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SQUARING THE WELFARE CIRCLE IN HONG KONG

Lessons for Governance in Social Policy

Chack Kie Wong

Abstract
This article examines how the Hong Kong Special Administrative Region government squares the welfare circle. Because of the constrained institutional pathway of the established welfare system, the government is not successful in either reducing public expenditures or raising taxes. The article argues that it is important to look into the role of institutional design in the management of public expectations.

Keywords: squaring the welfare circle, governance, welfare state, managing public expectations, welfare institutions

Introduction
This article looks at governance in social policy in the post-1997 era in the Hong Kong Special Administrative Region of China (hereafter Hong Kong SAR; before 1997, Hong Kong). It assesses the abilities of the SAR government in striking a proper balance between rising demand for social services and benefits on the one hand, and the simultaneous need to limit public expenditures on the other, all the while maintaining popular legitimacy. A number of authors use the term “squaring the welfare circle” to describe the challenges that governments in the West’s
affluent societies are now facing.¹ In George and Miller’s view, the term signifies the continual and intensifying struggle of governments in all advanced industrial societies to harmonize the need for meeting the constantly rising demand for social service provisions and benefits while also accommodating simultaneous insistence on limiting public expenditure.²

The background to the dilemma of squaring the welfare circle is the drastic social and economic changes welfare states are facing: aging populations, shifting labor markets, economic globalization, and weakened families. All these social and economic changes have pressured the welfare states into a state of “permanent austerity”³ because of falling growth rates, reduced scope for raising taxes, and the belief that tax increases undermine work, savings, and investment incentives.⁴ The ability to square the welfare circle is not only about resources but also about managing the public expectations of those who have already become vested interests in the current system. This suggests that there is likely an institutional pathway or path dependency once a welfare system or welfare state is established,⁵ albeit in our case a non-Western, neo-liberal welfare state with comparatively small public social expenditures. In other words, it is important to pay attention to the squaring of the welfare circle challenge because public demands for social services and benefits are unlimited, and people who enjoy public welfare are likely to resist any attempt to cut back their entitlements. Hence, governance plays an important role in terms of managing public expectation and designing welfare institutions in ways that can harmonize right with responsibility.


². See George and Miller, Social Policy Toward 2000, p. 1.


Social policy refers to the social actions taken by the state’s policy makers to improve human well-being or welfare. The major program tools of social policy are the “big five” of social services—education, health care, housing, personal social services, and social security. In the Hong Kong SAR, personal social services and social security are classified under the category of social welfare. Social actions require financial support. To do this, governments must extract resources from society, particularly from the economy. Here lies the issue of squaring the welfare circle.

According to George and Taylor-Gooby, there are two major perspectives on how governments in affluent Western societies respond to this challenge. The first perspective suggests that the welfare circle challenge is a zero-sum game; therefore, governments can either increase taxation or cut provisions or carry out a combination of both. The authors find that governments in the U.K. and U.S. follow this perspective in responding to the welfare circle challenge. The second perspective has a positive assumption about the relationship between social policy and the economy: some forms of welfare expenditure are conducive to stronger economic growth, have an investment function, and can increase the resources available for redistribution. According to this complementary view, education and labor market policy, and even family policy, can be designed to enhance economic competitiveness. George and Taylor-Gooby find governments in Europe, the Nordic countries in particular, with this optimistic view about the welfare circle challenge.

These two perspectives toward the welfare circle reflect divergence, not convergence, although social structural and economic forces are similar and constant. In this light, it is worthwhile to examine how non-Western welfare states square the welfare circle. In this study, we look into the case of the Hong Kong SAR, an affluent Chinese society on the Asian Pacific rim, to see which response pattern it adopts in squaring the welfare circle—despite the fact that the SAR lacks a mature welfare state. Its experience is valuable, not only for the reasons mentioned above but also because culturally, Hong Kong is part of a larger Confucian tradition. Accordingly, the Chinese people of Hong Kong are assumed to possess a self-reliance ethos that is supposed to constrain demands for social services and benefits. In other words, it is easier for the SAR government to square the welfare circle than it is for advanced countries in the West. How far is this true?

This paper is organized as follows. First, it looks at the main features of Hong Kong’s welfare system. This will provide an understanding of the

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heritage of the present system and how its institutional features affect later development. Second, the paper examines the efforts of the SAR government to square the welfare circle in the post-1997 era. Last, it discusses the dilemmas and difficulties of the government in doing so.

Main Features of the Hong Kong Neo-Liberal Welfare State

Walker and Wong\(^8\) conceptualized Hong Kong as a neo-liberal welfare state on the basis of their analysis of social policy before the 1997 sovereignty handover. Here, this paper refers to Hong Kong’s welfare system as a welfare state. A state is a political entity; a welfare state is that political entity with welfare features. We refer to Briggs’s classic definition of welfare state here:

[A] welfare state is a state in which organized power is deliberately used in an effort to modify the play of the market forces in at least three directions—first, by guaranteeing individuals and families a minimum income irrespective of market value of their work or their property; second, by narrowing the extent of insecurity by enabling individuals and families to meet certain “social contingencies” . . . which lead otherwise to individual and family crises; and third, by ensuring that all citizens without distinction of status or class are offered the best standards available in relation to a certain agreed range of social services.\(^9\)

What we unveil below about Hong Kong’s welfare system shows these characteristic features of a welfare state. A neo-liberal welfare state is one that typically provides minimal state welfare. When public services and benefits are provided, they tend to be strictly means-tested and confined to the less fortunate. In other words, average persons living in a neo-liberal welfare state have to rely upon their own arrangements, for example, through consumption in the private sector or mutual support of family members, for meeting their welfare needs.

However, a neo-liberal welfare state can provide state welfare beyond the minimum, if a given social policy enhances economic growth. In the case of Hong Kong, such policies are more likely to be implemented. For example, Hong Kong’s pre-1997 welfare system had free and universal basic education. This was primarily because education was regarded as essential for economic growth; it had an investment function. Even in post-compulsory education levels, i.e., upper secondary education and above, the

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government also provided substantial subsidies to students. For example, university tuition fees were set at 18% of the full cost of a college education; students from low-income households could also apply for loans and grants. This provided an institutional environment where no one in Hong Kong was denied educational opportunities simply because of a lack of means. The Hong Kong SAR has inherited this social policy legacy.

Pre-1997 Hong Kong also had in place a health system resembling Britain’s National Health Service that provided basic health care to its people at low cost. The basic structure of universal health care was set in the mid-1960s, when the colonial government learned from a survey report that half of the respondents could not manage the fees at public clinics and 60% could not afford a public hospital. The policy was then established of providing public health care at low cost; such a policy was considered essential for enhancing labor productivity and promoting economic growth. The implication is clear: fees for public health care were extremely low and could be regarded more or less as a free provision, especially in the case of hospitalization. A government report in 1993 found that patients at an in-patient general ward received 90%–98% of the average operating cost in subsidies. Apparently today, this health care institutional legacy, inherited from the colonial era, has become the source of a dilemma for the SAR government: rising expectations fuel the rise in health care costs, but as yet there is only an inadequate built-in financing mechanism, which, except for long waiting times, prevents misuses and abuses.

Public housing was another social policy that had a strong economic flavor in colonial Hong Kong. The Housing Authority, a statutory body established in 1973, is responsible for planning, building, and managing all public housing programs for the government. One important structural impetus for building massive public housing, especially rental flats in the colonial age, was to provide a supply of stable and cheap labor for industrial production. In this regard, rent could be regarded as an indirect production cost, and its low level helped provide a favorable economic environment where labor did not need to ask for higher wages, if other factors were constant. The substantial differences in rent-to-income ratios between private and public housing were illustrative: in 1997, rent for private

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housing was around 26% of income but in the case of public housing totaled only about 9%. The difference represents a social wage for public housing tenants and a social cost that society must pay. In other words, public rental housing is income-redistributive, but this social equality function is latent. It does not work through the tax system (thereby traceable in public finance), but is disguised as a means-tested state provision. Hence, the progressive, egalitarian nature of public housing, rentals in particular, did not attract opposition from neo-liberal economists and property developers. It was only in the Hong Kong SAR era, when then-SAR Government Chief Executive Tung Chee-Hwa initiated the policy of building 85,000 apartments annually, that strong criticism erupted from property developers. Public housing and home ownership schemes, in particular, were so successful that the public sector always intruded on the interests of the market. This led to the eventual withdrawal of the policy and the end of home ownership schemes in 2002.

Apart from social policy as a function of economic growth, the other defining feature of a neo-liberal welfare state is its anti-redistribution stance. Social security captures this important feature of Hong Kong in its pre-1997 era. The main program in social security is Comprehensive Social Security Assistance (CSSA), a means-tested income maintenance program that provides a safety net for those who cannot support themselves financially. The scheme is designed to bring the income of such individuals and families up to a prescribed level to meet their basic needs. CSSA is basically a social assistance or poverty relief program. However, in mature welfare systems like those of the West, the defining social security program is usually its retirement benefits scheme, which is basically a pay-as-you-go system, meaning that there is an intergenerational redistributive element in retirement protection.

The colonial government’s choice in 1995 of retirement protection for Hong Kong reflects the neo-liberal values underlying Hong Kong’s welfare system. The Mandatory Provident Fund (MPF) is an employment-based forced savings scheme; it helps employees save money, with matching contributions from employers for retirement protection. The alternative option is a state pension that is supposed to benefit all people, not only employees. In principle a state pension, primarily a pay-as-you-go system, has the following redistributive functions: intergenerational, between retirees and the working population; inter-class, between high income and low income groups; and across employment status, between employees and non-working persons. Apparently these redistributive functions were not

13. Hong Kong Housing Authority, *Housing in Figures* (Hong Kong: Information and Community Relations Section, Hong Kong Housing Authority, 2000).
in line with the orthodoxy underlying the neo-liberal welfare state of colonial Hong Kong. The rejection of state pension should not be surprising simply for this reason. But MPF also has an important economic objective: it is a means to develop Hong Kong’s financial market and to socialize the whole working population to investment activities. Therefore, MPF meshed perfectly well with Hong Kong’s neo-liberal welfare state approach in the pre-1997 era.

The social policy programs briefly outlined above sound substantial and comprehensive. Social services and benefits ranging from health care to housing, education to income maintenance, should in principle be able to meet people’s basic needs for daily living. Moreover, because of rising economic standards, people both East and West have come to expect more from the welfare state. It is particularly obvious in the cases of two major universal social services—health care and education—that people in the Hong Kong SAR expect the best possible standards to be offered to all. But a comparative perspective highlights the inadequacy of the Hong Kong SAR’s neo-liberal welfare state because of its comparatively limited budget.

Take, for example, social expenditure of the Hong Kong SAR as a percentage of gross domestic product (GDP) in the second year of the new millennium. This ratio was 11.7% in 2001, a little lower than the 1960 average of 13.1% for what would become Organization for Economic Co-operation and Development (OECD) countries but comparable to the percentages for Norway and Ireland (both 11.7%) and the U.S. and Australia (10.9% and 10.2%, respectively) that year (see Table 1). In other words, the Hong Kong SAR welfare state is not mature, compared with those of the Western advanced economies, at least in public social expenditure terms. It is 40 years behind in this respect.

Even at this level of provisions and benefits, the neo-liberal welfare state does not have a reliable and sustainable fiscal base for supporting itself. It has relied heavily upon growth dividends for its funding, especially from the huge revenue of land sales and property taxes. For example, land sales were 13% (HK$ 27.1 billion) (US$3.5 billion) of government revenue in 1996–97. But they shrank to 2.6% (HK$ 2.5 billion) (US$320.5 million) of the SAR government’s operating revenue in 2003–04, the year that saw the outbreak of Severe Acute Respiratory Syndrome (SARS) and a substantial dip in the economy. As such, revenue from land sales is unstable and subject to economic fluctuations; the worst is that it is needed when it is in least


supply. Clearly, land sales are also a good proxy for economic growth. Moreover, the Hong Kong SAR has relied upon property taxes for revenue more than many other countries.\textsuperscript{16} For instance, a government-commissioned tax-base study found that in 1997–98, property tax constituted 5% of tax revenue in OECD countries and 10% in Asia Pacific countries, respectively, while the corresponding figure for the SAR was 24%.\textsuperscript{17}

Now we turn to the supply side of the welfare circle. Does the Hong Kong SAR have a sound fiscal base for supporting its welfare state? The neo-liberal welfare state sketched earlier shows the state funds nearly all non-contributory social services (e.g., health care and education) and benefits (e.g., social assistance), with the exception of the recently introduced MPF and public housing (still subsidized). From a financial sustainability perspective, this is definitely unhealthy. The Hong Kong SAR’s welfare state does not have a secure and sustainable fiscal base. Apparently, the

\begin{table}
\centering
\caption{Social Expenditure as Percentage of GDP in Selected OECD Countries and Hong Kong (selected years)}
\begin{tabular}{lcccccccc}
\hline
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Australia & 10.2 & 17.8 & 18.0 & 17.7 & 17.8 & 17.5 & 18.6 & 18.0 \\
Ireland & 11.7 & 19.4 & 18.2 & 16.8 & 15.6 & 14.2 & 13.6 & 13.8 \\
Japan & - & 13.5 & 13.7 & 13.8 & 14.5 & 15.1 & 16.1 & 16.9 \\
Norway & 11.7 & 26.0 & 24.9 & 24.1 & 25.7 & 25.8 & 23.0 & 23.9 \\
United States & 10.9 & 15.5 & 15.3 & 14.9 & 14.5 & 14.2 & 14.2 & 14.8 \\
OECD* & 13.1 & 22.5 & 22.7 & 22.3 & 21.9 & 21.9 & 21.6 & 21.9 \\
Hong Kong* & 8.3 & 8.7 & 9.0 & 11.3 & 12.5 & 12.0 & 11.7 & 11.7 \\
\hline
\end{tabular}
\begin{flushleft}
\textbf{NOTE:} Figures exclude transfers between the General Revenue Account and funds. *OECD includes countries of Australia, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. *Calculated per given financial year, e.g., 1995 = April 1995-March 1996.
\end{flushleft}
\end{table}

\textsuperscript{16} KPMG, Tax Base Study for the Hong Kong Government Advisory Committee on New Broad-based Taxes, Hong Kong (Hong Kong: Finance Bureau, Government of the Hong Kong SAR, 2001), p. 38.

\textsuperscript{17} Task Force on Review of Public Finance, Final Report to the Financial Secretary, Hong Kong (Finance Bureau, Government of the Hong Kong SAR, 2002).
following features attribute to this phenomenon. First, the Hong Kong SAR has a low-tax regime: 17.5% for a corporate tax rate and 16% for income tax. A 2006 government consultation document on tax reform reveals how narrow this tax base is: only 1.2 million out of 3.4 million employees pay salary taxes; the top hundred thousand taxpayers contribute 60% of the salary taxes. In other words, the majority of the population does not pay salary taxes; they do not see a personal financial responsibility but do feel they have a right to the expansion of the welfare state. Second, fees and charges for social services, health care in particular, are set at low levels that do not allow for substantial cost-recovery. This financial structure fuels abuses and poses an inherent obstacle for quality service. It will attract more demand to a level beyond the system’s coping capacity.

Third, the way the social security system is financed in the Hong Kong SAR has added pressure on government revenue. The retirement plan, the MPF, is basically a personal savings scheme that does not have any inter-class or intergenerational redistribution functions. In other words, the poor and the low-wage will have to rely upon social assistance for old age income protection. The high percentage of CSSA beneficiaries being elderly is a cause for concern. Here we see a dilemma in terms of the institutional design for old age protection. The choice of personal savings by MPF, instead of a pension scheme, seems to be the right thing to do from the neo-liberal perspective. However, it takes a long time to bring the neo-liberal system out of this dilemma—as now large number of citizens are entering old age without private means and have to rely upon social assistance. Further, the lack of unemployment insurance has forced unemployed people to rely upon CSSA for income support. This adds further pressure on the means-tested non-contributory social assistance scheme.

All of these features underscore important beliefs about the Hong Kong SAR’s neo-liberal welfare state. First, means-tested social services and benefits such as CSSA and public housing are for the poor, while universal services such as education and health care are perceived as being social services


for all. The former attracts less public support than the latter. Second, universal social services have stronger public support not only because of their wider coverage scope but also because they are associated with economic development. This is a primary feature of a neo-liberal welfare state. In other words, the structure of public support for social policy in the Hong Kong SAR is partly explained by the social policy’s function for economic development. Third, most of the population are not taxpayers or insurance subscribers for the services and benefits they enjoy; if they do pay, the fees and charges are low. Hence, the fiscal side of the welfare circle is seldom a concern to the users and the general public—they delegate the responsibility to the government. Finally, the provision of social services and benefits is regarded as a task for the government, not the public. These popular beliefs are divisive and instrumental; they do not foster a society where social obligations and empathy for the poor and the vulnerable are part of the culture.

Apparently, these popular beliefs also engender a classical moral hazard mentality—strong in rights but weak in responsibility—on the part of the users and the general public. Nevertheless, a local empirical study of social citizenship found that Hong Kong Chinese are generally “rights-deficit” in practice because they are reported to have similar or more responsibilities regarding rights to a job, a basic living, a basic education, and child care. However, the subjective indicators depicted in that study may reflect the inadequate social rights people enjoy in a neo-liberal welfare state; the study does not specifically address the issue of Hong Kong’s narrow and weak fiscal base.

The Efforts of the SAR Government to Square the Welfare Circle

In terms of squaring the welfare circle, the SAR government has performed in a mixed manner. It increased social expenditure in the post-1997 era, both in absolute amounts and as a percentage of total public expenditure. The exception was housing, if we use 1997–98 and 2004–05 as the comparators (see Table 2). Social welfare received the largest percentage gain in the same period, from HK$ 21.71 billion (US$2.783 billion) in 1997–98 to HK$ 34.119 billion (US$4.374 billion) in 2004–05. This was followed


<table>
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<tr>
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<th>97/98</th>
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<th>01/02</th>
<th>02/03</th>
<th>03/04</th>
<th>04/05</th>
<th>05/06*</th>
<th>06/07*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public expenditure</td>
<td>234,780</td>
<td>266,448</td>
<td>269,484</td>
<td>267,507</td>
<td>269,359</td>
<td>263,520</td>
<td>271,098</td>
<td>265,259</td>
<td>250,255</td>
<td>264,889</td>
</tr>
<tr>
<td>Social expenditure</td>
<td>121,370</td>
<td>145,106</td>
<td>155,689</td>
<td>154,932</td>
<td>148,559</td>
<td>144,297</td>
<td>149,790</td>
<td>141,729</td>
<td>136,915</td>
<td>140,824</td>
</tr>
<tr>
<td>Education</td>
<td>47,027</td>
<td>48,479</td>
<td>50,307</td>
<td>51,408</td>
<td>52,232</td>
<td>54,785</td>
<td>56,496</td>
<td>55,732</td>
<td>55,576</td>
<td>56,450</td>
</tr>
<tr>
<td>Health</td>
<td>27,982</td>
<td>31,400</td>
<td>31,894</td>
<td>32,753</td>
<td>34,213</td>
<td>33,199</td>
<td>34,231</td>
<td>32,355</td>
<td>31,639</td>
<td>32,340</td>
</tr>
<tr>
<td>Housing</td>
<td>24,651</td>
<td>38,850</td>
<td>45,872</td>
<td>42,606</td>
<td>32,055</td>
<td>24,031</td>
<td>24,031</td>
<td>19,523</td>
<td>15,874</td>
<td>15,821</td>
</tr>
<tr>
<td>Social welfare (Social Security)</td>
<td>(14,015)</td>
<td>(17,949)</td>
<td>(18,653)</td>
<td>(18,830)</td>
<td>(19,798)</td>
<td>(21,574)</td>
<td>(22,680)</td>
<td>(23,043)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Social expenditure as % of public expenditure</td>
<td>51.7</td>
<td>54.5</td>
<td>57.8</td>
<td>57.9</td>
<td>55.2</td>
<td>54.8</td>
<td>55.3</td>
<td>53.4</td>
<td>54.7</td>
<td>53.2</td>
</tr>
</tbody>
</table>


NOTE: Public expenditure, also known as Consolidated Public Sector expenditure, includes government expenditure, total expenditure of the trading funds, the Housing Authority and the previous Provisional Urban and Regional Councils (up to December 31, 1999), and payments from the Lotteries Fund. Where appropriate, historical figures have been adjusted to comply with the current classification expenditure.

*Revised estimates/estimates.
by education, from HK$ 47.027 billion (US$6.029 billion) in 1997–98 to HK$ 55.732 billion (US$7.145 billion) in 2004–05. These figures, respectively, represent rises of 57.2% and 18.5% over a period of seven fiscal years. The large rise in social welfare was largely due to social assistance benefits payments, an open-ended entitlement primarily for the elderly poor, the unemployed, and single-parent families. The only decrease was in housing, which dropped 20.8% between 1997–98 and 2004–05, primarily as a result of the government’s abandonment of massive housing construction projects from 1999–2000 because of a serious property market slump. Housing expenditures peaked at that time and began to decrease.

Moreover, the SAR government’s substantial increases in social expenditure should be placed against the background of a continued budget deficit during the same period. In the first eight years of the SAR era, 1997–98 to 2004–05, the government incurred budget deficits for five years, with the largest rate, −5% of GDP, in 2001–02 (see Table 3). In other words, in spite of the overall economic downturn and fiscal deficit, the SAR government still committed itself to spend more on social policy. Nevertheless, when the economy picked up again, in 2004–05, the government was able to restore fiscal balance.23

But Hong Kong residents expect more from their officials. The following two cases illustrate the dilemmas that the SAR government has faced. In 2004, a few public housing tenants filed suit in court for rent reductions because the overall median rent-to-income ratio had exceeded 10%, a standard set in 1997 by the legislature in an inflationary economic environment.24 (In a deflationary environment, public housing tenants should change their expectations.) Evidently, this was not the case: the tenants brought their lawsuits against the Housing Authority, reflecting not only expectations generated from the 1997 legislation but also their own personal hardships stemming from the overall economic downturn. Many public housing tenants have found themselves worse off than they were before; some belong to the new working poor. For example, 5.7% of the full-time employees earned less than HK$ 5,000 (US$641) a month in the third quarter of 2005.25 That is in general regarded as a working-poor wage.

From their complainants’ perspective, whether or not public housing finance could be sustainable after a rent decrease was not a concern. Apparently, they saw no personal responsibility to maintain sustainable public

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25. Financial Secretary, The 2006–07 Budget.
housing finance. If the SAR government continues to face such expectations, the welfare circle can hardly be squared. The Court of Appeal ruled in favor of the Housing Authority—it decided that the Housing Ordinance does not impose a duty on the authority to carry out a rent review every three years, nor to keep rents below 10% of median household income. In other words, the Housing Authority was allowed to carry out a flexible rent system for sustainable development.

The second case concerned the listing of public property on the stock market. When the Housing Authority decided in July 2004 to list its shopping malls and car parks by means of a real estate investment trust in the local stock exchange, it was once again faced with legal challenges. Two elderly public housing tenants, both welfare recipients, sought an injunction to block the listing. They alleged that the authority’s disposal of shopping malls and parking spaces was a breach of the Housing Ordinance. Underlying their litigation was the worry that the sale of public assets might affect their interests—they would have to pay a higher price for goods and services because the new management had an incentive to raise rents of shopping malls. In the end, the resulting injunction forced the authority to delay the listing of HK$ 21.9 billion (US$2.8 billion) of its assets until the end of 2005.

These two cases indicate the dilemma facing the SAR government. It was not very successful at managing the expectations of the people, especially those who are welfare beneficiaries, in a way compatible with the

### TABLE 3 Hong Kong Government’s Budget Balances, 1991/92 to 2005/06 (HK$ million)

<table>
<thead>
<tr>
<th>Year</th>
<th>91/92</th>
<th>92/93</th>
<th>93/94</th>
<th>94/95</th>
<th>95/96</th>
<th>96/97</th>
<th>97/98</th>
<th>98/99</th>
</tr>
</thead>
<tbody>
<tr>
<td>Budget surplus/ (deficit)</td>
<td>22,509</td>
<td>21,979</td>
<td>19,164</td>
<td>10,843</td>
<td>(3,113)</td>
<td>25,678</td>
<td>86,866</td>
<td>(23,241)</td>
</tr>
<tr>
<td>% of GDP</td>
<td>3.3</td>
<td>2.8</td>
<td>2.1</td>
<td>1.1</td>
<td>–0.3</td>
<td>2.1</td>
<td>6.5</td>
<td>–1.8</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>99/00</th>
<th>00/01</th>
<th>01/02</th>
<th>02/03</th>
<th>03/04</th>
<th>04/05</th>
<th>05/06*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Budget surplus/ (deficit)</td>
<td>9,952</td>
<td>(7,833)</td>
<td>(63,331)</td>
<td>(61,688)</td>
<td>(40,128)</td>
<td>21,356</td>
<td>4,057</td>
</tr>
<tr>
<td>% of GDP</td>
<td>0.8</td>
<td>–0.6</td>
<td>–5.0</td>
<td>–4.9</td>
<td>–3.2</td>
<td>1.7</td>
<td>0.3</td>
</tr>
</tbody>
</table>


*Revised estimate.*
new economic and fiscal realities. In other words, governance in social policy, in the case of the SAR government, is not simply a matter of adequate social resources. It is a matter of how well a social welfare system can be restructured to deal with the problems and challenges of the time and also how well people’s expectations of the government can be moderated. The litigations on rent reduction and on listing of government property assets are both cases in point.

These cases suggest that the SAR government lacks solid political legitimacy, despite its strong financial commitments for social policy in an economic downturn environment. Nonetheless, larger levels of spending on social policy cannot be maintained in the long run. Thus far, the government has been supported by cumulative reserves from the pre-1997 era, primarily from land sale revenues. Economic growth in 2004 through 2006 did give the government more breathing space. It had a surplus of HK$12 billion (US$1.5 billion) in 2004–05; however, if we discount the proceeds from the issuance of government bonds, there would be a deficit of HK$13.4 billion (US$1.7 billion). In the long run, the SAR government needs to take up the challenge of squaring the welfare circle. To this end, officials raised the idea of introducing a Goods and Services Tax (GST) in mid-2006, with the intention to broaden the tax base. But they failed to convince the public that this was the right method; strong opposition led the SAR government to back off the GST in early December 2006, nearly four months before the end of the public consultation period.

The dilemma facing the SAR government is threefold. First, the government has to meet the basic needs of its people that arise from worsening poverty, a widening income gap, population aging, unemployment, broken families (created by rapid social and economic changes), and many other serious social problems. Many of these problems are structural and have tremendous implications for social policy. For instance, according to the 2001 census, the lowest 40% of households owned only 11% of total household income, while the top 20% of households owned 56.5%. Apparently, many low-income households have to rely upon social services and benefits for basic living; hence, any increase in fee and charges for public and social services is likely to be fiercely resisted. The fees charged patients admitted to public hospitals’ casualty wards are a case in question. A nominal

fee of HK$ 100 (US$13), out of a cost of HK$ 570 (US$73), was introduced in late 2002 in an attempt to halt the misuse or abuse of this public health service. However, the fee still encountered strong opposition from patient advocacy groups, which argued that the charge would deter the poor and patients with chronic illnesses from seeking medical consultations.

The advent of an aging society in the Hong Kong SAR is another structural change that has significant implications for social policy. The ratio of persons of age 65 and above reached 11.7% in 2003 and is forecasted to rise to 27% by 2033. Clearly, an aging population will boost pressure on social policy for health care and income protection, while at the same time the size of the labor force will decline, resulting in reduced revenues for the government. Take the case of income protection for example. Nowadays, more than half of CSSA cases are elderly persons. This is a phenomenon unique among advanced countries, where the main recipients of poverty relief are usually single parents and low-income families. The clear underlying reason for this preponderance is that the Hong Kong SAR lacks a state pension. The newly introduced MPF is a personal forced savings scheme that requires time for participants to accumulate adequate income for protection. This retirement protection model does not offer income support for those who are currently aged. Henceforth, they have to rely upon government poverty relief. This explains the high percentage of elderly persons on CSSA, as mentioned above. In the long run, because the scheme relies on personal savings, low-income workers and non-contributors such as housewives have to look for social assistance when they get older. There is more to the list. But the point is clear that rapid social and economic changes, such as a widening income gap, rising unemployment, and an increase in the working poor, are structural and hostile to a government with a limited budget and especially against a shrinking economy.

Second, the SAR government has to restructure social service provisions and benefits to reduce costs and enhance economic competitiveness. Social services and benefits cannot be isolated from the economy. Restructuring social policy is part of a larger economic restructuring. The review of the CSSA is a case in question. The CSSA was implemented in June 1999, with the aim to provide assistance to the needy without reducing their incentive to work. Its Support for Self-reliance component is in

fact a workfare program, or disciplinary welfare, as one authority describes it, which requires the employable recipients to seek jobs and perform community service in exchange for benefits. The standard benefit rates were cut to ensure that these residents were not better off than citizens who were employed. The implication is clear—employable recipients are “encouraged” to seek jobs, hence, wages at the lower end of the labor market were driven down.

Despite the SAR government’s efforts to restructure social policy, expenditures for social assistance benefits keep rising. For example, despite the fact that elderly persons on CSSA declined from 57.3% of total cases in 1997–98 to 50.7% in 2004–05, their absolute caseloads rose from 112,067 to 150,399, respectively (see Table 4). In fact, the declining share of elderly persons on CSSA was made up for by the respective percentage increases for single-parent families and the unemployed, which rose from 8.8% and 9.8% in 1997–98 to 13.4% and 14.9%, respectively, in 2004–05 (see Table 4).

It is clear that the structure of expressed needs has changed, especially for the unemployed and single-parent families: these categories of people have to rely upon public welfare, primarily because of economic restructuring. In this regard, despite the cuts in standard rates of CSSA and the workfare initiatives, as mentioned earlier, CSSA expenditure has increased from HK$ 9.441 billion (US$1.21 billion) in 1997–98 to HK$ 17.631 billion (US$2.26 billion) in 2004–05 (Table 4). This represents an 86.7% hike in a period of seven years. In a similar vein, the SAR government’s reform initiatives in education were fueled by increases in respective spending. The successful reduction in spending—slower growth in social expenditure, not of revenue reduction—was in public housing. It was, ironically, not a factor of deliberate government effort but largely a result of lower production costs in a deflationary environment and the abandonment of massive housing projects because of the economic downturn.

Third, the government must manage the rising public expectations of a citizenry that has greater aspirations for quality social policies but is not eager to fund them. This is most vividly illustrated in the case of health care financing. A 1998 Harvard University team report projects that in order to maintain contemporaneous levels of quality and access to public health services, public health care expenditures might have to increase from 14% of the total government budget in 1998 to 20%–23% by 2016. Clearly, this is impossible, as expectations for other social services would also rise.

32. See Sammy Chiu, “Poverty, Vulnerability.”
<table>
<thead>
<tr>
<th></th>
<th>97/98</th>
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<th>98/99</th>
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<tbody>
<tr>
<td></td>
<td>Number</td>
<td>% of Total Cases</td>
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<tr>
<td>Old age</td>
<td>112,067</td>
<td>57.3</td>
<td>124,304</td>
<td>53.4</td>
<td>133,070</td>
<td>58.4</td>
<td>139,288</td>
<td>59.3</td>
<td>139,288</td>
<td>56.3</td>
<td>143,585</td>
<td>52.8</td>
<td>147,433</td>
<td>50.7</td>
<td>150,399</td>
<td>50.7</td>
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<td>Disabled and ill health</td>
<td>34,519</td>
<td>17.6</td>
<td>39,782</td>
<td>17.1</td>
<td>31,693</td>
<td>13.9</td>
<td>33,810</td>
<td>13.8</td>
<td>33,810</td>
<td>13.7</td>
<td>35,828</td>
<td>13.2</td>
<td>38,193</td>
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<td>Single parent family</td>
<td>17,161</td>
<td>8.8</td>
<td>25,613</td>
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<td>25,146</td>
<td>11.0</td>
<td>29,534</td>
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<td>11.9</td>
<td>34,249</td>
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<td>Unemployment</td>
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<td>9.8</td>
<td>31,942</td>
<td>13.7</td>
<td>26,185</td>
<td>11.5</td>
<td>31,602</td>
<td>12.8</td>
<td>43,237</td>
<td>15.9</td>
<td>48,450</td>
<td>16.7</td>
<td>44,224</td>
<td>14.9</td>
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<td>Low earnings</td>
<td>4,714</td>
<td>2.4</td>
<td>7,562</td>
<td>3.2</td>
<td>8,002</td>
<td>3.5</td>
<td>9,140</td>
<td>3.6</td>
<td>9,140</td>
<td>3.7</td>
<td>10,982</td>
<td>4.0</td>
<td>14,215</td>
<td>4.9</td>
<td>16,902</td>
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<tr>
<td>Others</td>
<td>8,076</td>
<td>4.1</td>
<td>3,616</td>
<td>1.6</td>
<td>3,919</td>
<td>1.7</td>
<td>3,818</td>
<td>1.6</td>
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<td>1.5</td>
<td>4,012</td>
<td>1.5</td>
<td>4,465</td>
<td>1.5</td>
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<td>Total cases</td>
<td>195,645</td>
<td>100.0</td>
<td>232,819</td>
<td>100.0</td>
<td>228,015</td>
<td>100.0</td>
<td>247,192</td>
<td>100.0</td>
<td>247,192</td>
<td>100.0</td>
<td>271,893</td>
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<td>290,705</td>
<td>100.0</td>
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<tr>
<td>Amount (HK$ million)</td>
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<td>17,631.0</td>
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**NOTE:** Figures are at end of the financial year.
Hence, it was logical for the Harvard health experts to recommend inserting an individual responsibility element into the health care system by increasing user fees, as well as initiating other viable financial options such as health care savings plans. Unfortunately, the public wanted to stick to the prevailing system, which lacks financial and organizational sustainability.\(^\text{35}\) The failure of the Harvard health experts’ recommendations for change was not an isolated incident; in 1993, the colonial government’s health care financing initiatives met with fierce public resistance and stagnated.\(^\text{36}\)

**Difficulties in Squaring the Welfare Circle**

As briefly mentioned, the neo-liberal welfare state of the Hong Kong SAR has become an entrenched part of its capitalist economic system. The welfare state has provided substantial and comprehensive benefits for the majority of the population. This is especially true in education, health care, and to a lesser extent, in public housing. In these areas, the demand for state welfare is genuine, reflecting the dependence of many SAR citizens upon the state to help them manage social risks beyond their personal control. Imagine the lowest 40% of households getting only 11% of total household income in 2001. The lower-income groups, quite a substantial minority, would have to depend upon state welfare to make up their insufficient market wages.

High expectations for state welfare are also a function of the lack of or inadequate built-in mechanisms to transact social services and benefits. During the colonial era, there were reasonable grounds for providing non-contributory universal and means-tested social services and benefits. As mentioned above, many people in colonial Hong Kong were very poor; a survey report revealed that half of them could not afford the fees at public clinics. This was the reason for the initial development of low fees and charges for public health services in the mid-1960s. But the low-tax regime and narrow tax base provided the context for today’s issues in which many people perceive no need to take some responsibility for their own welfare. More important, they take the provisions of non-contributory services and benefits for granted. Clearly, these institutional arrangements for service provisions are socially created.

This is not to suggest that those lower-income households were able to pay. But the institutional arrangements reduce their chance to recognize the fiscal side of the welfare circle. In other words, a growth-dividend fueled

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welfare state desensitizes people to the need and responsibility for squaring the welfare circle. In hindsight, because of a long period of economic development, the colonial era was too good to be true, a “growing cake” to be consumed, instead of a system that taxed people for the expansion of the welfare state. This development allowed redistribution without pain, to the majority. But the harsh reality of a continued budget deficit in the beginning years of the Hong Kong SAR is a wake-up call to alert people and the government to the need to manage expectations for squaring the welfare circle. For example, when the economy has begun to pick up, with economic growth for two consecutive years, the SAR government, as discussed, proposed a GST with the intention to broaden the tax base.

The strength of a neo-liberal state is its emphasis of self-reliance, underscored by the value of individualism, which fits well with market operations in a free economy like the Hong Kong SAR. But one important presumption of self-reliance is full employment, which has become currently difficult. In addition, policy failures of the colonial government to initiate contributory insurance schemes and substantial cost-recovery measures in retirement, unemployment, and health care when they were more affordable sowed the seeds for the present scenario. Now, government is unable to square the welfare circle, even at a level where social expenditure as a share of GDP is 40 years behind that in the OECD countries.

In other words, the present problem in squaring the welfare circle is partly structural—the vulnerability of people to social risks beyond their control. It is also partly state failure, through the colonial government’s inability to plan when the economy was able to make dividends for “painless” redistribution for the rainy days ahead. And it is partly institutional, lacking established, built-in mechanisms by the taxation system and fees and charges in social service transactions for managing people’s expectations.

Conclusion
The Hong Kong SAR has inherited a neo-liberal welfare state from its colonial past. In accord with Briggs’s definition of a welfare state, the Hong Kong SAR provides income guarantees, tackles social contingencies of different kinds, and ensures that the best standards of public education and health care are offered to all its citizens, regardless of class differences. As such, the Hong Kong SAR has a well-established welfare system or welfare state in place, although it is not as mature as those in the West, at least in expenditure terms. However, the welfare state is somewhat rigid and seemed to be on a path of growth amid an economic crisis, as illustrated by the two cases discussed above and the increase of social expenditures in the post-1997 era (Table 1).
The SAR government attempted to reduce social expenditures but was not successful. Nevertheless, it did reduce the size of the civil service establishment to an extent that was helpful in achieving fiscal balance. Moreover, it was evident that the SAR government also increased expenditures with an explicit investment function. In other words, the response pattern of the government to squaring the welfare circle is a mixture of the two perspectives mentioned above. First, officials attempted to reduce budgets and concomitantly increase taxes; second, they increased spending on social policy that had an investment function.

Regarding a smaller budget, it is clear that welfare institutions have enormous powers and lives of their own. They are able to change people’s values and behavior, although the Hong Kong SAR operates within a legacy of the Confucian ethos of self-reliance. Welfare institutions also created powerful interest groups favoring further intervention, as illustrated in the two litigation examples. In this vein, it is extremely important to design welfare institutions with mechanisms that can harmonize rights with responsibilities to avoid moral hazard.

In the case of the Hong Kong SAR, structural factors nevertheless have a role to play in welfare development. They are the basis for social protection and policy expansion: the poor in a vastly unequal society, at least in income terms, have to depend upon social policy. Nevertheless, the arrangements of welfare institutions are the contexts where the structural changes are embedded and moderated. For example, a universal health service at low cost to patients blurs the distinction between need and want and is vulnerable to abuse. Most important, it does not have a sustainable financial basis with inbuilt mechanisms to constrain demands for services. In this regard, it seems that there is much to be done as welfare institutions are socially created; hence, they can also be recreated to fit new social and economic contexts. Here, we come back to the issue of governance in social policy: the role of governments to manage expectations is important because public demand for social services and benefits is unlimited, as the case of Hong Kong vividly illustrates. The failure of this government role means that despite increases in social expenditures, political legitimacy still suffers. In this regard, the institutional design of social services and welfare benefits are part and parcel of good governance.