

**Further Cooperation between Hong Kong and
the Mainland's Telecommunications Sector
under the CEPA Framework**

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I. BACKGROUND

After seventeen months of consultation, the agreement on the main parts of the Closer Economic Partnership Arrangement (CEPA) between Hong Kong and the Mainland was finally reached and signed on 29 June 2003. Six annexes which opened up 18 services sectors including telecommunications to Hong Kong Service Suppliers (HKSS) were signed subsequently on 29 September 2003. The main purpose of the CEPA was to promote co-operation in trade and investment facilitation between Hong Kong and the Mainland.

There have been some concerns on whether or not the CEPA would violate China's WTO accession agreements since Hong Kong is an individual WTO member per se. In the Seminar on Cooperation and Exchange between Lawyers from Beijing and Hong Kong on 24 October 2003, the Secretary for Justice, Ms Elsie Leung, clarified on the issue:

“.....There is legal basis for the arrangement , it lies in Article 24 (8) of the General Agreement on Tariffs and Trade (GATT) and Article 5 of the General Agreement on Trade in Services (GATS). According to these provisions, Hong Kong and the Mainland may accord preferential treatment to each other as regional economies, so long as the treatment is not detrimental to other WTO members and those areas that are excluded from the undertaking of China upon its entry into the WTO..... It is only within one country that the two territories could enjoy such a close relationship and share in the prosperity without any boundary between them. It is only under two systems that two WTO members within the same country could make a CEPA arrangement.”

Under the framework of the CEPA, the Mainland government committed to open five value added services to Hong Kong's telecommunication service suppliers. Detailed terms were defined in Annex 4 of the CEPA as follows (Table 1):

Table 1: The Mainland's CEPA Commitments on Telecommunications

Sectors or sub-sectors	2. Communications services
	C. Telecommunications services
	Valued-added services
Specific commitments	<p>1. As from 1 October 2003, to allow Hong Kong service suppliers to set up joint venture enterprises in the Mainland to provide the following five types of value-added telecommunications services¹:</p> <ul style="list-style-type: none"> (1) Internet data centre services; (2) store and forward services; (3) call centre services; (4) Internet access services; (5) content services. <p>2. Hong Kong service suppliers' shareholding in the joint venture enterprises engaging in the value-added telecommunications services mentioned in item 1 above should not exceed 50%.</p> <p>3. There will be no geographic restriction for the joint venture enterprises formed by Hong Kong service suppliers and the Mainland to provide value-added telecommunications services mentioned in item 1 above.</p>

Source: Annex 4 of CEPA, <http://www.tid.gov.hk/english/cepa/files/annex4.doc>

¹ To implement in accordance with the Mainland's "Telecommunication business classification".

The CEPA has created favorable business environment facilitating Hong Kong's telecommunications sector to explore the fast-growing Mainland market, but certain evaluation and review on the present progress and future development is crucial. It is in this context that the Internet and Telecommunications Association of Hong Kong (ITAHK) commissioned the Department of Information and Systems Management, Hong Kong University of Science and Technology (HKUST) to conduct a research regarding further cooperation between Hong Kong and the Mainland's telecommunications sector under the CEPA framework. Findings of this research will be presented to the Ministry of Information Industry (MII) and other relevant government departments during a delegation visit to Beijing in May 2004. According to the ITAHK, the purpose of this visit is to enable its members to have an opportunity to meet with senior officials of the government in order to exchange ideas and experiences that may arise under the CEPA.

The agreement between the ITAHK and HKUST was formally signed in February 2004. From 10 February to 28 February 2004, the research team conducted interviews with six companies representing the fixed network operator, mobile network operator, mobile virtual network operator (MVNO), system integrator, value added service provider and the Mainland telecommunications operator. These companies generously spent their time with the research team and addressed a full spectrum of issues concerning the CEPA. On the basis of these interviews, the research team designed a questionnaire and distributed it to all ITAHK members in order to get broader views on concerned issues. By 22 March 2004, in total we have received seven feedbacks. In addition to filling the questionnaire, the participants have also provided certain constructive comments. The research team highly appreciates all participating ITAHK members for their generous support and insightful comments. It is impossible to prepare this report without their valuable participation.

This report will begin with a review on the latest development in Hong Kong's telecommunications sector since the six annexes of the CEPA were signed on 29 September 2003. It will then highlight major comments from the industry on the current CEPA arrangement and other relevant issues. Accordingly, recommendations will be proposed to both Hong Kong and the Mainland governments on measures to further facilitate cooperation between Hong Kong and the Mainland's telecommunications sector under the CEPA framework.

II. OVERVIEW

Hong Kong's telecommunications market has been fully liberalized since 2002. Investors from any part of the world, including those from the Mainland, can easily obtain a license and provide telecommunication services in Hong Kong without any constraints. In this case, the CEPA mainly concerns accession to the Mainland's telecommunications market. For those Hong Kong's investors who had operated in grey areas in China before the CEPA was signed, they can now obtain a legal status to eliminate potential policy risks in the future. For instance, 800 TELESERVICE, a call center service provider that has moved into the Mainland for more than three years in the way of cooperation, can now legally owns 50% of the company. For investors who have never been able to penetrate into the world's largest telecommunications market, the door is finally opened.

According to our fieldwork, it is believed that the CEPA will also benefit the Mainland service suppliers in terms of efficiency improvement and competitiveness enhancement. The highly competitive telecommunications market in Hong Kong has strengthened the market and technology responsiveness of Hong Kong's service suppliers. They are particularly strong in business intelligence, marketing strategies and technological expertise. In many instances, Hong Kong acts as a show window for new initiatives. In addition, Hong Kong service providers excel at project management due to the fact that all telecom companies in Hong Kong are owned by private investors. By setting up joint ventures, such expertise can be transferred to their Mainland partners. According to Blomstrom (1991), the transference of experience and expertise is perhaps the most significant externality of foreign or overseas direct investment. Since the Mainland market is going to open gradually according to its WTO commitments, the experience of Hong Kong companies would certainly be valuable for the Mainland companies to face the future intensified competition.

It may not be premature to claim that a smooth cooperation between Hong Kong and the Mainland's telecommunications sector will be beneficial to both parties. The question is: has the CEPA provided an ideal framework to pave the way for this cooperation? Can Hong Kong's telecommunications service suppliers benefit from the current arrangement? If Hong Kong's service suppliers are not motivated to enter the Mainland market, their experience and expertise will not be transferred to their potential Mainland partners, and, consequently, the Mainland's telecommunications sector won't be able to benefit from the CEPA too.

Reflected in a survey conducted by PricewaterhouseCoopers Hong Kong, it was generally agreed (77% of the respondents) that CEPA could bring economic benefits to Hong Kong. Among the various proposed benefits of CEPA, 'earlier set-up of wholly owned foreign enterprises' and 'lowering of entry requirements' were most favored.

Disappointingly, these two benefits would not apply to the telecommunications sector under the current CEPA arrangement. According to the CEPA, Hong Kong Service Suppliers (HKSS) were only allowed to set up joint ventures with not more than 50% ownership to provide value-added services, while the liberalization of the basic fixed and mobile telecommunication services sectors will follow the schedule under the WTO accession agreement. In addition, the entry requirements for telecommunication joint ventures, e.g. minimum registered capital of the joint venture, remain the same as under the WTO.

Table 2 compares the commitments of the mainland government under the CEPA and the WTO.

Table 2. The Mainland's Commitments under the CEPA and the WTO

	CEPA	WTO		
Sectors opened	internet data centre services; store and forward services; call centre services; internet access services; content services.	Electronic mail; voice mail; online information and database retrieval; electronic data interchange; enhanced/value-added facsimile services; code and protocol conversion and online information and/or data processing; plus Internet service and radio paging service		
Starting date	1 Oct. 2003	11 Dec 2001	11 Dec 2002	11 Dec 2003
Ownership ceiling for foreign investor	50%	30%	49%	50%
Geographic Restriction	No geographic restriction	Only Shanghai, Guangzhou & Beijing	Shanghai, Guangzhou, Beijing, Chengdu, Chongqing, Dalian, Fuzhou, Hangzhou, Nanjing, Ningbo, Qingdao, Shenyang, Shenzhen, Xiamen, Xi'an, Taiyuan & Wuhan	No geographic restriction

Source: *The WTO and the Trade Development Council of Hong Kong*

From 1 April 2003 the Ministry of Information Industry (MII) of China began to use a new service classification catalogue which is different from the previous one that was used when China entered the WTO in 2001. In addition to reclassifying the services into different types, the amended catalogue also added and deleted some services. Among the eight defined value added services in the new catalogue, five have been opened to HKSS under the CEPA (Table 3). According to the MII, services that were committed be opened under the WTO accession agreement can be reclassified into the new catalogue as follows:

1. online information and database retrieval, and electronic data interchange shall be reclassified as online data processing and transaction;

2. Electronic mail, voice mail and enhanced/value-added facsimile services shall be reclassified as store and forward services;
3. online information and/or data processing shall be reclassified as content services;
4. code and protocol conversion has not been a valid service yet so it is not listed separately in the new catalogue.

Table 3. Value Added Services in the New Catalogue of the MII

Type I Value Added Services	Type II Value Added Services
<ul style="list-style-type: none"> ◆ Online data processing and transaction services; ◆ Domestic multi-lateral communications services; ◆ Domestic IP-VPN services; ◆ Internet data centre services.* 	<ul style="list-style-type: none"> ◆ Store and forward services;* ◆ Call centre services;* ◆ Internet access services;* ◆ Content services.*

* : services that have been opened to HKSS under CEPA

Source: *The MII* (<http://www.mii.gov.cn>)

Compared with China's WTO commitments, Hong Kong service suppliers have gained the following relative advantages from the CEPA over other WTO members:

1. 71 days ahead of other overseas investors to enter the Mainland's telecommunications market for most of the value added services committed by the Chinese government under the WTO accession;

2. Hong Kong's service suppliers are entitled to provide, via joint venture, the Internet data center services and call center services which have not been committed by the Chinese government to open to other WTO members yet.

In order to enter the Mainland market under the CEPA, Hong Kong companies must first certify themselves as Hong Kong Service Suppliers (HKSS). Only after the certification can Hong Kong companies form joint venture with Mainland companies under the CEPA, while their mainland partner(s) will apply for the corresponding local license(s). Interestingly, some companies have already formed joint ventures with Mainland companies outside of the CEPA framework. In this case, no certification for HKSS is needed, but only the relevant local licenses to operate in the Mainland.

Right after the six annexes of CEPA were signed, six Hong Kong companies had immediately shown their interests in obtaining the HKSS certification (Table 4). These companies have been working very closely with the departments involved, e.g. the Office of Telecommunication Authority (OFTA), the Trade and Industry Department (TID), etc. to get the certification. According to TID, companies who would like to apply for the certification need to produce relevant documents, including the Certificate of Incorporation, the Business Registration Certificate, Annual Report and Annual Profit Tax Returns. Written reports by a Designated Professional are also needed to certify that the business premise(s) is/are based in Hong Kong and more than 50% of the staff employed by the applicant for engaging in its substantive business operations in Hong Kong are residents staying in Hong Kong without limit of stay and people from the Mainland staying in Hong Kong on One Way Permit, to TID. They also need to be examined by OFTA about their experience in the corresponding Value Added Service (VAS) sector(s). By 5 May 2004, 13 out of 17 applying Hong Kong service suppliers in the telecommunications sector have obtained the certificate.

Table 4. The First Six HKSSs That Have Applied for the HKSS Certification

Operator	Business
CSL Hong Kong Ltd.	Mobile, roaming and value-added service
China Motion	Fixed line, long distance, pager, mobile and value-added services
Hong Kong Broadband Network Ltd.	Internet and value-added services
New World Telecommunications	Fixed line, mobile, long distance, internet and value added service
Sunday Communications	Mobile and value-added services
Peoples Telephone	Long distance, mobile and value-added services

In recent years, Hong Kong companies have already established substantial working relationship with Mainland companies. This working relationship makes it possible for Hong Kong and the Mainland companies to quickly set up joint ventures under the CEPA. In particular, New World Telecommunications has announced its plan to form a 50-50 joint venture with a Mainland partner (name undisclosed) where the new company will focus on providing paging, Internet access and information services. Moreover, Hutchison Whampoa Limited is reported to seek to enter partnership with mainland China's telecom carriers who may obtain 3G mobile telecom operation licenses, such as China Mobile.

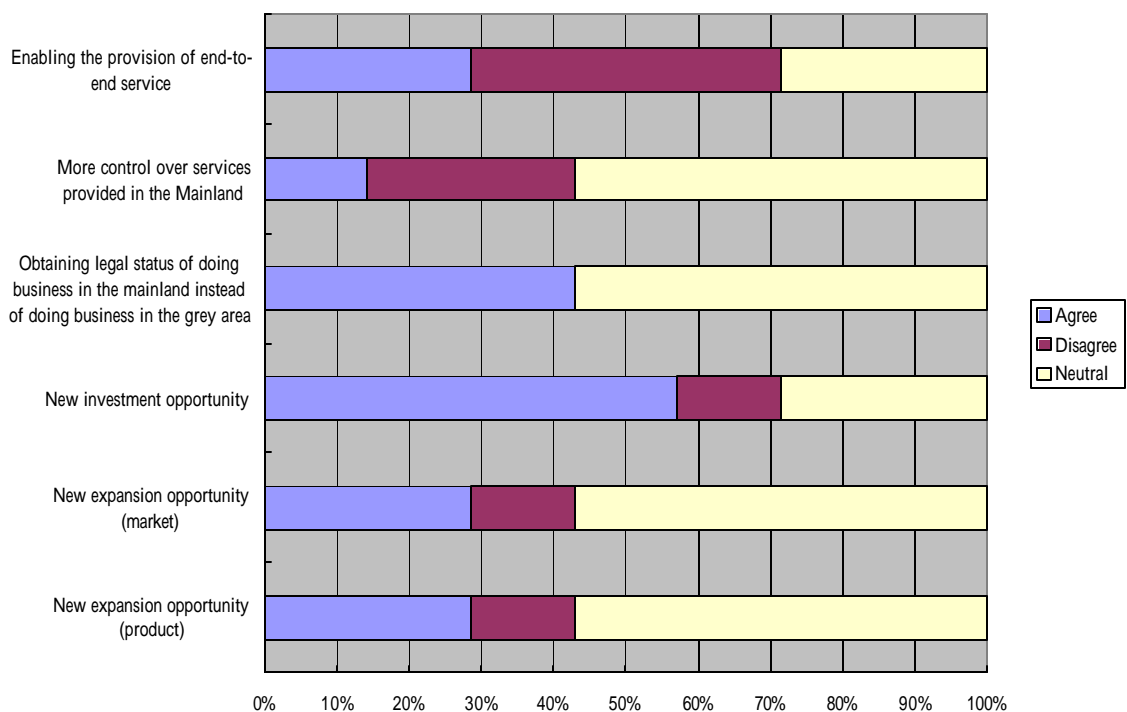
Not only have Hong Kong companies expressed their enthusiasm, China companies were also keen on working with Hong Kong companies. For example, Greatwall Broadband, a broadband Internet access service provider in China, was planning to collaborate with a Hong Kong telecom operator (name undisclosed) to jointly tap the broadband Internet service market in Mainland China starting early next year.

Nevertheless, although progress has been made since the CEPA was signed, the pace does not seem to be as fast as expected. This can be partly attributed to the limitations of the current CEPA arrangement. For example, the 71 days seems not sufficient to offer Hong Kong service suppliers with early-mover advantages as much as claimed. In fact, the first license for value added services provision by joint venture in the Mainland was granted to Liang Tong Shi Ke (联通科), a joint venture between China Unicom and SK Telecom of Korea. To further facilitate cooperation between Hong Kong and the Mainland's telecommunications sector, it is necessary to understand concerns of the industry regarding current CEPA and, if possible, remove the existing barriers. Section III of this report will summarize comments upon the current CEPA made by Hong Kong's telecommunications sector.

III. THE INDUSTRY'S COMMENTS ON CEPA

For the purpose of the research, comments from the industry were collected during fieldwork. As indicated in Figure 1, most respondents thought the CEPA could not benefit Hong Kong's telecommunication industry as much as claimed because the agreement was too restrictive. There were also administrative barriers to be overcome. Major issues raised include HKSS certification and license application, participation of the Hong Kong partner(s), capital flow, taxation, CEPA's advantages versus China's WTO accession agreements and China's telecommunications policies and regulations. These comments will be addressed in the rest of this section.

Fig. 1 Hong Kong Telecommunication Service Suppliers' Comments on Benefits of the CEPA



3.1 General Comments on the CEPA from Hong Kong's Telecommunications Sector

(a) The CEPA failed to enable the provision of end-to-end service: The CEPA did not grant HKSSs the rights of constructing or reselling the necessary infrastructure, therefore it is impossible for the entrants to provide end-to-end service under its own brand for both domestic communication and cross-border communication;

(b) The CEPA failed to enable more control over services provided in the Mainland: For the same reason given in (a), Hong Kong service operators cannot have significant control over services in the Mainland. Therefore, they cannot control the quality, the pricing scheme and marketing strategy;

(c) The CEPA has granted legal status for service providers who have been doing business in the grey area: As the case of 800 TELESERVICE has demonstrated, the operation strategy has changed from collaboration to owning 50% of the company legally;

(d) The CEPA has indeed provided new investment opportunities: Among all eight categories of value added services defined by the MII, the CEPA has opened five services to Hong Kong service suppliers. This has undoubtedly opened new opportunities for investment. However, there is argument that most of these services have limited market value for investment. It was said that the Internet access market has been dominated by the incumbent fixed network operators; Internet Data Center, similar to Hong Kong, has suffered market saturation for a long while; the call center service is a labor-intensive service, therefore has never been the strengths of Hong Kong service suppliers except for those who have already established well in the Mainland; the market potential for store and forward services is limited. The only attractive investment opportunity is information service as this is a strength of many Hong Kong SMEs (Telecom Monthly, 11/2003);

(e) The CEPA failed to facilitate the expansion of Hong Kong's telecommunications operators: The CEPA has indeed provided new investment opportunities for investors, but not expansion opportunities. For example, a fixed network or mobile network cannot expand their current business and facility to the Mainland under the current CEPA. In this case, unless they want to invest on new services specifically for the Mainland market, otherwise the CEPA provides them with almost no benefits.

3.2 HKSS Certification and License Application

To be eligible to operate in the Mainland, Hong Kong telecommunication service suppliers must first be certified as Hong Kong Service Suppliers (HKSS) by the Trade and Industry Department of Hong Kong. The certification would not be granted until all the relevant documents were supplied and examined. Many companies thought the examination process should be simplified and shortened, especially in the case where the applicant had conducted business in Hong Kong for a significant period of time. They believed the department(s) concerned should already possess the required track records to prove the experience of the applicant.

Other than the application process, some respondents thought the criteria for HKSS (Table 5) might be tightened to prevent foreign telecommunication giants from using Hong Kong simply as a stepping stone to enter into the Mainland market. It is possible that multinational companies set up their subsidiaries in Hong Kong for the sole purpose of getting the HKSS certification. The respondents reckon that Hong Kong companies would be left on an unlevelled playing field in terms of capital and experience endowment when compared against the foreign telecommunication giants. They thought the true meaning of the CEPA, which was to facilitate trade between Hong Kong and the Mainland, might be eroded if the CEPA turned out to be more favourable to multinational companies than Hong Kong companies.

Table 5. Requirements for HKSS Certification

<p>(1) General Requirement</p>	<p>The company should be incorporated or established pursuant to the Companies Ordinance or other relevant laws of the Hong Kong Special Administrative Region, and have obtained a valid Business Registration Certificate. If required by law, it should also have obtained the license or permit for providing such services; and engage in substantive business operations in Hong Kong.</p>
<p>(2) The nature and scope of business</p>	<p>The nature and scope of the services provided by a Hong Kong service supplier in Hong Kong should encompass the nature and scope of the services it intends to provide in the Mainland.</p>
<p>(3) Years of operation required</p>	<p>A Hong Kong service supplier should be incorporated or established in Hong Kong, and have engaged in substantive business operations for 3 years or more.</p>
<p>(4) Profits tax</p>	<p>During the period of substantive business operations in Hong Kong, a Hong Kong service supplier should have paid profits tax in accordance with the law.</p>

(5) Business premises	A Hong Kong service supplier should own or rent premises in Hong Kong to engage in substantive business operations. The scale of its business premises should be commensurate with the scope and the scale of its business
(6) Employment of staff	More than 50% of the staff employed in Hong Kong by the Hong Kong service supplier should be residents staying in Hong Kong without limit of stay, and people from the Mainland staying in Hong Kong on One Way Permit.

After an entity is certified as a HKSS, it would need to find a mainland partner and the partner will apply for the relevant Mainland licenses. Some companies thought the requirements, which seemed reasonable on a broad sense, might be too stringent when the details are considered. One of our respondents found that, for example, the definition of experience in operating call centre implicitly means providing services to external parties but not the telecommunication company's own customers. Moreover, the processing time of the license application was considered too long. Currently, it takes at least 180 days before a license is issued, provided that the applicant has already supplied all the required documents in the first attempt. Due to the fact that different service needs different license, the overall time to get licenses may exceed 180 days. The industry believed that there was room for streamlining regarding the application processes of both the HKSS certification and the Mainland licenses.

3.3 Participation of the Hong Kong Partner(s)

Under CEPA, Hong Kong companies could take a maximum ownership of 50% in a joint venture in Mainland. While choice of a foreign subsidiary's ownership structure generally includes whole, majority, split (or equal), or minority ownership (Beamish/Banks 1987, Gomes-- Casseres 1990), researches showed that majority ownership outperform all others. To a great extent, such ventures are relatively free from conflicts of interest and coordination costs, compared to those with a minority position. Therefore, majority control allows foreign partners to direct operations effectively and efficiently, which improves performance. Majority ownership is also superior to the wholly-owned option because the latter is unable to provide the benefits offered by local partners (Hongxin Zhao, Yadong Luo: 2002).

86% of the respondents found the ownership requirement inhibiting (Figure 2) because the Hong Kong partner(s) might have to compromise on the joint venture's overall strategies and operational decisions due to its non-majority stake (Figure 3). They also felt that greater control was required to hedge the risk of investment given the high degree of uncertainty under Mainland's institutional framework. Furthermore, telecommunication services encompass not only physical resources but also intellectual ideas. The Mainland partner will want the overseas partner to transfer as much advanced ideas to the joint venture as possible. In some cases, the local partner sees the joint venture as a means to acquire these intellectual ideas for its own operations. This tends to occur where the local partner maintains a separate legal existence which is not absorbed by the joint venture. Hong Kong companies felt that a majority stake in the joint venture could minimize the chance and the harm of detrimental imitation of original ideas.

Fig. 2 Responses to “Is an ownership of not more than 50% adequate?”

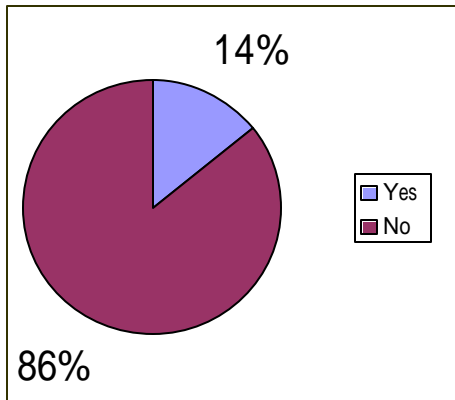
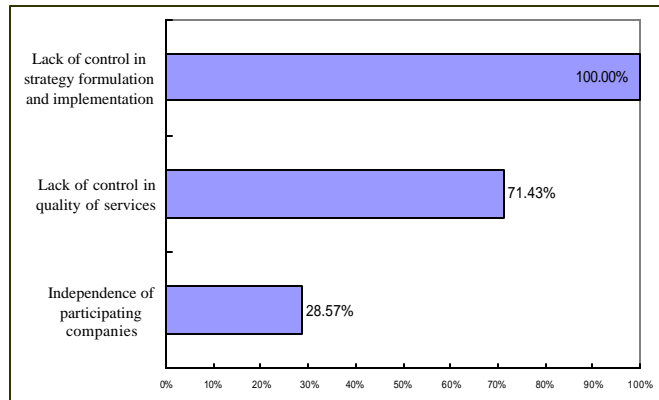


Fig. 3 Responses to “What is/are the major concerns of an ownership of not more than 50%?”



3.4 Capital Flow

Under the current regulations, Hong Kong companies found it hard to withdraw capital out of the territory once it is invested into Mainland. Before foreign currency could be transferred out of Mainland, the company needed to apply to the concerned departments. Theoretically speaking, there should be no tax for the remittance per se. However, the capital intended to be remitted needs to be screened for tax avoidance by the government agency. If the sum of money was proved to be profits earned in the Mainland, a standard tax rate on income will be applied according to the enterprise’s location. This could slow down the capital flow and increase the cost of operations for companies working across the border. Restrictions on capital flow and the alleged processing fees have reduced the flexibility in financing the business, for not only the telecommunication companies, but investments of all kinds.

Although the foreign exchange control of China may have obstructed the operations of foreign invested enterprises, the Central Government has to have reasonable protection measures in place to prevent detrimental capital movements to and from the Mainland. Indeed, concession has already been made when the State Administration of Foreign Exchange relaxed the control on the FIE’s current account remittance in 1996.

Recently, Hong Kong banks were permitted to provide RMB services to Hong Kong residents. Individual users are allowed to set up RMB accounts in Hong Kong and could remit up to RMB\$50,000 per day across the border. The current policy caters primarily to the needs of tourists and businessmen. However, loaning and interbank services are still not available. Businesses are not allowed to conduct RMB transactions which would involve larger amounts of money.

3.5 Taxation

For companies having employees who have worked in the Mainland for more than 183 days, the employees would need to pay tax to both the Mainland and Hong Kong government. The income earned in Mainland would be taxed according to the Mainland rates and the tax payer would not be able to enjoy the normal tax benefits provided by the Hong Kong Government. Companies thought the practice had significantly reduced the incentive for employees to work in China. To rectify the problem, the companies could either hire professionals from the Mainland, which had comparable wage rates to Hong Kong professionals, or bear the difference in tax payments between Mainland and Hong Kong for the employees so that the employees only need to pay the Hong Kong rate. Either way the cost of operation would increase. In addition, some companies found it an administrative burden to count the number of days the employees have worked in Mainland. Again, the industry thought that better tax policies would not only benefit the telecommunications industry, but all other industries.

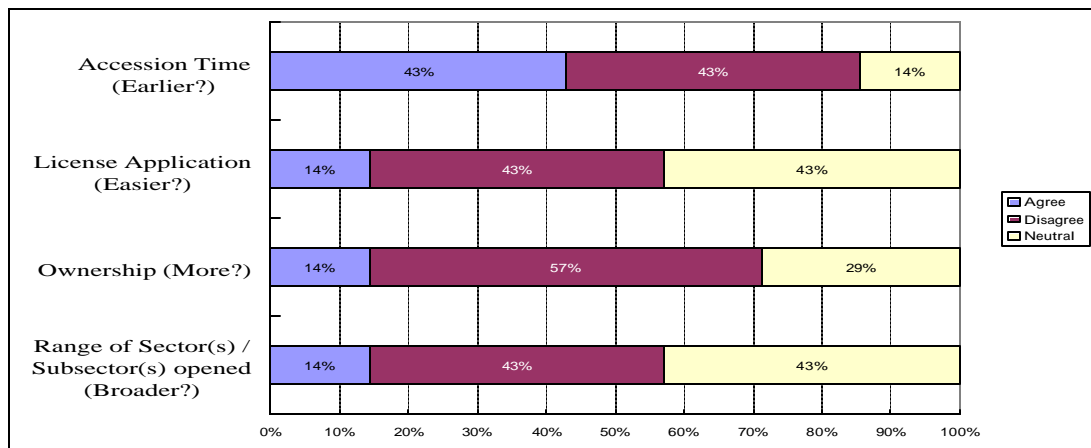
3.6 CEPA versus China's WTO Accession Agreements

Although Hong Kong companies were believed to be able to enjoy early entrance to the Mainland market under the CEPA, the industry did not think that was the true picture when the CEPA was compared against China's WTO accession agreements.

It was found that Hong Kong only gained a time advantage of 71 days to set up joint ventures in Mainland. Like other WTO members, Hong Kong investors were also subject to a 50% ownership ceiling in the telecommunication joint venture. To make things worse, foreign companies did not need to obtain the HKSS certification, which could span more than 3 months, under the WTO accession agreement. As a result, joint ventures between Mainland and foreign companies have already been formed while some Hong Kong companies are still waiting for the HKSS certification.

The picture was no better in terms of sectors opened. Call centre and Internet Data Center were the only two exclusive services opened to Hong Kong companies while the other three were included in the WTO accession agreement. Since call centre may not be the main line of service for most Hong Kong companies, and the Internet Data Center market has reached saturation, the attractiveness of the CEPA became limited. Also, the CEPA only touched on value added service but not basic mobile and fixed telecommunication services. It follows that Hong Kong companies would not have time advantage in these two markets over foreign companies. As a result, the industry did not see much preferentiality offered by the CEPA over the WTO accession agreement.

Fig. 4 Advantages of CEPA in comparison to the WTO



3.7 China's Policies and Regulations

There were both positive and negative comments on China's telecommunication policies and regulations. On the one hand, some respondents found the value added service policies in China favourable when compared to the ones in Hong Kong. In Hong Kong, there is no discreet and dedicated regulations for each of value added telecommunication services, fixed network services and mobile network services. The telecommunication giants usually provide all three categories of services. The small and medium sized enterprises would not be able to compete in terms of capital and brand name. In China, however, value added services are regulated separately from the basic telecommunication services. It became even clearer after the MII amended the service classification catalogues. Although the basic telecommunication service sector in the Mainland was already dominated by a few players, smaller companies believe that there are still rooms for development on different levels of value added service, especially in content provision services. The basic service providers in the Mainland also thought that they alone might not be able to handle the huge value added services market. This represented business opportunities for overseas telecommunication companies.

On the other hand, there are a number of aspects regarding China's policies and regulations that the industry would like to improve. Firstly, there are a lot of grey areas in the current classification of telecommunication services. Some of the technologically available services, e.g. Mobile Virtual Network Operator (MVNO) and International Simple Resale (ISR), are not found in the amended services classification catalogue. One can regard these unclassified services as opportunities, but the risk associated with entering into such businesses will be too high.

Secondly, the industry would also welcome transparent regulations on pricing, interconnection, etc. Since local players have an advantage in their existing facilities, there is

a lot of room for them to undercut the FIEs. They may also deny the FIE's access to their infrastructure. Therefore, regulations are necessary to level the playing field.

Thirdly, there should be clear and fair competition policies, and effort to speed up the draft of the Telecommunication Act, to protect the interests of different interests groups. Apart from providing incentives to attract foreign direct investment, specific policies which serve to prevent or punish the abuses of dominant positions should be set up. This can confirm China's commitment to promote competition after its entrance into the WTO.

Lastly, there is a need for stricter enforcement of Intellectual Property laws and regulations. As mentioned earlier, the relatively weak enforcement may cause considerable damages to Hong Kong telecommunication companies.

IV. RECOMMENDATIONS

In view of the limitations of the current arrangement, certain recommendations are made in the direction of CEPA to further strengthen the cooperation between the telecommunication sectors in Hong Kong and the Mainland. The recommendations made are related to the definition of HKSS, the HKSS certification and license application process, the ownership constraints, capital flow, taxation issues, sectors opened under CEPA, communications channel, support from the Hong Kong Government and the initiative of setting up a telecommunication special zone in the pearl river delta (PRD) area.

4.1 Definition of the HKSS

Since it is possible that foreign companies might make use of Hong Kong to benefit from the CEPA, some local companies would like to see stricter requirements for HKSS certification. For example, the years of operations in Hong Kong required might be increased from 3 years to 5 years. Also, applicants should satisfy a minimum investment commitment in Hong Kong. This will be fair for companies that have contributed to the development of Hong Kong's infrastructure. It can also strengthen Hong Kong as the regional information hub by increasing the absolute amount of resources invested into Hong Kong's telecommunications sector.

On the other hand, it is essential to seek an optimal point when formulating the criteria for HKSS certification. While the minimum requirement on investment or years of operation may be favorable for big companies, SMEs may suffer even though they are genuinely contributing to the industry. If the criteria are not set properly, the overall effect may be inhibitive rather than constructive. A balanced view is to remain with the current criteria.

4.2 Streamlining of Application Process

It was suggested that the overall application process could be streamlined. One way of doing so is to set up a special workgroup including officials from both Hong Kong and the Mainland for the purpose of CEPA related applications. In this case, effort on documents examination and applicant assessment would not be duplicated and the processing time can be reduced significantly. Alternatively, the Hong Kong government might lobby for removal of a certain procedures in the license application process provided that the applicants have been thoroughly assessed by the relevant institutions in Hong Kong.

In addition, it was also suggested that the schedule for license application could be more flexible. Currently, the Ministry of Information Industry (MII) would only accept application(s) in October. If a company shall miss the deadline, they would have to wait for another year. It is believed that by lengthening the collection period, Hong Kong companies' entrance into the Mainland market would be facilitated.

4.3 Majority Management Control

To overcome the limits arisen from the ownership constraint, the Hong Kong Government may lobby for an increase in management participation for the Hong Kong partner(s) in the joint ventures. One such example is the 50 percent plus one share arrangement in Alcatel Shanghai Bell. The purpose of such an arrangement is to allow the foreign partner to have more control over the joint venture's strategy and service quality, hence improving the overall efficiency of the joint venture.

Alternatively, a one-share-multiple -vote system may be considered if the joint venture is to go public. Deviations from the one share/one vote principle result in a transfer/delegation of power to those with voting rights greater than their cash flow rights. For example, holders of non-voting shares delegate the power to take corporate decision to holders of voting shares. If policy makers wish to attract foreign direct investment, they can introduce and/or strengthen provisions that favor concentration of control. This objective can be achieved without having to overhaul the entire legal and regulatory framework. If policy makers find it impossible to cancel existing privileges of powerful lobby groups, they can introduce a counter measure to achieve the same objective. For example rather than abolish multiple voting rights, they can introduce cumulative voting, which will give minority shareholders a means to elect directors to the board and thereby obtain better protection (Fremond and Capaul: 2003).

Another solution is to seek “One Country Treatment” for Hong Kong companies. The “One Country Treatment” is different from “National Treatment” which is supposed to be offered to all WTO members. In this case, Hong Kong companies would be treated as equal to Mainland companies and many previously mentioned problems, e.g. capital flow, range of sectors opened, etc., would no longer exist. The most important point is that Hong Kong companies would be allowed to set up wholly owned operations in Mainland. Nevertheless, this solution may arouse legal and political concerns around the ‘One Country Two Systems’ issue. The ‘two systems’ would converge if “One Country Treatment” is granted. Since the HKSS status is already considered preferential, further changes in Hong Kong companies’ status may be regarded inappropriate in the near term.

There are currently more than 8,000 value added service providers in the Mainland. Remove the ownership limit for joint ventures may not threaten the cohesiveness of the industry and national security. If the government really concerns about this, it may follow the practice of

some other countries when they privatized their telecommunication companies in the 1980s. The government can hold a so-called “golden share” or “special share” of the privatized companies which gives the government the control of a majority shareholder irrespective of the actual weight of the private ownership in the firm’s capital. That is, the government can veto the decisions of the board of directors under some specific circumstance, e.g. when the national security is threatened. In the specific context of CEPA, we may define this special share as “CEPA share”. The “CEPA share” may be a virtual share, namely the government has no financial investment in these joint ventures. For qualified HKSS, as long as they accept this specific arrangement, we shall leave the market to decide the ownership structure between the HKSSs and their Mainland partners. Of course, the government needs to explicitly clarify terms of the “CEPA share”, e.g., under what circumstances will the government exercise its right granted by the “CEPA share”.

In fact, the removal of HKSSs ownership limits may also benefit the Mainland investors because a ceiling of 50% overseas ownership implies the Mainland partners will undertake at least 50% of investment risk.

4.4 Tax Agreements

Many recommendations have been made by tax professionals to eliminate the double taxation issue which has discouraged Hong Kong citizens to work across the border. For example, Deloitte Touche Tohmatsu has proposed a simplified taxation structure for Hong Kong residents working in China to encourage tax compliance. The framework for such a structure could include a deemed income split for those Hong Kong workers whose presence in China exceeds 183 days annually, whereby half of the person’s income would be deemed earned in Hong Kong and half would be deemed earned in China. This proposal would provide ease of

tax administration thereby encouraging compliance while providing that both Hong Kong and China receive tax revenues.

It was also suggested that Hong Kong citizens who worked across the border could be taxed according to the Hong Kong rates and all the tax benefits would still apply. This suggestion stems from the “One Country Treatment” proposal. It is important to note that significant differences exist between the Hong Kong and the Mainland tax systems. While cross-border business activities between the Mainland and Hong Kong are expected to increase, the tax payments from these individuals will represent an increasingly important part to the Governments’ income. Such suggestion would therefore require careful provisions so that the existing legal framework would not be disturbed.

4.5 Capital Flow

We suggest that the foreign currency regulatory authority grants Hong Kong service suppliers a certain volume a quota for withdrawing the foreign currencies from the Mainland freely on the basis of their historical transaction records. Screening of the tax avoidance may be conducted at the end of every three months or six months as long as the quota is not exceeded.

4.6 Telecommunication Services Classification and Sectors Opened to HKSS

In general, the industry thinks that there is still room for further liberalization. In the broad sense, the industry would like to seek earlier accession or higher ownership in the basic telecommunication markets for Hong Kong companies compared to other WTO members. Even if it is difficult to get more favorable terms than the WTO commitment, the Central Government should consider giving higher priorities to HKSSs in the process of licensing for basic services, such as 3G.

As to the value added service market, there are a few items that the industry would like to seek clarification on their classification. Before the latest amendment of the *Telecommunication Service Classification Catalogue* in April 2003, Resale of Basic Service was categorized as a basic telecommunication service but administered as a value added service. However, resale of basic service was not found in the new catalogue. It is believed that Hong Kong companies would be interested in resale, such as International Simple Resale (ISR), as it allows the provision of one-stop services to their clients. Similar to ISR, Mobile Virtual Network Operator (MVNO) is another item that needs clarification. The industry would like to see the opening of these two sub sectors exclusively to Hong Kong and the Mainland companies. This will not violate China's WTO commitments as the two services were not included in the agreement.

In addition to ISR and MVNO, the industry would also like to see more liberal regulations on IP based VPN. IP-VPN is currently classified as value added service, but it has to be provided over public Internet resources. In other words, the service supplier may not be able to acquire leased capacity and install routers for its own IP backbone. The quality of service could be seriously affected in this case and the opportunity will be limited. It is predicted that the China IP-VPN market will grow strongly in the next three to five years as enterprises networking requirements increase - in particular the finance, energy, government, and transport verticals. The market size could reach USD\$1 billion in 2006.

Although the Mainland players have been very ambitious and progressive in the value added services market, many of them commented that the market demand is too large to be entirely covered by local players. They expect the unmet demand to grow when the Mainland becomes increasingly liberalized under the WTO accession agreement. This implies opportunities for Hong Kong companies.

4.7 Setting up a Regular Communication Channel between Hong Kong and the Mainland

According to the CEPA, Hong Kong Government and the Mainland government will periodically communicate each other to review progress and problems in the process of deploying the CEPA. Due to the fact that telecommunications is a highly professional industry, and Hong Kong has an evidently different regulatory framework from the Mainland, there is strong urge from the industry to set up an effective and telecommunications-specific communication channel between the Mainland and Hong Kong involving both the industry and the regulatory bodies. The establishment of this channel can effectively increase the transparency of policy and regulations. It is of utmost importance that the telecommunications companies have clear information on the regulatory environment so that services can be provided in a legitimate manner. Clearance of the grey areas in classification and the regulatory framework can significantly reduce the risk of investment. To do so, regular seminars may be held so that officials from both governments could share their experience and contribute to regulations and policies that facilitate cooperation.

4.8 Support from the Hong Kong Government

Apart from increasing transparency of laws and regulations, another objective of CEPA was to promote the use of e-business between the Mainland and Hong Kong. Annex 6 of the CEPA agreement highlighted the objective of building up a sophisticated e-business platform crossing Hong Kong and the Mainland as follows:

6. *Electronic Business*

The two sides recognize that the application and promotion of electronic business will create more trade and investment opportunities for both sides. They agree to step up exchange and cooperation in the area of electronic business.

6.1. *Cooperation Mechanism*

Under the guidance and coordination of the Joint Steering Committee, the two sides will set up a working group to act as a communication channel as well as a consultation and coordination mechanism for cooperation in electronic business, with a view to promoting cooperation and joint development in the area of electronic business.

6.2 *Content of Cooperation*

The two sides agree to cooperate in the following areas:

6.2.1. Cooperate in specialized projects in respect of the study and formulation of rules, standards and regulations of electronic business, with a view to creating a favourable environment for promoting and ensuring the healthy development of electronic business.

6.2.2. Strengthen exchange and cooperation in areas such as corporate application, promotion and training. Make full use of the relevant government departments of the two sides in promotion and coordination, step up promotion for electronic business, foster interaction between the enterprises of the two sides, and facilitate the launching of electronic business among the enterprises through demonstration projects.

6.2.3. Strengthen cooperation in implementing e-government, intensify exchange and cooperation in the development of e-government at various levels.

6.2.4. Cooperate in economic and trade information exchange, and expand the scope and extent of cooperation.

However, so far no concrete directions or measures were given other than merely stating the objective. It is hoped that the Hong Kong Government could take the initiative to draw up more specific areas of promotion regarding e-business. Participation of the two governments is particularly important when it comes to e-government. It is believed that an effective e-business platform will not only facilitate the increasingly frequent trade and exchange between Hong Kong and the Mainland, but also generate extra business opportunities for telecommunication service providers.

Additionally, the industry also calls for professional support for Hong Kong companies. More resources should be allocated to assist Hong Kong companies in setting up their businesses in the Mainland. For example, the Trade Development Council may join force with non-governmental telecommunication associations to publish market information on the Mainland telecommunication industry. In addition, since the regulations and regional incentive programs are rather complicated in the Mainland, the relevant government departments should consider providing industry specific advisory on legal, finance and tax issues in the mainland. The advisory service will be valuable and crucial for small and medium sized enterprises which cannot afford in-house professionals due to their limited resources. The advisory service will be financially compensated on the basis of cost of each case per se. This is thought to be more advantageous than merely bridging the Mainland and Hong Kong companies. The SMEs need more sophisticated support.

The industry also suggests the government to conduct some pioneering research in order to adjust Hong Kong's telecommunications policy with long-term visions. This will facilitate Hong Kong as a show window of innovative services and technologies in the Asia-Pacific region.

4.9 Telecommunications Special Zone

Members from the industry and some academia have proposed a Telecommunication Special Zone in the Pearl River Delta (PRD) area (the “Zone”). The “Zone” would allow Hong Kong-registered telecommunications service providers to enjoy broader benefits from liberalization. Suggestions include:

1. *To solve such questions as full control of VAS operation, management control of 50:50 JV);*
2. *Cross-border VPN using X.25, Frame Relay, ATM and IP to serve enterprise segments;*
3. *Supplementary licenses for network facilities including campus based network, and wireless local loop as last mile access;*
4. *Mobile virtual network operator arrangement;*
5. *HK’s participation in the new 3G mobile network investment in China;*
6. *Leveraging the Guangzhou and Hong Kong Internet Exchanges to better serve the PRD & HK cyberspace dimension. This would facilitate more innovative services to the consumers and enterprises over the public Internet and managed IP networks.*

There was consensus among Hong Kong’s telecommunications sector that the zone would be beneficial to both the Mainland and Hong Kong. However, reservation is expected from the Central Government because there is a risk that the Zone may violate the existing policies and regulations. Modifications may be required specifically for the Zone.

V. CONCLUSION

In this research, the industry's comments on the current CEPA arrangement and suggestions on further cooperation under the CEPA framework were collected and studied.

Although Hong Kong as a whole welcomed the CEPA and believed the arrangement could bring benefits to the Hong Kong economy, the telecommunication industry thought the impact of the CEPA was more psychological than practical. Nevertheless, they did appreciate this positive first step. When compared against China's WTO accession agreements, the relative favorable benefits brought by the CEPA to the Hong Kong telecommunication service suppliers were rather limited. The interests of the Hong Kong telecommunication service suppliers and the Mainland telecommunication regulations appear to be in conflict with each other. The Hong Kong telecommunication service suppliers naturally expected higher degree of liberalization, while the Mainland regulatory bodies had to retain a considerable level of protection to the local players and at the same time abide to the WTO accession agreements.

In light of the limitations, several recommendations were made, including the concept of "CEPA share" and "Quota for capital flow". These recommendations sought to create a better business environment without disturbing the current legal and regulatory framework. The Hong Kong telecommunications industry would like to help create a win-win situation for both the industry players and the regulatory bodies in the Mainland and Hong Kong under the CEPA framework. For this to happen, a high level regular communication channel for interactive information exchange between the parties of interests in Hong Kong and the Mainland would be critical.

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