

For information  
on 20 May 2008

**Legislative Council  
Panel on Commerce and Industry**

**Commerce and Trade Relations between  
the Mainland and Hong Kong**

**Introduction**

This paper briefs Members on recent developments in the trade relations between the Mainland and Hong Kong, including the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA), changes in the business environment for Hong Kong-owned enterprises in Guangdong, and the measures undertaken by the HKSAR Government to assist the trade.

**Trade relations between the Mainland and Hong Kong**

2. The Mainland continues to be the largest trading partner of Hong Kong. In 2007, the total merchandise trade between the Mainland and Hong Kong was HK\$2,638 billion, which represented 47.5% of the total trade value of Hong Kong during the period. On the other hand, Hong Kong ranked third among the trading partners of the Mainland, after US and Japan. We accounted for 9.1% of Mainland's total external trade in 2007.

3. Hong Kong is the Mainland's largest source of realized direct foreign investment, accounting for about 39.6% of the national total as at end of March 2008, with a cumulative value of realized direct investment at HK\$2491.3 billion. At the same time, the Mainland is Hong Kong's biggest external investor. By the end of 2006, the stock of inward direct investment from the Mainland amounted to HK\$2,024.3 billion, accounting for 35.1% of our total. There are over 2,600 Mainland related enterprises operating in Hong Kong, covering a wide range of economic activities

including imports/exports, wholesale/retail, transportation and warehousing, etc.

4. Hong Kong is the most important entrepot for trade between the Mainland and the rest of the world. The value of re-export goods destined for the Mainland was HK\$1,267.7 billion in 2007, accounting for 49.2% of Hong Kong's total re-export trade in 2007. The value of re-export goods originated from the Mainland through Hong Kong was HK\$1,597.8 billion in 2007, accounting for 62% of Hong Kong's total re-export trade.

### **Recent developments on CEPA**

5. CEPA, a free trade agreement between Mainland and Hong Kong, was signed on 29 June 2003. Subsequently, supplements to CEPA were signed in each of the following years. With the implementation of these agreements, 1,502 types of Hong Kong-made products (including electrical and electronics, plastic, textiles, chemical and pharmaceutical products) enjoy zero tariff when they are imported into the Mainland. Service suppliers in 38 service areas, including advertising, banking, distribution, transport and logistics services, can now enjoy preferential access to the Mainland market.

6. As at 30 April 2008, a total of 33,403 Certificate of Origin applications under CEPA have been approved, with a total export value of goods amounting to over HK\$ 12.7 billion. 1,193 Hong Kong Service Supplier applications have been approved, with 1,962 certificates issued.

7. We continue to work very closely with the Mainland authorities on the gradual implementation and further liberalization of CEPA. On the latter, both sides have started discussion and we will announce the outcome once discussion has concluded. We have also held consultation sessions to gauge the views of the trade on various CEPA issues. In addition, we have assisted the Mainland authorities in conducting CEPA training for provincial/municipal officials to enhance their understanding of the arrangements for CEPA-related measures. We will continue to enhance the promotion of CEPA in Hong Kong, the Mainland as well as overseas.

## **Business environment for Hong Kong-owned enterprises in Guangdong**

8. Hong Kong-owned enterprises have invested in a large number of manufacturing operations in the Mainland. In the Pearl River Delta alone, 56,000 manufacturing operations are owned by Hong Kong enterprises, many of them are involved in the processing trade. Recent changes in several policy areas in the Mainland, especially those related to the processing trade and the Labour Contract Law, would have an impact on these factories. Some of the more significant changes in recent months are outlined below.

### (a) Adjustments to Policies related to the Processing Trade

9. Since late 2006, the Mainland has been introducing a series of measures related to the processing trade. The objectives are to restrict the operation of polluting, resource-intensive and energy-intensive industries, and encourage enterprises to move up the value chain, upgrade their production technologies or shift their operation to the central and western regions of the Mainland. A number of announcements were made in 2007 and early 2008 under which lists of restricted and prohibited commodities were promulgated for the processing trade.

10. Given the general policy objectives mentioned above, further restrictive measures on processing trade may be introduced by the Mainland authorities from time to time.

### (b) Labour Contract Law

11. Since 1 January 1995, the Labour Law had been the major piece of labour legislation in the Mainland. It regulates employer-employee relationship and labour contracts. On 29 June 2007, the Standing Committee of the National People's Congress of the Mainland enacted the new Labour Contract Law to further strengthen labour protection. The new legislation was implemented on 1 January 2008. However, the detailed Implementation Regulations have not yet been promulgated.

12. The Labour Contract Law elaborates and strengthens provisions

of the Labour Law relating to labour contracts, including the terms and conditions of employment contracts, and the associated labour rights, benefits and protection. It introduced a number of new requirements, such as the provision of written contracts to employees within one month of hiring, the need to enter into permanent contracts with an employee once he has served for a certain period of time, a maximum duration for probationary periods, the conditions under which an employee contract may be terminated, and the need for severance payment upon expiry of labour contracts.

13. Recently, in response to the concerns of the trade, the Mainland authorities have started public consultation on the Draft Implementation Regulations of the Labour Contract Law.

(c) Tightening of Environmental Standards

14. The Mainland authorities have introduced more stringent environmental standards. Apart from the policy changes on the processing trade which discourage the operation of polluting, resource-intensive and energy-intensive industries, manufacturing operations are also required to meet more stringent standards with regard to air emission, waste treatment and wastewater discharge. Accordingly, many factories would need to upgrade their production systems and facilities to meet the new requirements. Another option for the operators is to relocate their factories to dedicated environmental or industrial parks in order to continue their operations. For example, Guangdong has set up industry-specific bases or parks for electroplating operation, as well as for paper and leather processing.

(d) Enterprise Income Tax Law

15. Announced on 16 March 2007, the Enterprise Income Tax Law took effect on 1 January 2008. This legislation aims at following international practices in providing a uniform tax regime for all enterprises. Under the new legislation, the corporate tax rates for foreign-owned enterprises would be the same as those for Mainland enterprises. For instance, the income tax rate for both types of enterprises is 25%. The legislation also phases out certain tax preferences (e.g. those available to

export-oriented enterprises, including many Hong Kong-owned enterprises) while introducing new benefits (e.g. those available to high-technology industries). Furthermore, it stipulates the same principles for deduction of expenditure items, such as research and development expenses, or employment of disabled staff, for Mainland and foreign-owned enterprises.

### **Measures Undertaken by the HKSAR Government**

16. The above new legislation and measures aim to improve the industrial structure of the Mainland. However, we are concerned with the cumulative impact of these policy adjustments, taken together with other factors such as the rising costs of raw materials and appreciation of Renminbi, on our enterprises. It could be expected that the cost of production for enterprises would increase, especially in the short to medium term, and individual operations would be affected to varying degrees depending on their respective strength and competitiveness. Furthermore, many of the enterprises are also concerned about the practicability of some of the proposed measures, as well as their lack of specificity.

17. The HKSAR Government has been staying in close communication with the trade, reflecting the trade's concerns and conveying our recommendations to the Mainland authorities, while at the same time encouraging Hong Kong-owned enterprises in the Mainland to upgrade, restructure and relocate their operations in order to adapt to the changing environment and the policy adjustments. In short, we have adopted a multi-pronged approach to assist enterprises, including the following -

- (i) using various channels (written communication and meetings with the top echelon ) to reflect the trade's views and to make recommendations to the Mainland authorities;
- (ii) through the "Task Force to Support the Processing Trade" established last year, exploring with the trade measures to cope with the adjustments in the Mainland's processing trade policy;
- (iii) cooperating with the Guangdong Province, through the "Hong Kong/Guangdong Expert Group on the Restructuring and

Upgrading of the Processing Trade”, to assist enterprises to restructure and/or upgrade;

- (iv) organizing seminars to enhance the understanding of the trade on new legislation and measures;
- (v) organizing trade delegations to visit the central and western regions of the Mainland with a view to encouraging Hong Kong enterprises to relocate their operations and to explore new markets<sup>1</sup>;
- (vi) through the “SME Funding Schemes”, assisting SMEs to acquire new equipment that meet the latest environmental requirements, to restructure or relocate, and to explore new markets. Hong Kong enterprises may also apply for the “Innovation and Technology Fund” to improve their technological level, and to introduce more innovative concepts to their businesses;
- (vii) through industry support bodies such as the Hong Kong Trade Development Council and the Hong Kong Productivity Council, assisting enterprises to upgrade their technological knowhow and environmental performance, restructure their modus operandi and develop new markets, etc.; and
- (viii) through partnership with the Guangdong Provincial Government and the Hong Kong Productivity Council, launching a new initiative to assist the trade to upgrade, transform and relocate, including a series of industry-specific / cross-sector seminars, provision of on-site technical assessment and advice to factories, new solutions with banks, IT and equipment specialists, etc, as well as a support centre and website for information dissemination.

18. The efforts of the Government and the trade have yielded some

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<sup>1</sup> Two delegations were led by the Secretary for Commerce and Economic Development last year, one to Chenzhou (in Hunan Province) in August 2007, and the other to Ganzhou (in Jiangxi Province) in December 2007. The Chief Executive led a delegation to Wuhan (in Hubei Province) in April 2008. The Permanent Secretary for Commerce and Economic Development (Commerce, Industry and Tourism) will lead a fourth delegation to Nanning (in Guangxi Province) in June 2008.

success. The central authorities are reconsidering the timing for and details of further measures related to the processing trade. In some cases, relief measures were put in place, such as Announcement No. 71 of 2007 promulgated on 5 September 2007 by the Ministry of Commerce, General Administration of Customs and the China Bank Regulatory Commission, which allows the trade to fulfill the standing book deposit requirement by a number of means, including cash and bank guarantees, thus alleviating the pressure on the cashflow of enterprises. On the Labour Contract Law, as mentioned in paragraph 13 above, the Mainland authorities have initiated consultation on the draft Implementation Regulations. As with earlier consultation exercises, we will reflect the trade's concerns and suggestions to the relevant authorities.

## **Conclusion**

19. We believe that the recent policy adjustments of the Mainland will bring about sustainable and healthy development to the national economy in the long term. While such policy adjustments will pose challenges to the trade, we will continue our efforts to provide assistance to them. More significantly, the rapid economic development of Mainland will continue to provide enormous room and potential for furthering the development of trade between Mainland and Hong Kong, with CEPA reinforcing our comparative advantage in tapping the market potentials of the Mainland.

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