

1997 and Government Intervention in the Hong Kong Economy

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In the United States and many other parts of the world, Hong Kong is widely seen as a perfect example of laissez-faire. This, however, is only partially true, in the opinion of Mr. Kurt Schuler, visiting fellow of G.T. Management (Asia) Ltd. In a speech given to an IES audience on 10th of August, Mr. Schuler pointed out that a closer look at the local economy will show that the Hong Kong Government is increasingly intervening in the economic affairs of the territory. His account of how and why this has happened is both informative and insightful. Reproduced below is the full text of his speech.



Mr. Kurt Schuler

There is an indissoluble link between economic freedom and political freedom. Economic freedom—the right to live where one chooses, to work where one pleases, and to enjoy the fruits of one's labor—is the basis for many so-called political freedoms. For example, freedom of the press does not exist in countries where the government owns all the presses.

Since the June 4 Beijing massacre, public opinion in Hong Kong has focused on taking the political measures necessary to safeguard human rights here. The right of abode and a speed-up of the timetable for fully democratic elections are important. But so far, public opinion has paid no attention to economic measures that are equally vital if Hong Kong is to preserve its freedom. I wish to speak to you about tonight about the economic foundations of freedom in Hong Kong.

Most of the rights that China promises to respect in the Basic Law draft are already guaranteed to its own citizens in its own constitution. We know how little human rights are respected in China. But let us be optimistic, and suppose that China will respect human rights in Hong Kong. Even so, present arrangements offer the government many perfectly legal ways of reducing freedom. The current government has rarely taken advantage of them because its attitude is relatively benevolent. The same cannot be said about the Chinese government, which may stay within the letter of the Basic Law, yet use every legal power at its command to harrass, intimidate, and silence dissent. Hong Kong needs to strip the government of economic powers that have the potential of being abused for political ends. Economic power that depends on the government for its existence may easily become subservient. Economic power that does **not** depend on the government for its existence can be a base for resistance to infringements on freedom.

The 'Command Posts' of the Economy

Last year, government expenditure in Hong Kong was slightly under 15 percent of gross domestic product. That

figure is lower than for all save a few desperately poor countries. Hong Kong has probably the least regulated economy in the world. However, government economic influence is substantial, and far more widespread than it appears from statistics. Licenses and regulations limit competition in many sectors of the economy.

Certain sectors of the economy are 'command posts'. Because of their importance, they have a close relation to political power. The 'command post' sectors are communications, education, law and police, land, money, and taxation. In other sectors, government intervention can make life frustrating, but it is less of a threat to liberty. Examples of less vital sectors are transportation, housing, health, utilities, culture and recreation, environment, and public works.

I shall review the "command posts" of the economy one by one, and discuss what might be done to free them of possible political influence.

Communications

Except for the newspaper and magazine press, which is fiercely competitive, communications in Hong Kong are controlled by government-owned or government-licensed monopolies. The most plausible argument usually given for the monopoly system is that monopoly is necessary to ensure universal service or high-quality service. Competition supposedly results in firms serving only the customers who are richest or easiest to reach. But though the argument sounds convincing, it has little foundation in fact. Competition produces a variety of services, tailored to consumers with a wide range of needs and incomes.

Monopoly licensing is dangerous because it makes licensed companies depend as much on the government as on consumers for their success. Licensed companies are subject to pressure to kowtow to the government to keep their licenses. When licenses expire, the government may award the licenses to more politically favored groups, or even take over ownership itself. It is possible that when

current licenses end after 1997, the Chinese government or front groups will take over Hong Kong's communications system. The implications for freedom are very bad indeed. The communications sector needs to undergo great changes to avoid such a fate.

The only government-owned monopoly in the communications industry is the Post Office. Its stranglehold over mail delivery serves no purpose. Private, competitive firms are perfectly capable of delivering mail. Our experience with competitive parcel delivery in the United States is that private firms do a cheaper and better job than the government. In Hong Kong, private firms already deliver documents by messenger and provide express international delivery.

A monopoly of mail delivery is a threat to freedom of speech. When the Royal Mail becomes the People's Mail, will it still deliver foreign newspapers and magazines if they oppose the Chinese government's political views? With competitive delivery, that is not a problem; somebody is always eager for the business. The Post Office should be given to its employees. Competition should be introduced class by class, until it covers all mail.

Other parts of the communications industry are government-licensed private monopolies. The largest is Hong Kong Telecom. Its franchise runs until 1995 for local telephone service and until 2006 for international service. There is reason to introduce competition much sooner. Competition in trunk call service has been quite beneficial in the United States and Britain, especially to business users. It has brought much lower costs and a range of new services that the old monopoly companies were too stodgy to offer.

Hong Kong already has competition in mobile radiotelephones, where there are three companies, and in radio paging. They have made Hong Kong one of the best-served cities for those types of technology. Radiotelephone or cable television networks could become the basis for new telephone systems. Hong Kong also may be able to support other companies based on more familiar technology because its large number of users within a small area makes for economies of construction. In return for allowing competition now, the government could free Hong Kong Telecom from rate regulation and give it a permanent, nonmonopoly franchise.

There is ample room for competition in cable television as well. The monopoly license awarded to Wharf Holdings is not necessary. Cities in the United States that allow competition have found that it reduces costs for subscribers. In the town where I lived earlier this year—Athens, Georgia—the immediate effect of the city government awarding a second cable television license earlier was to make the established company cut prices 15 percent. Cable television can be a source of access to foreign broadcasts. Therefore, it should not be in the hands of a single company that is at the mercy of the government for its survival.

The prohibition against wiring more than one TV set to a single satellite dish serves no purpose but to limit satellite reception to the rich. It should be abolished.

Television and radio are limited and monotonous here compared to other large cities with easier licensing rules. New York, Paris, and Rome have many more television and radio channels. The government should allot and auction new television and radio channels. Furthermore, instead of

the current system of twelve-year licenses, it should give stations ownership of the airwaves, so that they need never fear losing their license because they offend the Chinese government with forthright news reporting. Restrictions on the types of programs broadcast, on foreign ownership, and on non-broadcasting activities, all of which limit competition, should go.

The Television and Entertainment Licensing Authority has already proved to be an enemy of free speech. It banned a commercial on the right of abode on the grounds that the television code forbids advertisements of a political nature. If that is how it behaves now, how will it act when the Chinese run it? The Authority should be done away with. Radio Television Hong Kong should be sold to the private sector to avoid being used as a propaganda organ after 1997. The British Forces Broadcasting Service's two radio channels should also be sold, to prevent them from automatically becoming People's Liberation Army channels. If the Chinese government wants media outlets in radio and television, make it pay for them on the open market, on equal terms with other parties.

Education

The Basic Law draft guarantees freedom of academic research. But as anyone who been involved in the academic world knows, what gets researched depends on what universities are willing to pay for. In the United States, state universities have sometimes had their funding cut when professors expressed politically unpopular ideas. Concern over government funding has, for instance, caused political science departments to deny tenure to Marxists and hire only right-wingers. One can easily imagine that discrimination running in the opposite direction might be practiced in Hong Kong after 1997. One way to encourage academic diversity would be to lift the moratorium, in effect since 1978, that has prevented new private institutes from gaining formal government recognition as institutions of higher education.

Politics is a danger in elementary and secondary schools as well as at the university. Some subjects, especially history, are politically charged. I am told that students here do not study Chinese or Hong Kong history past 1948, because of its political implications. To make sure that education does not become indoctrination, it should become consumer-centered rather than government- and school-centered. At present the student, who is supposed to be the reason for the educational system, is an unimportant person in it. Education vouchers are the solution. Government schools could be turned over to teachers. Under a system of vouchers, parents would send their children to the school of their choice. Schools would compete to attract students and depend only on their success in doing so for funding. That would make them more responsive to students' needs and free them of political interference with budgets and academic governance.

Law and Police

It is even possible to encourage the private sector in law. The government could allow private companies to set up courts whose decisions would be binding on parties that gave mutual voluntarily consent beforehand. Such courts already exist in California and some other American States.

In Hong Kong, they could offer an alternative to a government-run court system that may be heavily influenced by politics after 1997.

Hong Kong should also give some thought to privatizing police functions, for instance, by letting neighborhood associations contract with private companies for police protection. (Perhaps some sort of voucher system would be advisable here, as with education.) Dispersing police power to the private sector would help prevent it from being used as a political tool.

Land

The Hong Kong government's position from the founding of the territory has been that in principle, all land belongs to the Crown. There seem to have been two reasons for the policy. First, it asserted British (as opposed to Chinese) government control over Hong Kong. Second, by not granting freehold ownership rights such as that exists under British law, it avoided the possibility that freehold rights might conflict with ownership rights under Chinese law should the territory revert to China. Crown ownership assures that any conflict with Chinese law can, if necessary, be resolved when a lease expires, by rewriting the terms.

The result is that the whole territory is going to become Chinese government property when present leases expire after 1997. (Most building leases are granted for 75-year terms.) What is the logic of that? The Chinese government has done nothing for Hong Kong; Hong Kong has prospered despite the Chinese government. The land belongs properly to those who have developed it and now occupy it. If the government cannot grant freehold ownership because that would conflict with Chinese law after 1997, it could grant long-term leases, lasting at least until 2047, and preferably running 999 years, by which time I hope the communist system will have perished.

Some economists have argued that the government should retain ownership of the land because land is so scarce in Hong Kong. But it is precisely when a good is scarce that private ownership is generally superior to government ownership in managing the good efficiently. The Chinese government's record of land stewardship is poor. Especially in agriculture, government ownership has retarded China's economic growth.

Money

The Exchange Fund has immense reserves, which are getting larger every year thanks to government surpluses and interest on assets. The government refuses to say how large the fund is, but it probably contains over HK\$100 billion. That is about \$20,000 for every person in Hong Kong. It is absurd to be accumulating a nest egg for the Chinese, who may well use it to increase state control of the economy and reduce liberty.

The money in the fund should be used for the benefit of Hong Kong residents now. One way to do so would be to cut taxes substantially and cover any deficit by drawing on the Fund. Another way would be to give a share of the money to every citizen. Perhaps the distribution should be weighted in favor of poor people, so that they would have the means to buy a second passport if they wanted. There are some countries—not Australia, Canada, or the United



Mr. Schuler at the dining table with IES Chairman Mr. Henry Woo (left) and Mr. P.C. Lund

States, unfortunately, but countries considerably more free than China—where \$20,000 is enough to buy citizenship.

The Exchange Fund also contains principal and interest from forced bank deposits. That money should be returned to the banks. The Exchange Fund itself could be abolished. It is not necessary for preserving the exchange rate. The banks themselves were responsible for preserving the rate (which was then against silver rather than the U.S. dollar) from 1845 to 1935. They did an admirable job. Abolishing the Exchange Fund and turning over exchange-rate responsibility to the banks would also eliminate the government's temptation to manipulate the exchange rate to benefit the Fund.

The basis of note issue would, of course, also change. During the years 1845 to 1935, Hong Kong had good experience with little-regulated note issue. It could work well again today. Furthermore, letting the Bank of China issue notes competitively would eliminate complaints that the present system does not treat it fairly. The present government could offer the Bank of China and other Chinese-owned banks the right of note issue in Hong Kong in exchange for securing the right of Hong Kong banks to establish branches freely in Guangdong province, or even throughout China.

Taxation

The power to tax is the power to destroy. Hong Kong should be particularly wary of increasing that power as 1997 approaches. In his budget speech earlier this year, the Financial Secretary announced that his department was studying the desirability of a sales tax as a way of broadening the base of the tax system. The last thing Hong Kong needs right now is a broad tax base. The government should in fact be making an effort to make the base as narrow as possible, so that the post-1997 regime would have difficulty using the tax system as a means of expropriation.

The sales tax should not be adopted. Personal and corporate income taxes should be cut, as should stamp duties on stocks and other documents. The past surpluses lodged in the Exchange Fund are about equal to one year's spending. If not distributed in a lump-sum payment to citizens, as I suggested previously, they would offer an ample cushion for making up any deficit generated from cutting taxes.

Perhaps the ideal from the standpoint of personal liberty would be to have government revenue derived entirely from

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