Long-run and Cyclic Movements in the Unemployment Rate in Hong Kong: A Dynamic, General Equilibrium Approach

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Summary

Prior to the late 1990s, low unemployment was a standard feature of macroeconomic life in Hong Kong. Between 1985 and 1997, the Hong Kong unemployment rate averaged 2.5 percent. The picture changed dramatically after 1997 with the unemployment rate rising to 6.2 percent by 1999 and remaining above 5 percent through 2005. What caused the large and sustained increase in the Hong Kong unemployment rate?

This paper provides some answers based on a model of the Hong Kong economy that has three important features. First, demand for domestic goods depends on household demand and exports. Second, imported goods are treated as inputs to the production of the domestic consumable good rather than as separate consumable products. Third, workers and firms bargain over wages so that unemployment occurs even in the long run. Parameters for the model are chosen so the model's predictions about variables like output per capita agree with average values computed using Hong Kong data for 1985 to 2005.

Two types of analysis are undertaken. First, I conduct a set of "what if" experiments to investigate whether the observed increase in Hong Kong unemployment is likely to be permanent and, if so, to determine what caused the permanent increase. Second, I conduct a short-run analysis to determine whether the observed path of the unemployment rate might have been a temporary, although sustained, response to temporary disturbances experienced by the Hong Kong economy. I conclude that the data favor the latter explanation.