

The Basic Law of the Hong Kong Special Administrative Region: Economics and Norms of Credibility

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I. CREDIBILITY NORMS: MEANS OF EVALUATING HONG KONG'S FUTURE

Central to the achievement of the Sino-British Joint Declaration on the Question of Hong Kong (Joint Declaration)¹ was the economic rationale of maintaining the "prosperity and stability" (*fanrong anding*) of the territory.² This declared common objective, while not exclusively confined to the economic sphere, reinforced earlier assurances that investors could set their hearts at ease;³ it also proved to be the primary catalyst in the successful completion of the Sino-British accord.⁴ Not only does the term "prosperity and stability" appear in the Joint Declaration,⁵ but the Basic Law Drafting Committee (Drafting Committee) for the Hong Kong Special Administrative Region (Hong Kong SAR) has since dignified the phrase by enshrining it in the Preamble of the Collection of Draft Provisions of the Basic Law (Collection) and placing it alongside the statement of the national goal of reunification.⁶

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1. Joint Declaration of the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the People's Republic of China on the Question of Hong Kong, 23 I.L.M. 1366 (1984) [hereinafter Joint Declaration].

2. *Id.*, preamble.

3. This comment was made by Deng Xiaoping to the then Governor of Hong Kong, Sir Murray MacLehose (now Lord MacLehose) during the latter's visit to Beijing in March 1979. J. CHEN, HONG KONG IN SEARCH OF A FUTURE 244 (1984).

4. See D. BONAIVA, HONG KONG 1997 at 99 (1983).

5. Joint Declaration, *supra* note 1, preamble, art. 4.

6. Collection of Draft Provisions of the Various Chapters Prepared by the Subgroups of the Drafting Committee (Secretariat of the Drafting Committee for the Basic Law comp. Dec. 1987) (translated by the Consultative Committee for the Basic Law) [hereinafter Collection] Preamble. Note that the Draft Basic Law is scheduled for release at the end of April 1988 or the beginning of May and is expected to incorporate the draft provisions of the Collection.

Maintenance of Hong Kong's "prosperity and stability" has thus become a basic objective of the political agenda, a *jiben fangzhen zhengce* (fundamental policy direction).⁷ It is unnecessary here to go into the supposed dialectical function of a *fangzhen* (also called a "duality norm").⁸ A caveat, nevertheless, should be sounded at the outset: within the economic and political realities of the contemporary world of the Joint Declaration lies a largely unnoticed reservoir of ideology which could burst abruptly upon the landscape to change our perception of things. For example, the meaning of such key words and concepts used in the Joint Declaration as "autonomy," "upholding national unity," "sovereignty," "freedom according to law," "accountability," "election" and so forth might be subject to ideological reinterpretation.⁹ To varying degrees, these terms have been the subject of controversy or the focus of concern in Hong Kong.

The wording of the Preamble to the Collection illustrates this ideological sub-context; immediately after inclusion of the term "prosperity and stability" follows a pregnant reference to "the history of Hong Kong and its realities,"¹⁰ thereby signifying that the necessary "specific conditions"¹¹ are present to justify the establishment of the Hong Kong SAR under article 31 of the Constitution of the People's Republic of China (PRC) as an instance of the application of the Chinese Communist ideological line of "seeking truth from facts" (*shishi qiushi*).¹² In the Marxist world view this principle appears in economic garb, proclaiming that truth is to be sought primarily from

7. *Jiben* means "fundamental" or "basic," *fangzhen* means "a direction indicator" and *zhengce* means "a political norm" or "policy." The English text of the Joint Declaration uses the term "basic policies" (effectively rendering the first and third words of the Chinese expression and ignoring the second). See Joint Declaration, *supra* note 1.

8. The first type of norm is *zhengzhi luxian* (political line). The second is *fangzhen*. See *id.* The third is *zhengce*. See *id.* For a discussion of the three types of party norms, see von Senger, *Recent Developments in the Relations between State and Party Norms in the People's Republic of China*, in *THE SCOPE OF STATE POWER IN CHINA* 171, 176-184 (S. Schram ed. 1985).

9. If, for example, "the realization of sovereignty" is deemed to require a plenary power of interpretation of *all* aspects of the Basic Law to be retained by the Standing Committee of the National People's Congress (NPC), then this phrase would mean that the Standing Committee would have power to exercise legal supervision relating to internal affairs of the Hong Kong SAR.

10. Cf. Joint Declaration, *supra* note 1, para. 3(1).

11. THE CONSTITUTION OF THE PEOPLE'S REPUBLIC OF CHINA, art. 31 (1982) [hereinafter PRC CONST.] stipulates that "[t]he state may establish special administrative regions when necessary. The systems to be instituted in special administrative regions shall be prescribed by law enacted by the National People's Congress in the light of the specific conditions."

12. Yan, *The Scientific Meaning and Characteristics of One Country, Two Systems*, HONGQI, Mar. 16, 1985, at 18-20.

economic facts.¹³ One such fact is Hong Kong's continuing role as an economic dynamo of the PRC's Four Modernizations.¹⁴

It is outside the scope of this short commentary to explore the whole range of inter-relationships between politics and economics which will form the political economy of the Hong Kong SAR.¹⁵ Yet the economic profile of the Hong Kong SAR, which will take shape from within the crucible of "one country, two systems" (*yiguo liangzhi*), cannot be viewed in isolation from this new hybrid political structure. The economics of the Basic Law is bound to be shaped by its politics, although Lu Ping, Secretary General of the Hong Kong and Macao Affairs Office of the State Council of the PRC, has put the matter another way: "The economy," he said, "is the base, politics is the superstructure."¹⁶ Be that as it may, it is essential to examine the economic fundamentals sought to be protected by reference to the political profile of the future Basic Law and to evaluate both the economic and political structures by reference to, among other things, their credibility.

Nothing illustrates this better than the promise of "a high degree of autonomy" (*gaodu zizhi*).¹⁷ The concept is essentially political, but it has an economic impact so profound that without the promised autonomy, the ability of the Hong Kong SAR to become more than just another Chinese coastal city would be completely destroyed. More accurately, unless visibly credible steps are taken to realize the promise of autonomy, the declared objective of "prosperity and stability" will become unattainable.

The Joint Declaration itself was largely an exercise in building

13. See, e.g., Deng Xiaoping, *Uphold the Four Cardinal Principles*, in *SELECTED WORKS OF DENG XIAOPING 1975-1982*, 189-190 (1984), quoting MAO ZEDONG, V *SELECTED WORKS OF MAO ZEDONG* 393 (1987).

14. See A. RABUSHKA, *THE NEW CHINA: COMPARATIVE ECONOMIC DEVELOPMENT IN MAINLAND CHINA, TAIWAN & HONG KONG* 152 (1987) for a summary of the benefits the PRC derives from Hong Kong, which include 30-40 percent of the PRC's total earnings of foreign exchange. Note, however, that the figures given by Rabushka in relation to the balance-of-trade are over-taken by the recent phenomenal growth in the Hong Kong-China trade. See *infra* note 78 and accompanying text.

15. Hicks, *The Political Economy of 1997*, in *HONG KONG AND 1997: STRATEGIES FOR THE FUTURE* 399 (Y.C. Jao ed. 1985).

16. This response is Lu Ping's answer to a question put by Lee Yee, Editor-in-Chief of *The Nineties*, a local monthly newsmagazine, during the former's visit to Hong Kong in early 1985. Lee Yee's question was: "Will Hong Kong after 1997 retain only its capitalist economic system, and not the capitalist political system?" Lu Ping's full answer was: "Certainly not. The Sino-British Joint Declaration stipulates the maintenance of the capitalist social system, this includes the economic system as well as the political system. The economy is the base, politics is the superstructure." See Cheng, *Hong Kong: The Pressure to Converge*, 63 *INT'L AFF.* 271, 279 (1987).

17. Joint Declaration, *supra* note 1, para. 3(2).

credibility. The PRC could have simply made a unilateral declaration of its basic policies regarding Hong Kong. Such a unilateral declaration, however, would not have had the credibility of a negotiated settlement and the external restraint constituted by a legally binding treaty. Even a legally binding treaty, however, may be lacking in credibility. Hence, the need to develop norms of credibility by which the promised future may be evaluated.

In its broadest sense, a credibility norm is simply any standard by which the credibility of a system or enterprise may be judged. The promise of autonomy (*gaodu zizhi*), the principle of continuity (*zhidu bubian*)¹⁸ and the precept of maintaining prosperity and stability (*fanrong anding*) are three primary norms by which the draft provisions of the Basic Law and the concept of "one country, two systems" may be evaluated.

There is another prescriptive, rather than descriptive, sense in which the term credibility norm is used herein. Because the primary norms may themselves be deficient in credibility either initially or by reason of subsequent developments, it becomes imperative to solve the credibility problem if an enterprise is to be a success. In its prescriptive sense, therefore, a credibility norm is a rule of action which seeks to augment that which is perceived to be deficient in credibility.¹⁹ It is thus a principle of selection which seeks out among available options that which provides the most credible solution to a given problem. Therefore, the development of a credibility norm involves, first, a judgment as to what deficiency in credibility exists and, second, a decision as to what must be done to cure the deficiency.²⁰

An illustration on the level of selection of options is supplied by the controversy over how the chief executive for the Hong Kong SAR

18. *Zhidu bubian* means "no change in systems," a principle which is incorporated in the Joint Declaration in the provisions which preserve and continue existing socio-economic systems, laws and various institutions. See, e.g., Joint Declaration, *supra* note 1, para. 3(5).

19. Credibility norms also add to and protect the credibility of established systems. "Justice must not only be done but must also be seen to be done" and "where there is a right there must also be a remedy," are examples of credibility norms. Credibility norms are exemplified in the principles underlying the development not only of open justice but also of open government and of a system of checks and balances. Checks and balances efficaciously disperse power among sound and credible institutions without causing paralysis in the center of government. Furthermore, political and legal norms and functions are credibly separated, at least on the operational level, without necessarily denying their ultimate relationships.

20. The judgment may be reached by one or more methods, ranging from plain common sense to sociological surveys, historical analyses, trend analyses and public opinion polls. Joseph Cheng cites a poll showing that, in August 1986, the confidence of the Hong Kong people in the political future of the territory had declined since the summer of 1985. While the majority of those interviewed were still confident about Hong Kong's overall future, the percentage of respondents who were "very confident" had dropped from 23% to 11%; the drop was sharper among the better educated. Cheng, *supra* note 16, at 280.

should be chosen. The elaboration by the PRC Government of its basic policies regarding Hong Kong contained in Annex I of the Joint Declaration stipulates that the chief executive for the SAR is to be appointed by the Central Government on the basis of either "consultations" or "elections" held locally.²¹ A consultative model, therefore, would be in perfect accord with the letter of the Joint Declaration, but, in this writer's view, lacks credibility when considered in conjunction with the promised high degree of autonomy.

Demonstration of real credibility will require something more than minimum compliance with the Joint Declaration. Nothing less than a full and generous implementation of the Joint Declaration will succeed in maintaining Hong Kong's prosperity. The principle of full and generous implementation is a credibility norm which works on the premise that credibility is best tested in areas where a choice of options exists. Thus, if the PRC Government shows a propensity to exercise greater control of the Hong Kong SAR whenever the option presents itself, or if it re-interprets terms in the Joint Declaration so as to secure such control, questions will naturally arise as to what credence should be placed in the promised autonomy. If, on the other hand, it measures up to the credibility norm of full and generous implementation, favoring options which give as high a measure of self-rule as is consistent with the terms of the Joint Declaration, the credibility of the entire enterprise will be immeasurably enhanced. The principle of full and generous implementation also leads to recognition of the opportunity to translate, where appropriate, various rules of self-restraint into credible constitutional guarantees or directive principles, a point discussed below.

This analysis focuses on the economy and autonomy provisions of the Collection, not only because of the inter-relationship between these areas, but principally because such an approach will enable the credibility of the new political order to be tested at both its strongest and its weakest points. The realm of economics is one where the impact of a credibility problem is often measured in dollars and cents, as Hong Kong's 1983 financial crisis amply demonstrated.

II. A LESSON IN THE ECONOMICS OF CREDIBILITY

A review of the confidence crisis in 1983 that brought Hong

21. Joint Declaration, *supra* note 1, Annex I, part I. The working draft of the Basic Law states that the chief executive shall be selected by election or through consultations held locally, and be appointed by the Central People's Government. The draft then proceeds to list four sets of proposals regarding the specific methods of selecting the chief executive. Collection, *supra* note 6, art. 45.

Kong's financial system to the brink of total collapse is useful for a number of reasons. In the first place, it will give the reader an idea of Hong Kong's monetary system. Second, it will demonstrate the volatility of Hong Kong's small open economy. Third, it will show the limits of the Hong Kong Government's policy of "positive non-intervention." Fourth, it will help us to fathom the PRC's "bottom line" regarding Hong Kong. Fifth, and above all, it will give us a lesson in the economics of credibility.

In the period between November 1974 and October 1983, Hong Kong had a floating exchange rate system.²² Because there was (and still is) no central bank, the money supply could not be effectively controlled and automatically increased with inflation. The domestic monetary expansion, unlike under a fixed exchange rate system, was not checked through foreign transactions. Rather, any disequilibrium in the balance of payments was corrected through the exchange rate, rather than by changes in the money supply.

The period from the second quarter of 1977 to the middle of 1982 saw an extraordinary growth in the money supply (in all three monetary aggregates, M1, M2 and M3),²³ due principally to hyper-speculative activity in the property and stock markets. The domestic economy became "overheated;" interest rates were low compared with Euro-dollar yields. The exchange rate of the Hong Kong dollar "floated" generally downward despite the efforts of the licensed banks (operating under the Interest Rate Agency established in 1964, which determined deposit interest rates) to arrest the downfall by repeatedly setting interest rates at higher levels. As of March 31, 1977, the exchange rate of the Hong Kong dollar was approximately US\$1 = HK\$4.62 (HK\$1 = US\$0.216).²⁴ On June 30, 1982, it had fallen to US\$1 = HK\$5.91 (HK\$1 = US\$0.169).²⁵ During the period of the floating rate, from November 1974 until July 1978, the trade-weighted

22. The "floating" exchange rate system, combined with a discretionary conversion of Hong Kong dollars into foreign assets to back the currency, became a fiat standard. Under a fiat standard, money does not require the backing of any physical commodity and need not be convertible. Hong Kong went from a commodity standard (silver, prior to 1935), to a foreign exchange standard (pound sterling, 1935-1972; U.S. dollar "pegged" system, 1972-1974), to a fiat standard (1974-1983 when the U.S. dollar was "floating") and then back to a foreign exchange standard (U.S. dollar "linked rate" as distinguished from "pegged" system). GOVERNMENT INFORMATION SERVICES, HONG KONG 1987, at 56 (A. Ismail ed. 1987) [hereinafter HONG KONG 1987].

23. M3 is the broadest definition of money supply. It rose over 60% in 1981 during the property and stock market boom but sharply contracted in 1982, falling to 30% annual growth.

24. Jao, *The Monetary System of and the Future of Hong Kong*, in HONG KONG AND 1997: STRATEGIES FOR THE FUTURE 362 (Y.C. Jao ed. 1985) [hereinafter *Monetary System*].

25. *Id.*

exchange rate index²⁶ stayed above 100. After reaching a peak of 115.5 in early 1977, it declined to a record low of 65.3 in September 1983.²⁷

Analysts generally agree that while there were underlying economic reasons which aggravated the situation, the key factor between September 1982 and September 1983 was the political uncertainty caused by a stalemate in the Sino-British negotiations.²⁸ This is borne out by the fact that by September 1982, the economic indicators had improved, exports were up, the money growth had decelerated and the interest rates differential had been reduced.²⁹

It is generally believed that in September 1983 Britain still held the negotiating stance that it would be in the interest of all parties for British administration to continue for a specified period beyond 1997 in return for recognition of Chinese sovereignty over the whole of the territory. The PRC flatly rejected the proposal: sovereignty was non-negotiable and included administration. In the fall of 1983, the PRC made public its intention to announce unilaterally its basic policies regarding Hong Kong if the United Kingdom did not reach an agreement with the PRC by September 1984.³⁰

On "Black Saturday," September 24, 1983, the exchange rate plunged by 12.9% within 48 hours to US\$1 = HK\$9.6 (HK\$1 = US\$0.104),³¹ with the trade-weighted exchange rate index likewise falling to 57.2 (a drop of 11.6% over the same short interval).³²

The PRC did not yield on the sovereignty issue, or more accurately, on what it conceived sovereignty to mean. Premier Zhao Ziyang was reported to have said: "No country can put prosperity ahead of sovereignty."³³ Sovereignty, as defined by the PRC, was the bottom line.

26. The index is calculated as a trade weighted average of the external value of the Hong Kong dollar in terms of fifteen foreign currencies, taking December 18, 1971, as the base.

27. By "Black Saturday," September 24, 1983, panic was so great that many consumers were beginning to hoard rice and foodstuffs. For a detailed account of the crisis, see Greenwood, *The Stabilization of the Hong Kong Dollar*, ASIAN MONETARY MONITOR, Nov.-Dec. 1983, at 9, 37.

28. See Jao, *The 1997 Issue and Hong Kong's Financial Crisis*, 2 J. CHINESE STUD. 115-16 (1985). See also RABUSHKA, *supra* note 14, at 179.

29. *Monetary System*, *supra* note 24, at 363.

30. See BONAVIDA, *supra* note 4, at 108. Although it was not until September 30, 1983, that Ji Pengfei reportedly delivered the ultimatum, the PRC in fact had been making its "unilateral" plans known months earlier, with the implicit message that, agreement or no agreement, the basic policies had been decided. *Id.* at 105-07.

31. *Monetary System*, *supra* note 24, at 363.

32. *Id.*

33. THE FUTURE OF HONG KONG: TOWARD 1997 AND BEYOND 9 (H. Chiu, Y.C. Jao & Y. Wu eds. 1987) [hereinafter THE FUTURE OF HONG KONG].

While the PRC's negotiating stance did not publicly soften (at least not until the British had conceded full sovereignty), there can be no doubt that the PRC was seriously concerned about the consequences of a total collapse of Hong Kong's financial system. Through the Bank of China and various other agencies, the PRC had been quietly extending credit and stepping up investments. Since 1982, the PRC had changed from being a *net borrower* to a *net lender*, with claims reaching HK\$13.708 billion (US\$1.757 billion) as of June 30, 1984.³⁴

This activist intervention has been interpreted as an attempt by the PRC to stabilize the financial sector in Hong Kong.³⁵ Y.C. Jao has calculated that during the 1982-1983 crisis the PRC lost about US\$1.1 billion in Hong Kong.³⁶ He makes an important observation that despite such losses the PRC refrained from attempting to pass the loss to Hong Kong consumers by, for example, sharply increasing the supply prices of Chinese goods.³⁷ Furthermore, Ji Pengfei, the Director of the Hong Kong and Macao Affairs Office, told a visiting delegation of Hong Kong academics that the PRC would be prepared to assist in the stabilization of the Hong Kong dollar, provided that any currency disturbance was not "deliberately created to embarrass China."³⁸

The Hong Kong Government, reversing its previous policy stance, took a series of decisive steps of its own to stabilize the financial market. Between September 25 and October 15, 1983, plans were worked out to achieve "full convertibility" of the Hong Kong dollar. The two note-issuing banks³⁹ had to submit US dollars to the Exchange Fund for new Certificates of Indebtedness (CIs)⁴⁰ in respect of any note issued at a fixed rate of US\$1 = HK\$7.80⁴¹ (the same rate at which CIs would be redeemed). At the same time, other banks and deposit-taking companies had to exchange HK dollar banknotes for US dollars or vice versa with the said note-issuing banks at the same rate.

34. See *Monetary System*, *supra* note 24, at 368.

35. See, e.g., *id.* at 375.

36. Jao, *Economic Prospects after the Sino-British Agreement*, in *THE FUTURE OF HONG KONG*, *supra* note 33, at 67.

37. *Id.*

38. *Monetary System*, *supra* note 24, at 375.

39. The Hong Kong Shanghai Bank and the Standard Chartered Bank both issue legal tender.

40. For an explanation of the exchange fund, see GOVERNMENT INFORMATION SERVICES, HONG KONG 1988: A REVIEW OF 1987 60-61 (A. Ismail ed. 1988) [hereinafter HONG KONG 1988]. Cf. Joint Declaration, *supra* note 1, Annex I, part VII (providing for the continuation of the exchange fund after 1997).

41. HONG KONG 1988, *supra* note 40, at 59.

Convertibility at the fixed rate was not extended to the non-bank sector. However, if the market exchange rate was higher or lower than the fixed rate, the forces of "arbitrage and competition"⁴² would bring the market rate close to 7.80. This "linked exchange rate system" is different from a "pegged" system, such as that which operated in Hong Kong for a short period (1972-1974) after the territory went off the sterling standard. Unlike the "pegged" system, the "linked exchange rate system" (which has operated in Hong Kong since October 15, 1983) does not merely credit the Hong Kong dollar deposit accounts of the Exchange Fund against new CIs outstanding, but the CIs must also be fully covered by US dollars.

The currency stabilization measures adopted by the Hong Kong Government to meet the crisis also included the abolition of the ten percent interest withholding tax on Hong Kong dollar deposits and a package to rescue two financially-distressed institutions. The measures worked, helped by the rise in the US dollar against other currencies. Of even greater importance was the change in political atmosphere when Britain finally conceded both sovereignty and administration. The PRC, for its part, took a more conciliatory stance and began to strengthen its assurances of a "high degree of autonomy" for Hong Kong and the preservation of its capitalist system and life-style. Thus ended one of the most critical periods of Hong Kong's recent history.

The passing of the crisis did not mean that there was no longer any credibility problem in relation to the promises made by either or both of the negotiating parties.⁴³ What it seems to indicate is that there was a clear public perception that a negotiated settlement was better than none; that a substantially long period of transition (twelve years), which would allow for orderly plans, was infinitely better than a sudden change-over to communist rule. This was borne out by, among other things, a brief financial crisis in July 1984, when the talks ran into some difficulties over the PRC's proposal for a Joint Liaison Group, a proposal which initially gave rise to fears that

42. The process of "arbitrage and competition" takes place when there exists a difference between the free-market rate and the Exchange Rate Fund's rate; banks buy in the cheaper market and sell in the more expensive one until the difference between the returns from taking loans and the returns from holding cash in either market is equal to the transaction costs of the operations.

43. Capital outflows in 1984 have been estimated to be in the region of HK\$12.5 billion (about US\$1.5 billion), equivalent to about 5% of gross income in Hong Kong. RABUSHKA, *supra* note 14, at 182, citing Greenwood, *The Stabilization of the Hong Kong Dollar*, ASIAN MONETARY MONITOR, Nov.-Dec. 1983, at 9. The worth of foreign assets accumulated by Hong Kong residents in 1985 has been estimated to be in the region of US\$3 billion. Bowring, *Confidence Still the Key*, FAR E. ECON. REV., Feb. 13, 1986, at 86.

power-sharing could spell a virtual takeover before 1997. The crisis passed when it became clear that the Joint Liaison Group was not intended to be an organ of power.

The 1983 financial crisis has left imprints not only in the current workings of the monetary system but also in the content of the Draft of the Basic Law. After briefly examining the structural principles of the future Basic Law, we shall take a closer look at the economic fundamentals sought to be protected.

III. STRUCTURAL PRINCIPLES: THE GENERAL PROFILE OF THE BASIC LAW

The Basic Law will be both a law of the PRC, thus a product of socialist legality, and the founding law of the Hong Kong SAR, thus an instrument whereby the capitalist system, its laws and institutions are preserved. It must also seek to give credible expression to the principles of autonomy and continuity, upon which the realization of the objective of prosperity and stability will depend. Seven structural principles characterize the general profile of the Basic Law. They can be broadly summarized as follows:

(1) A *Sovereignty Principle*, which upholds national unity and territorial integrity and assigns to the Central Government responsibility for foreign affairs and defense.⁴⁴

(2) An *Autonomy Principle*, which assigns to the Hong Kong SAR (subject to the Sovereignty Principle) executive, legislative and independent judicial power including that of final adjudication.⁴⁵ Apart from a high measure of self-rule by local inhabitants of the Hong Kong SAR, the principle likewise carries with it full financial autonomy and full autonomy in external trade relations.⁴⁶ However, unless the promise of autonomy is implemented in accordance with the principle of full and generous implementation, the measure of autonomy achieved is unlikely to be credible.⁴⁷

(3) An *Exclusionary Principle*, which seeks to protect the integrity of the Hong Kong system by excluding from the Hong Kong SAR the PRC's socialist system and practices, and, by implication,

44. Joint Declaration, *supra* note 1, para. 3(2); Collection, *supra* note 6, preamble & ch. 2, art. 13.

45. Joint Declaration, *supra* note 1, paras. 3(1), 3(2); Collection, *supra* note 6, ch. 4.

46. Collection, *supra* note 6, ch. 5, secs. 1-3; Joint Declaration, *supra* note 1, para. 3, cls. (8)-(10).

47. For an example from European history between the world wars illustrating the possible inadequacy of international recognition of autonomy, see Interpretation of the Statute of the Memel Territory (U.K. v. Lith.), 1932 P.C.I.J. (ser. A/B) No. 49 (Aug. 11, 1932), *quoted in* Dinstein, *Autonomy*, in *MODELS OF AUTONOMY* 296 (Y. Dinstein ed. 1981).

socialist and other PRC laws.⁴⁸

(4) A *Preservationist Principle*, which seeks to preserve Hong Kong's existing capitalist system and life-style, its socio-economic systems, its laws and many of its institutions basically unchanged.⁴⁹

(5) A *Development Principle*, which, while emphasizing the need for continuity with existing systems, allows or expressly provides for change. An example that relates to the economy is an article of the Collection which provides that the Hong Kong SAR Government "shall maintain the previous social welfare system and decide on its own the development and improvement of social welfare in accordance with economic conditions and social needs."⁵⁰ This principle would seem to have more "comfort" value than legal value to social welfare advocates, in view of the subsequent articles of the Collection which read rather like an excerpt from Milton Friedman.⁵¹ Ironically, the PRC, a communist nation, is creating a legal framework (for Hong Kong) based on free-market economics:

Article 106: The Hong Kong SAR shall continue to maintain a policy of low tax rates.⁵²

Article 109: The Hong Kong SAR shall . . . continue to adopt free and open monetary and financial policies.⁵³

Article 111: The Hong Kong SAR shall safeguard the free flow of all capital within, into and out of the Hong Kong

48. Joint Declaration, *supra* note 1, para. 3(5); Collection, *supra* note 6, ch. 5.

49. *Id.*

50. Collection, *supra* note 6, art. 152.

51. Milton Friedman has, in his writings, consistently praised Hong Kong for being the best modern example of a free-market economy. See, e.g., M. FRIEDMAN, *FREE TO CHOOSE* (1980).

52. Collection, *supra* note 6, art. 106.

53. *Id.* art. 109. Hong Kong has a relatively low, simple, certain, territorially-sourced and efficient tax structure. There is no overall income tax. Direct tax is levied under four separate headings: "profits," "salaries," "property" and "interest." Following the presentation of the 1988-89 Budget on March 2, 1988, the standard rate of personal taxation has been reduced from 16.5% to 15.5% and of corporate profits tax from 18% to 17%. Some Basic Law Consultative Committee members have suggested that the article be amended to read: "... a policy of low tax regime and a simple and consistent tax system." Concerns which have been expressed include: (1) a low tax rate can be maintained in the long run only if the tax base is broadened; (2) a low tax rate does not guarantee the amount of tax paid is also low if the taxpayers have to pay more types of taxes; and (3) a low effective rate of tax (tax paid as a percentage of assessable income) should also be distinguished from a low marginal tax rate (the rate at which the tax is levied on additional income earned). Letter from E.K.T. Chen, a member of the Basic Law Consultative Committee, to Amy Ho, Administrative Officer of the Consultative Committee for the Basic Law (Sept. 25, 1987) (on file with author).

It should be noted that article 105 provides that "the People's Government shall not levy taxes on the Hong Kong SAR," and that article 18 provides that expenditures for the military forces shall be borne by the Central People's Government." See Collection, *supra* note 6, arts. 18, 105.

SAR.⁵⁴

Article 112: The Hong Kong SAR shall safeguard the free operation of financial business and financial markets, and regulate and supervise such businesses and markets in accordance with law⁵⁵

Article 116: The Hong Kong SAR shall adopt a free trade and economic system.⁵⁶

Article 117: The Hong Kong SAR shall be a free port⁵⁷

Article 121: The Hong Kong SAR shall adopt free and open policies regarding industry, commerce and other enterprises.⁵⁸

(6) *A Principle of Liberty*, which by way of a Bill of Rights, adds to the economic freedoms constitutionally protected or which are directed to be protected by law.⁵⁹ Without freedom, Hong Kong would have remained little more than a "barren island," the description given to it by Lord Palmerston, Britain's Foreign Secretary at the

54. Collection, *supra* note 6, art. 111. Cf. Joint Declaration, *supra* note 1, para. 3(7) ("There will be free flow of capital.").

55. Collection, *supra* note 6, art. 112. The October 1987 stock market crash has led to the setting up of a Securities Review Committee by the Hong Kong Government to review the constitution, the distribution of power, management and operation of the Hong Kong Stock and Future Exchanges, whose international reputation suffered a blow with the four-day suspension of trading on October 20, 1987. The resource package put together by the Hong Kong Government included an initial credit facility of HK\$2 billion to the Hong Kong Future Guarantee Corporation of which HK\$1 billion was provided from the Exchange Fund and the balance by the shareholders of the Guarantee Corporation and others. An additional facility of HK\$2 billion (HK\$1 billion from the Exchange Fund and HK\$1 billion from the two note-issuing banks, The Hong Kong and Shanghai Bank, the Standard Chartered Bank, and from the Bank of China) was later extended to the Corporation. See generally HONG KONG 1988, *supra* note 40, at 58.

56. Collection, *supra* note 6, art. 116.

57. *Id.* art. 117. The status of Hong Kong as a free port is the bedrock of Hong Kong's free trade policies. Since its foundation in 1841, Hong Kong has always been a free port. There is no general tariff on imported goods, but duties are charged on seven groups of commodities irrespective of whether they were imported or manufactured locally, namely hydrocarbon oil, intoxicating liquor, non-intoxicating liquor, methyl alcohol, tobacco, non-alcoholic beverages and cosmetics. HONG KONG 1987, *supra* note 22, at 60.

58. Collection, *supra* note 6, art. 121. It is sometimes said, erroneously, that Hong Kong does not have an "industrial policy." That is true only if the term is narrowly understood to mean a program, directed by government (whether supported by subsidies or other incentives or in some other way), under which private investment is channelled towards certain industries deemed to be "desirable" or "strategic." The Hong Kong Government seems to have adopted a different approach. It sees its role as providing necessary infrastructure, giving institutional support, maintaining a climate conducive to business and strengthening the sources of growth. See Yun-Wing Sung, *The Role of the Government in the Future Industrial Development of Hong Kong*, in HONG KONG AND 1997: STRATEGIES FOR THE FUTURE, *supra* note 15, at 405-08.

59. See Collection, *supra* note 6, ch. 3.

beginning of the Opium Wars.⁶⁰

(7) A *Principle of Mediation* which, by way of an inter-system link, constituted by the Basic Law itself or by specially created organs such as the Basic Law Advisory Committee, mediates between the Hong Kong SAR and the mainland system.⁶¹ This link must never be turned into a lever of control that undermines the SAR's autonomy.

The Basic Law Advisory Committee, which has yet to be formed, will comprise, it is envisioned, members drawn from both systems. The Committee will advise the Standing Committee of the NPC on questions relating to interpretation, amendment and similar issues concerning the Basic Law. The legal supervisory role of the Standing Committee is a critical one that must be carefully defined and circumscribed by the NPC.⁶² It is sometimes overlooked that its impact extends to the economic sphere.

IV. A CLOSER LOOK AT THE ECONOMIC PROFILE: CONCEPTUAL PROBLEMS

It can truly be said that the economic profile of the Draft Basic Law is made in the image of Hong Kong. An entire package of policies, ranging from broad fundamentals like the principle of free trade and the territory's status as a free port and a separate customs center, to the particular strategies like those adopted by the Hong Kong Government in its budgetary planning, are among the determinants of growth which are now to be constitutionalized in the Basic Law.

Yet these attempts to preserve a system (i.e., the principle of continuity), while at the same time mandating profound political changes, have severe limitations. The system now sought to be preserved was born of a particular ambience. It is, however, not static but dynamic. In the very process of attempting to "replicate" the system, a wholly new mechanism is being engineered. The limits and the utility of the pending constitutionalization can be illustrated and developed in four ways.

First, it is an over-simplification to suppose that the preservation of the current socio-economic systems can be successfully achieved by translating present-day economic policies into constitutional guarantees without regard to the ever-rapidly changing economic scene. This is not to say that there should be no protection for any of our economic fundamentals. What it means, however, is that every care

60. HONG KONG 1987, *supra* note 22, at 1.

61. For the function of the proposed Basic Law Advisory Committee, see Collection, *supra* note 6, arts. 16, 168, 169.

62. See *infra* text accompanying note 82.

should be taken to distinguish between broad principles and the more detailed policies and strategies, between the macro and the micro levels, and between structural and operational principles. Specifically, taxation and currency policies are only micro-components of a macro-approach that the present Hong Kong administration adjusts to maintain the optimal course for its free economy. The volatility caused by uncontrollable factors in an open economy demands flexibility on the part of the present and the future Hong Kong administration.

Second, even in relation to fundamental areas that are perceived to be the proper subject of some degree of constitutional protection, the point must be grasped that the very entrenchment of such fundamentals — for example, that the Hong Kong dollar shall remain freely convertible (Article 113), or that no exchange control policy shall be applied to the Hong Kong SAR (Article 110) — will immediately create a new situation, different from the present. On the one hand, there will be a loss of at least a degree of flexibility on the part of the government, while on the other hand, a more stable environment will in principle be created, which may be vital to the Hong Kong SAR's status in world markets.

Third, different methods of constitutional protection should be explored with a view to securing the appropriate aspect of continuity, stability or flexibility, as the case may require. One method would be to set out — by way of appendices to the Basic Law — the lower-level propositions (i.e., the more detailed policies) and to permit a more flexible regime of amendment to apply to these appendices. Another method would be to distinguish between directive principles and justiciable guarantees.⁶³ Whatever method is used, however, care should be taken on the one hand not to straight-jacket the Hong Kong SAR's economy, nor on the other hand to reduce any section of the Basic Law to a set of pious propositions.

Fourth, constitutionalism hinges on interpretation. This raises the question as to who should be interpreting the Basic Law. Interpretation implies a power of legal supervision and therefore

63. The Irish Constitution employs "Directive Principles on Social Policy." CONSTITUTION OF IRELAND, art. 45, in 3 CONSTITUTIONS OF NATIONS, 463, 493 (1968). India followed the example of Ireland: Part IV of its Constitution sets out the responsibility of the state to secure a social order for the promotion of the welfare of the people, followed by provisions of state policy on socio-economic matters. Article 37 provides:

The provisions contained in this Part shall not be enforceable by any court but the principles therein laid down are nevertheless fundamental in the governance of the country and it shall be the duty of the state to apply these principles in making law.

See Chan, *A Bill of Rights for Hong Kong?*, in CIVIL LIBERTIES IN HONG KONG 72, 77-78 (R. Wacks ed. 1988).

introduces a radically new element to the formulation and implementation of economic policies in this territory.

American readers who are concerned with the need to restore a balanced budget may be especially interested to learn that one proposal would include in the Basic Law a constitutional limitation on any systematic use of deficit spending, as well as a limitation on the rate of increase of income and expenditure in the Hong Kong SAR budget. The proposal vividly illustrates both the strengths and weaknesses of constitutional control of financial policies. Article 104 of the Collection provides as follows:

The drawing up of the Hong Kong SAR budgets shall follow the policy of maintaining a basic balance between income and expenditure. The rate of increase of income and expenditure in the Hong Kong SAR budget shall not in principle exceed the growth rate of the Gross Domestic Product.

Article 104 is a good example of the extent to which the drafters of the Basic Law may be prepared to go in order to replicate in the Basic Law the systems and policies of the current government, which are perceived to have been responsible for the remarkable economic success of Hong Kong. (The proposals embodied in article 104, however, do not necessarily represent the views of all the drafters, or a final formulation of the Basic Law.) Article 104 in fact reflects the main budgetary technique used by the Hong Kong Government in managing its affairs, the "Medium Range Forecast," a plan based on a rolling five-year forecast of expenditure and revenue.⁶⁴

Despite the generally accepted wisdom (at least in Hong Kong) of such prudent policies, the fact remains that these are strategies which can hardly be incorporated in the Basic Law without a significant loss of flexibility. While there may be a case for stipulating a conservative fiscal policy as a constitutional directive principle, it is

64. Several principles underlie the strategy of the Medium Range Forecast. The first is that the planned rate of growth of public sector expenditures should not exceed the forecast growth rate of The GDP. The second is that there should be "a broad balance" of revenue and expenditure, with a tilt in favor of achieving a surplus. The third is that at least half of the capital spending should be from the operating surplus. These principles reflect a prudent fiscal policy which has long been adopted by the Hong Kong Government, a policy that was at least partly responsible for the fact that with only four exceptions (1974-5, 1982-3, 1983-4, and 1984-5), revenue has shown a surplus of income over expenditure at the end of each of the past twenty years. HONG KONG 1988, *supra* note 40, at 63. For a layman's description of the Medium Range Forecast as employed by the Hong Kong Government, see *id.* at 62, 63. For a more technical analysis, see *Government Information Services, The 1988-89 Budget: Speech by the Financial Secretary, (Moving the Second Reading of the Appropriation Bill, 1988)*, app. A (Mar. 2, 1988).

difficult to see how a limit to the rate of growth of expenditure and income in the budget should be constitutionally predetermined (presumably for fifty years after 1997). Among other things, this would profoundly limit the size of the public sector. In the present context this "enforced continuity" suggests that both the financial and political autonomy of the Hong Kong SAR might be undermined. As a consequence, the temptation to resort to statistical manipulation or redefinition of such key concepts as the "public sector," in an attempt to escape this vise, might become difficult to resist. The unavoidable conclusion is that "continuity" can only be mandated to a certain degree.

The question has been raised as to whether the economic profile of the Hong Kong SAR (which is supposed generally to reflect the economic profile of the Basic Law, assuming its effective implementation) will indeed be a true reflection of the current economic system and practice in Hong Kong. The answer which this writer would suggest is that, although the economic profile can be said to be "made in the image of Hong Kong," it will not in fact be a mere copy or true image of Hong Kong. It should be emphasized that there is no lack of credibility with regard to the PRC's desire to preserve the continuity of Hong Kong's economic success. Its ability to do so, however, has yet to be fully tested and demonstrated.⁶⁵ As regards the autonomy norm, the problem of credibility runs somewhat deeper.

V. SPECIFIC DIMENSIONS AND PROBLEMS AS TO AUTONOMY

A. *The Concept of Autonomy.*

The primary indicator of the system's credibility and workability is the "high degree of autonomy" (*gaodu zizhi*)⁶⁵ promised in the Joint Declaration. While there is no generally accepted definition of "autonomy" in international law, the concept of territorial autonomy⁶⁶ is commonly understood in terms of self-rule (*zizhi*) by reference to a defined area within the jurisdiction of the metropolitan state. Autonomy is therefore different from independence and complete self-determination. The degree of autonomy is determined by the measure of political freedom possessed by the regional authority to regulate its own affairs; the fuller the measure, the higher the degree of autonomy.

In the 1950s, the concept of "internal self-government" was a

65. Joint Declaration, *supra* note 1, para. 3(2).

66. "Territorial autonomy is established in a delineated portion of the territory of a state and it relates to all the inhabitants within the area; personal autonomy is accorded to members of a certain (ethnic, linguistic or religious) community irrespective of their place of residence." See Dinstein, *Autonomy*, in *MODELS OF AUTONOMY*, *supra* note 47, at 292.

focus of a study by the United Nations, principally in the context of the obligation of states to transmit to the U.N., under article 73(c) of the U.N. Charter, information relating to non-self-governing territories administered by the member states. The United Kingdom, in submitting its lists of criteria, emphasized the importance of looking beyond constitutional instruments to the reality of constitutional guarantees.⁶⁷ The United States, for its part, underlined the need for establishing within each territory a "truly democratic society" and the development of "broadly based, democratic domestic institutions through which the will of the people [could] be made known on a continuing basis."⁶⁸ In other words, the autonomy of a region is determined not only by the competence of its organs but also by the organs' composition and how effectively they articulate local needs and concerns.

It was by no means surprising, therefore, that when PRC leaders floated the idea of *gaodu zizhi*, they simultaneously emphasized *gang-ren zhigang* ("Hong Kong people administering Hong Kong").⁶⁹ The first promise would not be credible without the second, and the second would be inadequate without the first, since autonomy has both political and economic aspects. It is therefore quite logical to find in the Collection, immediately after the clause that the Hong Kong SAR is authorized to exercise a high degree of autonomy, a stipulation to the effect that the executive authorities and the legislature shall, in accordance with the Basic Law, be composed of permanent inhabitants of the Hong Kong SAR. The mere fact that the government and legislature will be composed of local inhabitants does not, however, guarantee a high degree of autonomy. The methods of selection of the chief executive, principal officials and members of the legislature are of paramount importance. The Collection has listed a number of options for further debate.⁷⁰ The choice of options will be critical in determining the degree of autonomy that the Hong Kong SAR will in reality enjoy.

B. *The Basic Law and "Gaodu Zizhi"*

It may be useful at this point to see in what other principal ways the Collection seeks to secure the high degree of autonomy which, under article two thereof, the NPC authorizes the Hong Kong SAR

67. U.N. Doc. A/AC 58/1/Add.3, at 17-22 (July 16, 1952). See Sohn, *Models of Autonomy Within the United Nations Framework*, in *MODELS OF AUTONOMY*, *supra* note 47, at 5, 14-15.

68. U.N. Doc. A/AC 67/2, at 37-40 (May 8, 1953).

69. See Cheng, *supra* note 16, at 271.

70. Collection, *supra* note 6, arts. 45, 64. See Dinstein, *supra* note 47, at 15-16, 19.

to exercise. The exclusion of the socialist system and practices from the Hong Kong SAR⁷¹ means, among other things, that the PRC's centrally-planned economy has no application to the Hong Kong SAR. The placing of the Hong Kong SAR under the direct authority of the Central Government⁷² further means that the provincial authorities have no authority over the Hong Kong SAR. The preservation of the pre-existing corpus of laws, except those which contravene the Basic Law and are subject to amendment by the Hong Kong SAR legislature,⁷³ indicates that the Hong Kong SAR will have a system of law which is distinct from that of the PRC. Lastly, the vesting in the Hong Kong SAR of the final power of adjudication⁷⁴ means that the Supreme People's Court of the PRC will form no part of the judicial system of the Hong Kong SAR.

Many of the provisions of the Basic Law will be concerned with securing the full measure of autonomy necessary for the Hong Kong SAR in the economic sphere. The Collection stipulates, for example, that the Hong Kong SAR shall be vested with executive power and that it shall, in accordance with the Basic Law, manage executive affairs relating to a plethora of varied matters.⁷⁵ There are separate provisions dealing with legislative powers⁷⁶ and judicial powers.⁷⁷ An entire chapter (chapter five) is devoted to the economy under which full autonomy is given to the Hong Kong SAR in relation to public finance and taxation, monetary affairs, external trade, economic relations, and so forth.

C. *External Dimensions*

The concept of "one country, two systems" would simply be unworkable without making provisions for external autonomy. Hence the necessity, among other things, to authorize the Hong Kong SAR, on its own, to use the name "Hong Kong, China" to maintain and develop relations and conclude and implement agreements with third countries and other entities (article 158). These and other provi-

71. Collection, *supra* note 6, art. 4.

72. *Id.* art. 11.

73. *Id.* art. 8.

74. *Id.* art. 18.

75. *Id.* art. 15. Article 15 lists these matters as finance, monetary affairs, economy, industry and commerce, trade, taxation, postal service, civil aviation, maritime affairs, transport, agriculture and fishery, civil service, home affairs, labor, education, medical and health affairs, social welfare, recreation and culture, municipal construction, town planning, housing, land and real property, public order, immigration, climatology, communications, science and technology, sports and other areas.

76. *Id.* art. 16.

77. *Id.* art. 18.

sions dealing with external affairs contained in chapter 7 of the Collection follow closely section XI of Annex I of the Joint Declaration, which also declares that international agreements to which the PRC is not a party but which are implemented in Hong Kong "may remain implemented in the Hong Kong SAR." However, the Joint Declaration has no effect *erga omnes* insofar as it presupposes or seeks to create an international status for the Hong Kong SAR. Quite a few of the Joint Declaration's provisions can only be fully constituted with the consent or recognition (express or implied) of third parties. In Hong Kong's future, therefore, the international dimensions of credibility are highly relevant.

In connection with external commercial relations, a territory is sometimes said to have "full autonomy" even when it does not have any real degree of representative government. Hong Kong under British administration is a case in point. It is by virtue of its so-called "full autonomy" that it has been able to participate in external commercial relations. On April 23, 1986, Hong Kong became the ninety-first contracting party to the General Agreement on Tariffs and Trade (GATT), the cornerstone of Hong Kong's external trade relations.⁷⁸ Prior to its becoming a contracting party, Hong Kong had already been participating in GATT from within the United Kingdom delegation. In order to protect the separate and distinct interests of Hong Kong, the United Kingdom spokesman for Hong Kong was always a Hong Kong government official, thus enabling Hong Kong to take positions different from those of the EEC (and thus, from those of the United Kingdom). Since April 23, 1986, the head of the Hong Kong Government Office in Geneva has been appointed as the permanent representative of Hong Kong to GATT.

In the United Kingdom declaration relating to Hong Kong's separate GATT contracting party status, the British Government formally notified the Director-General of GATT that Hong Kong possesses "full autonomy" in the conduct of its external relations and of other matters provided for in GATT. At the same time, the Chinese Government made a parallel declaration that from July 1, 1997, the Hong Kong SAR will meet the requirements of a separate customs territory to be deemed a contracting party and therefore may, using the name of "Hong Kong, China," continue to be deemed a

78. HONG KONG 1987, *supra* note 22, at 41. Since June 25, 1987, Hong Kong has become a separate member of the Customs Co-operating Council. The PRC made a declaration that if Hong Kong were admitted as a separate member of the Council, the Hong Kong SAR might, using the name "Hong Kong, China," continue such membership with effect from July 1, 1997. *Id.*

separate contracting party to GATT.⁷⁹ In this connection, Annex II to the Joint Declaration refers specifically to the need for the Sino-British Joint Liaison Group to consider maintaining Hong Kong's participation in GATT as well as in the Multi-Fiber Arrangement (MFA), the purpose of which is the orderly development and expansion of international trade in textiles. The MFA provides the framework within which Hong Kong negotiates bilateral restraint agreements with textile importing countries.

The PRC is now seeking re-entry into the ninety-six nation GATT, pledging to intensify its economic reform program and to expand trade. Shen Jueren, Assistant Minister of Foreign Relations and Trade, asked that the PRC be accorded most-favored-nation treatment within the GATT system as well as preferential treatment as a developing country. The United States, the EEC and Japan are seen as the key countries in deciding the terms for the PRC's entry (or, more accurately, re-entry, since China ceased to be a contracting party in 1950). It is reported that delegates have submitted more than 300 questions regarding the PRC's memorandum on its foreign trade policy put before GATT a year ago.⁸⁰ This illustrates an important point: the leverage that these nations may have in relation to the external trade policies of an applicant for participatory rights.

The outcome of the PRC's application is as yet unknown, but this will not affect Hong Kong's current status in GATT.

D. Some Problem Areas

The Hong Kong SAR must be able to develop an "adversarial stance" to represent and assert its own separate interests in world markets, even when that stance might conflict with the interests of the PRC. This is essential to the protection of the Hong Kong SAR's status as a separate customs territory, and inherently appropriate for a contracting party to international agreements. The Basic Law will have to make provisions to ensure that such a development is not only permitted but positively encouraged. This will add credibility to the external trade autonomy of the Hong Kong SAR.

A more difficult problem relates especially to internal autonomy. This concerns the NPC Standing Committee's powers of interpretation of the Basic Law and the power to nullify laws of the Hong Kong SAR in conflict with the Basic Law or with its legal procedures. A dispute may arise, for instance, as to what a "basically balanced budget" or a "policy of low tax rate" means under the Basic Law. If

79. *Id.* See also Collection, *supra* note 6, art. 158.

80. S. China Morn. Post (Business section), Feb. 24, 1988, at 1, col. 3.

the NPC Standing Committee exercises its powers to interpret the Basic Law or to declare invalid a Hong Kong SAR law even though the matter relates to something which is clearly internal to the Hong Kong SAR, the autonomy of the Hong Kong SAR will be undermined.

Of course, the problem is not restricted to financial matters. One possible solution is to translate rules of self-restraint into directive principles in the Basic Law. That is to say, the NPC Standing Committee will, despite its strict legal powers, refrain from exercising any powers of interpretation in relation to the Basic Law or from nullifying any Hong Kong SAR law if the matter does not concern foreign affairs or defense or Central Government-SAR power relations. Such a rule of self-restraint, to be credible, should be translated into a directive principle in the Basic Law and machinery should be set up to deal with the problem of legal classification as to whether a particular issue does or does not pertain to matters that are reserved to the Central Government.⁸¹

The machinery established should ensure that the NPC Standing Committee will not assert a "control of expediency" (*Fachaufsicht*) over the Hong Kong SAR in relation to its financial or other internal affairs and that any power of "legal supervision" (*Rechtsaufsicht*) will be restricted at least in practice to foreign affairs and defense (as distinguished from those external affairs delegated to the Hong Kong SAR and from internal affairs).⁸²

VI. CHANGING PATTERNS

Hong Kong is almost entirely dependent on foreign trade and is vulnerable to external forces, particularly foreign protectionism. In 1987, both exports and imports stood at US\$48.5 billion,⁸³ one quarter of the foreign trade of Japan while Hong Kong has only five percent (5.5 million) of Japan's population and an area of only about 1,000 square kilometers consisting mostly of outlying islands and hill

81. The Special Committee on Law of the Basic Law Consultative Committee has conveyed to the Drafting Committee the views of some of its members that the legal and political functions of "the Basic Law Advisory Committee" (which has yet to be formed) should be separated and that the legal functions should be limited to classification of issues. The idea of translating rules of self-restraint into directive principles was developed by the author, who is a chairperson of the Basic Law Consultative Committee, from the sources listed in footnote 63.

82. Cf. Ress, *The Legal Status of Hong Kong after 1997*, 46 ZEITSCHRIFT FÜR AUSLÄNDISCHES ÖFFENTLICHES RECHT UND VÖLKERRECHT 648, 669 (1986). Ress asserts that "[t]he Standing Committee of the NPC has the power to exert a legal supervision (*Rechtsaufsicht*), but not a control of expedience (*Fachaufsicht*)."
Id.

83. See Trade Analysis Section, Census & Statistics Dept., Hong Kong Gov't, Hong Kong Trade Statistics Summary, Dec. 1987.

country. Despite the common characterization of Hong Kong's economy as an open but small economy, it is the thirteenth largest trading entity in the world; total imports and exports of goods amount to about 180% of its Gross Domestic Product (which does not include trade in services).⁸⁴ Hong Kong has recently overtaken Rotterdam as the busiest container port in the world, with a throughput of 3.45 million containers and a turn around time for container vessels of thirteen hours.⁸⁵

A new dimension to this story is the changing pattern of trade in which the PRC has emerged as the largest trading partner of Hong Kong.⁸⁶ Trade between Hong Kong and the PRC has grown by 1105% in value terms between 1979 and through 1987.⁸⁷ That trade is still expanding rapidly, in the first half of 1987 increasing by 52% over the first six months of 1986.⁸⁸ Hong Kong is now the largest single market of Chinese exports. More impressively, between 1979 and 1985 approximately two thirds of all pledged external investment in the PRC came from Hong Kong.⁸⁹

Also of great potential significance is the increasing amount of manufacturing which is sub-contracted to the PRC by Hong Kong businesses. This activity provides employment to an estimated one million PRC workers in the Pearl River Delta.⁹⁰ Therefore, the "China factor" has already assumed, in these and other respects, an unprecedented degree of economic importance well before 1997, quite apart from the ever growing political influence which the PRC wields as the incoming sovereign power.

There is nothing in the Collection itself which would impinge on this growing China trade. Quite the opposite, the sheer magnitude of PRC interests in the territory will have far-reaching implications in shaping the practice of "one country, two systems." This influence may particularly affect the actual degree of autonomy which the Hong Kong SAR will be able to enjoy. Its precise long term effects on Hong Kong's "prosperity and stability," both positive and negative, have yet to be fully assessed. There can be no doubt that so far it has at least contributed to stability, and therefore has increased the credi-

84. HONG KONG 1987, *supra* note 22, at 11.

85. S. China Sun. Post, Mar. 6, 1988, at 1, col. 2.

86. HONG KONG 1987, *supra* note 22, at 12.

87. HONG KONG 1988, *supra* note 40, at 53.

88. Address by Governor Sir David Wilson at the opening of the 1987-88 session of the Legislative Council (Oct. 7, 1987), at 8.

89. *Id.*

90. *Id.*

bility of the precept of maintaining Hong Kong's "prosperity and stability."

A caveat, however, was recently sounded by the publisher of the pro-PRC monthly, the *Mirror* magazine, Xu Si-men. Mr. Xu is a Hong Kong member of the National Committee of the Chinese People's Political Consultative Conference. During the Conference's recent meeting on April 4, 1988, Mr. Xu is reported to have said that the flow of Chinese money into Hong Kong could adversely affect the territory's capitalist economy because "some wealthy Chinese companies were devastating middle and small-scale enterprises in Hong Kong." He said that the main problem was that the plans of Chinese companies were not clear and that "the companies did not operate according to local economic rules." He called upon Beijing not to exercise too much control over Hong Kong before or after 1997.⁹¹

Hong Kong has a hardworking population with keen entrepreneurial instincts, a population which lives and thrives in an environment that provides a stable legal and administrative framework. Over the years the administration has generally commanded broad support and enjoyed the respect of the population. For its part, the government has adopted a policy of "positive non-intervention" in keeping with a primary role as provider of the necessary infrastructure for a market-disciplined economy and an open and free society under the Rule of Law. Many of these factors will be difficult to replicate in the Hong Kong SAR merely through a constitutional framework. In the meantime, a rise in emigration⁹² will drain the commercial and financial skills which Hong Kong needs unless this is compensated for in due course by people returning after they have acquired rights of residence abroad.

VII. FACTORS AFFECTING CREDIBILITY

It is probably true to say that, to date, Britain and the PRC have been more successful on the international front in gaining support for the Sino-British accord than they have been in keeping up the level of confidence of the people of Hong Kong in the future of the territory. The foregoing analysis can be summarized in the context of eleven areas where the three primary norms discussed in this paper — autonomy, continuity, and prosperity and stability — can achieve credibility, or, in the alternative, can fail wholly or partially. These areas can

91. His speech elicited a promise from then acting Prime Minister Li Peng to look into the problem of "too much meddling in Hong Kong." *S. China Morn. Post*, Apr. 6, 1988, at 7, col. 4.

92. Ching, *Exodus Threatens Financial Future*, *TRIPLE A*, Feb. 1988, at 27.

be seen as the principal factors affecting the confidence-index regarding the new political order. Although the factors might be organized according to any number of different schemes, for purposes of this analysis, these factors are grouped into three categories: actions by and within the PRC, bilateral interactions between Hong Kong and the PRC affecting the Hong Kong SAR's development, and events and conditions external to Hong Kong.

A. *Actions By and Within the PRC*

Central Policies of the PRC. Hong Kong's geo-political situation is such that any significant change of direction in the PRC, such as with continuing economic reform or an open door policy, is likely to have an immediate impact on Hong Kong. Of particular importance is the consolidation of reformist policies of the present-day PRC leadership: efforts to curb inflation, solve the problems associated with development of a commodity economy, and experiment with market mechanisms.⁹³ The recent opening up of another 140 coastal cities and towns to foreign investment (bringing the total number of such cities to 284, comprising 320,000 square kilometers and a population of 160 million) marks a significant step forward in the national strategy of developing coastal regions.⁹⁴ How the Hong Kong SAR will interact with the economies of these and other regions (such as Hainan) is something which remains to be seen. It should be noted that in 1985, the provinces of Jiangsu and Zhejiang plus Shanghai already accounted for more than twenty percent of the PRC's GDP, or some US\$55 billion (i.e., about two-thirds of South Korea's GDP in the same year) with average regional GDP growth of more than fifteen percent over the previous four years.⁹⁵

The PRC's Legal Reforms. The development of the Rule of Law is an ongoing story in China.⁹⁶ Current concerns include problems with abuse of power by cadres,⁹⁷ human rights issues,⁹⁸ and inadequate legal protection for Hong Kong residents doing business in the

93. do Rosario, *Development & Growth Create New Confusion*, FAR E. ECON. REV., Mar. 24, 1988, at 59-60. See also do Rosario, *Inflation: The Threat to Further Changes*, FAR E. ECON. REV., Mar. 24, 1988, at 61-63; do Rosario, *Spirit Willing But the Flesh Is Weak*, FAR E. ECON. REV., Mar. 24, 1988, at 64-65; Cheng, *New Freedom to Make a Profit*, FAR E. ECON. REV., Mar. 24, 1988, at 74.

94. S. China Morn. Post, Apr. 6, 1988, at 1, col. 5.

95. Delfs, *Run for Election But Do Not Expect to Win*, FAR E. ECON. REV., Mar. 24, 1988, at 57.

96. Epstein, *Growing Problems with the Abuse of Power*, *id.* at 81.

97. *Id.*

98. *Id.* See generally, R. EDWARDS, L. HENKIN & A. NATHAN, *HUMAN RIGHTS IN CONTEMPORARY CHINA* (1986).

PRC.⁹⁹

The PRC's Political and Other Reforms. Success of the Four Modernizations depends greatly on improvement of the cadre management system. Of far-reaching importance is the *nomenklatura* (*zhiwu mingcheng biao*) system, which has been described as "arguably the major instrument of Communist Party control over contemporary China's political, economic, social, and cultural institutions."¹⁰⁰

B. Bilateral Interactions Between Hong Kong and the PRC Affecting the Development of the Hong Kong SAR.

The "China Factor." Growing trade links between the PRC and Hong Kong and the PRC's near omnipresence suggest commensurate influence in Hong Kong.¹⁰¹ The wide range of activities of the PRC through its numerous agencies in Hong Kong is bound to affect the future relationship of the Hong Kong SAR with the Chinese Communist Party, with the organs of the Central Government, with provincial authorities and with other entities of the PRC. The manner in which the PRC's agencies carry out their activities or wield their influence will affect the chances for free and fair trade and of the sanctity of the principle of non-interference.¹⁰²

Sino-British Relations. The official line is that cordial relations between the two countries are essential to Hong Kong's prosperity and stability.¹⁰³ The British dilemma, however, is how to maintain the cordial relationship without appearing to be a mere caretaker for the PRC during the transition before 1997.¹⁰⁴

Representative Government in Hong Kong During the Transition Period Before 1997. The issue of territorial constituency-based "direct elections" to Hong Kong's law-making body, the Legislative Council, has become an acid test of the chances of realizing true autonomy in Hong Kong. So far, the PRC is taking the line that direct elections must wait for the Basic Law to be promulgated in 1990.

Formation of the First (Provisional) Hong Kong SAR Govern-

99. Epstein, *supra* note 96, at 82.

100. Burns, *China's Nomenklatura System*, PROBLEMS OF COMMUNISM, Sept.-Oct. 1987, at 36.

101. See *supra* text accompanying notes 86-89.

102. Wu, *In the Shadow of 1997: Interaction Between Hong Kong and its Economic Partners and Neighbors*, in THE FUTURE OF HONG KONG, *supra* note 33, at 139-154.

103. The accusation of being a "lame duck" has been levelled at the Hong Kong Government by many who see the slowing down of political reforms in Hong Kong as a direct result of pressure from the PRC.

104. See the 1987 H.K. Government Green Paper on the review of developments in representative government, the 1988 H.K. Government White Paper Lau, *The Grey Paper*, FAR E. ECON. REV., Feb. 18, 1988, at 14.

ment.¹⁰⁵ Six different proposals are set out for public discussion in article 170 of the Collection, ranging from a narrow based "consultation" model to a broad based "election" model. The method of formation is critical. If continuity is substantially disrupted, or if the first government is seen to be nothing but a creature of Beijing, the prospect is likely to have an untoward effect on Hong Kong's economy. The question is: will Zhao Ziyang's dictum, "No country can put prosperity ahead of sovereignty,"¹⁰⁶ again be invoked?

Final Drafting of the Basic Law. The manner in which Beijing finally drafts the Basic Law and its degree of responsiveness to public opinion may yet vary. Issues yet to be satisfactorily resolved include the interpretation of the Basic Law, the power to nullify Hong Kong SAR laws and the application of PRC laws (including provisions of the PRC Constitution). Resolution of these points will have a profound impact on the Hong Kong SAR's autonomy, and thus its economy.¹⁰⁷

C. Events and Conditions External to Hong Kong

Status as a Trading Partner. Hong Kong needs membership or participatory rights in international trade and other organs and multilateral agreements. The cornerstone of Hong Kong's external trade relations is GATT.¹⁰⁸ It remains to be seen whether all measures to carry such rights over to the Hong Kong SAR will succeed.

*Recognition of Hong Kong SAR Travel Documents.*¹⁰⁹ What is popularly called "a fire-exit" is necessary to encourage people to stay in Hong Kong or to return after acquiring rights of residence abroad.¹¹⁰

105. Advocates of a "through train" believe that the legislature should be wholly elected by June 30, 1997 and that only a nominal reappointment of members to the new SAR legislature should be made. This method, it is argued, is the least disruptive. There are others who argue that "the realization of sovereignty" would require a disbandment and what would amount to a vetting of candidates for the new SAR legislature.

106. THE FUTURE OF HONG KONG, *supra* note 33, at 9.

107. Another issue which will have an impact on Hong Kong's position as an international center is the question of the language of the law. The importance of having an authentic English language version of the Basic Law cannot be over-emphasized. For the author's views on the subject, see FAR E. ECON. REV., Feb. 16, 1988, at 34.

108. See *supra* text accompanying notes 78-80. See also Dicks, *Treaty, Grant, Usage or Sufferance*, 95 CHINA Q. 439 (1983).

109. See the Exchange of Memoranda accompanying the Joint Declaration, *supra* note 1, for the status of British Dependent Territories Citizens (BDTC) and the PRC's stance which permits Chinese nationals in Hong Kong who were previously called BDTC to use "travel documents" issued by the Government of the U.K.

110. The Governor has recognized this concern of Hong Kong citizens. See Address by Governor Sir David Wilson, *supra* note 88, at 64-65.

The Attitude of the PRC Towards Taiwan and Vice Versa. The concept of "one country, two systems" was originally intended to be a model for Taiwan.¹¹¹ The first question here is: will the PRC change any of its policies towards Hong Kong once it is clearly perceived that the model is not acceptable to Taiwan? The second question is: what impact on the Hong Kong economy will result if Taiwan changes its investment or other policies regarding Hong Kong? The third question is: what effect will a more open Taiwan have on Hong Kong and the PRC following the recent reforms including the relaxation of travel and other restrictions in Taiwan?

There are other important factors that operate independently, or partly as cause and partly as effect (for example, the pattern of the investment, including fixed capital formation, in Hong Kong and the performance of various sectors of the economy). From these various factors it is possible to discern in which areas the concept of "one country, two systems" may lack credibility and to find ways and means of making good the deficiency insofar as shall prove practical. Whether or not this "tale of two systems" will have a happy ending will depend on how these factors take shape in a future that is already very much upon us.

CONCLUSION

Cause for cautious optimism remains if two recent clues as to current PRC policy are borne out by actual events. The first relates to the Seventh National People's Congress, which is still in progress as of this writing. So far, the signs are that the reformist line is being reaffirmed, with a new accent on "ideological liberation."¹¹² The second clue concerns the reassurances given by then acting Prime Minister Li Peng on April 5, 1988, that the PRC will fully implement the promise of "*Gangren zhigang*,"¹¹³ a phrase which PRC leaders had not used for some time. There appears to be a recognition that a problem of credibility does exist. Whether the PRC will follow up on this apparent recognition with concrete action remains to be seen. It is hoped that a collaborative effort will be made by all who have a stake in or who are otherwise concerned about Hong Kong's future to carry the dynamism and imaginative thrust contained in "one country, two systems" through to a successful conclusion.

111. See Wu, *Can the Hong Kong Settlement Serve as a Model for Taiwan?*, in *THE FUTURE OF HONG KONG*, *supra* note 33, at 155.

112. Delfs, *With Cat-like Tread*, *FAR E. ECON. REV.*, Mar. 24, 1988, at 49.

113. Yeung, *Change of Tactics in the Confidence Stakes*, *S. China Morn. Post*, Apr. 7, 1988, at 17, col. 1.

