh look.

What about the benefits for China? One motivation for the central leadership to push CEPA obviously is to boost Hong Kong's economy, especially after the devastation that SARS has wrought. Ostensibly, there seem little concrete benefits for China in the just signed agreement. However, we surmise that the same reason why former Premier Zhu Rongji was so interested in China getting into the WTO several years ago can apply in this case: this agreement will improve China's competitiveness.

Many rules and regulations are involved in implementation of WTO commitments. China may now be an old hand in multilateral negotiations but it is relatively inexperienced in internationally compliant regulatory reform. CEPA's early liberalization measures enable China to test-run its regulatory changes in services trade. WTO commitments mean more market players in the future. In addition, 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. This "capacity-building" is a standard WTO-acknowledged way of helping less developed economies open up.

And building up its service sector is vital for China to absorb the millions of workers displaced from non-competitive state owned enterprises.

Then there is an argument related to the upcoming WTO negotiations. On the face of it, CEPA disadvantages China by making China "show its hand" in future services negotiations. But this actually lets China test some potential concessions first to see if it is workable before offering them in the next round. Some will argue this makes China's negotiation position less favourable by letting others know what it has offered to a third party. On the contrary, it actually puts China in the leadership position in the Doha round, showing that it is willing to push the envelope of liberalization in the face of piecemeal restrictions in the OECD. China's message to other WTO's members will be 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.*

But few WTO members are willing to be as open as Hong Kong. If they want the China market badly and are willing to be open to China, then under the WTO's Most Favored Nation principle, they have to open to the same extent to all other WTO members. None of the Quad (US, EU, Japan, and Canada) will be willing to do that. Hence there is no need for China to worry that others will be besieging it for the same type of concessions as CEPA in the Doha round. What this does mean is that other countries can only try to gain what Hong Kong has through bilateral negotiations with China, i.e. through a Free Trade Agreement. And China would welcome such negotiations if the partner is right.

As Premier Wen Jiabao said soon after the signing on June 29th, China is thinking of including Hong Kong once China and ASEAN conclude their own Free Trade Agreement. It would have been 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.

Macao will be included in our CEPA soon, and China has its eyes on including Taiwan in this CEPA if the political difficulties are be resolved. Korea and Japan already expressed interest to join in an FTA with China. Europe already has one for the whole continent, and the United States is trying to get an FTA for the entire Americas, so having one FTA for all of Asia with China as the prime driver will not be that far-fetched.

Therefore, while there may be talk now of this CEPA being a "gift" to Hong Kong, if we step back we can see that there are wider economic and strategic implications for both Hong Kong and China in this agreement.

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