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Hong Kong: The Benefits of Economic Freedom

Hong Kong (now a Special Administrative Region of China) is a remarkable place.

Few who visit fail to be impressed by the work ethic of its people and its energy, dynamism and prosperity.

At the end of World War II Hong Kong was a small fishing port with a dirt-poor population of 600,000 – its per capita income was about one-quarter that of Britain.

Today, with a population of around 7 million, Hong Kong enjoys a per capita gross national income (purchasing power parity basis) of US\$38,200, above that of Britain and Australia and 40% higher than New Zealand, according to World Bank figures.

Moreover, Hong Kong continues to get richer. Over the 10 years 1999-2008, Hong Kong's real GDP grew by an average of 5.3% a year, compared with New Zealand's average growth rate of 3.3% in that period, according to the International Monetary Fund.

Hong Kong was hard hit by the 1998 Asian economic crisis; its economy went into a steep recession and unemployment rose sharply. However, with tight economic management it recovered strongly from 2003 onwards, and the unemployment rate is now down to 3.4%. Labour productivity growth in the past four years averaged 4.8% per annum (New Zealand's rate in the measured sector of the economy since 2000 has been only 1.1% a year).

Hong Kong's proximity to mainland China has obviously helped its recent development, but it became wealthy long before China's economic growth spurt.

Rather, its prosperity has been built on good institutions and policies – a sound legal system, secure property rights, low taxes and a free trade regime.

The late Nobel Laureate in economics Milton Friedman held up Hong Kong as the best exemplar of a free-market economy. It has consistently ranked highest in the international indexes of economic freedom.

As the Financial Secretary said in the 2008/09 budget in February, Hong Kong upholds “the principle of ‘Big Market, Small Government’, so that the share of public expenditure will be maintained at 20 percent or below of GDP.”

In New Zealand, the share of total government spending in the economy is 42% according to the OECD, a figure much too high for fast growth.

The Financial Secretary went on to say, “A big market can increase the share of the private sector in the economy and allow market forces to allocate our limited resources in the most efficient way for the maximum benefit of the community as a whole. A small government can prevent the public sector from acquiring excessive resources and thus reducing efficiency in the allocation and use of resources.

“Moreover, a small government can minimise regulation, thereby facilitating business operations and attracting overseas investment.”

With public expenditure as a proportion of GDP down to 15.9 percent in 2007-08, the budget announced large tax reductions as well as spending increases.

For many years, Hong Kong has had essentially a flat income tax regime. The budget cut the standard rate of salaries tax (roughly equivalent to personal tax in New Zealand) by one percentage point to 15%, and cut the corporate profits tax to 16.5%.

In addition, in keeping with the principle of “leaving wealth with the people”, the budget surplus was reduced by large one-off refunds of tax to both individual and corporate taxpayers.

The Financial Secretary expressed concern that “some disadvantaged groups have not yet been able to enjoy the fruits of economic growth” and affirmed “It is the duty of the Government to provide a final safety net for those who cannot help themselves.”

To this end, many additional support measures for charities, families with children, persons with disabilities, the elderly and other groups were announced.

Nevertheless, the government’s view is that it “should not attempt to narrow the wealth gap by redistributing wealth through high levels of tax and welfare. Such a measure would only inhibit people’s incentive to work hard and, in turn, undermine the productivity and competitiveness of the community as a whole.”

There are other interesting features of Hong Kong’s economic framework.

It has a very free labour market with high wage levels that owe little or nothing to unions, which hardly exist.

This undermines finance minister Michael Cullen’s claim that Australian wages are higher than New Zealand’s because of unionisation.

Hong Kong has no statutory minimum wage, preferring to allow low productivity workers to get initial jobs and a foot on the bottom rung of the income ladder.

It does not have a general competition law regulator. Its prosperity confirms that, at most, competition law has only a small role to play given economic freedom and open markets.

As with other countries, it is not hard to find aspects of Hong Kong’s economic arrangements to cavil at.

But for countries aspiring to prosperity (getting into the top half of the OECD?) it is a model well worth studying.

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