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# The Golden Gang of Three

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How did three highly successful island economies in the western Pacific achieve their solid fiscal records?

Taiwan, Singapore, and Hong Kong have been cited as having the best performing economies in a field of 85 countries. The U.S. ranked 25th in the survey, which covered the period from 1974 to 1981.

Using the 1973 oil crisis as the starting point, *Euromoney*, an international financial monthly, employed a weighted formula of five variables: economic growth, rate of inflation, strength of SDR (special drawing rights) exchange, export growth, and balance of payments. While most countries blame the price of oil as the primary cause of sluggish economic growth, the front runners ironically have a common handicap—a lack of oil to fuel rapid industrial expansion. Other similarities among Taiwan, Singapore, and Hong Kong are superficial, the study said, and can easily be misleading. All are island economies that depend on manufacturing for export. The population in all three is ethnically Chinese. And all three have strong central governments. The similarities end there.

The differences, in fact, far outweigh the similarities. Singapore is a sovereign republic, while Taiwan wants to assert a sovereignty that most of the world refuses to recognize. Hong Kong is a colony where people do not vote and are not interested in the vote. Government intervention in business is markedly strong in Taiwan, selectively assertive in Singapore, and comparatively weak in Hong Kong. Taiwan has a semblance of a primary economic base: agriculture. Both Singapore and Hong Kong have practically no such base.

Hong Kong is ahead in the tertiary services sector —banking, finance, transport and tourism, social and personal services—followed by Singapore. Finally, the fiscal policies of the three countries are diverse, although all have the objective of raising revenue.

The fiscal policies of these countries will be examined in this article. The fiscal strategies employed to achieve economic objectives will be surveyed, but no attempt will be made to reconcile how the different fiscal policies achieve the same objective. The economic achievements of the three countries will be outlined and the investment outlook surveyed.

## TAIWAN

The Organization of Economic Cooperation and Development (OECD), a grouping of the world's industrial countries, recently nominated Taiwan as one of the ten "newly industrialising" countries. Dr. Herman Kahn of the Hudson Institute in New York attributed the Taiwan economic miracle to the "fostering of a dedicated, motivated, responsible, and educated citizenry and a sense of commitment, organizational identity, and institutional loyalty." When Cesar Virata, the Philippines's prime minister, was asked how it was that Taiwan was so much ahead of his resource-rich country, his answer was simply, "Well, they are different. They were trained by the Japanese." Indeed, Taiwan was occupied by Japan for 50 years, just as the Philippines was under U.S. tutelage for almost 50 years.

Traditionally, Taiwan was a two-crop economy, sugar and rice. When the retreating armies of Chiang Kai Shek took refuge on the island, the lesson of defeat they brought with them was the tactic of victory employed by Chairman Mao—land for the landless. In 1951, the Kuomintang government instituted a massive land reform. It also provided incentives for raising farm productivity, thereby increasing purchasing power. With the expansion of the agricultural industry, the government turned to strengthening the island's physical and social infrastructure, in particular making education available at all levels. This set the environment for growth. Today, 95 percent of the young workers of Taiwan have received at least eight years of education.

In the late fifties, the economic planners developed the manufacture of a wide variety of consumer goods. This reduced unemployment, further increased purchasing power, and widened income distribution. To encourage private savings and capital formation, attractive interest rates were coupled with tax incentives. Finally, to overcome the limited size of the domestic market, export-oriented industries received massive government assistance in the form of tax relief, soft loans, and other measures to be discussed below. This strategy succeeded beyond everyone's expectations. In the fifties, the total trade amounted to about a third of a billion U.S. dollars. In a little over two decades, it grew to US$24 billion, a 70-fold increase. In the fifties, manufacturing accounted for less than 14 percent of the gross domestic product (GDP). Today, it represents more than 30 percent and is comparable to most developed western European economies. By 1978, this island state of 17.6 million people was the eighth largest trading partner of the U.S. and its fourth largest supplier of manufactured goods after Japan, Canada, and West Germany.

The government's fiscal policy is geared to raising revenues to meet the needs of both public investment and government services. Sustained economic growth increases tax revenues, of course. In fact, Taiwan's revenues since 1964 have outpaced the increase in government investment and expenditures—despite inflationary obstacles.

To maintain its growth pace, the government has employed imaginative fiscal incentives. These measures necessarily resulted in lower revenues from profits tax, but they did not result in a deficit. The government counterbalanced this by establishing customs and tariff measures which insulated domestic industry from outside competition. However, the tariff wall was built with several openings. Doors were designed for foreign manufacturers to import capital goods with high technology. They also were designed for manufacturers who will produce goods for export, train workers in superior production techniques, and introduce efficient management and marketing strategies. Manufacturers who bring new ideas and products may own 100 percent of their operations and may remit all profits plus repatriate 20 percent of invested capital annually. Thus, the doors are open to go in and out.

In addition to a five-year tax holiday, there is an exemption from tariff duties for experimental instruments and equipment not domestically produced. To top these perks, up to 90 percent of the total letters of credit for export sales will be financed with soft loans, generally at about half the prevailing discount rate. The purchase of plant premises—of up to 70 percent of cost—also can be financed with low rates for as long as 10 years. Many real estate taxes, sale taxes, stamp duties, and municipal taxes also have been drastically reduced.

The tax and nontax incentives have worked. But will they continue to work? The cloud that hangs over Taiwan is really the protectionist sentiment in the developed countries. Taiwan is slowly lowering its tariff walls in response to this sentiment. But it will need to import greater technology to increase the value of its exported products. Quality will have to replace

quantity. Because Taiwan is no longer a labour-surplus economy, capital intensity will have to take the place of labour intensity. With lower tariff revenues to finance the restructuring of industrial production, however, it is doubtful whether the budget surplus can be maintained forever. No longer can the 10,000 postal savings banks, which accept deposits even on Sundays, finance the required restructuring of industrial production. In about five years the economy will mature, and with maturity comes an industrial economy's problems of deficits and inflation.

On the other hand, Taiwan is not a highly leveraged economy. Its foreign debt, in fact, is smaller than its foreign currency reserves. Taiwan has recourse to the world's capital markets. Thus, an economy which attains this level of industrial development can compete. If the "commitment, organizational identity, and institutional loyalty" are kept intact, Taiwan not only will compete, it will compete well.

## SINGAPORE

Fifty years ago, according to W. Somerset Maughan, the busy streets of Singapore were filled with rickshaws, sweaty, fat Dutchmen, masters of tramp steamers, out-of-work mining engineers, planters from the Malay peninsula on vacation, wealthy merchants giving lavish luncheon parties, Chinese, Malays, and Sikhs. The characters you meet in Lee Kuan Yew's island republic are still the same, except their jobs have changed.

Dutchmen are more likely to be shipping executives of container shipping lines. The engineers are probably designers of rigs. After all, Singapore is the world's largest builder of jack-up rigs and the second largest builder of submersibles. The planters on holiday of 50 years ago are today log exporters from Sarawak and Sabah. The luncheon parties are replaced by bankers' closing cocktail parties. The population is still Chinese, Malay, and Indian. Richshaws, however, have given way to Datsuns.

The British East India Company founded Singapore as a trading station more than 160 years ago. Entrepôt trade and commerce was and still is an important element (about 25 percent) in the composition of Singapore's GDP. Transport (14 percent), manufacturing (27 percent), financial and business services (15 percent) basically make up the economy of this island state of about 2.4 million people. The financial sector was the fastest growing industry last year. It is the sexy sector of the economy. The government is actively pursuing its expansion as the pay scales in this vibrant area begin to compare with most western economies. Manufacturing, however, remains the largest component of the GDP and still rates high on the scale of government priority.

The economy grew at an inflation adjusted rate of 10.2 percent in 1980. The government hopes to maintain the momentum between 8 to 10 percent growth annually over the next decade, a projection that is not really out of line with other nations in the region. This rate of expansion is about two to three times greater than in Europe and North America.

A disciplined work force, constantly exhorted by the government propaganda machinery to adopt "the Japanese way of thinking," is the stellar attraction Singapore offers foreign capital. The loft and wings of Singapore's stage are packed with tax and nontax incentives.

For the manufacturing sector—considered by the government as a pioneer industry—a tax relief of five years, or a longer period not exceeding ten years, is liberally granted. Dividends declared out of the exempt income is similarly exempt from tax when it reaches the hands of investors. And if a manufacturing concern contemplates expanding its production through capital investment of about US$5 million, it will receive tax relief for five years. Similarly, a company engaged in the production of goods for export can secure a tax relief on its export profits.

To the commercial and trading sector, the government gives a wide variety of incentives. Companies engaged in warehousing or in servicing products for reexport receive a 50 percent discount on export profits. A company engaged in consulting, engineering, or management can take home 50 percent tax-free income from overseas projects. When local companies promote exports in foreign trade fairs, conduct foreign market studies, or publish promotional export materials, they get a double deduction for expenses incurred, subject to certain limitations. As for the banking and financial services sector, profits generated from loans to borrowers outside Singapore are taxed at the minimal rate of 10 percent.

This wealth of incentives has proven successful in attracting foreign capital and expertise to Singapore. However, the tack which Singapore must take to justify its recent wage increases must be bold; otherwise, its competitive stance may be lost against such low-wage cities as Manila, Djakarta, or even Kuala Lumpur. Productivity must improve radically; the value added to raw materials must be high; and research and development for high technology products will have to be encouraged.

The 1982 budget was structured to increase productivity, (including through personal income tax cuts) and to encourage industries in the services sector. The targeted productivity increase is between 6 to 8 percent annually. Computer programming, consulting, and financial services are the areas which the government hopes to be the leading edge of the 10 percent

inflation-adjusted growth of the economy. If the government succeeds in its objective (and on its track record alone there is no reason why it shouldn't) Singaporeans will reach Japan's current level of per capita GNP by the end of this decade.

As a financial centre, the government has several ideas to attract insurance services and fund management services. More regional and international companies will be encouraged to list their shares on the local stock exchange. Members of the Singapore Gold Exchange, either as brokers or dealers, are now taxed 10 percent on transactions in gold bullion.

In order to sell high skill and high value-added medical services, tax incentives are being considered for investment in hospitals and in medical equipment. Apart from training more doctors, Singapore's medical registry will be opened to qualified foreign doctors without the necessity of reciprocity.

Tax liberalisation policies also are being studied to include:

- Revised depreciation schedules to encourage automation.
- Accelerated depreciation for computers and R & D equipment.
- Further incentives for R & D.
- Incentives for offshore leasing.

The overall development strategy is to encourage Singaporeans to change their work ethic, to study more, and to produce more goods and services with practically the same number of workers in the same amount of time. There will be no room for idle hands or minds. In return, workers will get higher pay and lower taxes.

To some this is an ideal; to others it may be an unacceptable regimentation. Many say it takes away the very creative and innovative force that propels growth in Singapore today. Lee Kuan Yew does not really have a successor as the chief executive officer of Singapore, Inc. There is little doubt that the eloquent leadership and imagination of this Cambridge-educated barrister will pull the plan through to the next decade. His successor, however, may have problems. With a higher standard of living comes such mundane ideas as flexibility, less regimentation, and more freedom.

Some students have started to grumble. A member of parliament in opposition to Lee Kuan Yew's People's Action Party was elected in an October by-election—the first time this has occurred since the sixties. The challenge of the future is how to loosen the reins of government. Singaporeans may no longer be content after three years of an annual 20 percent pay increase. They may start to ask, if not demand, intangible benefits. As a petite student of French in Singapore's National University aptly put it, "Singaporeans will no longer be content with what is mandated they should get. We will stand up one day instead of simply sitting under a tree waiting for Godot."

## HONG KONG

A family of four, on arriving in Hong Kong from Manhattan, took a taxi through the harbour tunnel. When the taxi surfaced on the Hong Kong side, the four-year-old girl told her father, "Papa, we are home." Obviously, the little girl thought they had just crossed the Lincoln Tunnel under the Hudson and surfaced amidst towering buildings on 42nd Street.

Hong Kong's population, like that of Manhattan's, lives and works at an urgent pace—the pedestrians weaving their way through the congested noisy traffic or hurrying along crowded pavements from one air-conditioned office to the next. Shops in Central Hong Kong are as elegant as those on Fifth Avenue in midtown. Shopkeepers in both cities are not there to develop sales; they are there to sell, period.

Students of history probably will conclude that it was simply an aberration in the normal course of human events when, in the second half of the 1940s, 600,000 people packed into one small island and a tiny beachhead on the rugged South China coast remained insulated from an upheaval that changed the lives of one of every four human beings on this planet. Hong Kong emerged from World War II with a devastated economy. But entrepreneurs were quick to reestablish their warehouses. Between 1947 and 1957, the value of total trade increased at an annual average of 35 percent.

In 1952 disaster struck the colony when the United Nations imposed a trade embargo on China. Exports to China plummeted from HK$1.6 billion to HK$100 million 10 years later. Meanwhile, as refugees from China were swelling the population, the U.S. and the U.K. quickly replaced China as the largest markets for Hong Kong's exports—which became light, locally manufactured goods. Thus, the trade embargo with China forced a structural change in Hong Kong's economy, from essentially one of trading to one of fabrication and manufacturing.

Thus transformed, Hong Kong entered the 1960s well equipped to cash in on the rapid expansion of world trade. Manufacturing became the largest contributor to the GDP and to employment. In that decade, exports from Hong Kong to the world increased by more than 300 percent. The population increased, too; today it stands at five million.

The discipline of the marketplace appears to have worked well in terms of trade and the restructuring of industry in Hong Kong. The former financial secretary (now chief secretary) of the British colonial administration, Sir Philip Haddon Cave, said, "I believe passionately that if the mixed economy as we know it is to survive, the free-market forces should dictate the economic life of the community." Nowhere is this better illustrated than in the realm of fiscal policy. Hong Kong, to many investors and professionals, is a "tax haven." With the corporate income tax at 16.5 percent and individual income tax at 15 percent, Hong Kong indeed appears to be a comparatively low tax jurisdiction.

This tax structure has been used as a model by conservative economists to demonstrate that low taxation propels economic growth and that it has been the primary instrument in transforming Hong Kong into an industrialised economy. However, any society at this stage of development requires government infrastructural support to function. Hong Kong provides such support. It has free medical services for the needy, government hospitals, some of the free world's most extensive (per capita) public housing, and a very good, albeit crowded, road network. These services require tremendous amounts of capital investment, of course, but the capital comes not from tax revenues. It comes from income of a capital nature.

Estimated revenue and receipts for tax revenues in 1980-1981 amounted to about 38 percent of the total government revenue. Land sales, revenue from property and investments, and rates on real property account for over 40 percent of the total government revenue. Because it directly benefits the government to keep land prices and redevelopment fees extremely high, rents and real estate prices are the highest in the world. The government finances all of its capital expenditures from the income derived from its capital—that is, land, since practically all of it belongs to the government as the Crown lessor. Thus, the taxpayer may be paying low taxes, but his rent is sky high. In terms of take-home pay and costs to the employer, Hong Kong is more expensive than either New York or London.

The euphemism used by the colonial administration to describe its fiscal policy is "neutrality." Again, in Sir Philip's words, neutrality means "neutral with regard to the growth rate of the economy, neutral as regards to cost/price structure, at least neutral and preferably (positive) to enterprise and investment. Having designed our fiscal policy. . . if the consequence is that we have a lot lower-based tax system, that is the consequence. . . it's not an objective."

Therefore, Hong Kong does not grant any tax incentives to investors, whether foreign or domestic. With comparatively low tax rates, foreign investors do not look for or expect tax breaks or tax holidays. On the other hand, the same foreign investors, with their unflinching allegiance to free enterprise and to fair, open competiton, are vociferous in protesting against the "unconscionable" price of office space and living accommodations. These free enterprisers are, ironically, the vanguard of the forces for rent controls. Rightly or wrongly, the action of these foreign investors is simply a logical and opposite reaction to Hong Kong's neutral fiscal policy—neutral to the taxation of enterprises and individuals but monopolistic and manipulative vis-a-vis property prices.

Despite higher rental and even higher taxation of offshore earnings of banks situated in the Colony (16.5 percent vs. 10 percent in Singapore), Hong Kong remains the international financial centre of Asia. The growth of the financial services sector is nothing short of phenomenal. In less than 10 years (1971-79) its contribution to the GDP increased from 14 percent to 21 percent. The initial stimulus that triggered the expansion was the consistent growth performance of the economy. Also contributing was a policy of positive noninterventionism in the economy and, more particularly, of minimum regulation of, and minimum reporting requirements for, banks and other financial institutions, plus a stable fiscal system with relatively low tax rates.

Any guesstimate as to Hong Kong's future must necessarily dwell on the expiration of its lease. Indeed, given that 1997 is but 14 years away, it is becoming exceedingly difficult for many to comprehend how today's accelerated growth can be sustained in trading, manufacturing, and financial services.

What the U.K. will do is hardly relevant. The standard line here is that all it will take is a telephone call from China advising that the People's Army is moving in, and the Prince of Wales' own Gurkha Rifles will move out. Nor is international law really the issue. What matters is that China does not recognize what it refers to as the "unequal treaty" which ceded Hong Kong in perpetuity and leased the New Territories to the U.K. The economics of China's tolerance of the British "management" of the Colony is what really counts.

About 70 percent of Hong Kong's water supply comes from China. Practically all of its fresh food comes from China. It is reported that about 25 percent of the credit extended to Hong Kong borrowers is provided by China's 13 banks and finance companies operating in Hong Kong. On the other hand, Hong Kong is the prime source of China's foreign exchange. Estimates vary, but between 40 percent and 70 percent of China's hard currency is earned from or through Hong Kong. China's government corporations are major investors in Hong Kong real estate as well as the stock market.

Many observers rely on these facts to reinforce the belief that China will simply not make that telephone call. The proposition most businessmen, political observers, and China watchers agree on is this: as long as China needs a window to trade with the world, a place to raise foreign exchange, and a training ground on how to deal with a free-market economy, it will not make that telephone call. If, in 14 years, it can open new windows, find other markets to raise hard currency, and develop new training grounds for its cadres in free enterprises, it may yet make that call—collect. But why should China want Hong Kong back? The answer is simple: it is Chinese; and it is China. ▲