

**Commission on Strategic Development  
Committee on Economic Development and  
Economic Cooperation with the Mainland**

**How to power ahead Hong Kong's economic cooperation  
with the Mainland on all fronts**

**I. Current situation and trends of economic cooperation with the Mainland**

Economic cooperation between Hong Kong and the Mainland has a long history. In the 1950's, entrepreneurs and capital from the Mainland helped promote our industrial development. In the early 1980's, with massive relocation of our manufacturing operations to the Mainland, especially the Pearl River Delta (PRD) region, the manufacturing sector was able to increase production and competitiveness by capitalising on the Mainland's low operating costs. Through years of investment in the Mainland's manufacturing sector, Hong Kong has been facilitating industrialization, rapid economic development and growth of the Mainland, whilst also serving an important intermediary role between the Mainland and the rest of the world.

2. There is indeed very close economic cooperation between Hong Kong and the Mainland. Both parties have been influencing each other through mutual support, forming a closely interwoven relationship as illustrated below:

- The import and export trades and the related producer services, with their value added contribution accounting for over 30% of Hong Kong's GDP, is Hong Kong's most prominent economic pillar. Over the past two decades, the Mainland's total external trade recorded a robust annual increase of 17% on average. During the same period, Hong Kong's import and export trades grew at about 12% annually. Hong Kong's re-export trade to GDP ratio grew to 147% last year, compared with just 21% of the GDP in 1980. Over 90% of Hong Kong's re-export trade is related to the Mainland. In recent years, Hong Kong's off-shore trade development has also been closely related to the Mainland. The Mainland's manufacturing and export activities, and Hong Kong's external trades and related producer services are mutually dependent and at the same time supporting each other.

- The large amount of inward and outward investments signify Hong Kong's highly open economic system. They have made significant contributions to Hong Kong's economic development. The Mainland is a major source of inward investment to Hong Kong. As at the end of 2004, 2 258 Mainland enterprises, approved and recorded by the State Ministry of Commerce, have been established in Hong Kong, involving an aggregate investment of US\$30.4 billion. According to the Census and Statistics Department, as at the end of 2003, the accumulative value of Hong Kong's inward Direct Investment (DI) was HK\$2,960.4 billion at market value. Apart from tax haven economies, the Mainland was a major source of inward DI to Hong Kong, accounting for 26% of the total value. Mainland investments covered a wide range of economic activities including import and export trades, investment holding, real estate, wholesale and retail, finance, transportation, etc., forming a key part of Hong Kong's economy.
- Over the past two decades or so, huge investments from Hong Kong has been a major driving force behind the Mainland's economic development. As at September 2005, there were 250 000 Hong Kong investments in the Mainland, involving a contractual value of around US\$500 billion with a realised amount of US\$254 billion. Investment in Guangdong alone amounted to about US\$100 billion, engaging a workforce of about 10 million. Our outward investment has brought back substantial income. In 2004, income inflow generated from outward DI accounted for 17% of Hong Kong's GDP, of which 40% came from investments in the Mainland.
- With continuously increasing economic cooperation, the border crossings between Hong Kong and the Mainland have become the busiest control points in the world. In 2004, land traffic between Hong Kong and the Mainland registered 9.75 million goods vehicles trips and 4.32 million passenger vehicle trips. Sea traffic to and from Hong Kong involved over 90 000 ocean-going vessels and river vessels. The continuous traffic shows that the cargo and passenger flows between the two places have been growing rapidly and becoming busier and busier. In 2004, over 120 million metric tonnes of goods were transported between Hong Kong and the Mainland by land and by sea, while the number of cross-border trips made by residents of the two places reached 144 million.
- Hong Kong is the largest international financial centre and the most important capital market of China. As at the end of September 2005, there were 318 Mainland enterprises listed on the Main Board and the Growth Enterprise Market, the total equity raised being over HK\$1,000 billion with market capitalisation around HK\$2,600 billion. Currently, Mainland enterprises account for about one third of our total stock market capitalisation, about half of our total market turnover, and as much as 90%

of the Initial Public Offering equity funds raised. They are the most active component of Hong Kong's stock market. Hong Kong is also China's largest fund raising and project financing market outside the Mainland, as well as the principal offshore base of personal financial management for Mainland residents. After more than 20 years of rapid growth, it has become an urgent task for the Mainland to develop, reform and open up its financial sector. Hong Kong should have an active role to play in Mainland's capital intermediation and financial reform.

- Tourism is one of Hong Kong's pillar industries. The Mainland factor was particularly important to this industry because the Mainland, especially the PRD region, apart from being Hong Kong's major source of visitors, has developed with Hong Kong into an integrated tourism market. In 2004, the number of visitors to Hong Kong reached an all-time high of 21.81 million, of whom 12.25 million or 56% were from the Mainland, accounting for about 60% of the increase in tourist arrivals. Mainland visitors rank top in tourist spending, accounting for about 70% of the total tourist spending. Hence a major influence to the retail market. In the first nine months of 2005, Mainland visitors under the Individual Visit Scheme continued to surge by 37.1%. They have become the major driving force that rekindles the growth of tourism, consumer spending and other related sectors in Hong Kong. A Greater PRD tourism ring has been formed within which Hong Kong and the neighbouring areas complement each other's edge to achieve mutual prosperity and growth. Hong Kong's tourism industry can leverage this "Greater PRD brand" to attract more visitors. At the same time, large number of Hong Kong residents are travelling to and from the Mainland, about 6 million visitors trips a month, providing a major source of tourist income for the Mainland.
- Close economic cooperation with the Mainland has created many employment opportunities for Hong Kong residents. As shown by a survey conducted by the Census and Statistics Department from January to March 2005, some 238 000 Hong Kong residents had worked in the Mainland during the 12 months before the survey. According to the "Made in Pearl River Delta-the Metamorphosis of Hong Kong's Manufacturing industry" study conducted by the Federation of Hong Kong Industries in 2002, it was estimated that about 63 000 Hong Kong companies were engaged in production activities in the Mainland with 477 000 Hong Kong-based employees, about 14.8% of Hong Kong's total employment. Together with the employees of the firms directly involved in providing support services to these enterprises, over 500 000 jobs have been created for Hong Kong residents as a result of our business development in the Mainland. If the jobs created by Mainland investments and tourist spending in Hong Kong

are also taken into account, the contributions of the economic cooperation between the two places to employment in Hong Kong are even greater.

3. The four major industries, namely financial and professional services, trading and producer services, tourism, and logistics, contribute to over 50% of Hong Kong's GDP. These industries are the most important initial source of income and source of external income. They also account for 44% of the total employment in Hong Kong. Their activities are closely linked with economic cooperation with the Mainland, either forming a product supply chain (e.g. trading and related producer services) with the Mainland or targeting the Mainland as the major market (e.g. tourism and certain financial services). It is estimated that the value added directly resulting from economic cooperation with the Mainland accounts for at least 30% of Hong Kong's GDP, while its share of total employment is at least 25%. They provide an impetus for the prosperity and development of Hong Kong.

4. Against this background, the SAR Government attaches great importance to our economic cooperation with the Mainland. We have adopted a series of policies and measures to enhance cooperation. First, we have determined the direction and strategy for development, with "leverage the Mainland, engage the world, and act as a bridge linking the Mainland and the world" as our main development strategy. We aim to seize the opportunities brought about by the Mainland's rapid economic development, and to consolidate Hong Kong's position as Asia's world city and a key international financial, trading, transportation and information hub. We believe that being a multi-functional international centre, Hong Kong has a pivotal and unique role to play in the opening up and development of the Mainland.

5. Second, we are committed to promoting and implementing the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA), with a view to providing a new platform for enhanced cooperation. Since its implementation in 2004, CEPA has been functioning well on the whole. Agreement has recently been reached on CEPA III, under which all products of Hong Kong origin may be imported into the Mainland tariff free. On trade services, further liberalisation measures have been introduced for the 27 sectors that have already been covered, including some professional service sectors. The Individual Visit Scheme launched under CEPA brought about 4.26 million additional trips and \$6.5 billion in additional tourist spending by Mainland visitors in 2004 alone. According to an internal assessment, over 29 000 jobs would be created for Hong Kong residents in the first two years of the implementation of CEPA, which could lower the unemployment rate by at least 0.8 percentage point.

6. Third, we take part in promoting regional economic cooperation. The Pan-PRD regional cooperation initiative launched last year enables Hong Kong to expand its economic hinterland from PRD to the enormous region of nine provinces/region of southern China, which covers an area of 2 million square kilometres with a population of 460 million. The SAR Government is determined to take part in promoting Pan-PRD cooperation by leveraging our strengths to actively provide services that can facilitate development in the Pan-PRD region and help the Pan-PRD provinces/region to go out beyond the Mainland. Hong Kong/Guangdong cooperation features prominently in the Pan-PRD regional cooperation. Through concerted efforts of the Hong Kong and Guangdong governments, the scope of cooperation keeps expanding. Significant results have been achieved in areas such as investment and trade, cross-border infrastructure, facilitating people and cargo flows, environmental protection and hygiene, implementation of CEPA, attracting Guangdong enterprises to Hong Kong, technology and education, as well as joint overseas promotion. In the eighth plenary session of the Hong Kong/Guangdong Cooperation Joint Conference held in last September, the two sides agreed to step up cooperation in information sharing and food safety. Hong Kong will also work closely with Shenzhen in border control point development, infrastructural planning, food safety, law and order, ecological improvements, as well as development of the land along the border.

## **II. Major issues pertaining to Hong Kong and Mainland cooperation**

7. After a prolonged and painful restructuring, the Hong Kong economy finally showed signs of a strong rebound in 2004 and has continued to grow strongly in 2005. The problems of unemployment, deflation, negative equity and fiscal deficit that have troubled Hong Kong for a long time have been alleviated or resolved. Our economy is now facing favourable opportunities for accelerated development mainly because the Mainland is formulating its Eleventh Five-Year Plan, the target of which is to achieve by 2020 a quadruple growth in GDP from 2000. This implies that for the next 15 years, the Mainland economy will continue to develop rapidly. It is likely to become the second largest economy and the largest trading nation in the world. As a multi-functional international services centre, Hong Kong can contribute to the development of the Mainland and benefit from the Mainland's economic development. Furthermore, regional economic cooperation is gathering momentum in Asia. The formation of the China-ASEAN (10+1) Free Trade Area, enhanced economic cooperation between China and the seven countries of South Asia, and other developments, will open up more opportunities for Hong Kong, which is strategically located at the heart of the Asia-Pacific region.

8. Against this background, we believe that as a highly open and developed economy, Hong Kong will continue to maintain its edge and provide useful support to the Mainland. In the future, Hong Kong will continue to play an active role in the Mainland's building of a moderately prosperous society. We can put into full play our strengths, such as our business acumen, flexible financial system, sound legal system, free and open policies, as well as our international flavour, to provide strong support for the modernisation of the Mainland. However, we have to recognise that there are challenges. For instance, some of our intermediary functions will be weakened by the opening up of the Mainland to the outside world; competitive pressure from the rapidly rising Mainland metropolises; the restructuring of Guangdong industries towards heavy and chemical industries and productive service industries will present new issues for Hong Kong/Guangdong cooperation. We need to seriously take stock of the new situation and find ways to solve the problems, in order to seek a breakthrough in the economic cooperation between Hong Kong and the Mainland. Issues that need to be considered include the following:

**(1) Should Hong Kong be included in national development strategies and planning?**

9. Economic cooperation between Hong Kong and the Mainland has intensified over the past two decades and has brought about a clear division of labour between Hong Kong and the Mainland, particularly the PRD region. This cooperative relationship has developed primarily as a result of market forces. The new direction of our economic development is to seek an enhanced level of economic cooperation with the Mainland with a view to fully capitalising on our strengths to provide better services for the booming Mainland economy. This will make Hong Kong a major services centre of China, and also strengthen our status as a major international services centre.

10. The recently announced Eleventh Five-Year Plan has also described maintaining Hong Kong's status as a multi-functional international centre. Nevertheless, it should be noted that the description will neither change Hong Kong's position as an "external economy" nor establish any positioning for Hong Kong through national strategies and policies. Therefore, there are views that Hong Kong should be included in the national development strategies and planning under the "One Country, Two Systems" principle to confirm our unique functions and position, as well as our role in the opening up and development of the country. This will not only be beneficial to the long-term prosperity and stability of Hong Kong, but also to the reform, opening up and modernisation of the Mainland. However, there are also views that the inclusion of Hong Kong in the national development strategies and planning will undermine the autonomy of the Hong Kong economy and arouse concern in the international community, which will impact "One Country, Two Systems".

Even if the inclusion is legally feasible, there remains the issue of how Hong Kong should consult with the Central Government.

11. The merits and demerits of including Hong Kong in the national development strategies and planning and how it should be done require careful consideration. An option that may be even more favourable to Hong Kong is to continue to adopt the current statement on the strategic development of Hong Kong and Macao in the recently announced Eleventh Five-Year Plan : to maintain Hong Kong and Macao's long term prosperity and stability; to strictly observe a high degree of autonomy - "One Country, Two Systems"; "Hong Kong people governing Hong Kong" and "Macao people governing Macao"; to strictly comply with the basic laws of the special administrative regions; to strengthen and promote cooperation in business and trade, science and education, culture, sanitation, sports, etc. among the Mainland, Hong Kong and Macao; to continue to implement CEPA with Hong Kong and Macao; to strengthen cooperation in infrastructure, development of industry sectors, resource utilisation, environmental protection, etc. between the Mainland, Hong Kong and Macao; to support Hong Kong's development in finance, shipping and transportation, tourism, and information services; and to maintain Hong Kong's status as international financing trading, shipping and transportation centre.

**(2) How to enhance the status and role of Hong Kong in the opening up of the Mainland to the world?**

12. With the impending end of the phase-in period of China's accession to the World Trade Organisation, the Mainland is going to open up to the world and comply with international standards in more areas. With the opening up of the economy and the rapid reform of the financial system in the Mainland, many transactions and activities that could not be carried out outside the Mainland in the past could become feasible in the future, such as a Renminbi derivatives market, etc. Because of its mature and sound financial system, Hong Kong could become an off-shore centre for Renminbi transactions at the right moment. However, as this involves the country's overall opening up strategies and policies, the feasibility and implementation of this option should be further explored. Furthermore, given the country's endeavour to change the mode of growth from intensive to extensive, further consideration should also be given to how best Hong Kong can assist the Mainland to further develop external economic and trade cooperation, including maintaining a healthy growth in exports, enticing and enhancing the quality of foreign investments and capital, building brand names, and facilitating integration with the international markets.

### **(3) How to attract Mainland enterprises to invest in Hong Kong?**

13. To be a services hub for China, Hong Kong in the long run has to develop a headquarters economy to become home to the head offices and operations centres of Mainland enterprises. Although Hong Kong has many attractions as the regional headquarters for Mainland enterprises, existing constraints on capital flow, scopes of investment, and movement of people have made it difficult for Mainland enterprises to enter Hong Kong freely. Shanghai, on the other hand, is not subject to any restrictions and has attracted a substantial number of enterprises from other parts of the country to expand their business and set up head offices or branches there. In 2004 alone, 15 000 enterprises from other parts of the country invested some RMB 60 billion in Shanghai. It can be seen that in developing a headquarters economy, Hong Kong faces keen competition from Shanghai. Under the prevailing conditions, how should we give full play to our strengths with a view to attracting Mainland enterprises to invest and set up offices or regional headquarters here, to develop their international businesses? What can we do to overcome the barriers against Mainland enterprises, especially private enterprises, coming to Hong Kong to invest and develop their businesses?

### **(4) How to enhance circulation and integration of Hong Kong and the Mainland's talent?**

14. In the coming years, the Mainland economy will strive for, among other important goals, a new mode to achieve economic growth by enhancing capability in self-innovation. To achieve this, the Mainland will have to make breakthroughs in scientific and technological developments, and human resources development. If Hong Kong is to service the Mainland economy, we have to follow closely its development direction and meet its demands. Since science and technology are untrodden areas in terms of cooperation between the two places, should we put in more efforts in these areas; if so, should we start with upgrading our own research and development capabilities or the manufacturing industries in Hong Kong and the PRD? Or, should we further leverage on our financial centre functions to provide financial services such as provision of venture capital, to expedite industrial restructuring in the region? In order to maintain our competitiveness, promote our international status, and improve our quality of life, we have to maintain our edge in attracting and retaining talent. As a bridge linking the Mainland and the international community, Hong Kong needs a large pool of talent who are familiar with the situation in both places. In this connection, we have to speed up the nurturing of our own talent and bring in talent in various fields from the Mainland as well. What policies should Hong Kong adopt to better attract Mainland talent to pursue their careers in Hong Kong? Could increasing the number of Mainland students to be admitted to our tertiary institutions achieve such a target?



**(5) How to expedite total integration between Guangdong and Hong Kong in the new era?**

15. It is a irreversible trend that Guangdong and Hong Kong will be integrating more comprehensively in various aspects. At the sixth plenary session of the Hong Kong/Guangdong Cooperation Joint Conference, both sides set out the common direction and objective of jointly developing the Greater PRD into the most dynamic economic region in the world, and reached a consensus on the division of labour between the industries of the two places. However, certain new developments in the Hong Kong and Guangdong cooperation over the past two years have prompted us to further consider how best we should speed up the integration process. The more important issues include:

(1) With further development and upgrading of the Guangdong economy, there have been continued changes to the previous “front shop and back plant” mode of cooperation. The need or otherwise to establish a new mode of cooperation, in the light of various changes, to expedite total economic integration of the two places is a priority issue to be considered.

(2) In recent years, Guangdong industries have undergone significant restructuring. Heavy and chemical industries have been developing rapidly as new pillars of the economy. As our link with Guangdong’s heavy and chemical industries is relatively weak, what should we do to adapt to these changes? Also, how to prevent the worsening of the air and water quality in the region arising from the development of Guangdong’s heavy and chemical industries?

(3) In the face of scarcity of resources, labour shortage and rising operating costs, Guangdong has to upgrade its economic structure by developing high value-added industries. As most of the Hong Kong manufacturing operations in Guangdong are labour-intensive, what should we do to expedite their restructuring and upgrading?

(4) Guangdong is vigorously developing productive services industries, including logistics, trading, convention and exhibition, and producer services. This has brought about investment opportunities and keen competition for Hong Kong as well. The most notable example is the logistics industry. How should we maintain our competitiveness? With high operating costs, the competitiveness of some low value-added operations of the logistics industry, such as port cargo transport, is diminishing. Should these operations be retained or phased out? How should they be phased out and what measures should be taken to address the employment needs of the displaced workers?

**(6) How to strengthen cooperation between Hong Kong and the rapid growing regions (e.g. Yangtze River Delta and Bohai Rim) in the Mainland?**

16. The national economic growth points are moving from Guangdong, in the early stage of economic reform, to Yangtze River Delta and Bohai Rim most recently. Whilst strengthening economic ties with Guangdong, Hong Kong should also proactively develop cooperation with other rapidly developing regions in order to achieve our objective of sustainable development. How should we provide our quality services (e.g. regional headquarters function, financial and other professional services) to the regions more physically distant from us?

**(7) What measures should be adopted by the SAR Government to enhance cooperation?**

17. What policies and measures of greater intensity should be adopted by the SAR Government to further promote economic cooperation between the two places? If CEPA is the major platform for cooperation between Hong Kong and the Mainland, how should we introduce new liberalisation measures while implementing and promoting CEPA within the framework of the first three phases? Is it necessary and possible for Hong Kong to conclude similar CEPA or free trade agreements with other places? To encourage the upgrading of our manufacturing operations in Guangdong, should the SAR Government adopt special policies to support them, such as providing the enterprises with concessions or subsidies for scientific and technological research and development? Should the SAR Government help Hong Kong services sectors and providers to overcome the barriers that they encountered when entering the Mainland market under CEPA, say, by concluding agreements with local authorities in the Mainland? All these are pressing issues that require thorough consideration.

(Statistics quoted in the paper are mainly obtained from the Census and Statistics Department of the HKSAR Government and the State Statistics Bureau.)

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