
Freedom Works: The Case of Hong Kong

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Hong Kong has an impressive reputation for economic freedom and classical-liberal virtues. In a series of articles, Milton Friedman used Hong Kong to show how the power of free markets combined with little else can create wealth, pointing out that its per-capita income rose from 28 percent of Britain's in 1960 to 137 percent of Britain's in 1996. As Friedman wrote in 1998, "Compare Britain—the birthplace of the Industrial Revolution, the nineteenth-century economic superpower on whose empire the sun never set—with Hong Kong, a spit of land, overcrowded, with no resources except for a great harbor. Yet within four decades the residents of this spit of overcrowded land had achieved a level of income one-third higher than the residents of its former mother country" (<http://tinyurl.com/5s3cmw>).

Friedman's evaluation corresponds to Hong Kong's consistent ranking at the top of both the Heritage Foundation's *Index of Economic Freedom* and the Fraser Institute's *Economic Freedom of the World* reports. In the 2008 Index, for example, Hong Kong scored 90 percent or better on seven of the ten measures of economic freedom. Impressively, Hong Kong's weakest score (freedom from corruption, where it ranks 13th of the 180 countries rated in 2006 by Transparency International) put it well ahead of the United States (fifth most free overall, 20th on freedom from corruption).

Why has Hong Kong been so free?

Hong Kong never would have become the economic powerhouse it is today if either British or Chinese senior politicians had had any say in the matter. Britain acquired Hong Kong island in 1842 (additional territory came later) through a deal between the British representative, Captain Charles Elliot, and the Chinese negotiator, the Marquis Ch'i-ying, to settle a small war that had broken out over trade issues. (Compensation for a Chinese seizure of British opium was one issue,

but the dispute was broader than the issue of opium, and recent scholarship tends to cast doubt on the conventional labeling of the dispute an "opium war.")

The resulting deal was unpopular both with the Chinese Imperial Court and the British government. The Chinese authorities disliked any cession of territory to the British and worried about the impact on tariff revenues of creating a British-

controlled port. Moreover, the Chinese disdained the British obsession with trade. The British government thought Hong Kong a poor location compared to the possible alternatives, such as Formosa. Nonetheless, the limits to communication in the nineteenth century had forced the two governments to delegate the authority to resolve the dispute to their representatives on the



View of Hong Kong from Victoria Peak

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scene, so they were left with what Frank Welsh's excellent one-volume history, *A History of Hong Kong*, terms "a source of embarrassment and annoyance to its progenitors since it first appeared on the international scene." (Unless otherwise indicated, quotations are from Welsh's book.)

Early History

Early assessments of Hong Kong's potential were pessimistic. Lord Palmerston, in possibly the worst prediction ever made by a British diplomat, concluded that it was "a barren island, which will never be a mart of trade." The colonial treasurer, Robert Montgomery Martin, a prolific writer on Britain's overseas possessions (including a five-volume *History of the British Colonies* published in 1840), echoed Lord Palmerston's assessment in 1844, finding that "there is no trade of any noticeable extent in Hong Kong. . . . There is scarcely a firm in the island but would . . . be glad to get back half the money they have expended in the colony and retire from the place. . . . There does not appear the slightest probability that, under any circumstances, Hong Kong will ever become a place of trade."

Some trade did begin, however, as a result of the establishment of British merchants' warehouses. But early British policies concerning their new territory did little to promote economic growth. An 1847 Parliamentary investigation of the economic situation in Hong Kong found that British rule had initially brought with it a government bent on raising "as large a revenue as possible" and that this had damaged trade, concluding that the restrictions on trade instituted by the early British administration to raise revenue meant that "[f]rom this time may be dated the reverses of Hong Kong."

Hong Kong physically expanded twice during the nineteenth century. Territory on the mainland opposite Hong Kong island, Kowloon, was acquired in a "casual way" for 500 taels during a Sino-British conflict in 1859 in a deal between a British Consul and a Ch'ing official. And in 1898 Britain leased for 99 years the

New Territories, additional mainland territory plus some islands. In both cases, the rationale for expansion was to protect the harbor from the range of guns located on the mainland. Although the British hoped to eventually make the New Territories lease a more permanent arrangement, their agreement to the lease rather than a permanent cession of control played an important role in the eventual return of the entire territory to the People's Republic of China in 1997.

Britain did relatively little with its new colony, beyond establishing public order and extending the rule of law. The result was essentially a treaty port, much like those that European powers established on the mainland under the Treaty of Nanking in 1842-43. One reason for Britain's relatively hands-off policy was the persistence of the view formed by early colonial officials

that the Chinese residents did not want or appreciate British lawmaking. This attitude is clear in the testimony to a mid-nineteenth-century Parliamentary committee looking into administration of the colony by Col. John Malcolm, an aide to the governor, who told the British M.P.s that "the Chinese are a peculiar people, and they do not like being interfered with. They do not

understand us; they cannot understand our ways; and when they are told that they are to do first one thing and then another, they get frightened and will not come to us." Whether it was a characteristic "peculiar" to the Chinese to dislike arbitrary government or not, the avoidance of conflicting mandates and general tendency to leave people alone—policies adopted in pursuit of trade—gave the colony the benefit of the rule of law from the start.

A Natural Trading Center

What did Britain create in Hong Kong? The combination of the excellent harbor and the rule of law meant Hong Kong was a natural trading center. But it was not the best place to trade in China, and by the early twentieth century Shanghai was successfully winning trade away from Hong Kong. Shanghai offered



Hong Kong Harbor, January 1, 1910
Library of Congress

a more educated population, a more convenient location, access to European protection under treaty concessions by the Chinese government, and relatively little Chinese-government interference due to the decline of imperial power. By the 1910s Shanghai had become a significantly more important center of trade than Hong Kong. With the British choosing the more defensible Singapore as the center of British naval power in the region, Hong Kong also lost importance for the British government. As a result, the colony languished as a backwater, becoming known as a center for prostitution and gambling rather than the economic powerhouse it is today.

One thing Britain did not create in Hong Kong was a democratic government. No local democratic institutions were permitted to develop, as were allowed in most other British colonies, because the British were unwilling to give the Chinese majority a real voice in administration. As a result, as Welsh concludes, “Hong Kong was to continue as authoritarian an administration as any Chinese government, but the final authority was to be the law, rather than individual whim.”

China’s imperial central government rarely favored economic freedom, and the late nineteenth and early twentieth centuries were no exceptions. As the central government’s power ebbed away, regional warlords began to establish rival, but equally predatory centers of power. European, American, and Japanese power in China also expanded, focusing on access to the Chinese market for their nationals, but not creating economic freedom for the Chinese within their spheres of influence. Hong Kong’s stability increasingly drew migrants from elsewhere in China. Population grew from 600,000 in 1920 to over a million in 1938. As conditions worsened in China with the Japanese invasion and fighting between regional warlords, the Kuomintang (Nationalists), and communists, 5,000 migrants a day began to pour into Hong Kong. By March 1950 the city had 2.3 million people, which brought Hong Kong both a significantly increased

workforce and the human capital of Chinese entrepreneurs who escaped ahead of Mao’s armies. Moreover, the communist victory on the mainland meant that Shanghai ceased to be a serious competitor.

Finding Freedom in Hong Kong

Life on the edge of communist China was not easy. During the Korean War, embargoes on trade hurt the city’s entrepot business, forcing many Hong Kong traders to reinvent themselves as manufacturers. The continuing influx of refugees from the mainland strained the colony’s infrastructure. But the flood brought refugees like Jimmy Lai, one of the millions of penniless individuals who sought freedom in Hong Kong.



Jimmy Lai, Chairman/CEO of Next Media, Hong Kong
Acton Institute, *The Call of the Entrepreneur*

While working in the Shanghai railway station as a porter, Lai was given his first chocolate bar by a traveler. Hungry, Lai immediately ate it. Running after the man, he asked where this wonderful food came from and the answer was “Hong Kong.” Determined to get to the place where such wonders were available, Lai eventually persuaded his mother to allow him to escape and was smuggled out of China in the

bottom of a fishing boat. On his arrival in Hong Kong, he went to work the same night in a garment factory. Today, Lai is a billionaire, owner of one of the most successful media companies in Asia. His drive and entrepreneurial skills played a major role in his success, of course. (Lai movingly tells his story in the Acton Institute’s documentary *The Call of the Entrepreneur*.) But it was the freedom available in Hong Kong that allowed him to put his talents to work. That freedom took many forms, including an absence of the currency restrictions in force at the time in the United Kingdom and much of Europe, and few laws regulating businesses. As a result, Hong Kong began to flourish.

Why? As Hong Kong’s last British governor, Christopher Patten, wrote in his memoir, *East and West*, the refugees from communism who flooded into Hong Kong

arrived in China's only free city; it was indeed (in the words of Chinese journalist Tsang Ki-fan) "the only Chinese society that, for a brief span of 100 years, lived through an ideal never realized at any time in the history of Chinese society—a time when no man had to live in fear of the midnight knock on the door." Hong Kong had a competent government, pursuing market economics under the rule of law. It was a government that fully met the Confucian goal—"Make the local people happy and attract migrants from afar."

The *laissez-faire* attitude of the Hong Kong government on economic matters was cemented by Sir John Cowperthwaite, the colony's financial secretary from 1961 to 1971, whom Welsh called a "political economist in the tradition of Gladstone or John Stuart Mill" and the personification of "unreconstructed Manchester-school free traders." Cowperthwaite had almost complete control of Hong Kong government finances and used it to implement his policy of "positive non-intervention." Friedman gave Cowperthwaite a great deal of the credit for Hong Kong's success, citing approvingly Cowperthwaite's refusal to collect most economic statistics on the grounds that "[i]f I let them compute those statistics, they'll want to use them for planning." Jimmy Lai has a bronze bust of Cowperthwaite at his company's entrance (as well as ones of Friedman and F. A. Hayek).

Cowperthwaite deserves the accolades he has received. During his decade as financial secretary, real wages rose by 50 percent and the portion of the population in acute poverty fell from 50 to 15 percent. What is remarkable is that Hong Kong accomplished this with no resource other than its people. The colony had no real agricultural land, no natural resources, and even the one resource it did have—people—lacked much education. Indeed, few at the time thought that the masses of refugees who reached Hong Kong during the 1950s would amount to anything other than a burden for the state.



Christopher Patten, last governor of British Hong Kong
European Commission—Audiovisual Service

Most remarkably, Hong Kong's transformation occurred when social democrats ruled Europe and Lyndon Johnson's Great Society dominated American politics, both reflecting the consensus among the political elites in Europe and North America that the welfare state and interventionist economic policies were the only sensible direction for advanced societies. Even in the developing world, interventionist economic policies like industrialization through import substitution, which relied on high tariff walls to protect domestic industries, were widely accepted. Tiny Hong Kong thus managed to adopt and hold to free-market and free-trade policies that ran counter to the policies of the British government and the consensus of policy analysts

and development economists everywhere, and did it while perched precariously on the edge of a massive communist dictatorship in the midst of self-destructive policies like the Great Leap Forward and the Cultural Revolution.

No Libertarian Paradise

While consistently freer than most places, Hong Kong has never been a libertarian paradise. Government-subsidized housing has long dominated Hong Kong's residential market, with 60 percent of residents living in it at one time. And the government manipulated (and continues to do so) the land market

to maximize sales revenues for public coffers, which plays an important role in causing the housing shortages that required the public housing "solution." Medical care has also long been socialized. Moreover, Hong Kong had serious corruption problems even during the height of the Cowperthwaite era, with the police in the 1960s and early 1970s "riddled with corruption," according to former Governor Patten.

Then there is Hong Kong's persistent "democratic deficit." Hong Kong managed to escape the post-World War II wave of democratization in the rapidly dwindling British Empire because, as one British official put it in a radio interview in 1968, "the electorate of Britain didn't care a brass farthing about Hong Kong." Indeed, Britain showed almost no interest in expanding

representative government in the colony until it became clear that Hong Kong would “return” to China in 1997 when the lease on the New Territories expired.

In some sense this democratic deficit served Hong Kong well, for men like Cowperthwaite and Patten held classical-liberal ideas on economic freedom and so largely refrained from actions that might have won popular approval (and certainly would have in Britain). But the lack of representative government also allowed Britain to treat Hong Kong’s residents shamefully when Britain rejected allowing Hong Kong passport holders the right of residence in Britain, fearing a flood of refugees in advance of the return to China. (The rest of Europe behaved no better.)

“One Country, Two Systems”

Hong Kong returned to China in 1997 under an Agreement negotiated between Britain and the People’s Republic which provided a guarantee that for at least 50 years Hong Kong and China would be “one country, two systems.” (Formally, Hong Kong and the former Portuguese colony of Macau are both “Special Administrative Regions” of China.) The return itself was inevitable, as was China’s willingness to preserve capitalism in its midst. Not only were Hong Kong island and Kowloon unsustainable without the leased New Territories, where much of the water supply was located, but British voters still didn’t care a farthing for Hong Kong in the 1990s. China’s interest in the preservation of the goose that laid the golden eggs was also clear. The People’s Republic had long made use of Hong Kong—which it could have seized by force at any time—as a means of accessing foreign markets and sources of capital. At times 80 percent of China’s foreign income came through Hong Kong. China also wanted to demonstrate to Taiwan that peaceful reunification was possible.

The danger was that China’s leadership would not understand what Patten, in his book, termed “the relationship between Hong Kong’s hardware—a capitalist economy—and its software—a pluralist society—and

yet it was the latter that enabled the former to function so well.” Thus far Hong Kong’s new rulers have shown themselves remarkably adept at continuing the smooth functioning of both the hardware and the software. Whether that will remain true in the long run is still an open question, of course.

Chinese Emperor Tao-kuang’s initial reaction to the British had been that “these barbarians are wanting in any high purposes of striving for territorial acquisition; they always look on trade as their first occupation.” Frank Welsh concluded his history by noting that Hong Kong “proved the Emperor’s point.” It is not just the British who made Hong Kong a success. It is the people of Hong Kong, from factory workers to entrepreneurs, who turned Hong Kong from a barren island to an economic powerhouse. They were able to do so because the Hong Kong government generally left them sufficiently alone. Hong Kong is far from perfect, and far from a libertarian dream world. But it remains a dramatic example of how far human ingenuity and entrepreneurial talent can take a society.

Why has Hong Kong been so free? Partly, Hong Kong has been fortunate to be ruled by men who understood their role as quite limited. Not quite the classical-liberal ideal, even under Cowperthwaite, but nonetheless significantly closer than any other twentieth-century society. And the combination of Britain’s failure to provide any real democratic institutions and its lack of interest in Hong Kong allowed those men to hold to those policies, even as Britain herself experienced economic disaster under the socialism of the 1950s–70s. Hong Kong also benefited from the example of China’s disastrous 1960s economic policies. With so many residents having come as refugees from communism, demand for freedom in Hong Kong was high. Freedom made possible the success of Jimmy Lai, and that of the millions who did not become billionaires but who had a higher standard of living than most of the world through their own efforts.

Hong Kong was lucky that freedom was tried. But Hong Kong’s people proved that freedom worked. **FEE**