

Political Economy of Governance and Public Trust: The Promise of Autonomy and Post-1997 Hong Kong Inertia

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Analytical Background

National and sub-national entities across the globe vary markedly in their attributes and performance. The enduring idea of convergence over time cannot be dismissed altogether, notwithstanding the conceptual and empirical challenges. By the same token, one cannot overlook the notable efforts on the part of social scientists engaged in comparative analysis to reduce complexity by identifying fundamental similarities between systems and placing them in a small number of broad categories. Nevertheless, without stretching the notion beyond its inevitable limits, there is considerable scope for exploring the unique characteristics and functioning (in terms of inputs processed and outputs produced) of different forms of public governance (liberally defined) in their specific settings.

The Hong Kong experience arguably lends support to this assertion in that the territory may legitimately be viewed as *sui generis* in several respects. It is a city in China, but one enjoying a high degree of autonomy in the external as well as the domestic arenas. Hong Kong has a British-style “neutral” bureaucracy, driven by Anglo-Saxon principles of the “rule of law” (as distinct from the “rule of man”), an independent judiciary, and free media, while operating comfortably as a component of an authoritarian, or at least quasi-authoritarian, multi-level political structure. It has a genuinely open economy – subject to very limited intervention via the allocative, redistributive, and regulatory channels – which is closely integrated into one that is in the midst of a transition from socialism to capitalism. Perhaps paradoxically, the picture painted here remains largely intact despite the painfully slow progress toward representative democracy.

Such a politico-economic mosaic cannot easily be found elsewhere, whether at this juncture or from a historical perspective (although rough

parallels may be drawn with, *inter alia*, historical Shanghai and Venice). Moreover, that special configuration has been solidified since the curtain fell on the Cultural Revolution and China began lowering the barriers which previously kept it in a state of virtually complete isolation. During the ensuing period, Hong Kong has consolidated its status as an "intermediary of capital," or a pivot of decision making featuring the exchange of capital within Asia and between the region and the rest of the world. Metropolises which perform this role normally serve as crucial points of intersection between local and foreign social networks of capital (the term "social networks" is employed in this context to highlight the fact that intermediary decision making about the exchange of capital rests on bonds that extend beyond pure market calculations of profit and loss to include deeper, wider social relations).¹

In the wake of the massive dislocation brought about by Mao Zedong's ultra radical experiments, notably the Great Leap Forward and the Cultural Revolution, his more pragmatic successors have adopted an "open-door" policy, providing Hong Kong with an opportunity to rapidly shift the low end of its manufacturing sector (effectively "de-industrializing" in the process) across the border and reshape itself as an intermediary of capital on a scale not witnessed before, neither in the qualitative nor the quantitative sense of the term. The post-1978 transformation has largely been geared toward maximizing advantages arising from China's market reforms in general and its increasingly liberal trade regime in particular.²

As an intermediary of capital with a pronounced mainland orientation, Hong Kong has reached new heights as China's financier, trading partner, middleman, and facilitator. It has thus played a prominent role as a source of direct and indirect investment funds, as well as a provider of syndicated loans (financier). It has also acted as a major exporter and importer of goods/commodities and services, both directly (trading partner) and indirectly (middleman). Finally, it has functioned as a vital contact point, conduit of information and technology, and training ground.³

Prior to the post-1978 turnabout, China preferred direct trade because it could be employed as a potent political instrument. Having opted for a more outward-looking foreign policy, and having reaped the inevitable international rewards from embracing accommodation (i.e. worldwide political

¹ D. R. Meyer, *Hong Kong as a Global Metropolis* (Cambridge: Cambridge University Press, 2000).

² Y. W. Sung, *The China-Hong Kong Connection* (Cambridge: Cambridge University Press, 1991).

³ *Ibid.*

recognition), China has no longer found it necessary to pursue its trade and political agendas and has encouraged, rather than merely tolerated, the channeling of trade activities indirectly via Hong Kong, which has consequently thrived as a center of intermediation. This economically inspired strategy has been pursued vigorously for the past quarter of a century, benefiting the two sides enormously.⁴

The division of labor is underpinned by sound business logic. China lacks skills in intermediary services – including communications, finance, insurance, marketing, and legal services. Such skills, on the other hand, are abundant in Hong Kong. Moreover, intermediation requires fast response to shifts in global demand and quick identification of profitable opportunities. As indicated, the Hong Kong economy enjoys minimal government intervention and is therefore remarkably flexible. One should thus not be surprised that its more rigidly controlled Chinese counterpart has grown to depend heavily on Hong Kong-sourced intermediary services.⁵

It should be noted that, as a result of the implementation of the open-door policy, the number of Chinese export-import firms has increased significantly and many now compete fiercely with the established Hong Kong players. However, most of the mainland operators are state-owned enterprises hampered by administrative controls. In the very long run, when economic reform reaches a more mature stage, efficient/profit-maximizing Chinese trading firms may emerge. Nevertheless, given economies of scale and economies of agglomeration in the provision of intermediary services, Hong Kong's status as the pre-eminent supplier of such services in the Greater China area should not be at risk, provided no serious exogenous shocks occur.⁶

Even in the very long run, Shanghai is the only city capable of challenging Hong Kong's position as a center of intermediation. Still, its communications and transport infrastructure is not of a comparable standard and its service industries are rudimentary. China's commodity trade is shifting toward less bulky and more heterogeneous goods and thus boosting the demand for Hong Kong-style intermediation. This trend is reinforced by the development of trade in services and acceleration of investment flows, activities characterized by relatively high product heterogeneity. By the same token, the secular decline in transportation costs implies that the

⁴ *Ibid.*; Y. W. Sung, *The Emergence of Greater China* (Basingstoke: Palgrave, 2002).

⁵ Sung, *The China-Hong Kong Connection*.

⁶ *Ibid.*

locational advantages of Shanghai are becoming less important while proficiency in trading skills is assuming greater significance.⁷

The Chinese themselves are continuing to establish trading companies in Hong Kong, signaling that they recognize the territory's strengths as a center of intermediation. Some local players regard the build-up ambivalently because this inevitably leads to further intensification of competitive pressures. However, from a broad macro perspective, the situation should not be viewed as a "zero-sum game" due to positive spillovers resulting from economies of agglomeration: provided they act according to the "rules," the new entrants in fact enhance Hong Kong's status as a regional leader in the supply of intermediary services.⁸

Hong Kong has aptly been described as a "global metropolis for Asia."⁹ This designation rightly suggests that the scope of intermediation is not confined to Greater China. Rather, the territory serves as a meeting place for Asian and foreign social networks of capital. Moreover, the trade linkages embedded in its domestic exports, imports, and re-exports are global in nature. Its role as an emporium of finance, circulator of financial capital, risk control hub, and corporate management center also has wide international ramifications, placing it functionally on a par with global metropolises/providers of intermediary services such as London and New York.¹⁰

The Relevance of Trust

As an intermediary of capital on a global scale, Hong Kong displays remarkable dynamism and resilience. At the same time, the open nature of its economy, the size constraint (China/Southern China does not qualify as a hinterland in the strict sense of the term), and pronounced industrial/sectoral concentration (even in the absence of dominance by a handful of firms), renders the territory vulnerable to shocks, particularly exogenous ones. Its ambiguous political status and uncertainties stemming from the measure of arbitrariness characterizing policy-making and implementation in China compound the problem.

⁷ *Ibid.*

⁸ *Ibid.*

⁹ Meyer, *Hong Kong as a Global Metropolis*

¹⁰ *Ibid.*; Y. C. Jao, *Hong Kong as an International Finance Center* (Hong Kong: City University Press, 1997); Y. C. Jao, *The Asian Financial Crisis and the Ordeal of Hong Kong* (Westport: Quorum, 2001).

The significance of the non-economic side of the picture cannot be underestimated. Chinese institutions currently exhibit a modicum of stability and transparency, and to some extent a sense of accountability and due process is beginning to permeate the system.¹¹ Nevertheless, authoritarian inertia remains strong and policy outcomes are difficult to predict.¹² Hong Kong has partially insulated itself from the political winds blowing in the mainland, but the insulation has not been complete and has become less effective over time.¹³ The territory's position as a global metropolis for Asia is largely intact, yet, as it continues to gravitate toward China, an arguably unsuitable "host" for such a cosmopolitan and sophisticated entity, possible challenges to its ultra-capitalist and decidedly Western-style *modus operandi* may emerge.

Indeed, post-1997 economic performance has been unambiguously lackluster. The loss of momentum can be attributed to a host of external and internal factors, notably the deflationary pressures induced by the Asian currency/financial crisis and the collapse of the property market. The unprecedented malaise that had afflicted global equities in 2000–2002, the spectacular terrorist strikes at symbols of America's commercial and military power and their aftermath, and serious environmental crises (the SARS epidemic and the bird-flu scare) have also taken their toll on the economy. The structural, cyclical, and event-specific disruptions have deprived Hong Kong of its traditional vitality.

However, it is legitimate to posit that, despite the absence of scientifically supported evidence, additional negative influences have been at work. After all, global economic activity has hardly ground to a halt during this period and China has simply gone from strength to strength, albeit unevenly so. The export engine has thus not really stalled. It is the domestic side that has faltered dramatically, and placing the blame entirely on property market woes may not be altogether appropriate. The feeble state of the financial services industry and the great damage brought about by the severe bear market in equities should be highlighted in this context as well, though some residual, less tangible, elements may have reinforced the downward trend.¹⁴

¹¹ T. Saich, *Governance and Politics of China* (New York: Palgrave, 2001).

¹² M. Mushkat, "The Political Economy of China's Future," *Global Economic Review*, Vol. 31, No. 3 (2002), pp. 41–66; M. Mushkat, "Economic Reform, Discontinuous Change, and China's Future," *Perspectives on Global Development and Technology*, Vol. 2, No. 2 (2003), pp. 255–282.

¹³ M. Mushkat and R. Mushkat, "The Political Economy of Constitutional Conflict in Hong Kong," *Tilburg Foreign Law Review*, Vol. 11, No. 4 (2004), pp. 756–781.

¹⁴ S. H. Lo, *Governing Hong Kong* (New York: Nova Science, 2002).

The prevalence of strains beyond the strictly economic domain lends substance to this contention. These strains have apparently culminated in a "crisis of legitimacy" and may have triggered a process of "political decay." The origins of the former can be traced to rising democratic aspirations in a complex urban environment, where the emerging social structure is skewed toward the middle class, against the backdrop of infringements on local autonomy by China (and selectively the pre-1997 government, in the twilight phase of colonial rule). The lack of sensitivity toward these aspirations is a source of widespread cynicism that manifests itself directly and indirectly regarding government institutions and the policy establishment presiding over them.¹⁵

Political decay is another symptom of "reverse democratization." It seems to take the form of a material deterioration in government performance as evidenced, *inter alia*, by the adoption of a Third World-style personal rule at top echelons of the executive branch, reliance on patron-client networks, politicization of the judiciary, a cavalier attitude toward freedoms in general and civil liberties in particular, indifference to public opinion, poor response to demands from the grass roots, erratic policy formulation and implementation, symbolic manipulation, and a propensity to play one segment of the community against another.¹⁶

The protracted economic slump and the symptoms of political discomfort, possibly even atrophy, may be indicative of a more fundamental problem. Policy diagnosis is not an exact science and there is undoubtedly scope for different interpretations. Nevertheless, it is analytically attractive, and, from a practical standpoint, convenient, to proceed on the assumption that the post-1997 constitutional structure/process, broadly defined, is sub-optimal and that it begets (*inter alia*, but this factor seems to merit close attention) a low level of trust throughout the community, particularly vis-à-vis the government.

The phenomenon should not be dismissed as trivial. Intermediation Hong Kong-style cannot flourish unless rooted in trust. Otherwise, it may be prohibitively costly to monitor risks stemming from opportunistic and malfasant behavior of parties involved in the process. Since such risks are common and serious, demand for the norm of trustworthiness among intermediaries is exceptionally strong. Indeed, this explains their preference for relying on networks that revolve around families, ethnic groups, and religious communities, whose members share beliefs and values, and participate

¹⁵ *Ibid.*

¹⁶ *Ibid.*

in relations that extend beyond the business domain and reach across nations. The high level of trust permeating these networks can be considered as a form of social capital that confers significant advantages to insiders.¹⁷

Foreign Lessons

The relationship between trust and economic performance extends beyond the provision of intermediary services. The so-called "Dutch miracle" provides a useful illustration. For the Netherlands, the postwar period until 1963 was one of robust GDP expansion, full employment, and modest wage increases (because of government wage controls). However, wage inflation accelerated after 1963, as the mechanism designed to contain it ceased functioning effectively. This coincided with the transition to a modern welfare state, featuring a significant enhancement of the social security system. The discovery and exploitation of large stocks of natural gas contributed to the political belief that such an extensive and generous system was sustainable and could be funded readily.¹⁸

The oil shock of 1973 proved to be the final turning point in the process of deterioration sparked by policy changes during the preceding decade. It resulted in much higher energy prices and, via the automatic price compensation apparatus, in a proportional rise in wages and benefit levels. The guilder remained strong because of the revenues from the sales of gas abroad, thus hampering exports and stimulating imports. The economic difficulties that ensued became known as the "Dutch disease." Prices and wages had escalated while profits had shrunk. In 1982, both the private sector and its public counterpart were languishing: depressed corporate cash flows, dwindling investments, high unemployment, and ballooning government budget deficits seemed to be the norm.¹⁹

Since then the Netherlands has experienced a remarkable economic revival. The "Dutch disease" has given way to the "Dutch miracle." Highlights include a jump in labor participation to levels seldom seen in Europe in the past three decades, a dramatic decline (by international, let alone European, standards) in the unemployment rate, and a shift in government finances from a massive deficit to a modest surplus. Cyclical fluctuations have not

¹⁷ Meyer, *Hong Kong as a Global Metropolis*.

¹⁸ F. A. G. Den Butter and R. H. J. Mosch, "The Dutch Miracle," *Journal of Institutional and Theoretical Economics*, Vol. 159, No. 2 (June, 2003), pp. 362–391.

¹⁹ *Ibid.*

become a thing of the past – this is not a realistic prospect for a small and open economy (making the analogy with Hong Kong appropriate) – but the range has narrowed substantially.²⁰

This formidable transformation of the economic landscape is largely attributable to radical institutional “re-engineering.” Specifically, policy makers responded to the pre-1982 stagflation by refashioning key institutions in a manner likely to foster trust and (hence) cooperation. A viable institutional framework was created to facilitate productive dialogue between bodies such as government departments, the central bank, employer organizations, labor unions, and advisory groups. The framework is geared toward minimizing opportunistic behavior and reinforcing expectations of mutually beneficial problem solving.²¹

The Dutch case may have some special features, but it is by no means unique. There is an emerging body of academic literature addressing the positive relationship between micro-level trust and macro-level economic performance.²² Moreover, the relationship may hold across the policy spectrum, manifesting itself in a wide array of areas not directly related to the management of the economy (it may thus be appropriate to focus on societal performance in the broad sense of the term).²³ Given this backdrop, tangible benefits might arguably accrue from incorporating the concept of trust into the analysis of key dimensions of the post-1997 Hong Kong government system. First, however, the concept itself needs to be elaborated.

Decoding Trust

The term “trust” carries a variety of connotations. It is employed liberally for different, and at times vaguely related, purposes. The ambiguity to which this gives rise manifests itself in formal as well as informal settings. The following examples illustrate the point: “Trust you to do something like

²⁰ *Ibid.*

²¹ *Ibid.*

²² S. Knack and P. Keefer, “Does Social Capital Have an Economic Payoff?” *Quarterly Journal of Economics*, Vol. 112, No. 4 (November, 1997), pp. 1251–1288.

²³ J. Coleman, *Foundations of Social Theory* (Cambridge: Harvard University Press, 1990); J. Knight, *Institutions and Social Conflict* (Cambridge: Cambridge University Press, 1992); R. D. Putnam, *Making Democracy Work* (Princeton: Princeton University Press, 1993); F. Fukuyama, *Trust* (London: Penguin, 1995); F. Fukuyama, *The Great Disruption* (New York: Free Press, 1999); K. Cook, *Trust and Society* (New York: Russell Sage, 2000); R. D. Putnam, *Bowling Alone* (New York: Simon and Schuster, 2000).

that!" "We trust you have enjoyed your flight with Cathay Pacific," and "Othello's trust in Iago was misplaced." In the first sentence, the term is used ironically, although it implicitly incorporates the notion of expectations being met, while in the second it delicately conveys something intermediate between an expectation and a hope.²⁴

In certain circumstances, trust is invoked to impart a sense of delegated responsibility, particularly when corroboration poses difficulties. A politician of such egregious ethical turpitude that she has long ceased to be trusted by any of her constituents may thus nevertheless, on the exposure of some new failing, be said to have once again violated the public's trust. It would hence be unproductive to explicate the meaning of the term wherever it comes into play, since there is no one common phenomenon that all its variants reflect. Rather, relevant dimensions of trust should be highlighted in specific contexts.

A number of avenues can be explored in seeking ways to render the term meaningful for students of the post-1997 Hong Kong environment. On balance, the sentence "Othello's trust in Iago was misplaced" contains elements that may provide a foundation for such a construction. At a rudimentary level, Othello displayed a willingness to "let down his guard," or forgo potentially costly measures to protect himself against opportunistic behavior by Iago. That willingness, in turn, was based on the expectation, which subsequently proved to be incorrect, that Iago's actions would validate Othello's beliefs. The example captures the essence of interpersonal (a group or an institution would qualify as a "person" for this purpose) trust, a variant that can be utilized fruitfully in assessing societal performance.

Interpersonal trust consists apparently of two components: one affective or emotional and one cognitive (the former should not be viewed as "non-cognitive" because affective states may themselves have a cognitive dimension). Generally speaking, to trust someone is equivalent to displaying an optimistic attitude about her goodwill (the affective element) and having the confidence that, when the need arises, she will be directly and favorably moved by the thought that another party is counting on her (the cognitive component). If A's attitude toward B (in a given domain of interaction) is predominantly characterized by optimism about B's goodwill and by the expectation that B will be directly and favorably moved by the thought that A is counting on her, then A has a trusting relationship with B (within that domain).

²⁴ The references to the academic works surveyed in this section and the beginning of the following one are available in the longer version of the paper, which can be obtained from the authors.

There can be moments of trust within relationships that are not characterized entirely by trust, although, if the attitude and expectation are too fleeting, it would obviously not be appropriate to argue that A trusts B. The attitude and expectation characteristic of trust presumably combine to explain why trusters are willing, when the need arises, to rely on those they trust. It should be noted that both components are underpinned by the same psychological factor. Specifically, the confident expectation that the one trusted will respond directly and favorably to the thought that the truster is counting on her is also grounded in the attitude of optimism, which thus constitutes the focal point in this analytical structure.

Here, there is a risk of overstatement which should be properly highlighted. The attitude of optimism is directed at the goodwill of another. One can trust a person with whom one is engaged in a challenging endeavor without necessarily exhibiting a high degree of optimism regarding the success of the joint venture. Trust does not invariably imply a tendency to "look on the bright side." It does, however, lead the truster to anticipate that the other party in the relationship will display goodwill, and this is the aspect of optimism that should be accorded attention in the present context.

Optimism about goodwill is a necessary, but not sufficient, condition for establishing trust, the reason being that some people are very well intentioned, but not capable of acting effectively, when the need arises. It should thus be emphasized that trust is optimism about the goodwill and *competence* of another. The argument requires additional refinement: except perhaps with one's most trusted intimates, the optimism borne is seldom global. This is not to imply that the optimism itself is qualified and rather than being unreserved optimism is one of the restricted variety. What is qualified is not the optimism itself but the domain over which it extends.

While trust essentially amounts to an attitude of optimism that the goodwill and competence of another will extend to the domain of interaction between the parties involved, it is not exhausted by such an attitude. The affective component of trust needs to be supplemented by the expectation that the one trusted will be directly and favorably moved by the thought that someone is counting on her. Being directly and favorably moved by this thought may not provide the person trusted with an overriding motive. For example, the potential response could be influenced by other concerns or even the belief that what the truster is counting on is not, under the circumstances, in her own best interests.

Nevertheless, one is assumed not to be trustworthy unless one is willing to accord significant weight to the fact that the other is counting on one, and so will not allow that consideration to be overruled by any other element

entering into the decision. Put differently, one would not trust if one thought that counting on someone normally resulted in this being taken into account, yet ultimately being overlooked because of more powerful influences at work. Were that the case, the other would appear unwilling, from the perspective of the truster, to pay sufficient importance to the thought that she was counting on her.

Of course, the truster's expectation does not have to be fulfilled in every instance and it is not necessary to couch the argument in such terms. Someone does not show herself untrustworthy simply because there are occasions on which the thought that another person is counting on her is not the factor that determines her response. By the same token, when the attitude and expectation lead the truster to willingly rely on the one trusted, there may be (although this is by no means the norm) some vagueness about what the truster is counting on her for. There may be a number of ways of adequately responding to the thought that one is being counted on, which is why trusting is associated with discretionary powers.

The qualification "directly" in "directly and favorably moved by the thought that someone is counting on her" is required to distinguish trusting from certain cases of mere reliance. For example, one may assume that another person will be moved by the thought that she is being counted on because of the prospect of retaliation in the event she does not fulfill the expectation. If one believes that the other party will be directly moved by fear and only indirectly moved by the thought that she is being counted on, the relationship is not characterized by a high degree of trust, even if behavioral responses follow a pattern consistent with a fundamentally optimistic outlook.

This account of trust may convey the impression that the forces at work are almost exclusively of the emotional variety. This is by no means the case. Trust – and, by implication, distrust – feature prominently in rational discourse and can be examined from a game-theoretic perspective (optimism vis-à-vis other parties is thus not necessarily the product of some inherent psychological tendency to respond to social stimuli in a predetermined fashion). Two key elements normally come into play when trust is subjected to analysis rooted in rational logic: the knowledge allowing the truster to take an "optimistic" view of the relationship (or otherwise) and the incentives of the trusted to fulfill those expectations.

A more elaborate statement of the rational theory, centered on knowledge and incentive factors, might be along the following lines. First, one displays trust toward another person if one has adequate reason to believe that it will be in the latter's interest to be trustworthy in the relevant way at

the relevant time. One's trust does not hinge on one's own interests, but on the interests of the trusted. It is encapsulated in one's judgment of those interests (hence the term "encapsulated interest"). Adequate reason for such an expectation will typically rest on past experience and on likely future incentives.

Past experience determines the reputation of actors in the social arena. The concept of "reputation" is accorded an increasingly important role in efforts to construct economic, political, and psychological theories. It commonly refers to the level of trust one is perceived to merit. A person's reputation is established over time and reflects her adherence to or violation of norms that others regard as a signal regarding future behavior in a variety of situations. In experimental work conducted by researchers associated with the rational choice school, one gains a reputation as others learn, in games with incomplete information, about one's propensity to employ a particular strategy.

Trust may thus be viewed as a product of learning. This observation extends beyond specific contexts, involving past experience with acquaintances. New encounters may also be approached in a similar manner. To put it more explicitly, when a person meets someone with whom she is not familiar, her willingness to trust that party or otherwise may depend on a wide range of experiences. She enters the relationship carrying expectations that, whether positive or negative, usually constitute a generalization from past encounters featuring people exposed to previously. As Hardin suggests: "My prior experiences with trust may have been so charmed that I optimistically trust this new person. Or they may have been so disastrous that I pessimistically distrust her."²⁵

No clear distinction has so far been drawn between trust and trustworthiness. The two concepts are often treated as one in the academic literature, with claims about the former that might well apply to the latter rather than across-the-board. In particular, writers often transfer to trust the moral approbation for which trustworthiness appears to be a more appropriate target. The point is that, independently of whether there is something moral about being trustworthy or untrustworthy, trust might be fully explicable as a capability or as a product of rational expectation without any moral residue.

The work of Gleaser and his colleagues is illuminating in this respect in that they, perhaps more succinctly than other scholars, have been able to bring out formally the distinction between trust and trustworthiness. Gleaser

²⁵ R. Hardin, "Trustworthiness," *Ethics*, Vol. 107, No. 1 (October, 1996), p. 27.

et al. define trusting behavior (the emphasis is on behavior rather than attitude, but the former is an extension of the latter) as “the commitment of resources to an activity where the outcome hinges on the cooperative behavior of others” and trustworthy behavior as one that “increases the returns to people who trust you.” These definitions underpin their empirical studies and are reinforced thereby.²⁶

The Government Dimension

As indicated, institutions in general and governmental organizations in particular may be treated as “persons” for the purpose of analyzing trust. The various dimensions of the concept come into play in such contexts, but the emphasis is normally on inductive generalization featuring encapsulated interest. Specifically, it is usually posited that people often expect an institution to act in a certain way because it has seemingly always done so and they are guided by that expectation (this constitutes an “inductive generalization”). Moreover, it might be possible to know enough about an institution to be able to unpack it, to assess the motivations of individual organizational role holders, and to judge how these fit together, to produce responses consistent with one’s interests (the “encapsulated interest” factor).

Government cannot be viewed as just another institution. The nature of its relationship with the citizens subject to its jurisdiction is fundamentally different from that between private parties. The crucial difference does not lie in the relative size of the entities involved. After all, a consumer dealing with a large organization is in the same relative size position as a citizen is with respect to most governmental organizations. What is unique to the latter is their role as the sole providers of public and other goods and services, their coercive power to collect taxes (and equivalent) to pay for these goods and services, and (critically) the absence of a link between what the citizen receives from them and what she pays for the privilege.

Firestone Tire Company aims to establish a reputation for a high-quality product because consumers need not purchase its tires. By contrast, citizens do not purchase public goods from government as part of a voluntary exchange. The amount they pay in taxes (and equivalent) does not determine the amount or quality of government services they receive. If, as the standard model of taxpayer behavior maintains, the perceived quality of

²⁶ E. L. Gleaser *et al.*, “Measuring Trust,” *Quarterly Journal of Economics*, Vol. 115, No. 3 (August, 2000), pp. 811–846.

government goods does not influence the level of taxes remitted, a government does not have a *financial* incentive to invest in its reputation for public goods production, since it will not be able to capture the return to such an investment (it might obviously have a political motive to do so).

The distinctive element of the relationship between taxpayer and government is the "free-rider problem," known as the "zero contribution" thesis. Because the outcome for one personally is not affected by one's own "contribution," no one is likely to pay taxes, or contribute voluntarily to a public good, unless the threat of punishment renders it necessary. Governments thus have a political, but not a financial, incentive to invest in trustworthiness, and taxpayers have no incentive to display trustworthiness vis-à-vis the government, unless the enforcement regime renders it in their financial interest.

Although trust in other people and trust in government differ in some respects, they may be related. Some writers argue that confidence in government may be partly a reflection of the more general relationship of trust in people – if people are untrustworthy in general, then people in government are untrustworthy as well. Indeed, the latter may be judged even more harshly in such circumstances on the assumption, valid or otherwise, that being in government creates opportunities for taking advantage of institutional power (for exploitation) that are not available to ordinary people.

By the same token, confidence in government can be a positive force in trusting others, in part because government can act as a safeguard for people's willingness to extend trust to others. Establishing an equitable and efficient legal system is perhaps the most obvious example of this phenomenon. The corollary presumably is that a government, including that of Hong Kong, can operate in a manner conducive to the creation of a "virtuous circle" featuring a policy stance designed to promote trust vis-à-vis the institution itself, then at the micro/interpersonal level, and ultimately reinforcing trust directed toward the government (on the other hand, a highly centralized state, such as pre-reform China, may undermine cooperation and destroy trust among individuals, leading to a "vicious circle"-style micro/macro-level downward spiral in the attitudinal domain).

In a competitive political system, even one falling short of the democratic model (i.e. Hong Kong), governments face incentives to establish good reputations in order to encourage the electorate to select them rather than their rivals in the future (this statement is to some extent valid even in an environment where the executive branch dominates the political process, but is partially constrained by structural adjustments resulting from quasi-democratic initiatives). Moreover, since capital is increasingly mobile (highly

so in Hong Kong), governments with good reputations for cooperating with its purveyors are likely to reap the rewards in the form of relatively strong foreign investment inflows (which, in turn should bolster their domestic standing).

The role of government reputation and credibility has been examined extensively, most commonly in the context of monetary policy, albeit by no means exclusively so. In such situations, it is in the individuals' interest to assess whether commitments made by the government are credible. Should sufficiently large numbers conclude otherwise, the policy implications might be quite adverse (i.e. government functioning could be impacted negatively). From a more narrow – yet distinctly practical – perspective, the question arises whether trust in government may cause citizens to abandon their short-term financial incentive to engage in free riding, and vice versa.

In this regard, Levi argues that citizens are likely to trust government only to the extent that they believe it is acting in their interests, that its procedures are fair, and that their trust of the state and others is reciprocated. She contends that government trustworthiness, reinforced by the perception that others are doing their share, may induce people to become "contingent consenters" who cooperate even when their short-term material self-interest would render free riding the individual's best option. Thus, "the willingness to pay taxes quasi-voluntarily or to give one's contingent consent to conscription often rests on the existence of the state's capacity and demonstrated readiness to secure the compliance of the otherwise noncompliant."²⁷

The definitions of trustworthiness of government and trust in government adopted here are in the spirit of Levi. Government trustworthiness comprises all those actions that may induce people to forgo their opportunistic behavior and become contingent compliers. Trust in government is a belief that the government is carrying out those actions. The first two dimensions of this do depend on the reciprocal actions of other citizens, and in such cases trust is close to "approval." The third dimension – the perception that others are contributing their share – is more closely related to the notion of trust in others touched upon earlier, because it refers to whether people act as if others will follow through on what they have promised to undertake (which, as indicated, may hinge on government trustworthiness).

It should be emphasized again that government is not without influence as regards the patterns of interpersonal trust at community level. Its conduct

²⁷ V. Braithwaite and M. Levi, *Trust and Governance* (New York: Russell Sage, 1998), p. 91.

undoubtedly impinges on generalized/social trust and the atmosphere of trustworthiness prevailing in spheres of life beyond its direct control. To reiterate, generalized trust reflects a tendency to generally trust others or, to state it more explicitly, constitutes trust in random others or in social institutions which has no grounding in specific prior or subsequent relationships with those others. And, as often argued or implied, generalized trust comes into play without taking into account the variable grounds for trusting particular others to different degrees.

Typically, this form of trust manifests itself in the behavior of a child who has grown up in a very benign environment in which virtually everyone has always been trustworthy. The former child now faces others with relatively positive expectations based on inductive generalization. The value of generalized trust is the value of such an upbringing: it gives a person the sense of running little risk in cooperating with others, so she may more readily enter into relationships with others. Of course, this yields tangible benefits only if others are in fact relatively trustworthy.

The above example may need to be slightly fine-tuned to capture the essence of an atmosphere of trustworthiness. The point of origin remains intact. Children who grow up, particularly from their earliest days, in a supportive environment have reason to suppose that people are trustworthy. They are thus inclined to risk entering into relationships with others that will prove rewarding for them if those others turn out to be trustworthy. To take this a step further, such persons provide others with a reason to be trustworthy because those others thereby develop beneficial relationships with them. Trustworthiness begets trust, which begets trustworthiness, albeit perhaps to a lesser extent.

This general background or atmosphere of trustworthiness contributes to a smoother social functioning than would otherwise be the case. Hence, life in a community which is experiencing violent disruption on a large scale, as in Somalia at the end of the twentieth century, is hampered by the prudent lack of trust and the disastrous absence of institutions to enable joint enterprises to proceed even without such trust. Endeavoring to introduce trust in this type of setting would be a futile exercise. What is required for a constructive atmosphere is trustworthiness, which can be fostered by effective institutions located at crucial points in the power structure. In other words, this is a challenge for government, whose key role in promoting trust is obvious. The consequences of unsatisfactory performance on that front are addressed next, in the Hong Kong context.

Implications for Societal Performance and Post-1997 Hong Kong

The importance of trust extends beyond the conceptual domain. The difficulties encountered in coming to grips with its principal dimensions, which stem from its abstract nature, and those confronted in endeavoring to operationalize it, which present a perhaps even greater challenge, should not obscure the fact that trust is a factor of considerable practical significance. The "Dutch miracle" has been invoked earlier in order to provide a vivid illustration of the extent to which it may enhance institutional effectiveness. This idea needs to be explored from a broader perspective because government-induced erosion of trust may account for the sub-optimal functioning of Hong Kong since the transfer of sovereignty from Britain to China.

The economy is the principal channel through which trust influences societal performance. In its absence, exchange cannot take place other than by means of coercion, which is a costly management mechanism, and one likely to produce limited long-term results to boot. Government plays a pivotal role in the process by underwriting interpersonal trust, inspiring trust in its institutions and the environment in which they are embedded, fostering a climate of trustworthiness, and promoting cooperation at both the micro and macro levels. When it acts as a source of positive impulses, this normally leads to a more efficient utilization of resources (in the broad/ economic, as well as the narrow/engineering, sense of the term) and a healthier expansion of output than might be expected in a less supportive setting (greater "fairness" and better "accountability" may be the other two policy-related by-products of such efforts).

The "Dutch miracle" serves as a powerful contemporary example of the extent to which trustworthy conduct in the public domain may impinge on the working of the economy. The impact in the above case was decidedly favorable. Another example, at the opposite end of the policy spectrum, and one of historical interest, is that of pre-eighteenth century Neapolitan society under Spanish rule. As has been well documented, after the revolt of 1647, the Habsburgs proceeded deliberately to destroy trust relations in virtually all spheres of social life in order to maximize control until Naples was absorbed into Austria under Bourbon rule in 1724. The economic consequences were unambiguously negative, a phenomenon that attracted the attention of some of the leading local scholars of the period, driven by a desire to find a blueprint for reconstruction.

If the Fukuyama thesis²⁸ (reinforced elegantly by Seligman)²⁹ is valid, socialist stagnation may be addressed from a similar perspective. Lack of trust is pervasive in such circumstances, manifesting itself most starkly in the realm of the relationships between the government and the people. Centralization may be viewed as an aggravating factor, but in itself it need not cause widespread economic disruption. After all, the Swedish experience illustrates, at least selectively and tentatively, that centralized structures may operate in a satisfactory fashion if other conditions are met. A reasonably high degree of trust among members of the community, including (indeed, particularly) the government sector, may prevent the costs associated with top-down command systems from escalating to unpalatable levels.

The micro dimension of the relationship between trust and economic vigor has been explored in considerable detail. The underlying assumption of those who have followed this analytical path has been that activities that require agents to rely on the future actions of others are accomplished at lower cost in high-trust environments. As Arrow has observed: "Virtually every commercial transaction has within itself an element of trust, certainly any transaction conducted over a period of time. It can plausibly be argued that much of the economic backwardness in the world can be explained by the lack of mutual confidence."³⁰

Trust-sensitive transactions include those in which goods and services are provided in exchange for future payment, employment contracts in which managers depend on employees to perform tasks that are difficult to monitor, and investment and saving decisions that hinge on assurances by governments or banks regarding the safety/non-expropriation of assets. Individuals in higher-trust societies spend less to protect themselves from being exploited in economic transactions. Written contracts are less likely to be needed, and they do not have to specify every possible contingency. Litigation may be less frequent.

The wide scope for action, both in the pre-contractual and post-contractual phases, without recourse to formal institutions, may have far-reaching economic consequences. For example, informal credit markets based on strong interpersonal trust may facilitate investment where there is no well-developed formal system of financial intermediation, or where lack of assets limits access to bank credit. By the same token, interpersonal trust may pro-

²⁸ Fukuyama, *Trust*; Fukuyama, *The Great Disruption*.

²⁹ A. B. Seligman, *The Problem of Trust* (Princeton: Princeton University Press, 1997).

³⁰ K. Arrow, "Gifts and Exchanges" *Philosophy and Public Affairs*, Vol. 1, No. 4 (Winter, 1972), pp. 343-362.

vide an imperfect substitute for government-backed property rights or contract enforcement where governments are unwilling or unable to provide them.

As noted, high trust obviates the need to divert resources in order to protect oneself – through tax payments, bribes, private security services and equipment, and the like – from unlawful (criminal) violations of one's property rights (of course "exploitation" does not have to assume this particular form). At the opposite end of the attitudinal spectrum, low trust may have the effect of discouraging innovation. The point is that, in such circumstances, entrepreneurs must devote more time to monitoring possible malfeasance by partners, employees, and suppliers. They thus have less time to devote to product-centered and process-centered innovative activities.

At the macro level, government officials in higher-trust societies may be perceived as trustworthy, and their policy pronouncements may therefore be viewed as more credible. To the extent that this is the case, trust also triggers greater investment and stimulates economic activity in general. Promises by central bankers that they will not raise interest rates, assurances by ministers of finance that a nominal exchange rate anchor is fixed in stone, and guarantees that tax legislation will not be rapidly amended are all likely to be more credible in societies where a high level of trust prevails. In such societies agents adopt more appropriate horizons when making investment decisions, and choose production technologies that are optimal over the long, rather than short, run.

Higher-trust societies not only have stronger incentives to innovate and accumulate physical capital but are also likely to have higher returns to accumulation of human capital. Where trust improves access to credit for the poor, enrollment in secondary education – which, unlike its primary counterpart, has a high cost in forgone income – may be higher. As has been empirically demonstrated, trust and its by-products (e.g. civic involvement) are correlated with better performance of government institutions, including publicly provided education. Higher-equality schools, in turn, increase the return to education.

Where trust facilitates the enforcement of contracts, the return to specialized education will increase. By contrast, lower-trust societies tend to be saddled with poorly functioning educational systems. The problems encountered in such settings often reflect the opportunities that would present themselves otherwise. One interesting feature seen in educational systems not underpinned by a relatively strong sense of trust is the propensity to focus on the personal attributes of candidates, as distinct from academic/professional credentials, when making decisions regarding admission, recruit-

ment, selection, promotion, retention, and the like. The quality of education inevitably suffers as a result.

As pointed out earlier, trust breeds cooperation and the latter may generate a wide range of economic benefits. Most notably, cooperative norms act as constraints on narrow self-interest and lead individuals to contribute to the provision of public goods of various kinds. It has thus been observed that internal (e.g. guilt) and external (e.g. ostracism and shame) sanctions derived from such norms alter tangibly the perceived advantages and disadvantages of cooperating and defecting in a prisoner's dilemma type of a game/social situation. This may enhance the performance of the global economy, rather than merely national/sub-national economic entities.

For many collective action problems, norms leading to cooperative solutions improve allocative efficiency from a societal perspective because they help resolve prisoner-style dilemmas without imposing substantial external costs on other parties (unlike cartel-type arrangements, for example). The "civic" norm discouraging littering is a case in point. Similarly to the extent that civic norms effectively constrain opportunism, the costs of monitoring and enforcing contracts are likely to be lower, raising the return on various forms of investment and other economic transactions.³¹

In addition to the more direct impact on the economy outlined above, trust and civic norms may exert positive influence indirectly, through political channels. Specifically, they may enhance the effectiveness of government operations and the quality of economic policies by affecting the character and level of political participation. Familiarity with and involvement in public affairs by a large percentage of the community are important potential checks on the ability of politicians and bureaucrats to seek benefits for themselves or the narrow interests with which they are allied. "Self-centered"/"rational" individuals (as portrayed by public choice theorists) may be disinclined to acquire information about the performance of public officials or to vote, and trust and civic norms play a crucial role here by offsetting such tendencies.

This is reflected in the work of Putnam, who has shown that regional governments in the more trusting, more civic-minded northern and central parts of Italy provide public services more effectively than those in the less trusting, less civic south. Moreover, citizen-initiated contacts with government officials in the south normally revolve around issues of narrowly personal concerns, whereas contacts in the more trusting parts of the country

³¹ Knack and Keefer, "Does Social Capital Have an Economic Pay-off?"

often touch on matters with implications for the region as a whole.³² Survey evidence from the United States is consistent with these findings.³³

The emphasis on the economic dimension of societal performance is understandable in such contexts. This should clearly not be exaggerated, however. In the final analysis, the dependent variable is the "quality of life" rather than the "state of the economy." Terms such as "cooperation" and "civic norms" have connotations that extend beyond efficiency and effectiveness in their conventional form. The corollary is that the functioning of government institutions needs to be viewed from a broader perspective. By operating in a trustworthy fashion, as well as fostering both generalized trust and an atmosphere of trustworthiness, they may prove instrumental in shaping the social – and even physical – environment in many subtle ways that render this environment attractive from a psychological and philosophical standpoint.

The Hong Kong side of the picture, particularly in relation to the post-1997 dynamics, has thus far not been examined methodically. The uneven evolution of the territory under Chinese rule, and its increasing fragility, has not escaped academic attention. The idea, highlighted earlier, that growing particularism and reverse democratization are sowing the seeds of political decay has been cogently articulated and seems to have considerable merit.³⁴ This may well capture more effectively than any other similar formulation the sense of deterioration stemming from the perception that structural stagnation is setting in and is beginning to take its toll.

Another relevant notion put forward suggests that the institutional components of the post-1997 political system have become "disarticulated." Specifically, given that the set-up amounts to "neither parliamentary fish nor presidential fowl, the executive, the bureaucracy, and the legislature (which is divided within itself) each pursue their own agendas, punctuated by occasional skirmishes on the boundaries of their domains and by subterranean campaigns to extend their jurisdictions."³⁵ The reasons "lie in the factors behind the formal power arrangements embedded in the Basic Law on the one hand, and the domestic politics of the transition on the other, both of

³² Putnam, *Making Democracy Work*; H. Farrell and J. Knight, "Trust, Institutions, and Institutional Change," *Politics and Society*, Vol. 31, No. 4 (December, 2003), pp. 537–566.

³³ Knack and Keefer, "Does Social Capital Have an Economic Payoff?"

³⁴ Lo, *Governing Hong Kong*

³⁵ I. Scott, "The Disarticulation of Hong Kong's Post-Handover Political System," *China Journal*, Vol. 22, No. 43 (January, 2000), p. 29.

which left an indelible and incompatible imprint on the ways in which institutions actually work."³⁶

A disarticulated political system cannot, by definition, be an entirely effective one. Policies formulated are unlikely to display a high degree of strategic depth, coherence, and consistency. Policy implementation may pose an even greater challenge because stimuli emanating from the sources of strategic initiative are bound to dissipate in the face of centrifugal pressures straining execution channels. This scarcely qualifies as a favorable backdrop insofar as maximizing societal performance is concerned, even in an environment where the private sector enjoys substantial autonomy and remains large relative to its public counterpart.

Particularism, reverse democratization (or decay, their by-product), and disarticulation can be combined within a broader analytical framework capable of providing better insights into the causes of the post-1997 paralysis than each of these factors alone. Such a framework would not necessarily qualify as comprehensive, however. The current Hong Kong scene is rather complex and by no means thoroughly researched. There is considerable scope for exploring it from different angles and adding, even if tentatively, new elements to the evolving explanatory equation. Incorporating trust into the picture might be a step in the right direction.

Toward a Trusting Constitution

The principal-agent concept could be invoked in order to place the argument on a solid theoretical footing and weave the various threads into a coherent pattern. An agency relationship is one in which a "person" (the agent) acts on behalf of another (the principal). This is the economic meaning of the term, which is viewed more narrowly in legal contexts. Examples abound, and the two offered here are chosen partly because they are simple and partly because they illustrate the phenomenon in both its micro and macro forms. Thus, a medical doctor is the agent of a patient, and a legislature is the agent of the electorate.

Formally speaking, the post-1997 Hong Kong institutional structure and *modus operandi* are rooted in the Sino-British Joint Declaration and the Basic Law. In theory, China is bound to impose virtually no constraints on the capitalist enclave, which should to all intents and purposes practice self-government and progress gradually, albeit not at a snail's pace, toward full-

³⁶ *Ibid.*

fledged democracy or equivalent. The pre-1997 “rules of the (institutional) game” derived largely from British parliamentary traditions (even if subject to colonial-style “adjustments”) ought to remain intact.³⁷

Given this legal backdrop, the Hong Kong Government (the agent) should generally be able to reflect the preference/wishes of the local people (the principal). In practice, China exerts strong influence over senior-level executive appointments. Consequently, the top echelon of the policy apparatus is dominated by elements with an unambiguous “patriotic” orientation. Their power base is the Communist Party infrastructure in Beijing – and, to a lesser extent, Guangdong Province – and their values (“strategic drivers”) are akin, in some key respects, to those of China’s leaders. As matters stand, the latter act as the principal, and the local grass-roots factor is not entirely relevant.³⁸

Since the agent is controlled by a party operating elsewhere, it is not deemed accountable. The problem is compounded by the inevitable tendency to accord greater importance to loyalty than merit in recruiting members of major executive organs. The corollary is that the agent performs inadequately and is perceived as ineffective. This is not just a matter of producing policies that at times are inappropriate and may even lack substance. The agent experiences difficulties in formulating clear rules, abiding systematically by them, displaying a high degree of transparency, and acting in a consistent fashion (across issues and over time).³⁹

Inadequate accountability and effectiveness apparently translate into low trust. Surveys conducted by academic bodies and think tanks reflect poor sentiment vis-à-vis the government. Interestingly, this contrasts with the fundamentally positive attitude exhibited toward its colonial predecessor (which, paradoxically, operated more or less independently of the ultimate sources of power in London). The poor sentiment equates with a lack of approval or, to state it more explicitly, a low level of trust. A careful reading of the responses points to possible concerns about agent trustworthiness.⁴⁰

The evidence regarding the impact, if any, on generalized trust and on the atmosphere of trustworthiness is more diffuse and more difficult to interpret. Nevertheless, there is reason to believe that the agent may have

³⁷ R. Mushkat, *One Country, Two Legal Personalities – The Case of Hong Kong* (Hong Kong: Hong Kong University Press, 1997).

³⁸ Lo, *Governing Hong Kong*; Scott, “The Disarticulation of Hong Kong’s Post-Handover Political System”.

³⁹ Lo, *Governing Hong Kong*; Scott, “The Disarticulation of Hong Kong’s Post-Handover Political System”.

⁴⁰ www.ssrc.hku.hk; www.hkb.edu.hk.

contributed to some deterioration on both fronts, although one should obviously not overstate the point. Post-1997 Hong Kong is witnessing an increase in certain forms of lawlessness. Commercial crime and private sector corruption are notable examples. The main cause may be the fragility of the economy, but it is by no means far-fetched to argue that the agent is partly responsible for the phenomenon, even if indirectly.⁴¹

The intensification of political conflict may legitimately be viewed as a symptom of the same problem – indeed, less unequivocally so. It would be not inappropriate to counter that the government is the prime target for expressions of political “voice” (and “exit,” or apathy) and that this is an issue that involves the relationship between the public and the authorities (i.e. mistrust channelled from the former to the latter). Be that as it may, the horizontal, as distinct from vertical, dimension of the picture cannot be overlooked. Specifically, the conflict also manifests itself at the inter-group level and may thus be regarded as an indication that interpersonal trust has ebbed.⁴²

United Front-style tactics, inspired and reinforced by the external principal, have played a significant role in encouraging political fragmentation. Patriotic elements have been supported and their “non-patriotic” counterparts have been shunned. Indeed, the latter have been the target of periodic campaigns, strategically timed (to coincide with key events) and featuring psychological pressure and possibly worse. Dialogue between the two sides, and hence interpersonal trust, has not been promoted by the agent, who has pursued a policy of containment/isolationism vis-à-vis parties not willing to toe the official line.⁴³

The rule of law is a vital component of the institutional foundation underpinning interpersonal trust – in fact, all forms of trust – in a modern society.⁴⁴ Neither the agent nor the external principal can be said to have consistently followed a strategy designed to undermine the pre-1997 legal order. The status quo is largely intact and there is no compelling evidence to suggest that confidence in the system has eroded materially or that its effectiveness has diminished tangibly. Nevertheless, steps have been taken

⁴¹ Lo, *Governing Hong Kong*.

⁴² *Ibid.*

⁴³ *Ibid.*

⁴⁴ J. Knight, “The Bases of Cooperation,” *Journal of Institutional and Theoretical Economics*, Vol. 15, No. 4 (December, 1998), pp. 754–763.

from time-to-time which have weakened it at the edges. If the pattern persists, the adverse implications might be potentially serious.⁴⁵

A number of incidents involving "selective non-prosecution" should be singled out in this context. Perhaps the most flagrant deviation from the norms commonly applied in such circumstances has been the decision by the Justice Department not to prosecute Sally Au, a well-connected tycoon, enjoying a position of prominence in the publishing industry, and a member of the Chinese People's Political Consultative Conference. Ms Au escaped unscathed despite being named in charges by the Independent Commission Against Corruption (ICAC) as a party (together with senior executives in her company, the *Hong Kong Standard*, a newspaper) to a conspiracy to defraud purchasers of advertising space. The action, or rather inaction, came in the wake of another contentious decision not to initiate legal proceedings against the Xinhua News Agency, one of China's most powerful organs in Hong Kong, for a breach of the Personal Data (Privacy) Ordinance.⁴⁶

Other notable departures from the spirit of the rule of law have included the occasional timidity displayed by the local judiciary in matters perceived as relating to the "One Country" component of the "One Country, Two Systems" formula and the reinterpretation of the Basic Law by the Standing Committee of the National People's Congress (an interpretation has also taken place, regarding democratic reform, with possibly serious consequences, but it has no additional ramifications from the specific legal perspective adopted here). Judicial timidity arguably manifested itself with respect to China's controversial step to establish a Provisional Legislature in the territory upon the resumption of sovereignty. This institutional mechanism was not provided for in either the Basic Law or the NPC Decision on the Method for the Formation of the First Government and the First Legislative Council of the Hong Kong Special Administrative Region.⁴⁷

Both documents presupposed the "through train" scenario for the last colonial legislature of Hong Kong. The 1995 election to the Legislative

⁴⁵ R. Mushkat, "The Future of Hong Kong's International Legal Personality," *Southern Illinois University Law Journal*, Vol. 22, No. 2 (Winter, 1998), pp. 275-292; R. Mushkat, "Autonomy and Human Rights Concerns in Post-Handover Hong Kong," in J. W. Delapena and P. N. Norton, eds., *China and Hong Kong in Legal Transition* (Chicago: American Bar Association, 2000), pp. 163-175.

⁴⁶ Mushkat, "The Future of Hong Kong's International Legal Personality"; Mushkat, "Autonomy and Human Rights Concerns in Post-Handover Hong Kong."

⁴⁷ A. H. Y. Chen, "The Provisional Legislative Council of the SAR," *Hong Kong Law Journal*, Vol. 27, Part 1 (1997), pp. 1-11; R. Mushkat "Scrapping Hong Kong Legislation; An International Law Perspective," *Hong Kong Law Journal*, Vol. 27, Part 1 (1997), pp. 12-14.

Council would be conducted according to an electoral system (conforming broadly with para 6 of the 1990 NPC Decision), the details of which would be agreed upon by the UK and PRC, and the general principle would be applied that members of this last colonial LegCo would become members of the first post-colonial legislature. While the jettisoning of this principle reflected complex political considerations, which cannot be dismissed lightly, the reluctance of the Hong Kong judiciary to address squarely the legality of the initiative has raised legitimate concerns about the procedural underpinnings of the post-1997 institutional order.⁴⁸

It should be acknowledged that Hong Kong judges are constrained from exercising jurisdiction "over defense and foreign affairs." Moreover, they are required to obtain an executive certificate on "questions of fact concerning acts of state whenever such questions arise in the adjudication of cases." At the same time, it behoves them to preserve judicial independence as stipulated in the Sino-British Joint Declaration and the Basic Law.⁴⁹ The position has been stated unambiguously by a former Attorney General, who has commented that the local courts are empowered to "determine whether an act is or is not an act of state." And as he has further observed: "If guarantees in the Basic Law could be overridden by decisions of the National People's Congress, and the Courts of the Hong Kong Special Administrative Region were powerless to question the legality of those decisions, this would be a devastating blow to the rule of law and to confidence in Hong Kong's future."⁵⁰

The Chinese legal system is based on civil law and remains authoritarian in nature. Interpretation of legislation passed by the NPC is not (generally) for the courts but for the latter through its Standing Committee. This type of "extra-judicial interpretation," although not at variance with civil law conventions, is anathema to those whose legal values reflect common law traditions. It undermines the fundamental principle of division of power between the courts and the legislature which is a cornerstone of the system of checks and balances that characterizes the rule of law in Hong Kong.⁵¹

The reinterpretation of the Basic Law by the Standing Committee of the NPC may be viewed from a similar perspective. The issue had its origins in a Court of Final Appeal ruling potentially paving the way for a mass influx

⁴⁸ Chen, "The Provisional Legislative Council of the SAR"; Mushkat, "Scrapping Hong Kong Legislation; An International Law Perspective."

⁴⁹ Mushkat, "Autonomy and Human Rights Concerns in Post-Handover Hong Kong."

⁵⁰ *Ibid.*, pp. 166-167.

⁵¹ Mushkat, "The Future of Hong Kong's International Legal Personality"; Mushkat, "Autonomy and Human Rights Concerns in Post-Handover Hong Kong."

of mainland-born children of Hong Kong residents, at least according to the government. Shortly thereafter, the court of Appeal flexed its liberal muscles by declaring the flag desecration laws, introduced following the resumption of Chinese sovereignty, to be unconstitutional. The Chief Executive of the HKSAR subsequently made a request through the State Council in Beijing, invoking Articles 43 and 48(2) of the Basic Law, for a formal interpretation of the relevant provisions of the document by the NPCSC. The latter obliged by expressing an opinion that rendered the CFA judgment effectively invalid.⁵²

It is interesting to note that the local judiciary learned its lesson quickly and well. Within six months of the NPCSC ruling, the CFA accepted and applied the externally imposed yardstick in a case involving immigration matters. The Chief Justice and the five judges agreed that the NPCSC had a power under Article 158(1) of the Basic Law and its exercise was "not restricted or qualified in any way by 158(2) and 158(3)." In the Court's adjusted view, the NPCSC interpretation of Basic Law was valid and binding, meaning that the courts in the HKSAR were "under a duty to follow."⁵³

The government's appeal against a decision in favor of 17 migrants was allowed, although one of the judges dissented on the grounds that it was unfair to remove them without considering whether there were strong humanitarian reasons for allowing them to stay. Moreover, the CFA overturned the Court of Appeal ruling by declaring the laws that make it a crime to desecrate the national and regional flags valid. The Chief Justice opined that "at the early stage of the new order following resumption of sovereignty," the criminalization of flag desecration is "a justifiable restriction on the guaranteed right to the freedom of expression."⁵⁴

This scarcely qualifies as a reassuring assessment from a liberal standpoint.⁵⁵ The picture is by no means unambiguously negative. The government for the most part tolerates dissent and displays equanimity in the face of orderly, even large-scale protest. The decisions to admit convicted "spy" Li Shaomin to Hong Kong and not to prevent Nobel Laureate Gao Xingjian,

⁵² *Ibid.*

⁵³ B. Weng, "Sinicization and the Rule of Law in the HKSAR," *CSIS Hong Kong Update* (Spring, 2000), p. 4.

⁵⁴ *Ibid.*

⁵⁵ Y. Ghai, "The Continuity of Laws and Legal Rights and Obligations in the HKSAR," *Hong Kong Law Journal*, Vol. 27, Part 2 (1997), pp. 135-151; Y. Ghai, *Hong Kong's New Constitutional Order* (Hong Kong: Hong Kong University Press, 1999); J. M. M. Chan, H. L. Fu, and Y. Ghai, *Hong Kong's Constitutional Debate* (Hong Kong: Hong Kong University Press, 2000).

a *persona non grata* in China, from visiting the territory suggest that the agent's values are not skewed firmly in an authoritarian direction. On the other hand, actions such as those outlined above (which are not necessarily the exception to the norm, as the caution exhibited toward the Falun Dafa/Falun Gong movement indicates) may legitimately be regarded, from a long-term perspective, as the thin end of the wedge insofar as the rule of law is concerned.⁵⁶

Perhaps the most ominous development on that front was the attempt to introduce a highly restrictive national security legislation prohibiting secession, sedition, subversion, treason against the Central People's Government, theft of state secrets, and harmful links with foreign political organizations. The attempt failed because of massive grass-roots resistance. The agent and the external principal are probably rethinking their approach to the subject and no new initiatives are expected in the near future. The next move is likely to be timed more carefully (to coincide with signs of economic vigor, solid demand for labor, and asset market vibrancy) and will probably feature greater flexibility on the part of the government with respect to the content of the package.⁵⁷

A less inept management of the process (tactics) and a less oppressive set of proposals (strategy) would obviously amount to an improvement over the confrontational maneuvers and ideological rigidity seen previously. However, this should not obscure the fact that the episode reveals that the agent and external principal are apparently pursuing a course that is bound to reshape the legal order, even if initially just at the margin, in a manner inimical to the maintenance of a high level of trust. In technical parlance, they seem intent on ensuring that the "constitution" assumes a form that minimizes its (or "One Country's"/Communist Party's) vulnerability to threats by "knaves" (the assumption is that human beings, notably non-patriotic ones, are knaves; the purpose of a constitution is thus primarily to limit the extent of exploitative behavior).⁵⁸

⁵⁶ Mushkat, "The Future of Hong Kong's International Legal Personality"; Mushkat, "Autonomy and Human Rights Concerns in Post-Handover Hong Kong."

⁵⁷ Mushkat and Mushkat, "The Political Economy of Constitutional Conflict in Hong Kong."

⁵⁸ J. M. Buchanan and G. Brennan, *The Calculus of Consent* (Ann Arbor: University of Michigan Press, 1962); G. Brennan and J. M. Buchanan, "Predictive Power and the Choice among Regimes," *Economic Journal*, Vol. 93, No. 369 (March, 1983), pp. 89-105; G. Brennan and J. M. Buchanan, *The Reason of Rules* (Cambridge: Cambridge University Press, 1985).

This vision has not gone unchallenged in the legal literature. The implicitly negative view of human nature has been rejected by many law students, and a few have shown their reservations by adopting a radically different definition of the problem: "What most needs explanation is not why some people are criminals but why most are not."⁵⁹ In the preceding section of this paper, a synthesis has been undertaken of the work of scholars who believe that public spiritness manifests itself in political settings and who contend that trust can influence favorably the relationship between citizens and the state in a variety of ways. Those who belong to this school of thought posit that an important function of a constitution is to promote cooperation in its horizontal (at community level) and vertical (between the government and the public) dimensions.⁶⁰

This argument has been extended further in recent years. It is now often postulated that a constitution designed for knaves, or even for purely self-interested citizens, tends to "crowd out" civic virtues. People are inclined in such circumstances to take full advantage of all legal opportunities and pay less attention to the letter and spirit of the constitution. The effort to constrain citizens constitutionally may thus have adverse consequences. Although a constitution, and, more generally, public laws and regulations, must limit the scope for knave-like behavior, as well as prevent the exploitation of the citizenry by free riders and professional politicians, it should also help nurture civic virtues. The general spirit of the law, including specific rules, ought to acknowledge people's fundamental goodwill.⁶¹

The notion of "crowding out"/"crowding in" and, by implication, a "trusting constitution" has sound socio-psychological underpinnings. Laboratory experiments point to a close relationship between "external intervention" (the independent variable) and "intrinsic motivation" (the dependent variable). When the former assumes a controlling form ("extrinsic control"), limiting the extent to which individuals are free to determine actions by themselves,

⁵⁹ J. Q. Wilson, *The Moral Sense* (New York: Free Press, 1993), p. 24; A. Etzioni, *The Moral Dimension* (New York: Free Press, 1988); R. B. Reich, *The Power of Public Ideas* (Cambridge: Ballinger, 1988); J. J. Mansbridge, "Public Spirit in Political Systems," in H. J. Aron, T. E. Mann, and T. Taylor, eds., *Values and Public Policy* (Washington: Brookings, 1994), pp. 146-172.

⁶⁰ C. R. Sunstein, "Political Self-Interest in Constitutional Law," in J. J. Mansbridge, ed., *Beyond Self-Interest* (Chicago: Chicago University Press, 1990), pp. 209-223.

⁶¹ B. S. Fry, "A Constitution for Knaves Crowds Out Civic Virtues," *Economic Journal*, Vol. 107, No. 443 (July, 1997), pp. 1043-1053. The establishment of a "trusting constitution" does not of course automatically produce civic virtues. This is only the case if the constitution is considered to be fair, and hence is widely accepted. An essential prerequisite for a trusting constitution is the provision of extensive participation rights to citizens.

the motivation to engage independently in constructive tasks (i.e. intrinsic motivation) is correspondingly reduced. On the other hand, an external control mechanism reflecting a positive view of human nature, or a trusting constitution, has the effect of enhancing intrinsic motivation (i.e. "crowding in" civic virtues).⁶²

As indicated, there is no solid empirical evidence to suggest that a government-induced decline in trust is responsible for Hong Kong's lackluster post-1997 societal performance. Be that as it may, the idea has considerable appeal, if articulated in a restrained fashion.⁶³ Without stretching it beyond the point of credibility, one may hypothesize that trust-impairing steps taken by the agent, reinforced and in all likelihood selectively inspired by the external principal, have partly contributed to the economic malaise which has plagued the territory for the past seven years or so (of course other steps may have had a more positive impact).⁶⁴ The fall in educational standards,⁶⁵ increasing signs of micro-level alienation/anomie (e.g. rise in age-specific suicide rates),⁶⁶ and escalation of macro level conflict (most notably, in the political arena)⁶⁷ lead tentatively to the conclusion that the problem should be defined in societal, rather than merely economic, terms.

Concluding Remarks

Hong Kong serves as a regional/global intermediation center and, as such, its smooth functioning depends on a high level of trust. The post-1997 period has proved challenging for the territory. Its economic engine has sputtered and its social fabric has become strained. A number of explanations

⁶² R. M. Titmuss, *The Gift Relationship* (London: Allen and Unwin, 1970); M. R. Lepper and D. Greene, *The Hidden Costs of Reward* (Hillsdale: Erlbaum, 1978); E. L. Deci and R. M. Ryan, *Intrinsic Motivation and Self-Determination in Human Behavior* (New York: Plenum, 1985).

⁶³ Lo, *Governing Hong Kong*.

⁶⁴ Sung, *The China-Hong Kong Connection*; Mushkat and Mushkat, "The Political Economy of Constitutional Conflict in Hong Kong"; Y. C. Jao, *The Asian Financial Crisis and the Ordeal of Hong Kong* (Westport: Quorum, 2001); Y. W. Sung, *The Emergence of Greater China* (Basingstoke: Palgrave, 2002).

⁶⁵ A. Sweeting, *Education in Hong Kong* (Hong Kong: Hong Kong University Press, 2004).

⁶⁶ A. Kauler, "Suicidal Behavior, Bereavement, and Death Education in Chinese Adolescents," *Australian Social Work*, Vol. 57, No. 1 (March, 2004), pp. 90 - 92.

⁶⁷ Scott, "The Disarticulation of Hong Kong's Post-Handover Political System"; Lo, *Governing Hong Kong*.

have been offered to account for this phenomenon and at least two theoretical perspectives have been generated to place it in a broader context. A trust-focused conceptualization, grounded in a principal-agent framework, may provide the analytical effort with a useful additional dimension, and one whose attraction extends potentially beyond the practical confines of the policy domain into the realm of moral values. From a normative standpoint, Hong Kong could benefit from a strategic shift toward a trusting constitution, in the general sense of the term.

Einführung

Im April 1997 betritt ein hochrangiger britischer Offizier, der sich zuvor der internationalen Medienöffentlichkeit hatte, auf einer Pressekonferenz in Singapur lehrstuhlmäßig die wichtigsten Dinge an der Handlung in Nordvietnam. Dabei werden nicht nur die militärische, sondern auch die politische Situation im Nordvietnam diskutiert und die Rolle der CIA kritisch geäußert. Der Offizier geht nicht nur auf die militärische Situation im Nordvietnam ein, sondern auch auf die politische Situation und die Rolle der CIA. Die Rolle der CIA wird kritisiert und die militärische Situation im Nordvietnam wird ebenfalls diskutiert.

Die Ereignisse dienen in der Geschichte der internationalen Politik Vietnam's einseitige Vorgehens, das ein signifikantes Beispiel für die "New Realism/Anti-Realist" ist. Es ist ein Beispiel für die "New Realism/Anti-Realist" und es ist ein Beispiel für die "New Realism/Anti-Realist".

1. Ich danke meinen Kollegen Dr. James Brigg für seine Hilfe bei der Übersetzung dieses Textes. Diese Arbeit wurde unter der Leitung von Prof. Dr. Hans-Joachim Lauth durchgeführt.

2. Vgl. hierzu die Ausführungen von Prof. Dr. Hans-Joachim Lauth in seiner Arbeit "Die Rolle der CIA im Vietnamkrieg" (1997), S. 10.

3. "The Role of the CIA in Vietnam: A New Perspective", in: *Journal of American Studies*, 31 (1997), S. 10-15.

4. Vgl. hierzu die Ausführungen von Prof. Dr. Hans-Joachim Lauth in seiner Arbeit "Die Rolle der CIA im Vietnamkrieg" (1997), S. 10.

5. Hong Kong's transition to the 1997 era is discussed in detail in the book by *Michael Chubb* and *John King* (1997).