

**Economic Summit on
“China’s 11th Five-Year Plan and the Development of Hong Kong”**

Trade and Business

(Translation)

Purpose

Paper Ref. 2006 ES/1 has provided an analysis and recommendations on how to develop Hong Kong as international financial, trading and maritime centres under the 11th Five-Year Plan. This paper examines the opportunities and challenges of Hong Kong in trade in goods under the 11th Five-Year Plan from the perspective of the Government and public organisations, with a view to generating discussions among the various sectors in the community to formulate a practical “action agenda” by the Economic Summit in the coming few months.

Background

2. From the global perspective, Hong Kong was the world’s 11th largest trading entity in goods in 2005 (the value of total trade amounted to US\$592.9 billion) according to a report of the World Trade Organisation – the 11th largest importer (the value of imports amounted to US\$300.6 billion) and the 11th largest exporter (the value of exports amounted to US\$292.3 billion).

3. The Mainland is Hong Kong's largest trading partner. In 2005, trade between Hong Kong and the Mainland amounted to HK\$2,061.9 billion (US\$265.1 billion), accounting for 45.0% of Hong Kong's total trade. Reciprocally, Hong Kong was the Mainland's third largest trading partner (after the US and Japan) in 2005. Trade between the Mainland and Hong Kong accounted for 9.6% of the Mainland's total trade. Hong Kong is also an important entrepot for the Mainland. In 2005, re-exports of Mainland-origin goods through Hong Kong accounted for 62.1% of Hong Kong's total value of re-exports while Hong Kong's re-exports to the Mainland accounted for 45.8% of the total value of re-exports.

4. The Mainland has a population of over 1.3 billion, a potentially huge consumer market with enormous development potential. With the rapid expansion of the middle class and the continual rise in per capita spending capacity, there has been a growing demand for imports in the Mainland. In 2005, the Mainland imported US\$660 billion of goods. Imports also grew strongly by 22% in the first five months of 2006. Among the provinces, municipalities and autonomous regions, neighbouring Guangdong Province ranked the 6th in per capita GDP in the Mainland, making it a prominent consumer market.

5. Hong Kong products has always been popular among Mainland consumers, the Mainland's policy of expanding domestic demand can help create a larger export market for Hong Kong products. The tariff free access under the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) has also provided new opportunities to promote Hong Kong brand name products in the Mainland.

6. The 11th Five-Year Plan states that the Mainland should maintain stable and rapid economic development by further expanding domestic demand, thus regulating the relationship between investment and consumption (i.e. rationalizing the scale of investment and strengthening the role of consumption in economic growth.)

7. On top of economic development, the Mainland also calls for resource conservation, environmental protection and a fundamental change in the mode of economic growth. In addition, the Mainland also aims to promote national economic and social informatisation, "new industrialization" resource-conserving, clean, safe and sustainable development. As Mainland provinces are rectifying heavily polluting industries, many Hong Kong-invested enterprises in the Mainland,

particularly those heavily polluting trades operating in the Pearl River Delta (PRD), will face new challenges. On the other hand, the provinces will be in great need of external investment and support in technology, management, financing and environmental protection industry as they embark on environmental planning work. These new developments will result in both crises and opportunities for which Hong Kong businesses should now be considering how to manage.

8. The Guangdong Province's 11th Five-Year Plan proposes to optimize export commodities and export trade structure. It focuses on expanding the exports of brand name products with proprietary intellectual property content, encouraging the exports of products with high-technology and high value-added content, and restricting the exports of high resource, high energy consumption products, as well as those that are highly polluting. The plan also suggests enhancing the comprehensive management of environmental programmes, improving the environmental and policy formulation, and strictly implementing the environmental impact assessment system on construction projects. Planning of industry distribution and industrial construction projects will be based on the environmental capacity and resources protection capabilities of the respective regions. The province will also actively explore charging of a reasonable effluent fee and formulate a policy on applying such levy.

Opportunities and Challenges

9. With the Mainland's new development direction through expansion of domestic demands, optimization of industrial structures, resource conservation and environmental protection, innovation enhancement, etc. to promote sustainable development, we have attempted to analyse the opportunities and challenges facing Hong Kong businessmen in several areas :

(I) Brand Building in the International and Mainland Market

10. According to the Top 100 Global Brands Scoreboard 2006 published by the BusinessWeek magazine, there are only ten top global brands in Asia. None are from the Mainland or Hong Kong are on the list¹. This is one indication that Hong Kong products are still not widely

¹ HSBC is regarded as a British brand.

known to the international market. In a 2002 report, the Hong Kong Trade Development Council (TDC) set out the reasons for the low level of brand building in Hong Kong. The main reason was that Hong Kong only had a limited domestic market and lacked a critical mass of local consumers. In addition, Hong Kong manufacturers had a limited knowledge of the preferences, taste and other demands of overseas consumers. In recent years, local industries have gradually realised the importance of brand building to boost Hong Kong exports and have allocated substantial resources to the development of brand names. Under the 11th Five-Year Plan, the policy of expanding domestic demand will provide a great opportunity not only for the export of Hong Kong products, but also for the domestic sales of goods produced by Hong Kong-invested manufacturers in the Mainland. .

11. From a macro perspective, Hong Kong itself is a brand. It represents quality, confidence, style, genuine goods at fair prices and value for money. Since the implementation of the Individual Visit Scheme, a huge number of Mainland visitors have come to Hong Kong and shopped for local goods (though not all of the goods are locally manufactured), ranging from high-value jewellery accessories to popular food items such as moon cakes. This reflects the Mainland consumers' trust and desire for Hong Kong products, and pave the way for our products to enter the Mainland consumer market.

12. Hong Kong manufacturers, especially those producing medium- and high-end products, should consider how to build and strengthen their own brand names. A brand name gives a product with a distinct identity, differentiates it from similar products, and assures consumers of its value. A successful brand needs to be supported by quality, service and originality. The challenges for Hong Kong enterprises are how to upgrade the product design and quality, make better use of innovative technologies, enhance productivity, optimise production workflow, improve customer and after-sales services, and embark on effective promotion in the Mainland market.

(II) Exploiting the Mainland's Domestic Market

13. To take advantage of lower production cost, outward processing forms a significant portion of trade between HK and the Mainland. In 2005, trade involving outward processing in the Mainland amounted to HK\$388.5 billion (US\$50 billion), accounting for 38% of our total exports to the Mainland; whereas the total imports from the Mainland involving

outward processing also reached HK\$692 billion (US\$89 billion), accounting for 66% of our imports from the Mainland. According to Guangdong Province statistics, the cumulative number of contracted direct investment projects from Hong Kong in Guangdong was 87 274 at end-2005. Many of these are related to the manufacturing industry and processing trade activities. The majority of these products are exported to overseas markets using Hong Kong's efficient logistics and transportation services. Given the important role of Hong Kong-invested factories in Southern China's manufacturing sector, these enterprises are capable of restructuring from ones focusing solely on processing trade activities to those capable of making inroads into the Mainland's domestic market.

(III) Environmental Protection Requirements in Guangdong Province

14. With the rapid economic growth of the Mainland over the past few years, excessive energy consumption by some industries has aggravated the environmental pollution problems. In this connection, the 11th Five-Year Plan calls for resource conservation, environmental protection and a fundamental change in the mode of economic growth. The 80 000-odd Hong Kong-invested factories in Guangdong are facing serious resource and environmental problems.

15. In order to attain a more balanced economic development, the Guangdong provincial government is determined to develop its east and west wings as well as the northern mountainous area with a view to gradually shifting the labour intensive industries to these areas. In this connection, Guangdong Province has formulated the "Outline of the Planning of the Environmental Protection of the Pearl River Delta" and the "Environmental Protection Plan for Guangdong Province" and other environmental protection plans, with strict requirements on the designation and control of functional areas. In order to strengthen the pollution control and management of heavily polluting trades, Guangdong Province has proposed explicitly to speed up the "unified planning, unified location" for heavily polluting trades such as galvanization, chemical pulping and production, leather making, textile printing and dyeing, smelting, fermentation, solid waste processing, etc., in order to achieve centralised control, centralised rectification and centralised management of pollution.

16. While the strict control of environment pollution and resource conservation has created problems for some Hong Kong-invested enterprises in Guangdong Province, it will also bring about business

opportunities to the environmental protection enterprises. For example, the planning of the environmental protection business requires the participation of well-established companies with advanced technology and quality management in investment, development and operation.

17. There is much room for cooperation in environmental protection industry between Hong Kong and the Guangdong Province. For example, a Hong Kong enterprise has developed particulate reduction devices that can be retrofitted on eligible diesel vehicles and can reduce vehicle emission by half. The introduction of similar products in Guangdong Province and other regions will bring about tremendous business opportunities to Hong Kong enterprises.

Responses/Actions taken by the Government and Other Sectors

(I) Developing Brand Name Products

18. Under the free market policy, the HKSAR Government is committed to providing the maximum support to industries and create a business friendly environment, as well as improving intellectual property protection system needed to develop creative industries and brands in Hong Kong.

19. Hong Kong's comparative advantage has shifted from low-skilled and labour-intensive production to high value-added and knowledge-based activities. As such, the Government encourages the industries to move up the value ladder from Original Equipment Manufacturing (OEM) to Original Design Manufacturing (ODM) and Original Brand Manufacturing (OBM).

20. In recent years, the Government has provided considerable support to the industrial sector in response to the restructuring of industries. To provide an environment conducive to the development of high value-added and technology-based industries, the Government has set up the Innovation and Technology Fund (ITF) to encourage and support initiatives conducive to innovation and technology upgrading of local industries. By April 2006, \$2.3 billion was committed under the ITF to establish five research and development centres, namely, automotive parts and accessory systems, logistics and supply chain management enabling technologies, nanotechnology and advanced materials; textile and clothing; and, communications technologies. These centres will provide a one-stop

services shop for these industries and help them move up the technology ladder and to develop high value-added products. In addition, the Government supports the establishment of the Integrated Circuit Design and Development Support Centre at Science Park as well as the Digital Media Centre and the Wireless Solutions Development Centre in Cyberport, with a view to helping small and medium enterprises (SMEs) develop ODM capability. The SME Export Marketing Fund under the SME funding schemes implemented by the Government also provides financial assistance to SMEs in export promotion activities, indirectly facilitating Hong Kong's economic shift towards high value-added and knowledge-based activities and production, and promoting the growth of Hong Kong's trade in goods.

21. On the promotion of design and creativity, the Government and various organisations have introduced several initiatives to assist industries to make better use of design to enhance the product values, and to develop their own brands. For example, the Hong Kong Design Centre is committed to promoting design as a value-added activity, raising design standards and fostering design-related education, and raising the profile of Hong Kong as an innovative and creative hub. To position Hong Kong as a centre of design excellence in the region, the Government has also launched the DesignSmart Initiative to strengthen the support for design and innovation, instill high value-added content, substantial intellectual property and innovative elements into the production processes, provide funding for worthwhile design and branding projects and research, incubate start-up design ventures, and promote and honour design excellence and branding. In addition, local higher education institutions such as the Polytechnic University's School of Design, the Hong Kong Design Council, and professional bodies have been playing a pivotal role in raising design standards in Hong Kong, in fostering design-related education, and in training design talent. All these measures help enhance the potential of brand development in Hong Kong.

22. Many business chambers, trade associations and government subvented organisations also strive hard to develop of Hong Kong brands. Under the planning and promotion of the Hong Kong Brand Development Council, many local enterprises actively pursue excellence in the development of brands and products, and reinforce the status of Hong Kong original brands. The Hong Kong Q-Mark Scheme, the Hong Kong Top Brand Awards and the Hong Kong Top Service Brand Awards showcase the efforts and accomplishment of many local enterprises in

brand building. Besides, the Hong Kong Awards for Industries, established through the merging of the former Hong Kong Awards for Industry and Hong Kong Awards for Services, recognise the outstanding achievements of Hong Kong enterprises in moving towards higher technology and higher value-added activities. Awards are given in seven categories, namely consumer product design, machinery and equipment design, customer service, environmental performance, innovation and creativity, productivity and quality, and technological achievement. In addition, many exhibitions are held to showcase Hong Kong products, among which the annual Hong Kong Brands and Products Expo is a prominent example. Its organiser, the Chinese General Chamber of Commerce, has also held similar exhibitions in various Mainland cities to promote Hong Kong brand name products in recent years.

23. The TDC also contributes to enhancing the image and status of Hong Kong brand name products in the global market. Its efforts include organising and encouraging Hong Kong manufacturers to take part in local and overseas promotional functions, promoting the high quality and sophisticated design of Hong Kong products through market-specific publicity campaigns, and building up the image and reputation of Hong Kong original brands. The TDC has put special focus on the Mainland markets to promote Hong Kong products. It has held a series of promotional activities highlighting Hong Kong brand name products in leading department stores and organised the “Style Hong Kong” events in major Mainland cities which, by gauging the demand and taste of different markets in the Mainland provided useful references to Hong Kong manufacturers during the manufacturing and design processes. From 2006, the TDC has set up “Style Hong Kong Gallery” in trade fairs held overseas to promote Hong Kong brand name products.

24. CEPA serves as a catalyst for the industrial restructuring in Hong Kong. The zero tariff measures minimizes the costs of Hong Kong products exported to the Mainland and thus increases the competitiveness of Hong Kong products in the Mainland consumer market. CEPA also encourages the manufacturing in Hong Kong of brand name products or products with high value-added content or substantial intellectual property input which has helped to accelerate Hong Kong products’ penetration into the growing Mainland consumer market. Overseas investors may leverage on the economic synergy between Hong Kong and the Mainland, as well as the zero tariff preference and the trade and investment facilitation measures under CEPA to manufacture products in Hong Kong for export to the

Mainland. Given the effective intellectual property protection regime in Hong Kong, overseas investors may also set up research and development centres or manufacture proprietary products in Hong Kong.

25. The trade and investment facilitation measures under CEPA also enhance trade and investment activities between the Mainland and Hong Kong. For example, a series of customs facilitation measures have been implemented to speed up the flow of goods between Hong Kong and the Mainland while various arrangements on transparency in laws and regulations have enabled investors to gain a better understanding on the Mainland's laws and regulations. The incorporation of intellectual property (IP) protection under trade and investment facilitation measures this year further accelerates the launch of Hong Kong brand name products to the Mainland market. According to the latest thinking, the Mainland would set up an Intellectual Property Protection Coordination Centre in Hong Kong, which will provide a platform for exchanges on issues relating to IP protection between the two sides, and dissemination of information on IP protection to traders.

(II) Strengthening Ties with the Mainland Authorities and Exploiting the Mainland's Domestic Market

26. The Government strives to foster closer ties with the Mainland authorities. For example, the Pan-Pearl River Delta Regional Co-operation Framework Agreement, the Hong Kong/Guangdong Co-operation Joint Conference, the Hong Kong-Shanghai Economic and Trade Co-operation Conference and the Hong Kong-Beijing Economic and Trade Co-operation Conference all provide effective platforms for communication between the two places, the elimination of barriers on the flow of goods between provinces in the Mainland and the healthy development of trade and investment between Mainland and Hong Kong. The Government has also decided to strengthen its representation in the Mainland by establishing a Mainland Affairs Liaison Office under the Constitutional Affairs Bureau, establishing two Economic and Trade Offices in Chengdu and Shanghai, and by expanding the scope of functions of Hong Kong Economic and Trade Office in Guangdong (GDETO). Through the promotion of economic and trade collaboration, as well as the building of liaison networks, with individual provinces/regions, the Government is determined to strengthen the support for Hong Kong businessmen operating in the Mainland, publicise the products and roles of Hong Kong, as well as promote and advertise CEPA in the Mainland

with a view to further promoting the development of Hong Kong's trade in goods.

27. As the renowned factory of the world, the Mainland's gross industrial output value is increasing steadily. Given that Guangdong Province has suggested accelerating the development of principal industries like automotive parts and steel-led industries in its 11th Five-Year Plan, the demand for raw materials, particularly steel, will keep on rising. With the encouragement of the Mainland government to produce high value-added and high quality products, Mainland enterprises start to acquire raw materials from all over the world to enhance the quality and competitiveness of their products. A vast majority of Mainland enterprises are SMEs lacking adequate knowledge about the global market. On the other hand, Hong Kong enterprises have strong international business network and shrewd market acumen, and are familiar with international trade rules. They will surely provide sourcing services to the Mainland enterprises and meet the national demand for imported products and raw materials.

28. With the efforts in the past years, Hong Kong has established its status as the international sourcing centre. However, the Internet has brought about challenges to Hong Kong. More and more buyers may choose to procure on-line in order to save the agent commissions, or the rental and other administration fees arising from the setting up of a sourcing centre in Hong Kong. Furthermore, many multinational enterprises have set up Mainland offices in addition to their sourcing offices in Hong Kong. Last year, Walmart moved its regional sourcing headquarter from Hong Kong to Shenzhen. In face of such challenges, Hong Kong has to proactively publicise its strengths as the regional headquarters, and demonstrate the advantages of Hong Kong as the prime sourcing centre for goods and raw materials.

(III) Assisting Hong Kong-Invested Enterprises in Guangdong to Meet the Environmental Protection Challenges

29. Apart from encouraging our manufacturing sector to move up the value chain, the Government, together with various quasi-government organisations and business associations, has provided support at various fronts to the Hong Kong businessmen in the Mainland facing enhanced efforts (especially Guangdong) to protect the environment, and the new

environmental protection requirements² of economies such as Europe, the US and Japan.

30. The GDETO maintains a close liaison with the Guangdong government, with a view to reflecting the views of Hong Kong investors, assisting them to communicate with the relevant Guangdong authorities and collecting and disseminating as much information as possible to facilitate advance planning. In addition to providing assistance to Hong Kong manufacturers by organising familiarisation visits to the Mainland for to better understand the investment environment and latest economic and trade situation of areas accommodating relocated industries, the GDETO, in collaboration with the Hong Kong Productivity Council, is discussing with individual PRD cities on possible options of central administration and control, as well as encouraging governments of the cities/counties concerned to achieve a win-win situation by enlisting Hong Kong businessmen in the provision of environmental facilities.

31. The Hong Kong Productivity Council is committed to promoting the use of cleaner production technology among enterprises. Its efforts include:

- (a) Producing technical guides for the reference of different trades including bleaching and dyeing, electroplating, circuit board manufacturing, and food and leather industries. Through the provision of consultancy service on environmental protection, the Council assists business organisations to design, formulate and implement environmental management systems in compliance with the ISO 14001 standard;
- (b) With the development in environment technology innovation, assisting the industries concerned in complying with the relevant

² For example, the European Union (EU) has recently adopted directives on green production, including the Directive on Waste Electrical and Electronic Equipment (WEEE) which took effect in August 2005, and the Directive on the Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment (RoHS) which entered into force on 1 July 2006. The WEEE Directive requires producers and distributors of electrical and electronic equipment to be responsible for collecting and processing waste electrical and electronic equipment and the expenses incurred. The RoHS Directive requires that the content indices of six hazardous substances including lead, mercury, cadmium, hexavalent chromium, polybrominated biphenyls and polybrominated diphenyle ethers in electrical and electronic equipment should comply with EU standards. Should violations be detected in sampling tests, the whole product lot will be recalled and destroyed on site. Entry into the EU market of such equipment in the future will be prohibited.

laws and regulations in Hong Kong, the Mainland and other overseas markets by controlling the emission of fumes, smoke, exhaust, wastewater and dust particulates during production processes. The Environment and Product Innovation Laboratory of the Council conducts a comprehensive range of pollution analysis including that of industrial effluents, noise measurements and treatability tests on waste and wastewater, with the aim to assisting the industries concerned to comply with the local and international environmental legislation;

- (c) Establishing the Green Manufacturing Network as a platform for dissemination and sharing of environmental information, organising regular seminars and workshops, and compiling guides assisting different trades and industries to comply with environmental protection requirements;
- (d) Discussing with the industries and Government the setting up of a centre for promotion and research of cleaner production, as a source of technical support for the industries; and
- (e) Setting up wholly owned subsidiaries in Guangzhou, Dongguan and Shenzhen in recent years to provide integrated services providing direct support to Hong Kong-invested enterprises operating in the Mainland. Major areas of work in the future will include greater support for cleaner production.

32. Apart from the Hong Kong Productivity Council, various organisations and business associations have implemented environmental protection programmes and measures as well:

- (a) The Sustainable Development Sub-group under the Greater Pearl River Delta Business Council is exploring measures to improve air quality; to raise awareness of energy saving, emission reduction and application of clean production technology among the Hong Kong manufacturing industries in Guangdong; and to introduce clean production measures to enterprises in the Greater PRD;
- (b) The Greater Pearl River Delta Business Council has joined hands with the Hong Kong General Chamber of Commerce, the Business Coalition on the Environment, the Guangdong Sub-

Council of the China Council for the Promotion of International Trade and the Guangdong Environment Protection Industries Association to launch the “Clean Air Charter”, encouraging all investors in the PRD to observe the Charter;

- (c) The Hong Kong Green Manufacturing Alliance, founded by seven business and trade organisations, encourages local manufacturers to comply with environmental legislation, seeks to raise their environmental awareness and promotes the application of green processes and products with a view to enhancing their competitiveness;
- (d) The Federation of Hong Kong Industries launches the One Factory-One Year-One Environmental Project Programme. It is a voluntary programme which requires participating manufacturers to implement at least one environmental project each year to reduce pollution in Hong Kong and the PRD and to improve the environment of the region; and
- (e) The TDC has also joined force in areas under its ambit. For example, the TDC organised a seminar on “RoHS Policies and Enforcement Conference” where enterprises shared their experience in complying with the RoHS Directive in the production and manufacturing processes. It also helps promote Mainland study visits and investment projects among Hong Kong enterprises.

Recommendations

33. In response to expanding domestic demand in the Mainland, and to assist Hong Kong-invested enterprises in the Mainland rise to environmental protection challenges, Members are invited to give their views on the following recommended measures or make suggestions on other areas for further consideration:

- (a) In order to preserve the competitiveness of Hong Kong products in the international arena and in the Mainland market, the Government will further promote the development of Hong Kong brands by encouraging enterprises to enhance product design and quality, improve services, make better use of innovative

technology, increase productivity and optimize production workflow, and upgrade quality control;

- (b) Industries and enterprises will promote proactively Hong Kong brand name products in the Mainland by capitalising the generally fine reputation of Hong Kong products;
- (c) The Government and related organisations will further intensify their efforts in publicising Hong Kong as a prime sourcing hub and as an intermediary role, whereby Mainland enterprises may source their goods in Hong Kong and multi-national enterprises may use Hong Kong as the platform for business matching when they enter the Mainland consumer market;
- (d) In an effort to encourage Hong Kong businesses to actively explore the domestic market of the Mainland, the Government will, through the existing cooperation channels with the Mainland, seek to overcome the internal trade barriers (such as taxation issues and the flow of goods between provinces).
- (e) The Government will continue to strengthen liaison with the related authorities in Guangdong, and to disseminate to Hong Kong businessmen the latest policies, measures and relevant information on investment and trade (including those on environmental protection) as early as possible, so as to deepen their understanding on the Mainland investment environment and to facilitate them to explore the business opportunities in the Mainland; and
- (f) The Government will continue to support and encourage business associations and enterprises to initiate environmental programmes.

Advice Sought

- (a) Is the above analysis on the international competitiveness of Hong Kong in trade in goods comprehensive and thorough? Are there any other issues that need to be addressed ?
- (b) Is the above analysis on the opportunities and challenges faced by Hong Kong businessmen under the 11th Five-Year Plan

comprehensive and thorough? Are there any other issues that need to be addressed?

- (c) Is the above analysis on the opportunities and challenges faced by Hong Kong businessmen under the Guangdong Province's 11th Five-Year Plan and the development in the region comprehensive and thorough? Are there any other issues that need to be addressed?
- (d) Are the measures proposed above for the government and public organisations to further consolidate and develop the domestic market in the Mainland and to assist Hong Kong businessmen in the Mainland to meet the environmental protection challenges pragmatic? Do we need to adjust our directions or strategies?
- (e) Do the issues on how to further consolidate and develop Hong Kong as an international business and trade hub in this paper and in Paper Ref. 2006 ES/3 require further analysis and study?

Commerce, Industry and Technology Bureau
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