

**MAINLAND AND HONG KONG
CLOSER ECONOMIC PARTNERSHIP ARRANGEMENT
(CEPA)**

Third Phase of Trade Liberalization (CEPA III)

Introduction

This note informs members of the outcome of the Administration's discussions with the Mainland on the third phase of CEPA (CEPA III) on further liberalization of trade in goods and services.

Background

2. The Mainland and Hong Kong signed the main text of CEPA on 29 June 2003 and its Supplement on 27 October 2004 (CEPA I and CEPA II). As CEPA adopts a building block approach, the Central People's Government (CPG) and the Government of the Hong Kong Special Administrative Region (HKSARG) entered into consultation regarding further trade liberalization between the two places in May 2005. After months of continued and intensive exchanges, the two sides reached agreement on the third phase of further trade liberalization measures (CEPA III) on 18 October 2005 in Hong Kong.

Summary of Further Liberalization under CEPA

Trade in Goods

Import Tariff

3. Under CEPA I and CEPA II, the Mainland is applying 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 has now agreed to give all products of Hong Kong origin tariff free treatment starting from 1 January 2006 except for prohibited articles (such as used or waste electrical machinery and medical/surgical products, chemical residual, municipal

waste, tiger bone and rhinoceros horn), upon applications by local manufacturers and upon the CEPA ROOs being agreed and met.

Rules of Origin

4. Goods importing into the Mainland must fulfil the CEPA ROOs to enjoy tariff free treatment. On top of the goods 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 261 tariff lines. The overwhelming majority of the agreed ROOs for these products basically resemble the liberal rules adopted in CEPA I and II.

5. Of all the products covered in the 1,369 (1,108 + 261) tariff codes, Hong Kong's existing process-based origin rules have been adopted for 1,014 of them (74%). These items include textiles and clothing, food and beverages, pharmaceutical products as well as some plastic and metal products. "Change in tariff heading" is adopted for 155 products (11%) whereas a 30% value-added requirement is adopted for 116 products (9%). Both sides also agreed on the ROOs for the remaining 84 product codes (6%) (including fish and aquaculture products) taking into account the characteristics of the products concerned.

6. The Mainland has also agreed to relax the CEPA ROOs for watches by waiving the 30% value adding requirement for watches of Hong Kong brand names. The revised rules should be conducive to the further development of the timepiece industry in Hong Kong.

7. The lists of products and their CEPA ROOs can be found in website of Trade and Industry Department (TID) at <http://www.tid.gov.hk/english/cepa/index.html>. For products that have no agreed CEPA ROOs for the time being, both sides have agreed that enterprises may apply and request to include them in subsequent phases of ROO discussions which will be held twice a year (instead of once a year as in previous phases of CEPA). This will provide further flexibility to potential investors planning to manufacture products that are not yet currently produced in Hong Kong. Detailed application arrangements will be announced soon.

Procedures for Claiming Zero Tariff

8. To claim zero import tariff under CEPA, products being exported into the Mainland must be accompanied by a Certificate of Hong Kong Origin-CEPA (CO(CEPA)) issued by TID or one of the Government Approved Certification

Organizations (GACOs) ^(Note 1). Before applying for CO(CEPA), manufacturers are required to apply for a Factory Registration (FR) with TID to demonstrate that their factories possess sufficient capacity to produce the goods for export. The application procedures and the conditions of issuing CO(CEPA) are set out in Certificate of Origin Circulars No. 24/2003 issued on 14 November 2003 and No. 19/2004 issued on 30 December 2004. These circulars can be downloaded from TID's website (www.tid.gov.hk/english/cepa/trade_goods.html).

Trade in Services

9. Taking the three phases of CEPA together, the Mainland has agreed to provide preferential treatment to Hong Kong service suppliers in 27 service areas

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- accounting services
- advertising services
- airport services
- audiovisual services
- banking services
- cultural services
- convention and exhibition services
- distribution services
- freight forwarding agency services
- individually owned stores
- information technology services
- insurance services
- job referral agency services
- job intermediary services
- legal services
- logistics services
- management consulting services
- medical and dental services
- patent agency services
- professional qualification examinations
- real estate and construction services
- storage and warehousing services
- securities and futures services
- telecommunications services
- tourism services
- trade mark agency services
- transport services (including road freight/passenger transportation services and maritime transport services)

(Note 1) Under the Protection of Non-Government Certificates of Origin Ordinance (Cap. 324), there are five Government Approved Certification Organizations (GACOs) designated to issue certificates of origin: the Chinese Manufacturers' Association of Hong Kong; Federation of Hong Kong Industries; the Hong Kong General Chamber of Commerce; the Indian Chamber of Commerce, Hong Kong; and the Chinese General Chamber of Commerce.

Further liberalization measures spreading across 10 areas, namely legal, accounting, audiovisual, construction, distribution, banking, securities, tourism, transport and individually owned stores have been introduced under CEPA III. The new liberalization measures will take effect from 1 January 2006.

10. Broadly speaking, the liberalization permits earlier access for Hong Kong service suppliers to the Mainland market, ahead of China's World Trade Organization (WTO) timetable. In some sectors, like audiovisual services, transport services and distribution services, the concessions go beyond China's WTO commitments. The liberalization measures under CEPA I and II can be downloaded from TID's website (http://www.tid.gov.hk/english/cepa/legaltext/cepa_legaltext.html). Details of the new liberalization measures of CEPA III are outlined in **Annex** to this paper.

Trade and Investment Facilitation

11. The two sides agreed that trade and investment facilitation plays a crucial role in the successful implementation of CEPA. 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 -

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

Further Liberalization

12. CEPA is an open and developing platform. The HKSARG will seek to engage the Mainland authorities on further liberalization of trade in goods and services in the Mainland market in due course.

Way Forward

13. The CPG and the HKSARG will work closely on implementation details of CEPA III. We will inform the trade of relevant implementation measures shortly.

14. The HKSARG shall spare no effort in encouraging the local business sector to make full use of the preferences under CEPA. We will also underline the many business opportunities offered by CEPA in our promotion work to attract more foreign investment to Hong Kong.

Implications of Implementation

15. CEPA has been offering new business opportunities in the Mainland for Hong Kong businesses and service suppliers, enhancing the attractiveness of Hong Kong to overseas investors. The zero import tariff preference, including the adoption of more flexible ROOs for watches, has the potential to attract to Hong Kong manufacturing of brand name products, or manufacturing process with high-value added content or substantial intellectual property input. The Administration's study on the economic impact of CEPA I revealed that the overwhelming majority of respondents considered that CEPA I was beneficial to the Hong Kong economy. About 29,000 new jobs have been and are forecast to be created for Hong Kong in the first two years of implementing CEPA I (including the "Individual Visit Scheme").

16. Trade and Industry Department and the Customs & Excise Department will continue to carry out the part of CEPA work related to the certification of goods of Hong Kong origin and of Hong Kong service suppliers. Relevant policy bureaux and departments will be involved in the implementation of those parts of CEPA III under their purview.

Consultation with Business and Professional Communities

17. We have been in touch with the business and professional communities in formulating the strategy for CEPA III. Their views and requests have been taken into account in drawing up Hong Kong's wish list in this phase of consultations with the Mainland. We will stay in close and constant dialogue with the stakeholders in the implementation of the further liberalization measures and in talks with the Mainland on any new phases of CEPA.

18. We will continue to keep the Committee informed of the major developments of CEPA.

Trade and Industry Department

October 2005

**The Third Phase of the Mainland
and Hong Kong Closer Economic Partnership Arrangement (CEPA III)**

Further Liberalization of Trade in Services

< Courtesy English Translation >

Effective date of the liberalization measures listed below: 1 January 2006

Service Sectors	Sector-specific Commitments
Legal services	<ol style="list-style-type: none">1. To allow a Hong Kong law firm (office) that has set up a representative office in the Mainland to operate in association with one Mainland law firm situated in the province, autonomous region or municipality where its representative office is situated.2. A Hong Kong resident who is allowed to practise in the Mainland will practise in one Mainland law firm only, and will not simultaneously be employed by the representative office set up by a law firm of a foreign country in China, or the representative office set up by a law firm of Hong Kong or Macao in the Mainland.
Accounting, auditing and bookkeeping services	<ol style="list-style-type: none">1. The validity period of the "Temporary Business Permit", applied by Hong Kong accounting firms for the purpose of conducting business on a temporary basis in the Mainland, is extended from one year to two years.
Construction professional services	<ol style="list-style-type: none">1. For construction and engineering design enterprises and urban planning service enterprises set up in the Mainland by Hong Kong service suppliers, the performance of the enterprises both in Hong Kong and in the Mainland is taken into account in assessing the qualification of the enterprises in the Mainland.2. To relax the requirements under Article 15 of the Ministry of Construction Decree No. 114 "Regulations on Administration of Foreign-Invested Construction and Engineering Design Enterprises" as follows: on the application as a construction and engineering design enterprise by a wholly foreign-owned construction and engineering design enterprise set up by a Hong Kong service supplier in the Mainland, the number of Hong Kong residents qualified as certified architects or certified engineers in China and the number of Hong Kong residents having the relevant design experience should not be less than 1/4 of the total number specified under the qualification grading criteria for certified practising staff and key technical personnel; on the application as a construction and engineering design enterprise by an equity or contractual joint venture construction and engineering design enterprise set up by a Hong Kong service supplier in the Mainland, the number of Hong Kong residents qualified as certified architects or certified engineers in China and the number of Hong Kong

Service Sectors	Sector-specific Commitments
	<p>residents having the relevant design experience as key technical personnel should not be less than 1/8 of the total number specified under the qualification grading criteria for certified practising staff and key technical personnel.</p> <ol style="list-style-type: none"> 3. For urban planning service enterprises, in the form of equity joint ventures or contractual joint ventures, set up in the Mainland by two or more Hong Kong service suppliers, the performance of all individual enterprises both in Hong Kong and in the Mainland is taken into account in assessing the qualification of the equity joint ventures or contractual joint ventures enterprises in the Mainland. 4. To relax the requirement of the residential period in the Mainland for Hong Kong professional and technical staff by counting their period of residence in Hong Kong as their period of residence in the Mainland.
Audiovisual services	<ol style="list-style-type: none"> 1. Hong Kong service suppliers are permitted to establish wholly-owned companies in the Mainland, each of which may construct or renovate more than one cinema theatre at more than one location for the operation of film screening business. 2. The Cantonese version of motion pictures co-produced by Hong Kong and the Mainland is permitted to be distributed and screened in Guangdong Province, after obtaining the approval of the relevant authorities in the Mainland; the Cantonese version of motion pictures produced by Hong Kong and solely imported by the Film Import and Export Corporation of the China Film Group Corporation is permitted to be distributed and screened in Guangdong Province, after being examined by and obtaining the approval of the relevant authorities in the Mainland. 3. The import of Chinese language motion pictures made by production companies which are set up in accordance with the relevant laws of the Hong Kong Special Administrative Region and own more than 50% of the copyright of the motion pictures concerned * is exempted from quota restrictions for distribution in the Mainland, after being examined by and obtaining the approval of the relevant authorities in the Mainland. 4. Television dramas co-produced by the Mainland and Hong Kong should be subject to the same standard on the number of episodes as that applicable to Mainland domestically-produced television dramas. <p>【* Hong Kong residents should comprise more than 50% of the principal personnel in the motion pictures concerned. Principal personnel includes personnel performing the roles of director, screenwriter, leading actor, leading actress, supporting actor, supporting actress, producer, cinematographer, editor, art director, costume designer, action choreographer, and composer of the original film score.】</p>

Service Sectors	Sector-specific Commitments
Distribution services	<ol style="list-style-type: none"> <li data-bbox="424 315 1375 495">1. To allow Hong Kong service suppliers to operate commission agents' services in respect of chemical fertilizers, processed oil and crude oil, and wholesale and retail services in respect of chemical fertilizers, on a wholly-owned, equity joint venture, or contractual joint venture basis. <li data-bbox="424 517 1375 884">2. For the same Hong Kong service supplier which opens more than 30 stores accumulatively in the Mainland, if the commodities for sale include books, newspapers, magazines, automobiles (this restriction to be lifted from 11 December 2006), pharmaceutical products, pesticides, mulching films, chemical fertilizers, staple food, vegetable oil, edible sugar and cotton, and the above commodities are of different brands and come from different suppliers, the Hong Kong service supplier is allowed to become the controlling shareholder, with the proportion of capital contribution not exceeding 51% *. <p data-bbox="496 907 1366 969">【* If the commodity for sale is processed oil, the Mainland's commitments to members of the World Trade Organization are still applicable.】</p>
Banking services	<ol style="list-style-type: none"> <li data-bbox="424 1021 1375 1314">1. The level of operating funds required of Mainland branches of Hong Kong banks for offering renminbi and foreign currency businesses to local customers will be assessed on the basis of all Mainland branches of the bank concerned rather than each branch individually, and on the condition that the average level of operating funds of all Mainland branches of the bank concerned is over RMB500 million, the requirement on the level of operating fund of an individual branch should not be less than RMB300 million.
Securities and futures services	<ol style="list-style-type: none"> <li data-bbox="424 1361 1375 1469">1. The Mainland shall allow qualified Mainland securities companies which belong to the pilot innovation type to set up subsidiaries in Hong Kong in accordance with the relevant requirements. <li data-bbox="424 1491 1375 1599">2. The Mainland shall allow qualified Mainland futures companies to operate futures business in Hong Kong, including the setting up of subsidiaries.
Tourism and travel related services	<ol style="list-style-type: none"> <li data-bbox="424 1648 1375 1865">1. To lower the entry requirement in the Mainland for Hong Kong travel agents: the annual business turnover of the Hong Kong travel enterprises should not be less than US\$25 million for setting up wholly owned travel agents in the Mainland; and not less than US\$12 million for setting up joint venture travel agents in the Mainland.

Service Sectors	Sector-specific Commitments
Transport services	<ol style="list-style-type: none"> 1. To allow Hong Kong service suppliers to set up wholly-owned companies in the Mainland to provide, for tugs that they operate between Hong Kong and Mainland ports, regular business services such as shipping undertaking, issuance of bills of lading, settlement of freight rates and signing of services contracts. * 2. To allow Hong Kong service suppliers to set up wholly-owned companies in the Mainland to provide ship maintenance and repair services. 3. To allow Hong Kong service suppliers to set up wholly-owned companies in the Mainland to provide services of international ocean container leasing, buying and selling as well as trading of container parts. 4. To allow Hong Kong service suppliers to set up wholly-owned companies in the Mainland to provide ship survey services for ships registered in Hong Kong. 5. To allow Hong Kong service suppliers to set up enterprises in the form of equity joint venture or contractual joint venture in the Mainland to provide air transport sales agency services. The registered capital requirement will be the same as that for Mainland enterprises. <p>【* The requirement that “50%, or more of the ships owned by it, calculated in terms of tonnage, should be registered in Hong Kong” as set out in Annex 5 of “CEPA” is not applicable to Hong Kong service suppliers which provide towing services.】</p>
Individually owned stores	<ol style="list-style-type: none"> 1. To allow Hong Kong permanent residents with Chinese citizenship to set up, in accordance with the relevant Mainland laws, regulations and administrative regulations, individually owned stores in all provinces, autonomous regions, municipalities directly under the Central Government in the Mainland without being subject to the approval procedures applicable to foreign investments, to provide the following four kinds of services including import and export of goods and technologies; photography and photographic processing services; washing, cleaning and dyeing services; and repair and maintenance of motor vehicles and motorcycles; excluding franchising operation. No more than 8 persons should be engaged in the operation of the individually owned stores, and the business area of such stores should not exceed 300 square meters.