A preliminary draft

Replicating Hong Kong: Is it a viable economic development strategy for developing countries?

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Abstract:

This study addresses the viability of Paul Romer's charter cities idea as an economic development strategy of developing countries. When the ides was proposed, Romer cited Hong Kong as the most successful case of charter city. Based on the theoretical framework developed from institutional theories of economic growth and institutional changes, we assess the viability of charter city idea and the soundness of the economic performance of Hong Kong. The case study reveals that the charter city idea is, indeed, a brilliant one which can bring economic prosperity to developing countries in early stage of development. But, it, as is asserted elsewhere, is not politically correct guide to economic development. The case of Hong Kong confirms this assertion by revealing that the exclusion of politics which has been key factors for Hong Kong's economic success is now become the serious bottleneck for further development of the country.

Key words: charter cities, economic development strategy, political institution, economic institution, Hong Kong

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I. Introduction

A few years ago, Harvard Business review announced 10 breakthrough ideas for 2010, the ideas which were believed to make the world better. Included here is the idea of charter cities proposed by economist Paul Romer as a strategy of economic development for developing countries. Since many developing countries today are stuck with old rules that slow down economic growth by blocking inflow of technology, preventing successful urbanization and stifling personal ambitions, the idea is, to let them to have new rules that are known to work better than the one they have, through chartering new cities in their country. When Romer proposed his idea, he citied the city of Hong Kong as the successful case of charter city which fuelled the economic growth of both the surrounding cities like Shenzhen and the entire mainland China. Romer attributed the success of Hong Kong to the fact that the British government had administered rules that made the city livable and allowed a market-based economy to flourish.

The starting point for this study is several recent phenomena observed in Hong Kong. While there is no question about the economic success of Hong Kong, the recent trends in Hong Kong are clearly worrisome. The income inequality of Hong Kong measured by Gini index is one of the highest in the world at this point (Lap et al., 2007). Although Hong Kong enjoys the highest ranking in the index of economic freedom in the world, it is also at the highest in the crony capitalism index developed by Economist (The Economist, Mar 15, 2014). The country continues to struggle to build democratic political system and face strong resistance not only from Chinese community government, but also from some business leaders with political power who sprang up during the very economic growth path. While the historical path which led to such situation could be complex, it seems to be caused by the economic development strategy founded upon the castration of politics. All these current phenomena appear the inevitable consequences of such economic development strategy. So we here raise a question: Is replicating Hong Kong a viable alternative to economic development strategy for developing countries? This question is addressed in the following pages.

The remainder of this paper unfolds as follows. The second section is concerned with the development of theoretical framework of this study. We examine several relevant theories on institutional foundation of economic development and institutional changes. We then develop a framework for assessing the viability of the charter city idea and the Hong Kong case. The third section assesses the details of charter city idea from the theoretical perspective. The fourth section addresses the economic success of Hong Kong and questions whether Hong Kong could be as a charter city. The fifth section concludes by answering the question: Is replicating Hong Kong a viable economic development strategy for developing countries.

Ⅱ. Theoretical framework[1)]

This section introduces the theoretical framework of this study. Since we are concerned with the idea of charter city, which is a meta-rule to move from bad rule to good one, two streams of theoretical studies are examined. We focus on the theories on the institutional foundation for economic development and theories on institutional change. Drawing upon the understandings of such institutional theories, we delineate propositions on which the assessment the viability of charter city idea can be made.

1. Institutional Foundation for economic growth

A particularly useful approach for the purpose of this research is given by Acemoglue et al., (2005). His approaches focus on the institutional foundation of economic development. Figure 1 shows the relationship among the major elements in this theory. The key message of this approach is two fold. One is that economic institution is most important in determining the economic performance. Economic institutions comprises property right and distribution of economic resources. So good economic institutions are those that provide security of property rights and relatively equal access to economic resources to a broad cross-section of society and thus generate economic growth.

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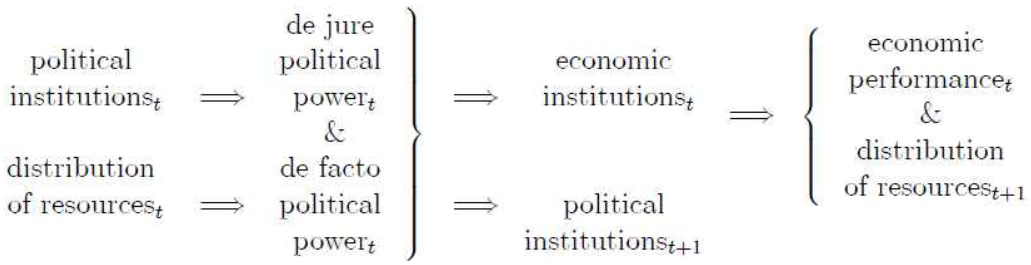
1) We use the terms institution and rule interchangeably and follows the definition that institutions are systems of established and embedded social rules that structure social interactions (Hodgson, 2006: 18).

Another point is that the economic institutions are determined by political power, i.e., who has the power to get their way. The political power comprises two components, de jure and the facto one. The de jure political power refers to power that originates from the political institutions in society. Examples of Political institutions include the form of government such as democracy or dictatorship and the extent of constraints on politicians and political elites. The facto political power refers to power to impose their wishes on society and has two sources. It depends either on the ability of group in question to solve the collective action problem or on its economic resources, which determine both their ability to use existing political institutions and also their option to hire and use force against different groups.

Figure 1. Relationship between Political and Economic Institution



Source: Acemoglue et al., (2005)

In this theory, the distribution of political power in society is also endogenous. In order to see this, we need to identify two state variables, i.e., political institutions and the distribution of resources. The knowledge of these two variables at time t is sufficient to determine all the other variables in the system. Political institutions determine the distribution of de jure political power in society, and the distribution of resources influence the distribution of de facto political power at time t. These two source of political power, in turn, affect the choice of economic institutions and influence the future evolution of political institutions. Although economic institutions are the essential factor shaping economic outcomes, they are themselves endogenous and determined by political institutions

and distribution of resources in society.

One important implication drawn from this framework is that persistence of inefficient economic institutions in real world could result from political institution. This implication may be rephrased as a question, i.e., why do groups with political power not change them to better institutions? The major causes of such inefficiency, according to Acemoglue (2005), is the commitment problem in politics. The commitment problem is the difficulties involved in keeping the promise made ex ante. When it comes to institutional choice, the problem is that there is no such impartial third party that can be trusted to enforce contracts. So in general, government face this problem because there is usually no third party to enforce agreements between various group in society. Whatever group holds power will use that power in its own best interest. Thus, ruling elites who have a vested interest in maintaining their power in society with inefficient institutions may not agree to give up that power because the winners of institutional change may not be able to commit to compensation schemes for the losers.

2. Institutional changes

There are many approaches which addressed the issues of institutional changes. In these studies, scholars used different classification of institution. Roland (2004) addressed this issue based on the capacity of institutions to change slowly or rapidly. He defined the slow moving institution as those which change slowly, incrementally, and continuously. Social norms are more often an example of slow-moving institutions. While some social norms and values can change very rapidly in historical terms, in general, social norms and values change slowly.

The fast moving institutions are those change more rapidly and discontinuously in large steps. Political institutions can be fast-moving institutions, which change nearly overnight when there are revolutionary moment. Political institutions have the potential for centralized decisional changes in large steps. Legal systems tend to be faster-moving institutions than social norms but slow-moving than political institutions. A given law can be changed overnight, but legal systems are rarely changed as rapidly

as political institutions, such as electoral rules.[2)]

The feature of the interaction between these two types of institutions is that slow moving institutions may affect the appropriate choice of fast-moving institutions. The different dynamics of slow-moving institutions may make some fast-moving institutions are inadequate in some cases. Slow-moving institutions are by definition good candidates to influence fast-moving institutions, since the former may change little when the latter are changing dramatically. On the other hand, slow-moving institutions must also change continuously so as to produce inconsistencies with fat-moving institutions and thereby create pressure for change.

3. Some Propositions.

Given discussions on these theories, we may now draw some propositions with regard to institutional reform. These propositions can be the basis for assessing the viability of the charter city idea and the soundness of Hong Kong model as economic development strategy for developing countries. The first proposition has do with the focus of institutional reform. As we discussed above, we may argue that the target for institutional reform is on the fast-moving institutions. Particularly, the political institution can be the best target for institutional reform since that institution can have potential both for change in nearly overnight and centralized decision change. So this discussion leads to our first proposition.

Proposition 1: Institutional reform must focus on fast-moving institutions, particularly political institution.

The second proposition has to do with the institutional interaction. According to Berkowitz et al. (2001), when countries receive foreign legal systems without similar predispositions, they tend to be much more constrained in their ability to develop the formal legal order and to have greater difficulties in developing effective legal systems. This is often called

2) The effectiveness of the legal system and the enforcement of laws depend on their acceptance and legitimacy in society and on the expectations of many actors. Thus, the legal system is very similar to social norms, except that the system of rewards and punishments is legally codified and can be changed rapidly than social norms, which can never change by fiat.

the transfer effects. This effect often result from either slow-moving institution influence fast-moving institutions.

It is important to see that the interaction between slow-moving and fast-moving institutions implies that different cultural paths (slow-moving institutions) may affect the appropriate choices of fast-moving institutions. So the reform of fast-moving institutions in a given country must in part build on existing slow-moving institutions that have arisen in countries with different cultural and historical past. Ignoring these pasts in designing institutional reform is likely a recipe for failure. So this leads to our second proposition.

Proposition 2: Institutional reform must overcome transfer effects.

The third proposition for institutional reform has to do with the influence of politics. According to Acemoglue (2005), there three different channels via which the political influence will lead to the choice and persistence of inefficient institutions. These are hold-up, political losers and economic losers.

As for the hold-up issues, studies showed that constraints and checks on the use of political power by the elite are typically conducive to the emergence of better economic institutions (Acemoglue et al., 2005: 437). When political elites cannot use their political power to expropriate the incomes and assets of others, even groups outside the elite may have relatively secure property rights. Also, if political power is in the hands of a relatively broad group containing those with access to the most important investment opportunities, economic institutions protecting the rights of a broad cross-section are more likely to arise.

It is also true that a good economic institutions are more likely to arise and persist when there are only limited rents that power holder can extract from the rest of society. This is because such rents would encourage them to opt for a set of economic institutions that make the expropriation of others possible. Finally, considerations related to issues of political losers suggests that institutional reforms that do not threaten the power of incumbents are more likely to success. So our third proposition for

institutional reform can be read as follows.

Proposition 3: The influence of existing political power must be minimized in institutional reform.

Ⅲ. Charter Cities Idea

A charter city is an entity where the governing system is defined by the city's own charter rather than by national laws. The charters are specified by law, and modified by decision of its administration established in the charter. These cities can be administered predominantly by citizens or through a third-party management structure, because a charter gives a city the flexibility to choose the types of government structure. In the following, we disentangle the idea of charter city proposed by Romer (2009). The details of the charter city idea are put together by examining several documents written over the years.

1. The Basic Structure

The structure of charter cities may vary depending on where it is established. But all charter cities would share four common elements (Romer, 2009). The first element of charter city is an undeveloped piece of land that is large enough to eventually host an entire city. The second element is a charter that pre-specifies the broad rules that would apply there. A charter should outline general principles and describe the process whereby the detailed rules and regulations will be established and enforced in a city. It should provide a foundation for a legal system that will let the city grow and prosper.

The third elements is a commitment to choice, backed by both voluntary entry and free exit for all residents, employers, and investors. The broad commitment to choice means that only a country that wants to create a new charter city will contribute the land to build one. If there are any partner countries, they will help establish the new rules only if they choose to do so. Only firms that seek out these rules will invest in the city or hire workers there. Only people who make an affirmative decision to move to the new city will live under its rules. They will stay only if its rules are as

good as those offered by competing cities. The fourth is a commitment to the equal treatment of all residents under the law. In a charter city, legitimacy derives from residents decision to opt-in to the new rules as well as the social inclusion that follows from equal applications of the rules to all residents.

2. Governance Type

A charter city's governance structure also vary depending on where it is established. Figure 2 shows several type of charter city governance arrangements. In order to understand the governance of charter city, we need to identify actors involved in charter city. There are three distinct roles played by participating nations in charter city. The first actor is host country which provides the land. The second actor is the source country which supplies the people who move to the new city. Finally, a guarantor country may ensure the charter to be respected and enforced for decades into the future. Because these roles can be played by a single nation or by several countries working together as partners, there are many potential charter city arrangements.

Figure 2. Governance of Charter City

Type	Host Country	Guarantor Country	Source Country	Examples
Type 1	Developing	Developing	Developing, Other	Shenzhen
Type 2	Developing	A developed country	Developing	Hong Kong
Type 3	Developing	A group of developed countries	Developing, Others	

Note: Developing indicates developing countries; Developed indicates developed countries; Other indicates other developing countries.

The first type city is the one in which one country to assume all three roles. In this type, a local government of host country will normally assume the role as initiator. The central government can act as partner to

the local authorities. This type can be found in China which did in establishing the special economic zone where the new city of Shenzhen emerged. A variant of this type would be the one in which the host and guarantor country is the same one, but the source country is different. In this type, the charter city may be built in the host country and people from source country can migrate to the new cities.

The type 2 city is the one where host country and guarantor country is different. The host countries may be developing countries, but the guarantor country can be developed countries. So different legal structure would be applied. The host country could sign an agreement with guarantor country which create some authority that has the right to administer the basic functions of government. Each country could be party to the appointment of authority officials.[3)]

But there may be problems in this second type. The problem is that developed countries may not assume the role of guarantor country. Despite the good argument that Romer makes for his vision, the responsibility must be unpopular. Sensing these potential problems, Romer has come up with new variants on his formula, the third type. The type 3 city is the one where a group of advanced countries could share the burden of trusteeship, rather than one nation shouldering the responsibility alone. In this governance type, the territory for the charter city could be provided by one country to reduce the sensitivities over land and sovereignty, while the migrant workers come from another.

3. Institutional Foundation

How can we lay the institutional foundation for charter city? Given the basic structure and governance arrangement, we now identify the process of laying the institutional foundation for charter city. As we discussed previously, the most important task is to establish the right economics institutions since they have direct bearings on economic growth. While establishing these institutions is done by outside intervention, it is also

3) Romer argues that this kind of international agreement has many historical precedents including Hong Kong's Basic Law and the Regional Assistance Mission to the Solomon Islands (Romer, 2010).

important to find ways to sustain such economic institutions. Also important is to find way to make such economic institution comparable to other slow-moving institutions.

1) Establishing Right Institutions

As noted in he first proposition, we may first focus on the establishment of political institutions. The political institution is the fast moving institution with potential to change in one step and determines the nature of economic institutions. So establishing the right political institutions can be an absolute prerequisite for establishing the right economic institutions.

In charter city, political institutions can be established either by outside intervention or local authority of host country depending upon the governance type. The nature of political institution may also be determined by the governance types. As we discussed in the theoretical foundation, it seems that the establishment of political institutions would be done without resort to democratic process. We are well aware that it is the political process which prevents from adopting right rules in most developing countries. So modification to the democratic process may be necessary. In the charter city, the influence of democratic politics in establishing political institutions is suppressed in order to set up the right rule more easily.

The second step of institution building is to get the right economic institutions. As we discussed previously, we can establish the right economic institutions as long as we have right political institutions. In the charter city, since we do not have democratic political institutions, we can build relatively easily good economic institutions as long as we have right idea on economic institutions. Even in the type I city, if the influence of central government could be minimized, then we can easily have the right economic institutions to be established.

It appears that Romer also seems to doubt that democracy is a necessary condition for economic progress (Mallaby, 2011). He asserts that to the extent that opt-in charter cities offer a third way, that is, something between pure democracy and pure authoritarianism, those who care for liberty might do well to embrace the experiment. He also says that charter

cities make it harder for authoritarians to claim that their system offer the only fast route out of democracy and politically, democracy will be introduced gradually. He finally adds that only when the governing body deems that the time is ripe will citizens be able to elect the members of the normative councils such as local parliaments.

2) Forming Governing Body

Given that we have right political and economic institutions, we next need to form the efficient governing body which can sustain such institutions. While the rules can be established by outside agencies, it has to be administered by the government of charter cities. The government of charter cities must be efficient and in some way administered well the newly established rules.

There a few options here. One option may be that the charter cities could be autonomous regions with new rules that are administered by a city manager with a strong executive powers. The city manager might have wide discretion in the pursuit of a mandate to oversee safe and prosperous city, but he or she would ultimately be accountable to elected leaders. Another options could be to follow the example of Hong Kong and create a partnership with one or more foreign countries. This arrangement could be like the one between the British and the Chinese, but entered into voluntarily (Romer, 2010: 9). Because some governments in developing countries lack the credibility needed to make commitment to long-term investors, they could benefit from a partnership with a government that can make such commitments.

Regardless of the type of options, the government must be the one with strong but accountable executive power. Romer cited the modern central bank as the example of efficient government (Romer, 2010). The cental bank used the mechanism of a strong but accountable executive with a great deal of success. The central bankers were given clear mandates on issues like price stability and growth. It is also given wide discretion in pursuit of those mandates. Elected representative don't have a say on the rules of monetary policy, but they do get to specify the mandate and hold central bank accountable for living up to it.

3) Comparability to slow-moving institutions

The third issues need to be address is the comparability of the new institutions to the slow-moving institutions. As we discussed, it is important that the building of fast moving institutions in a given country must build on existing slow-moving institutions. In general, the slow-moving institutions such as culture and norm can move together with people, it seems important that what kind of people are residing in charter cities.

There are several possibilities. As we saw in Figure 2, the comparability to slow-moving institutions may not be a serious problem in type 1 city. On the other hand, we may face the problem of transfer effect in the case of type 2 city, because of difference between guarantor and source country. Scholars identifies three processes capable of overcoming these transfer effects. To begin with, institutional transfer can be intentionally made to adapted to stick to the existing slow-moving institutions (Berkowitz et al., 2001: 167). And familiarity with fast-moving institution may also reduce the need for adaptation. Finally, slow-moving institutions may change as fast moving institutions influence behavior and ultimately beliefs among the population (Hodgson, 2006).

Romer also explains that success or failure of charter city will depend not just on good rules, as in laws, but on the social norms that established by its inhabitants. He says that the key is to begin with a core of people who share certain new norms, as when William Penn attracted people to Pennsylvania who were committed to his charter's legal promise of freedom of religion (Romer, 2010). Once the norms are well established in a community, subsequent immigrants will adapt to them. So he argues that even though the region are supposed to be open to anybody, the inflow of people may have to be controlled (The Economist, Dec. 10th, 2011).

Ⅳ. The Case of Hong Kong

Hong Kong is frequently cited as the most successful case of charter cities. Since British occupation, the rocky island off the coast of China became a

major center for international trade and finance due to the market base economy and British common law. This section details the economic success of Hong Kong focusing on the institutional foundation for the economic success. We begin with a brief description of Hong Kong's history, and then examine the institutional factors.

1. Hong Kong's economic success

Prior to the arrival of the British in 1841, Hong Kong was home to a series of scattered Chinese fishing and farming community. For over 150 years, the British maintained Hong Kong as an enclave, plainly separated from Mainland China in many ways. Hong Kong became a Crown Colony within the British Empire with a constitution provided in the Letters Patent issued through the Privy Council in London.[4] This was the customary method the British used for providing constitutional underpinnings to colonies like Hong Kong.[5] Such colonies remained subject to the operation of the direct application of UK law in certain circumstances and their own law making powers were limited, normally, to laws having effect within the specific colony.

In 1898, the British obtained a 99 year lease of the "New Territories" under the Second Convention of Peking. This added a large area north of the Kowloon Peninsula plus a number of nearby islands to the existing Crown Colony. The land area of Hong Kong was increased to just over 1,000 ㎢ the same as its area today. The population at this time was around 250,000.

In 1945, Hong Kong's per capita Gross Domestic Product (GDP) was, by some estimates, lower than that of India and Kenya. By 1992, Hong Kong's per capita GDP had overtaken that of the UK. By 2004, Hong Kong was ranked at 23 in a global, "highest GDP per head" table, ahead of Canada and Australia (Cullen, 2006). However, wealth distribution in Hong Kong

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4) The Letters Patent for Hong Kong, which were subject to a number of amendments, remained Hong Kong's primary constitutional document until the change of sovereignty in 1997.

5) Other larger, usually "white" dependencies within the British Empire, like the Australian colonies, were provided with Westminster enacted constitutions and full parliamentary systems of elected government.

remains very uneven and significant poverty persists. But there is no denying that Hong Kong has materially transformed itself over the decades since 1945 from a war ravaged colony of less than 800,000 to a leading international service centre with a population of some 7 million.

On July 1, 1997, the China resumed full sovereignty over Hong Kong from the UK under the terms of the Sino-British Joint Declaration of 1984. The mini-constitution of the Hong Kong, the Basic Law captures, in constitutional form, the essence of the "One Country - Two Systems" agreement reached between London and Beijing on the return of Hong Kong to Chinese sovereignty in the Joint Declaration. Passed in 1990, the Basic Law came into effect on July 1, 1997. The Basic Law guarantees the Hong Kong a high degree of separation and autonomy within the China. It provides, for example: a wide-ranging set of individual rights guarantees (based on the International Covenant on Civil and Political Rights); the continuation of Hong Kong's Common Law legal system; complete currency, taxation and fiscal autonomy; and the preservation of Hong Kong's status as a recognized, international actor.

2. Hong Kong as a Charter City

1) Political Institutions

The first element which made Hong Kong a typical charter city is it's political institutions. When the British deployed gunboat diplomacy, it also brought their particular brand of macro-politics in Hong Kong. The political institution the Briton brought comprised of independent judiciary and a minimum level of government accountability. Also, the Rule of Law was established which initially protected the rights of the propertied class. But the fundamental rationale underpinning this version of the Rule of Law was that no one should be above the law, which ultimately made it difficult to contain its benefits from spreading to all levels of society. Despite the lack of democratic government, the Rule of Law began to touch all Hong Kong people to some degree in the decades following World War II.

In addition, the British actively and successfully discouraged mass interest in greater politicization of Hong Kong. This complied with the unwritten

provisions in their "pact" with Beijing, which endured until the early 1990s. It also suited Hong Kong's Chinese and Non-Chinese business elites who typically felt that the lack of electoral politics was good for trade and business. And they were, throughout this period, highly influential with the government of Hong Kong.

Currently, the Hong Kong Government is comprised entirely of Hong Kong people but it remains, according to Beijing's preference and under the terms of the Joint Declaration and the Basic Law, an entirely appointed (by Beijing) government. So there is no genuine democracy. The most significant factor underpinning this sub-optimal governance outcome has been the steadfast opposition amongst Hong Kong's wealthy elites. Also important is Beijing's reluctance to move beyond the Hong Kong's currently highly limited form of democratic participation to a system of full democracy. The Basic Law clearly allows for full democratic government in the Hong Kong, especially from 2007 onwards, but it does not mandate such change until now.

2) Economic Institutions

Despite such sub-optimal governance, the economic institution in Hong Kong has been instrumental to the economic success of Hong Kong. With the relatively stable political environment, an economic system evolved in Hong Kong which strongly favoured private endeavor. Under the British model, the rule of law was primarily focussed on protecting property rights of individual investors. Taxes were kept law, the Government regulated commerce lightly and in particular avoided participating directly or indirectly in most aspects of the market (major exception being the land and housing markets). The government also increasingly turned its mind to producing and improving public health, education and infrastructure goods. The low-regulation, political-economic framework which evolved under British rule allowed the post-war Hong Kong success story to gather remarkable momentum, especially from 1960.

With regards to economic institutions, we need to focus on the role of land market in the economic growth of Hong Kong. When the British established Hong Kong as a free port, goods could enter and leave free of any

customs or similar duties. This continues to be the case today. Indeed, Hong Kong has long prided itself on its low and simple tax regime. A limited form of income tax was only, effectively, introduced after World War II and tax rates today remain amongst the lowest in the developed world. Despite this low tax regime, Hong Kong has still managed to provide public housing on a massive scale, to finance excellent transport and communications systems and sound education and good health systems.

How can it be possible? The explanation for this apparent fiscal miracle has a number of facets. First, the Hong Kong Government has had access to a revenue source rarely available in the modern age to most governments: land. As noted earlier, Hong Kong is not large (at around 1,000 ㎢). And, until relatively recently, one had to live and work within this small area if one wished to make a life based in Hong Kong. From its inception, British Hong Kong did not allow virtually any sale of freehold land. All land was made available as leasehold land. Moreover, the practice grew of restricting the availability of land for development. This drove up the price of land and revenue receipts.

This land management system has become self-reinforcing and financially addictive for the Government. Government land policy has fostered one of the highest densities of any major city in the world.[6] This density has allowed the provision of first rate transport and communications systems with greater speed and lower cost than would otherwise have been the case. Hong Kong's land policy enables the government to lease the land and to raise revenue. The land system is legacy of British colonialism. London wanted Hong Kong to be self-financing. So the colonial authority raised money by leasing land, and apparently free source of revenue that persists to this day. All derived revenues are exclusively at the state disposal. This governmental control over ownership of land can be regarded ad an exception to Hong Kong's laissez-faire economy.

3) Cultural Factors

6) Hong Kong has more skyscrapers, at over 7,400, than any other city on the planet, including New York. The majority of these are residential.

In having such favorable institutional foundation for economic growth in Hong Kong, we must not ignore the cultural factors behind it. The first cultural factor has to do with the people attitude toward politics. It is true in Hong Kong that the ordinary mass of people genuinely remained largely apolitical. Elite views had some influence in this regard. But other factors were also important in explaining this comparative lack of interest in politics. The vast majority of the post-war population had mostly fled from the China. Many of them saw Hong Kong as a staging post. Their aim was to migrate usually to a range of Western, English speaking countries. They saw themselves as sojourners. Because of this attitude of people, the Hong Kong was able to grow as global economic city without much intervention of politics despite its continuing growth of income.

Also, it is important to note that although people lived often in very difficult circumstances with many new migrants from the earlier post-war period having to live in hillside shanty-towns, they had entered an economy which was, year after year, growing at a prodigious rate. This reality offered hope. It created a more positive general mood than one would normally encounter in such a poverty ridden environment. It helped create an atmosphere where concentrating on family economic betterment rather than politics made good sense to many.

Even though we accept the lack of politics of the general public, we still question why has the government of Hong Kong been not been put under pressure to develop a welfare state of the complexity typically encountered in most other developed economies? Despite continued rise of income level, the government spending in welfare has not increased significantly. In 1997, less than 5% of public expenditure was devoted to transfer payments in Hong Kong, whilst 50% of public expenditure was on direct health, welfare, education and housing infrastructure. In the US, at the same time the comparable figures were around 33% and 22%, respectively. Again, cultural reasons provide an important part of the explanation for this. The importance of cultural factor can be found in the fact that behind is trend is the chinese family structure. In the case of difficult situation, chinese people may look for help not from the government, but from their families. The family are normally the one to provide emergency funds.

Ⅴ. Discussions

In the beginning of this paper, we raised a question : Is replicating Hong Kong a viable alternative to economic development of developing countries? Now that we have discussed the details of charter cities model and the institutional factors behind the economic growth of Hong Kong, we are ready to answer the question. The answer is given in three parts. In general discussion, we discuss the comparability of charter city model to the propositions in theoretical framework. Then we address some current issues facing Hong Kong. Following to this discussion is our answer to the question.

1. General Discussion

As we have discussed thus far, the idea of charter city seems to be a sound economic development strategy for developing countries. In a charter city, a host county government can create what amounts to internal start-ups, i.e., quasi-independent city-state that begin with a clean state and are then overseen by outside experts. It will have its own government, write its own laws, manage its own currency, and eventually, hold their own elections (The Economist, Dec. 10, 2011).

In charter city, the rich countries can oversee the administration of charter cities, in particular the judicial system and the police. This would not only protect them from interference by the host country but avoid a common problem in poor countries: that elected leaders, once in office, abuse their power to entrench their rule and enrich themselves (The Economist, Dec. 10, 2011).

Furthermore, Romer argues when people vote with their feet to come and live in a charter city, they opt in its rule, in a way that makes possible a new form of governance: neither authoritarian nor (at least initially) full democratic. What we can see here is an assertion that the democracy by ballot casting can be replaced by the democracy by the voting by the feet (Mallaby, 2011).

In fact, the Romer's contention that a developing country can achieve good

government by importing the credibility of foreigners can be found in real world examples. For example, when Panama or Ecuador decides to do business in dollars, or when Slovenia embraces the euro, each country is importing the credibility of a foreign central bank. Similarly, joining the World Trade Organization is a proven way for developing countries to import the rich world's tariff structure, intellectual and property rules, and domestic regulations. So they can persuade investors that the reform is permanent. Finally, importing foreign election monitors or peace keepers can compensate for weak political institutions or security forces (Mallaby, 2011).

2. Emerging Issues in Hong Kong

So far, we have discussed the institutional foundation of Hong Kong's economic success. Before we begin the final discussion on the viability of charter city, we may need to look some of the recent issues emerging in Hong Kong. This trend seems to be crucial in assessing the viability of charter city model.

Despite its democratic deficit and governance difficulties, Hong Kong remained fairly politically stable over the decades after World War II. Early on, after cultural revolution began in the Mainland in 1966, Hong Kong was rocked by an unprecedented level of rioting and violent politics for several years. But this has been the exception to the rule. For the majority of this period Hong Kong operated primarily as an economic city rather than as a political city.

But the political landscape had changed dramatically over the last decade-plus. A fundamental turning point was the bloody and lethal breaking up of the Tiananmen Square protest movement by the Chinese government on June 4, 1989. It is clear that, since then Hong Kong has become an increasingly political city. The process of politicization gained especially strong momentum in 2003 when the Hong Kong government tried to ram through new anti-subversion laws even while the SARS epidemic remained a serious threat.

In addition to this change, there are several other issues emerging recently

in Hong Kong. The first issue is the rising income inequality. The Gini coefficient in Hong Kong now reached 0.537 in 2010 which is one of the highest rates in the developed world and signifies excessively large income disparity in Hong Kong. Starting in 1973, the country's Gini coefficient measures 0.43 on par with the United States. For the next 20 years, inequality slowly grew and by 1991 measures 0.476. During the 1990's income inequality spiked 0.518 by 1996. But the problem is the fact that the Hong Kong government has no major welfare or economic reform policies on the table that may lower inequality.

As the economic disparity widens, rising public awareness on this issue had ignited social instability. The flame of fury has been spreading across Hong Kong. The grassroots are not benefiting from the prospering economy and their bosses often have excuse to cut pay. The rich is gaining from the sufferance of the poor under the surge of real estate prices. There are unjust to let poor suffer for the gratification of the rich and are no longer tolerated by the majority of people in Hong Kong.

Another issue in Hong Kong is the problem of crony capitalism. As indicated by the Economist, Hong Kong is recorded the highest in the ranking of crony capitalism index out of 23 countries (The Economist, Mar 15, 2014). This index was created by calculating the total wealth of those of the world's billionaires who are active mainly in rent-heavy industries and compare that total to world GDP to get a sense of its scale. This is indication of the fact that many billionaires in Hong Kong are involved in crony business sector. Included here are the industries that are vulnerable to monopoly, or that involve licensing or heavy state involvement.

Behind the problem of crony capitalism is the government of Hong Kong. Consider the real estate business which is the typical crony sector in Hong Kong. We can see a strong connection between business and government. Government policy has driven up the price of land hugely. The Government, historically, could always, it seemed, rely on accessing any additional revenue it needed by leasing land long-term (as the sole supplier) into a market with ever rising prices. Strict usage conditions are stipulated in each government lease. If a developer purchases an old building wishing to rebuild at say five times the height of the building to

be replaced, the developer needs to obtain a variation to the purchased lease. To get this, the developer has to pay a substantial land premium to the Government. When one adds in the profits tax paid by developers and all the others involved in construction, transaction based stamp duties and salaries tax paid by those working in the sector, the Hong Kong government continues to rely on land transaction related revenues for around 50% of its income. Due to such practice in real estate business, only wealthy developers can enter the market and get the benefit at the expense of ordinary people.

3. Charter City a Viable Alternative?

By now, it seems clear that the charter city idea is the economic development strategy basically based on the exclusion of politics in the process of institutional building. Since political institutions hinder the adoption of better economic institutions, the charter city model can establish relatively easily the right economic institutions which is congenial to economic growth of developing countries. Indeed, the exclusion of politics enable us to have right economic institutions and be effective strategy for economic growth at least in early stage of economic growth.

So the charter city model proposed by Romer is a politically incorrect guide to economic development of developing countries, as Mallaby (2011) asserted. Indeed, the idea of charter city is not keeping with the idealized vision of development, in which freedom and prosperity advance in lockstep, with democracy serving as the necessary companions to economic progress. But despite the undemocratic political institutions, we may have some economic growth as long as we can set up the right economic institution.

But we assert that it cannot be a viable alternative. To have sustained economic growth, we need to have economic institution which allow relatively equal access to economic resources to a broad cross-section of society and thus generate economic growth. This requires some kind of democratic political institutions. This is because, as we discussed previously, political institution determine the distribution of de jure political power and the distribution of resource influence the distribution of de facto

political power. And these two sources of political power affect the choice of economic institutions and influence the future evolution of political institutions. So with wrong political institutions and distribution pattern in early stage, we may have bad economic institutions which may be detrimental to the sustained economic growth. There is also no guarantee that we can have politically right institutions in the later stage of development. This is what we have seen in the case of Hong Kong. The politically incorrect guide can eventually bring about economically incorrect outcomes such as income inequality and crony capitalism and continuing political struggles.

Then the question may be what might be the alternative to the charter city idea. Or put it differently, what would be the politically correct guide for economic development strategy for developing countries? We propose the chartering of political leadership, instead of building charter city. The chartering of political leadership involves borrowing and getting help on political leadership from advanced economy. This is just like the example where importing foreign election monitors or peace keepers can compensate for weak political institutions. This can be done through international development institutions. When they help low income countries, they can put some conditions. The condition would be that the recipient countries must get some advice and help from expert of developed countries on the reforming some political institutions. Only if they accept this recommendation, they can get the help from such institutions.

Since political institution and policy outcome is very important for the economic development of developing countries especially in the early stage of economic development. So if we set up right political institutions, then we can have a favorable environment which enable to have good economic institutions as well as relatively equitable distribution of resources. With this approach, the speed of economic growth may be rather slow. But the result would be much more sustainable. Since political power is the major determinant of both economic institution and distribution of resource, the chartering of political leadership could be a viable alternative to the charter city idea for economic development of developing countries.

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