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Why Hong Kong Needs the Admission of Mainland Professionals Scheme

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Economic Analysis

Whenever Hong Kong attempts to admit human resources from the Chinese mainland there is always controversy. The most often touted criticism of such initiatives is none other than that it takes away jobs from the local residents. This is misguided criticism and stems from a faulty application of economic analysis.

It is believed that admitting human resources into Hong Kong implies an increase in the supply of human resources. Given an unchanged demand for human resources it is inevitable that wages will fall. Local residents will be negatively impacted in two ways. First, wages will fall. Second, some workers will be displaced from their jobs because they cannot compete with the newly arrived human resources. Figure 1 below provides a graphic representation of this belief.

Figure 1 about here

Before the admission of human resources, Hong Kong workers will earn wages OX and the level of employment is OB. After the arrival of new human resources, the supply of human resources shifts from L^s_1 to L^s_2 and wages fall from OX to OY. Total employment increases to OC. AC indicates the number of jobs held by the newcomers. Local employment declines from OB to OA. In other words, AB is the number of local residents who will lose their jobs.

According to the above analysis, obviously admitting human resources is detrimental to the interest of local residents. But is this really the correct analysis? I do not think so. The fatal flaw in the above analysis is that it assumes that the demand for human resources will remain unchanged in response to the increase in human resource supply. This is simply incorrect and takes a totally static view of how market economies work.

In a dynamic free market economy with unfettered capital mobility, capital flows to locations where human resources are readily available. As a consequence, increase in human resource supply would attract capital inflows into Hong Kong that would in turn increase the demand for human resources. In a world of unfettered capital mobility, the

increase in demand for human resources would restore wages to its original level. Figure 2 depicts graphically the changes that would take place in such a world.

Figure 2 about here

It is important to note that the above result does not really depend on whether the imported workers are skilled or unskilled. There is, moreover, a presumption that the importation of skilled workers would create more jobs for unskilled workers because new capital flows into the economy.

This is not merely theoretical conjecture but is grounded in numerous empirical analyses. The best known example is the Israeli experience, which is important enough to recount below.

The Israeli Experience

Israel's recent phenomenal economic success is the result of the massive influx of skilled immigrants that took place between 1990 and 1995, when some 700,000 immigrants arrived in Israel, mostly from what was the USSR, representing an increase in the population of close to 16 percent. Constitutionally Israel is committed to taking Jewish immigrants from abroad. This has turned out to be a blessing for Israel's long term economic development.¹

The average annual GDP growth jumped from 2.2 percent in 1988-1989 to 6.0 percent in the period 1990-1995. Average annual per capita GDP growth jumped from 0.4 percent to 2.6 percent in the corresponding periods. This phenomenal growth was triggered by the immigration wave that took place after 1989.

Despite an initial increase in the rate of unemployment, it subsequently fell to below its erstwhile level. The wave of immigration was successfully translated into jobs and growth rather than unemployment as was first feared. Real wages in the business sector fell as a result of the rapid increase in labor supply. By 1995, real wages in the business sector were 7 percent below what they were in early 1989. The earnings of the natives remained flat during 1990-94, while the earnings of immigrants gradually grew from a much lower level. The unemployment rate of the natives remained stable during 1990-92, implying that the increase in aggregate unemployment was entirely among the immigrants. Since 1992, the unemployment rate of the natives has fallen as a result of the expanding labor market. The unemployment rates of the immigrants were very high initially, but subsequently converged with increasing rapidity on the native rate.

The flexibility of the Israeli labor market paved the way for job creation both directly and also indirectly through capital accumulation. Lower wages raised the demand for labor and increased the return to capital. The latter created an investment boom; the capital stock expanded, and so the demand for labor increased yet further. Table 1 shows that average annual business investment growth jumped from -5.2 percent in 1988-1989 to 16.1 percent in the period 1990-1995. The bull run in the Tel Aviv stock

exchange in 1990-93, during which share prices tripled, can be understood as reflecting the subsequent increase in earnings of Israeli firms.

The flexibility of the Israeli labor market and the entrepreneurial capacity of the Israelis made it possible for Israel to capitalize on the immigration wave. There is little doubt that the Israeli experience contains an important lesson for Hong Kong, which is also well known for its flexible labor market and entrepreneurial capacity.

The socio-demographic characteristics of the immigrants are interesting. One obvious point is the disproportionate number of highly educated immigrants that were employed in scientific and academic occupations in the USSR. The recent growth of technology intensive industries in Israel is a direct beneficial consequence of the new wave of immigrants that arrived after 1989.

The importance of bringing highly skilled talent into Hong Kong must become the central feature of any policy to add value to Hong Kong's industries. This is the only factor that will alter Hong Kong's comparative advantage in a significant manner to make a real difference. This is demonstrated by the experience of Israel recently, but also in the past by Hong Kong's own history in the post-war years.

To enhance the economic prospects of Hong Kong and to create jobs for our own population I support the newly proposed scheme to admit mainland professionals into Hong Kong.

¹ Michael Beenstock and Jeffrey Fisher, "The Macroeconomic Effects of Immigration: Israel in the 1990s", *Weltwirtschaftliches Arkiv*, 133 (2), 1997: 330-358.