

# Hong Kong

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## Introduction

The minimalist state of Hong Kong is under transformation in the brave new post-colonial world. On 1 July 1997 British rule ended. China resumed sovereignty over Hong Kong and granted it the right to self-government for at least 50 years, except over diplomatic and defence matters. Under an arrangement described as “one country; two systems,” Hong Kong has become a Special Administrative Region (SAR) of the People’s Republic of China. As an administrative state, colonial Hong Kong had been at the forefront of the East Asian economic “miracle” between the 1970s and the mid 1990s. Colonial Hong Kong, however, was an exception in a region where economic developments have been largely propelled by state-led strategies.<sup>1</sup>

That East Asian states have been able to develop their economies rapidly has been attributed to state capacity in the region. Works on industrializing Asian economies such as South Korea and Taiwan have emphasized the existence of effective states with well-developed bureaucracies capable of formulating economic policy without being captive to rent-seeking societal groups. While the political elite did form alliances with business interests, the relationship was highly unequal, with the state acting the dominant partner. Most of these states have been described as “strong states” which were willing to coerce business groups to move towards economic objectives formulated by the government.<sup>2</sup>

The colonial Hong Kong state, however, was widely seen to be minimalist. The government was not regarded as a dominant partner in its infamous alliance with the business community. In fact a popular characterization of the government-business relationship was that Hong Kong was ruled by the “Royal Hong Kong Jockey Club, Jardine Matheson and Co., the Hongkong and Shanghai Bank, and the Governor – in that order.”<sup>3</sup>

Institutionally, major business interests had been very much an integral part of the system of governance in colonial Hong Kong. A closer look, however, suggests that Hong Kong could hardly be considered a “weak state” in terms of its autonomy against society, its organizational capacity, and its effectiveness in implementing policies. The territory’s well-established economic philosophy of “positive non-interventionism” was not simply the outcome of a pro-business agenda, but also a deliberate choice by a colonial administration whose *raison d’être* was almost completely commercial. In fact, colonial Hong Kong was a dominant state. Formal political authority was concentrated in the hands of the governor, a representative of the queen of England whose formidable powers were comparable to those of the monarch in pre-democratic England; and the governor was appointed by London from the ranks of the Colonial Service and, after the demise of the Colonial Office, the Foreign and Commonwealth Office (Chris Patten, the last governor, was the only exception). In addition, colonial Hong Kong was served by a well-developed and highly efficient bureaucracy when the city went through its industrialization stage during the 1960s and 1970s. In practice the administration ruled in coalition with the major British business corporations and with the support of prominent local Chinese.<sup>4</sup>

The political system of colonial Hong Kong had remained more or less unchanged and not directly challenged (apart from an interruption of three years and eight months of Japanese occupation between 1941 and 1945) for almost one and a half centuries until the Sino-British talks on the future of the territory began in the early 1980s. Hong Kong experienced rapid economic expansion between the 1960s and 1980s despite a brief period of political turbulence in the late 1960s when the Cultural Revolution swept through mainland China. Although Hong Kong was not immune from the upheaval, the Chinese leadership made no attempt to challenge the territory’s status and Hong Kong remained British.<sup>5</sup>

Hong Kong’s economic performance remained impressive without political change until the 1980s when, fearful of an uncertain future under Communist rule, the people of Hong Kong became more assertive politically. The political turbulence in the 1980s, however, did not make any major impact on Hong Kong’s prosperity. Difficulties did occur in early

1983 when the government had to peg the Hong Kong currency to the U.S. dollar at a fixed rate to maintain economic stability.

According to the 1984 Sino-British Agreement on Hong Kong's future and the constitutional arrangements in the form of the Basic Law, Hong Kong's political and economic system are to be preserved. Some have argued that Hong Kong is merely being transferred from one type of authoritarian rule (in the form of British colonialism) to another (in the form of Chinese communism). Economically, given the integration of the Hong Kong and mainland China economies, many have maintained that the economic situation in Hong Kong would not be affected by the handover. In fact the SAR administration uses the expression, "business as usual" to describe post-handover Hong Kong.

This chapter suggests that internal political developments in Hong Kong since the mid-1980s have made a significant impact on economic management in the territory, and that this trend will be accentuated in Hong Kong's search for a post-colonial order after China's resumption of sovereignty. Although the democratization process which began in the 1980s was temporarily reversed when colonial Hong Kong became a Chinese SAR, the political system in Hong Kong had already undergone important changes prior to the political handover. This chapter examines the impact of democratization on Hong Kong's economic governance and the implications of such changes for post-colonial Hong Kong.

## Economic growth without democracy

The administrative state of colonial Hong Kong adopted a pro-business stance. Local business elites exercised influence over government through representation in the Executive Council (the highest advisory body in the colony), and the Legislative Council was dominated by civil servants up to 1976. Even by the mid-1980s the membership of both councils was entirely appointed by the government. The colonial administration also set up a consultative system in the form of committees to advise the government on matters related to the economy.<sup>6</sup>

Unlike with neighbouring Southeast Asian states, decolonization did not come to Hong Kong following the end of the Second World War as China plunged into civil war almost immediately after Japan's defeat. The leadership of the People's Republic of China then decided that British Hong Kong would serve as a window for the newly established communist state which was isolated by the West because of Cold War politics. Hong Kong faced major political challenges in the 1950s, with an uncertain political future, a massive influx of refugees from across the border,

and economic difficulties when the colony's entrepôt trade collapsed following the United Nations sanctions against China as a result of the Korean War. The colony, against all odds, managed to survive when it became clear that China had no intention of taking over the city. Strategically located, with a liberal economic policy and stable political order, Hong Kong managed to survive and prosper.

Within a 36-year span from 1961 to 1997 Hong Kong rose to be one of the richest territories in Asia, and its average wealth even surpassed that of its colonial master when the British departed. The economy took off in the 1960s, and expansion was at its most dramatic during the 1970s. During the 1960s economic growth averaged 11.7 per cent per year and international trade expanded four times at an annual rate of nearly 10 per cent. The 1970s saw Hong Kong's economy growing at an even faster pace, with an average annual increase of 21.1 per cent. Hong Kong's economic expansion was less spectacular in the 1980s, but still impressive by any standards with a 6.3 per cent average annual growth rate. The first half of the 1990s saw continuous expansion of the economy and a steady climb of per capita income. By the time that the territory turned into a SAR in 1997, Hong Kong had maintained an annual growth rate of 7 per cent for two decades, twice as fast as the world economy. Its GDP per capita, which grew at an average rate of 5 per cent per year, also doubled in the same period to reach US\$26,400. Hong Kong's average wealth was second only to that of Japan and Singapore, and surpassed not only that of the U.K. but also that of countries such as Canada and Australia.<sup>7</sup>

Unlike other East Asian economies, Hong Kong did not begin its industrial development with a phase of import substitution. In the 1950s Hong Kong's economy was based on entrepôt trade; it shifted to export-oriented industrialization in the 1960s, to internationalization of the financial sector in the 1970s, and to expansion of the service sector as well as relocation of its manufacturing sector in the 1980s. As a leading economist observed, all these phases took place without government plans or directives.<sup>8</sup> The government, confined its role to exercising varying degrees of microeconomic control over essential public services including transportation, postal services, and public utilities such as water, electricity, and land supply, and to providing regulatory frameworks. It followed a non-intervention approach to the development of private industries. In macroeconomic terms, the colonial government also resisted employing fiscal policies to accommodate the different stages of the business cycle. But the government did follow a stabilizing budgetary policy reminiscent of the Keynesian model, with budget surpluses during periods of fast growth and deficits during periods of recession.<sup>9</sup>

A number of theories have been advanced to explain why Hong Kong stayed politically stable under colonial rule for so long when turbulence

swept through neighbouring countries in the form first of the anticolonial struggle for national independence and then of internal struggle for democracy. The administration was able to provide an economic haven for both people and capital from the political and economic turbulence in China. With a stable political environment and a common law system as well as an efficient public service, the British government was able to keep its rule in the territory. Hong Kong was part of China when Britain took over and the local population has always been largely Chinese, but there was little support for independence. When the Chinese Communists took power in 1949 they deliberately kept Hong Kong as a window to the world because of economic and strategic considerations.

If China's decision not to challenge colonial rule provided the external context for political stability without independence, the absence of a strong political demand for democracy in Hong Kong has been explained with reference to specific historical circumstances, the bureaucratic polity, and the political cultures of the population.

Decolonization did not come to Hong Kong, partly because the people in Hong Kong did not see themselves as a separate nation from mainland China, and many went to Hong Kong for temporary refuge from the upheavals in the mainland and considered the British-administered territory as a place of transit from where they would move on once they secured the economic means to do so. By the 1970s, however, the local population, better educated and with a stronger sense of belonging, began to demand more political involvement in the governmental process. When Sino-British negotiations began in the mid-1980s Hong Kong society was further politicized by the uncertain prospect of reunification under Chinese Communist rule. A democracy movement developed rapidly.

During the Sino-British talks the people of Hong Kong were often relegated to the position of bystanders, but many did make their views known and political groups were formed to champion their political demands. By 1984 when the Sino-British agreement on Hong Kong's future was reached, the political system was being gradually liberalized. Political reforms in the 1980s began at the local level with the establishment of district boards with elected members to advise the government on matters affecting the welfare of the district. The government subsequently not only further broadened the base of citizen representation at the level of local and district administration, but also introduced elected seats to the Legislative Council as the British and Chinese governments negotiated for Hong Kong's future in the early and mid-1980s.

Although the Chinese government remained suspicious of British intentions, it accepted limited democracy for Hong Kong. By 1991 the people of Hong Kong had already taken the first steps towards democracy

by directly electing their representatives to the Legislative Council which was moving towards a fully elected legislature. Sino-British confrontations over the pace and scope of the democratization process, however, marked much of the final phase of Hong Kong's existence as a British colony with the arrival of the last British governor, Chris Patten, in July 1992.

In the aftermath of the 1989 Tiananmen crackdown on the pro-democracy student movement in Beijing, the British government attempted to restore both the confidence of Hong Kong and its international reputation as a responsible colonial power by pushing for faster democratic reform and introducing a higher degree of representation in the last colonial Legislative Council elections in 1995. Following the introduction of a constitutional reform package, which was vehemently opposed by the Chinese government, the people of Hong Kong cast their votes for a fully elected Legislative Council in September 1995. Electoral politics and political parties have also emerged in the political landscape of Hong Kong politics where the voices for labour and other grass-roots groups and demands for more government action to improve the livelihood of the people have become important elements in local politics. The Hong Kong government's traditional hands-off approach to economic governance was increasingly challenged towards the end of colonial rule.

## Hong Kong under Chinese sovereignty

The first Hong Kong SAR government under Tung Chee-hwa's leadership is widely expected to be a pro-business administration. The fact that Tung Chee-hwa comes from the business community himself and is supported by prominent businessmen in the territory has given rise to suggestions that Beijing's promise of "Hong Kong people ruling Hong Kong" (*gangren zhigang*) would turn out to be "business people ruling Hong Kong" (*shangren zhigang*). Moreover, the rationale for Hong Kong's existence as a SAR and the privileges granted to the territory in maintaining a high degree of autonomy is based primarily on economic considerations. Although the "one country, two systems" formula is also used by the mainland government as a solution to the problem of reunification with Taiwan, Beijing obviously would like to see an economically thriving Hong Kong dominated by business interests rather than a politically active Hong Kong dominated by popularly elected democrats and grass-roots leaders.

Tung Chee-hwa himself has repeatedly asserted that Hong Kong became too politicized during the decade or so of political transition since the signing of the Sino-British Joint Declaration on Hong Kong's future

in 1984. He would, presumably, prefer the return of the old political order which was characterized by "administrative absorption of politics," with the top echelon of government working closely with the business elite, and a restoration of the pre-Patten colonial government's laissez-faire approach to economic governance. In fact a few months after the reversion of sovereignty the SAR administration under Tung Chee-hwa insisted that things had remained unchanged in Hong Kong. If that is the case the departure of the British simply represents the replacement of one business elite group by another. The only difference would be that instead of having a pro-British business orientation, the SAR would shift towards a more pro-mainland orientation.

While the business community cannot expect the same degree of domination in Hong Kong's economic governance as it had in colonial times, it has regained its prominence as a central political force in the SAR. The chief executive is a former businessman. His closest advisers in the form of the Executive Council are also dominated by people from the business community and professionals. Among the members only Tam Yiu-chung, a trade unionist and member of the Democratic Alliance for the Betterment of Hong Kong, comes from a grass-roots background. Many executive councillors also have close connections with the mainland.<sup>10</sup>

Beijing loyalists were also able to dominate the provisional legislature established by the Beijing government following the collapse of the Sino-British talks regarding the Patten reforms. While a majority of the Provisional Legislative Council members served in the 1995 Legislative Council under the former colonial administration, political dynamics have undergone significant changes. The Democratic Party, the largest political force in the 1995 Legislative Council, was out of the provisional legislature. Political parties and other groups such as the Democratic Alliance for the Betterment of Hong Kong, the Hong Kong Progressive Alliance, and the Liberal Party, which had good relations with the leadership in Beijing during the territory's transition, became dominant forces in the legislature.

While pro-democratic forces returned to the first SAR Legislative Council following the May 1998 elections, the number of Democratic Party councillors has been reduced by 6 from 19 to 13, and the overall political strength of pro-democracy forces is short of one-third of the legislature (see table 12.1). The electoral arrangements for the first legislative elections in the SAR had the effect of ensuring that the Democratic Party and other pro-democracy groups such as the Frontier would be only a minority in the first Legislative Council in 1998. Of the 60 council seats only 20 were to be filled by direct elections based on geographical areas. Thirty seats, or half of the total, were to be filled by professional and business groups which were formed into functional constituencies, and

Table 12.1 **Political party/group strengths in Hong Kong's legislature, 1995–2000**

	Legislative Council (1995–1997)	Provisional Legislative Council (1997–1998)	First SAR Legislative Council (1998–2000)
Democratic Party	19	0	13
Liberal Party	10	10	9
DAB/FTU	7	11	10
ADPL	4	4	0
HKPA <sup>1</sup>	2	6	5
LDF <sup>1</sup>	1	3	n.a.
NHKA	1	2	n.a.
123 DA	1	0	0
Citizen Party <sup>2</sup>	n.a.	n.a.	1
Frontier <sup>3</sup>	n.a.	n.a.	3
NWSC <sup>4</sup>	n.a.	n.a.	1
Independents	15	24	19
Total	60	60	60

Source: Compiled by the author based on electoral results supplied by the government.

123 DA: 123 Democratic Alliance.

ADPL: Association for Democracy and the Development of the People's Livelihood.

DAB: Democratic Alliance for the Betterment of Hong Kong.

FTU: Federation of Trade Unions.

HKPA: Hong Kong Progressive Alliance.

LDF: Liberal Democratic Foundation.

NHKA: New Hong Kong Alliance.

NWSC: Neighbourhood and Workers' Service Centre.

<sup>1</sup> The HKPA and the LDF merged on 26 May 1997.

<sup>2</sup> The Citizen Party, formed in May 1997, did not take part in the Provisional Legco elections.

<sup>3</sup> The Frontier, formed on 26 August 1996, did not take part in the Provisional Legco elections.

<sup>4</sup> The NWSC candidate was also a Frontier member but decided to run under the NWSC banner.

10 seats were to be filled by an electoral committee. Motions, bills, or amendments of government bills introduced by individual Legislative Council members can only be passed with the support of a majority of members from both categories. This effectively imposes limitations on the power of the Legislative Council. Pro-Beijing forces, well represented in the functional constituencies and the Election Committee seats, have remained dominant in the legislature.

With more pro-Beijing businessmen gaining political prominence, and as mainland China becomes one of the leading investors in Hong Kong,



a key question is: will various state enterprises from the mainland and other business ventures funded by mainland China-related organizations become the new *hongs* – firms owned and managed by British interests, which dominated the territory in colonial times? Chinese state enterprises had a long history of business activity in Hong Kong when the China Merchants Corporation was established. From 1949 to the late 1970s most mainland enterprises in Hong Kong were primarily trade agents without local business interests. By 1978 there were only 122 mainland enterprises in the territory. Their number expanded dramatically during the 1980s when a large number of provincial governments, major cities, and ministries set up companies in Hong Kong. By 1989 mainland enterprises registered in Hong Kong reached over 2,500. Between 1989 and 1991 the central government weeded out those considered not to have the necessary management and business capacities and the number was reduced to 1,500, before rising steadily to 1,830 in 1996.<sup>11</sup>

By the mid-1990s the mainland had already become a significant economic force in Hong Kong. In 1995 the gross asset value of mainland enterprises was estimated to be more than HK\$1,300 billion (US\$170 billion). Altogether there were 11 mainland conglomerates in Hong Kong with over HK\$10 billion (US\$1.2 billion) gross assets. Since May 1994 the Bank of China also became a Hong Kong dollar note issuing bank. With 11 sister banks, the Bank of China group has become the second largest banking group in the territory after Hongkong Bank. In addition to the financial sector, mainland enterprises have also penetrated into all the other major sectors of the Hong Kong economy, including trading, transportation, construction, real estate, hotels, retailing, and tourism.<sup>12</sup>

Many mainland enterprises also made use of the capital market in the territory by seeking public listing in the stock market. By mid-1997 the 63 listed enterprises, with a total share value of almost HK\$390 billion (US\$50 billion), were popularly referred to as “red-chip companies.” The red chips achieved record highs in the run-up to the handover. In fact share prices for blue chips also went up whenever rumours about the injection of capital from mainland enterprises were reported. Some observers are referring to such companies as “pink chips.” The expansion of mainland businesses in Hong Kong and their penetration of the economy have been extensive.

Representatives from major mainland enterprises are becoming not only more influential in the boardrooms of Hong Kong’s corporate world, but also in public institutions. One example is the Exchange Fund Advisory Committee. The Exchange Fund reserves are a key element in maintaining Hong Kong’s financial stability. On 17 October 1983 the Hong Kong government adopted a linked exchange rate system at a fixed rate of US\$1 to HK\$7.80. The core feature of the arrangement is the full

backing of domestic currency notes by a foreign currency. In the foreign exchange market, the Hong Kong dollar exchange rate is determined by supply and demand. The rate has remained remarkably stable since 1983 largely because of Hong Kong's large official reserves. The reserves forming the Exchange Fund, managed by the Hong Kong Monetary Authority (HKMA), reached HK\$535 billion at the end of 1996, or HK\$83,316 per person in the territory. According to the Exchange Fund Ordinance, the financial secretary exercises control of the fund in consultation with an Exchange Fund Advisory Committee chaired by himself, with other members who are appointed by the governor. The committee advises the financial secretary as controller of the Exchange Fund on general policy relating to its deployment.<sup>13</sup> While the committee members sit in a personal capacity, they represent major banks in the territory.

In 1997 the membership consisted of the financial secretary, the chief executive of the Hong Kong Monetary Authority, and top management representatives from major banks in Hong Kong, including the Hongkong and Shanghai Banking Corporation, the Bank of East Asia, the Standard Chartered Bank, the Chase Manhattan Bank, the Hang Seng Bank, and the Bank of China. Many members are also politically influential. Anthony Leung of Chase Manhattan is a member of the SAR Executive Council; the Bank of East Asia's David Li, who served on the SAR's selection and preparatory committees, represents the Financial Constituency in the Legislative Council. All are prominent figures in the field of finance who have spent most of their careers in the territory, with the exception of Bank of China's Liang Xiaoting.<sup>14</sup> Mr. Liang's membership clearly has to do with his position at the Bank of China. More representatives from major mainland banks and other enterprises are likely to be appointed to important advisory bodies. The formation of the Hong Kong Chinese Enterprises Association in 1991 gave such enterprises a collective and distinct political voice. It is perhaps not surprising that as mainland business activities in the SAR expand, representatives from the more powerful enterprises will be appointed to major advisory bodies and play a more influential role in Hong Kong's economic governance.

However, the mainland Chinese enterprises are unlikely to play a role similar to that played by the *hongs*. The domination of British business interests was evident in the days of colonial rule. In 1965 over one-third of the seats of the Executive, Legislative, and Urban Councils were occupied by British businessmen. In 1976 all but two of the major business groups were owned and controlled by expatriate business families. But the *hongs* have been on the decline since then. By 1986 Chinese businessmen such as Li Ka Shing and Y. K. Pao had taken over a number of British firms, and expatriates occupied only 13 per cent of the council

seats. The steep decline of the British businesses and their political influence reflected structural changes in the Hong Kong economy. A number of local Chinese firms have become immensely successful. The structural diversity of the Hong Kong economy, which consists of international businesses, a number of large Chinese firms, numerous small and medium-sized enterprises, and Chinese enterprises which are in turn diversified in nature, means that business interests are not always coherent, and this would make it hard for mainland Chinese enterprises to acquire the kind of dominance that the *hongs* once possessed.<sup>15</sup>

Moreover, the political elite from the pro-Beijing business community may also encounter resistance from the ranks of the bureaucracy. Unlike their counterparts elsewhere, as the elite of an administrative state Hong Kong's top civil servants have been both politicians and administrators responsible for formulating and implementing policies. Therefore they have had power to make policy choices as well as to explain government policies to the public. The rise of the new elite is threatening their positions.

Although pro-China and pro-business interests will be influential forces in shaping the economic governance of the Hong Kong SAR, the diverse economic structure and fragmentation of business and pro-China interests as well as resistance within the administration are likely to limit their influence. The introduction of electoral politics in Hong Kong also means that labour and welfare interests cannot be easily brushed off. While the institutional machinery which serves the new political elite in the SAR has become more powerful, Hong Kong's democratization in recent years has injected new elements into government-business relations as the territory transforms into a SAR within the PRC.

Only a few days before the political handover, on 25 June 1997, the Legislative Council hastily passed new labour laws to provide workers with the right of collective bargaining and better conditions of work. The government was opposed to the introduction of such laws, arguing that they had not been properly discussed in the normal consultative channels such as the Labour Advisory Board. The secretary for education and manpower, Joseph Wong, suggested that the laws would adversely affect industrial relations in Hong Kong with far-reaching consequences. The members of the Liberal Party, which represents business interests, walked out of the council meeting in disgust when their opposition to the bills was ignored by other legislators representing grass-roots and labour interests.<sup>16</sup>

Major chambers of commerce in Hong Kong expressed their opposition to the new labour laws in a joint newspaper advertisement, and many expect the SAR government to repeal the laws. Chairman of the Hong Kong General Chamber of Commerce James Tien wrote on 29 June 1997

that Hong Kong had been polarized by labour issues and policies under the last colonial administration. Tien, who is also a member of the Liberal Party, expected that "In the SAR era, employers and employees, instead of resorting to collective bargaining, strikes, union militancy and private members' bills will resolve their differences through reason, dialogue and compromise, and work towards a common goal – maintaining stability and prosperity for Hong Kong." He further maintained that "we need to ensure the executive administration is not overwhelmed by populist politicians who entice voters with free lunches and welfare promises. The representation in the legislature needs to be more diverse and reflective of the wide range of views in our community." He predicted that "In the SAR era, with economics taking precedence over politics, we will return to a more orderly and productive environment which we had during the time when our GDP growth was double what it is today."<sup>17</sup>

When the SAR government introduced the Legislative Provisions (Suspension of Operation) Bill 1997 to freeze seven laws passed by the former Legislative Council, including those related to labour matters, members of the Provisional Legislative Council raised objections.<sup>18</sup> The government's unprecedented move to suspend ordinances already in operation was seen as a departure from usual practices.<sup>19</sup> The Provisional Legislative Council supported the administration's position on four ordinances related to labour matters with 40 votes, but not the other ordinances. The council also extracted a promise from the government not to extend the freeze beyond 30 October 1997 without its approval.

There is little doubt that the business community has maintained its influence and indeed reasserted itself as the central political force under the Tung administration. This is demonstrated by the reversal of the democratization process with the establishment of a more pro-business and pro-Beijing Provisional Legislature. Pro-Beijing political forces continued to dominate the first SAR Legislative Council, helped by the new electoral arrangements, and pro-democratic political forces were left with 19 seats following the elections.

Unlike in the old colonial days, the legislature will not be dominated by the business elite alone. Not only will a significant minority voice in the form of the Democratic Party be likely to persist, but some of the pro-China groups such as the Democratic Alliance for the Betterment of Hong Kong, and the Hong Kong Federation of Trade Unions, are also strongly oriented towards labour and grass-roots interests. The labour laws passed by the Legislative Council were the result of a coalition among groups with different positions on the Beijing government. Furthermore, according to the Basic Law additional directly elected seats will be gradually introduced in the legislature: half of the 60-member assembly will be returned by direct election by 2004. With the introduction

of competitive electoral politics, even in a limited form, and with a much better-developed political culture of open debate and discussion, even under constraints, the political landscape of Hong Kong has undergone fundamental change. The conditions for restoring the old intimate business-government relationship no longer exist.

Towards the end of colonial rule the administration had come under increasing pressure to re-define "positive non-interventionism." Political changes following the Sino-British negotiations for the return of Hong Kong to Chinese sovereignty have opened up a political system which was remained closed to those outside the establishment. As a commercial centre Hong Kong has also faced tougher competition from neighbouring industrializing economies. This chapter examines changes in the business-government relationship in the Hong Kong SAR by examining three interrelated issues: economic ideology, institutional and policy developments, and the political environment in the territory.<sup>20</sup>

## Economic ideology in flux

Hong Kong's minimalist approach, originating in the nineteenth-century British tradition of allowing free play to market forces, has guided the government's economic policies ever since the establishment of the colony. In 1997 the territory won the title of the world's freest economy, according to the Heritage Foundation's index of economic freedom, for the third time in a row. In its 1997 review the foundation declared: "There is little government interference in the marketplace; taxes are low and predictable; increases in government spending are linked closely to economic growth; foreign trade is free; and regulations, in addition to being transparent, are applied both uniformly and consistently. Hong Kong now has the world's freest economy."<sup>21</sup>

The colonial administration's last annual report stated that "the government advocates free and fair competition. Business decisions are left to the private sector, except where social considerations are over-riding. It is considered that the allocation of resources in the economy is best left to market forces. Adopting this free-market philosophy, the government has not sought to influence the structure of industry through regulations, tax policies or subsidies." The government also held to a low tax regime and contained the growth rate of public-sector expenditure.<sup>22</sup> A recent analysis of the strength of the Hong Kong economy contains the following observation: "The clear separation in Hong Kong between the role of the government as referee, and the role of private companies as active players in the economy, is unique in Asia and rare world-wide."<sup>23</sup>

Although the Chinese system is officially socialist, the Chinese version

of socialism clearly embraces the principles of a free-market economy. At the time of the political handover in July 1997, the arguments for believing that Hong Kong's economy would continue to prosper under the same model of economic governance were very powerful. The Hong Kong economy remained robust, and the economic fundamentals were strong. The new administration's more pro-business outlook as well as Beijing's economic interests in Hong Kong should also ensure that the political transition would not bring economic disruption, and that the ideology of a free-market economy would continue to guide the SAR. The major concern seemed to be arising from the growing presence of mainland enterprises in the SAR and whether the administration could maintain the integrity of its legal system without special privileges for Chinese enterprises in the territory.<sup>24</sup>

The constitutional arrangements for the Hong Kong SAR, as promised by the Joint Declaration and confirmed by the Basic Law, are meant to ensure the continuation of the existing system in Hong Kong which was guided by a liberal economic ideology. The Basic Law stipulated: "The socialist system and policies shall not be practised in the Hong Kong SAR, and the previous capitalist system and way of life shall remain unchanged for 50 years" (Article 5).

The framework of economic governance as provided for under the Basic Law included the following elements: independence, preservation of the present economic and legal framework, development of appropriate policies to maintain the current financial system which is both liberal and highly open, and maintenance of the existing international network. These features are stipulated by various articles in the Basic Law:

- The Hong Kong SAR shall have independent finances. It shall use its own financial revenues without contributing to the central government. The central government also cannot levy taxes in the SAR. (Article 106.)
- The SAR shall practise an independent taxation system and continue to pursue a low-tax policy. (Article 108.)
- The Hong Kong SAR shall provide an appropriate economic and legal environment for maintaining Hong Kong's status as a financial centre. (Article 109.)
- The Hong Kong SAR shall formulate its own monetary and financial policies, and safeguard the free operation of financial business and markets with proper regulations. (Article 110.)
- The Hong Kong SAR shall ensure the continued free convertibility of currency with no foreign exchange control, and the free flow of capital in and out of the territory. (Article 112.)

- The Hong Kong SAR shall maintain its status as a free port, remain as a separate customs territory, and pursue a policy of free trade. (Articles 114, 115, and 116.)

In a study of the legal order of the SAR, one of Hong Kong's most prominent public law experts states that "the intention in the Basic Law was to entrench the existing capitalist system."<sup>25</sup> The reference to previous/existing practices and policies suggests that the SAR government would have to operate within the economic framework that was in place prior to the signature of the Joint Declaration between the two sovereign governments. While the legal framework stipulated in the Basic Law has guaranteed the independence and liberal orientation of the economic system in Hong Kong, the SAR would still be able to pursue broad economic objectives using different instruments and with varying degrees of involvement in macroeconomic management.

Hong Kong's 1997–98 budget, which is a product of joint Sino-British consultation, confirmed that the capitalist system will remain unchanged, and the commitment to Hong Kong's role as an international business and financial centre was demonstrated by the administration's decision not to increase business and profit taxes. In 1998, when the financial secretary announced tax cuts and increased benefits for the public in the first budget that was prepared wholly for the SAR, he also maintained that the SAR government remained small and efficient, with total public expenditure kept below 20 per cent of GDP.<sup>26</sup>

At the time of the political handover, the administration was set to carry on the *laissez-faire* tradition of the previous administration. The SAR inherited a very strong economy. In 1997 Hong Kong was the world's fifth largest banking centre for external financial transactions, the fifth largest foreign exchange market, the seventh largest stock market, the seventh largest trader, and the busiest container port. It was ranked as the second most competitive economy in the world in 1997 after Singapore by the World Economic Forum, and reclassified as an advanced economy by the International Monetary Fund. In Financial Secretary Donald Tsang's words, "Hong Kong is already the best place in the world in which to do business. The Government is totally committed to ensuring that it remains so."<sup>27</sup>

In February 1998, outlining some of the economic problems Hong Kong could have to weather in 1998 and 1999, the financial secretary remained optimistic about the SAR's economic situation. Acknowledging the economic pain resulting for the SAR from a sharp decline in stock-market and property-market values, he nevertheless remained optimistic about Hong Kong's economic outlook. While the government recognized

that the financial turmoil would damage the territory's external trade growth and that unemployment would likely rise, the financial secretary forecast a modest yet positive GDP growth of 3.5 per cent for 1998. He also predicted a solid 4.8 per cent growth in exports of goods and a 3.5 per cent growth of exports of services, as well as an inflation rate at around 5 per cent.<sup>28</sup>

In choosing "Riding Out the Storm: Renewing Hong Kong Strengths" as the title of his speech, the financial secretary maintained that he was guided by two principles: assurance of continuity matched with incentives for new growth. The chief executive has also repeatedly affirmed that "we practise a sound macro-economic policy of small government, with strong support for the free market."<sup>29</sup> This seemed consistent with the economic policy of previous administrations. In short, the new SAR government indicated that it would continue a pro-business and laissez-faire economic policy, i.e., "business as usual."

But as Norman Miners has pointed out, the government's belief in the free market is not absolute. Sir Philip Haddon-Cave, financial secretary of the territory during the 1970s, who coined the term "positive non-intervention" to describe the government's approach to economic management, clearly felt that the administration did have a role in the management of Hong Kong's economy. His view was that the government would provide the basic legal framework and infrastructure to facilitate the operation of market forces.<sup>30</sup> From the 1970s onward, however, the growing sophistication of the Hong Kong economy, and rising protectionism in the form of non-tariff barriers in the industrialized world as well as the intensification of competition from neighbouring countries, have eroded the liberal economic ideology of the administration.<sup>31</sup> In fact the business community, which had in past always endorsed the liberal economic ideology of the government, has urged the government to provide more support to business.

While the government has continued to adopt a hands-off approach to economic management, a number of economic crises have forced the government to step up regulatory actions and provide more direct support to local industries. For example, the government established the Securities and Futures Commission in 1989 to regulate the trading of securities, futures, and leveraged foreign exchange contracts in response to the exposure of deficiencies of regulatory framework following the market crash of 1987.<sup>32</sup> Reflecting growing pressure on the government to assume a more active role in regulating economic activities and providing more support to local businesses, the Hong Kong 1997 yearbook proclaimed that the government's policy was "minimum interference and maximum support."<sup>33</sup> In fact the market crash of 1997 prompted the government to conduct a comprehensive review of the financial markets



in Hong Kong. Although the report maintained that the economic system in the territory was sound and the regulatory mechanism had worked during the financial crisis, it also made specific recommendations to tighten the regulatory framework further.<sup>34</sup>

In his first policy speech as chief executive of the SAR, Tung Chee-hwa suggested that under his leadership Hong Kong's development strategy would be based on a free-market economy and a prudent fiscal policy. But he obviously considered that a new strategy would be required to push Hong Kong forward. He announced that a commission on strategy development would be set up to "conduct reviews and studies on our economy, human resources, education, housing, land supply, environmental protection, and relations with the Mainland, to ensure that our resources are well used, and that we keep up with the world trends in competitive terms, and that we maintain the vitality of Hong Kong's economic development."<sup>35</sup> Thus while Tung preaches the same fundamental economic philosophy as previous administrations, he obviously also wants to adopt a more proactive approach in developing a new economic strategy for the SAR.

From a different direction, the introduction of a more representative Legislative Council since the early 1990s has also generated more pressure for the promotion of labour and welfare rights, which in turn has led to more intense pressure on the government from the business community to protect business interests in Hong Kong.

In general, the number of public institutions involved in developing government economic policies, maintaining the regulatory framework for the economy, and promoting economic growth and better opportunities for Hong Kong businesses has grown steadily in recent years.

## Institutional and policy changes

The Hong Kong state has been described as weak not because it has an ineffective administration or one with limited autonomy vis-à-vis society, but because it has kept government involvement in the economy to a minimum in the past. The weakness of the Hong Kong state was therefore the result of a policy choice guided by a liberal economic ideology and other political considerations. In terms of resource and capacity the bureaucratic machinery of Hong Kong is by no means weak.

The chief executive of the SAR took over a powerful bureaucratic machinery when he assumed office on 1 July 1997. Under colonial rule, political power was always concentrated in the hands of the governor. The governors were advised by the Executive Council and implemented government policies through the policy branches which were in turn

supported by government departments and agencies. A parallel network of statutory bodies, many directly answerable to the governors, also existed to support or implement government policies when direct governmental control was regarded as inappropriate.

When the SAR government came into existence in 1997 there were 15 policy and resources bureaux,<sup>36</sup> 71 government departments and agencies, plus a number of statutory bodies.<sup>37</sup> The government employed over 180,000 civil servants, or about 6 per cent of the labour force. Until the 1980s the legislature was an appointed body dominated by the civil service and business. The formal governmental and public agencies or corporations were supported by 500-odd boards, councils, and advisory committees composed of civil servants and members of the public appointed by the government.

It is not my intention to review comprehensively all the institutions involved in the economic governance of Hong Kong. This section highlights the role of some of the more important institutions and assesses the impact of Hong Kong's political transition on such institutions.

Of the three major categories of public institutions – government branches and departments, other public agencies, and advisory committees – those in charge of financial matters and trade and industry are the most relevant in the present context. The Finance Bureau (formerly the Financial Branch) plays a critical role, being responsible for overall resource planning including drawing up and applying overall public expenditure guidelines. It manages and co-ordinates the annual resource allocation exercise, and compiles the annual estimates. In addition, the bureau also manages the government's revenue policy and administration, both to ensure that sufficient revenue is raised, and to keep the tax system as simple, stable, and productive as possible. It lays down and implements policies and procedures to ensure effective control and management of public revenues and expenditure, including assets and investments. Its other roles include: exercising policy responsibility for taxation, rates, fees, and charges; government accounting arrangements; procurement and tendering; land transport; printing; information technology; and the government estate. Finally it also serves as the formal interface between the administration and the legislature on all financial matters.<sup>38</sup>

Other government bureaux and departments such as the trade and industries departments also play important roles in economic governance and in facilitating the expansion of the economy. The Trade Department, for example, proclaiming its mission as to be a driving force in liberalizing world trade, plays a key role not only in the promotion and protection of Hong Kong's economic and trade interests, but also in ensuring compliance, and in safeguarding the integrity and credibility of Hong Kong's trade regime. The department has to make sure that Hong Kong indus-

trialists and traders observe the textiles control policy in accordance with the World Trade Organisation Agreement on Textiles and Clothing. It also imposes licensing control for pharmaceutical products and medicines on health and safety grounds, and ensures the availability of essential foodstuffs for emergency situations. It exercises licensing control over local consumption of controlled substances as agreed under the 1987 Montreal Protocol on Substances that Deplete the Ozone Layer. The department also imposes licensing control over strategic commodities to prevent Hong Kong being used as a conduit for the proliferation of weapons.<sup>39</sup>

The Industry Department is responsible for facilitating the further development of manufacturing and service industries. While the department has declared that its commitment to promote manufacturing and service industries will not lead to interference with market forces, it has become more active in developing closer relationships among government, business, education and training institutions, and industrial support bodies. Its priority areas include "physical, human and technological infrastructure; productivity and quality; applied research and development of products and processes; technology upgrade and transfer; and monitoring and informing industries of world-wide developments that may impinge on their competitiveness in the global market."<sup>40</sup>

Although the government does subscribe to a liberal economic ideology, it is clear that the government cannot be truly *laissez-faire* as the Hong Kong economy becomes increasingly complex and sophisticated. In recent years the Hong Kong government's role in macroeconomic management has become far more visible. A large number of government departments and other public corporations have been set up to regulate the economy and provide more support to local industries, to ensure the territory's compliance with international agreements.

One example is the Intellectual Property Department. As intellectual property has become an important element in the world trade regime, the government established the department on 2 July 1990. It is the focal point in the review and enforcement of Hong Kong's intellectual property legislation. The department also administers the system of registration of trade marks and patents.<sup>41</sup> Of the numerous institutions established in recent years in economic governance, the most important is the Hong Kong Monetary Authority. It was established on 1 April 1993, by merging the Office of the Exchange Fund with the Office of the Commissioner of Banking. The primary monetary policy objective of the HKMA is to maintain exchange rate stability within the framework of the linked exchange rate system which is set at the rate of approximately US\$1.00 to HK\$7.80. The authority is also required to promote "the safety and stability of the banking system through the regulation of

banking business and the business of taking deposits, and the supervision of authorized institutions; and to promote the efficiency, integrity and development of the financial system, particularly payment and settlement arrangements.”<sup>42</sup> In defence of the Hong Kong currency in October 1997, the HKMA adopted measures which led to increased interest rates in the territory. The attack on the Hong Kong currency has prompted debates in Hong Kong about the link system. While a majority of Hong Kong analysts and the public support the system, some economists have argued that the HKMA should not rely solely on interest rates to defend the Hong Kong currency. But after the HKMA’s review of the currency defences, the government decided to continue with the existing linked exchange rate mechanisms.<sup>43</sup> In August 1998, however, the government decided to intervene in the stock market to prevent “speculators” who were engaged in double play – selling Hong Kong dollars to force a higher interest rate and selling short in the stock market anticipation of a fall in stock prices as a result of an interest rate increase.

The government’s more proactive approach to economic management is reflected by the establishment of organizations such as the Hong Kong Industrial Technology Centre Corporation, the Hong Kong Industrial Estates Corporation, a Software Industry Information Centre and Cyberspace Centre, and efforts in promoting research and development as well as the establishment of the Government Task Force on Services Promotion.

The financial secretary in the 1997 budget reaffirmed the proactive approach. He identified government efforts in four areas: manufacturing, services, the financial sector, and infrastructure. In his speech he announced the government’s plans in support of the manufacturing sector which included: HK\$410 million earmarked for Science Park Phase I; planning for a second industrial technology centre; planning work started on a fourth industrial estate; applied research and development schemes to support technology ventures with HK\$250 million seed money. In the area of services promotion, the government announced the formation of a new Services Promotion Strategy Group, bringing the government and the private sector together. The government also concluded negotiations on all major air services agreements and issued six new licenses for personal communications services. The Export Credit Insurance Corporation is to introduce a specific insurance policy for small and medium enterprises. Through the Services Support Fund, the government committed HK\$28 million to help 14 projects. The Trade Development Council is to spend another HK\$30 million in 1997–98 to promote exports of services. The financial sector is supported through the introduction of legislation to permit development of a captive insurance industry. A Mortgage Corporation is to commence operation in 1997. The government is also

to develop a Mandatory Provident Fund to spur creation of new financial products, and launched 10-year Exchange Fund Notes. A large number of infrastructural projects have also been completed or are about to be finished, including the Western Harbour Crossing (HK\$7.5 billion) the Ching Ma Bridge, the world's longest road/rail suspension bridge (HK\$7.9 billion), the Convention Centre Extension, the new international airport with a second runway, and plans for the Western Corridor Railway and commuter railway extensions.<sup>44</sup>

The government also formed a Business Advisory Group on 1 December 1996, and established three subgroups in February 1997 to examine issues such as deregulation, cost of compliance assessment, and transfer of services to the business sector. The new Business and Services Promotion Unit was formed in May 1997 to provide executive support. A one-stop Business Licence Information Centre in the Industry Department was opened in September 1997.

In its policy programmes for 1997–98 the Tung administration committed about US\$64 million to support the commercialization of research in information technology and other high technology fields,” and US\$6.4 million to “finance initiatives which help sustain and improve the competitiveness of the service sector.” The government also moved ahead with the development of the Science Park at Pak Shek Kok, and the establishment of a second technology centre as well as a fourth industrial estate in Tuen Mun, and explored the need for the establishment of a business park.<sup>45</sup>

The last colonial administration had set in train a proactive approach and gradually developed a set of institutional arrangements which have become more complex and much wider in scope than before. Instead of reversing the trend in economic governance, the Tung administration has maintained a strong element of institutional continuity and strengthened the government's role in economic affairs.

## Conclusions

Political developments in Hong Kong since the 1980s have altered the framework of economic governance which once served the colonial state well. Towards the end of Hong Kong's colonial days, its liberal economic ideology had already been eroded not only by a deteriorating international economic environment and increased competition from neighbouring economies, but also by a more politicized domestic environment. While the government still maintained a policy of minimum interference, positive non-interventionism was re-defined. The institutions involved in

economic governance have become more powerful as a result of new regulatory requirements created by the increasing sophistication of the economy as well as international developments.

The “weak state” of Hong Kong has tried to become more assertive since the establishment of the SAR by attempting to restore the pre-Patten political framework. The new political framework which has emerged in the SAR, however, is far more complex than the old days. The dominance of the bureaucrats is being challenged by the new pro-Beijing business elite in a system which is marked by the growing importance of competitive politics. Internationally, the globalized nature of the world economy has reinforced the vulnerability of an open and relatively small economy like Hong Kong and the importance of keeping the territory competitive. The SAR economy has been badly shaken by external economic forces. The Asian financial crisis, precipitated by the collapse of Southeast Asian currencies in the second half of 1997, subsequently led to a wider financial turmoil in the region and crippled most East Asian economies. The transfer of sovereignty and domestic political changes have also led to the reconfiguration of economic and political interests.

While mainland Chinese enterprises are becoming more important in the territory, they do not seem to have acquired special privileges. To what extent influences from Beijing would in the long run eventually alter the rules of the game in Hong Kong still remains unclear. For the time being, however, the central government has adopted a hands-off approach to the SAR. The more immediate challenge to the Tung administration is that on the one hand it has to respond to popular demand for improving the livelihood of the people, and on the other hand it must face the business groups’ misgivings about turning Hong Kong into a welfare state as well as their demand for more resources during a major economic downturn. The government’s approach to economic management is evolving within the framework of domestic and international political and economic situations which have been changing rapidly. As Hong Kong becomes more politicized and the contradictions in the political system surface, it is hardly surprising that the model of economic governance as practised in colonial days has become inappropriate. Unfortunately, the Hong Kong SAR will only be able to develop a coherent approach to economic governance after it establishes a stable political order.

## Notes

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38. The official description of the various roles of the bureau is at its website, Hong Kong Government Information Centre: <http://www.info.gov.hk/fb>.
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