

# **Hong Kong Economy (ECON 2150 2008-09): Introductory notes**

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# Outline

- (1) Hong Kong's geographical and socio-economic backgrounds**
- (2) A brief chronology of HK's economic development**
- (3) Sources of growth in the HK economy**
- (4) The role of the government**

# (1) Geographical and socio-economic backgrounds

## Background:

Occupied by the UK in 1841, Hong Kong was formally ceded by China the following year; various adjacent lands were added later in the 19th century. Pursuant to an agreement signed by China and the UK on 19 December 1984, Hong Kong became the Hong Kong Special Administrative Region (SAR) of China on 1 July 1997. In this agreement, China promised that, under its "one country, two systems" formula, China's socialist economic system would not be imposed on Hong Kong and that Hong Kong would enjoy a high degree of autonomy in all matters except foreign and defense affairs for the next 50 years.

## Geography

<b>Area:</b>	<i>total:</i> 1,092 sq km	<b>Land use:</b>	<i>arable land:</i> 5.05%
	<i>land:</i> 1,042 sq km		<i>permanent crops:</i> 1.01%
	<i>water:</i> 50 sq km		<i>other:</i> 93.94% (2001)

**Natural resources:** outstanding deepwater harbor, feldspar

<https://www.cia.gov/library/publications/the-world-factbook/geos/hk.html>

## (1) Geographical and socio-economic backgrounds



# 泛珠三角



<http://www.pprd.org.cn/>

# Greater Pearl River Delta



# (1) Geographical and socio-economic backgrounds



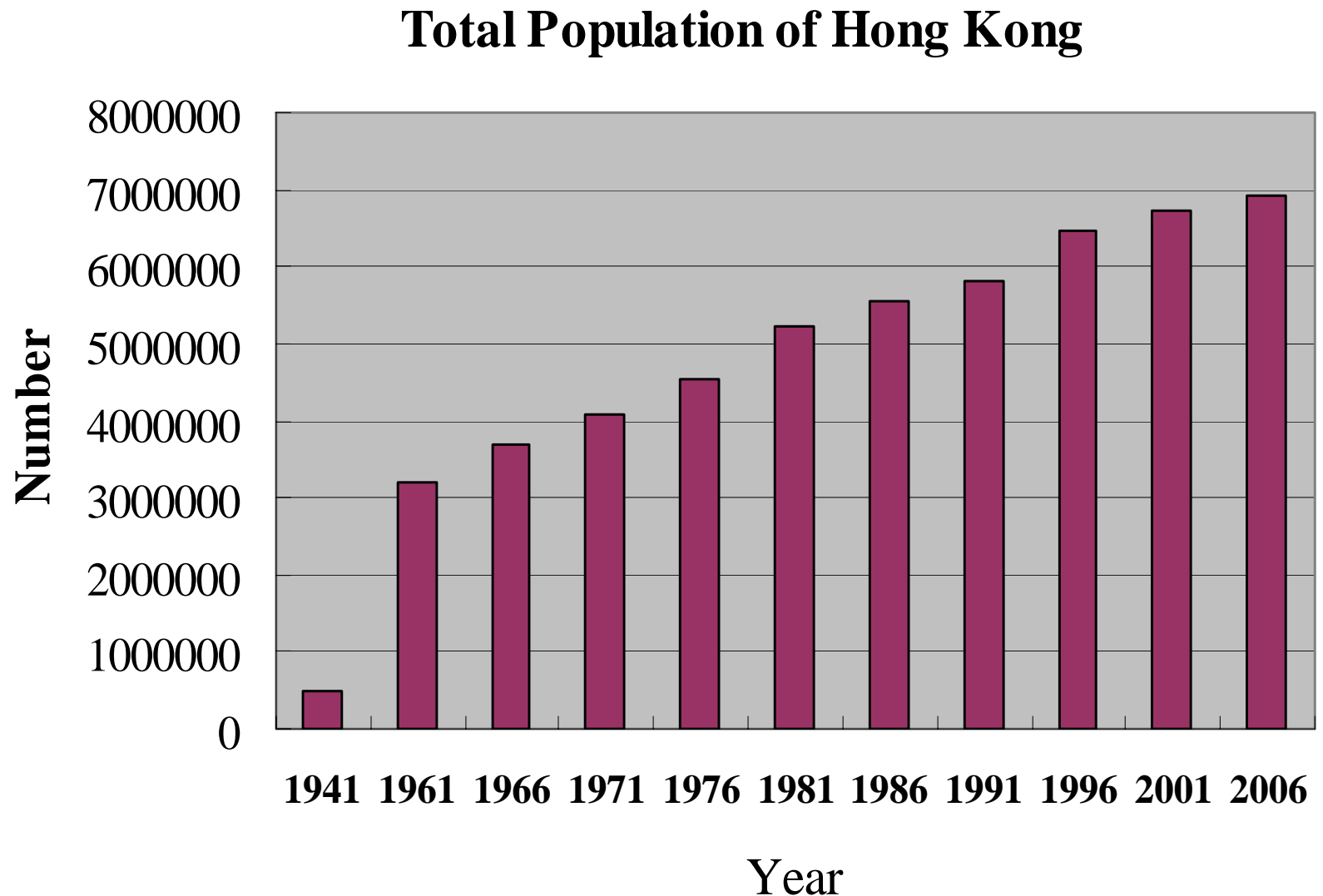
Indicator	Unit	Reference period	Magnitude
Population	'000	Mid-2007	6 925.9
Labour force <sup>Ⓐ</sup>	'000	2007	3 640.5
Unemployment rate <sup>Ⓐ</sup>	%	2007	4.0
Real wage index (Sep. 1992=100)		Sep. 2007	116.7
Per capita GDP in chained (2005) dollars <sup>Ⓐ##</sup>	HK\$	2007	227,008
Per capita GDP at current market prices <sup>Ⓐ</sup>	HK\$	2007	232,836
GDP in chained (2005) dollars <sup>Ⓐ##</sup>	HK\$ billion	2007	1,572.2
GDP at current market prices <sup>Ⓐ</sup>	HK\$ billion	2007	1,612.6
Value of total exports	HK\$ billion	2007	2,687.5
Quantum index of total exports (Year 2000=100)		2007	183.4
Value of imports	HK\$ billion	2007	2,868.0
Index of industrial production (Year 2000=100)		Average of the first 3 quarters of 2007	81.4
Telephone lines	'000	2007	3 883
Visitor arrivals	'000	2007	28 169



## (2) A brief chronology of HK's economic development

- |                  |   |
|------------------|---|
| <u>Pre-1950s</u> | As a sleeping entrepôt (轉口港), with relatively little else in economic development.  |
| <u>1950s-60s</u> | There was a <b>large influx of immigrants</b> from Mainland China, as well as some capital. HK embarked on <b>labour-intensive, export-oriented industrialisation</b> making low-end consumer products sold to the U.S. and Europe.               |
| <u>1970s</u>     | Facing rising costs and challenges by other Asian competitors, the HK government set up the Committee on Industrial Diversification, which turned out to be “irrelevant” for entrepreneurs who sought short-term profits as China then opened up. |

## Influx of population (immigrants) from Mainland China after WWII



## (2) A brief chronology of HK's economic development

1979

China began its economic reforms and open policies, and HK's external economic environment saw a sea change in terms of cost calculations and profit opportunities.

1980s

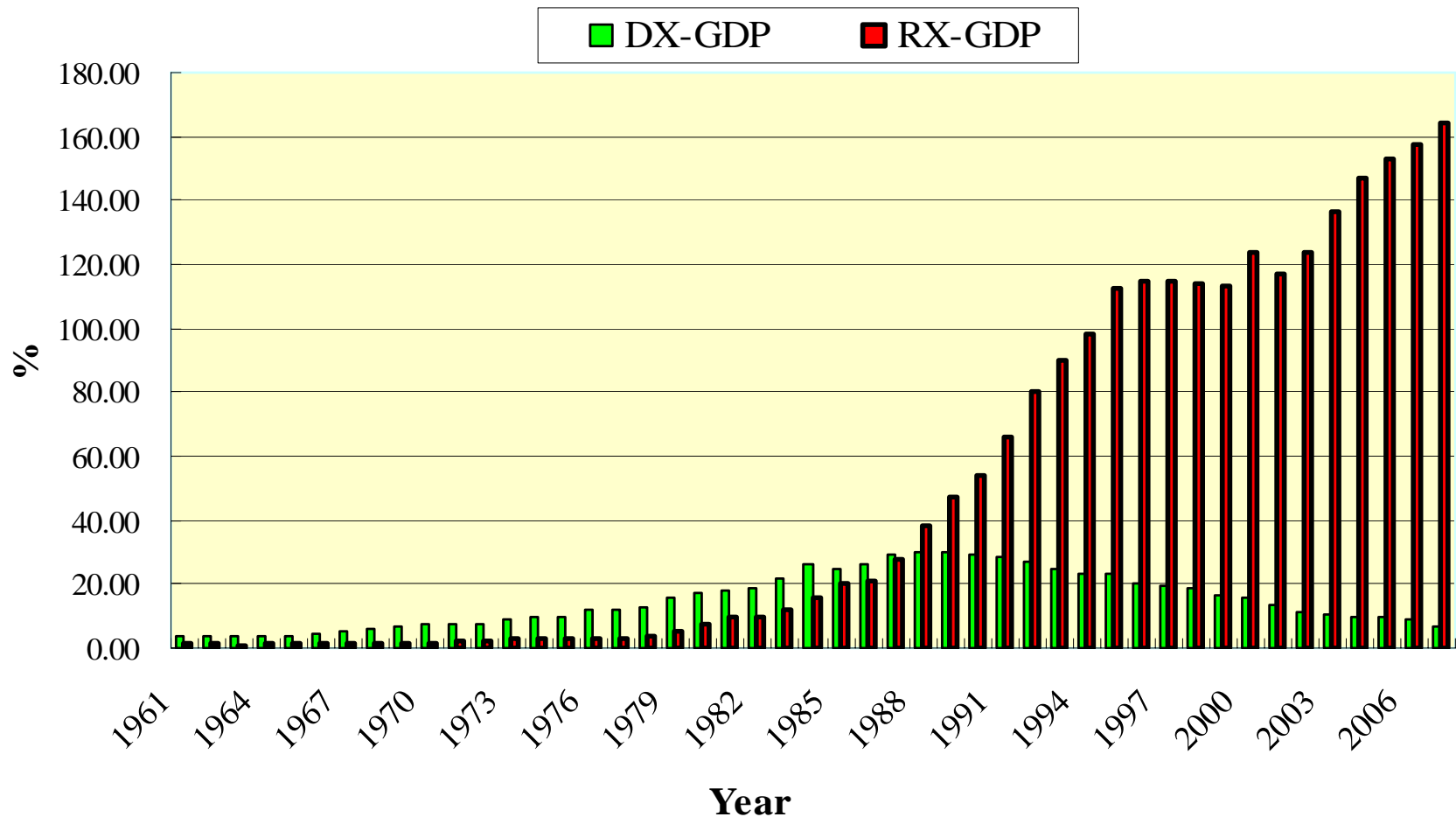
**Structural transformation** in HK's economy; massive relocation of manufacturing industries to south China; **re-exports exceeding domestic exports** again in 1988.

1990s

**The de-industrialization and “Manhattanization” of HK.** Transitional politics towards 1997 leading to “short-termism” in all parties. Financial and property bubbles. **Demographic** growth slowed and aging emerged as a problem.

# Back to entrepôt – resurgence of re-exports

## Ratios of Domestic Exports (DX) and Re-exports (RX) of Goods to GDP



# Economic structural transformation

**Table 1: Hong Kong's GDP by Industrial Origin at Current Factor Cost**

Unit: %

	1970	1975	1980
Agriculture and fishing	2.0	1.4	1.0
Mining and quarrying	0.2	0.1	0.0
Manufacturing	30.9	26.9	25.1
Electricity, gas and water	2.0	1.8	1.3
Construction	4.2	5.7	7.1
Services	60.1	63.6	65.2
Wholesale, retail and import/export trades, restaurants and hotels	19.6	20.7	19.2
Transport, storage and communications	7.6	7.2	7.2
Financing, insurance, real estate and business services	14.9	17.0	25.9
Community, social and personal services	18.0	18.7	12.9
Activities not adequately defined	0.6	0.5	0.3
Total	100.0	100.0	100.0

Source: Census and Statistics Department, HKSAR Government

Note: The total is GDP at factor cost. The series under-estimated "ownership of premises" and were discontinued after 1980. So Table 1 is "not strictly comparable" to Table 2.

# Economic structural transformation

**Table 2: Hong Kong's GDP by Economic Activity at Current Prices (%)**

Unit: %

	1980	1990	2000	2006
Agriculture and fishing	0.8	0.2	0.1	0.1
Mining and quarrying	0.2	0.0	0.0	0.0
Manufacturing	22.8	16.7	5.4	3.2
Electricity, gas and water	1.5	2.4	2.9	2.8
Construction	6.5	5.2	4.9	2.7
Services	68.3	75.4	86.6	91.2
Wholesale, retail and import/export trades, restaurants and hotels	19.4	23.7	24.6	27.9
Transport, storage and communications	6.9	9.00	9.5	9.6
Financing, insurance, real estate and business services	21.7	18.9	21.4	25.0
Community, social and personal services	11.9	14.1	19.9	18.1
Ownership of premises	8.4	9.7	11.3	10.6
Total	100.0	100.0	100.0	100.0

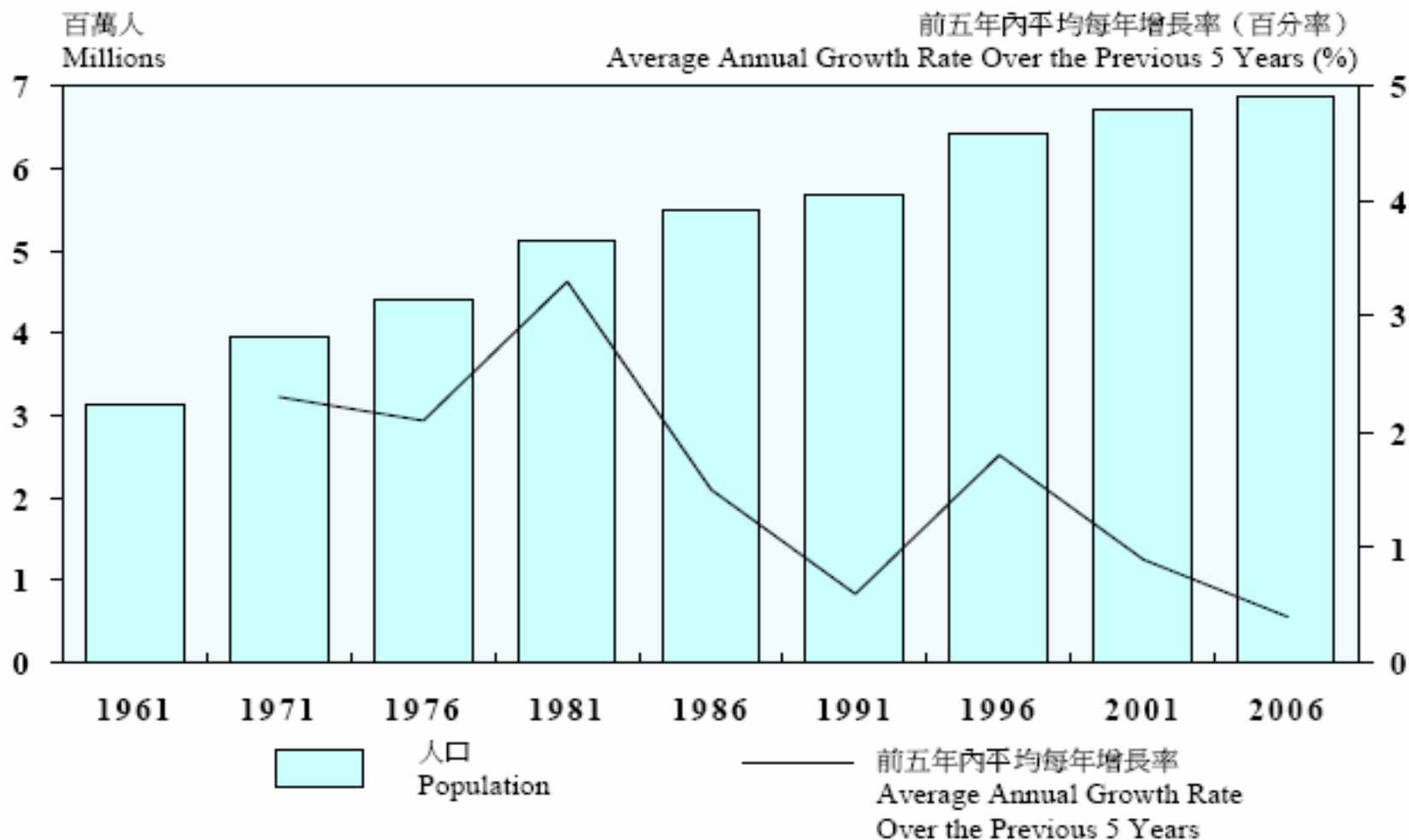
Source: Census and Statistics Department, HKSAR Government

Note: The total is GDP at factor cost.

## (2) A brief chronology of HK's economic development

圖 1 一九六一年至二零零六年的人口及平均每年增長率

Chart 1 Population and Average Annual Growth Rate, 1961 - 2006



## (2) A brief chronology of HK's economic development

表 2 一九九六年、二零零一年及二零零六年按性別及年齡組別劃分的人口

Table 2 Population by Sex and Age Group, 1996, 2001 and 2006

性別 Sex	年齡組別 Age Group	1996		2001		2006	
		數目 Number	百分比 %	數目 Number	百分比 %	數目 Number	百分比 %
合計 Both sexes							
	0 - 14	1 151 038	18.5	1 109 417	16.5	939 675	13.7
	15 - 24	869 511	14.0	920 445	13.7	909 005	13.2
	25 - 34	1 188 424	19.1	1 108 529	16.5	1 052 126	15.3
	35 - 44	1 178 522	19.0	1 360 487	20.3	1 248 855	18.2
	45 - 54	683 569	11.0	960 417	14.3	1 193 788	17.4
	55 - 64	516 937	8.3	502 042	7.5	668 101	9.7
	65+	629 555	10.1	747 052	11.1	852 796	12.4
	總計 Total	6 217 556	100.0	6 708 389	100.0	6 864 346	100.0



## (2) A brief chronology of HK's economic development

1997-99

“One country, Two Systems”: **“The river water shall not intrude into the well water.”** (河水不犯井水) The pre-1997 bubbles then burst and deflation unfolded.

2001-2003

SARS epidemics broke out and there was a political crisis for the HKSARG.

2003 -  
Present

**Mainland China coming to help:** Closer Economic Partnership Arrangement (CEPA), the “Individual Visit Scheme”, “Pan Pearl River Delta (PPRD) Regional Cooperation Framework Agreement” (the so-called “9+2 Agreement”). Amidst HK's internal political anomie, inter-city competition (with the Mainland counterparts) is on the rise. **HK becomes a “service economy”.**

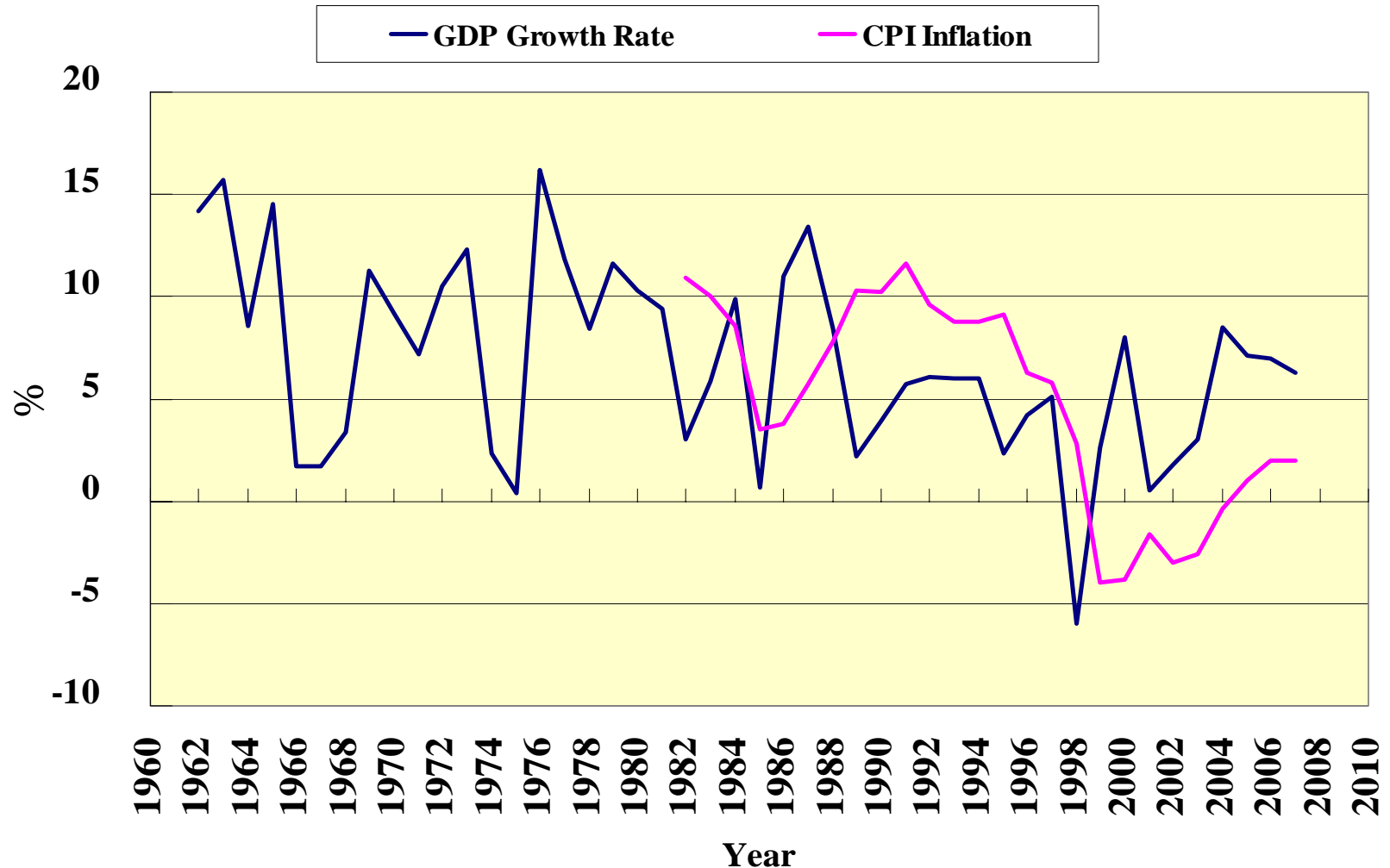
## (2) A brief chronology of HK's economic development

表二：香港的就业结构(%)

	2001	2006
渔农业	0.3	0.3
采矿及采石业	0.0	0.0
制造业	6.6	5.1
电力、燃气及水务业	0.4	0.4
建筑业	9.0	8.0
服务业	83.7	86.1
批发、零售、进出口贸易、饮食及酒店业	33.6	34.0
运输、仓库及通讯业	10.7	10.5
金融、地产及商用服务业	14.7	15.4
公共行政	4.1	3.7
教育、保健、小区、社会及个人服务业	20.6	22.5
总计	100.0	100.0

## (2) A brief chronology of HK's economic fluctuations

**Hong Kong's Economic Growth and Inflation**



### (3) Sources of growth in the HK economy

- The growth of an economy like Hong Kong can be analysed from three angles:
- (1) The expenditure/demand approach:  
$$\Delta \text{GDP} \equiv \Delta C + \Delta I + \Delta G + \Delta \text{NX} ;$$
- (2) The sectoral approach: primary + secondary + tertiary sectors of the economy.
- (3) The aggregate production approach:

$$Y_t = AK_t^\alpha L_t^\beta$$

### (3) Sources of growth in the HK economy

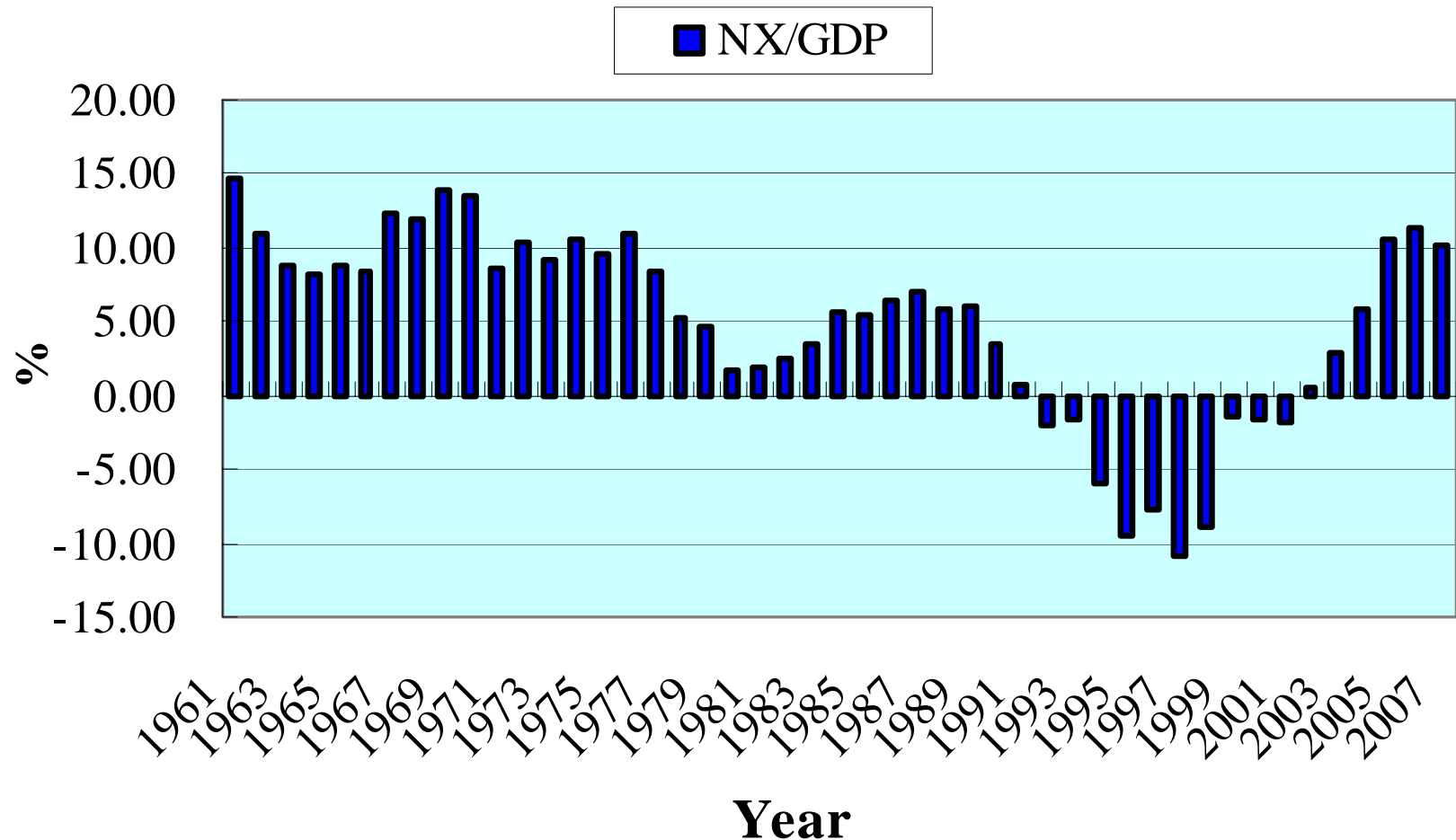
- (1) The expenditure/demand approach:

$$\Delta \text{GDP} \equiv \Delta C + \Delta I + \Delta G + \Delta NX ;$$

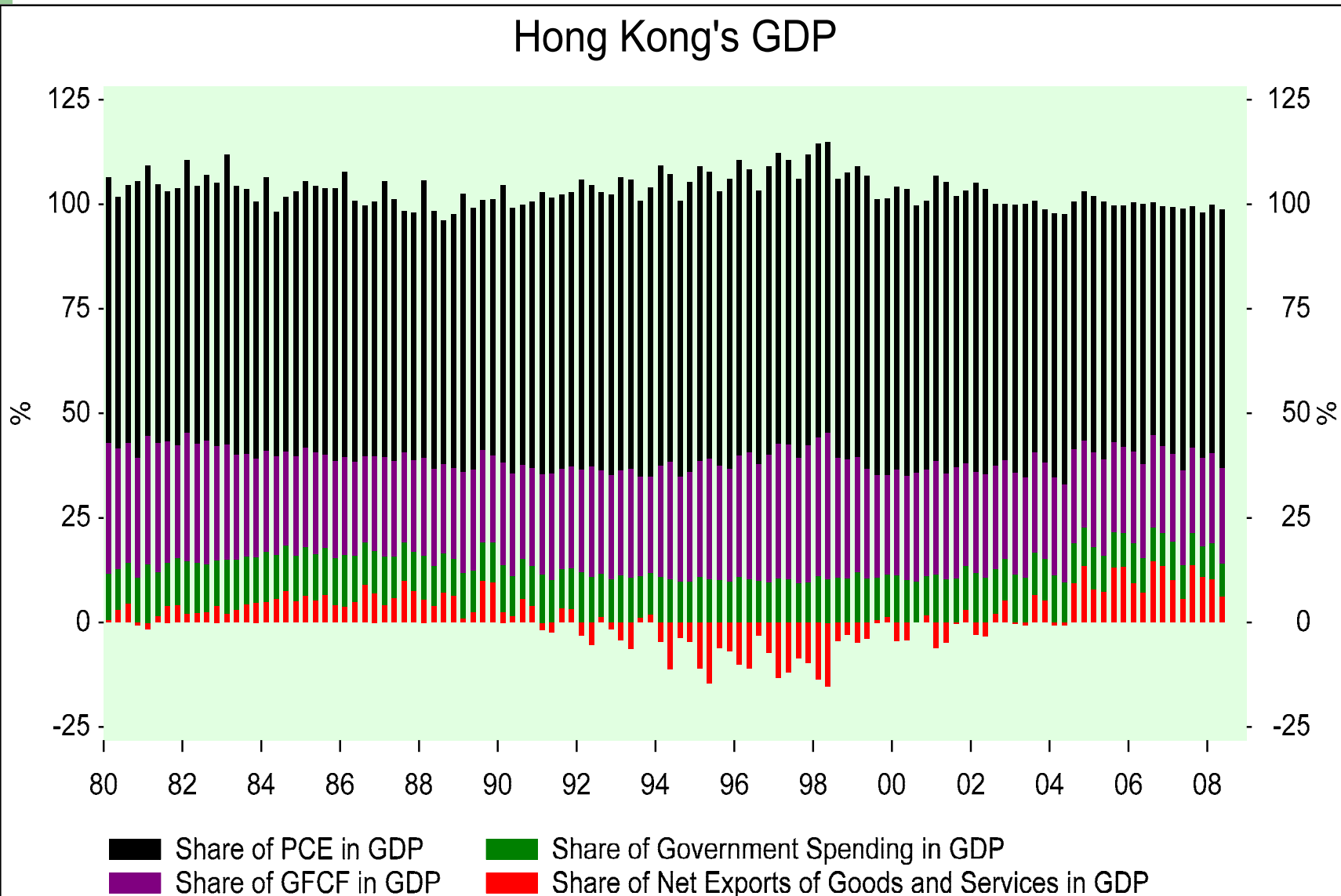
- The proper way is to use changes in value-added of each demand component on the RHS and calculate their percentage contribution to GDP growth, all in real dollar terms.
- Because HK is a small open economy, these components (both domestic – C, I, G and external – NX) tend to fluctuate quite a lot, especially over cycles.
- The following charts are indications of the **cyclical patterns of demand components** (but they do not represent growth accounting directly).

### (3) Sources of growth in the HK economy

**Net exports of Goods and Services (NX) as a percentage of GDP**



### (3) Sources of growth in the HK economy



Source: Hong Kong Census and Statistics

### (3) Sources of growth in the HK economy

- As to the sectoral approach, again changes in value-added should be used in a proper calculation. The results would yield more meaningful findings over time for the structural (rather cyclical) changes in the HK economy.
- Because of the historical trend of the relative changes in the importance of sectors, the two previous charts (albeit they do not constitute growth accounting) already give a concrete picture of **the decline in the significance of manufacturing and the rising influence of services for HK.**



### (3) Sources of growth in the HK economy

**Table 2: Hong Kong's GDP by Economic Activity at Current Prices (%)**

Unit: %

	1980	1990	2000	2006
Agriculture and fishing	0.8	0.2	0.1	0.1
Mining and quarrying	0.2	0.0	0.0	0.0
Manufacturing	<b>22.8</b>	<b>16.7</b>	<b>5.4</b>	<b>3.2</b>
Electricity, gas and water	1.5	2.4	2.9	2.8
Construction	6.5	5.2	4.9	2.7
Services	<b>68.3</b>	<b>75.4</b>	<b>86.6</b>	<b>91.2</b>
Wholesale, retail and import/export trades, restaurants and hotels	19.4	23.7	24.6	27.9
Transport, storage and communications	6.9	9.00	9.5	9.6
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Community, social and personal services	11.9	14.1	19.9	18.1
Ownership of premises	8.4	9.7	11.3	10.6
Total	100.0	100.0	100.0	<b>100.0</b>

Source: Census and Statistics Department, HKSAR Government

Note: The total is GDP at factor cost.

### (3) Sources of growth in the HK economy

- Regarding the third production approach, a useful reference is Jiming Ha and Cynthia Leung, “Estimating Hong Kong’s Output Gap and Its Impact on Inflation”, *Research Memorandum*, Hong Kong Monetary Authority, November 2001 ([www.info.gov.hk/hkma/eng/research/RM1701\\_output\\_gap.pdf](http://www.info.gov.hk/hkma/eng/research/RM1701_output_gap.pdf)).
- The approach utilises the aggregate production function and some advanced econometric techniques to derive HK’s **“potential (full employment) GDP” (declining/maturing)** and the “gap” between it and the actual GDP.

$$Y_t = AK_t^\alpha L_t^\beta$$

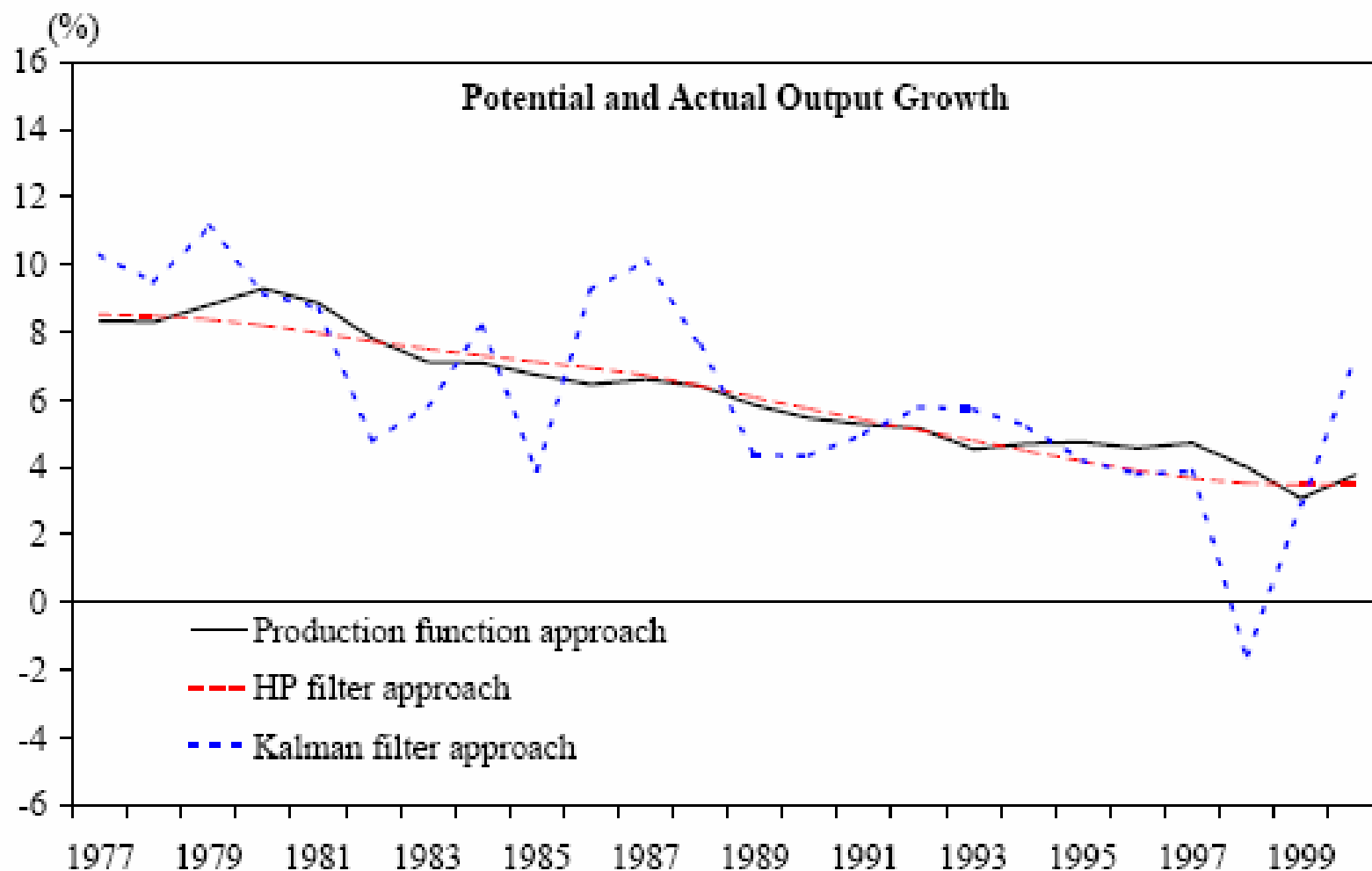
### (3) Sources of growth in the HK economy

**Table 2. Hong Kong—Potential Growth and Sources of Growth**  
(In percent)

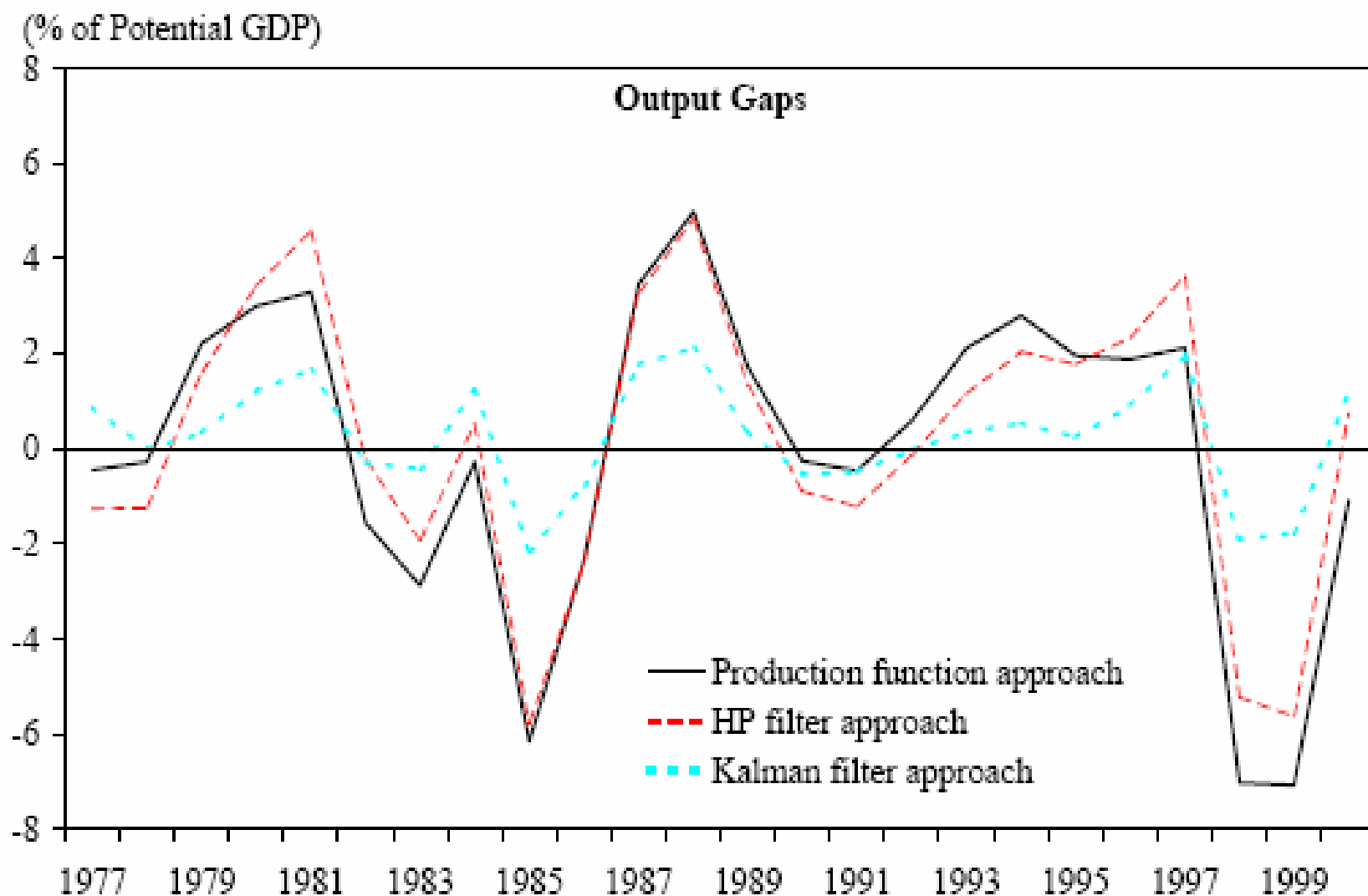
	1977-1984	1985-1997	1998-2000
<b>Annual growth of potential output</b>	<b>7.9</b>	<b>5.3</b>	<b>3.6</b>
<i>Annual growth of factor inputs and TFP</i>			
Labour	3.7	1.5	1.3
Capital	8.7	7.9	5.6
TFP	2.4	1.6	0.8
<i>Shares contributed by factor inputs and TFP</i>			
Labour	31	18	23
Capital	39	52	55
TFP	31	30	21

### (3) Sources of growth in the HK economy

Chart 2. Estimates of Potential Output Growth and Output Gaps



### (3) Sources of growth in the HK economy



## (4) The role of the government

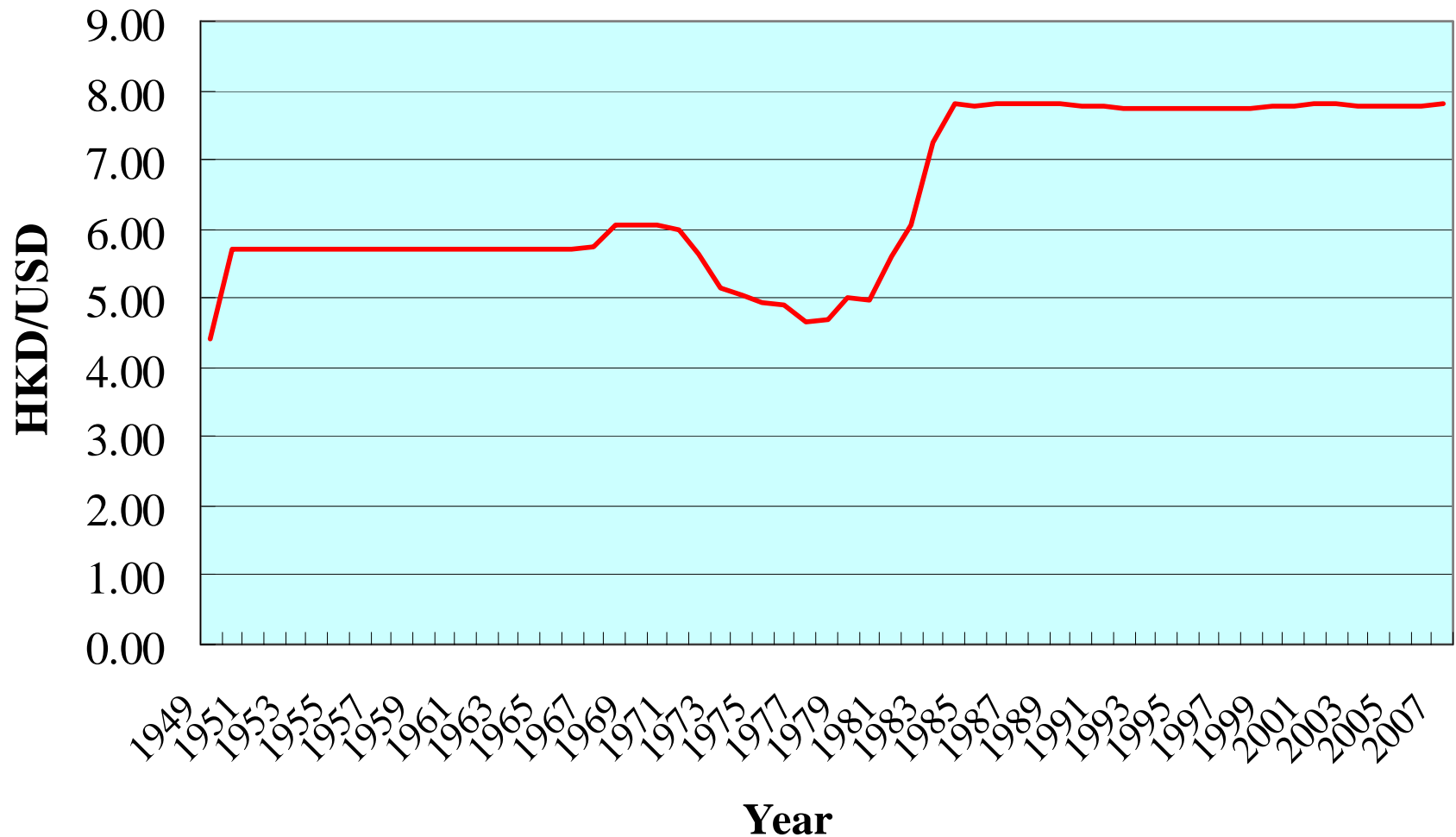
- Several factors have determined the limited role of the government in the development and management of the HK economy. They include:
- (1) Colonial constraints
- (2) The “transition” syndrome
- (3) Neo-conservatism
- HK has been consistently regarded as the “freest economy” in the world by conservative organizations such as the Heritage Foundation and the Fraser Institute.

## (4) The role of the government

- (1) Colonial constraints: Caution was always the key in governing a colony. Balanced budgets, monetary stability, and the avoidance of long-term commitments constituted the basic elements of sound economics.
- In the pre-1970s period, the key term was ***laissez faire*** (自由放任) as expounded by the Financial Secretary of 1961-1971, John James Cowperthwaite, who argued that Hong Kong was an “**un-Keynesian**” **economy**.
- In the 1970s, because of political and social instability in the late 1960s, the then governor Murray MacLehose embarked on some more proactive government programmes including housing and education, and the ICAC. The then Financial Secretary Philip Hadden-Cave coined the term “**positive non-interventionism**” (積極不干預) to assure believers in free market.

# Caution is the key

## The nominal exchange of the Hong Kong Dollar





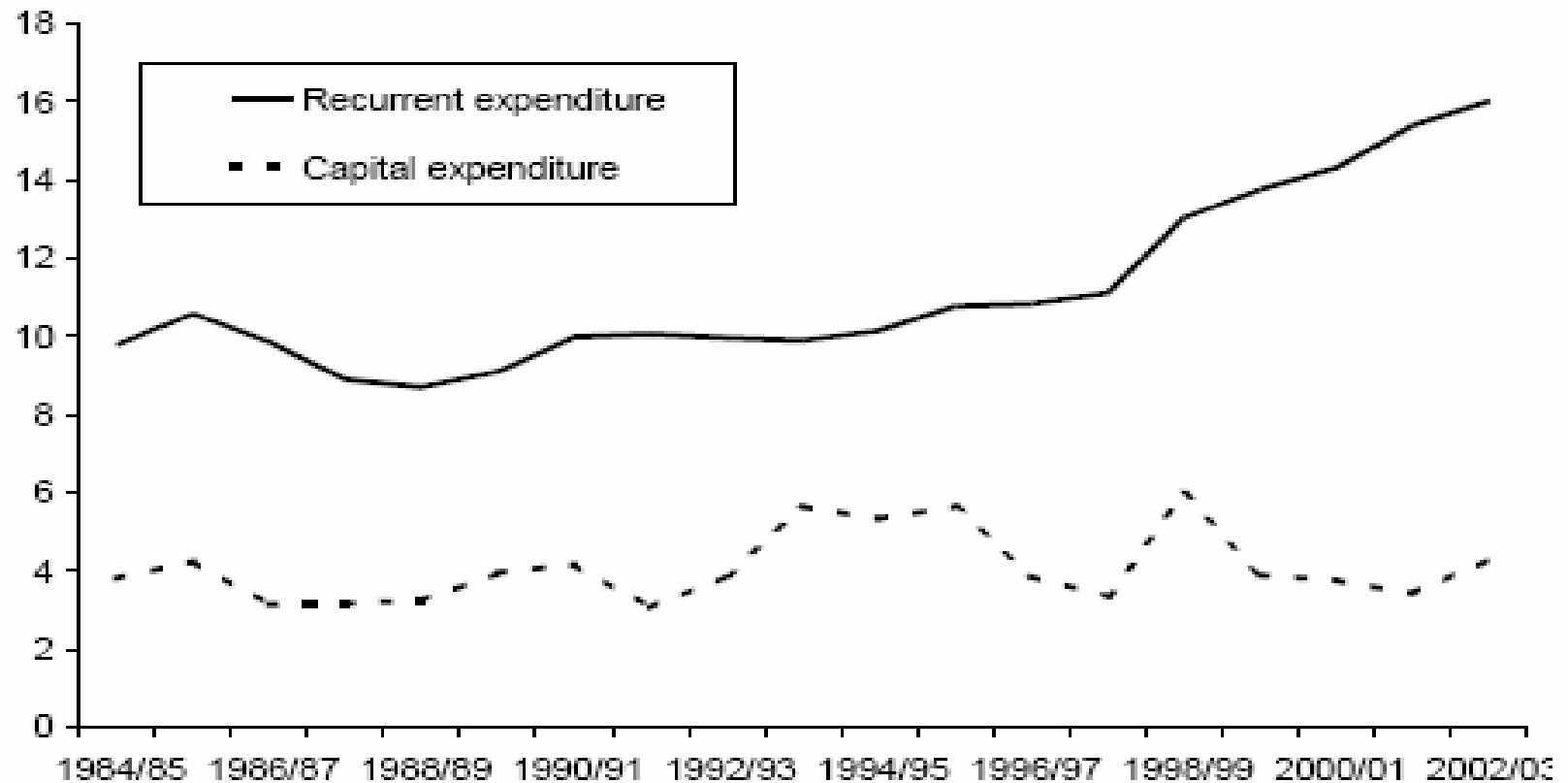
## (4) The role of the government

- (2) The “transition” syndrome: The lengthy political transition from 1980s to 1997, coupled with wrangling between the Chinese and British governments, also dampened any major initiatives that the Hong Kong administration could take in the pre-1997 period with regard to institutional reforms, economic restructuring and upgrading, and social empowerment.
- The motto of the time seemed to be **minimalism: “the less change, the better”**, and whether government expenditure should be kept below 20% of GDP became a topic of debate, often with little regards to HK’s long-term development.

# Caution is the key

Graph 2

Recurrent and capital expenditure<sup>1</sup>  
as a percentage of GDP



<sup>1</sup> Based on 2002/03 budget projection.

## (4) The role of the government

- (3) Neo-conservatism: Reaganism and Thatcherism of the 1980s led to a worldwide shift to the right in politics, economics and ideologies. Being a metropolitan city populated largely by migrants from the Mainland and their descendents, Hong Kong was easily influenced. The younger elites were very much disposed towards western thinking, with relatively little understandings about the sea change on the Mainland. Many of the elder generations were die-hard anti-communists. *Laissez faire* and libertarianism found echo in the heart of most. The aftermaths of 1989 and the uncertainty surrounding the 1997 transition only heightened the suspicion towards local government interventions and Beijing-sponsored moves.

## (4) The role of the government

- Initially after 1997, the Chief Executive of the HKSARG, Tung Chee Hwa, wanted to do something different: “The SAR Government has drawn up long-term plans to enhance Hong Kong's competitiveness and maintain its economic vitality...developing high value-added and high technology industries; and developing such new and integrated industries as information technology, telecommunication, filming and television.”
- However, having suffered economic and then political setbacks, the Policy Address by Tung Chee Hwa at the beginning of 2003 marked a turning point of abandoning ambitions of maintaining the SAR as an economy with unique characteristics. The new motto was “**big market, small government**” (大市場，小政府).

## (4) The role of the government

- Under Donald Tsang, the second CE of the HKSARG, the emphasis has been on economic integration with Mainland China, in line with CEPA, and PPRD developments. The motto is still “big market, small government” . The difference with the colonial past is that the HKSARG is much more inclined towards **linkages with the Mainland**.
- The government’s role is to remove artificial and unnecessary policy barriers between HK and Mainland economies and to facilitate **resource flows across the border**. The market would then determine the optimal distribution of economic activities.