

Protecting Free Trade

The Hong Kong Paradox, 1947–97

A Personal Reminiscence

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香港大學出版社

HONG KONG UNIVERSITY PRESS

Hong Kong University Press
14/F Hing Wai Centre
7 Tin Wan Praya Road
Aberdeen
Hong Kong
www.hkupress.org

© Hong Kong University Press 2012

ISBN 978-988-8083-98-5

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British Library Cataloguing-in-Publication Data

A catalogue record for this book is available from the British Library.

10 9 8 7 6 5 4 3 2 1

Printed and bound by Liang Yu Printing Factory Ltd., in Hong Kong, China

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Chapter One

Early Problems

The Second World War ended in 1945. Its aftermath marked a time of upheaval and change for victor and vanquished alike. For Great Britain, it meant the end of empire as nations, colonies, protectorates, trucial states and other sundry places under its administration gained their independence. Among the United Kingdom's few remaining dependent territories was Hong Kong. Although Britain was steadily dismantling its empire and returning sovereignty to the peoples of their native lands around the world, it stoutly refused to hand its Far Eastern outpost over to Generalissimo Chiang Kai-shek of the Kuomintang. Nor could it grant Hong Kong independence. To begin with, it had leased 90 percent of Hong Kong from China, so it was not actually Britain's to give away. A far more persuasive reason was that China would never have allowed it. Whenever the occasion offered, her statesmen drew attention to China's '*unequal treaties*' with other countries. Everyone knew of whom they spoke. As Mr. Chou En-lai, China's Foreign Minister, so succinctly put it: Hong Kong, all of it, would revert to China '*when the time was ripe*'. The late 1940s clearly did not represent such a time. So, Hong Kong had no choice in the matter.

For Hong Kong, the years immediately following the Second World War represented something of a swashbuckling era with survival the immediate priority. It was a British colony that had to get back on its feet following the Japanese occupation and also to deal with a growing number of refugees from the upheaval in China just across the Shum Chun River.

When Mao Tse-tung began his liberation of China, and Generalissimo Chiang Kai-shek took his government and, reportedly, a considerable amount of gold to Taiwan, Britain quickly recognised the new Chinese government. It then proceeded to ignore, equally quickly, the several hundred thousand Chinese who, not sharing Britain's enthusiasm for Chairman Mao's new regime, took up residence in its tiny colony. Shanty towns built of wooden packing

cases and cardboard boxes soon covered the hillsides of Hong Kong Island and Kowloon. They were founded on nothing more than the conviction that these fragile habitations were to be preferred to the eventual prosperity Chairman Mao promised. The efforts of the Chairman's supporters to deny people access to the capitalist distractions of Hong Kong were more than matched by those who begged to differ. By 1952, over a million were estimated to have voted with their feet for Cardboard in preference to Communism. Christmas 1953 proved a turning point and the date from which Hong Kong's modern history might be said to begin. A massive fire swept through the shanty town at Shek Kip Mei. It finally forced the Hong Kong government to recognise that it had what the Colonial Secretary, Claude Burgess, described as a 'problem of people'. The government took two far-reaching decisions: first, to house the homeless and, second, to find them jobs. It was in the light of such unpromising beginnings that Hong Kong, comprising the island seized in 1841, a small part of the Kowloon peninsula, and a ninety-nine-year lease on the New Territories, set out to make its fortune, overseen by an inexperienced and outdated colonial government.

When I joined in 1958, as an Executive Officer, Class II, number sixty-seven on (and the bottom of) the seniority list, the government structure differed little from pre-war days. The top brass included the Governor, the Colonial Secretary, the Financial Secretary, the Secretary for Chinese Affairs (a Brit, of course) and the Heads of Departments. Administrative Officers, known as cadets and virtually all Brits, filled the top posts in the Colonial Secretariat and the departments. The middle management level consisted of the Executive Officers, mostly expats. Then came the Clerical Officers, all Chinese, who actually did the work. Alongside these 'generalists' stood the professionals — policemen, firemen, engineers and architects, among others, where the distinction between locals and expats appeared less pronounced. The arrival of expats from other British colonies often swelled the ranks of the 'professionals'. They had transferred to Hong Kong as their original places of work achieved independence.

Daily life was rather different from today as well. There were three sedan chairs at the bottom of Ice House Street which could be hired to carry you up the slope to mid-levels for some exorbitant fare — about two dollars, as I recall, with others at Taikoo Sugar Refinery at North Point.

The 'new' Star Ferry terminal remained the subject of grumbles because of the distance one had to walk to board; previously the ferries had come

alongside and you just hopped on. They charged you five cents for second class and ten cents if you wanted to travel on the upper deck. At the Hong Kong Island terminal, a long line of Mercedes-Benz taxis waited for customers; flag fall one dollar fifty cents while on the Kowloon side, just one dollar. Also at the Star Ferry, numerous rickshaws competed for business at fifty cents for so many minutes.

My wife and I lived in a three-bedroom apartment on the fifth floor of a 'private tenancy' in MacDonnell Road (because of the dearth of government quarters) with a nice view of Government House and the harbour beyond. The rent was HK\$950 a month of which I paid \$50 and the government the rest. I could afford to run a second-hand Austin A40. Its registration number plate, HK520, probably would command a fortune now if it still existed. We hired a live-in *amah*, could afford the monthly subs of the cricket and football clubs, maintained a credit of two hundred dollars with Shui Tai, our *comprador*, and ate out at Jimmy's Kitchen or Maxim's or the Paramount Restaurant once a fortnight. I always took lunch at the China Fleet Club just opposite Police Headquarters in Arsenal Street: breaded prawns, chips, a glass of San Mig and a game of snooker.

I obtained my car driving licence in 1959. You could do it in one of three ways. For Chinese, they paid a considerable sum of money to an expatriate police sub-inspector (local officers being suspected of too much leniency) who then placed the sought after 'PASS' chop on the application form. For expatriates who knew someone in the police, they spent a pleasant half an hour chatting in the front seat of the car and then received the necessary chop. For the rest, they actually took the test, hoping for the best. At the time I took the test, I was working in Police Headquarters and had considerable difficulty in persuading anybody that I really wanted things done properly. I remember that traffic volumes were such that I was able to do my three-point turn and emergency stop outside the Helena May on Garden Road.

Road space was shared by a few private cars, mostly British made, buses, trams, taxis, rickshaws and tricycles. The latter had a large red box container at the front, and provided an effective and efficient goods delivery service around town. Immaculately uniformed police constables with pristine white gauntlets regulated the whole, choreographing the movements of traffic at busy junctions with balletic arm and hand gestures from pagoda-roofed pedestals.

In summer, we packed winter clothing away in camphor-wood chests to protect them from the heat and humidity, and placed them in Dairy Farm's cold

storage. Lane Crawford (up-market) and Whiteaways (mid-market) provided goods from 'home', while China Products sold everything at unbelievably low prices. Every expat family used a *comprador* to deliver anything you wanted twice a day and extend a month's credit before asking for payment. Every Christmas, he would deliver a bottle of wine or a turkey as a present which regulations specifically excluded from the definition of 'corrupt gifts' under the law. You hired at least one Chinese *amah*. She expected (and received) a thirteen-month salary every year, the thirteenth payable at Chinese New Year, when deafening fire-crackers celebrated the departure of one animal from the Chinese zodiac and the arrival of the next.

Looking back, sixty years later, these seemed to have been halcyon days for the expat. The local may not wax quite so nostalgic. Such days were not to last much longer.

For Hong Kong stood out as a rather irritating pimple of entrepreneurial activity on the bottom of the map of the world's largest socialist country. As the years passed, it became the target of hypocritical hyperbole from developed countries who claimed to sympathise with Hong Kong's delicate situation and applauded its efforts to achieve self-reliance, but then loudly complained about the 'floods of imports' by which it sought to do so. Nor did Hong Kong have many friends among the developing countries who became increasingly jealous of the territory's growing success. Perhaps, remaining the last significant jewel in the British imperial crown became Hong Kong's greatest sin. Where others had thrown off the shackles of colonialism and were in a right old mess, Hong Kong continued to move steadily from strength to strength, something colonies supposedly did not do. By the late 1970s, Hong Kong had become the world's largest exporter of clothing, and the thirteenth largest exporter (of some 135) in the world overall. As unofficial leader of the developing countries in matters affecting textiles and clothing, it was seen as a tough but reasonable negotiator and respected for its efforts to live up to its beliefs and international obligations. It was voted year after year as the best place in the world in which to do business (and still is).

It achieved all these without a cent of financial help from anyone. As Hong Kong's man in London, Earnest Grimwood, was wont to put it 'The colony not only had to pull itself up by its own bootstraps, it had to make the bloody things in the first place.' The hundreds of thousands who, preferring capitalism to communism, crossed into Hong Kong from China in the early fifties, had brought with them a wide range of skills as well as a pressing need to find

outlets for their expertise. A happy compromise emerged as to how this might be accomplished: the market would decide how the skills were to be used, while the government would seek to create a stable environment in which business could flourish under the rule of law. This was no formal solution agreed upon following consultation between governing and governed: it just happened that way. The *laissez-faire* approach undoubtedly derived from Hong Kong's historical role as a free port, with no point in it being anything else. From the beginning, Hong Kong had served as an entrepôt for China. By the time Chairman Mao had come to power, it had already developed into China's busiest port. Although not much went into China, whatever trade there was usually went through Hong Kong. There was however plenty of goods coming from China, earning much needed foreign currency for the People's Republic, and providing Hong Kong with welcome economic side benefits.

In addition to its port, Hong Kong possessed a small industrial base, mainly Cantonese-owned factories, producing such goods as preserved ginger, a motley array of towels, embroidered table cloths and place mats and enamelware, exported largely to West Africa. There were none of the protective import duties then common in other countries because there was nothing to protect and emerging industries needed access to raw materials from the cheapest sources worldwide. The new residents from China included entrepreneurs from Shanghai who had owned spinning and weaving mills there. They re-established their operations in Hong Kong, providing not only industrial diversification but a challenge to the local and somewhat old-fashioned Cantonese textile industry. Business began to pick up, creating jobs while the Colony's output started to grow. By the late 1950s, Hong Kong exported most of its production, mainly to other South East Asian countries and some to the United Kingdom, although how much and to whom, remained unclear.

The collection of trade data was the responsibility of the Statistics Branch of the Commerce and Industry Department. However, it was not until 1960 that Hong Kong finally separated domestic exports from re-exports. Domestic exports consist of goods produced in Hong Kong while re-exports represent goods imported into Hong Kong, then shipped out again to other destinations without undergoing any processing. By the mid-1950s, the inability to distinguish between domestic and re-exports was giving rise to increasing suspicion that some of Hong Kong's exports were in fact made elsewhere, and passed off as Hong Kong products. In particular, Japan had been a major supplier of cheap goods to Europe before the war. Afterwards, its trade became subject to

many restrictions. A nearby free port such as Hong Kong might clearly tempt enterprising traders to use the port to export prohibited Japanese goods into its former markets in Europe and America. China trade posed yet another problem. While Chairman Mao had added the word 'People's' to the country's title to create the People's Republic of China (PRC), the Generalissimo had taken what remained of his Republic of China (ROC) to Taiwan, which he pretended was China proper. The United States of America, who could not bear the thought of a billion 'Red China commies' opposite them just across the Pacific, shared this pretence. In 1950, the USA introduced legislation under its Foreign Assets Control Regulations that banned all imports from the People's Republic of China. Further, it also prohibited the import of any goods from any country that had used raw materials from the PRC. It added North Korea as well for good measure. It was obvious that a smart trader in Hong Kong might try to circumvent FAC Regulations by importing Chinese goods into Hong Kong, changing the origin labels on the products and exporting them to the USA. The potential competition between true Hong Kong products and those made elsewhere and subsequently relabelled in Hong Kong clearly undermined its efforts to establish a domestic manufacturing industry. It also threatened Hong Kong's international reputation. The absence of separate export statistics muddied the waters still further while, perhaps, providing a convenient cover for those who did not want trade activity too closely scrutinised.

Thus, no sooner had Hong Kong begun to deal with its 'problem of people' than a 'problem of products' began to emerge. The problem with products was two-fold. Although the population had more than doubled, clearly, the total Hong Kong market remained too small to sustain the volume of goods its nascent industries now produced. South East Asia offered a wider market of sorts albeit small, while many countries in the region maintained import restrictions on the types of products Hong Kong was making. Thus, an urgent need existed to find bigger and better markets abroad, in Europe and the USA, for example, in order for the government to achieve its goal of creating full employment. The other issue involved securing access to those larger markets and persuading them that a Hong Kong product indeed represented what it claimed. Much of this occurred before I arrived but I was aware of some of the issues as I had been working in an import house in London before coming to Hong Kong.

On my arrival, I was asked whether I had given any thought to the department I would like to join. Someone had tipped me off that the Commerce and

Industry Department¹ offered a good posting. There was a lot happening there, he had said, and the chance to travel. So, I explained to the Establishment Officer that I had been working in an import house in London for three years doing business with Hong Kong and suggested that the DC&I might put my knowledge and skills to good use. The next day, they posted me to the civilian staff of the Hong Kong Police Force. After a year in PHQ and the pulling of appropriate strings, I was posted in November 1959 to the Commerce and Industry Department and stayed there for the next twenty-odd years.

The 1959 organisation chart of the department throws interesting light on how the government perceived Hong Kong's trade priorities, as well as on its management structure. The Director of Commerce and Industry, H. A. 'Ginger' Angus, who reported directly to the Financial Secretary, headed it. A Deputy Director, Dermont Barty, who had transferred from the Indian Civil Service after Independence, supported him. He dealt with 'general administration' and 'statistics'. Two Assistant Directors, George Hole and Pat Dodge, oversaw 'Controls' and 'Preventive Service' and 'Trade Promotion', 'Industry' and 'Certification of Origin' respectively. A young Administrative Officer, David Akers-Jones, handled 'Trade Licensing', 'Dutiable Commodities' and 'Supplies'. These gentlemen formed the 'Directorate', which included Akers-Jones, due to his status as an Administrative Officer although he did not hold a directorate position. The organisational hierarchy comprised Directorate, Branch and Section. The department consisted of eight branches. The first, the Preventive Service (PS), the uniformed precursor of the present Customs and Excise Department, was charged with anti-smuggling duties and protecting the public revenue arising from the five commodities that attracted excise taxes. It also undertook factory inspections and consignment checks. The second, the Supplies Branch, ensured that the colony maintained a three-month supply of rice, corned beef, coal and firewood. The third, the Dutiable Commodities Branch, headed by an Assistant Trade Officer (ATO), collected the revenue

¹ The Commerce and Industry Department was the official name of the department at this time. Customers in trade and industry always knew it as the Department of Commerce and Industry, or DC&I, for short. It could not use the abbreviation CID to avoid confusion with the Police. I use the form DC&I hereafter for convenience. Later, it became a 'federal' department comprising three separate but interrelated departments — Trade Department, Industry Department and the Customs and Excise Department, headed by the Director of Trade, Industry and Customs, known as D-TIC. Later still, after I had left Hong Kong, the name and structure changed again.

arising from excise duties on ethyl alcohol (wines, spirits and beer, among others, and some perfumes), the elegantly named table waters, hydrocarbon oils (i.e. petrol), tobacco and methyl alcohol. The fourth, the Statistics Branch, headed by Cyril Stratton, faced the unenviable task of trying to keep track of the arrival and departure of goods, into and from Hong Kong, their points of origin and their destinations. The fifth, the Trade Licensing Branch also headed by an ATO, handled import and export licensing. The sixth, the Industry and Certification Branch, contained sections dealing with 'Industry' (headed by Jimmy McGregor, Acting Trade Officer); 'Certification' (led by Alan Trickett, also Acting Trade Officer) along with sections that gathered industry statistics (Acting Trade Officer, Len Dunning) and issued various types of certification (Executive Officers, Class II) and 'Industry Inspections.' The seventh, the Export Promotion Branch, supervised by a Senior Trade Officer (STO), assisted by Bill Dorward, Acting Trade Officer, comprised two sections (headed by ATOs) — 'Trade Publications and Library (one bookcase!) Section' and 'Trade Enquiries, Trade Fairs, Business Visitors, etc. Section' [*sic*]. Listed among the staff in this section is one L. W. R. Mills, Executive Officer. Finally, the eighth, the Overseas Trade Relations Branch, comprised one STO. No one quite understood its function. The STO, beavered away in a small office on the fourth floor of the Fire Brigade Building, and communicated upwards with the Directorate from time to time but rarely with the hoi polloi below. Some ten years later, this one-man show had transmogrified into the Commercial Relations Divisions of DC&I and, subsequently, became the Trade Department.

The Administration and Finance Branch kept meticulous records of how late we were for the office, how much leave each of us was due or had taken, how much money we had spent, whether we had receipts (no receipt, no reimbursement), and made sure that we all travelled using the right class of transport and stayed at hotels with the correct number of stars when we were overseas. This nonsense came to an abrupt halt when I was appointed secretary to a Hong Kong Trade Mission to Australia in 1961. The mission was led by 'Duggie' Clague (later Sir Douglas Clague). Under the rules, Unofficials were entitled to first class travel and five-star hotels. Civil servants were accommodated and travelled at the level appropriate to their ranking in the hierarchy. Thus, when we travelled to Australia, the other five members of our group, including Dermont Barty, Deputy Director of Commerce and Industry, flew first class and stayed at top hotels throughout. I had to fly economy class, which required me to leave the plane first so that I could run around to the front of

the plane to join the other members and meet the welcoming party. The hotel situation was even more ridiculous. As I was only a junior, I had to stay in a different hotel altogether. And being too junior to qualify for taxi travel, I had to catch a bus to the hotel where the others were staying to rejoin the party. Duggie Clague declared 'enough', and insisted I travel and stay with the rest of them. The hapless Dermont Barty spent the rest of the trip worrying about how he would explain this to the Director when we returned to Hong Kong. The rules were eventually changed. The Export Promotion Branch kept me very busy. Trade was growing, and the significance of the first piece of paper to which this story relates rapidly became apparent as importing countries sought ways to limit the flow of goods from Hong Kong.

Epilogue

So, that is the story of my years in Hong Kong. It was a challenging time for the territory and an exciting period for me. I would not have wished to spend those years in any other place or in any other way. To my mind, I arrived at just the right time and I left at just the right time. The Hong Kong of 1958 was so different from that of 1989. Within those thirty-one years, Hong Kong was transformed from a dot on the map with its name underlined in red and the letters (Br.) after it, to a place of which everyone had heard, in which all had prospered, with an economic record that few, if any, have equalled. Yet, the reasons for its success contained no closely guarded secrets, the means were available to all; they were demonstrably successful; and almost universally ignored.

In struggling to describe adequately the basis for this transformation, I came across the last published article of the late Milton Friedman, the 1976 Nobel laureate in economics and senior research fellow at Stanford's Hoover Institution. In October 2006, he wrote:¹

'At the end of World War II, Hong Kong was a dirt-poor island with a per capita income about one quarter that of Britain's. By 1997, when sovereignty was transferred to China, its per capita income was roughly equal to that of the departing colonial power, even though Britain had experienced sizeable growth over the same period. That was a striking demonstration of the productivity of freedom, of what people can do when they are left free to pursue their own interests.

'The success of *laissez-faire* in Hong Kong was a major factor in encouraging China and other countries to move away from centralized control toward greater reliance on private enterprise and the free market. As a result, they too have benefited from rapid economic growth. The ultimate fate of China

¹ Milton Friedman, 'Hong Kong Wrong,' *Wall Street Journal*, 6 October 2006, A14.

depends, I believe, on whether it continues to move in Hong Kong's direction faster than Hong Kong moves in China's.'

There is not much that can be added to that because anybody with the slightest knowledge of, or interest in, Hong Kong can see for themselves the truth it encapsulates.

What makes the Hong Kong story intriguing, as I have tried to show, is that in protecting 'the productivity of freedom, of what people can do when they are left free to pursue their own interests ... and ... the success of laissez-faire ... and ... reliance on private enterprise and the free market', Hong Kong had to engage in practices totally at variance with its fundamental philosophy.

This philosophy, attributed by most to the tenure of Sir John Cowperthwaite as Financial Secretary and described on a number of occasions by one of his successors, Sir Philip Haddon-Cave, as 'positive non-interventionism', could only be defended by means of Hong Kong engaging with those with different philosophies and greater economic and political power, and then fettering its ability to pursue the philosophy at the heart of its success, thereby, creating the paradox, the subject of this book.

The paradox was then compounded by the irony that the way in which Hong Kong went about playing the game by the rules of the other side, enshrined in such instruments as the GATT, the MFA, certification of origin and Commonwealth Preference, furthered the interests of Hong Kong immeasurably and those of the rule-makers, hardly at all. In so doing, Hong Kong created yet another phenomenon, what might be called 'negative positive-non-interventionism', that is to say, if positive non-intervention means a conscious decision to do nothing, then, negative positive-non-intervention, is the conscious decision to do just enough to preserve the ability to do nothing.

Mr. Friedman might be spinning in his grave at such a proposition; yet, Hong Kong did precisely that and has derived much of its prosperity from it.

By agreeing to trade restrictions, by limiting the activities of its greatest export earner, its largest industry and its highest employer of labour, as well as by the effective (= doing the right things) and efficient (= doing things right) way it exploited the constraints, Hong Kong not only survived, but prospered.

Is there then a lesson here for others? Is negative positive-non-intervention the answer to the world's ills? I think not. Negative positive-non-intervention was a product of its time, a time that has passed. So, we need to add one more word to our definition: Hong Kong deployed, in effect, *timely* negative positive-non-interventionism.

As I said in the Prologue, Hong Kong has always had to accept and adapt to the circumstances in which it found itself at any particular time. By 1989, a change in the structure of Hong Kong's economy was already underway. It had moved from entrepôt immediately after the Second World War to manufacturing centre in the 1960s and 1970s. Then, with growing offshore investments engendered by textile restraints and the opening up of China, servicing those investments became increasingly important. Hong Kong was changing into the front office for China's massive expansion. The service industries saw the benefits of Hong Kong's open economy and business-friendly environment. Hong Kong no longer offered 'prices lower than in their country of origin' as one of the old slogans of the Hong Kong Tourist Association used to claim. According to a popular saw of the time, Chinese *amahs*, now replaced by Filipina maids, owned the properties they had once worked in. Hong Kong had become prosperous.

As this history makes clear, the MFA changed many things in Hong Kong. One can never say whether this was for the best since no one knows what might have been. It is a fact, however, that Hong Kong profited mightily from the restraints on its trade thanks to its ability to exploit them to the full. With advice directly from the TEXTAB, Hong Kong's negotiators were able to find solutions to, and squeeze the last drop from, seemingly unredeemable situations. Hong Kong's huge quota base created a massive sellers' market. When a Hong Kong manufacturer could not fill an order, he was off to the Philippines or Sri Lanka where he would open a factory and deliver the goods from there. He was able to charge buyers the highest price the market would stand, inflated by the premium that the quota transfer system provided. The wealth thus created was ploughed back into Hong Kong or invested in other countries in the region. Huge investments were made in China, thus recementing original ties and building understanding in China as to how valuable Hong Kong really was.

This prosperity flowed downwards to the whole population. Other parts of the government came into their own as high revenues from low taxes and income from land sales financed more social and public works projects.

Hong Kong achieved all of this alone, while it relied on market forces (even those involving restraints on trade) to lead it where best it should go.

So, when, within a few years more, Hong Kong no longer stood as the industrial heart of South East Asia and had transmogrified, yet again, into something different, this time, to take its place among the world's leading service

and financial centres, one could be forgiven for thinking that all the effort that went into preserving Hong Kong industry, all the crises that it had faced and dealt with, all the indignities forced upon Hong Kong by those with greater political and economic power and all the grandstanding, as erstwhile Financial Secretary Bembridge called it, went for naught.

Nonetheless, the older hands might justly claim that it all started with just five pieces of paper and TEXTAB meetings on a Thursday afternoon in Fire Brigade Building.

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For convenience, the principal provisions of instruments such as the GATT and MFA are indexed under the headings GATT principal provisions, MFA principal provisions, and so on followed by page references. Other references to the GATT, etc, are listed in the usual way.

Individual persons are grouped under the generic heading Personalities.

Given the various name changes undergone by the (original) European Economic Community, all references to the group are placed under the heading EEC.

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