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Toward Collaborative Governance in Economic Cooperation  
between Hong Kong and Mainland China

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## **Abstract**

Economic cooperation between Hong Kong and Mainland China, especially Guangdong province, has flourished since the establishment of the Hong Kong Special Administrative Region (HKSAR) in 1997. The landmark in this process was the conclusion of the free trade agreement (FTA) between the two areas in 2003. The Closer Economic Partnership Arrangement (CEPA) between Hong Kong and the Mainland cover liberalization of trade in goods, liberalization of trade in services, mutual recognition of professional qualifications, and other trade facilitation measures. This paper argues that a *collaborative governance regime* based on network coordination is emerging under “One Country, Two Systems” (OCTS) and the collaborative approach will be used to explain the intensifying Hong Kong-Mainland economic cooperation. This paper has three parts. Part one provides an overview of the evolution of intergovernmental mechanisms between Hong Kong and the Mainland and introduces the analytical framework. Part two discusses how the framework can be applied to the intergovernmental mechanisms on CEPA and part three analyzes the key provisions of CEPA and its implications.

# **Toward Collaborative Governance in Economic Cooperation between Hong Kong and Mainland China**

## **I. Introduction**

In response to competition in the global economy, the economic and spatial transformation of south China since late 1978 is characterized by the relocation of Hong Kong's manufacturing to the Mainland, its own development into a service and financial center, as well as the phenomenal industrialization and urbanization in Guangdong province, especially in the Pearl River Delta (the PRD) where the factors of production are cheaper (Sit, 2006).<sup>1</sup> Complementary relations between Hong Kong and its hinterland reached a plateau by the late 1990s and both Guangdong and Hong Kong governments tried to move beyond the market to explore more government-led cooperation (Cheung, 2012b).

Economic cooperation between Hong Kong and Mainland China, especially Guangdong, has flourished since the founding of the Hong Kong Special Administrative Region (HKSAR) in 1997. The Closer Economic Partnership Arrangement (CEPA) was the first free trade agreement (FTA) established between Hong Kong and the Mainland. Since Hong Kong's economic links concentrate on the

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<sup>1</sup> The economic core of Guangdong is the PRD which comprises nine cities, namely Dongguan, Foshan, Huizhou, Guangzhou, Jiangmen, Shenzhen, Zhaoqing, Zhongshan and Zhuhai.

neighboring Guangdong province, economic integration with this region has been further expedited by CEPA (Chan, 2010). The second milestone was the promulgation of a key regional plan, the Outline of the Plan for the Reform and Development of the PRD, 2008-2020 (the Outline Plan) in 2008, which supported economic integration and cooperation within the PRD and between Hong Kong and Guangdong. According to the Outline Plan, the PRD would work together with Hong Kong in the development of modern services, science and technology and higher education, among other areas. The Greater PRD region comprised of the PRD, Hong Kong and Macao aspired to become one of the mega metropolitan areas in the world (NDRC, 2008). The role of Hong Kong in Guangdong would transform from one concentrating on export-oriented investment to one facilitating the development of a modern service economy. Just as Hong Kong uses CEPA to promote its trade and services on the Mainland and to secure its cooperation with Guangdong, the province seized this as an opportunity to expedite its own industrial restructuring because export-led processing manufacturing, a key driver of its development, could not sustain its economic future. The latest milestone was the dedicated chapter on Hong Kong and Macao in the 12<sup>th</sup> National Five Year Plan (FYP) promulgated in March 2011, which symbolized Hong Kong's deepening integration with China.

CEPA covers four areas. First, liberalization of trade in goods is achieved

through a tariff-free treatment of all goods of Hong Kong origin imported into the Mainland, upon applications by local manufacturers and the agreements of CEPA rules of origin. Second, liberalization of trade in services allows for preferential treatment of Hong Kong service suppliers (HKSS) entering into the Mainland market. Third, agreements for the mutual recognition of professional qualifications were expedited. And fourth, trade and investment were facilitated through bilateral measures to improve the overall business and regulatory environment. CEPA adopts a building-block approach. Subsequent to the conclusion of the Main Text and Six Annexes in 2003, nine Supplements were concluded between 2004 and 2012.

This paper argues that a *collaborative governance regime* based on network coordination is emerging under “One Country, Two Systems” (OCTS) and the collaborative approach will be used to explain the intensifying Hong Kong-Mainland economic cooperation.<sup>2</sup> This paper has three parts. Part one overviews the evolution of intergovernmental mechanisms between Hong Kong and the Mainland and introduces the analytical framework. Part two discusses how the framework can be applied to the intergovernmental mechanisms on CEPA and part three analyzes the key provisions of CEPA and its implications.

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<sup>2</sup> Aside from documentary data, the author has used information provided in seminars and conferences on CEPA and many interviews and conversations with officials and experts in both areas. However, the full details of the intergovernmental meetings are kept confidential and cannot be obtained even through such interviews. This paper cannot offer a systematic assessment of the operation of the intergovernmental mechanisms involved because of the lack of sufficient publicly available information.

## **II. Toward Collaborative Governance in Economic Cooperation under “One Country, Two Systems”: Intergovernmental Mechanisms for Managing CEPA**

### **The Evolution of Intergovernmental Mechanisms under “One Country, Two Systems”**

The HKSAR functions like a highly autonomous city-state. The HKSAR government possesses substantial powers in economic, financial and social affairs, including international economic relations, except diplomacy and defence (Cheung, 2011). A relatively clear delineation of power between the central authorities and the HKSAR is stipulated in the Basic Law, Hong Kong’s mini-constitution, but it has not specified how the HKSAR should conduct intergovernmental relations with Chinese counterparts. While the central authorities have increasingly shaped Hong Kong’s internal governance since 2003, Beijing has strongly supported economic cooperation with Hong Kong (Cheung, 2011). Consequently, this has allowed both the central and HKSAR governments room to innovate on intergovernmental mechanisms. As Hong Kong is a member of the World Trade Organization (WTO) and China finally joined the organization in 2001, the conduct of CEPA negotiations and its provisions have to abide by this international regime to ensure proper compliance by all parties.

Efforts to enhance both vertical and horizontal coordination with different

Mainland governments have been attempted by the HKSAR government since 1997. Cooperation with the Mainland cuts across different policy arenas, hence this requires a consensus among Hong Kong's top policy-makers, notably the Chief Executive and his deputies, the Chief Secretary for Administration and the Financial Secretary, to drive the collaboration. Both Guangdong and Hong Kong emphasized bilateral cooperation as soon as the HKSAR was established. Indeed, the Hong Kong Guangdong Cooperation Joint Conference framework (the HKGDCJC) was created in 1998, but the lack of enthusiasm under a former Chief Secretary (1997 to mid-2001) did not facilitate such an endeavor.

The HKGDCJC framework was reorganized and upgraded in August 2003 to strengthen horizontal coordination between Hong Kong and Guangdong. Originally headed by Guangdong's Executive Vice-governor and HKSAR's Chief Secretary, the Conference was upgraded to the level of Guangdong's Governor and Hong Kong's Chief Executive. An Executive Vice-governor and the Chief Secretary would steer and follow up. Other key improvements include: (a) aside from the annual plenary, annual working-level meetings were convened to monitor developments; (b) a Liaison Office was established on each side to coordinate day-to-day affairs; (c) research institutes were designated to offer research support; and (d) a business committee was created to foster economic links with the business sector on both sides (the Greater



PRD Business Council was established in 2004). Further, a total of fifteen expert groups were consolidated under the HKGDCJC to build coherence in intergovernmental cooperation. Before 2003, such groups covered conventional areas such as boundary management, environmental protection, infrastructural coordination and tourism. After mid-2003, the scope of cooperation was extended to new socio-economic spheres. By 2012, a total of 22 expert groups covering a wide range of areas, including infrastructure, innovation, economic development, planning, education, trade, social welfare, regional cooperation, environment, services, sustainability and implementation, have been established.

### **Studies on Collaborative Governance and Coordination**

The study of governance has expanded rapidly in public administration and political science, but despite the abandonment of the assumption of a powerful, national state that can steer socio-economic transformation, there is a diversity of empirical focus and theoretical perspectives on the changing interactions and relationships between the state, civil society and the market under globalization (e.g. Bevir, 2011; Chhotray and Stoker, 2009; Pierre and Peters, 2000). One of the major interests in governance studies concerns the changes in the relations between different levels of government, both within and between nation-states, with the rise of subnational authorities such as

cities and regions and supranational units such as the European Union and international institutions such as the WTO (Pierre and Peters, 2000, pp. 114-136).

As globalization advances, global cities and global city regions emerge to meet the demand for command and control functions in the global economy. Amid the dispersal of authority from central governments to supranational, regional and local governments, and the proliferation of public-private networks, state and non-state actors at different territorial levels are becoming interdependent, forming general-purpose or special-purpose governing jurisdictions (Cheung, 2010, pp. 50-53). Three main perspectives, namely the global cities/global city regions, multi-level governance, and coordination, have been applied to the study of regional development in Greater China (Cheung, 2010). The applicability of the global cities/global city regions perspective is complicated by the challenges confronting Hong Kong as a command and control center of the global economy with the rise of Chinese cities and the rivalry between local jurisdictions within the Greater PRD. The multi-level governance perspective also underestimates the continued importance of the central government and lacks a theoretical explanation of the complex interactions between the actors (Cheung, 2010). Hence these two perspectives seem less promising than the coordination perspective in analyzing the intergovernmental coordination that underpins Hong Kong-Mainland economic cooperation.

Inter-organizational or intergovernmental coordination is usually attained through one of three mechanisms: hierarchy, market and network (Bouckaert et al., 2010). Hierarchy uses political or bureaucratic authority, which would be translated into rules and planning in top-down control. However, China largely abandoned central planning since 1978 in favor of a decentralized, market-oriented development model. As the central government cannot effectively coordinate the localities in a fragmented planning system, it is common for local governments to influence the central authorities through bargaining and lobbying (Xu, 2008). On the other hand, the market approach suggests that policy actors can coordinate through exchanges based on self-interest, using “regulated quasi-markets and economic incentives” to generate “incentives for actors to coordinate, and to enhance their collective performance” (Bouckaert et al., 2010, p. 42). This perspective does not seem applicable to the intergovernmental coordination in Hong Kong-Mainland economic cooperation. Although the different government players act on their particular interests, they are not actually engaged in market-type exchanges. The third mechanism is networks, which can be defined as “stable patterns of cooperative interaction between mutually dependent actors around specific issues of policy (or management)” (Bouckaert et al., 2010, p. 44). There are different types of network-type coordination ranging from information sharing and “mutual awareness

of interdependence and common interest” to agreements or contracts, joint decision-making mechanisms or joint organizations (Bouckaert et al., 2010, p. 45). Such coordination aptly illustrates the Hong Kong-Mainland case as the promotion of economic cooperation at the intergovernmental level depends upon give-and-take, rather than just maximization of self-interest, and the adjustment of mutual demands after reiterative interactions between different actors. Each of the players also has to engage its own clusters of stakeholders to achieve collaborative objectives. Although the concept of network coordination is useful in characterizing the intergovernmental interactions between Hong Kong and Mainland China, it does *not* offer a robust framework to explain the process, dynamics and outcomes of such interactions.

In the study of collaborative governance, some theoretical frameworks are more narrowly focused. For instance, Ansell and Gash concentrated on “formal, consensus-oriented and deliberative” public policy processes engaging both government and non-government stakeholders (2008, p. 544). Others examined collaborative network management (e.g. Agranoff and McGuire, 2004) or collaborative public management when governments in developed democracies could no longer effectively deliver public service and meet community demands in a top-down manner (e.g. Bingham and O’Leary, 2008). Still others studied participatory governance or democratic governance (e.g. Bevir, 2010). The integrative framework

formulated by Kirk Emerson and his colleagues (2011), however, is not only more comprehensive and not restricted to inter-agency coordination and public management issues resulting from a decentered or hollowed state in developed democracies. It also details the structures, processes and dynamics of collaborative processes in generating policy outputs and outcomes. Hence this paper will apply this collaborative perspective to the growing Hong Kong-Mainland economic relationship.

### **Toward a Collaborative Governance Regime (CGR) in Greater China**

Most studies on CEPA analyzed the structures of economic integration (e.g. Chen et al., 2006 and 2008; Chiu, 2006) or the economic impacts of CEPA (e.g. Chen and Zeng, 2006; Li, 2008). Others examined the role of CEPA in fostering regional integration (e.g. Chan, 2010) or the legal challenges involved (e.g. Zhang, 2010).

Most of these studies are prescriptive and policy-oriented. None has examined the issue from a collaboration perspective. The collaborative perspective draws from inter-organizational studies. According to Emerson et al. (2011, p. 2), collaborative governance can be defined as “the processes and structures of public policy decision making and management that engage people constructively across the boundaries of public agencies, levels of government, and/or the public, private and civic spheres in order to carry out a public purpose that could not otherwise be accomplished.” This

approach highlights not only formal and informal interactions, but also non-governmental, governmental and intergovernmental collaboration (Emerson et al., 2011, p. 14). What is unique about the governance arrangements under OCTS is that collaborative mechanisms were adopted in intergovernmental cooperation, at least in the economic arena, within a unitary socialist polity.

Under OCTS, Hong Kong operates as a separate economic system within the Chinese polity. While the State Council, the highest executive authority, is the superior of the HKSAR, intergovernmental interactions do *not* follow a hierarchical pattern whereby the central government imposes its will over Hong Kong. Instead, intergovernmental interactions between Mainland China and the HKSAR occur through vertical and horizontal networks characterized by “bargaining, negotiation and mutual cooptation among the participants” (Bouckaert et al., 2010, p. 44). For instance, central ministries negotiated CEPA and its subsequent expansion with the HKSAR government in accordance with WTO rules. Hierarchical coordination can still be found in central-provincial relationships in China as it is within the socialist polity. However, interactions between the central authorities in Beijing and Hong Kong and between Hong Kong and Guangdong, are like voluntary collaboration between organizations or governments. Beijing does not dictate to Guangdong or Hong Kong unilaterally; rather, it often approves a strategic framework to promote

cooperation between Hong Kong and its neighbor.

The collaborative governance regime (CGR) framework can be applied to the intergovernmental mechanisms created for CEPA and related areas (Emerson et al., 2011, p. 35; see Table 1). First, the political, legal, socioeconomic, and environmental features frame the *system context* of the CGR. These factors shape the collaboration dynamics by providing incentives and disincentives for the actors. For example, with China's accession to the WTO, the Hong Kong General Chamber of Commerce recommended the FTA concept to the HKSAR government, which proposed it to Beijing in late 2001. The HKSAR government pursued vertical coordination by lobbying the central government for support to build cooperation with Guangdong. Initially, the central authorities were concerned that foreign firms in Hong Kong would exploit this FTA to enter the Mainland market earlier than the WTO schedule. However, the economic downturn exacerbated by the Severe Acute Respiratory Syndrome in early 2003 further weakened the Hong Kong economy in the aftermath of the Asian Financial Crisis. In response to the weak performance of the HKSAR administration under Tung Chee-hwa in coping with the economic deterioration and the political crisis triggered by the anti-national security legislation in mid-2003, which aroused grave concerns about the encroachment of civil liberties in Hong Kong, Beijing employed a more proactive strategy to support the HKSAR and its economic

integration with the Mainland (Cheung, 2011). The subsequent global financial tsunami that erupted in 2008 also prompted Beijing to continue supporting Hong Kong's economy with measures ranging from expansion of CEPA to backing Hong Kong's efforts to become an international financial center.

Second, the *drivers* of a CGR refer to leadership, consequential incentives, interdependence and uncertainty, which initiate and steer the direction of a CGR (Emerson et al., 2011, p. 9). Leadership is crucial in initiating and sustaining collaboration by securing resources and making a commitment to reinforce the collaboration. Consequential incentives concern internal or external crisis, threats and opportunities. Interdependence means that different parties realize they cannot accomplish a goal on their own except through collaboration. Uncertainty is also a main challenge in managing collective problems and is related to other drivers such as interdependence. These drivers are useful in explaining the key landmarks in Hong Kong-Mainland/Guangdong cooperation since 1997. Although Tung Chee-hwa, the first Chief Executive of the HKSAR, stressed cooperation with the Mainland, he lacked administrative support to steer such collaboration; he could only secure such support when a new Chief Secretary and a new Financial Secretary assumed office in mid-2001. From 1998 to 2001, economic cooperation had low policy agenda status and thus, the HKGDCJC was not very effective. More cross-boundary initiatives were



proposed only after mid-2001. Aside from the continual effort of Tung Chee-hwa and the change of senior administrative leadership in Hong Kong in mid-2001, the appointment of Donald Tsang as the Chief Executive in 2005 (after Tung's departure) and his re-appointment in 2007 consolidated the agenda toward closer cooperation with the Mainland.

Similarly, the leadership factor in Guangdong is equally important to make collaboration work. While the former Guangdong leader Zhang Dejiang championed Pan-PRD regional cooperation involving 9 provinces plus Hong Kong and Macao, the lack of central endorsement and his departure soon shelved this initiative. In response to the intense competition from other regions such as the Yangtze Delta, Guangdong province has been exploring its development strategy amid great uncertainty both regionally and globally. Guangdong's reorientation toward the development of modern services and the upgrading of its manufacturing has become more prominent after Wang Yang's appointment as Party Secretary in late 2007. Unlike his processor, Wang favored closer cooperation with Hong Kong in order to support Guangdong's economic transformation into a modern economy (Cheung, 2012a). This provides incentives for the province to open up its market to Hong Kong services and investments under CEPA. The provincial authorities also partnered with Hong Kong in seeking central government approval over the Outline Plan for the PRD in late

2008 (Cheung, 2012a). Last but not least, strong support from the central leadership under Hu Jintao and Wen Jiabao is critical because none of the CEPA initiatives could be approved without their backing.

Third, the collaborative dynamics consist of principled engagement, shared motivation and capacity for joint action. Together they produce collaborative actions to achieve the goals of the CPR (Emerson et al., 2011, pp. 10-12). Principled engagement takes place when different stakeholders interact in cross-organizational networks to resolve problems under principles such as fair, balanced representation and communication. Shared motivation comes from the fostering of trust and understanding which comes from repeated quality interactions between the actors. Such processes “will stimulate the development of institutional arrangements, leadership, knowledge, and resources” (Emerson et al., 2011, p. 16) which sustain the capacity for joint actions.

The approval of CEPA by the central government coincided with the reorganization of the HKGDCJC in 2003. The revamped HKGDCJC promotes a new institutional mechanism that facilitates (a) clear steering and monitoring from the highest level of government; (b) deepening of cooperation for information exchange and joint actions through expert groups; and (c) engagement of the non-government sector (e.g. collaboration with the Greater PRD Business Council). Regular working

meetings by the expert groups, mentioned previously, meet as needed. This network of expert groups shows that intergovernmental cooperation between Hong Kong and Guangdong is becoming much more institutionalized. These revamped mechanisms and other institutional arrangements under CEPA stimulate *collaboration dynamics* (see below).

Finally, these interactions have produced *collaborative outcomes*, namely *impacts* and *potential adaptation* which may change the system context and the collaboration process in government. The nine Supplements to CEPA and the early implementation measures introduced can be considered *collaborative outcomes*, as they are mutually beneficial to both Hong Kong and Guangdong. These *collaborative policy outputs* that resulted from intergovernmental negotiation and coordination should be considered as the outcomes of this CGR as these were produced after intense negotiation and coordination among different governments and their respective professions and industries.

[Table 1 about here]

## **Collaborative Dynamics**

CEPA is an apt example of a CGR not only between the Hong Kong and Mainland Chinese governments, but also between these governments and the professional and business sectors.

### *Joint Steering Committee (JSC)*

First, the highest level is a JSC chaired by a vice-minister of the Ministry of Commerce (MOC) and the Financial Secretary. Its functions include: (a) supervision of the implementation of CEPA; (b) interpretation of the provisions; (c) resolution of disputes that may arise from implementation; (d) amendment of the contents of CEPA; and (d) steering on its various working groups. In short, this Committee oversees the institutional infrastructure, coordinates the interactions between different units within its ambit, and approves of further supplements to CEPA.

### *Senior Officials Meetings*

Below the JSC is a senior officials' meeting, established in 2007, that meets at least annually to discuss the expansion of CEPA, examine macro issues and review implementation. Ongoing dialogues between different departments in the HKSAR government and their Mainland counterparts have become very common (Interview,

2012a). As the Basic Law promises Hong Kong a high degree of autonomy, Beijing has *not* used hierarchy to achieve coordination and imposed its authority unilaterally over intergovernmental interactions between Hong Kong and the Mainland/Guangdong. Instead, such interactions are characterized by efforts to establish “common knowledge, common values and common strategies between partners” (Bouckaert et al., 2010, pp. 49-50). These intergovernmental interactions are held at an appropriate administrative level of the central government and the HKSAR. For instance, a vice-minister of the MOC and the Financial Secretary would lead the JSC while the senior officials meeting would be led by a deputy division head of the MOC and the Director of the Trade and Industry Department (TID) of the HKSAR. There are ongoing dialogues among the lead agencies, i.e. the Commerce and Economic Development Bureau (CEDB) and its subordinate TID, the MOC and related bureaus. The TID mainly serves as a coordinator of different bureaus and departments inside the HKSAR government.

#### *Expert Group on CEPA Services Implementation*

Since most of Hong Kong's investments in China are located in Guangdong, an expert group was formed under the HKGDCJC to discuss implementation procedures for CEPA. While many expert groups touch upon different areas related to CEPA, this

expert group is the key mechanism dealing with the services, the core challenge for Hong Kong's firms to benefit under CEPA (CITB, 2004). Led by a permanent secretary of the CEDB and its counterpart from Guangdong's Economic and Information Commission, the group exchanges information on service cooperation and explores measures to improve implementation and cooperation. The group has also jointly conducted seminars to disseminate information and consult the industry in Hong Kong and their Chinese counterparts (Interview, 2012b).

#### *Network Mechanism of the Central Government in Hong Kong*

Central government has been very supportive of Hong Kong and its integration with the PRD, in order to accelerate the economic transformation of Hong Kong and the upgrading of services and industries in Guangdong (Cheung, 2012a). The representative of the central authority in Hong Kong is the Liaison Office (LO) of the Central Government. Inside the LO is a Trade Office of the Economic Affairs Department, which is jointly led by the MOC and the LO. Its main functions include: strengthening the liaison between the HKSAR government and the relevant authorities in the Mainland, participating in the JSC on CEPA, implementing and negotiating arrangements under CEPA, promoting cooperation between the two sides, building a platform for consultation on financial and trade-related matters, and providing support

to cooperation between enterprises from both sides (DFTEC, 2007 & 2011). The importance attached by the central government to these major functions in network coordination with both business and government in Hong Kong is reflected in the appointment of a highly experienced official (aged 51) at the deputy-ministerial level of the MOC to assume the deputy directorship of the LO over economic affairs (*Hong Kong Economic Times*, 2003).

In sum, the formulation and implementation of CEPA measures show that Hong Kong and Mainland China (and especially Guangdong) have been able to build upon the mutual trust and understanding developed since 2003. Based on the authors' interviews with officials familiar with trade issues, such interactions are frequent and based on good understanding of each other since 1998. The proliferation of intergovernmental units between Hong Kong and Guangdong shows that bilateral collaboration has reached a higher level of network coordination. The expert groups demonstrate that deliberation has reached a higher level of specialization, and can effectively address issues in a variety of areas. Since 2003, many business associations and professional bodies requested the expansion and implementation of CEPA arrangements. Supplement VIII addressed many of the requests from Hong Kong's businesses, although not always to the full extent requested. Guangdong province was interested in expanding investment in services from Hong Kong because

it aimed to upgrade its services. While the localities inside Guangdong did not fully welcome the influx of such Hong Kong services initially because of protectionist sentiments, the impact of Hong Kong services on Guangdong was not as strong as expected. Moreover, it was recognized that such Hong Kong services would bring investment and employment. Guangdong ultimately welcomed early implementation because it gave them more power to approve such service investments and was beneficial for opening up to foreign investment in this area. In short, the formulation and implementation of CEPA measures show that Hong Kong and Mainland China (and especially Guangdong) were able to build upon the mutual trust and understanding developed through intergovernmental mechanisms since 2003.

### **III. An Analysis of Key Provisions of CEPA and its Implications for Collaborative Governance**

CEPA covers three main areas. First, it functions as an intergovernmental mechanism effectively producing *collaborative outcomes* in liberalizing the trade in goods. For example, the Mainland applied zero-tariff to the import of 273 goods of Hong Kong origin stated in the initial CEPA agreement, and another 713 goods in Supplement I signed in 2004 (TID, 2003a, 2004). The rules of origin have also become more flexible since 2009. For instance, in Supplement II, both sides agreed to discuss the



rules of origin more frequently, from once a year to twice a year (GIC, 2005) and since 2006, the Mainland offered zero-tariff to *all* imports of Hong Kong origin after signing Supplement II (TID, 2005).

In the trade in services, a total of 21 service sectors were liberalized under CEPA in 2003 (TID, 2003b). With the adoption of the nine Supplements, the number increased to 47 services. All in all, these changes involved a total of 338 liberalization measures (GIC, 2012b). These can be divided into different categories, including (1) relaxation on the minimum assets and registered capital required for establishing an enterprise in the Mainland; (2) permission to provide services in the Mainland in the form of wholly-owned operations (by 2011, HKSS in 35 service sectors were allowed to establish such wholly-owned operations); (3) waiving the residency requirement for the Hong Kong staffs/representatives in the Mainland; (4) relaxation on the proportion of foreign shareholding in some services; and (5) reducing the restrictions for some sectors on the location of operations, scope of services and potential customers (Chan, 2010).

Another focus of the liberalization in services came with the adoption of the “early and pilot implementation” strategy since Supplement V, which allows various liberalization measures to be first implemented in selected provinces or cities before full implementation nationwide. Owing to its close economic ties with Hong Kong,

Guangdong province was selected for most of these measures. The central government delegated powers to Guangdong provincial government upon approval of the applications from HKSS to establish operations in Guangdong in areas such as outpatient clinics, environmental pollution control facilities, travel agencies, enterprises providing road freight transport services, repair and driver training, passenger and freight transport stations, and medical institutions. Guangdong government was also granted authority in issuing accounting qualification certificates and approving applications from Hong Kong enterprises to organize foreign economic and technical exhibitions. Since 2008, 64 measures were announced for ‘early and pilot implementation’ under CEPA. In Supplement VIII, some pilot measures in Guangdong were extended. For instance, the mutual recognition of qualifications for architects and structural engineers was extended from Guangdong to the whole country. The permission to establish wholly-owned hospitals was also extended from five provinces and municipalities in Supplement VII to all centrally administered municipalities and provincial capitals (TID, 2011). Moreover, the definition of “HKSS” was relaxed over time to facilitate trade in services. (TID, 2011). The latest Supplement IX signed in mid-2012 further relaxed market entry conditions for 21 sectors, and offered favorable treatment of education services. Some of the early implementation measures would also be piloted in Qianhai and Hengqin, two new

sites designated for Guangdong's reform a in services in cooperation with Hong Kong (TID, 2012c).

Trade and investment facilitation measures helped to improve or create new *institutional and procedural arrangements* to expedite cooperation, enhance transparency of rules, adopt standard conformity and improve information exchange between Hong Kong and the Mainland (Chan, 2010). The Main Text includes cooperation measures in seven areas, namely “trade and investment promotion”, “customs clearance facilitation”, “commodity inspection and quarantine, food safety and quality and standardization”, “electronic business”, “transparency in laws and regulations”, “cooperation of small and medium enterprises”, “cooperation in Chinese traditional medicine and medical products” (TID, 2010). By Supplement IX, such facilitate measures have increased to ten, extending to such areas as “protection of intellectual property”, “cooperation on branding” and “cooperation on education” (TID, 2011, 2012c).

### **From Building Capacity for Joint Actions to Collaborative Actions**

These facilitation measures provide ample examples of (a) *building capacity for joint action* and (b) collaborative policy outputs or *collaborative actions* from Emerson's perspective. These involve the coordination and cooperation between specific

agencies of governments between Hong Kong and the central/Guangdong authorities and the engagement between these governments and their professional and business operators on both sides. They cover three broad categories: (a) *procedural and institutional arrangements*, which develop new (or strengthen existing) administrative measures for joint action to achieve better coordination and cooperation, (b) *sharing information and knowledge* or resources and exchange/training, and (c) *joint efforts* which entail specific joint measures that would be undertaken together (sometime in partnership with industry and professions). These can be considered as *collaborative actions* or CGR outputs. For some areas, the JSC coordinates and steers the development of newly established working groups (e.g. e-business and branding), while for others, relevant government agencies will employ measures to promote industries (e.g. Chinese medicine and environmental industry) or improve intergovernmental mechanisms in policy implementation (e.g. customs clearance and inspection of commodities and food safety).

CEPA also includes a series of mutually beneficial measures to strengthen the financial cooperation between Hong Kong and the Mainland. For instance, more favorable arrangements were adopted for Hong Kong banks to establish branches in the Mainland (TID, 2007). The focus was not only on improving market entrance for Hong Kong enterprises, but more importantly, the “full utilization of financial

intermediaries in Hong Kong during the process of reform, restructuring and development of the financial sector in the Mainland” (TID, 2003b). For instance, the Mainland supported Chinese banks to relocate their international treasury and foreign exchange trading centers to Hong Kong (TID, 2003b). Qualified Mainland securities and futures companies were also allowed to set up subsidiaries in Hong Kong (TID, 2007, 2009, 2010). Supplement VIII states that the banking industry in the Mainland should “make use of the Hong Kong’s international financial platform” for its development (TID, 2011). Financial cooperation was further strengthened in Supplement IX, including efforts by Mainland authorities to support qualified Chinese firms to get listed in Hong Kong and cooperation in the development of commodity futures market and facilitating Hong Kong’s financial sector to participate in China’s capital markets (TID, 2012c; GIC 2012b). Such provisions show that the CGR has produced mutually beneficial arrangements conducive to the financial development of both sides.

Another major provision of CEPA is the mutual recognition of professional qualifications between Hong Kong and the Mainland. Since 2003, Hong Kong and the Mainland agreed on mutually recognition of six kinds of professional qualifications, namely construction and related engineering services, securities and futures services, insurance services, patent agents services, professional accountancy services, and

estate agents (TID, 2012a). CEPA also addresses the registration and practice issues after Hong Kong residents have obtained professional qualifications. Further, CEPA includes some favorable measures for Hong Kong residents to obtain Chinese professional qualifications more easily (TID, 2009).

### **Implications of CEPA**

CEPA has contributed to Hong Kong's prosperity and its deepening integration with the Mainland, especially the PRD (Chan, 2010; Chen et al., 2008). This section analyzes the benefits and limitations of CEPA, focusing more on the Hong Kong case because unlike Hong Kong, Guangdong has not yet conducted careful assessments of its impacts.

#### *Benefits from CEPA*

The liberalization of trade in goods under CEPA helps Hong Kong manufacturers save cost on tariffs by applying the Certificate of Hong Kong origin-CEPA, or CO(CEPA).

From 2004 to April 2012, the total export value of goods from Hong Kong under CEPA jumped from HK\$0.99 billion to HK\$40 billion (CITB, 2005, p.1; GIC, 2012a).

The total tariff savings under CPEA largely increased from 66 million yuan to 2.83 billion yuan (CITB, 2005, p.2; GIC, 2012a). Besides, from 2004 to May 2012, the

number of the approved applications for CO(CEPA) greatly increased from 3,211 to 85,015. The number of the approved applications also rose from 3,008 to in 2004 to 83,093 in May 2012. (CITB, 2005, p.2; TID, 2012b). Besides, the sectoral distribution of the applications for CO(CEPA) shows changes during the past 8 years. In 2005, the approved applications for CO(CEPA) mainly concentrated on the products of “textiles and clothing”, “pharmaceutical products”, “chemical products and coloring” and “plastics and plastic articles”. However, some niche products, such as food and beverages, were not allowed to apply for CO(CEPA). This problem was completely solved after Supplement II. By May 2012, the application for CO(CEPA) for the products of “food and beverages”, “textiles and clothing”, “plastics and plastic articles” and “pharmaceutical products” accounted for around 80 percent of such applications.

The liberalization of trade in services under CEPA facilitates the entrance of HKSS to the Mainland market. Since 2003, 1,663 applications for Certificate of HKSS have been received and 1,615 approved. The approved applications concentrated on “transport and logistics services”, “distribution services”, “air transport services” and “advertising services”, accounting for around 70 percent of the total applications. Although the number of applications for HKSS Certificates recorded declines in recent years, CEPA is still inducing an increasing the amount of capital investment in Hong Kong through the liberalization of trade in goods and

services. The recent assessment on the impacts of CEPA by the HKSAR government shows that the liberalization of trade of goods under CEPA induced an additional HK\$103 million and HK\$202 million capital investment to Hong Kong in 2005 and 2006 respectively (CITB, 2007, p. 2). The liberalization of trade in services under CEPA induced HK\$2 billion and HK\$1.7 billion capital investment to Hong Kong in 2005 and 2006 respectively (CITB, 2007, p. 2). Supplement III signed in June 2006 further liberalized trade in services by relaxing market access conditions for legal services, construction, information technology, convention and exhibition, audiovisual services, distribution, tourism, transport and individually-owned stores, which greatly favors their development. The business receipts obtained by Hong Kong companies engaging in trade in services from Mainland-related business due to CEPA recorded a drastic increase from HK\$4.2 billion in 2006 to HK\$18.3 billion in 2007 (EABF Unit, 2010b, p. 8). By 2009, the liberalization of trade in services had already brought a cumulative total of business receipts of HK\$61.6 billion to these Hong Kong companies (EABF Unit, 2010b, p. 8).

Another benefit brought by CEPA is the facilitation on the flow of people between Hong Kong and the Mainland China, most notably tourists joining the Individual Visit Scheme (IVS). In 2011, Mainland residents made 18.3 million trips to Hong Kong under the IVS, accounting for 65.3 percent of all the Mainland visitors. In fact,



Mainland China has become the largest source of visitors to Hong Kong and accounted for 67 percent of the total arrivals in 2011 (Tourism Commission, 2012). In 2009, the IVS visitors have generated HK\$26.4 billion in tourist spending in Hong Kong, which was almost three times the amount in 2004 (EABF Unit, 2010a, p.3). The value-added brought by IVS to Hong Kong's economy was estimated to be HK\$16.1 billion in 2009, about 2.5 times the amount in 2004 (EABF Unit, 2010a, p.5).

CEPA also increases employment in Hong Kong. By 2006, 34,938 job opportunities were created in Hong Kong, accounting for 12 percent of the total new jobs created in Hong Kong in that period (CITB, 2007, p. 1). Of the new jobs created by CEPA, 73.7 percent of them were related to the IVS, while 26.3 percent of them were created by the liberalization of trade in goods and services (CITB, 2007, p. 2). The estimated number of jobs created by the IVS increased from 19,158 in 2004 to 50,281 in 2009 (EABF Unit, 2010b, p.5). CEPA has fostered the mobility of production factors between Hong Kong and the Mainland, which was mainly achieved by the mutual recognition of the professional qualifications and the increased flow of capital (Chan, 2010, p.169).

*CEPA's impacts on the Mainland and Guangdong*

Not only has CEPA supported Hong Kong's economy, but it has also produced benefits to the Mainland. The assessment by HKSAR government in 2006 shows that CEPA had induced HK\$9.2 billion investment in the service sector in the Mainland between 2004 and 2006 (CITB, 2007, p.5). CEPA created around 17,000 job opportunities in the Mainland in the same period and 16,000 of them were filled by the Mainland residents (CITB, 2007, p.5). Owing to its close economic ties with Hong Kong, Guangdong benefited most from the economic cooperation with Hong Kong.

One of the major benefits brought by CEPA on Guangdong is the introduction of foreign investment from Hong Kong. The actual utilized foreign investment from Hong Kong to Guangdong increased by 44 percent from US\$11 billion in 2003 to US\$13 billion in 2010 (SBG, 2004, p. 455, 2011, p. 498). Although the investment from Hong Kong still concentrates on manufacturing, the increasing investment in services is largely facilitated by CEPA. In 2011, Hong Kong's investment in service accounts for 44 percent of the total actual foreign investment in Guangdong, which is 17 percent higher than its figure in 2003 (People's Daily Online, 2012). Since 2004, the actual foreign investment from Hong Kong in Guangdong's services amounted to US\$30 billion, mainly focusing on "wholesale and retail", "leasing and business services" and "transport, storage and postal services." The trade between Guangdong and Hong Kong is also boosted by CPEA. The total value of trade between

Guangdong and Hong Kong increased by 170 percent from US\$60 billion in 2003 to US\$159 billion in 2010 (SBG, 2004, p. 455, 2011, p. 473). Other benefits of CEPA are also noteworthy. Guangdong's experts argue that CEPA has contributed positively to the liberalization of trade in the Greater PRD and generated the impetus for improving the regulatory and business environment inside the province and adopting international business practices, although currently many institutional obstacles blocking the entry of Hong Kong services to the PRD have not been fully removed yet (Chen et al., 2008).

### **Limitations of CEPA**

It is apparent that CEPA has brought substantial benefits to Hong Kong's economy, but Hong Kong enterprises believed the benefits brought by the liberalization of trade were more significant than the benefits from the liberalization of services. According to a survey conducted by the HKSAR government (CITB, 2007), 77 percent of the Hong Kong's enterprises engaging in trade in goods believed that CEPA was conducive to their industries. On the other hand, only 47 percent of the Hong Kong's enterprises which engaged in trade in services held the same view. In fact, the general trend of applications for HKSS Certificates has been declining since 2005. As mentioned above, the approved applications for such Certificates mainly concentrated

in the traditional services, such as “transport and logistics services”, “distribution services”, “air transport services”. This reflects that the major function of CEPA at the moment is mainly to serve export processing between Hong Kong and the Mainland, while other services, such as professional services, still cannot easily enter or prosper in the Mainland.

In the survey conducted by the HKSAR government in 2006, 60 percent of the holders of HKSS Certificates reported that they encountered difficulties when setting up business in the Mainland under CEPA. The difficulties included “long processing time”, “complicated application procedures”, “insufficient transparency in policies and regulations”, and “high entry requirement” (CITB, 2007, p.14). Hong Kong service providers reported that they faced problems such as “not familiar with the business environment in the Mainland”, “complicated or heavy taxation system in the Mainland”, “insufficient transparency in policies and regulations” and “variation in the implementation of policies among local regions” (CITB, 2007, p.15). In fact, over 95 percent of HKSS entering Guangdong did not go through the CEPA channel (The Greater PRD Business Council, 2012, p.3).

The poor utilization of the CO(CEPA) and HKSS Certificates reflects that the industrial and business sector did not fully recognize the benefits brought by CEPA. Approved CO(CEPA) applications rose substantially from 3,008 in 2004 to 19,033 in

2006 and 83,093 by May 2012 (CITB, 2005, p. 6 and 2007, p. 25; TID, 2012b).

However, the utilization rate of CO(CEPA) rose only slightly from 4.7 percent in 2004 to 8.1 percent in 2005 and 11.5 percent in 2006 (CITB, 2007, p. 43). Although the cumulative number of such HKSS Certificate issued rose by over 120 percent from 668 in 2004 to 2173 in September 2009, only 48 percent of the certificate holders established business operations in the Mainland during this period and they concentrated in three service sectors, namely management consulting (69.7 percent), freight forwarding agency (65.5 percent) and placement and supply services of personnel (62.0 percent) (EABF Unit, 2010b, p.3).

## **Conclusions**

This paper has adopted the collaborative framework to examine CEPA and other related issues in economic cooperation by focusing on intergovernmental interactions among the central government, the Guangdong and HKSAR governments as well as their respective business sectors. Under OCTS, vertical coordination between the central government and the HKSAR governments and horizontal coordination between the Hong Kong and the Guangdong government have become increasingly frequent and productive. Although initially less active, the collaboration between Hong Kong and Guangdong has become much more effective after revamping the

HKGDCJC in 2003. There may be competing assessment of the outcomes of CEPA, but the collaboration achieved by these intergovernmental mechanisms has moved the different parties forward in further expanding CEPA provisions. This is the most important indicator of the achievement of collaborative outcomes. In sum, the growing intergovernmental interactions have contributed to better economic cooperation under the CEPA framework, although there are still issues and challenges (such as difficulties in implementation) that confront these different jurisdictions.

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**Table 1. A Diagnostic or Logic Model Approach to Collaborative Governance**

Dimension and Components			The Collaborative Governance Regime				Collaborative Outcomes	
			Collaborative Dynamics			Outputs	Outcomes	
			Principled Engagement	Shared Motivation	Capacity for Joint Action	Collaborative Actions	Impacts	Adaption
Elements within Component	- Resource Conditions	- Leadership Consequential	- Discovery Definition	- Mutual Trust Mutual	- Procedural/Institutional Arrangements	Will depend on context and charge, but might include:	Will depend on context and charge, but aim is to alter pre-existing or projected conditions in System Context	- Change in System Context
	- Policy Legal Frameworks	Incentives	- Deliberation Determination	Understanding Internal	Leadership	- Securing Endorsements		- Change in collaborative governance regime
	- Prior Failure to Address Issues	- Uncertainty		Legitimacy Shared	- Knowledge Resources	- Enacting Policy, Law, or Rule		- Change in Collaborative Dynamics
	- Political Dynamics/Power Relations			Commitment		- Marshalling Resources		
	- Network Connectedness					- Deploying Staff		
	- Levels of Conflicts/Trust					- Siting/Permitting		
	- Socio-economic/Cultural Health & Diversity					- Building/Cleaning Up		
						- Enacting New Management Practice		
						- Monitoring Implementation		
						- Enforcing Compliance		

Source: Emerson et al. (2011, p.7)