

For information

**LEGISLATIVE COUNCIL PANEL ON  
COMMERCE AND INDUSTRY**

**MAINLAND AND HONG KONG  
CLOSER ECONOMIC PARTNERSHIP ARRANGEMENT  
(CEPA)**

**IMPACT ON THE HONG KONG ECONOMY**

**PURPOSE**

This note informs members of the key findings of a study of the Administration on the impact of the first three phases of CEPA<sup>1</sup> on the Hong Kong economy.

**DETAILS**

2. At the meetings of the Commerce and Industry Panel on 15 February 2005 and 19 April 2005, the Administration briefed members respectively on the preliminary and final findings of a study on the economic impact of the first phase of CEPA<sup>2</sup> (vide CB(1)861/04-05(03) and CB(1)1259/04-05(03)). Since then, CEPA has further expanded to allow zero tariff treatment for imports of all Hong Kong products which meet the CEPA rules of origin criteria starting from 1 January 2006 and to provide new preferential treatments for Hong Kong service suppliers in 27 services areas (from 18 service areas in the first phase).

3. Pursuant to further liberalisation under CEPA, the Administration decided in the third quarter of 2006 to update the impact of CEPA on the Hong Kong economy. The study is also in line with a recommendation made by the Focus Group on Trade and Business (the Focus Group) established under the Economic Summit on “China’s 11<sup>th</sup> Five-year Plan and the Development of Hong Kong” conducted in September 2006, proposing that the Administration should carry out researches on the economic benefits of CEPA to Hong Kong so as to facilitate CEPA promotional work.

<sup>1</sup> The first three phases of CEPA refers to the CEPA, the Supplement to the CEPA, and the Supplement II to the CEPA, major liberalisation measures of which took effect in January 2004, January 2005 and January 2006 respectively.

<sup>2</sup> The study on the first phase of CEPA covered the actual economic impact of CEPA in 2004 and the expected economic impact in 2005, as a result of the major liberalisation measures which took effect in January 2004.

4. This latest study was conducted by the Commerce, Industry and Technology Bureau, in collaboration with the Trade and Industry Department, the Economic Analysis and Business Facilitation Unit and the Census and Statistics Department. The Hong Kong Tourism Board also provided inputs to the study. Data collection and analysis took place in the fourth quarter of 2006 and the first quarter of 2007. The study mainly covers three areas of CEPA, namely trade in goods, trade in services, and the Individual Visit Scheme (IVS).

5. Besides findings on the economic impact of the first three phases of CEPA between 2004 and 2006, the study also offers a forecast of its impact on the Hong Kong economy in 2007 and beyond. Detailed findings are set out in the study report in Attachment I. A gist of the key findings is set out below.

### **Benefits to Hong Kong**

#### Trade in Goods

6. For trade in goods, 89% of the responding companies considered CEPA beneficial to the Hong Kong economy and 77% considered CEPA beneficial to the manufacturing sector. Respondents from the pharmaceutical industry, and the food and beverages industry accorded the highest recognition to the usefulness of CEPA.

7. CEPA induced net additional capital investment in Hong Kong, amounting to HK\$103 million in 2005, HK\$202 million in 2006, and a planned HK\$239 million in 2007 and beyond<sup>3</sup>. Establishments engaged in the manufacturing/exports of pharmaceutical products topped the list in terms of total actual and planned capital investment in 2005 to 2007 and beyond.

8. As at end 2006, 19 033 CEPA certificates of origin were issued and products with a total value of about HK\$6.8 billion were entitled for tariff free treatment upon importation into the Mainland<sup>4</sup>. Most commonly exported products include pharmaceutical products, plastics and plastics articles, and textiles and clothing.

<sup>3</sup> Figure for 2004 not available. The first economic impact assessment did not cover data on capital investment induced by the liberalization of trade in goods under CEPA.

<sup>4</sup> As at end April 2007, 22 429 CEPA certificates of origin were issued, involving over HK\$8 billion worth of exports.

## Trade in Services

9. For trade in services, 74% of the responding companies considered CEPA beneficial to the Hong Kong economy, and 47% considered CEPA beneficial to their own industries. Respondents from the banking services, accounting, auditing and bookkeeping services, and legal services accorded the highest recognition to CEPA for benefiting their industries and their establishments.

10. The first study gathered that the CEPA-induced additional capital investment in 2004 stood at HK\$1.0 billion. According to the current study, the cumulative amount of additional capital investment rose to HK\$4.8 billion by 2006, representing an increase of 380% over two years. The expected capital investment in 2007 and beyond totalled HK\$2.4 billion. The distribution services, and the freight transport and logistics services contributed the bulk of actual and planned additional investment in 2004 to 2007 and beyond.

11. As at end 2006, 1 021 Hong Kong Service Supplier (HKSS) applications were approved with 1 697 HKSS certificates issued<sup>5</sup>. Services areas most commonly applied for include transport and logistics services, distribution services, advertising, and construction services.

## Individual Visit Scheme

12. As at end 2006, the Individual Visit Scheme (IVS) was implemented in 44 Mainland cities<sup>6</sup> and Mainland residents made over 17.2 million trips to Hong Kong under the IVS, accounting for 39% of all the trips made by Mainland visitors (43.6 million trips) to Hong Kong. The percentage share concerned increased from 28% in 2004.

13. The IVS visitors generated an additional tourist spending of HK\$ 22.7 billion between 2004 and 2006. The additional spending concerned was estimated at HK\$9.3 billion in 2006, almost 38% higher than that in 2004. Major spending was made in the retail sector, hotel accommodation and restaurants.

## Job Creation under CEPA

14. The first study estimated that the first phase of CEPA created about 29 000 jobs for Hong Kong residents in 2004 and 2005. The current study estimated that about 35,000 new jobs were created for Hong Kong residents in Hong Kong between 2004 and 2006 as a result of the first three phases of CEPA with breakdown as shown in the table below.

<sup>5</sup> The figures as at end April 2007 are 1 063 applications approved and 1 753 certificates issued.

<sup>6</sup> The number of Mainland cities increased to 49 on 1 January 2007.

Number of jobs created for Hong Kong residents in Hong Kong  
as a result of the first three phases of CEPA

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| <b>Year</b>        | <b>Trade in Goods</b> | <b>Trade in Services</b> | <b>IVS</b>          |
|--------------------|-----------------------|--------------------------|---------------------|
| 2004               | 1 000*                | 1 415*                   | 19 158 <sup>#</sup> |
| 2005               | 736                   | 2 880                    | -1 343 <sup>@</sup> |
| 2006               | 1 583                 | 1 582                    | 7 927               |
| <b>Total</b>       | <b>3 319</b>          | <b>5 877</b>             | <b>25 742</b>       |
| <b>Grand Total</b> |                       |                          | <b>34 938</b>       |

\* Based on results of the first study conducted in 2004/05.

# Revised estimate based on latest available data.

@ The number of new jobs created attributable to IVS declined in 2005 as a result of rising labour productivity, and higher level of increase in same day IVS visitors in comparison with overnight IVS visitors.

Taking into account the 1 000 CEPA-generated new jobs in the Mainland filled by Hong Kong residents, (please see para. 18), the total number of new jobs created for Hong Kong between 2004 and 2006 as a result of CEPA was about 36,000.

15. It was expected that 3 642 new jobs would be further created in Hong Kong in 2007 and beyond as a result of the first three phases of CEPA liberalisation measures in goods and services. Another 1 438 new jobs would be created for Hong Kong residents in the Mainland in 2007 and beyond.

#### Trade and Investment Facilitation

16. While trade and investment facilitation was not covered in the quantitative study, the Administration has attempted to gather the effect so far of the trade and investment facilitation measures under CEPA on attracting foreign investments to Hong Kong. According to the information provided by the Mainland authorities, following the implementation of the new facilitation policy for Mainland enterprises to invest in Hong Kong and Macao in end August 2004, a total of 603 Mainland enterprises have been granted approval for investing in Hong Kong between September 2004 and December 2006, with planned investment totalling US\$3.9 billion.

17. A study of the Administration further indicated that of the 3 845 regional headquarters and regional offices set up in Hong Kong as at 1 June 2006, 28% considered that CEPA has strengthened the business environment in Hong Kong and has rendered it a suitable location for setting up regional headquarters and regional offices. Furthermore, of the 246 foreign companies assisted by Invest Hong Kong to set up or expand business in Hong Kong in 2006, 61 (or 25%) considered CEPA a relevant factor affecting their investment decision.

## **Benefits to the Mainland**

18. The study has also gathered some data on the economic impact of CEPA on the Mainland though its major focus is on Hong Kong. Between 2004 and 2006, CEPA induced HK\$9.2 billion investment in the services industry in the Mainland and as at end 2006, CEPA created almost 17,000 new jobs in the Mainland (1,000 filled by Hong Kong residents and almost 16,000 filled by Mainlanders). The more significant part of CEPA to the Mainland however lies with the intangible benefits, that is, the transfer of quality capital and management and professional skills to the Mainland for its long term economic development.

## **Actions to enhance implementation and liberalisation**

19. The Administration attaches great importance to the views of the trade on both the implementation and further liberalisation of CEPA. Some companies in the manufacturing/exporting sectors considered that they could not fully benefit from the CEPA tariff preferences because they were not familiar with the application process. Some in the services sectors wished to see further improvements in the regulatory environment of the Mainland market to facilitate their setting up of business under CEPA as well as further broadening and deepening of the CEPA liberalisation measures. Furthermore, in response to another recommendation arising from the Focus Group, the Secretary for Commerce, Industry and Technology chaired the first CEPA Consultative Forum on 30 March 2007 to gather views of the business and professional bodies on CEPA implementation and liberalisation. The Administration will continue to liaise closely with the Mainland authorities on the implementation problems under CEPA through various mechanisms. A new package of CEPA liberalisation measures will be announced towards end June 2007.

## **Concluding Remarks**

20. The study has attempted to provide certain quantitative information on the CEPA benefits to the Hong Kong economy. Of note, the intangible benefits are considerable as CEPA provides a new economic platform for Hong Kong to further develop its business relation with the Mainland in the long term. It has also helped rebuild confidence in the economy after a prolonged period of economic slowdown caused by the Asian financial crisis and aggravated by the SARS outbreak. Though the strong rebound in consumption, investment, and overall economic growth in the past few years may not be entirely attributable to CEPA, the CEPA should have played an important role in helping to kick-start the recovery. Attachment II set out in further details a qualitative assessment on the economic impact of CEPA.

21. Finally, we also wish to point out that the usefulness of conducting an opinion survey to quantify the economic significance of CEPA tends to

diminish over time. In such survey, we rely on the respondents' perception of the effects of CEPA on them and these perceptions will vary and fade with time. Also, the CEPA benefits are often so entwined with the general macro environment that it is difficult to disentangle and quantify them from the findings.

## **BACKGROUND**

22. CEPA is the first free trade agreement signed by the Mainland and Hong Kong. Since its first signing in June 2003, three supplements to the CEPA were concluded in 2004, 2005 and 2006 respectively. The latest supplement, the Supplement III to the CEPA, took effect on 1 January 2007. CEPA comprises three major pillars of liberalisation and cooperation, viz. trade in goods, trade in services, and trade and investment facilitation. The IVS constitutes part of the liberalisation measure under trade in services. Details of CEPA and its implementation have been reported to this Panel, vide CB(1) 2101/02-03(01), CB(1)2524/02-03(01), CB(1)1710/03-04(04), CB(1)2500/03-04(01), CB(1)90/05-06(01) and CB(1)1898/05-06(01).

Commerce, Industry and Technology Bureau  
June 2007

**The Mainland and Hong Kong  
Closer Economic Partnership Arrangement (CEPA)**

**Review of economic impact on the Hong Kong economy**

**Main Report**

**Main content**

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**The Mainland and Hong Kong  
Closer Economic Partnership Arrangement (CEPA)  
Review of economic impact on the Hong Kong economy  
(Overview)**

**Background**

1. The Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) was first introduced in January 2004. This has progressed through three phases of enrichment in merchandise products and service sectors coverage. An economic impact assessment of CEPA was first conducted in the fourth quarter of 2004/first quarter of 2005, and the findings presented to LegCo in May 2005.
2. After three years of implementation, the Administration (comprising the Trade and Industry Department, the Economic Analysis and Business Facilitation Unit, the Census and Statistics Department, and led by the Commerce, Industry and Technology Bureau) has recently completed a review and update of CEPA's impact on the Hong Kong economy. A summary of the major findings is given below.

**Overall impact of CEPA**

3. While some of the benefits of CEPA such as increased confidence and enhanced accessibility to the Mainland market may not be readily quantifiable, there are other aspects such as induced employment and induced capital investment that may be estimated. A summary of the latter impacts on the Hong Kong economy is outlined in *Figures 1 and 2* below.
4. Although the number of persons engaged in Hong Kong due to CEPA may appear relatively small, at around 35 000 persons at end-2006 and accounting for only about 1% of the total employed persons, the number of new jobs created due to CEPA was however not insignificant, equivalent to about one quarter of the total unemployed in 2006 and accounting for around 12% of all the new jobs created since mid 2003.
5. Moreover, CEPA is also beneficial to the Mainland economy. The total number of new jobs created in the CEPA related services sectors in the Mainland reached 16 700 by 2006. Of these, 1 000 new jobs created were filled by Hong Kong residents and 15 700 were filled by non-Hong Kong residents (presumably the Mainlanders) (*Figure 3*).
6. Taking together the new jobs created for Hong Kong residents by CEPA in both Hong Kong and the Mainland, there was a total of 36 000 CEPA-induced added employment by 2006.



**Figure 1: Summary of CEPA-induced employment / new jobs created in Hong Kong**

| As at year-end         | Trade in Goods <sup>^</sup>             |                           | Trade in Services                       |                           | Individual Visit Scheme                 |                           | Overall   |                           |
|------------------------|---|---------------------------|---|---------------------------|---|---------------------------|---|---------------------------|
|                        | Persons engaged <sup>(+)</sup><br>(no.) | New jobs created<br>(no.) | Persons engaged <sup>(+)</sup><br>(no.) | New jobs created<br>(no.) | Persons engaged <sup>(+)</sup><br>(no.) | New jobs created<br>(no.) | Total number of persons engaged <sup>(+)</sup><br>(no.) | New jobs created<br>(no.) |
| <b>2004</b>            | 1 000*                                  | 1 000                     | 1 415*                                  | 1 415                     | 19 158 <sup>#</sup>                     | 19 158                    | 21 573  | 21 573                    |
| <b>2005</b>            | 1 736                                   | 736                       | 4 295                                   | 2 880                     | 17 815 <sup>~</sup>                     | -1 343 <sup>~</sup>       | 23 846  | 2 273                     |
| <b>2006</b>            | 3 319                                   | 1 583                     | 5 877                                   | 1 582                     | 25 742                                  | 7 927                     | 34 938  | 11 092                    |
| <b>2007 and beyond</b> | 4 881                                   | 1 562                     | 7 957                                   | 2 080                     | -                                       | -                         | -   | -                         |

- Notes : (+) Persons engaged refers to the number of persons employed at the end of each period.  
 (^) Persons engaged for Trade in Goods was estimated by *change in persons engaged due to CEPA* in the corresponding years.  
 (\*) Based on results of survey conducted in 2004/05 for the previous CEPA EIA (economic impact assessment).  
 (#) Revised estimate based on latest available data.  
 (~) For details, see paragraphs (q) and (r).

**Figure 2: Summary of CEPA induced capital investment in Hong Kong**

(HK\$ million)

|                        | Trade in Goods | Trade in Services | Total |
|------------------------|----------------|-------------------|-------|
| <b>2004*</b>           | N/A            | 1,012             | N/A   |
| <b>2005</b>            | 103            | 2,094             | 2,197 |
| <b>2006</b>            | 202            | 1,733             | 1,935 |
| <b>2007 and beyond</b> | 239            | 2,406             | 2,645 |

Note: (\*) Figures may not add up due to rounding.

**Figure 3: CEPA induced employment / jobs created in the Mainland**

|                        | Persons Engaged<br>(no.) | Of which      |                  | New jobs created<br>(no.) | Of which       |                  |
|------------------------|--------------------------|---------------|------------------|---------------------------|----------------|------------------|
|                        |                          | HK residents  | Non-HK Residents |                           | HK residents   | Non-HK residents |
| <b>2004*</b>           | <b>2 842</b>             | 544<br>(19%)  | 2 298<br>(81%)   | <b>2 842</b>              | 544<br>(19%)   | 2 298<br>(81%)   |
| <b>2005</b>            | <b>9 414</b>             | 574<br>(6%)   | 8 840<br>(94%)   | <b>6 572</b>              | 30<br>(0.5%)   | 6 542<br>(99.5%) |
| <b>2006</b>            | <b>16 696</b>            | 1 000<br>(6%) | 15 696<br>(94%)  | <b>7 282</b>              | 426<br>(6%)    | 6 856<br>(94%)   |
| <b>2007 and beyond</b> | <b>30 178</b>            | 2 438<br>(8%) | 27 740<br>(92%)  | <b>13 482</b>             | 1 438<br>(11%) | 12 044<br>(89%)  |

Notes: (\*) Results of survey conducted in 2004/05. The survey then covered only those services sectors, trade products and IVS as at CEPA I.

( ) % share of the total.

## Summary of major findings

- (a) **General opinion about CEPA's economic benefits:** most of the business establishments surveyed consider CEPA beneficial to the Hong Kong economy (*Figure 4*). Feedbacks from informal consultation with CEOs and senior management in the trade and services sectors unanimously indicate that CEPA has played a crucial role in rebuilding confidence after a prolonged period of economic slowdown caused by the Asian financial crisis in 1997 and further aggravated by the SARS disease in the early part of 2003. There has been a vivid recovery in investment sentiment from the third quarter of 2003.

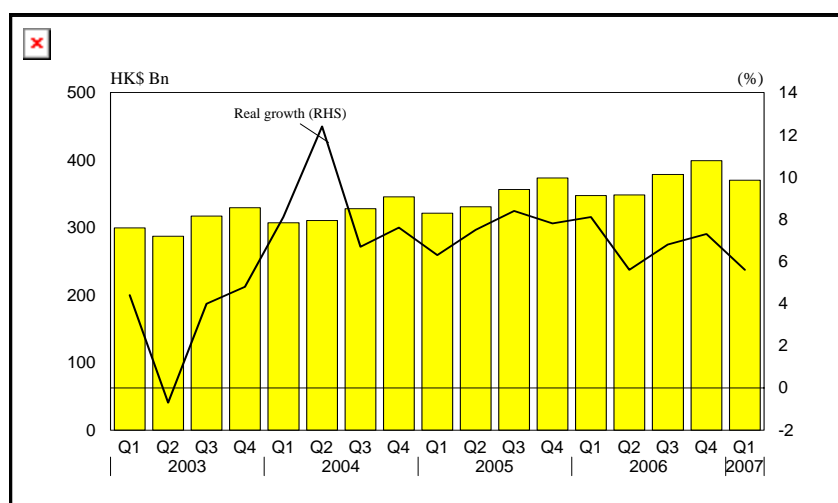
**Figure 4: Survey respondents' overall opinion on the benefits of CEPA to the Hong Kong Economy**

(% of total)

|                   | Beneficial | Not beneficial/ Negative | Not Applicable/<br>no effect at all |
|-------------------|------------|--------------------------|-------------------------------------|
| Trade in Goods    | 89         | 11                       | -                                   |
| Trade in Services | 74         | 4                        | 22                                  |

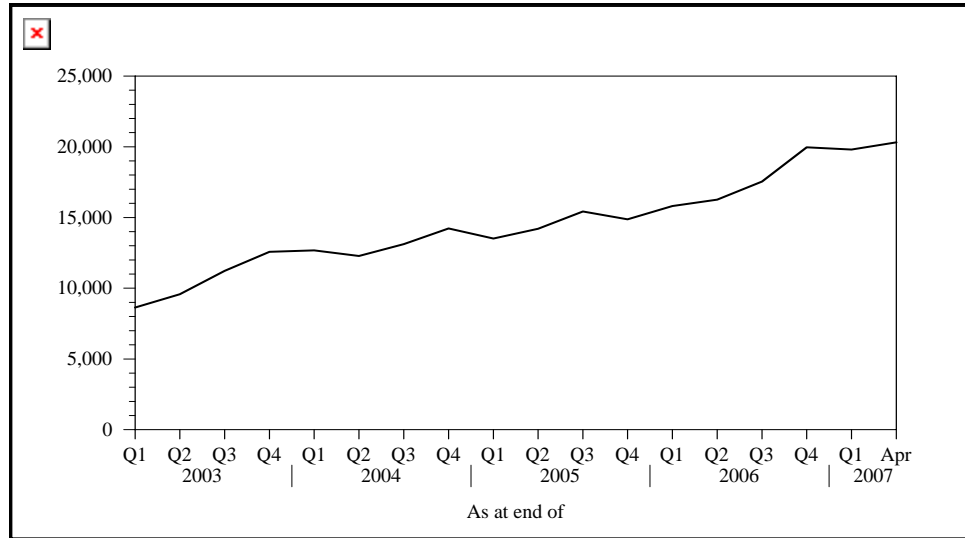
- (b) Hong Kong's GDP reverted from a decline of 0.7% in the second quarter of 2003 to growth of 4.0% and 4.8% in the third and fourth quarters, before climbing further to annual growth of 8.6% in 2004, 7.5% in 2005 and 6.9% in 2006 (*Figure 5*)<sup>(1)</sup>. Investment in machinery, equipment and computer software bounced back to double-digit increase from 2004. Private consumption revived after two consecutive years' of decline in 2002 and 2003. The Hang Seng Index staged a strong rebound after April 2003 to close 2006 at 19 965<sup>(2)</sup>. Although these rebounds may not be entirely attributable to CEPA, it should have been an important confidence booster that helps kick start the recovery (*Figure 6*).

**Figure 5: Hong Kong's GDP**



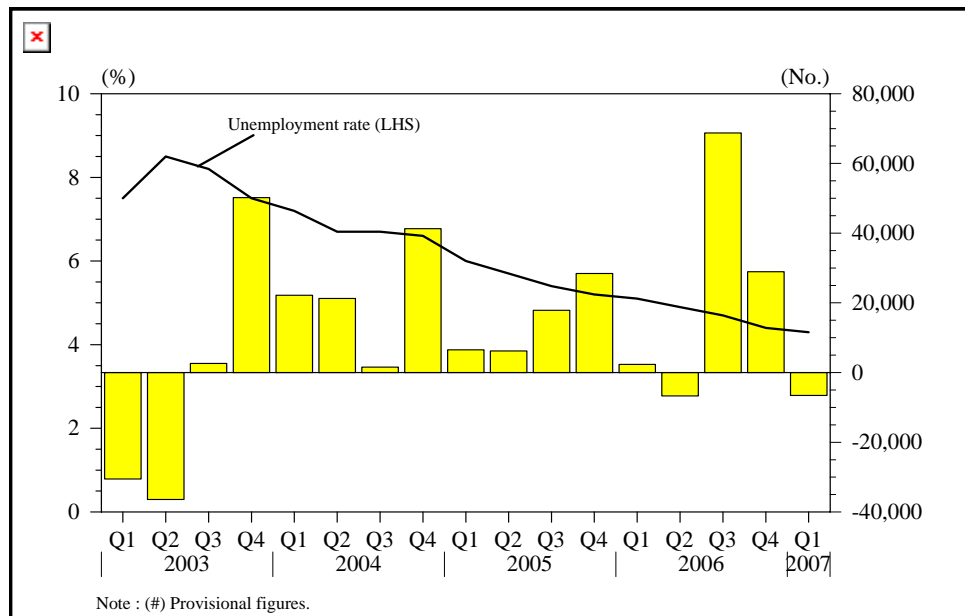
- (1) GDP grew by 5.6% in real terms in the first quarter of 2007 over a year earlier.  
 (2) The Hang Seng Index continued to rise, closing at 20,995 on 17 May 2007.

**Figure 6: Hang Seng Index**



- (c) Reflecting this general pick-up in economic activities, labour demand rose strongly pushing total employment to successive new highs, bringing the 4<sup>th</sup> quarter 2006 unemployment rate down to 4.4% from 8.5% in mid-2003 (*Figure 7*)<sup>(3)</sup>. Over the period, some 299 000 additional jobs have been created, benefiting workers in different sectors and at different skill levels.

Figure 7: Unemployment rate and number of new jobs



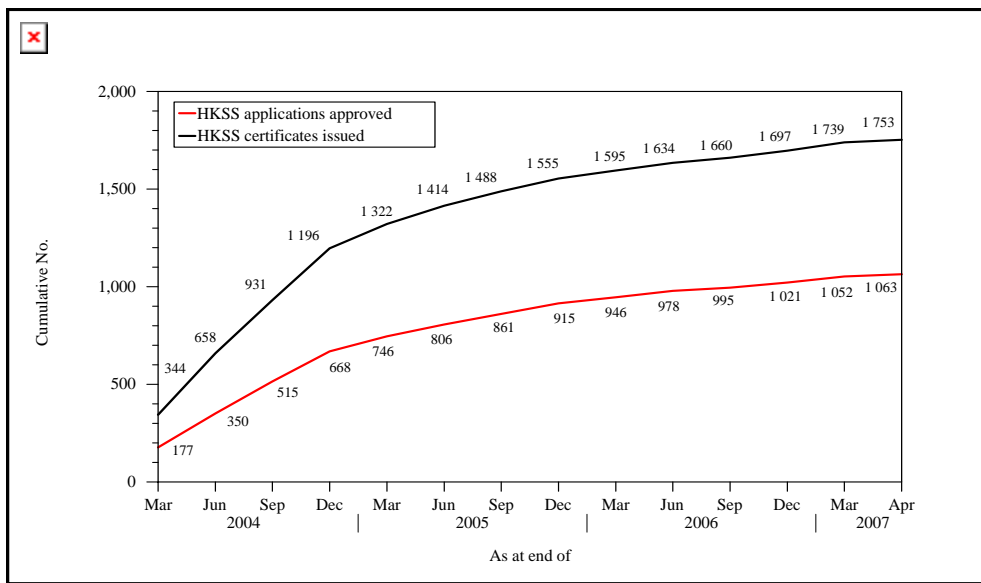
- (d) **Trade in services**<sup>(4)</sup>: the survey covered 22 service industry groups, equivalent to 25 out of the 27 service areas under CEPA (see footnote to Annex I). The total number of establishments within the survey coverage

<sup>(3)</sup> The seasonally adjusted unemployment rate edged down further, to 4.3% in the first quarter of 2007.

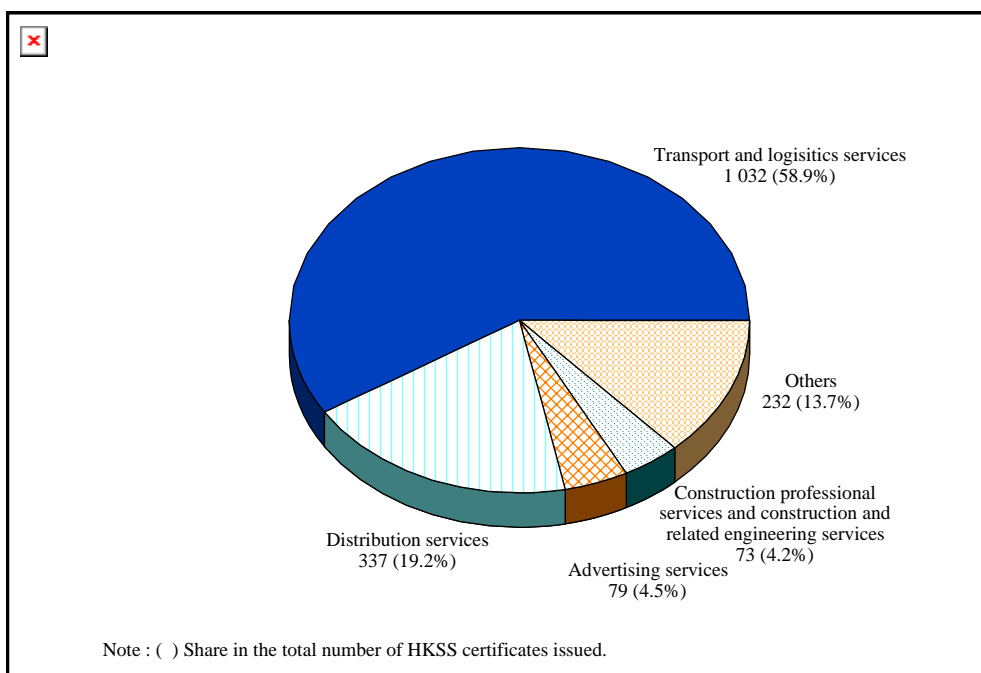
<sup>(4)</sup> For details, see Appendix I.

was estimated to be 149 749 as at 30 September 2006. Of the 968 HKSS (Hong Kong Service Supplier) holders as at 7 September 2006, 306 were selected for enumeration. Of the remaining 148 781 non-HKSS holders, 1 763 were selected for enumeration. The overall response rate was 87% (75% for HKSS-holders and 89% for non-HKSS holders). The situation of HKSS applications approved and certificates issued as at end-April 2007 is summarized in *Figures 8 and 9*. It could be seen that most of the certificates issued are for the transport and logistics services and the distribution services.

**Figure 8: Number of HKSS applications approved and certificates issued**



**Figure 9: Number of certificates of HKSS issued by major services sector as at end-April 2007**



- (e) 74% of the responding establishments considered CEPA beneficial to the Hong Kong economy, 47% considered CEPA beneficial to their own industries, and 92% considered CEPA beneficial to their own business. Specifically, there are higher proportions of establishments in the banking services, information technology services, accounting, auditing and bookkeeping services, legal services, and architectural and engineering services that considered CEPA beneficial to the Hong Kong economy, to their own industries, and/or to their own business in the Mainland (*Figure 10a*).

**Figure 10a: General opinion of service providers about CEPA**

(% of total)

| Industry Group                         | Beneficial to Hong Kong economy | Beneficial to their industries | Beneficial to their establishments <sup>(#)</sup> |
|--|---------------------------------|--------------------------------|---|
| Banking services                       | 96                              | 88                             | 100   |
| Accounting, auditing & bookkeeping     | 91                              | 66                             | 100   |
| Information technology                 | 92                              | 42                             | 75  |
| Legal services                         | 89                              | 59                             | 100   |
| Architectural and engineering services | 68                              | 58                             | 72  |
| <b>Overall (22 industries)</b>         | <b>74</b>                       | <b>47</b>                      | <b>92</b>   |

Note: (#) Applicable only to establishments with business in the Mainland and perceived that CEPA has an impact on their business.

- (f) For the 22 service industry groups taken together, the CEPA-induced additional capital investment in Hong Kong amounted to HK\$2.1 billion in 2005, HK\$1.7 billion in 2006, and an expected further HK\$2.4 billion in 2007 and beyond. Over the years, the CEPA-induced additional investment has been mainly in plant and machinery. Amongst the 22 service industry groups, distribution services and freight transport and logistics contributed the bulk of additional investment in the past few years (*Figure 10b*).

**Figure 10b : CEPA-induced capital investment in the services industry in Hong Kong**

(HK\$ million)

| Industry Group                  | 2004*        | 2005         | 2006         | 2007 and beyond (expected) |
|---------------------------------|--------------|--------------|--------------|----------------------------|
| Distribution services           | 192          | 1555         | 912          | 735                        |
| Freight transport and logistics | 434          | 480          | 558          | 1,026                      |
| Tourism and related services    | 1            | 35           | 187          | 346                        |
| <b>Overall (22 industries)</b>  | <b>1,012</b> | <b>2,094</b> | <b>1,733</b> | <b>2,406</b>               |

Note: (\*) Results of survey conducted in 2004/05.

- (g) The capital investment committed in the Mainland was larger than in Hong Kong. In 2005, induced by CEPA HK\$4.2 billion was invested in the Mainland. Distribution services and freight transport and logistics registered the largest amount of investment in the Mainland in 2004 to 2006. Both industries continued to expect large investment in 2007 and beyond (*Figure 10c*). Investment from the banking services was also rather substantial in 2004 and 2005.

**Figure 10c : CEPA-induced capital investment in the services industry in the Mainland**

*(HK\$ million)*

| Industry group                  | 2004*        | 2005         | 2006         | 2007 and beyond (expected) |
|---------------------------------|--------------|--------------|--------------|----------------------------|
| Distribution services           | 862          | 1,575        | 716          | 1,143                      |
| Banking services                | 809          | 1,080        | 240          | 120                        |
| Freight transport and logistics | 726          | 1,095        | 778          | 1,454                      |
| <b>Overall (22 industries)</b>  | <b>2,867</b> | <b>4,218</b> | <b>2,106</b> | <b>4,641</b>               |

Note: (\*) Results of the survey conducted in 2004/05.

- (h) On the employment front, CEPA-induced employment in Hong Kong in the 22 industry groups was estimated to be 4 300 and 5 900 in 2005 and 2006 respectively, and was expected to reach around 8 000 in 2007 and beyond. The number of new jobs created in Hong Kong due to CEPA was by far the largest in the distribution services, at around 2 800 in 2005 and 1 100 in 2006 (*Figure 10d*).

**Figure 10d: CEPA-induced employment in the services industry in Hong Kong**

*(no. of persons engaged)*

| Industry Group                  | 2004*                | 2005                 | 2006                 | 2007 and beyond (expected) |
|---------------------------------|----------------------|----------------------|----------------------|----------------------------|
| Distribution services           | 386 (386)            | 3 216 (2 830)        | 4 330 (1 114)        | 4 354 (24)                 |
| Freight transport and logistics | 765 (765)            | 491 (-274)           | 515 (24)             | 708 (193)                  |
| Tourism and related services    | 24 (24)              | 95 (71)              | 332 (237)            | 692 (360)                  |
| <b>Overall (22 industries)</b>  | <b>1 415 (1 415)</b> | <b>4 295 (2 880)</b> | <b>5 877 (1 582)</b> | <b>7 957 (2 080)</b>       |

Notes: (\*) Results of the survey conducted in 2004/05.

( ) Number of new jobs created.

- (i) As for CEPA-induced employment in the Mainland by the 22 services industry groups, again the largest contributor came from distribution services and freight transport and logistics. Most of the staff employed and new jobs created were filled by non-Hong Kong residents (*Figure 10e*).

**Figure 10e: CEPA-induced employment in the services industry in the Mainland**

(No. of persons engaged)

| Industry group                  | 2004*        |                  | 2005                |                          | 2006                   |                           | 2007 and beyond (planned) |                            |
|---------------------------------|--------------|------------------|---------------------|--------------------------|------------------------|---------------------------|---------------------------|----------------------------|
|                                 | HK Residents | Non-HK Residents | HK Residents        | Non-HK Residents         | HK Residents           | Non-HK Residents          | HK Residents              | Non-HK Residents           |
| Distribution services           | 464          | 967              | 304<br>(-160)       | 3 344<br>(2 377)         | 682<br>(378)           | 7 552<br>(4 208)          | 1 025<br>(343)            | 10 826<br>(3 274)          |
| Freight transport and logistics | 62           | 1 039            | 165<br>(103)        | 3 989<br>(2 950)         | 171<br>( 6)            | 5 399<br>(1 410)          | 303<br>(132)              | 6 600<br>(1 201)           |
| Banking services                | 6            | 87               | 8<br>(2)            | 115<br>(28)              | 8<br>( 0)              | 155<br>( 40)              | 14<br>( 6)                | 244<br>(89)                |
| Tourism and related services    | 0            | 0                | 0<br>(0)            | 6<br>(6)                 | 1<br>(1)               | 25<br>(19)                | 8<br>(7)                  | 93<br>(68)                 |
| <b>Overall (22 industries)</b>  | <b>544</b>   | <b>2 298</b>     | <b>574<br/>(30)</b> | <b>8 840<br/>(6 542)</b> | <b>1 000<br/>(426)</b> | <b>15 696<br/>(6 856)</b> | <b>2 438<br/>(1 438)</b>  | <b>27 740<br/>(12 044)</b> |

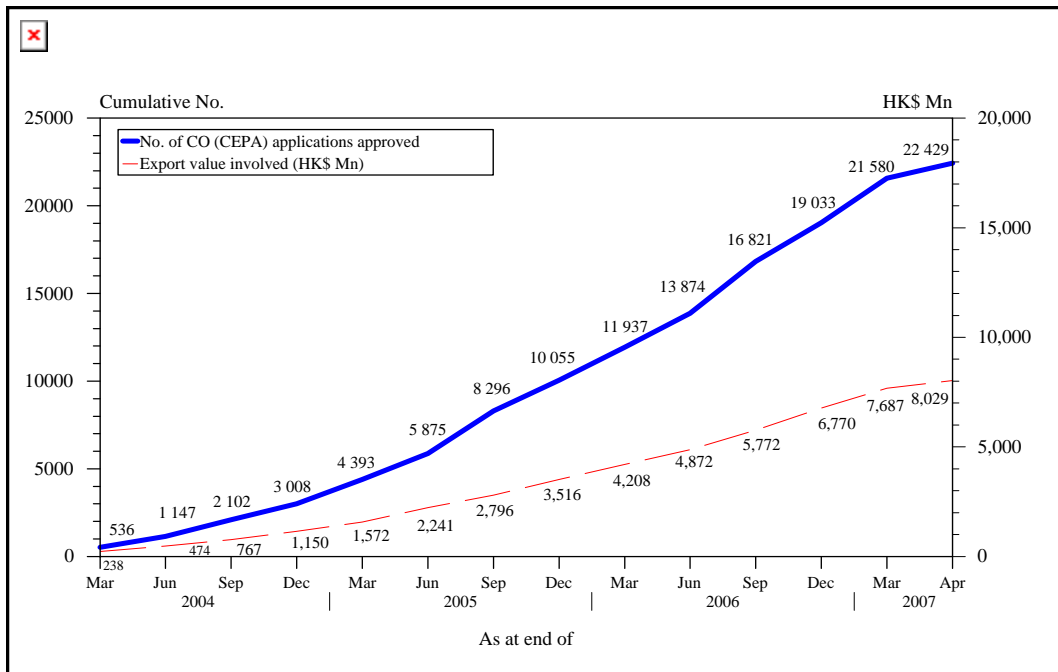
Notes: (\*) Results of the survey conducted in 2004/05.

( ) New jobs created.

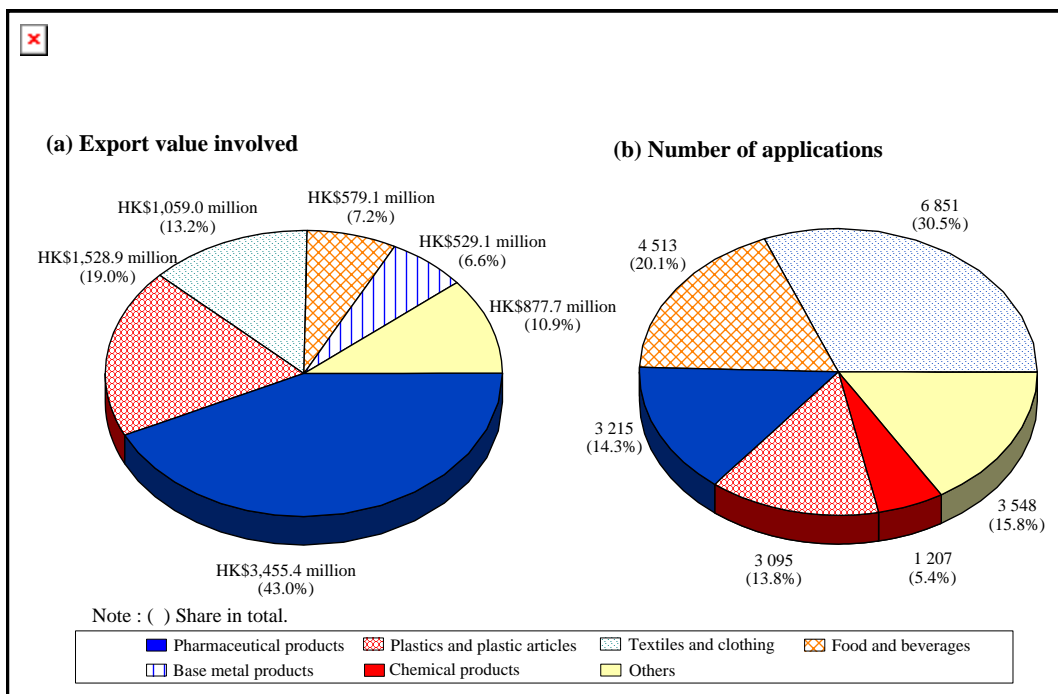
- (j) **Trade in goods<sup>(5)</sup>**: the survey covered around 8 903 establishments, with 4% being manufacturers/traders engaging in domestic exports of the CEPA products using CO(CEPA) or having applied for commodities to be covered in the second phase of consultations on CEPA Rules of Origin (ROOs) in 2006 (number of CO(CEPA) approved reached 22 429 as at end-April 2007, see **Figure 11 and Annex II**), and 96% are traders exporting these products to the Mainland but have not applied for or used CO(CEPA). Of the 363 establishments which applied for or held approved CO(CEPA)s, 199 were sampled with 163 successfully enumerated. As for the 8 540 non-CO(CEPA) users which have exported CEPA covered goods, 349 were sampled with 255 successfully enumerated. The overall response rate was 76% (82% for CO(CEPA) users and 73% for non-users).
- (k) Of the approved CO(CEPA) at end-April 2007, most of the applications were made by textiles and clothing (30.5%), followed by food and beverages (20.1%) and pharmaceutical products (14.3%). However, in terms of export value involved, pharmaceutical products accounted for nearly 43% of the total, followed by plastics and plastics articles (19%), and textiles and clothing (13.2%) (**Figure 12**).

(5) For details, see Appendix II.

**Figure 11: CO(CEPA) applications approved and Export value involved**



**Figure 12: Approved CO(CEPA) applications by major product type as at end-April 2007**





- (l) 89% of the responding establishments considered CEPA beneficial to the Hong Kong economy and 77% considered CEPA beneficial to the manufacturing sector. Of these, those engaging in pharmaceutical products showed the largest percentages of establishments that considered CEPA beneficial to the Hong Kong economy, to the manufacturing industry, and/or to their own business in the Mainland (*Figure 13a*).

**Figure 13a: General opinion of traders/manufacturers about CEPA**

*(% of total)*

|                    | <b>Beneficial to Hong Kong's economy</b> | <b>Beneficial to Hong Kong's manufacturing</b> | <b>Beneficial to the future business of the Company</b> | <b>Beneficial to the current business of company in relation to the Mainland market</b> |
|--------------------|--|--|---|---|
| Pharmaceuticals    | 93                                       | 95   | 78  | 81  |
| Food and beverages | 90                                       | 89   | 55  | 50  |
| <b>Overall</b>     | <b>89</b>                                | <b>77</b>                                      | <b>35</b>   | <b>26</b>   |

- (m) Net additional CEPA-induced capital investment in Hong Kong amounted to HK\$103 million in 2005, HK\$202 million in 2006, and a planned HK\$239 million in 2007 and beyond. Establishments engaged in the manufacturing/exports of pharmaceutical products constituted around 70% of the total actual/planned capital investment in 2005 to 2007 and beyond (*Figure 13b*).

**Figure 13b: CEPA-induced capital investment in Hong Kong for traders/manufacturers**

*(HK\$ million)*

| <b>Commodities Group</b>                    | <b>2005</b>  | <b>2006</b>  | <b>2007 and beyond (expected)*</b> |
|---|--------------|--------------|------------------------------------|
| Pharmaceuticals                             | 36.3         | 188.2        | 159.4                              |
| Food and Beverages                          | 26.8         | 23.4         | 64.5                               |
| <b>All commodity groups covered by CEPA</b> | <b>103.3</b> | <b>202.2</b> | <b>238.9</b>                       |

Note: (\*) Covers only those traders/manufacturers who have either used CO(CEPA), have applied for commodities to be covered in the second phase of consultations on CEPA ROOs in 2006, or have exported goods covered by CEPA during 2005 and in the first eight months of 2006.

- (n) Along with the rise in CEPA-induced capital investment, an estimated 736 and 1 583 new jobs were created in Hong Kong in 2005 and 2006 respectively. For 2007 and beyond, another 1 562 new posts are planned. Again, most of the jobs created were involved in either the manufacturing or trading of pharmaceutical products (*Figure 13c*).

**Figure 13c: New jobs created due to CEPA in trade/manufacturing in Hong Kong<sup>#</sup>**

(no. of new jobs)

| Commodities Group                           | 2005       | 2006         | 2007 and beyond (expected)* |
|---|------------|--------------|-----------------------------|
| Pharmaceuticals                             | 712        | 924          | 1 249                       |
| Food and beverages                          | 25         | 82           | 75                          |
| <b>All commodity groups covered by CEPA</b> | <b>736</b> | <b>1 583</b> | <b>1 562</b>                |

Note: (\*) Covers only those who have either used CO(CEPA), or applied for commodities to be covered in the second phase of consultations on CEPA ROOs in 2006, or have exported goods covered by CEPA during 2005 and in the first eight months of 2006.

(#) The cumulative number of persons engaged could not be estimated for individual sectors, since similar breakdowns were not available in the previous survey conducted in 2004/05.

(o) **Individual visit scheme (IVS)<sup>(6)</sup>**: Mainland visitors to Hong Kong continued to rise (**Figure 14**). The increased convenience of IVS should have increased the frequency of travel, but shortened the length of stay of some of the Mainland visitors. Moreover, as the Mainland visitors become more acquainted with the use of IVS, more of the Mainland visitor trips will be shifted to the IVS mode. In other words, these trips would have been made even without the IVS scheme (i.e. the diversion effect).

**Figure 14 : Mainland visitor arrivals since the adoption of the IVS**

(No. of persons)

|      |         | Total      |           |           | Arrivals on IVS |           |           | Arrivals on Non-IVS |           |           |
|------|---------|------------|-----------|-----------|-----------------|-----------|-----------|---------------------|-----------|-----------|
|      |         | All        | Same-day  | Overnight | All             | Same-day  | Overnight | All                 | Same-day  | Overnight |
| 2003 | Jul-Dec | 5,231,851  | 1,671,508 | 3,560,343 | 667,271         | 136,022   | 531,249   | 4,564,580           | 1,535,486 | 3,029,094 |
| 2004 |         | 12,245,862 | 4,451,980 | 7,793,882 | 4,259,601       | 1,176,537 | 3,083,064 | 7,986,261           | 3,275,443 | 4,710,818 |
| 2005 |         | 12,541,400 | 4,511,695 | 8,029,705 | 5,550,255       | 2,002,155 | 3,548,100 | 6,991,145           | 2,509,540 | 4,481,605 |
| 2006 |         | 13,591,342 | 5,157,064 | 8,434,278 | 6,673,283       | 2,509,947 | 4,163,336 | 6,918,059           | 2,647,117 | 4,270,942 |

(p) Allowing for the various influences and the diversion effect as estimated by Hong Kong Tourism Board based on their survey findings, the incremental visitor spending induced by IVS is estimated to be HK\$9.3 billion in 2006 (**Figure 15**). Applying the tourism services related GDP multiplier, the net incremental spending by IVS visitors is expected to generate and raise Hong Kong's GDP by HK\$6.5 billion or 0.44% in 2006. This in turn is estimated to generate employment for 25 742 persons in 2006, implying a net increase of 6 600 new jobs since 2004<sup>(7)</sup>.

(6) For details, see Appendix III.

(7) Value-added per person engaged in 2006 is not yet available. It is assumed that the value-added per person engaged for the overall economy has maintained a stable relation with that for the individual economic sectors in 2006 as in the preceding years.

- (q) Demand for inbound tourism services bounced back after the SARS disease in 2003. Business receipts picked up strongly in the tourism-related sectors (e.g. retail, hotel, restaurants, domestic and cross boundary transport, personal entertainment etc.). Employment in the related sectors also rose, albeit at a less rapid pace, suggesting that employers were reluctant to hire additional workers before they were fully confident that the rise in demand was going to persist. As a result, lately labour productivity in the tourism sector, as represented by the value-added per person engaged in the sector, showed a sharp increase from the trough in 2003.
- (r) The incremental visitor spending pertaining to IVS in 2005 was broadly the same as in 2004. Reflecting the diversion effect, there was a rising shift of Mainland visitors to IVS during 2005. Furthermore, among the IVS visitors, there was a larger mix of same day visitors, who tend to spend less on hotel, restaurants and domestic transport compared with the overnight visitors, although their frequency of visits may be higher. Given the rising labour productivity, the number of new jobs attributable to IVS thus saw a decline in 2005. As the shift to IVS tended to stabilise, there was a renewed pick up in incremental visitor spending and hence employment attributable to IVS in 2006.

**Figure 15: Summary impact of the Individual Visit Scheme**

|      | <b>Incremental visitors<sup>(#)</sup></b><br>(No.) | <b>Incremental tourist spending<sup>(*)</sup></b><br>(HK\$ million) | <b>GDP Contribution</b><br>(HK\$ million) | <b>Persons engaged</b><br>(No.) | <b>(New jobs created)</b><br>(No.) |
|------|--|---|---|---------------------------------|------------------------------------|
| 2004 | 2 513 525  | 6,734   | 4,714                                     | 19 158                          | 19 158                             |
| 2005 | 2 721 388  | 6,644   | 4,651                                     | 17 815                          | -1 343                             |
| 2006 | 3 272 029  | 9,278   | 6,495                                     | 25 742                          | 7 927                              |

Notes: (#) Incremental visitors refer to visitors as induced by IVS. These include visits from first time visitors who came because they were attracted by IVS and those who increased their travelling frequency as a result of the convenience and flexibility brought by using IVS.

(\*) Including spending on cross-boundary transport.

- (s) Finally, matching the incremental tourism spending to the different tourism related sectors, and making reference to the value-added content of each, the first round net contribution is estimated in *Figure 16*. While the overall employment in tourist related industries rose steadily in the past few years, the spending pattern of IVS visitors has changed, and the benefits of CEPA tended to vary between sectors. More specifically, while shopping expenses of the IVS visitors rose substantially, their spending on hotel accommodation and on dining dropped. The employment situation as revealed in *Figure 16* largely reflects these changes.

**Figure 16: First round net contributions of the Individual Visit Scheme by selected sectors ^**

|                             | <b>Overall Economy</b> | <i>of which</i>                  |                     |                    |  |  |
|-----------------------------|------------------------|----------------------------------|---------------------|--------------------|--|--|
|                             |                        | <u>Hotel and boarding houses</u> | <u>Retail trade</u> | <u>Restaurants</u> | <u>Other personal services<sup>#</sup></u> | <u>Cross boundary passenger services</u> |
| <b>Incremental Spending</b> |                        |                                  |                     |                    |  | (HK\$ million)                           |
| 2004                        | <b>6,480</b>           | 413                              | 4,736               | 900                | 431  | 254                                      |
| 2005                        | <b>6,443</b>           | 138                              | 5,374               | 667                | 264  | 201                                      |
| 2006                        | <b>8,907</b>           | 340                              | 7,689               | 670                | 207  | 372                                      |
| <b>Value added</b>          |                        |                                  |                     |                    |  | (HK\$ million)                           |
| 2004                        | <b>4,714</b>           | 246                              | 727                 | 329                | 222  | 80                                       |
| 2005                        | <b>4,651</b>           | 85                               | 833                 | 241                | 140  | 60                                       |
| 2006                        | <b>6,495</b>           | 196                              | 1,119               | 237                | 110  | 123                                      |
| <b>Employment</b>           |                        |                                  |                     |                    |  | (persons engaged)                        |
| 2004                        | <b>19 158</b>          | 790                              | 6 306               | 3 141              | 870  | 74                                       |
| 2005                        | <b>17 815</b>          | 213                              | 6 779               | 2 204              | 500  | 51                                       |
| 2006                        | <b>25 742</b>          | 666                              | 10 339              | 2 282              | 408  | 119                                      |

Notes: (^) As these estimates do not cover the subsequent rounds of impact, the summation of the first round impact on the different sector is significantly smaller than that on the overall economy.

(#) Other personal services include travel agent, airline ticket agents, domestic transport and other personal entertainment.

(t) **Trade and investment facilitation<sup>(8)</sup>**: the Mainland and Hong Kong have agreed on eight areas for promoting cooperation. These are, namely, trade and investment promotion; customs clearance facilitation; commodity inspection and quarantine, food safety, quality and standardization; electronic business; transparency in laws and regulations; cooperation of small and medium enterprises; cooperation in Chinese traditional medicine and medical products sector; and protection of intellectual property.

(u) Of the 3 845 regional headquarters and regional offices surveyed in 2006, 28% considered that CEPA has strengthened the business environment in Hong Kong and has rendered it a suitable location for the setting up of RHQ/ROs. In addition, around 10% indicated that their investment activities were affected by CEPA.

(v) According to Invest Hong Kong, among the 246 foreign companies which they assisted in setting up or expanding business in Hong Kong in 2006, 61 (or 25%) have indicated that CEPA is one of the factors considered

(8) For details, see Appendix IV.

when making the investment. Of the 61 companies, 22 indicated that they invested in Hong Kong because of CEPA. Some others have either accelerated their investment plans, and/or invested more capital or employed more staff as a result of CEPA.

- (w) According to the State Ministry of Commerce, between 1 September 2004 and end-December 2006, a total of 603 Mainland enterprises were granted approval to invest in Hong Kong. Their planned investment totalled US\$3.9 billion. The major business activities of these enterprises include trading, consulting and R&D, tourism and entertainment, and transport and logistics.
- (x) Furthermore, relevant Government Departments and the Hong Kong Trade Development Council have stepped up promotional efforts to attract more Mainland enterprises to invest in Hong Kong, by offering a comprehensive range of business facilitation services and assistance.
- (y) **Factors constraining the CEPA benefits:** difficulties encountered by Hong Kong service providers in setting up and running business in the Mainland are summarised in *Figures 17 and 18*.

**Figure 17: Difficulties encountered when setting up business in the Mainland under CEPA (HKSS holders only)**

| <b>Difficulties in opening up business in the Mainland</b>                                       | <b>Percentage of establishments reporting difficulties<sup>^</sup></b> |
|--|--|
| No difficulties  | 40.0%  |
| Long processing time   | 21.7%  |
| Complicated application procedures   | 18.9%  |
| Insufficient transparency in policies and regulations  | 13.3%  |
| High entry requirement   | 12.2%  |
| Insufficient knowledge of CEPA among Chinese officials   | 10.1%  |
| Variation in the implementation of policies among local regions                                  | 5.0%   |
| Lack of communications or inconsistent information flow between the central and local government | 2.8%   |

Note: (^) Respondents might report one or more difficulties and the sum of percentages might exceed 100%.

**Figure 18: Difficulties encountered when running business in the Mainland under CEPA(HKSS holders only)**

| <b>Difficulties in running business in the Mainland</b>         | <b>Percentage of establishments reporting difficulties<sup>#</sup></b> |
|---|--|
| No difficulties reported <sup>^</sup>                           | 63.2%  |
| Not familiar with the business environment in the Mainland      | 20.3%  |
| Complicated or heavy taxation system in the Mainland            | 8.0%   |
| Insufficient transparency in policies and regulations           | 8.0%   |
| Variation in the implementation of policies among local regions | 6.8%   |
| Complicated legal system  | 3.7%   |

Notes: (^) Some respondents reported “No difficulties” because the company was newly established under CEPA.

(#) Respondents could report one or more difficulties and the sum of percentages might exceed 100%.

- (z) As for Hong Kong manufacturers/traders, their difficulties are as summarised in *Figure 19*.

**Figure 19: Difficulties faced by Hong Kong manufacturers/traders that limit benefits from CEPA**

(% of respondents)

|  | <b>All commodity groups covered by CEPA</b> | <b>Of which:<br/>Pharmaceuticals</b> | <b>Food and Beverage</b> |
|--|---|--------------------------------------|--------------------------|
| 1. Goods did not satisfy conditions for Hong Kong origin under CEPA                                      | <b>37</b>                                   | 16                                   | 29                       |
| 2. Insignificant tariff savings  | <b>8</b>                                    | 31                                   | 11                       |
| 3. Unfamiliar with application process   | <b>16</b>                                   | 20                                   | 14                       |
| 4. Cannot comply with separate set of regulations governing issuance of Certificate of Origin under CEPA | <b>4</b>                                    | 0                                    | 7                        |
| 5. Restrictions on distribution of goods in the Mainland   | <b>5</b>                                    | 5                                    | 10                       |
| 6. Others <sup>(#)</sup>   | <b>51</b>                                   | 43                                   | 54                       |
| 7. No difficulties   | <b>3</b>                                    | 16                                   | 9                        |

Note: (#) The responses classified as “others” varied widely between different respondents, relatively common ones include: application procedures complicated, lack of skilled manufacturing labour in Hong Kong, issue of CO(CEPA) requires too much time and is not suitable for fast turn-around trading.

(zz) Areas for improvement identified are as summarised in **Figure 20**.

**Figure 20: Aspects that could be further enhanced**

*(% of respondents citing those areas)*

|    |   |     |
|----|---|-----|
| 1. | Allowing wholly-owned or joint venture operations                               | 25% |
| 2. | Reducing the requirement for registered capital                                 | 31% |
| 3. | Relaxing the restrictions over geographical location                            | 25% |
| 4. | Relaxing the restrictions over business scope                                   | 27% |
| 5. | Setting up one-stop enquiry point and dedicated processing counter              | 29% |
| 6. | Delegating the approval authority from the central government                   | 23% |
| 7. | Expanding business scope  | 31% |
| 8. | Expanding the Mainland market   | 26% |
| 9. | Attracting foreign investment partner in jointly developing the Mainland market | 17% |

### Services Industries covered in the current round survey

1. Legal services
2. Accounting, auditing and bookkeeping services
3. Real estate services
4. Advertising services
5. Management consultancy services
6. Convention and exhibition services
7. Telecommunications services
8. Audio-visual services
9. Construction and related engineering services
10. Distribution services
11. Insurance services
12. Banking services
13. Securities services
14. Tourism and related services
15. Architectural and engineering services
16. Passenger transport services
17. Freight transport and logistics
18. Medical and dental services (private hospitals only)
19. Air transport services
20. Cultural services
21. Information technology services
22. Job referral agency/job intermediary services

Note: There are 27 service areas under CEPA. Among them, “patent agency services” and “trade mark agency services” are covered under legal services. “Job referral agency services” and “job intermediary services” are combined as a single industry group. “Professional qualification services” straddle across different sectors and its economic impact is hard to identify separately. For “individually owned stores”, a sampling frame of individual persons who are likely to own a store is not readily available. These two latter service areas are thus not covered in the present survey.



## Annex II

### Statistics on CO(CEPA) applications

| Products Types  | CO(CEPA) Applications Received |                      | CO(CEPA) Applications Approved <sup>(*)</sup> |                      | Cumulative FOB Value |                      |
|---|--------------------------------|----------------------|---|----------------------|----------------------|----------------------|
|   | As at end-2006                 | As at end-April 2007 | As at end-2006                                | As at end-April 2007 | As at end-2006       | As at end-April 2007 |
|   | (No.)                          | (No.)                | (No.)   | (No.)                | (HK\$ million)       | (HK\$ million)       |
| Food and Beverages  | 3 596                          | 4 601                | 3 534   | 4 513                | 480.9                | 579.1                |
| Food Residues and Animal Fodder                               | 9                              | 16                   | 9   | 16                   | 0.4                  | 0.7                  |
| Chemical Products   | 1 092                          | 1 275                | 1 033   | 1 207                | 215.4                | 259.1                |
| Pharmaceutical Products                                       | 2 894                          | 3 280                | 2 835   | 3 215                | 3,026.0              | 3,455.4              |
| Colouring Matters   | 825                            | 955                  | 804   | 934                  | 249.4                | 289.5                |
| Cosmetics   | 34                             | 43                   | 32  | 37                   | 1.7                  | 2.9                  |
| Plastics and Plastic Articles                                 | 2 652                          | 3 143                | 2 617   | 3 095                | 1,221.3              | 1,528.9              |
| Leather and Furskin Articles                                  | 18                             | 21                   | 15  | 16                   | 5.5                  | 5.5                  |
| Paper and Printed Articles                                    | 1 041                          | 1 067                | 1 003   | 1 028                | 75.4                 | 83.0                 |
| Textiles and Clothing   | 6 294                          | 7 249                | 5 891   | 6 851                | 879.3                | 1,059.0              |
| Jewelry and Precious Metals                                   | 168                            | 210                  | 167   | 209                  | 60.2                 | 69.4                 |
| Base Metal Products   | 749                            | 910                  | 737   | 900                  | 416.9                | 529.1                |
| Machinery and Mechanical Appliances                           | 10                             | 12                   | 9   | 11                   | 4.8                  | 6.6                  |
| Electrical and Electronic Products                            | 319                            | 387                  | 300   | 364                  | 61.7                 | 73.1                 |
| Optical, Photographic and Cinematographic Instruments & Parts | 66                             | 79                   | 63  | 76                   | 62.9                 | 77.9                 |
| Clocks and Watches and Parts Thereof                          | 131                            | 153                  | 118   | 140                  | 8.1                  | 9.9                  |
| Furniture   | 1                              | 1                    | 1   | 1                    | 0.02                 | 0.02                 |
| Toys and Games or Sports Requisites                           | 1                              | 1                    | 1   | 1                    | 0.009                | 0.009                |
| Miscellaneous   | 3                              | 3                    | 3   | 3                    | 0.04                 | 0.04                 |
| <b>Total<sup>(#)</sup>:</b>                                   | <b>19 765</b>                  | <b>23 218</b>        | <b>19 033</b>                                 | <b>22 429</b>        | <b>6,770.3</b>       | <b>8,029.2</b>       |

Notes: (\*) The total figure may not be equal to the sum of CO(CEPA)s covering CEPA I, II & III + products as one CO(CEPA) can cover products of all phases.

(#) The total figure may not be equal to the sum of all Product Types as one CO(CEPA) can cover products of more than one type.

**Mainland and Hong Kong  
Closer Economic Partnership Arrangement (CEPA):**

**Review of economic impact on the Hong Kong economy  
(Trade in services)**

**General Remarks**

CEPA constitutes an important platform for the Mainland and Hong Kong to re-orientate their economic ties through the tightening of relations in trade in services. By opening up a host of services industries in the Mainland to direct investment from Hong Kong and allowing freer cross-boundary flow of people and expertise, CEPA has laid a solid foundation for a new business relation between the Mainland and Hong Kong to evolve over time.

2. The Mainland has undergone rapid economic development over the past two decades. The secondary industry has thrived and has outstripped development in the tertiary industry. To achieve more balanced growth and to take the economy's development to a higher level, the Mainland Government has acknowledged the need to strive for quality growth supported by an efficient services sector. International investors are now eyeing the vast opportunities arising from the economic restructuring in the Mainland.

3. Today, the Mainland is not lacking in capital for investment. It is rather more in need of knowledge, technology and management skills to advance overall economic development. The orientation of policies towards foreign direct investment has shifted towards attracting soft skills and knowledge, instead of hard currency. Hong Kong as the Mainland's largest foreign investor and key financial centre should re-orientate to the changing needs of the Mainland.

4. Under CEPA, the Mainland offers opportunities for preferential access to Hong Kong's service providers, ahead of and beyond the commitment of China in the WTO. This has given companies in Hong Kong a "first mover" advantage in establishing an early presence in the Mainland market. It is important that Hong Kong should grasp the opportunities thus arising, and turn itself into a conduit of "quality" capital for the Mainland, in order to stay competitive vis-à-vis other

foreign investors as the Mainland economy opens up wider to foreign investment.

5. Hong Kong should strengthen its role as a key service provider and a major conduit for the up and rising Mainland enterprises to gain access to modern management skills and concepts, thereby raising further their competitiveness in international trade and investment. CEPA is and will continue to be a mutually beneficial arrangement for both Hong Kong and the Mainland. Cooperation between the two should help clinch an even stronger Mainland-Hong Kong partnership that enhances the mutual competitiveness of both in the region as well as in the global market.

### **Economic impact evaluation: Methodology**

6. The economic impact evaluation of CEPA measures for trade in services on the Hong Kong economy is based on the findings of a statistical survey of 22 services sectors opened to Hong Kong investors/service providers.

7. The objective of the survey was to collect from establishments in the 22 service industry groups their opinions on the impact of CEPA on the Hong Kong economy, their own industry and their own establishment, as well as to collect financial data relating to the impact of CEPA on their own establishment.

8. The current round of survey covered the following 22 services sectors:

- (i) Legal services
- (ii) Accounting, auditing and bookkeeping services
- (iii) Real estate services
- (iv) Advertising services
- (v) Management consultancy services
- (vi) Convention and exhibition services
- (vii) Telecommunications services
- (viii) Audio-visual services
- (ix) Construction and related engineering services
- (x) Distribution services
- (xi) Insurance services
- (xii) Banking services
- (xiii) Securities services
- (xiv) Tourism and related services

- (xv) Architectural and engineering services
- (xvi) Passenger transport services
- (xvii) Freight transport and logistics
- (xviii) Medical and dental services (private hospitals only)
- (xix) Air transport services
- (xx) Cultural services
- (xxi) Information technology services
- (xxii) Job referral agency/job intermediary services

9. There are currently 27 service areas covered under CEPA. Among them, “patent agency services” and “trade mark agency services” are covered under legal services. “Job referral agency services” and “job intermediary services” are combined as a single industry group. “Professional qualification services” straddle across different sectors and its economic impact is hard to identify separately. For “individually owned stores”, a sampling frame of individual persons who are likely to own a store is not readily available<sup>(1)</sup>. These two latter service areas are thus not covered in the current round of survey.

10. The survey reference period covers the calendar years 2005 and 2006. Questionnaires were sent to 2 069 establishments selected for enumeration, 1 800 (231 HKSS holders and 1 569 non-HKSS holders) were successfully enumerated while 269 establishments (75 HKSS holders and 194 non-HKSS holders) failed to respond. The overall response rate was 87% (75% for HKSS holders and 89% for non-HKSS holders). The HKSS-holders were mainly interviewed face-to-face, while the non-HKSS holders were mainly enumerated via telephone.

11. It should be noted that the survey attempts to evaluate the direct impact of CEPA measures on the Hong Kong economy at both the macro and micro levels. However, the interpretation of the impact valuation may be constrained by the fact that the CEPA effects tend to permeate through all facets of economic and social development. These are often

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(1) Although “individually owned stores” are not covered in the survey, data available from the Mainland authorities show that Hong Kong residents are making good use of the liberalization measure under “individually owned stores”. As at December 2006, 2 485 individually owned stores were set up by Hong Kong residents in 24 out of the total 32 provinces, centrally administered municipalities and autonomous regions of the Mainland, with registered capital amounting to Rmb 139 million. The majority of them are in Guangdong Province (2 082 individually owned stores with registered capital of Rmb 106 million). With respect of the business scope, most engage in retail, and food and beverage businesses.

so entwined with the general macro-environment and embodied in the ultimate outcome that it is difficult to disaggregate for meaningful quantification.

### General Opinion

12. The majority of the respondents regarded CEPA beneficial to the Hong Kong economy as a whole. However, the response for individual industries varied. For instance, most of the banking, legal and accounting services providers regarded CEPA beneficial to their industries. But there were quite a number of respondents from other industries that did not attribute the performance of their industries to the benefits of CEPA. Overall, slightly less than half of the respondents regarded CEPA beneficial to their industries (*Table 1*).

**Table 1: General opinion of service providers about CEPA**

| Industry Group                         | (% of total)                        |                                |   |
|--|-------------------------------------|--------------------------------|---|
|  | Beneficial to the Hong Kong economy | Beneficial to their industries | Beneficial to their establishments <sup>(#)</sup> |
| Legal services                         | 89%                                 | 59%                            | 100%  |
| Accounting, auditing & bookkeeping     | 91%                                 | 66%                            | 100%  |
| Real estate services                   | 72%                                 | 54%                            | 100%  |
| Advertising services                   | 63%                                 | 45%                            | 99%   |
| Management consultancy services        | 74%                                 | 48%                            | 100%  |
| Convention and exhibition services     | 79%                                 | 63%                            | 94%   |
| Value-added telecommunication          | 74%                                 | 34%                            | 100%  |
| Audio-visual services                  | 89%                                 | 47%                            | 97%   |
| Construction & related engineering     | 65%                                 | 55%                            | 100%  |
| Distribution services                  | 77%                                 | 43%                            | 88%   |
| Insurance services                     | 60%                                 | 49%                            | 100%  |
| Banking services                       | 96%                                 | 88%                            | 100%  |
| Securities services                    | 79%                                 | 42%                            | *   |
| Tourism and related services           | 80%                                 | 55%                            | 100%  |
| Architectural and engineering services | 68%                                 | 58%                            | 72%   |
| Passenger transport services           | 58%                                 | 42%                            | 100%  |
| Freight transport and logistics        | 70%                                 | 48%                            | 100%  |
| Medical and dental services            | 83%                                 | 50%                            | N/A   |
| Air transport services                 | 85%                                 | 75%                            | *   |
| Cultural services                      | 83%                                 | 41%                            | *   |

| Industry Group                        | (% of total)                        |                                |   |
|---------------------------------------|-------------------------------------|--------------------------------|---|
|                                       | Beneficial to the Hong Kong economy | Beneficial to their industries | Beneficial to their establishments <sup>(#)</sup> |
| Information technology                | 92%                                 | 42%                            | 75%   |
| Job referral agency/ job intermediary | 49%                                 | 32%                            | 100%  |
| <b>Overall</b>                        | <b>74%</b>                          | 47%                            | 92%   |

Notes: (#) Applicable only to establishments with business in the Mainland and at the same time perceived that CEPA has an impact on their business.

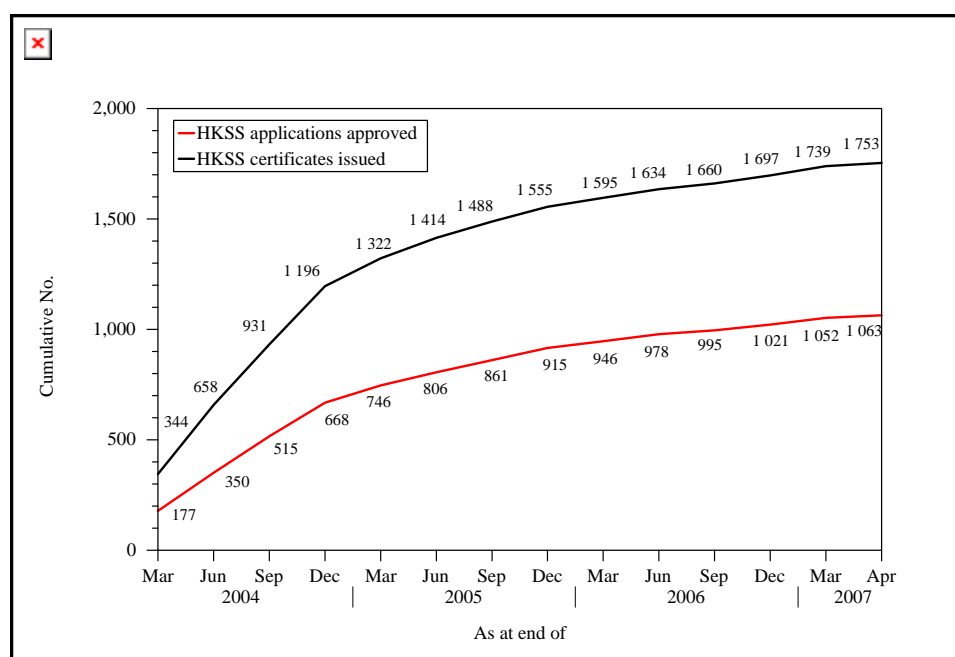
(\*) Figures suppressed to preserve confidentiality of data related to individual establishment as the number of establishments involved is too small.

13. Interestingly, for respondents with business in the Mainland, nearly all of those who perceived CEPA having an impact on their business regarded CEPA as beneficial. Generally speaking, a higher percentage of HKSS holders than non-HKSS holders opined that CEPA was beneficial to the overall economy and to their industry.

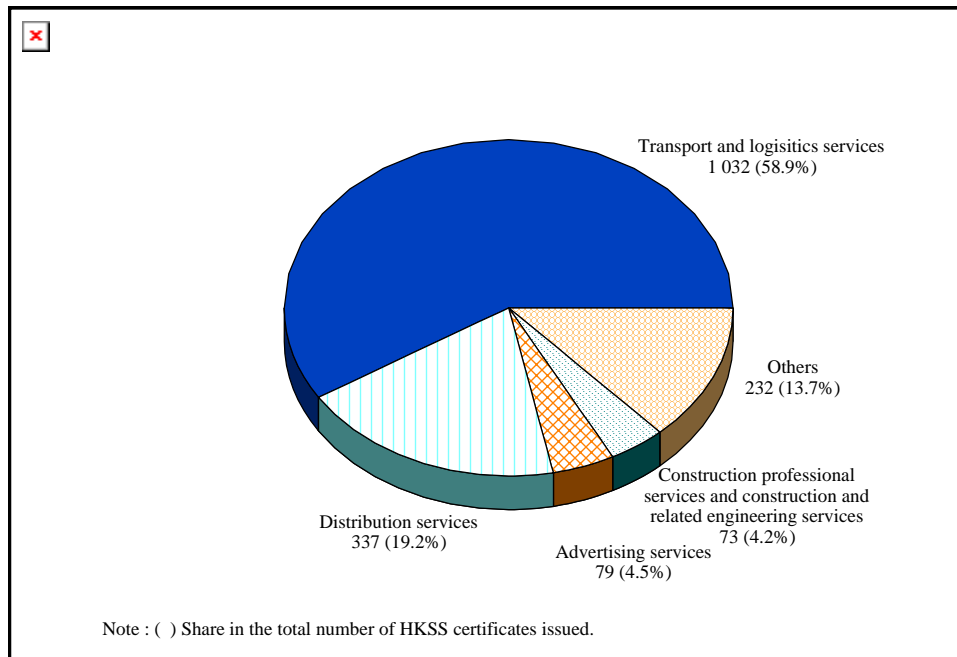
### Issuance of Hong Kong Service Supplier certificates

14. The number of HKSS certificates issued increased steadily over the years. Altogether 1 753 certificates of HKSS were issued in the 22 services sectors as at end-April 2007. The bulk is in transport and logistics and distribution services, at 1 032 and 337 respectively (*Charts 1 & 2*)

**Chart 1: Number of HKSS applications approved and certificates issued**



**Chart 2: Number of certificates of HKSS issued to major services sectors as at end-April 2007**



### **Plans of setting up operation in the Mainland**

15. Among the HKSS certificate holders surveyed, 45% have set up operation under CEPA in or before 2005 and 14% in 2006. Another 10% indicated that they have plans to do so in 2007 or beyond. Management consultancy (91%), banking services (80%), audio-visual services (80%), job referral agencies/ job intermediaries (79%) , legal (78%) and freight and transport logistics (78%) have the highest percentages of HKSS certificate holders having /have plans to set up operation in the Mainland (**Table 2**). For the remaining HKSS holders, the main reason for not setting up or planning to set up operation was that they already had operations in the Mainland before CEPA came into effect.

**Table 2: Percentage of establishments setting up/ planned to set up operation in the Mainland under CEPA by service industry group**

| Service industry group                 | Establishments which have/planned to set up operation in the Mainland under CEPA (%) |           |                            |           |                            |
|--|--|-----------|----------------------------|-----------|----------------------------|
|  | HKSS Holders   |           |                            |           | Non-HKSS holders           |
|  | 2005 or Before   | 2006      | 2007 and beyond (expected) | Total     | 2007 and beyond (expected) |
| Legal services                         | 22   | 0         | 56                         | 78        | 2                          |
| Management consultancy services        | 77   | 5         | 9                          | 91        | 6                          |
| Audio-visual services                  | 33   | 13        | 33                         | 80        | *                          |
| Distribution services                  | 52   | 10        | 5                          | 67        | *                          |
| Banking services                       | 60   | 20        | 0                          | 80        | 0                          |
| Freight transport and logistics        | 51   | 19        | 8                          | 78        | 4                          |
| Job referral agency / Job intermediary | 7  | 29        | 43                         | 79        | *                          |
| <b>All above</b>                       | <b>45</b>  | <b>14</b> | <b>10</b>                  | <b>70</b> | <b>1</b>                   |

Note: (\*) Denotes less than 0.5%.

16. CEPA has generated 9.1 billion worth of services receipts for companies in the 22 services industry groups covered since 2004. This is equivalent to 4.4% of these companies' overall services receipts from the Mainland market during the same period. Services receipts from the Mainland due to CEPA grew remarkably over the years. At HK\$4.2 billion in 2006, the value of services exported to the Mainland due to CEPA was 2.6 times that in 2004. It is expected to grow a further 28% to HK\$5.3 billion in 2007 and beyond (*Table 3*)

17. Amongst the 22 industry groups, distribution services recorded the largest CEPA-induced exports of services in 2004, 2005 and 2006, at HK\$1.1 billion, HK\$2.0 billion, HK\$2.5 billion respectively. This accounted for over 60% of all the CEPA induced exports of services between 2004 and 2006. This was followed by freight transport and logistics, which exported services with a value of HK\$2.2 billion due to CEPA in the past three years.



**Table 3: Amount/expected amount of services receipts from the Mainland**

(HK\$ million)

| Service industry group                              | 2004*         |                    | 2005          |                    | 2006          |                    | 2007 and beyond (expected) |                    |
|---|---------------|--------------------|---------------|--------------------|---------------|--------------------|----------------------------|--------------------|
|   | Total amount  | Amount due to CEPA | Total amount  | Amount due to CEPA | Total amount  | Amount due to CEPA | Total amount               | Amount due to CEPA |
| Distribution services                               | 38,288        | 1,120              | 50,506        | 1,967              | 55,596        | 2,522              | 53,657                     | 2,507              |
| Freight transport and logistics                     | 11,183        | 129                | 11,260        | 880                | 12,829        | 1,164              | 22,814                     | 1,918              |
| Value-added telecommunication                       | 911           | 2                  | 529           | 3                  | 645           | 1                  | 791                        | 1                  |
| Audio-visual services                               | 73            | 0                  | 66            | 4                  | 87            | 8                  | 258                        | 23                 |
| Others <sup>(#)</sup>                               | 9,440         | 332                | 7,967         | 469                | 8,808         | 484                | 10,187                     | 883                |
| <b>All 22 service industry groups<sup>(+)</sup></b> | <b>59,894</b> | <b>1,582</b>       | <b>70,328</b> | <b>3,323</b>       | <b>77,965</b> | <b>4,179</b>       | <b>87,707</b>              | <b>5,332</b>       |

Note: (\*) Figures for 2004 refer to the results of the “Survey for Assessing the Impact of CEPA on the Hong Kong Economy” conducted in 2004/05.

(#) “Others” refers to the remaining 18 service industries not explicitly specified in the table. For a full list of 22 service industries, please refer to paragraph 8.

(+) There may be a slight discrepancy between the sum of individual items and the total as shown in the table owing to rounding.

### **Induced capital investment**

18. For the 22 service industry groups taken together, the CEPA-induced additional capital investment in Hong Kong amounted to HK\$2.1 billion in 2005, HK\$1.7 billion in 2006, and an expected further HK\$2.4 billion in 2007 and beyond. Over the years, the CEPA-induced additional investment has been mainly in plant and machinery. Amongst the 22 service industry groups, distribution services and freight transport and logistics contributed the bulk of additional investment in the past few years (*Table 4*).

**Table 4 : CEPA-induced capital investment in the services industry in Hong Kong**

(HK\$ million)

| <b>Industry Group</b>                        | <b>2004*</b> | <b>2005</b>  | <b>2006</b>  | <b>2007 and beyond (expected)</b> |
|--|--------------|--------------|--------------|-----------------------------------|
| Distribution services                        | 192          | 1,555        | 912          | 735                               |
| Freight transport and logistics              | 434          | 480          | 558          | 1,026                             |
| Audio-visual services                        | 21           | 0            | 61           | 0                                 |
| Tourism and related services                 | 1            | 35           | 187          | 346                               |
| Others <sup>(#)</sup>                        | 364          | 24           | 16           | 300                               |
| <b>Overall (22 industries)<sup>(+)</sup></b> | <b>1,012</b> | <b>2,094</b> | <b>1,733</b> | <b>2,406</b>                      |

Note: (\*) Results of survey conducted in 2004/05.

(#) "Others" refers to the remaining 18 service industries not explicitly specified in the table. For a full list of 22 service industries, please refer to paragraph 8.

(+) There may be a slight discrepancy between the sum of individual items and the total as shown in the table owing to rounding.

19. The CEPA-induced capital investment in Hong Kong was smaller in 2005 than earlier expected (according to the survey conducted in 2004). However, investment in the Mainland was much higher than earlier expected, and was higher than that in Hong Kong as well (*Table 5*).

20. In 2005, HK\$4.2 billion of CEPA-induced investment took place in the Mainland. Distribution services, and freight transport and logistics registered the largest amount of investment in the Mainland since the implementation of CEPA in 2004. Both industries continued to expect large investment in 2007 and beyond. Investment from the banking services was also very substantial in both 2004 and 2005.

**Table 5: CEPA-induced capital investment in the services industry in the Mainland**

(HK\$ million)

| <b>Industry group</b>                        | <b>2004*</b> | <b>2005</b>  | <b>2006</b>  | <b>2007 and beyond (expected)</b> |
|--|--------------|--------------|--------------|-----------------------------------|
| Distribution services                        | 862          | 1,575        | 716          | 1,143                             |
| Banking services                             | 809          | 1,080        | 240          | 120                               |
| Freight transport and logistics              | 726          | 1,095        | 778          | 1,454                             |
| Audio-visual services                        | 24           | 6            | 111          | 80                                |
| Value-added telecommunications               | 224          | 300          | 0            | 74                                |
| Others <sup>(#)</sup>                        | 222          | 163          | 260          | 1,769                             |
| <b>Overall (22 industries)<sup>(+)</sup></b> | <b>2,867</b> | <b>4,218</b> | <b>2,106</b> | <b>4,641</b>                      |

Note: (\*) Results of the survey conducted in 2004/05.

(#) "Others" refers to the remaining 17 service industries not explicitly specified in the table. For a full list of 22 service industries, please refer to paragraph 8.

(+) There may be a slight discrepancy between the sum of individual items and the total as shown in the table owing to rounding.

## Induced employment

21. CEPA-induced employment in Hong Kong, in terms of persons engaged, in the 22 industry groups was estimated to be around 4 300 in 2005 and 5 900 in 2006. This was expected to reach around 8 000 in 2007 and beyond. The number of new jobs created in Hong Kong due to CEPA was by far the largest in the distribution services, at around 2 800 in 2005 and 1 100 in 2006 (*Table 6*).

**Table 6: CEPA-induced employment in the services industry in Hong Kong**

*(no. of persons engaged)*

| <b>Industry Group</b>           | <b>2004*</b>         | <b>2005</b>          | <b>2006</b>          | <b>2007 and beyond<br/>(expected)</b> |
|---------------------------------|----------------------|----------------------|----------------------|---------------------------------------|
| Distribution services           | 386 (386)            | 3 216 (2 830)        | 4 330 (1 114)        | 4 354 (24)                            |
| Freight transport and logistics | 765 (765)            | 491 (-274)           | 515 (24)             | 708 (193)                             |
| Tourism and related services    | 24 (24)              | 95 (71)              | 332 (237)            | 692 (360)                             |
| Others <sup>(#)</sup>           | 240 (240)            | 493 (253)            | 700 (207)            | 2 203 (1 503)                         |
| <b>Overall (22 industries)</b>  | <b>1 415 (1 415)</b> | <b>4 295 (2 880)</b> | <b>5 877 (1 582)</b> | <b>7 957 (2 080)</b>                  |

Notes: (\*) Results of the survey conducted in 2004/05.

( ) Number of new jobs created.

(#) "Others" refers to the remaining 19 service industries not explicitly specified in the table. For a full list of 22 service industries, please refer to paragraph 8.

22. As for CEPA-induced employment in the Mainland in the 22 services industry groups, again the largest contributor came from distribution services, followed by freight transport and logistics. Most of the staff employed and the new jobs created were filled by non-Hong Kong residents (*Table 7*).

**Table 7: CEPA-induced employment in the services industry in the Mainland**

(no. of persons engaged)

| Industry group                  | 2004*        |                  | 2005                       |                                | 2006                          |                                 | 2007 and beyond (planned)      |                                  |
|---------------------------------|--------------|------------------|----------------------------|--------------------------------|-------------------------------|---------------------------------|--------------------------------|----------------------------------|
|                                 | HK Residents | Non-HK Residents | HK Residents               | Non-HK Residents               | HK Residents                  | Non-HK Residents                | HK Residents                   | Non-HK Residents                 |
| Distribution services           | 464          | 967              | 304<br>(-160)              | 3 344<br>(2 377)               | 682<br>( 378)                 | 7 552<br>(4 208)                | 1 025<br>( 343)                | 10 826<br>(3 274)                |
| Freight transport and logistics | 62           | 1 039            | 165<br>( 103)              | 3 989<br>(2 950)               | 171<br>( 6)                   | 5 399<br>(1 410)                | 303<br>( 132)                  | 6 600<br>(1 201)                 |
| Banking services                | 6            | 87               | 8<br>( 2)                  | 115<br>( 28)                   | 8<br>( 0)                     | 155<br>( 40)                    | 14<br>( 6)                     | 244<br>( 89)                     |
| Tourism and related services    | 0            | 0                | 0<br>( 0)                  | 6<br>( 6)                      | 1<br>( 1)                     | 25<br>( 19)                     | 8<br>( 7)                      | 93<br>( 68)                      |
| Audio-visual                    | 3            | 83               | 2<br>(-1)                  | 162<br>(79)                    | 5<br>(3)                      | 337<br>(175)                    | 12<br>(7)                      | 2 032<br>(1 695)                 |
| Value-added telecommunications  | 0            | 0                | 1<br>(1)                   | 141<br>(141)                   | 1<br>(0)                      | 144<br>(3)                      | 1<br>(0)                       | 211<br>(67)                      |
| Others <sup>(#)</sup>           | 9            | 122              | 94<br>(84)                 | 1 083<br>(961)                 | 132<br>(38)                   | 2 084<br>(1 001)                | 1 075<br>(943)                 | 7 734<br>(5 650)                 |
| <b>Overall (22 industries)</b>  | <b>544</b>   | <b>2 298</b>     | <b>574</b><br><b>( 30)</b> | <b>8 840</b><br><b>(6 542)</b> | <b>1 000</b><br><b>( 426)</b> | <b>15 696</b><br><b>(6 856)</b> | <b>2 438</b><br><b>(1 438)</b> | <b>27 740</b><br><b>(12 044)</b> |

Notes: (\*) Results of the survey conducted in 2004/05.

( ) Number of new jobs created.

(#) "Others" refers to the remaining 16 service industries not explicitly specified in the table. For a full list of 22 service industries, please refer to paragraph 8.

## Difficulties encountered by respondents

### (a) Setting up business in the Mainland under CEPA

23. Helped by the vast experience accumulated in the past in setting up companies in the Mainland, and to some extent, the assistance from the various trade associations and government bodies, 40% of the respondents felt that they did not face any insurmountable difficulties when setting up business in the Mainland under CEPA. However, there were still some common deterrence such as the long processing time (22%) and complicated application procedures (19%), as cited by the survey respondents (*Table 8*).

**Table 8: Difficulties encountered when setting up business in the Mainland under CEPA (HKSS holders only)**

| <b>Difficulties in opening up business in the Mainland</b>                                       | <b>Percentage of establishments reporting difficulties<sup>^</sup></b> |
|--|--|
| No difficulties  | 40.0%  |
| Long processing time   | 21.7%  |
| Complicated application procedures   | 18.9%  |
| Insufficient transparency in policies and regulations  | 13.3%  |
| High entry requirement   | 12.2%  |
| Insufficient knowledge of CEPA among Chinese officials   | 10.1%  |
| Variation in the implementation of policies among local regions                                  | 5.0%   |
| Lack of communications or inconsistent information flow between the central and local government | 2.8%   |

Note: (^) Respondents might report one or more difficulties and the sum of percentages might exceed 100%.

(b) Running business in the Mainland under CEPA

24. Again, the majority (63%) of the HKSS certificate holders reported no difficulties in running business in the Mainland, although some were not familiar with the business environment in the Mainland (20%) (*Table 9*).

**Table 9: Difficulties encountered when running business in the Mainland under CEPA(HKSS holders only)**

| <b>Difficulties in running business in the Mainland</b>         | <b>Percentage of establishments reporting difficulties<sup>#</sup></b> |
|---|--|
| No difficulties reported <sup>^</sup>                           | 63.2%  |
| Not familiar with the business environment in the Mainland      | 20.3%  |
| Complicated or heavy taxation system in the Mainland            | 8.0%   |
| Insufficient transparency in policies and regulations           | 8.0%   |
| Variation in the implementation of policies among local regions | 6.8%   |
| Complicated legal system  | 3.7%   |

Notes: (^) Some respondents reported “No difficulties” because the company was newly established under CEPA.

(#) Respondents could report one or more difficulties and the sum of percentages might exceed 100%.

## Suggested improvements

25. Notwithstanding the high percentage of respondents indicating that they have encountered no difficulties in setting up or running businesses in the Mainland under CEPA, some areas for improvement are still identified. The details are as set out in *Table 10*.

**Table 10: Aspects that could be further enhanced**

*(% of respondents citing those areas)*

|  |     |
|--|-----|
| 1. Allowing wholly-owned or joint venture operations                               | 25% |
| 2. Reducing the requirement for registered capital                                 | 31% |
| 3. Relaxing the restrictions over geographical location                            | 25% |
| 4. Relaxing the restrictions over business scope                                   | 27% |
| 5. Setting up one-stop enquiry point and dedicated processing counter              | 29% |
| 6. Delegating the approval authority from the central government                   | 23% |
| 7. Expanding business scope  | 31% |
| 8. Expanding the Mainland market   | 26% |
| 9. Attracting foreign investment partner in jointly developing the Mainland market | 17% |

**The Mainland and Hong Kong  
Closer Economic Partnership Arrangement (CEPA):**

**Review of economic impact on the Hong Kong economy  
(Trade in goods)**

**General Remarks**

Hong Kong has long become a service-based economy. The importance of domestic exports and manufacturing has diminished over the years. Domestic exports now account for only 5.5% of Hong Kong's total exports and manufacturing only 3.4% of GDP and 6.4% of total employment. Of Hong Kong's domestic exports, about 30% are destined for the Mainland. Of these, slightly more than half are associated with outward processing arrangement and are thus not subject to tariff in any case. The direct impact of CEPA for trade in goods is thus unlikely to be overwhelmingly large.

2. However, against the backdrop of a rapidly expanding domestic economy in the Mainland, the demand for quality goods from all over the world can be expected to rise over time. Hong Kong's products are likely to benefit from this. Moreover, the increased flexibility in expanding the list of CEPA Rules of Origin (ROOs) for goods qualifying for tariff-free treatment implies that more Hong Kong manufacturers could potentially benefit from the arrangement.

3. Attempts are made to assess the impact of CEPA on trade in goods, although there are constraints to the assessment. For instance,

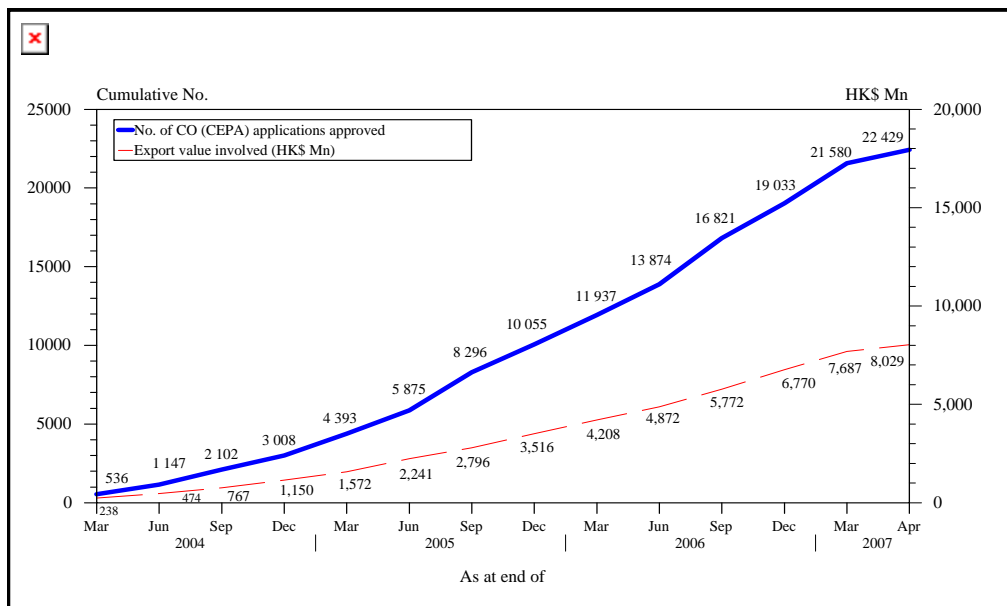
- the benefits of CEPA are often so entwined with the general macro-environment and embodied in the ultimate outcome that it is difficult to disaggregate and attribute; and
- the intangible benefits of CEPA, such as the revived business confidence in view of the support given by the Central Government could not be captured in the assessment.

**Trade in goods under CEPA**

4. Since 1 January 2006, the Mainland agreed to give all products of Hong Kong origin tariff free treatment, upon applications by local manufacturers and upon the CEPA ROOs being agreed and met. As at 30

April 2007, the Trade and Industry Department and the Government Approved Certification Organizations received a cumulative 23 218 CO(CEPA) applications, of which 22 429 applications were approved, involving products with a total value of HK\$8.0 billion (*Chart 1*; for details please refer to *Appendix IIa*).

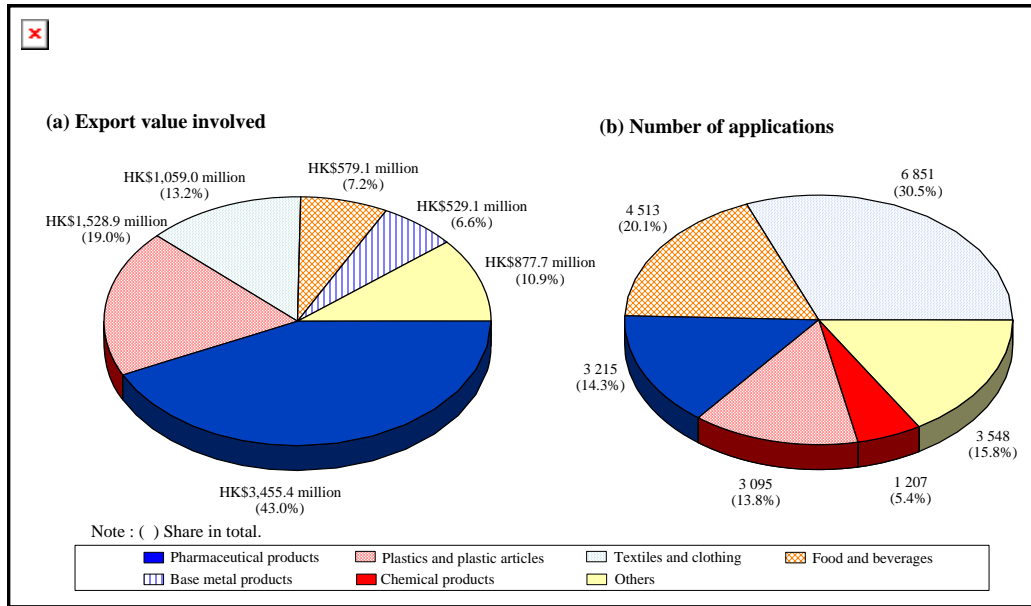
**Chart 1: CO(CEPA) applications approved and export value involved**



5. Most of the CO(CEPA) applications came from the textiles and clothing industries (30.5%), followed by food and beverages (20.1%) and pharmaceutical products (14.3%). However, in terms of export value involved, pharmaceutical products accounted for nearly 43% of the total, followed by plastics and plastics articles (19%), and textiles and clothing (13.2%) (*Chart 2*)



**Chart 2: Approved CO(CEPA) applications by major product type as at end-April 2007**



6. The number of the approved CO(CEPA) in 2006 was 27% higher than in 2005, and the corresponding export value was 38% higher over the same period. At HK\$3.3 billion in 2006, this was equivalent to 2.4% of Hong Kong's total domestic exports and 8.1% of Hong Kong's domestic exports to the Mainland in the same year. There was a notable increase in the relative share of CO(CEPA) products in Hong Kong's domestic exports (*Table 1*).

**Table 1: Export value of CO(CEPA) products and its relative share to Hong Kong's domestic exports**

|                | Export value of CO(CEPA) products (HK\$ million) | Share of domestic exports to the Mainland (%) | Share of total domestic exports (%) |
|----------------|--|---|-------------------------------------|
| 2004           | 1,150  | 3.0   | 0.9                                 |
| 2005           | 2,366  | 5.3   | 1.9                                 |
| 2006           | 3,254  | 8.1   | 2.4                                 |
| 2007 (Jan-Apr) | 1,259  | 10.6  | 4.1                                 |

### Methodology for CEPA impact assessment

7. The assessment was based on the findings of a statistical survey, covering around 8 903 establishments. Of these, only 4% are manufacturers/traders engaging in domestic exports of the CEPA products

using CO(CEPA) or having applied for commodities to be covered in the second phase of consultations on CEPA ROOs in 2006. The rest are traders exporting these products to the Mainland, but have not applied for or used CO(CEPA). Of the 363 establishments which applied for or held approved CO(CEPA)s, 199 were sampled and 163 successfully enumerated. As for the 8 540 non-CO(CEPA) users which have exported CEPA covered goods, 349 were sampled and 255 successfully enumerated. The overall response rate was 76% (82% for CO(CEPA) users and 73% for non-users).

### General Opinion

8. Manufacturers and traders are generally positive about CEPA’s benefit to the Hong Kong economy and to the manufacturing sector, though they tend to attribute less significance of CEPA to their own business (*Table 2*). Traders/manufacturers in the pharmaceutical, and food and beverage industries are generally more positive about CEPA’s benefits than those in other industries.

**Table 2: General opinion of traders/manufacturers about CEPA**

|                    | <i>(% of total)</i>                        |  |   |   |
|--------------------|--|--|---|---|
|                    | <b>Beneficial to the Hong Kong economy</b> | <b>Beneficial to Hong Kong's manufacturing</b> | <b>Beneficial to the future business of the company</b> | <b>Beneficial to the current business of the company related to the Mainland market</b> |
| <b>Overall</b>     | <b>89</b>                                  | <b>77</b>                                      | <b>35</b>   | <b>26</b>   |
| <i>Of which:</i>   |  |  |   |   |
| Pharmaceuticals    | 93   | 95   | 78  | 81  |
| Food and beverages | 90   | 89   | 55  | 50  |

### CEPA coverage and usage

9. CEPA’s coverage has expanded visibly over the years. It expanded from around 64% of the value of Hong Kong domestic exports to the Mainland in 2004 to over 70% in 2006 (*Table 3*).

**Table 3: Domestic exports to the Mainland and CEPA coverage**

| Year | Food and beverage<br>(HK\$ million) | Pharmaceuticals<br>(HK\$ million) | Others<br>(HK\$ million) | Total<br>(HK\$ million) |
|------|-------------------------------------|-----------------------------------|--------------------------|-------------------------|
| 2001 | 314                                 | 750                               | 48,483                   | 49,547                  |
| 2002 | 363                                 | 708                               | 40,303                   | 41,374                  |
| 2003 | 299                                 | 1,037                             | 35,422                   | 36,757                  |
| 2004 | 318 (0.1%)                          | 863 (97.4%)                       | 36,717 (64.2%)           | 37,898 (64.4%)          |
| 2005 | 458 (47.9%)                         | 1,124 (99.6%)                     | 43,060 (64.7%)           | 44,643 (65.4%)          |
| 2006 | 605 (48.6%)                         | 1,222 (99.8%)                     | 38,441 (69.6%)           | 40,268 (70.2%)          |

Note : ( ) Figures in brackets refer to the percentage shares of products with agreed CEPA ROOs, regardless of whether the goods have claimed tariff free treatment or not (i.e. exported with approved CO(CEPA)s or not).

10. Since its introduction in 2004, the overall CO(CEPA) utilization rates have improved from 4.7% to 11.5%, reflecting gradual acknowledgement of the CEPA benefits and wider usage of the scheme in the trade (*Table 4*).

**Table 4: Goods with approved CO(CEPA)s and CO(CEPA) utilization rates<sup>(\*)</sup>**

| Year | Food and beverage<br>(HK\$ million) |          | Pharmaceuticals<br>(HK\$ million) |         | Others<br>(HK\$ million) |        | Total<br>(HK\$ million) |         |
|------|-------------------------------------|----------|-----------------------------------|---------|--------------------------|--------|-------------------------|---------|
| 2004 | 0.3                                 | (100.0%) | 737                               | (87.7%) | 413                      | (1.8%) | 1,150                   | (4.7%)  |
| 2005 | 188                                 | (85.4%)  | 1,088                             | (97.2%) | 1,091                    | (3.9%) | 2,366                   | (8.1%)  |
| 2006 | 293                                 | (99.6%)  | 1,201                             | (98.5%) | 1,760                    | (6.6%) | 3,254                   | (11.5%) |

Notes: ( ) Figures in brackets refer to the value of goods with CO(CEPA)s as a % of total domestic exports of goods that have agreed ROOs (i.e. CO(CEPA) utilization rates).

(\*) Please note that the utilization rates are for reference only, as goods with approved CO(CEPA)s may not be exported eventually.

11. Commodities such as pharmaceuticals and food & beverage products have recorded faster-than-average export growth over the years. This should be partially attributable to their higher CO(CEPA) utilization rates. It should have also helped offset some of the decline in the exports of other commodities (*Table 5*).

**Table 5: Domestic exports to the Mainland and its growth rates**

| Year              | Food and beverage<br>(HK\$ million) | Pharmaceuticals<br>(HK\$ million) | Others<br>(HK\$ million) | Total<br>(HK\$ million) |
|-------------------|-------------------------------------|-----------------------------------|--------------------------|-------------------------|
| 2001              | 314 -                               | 750 -                             | 48,483 -                 | 49,547 -                |
| 2002              | 363 (15.8)                          | 708 (-5.7)                        | 40,303 (-16.9)           | 41,374 (-16.5)          |
| 2003              | 299 (-17.7)                         | 1,037 (46.5)                      | 35,422 (-12.1)           | 36,757 (-11.2)          |
| 2004              | 318 (6.5)                           | 863 (-16.7)                       | 36,717 (3.7)             | 37,898 (3.1)            |
| 2005              | 458 (44.0)                          | 1,124 (30.3)                      | 43,060 (17.3)            | 44,643 (17.8)           |
| 2006              | 605 (31.9)                          | 1,222 (8.7)                       | 38,441 (-10.7)           | 40,268 (-9.8)           |
| Five year average | (14.0)                              | (10.2)                            | (-4.5)                   | (-4.1)                  |

Notes: ( ) Figures in brackets are their respective growth rates.

## CEPA-induced change in scale of operation

### (a) Capital Investment

12. Net additional CEPA-induced capital investment in Hong Kong amounted to HK\$103 million in 2005, HK\$202 million in 2006, and a planned HK\$239 million in 2007 and beyond (*Table 6*). Establishments engaged in the manufacturing/exports of pharmaceutical products constituted around 70% of the total actual/planned capital investment in 2005 to 2007 and beyond. And those involved in trading/producing food and beverage products accounted for around 20% of the total during the same period.

**Table 6: CEPA-induced capital investment in Hong Kong for manufacturers/traders**

(HK\$ million)

|   | 2005         | 2006         | 2007 and beyond (expected)* |
|---|--------------|--------------|-----------------------------|
| <b>All commodity groups covered by CEPA</b> | <b>103.3</b> | <b>202.2</b> | <b>238.9</b>                |
| <i>Of which:</i>                            |              |              |                             |
| Pharmaceuticals                             | 36.3         | 188.2        | 159.4                       |
| Food and Beverages                          | 26.8         | 23.4         | 64.5                        |

### (b) Occupancy of self-owned or rented premises

13. As some of the firms expanded their scale of operation in Hong Kong, there was a net take-up of both industrial and non-industrial premises due to CEPA. A net total of 14 657m<sup>2</sup> and 14 670m<sup>2</sup> of industrial and non-industrial floor area was taken up due to CEPA in 2005 and 2006 respectively. Another

21 351m<sup>2</sup> was planned for 2007 and beyond (*Table 7*). The take-up of industrial premises due to CEPA in 2005 was equivalent to around 5% of the total take-up of flatted factories<sup>(1)</sup> in the same year.

14. For the pharmaceuticals, all of the additional floor space taken up due to CEPA in 2005 was for industrial use. However, in 2006 additional non-industrial premises were also taken up. The take up accounted for nearly all of the non-industrial premises taken up due to CEPA in that year. Looking ahead, pharmaceuticals will see further increase in production capacity, as reflected in their expected floor area expansion in 2007 and beyond. The industrial floor area figure indicated is nearly 15 times their space taken up due to CEPA in 2005 and 2006 combined.

**Table 7: Estimated net increase in occupied premises due to CEPA**

(sq. m)

|   | 2005          |                | 2006         |                | 2007 and beyond<br>(expected)* |                |
|---|---------------|----------------|--------------|----------------|--------------------------------|----------------|
|   | Industrial    | Non-industrial | Industrial   | Non-industrial | Industrial                     | Non-industrial |
| <b>All commodity groups covered by CEPA</b> | <b>10 866</b> | <b>3 791</b>   | <b>2 470</b> | <b>12 200</b>  | <b>21 051</b>                  | <b>300</b>     |
| <i>Of which:</i>                            |               |                |              |                |                                |                |
| Pharmaceuticals                             | 640           | 0              | 755          | 12 000         | 20 333                         | 0              |
| Food and Beverages                          | 2 800         | 0              | 680          | 200            | 470                            | 300            |

**(c) Employment**

15. Along with the rise in CEPA-induced capital investment, an estimated 736 and 1 583 new jobs were created in Hong Kong in 2005 and 2006 respectively. For 2007 and beyond, another 1 562 new posts are planned (*Table 8*). Again, most of the jobs created were involved in either the manufacturing or trading of pharmaceutical products.

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(1) 2006 figures on the total take-up of flatted factories are not available yet. However it should not account for a significant share either, as most of the floor area take-up was in non-industrial premises.

**Table 8: New jobs created due to CEPA in trade/manufacturing in Hong Kong<sup>#</sup>**  
*(no. of new jobs)*

|   | 2005       | 2006         | 2007 and beyond (expected)* |
|---|------------|--------------|-----------------------------|
| <b>All commodity groups covered by CEPA</b> | <b>736</b> | <b>1 583</b> | <b>1 562</b>                |
| <i>Of which:</i>                            |            |              |                             |
| Pharmaceuticals                             | 712        | 924          | 1 249                       |
| Food and beverages                          | 25         | 82           | 75                          |

Note: (\*) Covers only those who have either used CO(CEPA), or applied for commodities to be covered in the second phase of consultations on CEPA ROOs in 2006, or have exported goods covered by CEPA during 2005 and in the first eight months of 2006.

### **Factors constraining the CEPA benefits for trade in goods**

16. One of the main difficulties respondents faced in taking advantage of CEPA was that their goods did not satisfy the conditions for Hong Kong origin under CEPA. This could be due to more fundamental reasons, such as high transportation and production costs, proximity to supply chain, lack of suitable factory space, etc., rendering it difficult for many industries to locate and conduct the major necessary production processes in Hong Kong in order to satisfy the CEPA ROOs. This implies that those industries with otherwise high Mainland tariff rate, high capital intensity, high value-added content, high intellectual property content and well established brand names should be able to overcome this difficulty more easily and be able to benefit more from CEPA.

17. Other common factors cited were that they are not familiar with the application process, and information regarding CEPA was scattered. These could be overcome over time.

18. For the pharmaceuticals and food & beverage segments in particular, some respondents opined that they lacked distribution support in the Mainland, which may be due to lack of information on retail outlets in the Mainland and the need to apply additional licenses to sell products in the Mainland. Very often, the application of licences in the Mainland is complicated and involves various authorities, and procedures also vary between provinces and/or cities. Details of the survey result are tabulated in *Table 9*.

**Table 9: Difficulties faced by Hong Kong manufacturers/traders that limit benefits from CEPA**

*(% of respondents)*

|  | <b>All commodity groups covered by CEPA</b> | <b>Of which: Pharmaceuticals</b> | <b>Food and Beverage</b> |
|--|---|----------------------------------|--------------------------|
| 1. Goods did not satisfy conditions for Hong Kong origin under CEPA                                      | <b>37</b>                                   | 16                               | 29                       |
| 2. Insignificant tariff savings  | <b>8</b>                                    | 31                               | 11                       |
| 3. Unfamiliar with application process   | <b>16</b>                                   | 20                               | 14                       |
| 4. Cannot comply with separate set of regulations governing issuance of Certificate of Origin under CEPA | <b>4</b>                                    | 0                                | 7                        |
| 5. Restrictions on distribution of goods in the Mainland   | <b>5</b>                                    | 5                                | 10                       |
| 6. Others <sup>(#)</sup>   | <b>51</b>                                   | 43                               | 54                       |
| 7. No difficulties   | <b>3</b>                                    | 16                               | 9                        |

Note: (#) The responses classified as “others” varied widely between different respondents, relatively common ones include: application procedures complicated, lack of skilled manufacturing labour in Hong Kong, issue of CO(CEPA) requires too much time and is not suitable for fast turn-around trading.

## Appendix IIa

### Cumulative statistics of CO(CEPA) applications

| Products Types  | CO(CEPA) Applications Received |                      | CO(CEPA) Applications Approved <sup>(*)</sup> |                      | Cumulative FOB Value |                      |
|---|--------------------------------|----------------------|---|----------------------|----------------------|----------------------|
|   | As at end-2006                 | As at end-April 2007 | As at end-2006                                | As at end-April 2007 | As at end-2006       | As at end-April 2007 |
|   | (No.)                          | (No.)                | (No.)   | (No.)                | (HK\$ million)       | (HK\$ million)       |
| Food and Beverages  | 3 596                          | 4 601                | 3 534   | 4 513                | 480.9                | 579.1                |
| Food Residues and Animal Fodder                               | 9                              | 16                   | 9   | 16                   | 0.4                  | 0.7                  |
| Chemical Products   | 1 092                          | 1 275                | 1 033   | 1 207                | 215.4                | 259.1                |
| Pharmaceutical Products                                       | 2 894                          | 3 280                | 2 835   | 3 215                | 3,026.0              | 3,455.4              |
| Colouring Matters   | 825                            | 955                  | 804   | 934                  | 249.4                | 289.5                |
| Cosmetics   | 34                             | 43                   | 32  | 37                   | 1.7                  | 2.9                  |
| Plastics and Plastic Articles                                 | 2 652                          | 3 143                | 2 617   | 3 095                | 1,221.3              | 1,528.9              |
| Leather and Furskin Articles                                  | 18                             | 21                   | 15  | 16                   | 5.5                  | 5.5                  |
| Paper and Printed Articles                                    | 1 041                          | 1 067                | 1 003   | 1 028                | 75.4                 | 83.0                 |
| Textiles and Clothing   | 6 294                          | 7 249                | 5 891   | 6 851                | 879.3                | 1,059.0              |
| Jewelry and Precious Metals                                   | 168                            | 210                  | 167   | 209                  | 60.2                 | 69.4                 |
| Base Metal Products   | 749                            | 910                  | 737   | 900                  | 416.9                | 529.1                |
| Machinery and Mechanical Appliances                           | 10                             | 12                   | 9   | 11                   | 4.8                  | 6.6                  |
| Electrical and Electronic Products                            | 319                            | 387                  | 300   | 364                  | 61.7                 | 73.1                 |
| Optical, Photographic and Cinematographic Instruments & Parts | 66                             | 79                   | 63  | 76                   | 62.9                 | 77.9                 |
| Clocks and Watches and Parts Thereof                          | 131                            | 153                  | 118   | 140                  | 8.1                  | 9.9                  |
| Furniture   | 1                              | 1                    | 1   | 1                    | 0.02                 | 0.02                 |
| Toys and Games or Sports Requisites                           | 1                              | 1                    | 1   | 1                    | 0.009                | 0.009                |
| Miscellaneous   | 3                              | 3                    | 3   | 3                    | 0.04                 | 0.04                 |
| <b>Total<sup>(#)</sup>:</b>                                   | <b>19 765</b>                  | <b>23 218</b>        | <b>19 033</b>                                 | <b>22 429</b>        | <b>6,770.3</b>       | <b>8,029.2</b>       |

Notes: (\*) The total figure may not be equal to the sum of CO(CEPA)s covering CEPA I, II & III + products as one CO(CEPA) can cover products of all phases.

(#) The total figure may not be equal to the sum of all product types as one CO(CEPA) can cover products of more than one type.



### **The Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA):**

#### **Review of economic impact on the Hong Kong Economy (Individual Visit Scheme)**

##### **Background**

The Individual Visit Scheme (IVS), introduced under the framework of CEPA, was first implemented on 28 July 2003. The scheme allowed residents from designated cities on the Mainland to visit Hong Kong two times within a period of up to one year and stay in Hong Kong each time for up to seven days. Eligible applicants may apply for new endorsements once the current one expired or has been used up.

2. The scheme has been successively extended over the years. It now covers 49 cities, including all the 21 cities of the Guangdong province, the capital cities of the remaining eight Pan-PRD provinces, plus Tianjin, Beijing, Shanghai and the provincial capitals of Hebei, Henan, Jilin, Anhui and Hubei. (see *Appendix IIIa* for the geographical coverage of the scheme).

3. This note attempts to assess the implications of IVS for the different tourism-related sectors in Hong Kong in terms of both value-added and employment and also the macro impact for the economy as a whole.

##### **Latest situation**

4. Since the introduction of IVS, Mainland visitors have made 17.2 million trips to Hong Kong under the scheme. The total number of Mainland visitor arrivals in 2006 was two times the number of trips in 2002 (at 6.8 million) or 1.9 times in the twelve-months preceding August 2003 (at 7.3 million) (*Table 1*). Along with this, tourism receipts also rose visibly (*Table 2*).

**Table 1: Mainland visitors to Hong Kong**

(Thousands of persons)

|              | All visitors   | Total             |                    | All visitors  | IVS Arrivals      |                    | All visitors  | Non-IVS Arrivals  |                    |
|--------------|----------------|-------------------|--------------------|---------------|-------------------|--------------------|---------------|-------------------|--------------------|
|              |                | Same-day visitors | Overnight visitors |               | Same-day visitors | Overnight visitors |               | Same-day visitors | Overnight visitors |
| 2003 Jul-Dec | <b>5231.9</b>  | 1671.5            | 3560.3             | <b>667.3</b>  | 136.0             | 531.2              | <b>4564.6</b> | 1535.5            | 3029.1             |
| 2004         | <b>12245.9</b> | 4452.0            | 7793.9             | <b>4259.6</b> | 1176.5            | 3083.1             | <b>7986.3</b> | 3275.4            | 4710.8             |
| 2005         | <b>12541.4</b> | 4511.7            | 8029.7             | <b>5550.3</b> | 2002.2            | 3548.1             | <b>6991.1</b> | 2509.5            | 4481.6             |
| 2006         | <b>13591.3</b> | 5157.1            | 8434.3             | <b>6673.3</b> | 2509.9            | 4163.3             | <b>6918.1</b> | 2647.1            | 4270.9             |

**Table 2: Tourist spending from Mainland visitors**

|             | Total        |          | Same-day visitors |          | Overnight visitors |          |
|-------------|--------------|----------|-------------------|----------|--------------------|----------|
|             | HK\$ million | % growth | HK\$ million      | % growth | HK\$ million       | % growth |
| <b>2001</b> | 17,432.16    | 20.6     | 1,609.5           | 32.0     | 15,822.7           | 19.5     |
| <b>2002</b> | 28,052.03    | 60.9     | 1,996.1           | 24.0     | 26,056.0           | 64.7     |
| <b>2003</b> | 33,377.82    | 19.0     | 3,578.1           | 79.3     | 29,799.7           | 14.4     |
| <b>2004</b> | 38,582.55    | 15.6     | 4,641.5           | 29.7     | 33,941.0           | 13.9     |
| <b>2005</b> | 42,196.38    | 9.4      | 5,626.7           | 21.2     | 36,569.7           | 7.7      |
| <b>2006</b> | 47,605.37    | 12.8     | 7,926.0           | 40.9     | 39,679.3           | 8.5      |

## Methodology

5. In December 2006, the Hong Kong Tourism Board interviewed a random sample of IVS visitors to estimate the additional trips spurred by IVS and the incremental IVS visitors' spending on different items. From the incremental visitors' spending generated by IVS, and applying the results of the econometric model on GDP forecasting, the impact of IVS on the Hong Kong economy was estimated. The methodology was similar to that adopted in the previous assessment done in 2004.

6. Broadly speaking, IVS visitor arrivals could be divided into two categories, those induced by *substitution effect* and those by *demand creation effect*.

- (a) ***Substitution effect*** – this includes those visits that would have been made even without IVS; IVS was used mainly as a substitution for other travel documents.

- (b) ***Demand creation effect*** – the visits made are as induced by IVS. These include visits from first time visitors who came because they were attracted by IVS and those who increased their travelling frequency as a result of the convenience and flexibility brought by using IVS. Arrivals as induced by this effect are referred to as “incremental IVS arrivals”, the main focus of this assessment exercise.

7. Finally, matching the IVS visitors’ spending on different items to the related sectors, and making reference to the business receipts and value-added content of the said sectors and their relationship with employment, the impact of IVS on major tourism-related industries was also estimated<sup>(1)</sup>.

### **Incremental IVS arrivals**

8. Incremental IVS arrivals continued to rise in 2006 (from 2.5 million in 2004 to 3.3 million in 2006), alongside with the increase in overall IVS arrivals. These additional visitor arrivals have brought more tourist spending to the Hong Kong economy.

9. The share of incremental arrivals to overall IVS visitor arrivals has fallen from 59% in 2004 to 49% in 2006, as more Mainland visitors

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(1) There are however some constraints in evaluating the impact of IVS:

- **Time gap between the present survey and the first of IVS launch and the effects of inaccurate memory.** The estimation of incremental arrivals requires knowledge of visitors’ pre-IVS visiting frequency. Its accuracy may be affected by visitors’ fading recollection of past visits. As the time gap between the survey period and the initial launch of IVS increases, the reliability of visitors’ memory diminishes.
- **Difficulty in isolating the impact of IVS.** Expected travelling frequency after the launching of IVS is used in the model estimation, yet there are various factors apart from IVS, such as visitors’ travelling experience in Hong Kong, that could affect their responses regarding their expected future visiting frequencies, and hence would be included in the estimated incremental arrivals.
- **Lagged data used in estimating GDP/employment contribution.** As relevant data (e.g. value added per person) are available only with a significant time lag (up to one year), various assumptions have to be used and visible revisions might have to be made when more data become available subsequently.

switched from other travelling documents to using IVS. This implies that IVS is a more convenient alternative for the Mainland visitors. The benefits include convenience, flexibility, and improved communications that facilitate business contact and promote better understanding between people in the Mainland and in Hong Kong. While not all of these benefits are readily quantifiable, their significance as a catalyst for future visitor arrivals, e.g. as a word-of-mouth publicity, should not be under-estimated. The IVS is mutually beneficial to both the Mainland and Hong Kong.

### **Incremental spending by IVS visitors**

10. In 2006, the incremental spending induced by the Mainland visitors is estimated to be HK\$9,278 million, nearly 38% higher than that in 2004 (*Table 3*). The larger incremental spending was mainly driven by more incremental arrivals and higher per capita spending of IVS visitors.

11. The increased convenience of IVS has increased the frequency of travel, while shortening the length of stay of some of the Mainland visitors. According to Hong Kong Tourism Board's statistics, the share of same-day visits among IVS visitor arrivals rose from 27.6% in 2004 to 37.6% in 2006. But the average length of stay for overnight IVS visitors fell, by 0.2 days to 2.5 days in 2006 compared to 2004.

**Table 3: Incremental IVS visitor arrivals and tourist spending**

|      | <u>Incremental visitor arrivals</u><br>(million) | <u>Incremental tourist spending</u> <sup>(*)</sup><br>(HK\$ million) |
|------|--|--|
| 2004 | 2.51 (27.6%)                                     | 6,734  |
| 2005 | 2.72 (36.1%)                                     | 6,644  |
| 2006 | 3.27 (37.6%)                                     | 9,278  |

Notes : ( ) % of same-day visitors

(\*) Including spending on cross-boundary transport.

12. In 2005, despite an 8% increase in the number of incremental visitor arrivals, the incremental tourist spending was only broadly similar to 2004. This reflected that there was a larger mix of same-day visitors, who tended to spend less on hotel, restaurants and domestic transport than overnight visitors. However, in 2006, both the number of incremental visitor arrivals and per capita spending (especially those of same day visitors) rose visibly (*Table 4*), offsetting the impact of a larger mix of same-day visitors. As a result, incremental tourist spending recorded a 40% growth in the same year.

**Table 4: Per capita spending of Mainland visitors**

|                   | Mainland Visitors Overall |                   | IVS                |                   | Non-IVS            |                   |
|-------------------|---------------------------|-------------------|--------------------|-------------------|--------------------|-------------------|
|                   | Overnight visitors        | Same-day visitors | Overnight visitors | Same-day visitors | Overnight visitors | Same-day visitors |
| <b>2004</b>       | \$4,355                   | \$1,043           | \$3,305            | \$1,644           | \$4,908            | \$820             |
| <b>2005</b>       | \$4,554                   | \$1,247           | \$3,829            | \$1,663           | \$5,267            | \$928             |
| <b>2006 Q1-Q3</b> | \$4,599                   | \$1,526           | \$3,969            | \$1,978           | \$5,395            | \$963             |

### **Contribution to the Hong Kong Economy**

#### (a) Value added

13. Applying the tourism services related GDP multiplier, the net incremental spending by IVS visitors was estimated to raise Hong Kong's GDP by HK\$6.5 billion or 0.44% in 2006.

14. The overall Mainland visitor arrivals have been rising steadily in the past few years. However, the spending pattern of IVS visitors has changed, and the benefits of CEPA tended to vary between sectors. More specifically, retail sales benefited more as shopping expenses of the IVS visitors rose substantially, while hotel accommodation and restaurant did not get as much business from Mainland visitors as before.

15. Matching the incremental tourist spending to the different tourism related sectors, and making reference to the value-added content of each, the first round net contribution is estimated in *Table 4*. Value-added induced by IVS in the retail trade rose steadily over the past two years, and was 54% higher compared to 2004; that of hotel and boarding houses fell in 2005, and albeit rebounding in 2006, was still 20% lower than in 2004. The fall in dining expenses seemed to have stabilized in 2006 and thus the IVS-induced value-added from restaurants stabilized as well.

#### (b) Employment

16. The IVS-induced employment as revealed in *Table 5* reflected the changes in IVS visitors' spending pattern. Persons engaged in retail trade due to IVS rose 64% compared to 2004, while those engaged in hotels and restaurants declined.

17. The overall number of jobs induced by IVS actually fell in 2005, partly due to lower tourist spending in some sectors, and partly due to higher productivity of workers (as represented by a sharp increase in

value added per person engaged). Normally, employers are less willing to engage additional workers before they are fully confident that the rise in demand is going to persist. As incremental visitor arrivals and rising spending sustained and accelerated in 2006, employment attributable to IVS rebounded.

18. All in all, it is estimated that the additional visitor spending has generated employment for 25 742 persons in 2006, implying a net increase of 6 600 jobs since 2004<sup>(2)</sup>, the bulk of these took place in the retail trade sector (61%).

**Table 5: First round net contributions of the Individual Visit Scheme by selected sectors <sup>^</sup>**

|                             | <b>Overall Economy</b> | <i>of which</i>                  |                     |                    |  |  |
|-----------------------------|------------------------|----------------------------------|---------------------|--------------------|--|--|
|                             |                        | <u>Hotel and boarding houses</u> | <u>Retail trade</u> | <u>Restaurants</u> | <u>Other personal services<sup>#</sup></u> | <u>Cross boundary passenger services</u> |
| <b>Incremental Spending</b> |                        |                                  |                     |                    |  | (HK\$Million)                            |
| 2004                        | <b>6,480</b>           | 413                              | 4,736               | 900                | 431  | 254                                      |
| 2005                        | <b>6,443</b>           | 138                              | 5,374               | 667                | 264  | 201                                      |
| 2006                        | <b>8,907</b>           | 340                              | 7,689               | 670                | 207  | 372                                      |
| <b>Value added</b>          |                        |                                  |                     |                    |  | (HK\$Million)                            |
| 2004                        | <b>4,714</b>           | 246                              | 727                 | 329                | 222  | 80                                       |
| 2005                        | <b>4,651</b>           | 85                               | 833                 | 241                | 140  | 60                                       |
| 2006                        | <b>6,495</b>           | 196                              | 1,119               | 237                | 110  | 123                                      |
| <b>Employment</b>           |                        |                                  |                     |                    |  | (persons engaged)                        |
| 2004                        | <b>19 158</b>          | 790                              | 6 306               | 3 141              | 870  | 74                                       |
| 2005                        | <b>17 815</b>          | 213                              | 6 779               | 2 204              | 500  | 51                                       |
| 2006                        | <b>25 742</b>          | 666                              | 10 339              | 2 282              | 408  | 119                                      |

Notes: (^) As these estimates do not cover the subsequent rounds of impact, the summation of the first round impact on the different sector is significantly smaller than that on the overall economy.

(#) Other personal services include travel agent, airline ticket agents, domestic transport and other personal entertainment.

(2) Value-added per person engaged in 2006 is not available yet. It is assumed that the value-added per person engaged for the overall economy has maintained a stable relation with that for the individual economic sectors in 2006 as in the preceding years.

## Appendix IIIa

### Individual Visit Scheme Geographic coverage

| Effective Date   | Additional cities/ provinces covered                                       | Registered population (2005)<br>(Million Persons) | GDP (2005)<br>(Billion Rmb) | Per capita GDP in 2005<br>(Rmb) |
|------------------|--|---|-----------------------------|---------------------------------|
| 28 July 2003     | Dongguan, Foshan, Zhongshan, Jiangmen                                      | 10.47   | 625.04                      | 59,687.20                       |
| 20 August 2003   | Guangzhou, Shenzhen, Zhuhai, Huizhou                                       | 13.20   | 1,154.35                    | 87,474.74                       |
| 1 September 2003 | Shanghai, Beijing  | 25.41   | 1,604.05                    | 63,127.64                       |
| 1 January 2004   | Shantou, Chaozhou, Meizhou, Zhaoqing, Qingyuan, Yunfu                      | 22.94   | 224.07                      | 9,767.94                        |
| 1 May 2004       | Shanwei, Maoming, Zhanjiang, Shaoguan, Jieyang, Heyuan, Yangjiang          | 32.39   | 293.80                      | 9,071.03                        |
| 1 July 2004      | Nanjing, Suzhou, Wuxi, Hangzhou, Ningbo, Taizhou, Fuzhou, Xiamen, Quanzhou | 48.69   | 1,999.52                    | 41,069.18                       |
| 1 March 2005     | Tianjin, Chongqing*  | 37.37   | 673.30                      | 18,015.52                       |
| 1 November 2005  | Chengdu, Jinan, Dalian, Shenyang   | 29.43   | 848.16                      | 28,816.63                       |
| 1 May 2006       | Nanchang, Changsha, Nanning, Haikou, Guiyang, Kunming                      | 27.64   | 513.96                      | 18,591.45                       |
| 1 January 2007   | Shijiazhuang*, Zhengzhou, Changchun <sup>#</sup> , Hefei, Wuhan            | 36.24   | 812.86                      | 22,427.60                       |

Notes : (\*) Population for permanent population (常住人口).

(#) 2004 figure for population and GDP .

**The Mainland and Hong Kong  
Closer Economic Partnership Arrangement (CEPA)**

**Review of economic impact on the Hong Kong economy  
(Trade and Investment Facilitation)**

**Background**

Under CEPA's framework of trade and investment facilitation, the Mainland and Hong Kong initially agreed on promoting co-operation in the following seven areas, namely, trade and investment promotion; customs clearance facilitation; commodity inspection and quarantine, food safety, quality and standardization; electronic business; transparency in laws and regulations; cooperation of small and medium enterprises; and cooperation in Chinese traditional medicine and medical products sector.

2. In view of the increased awareness of the importance of intellectual property rights in advancing economic development and promoting economic and trade exchanges, a new item on "protection of intellectual property" was added in June 2006. This becomes the eighth area of cooperation in the CEPA framework of trade and investment facilitation.

**Latest situation**

3. The trade and investment facilitation measures under CEPA have impacted positively on attracting Mainland and foreign investment to Hong Kong. According to the 2006 survey by the Census and Statistics Department, as at 1 June 2006, there were 1 228 companies setting up regional headquarters and 2 617 companies setting up regional offices in Hong Kong, representing respectively increases of 27% and 17% over the surveys findings for 2003. The number of regional headquarters of Mainland enterprises in Hong Kong alone increased from 84 in 2003 to 112 in 2006.



4. Of the 3 845 regional headquarters and regional offices surveyed in 2006, 28% considered that CEPA has strengthened the business environment in Hong Kong and has rendered it a suitable location for the setting up of RHQ/ROs. In addition, around 10% indicated that their investment activities were affected by CEPA and the most common effect was setting up of new business expansion plans.

5. Moreover, according to Invest Hong Kong (Invest HK), among the 246 foreign companies which they assisted in setting up or expanding business in Hong Kong in 2006, 61 (or 25%) have indicated that CEPA is one of the factors considered when making the investment. Of the 61 companies, 22 indicated that they invested in Hong Kong because of CEPA. Some others have either accelerated their investment plans, and/or invested more capital or employed more staff as a result of CEPA<sup>(1)</sup>.

6. Following the implementation of investment facilitation policy in August 2004, Mainland-Hong Kong business and investment have strengthened further. According to the Ministry of Commerce, a total of 603 Mainland enterprises were granted approval to invest in Hong Kong from 1 September 2004 to the end of December 2006. Their planned investment totaled US\$3.9 billion. The major business activities of these enterprises include trading, consulting and R&D, tourism and entertainment, and transport and logistics (*Table 1*).

**Table 1: Approved Mainland investment projects in Hong Kong**

|                                  | 2003 | 2004 | 2005 | 2006 | 1 Sep 04-31 Dec 06* |
|----------------------------------|------|------|------|------|---------------------|
| Mainland enterprises (No.)       | 73   | 160  | 253  | 282  | 603                 |
| Investment amount (US\$ billion) | 0.27 | 0.96 | 1.44 | 2.01 | 3.92                |

Note: (\*) Since the implementation of investment facilitation policy in August 2004.

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(1) These figures add up to more than 61 because a company may indicate more than one effect of CEPA.

## **Actions**

7. Furthermore, relevant Government Departments and the Hong Kong Trade Development Council have stepped up promotional efforts to attract more Mainland enterprises to invest in Hong Kong, offering a comprehensive range of business facilitation services and assistance. These include:

- Expanding existing promotional units in Guangdong and setting up new promotional units in Beijing, Shanghai and Chengdu;
- Setting up a toll-free investment hotline in the Mainland for enquiries from Mainland investors about investing in Hong Kong;
- Setting up investment service centres in Invest Hong Kong's headquarter, the Office of HKSARG in Beijing and the Hong Kong Economic and Trade Offices in Guangdong, Shanghai and Chengdu staffed by experts from Invest HK, offering information and advice to Mainland investors on matters relating to investing in Hong Kong;
- Further introducing an edition tailored for Guangdong enterprises by Invest HK in June 2006, after the initial launch of a "Step-by-Step Guide" detailing procedures for Mainland enterprises to obtain relevant government approvals in the Mainland and the steps for setting up businesses in Hong Kong;
- Supporting and participating in major international business events to raise Hong Kong's profile and to promote CEPA;
- Arranging joint investment promotional activities with major Mainland provinces and cities;
- Conducting research on Mainland enterprises' needs for business and trade services in Hong Kong, providing information on doing business in Hong Kong and producing publications (such as Invest Hong Kong Guidebook) to promote investment in Hong Kong;
- Establishing enquiry telephone hotlines, providing e-mail service and developing a CEPA designated web site

(<http://www.tid.gov.hk/english/cepa/>) to answer public enquiries and provide the public with updated CEPA information, including implementation details and relevant Mainland rules and regulations; and

- Collating information on the Mainland rules and regulations governing the provision of CEPA service sectors, and constructing a database to include reference materials for individual services for public use. The reference materials have been uploaded onto a dedicated government website on CEPA and sent to concerned trade and industrial organisations.

**The Mainland and Hong Kong  
Closer Economic Partnership Arrangement (CEPA)**

**Review of economic impact on the Hong Kong economy**

**Further Assessment**

**1. *CEPA provides a new economic platform***

- *With the mainland of China (the Mainland) shifting its development focus from manufacturing to services and from “quantity” to “quality” growth, Hong Kong needs to re-orientate its role to meet the changing needs of the Mainland economy.*
- *CEPA is timely in laying a solid foundation for a new business relation to evolve between the Mainland and Hong Kong over time. By allowing freer cross-boundary flow of people, expertise and direct investment between the two places through CEPA, this has given Hong Kong investors the “first mover” advantage in establishing an early presence in a host of services industries in the Mainland.*
- *The Mainland today is not in lack of capital. What it needs is to amass knowledge, invent technology, and apply modern management skills quickly enough to catch up with the advanced economies, to gain in international competitiveness, and to achieve “quality” growth. CEPA has helped strengthened Hong Kong’s service provider and conduit roles for the effective channelling of “quality” capital and management know-how into the Mainland.*
- *CEPA is and will continue to be a mutually beneficial arrangement in fostering cooperation and in clinching an even stronger Mainland-Hong Kong partnership that enhances the mutual competitiveness of both places in the region and in the global market.*
- *Reflecting this, there is an increase in Mainland companies investing in Hong Kong, making use of the various financial and other support facilities and services in Hong Kong, thereby consolidating Hong Kong’s position as an international financial centre. At the same time, the listing exercises associated with Mainland enterprises in Hong Kong have become more active. This serves to demonstrate the function of Hong Kong as a two-way platform, bringing Mainland enterprises and investments to reach out to the global market through investing/listing in Hong Kong, as well as bringing foreign investments*

into the Mainland, thus further strengthening Hong Kong's key intermediary role.

## **2. CEPA helps rebuild confidence**

- *Most of the business establishments surveyed consider CEPA beneficial to the Hong Kong economy. Feedbacks from informal consultation with CEOs and senior management in the trade and service sectors unanimously indicate that CEPA has played a crucial role in rebuilding confidence after a prolonged period of economic slowdown caused by the Asian financial crisis in 1997, and aggravated by the SARS outbreak in the early part of 2003 (Figure 4)<sup>(1)</sup>.*
- *Reflecting this, as at 1 June 2006, there were 1 228 companies setting up regional headquarters and 2 617 companies setting up regional offices in Hong Kong, representing respective increases of 27% and 17% over 2003 (Appendix IV).*
- *Of these 3 845 regional headquarters and regional offices, 28% considered that CEPA has strengthened the business environment in Hong Kong and has rendered it a suitable location for the setting up of regional headquarters/regional offices. And around 10% indicated that their investment activities were affected by CEPA.*
- *Furthermore, of the 246 foreign companies assisted by Invest HK to set up or expand business in Hong Kong in 2006, 61 (25%) considered CEPA a relevant factor affecting their investment decision. And of these 61 companies, 22 invested in Hong Kong because of CEPA.*

## **3. CEPA benefits tend to permeate through the general macro-environment**

- *The benefits of CEPA are often so entwined with the general macro-environment and embodied in the ultimate outcome that it is difficult to disentangle and quantify. Moreover, the intangible benefits, such as revived business confidence, cannot be readily quantifiable.*
- *However, the confidence boosting effects are reflected in the macro-economic data, such as the strong rebound in consumption, investment, and overall economic growth. Demonstrating these macro-benefits, Hong Kong's GDP reverted from a decline of 0.7% in the second quarter of 2003 to growth of 4.0% and 4.8% in the third and*

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(1) Please refer to the Main Report for figures and appendices quoted in this document.

*fourth quarters, before climbing further to annual growth of 8.6% in 2004, 7.5% in 2005 and 6.9% in 2006. Investment in machinery, equipment and computer software bounced back, private consumption revived, and employment rose strongly. Although these rebounds may not be entirely attributable to CEPA, it should have been an important confidence booster that helped kick-start the recovery (Figures 5 and 7).*

- *Furthermore, the revival in business confidence is reflected vividly in the rise in prices in the financial and asset markets. The successive new highs of the Hang Seng Index, indicates a general perceived rise in long-term income and profits potential of companies in Hong Kong (Figure 6). The Index embraces a whole spectrum of companies engaging in varied businesses, including banking, insurance, property, manufacturing, logistics, telecommunications, retail trades, etc.*

#### **4. CEPA is a mutually beneficial arrangement to the Mainland and Hong Kong economies**

- *The quantitative estimates below represent only a part of the CEPA benefits. Indeed a more significant part is reflected in Hong Kong's intangible roles in facilitating the transfer of "quality" capital and management techniques that are most needed for the Mainland's long-term economic development. The recent rebound in macro-economic data and in the financial and asset prices reflected that the market take cognizance of the perceived advantages of CEPA in advancing the mutual competitiveness of Hong Kong and the Mainland in the region and in the global market as a whole.*
- *Since the inception of CEPA in 2004, there was a total of 36 000 CEPA-induced added employment for Hong Kong residents in both Hong Kong and the Mainland by 2006. Although the number of persons engaged in Hong Kong due to CEPA was not large, at around 35 000 at end-2006 and equivalent to only 1% of the total employment in Hong Kong, it was close to one quarter of the total number of unemployed persons at end-2006 (153 700). Moreover, the number of new jobs created by CEPA was not insignificant, accounting for nearly 12% of all the net new jobs created since mid 2003 (Figures 1 and 3).*
- *CEPA is also beneficial to employment in the Mainland. The total number of new jobs created in the Mainland reached 16 700 by 2006. Of these, 1 000 were filled by Hong Kong residents, and the rest by non-Hong Kong residents (presumably the Mainlanders).*

- *CEPA-induced capital investment in the Mainland was larger than in Hong Kong. While such investment is expected to rise further in both places in 2007 and beyond, the forecast growth rate is likely to remain faster in the Mainland than in Hong Kong (Figures 2, 10b and 10c).*

## **5. Trade in services**

- *The potential for mutual cooperation in services trade between the Mainland and Hong Kong is enormous. According to the Mainland's "11<sup>th</sup> Five-Year Plan", the services sector is targeted to raise its share of GDP by 3 percentage points from its present level in five years' time. Over the longer term, the share of the services sector in GDP is likely to rise even further. In many advanced economies, their current services sector share is close to 70% or more, while the Mainland's services sector share is only around 40% at present. The scope for services sector expansion in the Mainland is thus substantial.*
- *At the same time, the Mainland has targeted to make domestic demand, in particular, consumer spending a more important driver of economic growth, in order to bring a more balanced growth structure with less reliance on external trade. The large trade surplus and soaring foreign exchange reserves have invited trade tension with the major trading partners on the one hand, and increasing monetary policy challenges and rising inflationary and asset price appreciation pressures on the other.*
- *Recognizing the market potential in services and consumer demand in the Mainland, management consultancy (91%), banking services (80%), audio-visual services (80%), job referral agencies (79%), legal (78%), and freight transport and logistics (also 78%) all have high percentages of HKSS certificate holders indicating that they either have plans or they have already set up operation in the Mainland (Appendix I).*
- *Services receipts from the Mainland due to CEPA grew remarkably over the years. At HK\$4.2 billion in 2006, it was 2.6 times that in 2004. A further growth of 28% is expected for 2007 and beyond. Distribution services sector is the largest contributor, followed by freight transport and logistics. Again, both account for the largest CEPA-induced capital investment in Hong Kong and in the Mainland, while investment in the Mainland from banking services is also substantial. Meanwhile, distribution services remain consistently the largest contributor to CEPA-induced employment in both Hong Kong and the Mainland.*

- *More specifically, with effect from 1 January 2006, Hong Kong service suppliers are allowed to become the controlling shareholders for chain stores in the Mainland selling specific products and with more than 30 outlets (a major breakthrough for the distribution services under CEPA). Making use of CEPA, a Hong Kong-based British retailing group has opened its first wholly-owned store in Guangzhou in October 2004, by seizing the "first mover advantage" ahead of China's WTO commitment, and now operates a health and beauty retail chain in South China. Two very prominent Hong Kong "home-grown" enterprises also take advantage of CEPA, with one operating 62 convenience stores in Guangzhou, Dongguan and Shenzhen, and another health and beauty retailer opening 200 outlets in the Mainland by June 2006.*
- *In addition, audio-visual services are seen to demonstrate promising potential in 2007 and beyond. In 2006, of the top 10 box office hits, 5 were Mainland-Hong Kong co-productions. The number of such co-productions rose from an average of 10 per year before CEPA to about 30 a year since the implementation of CEPA. Also, under CEPA, Hong Kong service suppliers are now permitted to construct, renovate and operate cinema theatres on wholly-owned basis with effect from 1 January 2005. There are at present nearly 30 cinemas operating with money from Hong Kong. As of February 2007, 20 Hong Kong service suppliers hold certificates to operate audio visual business in the Mainland, with 4 on motion picture distribution, 5 on cinemas, 10 on video and sound recording products distribution services, and 1 with both certificates for distributing video products and motion pictures at the same time.*

## **6. Trade in goods**

- *As at end-April 2007, most of the approved applications for CO(CEPA) were in the pharmaceutical and food and beverage industries (Appendix II). They accounted for the bulk of CEPA-induced capital investment and employment in trade and manufacturing. CEPA has enabled some producers to make use of Hong Kong to build brand-name, and sell those medicine and health food products produced in Hong Kong to the Mainland consumer market. Better "intellectual property rights" protection in Hong Kong is another attraction. The market potential for these products in the Mainland is substantial, given its rapid growth and rising income and standard of living.*



## **7. Individual visit scheme (IVS)**

- *IVS should have facilitated people's flow, promoted cross-boundary understanding, and tightened business contact between the Mainland and Hong Kong. While these benefits are vivid, they are intangible and difficult to measure and quantify.*
- *Nevertheless, the increased convenience of IVS has raised the frequency of travel and incremental visitor spending in Hong Kong (Appendix III). It is estimated that the net incremental spending by IVS visitors has raised Hong Kong's GDP by HK\$6,495 million or 0.44% in 2006. This in turn has generated employment for 25 742 persons, implying a net increase of 6 600 new jobs since 2004.*

## **8. Way Forward – Deepening of CEPA**

- *From the survey, respondents have identified several factors constraining the benefits of CEPA, viz. long processing time, complicated application procedures, insufficient transparency in policies and regulations, and high entry requirement. As CEPA adopts a building-block approach, these various issues will be taken up in the regular dialogue between the Mainland and Hong Kong authorities. There will be constant exchange of views and experiences gathered from CEPA's implementation, with a view to deepening further CEPA as an economic infrastructure and solid platform to clinch an even closer mutual economic tie between the Mainland and Hong Kong. This should enable the micro-benefits at the industry level to be effectively permeated through to benefit the macro-economies in the two places.*
- *Finally, while CEPA will remain an important infrastructure facilitating economic flows between Hong Kong and the Mainland, the usefulness of conducting survey to assess the Arrangement's economic significance tends to diminish over time. The longer the time gap between the survey and the first launch of CEPA, the reliability of the survey findings will reduce due to memory lapse. It will be increasingly difficult to estimate the incremental impact of CEPA as it entwines with the general macro economic growth. Moreover, the more significant part of the CEPA benefits lies with its intangible roles in facilitating the transfer of "quality" capital and management skills to the Mainland for the latter's long-term economic entrenchment, which cannot be readily measurable.*