

**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**

FOURTH BI-MONTHLY REPORT

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EXECUTIVE SUMMARY

1. Impact and implications of the global food shortage on China

While an ample level of grains reserve is currently shielding China from the severity of the global food shortage, threats could arise in the longer term. On one hand, the use of grains for feeds and food processing is growing at a rapid pace, leading to the persistent growth of total grains consumption. On the other hand, the supply of arable land and water resources is tightening while weather conditions have become increasingly unstable, adding pressure to grains production. Moreover, the infrastructure facilities of the agricultural industries have aged and worn out while farmers have become less keen in grain sowing, hurting the certainty of grains supply. To ensure food security and stabilize grains prices, the ultimate solution would be to improve production efficiency and perfect the grains reserve system. These would provide the government with greater flexibility when measures need to be introduced to adjust market balance. China also needs to cultivate proper habits in grains consumption to avoid wastage. As the major source of food imported into Hong Kong, food security in China is closely tied to the welfare of Hong Kong. With China foodstuffs prices much lower than international market levels, opportunists are found smuggling/re-exporting China foodstuff to other markets. The HKSAR Government should strengthen cooperation with the Mainland to counter these crimes, helping to ensure the country's food security and safeguard Hong Kong's food supply.

2. The impact of Mainland's inflation on Hong Kong

Affected by surging food prices attributable to the rally of the global agricultural commodities market, and excess liquidity which supported continued loan growth, Mainland prices have risen continuously in the last year, with inflation reaching the highest level seen in the past 12 years. As inflation is expected to edge up further, there is little room for optimism. Given the Mainland is Hong Kong's largest source of food imports, the rise in Mainland food prices inevitably led to a rise in food prices in Hong Kong. As food accounts for more than 30% of monthly expenditures of low income households, the trend is starting to affect their livelihoods. Meanwhile, the Mainland has adopted tighter monetary policies in an effort to curb inflation, leading to a decline in liquidity. This, in turn, would take toll on the investment environment, particularly the equities market. Hong Kong would inevitably be affected by the consolidation of the Mainland stock market. On top of these, the Mainland has

recently allowed more rapid appreciation of the Renminbi to further ease the pressure of excess liquidity on inflation. This not only further pushed up the import prices of foodstuffs from the Mainland and added to local inflationary pressures, but is also hurting Hong Kong manufacturers which have operations based in the Mainland.

3. Impact of Sichuan earthquake on China's future development

The earthquake which hit Sichuan on May 12 has caused the loss of tens of thousands of lives and destruction of innumerable constructions and infrastructure facilities. The damage on the local economy is grave, directly shaving an estimated Rmb520 billion off the economy. However, Sichuan's share in the national economy is still relatively small, the earthquake is thus unlikely to have serious impact on the national economy, and would not cause the Mainland to alter its overall development path. As refugees of the earthquake are being resettled and reconstruction work progresses, another round of rapid investment into fixed assets would ensue, promoting economic growth. During the calamity, developments of Hong Kong real estate companies have not been seriously damaged; projects were only affected in terms of delays in schedule. Outside of Sichuan, however, the earthquake would have indirect impact on Hong Kong manufacturers in the Pearl River Delta region, as workers that originated from Sichuan are likely to return to the province to help the reconstruction. This would add to the severity of labour shortage in the region and put further pressure on the employment problems faced by Hong Kong manufacturers. The psychological damage caused by the Sichuan earthquake is also likely to dampen Mainland residents' travel interests abroad, hurting Hong Kong's tourism industry.

4. Direct links and cross-strait economic cooperation

The cross-strait region is marked by the Taiwan Strait, with Taiwan on the east and Fujian and its peripheral areas on the west. Because the two sides had taken diverse paths in developing their economies, there is much room for one to complement the other; cross-strait economic and trade cooperation has thus yielded dramatic results. Now that the political environment has turned around, "direct links" are likely to be established, strengthening the clustering and radial effect of the cross-strait economies. The market expects "direct links" to usher in improved transportation network and further integration of economic and trade flows across the strait. These would, in turn, spur a new round of economic prosperity in Taiwan and rejuvenate foreign interest in investing in the island. While the imminence of "direct links" inevitably triggers concerns that Hong Kong's traditional middleman role would be eroded, it is also worth highlighting that "direct links" would also lead to more extensive

cross-strait economic and trade flows. The result would be even stronger demand for various services, allowing Hong Kong to take the initiative to maintain its middleman role.

5. Prospects are bright for Hong Kong and Guangdong to cooperate in cultural creative industry

The cultural creative industry is an extension of the cultural industry, with an emphasis on creative abilities and the contribution of culture and arts to the economy. In Guangdong's plan to restructure its economy in the 21st century, spurring the development of cultural industry and expanding its share in the province's GDP are important. Guangdong will strive to boost the industry's annual average growth to more than 15% during the period of the Eleventh Five-Year Plan, with an aim to boost its value-added to Rmb300 billion or around 8% of its GDP by 2010. Hong Kong is well-known for its creativity; its creative industry boasts of abundant talents, technical skills, funding, a free market, and comparative advantage in tapping markets overseas. Guangdong, on the other hand, is blessed with robust cultural resources, vast opportunities in the domestic market, an abundant reserve of talents and a relatively solid foundation of development. Given the diversity between the two, there is evidently much room for both sides to cooperate. Leveraging on its unique advantages, Hong Kong will be able to find itself an appropriate and irreplaceable position in the co-operation with Guangdong. With extensive experience in market development, Hong Kong can help Guangdong's cultural creative industry when tapping the international market, expanding its scope and discovering new dimensions for its long term development.

6. As Guangzhou strives to develop into a model metropolis, more opportunities for cooperation with Hong Kong are created

Guangdong Party Secretary Wang Yang asked that Guangzhou look beyond the restraints set by existing administrative boundaries and facilitate the coordinated development of the entire Pearl River Delta. This could be achieved by scientifically determining the suitable positions and industries for its development. Efforts to develop the city into a model metropolis by establishing a "modern industrial system" and fostering a "livable city" would help Guangzhou strengthen its central position in the region. Given its objective of establishing a "modern industrial system", Guangzhou will speed up the development of modern services and manufacturing industries, strengthen its innovative and creative abilities, and promote the integration of informatization and industrialization. All these give rise to new

opportunities for Hong Kong's participation. Under the CEPA framework, Hong Kong can step up its cooperation with Guangzhou in the areas of modern services, particularly in service outsourcing, finance, exhibits and conventions, logistics and cultural creative industries. In fostering an environment to enhance its position as a "livable city", Guangzhou will strive to improve its environment and strengthen the protection of its ecology. Leveraging on its experience and proven track record in environmental protection, it will not be difficult for Hong Kong to find new business opportunities.

7. Zhuhai's evolution into a new ecological and civilized special economic zone (SEZ) gives rise to more opportunities for cooperation with Hong Kong

At the start of the year, the Ministry of Environmental Protection designated Zhuhai and five other cities as pilot-testing grounds for constructing ecological and civilized environments. With a concrete outline of its development path, Zhuhai finds itself amidst a series of new opportunities. To strike a balance between ecology & civilization and development, Zhuhai will focus on high-technology and high value-added segments of the economy; for these segments to provide a solid foundation for development, Zhuhai needs to improve its infrastructure facilities. In Guangdong's new development strategy, Zhuhai is set to become a transport hub for the western Pearl River Delta, various infrastructure plans are in place to improve the links between the city and Hong Kong. Moreover, Zhuhai's future development would focus on low-pollution and high value-added industries, such as logistics, tourism, human resource training, most of which are service-oriented and best suited for Hong Kong's involvement. Going forward, Zhuhai and Hong Kong will find expanded room for cooperation.

8. Dongguan overcoming its economic hurdles and the implications for Hong Kong's supporting services industries

Having to cope with issues including the continued rise in the costs of raw materials and labour, movement in the Renminbi exchange rate, China's macroeconomic control, adjustments in rules governing process manufacturing, introduction of new measures such as the new labour law and unification of tax systems, Dongguan is forced to come up with a whole new development plan to be able to overcome the hurdles currently faced by its economy. Restructuring is required in both economic and social aspects, and upgrading of both urban and industrial set ups would be necessary. The following are currently underway: pursuing the city's prosperity by

developing technologies, cultivating large-scale enterprises, stepping up tourism development, establishing bonded logistics parks, expanding its market by leveraging on Shenzhen as Dongguan's frontier "shop" and promoting integration with Hong Kong. In the process, Dongguan would require the support of various services industries and this is expected to be met with help from Hong Kong. Dongguan is actively seeking Hong Kong's participation in areas where Hong Kong enjoys innate strengths -- companies specializing in the areas of finance, logistics and convention can leverage on the platform provided by Dongguan to expand their market network.