



香港工業總會
FHKI Federation of
Hong Kong Industries

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“Made in Hong Kong – The Way Forward for Hong Kong Industries” Executive Summary

Research Background

The manufacturing sector in Hong Kong reached its peak in the early 1980s, hiring close to one million local workers. Subsequently, as the cooperation between Hong Kong and the Pearl River Delta (“PRD”) in the form of “Front Shop, Back Factory” gradually took shape, Hong Kong-invested manufacturers had hired approximately 10 million employees in the region at the peak time of 2008. The “Front Shop, Back Factory” model also catalysed the development of Hong Kong’s headquarters economy. Although the production activities of Hong Kong-invested manufacturers are mainly carried out in the PRD, many producer services are still based in Hong Kong, such as product and technology development, innovative design, prototyping, testing and certification, etc. leading to the smooth transition of Hong Kong’s economy towards the service industry.

The financial tsunami in 2008 was a huge blow to the economy of many developed economies. It prompted nations to re-examine the importance of the manufacturing sector in stabilising the economy and employment, and subsequently to promote the high value-add development of the sector, drive demand for producer services and create high-income job positions. Concurrently, because of the receding global economy, Hong Kong-invested manufacturers, who previously depended on orders from multinational corporations, must also re-position themselves to avoid being eliminated. Apart from solidifying their pivotal roles in the production lines, many Hong Kong-invested manufacturers are also proactively extending upstream or downstream along the production chain, strengthening R&D and brand building and opening up new markets, thereby moving from the low-cost model towards more competitive, leading position in the production chain.

Today, Hong Kong-invested manufacturers face diverse changes in the operating environment, from the eastward shift of the global economic centre, US-China trade disputes, signing of the Regional Comprehensive Economic Partnership Agreement (RCEP), to the new business model led by COVID-19 pandemic. Against such a background, Hong Kong-invested manufacturers must consider how to adjust their production chains and operating strategies to sustain development.



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Purpose and Method of Research

The purpose of this research, in the context of the economic and political developments in Hong Kong, the Mainland, and internationally, and of the evolutions in the business environment, is to understand the coping strategies of Hong Kong-invested manufacturers and explore the development outlook for Hong Kong's industry for putting forward policy proposals for Hong Kong's future industrial development. The research team conducted big data analysis, questionnaire surveys, focus group discussions, and literature reviews to understand the current operating conditions and strategies of Hong Kong-invested manufacturers, including how to implement the "China + 1" strategy, the progress of upgrading and transformation and the expansion of domestic and ASEAN market, etc.

Operating Conditions of Hong Kong-invested Manufacturers

- 1. The Greater Bay Area ("GBA") is the most preferred location for Hong Kong-invested manufacturers.** In 2016, there were approximately 46,000 Hong Kong-invested manufacturers in the Mainland, of which 32,000 were engaged in export trade. With respect to regional distribution, approximately 48.5% of Hong Kong-invested manufacturers were located in Guangdong Province, mainly in the GBA's Shenzhen and Dongguan, and 26.9% were within the Yangtze River Delta.
- 2. The total output value of Hong Kong-invested manufacturers in the Mainland in 2019 was equivalent to 23.7% of Hong Kong's GDP in the same year.** In 2019, the total profit of Hong Kong-invested manufacturers in the Mainland was RMB¥609.3 billion, approximately HK\$608.1 billion when converted, which was equivalent to 23.7% of Hong Kong's GDP (HK\$2.87 trillion) in that year.
- 3. Faced with rising operating costs in the Mainland, Hong Kong-invested manufacturers have shifted their production lines to lower-cost areas.** The year 2008 was the peak for the operations of Hong Kong-invested manufacturers in the Mainland. In 2007, about 2,500 Hong Kong-invested manufacturers entered the Mainland; however, that number began to fall since 2008 to less than 800 in 2016 (there was a short rebound during 2010-2011 in response to the state's RMB¥4 trillion stimulus measures to expand domestic demand and to promote steady economic growth). The entry-exit ratio was 7:2. The financial tsunami in 2008 and the Labour Contract Law promulgated in the same year created internal and external pressures against the operations of Hong Kong-



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invested manufacturers. In addition, the promulgation of various industrial policies aimed at enhancing green production in the Mainland has increased the costs of corporate compliance. It will be increasingly difficult for manufacturers to operate in the PRD if they are unable to change their mode of operation and to upgrade in line with national policies.

- 4. Hong Kong-invested manufacturers constitute one of the major driving forces of Mainland exports.** From 2000 to 2016, Hong Kong-invested manufacturers, despite comprising less than 10% of manufacturing corporations in the Mainland, contributed almost 20% of the Mainland's overall manufacturing exports. Taking 2016 as an example, there were approximately 15,000 Hong Kong-invested export manufacturers, accounting for 4.6% of the total in the Mainland, whose export value was US\$194.6 billion (accounting for 19.0% of the Mainland's total manufacturing exports). In addition, the sales network of Hong Kong-invested manufacturers is comparatively more internationalised, allowing them to act as the agent between the Mainland manufacturing sector and the international market.
- 5. Hong Kong-invested manufacturers are headquartered in Hong Kong, driving the development of producer services industry.** According to survey results, 90% of the respondents are headquartered in Hong Kong. Hong Kong retains its headquarters economy status. The main functions of the Hong Kong establishments include sales and marketing (including online marketing) (78.4%), financial, accounting, and legal services (74.5%), and administrative management (68.4%). On the other hand, the percentage of Hong Kong establishments engaging in operations related to product production (such as product design, technical support, R&D, and engineering technology) are lower than those in the Mainland. However, Hong Kong-invested manufacturers, whose main operations are production in the Mainland, are actively integrating upstream or downstream along the production chain, and have been driving the demand of many producer services industries in Hong Kong. According to estimations by the research team, since the 1980s, although manufacturing activities in Hong Kong have decreased, the percentage of the producer services in the local GDP have been continuously increasing, from 28.7% in 1980 to 42.2% in 2019.



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Coping Strategies adopted by Hong Kong-invested Manufacturers

Strategy 1: “China + 1”

The survey shows that 23% (53 companies) of the respondents adopt the “China+1” strategy to cope with the Sino-US trade dispute. 80% of them prefer to set up production lines in ASEAN countries. Hong Kong-invested manufacturers opt for the “China+1” strategy mostly due to customers’ requirements (62.3%), coping with the increase in production costs in the Mainland (56.6%) and avoiding the sudden increase in US tariffs (54.7%).

Strategy 2: “Business Repositioning”

Repositioning of business strategy. According to FHKI’s 2015 study, 46% of Hong Kong-invested manufacturers have adopted “management innovation” as their main business strategy at that time. 53% of the respondents in the current survey adopt the same strategy. Nowadays, Hong Kong-invested manufacturers are more inclined to adopt “strengthening technology research and development” (57%) and “strengthening product design” (59%), the ratio has doubled comparing to the 2015 survey and exceeded the ratio of choosing “management innovation”. This shows that most of the respondents are working to upgrade their business towards the upper-stream of production chain.

Repositioning of the sales market. Facing the Sino-US trade dispute, 59% of manufacturers that mainly serve the Mainland market expand the domestic market adapting to the national dual circulation strategy; 33% would increase the share of sales in the Mainland and expand production capacity; 35.9% would develop the ASEAN market. Even for manufacturers that focus on European and American markets, 51.1% would expand the Mainland market, and 28.9% would both increase the share of sales in the Mainland and explore the ASEAN market. Shifting from the traditional European and American markets to both the Mainland domestic market and the ASEAN market is a clear trend.

Strategy 3: “Upgrade and Transformation”

Hong Kong-invested manufacturers are inclined to invest in R&D activities and product development. In 2020, 26% of the respondents indicated that they would spend more than 10% of their turnover for R&D and product development purposes, while only about 10% indicated the same in 2015. Moreover, despite the Sino-US trade wrestling and COVID-19, Hong Kong-invested manufacturers are still willing to invest in R&D. More than half (53%) said they would increase investment. From this point of view, R&D innovation is the business strategy of many manufacturers in the face of adversity.



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Strategy 4: “Establishing Production Lines in Hong Kong”

In recent years, the cost advantage of setting up factories in the Mainland has gradually diminished as various operating costs continued to increase. On the other hand, the Hong Kong Government strive to implement policies and provide subsidies to attract high value-added manufacturing to Hong Kong. It has also introduced the “Reindustrialisation Funding Scheme” to help traditional Hong Kong manufacturers to establish automated and smart production lines. Quite a number of Hong Kong-invested manufacturers have started to actively consider setting up part of their production lines in Hong Kong. The survey shows that a total of 61 respondents (26.8%) have set up production lines in Hong Kong, and 24 respondents (approximately 10%) indicate that they have the intention to relocate back to Hong Kong.

The Future Developments of Hong Kong Industries

Based on the coping strategies of Hong Kong-invested manufacturers, global shifts in manufacturing activities and local development of “re-industrialisation”, the Federation believes that the traditionally “Made in Hong Kong”, which represents products manufacturers locally, should now be more broadly understood as “Made by Hong Kong”, covering diverse products that are researched and developed, designed and produced by Hong Kong-invested manufacturers with the intellectual and quality excellence originated from Hong Kong. Local industrial policies should look beyond “re-industrialisation” and take a more holistic view of “industry” as a whole, taking into account of the unique operation characteristics of Hong Kong-invested manufacturers, to cover multiple dimensions of manufacturing activities local and abroad, production to producer services along the value chain, traditional and emerging manufacturing sectors, export and domestic sales markets. As a result, a comprehensive policy blueprint shall be developed with resources allocated to strategic areas to address the pain points of Hong Kong-invested manufacturers under current conditions and global business trends.

1) Review Economic Data to Reflect Industrial Development

Hong Kong’s industrial production activities have expanded abroad, forming a regional, massive and highly competitive production base. The headquarters of these manufacturers in Hong Kong mainly focus on producer services activities such as R&D, product design, market expansion, and logistics chain control. These activities are relatively high value-added in the production chain. Yet, such activities are not clearly differentiated in local economic statistics, nor are their output value regarded as related to manufacturing. As time goes by, the



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manufacturing sector has undergone rigorous transformation where diverse producer service sectors have been developed and become mature, forming an extended and intertwined industrial system. The traditional narrow definition of “manufacturing” may be obsolete for us to fully understand the industry and the far-reaching impact of manufacturing activities. Economic analysis agencies or countries are now inclining towards disaggregating the service sector, so that they can have a more accurate assessment of the contribution of each sector to the national economic development.

Policy Recommendations

- Review the classification method of the service industry: Disaggregate “producer services” from the services industry to clearly differentiate the economic value of “producer services in local GDP. References can be made to the National Bureau of Statistics’ producer services industry classification in 2019 regarding the classification method and concept. This can help policymakers understand the output value and trends of various producer services.
- Update industrial classification: Revise the industrial classification regularly (e.g. every 5 years) according to latest economic development, removing outdated categories and adding emerging industry classifications. At the same time, the statistical methods of industrial census can be fine-tuned to raise data accuracy and aid the analysis of the rapidly-changing modern economy.
- Conduct census on the offshore production activities of Hong Kong-invested manufacturers: Include the total output value of Hong Kong-invested manufacturers’ overseas production units into official statistics. This will aid the understanding of how offshore manufacturing activities impact on Hong Kong’s economy, and will allow policies promoting Hong Kong-invested manufacturers’ overseas production to be formulated, thereby driving the development of the local producer services in turn.

2) Developing local “re-industrialisation” of selected industries to build core technological competence

Having high value-added manufacturing activities locally is the most direct way to drive technological research and the demand for manufacturing technology services. It can also effectively accelerate the grooming of talent pool and promote R&D commercialisation between manufacturers and the academia. This will help traditional manufacturers upgrade



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and transform, create new and advanced manufacturing industries, drive demand of producer services and ultimately reshaping the local manufacturing ecosystem. The Federation is of the view that, despite the fact that large-scale mass production is difficult in Hong Kong, certain most competitive and high value-added manufacturing activities should be selected where policy incentives are offered to encourage their local production. These industries will become new pillars of Hong Kong's economy with focused investments into developing core technology and manufacturing talent pool.

2.1 Selecting Industries with regard to national economic strategies and local manufacturing capabilities

Among the diverse manufacturing sector, the Government should change its “big market, small government” mentality by selecting advantageous industries for promoting local “re-industrialisation”. By concentrating resources from the industry, academia and research sectors to develop core technology and groom the manufacturing technology talent base, coupled with facilitative policies, it is expected that the industrial and business communities will be encouraged to pursue development in such industries.

Policy Recommendations

In the Federation's view, Hong Kong possesses the ability to develop the following high value-added manufacturing industries:

- **Advanced electronics**: the advanced electronics industry, particularly the semiconductor industries, is one of the national key technological areas. The industry has extremely wide applications with strategic significance to national industrial development. Hong Kong also possesses profound industrialisation abilities and more convenient export-import policies. Thus, it will be more cost-efficient to conduct high value-added assembling processes in Hong Kong than in the Mainland.

- **Food technology and food processing**: currently, “food, beverage, and tobacco products” is the main local manufacturing industry, accounting for one-third of the total value-added of the industry. Processed food produced in Hong Kong have always been highly reputed. Local factories implement strict food safety and quality control, and possess both the facilities and skilled workers. There is also a mature market network. Moreover, the food production industry covers all primary, secondary and tertiary industries, with great room for introducing innovative technologies and improving production capabilities, allowing the industry to undergo high value-added transformation.



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- **Recycling and environmental industry:** Facing the saturation of landfills and increased restrictions against waste export, Hong Kong desperately needs to improve the production chain of its circular economy by promoting the local recycling and environmental industry, thereby expanding the local ability and capacity to handle waste. While the government has been promoting the reduction of waste at source in recent years, the next step must involve mobilising the manufacturing sector to construct downstream industries for turning waste into resources; only then can resource recycling be achieved. Therefore, the government should allocate more large-scale industrial land and encourage manufacturers to invest in the high value-added recycling industry by introducing new technologies. This will turn the industry into one of the pillars of Hong Kong's re-industrialisation.
- **Biotechnology:** Biotechnology industry is one of the most important areas of scientific research and innovation internationally, as demands for medical healthcare are continuously on the rise due to aging population. Medical technology is also an important area of innovation promoted by the Hong Kong government. Hong Kong possesses a profound biotechnological research foundation, and the government has been heavily investing in the "Health@InnoHK" platform, provide support to the industry through the Hong Kong Science and Technology Parks Corporation, and coordinate with Mainland governments for the circulation of scientific research resources. In addition, Hong Kong has an advantage in clinical tests, and pre-profit biotechnology companies are allowed to list in Hong Kong. These factors enable biotechnology manufacturers to commercialise most advanced upstream scientific research in their businesses.

2.2 Reconstructing the Industrial Talent System

According to research findings, many Hong Kong-invested manufacturers face difficulties such as industrial talent shortage and high turnover rate when pursuing strategies like upgrading and transformation and local re-industrialisation. Ever since the Hong Kong government has begun promoting the development of innovation and technology, funding programmes for R&D talent have been introduced for tertiary institutions and the industry. The education and employment support in this area are gradually getting on track, and have received wide support from the industry. However, the process of grooming industrial talents required by "re-industrialisation" still lags behind.



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Policy Recommendations

The Federation suggests the government should nurture a talent base for Hong Kong's "re-industrialisation" in the three directions below:

- Strengthen the provision and recognition of applied subjects in the education system and construct articulation pathway: More courses related to advanced manufacturing can be provided across secondary school, apprenticeship schemes, diplomas and degree programmes, with industry's participation to strengthen the credibility of applied subjects across the board. These include encouraging institutions to offer Applied Degree programmes, subsidising the industry and institutions to jointly organise dual-track programmes, enhancing existing apprentice training programmes and "Earn & Learn Scheme", increasing the recognition and participation rate of "Applied Learning Subjects" in secondary schools, and broadening the coverage of the "STEM Internship Scheme" to cover subjects related to the manufacturing industry and associate degrees.
- Attract experienced industrial talent by utilising the Qualifications Framework and accreditation system: Formulate policies for the accreditation and attracting of experienced industrial talent to aid the industry hiring experienced technical personnel in the short run. This includes opening up the talents market, providing professional accreditation for engineers belonging to the industrial group, and utilising the Qualifications Framework mechanism for the accreditation of experienced technology personnel.
- Reshaping the image of the modern industry with joint efforts of schools and industry: Promote closer cooperation between businesses and schools to help students understand how industry and technology are closely related to our daily life, and to create a more concrete and positive impression towards the modern industry and the spirit of "craftsmanship".

2.3 Supporting Specific Industries with Government Procurement

Many governments cause funds to flow into the market and simultaneously facilitate the development of SMEs in specific industries by strategically employing public procurement policies that are beneficial for SMEs to tender. However, under the existing government procurement policies in Hong Kong, it is difficult for SMEs to compete with large scale manufacturing corporations with their very limited resources. The Federation recommends the government to further review its procurement policies to provide local manufacturing SMEs



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with more business opportunities, and to encourage them to invest in advanced manufacturing and upgrading traditional operations.

Policy Recommendations

- Invoke negotiation exemptions under the “WTO Agreement on Government Procurement”: the government should actively negotiate for exemptions under the WTO Government Procurement Agreement. Especially, selected industries should be added to the list of exempted entities, and the government can prioritise the procurement of locally produced recycled and reused products in furtherance of the aim of sustainable development.
- Set out a target ratio of procurement from SMEs: Referring to other economies, the government should require public institutions to provide SMEs the opportunity to take part in government procurement with target ratio set, implement payment mechanisms that can ease the SMEs’ financial pressure, and formulate a lists of products with SMEs associations for which only tenders from SMEs are accepted.
- Increase public green procurement: the green procurement list should be broadened with increased budget for government departments to procure green products. Also, specific green standards and target procurement ratio should be set out for locally recycled and reused resources.

2.4 Improving Industry Support Measures and Formulating “Re-industrialisation”

Performance Indicators

Economies that are undergoing “re-industrialisation” or promoting advanced manufacturing industries (including China, the United States, and Singapore, etc.) all have many policies benefitting industrial development. The Hong Kong government needs to adopt more proactive measures and review the existing industrial policies or regulations that were aimed at traditional, labour-intensive manufacturing activities. This will lead to the gradual establishment of industrial ecosystem and create favourable conditions for “re-industrialisation”.

Policy Recommendations

- Industrial land planning: the government is recommended to provide more attractive land premiums for industrial buildings redevelopments to suit advanced manufacturing, in order to encourage landlords to preserve industrial buildings for industrial uses. The



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government is also recommended to set up industrial parks or special industrial buildings for selected industries, where common facilities, infrastructure, emission systems, industrial support, logistics and transport facilities are provided.

- Facilitate technology transfer between the industry and institutions: when granting funds to universities' scientific research projects, the government and the Research Grant Council should designate part of the funds for the commercialisation of research outcomes in order to encourage investment into applied research and allow researchers to help solve practical technological challenges in the industry. The existing funding schemes should also be optimised to encourage cooperation between universities and the industry in carrying out applied research projects. To facilitate exchange, regulations concerning the practice of R&D personnel outside schools should also be appropriately relaxed.
- Review factory licensing and certificate of origin requirements in light of the characteristics of advanced manufacturing: The local manufacturing sector is developing towards small volume, high value-added and more producer service-oriented, which the nature and factory set-ups are very different from the labour-intensive manufacturing in the past. Therefore, the Federation suggests the government should make appropriate adjustments to the application procedures and requirements for "Factory Registration" and "Certificate of Origin", taking more proactive approach in seeking to understand the operations of advanced manufacturing enterprises and facilitate their license applications.
- Appropriately relax the application requirements for government funding schemes: the government has always maintained various funding schemes for encouraging R&D and technological applications. However, as many schemes can involve larger sums (for example, up to HK\$15 million can be granted under the "Re-industrialisation Funding Scheme"), the approval processes are complicated and create heavy administrative burden on SMEs applicants. The Federation hopes that the government authorities can review the application requirements of these funding schemes and consider relaxing the requirements appropriately for applications of smaller funding amount to facilitate SMEs using the funds for upgrade and transformation.
- Formulate cross-department implementation plans for "re-industrialisation" and performance indicators: Due to the fact that "re-industrialisation" involves multiple



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policy areas from economic development, R&D, education, talent admission, land supply to financing, the Federation is of the view that the government should formulate cross-department development roadmaps, implementation plans and performance indicators to help review the progress of each policy area. The government can formulate five-year plans according to the trends of specific industrial data, and to promote the local industrial output value to reach a certain targeted proportion of the GDP.

3) Strengthening Producer Services to Become the Hub of Regional Manufacturing Development

Hong Kong has always been Asia's financial and trade centre, possessing a mature international business network and extremely favourable conditions for becoming the core of manufacturing production value chain in Asia. Using the GBA and Southeast Asia as bases for mass production, and fully utilising its advantages as a knowledge-based economy and profound manufacturing foundations, Hong Kong can provide upstream and downstream producer services (including scientific research, design, procurement, logistics and trade, sales, financing and insurance, etc.) as well as advanced manufacturing procedures, which are the most value-added economic activities along the production chain. Moreover, by taking advantage of beneficial policies such as the "14th Five-year Plan" and RCEP, Hong Kong can lead the development of the manufacturing sector in the region by transferring innovations and technical know-how to upgrade manufacturing activities within the region, and will ultimately usher in a new era of Hong Kong's industry.

Policy Recommendations

- Strengthening Hong Kong's role as an international innovation and technology centre in the GBA: Hong Kong has been positioned as the GBA's international innovation and technology centre under the "14th Five-year Plan". Hong Kong should seize this opportunity to actively strengthen the innovative abilities of selected industries, and streamline policies with the rest of GBA to allow seamless integration of scientific research activities, movement of talent, protection of intellectual properties, product standards, trading and professional services etc. These measures will allow cooperation between the scientific research teams from Hong Kong and the Mainland to achieve technological breakthroughs and the commercialisation of research outcomes. Due to the fact that Hong Kong-invested manufacturers are active in R&D in the Mainland, the government should accordingly formulate more comprehensive strategies to assist Hong Kong-invested manufacturers in the Mainland in facing challenges such as talent acquisition and cross-border R&D cooperation, and thereby to promote the high-tech



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development of local producer services. Moreover, Hong Kong can ride on its capacity in testing and certification to help connect the Chinese and foreign markets by assisting GBA and overseas corporations to meet various product specifications requirements and certification standards.

- Strive for a leading position in the production chain in Asia's manufacturing sector: As the manufacturing in the Mainland is transforming towards high-tech directions, labour-intensive manufacturers are beginning to set up production lines in Southeast Asia instead. In addition, the implementation of RCEP will also gradually remove trade barriers across the region. It is anticipated that manufacturing activities in Asia will significantly increase, with stronger cooperation between economies in different parts of the production chain. As the gateway between the GBA and the world, the Federation recommends the government to step up its effort to assist Hong Kong-invested manufacturers to seize the opportunity and to strive for an advantageous leading position in the production chain of Asia. For example, the government can assist Hong Kong-invested manufacturers open up the ASEAN market by negotiating for preferential investment terms on a government-to-government basis, reviewing the positioning of Hong Kong Export Credit Insurance Corporation and their insurance products, and promoting "Made by Hong Kong" brands in emerging markets, etc.

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