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Madam President,

## *I. Introduction*

1. In the past year, since I delivered the first Policy Address of the Hong Kong SAR Government, Hong Kong people have been running Hong Kong in accordance with the Basic Law. The Central Government has, by its actions, fulfilled its promise to allow Hong Kong a high degree of autonomy. The international community has generally recognised that the principle of “One Country, Two Systems” has been realised successfully in Hong Kong. The fact that China has given us her full support is something that we should take comfort in.

2. Today, Hong Kong still staunchly upholds the rule of law and practises a free market economy. Our citizens enjoy freedom of speech, freedom of the press, freedom of association and assembly, as well as the many other rights provided for in the Basic Law. In May this year, more than half of all registered electors cast their votes in the election of the first Legislative Council, representing the highest ever voter turnout rate in Hong Kong’s history.

3. Yet at the same time, 1998 has been, to say the least, a trying year for Hong Kong. As the Asian financial crisis swept through the region, our economy came under tremendous strain. Unfortunate incidents in our health care sector and the difficulties which marred the opening of the new airport have dealt a blow to Hong Kong’s reputation overseas and have dented our citizens’ confidence. I am determined that the SAR Government should be more vigilant and seek to improve its performance so that it can lead Hong Kong effectively in coping with future challenges.

## **The Asian Financial Crisis**

4. The financial crisis began in Asia last July, and has since extended to Russia, Eastern Europe and South America. Today it is no longer simply a regional crisis, but one which has global economic implications. Inevitably, Hong Kong has found itself facing economic difficulties. The economic

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downturn led some people, as well as international hedge funds, to question the SAR Government's resolve and ability to maintain the linked exchange rate. They took the view that the Hong Kong economy was very much a "bubble" economy and that the SAR Government would not be able to stand the economic strain which would be caused by maintaining the linked rate. Intense pressure to short-sell the Hong Kong dollar resulted in interest rates moving sharply higher. At the same time, overseas banks and investors moved their funds out of the Hong Kong market, thereby reducing further the liquidity in our banking system. The banks took a pessimistic view of the prospects of the commercial sector, and credit became even more difficult to obtain. The resulting steep decline in the property and stock markets led to a contraction of asset values and severely dampened consumer spending. In addition, the rapid depreciation of Asian currencies and the sharp decline in the number of inbound tourists took their toll on our tourism and service industries. Together, these factors have put Hong Kong in the difficult position which we face today.

## Hong Kong's Economic Re-adjustment

5. The financial turmoil has not only rocked our economy; it has also exposed inherent weaknesses in Hong Kong's economic structure. Our economy, after years of over-heated development, already shows the characteristics of a "bubble" economy. Hong Kong has also become one of the most expensive cities in the world in which to do business, and this has affected our competitiveness. For many years, the financial and real estate sectors have been the main pillars of the Hong Kong economy, and both will continue to make significant contributions to the prosperity of Hong Kong. However, because our economic base has been too narrow, whenever these sectors have encountered problems the Hong Kong economy has suffered. At present, our economy is in a difficult period of adjustment. But this adjustment is necessary, because it will help us to improve our competitiveness.

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## Relieving the Pressure through Change

6. The Government, after a thorough analysis of the overall economic and social situation, has used our reserves to put forward a number of measures aimed at easing pressure on the public and creating the conditions necessary for economic and social stability. In his Budget last February, the Financial Secretary put forward tax concessions which will cost over \$13 billion in lost tax revenue in 1998-1999. He also undertook to earmark \$235 billion in government expenditure on infrastructure projects within five years. In June, the Government set up the Task Force on Employment which has so far helped over 17 000 people find jobs. We anticipate that the number of vacancies will increase to 100 000 by the end of next year. We announced in the same month a moratorium on the land sales programme, together with a series of measures specifically aimed at alleviating economic hardship. These included a rate rebate and the setting up of a fund to assist small and medium-sized enterprises. All these measures, together with the freeze on rental payments and tariffs agreed by the Housing Authority, Housing Society, Kowloon Canton Railway Corporation and the Mass Transit Railway Corporation, add up to a total of \$20 billion foregone to relieve pressure on the public.

7. The full effect of some of these measures may not be immediately evident. For example, it will take time for our investment in infrastructure and the various tax concessions we have made to produce a visible economic benefit. Furthermore, for a small, open and outward-looking economy such as ours, external factors are very important. Should these factors remain unfavourable, they will present a palpable obstacle to Hong Kong's economic recovery. However, I do believe that the measures which we have put forward will not only provide some degree of relief, but will also lay a solid foundation for the recovery.

8. In order to restore order to our financial markets, the Government's monetary authorities announced last month a series of measures aimed at supporting our currency and strengthening the markets. I would like to make it clear that in putting forward these measures it is not our intention to interfere with market forces, nor is it our intention to broaden the powers of the Government. Rather, our aim is to consolidate Hong Kong's ability to

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manage its monetary affairs, so that we can counter manipulation of our markets and stabilise interest rates. The Government is committed to ensuring that we maintain our status as an international financial centre, as well as the vitality of our financial markets. The linked exchange rate will remain, and we will strictly enforce the provisions of the Basic Law which stipulate that no foreign exchange control shall be applied in the Hong Kong Special Administrative Region.

9. The changes which have taken place during the past year in the financial markets of Asia and of other regions in the world have led me to conclude that the time is ripe for the international community to increase co-operation with regard to the functions of the global financial system. A number of economies have now agreed that the indiscriminate free-flow of large sums of capital through world markets threatens the stability of this system. Experience tells us that in an integrated global market, no single economy can expect to be immune from the results of financial turmoil elsewhere in the world. I hope that the relevant international organisations will step up co-operation and communication, with a view to establishing a more robust financial order, through which each and every economy can exercise better risk management, and enjoy a more stable environment for growth. We will participate fully in these co-operative efforts.

10. This year, we predict that Hong Kong's economic growth will shrink by 4%. Our unemployment rate which has already reached 5%, will continue to rise, while corporate profits will continue to fall. This difficult economic situation will continue well into 1999. During this period of adversity, both employers and employees will come under severe economic pressure. Thinner margins and lower returns will put a strain on employers, while workers will face pay adjustments and rationalisation of staff numbers. I would urge employers and employees to build up mutual communication and understanding so as to help tide them over these difficult times. Full economic recovery in Hong Kong depends on four major factors: improvement in the external economic environment; moderation of interest rates; stabilisation of property prices; and increased public confidence. External factors are beyond the Government's control. Nevertheless, we are

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committed to creating the best possible environment for our economic progress, and to putting Hong Kong back on the road to growth and prosperity as soon as possible.

## The Challenge of Opportunities on the Mainland

11. To spark our economy into resuming its growth and to help us chart a course for our longer term development, we have to adopt two key initiatives. First, we must work to maintain Hong Kong's status as an international trading centre. Second, we must strengthen our co-operation with the Mainland in all areas. The World Bank estimates that China will, in the twenty-first century, become one of the largest economic entities in the world. I believe that most people in Hong Kong have had the same experience of the Mainland as I have. During each of my periodic visits to the big cities on the Mainland, I am amazed by the tremendous pace at which conditions improve, both with regard to the "hardware", such as civic amenities, transport systems, and infrastructure, and the "software", for example, the skills of the people, levels of service and the degree of cultural development. There are positive changes happening everywhere in China, which is something that should give us all reason to be optimistic.

12. China has historically provided the impetus for Hong Kong's economic growth, and we have always played an important role in promoting the Mainland's relationship with other countries. Since the implementation of reforms and the opening of doors to the international community began in 1978, the Mainland has provided an expansion zone for Hong Kong's manufacturing sector. Hong Kong in turn has become the Mainland's most important centre for fund-raising, trading and re-export. Now, with the success of her reforms, China is becoming more open and her market mechanisms are maturing. The international business community has acquired a deeper understanding of China. As China passes through the different phases of modernisation, Hong Kong will have different roles to play and new functions to perform. To strengthen our position, Hong Kong must now chart a new course and find a new niche for ourselves. We must now consider how to reinforce our role as the bridge between China and the international community, as well as how to enhance our function as a leading business centre for China and the Asia Pacific region.

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**13.** I mentioned in last year's Policy Address the need to explore the potential of our new relationship with China, in particular with the neighbouring areas, and to promote joint development to a greater degree. The Hong Kong-Guangdong Co-operation Joint Conference has made a number of new breakthroughs in this regard. In the six months since its first meeting in March this year, the Joint Conference has agreed on: the need for longer opening hours at our land boundary crossing-points; concerted joint efforts to protect the environment; more initiatives to promote tourism; and measures to assist Hong Kong businessmen with operations in Guangdong. This is an excellent start and I anticipate more good news from future meetings.

**14.** The "One Country, Two Systems" concept puts Hong Kong in a strong position to develop our special status. We must make the most of this advantage, and grasp the opportunity to expand further our business links and economic co-operation with the Mainland in areas such as finance, trade, transport, communication, energy, innovative technology, raw materials, tourism and agricultural development.

**15.** The Government will look to play a leading role in creating an environment conducive to greater co-operation between the Mainland and Hong Kong. This will offer our industrial and commercial sectors greater scope for development, open up more job opportunities to our people and put us back on course for a prosperous future.

## **A Strategy for Long-term Development**

**16.** We must ensure that Hong Kong can continue to respond flexibly and effectively to the forces of change. In my first Policy Address, I announced the formation of the Commission on Strategic Development. Since the Commission's first meeting early this year, we have analysed a number of major trends and driving forces which may affect Hong Kong in the next 30 years - worldwide, regionally and in China - including the impact of globalisation on trade and investment; technological development; the effect of

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an ageing population throughout the world; issues regarding the natural environment; and the impact of economic reform in Asia's two most important economies - China and Japan.

**17.** Right from the early stages of its work, the Commission has been aware of the need for Hong Kong to establish a distinct position for itself following reunification. We have studied the roles of New York and London, which are not only the most cosmopolitan cities in America and Europe respectively, but are also international financial centres, tourist destinations, homes for the headquarters of multi-national corporations and international communication and transportation centres. I believe that Hong Kong too has the potential to become, not only a major city within one country, but also the most cosmopolitan city in Asia, enjoying a status similar to that of New York in America and London in Europe. We must seek, as our ultimate goal, to realise this potential. We must devote our efforts to consolidating our position and at the same time give renewed impetus to our economic development.

**18.** However one looks at the situation, Hong Kong is going through a period of change. This had led to unease and difficulty, but it can also be a force for stimulating new ideas and creating new opportunities. Later in this Policy Address, I shall put forward a package of measures aimed at enhancing the quality of life in Hong Kong. First, I shall explain the plans and proposals that the Government will take forward in order to help Hong Kong plot its course towards economic revival.