A Free-Market Constitution for Hong Kong: A Blueprint for China

Alvin Rabushka

China's leaders understand the basis for Hong Kong's stability and prosperity. In particular, they recognize that the adoption of Hong Kong's institutional and policy mix would go a long way toward promoting growth on the mainland. The central message of this paper is that the provisions of Hong Kong's draft Basic Law, which may be regarded as a free-market constitution, can serve as a blueprint for economic reform in China. Likewise, the market-oriented economies of the other Pacific Rim "dragons"—Singapore, Taiwan, and Korea—also provide valuable lessons for China, some of which will be examined along with the Hong Kong model.

Hallmarks of Hong Kong's Economic Success

In contrast with the vacillating economic strategies and policies that prevailed in mainland China between 1952 and 1978, which often reflected ideological struggles over the proper objectives and means to implement socialism, Hong Kong maintained an extraordinary degree of stability in its political and economic institutions. Founded as a free port in 1841, Hong Kong has an economy today that depends on export-oriented light manufacturing industries along with a myriad of servicing industries within a free-port, free-enterprise environment. Highly developed banking, insurance, and shipping systems complement its industrial sector.

A rundown of Hong Kong's fiscal and economic policies reveals a portrait of life that encompasses balanced budgets (almost always in surplus), avoidance of public debt, an economy ethic in government that strives to avoid wasteful spending, an aversion to central planning, minimum intervention in or regulation of the private sector,

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The author is Senior Fellow at the Hoover Institution at Stanford University.

commercial provision of public economic services, a constitutional and legal framework that protects private property and a whole range of personal freedoms, free trade, free movement of capital, avoidance of subsidies to industry, minimally intrusive general business requirements (it takes little time or money to open a business), a free market in labor, and a system of low rates and low overall taxation. In short, free trade, free markets, low taxes, nonintervention, and personal liberty are the hallmarks of Hong Kong's economic success.

The Future of Hong Kong

Hong Kong has experienced several noticeable episodes of political and economic instability since 1949. The two most dramatic occurred in 1966–67 as a spillover of the Cultural Revolution on the mainland and in 1982–84 during the Sino-British negotiations over the future of Hong Kong. As political confidence in the future waned during the talks, the colony experienced a run on the Hong Kong dollar and a sharp decline in stock and property values. The signing of the Joint Declaration in 1984 restored a measure of stability to Hong Kong and the economy quickly resumed its upward economic path. Apart from external political shocks, Hong Kong's resilient capitalistic economy has successfully weathered international recessions, trade quarrels, oil shocks, and internal disputes. Its free-market economy has enabled Hong Kong businessmen to adjust quickly to changing external circumstances.

China's political leaders and economic analysts are well aware of Hong Kong's achievements. They are also aware of the institutions and policies in Hong Kong that have made the territory's remarkable prosperity possible. Over 700 Chinese firms, encompassing banking and finance, travel, shipping, city, provincial and national organizations, insurance and oil companies, and special economic zone organizations, among others, have steadily expanded their direct investments and business activities in the colony, now running into the billions of dollars.[1] In addition, tens of thousands of mainland personnel have been dispatched to Hong Kong to learn how to do business in a market-based economy. The Bank of China group is believed to be the second largest holder of deposits in Hong Kong after the Hongkong and Shanghai Banking Corporation.

[1]These estimates, obtained from the *Far Eastern Economic Review* (23 June 1988, pp. 64–66), reflect a variety of sources including Beijing's own calculations, local Hong Kong university professors, and the U.S. State Department's Foreign Commercial Service. The total capital investment of Chinese-funded enterprises in Hong Kong is estimated to range between U.S. $7–12 billion.

Chinese political leaders have also learned, especially from the crisis of confidence that erupted in 1983 when the Sino-British talks appeared to be going poorly, that political confidence in the future of Hong Kong is extremely fragile and, if shattered, threatens to destroy its stability and prosperity. A prosperous Hong Kong is deemed essential in China's developmental plans to provide hard currency earnings, to provide access to trade and technology, and to serve as a proxy for the absence of a major Southern port city.

Since 1982, when China publicly announced plans to resume sovereignty and administrative authority over Hong Kong on July 1, 1997, when Britain's 99-year lease on the New Territories is scheduled to expire, Chinese authorities have repeatedly stated their primary objective of preserving stability and prosperity in Hong Kong. To maintain stability and prosperity, Deng Xiaoping advanced the novel doctrine of "one country, two systems," in which socialism on the mainland and capitalism in Hong Kong would peacefully coexist within one sovereign China.[2] In particular, China guaranteed that Hong Kong would be allowed to retain its capitalist way of life for 50 years after 1997 until 2047.

The Draft Basic Law: Lessons for China

Under the provisions of the Sino-British Joint Declaration, Hong Kong is to receive its own mini-constitution. Upon the resumption of the exercise of sovereignty over Hong Kong, China agreed to establish a Hong Kong Special Administrative Region (HKSAR), which would retain a high degree of autonomy in all matters except defense and foreign affairs. The National People's Congress (NPC) of the People's Republic of China will enact and promulgate a Basic Law by 1990.

In April 1985, the NPC established a drafting committee for the Basic Law of the HKSAR, which comprised 59 members, among whom 23 were from various sectors in Hong Kong. To ensure that the drafting committee received a wide range of public opinion within Hong Kong, it set up a consultative committee of 180 persons reflecting the various sectors and strata in Hong Kong. In April 1988 the drafting committee issued a draft Basic Law, on which it solicited

[2]Chinese officials hope that the successful application of the "one country, two systems" doctrine in Hong Kong would provide a mechanism for the gradual unification of Taiwan with the mainland on a similar basis. That is, socialism in China and capitalism in Taiwan could peacefully coexist within one sovereign political system. Failure of the "one country, two systems" experiment in Hong Kong would make it virtually impossible to extend the same doctrine to Taiwan, thereby thwarting reunification.

opinions from the general public during May-September 1988. Following amendments and revisions, a second draft Basic Law was issued in February 1989, on which consultation was scheduled through July 1989. Following another bout of further possible amendments and revisions reflecting the second round of consultation, the final version is scheduled to be promulgated by the NPC sometime in 1990.[3]

The draft Basic Law contains a statement of general principles, along with chapters that enumerate the relationship between the HKSAR and Chinese central authorities, the fundamental rights and duties of Hong Kong residents, political structure, the economy, social services, external affairs, interpretation and amendment of the Basic Law, and a variety of supplementary provisions. The draft also contains a preamble that states that the mainland's socialist system and policies will not be practiced in Hong Kong.

To the best of my knowledge, the proposed Basic Law for the HKSAR is unique among contemporary national constitutions in one respect: It enshrines general principles and concrete policies to preserve individual economic freedom. It does so because Chinese authorities recognize that the preservation of economic freedom in Hong Kong is critical to its continued stability and prosperity. The list of economic liberties is in addition to a standard list of civil rights that normally appears in a constitutional document. A review of the economic provisions in the draft Basic Law for the HKSAR provides lessons that China can bring to bear upon its own development.

Importance of Private Property Rights

Perhaps the most fundamental individual economic right of all is itemized in Chapter I in the draft Basic Law, which sets forth general principles. Article 6 (of Chapter I), in particular, protects rights of private property relating to acquisition, use, disposal, inheritance,

[3]This process has been politically charged. Some advocates of direct democracy in Hong Kong assert that a coalition encompassing local big business, the colonial government, and Chinese authorities has conspired to minimize the extent of political reform in Hong Kong to ensure that when China takes over in 1997 it will retain an iron grip over the HKSAR's new political structure. Opponents of rapid democratic reform argue that direct democracy imperils Hong Kong's stability and democracy and that democratic reforms need to be introduced gradually. This paper, however, focuses almost exclusively on questions of economic policy, not political structure, and therefore the political structure of Hong Kong is not discussed.

Throughout this paper, citation of specific articles in the draft Basic Law refers to the April 1988 version. Some renumbering and rewording of articles transpired in the second draft, but the main provisions in the first draft largely remained in force. It is presumed that all of these provisions will be preserved in the final version.

and compensation for lawful takeover at market prices in convertible forms of payment. Private property rights are the keystone of Hong Kong's market economy and their preservation is essential in maintaining Hong Kong's capitalistic system. By way of contrast, China is in the very preliminary stages of injecting property rights into its socialist economic system. Prior to 1982, individuals could not own land, which belonged to the state. Revisions to the constitution in 1982 allowed for the development of "individual" economy and gave citizens the right to own houses and inherit private property. Rural economic policies, begun in 1978, have created a de facto system of property rights in agriculture, in which peasants can inherit or trade 15-year leaseholds to specific plots of land, and agricultural output has sharply increased in response to these new individual incentives made possible by a system of property rights in agriculture. State or collective ownership remains the primary form of urban and industrial ownership. To improve industrial efficiency, China will have to make major strides in creating and enforcing a system of private property rights in urban land, business ownership (other than very small enterprises that are currently private), and a variety of financial assets.[4] China's attempts to reduce and phase out urban food subsidies will have to encompass the government's control over housing, jobs, and other amenities. Since Chinese urban residents have enjoyed housing and food subsidies for decades, phasing out subsidies and moving to a system of private ownership will be extremely difficult.

Maintaining a Rule of Law

Private property flourishes only within a framework of the rule of law. Article 8 stipulates that the laws in force in Hong Kong, including common law, customary law, and legislation, shall be maintained. Retention of the existing legal system serves to protect private property rights. In particular, the British legal system, arising from the common law, is especially concerned with protection of private property. Confidence in the legal system requires an independent judiciary, which is provided in the draft Basic Law; it shall have jurisdiction on all affairs arising within Hong Kong, except cases relating

[4]Several delegations of Chinese economists from academic institutions, the State Council, the Chinese Academy of Social Sciences, and the Economic Structure Reform Commission have visited Stanford University. They have indicated that the topic of reforming ownership rights of property is an issue in internal debate along with the important task of price reform. The debate centers around the speed with which some measure of private property rights can be injected into the industrial urban economy. There is growing recognition that price reform without property reform will not yield the maximum gains in economic performance.

to defense and foreign affairs. China, in contrast, lacks a fully articulated legal system that would permit contract disputes to be resolved with some measure of certainty. As well, the judiciary is more an arm of the government that seeks to implement state policy rather than settle disputes among individuals on a totally impartial basis. China will need to forge ahead with the development of a national commercial legal system that serves both the Chinese and international business communities and with the development of a court system that applies the law impartially.

Fundamental Rights and Duties

Chapter III of the draft Basic Law enumerates fundamental rights and duties of the residents: equality before the law; the right to vote; freedom of speech, association, assembly, and trade unions; the prohibition of unlawful search and seizure; freedom and privacy of communications; freedom of movement; freedom of occupation; freedom of academic research; the right to legal counsel; and so forth. These rights are virtually identical with those enumerated in Chapter Two of China's own national constitution and thus offer nothing new in terms of economic principles. In reality, most Hong Kong residents have enjoyed these rights relatively free from government interference. In China, these rights have often been suppressed. Few Chinese subjects have enjoyed freedom of occupation, movement, and academic research on sensitive topics, though the situation has improved in recent years. Freedom of occupation and movement, in particular, are important to moving labor to where that economic resource can be used more efficiently.[5]

Economic Policies for Stable Growth and Prosperity

To preserve prosperity in Hong Kong and to maintain the region's capitalist economy, the Basic Law Drafting Committee members, of whom the majority are mainland Chinese schooled in the socialist system, have enunciated a set of economic policies that govern the conduct of public finance and taxation, money and finance, external trade and economic relations, industry and commerce, land leases, shipping, and aviation. These policies are regarded as the keystone of Hong Kong's prosperity. Indeed, knowledgeable Chinese recognize that these policies are generally conducive to fostering a climate

[5]Since 1949, the government in China has generally assigned most jobs. Chinese are attached to work units, which carry housing, ration coupons, and other benefits. Few Chinese are free to leave their jobs and take up others without official permission, nor can employers summarily dismiss employees. China will need to develop free labor markets, as exist in Hong Kong, to gain maximum benefit from its large labor force.

for economic growth. The issue in China is how to overcome the political obstacles and historical conditions that prevent rapid implementation. These economic policies are set forth with remarkable clarity in Chapter V of the draft Basic Law.[6]

Public Finance and Taxation. Two themes have historically governed the conduct of Hong Kong's public finances. First, low rates of direct taxation stimulate work, saving, and investment, thereby fostering high rates of economic growth. Moreover, in Hong Kong's open economy, deficit financing is inappropriate since any increase in public spending can leak overseas. Balanced (surplus) budgets are considered the norm of sound fiscal policy. Second, the size of the public sector must be kept small to prevent it from crowding out the private sector.

Article 107 stipulates that the HKSAR shall continue to practice a low tax policy, which means that any expansion in public sector spending must come either from the fruits of economic growth or by substituting spending in one program for another. Article 105 links Hong Kong's low tax system into a budgetary policy which requires that, taking one year with another, revenues and expenditures remain in balance. To ensure that the public sector does not grow in relative terms, the policy also stipulates that the rate of increase of taxes or spending shall not exceed that of the gross domestic product. These provisions ensure that the government will remain limited in its scope and size, which means that the creation and distribution of income is left in private hands.

In general, China has pursued a conservative fiscal policy, mindful of the fact that inflation destroyed the political basis of support of the Nationalist Party. Until recent years, China's command and control economy had little need for a formal system of taxation, since nearly the entire economy was under public ownership in which the government supplied all inputs and collected all receipts of industry. As China moves in the direction of injecting market forces into its economy, it will replace its system of allocating and collecting funds by a system of taxation based on salaries and profits.[7] It must gradually

[6]It is somewhat ironic that a socialist system is setting forth specific economic rights in a constitution that will apply to a portion of its own territory considering that no Western industrial capitalist democracy contains similar measures in its own constitution.

[7]Chinese venture capitalists have complained that rates of taxation on business profits have risen from 55 percent to nearly 80 percent in the past few years, thus adversely affecting incentives. As well, a steeply graduated personal income tax with a top marginal rate of 60 percent was enacted in 1987, ostensibly to capture a share of the windfall benefits that accrued as prices were deregulated. Nonetheless, it seems counterproductive to tax heavily the class of investors, self-made entrepreneurs, and skilled

reduce the scope and size of the public sector to insure that resources are used efficiently either in private hands or under autonomous management. The lesson that Hong Kong provides is that low rates of taxation and limited government supply strong incentives to individuals.

Money and Finance. Hong Kong is an international financial and banking center. Indeed, the financial services sector is the most rapidly growing part of its economy, now contributing nearly one-quarter of gross domestic product. The draft Basic Law addresses the features of money and finance that foster a prosperous financial sector in Hong Kong.

To begin with, the draft Basic Law requires that the HKSAR shall continue to practice free and open monetary and financial policies. In particular, this calls for the following provisions: No exchange controls shall be imposed in the HKSAR: free flow of capital within, into, and out of the region; free entry into financial business and financial markets; and maintenance of a freely convertible Hong Kong currency (backed up by a reserve fund of no less than 100 percent freely convertible foreign currency). Hong Kong is to retain a free market in money.

The contrast with China could not be more striking. China lacks even rudimentary domestic capital markets. Exchange controls severely limit access to foreign currency. The Renminbi, China's national currency, is not freely convertible into foreign currencies by Chinese or foreigners, nor is it backed by any foreign currency or commodity. The banking and financial services sectors are not open to free internal or external competition. The state exercises disproportionate control over the allocation of credit and investment, though it is moving away from grants and subsidies to the use of interest rates. Before China can deploy its scarce capital efficiently, it will have to create capital markets in which the supply of credit and capital is carefully matched with those individuals and organizations that can use them most efficiently.

Trade and Industry. Sections 3 and 4 (in Chapter V of the draft Basic Law) combine to ensure policies of free external and free internal trade. Specific articles are written to ensure that the HKSAR shall continue to do business on the basis of external free trade, and to that end the free movement of goods, intangible assets, and capital

workers upon whose efforts China's growth depends. Hong Kong's top marginal tax rates, in comparison, range between 15 percent and 16.5 percent for personal income and profits, respectively.

shall be maintained. Foreign investment shall be protected by law. The region shall remain a free port, true to its historical founding principles dating back to 1841. Finally, the HKSAR shall practice free and open policies regarding industry, commerce, and other trades. This latter provision is designed to ensure free entry and exit into most lines of economic activity (except such regulated monopolies or licensed franchises as power, telephone, and transportation). These provisions require that prices remain unregulated and that the price mechanism adjust supply with demand, both on internal and external markets.

Once again, the contrast with mainland China is marked. Foreign trade has largely been governed by the Ministry of Foreign Economic Relations and Trade. Recent progress has been made in granting various enterprises the right to buy and sell in world markets with fewer restrictions than in the past, but China is a great leap away from any semblance of free external trade. Similarly, the bulk of industrial output is still generated by state-owned enterprises or collectively owned enterprises in accordance with state directives.

The remaining provisions in the draft Basic Law pertaining to economic policy maintain existing land use rights, retain the territory's existing system of private shipping business, and continue the existing system of civil aviation management and Hong Kong-licensed air carriers.

No article in Section V specifically deals with the subject of business regulation, which potentially affects the costs of doing business in Hong Kong in the form of fringe benefits, environmental controls, and so forth. The general principles in Chapter I state that the existing capitalist system and way of life shall not be changed for 50 years, which implies that the general policy of nonintervention in the private sector shall be maintained. The existing system also eschews subsidies to consumers or business firms. There is, curiously, a specific provision to maintain the existing social welfare system, but its chief hallmark is that it consumes a relatively modest share of national income and does not typify the vast schemes of costly welfare programs found in the Western democracies.

A Free-Market Constitution

The Basic Law Drafting Committee was not content to rest with a statement of general economic principles. It believed that confidence in Hong Kong's future required a detailed specification of economic institutions and policies in the form of a free-market constitution. The chief features of this "constitution" include private property, the rule of law, freedom of occupation and movement, low taxes, a limit on the scope and size of government, free movement of capital, a convertible (fully backed) currency, free entry into any line of business, unregulated prices, free trade, and the retention of a free port. These provisions were judged to be the *sine qua non* of Hong Kong's stability and prosperity.

One is tempted to suggest that China turn over the management of its economy to the Hong Kong government. But a good substitute for that recommendation is for Chinese economic planners to study the draft Basic Law for the HKSAR, which was written by a China-dominated committee, in which its own members displayed their understanding of Hong Kong's free-market economy. Of course, the drafters were not encumbered with an official ideology of socialism for the HKSAR, which hampers efforts at market-oriented reforms on the mainland. It would be vastly more difficult to copy Section V of the Hong Kong Basic Law into China's own constitution, even though policymakers are grappling with the means of injecting reforms that create equivalent incentives. The critical fact, however, is that Chinese officials clearly recognize the policies that are conducive to prosperity, and in doing so implicitly recognize the need for a free-market constitution.

Lessons from the Other Dragons

Singapore, Taiwan, and Korea differ from Hong Kong in many respects, and numerous books and articles have been written stressing the uniqueness of each country's developmental experience. However, one can discern a common mix of institutions and policies that propelled each into the ranks of industrial modernity within the short span of a generation.

Singapore, Taiwan, and Korea each endured major wartime disruption, each lacked abundant natural and financial resources, and each was a poor country with a low standard of living. All three initially embarked on a program of import-substitution behind a protective wall of tariffs and quotas. All sought foreign aid. Growth under this initial strategy was at best moderate.

External circumstances prompted the leaders of all three countries to switch strategies from an import-substitution policy for a limited domestic market to the development of labor-intensive, manufactured goods for export to world markets. International price competition replaced domestic subsidies and tariffs; private firms decided what to produce and where to sell. Government relaxed its grip on the economy and allowed the marketplace to determine the pattern and scope of economic development.

What were the major ingredients that went into a successful strategy of growth? To begin with, emphasis was placed on the private sector for the creation of jobs and the distribution of income and wealth. Although the government in each country played a role in allocating credit, building infrastructure, and guiding development, by and large, the private sector was the primary engine driving growth. This strategy required a system of private property rights that would protect both domestic and foreign investors.

Another critical factor was reform of the exchange rate system to ensure that each country's currency was not overvalued. An overvalued currency cheapens imports, makes exports more expensive thus hampering their growth, and invariably leads to a balance-of-payments crisis.

Other important factors included stabilizing the labor market to give foreign and domestic investors confidence that strikes and labor agitation would not distort investors' calculations of profitable investments. All three governments adopted a number of measures to encourage national savings and capital formation, and each country quickly developed extremely high rates of capital formation. In every case, tax incentives were used to encourage foreign and domestic investment, which included such devices as tax holidays, accelerated depreciation, duty-free export processing zones, credits for exports and research and development, special low rates of tax, preferential treatment in the form of low rates imposed on interest and dividends, and exempting capital gains from taxation. A final emphasis was the need to hold down spending on social programs until high rates of economic growth provided sufficient revenues to finance a growing list of government programs out of growth, rather than at the expense of growth. As well, each country tried to run their utilities and government economic enterprises on a commercial basis in which services were priced to reflect full opportunity costs, rather than depend on heavy subsidies.

Conclusion

The standard of living of the four dragons—Hong Kong, Korea, Singapore, and Taiwan—has caught and surpassed a number of European countries. Moreover, the dragons continue to enjoy near double-digit growth rates in the late 1980s. In my view, the single most important factor that accounts for their economic success is that each country affords its residents a considerable measure of economic freedom. This factor translates into a well-defined and enforced system of private property rights, an effective legal system that protects the individual's economic and political liberties, reliance on private enterprise for the creation and distribution of income, and the maintenance of economic policies that motivate and reward individual behavior.

China itself would no doubt like to become the fifth dragon and has taken a series of bold measures to that end. Careful study and application of the economic institutions and policies that propelled the four dragons from third-world to first-world status provide a clear set of measures that can assist China in its effort to modernize.

Chief among these measures are the principles and economic policies incorporated into Hong Kong's free-market constitution, as set out in the draft Basic Law. By applying this blueprint to the economic reforms in China, the basis will be established for a new Chinese order characterized by individual freedom and prosperity.

FREEDOM AND REFORM IN ASIAN-PACIFIC ECONOMIES

Richard Y. C. Wong

A commentator is expected to find faults with what the author has to say, but I find myself in substantial agreement with what Alvin Rabushka has written. My comments, therefore, are largely directed at certain omissions in Rabushka's paper, whose inclusion I think would make his case for economic freedom convincing. In particular, I believe Rabushka's argument would be enhanced by taking a more thoroughgoing comparative institutions approach, and that his treatment of the draft Basic Law would benefit from a closer examination of the implementation problem and those provisions that clash with economic freedom.

A Comparative Institutions Approach

The Asian Pacific region provides many useful examples of economies that are great successes or dismal failures. Much can be learned from comparing and contrasting the different institutions and policies adopted by these countries as they developed over time. A comparative analysis of the varying economic growth experiences of these countries would provide useful lessons for China.

The major omission in Rabushka's paper is that he does not make full use of such comparisons, although he does so to some extent elsewhere (see Rabushka 1987). Here, he simply concentrates on some of the success cases. A useful comparative analysis, however, must contrast success with failure and bring out the essential differences between them.

Rabushka does distill from the success stories, based primarily on the experience of Hong Kong, a number of policies that he regards

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The author is Director of the Hong Kong Centre for Economic Research and a Senior Lecturer in Economics at the Chinese University of Hong Kong.

as essential for economic success. These policies include the protection of economic and personal liberties through the creation of a sound legal framework, the maintenance of a competitive price system, and a tax system conducive to saving and investment. The problem, however, is that Rabushka does not spell out in sufficient detail which of the various policies are most important for China and how they can be implemented given existing constraints and opportunities.

These are difficult issues, but the experience of the Asian-Pacific countries offers some guidance. The strategy adopted by and the experience of Taiwan—and to some extent South Korea, Singapore, and post-Sukarno's Indonesia—in deregulating the economy, scaling back protectionist policies, raising suppressed interest rates, and letting the exchange rate be set close to market levels are highly relevant. Indeed, the political and economic strategies, which are pursued by these governments—with varying success and in the face of opposition—to achieve a general move toward a more open and competitive system in which prices reflect scarcity values, deserve detailed examination. The adopted strategies provide hints as to what priorities should be set and what steps should be taken in implementing a policy of successful liberalization. One general observation is that few countries began by relaxing all prices at once; instead, most tried to focus on interest rates and exchange rates.

There are also negative experiences. In the 1970s, South Korea backslid into greater protectionism and suffered from it. The manipulative industrial policies in Singapore in the 1970s paved the way for a loss in economic responsiveness during the worldwide recession in the early 1980s, which hit Singapore with unusual severity. In some countries, state monopolies simply became private ones without resulting in much improvement in economic efficiency and often generated significant social unrest because inequities and corrupt practices became more evident.

Another major issue is the extent to which these policies can be carried without the creation of new institutions and a fundamental change in the organization of the economy and even the polity. Within China there is an ongoing debate about the appropriate policy mix on the one hand and fundamental reform on the other. The Chinese authorities seem to have achieved some limited consensus regarding the need for basic reform, but the issue of pace and how far it should go remains highly contentious.

Here again the Asian-Pacific economies provide many important lessons. The case of North and South Korea (or for that matter East and West Germany) is a powerful illustration of Rabushka's claim that "economic freedom" in the Asian dragons is "the single most important factor that accounts for their economic success." In particular, the experience of the four dragons strongly suggests that modernization requires not only the adoption of sound economic policies, but also the creation of an institutional framework based on private initiative and competition.

Even within capitalist countries, where private property rights are recognized, economic policy failures are quite common and are primarily associated with the fact that highly interventionist governments often impede the process of price competition and hence the individual's economic freedom to engage in production and exchange. Arbitrary transfers and barriers to entry weaken private property rights. Marco's Philippines, Sukarno's Indonesia, and to a lesser extent Malaysia, South Korea, and Taiwan in the 1950s were not success stories, largely because the wrong policies were pursued. A proper institutional framework is essential and will be strengthened by the consistent application of free-market policies. Interventionist policies can erode even the best-designed institutions.

The Draft Basic Law: Its Implementation and Inconsistency

One of the most interesting experiments in the Asian-Pacific region, of course, is Hong Kong, which will have a fundamental change in its political system after 1997. Whether such a change also would bring with it a gradual change in economic policies that over time would weaken the present institutions, which allow a great measure of individual economic freedom, is a matter of great concern. The draft Basic Law, which would serve as the constitution for Hong Kong after 1997, may provide some limited hints of likely future events.

According to Rabushka, the fact that China is willing to enshrine many of the successful policies adopted by Hong Kong in the draft Basic Law demonstrates China's recognition of the value of these policies in leading to economic success. The only remaining issue for Rabushka appears to be for China to adopt these policies for her own modernization. While I think there is much truth in this, there are two fine distinctions that should be noted.

First, the challenge facing China in overcoming the political and economic obstacles blocking the path toward reform is much more formidable than merely preserving policies that have proven successful in Hong Kong. For this reason, the problem of how to implement "a free-market constitution" in China is at least as important as what such a fundamental law should include. Second, the draft Basic Law is itself not an unambiguous document or "blueprint for China." Rabushka has correctly pointed out that the draft Basic Law includes many articles that aim to limit the arbitrary power of the state in economic policymaking and to preserve individual economic freedom. But he fails to emphasize that it also includes articles to the contrary, for example, the provision that the state should actively promote industries. The enforcement of this provision would open the way for the introduction of preferential and interventionist economic policies. In many ways the draft Basic Law is necessarily a contradictory document. It hopes to incorporate the interests of various parties—both within and outside Hong Kong—whose goals are dissimilar and whose time horizons are different.

Finally, in considering freedom and reform in Asian-Pacific economies, the role of the political system in determining economic policies needs further scrutiny. It is not sufficient to enumerate sound policies and institutions. Why do some countries adopt "free-market constitutions" and others do not? In answering this question, it is necessary to go beyond Rabushka's analysis to something more fundamental within the political system. The task is obviously difficult, and I am not sure that the experiences of the Asian-Pacific countries have given us clear lessons on this account—much work remains to be done.

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