Economic Analysis of the Minimum Wage Ordinance & Individual Visit Scheme

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Economic Analysis of the Individual Visit Scheme in Hong Kong
Background of IVS

2003 SARS, economic downturn

- Slow real GDP growth
- Unemployment rate rose to 7.9%
- IVS to stimulate the economy
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Individual Visit Scheme (IVS)

- Permanent residents from selected mainland cities
- Allowed to visit Hong Kong and Macao in their individual capacity
- Covers 49 cities from 18 provinces
  - Guangdong Province, Beijing, Shanghai, Chongqing...
Importance of IVS

Total number of visitor arrivals in 2013
- 54.3 million
- an increase of 11.7% when compared to 2012
- 350% of the figure in 2003

Mainland visitors
- Taking a larger proportion over time
- Mainland visitors >50% since 2003
- IVS > non IVS since 2007 (67.6% in 2013)
- IVS accounted for 50.6% of total visitor arrivals in 2013

Source: Hong Kong Annual Digest of Statistics, various years
Importance of IVS

Sources of Inbound Visitors Year 2000

- The Mainland of China: 29%
- USA: 18%
- Europe, Africa and the Middle East: 14%
- Japan and Korea: 9%
- South and Southeast Asia: 8%
- Taiwan: 9%
- Others: 13%

Source: Hong Kong Annual Digest of Statistics (2001 and 2014)

The Mainland of China is the major source of visitor arrivals

Sources of Inbound Visitors Year 2013

- The Mainland of China: 75%
- USA: 4%
- Europe, Africa and the Middle East: 4%
- Japan and Korea: 4%
- South and Southeast Asia: 4%
- Taiwan: 2%
- Others: 4%

The Mainland of China is the major source of visitor arrivals
Properties of IVS: Where do they from?

- Majority from Shenzhen
- Followed by cities of Guangdong Province
- These two districts accounted for 80%
- Relatively few from more distant cities like Beijing and Shanghai

Source of IVS visitors in 2013 (Jan – Jun)

- Shenzhen: 49%
- Guangdong Province: 31%
- Shanghai: 4%
- Others: 13%
- Beijing: 3%

Source: Hong Kong Tourism Board
Properties of IVS: How long they stay?

Overnight vs. Same Day

- IVS visitors tended to stay shorter but with higher frequency
- Proportion of same-day visitors increasing since 2003
- Same day visitors: 64.9% in 2013

Source: Hong Kong Tourism Board
Properties of IVS: How much they spend?

- On average, IVS visitors spent more than non-mainland visitor.
- Major spending: Shopping + Hotel Accommodation.

**Average Spending per Day**

<table>
<thead>
<tr>
<th>Spending Level (HK$)</th>
<th>Overnight Non-Mainland</th>
<th>Overnight IVS</th>
</tr>
</thead>
<tbody>
<tr>
<td>HK$0</td>
<td>HK$1,970</td>
<td>HK$3,593</td>
</tr>
</tbody>
</table>

**Spending of overnight visitors**

- 購物 (shopping): 12%
- 酒店住宿 (hotel accommodation): 9%
- 酒店以外膳食 (meals outside hotels): 6%
- 雜項服務 (miscellaneous services): 73%

Source: Hong Kong Tourism Board
Benefits of an Industry

• Value-added
  – the net output, i.e. the value of gross output less the value of intermediate consumption (the value of goods and services used in the course of production)

• Employment opportunities created
VA of Inbound Tourism

• Tourism in the 4-pillar industries
  – Smallest in the 4 pillar industries
  – Contribute about 5% to GDP in 2013

Value Added of the 4 Pillar Industries in 2013

- Tourism 5%
- Financial Services 17%
- Trading and Logistics 24%
- Professional Services and Other Producer Services 12%
- Others 42%

Source: Hong Kong Annual Digest of Statistics
VA of Inbound Tourism

Contribution of Tourism in 2012: 4.7% of GDP
  Inbound Tourism: 3.9%
  Outbound Tourism: 0.8%

Tourism is not an *industry*!?
instead of fitting into a single product or service category, the expenditure on tourists brings benefits to various sectors of the economy.

Tourism Value Added (TVA)
• value added by industries providing goods & services directly to visitors
• Inbound tourism: 2.5% - 4% to the nominal GDP

In 2012, IVS
• around 50% of all visitors
• 33% of inbound tourism industries total value-added

Source: Sung (2014)
VA of Inbound Tourism

4 Major Tourism Industries in HK:

- Retail Trade
- Food & Beverage Services
- Passenger Transport
- Accommodation Services

Proportion of TVA of major tourism industries in 2013

Source: Hong Kong Annual Digest of Statistics (2014)
Employment of Inbound Tourism

- Tourism in the 4-pillar industries
  - Rank 3rd in the 4 pillar industries (followed by Financial Services Industry)
  - Contribute about 7% to employment in 2013

![Pie chart showing the contribution of employment by sector]

Contribution of Employment

- Tourism: 53%
- Financial Services: 21%
- Trading and Logistics: 13%
- Professional Services and Other Producer Services: 6%
- Others: 7%

Source: Hong Kong Annual Digest of Statistics (2014)
In 2012,
• 250,900 employment opportunities are created by tourism
• 6% of total employment
• 2.4% contributed by IVS alone (Sung 2014)

Source: Hong Kong Annual Digest of Statistics (various years)
Employment of Inbound Tourism

Characteristics of Employment in tourism

- Labour intensity (ratio of employment to the value-added)
- the number of jobs existing in the sector per unit of value-added or product of the sector
- The larger the ratio, the more labour intensive an industry is.

Ratio of Employment to Value-Added (in million HKD) of the Four Pillar Industries, 2012

Source: Census and Statistics Department
Employment of Inbound Tourism

Characteristics of Employment in tourism

• Eurostat (2008)
  – Relatively a larger number of young (aged under 35) and female workers
  – workers with lower educational qualifications
  – a higher proportion of temporary jobs

• Higher accessibility: relatively low educational attainment, age, and recruitment requirements

• Higher flexibility: more workers are employed in a part-time basis
Employment of Inbound Tourism

Characteristics of Employment in tourism

Source: Report on Annual Earnings and Hours Survey (2012)
Costs of Inbound Tourism

1. Opportunity Cost

Opportunity cost of providing accommodation services
= Cost of hotel construction + Value of sports complex
Costs of Inbound Tourism

2. External Cost

Externalities (界外效應) arise when third parties are affected by a transaction or an activity uncompensated.

A typical example of external costs (or negative externality) is pollution – by-standers or even the society as whole are adversely affected when there is air pollution as a result of factory production.
Gago and Labandeira (2006) attempted to explore the external cost associated with tourism and analyzed the impacts of imposing tourism tax to relieve the negative effects of inbound tourism.
Costs of Inbound Tourism

External Cost

- Overproduction
- SMC > SMB
- DWL

<table>
<thead>
<tr>
<th>Price</th>
<th>Social Marginal Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Supply (Private Marginal Cost)</td>
</tr>
<tr>
<td></td>
<td>Demand (Private Marginal Benefit)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Quantity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social Optimal Q</td>
</tr>
<tr>
<td>Market Q</td>
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</tbody>
</table>

Deadweight Loss
Costs of Inbound Tourism

In theory, the problem caused by external costs could be solved if the government imposed a *corrective tax* (修正租稅).

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<th>Quantity</th>
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</tr>
<tr>
<td><strong>Demand (Private Marginal Benefit)</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Market Q before Tax</strong></td>
<td><strong>Market Q after Tax = Social Optimal Q</strong></td>
</tr>
<tr>
<td><strong>Market Q after Tax = Social Optimal Q</strong></td>
<td><strong>Price</strong></td>
</tr>
</tbody>
</table>

However, in practice it is very difficult to estimate the size of external cost.
Costs of Inbound Tourism

• The external cost of IVS is very difficult to quantify (e.g. over-crowded environment in some districts)

• Much of these costs of becomes significant when the number of visitor arrival is high, relative to the capacity to receive visitors.
Costs of Inbound Tourism

• Traditional businesses and other small and medium enterprises (SMEs) were forced to close down or move to areas with lower rent.

• Multi-national and prestigious brands and corporations expanded their retail outlets and replaced the original local stores.
### Costs of Inbound Tourism

#### Change in Number of Retail Stores by Industries from 2004 to 2013

<table>
<thead>
<tr>
<th>Industry</th>
<th>Percentage Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cosmetics and personal care products</td>
<td>1500.0%</td>
</tr>
<tr>
<td>Wearing apparel and footwear</td>
<td>41.5%</td>
</tr>
<tr>
<td>Leather goods</td>
<td>32.9%</td>
</tr>
<tr>
<td>Jewelry and watches</td>
<td>30.5%</td>
</tr>
<tr>
<td>Audio and video equipment and photographic equipment</td>
<td>21.6%</td>
</tr>
<tr>
<td>Food stuff</td>
<td>4.7%</td>
</tr>
<tr>
<td>Medicine, health supplements and Chinese drugs</td>
<td>4.7%</td>
</tr>
<tr>
<td>Non-specialized goods(groceries of Chinese provisions and general household goods)</td>
<td>-29.5%</td>
</tr>
<tr>
<td>Books, newspapers and stationery</td>
<td>-25.4%</td>
</tr>
</tbody>
</table>

Source: Census and Statistics Department
Costs of Inbound Tourism

• Many claimed that shop variety has been reducing due to large number of visitor arrivals.
  – Daily lives of local citizens are affected
  – Traditional stores and some SMEs are affected
  – Heavy reliance on tourists
Income Redistribution Effect

• Rapid increase in shop rental rates
  – benefits landlords and chain stores especially luxury brand

• Contribute to employment
  – especially for low skilled labour

• Overall impact? May not be as straightforward as it seems.
Macro Theory: AD-AS Model

Aggregate Demand - the total demand for goods and services in an economy

$$\text{AD} = C + I + G + (X - M)$$

Spending by visitors:
- included in export of services
- $X \uparrow, \text{AD} \uparrow$
Macro Theory: AD-AS Model

Aggregate Demand

$AD = C + I + G + (X - M)$

Inbound tourism stimulates $C$
- $\uparrow$ disposable income
- $C \uparrow$

Inbound tourism stimulates $I$
- $\uparrow$ capital investment on tourism
- e.g. accommodation, restaurants

Multiplier Effect
Aggregate Supply - total supply of goods and services that firms in a national economy.

The aggregate supply is constrained by the production capacity.
Macro Theory: AD-AS Model

The impacts of IVS will be different when the economic conditions are different

When there is room for expansion...

When it is close to capacity...
Policy Analysis & Evaluation

Policy:

- Expand IVS to cover more cities
- Expand the scope of multiple-entry Individual Visit endorsement (M permit)

1. \(\uparrow\) in AD may be small

(a) Visitor arrivals
- slower expected income growth of mainlanders
- rising price level in HK
- Dropping exchange rate of other countries

(b) Lower-spending visitors
- people from the second or third tier cities
Aggregate Supply – are we getting close to the capacity constraint?

(a) Accommodation Service
- extremely high room occupancy rates
- inelastic supply of hotel rooms

(b) Public Transportation Service
- MTR expansion
  - constrained by the current infrastructure
  - constrained by the maximum train frequency

(c) Retail and Catering Services
- retail premises for stores
- labor constraints

Unemployment rate in recent years: 3.3% – 3.4%
lowest level since 2000
2. SRAS

depends on HK’s ability to produce

(a) HK is reaching production capacity
  • translated into inflationary pressure ($P\uparrow$)
  • hardly significant increase in real output ($Y\uparrow$)

(b) High rental rate of shops and labour cost
  • SRAS $\downarrow$
Conclusion
THE END

Thank you and questions are welcome!
Reference and Sources

• Sung, Yun-Wing (2014), Economic Benefits of the Independent Visitor Scheme for Hong Kong: How Large are They?, Shanghai-Hong Kong Development Institute, CUHK

• Cover photo: Patrick Cheung
• Images: Office.com
• Graphs: produced by author
• Data: Census & Statistics Department, HK Annual Digest of Statistics, HK Monthly Digest of Statistics, HK Tourism Board, Rating and Valuation Department, Report on Annual Earnings and Hours Survey