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To: Chair, LegCo Panel on Economic Services

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From: Leonard K. Cheng
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Subject: Disney Theme Park

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Thank you for inviting me to attend a special meeting of your panel this morning. Unfortunately, due to my prior commitments at HKUST, I am sorry I cannot attend the meeting. I would like to thank you for giving me an opportunity to make a few observations on the Disney theme park project proposed by the HKSAR Government.

1. I think that a Disney theme park will help to re-establish Hong Kong as a center of tourism. It is not clear how the trend of a weakening tourism industry can be reversed without a world class attraction such as the Disney theme park.
2. The proposed joint venture between the HKSAR Government and Walt Disney has been characterized by some local commentators as chicken and soy sauce. In terms of financial contribution this characterization seems correct, but in terms of economic benefits the analogy is totally misleading. The chicken offered by Hong Kong will not be of much value without a magical sauce that only a few companies in the world can supply.
3. Ideally, Hong Kong should try to get as good a deal as possible. But the reality is that we need Disney to help us reinforce our key tourism industry at a time when our macro economy shows weaknesses and our industries are looking for new direction. We are not in a strong bargaining position to get a large share of the financial gains but to shoulder a small fraction of the risks involved. So long as the economy as a whole gains from the venture, I think we should go ahead. If the terms of the joint venture can be varied, I would prefer Walt Disney to take a larger equity stake with corresponding increased privileges and responsibilities.
4. Based on the proposed equity and debt arrangement and the Government's description of the process of negotiation, it seems clear that Walt Disney is not keen to take a majority stake. Instead, it tries to minimize its exposure to risks by collecting management and franchise fees. Perhaps it is not very optimistic about the financial results of the venture. To ensure Walt Disney's commitment and to reduce the risks to the SAR Government, it would

be desirable to increase the equity share of Walt Disney (with corresponding contribution in resources, of course).

5. I have read the “Economic Assessment of the Hong Kong Disneyland Project,” a Briefing Paper prepared by the Economic Analysis Division of the Financial Services Bureau, to have a better understanding of what is called the “net economic benefit in present value over 40 years.” Two kinds of data are needed to calculate such a figure, namely, the flow of net economic benefit over the 40-year period and a “discount rate.” I think the discount rate of 4% or 5%, though substantially below the prime rate, would seem appropriate for a long-term project that is expected to generate significant benefits to the rest of the economy. However, I think equating “value-added” to “net economic benefit” is conceptually wrong, and is hard to justify as a reasonable approximation over a period as long as 40 years.
6. The value-added generated by any project is equal to the sum of wages and salaries, rent, profits, and other returns to assets. In contrast, the net benefit of the project is equal to the value-added generated by the project less the value-added that would have been generated by the local factors of production in the absence of the project. The latter measures the opportunity costs of these factors. Only if the factors will remain unemployed, thus yielding zero value-added, in the absence of the project will it be true that the net benefit is equal to the entire value-added. One may argue that now and in the near future Hong Kong suffers from serious unemployment, so the opportunity costs of factors employed by the theme park are very low. However, this cannot be true for the entire period between 2005 and 2045. That is to say the so-called “net economic benefit” as presented by the Government would be biased upward, perhaps quite seriously.
7. Not to be misunderstood, I should clarify that I do not think the net benefit will be negligibly small if Hong Kong is close to full employment. The factors employed by Disney might be more productive than if they are employed by other alternative industries. To the extent that is true, Disney will still bring net economic benefit even with full employment.
8. Similar comments can be made about the employment effect of the project. The employment generated by the project represents a net addition to total employment of the macro-economy only if the workers employed by Disney will remain unemployed without the project. In a situation close to full employment, an increase in the employment in one sector is likely to be offset by a decrease in employment in other sectors. Thus, the Keynesian income-employment multiplier effects are not likely to be valid over the entire 40-year period.
9. To sum up, the figure of \$148 billion of discounted net economic benefit for the Base Case seems like a serious over-estimate of the what the Government attempts to measure.
10. Against my above comments, I see substantial indirect benefits to be derived from the project. I do not see any better project than the Disney theme park to help Hong Kong's international image as a cosmopolitan city. With that, the government will be more effective in attracting foreign direct investment to come to Hong Kong (the days that the government can count on its low profit tax alone and need not aggressively attract foreign investment are over). In addition, I believe the project will be a boost to investor confidence, which will speed up Hong Kong's economic recovery. Unfortunately, these indirect benefits in the short-run and long-run are not easy to nail down.