

For Information

## **LEGISLATIVE COUNCIL PANEL ON MANPOWER**

### **The System of Certificates of Origin under the Mainland and Hong Kong Closer Economic Partnership Arrangement and Its Implications on Employment in the Manufacturing Sector**

#### **PURPOSE**

The note informs members of the system of certificates of origin under the Mainland and Hong Kong Closer Economic Partnership Arrangement (hereinafter referred to as CO(CEPA) and CEPA respectively), and discusses its implications on employment in the local manufacturing sector.

#### **DETAILS**

2. CEPA is the first free trade arrangement concluded by the Mainland of China and Hong Kong. It opens up huge market opportunities for Hong Kong-made goods and services, ahead of and beyond what China has committed in the World Trade Organisation. Under CEPA, the Mainland has agreed to eliminate tariffs on imported goods of Hong Kong origin by stages. Since 1 January 2005, Hong Kong-made products covered in 1,108 Mainland tariff codes may enter the Mainland tariff free. Details of the liberalization measures of CEPA have been reported to the Legislative Council (vide papers CB(1)2524/02-03(01) and CB(1)124/04-05(01)).

3. For a consignment to enjoy zero tariff preference under CEPA, the Hong Kong manufacturer or exporter concerned needs to apply for a CO(CEPA) before shipment as the proof that the relevant rule of origin has been met. The Trade and Industry Department (TID) is responsible for the administration of the certification system, which is backed up by a comprehensive legal framework rigorously enforced by the Customs and Excise Department (C&ED). Details of the operations of this system are set out in the following paragraphs.

## The Certification System

4. Hong Kong's Certificate of Origin system, including CO(CEPA), is backed up by the Export (Certificates of Origin) Regulations of the Import and Export Ordinance (Chapter 60) and the Protection of Non-Government Certificates of Origin Ordinance (Chapter 324). The laws provide the Director-General of Trade and Industry with the power to operate the system, and they impose heavy penalty for certification offences.

5. Under CEPA, goods must have undergone a reasonable amount of processing and production in Hong Kong in order to be eligible for zero tariff. To this end, a set of CEPA origin rules has been drawn up and agreed between the Mainland and Hong Kong. Amongst the 1,108 products covered by the CEPA-zero tariff arrangement, 72% adopt process-based origin rules, 13% adopt the "change in tariff heading" rule, and 9% adopt the "30% value-added requirement" rule. The origin rules for the remaining 7% (e.g. fish and aquaculture products) are designed with regard to the characteristics of the products concerned.

6. Traders (either the exporter or manufacturer of the goods meeting the relevant CEPA origin rules) need to lodge their CO(CEPA) applications with TID direct or through any of the five Government Approved Certification Organizations (GACOs)<sup>(Note)</sup>. To qualify for application of CO(CEPA), the manufacturer of the concerned goods must first obtain Factory Registration (FR) status from TID. To apply for FR, a factory is required to possess valid Business Registration, fixed and self-contained premises (which may be self-owned or rented), machinery and labour force to produce the registered goods. It needs to maintain adequate books and records on its operations. TID has pledged to complete processing a CO(CEPA) application within 1.5 working days under normal circumstances. An approved CO(CEPA) is valid for 120 days. As at 31 May 2005, we have received 5,538 CO(CEPA) applications, of which 5,194 have been approved. The total export value of the goods amounted to around HK\$1.87 billion.

7. To facilitate verification of goods at customs control points and speed up customs clearance, we have established an electronic data exchange mechanism with the Mainland. Information on each CO(CEPA) is transmitted by TID to the Mainland Customs electronically. Both sides

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<sup>(Note)</sup> Chinese Manufacturers' Association of Hong Kong; Federation of Hong Kong Industries; Hong Kong General Chamber of Commerce; Indian Chamber of Commerce, Hong Kong; and Chinese General Chamber of Commerce.

have also agreed on a set of procedures in case the claims of zero tariff cannot be verified immediately and have appointed liaison persons to enable speedy and effective communication in resolving problematic cases.

### **Enforcement of the Certification System**

8. C&ED deploys a dedicated team of 52 experienced Trade Controls Officer Grade officers to enforce the CO(CEPA) system. Enforcement measures are outlined below.

#### **(A) Factory Inspections**

C&ED conducts inspections of the premises and the production facilities of the factories applying for FR (ref. para.6 above) or for the annual renewal of FR. C&ED officers verify the production capability of the applicants before giving recommendations for their registration. C&ED conducts half-yearly routine inspection on registered factories.

#### **(B) Consignment Checks and Costing Checks**

C&ED conducts consignment checks on selected CO(CEPA) applications to ensure compliance with the CEPA rules of origin. C&ED also conducts costing checks on selected products whose origin rules are determined by value-added content.

#### **(C) Blitz Checks at Control Points**

C&ED conducts blitz checks at various control points to examine goods being exported to the Mainland under CO(CEPA) to guard against substitutions and false labeling. C&ED applies risk management techniques in selecting cargoes for examination.

#### **(D) Investigation and Prosecution**

C&ED investigates all suspected violations or abuses of the CO(CEPA), and takes prosecution action against offenders under the Import & Export Ordinance (Chapter 60), the Protection of Non-Government Certificates of Origin Ordinance (Chapter 324), and the Trade Descriptions

Ordinance (Chapter 362). On conviction, the maximum penalty is a \$500,000 fine and five years imprisonment.

### **Enforcement Statistics**

9. Since the implementation of CEPA in 2004, C&ED has conducted 1,078 consignment checks at factories and examined 261 consignments exported under CO(CEPA) at the control points up to the end of April 2005. There are altogether 11 cases that require investigation, two of which are referrals from the Mainland Customs. Most of these cases have turned out to be breaches of minor or technical nature. Two have led to prosecution.

### **Co-operation between Hong Kong and the Mainland Customs on CEPA**

10. C&ED and the Mainland Customs maintain close cooperation on the enforcement of the CO(CEPA) system. In the first year of implementation of CEPA, the two Customs met quarterly to analyze the CEPA statistics, review their monitoring work and exchange intelligence. Since December 2004, regular review meetings have been changed to half-yearly with ad hoc meetings held at anytime on a need basis. The two sides have separately appointed a CEPA Liaison Officer as a direct contact point for instant exchange of intelligence and resolving day-to-day CEPA enforcement problems. Information relating to CEPA enforcement may also be exchanged under the “Customs Co-operative Arrangement” framework between the two Customs. The Mainland Customs may request under the framework the assistance of C&ED for investigation into suspected Customs fraud cases and vice versa.

### **Implications on Local Employment**

11. The CEPA zero tariff preference for Hong Kong origin goods will help attract to Hong Kong manufacturing of brand name products, or manufacturing process with high-value added content or substantial intellectual property input. To maximise the commercial attractiveness for such manufacturing processes to take place in Hong Kong thus providing more job opportunities, the Administration has endeavoured to keep the CEPA-related origin rules simple and user-friendly while ensuring that products enjoying CEPA preferences are genuinely made in Hong Kong. The Administration attaches great importance to upholding the integrity of the certification system under CEPA, and believes that with the

vigorous enforcement of the measures and safeguards outlined in the above paragraphs, abuses and illegal circumvention can be minimised and the employment prospects for the manufacturing workforce arising from CEPA well protected.

12. CEPA has brought considerable economic benefits and contributed to the across-the-board improvement in the employment situation of Hong Kong, including that of the manufacturing sector. According to a recent study of the Administration on the economic impact of the first phase of CEPA (CEPA I) on the Hong Kong economy in 2004 and 2005, companies in Hong Kong engaging in the manufacturing/trading of domestic exports of CEPA I products to the Mainland hired about 1,000 additional employees in 2004. A further 1,280 jobs are forecast to be created in 2005. CEPA I has also boosted the use of premises, and machinery and equipment of the manufacturing sector in 2004 and its impact is expected to extend to 2005. With more products being given tariff free treatment, we believe CEPA's job creation effect for the manufacturing sector will intensify steadily.

13. The key findings of the above study were reported to the Panel on Commerce and Industry on 15 February 2005 and 19 April 2005 (vide papers CB(1)861/04-05(03) and CB(1)1259/04-05(03)). Discussions of the study at these two meetings were open to all Legislative Council members.

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