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The economic strategy for the Hong Kong SAR: Evidence from productivity and cost analysis

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Abstract

By using a growth accounting framework for the period 1980–2000, this paper estimates Hong Kong's total factor productivity and unit labor cost of twenty industries classified into three economic sectors of tradable goods, tradable services and non-tradable services. The results show that Hong Kong's total factor productivity has fallen in the 1990s. The competitiveness of the three sectors of tradable goods, tradable services and non-tradable services has increased, remained unchanged and declined, respectively in the last two decades. Policy recommendation for Hong Kong will be to aim for a supply-drive strategy so as to broaden the economic base.

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1. Introduction

After becoming a British colony in 1842, Hong Kong became an important trading and re-export hub. Over the years, Hong Kong had acted as a “shelter” receiving a large number of natives fleeing from Mainland China in pursuit of political stability and economic opportunities. Hong Kong's economic openness and desire to attain economic

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security enabled Hong Kong to supply goods and services to the rest of the world. The rise in income and demand was the result of the successful outcome of the supply-driven economic strategy.

On July 1, 1997, Hong Kong became the Special Administrative Region (SAR) of the People's Republic of China. The Central People's Government in Beijing adopted the "one country, two systems" approach in the post-1997 Hong Kong. Since 1985, Hong Kong experienced economic revival and wealth appreciation, but the rapid growth was soon fuelled with speculation in stocks and properties in the early 1990s, resulting in the economic bubble that eventually burst after the outbreak of the Asian Financial Crisis (AFC) in 1997–1998. The economic problem facing the post-AFC Hong Kong economy was structural imbalances with unemployment rate exceeding 7% in 2002. Such short-term fiscal incentives as the creation of temporary employments and assistance to small- and medium-sized industries have been introduced. After the outbreak of the severe acute respiratory syndrome (SARS) in the spring of 2003, additional demand-driven solutions aimed to revive the Hong Kong economy, including the entry of visa-free Mainland travelers and the conclusion of two Closer Economic Partnership Agreements in 2003 and 2004 that permitted tariff-free exports of goods and services to Mainland were introduced. Economic optimism resulting from demand-driven policies has picked up and it is expected that when the new Disney Theme park opens in September 2005, the Hong Kong economy would have recovered considerably.

Table 1 shows that Hong Kong's macro-economy generally performed better in 1980s than in 1990s, and the first half of 1990s was better than the second half of 1990s. Strong re-exports growth lasted till the first half of the 1990s, and export of services maintained high. Growth in domestic investment remained robust in the 1986–1995 decade. The average real GDP growth maintained at 6.56% in the 1980s and 5.1% in the 1990s. Beginning from the early 1990s, despite the large total export to GDP ratio, domestic export could not keep pace with its growth rate.

Post-AFC economic solutions advocated by the free-market school (Enright, Scott, & Dodwell, 1997; Wong & Tao, 2000; Imai, 2001) supported demand-driven policies and argued that the Hong Kong economy can recover along with the rest of the world as the linked exchange rate shielded Hong Kong from price differentials. On the contrary, structural or supply-driven advocates (Dodsworth & Mihaljek, 1997) noted the structural

Table 1
Periodic average growth rates in Hong Kong's macroeconomic indicators

Period average	Real GDP	DI	Domestic export	Re-export	Services export	Unemployment	Total export/GDP
1981–1985	5.58	7.20	14.64	29.28	16.00	3.82	77.30
1986–1990	7.54	22.10	12.14	32.35	18.58	1.66	102.78
1991–1995	5.36	16.58	0.56	22.04	13.30	2.18	118.07
1996–2000	3.64	1.26	−4.62	4.90	3.56	4.16	113.66
1981–1990	6.56	14.56	13.39	30.80	17.29	2.74	90.04
1991–2000	5.10	7.96	−2.03	13.47	8.43	3.17	115.86
2000–2004	4.76	2.74	−5.48	10.28	9.92	6.40	133.22

DI = domestic investment. Sources: *Hong Kong Annual Digest of Statistics*, Census and Statistics Department, various years.

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