

The Political Economy of Unhappiness

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So unhappy.....

Whither the Hong Kong economy? The hi-tech bubble, never much more than a financial phenomenon, seems to be rapidly deflating, or even bursting. Chief Executive C.H. Tung's grand initiatives regarding the bright future of Hong Kong remain what they were, initiatives. Double-digit quarterly growth rates have not brought in the "feel good" factor. Indeed, the manager of the congee and noodle shop near my university told me that it had had the worst summer in recent memory. Witch hunts have become a favourable game, with formerly well protected figures falling like dominos. Few are keen to put their heart on a determined course for the future.

I wrote a piece called "Why are we so unhappy?" (我們為何如此不快樂?) on *Ming Pao* in early June (which is also posted on this web page). My wife wisely quipped then that it was me who was unhappy. Well, who knows one better than one's other half. In any case, it turned out to be prophetic, in both the social and the personal sense. However, the "summer of discontent" unfolded with such ferocity that went beyond my expectations. People were so unhappier than I had thought.

The illusive "feel good" factor

It has by now become clear that the "feel good" factor is very illusive in politics and economics. Recovery, even boom, seldom brings good fortune to political leaders. John Major was thrown out despite the Thatcher revolution and emerging prosperity in the UK after a long period of doldrums. The same could be said of Bush the father following Reaganism and a military victory. Similar fate has fallen on Al Gore in the afternoon (evening?) of a Clinton boom. From the political angle, who in Taiwan now miss Lee Tung-hui, the self-styled Moses? Most are probably too worried about the sliding stock market. And poor Chen Shui-bian, the "son of Taiwan", has not even

had a recognisable political honeymoon.

Hong Kong as an underdeveloped case

Hong Kong is a half-baked (quarter-baked?) democracy. Being its CE is by institutional nature one of the hardest jobs in the world, with little legitimacy. The only way to command respect lies in “delivering the good”. Tung has been very unlucky: the East Asian crisis did not help at all. And he has few competent generals and soldiers of his own, who believe and execute what he has in mind, which is often inconsistent or incoherent.

It is both a matter of form and substance. Witness the fuss over whether the target of 85,000 residential units existed or not. Even up to now, the SAR government has failed to articulate a clear picture about its housing policy. But to be fair, I am so disappointed that not even an economic disaster like that in the past few years has managed to waken people, to lead them into a serious process of soul searching and accepting responsibility. Instead, many just ventilate their anger in a rude way. A service economy would only thrive on the quality of its manpower. And,, well. We all have to look straight into the mirror.

The “policy-less” regime

The other day I met an economist from a foreign country in a workshop. She asked me a question I found very difficult to address. “What kind of strange economic system is there in Hong Kong?” she pondered. “You have a currency board system, which means you don’t have an exchange rate policy. Under the fixed rate of 7.80, you can’t practice monetary policy in the form of affecting the money supply or the interest rates. According to the Basic Law, the government needs to strive to balance the budget. So you have no fiscal policy. And Hong Kong prides itself as the freest economy in the world, which means income policy, industrial policy and all the rest of interventionism are out. I wonder how you can survive and thrive under such a policy-less regime!”

I was stunned for a few seconds, although I could immediately protest that the fixed exchange rate was also a policy, a “nominal anchor”, so to speak. But her “gibe” really got me confronted with Hong Kong’s dilemma. When I gathered myself again,

I responded, “Well, there are actually many policies that the Hong Kong government is practicing. Although it tries to balance the budget at the aggregate level, the ways it taxes various parties and spends on different sectors involve ‘policies’, at the micro level at least. Chief Executive C. H. Tung wants to address the problem of poverty: that probably does not constitute an income policy, but the government is not turning a blind eye on the issue. And Hong Kong is trying hard to promote tourism and will build a Disneyland; there is also going to be a cyberport. Moreover, Mr. Tung has talked about ‘long-term planning’. That could perhaps pass as some kind of industrial policy?”

I felt quite satisfied with my explanation at that time, and this kind lady just let me off. On second thought, though, I sensed that my answer was superficial. So there are many “policies”, but what do they constitute as a whole? This reminds one of the issue of competition policy, and the debate about the comprehensive versus the sector-specific approaches. Micro-policies could be so incoherent that at the macro level one might still characterize a regime as policy-less.

Remembering but not endorsing Hadden-Cave

The colonial government did try to sort out its economic policies in the past. Philip Hadden-Cave, the Financial Secretary of the 1970s, coined the famous term “positive non-interventionism”. Hamish Macleod, the Financial Secretary preceding the present one, Donald Tsang, attempted once to bury the concept. I supported the move by writing an article on *Ming Pao*, but he retracted quickly in the midst of outcry in the conservative camp. The SAR government is now in a split mind. Intervene or not intervene, that is the question!

The problem is that the government is inconsistent between its words and its deed. It does intervene, indeed rather heavily, in quite a number of sectors; and Tung was initially ambitious about “long-term planning”. Perhaps we need a “Hadden-Cave” of the new millennium to give Hong Kong’s overall economic policy a credible reshuffle and presentation (hopefully a less *laissez faire* version). People should feel happier if they know what the government really wants to do, and does what it says.

Epilogue (18 March 2001): the unhappiness of being “squeezed”

I awake “again” to the alleged “cruelty” of “imposed reserves”, having talked to and

argued with informed commentators lately. (Although I must state that I said things of similar nature years ago and got once reprimanded in private. That hadn't affected my behaviour.)

According to the "latest" statistics, Hong Kong has the third or the fourth (sorry for being a bit lazy of not having been constantly updated) largest foreign exchange reserves in the world, i.e. US\$114.3 billion (HK\$891.54 billion) at the end of February 2001, compared with Japan, Mainland China, and Taiwan. A big chunk of the money is accumulated fiscal reserves deposited into the Exchange Fund, to the tune of HK\$432.91 billion at the end of the fiscal year of 2000, as revealed by Financial Secretary Mr. Donald Tsang in his recent budget.

Not all of assets of the Exchange Fund are in foreign currencies, and not all of the fiscal reserves (HK\$432.91 billion) have been converted to US dollars (a properly trained accountant might be cursing me), given the fact that the SAR Government is keeping a defined portfolio of Hong Kong equity shares after the August 1998 stock market intervention. In any case, it is interesting (?) to note that cumulative fiscal reserves by the government account for about 40% of Hong Kong's foreign exchange reserves.

Remember a key point: foreign exchange reserves are always a two-edged sword. Have more of them and we are safer against speculators. Have too much of them and we are lending our precious money to foreigners to spend, instead of investing in our own future. Does Hong Kong need more investment for tomorrow or the next decade? Can we do it without running budget deficits, while conservatives are scrutinizing any number in the red?! Hence my apathy/disinterest about this annual show-biz of budgetary discussions/debates, in the lack of a framework about Hong Kong's future economic trajectory.

How do our three other competitors (in getting the prize of the largest foreign exchange reserves in the world) achieve what they have obtained? Honestly, I've not done any rigorous statistical research. But for one thing I am confident: their governments have not succeeded in generating cumulative fiscal reserves of our relative scale, and then in having those reserves converted into foreign currencies. I guess they've arrived at what they are by running balance of payments (BOP) surpluses through net current account and capital account inflows (instead of fiscal surpluses). Some economists will fault me here for failing the logic of the simple BOP identity equations (for every seller of the domestic currency there must be a buyer).

Well, I couldn't care less!

Fiscal prudence should be two-way: no huge deficits, nor surpluses. We, like the rest of the world, have been too kind to surplus-makers, and too lean on deficit-makers. What about the Basic Law? Any sanction against cumulative surpluses? How can the SAR government rectify them without running annual deficits, which are allegedly against the spirit of the Law, on a myopic year-to-year basis? I wonder why Hong Kong deserves this sort of degenerate discourse?

To put the numbers in the proper context: Hong Kong's fiscal reserves in the mid-1980's represented half a year of government expenditure, it has now tripled to more than 18 months. Our foreign exchange reserves presently cover over 400% of our monetary base. Is that enough or not? Well, conventional currency board economics talks about 100%, 110%, or more (hence the HKMA's own rule on the backing portfolio). Nice to be so affluent to go all the way, isn't it, at least from a security viewpoint? But what about the opportunity costs, of investing the money in alternative areas, particularly in bettering our own economic future?

Would you feel happy if the government is alleged to have squeezed you to generate huge reserves to "defend" the exchange rate that it happened to have chosen, even after having installed effective arbitrage mechanisms that do not normally require active intervention by the monetary authority?

I am not asserting that the above represents the full reality in Hong Kong. But meeting with intelligent people sometimes "wakes" one up, perhaps "again". In my case, it was nothing new at all, just a "mean-reversion", if you know what I am saying (if not, forget it). Anyhow, in this unsettling spring season, with its humidity and temperature, I got an uneasy feeling creeping into me. More homework to do, for everyone, I guess. There should certainly be a proper debate about all those ratios!

In the meantime, I, like many of you, do not have a lot of reasons to feel happy about this confounding fiscal-monetary-exchange rate mix, which has emerged (by default?) in a "policy-less regime", and the direction that the Hong Kong economy is apparently heading.