

PART TWO

CASE STUDIES IN THE RELATIONSHIP BETWEEN POLITICAL, ECONOMIC AND CIVIL FREEDOMS

Chapter 4

Economic, Civil, and Political Freedoms: The Cases of Singapore and Hong Kong

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INTRODUCTION

A tale of two cities, Singapore and Hong Kong, is the opposite of Charles Dickens' *Bleak House*. Once upon a time, two islands stood barren, with nary a soul or house upon them. In Southeast Asia on the equator, Sir Thomas Stamford Raffles acquired the tropical island of Singapore in 1819 from Holland in exchange for Britain's territorial claims in the Dutch East Indies. He declared it a free port, setting in motion its history as an important trading centre. Captain Henry Elliot, twenty years later, seized Hong Kong from China to provide a secure base for British traders. Reflecting the laissez-faire sentiments of the day, he declared the island a free port, which developed as a trading emporium between East and West. Both colonies suffered severe wartime devastation under Japanese rule. Yet both rebounded, attaining levels of prosperity that are the envy of the developing world.

Singapore is a global city-state, which boldly implemented ambitious development policies and achieved remarkable economic growth with social stability. In the twenty years since it became an independent state in 1965, its per capita gross national product increased from \$470 to approximately \$6,800. With the exception of an economic contraction during 1985, Singapore generally maintained rapid economic growth, full employment, high productivity, and low inflation rates.

The British Crown Colony of Hong Kong was equally successful. Hong Kong represents the single best example of the market-economy model of development. Hong Kong overcame as many obstacles as any nation ever

faced and received virtually no foreign aid in the process. Its land area is almost resourceless and consists largely of unproductive granitic rock formations. It suffers a population density that ranks it among the world's most overpopulated areas per square mile, and it is dependent on imports for its food, raw materials and all capital equipment. Located thousands of miles away from its most important markets, Hong Kong has not had full control over population movements across its borders; and it is ruled by a colonial government that critics regard as obsolete, antiquated, and inconsistent with the principles of independence, self-rule and human dignity.

Despite these formidable obstacles, the rate of growth of the Hong Kong economy was so rapid for so long that it came to have an almost certain inevitability. In 1948, per capita income stood at \$180. Hong Kong's post-war transformation from a British trading post to an industrial economy was so dramatic that by 1985 per capita income surpassed \$6,000, despite a severe economic shock during 1982-1984. In September 1982, China announced it would recover sovereignty over Hong Kong on July 1, 1997, when Britain's 99-year lease over Hong Kong's New Territories expires. The prospect that China intended to replace British rule sent the Colony's financial, stock, and property markets into a sharp tailspin, which reflected an initial loss of confidence in Hong Kong's future. Real growth recovered by 1984 after Hong Kong weathered a currency crisis, capital outflow, declining investment, eroding public finances, and all the uncertainties attending the transition to communist rule in 1997.

The outline of this paper is as follows. First I describe the general concepts of economic, civil and political freedoms as they are used in this paper. Then, I present brief accounts of each city-state. Starting from their historical backgrounds, I review the development of their economic, civil, and political systems. In the final section, I analyze the links between economic, civil, and political freedoms for these two cases.

CONCEPTS AND MEASURES OF FREEDOM

For working purposes, the data published in the annual January-February issue of *Freedom House* supply clear rankings on civil liberties and political rights for most nations of the world. Countries are ranked on a seven-point scale from "most free," a score of 1, to "partly free," (3-5) to "not free," a score of 7.

Civil liberties encompass freedom of the press, court protection of the individual, free expression of personal opinion, and free choice in occupation, education, religion, residence, and so on. The opposite extreme is pervading fear, little independent expression even in private, and swift imprisonment and execution by a police state. In 1984, Singapore ranked 5

and Hong Kong ranked 2. Both Singapore and Hong Kong have sustained these exact ratings since 1975. It is important to note that Hong Kong, a British Crown Colony, is only one notch below the highest rating, whereas Singapore, an independent nation since 1965, is two notches from the bottom.

Political rights range from the presence of a fully competitive electoral process, to a limited role for opposition parties within a predominantly one-party state, to the complete absence of free elections, or the rule of despots unconstrained by public opinion or popular tradition. In 1984, Singapore ranked 4 and Hong Kong ranked 4. Compared with a decade earlier, Singapore improved one notch from 5 in 1982 and Hong Kong declined one notch from 3, the downgrading occurring in 1980. No explanation was given in the accompanying text to explain the reevaluation of Hong Kong's rating by the author. Since the competitive nature of the electoral process is the key to high scores on political rights, the election of an opposition leader to Singapore's parliament in December 1981 in a predominantly one-party state warrants some improvement in its ranking. However, colonial Hong Kong, which has seen a considerable expansion of elections throughout the 1980s to encompass the Urban Council, District Boards, rural Regional Councils, and even its previously fully-appointed Legislative Council, mysteriously fell in the ranks. Hong Kong deserves better, much better!

Freedom House provides no comparable concept, measure or ranking of economic freedoms that might be compared with civil liberties and political rights. A comparable treatment would require the analyst to develop a variety of indicators and assemble the requisite data to score countries on an overall measure of economic freedom.

A good approximation to the attributes of economic freedom appears in *Free to Choose*. In their best-seller, Milton and Rose Friedman propose adding an economic bill of rights to the American Constitution to preserve economic liberty.¹ Seven suggested amendments include: (1) a tax or spending limit on the federal share of national income; (2) no duties on imports or exports; (3) no wage and price controls; (4) no government-imposed occupational licensure; (5) all direct taxes must be assessed at a flat rate; (6) a money supply growth rule to insure sound money; and (7) an inflation-protection amendment. To these we might add such provisions as free movement of labour and capital, lack of exchange controls, proprietary rights, free entry and exit in every line of industry, and absence of state monopolies for procurement or distribution, some of which are implied in the Friedman bill.

SINGAPORE

Singapore, “the Lion City,” is an island, city-state economy, located on the equator.² About 77 percent of its 2.5 million people are Chinese; Malays constitute just under 15 percent and Indians just over 6 percent.³ Its land area of 600 square kilometres is largely devoid of natural resources, and its people import the bulk of their food and raw materials. Singapore’s major assets are a strategic location on the trade routes connecting Europe and Japan, an excellent harbour that does not require periodic desilting, a diligent workforce, and an honest, efficient government inherited from British colonial days.

Founded in 1819 by Sir Thomas Stamford Raffles, an entrepreneurial employee of the East India Company, Singapore soon became a well-known port and marketplace in Southeast Asia as well as the centre of British economic interests in the region. Raffles grafted a policy of economic liberalism onto a strategic location. By making Singapore a free port, he broke the Dutch trade monopoly in the region. Trade became the major economic activity, and British influence spread over the entire Malay peninsula.

For the next century-and-a-half, the island’s rulers adhered to its founder’s vision of making Singapore a great emporium resting on the Victorian doctrine of free trade. Successive colonial governors zealously nurtured the port, maintained a lean and efficient administration, and allowed merchants and bankers full scope for the exercise of their talents—a nineteenth century *laissez-faire* approach to economic affairs. Taxes were held to a minimum, and no harbour dues were levied as these could harm shipping and commerce. Indeed, voluntary contributions of private citizens, not government taxes, financed the construction of the island’s first lighthouse. It was government policy to avoid monopolies and encourage competition to assure efficient business practices and low costs.

Politically, Singapore moved from a trading post under the control of the East India Company to a British Crown Colony in 1867. It was integrated into a broader political unit known as the Straits Settlements, which encompassed the British possessions of Penang and Malacca. It developed close economic ties with the nine states of peninsular Malaya that were under British influence. It adopted a financial system which pegged the Singapore dollar to the pound sterling, in which the local bank note issues enjoyed 100 percent backing in sterling. Its steady growth as a trading centre and home to British regional interests was interrupted when Japan occupied the strategic port during World War II. The British returned in 1946, but Singapore had a new status as a separate Crown Colony, since Penang and Malacca were joined into a broader Federation of Malaya.

Political independence was inevitable, and elections were first held in 1947. Singapore gradually moved to internal self-government in 1959 when Lee Kuan Yew, Singapore's first Prime Minister, and his People's Action Party (PAP) took control. The PAP attained full independence through a merger with Malaysia in 1963. However, this merger was shortlived. Singapore was expelled from Malaysia in 1965, when it became an independent, sovereign nation.

Apart from having to rehabilitate a war-ravaged economy, the immediate post-war years placed three major obstacles in Singapore's path to prosperity. First, a communist insurgency in Malaya between 1948 and 1960 spilled over into urban Singapore in the form of labour-union agitation. Labour unrest would complicate any plan to encourage industrialization. Political stability was a *sine qua non* of development. Second, as rising protectionism brought stagnation to entrepôt trade during the 1950s, unemployment threatened to become a serious domestic problem. Third, shortly after independence in 1965, Britain announced plans to withdraw its armed forces stationed in Singapore at an accelerated pace. Since British military spending accounted for almost 20 percent of the gross national product and 6 percent of employment, accelerated withdrawal threatened to create both a severe recession and a defence vacuum.

Lee Kuan Yew and the PAP proposed a political union with Malaysia, which would provide a good-sized domestic market for an industrial strategy of import substitution. Expulsion from the union with Malaysia in 1965, on political grounds by the government in Kuala Lumpur, destroyed the import-substitution strategy, since after 1965 Singapore-based goods faced a tariff wall throughout the rest of Malaysia. Producing for the smaller domestic market in Singapore alone could not generate enough new jobs. Factories which had been established with the hope of a larger market faced excess capacity. By the mid-1950s, the British had largely defeated the local communist insurgency in Malaya, thus restoring overall stability to the region. The PAP set about creating jobs through a policy of industrialization and shifted from exclusive reliance on the entrepôt trade that historically had been the foundation of the economy.

Independent Singapore inherited the free port and free-trade policies of its colonial past. Until the end of the 1950s, when entrepôt trade was the mainstay of the economy, the only major import and excise taxes were on petroleum, liquor, and tobacco, levied for revenue purposes. During the import-substitution phase of industrialization from 1959 through 1967, tariffs and quotas were imposed to protect nascent industries.

To assist local entrepreneurs and to stimulate the development of import-substituting activities, the government adopted legislation in 1959 exempting approved "pioneer industries" from the 40 percent company

profits tax for five years and generous depreciation allowances. It temporarily abandoned the principles of free trade in favour of modest import tariffs and quotas. The government actively directed and participated in the economy. It created an Economic Development Board in 1961 to grant loans to approved companies and to take equity positions. The Board was also responsible for planning, construction, and operation of industrial estates.

External adversity provided a golden opportunity for Lee Kuan Yew and the PAP. The withdrawal of British military forces freed-up a large piece of land that the government converted into a major industrial estate, providing choice facilities to foreign investors. Deprivation of a common economic market with Malaysia forced a change in policy away from import substitution and toward manufacture for world markets. A candid internal assessment of the poor performance of highly protected “pioneer” industries, along with the recognition that import protectionism damaged the entrepôt trade and inhibited the development of new exports, reinforced the reality of a shrinking domestic market. The government also got control of the labour movement with restrictive legislation on labour activists and union activity.

Economic Policy After Independence

After 1965, as a new, independent city-state with a sharply contracted domestic market, Singapore shifted quickly to the strategy of export-oriented industrialization. The government turned to already experienced foreign companies to invest and manufacture for export. Adding to the “pioneer status” legislation, companies were given tax incentives to export. Other measures permitted total foreign ownership of Singapore firms, free immigration of necessary business personnel and remittance of profits, no controls on capital movements, favourable tax provisions for research and development in high-technology industries, provision of readily-available factory sites accompanied by many amenities, and subsidies for manpower training programs. Singapore’s government gave foreign and local businessmen a large measure of economic freedom.

To summarize, Singapore’s economic policy adopted the most typical features of the capitalist system, including private ownership, Western commercial law, encouraging foreign and domestic investment, and, where possible, adhering to the practice of free competition to attain the fastest economic growth. Singapore’s rulers emphasized the importance of economic production, making as much profit as possible, and only then to consider the problem of the distribution of wealth. Economic rewards were based largely on individual ability and performance.

Labour Regulation

A second target of economic policy was a peaceful labour movement. To secure this aim, in 1966, the PAP enacted legislation that prohibited strikes unless approved by a majority of union members in secret ballot, required registration of all unions, and forbade noncitizens and criminals from working in union activities. Further legislation in 1968 placed the promotion, transfer, recruitment, retrenchment, and assignment of tasks of workers within the sole prerogative of management—these subjects were held to be outside the scope of labour-management negotiations. The Act also encouraged collective agreements of three to five years duration.

The results were spectacular. In 1961, 116 strikes cost Singapore 410,000 lost man-days of work. The communist grip on labour unions was broken in 1964. After 1968, only seven strikes erupted in the next three years. Days lost to industrial unrest fell to 1,011 in 1977 and completely disappeared in 1978.

In effect the government set up a system of wage nonbargaining. With acquiescent unions—35 Members of Parliament were placed in the National Trades Union Congress in 1979—wage levels are decreed annually on the recommendation of a tripartite National Wages Council (NWC) composed of employers, unions, and government representatives. The NWC was set up in 1972 to recommend orderly wage changes to prevent wages from rising too rapidly and, by pricing Singapore goods out of world markets, slow down investment and economic growth.

Until 1978, increases in productivity generally exceeded wage rises. In 1979, as part of a conscious policy to use labour more efficiently (given a labour shortage and stringent immigration controls), the government raised the average wage of a semi-skilled worker by 18 percent. Wages rose 19 percent in 1980 and 20 percent in 1981. The high-wage policy, which was supposed to remain in force for three years to make up for wages having lagged behind productivity in the 1970s, was continued right up to 1985, and ran well ahead of productivity increases. Finally, the economy turned sour in 1985. Singapore's official estimate of economic growth was -1.7 percent in 1985 and is projected at -2.0 percent for 1986.

Bad results required drastic measures. The response to a contracting economy, the first in Singapore's post-independence period, and an excessive wage-cost problem was a two-year freeze on wages as expressed by annual NWC guidelines.⁴

Government Intervention

The laissez-faire policies of the colonial era gave way to a more activist and interventionist approach taken by the PAP government. Apart from severely curtailing the freedom of organized labour, the PAP government designed, directed, and participated in a bold, comprehensive industrialization programme. Earlier we noted the establishment of the Economic Development Board in 1961, which acted as the overall agency for economic development under the Ministry of Finance. The Board initiated projects and financed them in the form of loans and equity participation. It played a crucial role in the 1960s in the promotion of industrialization. The growth of manufacturing led to the creation of separate agencies during 1968-1969 for the management of industrial estates, financing of industrial development, promotion of industrial exports, and even provision of shipping services. These agencies are the Jurong Town Corporation, the Development Bank of Singapore, the International Trading Company, and the Neptune Orient line.

The government established a number of wholly owned and partially owned companies. The largest is Singapore Airlines. Other industries with substantial government ownership include trading, transportation, communications, finance, construction, shipbuilding and repairing, electronics, and engineering. By mid-1975, the government had equity participation in 52 enterprises, with a capital investment of \$173 million.

Government equity investment must be kept in perspective. Total paid-up capital of foreign-controlled manufacturing firms reached \$583 million by 1973; domestic equity capital stood at about one-third of that level. Total accumulated foreign investment in 1975 reached \$1,426 million. The development of a manufacturing industry for export in Singapore occurred predominantly in the subsidiaries of foreign companies, which substantially exceeded the government's participation in industries and business enterprises.

In 1981, the government set up a high-powered investment corporation for the purpose of buying up or buying into high-technology western companies. Its operating fund, derived from Singapore's extensive foreign exchange reserves, was in the billions of dollars. At that time, Singapore's rulers envisaged an even greater role for the state sector in the island's economic future. By 1984 the government directly owned or controlled 450 companies and indirectly about 40 more through its statutory boards. Total paid-up capital of the 450 companies was \$1.1 billion. Fixed assets were \$8.1 billion, shareholders' funds totalled \$2.9 billion, and turnover in

these companies was \$3.5 billion, equivalent to 24.6 percent of the 1983 gross domestic product.⁵

When the economic bubble burst in 1985, the government set up an economic committee under the direction of Prime Minister Lee Kuan Yew's son, Lee Hsien Loong. Its report, issued in 1986, recommended that Singapore reduce government regulation of business and excessive government-imposed costs. It blamed the island's economic malaise on high taxes and government intervention. The report stressed that individual entrepreneurship and private capital should be assigned the primary role in the development process over the corporate state and public capital in order to restore the economy to a high-growth path.

Public Finance⁶

It has been the policy of Singapore's government to concentrate on trade rather than foreign aid. Accordingly, Singapore has no net foreign debt. External assets exceed liabilities.

Since independence, public spending has remained in a narrow range, usually below 25 percent of gross national product, despite a sharp increase in defence spending following the withdrawal of British forces.

On average, direct taxes (largely income and property taxes) supply one-third of government revenue, indirect taxes about one-sixth, the sale of government goods and services about 8 percent, and investment income and miscellaneous receipts about 12 percent, which represent earnings on Singapore's official surpluses, largely external assets.

Shortly after attaining internal self-government in 1959, Singapore's leaders stretched the top marginal income tax rate from 30 to 55 percent by 1961 on taxable income exceeding US\$30,000. Since per capita income was below \$1,000, only a handful of the population paid high rates. But Singapore's leaders remained conscious of the disincentive effects that would confront its citizens as growth pushed the middle class into high tax brackets. Accordingly, they raised the threshold for the top rate from \$30,000 in 1977 to beyond \$100,000 by 1977. In 1979 the government announced a series of rate reductions that slashed the top rate to 40 percent in 1985, which bites at a threshold exceeding \$300,000, thus bringing the top marginal tax rate in line with the corporate rate. With per capita income of \$6,800 in 1985, most Singaporeans faced an effective tax rate (disregarding personal allowances) of 10 percent.

Singapore also imposes a compulsory savings scheme—a tax—known as the Central Provident Fund (CPF), to which most employed residents of Singapore and all employers are subject. Established in 1955, the CPF initially imposed a 5 percent payroll tax on both employer and employee. The combined payroll tax rose, by 1980, to 37 percent, and reached the staggering sum of 50 percent by 1985. The sum is withheld and put into the national pension fund. The fund, in turn, invests its receipts in treasury securities, which are issued by, and the proceeds subsequently held by, the Monetary Authority of Singapore (MAS). Proceeds of these treasury-debt sales are then funneled into development expenditures and loans to statutory boards, but most is invested overseas.

Conceptually, CPF funds can be treated as public sector assets which are held by the MAS. In effect, the CPF acts as an arm of the MAS, withdrawing liquidity (via the payroll tax) from the domestic economy. Proceeds of government securities, “borrowed” from the CPF, are initially deposited with the MAS, which converts these funds into gold and foreign currencies, which appear as assets on the MAS balance sheet. In essence, the CPF is a mechanism for national savings that the government can direct into infrastructure, public housing, and external assets.

Individual contributions to the fund are credited with annual interest, typically exceeding the inflation rate but below the market rate of interest. Funds may be withdrawn before retirement to purchase an apartment in a government housing estate.

A declining economy in 1985 prompted the government to reduce the CPF rate for employers from 25 to 15 percent for two years in order to reduce wage costs.⁷ It also announced reductions in both the corporate profits tax from 40 to 33 percent and the top individual marginal rate to 33 percent. The PAP has consciously sought to remove any tax disincentives to hard work. The property tax sector received a temporary fix instead of the permanent rate reduction from 30 to 16 percent that this distressed sector had sought. In general, post-1985 policy is concentrating on reducing fiscal surpluses, shifting savings to the private sector to encourage indigenous investment (much of Singapore’s savings has been invested outside Singapore by the MAS), lowering income and payroll taxes, privatizing some public-sector businesses, removing regulatory rigidities, and giving greater play to market forces.

Social Construction and Control⁸

The PAP government has remained extremely active in such social programmes as public housing, community development, and communica-

tions and education. When Singapore attained internal self-government in 1959, the PAP government accorded the housing problem top priority. It established the Housing Development Board (HDB) in 1960 to undertake large-scale public housing programmes, slum clearance and urban renewal. In 1975, reflecting Singapore's rising prosperity, the government set up another body known as the Housing and Urban Development Company (HUDC) to build apartments for middle-income groups. The government has willingly met the funding requests of the several housing boards for new construction.

The rentals and sale prices of HDB and HUDC units are heavily subsidized. HDB subsidies range from 44 percent for a three-room apartment to 27 percent for five-room units. Compared to private apartments, HUDC units are priced at a 50 percent discount. By March 1980, about two-thirds of Singapore's population lived in public housing estates. The government estimates that about 80-85 percent of the total population will live in high-rise public housing estates by 1992, when the urban redevelopment programme is completed. This will be a unique achievement for a non-communist country.

In addition, the Boards have the power to acquire compulsorily, through the Lands Acquisition Act of 1966, any private land it needs for housing development. Between 1960 and 1979, the government's share of land ownership rose from 44 percent to 67 percent. The government is also empowered to acquire lands to prevent speculation in the private property market. It typically pays below-market prices.⁹

Apart from public housing, the government has developed over 250 community centres. The PAP employs these centres as powerful channels for mobilizing mass participation in community development and support of government policies. The first centres were set up in the early 1950s when Singapore was still a British colony, but control over the community centres was decentralized. On obtaining power in 1959, the PAP disbanded all management committees of the centres and put all community organizations under the control of the Department of Social Welfare. In 1960, the PAP government enacted the People's Association Ordinance. The Prime Minister serves as chairman, and all management committees of community centres are recommended by Members of Parliament and appointed by the Prime Minister.

The PAP government has retained tight control of education and the mass media since 1959. It nationalized all schools and colleges in Singapore and put them under control of the Ministry of Education. All mass media are under the control or guidance of the government.

The PAP government has used the mass media, especially the press, radio and television, to promote and cultivate a national Singaporean identity out of the diverse Chinese, Malay, Indian, and Eurasian ethnic loyalties. Newspapers are privately owned, and are printed in English, Chinese, Malay, Tamil, and Malayalam. While reflecting the views of the public, the press generally supports government policies.

Government guidance and regulation of the press and other instruments of communication seriously encroaches on Western norms of press and speech freedom.¹⁰ The PAP government believes that Singapore's unique social, cultural and political situation justifies the application of boundaries for the freedom of the press. Newspapers must renew their licences with the government every three years. While there is no formal censorship mechanism, the newspapers adopt a cautious approach and usually exercise self-censorship to make sure that their editorial policies are in line with national policies.

Self-censorship became customary after 1971, when the PAP government took a series of measures against the press. First, it arrested the four senior executives of *Nanyang Siang Pau*, one of the two largest Chinese dailies, on a charge of having launched a deliberate campaign to stir up Chinese racial emotions. It then took disciplinary measures against the managing editor of the *Eastern Sun*, one of the two largest English dailies, accusing him of receiving a start-up loan from communist sources, and subsequently closed down the paper. It later shut down the *Singapore Herald*, which was distinguished by its slightly more critical editorials on government policy. In 1980, the PAP government temporarily suspended permits for two Chinese newspapers, *Min Pao* and *Shin Min Daily*, until the publishers pledged in their appeals to modify their editorial policies.

Reported cases of self-censorship include withholding from circulation an issue of the *Far Eastern Economic Review* by its distributor in March 1977 for fear that some replies by the *Review's* editor to certain charges by the Singapore government might constitute libel. Similarly, an issue of *Time* magazine in August 1977 contained 26 blacked-out words in a story regarding alleged government muzzling of the press in Singapore.

In general, the Newspaper and Printing Presses Act (1974) authorizes the government to grant and withdraw licences for the operation of printing presses in Singapore. A Board of Film Censors may ban films for such reasons as glorification of gangsterism, violence, crime, hippies, free love, promiscuity, homosexuality, lesbianism, incest, permissiveness, religious prejudice, racism, and political reasons. The Undesirable Publication Act (1967) prohibits the importation, sale or circulation of foreign publications

considered contrary to the public interest, which includes those that may be politically, morally, religiously, or ethnically offensive.

The government fully controls and operates radio and television services, which, therefore, always respond to government calls for promoting national identity. Only one private cable broadcasting service, Rediffusion, is allowed to provide service. It used to receive a permit of ten years duration, but in 1980 was asked to renew its permit each year. Ostensibly the cabled broadcasting service tarried in switching from various Chinese dialects to Mandarin, which the government asserted jeopardized its national policy of promoting Mandarin.

One-Party Dominance¹¹

Under Lee Kuan Yew's leadership, the PAP government tolerated the existence, but not the effectiveness, of political competition. It explicitly withholds legal recognition from the communist party and parties associating with communists. In 1972, it extended its vigilance and scrutiny to all political parties on the grounds that no political party in Singapore may be used as a proxy by a foreign power to capture control of the country. The PAP shows no commitment to a competitive political system.

The PAP oligarchy has ruled with a benevolent hand. It has successfully delivered such political and economic goods as safety, law and order, and a rapid rise in living standards. It has, in Confucian terms, earned the "mandate of heaven." Its authoritarian, paternalistic style fits the notions of good government for people reared in the Chinese cultural tradition, who comprise three-quarters of the island's population. Confucianism stresses that good government should be based upon virtue and operate for the benefit of the people, as parents affectionately care for their children; in turn, the tradition emphasizes deference to authority and filial piety as the basis of superior-subordinate relations, which curbs tendencies to openly oppose or reject authority. The dominant one party system in Singapore is also congruent with Singapore's colonial heritage, which consisted of paternalistic British rule based on centralized authoritarian decision making and executive dominance from 1819 through 1959. Notions of democratic values and political liberalism rarely extended beyond a small number of politicized Western-educated intellectuals to the general public.

In October 1981, opposition Workers' Party leader J.B. Jeyaretnam broke the PAP's 13-year monopoly in parliament winning a by-election.¹² PAP leaders regarded his election as an aberration from their rightful political monopoly. However, the 13 percent swing against the PAP in the December 1984 general election, which returned two opposition candidates

including Jeyeretnam, forced the party to take note that it was losing support, even though 77 PAP members won their contests. The televising of subsequent parliamentary debates, intended to show up the lone opposition duo, backfired. A majority of viewers polled in a newspaper survey in April 1985 revealed that 63 percent had negative feelings about PAP members. Critical letters began pouring into the newspapers, challenging government policies. The second generation of PAP leaders may have to earn its legitimacy.

HONG KONG

Since its founding in 1841, and especially during the period of postwar British colonial rule, Hong Kong has been the world's closest approximation to a free-market, private-enterprise, capitalistic economic system.¹³ Its residents have enjoyed the trading benefits of a free port, low taxes and limited government intervention in their economic and social affairs. But the British colony's post-war future was always under a cloud, regulated by the precise date of midnight, June 30, 1997—the moment Britain's 99-year lease on the New Territories (90 percent of the colony) expires. Novelist Han Suyin coined the phrase aptly describing Hong Kong as a “borrowed time, borrowed place,” an entity with a perpetually uncertain future.

In 1982, Hong Kong's uncertain future leapt onto centre stage. Chinese leaders Deng Xiaoping and Zhao Ziyang firmly indicated to British prime minister, Mrs. Margaret Thatcher, during her September visit to Beijing, that China would reclaim sovereignty and administrative authority over Hong Kong on July 1, 1997. On December 19, 1984, after two years of intense negotiations, the British and Chinese governments signed a joint declaration that determined Hong Kong's political future. On July 1, 1997, Hong Kong will be reincorporated into mainland China as a Special Administrative Region. In return for the British transfer of sovereignty, China guaranteed in writing that Hong Kong would retain considerable autonomy; in particular, the territory's more than five million residents could retain their present social, economic, and legal systems for an additional 50 years through 2047.¹⁴

Physical Setting, Population and Resources

Hong Kong lies inside the tropics on the Southeast coast of China, adjoining the province of Guangdong.¹⁵ It consists of a small part of the Chinese mainland and a scattering of offshore islands, the most important of which is Hong Kong Island. By 1985, the total land area of the Colony was 1,067 square kilometres (about 410 square miles). Of the 1,067 square

kilometres in the colony, 9 percent was used for farming and 74.7 percent was marginal unproductive land. Built-up urban and rural lands comprised the remaining 16.3 percent, within which most of Hong Kong's people lived and worked.¹⁶

Hong Kong remains one of the most densely populated places in the world.¹⁷ The total population at the end of 1984 was 5,397,500, almost evenly balanced between males and females. The 1981 Census showed that 57 percent was born in Hong Kong; the other 43 percent was largely refugees and immigrants from other countries, mainly China. About 98 percent of the population was classified as Chinese on the basis of place of origin and language, most originating from Guangdong Province.

The British physically occupied Hong Kong in early 1841, well before the Sino-British Treaty of Nanking, signed on August 29, 1842, legally transferred sovereignty and administrative control to Her Majesty's Government.¹⁸ By the end of 1841, the population of Hong Kong stood at about 15,000, of whom only a minority was foreigners. The great majority was Chinese people of the surrounding region, attracted to Hong Kong for its employment and commercial opportunities, despite the prevalence of tropical diseases. Captain Elliot, the de facto administrator of seized Hong Kong, announced that its Chinese residents would enjoy British protection, but would be governed by traditional law. Trade would be free of tariffs. Both economic and personal liberty were early fixtures of colonial Hong Kong.

The small Colony of Hong Kong almost entirely lacks natural resources. Its mineral wealth is negligible. Only one-seventh of its land is arable; the colony cannot, therefore, feed itself and throughout most of its history encountered difficulty in maintaining an adequate water supply, which it has remedied by building reservoirs and purchasing water from mainland China. Almost all industrial materials, capital goods, and the vast majority of foodstuffs are imported.

Economic and Political History Since 1841

Hong Kong became a British possession in 1841 for the simple purpose of trade with China. Although the British dominated foreign trade with China since the end of the eighteenth century, conditions at Canton were unsatisfactory, reflecting the conflicting viewpoints of two different civilizations.¹⁹

The Chinese regarded themselves as highly civilized, with little need of foreign imports. They stringently restricted foreign traders to a clearly defined trading season, excluded family members from Chinese soil,

confined the traders to a small area, forbade them from entering the city of Canton or learning Chinese, and arbitrarily varied shipping dues. Nonetheless the lucrative opium trade brought foreign free traders who hoped to get rich quickly. To stem the outflow of silver from China that financed opium imports, the Chinese emperor appointed Lin Zexu (Lin Tse-hsu) to stamp out the opium trade. He surrounded the foreign factories and compelled all foreign traders to turn over their stocks of opium. The British community retired to Macau, and then took refuge on board ships in Hong Kong harbour in summer 1839.

The British sent an expeditionary force in June 1840 to back their demands for a commercial treaty or the cession of a small island where they could live free from threats under the security of their own flag. Hostilities alternated with negotiations until the Treaty of Nanjing, signed on August 29, 1842, ceded Hong Kong Island to Britain in perpetuity. (China labelled this and subsequent treaties with Britain and other foreign powers “unequal” and therefore invalid in international law.) It also opened five Chinese ports for trade. A supplementary treaty in October 1843 granted Chinese subjects free access to Hong Kong Island for trading purposes.

Two subsequent treaties filled out the territory of British Hong Kong. The Convention of Peking in 1860, which terminated the Second Anglo-Chinese War (1856-58), ceded the Kowloon Peninsula, located directly across the harbour from Hong Kong Island, to Britain in perpetuity. The Sino-Japanese War of 1895 encouraged the British to augment their defensive position by demanding, and gaining control of, the territory north of Kowloon up to the Shum Chun River, and 235 adjacent islands. In accord with the terms in the Convention of Peking in 1898, China ceded sovereignty of these New Territories to Britain for a period of 99 years.

Colonial administration of Hong Kong followed normal British overseas practices, with a governor appointed from London assisted by nominated, not elected, Executive and Legislative Councils. British exclusivity in government gradually yielded to Chinese participation in both councils. On several occasions, local British residents pressed for self-government, but the home government rejected these demands fearing that a small European community might use self-government to take unfair advantage of the Chinese majority.

From its beginning, Hong Kong developed as an entrepôt free port, a mart and storehouse for goods in transit to Asia and the West.²⁰ This entrepôt activity diminished after World War II when the transition to an industrial economy took place.

Since World War II, manufacturing, largely export-oriented, light industries, became the mainstay of Hong Kong's economy, augmented by a myriad of servicing industries. Highly developed banking, insurance, and shipping systems created in the entrepôt era flourished in the 1960s, 1970s, and 1980s. In keeping with its free-port tradition, Hong Kong eschewed tariffs or other restrictions on the import of commercial goods.

The Political Geography of Hong Kong

From the end of World War II through July 1982, Hong Kong enjoyed remarkable political and economic stability. Local Chinese did not clamour for democracy, a British-style welfare state, or political independence. Meanwhile, China resisted political encroachment on Hong Kong. What made these circumstances possible?

One answer is found in Hong Kong's political geography.²¹ Hong Kong's prosperity served mainland China's developmental interests, largely through China's foreign exchange earnings arising from doing business in and with Hong Kong. Entrepreneurs from Britain and other countries benefitted from commerce in Hong Kong. Finally, the local residents, many refugees from China, found personal opportunity for economic improvement—life in Hong Kong was materially good. They did not clamour for more state intervention in their personal lives; many of them fled an oppressive communist government in order to obtain personal freedom in Hong Kong.

China's Benefits from Hong Kong

Since the mid-1960s, receipts from Hong Kong, which ranged as high as \$6 billion in 1983 alone, accounted for between 30-40 percent of China's total earnings of foreign exchange.²² China supplied Hong Kong with about 20 percent of its imports, a wide range of inexpensive consumer goods, oil products, the bulk of its food imports, and annually increasing quantities of fresh water. It bought less in return, leaving a balance-of-trade surplus which helped finance China's development policies. In addition, Hong Kong was the clearing house for remittances to China. Local and overseas companies and individuals remitted to their relatives and business associates upwards of \$100 million a year.

Hong Kong has the largest, deepest, and most modern port facilities along the China coast. It was an important redistribution centre for goods made in China to the outside world. Apart from quantifiable economic and financial benefits, Hong Kong provided China with indirect, but tangible, benefits in the form of access to Western technology and modes of busi-

ness management, a convenient centre for trade contacts and financial negotiations, a training ground for thousands of Chinese technicians and service personnel, and a first-hand opportunity to observe the workings of a free market economy.

Finally, China is in the fourth millennium of its national history. Consolidating its power over the mainland and beginning the job of national economic reconstruction after 1949 were more important tasks for the communist leadership than recovering Hong Kong. The half century to 1997 is just the blink of an eye on China's time horizon. Why not let the British administration and people of Hong Kong develop the most modern city in Asia outside Japan? It would, sooner or later, fall into China's hands.

Britain's Relationship to Hong Kong

Apart from a few scattered offshore, tax haven islands, and Gibraltar, Hong Kong became Britain's sole remaining major colony by the 1960s.

Local pressures on the British to hand over independence were missing in post-war Hong Kong. China ruled out national independence for Hong Kong as a feasible political option. China's leaders regarded sovereignty as indivisible. Too, a large proportion of Hong Kong residents were not Hong Kong born, but were refugees from the various provinces of China. Many of these refugees were politically acquiescent, seeking comfort and security; upon arriving in Hong Kong, they scrupulously disdained any form of political agitation. Besides, since most Hong Kong residents always presumed that their future would be determined by ministers in London and Beijing, there was little scope or point to local political activism. Therefore, most concentrated their efforts in economic, not political, activity.

In the nineteenth century, Hong Kong served as one of a string of British naval stations around the world that provided bunkering and repair facilities. By the 1980s, there was no British fleet in the Far East and the British base in Hong Kong became an isolated outpost.

Hong Kong provided Britain with modest economic benefits, which were concentrated in a handful of trading companies and individuals. Some funds flowed from Hong Kong to Britain in the form of pensions paid to retired Hong Kong civil servants living in Britain, dividends paid to British shareholders in Hong Kong firms, and payments for commercial facilities arranged through the City of London. British firms provided the railways and rapid transit carriages. The nationalized British Airways Corporation gained from Britain's authority to negotiate landing rights at Hong Kong's airport. Britain used its management of the Colony's exter-

nal affairs to grant landing rights in Hong Kong in exchange for preferential foreign routes to British Airways. Finally, expatriate British civil servants serving in the Hong Kong government enjoyed a great deal of local respect and an especially comfortable standard of living.

The Local People

To round off this tripod of consent, it remains to note that the vast majority of Hong Kong Chinese were content with British administration, despite any personal dislike of or racial aversion to “barbarians” or foreign rulers. While China convulsed in periodic political campaigns, post-war Hong Kong remained remarkably free of serious outbreaks of rioting, strikes or other forms of labour or political agitation. For most residents, Hong Kong was the only alternative to living on the Communist-ruled mainland. Too, life in Hong Kong was materially rewarding, with rapidly rising incomes. Finally, the Hong Kong government was exceptionally efficient. It housed nearly half the population in subsidized housing at below-market rents, provided a wide battery of medical and health services, and developed roads, communications, port facilities, waterworks, and public utilities at high levels, without high taxes.

Historical Precedents of Economic and Fiscal Policy

Beginning with Captain Elliot’s occupation of Hong Kong Island in 1841, the colonial government adhered to a set of free-market economic policies and conservative fiscal policies.²³ Hong Kong rigidly eschewed central planning, regulation of the private sector, budget deficits, high tax rates, industrial subsidies, costly labour regulations, and other instruments of state control. These policies were rooted in historical precedents of financial administration, a constitutional system of government, and the dogged application of an economic philosophy of nonintervention.

Hong Kong was a barren island with no large or established community entitled to political representation. It was established as a military, diplomatic, and trading station, not as a colonial settlement in the normal sense. For these purposes, the British Secretary of State for War and the Colonies imposed firm imperial control on the new colony. Self-government was never a feature of Hong Kong’s development.

In practice, administrative absolutism meant that the colonial government did little more than maintain law and order, and raise taxes to pay for the cost of a modest civil establishment and necessary public works. Parliament instructed Hong Kong’s governors to take from colonial resources all public expenditures except the salaries of only three

principal officers in the colonial government. In 1855 the governor happily announced that Hong Kong had reached the objective of fiscal self-support, thus entrenching the doctrine and practice of balanced budgets.

Hong Kong, as a Crown Colony, was administered under the colonial regulations. The regulations date back to 1837 and serve as “directions to Governors for general guidance given by the Crown through the Secretary of State for the Colonies,” especially in financial and administrative matters.²⁴ It was the responsibility of the Colonial Office to see that colonies did not incur debt and impose a charge on the British Treasury.²⁵

Colonial Office policy and the colonial regulations which applied to Hong Kong reflected the prevalent economic theories of nineteenth-century Britain, which stressed the passive role of government in the economy. Private individuals and companies, not the government, were responsible for the creation and distribution of wealth.

The form and scope of the budget changed little since the granting of financial autonomy by Britain to Hong Kong in 1958. Nineteenth-century values of economic liberalism influenced official thinking and practice in post-war Hong Kong.

Constitutional and Administrative Framework

Until September 1985, Hong Kong never had any form of representative democracy.²⁶ Administrative and executive authority lay in the hands of appointed civil servants whose personnel, at the higher levels, were largely recruited from the United Kingdom, though the pace of localization accelerated in the 1970s. Through the early 1980s, neither periodic elections nor public opinion polls guided or constrained the administrative decisions of these appointed officials. Hong Kong political activity took the form of decision making by appointed officials, sometimes within the administration, often in consultation with one of a myriad of official advisory committees, or, on occasion, by openly soliciting the public’s views.

Constitutional authority for making policy was concentrated in the Governor, assisted, in practice, by his Executive Council. The Governor’s powers were defined by the *Letters Patent and Royal Instructions to the Governor of Hong Kong*. As representative of the Queen, he was the head of government, and constitutionally accepted his instructions from the Secretary of State, though, in practice, instructions were rarely given.

As chief executive, the Governor held final responsibility for the administration of the Colony. He made laws by and with the advice and consent of the Legislative Council. In the execution of his duties, the *Royal In-*

structions stipulated that he shall consult with the Executive Council—his advisory body consisting of both *ex officio* members of government and other official and unofficial (non-government servants) persons appointed by the Secretary of State on the Governor’s nomination. No provision existed for formal voting in the advisory body; the Governor sought to distill a consensus from the advice he was given and act on this advice unless he had overwhelming reasons for not doing so. The council met regularly, in confidence, and its proceedings were confidential, though many of its decisions were later announced.

The *Letters Patent* also set forth the constitutional foundations of the Governor’s legislative authority. Clause VII stipulated that “The Governor, by and with the advice and consent of the Legislative Council, may make laws for the peace, order, and good government of the Colony.” In the end of 1984, the Legislative Council consisted of the Governor as its presiding officer, three *ex officio* high public officials, and forty-three nominated, hand-picked members, of whom thirty were not civil servants. A clear majority of Legislative Councillors were drawn from the private sector.

In November 1984, the colonial government implemented a system of indirect elections to the Legislative Council.²⁷ Twelve members are selected by an electoral college comprised of members of various locally-elected bodies (District Boards, Urban Council, Regional Council). Another twelve are chosen by specific, functional constituencies. Of the 56 members of the Legislative Council, 24 are elected, 22 are appointed non-civil servants, and 10 are high ranking civil servants. *Ex officio* and nominated members still hold a clear majority. The first election under the completely new system of partially representative government was held in September 1985. The government also committed itself to a further review of representative government in 1987 (though Beijing expressed dismay in late 1985 over the rapid pace of political reform).²⁸

Decisions of the legislature are typically consensual, with an occasional holdout or two among the appointed unofficial members. The Legislative Council rarely withholds consent from legislation proposed by the official bureaucracy. Proceedings in the legislature rely heavily upon British parliamentary procedure in which the government proposes and the legislature disposes. The norm is that official motions are overwhelmingly accepted, although members often use the forum to speak on topics of personal or public interest.

In sum, the economic and fiscal policies of the Hong Kong government have been determined largely by the Governor and his high ranking subordinates, especially the Financial Secretary, who oversees the operations of the Finance, Monetary Affairs, Trade and Industry, and Economic Services

Branches of the government. In addition to his responsibility for preparing the annual budget estimates, the Financial Secretary and his aides are heavily involved in wide-ranging activities that bear upon the fiscal health of government and the economic health of the Colony.

The Legal System

Generally speaking, the law of Hong Kong follows that of England and Wales; the common law and rules of equity were in force in Hong Kong through 1985 so far as they were applicable to the circumstances of Hong Kong.²⁹ On occasion, laws were made to apply to Hong Kong by order of Her Majesty in Council, as expressed by Article IX of the *Letters Patent*. In practice, this was largely confined to matters which affect Hong Kong's international position, such as civil aviation treaties. Local legislation, closely modelled on British or Commonwealth country statutes, augmented the common law. Cases from Commonwealth countries and the United States were quoted in the courts and considered with respect. The Hong Kong courts applied a doctrine of binding precedent similar to that adopted by English Courts. Appeals from Hong Kong courts could be lodged with the Privy Council in England, whose decisions were binding on Hong Kong courts. In short, Hong Kong residents enjoyed fundamental human rights protected under the rule of law.

Economic Policy and Performance

The performance of the colony over the last thirty-five years owes much to the minimum of interference with the free play of market forces. A low top 17 percent tax rate on individual earnings and 18.5 percent on corporations, and the lack of any capital gains tax, encourages risk-taking and hard work. The absence of tariffs and other restrictions on trade, including capital movements, makes investment in Hong Kong very attractive.

In the early stages of its industrialization, real gross domestic product grew about seven percent per year from 1948 to 1960. Between 1961 and 1980, real GDP rose 9 percent per year. As large numbers of countries stagnated in the early 1980s due to a worldwide recession, Hong Kong managed to sustain a real annual average growth rate of 7.6 percent between 1979-1984 (despite both a serious credit crunch in 1982 following an overheated property boom and an economic confidence shattering political crisis that accompanied China's announcement in September 1982 that it would takeover Hong Kong in 1997).

A steadily rising stream of industrial exports fueled Hong Kong's rapid economic growth. Exports increased by 9.4 percent a year in real terms during the 1970s. In constant terms, the value of total exports doubled between 1981 and 1984; in volume terms, domestic exports grew at an annual average rate of 9.6 percent between 1979-1984.

During the 1970's, productivity (measured by output per work-hour) increased eight percent per year at the same time hours worked per worker fell two percent per year; thus Hong Kong's labour force produced more while working fewer hours. Since the oil-reduced recession of 1974, the unemployment rate has fallen beneath three percent and the economy has worked at a full employment level despite an inflow of several hundred thousand immigrants and refugees. From the late 1950s until the mid-1970s, real wages more than doubled, and have continued to rise in the last decade.

Capital formation (savings as a share of GDP) has exceeded 20 percent throughout the 1960s and 1970s. Hong Kong's industrial transformation occurred without foreign aid or special concessions to overseas investors.

What factors have fueled Hong Kong's outstanding economic success? The answers can be found in the territory's liberal economic policies and its prudent, conservative fiscal policies.

Economic affairs in Hong Kong are conducted in an environment of free enterprise. Since 1841, government policy has dictated a hands-off approach toward the private sector, one that is well suited to Hong Kong's exposed and dependent economic and political situation. Due to its small and open nature, the economy of Hong Kong is very vulnerable to external factors, and government action to offset unfavorable external factors is often of limited effectiveness. The government holds the view that the allocation of resources in the economy is most efficient if left to market forces. Nor has the government tried to dictate the structural development of the economy.

Hong Kong's economy can be described as a free-enterprise system. It enjoys a tax structure with low rates that provides incentives for workers to work and for entrepreneurs to invest. Both workers and entrepreneurs are highly motivated, given that all individuals have equal opportunity to get rich if they work hard or succeed. The primary role of the government is to provide the necessary infrastructure together with a stable legal and administrative framework conducive to economic growth and prosperity. The infrastructure includes a modern and efficient seaport in which is located the world's third largest container port, a centrally-located airport with a computerized cargo terminal, and excellent world-wide communications. There are no import tariffs, and revenue duties are levied only on

tobacco, alcoholic liquors, methyl alcohol, some hydrocarbon oils, and the first registration of motor vehicles.

Apart from providing the necessary infrastructure, either directly or through cooperation with privately owned public utility companies and autonomous bodies, the government neither protects nor subsidizes manufacturers. It normally intervenes only in response to the pressure of social needs. The philosophy that underlies government in Hong Kong can be summed up in a few short phrases: law and order, minimum interference in private affairs, and the creation of an environment conducive to profitable investment. Regulatory economic controls are held to a minimum, no restrictions are placed on the movement of capital, and the few direct economic services provided by government are operated on a commercial basis.

Hong Kong is a completely free market in money. No barriers restrict exchange between the Hong Kong dollar and other currencies. Indeed the ever-increasing funds that were attracted to Hong Kong banks helped finance industrial development and have made Hong Kong today a major financial centre. The colony's currency, the Hong Kong dollar, is linked to the U.S. dollar at a fixed rate of HK\$7.80 to US\$1, which means that the new issue of Hong Kong bank notes must be backed by equivalent U.S. dollar reserves.³⁰ Hong Kong residents who hold Hong Kong dollar banknotes thus effectively conduct their business in U.S. dollars one step removed, since they can convert their local currency into U.S. currency at a guaranteed fixed rate. Hong Kong public officials can only create new local money after first acquiring U.S. dollars to back the issue of local notes either through a balance of trade surplus or capital inflows from abroad.

It is a general principle of Hong Kong's economic and tax policy not to discriminate between residents and non-residents. On this principle, overseas investors may fully own local factories.

Hong Kong is a duty-free port and allows the entry and exit of most raw materials, consumer goods and commodities, with only a registration charge. The absence of tariffs and exchange controls means that Hong Kong manufacturers can supply both domestic and foreign markets on the basis of least-cost production.

The government of Hong Kong does not impede the setting up of private business enterprise. Free entry is permitted and encouraged into almost every line of production. Legal formalities to set up business are few and inexpensive. Except for land grants from the mid-1970s to land-intensive industries that inject new technology into the economy, no protection or government assistance is traditionally given to manufacturing industries, utilities, service industries, or private citizens. No attempt is

made to distort factor prices in favour of any particular type of development. Market forces are allowed to shape the economy, and industries that lobby for protection from the competitive forces of the market place are fiercely resisted. As a result, Hong Kong enjoys among the most modern factory facilities in the world.

Hong Kong does not impose a statutory minimum wage. Earnings of industrial workers fluctuate with overall economic activity. Loyalties to firms are less important than salary and fringe benefits and thus workers respond quickly and rationally to market opportunities. Trade unions play little part in setting wages or working conditions. Labour is highly mobile between industries and trades, with little restrictions owing to rigid craft demarcation or entry protected by trade unions. The result of a free market in labour, which accompanies a free market in business and investment, is that most of Hong Kong's work force is fully employed and enjoys steadily rising wages.

In spending only what it can afford, the Hong Kong government is, by worldwide standards, unique. Except for a small number of tropical paradise tax havens, no other government so intently holds expenditure within means. Its standard rates of tax on earnings and profits (a maximum rate of 18.5 percent on business profits and 17 percent on salaries and interest) is the lowest in the industrial world and its official government reserves are the largest in proportion to any year's expenditure.

The official view in Hong Kong is that a low rate tax system facilitates rapid economic growth, which, in turn, yields sufficient tax revenues to finance essential public services. Personal allowances are extremely generous. A family of four does not pay income tax unless it earns more than US\$11,000. Indeed, in the 1982 tax year, only 218,000 salaried taxpayers of a total population exceeding 5 million paid any income tax in the 1982 tax year. Moreover, 13,000 salaried taxpayers, about 6 percent of the total number in the salaried tax net, contributed over half the total yields from the salaries tax, despite the low rate.

Hong Kong developed extensive housing, education, health, and other social and community services through low rates of taxation, with virtually no need to resort to borrowing. Budgetary policy is virtually unique in Hong Kong. In thirty-two of the last thirty-five years through 1982, the budget ended the year in surplus and interest earnings on the accumulated surplus is sufficient to pay for the territory's police force. Moreover, these surpluses accrued after charging most capital expenditure against current revenue.

Government spending and public-sector employment are closely monitored to guarantee that the rate of growth of the public sector does not outpace that of the private sector. This is to insure that the public sector,

which has a natural tendency to grow over time, does not crowd out the private sector to the detriment of Hong Kong's external competitiveness. In recent years, government spending as a share of GDP ranged from 13 to 19 percent, but the financial authorities are watchful to prevent the share from surpassing the critical 20 percent threshold. Between 1982 and 1986, government's share of GDP declined from 19 to 16 percent, as the Financial Secretary tightened the government's belt in response to the political crisis of the early 1980s.

How did the common worker fare under this system? The evidence on post-war income distribution suggests that the 70 percent of the population in the third through the ninth deciles gained the greatest share of the increase in national income. Low-paid unskilled workers benefitted most from the rapid increase in employment opportunities. The well-being of the poorest 20 percent showed dramatic improvement: By 1976, their average household income reached US\$1,300, which surpassed the poverty index of all Asian countries. Under a low-tax regime, rising income translates fully into greater purchasing power and a higher standard of living for lower income families.

Hong Kong's Future?

Hong Kong's future came into open concern on July 18, 1982, when a local newspaper story reported an announcement from Beijing that China definitely intended to reclaim sovereignty over the whole of Hong Kong by 1997, when Britain's 99-year lease on the New Territories expires. Any hopes of the status quo of British rule continuing into the twenty-first century permanently ended when Chinese leader Deng Xiaoping personally conveyed this statement of official Chinese policy to Mrs. Margaret Thatcher, the British prime minister, during her September 1982 visit to Beijing.

Although the worldwide recession hit Hong Kong's exporters earlier in 1982, reinforcing the economic slowdown produced by a monetary contraction, Beijing's summer announcement shattered political confidence in Hong Kong's economic future. Despite promises by Chinese authorities that Hong Kong's free-wheeling economy would not be integrated into China's socialistic, state-directed system, the stock, property, and foreign exchange markets fell sharply. The Hong Kong economy remained on shaky ground throughout a string of Sino-British negotiations over the future of Hong Kong, which were held from September 1982 through September 1984. The Financial Secretary presided over three successive budget deficits, raised the top corporate and individual tax rates two per-

centage points, entered the local credit markets for the first time to borrow HK\$1 billion, and drew down a major chunk of Hong Kong's vaunted fiscal reserves. Land values stagnated. The stock exchanges did not recover until July 1984, when the outlines of an apparent agreement came into focus. Despite a strong recovery in export orders throughout 1983 and 1984, new investment in plant and equipment failed to materialize for the first time in Hong Kong's post-war history. Many investors lacked confidence that Chinese authorities would preserve the free market economic system of Hong Kong after 1997, and began to transfer resources out of the colony.

On September 26, 1984, the British and Chinese governments initialled the draft agreement on the future of Hong Kong, which was ratified by both sides in 1985. Beijing would recover sovereignty and administrative authority over the entire territory of Hong Kong, but China promised Hong Kong a high degree of autonomy in all matters save foreign affairs and defence. (The enforcement of this agreement after 1997 depends on China's goodwill, not Britain's presence.) Hong Kong would retain its social and economic systems, including rights of person, free speech, press, assembly, association, travel, movement, correspondence, strike, choice of occupation, academic research, religion, and private ownership of property. (These same rights are stipulated in China's own constitution, but have been routinely disregarded by the mainland's Communist rulers.) Hong Kong would remain a free port, a separate customs territory, maintain its own convertible, fully-backed currency, run its own public finances (remitting no taxes to China), issue its own travel documents, and operate its own police force. These policies would be stipulated in a Basic Law (constitution) of Hong Kong, which would become a Special Administrative Region of China, and would remain unchanged for 50 years. The underlying idea is Deng Xiaoping's concept of "one country, two systems [socialism and capitalism]."

Only time will tell if Hong Kong successfully retains its free-market economy, high growth rate, and personal liberties under the rule of law just before and after 1997. Estimates of annual capital outflow in both 1985 and 1986 are in the neighbourhood of \$2.5 billion, suggesting that Hong Kong's better-heeled residents are taking few chances.

SUMMARY AND CONCLUSION

Singapore and Hong Kong arose in virtually identical nineteenth-century circumstances—as free port, free trading city-states under British colonial rule. Against the backdrop of centuries-long imperial dynastic traditions,

British rule introduced private property, civil liberties, and a general concern for individual rights into East and Southeast Asia.

It is worth noting that the Chinese language had no word for individual freedom before the twentieth century. In 1911 Sun Yat-sen's followers overthrew the decaying Qing dynasty and set about creating a Western-style constitutional democracy. This was the first time that the concept of individual freedom played a role in over four millennia of China's history. Thus Singapore and Hong Kong offered their residents freedom and opportunity absent in neighbouring lands.

In 1985, the two city-states have markedly diverged. In Singapore, one man, Lee Kuan Yew, and one political organization, the People's Action Party, have exercised virtually unchallenged power since gaining independence from Britain. Although they have assigned to private enterprise primary responsibility for the creation and distribution of wealth, the PAP government consciously abandoned the *laissez-faire* practices of its colonial past. The government established a large number of state-owned corporations and became the Republic's primary landowner and landlord. On the political front, the PAP effectively suppressed all political opposition and muted its media critics. The "Singapore model" generated high growth until its high-wage policy of the 1980s not only braked, but reversed, the course of economic progress. Back-to-back years of economic contraction brought calls for renewed emphasis on private enterprise and a diminished role for the state in Singapore's economy.

How will economic, political, and civil freedoms fare in Singapore's future? The PAP government appears ready to enhance economic freedom, has shown somewhat more tolerance to its political opposition in the 1980s, and may ultimately tolerate a greater measure of free expression. But as of 1986, Singapore affords its citizens a much greater measure of economic liberty than of political or civil rights.

In 1986, Hong Kong's economic, political, and civil institutions were still readily traceable to its 1841 founding: a free market economy, colonial rule, and legal protection of individual rights, including freedom of speech, press, travel, employment, and so forth. Apart from the normal ups and downs of international business cycles, the one serious blip in Hong Kong's sustained post-war economic progress occurred in 1982-1984 after Chinese leaders announced in 1982 that they would recover sovereignty and exercise administrative authority over the territory by 1997.

The clock is counting down on British Hong Kong. At the stroke of midnight on June 30, 1997, the five yellow stars on red flag of the People's Republic of China will be raised at Government House and the Union Jack will be lowered, folded up, and put away for good. Of course, the outlines of post-1997 political organization in Hong Kong will be in

place well before 1997 as Britain prepares for an orderly withdrawal. Since the Sino-British Joint Declaration does not permit any expatriate to hold the post of department head in the government of the Special Administrative Region of Hong Kong after 1997, apart from the Governor and perhaps one or two high-ranking aides, most Western faces will be gone by the early 1990s.

China has promised in writing a high degree of autonomy to Hong Kong. It said that Hong Kong's people can retain their economic, political, and social systems for 50 years until 2047. But will China's guarantees be durable? For their part, the British are trying to reform the Colony's political structure in the direction of greater local representation. If Hong Kong's residents are to govern themselves, they require local institutions by which they can retain autonomy. Some analysts argue that representative institutions, including direct election of all members of the legislature, may be the only effective means of building the broad-based support on which Hong Kong's post-1997 leaders can resist mainland China's blandishments—a curious political twist. If the autocratic, but benevolent, colonial structure remains intact until 1997, China will inherit a mechanism whose virtually unconstrained authoritarian legal powers are no longer moderated by British traditions of individual rights and gaining the consent of the governed.

NOTES

1. Milton Friedman and Rose Friedman, "The Tide is Turning," *Free to Choose* (New York: Harcourt Brace Jovanovich, Inc., 1980), Chapter 10.
2. For a comprehensive history of Singapore from its founding until the mid-1970s, see Mary Turnbull, *History of Singapore 1819-1975* (Singapore: Oxford University Press, 1975). For a cross section of development issues, see Peter S.J. Chen, ed., *Singapore: Development Policies and Trends* (Singapore: Oxford University Press, 1983). An overview of Singapore is presented in the government's official annual report entitled *Singapore 1984*, published by the Information Division, Ministry of Culture. On more concrete topics of economic development see Lee Soo Ann, *Singapore Goes Transnational* (Singapore: Eastern Universities Press, 1977); Goh Keng Swee, *The Practice of Economic Growth* (Singapore: Federal Publications, 1977); and Theodore Geiger, *Tales of Two City-States: The Developmental Progress of Hong Kong and Singapore* (Washington, D.C.: National Planning Association, 1973).
3. Many newly independent countries have adopted xenophobic policies, expelling long-time foreign residents and traders. In contrast, Singapore welcomes its foreign community. The official line, stated in the government's annual report, is that "this foreign community is an important segment of the population because of its valuable contributions to the country's economy." See *Singapore 1984*, p. 4.
4. *Far Eastern Economic Review*, March 27, 1986, p. 73.
5. *Far Eastern Economic Review*, July 25, 1985, pp. 68-69.
6. For details on Singapore's public finances see the Singapore Yearbook, Singapore's annual budget documents, and the annual report of the Board of Commissioners of Currency. Thoughtful accounts of the Monetary Authority of Singapore, the currency system, the Central Provident Fund, and the links to the budget are found in *The Financial Structure of Singapore* (Singapore: Monetary Authority, June 1980); Tan Chee Huat, *Financial Institutions in Singapore* (Singapore: Singapore University Press, 1978); and John R. Hewson, "Monetary Policy and the Asian Dollar Market," in *Papers on Monetary Economics* (Singapore: Singapore University Press for the Monetary Authority of Singapore, 1981), pp. 165-194.
7. *Far Eastern Economic Review*, March 27, 1986, pp. 72-79.

8. See Peter S.J. Chen, "Singapore's Development Strategies: A Model for Rapid Growth," in Peter S.J. Chen, ed., *Singapore: Development Policies and Trends*, pp. 13-20.
9. During 1979 and 1980, the press reported a large number of appeals lodged against government compulsory purchases in which the transaction prices were 20 percent below the value claimed by the owners and assessed by chartered land valuers.
10. Eddie C.Y. Kuo, "Communication Policy and National Development," in Peter S.J. Chen, ed., *Singapore: Development Policies and Trends*, pp. 268-281.
11. See Chan Heng Chee, *The Dynamics of One Party Dominance: The PAP at the Grass-roots* (Singapore: Singapore University Press, 1976) for an account of how the People's Action Party came to exercise virtually unchallenged hegemony of Singapore politics.
12. *Far Eastern Economic Review*, July 11, 1985, pp. 34-37.
13. The material in this section draws from two books I have written on Hong Kong. See *Value for Money: The Hong Kong Budgetary Process* (Stanford: Hoover Press, 1976) and *Hong Kong: A Study in Economic Freedom* (Chicago: University of Chicago Press, 1979). The first volume analyzed policy-making and budgetary practice within the Hong Kong government. The second presented a comprehensive treatment of politics and business in Hong Kong, showing the structure of the Colony's free market economy and documenting its remarkable economic growth.
14. For a detailed account of the negotiations, the issues, and their resolution, see Bruce Bueno de Mesquita, David Newman and Alvin Rabushka, *Forecasting Political Events: The Future of Hong Kong* (New Haven and London: Yale University Press, 1985).
15. Valuable descriptive material and statistics on Hong Kong are published in an annual report, of which the most recent edition used is *Hong Kong 1985: A Review of 1984* (Hong Kong: Government Printer, 1985). A convenient source of recent data is the *Hong Kong Monthly Digest of Statistics* (Hong Kong: Census and Statistics Department).
16. *Ibid.*, p. 117.
17. *Ibid.*, pp. 284-285.
18. For an excellent political history of the founding and early years of Hong Kong, see G.B. Endacott, *Government and People in Hong*

- Kong* (Hong Kong: Hong Kong University Press, 1964). A summary treatment appears in *Hong Kong 1985*, pp. 291-299.
19. *Hong Kong 1985*, pp. 292-293.
 20. This section draws from Alvin Rabushka, *Hong Kong: A Study in Economic Freedom*, pp. 16-20.
 21. Alvin Rabushka, *Hong Kong: A Study in Economic Freedom*, pp. 20-29. See also Norman J. Miners, *The Government and Politics of Hong Kong* (Hong Kong: Oxford University Press, 1975), pp. 1-46.
 22. Derived from *Hong Kong Monthly Digest of Statistics*, November 1985, Tables 5.4 and 5.5, pp. 24-25. For a comprehensive review of the economic interdependence of China and Hong Kong, see A.J. Youngson, ed., *China and Hong Kong: The Economic Nexus* (Hong Kong: Oxford University Press, 1983), *passim*.
 23. This section is summarized from Alvin Rabushka, *Value for Money*, pp. 12-37.
 24. Sir Charles Jeffries, *The Colonial Office* (London: George Allen & Unwin Ltd., 1956), pp. 106-107.
 25. See Brian L. Blakeley, *The Colonial Office, 1968-1892* (Durham: Duke University Press, 1972), pp. 135-149. The regulations that applied in early Hong Kong were *Rules and Regulations for Her Majesty's Colonial Service* (London: Her Majesty's Stationery Office, 1843).
 26. See Alvin Rabushka, *Value for Money*, pp. 38-82. See also *Hong Kong 1985*, pp. 294-295.
 27. "White Paper: The Further Development of Representative Government in Hong Kong," November 1984.
 28. Emily Lau and Philip Bowring, "Laying down the law," *Far Eastern Economic Review*, December 5, 1985, pp. 12-15. Xu Jiatur, director of Xinhua news agency (China's unofficial mission in Hong Kong), in an unprecedented local press conference on November 21, 1985, implicitly accused Britain of "having a tendency to deviate from the joint declaration." He also stated that the political system of the Special Administrative Region of Hong Kong was China's business and would be clearly stated in the Basic Law. Some Hong Kong residents interpreted Xu's remarks as calling for a halt to all political reforms until 1990, when the Basic Law comes into being.

29. *Hong Kong 1985*, pp. 63-69.
30. The architect of Hong Kong's fixed U.S. dollar exchange rate system is John G. Greenwood, an economist with G.T. Management (Asia) Ltd. in Hong Kong. Over the years he has published a series of articles describing the shortcomings that existed in Hong Kong's floating exchange rate system during 1974-1983 and feasible reforms in a journal he edits, *Asian Monetary Monitor*. The most important articles are "Hong Kong's Financial Crisis—History, Analysis, Prescription," *Asian Monetary Monitor* 6, no. 6 (November-December 1982), pp. 2-69; "How to Rescue the HK\$: Three Practical Proposals," *AMM* 7, no. 5 (September-October 1983), pp. 11-39; "The Stabilization of the Hong Kong Dollar," *AMM* 7, no. 6 (November-December 1983), pp. 9-37; and "The Operation of the New Exchange Rate Mechanism," *AMM* 8, no. 1 (January-February 1984), pp. 2-12.

Discussion

Edited by Michael A. Walker

Alvin Rabushka Both Hong Kong and Singapore have a number of common origins which I think are worth keeping in mind, although there are also some dissimilarities, and there is always going to be a problem as we get deeper and deeper into the personalities and idiosyncracies in history in any given case. The salient common points that one wants to keep in mind are that both territories started as virtually uninhabited islands, both territories had superimposed upon them external systems of political and economic organization. They had colonial-type systems and laissez-faire free trade economies imposed on them. Neither tried substantially to disrupt or alter the indigenous cultures of either the Malay or Chinese populations. And finally, of course, both populations are heavily Chinese; in the case of Hong Kong, 98 percent, and in the case of Singapore it came to be about 75 percent.

The next thing I want to talk to you about is the word “freedom.” In Chinese the word “freedom,” *zi you*, consists of two characters, and what is important about this word is that it didn’t exist until the 20th century. In fact, the Chinese had to manufacture a word. And why did they get into this business? In the 19th century they were overrun by the West, were whipped by the British in the Opium Wars, and the Western powers developed their spheres of influence. China’s leaders decided that Chinese culture was still superior to all other cultures, but Chinese science, Chinese technology, Chinese military capability, and the Chinese economy were not. And maybe, just maybe, in trying to learn from the West to modernize and make China independent and strong, you needed to borrow the political systems in addition to their economies, their military machines, and their technologies. In borrowing the political systems you needed the structures of governments, like presidents, legislatures and judiciaries, and you needed the language with which to talk about them. So this word “freedom,” and individual liberty, keeps cropping up. From the beginning of China’s recorded history there were no such words. So they had to manufacture this word *zi you*, “freedom,” which actually means “to move oneself or self-movement.” To a Chinese who has been raised, educated and brought up in traditional language and culture, the word is not self-movement so much as what it means in a cultural context: selfish, greedy, putting oneself ahead of family, community, and village. It is very

instructive to examine liberty in the latest dictionary put out five or six years ago by the People's Republic of China. One definition refers to something like the freedom of speech, assembly and other rights as guaranteed in the constitution, which of course isn't worth the paper it is printed on; another notion of liberty as defined here is the petty bourgeoisie's aversion to discipline; and there is another one called "Capitalist tendencies to run wild." This is what the Mainland Chinese communists mean by "freedom." But if you look at the pre-communists, what you find is that there is a heavy emphasis on selfishness in the dictionary, as opposed to village, clan, commune, province, country, emperor, and so forth.

It shouldn't, therefore, surprise you that the Chinese imported an American, Professor Willoughby, to write a constitution in 1911, after the revolution. That constitution didn't last very long. Yuan Shihkai who was the succeeding general dissolved it, declared himself monarch, re-established the old imperial system, and as fate would have it he died because he misbehaved. But in any case, you never really got, in this creation of freedoms, while they are in the constitution—and also in the constitution of Taiwan, by the way—any sense of what these words mean. But when the British brought them to Singapore and brought them to Hong Kong, they were predicated upon a common law tradition. They were predicated upon a parliamentary system. They were predicated upon a Manchester liberal notion of the economy. And the British imposed these on the indigenous people, set up systems of property rights, and over a period of time began to increasingly educate them. So to say you are a Westernized Chinese means that you hold to the common law tradition. And to say you are a Westernized Chinese in Hong Kong who is a little bit nervous about 1997 and the absorption of Hong Kong into the People's Republic of China is to say you are a little worried about the rule of law giving way once again to the rule of man, and the loss of your individual liberties. Because articles 51 and 54 in the Chinese constitution allows the suspension of rights in articles 28 through 50 in the interest of the state or in the interest of national security.

Now let me just make a comparative observation about the two. While their early histories were quite similar economically, politically and socially, upon independence Singapore decided to go the import substitution route but was smart enough to scrap it quickly and return to an export-oriented free trade system, with a somewhat activist government; that is, there are some state-owned corporations, but as a total share of the national assets and national income they are not terribly consequential. They have a conservative fiscal policy. They have had a very sound monetary policy. But they are very heavy handed in social controls, and quite rightly end up with a very low civil liberties score of 5 on the Freedom House scale, and I think that is basically correct. They end up with a political

freedom scale of about 4, and that's okay, or maybe a touch on the generous side. With economic freedom, a score of 2 is maybe what I would give them, if there were a 7-point scale.

Turning to Hong Kong, which never really departed from its original 1841 philosophy of economic liberalism, fiscal conservatism, free trade and a generally non-interventionist government, the civil liberties score is 2, which is probably right, or 2-plus or 1-minus. From time to time there have been occasional odd intrusions on it, but by and large, as an individual, and for those of us who have spent a lot of time in Hong Kong, one feels no less free in Hong Kong than one does in the United States on a civil liberties dimension. In terms of economic liberty, surely it is the number one with the star on the top. Nobody's close to being in second place. There is a big gap with whoever is number two in the world. And while it is not perfect by the theory of competitive markets, it is so much closer that anybody else has a long way to go to catch up.

Finally, political freedom. Here the Freedom House score is 4. (By the way, there was some earlier confusion. They do publish an ancillary list of dependent territories; it just wasn't in the paper.) One juggles and compares Singapore at 4 and Hong Kong at 4. Large numbers of Chinese from Singapore tell me they think they feel freer in Hong Kong, even though Hong Kong is not a country and therefore one cannot vote on one's rights. Whereas in Singapore, while one can, one really isn't exercising any freedom of vote in a one-party state highly controlled, where the opposition may be in jail if they are a little too outspoken.

The final thought I want to offer you is a curious irony, a paradox. That is, I think that many of us see Hong Kong as having been able to have a long-run view of the future and being free from day-to-day electoral pressures, being relatively free from interest group lobbying; the government's been able to put in place and maintain a steady regime of economic liberalism, fiscal conservatism and low tax rates, and the departures from that are minor and inconsequential over the long run. Therefore, anybody's been able to take a long-run view subject to the China factor. And the China factor has now materialized, and the long-run view is shrinking by a year every year—namely, 1997 is the deadline of British rule in Hong Kong.

This whole aversion to democracy in Hong Kong, which is something that might have interfered with its economic freedoms, now becomes possibly the only mechanism to preserve it. By that I mean that there has to be a buffer between the people of Hong Kong and the government in mainland China. That buffer has, for 140 years, been the British. The British are going. And while the Chinese have promised a great deal of autonomy and 50 years of maintaining their social, economic and political

systems unchanged, what is the enforcement mechanism for that? The international treaty is no enforcement mechanism at all. It's not even a treaty; it's simply a joint declaration. The enforcement mechanism, it appears, has to be some sense of internal buffer with which local people can resist the blandishments emanating from Beijing. And it may just be that some form of locally elected representative institutions will provide local people some rallying point around which they can in fact resist bureaucratic rule from across the border. It may be a very weak buffer, but it may be perhaps the only buffer. So that these economic freedoms that have pretty much remained intact, apart from Japanese occupation, since 1841 may now depend upon some form of democratic evolution.

Alan Walters A most interesting question emerges from this paper. Why did Hong Kong and Singapore so successfully resist the tide of dirigisme and socialism which swamped both economic advance and civilised progress in so many other, for the most part ex-colonial, countries? As Rabushka points out, they had no natural advantages of plentiful resources, like their neighbours Malaysia or Thailand. On the contrary, poor Hong Kong had to cope with continual waves of penniless, illiterate and often disease-ridden migrants on an inhospitable, densely populated peninsular and island rock.

This puzzle has led to the suggestion that economic progress is spurred by the *absence* of natural resources, and that this is the main explanation for the success of the four little dragons as well as Japan, Israel and the many wealthy mercantile city states of Northern Europe from the 15th to the 19th century. But, apart from the anomaly of embracing the idea that nothing is better than something, this cannot be adduced as a necessary reason for the rejection of socialism and a highly regulated economy. There are many resource-poor states that have embraced socialism or communism; perhaps Albania is the most notorious example.

It is, however, possible to argue that the availability of resources and the rents that are derived from them does provide a fertile ground for statism. The appropriation of the rents through political activity does divert effort from producing goods and services. At least Hong Kong and Singapore were spared this temptation.

I suggest that the main reason is to be found in the colonial history. From the work of Peter Bauer and Basil Yamey we know that in Britain's African colonies, until the 1930s the ambient administrative system was very similar to that which obtains today in Hong Kong. The colonial administration provided a stable monetary system, usually a currency board, law and order, and the basic infrastructure for transport, elementary educa-

tion and health. Government bore only lightly on economic activity; taxes were low and there was substantial economic freedom.

This benign administration changed in the 1930s. Ideas of socialism took root in Britain during the 1930s. Statism, syndicalism and communism became fashionable at the great universities, particularly Cambridge and Oxford, and soon infected the civil service. The upper echelons of the colonial office, particularly under the leadership of Sir Andrew Cohen, head of the African Department at the Colonial Office and Lord McPherson, who eventually became head of the Colonial Office, readily embraced the role of more government economic ventures and more regulation and controls. They found sympathetic ears from Labour Colonial secretaries and, perhaps more surprisingly, from Conservative Secretaries who believed in big business and were contemptuous of small peasants.

Such notions were readily implanted in the colonies during the last half of the 1930s, with all the paraphernalia of marketing boards to regulate prices (and swell the coffers of the rulers), controls on production and wages, et cetera. During World War II such colonies were harnessed to the controlled war economy and later to the post-war regulated systems. The apparatus of a socialist state, with all its deadly potential, was bequeathed by the dying colonial administration to the new rulers.

Why did not Hong Kong and Singapore succumb to this socialization? One reason is that both were ports and entrepôts rather than sources of food or raw materials or of manufactures before 1950. As Rabushka points out, they were established initially to secure free ports and so the regulatory apparatus of a socialist system would soon have eliminated their livelihood. A distinguished official in the Foreign and Commonwealth Office has suggested that the great British trading companies, such as Swires and Hutchinsons, put considerable pressure on the Colonial Office to retain the free market system in Hong Kong. (I find this rather difficult to credit. Most business pressure seems to be in the form of trying to secure and protect monopoly positions.) One cannot, therefore, put too much faith in this rationalization for the relative immunity of Hong Kong and Singapore. It would not be difficult to imagine a civil servant arguing that the entrepôt trade was too fragile a basis for Hong Kong development and that what was really required was the establishment of a manufacturing base, which, according to the contemporary ideas of development, would require tariff protection, government sponsorship, control or even ownership.

Perhaps one of the reasons for the rejection of such socialist development was the fact that the colonial office, and later the foreign and commonwealth office, regarded Hong Kong as ultimately part of China.

Unlike the colonies of Africa and Asia, Hong Kong was merely a small chip off a big country, and was always considered to be a temporary ward of the colonial office until 1997. Ironically there was thought to be little of a future for Hong Kong except as a port for China. And who could forecast what would happen to that vast country riven with civil strife and social upheaval? Hong Kong was regarded as a backwater of the colonies.

Perhaps this was aided by the fact that both Hong Kong and Malaysia (including Singapore) were occupied and devastated by the Japanese during the war. They were never part of the regulated war economy of the United Kingdom. (Perhaps that is also the explanation for the fact that Malaysia also substantially eschewed socialism in its post-war development.) Furthermore, by the time the turmoil in the Far East had subsided, Singapore, Malaysia and Hong Kong had had ample time to observe communism in practice. The bloody insurgency in Malaysia and Singapore was suppressed but the fight against the conspiratorial communist party, as it sought to undermine the fragile period of early independence, continued through into the 1960s. Similarly the haven of freedom and prosperity in Hong Kong contrasted sharply with the repression and degradation on the mainland.

The real puzzle is that Hong Kong, and for its colonial period, Singapore, enjoyed one of the most efficient governments in the third world, yet that government was appointed by a foreign office and metropolitan government riddled with the ideology of socialist planning—perhaps one of the most inefficient governments of the industrialised nations. (Harry Johnson once suggested that the best solution to Britain's economic problem was to swap governments with Hong Kong.) The governors and civil servants appointed by the foreign and commonwealth office were committed to the principles of small government and free private enterprise and trade.

I suppose that in part the anomaly is explained by the traditional (British) colonial form of government known as indirect rule, particularly with respect to the Straits Settlement (later Malaysia and Singapore). Indirect rule enabled the colonial administrators to exercise oversight of an indigenous system of local government by the traditional rulers (mainly Malays). But the colonial authorities insisted on the basic framework of English law covering trade, commercial arrangements and the protection of property. The colonial (later the foreign and commonwealth) office appeared to choose its administrators carefully so that they would fit well in the ambient system of unobtrusive government. (No doubt many will remember Sir Sydney Caine as a superb financial secretary in Malaysia before he became Director of LSE.)

In Hong Kong, however, there was no indirect rule of the kind practised in Nigeria or Kenya or Malaysia. British law obtained throughout. The chief officers were appointed by the Colonial Office. The British colonial authorities, nevertheless, managed to place the appropriate Manchester liberals in all the senior offices of the colony. But this selectivity must have been reinforced by the fact of the great success of Hong Kong and Singapore, and of course to a lesser extent Malaya. Demonstrably, small government worked well in contrast to the mainland with the Kuomintang chaos of 1946-49, and the turmoil and degeneration after 1957.¹ Hong Kong's unrivalled performance was the ultimate reason that it retained its economic system. It would be unwise, however, to presume that such continued success, so confidently expected, will ensure that the economic and governmental system remains in place. The benign colonial administration was, like the colony itself, an odd and beautiful anachronism in a socialist sea.

Walter Block I wanted to thank Alvin for a very interesting and informative piece, but as is my wont I come not to praise but to criticize. I have three very small criticisms. The first amounts only perhaps to a typographical error. On page 2 he mentions in the sentence: "It suffers a population density that ranks it among the world's most overpopulated areas per square mile." Now I would substitute for "overpopulated" "highly populated." I don't like that word "overpopulated." It just seems to me that it is very antithetical to human rights, properly understood, to suppose that there can be too many people. I was having a discussion, before I came here, with a person who has eleven children and who is making a claim that we have overpopulation. I asked him which of his children he wished were never born. He was aghast at that, just as I am aghast by the concept of overpopulation. I don't think there is overpopulation anywhere; there can only be highly concentrated population.

I also would take issue on page 5 with the list of rules in this economic bill of rights. Rule 6: "A money supply growth rule to ensure sound money." In my view, to argue by analogy, the best relationship between church and state is one of complete separation. And the same goes for the relationship between education and state; it should be one of complete separation. Likewise for the relationship between money and state, it too should be one of complete separation. I don't think that the Feds can be trusted to apply a 3-5 percent rule, or anything else. I think the best thing to do is repeal the Fed root and branch; just disband it. Instead, we could have a free market money, whatever it is—gold, platinum, or competing monies or what have you. But I certainly would be reluctant to accept a

money supply rule because it implies the continued existence of a Central Bank.

The third point is on page 42 where it says that Hong Kong has a completely free market in money. Yet in that paragraph we learn that Hong Kong public officials can only create new local money after first acquiring U.S. dollars to back them up. Well, if the U.S. is not a completely free market in money, and Hong Kong is dependent upon the U.S., then Hong Kong can certainly not have a free market in money, based on government fiat currency.

Gordon Tullock First, with respect to this business of how it remained free, I happen to have been a vice consul in Hong Kong during the latter part of the Labour government, and I can tell you that they pretended vigorously that they were a welfare state. The annual report said they had the same rules as England. They had lots of social welfare officers, and so forth. And, as a matter of fact, they did, except that the appropriations were such that they could deal with perhaps one-half of one percent of the population. I always suspected that one-half of one percent paid for its privileges, because another aspect of the government was that it was thoroughly corrupt—at least the junior English people. I don't know if the higher-ups were, but I do know one of my Chinese friends who came over from Macao by writing a letter to the Governor himself—they both happened to have been in the same college in England. He was invited for dinner and the Governor said, "Now, why did you bother to use a letter instead of paying the usual fee?"

With respect to overpopulation, you have to remember, the population is there because they can't get out. It is not that they are there voluntarily. They left Communist China voluntarily, but they are not staying in Hong Kong voluntarily.

Finally, with respect to democratization, I regard that as waving a red flag before a bull. There is nothing that the Chinese government wants less than a demonstration that genuine democracy can work anywhere within its area. As it happens, it is, of course, a violation of the joint agreement, because the joint agreement says they will retain the same situation for the next fifty years, and the democratization has occurred after that joint agreement. So I would deduce that one way or another Hong Kong is going to be part of China with some odd, decorative, special characteristics within three or four years of 1997, provided it makes 1997.

Brian Kantor A Chinese person was asked about the relative performance of a particular governor, and the answer he got was, “Well, he was very good, but there were mudslides...” In other words, he was held responsible for what we would call “acts of God.”

There is one feature of Hong Kong’s economic life that has escaped attention and shouldn’t have done, and I think you would remove the asterisk from the 1 if you thought about it. Hong Kong appears very densely populated in parts. There are areas of Hong Kong, particularly some of the islands, where in fact there are almost no people at all. Lantau, which is only a half mile away, is rural bliss, there are few people there. There are parts of Hong Kong Island itself which are quite sylvan. And you ask yourself why, and then you discover the answer: The Hong Kong government is the only developer of land. There is only one land developer; there is a monopoly of land development. And the revenues from long lease sales, 99-year lease sales, go straight into the budget. So, whereas Hong Kong is lightly taxed in the usual sense, in fact what they get away with in the form of lower taxation they suffer in the form of unnaturally high rents, because the supply of land for development purposes is artificially restricted. I think that is an important limitation on market forces. Hong Kong would in fact have developed much less densely if there had been free access to the land development market.

Also in Hong Kong there is serious regulation of utilities. All the utilities—the telephone company is government, the utility companies, some of the transport—are regulated by officials according to what are known as “schemes of control,” and they don’t make an awful lot of economic sense.

So, if you ask yourself where Hong Kong succeeds economically, I think that one real advantage there is minimal interference with imports or exports. That is an enormous advantage. The other one, I think, is in the labour market. There is really minimum interference in the labour market. Also, I think what is of particular advantage to Hong Kong right now, given the uncertainty about 1997, is freedom from exchange control. That, I think, is very important in helping Hong Kong at the moment, because it enables the people who live there to diversify their portfolios while outside investors from the rest of the world who are willing to take a gamble perhaps on Hong Kong are freely able to do so. So I think that is very important to them at the moment.

Raymond Gastil I wanted to make two points. One relates to the Survey of Freedom, and that is that Hong Kong makes a good example of the attempt of the Survey to actually look at the behaviour of factors in a situation rather than to have any definite categories which are given

points. In the case of Hong Kong, the reason why I gave it as high a political rating as it received, over a long period of years, was because I knew that the people in Hong Kong were there largely because they didn't want to be in China. So I knew that in Hong Kong, unlike many other colonies that the Survey dealt with, there was really no question about whether the people wanted British rule or didn't want British rule. The fact that the British were ruling it, without much local supervision over that, really wasn't as important as those facts in defining Hong Kong.

More recently, in the last couple of years, because of the reasons that Alvin mentioned, Hong Kong has tried to develop legislative institutions which will introduce—and they are doing it very slowly—an element of democracy into the situation, because the British have, without Hong Kong agreeing to it, made an agreement with China by which the society is essentially being given over to the tender mercies of Communist China. In effect, the British have reduced the rights of the Hong Kong people politically at least as much as they have increased it by granting these legislative institutions. So I am just saying that is a good example of a judgement that doesn't fit the standard rules for judging political rights.

I thought this was one of the most interesting papers, but I am not clear what the point is supposed to be, and that is something that maybe you will comment on later. The point I drew from it—as I did from some of the other papers—was that perhaps we can come up with some ideas of the limits of the positive effect of political and civil liberties on economic development. In other words, there is probably an optimum point for these freedoms in relation to economic development, and once you go beyond that point you may have a declining relationship. That is a suggestion that comes to me, at least, but maybe you have other conclusions.

Herbert Grubel I spent last fall in Singapore and studied the origins of its economic miracle. The story I encountered is much the same as that told by Alan Walters about Hong Kong.

However, one fundamental characteristic of the developments in Singapore remains a puzzle to me. Lee Kuan Yew was educated in Cambridge and there undoubtedly was exposed to all of the powerful and then current ideas about the merits and feasibility of social democracy and the welfare state. When he took office as prime minister of Singapore, he and his government were subjected to strong pressures to initiate a broad system of social security. One Singapore minister of the period is fond of telling a story about delegations from the International Labour Office in Geneva. These delegations would come regularly to his office and insisted that the

government of Singapore was severely remiss in its duty by not initiating modern social welfare programmes. The minister became tired of these visits and was able to stop them only after he announced that he would toss the delegation out of the window of his office.

Given the intellectual and political spirit of the 1950s and 1960s and the educational background of Singapore's leaders, the puzzle is why and how they resisted the resultant pressures for the creation of a welfare state in Singapore. Kernial Sandhu of the Institute of Southeast Asian Studies in Singapore and John Wheatly of the Committee for Social Thought of the University of Chicago are in the process of editing a volume of essays to be titled *Managing Success—Singapore*. In it this puzzle will be addressed.

A tentative answer to the puzzle found in these essays suggests the following. On the one hand, the government was run by a party which maintained all of the outward ideological commitment and internal organizational structure of a party strongly committed to socialist ideals. To this day, the ruling party is known as the People's Action Party. On the other hand, the policies of the party were set by leaders, including Lee Kuan Yew, who had seen the adverse consequences of a ruthless Marxist organization in operation during the turbulent years after the end of the Japanese occupation. But this is really only a partial answer. Why did these leaders not take up the positions of power and the opportunity "to do good" that the Marxist system would have provided them and that so many leaders in other developing countries found impossible to resist? I have no answers to this question and wonder whether anyone here has any.

Michael Parkin The thing that really puzzles me about these two examples is not the thing that really puzzles Alan, although Alan's real puzzle is a real puzzle. The real puzzle arises from the other side of the political marketplace. We spent a lot of time in the last number of years trying to develop an ingenious theory of how come we get such bad governments and how come we get such big governments. These theories usually run—at least those that seem plausible—in terms of the political process being a process in which there are rents that are being created that someone sees as being proper to exploit, and to invest their resources in that rent-grabbing rather than wealth creating activity.

Now, I always found those explanations very appealing, and they make a lot of sense, in explaining things that I have seen in most countries of the world. But then I come to these odd-ball cases, and the question arises, what is it about them that makes them different? Why is it that the rents that are there are not being grabbed, and in the process, wealth being dissipated in the same way that seems to be occurring in other places? So my

puzzle is not why did Lee Kuan Yew do that things that he did, but why did he get into power, and how was he able to stay in power, when there were so clearly incentives for others to remove him, and do, by their standards, a better job for themselves but a worse job for the people? And why in particular these two cases? Why Hong Kong and why Singapore? Have there not been elements that have emerged, probably in the 1940s I would think would have been the time when it ought to have happened, before the really clear example of the People's Republic was there? But why did these countries manage to stay as placid and secure as they did at that time? It seems to me a major puzzle. And if there is a simple answer, or an answer, it would help a great deal to shed an important light on these other theories as to why we see the growth of rent-grabbing governments in other places.

Gordon Tullock The answer to why Lee Kuan Yew stayed in power is simple: He has efficient secret police. (Laughter)

Now, I will turn to other matters. In particular, I would like to elaborate a little bit on something that Brian said. What he said was perfectly correct. But I don't think most of you understood it, and it does show that the Hong Kong government civil servants sometimes make ghastly mistakes. Their method of financing a large part of the Hong Kong government is to sell a small part of this empty land every year at auction; that is, you pay a large "purchase" fee in return for a 99-year lease at a very low rental. They will tell you they can't sell it all because they have to save it for future generations, and this is as idiotic a revenue-raising method as I can name. From Peter Bauer's work I deduce that they did this in Malaya for a while, too. As far as I know these are the only two places in the world that follow this particular feeble-minded approach to real estate. This is a government which in many other respects is extremely efficient, but this is their principal source of revenue.

Douglass North I am going to add to what Gordon said and what Brian said, because I think we may very well have overdone our praising of Hong Kong and so on. Hong Kong has also had, in addition to its controlled lands, rent controls since 1921. That's a long time—a long time before most places in the world had rent control. It has persisted with it all through these years, as my former colleague, Steve Chung, has written about very eloquently. So I think we could overdo it.

Alan Walters Yes, I think it is overdone in many ways. I do think it's wrong, for instance, for Brian to say there are substantial regulations of utilities. The bus system is one of the best in the world. The public light

buses came in, and were allowed to come in, run by gangsters initially, but they worked well. They were immensely popular. They were eventually legitimized and became an essential part of the system. All Hong Kong buses are private. The public light buses are not regulated with respect to the fares. It is one of the few major cities in the world where the fares are not regulated. Nor is entry regulated; entry is free.

On the other points that were made, it is true that rent control was instituted in 1921. But now rent control is largely a cipher. It has disappeared, and the process of key money and all the rest of it is gone. Of course, it only applied to existing buildings and not to new ones. So, there was much demolition and reconstruction. Hence you got big turnover of buildings and a great deal of waste as a consequence.

I would also like to come back to another point which I think it is necessary to make. It was suggested that one of the reasons why they retained such a degree of freedom and didn't go in for rent seeking was because (this was suggested, incidentally, by a foreign office official) the colonial government in Hong Kong, and to a lesser extent in Singapore, was dominated by the Swires and the Hutchinsons—the big merchant firms who wanted free trade. That's the first time I have heard of a merchant firm wanting free trade. Normally they are rent-seeking operators of the first water and constantly pressing for exclusive rights, and so on. If you read the history of the Swires, you find they were desperately trying to get special consideration. For reasons which are not clear, the foreign office didn't want any part of it.

Alvin Rabushka There are a lot of points here that are matters of fact and some matters of theory and some matters of interest. Let me deal first with this business of why Hong Kong and Singapore didn't succumb to the socialist road or the interventionist road.

Let me begin by telling you a little story. In about 1971 a new governor arrived on the scene in Hong Kong, Sir Murray MacLehose who was the first professional diplomat ever appointed to be governor of Hong Kong. Up until that time, it had been colonial service types. He worked for a different master, the foreign office, and he thought that Hong Kong was really a municipality as he saw it from his foreign office perspective. He decided that he would try to ratchet up, as hard as he could and as quickly as he could, social spending. His plans were ground to a halt by the world recession and the oil crisis of '73-'74. Then the Hong Kong economy rebounded in '75, more rapidly than any other economy in the world, and grew over the next six years at the highest rate of any economy in the world. And in part because the adjustment mechanism had been so quick, real wages had fallen, returns to capital had increased, the economy be-

came more efficient and more competitive. Meanwhile, the financial secretary was summoned to London and he was told that he had two choices: he could either quit or he could increase social spending significantly. Well, he didn't like this, and his basic position on this was: no, I am not going to do that, and I guess you may have to fire me but I would be careful about that because if you do that and lose the confidence of the local business community you are not going to get very far.

Now, what in fact had happened was that all through the '50s, '60s and early '70s the British were trying to decolonize. They forgot about Hong Kong—just plain forgot about it—and woke up in 1970 and discovered they had a colony left. It was the only big one they had, and it was about time they started meddling and interfering. They didn't like limited government, and they didn't like the lack of a welfare state. They didn't like the repudiation of labour policies, and they tried to do something about it. The one attempt to do something about it didn't succeed, and so Hong Kong has been allowed to go off on its merry way.

Now, aiding and abetting that all along has been the fact that China was not prepared to ever tolerate an independent third government in China. So the development of anything remotely resembling institutions of political independence would have been nipped off in the bud. Therefore competing, entrepreneurial, rent-seeking political groups would not have been allowed to play the game even if the British wanted to let them play. The Chinese wouldn't have let them play that game.

In the case of Singapore, I think the answer is much simpler and much easier. It turned out that the import substitution scheme Lee Kuan Yew proposed, following conventional learnings he might have picked up in England and elsewhere and that the rest of the world followed, worked out perfectly fine on paper so long as Singapore was part of the Federation of Malaysia. But in 1963 when Singapore was rudely expelled one day, and they woke up to find that they were this little island with a population of two million, the notion of having a hinterland and a bigger market collapsed, and so they quickly discovered that they had to go the export route. They did it; other countries that had similar situations didn't.

Tibor Machan In these various equations, I would like to know where, if anywhere, the fact of very little military preparation, financing and so on figures in. I don't know if anywhere. But I would just like to know, because it seems as if very often the existence of a military industrial complex serves as an excuse for rent-taking and makes opportunities that are horrendous.

Second, did someone in Hong Kong read Henry George?

Alvin Rabushka Everybody's got that wrong, but I will answer later.

Ingemar Stahl As I understand the discussion, the major thing about Hong Kong and Singapore may be their free trade policies. What are the political prerequisites or conditions for keeping a free trade policy once you have started it? I think that is the crucial point. This type of free trade could be put on the Freedom House list as a kind of civil right—I should have the right to enter into trade with anybody inside or outside my country. If that were a dominant part of civil rights, I think that would give a very good correlation between GDP per capita and that specific type of civil right. It is important to reformulate part of free trade as civil rights in the sense that you should have the right to enter into trade with anybody inside or outside your country without interference from the government.

Another thing which I think is important in these city-states is that there have been no pressure groups from declining industries. There are obviously no agricultural organizations trying to preserve high food prices and trying to stop imports of food, for very obvious reasons. Can it be that the answer to many of our questions can be found in an explanation framework that there were no pressure groups from the declining industries?

The final question would be, do we have any observations whatsoever of countries which have been changing from a protective policy to a free trade policy? Are there any on this list of 165 observations where we have this type of policy change? It is one thing to preserve a free trade status, another thing to go from a protective status to a free trade status. Hong Kong and Singapore are unique countries in the way that they have preserved free trade, and we can discuss the political prerequisites for that. But do we have any observations of countries which have been highly protective and have changed to free trade states?

Assar Lindbeck To answer Ingemar's last question, many countries have been studied. There are many studies by the World Bank, Ann Krueger and others. They usually get much higher growth rates, for instance, for those countries. There are a dozen or so countries which started with import substitution policies in the fifties and switched to an export-oriented strategy. Bella Belasas has written about them.

Was your question what we know about civil liberties in those countries?

Ingemar Stahl No, the political prerequisites or conditions for changing that type of policy.

Assar Lindbeck No, maybe they have not studied the political prerequisites. They have just noted that some countries have switched. I think it is usually small countries because import substitution policies start to give declining returns much faster in a small country than in a large country. In India you can pursue import substitution with much less cost than in Hong Kong and Singapore. I think the smallness of these nations is one explanation of why they have abandoned import substitution. It is much more expensive for a small country, like Sweden, for that matter.

Peter Bauer Did not Britain and France shift occasionally from a protectionist stance in the 19th century? The repeal of the Corn Laws and the Colsden-Chevalier Treaty of 1860 seem examples.

I would like now to ask some questions rather than making new points. First, does the joint declaration of 1985 make any substantial difference to the prospects in Hong Kong? The People's Republic of China could have taken Hong Kong at any time since 1950. Does not what will happen to Hong Kong depend on the play of political forces in the People's Republic of China? Perhaps Alvin, Gordon or Brian could comment on this.

Second, does the joint declaration cover only the New Territories or does it apply also to Hong Kong Island and to Kowloon?

Third, does the Hong Kong government sell the land simply to the highest bidder or does it take into account the use to which the land will be put? Before the war in the British colonies of S.E. Asia the government, when giving out public land for private use, set different terms for land in accordance with the use to which it was being put, including the different commodities produced on it. Perhaps people would enlighten me on these subjects.

Brian Kantor Alan raised the point about bus riding. I don't want to go into any great detail, but I understand there was a strike of taxi or ordinary bus service, and so they allowed this new entrant into the market. But anyway, they all seem to charge the same fees, and taxis are regulated and all seem to charge the same fees. The point, I think, about this is that the closer one looks at these countries, the more one appreciates how, in fact, regulated they are. That comes as something of a shock. They are not exemplars of free market economies. The forced saving scheme in Singapore—a huge proportion of the GNP was being forced, and where

