

**Using Opium as A Public Revenue Source –
Not as Easy as It Looks: The British Hong Kong Experience**

by

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Introduction

The broad aims of this article are: to summarise the reasons the colonial government in Hong Kong decided to make the internal retail trade in opium a major source of revenue; to explain the operation and enforcement of this revenue system; to evaluate the fiscal performance of this revenue system; and to consider its contemporary and lasting impact on the development of Hong Kong. Our primary research focus is on the first 50 years of the operation of the system for it took almost this long for the revenue raising performance of the system finally to match the original, fund-raising expectations.

As we explain, despite this problematic experience, the opium trade helped, over time, to boost government income indirectly (while, at the same time, the opium revenue system, itself, gradually established a firm fiscal footing). One could say that the ‘fiscal fix’ Hong Kong found itself in when the opium-based revenue regime slipped below expectations was put right as a result of the way that the overall opium trade powered the early Hong Kong economy; the ‘fiscal fix’ thus worked after all.

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One aspect of these developments in Hong Kong which is notable is that British Hong Kong modelled its early opium revenue system on the system which had already been operating in British Singapore for around 20 years before the British first acquired Hong Kong Island in 1841. In fact, unlike in Hong Kong, the Singapore opium revenue system proved to be highly effective from the outset (and on a long-term basis) as a direct generator of public revenues. There is not space in this article to investigate this comparative anomaly in depth but we do discuss certain possible reasons why this divergence may have occurred, below.

A Brief Overview of the Opium Trade

Opium, a drug derived from the latex of the opium poppy and which is commonly linked to notions of trade, colonial development and war, did not actually become a valued item of high volume international trade until the 19th century when it was exported to China, above all, for ‘recreational’ purposes. Prior to that, and for much of its history, opium was primarily used for medicinal purposes where it served above all as a painkiller. One of the earliest records of opium’s medicinal role dates back to 1500 B.C. where its uses were noted by the Ancient Egyptians in the Ebers Papyrus.²

The rise of opium’s prominence in international trade as a valued commodity was in part due to the trade imbalances that many of the European powers, most notably Britain, had developed with China by the start of and during the 19th century. In the case of Britain, trade with China was almost exclusively handled by the East India Company (EIC)³ which was very influential and had very close ties to the British government. Exports of tea, silk and porcelain, which were highly sought-after in the domestic UK market, generated large trade surpluses for China. In contrast, China was largely self-sufficient and uninterested in British products. The Chinese imperial court also adopted a somewhat high-handed attitude in dealing with foreign trade epitomized by the Qing (Manchu) Dynasty Emperor, Qianlong, who claimed “our Celestial Empire possesses all things in

² M. J. Brownstein, “A brief history of opiates, opioid peptides, and opioid receptors” (1993) *Proc Natl Acad Sci USA Vol. 90 (12)*, 5391

³ The EIC was also known as the East India Trading Company. It was founded in 1600 by royal charter granted by Queen Elizabeth I and was initially given a monopoly over all of Britain’s trade in the East. ‘East’ meant (or came to mean) all of Asia plus south-east Asia. It played a vital role in the expansion of the British Empire and was a dominant player in world trade until it was dissolved by an Act of Parliament in 1874.

prolific abundance” and therefore has “no need to import the manufactures of outside barbarians in exchange of our own produce”.⁴

The British (and other) opium traders had largely been able to ignore (Qing Dynasty) attempts to stop the trade. Finally, in 1839, the Chinese Emperor took much stronger action than hitherto, when he appointed Lin Zexu, an official with a powerful and deserved reputation for incorruptibility, as Special Imperial Commissioner to Canton to suppress the opium trade. Lin swiftly confiscated and destroyed 20,283 chests of British opium valued at around £2 million.⁵ This event prompted the British government to send an expeditionary force to China in retaliation, triggering the start of the First Opium War that ultimately resulted in a Chinese defeat⁶ and the ceding of Hong Kong Island to the British under the Treaty of Nanking in 1842 (the British had taken actual possession of Hong Kong Island in 1841)..

The opium trade would continue to flourish in China for years to come and it was not until 1906 that China mustered the will to end its ‘opium addiction’ once and for all with the Emperor issuing an edict that all opium importing, growing and retailing must end in ten years time.⁷ China was able to obtain the support of the United States in its efforts and this culminated in a bargain with Great Britain in

⁴ S. Tsang, *A Modern History of Hong Kong* (Hong Kong: Hong Kong University Press, 2004), 5- This statement was made by Emperor Qianlong during Lord Macartney’s first embassy to China (1792-1794). Lord Macartney was sent by King George III to China with the goal of opening the country to trade with Britain but due to cultural differences and tensions over protocol (including the British emissaries refusal to kowtow in front of the Chinese Emperor), the embassy ultimately ended in failure. The Qing Dynasty, China’s last Imperial Dynasty lasted from 1644 to 1912.

⁵ Tsang, above fn.4, 9-10 - Before the British traders surrendered their opium stocks to Commissioner Lin, they were reassured by then Chief Superintendent of Trade, Captain Charles Elliot, that the British government would compensate them for their losses. This meant that the opium stocks which Lin confiscated were technically property of the British government and their subsequent destruction a direct blow to the British imperial treasury (ibid.).

⁶ Lin Zexu was born in 1785 in Fujian Province. He rose rapidly through the ranks of the senior bureaucracy. China’s defeat in the First Opium War resulted in Beijing using Lin as a scapegoat for this defeat. He was punished by being sent to a remote posting in Xinjiang. His career never really recovered. He died in 1850. See, H. Chang, *Commissioner Lin and the Opium War* (Cambridge: Harvard University Press, 1963).

⁷ E. N. La Motte, *The Opium Monopoly* (New York: MacMillan, 1920) Chapter 15 (History of the Opium Trade in China) at: <http://www.druglibrary.org/schaffer/history/om/om15.htm> [accessed, June 10, 2011].

1907 in which both nations agreed to diminish opium export and cultivation over a ten year period.⁸ This method proved to be successful and by 1917, China was practically rid of opium.⁹ However, the closing of the China market did not spell the end of Hong Kong based dealings in opium. Demand for opium continued to be met in other markets, including within the established Crown Colony of Hong Kong. It was not until after the World War 2 - and at the strong insistence of their American allies - that the British Commander-in-Chief, who ran the interim administration of post-war Hong Kong, issued a proclamation, in September 1945, which declared a total prohibition on the sale and distribution of opium in the colony.¹⁰

The Founding of British Hong Kong

Much of Hong Kong's history is intrinsically linked to and in some instances even considered by scholars to be a 'by-product' of the opium trade that flourished in Asia during the nineteenth century. This drug's relationship with Hong Kong is best summarised by historian Christopher Munn who wrote that 'the colony was founded because of opium; its principal merchants grew rich on opium and its government subsisted on the high land rent and other revenue made possible by the opium trade'.¹¹

One might also add that opium contributed directly to the social development of the colony. For example, one of the best regarded, secondary level educational institutions in Hong Kong today, the Belilios Public School, was founded on the philanthropy of a successful opium trader.¹²

⁸ Ibid.

⁹ Ibid.

¹⁰ M. Booth, *Opium: A History* (London: Simon & Schuster, 1996), 173.

¹¹ C. Munn, "The Hong Kong Opium Revenue 1845-1885" in T. Brook & B. T. Wakabayashi, (eds.) *Opium Regimes: China, Britain and Japan, 1839-1952* (California: University of California Press: 2000), 107

¹² The Belilios Public School (previously the Central School for Girls) was established in 1890 and was mainly funded by a donation of \$25,000 from Emmanuel Raphael Belilios, a remarkably successful Hong Kong opium trader and philanthropist. Mr. Belilios also made donations to help set up the Alice Memorial Hospital, scholarships to help needy students pursue an education in universities and a probation home to help Chinese girls that had been driven into crime and

Munn's first point, above, is easy to understand as the cession of Hong Kong to the British was a result of the First Opium War.¹³ The second point alludes to Hong Kong's importance as a 'central warehouse' for opium export to China and to Chinese overseas communities¹⁴ (it was estimated that in the late 1840s three-quarters of the total opium crop produced in India passed through Hong Kong¹⁵).

Notwithstanding the extensive literature surveying the impact of the international opium trade, one aspect of that trade which has been under-researched to date is the role of opium as a direct public revenue source for sustaining the colony of Hong Kong.

This article seeks to evaluate the importance of opium revenue to the development of the public revenue system in the colony. We first look at the reasons which prompted the colonial government to seek revenue from opium and the initial process of carrying this out. We then explore the problems associated with making this revenue system work despite the seeming 'relative ease' of establishing an opium revenue system. Comparison will be made here to other sources of government revenue to show that, while revenue derived from opium failed to fund the growing colonial administration in the manner initially anticipated, alternative sources of revenue, especially land-related revenue, played a vital role in taking over much of the public funding role that opium was originally to fill. Finally, we look at how various factors came together to enhance the success of the opium revenue system significantly. We also discuss the long-lasting impact of opium (and other somewhat unorthodox revenue sources) on the shaping of the Hong Kong revenue regime.

prostitution by poverty. For more information, please refer to <http://www.belilios.net/> & http://en.wikipedia.org/wiki/Belilios_Public_School [accessed, January 7, 2011].

¹³ Tsang, above fn.4, 14-15 – The First Opium War, also known as the First Anglo-Chinese War, lasted from 1839 to 1842. This war ended with the signing of the Treaty of Nanking on August 29 1842 which ceded Hong Kong Island to British control.

¹⁴ Important overseas markets for Hong Kong's prepared opium included the Chinese migrant-mining communities in California and Australia.

¹⁵ Munn, "The Hong Kong Opium Revenue 1845-1885", above fn. 11, 107

The Hong Kong Opium Monopoly

Introduction

Much of the focus in relation to the study of Hong Kong and the opium trade has had a sociology or criminology focus or has centred on Hong Kong's strategic proximity to China and the vital role it played as a safe depot for the opium before it was transported, especially to (Qing Dynasty) China, illicitly at first. Later the trade was legalised by the Chinese government under British pressure at the conclusion of the Second Opium War via the Treaty of Tientsin in 1858 when opium became a 'foreign medicine'.¹⁶ Opium was also traded from Hong Kong to overseas Chinese communities. The research emphasis in the past also appears to have focused most on the large foreign firms such as the American firm Russell & Co. and the British firms Dent & Co. and Jardine Matheson & Co. which conducted their opium-related businesses via Hong Kong.

It was true that these firms were intricately linked to and dominated most of the opium trade with China as part of what William Jardine of Jardine Matheson & Co. once referred to as "the safest and most gentlemanlike speculation I am aware of".¹⁷ None of the norms of this larger opium trade applied to the supplying of opium within the Hong Kong colony, however. In fact, the trade in opium within Hong Kong was regulated (initially and mainly – see further below) through a government-conferred monopoly licensed chiefly to local Chinese entrepreneurs who, through the trade, rose to form part of the Chinese elite within the colony. It was from this internal trade that the colonial government principally derived their direct opium-based, public revenue.

¹⁶ P.K. Lee, "Drug Policy and Legislation in Hong Kong 1841-1959" MA Thesis (Hong Kong: The University of Hong Kong, 1999), 23. The Treaty of Tientsin was signed in 1858. The Chinese government had decided to legalise opium in China as it needed to raise revenue, inter alia, to finance military expeditions to suppress rebellions which broke out in the 1850s (including the Taiping Rebellion). By legalising the opium trade, opium was no longer considered contraband in China and was thus subjected to import tariffs levied by the Chinese government. Subsequently, large scale opium cultivation in China also commenced.

¹⁷ C. A. Trocki, *Opium, Empire and the Global Political Economy: A study of the Asian opium trade 1750-1950* (New York: Routledge, 1999), 101 – In the early years of Jardine Matheson and Co.'s founding, it dealt almost exclusively in the opium trade. It was a very lucrative business as the average profit per chest of opium was \$20 and in the 1830s, they were able to trade over 6000 chests each year to generate an annual profit of over \$100,000.

The Need for Opium-Based Revenue

The signing of the Treaty of Nanking officially ceded Hong Kong Island to British control and marked the start of colonial Hong Kong. From the outset the young colony was besieged by many crises threatening its survival, one of which was how to fund and maintain the colony itself. Following the loss of the American Colonies in the American War of Independence (1775-1783), British Empire policies were developed which required colonies to be financially self-reliant so as to avoid burdening the imperial treasury.¹⁸

This local-funding policy encountered resistance from British traders who were discontented about having to pay internal taxes and licensing fees in order to support colonial development and they feared that their commercial interests would be affected by the local administration. This conflict between colonial officials and the merchants generally boiled down to “whether the state existed to serve the needs of the British merchant or to promote its own interests as well.”¹⁹ The British traders argued that Hong Kong was only “a seat of English Government in China” and was part of the British Embassy in China, so its costs “ought to be borne by the nation.” The colonial officials, on the other hand, argued that “of course” Hong Kong was a colony and the standard colonial practices should apply.²⁰ Ultimately, the colonial officials prevailed and the Hong Kong colonial government had to seek a reliable source of revenue in order to achieve self-sufficiency.

To find a source of revenue for the colony was both challenging and problematic. Having been described by Lord Palmerston as ‘a barren rock with hardly a house upon it’²¹, Hong Kong clearly lacked natural resources or established industries to rely upon as a revenue base. Although the opium trade with China seemed promising, Hong Kong had been declared a free port in 1841 so it was unable to

¹⁸ T.W. Ngo, “Industrial History and the Artifice of Laissez-faire Colonialism” in T.W. Ngo (ed.) *Hong Kong’s History: State and society under colonial rule* (New York: Routledge, 1999), 133.

¹⁹ H.H. Traver, “Colonial Relations and Opium Control Policy in Hong Kong, 1841-1945” in H.H. Traver & M.S. Gaylord, (eds.) *Drugs, Law and the State* (Hong Kong: Hong Kong University Press, 1992), 138.

²⁰ Ibid, 138-139.

²¹ Tsang, above fn.4, 14.

rely on any trade tariffs to raise revenues.²² Any levy duties on trade would also have triggered bitter political opposition from British merchants in Hong Kong.²³ Therefore, the colonial government turned to deriving revenue from ‘internal’ business activities inside the colony, mainly in the form of selling Crown land (in the form of leaseholds – see below) and from internal opium consumption.

The introduction of the policy of using opium as a key source of government revenue was not without its critics, many of whom, in both Britain and Hong Kong, questioned the moral and political implications of raising revenue from opium. When Colonial Treasurer R. Montgomery Martin first presented the idea to the British Parliament, critics viewed this as making a “private vice a source of public revenue”²⁴ and the future Chief Justice of Hong Kong, Sir John Smale, described opium as one of the “three evils” of Hong Kong.²⁵ However, these objections were dismissed by the Governor of Hong Kong, Sir John Davis, on the grounds that the administration was to classify opium “with spirits [alcohol] and such other unnecessary stimulants”²⁶ which were readily taxed to raise revenue. Governor Davis also noted that despite China having yet to legalise opium, there was a ‘perfect understanding’ between the British and Chinese governments that each shall adopt their own laws regarding opium.²⁷ The passing of Ordinance No.21 of 1844 (entitled the Opium Ordinance) in the Hong Kong Legislative Council established the beginning of the colonial government’s monopoly over the sale of retail opium.

²² Traver, “Colonial Relations and Opium Control Policy in Hong Kong, 1841-1945”, above fn.19, 136.

²³ Lee, above fn. 16, 9

²⁴ Parliamentary Papers, *British Parliamentary Paper: Report of Select Committee on Commercial Relations with China, Vol. 38* (Shannon: Irish University Press, 1971), 456

²⁵ Munn, “The Hong Kong Opium Revenue 1845-1885”, above fn. 11, 108, 123 – Sir John Smale was Chief Justice of Hong Kong from 1866 to 1881. He considered the “three evils” of Hong Kong to be the opium trade, the licensing of brothels and female slavery.

²⁶ Parliamentary Papers, *British Parliamentary Paper: Correspondence, Dispatches, Reports, Ordinances, Memoranda and other Papers Relating to the Affairs of Hong Kong 1846-60, Vol. 24* (Shannon: Irish University Press, 1971), 20-21.

²⁷ Traver, “Colonial Relations and Opium Control Policy in Hong Kong, 1841-1945”, above fn.19, 137.

Operation of the Opium Monopoly

Under Ordinance No.21 of 1844, the colonial government's opium monopoly operated by relying on a system called the 'opium farm'²⁸. The opium farm was a legal monopoly to sell raw and prepared opium in amounts of less than one chest that was granted by the colonial government by way of competitive bid. The highest bidder would be leased the monopoly for one year and was known as the 'opium farmer'.²⁹ The opium farmer had the liberty of setting the retail price of opium and could board vessels to search for illicit (retail) opium.³⁰ The opium farmer's monopoly was further protected by penal sanctions in Ordinance No.21 of 1844 which made it a criminal offence for anyone to possess opium (for consumption) that had not been bought from the farmer. For the first offence, the offender had to pay a fine of 100 dollars and was liable to two months imprisonment; for the second offence, to a fine of 250 dollars and imprisonment for four months and for every subsequent offence, to a fine of 500 dollars and imprisonment not exceeding six months.³¹ This, in theory, allowed the opium farmer to enjoy the all the profits derived from the internal sale of opium while alleviating fears that competitors would enter the market and siphon off his profits or drive down prices.

This model shared similarities with other British colonial monopolies and, in particular, it closely resembled the Singapore opium monopoly. Singapore, like Hong Kong, was blessed with a natural well sheltered, deep water harbour. In each case, this factor particularly attracted the British. Singapore was acquired for the EIC by Sir Thomas Stamford Raffles, from the Sultan of Johor, as a trading post in 1819. Singapore was ceded in perpetuity to the EIC in 1824 and incorporated into the Straits Settlements in 1826. Like Hong Kong, Singapore was established as a free port so customs duties could not be applied and trade could not be directly taxed. An opium farm system was first established in Singapore as a key source of public revenue in 1819, very shortly after the EIC

²⁸ Today we might call such an arrangement an 'opium franchise'. The term farm used in the ordinance did not, of course, refer to some sort of horticultural farm. Rather the term indicated a 'farming out' of the right to retail opium within British Hong Kong.

²⁹ Traver, "Colonial Relations and Opium Control Policy in Hong Kong, 1841-1945", above fn.19,137

³⁰ Lee, above fn.16,12

³¹ Ibid, 12

acquired the new colony. The opium farm quickly established itself as a mainstay of the public revenue system in Singapore. Over the next 80 years it generated 40% or more of the colony's locally generated revenue.³² Successive Hong Kong Governors saw this Singapore revenue regime as a successful model to imitate.³³

It should be noted that government-granted monopolies were not uncommon in Hong Kong and many industries, both necessary services (such as (in due course) electricity production) and private vices (such as brothels) were under a monopoly or licensing system in the colony at one time or another. One of the most famous and long-lasting of these monopolies, which still exists today, is the Hong Kong Jockey Club (formerly the Royal Hong Kong Jockey Club). The Hong Kong Jockey Club holds a monopoly on all gambling activities in the city and is both the Hong Kong government's largest taxpayer and the city's largest private donor to charities, contributing over HK\$1 billion to charity annually.³⁴

This system of monopolies and licences reflected the British administration's key objectives of: controlling undesirable activities while keeping them at arm's-length and; generating revenues from these controlled activities.

³² See C. A. Trocki, "Drugs, Taxes and Chinese Capitalism in Southeast Asia" in T. Brook & B. T. Wakabayashi, (eds.) *Opium Regimes: China, Britain and Japan, 1839-1952* (California: University of California Press: 2000). In fact, other colonial regimes (for example the French and Dutch) relied on opium farm, public revenue systems (as well as direct taxation of trade). From 1886-1895, around 35% of total public revenues in the Netherlands East Indies were opium-based and from 1861-1895 about 30% of all public revenues in French Indo-China were derived from the opium farm system (ibid.).

³³ Munn, "The Hong Kong Opium Revenue 1845-1885", above fn. 11, 105-106. The Singapore opium monopoly was far more successful than the Hong Kong opium monopoly, though there are no conclusive reasons as to explain why this was so. This difference seems even more baffling when one also notes that Hong Kong fairly soon had a larger Chinese population than Singapore (plus access to millions of potential smokers in China and a more vibrant export market). Christopher Munn suggests it might possibly be due to the lack of already established, indigenous Chinese elites in Hong Kong for the British to collaborate with in managing the growing Chinese population. It was estimated that Hong Kong Island originally had a population of around 7,000 comprised of mostly fishing families when the British took possession (see, Tsang, above fn.4, 18) In fact there was a great level of mistrust between the British authorities and the Chinese bourgeoisie (as they migrated, above all from neighbouring Guangdong Province, and began to establish themselves) and business co-operation between the two was often centred on immediate gains rather than building long-term relations, according to the above view...

³⁴ For more information see: <http://corporate.hkjc.com/corporate/history/english/index.aspx> [accessed, June 6, 2011].

The first opium monopoly was auctioned off to British merchants George Duddell and Alexander Mathieson who were unsuccessful and only maintained the monopoly for three months before selling it off to a Chinese collaborator of the colonial government, Lo AQui.³⁵ The primary reason that the Duddell-Mathieson monopoly failed was because of their inability to enforce their monopoly by stopping the flow of competing illicit opium. Their efforts were further frustrated when Chief Magistrate William Caine ruled that the opium monopoly did not extend to opium purchased for the purpose of export regardless of how small the quantity might be, which made it extremely difficult to prosecute smugglers (into Hong Kong) successfully.³⁶ Lo AQui, on the other hand, had close connections to (if he was not the actual leader of) the Chinese syndicates in early Hong Kong and could therefore muster the manpower to enforce the monopoly e.g. by boarding ships to search for illicit opium.³⁷ Lo was further helped by the passing of a new opium ordinance in July 1845 which effectively plugged the loophole by making the sale of opium in quantities of less than one chest 'for any purpose' subject to the opium monopoly.³⁸ From then on the opium monopoly was mainly leased to the Chinese whom Governor Davis indicated were the best opium farmers "as the farmers themselves are Chinese, their perfect knowledge of their own countrymen renders them incomparably the best tax-gatherers in a case of this kind."³⁹

Despite the expectation that the opium farm would be a reliable source of government income, the revenue from opium still lagged behind other sources (e.g. liquor licences) in the first three years of its operation (1845-1847). This was mainly due to the continuing wide availability of illicit opium *and* the particular

³⁵ Munn, "The Hong Kong Opium Revenue 1845-1885", above fn. 11, 112

³⁶ Ibid, 113.

³⁷ T. P. L. Cheung, "The Opium Monopoly in Hong Kong 1844-1887" MPhil Thesis (Hong Kong: The University of Hong Kong, 1987), 71-73 – Lo AQui, who was also known as Lo Aking, was head of the Lo clan in Hong Kong. Besides being the opium farmer, he also engaged in money-lending, gambling and running brothels in Hong Kong. He often relied on the Triad societies to protect his interests. For example, when the Governor's Residence was raided by bandits and Sir John Davis lost a watch, it was recovered soon after by Lo AQui once he was told of it (ibid.).

³⁸ Munn, "The Hong Kong Opium Revenue 1845-1885", above fn. 11, 113

³⁹ Ibid, 111

conflict of interest between the opium farmer and the colonial administration.⁴⁰ As the opium farmer was mainly concerned with maximising his return on his investment, he could flood the market with prepared opium just before his lease was due to expire. This helped make the opium farm lease less attractive and drove down the price of the bid needed to secure the next lease.⁴¹

This forced the government to replace the opium farm system in 1847 with an *opium licensing* system which was similar to the licensing system for liquor and allowed opium to be sold by a number of licensed dealers. The aims of this new policy were to introduce more competition into the retailing of opium and to increase government revenue derived from opium.⁴² It was expected that the increased competition would bring down the price of retail opium and dissuade the illicit sale of opium by making the illegal dealings less profitable.⁴³ The end result was meant to be a significantly increased sales volume of legal opium. However, the licence system was ultimately unsuccessful: it only produced average annual revenue of less than £2000 in the ten years it was in operation,⁴⁴ an amount even lower than the opium farm system. While the increased competition did succeed in lowering the retail price of opium, the price of illicit opium was still cheaper than that of licensed opium. Perhaps more importantly, under the licensing system, there was no person or body tasked with the discovery and confiscation of illicit opium, thus allowing its continued, too comfortable, flow onto the Hong Kong market.⁴⁵

With the end of the Second Opium War (1856-1858) and the signing of the Treaty of Tientsin in 1858, the opium trade was legalised in China and the colonial government decided to remove all restraints on the sale of raw opium in Hong Kong so that traders could now, without any regulatory difficulty, process

⁴⁰ Traver, “Colonial Relations and Opium Control Policy in Hong Kong, 1841-1945”, above fn.19, 137

⁴¹ Ibid.

⁴² Ibid, 139.

⁴³ Lee, above fn. 16,19

⁴⁴ Cheung, above fn. 37, 126.

⁴⁵ Traver, “Colonial Relations and Opium Control Policy in Hong Kong, 1841-1945”, above fn.19, 139

raw opium in the colony for export to China.⁴⁶ Ordinance No.21 of 1844 was replaced by Ordinance No.2 of 1858, which removed all restrictions on the distribution of raw opium but the sale and distribution of prepared opium (ready for human consumption) remained a government monopoly. This had the effect of further securing Hong Kong's position as a major centre of commerce for the opium trade with China.

The city's continuing free port status meant that the larger, external opium trade with China was not subject to import duties while the internal sale and consumption of opium within the colony remained subject to the monopoly (licence-based) system authorized by the government.⁴⁷

The opium farm system was also reintroduced under the new ordinance to replace the existing licensing system and the offence for the possession of illicit opium was increased so that for the first offence, the offender was liable to pay a fine of 250 dollars and three months imprisonment and for every subsequent offence, a fine of 500 dollars and imprisonment not exceeding six months applied.⁴⁸ The ordinance also introduced incentives for informers to report offenders to the authorities by rewarding the informer with "one-half of the pecuniary penalty (if any) imposed on the defendant by the court".⁴⁹ These new measures were introduced so as to help the opium farmer enforce his monopoly in order to make the opium farm licence more attractive to potential bidders.

The signing of the Chefoo Convention in 1885 between Britain and China had a large impact on the Hong Kong colonial government's opium revenue. The Chefoo Convention was particularly aimed at stopping the smuggling of illicit opium into China (especially from Hong Kong).

The colonial government implemented Opium Ordinance No.22 of 1887 to give effect to the Convention.⁵⁰ Under this new ordinance, movement of raw and prepared opium within the colony was once again forbidden without the consent

⁴⁶ Ibid.

⁴⁷ Ibid, 140

⁴⁸ Lee, above fn.16, 27

⁴⁹ Ibid, 28

⁵⁰ Ibid, 31

of the opium farmer, and additionally, all smuggled opium which had been confiscated had to be returned to the opium farmer.⁵¹

This created an ‘excellent loophole’ in that the opium farmer occupied an ‘enviable position’ where he could now smuggle opium into China without any real fear about the loss of his opium. If his illegal shipments were detected by British authorities then, by law the confiscated opium would be returned to him - and he could either sell the opium internally in Hong Kong or try once again to smuggle it into China.⁵² Moreover, any confiscated opium sent by rival smugglers was also returnable to the opium farmer.

This new development made the opium farm a very attractive business proposition to many. There was real competition in bidding for the opium farm licence, driving up the value of bids and allowing the colonial administration to benefit significantly.⁵³ Finally, the original aim for opium to form a major source of revenue for the colonial administration was realised. Opium-related revenues doubled, for example, between 1888 and 1889 and direct opium-based revenues remained notably far more robust (than had previously been the case) in subsequent years – see Table 1, following.

Other Sources of Revenue⁵⁴

From the above discussion, we can see that revenue collection based on opium retailing proved, compared to the Singapore experience, to be rather disappointing over a period of decades following the establishment of British Hong Kong. Opium-related public revenues in Hong Kong varied between 5-15% of total public revenues with many years producing a return of less than 10% of total revenues (see Table 1, following). These figures were far below the

⁵¹ Traver, “Colonial Relations and Opium Control Policy in Hong Kong, 1841-1945”, above fn.19, 140

⁵² Ibid, 141

⁵³ Ibid.

⁵⁴ This Section and the next draw on arguments made in R. Cullen and A. Wong, *The Foundations of the Hong Kong Revenue Regime* (2008) at: <http://www.civic-exchange.org/wp/the-foundations-of-the-hong-kong-revenue-regime-2/> [accessed, June 5, 2011].

40% of total public revenues consistently derived, year-on-year, from opium-based transactions in (also duty free) Singapore.⁵⁵

In fact, this major shortfall (compared to the initial outlook) proved to be notably less harmful for the new colony's fiscal good health than might have been expected. The key explanation for this outcome is the success of the parallel land-based revenue system introduced into the colony virtually from its inception.

Brown and Loh explain that the early development of what remains, to this day, a fundamental aspect of the operation of the Hong Kong revenue regime – land-transaction revenues – derived from the fact that the very first Hong Kong governments were able to assert that they owned the superior title to all land.⁵⁶ As noted earlier, British Hong Kong, initially (from 1841/42) consisted only of Hong Kong Island. The Kowloon Peninsula was added in 1860. The small number of existing residents appear to have been mainly fishermen and families who lived on their boats plus some farmers. In the eyes of the colonizers, it seems these locals lacked any firm claims over dry land areas.⁵⁷ (When the British acquired the New Territories in 1898, the land rights of indigenous, long settled farming communities were recognized.⁵⁸)

Brown and Loh maintain that:

At the outset, the administration decided that any interests in land sold to the private sector should be leasehold interests, rather than the freehold interests that could have been offered. The only practical way of releasing land was through auction and the first auctions were held in the 1840's. Commentators were already describing the frenetic bidding from the merchants and volatility of the market. To prevent abuse, the leasehold interests were granted with terms attached limiting the types of usage, which eventually became the key determinant in assessing the economic value of a piece of land.

⁵⁵ See discussion above re British Singapore.

⁵⁶ S. Brown, and C. Loh, *Hong Kong: The Political Economy of Land* (2002), 8-9, at: <http://www.civic-exchange.org/publications/2002/The%20political%20economy%20of%20land.pdf> [accessed, June 7, 2011]

⁵⁷ The total local population at the time of the occupation of Hong Kong Island by the British was around 7,000. See Tsang, above fn.4, 18

⁵⁸ Brown and Loh, above fn. 56, 8-9, See, also, R Nissim, *Land Administration and Practice in Hong Kong* (2nd. Ed.) (Hong Kong: Hong Kong University Press, 2008) Chapters 1 and 2.

In the initial years after the founding of the colony, there was some discussion back and forth with Whitehall over what interests in land should be sold, whether freehold land should be released, and whether auction was the correct approach. Some twenty years after Hong Kong's founding, an expedient decision was made. The British garrison in Hong Kong was not to be funded from Whitehall any longer, and government ownership of the land market in Hong Kong was proving to be a good revenue generator to help pay expenses.⁵⁹

Property rates were imposed on the new property (leasehold) owners also, almost from the outset.⁶⁰ Another early (and continuing) impost introduced in Hong Kong was Stamp Duty, in 1866.⁶¹

A further early source of revenue came through taxes and fees related to gambling. The Hong Kong Jockey Club (HKJC) (previously the Royal Hong Kong Jockey Club) was founded in 1884 to run and promote horse racing.⁶² Excise Duties (for example on hydrocarbon oil; alcoholic drinks and tobacco products) have also long been imposed in Hong Kong.⁶³ (Estate Duty was applied from the 1930s. It was never a major revenue-raiser (it applied only to Hong Kong assets) and it was entirely suspended in 2006.⁶⁴)

Remarkably, British Hong Kong was able to survive and thrive in terms of revenue-raising for around 100 years without need to resort to any sort of income tax. The first, effective (though highly restricted) income-type taxes date from 1947 with the passing of the Inland Revenue Ordinance which used a fully schedular system to impose separated, business, property and personal

⁵⁹ Brown and Loh, above fn. 56

⁶⁰ R. Nissim, *Land Administration and Practice in Hong Kong* (2nd. Ed.) (Hong Kong: Hong Kong University Press, 2008), Chapters 1 and 2.

⁶¹ Stamp Duty Ordinance (1866) – today, Stamp Duty Ordinance (1981). See, also, J. Lou, “Hong Kong: An Offshore Financial Centre in the Far East – Its Present and Future” (1998) *52 Bulletin for International Fiscal Documentation*, 297

⁶² The HKJC was established to operate on a non-profit basis. See, *Hong Kong Jockey Club – History*, at: http://www.hkjc.com/english/corporate/corp_history.asp [accessed, June 7, 2011]

⁶³ See, *Hong Kong: Customs Excise*, at: <http://www.gov.hk/en/about/abouthk/factsheets/docs/customs.pdf> [accessed, June 6, 2011]

⁶⁴ Estate Duty Ordinance (1932). See, too, *Abolition of Estate Duty – Inland Revenue Department Press Release*, at: <http://www.ird.gov.hk/eng/ppr/archives/07042501.htm> [accessed, June 6, 2011]

extortion income taxes (though only on income with a Hong Kong source).⁶⁵ That is, there was (and still is) no general, global income tax nor any taxation of interest (for the most part) nor dividends. Predictably, perhaps, Hong Kong has yet to see any need to introduce either a formal capital gains tax nor any sort of general sales or consumption tax.⁶⁶

Conclusion

By 1890, 55% of China's imports and 37% of her exports passed through Hong Kong.⁶⁷ Over the first 50 years, economic growth in British Hong Kong was, in sum, notably impressive. As in the case of another key East Asian, British Empire City-State, Singapore, a foundation stone of this economic success was the trade in opium.⁶⁸

Despite this huge growth in trade, especially in the opium trade, and Hong Kong's pivotal role, the Hong Kong government battled with only limited success for several decades to use opium-based transactions as a primary if not the primary source of public revenue for the new colony. This lack of success seemed odd given the comparative ease with which Singapore (and other

⁶⁵ See, further: M. Littlewood, *Taxation Without Representation: The History of Hong Kong's Troublingly Successful Tax System* (Hong Kong: Hong Kong University Press, 2010); and Cullen, and Wong, above fn. 54. A Wartime Revenue Ordinances was introduced in 1940 and a revised version became law in 1941 but the income taxes applied never really had time to take effect before the Japanese overran British Hong in early December, 1941.

⁶⁶ Cullen and Wong, *ibid.* A serious attempt was made in 2006 to canvass the possibility of introducing a Goods and Services Tax (GST) in Hong Kong – but the Hong Kong government back away from this public consultation exercise before it was completed in the face of powerful public opposition (and a resurgent economy). See: A. Wong, “The Source of the Source Problem in Hong Kong (And How to Respond to It)” (2011) *Hong Kong Law Journal* (Vol.41) (forthcoming).

⁶⁷ Rating and Valuation Department of the Hong Kong Special Administrative Region, *A Chronology of Events*, at: http://www.rvd.gov.hk/en/publications/chron_events.htm [accessed, June 6, 2011]

⁶⁸ See, for example: E. N. La Motte, *The Opium Monopoly* (New York: MacMillan, 1920) at: <http://www.druglibrary.org/schaffer/history/om/om15.htm> [accessed, June 10, 2011]; and C. Feige, and J. A. Miron, “The Opium Wars, Opium Legalization, and Opium Consumption in China” at: http://www.economics.harvard.edu/faculty/miron/files/opiumwars_ael.pdf [accessed, June 10, 2011].

colonial outposts in East Asia) had been able to deploy an officially-sanctioned opium monopoly regime to raise very significant public revenues.

It is true that, as Hong Kong was declared a Free Port from the outset of its founding, there was no way to derive revenue from the import-export trading activities in opium (or other goods). But this restriction also applied to Singapore. As we noted earlier, the most credible explanation advanced for this interesting discrepancy is that the British administration in Singapore, at its founding as a British Colony, was able to work with certain established Chinese trading elites who could see the benefits of running the new opium farm over the longer term. In Hong Kong, at the same point in its history, there were, it appears, no similarly (long-term) motivated elite groups with which to work.

Ultimately, this early comparative failure of the Hong Kong opium revenue regime to match expectations proved to be less than crucial. The 'fiscal fix' which the depleted revenue flows created was made good by other public revenue streams, most of all by income derived from land-related transactions.

From its inception, British Hong Kong did not allow (virtually) any sale of freehold land.⁶⁹ All land was made available as leasehold land (with strict conditions attached to each particular leasehold-usage). And landholders wishing to vary the usage allowed on a particular lease had, on each such occasion, to pay a premium to the Hong Kong government to secure the variation - see Table 2, following.

Moreover, the practice grew of restricting the availability of land for development. This tended to drive up the price of land (towards the upper limits of what the market would accept) and also revenue receipts.⁷⁰ When one factored in the

⁶⁹ The Hong Kong Anglican Cathedral occupies freehold land. Landholders in the New Territories have also historically been allowed, by the government, to enjoy certain special rights to land based on ancestral rights which derive from membership of long established communities in the New Territories. See, further, Nissim, above fn. 60.

⁷⁰ In 1995/96, during the last years of British rule, the Hong Kong government still derived some 32% of total revenues from land-related transactions (including sales, lease modification premiums and Stamp Duties – but not including Profits Tax and Salaries Tax arising directly from the real estate sector) see, C. Loh, "The Government's High-Land-Price Policy: Can Hong Kong People Afford it?" at: <http://www.citizensparty.org/housing/landpric.html> [accessed, June 6, 2011]. See, too, D.A. Bell, "Hong Kong's Transition to Capitalism" at: http://www.findarticles.com/p/articles/mi_qa3745/is_199801/ai_n8787332 [accessed, June 6, 2011]. When one adds in the Profits Tax paid by developers and all the others involved in construction, transaction based Stamp Duties and Salaries Tax paid by those working in the sector,

consistent strong, opium-based, growth in the economy over the first 50 years, the Hong Kong government found that its land-based revenue regime more than compensated for the shortfall in expected funding from the opium-based revenue stream. Indeed, the colony's fiscal foundations proved to be so sturdy that, within around 40 years of its founding, the Hong Kong government had already amassed more than one year's total normal public expenditure in fiscal reserves.⁷¹

This land-related revenue regime was further strengthened as the total area comprising the Crown Colony increased significantly, initially in 1860 and then in 1898. The expansion of Hong Kong increased the Hong Kong government's 'land-bank' greatly.

the HKSAR government has continued to rely, in recent years, on land transaction related revenues for around 50% of its income, see, A. Halkyard, "The Hong Kong Tax Paradox" (1998) *Revenue Law Journal* (Vol. 8), 1. This heavy reliance on land transaction revenues in Hong Kong bears some resemblance to the theories propagated by Henry George, the 19th century American economist and social reformer who long advocated the introduction of a single tax on the unimproved value of all land to replace all other taxes. See, J.P. Smith, *Taxing Popularity: The Story of Taxation in Australia*, (Canberra: Federalism Research Centre, 1993), 18-24. A Henry George follower (also a Quaker) Lizzie Magie, created the precursor to the board game Monopoly in 1904 to demonstrate his theories (see: <http://www.answers.com/topic/henry-george> [accessed, June 6, 2011]).

⁷¹ In 1884, Hong Kong was one of the few colonies within the British Empire carrying zero debt. In fact Hong Kong ran a current account surplus for most of the years from 1873 to 1882 with that surplus in some years reaching close to 20% of total expenditure thus allowing the accumulation of very significant reserves. See, *The Colonial Office List for 1884*. (London: Harrison, 1862-1925), 18, 92. (This savings habit has persisted; in mid-2011 Hong Kong's public foreign reserves exceeded US\$250 billion (see: <http://www.info.gov.hk/hkma/eng/statistics/msb/attach/C05.xls> [accessed, June 7, 2011].) of which approximately US\$76 billion are Government Fiscal Reserves (over 20 months of total current Hong Kong government expenditure.) see: <http://www.hic.com.hk/eBulletin/tax/budget2011-12/budget.html> [accessed, June 7, 2011].) The Hong Kong government has also historically been able to control expenditure quite effectively. Services were limited in keeping with 19th century practice but even more so given the remarkable self-reliance (repeated examples of dire poverty notwithstanding) of the majority Chinese population. This was the case from when the British established their Hong Kong colony and it remains the case to a very large extent, today. Goodstadt argues convincingly that Hong Kong's social spending policies have long been and remain deeply flawed – a position made all the more indefensible given the HKSAR's massive fiscal reserves and familiarity with world-wide best practice, see, L. F. Goodstadt, *Uneasy Partners; The Conflict Between Public Interest and Private Profit in Hong Kong* (Hong Kong: Hong Kong University Press, 2005).

In 1945, Hong Kong's per capita Gross Domestic Product (GDP) was, by some estimates, lower than that of India and Kenya.⁷² By 1992, Hong Kong's per capita GDP had overtaken that of the UK. By 2004, Hong Kong was ranked at 23 in a global, 'highest GDP per head' table, ahead of Canada and Australia.⁷³ Wealth distribution in Hong Kong remains very uneven; significant poverty persists. But there is no denying that the British City-State materially transformed itself over the decades following 1945, from a war ravaged colony of less than 800,000⁷⁴ to a leading international service centre with a population of some 7 million.

It is worth noting, too, that the post-war governments in Hong Kong were, in fact quietly but actively hostile to the idea of seeking low-cost development finance from the World Bank when Hong Kong was being re-built right through into the 1960s. Almost certainly, Hong Kong would have qualified to borrow from this then new international financial institution (which had been established in 1947). Successive Hong Kong governments implied they would accept such loans if they were offered on 'reasonable terms' – whilst, in reality, avoiding entering into any such borrowing for fear of the way the World Bank might begin to demand changes in the Hong Kong government's preferred economic model. In particular, the government worried that the World Bank would strongly advocate the adoption of a more modern tax system and insist on the collection of proper economic statistics.⁷⁵

We raise these observations from more recent times because we believe that that the robust attitudes taken by successive Hong Kong governments in the modern era – and the stunningly successful recovery of Hong Kong after the last war – are rooted in Hong Kong's rather special fiscal - and economic - history.

The direct and indirect, opium-based fiscal foundations laid in the first 50 years of the colony proved to be remarkably strong. The indirectly strengthened land-based revenue system has proved to be so successful that it remains a mainstay of the Hong Kong fiscal regime to this day. On these foundations has been built an extraordinarily successful, low tax, trading economy which long ago gave up

⁷² J. Bartholomew, *The Welfare State Made Britain Poor* – extract from book at: <http://www.moneyweek.com/article/593//the-welfare-state-made-britain-poor.html> [accessed, June 6, 2011].

⁷³ *Pocket World in Figures 2005* (London: The Economist – Profile Books, 2004) p.28.

⁷⁴ See: <http://www.demographia.com/db-hkhist.htm> [accessed, June 6, 2011].

⁷⁵ L. F. Goodstadt, *Profits Politics and Panics: Hong Kong's Banks and the making of a Miracle Economy, 1935 – 1985* (Hong Kong: Hong University Press, 2007), 98-100.

being opium-reliant.⁷⁶ These foundations were also fundamental in allowing the colony to thrive without need to resort to any sort of direct income taxation for around 100 years – and when such taxes came they were kept low and simple (as they still are). The very high levels of economic activity have been an important factor in maintaining sufficient revenues using a minimalist taxing approach. That minimalist taxing approach has, in turn, amplified the attractiveness of Hong Kong as a trading centre. A more business (or taxpayer) friendly tax regime operating within a normal (non-palm-tree) integrated trading economy would be difficult to find.

Those early experiences also demonstrated to Hong Kong that, even when financial public policies do not proceed according to plan, other alternatives which can help put things right may well emerge – *provided* your economy maintains strong growth. But how does a jurisdiction arrange to sustain such overall, remarkable economic growth across a time span of more than 150 years? Any sort of full response to this question requires a further article but it is possible to state briefly and with confidence that, above all, this growth - and Hong Kong's success - are attributable to the cross-generational, consistent energy, hard work, intelligence and remarkable self-reliance of the local population.⁷⁷

⁷⁶ As noted in Part 2, above, against remarkable odds and as a product of an agreement between the UK and Qing Dynasty China, the officially sanctioned trade in opium between Hong Kong and Mainland China was increasingly and greatly reduced between 1907 and 1917. See, E. N. La Motte, *The Opium Monopoly* (New York: MacMillan, 1920) Chapter 15 (History of the Opium Trade in China) at: <http://www.druglibrary.org/schaffer/history/om/om15.htm> [accessed, June 10, 2011].

⁷⁷ Goodstadt puts it this way: "There was never any need for the rulers to keep the people of Hong Kong at a distance or to exclude them from participation from government....It would have been hard to find anywhere a society more socially responsible and tolerant, more politically mature and self-reliant, or a people easier to serve and rule. They were ideal constituents, the secure foundations on which Hong Kong's success had been built despite the economic turbulence and political uncertainty..." see, L. F. Goodstadt, *Uneasy Partners; The Conflict Between Public Interest and Private Profit in Hong Kong* (Hong Kong: Hong Kong University Press, 2005), 228. There is claim, possibly apocryphal, that Friedrich Hayek once observed that "socialism is an excellent system – for up to 12 people". The socio-economic operation of the typical Chinese family in Hong Kong lends a certain positive credence to this claim.

**Table 1: Opium Revenue compared to the Total Revenue derived from 1844
– 1894**

Year	Total Opium Revenue (£)	Total Revenue Collected (£)
1844	X	9534
1845	2384	22,242
1846	4118	27,047
1847	3183	31,078
1848	1867	25,072
1849	1566	23,617
1850	1406	23,526
1851	1313	23,721
1852	1479	21,331
1853	1497	24,700
1854	1856	27,045
1855	2558	47,973
1856	2587	35,500
1857	2462	58,842
1858	4508	62,476
1859	5867	65,225
1860	10,393	94,182
1861	12,412	127,241
1862	15,921	131,512
1863	16,175	120,078
1864	16,312	132,884
1865	14,389	195,919
1866	15,346	160,226
1867	19,694	199,040
1868	19,985	236,295
1869	22,637	192,464
1870	23,558	190,673
1871	23,767	175,962
1872	25,500	192,714
1873	26,145	176,579
1874	27,291	178,107
1875	28,541	186,818
1876	27,708	184,405
1877	27,500	209,398

1878	29,042	208,500
1879	46,186	212,121
1880	45,104	235,411
1881	41,345	291,409
1882	45,985	266,120
1883	34,983	283,706
1884	25,044	257,667
1885	33,828	275,443
1886	39,273	300,985
1887	40,132	314,098
1888	40,060	342,640
1889	94,257	401,220
1890	99,500	415,671
1891	81,229	421,938
1892	84,979	466,028
1893	63,500	432,945
1894	71,000	476,501

Table 2: Land Leases and Land Premiums compared to the Total Revenue derived from 1844 – 1894

Year	Land Leases (£) (Rent on Land for Buildings/ Leased Lands) *	Premiums on Land Sold (£)	Total Revenue Collected (£)
1844	5545	X	9534
1845	12,067	X	22,242
1846	12,388	X	27,047
1847	13,996	X	31,078
1848	12,175	X	25,072
1849	10,035	X	23,617
1850	11,416	X	23,526
1851	11,127	43	23,721
1852	9,061	192	21,331
1853	11,455	165	24,700
1854	10,266	1179	27,045
1855	11,199	15,720	47,973
1856	14,389	1141	35,500
1857	14,847	14,743	58,842
1858	17,907	1894	62,476
1859	18,050	1493	65,225
1860	17,878	18,182	94,182
1861	20,625	36,374	127,241
1862	21,688	29,710	131,512
1863	27,212	1352	120,078
1864	24,293	2778	132,884
1865	30,886	12,218	195,919
1866	28,395	255	160,226
1867	29,153	12,812	199,040
1868	26,901	3062	236,295
1869	27,228	X	192,464
1870	25,754	X	190,673
1871	24,935	83	175,962
1872	24,602	83	192,714
1873	24,383	201	176,579
1874	24,485	237	178,107
1875	24,510	606	186,818
1876	24,512	2979	184,405
1877	25,115	17,706	209,398

1878	25,076	2,298	208,500
1879	27,174	293	212,121
1880	26,076	1250	235,411
1881	25,649	42,429	291,409
1882	29,264	3,821	266,120
1883	29,962	5,358	283,706
1884	32,528	4,103	257,667
1885	30,150	13,887	275,443
1886	31,102	7,236	300,985
1887	34,166	32,341	314,098
1888	32,630	33,477	342,640
1889	34,834	33,234	401,220
1890	37,535	3,401	415,671
1891	37,533	10,783	421,938
1892	39,556	25,381	466,028
1893	43,927	13,119	432,945
1894	47,616	14,853	476,501

* Note: Excludes premiums on land sold (Starting from 1860 premiums accounted for a large part of revenue regarding land, sometimes even exceeding land leased). Premiums typically were paid to convert land-use terms in existing leases.

** 1878 - 1889 opium revenue & total revenue; courtesy of Lucy Cheung's research. Please see: Cheung, Tsui Ping Lucy. "The Opium Monopoly in Hong Kong 1844-1887" MPhil Thesis (Hong Kong: The University of Hong Kong, 1987)

*** Note: From 1878 onwards, there was a change to using the dollar instead of the pound. The figures from 1878 onwards are calculated by hand using the exchange rate listed in The Colonial List for 1884 with 1 dollar rated at 4s 2d (4 shillings and 2 pence).