The 50-year Impact of Positive Non-interventionism on Hong Kong

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The policy of non-interventionism advocated by the late Financial Secretary John Cowperthwaite since the 1960s has been revered as the core value of Hong Kong's economic policy for over half a century. During his office tenure, he objected to providing free primary and secondary schooling and was even against thorough economic statistics or research so as to prevent government intervention in the economy based on the data! Such a laissez-faire approach may seem extreme today but, during the city's economic heyday in the 1970s, it was widely regarded as most suitable for a small open economy like Hong Kong.

Laissez-faire not a cure for all ills

By the mid 1970s, the then Financial Secretary Philip Haddon-Cave further characterized the economic policy as "positive". As he clarified time and again, "Positive Non-interventionism" did not mean "positively non-interventionist" but positively weighing the social and economic consequences before selectively participating in economic activities, particularly for infrastructural investments. The best cases in point during the period: the nine-year free compulsory education, the 10-year Housing Programme, and the construction of the Mass Transit Railway. Strictly speaking, even back in the 1970s to the 1980s, the laissez-faire, non-interventionist governance approach already existed in name only. And yet after the 1997 handover, many people still believe that in order for the free-market economy to run efficiently, the SAR Government should still "positively refrain from intervening" in the market.

The Heritage Foundation of the US may well be in support of such an interpretation of free economy. The recent delisting of the SAR from the Index of Economic Freedom released by the Foundation has prompted not just heated debate among the general public and government officials but also widespread lamentation in the local community. However, from the long-term economic-development perspective, I think the real food for thought is: has Hong Kong, as one of the cities plagued by the largest wealth gaps in the world and the highest housing prices, paid too great a price to defend its halo as the “world’s freest economy”?

As per the Heritage Foundation’s ranking criteria, virtually all types of government intervention (including tax and redistribution, stabilization policies by the government, and public monopoly) are regarded as harmful to economic growth. Nevertheless, it is simply economics 101 that in case of market failure, the government has an obligation to step in with discretion.

Take the COVID-19 pandemic for example. The British Prime Minister Boris Johnson initially held firm the belief that herd immunity was achievable without government regulation. Subsequently as the coronavirus got out of hand, he had no choice but to acknowledge the necessity of forceful intervention by the administration. Since control of infectious diseases is a matter of public interest, free-market operations alone will not suffice. The challenge to community-wide vaccination is collective action, which causes market failure. It thus reveals that rationality of individuals is not necessarily realized in collective action.

In response to the economic havoc wreaked by COVID-19, governments around the world have come up with timely relief measures. Judging by the criteria of the Heritage Foundation, however, the international community will inevitably be subject to criticism for curtailing free economy.

Proper functioning of the free market hinges on a sound regulatory system and various policy tools to address market failure. Governments of quite a few developed countries are now contemplating a new social contract for the post-pandemic era in a bid to achieve a more equitable risk distribution between countries and citizens and to expediate adjustment of social benefits. A widely-debated topic in Western academia is that since the 1980s, under the “hyper-globalization” trend led by Europe and the US, coupled with the prevailing neoliberalist consensus worldwide, not only has social inequality deteriorated but individuals have come to shoulder excessive risks in terms of healthcare and retirement protection. Remedies should have already been in place to correct these phenomena (including the liberalism Hong Kong has been subject to since the colonial era). Yet as things stand, while Hong Kong finds itself in economic dire straits, an outmoded index of an American think tank somehow still catches the attention of Hongkongers.

The pros and cons of excessive control

The economic realms in which Singapore – another small open economy – has outperformed Hong Kong for the past 20-odd years are mostly attributable to the active intervention of "big government". For example, Singapore boasts not only a superior public housing scheme but also a more diversified economy, with high-end manufacturing industries (including electronics, pharmaceuticals, and aerospace engineering) taking up 18% of its GDP.

Having said that, excessive intervention could undermine market efficiency. As pointed out by the University of Chicago's Professor of Economics Chang-Tai Hsieh in his research study published in 1998, between the 1970s and the 1980s, the total factor productivity of Singapore was not only way behind compared with the other three "Little Dragons of Asia" but also remained in negative territory. This goes to show that excessive intervention by the government could result in low productivity or even spare capacity in certain sectors.

On the contrary, from the early 1970s to the late 1990s, despite the Positive Non-intervention policy adopted by the Hong Kong Government, the city enjoyed high-speed growth. In fact this was closely related to China and the overall global political and economic climate. In the 1970s Hong Kong was able to reap the bonus from the pre-marketized Mainland China prior to benefiting from its economic reform and opening up. The world then entered a phase of "hyper-globalization" in the next 20 years. To counter the former Soviet Union during the Cold War, the US re-established diplomatic ties with China in the mid 1970s. Improvements in the bilateral relations were sustained thereafter before culminating in China's accession to the World Trade Organization in 2000. Against this international political and economic backdrop, a low tax regime and non-interventionism were naturally conducive to Hong Kong's role as a super-intermediary for foreign trade and asset flows for both China and the region.

An economic policy in desperate need of change

However, such seemingly logical non-interventionist thinking has sowed the seeds of the Hong Kong Government's neglect of long-term economic planning, leading to a lack of policies in terms of talent, population, and industries. Out of market considerations, many local manufacturers have moved their production bases or even research and development (R & D) set-up to the Pearl River Delta (now within the Guangdong-Hong Kong-Macao Greater Bay Area), lowering the share of the industrial sector in both the local GDP and workforce to less than 2%. Sluggish industrial activity has, on the one hand, limited the transfer of technology and R & D results to the market, compromising its benefit to the citizens and the competitiveness of Hong Kong. On the other hand, the local economy has since overly relied on service industries, especially finance and trade, making Hong Kong more vulnerable to the fluctuations in the external economic environment.

Of the four pillar industries formerly highlighted by the SAR Government, with the exception of finance, the percentage share of the others in overall employment has been decreasing on an annual basis. Many of those who have left the pillar industries are then employed to do low-paid work in service industries. The fact that these service industries have not been able to offer on-the-job training or opportunities for enhancing skills has dampened the newcomers' potential for upward social mobility, further widening Hong Kong's wealth gap.

Even in the US, where little mention has been made of its industrial policies over the preceding decades, things are beginning to change. Both President Biden and the US Congress have put forward industrial-policy proposals, with a focus on the semiconductors domain. For instance, at the start of 2021, the US Congress promulgated laws in support of plant construction, R & D, and manpower-training incentives related to semiconductors. Biden has also announced that loopholes in the supply chains for semiconductors, batteries, and pharmaceuticals would be monitored. As a matter of fact, similar policies addressing high-tech industries were already covered in *Jump-starting America*, a book co-authored by Jonathan Gruber and Simon Johnson less than two years ago.

During the stable and prosperous "hyper-globalization" decades starting from the early 1990s, the "big market, small government" non-intervention approach of the colonial government could be fairly regarded as appropriate for Hong Kong's economic development. However, times have changed. The world's economy has undergone "reverse globalization" for over a decade. What's more, given the China-US power struggle and the continued opening up of the Mainland's economy and financial market, it is no easy task for Hong Kong to depend on super-intermediary activities to propel its economic development.

As I posited in my article in this column last October ("Hong Kong's Third Economic Transformation: What Are We Waiting for?"), Hong Kong must undergo another economic transformation, taking advantage of the current pandemic worldwide and the pressure of China-US friction as well as the opportunities afforded by the national dual-circulation strategy. With the core goal of creating diverse employment opportunities which promote socially-upward mobility, the SAR Government should systematically launch policies and provide incentives for companies and individuals capable of producing clearly positive spillover effects so as to boost inclusive and sustainable growth.

Recent years have seen the SAR Government turning its attention to high-tech industries, making up its mind to attract foreign talent and train local tech professionals, and taking measures to kick-start reindustrialization. All these developments are a good start and are most encouraging. However, to achieve effective economic transformation, both policymakers and the community at large must first revisit the "positive non-interventionism" philosophy to see if it is still suitable for Hong Kong's economic situation at present and if it is possible to find a more ideal balance between government and market.