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Hong Kong: Prospects of Autonomy under Chinese Rule after 1997

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Hong Kong: Prospects of Autonomy under Chinese Rule after 1997

I. INTRODUCTION

One of the more notable achievements of the British empire was the creation of a capitalist enclave at the doorstep of a Communist Giant. In the roughly 150 years that the British have occupied Hong Kong, they have transformed this desolate rock¹ off the southeastern coast of China into "Asia's finest example of free trade and capitalism."² Today, Hong Kong is the world's third largest banking center behind New York and London³ and the world's busiest container port.⁴

1. W. BEAZER, *THE COMMERCIAL FUTURE OF HONG KONG* 1 (1978) [hereinafter BEAZER]. Other than its superb, sheltered natural harbor, perhaps the best on the coast of China, Hong Kong has virtually no natural resources. *Id.*

2. Current Development, *Hong Kong: China's June 4 Massacre, Emigration and Capital Flight*, 3 *GEO. IMMIGR. L.J.* 293, 293 (1989) [hereinafter Current Development].

3. King, *The Trade Situation for 1997 and Beyond*, 99 *L.A. Daily J.*, Sept. 29, 1986, at S12, col. 1.

4. *Second World Container Congress Opens in Hong Kong*, *XINHUA GEN. OVERSEAS NEWS SERVICE*, May 13, 1989. In 1988, the Hong Kong container port handled over four million teus (twenty-foot equivalent units), an increase of 23% over 1987. The Hong Kong Marine Department estimates Hong Kong has replaced Rotterdam as the number one container port in the world. *Id.*

Hong Kong's jeweled economy stands to lose its luster in 1997 when China reclaims⁵ sovereignty over the colony.⁶ Two decades of debate between Great Britain and China culminated with the Sino-British Joint Declaration,⁷ guaranteeing Hong Kong a "high degree of autonomy"⁸ after its return.⁹ Despite this guarantee, many Hong Kong residents are concerned that China will fail to uphold the Declaration and are divesting their resources and emigrating to safer havens abroad.¹⁰ China's June 4, 1989 crackdown of the student democracy movement¹¹ at Tiananmen Square aggravates Hong Kong's concerns that the Declaration's guarantees are empty promises.¹²

Within the last decade, China has addressed some of Hong Kong's concerns and has taken bold measures to invigorate a domestic economy left stagnant by Mao Zedong. China has attempted to decentralize its economy and has delineated certain regions as Special Economic Zones¹³ to attract foreign investors. These zones offer investors free enterprise, preferential tax treatment, and cheap and

5. See, e.g., Corwin, *China's Choices: The 1984 Sino-British Joint Declaration and Its Aftermath*, 19 L. & POL'Y INT'L BUS. 505, 510-19 (1987) [hereinafter Corwin]; P. WESLEY SMITH, *UNEQUAL TREATY 1989-1997: CHINA, GREAT BRITAIN AND HONG KONG'S NEW TERRITORIES*, 162-63, 167-68, 185-87 (1980); Day, *The Recovery of Hong Kong by the People's Republic of China - A Fifty Year Experiment in Capitalism and Freedom*, 11 SYRACUSE J. INT'L L. & COM. L. 625, 632-33 (1984) [hereinafter Day] (all discussing China's longstanding position that it never surrendered sovereignty over Hong Kong). See Mushkat, *The International Legal Status of Hong Kong Under Post-Transitional Rule*, 10 HOUS. J. INT'L L. 1, 2 (1987). Though the British occupy Hong Kong, China has consistently maintained that Hong Kong always has remained a Chinese territory. *Id.* China's position is that the acquisition of Hong Kong was through the use of force and as such was illegal under international law. *Id.*

6. See Current Development, *supra* note 2, at 293; Day, *supra* note 5, at 629; Cheng, *An Economic Analysis of Capital Flight in Hong Kong*, 17 INT'L L. & POL. 683 (1985) [hereinafter Cheng].

7. Joint Declaration on the Question of Hong Kong, ¶ 3(2), Dec. 19, 1984, United Kingdom - People's Republic of China, 1984 Gr. Brit. T.S. No. 20 (Cmd. 9352), *reprinted in Sino-British Agreement Determines Future of Hong Kong*, 7 LOY. L.A. INT'L & COMP. L.J. 139, 142-43 (1984) [hereinafter Joint Declaration].

8. *Id.*

9. *Id.*

10. See generally Current Development, *supra* note 2, at 293 (discussing potential problems of the Declaration and Hong Kong's emigration and capital flight).

11. For detailed reports concerning the Chinese student democracy movement, see Wash. Post, May 19, 1989 - July 1, 1989; N.Y. Times, May 19, 1989 - July 1, 1989; TIME, May 29, 1989, June 5, 1989, June 12, 1989; NEWSWEEK, May 29, 1989, June 5, 1989, June 12, 1989. See also Current Development, *supra* note 2, at 300 n.66.

12. Current Development, *supra* note 2, at 300-01.

13. See H. HARDING, *CHINA'S SECOND REVOLUTION* 164 (1987) [hereinafter HARDING]. China selected several areas along the South East coast—as "Special Economic Zones" [SEZs]. These SEZs are similar to the free export-processing zones established in Taiwan, South Korea, and other developing countries in the 1960s and 1970s. The SEZs encourage foreign investment in export projects by providing a modern physical infrastructure, a well-trained labor force, preferential tax rates, exemptions, and holidays. *Id.*

efficient labor.¹⁴ These measures modernizing the mainland's economy give Hong Kong brighter prospects of remaining autonomous and reassure the colony that its economic and social stability should remain undisturbed.

Part One of this article traces Hong Kong's development as an industrial colony, comparing Hong Kong's success with China's development during the same period. The scope of the Declaration, some of the Declaration's potential problems, and Hong Kong's concern over its future are addressed in Part Two. By analyzing Hong Kong's important role in China's efforts to modernize its economy, the last section explores the likelihood that China will uphold the spirit of the Declaration. The paper concludes that Hong Kong's vital role in China's economic development ensures the colony continued autonomy and prosperity.

II. HISTORY OF HONG KONG

A. Pre-Colonial Hong Kong

Hong Kong's history is, in large measure, a story of commercial development.¹⁵ The territory began as a sparsely populated island, with pirates using it mainly as an anchorage.¹⁶ In the early 1800s, the expanding British Empire sailed to the Far East, seeking Chinese silk and tea.¹⁷ The British amassed a substantial trade deficit with China and, in an effort to balance that deficit, introduced opium to the Chinese.¹⁸ Futile efforts by Chinese authorities to ban the illegal

14. See *infra* notes 260-83 and accompanying text discussing China's Special Economic Zones.

15. See generally HONG KONG: THE INDUSTRIAL COLONY (K. Hopkins ed. 1971); J. ENGLAND & J. REAR, INDUSTRIAL RELATIONS & LAW IN HONG KONG (1981); A. RABUSHKA, HONG KONG: A STUDY IN ECONOMIC FREEDOM (1979) [hereinafter RABUSHKA, ECONOMIC FREEDOM]; CHINA AND HONG KONG: THE ECONOMIC NEXUS (A. Youngson ed. 1983); BEAZER, *supra* note 1 (all discussing Hong Kong's economic development into an industrial colony).

16. Day, *supra* note 5, at 629.

17. Tso, *The Legal Implications of the Sino-British Treaties Regarding Hong Kong*, 4 LOY. L.A. INT'L & COMP. L.J. 111, 111 (1981) [hereinafter Tso].

18. *Id.* See G. ENDACOTT, A HISTORY OF HONG KONG 10 (2d ed. 1973) [hereinafter ENDACOTT]. Opium was used as a medicinal drug in China since the T'ang Dynasty. But the practice of smoking opium was a more recent phenomena, and from its introduction in the seventeenth century, it gradually became a serious problem. The British imported opium mainly from India and brought one million British pounds in annual revenue to the Indian Government. *Id.*

import of opium¹⁹ ended when China seized shipments in Canton.²⁰ China's assault on the illegal drug trade infuriated the British and ignited the Opium War.²¹ The Chinese proved no match for the British Navy. Defeated and forced into signing the Treaty of Nanking,²² China ceded Hong Kong Island to Great Britain in perpetuity.²³ Over the next fifty years, Britain also seized Kowloon Peninsular and Stonecutters Island,²⁴ and leased the New Territories for ninety-nine years.²⁵

B. Hong Kong: A British Entrepot

1. Pre-1900 Economy

Britain's commercial empire required a mercantile station in the Far East to suppress robbery and piracy, guarantee contract law,

19. ENDACOTT, *supra* note 18, at 11. In the eighteenth century, the Chinese government passed edicts against the smoking of opium and prohibited its importation. The Chinese took the view that opium was harmful and should be suppressed, that foreigners coming to China should obey Chinese laws, and that foreigners should not import drugs which destroyed men and which hurt the Chinese economy. However, China was powerless to stop the traffic; the local officials found it profitable to turn a blind eye on the trade. Not surprisingly, many officials defied the opium edicts. *Id.*

20. *Id.* at 12. Lin Tse-hsu, a special Imperial Commissioner for the suppression of the opium trade, arrived in Canton on March 10, 1839. He ordered all foreign merchants to surrender the opium in their possession and sign a bond prohibiting future opium importation on penalty of death. He seized several factories in Canton and other outposts and held Europeans hostage to enforce the orders. *Id.*

21. *Id.* at 14-35. The Opium War (1839-42) arose as a result of the Chinese attempt to control and stamp out the illicit trade in opium. *Id.*

22. Treaty of Nanking, Aug. 29, 1842, China-Great Britain, 30 B.S.P. 10, *reprinted in* 6 HERTSLER'S COMM. TR. 221 (effective July 17, 1843).

23. *Id.*

24. Convention of Peking, Oct. 12, 1860, China-Great Britain, 50 B.S.P. 10, *reprinted in* 11 HERTSLER'S COMM. TR. 112. The British negotiated a perpetual lease on these two territories. *Id.*

25. Convention Respecting an Extension of Hong Kong Territory, June 9, 1898, China-Great Britain, 90 B.S.P. 17, *reprinted in* 21 HERTSLER'S COMM. TR. 291 (effective Aug. 6, 1898). Great Britain acquired the New Territories as a Crown Lease. The British practice in treaty ports was to compensate the Chinese for their concession by paying an annual ground rent equivalent to the pre-existing land tax. The British Consul meanwhile bought out private Chinese rural owners at the market price, and then granted Crown leases for 999 years at the same ground rent that was being passed on to the Chinese government. The Chinese authorities did not challenge this practice. However, when the lease of Wei-hai-wei was granted to Britain in 1898, Peking protested, stating that a 999 year lease amounted to an alienation of more than what Britain "owned." Britain heeded Peking's objection. Peking's protest may have had some bearing on the decision to restrict Crown leases in the New Territories to the term of Britain's tenure to 99 years. Duncanson, *The Anglo-Chinese Negotiations*, in HONG KONG: A CHINESE AND INTERNATIONAL CONCERN 27 (J. Domes & Y. Shaw eds. 1988) [hereinafter Duncanson].

and provide safe trading conditions.²⁶ The British declared Hong Kong a free port and developed the colony into an entrepot²⁷ for British commerce.²⁸ Hong Kong's early industries involved shipbuilding and repairing to support the colony's seafaring trade.²⁹ In time, as Hong Kong became the headquarters for major British merchant houses,³⁰ the ancillary industries of banking, insurance, accounting, and legal services developed.³¹

2. 1900 - World War II Economy

In the early decades of the twentieth century, a substantial number of small factories opened to meet the demands of foreign markets. These demands arose because World War I cut off foreign markets from overseas suppliers and the Ottawa Agreement of 1932³² encouraged local merchants to export their goods to Commonwealth nations.³³ The rise in exports brought a commensurate development in Hong Kong's shipping industry.³⁴

3. Post-World War II Economy

The Japanese occupation during World War II decimated Hong Kong's economy.³⁵ Hong Kong's population fell from more than 1.6

26. Day, *supra* note 5, at 629.

27. See T. GEIGER, *TALES OF TWO CITY-STATES: THE DEVELOPMENT PROGRESS OF HONG KONG AND SINGAPORE* 7 (1973) [hereinafter GEIGER] (explaining the functions of an entrepot). An entrepot is an economic center which is usually a port. It carries on certain essential distribution, financial, communication, and transportation functions. The entrepot collects goods and products from the hinterland. By combining, sorting, semi-processing and grading these products, the entrepot is in a position to meet the requirements of foreign buyers. It also maintains a continuous inventory of manufactured goods and raw materials ready for re-export to the hinterland. *Id.*

28. BEAZER, *supra* note 1, at 2. Lord Pottinger, Hong Kong's first Governor, set the standard and style for future Governors. *Id.* at 22. He kept the colony a free port and moved the Superintendency of Trade from Macao to Hong Kong. *Id.* at 21. Lord Pottinger resisted incursions by the army and navy as he wanted Hong Kong to be a commercial port. *Id.* at 35.

29. RABUSHKA, *ECONOMIC FREEDOM*, *supra* note 15, at 16.

30. *Id.*

31. *Id.*

32. See GEIGER, *supra* note 27, at 70 (discussing the rise of Hong Kong's export industry). The Ottawa Agreement provided preferential tariff treatment to Commonwealth countries. Hong Kong's status as a Crown colony and the United Kingdom's long-standing ties to Hong Kong's merchant houses entitled Hong Kong to the Commonwealth tariff preferences under the 1932 Agreement. *Id.*

33. Brown, *The Hong Kong Economy: Achievements and Prospects*, in *HONG KONG: THE INDUSTRIAL COLONY* 1 (K. Hopkins ed. 1971) [hereinafter Brown].

34. *Id.*

35. *Id.* at 1-2.

million in mid-1939 to less than 600,000 in mid-1945.³⁶ Many of the remaining inhabitants were impoverished and unskilled.³⁷ The entrepreneurs, technicians, and skilled workers essential to the entrepot economy either had died or fled the territory.³⁸ More significantly, the War devalued the colony's currency, froze all bank accounts and financial assets, and evaporated internal and external credit lines, completely disrupting Hong Kong's network of external economic relationships.³⁹ Neither the Chinese commodities which Hong Kong exported nor the raw materials and manufactured goods the colony imported to re-export to China were available under the conditions prevailing when the Japanese surrendered.⁴⁰

C. Hong Kong: The Industrial Colony

1. Hong Kong's Industrial Revolution

Immediately after World War II, local residents returned to their entrepot industry and reestablished Hong Kong's economy.⁴¹ The surviving colonial government improvised a functional administration,⁴² and the few businessmen and bankers who remained during the War resumed their operations in makeshift quarters.⁴³ By promptly restoring Hong Kong's currency and credit, the business community enabled the colony's money supply and bank deposits to flourish.⁴⁴ Ample funds became available to support Hong Kong's rise as an industrial colony.⁴⁵

While Hong Kong's economy revived itself in the post-World War II period, China locked itself in an internal struggle between two political factions, the Kuomintang and the Communists, which cul-

36. GEIGER, *supra* note 27, at 65. War deaths, mass deportations by the Japanese, and flights to native towns and villages in Guangdong contributed to this decline. *Id.*

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.*

41. GEIGER, *supra* note 27, at 65. Restoration of Hong Kong's entrepot activities required reestablishing business firms and banks and their relationships with foreign suppliers and customers. The British and Chinese-owned merchant houses, insurance companies, shipping firms, and banks rapidly rebuilt such ties not only in East and Southeast Asia and in the United Kingdom, but also in Australia, the United States, and Canada, whose economies were undamaged by the war and rapidly were being reconverted to civilian production. *Id.* at 66.

42. *Id.* at 65.

43. *Id.*

44. *Id.* at 69.

45. *Id.*

minated in civil war. The strife of another war in China sent refugees into Hong Kong, doubling the colony's population.⁴⁶ Refugees from Shanghai, fearing a Communist takeover, relocated their capital in Hong Kong, where both the refugees and their money were safe.⁴⁷

2. *Developing an Export Economy*

Shanghai capital was used to develop Hong Kong's textile industry⁴⁸ and sparked a tremendous growth in the manufacturing sector.⁴⁹ The colony's focus on exports largely contributed to the manufacturing sector's phenomenal development.⁵⁰ Exports of manufactures offered more promising growth than primary products, the major export items of Southeast Asian countries.⁵¹ Moreover, by specializing in manufacturing, Hong Kong enterprises were able to overcome the disadvantages of researching, designing, and marketing a product overseas.⁵² Under this framework of industrialization, Hong Kong

46. Brown, *supra* note 33, at 2. Chinese refugees fled mainly from the Guangdong Province and from Shanghai. From 1950 onwards, immigration from China was subject to restrictions except for one short period. Three more surges occurred in 1951-52, 1957-58, and in 1962, when refugees broke through the land borders. *Id.*

47. *Id.* Before the war, Shanghai was China's industrial center. Chinese entrepreneurs and technicians were engaged mainly in the manufacture of cotton textiles and had developed all stages of production in Shanghai. After the war, Shanghai mill owners placed large orders for spinning, weaving, knitting, and finishing equipment in the United Kingdom and the United States, but, owing to war-shortages in these countries, deliveries began late in 1947. By that time, the threat of a Communist takeover of China was evident, and many Shanghai businessmen off-loaded their new machinery in Hong Kong as a precautionary measure. As Communist armies neared Shanghai, many businessmen and technicians followed their investments to Hong Kong. With the help of bank loans, these businessmen constructed factories to put their equipment into operation. GEIGER, *supra* note 27, at 69. For a more extensive analysis of the rise of capitalism in Shanghai, see P. COBLE, JR., *THE SHANGHAI CAPITALISTS & THE NATIONALIST GOVERNMENT, 1927-1937* (1980).

48. BROWN, *supra* note 33, at 2. See GEIGER, *supra* note 27, at 69 (recounting the textile industry's development in Hong Kong). In 1948, Hong Kong had 8,000 spindles; by the end of 1951, Shanghai refugees built 210,000 spindles and 4,500 power looms and put them into operation. A number of Shanghai businessmen started textile finishing operations and began producing cotton undergarments, mens's shirts, children's clothes, and other apparel. *Id.*

49. BROWN, *supra* note 33, at 2.

50. *Id.* at 3. In recent years, 80% of all manufactures were exported. *Id.*

51. Owen, *Economic Policy in Hong Kong*, in *HONG KONG: THE INDUSTRIAL COLONY* 153 (K. Hopkins ed. 1971). Demand for manufactures tends to rise at least as fast as income in developed countries, whereas demand for primary products tends to lag behind, particularly when primary products compete with synthetic substitutes. *Id.*

52. *Id.* at 154-55. Asian companies were often at a disadvantage in comparison to their rivals in the more developed nations in researching, designing, and marketing a product for overseas consumption because Asian firms were culturally unfamiliar with foreign markets. By concentrating their efforts at manufacturing designs created by European and American firms, Hong Kong's textile industry allayed themselves to, rather than competed with, the managerial skills of more advanced nations and were able to develop rapidly into foreign markets. *Id.*

industries expanded and established themselves in the international market.⁵³

3. *Diversification*

Hong Kong's manufacturing firms grew vertically and horizontally.⁵⁴ Textile, spinning, and weaving companies started clothing subsidiaries;⁵⁵ enterprises assembling radios and other electronic equipment diversified to produce a variety of transistors, diodes, and component parts;⁵⁶ and some companies branched off to manufacture completely different product lines.⁵⁷ This diversification contributed to a substantial rise in industrial output. Between 1950 and 1964, Hong Kong's industrial output rose at an unprecedented rate of 30 percent per year.⁵⁸ Today, more than 50,000 manufacturing firms are established in Hong Kong.⁵⁹

4. *Hong Kong's Present Economy*

Hong Kong stands as one of the top 20 trading countries.⁶⁰ The colony's entrepot history has turned this island into one of the world's more active export⁶¹ and re-export economies.⁶² The colony is a major foreign exchange⁶³ and commodities market,⁶⁴ a commu-

53. *Id.*

54. GEIGER, *supra* note 27, at 65.

55. *Id.*

56. *Id.*

57. *See id.* (illustrating that a successful flashlight company started a toy factory; a toothbrush manufacturer became the world's largest producer of medium-priced binoculars and an exporter of low priced cameras to Japan).

58. BROWN, *supra* note 33, at 8.

59. HONG KONG GOV'T, CENSUS & STATISTICS DEP'T, *reprinted in* INDUSTRIAL INVESTMENT HONG KONG: STATISTICAL TABLES 1989, at 10 (1988).

60. Prybyla, *The Hong Kong Agreement and Its Impact on the World Economy*, in HONG KONG: A CHINESE AND INTERNATIONAL CONCERN 167, 170 (J. Domes & Y. Shaw eds. 1988) [hereinafter Prybyla]. In 1982, Hong Kong exported about 99% of its manufactures. The Colony's merchandise trade with the outside world was 182% of its Gross Domestic Product. Its exports equaled that of China, a country with 200 times more people and 9,600 times more land. *Id.*

61. *See id.* Hong Kong is the world's largest exporter of garments, plastic toys, and watches. *Id.* Further, Hong Kong is a large exporter of a variety of other products, including: radios, cassette recorders, computer memory systems, calculators, transistors, semi-conductors, television games, photographic equipment, textile yarns, fabrics, electric household goods, clothing, floor tiles, and travel goods. *Id.*

62. *Id.* Among the products Hong Kong re-exports are: textiles, clothing, precious stones, watches, clocks, and electric machinery. *Id.*

63. *Id.*

64. Jao, *Hong Kong's Future as a Free Market Economy*, in HONG KONG: A CHINESE AND INTERNATIONAL CONCERN 205 (J. Domes & Y. Shaw eds. 1988) [hereinafter Jao, *Free Market Economy*]. Hong Kong is Asia's leading center and one of the world's larger gold markets. *Id.* Hong Kong is the world's third largest gold and diamond trading center. *Id.*

nications center serving Southeast Asia,⁶⁵ and an important financial center.⁶⁶ Because of Hong Kong's central location and state of the art facilities,⁶⁷ a large number of multinational enterprises have established their headquarters in the colony.⁶⁸ Both businessmen and visitors are attracted to this crown colony.⁶⁹

III. CHINA'S ECONOMIC HISTORY— A COMPARISON WITH HONG KONG

China's history traces back 4,000 years and recounts the world's oldest continuing civilization.⁷⁰ To appreciate China's past and to predict its future, one must be mindful of the Confucian canons upon which the Chinese structured their political, economic, and social systems. Confucianism prescribed a social hierarchy based on family relations.⁷¹ Its teachings, however, spread far beyond the family and permeated the country's legal,⁷² political,⁷³ and educational institutions.⁷⁴ Confucianism also molded the Chinese perception of the world order, placing China at the center of the universe.⁷⁵ Locked

65. Prybyla, *supra* note 60, at 170.

66. *Id.*

67. See Fishburne, *Hong Kong 1997: Practical Aspects*, 20 CASE W. RES. J. INT'L L. 43, 44 (1988) [hereinafter Fishburne]. Many office buildings exist and more are being built. Acceptable expatriate housing is in place. World class hotels are available for business travellers. Communications, data processing, and related equipment and services from across the world are available in Hong Kong. *Id.*

68. Prybyla, *supra* note 60, at 171. These organizations include 800 American corporations with offices, factories, or joint ventures within the region. *Id.*

69. *Id.* Hong Kong is a spectacular tourist city. In 1984, Hong Kong attracted 3.2 million visitors from around the world. 20% were from the United States and an additional 20% from Japan. *Id.*

70. J. MELBY, *THE MANDATE OF HEAVEN 3* (1968) [hereinafter MELBY]. Archeological studies may date China's origins back even earlier. *Id.*

71. J. SHERIDAN, *CHINA IN DISINTEGRATION: THE REPUBLICAN ERA IN CHINESE HISTORY, 1912-1949*, at 16 (1975). Central to Confucian thought is the patriarchal family system in which status was determined by age, sex, and generation; elders dominated younger, and male dominated female. Filial piety was the chief virtue, but all other obligations of superiority and subordination inherent in the family hierarchy—such as those between older and younger brothers and between generations—were also strictly observed. *Id.*

72. See *id.* Chinese law, for example, reinforced the Confucian tenets of family relationships and discriminated according to Confucian notions of age, generation, and sex. *Id.*

73. See H. QUIGLEY, *CHINA'S POLITICS IN PERSPECTIVE 4* (1962). Confucianism justified the patriarchy between the emperor and the subject. The country may be analogized to a large family—with the emperor as the father and the Chinese people as his children. In this regard, all subjects had a filial duty to serve the emperor. *Id.*

74. See MELBY, *supra* note 70, at 4. The Chinese educational system centered around the Confucian books. Chinese scholars studied years to memorize these books before taking the Imperial Exams to qualify for civil service. *Id.*

75. The Chinese name for China is "Zhong Guo," literally translated as "Middle Kingdom".

in a sense of self-assured cultural superiority,⁷⁶ the Chinese were content to live in isolation, believing that the outside world had nothing to offer them.⁷⁷ By emphasizing self-reliance, Confucianism bred discontentment over foreign intrusion⁷⁸ and exacted heavy tolls upon those reasserting the country's autonomy.⁷⁹

A. China's Traditional Economy

China's economic development traced a path opposite that of Hong Kong. The Chinese emphasized subsistence and grounded their economy in agriculture.⁸⁰ Human effort, animal power, and natural fertilizers cultivated the farmlands.⁸¹ Although floods, droughts, and plagues frequently devastated harvests,⁸² China's traditional farmers fed a Chinese population that doubled in size between 1750 and 1850, reaching 400 million people.⁸³

76. MELBY, *supra* note 70, at 3. Although China isolated itself from the world during much of its recorded history, at no time was China's interior in close contact with any other culture even remotely equal to its own. The occasional invasions by nomads from the north and west whose military strength forced their way into the interior invariably were absorbed by the Chinese culture and vanished with little trace. To the Chinese, this proved their innate superiority to all other peoples, a belief strongly ingrained even today. *Id.*

77. Recent Development, *Current Developments in the People's Republic of China: Has China Changed?*, 1 TRANSNAT'L LAW. 505, 506 (1988) [hereinafter Recent Development]. See R. NORTH, CHINESE COMMUNISM 10 (1966). China's isolationism is often illustrated by a tale wherein a Chinese emperor told King George's envoy "as your Ambassador can see for himself, we possess all things. I set no value on objects strange or ingenious, and have no use for your countries' manufactures." *Id.*

78. MELBY, *supra* note 70, at 5. The Confucian Doctrine emphasized a system of ordered harmony. The Emperor ruled by the Mandate of Heaven and had certain rights and responsibilities. Each person also had complementary rights and responsibilities. Ordered harmony depended upon acceptance of one's role in the social order; so long as each citizen performed properly, the Emperor retained the Mandate. When any person failed, for whatever reason, the Emperor lost the Mandate, which passed to whomever gave evidence of being able to perform a monarch's role. *Id.* Foreigners, who coerced China into ceding portions of the Middle Kingdom in order to conduct trade, understood and accepted little of China's cultural practices. By failing to observe their position in the social order, foreigners disrupted China's ordered harmony that invariably led a monarch to his downfall. *Id.*

79. See, e.g., J. ESHERICK, THE ORIGINS OF THE BOXER UPRISING (1987) (discussing the Boxer Movement of the late nineteenth century); S. PEPPER, CIVIL WAR IN CHINA: THE POLITICAL STRUGGLE, 1945-1949 (1978) (recounting the Chinese Civil War). See *infra* notes 88-93 and accompanying text (discussing the Great Leap Forward); see also *infra* notes 94-98 and accompanying text (discussing the Cultural Revolution).

80. HARDING, *supra* note 13, at 13.

81. *Id.*

82. See *id.*

83. *Id.* By expanding the arable farmlands, adding more water, improving the strains of seeds, and growing two or three crops a year, China's rural economy fed a population that doubled in size. But China's agriculture encountered problems of diminishing marginal returns from the traditional technologies employed. New arable land became increasingly scarce, and further inputs of available seed, fertilizer, and labor could not keep up with the demands of the growing population. As per capita incomes fell, poverty and despair in the countryside became widespread. Discontentment fueled the peasant uprisings of the nineteenth century. *Id.* at 14.

B. *China's Rise to Industrialization*

By the mid-nineteenth century, China's traditionalism was helpless against the militarily superior Western nations which forced China to open its economy to those seeking silk, tea, inks, brushes, and porcelain.⁸⁴ China's defeat in the Opium War opened "treaty ports" where foreigners could conduct trade. The humiliation of conceding land to foreign nations convinced some Chinese of the need to industrialize the country to meet the military challenge from the West.⁸⁵

By 1949, China had developed a small industrial base concentrated in Manchuria and Shanghai. The bulk of China's industries involved light manufactures such as textiles, cigarettes, matches, and other consumer goods.⁸⁶ Although confiscatory taxation, foreign invasion, civil war, and inflation intermittently disrupted China's developing economy, China's industrial base provided a rich foundation of raw materials and energy supplies for continued development under the Communist regime.⁸⁷

When Mao Zedong and the Communist Party gained control of the Chinese government in 1949, they implemented an economic policy emphasizing large-scale industry.⁸⁸ The Party selectively incorporated the Marxist economic model⁸⁹ and borrowed heavily from the Soviet Union to industrialize China.⁹⁰ When the Soviets suspended technical aid to China because of ideological differences,⁹¹ the Chinese

84. *Id.* China's unchallenged prestige created an unawareness of the changing relative status of the modern challenge until it appeared at China's doorstep. *THE MODERNIZATION OF CHINA* 514 (G. Rozman ed. 1981).

85. HARDING, *supra* note 13, at 14. China's defeat in the Opium Wars of 1840-42 and 1856-60 convinced Chinese officials and merchants to absorb foreign technology and initiate a program of industrialization. *Id.*

86. *Id.* Foreign owned plants produced one-third of this output. *Id.*

87. *Id.*

88. A. RABUSHKA, *THE NEW CHINA: COMPARATIVE ECONOMIC DEVELOPMENT IN MAINLAND CHINA, TAIWAN, AND HONG KONG* 55 (1987) [hereinafter RABUSHKA, *THE NEW CHINA*].

89. Recent Development, *supra* note 77, at 508. Mao Zedong molded the Marxist economic and political theory into a uniquely Chinese economic system to benefit from certain aspects of the Soviet model and to avoid the problems inhering from the Soviet experience. *Id.*

90. RABUSHKA, *THE NEW CHINA*, *supra* note 88, at 58. By 1955, 156 Soviet-assisted major projects had become the backbone of modern Chinese industry. Together with 143 ancillary projects, these heavy industrial projects absorbed over one-half of all industrial development during the first Five Year Plan. The Soviets supplied between 50% and 70% of all equipment used in these projects. *Id.*

91. See J. CHESNEAUX, *CHINA: THE PEOPLE'S REPUBLIC, 1949-1976*, at 101 (1977). In the summer of 1960, the Soviet Union announced that it was withdrawing its technicians and ending its assistance to China. This withdrawal occurred because of the growing ideological

turned inward and looked to self-sufficiency as the foundation of their economy.⁹² Mao Zedong directed China towards the Great Leap Forward⁹³ and the Cultural Revolution,⁹⁴ isolating the country from the world.⁹⁵ Although these events laid the Chinese economy to waste, an overview of China's industrial development between 1952 and 1978 suggest the Chinese largely met their industrial goals. During those years, the heavy industrial output index increased twenty-eightfold,⁹⁶ in comparison to a sixteenfold increase in the gross industrial output index.⁹⁷ Heavy industry also occupied a greater proportionate share of total Chinese output, rising from 30 percent in 1949 to 72 percent in 1978.⁹⁸

C. China's Centrally Planned Economy

Following the Soviet economic model, Mao's China transferred the means of production from private to public hands.⁹⁹ The Chinese

differences between the two countries; the Chinese denounced the Soviets as revisionists and the Soviets criticized China's Great Leap Forward and people's communes. Additionally, the Soviets failed to support China in two serious international disputes, the Taiwan Straits Affair and the conflict with India after the Tibetan rebellion. The two countries' relationship further deteriorated until the alliance was finally broken. *Id.*

92. RABUSHKA, *THE NEW CHINA*, *supra* note 88, at 58.

93. *See* Day, *supra* note 5, at 640 (discussing the Great Leap Forward, 1958-62). During these years, Mao decentralized industry and placed exacting demands on peasants to support China's modernization. *Id.* The Great Leap Forward produced major economic dislocations, including three years of severe recession during 1959-61, and famine conditions in which 30 million people starved to death. RABUSHKA, *THE NEW CHINA*, *supra* note 88, at 34.

94. *See* HARDING, *supra* note 13, at 12 (examining China's internal struggles from 1966-76, called the Great Proletarian Cultural Revolution). The Cultural Revolution forced the Chinese to adhere to the ideological purity of Marxist-Leninist Communism and to denounce all bourgeois and intelligentsia. The Revolution threw out all Western influences and denounced Western philosophies. During the Revolution, the Party abolished the rule of law, except those edicts the Party issued. *EAST ASIAN EXEC. REP.*, Apr. 15, 1987, at 7.

95. RABUSHKA, *THE NEW CHINA*, *supra* note 88, at 58.

96. *Id.* at 55. The composition of industrial output changed in favor of such heavy industries as engineering and petroleum, which replaced textiles and food processing as the largest contributors to the value of output. *Id.*

97. *Id.*

98. *Id.* Total industrial employment increased from 12.5 million in 1952 to 50 million in 1978; in state-owned industrial enterprises employment rose sixfold from 5.1 million to 30.4 million. In constant inflation-adjusted prices, output per person in state-owned industrial enterprises nearly tripled. The ratio of capital employed per worker in state-owned enterprises rose fivefold, from 2,102 yuan per worker to 10,464 yuan. Overall, the estimated injections of new capital contributed about three-quarters, and additional labor about one-quarter, to the growth of industrial output. *Id.*

99. *Id.* at 57. State commercial enterprises took over wholesale and retail distribution from private firms. In early 1952, the government fiercely attacked domestic capitalists, accusing them of tax evasion, bribery, theft of state property, cheating on government contracts, and stealing state information for private speculation. Within four years, the state replaced the private sector and directly produced 68% of output. Private commerce declined from 85% of retail sales in 1950 to less than three percent in 1957. *Id.*

government distributed goods and allocated the country's investment and labor resources.¹⁰⁰ The government dictated procurement quotas and set rigid prices on all major goods.¹⁰¹ This bureaucratic system created a number of institutional deficiencies, including: (1) inability to respond to consumer demands, producing surpluses of unwanted goods and shortages of highly desired goods;¹⁰² (2) difficulties in collecting and coordinating required information;¹⁰³ (3) an absence of labor markets;¹⁰⁴ (4) low incentives;¹⁰⁵ (5) lack of entrepreneurship;¹⁰⁶ (6) misallocation of resources;¹⁰⁷ and (7) political interference in economic tasks.¹⁰⁸

D. Industrial Reforms

Upon Mao's death in 1976, a more pragmatic leadership took control of the Chinese Communist Party.¹⁰⁹ The inefficiencies of the

100. See Guoguang & Ruisan, *Restructuring of the Economy*, in CHINA'S SOCIALIST MODERNIZATION 87, 89 (Y. Guangyuan ed. 1984), stating that all enterprises had to "seek approval for doing everything, big and small, from the higher departments which were divorced from the front line of production, had no responsibility for the results of the operations of the enterprises and often gave impractical and disconnected mandatory directives." *Id.*

101. HARDING, *supra* note 13, at 15. The Chinese system identified a level of production rather than a certain quality of product or an efficient level of production. *Id.*

102. See RABUSHKA, *THE NEW CHINA*, *supra* note 88, at 30. The planners' unwillingness to free prices created a limited private economy. *Id.*

103. See *id.* at 32. Information requirements in a planned economy are daunting. Production, collection, analysis, and transmission of economic statistics accompany a huge statistical, ministerial, and planning apparatus. Millions of prices must be set and adjusted. These adjustments are often late, infrequent, or unrelated to the realities of production. Individuals face incentives to misreport statistics to claim above-target production, causing planners to set even higher targets in subsequent years. *Id.*

104. See *id.* at 30.

105. See *id.* at 33. The state assigned workers to enterprises regardless of whether they desired the post or had suitable skills. More desirable jobs often were assigned as compensation for favors or as a form of bribery or corruption. Once assigned, workers could not be discharged for incompetence and received equal pay no matter how hard they worked. Bonuses, overtime, and piecework were curtailed or abolished. *Id.*

106. See *id.* Factory managers faced many disincentives in streamlining efficiency, promoting industrial safety, and improving product quality. The Chinese rejected as "elitist" sound business practices such as labor discipline, prevention of absenteeism, attention to quality, and industrial safety. No managerial efforts were rewarded with higher salaries. The State further required all enterprises to surrender their receipts, limiting managerial choice. *Id.*

107. See RABUSHKA, *THE NEW CHINA*, *supra* note 88, at 33. Factory managers had no incentive to economize on the use of capital because planners provided them on a cost-free basis. Because of this, factory managers requested more capital than could be used efficiently, in the event that fewer capital inputs were provided than requested. *Id.*

108. See *id.* at 30.

109. HARDING, *supra* note 13, at 40. When Mao died, three factions vied for control over the Chinese Government. One group, Jiang Qing, fought to preserve the spirit of the Cultural Revolution; another, led by Hua Guofeng, wished to restore the political and economic institutions of the 1950s while still remaining loyal to Mao; the third, Deng Xiaoping's

Soviet economic model required readjustments of the economy and decentralized administrative control.¹¹⁰ The State permitted the development of locally owned collective enterprises and individual enterprises with private capital,¹¹¹ reduced the number of cadres in factory leadership positions,¹¹² expanded enterprise autonomy,¹¹³ eliminated losses at state-operated enterprises,¹¹⁴ and eliminated working capital as grants from the state budget.¹¹⁵ These changes in the Chinese economy allowed experimental enterprises to increase their output fifteen percent from 1978 to 1979 and increase general profits thirty-three percent.¹¹⁶ By 1985, although state ownership and planning still dominated the economy, private ownership and economic activity

followers, argued to modernize China's economy. Within a month of Mao's death, Hua Guofeng ousted the leftists and took control of the Chinese Government. But Hua faced many hurdles in reviving a sluggish economy decimated by the Cultural Revolution and failed to alleviate the confidence crisis plaguing urban China. These failures shifted Chinese politics to the rightist reformers, led by Deng Xiaoping. *Id.*

110. RABUSHKA, *THE NEW CHINA*, *supra* note 88, at 78. The Third Plenum of the 11th Central Committee of the Chinese Communist Party called for "readjusting, restructuring, consolidating, and improving the economy." *Id.* at 79. Since then, China has undertaken a variety of experiments and reforms in industrial enterprises. The innovations started on a small scale, primarily in Sichuan Province, and spread throughout the country. These reforms included campaigns to eliminate losses in state-owned enterprises, substitution of income taxes for the remission of profits to the state, and expanding local managerial decision-making authority. *Id.*

111. *Id.* at 81. Between 1978 and 1980, the number of private enterprises increased from 150,000 to 400,000. Other new economic institutions included joint state-private enterprises allowing shareholders to receive dividends from profits and producer's cooperatives where private parties pooled their capital to establish an enterprise. *Id.*

112. *Id.* The State authorized enterprises to train and test for enterprise managers. *Id.*

113. *Id.* Experimental enterprises were allowed: (1) to produce and market additional merchandise in response to market demand after meeting a government specified output target; (2) to sell its above-target output and any new products it developed; (3) to retain three to five percent of the profits made according to the state plan, as well as an additional 15% to 20% of profits from above-plan sales; (4) to retain 60% of depreciation funds for technical renovation and innovation; (5) to pay its workers and staff a production bonus of 17% of standard total wages; (6) to appoint middle management without interference from higher state bodies; and (7) to be charged at zero interest on working capital for quota sales and at low rates for above-quota production, but at high rates to finance excess inventory. *Id.* at 79.

114. *Id.* at 81. This allowed state enterprises to fire managers who failed to meet production targets and substitute income taxes for remission of profit to the state. *Id.* The Head of the State Economic Commission announced the cancellation of subsidies to unprofitable state enterprises. To ensure factory efficiency, the State adopted measures to crack the "iron rice bowl"—a practice that guaranteed employment regardless of the employee's productivity. The State authorized managers to sign contracts with new workers linking pay with performance, and to dismiss unproductive staff. Wren, *China Seeks to Cut Redundant Labor*, N.Y. Times, Jan. 2, 1983, at A3, col. 1.

115. RABUSHKA, *THE NEW CHINA*, *supra* note 88, at 81.

116. *Id.* at 79 (stating that the figures for non-reform enterprises were three and seven percent). Based upon the encouraging performances of these experimental enterprises, the State Council authorized an additional 4,000 enterprises in 1980. By June 1980, 6,600 experimental enterprises existed, nearly 16 of the total enterprises. *Id.* This growing fraction produced 60% of the total value of output and earned 70% of the total profits. *Id.*

occupied a greater proportion of the Chinese economy.¹¹⁷

E. The Results of China's Industrial Reforms

The new economic policies shift China's economy away from central planning towards a greater reliance upon market forces. These policies do not signal a new wave of capitalism in China; they reflect the compromise that regulation through market forces is compatible with socialist public ownership.¹¹⁸ Unfortunately, these reforms fall far short of their announcements.¹¹⁹ China remains far from a truly competitive, private-enterprise economy; managers at state-owned enterprises do not enjoy the autonomy they were promised. The Government still restricts free entry into and exit out of markets, free purchasing and marketing of all commodities, and flexibility to vary prices.¹²⁰ Despite their shortcomings, China's reforms liberated factory managers from a regime of mandatory central planning and permitted a system of non-binding instructive planning to prevail.¹²¹

IV. REASSERTION OF CHINESE SOVEREIGNTY OVER HONG KONG

Because of Hong Kong's and China's divergent economic practices, Hong Kong residents and business community grow more anxious over the colony's future as July 1, 1997 approaches.¹²² For awhile, many in Hong Kong were hoping China would extend the British

117. *Id.* In 1985, state-owned enterprises accounted for 70% of gross urban industrial output, collectively owned enterprises accounted for about 28%, and private enterprises accounted for less than one percent. *Id.* Though still a small fraction of the Chinese economy, private businesses produced a growing proportion of the total yuan value of retail sales, jumping from 210 million yuan to 66.1 billion yuan between 1978-85. *Id.*

118. *Id.* at 82. To assist the process of socialist modernization, Chinese officials recently encouraged full enterprise autonomy, including: incentives to increase labor productivity, reduced planning, a rational price system, reform of the tax, financial, and banking systems, competition, consumer sovereignty in the marketplace, the rule of law, eliminating bureaucracy and overstaffing, wage differentials to reflect differences in skill, acceptance of unequal distribution of income, the expansion of the place of the individual economy, contracting out the work of state-owned enterprises to individuals and small-scale collectives, opening of China to foreign investment, and replacement of old party comrades with young professionals. *Id.* at 83.

119. *Id.* at 84. Although the reform measures significantly altered the structure of industrial operations, industrial efficiency lagged. Between 1978-82, for example, a 37% increase in fixed assets, an 18% increase in working capital, and a 16% increase in workers and employees were required to expand output by 26%. The productivity of fixed and working capital continued their downward trend, although labor productivity showed a modest gain. *Id.*

120. RABUSHKA, *THE NEW CHINA*, *supra* note 88, at 88.

121. *Id.*

122. *See infra* notes 179-230 and accompanying text concerning Hong Kong's fears over reunification with China and the colony's response, including capital flight and emigration.

lease on the New Territories for another ninety-nine years,¹²³ but that dream faded when China demanded the return of the New Territories.¹²⁴

A. The Chinese Position Regarding Hong Kong

From the Chinese historical perspective, the British extorted Hong Kong Island and Kowloon through the "Unequal Treaties,"¹²⁵ when China was incapable of defending itself.¹²⁶ Believing itself coerced into these agreements, China denounces their validity.¹²⁷ Although the British have de facto control over Hong Kong,¹²⁸ the Chinese reject any British claim of permanent possession, let alone a claim of sovereignty, over the colony.¹²⁹ Moreover, the Chinese refuse to surrender any portion of their country, especially if its society and culture still recognizably belongs to Chinese civilization.¹³⁰

123. See *Editorial*, BUS. WEEK, Mar. 5, 1984, at 112. No matter how remote the possibility, some writers suggested that China sign a new lease agreement, or simply ignore the expiration date, on the theory that the agreement is void anyway and conditions are not yet ripe for resolution. Either course would maintain a situation more profitable to China than to Great Britain. *Id.*

124. Park, *British Pressured Over Hong Kong*, Philadelphia Inquirer, Nov. 10, 1983, at 4E, col. 1. China asserted that if no agreement was reached regarding the future of the New Territories upon the expiration of the lease, China would retake control over the region. *Id.*

125. The "Unequal Treaties" refer to the Treaty of Nanking in 1842, the Convention of Peking in 1860, and other treaties that forced China to cede Chinese territory to foreign nations.

126. GEIGER, *supra* note 27, at 133. See also *supra* notes 22-23 and accompanying text (discussing Treaty of Nanking and Convention of Peking).

127. See *infra* notes 243-48 and accompanying text (examining grounds when a treaty is invalid under Chinese law).

128. Although the Chinese do not recognize the British occupation in Hong Kong as lawful, by entering into the Declaration, China is conceding that Britain has de facto control over the colony.

129. Mushkat, *The Transition from British to Chinese Rule in Hong Kong: A Discussion of Salient International Legal Issues*, 14 DEN. J. INT'L L. & POL'Y 171, 178 (1986) [hereinafter Mushkat, *Salient Legal Issues*]. China has made many statements rejecting Britain's claim of sovereignty over Hong Kong. For example, the Chinese ambassador to the United Nations, in an address to the Chairman of the Special Committee on the Independence for Colonial Countries, sought to remove Hong Kong from the list of territories falling within the Committee's terms of reference, stating:

Hong Kong . . . [is] part of Chinese territory occupied by the British . . . authorities. The settlement of the question[] of Hong Kong . . . is entirely within China's sovereign right and does not fall under the ordinary category of colonial territories. . . . With regard to the question[] of Hong Kong . . . the Chinese Government has consistently held that [it] should be settled in an appropriate way when the conditions are ripe. The United Nations has no right to discuss the[] question[].

1 PEOPLE'S CHINA & INTERNATIONAL LAW: A DOCUMENTARY STUDY 384 (J. Cohen & H. Chiu eds. 1974).

130. GEIGER, *supra* note 27, at 133.

B. The British Position Regarding Hong Kong

The United Kingdom regards both the Treaty of Nanking and the Convention of Peking as valid agreements.¹³¹ As such, Kowloon, Stonecutter's Island, and Hong Kong Island belong to the United Kingdom in perpetuity.¹³² However, the British have agreed to return Hong Kong in its entirety when the lease on the New Territories expires.¹³³ At the end of the lease, Hong Kong will lose ninety-two percent of its territory,¹³⁴ and with the loss of territory, a vital section of the economy.¹³⁵ To ensure Hong Kong's thriving economy, the British had virtually no choice but to negotiate a return of the entire colony.¹³⁶

131. Duncanson, *supra* note 25, at 30. The British contend that although coerced treaties have been condemned since the conclusion of the Covenant of the League of Nations, earlier treaties are not thereby invalidated; nearly all treaties result from hard bargaining and contain provisions the signatories would like to avoid; and no case claiming the invalidity of the most notoriously unequal treaty of modern times, the Treaty of Versailles, has ever been brought to the Permanent Court of International Justice. *Id.*

132. GEIGER, *supra* note 27, at 133.

133. Day, *supra* note 5, at 634. By the late 1970s, Hong Kong's investors and residents already were expressing concern over the colony's future. China stood firm on its position that if no agreement was reached, it would retake the New Territories at the expiration of the lease in 1997. With the New Territories severed, the ceded colony would be cut off from its supply line and no longer would be viable. Since no practical way to maintain a divided Hong Kong existed, Britain negotiated an international agreement to return the entire colony. *Id.*

134. See Castle, *The Reversion of Hong Kong to China: Legal and Practical Questions*, 21 WILLAMETTE L. REV. 327, 333 (1985).

135. Tso, *supra* note 17, at 634. Hong Kong's Kai Tak airport and a large portion of its harbor facilities are located in the New Territories. *Id.*

136. Chiu, *Introduction*, in *THE FUTURE OF HONG KONG* 8 (H. Chiu, Y. Jao & Y. Wu eds. 1987). In 1983, China announced its plans for the future of Hong Kong if no agreement with the United Kingdom was reached over the issue of sovereignty over Hong Kong. Faced with a dilemma of either accepting an agreement with China on the latter's terms or having no agreement at all, the United Kingdom acquiesced to China's demands for sovereignty. Prime Minister Margaret Thatcher informed Premier Zhao that the United Kingdom would sever all its ties with Hong Kong. *Id.*

Originally, the British negotiated to exchange sovereignty over Hong Kong for continued administrative control. But the People's Republic of China rejected this proposal on three grounds: (1) by accepting the British proposal, China would implicitly be accepting the validity of the Treaty of Nanking and the Convention of Peking, which is contrary to China's longstanding position; *id.* (2) assuming that China accepted continued British control over Hong Kong, China could not justify a demand to reunify with Taiwan. Taiwan adamantly refuses to reunify. If China were to leave Taiwan alone for another 50 years, China may have to use its military to achieve its unification goals. Ironically, if no Taiwan problem existed, China might tolerate the British proposal because at any time China could remove the British and restore Chinese sovereignty over Hong Kong; *id.* (3) since Mao's death, no Chinese leader has been in a position to concede Chinese sovereignty for fear that a rival faction might gain an upper hand in the ongoing power struggle in China's domestic politics. However, any leader who recovers sovereignty over Hong Kong would have his prestige greatly enhanced. *Id.* at 9.

V. THE SINO-BRITISH JOINT DECLARATION

Although the Chinese and British governments are concerned with a smooth transition when China reasserts sovereignty over Hong Kong,¹³⁷ great skepticism surrounds this "marriage of the century."¹³⁸ With a view to securing Hong Kong's prosperity after its return,¹³⁹ the two governments negotiated the Sino-British Joint Declaration.¹⁴⁰ The Declaration recognizes the difficulties in assimilating two vastly different cultures¹⁴¹ and declares Hong Kong a Special Administrative Region¹⁴² when the colony is returned to China.¹⁴³ The region, although subject to the authority of the Central People's Government of the People's Republic of China, will enjoy a high degree of autonomy in all matters,¹⁴⁴ except foreign and defense affairs.¹⁴⁵ Hong Kong will have independent executive, legislative, and judicial power.¹⁴⁶

A. Political Autonomy

The Hong Kong Government will be comprised of local residents.¹⁴⁷ The Central People's Government will appoint the Chief Executive

137. Both Governments will establish a Sino-British Joint Liaison Group to effectively implement the Joint Declaration. Annex II, Sino-British Joint Liaison Group, at ¶ 3, *reprinted in* 7 LOY. L.A. INT'L & COMP. L.J. 139, 158 (1984). The Joint Liaison will (a) conduct consultations on the implementation of the Joint Declaration; (b) discuss matters relating to the smooth transfer of the government in 1997; and (c) exchange information and conduct consultations on subjects that both governments may agree upon. *Id.*

138. Kristof, *Hong Kong, Wary of China, Sees Its Middle Class Fleeing*, N.Y. Times, Nov. 9, 1987, at A1, col. 1 [hereinafter Kristof]. China is not only one of the more regulated societies in the world, the country is also enormous and economically sluggish. In sharp contrast, Hong Kong is a monument to laissez-faire capitalism; the island is a tiny, pulsating territory that dominates southern China with its commercial activities. *Id.*

139. See Joint Declaration, *supra* note 7, at Introduction (reflecting China's and Great Britain's desire to preserve Hong Kong's flourishing and dynamic society and economy).

140. *Id.* The Declaration states, "the Government of the United Kingdom of Great Britain . . . and the Government of the People's Republic of China have . . . agreed that a proper negotiated settlement of the question of Hong Kong . . . is conducive to the maintenance of the prosperity and stability of Hong Kong. . . ." *Id.*

141. This is the probable meaning behind the Joint Declaration, ". . . Upholding national unity and territorial integrity and taking account of the history of Hong Kong and its realities. . . ." *Id.* at ¶ 3(1).

142. *Id.* Article 31 of the Chinese Constitution states, "The 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." Constitution of the People's Republic of China, art. 31, *adopted by the Fifth Session of the Fifth National People's Congress, Dec. 4, 1982, reprinted and translated in CHINA LAWS FOR FOREIGN BUSINESS* ¶ 4-500 (CCH Australia Ltd. 1987).

143. Joint Declaration, *supra* note 7, at ¶ 1.

144. *Id.* at ¶ 3(2).

145. *Id.*

146. *Id.* at ¶ 3(3). The judicial power includes that of final adjudication. *Id.*

147. *Id.* at ¶ 3(4).

from a list of candidates received in local elections or through local consultation.¹⁴⁸ The Chief Executive shall then nominate all principal officials whom the Central People's Government will later appoint into office.¹⁴⁹

The Hong Kong legislature will also consist of locally elected representatives.¹⁵⁰ The legislature will be authorized to enact laws and report them to the Standing Committee of the National People's Congress for the record.¹⁵¹ These laws will be valid if they conform with the provisions of the draft Basic Law, the future Constitution of the Hong Kong Special Administrative Region.¹⁵²

B. Economic Autonomy

In order to maintain Hong Kong's prosperity and stability, the Declaration preserves Hong Kong's current economic system.¹⁵³ The Declaration provides that socialist policies will not be practiced in the Hong Kong Special Administrative Region.¹⁵⁴ Further, China promises not to interfere with Hong Kong's capitalist structure for fifty years.¹⁵⁵

Under the Declaration, Hong Kong will decide its economic and trade policies¹⁵⁶ and will retain its status as a free port and separate customs territory.¹⁵⁷ China promises not to disturb the free movement of goods and capital to and from Hong Kong¹⁵⁸ and authorizes Hong Kong to maintain and develop its own economic and trade relations with other states and regions.¹⁵⁹ Using the name "Hong Kong, China,"¹⁶⁰ Hong Kong shall participate in all relevant international organizations and international trade agreements.¹⁶¹ Further, Hong

148. Joint Declaration, *supra* note 7, at ¶ 3(4).

149. *Id.*

150. Annex I, Elaboration by the Government of the People's Republic of China of its Basic Policies Regarding Hong Kong, *reprinted in* 7 *LOY. L.A. INT'L & COMP. L.J.* 139, 146 (1984) [hereinafter Annex I].

151. Joint Declaration, *supra* note 7, at ¶ 3(4).

152. Annex I, *supra* note 150.

153. Joint Declaration, *supra* note 7, at ¶ 3(5).

154. Annex I, *supra* note 150.

155. Joint Declaration, *supra* note 7, at ¶ 3(12).

156. Annex I, *supra* note 150.

157. Joint Declaration, *supra* note 7, at ¶ 3(6).

158. Annex I, *supra* note 150.

159. *Id.*

160. *See* Joint Declaration, *supra* note 7, at ¶ 3(10).

161. Annex I, *supra* note 150. Hong Kong shall be permitted to participate in the General Agreement on Tariffs and Trade and arrangements regarding the international trade in textiles. *Id.*

Kong may issue its own certificates of origin for locally manufactured products.¹⁶²

Hong Kong will enjoy independent finances and shall not declare its revenues to the Central People's Government.¹⁶³ The Chinese Government agrees not to levy taxes on the territory.¹⁶⁴ Hong Kong will remain an international financial center¹⁶⁵ and its markets for foreign exchange, gold, securities, and futures will continue undisturbed.¹⁶⁶ The Declaration also secures the free flow of capital¹⁶⁷ and the continued circulation and free convertibility of the Hong Kong dollar.¹⁶⁸ Hong Kong shall handle its own financial matters,¹⁶⁹ including disposing of its financial resources¹⁷⁰ and drawing up its budgets and final accounts.¹⁷¹ The only procedural imposition on the Hong Kong Government is that it must report its budgets and final accounts to the Central People's Government for the record.¹⁷²

C. Cultural Autonomy

The Declaration promises to preserve Hong Kong's social structure, retaining the region's lifestyle.¹⁷³ The Declaration guarantees that the rights and freedoms long enjoyed by Hong Kong residents will be legally protected.¹⁷⁴ Hong Kong will decide its own policies regarding culture, education, science, and technology.¹⁷⁵ Local students will enjoy the freedom to choose their fields of education and to pursue education abroad.¹⁷⁶ Hong Kong school districts may solicit staff and

162. *Id.* Hong Kong is authorized to issue certificates of origin in accordance with the prevailing rules of origin. *Id.*

163. *Id.*

164. Joint Declaration, *supra* note 7, at ¶ 3(8).

165. *Id.* at ¶ 3(7).

166. *Id.*

167. *Id.*

168. *Id.*

169. *See* Annex I, *supra* note 150.

170. *Id.*

171. *Id.*

172. *Id.*

173. Joint Declaration, *supra* note 7, at ¶ 3(5).

174. *Id.* These rights include: personal rights, free speech, free press, the right of assembly, association, travel, movement, correspondence, the right to strike, the choice of occupation, academic research, religious freedom, right to own private property and private enterprises, and the right of inheritance. *Id.*

175. Annex I, *supra* note 150. Annex I also provides that Hong Kong may select its own policies regarding the educational system and its administration, the language of instruction, the allocation of funds, the examination system, the system of academic awards, and the recognition of educational and technological qualifications. *Id.*

176. *Id.*

teaching materials for educational purposes from outside the territory.¹⁷⁷ Additionally, the Chinese Government promises not to interfere with Hong Kong's religious and community organizations.¹⁷⁸

VI. HONG KONG'S FEARS AND CONCERNS OVER RETURNING TO CHINA

Although the Declaration promises Hong Kong a high degree of autonomy, China's history of political instability and abrupt changes in China's social climate demonstrate that promises may not necessarily lead to future compliance.¹⁷⁹ Many Hong Kong residents and business communities are concerned over Hong Kong's future and have unsettling questions about the Declaration.

A. Fear of Political Intrusion

1. Local Representation

Hong Kong residents are normally complacent over the political process.¹⁸⁰ The Tiananmen Square massacre stunned the colony and gave rise to calls for greater representation in the colony's future legislature.¹⁸¹ Under the current version of the draft Basic Law, only one-third of the Hong Kong legislature will be publicly elected.¹⁸²

177. *Id.*

178. *Id.*

179. Chiu, *The International Law of Recovery and Multi-System Nations - With Special Reference to the China (Mainland - Taiwan) Case*, 1 CHINESE Y.B. INT'L L. & AFF. 1, 11 (1981). In 1951, China promised not to "alter the existing political systems" nor "to change the established status, functions, and powers" of the Tibetan government. *Id.* Despite this agreement, in 1959 China invaded Tibet, forcibly seizing it and killing thousands. *Id.*

180. Stormont, *China Severely Limits Elections in Post-1997 Hong Kong*, THE REUTER LIB. REP., Dec. 15, 1989 [hereinafter Stormont]. As residents of the world's most capitalist city, Hong Kong citizens have long been viewed as being concerned only with making money. Loyalties to firms are less important than salary and fringe benefits, making workers respond quickly and rationally to alternative market opportunities. RABUSHKA, ECONOMIC FREEDOM, *supra* note 15, at 75.

181. Stormont, *supra* note 180.

182. As of the time of this publication, the most recent version of the draft Basic Law, February 1990, provides that only 20 of 60 members in the legislative council will be democratically elected in 1997. Hurd, *Accused of Cave-in on Hong Kong*, N.Y. Times, Feb. 17, 1990 (NEXIS, INTL library).

Thousands of angry students boycotted classes, held sit-ins, and street demonstrations denouncing Britain's "selling-out" to China and protesting the Chinese-imposed decision to limit democratic elections to the territory's legislature. Braude, *Students Condemn Hong Kong Deal*, N.Y. Times, Feb. 17, 1990 (NEXIS, INTL library).

Although the draft Basic Law remains tentative until ratification, significant changes in the draft are unlikely before the National People's Congress officially adopts the Basic Law. *Id.* The tentative date for ratification of the Basic Law as of the time of publication is April 4, 1990. Telephone interview with spokesperson for the Hong Kong Economic and Trade Office, in San Francisco (Mar. 27, 1990).

Many fear that without a majority in the legislature, the voices of the Hong Kong representatives will effectively be muffled; if Chinese loyalists constitute a majority of the legislature, they could enact any law they wished and greatly interfere with Hong Kong's legislative autonomy.¹⁸³

Furthermore, China is vested with the power to appoint the Chief Executive of Hong Kong.¹⁸⁴ This ensures that no person will hold the executive office unless the person represents and promotes Chinese interests. Since the Chief Executive is authorized to appoint the secretarial staff,¹⁸⁵ all persons holding significant posts in Hong Kong's future government will be persons furthering Chinese goals.¹⁸⁶ Through the Executive Staff, China could have complete control over Hong Kong's Government.

One writer criticizes Hong Kong's proposed future political structure as too conservative and authoritarian.¹⁸⁷ Under this view, Hong Kong's system of representative government is a "democratic mirage"¹⁸⁸ because representatives are elected into bodies having no real power.¹⁸⁹ The Government's alleged misrepresentations have baited the Hong Kong people into a democratic trap—positive power lies not in the legislative council, but in the civil service and secretarial posts over which China may have complete control.¹⁹⁰

2. *Conflict with the National Constitution*

Of great concern to Hong Kong is the ability of the colony's future legislature to effectively enact its own laws. The Chinese

183. See Stormont, *supra* note 180. As the current version of the draft Basic Law stands, the Hong Kong public elects an insufficient number of representatives to the Legislative Council to constitute a ruling majority. *Id.*

184. Joint Declaration, *supra* note 7, at ¶ 3(4).

185. See *id.*

186. Lee, *Hong Kong: The Human Rights Dimension*, in *THE FUTURE OF HONG KONG: TOWARD 1997 AND BEYOND* 115, 131-32 (H. Chiu, Y. Jao & Y. Wu eds. 1987) [hereinafter Lee]. Deng Xiaoping made it clear to two delegations from Hong Kong that the region will be run by local Chinese "patriots" after 1997. Deng further explained, "[we] don't require them all to favor China's socialist system, but only ask them to love the motherland and Hong Kong. . . . Hong Kong must be administered by Hong Kong residents with patriotic Chinese as the main body." *Id.*

187. See Lockwood, *Colony Safeguards Spurned by China*, *Daily Telegraph*, Dec. 16, 1989, at 7.

188. See Walden, *Hong Kong Chases a Democratic Mirage*, *Asian Wall St. J.*, Mar. 7, 1985, at 12.

189. *Id.*

190. *Id.* The secretarial posts carry significant responsibilities in Hong Kong's government. They oversee the entire legislative process for Hong Kong, carry out legislative enactments, and decide many issues affecting Hong Kong's internal and external affairs. *Id.*

Constitution entitles the State Council¹⁹¹ to “alter or annul inappropriate decisions and orders issued by local organs of state administrations at different levels.”¹⁹² Since the Hong Kong Special Administrative Region is a local administrative organ, the State Council expressly is authorized to annul, or alter, any of Hong Kong’s legislative enactments that conflict with the National Constitution.

B. Fear of Economic Intrusion

Hong Kong’s laissez-faire economy relies upon market forces to allocate its resources efficiently. This capitalist approach stands in sharp contrast to the traditional practice of central planning in mainland China.¹⁹³ Many investors are skeptical that the Chinese Government can successfully operate a free enterprise and trade territory with only minimal interference.¹⁹⁴ Further, many Hong Kong residents fear living under an economic system from which they escaped four decades ago.¹⁹⁵ China has given no assurances to Hong Kong that its future will be prosperous. Instead, the Chinese have openly criticized Hong Kong and sternly warned the colony not to interfere with Chinese affairs. One commentary, reportedly written by an official of the Chinese Government, conditions Hong Kong’s continuing capitalist system upon local support of the Chinese Government, stating, “[the Central People’s Government] will not allow

191. See Constitution of the People’s Republic of China, art. 85, *adopted by the Fifth Session of the Fifth National Peoples Congress, Dec. 4, 1982, reprinted and translated in CHINA LAWS FOR FOREIGN BUSINESS* ¶ 4-500 (CCH Australia Ltd. 1987). “The State Council, that is, the Central People’s Government of the People’s Republic of China, is the executive body of the [National People’s Congress,] the highest organ of state power; it is the highest organ of state administration.” *Id.*

192. *Id.* at art. 67. This may render the Executive Organ in Hong Kong vulnerable to administrative interference from structurally higher levels of government within the People’s Republic of China. See Mushkat, *Salient Legal Issues*, *supra* note 129, at 181.

193. RABUSHKA, *THE NEW CHINA*, *supra* note 88, at 162.

194. *The Future of Hong Kong*, *BUS. WEEK*, Mar. 15, 1984, at 50, 52; See *A Whiff of Panic in Hong Kong*, *BUS. WEEK*, Nov. 15, 1982, at 172, 176. The Chinese Government has traditionally exercised strict control over every aspect of the country’s economy. *Id.* The capitalist system, which the Joint Declaration promises to keep in Hong Kong for 50 years, leaves the people alone. Prybyla, *supra* note 60, at 177. Socialism—Stalinist, Maoist, Dengist—is in varying degrees, the antithesis of laissez-faire capitalism. *Id.* The nature of the socialist system is one that is constitutionally incapable of non-interference. Despite the many reforms over the last decade, the Chinese socialist economy still rests upon philosophical premises that are fundamentally at odds with the premises, qualities, and temperments of a free market economy. *Id.*

195. Kristof, *supra* note 138, at A1, col. 1.

people to use Hong Kong as a base for subverting the Central People's Government."¹⁹⁶

C. Fear of Cultural Intrusion

Hong Kong's population is predominantly Chinese.¹⁹⁷ Although many of its citizens observe Chinese customs, Hong Kong is culturally distinct from the mainland; the colony's greater exposure to foreigners has "westernized" its residents in many ways.¹⁹⁸ Hong Kong's culture combines hard work with the freedom to enjoy leisure activities.¹⁹⁹ Its culture has a unity that Beijing may not understand, perhaps not even accept.²⁰⁰ Many in Hong Kong wonder how long the Chinese Government will tolerate the territory's freedoms or how China will keep the ideological "HongKongization"²⁰¹ from spreading into the mainland. These fundamental questions reflect Hong Kong's fear that the freedoms it now possesses will be taken away long before the fifty year guarantee expires.²⁰²

Hong Kong residents also are concerned about their human rights after the Colony reverts to China. China's respect for human rights, although improved substantially since the Maoist era, is still signifi-

196. See *China Warns Hong Kong Residents*, Wash. Post, July 22, 1989, at A18, col. 1, stating "... [n]ot engaging in activities to overthrow [the Chinese Government] is a precondition for allowing Hong Kong to retain its capitalist system." *Id.*

197. Lohr, *Few in Hong Kong Seek Democracy*, N.Y. Times, Oct. 7, 1982, at A3, col. 1. 98% of Hong Kong's population is Chinese. *Id.*

198. See generally Baker, *Life in the Cities: The Emergence of Hong Kong Man*, 95 CHINA Q. 469, 478-79 (1983) (describing life in Hong Kong). Hong Kong Man is highly competitive, tough for survival, quick-thinking and flexible. He wears Western clothes, speaks English or expects his children to do so, drinks Western alcohol, has sophisticated tastes, and expects life to provide a constant stream of excitement and new opportunities. He is not British nor Western; he is merely Westernized. Yet Hong Kong Man is not Chinese in the same way as his brother is in the People's Republic of China. Hong Kong Man is sui generis and Hong Kong's future is more difficult to resolve because of him. *Id.*

199. Hicks, *Hong Kong on the Eve of Communist Rule*, in THE FUTURE OF HONG KONG: TOWARD 1997 AND BEYOND 27 (H. Chiu, Y. Jao & Y. Wu eds. 1987) [hereinafter Hicks]. Horse racing, Macao casinos, gambling, lotteries, nightclubs, and other recreational activities give Hong Kong residents a zest for life to balance the colony's demanding work ethic. *Id.*

200. See *id.*

201. See HARDING, *supra* note 13, at 82 (discussing China's fears over Hong Kong's growing influence). China is concerned that its citizens will start to believe that anything foreign is superior to its Chinese counterpart. The Government complains that this "national nihilism" will undermine the traditional virtues of diligence, frugality, and patriotism in Chinese culture. China sees the materialism and selfishness of the West as the root of crime, corruption, and inflation and believes that Western ideas and capitalism excessively influence literature, art, music, and film. These are the feared effects of "HongKongization." *Id.*

202. Chiu, *Introduction*, in THE FUTURE OF HONG KONG: TOWARD 1997 AND BEYOND 18 (H. Chiu, Y. Jao & Y. Wu eds. 1987).

cantly below Western standards.²⁰³ Although the Declaration states that “the provisions of the International Covenant on Civil and Political Rights and the International Covenant on Economic, Social and Cultural Rights as applied to Hong Kong shall remain in force,”²⁰⁴ these covenants are not incorporated into Hong Kong’s laws and residents whose rights have been violated have no remedy in court.²⁰⁵ Many Hong Kong residents criticize the Declaration for failing to mention basic freedoms: the right to life, the right to a fair trial, and the protection against torture and cruel and unusual punishment.²⁰⁶

203. Although China has liberalized its economic, social, and cultural spheres, its human rights record, particularly in regard to political dissidents, is still unsatisfactory. See J. COPPER, F. MICHAEL, & Y. WU, *HUMAN RIGHTS IN POST-MAO CHINA* (1985) (discussing China’s position regarding human rights); Lee, *supra* note 186, at 115-37 (questioning China’s ability to respect Hong Kong’s human rights). To Beijing, the “slogan” of human rights that includes freedom and equality is of Western origin. *Id.* at 129-30. Under the Chinese view, “human rights” is a bourgeois term used to oppose feudalism. *Id.* at 130. Since the bourgeoisie has corrupted “human rights”, scientific Marxism must replace it. *Id.* at 130-31. As one article explains:

History shows . . . [that] the slogan of human rights has played an important role in breaking through the shackles of feudal ideology, encouraging people to rise to fight and propel the bourgeois revolution . . . the slogan of human rights is after all a slogan of the bourgeoisie. Although it includes all nominal universal principles of man, in reality, it is nothing but the right of the bourgeoisie. In [a] capitalist society, the capitalists occupy the means of production and monopolize the ideology in society and [the] propaganda machine. . . . It is not strange that the slogan of human rights was later turned into a tool for the imperialists and bourgeoisie to attack the proletariat and socialism. . . .

Unlike the slogan of human rights which reflects bourgeois ideas such as freedom and equality, marxism puts forward the scientific viewpoint of freedom and equality. . . . Establishment of the proletarian democratic dictatorship, abolition of private property, elimination of classes and eventual realization of Communism are the definitive Marxist statement on the equality and freedom of man.

Commentary, *Heilongjiang Ribao (Harbin)*, May 20, 1981, at 3, in FOR. BROADCASTING INFO. SERV., CHINA, June 17, 1981, at K17. See also Lee, *supra* note 186, at 130 (discussing how China evades Western criticism of its human rights record). By rejecting the Western notion of “human rights” and following the Marxist line, Beijing put itself outside the Western concept of human rights and outside of Western criticism. Given this position, Beijing’s record for human rights is, not surprisingly, poor. See *supra* notes 11-12 and accompanying text (referring to China’s recent crackdown and swift execution of numerous pro-democracy protestors as underscoring the country’s abysmal standard of human rights).

204. Annex I, *supra* note 150.

205. Lau, *Colony’s Government Proposes Bill of Rights: Confidence Building*, FAR E. ECON. REV., Oct. 26, 1989, at 19. In attempting to restore local confidence, the Hong Kong Government announced plans to enact a bill of rights for the territory. The bill of rights would incorporate all “relevant” provisions of the International Covenant on Civil and Political Rights. Although this bill would be supreme over all other laws in Hong Kong, the fact remains that it would not supercede the Basic Law as prescribed by the Joint Declaration. *Id.*

206. Lau, *Basic Problems of Law*, FAR E. ECON. REV., Aug. 11, 1988, at 18, 19. Article 39 of the draft Basic Law proposes that the rights and freedoms of Hong Kong residents can be restricted “for the maintenance of national security, public order, public safety, public health, public morals and for safeguarding the rights and freedoms of other persons.” *Id.*

VII. HONG KONG'S RESPONSE

Hong Kong's fear over reunification with China has shattered the residents' and business community's confidence in the future.²⁰⁷ Skeptical that the Declaration's guarantees will be upheld, many Hong Kong residents have voted with their feet, causing capital flight²⁰⁸ and "brain drain."²⁰⁹

A. Capital Flight from Hong Kong

Following the British Jardine Matheson conglomerate's²¹⁰ decision to relocate its headquarters to Bermuda,²¹¹ many Hong Kong businesses are expected to take measures to secure their financial positions in the event that Hong Kong's economic conditions deteriorate.²¹² Hong Kong businesses have undertaken various strategies of "precautionary diversification" in order to protect themselves: (1) removing the registered head office from Hong Kong to a foreign country, usually one that is a tax haven;²¹³ (2) establishing a branch office, or acquiring a foreign firm wholly or in part;²¹⁴ (3) selling

207. Prybyla, *supra* note 60, at 169-70. Hong Kong's economic performance is the product of an unfettered exercise of choice by private economic agents. This freedom, and the pressures that go with it, allows Hong Kong to respond quickly to changing conditions in the world market. *Id.* at 169. This freedom also greatly contributes to the nervousness, speculativeness, and volatility in Hong Kong's economy. The fascination with risk, speculative activity, the cycles of exuberance and anxiety, impatience, and frayed nerves are the facts of life of any free market. If Hong Kong is, as some people have suggested, money, and money is confidence, then the slightest change in the delicate pattern of factual information, rumor, and interpretation on which confidence rests will have instant and large effects on decisions to consume, save, invest, remain, or leave for more congenial environments. Like its owners, money is extremely mobile. *Id.* at 170.

208. See Current Development, *supra* note 2, at 305. See also Cheng, *supra* note 6, at 683 (examining capital flight from Hong Kong). Investors are concerned over Hong Kong's economic future. Those concerns have contributed to capital flight from Hong Kong. As 1997 approaches, many investors are expected to leave the colony and re-invest their money in the United States and other countries. *Id.* at 684.

209. Current Development, *supra* note 2, at 305. "Brain drain" describes the emigration of a country's educated. *Id.*

210. Jardine Matheson is the oldest British trading company in Hong Kong. In 1859, a representative of the Jardine Matheson arrived in Shanghai seeking Chinese silk.

211. See Wu & Jao, *Economic Consequences of 1997*, 20 CASE W. RES. J. INT'L L. 17, 32 (1987) [hereinafter Wu & Jao] (citing *Jardine's Holding Company Quits Hong Kong*, S. China Morning Post, (Hong Kong), Mar. 29, 1984). See also *Will Other Companies Follow Jardine Out of Town?*, BUS. WEEK, Apr. 16, 1984, at 62.

212. See Wu & Jao, *supra* note 211, at 32 (citing *Jardine's Holding Company Quits Hong Kong*, S. China Morning Post, (Hong Kong), Mar. 29, 1984); *Will Other Companies Follow Jardine Out of Town?*, BUS. WEEK, Apr. 16, 1984, at 62.

213. See Wu & Jao, *supra* note 211, at 32.

214. See *id.*

the firm's equity to a foreign firm or forming a joint venture with a foreign firm,²¹⁵ and (4) transferring liquid assets abroad, leaving in Hong Kong sufficient resources only for transactional purposes.²¹⁶ These precautionary strategies do not imply outright withdrawal from Hong Kong,²¹⁷ but the businesses adopting the strategies further undermine the already questionable level of confidence Hong Kong residents have in their future.²¹⁸

B. Emigration from Hong Kong

Instead of remaining in Hong Kong and relying upon Chinese promises of future autonomy, many Hong Kong residents have emigrated to foreign shores,²¹⁹ and a growing number are expected to leave.²²⁰ The projected number of Hong Kong residents expected to emigrate in 1990 is 55,000, up thirty-one percent from 42,000 in 1989.²²¹ The escalating emigration rate greatly concerns Hong Kong's

215. See *id.*

216. *Id.*

217. See Jao, *Hong Kong's Economic Prospects After the Sino-British Agreement: A Preliminary Assessment*, in *THE FUTURE OF HONG KONG: TOWARDS 1997 AND BEYOND 75* (H. Chiu, Y. Jao & Y. Wu eds. 1987) [hereinafter Jao, *Hong Kong's Economic Prospects*]. Unless conditions become intolerable, few firms will abandon Hong Kong even after 1997. The attractions of Hong Kong's business climate and the lure of China's enormous market are considerable. As an example, Jardine Matheson's decision to move its legal domicile to Bermuda in 1984 has not resulted in the winding down of its operations. On the contrary, the company is expanding its business with China. *Id.*

218. Matthews, *Flight of Capital Raises Fears in Hong Kong: Officials See Threat to Economic, Political Autonomy Under Chinese Rule*, Wash. Post, July 14, 1989, at G1. The most prominent case of "precautionary diversification" is the Hong Kong and Shanghai Banking Corporation (HSKB), a British Bank founded and incorporated in Hong Kong in 1865. The HSKB is Hong Kong's de facto central bank; HSKB cannot move its head office elsewhere without causing an immediate financial panic. This caution, however, has not prevented HSKB from diversifying. In 1980, HSKB completed the acquisition of Marine Midland Bank of the United States, a merger that catapulted HSKB's global ranking to the seventeenth largest commercial bank in the world. In 1981, HSKB unsuccessfully tried to take over the Royal Bank of Scotland, but the British Monopoly and Merger Commission thwarted its attempt. Jao, *Hong Kong's Economic Prospects*, *supra* note 217, at 75.

219. See Kristoff, *supra* note 138, at A1, col. 1. With less than 10 years of British control remaining, growing numbers of Hong Kong's population are bidding farewell to this "fragrant harbor," the literal translation of Hong Kong. Many Hong Kong citizens do not trust China's promises and are leaving to bear cold Canadian winters and other hardships still only dimly understood. *Id.*

220. Jones, *Exodus from Hong Kong Gathers Steam Since Beijing Crackdown on Protests*, Asian Wall St. J. Weekly, Sept. 18, 1989, at 11 [hereinafter Jones, *Exodus from Hong Kong*]. The Hong Kong government says that the effect of China's June 4, 1989, crackdown on the student democracy movement will not be seen in 1989's final emigration numbers because of the time it takes for applications to be filed, processed, and acted upon. Nevertheless, many private analysts are skeptical that fewer people are leaving in 1989 than in previous years. *Id.*

221. *Id.* This is almost three times the average rate of emigration from Hong Kong during the early 1980s. *Id.*

government and local businesses because of the resulting brain drain of young middle managers and professionals.²²² A recent study shows a disproportionately large number of emigrants in the twenty-five to forty-four age group.²²³ But of graver concern is the fact that those leaving are generally better educated than is the population as a whole. This disparity in educational levels is evidenced dramatically by the fact that eighteen percent of the emigrants in 1987 held college degrees in contrast to the overall population average of three and a half percent.²²⁴ Hong Kong's brain drain is further exacerbated by favorable immigration laws in foreign countries designed to benefit their domestic economies.²²⁵

The anxiety which Hong Kong citizens feel is reflected further in the increased number of applications for Certificates of No Criminal Convictions. These Certificates are issued by the police department and typically are required for visa applications.²²⁶ In 1985, 23,063 persons applied for these Certificates.²²⁷ In 1986, applications rose fifty-four percent to 35,605;²²⁸ within the next year, they rose another fifty percent to 53,471.²²⁹ Although as a government spokesperson has explained, "[the] whole idea is to keep Hong Kong people here and keep Hong Kong successful, not to have them go and live on

222. *See id.* (discussing the Hong Kong Government's concern over the colony's brain drain).

223. *Id.* A large percentage of Hong Kong's emigrants who are of working age come from the colony's middle management ranks. Of the 30,000 emigrants in 1987, some 7,400 or 25% of the total were in the "professional, technical, administrative and managerial" categories of the work force. This stands in contrast to about 11% of the colony's work force who belong in the same category. *Id.*

224. *Id.*

225. Weaver, *Immigration for Investors: A Comparative Analysis of U.S., Canadian and Australian Policies*, 7 B.C. INT'L & COMP. L. REV. 113, 114 (1984) [hereinafter Weaver]. Canada, the United States, and Australia are the three popular destinations where Hong Kong residents are emigrating. Kristof, *supra* note 138, at A1, col. 1. Canada and Australia have investment visas available to lure Hong Kong's citizens. Weaver, *supra*, at 114. These laws generally require an investment of a certain amount of money in a domestic enterprise that will create jobs for local citizens. *Id.* at 124. Although the United States generally has restricted its immigration policies to that of family reunification, recently it has increased the quota permitted for Hong Kong relatives to immigrate. *Id.* at 114. Additionally, the United States Senate has approved a measure permitting investment visas for anyone investing \$1,000,000 into a new commercial enterprise employing at least 10 U.S. citizens. S. 358, 101st Cong., 1st Sess. (1989).

226. *See* Current Development, *supra* note 2, at 304. The Certificate of No Criminal Conviction serves little purpose other than to support visa applications. 45 countries require this document to be included as part of the immigration application. *Id.*

227. *Id.*

228. *Id.*

229. *Id.*

the other side of the world,"²³⁰ the Hong Kong government continues to be unsuccessful in allaying the fears and curtailing the exodus of its citizens.

VIII. WILL CHINA COMPLY WITH THE JOINT DECLARATION?

Hong Kong's economic miracle is attributable to an industrious labor force, a legal structure based upon British common law,²³¹ economic freedom, and political and social stability.²³² Capital flight and emigration of Hong Kong's professionals impair the colony's competitiveness and are deleterious to the colony's economy. If the colony is to prosper after 1997, China must comply with the spirit of the Declaration and keep Hong Kong autonomous.

A. International Law

1. Is China Bound to the Declaration?

The Declaration provides that the Chinese and British Governments "agree to implement" the terms of the agreement and its three annexes²³³ and that the Declaration shall be "equally binding"²³⁴ on both countries. Further, both governments are content with the scope

230. See Jones, *Exodus from Hong Kong*, *supra* note 220, at 11 (quoting Mike Rowse, spokesman for the Hong Kong government).

231. Jao, *Free Market Economy*, *supra* note 64, at 207. Hong Kong has a well-established legal system, which effectively protects personal liberty and other human rights as well as private property and contracts. *Id.* Recent studies in economics emphasize the importance of law for the efficient allocation of resources and the effective preservation of incentives to all economic agents, especially entrepreneurs. Coase, *The Problem of Social Cost*, 3 *J. L. & Econ.* 1 (1960). Moreover, Hong Kong's legal system is based on English common law and equity, and is widely understood and appreciated by commercial nations, particularly English-speaking countries sharing the same traditions with whom Hong Kong maintains close economic and commercial ties. Jao, *Free Market Economy*, *supra* note 64, at 207.

232. Jao, *Free Market Economy*, *supra* note 64, at 206. Since 1945, Hong Kong has enjoyed a high degree of political and social stability. While not directly responsible to the general public, the colony's paternalistic government, led by British nationals, has been responsive to local demands. This system of implicit "rule by consent" has secured a high degree of political stability. Hong Kong also has attracted a huge influx of refugees who are victims of repression and tyranny. These immigrants share a distaste for political turmoil and value Hong Kong as a safe haven. Their "refugee mentality" is conducive to the colony's social stability. *Id.*

233. Joint Declaration, *supra* note 7, at ¶ 7.

234. *Id.* at ¶ 8. The Joint Declaration became binding upon ratification on May 27, 1985. Harding, *The Future of Hong Kong*, 12 *CHINA BUS. REV.* 31, 33 (Sept.-Oct. 1985) [hereinafter Harding, *The Future of Hong Kong*].

of the agreement,²³⁵ suggesting the spirit of the Declaration will be upheld. Under these circumstances, one may not reasonably conclude that the two countries would negotiate a Declaration only to deliberately repudiate it.²³⁶ Ultimately, however, China's obligations depend less upon the Declaration's substantive provisions under international law than upon the practical consequences of subverting the agreement.²³⁷

2. Substance over Form

The Chinese signed approximately 2000 international agreements between 1949 and 1976²³⁸ and view these and other international treaties as important sources of international law.²³⁹ Although the form of these agreements have differed, China's willingness to view them as sources of international law is not affected.²⁴⁰ As one Chinese theorist noted, "although in practice various names are used for international treaties, such as treaty, agreement, protocol, exchange of notes, and declaration, these names do not have legal significance."²⁴¹

235. The late Hong Kong Governor Sir Edward Youde and British Foreign Secretary Sir Geoffrey Howe have repeatedly stressed that the agreement is binding. Ching, *Hong Kong Clears the First Hurdle*, Asian Wall St. J., Oct. 1, 1984, at 6, col. 5. Prime Minister Zhao added, "Since both China and Britain, as well as the Hong Kong people, consider the Declaration excellent, we [China] have no reason not to implement it." Wren, *China Vows to Honor Hong Kong Pact*, N.Y. Times, Oct. 4, 1984, at A3, col. 4.

236. Jao, *Free Market Economy*, *supra* note 64, at 211.

237. See Corwin, *supra* note 5, at 510.

238. G. SCOTT, CHINESE TREATIES 61 (1975) [hereinafter SCOTT].

239. Corwin, *supra* note 5, at 510.

240. *Id.* at 511.

241. See Vienna Convention on the Law of Treaties, art. 2(1)(a), U.N. Doc. A/CONF. 39/27, reprinted in 8 I.L.M. 679, 680-81 (1969). "A treaty is an international agreement concluded between states in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation." *Id.* (emphasis added). Under Chinese law, as long as a written statement is endorsed by two or more governments and does not merely reflect general principles but agreements on specific questions that incorporate definite rules of conduct, that statement will be legally binding on the parties (no reference made to form). Cohen, *Legal Implications of Recognition of the People's Republic of China*, 72 AM. SOC'Y INT'L L. PROC. 240, 242 (1978). The Chinese tend to look to the consensual intent rather than the specific modality or form of an agreement as the source of its binding force. H. HSIUNG, LAW AND POLICY IN CHINA'S FOREIGN RELATIONS 223 (1972).

Cf. Wang, Kuo-chi Mao-i T'iao-yueh Ho Hsieh-ting [INTERNATIONAL TRADE TREATIES AND AGREEMENTS] (1958), portions translated in 2 PEOPLE'S CHINA & INT'L L. 1162, 1162-63 (1974) (suggesting that "treaty" should be used for important international documents—those relating to political or economic concerns). An agreement usually refers to special or short-term issues. *Id.* However, the authority required to conclude a treaty is usually greater than the authority required to conclude an agreement. *Id.*

Instead, the Chinese place more value upon an international agreement's substantive terms than upon its label. This emphasis stems from 150 years of humiliation attributed to the "Unequal Treaties"²⁴² which forced China to concede territory to militarily superior nations.²⁴³ Under the Chinese view, whether an international agreement is valid depends upon the agreement's substantive provisions.²⁴⁴ A treaty is unequal if: (1) the contracting parties are of unequal bargaining strength at the time the agreement is consummated;²⁴⁵ (2) the treaty's terms are based upon "unequal" or "non-reciprocal" considerations;²⁴⁶ or (3) the treaty encroaches upon a nation's sovereignty.²⁴⁷ Agreements falling within any of the three categories are void and can be unilaterally abrogated at any time.²⁴⁸

242. The "Unequal Treaties" refer to the Treaty of Nanking in 1842, the Convention of Peking in 1860, and other treaties that forced China to cede territory to foreign nations.

243. SCOTT, *supra* note 238, at 17-28. During the nineteenth century, facing military pressure from England, France, and Russia, the Chinese acquiesced to the Treaties of Nanking, the Bogue, Wanghia and Whampoa, which imposed significant infringements upon Chinese sovereignty. In 1858, after the Arrow War, the English and the French continued to exercise "gunboat diplomacy" to force further concessions from China. During this war, Russia took advantage of China's weak position to encroach further upon Chinese territory. The Chinese and Russians eventually concluded the Treaty of Aigun, which reflected these adjusted borders. *Id.* at 23.

244. Corwin, *supra* note 5, at 511. The idea of substantive equality fits into a broader scheme of ideal conditions for international accords. These conditions are set forth in the Five Principles of Peaceful Coexistence: (1) mutual respect for each other's territorial integrity and sovereignty; (2) mutual non-aggression; (3) mutual non-interference in each other's internal affairs; (4) equality and mutual benefit; (5) peaceful co-existence. SCOTT, *supra* note 238, at 92.

245. See SCOTT, *supra* note 238, at 92.

246. See *id.* at 93.

247. See Mushkat, *Salient Legal Issues*, *supra* note 129, at 176. The Chinese believe that sovereignty is the most important principle of international law and the most valuable characteristic of the state. They consistently dismiss any attempt to subvert, dilute, or transfer sovereignty as contrary to international law. *Id.* The People's Republic of China is extremely sensitive of encroachments upon another nation's sovereignty, and opposes the United Nations' efforts to actively engage in world affairs as a peace-keeping force. In particular, the Chinese reject "the use of any third party judicial body such as the International Court of Justice." *Id.* China claims that these interventions violate Article 2, ¶ 7 of the United Nations Charter, which prohibits the United Nations from intervening in domestic affairs. SCOTT, *supra* note 238, at 50.

248. Unequal treaties became a significant issue in international law with the territorial concessions of the later nineteenth century. China challenged the validity of such treaties, arguing that unequal treaties could be abolished under the theory of *rebus sic stantibus*. See BLACK'S LAW DICTIONARY 1139 (5th ed. 1979) (defining this as a condition attaching to all treaties that the treaty shall cease when facts available to the parties at the time of entry have substantially changed). In effect, China was no longer the weak victim of imperialist powers. The unequal treaties, a product of duress, could be abolished. However, "[T]reaties of a slave nature can be unilaterally abolished regardless of whether there has been a vital change of circumstances." H. CHIU, *THE PEOPLE'S REPUBLIC OF CHINA AND THE LAW OF TREATIES* 103 (1972).

3. Practicality over Substance

Because nations rarely enter into agreements with equal bargaining strength and a treaty's substantive provisions seldom confer equal benefits to both sides, almost all international agreements would be void under Chinese law.²⁴⁹ In practice, however, China's compliance with international agreements depends more upon the treaty's usefulness to Chinese goals than upon strict notions of international law.²⁵⁰ One commentator observed, "[if an international agreement] is useful to [China], to socialist enterprise, or to the peace of the world, we will use it . . . [if not, China] will not use it and should create a new instrument to replace it."²⁵¹ China's history of invalidating international agreements supports this observation. In 1928, the Nationalist Government unilaterally annulled all prior agreements conflicting with China's opposition to the Unequal Treaties and China's insistence of sovereignty.²⁵² However, and more pertinently, although China always has regarded the British occupation in Hong Kong as an infringement on Chinese sovereignty, the Government has never taken affirmative measures to remove the British.²⁵³ Hong Kong's commercial development makes the colony an important trading partner for the Chinese, a relationship that the Chinese wisely did not wish to disrupt.²⁵⁴ Consequently, notwithstanding the Declaration's provisions binding the Chinese to the agreement, the Declaration must be viewed in light of Hong Kong's influence on Chinese efforts to modernize their economy.

249. Corwin, *supra* note 5, at 513. Under the Unequal Treaties doctrine, no degree of inequality is necessary to invalidate an agreement. This being the case, the doctrine serves to invalidate almost all international agreements. *Id.*

250. Comment, *Legal Aspects of the Sino-British Draft Agreement on the Future of Hong Kong*, 20 TEX. INT'L L.J. 167, 185 n.168 (1985).

251. Chiu, *The Nature of International Law and the Problem of a Universal System*, in LAW IN CHINESE FOREIGN POLICY: COMMUNIST CHINA & SELECTED PROBLEMS OF INTERNATIONAL LAW 3 (1972) (quoting Ch'en, *Refuting the Absurd Theory Concerning International Law*, People's Daily, Sept. 18, 1957).

252. SCOTT, *supra* note 238, at 87-88.

253. Duncanson, *Hong Kong as a Crown Colony*, in HONG KONG: A CHINESE AND INTERNATIONAL CONCERN 9-10 (J. Domes & Y. Shaw eds. 1988). The British officials feared in 1945 that Chiang Kai-Shek might insist on the return of Hong Kong after Japan's surrender. Stalin taunted Churchill with that prospect at Yalta and Roosevelt encouraged Chiang to raise the issue, but Chiang made no such demand. Hong Kong remains as the only foreign enclave in China to survive the peaceable moves for retrocession between the World Wars and the Communist takeover, which removed all the other enclaves. China was aware that Hong Kong differed from other settlements and concessions—that the self-esteem lost was more than offset by the wealth gained. *Id.*

254. See generally Jao, *Hong Kong's Economic Prospects*, *supra* note 217, at 76-79 (discussing Hong Kong and China's growing economic interdependence).

IX. CHINA'S MODERNIZATION PROGRAM

Although Mao successfully rid China of many historical inequities,²⁵⁵ his leadership became increasingly irrational in his later years.²⁵⁶ The Chinese faithfully followed him into social and economic reforms of apocalyptic proportions. Mao's policies created economic stagnation, and when Mao died, the country sought radical reforms to break the cycle of wallowing.²⁵⁷ The reform-minded Chinese Government instituted the "Four Modernizations"²⁵⁸ to invigorate China's economy. Steering away from the socialist economic model, the Government decentralized the economy to allow greater market regulation of domestically produced goods. The Government also "opened the door" to foreign investment, increasing China's interaction in the international economy.²⁵⁹

A. Special Economic Zones

Of all the reforms undertaken in the post-Mao period, the most widely publicized is the creation of Special Economic Zones [SEZs].²⁶⁰

255. See HARDING, *supra* note 13, at 11-12. Mao Zedong raised the stature of the working class, launched the country on a path of industrialization, and ended foreign privilege in China. *Id.*

256. See *supra* notes 88-98 and accompanying text (discussing the Great Leap Forward and the Cultural Revolution).

257. HARDING, *supra* note 13, at 12.

258. See Nishitateno, *China's Special Economic Zones: Experimental Units for Economic Reform*, 32 INT'L & COMP. L.Q. 175, 175 (1983) [hereinafter Nishitateno]. The "Four Modernizations" is an effort to help China catch up with the developed Western nations by the end of this century in four fields: agriculture, industry, science and technology, and national defense. Through this new effort, the communist leaders seek to reform the political and policy making system, revitalize the educational system, increase China's role in the global economy, and alter the nation's demographic trajectory. Lampton, *The Implementation Problem in Post-Mao China*, in POLICY IMPLEMENTATION IN POST-MAO CHINA 3 (D. Lampton ed. 1987).

259. HARDING, *supra* note 13, at 131. Although Mao's economic policy emphasized self-reliance, China was not as autarkic as observers commonly perceived. Certainly the Cultural Revolution seriously impaired China's economic ties with trading partners, with exports declining to less than three percent of the national output in 1970. But after this low point, Beijing dramatically increased the import of industrial supplies and foreign technology, and expanded the export of agricultural products, raw materials, and manufactured goods. By 1975, China's total foreign trade increased more than 250%, reaching nearly \$15 billion, and exports rose to five percent of national output, the highest level in China's history. Hua Guofeng's leadership brought another surge in trade, surpassing \$20 billion in 1978—a 40% increase from 1975. *Id.*

260. An important function of the SEZs is to serve as a mechanism for the introduction, study, and absorption of technology in a wider range of industries than in most export-processing zones. They are laboratories in which new management techniques and economic policies can be tested before being adopted in the rest of China; they are filters which screen out those aspects of foreign technology and culture that are not considered appropriate for Chinese needs; they also are lubricants that facilitate China's reunification with Hong Kong, Macao, and Taiwan. *Id.* at 164.

In 1980, China delineated certain areas within Shenzhen, Zhuhai, and Shantou in Guangdong Province and Xiamen in Fujian Province as SEZs²⁶¹ to develop external economic cooperation and technical exchanges and to promote the socialist modernization program.²⁶² In an SEZ, enterprises are treated more favorably than in other areas regarding matters such as the tax rate and the scope of the enterprise's operation.²⁶³ The SEZs link China to Hong Kong as well as to the world.²⁶⁴ Each SEZ seeks to attract "all items of industry, agriculture, livestock breeding, fish breeding and poultry farming, tourism, housing and construction, research and manufacture involving high technologies and techniques that [encourage] international economic cooperation and technical exchanges"²⁶⁵ By guaranteeing that

261. See Pow & Moser, *Law and Investment in China's Special Investment Areas*, in FOREIGN TRADE, INVESTMENT, AND THE LAW IN THE PEOPLE'S REPUBLIC OF CHINA 201 (M. Moser ed. 1987) [hereinafter Pow & Moser]. A number of considerations prompted the nation's planners in choosing the locations for China's SEZs. The most important of these are geographical factors:

(1) The zones are situated along the coast to facilitate the importation of raw materials and the exportation of finished products to the international market;

(2) Guangdong and Fujian provinces are the ancestral homes for most overseas Chinese and therefore hold a special attraction for these investors—for many wealthy overseas Chinese the opportunity to assist in the development of the motherland and simultaneously obtain a return on their investments holds both a sentimental and a practical appeal;

(3) The SEZs' proximity to Hong Kong provides investors with easy access to the zones, and permits the SEZs to tap the infra-structural resources of one of the world's financial centers;

(4) Locating three SEZs in the Guangdong province may also have been influenced by political considerations. By developing the Shenzhen SEZ on the opposite side of the border to The New Territories of Hong Kong, China may accelerate the rate of economic development on the Chinese side and promote economic integration between Hong Kong and Guangdong.

Id. at 202.

With two interdependent economies along side each other, China has a formula for reunification in which Hong Kong might retain its present economic system within the framework of a "super-SEZ," or at least of erasing the economic boundary between the two areas and thereby facilitating the reunification process.

Id.

262. Regulations of the People's Republic of China on Special Economic Zones in Guangdong Province, art. 1, *approved* by the 15th Session of the Standing Committee of the 5th National People's Congress, Aug. 26, 1980, *reprinted and translated* in CHINA LAWS FOR FOREIGN BUSINESS ¶ 70-800 (CCH Australia Ltd. 1987) [hereinafter Guangdong Regulations].

263. Nishitateno, *supra* note 258, at 176. These areas are similar to the Export Processing Zones (EPZ) which can be seen in India, Korea, and other developing countries. EPZs are usually found in countries with undeveloped and weak economies which seek to attract foreign capital and advanced technology. By providing the land, raw materials, and labor resources foreign businesses need, EPZs establish a mutually beneficial system for the production of goods for export. *Id.* Special Economic Zones differ in that their emphasis is not to attract export industries exclusively. *Id.* at 177.

264. HARDING, *supra* note 13, at 164.

265. Guangdong Regulations, *supra* note 262, at art. 4.

all assets, profits, and other legitimate rights and interests will be legally protected,²⁶⁶ China will ensure that investors are given favorable investment opportunities in stable business environments.²⁶⁷ Investors are encouraged to open factories, set up enterprises with their own investments, or undertake joint ventures with Chinese investors within the SEZs.²⁶⁸

1. Finance

The SEZ Regulations provide that the "lawful profits" of investors, as well as the wages and other "legitimate income" of non-Chinese SEZ personnel, after payment of income tax, may be remitted out of China in accordance with the stipulations of the foreign exchange control measures of the SEZs.²⁶⁹ Investors may open accounts and handle foreign exchange matters in banks registered in the SEZs. Investors also may apply for insurance through insurance companies registered within the zones.²⁷⁰

2. Preferential Tax Incentives

Foreign enterprises are given preferential treatment regarding import duties. Machinery, spare parts, raw materials, vehicles, and other means of production for the enterprise are exempted from import duties.²⁷¹ Other necessary consumer goods are subject to full or lower import duties or exempted altogether.²⁷²

The standard tax rate levied on profits and income of the enterprises within the SEZs is fifteen percent.²⁷³ Additionally, enterprises with an investment of U.S. \$5 million or more, and those involving

266. *See id.* at art. 1.

267. *Id.* at art. 4.

268. *Id.* at art. 1.

269. *Id.* at art. 15. No comprehensive foreign exchange rules formulated specifically for the SEZs have yet been announced. The central piece of legislation is the Provisional Regulations of the People's Republic of China Governing Foreign Exchange Control, issued by the State Council on December 18, 1980. Currently, this national foreign exchange regulation is being applied in the zones. However, on November 16, 1985, the Shenzhen government promulgated the Provisional Measures of the Shenzhen Special Economic Zone on Foreign Exchange Adjustment. The objective of these measures is to facilitate currency conversion of renminbi and foreign currency funds held by enterprises in the zone in accordance with a floating rate of exchange, and in the process curbing the black market in currency transactions. Pow & Moser, *supra* note 261, at 208.

270. Guangdong Regulations, *supra* note 262, at art. 8.

271. *Id.* at art. 13.

272. *Id.* These exemptions depend upon the needs of each enterprise. *Id.*

273. *Id.* at art. 14.

higher technologies or having a longer cycle of capital turnover, will receive additional preferential tax treatment.²⁷⁴ Investors who reinvest their profits in the SEZs for a minimum of five years may apply for exemption from income taxes on profits from these reinvestments.²⁷⁵

3. Labor

SEZ labor service companies recommend employees to foreign enterprises.²⁷⁶ The investor may, with the consent of the Guangdong Provincial Administration of Special Economic Zones,²⁷⁷ recruit his own employees.²⁷⁸ Investors may employ foreign personnel for technical and administrative work.²⁷⁹ A foreign enterprise will manage its employees according to its own business' requirements.²⁸⁰

The terms of employment, including the scales and forms of wages, award methods, labor insurance, and various state subsidies, shall be provided in the employee's labor contract.²⁸¹ The labor contracts are between the enterprises and the employees and must conform to the stipulations of the Guangdong Provincial Administration of Special Economic Zones.²⁸² An enterprise shall stipulate the job requirements in the contract and may dismiss an employee according to the provisions of the employee's contract.²⁸³

274. *Id.*

275. Guangdong Regulations, *supra* note 262, at art. 16.

276. *Id.* at art. 19.

277. The Guangdong Provincial Administration of Special Economic Zones regulates the SEZs within Guangdong. This body is independent of the pre-existing administration in Guangdong in order that it may deal with the peculiarities of the SEZs. Nishitateno, *supra* note 258, at 178. A similar administrative organ exists in Fujian. *Id.*

These provincial administrations exercise the functions to: (1) draw up plans for the special zones and organize for their implementation; (2) examine and approve investment projects of investors in the special zones; (3) deal with registration of industrial and commercial enterprises in the special zones and with land allotment; (4) coordinate the working relations among the banking, insurance, taxation, customs, frontier inspection, postal and telecommunications and other organizations within the zones; (5) provide staff members and workers needed by the enterprises in the special zones and protect the legitimate rights and interests of these staff members and workers; (6) run education, cultural, health and other public welfare facilities in the special zones; (7) maintain law and order in the special zones and protect according to law the persons and properties in the special zones from encroachment. Guangdong Regulations, *supra* note 262, at art. 23.

278. Guangdong Regulations, *supra* note 262, at art. 19.

279. *Id.* at art. 10.

280. *Id.* at art. 20.

281. *Id.* at art. 21.

282. *Id.*

283. *Id.* at art. 20.

B. Special Economic Zones: The First Ten Years

1. Achievements

Special Economic Zones grant foreign enterprises preferential tax incentives and permit the necessary flexibility for companies to conduct their affairs efficiently. The SEZs replicate the export free processing zones that have made Taiwan, Singapore, and South Korea the industrial powerhouses of Asia. An examination of Shenzhen, the largest SEZ, reveals China's successful efforts at modernization.²⁸⁴ Shenzhen has been established in the Southern coast of China, close to the Hong Kong border, to enable it to benefit from the foreign enterprises conducting business in Hong Kong. Because of its isolation, Shenzhen has enjoyed rapid growth in both total output and foreign investment;²⁸⁵ Hong Kong interests top all others and account for 80 percent of total foreign investment.²⁸⁶ By 1985, Shenzhen already had attracted more than half of the original target established for foreign investment²⁸⁷ for the zone from 1980 to 2000.²⁸⁸ Almost overnight, a sleepy town transformed itself into a bustling city, with high-rise office buildings, fashionable hotels, and wide streets rivaling those in Hong Kong.²⁸⁹

284. Pow & Moser, *supra* note 261, at 204. Largely because of its size, comparatively well-developed infrastructure, and proximity to Hong Kong, Shenzhen has advanced beyond all the other SEZs. To date, Shenzhen has attracted the bulk of direct foreign investment in the SEZs. By the end of 1984, more than 3000 agreements had been signed with foreign investors committing H.K. \$15 billion, the equivalent of U.S. \$1.9 billion. *Id.*

285. HARDING, *supra* note 13, at 165.

286. Pow & Moser, *supra* note 261, at 204.

287. HARDING, *supra* note 13, at 165. Within five years of its creation, Shenzhen had attracted U.S. \$840 million in direct foreign investment—one seventh of the national total and more than half the zone's original target for foreign investment. *Id.*

288. *Id.* See Pow & Moser, *supra* note 261, at 204, stating:

While the other zones are beginning to intensify their attempts to attract investment, Shenzhen has unveiled a detailed long-range development plan which calls for exports to reach U.S. \$5.2 billion per annum by 1990, and annual industrial output to reach U.S. \$7.1 billion by 2000. The draft plan, announced in September 1982, outlines a number of development projects in the areas of light industry, agriculture, tourism, and transportation, and anticipates that before the end of the century foreign investment in these projects will exceed U.S. \$7.2 billion. Under the plan, it is expected that by the year 2000 there will be 1,500 enterprises employing more than 400,000 workers, but by the end of 1985 Shenzhen's population already had reached 400,000 and the zone had more than 750 industrial enterprises.

Id.

289. HARDING, *supra* note 13, at 165. The changes make China unrecognizable to those who last visited the country before 1976. Youths wear blue jeans and T-shirts like their

2. Costs

Shenzhen's accomplishments have not been achieved without considerable social and economic costs. The Shenzhen SEZ places a greater burden on the central treasury—in investments made and taxes forgiven—than originally anticipated.²⁹⁰ Shenzhen has attracted fewer "high tech" industries²⁹¹ and generated less foreign exchange than the government had projected.²⁹² Further, both Hong Kong's currency²⁹³ and culture²⁹⁴ have replaced those indigenous to Shenzhen.

C. Hong Kong's Role in China's International Economic Expansion

China's resurgence in the international marketplace, particularly through the SEZs, has allowed Hong Kong's exports and re-exports to China to soar. Within the last fifteen years, Hong Kong has

counterparts in East Asia. Women again are wearing the *cheongsam* that was commonplace before the communist takeover. Disco music blares from radios and television antennas that sprout from urban apartment complexes and suburban homes. Enthusiastic audiences gather to watch Western films ranging from *The Turning Point* to *Rambo*. Throngs of foreign tourists patronize China's new and modern hotels managed by Sheraton and Holiday Inn, and eat at restaurants catered by Maxim's of Paris and Hong Kong's most successful restaurateurs. *Id.* at 1.

290. *Id.* at 165-66. Originally, in 1982, a 20 year development plan called for an expenditure of 3.7 billion yuan in capital construction. However, the entire amount was spent within the first two years, and the projected investment was increased to 7.5 billion yuan for the next five years. In all, Shenzhen required more than twice the investment initially forecast for 20 years. *Id.*

291. See Pow & Moser, *supra* note 261, at 204. In earlier years, more than half of the total investment projects in Shenzhen involved light industrial and small-scale processing and assembly operations. Shenzhen is beginning to attract more large-scale industrial investments. *Id.*

292. HARDING, *supra* note 13, at 166. Shenzhen developed into more of an import-procurement zone than the export processing zone it was designed to be. Instead of exporting goods, China has consumed more than two-thirds of Shenzhen's output. *Id.*

293. *Id.* Within the last few years, debate has centered over whether the SEZs should have their own currency. Presently, Shenzhen has three currencies in circulation: renminbi, foreign exchange certificates, and Hong Kong dollars. Prices of goods and services vary in accordance to the type of currency offered for payment. The currency most in demand is the Hong Kong dollar, and it has become the prevalent currency within the Shenzhen SEZ because it assures foreign entrepreneurs and local workers of total convertibility. *Id.*

294. *Id.* One senior leader who visited Shenzhen noted that the SEZ had turned completely capitalistic. *Id.* at 168. Tipping, prostitution, smuggling, and corruption have become flagrant in Shenzhen and are growing concerns for Chinese officials. *Id.* at 166. In the late autumn of 1982, posters went up around Shenzhen announcing that the Triad Societies—14K, the *Wo Sihing Wo*, and the *Shui Fong*—from Hong Kong were infiltrating Shenzhen to "smuggle and peddle drugs, get people to flee abroad, lure innocent girls into prostitution, commit assault and robbery and carry out all kinds of outrages to disrupt public order." Wren, *China Attracts Hong Kong's Money, and Gangsters*, N.Y. Times, Mar. 31, 1983, at A2, col. 3.

played an increasing role as the major entrepot through which China and its SEZs sold exports and procured imports.²⁹⁵ Within this period, China assumed a greater share of Hong Kong's trade.²⁹⁶ Traditionally, China has maintained a large balance of payments surplus with Hong Kong.²⁹⁷ But China's increasing trade with Hong Kong dramatically reduced this surplus from \$3.2 billion in 1982 to \$2.1 billion in 1984.²⁹⁸ The growth in commercial activities between the two countries demonstrates a developing symbiosis between the two economies.²⁹⁹

D. Prospects for the Special Economic Zones

Although the problems with the SEZs have drawn harsh criticism from the conservative members of the Chinese Communist Party,³⁰⁰ the SEZs have been permitted to continue. Supporters argue that Shenzhen's development should be viewed as a staged process in which results are gradually achieved.³⁰¹ Others argue that Shenzhen should not limit its economy exclusively to foreign markets; they encourage Shenzhen to open itself to "both the outside world and

295. HARDING, *supra* note 13, at 145. Hong Kong's share of Chinese trade rose from 11% in 1978 to 22% percent in the mid-1980s. Between 1974 and 1984, China doubled its share of Hong Kong's trade from 9% to 18%. Hicks, *supra* note 199, at 51.

296. Hicks, *supra* note 199, at 51. In 1984, 27% of Chinese exports went to Hong Kong, up from a negligible amount in 1979. *Id.*

297. Although no official balance of payments data exists for either the People's Republic of China or Hong Kong, trade statistics reveal that since 1952, the balance always has been unfavorable to Hong Kong. China's trade surplus with Hong Kong in the 1950s, totaled U.S. \$772,830,000. The Chinese trade surplus with Hong Kong in the 1960s grew 314% to U.S. \$3,202,830,000, and again grew 315% to U.S. \$13,319,950,000 in the 1970s. Jao, *Hong Kong's Role in Financing China's Modernization*, in CHINA AND HONG KONG: THE ECONOMIC NEXUS 17 (A. Youngson ed. 1983) [hereinafter Jao, *Financing China's Modernization*].

298. Hicks, *supra* note 199, at 51-52.

299. While trade statistics illustrate one face of a growing interdependence between Hong Kong and China, the colony plays a greater role in helping China reach its goals of modernization. Since Hong Kong is the world's third largest banking center, and a major tourist center in the Far East, it is an important source of foreign exchange and a source for both short and long-term loans for China. See generally Jao, *Financing China's Modernization*, *supra* note 296, at 24-44 (discussing the various means by which Hong Kong provides China with foreign exchange — banking, remittances and other unrequited transfers, and tourism and travel expenditures). Further, Hong Kong entrepreneurs are exceptionally responsive to incentives and, given the right investment climate, are more willing to invest in favorable business environments. Beginning in 1977, Hong Kong residents have pledged more than U.S. \$2 billion in investments in China's Special Economic Zones, more than that from any other country. *Id.* at 44-60.

300. See HARDING, *supra* note 13, at 168. The criticisms involved political and symbolic issues. One senior leader who visited Shenzhen was quoted in the Chinese Press, "apart from the five starred red flag, everything in Shenzhen has turned capitalistic." Another leader reportedly burst into tears during an inspection tour, declaring he would never have joined the Communist Party had he known Shenzhen would be the result. *Id.*

301. *Id.* at 169.

the areas at home,"³⁰² and to draw and sell capital along broader horizons.³⁰³ In a much publicized statement supporting the Shenzhen Special Economic Zone, Deng Xiaoping stated that Shenzhen was still in an experimental stage and that the Zone represented the correct approach to China's foreign economic relations.³⁰⁴ In early 1986, Chinese leaders agreed to allow a grace period for the SEZ, to significantly improve its foreign exchange and capital accounts.³⁰⁵ Despite the grace period, the SEZs will probably survive their present difficulties, if only because disbanding them would greatly damage China's longer term goals concerning Hong Kong.³⁰⁶

X. THE LIKELIHOOD THAT CHINA WILL UPHOLD THE JOINT DECLARATION

Hong Kong's role in China's economic development guarantees China will uphold the spirit of the Declaration. During the past decade, China pursued a bold new venture for modernizing its economy and continues to trade actively at the international level. Since Hong Kong is the primary entrepot through which China conducts this trade, China's potential for growth is dependent upon the Colony's continued health and vigor. China must ensure Hong Kong's economic and political stability in order to achieve its own economic goals.

Evidence suggests that throughout the 1980s, China has been concerned with Hong Kong's stability and future economy. In 1982, when Hong Kong's economy stumbled because of the deteriorating confidence over the Colony's future, China took immediate action to prevent financial disaster. The Chinese government made sizeable investments in all sectors of Hong Kong's economy,³⁰⁷ while domestic

302. See *id.* (quoting an official of the provincial economic system reform commission in Guangdong).

303. *Id.*

304. *Id.* China consistently has emphasized that its economic policies are not transitory. See Wren, *China Vows to Honor Hong Kong Pact*, N.Y. Times, Oct. 4, 1984, at A3, col. 4. Deng Xiaoping, referring to China's economic modernization, stated, "Our policy will not change and no one can change it because the policy is correct and effective." *Id.*

305. HARDING, *supra* note 13, at 169. Some reports suggest that Shenzhen was told to increase the share of total output that it exported from 40% in 1985, to 60% in 1990, reduce transshipment of foreign goods to other provinces, and cut back on imports of foreign components. *Id.*

306. *Id.*

307. See Jao, *Free Market Economy*, *supra* note 64, at 213. According to Wang Kuangying, Chairman of the Beijing-owned Everbright Industrial Corporation, China had, by early 1984, invested some U.S. \$4 million in more than 300 Hong Kong projects through 50

financial institutions lent money to their counterparts in Hong Kong.³⁰⁸ Two years later, the Government took over two large Hong Kong industrial firms in order to avert their bankruptcy. The following year, the Bank of China financially supported the Kah Wah Bank when it suffered a run.³⁰⁹ Although self-interest may partially explain these actions, they do demonstrate a legitimate interest in Hong Kong, an interest China is unlikely to abandon by renouncing the Declaration.

A breach of the Declaration would unravel the developing economic relationship between Hong Kong and China and undermine many advantages an autonomous and prosperous Hong Kong could confer on China. As a valuable entrepot for the Chinese, Hong Kong provides a wealth of opportunities for local Chinese industries,³¹⁰ particularly those within Shenzhen. A breach of the Declaration would adversely impact China's domestic economy and restrict access to the vital resources that China needs to realize its own economic aspirations.³¹¹ Because Hong Kong is an international financial center, a breach would anger many countries which have made sizeable investments in Hong Kong's economy.³¹² If these countries were to withdraw those funds and remove their citizens from Hong Kong,

representative and trade offices. *Id.* The Industry Department of the Hong Kong Government estimates that at the end of March 1985, Beijing owned or controlled 124 firms in trade and industrial promotion, 44 in banking and finance, five in insurance, 19 in manufacturing, four in publishing and printing, 53 in transportation and tourism, and 26 in real estate and construction. *Id.*

308. *Id.* at 212-13. Between 1979-1981, Hong Kong's financial institutions as a whole were net lenders to their Chinese counterparts, a position consistent with Hong Kong's status as a financial center in the Pacific. But from the first quarter of 1982 through the second quarter of 1985, Hong Kong's financial institutions became net debtors. In 1984 Hong Kong's net indebtedness to China reached a peak of H.K. \$13,784 million, the equivalent of U.S. \$1,758 million. However, after the Declaration was signed in the fall of 1984 and local confidence was restored, Hong Kong once again became net lenders to China. *Id.*

309. *Id.* In December 1985, the Hwa Jian Company, a state-run enterprise under the State Council's Overseas Chinese Affairs Office, took a substantial equity interest in Kah Wah Bank through a joint venture with Singapore interests. *Id.*

310. See Corwin, *supra* note 5, at 520.

311. Harding, *The Future of Hong Kong*, *supra* note 234, at 33. Hong Kong provides China with a valuable source of hard currency, investment capital, managerial, financial, and technological expertise that China seriously lacks for its modernization. In recent years, China has sent study groups to Hong Kong to learn these skills and implement them in the Chinese economic structure. *Id.*

312. Prybyla, *supra* note 60, at 171. Almost half of all foreign investment in Hong Kong is American. *Id.* at 173. Japan is second, with about 25%; Britain is a distant third, with six percent. *Id.* Despite recurrent jitters, capitalist investors, especially Americans, keep coming into Hong Kong. However, most investments in Hong Kong, domestic as well as foreign, are relatively short-term in nature. *Id.* at 171. They can be recouped within five years or less, with handsome profits into the bargain. "Almost everybody agrees that there is that much time, perhaps more, before the shadow of 1997 casts a pall." *Id.*

the exodus of capital and human resources would greatly diminish Hong Kong's value to China.³¹³ As the leading source of foreign exchange, an unexcelled financial center, entrepot, and information center, Hong Kong has become an invaluable asset to the Chinese.³¹⁴ If Beijing upholds the spirit of the Declaration, it will inherit Hong Kong's first-rate services and state of the art facilities from Britain³¹⁵ virtually without cost—services and facilities which China otherwise could never reproduce.³¹⁶

XI. CONCLUSION

As July 1, 1997 approaches, anxious investors must decide whether to remain in Hong Kong or to abandon the Colony altogether. Hong Kong's future autonomy lies in the hands of its residents who invest their skill and capital in the Colony's miracle economy. These residents share a grave concern over Hong Kong's future, and their emigration substantially devalues the Colony to the Chinese. The concerns over Hong Kong's future cannot be lightly set aside and China has boldly addressed them.

The Chinese wish to preserve Hong Kong's autonomy and prosperity. By drafting the Sino-British Joint Declaration and making sizeable investments in the Colony, China hopes to bolster investor confidence in Hong Kong and retain the Colony's status quo. Additionally, by decentralizing administrative control over its own economy, China is narrowing the disparity between Chinese socialist modernization and Hong Kong's laissez-faire capitalism. China's domestic reforms reinvigorate its private economy and alleviate some of Hong Kong's fears over reunification.

Hong Kong's future is brighter in light of China's development of Special Economic Zones, areas where foreign investors are welcome to exert their capitalist influence. Within a period of five years, Shenzhen SEZ, which borders Hong Kong, has transformed itself from a quiet town into a bustling city. Although Shenzhen has

313. Corwin, *supra* note 5, at 521-22.

314. Jao, *Free Market Economy*, *supra* note 64, at 213.

315. Fishburne, *supra* note 67, at 44. Hong Kong serves as a business and financial center in part because of its strong existing infrastructure. Many office buildings exist and more are being built. Acceptable expatriate housing is in place. Hong Kong has a communications network that is second to none. World class hotels are available for business travellers. State of the art communications, data processing, and related equipment and services from across the world are available in Hong Kong. This infrastructure will remain after 1997. *Id.*

316. Jao, *Free Market Economy*, *supra* note 64, at 215.

strained the national treasury and tainted Chinese culture, the city has made substantial advances in attracting foreign investments and foreign exchange. Most importantly, Shenzhen has lured many Hong Kong businesses and has become a fertile economic laboratory for screening Hong Kong's entrepreneurial practices. By studying the successful business practices of foreign ventures within the SEZs, China hopes to educate domestic enterprises and improve the mainland's economy. Continued development of the SEZs will narrow the standard of living separating China and Hong Kong, assure Hong Kong a high degree of autonomy, and give the Colony hope for a prosperous future.

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