

A Few Practical Ideas about the Hong Kong Economy

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25 October 1999

As I have said in many of my papers since 1993 (e.g. Tsang, 1993 and Tsang, 1999), the Hong Kong economy has been facing serious problems and challenges engendered by the so-called “structural transformation” process. Contradictions had accumulated before 1997. The local turmoil resulting from the East Asian financial crisis only served as a wake-up call.

Let me now say a few things that may be more useful. I think important initiatives need to be taken by the SAR government and the private sector to shift the economy towards a more viable trajectory. Apparently, some initiatives have been started, with others hanging in mid-air or shelved. To see the intended ones through and to activate truly merited moves, the following “practical” ideas on what the government should or can do just came to my mind.

1. Rectifying Hong Kong’s structural imbalance: the annual target of 85,000 residential units

There is no doubt that it should be a land supply target, which needs to be pursued if the structural imbalance in the Hong Kong economy, propelled by sky-high property prices in the past, is to be rectified. While the government can only control about 50,000 residential units through public provision, it must “anticipate” the private demand for new land that can be turned into residential buildings. Whether the private sector would use the new (and their own re-developed) land to build the estimated 35,000 units is of course up to the developers. After all, Hong Kong is supposed to be the freest economy in the world (or is it the second freest now?).

In any case the government, being the monopolist of new land, needs a number to prepare it well before hand. 85,000 seems to be a reasonable medium-term target given Hong Kong’s demographic and migration trends, and I do not see why there

should be an insufficient number of developers to pick up the new land supply over time, although yearly demands may fluctuate. That should keep property prices stable; and a steadfast following of the target will prevent another economic bubble that reproduces structural imbalance and further undermines Hong Kong's competitiveness.

2. Picking the winners: "walking on both legs"

Lately, the government seems to have embarked on initiatives that involve itself in directly "choosing the winners", e.g. the cyberport, the Disneyland, the silicon harbour, etc. The prospective "winner" might even be a particular enterprise rather than a sector. In a way, I sympathize with that approach, as it is more expedient and could produce quicker results. Given the time that Hong Kong lost in the past decade, and the haunting tasks facing us, this is understandable and I would endorse it as one of the options. The risk is that the government may tie its hands with a loser.

Nevertheless, I think the government should be "walking on two legs" by also letting the market mechanism into the filtering process. Parallel to choosing winners directly, it should provide bidding procedures and tax incentives: e.g. tax holidays, and tax reductions on broad sectors and ranges of activities. Of course, the government still needs to take a view; but the majority of these incentives will apply only if those who wish to take advantage of them pass the "market test", e.g. profit tax reductions can be invoked after an enterprise has achieved a profit.

Perhaps the two approaches should be combined into an innovative package: i.e., in a move to pick any winner, the government would build in incentive mechanisms that kick in as profit and other relevant market success indicators surface.

3. The dual economy: industrial and employment concerns

The Hong Kong economy faces two key problems in the future: (1) finding high value-added locomotives (e.g. "cyber-xxx's"); and (2) locating activities that, whilst low value-added in nature, provide significant employment opportunities (including "labour-intensive tourism": Disneyland plus its multiplier effect?). Can Hong Kong's private sector solve both problems without bureaucratic intervention? If no, the SAR Government has to think about some kind of an industrial policy and an employment

policy.

4. Competitiveness: internal versus external

While Hong Kong needs to enhance its competitiveness against international competitors, it should also ensure that there is sufficient competition within the domestic sectors, so that the consumer gets a fair deal. This is particularly important in an era of relatively low growth rates. Those who were used to huge incomes/profits in the past (e.g. many of our financiers, developers, professionals, and various franchisees) should wake up, or should be waken up, as consumer tolerance is likely to be declining fast. Moreover, competition is a key to the promotion of internal productive efficiency.

COMPAG, chaired by the Financial Secretary, was a useful step; but the government needs to look seriously into the possibility of “formalizing” it: for a start, perhaps by giving it some investigative powers. In the longer run, a comprehensive competition law and a competition authority are in my view necessary. (Declaration of interests: I am a member of the Consumer Council and the chairperson of its Competition Policy Committee. My personal---not the Council’s---view is that the Council is overloaded with duties that are not normally expected of a consumer organization, e.g. conflicts among businesses that have no direct relevance to consumer welfare. They are routed to the Council because there are so few effective channels that address the mounting issues of fair competition in Hong Kong.)

5. Changing the research culture: separate funding for applied and policy research

To help the Hong Kong economy to enhance its productivity, there is a strong need for a “triangular” alliance among the government, the private sector, and the universities, which is prevalent in the US and Europe. Some of our university staff should be encouraged to engage in more applied and policy research that is less glamorous in academic terms, but yields higher practical value. But the academics won’t do so unless the proper incentive mechanisms are put in place: and they are not!

I have heard so many of my colleagues, including deans and department heads of other universities, complaining about the lack of respect for applied and policy research, as a result of government funding policies. That is strange because the UGC and the RGC theoretically stress the importance of it. Somehow, university authorities

are inclined to assess their staff largely on the basis of basic and theoretical research that would result in publications in international refereed journals (obviously these journals are much less interested in applied and policy research output from Hong Kong). And unfortunately, the RAE (research assessment exercise), as currently practiced, does not seem to be dispelling that bias effectively. The end result: our dons are not doing much practical research.

I therefore suggest that the RGC provides two separate research funds: one for basic research, the other for applied and policy research. They need not be of equal sizes, but should be scrutinized by different panels. Moreover, the RAE should also give separate scores for these two types of research output. Only with such visible measures can our research culture be genuinely modified. Otherwise, the lamentable *status quo* will simply continue.

6. Revised policy to fight pollution

The environment has become one of key concerns for the population as well as the SAR Government. Hence the emphasis placed on it by Chief Executive Tung Chee Hwa in his latest Policy Address. With regard to air pollution, a main culprit is the foul exhaust from motor vehicles, particularly those using illegal fuels that are much cheaper than the products available from the petrol filling stations of the oil companies. The government cannot regulate the contents of those illegal products, which are environmentally more harmful.

According to informed sources, over 50% of the diesel fuels used in Hong Kong are from illegal channels like black markets and improper Chinese supplies! That is largely due to the phenomenon of high oil prices in Hong Kong, which in turn is induced by government policy. Duty on diesel now represents about 36% of the retail price, and that on unleaded petrol around 60%.

Such heavy duties are motivated by fiscal needs, transportation planning as well as environmental considerations. However, the government's policy has not produced the desirable results because evasion is rampant. The government is not getting the revenues that it wants, while illegal fuels aggravate the deterioration in Hong Kong's environment.

Some have proposed that the government should lower the duties on oil products

substantially and crack down hard on illegal supplies to solve the evasion problem; while using ERP (electronic road pricing) to recover and enhance revenues. The end result would be an improvement in consumer welfare, not just price-wise, but also environmentally. This is not an original proposal of mine, but I think it deserves very careful consideration.

7. Dealing with the operating deficit

Given huge fiscal reserves and the relatively small sizes of the budget deficits that the financial crisis has been causing Hong Kong, we should not be too concerned about the fiscal soundness of the SAR Government. However, one worrying sign is the emergence of an operating deficit, largely due to the shortfall between recurrent revenue and recurrent expenditure (the "operating account" also has small non-recurrent components). Even in the fiscal deficits of the 1980s (as a result of the bursting of the bubble of 1979-81), the recurrent account was still in surplus, although the surplus was not large enough to cover the non-recurrent deficit, the latter due to the collapse in land sales. This time round, an operating deficit has emerged.

An operating deficit is worrying because recurrent expenditure, a large chunk of which consists of the salaries and wages, is much more difficult to rein in than capital expenditure. Of course, an operating deficit may be a result of cyclical factors, or that of long-term trends, or a combination of both. I have not performed a decomposition exercise (I am not sure I would have sufficient data to do it). However, one indication suggesting long-term influences is that fees and charges received by the government have failed markedly to catch up with the pace of total government recurrent expenditure. The ratio of them has fallen from about 20% ten years ago to the present one of roughly 8%.

This is perhaps not surprising in an era of democratization in Hong Kong. It has become more difficult for government officials to raise levels of fees and charges to recoup costs (or to fulfill the five types of criteria that the government has announced), not to say to impose new fees and taxes, as many politicians in the LegCo, with an eye on their constituency, tend to side with populism. Toll charges on tunnels were clear past examples; while the proposed land departure tax might yet become another one.

If this observation is accurate, the problem is not purely "economic" in nature. It

is political economy or even a matter of politics. Its solution requires negotiation skill on the part of the government and serious consideration of genuine public interests, not just narrow sectoral ones, on the part of the politicians.

References

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