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Stable Money and Economic Growth in Hong Kong

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Stable Money and Economic Growth in Hong Kong

Reed J. Irvine

The most notable postwar example of economic growth in conjunction with non-inflationary policies in Asia, if not in the world, is found in Hong Kong. Hong Kong has been badly neglected by economic analysts. The fact that it is not self-governing has led some people to rule it out as a proper object of economic study, but this is clearly a non-sequitur. It is true that many people believe that the colonial system is an obstacle to economic growth. If true, this makes the growth of Hong Kong even more remarkable and deserving of study.

It is sometimes said that Hong Kong is too small to be significant. In terms of area, it is small, encompassing a mere 391 square miles. But in this area live an estimated 2.8 million people. The population is greater than that of Costa Rica, El Salvador, Honduras, Iceland, Israel, Jordan, Lebanon, New Zealand, Nicaragua and Paraguay, and about as large as that of Uruguay. It is therefore not an insignificant example.

The results of orthodoxy

Hong Kong is one of the few countries in Asia that has adhered steadfastly to balanced budgets and sound money throughout the postwar period. The government budget is unfailingly balanced and substantial surpluses have been incurred each year. Only one Government loan has been floated during the postwar period. That was a HK\$50 million^{1/} issue in 1947-48. The public debt outstanding at the end of 1958 was equal to eight weeks normal revenue. Government expenditures have largely been confined to provision of administration, law and order, education and other social services and public works.

There has been no occasion to finance government activities with printing press money in Hong Kong. Neither is there any means by which this could be done. The currency is issued by four large commercial banks, but 95 per cent is issued by the Hong Kong and Shanghai Banking Corporation. The notes are backed 100 per cent by sterling assets. While inflation through expansion of bank credit is possible, it would be automatically countered by the contraction of currency if it went so far as to cause a balance of payments deficit. Hong Kong banks maintain high liquidity ratios as a matter of policy rather than law. Bank statistics are not available for deposits, but bank clearings data indicate that bank credit has probably undergone no great expansion since 1950.

^{1/} The official exchange rate is HK\$5.714 to U.S.\$1.00.

Under this rigid system, Hong Kong has enjoyed remarkable freedom from inflation. No official price statistics are available, but a cost-of-living index prepared by Mr. Edward Szczepanik of the University of Hong Kong shows the following movements:

Cost of Living Comparison
1953=100

	1947	1948	1949	1950	1951	1952	1953	1954	1955	1956
Hong Kong	78	77	86	90	98	99	100	98	95	98
United States	76	83	86	90	97	99	100	100	100	102

Source: Szczepanik, Edward, The Economic Growth of Hong Kong, Oxford, 1958, p. 20 and International Monetary Fund, International Financial Statistics.

This index reveals a remarkably close correspondence between Hong Kong and U. S. prices from 1947 to 1953. From 1953 to 1956, Hong Kong prices dipped down while U. S. prices inched up. The price rise in Hong Kong prior to 1953 cannot be considered a product of inflationary pressure within the colony. It clearly reflects the worldwide inflation prevailing in those years. A trading community like Hong Kong with its currency linked to sterling could not hope to insulate itself from rising prices in the rest of the world.

The stimulus of stability

The fact that the rise in the cost of living in Hong Kong was smaller in this period than in many other countries no doubt helped the growth of industry in Hong Kong. It made it easier for Hong Kong-made goods to find markets abroad and to compete with imports in the domestic market. Avoidance of inflation has in a sense constituted "protection" for Hong Kong's infant industries, but unlike tariff and quota protection designed to keep out imports of competitively priced goods,^{1/} this form of protection gave Hong Kong goods an advantage not only in the domestic market but in foreign markets. This was of tremendous importance in view of the limited nature of the home market. At the same time, the Hong Kong manufacturers and consumers were not denied access to those goods which could be procured from abroad more cheaply than they could be produced in Hong Kong. This was also advantageous in the development of industry in Hong Kong, since it helped keep manufacturing costs low.

Had Hong Kong not avoided inflation it might have been difficult to maintain the freedom from exchange controls that has been one of Hong Kong's great strengths in the postwar period. Hong Kong businessmen have not been plagued with expensive, time-consuming red tape, the prohibitions on buying in the cheapest markets, and the shortages of needed raw materials and equipment that have been the bane of entrepreneurs in countries burdened with cumbersome and rigid exchange control systems.

^{1/} Hong Kong has no protective tariffs or quotas.

Given these advantages, how much growth has Hong Kong enjoyed? Hong Kong does not compute national income figures, nor does it publish an index of industrial production. However, there are indicators of the rate of economic progress. We will here cite three: consumption of electricity, the number of factories and factory employment, and exports of goods of Hong Kong manufacture.

Electric power consumption

The growth of electricity consumption reflects both Hong Kong's burgeoning industry and commerce and the increased consumption for domestic purposes. Total use of electricity more than quintupled between 1948 and 1958. Industrial use increased by nearly six times in the same period.

Electricity Consumption in Hong Kong

Million Kw. Hours

	Total		Industrial	
	KWH	Index	KWH	Index
1948	153.4	100	48.0	100
1950	283.4	185	98.8	206
1952	388.3	253	135.9	283
1954	482.3	314	166.6	347
1956	650.0	424	235.3	490
1957	739.8	482	268.5	559
1958	794.1	518	284.1	592

Source: Department of Commerce and Industry of The Hong Kong Government, Directory of Commerce, Industry, Finance, 1957, p. 73 and 1959, p. 59.

It should be noted that Hong Kong has no natural resources which can be used for the production of power and that electricity must be generated from imported fuels. Electricity is comparatively expensive for this reason. This is one of the disadvantages that has made Hong Kong's growth all the more remarkable.

Factories and employment

The number of registered factories and factory workers provides striking proof of the industrial expansion in Hong Kong in the postwar period.

Registered and Recorded Factories and
Industrial Workers, 1940-1956
1948=100

Year	Factories		Workers	
	Number	Index	Number	Index
1940	800	63	30,000	47
1948	1,266	100	63,873	100
1950	1,752	138	91,986	144
1952	2,088	165	98,126	153
1954	2,494	197	115,453	180
1956	3,204	253	144,581	226
1957 (March) ^{1/}	3,290	260	148,135	232

These figures do not give a complete picture of manufacturing employment in Hong Kong, since they exclude concerns employing fewer than fifteen persons and not using power equipment. However, it is probable that the unregistered and unrecorded firms have also shown a similar rate of growth in this period. The industrial growth has covered a wide range of products. In 1958, over 350,000 spindles were operated in the cotton textile industry, producing over 120 million pounds of cotton yarn. Most of the yarn was used in Hong Kong to produce over 270 million square yards of cotton textiles. Hong Kong has become a major competitor in world cotton textile markets in just a few short years. More recently the manufacture of clothing has expanded rapidly. A wide variety of other products, including toys, plastics, footwear, enamelware, furniture and fixtures, leather goods, flashlights and batteries, cement and metals, are now produced in Hong Kong in substantial quantities.

The fact that the consumption of electricity by industry has grown about twice as fast as the number of workers employed in registered factories no doubt reflects in part the increased utilization of power equipment per worker. Businessmen have invested heavily in plant and equipment in Hong Kong, and many Hong Kong factories, especially the textile plants, are equipped with the most modern machinery available.

^{1/} Not including "recorded factories." A recorded factory is one employing 15 to 19 workers but which is not registerable. A registered concern is one employing 20 or more workers or using power machinery. Data for 1940-1956 from Szczepanik, Edward, *op. cit.*, p. 159; 1957 data from "Far Eastern Economic Review" February 20, 1958, p. 250.

The Colony has enjoyed a high rate of capital formation in the absence of both inflation and restrictions on consumption. Much of the capital has come from abroad, not only from Mainland China but from neighboring countries in Southeast Asia. The financial stability and freedom from controls on capital movements have unquestionably been important factors in the attraction of capital to Hong Kong. The lure has been strong enough to overcome fears engendered by Hong Kong's proximity to communist China and uncertain long-run political future.

Exports

The most striking evidence of Hong Kong's industrial growth is found in her export performance. Hong Kong's newly developed industries have demonstrated the ability to compete effectively in world markets. This means that industrialization in Hong Kong has not been achieved through the substitution of high cost, inefficiently produced domestic goods for cheaper imports barred by quotas or tariffs. This is in vivid contrast with the situation in many other countries that have made strenuous efforts to foster industrial development in recent years. In country after country domestic manufactures have been protected from the competition of imports by various exchange and import restrictions. These measures have added to domestic inflationary pressures by increasing the cost of both domestic and imported goods. These countries have rarely succeeded in developing new industries whose products could be exported without some form of subsidy.

Hong Kong's manufactures, on the other hand, have become extremely important in the colony's export trade. In 1958, total exports amounted to HK\$2,989 million, of which 42 per cent, or HK\$1,260 million, consisted of goods manufactured and processed in Hong Kong. In 1948, exports of domestically produced goods were not separately recorded, but it is estimated that they comprised only 15 per cent of the total exports of HK\$1,583 million shipped in that year.^{1/} The dramatic expansion of the export of Hong Kong products has offset the loss of a substantial part of the Mainland China trade which was formerly of prime importance to Hong Kong. It has enabled the colony to maintain its rapidly increasing population and living standards that are high by Asian standards.

Growth without "gimmicks"

This achievement appears even greater when one recalls that Hong Kong is not endowed with mineral wealth, has no great agricultural resources and even lacks an adequate supply of water. Faced with these disadvantages and with virtually no outside aid, Hong Kong elected to spurn inflation, protection and other "gimmicks" that are often alleged to be essential for the country that wants rapid economic growth. The colony is "one of the very few, if not now the only territory which has remained completely faithful to liberal economic policies of free enterprise and free trade." With these policies Hong Kong has established a record of economic growth in the postwar period that far outshines that of any other underdeveloped country in Asia.

^{1/} Directory of Commerce, Industry, Finance, Hong Kong, 1959, p. 10.
See the appended table for Hong Kong's trade figures.

Appendix

Economic Growth in Hong KongHong Kong's Trade: 1948, 1954-58
(HK\$ Million)

		1948	1954	1955	1956	1957	1958
Exports	Domestic Products		863.5	1,002.9	1,114.7	1,202.0	1,260.3
	Re-exports	1,582.7*	1,553.5	1,531.1	2,094.9	1,814.3	1,728.5
	Total	1,582.7	2,417.0	2,534.0	3,209.6	3,016.3	2,988.8
Imports		2,077.5	3,435.4	3,718.9	4,566.2	5,149.5	4,593.7
Balance of visible trade		-494.8	-1,018.4	-1,184.9	-1,356.6	-2,133.2	-1,604.9

* Not separately recorded

Source: Directory of Commerce, Industry, Finance, 1959, p. 10