

The U.S. Economy and Hong Kong – Reason for Optimism

Speech to the Hong Kong General Chamber of Commerce

Mr. James E. Thompson
Chairman, Crown Worldwide Holdings Ltd and
2003 AmCham Chairman
Friday, January 24, 2003

It's a pleasure to be with you today and present some views on the U.S. economy. Let me start by saying I'm not an economist so my views are those of a businessman who is a keen observer of various indicators affecting the economies in the United States and Asia. I guess this is also a description of an economist but the difference is that they get paid to do it and have to be responsible for what they predict. I don't. However, having said that, I'm quite proud of the fact that I publicly predicted a GDP growth of 2.5 % for Hong Kong in January 2002 and the Financial Secretary and almost all economists said it would be 1%. The final figure is not out but the latest projections are that it will be 2.1% or thereabouts.

I'm also a bit of an optimist by nature and it's hard to change that outlook as I look ahead. I'm like the patient who's doctor advised him that he should take it easy and not work so hard. To which the patient replied by saying, "I tried relaxing Doc but I found it really made me tense." In my case, I find being negative really makes me tense.

I'd also like to say up front that not all my remarks will be about the United States or the U.S. economy. A good part of my talk will be about Hong Kong and a few observations I've made about the local situation. I'll be going over to RTHK after this lunch to read my "Letter to Hong Kong" on air and my talk today will include much of that letter which expresses my thoughts on the general pessimism in Hong Kong today.

Let me begin my remarks today by giving you my views on the state of the American relations with Hong Kong and China and make a few comments on the situation going forward.

The relations between the United States and China are stronger than they have been for the past 53 years. We in the American business community have continually stressed to our Government leaders that the best way to bring our two countries closer together is through trade. We've entered into many debates to get this point across in Washington and we savor the success we've had. Today, our economies are becoming strongly interlocked through the most active trade channels in the world and, largely because of that, we're continuing to see positive changes in China. We also know that this development of trade has helped Hong Kong as well.

At this stage the trade is heavily imbalanced in China's favor but there are encouraging signs that China is increasing their imports from the United States and we will be aggressively supporting the effort of American companies to sell more to China as the people of that country become wealthier.

We also see tremendous improvements in the political relationship between the United States and China. We've been informed that the meeting between President Bush and President Jiang that took place in Crawford, Texas in October was extremely cordial and an excellent dialogue has been established between the American and Chinese leaders. There are obviously still many differences in the way the two governments are structured as well as the priorities they've established, but the fact that we are developing an understanding relationship rather than a confrontational relationship would certainly signal the potential for a long period of peaceful relations in this region as we move forward.

The new designated leader of China, Hu Jintao, is said to be a very serious gentleman without much personality or sense of humor but we were told a story by the U.S. Ambassador to Beijing that paints a slightly different picture. (I'll be happy to share my technology with you story).

In the realm of commerce much of what happens in Hong Kong and China relates to the U.S. economy so allow me to talk about that.

Americans are the world's greatest consumers and their desire and ability to consume has been a very large factor in holding up the U.S. economy during the past year. It's also a major factor in helping the Chinese economy boom over the past few years.

When God created consumers he may have scattered them around the world but he most definitely put the most aggressive ones in the United States. I remember when Rudy Guliani was trying to get New York cleaned up and he told the New York taxi drivers that they had to start being polite. They responded violently by saying "Look, we're New York taxi drivers and we have a God-given right to be rude – so get out of here and don't tell us how to act." Well, the same applies to American as consumers. They feel they have a God given right to own everything and in most cases three of four of everything. Fortunately, most of them have pretty big houses to accommodate a lot of possessions.

I'm in the warehousing business and one statistic that I haven't actually seen but I know would be staggering is just how much, in terms of tangible goods, is kept in movers warehouses around the U.S. I'm sure it would be enough to furnish all the houses of all the people in several countries. This is the stuff that's excess and stored away – much of it never to be seen again. It's not the stuff actually being used in their homes today. My point is that Americans have taken on excessive consumption as something as natural to them as excessive eating. We're really good at it and we love being the world champions. This is what has kept economies around the world growing.

So, largely because of these consumers, the U.S. economy in 2002 grew at a respectable rate of about 2.5-3.0%. This compares with a rate of only .3% in the previous year. The third quarter growth rate in the United States was actually 4% but the last quarter of 2002 saw slower growth. This factor, combined with U.S. election results in November that were favorable to the Republican Party, was probably the motivation for the President to unveil his economic stimulus package now. This package is not intended to be a solution but it's exactly what it's called – a program to stimulate the economy. It's intended to put some money back into people's pockets and, hopefully, they will spend it, which will

create more jobs and growth in the United States. If this happens, the knock-on effect should be the renewal of overall consumer and business confidence and, possibly, get President Bush re-elected. The current President Bush is well aware of the fact that his father was not re-elected for a second term because the economy tanked after the Gulf War ended. His father went from a 90% approval rating to being booted out of office in a little over a year. George W. will do everything in his power to avoid that fate.

The Bush stimulus package will be massaged and changes to it are inevitable. But with unemployment rising slightly and the economy in a lull at the moment, it's clear that Congress must push something through. If the Democrats block it, the President will tell the public "I tried to help you but the Democrats don't seem to care about your well being." The Democrats are trying to put forward a program that offers more benefits up front but the Republican version is a much larger package. There may well be a compromise that will reflect more instant relief.

Time will tell if the measures that are ultimately agreed to by Congress will have the desired effect but I think everyone agrees that it's good to see action being taken to give the U.S. economy a kick-start for 2003. Even though the real benefits won't be felt until 2004, with the passage of the legislation, people will know they will have more money to spend and will probably spend it in anticipation of receiving it.

The good news for the economy in the past year - and also looking ahead - is that interest rates are unlikely to change meaning there will still be cheap money around for a while yet. There are also no signs of inflation increasing. Inflation is being kept down to a large extent by the massive quantity of inexpensive products from China that are available in the United States.

I might add that on the subject of the increase in manufacturing output in China, that we recently had a large delegation of U.S. Congressmen and women visit us here in Hong Kong. This was the largest U.S. Congressional delegation to come to Hong Kong since 1997. They were mostly Democrats and mostly from strong labor areas of the United States. For those of you who may not be aware, each member of the House of Representatives has a constituency of about 600,000 people and they are elected every two years. As a result, they are much more interested in domestic grass roots issues - such as jobs. Senators on the other hand are elected for six years and tend to see the bigger picture on issues such as world trade.

These visiting Congressmen expressed very strong feelings that China was undermining the American ability to manufacture - thus costing the United States a lot of jobs - and they expressed the opinion that there would be far more aggressive stands in Congress against foreign trade in the future. As free trade enthusiasts we found it hard to agree with their views but I do believe that as more and more manufacturing jobs are lost in the U.S. and other countries of the world, a backlash against China is almost inevitable.

The biggest detriment to the growth of the U.S. economy has been the reluctance of businesses to expand their capital spending. As I mentioned, consumers have been doing their part but businesses have been very slow to make new investments either domestically or internationally. Business spending is the "key factor" in the health of the

U.S. expansion in the year ahead and it is unlikely to accelerate until the nation's conflict with Iraq is resolved.

Iraq is the reason people are thinking or saying that business investment in particular will continue to be retarded. It's an uncertainty that's expected to go away later in the year and lay down a foundation for growth.

Businesses are cautious in an environment of uncertainty and the potential for war in Iraq continues to cause that uncertainty.

In addition, the past few years have forced all companies that wish to survive to tighten their belts and this, of course, means reducing staff to the lowest possible level. It's for this reason that the unemployment rates in the major economies of the world are in the range of 5.5 –8.0% (the U.S. is about 6.0%). When the economic situation starts to improve, re-hiring staff is usually the last thing companies tend to do. They've worked hard to slim down and they don't want to inflate their workforce unless they feel that any economic rally is going to be sustained. Most economists anticipate a reduction in unemployment in 2003 and I would tend to agree but I think it will come at a very gradual pace and, as I've said, so much depends on any action in Iraq.

So the signs for the U.S. economy are a bit mixed but there are a lot of reasons to be hopeful because we know that there will be a strong focus on the economy in the run-up to the next presidential election in just twenty-two months. If the U.S. economy does strengthen, that can only be good for Hong Kong and China because it will call for increased purchases of consumer goods from this region and possibly increased American investment in China and Hong Kong.

I should also mention the U.S. dollar and the ballooning deficit. The dollar has been on a long bull run and is now starting to slide. I think that it will be moderately weak throughout 2003. Much support for the dollar comes from overseas countries investing in the U.S. and the fact is, it's difficult to find any real alternative to the U.S. when it comes to parking their money in a safe place. A weaker dollar will, of course, help Hong Kong and China and the big loser will be Japan who may well have to accelerate the transfer of their manufacturing to China because it will be far too expensive at home.

The other issue is the deficit in the U.S. A war with Iraq is expected to cost anywhere from US\$80-150 Billion. The Gulf War was also expensive but 60% of the cost was recovered from Kuwait, Saudi Arabia and Japan. It's not likely that the same will happen this time. The U.S. may have to bear most of the costs unless they plan to receive repayment in the form of Iraqi oil. The cost of the war plus the major tax concessions being proposed is predicted to run the 2003 deficit up to US\$275 Billion and this would increase to US\$350 Billion in 2004. Amazingly, measured against the size of our now US\$10.5 Trillion dollar economy this would be smaller in percentage terms than the deficits of the late 80's early 90's. However, it will have the effect of keeping the dollar weaker.

So my conclusion about the U.S. economy, as I think a real economist might conclude, is that there are a lot of factors to consider and there is no clear picture, but I'm an optimist

and I think it will be a relatively good year in the U.S. and the economy will grow at a pace of 3 to 3.5%.

A very brief word about Container Security.

Now I'd like to switch directions and give you a few thoughts about Hong Kong.

We have a situation in Hong Kong today where the average citizen is a bit pessimistic about Hong Kong and life in general. I ask myself, as I'm sure many of you do, "Why aren't the Hong Kong people more optimistic about this wonderful city?"

From almost the beginning of the 90's right up until July 1997 we had a situation in Hong Kong where:

- Unemployment here was 2.3% - that's virtually full employment. If any of you were here at that time as employers you might recall that retaining staff was a nightmare. There were so many jobs available that workers in all fields would leave for relatively small pay increases. Annual pay increments were at an unsustainable double-digit percentage for several consecutive years. This was inflationary and prices of everything rose dramatically. Some companies gave up on training staff because of the uncertainty of being able to retain staff. This was not a healthy situation for Hong Kong.

- Also during these years property prices were escalating dramatically. It was great if you were a property owner but a nightmare if you wanted to buy or rent. This was the formation of a classic property bubble and we were living in an unreal world of stratospheric property prices. Fairly ordinary apartments were selling for millions of U.S. dollars. Our residential and office property prices shot up to be the highest in the world. Sadly many people jumped into the market when it was at the top and these are the people that are dealing with a negative equity position today. The bubble burst.

- The stock market was a 'sure thing'. The Hang Seng Index moved from about 6000 in 1990 to about 17,000 in mid 1997. Everybody was jumping in. Profits could be made on almost every listed stock.

In short, it was an unreal world we lived in here but, sadly, for many people in Hong Kong, those crazy numbers of five years ago became the benchmark which they used as a standard and I know many people still long for those golden days to return when there was easy money to be made everywhere.

The end came at the same time as the handover but, ironically, it had nothing to do with the handover. The poorly managed economies started to crash around Asia in 1997, and Hong Kong, while it certainly didn't crash, could not avoid being caught up in the landslide.

Since July 1997 we have seen a steady downhill slide in many areas such as property and the stock market and we've seen a rise in unemployment.

In the last five years Hong Kong, like many world economies, has been subject to the Asian crisis, the technology crash, the 9/11 tragedy and its aftermath and the global economic slump. All of these events have been beyond the control of the Hong Kong Government or the business people here.

The memories of the golden days of the mid 90's combined with the prolonged adjustment period that's resulted from external economic forces is, in my opinion, the major cause of concern and pessimism among many of the people of Hong Kong today.

Many of the citizens of Hong Kong that have been caught up in this slide ask themselves why it's happening. To a large extent, the fact that it coincided with the handover would lead them to believe it's the fault of the administration of Tung Chee-hwa. As a matter of fact it seems to be the national sport in Hong Kong to berate government officials about everything that's a problem here. I would have a hard time agreeing that the issue is that simple.

Hong Kong is an economy that is, and has always been, ruled by market forces. Just as people had the opportunity to make money in the boom times of the 90's without government interference, so we must adjust to the leaner times and not expect the government to solve all of our problems. We can't have it both ways. Either the government gets more involved and we pay for that through much greater taxes or we allow the market to operate freely. I certainly prefer to operate my business in a very free market environment with a low and simple tax structure. This has always been Hong Kong's attraction to foreign and local investors.

In my personal opinion, I don't really think there is much reason to complain about the situation in Hong Kong today.

I look at Hong Kong and I see the following realities.

Hong Kong is a very rich society. The GDP per capita today is nearly US\$25,000 putting us among the highest in the world.

Yet.....despite that

- Hospitalization for both inpatient and outpatient care is so inexpensive you might think of it as basically free.

I would add that the level of medical care must be good because Hong Kong has the second's longest life expectancy in the world slightly behind Japan.

- The first nine years of education in Hong Kong is free for everyone attending government schools with the next three years being very inexpensive.

- Over 50% of the people of Hong Kong live in free or highly subsidized housing. Another large group own, or are buying, their own homes.

- Approximately 65% of the people of Hong Kong are not subject to income taxes largely due to generous allowances put in place by the Hong Kong Government during the good days.

In addition to these things let me point out a few other joys of Hong Kong that are free.

- Hong Kong is one of the safest cities in the world and that has great value to anyone who loves to live without fear of being robbed or mugged. This is the result of an excellent police force and a strong legal system.

- We live in a very free and open society where there is constant criticism of issues in the media. We're debating Article 23 legislation but I haven't seen anything to indicate that our ability to speak up and complain about policy has changed or will change.

- Corruption is virtually non-existent in Hong Kong. Can that be said about many countries in this part of the world?

- We live in one of the most beautiful cities in the world but on this point even an optimist like me would have to add the qualification that we must see more progress toward cleaning up our sea and air. The environmental issues are continuing to be addressed but we must continue to push for further and more rapid improvement.

- Finally I would point out that consumer prices and property prices have been dropping far more than salaries since 1999 which makes Hong Kong a less expensive city for all of us. In 1997 Hong Kong's greatest failing was that it was exorbitantly expensive. We were considered to be uncompetitive when it came to attracting foreign investment. But costs have now come down. I would argue that deflation in a situation such as ours is not necessarily a bad thing. We needed to become less expensive.

Unemployment here is high at the moment but Hong Kong is employing 200,000 more people today than it did in 1997. I look for the economy to improve in 2003 and I think we will see unemployment drop to a level of 5.5-6.0% by the end of 2003.

With so much available to the people of Hong Kong free of charge and the cost of living continuing to drop faster than salaries I cannot be convinced that Hong Kong people are less well off today and certainly don't feel there is justification for the negative mindset that seems to be continuing.

A new report by the investment bank CLSA stated that the economic recovery in Hong Kong had begun in the third quarter of last year and we are now on the upward swing in 2003. They predict increased growth throughout the year and this will result in lower unemployment and a slowdown in the rate of deflation.

There is a psychological problem among many in Hong Kong that probably stems from the fact that the glory days of the 90's have disappeared and it's hard to see what lies ahead. My advice to the people of Hong Kong is – "Count Your Blessings" and appreciate the joys of this place you live.

The new expanded area of Hong Kong and the Pearl River Delta create a huge new economy that we can benefit from. Hong Kong will be a great force in shaping the region by using our skills as international traders, financiers, logisticians and dynamic businessmen with long established links to the other economies of the world. We're really good at these things and the much larger economy that we will be part of can only enhance our prospects for more business opportunities.

How could a person **not** be optimistic about the many opportunities this presents?

So what do I see ahead?

I see a rebounding economy in 2003. Our GDP growth in 2002 will most likely exceed 2% - which will be more than double that predicted in the Financial Secretary's Budget Address last March (I predicted 2.5%) - and I believe our GDP growth will be at least 4% in 2003. I base my optimism on the fact that Hong Kong will continue to solve its economic problems and the U.S. economy will continue to improve. I also see China continuing to have solid growth with some of the benefits - such as many more mainland tourists coming here - rubbing off on Hong Kong. I also believe that deflation will slow this year as the economy revives.

The deficit here in Hong Kong is high and certainly will not be eliminated in 2003 but steps have been announced in the Chief Executive's Policy address to reduce it and more specifics will be forthcoming in the Budget Address in the weeks ahead. It's encouraging to note that the size of the Civil Service has already been reduced from a high of nearly 190,000 in 1998 to about 175,000 now and it will be further reduced to 160,000 in the years ahead through a freeze in hiring and normal retirement. Further government cost reductions are underway and, in my view, as long as government is taking this action aggressively, the community should be willing to chip in as well. Everyone should be required to sacrifice a bit to help balance the books. We in the American Chamber were delighted to hear the Chief Executive adamantly say last week that there will be no Sales Tax in Hong Kong. We have submitted this view to the Hong Kong Government because we feel there are far better ways to solve the deficit - starting with cost reductions and getting the economy going again.

Let's face it. Hong Kong is not going to run out of money anytime in the near future so we still have time to fix our problems.

I think we will see unemployment drop to a level of 5.5-6.0% by the end of 2003. In the past several years, companies have had to be cautious in their staffing in their attempts to become lean and efficient in a slow economy. When they do this, rehiring people is the last step taken when the rebound occurs. The interesting thing about employment in Hong Kong is that there have been over 200,000 additional jobs created in the past five years so the workforce today is larger than it's ever been. However, with 65,000 new people coming into Hong Kong each year we need to create even more new jobs to keep up. With many new projects such as Disneyland, the airport Exhibition Center, the new government offices, the Western Kowloon project and others coming up, I think we will see more jobs being created and unemployment will gradually decrease.

One other point I'd like to make relative to the subject of cutting costs. In Hong Kong, as in other parts of the world, businesses have been cutting costs for a number of years now. All of us, regardless of our industry have felt that. The cycle of becoming more competitive has resulting in companies becoming much more efficient. I contend that because of that tightening up, companies in Hong Kong stand ready to perform extremely well in the years immediately ahead and we'll see very exciting results from those companies that have taken strong action to cut costs during the lean years we've just been through.

My view is that whether you were born and raised here or came here last month. Whether you're here on a 2-3 year assignment or you've made Hong Kong your home for decades, you have to be excited about this city and all it has to offer.

A recent survey taken by the AmCham in Korea asked a large group of Fortune 500 companies operating in the Asia Pacific Region numerous questions about tax, labor flexibility, foreign exchange controls, work permits and other issues. The cities being rated in the survey were Shanghai, Singapore, Tokyo, Hong Kong and Seoul. Hong Kong was rated the highest in many categories and the highest overall. This is one more indication that people outside of Hong Kong, and particularly multinational businesses, think this is the greatest city in Asia.

Ladies and Gentlemen, I'm fully aware that we have issues to deal with in Hong Kong. What city or country doesn't? It's not my intention to over simplify things here or ignore issues that we have to deal with as we continue to build this great city. Every society must face this. However what I had hoped to do in this talk is create a view – maybe you could call it a Balance Sheet – that would show the tremendous assets we have in Hong Kong, both tangible and intangible, and ask ourselves if we really justified in our negatives views and steady stream of complaints.

My hope for this year is that everyone will look around them and see that things are not so bad after all. We have a lot going for us and there is plenty of reason to be excited about the next few years. I hope our economy will do well this year but most of all I hope we will see more smiles on the faces of the people of Hong Kong.

Thank you very much.