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Panel on Commerce and Industry

Meeting on 18 July 2006

**Background brief on developments of the
Mainland and Hong Kong Closer Economic Partnership Arrangement**

Purpose

This paper updates developments of the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) and Members' deliberations on the subject.

Background

2. CEPA is the first free trade agreement ever concluded by the Mainland and Hong Kong, covering liberalization of trade in goods, trade in services, as well as trade and investment facilitation between the two places. The Mainland and Hong Kong signed the main text of CEPA on 29 June 2003 and its six Annexes on 29 September 2003 (CEPA I). CEPA I was fully implemented on 1 January 2004. As CEPA adopts a building block approach, the Central People's Government and the Government of the Hong Kong Special Administrative Region entered into consultation with a view to further broadening and enriching the scope of CEPA. The two sides reached agreement on the second and third phases of further trade liberalization measures (CEPA II and CEPA III) on 27 October 2004 and 18 October 2005 respectively. CEPA II and CEPA III came into full implementation on 1 January 2005 and 1 January 2006 respectively.

Trade in goods

3. Under CEPA I and CEPA II, the Mainland applies zero import tariff for Hong Kong origin products covered in 1 108 Mainland 2005 tariff codes and meeting CEPA rules of origin (ROOs). Under CEPA III, the Mainland agrees to give **all** products of Hong Kong origin tariff-free treatment starting from 1 January 2006, upon applications by local manufacturers and upon the CEPA ROOs being agreed and met. On top of the products covered in CEPA I and CEPA II, the

Mainland and Hong Kong have also agreed on the ROOs for a list of goods covered in 262 Mainland 2006 tariff codes. Under the first three phases of CEPA, the Mainland and Hong Kong have reached agreement on the CEPA ROOs for a total of 1 370 Hong Kong products which can enjoy zero tariff when being exported to the Mainland. The Mainland has also agreed to amend the existing ROOs to waive the 30% value adding requirement for watches of Hong Kong brand names to be eligible for zero tariff.

4. For products that have no agreed CEPA ROOs for the time being, both sides have agreed that Hong Kong manufacturers may apply and request to include them in subsequent phases of ROO discussions held twice a year after 2005 (instead of once a year as in previous phases of CEPA). This provides further flexibility to potential investors planning to manufacture products that are not yet currently produced in Hong Kong.

Trade in services

5. As a result of the first two phases of CEPA, the Mainland has given preferential market access to Hong Kong service suppliers in a total of 27 services areas since 1 January 2005.

6. Under CEPA III, there are 23 further liberalization measures covering 10 existing areas, namely legal, accounting, audiovisual, construction, distribution, banking, securities, tourism, transport and individually owned stores. All the liberalization measures took effect on 1 January 2006. Broadly speaking, the liberalization measures under CEPA permits earlier and wider access for Hong Kong service suppliers to the Mainland market, ahead of China's World Trade Organization (WTO) timetable. In some sectors, like legal, audiovisual, transport, banking and insurance services, the concessions go beyond China's WTO commitments.

Trade and investment facilitation

7. Both the Mainland and Hong Kong agree that trade and investment facilitation plays a crucial role in the successful implementation of CEPA, and agreed to enhance co-operation in seven areas, such as investment promotion, customs clearance facilitation, transparency in laws and regulations, etc. Some of the measures under CEPA III have been worked out with the intention to enhance the flow of trade and investment between the two places. Major achievements include:

- (a) textiles and clothing products under Hong Kong's Outward Processing Arrangement are exempt from the Mainland's export duty when they are re-imported to Hong Kong; and
- (b) the permission for certain types of Mainland securities and futures companies to come to establish subsidiaries in Hong Kong.

Issues of concern considered by Members

Discussion at the Panel on Commerce and Industry

8. The Panel has followed closely the implementation of CEPA at its meetings held on 30 June, 13 October 2003, 10 May, 19 October 2004, 15 February, 19 April 2005 and 15 November 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 afforded by CEPA.

Economic benefits

9. The Administration considers that CEPA will enhance the attractiveness of Hong Kong to overseas investors that wish to access the Mainland market. The zero import tariff preference would also attract to Hong Kong the manufacturing of brand name products or activities with high-value added content or substantial intellectual property input. Moreover, liberalization in trade in services will offer new business opportunities in the Mainland for Hong Kong professionals and service providers. The Panel also notes the Administration's analysis that Hong Kong should turn itself into a conduit of "quality" capital in order to stay competitive vis a vis other foreign investors in the Mainland market. CEPA has thus laid the foundation for a new business platform to shape the longer-term socio-economic relations between Hong Kong and the Mainland.

10. Some members of the Panel, however, have cautioned that the Administration should not be over-optimistic, commenting that the economic benefits derived from CEPA to Hong Kong have so far come about only from the implementation of the policy, rather than from any proactive efforts on the part of the Government to tap the best advantages from CEPA. The Government should conduct a comprehensive review on where and how it could strengthen measures to facilitate different sectors and industries in fully utilizing the liberalization arrangements under CEPA.

Job creation under CEPA

11. The impact of the implementation of CEPA on local employment is another major concern for the Panel. Members note that according to a projection made by the Administration in 2004, about 20 000 new jobs were estimated to be created in 2004 while some 9 000 would be created in 2005. Many of the new jobs were found in the services sector. Some Members remain concerned that as Hong Kong's manufacturing sector moves away from labour-intensive operations to capital-intensive processes, Hong Kong's industrial development and the job opportunities of manufacturing workers would unlikely improve. The Administration has nevertheless advised that the local business community would need time to plan and adjust their strategies and mode of operation under CEPA. If the initial response of the Mainland market is favourable, local manufacturers

will likely set up additional production lines and engage more staff, thereby boosting local employment.

12. Some members of the Panel consider that it is high time for the Administration to take strengthened steps to promote CEPA to overseas investors and render assistance to traditional local industries such as textiles and garments to move up the value chain to gain benefits from the CEPA arrangements. It should also encourage Hong Kong manufacturers in the Mainland to relocate their operations back to Hong Kong. These measures would boost the local economy and create more job opportunities.

13. The Panel has requested the Administration to monitor the impact of CEPA on job creation for the local workforce and report development to the Panel.

Support measures

14. To encourage Hong Kong manufacturers to relocate or set up their production base in Hong Kong, some members have suggested that the Administration should consider the introduction of new initiatives such as land grant and tax concessions. While the Administration is not in favour of providing discriminatory tax incentives to a particular sector or industry, and there is no plan to provide such concessions for the purposes of CEPA, the Administration has referred to a number of concessions which are generally applicable to all sectors, such as the deductions allowed for profits tax purposes, depreciation of machine and equipment, etc.

15. Some members have also suggested that the land released as a result of the reduction of the frontier closed area might be developed as a production base for the local manufacturing industries. On this issue, the Administration has advised that as the use and development of the frontier closed area is still being studied by various bureaux and departments, the suggestion to develop the area in the light of CEPA would be further examined.

16. Some members have referred to trade barriers currently confronting Hong Kong enterprises and urged the Administration to work more closely with the Mainland authorities in overcoming these impediments. The Administration has confirmed that it will maintain close liaison with the Mainland authorities and will continue to improve the operational procedures under CEPA in the light of implementation experience. Members also note that a dedicated team of staff has been set up in the Trade and Industry Department to oversee the coordination and implementation of the liberalization measures under CEPA. It also handles enquiries, takes follow-up actions and maintains a website on CEPA.

17. Members have also expressed concern about the assistance available to Hong Kong businessmen and professional bodies when they encounter problems in connection with their investment or business in the Mainland. In this connection, the Panel has noted from the Chief Executive's 2005-06 Policy Address that in

addition to the Hong Kong Economic and Trade Office (ETO) in Guangdong and the Beijing Office, the Administration will discuss with the Central Authorities the setting up of additional offices in Shanghai and Chengdu. The Administration has lately reported that the new ETOs in Shanghai and Chengdu respectively are planned to be established in the third quarter of 2006.

Promotion and dissemination of information

18. Owing to the importance of CEPA, members have highlighted the need to step up the publicity and promotion of CEPA. The Administration has assured members that it will spare no effort in this regard. Invest Hong Kong and the overseas ETOs of the 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.

19. 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.

20. Regarding some members' concern about the provision of information to assist Hong Kong residents to set up individually owned stores in the Mainland, the Administration has confirmed that the Trade and Industry Department has published information on its website to facilitate Hong Kong residents to have a better understanding of the procedures, formalities and the documents required for setting up such stores.

Discussion at Council meetings

21. Questions on the implementation of CEPA, ranging from CEPA Certificates of Origin to market entry facilitation measures to assist businessmen in grasping the business opportunities provided by 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. A motion on deepening CEPA moved by Hon WONG Ting-kwong and as amended by Hon SIN Chung-kai was carried at the Council meeting on 15 June 2005.

22. 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.

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