The First SAR Budget

Y. C. Richard Wong

An early glimpse of the first SAR government budget was made available last week. It had few surprises. The major areas of expenditure growth were housing, social welfare, education and infrastructure. These were the areas emphasised in the Chief Executive's policy address on 8 October 1997. By increasing public expenditure by some 11.3 per cent and permitting public expenditure to rise to 19.2 per cent of the projected GDP the SAR government has apparently made good on the Chief Executive's pledges.

Between the Chief Executive's earlier policy address and the budget speech on 18 February 1998 an unforeseen financial crisis has swept through most of the Asia-Pacific economies. The prospect for high economic growth in the region for next year has dimmed considerably. Has the SAR government compromised its hard-earned reputation for fiscal conservatism by allowing public expenditure to rise by so much as the economy moves into rather tough times?

Hard economic times are well known to Hong Kong in the post-war era. It happened in the early 1950s when the United Nations imposed a trade embargo against China after the outbreak of hostilities on the Korean peninsula. The effect devastated Hong Kong's entrepot trade and total exports from the territory only recovered to its original level after an entire decade.

John Cowperthwaite had to manage the worst property market asset bubble Hong Kong experienced in the early 1960s and the confidence crisis in the late 1960s due to civil unrest in the territory. Phillip Haddon-Cave had to steer the economy through two oil crises during which the unemployment rate reached almost 10 per cent in the early 1970s. John Brembridge had to wrestle with the Reagan interest rate hikes and the collapse of the Hong Kong dollar in the early 1980s.

In the past, Financial Secretaries in the territory have responded to similar crises by raising taxes and cutting expenditures to balance the budget. In better times they work hard against popular pressure to build up fiscal reserves through surplus budgets to cushion against bad years. This is fiscal conservatism at its best and it has served Hong Kong well. As a consequence, our economy has remained resilient in the face of adversity and has rebounded quickly and ahead of others as overall conditions improve.

Mr. Donald Tsang's budget this year has two major challenges. The first challenge is to balance the budget and resist popular demand for tax relief in the face of dwindling revenues due to slower economic growth. His task is no different from those faced by his predecessors and his performance will certainly be measured against theirs. The second challenge is how to keep Mr. Tung Chee Hwa's pledges alive. If he succeeds in meeting both challenges Mr. Donald Tsang would have upstaged his predecessors by squaring the circle.

On the surface this may apparently be the case. The proposed budget is unlikely to include tax cuts and will still record a surplus. But this would be achieved by assuming that GDP would continue to grow at 5 per cent next year. An estimate some would consider to be on the optimistic side. Furthermore land premium is forecasted to go down by only 30 per cent. An assumption that is very much crystal ball gazing at this point in time.

Would it not have been more prudent for Mr. Donald Tsang to roll back some of Mr. Tung Chee Hwa's commitments by delaying them? Previous Financial Secretaries had taken such a decision in the face of economic adversity. Cowperthwaite reduced the proposed 10-year public housing programme to house 200,000 persons each year by a half. He even argued eloquently against the proposed mass transit railway scheme and expressed doubt about its ultimate profitability. Haddon-Cave similarly halved MacLehose's even more ambitious 10-year public housing programme to build sufficient units to house 1.5 million people. And Brembridge stopped the proposed new airport.

Mr. Donald Tsang is not expected to recommend this in the upcoming budget. On the contrary, the government would probably be parading additional public spending as a demonstration of its wisdom and resolve to steer the Special Administrative Region towards its future destiny. Some in government would suggest that this would create jobs and provide the necessary fiscal stimulus. Others would acknowledge that the effects of fiscal expansion could hardly be felt in the near future, but nevertheless Hong Kong's economic prospects will be better off as a consequence of the investments made today.

Who can fault an investment made on our behalf and for our future? Nevertheless taxpayers have a legitimate right to know if the rates of return that is promised are really all that attractive. Given our level of fiscal reserves the issue at stake is not affordability, but a question of the yield.

Certainly one of the first lessons of the Asian financial turmoil is that government driven or willed investments is the root cause of the present sad predicament in many nations. And the effects have been worsened by lax fiscal and monetary restraints. It is unfortunate that ambitious public plans often fail spectacularly, and they almost always do so eventually. The late Professor von Hayek called it the fatal conceit.

One would at least hope that the government would still deem it prudent to try to obtain private sector participation in these new initiatives as they have done so in the past so that sound commercial principles will have a better chance of being respected. Unless this occurs, sensible observers and the public at large will not be assured that this is money well spent in times like this regardless of the vision that is bravely marketed.

It is worth recalling the mixed record of achievements of public housing programmes in Hong Kong. They provide an excellent illustration of the limits of public intervention. In Hong Kong's post war colonial history there have been many major attempts to resolve the problem of housing in the territory. The first more modest plan was the only one to succeed; the subsequent more ambitious attempts have failed by wide margins.

In 1954-64, the main housing objective was to resettle squatters to clear land for redevelopment. The target was to relocate 50,000 persons each year. The programme achieved its goal, and between 1954 and 1965 the resettlement estates housed a total of 607,673 persons.

In 1965-73, a ten-year building programme that would house on average 220,000 persons each year was announced. In the end the programme fell short of its initial target by more than 50%. In 1973-83, a new ten-year building programme was initiated with the aim of building enough units to house 1,535,000 persons. The programme too fell short of its production target by 50%. Both of these latter attempts failed because of overpowering effect of unforeseen adverse economic conditions.

The period since the mid-1980s has been one of policy neglect in the housing area. Mr. Tung has correctly tried to redress the problem since he assumed office. His long term housing strategy is to stabilize property prices by increasing supply and to achieve a 70 per cent homeownership rate. These are undoubtedly laudable goals and would achieve a battery of desirable economic, political and social objectives in the long run.

The government’s housing and homeownership targets were unfortunately conceived before Asia succumbed to the current financial crisis. To his credit he has prudently taken steps to concede that private sector annual targets can be rescheduled to avoid a property market meltdown that would have broader financial and economic implications.

The public sector targets, however, remain and the Housing Authority is expected to deliver them as planned. The issue is not whether the SAR government can and should keep its pledge, but whether it should stick to it religiously. Governments everywhere who defy market forces do so at their own peril and those who attempt to harness it have time and again been proven to be inadequate to the task.

The government in a small open economy like Hong Kong has even fewer options. It is better for the government to focus on what it has always does best, hold expenditures down and balance the budget. Mr. Donald Tsang's budget will certainly be scrutinised for whether government is marching us off to a brave new world or it is still business as usual.

Y. C. Richard Wong is Professor of Economics and Director of the School of Business at the University of Hong Kong.