

HKUST Forum on the Future Development of Hong Kong:
The Government's Role in the Economy
From Positive Non-interventionism to Proactive Market Enabler

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President, Members of the University, ladies and gentlemen,

I am most delighted to have the opportunity to speak at this Economic Forum organized by HKUST. It is particularly gratifying to see that so many of the enlightened Hong Kong leaders are willing to come together to explore the route to revitalizing Hong Kong's economy.

Government's role in the economy of Hong Kong was widely debated after Financial Secretary, Antony Leung's 2002-03 Budget speech in March. In his Speech, Mr. Leung used the term "Proactive Market Enabler" to describe the economic philosophy of the SAR Government. Subsequently, Mr. Leung was subsequently criticized to have betrayed the doctrines of "Market Economy" by moving Hong Kong away from the traditional free market principles. The Asian Wall Street Journal even described the Budget day "A dark day for Hong Kong".

Hong Kong has long been viewed as the classic model of market economy. Last year, the Heritage Foundation ranked Hong Kong as the world's freest economy for the eighth year in a row. The Fraser Institute echoed this recognition at about the same time. However, as we all know, the economic philosophy adopted by the Hong Kong Government has long since departed from the doctrines of laissez-faire. As officially admitted by Sir Philip Haddon-Cave in the 1970s, the Government's stance was "Positive Non-intervention", meaning that the government would intervene when the market fails, ie. the Government would go in when the private sector is not ready to invest in projects that are beneficial to the economy as a whole. It was suggested that for cases where the Government decided not to initiate any action, the decision had been made after careful analysis and consideration. In other words, "no intervention" was the result of rationalization conscious efforts, not sheer abdication of action.

In 1995, Sir Hamish Macleod, the then Financial Secretary, coined the phrase "Hong Kong style Consensus Capitalism" to suggest that initiatives used to stimulate economic development were normally met with public support. In 2000, the immediate past Financial Secretary, Mr Donald Tsang, unambiguously stated that "the Government's primary role was to provide the most business-friendly conditions possible", with "Maximum Support and Minimum

Intervention”.

It was clear that all the previous Financial Secretaries, whilst trying vigorously to promote good practices of the market economy, realized that there would be instances when the government must intervene in the interest of the public. So, why was it “Hong Kong’s Dark Day” when Mr. Leung was attempting to give the long adopted public finance philosophy a proper name? The Government has all along been intervening in the market for the public good. Examples include the adoption of a high land price policy, the implementation of the linked foreign exchange rate system, the provision of industrial land at concessionary rates in the form of industrial estates and the setting up of the Science Park, and the assistance given to small and medium sized enterprises in the form of grants and low interest loans at different times.

The most legendary incident of market intervention occurred in August 1998 when the SAR Government used its reserves to support the Stock Market to counter speculative attacks on our currency. Mr. Tsang, the then Financial Secretary, was at that time widely criticized by foreign press for violating the free market principles in a city that had enjoyed the reputation as one of the modern examples where free market economy is practiced with great success. However, the measures taken by Mr Tsang effectively restored market stability, and unintentionally made the Government some profits from the transactions. Had the Government adhered to strict non-interventionism, and the strategy of the speculators allowed to succeed, the stock market would have plummeted, with the consequence of an unstable economy and a weak currency.

The Government’s long term commitment to a high land-price policy is another footprint of our Government’s involvement in the market, though whether its application was consistently in the public interest was more debatable. The Government had been adopting this policy since the 1960s by restricting land supply to buffer the property market. As a result, the economy boomed with strong domestic consumption supported by an expanding affluent middle class. Unfortunately, this also led to intense speculations pushing land prices beyond the affordability level of the average citizen. The SAR Government decided to intervene in 1997 by increasing the supply of land for both public and private housing development. This initiative, coupled with the Asian financial crises, has unfortunately caused the slump in our property market since. In an attempt to halt the slump, the SAR Government decided to intervene again by suspending the Home Ownership Schemes and slowing down the completion of public housing units.

Right now Hong Kong is still deep in an economic depression with the GDP dropping a

further 0.9% in the first quarter of this year. Unemployment rate has risen to 7.4% and is expected to rise further; investment shrinks and consumption remains weak; the gap between the rich and the poor is widening. The crime rate is on the rise, and the confidence level of the general public is at its lowest ebb. The SAR Government is urged and expected to take effective actions to help the community to ride out the storm.

In face of Hong Kong's current socio-economic landscape, the issue is not whether the Government should intervene to revive the economy but what it should do. The more important consideration is how to define a set of parameters within which the Government should operate, and to prevent the Government from involving in the economy where there is no market failure. Mr. Leung has repeatedly affirmed that the Government would not pick the winners but would leave the playing field to market-players. An article in the Economist in June talked about the losers-picking practice of the Singapore Government. It reported that the industrial champions chosen by the Singapore Government did not perform as well as expected, while some of the ready-to-write-off businesses have instead prospered. This confirms the long held belief that businessmen, not officials, have a better understanding of business, and therefore are better qualified to pick winners.

Whatever the Government decides to do, it should only be implemented after a careful analysis of our strengths and weaknesses, having taken into account the global trends and the development in our neighboring regions. The involvement of the Government in the Disneyland amusement park project is an attempt to secure projects beneficial to developing the tourist industry when the private sector does not find it attractive enough to invest in a single project. The discussion with the Central Government on a Closer Economic Partnership Arrangement with the Mainland should be seen as the SAR Government's effort to secure more favorable market access for the Hong Kong enterprises ahead of players from other parts of the world. This is an intervention that only the Government can initiate and can prove to be effective.

While I agree with the SAR Government's analysis of our strengths and its commitment to the continuing development of Hong Kong as a financial, business, tourist and logistics center, I would like to point out that the manufacturing sector of our economy has consistently been under-rated. A recent study conducted by the Business & Professionals Federation of Hong Kong reveals that our economy still relies considerably on manufacturing. Though the contribution of the actual production activities to HK GDP is less than 10%, the share of GDP generated by manufacturing support services is estimated to be as high as 42%. Therefore, the maintenance of a strong manufacturing sector, taking full advantage of the Mainland as a production base, would have wide implications for Hong Kong's economic growth and

competitiveness. The Government's continuing support of this sector in the form of low interest loans to the small and medium sized enterprises and provision of support services such as those offered by the Productivity Council to companies with operations in the Mainland is, in my view, timely and appropriate.

It is disheartening to see Hong Kong dropping to the 13th place in the global Competitiveness Report issued by the World Economic Forum as a result of our lagging behind in technology development and application. In 1999, Hong Kong spent only 0.48% of our GDP on R&D, when Japan spent 3.15% and Taiwan 2.05%. Though Government funding for research rose to HKD468 million in 2001, a 10.6% increase from 1999, we are still far behind in our spending on research. Without a breakthrough in our R&D investment, Hong Kong would definitely not be recognized as a significant player in the knowledge economy. In most other economies in the region, examples abound where the Government has to take the lead in increasing spending on R&D, thereby facilitating the growth of knowledge based companies, which in turn take the economy's development to the next higher level.

In the new economy, a society's manpower quality corresponds more or less to its competitiveness. Our Government has taken a right move to reform the education system, but we must not forget that it takes long term planning and commitment to excellence for the reform to bear fruit. Recently, the recommendations made in the UGC Higher Education Report have sparked off a controversy in Hong Kong. Any decisions made on this subject would be crucial for our future and therefore decisions should not be made hastily. While it is absolutely right to ask for greater efficiency in using our scarce resources on higher education, it is wrong to cut back spendings in this area when in fact what is needed to support our next round of growth is an increase in investment to turn our young people into productive knowledge workers.

The globalization of markets and the rapid advancement of information technology have accelerated the pace of economic development. The rate of change is so fast and the nature so complex that market forces often tip in favour of those who are most ready to change. The whole community should be prepared to accept and embrace change. Indeed, success in economic transformation is increasingly dependent on the ability in anticipating change, planning forward, and ensuring effective coordination between the Government, business community, and academics.

Sir Winston Churchill said in 1942, "This is not the end. It is not even the beginning of the end. But it is, perhaps, the end of the beginning." This is where we are, the end of the beginning. Our success in the past has given us some competitive advantages to enter into the

knowledge-based Information Age. However, our economy needs a transformation in order to remain competitive in the new landscape. There is a crucial role, proactive and instrumental, in the transformation process, that can only be taken up by the Government!