

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

Purpose

The paper 2006 ES/1 has provided strategic analysis and made suggestions on how to develop Hong Kong into an international financial, trading and maritime centres under the 11th Five-Year Plan. This paper examines the opportunities and challenges for the services industry of Hong Kong from the perspective of the Government and related organizations. We hope that this could generate constructive discussions among the public which will enable the Government to formulate a practical “action agenda” in the coming months.

Background

2. According to the World Trade Organisation, Hong Kong’s total trade in services amounted to US\$91.9 billion (1.9% of the total volume of world trade in services) in 2005, an increase of 10.2% over 2004, making Hong Kong the world’s 16th largest services trading entity¹. The annual statistics compiled by the Government on the external direct investment of Hong Kong show that our inward direct investment mainly goes into the services sectors, especially those related to the wholesale, retail, imports/exports trade services, transport and related services, real estate and other business support services.

¹ Ranked 11th (US\$60.3 billion) in exports of services, and ranked 20th (US\$31.6 billion) in imports of services.

3. The quality of the services industry in Hong Kong is very high by international standards after continuous efforts of the industry over the years. The services industry currently contributes to 90% of our Gross Domestic Product (GDP). On the other hand, the services industry in Mainland is still at a developing stage and accounts for about 40% of the GDP. As the Mainland economy continues to enjoy vigorous growth, its progressively liberalized market and expanding foreign trade has led to greater demand for different types of services, especially professional services. Meanwhile, economic globalization and China's accession to the World Trade Organization have intensified the Mainland's need for better integration into the world economic system. For this reason, growth in volume alone is not enough for their services industry. It is imperative that the industry improves its quality to meet international standards in its management, operation and performance.

4. Hong Kong should develop itself into a services hub for China and serve as a two-way servicing platform. Not only can the Mainland services industry import professionals from Hong Kong and through Hong Kong, from overseas, it can also use Hong Kong as a springboard to reach out to the world market.

5. In the 11th Five-Year Plan, it is mentioned that China will optimise and upgrade its industrial structure and accelerate the development of its services industry. This will have significant impact on Hong Kong as an international centre for trade and business. Relevant contents of the 11th Five-Year Plan are set out as follows:

- Chapter 3 – Adjust the structure and organisation of the raw material industry; exercise stringent control over the productivity for additional iron and steel; and promote restructuring and upgrading of the building material industry, with emphasis on the conservation of energy resources, the protection of natural environment and the upgrading of product quality.
- Chapter 4 – Adhere to the principles of using market orientation, commercialisation and socialisation; widen the scope of the services industry, expand its scale, optimise its structure, strengthen its function and regulate its market, so as to improve the level of the services industry and its share in the GDP.

- Sections 16 to 17 – Vigorously promote the development of the producer’s services industry; deepen specialisation and labour division; reduce social transaction cost and improve resource allocation efficiency..... Give priority to development of the transport industry; promoting the development of modern logistics; orderly develop the financial services; actively develop the information services; regulate and develop the commercial and professional services; foster the development of the real estate sector; boost tourism, etc.
- Section 18 – End monopoly; relax the scope of market access; develop an open, fair and regulated system for the market access of specific trades; encourage the injection of community capital into the services industry, increase the proportion of non-public-owned operations in the economy..... Perfect the system for the setting of standards, and promote standardisation in the services industry. Big cities should accord priority to the development of the services industry and those which are well placed should gradually restructure its industries to become service economies.

6. The 11th Five-Year Plan of the Guangdong province proposes to optimize the structure of the services industry, accelerate the growth of the commercial services industry, strengthen the development of related services in the areas of legal, accounting, financial consulting and product design, as well as the development of the well established wholesale and retail services. The 11th Five-Year Plan of Guangdong also proposes to enhance regional cooperation. Following the principle of “forward looking approach, holistic, pragmatic and mutual benefit”. The Plan proposes to further implement CEPA with Hong Kong and Macao, to enhance cooperation in all aspects with reference to the advantages of each city, and to attract the modern services from Hong Kong and Macao to upgrade the competitiveness of services industry in Guangdong.

Opportunities and Challenges

7. Hong Kong has established its position as an international hub for trade and services. Apart from the abundant inflow of foreign capital, Hong Kong has acquired from the foreign enterprises technical expertise

and management experience. For this reason, our services industry has made significant progress. Its performance now measures up to international standards. With a wealth of talented professionals and good management practices, adding to the well-established infrastructure, independent legal system, simple tax regime and sound financial policy, Hong Kong becomes the preferred choice to those wanting to establish their businesses in the South-East Asian market and in particular, the Mainland market.

8. Compared with Hong Kong, the services industry on the Mainland is currently at a fledging stage. Most of the companies in the Mainland are small and medium-sized enterprises with limited knowledge of the international market. On the contrary, Hong Kong enterprises enjoy a strong international business network. Sensitive to market developments and familiar with the rules of international trade, our companies can provide services to help the Mainland enterprises to source for raw materials and other imported goods to meet China's growing demand for them. As an international metropolis, Hong Kong attracts many foreign enterprises and experienced personnel with international outlook. Mainland enterprises can establish purchasing centres in Hong Kong to capitalize on the advantages of Hong Kong, which include a business environment characterized by a high degree of freedom and transparency, and a sound legal system.

9. Under the 11th Five-Year Plan, the Mainland has to continue with its industrial restructuring and expedite the development of its services industry. As Hong Kong is well developed in areas such as financial services, insurance, logistic services, trade and tourism, Hong Kong can play a key role in the development of the services industry on the Mainland, and act as China's service centre with a two-way servicing platform. The Mainland can bring in professionals of the services industry from Hong Kong or from foreign countries through Hong Kong. It can also use Hong Kong to enter into the international market.

10. In response to the "venture out" policy of the Mainland enterprises, Hong Kong can act as a gateway and play an intermediary role. In the past 27 years of market reform and liberalisation, Mainland enterprises basically focused on the "bringing in" of foreign investment. According to the Ministry of Commerce, the foreign capital realized over the period amounted to over US\$600 billion but the outward direct investment only totalled US\$60 billion. In the face of economic

globalization, Mainland enterprises should act proactively to “venture out”. The services industry of Hong Kong enjoys free flow of information. There is a large pool of professional talent who are multilingual, familiar with the rules of international trade, as well as having an international business network. All these are what the Mainland enterprises need.

11. Hong Kong’s services industry is at an advantageous position, but at the same time there are also a number of concerns we need to address. The rent and labour cost of Hong Kong is much higher than our neighbouring regions, and the operating cost is also high. In the Mainland, the market is opening up and attracting more foreign investment. Given the continued reform of the Mainland enterprises, their operation will gradually improve. Moreover, with the Mainland giving strong policy support to their private enterprises, their business are developing rapidly. All these would mean that Hong Kong companies will face severe competition and challenges.

12. Hong Kong is facing increasing competition from the Mainland cities. Developing the services industry is at the core of the industrial restructuring in the Mainland. The 11th Five-Year Plan has called upon the major cities to give priority to the development of the services industry. In their respective 11th Five-Year Plans, cities such as Shanghai and Guangzhou have set for themselves the target of developing into a financial hub or a logistics centre at international or regional level, and have formulated specific policies to achieve the goal. Under the circumstances, although the Mainland services industry may not be able to pose a serious threat to Hong Kong in the short term, it is inevitable that competition will become increasingly intense.

13. Meanwhile, the increasing use of the internet has made a major adverse impact on Hong Kong. Increasingly, buyers prefer to make the purchase through the internet to save the costs of the intermediaries, as well as the rent and the administrative overheads of maintaining an office in Hong Kong. While some multinational corporations may have stationed themselves in Hong Kong to purchase products from the Mainland, they have also established offices in the Mainland. Wal-Mart even withdrew from Hong Kong and established its regional headquarters in Shenzhen last year.

Responses / Actions taken by the Government and Other Sectors

Promotion of Hong Kong Services Industry

14. On the international front, InvestHK is dedicated to attracting inward investment by promoting Hong Kong's advantages as a trading, investment and business hub in Asia. It proactively assists enterprises interested in establishing businesses in Hong Kong and promotes Hong Kong's strength as the base for business and as a springboard to the Mainland market. The major promotion activities include 9 business areas : commercial and professional services; consumption, retail and merchandise; financial services; information technology; telecommunication; media and multi media; technology (including electronic enterprise and biotechnology); tourism and media entertainment; and transport. Moreover, the Trade Development Council (TDC) will promote Hong Kong to the overseas market according to different market needs. For instance, in recent years, the TDC concentrated on the promotion of logistics, information and communication technology to Japan and USA; patent services to South Korea; exhibition services to Germany and UK. Meanwhile, it also receives financial services groups from Europe, Japan and American and promote Hong Kong as the ideal platform for investment, and Asian capital centre.

15. The TDC provides Mainland enterprises with information on both Hong Kong and international markets, publicises our services industry to them, assists enterprises to set up offices in Hong Kong and provides follow up services to these enterprises and encourages them to expand their business. At the end of August 2004, the Mainland introduced new measures to facilitate outbound investments. These measures encourage Mainland enterprises to invest in Hong Kong. As at the first quarter of 2006, 378 Mainland enterprises have been given permission to invest in Hong Kong, with total investment of 2.23 billion Hong Kong dollars. These enterprises not only bring investments into Hong Kong, they also supply products and services and at the same time, increase demands for Hong Kong services.

16. The TDC also plays a key role in promoting trade co-operation between Hong Kong and the Mainland and in consolidating Hong Kong's position as a trade platform for the Mainland. The TDC has 11 offices in the Mainland. It provides matching services to help the Mainland enterprises to seek trade partners in Hong Kong. It organizes promotion

activities in the Mainland with other Hong Kong organizations. These activities include visits by Mainland trade delegations to Hong Kong and vice versa. The visits allow the Mainland enterprises to get a better understanding of Hong Kong services industry and provides opportunities for the Hong Kong services to enter the Mainland market. The TDC's web service also provides Mainland enterprises with information about the Hong Kong and the international market, assists them to devise their business strategies and provides Hong Kong companies with Chinese trade advisory services.

Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA)

17. The Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) has helped Hong Kong's services industry open up an enormous market. Economic co-operation and integration between the two places has been greatly strengthened. Since its implementation in 2004, CEPA has successfully promoted the development of various services industry. The Mainland has opened up 27 service sectors to Hong Kong service suppliers, who can enjoy a "first mover" advantage over other World Trade Organisation members. They can enter the Mainland market ahead of others, and under more favourable conditions. By end-August 2006, 968 Hong Kong registered enterprises had obtained Hong Kong Service Supplier certificates for access to the Mainland under CEPA. More than 80% of them have already set up operations in the Mainland, or are planning to do so. These include enterprises in the banking, distribution, transportation and logistics sectors.

18. According to a report on "The Impact of CEPA on the Hong Kong Economy" completed in April 2005, companies in the 18 service areas covered by CEPA I increased capital investment in Hong Kong by HK\$5.5 billion in 2004 and 2005 because of CEPA. Service receipts generated as a result of CEPA I in 2004 and 2005 amounted to HK\$5.4 billion.

19. Since the implementation of CEPA, Hong Kong has enjoyed continued economic growth. Our Gross Domestic Product rose 8.6% in 2004, 7.3% in 2005, and 8.0% year-on-year in the first quarter of 2006.

20. Through our Economic and Trade Offices, we will strengthen communication and co-operation with provincial and municipal

governments. We will adopt complementary measures to collaborate with the provinces and municipalities to implement CEPA such as information exchange and linkage, as well as trade and investment facilitation. With regard to the development of the provinces and the relevant strengths of our service industries, the Economic and Trade Offices will formulate plans to foster the implementation of CEPA in various provinces by stages. In regards to Guangdong, an Expert Group on Services Implementation under CEPA has been set up under the Hong Kong/Guangdong Co-operation Joint Conference to drive the implementation of CEPA in Guangdong Province.

Strengthening Liaison with Mainland Provinces and Municipalities

21. Hong Kong has worked hard to promote and strengthen mechanisms for co-operation with Mainland provinces and municipalities, and in particular Guangdong Province. These include the Pan-Pearl River Delta Regional Co-operation Framework Agreement, the Hong Kong/Guangdong Co-operation Joint Conference, Hong Kong/Beijing Economic and Trade Co-operation Conference and Hong Kong/Shanghai Economic and Trade Co-operation Conference. Under these cooperation frameworks, Hong Kong and its Mainland counterparts agree to use CEPA as the basis for strengthening exchange and co-operation at the government, enterprise and community levels with emphasis on developing modern services.

22. Apart from co-operation under the CEPA framework, the HKSAR Government also strives to strengthen liaison with our major business partners in the Mainland and to attract them to invest in Hong Kong. In June this year, the Chief Executive led a business and trade delegation to Guangxi and attended the Hong Kong-Guangxi Business Co-operation Symposium to promote the strengths of our services industry and offer assistance to Guangxi enterprises to “venture out” and to expand into overseas markets. The Chief Executive will lead business delegations to other provinces in the Pan-Pearl River Delta, including Hunan, Guizhou and Jiangxi and will also attend the first Expo of Central China for Trade and Investment to be held in Changsha, Hunan this September, with the objective of promoting Hong Kong’s services industry to local governments and enterprises, and strengthening co-operation and exchanges between the governments and enterprises of the two places.

23. To further foster relations between Hong Kong and the Mainland, and to provide support for Hong Kong businesses operating in the Mainland, the Government set up the Mainland Affairs Liaison Office under the Constitutional Affairs Bureau in April 2006. It has since extended the services of the Hong Kong Economic and Trade Office in Guangdong to five provinces in the region, namely Fujian, Jiangxi, Guangdong, Guangxi and Hainan. The Government is planning to set up two more Economic and Trade Offices in Chengdu and Shanghai in the latter half of 2006. The three offices, together with the Beijing Office, will strengthen liaison with the relevant authorities in the Mainland so as to establish a closer working relationship.

Recommendations

24. To maintain its strengths internationally, nationally and in particular in the region, Hong Kong's services industry will have to keep making improvements in terms of efficiency and service standards. Also, Hong Kong must work out the means to sustain its edge as an international trade and business centre in the Mainland market where competition has become increasingly intense, for instance, by keeping up a fully developed market system, international exposure, and the ability to innovate and add value. We should, at the same time, take the initiative to step up exchanges and co-ordination with the Mainland. To tie in with China's development trend of emphasizing services industry development, members are invited to comment on the following recommendations and put forward other worthy suggestions:

- (a) Actively attracting multinational corporations to set up regional headquarters in Hong Kong to take forward high quality research and development, design and marketing projects. With a critical mass of experts and enterprises gathered in Hong Kong, we will gain synergy, which in turn will help maintain Hong Kong's position as the most internationalised service centre in the region. We will also support established Mainland enterprises, including those in the services industry, to use Hong Kong as their base to "venture out". We will help them develop international businesses, build up overseas marketing networks, carry out merger or acquisition locally and overseas, and build up strategic alliances.

- (b) Raising the standard of Hong Kong's services industry. The Government encourages individual sectors of the services industry to formulate long-term Mainland development strategies and to motivate its practitioners to make more proactive and long-term arrangements for the implementation of such strategies, including the development of the interpersonal networks vital to the industry. At the same time, the Government encourages the services industry to make good use of, and to further promote, the Hong Kong brand, ensure quality performance, as well as improve the various monitoring regulations and ensure their proper implementation. The Government also encourages services industry to expand their service targets to include Mainland enterprises so as to help promote standardisation for the Mainland services industry and raise their performance standard.
- (c) The Government will continue to join hands with Mainland provinces and municipalities to promote the advantages of the region to foreign investors, highlighting Hong Kong's role as an effective stepping stone for investors worldwide to enter the Mainland market. Efforts will also be made to encourage multinational corporations to set up regional headquarters or offices in Hong Kong to provide effective support services to their enterprises in the region by utilising Hong Kong's advantages in the services industry. In the 11th Five-Year Plan, it is stressed that *"the rise of the Central Region shall be built on the existing foundation, and achieved through helping its industries move up the value chain, promoting industrialisation and urbanisation, and growing up while exerting the advantages of linking the east and west and industrial development"*. With rich experience in investment, business operation and joint ventures on the Mainland, Hong Kong can play an active role in the economic and trade development of the Central Region.
- (d) Deepening liberalisation measures under CEPA. CEPA is an open agreement which adopts a building block approach. We will, in consultation with the Central Government, make a continued effort to deepen and broaden its content, with a view to facilitating the long-term development of the various services mentioned in the 11th Five-Year Plan, including the financial and information services, logistics, and tourism. The

Government will maintain close liaison with the Ministry of Commerce and other ministries, commissions and authorities under the Central Government that oversee the four service industries mentioned above, so as to broaden and deepen the scope of CEPA. Sector-specific measures to enable Hong Kong businesses to make the best use of CEPA for market access in the Mainland should work to expand the scope of development for our services and optimise the services industry there. A good example is that under a liberalisation measure recently introduced under CEPA, travel agents set up by Hong Kong enterprises can, on a pilot basis, apply to operate group tours to Hong Kong and Macao for residents of Guangdong starting from 2007, implying a very broad scope of cooperation between the two places. Meanwhile, individual liberalisation measures newly added under CEPA should be implemented flexibly, say, ahead of the original schedule, so as to cater for the development needs of individual services;

- (e) Facilitating the implementation of CEPA. While striving for further liberalisation of the Mainland market, the Government aims to seek the policy support of the Central Government to maximise the benefits of CEPA, for instance, introducing amendments to relevant laws and regulations speedily, and fine-tuning the regulatory framework for the services industry. Noting the difficulties reflected by Hong Kong businesses in relation to starting new operations in the Mainland, the Government should explore with various provinces and municipalities the provision of facilitation measures such as one-stop investment advisory services and a designated counter for CEPA-related applications. These measures will help our services industry start business in the Mainland under CEPA.
- (f) Strengthening liaison and co-operation with the Pan-Pearl River Delta as well as other provinces and municipalities. Given our geographical proximity and close economic and trade relations with the Pan-Pearl River Delta provinces/areas, and the signing of the Pan-Pearl River Delta Regional Co-operation Framework Agreement, regional growth remains the core objective and the driving force of co-operation in the region. With the setting up of the Economic and Trade Office in Chengdu and the expanded coverage of the Economic and Trade Office in Guangdong, we

will strengthen our efforts in promoting Hong Kong's services industry in the Pan-PRD region and the effective implementation of CEPA. The Government will see to the early launch of a sector-specific reference database on Mainland policies, laws and regulations, and will organise briefing sessions to acquaint our services industry with the details.

- (g) Using the Hong Kong TDC as a promotion platform. The TDC will strengthen its co-operation with government departments at different levels in the Mainland to facilitate Hong Kong businessmen to seize the opportunities brought about by the implementation of CEPA and the 11th Five-Year Plan. Through the "Guangzhou-Hong Kong CEPA Market Entry Facilitation Group", it will continue to liaise with the industrial and commercial departments of Guangzhou to assist Hong Kong businessmen in resolving the difficulties encountered in obtaining approval for starting businesses and in applying for setting up individually owned stores in Guangzhou. In addition, the TDC will organise more exhibitions in the Mainland and arrange for more trade tours to Mainland cities. It will continue to organise the annual CEO and CFO forums, with forum themes based on the needs of enterprises. Leaders of prominent enterprises, both local and overseas, will be invited to attend these forums to explore opportunities for future development and co-operation. All these efforts will further enhance the level of co-operation between Hong Kong and Guangdong. The TDC will co-organise the first "Expo of Central China for Trade and Investment" to be held in Changsha, Hunan this September in a bid to promote both the services industry and the intermediary role of Hong Kong.

Advice Sought

- (a) Is the analysis on the international competitiveness of Hong Kong's services industry sufficiently comprehensive and thorough? Is there any supplement to the analysis?
- (b) Is the analysis of the opportunities and challenges for Hong Kong's services industry under the national 11th Five-Year Plan sufficiently comprehensive and thorough? Is there any supplement to the analysis?

- (c) Is the analysis of the opportunities and challenges for Hong Kong's services industry under the 11th Five-Year Plan of the Guangdong Province sufficiently comprehensive and thorough? Is there any supplement to the analysis?
- (d) Whether the actions taken by the Government and public bodies can achieve the purposes of consolidating and developing the services industry? How should the strategy be adjusted?
- (e) Whether the issues raised for consideration in this paper and paper 2006 ES/2 concerning the consolidation and development of Hong Kong as an international commercial and trading centre are appropriate issues for further consideration?

Commerce, Industry and Technology Bureau
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