

Proposed Legislative Amendments on Rules of Origin for Arrangements/Agreements of Trade Liberalisation

Purpose

This paper briefs Members on the proposed amendments to the Trade Descriptions Ordinance (Cap. 362) (“the Ordinance”) that would allow more room for goods exported from Hong Kong to enjoy preferential tariff treatment, on the basis of the rules for determining places of origin. This is to reflect the more flexible criteria in an agreement of trade liberalisation that Hong Kong has recently concluded with some other economies.

Background

Arrangements/Agreements of Trade Liberalisation

2. In the 2006-07 Policy Address, the Chief Executive foreshadowed that we would seek to enter into more arrangements/agreements of trade liberalisation (“ATLs”) with our trading partners so that our goods and services may gain access to external markets under more favourable conditions.

3. Further to the two ATLs that Hong Kong had forged respectively with the Mainland and New Zealand¹, we signed on 21 June 2011 another ATL with the European Free Trade Association (“EFTA”)². We will continue to pursue more such arrangements/agreements with our trading partners in future.

Rules of Origin

4. ATLs in general cover, among others, commitments on preferential import tariff for goods. For an ATL signatory to enjoy such preferential treatment when exporting a product to another signatory, the goods concerned must be products “originated” (i.e. manufactured/produced) in the former. For each type of products, detailed rules for conferring such a status (hereafter referred to as “rules of origin”) may be set out in individual ATLs.

¹ They are (a) the Mainland and Hong Kong Closer Economic Partnership Arrangement (“CEPA”); and (b) the Hong Kong, China - New Zealand Closer Economic Partnership Agreement.

² EFTA comprises Iceland, Liechtenstein, Norway and Switzerland.

5. Provisions for determining the place of origin/manufacture to be marked on goods are currently specified in the Ordinance. The basic principle is that manufactured goods are considered to have originated in a certain place where the last process that substantially transforms the materials used takes place. In brief, the relevant rule is tied to a process, namely the “last substantial transformation”³.

6. For the ATLs that we have signed with the Mainland and New Zealand, the rules of origin therein are generally consistent with the “process-based” rules currently specified in the Ordinance.

Alternative “Value-based” Rules

7. As for our latest ATL with EFTA, apart from the “process-based” rules of origin, it contains an alternative set of origin-conferring criteria for preferential tariff treatment. They are hereafter referred to as “value-based” rules. Under these rules, goods are allowed to claim origin of a certain place based on the proportion of the “enhancement in value” attributable to that place⁴. Measured against the total value of the finished products, this “enhancement” needs to fulfill a certain percentage requirement, which may be different for individual categories of goods.

8. The alternative set of “value-based” rules of origin provides added flexibility for Hong Kong traders to claim tariff concessions under ATLs. The more likely beneficiaries are products which undergo in Hong Kong processes that add high value (such as assembly in tandem with product design), relative to the costs of the materials used for producing the goods. As an illustration, under the ATL with EFTA, woven garments bound for EFTA would be able to enjoy preferential tariff treatment even if our traders do not carry out the “last substantial transformation” process in Hong Kong⁵, so long as 40% of the value of the final product is attributable to the processing steps done in Hong Kong.

³ In the Ordinance, there is another “process-based” rule whereby goods are considered to have originated from a place if they are wholly grown or mined there. This is mainly applicable to natural products and hence much less relevant in the context of goods “originated” from Hong Kong.

⁴ The value of the goods in question may be “enhanced” in a place as a result of costs incurred in that place for processing/manufacturing the goods, such as material, labour, overhead, logistics and other services such as design etc. Any profit may also be taken into account.

⁵ In this case, the “last substantial transformation” process is assembly, i.e. sewing of woven “cut-pieces”/component parts into garment.

9. For the ATL with EFTA, the “value-based” rules apply to over 90% of Hong Kong’s domestic products to the EFTA States, including jewellery products as well as watches and clocks. Such rules are welcomed by the industry.

Present Legislative Framework

10. At present, the rules of origin in the Ordinance serve the policy objectives of -

- (a) protecting the interest of Hong Kong consumers by ensuring that the claimed places of origin for imported goods are accurate; and
- (b) helping to ensure that the places of origin/manufacture marked on goods originated in Hong Kong for export to other economies are intact.

For goods, the place of origin/manufacture is one type of trade description. Application of false trade descriptions to goods as well as the sale/import/export of such goods are criminal offences under the Ordinance⁶.

11. The existing Ordinance provides for the “process-based” rules of origin. The basis is set out in the Ordinance as follows -

- (a) the Ordinance contains provisions which accommodate the mainstream rules under the “process-based” concept, including the “last substantial transformation” process; and
- (b) the Ordinance empowers the Commissioner of Customs and Excise (“C,C&E”) to make orders to accommodate any product-specific process-tied modifications as may be agreed under individual ATLs after negotiations where the same is not adequately covered by the provisions in para.11(a) above. This order-making provision has hitherto been used to cater for such modifications as those called for under the relevant ATLs with the Mainland and New Zealand⁷.

⁶ The maximum penalties are a fine of \$500,000 and imprisonment for five years.

⁷ For example, C,C&E made an Order in September 2010, one of the objectives was to accommodate the more flexible rules of origin under CEPA for certain types of textile made-up articles such as shawls and ties. They may be marked as originated from Hong Kong if either the weaving/knitting of fabric or the last step of sewing of “cut-pieces” into products takes place in Hong Kong.

12. The Trade and Industry Department (“TID”) provides guidelines through administrative documents (such as trade circulars and the full text of the ATLS) to facilitate the industry’s understanding of the product-specific origin-conferring processes/criteria under the relevant ATLS.

Proposed Legislative Amendments

13. As foreshadowed in the Legislative Council brief titled “Free Trade Agreement between Hong Kong and the Member States of the European Free Trade Association” issued on 22 June 2011 (file ref: CR WT 324/9/10), we need to amend the Ordinance to cater for the additional “value-based” rules of origin in implementing the ATL with EFTA⁸. Such a concept may feature in ATLS that Hong Kong would possibly sign with other economies in future.

14. In drafting the proposed legislative amendments, we are mindful that the “value-based” concept is evolving and may be presented in different ways. At the moment, there are two possible mainstream ways of expressing this concept in individual ATLS –

- (a) a formula that puts a cap on the value attributable to non-signatory places, against the total value of the goods. Our ATL with EFTA adopts this approach⁹; and
- (b) a formula that gives a floor to the value attributable to signatory places, against the total value of the goods. This is used in some ATLS elsewhere and may be used in ATLS relevant to Hong Kong in future. Under such a formula, the aggregate increase in value of the goods attributable to the ATL signatory places, as a proportion of the total value of the goods, should meet a minimum threshold stipulated for the goods concerned in the ATL.

⁸ If the law is not amended, Hong Kong traders marking goods for export under ATLS as having a Hong Kong origin pursuant to the value-based rules of origin may inadvertently contravene the Ordinance if the goods do not satisfy the rules on Hong Kong origin under the existing process-based rules in the Ordinance.

⁹ For the ATL with EFTA, most of the goods would be considered as having “originated” from Hong Kong (or EFTA as the case may be) if the value of the materials procured from places other than Hong Kong and EFTA States accounts for no more than 60% of the manufacturer’s selling price of the goods.

15. We propose to make reference to the present legislative framework and amend the Ordinance to cater for the “value-based” concept, including the two possible formulae in para.14 above. By doing so, we will be able to implement the ATL with EFTA, whilst at the same time providing room to accommodate future ATLs as far as possible. To this end, the present rules of origin in section 2(2) of the Ordinance would need to be amended. We would also consider referring to individual ATLs in the legislation to cater for possible variations of the formulae in individual ATLs.

16. Administratively, TID will continue to provide access to the full text of ATLs. TID will also issue guidelines to facilitate the industry’s understanding of the details, including the specific threshold percentages for various types of goods as may be set out in individual ATLs.

Claiming Preferential Tariff Treatment

17. The exact detailed arrangements for Hong Kong exporters to claim tariff concessions would depend on individual ATLs.

18. In the case of the ATL with EFTA, exporters are required to complete a self declaration of origin. No certificates of origin are required. The Customs and Excise Department (“C&ED”) would assist in carrying out verification of the origin declarations upon request by EFTA customs authorities, and may make investigation on receipt of specific information on suspected offences. C&ED may request the production of documents to demonstrate that the exporting goods fulfill the rules of origin under the ATL with EFTA, which are those usually kept by the business sector in a normal business environment¹⁰.

Public Consultation

19. We have consulted the major industry associations representing the producers and traders of our major exports to the EFTA States and elsewhere¹¹. They fully support the proposed legislative amendments which would provide added flexibility for them to tap the business opportunities offered by ATLs. They hope to see the enactment of the amendments as soon as possible so that they could reap the benefits

¹⁰The documents include production records, workers’ wages records, and invoices of materials used in the manufacture of the products.

¹¹The manufacturing sectors consulted include jewellery, watches and clocks, textiles, electronic and electrical as well as plastic products.

offered by the ATL with EFTA early. We have also kept the major chambers of commerce informed of the legislative proposal.

Advice Sought

20. Subject to Members' views, we hope to be able to introduce the legislative amendments into this Council before the end of this year. We would aim at completing the legislative exercise before mid-2012, i.e. the planned implementation date for the ATL with EFTA.

Commerce and Economic Development Bureau
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