

GLOBALIZATION AND FISCAL MANAGEMENT IN HONG KONG

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This paper studies the impact of globalization on the fiscal management of the Hong Kong economy. Globalization refers to two distinct developments (Gilpin, 2000, p.353). The first development is the social, economic, and technical unification of the globe. With the advent of the technological revolution in communication and transportation, cultural and territorial barriers that divide societies are falling apart. Consequently, political, social and economic activities are becoming worldwide in scope. The second development is that transnational economic forces are breaking down national boundaries and integrating national economies. International trade and financial flows are creating a highly interdependent global economy. Generally speaking, globalization is a spatial phenomenon that links the world together by the growing interdependence and interconnectedness between states as a result of the intensification of international social, political, and economic activities (Held, 1995, p.12). These developments have significantly affected the operation of the Hong Kong economy and the fiscal philosophy of the Hong Kong government. The essence of this paper is to evaluate the values and financial policies as adopted by the Hong Kong Special Administrative Region government in response to the challenges of globalization.

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Fiscal management in Hong Kong could be analyzed at both the macro and micro levels. The macro level concerns the overall fiscal philosophy of the government. “Positive non-intervention” and “prudent fiscal management with a surplus budget” could best sum up the fiscal philosophy of the Hong Kong government. The micro level concerns a system of financial processes and structures for government departments to manage resources effectively and efficiently. The Hong Kong government has established a new system of financial resource management in the forms of privatization, corporatization, trading funds, performance measurement, cost recovery, and productivity gains.

The Tung administration since July 1997 has tried hard to re-define the role of government in the economy and to consolidate the new financial structures and processes under the initiatives of public sector reform. However good is the intention of the Tung administration in managing the financial resources of the public sector, criticisms and failures in some areas are heard. This paper aims to present a fair and objective assessment of the fiscal management in Hong Kong and to share the concerns and experience of fiscal management with state leaders and academics of other places. It is argued that the economic management principles in Hong Kong are now inadequate to deal with the immense economic impacts of globalization.

Globalization and Hong Kong

In the twenty-first century, the term “globalization” is a fashionable word used frequently by statesmen, academics, business tycoons, and economists. The popular use of the term by professionals in different fields reflects a wide scope of meanings and perspectives attached to it. McGrew (1992, p.23) refers globalization to the multiplicity of linkages and interconnections between the states and societies which make up the modern world system. Globalization describes the process by which events, decisions, and activities in one part of the world can come to have significant consequences for individuals and communities in quite distant parts of the globe (Ibid). Taking the same broad perspective, Giddens (1994, p.4) simply defines globalization as “action at distance”. The sociological perspective regards globalization as “a social process in which the constraints of geography on social and cultural arrangements recede and in which people become increasingly aware that they are receding” (Waters, 1995, p.3). The OECD (1996, p.9) provides an economic perspective, referring globalization as “an evolving pattern of crossborder activities of firms involving international investment, trade, and collaboration for purposes of product development, production and sourcing, and marketing.” A concise economic meaning is provided by Strange (1995,

p.294) who suggests “globalization means the partial erasure of the distinctions separating national currency areas and national systems of financial regulation.”

Globalization has happened because technological advances have broken down many physical barriers to worldwide communication, barriers which used to limit how much connected or cooperative activity of any kind could happen over long distances (Langhorne, 2001, p.2). With the benefit of technological communication, human beings have the ability to conduct their activities across the world regardless of the boundaries of government authority, nationality, and geography. These activities may be commercial, financial, religious, cultural, social or political (Ibid). In grouping these activities into a systematic pattern, Appadurai (1996, pp.33-37) identifies five dimensions or terrain of globalization: (1) ethnoscaples – the moving landscape of tourists, immigrants, refugees; (2) technoscaples – relating to flows of technology and information across boundaries; (3) finanscaples – a virtual landscape configured by currency markets, financial innovations and currency speculations; (4) mediascaples – the dissemination and proliferation of images; and (5) ideoscaples – the political and strategic diffusion of images by states and oppositional movements.

As the whole world is wired up and increasingly interdependent, the impact of globalization is not only worldwide but also multifarious. As far as this paper is concerned, economic and political impacts are the foci of discussion. In the economic sphere, changes in the production process lead to production becoming more internationalized, regulations across states become more alike, factors of production like capital, know-how become more mobile (Busch, 2000, p.29). As the global economic market becomes highly volatile, the extent that governments could, either by domestic policy measures or by combined action, attempt to control it has been substantially reduced. Langhorne (2001, p.20) even describes the global market now presents itself as a leviathan. In the political sphere, increasing global interdependence among nation-states will subsequently reduce the political systems’ room for manoeuvre. Globalization will therefore imply the sacrifice of some autonomy – since an ever larger part of a country’s or an economy’s feasible actions is determined or at least circumscribed by the actions of other countries or economies (Busch, 2000, p.43). The political price of globalization is a relative loss of sovereignty.

Under the wave of globalization, Hong Kong has been intricately wired up with the international economy. Hong Kong is a major international financial centre, comprising an integrated network of institutions and markets which provide a wide range of products and services to international customers and investors. Hong Kong’s financial markets are characterized by a high degree of liquidity, minimum barriers of access to the market by foreign businesses, and an absence of restrictions on capital flows into and out of Hong

Kong. The importance of Hong Kong in the global banking world is demonstrated by its external orientation. The external assets held by banks reached US\$461 billion, making Hong Kong one of the largest banking centres in the world (Information Services Department, 2001). There were 128 local representative offices in Hong Kong from over 40 countries in 2000 (Ibid). These include 77 out of the world's largest 100 banks. Together they operated a comprehensive network of 1,581 local branches. The average daily net gross foreign exchange turnover was estimated at US\$79 billion in 2000 (Ibid). This represented about 4% of the world total. Hong Kong was ranked seventh in the world in terms of the volume of foreign exchange. Hong Kong's stock market is also one of the largest in the world and the second largest in Asia in terms of market capitalization. It reached US\$500 billion in 2000 (Ibid). The Gold and Silver Exchange Society operates one of the largest gold bullion markets in the world. Turnover on the society totalled 14.36 million taels in 2000 (Ibid). Hong Kong is also one of the most open insurance centres in the world. Its openness is acknowledged in the commission of European Communities Report (1992). Hong Kong is the regional centre for portfolio management activity, including authorized unit trusts, mutual funds, and institutional fund management. In 2000, there were over 1,600 authorized unit trusts and mutual funds in Hong Kong. Their total value in 2000 was US\$200 billion (Information Services Department, 2001).

The international character of the Hong Kong economy is also reflected from its service orientation and trade value. Hong Kong's exports of services, as a ratio to GDP, are significant by international standards. In 2000 Hong Kong exported US\$40 billion worth of services, bearing a ratio of 20.6% to its GDP (Ibid). This ranked second after Japan in the region in terms of the absolute value of exports of services, and was behind only Singapore in terms of the ratio of exports of services to GDP. In the region, Hong Kong, along with Singapore and the Philippines, are consistently net exporters of services. In the world Hong Kong ranked tenth in the league table of exports of services.

International trade has been an important economic activity that sustains the Hong Kong economy. The total value of all trade in 2000 was US\$3,500 billion, constituting a significant portion of Hong Kong's GNP (Ibid). The main import items are electrical machinery, apparatus and appliances, telecommunications, and office machines. The principal suppliers were Japan, the United States, and the United Kingdom. The main domestic export items are apparel and clothing accessories, electrical machinery and appliances. The major markets were the United States, the United Kingdom, Germany, Japan and Taiwan. For re-exports, the principal items are electrical machinery, apparatus and appliances, telecommunications, apparel and clothing accessories, and office machines. The main markets are the United States, Japan, Germany, and the United Kingdom.

As the Hong Kong economy relies heavily on international investment and trade, the volatility of its economy is totally linked up with the global economy. A dramatic change of the world economy will no doubt immediately affect the export-led economy in Hong Kong. The sensitive nature of the Hong Kong economy to the global economy also implies the financial policies of the Hong Kong government will be externally driven. Government leaders in Hong Kong have to respond not only to domestic changes but also to external economic challenges. Fiscal management policies in Hong Kong are inevitably circumscribed and constrained by the changes in the international economy.

Economic Challenges and Crises

The Asian financial crises in 1998 demonstrated the vulnerability of the Hong Kong export-led economy and the negative impact of globalization. The destructive impact of the Asian financial crisis on Hong Kong was first felt in October 1997. When international speculators attempted to break the HK-US dollar peg by short-selling large amounts of HK dollars, the Hong Kong government drastically increased the inter-bank loan interest rate overnight to 300 per cent. The stock market dropped quickly with the Hang Seng Stock Index sliding from 10,000 to 8,000 points within one day after the drastic increase of interest rate. The financial situation further worsened in January 1998 when several financial investment companies went bankrupt with a large number of bad loans and illegal share transactions. Many businesses reported net losses, and resorted to cutting workers' wages and sacking employees. Private consumption shrank significantly, resulting in the closing down of large department stores, including the Japanese Matsuzakaya, Daimaru, and Yaohan. The Hong Kong government recognized the depressing economic situation in May 1998 and recorded two per cent negative economic growth rate in the year of 1998-1999. The projection was a drastic regression from the Financial Secretary's earlier projection of a 3.5 per cent economic growth rate. In June 1998, the property market suffered a heavy loss with a 50 per cent drop in value. Many mortgages turned into bad loans and buyers had to forfeit their deposits owing to banks' disapproval of their mortgage applications. In August, the HK-US dollar peg again came under attack from international speculators, and this resulted in a record low Hang Seng Stock Index of 6,554 since 1992.

Economic indicators of 1997 and 1998 clearly showed the severity of the impact of the Asian financial turmoil on Hong Kong. According to an economic report (*Apple Daily News*, 26 October 1998), the Hang Seng Stock

Index dropped from 16,673 points in August 1997 to 6,554 in August 1998; representing a fall of 41 per cent. The prime interest rate rose from 8.75 per cent in September 1997 to 9.75 per cent in October 1998 (Ibid). The GDP growth rate decreased from 6.9 per cent in 1997 to a record low of - 7.1 per cent in 1998, and the rate of unemployment increased from 2.4 per cent to 5 per cent (Ibid). The number of unemployed increased from 74,000 in 1997 to 181,000, and the number of vacant posts dropped from 11,390 in 1997 to 10,666 (Ibid). The average wage dropped from HK\$10,641 in 1997 to HK\$10,000 (Ibid). The number of approved social security subsidy cases increased from 16,462 in 1997 to 26,215 in 1998 (Ibid). The property price decreased from an average of HK\$7,500 per square foot in 1997 to HK\$3,500 per square foot in 1998 (Ibid). The retail value dropped from HK\$204 billion in 1997 to HK\$170 billion in 1998, with a 16.7 per cent decrease (Ibid). The annual financial surplus decreased from HK\$809 billion in 1997 to HK\$214 billion deficit in 1998, as a result of sharp decreases in government revenue from profit tax, land sales, and stamp duties (Ibid). The number of tourists dropped from 977,248 in June 1997 to 859,310 in August 1998, implying a decrease in tourist expenditure as a source of income (Ibid).

The GDP growth rate in the second quarter of 2001 was only 0.5 per cent. Even the government revised its estimated annual GDP growth rate from 3 per cent to 1 per cent, major banks in Hong Kong estimated a zero growth of the economy (*South China Morning Post*, 1 September 2001). According to the government statistics, the estimate for total export is even more pessimistic. The estimated annual growth rate of total export is revised from 3.1 per cent to - 1.1 per cent (Ibid). The manufacturing industry will suffer a decrease of 11.6 per cent in production and exports to the United States a decrease of 9 per cent in export value.

The decrease is expected to deteriorate further after the terrorist attacks in the United States on 11 September 2001. In terms of re-export, the estimated annual growth rate was revised down from 4.5 per cent to 0 per cent. The deflation rate is estimated to be 1.3 per cent in 2001 (Ibid). The consumption power of households is sharply weakened, as reflected in a survey conducted by the Chinese University of Hong Kong (*Apple Daily News*, 1 June 2001). 45 per cent of household families in the survey reduced their total family expenditure up to 30 per cent, compared to last year's family expenditure. 56 per cent of respondents said their total income was reduced and 21 per cent of respondents expressed no confidence in the economic development in Hong Kong. Unemployment has been worsening since 1997. The unemployment rate climbed from 2.2 per cent in 1997 to 4.9 per cent in August 2001 (*South China Morning Post*, 18 September 2001). The most affected industries are construction, property, infrastructure, transport, wholesales, retails, and food catering. Unemployment is expected to spread to the fields of information technology, telecommunication, banking, and financial

services. These depressing economic data and pictures present a big and real challenge to the fiscal management philosophy and policies of the Hong Kong government.

Fiscal Management in Hong Kong

Economic development policies of Hong Kong are governed by two salient economic philosophies of “positive non-intervention” and “prudent fiscal management with a surplus budget”. These two economic philosophies have been adopted by the Hong Kong government for almost half a century since the end of the Second World War. They form the economic framework within which economic policies and social service programmes are drafted and planned.

The principle of “positive-non-intervention” in the context of Hong Kong means a minimum of government regulations and interference in business practices and decisions. The phrase of “positive non-intervention” has been used by officials to describe the role of government in the economy and the social service sector. Sir Philip Haddon-Cave, the Financial Secretary during 1971-1981, provided the best explanation of the phrase by saying that “government intervention and involvement would be minimum except under special circumstances” in his speech addressed to the Legislative Council in 1976 (*Hansard*, 1976, pp.827-830). The government proudly attributed the past success of the Hong Kong economy to “the consistent economic policies of free enterprise and free trade” (*Hong Kong Yearbook*, 1985, p.71). The principal role of government in the economy, as clearly spelt out in the same document, was “to ensure a stable framework in which commerce and industry can function efficiently and effectively with minimum interference. The government normally intervenes only in response to the pressure of economic and social needs, and neither protects nor subsidizes manufactures” (*Ibid*).

The same economic ideology continued in the 1990s: “The government considers that, except where social considerations are over-riding, the allocation of resources in the economy is best left to market forces with minimal government intervention in the private sector. This basically free-enterprise, market-disciplined system has contributed to Hong Kong’s economic success” (*Hong Kong Yearbook*, 1991, p.63). As such, the primary role of the government is “to provide the necessary infrastructure and a sound legal and administrative framework conducive to economic growth and prosperity” (*Ibid*).

The second principle of economic management, “prudent fiscal management” with a surplus budget, is indeed a by-product of the principle of “positive non-intervention”. As the government is determined to restrain its involvement and role in the economy and the social sector, government expenditure would only be made on basic and necessary areas such as law and order, administration, and infrastructure. The idea of “prudent fiscal management” originated from the Financial Procedures contained in the Colonial Regulations stipulating the ultimate fiscal principle of self-support and balanced budget.

The objective was to ensure that there was no need for the British government to financially support the colony. This principle was further refined by successive Financial Secretaries in Hong Kong for preparing annual surplus budgets. In the 1970s, this set of budgetary guidelines was developed by the then Financial Secretary Hadden-Cave:

1. Recurrent expenditure should absorb no more than 80 per cent of recurrent revenue and at least 60 per cent of capital expenditure should be financed by the surplus on recurrent account. Recurrent expenditure should not be more than 70 per cent of total expenditure.
2. The residual deficit on capital account should at least be financed half by capital revenue and no more than half with debt.
3. Annual debt service charges should not, at any time, exceed income earned on our fiscal reserves.
4. Recurrent revenues should at least be 88 per cent of total expenditure.
5. The balance of the fiscal system is defined by the following two ratios: the ratio of direct to indirect taxation targeted at 55:45 and the ratio of direct and indirect taxation taken together to all other recurrent revenue targeted at 70:30.
6. The rate at which total expenditure by the public sector can grow annually in real terms, based on historical experience in the 1970s, can be taken to be about 10 per cent.
7. The free fiscal reserves at the beginning of the financial year should at least be 15 per cent of estimated expenditure (Tang, 1997, p.190).

In the 1980s, the budgetary guidelines were refined and explicit budget criteria were set with the introduction of Medium Range Forecast. The most important budgetary criteria were:

1. The government aims to maintain adequate reserves in the long term.
2. A substantial element of capital expenditure must be financed from a surplus on operating account (recurrent revenue in relation to recurrent expenditure). A broad target of at least a 50 per cent funding of capital expenditure from the operating surplus is adopted.
3. It is intended that expenditure growth should not exceed the assumption as to the trend growth in GDP.
4. Over a period of time, the aim is to contain capital expenditure growth within overall expenditure guidelines, i.e. within the assumption as to the trend GDP growth (*Budget*, 1986-87).

Most of the previous budgetary guidelines have been retained in the 1990s. These financial practices have been continued in the post-handover Hong Kong under the Chinese sovereignty. The Basic Law (constitution for Hong Kong) stipulates that the Hong Kong Special Administrative Region shall follow the principle of keeping expenditure within the limits of revenues in drawing up its budget, strive to achieve a fiscal balance, avoid deficits, and keep the budget commensurate with the growth rate of its gross domestic product (Article 107). The aim to maintain adequate reserves in the long term has been reiterated in the 1997, 1998, 1999, and 2000 annual financial budgets.

The Hong Kong government has supplemented these two fiscal management philosophies with a new fiscal management framework since 1993. The Efficiency unit (1993) has embarked on four reform areas in the public service: (a) financial and human resource management reform, a review of the role of the finance branch and the civil service branch; (b) institutional reform, which introduces the practice of trading funds, contracting out, and corporatization; (c) operational reform, which involves publication of performance pledges and the establishment of a business centre; and (d) policy management reform, a review of the role of policy branches and the division of responsibility between a policy branch and a department.

To operationalize the new fiscal management framework, two overarching principles are adopted by the Hong Kong government. The first principle is “living within our means” which is aimed at ensuring that “the public sector remains a relatively small part of the economy, the right balance is struck between expenditure and a revenue, adequate reserves are

maintained, and a clear agenda based on priorities is developed” (Efficiency Unit, 1995, p.6). The core values identified are partnership with the private sector and foresight. All policy makers are requested to adopt this principle by applying the following fiscal guidelines: (a) government spending should not outstrip the rate of economic growth, taking 1 year with another; (b) sufficient recurrent revenue should be raised to cover recurrent commitments and to contribute to capital expenditure; (c) reserves should provide an adequate cushion to meet known commitments and future uncertainties by assessing community needs (through the Legislative Council, District Councils, advisory committees, and public consultation), planning (through reviewing baseline expenditure, spending pressures, efficiency improvements, proposed initiatives, and areas of concern), prioritizing resource allocation (through submission of departmental and policy resource bids), and reviewing performance (through key performance measures and expenditure).

The second principle is “managing for performance”, which is aimed at promoting “a trained and well-equipped civil service, continuous improvement in service, and value for money” (Efficiency Unit, 1995, p.6). The core values underpinning this principle are leadership, expertise, effectiveness, efficiency, and propriety. Managers are requested to adhere to the principle by refining performance measures (through the use of quality and quantity measures), managing by programme (through developing comprehensive programme structures and annual programme plans), improving efficiency (through business reviews, value-for-money studies, and departmental efficiency initiatives), managing public finances (through developing statutory framework, accounting framework, annual estimates and in-year management), managing human resources (through developing a human resource management plan in each unit, with the emphasis on management of people rather than administration of rules), managing support services (through the provision of central and internal support services), preparing departmental plans (including mission, programme plans, performance measures, financial summary, an efficiency plan, and a human resource management plan), and reviewing progress (through a progress report highlighting the performance and proposing remedial action).

A Critical Assessment

The fiscal management philosophy and practices of Hong Kong had been successful in transforming Hong Kong into a leading international financial centre with a high standard of living. In the last three decades, Hong Kong enjoyed steady economic growth, with an average annual growth of 5 per cent

in per capita GDP (*Hong Kong Annual Digest of Statistics*, various years). Unemployment remained low, with an average of 2 per cent of the total working population per year. With a stable employment situation, the working population enjoyed real wage increases, and the real wage index recorded a steady increase over the last thirty years with an average annual growth rate of 3 per cent. In terms of the distribution of income, the size of the middle class expanded, with more people earning the middle range monthly income. With reference to housing tenure, the number of owner-occupiers increased from 23.2 per cent of the total population in 1976 to 48.2 per cent in 1996. As a result of stable economic growth and real wage increase, private consumption grew over ten times from 1967 to 1997. The stock market, an indicator of the profile of financial investment, also experienced continuous growth and expansion. The Hang Seng Stock Index jumped from 100 points in 1964 to 16,673 in 1997. Besides, Hong Kong had been successful in transforming itself from a manufacturing-based to a business and financial-service based economy. In the 1970s, the manufacturing industries made the largest contribution to the GDP. Yet employment in the financial and wholesale business and financial services took the largest share (two-third) of the total employment in the 1990s.

It would be true to say that the economic success of Hong Kong was a result of a number of factors, including a strategic geographical location, a deep harbour for shipping, an efficient civil service, a sophisticated communication and transport system, a hard-working population, a large Chinese hinterland, and a beneficiary of the open door policy of China. Yet it would be equally fair to argue that the economic management policies of the Hong Kong government facilitated, if not contributed, to the continuous growth and prosperity of the economy. The economic management principles at least did not obstruct or create any damage to the free operation of the economy which was regulating itself through the dynamic interaction of the various economic actors. The government did a good job in restraining itself from over-regulating or intervening the markets. As the government intervention in the economy was minimal, economic actors made free choices according to various market situations. With a minimum of government regulation and an absence of irregular influence, the advantages of a free market mechanism were thus fully realized. The operation of the *laissez-faire* economy was further backed up by the restrained role of the government in the social sector. Tax rate remained low, as a result of “prudent” government expenditure on social welfare services. This directly encouraged investment, consumption, and expansion of business operations. The prudent economic management principle certainly lessened the economic burden of the society and helped boost the overall investment confidence and incentive. Under such a favourable economic environment, business investors had ample opportunities for flourishing.

However, globalization was a severe test on the effectiveness of these two economic management principles. The impact of the Asian financial turmoil was so strong that people began to question the usefulness of the economic management principles of the government of Hong Kong. Although the Asian financial crisis started in Thailand in May 1997 and reached Hong Kong in October 1997, the government had not done anything until February 1998 to prevent it from affecting Hong Kong or to minimize its impact. The Financial Secretary announced the 1998 Budget in February to reduce various taxes including business tax, security stamp duty, rates, airport tax, and property tax. With the concession of taxes, the government estimated that the budget would still be a surplus budget. The objective of these tax concessions was to stimulate consumption, in view of a slow economic growth. However, the government did not give any warning about the Asian financial turmoil. Perhaps the attention of the government was too much drawn to the plunging property market, as a result of the introduction of a new housing policy by the government.

Chief Executive Tung announced in his 1997 Policy Address that 85,000 new housing units would be provided every year and that a series of measures would be in place to regulate the overheated private property market. This housing policy precipitated a slide in the private property market, and the price of private properties fell 40 per cent within six months. Recognizing the serious threat to the economy, the government slightly relaxed the rules for the transaction of private properties in May 1998. This was hoped to stimulate the ailing property market, while the government still insisted on the target of the annual provision of 85,000 housing target. Apart from the attempt to revive the property market, the Monetary Authority of Hong Kong also injected more money into the banking system in order to relieve the tight currency circulation. Furthermore, the government was keen to promote tourism by relaxing the visa requirements for visitors from Taiwan and mainland China.

A second round of rescue bid to save the economy was announced by the government in June 1998. The total amount of money involved in the rescue bid was estimated to be HK\$44 billion. These included:

1. suspending land sales until March 1999 and freezing grants for sandwich class housing;
2. providing HK\$3.6 billion to double to 12,000 the number of first time home-buyers benefiting from the starter loan scheme, and HK\$3.3 billion to increase from 4,500 to 10,000 the number benefiting from the home purchase scheme;
3. exempting interest earned locally from profits tax, aiming to provide an

extra HK\$200 billion in liquidity for the banking sector through repatriation of offshore deposits;

4. setting up a HK\$2 billion scheme to help non-export related small and medium businesses obtain loans;
5. rebating rates of HK\$3.85 billion for first quarter;
6. cutting duty on diesel by 30 per cent;
7. reducing by HK\$200 million annually the charges paid by importers and exporters; and
8. freezing pay increase for 331 directorate officials.

The third rescue bid, aimed at mapping out long-term strategies for growth, was packaged in Tung's second Policy Speech delivered in October 1998. Tung alleged that the economic downturn was a result of both external and internal factors. The external factors were attributed to "the intense pressure to short-sell the Hong Kong dollar", "the withdrawal of funds from overseas banks and investors", "the rapid depreciation of Asian currencies", and "the sharp decline in the number of inbound tourists" (*Policy Address*, 1998, p.2). These factors were claimed to cause high interest rate, reduction of the liquidity in the banking system, steep decline in the property and stock markets, and contraction of consumer and tourist spending.

Tung regarded a "bubble economy" and a "narrow economic base" as the main internal factors which made the Hong Kong economy vulnerable. According to Tung, "Hong Kong has become one of the most expensive cities in the world in which to do business, and this has affected our competitiveness. Our economic base has been too narrow, whenever the financial and real estate sectors have encountered problems, the Hong Kong economy has suffered" (Ibid). Based on such analysis, Tung's 1998 *Policy Address* was tuned to tackle the external challenges and to strengthen the internal economic structures.

Tung proposed a number of major long-term strategies for growth in the 1998 *Policy Address*:

1. strengthening government support for innovation and technological development by setting up an Applied Science and Technology Research Institute;
2. setting up a HK\$5 billion Innovation and Technology Fund to provide finance for projects which will contribute to the improved use of

- innovation and technology in the industrial and commercial sectors;
3. positioning Hong Kong as an Internet Hub for the Asia Pacific region to help Hong Kong, mainland, and overseas businesses to produce, distribute, and market their goods more effectively both within the region and beyond;
 4. developing a world class teleport to provide the best possible global satellite links;
 5. enhancing Hong Kong's role as an international financial services centre by strengthening regulatory systems and developing new products (eg. The creation of a Venture Board for the trade of shares in smaller and emerging companies);
 6. drawing up plans for a new state-of-the-art performance venue to boost Hong Kong's status as Asia's entertainment and events capital;
 7. establishing a Heritage Tourism Task Force and a Commissioner for Tourism;
 8. opening a Small and Medium Enterprises Office to coordinate services and assistance for smaller businesses.

Perhaps these initiatives would require a long time to have a real impact on the economy. The 1999 and 2000 *Budgets* also did not help much the economy and the public confidence in the government. The government recorded a deficit of HK\$22 billion and HK\$11 billion in 1999 and 2000 respectively (*Budget*, 2001). These were the two deficit budgets that the Hong Kong government encountered in the past thirty years. This phenomenon not only deviated from the salient principle of "Setting Positive Budget" but also violated the principle of Article 107 of the Basic Law of maintaining a fiscal balance and avoiding deficits. The major reductions of the government income came from the sharp decrease of property tax (-17.4 per cent) and the personal income tax (-13.8 per cent) in 2000. The fiscal reserves in Hong Kong have been decreasing since 1998, from HK\$4,252 billion to HK\$3,887 billion in 1999 and subsequently to HK\$3,831 billion in 2000. Against these negative figures, the 1999 and 2000 *Budgets* were seen as ineffective economic management documents by various political parties, including the pro-government parties.

In the 2001-2002 *Budget*, the government stressed the need for "a prudent and responsible budget". It outlined four budget strategies: (a) maintaining steady economic growth and ensuring improvement in people's

livelihood, (b) devoting more resources to address the needs of the community, (c) enhancing public sector productivity, and (d) striving to achieving fiscal balance. In implementing these budget strategies, government expenditure will amount to HK\$252 billion in 2001-02, an increase of HK\$26.6 billion over that in 2000-01. Expenditure items cover all initiatives announced by the Chief Executive in his previous *Policy Addresses*, including: improving education; strengthening training; easing unemployment; helping the disadvantaged; increasing building safety; and upgrading the environment. On top of these, the Financial Secretary announced the following additional expenditure initiatives – support for the disabled, care youth at risk, training for those with low educational attainment, and support for employers' staff training. The size of the civil service will continue to shrink, with number of posts by the end of 2002-03 well below 1994-95 level. Enhanced Productivity Programme will continue apace, delivering 5 per cent savings to fund new and improved services by 2002-03. Privatization of government tunnels is put on the agenda to improve management of government assets. An overall deficit of HK\$3 billion for 2001-02 is forecasted and an operating deficit of HK\$16.6 billion is also expected for the same budget year. Three grand strategies for development are proposed by the Financial Secretary (*Budget, 2001*):

1. capture opportunities from China's coming accession to the World Trade Organization; step up cooperation with Guangdong Province, especially with the Pearl River Delta, to capitalize on regional competitive advantage;
2. upgrade human capital to meet demands of a knowledge-based economy and to help improve the standards of living of the disadvantaged; implement an Admission of Mainland Professionals Scheme to address a shortage of professionals in order to sustain economic vitality;
3. strengthen Hong Kong as a centre for international finance and high-value-added services and strive to excel as Asia's World City.

Yet these fiscal measures and economic policies did not increase the public confidence in the economic management ability of the government and the economic prospect of Hong Kong. A survey conducted by the Chinese University of Hong Kong showed that 73.5 per cent of respondents were dissatisfied with the economic situation (*South China Morning Post*, 31 August 2001). In the same survey, 54 per cent of respondents thought that the Hong Kong economy would further deteriorate in the years to come. Over half (57 per cent) of the respondents worried that they would be unemployed. The lack of confidence towards the unclear economic future of

Hong Kong is further dragged down by the terrorists' attack in the United States on 11 September 2001. After meeting with the Financial Secretary, members of the Economic Advisory Committee of the Hong Kong government admitted that the Hong Kong economy would seriously suffer from a large reduction of foreign investment (especially from the United States), trade (exports to the United States), and tourists' expenditure (*South China Morning Post*, 23 September 2001).

The lack of public confidence in the Tung administration and the poor economic performance could be attributed to the inconsistent economic policies and the low responding capability of the government towards the changing international economy. It would be fair to say that "the full effect of the government measures to tackle the depressing Hong Kong economy might not be immediately evident" (*Policy Address*, 1998) and that "the government has no magic to immediately fix the economy" (*Hong Kong Standard*, 5 November 1998). Yet a closer look at the economic actions of the government suggest that these activities were inconsistent with the economic management principle of "positive non-intervention". The Hong Kong Policy Research Institute found that the index of free market operation in Hong Kong dropped from 100 in 1997 to 94.3 in 1998 (*Apple Daily News*, 18 February 2000).

The government's firm commitment to direct the housing market by the annual provision of 85,000 new housing units was a case in point. The housing policy was regarded by many developers as direct intervention of the housing market. It was criticized that the market principles of demand and supply were disrupted by the government directives of building respectively 55,000 and 30,000 public and private housing units every year. Private housing in the context of Hong Kong was not only a matter of basic living necessity, but also a tool of investment. As the property market enjoyed rapid growth in the past ten years, the public regarded property as a reliable source of saving and investment. The drastic change in government policy disturbed this belief and led to the sudden collapse of the private property market. Yet on 5 July 2000, Tung suddenly told the public that the 85,000 target had not existed since 1998. Legislators and even members of the Executive Council wondered why they had not been told of the change in 1998 and pointed out that officials had repeatedly insisted since then that the housing policy was still in force (*South China Morning Post*, 6 July 2000). Furthermore, Tung did not clarify whether the housing target had been scrapped, although it did not exist. Tung's housing policy and public speeches confused the public and the developers about the role of government in the property market as well as the direction of the property market. The confusing housing policy not only deviated from the "positive non-intervention doctrine" but also reduced significantly the amount of government revenue from land sales, property tax, rates, and stamp duties.

The general public and investors were further upset by the low responding capability of the government in handling changes and crises in the global economy. This affects the government's degree of awareness and alertness to foresee problems and to map out preventive measures to minimize the scope and impact problems. In commenting on the economic situation in Hong Kong, the Financial Secretary, Antony Leung, said that "what the government could do was not much." (*Apple Daily News*, 1 September 2001) The then Chief Secretary for Administration admitted in a Legislative Council meeting that "the government underestimated the scope and impact of the Asian financial turmoil on the economy of Hong Kong" and that "the government would learn from this experience" (*South China Morning Post*, 5 November 1998). The government actions taken during the financial turmoil seemed to be mainly reactive to the actions initiated by international speculators. For instance, the Monetary Authority drastically raised the inter-bank loan interest to 300 per cent overnight after the Hong Kong dollars had been short-sold in October 1997. On another occasion, the government injected HK\$1,120 billion into the stock market after the stock and future markets had been manipulated by international speculators in August 1998. These two incidents reflected that the government was not well-equipped with foresight, ability to anticipate problems, and to discover inherent weaknesses of the financial system.

The impact of economic globalization in general and the Asian financial turmoil in particular on Hong Kong and the actions of the government to deal with them exposed a number of problems and weaknesses inherent in its economic management principles. First, the monetary policy of pegging the US and Hong Kong dollars limits Hong Kong's ability to respond to external economic changes. In times of economic downturn, the linked monetary policy lowers Hong Kong's competitiveness in terms of trades and services as Hong Kong goods and services become relatively expensive. In times of economic prosperity, Hong Kong will receive less economic earnings because Hong Kong dollars are under-valued. Yet the Chief Secretary affirmed in a speech given to the American Society (Hong Kong Branch) on 29 November 2001 that the Monetary Authority would not change the pegged dollar policy. Second, the Basic Law constrains Hong Kong's fiscal strategy, as the government is constitutionally tied to produce surplus budgets, hence restricting the ways government could twist its expenditure and revenue. Third, there are not enough monitoring measures or efforts to oversee the normal functioning of the financial market. The government over-emphasizes non-intervention while under-estimating the risk of market manipulation by international speculators. Fourth, the economic base of Hong Kong is too narrow with the property and financial sectors as the main economic pillars. As the government did not invest resources in new areas of growth under the principle of "non-intervention" and "prudent spending", the Hong Kong

economy has become vulnerable to external changes. Fifth, there are inadequate economic and social security protections for the general citizens due to the limited role of the government in social and economic services. Thus the adverse impact of such crises on the citizens and the economy are magnified. Sixth, the government introduced short-term, piece-meal, and inconsistent economic policies owing to the lack of vision and long-term planning. Seventh, the responding capability of the officials is low with a low level of awareness and alertness, and this is a result of their prolonged reliance on the principle of “non-intervention”. Thus “positive non-intervention” results in unresponsiveness; “prudent fiscal management” results in inflexibility and conservatism; and the sought for short-term immediate success results in market intrusion.

At the micro level of fiscal management, the new initiatives of public sector management under the New Public Management (NPM) approach recorded improved performance and successes in some service areas. For instance, the Healthcare and Social Welfare Bureau increased 2,600 subsidized beds for the elderly in 2000 (*Progress Report, 2000*). The waiting time for getting admitted into the subsidized homes for the elderly was shortened from 24 months to 21 months. The number of licensed private homes for the elderly was also increased from 179 in 1999 to 410 in 2000. In the medical realm, 460 additional beds were installed in public hospitals with a ratio of 4.2 beds per 1000 persons. The number of doctors receiving family medicine training was increased from 210 to 316. The utility rate of women clinics was increased from 46 per cent to 175 per cent. The age limit for using women clinics was relaxed from 45 to 65. 4,000 doctors, 7,000 nurses, and 3,000 medical professionals received in-service training in various fields in 2000. The waiting time in specialist clinics was shortened to an average of 60 minutes from 120 minutes. The waiting time for new patients to be admitted into specialist clinics was reduced from 8 weeks to 5 weeks in 2000.

In social welfare, “service quality standards” were released for monitoring the quality of social services. 13,000 social welfare workers received 13 in-service training programmes in 2000. The Social Welfare Department provided 300 additional day-care kindergarten places. 500 additional places in day-care centres for the disable were added. In public works, the number of inspection of lift safety in construction sites was 268, higher than the original target of 200. Structural inspection visits in construction sites were increased from 950 in 1999 to 1,300 in 2000, an increase of 35 per cent. The number of water quality inspection in reservoirs was increased 15 per cent. 4.2 per cent of total savings was recorded in 2000, reaching the target of 5 per cent productivity gains. These data suggest that public service provision and delivery have been improved through the NPM approaches of financial and human resource management practices in the government. Yet negative side effects are also visible with the implementation

of the NPM fiscal management approaches. These side effects could receive back-fire which affects the adaptability of the Hong Kong government to deal with changes in the international economy. The first side effect is the concern of accountability. The NPM fiscal management framework aims to enhance managerial responsibility and decentralization. Managerial responsibility increases through empowering managers with more powers and duties. Decentralization is realized through privatization and corporatization of public services. However, this raises the concern of political accountability. As more responsibilities are delegated to more departmental managers and more public services are decentralized to independent agencies and businesses, it becomes practice that they, rather than the central government, are made answerable for their policies and decisions to the legislature and elected politicians. Yet there is a lack of a democratic structure and effective mechanism to hold departmental managers and independent bodies responsible for their performance and decisions in the context of Hong Kong.

A ministerial responsibility system is absent in Hong Kong. Although the civil servants make most of the decisions, they are immune from political responsibility. The refusal of the Housing Department Head to resign over a housing scandal after the passage of a vote of no confidence in the Legislative Council was a case in point. The housing scandal also revealed a lack of government monitoring over the performance and quality of contracted constructors. Moreover, members of Executive Council (advisory body to the Chief Executive) are not politicians with departmental portfolio or full time politicians, hence holding no political responsibility at all. The Hong Kong Chief Executive is neither chosen by the Legislative Council nor directly elected by the general public. The Chief Executive is protected by the Basic Law which does not provide any mechanism to remove the government or the Chief Executive on the basis of poor performance. Tung refused the request of the Legislative Council to attend Legislative Council meeting once a month to explain government policies and performance. The Legislative Council is also inhibited from initiating any bills that are related to government structure, operation, policies, and expenditure. Although the NPM fiscal framework aims at providing more economical and effective services through decentralization and privatization, there are no effective constitutional measures in Hong Kong to hold departmental managers and independent agencies politically responsible. Constitutional and legal controls on corporations and non-departmental public bodies involved in making and implementing public policies are even more difficult. Fiscal policies and financial measures made by these decentralized bodies may therefore not be responsive to the needs of the society.

Another concern is the lack of a coherent strategy of an overall governance of the society. As departmental and corporation managers are empowered to make more decisions and to manage budgets, different

departments, units, agencies, and corporations could produce different programmes and plans that would be either duplicated or redundant. It could also be possible that the financial programmes and policies are inconsistent and contradictory to each other. A real success of the NPM fiscal management framework will, therefore, also need a strengthened coordination framework to oversee the operation and plans of government departments, agencies, corporate bodies, non-departmental bodies, privatized units, and contract companies. What is missing in the fiscal management framework in Hong Kong is the emphasis on cross-functional and cross-departmental coordination. A renewed coordination framework could enhance the coordination capability of the government to minimize waste, loss of control, and negligence. This is particularly important to export-led economies like Hong Kong where the government has to take concerted actions quickly to deal with rapid and dynamic changes in the global economy. Hood (1995, p.113) pointed out that a possible unintended outcome arising from the NPM is the emergence of a “headless chicken” state (a structure of no-one-in-charge management in which everything is up for grabs at every stage and there are no clear rules of the road or demarcation of responsibilities). The lack of quick response to the Asian financial turmoil is an indication that the authorities and officials in charge of financial management, including the Monetary Authority, the Economic Bureau, the Treasury, and the Financial Services Bureau did not have a coordinated financial management framework or system to handle crises and sudden changes in the Hong Kong economy as well as in the international economic system.

A third concern is the proper balance between social and economic values in making strategic planning decisions on public policies. The NPM fiscal management approaches put a lot of emphasis on economic and business considerations such as cost recovery, profit maximization, value for money, and users pay concepts. Trading funds are now injected into the Electrical and Mechanical Services Department, the Land Registry, and the Companies Registry for generating their own income. Efficiency initiatives take the forms of business reviews and value-for-money studies in every government department and corporate body. The entire government is now running like a business with cost and measurable output identified as the most important considerations in the provision of public services. A “gridlocked contract state” emerges when public service provision is a matter for private corporations or organizations operating in a business look-alike style (Hood, 1995, p.113). Financial policies are set and human resources are deployed for achieving maximum efficiency in economic terms. With such kind of thinking, there is a danger that such social values as justice, fairness, and equality, or the political values of liberty and freedom might be neglected or sacrificed, for the sake of cutting labour and operational costs. As some social functions like welfare, health care, and housing might not simply take economic costs as the

only consideration, the indiscriminate use of business and economic values in the provision of social services began to receive criticisms from elected politicians and dissatisfaction from the general public. Neglecting social values could be dangerous, resulting in social unrest and political instability. As the Hong Kong society has been politicized, a careful balance between business and social values has to be drawn in managing the economy and providing social services. In times of economic prosperity, the public sentiment against the use of business practices in social services may not be visible. Yet, in a time of economic depression, when most citizens cannot afford expensive social services based on economic calculations, the entrepreneurial approach would be problematic. This scenario also applies when there is a wide gap in come distribution. If most of the people could not afford to buy the expensive social services formulated according to the NPM model, social problems could be aggravated and social stability could be disrupted.

Conclusion

Globalization has no doubt affected the operation and management of the Hong Kong economy which is wholly linked up with the international economy. The export-led and finance-led economy makes Hong Kong become very vulnerable to external influences and changes. The Asian financial turmoil has fully exposed the weaknesses of the fiscal management philosophy and practices adopted in Hong Kong. Perhaps the doctrines of “positive non-intervention” and “prudent fiscal management with a surplus budget” are in the strictest sense outmoded in an age of globalization. What further ties up the hands of the Hong Kong government is the inflexible pegged US – Hong Kong dollars monetary policy. Both the fiscal and monetary policies are restraining Hong Kong’s economic adaptability in an age of globalization. If Hong Kong has to maintain its vigour, there will be a need to modify if not totally discard these two fiscal management philosophies. Pro-active and preventive elements have to be inserted into the grand fiscal management philosophies. A review of the recent initiatives taken by the Chief Executive and Financial Secretary suggests that the government is not taking enough efforts to transform Hong Kong into a knowledge-based economy and to stimulate investment confidence. Moreover, the NPM fiscal management approaches have to be further refined in order to minimize making confusing and contradicting policies, to increase responsiveness, and to balance social and economic needs. The above experience and lessons from Hong Kong could perhaps shed some light on the fiscal management of those economies and societies which are export- and finance-led in an age of globalization.

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