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The Reintegration of Hong Kong into the People's Republic of China

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NOTES

The Reintegration of Hong Kong into the People's Republic of China: What It Means to Hong Kong's Future Prosperity

ABSTRACT

On June 30, 1997, the United Kingdom will cede administrative control of Hong Kong to the People's Republic of China. Hong Kong achieved great prosperity under British rule, but the affect of China's influence on Hong Kong's future economic success is an issue of much concern as the 1997 transfer of sovereignty nears. This Note analyzes the transfer of sovereignty and what it will mean to Hong Kong's economic future. The author outlines the history of Hong Kong and discusses the British role in creating the prosperous colony. The author then analyzes the Joint Declaration, the document which governs the transfer of sovereignty, and the Basic Law, which will serve as Hong Kong's constitution. The author addresses the current climate in Hong Kong, focusing on attitudes and developments in both Hong Kong and China, to evaluate how the upcoming transfer has been received and what effects it has created. The author concludes that the Hong Kong of the future will continue to prosper and remain a Pacific economic center. However, the brightest days of Hong Kong have passed, and Hong Kong will not likely recapture the financial success of the "glory days" of the late 1980s.

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I. INTRODUCTION

At midnight on June 30, 1997, the United Kingdom¹ will cede administrative control of Hong Kong to the People's Republic of China. Since Great Britain gained control of Hong Kong in the nineteenth century, Hong Kong has developed into a leading world economic center. Indeed, Hong Kong's status as a free port—with almost no import duties and few restrictions on which states' merchants and goods can conduct business—has enabled it to become one of the world's leading economic centers. Because of Hong Kong's importance to the world economy, Hong Kong's upcoming reintegration into the People's Republic of China raises many issues for those who reside or conduct business in Hong Kong. The most important issue is whether Hong Kong will enjoy the same level of prosperity after the transfer of sovereignty as it currently enjoys under British rule. The analysis of this issue, however, raises several other questions. What will become of the permanent residents of Hong Kong? How will China treat Hong Kong? How will the rest of the world treat Hong Kong? What will be the result of the interplay between the Chinese socialist system and the capitalist system of Hong Kong? This Note will attempt to address these issues.

Part II of this Note discusses the history behind the settlement of Hong Kong and describes how it became part of the British Empire. Part III discusses the Joint Declaration, the document that outlines the policies regarding the transfer of Hong Kong's sovereignty to China. After tracing the history of the Joint Declaration, this Note outlines various perspectives of the persons and states directly affected by the transfer of sovereignty. Ultimately, Part III analyzes the Joint Declaration and its effect on Hong Kong upon the transfer of control. Part IV addresses the Basic Law, which will serve as Hong Kong's constitution after China takes control of the territory. Finally, Part V discusses the commercial and economic implications of the transfer of sovereignty by examining the economic climate in Hong Kong from the late 1970s to the present, with particular emphasis on

1. Throughout history, England has been referred to as England, Great Britain, and the United Kingdom. In 1706, Scotland united with England and Wales, and the resulting alliance was named Great Britain. In 1922, the southern counties of Ireland formed the Irish Free State, and the name of Great Britain was changed to the United Kingdom of Great Britain and Northern Ireland. See, e.g., Stephanie J. Millet, Note, *The Age of Criminal Responsibility in an Era of Violence: Has Great Britain Set a New International Standard?*, 28 VAND. J. TRANSNAT'L L. 295, 298 n.8 (1995) (citing RICHARD J. TERRILL, *WORLD CRIMINAL JUSTICE SYSTEMS: A SURVEY* 1 (1992)).

China's unique "one country, two systems" arrangement. This Note concludes that although the future prosperity of Hong Kong is bright, Hong Kong has already reached its peak as a leading economic and financial center.

II. HISTORICAL BACKGROUND

A. *Hong Kong in the 1800s*

Hong Kong's development as a leading world commercial center began in the 1800s when the British Empire expanded into the Far East.² In its quest for Chinese silk and tea, the Empire founded Hong Kong as a British colony in 1841.³ Since the 1800s, Hong Kong has grown from a sparsely populated island⁴ to an affluent colony of almost six million people.⁵

2. See Johnson C. Ng, Note, *Hong Kong After 1997: An Experimental Government Practicing Capitalism Within a Socialist Sovereign*, 10 N.Y.L. SCH. J. INT'L & COMP. L. 67, 69 (1989); Eric K. Shiu, Recent Development, *Hong Kong: Prospects of Autonomy Under Chinese Rule After 1997*, 3 TRANSNAT'L LAW. 141, 143 (1990).

3. See HONG KONG 1981, at 232 (Cynthia K. Rao ed., 1981). Under the Convention of Chuanbi, Hong Kong Island was ceded to Great Britain on January 20, 1841. A naval landing party raised the British flag on the island on January 26, 1941, and Captain Charles Elliot of the Royal Navy proclaimed Hong Kong a Crown colony. *Id.* Prior to the establishment of a permanent British settlement at Hong Kong, foreign trade with China was based in Guangzhou (Canton). Within Guangzhou, all foreign merchants were strictly regulated. They were not allowed: to reside in Guangzhou year-round; to have contact with the local Chinese residents; to learn to speak the Chinese dialects; or to carry firearms. European women were not allowed to enter factories. Moreover, customs duties were levied inconsistently, port dues on British ships were excessive, and the Chinese trading monopoly set all prices on goods, thereby preventing the British from bargaining freely. The Chinese also referred to the Europeans as "barbarians" and treated them as such. As a result, the British wanted a better trading situation: the British traders wanted to come and go as they pleased; they wanted duties and taxes to be levied consistently; and they wanted to be treated as equals rather than as a lower class of people. The establishment of a permanent British colony would help to accomplish these goals and would allow Britain to exert more control over foreign trade with China. See G.B. ENDACOTT, A HISTORY OF HONG KONG 5-10 (1958) [hereinafter ENDACOTT, 1st ed.].

4. In 1851, the population of Hong Kong was approximately 30,000. HONG KONG 1981, *supra* note 3, at 234. Before the arrival of the British Empire, Hong Kong was used as a port by pirates. See Shiu, *supra* note 2. For a fictional, but highly accurate, description of the quality of life and atmosphere in Hong Kong in the 1800s, see JAMES CLAVELL, TAI-PAN (1966).

5. The population of Hong Kong in 1991 was approximately 5.7 million. THE WORLD ALMANAC AND BOOK OF FACTS 1995, at 840 (Robert Famighetti ed., 1995). See Patricia H. Palumbo, Comment, *Analysis of the Sino-British Joint Declaration and the Basic Law of Hong Kong: What Do They Guarantee the People*

Trade between the Chinese merchants and the British traders was one-sided. The British bought Chinese silks, *nankeens* (a type of fabric), and teas; the Chinese bought nothing from the British in return.⁶ As a result, the British quickly amassed a large trade deficit with China and, in an attempt to eliminate that deficit, introduced opium to the Chinese market.⁷ Recognizing the deleterious consequences of using this drug, in 1839 the Chinese government attempted to ban the import of opium.⁸ The prohibition on opium and the subsequent crisis surrounding the seizure of illegal opium shipments in the southern port city of Guangzhou (Canton) infuriated the British,⁹ who were desperately trying to reduce their trade deficit with China. The tension between the British and the Chinese culminated in the first Opium War,¹⁰ which lasted from 1839 to 1842.¹¹

of *Hong Kong After 1997?*, 6 CONN. J. INT'L L. 667, 669 (1991). As anecdotal evidence of Hong Kong's wealth, Palumbo notes that it has the largest concentration of Rolls-Royces in the world. Additionally, Hong Kong has "100 fur retailers and up to a dozen brands of French cognac." *Id.*

6. See JEAN CHESNEAUX ET AL., *CHINA FROM THE OPIUM WARS TO THE 1911 REVOLUTION* 49-50 (Anne Destenay trans., 1977). The Chinese believed that they had no need for products offered by the European traders. The Europeans desired trade with China, and if they wished to do so, then they had to accept the terms dictated by the Chinese. See ENDACOTT, 1st ed., *supra* note 3, at 6.

7. See G.B. ENDACOTT, *A HISTORY OF HONG KONG* 10 (2d ed. 1973) [hereinafter ENDACOTT, 2d ed.]. Opium, purchased by traders in India, was in heavy demand on the Chinese market. The British did not want to continue paying for goods with silver, and opium was the only product in which the Chinese showed considerable interest. This demand for opium led to widespread smuggling of opium by Western traders. This triangle of Chinese tea, Indian opium, and British silver enabled the British to create a more favorable trade balance. See CHESNEAUX ET AL., *supra* note 6, at 53-54.

8. See ENDACOTT, 2d ed., *supra* note 7, at 11. Opium has a long history of medicinal use in China, but in the seventeenth century recreational opium-smoking for pleasure became common. As a result, addiction to opium as a drug became a serious problem for the Chinese. *Id.* at 10

9. See *id.* at 12. All foreign merchants were ordered to surrender the opium in their possession. Additionally, several factories in Guangzhou were seized, and many Europeans were held hostage by Chinese government officials. *Id.*

10. For a more detailed description of the conflict, see *id.* at 14-34.

11. See CHESNEAUX ET AL., *supra* note 6, at 62. One commentator defines the underlying causes of the Opium War as follows:

(1) The British merchants were dissatisfied with the Chinese rules governing trade and the arbitrary duties and charges on ships and goods.

(2) The British believed that force was the only way to get the Chinese to change their regulatory policy.

(3) The British merchants wanted to abolish the monopolies held by Chinese merchants and to open China to free trade with Western traders.

(4) The British government wanted to open negotiations with the Chinese government, but the Chinese would not admit to being equals

The Treaty of Nanjing¹² officially ended the Opium War between Great Britain and China. Under the terms of this treaty, the Island of Hong Kong was ceded to Great Britain in perpetuity,¹³ and thus Britain gained control of the first territory comprising modern-day Hong Kong.¹⁴ Yet, fighting between the two states continued in the years following the signing of the Treaty of Nanjing. After eighteen more years of conflict,¹⁵ China ceded additional territories to Great Britain.¹⁶ Under the 1860 Convention of Beijing,¹⁷ Great Britain acquired two more territories of modern Hong Kong as China ceded Kowloon Peninsula and Stonecutters Island to Great Britain in perpetuity.¹⁸

with the British. Thus, negotiations would not occur unless the British used force.

(5) Europeans were treated as "barbarians" by the Chinese.

(6) The Chinese believed that they were self-sufficient. Therefore, they did not need to trade with the Europeans, and if the Europeans did not like the terms of trade, they could return to Europe.

(7) The growth of the opium trade—illegal in the eyes of the Chinese government—created a potential for conflict. However, without the opium trade, Great Britain's trade deficit with China would increase.

ENDACOTT, 1st ed., *supra* note 3, at 14.

The conflict began when Commissioner Lin Zexu was sent to Guangzhou to deal with the growing opium problem. He forced all Westerners to hand over their opium, which was then destroyed. The British traders retreated to uninhabited Hong Kong Island to regroup. The conflict began—war was never officially declared—in southern China and then moved north toward the mouth of the Yangtze River. The Chinese forces were soundly defeated by the British, and a peace treaty was signed in August 1842. See MILTON W. MEYER, CHINA 254 (2d ed. 1994).

12. Treaty of Nanking, Aug. 29, 1842, China-Gr. Brit., 30 Brit. For. St. Pap. 389, 93 Consol. T.S. 465.

13. *Id.* art. III, 30 Brit. For. St. Pap. at 390, 93 Consol. T.S. at 467. Additionally, five ports—Fuzhou, Guangzhou, Ningbo, Shanghai, and Xiamen (Amoy)—were opened to British traders. In these cities, the British were allowed to station a government trade official. They were also permitted to reside in these cities year-round. Moreover, the British merchants could trade with whomever they wished; the Chinese merchants no longer held a monopoly on all trade. See MEYER, *supra* note 11, at 254-55.

14. The colony of Hong Kong consists of Hong Kong Island, Kowloon Peninsula, the New Territories, and Stonecutters Island.

15. See Nancy C. Jackson, *The Legal Regime of Hong Kong After 1997: An Examination of the Joint Declaration of the United Kingdom and the People's Republic of China*, 5 INT'L TAX & BUS. LAW. 377, 380 (1987).

16. See Wendy D. Bowie, Note, *The Effect of the Tiananmen Square Massacre Upon Negotiations for the Draft Basic Law of the Hong Kong Special Administrative Region*, 8 DICK. J. INT'L L. 245, 248 (1990).

17. Convention of Friendship, Oct. 24, 1860, China-Gr. Brit., 50 Brit. For. St. Pap. 10, 123 Consol. T.S. 71 [hereinafter Convention of Beijing].

18. *Id.* art. VI, 50 Brit. For. St. Pap. at 12, 123 Consol. T.S. at 73. Kowloon Peninsula, approximately one mile from Hong Kong Island, extends toward the

Great Britain acquired the final component of modern-day Hong Kong, the New Territories, in 1898.¹⁹ The Sino-Japanese War left China in a severely weakened economic condition, and Great Britain and other Western powers exploited this condition by demanding additional concessions and rights within mainland China.²⁰ The British, concerned with Western imperialism in the Far East, sought to expand the territory of Hong Kong to defend it from attack by a European power or the United States.²¹ In the Convention of 1898,²² Great Britain convinced China to lease the New Territories to Great Britain for ninety-nine years.²³ Hong Kong Island, Kowloon Peninsula, Stonecutters Island, and the New Territories constitute present-day Hong Kong.

B. *Developments in the Twentieth Century*

The New Territories have become so integrated with the remainder of the territories constituting Hong Kong that the Chinese government has found it impractical to treat the entities separately.²⁴ In fact, the People's Republic of China refused to enter into any negotiations regarding Hong Kong unless all of present-day Hong Kong was treated as a single territory.²⁵ Thus,

island of Hong Kong into Victoria Harbour. Stonecutters Island is a small area of land situated in the harbor between Hong Kong Island and Kowloon Peninsula.

19. For a discussion of the three agreements, see generally PETER WESLEY-SMITH, *UNEQUAL TREATY 1898-1997* (1983). After explaining China's view that the treaty is unequal, Wesley-Smith discusses both the history of the 1898 agreement and its impact on the future of Hong Kong.

20. See Hungdah Chiu, *Introduction*, 20 CASE W. RES. J. INT'L L. 1, 1 (1988). The Sino-Japanese War (1894-1895) arose over a dispute about the rights held by China and Japan. The Japanese, using a more modern military force than the Chinese, easily prevailed in this short conflict. The treaty ending the conflict imposed harsh terms on China. China lost its rights in Korea, recognized Korea as an independent state, paid an indemnity to Japan, and opened four port cities to trade with the Japanese. See MEYER, *supra* note 11, at 263-64. The ease with which Japan prevailed clearly demonstrated China's military weakness and caused China to lose territory for the first time since the 1860 Treaty of Beijing. Moreover, the indemnity paid to Japan depleted China's treasury. See WESLEY-SMITH, *supra* note 19, at 22.

21. See ENDACOTT, 1st ed., *supra* note 3, at 260-62. The acquisition of the New Territories increased the territory of the Hong Kong colony by 355 square miles. *Id.* at 262.

22. Convention of Respecting an Extension of Hong Kong Territory, June 9, 1898, China-Gr. Brit., 90 Brit. For. St. Pap. 17, 186 Consol. T.S. 310 [hereinafter Convention of 1898].

23. *Id.* para. 1.

24. See Palumbo, *supra* note 5, at 670.

25. See *id.* China has gone so far as threatening to discontinue the supply of water and other resources to Hong Kong. Given that China is the sole supplier

the expiration of the lease on the New Territories alone is the functional equivalent of the expiration of a lease on all of Hong Kong.²⁶

Chinese governments have consistently demonstrated a strong desire to reunite all Chinese territory lost over the years with the rest of mainland China. Both the Chinese people and the Chinese governments through the years have always believed that all Chinese persons should be united one in nation.²⁷ Thus, various factions within China had long considered the three agreements²⁸ through which Great Britain acquired modern-day Hong Kong as "unequal treaties."²⁹ Moreover, one of the primary goals of China's Nationalist Revolution, which overthrew the Manchu Dynasty and founded the Republic of China in 1912, was to abrogate the treaties and to recover the territories lost by the Manchu Dynasty to the British Empire in the 1800s.³⁰ The Communist government of China, which succeeded the Nationalists in 1949, has likewise maintained that Hong Kong is properly Chinese territory, which should be reintegrated into the Chinese mainland.³¹ The People's Republic of China has

of water to Hong Kong and the chief supplier of resources, the United Kingdom considers this threat credible. *See id.* at 670-71.

26. *See id.* at 670.

27. China's primary goal is to reunite mainland China with the island of Taiwan. Some scholars opine that the "one country, two systems" approach to Hong Kong may also be applied to the People's Republic and Taiwan. *See, e.g.,* Agnes J. Bundy, *The Reunification of China with Hong Kong and Its Implications for Taiwan: An Analysis of the "One Country, Two Systems" Model*, 19 CAL. W. INT'L L.J. 271 (1989).

28. Treaty of Nanking, *supra* note 12; Convention of Beijing, *supra* note 17; Convention of 1898, *supra* note 22.

29. Chiu, *supra* note 20, at 1-2. *See generally* WESLEY-SMITH, *supra* note 19, for a discussion of the Chinese view that the treaties are unequal.

30. *See* Chiu, *supra* note 20, at 2. Chinese nationalism came into prominence at the beginning of the twentieth century and revolved around two themes: hatred of the Manchu Dynasty and hostility toward imperialism. While all the layers of Chinese society did not have the same vision for the future of China, these twin themes provided lightning rods that united much of China for the revolution. *See* CHESNEAUX ET AL., *supra* note 6, at 362-63. The reintegration of Hong Kong into mainland China is considered one of the top priorities for the Chinese and "a mandate of the Nationalist Revolution." Palumbo, *supra* note 5, at 671. The Communists became more prominent in the late 1920s and began to compete with the Nationalists for control of China. This competition for control ultimately resulted in the overthrow of the Nationalists in 1949. *See* MEYER, *supra* note 11, at 278-91. The Nationalist government fled to Taiwan after they lost control of the mainland, and the Communists (led by Mao Zedong) took power in 1949. *See id.* at 671 n.26.

31. *See* Chiu, *supra* note 20, at 1-2. The Communist government views Taiwan as Chinese territory that should be recovered by the People's Republic of China. *See, e.g.,* Bundy, *supra* note 27, at 274.

remained very interested in reasserting its control over Hong Kong when the opportunity presented itself.³²

III. THE JOINT DECLARATION

In 1984 the People's Republic of China and the United Kingdom signed the Joint Declaration,³³ the document governing the transfer of control of Hong Kong from the United Kingdom to China in 1997. The Joint Declaration also outlines the terms of governance of Hong Kong by the People's Republic of China after the transfer of control has occurred in 1997. The major provisions of the Joint Declaration may be summarized as follows:

1. In 1997 Hong Kong will become a Special Administrative Region of the People's Republic of China under Article 31 of China's Constitution.³⁴ Hong Kong will enjoy a "high degree of autonomy," except in matters pertaining to foreign affairs and defense.
2. Hong Kong will be vested with executive, legislative, and independent judicial power, including final adjudication.
3. Hong Kong's chief executive will be appointed by the People's Republic of China after elections or consultation in Hong Kong. The government of Hong Kong will be composed of Hong Kong residents.
4. Hong Kong shall maintain capitalistic economic and trade systems for fifty years after 1997.
5. The existing social and economic system will remain unchanged. Freedoms of speech, movement, press, assembly, strike, and religion, among other freedoms, will be protected by law. Similarly, private property rights will be protected.

32. See Bundy, *supra* note 27, at 274.

33. Joint Declaration of the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the People's Republic of China on the Question of Hong Kong, Dec. 19, 1984, P.R.C.-U.K., 1984 Gr. Brit. T.S. No. 26 (Cmd. 9543) [hereinafter Joint Declaration].

34. Article 31 provides: "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 special conditions." ZHONG HUA REN MIN GONG HE GUO XIAN FA [Constitution] art. 31 [hereinafter P.R.C. CONST.]. Accordingly, Article 62(13) of the Constitution provides the National People's Congress with the power "to decide on the establishment of special administrative regions and the systems to be instituted there." *Id.* art. 62(13).

6. Apart from displaying the national flag and emblem of the People's Republic of China, Hong Kong may use a regional flag and emblem of its own.

7. Hong Kong may participate in relevant international organizations and international trade agreements. It may establish official and semi-official economic and trade missions in foreign states, using the name "Hong Kong, China" to maintain and develop relations and to conclude and implement agreements with states, regions, and relevant international organizations in appropriate fields.

8. The People's Republic of China defense force stationed in Hong Kong shall not interfere with the internal affairs of Hong Kong, and the expenditures for these military forces shall be borne by China's Central People's Government.

9. China's National People's Congress will enact a Basic Law to implement the Joint Declaration.³⁵

From the perspective of Hong Kong and the United Kingdom, the Joint Declaration is an international agreement that gives the People's Republic of China control over Hong Kong, yet limits the extent of control that China may exert over Hong Kong after the transfer of sovereignty.³⁶ The Chinese, however, have not indicated that they hold the same view regarding the Joint Declaration. Thus, whether the Chinese will treat the Joint Declaration as an international agreement—rather than as merely a domestic agreement that can be unilaterally overridden by the Chinese government—is still unknown.³⁷

A. *The History of the Joint Declaration*

Since 1983 the People's Republic of China has maintained that it would not allow Hong Kong to become an independent state.³⁸ However, in response to a worldwide movement that

35. Chiu, *supra* note 20, at 5-6.

36. See Bundy, *supra* note 27, at 273.

37. See text accompanying *infra* notes 68-72. The PRC does not recognize agreements that it deems unequal or that infringe upon the sovereignty of one of the contracting parties. The PRC, however, has been inconsistent in applying this standard. This inconsistency has led several commentators to the conclusion that whether the PRC complies with international agreements is determined by political motivations rather than interpretations of public international law. See Bundy, *supra* note 27, at 273-74.

38. Cf. Jürgen Domes, *The Impact of the Hong Kong Problem and Agreement on PRC Domestic Politics*, in HONG KONG: A CHINESE AND INTERNATIONAL CONCERN 79, 87-89 (Jürgen Domes & Yu-Ming Shaw eds., 1988).

encouraged the granting of independence to colonial states,³⁹ the People's Republic of China was willing to maintain the status quo of Hong Kong and thus entered into negotiations concerning the Joint Declaration.⁴⁰ Despite China's assertions of its right to control Hong Kong, the United Kingdom had always claimed its right to rule the territory. In fact, until the late 1970s, the United Kingdom had stood by its assertion that the agreements ceding Hong Kong to it were perfectly valid.⁴¹ In the late 1970s and early 1980s, as the expiration of the United Kingdom's ninety-nine-year lease approached, both the controversy surrounding the Hong Kong independence movement and the attempts by China to exercise control over Hong Kong increased. Moreover, the infeasibility of having the United Kingdom continue its administration of Hong Kong after 1997 became more and more apparent. As a result, the United Kingdom began to negotiate with China over the future of Hong Kong.⁴² In 1982, in anticipation of the upcoming expiration of the lease of the New Territories, British Prime Minister Margaret Thatcher traveled to China to broach the issue of negotiations regarding Hong Kong.⁴³ These meetings firmly established China's unwillingness to consent to any agreement that would allow the United Kingdom to continue to administrate any portion of Hong Kong.⁴⁴

Because the United Kingdom's continued governance over Hong Kong remained doubtful, the United Kingdom had two goals in subsequent negotiations with China. First, the United Kingdom sought to preserve the safety of the residents of Hong Kong. Second, the United Kingdom sought to maintain investors' confidence in the territory.⁴⁵ The United Kingdom's safety concerns stemmed primarily from the territory's dependence on

39. See Palumbo, *supra* note 5, at 672. Specifically, in 1960 the United Nations Declaration on the Granting of Independence to Colonial Countries and Peoples was issued. Hong Kong was not included in this declaration, but it did encourage a movement for Hong Kong's independence. Additionally, in 1964, the World Youth Forum Resolution mentioned Hong Kong among a list of areas to be granted independence. *Id.*

40. Chiu, *supra* note 20, at 3; see also Domes, *supra* note 38, at 88.

41. See Bundy, *supra* note 27, at 273.

42. See Ng, *supra* note 2, at 73.

43. Thatcher negotiated with then-Premier Zhao Ziyang and then-Chairman of the Military Affairs Commission, Deng Xiaoping. Zhao is no longer Premier of China and Deng has resigned from his position; however, Deng is still regarded as China's paramount leader. See Chiu, *supra* note 20, at 4.

44. See Hungdah Chiu, *Introduction, in THE FUTURE OF HONG KONG 7-9* (Hungdah Chiu et al. eds., 1987).

45. See Ng, *supra* note 2, at 73.

the mainland for valuable subsistence resources.⁴⁶ Moreover, the United Kingdom feared that the fate of Hong Kong would be determined unilaterally by the People's Republic of China if the two countries failed to reach an agreement on the issue.⁴⁷ On the other hand, the British feared that investors would divert funds away from Hong Kong if its political, economic, and social future were uncertain. However, if the United Kingdom could negotiate an agreement that would provide hope for a smooth transfer of sovereignty, then investors would continue to look to Hong Kong for both short-term and long-term investment opportunities.

On September 26, 1984, the United Kingdom and the People's Republic of China initialed the Joint Declaration,⁴⁸ which the parties signed on December 19, 1984. The Joint Declaration signified the United Kingdom's relinquishment of sovereign control over Hong Kong in deference to administration of the territory by the People's Republic of China.⁴⁹

B. *Perspectives on the Transfer of Sovereignty of Hong Kong to China*

1. British and Hong Kong Perspectives Prior to the Signing of the Joint Declaration

Since the 1800s, the British government has acted as a "benevolent dictator" toward Hong Kong. The Hong Kong and British governments made policy choices in the best interests of Hong Kong, and the residents of the territory had limited input into its administration. Consequently, the territory's residents have shown little interest in the politics surrounding the administration of Hong Kong.⁵⁰

46. Hong Kong depends almost entirely on China for water, meat, vegetables, and food grains. The United Kingdom recognized that China could paralyze Hong Kong by shutting off its water supply. See Palumbo, *supra* note 5, at 673.

47. See *id.*

48. See Joint Declaration, *supra* note 33.

49. See Palumbo, *supra* note 5, at 674.

50. *Id.* at 684. Prior to 1982, the Urban Council was the only governmental body in Hong Kong that was publicly elected; however, the right to vote was held only by those who met certain educational, financial, or occupational qualifications. Therefore, the residents of Hong Kong exercised little control over the government around them and had virtually no way to change the situation. As a result, only 34,381 residents of Hong Kong registered and only 6,195 actually voted in the 1981 elections. These voters represented only a fraction of the potential electorate of 440,000. See NORMAN MINERS, *THE GOVERNMENT AND POLITICS OF HONG KONG* 118-25 (4th ed. 1986).

a. Hong Kong Under British Rule—1842-1984

The Legislative Council (Council) has been the law-making body of Hong Kong since 1842. Until 1985, the members of the Council were appointed by the Governor of Hong Kong, and these members swore an oath of allegiance to the Queen of England.⁵¹ In making the laws of Hong Kong, the Council considers two categories of bills. The first category relates to minor administrative matters.⁵² The second category contemplates more substantive changes in the law, including: finance bills, which authorize the budget for Hong Kong's government and implement changes in taxation; substantial amendment to, or complete recasting of, old ordinances; and legislation on completely new subjects.⁵³ For a bill to become law, the Council must pass it and the Governor must assent to it.⁵⁴ The British Parliament, however, retains the right to disallow any bill passed by the Council and assented to by the Governor.⁵⁵ Thus, until

51. See MINERS, *supra* note 50, at 118.

52. See *id.* at 125. These laws include:

- (a) Clarifying ambiguities in drafting and rectifying minor omissions in the law;
- (b) Simplifying procedures; redefining the powers and duties exercised by particular officials;
- (c) Implementing international conventions and agreements (for example, controlling the packing and labeling of dangerous goods carried by air);
- (d) Repealing obsolete ordinances;
- (e) Increasing the penalties for certain offenses; altering the liability to include the payment of costs or compensation;
- (f) Changing the composition and powers of legally constituted bodies (for example, making changes to the Housing Authority or the Productivity Council);
- (g) Bills to incorporate or regulate the affairs of private institutions.

Id.

53. *Id.* at 125-26.

54. See *id.* at 129. Laws are passed in this manner in all but two situations. First, the Governor must obtain the Secretary of State's consent before assenting to any bill relating to (a) divorce, (b) the grant of land or money to the Governor, (c) currency and the issuance of bank notes, (d) banks and banking practices, (e) the imposition of differential duties, (f) anything inconsistent with treaties binding upon the United Kingdom, (g) the discipline and control of the armed services, (h) anything prejudicing the rights, property, trade, or shipping of British subjects not living in Hong Kong, (i) discriminatory legislation against non-Europeans, and (j) any provision previously disallowed or not assented to. *Id.* at 130. Second, the Secretary of State must also consent to a bill that contains a clause requiring the Secretary's consent. *Id.*

55. *Id.* at 131.

1984, the British government maintained the right to exercise nearly complete control over Hong Kong.

b. Hong Kong Under British Rule—1984-present

The approaching transfer of sovereignty from the United Kingdom to the People's Republic of China in 1997 has heightened political awareness throughout Hong Kong.⁵⁶ The residents of Hong Kong have begun to take a very active interest in the transfer of sovereignty and the subsequent administration of Hong Kong. For example, in 1985 twenty-four seats on the Legislative Council were filled through public elections. This election marked the first time that any members of the Legislative Council were publicly elected—a significant step toward creating a system of government that will be more accountable to the citizens of Hong Kong.⁵⁷

Hong Kong's residents welcomed the impending transfer of sovereignty when the United Kingdom and the People's Republic

56. See Palumbo, *supra* note 5, at 684. Palumbo notes the British Parliamentary system, with its checks and balances, has assured residents of Hong Kong that the British government will not control the colony oppressively. *Id.* China, however, has a centralized government with no checks or balances to protect the interests of Hong Kong. *Id.* Therefore, the people of Hong Kong are taking an interest in Hong Kong government while the opportunity still exists. *See id.*

57. See MINERS, *supra* note 50, at 119. Despite the trend toward political involvement, occasionally there are signs that political apathy will return. One businessman has even remarked:

I don't think the pattern [of government in Hong Kong] has really changed. The British, despite the window-dressing, still go ahead and decide things. People here are used, if not resigned, to that. [The British are] already making their separate arrangements with China.

The people that are already on [the Legislative Council] who are not government officials will be the ones who stand for election. It will be the same old faces, so what's the point?

Chris Peterson, *After All the Fuss, Hong Kong Grapples with Voter Apathy*, Reuter Library Report, Oct. 24, 1990, available in LEXIS, News Library, Non-US File. Another businesswoman has added: "I'm not registering [to vote] simply because I can't see how it will help Hong Kong after 1997. I'm very pessimistic about life here under Chinese rule, and I simply don't see the point. Call it apathy if you like." *Id.* See also *Hong Kong Reform Plans Lose Support*, TORONTO STAR, June 27, 1994, at A13.

Other Hong Kong residents do not see the apathy in present-day Hong Kong, but expect the apathy to return when the business people in Hong Kong begin to make money under Chinese administration. "In the past 10 years the reality has been that to make money you have had to be more interested in politics and in what's going on around you. Perhaps in 10 or 20 years' time, when Hong Kong is prosperous again, apathy will come back." Stephen Vines, *Hong Kong Hopes, Fears and Plans*, GUARDIAN, May 5, 1992, at 2, available in LEXIS, News Library, Non-US File.

of China announced it in 1984. Unlike its prior governmental actions regarding Hong Kong, the British government actively consulted public opinion during the negotiations of the draft of the Joint Declaration with China.⁵⁸ Accordingly, the majority of Hong Kong's residents supported the draft agreement.⁵⁹ Those who endorsed the agreement primarily did so because the Joint Declaration seemed to provide a suitable framework for maintaining Hong Kong's prosperous system. Furthermore, the policies outlined in the draft appeared to offer a stable regional environment and, perhaps most importantly, continued economic stability.

Public support for the draft agreement, however, was not unanimous. Dissenters expressed considerable concern over the potential incompatibility of the "runaway" capitalist system of Hong Kong and the socialist system of China.⁶⁰ Additionally, the growing political unrest in China in the years before the signing of the Joint Declaration and the potential effect that such unrest could have on Hong Kong disturbed many Hong Kong residents.⁶¹ Perhaps the greatest concern in Hong Kong is that the Chinese government will not honor its promise to maintain Hong Kong's capitalist system after the exchange of sovereignty.⁶²

58. Palumbo, *supra* note 5, at 684; see also WHITE PAPER: A DRAFT AGREEMENT BETWEEN THE GOVERNMENT OF THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND AND THE GOVERNMENT OF THE PEOPLE'S REPUBLIC OF CHINA ON THE FUTURE OF HONG KONG (Sept. 26, 1984). Palumbo notes that this White Paper was published and circulated among the people of Hong Kong in order to solicit public opinion about the transfer of sovereignty. See Palumbo, *supra* note 5, at 684-85 n.126.

59. See *Background to the Negotiations Preceding the Sino-British Joint Declaration*, in THE FUTURE OF HONG KONG, *supra* note 44, at 202 [hereinafter *Background to Negotiations*]. The Governor of Hong Kong established an Assessment Office "to provide the British Government with an analysis and assessment of opinion in Hong Kong on the draft agreement." *Id.* at 201. The office received views from the media, 430 representative organizations and groups, and twenty-three opinion polls. *Id.* at 202. In his report, the Commissioner of the Assessment Office concluded that most of the people of the colony supported the draft agreement—a conclusion accepted as reliable by independent observers. *Id.* Moreover, all the principal representative bodies in Hong Kong—including the Executive Council, the Legislative Council, the Urban Council, and all eighteen district boards—voiced their support. *Id.* at 202.

60. Palumbo, *supra* note 5, at 685.

61. *Id.* For a discussion of political unrest, the Tiananmen Square massacre, and its impact on Hong Kong, see Bowie, *supra* note 16. Bowie, while not reaching any conclusions about the condition of Hong Kong after 1997, voices many concerns over the unrest in China. *Id.* at 264-66. Specifically, she notes that the power struggle within the Chinese government renders the entire situation very unpredictable. *Id.* at 264-66.

62. See *Background to Negotiations*, *supra* note 59, at 219.

In 1984, upon the signing of the Joint Declaration, British Prime Minister Margaret Thatcher conveyed the optimism held by the British about the upcoming transfer of sovereignty.⁶³ Confidence in Hong Kong's government and, thus, its economic future would begin to wane if Hong Kong were perceived as having a bleak future. Indeed, the British had an incentive to secure Hong Kong's future because many British citizens and corporations had invested in Hong Kong. Many had lived in Hong Kong for a number of years and considered it home, and the British citizens who intended to remain in Hong Kong after the transfer of sovereignty sought reassurances that their social freedoms and property rights would still be protected. They relied on the British government to protect their interests, which could be accomplished through a smooth transfer of sovereignty that allowed Hong Kong to maintain its unique role in the global economy as a center of trade and finance. Therefore, the United Kingdom wanted to negotiate an agreement with the People's Republic of China that would maintain the stability and prosperity of Hong Kong.⁶⁴

Upon entering the negotiations, the British shouldered a heavy burden. For the sake of Hong Kong, they had to reach a compromise with China that would preserve the rights and freedoms of the people of Hong Kong.⁶⁵ Furthermore, the British government recognized political strife and possibly violence would erupt if it were unable to reach an agreement acceptable to both the people of Hong Kong and the government of China.⁶⁶ Given that the British were going to lose a valuable part of their empire,

63. See *id.* at 203. In remarks to the Executive and Legislative Council in Hong Kong after the signing of the Joint Declaration, Prime Minister Thatcher stated that the Joint Declaration alone did not ensure a successful future for Hong Kong. *Id.* Rather, the future of Hong Kong would be determined by the "resilience, imagination and sheer hard work" of the people of Hong Kong. *Id.* at 203. The residents of Hong Kong had created one of the world's great market economies. The efforts taken by Hong Kong's residents from the signing of the Joint Declaration to the transfer of sovereignty in 1997 would be the decisive factor in Hong Kong's future. *Id.* Ultimately, she stated that she expected the prosperity of Hong Kong to "flourish and endure." *Id.*

64. *Id.* at 199.

65. See Palumbo, *supra* note 5, at 686.

66. *Id.* at 686-87. Cf. Ta-ling Lee, *Hong Kong: The Human Rights Dimension*, in *THE FUTURE OF HONG KONG*, *supra* note 44, at 115-33. A poll of Hong Kong residents in April 1983 revealed that ninety-five percent favored no change in the administrative control of Hong Kong. *Id.* at 123. Only forty-two percent thought that Hong Kong's becoming a special administrative region of the PRC was "acceptable, and a mere twenty-six percent favored an outright return of administrative control of Hong Kong to the PRC." *Id.* While the opposition to Chinese administration of Hong Kong was not unanimous among the Hong Kong population, the overwhelming majority of residents favored maintaining the status quo. *Id.*

they could only hope to get the best arrangement for the people of Hong Kong.⁶⁷

2. The Chinese Perspective on the Joint Declaration

The People's Republic of China approached Hong Kong as a domestic, rather than international, concern.⁶⁸ This view of Hong Kong has raised the issue of whether the Chinese will honor the Joint Declaration after 1997 at all.⁶⁹ The Chinese government has in the past shown a tendency of honoring domestic agreements much less rigorously than international agreements; this record, in turn, creates a greater cause for concern.⁷⁰ China may deem the Joint Declaration valid only during the transitional period from 1984, when the Joint Declaration was signed, until June 30, 1997, when the parties execute the transfer of sovereignty and the Basic Law takes effect as the law of Hong Kong.⁷¹ The People's Republic of China will likely regard the administration of Hong Kong as a purely domestic issue governed only by domestic law because China will maintain that no international agreement and, therefore, no international law would govern the administration of Hong Kong after 1997. If China conducts the administration of Hong Kong solely on a domestic level, then British warnings or pronouncements made after the transfer of sovereignty will have little if any effect on China's decision making.⁷²

67. Technically, the United Kingdom could have retained parts of Hong Kong—Hong Kong Island, Kowloon Peninsula, and Stonecutters Island—but the loss of the New Territories would have meant the loss of almost ninety-two percent of Hong Kong's land. For the sake of political expediency, the United Kingdom opted to cede all of present-day Hong Kong back to the PRC. See Palumbo, *supra* note 5, at 687.

68. *Id.* China has always viewed Hong Kong as part of China and has looked forward to its reintegration into the mainland. *Id.*

69. See generally Hungdah Chiu, *The 1984 Sino-British Agreement on Hong Kong and Its Implications on China's Unification*, 21 ISSUES & STUD. 13 (1985).

70. See *id.* This history, to a large part, could explain the Chinese negotiating strategy of refusing to enter into treaty negotiations with Britain regarding Hong Kong. Instead of agreeing to a treaty, the two parties agreed to a joint declaration. For a discussion of the distinctions between treaties and other international agreements, see generally LOUIS HENKIN ET AL., *INTERNATIONAL LAW* 416-543 (3d ed. 1993).

71. See Palumbo, *supra* note 5, at 688.

72. For an opinion that the Joint Declaration is an international agreement, see Georg Ress, *The Hong Kong Agreement and Its Impact on International Law*, in *HONG KONG: A CHINESE AND INTERNATIONAL CONCERN*, *supra* note 38, 129, 135-37. The name given to the agreement does not affect its status as an international document. The Joint Declaration is binding upon the PRC after the transfer of sovereignty. See *id.*

3. Recent Hong Kong Perspectives

Residents of Hong Kong initially welcomed the publication of the draft Joint Declaration. Today, however, Hong Kong residents view the impending transfer of sovereignty with pessimism. This pessimism springs largely from the political turmoil in the People's Republic of China following the Tiananmen Square massacre in 1989.⁷³ The massacre instigated numerous political changes within China. For instance, Zhao Ziyang, a co-signor of the Joint Declaration, was removed from the office of Prime Minister of China.⁷⁴ Hong Kong residents fear similar incidents like Tiananmen Square could occur within China after 1997 and seriously affect Hong Kong if the world economic community reacts harshly to China and decreased investment results.

Additionally, many residents of Hong Kong contend that the actual transfer of power to the People's Republic is rife with problems. Public opinion illustrates widespread dissatisfaction with the British government's issuance of the November 21, 1984 White Paper, a formal British document that details how a representative government for Hong Kong would be developed so that Hong Kong could function autonomously.⁷⁵ While the White Paper expressed the British government's favorable opinion of the transfer of sovereignty, a close reading of the Joint Declaration itself reveals a startling number of ambiguities and uncertainties.⁷⁶ Because the White Paper offered a means of

73. See Bowie, *supra* note 16, at 247. In May and June of 1989, many students in Beijing protested against government oppression through non-violent demonstrations and hunger strikes. On June 4, 1989, the People's Liberation Army of the Government of the People's Republic of China killed thousands of these protesters, most of whom were reported to be peaceful. Interview with Nicholas Kristof, *New York Times* Beijing Correspondent, in Beijing, P.R.C. (May 14, 1992).

74. See Palumbo, *supra* note 5, at 688. Zhao disappeared from public view after his removal. He was reportedly removed because he had been too sympathetic to the concerns of the protesters. *Id.*

75. See George L. Hicks, *Hong Kong on the Eve of Communist Rule*, in *THE FUTURE OF HONG KONG*, *supra* note 38, at 35-36. See generally WHITE PAPER: THE FURTHER DEVELOPMENT OF REPRESENTATIVE GOVERNMENT IN HONG KONG (Nov. 21, 1984).

76. First, it is unusual for the PRC, a socialist state, to consent to an agreement providing that socialist policies shall not be practiced in part of its territory—Hong Kong. Ress, *supra* note 72, at 140-44. Second, the Joint Declaration contains no clause addressing the interpretation of the Joint Declaration. *Id.* Third, the "high degree of autonomy" that is to exist in Hong Kong after 1997 may be restricted by the ability of Standing Committee of the PRC's National People's Congress to interpret statutes. *Id.* Fourth, the role of the PRC military in defending Hong Kong may ultimately expand into interference in the internal affairs of Hong Kong. *Id.* Fifth, there is no guarantee that the

including the residents of Hong Kong in the negotiations over the transfer of sovereignty, the vagueness of both the White Paper and the Joint Declaration has left many Hong Kong residents without a voice in Hong Kong's future.⁷⁷ In fact, the people of Hong Kong recently have expressed strong misgivings about their lack of participation in the actual negotiation of the Joint Declaration.⁷⁸ Allowing the residents of Hong Kong to have greater control over their future would likely lessen the fears and uncertainties that have emerged in anticipation of the transfer of sovereignty.⁷⁹

Prior to the Tiananmen Square massacre, conventional wisdom in Hong Kong held that the Joint Declaration would have neither a positive nor a negative economic effect on Hong Kong.⁸⁰ However, after the political turmoil within China erupted, the growth of Hong Kong's economic markets fell below average.⁸¹ The escalation of political tensions in China has resulted in an increase in emigration from Hong Kong.⁸² However, recent events have encouraged many Hong Kong residents that Hong Kong will continue to prosper after the transfer of sovereignty.⁸³ In fact, the easing of political tensions in China has coincided with favorable economic conditions in Hong Kong.⁸⁴ Today, the majority of Hong Kong residents are optimistic about the transfer of sovereignty in 1997 and view the Joint Declaration as providing

judiciary, like the executive and legislative branches, will be composed of local inhabitants.

77. See generally Palumbo, *supra* note 5, at 689.

78. See Yuan-li Wu, *In the Shadow of 1997: Interaction Between Hong Kong and Its Economic Partners and Neighbors*, in *THE FUTURE OF HONG KONG*, *supra* note 44, at 116-20.

79. See *id.* Martin Lee, leader of the democracy movement in Hong Kong, has been very critical of the British and Chinese governments' refusal to allow Hong Kong to participate in the negotiations.

80. See Chiu, *supra* note 20, at 13.

81. Hong Kong's economy expanded at a rate of only 2.5% in 1989, which is less than one-third of its usual growth. Because the Tiananmen Square massacre occurred in June, rather than in January (or some other month towards the beginning of the year), it is possible that the growth rate could have been much lower. See Palumbo, *supra* note 5, at 690.

82. See *id.*

83. See *id.* For a Hong Kong citizen's opinion of the Joint Declaration, see Anthony Neoh, *Hong Kong's Future: The View of a Hong Kong Lawyer*, 22 *CAL. W. INT'L L.J.* 309 (1992). Neoh does not reach any conclusions regarding the ultimate effect of the exchange of sovereignty because he views the future of Hong Kong as a wait-and-see process.

84. For example, as the Chinese government has released more and more of the prisoners taken in response to the massacre, the Hong Kong stock market has steadily increased.

the necessary assurances that Hong Kong will continue to prosper and grow economically.⁸⁵

C. Analysis of the Joint Declaration

The stated purpose of the Joint Declaration is the "maintenance of the prosperity and stability of Hong Kong."⁸⁶ More specifically, the Joint Declaration is premised on one overriding principle: "[T]he socialist system and socialist policies shall not be practiced in the Hong Kong Special Administrative Region and . . . Hong Kong's previous capitalist system and lifestyle shall remain unchanged for fifty years."⁸⁷ In reaching the Joint Declaration agreement, both the United Kingdom and the People's Republic of China made significant compromises. The United Kingdom ceded the entire territory of Hong Kong—Hong Kong Island, Kowloon Peninsula, and Stonecutters Island—back to China.⁸⁸ The United Kingdom also consented to China's absolute sovereignty over Hong Kong, and neither sought nor received assurances of a British presence in Hong Kong after the transfer of sovereignty.⁸⁹ China, meanwhile, consented only to allow Hong Kong to maintain its existing social and economic system,⁹⁰ and agreed to outline its policies regarding Hong Kong in a "clear, detailed manner."⁹¹ China's specific delineation of its policies toward Hong Kong afforded Hong Kong and the United Kingdom more certainty about the future by limiting China's freedom to maneuver after the transfer of sovereignty in 1997.

1. China's Administrative Control Over Hong Kong

The most important and obvious aspect of the Joint Declaration is that Great Britain will relinquish control of Hong Kong to China.⁹² Hong Kong will no longer be part of the British Empire. Thus, despite the provisions of the Joint Declaration and the Basic Law that attempt to address concerns over maintaining the economic status quo in Hong Kong, there are no guarantees

85. See Palumbo, *supra* note 5, at 690.

86. Joint Declaration, *supra* note 33.

87. Bundy, *supra* note 27, at 274 (quoting the Joint Declaration).

88. See *id.* at 274-75.

89. See *id.* at 275.

90. See Joint Declaration, *supra* note 33. Perhaps the most surprising aspect of China's concessions to the British is not China's agreeing to allow a capitalist economy to exist under Chinese authority, but rather its agreeing to allow the inhabitants of Hong Kong to continue to enjoy freedoms such as freedom of speech and freedom of the press.

91. See Bundy, *supra* note 27, at 275.

92. Joint Declaration, *supra* note 33.

that China will behave in the same predictable fashion toward Hong Kong as did the United Kingdom.⁹³ The Joint Declaration establishes Hong Kong as a Special Administrative Region (SAR) of China in accordance with the provisions of the Chinese Constitution, a unique distinction for a territory under Chinese control.⁹⁴ While China will likely comply with the Joint Declaration, uncertainty ultimately exists about the meaning of the term "Special Administrative Region." The Chinese Constitution explicitly provides that "[t]he 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."⁹⁵ Therefore, Hong Kong's treatment as a special administrative region will be determined by China's domestic law, not the Joint Declaration. By its terms this provision offers no guarantees about Hong Kong's future treatment under Chinese rule. Because the status of the Special Administrative Region depends on domestic law, the Chinese legislature could conceivably amend its prior legislation and alter its policy towards such regions. In addition, China could amend its constitution, potentially altering the treatment of Hong Kong and any other Special Administrative Regions.

These scenarios, however, run contrary to the commonly held belief that China will benefit from the continuing prosperity of Hong Kong.⁹⁶ After all, China is Hong Kong's largest trading partner, accounting for one-third of Hong Kong's exports.⁹⁷ The two economies are so interrelated that the success of one depends on the success of the other. Thus, many observers believe that

93. Furthermore, if a dispute over the interpretation of the Joint Declaration or the Basic Law arose, the British government probably will not have any legal recourse. It is unlikely that the PRC would consent to the jurisdiction of the International Court of Justice to decide disagreements concerning the Joint Declaration. Additionally, given that the Basic Law is seen as domestic legislation, it would not be open to interpretation by the British.

94. Joint Declaration, *supra* note 33, para. 3(1). As a Special Administrative Region, Hong Kong will enjoy a special legal status. Hong Kong will have limited ability to conduct its own foreign affairs in fields such as: "economic, trade, financial, and monetary areas and participation in international organizations and conferences not limited to states." *Res*, *supra* note 72, at 138.

95. P.R.C. CONST. art. 31.

96. Telephone Interview with Roy F. Grow, Frank B. Kellogg Professor of International Relations at Carleton College, Northfield, Minn. (Mar. 6, 1995) [hereinafter Interview with Grow]. It is not felt, however, that Beijing and Shanghai will benefit if Hong Kong thrives. Rather, success in Hong Kong implies that important contracts will be directed towards Hong Kong and away from Shanghai. *Id.*

97. See *It's Already 1997 in Hong Kong*, *ECONOMIST*, Dec. 18, 1993, at 36.

China will not alter its domestic law to circumvent the provisions of the Joint Declaration.⁹⁸

2. Hong Kong's Degree of Autonomy

The Joint Declaration provides that while the People's Republic of China will exercise direct authority over the Hong Kong Special Administrative Region, Hong Kong will "enjoy a high degree of autonomy."⁹⁹ Hong Kong's autonomy can be divided into three aspects—political autonomy, economic autonomy, and cultural autonomy—all of which affect the commercial future of Hong Kong.¹⁰⁰

Politically, according to the Joint Declaration, Hong Kong's government "will be composed of local inhabitants"¹⁰¹ appointed by the Chinese government. Thus, the Chinese government will appoint the chief executive of Hong Kong,¹⁰² and the chief executive will nominate persons to serve as Hong Kong's principal officials.¹⁰³ Ultimately, the nominated persons must be appointed to their positions by the Chinese government.¹⁰⁴ Pursuant to the Joint Declaration, the Hong Kong legislature will also consist of Hong Kong residents who are elected locally.¹⁰⁵ The legislature will have the authority to enact laws governing Hong Kong, provided that the laws are consistent with the Basic Law, the constitution of Hong Kong.¹⁰⁶

The governmental structure of Hong Kong afforded by the Joint Declaration appears to give Hong Kong a significant level of political autonomy. However, the actual extent of Hong Kong's autonomy will depend on two factors. First, interpretations of the

98. *Id.*

99. Joint Declaration, *supra* note 33, para. 3(2). However, Hong Kong will not enjoy autonomy in foreign and defense matters, "which are the responsibilities of the Central People's Government." *Id.*

100. See generally Shiu, *supra* note 2, at 158-61.

101. Joint Declaration, *supra* note 33, para. 3(4).

102. *Id.* The chief executive will be appointed from a list of candidates that is the result of local Hong Kong elections or local consultations. *Id.*

103. *Id.*

104. *Id.*

105. *Id.* annex I. Annex I is the elaboration of the PRC's basic policies regarding Hong Kong. The Annex also includes details regarding Hong Kong's domestic laws, its judiciary, and its economic system. In short, the Annex tries to explain in depth the Chinese interpretation of the twelve subparagraphs to paragraph 3 of the Joint Declaration. *Id.*

106. See *id.* ch. II. The Joint Declaration provides that "[t]he laws currently in force in Hong Kong will remain basically unchanged." Joint Declaration, *supra* note 33, para. 3(3). Whether these laws will remain unchanged hinges on the Basic Law, the document with which all of the laws passed by the legislature must comply. See *id.* See *infra* part IV (for a discussion of the Basic Law).

Basic Law must permit the passage of laws that allow Hong Kong to institute its own policies in areas such as infrastructure, taxation, and government assistance. For Hong Kong to enjoy a high level of autonomy, the powers of the Hong Kong legislature should be extended liberally so that the only restrictions are those imposed by the Joint Declaration. Thus, the Hong Kong legislature should be permitted to pass laws in every area except matters concerning foreign affairs and defense. Second, the persons appointed to government positions in Hong Kong must accurately represent the wishes of Hong Kong's populace. If those appointed to office in Hong Kong were mere puppets of the Chinese government diligently representing the wishes of the People's Republic and not those of Hong Kong's residents, only an appearance of autonomy would exist in Hong Kong.¹⁰⁷ The ramifications of such a scenario are unknown, as the decisions regarding Hong Kong would be made by the Chinese government in Beijing, rather than by the Hong Kong residents who transformed Hong Kong into a world financial and trading center. However, it is likely that investor confidence in Hong Kong would wane and economic growth would slow considerably.¹⁰⁸

Economically, the Joint Declaration provides for the "maintenance of the prosperity and stability of Hong Kong" by retaining Hong Kong's current economic system.¹⁰⁹ The Joint Declaration elaborates that capitalist, not socialist, policies will be practiced in Hong Kong¹¹⁰ for a period of at least fifty years.¹¹¹

Two provisions in the Joint Declaration offer Hong Kong's businesses hope that the capitalist system will be retained. The Joint Declaration provides that Hong Kong ultimately "shall decide its economic and trade policies on its own" and "shall retain the status of a free port and continue a free trade policy."¹¹² The Joint Declaration also authorizes Hong Kong to "maintain and develop economic and trade relations with all states and regions."¹¹³ Accordingly, Hong Kong will receive treatment as a separate customs territory and will be authorized

107. This is the fear of many Hong Kong residents today. Interview with Grow, *supra* note 96.

108. *Id.* However, these are only concerns about what could happen. Until 1997 arrives and there is an opportunity to see the government of Hong Kong in action, one can only speculate about the consequences of the transfer of sovereignty.

109. See Joint Declaration, *supra* note 33, para. 3(5).

110. *Id.* annex I, ch. VI.

111. *Id.* para. 3(12).

112. *Id.* annex I, ch. VI. This free trade policy includes the free movement of goods and capital. *Id.*

113. *Id.*

to participate in international organizations and international agreements.¹¹⁴

Of critical importance to many managers within Hong Kong is that Hong Kong will be treated separately from the People's Republic in matters regarding taxation.¹¹⁵ Hong Kong will not be required to declare its revenues to the Chinese government,¹¹⁶ and the People's Republic has agreed not to levy taxes of any kind on Hong Kong.¹¹⁷ Thus, the Joint Declaration may insulate Hong Kong somewhat from any internal financial strife in China. Furthermore, by not investing China with the power to tax Hong Kong, the Joint Declaration ensures that China will not be able to exert direct control over Hong Kong's fiscal policy.¹¹⁸ Hong Kong thus appears to have some safeguard against any attempt by China to slow economic growth in Hong Kong.¹¹⁹ Finally, the maintenance of a floating exchange rate will help to insulate Hong Kong from disturbances in the world economy.¹²⁰

Hong Kong is also poised to maintain its status as a leading world financial center because its financial markets will remain intact.¹²¹ The Joint Declaration provides that capital will be allowed to flow freely and that Hong Kong will continue to maintain its own currency.¹²² Because the Joint Declaration seems to provide for the ready availability of capital within Hong Kong, the incentive to invest in Hong Kong will likely continue to exist.¹²³

114. *Id.* As an example, the Annex names the General Agreement on Tariffs and Trade (GATT). However, China has not yet become a signatory to the GATT. It is unknown how Hong Kong and China would be treated if both ultimately signed the agreement.

115. Interview with Michel Collange, Manager of Merlin Gerin, Tianjin Plant, Tianjin, P.R.C. (Apr. 15, 1992) [hereinafter Interview with Collange].

116. See Joint Declaration, *supra* note 33, annex I, ch. VII.

117. *Id.* para. 3(8).

118. However, if China controls the composition of the Hong Kong legislature, it will indirectly formulate Hong Kong's fiscal policy.

119. Interview with Grow, *supra* note 96.

120. See RICHARD E. CAVES ET AL., *WORLD TRADE AND PAYMENTS*, 404-07 (5th ed. 1990). In an economy in which the trade balance is zero, a floating exchange rate will allow the currency to appreciate or to depreciate automatically until balanced trade is restored. The other side of this argument is that a floating exchange rate does not allow an economy to export its internal disturbances, because the currency will depreciate or appreciate until the trade balance returns to zero. See *id.*

121. Markets for foreign exchange, gold, securities, and futures exist currently in Hong Kong and will continue to exist after the transfer of sovereignty. See Joint Declaration, *supra* note 33, annex I, ch. VII.

122. See *id.* Currently, the Hong Kong dollar is freely convertible in all world markets. *Id.*

123. Interview with Grow, *supra* note 96. The growing investment in mainland China could prompt even greater growth in Hong Kong. The possibility

Commentators project that the Joint Declaration provision requiring the Chinese to maintain Hong Kong's capitalist economic and trade systems for fifty years after the transfer of sovereignty will have two effects on the commercial life of Hong Kong.¹²⁴ First, the "fifty year" provision gives investors and businesses some assurance that the possibility for profit in Hong Kong will remain just as great after the transfer of sovereignty as now exists. Second, the provision will encourage investment in Hong Kong in the years following the transfer of control once it becomes evident that the financial opportunities that existed under British rule will continue to exist under Chinese rule.¹²⁵

Culturally, the Joint Declaration provides that the existing social system in Hong Kong "will remain unchanged, and so will the life-style."¹²⁶ Specifically, the Joint Declaration states that specific rights and freedoms that are currently enjoyed in Hong Kong will remain protected.¹²⁷ In addition, China agreed not to infringe on religious organizations and the various facilities affiliated with those organizations.¹²⁸ These guarantees also work to enhance the commercial prosperity of Hong Kong by protecting Hong Kong against emigration and capital flight. Commentators suggest that if Hong Kong no longer becomes a desirable city in which to live, then many investors and entrepreneurs will leave and take their investment capital with them.¹²⁹

of using Hong Kong as both a source of investment capital and a point of entry into the Chinese resource and consumer markets leads some optimistic scholars to the conclusion that the brightest days of Hong Kong lie ahead. What will actually happen is not known of course, but Hong Kong's prosperity will depend on the internal power struggles within mainland China. If Shanghai is able to exert greater influence over China in the coming years, it could prosper at the expense of Hong Kong. *Id.*

124. Joint Declaration, *supra* note 33, para. 3(12).

125. Interview with Grow, *supra* note 96. This potential effect concerns both reinvestment from investors and investments that leave Hong Kong shortly before the transfer of sovereignty in 1997, as well as initial investment from first-time investors and those who had contemplated investment in Hong Kong but were unsure of the likelihood of success of those investments in the wake of the 1997 change. *Id.*

126. Joint Declaration, *supra* note 33, para. 3(5).

127. *See id.* The Joint Declaration provides that "[r]ights and freedoms, including those of the person, of speech, of the press, of assembly, of association, of travel, of movement, of correspondence, of strike, of choice of occupation, of academic research and of religious belief will be ensured by law in the Hong Kong Special Administrative Region." *Id.*

128. *See id.* annex I, ch. XIII. These affiliated facilities include schools, hospitals, and welfare institutions. *Id.*

129. Much of the current emigration from Hong Kong is driven by the high cost of living, especially residential expenses. However, some of the corporate

IV. THE BASIC LAW

The true health of Hong Kong, however, will be determined not by the Joint Declaration, but by the Basic Law of Hong Kong.¹³⁰ The Basic Law will attempt to implement the policies outlined in the Joint Declaration and will serve as a constitution for the Hong Kong Special Administrative Region.¹³¹ The Basic Law was drafted by a Basic Law Drafting Committee appointed in 1985 by the Standing Committee of the National People's Congress of the People's Republic of China. In 1990, the Basic Law was adopted by the National People's Congress. While the majority of the members of the Drafting Committee were from China, twenty-three of its fifty-eight members and four of its eight vice chairmen were from Hong Kong. Moreover, a Consultation Committee representing the business, labor, and professional communities of Hong Kong was created to offer nonbinding suggestions to the Drafting Committee.¹³² Thus, the Basic Law was drafted with some input from Hong Kong, but the document was ultimately approved by the Chinese government.

The Basic Law contains significant language which tries to ensure that many of Hong Kong's current laws will remain in force after the transfer of control to China.¹³³ Specifically, the Basic Law provides that "the common law, rules of equity, ordinances, subordinate legislation and customary law shall be maintained" in the Hong Kong Special Administrative Region.¹³⁴ Moreover, according to the Basic Law, "national laws" of the People's Republic of China generally will not apply in Hong Kong.¹³⁵

flight is merely a change of corporate headquarters on paper only. Interview with Grow, *supra* note 96.

130. Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China, Apr. 4, 1988, 29 I.L.M. 1520 (ratified March 1990; adopted by the National People's Congress, April 1990) [hereinafter Basic Law].

131. Joint Declaration, *supra* note 33, para. 3(12).

132. See Charlotte Ku, Introductory Note, People's Republic of China: The Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China [April 4, 1990], 29 I.L.M. 1511, 1511-12 (1990).

133. See Colleen M. Granahan, Note, *The Prospects of a Successful Reunification of Hong Kong and China in Light of the Events at Tiananmen Square*, 10 B.U. INT'L L.J. 83, 90 (1992).

134. Basic Law, *supra* note 130, art. 8. However, any laws that contravene the Basic Law will no longer be in effect. *Id.* Moreover, the legislature of the Hong Kong Special Administrative Region has the authority to amend the laws previously in effect in Hong Kong. *Id.*

135. See *id.* art. 18. The only national laws that will be applied locally within Hong Kong are the following:

1. Resolution on the Capital, Calendar, National Anthem and National Flag of the People's Republic of China;

However, while the Basic Law is generally regarded as Hong Kong's constitution, it is very different from a constitution in many respects. Most importantly, the Basic Law is not incorporated into the Constitution of the People's Republic of China. Thus, it is not part of the supreme law of China, and it will therefore probably receive treatment under applicable Chinese law as if it were a statute.¹³⁶ Aside from the possibility that the Basic Law could be annulled by a subsequent act of the National People's Congress,¹³⁷ a possibility that some scholars view as unlikely,¹³⁸ this discussion will focus more on what the Basic Law states on its face.

A. *Specific Provisions of the Basic Law*

The Basic Law provides that the "laws currently in force in Hong Kong will remain basically unchanged."¹³⁹ It further states that the law of Hong Kong shall be the Basic Law, the laws previously in force in Hong Kong,¹⁴⁰ and the laws enacted by the

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2. Resolution on the National Day of the People's Republic of China;
 3. Order on the National Emblem of the People's Republic of China Proclaimed by the Central People's Government;
 4. Declaration of the Government of the People's Republic of China on the Territorial Sea;
 5. Nationality Law of the People's Republic of China; and
 6. Regulations of the People's Republic of China Concerning Diplomatic Privileges and Immunities.

Id. annex III.

136. Palumbo, *supra* note 5, at 699.

137. *Id.* Although the Basic Law provides that there will be no material changes to the way of life in Hong Kong after 1997, there is much concern in Hong Kong that the Basic Law will not mean what it says on its face. *Id.*

138. Alteration of the Basic Law is a possibility, but it is not a probability. Interview with Grow, *supra* note 96.

139. Basic Law, *supra* note 130, art. 3(3). There is some debate as to what "basically" means, but this discussion will take a literal meaning of the term and assume that the laws of Hong Kong will be the same after 1997 as they are before the transfer. This also touches on another concern. The Basic Law provides today that the laws in effect in Hong Kong "tomorrow" (June 30, 1997) will be in effect for years to come (after 1997). *Id.* This, however, is a complicated issue and is properly left for a more in-depth treatment. The real question is what the laws of Hong Kong will be in June 1997 and what they will be in 2047.

140. Those laws include: "the common law, rules of equity, ordinances, subordinate legislation and customary law," except those laws in conflict with the Basic Law. *Id.* art. 8. For a discussion of the commercial laws currently in effect in Hong Kong, see generally COMMERCIAL, BUSINESS AND TRADE LAWS: HONG KONG (Agnes Yung & Allan P.K. Keese eds., 1983).

legislature of the Hong Kong Special Administrative Region.¹⁴¹ Much of the language in the Basic Law is ambiguous,¹⁴² however, and future interpretations are quite uncertain. Nevertheless, a number of scholars are still somewhat optimistic about the transfer of sovereignty to China and expect the Hong Kong of the future to resemble closely the Hong Kong of today.¹⁴³

In projecting the future economic health of Hong Kong, the Basic Law contains several provisions designed to maintain the existing capitalist system presently in effect in Hong Kong. For example, Article 106 of the Basic Law effectuates the Joint Declaration policy of reserving tax revenues collected by Hong Kong solely for Hong Kong.¹⁴⁴ The Joint Declaration prohibits the Chinese government from levying taxes upon Hong Kong.¹⁴⁵ Moreover, the Basic Law ensures that the government of Hong Kong will implement its own monetary and fiscal policies.¹⁴⁶ Hong Kong's currency, the Hong Kong dollar, will continue to circulate, will be issued according to the Hong Kong government, and will be fully backed by a reserve fund.¹⁴⁷ Furthermore, the Basic Law specifically provides that capital will continue to flow freely in and out of Hong Kong and that the Hong Kong dollar will remain fully convertible into other currencies.¹⁴⁸

The Basic Law also addresses Hong Kong's continuing status as a free-trade zone, which was recognized by the Joint Declaration over a decade ago.¹⁴⁹ The Basic Law provides that Hong Kong will continue to operate as a free port,¹⁵⁰ and that free trade policies will continue to exist in the territory after 1997.¹⁵¹

141. Basic Law, *supra* note 130, art. 18. There is, however, room for the Standing Committee to make additions to or deletions from a list of national laws. *Id.*

142. One writer notes that the meanings of "laws previously in force in Hong Kong" and "the judicial system previously practiced in Hong Kong" under the Basic Law are questionable. The answer to this question of interpretation is not likely to be known until after July 1, 1997. See *Hong Kong's Future Legal System*, 7 CHINA L. REP. 1 (1991).

143. Interview with Grow, *supra* note 96. However, Professor Grow believes that Hong Kong's prosperity likely reached its peak in the late 1980s. *Id.*

144. Basic Law, *supra* note 130, art. 106.

145. *Id.* See also text accompanying, *supra* notes 115-18 (discussing tax issues).

146. Basic Law, *supra* note 130, art. 110. Specifically, the Basic Law provides that the government "shall, on its own, formulate monetary and financial policies, safeguard the free operation of financial business and financial markets, and regulate and supervise them in accordance with law." *Id.*

147. *Id.* art. 111.

148. *Id.* art. 112.

149. See Joint Declaration, *supra* note 33, art. 3(6).

150. Basic Law, *supra* note 130, art. 114.

151. *Id.* art. 115. For a discussion of these principles as outlined in the Joint Declaration, see text accompanying *supra* notes 112-14.

B. *Potential Shortcomings of the Basic Law*

The economic provisions of the Basic Law raise several issues.¹⁵² The Basic Law, as it now stands,¹⁵³ requires Hong Kong to have a balanced budget¹⁵⁴ and to continue its policy of low taxation, under which low tax rates for individuals and corporations will remain in place and import duties will continue to be levied only upon a limited group of commodities.¹⁵⁵ These requirements may hamper the Hong Kong government's ability to react to potential swings in the economy or to conduct long-range planning.¹⁵⁶

Some commentators have suggested that the Basic Law represents pure propaganda and has no legal foundation.¹⁵⁷ Skeptical commentators note that as long as the ultimate interpretation of the Basic Law rests in China's hands, then Hong Kong's future prosperity will remain in doubt.¹⁵⁸ Almost all commentators agree that Hong Kong's continued success will depend not on the Basic Law, but rather on the international

152. For a discussion of other concerns with the Basic Law, see Anna M. Han, *Hong Kong's Basic Law: The Path to 1997, Paved with Pitfalls*, 16 HASTINGS INT'L & COMP. L. REV. 321, 325-35 (1993). Han discusses concerns with veto power under Article 17, national laws under Article 18, jurisdiction under Article 19, and treason and sedition under Article 23, in addition to concerns with the economic provisions of the Basic Law. *Id.*

153. Because June 30, 1997, is two years away, there is still a possibility that the Basic Law will be amended.

154. Basic Law, *supra* note 130, art. 107. Specifically, Hong Kong's expenditures must not exceed its revenue. However, the PRC includes the sale of treasury bonds as revenue (in contrast to the United States), which effectively allows the PRC to have a deficit. If the same is true in Hong Kong, the balanced budget requirement will not mean to Hong Kong what it would to a nation such as the United States. Interview with Penelope Prime, Carleton College Adjunct Professor of Economics, Beijing, P.R.C. (May 20, 1992).

155. Basic Law, *supra* note 130, art. 108. Import tariffs are imposed on only four commodities: alcoholic liquors, tobacco, certain hydrocarbon oils, and methyl alcohol. There is no general import duty on goods brought into Hong Kong.

156. See Han, *supra* note 152, at 334. This opinion is based on the belief that much of Hong Kong's success stems from its ability to adapt to a variety of situations. *Id.*

157. See, e.g., *id.* In particular, Han notes that while Article 109 of the Basic Law provides that the government shall take measures for the maintenance of Hong Kong as an "international financial center," a law cannot guarantee prosperity. Hong Kong's continued growth depends on world economics. *Id.* However, Han neglects the spirit behind the Joint Declaration and the Basic Law, which requires the Hong Kong government to take affirmative steps to promote the financial markets of Hong Kong, which is well within the power of the government.

158. *Id.*

perception of China and its administration of Hong Kong. If the international investment community believes that China will comply with the spirit of the Basic Law, then investment dollars will continue to flow into Hong Kong. However, if investors believe that the People's Republic of China will rule Hong Kong with a heavy hand, then capital flight and an emigration of managers, technicians, and entrepreneurs—a "brain drain"—will likely result.¹⁵⁹

Several factors indicate that the future of Hong Kong could be bright. For example, many experts on China believe that the Beijing government's inability to rule Guangdong Province, the Chinese province that borders Hong Kong, with an iron fist bodes well for Hong Kong.¹⁶⁰ If Beijing cannot completely control its mainland provinces, its ability to dictate policies that are carried out many miles away in Hong Kong seems less likely. Thus, global investors could perceive that the Chinese government in Beijing is incapable of obstructing the implementation of the policies outlined in the Basic Law. As a result, some scholars predict that the Chinese government will actually respect the provisions contained in the Basic Law after the transfer of control in 1997.¹⁶¹

V. THE COMMERCIAL IMPACT OF THE TRANSFER OF SOVEREIGNTY

A. Hong Kong's Response

When the People's Republic of China and the United Kingdom first announced negotiations concerning Hong Kong in the late 1970s, the economy of Hong Kong experienced a down cycle.¹⁶²

159. *Id.* If the perception of Hong Kong is that China is overseeing Hong Kong with an iron fist, then capital will be removed from Hong Kong, thereby jeopardizing Hong Kong's future prosperity. *Id.*

160. Interview with Grow, *supra* note 96. However, Beijing does have the ability to exert influence over Hong Kong by diverting valuable government contracts away from Hong Kong and towards other provinces. *Id.*

161. *Id.*

162. See Y.L. Wu & Y.C. Jao, *The Economic Consequences of 1997*, 20 CASE W. RES. J. INT'L L. 17, 22-24 (1988). While commentators who focus entirely on Hong Kong would like to believe that the conflict between China and the United Kingdom caused Hong Kong's economic woes, one must remember that Hong Kong's economy is export-driven. Therefore, down cycles in the United States in the late 1970s (particularly the high interest rates that discouraged investment) and the so-called "Reagan recessions" of the early 1980s likely exerted similar downward pressure on the Hong Kong economy. Not surprisingly, Hong Kong began to recover at the same time as the United States was making a significant recovery in 1984, coincidentally the time the Joint Declaration was announced.

The real growth rate in Hong Kong fell from 17.1% of gross domestic product (GDP) in 1976 to 2.9% of GDP in 1982.¹⁶³ A general feeling pervaded Hong Kong that post-Mao China would permit the status quo in Hong Kong to continue because of Hong Kong's economic importance to China. Thus, China's refusal to allow the United Kingdom to continue to administer any part of Hong Kong after 1997 surprised those who invested in Hong Kong.¹⁶⁴

Hong Kong's economy began to recover from this down cycle in 1982.¹⁶⁵ Many commentators attribute a key role in the economic recovery to the increased investor confidence in the wake of the Joint Declaration signed on December 19, 1984. Moreover, the implementation of a "linked exchange rate" system in October 1983 stanching the decline of the Hong Kong dollar. As the economy recovered, the unemployment rate dropped (from 5.1% in March 1983 to 2.1% at the end of 1985), and the real estate sector recovered from the uncertainty that existed at the beginning of the 1980s.¹⁶⁶ These factors helped spur investor confidence and allowed local entrepreneurs and investors to concentrate on productive and capital-intensive economic activities rather than distractions such as currency speculation.¹⁶⁷ Without such investor confidence, commentators contend that Hong Kong's economy would likely have continued to deteriorate.¹⁶⁸

Investor confidence arising out of the Joint Resolution's signing proved to be short-lived. The turmoil of the world economy in the late 1970s and early 1980s threatened to destabilize the economic situation in Hong Kong.¹⁶⁹ In fact, Hong Kong's own banking crisis from late 1982 until 1986¹⁷⁰ exacerbated Hong Kong's contemporary problems. The political uncertainty in Hong Kong, as well as the Hong Kong government's involvement in ending the banking crisis added to the turmoil in

163. See *id.* at 25 (citing data from Hong Kong Monthly Digest of Statistics; Hong Kong Government Economic Services Branch, 1987 Economic Prospects).

164. See *id.* at 21-22.

165. See *id.* at 22.

166. *Id.* at 24.

167. See *id.* at 22.

168. Cf. Interview with Grow, *supra* note 96.

169. Cf. Wu & Jao, *supra* note 162, at 21-26.

170. See *id.* at 26. The banking crisis began in November 1982 when the collapse of local property markets caused some fringe banks to overextend credit. The Hong Kong government became involved in the situation in September 1983, realizing that the failure of the banking sector might be perceived as an attempt by the government to sabotage the Joint Declaration and to undermine the economic health of Hong Kong. See *id.* at 26-27.

Hong Kong's economy. Because the government discarded its traditional *laissez faire* policy, investors were uncertain about how the Hong Kong government would treat the private sector in the future.¹⁷¹ Anxiety and uncertainty about the future in the early 1980s also lowered investor confidence, resulting in a portfolio shift away from Hong Kong investments and towards currencies and investments outside Hong Kong.¹⁷² Furthermore, the political uncertainty generated by the strife between China and the United Kingdom resulted in stagnant capital formation in Hong Kong in the early 1980s.¹⁷³

The uncertainty regarding Hong Kong's political and economic stability caused many firms located in Hong Kong to reevaluate their future in Hong Kong.¹⁷⁴ These firms undertook a strategy of "precautionary relocation or diversification."¹⁷⁵ This strategy involved four essential elements: (1) the removal of the registered head office from Hong Kong to a foreign state, preferably, a tax haven; (2) the establishment of branches or offices in foreign states, or the acquisition of foreign firms in whole or in part; (3) the sale of the firm's equity to a foreign firm, or the formation of a joint venture with a foreign firm in Hong Kong; and (4) the transfer of liquid assets abroad, leaving only sufficient funds for transaction purposes in Hong Kong.¹⁷⁶ In addition to capital flight and relocation by firms, a "brain drain" has also adversely affected Hong Kong, as entrepreneurs, managers, professionals, and technicians have left Hong Kong for many of the Western industrial powers.¹⁷⁷

After much of the initial uncertainty surrounding the signing of the Joint Declaration in 1982 had subsided, Hong Kong's economy began to return to its previous level of growth and prosperity. Typically, investors look for certainty over the life of

171. See *id.* at 26-27.

172. See *id.* at 27. In 1980, only 13.8% of investment was in foreign currencies. *Id.* at 28. That increased, however, to 47.5% in 1983 and to 56.4% in 1986. This shift could have been even greater if the Hong Kong government had not implemented the linked exchange rate system to insulate the Hong Kong dollar from worldwide monetary shocks. *Id.* at 28-29.

173. See *id.* at 29-31. Gross capital formation (in constant 1980 dollars) fell three percent from 1982 to 1986. *Id.* at 29.

174. See *id.* at 31-33.

175. *Id.* at 32.

176. *Id.* The authors note examples of huge conglomerates relocating to other countries and Hong Kong banks diversifying globally. See *id.*

177. *Id.* at 33. One writer maintains that a fifty percent increase in visa applications in both 1986 and 1987 illustrates that the Hong Kong government has been unable to restore investor confidence. See Shiu, *supra* note 2, at 168-69. See also Michael C. Davis, *To Go or Not to Go*, FAR E. ECON. REV., Apr. 18, 1991, at 20. Davis concludes that most people will remain in Hong Kong, hoping that it will continue to prosper under Chinese rule.

the investment before investing. They seek market stability so that unexpected factors do not cause the economy to take an unforeseen plunge.¹⁷⁸ Therefore, as uncertainty dissipated through the 1980s, the investing public became more certain of future prosperity in Hong Kong, investment increased, and the economy returned to rapid growth rates.¹⁷⁹

B. *The Current Climate in Hong Kong*

The Chinese and the British governments have both expressed optimism about the economic health of Hong Kong after 1997. The British Foreign Office Minister stated his opinion that Hong Kong would enjoy prosperity after 1997, and that the British government will take an active interest in Hong Kong until the actual transfer of sovereignty.¹⁸⁰ Similarly, the Director of China's Hong Kong and Macao Affairs Office¹⁸¹ has stated that China "must let all foreign investors rest assured that Hong Kong will remain an international financial and trade center."¹⁸² The Director provided further assurances by declaring China's intent to abide by the Joint Declaration and the Basic Law.¹⁸³

China's actions indicate its interest in ensuring the future prosperity of Hong Kong. For example, businessmen from Beijing have begun to accept and occupy seats on the boards of directors of Hong Kong companies; the state-owned Bank of China is preparing to issue Hong Kong bank notes; and Chinese investors have purchased enterprises such as cinemas, bookstores, publishing houses, and newspapers in Hong Kong.¹⁸⁴ Additionally, Chinese-owned companies have invested in Hong

178. Interview with Grow, *supra* note 96.

179. These growth rates resulted from investment made mostly in the latter half of the 1980s. These investments were perceived as certain because the life of the investments would expire before the transfer of sovereignty will occur. *Id.*

180. See *British Minister Vows to Stand Up for Hong Kong*, REUTER LIBRARY REPORT, Mar. 2, 1992, available in LEXIS, Nexis Library, Arcnws File. Specifically, Lord Caithness stated that the British government intended to defend Hong Kong's interests when necessary. Furthermore, he indicated that the United Kingdom would not make concessions to China simply to facilitate the transfer of sovereignty. See *id.*

181. For a discussion of the resolution of the conflict between Portugal and China over the administration of Macao, see Jaw-ling J. Chang, *Settlement of the Macao Issue: Distinctive Features of Beijing's Negotiating Behavior*, 20 CASE W. RES. J. INT'L L. 253 (1988).

182. *PRC Official Assures Hong Kong of Future Prosperity*, BBC SUMMARY OF WORLD BROADCASTS, Mar. 11, 1991, available in LEXIS, Nexis Library, Arcnws File.

183. See *id.*

184. See Peter Goodspeed, *Dragon's Shadow Falls Across Hong Kong*, TORONTO STAR, Oct. 27, 1991, at H3.

Kong's hotel, shipping, construction, and transportation industries.¹⁸⁵ Such widespread Chinese-backed investment implies that China realizes that Hong Kong's prosperity after 1997 depends, at least in part, on the Chinese government's encouragement of the success of the territory.¹⁸⁶ By investing in Hong Kong, China sends out a dual message. First, China expects Hong Kong to continue to prosper.¹⁸⁷ Second, China publicly supports Hong Kong.

At the same time, the popular perception in Hong Kong links its future prosperity with China's economy rather than with China's government. Recently, the Hong Kong stock market has begun to list a number of firms based in mainland China.¹⁸⁸ One of the leading investment bankers in Hong Kong has stated that "[t]here is no more exciting economy in the world than China's. It is the emerging industrial power in Asia, and Hong Kong has the market to play it; it is like Tokyo [thirty] years ago."¹⁸⁹ Sentiments such as these represent the interdependence that exists between the economies of Hong Kong and the People's Republic of China. Moreover, the Chinese economy is currently the fastest growing economy in the world.¹⁹⁰ As a result, the potential exists that the Hong Kong of the year 2020 will be even stronger than the Hong Kong of today.

Strong investor confidence in Hong Kong has also been demonstrated by an influx of investment capital, which began in the late 1980s. In 1987, for example, six new insurance companies submitted applications to the Hong Kong government

185. *Id.* Chinese companies have sizable interests in one of Hong Kong's major bus companies. *Id.* The Bank of China is Hong Kong's second largest financial institution. Businesses in mainland China handle almost fifteen percent of Hong Kong's exports and control ten percent of the manufacturing base. *Id.*

186. Interview with Grow, *supra* note 96.

187. Otherwise, the Chinese government (as represented by the Bank of China) would not invest its precious funds in a losing venture. Interview with Grow, *supra* note 96.

188. See Simon Holberton, *Mainland Moves the Market: Shares in Chinese Companies Are Hot Property in Hong Kong*, FIN. TIMES, Feb. 22, 1993, at 14. The Chinese companies listed on the Hong Kong exchange are large manufacturing and industrial companies. The Hong Kong market traditionally has been dominated by property companies, financial institutions, trading houses, and utilities. *Id.* The listing of the Chinese companies is significant not only because the firms are Chinese, but also because they are representative of the Chinese economy, an economy dominated by industrial and manufacturing businesses as a result of the availability of raw materials and cheap labor.

189. *Id.*

190. Roy F. Grow, *Resolving Commercial Disputes in China: Foreign Firms and the Role of Contract Law*, NW. J. INT'L L. & BUS. 161, 165 (1993).

to establish offices and conduct business.¹⁹¹ International Business Machines (IBM) made Hong Kong its headquarters for its business activities conducted in the Pacific Basin outside Japan.¹⁹² Moreover, many Japanese firms have established manufacturing plants in Hong Kong.¹⁹³ Thus, there are many indicators of strong investor confidence in the economic prosperity of Hong Kong after the transfer of sovereignty in 1997.

C. *The Commercial Implications of "One Country, Two Systems"*

Perhaps the most unpredictable feature of the transfer of sovereignty is the "one country, two systems" situation that will exist when China assumes control of Hong Kong falls under Chinese in 1997.¹⁹⁴ "One country, two systems" refers to the operation of the capitalist system of Hong Kong within the socialist system of the People's Republic of China. One commentator had concluded that a "one country, two systems" scheme could succeed only if the two systems remain economically segregated.¹⁹⁵ However, because China and Hong Kong interact on such a large scale and, thus, could not operate independently, the commentator concludes that the arrangement is bound to fail.¹⁹⁶

Other commentators have chosen to focus not on the feasibility of the "one country, two systems" scheme, but rather on the policies and goals surrounding the scheme. Many commentators contend that the primary goal of the government of the People's Republic of China is to reunite China's mainland with Taiwan.¹⁹⁷ The reunification of China and Hong Kong, therefore, takes on even greater significance because it portends China's

191. Ng, *supra* note 2, at 84. In fact, the number of overseas investment advisors has increased so significantly that the Hong Kong government established a committee to monitor their activities. *Id.*

192. *Id.* at 84-85. IBM's Hong Kong headquarters will oversee the company's activities in China, Korea, Taiwan, all of southeast Asia, Australia and New Zealand. *Id.*

193. *Id.* at 84. If the Japanese investments are representative of past Japanese business strategies, many Japanese companies are expecting their plants to be profitable for many years in the future. This expectation would indicate Japanese confidence in Hong Kong's prosperity after 1997. Interview with Grow, *supra* note 96.

194. For a more detailed discussion of the many differences between the Chinese system and the Hong Kong system, see Han, *supra* note 152, at 335-42.

195. *See id.* at 338.

196. *See id.* at 338-42. Because China is Hong Kong's largest foreign investor and one of its largest trading partners, the affairs of the two states are so interrelated that the rules accompanying each system will blur. *See id.* at 340-41.

197. Interview with Grow, *supra* note 96.

prospects of reunification with Taiwan.¹⁹⁸ If China has any chance of opening reunification negotiations with Taiwan, it must be able to point to the success of the Hong Kong "experiment" as evidence that Taiwan can prosper within the People's Republic. For this reason, China would go to great lengths to promote Hong Kong's capitalist system after 1997. China's desire to reunify Taiwan with the mainland lends credence to the belief that China will abide by the Joint Declaration and the Basic Law and take all necessary actions to ensure that Hong Kong prospers after the transfer of sovereignty.

D. *China's Special Economic Zones and Their Importance to Hong Kong*

1. The Advantages to Foreign Investors

In an effort to "open the door" to foreign investment in China, the Chinese government undertook numerous reforms, including the creation of Special Economic Zones (SEZs).¹⁹⁹ SEZs were first established in 1980 in southern China.²⁰⁰ Investors are attracted

198. For a discussion of the "one country, two systems" scheme and Taiwan, see Ng, *supra* note 2, at 89-92.

199. See HARRY HARDING, CHINA'S SECOND REVOLUTION 131 (1987). The Special Economic Zones (SEZs) are more than zones with special rates of taxation. They are designed to provide foreign investment with a common point of entry into the Chinese economy, so that technologies from a diverse array of industries can be studied and absorbed more easily. They have even been described as "laboratories," in which various aspects of foreign investment can be tested before introduction into the remainder of the Chinese economy. Thus, undesired technology can be filtered out, while compatible technology can be siphoned in. *Id.* at 164.

200. A number of considerations motivated China's planners in choosing the locations for the 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 to 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 into the infra-structural resources of one of the world's leading 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

to the Special Economic Zones for a number of reasons. First, investment in an SEZ receives favorable tax treatment.²⁰¹ China guarantees that all "assets, profits, and other legitimate rights and interests will be legally protected," thereby ensuring that investors are given "favorable investment opportunities in stable business environments."²⁰² In addition to lower taxation rates on profits,²⁰³ firms located in SEZs are subject to zero or low import duties.²⁰⁴ To encourage reinvestment, firms who reinvest their profits in any SEZ²⁰⁵ may receive exemptions from income taxes on profits resulting from those reinvestments.²⁰⁶

Second, profits earned within the SEZs may be taken out of China without penalty.²⁰⁷ Under this feature of an SEZ, investors were able to avoid the sting of China's multiple currency system, which consisted of one type of currency that was not convertible into foreign exchange and a second type that was convertible, but had limited circulation and availability.²⁰⁸ Recently, however, China has opted for one currency, which it has tried to make readily convertible. Although it is not always easy to convert Chinese currency for other currencies within China, exchanging Chinese currency for the more desirable Western currencies in markets such as Hong Kong and Singapore is relatively easy.²⁰⁹

Finally, firms located in SEZs also receive considerable advantages with regard to obtaining a labor force. To enable a firm locating in an SEZ to hire a labor force, SEZ labor service companies recommend laborers to firms locating in SEZs.²¹⁰ If a service company's recommendations are not desirable to the

side and promote economic integration between Hong Kong and Guangdong.

Shiu, *supra* note 2, at 174 n.261.

201. While joint ventures and private enterprises located outside of SEZs are taxed at a rate of thirty percent, they are taxed at no more than fifteen percent inside SEZs, and they may be taxed at a rate as low as seven and one-half percent. Interview with Collange, *supra* note 115 (Collange managed a plant in an SEZ located in Tianjin).

202. Shiu, *supra* note 2, at 174-75.

203. See *supra* note 201.

204. Machinery, spare parts, raw materials, vehicles, and other means of production for the enterprise are exempted from import duties. Shiu, *supra* note 2, at 175.

205. The funds must be reinvested for a minimum of five years. *Id.* at 176.

206. *Id.*

207. *Id.* at 175. This benefit, of course, is subject to any restrictions the PRC government decides to impose.

208. Interview with Collange, *supra* note 115.

209. Interview with Grow, *supra* note 96.

210. Shiu, *supra* note 2, at 176.

enterprise, the firm may recruit its own laborers.²¹¹ Furthermore, through pre-agreed labor contracts, employers in SEZs have the benefit of knowing with certainty the cost of labor before establishing a plant in the zone. In China, as in the United States, labor contracts set the terms of employment,²¹² but the cost of labor is so low that the result is not a labor monopsony, which inflates the cost of labor.²¹³

2. The Importance of the Special Economic Zones to Hong Kong

The Special Economic Zone in Shenzhen, China, which is located across the border from Hong Kong, has enjoyed rapid growth since its establishment in 1980.²¹⁴ Indeed, Hong Kong investment accounts for eighty percent of total foreign investment in Shenzhen,²¹⁵ and provides another example of the interdependence between Hong Kong and mainland China. The success of Shenzhen resembles the commercial success of Hong Kong under the British Empire.²¹⁶

Shenzhen's success as an SEZ has two distinct implications for Hong Kong. First, the trade ties between China and Hong Kong have become so strong that it is not possible to alter the economy of one without significantly altering the other's economy.²¹⁷ A shock to Hong Kong's economy will affect the Shenzhen economy; likewise, a shock to the Shenzhen economy will affect the Hong Kong economy. This interrelationship enhances the likelihood of the future prosperity of Hong Kong because China would potentially undermine its own economic interests if it were to take any actions that harmed Hong Kong's economic health. Second, the case study of the SEZs offers an example of a small scale capitalist economy existing within China's socialist structure. Thus, the success of SEZs such as Shenzhen implies that the economic health of Hong Kong will be preserved after 1997, even in a "one country, two systems" scheme.

Additionally, some commentators argue that the mere existence of Special Economic Zones within the People's Republic

211. *Id.*

212. The terms of employment include the scales and forms of wages, award methods, labor insurance, and various state subsidies. *Id.*

213. A monopsony is the functional equivalent of a monopoly of the labor force, where one organization controls the availability of all laborers.

214. HARDING, *supra* note 199, at 165.

215. Shiu, *supra* note 2, at 177.

216. HARDING, *supra* note 199, at 165.

217. See Shiu, *supra* note 2, at 178-79.

suggests the likelihood of future prosperity in Hong Kong.²¹⁸ By allowing fledgling outposts of capitalism to exist within mainland China, the People's Republic has demonstrated its potential willingness to foster capitalism in the China of the future, not just in Hong Kong. Any actions by the Chinese government that would dismantle the SEZ system and the growing pockets of capitalism would hinder China's longer-term goals of promoting prosperity within both Hong Kong and China.²¹⁹

VI. CONCLUSION

The transfer of Hong Kong from the United Kingdom to China could be looked upon with a great deal of optimism. Most of the literature that predicts economic hardship for Hong Kong after 1997 focuses on the level of investor confidence immediately following the announcement of the Joint Declaration. However, in today's volatile economic climate, many of the assumptions initially made about China and Hong Kong may no longer be valid. Since that time, Hong Kong has seen an influx of investment from the industrialized world and from mainland China.

Furthermore, many commentators approach the question of Hong Kong's future prosperity as a question of whether Hong Kong will be better off or worse off after the transfer of control. The question may more properly be viewed as whether Hong Kong will be able to maintain its existing economic structure. The pressure on China for Hong Kong to succeed and prosper has increased and, therefore, China will likely allow Hong Kong to continue to maintain its current system. The ultimate question regarding Hong Kong thus becomes: Will Hong Kong prosper in the twenty-first century?

The greatest potential for economic growth in the world exists in the People's Republic of China. The availability of raw materials, other resources, and low-cost labor has caused southeast Asia and China to become the world's chief manufacturing region for subcomponents, and the potential for manufacturing success within mainland China has barely been tapped. More important to those entrepreneurs and investors who are looking ten and twenty years ahead is the fact that China potentially possesses the largest consumer market in the world. One-fifth of the world's population resides in the People's

218. *See id.* at 180.

219. *Id.*

Republic, and as China becomes more and more developed, merchants all over the world will want to expand into China. The best way to accomplish this goal will most likely be entry into the Chinese market via Hong Kong.

It has often been said that after 1997, as goes China, so too will go Hong Kong. It is equally accurate to say that as goes Hong Kong, so too will go China. The two economies are inextricably linked and for them to sever their ties without seriously damaging both economies would be virtually impossible. This fact alone seems to be enough to ensure that China will take great pains to ensure that the provisions of the Joint Declaration will be honored so that Hong Kong is given every chance to prosper. When this view is coupled with the notion that the possibility for China's reunification with Taiwan rests in the success of China's administration of Hong Kong, the conclusion seems to be inescapable that the capitalist system of Hong Kong will continue past 1997 virtually unchanged. In the end, the forecast for the next century would seem to call for continued prosperity in Hong Kong. However, the "glory days" of economic and financial activity that Hong Kong experienced in the late 1980s are in the past, and Hong Kong will not likely achieve such a status in the world economy.

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