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Panel on Commerce and Industry

Meeting on 19 April 2005

**Background Brief on Recent Developments of
Mainland and Hong Kong Closer Economic Partnership Arrangement**

Introduction

In December 2001, the Chief Executive obtained the agreement of the Central People's Government (CPG) on the establishment of a form of free trade area between the Mainland and the Hong Kong Special Administrative Region (HKSAR). After a series of negotiations, the first phase of the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA I) was implemented on 1 January 2004 and the second phase (CEPA II) took effect on 1 January 2005. The scope of liberalization under CEPA will be broadened and enriched through continuous discussion between the two sides. A Joint Steering Committee jointly chaired by the Financial Secretary and the Vice Minister of Commerce of CPG has been set up to oversee the overall coordination of CEPA.

Scope of CEPA

Trade in goods

2. Under CEPA I and II, the Mainland has eliminated import tariff for 1 108 Hong Kong products under its 2005 tariff codes. The categories of products which benefit from zero tariff include jewellery, textiles and clothing, electronic components, watches and clocks, food and beverages and pharmaceutical products.

3. To facilitate traders to enjoy zero tariff under CEPA, the following pieces of subsidiary legislation have been made under the Trade Descriptions Ordinance (Cap. 362) to align the origin marking requirements for certain products with the CEPA origin rules:

- (a) Trade Descriptions (Country of Origin)(Watches) (Amendment) Order 2003 (L.N. 233 of 2003);
- (b) Trade Descriptions (Place of Manufacture) (Piece-Knitted Garments) Notice (L.N. 234 of 2003);
- (c) Trade Descriptions (Country of Manufacture) (Piece-Knitted Garments) Order (L.N. 157 of 2004);
- (d) Trade Descriptions (Country of Manufacture) (Textile Made-up Articles) Order (L.N. 186 of 2004); and
- (e) Trade Descriptions (Place of Manufacture) (Textile Made-up Articles) Notice (L.N. 187 of 2004)

Trade in services

4. Since 1 January 2004, the Mainland has given preferential market access to Hong Kong companies in 18 services sectors including accounting, banking, construction and real estate, insurance, legal, logistics, medical and dental, securities and telecommunications. With the implementation of CEPA II on 1 January 2005, the Mainland has lifted the geographical restriction and expand the business scope for the individually-owned stores set up by Hong Kong permanent residents with Chinese nationality. Market access will also be extended to eight new sectors including airport, cultural and entertainment, information technology, patent agency and trademark agency. Meanwhile, the HKSAR Government has been pursuing the mutual recognition of professional qualifications as part of, but on a separate track from, the services talks with the Mainland.

Trade and investment facilitation

5. Hong Kong and the Mainland have agreed on promoting cooperation in seven major areas including customs clearance, electronic commerce, trade and investment promotion and transparency in laws and regulations.

6. On recent facilitation measures, the Ministry of Commerce (MoC) announced on 6 September 2004 a new policy to encourage and support Mainland enterprises to invest and expand business in Hong Kong and Macao. With a few exceptions, Mainland enterprises intended to be set up in Hong Kong will be approved by the provincial authorities of commerce as delegated by the MoC, instead of by MoC itself.

Issues of concern considered by Members

Discussion at the Panel on Commerce and Industry

7. The Panel has followed closely the implementation of CEPA at the meetings held on 30 June, 13 October 2003, 10 May and 19 October 2004. It

has also considered the Administration's preliminary assessment on the impact of CEPA on 15 February 2005. In general, members welcome the implementation of CEPA and are keen to ensure that Hong Kong can make the best use of the opportunities brought about by CEPA.

Economic benefits

8. The Administration has expected that CEPA will enhance the attractiveness of Hong Kong to those overseas investors that wish to access the Mainland market. As the formula for calculating the value added percentage to qualify for zero tariff for certain products such as watches and clocks include the costs of design, research and patent incurred in Hong Kong, members note that the zero import tariff preference may attract to Hong Kong the manufacturing of brand name products or activities with high-value added content or substantial intellectual property input. As regards the impact of CEPA on the local economy, the preliminary report has revealed that CEPA has raised exports, improved profit margin and expanded local productive capacity. However, the impact on employment is relatively smaller owing to the capital-intensive nature of the manufacturing sector of Hong Kong. Some members have also suggested that the Administration should establish a high-level committee comprising Government representatives and business leaders to explore ways to maximize the opportunities presented by CEPA.

Further liberalization

9. The Panel notes that CEPA is an open and developing platform. The HKSAR Government has undertaken to continue discussion with the Mainland with a view to broadening its scope. Some members have raised concern about specific sectors such as whether "design" *per se* should be included as one of the sectors specified for liberalization in trade in services. The Administration has also been requested to discuss with the Mainland the feasibility of raising the 50% threshold in shareholding by Hong Kong service suppliers in joint venture enterprises set up in the Mainland for the provision of value-added telecommunication services. The Administration has noted members' views and re-affirms that it will continue to pursue with the Mainland authorities on further liberalization measures.

Promotion of CEPA

10. Owing to the importance of CEPA, members have highlighted the need to step up the publicity and promotion of CEPA to local and foreign investors. The Administration has assured members that it will spare no effort in this regard. Invest Hong Kong and the overseas Economic and Trade Offices of the SAR Government have included the business opportunities under CEPA as a significant part of their promotional activities. Members also note that the Trade Development Council, various industry organizations and chambers of commerce are also actively involved in promoting CEPA such as by organizing

thematic seminars on CEPA on their own or in conjunction with the Government.

11. The Panel considers it necessary to enhance the dissemination of information on CEPA for the benefit of the business community, especially small and medium enterprises. In response, the Administration has advised that it is working closely with the Mainland authorities to improve transparency and efficiency in the transmission of official information, especially that relating to rules and regulations. Members note that currently, the general public can access the official websites of all the 21 municipalities of the Guangdong Province via the hyperlinks set up in the home page of the Trade and Industry Department.

Opportunities brought about by CEPA

12. To enable Hong Kong to maximize the opportunities under CEPA, some members have urged the Administration to formulate new policy initiatives and strengthen its support measures. For example, to encourage Hong Kong manufacturers to relocate or set up their production base in Hong Kong, the Administration should consider concessions in land grant, taxation and machine investment, and facilitate the supply of skilled labour. The Panel also considers that the Administration should expedite the process of issuing Factory Registration and provide more practical assistance through greater inter-departmental coordination to help individual industries resolve difficulties they may encounter in setting up production lines in Hong Kong.

13. On trade in goods, members have urged the Administration to further streamline the application procedures for CO(CEPA) to encourage more Hong Kong enterprises to leverage on the zero-tariff arrangement which was applicable to Hong Kong products under CEPA I and II.

Discussion at Council meetings

14. Questions on the implementation of CEPA ranging from CEPA Certificates of Origin to facilitating businessmen in grasping the business opportunities under CEPA have been raised at Council meetings. On 9 July 2003, a motion on CEPA moved by Hon CHAN Kam-lam was carried. On 19 November 2003, Members passed a motion moved by Hon CHAN Yuen-han and as amended by Hon Kenneth TING, Hon LEE Cheuk-yan and Dr Hon YEUNG Sum on grasping the opportunities brought about by CEPA to enhance employment.

15. When speaking during the aforesaid motion debates, Members in general expressed support for CEPA but urged the Administration to formulate appropriate measures to improve the business environment and facilitate local enterprises, especially small and medium enterprises, to make the best use of the business opportunities brought about by CEPA, thereby creating more employment opportunities and improving the economy.

Assessment of the impact of CEPA

16. Having regard to members' concerns about the implications of the implementation of CEPA, in particular its economic benefits, if any, the Administration has announced that it will conduct a quantitative analysis of the economic impact of CEPA, including the effect on local employment and on various economic sectors, nine to 12 months after CEPA's implementation and will revert to the Panel in due course.

17. The Administration presented a preliminary assessment report to the Panel at its meeting on 15 February 2005 based on the available outcome of the analysis on the impact of the Individual Visit Scheme and the zero tariff on trade in goods. A full report which also covers trade in services and an analysis on trade and investment facilitation will be submitted to the Panel in April 2005. The Administration has been requested to include, inter alia, a more detailed analysis of the impact of CEPA on the local economy and employment, as well as concrete policy initiatives to assist Hong Kong traders and manufacturers to take advantage of the liberalization measures under CEPA.

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