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AND THE MANAGEMENT OF HONG KONG'S  
ECONOMIC AND SOCIAL DEVELOPMENT**

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# A Fragile Prosperity: Government Policy and the Management of Hong Kong's Economic and Social Development

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## Abstract

This paper examines the impact of 'ideological' preconceptions on Hong Kong policy-making both during and after the colonial era. An abiding commitment to *laissez faire* reflected demographic anxieties that were not dispelled by sustained, high-speed economic growth. Economic pessimism was encouraged by the influence of Malthus and John Stuart Mill and the rejection of Keynesianism although the economy was never as vulnerable as officials claimed. The analysis identifies the continuing costs, particularly for social policy, of official misconceptions about Hong Kong fundamentals.

Keywords: Hong Kong, Colonialism, Non-Interventionism, Welfarism, Population, Malthus

History makes a larger contribution to shaping day-to-day government behaviour in Hong Kong than in most modern societies. For all its differences with British colonialism, China's leaders recognised that Hong Kong had developed political and business systems essential to a flourishing capitalist environment. As a result, the economic and social policies and institutions that evolved under British rule have been entrenched in the Basic Law, the blueprint for post-colonial Hong Kong.<sup>1</sup> This constitutional document also provides for the continuing dominance of the business community in public affairs.<sup>2</sup> Thus, Hong Kong is locked by Chinese law into arrangements inherited from history, which makes the past a matter of immediate importance rather than academic interest.

The Chinese leadership's decision to perpetuate the past could be justified by Hong Kong's unique record. The colonial administration's overriding priority was economic expansion, and the results of that strategy have been widely applauded.<sup>3</sup> Throughout the second half of the last century, Hong Kong's economic record was superior to Asia's post-colonial states, and not even Singapore can produce convincing statistical evidence of a better performance.<sup>4</sup> With sustained high-speed growth came a level of social harmony and political stability which was equally impressive compared with the rest of Asia, despite the tensions created by alien rule and the absence of democratic government.<sup>5</sup> Hong Kong acquired a reputation for good government, sound policies and skilled administrators.<sup>6</sup> But impressive as the quality and delivery of public services were, the colonial administration was not very different at the policy level from the 'ramshackle appearance' said to be characteristic of public administration throughout the British Empire.<sup>7</sup> The capacity to produce sound policies, especially for longer-term programmes, was

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<sup>1</sup> On the achievements of British rule despite 'severe national oppression', see Liu Shuyong, *An Outline History of Hong Kong* (Beijing: Foreign Languages Press, 1997), p. 132.

<sup>2</sup> Lau Siu-kai, 'Tung Chee-hwa's Governing Strategy: The Shortfall in Politics', in Lau Siu-kai (ed.), *The First Tung Chee-hwa Administration. The First Five Years of the Hong Kong Special Administrative Region* (Hong Kong: Chinese University Press, 2002), p. 17.

<sup>3</sup> Among many examples of academic applause, see Christopher Howe, 'Growth, Public Policy and Hong Kong's Economic Relationship with China', *China Quarterly*, No. 95 (September 1983), p. 512.

<sup>4</sup> Comparative performances are discussed in Deepak Lal and H. Myint, *The Political Economy of Poverty, Equity, and Growth: A Comparative Study* (New York: Oxford University Press, 1996), p. 98; I. M. D. Little, *Collection and Recollections Economic Papers and their Provenance* (Oxford: Clarendon Press, 1999), pp. 197, 202, 228–9, 237–8.

<sup>5</sup> Siu-kai Lau, *Society and Politics in Hong Kong* (Hong Kong: Chinese University Press, 1982), p. 3; W. F. Jenner, *The Tyranny of History. The Roots of China's Crisis* (London: Penguin Books, 1992), p. 191.

<sup>6</sup> Ian Scott, 'The Public Service in Transition: Sustaining Administrative Capacity and Political Neutrality', in Robert Ash *et al.* (eds), *Hong Kong in Transition. The Handover Years* (London: Macmillan Press Ltd, 2000), p. 160; Lau Chi Kuen, *Hong Kong's Colonial Legacy* (Hong Kong: Chinese University Press, 1997), p. 32-3; Ahmed Shaiqul Huque *et al.*, *The Civil Service in Hong Kong. Continuity and Change* (Hong Kong: Hong Kong University Press, 1998), pp. 15-6.

<sup>7</sup> John Darwin, *Britain and Decolonisation: The Retreat from Empire in the Post-War World* (London: Macmillan, 1988), pp. 30–1.

handicapped by Hong Kong's inability to attract the best of the talent competing for posts in the United Kingdom's home and overseas civil services.<sup>8</sup>

At the same time, there has been a remarkable consistency in the official economic 'ideology' over the last 60 years. There has been an undeviating adherence, both before and after 1997, to a trio of self-denying covenants with the business community:

- a free port and free foreign exchange markets;
- small government, low taxation; and
- no government subsidies and minimal business regulation.

These commitments were not inevitable features of British rule. Although they had been universally honoured by the British Empire in its heyday, Hong Kong was already openly disputing their merits in the 1930s. The non-interventionism for which Hong Kong is now renowned is the outcome of decisions taken by Hong Kong officials after World War II, generally in defiance of Colonial Office policies.<sup>9</sup>

This paper attempts to trace how the prevailing economic dogmas emerged. It begins with Hong Kong's unique situation as a colony since it was not integrated into the United Kingdom, either commercially or financially. It explores the colonial administration's freedom to develop its own policies, regardless of London's wishes, and explains why the British rulers rejected Western models for economic and social development. It then explores the economic preconceptions of the last century's rulers and, in particular, their conviction that Hong Kong had a unique economic system which was self-regulating. As a result, the colonial administration was firmly opposed to any form of Keynesianism.

These attitudes can be attributed to the influence of the nineteenth century English intellectual, John Stuart Mill, this paper will argue. But they also reflect misconceptions among Hong Kong officials about the workings of a colonial currency board in a modern, commercial and industrial society once it has developed sophisticated financial institutions. The most potent influence of all, it will be claimed, was a Malthusian fear of population growth and a stubborn pessimism about the capacity of Hong Kong's people to maintain their prosperity. The paper concludes by illustrating how this sense of fragility has continued to affect policy making in the current century.

## 1. Why History Matters

The decision to preserve so much of Hong Kong's past in the Basic Law means that contemporary decision makers perpetuate the attitudes and responses of the last century to a remarkable degree, particularly in their budgetary and social policies. Budgetary management has been based on arbitrary

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<sup>8</sup> Steve Tsang, *Governing Hong Kong: Administrative Officers from the Nineteenth Century to the Handover to China, 1862-1997* (London: I. B. Tauris, 2007), pp. 182, 184-6. The author, it should be noted, takes a generally positive view of their performance.

<sup>9</sup> The change in official thinking which followed the resumption of British rule in 1945 is discussed in Leo F. Goodstadt, 'The Rise and Fall of Social, Economic and Political Reforms in Hong Kong, 1930-1955', *Journal of the Royal Asiatic Society Hong Kong Branch*, Vol. 44 (2004), pp. 62-4, 69.

guidelines rather than principles derived from systematic economic analysis, a structured social agenda or even comprehensive statistics. In many ways, officials have regarded the annual budgets as an accounting exercise which had only minimal impact on the economy, a disconnection from the business cycle that has attracted special concern over the last decade.<sup>10</sup>

This disconnection started with an attempt to ring-fence the government's reserves from the annual budget. From the mid-1960s, the Exchange Fund and the fiscal reserves were regarded as vital to the defence not of the economy as a whole but of the banks and the rest of the financial sector.<sup>11</sup> After the Asian financial crisis struck in 1998, the government stuck to this rule. In a brilliant exercise to halt the speculation that threatened the stability of both the stock and foreign currency markets, it 'diverted HK\$118 billion from the Exchange Fund ... and in less than three years had generated a return of HK\$100 billion'.<sup>12</sup> It was also willing to use part of reserves to maintain spending on capital works.

But domestic consumption was a different matter. The government did not hesitate to aggravate unemployment and deflation by reducing the size and payroll of the public service and by cutting social security benefits. In the five years from fiscal 1998, total government spending was almost constant although Hong Kong was suffering from its first economic recessions and its worst unemployment since the 1950s. This budgetary response was directly in line with precedents set by financial secretaries in the previous century. They had insisted that 'Keynesian' measures to counter economic downturns were impossible in Hong Kong's economic circumstances, although they did not hesitate to reflate the financial system when property and share bubbles burst and caused bank failures and corporate collapses in each decade until 1986.

The same budgetary preferences from the past continue to determine financial provisions for the social services. Historically, officials and business leaders have combined to set their faces against any form of social insurance that would protect individuals against sickness, unemployment and, above all, retirement. In the last years of British rule, considerable modernisation and expansion of the social services was introduced in disregard of criticism from business leaders and Beijing about the increased government

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<sup>10</sup> For a historical analysis, see Tang Shu-hung, 'The Hong Kong Fiscal Policy: Continuity or Redirection?', in Li Pang-kwong (ed.), *Political Order and Power Transition in Hong Kong* (Hong Kong: Chinese University Press, 1997), pp. 188-99, 203-5. For a review of recent budgetary behaviour, see Kui-Wai Li, *The Hong Kong Economy: Recovery and Restructuring* (Singapore: McGraw-Hill Education (Asia), 2006), pp. 190-5; Wilson Wong and Sabrina Luk, 'Economic Policy', in Lam Wai-man *et al.* (eds), *Contemporary Hong Kong Politics: Governance in the Post-1997 Era* (Hong Kong: Hong Kong University Press, 2007), pp. 183-4.

<sup>11</sup> Their role in the defence of the currency was publicised in 1961. The expectation that their use to counter deflation would be limited to the banking system was made clear in 1964. See the financial secretaries' statements in *Hong Kong Hansard (HH hereafter)*: A. G. Clarke, 1 March 1961, p. 46; J. J. (later Sir John) Cowperthwaite, 26 February 1964, p. 57.

<sup>12</sup> Donald Tsang Yam-kuen, Financial Secretary, *Government Information Services (GIS hereafter)*, 12 April 2001.

expenditure that followed.<sup>13</sup> Within the Hong Kong government itself, the budgetary implications of these innovations also caused concern. In response, measures were introduced during the 1990s to expand the fee-paying sector in educational and health services and to control welfare subventions, and these have been applied with increasing vigour ever since.<sup>14</sup>

## 2. A Choice of Loyalties

Hong Kong was able to evolve an economic 'ideology' very different from the United Kingdom and the other colonial territories because of its special economic characteristics. Throughout most of the colonial empire, the 'modern' sector of the economy was confined, with few exceptions, to export industries which were owned and controlled by United Kingdom companies. Historically, these raised their capital and bought their equipment from that country. The largest share of their export earnings was remitted to the United Kingdom as dividends to British shareholders, or to service London loans and to import British machinery. The result was a continuous export from a colony to the United Kingdom of capital resources, a distinguished colonial official pointed out before World War II.<sup>15</sup>

In the post-war era, the same complaint was voiced vigorously about the Third World as a whole.<sup>16</sup> But colonial economies seemed particularly vulnerable because of the high degree to which their economies were integrated into the United Kingdom. 'Whatever political and strategic reasons there may be for their being under the British flag', it was argued, 'from the standpoint of trade the colonial territories are essentially specialized producing parts of a widespread economy which has its financial, industrial, and managerial center in the United Kingdom'.<sup>17</sup>

Hong Kong, by contrast, was well-insulated against this unequal relationship. It was not part of the United Kingdom economic system, and China was the dominant influence on its development. Its trade and finance were integrated into global markets. Its own banks – not the United Kingdom capital market – were the major source of business capital. Its dominant banking institution, HSBC, then had its headquarters in Hong Kong, was controlled by Hong Kong legislation and was not part of the London financial system. Because of these special circumstances, Hong Kong's value added was not diverted to United Kingdom investors. Hong Kong officials were determined that this colony would not be exploited by the United

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<sup>13</sup> Alvin Y. So, 'Hong Kong's Problematic Democratic Transition: Power Dependency or Business Hegemony?', *Journal of Asian Studies*, Vol. 59, No. 2 (May 2000), pp. 370, 373, 377.

<sup>14</sup> The 1990s initiatives are described in Tang, *Political Order and Power Transition in Hong Kong*, pp. 217-23.

<sup>15</sup> Gerard L. M. Clauson, 'Some Uses of Statistics in Colonial Administration', *Journal of the Royal African Society*, Vol. 36, No. 145 (October 1937), pp. 10-2.

<sup>16</sup> H. W. Singer, 'The Distribution of Gains between Investing and Borrowing Countries' *American Economic Review*, Vol. 40, No. 2 (May, 1950), p. 475.

<sup>17</sup> Ida Greaves, 'The Character of British Colonial Trade', *Journal of Political Economy*, Vol. 62, No. 1 (February 1954), pp. 4-6.

Kingdom economy as other colonies were.<sup>18</sup> The colonial administration was suspicious even of London's programmes to promote the colonial empire's social and economic progress. In consequence, it rejected United Kingdom offers of aid during the struggle to rehabilitate the economy after the Japanese invasion and occupation.<sup>19</sup>

Nevertheless, the assumption persists that Hong Kong was unable to establish its own priorities because colonial officials must loyally pursue the goals set by London.<sup>20</sup> There is, for example, a widespread but erroneous view that the United Kingdom exploited Hong Kong by forcing the colonial administration to keep its foreign exchange reserves in London and help to defend sterling.<sup>21</sup> In practice, its officials showed no such loyalty.

- The Governor personally encouraged the exchange control staff to put the needs of the colony and its business first. In consequence, Hong Kong officials steadfastly neglected to enforce the exchange controls accepted by the rest of the Sterling Area, regardless of complaints from London.<sup>22</sup>
- In 1967, Hong Kong established its own exchange rate and subsequently insisted on guarantees for reserves held in London, a concession which independent Sterling Area members like Australia and Malaysia had never achieved. Hong Kong's breakthrough has been credited with leading to the demise of the Sterling Area.<sup>23</sup>

Similarly, some writers have claimed that industrial development was deliberately held back to protect United Kingdom interests and to maintain the political power of British-owned financial and commercial firms, leaving Hong Kong in a technological backwater.<sup>24</sup> In fact, the colonial administration consistently chose to do the opposite of what London decreed.

<sup>18</sup> Cowperthwaite makes a specific reference to Dr Ida Greaves, cited in f.n. 17 above, in defending Hong Kong's autonomy against the Colonial Office. (79) Cowperthwaite letter to W. F. Searle (Chief Statistician, Colonial Office), 8 June 1955. Hong Kong Public Records Office (HKRS hereafter) 163-9-88 'Trade. Balance of Payment Statistics. Policy regarding preparation of ...'.

<sup>19</sup> Cowperthwaite, Acting Director of Supplies, Trade and Industry minute to Colonial Secretary, 8 September 1947. HKRS163-5-2 'Colonial Production Colonial Development Corporation & International Bank Loans'.

<sup>20</sup> 'The colonial governor and the top bureaucrats only had one simple instruction from London – maintain the interests of Britain, especially its trade in Asia'. Chan Cheuk-wah, *The Myth of Hong Kong's Laissez-faire Economic Governance* (Hong Kong: Hong Kong Institute of Asia-Pacific Studies, 1998), p. 12.

<sup>21</sup> Alex H. Choi, 'State-Business Relations and Industrial Restructuring', in Tak-Wing Ngo (ed.), *Hong Kong's History. State and society under colonial rule* (London: Routledge, 1999), pp. 149-50.

<sup>22</sup> Frank H. H. King, *The Hong Kong Bank in the Period of Development and Nationalism, 1941-1984. From Regional Bank to Multinational Group* (Cambridge: Cambridge University Press, 1991), pp. 345-6; Catherine R. Schenk, *Hong Kong as an International Financial Centre. Emergence and Development 1945-65* (London: Routledge, 2001), pp. 80-93

<sup>23</sup> Y. C. Jao, *Banking and Currency in Hong Kong. A Study of Postwar Financial Development* (London: Macmillan, 1974), pp. 143-8.

<sup>24</sup> Alex Hang-keung Choi, 'The Political Economy of Hong Kong's Industrial Upgrading: A Lost Opportunity', in Leung, Benjamin K. P. Leung, (ed.), *Hong Kong: Legacies and Prospects of Development* (Aldershot: Ashgate,



- Before World War II, the Colonial Office in London tried to block the growth of manufacturing in the colonies. These efforts failed completely in Hong Kong's case, where both officials and business leaders were in favour of a retreat from *laissez faire* in order to protect local factories.<sup>25</sup>
- After World War II, London encouraged colonial territories to abandon *laissez faire* and promote manufacturing, as well as to introduce modern income tax systems in order to finance economic and social development programmes. The colonial administration in Hong Kong ignored the Colonial Office's directives.<sup>26</sup>

### 3. Business Frustrations

In retrospect, the refusal to accept responsibility for promoting industrial development proved the crucial issue in setting Hong Kong's economic management apart from the rest of Asia. If the business community had got its way, the colonial administration would have adopted much the same interventionist strategy as Singapore, South Korea or Taiwan. Aid to new industries would have taken priority in budgetary policy and in the use of the government's reserves. In the 1930s, Hong Kong's Governor had been anxious to allocate profits from the reserves used to back the currency for development projects. But after World War II, officials rejected any suggestion of such a scheme. As explained earlier, they believed that Hong Kong's reserves should be devoted to the defence of banking system and the currency, a decision which reflected financial secretaries' sense of where the greatest vulnerability of the economy lay.<sup>27</sup>

Business leaders, Chinese and British alike, were infuriated by this decision, especially since large annual budget surpluses were being amassed in the 1950s which were then invested in overseas securities. They wanted the fiscal reserves to be used, as other colonies did, to promote industrial development and thus match rival Asian economies which offered cheap finance and tax incentives to attract investment.

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2003), p. 279; Stephen Chiu, *The Politics of Laissez-faire. Hong Kong's Strategy of Industrialization in Historical Perspective* (Hong Kong: Hong Kong Institute of Asia-Pacific Studies, 1994), pp. 61-2; Tak-wing Ngo, 'Industrial history and the artifice of *laissez-faire* colonialism', in Ngo (ed.), *Hong Kong's History. State and society under colonial rule*, pp. 130-3; John Lo, 'The 1997 Issue and Hong Kong's Industrial Policy and Industrial Development, with Special Reference to Electronics', in Y. C. Jao *et al.* (eds), *Hong Kong and 1997. Strategies for the Future* (Hong Kong: Centre of Asian Studies, 1985), pp. 293, 297-8; Jeffrey Henderson, 'The Political Economy of Technological Transformation in the Hong Kong Electronics Industry', in Edward K. Y. Chen *et al.* (eds), *Industrial and Trade Development in Hong Kong* (Hong Kong: Centre of Asian Studies, 1991), p. 102; Suzanne Berger and Richard K. Lester (eds), *Made By Hong Kong* (Hong Kong: Oxford University Press, 1997), p. 57.

<sup>25</sup> *Report of the Commission ... to Enquire into the Causes and Effects of the Present Trade Recession ...* (Hong Kong: Noronha & Co., 1935), pp. 82-3, 86.

<sup>26</sup> Despatch from the Secretary of State for the Colonies to Colonial Governments, *Colonial Development and Welfare ...* (Cmd 6713/1945), pp. 3-5; HKRS41-1-6032 'Colonial Industrial Development – Legislation to encourage ...'; HKRS41-1-2769(1) 'Inland Revenue Ordinance: 1. General Question of Imposing etc ...'.

<sup>27</sup> See the comments on the colonial administration's fear in the context of both budget deficits and Keynesianism in Tang Shu-hung, 'The Economy', in Joseph Y. S. Cheng and Sonny S. H. Lo (eds), *From Colony to SAR. Hong Kong's Challenges Ahead* (Hong Kong: Chinese University Press, 1995), p. 120.

This clash over financial policies and the role of the reserves continued until the 1970s.<sup>28</sup> Only after Deng Xiaoping's economic reforms in 1978 and the prospect of cheap land and labour in southern China did the business campaign to force financial and fiscal concessions out of the colonial administration come to an end.

The decline of Hong Kong's manufacturing sector that followed, and its replacement by financial and other service industries, provided its own solution for the conflict over the proper contribution of the reserves to economic development. As Exchange Fund assets, they now underpinned Hong Kong's role as an international financial centre and related business activities, and the law was amended in 1992 to take explicit account of this development.<sup>29</sup> The government now had the justification for rescuing corporate fortunes which it had avoided as long as manufacturing dominated the economy, and so, for example, the Exchange Fund was used to reverse the collapse in share prices in 1998. The shrunken industrial sector has also meant that the post-1997 administration has seen no danger in such populist gestures as offering financial subsidies to small and medium enterprises for which the economic and commercial rationale was dubious.<sup>30</sup>

## 4. The Chinese Case

Politically, Hong Kong's British rulers' conviction that Hong Kong was a special case began with the belief that its Chinese population could not be subject to the same policies that London imposed on other territories. The colonial administration claimed to be under significant local political pressure to be sensitive towards what it regarded as Chinese cultural norms.<sup>31</sup>

- Hong Kong successfully campaigned for an exemption from enacting income tax legislation which other colonies were forced to adopt in 1922 because of '...the peculiar circumstances of Hong Kong

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<sup>28</sup> For details of the business campaign on these issues, see Leo F. Goodstadt, *Profits, Politics and Panics: Hong Kong's Banks and the Making of a Miracle Economy, 1935-1985* (Hong Kong: Hong Kong University Press, 2007), pp. 101, 185-6.

<sup>29</sup> To the Exchange Fund Ordinance (cap. 66) was added: s. (1A) '... the Financial Secretary may, with a view to maintaining Hong Kong as an international financial centre, use the Fund as he thinks fit to maintain the stability and the integrity of the monetary and financial systems of Hong Kong'.

<sup>30</sup> The lack first of justification and second of demand for these subsidies is plain from official reports. Small and Medium Enterprises Committee, *A Report on Support Measures for Small and Medium Enterprises* (Hong Kong: SAR Government, 2001), chapter 5; Market Research Division, 'Survey of the Financing Situation of Small and Medium-Sized Enterprises', *Hong Kong Monetary Authority Quarterly Report*, October 2000, p. 38; Legislative Council Panel on Commerce and Industry, *Progress Report on the Four Funding Schemes for Small and Medium Enterprises*, (CB(1)1670/01-02(03) 13 May 2002).

<sup>31</sup> Marriage was the most striking example of this colonial reluctance to interfere with what were regarded as China's traditions. A modern marriage law was enacted by the Chinese government in 1930. Hong Kong's Marriage Reform Ordinance came into force only in 1971.

and the Chinese attitude towards income tax'.<sup>32</sup> Hong Kong's exemption was renewed after World War II because the colonial administration claimed there were such insurmountable obstacles to operating an income tax as the way in which Chinese society defined dependents to include relatives other than an individual's own children.<sup>33</sup>

- Officials claimed that for the Chinese depositor, speculation and high returns were the attraction, rather than the stability of the bank. They later ignored a specific London directive to colonial governments to protect the public's bank deposits.<sup>34</sup> In 1948, the government rejected as unfair a proposal that only limited companies should be given bank licences on the grounds that the typical local Chinese-owned bank was unfamiliar with the statutory obligations that incorporation would bring.<sup>35</sup>
- After World War II, the government believed Hong Kong's industrialisation was unsustainable because Chinese residents were happy to operate in unsuitable premises and produce low-quality goods.<sup>36</sup> Wages were low, it was said, thanks to 'the importance of family ties in Chinese life with its attendant obligations to work for near and remote relatives'.<sup>37</sup>

The conviction that Hong Kong was a special case was especially evident in public administration and budgetary policies. Officials repeatedly rejected suggestions that their policies and programmes should be compared with the United Kingdom or Commonwealth countries.<sup>38</sup>

- In the 1960s, the Financial Secretary publicly declared that the Western-trained professional should abandon any desire to work to 'the highest professional standards he knows' because of Hong Kong's inferior economic situation.<sup>39</sup>

<sup>32</sup> (1) Commissioner of Inland Revenue (E. W. Pudney) memo to Financial Secretary, 8 January 1947, p. 1. HKRS41-1-2769(1) 'Inland Revenue Ordinance 1. General question of imposing etc... '.

<sup>33</sup> (35) Governor letter to Secretary of State for the Colonies, 17 May 1947. HKRS41-1-2769(1).

<sup>34</sup> (55) Memorandum by the Colonial Treasurer, 25 August 1936, p. 2. HKRS 170-1-307 'Banking Legislation'; DFS minute to Financial Secretary, 25 January 1950. HKRS41-3-3044. 'The Nam Sang Bank 1. Application from ... for a Banking Licence. 2. Balance Sheet of ... 3. Cancellation of the Licence of ... '.

<sup>35</sup> Financial Secretary letter to Governor of the Central Bank of China, 19 February 1948. HKRS 163-1-440. Simultaneously, a leading business weekly reported the prevalence of a totally different attitude: 'Many local [Chinese-owned] banks have, for reasons of respectability no doubt, organised their former shops into limited liability companies and ... have become proper bank companies'. 'The Position & Business of Chinese Native Banks', *Far Eastern Economic Review*, 18 February 1948.

<sup>36</sup> *Hong Kong Annual Departmental Report by the Commissioner of Labour for the Financial Year 1952-3* (Hong Kong: Government Printer, n.d.), p. 13.

<sup>37</sup> *Hong Kong Annual Departmental Report by the Commissioner of Labour for the Financial Year 1951-2* (Hong Kong: Government Printer, n.d.), p. 22.

<sup>38</sup> Cowperthwaite in particular. *HH*, 28 February 1962, p. 58; 26 February 1964, p. 52; 25 February 1965, p. 75; 24 February 1966, pp. 72-3; 24 February 1971, p. 417.

<sup>39</sup> The absurdity of this pronouncement was highlighted by Cowperthwaite's admission: 'I myself would not find it easy to say with precision what lowering of standards is necessary or justifiable'. *HH*, 28 February 1962, p. 58.

- In the 1980s, when Hong Kong was a mature industrial economy and about to become a leading international business and financial centre, a new Financial Secretary denounced those who sought improvements in public services as irresponsible do-gooders advocating unaffordable Western innovations.<sup>40</sup>

## 5. Business First

It is easy to form the view that Hong Kong developed a pragmatic ideology which put business growth ahead of social progress and won credibility thanks to the impressive results achieved by an outstanding team of officials.<sup>41</sup> Colonial officers transferred from other parts of the British Empire, however, found policy-making in Hong Kong was a casual, haphazard and unstructured process.<sup>42</sup> One financial secretary claimed that 'there can never be an adequate factual basis' for 'sophisticated planning' which, in any case, would lead to 'undesirable rigidities'.<sup>43</sup> Not surprisingly, then, major government programmes regularly rested on inadequate policy foundations.

- Education was the biggest single item in the 1990 budget, accounting for 15 per cent of total public expenditure. Yet, a government study team set up that year found that policy-making appeared to have collapsed in the educational field.<sup>44</sup>
- Public housing programmes provided homes for half the population by 1997. They have been hailed as 'the greatest investment of government in industry' because they raised the real incomes of the labour force.<sup>45</sup> These vast public investments had begun as improvised solutions to urgent situations and expanded subsequently on the basis of 'short-term thinking and policy-making with limited horizons'.<sup>46</sup>

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<sup>40</sup> Sir John Bremridge, Financial Secretary, *HH*, 29 February 1984, p. 592.

<sup>41</sup> On this flattering view of the past, see f.n. 6 above. There are dissenters, of course. 'Civil servants, on the whole, were keen to minimize mistakes, doing as little as possible so that they could retire comfortably back to Britain after a stable and colorless career'. Y. C. Richard Wong, 'Public Policies in the Hong Kong Economy: Emphasis on Manufacturing', in F. Gerard Adams and William E. James (eds), *Public Policies in East Asian Development: Facing New Challenges* (Westport: Praeger Publishers, 1999), p. 146.

<sup>42</sup> Trevor Clark, *Good Second Class* (Stanhope: The Memoir Club, 2004), p. 156.

<sup>43</sup> Cowperthwaite, *HH*, 26 March 1969, p. 213.

<sup>44</sup> Chris D. Godwin, Principal Assistant Secretary, Education and Manpower Branch, 'Pilot Study One: The School Education Programme: Redefining the Relationship between Policy Branch and Department', in Jane C. Y. Lee and Anthony B. L. Cheung (eds), *Public Sector Reform in Hong Kong. Key Concepts, Progress-to-Date and Future Directions* (Hong Kong: Chinese University Press, 1995), pp. 95, 96-7.

<sup>45</sup> David R. Meyer, *Hong Kong as a Global Metropolis* (Cambridge: Cambridge University Press, 2000), p. 148.

<sup>46</sup> Denis Bray, 'Recollections of a Cadet Officer Class II', in Elizabeth Sinn (ed.), *Hong Kong, British Crown Colony Revisited* (Hong Kong: Centre of Asian Studies, 2001), pp. 17-8; Roger Bristow, *Hong Kong's New Towns. A Selective Review* (Hong Kong: Oxford University Press, 1989), p.307.

In consequence, it would be difficult to derive a set of coherent and consistent principles or commitments from government programmes and pronouncements in the second half of the last century. Not even *laissez faire* was a binding dogma, and officials, by their own admission, looked on non-interventionism as a matter of pragmatism rather than principle.<sup>47</sup>

Nevertheless, there was never any doubt about the government's ultimate priority. 'In almost all aspects of public life', it has been claimed, 'Hong Kong is about business. The policy of non-intervention is largely a reflection of this reality'.<sup>48</sup> Social issues commanded no such importance in official thinking. In the early 1970s, the government was accused of allowing 'tremendous profits [to] co-exist with unnecessary squalor in the slums'.<sup>49</sup> A quarter of a century later, the complaint was still that the economy always came before those social initiatives 'which might in any way be thought to threaten [business] competitiveness'.<sup>50</sup>

The commitment to growth at all costs went hand in hand with an obsession with the perceived dangers of welfarism. This attitude emerged as a new feature of the colonial administration after World War II. In the dire emergency during the 1930s as Japanese troops invaded southern China, Hong Kong's response had been to introduce direct taxation and expand spending on social services.<sup>51</sup> After World II, the government retreated rapidly from commitments to the vulnerable and the deprived, and anti-welfarism became a dominant influence on the government's social policies and its budgetary management which persists to the present day.

Hong Kong officials were not alone in insisting that social development could come only at the expense of economic progress in the 1950s and that Western standards should not be applied to the Third World. Development economists and international agencies expressed similar reservations. One leading Asian specialist argued that poor countries could not afford to import the aspirations of Western democracies.<sup>52</sup>

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<sup>47</sup> K. Y. Yeung, 'The Role of the Hong Kong Government in Industrial Development', in Edward K. Y. Chen *et al.* (eds), *Industrial and Trade Development in Hong Kong* (Hong Kong: Centre of Asian Studies, 1991), p. 49; The best summary of the controversies over how *laissez faire* Hong Kong has been is Ma Ngok, *Political Developments in Hong Kong: State, Political Society, and Civil Society* (Hong Kong: Hong Kong University Press, 2007), pp. 17-26.

<sup>48</sup> David Mole, 'Introduction', in David Mole (ed.), *Managing the New Hong Kong Economy* (Hong Kong: Oxford University Press, 1996), p. 4.

<sup>49</sup> David C. Chaney and David B. L. Podmore, *Young Adults in Hong Kong: Attitudes in a Modernizing Society* (Hong Kong: Centre of Asian Studies, 1973), p. 186.

<sup>50</sup> Ahmed Shafiqul Huque, 'Understanding Hong Kong', in Paul Wilding *et al.* (eds), *Social Policy in Hong Kong* (Cheltenham: Edward Elgar, 1997), p. 20.

<sup>51</sup> Goodstadt, *Journal of the Royal Asiatic Society Hong Kong Branch*, pp. 62-4, 69.

<sup>52</sup> Benjamin Higgins, 'Economic Development of Underdeveloped Areas: Past and Present', *Land Economics*, Vol. 31, No. 3 (August 1955), pp. 189-90.

*In the now advanced countries the welfare state appeared only after generations of industrialization. In the present underdeveloped areas the usual policy seems to reverse this process. Most of these countries want the blessings of the welfare state today, complete with old age pensions, unemployment insurance, family allowances, health insurance, forty-hour work-week, and all the trimmings... it seems likely that the material standard of living of European wage-earners declined in the first stages of the Industrial Revolution. In terms of actual welfare, the industrial slum dweller in eighteenth century England was almost certainly worse off than the peasants who were their forebears.*

At the heart of this argument was a widespread assumption that a shortage of capital resources posed an overwhelming obstacle to growth in the Third World.<sup>53</sup> Prosperity could be attained only if welfare spending were held down, a view of the modernisation process based on the West's experience of economic take-off. The historical parallels were not relevant to Hong Kong, however. Because its rates of both investment and growth were much higher than during the United Kingdom's Industrial Revolution, its scope for social progress was not subject to the same economic constraints.<sup>54</sup>

Hong Kong officials, nevertheless, saw a perilous conflict between social services and business growth. Pragmatically, they accepted the need to provide public housing and not just industrial sites on a scale that has been compared to 'some socialist countries'.<sup>55</sup> But they made it plain to the community that there could be no question of introducing a 'welfare state'.<sup>56</sup> Even when, in the 1970s, the Governor, Sir Murray (later Lord) MacLehose, appeared ready to adopt more activist and populist attitudes, non-interventionism continued to prevail in practice. Thus, the Governor blamed the 'excessive risks' created by *laissez faire* for the dramatic stock market crash of 1973. Yet, he made no effort to compel his financial secretary to become more interventionist, with the result that the rest of the decade saw even more serious market 'bubbles' and financial collapses. Similarly, MacLehose publicly accepted a role for the government in tackling inflation, which became a major problem in this decade. But, instead of espousing realistic monetary policies, he saw the government's contribution to stable prices as largely limited to existing programmes of low-cost social services.<sup>57</sup> Furthermore, the government made it clear that greater social interventionism in the late 1970s was not a free choice. The main incentive to introduce compulsory secondary education and to improve employment rights, for example, was openly admitted to be the threat to Hong Kong's export markets from its sweatshop image.<sup>58</sup> Ironically, an attempt by his financial

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<sup>53</sup> For an IMF analysis of this issue, see E. M. Bernstein, 'General Problems of Financing Development Programs', *Journal of Finance*, Vol. 12, No. 2 (May 1957), pp. 168, 172.

<sup>54</sup> See the comparative data in Nicholas F. R. Crafts, 'The First Industrial Revolution: A Guided Tour for Growth Economists', *American Economic Review*, Vol. 86, No. 2 (May 1996), p. 198.

<sup>55</sup> Leonard K. Cheng, 'Strategies for Rapid Economic Development: The Case of Hong Kong', *Contemporary Economic Policy*, Vol. 13, No. 1, 1995, p. 30.

<sup>56</sup> On medical services, see Clarke, *HH*, 27 March, 1957, p. 114; on education, see Cowperthwaite, *HH*, 28 February 1962, p. 57.

<sup>57</sup> Macle hose, *HH*, 17 October 1973, pp. 25-6; Leo F. Goodstadt, 'Dangerous Business Models: Bankers, Bureaucrats & Hong Kong's Economic Transformation, 1948-86', *HKIMR Working Paper No. 8/2006*, June 2006, pp. 17-8.

<sup>58</sup> Kenneth Topley, Director of Education, *HH*, 12 April 1978 p. 737; MacLehose, *HH*, 6 October 1976, p. 20.

secretary at the end of the decade to find an alternative to *laissez faire* in the face of mounting Western protectionism led to an official report, none of whose proposed initiatives for industrial diversification proved viable.<sup>59</sup>

## 6. Social Insurance Costs

The hostility to welfarism combined with the government's belief in 'business first' led a conviction that employers ought not to be burdened with a contributory social security system.<sup>60</sup> The fiscal implications of this belief were serious. In the absence of a universal contributory scheme, essential social services would have to be provided by the government. This unavoidable outcome was ignored, however, principally on the assumption that the 'Chinese family' would always come to the rescue of members in distress. Within the colonial administration, the case for social insurance could not be completely dismissed. Governors were lobbied by officials familiar with the health, welfare and housing departments who knew from experience that for most of their clients, there was no extended family to offer the traditional safety net. But even governors were unable to overcome opposition from within the colonial administration itself, as well as from business leaders, to any form of social insurance.

- In 1967, the Financial Secretary killed off a proposal supported by the Governor for a social insurance scheme similar to other British colonies by alleging that it was part of a plot against profits.<sup>61</sup>
- In 1977, another Governor endorsed a similar proposal, which employers successfully blocked. By now, however, the government could no longer reject responsibility for financing the provision of welfare benefits in the absence of contributory schemes.<sup>62</sup>
- In the 1990s, worries about the rising costs of hospital services prompted discussion of public health insurance. Within the government, the proposal was unacceptable on the grounds that it would create a 'hypothecated health tax', thus reducing the government's budgetary autonomy. Business representatives attacked it as 'a threat to the low-tax policy'. Both groups condemned it as a major

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<sup>59</sup> *Report of the Advisory Committee on Diversification 1979* (Hong Kong: Government Printer, 1979), p. 167; Goodstadt, *Profits, Politics and Panics: Hong Kong's Banks and the Making of a Miracle Economy, 1935-1985*, pp. 163-6.

<sup>60</sup> Paul Wilding, 'Social Policy', in Lam Wai-man *et al.* (eds), *Contemporary Hong Kong Politics: Governance in the Post-1997 Era* (Hong Kong: Hong Kong University Press, 2007), p. 214.

<sup>61</sup> *A Report by the Inter-Departmental Working Party to Consider Certain Aspects of Social Security* (Hong Kong: Government Printer, 1967); M. 7 Governor to Financial Secretary, 22 June 1967; M. 24 Financial Secretary to Governor; (11) 'An Appreciation of the Report by the Inter-Departmental Working Party on Social Security', 10 October 1967. HKRS163-9-486, 'Social Security – Implications of Change in HK Status-Quo... '.

<sup>62</sup> MacLehose, *HH*, 11 October 1978, p. 257; 7 October 1981, p. 21

step towards the social insurance systems that were said to have introduced the 'collectivism' and welfarism that, allegedly, had undermined Western economies.<sup>63</sup>

- In 1993, the government tried to establish an old-age pension. Although the impact on public finances of this contributory, 'pay as you go' scheme was forecast to be very manageable, the proposal was defeated by an alliance of business interests and senior officials. Hong Kong's professional economists acted as their advocates.<sup>64</sup> They belonged overwhelmingly to the Chicago school, and their views paralleled the anti-Keynesianism of financial secretaries in the last century which is discussed below.<sup>65</sup>

Paradoxically and almost without notice, resistance to social insurance increased the direct tax burdens on professionals and the business community. Hong Kong has no income tax but it does levy a tax on 'salaries', a term which accurately reflects that middle class earnings are taxed while the labour force's wages are mostly exempt. It also levies a tax on profits generated within Hong Kong. In the absence of universal retirement benefits and social insurance schemes, the needs of the elderly, the unemployed, the sick and the disabled have to be financed by the state in a modern society. Caring for these clients accounted for 15 per cent of total public expenditure in 1990, a figure which had risen to 27 per cent by 2008.

## 7. Fragile Futures

Anti-welfarism was so potent an element in the preconceptions shared by officials and business leaders alike because it reflected an even more compelling concern: welfare seemed unaffordable because both groups were convinced of the fragility of Hong Kong and its success. Officials found it almost impossible to accept that the economy was not perpetually on the verge of collapse, while the business world was convinced, for example, that without constraints on free market competition, Hong Kong was doomed.<sup>66</sup>

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<sup>63</sup> Victor C. W. Wong, *The Political Economy of Health Care Development and Reforms in Hong Kong* (Aldershot: Ashgate, 1999), pp. 204-12.

<sup>64</sup> *Taking the Worry out of Growing Old: A Consultation Paper on the Government's Proposals for an Old Age Pension Scheme* (Hong Kong: Education and Manpower Branch, 1994), pp. 12-3, Appendix VII; Francis T. Lui, *Retirement Protection: A Plan for Hong Kong* (Hong Kong: City University of Hong Kong Press, 1998), pp. 6-7.

<sup>65</sup> On the Chicago School's role in Hong Kong, see Tang, *From Colony to SAR. Hong Kong's Challenges Ahead*, p. 130. Their influence proved decisive in 1994 in defeating the proposed pension scheme. Lui, *Retirement Protection: A Plan for Hong Kong*, pp. 6-7.

<sup>66</sup> On business anxieties, note H. D. Barton, *HH*, 16 March 1960, p. 94 and 19 March 1962, pp. 73-4. One economist was so convinced by business nervousness that he proposed a licensing system to deal with what he regarded as dangerous levels of competition. Nicholas Owen, 'Competition and Structural Change in Unconcentrated Industries', *Journal of Economics*, Vol. 19, No. 2 (April 1971), pp. 142-3, 147. Business lobbying for government controls and protection dates back to the start of the industrial take-off. See 'Notes of the Week Hongkong Industry Problems', *Far Eastern Economic Review*, 9 October 1952.



As Financial Secretary, Arthur Clarke presided over Hong Kong's manufacturing take-off after World War II and watched it overcome the Korean War embargoes and the loss of its Mainland markets. He confessed at the end of his career that he had always underestimated the wealth that the community was creating and which was available to finance the public sector. He forecast that future financial secretaries would fall into the same trap.<sup>67</sup>

*My successor will make exactly the same mistake that I have always made. He will underestimate revenue. He will underestimate his revenue, because, like me, like so many of us, he will never be able to comprehend how new and successful industries can be created overnight out of nothing, in the face of every possible handicap; how new trade can suddenly start up in some way that has never been thought of before; he, like me, will never be able to comprehend how on earth our enterprising, ingenious, hardworking people can ever manage to accomplish so much with so little*

He was right. In 1974, the government admitted that Hong Kong had been shielded from the world's economic problems in the past but warned that it now faced an uncertain future.<sup>68</sup> At the end of British rule, Clarke's warning was still being ignored. The last of the colonial financial secretaries emphasised the brittle nature of Hong Kong's success despite a record of unbroken growth unmatched by any other modern economy. This lack of confidence in Hong Kong's resilience has encouraged 'enormous caution in financial management',<sup>69</sup> to the detriment of both the physical and the social infrastructure.<sup>70</sup>

In theory, the sense of being at the mercy of events seemed to reflect Hong Kong's situation. Its emergence as a world-class manufacturing centre had seemed unlikely from the start.<sup>71</sup> How could it rely on China's continued tolerance of its booming capitalism during the mounting radicalism of the Maoist era? How could it retain its access to overseas markets when even the United Kingdom erected import barriers against its manufactured products? How could it guarantee homes and jobs for an immigrant influx and ensure social harmony?

The China factor was mainly a myth in the colonial era. Every day, China's state-owned enterprises in Hong Kong observed the colonial laws, cooperated with the colonial authorities and maintained the

<sup>67</sup> Clarke, *HH*, 1 March 1961, p. 58. This quotation was deployed almost half a century later to rebuke a post-colonial financial secretary for his lack of confidence 'about the ability of Hong Kong people in creating wealth'. Sin Chung-kai, *HH*, 24 January 2007, p. 4140.

<sup>68</sup> C. P. (later Sir Philip) Haddon-Cave, *HH*, 14 November 1974, pp. 217-8.

<sup>69</sup> The theme of fragility is explored very impressively in Paul Wilding, 'Social Policy and Social Development in Hong Kong', *Public and Social Administration Working Paper Series 1996/3*, City University of Hong Kong, pp. 33-5, 38.

<sup>70</sup> The most dramatic example was Sir John Bremridge's justification as Financial Secretary for not starting work on a replacement airport. He claimed that the financial burden of the new airport 'could result in halving the low cost housing programme', although he had admitted in the previous year that, in managing the public sector, 'the true shortage is of resources including people – and not of money'. *HH*, 23 February 1983, p. 520 and 24 February 1982, p. 428.

<sup>71</sup> The incredulity provoked by Hong Kong's industrial success was recorded by F. C. Benham, 'The Growth of Manufacturing in Hong Kong', *International Affairs*, Vol. 32, No. 4 (October 1956), pp. 460–1.

informal partnership that generated the hard currency which Beijing needed. These earnings tended to rise during periods when the Mainland faced internal extremism and external tension, as the colonial administration knew full well from its own confidential financial data.<sup>72</sup> Even less well-founded were the fears of Western protectionism. The government publicly explained the enormous benefits that Hong Kong had derived from import restrictions overseas which preserved its existing market share against potential lower-cost entrants to these markets from the Third World.<sup>73</sup> Industrialists had ample experience of how, in cooperation with officials, these restrictions were turned into lucrative commercial advantages for the local exporter.<sup>74</sup> In consequence, Hong Kong was able to remain 'the largest quota holder in the world...the de facto control centre of the world's textile and garment trade' until the end of the century.<sup>75</sup>

## 8. Malthusian Menaces

In fact, the persistent fear of the future cannot be accounted for in terms of either the political or economic experiences of the second half of the last century. This preconception has its origins in a sense of panic created by the post-1945 influx of immigrants. For the government, they had created an intractable 'problem of people'. A 1957 policy statement confessed that the colonial administration had been paralysed by the 'the immensity of the problem' created by an immigrant population which it viewed as an almost impossible burden on public services.<sup>76</sup> The immigrants were demonised as 'strangers' for whom the rest of the community had already mortgaged its own future and now might well be 'required to pay interest on the pledge at compound interest'.<sup>77</sup> Officials were blind to the way in which breakneck industrialisation was providing jobs and rising wages. By the 1961 Census, unemployment had fallen to only 1.3 per cent. Yet, despite ample evidence of intense demand for labour, the government refused for a further three years to accept that the immigrants were not a burden on the economy.<sup>78</sup>

<sup>72</sup> Leo F. Goodstadt, 'Painful Transitions: The Impact of Economic Growth and Government Policies on Hong Kong's "Chinese" Banks, 1945-70', *HKIMR Working Paper No. 16/2006*, November 2006 p. 14-5 and Table V: 'China's Imports and its Sterling Offtake from Hong Kong, 1957-73', p. 22.

<sup>73</sup> *Hong Kong Report for the Year 1969* (Hong Kong: Government Press, 1970), p. 5.

<sup>74</sup> The origins of this successful government-partnership are recorded in HKRS163-1-2861 'Cotton Textiles Allocation of quota to restricted markets'; HKRS270-5-56 'Cotton Advisory Board. Minutes of Meeting'; and HKRS163-1-118 "Federation of Hong Kong Industries Minutes of the Meetings of the...".

<sup>75</sup> Henry Wai-chung Yeung, *Transnational Corporations and Business Networks. Hong Kong firms in the Asian Region* (London: Routledge, 1998), pp. 130, 206-7.

<sup>76</sup> This statement was published in *Hong Kong Annual Report 1956* (Hong Kong: Government Printer, 1957), chapter 1 'A Problem of People'. It was widely distributed in pamphlet form (Hong Kong Government, *A Problem of People* (Hong Kong: Government Printer, n.d.) and subsequently in an enlarged and updated version (Hong Kong Government, *A Problem of People* (Hong Kong: Government Printer, 1960). It was reaffirmed as a continuing policy document in 1962. (C. B. Burgess, Colonial Secretary, *HH*, 13 June 1962, pp. 195-202).

<sup>77</sup> *Hong Kong Annual Report 1956*, pp. 12, 16 and 30. Labour costs were estimated to have risen by 20 per cent from 1958 to 1960. Clarke, *HH*, 24 February 1960, p. 50.

<sup>78</sup> K. M. A. Barnett, *Hong Kong. Report on the 1961 Census* (Hong Kong: Government Printer, n.d.), pp. 2, 33; R. M. Hetherington, Commissioner of Labour, 'Industrial Labour in Hong Kong', *Hong Kong Economic Papers*, Vol.

This blindness to burgeoning prosperity was inspired by a bleak Malthusianism which flew in the face of more than a century's experience. In Hong Kong, economic growth had accelerated after each new flood of refugees because the new arrivals meant 'more producers and more consumers'.<sup>79</sup> Significantly, London officials regarded the colonial administration's Malthusian forebodings as deliberately alarmist. As early as the mid-1950s, they described Hong Kong as 'rolling in money' and noted how buoyant revenues were despite the Financial Secretary's gloomy forecasts.<sup>80</sup> Hong Kong's pessimism was aggravated by a lack of socio-economic data until late in the 1970s, but this statistical deficit was itself Malthusian in origin. Problems were too overwhelming for accurate data to contribute to their solution, officials insisted, while more statistical information would encourage public criticism of the government's failure to find solutions.<sup>81</sup>

The 'migrant menace' was not finally exorcised until 1980 when the Mainland authorities were induced to cooperate in halting illegal immigration from Guangdong province. In justifying this change of policy, the Governor presented a Malthusian image of a virtually useless influx that echoed official claims three decades earlier but with the newcomers now demonised for criminal tendencies.<sup>82</sup>

*The educational level is usually poor and they have little to offer in skills. There is a noticeable lack of sympathy for them here; and their presence poses potential problems for law and order though this is impossible to quantify.*

The Governor's allegations had no basis in reality. As 91 per cent of the illegal immigrants were aged 15-34, they were able to make a significant economic contribution at minimal social cost in a tight labour market. They had higher rates of full-time employment than the local population, with a median wage equivalent to 80 per cent of the local labour force, which rose with each year of residence. They made few demands on the school system, public housing or welfare services. Young and fit, they required little by way of medical or hospital treatment.<sup>83</sup> As for criminal tendencies, they were indeed 'impossible to

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1963, No. 2 (March 1963), pp. 32 and 34 in particular; E. B. Teesdale, Colonial Secretary, *HH*, 20 May 1964, p. 212. Employers warned the government of a worsening labour shortage repeatedly. *HH*: J. D. Clague (Hutchison), p. 89 and H. D. M. Barton (Jardine Group), p. 94, 16 March 1960; P. Y. Tang (South Sea Textile Manufacturing), 30 September 1964, pp. 354-5.

<sup>79</sup> The phrase comes from John M. Carroll, *A Concise History of Hong Kong* (Lanham: Rowland & Littlefield Publishers, Inc., 2007), p. 163.

<sup>80</sup> W. G. Holland minute to Ashton 29 May 1956. London Public Records Office CO1030/392 'Financial Devolution Hong Kong'; P. Selwyn minute to Sir William Gorell Barnes, 6 July 1961. CO1030/1300 'The Future of Hong Kong'.

<sup>81</sup> Leo F. Goodstadt, 'Government without Statistics: Policy-making in Hong Kong 1925-85, with special reference to Economic and Financial Management', *HKIMR Working Paper No. 6/2006*, April 2006, pp. 7-8, 9-10.

<sup>82</sup> MacLehose, *HH*, 1 October 1980, p. 12.

<sup>83</sup> Their net contribution to Hong Kong is amply borne out by the data collected by the 1981 Census about arrivals between 1976 and 1980. An unconvincing attempt was made to distort the conclusions to be drawn from these figures by vague predictions of the future demand they would generate for public housing and social services. The Census figures, however, are too plain to lend support to the government's case against the newcomers.

quantify'. The government later admitted that illegal immigrants had been 'a statistically insignificant percentage of the total prosecution figures' for 1978 and 1979.<sup>84</sup>

For the first time in its history, nevertheless, Hong Kong cut itself off as completely as it could manage from a supply of fit, young people anxious to do better for themselves than they believed possible on the Mainland. This crucial demographic decision was made with no regard for its long-term consequences in terms of an ageing population.

## 9. Vigorous Distaste

It is difficult to trace the precise route by which Malthus came to exert such a powerful influence on Hong Kong more than a century after his death. Only a single direct reference by a Hong Kong official to Malthus has been found.<sup>85</sup> The most likely channel was via John Stuart Mill whose status as one of the most influential English thinkers continued well into the twentieth century.<sup>86</sup> He was not convinced of the benefits of economic growth and saw population increases as a serious burden on society.<sup>87</sup>

This despondency, both about the growth process and demographics, was challenged by J. M. Keynes who demonstrated how economies do not have to be passive victims of poverty and recession.<sup>88</sup> Hong Kong's colonial administration, however, proclaimed a vigorous distaste for Keynesianism. Officials took the view, it was noted in 1966, that Hong Kong's economy was 'absolutely unique' and 'can never conform in even a slight degree to the general pattern of economic development' enjoyed elsewhere in the world, a conviction that seemed closely linked to their fears about the economy's vulnerability.<sup>89</sup>

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*Hong Kong 1981 Census Main report Volume 1: Analysis* (Hong Kong: Government Printer, 1982), chapter 7 'Implications of New Inward Migration' and Table III 39-48, pp. 188-92.

<sup>84</sup> Once again, however, the official statistics did not fit the government's case, even when a sharply higher figure for April 1981 (7.5 per cent of all prosecutions) was produced. To overcome the problem of 'undetected, or, indeed, unreported' cases, a 'police assessment' was prepared incorporating 'criminal intelligence sources'. This exercise tried to portray the new arrivals as a dangerous menace by suggesting they were responsible for 'for between 35% and 45% of the crime of robbery with violence committed in the past three years'. L. M. Davies, Secretary for Security, *HH*, 13 May 1981, p. 842.

<sup>85</sup> This official foresaw a strong possibility of 'a Malthusian nightmare' through an immigrant influx. R. H. Hughes, 'Hong Kong – Far Eastern Meeting Point', *Geographical Journal*, Vol. 129, No. 4 (December 1963), p. 461. The author was Superintendent of the Crown Lands and Survey Office.

<sup>86</sup> Mill's influence tends to be under-estimated. See T. W. Hutchison, *On Revolutions and Progress in Economic Knowledge* (Cambridge: Cambridge University Press, 1978), p. 61.

<sup>87</sup> On Mill's views on the role of colonies in this context, see his *Principles of Political Economy with some of their Applications to Social Philosophy* (London: Longman, Green Reader, and Dyer, 1878), 8th edition, Vol. 2, pp. 597-603.

<sup>88</sup> J. R. Hicks, 'Growth and Anti-Growth', *Oxford Economic Papers*, Vol. 18, No. 3 (November 1966), pp. 261, 266-7.

<sup>89</sup> Gertrude Williams, *Report on the Feasibility of a Survey into Social Welfare Provisions and Allied Topics in Hong Kong* (Hong Kong: Government Printer, n.d.), p. 11.

From today's standpoint, an anti-Keynesian stance seems unremarkable and in line with a general trend among both government and academic economists. In the early post-war decades, however, its implications for the day-to-day management of Hong Kong affairs were not wholly benign. In that era, the dismissal of Keynes amounted to a rejection of macroeconomic theory in general, which made it harder to challenge the government's obsession with Hong Kong's vulnerability. In terms of policy decisions, hostility to modern economics meant that the government refused to investigate or measure national income until the 1970s; and it never produced balance of payments estimates throughout British rule. The colonial administration thus closed the door to informed analysis of the both the overall economy and the way in which individual sectors contributed to economic growth because the tools of macroeconomics and the information derived from national income accounts were regarded as of no benefit to policy making.

## 10. Self-Regulation and Non-Intervention

In place of modern economics, Hong Kong's policy makers until late in the 1970s clung to the view that the economy was guided by an automatic adjustment mechanism. Haddon-Cave offered the best summary of why, like his two predecessors, he believed that, given the nature of the Hong Kong economy, the government was tied to non-interventionism and that government involvement was not only redundant but perhaps perilous.<sup>90</sup>

*The Government does not attempt to regulate the economy either through its expenditure decisions or in other conventional ways, using monetary or fiscal devices. This is because the money supply is largely determined by the balance of trade as influenced from time to time by capital movements; whilst any major attempt to regulate demand through variations in tax rates or internal borrowing would tend to bring about changes in expenditure on imports rather than influence the volume of domestic output in the required direction.*

This analysis was derived ultimately from officials' perceptions of how the currency board system operated. The term 'currency board' was not part of the government's vocabulary,<sup>91</sup> but there is clear evidence that the government's faith in the automatic adjustment mechanism was grounded in its understanding of an academic debate about colonial currency boards in the 1950s.<sup>92</sup> Official thinking was

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<sup>90</sup> Haddon-Cave, *HH*, 3 April 1975, p. 691, f.n. 4.

<sup>91</sup> There was a single use of the term by an official in a historical reference (Cowperthwaite, *HH*, 18 December 1963, p. 303) and a brief comment by an elected legislator in the dying days of British rule. (Christine Loh, *HH*, 27 March 1996, p. 153).

<sup>92</sup> '3. In countries where economic and financial policies may result in internal and external price levels getting out of line and setting up inflationary tendencies (and unfortunately such countries are in the overwhelming majority today) it is very necessary to keep an eye on the balance of payments. But our economy is almost wholly external (our foreign trade is probably twice our national income) and our balance of payments is self-regulating either through the free exchange market or through our currency mechanism (whether one is a disciple of Prof. [Arthur] Lewis or Dr.[Ida] Greaves) and we have no occasion to intervene'. (79) Cowperthwaite letter to W. F. Searle, Colonial Office, 8 June 1955. HKRS163-9-88 'Trade. Balance of Payment Statistics. Policy regarding preparation of...'.

flawed, however. While it was true that deficit finance and reflationary budgetary policies were easier to adopt in economies less dependent on external markets than Hong Kong, the system was not as automatic or self-regulating as financial secretaries assumed.<sup>93</sup>

On this topic, it is possible to establish a clear link between the government's preconceptions and Mill, who had provided the first intellectual foundations for the common assertion that a colonial government was powerless to influence economic performance. He regarded colonial economies as no more than an extension of the United Kingdom. Inspired by Mill, one distinguished colonial economist went so far in the 1950s as to assert that British trade with the colonies ought not to be regarded as 'foreign' but as part of the United Kingdom's domestic commerce.<sup>94</sup>

The monetary arrangements adopted by almost all British colonies were dominated by currency boards, which made it easy to justify this view. Under the traditional colonial arrangements, 'local banks were merely branches of London banks, maintaining their basic liquidity in London'. The result was that 'the local economy could be regarded substantially as part of the British economy, in much the same way as a state of the USA is part of the Union'.<sup>95</sup> This dependency was reinforced in the last century by the lack of independent local currencies and by the Sterling Area's exchange controls. In the average colony, a well-known authority on colonial economies observed, 'the currency has no independent existence of its own, but is simply parasitical upon sterling'.<sup>96</sup> The leading academic expert on this topic in the 1950s declared that 'the colonies are in practice overseas parts of the United Kingdom monetary system, and have no responsibility for maintaining foreign exchange reserves or taking any other measures that would affect the value of their own currencies'.<sup>97</sup>

But comparisons with other colonies were misleading, and attempts to apply to Hong Kong conclusions drawn from the standard colonial monetary arrangements were misconceived. Hong Kong's financial system had virtually nothing in common with the rest of the colonial empire. There, almost all banking business was monopolised by branches of London banks, and these made little contribution to the creation of credit because bank lending had a limited place in the typical colonial cash economy. London

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<sup>93</sup> Official misconceptions on this issue are reviewed in Leo F. Goodstadt, 'Laissez-faire's limitations: The evolution of monetary policy in Hong Kong, 1935-80', in Catherine R. Schenk (ed.), *Hong Kong SAR's Monetary and Exchange Rate Challenges: Historical Perspectives* (Basingstoke: Palgrave Macmillan, 2008).

<sup>94</sup> Greaves, *Journal of Political Economy*, p. 3. As she acknowledged, this analysis was derived from Mill's theory of international trade.

<sup>95</sup> Anthony Latter, 'The Currency Board Approach to Monetary Policy – from Africa to Argentina and Estonia, via Hong Kong', in *Proceedings of the Seminar on Monetary Management organized by the Hong Kong Monetary Authority on 18-19 October 1993* (Hong Kong: Hong Kong Monetary Authority, n.d.), p. 27.

<sup>96</sup> Clauson, 'Some Uses of Statistics in Colonial Administration', p. 14.

<sup>97</sup> Ida Greaves, 'Dollar Pooling in the Sterling Area: Comment', *American Economic Review*, Vol. 45, No. 4 (September 1955), p. 656.

had no such presence or role in Hong Kong which had been remarkable, even before World War II, as a colony in which bank advances were a significant element in the money supply.<sup>98</sup> In addition, thanks to its role as a commercial and investment centre for China, Hong Kong had become a leading financial centre in its own right early in the last century, which gave it a remarkable degree of monetary independence.<sup>99</sup>

## 11. Lingering Legacy

As far as policy is concerned, the past lives on in contemporary Hong Kong. The fear of what the future holds remains a dominant sentiment. The government feels that its finances are even more fragile than ever. The Financial Secretary in 2006 reported that the fiscal reserves were enough to cover 15 months of government expenditure compared with an official target of one year.<sup>100</sup> But these reserves were deemed still inadequate. The government argued that they should be increased to as much as 36 months of total government spending – or 50 per cent of GDP.<sup>101</sup> In the business world, the sense of vulnerability was reinforced by the Asian financial crisis and the recession that followed. As in the past, it was taken for granted that business interests ought to prevail. The property market was hardest hit, and developers lobbied successfully in 2001 for the supply of public sector housing to be slashed and the sale of new building sites to be halted.<sup>102</sup>

This sense of vulnerability reinforces resistance to any tendency towards a higher priority for the social services. Thus, in 2006, the official responsible for health and welfare spoke in dire terms about the ruin caused by 'welfare states' in Western economies.<sup>103</sup>

*...in countries where welfarism is practised or a multitude of welfare services is provided,...many problems have emerged, such as unemployment, especially youth unemployment, domestic violence, shortage of elderly service... Worse still, it will undermine the people's resilience against adversities, which is not conducive to the healthy development of the economy in the long run.*

Fear of welfarism has continued to rule out social insurance despite repeated assertions of a threat of structural deficits undermining the commitment to balanced budgets and the need for new sources of revenue. In consequence, calls for contributory schemes to make up for shortfalls in government funding of health services and retirement benefits have been rejected. The one exception was a suggestion from

<sup>98</sup> G. L. M. Clauson, 'The British Colonial Currency System', *Economic Journal*, Vol. 54, No. 213 (April 1944), pp. 2, 22.

<sup>99</sup> Howard Curtis Reed, 'The Ascent of Tokyo as an International Financial Center', *Journal of International Business Studies*, Vol. 11, No. 3 (Winter 1980), 'Table 3. Rankings of Asian International Bank Centers', p. 28.

<sup>100</sup> Henry Tang, Financial Secretary, *HH*, 22 February 2006, pp. 4914, 4932.

<sup>101</sup> The best-argued case against the government's assertions is Sin Chung-kai, *HH*, 24 January 2007, pp. 4135-6.

<sup>102</sup> 'To avoid an overlap between the [public sector] and the private property market'. Donald Tsang Yam-kuen, Financial Secretary, *G/S*, 3 September 2001.

<sup>103</sup> Dr York Chow Yat-ngok, Secretary for Health and Welfare, *HH*, 29 March 2006, 6103.

the government of a compulsory savings scheme to cover the individual's health costs after retirement (a proposal which officials eventually dropped). If anything, government officials are now more hostile to social insurance than employers.<sup>104</sup>

Not surprisingly, Malthusianism remains alive and well. 'Population growth has always been a fundamental problem for Hong Kong', declared Hong Kong's first Chief Executive in 1999 in an attempt to justify a reinterpretation of a Basic Law provision which gave a right of permanent residence in Hong Kong to the children of Chinese citizens born in the Special Administrative Region.<sup>105</sup> By 2002, however, the government was forced to recognise that the danger was not that population growth would 'get out of control', as the Chief Executive had stated. Hong Kong's real demographic challenge, an official report admitted, was a shortage of people which meant an ageing population and a dwindling workforce.<sup>106</sup>

Thus, illegal immigrants ceased to be the principal 'burden' on budgetary resources and public services. They have been replaced by the elderly as the menace to Hong Kong's wellbeing. In the 2008 Budget Speech, the Financial Secretary issued a grim warning on this subject.<sup>107</sup>

*An ageing population is an internal challenge for Hong Kong that will have a profound impact on our community and economy... the working age population will begin to fall gradually after 2014... This means that the burden on each working person will more than double. Therefore, unless there is a substantial increase in labour productivity, an ageing population will lower our standard of living and undermine economic vitality and competitiveness.*

But as with the immigrants in the 1940s and 1950s, the government's current forebodings are overdone. Once again, the census data have been ignored. These show that the expansion of the elderly population has been more than offset by an even faster contraction in the number of children since 1961. Despite falling birth rates, the child dependency ratio in 2006 was still 9 per cent higher than the elderly ratio. Also

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<sup>104</sup> Robin Gauld and Derek Gould, *The Hong Kong Health Sector: Development and Change* (Hong Kong: Chinese University Press, 2002), pp. 127, 130, 134-5, 137-9, 147; *Lifelong Investment in Health Consultation Document on Health Care Reform* (Health and Welfare Bureau, 2000), pp. 54-5, 56; Christine Loh and Carine Lai, *Reflections of Leadership: Tung Chee Hwa and Donald Tsang, 1997-2207* (Hong Kong: Civic Enterprise, 2007), p. 54.

<sup>105</sup> Tung Chee Hwa, Chief Executive, *G/S*, 6 May 1999. On the right of abode controversy, See Albert H. Y. Chen, 'The Constitution and the Rule of Law' in Lau Siu-kai (ed.), *The First Tung Chee-hwa Administration. The First Five Years of the Hong Kong Special Administrative Region* (Hong Kong: Chinese University Press, 2002), pp. 75-8. The Chief Executive claimed that Hong Kong would be flooded by 1.67 million new residents within a decade. The statistical basis for this forecast was convincingly challenged. See Loh and Lai, *Reflections of Leadership: Tung Chee Hwa and Donald Tsang, 1997-2207*, p. 71.

<sup>106</sup> The Chief Executive announced the new approach to population somewhat obliquely (*G/S*, 1 July 2002). The statistical analysis demonstrating the severe social and economic costs of a declining population were detailed in Council for Sustainable Development, *Report of the Task Force on Population Policy* (Hong Kong, March 2002) URL: [http://www.info.gov.hk/info/population/eng/report\\_eng.pdf](http://www.info.gov.hk/info/population/eng/report_eng.pdf).

<sup>107</sup> John C. Tsang, Financial Secretary, *G/S*, pp. 10-11.



ignored is the official prediction that by 2033, the overall dependency ratio will not be very different from the mid-1980s.<sup>108</sup>

A disregard for statistical analysis affects policy making across the social services. Officials and business representatives have expressed alarm at the rapid expansion of welfare spending in the current decade, especially on social security which has been described as a direct threat to Hong Kong's low tax régime.<sup>109</sup> Nevertheless, after 1998, the government abandoned data-driven forward planning for its social welfare services. In the past, policy making began with an exercise 'which sought to match service provision with population level' in order to quantify demand and identify shortfalls. This 'conventional approach' was no longer serviceable, the Secretary for Health and Welfare argued, 'as resources are finite'. Instead, programmes would now be developed according to 'new strategic directions to achieve the paradigm shifts from "service provision" to "social investment"'.<sup>110</sup> This retreat from data-based planning was discredited by the same Secretary's decision to introduce planning for the Hospital Authority based on demand assessed initially on the basis of population.<sup>111</sup>

In the education field, policy has been bedevilled by a gap between official demands and available resources. An ambitious plan announced in 2004 for the transformation of the entire education system failed to foresee the increased burdens that radical changes in curricula and examination systems would impose on teachers.<sup>112</sup> Not until 2006 were measures introduced to ease teachers' workloads at a cost of HKD1.76 billion in annual recurrent expenditure.<sup>113</sup> There was a similar mismatch between policy and resources at university level. The official assumption was that universities could absorb cuts in funding without jeopardising their 'core activities and the quality of education',<sup>114</sup> and they were expected to underwrite the costs of adding a year to their first degree programmes.<sup>115</sup>

<sup>108</sup> The demographic data are from 2006 Population By-Census Office, *Thematic Report: Elderly People* (Hong Kong: Census and Statistics Department, 2008), Table 3.2 'Dependency Ratios, 1961 to 2006', p. 17; Support Group on Population Policy, *Enhancing Population Potential for a Sustainable Future* (Hong Kong: Sustainable Development Unit, 2006), Table 1.6 'Dependency ratios in Hong Kong', p. 47.

<sup>109</sup> Li, *The Hong Kong Economy: Recovery and Restructuring*, pp. 188-9.

<sup>110</sup> Dr Yeoh Eng-kiong, Secretary for Health and Welfare, *HH*, 5 February 2004, pp. 3097, 3098.

<sup>111</sup> *Hospital Authority. Annual Plan 2003-2004* (Hong Kong: Hospital Authority, 2003), pp. 15, 34, 35. URL: [http://www.ha.org.hk/hesd/v2/AHA/ANP0708/HAAP0708\\_E\\_final.pdf](http://www.ha.org.hk/hesd/v2/AHA/ANP0708/HAAP0708_E_final.pdf).

<sup>112</sup> Professor Arthur Li Kwok-cheung, Secretary for Education and Manpower, *G/S*, 11 December 2004.

<sup>113</sup> Li, open letters to teachers circulated by the Education and Manpower Bureau on 16 January and 27 February 2006.

<sup>114</sup> Tung, *G/S*, 6 December 2003. On the severity of the cuts, see Li, *G/S*, 18 June 2003; Fanny Law, Permanent Secretary for Education and Manpower, *G/S*, 12 November 2003.

<sup>115</sup> A history of the effort to push self-financing can be found in Education Bureau, 'Item for Finance Committee' (FCR(2007-08)36, November 2007). URL: [http://www.legco.gov.hk/yr07-08/english/fc/fc/papers/f07-36e\[1\].pdf](http://www.legco.gov.hk/yr07-08/english/fc/fc/papers/f07-36e[1].pdf). The financial constraints on the capital costs dating back to 2006 are very evident from Michael Suen, Secretary for Education, *G/S*, 23 January 2008.

## 12. Conclusions

The historical record demonstrates that there was a considerable gap between Hong Kong's overall performance – which was astonishingly successful – and the often ill-founded convictions on which policies were based. This style of government is a natural consequence of political arrangements where the decision makers do not come into office with political visions or ideological agendas that generate policy initiatives. The survival of such preconceptions is almost inevitable in a constitutional system where there is no electoral pressure on senior officials to justify their proposals or account for their performance in public.

Recent Hong Kong performance points to a similar mismatch between Hong Kong's ability to generate new growth in the face of considerable obstacles and the perceptions of the policy makers. The continuing conviction of Hong Kong's fragility and the persistence of Malthusian preconceptions that people are likely to pose insoluble problems may have a survival value in Hong Kong's special circumstances. In the absence of representative government, it is easy for challenges to be ignored. The government's dismal view of both the present and the future, especially when it comes to welfare, helps to displace complacency.

There are some preconceptions whose survival is harder to account for, in particular, the phobia about social insurance. Hong Kong is not a society where the public will tolerate leaving those in genuine need to suffer from penury. As a result, the development of social services is an expanding responsibility which the government cannot refuse and which annual budgets must finance. Yet, neither the government nor the business community has recognised how social insurance would ease budgetary pressures as well as reducing the potential tax burden on business.

Many of the inconsistencies and contradictions which this paper has identified are the result not so much of official indifference or incompetence but of a flawed approach to administration. The persistent conviction that sound policies are still possible if inconvenient statistics are ignored points to serious defects in the machinery for developing policies and taking decisions. Fortunately, Hong Kong's economic resilience and social cohesion generate such impressive results that the community can absorb the costs created by an administrative culture which maintains a preference for unsubstantiated convictions and preconceptions rather than rational principles and statistical information. In this context, the ultra-cautiousness shown in managing the budget and the government's reserves may have some merit, albeit unintended. Financial secretaries have not been able to take it for granted that the policies and programmes which they are asked to fund are as well-grounded in reality as their official colleagues believe or that they can deliver the results that they promise. Nevertheless, as this paper has illustrated, the costs of administrative failings have been severe, both economically and socially.

Perhaps the most striking conclusion of this paper is how much the style of government is peculiarly Hong Kong and markedly different from the United Kingdom and other former colonies. This historical feature has been of particular importance in the restoration of the exercise of Chinese sovereignty. Hong Kong's economy had always been dependent on the Mainland, and the colonial administration had always understood that, as a result, Hong Kong could not allow itself to be treated as an extension of United Kingdom markets and financial institutions. In consequence, Beijing had no need to try to disentangle Hong Kong from a set of commercial and financial relations which integrated it into the United Kingdom economy. Nor were there structures and systems to be dismantled because their goal was to promote the United Kingdom's interests at Hong Kong's expense. Thus, the Basic Law's drafters could preserve the policies and practices of the past without compromising China's national interests.