**Finding some breathing space**
DAVID LAN ( 29-09-2003 )

In the second quarter of this year, Hong Kong sank into a technical recession - its second in 18 months - with a decline of 3.7 per cent compared to the first quarter. Until a couple of months ago, Hong Kong was still very pessimistic about its future, with many people talking about a severe crisis of confidence paralysing the special administrative region.

Then, following the July 1 demonstration, a number of economic and administrative initiatives were introduced, and they have produced a positive impact on Hong Kong's economy. The improvements have been evident in people's general feeling and overall business sentiment.

Late last month, the government revised upwards the economic growth forecast for the current year to 2 per cent from 1.5 per cent. Now, even the long-depressed Hong Kong stock market is rallying.

How can we explain such a speedy recovery in Hong Kong's economy and people's confidence?

Maybe the Sars outbreak did not hit us as badly as we had all feared. More likely, it is the decisive and swift launching of the government's economic initiatives that has kindled hopes for a V-shaped economic recovery.

These initiatives seem to have been well-planned and properly co-ordinated in advance. They include a fresh determination to move towards greater Pearl River Delta integration, to pursue the bridge to Macau and Zhuhai, to link Hong Kong's Western Corridor to Shenzhen, to forge a Closer Economic Partnership Arrangement (Cepa) with the mainland and to allow mainland residents to visit Hong Kong as individual tourists.

Cepa has given Hong Kong companies selling a wide range of goods and services a head start towards tapping the huge mainland market. Compared to foreign companies, this head start ranges from one to three years in many cases and 10 years in some cases.

A Hong Kong company is defined as one that is incorporated in Hong Kong and pays

Hong Kong taxes. That gives the Cepa initiative a great attraction to foreign investors.

My discussions with a group of senior Japanese business leaders on the subject have convinced me that Cepa will attract a lot of high technology and new skills into Hong Kong's economy over the medium and long term. Foreign capital definitely wants to take advantage of Cepa to gain market access on the mainland.

The removal of restrictions on mainlanders coming to Hong Kong as individual tourists also will have significant long-term effects on Hong Kong's economy. According to City University professor Chan Yan Chong, a member of the New Century Forum, about three million additional individual tourists - on top of the more than six million tourists arriving in groups - from the mainland will come to Hong Kong every year.

All these visitors are likely to spend large sums of money, because they must honour the requests from family members at home to buy them brand-name products such as watches, jewellery, cosmetics, cameras, medicines and clothing - all tax-free in Hong Kong. The limit on the cash each mainlander can bring to Hong Kong has just been raised from US$2,000 to US$5,000. The total spending by these three million mainlanders could be as much as HK$117 billion a year, which would be a sizeable portion of Hong Kong's gross domestic product.

If Hong Kong handles this influx properly, it is not inconceivable that these individual tourists will keep visiting Hong Kong for at least the next 10 years, creating jobs here for unemployed people. This would create a breathing space that enables Hong Kong's government and people to work out proper plans and strategies to handle the challenges of economic restructuring, unemployment, deflation, budget deficits and public spending cuts.

Many people see allowing the influx of tourists from the mainland with enlarged spending power as one-way traffic, solely intended to speed Hong Kong's economic recovery.

But if we could broaden our view slightly, this move by mainland authorities can be interpreted as merely redressing the current situation, whereby over the past decades large numbers of Hong Kong visitors have visited the mainland for business and pleasure.

What is wrong with having two-way traffic from now on? It could only be described as a very healthy development.

Another argument we can put forward in favour of a larger influx of mainland tourists is that Hong Kong can serve as an effective experimental ground for the gradual relaxation of exchange controls on the yuan. Let us not forget that there has recently been tremendous pressure from the US, Europe and Japan for China to revalue the yuan. Spending by mainland tourists in Hong Kong can help to relieve such pressures.

The experiment would proceed in phases.

Phase one of more relaxed exchange controls would be the increased spending of up to US$5,000 by each mainland tourist in Hong Kong.

Phase two could be Financial Secretary Henry Tang Ying-yen's suggestion for Hong Kong to become an offshore centre for financial transactions in yuan.

Perhaps phase three could then be the purchasing of Hong Kong properties by mainlanders.

We should welcome all the recently introduced economic initiatives, which will bring real and lasting benefits to Hong Kong. The two-way traffic they will promote will also bring mutual benefits to Hong Kong and the mainland.

However, Hong Kong people must not forget that there are no panaceas for the many long-term economic problems that we must resolve. The government's recent initiatives merely provide us with a useful breathing space.

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