

# Hong Kong's Policy of Positive Nonintervention: A Critical Appraisal of the 1998 Stock Market Intervention

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*Hong Kong's success as an international commercial and financial center has often been attributed to a policy of "positive nonintervention" adopted by the government. Market forces were allowed to determine the level of supply and demand in a variety of areas related to public affairs. This has allowed Hong Kong to maintain a relatively small public bureaucracy and has led to a general acceptance of the administrative style and principles followed by the government.*

*Disagreements have been expressed over the claim of "positive nonintervention" made by the Hong Kong government, however, with analysts suggesting that interventions have been made in several areas such as housing, welfare, education, and health. This paper examines the policy of "positive nonintervention" with reference to a massive injection of funds by the Hong Kong government to bolster the sharply declining stock market in 1998, and reassesses the relevance of this claimed policy under current circumstances. The argument of this paper is that modern politics cannot be successfully governed by following a policy of "nonintervention." The government of Hong Kong, this paper finds, had to take a proactive role in developing services and regulating activities in the public interest. The Hong Kong government's claim to "positive nonintervention" relates simply to trade and commercial policies.*

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On a typical morning, a typical resident here may wake up in an apartment developed by one of a handful of billionaire Hong Kong property owners, take a bus to work owned by one of the same tycoons, and make a mobile phone call along the way over a tycoon-owned network.

On the way home, he may stop off at one of the two dominant grocery stores or pharmacies owned by tycoons, go to the post office to pick up a package that was cleared through the port by a tycoon-owned freight handler, or perhaps pay an electricity bill from a utility controlled by a tycoon.

Most casual students of Hong Kong know that a handful of fabulously rich people here control the bulk of real estate development, which is the lifeblood of the economy. Less well known is how concentrated other parts of the economy are, often in those same few, wealthy hands.

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Hong Kong has been an interesting phenomenon for social science researchers for a number of reasons. The enclave was one of the last outposts of the British empire until its return to China in July 1997. Although by definition a colony, Hong Kong was described as a "territory" throughout the 1970s and 1980s. There was little visible indication of colonial rule, as Hong Kong was allowed to operate virtually as an independent entity both in its own affairs and in dealings with the international community.

Yet, there were other indications to constantly remind the people of Hong Kong of its colonial status. Hong Kong was ruled by a small group of administrators under the direct leadership of a Governor who was appointed by the Queen of England. Senior positions in the government were held by expatriates, who were almost exclusively British nationals. Residents of the colony were not granted citizenship of the parent country, but were issued with travel documents. Moreover, the right of abode in the United Kingdom was also not granted. The public had to carry identification documents on their person at all times, and the police had the authority to challenge and check the identity of any one on the streets.

Despite such an apparently nonprogressive approach, the British were able not only to retain control over Hong Kong for over one hundred and fifty years but also bring about significant changes in the territory. Much

of the credit has been attributed to the policies pursued by the British government in administering Hong Kong. There appeared to be a conscious effort to guide Hong Kong in desired directions via an interesting mix of support, directions, and threat. This was done with the full cooperation of the local elite. In many cases, this approach has been described as the policy of "positive nonintervention."

This paper seeks to reexamine the policy of "positive nonintervention" adopted by the government of Hong Kong. The concept can be understood with reference to the economic and political system of Hong Kong. Hong Kong has apparently been able to establish a thriving free market with the aid of this "positive nonintervention" policy. However, the government must monitor, supervise, regulate, and even intervene in order to protect public interest and effectively govern the polity. Several studies have pointed out the role of the government in initiating, encouraging, and implementing changes in various areas of public interest. The case of government intervention in the Hong Kong stock market will be analyzed to add to the arguments in favor of such an explanation. The government's response to the financial crisis of 1997-98, including its intervention in the Hong Kong stock market, suggests that the policy of "positive nonintervention" has, in fact, been a policy of "controlled intervention." This paper also identifies the winners and losers in the controlled intervention by the government in a perceived environment of "positive nonintervention."

### **The Background of "Positive Nonintervention"**

The Hong Kong government has always claimed adherence to a policy of "positive nonintervention" since the early 1980s. The emergence of such a view can be traced partially to the political and economic system of Hong Kong. The territory had long been governed within the framework of a relatively simple political structure. The Governor was the most powerful person in the territory and was advised by his handpicked members of the Executive Council. A set of Charters and Instructions were issued by the British Colonial Office to guide the Governor in his administration, but there was virtually no arrangement for monitoring his per-

formance as long as the British interest was upheld. The Letters Patent elaborated the powers and functions of the Governor and the role of the Executive and Legislative councils. The Royal Instructions dealt "with the appointment of members of the Executive Council, the nature and proceedings in the Executive Council, the Governor's responsibility to consult the Executive Council on important policy matters, and his right to act against this advice."<sup>1</sup>

The Legislative Council (Legco) was and still is the highest lawmaking body for Hong Kong, and the Governor also served as its President until the mid-1990s. The Legco was constituted of official and nonofficial members, appointed by the Queen or the Governor. Subsequently, a system of electing members from a number of functional constituencies was introduced. By the early 1990s, the Legco comprised, apart from the President, three civil servants, eighteen members appointed by the Governor, eighteen directly elected members, and twenty-one members elected by functional constituencies (law, education, engineering, social service, labor, commerce, industry, architecture, finance, accountancy, real estate and construction, tourism, Urban Council, Regional Council, and such rural body as Heung Yee Kuk).<sup>2</sup> By 1995 the Legco reflected the advancements made in democratization with twenty directly elected members, thirty elected from functional constituencies, and ten elected by an Election Committee. Thus, there were efforts at opening up the political system by increasing the number of directly elected membership, but the reforms appear to be stalling after 1997. For all intentions and purposes, the Governor (Chief Executive since July 1, 1997) and his Executive Council have administered Hong Kong and retained effective control over public affairs in the territory.

As Scott has noted, "For most of Hong Kong's colonial history, power has resided almost entirely in the hands of a small, expatriate, bureaucratic elite."<sup>3</sup> The only other group that had an effective share of power was the

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<sup>1</sup>Hong Kong Government, *Hong Kong 1996* (Hong Kong: Government Printer, 1996).

<sup>2</sup>Sonry S.H. Lo, "The Changing Dimensions of Executive-Legislative Relations: The Case of Hong Kong," *Public Administration and Policy* 7 (1998): 70.

<sup>3</sup>Ian Scott, "Introduction," in *The Hong Kong Civil Service: Personnel Policies and Practices*, ed. Ian Scott and John Burns (Hong Kong: Oxford University Press, 1984), 5.

members appointed to the Executive Council. This group included the most prominent and influential people in Hong Kong. In keeping with the composition of Hong Kong society, these were the representatives of major business and commercial interests who had done extremely well under the existing system. This group had exposure to Western education and values, and was able to interact effectively with the British Governor and his senior officials. The first Chief Executive of Hong Kong, a former leader in the shipping industry, also appears to be most comfortable in working with a similar group of advisors. The government found their assistance invaluable, and thus was keen on protecting their interests. Such mutual support had the impact of turning Hong Kong into a politically apathetic society, and there was virtually no effort at promoting political development in the territory.

The nature of Hong Kong society and its political system has been described in several studies. Harris described Hong Kong as an "administrative no-party state" which could not be described as a "colony," except in the most severely technical legal sense. He argued that the administrative state "should be thought of not as a state devoid of legislative and judicial organs but as a state in which administrative organization and operations are particularly prominent." As a result, in Hong Kong "officials dominate where they must—though they prefer the 'market' to take care of the decision-making process."<sup>4</sup>

In brief, Hong Kong was ruled by the Governor, his advisors (influential traders and commercial personalities), and the public officials. This was facilitated by the fact that there was little interest in public affairs among the public in Hong Kong. Survey after survey have revealed the apathetic attitude of the people of Hong Kong and suggested that this orientation could be related to the reluctance of the residents (most of whom are refugees from China or their descendants) to "rock the boat," a rapid rate of economic growth, absence of industrial strife and political agitation, as

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<sup>4</sup>Peter Harris, *Hong Kong: A Study in Bureaucracy and Politics* (Hong Kong: Macmillan, 1988), 70.

well as "the efficiency of the colonial government machine."<sup>5</sup> Jones noticed an "ingrained political passivity" among the Hong Kong people.<sup>6</sup>

Some of these factors can also be related to the success of Hong Kong as a commercial and industrial center. Miners listed the following in explaining the prosperity achieved by Hong Kong: a hardworking labor force accustomed to factory disciplines; weak and nonmilitant trade unions; absence of discrimination against foreign firms and generally liberal immigration rules to permit the entry of skilled foreign workers; good external and internal communications; efficient services; low taxes, a free port, a convertible currency, and no restrictions on the repatriation of profits; a stable and efficient administration with prudent budgetary policies and consistent application of government rules and procedures; a British legal system impartially administered by an independent judiciary; and minimum government regulation and interference in business.<sup>7</sup> This list reflected the nonintervention and hands-off approach adopted by the Hong Kong government while strictly adhering to the established rules and regulations.<sup>8</sup>

Therefore, the slow pace of political development and the apathy of the common people toward public affairs suited the model of elite administration practiced by successive British Governors as well as the first local Chief Executive of Hong Kong. The attitudes of the ruling elite, which included mainly businessmen and senior government officials, were also compatible with this pattern of government. Consequently, the Hong Kong government was able to concentrate on economic development without having to deal with problems that surface in balancing economic with social and political development.

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<sup>5</sup>Norman Miners, *The Government and Politics of Hong Kong*, Fifth edition (Hong Kong: Oxford University Press, 1995), 34-35.

<sup>6</sup>Catherine Jones, *Promoting Prosperity* (Hong Kong: Chinese University Press, 1990), 6.

<sup>7</sup>Miners, *The Government and Politics of Hong Kong*, 45.

<sup>8</sup>Ahmed Shafiqul Huque, "Administering the Dragons: Challenges and Issues," in *Public Administration in the NICs: Challenges and Accomplishments*, ed. Ahmed Shafiqul Huque, Jermain Lam, and Jane Lee (Basingstoke: Macmillan, 1996), 7.

## "Positive Nonintervention" as a Strategy of Government

Hong Kong has frequently been described as a shining example of the free market economy operating at its best. The Heritage Foundation of the United States has voted Hong Kong as the world's freest economy four years in a row in the 1990s, with this high score derived from a low tax rate and lack of trade barriers. The claim is echoed in most publications of the government, notably the annual report entitled *Hong Kong*. In the earlier reports, there was no clear statement on the government's role, although freedom from trade restrictions was stated as one of the factors contributing toward development.<sup>9</sup> Other examples of such claims include no tariff and few restrictions on the import of commercial goods<sup>10</sup> and consistent economic policies of free enterprise and free trade.<sup>11</sup> However, the 1973 edition claimed that "Hong Kong is probably the only territory still completely faithful to liberal economic policies of free enterprise and free trade."<sup>12</sup> The 1981 edition described the Hong Kong system as one based on giving as free a play as possible to market forces, and nonintervention.<sup>13</sup>

The claim has been backed up by comments from some analysts. Friedman found a variety of factors which supported the Hong Kong government's claim and saw the closest approximation of a free market in Hong Kong's law and order, administration of justice, limited public works, and restricted scope for the state to respond to the need of the disadvantaged section of society.<sup>14</sup> Miners stated that the Hong Kong government "is more firmly committed to nineteenth-century policies of allowing free play to market forces than is the case anywhere else in the world."<sup>15</sup> Rabushka thought Hong Kong "most closely resembles the textbook model of the competitive market economy, encumbered only by the barest outlay of

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<sup>9</sup>*Hong Kong 1961*, 66.

<sup>10</sup>*Hong Kong 1971*, 21.

<sup>11</sup>*Hong Kong 1982*, 18.

<sup>12</sup>*Hong Kong 1973*, 12.

<sup>13</sup>*Hong Kong 1981*, 14.

<sup>14</sup>Milton Friedman, *Free to Choose* (Harmondsworth: Penguin, 1980), 54-55.

<sup>15</sup>Miners, *The Government and Politics of Hong Kong*, 47.

government."<sup>16</sup> Lau and Kuan noted that, "extolling the doctrine of laissez faire, the Hong Kong government opts for a minimal and noninterventionist economic role and operates an administrative apparatus that lacks the capacity for economic intervention."<sup>17</sup>

The term "positive nonintervention" appeared for the first time in an introduction to a book prepared by a senior civil servant Sir Philip Haddon-Cave, who did not find the term "laissez-faire" to be adequate in describing the policy adopted by the government. He postulated his strong belief in keeping "the relative size of the public sector as small as possible" and the reason was that "when the economy is enjoying strong growth, the relative size of the public sector should fall."<sup>18</sup>

Ho viewed "positive nonintervention" as the formula for the success of Hong Kong. He interpreted "positive" as the creation of "an environment that rewards industriousness and intelligence," and "nonintervention" as "a self-imposed restraint not to mess up with the working of the market and with private sector decisions." Ho's perception of an ideal environment included the elements of a free market, rule of law, and low tax rates.<sup>19</sup>

Can a government function effectively by leaving all decisions to the market forces? Hill has indicated that a state has little option but to play a guiding role in a variety of areas such as income maintenance, health, social care, housing, employment, education, and the environment in a combination of roles as planner, regulator, funder, purchaser, and/or provider.<sup>20</sup> Thus, it would be impossible to govern a modern state without taking such a role in developing and implementing public policy. Even Hadden-Cave "recognized a responsibility of the part of government to re-

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<sup>16</sup>Alvin Rabushka, *Hong Kong: A Study in Economic Freedom* (Chicago: University of Chicago Press, 1979), 83.

<sup>17</sup>Lau Siu-kai and Kuan Hsin-chi, "Public Attitude Toward Laissez Faire in Hong Kong," *Asian Survey* 30 (1990): 766.

<sup>18</sup>Philip Haddon-Cave, "Introduction," in *The Business Environment in Hong Kong*, ed. D.G. Lethbridge (Hong Kong: Oxford University Press, 1985), 15-18.

<sup>19</sup>Lok-sang Ho, "The Rise and Fall of the HK Economy" (Working paper no. 83 [11/98] CAPS, Center for Asian Pacific Studies, Lingnan College, Hong Kong, 1998), 2.

<sup>20</sup>For a detailed discussion of this important point, see Michael Hill, *Social Policy: A Comparative Analysis* (London: Prentice-Hall/Harvester Wheatsheaf, 1996), particularly chaps. 4-10.



spond when industries with social obligations (such as banking) ran into trouble, and when an institution (such as the stock market) needed regulation to prevent inequitable practice."<sup>21</sup> As time went by, indications of a clear role of government in a number of areas became apparent.

The impracticality of a state following a strategy of nonintervention has been pointed out in other studies as well. Lau and Kuan found a significant disparity between the government's claim of laissez-faire approach and the popular perception of the economic role of the government. Interestingly, respondents to their survey did accept the benefits of a minimalist government, but demanded more government intervention in promoting welfare services.<sup>22</sup> Jones does not see the successes of Hong Kong and the other East Asian Tigers as "miracle(s) of laissez-faire capitalism unbound," but finds it as a "contrived" effort.<sup>23</sup>

Castells, Goh, and Kwok have described the efforts by the government to rehabilitate victims of a fire in a squatter area which culminated in the development of a massive public housing program in Hong Kong.<sup>24</sup> Yip and Lau believe that the period of minimal intervention in housing services was terminated in 1954, and it was followed by a "period of ad hoc direct government intervention."<sup>25</sup> In course of time, the huge role played by the government in the provision of housing has made it the largest landlord in Hong Kong.

One of the most significant studies on the role of government in Hong Kong was written by Jonathan Schiffer in 1983 and subsequently published in a journal in 1991. As early as 1983, Schiffer noticed clear signs of substantial state intervention in governing Hong Kong. He found that

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<sup>21</sup> Arguments in support of such observations have been made in several studies. See Ian Scott, *Political Change and the Crisis of Legitimacy in Hong Kong* (Hong Kong: Oxford University Press, 1989), 190.

<sup>22</sup> Lau and Kuan, "Public Attitude Toward Laissez Faire in Hong Kong," 779-80.

<sup>23</sup> Catherine Jones, "Hong Kong, Singapore, South Korea, and Taiwan: Oikonomic Welfare States," *Government and Opposition* 25 (1990): 446.

<sup>24</sup> Manuel Castells, Lee Goh, and Yin-wang Kwok, *The Shek Kip Mei Syndrome: Economic Development and Public Housing in Hong Kong and Singapore* (London: Pion, 1990).

<sup>25</sup> Yip Ngai-ming and Lau Kwok-yu, "Housing," in *Social Policy in Hong Kong*, ed. Paul Wilding, Ahmed Shafiqul Huque, and Tao Lai Po-wah (Cheltenham: Edward Elgar, 1997), 40-41.

"non-market forces intervene significantly in all factor markets, having the combined effect of lowering costs of production for small-scale industry, the backbone of Hong Kong's export-led growth."<sup>26</sup> Gauld commented that "government involvement in health has increased, sometimes inadvertently, to the extent that a comprehensive range of services are provided virtually free-of-charge to Hong Kong residents."<sup>27</sup> Similarly, Chan and Leung stated that "the government is substantially and actively involved in education," although there are very few government schools in Hong Kong.<sup>28</sup>

Evidence of government intervention could be found in a number of other areas. This covered a wide range of activities such as regulation of the prices of transport, rice, and utilities in the labor market and the production of a large percentage of foodstuffs in a centrally planned economy (PRC) which was "traded to Hong Kong at something other than free-market prices." The subsidization of health, education, and shelter can be added to this list. Moreover, "The labour supply is partly determined by regulated immigration from the PRC; labour demand is partly determined by the policies of the Hong Kong government, the largest employer. The wage itself, aside from the subsidizing effect of the above factors, is also partly determined by governmental rates, which influence the private sector." Scott went to the extent of rejecting the idea of a "laissez-faire" government as "a contradiction in terms" and sought to describe Hong Kong as a "capitalist state."<sup>29</sup> Similarly, Cheung believes that the government had engaged in intervention "whenever it saw the political or administrative necessity to do so" and adds that "government decision makers were more guided by their bureaucratic rationale than by any particular ideological or philosophical fiat."<sup>30</sup>

The shift in focus from a hands-off approach toward a more proactive

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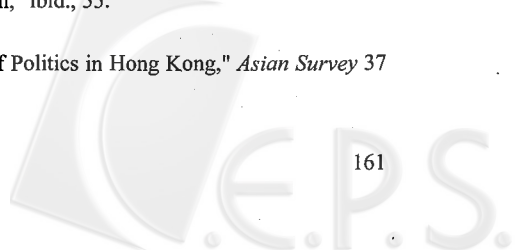
<sup>26</sup>Jona than Schiffer, "State Policy and Economic Growth: A Note on the Hong Kong Model," *International Journal of Urban and Regional Planning* 15 (1991): 194.

<sup>27</sup>Robin Gauld, "Health," in Wilding, Huque, and Tao, *Social Policy in Hong Kong*, 36.

<sup>28</sup>Chan Ho-mun and Joan Y.H. Leung, "Education," *ibid.*, 55.

<sup>29</sup>See note 21 above.

<sup>30</sup>Anthony B.L. Cheung, "Rebureaucratization of Politics in Hong Kong," *Asian Survey* 37 (1997): 723-24.



one was evident in several documents and statements coming from the public officials in Hong Kong. These claims of developing a free market and allowing the market forces to operate were usually related to the area of trade and commerce, and not necessarily all public affairs. In his first policy address, Governor Christopher Patten emphasized the need to "defend free markets and to give consumers the full redress against unscrupulous business practices to which they are entitled."<sup>31</sup> Within a year, Patten announced his priorities, which included concentration on specific improvements in the social services, education, and housing programs as well as delivering real improvements in the care for the elderly.<sup>32</sup> The proactive role of the state was being underlined.

In his first policy address delivered to the Legislative Council after the reversion to Chinese sovereignty in 1997, Chief Executive Tung Chee-hwa stated that "Hong Kong's development strategy will be based on two principles, a free market economy and a prudent fiscal policy" and the maintenance of "a world class supervisory regime without over-regulation."<sup>33</sup> At the same time, he outlined plans for regulations related to intellectual property rights, control on trade in strategic commodities, and expansion of public and private housing to indicate that the government has a definite role to play in promoting the free market. In his next address delivered the following year, Tung reiterated that Hong Kong "still staunchly upholds the rule of law and practises a free market economy," although the circumstances as well as the tone of the address had changed considerably. He admitted that weaknesses in Hong Kong's economic system have been exposed and highlighted a number of measures taken by the government "aimed at easing pressure on the public and creating the conditions necessary for economic and social stability."<sup>34</sup> One of these measures involved

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<sup>31</sup>Christopher Patten, "Our Next Five Years: The Agenda for Hong Kong" (Address at the opening of the 1992/93 session of the Legislative Council, 1992), 4.

<sup>32</sup>Christopher Patten, "Hong Kong: Today's Success, Tomorrow's Challenges" (Address at the opening of the 1993/94 session of the Legislative Council, 1993).

<sup>33</sup>Tung Chee-hwa, "Building Hong Kong for a New Era" (Address at the Provisional Legislative Council Meeting, 1997), 6, 8.

<sup>34</sup>Tung Chee-hwa, "From Adversity to Opportunity" (Address at the Legislative Council Meeting, 1998), 1, 3.

the massive intervention made by the government in August 1998. The following section intends to add this as yet another example to the body of works that disagree with the notion that the Hong Kong government practices "positive nonintervention." In fact, this intervention is different from those in other areas ever since the government has been repeating its commitment to the maintenance of a free and open market in the area of trade and commerce.

### **Government Intervention in the Hong Kong Stock Market**

The East Asian economic crisis was first noticed in Thailand in July 1997, and gradually spread across the region. Hong Kong appeared to be comfortable in the thought that it was insulated against such crisis due to the enclave's huge fiscal reserves and strict financial regime. The currency peg to the American dollar was considered another safeguard against an unfavorable balance of trade. As the economy contracted quarter after quarter, unemployment shot up to a fifteen-year high and the stock market fell sharply.<sup>35</sup> There were speculations about the impending delinking of the currency from the American dollar.<sup>36</sup>

The government thus realized that the crisis had indeed reached Hong Kong. It would result in a "loss of face" to see Hong Kong's vibrant and flourishing economy brought to the brink of a collapse within a short period of withdrawal of the British from this region. Intense pressure to short-sell the Hong Kong dollar resulted in interest rates moving sharply higher. At the same time, overseas banks and investors moved their funds out of the Hong Kong market, the liquidity of the banking system was reduced, decline in property and stock markets contracted asset values and dampened consumer spending.<sup>37</sup> Such a fiscal scenario has not been seen in Hong

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<sup>35</sup>*The Economist*, August 15, 1998.

<sup>36</sup>There is continuous debate about this issue. While some people think that the currency peg has made a positive contribution by way of promoting stability in the Hong Kong economy, others believe it acts as an impediment to competitiveness.

<sup>37</sup>Tung, "From Adversity to Opportunity," 2.

Kong for a long time, and local surveys indicated a sharp decline in the approval rating of the government. In response, on August 14, 1998, the government launched its first-ever defence of the local stock market with a concerted intervention which drove the Hang Seng index 8.5 percent higher.<sup>38</sup>

The Hong Kong government "launched a massive and unprecedented intervention in the stock, currency, and futures markets that continued through the next two trading days. . . . By most estimates, it spent HK\$3 billion (\$385 million) on August 14 alone, snapping up Hang Seng index stocks in a bid to drive currency speculators out of the market."<sup>39</sup> The government moved into Hong Kong's equity market for a second day, "throwing up to \$1 billion at share prices in a bid to relieve pressure on the Hong Kong dollar."<sup>40</sup> Although the exact figures are not known, estimates hold that approximately HK\$120 billion has been invested in the efforts to stave off the crisis. The Financial Secretary and the chief of the Hong Kong Monetary Authority (HKMA) appeared determined to thwart the efforts of the speculators. They believed "unnamed investment banks, acting on behalf of international hedge funds, undertook heavy speculative selling of Hong Kong dollars." The Financial Secretary rejected suggestions that his action "contravened Hong Kong's commitment to nonintervention" and stated "I must emphasise that our longstanding policy of nonintervention in the stock and futures markets remained unchanged."<sup>41</sup>

The battle raged until August 28, 1998, when the HKMA invested an estimated US\$9.3 billion into the stock market. During the two-week campaign, the Hong Kong government spent an estimated US\$15 billion of its US\$96.5 billion in foreign reserves.<sup>42</sup> The HKMA had taken a number of other measures to deal with the crises arising from the assault on Hong

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<sup>38</sup>*South China Morning Post* [hereafter *SCMP*], August 15, 1998.

<sup>39</sup>*Far Eastern Economic Review* [hereafter *FEER*], August 27, 1998, 59. The Hong Kong dollar is pegged to the currency of the United States. Officially, US\$1 is equivalent to HK\$7.80.

<sup>40</sup>*SCMP*, August 19, 1998.

<sup>41</sup>*Ibid.*, August 15, 1998.

<sup>42</sup>*Asiaweek*, September 11, 1998.

Kong currency and wide-scale speculation. The HKMA switched some of its foreign currency reserves into Hong Kong dollars to help counteract the pressure to sell the local currency and thus maintain interbank liquidity. Subsequently, the government decided to mount operations in the stock and futures markets in the latter half of August, purchasing the constituent stocks of the Hang Seng index and acquiring Hang Seng index futures contracts to counteract market manipulation.<sup>43</sup> These measures were followed up with a number of steps to strengthen the currency board arrangements and prevent further manipulation of the market.<sup>44</sup>

The move evoked mixed reactions from various quarters. As the *Far Eastern Economic Review* [*FEER*] reported, "Critics asked if the reputed capital of laissez-faire capitalism was losing its free-market bearings amid the regional economic storm."<sup>45</sup> The local Citizens Party condemned the intervention and criticized the use of taxpayers' money without the approval of the legislature.<sup>46</sup> There was widespread concern over the abandonment of the policy of nonintervention by the government. The *FEER* further noted, "By intervening, the government casually tossed aside the carefully cultivated free-market ethics that have distinguished Hong Kong's much-vaunted currency board: If the U.S.-dollar peg is to remain solid, then the economy must crumple to absorb shocks."<sup>47</sup> There was additional concern over the manner in which the decision was made and executed as well as its possible impact: "Money-market traders said despite the official action the Hong Kong dollar remained under attack in Asian trade yesterday, forcing interbank rates higher and raising fears that the currency-board system would face months of pressure."<sup>48</sup>

The intervention was described as "a short-term measure which would not arrest the market's decline or dissuade speculation."<sup>49</sup> The im-

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<sup>43</sup>Hong Kong Monetary Authority (HKMA), *Annual Report 1998*, 38.

<sup>44</sup>See "The Currency Board Account and Other Fine-tuning Measures to Strengthen the Currency Board Arrangements in Hong Kong," *Quarterly Bulletin* (HKMA), May 1999.

<sup>45</sup>See note 39 above.

<sup>46</sup>*SCMP*, August 15, 1998.

<sup>47</sup>See note 39 above.

<sup>48</sup>*SCMP*, August 19, 1998.

<sup>49</sup>*Ibid.*, August 15, 1998.

pact on potential investors was the most worrisome point, however. The *South China Morning Post* quoted an economist: "What the government is telling the world is that if you are a long-term investor, don't buy Hong Kong stocks. They are saying the market is a battlefield between the government and hedge funds."<sup>50</sup> A number of analysts as well as local and international investors considered this as a major setback.

Other potential damages could result from the intervention. The action could "delay the correction in asset prices needed to restore Hong Kong's competitiveness" and could "scare away retail investors."<sup>51</sup> If it had failed to reverse the market trend, a huge sum of money could have been lost. There were criticisms over the stocks picked by the government to invest in, and veiled accusations that the government was playing favorites in boosting up the stocks of preferred companies. Thus one report commented that "as Asian markets in the past year have cried out for more transparency and freer mechanisms, Hong Kong appears to be taking one of the region's freest markets in another direction."<sup>52</sup>

There were, interestingly, opinions in support of the intervention even outside the government. Not surprisingly, the chairman of the Real Estate Developers Association supported the action by saying "it was the government's duty to maintain market stability."<sup>53</sup> Some investment bankers found the move helpful in restoring confidence in the market.<sup>54</sup> The intervention could help raise a huge amount of money if the market recovered. It was also believed that the move would enhance citizens' confidence "in the peg as long as they think the government cares enough to save it."<sup>55</sup> Another analyst thought "this extraordinarily rare move, legal under the HKMA's broad authority to supervise the peg, worked."<sup>56</sup> Public opinion was divided as was evident from letters written to local newspapers. In the

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<sup>50</sup>Ibid.

<sup>51</sup>See note 39 above.

<sup>52</sup>*FEER*, August 27, 1998, 70.

<sup>53</sup>*SCMP*, August 15, 1998.

<sup>54</sup>*Hong Kong Standard*, August 25, 1998.

<sup>55</sup>*FEER*, August 27, 1998, 60.

<sup>56</sup>Kara Tan Bhala, "In Praise of Intervention," *ibid.*, September 3, 1998, 29.

words of the Chief Executive: "The government, after a thorough analysis of the overall economic and social situation, has used our reserves to put forward a number of measures aimed at easing pressure on the public and creating the conditions necessary for economic and social stability."<sup>57</sup>

As the stock market intervention took place in the year after Hong Kong's reintegration with the People's Republic of China, there were speculations over the PRC factor in this episode. One source stated that "the unprecedented move into the stock and futures markets was taken without reference to Beijing, adding that the mainland was unlikely to make good on its promises to back Hong Kong with its US\$140 billion reserves." The report went on to state that the PRC was not involved in the decision to intervene and that "Hong Kong and China's balance sheets will remain separate."<sup>58</sup> In fact, this crisis was an acid test of the policy of "one country, two systems" under which Hong Kong operates as a Special Administrative Region of China. The central leaders have demonstrated remarkable political acumen by not getting involved in the process. At the same time, it should be borne in mind that neither the PRC government nor Hong Kong would risk making the situation worse and thus tarnish their images so soon after reintegration. Therefore, the PRC acted as a strong supporting force, but avoided direct involvement throughout the period of stock market intervention in Hong Kong.

Overall, the massive intervention placed billions of dollars of public funds in the equities market and the risks associated with that were considerable. Questions could be raised about the method of deciding to intervene. Given the highly centralized and nontransparent nature of administration, the Hong Kong government was not expected to utilize wide consultation. Furthermore, the nature of the problem necessitated the pursuance of a strict code of secrecy and swift implementation. The move did stabilize the stock market, slowed the decline in real estate prices, and opened up the possibilities of reforming the financial system.

After the storm, the Hong Kong government was left holding a huge

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<sup>57</sup>Tung, "From Adversity to Opportunity," 3.

<sup>58</sup>*SCMP*, August 25, 1998.



portfolio of stocks and had to decide on the next step. There were different suggestions about the best possible course of action. It would have been possible to reap a huge amount of profit by selling the shares on the rejuvenated stock market. The government resisted the pressure to sell the shares acquired and decided to hold them.<sup>59</sup> A survey indicated that two-thirds of the respondents "were satisfied with the government's decision to hold on to the stock for the time being" and "should dispose of the shares gradually so as not to have a negative impact on the real economy."<sup>60</sup> A body was created to manage the huge portfolio and Sir T. L. Yang, a retired Chief Justice, was appointed as the chairman of the Exchange Fund Investment Limited. As events turned out, the stock market bounced back and the Hong Kong government reaped a windfall.

### Interpretations of "Positive Nonintervention"

The Hong Kong government has been using the term "positive non-intervention" in a rather loose sense, indicating its lack of interest in getting involved in the delivery of public services. In keeping with the nature of a colonial government, the exploitation of financial resources has remained the top priority and the government sensed a great opportunity in operating a free and unrestrained trading and commercial center. The statements from the government have repeatedly emphasized this aspect of the free market.

The perception of Hong Kong as a free society has been strengthened on the basis of observations about the system. Haddon-Cave saw "little scope for managing the economy"<sup>61</sup> of Hong Kong, while Lau thought the open nature of the Hong Kong economy rendered "any attempts on the part of the government to guide the economy relatively futile."<sup>62</sup> Haddon-

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<sup>59</sup>*Hong Kong Standard*, October 13, 1998.

<sup>60</sup>*SCMP*, January 11, 1999.

<sup>61</sup>See note 18 above.

<sup>62</sup>See Lau Siu-kai, *Society and Politics in Hong Kong* (Hong Kong: Chinese University Press, 1993), 173.

Cave's interpretation of "positive nonintervention" included elements of individual ownership, acquisition of accumulation wealth by individuals, a small public sector, user charges for public services, and sustenance of the work ethic through minimal stress of social and redistributive fiscal policies.

Financial secretaries of the territory have generally held conservative views on the role of the government in Hong Kong. Sir John Cowperthwaite (1961-67) was "a firm opponent of the provision of free services."<sup>63</sup> Throughout his tenure as the Financial Secretary, Sir John Brembridge (1982-86) demonstrated eagerness to keep the size of the public small.<sup>64</sup> His successor, Pierce Jacobs, stated that "as far as possible I intend to adhere to the policies we have successfully followed in the past."<sup>65</sup>

Later, Sir Hamish McLeod, Financial Secretary of Hong Kong during the twilight years of colonial rule, produced a variation of the ideology under the label of "consensus capitalism." Its five essential elements included private enterprise and small government; low taxation so that money is left in the pockets of the people; restraint on public expenditure so that it does not grow at a faster rate than the economy; provision of the social, physical and regulatory infrastructure required to support the market; and provision of support to the disadvantaged and the vulnerable groups in society.<sup>66</sup> This concept encapsulates the ideology of the government more competently than the vague term "positive nonintervention." Wilding found that the ideology emphasized "individual effort, individual responsibility, self-reliance, and self-help," stressed the virtues of independence and the economically and socially destructive nature of dependence, the natural superiority of private enterprise, and "private provision over public."<sup>67</sup>

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<sup>63</sup>Paul Wilding, "Social Policy and Social Development in Hong Kong" (Working Paper Series, Department of Public and Social Administration, City University of Hong Kong, 1996).

<sup>64</sup>Lo-Cheng Sik-sze, *Public Budgeting in Hong Kong: An Incremental Decision-Making Approach* (Hong Kong: Writers' and Publishers' Cooperative, 1990), 72.

<sup>65</sup>Hong Kong Government, *The 1987-88 Budget* (1987), 1.

<sup>66</sup>S. H. Tang, cited in Wilding, "Social Policy and Social Development in Hong Kong," 37.

<sup>67</sup>*Ibid.*

The position of the government was considered in the context of its relationship with business elite of Hong Kong. It is common knowledge that power is concentrated in a small group of people, usually led by the business tycoons. This group exerts a considerable amount of influence in shaping public policies, and is their foremost beneficiaries: "The government controls the supply of land to a small group of property developers who exert a substantial influence over prices."<sup>68</sup> The "dramatic recovery of the blue-chip Hang Seng index from its five-year lows last week to yesterdays close—courtesy of the government shoring up of the market—has enabled some of Hong Kong's biggest listed companies to make hefty gains" and the business leaders, mostly in the real estate sector, made paper profits between HK\$2.61 billion and HK\$671.8 million.<sup>69</sup> Thus, "the administrative and business elites have been united by common interests." Therefore, the concept of free market has been applied almost literally to suggest an absence of restrictions on making profits and retaining them. Some have argued that the Hong Kong government's reported trust in the free market was entirely for the benefit of this group and not meant to be a hands-off approach to governing.<sup>70</sup>

That position makes sense in view of the role of government in modern states. Hood and Schupert categorized the functions of government into "defining" related to the operational aspects of government, "physical resource mobilization" for development of infrastructure, and social services for advancement of welfare of citizens.<sup>71</sup> While the last two types of functions can be performed by private, semiprivate, and independent public enterprises, "defining" functions such as maintenance of law and order and collection of revenue cannot be performed with a hands-off approach. This is inherent in the definition of a government. The finance branch of the Hong Kong government took a similar view and iden-

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<sup>68</sup>*Hong Kong Standard*, August 31, 1998.

<sup>69</sup>*Ibid.*, August 20, 1998.

<sup>70</sup>Wilding, "Social Policy and Social Development in Hong Kong," 19.

<sup>71</sup>Christopher Hood and G.F. Schupert, eds., *Delivering Public Services in Western Europe: Sharing Western European Experience of Para-Government Organization* (London: Sage, 1988).

tified three broad types of services such as core (public order, social, economic, or regulatory), support (ancillary services such as printing, vehicles, computing, etc.), and commercial (services which are provided for the general public, at a charge).<sup>72</sup> Free-market principles cannot be, and never were, applied to the "defining" or "core" services of the government.

The Hong Kong government was able to avoid getting involved in the provision of public services up to a point. More importantly, special care was taken by the government to create an enterprise-friendly environment to support the business elite. In the absence of protest from the apathetic public and strong support from the powerful business elite, the government continued to place high priority on economic development, while social and political development lagged. The occasional efforts in these areas came in the wake of needs and were pushed by external forces. Governor Sir Murray MacLehose was instrumental in initiating a clear role of the government in social service provision, while Governor Patten undertook the mission of enhancing political development. But generally, all actions have been aimed at protecting the interest of the business community. Although the government's portfolio yielded a huge bonus of US\$52.2 billion, some reports hold that "a broker used by the government during its intervention in the financial markets last year made illicit profits on the deals" based on inside information and by allocating "the most profitable government trades to clients associated with the brokerage."<sup>73</sup>

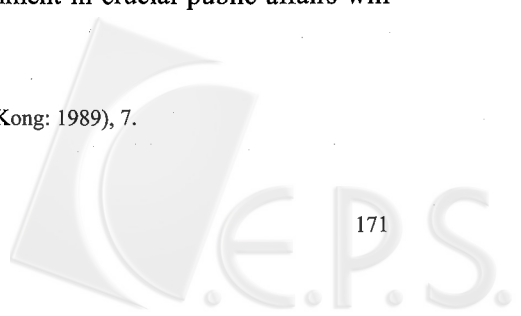
### **The Myth of Positive Nonintervention**

The Hong Kong government's claim of adopting a policy of "positive nonintervention" should not be interpreted literally. It cannot be applicable to every aspect of government in a modern state. Certain functions must be performed by the government and cannot be left to the mercy of market forces. Noninvolvement of the government in crucial public affairs will

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<sup>72</sup>Finance Branch, *Public Sector Reform* (Hong Kong: 1989), 7.

<sup>73</sup>SCMP, March 27, 1999.



affect the fundamental structure of the polity.

While it should be admitted that a government is obliged to take any step considered essential to the benefit of the community, the intervention by the Hong Kong government in the stock market can be viewed as inappropriate. Purchase of large volume of stocks did boost the market, but the other signs of economic vitality remained absent. The economy contracted, growth slumped, the real estate market and the retail sector continued to decline, and the rate of unemployment continued to rise. In the absence of economic robustness, artificial measures to hold up the stock market may result in large expenditures without providing any real benefit. At the same time, it should be borne in mind that the government was acting with the benefit of the community in mind. Such good intentions provide justification for the use of selective nonintervention on a case-by-case basis.

"Positive nonintervention" does not necessarily mean "nonintervention." The Hong Kong government has not been intervening positively to guide public policy. The government has been cautious to keep itself at a distance in those fields where market forces could act as checks and balances. Instead, there has been a conscious effort to provide all necessary assistance to facilitate a business-friendly environment, an environment which has contributed immense benefits to a small group of entrepreneurs. There has been "a low level of competition in several sectors, including bank deposits, supermarket sales, and the supply of gas" and as recently as March 1999, "contrary to normal procedure by which land is auctioned or tendered to the highest bidder, the government awarded a massive amount of prime land to the son of the tycoon Li Ka-shing, Richard Li, to develop a \$1.7 billion 'cyberport,' part of Hong Kong's recent push into high technology."<sup>74</sup>

There have been claims and counterclaims about the issue of "positive nonintervention" practiced by the Hong Kong government. There is no doubt that the principle followed by the government does try to ensure that unnecessary interference does not affect the operation of public and

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<sup>74</sup>*International Herald Tribune*, March 20-21, 1999.

private organizations. Therefore, it is inappropriate to describe this as "nonintervention." "Selective intervention" may be a more appropriate term to describe the actions of the Hong Kong government which seeks to support the business elite as required.

The intervention in the stock market came in the wake of severe anxiety among the business community over the sluggish economy and its impacts. The business elite felt threatened and needed the injection of a huge amount of money into the market to boost prices and regain investor confidence. Rather than departing from its established policy of so-called "positive nonintervention," the Hong Kong government played the same role as it always has by providing a much-needed boost to the interest of the business elite. In this way, the alliance of the ruling elite continues to prosper.

