**CENTRAL POLICY UNIT**
**HONG KONG SPECIAL ADMINISTRATIVE REGION**

# CONSULTANCY STUDY ON SOCIAL, ECONOMIC AND POLITICAL DEVELOPMENTS IN THE MAINLAND, WITH PARTICULAR EMPHASIS ON REGIONAL DEVELOPMENTS AND THE GUANGDONG PROVINCE

**THIRD BI-MONTHLY REPORT**

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# EXECUTIVE SUMMARY

1. Analysis of the implications of China's reform into a "super ministry system"

During the 17th CPC National Congress, it was proposed that the reform of China's administrative control structure needs to be stepped up, and that a service-oriented government be established. In particular, government departments are asked to consolidate their resources and explore possibility of adopting a "super ministry system" to systematically unify their functions. The move is an important part of China's administrative control reform to adapt to development of the market economy. By systematically integrating various government functions and departments, the reform would help to resolve problems such as overlapping between departments, duplication of functions, diffused management, lack of accountability, and over-concentration of power, helping the government to enhance its efficiency and effectivity. These are proactive and positive for strengthening the central government's macroeconomic controls, administrative planning and policy making, safeguarding the legal system and maintaining government order so that it can exercise a more macroscopic level of management. As Hong Kong further integrates with China, its economic development will become increasingly prone to changes in Mainland policies. By strengthening and perfecting macroeconomic controls and reasonably streamlining the functions of relevant departments, a more scientific, authoritative and effective macroeconomic control system will be developed. The reform would thus be helpful in reducing the risks faced by Hong Kong whenever the Mainland embarks on macroeconomic control measures, hence, would be positive to Hong Kong's long term development.

2. The impact of A-share market consolidation on Hong Kong

Since 2008, the Mainland's A-share market has lost its upward momentum amidst growing possibility of global recession triggered by the US sub-prime crisis and pressures induced by policy changes and funding in its own market. By mid-April, the A-share indices of both the Shanghai and Shenzhen stock exchanges have dropped over 40% from the peaks reached last October. Given the sharpness of this round of consolidation, it is unlikely that investors -- whether retail or institutional -- have maintained their positions unscathed. On April 20, the government started to introduce measures aimed at helping to stop the market's free fall. These measures included regulating the disposal of non-floating shares that would be unlocked and a cut in stamp duty on stock trading. The closer integration

between Hong Kong and the Mainland's economies and financial markets, coupled with the growing importance of H-shares and red-chips, as reflected in their 51% share in Hong Kong's market capitalization, makes Hong Kong prone to sharp movements in the Mainland market. From a positive perspective, the current round of market consolidation in the Mainland has highlighted the importance of fostering healthy market development. The Mainland is thus expected to gradually introduce measures to improve its market structure within the year. Such measures are likely to include the launching of stock index futures, growth enterprise market, listing of Mainland overseas assets, encouraging foreign enterprises to list in the A-share market, etc. The healthy development of the Mainland stock market would benefit Hong Kong in the long run.

3. Opportunities for Hong Kong arising from the rise of Pan-Beibu Gulf Economic Rim

The Pan-Beibu Gulf Economic Co-operation Zone encompasses the 7 countries of China, Vietnam, Indonesia, Malaysia, Philippines, Singapore and Brunei, with China and the interior regions of ASEAN as its hinterland. Fostering economic cooperation in this region makes the establishment of the China-ASEAN Free Trade Area (FTA) even more meaningful. It also strengthens the strategic role and function of Guangxi in the construction of the FTA, which has particularly important implications to the development of the Beibu Gulf areas of Guangxi. To promote development and cooperation in the Pan-Beibu Gulf Economic Rim, Guangxi will give priority to the development of its ports facilities, making the area a regional hub for China and ASEAN logistics, commerce, trade, processing and manufacturing industries. Given its underlying strengths in ports and logistics operations, as well as abundant human resources, Hong Kong is best positioned to play a key role in such a regional cooperation. For Hong Kong enterprises currently under the pressure of economic restructuring in the Pearl River Delta Region, the implementation of Pan-Beibu Gulf Economic Cooperation would provide an additional alternative for the relocation of their processing trade industries.

4. Pudong's Disneyland and strengthening Hong Kong Disneyland's competitiveness

Shanghai's mayor, Han Zheng, confirmed that the municipal government has submitted its application for constructing a Disney theme park to the National Development and Reform Commission. The proposed site of the theme park is located at the southwest side of Pudong's Chuannsha New Town, the size of which

is 3.7 times of Hong Kong's Disneyland. The plan is still awaiting the central government's approval. The launching of a Disney theme park in Shanghai would inevitably affect the flow of visitors into Hong Kong; the impact would, however, be moderate, as the two theme parks would be positioned differently in the market, adopt different operating modes as well as facilities. Moreover, the substantial size of the Mainland market also leaves ample room for two Disneylands. Nonetheless, faced with a larger scale competitor in Shanghai, Hong Kong should proactively enhance the competitiveness of its own theme park, overcome cultural differences and come up with unique recreational programs. By taking a development stream distinctly different from that of Shanghai Disneyland, Hong Kong can launch an entirely new campaign strategy aimed at raising the brand awareness towards Hong Kong's Disneyland in major target markets and attracting more Mainland visitors. Hong Kong should also employ various promotional strategies to entice travel agencies in the Mainland to aggressively promote Hong Kong Disneyland tours.

5. Guangdong's new round of self-innovation and its implications on Hong Kong

Given the growing need to keep up with international competition, self-innovation is the next necessary step on China's course of development. The government of Guangdong has always prioritized improving industrial competitiveness via technological development. To help Guangdong evolve into a new and innovative economy, the government has drafted the "Policies for Promoting Self-innovation in Guangdong". The policies set out would encourage investment into science and technology, provide tax incentives, financial support and generate demand via government sourcing to promote more rapid internalization of the importance of innovation, protection of intellectual property rights, development of human resources, and setting up of a platform for innovation, science and technology. Not only do Guangdong's proactive moves in promoting self-innovation serve to encourage Hong Kong entrepreneurs in the province to invest more resources towards innovative and higher value-added development, the policies adopted by the province in promoting self-innovation are also worthy of Hong Kong's attention. In this light, Hong Kong should actively complement Guangdong's new round of development towards self-innovation. Efforts could include assisting the province in coming up with new policies on human resource development to cultivate more talents, helping Guangdong establish an effective mechanism to guide investments towards improving the efficiency of research and development, and helping Guangdong to foster an environment that is conducive to self-innovation and managing intellectual property rights. Meanwhile, Guangdong's experience would also shed light for Hong Kong as it tackles issues affecting its own self-innovation,

thus benefiting both sides.

6. Guangdong proposes joint-establishment of a special financial zone with Hong Kong

With the focus of national economic and financial development policies and resources gradually shifting towards the Yangtze River Delta Region in recent years, the preferential policies which supported the rapid development of Guangdong's financial industry are no longer unique. As such, Guangdong took the initiative and proposed stepping up the development of its financial industry, with an aim of making it an important financial centre. In particular, it asked that Guangzhou and Shenzhen be developed into regional financial hubs to strengthen the clustering and multiplier effect of financial resources in these two cities. At the same time, it hopes that by complementing each other's strengths, stronger financial integration between Guangdong, Hong Kong and Macao can be fostered, forming a special finance zone for Guangdong-Hong Kong-Macao. To achieve this goal, Guangdong will actively seek the policy support of the central government so that reforms can be carried out on experimental basis involving areas such as channels for circulation of currency between the three province/special administrative regions, perfecting the payment system network, promoting cross-boundary establishment of financial institutions and equity alliances, widening and deepening of cooperation among financial institutions, and liberalizing the various channels of the financial markets across the three province/special administrative regions for pilot testing reforms. The Guangdong-Hong Kong-Macao joint special finance zone is the necessary step forward for Guangdong's financial sector as it faces more challenges. The proposal also benefits multiple parties, as the special finance zone could help Guangdong, Hong Kong and Macao find more room for development, helping Hong Kong to maintain and further strengthen its role as an international financial centre.

7. The location of Nansha's petrochemical project and environmental harmony in Guangdong and Hong Kong

Situated at the southeastern part of Guangzhou, Nansha is equipped with a vast seacoast suitable for the development of ports and oil refining projects; it has a solid petrochemical industry base. However, objections, mainly revolving around environmental issues, have been aired since the Nansha petrochemical project was unveiled. Hong Kong was among those who had indicated their opposition. Nansha is located upstream of Hong Kong and Macao, its sewage discharges directly harm the marine ecologies of the two cities. During the autumn and winter seasons,

the north-westerly wind also contributes to the worsening of air pollution in Hong Kong and Macao. In fact, compared to the city centre of Guangzhou, Hong Kong is even nearer Nansha, making its petrochemical project among the most important environmental concern for Hong Kong people. Situated at the tip of the Pearl River Delta region, and open to the north-westerly wind, to a certain extent, Hong Kong can only take passive action in protecting its environment. To be able to improve its environment substantially, it is imperative that Hong Kong coordinate with Guangdong; it also needs the sincere cooperation of Guangdong and the Mainland. How the Nansha project will be handled would have long-term impacts on the future environmental protection efforts of Guangdong and Hong Kong. With an urgent need to protect the environment, the choice of location for the petrochemical project, as well as the project itself, needs to be carefully reconsidered.

8. Promising opportunities and positive outlook for Hong Kong enterprises moving east into Huizhou

With past years' hard work, Huizhou has established itself as an export-led economy. Now that the Daya Bay petrochemicals park is being constructed, Huizhou's development has found new strength, its growth momentum further enhanced. The next five years would be the "golden years of development" for Huizhou, where the area for urban planning is being expanded by 100 sq.m., and total fixed asset investment is expected to exceed Rmb30 billion. This is the best time to encourage Hong Kong enterprises to move east into Huizhou. Since the establishment of the first Hong Kong-invested enterprise in Huizhou in 1981, Hong Kong companies have become an important engine driving the modern construction of Huizhou. Given Huizhou's comparative edges in its location, resources, environment, infrastructure facilities and industries, Hong Kong enterprises moving into Huizhou can consider opportunities in the following three areas: firstly, develop and improve traditional industries such as textiles and garments, shoe making, automobile, and construction materials; secondly, actively participate in Huizhou's pillar industries such as electronics, petrochemicals, high and new technology; thirdly, actively take part in industries that have vast potentials such as logistics, modern services, and tourism. Cooperating more closely with Huizhou and strengthening its relations would be helpful to both constructing a prosperous, democratic, civilized, harmonious and modern Huizhou, and maintaining Hong Kong's long term prosperity and stability.