

THE RECOVERY OF HONG KONG BY THE PEOPLE'S REPUBLIC OF CHINA—A FIFTY YEAR EXPERIMENT IN CAPITALISM AND FREEDOM

Christian C. Day*

I. INTRODUCTION

The People's Republic of China (PRC) has the opportunity to fashion a novel relationship with the capitalistic city-state of Hong Kong. This opportunity has arisen out of the September 26, 1984 Joint Declaration of the Government of the United Kingdom of Great Britain and Northern Ireland (UK) and the Government of the People's Republic of China on the Question of Hong Kong.¹ This Joint Declaration, issued with three integrated annexes, and an Exchange of Memoranda, comprises the text of the "agreement" between the UK and the PRC on the future of the current British Colony.² The UK-PRC agreement, which was signed in Peking on December 19, 1984,³ is an unprecedented solution to the PRC's

* Associate Professor of Law, Syracuse University College of Law; A.B. Cornell University, 1967; J.D. New York University School of Law, 1970.

1. Joint Declaration of the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the People's Republic of China on the Question of Hong Kong, signed at Peking Dec. 19, 1984, United Kingdom—People's Republic of China, 1984 Gr. Brit. T.S. No. 20, at 11-13 (Cmd. 9352) [hereinafter cited as Joint Declaration]. According to the Joint Declaration, its effectiveness is subject to "ratification and shall enter into force on the date of the exchange of instruments of ratification, which shall take place in Beijing before 30 June 1985." *Id.* at 13, para. 8. See Wren, *Chinese-British Accord States that Life in Hong Kong will be Basically Unchanged*, N.Y. Times, Sept. 27, 1984, at A12, col. 1.

2. What is termed by the British Government "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" consists of four separate documents and an associated "Exchange of Memoranda." The Exchange of Memoranda took place on the date of signature, December 19, 1984.

The four documents which comprise the "agreement" include (1) the Joint Declaration, *supra* note 1 (2) Annex I: Elaboration by the Government of the People's Republic of China of its Basic Policies Regarding Hong Kong; *id.* at 14-23, annex I (English translation) (3) Annex II: Sino-British Joint Liason Group; *id.* at 24-25, annex II (4) Annex III: Land Leases; *id.* at 26-27, annex III. The memoranda consist of (a) United Kingdom Memorandum, *id.* at 28; and (b) Chinese Memorandum, *id.* at 29 (English translation). The final clause of the Joint Declaration states that "[t]his Joint Declaration and its Annexes shall be equally binding." *Id.* at 13, para. 8.

3. Burns, *Hong Kong Accord is Signed in Peking*, N.Y. Times, Dec. 20, 1984, at A3, col. 4.

desired reunification with Hong Kong. This article analyzes the UK-PRC agreement and argues that this unique experiment, involving fundamentally dissimilar societies, will permit Hong Kong to flourish and that the PRC must respect the terms of the agreement for sound economic, political, and diplomatic reasons.

The societies and economies united by the agreement could not be more divergent. The inequalities and differences between the PRC and Hong Kong are overwhelming. The PRC is a great power,⁴ occupying 3,704,400 square miles,⁵ with a vast potential to dominate its neighbors.⁶ The PRC exerts significant influence in world affairs because of its strategic position in Asia and its pivotal role in the relationship between the super powers, the Soviet Union and the United States.⁷ Its economy is one of the world's largest, with a gross national product of \$352 billion dollars.⁸ Its armed forces make it a major power with approximately 4.2 million men under arms.⁹

Hong Kong is a British Crown Colony¹⁰ comprised of approximately 398 square miles.¹¹ It has virtually no natural

4. The PRC is a global power because of its population, army, economic power and location. Yet, it is also a developing power and a less-developed country. By virtue of its per capita income of between \$250 and \$500, it is somewhere above India, less than the Philippines and far below South Korea. See B. REYNOLDS, *China in the International Economy*, in CHINA'S FOREIGN RELATIONS IN THE 1980'S 71-106 (H. Harding ed. 1984) [hereinafter cited as CHINA'S FOREIGN RELATIONS].

5. THE STATEMAN'S YEARBOOK 344 (J. Paxten ed. 1984-85).

6. See generally LEVINE, *China in Asia: The PRC as a Regional Power*, in CHINA'S FOREIGN RELATIONS, *supra* note 4, at 107-45.

7. China has shifted its strategic alignment from time to time to balance the competing interests of the United States and the Soviet Union. See generally POLLACK, *China and the Global Strategic Balance*, in CHINA'S FOREIGN RELATIONS, *supra* note 4, at 146-76. After more than a decade of moving closer to the West, especially the United States, China is improving its relationship with the Soviets. See Burns, *China and Soviet Pleas by Mood of Peking Talks*, N.Y. Times, Dec. 30, 1984, at A1, col. 4.

8. Wren, *China Cuts a Hong Kong Deal with Assurances on All Sides*, N.Y. Times, Sept. 30, 1984, at E3, col. 1.

9. See IYLER, *Capitalism in the Making*, TIME, April 30, 1984, at 24-35. China's plans for economic development are requiring it to make manpower cuts in the military. Burns, *China Plans more Manpower Cuts in the Military*, N.Y. Times, Jan. 4, 1985, at A2, col. 3.

10. For the history of the Colony, see *infra* notes 25-54 and accompanying text.

11. The British Crown Colony adjoins Kwangtung province of the PRC. It is comprised of three distinct subdivisions: Hong Kong Island, the Kowloon Peninsula and Stonecutters Island, and the New Territories (approximately 357.5 square miles on the mainland). W. BEAZER, *THE COMMERCIAL FUTURE OF HONG KONG 1* (1978) [hereinafter cited as COMMERCIAL FUTURE]. As will be shown in the discussion of Hong Kong's history, the acquisition of the

resources,¹² except for its magnificent harbor.¹³ It has a population of 5.3 million.¹⁴ It has the most capitalistic economy in the world,¹⁵ and a gross domestic product of 28.7 billion dollars.¹⁶ Hong Kong is dependent upon the PRC for much of its water and food stuffs¹⁷ and is, for all practical purposes, undefended and undefensible.¹⁸

The PRC is the successor to a great civilization which has endured for thousands of years. Hong Kong is a vibrant trading and industrial colony founded less than one hundred and fifty years ago on a sparsely populated island. The disparities between Hong Kong and the PRC could not be more profound or pronounced.

The agreement on the future of Hong Kong is an extraordinary one. The PRC and Great Britain have agreed that China will recover sovereignty of the Crown Colony of Hong Kong in 1997, when the British lease for the New Territories (which comprise more than ninety percent of the Colony's area) expires.¹⁹ The PRC promises to leave Hong Kong fundamentally unchanged for fifty years, until 2047.^{19a} Hong Kong will be a Special Administrative Region (SAR) controlled by the PRC in matters of defense and foreign affairs.^{19b}

Colony in three stages, with the majority of the Colony obtained through a ninety-nine year lease, set the stage for PRC's retaking of the territory. See *infra* notes 62-63 and accompanying text.

12. It is virtually devoid of natural resources except some minimal deposits of iron ore, building stone, kaolin clay, graphite, lead and wolfram. Most of the mining and quarrying activity is for the production of building materials. A. RABUSHKA, *THE CHANGING FACE OF HONG KONG: NEW DEPARTURES IN PUBLIC POLICY* 6 (1973) [hereinafter cited as *CHANGING FACE*].

13. The magnificent harbor is probably the best on the China coast. *COMMERCIAL FUTURE*, *supra* note 11, at 1. It was obtained from China after the Opium War because of its ideal anchorage. G. ENDACOTT, *A HISTORY OF HONG KONG* 2 (2d ed. 1973) [hereinafter cited as *HISTORY OF HONG KONG*]. It was not established as a colony for British immigration and settlement, but rather as a mercantile station. *Id.* at vii.

14. Wren, *supra* note 8, col. 3.

15. See, e.g., A. RABUSHKA, *HONG KONG: A STUDY IN ECONOMIC FREEDOM* (1979) [hereinafter cited as *ECONOMIC FREEDOM*]; OWEN, *Economic Policy in Hong Kong*, in *HONG KONG: THE INDUSTRIAL COLONY* 141-206 (K. Hopkins ed. 1971) [hereinafter cited as *INDUSTRIAL COLONY*]; *COMMERCIAL FUTURE*, *supra* note 11, at 5.

16. Wren, *supra* note 8, col. 3.

17. See *CHANGING FACE*, *supra* note 12 at 32; *ECONOMIC FREEDOM*, *supra* note 15, at 16.

18. The British military presence in Hong Kong is inconsequential. Great Britain would not be able to launch a military campaign to retake Hong Kong as she did the Falkland Islands. See *No Cheering Over Hong Kong*, *THE ECONOMIST*, Sept. 22, 1984, at 17.

19. See *infra* notes 55-88 and accompanying text for a detailed analysis of the agreement's provisions.

The city-state will have its own executive, judicial and legislative powers.^{19c} It will maintain its free port status and its international banking system.^{19d} Its capitalistic system will be preserved as will its rights and fundamental freedoms, including freedom of speech, press, movement and religion.^{19e} The transition through 1997 will be overseen by a "Joint Liason Group" composed of representatives of the UK and the PRC.²⁰ What remains to be seen is whether the PRC will abide by the agreement and preserve the great benefits of the capitalistic society it will acquire.²¹

The PRC has the power to fundamentally alter Hong Kong's freedoms and economy and to impose its economic and political system on the colony. The UK does not seem prepared to guarantee Hong Kong's continued existence by force.²² However, a blatant violation of the agreement would not be in the PRC's political or economic interest, nor would it advance the PRC's esteem in the community of nations.

This article begins with a brief history of the Crown Colony and the New Territories.²³ Section II covers the transformation of Hong Kong from an entrepot colony²⁴ to a major industrial colony.

19a. Joint Declaration, *supra* note 1, at 12, para. 12.

19b. *Id.* at 11, para. 3(2).

19c. *Id.* para. 3(3).

19d. *Id.* para. 7.

19e. *Id.* para. 5.

20. *Id.* at 24, annex II, para. 1. See IYER, *A Colony's Uncertain Future*, TIME, Oct. 8, 1984, at 38. For other articles on the agreement, see Ching, *Hong Kong Clears a First Hurdle*, Wall St. J., Oct. 1, 1984, at 32, col. 4; Crossette, *Hong Kong Sees the Future: Will It Work?*, N.Y. Times, Sept. 27, 1984, at A1, col. 3; IYER, *Making a Deal for 1997*, TIME, Aug. 13, 1984, at 24.

21. The value of Hong Kong is the free enterprise system and the wealth it creates. If confidence in the stability of the society and economy is eroded or destroyed, the marvelously efficient and productive system would be destroyed. An outflow of capital would cripple Hong Kong. See ECONOMIC FREEDOM, *supra* note 15, at 92. Great concern is present in the Hong Kong community on the issue of whether the PRC will permit the system to survive. See, e.g., Sterbia, *Nervous Money: Hong Kong's Chinese Fearing '97 Takeover Seek Capitalist Havens*, Wall St. J., June 22, 1984, at 1, col. 1; Wren, *supra* note 8, col. 3.

22. There is no provision in the agreement providing for British enforcement in the event the PRC dishonors it. See generally Joint Declaration (and annexes), *supra* note 1; see also, *infra* notes 55-88 and accompanying text.

23. See *infra* notes 25-54 and accompanying text.

24. An entrepôt is an economic center which is usually a port. It carries on certain essential distribution, financial, communications and transportation functions. The entrepôt collects goods and products from the hinterland. By combining, sorting, semi-processing and grading these products, the entrepôt is in a position to meet the requirements of foreign

Section III analyzes the UK-PRC agreement and comments upon its major provisions. Section IV reflects on the agreement in the context of Chinese foreign policy and speculates upon whether it will be honored in light of those foreign policy trends. Section V addresses the rationale for the PRC to abide by the terms of the agreement. Lastly, the article concludes with speculation on the utility of the agreement as a model for the resolution of the Taiwan issue.

II. HONG KONG'S POLITICAL AND ECONOMIC HISTORY

The commercial history of Hong Kong is, in large part, the history of the colony. Hong Kong was founded by the British in the 1840's as an entrepôt.²⁵ It was not intended to be a permanent station for British immigrants and settlers, but was intended as a mercantile station from the outset. Trade demanded settled conditions, suppression of robbery and piracy, the guarantee of contracts and impartial justice.²⁶ Hong Kong was to assist Britain's commercial empire by establishing British commercial principles as well as law and order exclusive of Chinese control. It provided Great Britain with the minimal area required to establish British institutions and served as the headquarters for far eastern trade.²⁷

Until the nineteenth century Hong Kong and its environs were sparsely populated. There were few permanent settlers. Pirates made use of the anchorage, but the area itself played little part in Chinese history.²⁸ Britain's foreign policy and commercial goals required the establishment of a permanent British outpost.²⁹ The Opium War (1839-1842)³⁰ gave the British the opportunity to secure an island post which provided a more stable trading environment

buyers. It also maintains a continuous inventory of manufactured goods and raw materials ready for re-export to the hinterland. T. GEIGER, *TALES OF TWO CITY-STATES: THE DEVELOPMENT PROGRESS OF HONG KONG AND SINGAPORE* 7 (1973).

25. *Id.*

26. See *HISTORY OF HONG KONG*, *supra* note 13, at vii.

27. *Id.*

28. *Id.* at 3.

29. Lord Napier advanced the occupation of Hong Kong Island as he felt the Chinese would not enter into a commercial treaty without the threat of force. Sir Henry Pottinger (who negotiated the Treaty of Nanking) felt that a coastal city under British control would become a great emporium of trade. During the negotiations with the Chinese over the Opium War, Lord Palmerston believed that the British should acquire an *island*. But this demand was not as essential as freedom of commerce. *Id.* at 9-15.

30. British merchants traded opium (an Indian cash crop) for Chinese luxuries and en-

than Canton. As indemnity for the seizure of opium during the War, the Chinese ceded Hong Kong Island by the 1842 Treaty of Nanking.³¹

Hong Kong developed rapidly under the laissez-faire policies of the colonial administrations.³² In 1860, Kowloon and Stonecutters Island were ceded by perpetual lease to the British under the Convention by Peking of 1860.³³ In the mad scramble for additional territorial concessions at the end of the nineteenth century, the British also acquired the New Territories under a second Convention of Peking, this one in 1898.³⁴ The Convention of Peking of 1898 provided the colony with approximately 350 square miles of territory to be leased for ninety-nine years.^{34a} Thus, the present limits of the colony were established by 1898.

While the stated original purpose of the acquisition of the New Territories was for defense,³⁵ they were, in fact, assimilated into the commercial life of the colony.³⁶ Chinese customs and laws gave way to British law and customs as the colonial administration

couraged Chinese consumption of the drug. The Chinese authorities seized British trading factories and opium inventories in Canton and other outposts. The Opium War (1839-1842) arose as a result of the Chinese attempt to control and stamp out the illicit trade in opium. *Id.* at 14-35. For more information on the causes of the war, see COMMERCIAL FUTURE, *supra* note 11, at 11-16; Note, *The Legal Implications of the Sino-British Treaties Regarding Hong Kong*, 4 LOY. L. A. INT'L & COMP. L. J. 111, 111-12 (1981).

31. Treaty of Nanking, *signed at Nanking*, Aug. 29, 1842, China-Great Britain, 30 B.S.P. 389, *reprinted in* 6 *Hertsler's Comm. Tr.* [H.C.T.] 221 (effective July 17, 1843). The charter for the Crown Colony was formally granted on June 26, 1843. COMMERCIAL FUTURE, *supra* note 11, at 22. Pottinger was its first governor. His administration set the standard and style for other British governors. He made Hong Kong a free port and moved the Superintendency of Trade from Macao to Hong Kong. *Id.* at 21. Pottinger steadfastly resisted incursions by the army and navy as he wanted Hong Kong to be a commercial port. *Id.* at 35.

32. HISTORY OF HONG KONG, *supra* note 13, at 121.

33. Convention of Peking, *signed at Peking*, China-Great Britain, Oct. 12, 1860, 50 B.S.P. 10, *reprinted in* 11 H.C.T. 112 (effective Oct. 12, 1860).

34. Convention with China Respecting an Extension of Hong Kong Territory, *signed at Peking*, June 9, 1898, China-Great Britain, 90 B.S.P. 17, *reprinted in* 21 H.C.T. 291 (effective Aug. 6, 1898). For an excellent book on the Peking Convention of 1898 and the absorption of the New Territories into the Crown Colony, see P. WESLEY-SMITH, UNEQUAL TREATY. 1898-1997: CHINA, GREAT BRITAIN AND HONG KONG'S NEW TERRITORIES (1980) [hereinafter cited as UNEQUAL TREATY]. The text of the Peking Convention of 1898 is *reprinted in id.* at 191-92.

34a. Convention with China Respecting an Extension of Hong Kong Territory, *supra* note 34.

35. UNEQUAL TREATY, *supra* note 34, at 1.

36. The Convention of Peking of 1898 was the result of the desire of the commercial interests to expand Hong Kong's commercial influence. *Id.* at 11.

asserted its authority. Ultimately, the New Territories were completely integrated into the commercial and political system of the ceded territories. At present the colony functions as one unit and dismemberment is neither politically nor commercially feasible.³⁷

By the second decade of the twentieth century, Hong Kong had developed into one of the world's great ports.³⁸ By the 1930's its trading patterns were changing: trade with Great Britain and China was declining; trade with southeastern Asia and the western Pacific was growing.³⁹ World War II saw the colony decimated as the population dropped to 600,000 after the Japanese conquest. With the War's end, commerce and the population boomed as the Chinese who had fled the Japanese invasion returned. Hong Kong absorbed an additional 700,000 refugees from the PRC. By 1956 Hong Kong's population had swelled to two and one half million.⁴⁰

With the outbreak of the Korean War, the United States embargoed Chinese goods from the PRC. A new flood of Chinese refugees from the PRC saved both the economy and the colony itself, as the refugees brought labor, capital and skill.⁴¹ Hong Kong was rapidly transformed from an entrepôt to an industrial colony. This transition was in a large part facilitated by the infra-structure provided by the entrepôt economy. Capital was already present. The skilled population had substantial industrial experience from such industries as shipbuilding. Other services such as insurance, accounting and legal offices were present with their world-wide contacts. Because the world viewed Hong Kong as stable and industrious, precious capital was readily invested.

Hong Kong is now heavily export-oriented and has based its modern industrial and commercial expansion upon export-promoting industries.⁴² Hong Kong's economic growth has been spectacular. From 1950-76 real gross domestic product grew at a rate faster than

37. The Crown Colony and New Territories are so interdependent and integrated that no partitioning could reasonably occur. Much of the colony's population, industry and water supply are now in the New Territories. Partitioning would destroy the economic viability of the colony. Cf. *ECONOMIC FREEDOM*, *supra* note 15, at 24.

38. *HISTORY OF HONG KONG*, *supra* note 13, at 274.

39. *Id.* at 291.

40. *Id.* at 310.

41. *Id.* at 316. Many of the refugees were capitalists from Shanghai who established the textile industry.

42. *CHANGING FACE*, *supra* note 12, at 11-12.

any other Asian economy.⁴³ During the 1970's the growth rate averaged 16.7 percent while real prices rose only 7.4 percent.⁴⁴ Hong Kong buys approximately twenty percent of its water, oil and food from China. China purchases little from Hong Kong. Thus, China earns critical foreign exchange. Since the 1960's approximately forty percent of the PRC's foreign exchange has come from Hong Kong.⁴⁵

The PRC also has invested substantially in Hong Kong. The PRC has taken advantage of the capitalistic system to earn foreign exchange and experiment with new industrial products.⁴⁶ The Hong Kong economy will continue to do well. A growth rate of 8.5 percent was achieved in 1984 with 6.5 percent projected for 1985.⁴⁷

Throughout the twentieth century, China has consistently maintained that Hong Kong was obtained as a result of unequal treaties⁴⁸ and must be returned.⁴⁹ At the Paris Peace Conference in 1919 the Republic of China demanded the return of Hong Kong and other territories lost to European and Japanese imperialists.⁵⁰ Since the late 1970's there has been increased concern over the fate of Hong Kong.⁵¹ The PRC maintained its position regarding rendition, and began to exert substantial pressure on Great Britain in the early 1980's. Commercial interests also clamored for a resolution as their investments were at risk due to the uncertainty regarding the 1997 expiration of the New Territories lease.⁵²

43. COMMERCIAL FUTURE, *supra* note 11, at 54.

44. *Id.* at 51.

45. ECONOMIC FREEDOM, *supra* note 15, at 25.

46. *Id.*

47. ALEXANDER, *Jumping for Joy in the Pacific*, TIME, Nov. 12, 1984, at 78-79.

48. Unequal treaties became a significant issue in international law with the territorial concessions of the later nineteenth century. Jurisprudence developed in nations such as China challenging the validity of such treaties. The PRC articulated the position that the treaties could be abolished under the theory of *rebus sic stantibus*. In effect, China was no longer the weakened state which had been victimized by imperialist powers. The unequal treaties, which were a product of duress, could be abolished. "[T]reaties of a 'slave nature' can be unilaterally abolished regardless of whether there has been a vital change of circumstances." H. CHIU, THE PEOPLE'S REPUBLIC OF CHINA AND THE LAW OF TREATIES 103 (1972). For further discussion of these issues as they relate to the Hong Kong Colony, see Note, *Hong Kong's Future: Can the People's Republic of China Invalidate the Treaty of Nanking as an Unequal Treaty?*, 7 FORDHAM INT'L L.J. 534 (1984); Note, *supra* note 30.

49. The foreign policies of Imperial China, the Republic of China and the PRC have all sought rendition of the Colony and other foreign enclaves in China.

50. Only President Wilson was sympathetic. UNEQUAL TREATY, *supra* note 34, at 151-52.

51. See, e.g., COMMERCIAL FUTURE, *supra* note 11.

52. The uncertainty over the Colony's status threatened to produce a shaky economy with businessmen unwilling to make long-term investments. See, e.g., Lohr, *Hong Kong's*

The unequal treaties which transferred Hong Kong to British control have not provided a solid and unquestioned basis for the transfer of sovereign territory and administration.⁵³ The treaties did, however, provide for the colonial expansion of Hong Kong and secured its economic expansion.⁵⁴ That economic expansion is of key importance to the PRC and Hong Kong's other trading partners and provides the foundation for the agreement which resolved the rendition dispute.

III. THE AGREEMENT ON THE FUTURE OF HONG KONG

The recent agreement over the future of Hong Kong has ended years of speculation over what actions the PRC might take in 1997 to recover the Crown Colony upon the expiration of the UK's ninety-nine year lease. The agreement has given substance to the Chinese statements of the last several years that Hong Kong's system would be "basically unchanged" for fifty years.⁵⁵ By the late 1970's concern over the Territories' future was already being expressed by investors and inhabitants in the Colony.⁵⁶ Britain had determined that unless the problem was resolved, confidence would erode.⁵⁷ Although preliminary discussions were held, nothing tangible occurred. Prime Minister Thatcher, in September 1982, used the occasion of her visit to Peking to broach the opening of formal talks on the subject. Many unfruitful negotiating sessions were held during the next two years. The PRC reiterated its position that if an agreement were not reached, it would retake the New Territories upon the expiration of the lease in 1997.⁵⁸ British control of administra-

Shaky Rebound, N.Y. Times, Dec. 12, 1983, at D9, col. 1; IYER, *supra* note 20, at 51. In the uncertainty over the lease disposition, the Bank of China (owned by the PRC) was a big loser. *Id.* Ironically, the crisis in business confidence on both sides of the territorial border may have forced the lease talks to go forward and resolved the issue. The PRC and the British surely realized that without confidence, Hong Kong's vaunted value was a precarious commodity indeed.

53. UNEQUAL TREATY, *supra* note 34, at 188.

54. *Id.*

55. Ching, *supra* note 20, at 32, col. 4.

56. 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: Introduction, 1984 Gr. Brit. T.S. No. 20, at 1-10, 5, para. 5 (Cmd. 9352) [hereinafter cited as Introduction].

57. *Id.* para. 6.

58. See, e.g., Park, *British Pressured Over Hong Kong*, Philadelphia Inquirer, Nov. 10, 1983, at 4-E, col. 1.

tion after 1997 was unacceptable to the PRC.⁵⁹ What was acceptable to the PRC was the maintenance of a high degree of Hong Kong autonomy. The PRC recognized that it was desirable to maintain the existing framework of Hong Kong to preserve the flourishing and dynamic Hong Kong society and economy.⁶⁰ The British government recognized that there was no possibility of an amended agreement.⁶¹ Therefore it was forced to obtain the best treaty possible, as a reversion would take place on July 1, 1997 if there were no treaty. With the New Territories severed, the ceded colony would no longer be viable.⁶² As there was no practical way to maintain a divided Hong Kong, Britain took the only path available and negotiated an international agreement.⁶³

To protect the economic and political freedoms which had produced the booming Hong Kong economy, the PRC agreed to establish a Special Administrative Region of the PRC, the Hong Kong Special Administrative Region (HKSAR).⁶⁴ The HKSAR would preserve the legal system, including the common law, and would have its own legislative, judicial and executive branches.⁶⁵ It would be free to develop its own trade and economic policies⁶⁶ and to participate in the General Agreement on Tariffs and Trade (GATT).⁶⁷

59. Introduction, *supra* note 56, at 5, para. 10.

60. *Id.* para. 11.

61. *Id.* at 9, para. 29. Furthermore, while the British consulted with Hong Kong officials, *id.* at 6-7, paras. 15-18, they did not conduct a referendum to discover the views of the Colony. The Hong Kong government has no such consultative mechanism. See REAR, *One Brand of Politics*, in INDUSTRIAL COLONY, *supra* note 15, at 55-139; REAR, *The Law of the Constitution*, in INDUSTRIAL COLONY, *supra* note 15, at 339-406. A referendum would have been unwise as it may have split the Colony and destabilized the economy. Such polarization would have weakened Britain's negotiating position and made Hong Kong less attractive to the PRC thereby threatening the very society and economic system the British sought to preserve.

62. Introduction, *supra* note 56, at 9, para. 29.

63. *Id.*

64. The HKSAR was to be established pursuant to the provisions of Article 31 of the Constitution of the PRC. Joint Declaration, *supra* note 1, at 11, para. 3(1); *id.* at 14, annex I.

65. Joint Declaration, *supra* note 1, at 11, para. 3(3).

66. Introduction, *supra* note 56, at 10, para. 30.

67. *Id.* The ability of Hong Kong to participate in the General Agreement on Tariffs and Trade (GATT) is of crucial importance to the solution of the problem. With independence of action in trade policies, including membership in GATT, Hong Kong would be more valuable to the PRC than it would be by being bound by the PRC's trade arrangements. With its quasi-independent status, the beneficial status quo will be preserved whereby the PRC is able to market its goods in its own right through the Hong Kong free port. This synergism will make the whole greater than the sum of its trading parts.

The main document forming the agreement under discussion is the Joint Declaration referred to above. It is immediately apparent that the PRC is the dominant party as it declares that the common aspiration of the Chinese people is the recovery of not only the New Territories, but the entire colony when the lease expires.⁶⁸ The basic policies of the PRC toward Hong Kong are described below.

The HKSAR will be "directly under the authority" of the PRC but "will enjoy a high degree of autonomy, except in foreign and defense affairs."⁶⁹ The HKSAR will be vested with legislative, judicial and executive power. The existing laws will remain unchanged.⁷⁰ The government of the HKSAR will be composed of local inhabitants, but the chief executive will be appointed by the PRC after elections or consultations.⁷¹ Chinese and foreign nationals now employed in the government departments may remain in employment. British and other foreign nationals may be retained as advisors.⁷² The current social and economic systems of Hong Kong will remain unchanged.⁷³ Hong Kong's freedoms will also survive.

Rights 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 Private property, ownership of enterprises, legitimate right of inheritance and foreign investment will be protected by law.⁷⁴

68. Joint Declaration, *supra* note 1, at 11, para. 1.

69. *Id.* para. 3(2).

70. *Id.* para. 3(3).

71. *Id.* para. 3(4). This, too, will be an experiment. Hong Kong is not a democracy. REAR, in INDUSTRIAL COLONY, *supra* note 61, at 55. It is ruled by a Royal Governor who takes his directions from Great Britain. Key positions are all appointed by the Crown. CHANGING FACE, *supra* note 12, at 47-48. The Chinese majority (approximately 98% of the population) has a role which is largely consultative. To date the population has been largely apolitical and more concerned with commerce than government. Cf. REAR, in INDUSTRIAL COLONY, *supra* note 61, at 122.

72. Joint Declaration, *supra* note 1, at 12, para. 3(4).

73. *Id.* at 12, para. 3(5).

74. *Id.* These rights are all critical to the maintenance of the Hong Kong system. One author believes that the PRC's attitude toward Taiwan will prove to be crucial. For example, if the PRC does not allow aircraft of the Taiwanese National Airlines to land without removing government emblems from its planes or forbids pro-Taiwan demonstrations, the freedoms now enjoyed would be seriously eroded. Such actions would politicize the community and also undermine investor and foreign confidence in Hong Kong. Ching, *supra*

The free port will be maintained.⁷⁵ Hong Kong will remain an international finance center.⁷⁶ The free flow of capital will be permitted.⁷⁷ This, too, is of very great importance to the success of the experiment. Hong Kong, as a trading state, generally has trade deficits.⁷⁸ Nevertheless, its economy has been both expanding and extremely productive. Hong Kong has continued to expand its industrial base and its gross domestic product.⁷⁹ The source of this expansion has been retained earnings from its exports and the capital which flows freely into Hong Kong.⁸⁰ Investors know that the Hong Kong economy responds to economic conditions and makes currency adjustments automatically to reflect these conditions.⁸¹ As long as investors and traders have confidence in the free market system, capital investment in Hong Kong will remain high and the economy will prosper. Capital investment not only fuels Hong Kong's prosperity, but also contributes to the PRC's growth and well-being. The PRC must preserve Hong Kong's capital markets because of its need for a market outlet, for foreign exchange⁸² and for the return on its investments in Hong Kong.

note 20. If, on the other hand, the rights and liberties are respected, the PRC will be sending telling signals to Taiwan that its overtures can be trusted and a peaceful resolution to their differences might be reached. What effect the liberties may have upon the mainland Chinese is the unknown factor.

75. *Id.* at 12, para. 3(6).

76. *Id.* para. 3(7). See JAO, *Hong Kong's Role in Financing China's Modernization* in CHINA AND HONG KONG: THE ECONOMIC NEXUS 12-76 (A. Youngson ed. 1983) [hereinafter cited as NEXUS] on the critical economic role Hong Kong plays in China's economy and modernization plans.

77. Joint Declaration, *supra* note 1, at 12, para. 3(7).

78. See COMMERCIAL FUTURE, *supra* note 11, at 62.

79. For a society heavily dependent upon trade for its existence, to expand its industrial base and exports while experiencing trade deficits, outside capital must be attracted and invested in the economy. As Hong Kong has enjoyed an unfettered capital market, much of its productivity and earnings have come from foreign investors and tourism. *Id.* at 68-72. One authority has noted that much of Hong Kong's investment capital is directly attributable to its political stability. See CHANGING FACE, *supra* note 12, at 37. Without such capital inflows, Hong Kong would not earn the PRC its badly needed foreign exchange and would rather be a burden to the PRC.

80. CHANGING FACE, *supra* note 12.

81. For an excellent explanation of the capital market adjustments in Hong Kong's free market economy, see ECONOMIC FREEDOM, *supra* note 15, at 2-9.

82. The PRC is seeking to modernize by jettisoning the Soviet-based planned economy and moving toward an economy regulated by the market. The PRC is importing foreign capital and technology to accelerate this process. For information concerning the PRC's economic reforms after the death of Mao, see generally A. BARNETT, CHINA'S ECONOMY IN GLOBAL PERSPECTIVE (1981) [hereinafter cited as GLOBAL PERSPECTIVE]; THE CHINESE ECONOMIC

In furtherance of Hong Kong's freedoms, the HKSAR will be permitted to develop its own cultural and economic ties with other states and regions.⁸³ The maintenance of public order will be the responsibility of Hong Kong,⁸⁴ not the PRC. The agreement declares that the above policies will be stipulated in the "Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China, by the National People's Congress of the People's Republic of China"⁸⁵ The Basic Law will remain in effect for fifty years.⁸⁶ The agreement charges the British with preserving economic prosperity and stability until the takeover.⁸⁷ The agreement also provides for a Sino-British Joint Liason Group to facilitate the orderly transition.⁸⁸ Thus, with the formal signing of the agreement in Peking in December 1984, a detailed framework for the resolution of the Hong Kong lease dispute has been adopted by the PRC and Great Britain.

Notwithstanding the explicit tenor of the text of the Joint Declaration and the explanatory annex by the PRC, Hong Kong's continued vitality and economic and political freedoms depend upon the actions the PRC will take in 1997 and the years leading up to that transition date. If the PRC does not honor the treaty, or if investors believe the PRC will not abide by it, Hong Kong will be destroyed as a society and as a vital free-trade economy.

REFORMS (S. Feuchtwang & A. Hussain ed. 1983); CHINA'S ECONOMIC REFORMS (L. Wei & A. Chao ed. 1982). The movement away from state planning to an economy based upon the market has been dramatic. Cf. Salisbury, *Retracing Mao's Long March*, N.Y. Times, Nov. 18, 1984, (Magazine) at 42. Indeed, the principles being enunciated by the PRC leadership sound very capitalistic. See, e.g., Wren, *Chinese Announce Sweeping Changes in Their Economy*, N.Y. Times, Oct. 21, 1984, § 1 at 1, col. 6. This move toward the market economy will mesh nicely with Hong Kong's free markets. See generally NEXUS, *supra* note 76, on the interdependence of the Chinese and Hong Kong economies.

83. Joint Declaration, *supra* note 1, at 12, para. 3(10). The HKSAR may establish its own economic relations with Britain and other nations. *Id.* para. 3(9).

84. *Id.* para. 3(11).

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

86. *Id.*

87. *Id.* at 11, para. 4.

88. *Id.* para. 5. For further information on the Liason Group, see *id.* at 24, annex II. The Liason Group has no political power. Its power is largely based upon moral suasion. Also attached to the Joint Declaration is Annex I, Elaboration by the Government of the People's Republic of China of its Basic Policies Regarding Hong Kong. *Id.* at 14, annex I. This document describes, in greater detail, the operation of the HKSAR and its relationship to the PRC and the world.

IV. CHINA'S RECENT FOREIGN POLICY, ECONOMIC DEVELOPMENT AND ITS RELATION TO HONG KONG

China has tolerated Hong Kong because its relationship with the city-state has been so beneficial.⁸⁹ Nevertheless, China's recent history of domestic upheavals and seemingly wild gyrations in domestic and foreign policies make it difficult to assess whether the PRC will honor the agreement. China has been seen as a dissatisfied power, anxious to modify the international order. This dissatisfaction stemmed from the brutal humiliation suffered at the hands of Western powers when the opening of China was forced by gunboat diplomacy, and the "unequal treaties" with Britain, Germany, Japan and France in which China surrendered indemnities and treaty ports.⁹⁰ Throughout the twentieth century, Chinese foreign policy concerning the Hong Kong question has demanded rendition of the Hong Kong colony.⁹¹ The PRC had steadfastly maintained that the resolution of the issue was solely within the province of China as it did not recognize the validity of the treaties which established the Colony.⁹² Despite this professed attitude, the Colony has remained and prospered and the PRC has not threatened

89. Hong Kong's future as a free society depends upon its value to the PRC. As long as it is important to the PRC, it will be maintained. See COMMERCIAL FUTURE, *supra* note 11, at 3.

Hong Kong has been important to China as a source of trade surplus. JAO, *supra* note 76, at 14-24. It serves as a financial center for the PRC. *Id.* at 24-35. Hong Kong serves as an international base for the operations of Chinese-State-Controlled-Banks. *Id.* at 37. The Colony also provides the mainland with substantial equity capital. *Id.* at 49-59. Thus, as long as China has an outward-oriented trade policy, Hong Kong will provide it with a gateway to the west and foreign exchange earnings. HSU, *Hong Kong in China's Foreign Trade: A Changing Role* in NEXUS, *supra* note 76, at 180.

90. J. CAMILLERI, CHINESE FOREIGN POLICY: THE MAOIST ERA AND ITS AFTERMATH (1980). The humiliation of China by the West was a unique experience for that ancient culture as until modern times, despite fluctuations of imperial fortunes, the monolithic prestige of the Chinese empire has not been effectively challenged. *Id.* at 5.

91. See *supra* notes 48-52, 55-60 and accompanying text.

92. See, e.g., the letter of March 8, 1972 from the Chinese delegate, Huang Hua, to the UN Committee on Decolonization:

As is known to all, the question of Hong Kong and Macau belongs to the category of questions resulting from the series of unequal treaties left over by history, treaties which the imperialists imposed on China. Hong Kong and Macau are part of Chinese territory occupied by the British and Portuguese authorities. The settlement of the questions of Hong Kong and Macau is entirely within China's sovereign right and does not at all fall under the ordinary category of "Colonial Territories." Consequently, they should not be included in the list of Colonial Territories covered by the Declaration on the Granting of Independence to Colonial Territories and

Hong Kong's existence.⁹³ Does the current agreement and the cession of sovereignty now signal the end of Hong Kong's way of life?

While China's foreign policy since 1949 has been a complex combination of change and continuity, certain themes have been present. Peking has sought to maintain the security of its borders.⁹⁴ It has been mistrustful of more powerful allies and very ambivalent about seeking economic assistance and technology from foreign powers.⁹⁵ China has had a long-standing division in foreign policy over the desirability of modernization through contacts with foreign countries. Some leaders, such as Deng Xiaoping, have sought rapid modernization through the importation of foreign institutions and technology. Others, such as Mao Zedung (at times), have tried to preserve the purity of Chinese values by restricting China's foreign contacts.⁹⁶

China's commitment to modernization has caused its post-Mao leadership to increase greatly the level of foreign trade and interdependence. Foreign loans and other investments are now welcomed. However, these new relationships are linked intimately with Deng's sweeping domestic economic reforms. Some serious opposition (in the People's Liberation Army, for instance) still exists. If the reforms fail, China's links with the international economy may radically change once more.⁹⁷ If the reforms succeed, China's dependence upon and utilization of the benefits Hong Kong offers will grow. Such growth will continue to insure Hong Kong's existence as a free society and economy while linked to a communist state.

Peoples. With regard to the questions of Hong Kong and Macau, the Chinese government has consistently stated that they should be settled in an appropriate way when conditions are ripe. The United Nations has no right to discuss these questions. For the above reasons, the Chinese delegation is opposed to including Hong Kong and Macau on the list of Colonial Territories covered by the Declaration and requests that the erroneous wording that Hong Kong and Macau fall under the category of "Colonial Territories" be immediately removed from the documents of the Special Committee and all other United Nations documents.

COMMERCIAL FUTURE, *supra* note 11, at 2-3.

93. During the negotiations the PRC did threaten to retake the New Territories *after* the lease expired if the dispute was not resolved. But the PRC did not embargo food stuffs or threaten military action before the lease expired.

94. The Korean War, the shelling of Matsu and Quemoy and the recent Vietnam incursions can be seen in that context.

95. CHINA'S FOREIGN RELATIONS, *supra* note 4, at ix.

96. *Id.* at viii and ix.

97. *Id.* at ix. See also LIEBERTHAL, *Domestic Politics and Foreign Policy*, in *id.* at 43-77. For more on the Economic Reforms after Mao, see *supra* note 82.

There has been a fundamental link between modern China's domestic and foreign policy.⁹⁸ In the 1950's China became an ally of the Soviet Union. One of the largest transfers of technology and industry in the world's history occurred from 1950-57 when the Soviet Union assisted China in its drive toward modernization.⁹⁹ In the late 1950's China's relationship toward the Soviet Union cooled because of the thawing of the Soviet-American relationship and the disenchantment by Mao with the Soviet-style bureaucracy.¹⁰⁰ With the radical change in relations with the Soviet Union, the Chinese nation went into a decade of isolation, and, apparently, aberrant behavior¹⁰¹ in foreign affairs.

After dissatisfaction with the progress of modernization brought about by the Soviet model, China embarked upon the Great Leap Forward (1958-1962).¹⁰² Industry was decentralized. Neighborhood blast furnaces sprang up everywhere. The economies of scale were disregarded. China turned inward, determined to lift itself into modernity on the backs of the peasant blast furnace industry. The Great Leap Forward marked a termination of favorable trade relations with the Soviet Union and a great hostility towards the United States. China isolated itself from the world and the world's technology. The Great Leap Forward was an economic disaster.¹⁰³ Industry suffered, and the economy fell backwards. Rural production faltered.¹⁰⁴

In the late 1960's and early 1970's China was traumatized by the Cultural Revolution.¹⁰⁵ For several years industry, government, science and society were in disarray as the Maoists purged the bureaucratic elites from positions of power. The upheaval caused

98. See generally LIEBERTHAL, *supra* note 97.

99. *Id.* at 48.

100. *Id.* at 48. This model was alien to Mao's concept of peasant leadership.

101. The isolationism and attacks on foreign institutions of the late 1950's and the 1960's are not so aberrant when considered in the context of China's historic tension between nativists and modernizers. The nativist view of the world emphasizes Chinese culture and institutions. The modernizers are willing to accept the contamination and contact which foreign cultures bring if the benefits are large enough.

102. See generally J. CHESNEAUX, CHINA: THE PEOPLE'S REPUBLIC 1949-1976 83-112 (1979) [hereinafter cited as THE PEOPLE'S REPUBLIC].

103. Major errors were made in capital allocations. Energy development policies faltered. The decade of Maoist politics left the human capital in disarray.

104. See, e.g., LIEBERTHAL, *supra* note 97, at 56; GLOBAL PERSPECTIVE, *supra* note 82, at 3-4.

105. See generally THE PEOPLE'S REPUBLIC, *supra* note 102, at 138-70.

by this essentially nativist¹⁰⁶ movement left China divided and disorganized. After the Cultural Revolution, modernizers were united under Premier Zhou Enlai and, after 1973, under Deng. The modernizers gave great priority to the rapid economic development of China, favoring growth over policies of price stability and equality which had guided the economy for years. Rapid development called for increased ties with the international community and with foreign businesses. Political stability was needed to create confidence among foreign investors and to establish a viable framework for ongoing economic relations.¹⁰⁷ Domestic and foreign policies swung between Maoists and modernists until Mao's death in 1976.¹⁰⁸

The post-Maoist era has seen tensions among the Chinese modernizers over the optimal degree of foreign penetration. Domestically, Mao's victims were rehabilitated.¹⁰⁹ In foreign affairs, Deng sought to strengthen China by orchestrating an internationally united front against the Soviet Union. Since the 1970's China has begun to identify strategically with the Western powers and has obtained capital and technology from them.

The economic reforms saw the revival of the legal system and the introduction of the price mechanism to allocate investments. Since 1978, attempts to reform the economy proliferated through continued decentralization, material incentives, profits and the encouragement of efficient industries and farms to reinvest their profits.¹¹⁰ This contrasts sharply with the 1950's and 1960's when China's economic activity and foreign policy had been directed toward the creation and development of import-substituting industries aimed at achieving national self-sufficiency. While this policy did create a large industrial base,¹¹¹ it was not selective and China attempted to produce everything it needed without regard to efficiencies or cost.¹¹²

106. This was a nativist movement as it spurned foreign influences in an attempt to purify Chinese society. It also attacked Confucianism and other fundamental aspects of Chinese life in order to remake the social fabric.

107. LIEBERTHAL, *supra* note 97, at 53.

108. *Id.* at 53-54.

109. *Id.* at 55-59.

110. B. REYNOLDS, in CHINA'S FOREIGN RELATIONS, *supra* note 4, at 80. The economy has had great success in the rural sectors. See Salisbury, *supra* note 82.

111. See GLOBAL PERSPECTIVE, *supra* note 82, at 9-10.

112. B. REYNOLDS, *supra* note 4, at 80. This contrasts with the export-promotion policy which was used to modernize Korea, Taiwan, Hong Kong, and Singapore. Their economies

Under Deng, the policies have again shifted.¹¹³ Deng's reforms have aimed at rapid modernization, economic growth and political reforms designed to prevent the return of Maoist politics.¹¹⁴ Capitalism has been all but embraced as the nation moves toward a market economy. Extremely ambitious goals have been set. The reformers aim to quadruple the gross national product, double the energy output and raise per capita income to \$800 by the year 2000.¹¹⁵ Results in rural areas have been very gratifying,¹¹⁶ and the reforms have been inaugurated recently in urban areas.¹¹⁷

It is difficult to judge how China's reforms will fare¹¹⁸ and what their effect will be upon the long-range foreign policies of the PRC. China has attempted to reform the economy in order to maximize efficiency. It has made necessary administrative changes throughout the nation. The Communist Party has yielded control of the economy to the government. Nevertheless, tension remains as to the degree of modernization China is willing to accept.¹¹⁹ China is forced now by economic constraints to develop an export-led growth economy.¹²⁰ It has little choice. It can turn away from an open-door policy only if it is willing to sacrifice growth and an improved standard of living for an ideologically imposed mobilization of its people.¹²¹

grew at a rate of 7.9% in the 1960's and 8.6% per annum between 1970 and 1978. As these economies were labor-intensive, industrial employment grew rapidly and spread the benefits of economic growth widely through the population. *Id.* at 84-85.

113. See, e.g., IYER, *Capitalism Comes to the City*, TIME, Oct. 29, 1984, at 47; SWEEPING CHANGES, *supra* note 82; TANZER, *Karl Marx Must Be Spinning in his Grave*, FORBES, Nov. 19, 1984, at 258 [hereinafter cited as *Karl Marx*]; IYER, *supra* note 9.

114. LIEBERTHAL, *supra* note 97, at 55.

115. IYER, *supra* note 9, at 27.

116. *Id.* at 28; Salisbury, *supra* note 82.

117. IYER, *supra* note 114.

118. See Bennett, *Deng Xiaoping Forces Gain Momentum in Their Attempts to Transform China*, WALL ST. J., Dec. 13, 1984, at 34, col. 1. Many officials have lost their posts due to the reforms and are angry. The liberation from Marxist theology may be difficult for many to tolerate and the long-isolated Chinese people may not adapt to the sweeping changes being brought to them. *Id.*

119. B. REYNOLDS, *supra* note 4, at 66.

120. *Id.* at 67. If the PRC wishes to rapidly develop, export-led growth seems the route to follow. See B. REYNOLDS, in CHINA'S FOREIGN RELATIONS, *supra* note 4, at 113.

121. B. REYNOLDS, in CHINA'S FOREIGN RELATIONS, *supra* note 4, at 67.

In light of the recent pronouncements of the leadership of the PRC, such an about face seems unlikely. The PRC does not want to revert to the chaos of the cultural revolution and the Great Leap Forward. See Burns, *20 Years Wasted*, N.Y. Times, Feb. 21, 1985, at A7, col. 1.

This strategy failed in the Great Leap Forward and the upheaval that was the Cultural Revolution. While the continued embrace of the new economic reforms after Deng's death is not certain, it does seem unlikely that China will return to the economic and diplomatic chaos of the 1960's and early 1970's. If the PRC continues to modernize, it will benefit from Hong Kong as it has historically. Even if the PRC does not, and retreats into neo-Maoist or nativist convulsions, the maintenance of Hong Kong is in the PRC's best interest.

V. THE PRESERVATION OF A CAPITALISTIC HONG KONG IS IMPORTANT TO CHINA

There are strong diplomatic,¹²² economic¹²³ and military reasons¹²⁴ for China to preserve the basic capitalistic structure of Hong Kong. China's very ambitious economic plans will be enhanced greatly by a capitalistic economy in Hong Kong. The Hong Kong economy supplies China with much of its foreign exchange. For China to achieve its goals, it will need massive foreign investments and modern technology.¹²⁵ To obtain the required capital and investment, China will need stability and political maturity.¹²⁶ Investor

122. See *infra* notes 138-57 and accompanying text.

123. See *infra* notes 125-37 and accompanying text.

124. If the PRC honors the agreement, foreign exchange will be earned which can be used to modernize its military. It may lessen tensions in Southeastern Asia which could reduce the PRC's military establishment facing Taiwan. Presently the PRC is looking toward the United States for its weapons procurement program. See Burns, *Vessey in China: 2-Edged Symbolism*, N.Y. Times, Jan. 20, 1985, at A3, col. 1. Thus its demonstrated good faith may encourage the United States and other Western nations to enter into more favorable military and diplomatic arrangements. However, these military sales may have a devastating effect upon Taiwan's defense system as much of its matériel is approaching obsolescence. See Barnes, *Taiwan's Aging Arsenal Could Invite Attack by China*, Wall St. J., Jan. 21, 1985, at 23, col. 3.

125. China represents potentially the world's greatest market to business interests if the nation's resources and people can be tapped. Business interests are willing to take a long term approach on their investments because the market possibilities are so great. The immediate earnings also appear to be worth the risk-taking as China can use much in its rush to modernize. The PRC also buys such nonessential goods as soft drinks and cigarettes. The Chinese have generally been more liberal with investors who mixed technological investments in China with domestic sales than with those interests seeking merely to sell goods to China. *Karl Marx, supra* note 113, at 259. The latter would merely lead to a trade deficit. The former permits China to develop import-substituting industries or to create export-promotion industries, if the products have both a domestic and foreign market.

126. China seems to have moved into the status of a mature political power after the trauma of its revolutionary birth. See HARDING, *China's Changing Roles in the Contemporary World*, in CHINA'S FOREIGN RELATIONS, *supra* note 4, at 177-223.

confidence is critical. The modernization can ill-afford Great Leaps Forward and Cultural Revolutions.¹²⁷ A threat to disregard the agreement or an actual violation of it would signal political instability. Such actions would cause capital to be withdrawn from Hong Kong and would threaten foreign investment in China proper.

Even if China's economic plans fail or are scaled-down, a capitalistic Hong Kong will have sufficient value for the PRC to honor the agreement. From the PRC's inception as a nation, Hong Kong has had great economic importance. Immediately after the U.S. embargo of Chinese goods during the Korean War, Hong Kong served as an important outlet for Chinese products.¹²⁸ Since then a strong symbiotic relationship between Hong Kong and the PRC has evolved.¹²⁹ Hong Kong benefits from having relatively inexpensive supplies of food, consumer goods and cheap water. China obtains substantial foreign exchange and a trading post for its business contacts with the rest of the world.¹³⁰

Furthermore, Hong Kong is of immense benefit to the PRC as the service and financial center it has grown to be.¹³¹ Hong Kong's financial services assist China as a clearing house for remittances.¹³² China receives substantial indirect benefits through Western financial and political contacts in Hong Kong.¹³³ Hong Kong serves as a laboratory for Chinese economic experimentation.¹³⁴ Hong Kong also provides the PRC with an important redistribution center for Chinese goods. The PRC would not want to lose the value of such a facility.

127. One of the critical questions is whether Deng will succeed. Commentators have concluded that the longer he remains in power the greater the chance there will be for the success of his reforms. See, e.g., Bennett, *supra* note 118. Deng has been an astute politician and he has worked to achieve consensus. He has been careful to have others appear to be the true authors of many of the reforms. Wren, *Deng's Goals for China: Pragmatism and Profits*, N.Y. Times, Oct. 28, 1984, at E5, col. 1. Many leaders have been coopted into the reforms. *Id.*; see KELLY, "It Cannot Harm Us," TIME, Jan. 14, 1985, at 36-37. Furthermore, as one of the last great revolutionaries, he is not tied to the past. As a great revolutionary leader he can make fundamental changes. Finally, nothing succeeds like success. Rural China is prospering. Salisbury, *supra* note 82. The reforms are being introduced into the cities and the cadre's control over economic decisions is decreasing.

128. A. YOUNGSON, HONG KONG: ECONOMIC GROWTH AND POLICY 3 (1982).

129. COMMERCIAL FUTURE, *supra* note 11, at 3. See generally NEXUS, *supra* note 76 on the importance and complexity of the interdependence.

130. COMMERCIAL FUTURE, *supra* note 11, at 3.

131. *Id.* at 153; NEXUS, *supra* note 76, at 24-38.

132. ECONOMIC FREEDOM, *supra* note 15, at 25. China enjoys invisible earnings from remittances and unrequited transfers and tourism. JAO, in NEXUS, *supra* note 76, at 38-44.

133. ECONOMIC FREEDOM, *supra* note 15, at 25; R. HUGHES, BORROWED PLACE BORROWED TIME, HONG KONG AND ITS MANY FACES 40 (1976).

Expropriation would also not benefit the PRC. Capital, skilled labor and machinery would surely flee such encroachment, as they did when the PRC broke its promises to the capitalists of Shanghai.¹³⁵ Business confidence would evaporate. The economy would become a shambles. The PRC would lose a major market for its goods and raw materials. It would have only gained an angry urban population which could not feed itself. Thus, expropriation of the capital and a radical change in the economic freedoms is anti-theoretical to China's self-interest.

Since the 1960's approximately forty percent of China's foreign exchange has come from its Hong Kong trading partner.¹³⁶ This favorable trade posture has arisen as Hong Kong needs water, food stuffs and some raw materials from the Mainland. China does not have much need for the sophisticated products Hong Kong produces. Thus, a substantial trade imbalance has arisen. Currently, the trade imbalance is approximately five billion dollars.¹³⁷ The suppression of economic freedoms would deprive the PRC of very important economic benefits. This remarkable, symbiotic relationship has developed and thrived throughout the history of the PRC, regardless of the diplomatic or domestic political situation. To rupture this beneficial arrangement after 1997, would not make economic or political sense.

It is also in the PRC's diplomatic interest to honor the agreement. With the agreement, China has achieved a long-standing goal and has liberated Chinese territory. It has achieved a major diplomatic victory without resort to arms or the threatened use of arms.¹³⁸ In thirty-five years, China has risen from a beleaguered

134. China has already invested heavily in Hong Kong. Banks, shipping companies, department stores and plants are owned by the PRC. Any hostile action against the Crown Colony before 1997 or after control passes would seriously devalue these investments.

135. COMMERCIAL FUTURE, *supra* note 11, at 154. Threatened expropriation would have the same effect.

It is ironic that Hong Kong's economy was in a large part saved and revitalized by the Shanghai capitalists and skilled laborers who fled the PRC. If the PRC threatens the entrepreneurs, new homes will be available for them in Taiwan and other places. Immediately after the accord was announced, the Prime Minister of the Republic of China (ROC), Yu Kuo-hwa, promised to assist Hong Kong residents willing to resettle. *Taiwan Bids Hong Kong Fight Communism*, N.Y. Times, Sept. 27, 1984, at A12, col. 1.

136. ECONOMIC FREEDOM, *supra* note 15, at 25.

137. Hong Kong imports approximately \$5.9 billion in goods from the PRC. The PRC purchases \$865 million from Hong Kong. Wren, *supra* note 8, col. 3.

138. While China, in September 1983, did threaten to unilaterally occupy the New Territories in 1997 after the expiration of the ninety-nine year lease, *see* Park, *supra* note 58, it had a legal right to do so. The PRC did not threaten military force against the territory during the tenure of the lease.

nation to a potential super power.¹³⁹ Now it is in a position to take advantage of the world order. China has a large stake in the preservation of that order.¹⁴⁰ To dishonor the agreement would produce no diplomatic benefits. It would cost the PRC status in the international community.

The peaceful resolution of the Hong Kong situation will facilitate China's quest for great power status by aiding it in its program of modernization and economic expansion. To spur modernization, China has recently decreased the role of the military and has decreased the military budget.¹⁴¹ For this restructuring to be successful, China will need a relaxation of tensions. The continued existence of Hong Kong as a free society will reduce military tensions in Southeastern Asia and promote this objective. This enhances the PRC's policy of peaceful reconciliation with Taiwan.¹⁴² If the PRC violates the agreement, tensions with Taiwan and its other neighbors, including the Soviet Union, will undoubtedly rise.

It remains to be seen whether the agreement will smooth the way for the peaceful reunification of the Mainland and Taiwan. While it is tempting to imagine that this agreement will facilitate a resolution of the Taiwan issue, some commentators think that the analogy is too strained to be useful.¹⁴³

Hong Kong and Taiwan have radically different histories.¹⁴⁴ Hong Kong has always been a British Colony. Taiwan has enjoyed a substantial period of independence and self-government. The Chinese began immigration to Taiwan about one thousand years

139. For an excellent review of the transition from an isolated state to a potential world power, see generally HARDING, in CHINA'S FOREIGN RELATIONS, *supra* note 126, at 177.

140. *Cf. id.* at 218. Furthermore, the PRC has announced it will settle its territorial claims through "peaceful negotiation." J. HSIUNG, LAW AND POLICY IN CHINA'S FOREIGN RELATIONS 289 (1972).

141. See Burns, *supra* note 9.

142. China has been deemphasizing its military policy in territories adjacent to Taiwan and developing these areas as Special Economic Zones (SEZ's). See Karl Marx, *supra* note 114. If these areas develop economically, and trade with Taiwan is fostered, tensions could be further relaxed.

The legal structure of the SEZ's is described in detail in Nishitateno, *China's Special Economic Zones: Experimental Units for Economic Reform*, 32 INT'L & COMP. L.Q. 175 (1983).

143. See Copper, *Hong Kong Doesn't Provide a Pattern for Taiwan*, Wall St. J., Nov. 5, 1984, at 33, col. 3. For an exhaustive study of the Taiwan issue see generally CHINA AND THE TAIWAN ISSUE (H. Chiu ed. 1979) [hereinafter cited as TAIWAN ISSUE].

144. Copper, *supra* note 143. See *supra* notes 24-54 and accompanying text for the history of Hong Kong.

ago.¹⁴⁵ It was colonized several times and ceded to Japan in perpetuity in 1895.¹⁴⁶ On December 9, 1941, China declared all treaties between Japan and China void.¹⁴⁷ At the Cairo Conference the United States, Great Britain and China reaffirmed that all territories of the Republic of China which were stolen from China by Japan were to be returned.¹⁴⁸ In October of 1945, China took possession of Formosa and ruled it as a province until June 1949.¹⁴⁹ After the outbreak of the Korean War, the United States pledged to defend Formosa.¹⁵⁰ Since then the Republic of China has steadfastly resisted any reunion with the PRC.¹⁵¹

The Republic of China (ROC) is a sovereign nation-state which is not linked to China as a trading partner.¹⁵² While there are no important trading links at the present, the PRC could develop substantial trade relations with Taiwan, even though Taiwan is considerably more advanced industrially.¹⁵³ The PRC could exchange raw materials, primary energy and simple manufactured goods for services and more sophisticated goods.¹⁵⁴ If China established a relationship with Taiwan, it would profit from the export-oriented industrial development¹⁵⁵ in much the same manner as it has from its contacts with Hong Kong. The creation of such industries will take advantage of China's huge labor supply for the labor-intensive industries. The relaxation of military tension produced by increased

145. *Id.*

146. At that time it was permanently incorporated into the Japanese Empire. This was a result of defeats suffered in the Sino-Japanese War after which China also ceded the Pescadores Island Group. WENG, *The Legal Status of Taiwan*, in LAW IN CHINESE FOREIGN POLICY: COMMUNIST CHINA AND SELECTED PROBLEMS OF INTERNATIONAL LAW 123-24 (S. Leng & H. Chiu ed. 1972).

147. *Id.*

148. *Id.* This agreement was present in the other World War II conferences. *Id.*

149. *Id.* at 125.

150. *Id.* at 126.

151. See, e.g., CHAI, *Foreign Relations in Contemporary Republic of China: The Taiwan Experience 1950-1980* 383-89 (J. Hsiung ed. 1981); KAU, *Security and Defense Capabilities*, *id.* at 421-27.

152. Copper, *supra* note 143. Taiwan buys marginal amounts of medicinal herbs and dried fruits from the Mainland. No foreign investment in Taiwan comes from the PRC as is the case with Hong Kong.

153. LEVINE, in CHINA'S FOREIGN RELATIONS, *supra* note 6, at 128.

154. *Id.*

155. Taiwan is selling sophisticated products. Its electronic goods have surpassed textile shipments. ALEXANDER, *supra* note 47, at 79. It had a growth rate of 18% in exports and an overall growth rate of 9%. *Id.* As Taiwan is concerned about over-dependence upon the American market, trade with the PRC might be in its best long-term interest.

trade and other contacts would free scarce resources for the PRC's developing economy.

The military situation is not comparable. China cannot impose its will upon Taiwan without great cost. Unlike Hong Kong, which has a very modest defense force incapable of resisting the People's Liberation Army, the ROC is well armed and determined to resist.¹⁵⁶ Taiwan's sole military objective is the defense of its territory; China has many other military considerations, such as the Soviet Union and Vietnam. China could only conquer Taiwan by a costly invasion or with nuclear weapons.¹⁵⁷ A conventional invasion would harm China strategically, as the Soviet Union and the United States would probably intervene. Thus, China probably cannot accomplish the reunification through force or the threat of force. However, if the PRC respects the agreement and permits the Hong Kong Special Administrative Region to flourish, Taiwan and the PRC may both be induced into gradually lowering their guards. A strengthening of economic ties does seem to offer much to both Chinas. If economic links are fashioned, then overtures for a special reunification along the lines of the Hong Kong agreement may be attainable.

VI. CONCLUSION

China has a great opportunity for dealing with the small but vital economy and political entity which is Hong Kong in a most creative way. If the PRC honors the agreement, it will benefit greatly. China will demonstrate to the world that it has become a respectable member of the international community. It will earn great economic rewards from the capital exchange inflows and increased contact with the capitalistic society. This recent agreement also lessens military tension in the region and may lay the foundation for a special reunion¹⁵⁸ with Taiwan.

156. The ROC has resisted the threat of invasion and the shelling of Quemoy and Matsu. Presently the ROC has a 310,000 man army, a 235 vessel navy and an air force of 485 combat aircraft with 77,000 men under arms. THE STATESMAN'S YEARBOOK, *supra* note 5, at 357-58.

157. As the ROC may have nuclear weapons, that could be a costly decision. A conventional invasion would require a million soldiers and several weeks. Copper, *supra* note 143. Such a conventional invasion is unlikely due to China's preoccupation with a strong Soviet Union on its northern flank. CHAI, *supra* note 151, at 412. See also CHEN, *Taiwan in Peking's Strategy in TAIWAN ISSUE*, *supra* note 143, at 142. It is troubled by an aggressive Vietnam on its southern border. *Id.* Furthermore, it cannot discount American intervention.

158. This, however, still seems rather problematic at this stage. The PRC desires the annexation of Taiwan for political, military, economic and energy reasons. The ROC has

Many benefits will flow to the PRC if it keeps the agreement and permits the union of such unequal and distinctly different systems and societies. But if it fails to honor the agreement and uses naked force to alter Hong Kong, much harm will come to both it and Hong Kong. Self-interest and justice both dictate that the UK-PRC agreement on the future of Hong Kong will be honored.

resisted successfully any reunification and is politically committed to continued resistance.

The economic differences between the two Chinas are great. While the fate of Taiwan is closely related to mainland China, the ROC would resist reunification solely on economic grounds as Taiwan's standard of living is so much greater. PRYBYLA, *Economic Development in Taiwan* in TAIWAN ISSUE, *supra* note 143, at 124. The successful reunion of Hong Kong to the Mainland would serve as precedent for an economic framework, which would protect Taiwan and benefit the PRC. The PRC has stated that such an economic reunion with Taiwan is a possibility. CHEN, in TAIWAN ISSUE, *supra* note 157, at 132. Only if the economic differences can be overcome and the PRC modernizes and becomes a more liberal society will the agreement offer a model for the peaceful reunification of Taiwan and the PRC.