

HONG KONG EXPERIENCE OF DECENTRALIZATION: FROM FISCAL DECENTRALIZATION TO POLITICAL DEVOLUTION

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Hong Kong is a Special Administrative Region (HKSAR) under the sovereign control of the People's Republic of China (PRC). It is governed under the country's *One Country Two Systems* framework. This means that HKSAR is considered as an inalienable part of China's territory. Amidst this, it is given a degree of leeway to conduct its own affairs within the parameters set by the Hong Kong Basic Law that was provided for by the Central Government of the People's Republic of China. As far as the Basic Law is concerned, Hong Kong's status as a special administrative region allows it a high degree of autonomy that differentiates it from the autonomous regions inside China which have a limited sense of autonomy, contrary to their categorization. The perks of being an SAR includes expanding Hong Kong's capacity to conduct its own domestic (political, judicial and legislative) affairs and its economic relations

both within and outside of China. In essence, HKSAR is capable of practicing both political and fiscal autonomy though with certain limitations, as any decentralized system would. It is apparent that Hong Kong has benefited from its autonomy. This paper posits that a decentralized system of government like that of HKSAR draws power from different sources. Given its limited freedom to self-determination, Hong Kong desire for political autonomy is drawn from the confidence it developed because of its strong sense of fiscal autonomy. In this light, this paper aims to look into the following questions: What policies and provisions from China secure Hong Kong's fiscal autonomy? How did Hong Kong exercise its fiscal autonomy? What were the ramifications of Hong Kong's fiscal autonomy on its pursuit for political autonomy?

Before proceeding, some preliminary questions must first be answered.

PRC-HK Fiscal Relations

Although the island of Hong Kong has always been an inalienable part of China's vast territory, there was a time when it was colonized by foreign powers. Most notable of which was Great Britain's occupation of the island for 156 years which ended in July 1 of 1997 (Reuters, 2007). The end of British rule on Hong Kong was formalized when Great Britain and the People's Republic of China agreed that the island would maintain its autonomy from its sovereign for 50 years after the transfer (Cheung, 1998, p.308; HK Basic Law art.5). The legal manifestation of this agreement is in the

form of the *One Country Two Systems* framework that China has been practicing in Hong Kong and Macau since their return to China in 1997 and 1998 respectively. The Basic Law and the establishment of Hong Kong as a Special Administrative Region of China would have adverse effects on the relationship between Beijing and its regional counterpart. The first point that the Basic Law puts forward is the recognition of the PRC's role as the sovereign state and that HKSAR is an inalienable part of the country (HK Basic Law art.1). Since the agreement between Great Britain and China decided to preserve Hong Kong's autonomous status for 50 years after the transfer, the PRC recognizes that HKSAR will not practice socialism and will continue to practice capitalism (HK Basic Law art. 5, 18). To honor this distinction, the central government of the PRC and its different regions and municipalities are not allowed to interfere in the internal affairs of Hong Kong (HK Basic Law art.14, 22). Amidst this sense of autonomy in the region, there are some limitations on what HKSAR can and cannot do. As part of a decentralized system such as China, Hong Kong cannot completely pursue self-determination since it is not a sovereign state. Recalling that Article 1 of the Basic Law brings Hong Kong back to the reality that it is still merely a part of China, albeit a significant part of it. Because of this, the region is only allowed to exercise a limited amount of political autonomy since this is an aspect of decentralization that the Central Government in Beijing is weary of completely downloading to the region.

Chapter V of the Basic Law spells this out by focusing on Hong Kong's economy. First and foremost, HKSAR independently manages its own finances without having to send it back to the central government (HK Basic Law art. 106). It also has the capacity to practice its own independent taxation system and enact laws that concern the types of taxes, tax rates, tax reductions, allowances and exemptions, and other matters of taxation (HK Basic Law art. 108). And while the region's foreign affairs are represented by the people in the central government, it is still allowed to use the name Hong Kong, China when participating in relevant international organizations and international trade agreements (HK Basic Law art. 116). When compared to the legal grounds for Hong Kong's political autonomy, its capacity to determine its fiscal policy is considerably greater. While the selection of the region's leadership continues to be under the supervision of the central government thus raising public disenfranchisement on Beijing, Hong Kong's fiscal intentions are given more leeway. It is apparent that Beijing has a sense of confidence in Hong Kong. Support for downloading fiscal responsibilities down to the regional level shows how China puts trust on HKSAR's capacity to deliver positive results, as it has done so in the past.

Hong Kong's Exercise of Fiscal Autonomy

While Hong Kong remains as a region of the PRC, albeit one with limitations in some respects, its freedom to run its fiscal

agenda independently has been a defining factor of its identity. This has been characterized by maximizing its capacities in trade. Since it has historically and continuously acted as an important backdoor into China, engagement with the international community played an important role in Hong Kong's pursuit in exercising its fiscal autonomy. For starters, it is worth remembering that the government in China allowed Hong Kong to use its name and title when participating in relevant international organizations and international trade (HK Basic Law 116). Because of this, it has entered into a number of negotiations and joined international institutions in the past. A good example of this was when Hong Kong became an official member of the GATT in 1997 and an original member of the WTO since 1995. China allowed HKSAR to continue its membership in the GATT, and it would later on join the WTO in 2001 as well.

Still under the title of "Hong Kong, China", HKSAR was also able to establish bilateral agreements and relations with foreign actors and institutions on many subjects ranging from air services, investment promotions and protection, to taxation, and mutual legal assistance, among others (Zeng, 2003). Zeng's work identified 80 bilateral agreements between Hong Kong and other actors. This was an unprecedented move for HKSAR given its status as a non-sovereign country. According to the website of Hong Kong's Trade and Industry Department, it is a member of the following international trade organizations: *World Trade Organization, Asia-Pacific Economic Cooperation, Organization of Economic Cooperation*

and Development's Trade Committee, and the *Pacific Economic Cooperation Council*. Likewise, it has one signed Free Trade Agreement with ASEAN, five are in force, and three are under negotiation. Hong Kong is considered the first autonomous entity to enter into that many bilateral treaties in its name with foreign countries. It is apparent that Hong Kong's title as a Special Administrative Region has deep implications on its fiscal policy. Given the considerable number of bilateral agreements and memberships it holds in international trade organizations, the government of Hong Kong puts fiscal autonomy into practice mostly by maximizing its identity as a corporate actor, which allows it to make transactions and enter into agreements with other foreign entities. Hong Kong's choice to do so helps boost its economic performance and presence in the international community. These engagements abroad add a new layer on the relationship between China and Hong Kong since support for the latter's role in establishing agreements with other countries entails the former to further secure the latter's autonomy. And further supporting its autonomy would also have implications in areas outside of Hong Kong's fiscal interests.

Impacts of Hong Kong's Fiscal Autonomy

The government of the Hong Kong Special Administrative Region chose to maximize its corporate identity by engaging the international community. Even prior to the transfer, the island was relatively successful in managing its economy. During the many

years that the PRC isolated itself from the world, foreign investors and entrepreneurs perceived Hong Kong as the ideal backdoor into the Chinese economy. Foreign trade in Hong Kong played a significant role in defining who the region is today. Roughly 20 years before the transfer was even made, Hong Kong was identified as one of Four Asian Tigers (Hong Kong, Taiwan, Singapore, South Korea) which established it as a newly industrialized economy given its fast industrial growth. Given its history as a well-managed economy, it comes as no surprise that China allows Hong Kong to have more freedom in its fiscal capacities than its political ones, given the PRC's one-party system form of government (CFR 2018). Considering its status as an NIE back in the 70s, Hong Kong was in a particularly privileged position regarding the potential of its economy. While it has suffered the occasional let-down of the two financial crises that affected Asia and the world (i.e., the Asian Financial Crisis of 1997 and the Global Financial Crisis of 1999), the data gathered from CEIC showed how quickly the region was able to get back on its feet after the shocks of both crises. Hong Kong, being a part of the PRC, one of the contributing countries to the economic rebound after both crises, also benefited from this political-geographic relationship. This capacity of Hong Kong to perform well even under such difficult conditions has boosted confidence both in it both locally and internationally.

On the foreign front, the international community continues to build economic trade relations with Hong Kong. The region's

potential and capacity for trade is highlighted by the willingness of these countries to enter into bilateral trade agreements and free trade agreements between their governments and a non-state actor such as Hong Kong. This has been a significant development in the field of intergovernmental trade since there has never been such a high level of support for a non-state actor given by the international community. This recognition has further legitimized the role and capacity of HKSAR to act independently of the People's Republic of China even though it is bound to it. This has broadened the role of fiscal decentralization in the context of Hong Kong-China relations. The stability of Hong Kong's economy that was brought about by its capacity to maximize its corporate identity has also strengthened regionalist sentiments. Its manifestation is on the re-establishment of a Hong Kong or Cantonese identity that is distinct from that of the PRC (Wong, 2016; Pei, 2014). The rise of regionalist sentiment in HKSAR has reaffirmed the island's desire for self-sufficiency. Given the feats of Hong Kong's capacity for fiscal autonomy wherein it is able to establish bilateral and multilateral ties with sovereign states, it is apparent that there seems to be no desire to further deepen its fiscal autonomy. On the economic end, the most recent threat to its economy has been the liberalization of Shanghai since it created a new regional competitor against Hong Kong (SCMP, 2013). Noticeably, there is no apparent public clamor regarding expanding on its freedom to control and manipulate its own economic activities since the region has generally benefited from it.

The most recent direction of public discourse in Hong Kong was geared more towards the furthering of democratic procedures and principles. Namely, on the issue of universal suffrage for the people of Hong Kong to choose their leaders for themselves. Such was the rise of the Umbrella Movement back in 2013, which became another strain on the relationship between Beijing and its counterpart in Hong Kong. In essence then, Hong Kong's drive to deepen its political autonomy is not entirely a political agenda on its own. The desire to move for a deepening of political freedoms is grounded on the fact that the region has a strong sense of economic determination that drives it to desire for less concrete and more abstract principles such as democracy and universal suffrage.

Conclusions

Hong Kong Special Administrative Region is an area within the territory of the People's Republic of China wherein the national government ideology of socialism is not observed. In place of following the state ideology, the island was allowed to continue with its pre-existing capitalist ideation under British rule. When the British were about to transfer Hong Kong back to the PRC in 1997, the two parties agreed that for 50 years Hong Kong SAR would be left as an autonomously run region within the territorial area of China. Since Hong Kong has had a considerably degree of success, given the NIE status it received back in the 1970s, the PRC was less reluctant to download fiscal authority to the region since it

had succeeded in doing just that prior to its transfer back to China. This has been stipulated in chapter V of the Hong Kong Basic Law. It specifically highlights how HKSAR will have the right to control its own budget allotment separate from the PRC, have its own set of taxation rules and regulations, and most importantly the right to use the name Hong Kong, China when dealing with other trade entities.

Among the three points that were highlighted as the areas in which HKSAR could manoeuvre its own fiscal needs, it is in the third point where Hong Kong seems to shine. By taking on the name of “Hong Kong, China”, the government of Hong Kong gains a corporate type of identity that allows it to make transactions and sue. While the latter is seldom if ever used, HKSAR has very wisely made sure to maximize its capacity to make deals and transactions with the international community. Its decision to use its corporate identity when engaging with other entities has allowed it to gain traction and support from the international community. This has been an astonishing achievement for a non-state actor such as itself since there has never been a case when members of the international community have been more eager to support ongoing and pursuing trade relations with Hong Kong. In a way, this has some implication on HK-PRC relations. Other countries are willing to engage with Hong Kong because of two factors. First is its proximity to China and acting as a bridge or conduit between the two where foreign products and markets are able to enter the then closed PRC.

Second, Hong Kong's fiscal autonomy as an Special Administrative Region allows it to openly trade with the outside world since socialist state ideologies do not apply in Hong Kong. This support and interest from the international community pressures China to sustain the fiscal autonomy that it has been enjoying for years. On the other end, fiscal autonomy also brought with it the rise of a distinctly Hong Kong identity that is separate from the Mainland Chinese identity. This group is more regionalistic and appreciative of the achievements that their region has made amidst the limitations of their constitutional mandates. With this regard, fiscal policy brought fourth a Hong Kong identity that was proud of its regional roots and were willing to pursue them further.

The furthering of the Hong Kong identity, formed rather unintentionally by the fiscal decentralization process that China implemented on the region, has also furthered a regional desire for further self-determination. For the most part, this has been a movement towards universal suffrage. Advocates of this identity tend to look for a deepening of political autonomy, without abandoning the *One Country Two Systems* framework. If any, this new breed of people are more concerned with attaining universal suffrage and true representation for the Hong Kong people through popular elections, which is not an irrational notion since it is specifically stipulated within the constitutionally mandated goals of the Hong Kong Basic Law.

In the end, the decentralization process that happened in Hong Kong SAR was part of a negotiation between two parties. Hong

Kong, while in the middle of it all, was allowed to keep its autonomy on particular areas of government. To be specific, China chose to download fiscal responsibilities down to its regional counterpart in Hong Kong but opted to limit the downloading of political responsibilities given the importance of the Communist Party still maintaining some form of control over the island. Amidst this however, this study showed that even though the PRC tried to limit the degree of political autonomy experienced by Hong Kong it found a way to resurface. The key ingredient in the resurfacing of this regional level interest to increase political autonomy from China was identity. This identity was formed out of an increasing confidence in the capacity of Hong Kong to act and take of itself both internally and externally. Aside from identity, the root of all this change and development in Hong Kong was the downloading of fiscal capabilities into its own system. Particularly, the idea of self-representation in the international trading community by legally taking on a corporate role as a non-state actor. The case of Hong Kong shows how a single key provision matched with an opportunity.

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