

For information
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LegCo Panel on Manpower

Implications of Government Procurement of Goods and Services under World Trade Organization Agreement on Government Procurement on Local Employment

Purpose

This paper briefs members on the implications of imposing a requirement that priority be given to safeguarding the employment opportunities for local workers in government procurement of goods and services under the World Trade Organization Agreement on Government Procurement (WTOGPA).

Background

2. At the meeting of the LegCo Panel on Manpower held on 17 November 2005, Members urged the Government to conduct a comprehensive review of its procurement policy under the WTOGPA and impose a requirement that priority be given to safeguarding the employment opportunities for local workers in government procurement of goods and services; or otherwise to withdraw from the WTOGPA.

Background of WTOGPA

3. The WTOGPA aims at ensuring that its contracting parties conduct government procurement in accordance with the two major principles of “non-discrimination” and “transparency” so as to obtain the value for money. The spirit and objectives of the WTOGPA are fully consistent with the Government’s procurement policy. Joining the WTOGPA in 1997 has not led to any change in the Hong Kong Special Administrative Region (HKSAR) Government’s procurement policy.

Government procurement policy

4. The HKSAR Government’s procurement policy has always been guided by the principles of fair and open competition, transparency, public accountability and value for money. By encouraging participation through such principles, the Government seeks to procure goods and services available in the market through the most competitive tenders offering the value for money.

Imposition of a requirement giving priority to safeguard the employment opportunities for local workers

5. In line with our procurement policy and the WTOGPA, the HKSAR Government formulates, adopts and applies tender specifications according to the functions and performance of the products or services to be procured, not their brand or origin. Fair treatment is thus accorded to different origins and no requirement for local content or local production has been imposed. The WTOGPA also expressly prohibits the use of measures to encourage local development by means of requirements on domestic content¹.

6. Nevertheless, we have examined whether introducing a local content or local production requirement in the procurement of goods and services would indeed facilitate local employment and the implications of introducing such a requirement. Our findings and conclusion are set out in the ensuing paragraphs.

Procurement of goods

Size of government procurement of goods

7. In 2005, the total value of goods procured by the Government amounted to \$5.1 billion. This constituted only about 0.37% of our Gross Domestic Product (GDP)². Given the relatively small size of government procurement as against the whole local economy, any change in procurement policy such as requiring the goods to be procured to be produced locally is unlikely to attract suppliers to establish production facilities in Hong Kong, thereby creating a significant impact on the overall employment situation.

8. In response to some Members' suggestion, we have also examined the feasibility of requiring government uniforms and shoes to be procured from local manufacturers so as to create employment, particularly for small and medium-sized enterprises (SMEs). At present, the total value of all the government uniforms provided by the Government's contractors only amounts to some \$7.2 million in 2005. As for shoes, 22% (or \$2.1 million) were

¹ "Offsets" are prohibited by Article XVI of WTOGPA. A footnote to Article XVI defines "offsets" in government procurement as measures that are used to encourage local development or improve the balance-of-payment accounts by means of domestic content etc. Accordingly, any content requirement or favourable treatment accorded to domestic goods or services with a view to encouraging local employment will violate the rules against offsets. This prohibition is absolute.

² According to the Census and Statistics Department's Hong Kong Statistics (version as at 23 May 2006), Hong Kong's GDP in 2005 was \$1,382 billion.

uniform leather shoes produced by the Correctional Services Industries (CSI) for the disciplinary services departments and the Food and Environmental Hygiene Department (FEHD). The other 78% (or \$7.6 million) are procured by departments from the market. Given the small value involved, even if all the government uniforms and shoes (other than those for disciplinary services departments and FEHD which are already produced locally by CSI) were to be made in Hong Kong, and assuming that there will be suppliers willing to produce them locally, the number of local jobs to be created will be minimal.

Availability of goods

9. Of the \$5.1 billion of goods procured by government departments in 2005, \$3.5 billion was procured through tender by the Government Logistics Department (GLD). Of the \$3.5 billion of goods procured, \$3.4 billion (or about 97% in value) were not of Hong Kong origin. This is because the manufacturing base of Hong Kong has expanded beyond its boundary, with activities in Hong Kong focusing more on niche market products, as well as the higher value-added and knowledge intensive manufacturing processes. Even for some common items such as printing paper, toilet paper, steel chairs and cabinets, a review of the tender records shows that no offer of goods from Hong Kong origin was received. Details are at [Annex 1](#). Judging from this, departments may have practical difficulties procuring a large number of goods required for their daily operations if a local content or local production requirement is imposed.

Cost of goods of Hong Kong origin

10. A study on the common items procured through tenders, e.g. canteen chairs, steel storage racks, partition screens and workstation panels, revealed that there were price differences ranging from 50% to over 500% between the tenders offering goods of Hong Kong origin and those offering goods of other origins, many of which were from the Mainland. A list of the common items purchased by GLD in 2003-2005 with offers of goods of Hong Kong origin is at [Annex 2](#) for reference. In fact, requiring contractors to supply only goods of Hong Kong origin would restrict the contractors from using the best resources and technology in the market. This may not be in the overall public interest of Hong Kong.

11. Given the relatively small value of government procurement, the majority of the goods have to be sourced from outside through local suppliers or traders. We have considered giving preference to local companies for procurements not subject to WTOGPA but find this not practicable. Nowadays, it is simply not possible to distinguish local companies from overseas companies established in Hong Kong. As a matter of fact, many firms doing business in

Hong Kong may have an overseas origin but have established their offices in Hong Kong for decades. They have local business licences and local employees. Changes of ownership/partnership through business merger and acquisition often make it more difficult and not meaningful to distinguish whether they are local or non-local companies. Restricting procurement to local companies is not in line with Government procurement principles of open and fair competition and WTOGPA's non-discrimination principle.

Administrative and enforcement problems

12. There will also be practical administrative and enforcement problems if a local content or local production requirement is imposed. The procuring departments may need to carry out inspection into the production process to ensure compliance with the requirement by the contractors. This will lead to additional administrative cost. While this problem may partly be solved if the contractor is required to obtain a Certificate of Hong Kong Origin for reference by procuring departments, this may create a barrier or financial burden to doing business in Hong Kong and is not in line with our policy of creating a business-friendly environment for SMEs.

Procurement of non-construction services

13. In 2005, the value of government expenditure on procurement of non-construction services was \$5 billion, about 0.36% of our GDP. These services were mostly for the provision of cleansing, security, property management and IT services.

14. By the nature of these services which involve delivery on-site, and by virtue of the current policy on importation of labour, the concerned services are already sourced principally from local suppliers and are delivered by local workers.

15. We have examined the feasibility of imposing local content or local production requirement when outsourcing government printing service orders (which is not included in our WTOGPA specific commitments and hence is not subject to the WTOGPA).

16. The total value of government printing service orders has decreased in recent years from around \$300 million in 2002-03 to \$238 million in 2005-06 owing to the increasing use of electronic means and economy measures. Most of these orders were handled in house by GLD which will only arrange outsourcing if it does not have the necessary skills or equipment. The total value of all orders outsourced by the Government has decreased from \$61.5 million in 2002-03 to \$40.7 million in 2005-06. In 2005-06, over 60% of

the orders outsourced by GLD had a value of less than \$5,000 each. Although we do not require the successful tenderers to specify where the outsourced work is performed, all these orders were awarded to local printing service suppliers. We are given to understand that most of our local contract suppliers have printing facilities in Hong Kong. In view of the small value and the urgency of these orders, we believe that most orders were carried out in Hong Kong. The situation for orders outsourced by individual bureaux/departments may well be similar.

17. According to the Annual Survey of Industrial Production conducted by the Census and Statistics Department, the business receipt of the printing, publishing and allied industries in 2004 was \$29,221 million (figure for 2005 is not yet available). The value of government outsourced printing service orders in 2004 (\$50.8 million) only accounts for about 0.17% of the business receipt of this sector. Given that outsourcing only constitutes a relatively small fraction of Government's printing orders and an insignificant proportion in the total business receipt of the printing industry, imposing the local content or local production requirement would unlikely have any significant impact on the overall employment situation.

Procurement of construction services

18. In 2005, the value of government construction works amounted to \$26.5 billion (about 1.92% of our GDP). In the past five fiscal years, the Government spent a total of \$145 billion on construction projects – an average of \$29 billion per year – providing about 41 000 job opportunities for construction workers and 4 200 for professional and technicians per annum. However, public spending in the construction sector compared to the private sector is about 1 : 3 only. The majority of workers employed for public works are local workers by virtue of the prevailing labour importation policy.

Use of pre-fabrication

19. The WTOGPA does not impose any requirement on the use of pre-fabrication nor the place of production of pre-fabricated units. The widespread use of imported pre-fabricated units is a result of market force and technological advancement. Apart from cost saving, some pre-fabrication works actually cannot be done in Hong Kong because of their large scale and environmental impact. For instance, there is currently no local company specialising in producing large-scale pre-fabricated units of civil engineering works in Hong Kong. Besides, the technology development of pre-fabrication has improved efficiency, quality assurance of the construction process, environmental performance as well as site safety.

20. The practice of using pre-fabricated units produced outside Hong Kong for housing development has been in place since mid-1990s, before Hong Kong's accession to the WTOGPA. At present, about 20% of the reinforced concrete volume in building construction works of the Housing Authority (HA) involves pre-fabrication and such pre-fabricated units are manufactured outside Hong Kong. There is an exceptional case for a pilot project with 60% precasting, including major precast structural walls that are first used in public housing developments. For this project, the HA requires that the structural walls must be pre-fabricated on site to ensure effective quality control, whereas other precast units may be produced elsewhere. The HA will review the performance of this project after its completion. At present, there is no plan for increasing the use of prefabricated units in other public housing developments.

21. For projects in the public works programme scheduled to commence over the next 24 months, it is estimated that only about 1.6% of the total expenditure would be spent on prefabrication works for infrastructure projects. We do have cases of special consideration which prohibit prefabrications of certain construction elements, such as the Tamar project for security reasons. Such prohibitions will be similarly considered for projects which warrant special attention on the proviso that the WTOGPA provisions are complied with.

Other considerations

22. Imposing a local content or local production requirement will cast serious doubts on Hong Kong's policy of free trade and fair competition, and seriously undermine investors' confidence in Hong Kong's business environment and the Government's determination in maintaining a level playing field. This may adversely affect inward investment, overall economic competitiveness of Hong Kong and ultimately local employment opportunities.

Withdrawal from the WTOGPA

23. Our long-standing government procurement policy as set out in paragraph 4 above is proven to be effective in ensuring that public money is well spent through an open and transparent procurement process. This policy will remain the same regardless of the value of the procurement and whether we are a signatory of the WTOGPA. Backtracking from the WTOGPA and imposing a requirement giving priority to safeguarding the employment opportunities for local workers in the Government's procurement will therefore only result in a very negative impact on Hong Kong's international image as a free trade centre among overseas investors. It would seriously undermine the confidence of overseas investors in the fairness and openness of Hong Kong's business environment. Other signatories to the WTOGPA, including our major trading

partners like the United States and the European Union, may also deny Hong Kong traders access to their government procurement markets. This could result in our traders being discriminated in these government procurement markets.

Conclusion

24. Given the above considerations, it would not be practicable to impose a local content or local production requirement in government procurement. Moreover, such a change in the HKSAR Government's procurement policy is unlikely to generate significant local employment opportunities, and would create practical operational and enforcement problems as well as making our procurement more costly.

25. Nonetheless, we will continue to invest in public works and municipal projects, expedite urban renewal and promote maintenance and management of old buildings by the private sector in a bid to create jobs for the most hard-hit sector of the construction industry, though its jobless rate has fallen from the peak of 20% in August - October 2003 to the latest 11.3%. The commencement of the new Government Headquarters and Legislative Council Building project will provide some respite with the creation of some 2 700 construction jobs. The HKSAR Government will continue to earmark an average of HK\$29 billion annually for public works and municipal projects. A considerable number of construction and technical jobs will be generated. Meanwhile, it is estimated that 37 new hotels will be built in the coming five years (i.e. 2006 to 2010). These will provide more jobs for the construction sector. Consistent with the government procurement principles and the provisions of WTO GPA, consideration is being given to explore the feasibility of including enhancement of employment opportunity as one of the criteria in tender assessment to facilitate bidding for government contracts by social enterprises.

26. The Government will continue to adopt a pragmatic approach and spare no efforts in facilitating employment, taking into account various policy considerations. The Administration will continue to promote economic growth, thereby increasing employment in the market.

Commerce, Industry and Technology Bureau
Environment, Transport and Works Bureau
Financial Services and the Treasury Bureau
Government Logistics Department
Housing Department
Labour Department

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Annex 1**Common items purchased by GLD in 2003 – 2005
with no offer of goods of Hong Kong origin**

Description	No. of items	No. of tender offers by place of origin of goods			Place of origin of goods procured	Contract value of goods procured
		<i>Mainland China</i>	<i>HK</i>	<i>Others</i>		
Printing Paper for Office Use A4 and A3 sizes	4	0	0	7	Indonesia	\$73.00M
Enamel and Paint	21	8	0	7	Mainland China	\$1.20M
Office Sundries	23	20	0	4	Mainland China	\$2.70M
Toilet Paper	1	21	0	1	Mainland China	\$13.80M
White Cotton Gloves	1	24	0	3	Mainland China	\$2.20M
Cleansing Materials	4	7	0	0	Mainland China	\$2.20M
Sofas	6	36	0	0	Mainland China	\$0.63M
Vertical Steel Filing Cabinet	1	32	0	2	Mainland China	\$6.56M
Steel Office / Visitor / Meeting Chair	1	37	0	17	Taiwan	\$19.72M
Hand Roll Paper Towel	1	18	0	4	Mainland China	\$1.11M
Paper Towels (Manifold)	1	22	0	4	Mainland China	\$3.61M
Removable Self-stick Note Pads and Paper Strip	4	11	0	2	Mainland China	\$1.17M
Floppy Diskettes	1	6	0	6	Mainland China	\$1.56M

**Common items purchased by GLD in 2003 – 2005
with offers of goods of Hong Kong origin**

Description	No. of items	No. of tender offers by place of origin of goods			Place of origin of goods procured	Contract value of goods procured (A)	Offer of goods of HK origin (B)	Price difference between (B) and (A)	
		Mainland China	HK	Others				Amount	Percentage
Cleaning Rags and Cotton Waste	3	7	1	1	Mainland China	\$3.80M	\$6.90M	\$3.10M	+ 82%
Canteen Chair, Straight Back	1	34	2	1	Mainland China	\$0.24M	(i) \$0.67M	\$0.43M	+ 178%
							(ii) \$1.52M	\$1.28M	+ 529%
Chair Stackable, Polypropylene	1	43	1	10	Mainland China	\$0.46M	\$0.81M	\$0.35M	+ 75%
Steel Storage Racks	10	21	1	2	Mainland China	\$3.60M	\$10.47M	\$6.87M	+ 189%
Partition Screens & Workstation Panels for Government Property Agency	1	19	1	0	Mainland China	\$2.19M	\$3.33M	\$1.14M	+ 52%
Chair Stackable, Polypropylene	1	34	1	6	Mainland China	\$0.57M	\$1.45M	\$0.88M	+ 154%