PROTECTING AND ADVANCING THE RULE OF LAW IN HONG KONG

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1.0 INTRODUCTION

Over the last six months I have completed two substantial papers commissioned by Civic Exchange in Hong Kong: (A) “The Rule of Law in Hong Kong”; and (B) “Taxation and Democracy in Hong Kong” (co-authored with Tor Krever). The first paper was published by Civic Exchange in July, 2005 and is available from the website: www.civic-exchange.org/ under “Publications”. The second paper should be published by Civic Exchange by the end of November.

Each of these papers looks at certain aspects of the development of Hong Kong’s political structure. Although they do this from differing perspectives, the views expressed are related. What I want to do here, first, is review the main issues and conclusions arising from these two papers. Next I will draw together what the two papers have to say about protecting and advancing the Rule of Law in Hong Kong.

2.0 THE RULE OF LAW IN HONG KONG – BENCHMARKS AND PRESSURE POINTS

This paper has three main components:

First, it sets out a number of general benchmarks for testing the health of the Rule of Law in a given jurisdiction. In doing this, it draws significantly on the taxonomy of “thin” and “thick” Rule of Law systems used by Peerenboom. Briefly, a thin Rule of Law regime is characterized by: clear procedural rules for law making; publicly promulgated laws; no retrospective laws; laws made by a duly authorized law-making entity; relatively clear, consistent and stable laws; and fairly enforced laws. A thick Rule of Law regime enjoys important additional (political morality) features, typically including: democratic government; advanced protection for human rights and certain stipulations about property and economic system rights (Peerenboom, 2002).

Second, the paper argues, after reviewing the historical and contemporary record on the operation of the Rule of Law in Hong Kong, that the HKSAR continues, in 2005, to adhere, on balance, to primary Rule of Law Principles (see Appendix A). The robustness of the Rule of Law, post-1997, remains at risk, however. There look to be three main pressure points. What sets these apart from other Rule of Law challenges (for example, the use of ICAC and police powers and continuing minority discrimination problems) is that: (a) they each have the potential to destabilize the Rule of Law markedly; and (b) the resolution of each lies to a very significant extent in the hands of Beijing.

These three pressure points are:

A. The lack of an accountable, representative democratic government in the HKSAR;

B. The lack of a properly representative, primary law making body in the HKSAR; and

C. The way in which the independence of the HKSAR judiciary has been compromised since 1999 through the resort to Article 158 of the Basic Law.

Pressure point B refers to the British introduced, Beijing-HKSAR maintained, system of Functional Constituencies (FCs) within Hong Kong’s Legislative Council (LegCo). The FCs cast a permanent
shadow over the law-making legitimacy of LegCo. Pressure point B is clearly related to Pressure point A – but this particular aspect of Hong Kong’s democratic deficit possesses such potential to distort the operations of LegCo that it warrants separate identification. Pressure point C refers to the provision in the Basic Law which authorizes the Standing Committee of the National People’s Congress (SCNPC) in Beijing to issue interpretations of the Basic Law. The SCNPC has now done so three times since 1997 – each time controversially.

Third, the paper comments on how the challenges presented by these pressure points might best be met. It argues that:

The best way to buttress the long term stability of the Rule of Law in Hong Kong is to fix the democratic deficit. It is evident from the events of 2003-2005, especially, that: (a) most Hong Kong people want and are more than ready for full democratic government; and (b) Beijing and numbers of elite and some ‘pro-Beijing’ groups within in Hong Kong remain deeply resistant to anything other than “gradual” democratic change over an unspecified but lengthy time frame. The well reasoned, campaign for full democratization is proceeding despite the obstacles. The goal is achievable but within a time frame which is likely to remain significant.

The challenge of dealing with pressure point B revolves around tackling the problem of LegCo’s Functional Constituencies (FCs). The FCs are, in the 21st century, a notable political structure embarrassment. FC members frequently represent narrow interests and FCs are, at worst, a travesty of electoral politics. The LegCo voting rules have also been distorted so that they amplify the negative impact of the FCs on fully representative law making. This is a problem which needs to be addressed. The Standing Committee of the National People’s Congress (SCNPC) has, through its Basic Law Interpretation of April 2004 and subsequent endorsement of the Chief Executive’s report on constitutional development in Hong Kong, insisted that the FC system not be dismantled prior to the next LegCo election due in 2008. The 50:50 ratio of directly elected to FC lawmakers must be retained. These SCNPC decisions mean that only less radical changes to the FC system may be contemplated. Less sweeping reform measures which remain open notwithstanding the stated views of the SCNPC include: abolishing corporate voting in all FCs; broadening the franchise for FCs; requiring meaningful, minimum elector numbers; reviewing the current allocation of FCs with the aim of securing a better balance of sectoral representation; and introducing a requirement that the overriding responsibility of FC members is to the HKSAR (in accordance with Articles 66 and 73 of the Basic Law) rather than to their particular FC group. The overall aim is to renovate LegCo’s standing as a properly representative law making body and thus diminish this enduring Rule of Law shortcoming. (See, also, Appendix B.)

Pressure point C presents the most acute Rule of Law difficulty. Article 158 has the potential to destabilize both the Basic Law and the Rule of Law on a recurring basis. The lack of any widely agreed protocol on: (a) when it should be used; (b) how it should operate once it is invoked; and (c) what its relationship is with Article 159 (the Basic Law amendment provision) has given rise to continuing apprehension and, often, to polarizing debate. The negative fallout each time Article 158 has been used thus far has been bad for Hong Kong generally – and for Beijing and the HKSAR Government. All parties have a vested interest in working to find a better way of managing the use of Article 158. Yash Ghai suggested a sound framework in 2000 for the judicialization of Article 158. The need for an agreed set of protocols to govern the use of Article 158 has only grown since then.
This paper also has three main components.

First, it asks:

Why does Hong Kong retain, in 2005, both a surprisingly dated taxation system and a comparatively outmoded political system? This question is all the more pertinent given that Hong Kong is plainly, by most measures, a first-world, city-state and has been so for some time. A natural follow up question is, what relationship, if any, lies behind the creation and maintenance of these two fundamental, public policy, regimes?

We then explain the nature of these two regimes:

The Political Structure in Hong Kong
The HKSAR commenced political life, on July 1, 1997, with a deliberately maintained, colonial-style, governance system. The Basic Law enabled the colonial “executive-led” system to continue essentially unchanged.

Nowhere else in the developed world can one find a political structure, in 2005, which retains so many aspects of the late 18th century model on which it is based. Like Hong Kong, other developed jurisdictions maintain significant respect for the Rule of Law but, in addition, they have, over time, built democratic, multi-party, representative, systems of government. Hong Kong has what one commentator characterizes as a “thin” Rule of Law regime – in contrast to the “thick” Rule of Law regimes applying in almost all other advanced States.

The Revenue Regime in Hong Kong
Hong Kong first introduced an income tax in 1940, ostensibly in order to contribute to the financing of Britain’s war effort. This original taxation system lasted only briefly until Japanese occupation in 1941. In 1945 British rule resumed and in 1947 a new income tax regime (the Inland Revenue Ordinance (IRO)) based on its war-time predecessor, was enacted. The IRO has remained in place and essentially intact to the present day.

The Hong Kong income taxation system, both in its 1940 and 1947 incarnations, is peculiar in its use of operationally separate schedules. Different taxes are levied on different categories of income rather than a single income tax being levied on a taxpayer’s total income. It is also unusual in using a territorial or source-based system where profits or income arising outside of Hong Kong are not subject to taxation. (See, also, Appendix C.)

The fundamental, historical drivers of these two public policy “museum pieces” include:

- A powerful, conservative alliance over the last 150 plus years between successive Hong Kong Governments and a range of British and Chinese business and professional elites. (Over the last 25 years, Beijing has increasingly become a key player within this policy-shaping cluster.)

- A reliance by Government on the use of land as a revenue raising, oil-like commodity, to an extent not seen elsewhere in the modern developed world (particularly since World War II).

- The realpolitik, which, from 1949, governed Britain’s working relationship with the People’s Republic of China.
• Stunning (“Mini-Dragon”) economic growth rates post World War II (until 1998), which:
  (a) took Hong Kong’s per capita GDP from below that of India in 1946 to higher than that of Australia with 50 years; and (b) produced full employment and rising wages for an exceptionally adaptable and hardworking, mainly immigrant population.

• A “sojourner” population which tended to see Hong Kong for many years as, most of all, an excellent but still somewhat uncertain, staging post.

• A Government placed under (and which placed itself under) significantly less pressure to develop a “welfare state” of the complexity typically encountered in most other developed economies. (What evolved is a system which has been described as the “residual welfare state”.)

Second, we look at the literature discussing the linkages between increased taxation and political structure development which appear to have evolved over many centuries across a variety of jurisdictions:

It appears that one of the rallying cries of the American Revolution in the late 18th century, “no taxation without representation” was genuinely galvanizing at that time. The better view today, however, is that citizens of the modern world do not, as Ross puts it, “generally rebel against taxation without representation; rather, they appear to rebel against taxation without commensurate government services.” (Ross, 2004) Ross looks at the historical commentary as well as data from 113 countries over more than 25 years before coming down firmly in favour of the “cost-benefit” view of the linkage between revenue systems and political development. A number of other studies have come to similar or supporting conclusions.

In the modern world, in both rich and poor jurisdictions, citizens are concerned about their political rights. But when it comes to taxation, what they apparently seek, when they turn their minds specifically to this issue, is value for the money they pay to government.

Another way of putting this is to presume that the process of linking taxation to political structure development typically goes through two phases. Phase one (as noted by Ross) sees citizens applying a cost-benefit analysis. If they feel broadly satisfied that their form of government delivers fairly effective “goods” (in a mainly corruption-free manner) in return for taxes paid, then an increase in taxation may well be deemed acceptable once it is appropriately explained. The process enter phase two where citizens, having completed the phase one reckoning, find that, instead of being broadly satisfied, they collectively and markedly lack fiscal confidence in their particular form of government. In this case, any move to increase taxes may very well result in firm demands for serious political structure reform.

Third, we draw certain conclusions about the relationship between taxation and political development in the specific case of Hong Kong:

It does not appear that Hong Kong’s under-developed tax system is primarily a product of the lack of democracy which has been a hallmark of Hong Kong’s colonial-style political system. What our research suggests is that Hong Kong’s comparatively outmoded taxation and political systems have developed largely in parallel. The explanatory underpinnings of the outcomes we see today are quite similar, however. In particular, elite business groups in Hong Kong have, virtually from the inception of British rule, had an inordinate, self-focussed influence on much public policy development. There is no question that this influence has been particularly important in the mix of factors which has left Hong Kong with such a conspicuous democratic deficit in its system of government. These business-related groups have generally worked in harmony with other key shapers of that system including...
successive Hong Kong and UK Governments – and Beijing. The influence of these groups on the development of tax policy in Hong Kong has been even more notable.

It is now widely recognized that significant reform of these two systems is needed. The HKSAR Government accepts that reform of both systems is on the agenda, though it takes a different view on the degree of reform required, especially in the case of political reform, than do numbers of commentators.

The debate over reforming Hong Kong’s awkward political system has been running with some intensity for well over a decade. The HKSAR Government is, effectively, entirely appointed by Beijing. And LegCo remains seriously flawed as a law making body, most of all because of its system of Functional Constituencies. Hong Kong people know they are ready for full democratization and they see this as the best long term solution to Hong Kong’s governance shortfalls. What is perhaps most disturbing about the current position is that it prevents Hong Kong from using a “free political market” to choose the best leaders available. It also leaves Hong Kong without a modern, transparent system for replacing an under-performing Government.

The discourse on reforming Hong Kong’s revenue system is of a somewhat different nature to the political reform debate. The discussion about tax reform does not deal with issues as fundamental as how Hong Kong should choose its Government - and elect its Legislature. It remains contentious, of course, but the argument is primarily about the political-economy consequences of different tax policy options and about the legislative and administrative arrangements needed to implement change. (See, Appendix D.)

Our research suggests that, prima facie, the HKSAR Government is well placed, based on the historical fiscal record, to proceed with taxation reform as a project largely separated from the process of political reform. The erosion of the credibility of government in Hong Kong, post-1997, raises doubts about whether this conclusion holds so well today, however. The HKSAR Government knows, too, that its unelected status fundamentally undercuts its legitimacy. All of which has tended to make the Government, overall, rather timid when it comes to much major policy development and implementation.

4.0 CONCLUDING REMARKS

A “troika” comprising the HKSAR Government, the Government in Beijing and a range of business and professional elites in Hong Kong remains, collectively, very guarded about further democratic reform in Hong Kong. The new HKSAR Government led by Donald Tsang has recently put forward proposals for modest political structure reforms. These are what the troika refers to as reforms which are consistent with the principle of “gradually and orderly” progress towards the introduction of universal suffrage for electing the Chief Executive of Hong Kong and LegCo (see, Articles 45 and 68 of the Basic Law). In particular, this grouping is most reluctant to spell out any sort of timetable for introducing universal suffrage. (The Basic Law allows, on it face, but does not mandate, universal suffrage from 2007/2008.)

The post-1997 experience in Hong Kong – and especially the experience since 2003 following the Article 23 controversy and the SARS epidemic – has forever shut the gate on the idea of Hong Kong being a purely “economic city”. Political life today in Hong Kong is increasingly complex and sophisticated:
• Political understanding across the population in Hong Kong is well informed – and the media remains more free and diverse than in most other jurisdictions in East Asia. Yet Hong Kong retains a non-democratic system of government.

• No other first-world jurisdiction combines so much, well educated, civil-society activity with so much political limitation.

• The media has developed a special relationship with the public in Hong Kong. In almost all other liberal, developed jurisdictions, the “commentating energy” of the public tends to follow the electoral cycle. That is, people are apt to discuss public issues with greatest intensity as elections – occasions where governments change hands – are approaching. Elections for the LegCo are important in Hong Kong, but far less hangs on these elections than, for example, elections in Australia. Not surprisingly, Hong Kong residents see the collective expression of their views in the media as being important in a way that Australians do not.

• Everyone can see that the HKSAR Government is, effectively, entirely appointed by Beijing. And LegCo remains seriously flawed as a law making body, most of all because of its system of Functional Constituencies.

• The current system prevents Hong Kong from using a “free political market” to choose the best leaders available.

• The current system leaves Hong Kong without a modern, transparent system for replacing an under-performing Government.

• Hong Kong people know they are ready for full democratization and they see this as the best long term solution to Hong Kong’s governance shortfalls.

The optimal way of protecting and advancing the Rule of Law in Hong Kong would be to quicken the advance towards full democratic government markedly. Conversely, the lack of more meaningful progress towards full democratic government has placed additional stress on guarding against erosion of the Rule of Law. Apart from working for greater democratization, generally, this means Hong Kong needs to guard against – and address - the Rule of Law dangers inherent in:

• The operation of the Functional Constituency system in LegCo; and

• The use of Article 158 – the Interpretation provision – of the Basic Law.

Concurrent with Hong Kong’s debate about political reform, a major debate about taxation reform is now well underway in the HKSAR. There is wide agreement that tax reform is needed. The Hong Kong tax system depends on a comparatively very narrow base and too great a resort to funding current expenditures by selling off and otherwise deriving revenues from land-related transactions.

Can major tax reform (for example the introduction Hong Kong’s first ever, Goods and Service Tax) proceed without, at the same time, moving on major political reform? Our research suggests that, prima facie, the answer is “yes”. The historical track record suggests strongly that the Hong Kong Government enjoys a comparatively sound record fiscally. The same research says that, where, as in Hong Kong, citizens feel broadly satisfied that their form of government delivers fairly effective “goods” (in a mainly corruption free manner) in return for taxes paid, then an increase in taxation may well be deemed acceptable once it is appropriately explained – without need to make extra political concessions.
Despite the support in the literature for a capacity to enact tax reform in Hong Kong separately without, also, seriously moving on political reform, the Government does not act like it perceives itself to be well placed to move aggressively on major, needed tax reform. Indeed, the Government's own behaviour, post-1997, betrays a recurring lack of fundamental confidence. Given this political reality, the most sensible way forward would be to mesh serious tax reform in Hong Kong with meaningful political reform. This would assist the implementation of tax reform and boost Government credibility. More importantly, it would be in the best interests of Hong Kong.
APPENDIX A

RULE OF LAW BENCHMARKS

The Rule of Law is a concept which has been actively developed over several centuries. A turning point in its maturation is widely agreed to have occurred when A. V. Dicey summarized its broad parameters in 1885. Since then, the theory and practice of the Rule of Law have been the subject of an immense amount of commentary. Despite the ongoing, extensive discussion about the nature of the Rule of law, there is wide agreement about the core elements of this concept. Based on Dicey’s formulation:

- Government must always be subject to the law and never above it.
- All persons must be treated equally before the law regardless of status.
- Laws must be fairly and transparently made.
- Everyone subject to the application of the law is entitled to due process – that is the fair and proper application of the law.

This fundamental position has been appreciably developed over the last 100-plus years. Today’s expanded list of further (non-prioritized) key Rule of Law elements includes:

1. A properly representative, primary law making body (to which the Government is accountable).

2. Prospective laws only (no retrospective laws).

3. A consistent and stable body of law.

4. An independent, well trained judiciary.

5. An independent, well trained legal profession.

6. Properly staffed and well trained law enforcement agencies.

7. Laws to be generally acceptable to those to whom they apply.

8. Laws and law enforcement mechanisms which maintain genuine and fair law and order within the community.


10. Effective individual human rights protections.

11. Representative democratic government.

12. A clear separation between the State and political parties.
APPENDIX B

A BICAMERAL LEGCO?

The prominent, Business and Professionals Federation of Hong Kong (BPFHK) recently came out in support of a change to a bicameral system for LegCo. The BPFHK proposal suggests that the new HKSAR lower house (likely to retain 60 members) would be entirely elected by universal suffrage, whilst the new upper house would be comprised of FC members. The proposal also appears to accept that some of the “outstanding flaws” in the FC system need to be remedied. The proposal warrants further, detailed discussion. The fundamental issue which the proposal raises is: (A) whether it is primarily a genuine step towards reforming and then replacing the FC system; or (B) more a means to entrench a somewhat attenuated version of the current FC system within Hong Kong’s legislative structure. The realization of Aim B would just leave the HKSAR with a still badly compromised legislature casting a disturbing shadow over the Rule of Law.
APPENDIX C

KEY ASPECTS OF THE HONG KONG REVENUE REGIME

The Hong Kong revenue regime today encompasses the following key features:

- A narrow taxation base which still relies on operationally separate tax schedules for different types of income – no general income tax;
- Low taxation rates;
- No taxation of income derived from outside of Hong Kong regardless of the residence status of the taxpayer (source-based taxation);
- Simple and relatively stable taxation laws;
- Retention of stamp duties in the system;
- Almost no use (until recently) of Double Taxation Treaties;
- Comparatively constrained government spending;
- Very little government borrowing;
- Infrequent (until recently) deficit budgeting; and
- Massive accumulated fiscal reserves.

Despite its low tax regime, Hong Kong has still managed to provide public housing on a massive scale and to finance excellent transport and communications systems and comparatively sound, education and health systems. At the same time, it has managed to amass public, foreign currency reserves of over $US120 billion.

The explanation for this apparent fiscal miracle has a number of facets. One important explanatory factor has been the fact that successive Hong Kong Governments have had access to a revenue source rarely available in the modern age to most Governments: land. Government land policy has fostered one of the highest densities of any major city in the world. The Government, historically, could – as a monopoly “commodity” supplier - rely on accessing additional revenue by leasing land long-term into a market characterized by ever rising demand. The Government also has taken a large fiscal bite from many secondary market transactions. Ultimately, market forces set limits on the upper level of prices which might be obtained but within these constraints, the Government remained well-placed to benefit significantly from its continuing, primary role in the real estate market. It is now well recognized, though, that Hong Kong’s narrow (land revenue related) tax base is a serious, systemic, fiscal flaw which needs to be fixed.
APPENDIX D

REFORMING THE HONG KONG REVENUE REGIME

The fundamental issues which need to be addressed as Hong Kong prepares for tax reform include:

1. How can the Government best be “weaned” from its continuing, excessive dependency on revenues derived from land-related transactions?

2. Would Hong Kong benefit from the introduction of a new, general Goods and Services Tax (GST)?

3. Is it time to reconsider Hong Kong’s reliance on sourced-based or territorial taxation?

4. Is it time to consider replacing the schedular system in the IRO with a single, general income tax?

5. Should other reforms be considered in order to widen the tax base?

6. How can the tax burden be shared most fairly under any reformed system?

Item one is important. The “transformation” of land into an oil-like, government monopolized commodity in Hong Kong was not without its benefits in times past. But these benefits have come at an increasing cost. The “use by” date for this genuinely extraordinary system has passed.

Another crucial issue: if a GST were to be introduced, should most or all GST revenues be earmarked to help Government meet the needs of an ageing population and to reduce the high levels of very serious poverty which continue to blight Hong Kong?
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THE RULE OF LAW IN HONG KONG

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5.0 CONCLUSION
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