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# PUBLIC ADMINISTRATION AND POLICY

## An Asia-Pacific Journal

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# PUBLIC ADMINISTRATION AND POLICY

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## The Paradox of Governance

**Woon-kwong Lam**

Convenor of Executive Council, The Hong Kong SAR Government

(Following is the speech by the Convenor of Executive Council, Mr. Woon-kwong Lam, delivered at the AGM and Luncheon of the Hong Kong Public Administration Association, held in the Police Officers' Club on 7 June, 2013.)

President, Participants,

Thank you for inviting me.

Today, I am speaking in my individual capacity, not representing the Government, or the Executive Council, or any political interests. It will be one man's view, no more, no less.

And thank you for letting me choose my topic. What I am going to say would be neither ground breaking, nor insightful. It will be just common sense knowledge, knowledge derived from thousands of years of human civilization, instilled from the lessons we learned from centuries of governance, or more accurately, misgovernance.

Being common sense knowledge does not mean that it is not worth repeating. As public administrators in particular, we should remind ourselves regularly how modern concepts of governance came about. Otherwise, we risk missing the wisdom we have so painfully accumulated.

Let me begin with a quote from the late Robert Novak, a Conservative American political commentator: *"Always love your country, but never trust your government."*

Is this statement not a paradox? To those of us who have been under the subconscious but not inconsiderable influence of Confucian authoritarianism, the statement indeed sounds surreal. Government is, after all, the real-life representative of the country. However, to a right wing American columnist who believes that "government is the problem", this statement makes perfect sense.

Indeed, all modern day liberal democracies have their constitutions modeled exactly along Novak's paradox: public powers are too tempting and will thus be abused; those in power cannot be trusted; hence their powers must be checked by strong, independent, and balancing institutions.

Yet modern societies are getting increasingly complex. People are now better educated, better informed and better empowered at staking their claims, often direct to the government rather than going through agencies such as political parties.

Too often, the claims of different stakeholders are in conflict with each other. To resolve the conflicts and to take policies forward, it requires skillful coordination on the part of government, and strong sense of collaboration on the part of stakeholders.

Trust, the single most important factor in making the balancing acts work, should be a pre-requisite. And yet most modern day governments choose to base their constitutional design on the principle of distrust.

There lies the paradox of governance in modern day governments.

This paradox did not come into existence for most part of the world until the last century. Before that, most countries were ruled, for centuries, by kings and emperors who claimed their right to rule through divine authority such as God or Heaven. Trust is assumed to be an inherent part of this metaphysical relationship because faith in God or any Heavenly being must not be subject to questioning.

The modern day notion that *"no man is good enough to govern another man without the other's consent"* may seem like a late comer to the concept of governance. Or is it so? If we look closely at how our great grand forefathers had lived, in the times of pre-history, this seemingly late-coming principle was actually adopted by probably all early primitive societies.

Leaders in early primitive societies were almost never by inheritance. This has been observed by anthropologists who studied small primitive human communities that still exist in scattered parts of the world. It is also evidenced in the many legends that portray how the old, pre-historic world functioned, both in the East and in the West.

Leaders in pre-historic societies were chosen from among those who are either most capable, or most experienced, or most respected, or with all these qualities combined. While these societies might not have left behind any record of formal election processes, broad consent from among their own members was the way for their leaders to gain collective acceptance. They were certainly not democracies in the modern sense of the word, but they were not family-run enterprises either.

Why should collective acceptance be important in human societies? To answer this question, let us go back to the basics. Humans sit at the top of the five billion year old evolution tree. We belong to the family of the great apes, our closest surviving relatives in the evolution path. We are alone among all the surviving biological species in being able to manipulate the natural environment and make amazing achievements.

But we are communal beings. Our survival and well-being are dependent on being part of a larger community. We willingly give up a considerable part of our freedom for the greater good of the community where we belong. In return, we expect trustful and productive bonds among communal members, plus mutual protection and support in difficult times and during crisis.

When a community reaches a certain size, we need organized governance, in the form of government. *"The legitimate object of any government is to do for their own community of people whatever they need to have done, but cannot do it at all, or cannot do it so well for themselves, in their separate and individual capacities."* (Abraham Lincoln) The obvious examples are collective security and major public works such as dams and roads.

It is self-evident that government exists for the community of people it serves, not

the other way round. However, as communities grew bigger and governance became more complex, man's insatiable capacity for self-interest tempted many to monopolize their positions of power. Appealing to metaphysical sources that need no rational explanation, they claimed themselves and their dedicated successors to have divine and natural rights to rule in perpetuity.

It was due to the painful history of these outright and universal abuses of public power, which lasted for millenniums, that modern liberal democracies choose to anchor their governing institutions on the principle of separation of powers so they may check and balance against each other. The aim is to reduce the risk of power abuse and monopoly.

Seen from this light, the argument that liberal democracy is a form of governance only suited for the West is puzzling. The tendency for those in positions of power to abuse public powers is proven to be **universal** as well as **eternal**. Indeed, if we reflect on our own history dutifully and objectively, abuses by successive imperial governments against the well-being of the Chinese people took place on a much larger scale, simply because our empires were much bigger and our dynasties on average lasted much longer than those in the West.

Let us now come back to this trust-distrust dichotomy of liberal democracies. How can any government function under such a paradox, you may ask? The way it works is actually quite easy to understand: through constitutional design and through establishing the necessary supporting political culture, people gradually develop their trust in the governing institutions. And when they have sufficient faith in the ability of these institutions to check and balance against abuses and excesses in the system, they would grant their collective acceptance willingly. The dichotomy is thus turned into the two faces of the same coin which becomes trusted and usable currency.

Exercise of power by modern day government has to be based on collective acceptance by the people it governs. And collective acceptance is best realized through the majority, because it is most easily understood, and has the natural strength to make itself obeyed. Once the broad acceptance hurdle is overcome, government then owns the effective power of compliance. It can command acceptance of its policies considerably more effectively.

In a typical functioning democracy, though you may still not like certain acts that the government requires you to do, such as taxing you to reduce your wastes, or demanding that you go through the means test before qualifying for your old age allowance, the tendency for you to follow the rule of the game would be higher, because you consider the election valid and want to respect the majority will. Even if you one day become fed-up with what the government imposes on you, you still harbor the hope that you may vote it out at the next available opportunity.

Simply counting the majority is of course no panacea. Collective acceptance is never total. In any democracy, there will always be a percentage of "dissidents" who would defy any compliance measure imposed by the government.

John Kennedy, the popular American President of the 60s, once famously said,

**"One-fifth of the people are against all things all the time."** I don't know how he got the figure of one-fifth, but he was right to face up to the fact that even in a functioning democracy, you cannot please all people all the time. But government by majority at least runs less risk of being brought to a stand still by minority interests.

Some of you might now be crying foul: that what I had just said only exists in textbooks on politics, and elementary ones as such.

You might think I am turning a blind eye to what is happening in many liberal democracies now, after they had been hit by the worst financial crisis of the last half century.

Some of you might even be convinced that the liberal democratic form of governance is coming to an end, because voters are short-sighted, and popularly elected politicians have now run out of money in the public coffer to appease their voters. In other words, liberal democracies might have prospered in good times, but they would not survive the age of thrift.

No, I have not missed the point. But I judge that the current financial ice age would not mark the end of liberal democracies. It would instead be a catalyst towards upgrading the way these democracies work in the future: towards greater fiscal prudence; towards more use of civil societies and the private sector in the delivery of public service; and towards enhancing public participation in shaping and deciding on public policies.

I say this not out of blind faith. I witnessed how the Western world had come under bad, if not worse, fiscal and economic pressure in the 1970s and early 80s as a result of the over-blown welfare state. It hit the Nordic countries first, then the British Isles and Continental Europe. The depression resulting from the spending spree spread even across the Atlantic Ocean to hit the US badly in the early 80s.

Yet it did not bring the democracies to their knees. Instead, the self adjustment pendulum worked. From the US to the UK, voters turned right and voted in inspiring and strong leaders to bring their respective nations back on track.

In a less well known and more subtle way, the Nordic democracies quietly but determinedly turned back from the welfare front too. And they brought such fundamental changes to their own mode of governance that their economies remain remarkably resilient even after the recent financial turmoil. This particular experience of self adjustment well demonstrated the strength of mature democracies in overcoming major crisis and in defending themselves against high stake financial risks.

So have faith please.

Ladies and gentlemen, I end my talk today with a quote from an American theologian cum political commentator, Reinhold Niebuhr. He said, **"Man's capacity for evil makes democracy necessary, and man's capacity for good makes democracy possible."** It is yet another paradox which I would like to leave it to you to reflect on.

Thank you.

## **Critiquing Performance Management Regimes and their Links to Budgetary Decision-making and Resource Allocation**

**John Wanna**

Australian National University

### **Arguments**

My main motivation for writing this article is to dissuade governments and their public service advisers from the simplistic adoption of flawed performance management regimes, in the mistaken belief that these systems will improve both delivery performance and effective resource allocation. While performance management offers attractions to governments and legislatures (and has many willing and enthusiastic adherents) there are inherent distortionary dangers in adopting and using flawed systems.

The main arguments of this article directly challenge: (i) the contestable assumptions underlying performance monitoring in public sector environments, (ii) the deplorable implementation of performance measurement in practice; and (iii) the unfortunate outcomes of performance management in government.

In relation to the underlying assumptions, I argue we invest too much blind faith in the benefits and reliability of performance monitoring; and that we assume and often take for granted that certain selected indicators can provide valuable assessments of the performance of public delivery actors.

In relation to implementation, I suggest that we do not yet have a good grip on measuring and assessing performance in the public sector. We have developed relatively poor indicators and measuring metrics and many of the performance indicators we have are often distortionary (and possibly perverse). Indicators also tend to capture the conspicuous phenomena and observable criteria not necessarily the substantive issues or measures of effectiveness. As a general rule, performance measuring regimes tend to be self-calibrating rather than tailored to the specific needs of programmes or their context/starting points. Moreover, those responsible for establishing performance monitoring regimes in the public sector still tend to prefer centralized systems of monitoring, seeking to standardize measuring requirements and reporting formats, and establishing generalizable monitoring systems when an allowance for greater diversity may better capture real levels of effectiveness.

In terms of the outcomes of performance management, I would argue we tend to have even poorer evaluation and review capacities when judging performance-related data. When we produce performance information it is generally the case that limited use

is actually made of such information by governments and relevant overseers (and almost none by the citizenry). And, when thinking of future developments we should be very wary about trying to link performance monitoring and reporting of activities too closely with subsequent resource allocation, budgetary decision-making and the alluring mirage of 'performance budgeting'.

### **Reasons for Measuring Performance**

In recent decades, there has been a huge international interest in performance measurement and performance management across the Americas, Europe and Central Europe, Asia and the Pacific, and even parts of Africa (see Bouckaert and Halligan 2008 for an insightful international coverage). The high level of interest among governments represents a somewhat pious intellectual investment in the hope and aspiration that reliable evidence can be produced and used to benefit policy-making processes. But let us remind ourselves as to why we are measuring performance.

Performance in public sector agencies and programmes is not measured for its own sake. Rather assessments of performance are undertaken with some normative hope of improving certain policies, programmes, activities or operations, organizational achievements and community outcomes. It may be conducted by an external reviewer, professional evaluator or expert consultant, various committees, sometimes by programme managers and operational staff, or even by clients and citizens (end-users).

Performance monitoring and reporting can be undertaken for various reasons and at different stages of policy processes: it can be a rationale for policy interventions (initial motivation); it can be a deliberate aspect of good planning and design (formulation); it can be a form of comparative assessment (imposing competitive pressures or rankings); it can be a device for urging continuous improvement (productivity or effectiveness), or a defence and justification (a shield). However, in practice many examples of performance monitoring are patched-up exercises, very ad hoc and partial in nature and imposed ex-post well after the event or point of decision. Policy deliverers may have external indicators imposed upon them, sometimes relying on metrics or processes on which they were not particularly focused.

Yet, performance assessment (like coordination) is thus largely an assumed 'good', necessary beyond question or dispute (although there may be vehement disputes over the types and methods of information gathering). Many public management texts routinely present performance measurement as a vital component of good governance, an essential part of defensible policy processes, and a core responsibility of management. It is also seen as an important dimension of public accountability for service delivery and the deployment of resources, authority, equity or public value.

However, it should be noted that there is a strong tendency to centralize and standardize monitoring systems, to attempt to ensure comparability in reporting formats. But comparability can be a straitjacket. Performance measuring regimes in the public



sector tend to be run as bureaucratic exercises, becoming self-referential and self-calibrating rather than premised on the specific needs of programmes or their context/starting points. Performance regimes are thus expressions of power relations, potentially empowering some actors while disempowering others. Political executives and legislatures can impose performance regimes to 'control the reins', impose their particular priorities or extract savings. Executives may invest in performance monitoring as a way of protecting themselves and managing political risk. There can be a degree of distrust and cynicism shown towards performance measurement.

Performance reports are potentially utilised by different actors in the policy process. Ministers and politicians may view them as evidence of policy effectiveness or the net worth of additional resource investments. Yet they are risk averse wishing to avoid embarrassment and the full glare of scrutiny. Some managerial actors may use information for executive feedback on the progress and performance of policies/programmes. It is not necessarily a public process or transparent. Accountable actors (such as legislators, scrutiny bodies or auditors-general) may view performance data to gauge efficiencies and effectiveness to the extent they can. The media can use performance information in producing newsworthy stories, although only 'bad news' items tend to appear regularly. Unions or professional associations may use performance data to help regulate their employment practices, workloads or training requirements.

There have also been different waves of interest internationally in performance measurement. Many nineteenth century western governments were motivated by parsimony and imposed economies. Americans became interested in organizational performance ahead of most jurisdictions with the 'performance movement' of the early twentieth century feeding into broader reform efforts. Management was motivated by PPBS, MBO, ZBB, and later by performance based laws (GPRA, PART). This was accompanied by the development of extensive cultures of evaluation in post-war public policies—especially through randomized sampling and the highly quantitative use of management-derived surveys (open to agency bias) (see Radin 2006). Many other advanced nations began to focus on efficiency and technological improvements from the 1960s, with many developing nations following suit from the 1990s.

When governments embraced business-like practices from the 1980s onwards (managerialism, New Public Management, devolution, outsourcing) they often embraced performance measurement as a co-requisite to indicate improvement in management practices and outputs. Many governments announced extensive plans to evaluate programmes (the holy grail of policy evaluation and programme evaluation, which has often proved elusive, see Wanna et al. 2010). Over time, there has been a steady improvement in reporting arrangements and in their consistency, and generally many delivery areas of public policy now have pre-specified and timely reporting requirements; however such progress has not been linear (there has been some backsliding and gaming—especially between playing off input reporting versus output

reporting, and there remain questions over the quality of the information captured). Governments that dogmatically impose performance requirements on agencies can often generate resistance and push-back, and even non-compliance. Performance measurement even under more flexible business models of administration remains a 'work-in-progress'. In some jurisdictions arms-length monitoring bodies have also become more significant and can name and shame agencies publicly.

More recently, many governments internationally have committed themselves to realign public services through citizen engagement to better reflect citizens' preferences and satisfactions. This is ostensibly a means of reconceptualising performance from a client-oriented perspective. However, to date there is little evidence that citizens' expectations, citizen surveys, or satisfaction indices have been widely used in seeking feedback concerning the quality of services delivered by governments. There are some examples of nations undertaking regular citizen surveys of satisfaction (e.g. New Zealand, Canada) but not much close integration of this information with line delivery (see Lindquist et al. 2013 for some evidence of progress).

### **How do we Develop Performance Indicators?**

Indicators of performance are often surrogates. We grab what we can; we collect the collectable; we measure the measurable. Indicators have many limitations. If indicators are merely surrogates they may be readily collectable but tell us very little of importance. Criteria we can count and measure tend to be measured, and therefore become manufactured by the producers. There may be no causal link between the indicator(s) collected and the desired outcomes expected. Agencies may simply 'tick the box' to comply with the collection of data but it makes no difference to the performance of the organization. Perverse logics also apply in that many agencies will be tempted to generate results only in those criteria measured which may entirely distort their behaviour and in some cases be counter-productive. For instance, measuring police performance by arrest rates is a simple enough metric, but it provides incentives to police to arrest citizens for any slight misdemeanours, to record all arrests or make multiple arrests, and to show little discretion in making arrests. It can have other unintended consequences such as filling the courts and gaols with relatively non-serious offenders. Police may be tempted to arrest and imprison fine-defaulters who are not really criminals. Hence, performance indicators are open to gaming and deliberate cheating—easy pass marks in educational exams, re-admissions in hospitals, focusing on 'easy' clients to service.

Hence, crude performance indicators are often restricted to easily identified and observable criteria, but may be limited in their actual applicability and usefulness. Many of such indicators only indicate levels of activity, or the 'busy-ness' of agencies/deliverers (they are volume measures). Other indicators can capture process data (such as the number of meetings held, cabinet submissions processed, inspections undertaken), which provides a measure of public service routines or throughput.

Quantifiable indicators can be presented as positive or desirable achievements, or as negative features to be lessened or avoided. Positive indicators include desired targets, stretch targets or number of processed items completed; workload estimates; programme outputs. Negative indicators include such measures as backlogs, queues and waiting lists, losses of clients or consumers (say declining educational enrolments). Some indicators express ratios of inputs to outputs, but as productivity measures these ratios are dependent on many other assumptions and calculations—e.g., what fixed and variable costs are included in the inputs (including overheads) and what data on outputs can be generated. For instance, the costs of running a public school may be itemisable, but what departmental overheads and central government costs should be allocated to the school? Moreover, apart from such measures as school attendance indicators, what outputs in terms of quality of education can be quantified to weigh against the consolidated input aggregates? And, if we are interested in productivity improvements are we interested in organizational productivity (internal efficiency/innovativeness) or the wider economic productivity the function or service may assist in the community?

Additional problems with indicators are that we often find it difficult to produce or collect any reliable or relevant data—we frequently do not collect data on the actual things governments are interested in or commit resources towards. For instance, Australian governments commit funds to improve the 'school readiness of children' in early childhood yet there is no definition of what 'school readiness' means and no data collected on indicators of readiness. It is not even clear what kind of data might be collected in the first place. In some cases, governments can produce some data but it is of poor quality, unreliable, distorted, and non-comparable over time or between agencies/units. Data comparability can be impeded when actors use different definitions of concepts or designated activities (e.g., prison rehabilitation) and complicated by different collection methodologies. Data can be captured at different times or across totally different contexts (socio-economic, regional, ethnic or indigenous communities). Delays in processing or reporting data from the front line (compilations of which can sometimes take years to see the effects) can erode the data's usefulness in judging the effectiveness of policies/programmes or in policy/programme redesign.

Making judgments on poor quality data is inherently risky and problematic. The relationship between different sets of indicators pertaining to performance (say waiting times in hospitals versus health outcomes) are not necessarily straightforward or consistent. Improvements in one measure may come at the cost of another, or the measures may have almost nothing to do with each other. Some governments in introducing performance measuring regimes have called for far too many indicators of performance (the multiple indicator malaise)—such that agencies spend inordinate amounts of time chasing data on indicators and managers do not know what expectations they are meant to be managing towards. Indicator collection can become a veritable industry, and governments or legislatures tend to multiply the number of indicators required, piling demands for more information on top of other requests (including for accountability and corporate requirements) without culling indicators to a

feasible minimum.

As a general rule, the more we collect data on discrete activities and the associated outputs of an agency the more we can produce quantifiable indicators (but subject to the above qualifications); the more we seek to collect data on outcomes and the effectiveness of programmes the more problematic will be the indicators. Indeed, many governments do not collect data on outcomes they espouse as their objectives (e.g., environmental sustainability, safer communities and improved community capabilities, and improved social cohesion). Moreover, when we ask front line staff about the appropriateness of indicators they often reply that the indicators are of little use in their operations, are burdensome to report, distorting to behaviour, and often not really getting at what they are supposed to be doing (e.g., collecting quantifiable data on numbers of publications in universities when the issue is to measure the original contributions to knowledge).

There are also special problems in both federal and unitary nations with intergovernmental transfers and shared responsibilities for policy sectors. In federal nations sub-national governments will often accept funding proposals initiated by the central government without necessarily being committed to these policy objectives. Hence, considerable gaming can occur (e.g., over precise commitments, matching funding, the timing of resource commitments—front-ending versus back-ending); and some jurisdictions can regard gaming as an expected and legitimate part of intergovernmental relations because sub-national jurisdictions may have limited rights to taxation and no guaranteed shares of the taxes raised from their own residents.

In nations like Australia and Canada there is limited evaluation of performance where funding crosses jurisdictional boundaries, because neither level has the formal powers or sometimes even the inclination to monitor and hold to account. Their legislatures rarely investigate (if ever) policies/programmes/grants that are specified by the central executive, but operationally implemented by state or provincial governments; nor do their principal accountability actors (parliamentary committees, auditors-general, commissions of audit; performance or cost commissions). And if constitutional arrangements prevent substantial institutional re-design, then it is hard to make significant political headway over performance in areas of shared responsibilities. While various occasional pleas for reform can be made by actors (such as separating roles and responsibilities, rebalancing VFI, moving to guaranteed revenue shares, transferring responsibilities entirely one level of government) they have had little practical effect. Both these jurisdictions have only just enabled their respective auditors-general to investigate and audit performance over cross-jurisdictional funding arrangements.

### **Myths Associated with Performance Management**

There are many myths associated with performance management in the public



sector. These include that trust in government will increase or improve if governments perform better. This assumed association is neither a one-to-one relationship nor necessarily a positive relationship. Improved services can inflate community expectations and lead to disappointment and greater distrust. And as governments have attempted to show performance improvements in policy areas, it has often bred increased cynicism and disbelief.

Some believe that innovation creates better performance, but again the relationship is ambiguous. Innovations aimed at increasing effectiveness may come at the cost of efficiency. Innovations can increase cost-structures or timeliness—especially bottom-up innovations which may simply transfer transaction costs from providers to receivers. Moreover, major technological innovations can be costly investments, slow to implement, and take years to evaluate the benefits. And as Dunleavy and Carrera (2013) have argued major ITC innovations can undermine productivity in the short to medium-term, produce bureaucratic cultures of resistance, and be difficult to evaluate using a cost-benefit analysis. Similarly, many managerialists argued and believed that increased flexibilities in public management would lead to increased performance, yet when it came to demonstrating improved performance were generally unable to convincingly prove results. For instance, the Australian parliament repeatedly asked the government to produce reports evaluating the public sector reforms of the 1980s and 1990s, and although four reports were produced over a decade they were largely silent on performance improvement.

Personal incentives to improve performance are equally problematic. Rewarding high performers or high-performing units (branches, schools) can lead to the opposite effects system-wide—through discouragement of low-performers, envy, perceptions of fairness and unfairness, disputes over criteria/possibilities. It is not clear that rewarding high-performing entities actually leads to improved performance in those entities, and fortune/happenstance may have been an important contributor to enhanced performance levels. Performance pay for officials (or bonuses) again does not often lead to heightened individual or agency performance, and in their application can produce resentment, an undue emphasis on individualism, inflated exaggerations of personal contributions, team discouragement, even distorting of data and indicators (ANAO 1993). There can also be criticisms of the politicized system of reviewing and awarding performance bonuses, which may reward factors not related to performance (seniority, reputation, sensitivity, gender, regional-urban etc). This raises the whole issue of whether we can reward public sector people for good performance—it is not an easy question to answer.

There is also a powerful myth that modern public policies are evidence-based and supported by factual empirical assessments of circumstances, and that this can then (and should then) be tested to evaluate the value of the policy intervention. Performance measurement then is a form of policy evaluation. However, policies are still politically driven and governments have invested considerable 'face' in their policies, meaning that

unflattering evaluations threaten to embarrass the government or selected ministers. Under such conditions policies may evade review or be only partially reviewed to avoid criticism of the policy intent or design.

### **What do we get from Performance Measurement? The Tricky Task of Judging Performance**

Perhaps the most significant problem with performance indicators is that the connection between the reported indicator(s) and the desired results is generally opaque, and often the subject of much disagreement (Bouckaert and Halligan 2008). There is often no clear causal link between sets of indicators and the objectives of the policy/programme. We can readily capture reams of data but much of it may not tell us much about performance; and some may mislead. Moreover, the indicators may not be controlled by the agency or programme operators; and many other factors beyond the control of the agency or programme operators may contribute to the measure. Hence, as McDavid and Hawthorn (2012) have warned, reading off judgments of performance from flawed data or from information that does not tell the overseer or reviewer what they think they are getting. They recommend developing cultures of prudence and realistic appreciations of what is possible given circumstances.

Secondly, there is the question of whether the overseers and evaluators have the requisite skills and experience to review performance (McDavid and Hawthorn 2012). Do they have sufficient content knowledge and experience with similar policies/programmes to be able to credibly evaluate similar policies/programmes? Professional training in evaluation can often be perfunctory or inappropriate. Staff in specialist review bodies quickly lose their 'groundedness' and ability to empathise with implementation realities. Experienced joint-management reviews were once fashionable (consisting of elite peer reviews by independent experts) but have since tended to fall from favour (except with project management—e.g., UK Gateway Review methodologies). Generally, the review capacities of government in judging performance-related data are not great or verifiable (independently reviewed or audited).

Then, thirdly, there is the issue of whether governments actually use performance data when making policy choices, re-authorizing programmes, re-committing resources to ongoing programmes. Arguably, only limited use is actually made of performance information by governments and relevant overseers when judging policy outcomes and re-considering approvals or extensions (and unfortunately there is almost no direct involvement by the citizenry in policy/programme review—it remains almost an entirely perfunctory executive prerogative).

### **The Logic of Linking Performance Measurement to Budgeting And Further Resource Allocation**

There has been much recent rhetoric associated with the need to link performance measurement with budgeting and resource allocation. This invokes the notion that the

budget process can be structured to enhance performance/productivity and also demonstrate better performance in reporting. Yet, the links between budget decision-making and performance remain weak (if existent at all) and may have counter-productive or perverse consequences (e.g., an increase in prison escapes contrary to performance objectives may result in political embarrassment and the allocation of additional resources to prison managers—and skeptics may consider that there may also be an incentive to be lax with security).

Many governments have moved away from line item budgeting to framing the budget around expected results (e.g., outcomes, outputs, key performance indicators). Budget documentation has been extensively revised to provide results-based frameworks against which resources have been allocated. The impression given is that the government has weighed value for money considerations against its expected results and allocated resources accordingly. Cynics might argue that these governments have allocated their resources along traditional (legacy) lines and then presented them cosmetically in a result-based packaging. Certainly more performance information has been included in recent budget documentation (whereas little was included some decades ago) but it is not clear that an assessment of performance informs the basis for resource allocation.

If we see performance monitoring as a means of giving legislatures and taxpayers accountability information on the value for money of public provision then there are still major gaps in the governmental systems. Governments have talked about performance for over 30 years now and have accepted results-based strategic plans and budgetary documentation, but are reluctant to release detailed information and assessments of performance. Some jurisdictions provide more performance-related information in intended planning documents but such intentional commitments may not then be used for reporting purposes. Often what governments report is politically motivated, the parameters, indicators, or outputs can be changed by the executive to disguise lower than anticipated performance results.

These developments have encouraged some governments recently to talk of adopting 'performance budgeting'. But the concept is problematic for many reasons. Allen Schick began a study in the US entitled 'Does Performance Budgeting Perform?' and tried to disentangle the logics of linking the two processes together. He quickly found that performance budgeting was largely a hollow commitment and that there were insurmountable problems to be found in evaluating its performance as a new system of effective resource allocation.

Although there is currently a huge effort going on to link performance issues into the budget process, I would suggest that this trajectory is misplaced. Linking the two fields of budgeting and performance is likely to see neither achieved well—they essentially run on different and discrete logics. We may undermine the integrity of budgeting by insisting performance-related evidence is incorporated and used in some

way as a basis of decision-making; and conversely, we may undermine the integrity of performance improvement if we try to run it through the budget process. In short, I would argue that contrary to notions of moving to performance budgeting—the degree to which the budget is a suitable mechanism for examining performance is highly questionable.

Some of the more concrete problems associated with performance budgeting are: how might we reward or discipline parts of the public sector in a results-based budget framework? It is always possible to incorporate performance-related information into the budget process, but there are some real problems in using this information to formulate budgetary allocations. How might jurisdictions implement performance budgeting, would it make budgeting overly complicated and political, and what other problems would they encounter? Do we set minimal quotas, performance indicators or stretch targets? How can performance be accurately measured when line agencies will be largely in control of the performance information fed back into the process?

In the private sector there is far less argument about performance measures—but they are simpler and there is far less disagreement on the important indicators. In the public sector, the concept of performance and the nature of measurements (or findings) is highly contested and the subject of intense disputes. There is no agreed basis of comparison over time of between agencies. Also governments have to perform as well as they can in qualitative functions (e.g., economic policy advice, the assessment of the needs or training requirements of the unemployed, the facilitation of a competitive environment) or in areas of society in which they have been forced to act or take on a role (e.g., law enforcement, social assistance, treatment of the sick, housing the poor). If an agency over-performs do we reward it or cut its budget? If an agency underperforms do we censure it, reduce its funds, or allocate additional funds to help lift its performance. Is the answer different if a senior or indispensable minister is involved? In any of these cases the behavioural incentives lie essentially with the agent not the principal (as does the information). There are no easy answers to this conundrum—but perhaps we should try to address performance issues in their own terms not as part of a resourcing process. Some may respond that if we do not put performance issues into the budget then any actions that follow will not have teeth, but this suggests that the budget process can be used in such a way without generating perverse consequences, and that we cannot seek to improve performance even while leaving budgetary considerations to one side.

In some jurisdictions we are seeing governments attempting to reward or sanction delivery agencies for satisfying pre-determined performance standards. Their thinking is that delivery agencies will respond to behavioural economics and achieve higher levels of performance to receive additional performance payments for their programmes. There can also be sanction penalties associated with these initiatives, but already we know that the process of actually imposing sanctions is difficult and politically problematic for various reasons (imposing penalties on other jurisdictions, imposing

penalties on political or administrative colleagues, imposing penalties on front-line operators etc). Many public sector experts believe that sanctions do not work and that penalty provisions are deleterious to good performance or improving performance.

### Conclusion

Let me emphasize I am not against performance reporting and performance management. Rather, I am concerned that many of the systems we use are partial, distortionary, ill-equipped for purpose, not good at conveying important information on effectiveness and outcomes. This is not to suggest that governments should cease attempting to improve their performance measurement and reporting regimes, but that governments should look to the bigger picture of performance improvement, the lessons of policy learning, better policy design and improved implementation. Governments collectively need to explore what factors are driving performance results (positive or negative) and use these actively in pursuing a learning agenda. I would argue that a cooperative and no-fault environment is important to encourage real improvements in performance to materialize (rather than an adversarial, insular, defensive mindset interested in 'gotcha' politics and scapegoating). Hence, a different inter-agency culture may be required, along with greater initiative from amongst those organizations and agencies most directly involved in service design and delivery.

As a general point, I would suggest simply imposing more performance reporting requirements will have limited benefit to the overall public policy process, and it may harm actual output levels and the search for greater effectiveness. Improvements in measurement, transparency (show and tell or shame) and performance reporting can only go so far. They are relatively sterile measures, often punitive in rationale, retrospective, likely to discourage innovation or risk-taking, and likely to enhance the incentives for gaming within the system as a defensive instinct. It is also onerous to comply with the accountability burden for no apparent gain in performance or community benefit.

So, how might we improve public sector performance—for a start I would recommend we move from a performance management mindset to a learning and experimental mindset (see Sable 2005). The following points of advice may enable performance improvement to become an on-going learning experience that is not threatening or punitive but constructive and rewarding.

- Importantly, minimise the scope for arguments, get agreement on the usefulness of indicators;
- Ask the deliverers and those closest to the frontline how to measure real improvements, they usually know best if they are honest;
- Build in agreed implementation schedules for performance reviewing and improvement;
- Encourage learning by doing, scope for experimentation, how are agencies cultivating their capacities, anticipating their futures;

- Avoid using narrow output reporting tables, try to frame narratives, conduct mapping and client journeys of service experiences;
- Think of ways to motivate public organizations and their employees/networks—invest in celebrations, off-line rewards;
- Pick three most important high-level measures it would be desirable to achieve, not more;
- Use hard-edged complaints systems with real sanctions, and with the CEO personally accountable; and
- Engage the public in assessing services, ask for community assessments, as well as inputs from outreach agencies and constructive reviewers.

With these cultural and behavioural factors in mind, there are great possibilities for oversight bodies and legislatures to work with providers and delivery agencies to assess delivery chains to explore where significant improvements can be made and where governments could make better investments of resources. But this would require the development of better relationships between these bodies, based on mutual endeavour, cooperation and a common interest in resolving problems. Many of these oversight bodies as institutions stemmed from the hostile scrutiny accountabilities coming out of the nineteenth century, highly political, adversarial and blame-oriented in character. Initiatives such as joint performance auditing, constructive joint-management reviews especially of projects, learning from doing and from bottom-up experience, all have potential to improve policy design and delivery. Legislatures could also be encouraged to take on a more managerial oversight role rather than a tribunal or inquisitorial role. There is much scope for upper houses and parliamentary committees to move in this direction and undertake some of this work as well as for other specialist policy-review bodies, think tanks, and even community review mechanisms.

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## Iceland and New Zealand : Comparative Perceptions of Corruption in a Global Economic Downturn

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### Abstract

*Iceland's long, unblemished record as one of the world's least corrupt countries changed dramatically in the first decade of the Twenty-First Century, as evident in Transparency International's (TI) Corruption Perceptions Index (CPI), regarded as the most authoritative source on the relative levels of corruption in countries. Iceland dropped dramatically between 2005 and 2006, when Iceland was listed singly as the least corrupt country in the world on the CPI, and 2010 and 2011, when it was listed as 11<sup>th</sup> and 13<sup>th</sup>, respectively. Why did this happen? New Zealand, on the other hand, has maintained its status as one of the five least corrupt countries in the world in the CPI since the early 1990s (over the years, Denmark and New Zealand have been the most consistently least corrupt countries), when the measure was first employed. Over the last several years, and despite New Zealand's failure to ratify the UN's Convention against Corruption, it has consistently ranked at the very top of the CPI, sitting alone as least corrupt country in the 2011 CPI. This is especially significant in view of the bi-cultural and multi-cultural nature of New Zealand society, influences that are thought to increase the perceptions of corruption within a country, and that are not present in Iceland. We explore in comparative perspective the factors that may have contributed to Iceland's dramatic drop in the CPI, with special reference to the presence or absence of protective measures and media responses, with a view to identifying possible lessons for New Zealand from Iceland's experience.*

*"I don't believe New Zealand's unique. I think by and large New Zealand is a very honest country. But I think we have corrupt practices, albeit on probably a lesser scale to some other countries."*

Adam Feeley, Director of the Serious Fraud Office, New Zealand (Vaughan 2012)

### Introduction

This paper is an examination of corruption, perceptions of corruption, and the rapid drop between 2006 and 2011 in the world corruption rankings of Iceland, a country that by most accounts has very little corruption. Why did Iceland, which had ranked very

close to the top of Transparency International's (TI) Corruption Perceptions Index (CPI) as one of the least corrupt countries in the world, drop so precipitously after 2006? Could New Zealand, which has ranked the highest in the CPI (along with Denmark) since the CPI's inception in 1995, experience a similar drop? What would be lost if it did? The last question is relatively easy to answer: given the great value of "least corrupt country" to New Zealand's "clean, green" image, such a drop would be both hurtful and costly, as the case of Iceland has exemplified. The relation of perceptions of low levels of corruption to "clean, green images" of the respective countries, Iceland and New Zealand, is (or "was", in the case of Iceland) thought to encourage investment and support the growth of the economy. Corruption, on the other hand, is thought to drive down economies in developed countries, albeit with some disagreement (Rock and Bonnett, 2004: 110), undermining domestic and foreign investment, and limiting international collaborative development. The *perception* of corruption, one of the foci of our study, remains the best, and perhaps *only*, reliable measure of corruption (Lambsdorff 1999).

This is a comparative study, and both Iceland and New Zealand have worn, and in the case of New Zealand and four other countries, still wear, similar innocence 'halos'. As will be mentioned below, the two countries have striking points of comparison, including their relatively small size, island characteristics, and the historic international mobility of their professionals and skilled artisans, the innovative and risk-taking tendencies of their entrepreneurs and governments, their attractive if fluctuating currencies for international investors,<sup>1</sup> their natural beauty and dependence upon tourism, as Chatier especially notes in regard to Iceland (2010: 11), the export of natural resources and farmed products, and so on. Both countries are typically regarded abroad, rightly or wrongly, as nearly idyllic societies.<sup>2</sup> Like Iceland prior to 2008, it is probably true that most New Zealanders regarded, and continue to regard, the threat of increasing corruption as virtually non-existent, and the implementation of basic anti-corruption procedures, precautions against a rise in corrupt practices, or the perception of corrupt practices, as essentially irrelevant. Nevertheless, if perceptions of corruption in New Zealand were to increase, as they did so dramatically in Iceland after 2008, and if New Zealand were to lose its stellar ranking in the CPI—the world's leading measurement of corruption—we can assume at the very least that investments would diminish, the New Zealand dollar would lose much of its value, real estate speculation (which was a driving force in Iceland prior to 2008, and remains a driving economic force in New Zealand today) would collapse, and cultural proclivities to accept, and even engage in, corrupt practices would also rise, as they may have risen in Iceland since 2006. Adam Feeley, former Director of New Zealand's Serious Fraud Office (SFO) from 2009 to 2013, made this point repeatedly in his oft-repeated calls for a clearer definition of corruption in a New Zealand context, and the adoption of precautions to prevent its increase.

*Perceptions of corruption*, particularly on the part of business people (because they are thought to be most likely to encounter demands for bribes, influence peddling, and

so on), remains the central means of measuring *corruption*, as noted above (Lambsdorff 1999), because it is so difficult to define in a specific cultural setting, and even more difficult to measure, given its illegal and covert nature. *Transparency International*, the NGO most identified with the global measurement of, and struggle against corruption, employs the CPI as the 'best' measurement of available.<sup>3</sup> The CPI is based on a dozen major cross-national economics surveys, most of which query business people for their views on their own country's economy. Each has several questions on corruption, and the compilation of responses to these questions in a complex algorithm (that also includes the views of panels of academics) determines an international ranking of countries, from least corrupt to most corrupt. It is important to note from the outset that the CPI was intentionally designed so that there would be great stability and consistency, year-to-year, in the rankings: it remains very unusual for a country to move up or down the rankings significantly in a one or even two-year period. Iceland after 2008, however, has become a major exception in this regard.

The collapse of Iceland's new found (and fabulous) banking wealth after 2008 was staggering. The media typically reported the primary cause of the Icelandic financial crisis as government deregulation of the banking sector, and allocation of the ownership of previously state-owned banks to private families. A *New York Times* account of the aftermath of the crisis put this view succinctly:

When Kaupthing [one of the three private banks that failed] collapsed in 2008, it owed creditors, including local authorities, more than \$50 billion....The fraud office started to work with the Icelandic Special Prosecutor's Office in December 2009 to establish whether Kaupthing had lied to win clients for a specific deposit account. It is also investigating how some creditors, shareholders and executives benefited financially weeks or days before the bank's collapse. The problems started when Iceland relaxed its financial regulations, allowing banks to grow beyond their means. Taking on more debt, Kaupthing increased its profit fiftyfold over five years. When Kaupthing, along with Glitnir Bank and Landsbanki Islands, eventually imploded, they collectively owed the equivalent of about 12 times Iceland's gross domestic product. In the aftermath, the International Monetary Fund had to bail out Iceland (Werdigier 2011).

Nevertheless, Iceland now stands as a unique case in Europe. Greece, Spain and Portugal, to mention only the most egregious and recent cases, have engaged in extreme austerity measures to combat their apparent bankruptcies following the 2008 recession, and the EU struggles to "bail" them out. However, Iceland, perhaps because of its very small size and the early support of the IMF, has not engaged in similarly draconian policies. A significant level of social well-being was initially maintained, although massive layoffs and the disappearance of assets have seen Iceland suffer a dramatic drop in its development indicators—principally reflected in the UN's Human Development Index—and ultimately a dramatic (if temporary) drop in well-being.

If we consider the six top-ranked countries in the CPI over the period 1995-2011 (or, in the case of Iceland, 1998—when it first appeared in the CPI—to 2011), that is, all of the countries that have ranked in first place in the CPI at least once in its history, we can add their ranking scores (some of which represented 'ties'), and can divide these sums by the number of years of ranking in each case to yield an average ranking score, as noted in **Table 1**. Of those six countries that have ranked first in the CPI at least once, New Zealand and Denmark have the lowest (and identical) overall scores in this regard, and thus represent the two countries that have been perceived as the least corrupt countries in the world over the 17-year history of the CPI. New Zealand, currently ranked first alone in the CPI as least corrupt country, is an especially interesting case in this regard. As a small, bi-cultural and multicultural country, unlike Denmark, its 'rival' among those countries that are perceived as least corrupt, we would expect from international experience that different ethnic groups would tend to have stronger or lesser perceptions of corruption. This has apparently either not been the case in New Zealand, or has not significantly influenced the CPI. Furthermore, given the recent and rapid escalation of the use of the term 'corruption' in the New Zealand news media, and despite the collapse of many of its non-bank financial institutions after 2008, which exercised quasi-banking functions in many cases, any expected drop in New Zealand's CPI ranking has not transpired. What, then, caused the profound and rapid drop in CPI rankings of Iceland after 2008, and what can New Zealand learn from this?

**Table 1: CPI Rankings of Top-Ranked Countries,\* 1995-2011**

	Denmark	New Zealand	Finland	Sweden	Singapore	Iceland
1995	2	1	4	6	3	-
1996	2	1	4	3	7	-
1997	1	4	2	3	9	-
1998	1	4	2	3	7	5
1999	1	3	2	3	7	5
2000	2	3	1	3	6	6
2001	2	3	1	6	4	4
2002	2	2	1	5	5	4
2003	3	3	1	6	5	2
2004	3	2	1	6	5	3
2005	4	2	2	6	5	1
2006	4	1	1	6	5	1
2007	1	1	1	4	4	6
2008	1	1	5	1	4	7
2009	2	1	6	3	3	8
2010	1	1	4	4	1	11
2011	2	1	2	4	5	13
Σ	34	34	40	72	85	76
Σ / N	2	2	2.35	4.24	5	5.43

Sources: CPI Rankings, 1995-2011, TI Website: <http://cpi.transparency.org/cpi2011/results/>

\* These are all of the countries that have ranked first in the CPI at least once.

Iceland had developed a 'model' reputation as a developed, and very wealthy, country by 2005. With one of the highest standards of living in the world, a unique and romantic island existence, a small culturally cohesive population, and a powerful and recently privatised banking system, it was world-renowned for its investment banking, its clean, green image (except, perhaps, for its adherence to whaling), its exceptionally high ranking in Transparency International's Corruption Perception Index (CPI), its high ranking in the UNDP's Human Development Index (HDI), and the great cultural and economic progress that it had achieved from the Iceland described in Nobel Prize winning author Haldór Laxness's most famous account of poverty, brutality and struggle in Nineteenth and early Twentieth Century Iceland, *Independent People* (1999; 1934).

Evidence confirms that there is, and has been, very little corruption in Iceland, according to a formal definition of the term, at least over the last half century. There is significant evidence, however, of what one observer has referred to as "northern clientelism" (Kristinsson 2001), and what another has referred to as "social and economic incest" (Chartier 2010: 99 ff.).<sup>4</sup> It was, by most accounts, not corruption, but rather the adoption of a *laissez faire* privatisation of the banking system, the allocation of which was based upon traditional patron-client relations, that led to the grotesque financial bubble that burst dramatically by 2008. The Icelandic króna had become a popular speculation currency, but by 2010, after the virtual collapse of all of its banks, a catastrophic implosion of its inflated real estate market, a collapse of the krona, and a national bankruptcy of unprecedented scale, Icelanders began to describe the calamity as a product of corruption *and* clientelism. Clientelism and corruption are two distinct and very different phenomena, of course, and this heightened the surprise when Iceland's CPI rating dropped from first place (perceived as least corrupt country in the world) to thirteenth in a five-year period, a most unusual development given the CPI algorithm.

The case of Iceland points to the dangers of systemic weaknesses, or "blind spots", regarding potentially corrupt practices. The collapse of a number on financial institutions in New Zealand after 2008 also led increasingly to charges (particularly in the national and international news media) of rampant "corruption", as had the collapse of the Icelandic banking system after 2008 (e.g., Erlingsdottir 2010a-e; 2009a-e; Solnit 2009; Sigmundsdottir 2010; 2009). Some observers wonder if the media, with thousands of reports in the US, UK and Europe, had not actually created the crisis themselves (see: Chartier 2010: 33).

Iceland's post-2008 "Pots and Pans Revolution", which brought down the government and led to the dismissal of the chief director of the central bank, the creation of a new political party (*the Citizens' Movement*) based on popular demand for compensation after the financial crash, early elections, and the creation of a coalition government of the Social Democratic Alliance and the Left Green Movement, spelled

radical political change in Iceland. It also led to a change in perceptions, and especially the popular perceptions of corruption. While New Zealand began prosecuting the directors of the failed finance companies for fraud, Iceland prosecuted the directors of their major banks. The gravity of the Icelandic *agonistes* led to the drafting of a new constitution, based on the Danish one, and the significant reorganization and a considerable tightening of its anti-corruption legislation. Icelanders, including business people, now perceived their country as "corrupt". In the midst of this massive lowering of public trust in politicians and political and financial institutions in Iceland, bankers and executives left the country *en masse*. In 2011, seven major real estate brokers (with close connections to Icelandic banks) were arrested by the British Serious Fraud Office in London (Werdigier 2011), and later that year, and throughout 2012, a series of high profile arrests for fraud in connection with the banking collapse occurred in the UK, and in Iceland. In June, 2012, for example, nine people were arrested in London and Reykjavik for their possible responsibility for Iceland's financial collapse in 2008.

New Zealand and Iceland are vastly different societies and cultures, and so one must be careful in making comparisons. Nevertheless, a range of comparable characteristics, particularly in the "clean, green" and morally uncorrupted images that the two countries have enjoyed, especially during the second half of the Twentieth Century, their "island cultures", their small, unitary state structures, and their recent extraordinarily high standing in the CPI, suggest that it is not invalid to see them as kindred polities, in some important respects.

### Six Top-Ranked Countries and Their Relative Indicators

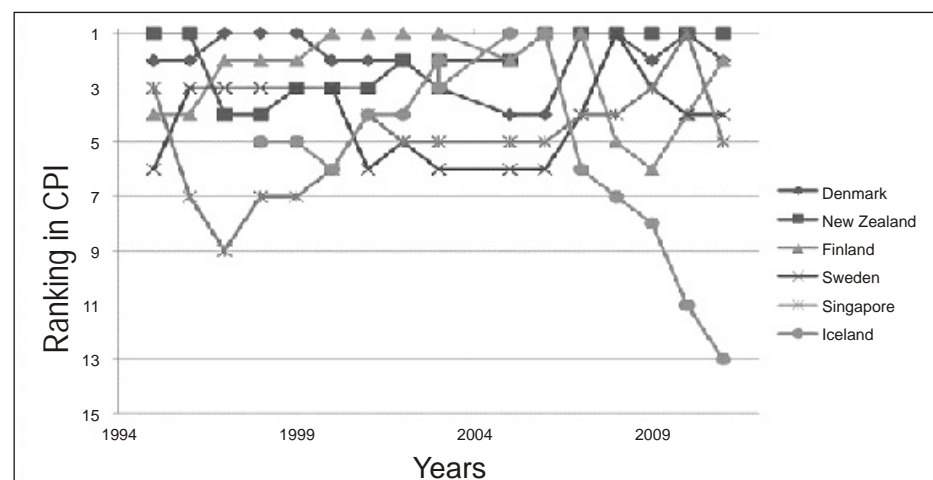
In the case of all the top-ranked countries in the CPI, there is a degree of comparability and the expectation of some annual variability, as Figure 1 indicates. However, the Icelandic CPI change after 2006 is simply unprecedented. Singapore dropped from 3<sup>rd</sup> place in 1995 to 9<sup>th</sup> place in 1997 (Iceland was not listed on the CPI until 1998, and does not figure the first three years of the CPI), although it quickly assumed its place among those countries perceived as least corrupt after that one "outlier" year. Iceland has dropped consistently since 2006 despite the largely successful resolution of its banking, real estate and government funding crisis, and a return to relative normality. While Sweden and Finland also suffered drops in their CPI rankings after 2008, Iceland dropped, from 1<sup>st</sup> place to 6<sup>th</sup>, 7<sup>th</sup>, 11<sup>th</sup> and now 13<sup>th</sup>. This is very much at odds with the CPI's algorithm, which almost precludes rapid change of this magnitude.

In examining the six top-ranked CPI countries on other measures, and from other perspectives, we find interesting contrasts and comparisons in varied indices, as, for example, in the UNDP Human Development Index (HDI) scores,<sup>5</sup> and in the UN Industrial Development Organization's (UNIDO) Competitive Industrial Performance (CIP) rankings. The respective HDI rankings, for example, show similar levels of ween



stability, and evince at least some relation to perceived levels of corruption, with the exception of Singapore, which has been ranked somewhere between 22<sup>nd</sup> and 35<sup>th</sup> in the HDI during the entire period. However, Iceland ranked in the top ten in the HDI until 2010, when it suddenly dropped from 3<sup>rd</sup> place (2009) to 17<sup>th</sup> place, before recovering slightly to 14<sup>th</sup> place in 2011, the most recent ranking.

Figure 1: CPI Rankings, Top-Ranked Countries,\* 1995-2011

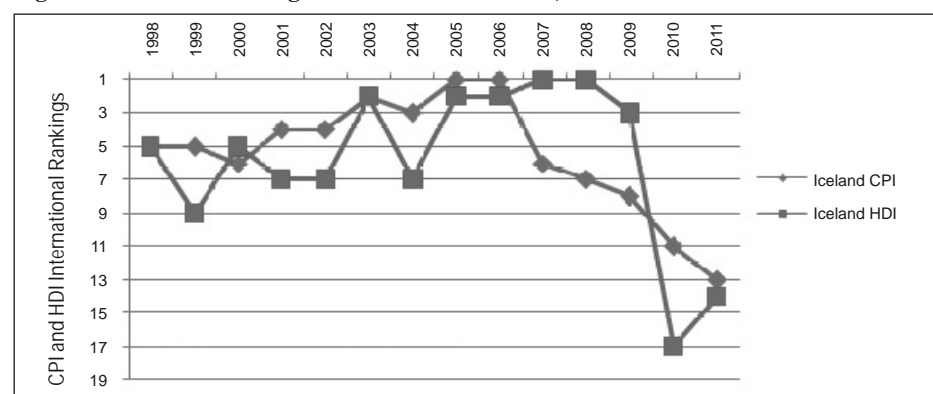


Sources: CPI Rankings, 1995-2011, TI Website: <http://cpi.transparency.org/cpi2011/results/>

\* These are the only countries that have ever ranked in first place in the CPI

Perhaps coincidentally, New Zealand had ranked in the second ten places (except for 1997 and 1998, when it ranked 9<sup>th</sup>), and suddenly jumped in the rankings in 2010, from 20<sup>th</sup> place (2009) to 3<sup>rd</sup> place, "slipping" to 5<sup>th</sup> in 2011. Most striking, however, is the very close relationship between the HDI and the CPI in the case of Iceland, as noted in Figure 2, given that by most accounts Icelandic victims of the economic collapse were insulated against the worst consequences of the crisis.

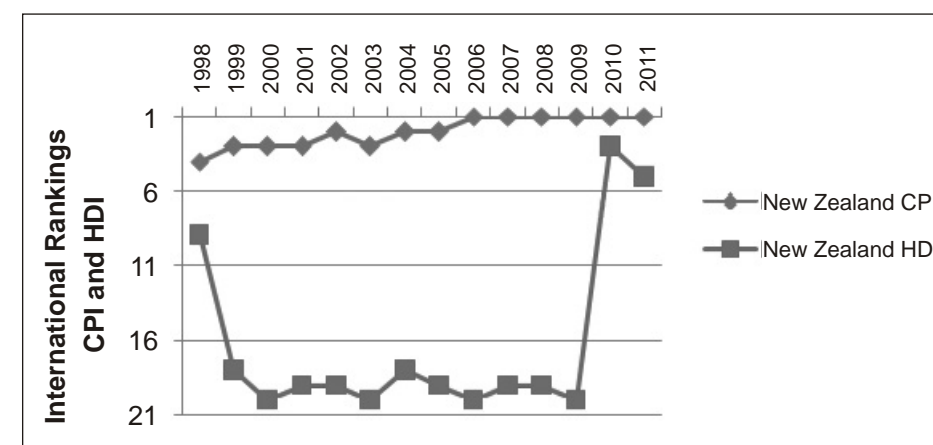
Figure 2: Iceland's Rankings in the CPI and the HDI, 1998-2011



Sources: CPI Annual Reports, HDI Annual Reports

It is understandable that the drops in human development indicators would correlate closely with drops in the CPI. Does this mean, however, that *perceptions of corruption* are little more than responses to difficult economic times? If so, why has this instability at the top of the CPI table not affected more countries? We can hypothesise that the profundity of Iceland's rise to global economic strength (however artificial), and its sudden collapse, explain the establishment of this apparent correlation. However, would not New Zealand's indicators have shown at least some sensitivity to this kind of relationship, if this were the case? New Zealand's bivariate relationship, in fact, shows no discernible relation, as Figure 3 demonstrates. Does this mean that a significant weakening of the financial sector in New Zealand, as happened after 2008,<sup>6</sup> had little effect on perceptions of corruption? Moreover, the rapid increase in New Zealand's HDI ranking between 2009 and 2010 is difficult to explain in historical context.

Figure 3: New Zealand's Rankings in the CPI and the HDI, 1998-2011



Sources: CPI Annual Reports, HDI Annual Reports

The United Nation's Industrial Development Organization (UNIDO) periodically produces the Competitive Industrial Performance Index (CIP). As it recently explained:

The Competitive Industrial Performance index, first developed by UNIDO ten years ago, assesses industrial performance using indicators of an economy's ability to produce and export manufactured goods. The CIP index can be used to rank and benchmark countries' industrial performance, making it particularly relevant for policymakers (UNIDO 2012).

Since the algorithm of the CPI is based upon data collected mostly from business people, it should not be surprising that there is also some relation between the CPI and the CIP, particularly as regards Iceland and New Zealand, although both rank extraordinarily low on this scale as compared to the other CPI top-ranked countries.

**Table 2: Comparing Scores in the HDI, CPI and CIP**

	UNDP <i>Human Development Index</i> (2011) International Ranking	Transparency International's <i>Corruption Perception Index</i> (CPI) (2000) International Ranking	Transparency International's <i>Corruption Perception Index</i> (CPI) (2005) International Ranking	Transparency International's <i>Corruption Perception Index</i> (CPI) (2011) International Ranking	UN Industrial Development Organization (UNIDO) World Competitive Industrial Performance Ranking (CIP) (2005) and (2009)
Iceland	14 <sup>th</sup>	6 <sup>th</sup> equal	1 <sup>st</sup>	13 <sup>th</sup>	43 <sup>rd</sup> and 38 <sup>th</sup>
New Zealand	5 <sup>th</sup>	3 <sup>rd</sup> equal	2 <sup>nd</sup> equal	1 <sup>st</sup>	48 <sup>th</sup> and 61 <sup>st</sup>
Denmark	16 <sup>th</sup>	2 <sup>nd</sup>	4 <sup>th</sup>	2 <sup>nd</sup> equal	23 <sup>rd</sup> and 26 <sup>th</sup>
Finland	22 <sup>nd</sup>	1 <sup>st</sup>	2 <sup>nd</sup> equal	2 <sup>nd</sup> equal	11 <sup>th</sup> and 9 <sup>th</sup>
Sweden	10 <sup>th</sup>	3 <sup>rd</sup> equal	6 <sup>th</sup>	4 <sup>th</sup>	10 <sup>th</sup> and 12 <sup>th</sup>
Singapore	26 <sup>th</sup>	6 <sup>th</sup> equal	5 <sup>th</sup>	5 <sup>th</sup>	3 <sup>rd</sup> and 1 <sup>st</sup>

Sources: UNDP (<http://hdr.undp.org/en/statistics/hdi/>); and Transparency International ([cpi.transparency.org/cpi2011/results](http://cpi.transparency.org/cpi2011/results)), ([Archive.transparency.org/policy\\_research/surveys\\_indices/cpi/previous\\_cpi/1998](http://archive.transparency.org/policy_research/surveys_indices/cpi/previous_cpi/1998)) and UNIDO Report ([http://www.unido.org/fileadmin/user\\_media/Publications/IDR/2011/IDR\\_OVERVIEW\\_EBOOK.pdf](http://www.unido.org/fileadmin/user_media/Publications/IDR/2011/IDR_OVERVIEW_EBOOK.pdf))

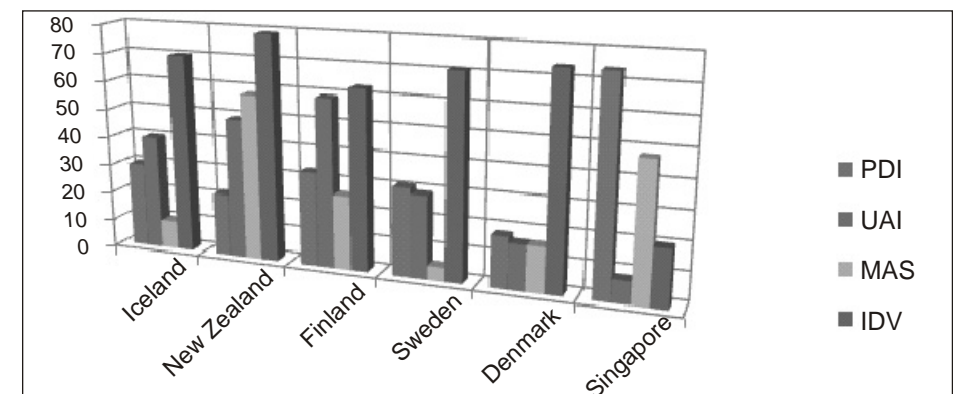
Geert Hofstede, in his long-standing cross-national cultural, organizational and psychological studies, has produced a series of indicators and indices to measure cultural attributes of comparative societies. Vaiman, Davíðsson and Sigurjonsson (2010), in their attempt to revise the concept of corruption to fit the case of Iceland, cite Hofstede's indicators. As they explain:

Iceland's PDI [Power Distance Index] is rather low, which means that people do not expect or accept power in the society to be distributed unequally, and that people are expected to make their own decisions and to take responsibility for their actions. A UAI [Uncertainty Avoidance Index] of 40 is also on the lower side, which makes Icelanders willing to take risks in their decisions and actions. This also shows that Icelanders are quite open and tolerant towards other cultures—a fact that is very prominent in the daily lives of most Icelanders. In regards to MAS [the Masculinity Index], a score of 10 is also rather low. This translates into a greater equality between genders, both in terms of one's position in society and in terms of respect. Other indicators of a "feminine" culture are a strong emphasis on social values (Iceland has a very generous welfare system), freedom and group decision making. With the IDV index [Individualism Index] of around 70, Icelanders are quite individualistic—this means that there is a strong distinction between personal and work environments, as well as a higher importance of immediate family and closest friends over the rest of one's relations. All in all, these

characteristics are quite similar to Hofstede's description of what is referred to as the Scandinavian culture (2010: 367).

It should not be surprising, by these criteria, that New Zealand and Singapore seem to stand apart from Iceland's (and Denmark's and Sweden's) cultural patterns, as illustrated in Figure 4. Finland, as a Nordic, but not a Scandinavian, country varies to some extent. New Zealand has a considerably higher Uncertainty Avoidance score than Iceland. Might this explain in part its greater insulation from the crash of 2008, and the lack of response shown in the CPI? In fact, culturally it looks more like Finland in some respects, and more like Singapore in others.

**Figure 4: Comparing Top-Ranked CPI Countries by Hofstede's Indices**



Note: Power Distance Index (PDI), the Uncertainty Avoidance Index (UAI), the Masculinity Index (MAS), and the Individualism Index (IDV)

Sources: <http://www.clearlycultural.com/geert-hofstede-cultural-dimensions/power-distance-index/>; and Vaiman et al., 2010

A rapid glance at the Hofstede's numbers (Table 3) confirms this. Outrage at unequal distribution of resources in the aftermath of a financial collapse might well have intensified the perception of corruption in Iceland, while the collapse of an institution such as South Canterbury Finance in New Zealand, while prosecuted (initially, at least), also elicited sympathy from a broad spectrum of society, many of whom cited the good works that the Hubbards (its founders and directors) had performed over the years.

**Table 3: Comparing Top-Ranked CPI Countries by Hofstede's Indices**

	PDI	UAI	MAS	IDV
Iceland	30	40	10	70
New Zealand	22	49	58	79
Finland	33	59	26	63
Sweden	31	29	5	71
Denmark	18	16	16	74
Singapore	74	8	48	20

Sources: <http://www.clearlycultural.com/geert-hofstede-cultural-dimensions/power-distance-index/>; Vaiman et al., 2010; Hofstede (2001).

## Banking Collapse and Media Allegations of Corruption in Iceland

The collapse of Iceland's banking system was theoretically a private matter, and thus not related directly to formal conceptualizations of corruption. Nevertheless, as the CPI has graphically demonstrated by 2011, the perception of corruption at the root of the banking scandal was widespread, with one study (Vaiman et al.) seeking to redefine 'corruption' so that it would include the events in Iceland. The view that a "northern clientelism" (Kristinsson 2001) was ultimately responsible for 'corrupt' favouritism shown by the government to privileged families in the allocation of the newly privatised banks in the 1990s found special attention in the post 2008 press, and is vaguely reminiscent of charges of corruption that were levelled at the New Zealand government in the sale of state assets. A profound lack of regulation of the banks following privatisation meant that bank stock prices were allowed to be inflated by speculation in which banks came to accept their own shares as collateral for loans that were often used to buy those same shares (Træteberg 2011: 306). Bankers who were thus inflating their own stock through these methods were part of the financial elite, and sat on the boards of other businesses. Vaiman et al. (2010), in their attempt to revise the concept of corruption to explain the Icelandic crisis, turned to political favouritism and clientelism as elements, noting that "the close links between individuals and other characteristics of the society...contributed tremendously to creating an environment of political favouritism and weak business culture that was conducive to corruption"(368). Perhaps merely recognising that the banking system, privatised or not, represented a vital part of the Icelandic state structure, and that the bankers should therefore have been recognised and regulated as 'public officials,' would have addressed much of the problem.<sup>7</sup> As Iris Erlingsdottir, an Icelandic journalist, wrote in the Huffington Post in 2010:

In the past twenty years, we have watched the government hand over our natural resources (notably the fishing quotas) and government banks to the favored families and friends. We have watched the government dictate to the nation that we would use our vast geothermal and hydro-electrical resources to power aluminum smelters, without ever giving an accounting (it is widely believed that we are selling the electricity to Alcoa, Alcan and the rest at a loss). The geothermal resources in the area surrounding Reykjavik were recently sold to a mysterious Canadian corporation (suspected of having Icelandic owners) for a ridiculously low price. This year's parliament had to once again deal with a bill that would hand over publicly-held water rights to wealthy individual landowners.... The businessmen and bankers who led us to ruin continue to sit on the boards of our largest institutions. The politicians and bureaucrats who oversaw the corruption and incompetence that bankrupted us still hold positions of authority and influence. The media that served primarily to cheer on the plutocrats remain firmly in place (2010b).

The nature of the alleged 'northern clientelism' (Kristinsson 2001) which Erlingsdottir and others have equated with corruption was linked to the sale of state assets to favoured insiders at low prices, and the creation of paper value from the sale of access. The latter case is perhaps best exemplified by the sale of fishing quotas by the government to private parties in the 1990s. The quotas were treated as alienable property. As Thoroddsen (2011) put it

This arrangement in effect turned the fish in the sea into private property: into assets that could be mortgaged and the money used for further investments...the fishing quotas created a capital base in Iceland where there was none before and added plenty of fuel to the nascent Icelandic stock market (Kindle range 217-21).<sup>8</sup>

A similar creation of investment capital took place through privatisation of the national pension funds, most of which became capital for the three major banks, and most of which were lost in the crash of 2008. The banks were privatised as well, and as their speculative value rose, investors borrowed money to invest in them...from...the banks. Soon, they were described as "Viking outvaders", buying up valuable properties in Scandinavia and, especially, in the UK. But like Ponzi schemes, their power depended upon growth, and the 2008 recession brought them, and their country, into bankruptcy.

Perhaps the strangest case of creating paper value out of government largesse was the putative patenting of the entire Icelandic gene pool by DeCode Genetics, a state supported research enterprise that sought to make use of the relative isolation of Icelanders over a thousand years, coupled with their Nordic penchant for record keeping. The founder, Kari Stefansson, was a personal friend and former schoolmate of the Prime Minister, David Oddsson (Thoroddsen 2011: Kindle loc 259). By staking their new venture on government support of their 'ownership' of all Icelanders' genetic records, they attracted massive foreign investment, so much so that before the stock was listed on NASDAQ it had a massive capital value in the late 1990s of 1.3 billion euros, and was selling on Iceland's 'grey market' for US\$65.00 per share (Thoroddsen 2011: Kindle loc 251-255). Despite the passage of a law by Iceland's parliament in December 1998 that allowed DeCode to take ownership of all Icelanders' medical records and genetic codes, problems arose in US courts over confidentiality, and by the time it was listed on NASDAQ, DeCode's value had dropped to US\$18.00/share, and its research was dependent upon investment from the overheated Icelandic market. It was delisted on NASDAQ in 2008, and filed for bankruptcy shortly thereafter, and although it continues to function under new ownership, and has been responsible for several important health discoveries, its massive value (in US dollars) has long since evaporated.

Was this corruption? It was certainly favouritism, and perhaps even clientelism.



Although the Icelandic news media and popular culture used the term 'corruption' often, there has been relatively little evidence to support the claims that Iceland was corrupt. Even Thoroddsen's book, *On Thin Ice; A Modern Viking Saga about Corruption, Deception and the Collapse of a Nation*, mentions corruption only three times, and at no time offers evidence of a clearly corrupt act. Nonetheless, Thoroddsen is echoing much of the Icelandic media and popular accounts of the crisis. Did Iceland's drop in the CPI rankings result from an increase in corruption? Is it rather the case that a sudden drop in the HDI rankings can lead to a complementary drop in the CPI? Or is it the case that the sale of state assets in Iceland, coupled with criminal mismanagement of the newly privatised holdings, necessarily leads to perceptions of corruption?

### **Allegations of Rising Corruption in New Zealand, and Government Responses**

Most discussions of the calamity that Iceland suffered after 2006 begin with an account of the financial "bubble" that accompanied the privatisation of the nation's banks, the rapid expansion of debt-financed assets, the momentous inflation of the Icelandic króna, the inflation of real estate and growth in real estate speculation—in short, the expansion of market values without the creation or manufacturing of anything. How was this allowed to occur? At least part of the problem seems to have stemmed from some of the cultural factors that Hofstede measures, including the UIA and IDV scores, both comparable to New Zealand's scores on these measures. While evidence and allegations of corruption have increased in recent years, there has certainly been no comparable drop in the HDI.

Contemporary concerns regarding corruption in New Zealand emerged clearly with the sale of state assets by the fourth Labour government after 1988. By 1990 even previously moderate Labour supporters like political pundit Bruce Jesson expressed profound disappointment and concern regarding the nature of the decisions that were quickly becoming law.

It would be exaggerating to say the government was corrupt in a literal sense. I don't think we ever reached the stage of bribes and backhanders. However, in a more fundamental sense this was a thoroughly corrupt government in that hardly anyone in it had any compunction about trading principles for short-term advantage.... The Fourth Labour Government corrupted everything that touched it. From cabinet, the circles of corruption spread outward, to caucus, to the party, to the public service, to the unions. All of them benefitted in one way or another from the existence of the Labour Government, and as its unpopularity deepened they did everything in their power to salvage it (Jesson 2005: 233).

In a subsequent 1991 essay, Jesson clarified, in terms reminiscent of the experience of Iceland, that

The main damage occurred when the share market went beserk between 1985 and 1987. New rich businessmen used investment companies to borrow billions of dollars offshore to take over other New Zealand companies. They had no assets other than the companies and the properties they were acquiring, yet their debts were phenomenal. When the share market collapsed, as it had to, the investment companies collapsed too. Their debts had to be repaid. And the companies they had acquired had to be sold, usually offshore (Jesson 2005: 236).

Twenty years later, there have been numerous concerns expressed in the New Zealand news media regarding high profile individuals such as Kim Dotcom and May Wang, and political figures such as John Banks and Taito Phillip Field, the first sitting member of Parliament to be convicted and gaoled for corruption in New Zealand, although a broad range of finance company failures, with hundreds of millions of dollars lost to mid-range investors, have represented the closest thing in New Zealand to the Icelandic crisis, although in per capita losses, it is not close. Major concerns were nonetheless expressed early on regarding the lending institutions' collapse, often in Ponzi-like scenarios. A dedicated prosecutor, Adam Feeley, was appointed as Director of the SFO to address the situation. As in Iceland, the argument could be made that major financial institutions, like banks, are actually quasi-state institutions, and therefore the question of fraud shades readily into concerns regarding corruption. It is certainly the case that such concerns quickly manifested themselves in official channels through initiatives taken by the SFO, the Reserve Bank of New Zealand (RBNZ), the Ministry of Justice and the Financial Markets Authority (FMA).

The 2012 Annual Report of the SFO reports that in the previous twelve-month period, investigations of New Zealand's many failed finance institutions were associated with losses of \$2.2b. This included the largest fraud case in New Zealand's history (South Canterbury Finance) with 21 charges laid against five individuals in relation to \$1.8b of funds. The SFO also secured finance company related convictions in respect of five companies and laid charges with regard to two other finance companies. The SFO charged persons with bribery, conspiracy, accepting secret commissions, attempting to pervert the course of justice, theft in a special relationship, dishonesty using documents, obtaining by deception, false statements and false accounting. These were all regarded as fraud cases within the private sector, although Adam Feeley nevertheless continued to call for a clearer legal definition of fraud in New Zealand, apparently sensitive to the wider state-related implications of such massive quasi-bank failures.

Despite numerous convictions and prison sentences, the general consensus is that prosecution of this quasi-bank fraud has been only partly successful. Casual observation and some surveys (e.g. Deloitte, 2012) indicate many New Zealand companies involved with exports and dealings abroad, moreover, do not have anti-ing

corruption policies, do not familiarise their employees with relevant bribery and corruption laws, are lax about validating, monitoring and reporting the behaviour of their agents and partners, and do not have a clear and accessible system for reporting suspicious behaviour. This situation has motivated the Ministry of Justice to produce brochures to educate citizens in this domain (Ministry of Justice, 2012). In addition, to address particular concerns, the New Zealand Government has in recent times sought to improve the overall regulatory domain in the finance sector. One particular initiative was the formation of the FMA. In a 2010, a cabinet paper by the Minister of Commerce, Simon Power, argued for change given concerns about the existing regulatory regime, particularly the fragmented nature of regulation and the lack of proactive investigation and enforcement, and additional concerns about the inadequate regulatory regime of KiwiSaver, a massive pension savings plan that involves billions of dollars in private and government investment schemes (Power, 2010).

There is abundant evidence that a broad-scale reform of the banking sector has also been planned, with key elements already undertaken. Given concerns that became evident during the GFC and the NZ Finance company debacle, the RBNZ has taken on new regulatory responsibilities (Reserve Bank 2012). These include: regulation of non-bank deposit takers; prudential supervision of insurance; and anti-money laundering and countering financing of terrorism. In September 2008, the RBNZ Amendment Act was passed, laying the foundation for a series of prudential regulations that have been developed by the central bank: new Non-Bank Deposit Taking prudential requirements concerning governance; risk management; capital requirements; related party exposure limits and liquidity have been in place since December 2010, as well as requirements concerning credit ratings, which have been in place since March 2010. The Insurance (Prudential Supervision) Act 2010 promotes the maintenance of a sound and efficient insurance sector and public confidence in the insurance sector. The Act applies to all insurers carrying on business in New Zealand (as defined by the Act) and includes: a licensing system for insurers based on meeting the Act's prudential requirements; supervision by the Bank of compliance with the prudential requirements; and powers under the Act for the Bank in respect of insurers in financial distress or other difficulties.

The Anti-Money Laundering and Countering Financing of Terrorism Act 2009 is another anticorruption initiative undertaken by New Zealand in the aftermath of the 2008 recession and its consequences (Reserve Bank 2012). The new law comes fully into force on 30 June 2013. It imposes a number of obligations upon reporting entities, including: assessment of the money laundering and terrorism financing risk that a reporting entity may reasonably expect to face; establishing, implementing and maintaining an AML/CFT compliance programme that includes internal procedures, policies and controls that will detect, manage and mitigate this risk; carrying out *customer due diligence* (CDD) (which includes customer identification and verification); on-going CDD; undertaking suspicious transaction reporting; and, robust record keeping.

Given the significant trading relationship between Australia and New Zealand and the significant movement of people between the two nations, problems emerging in Australia point also to the risks faced in New Zealand, especially as regards the banking system. Most New Zealand banks are Australian-owned and regulated. In this regard, the West Australian Corruption and Crime Commission (ACCC) reported a substantial increase in the number of misconduct allegations and investigations, the need for legislative change and possible changes to rules regarding the use of covert powers by surveillance agencies (Corruption and Crime Commission, 2012).

The 2011-2012 ACCC Annual Report noted 3,047 complaints were assessed, relating to 5,012 allegations and 9 "own propositions" of misconduct. In addition to other actions, 15 persons, including four public officials were charged with 596 criminal offences. The Commission also reported on the management of misconduct by Western Australia Police, and three cases of alleged public sector misconduct. Similar level of activity were reported by the Independent Commission against Corruption in New South Wales which in its 2010/211 year reported it had conducted 130 compulsory examinations, made corrupt conduct findings against 26 people, recommended that the advice of the Director of Public Prosecutions (DPP) be sought with respect to the prosecution of 16 people and recommended to relevant public sector agencies that disciplinary action be taken against 11 people in addition to other activities (Independent Commission Against Corruption 2011). Media reports in Australia also included increasing anxiety about organised crime.

The allegations of corruption in both Iceland and New Zealand have been closely linked to financial fraud. In Iceland, the connections between the deregulated Icelandic banks and shady British businessmen made for spicy reading. One of Kaupthing's largest operations outside Iceland was in Britain, where it helped facilitate corporate takeovers, among other deals. The bank financed Robert Tchenguiz's bid for the British supermarket chain Somerfield and the purchase of a stake in a retailer, J Sainsbury. He also sat on the board of Exista, an Icelandic holding company that was Kaupthing's biggest shareholder. In its 2006 annual report, Kaupthing showcased him in front of London's Royal Albert Hall in a two-page photograph, saying how he had picked the bank "time and again." The Tchenguiz brothers owe much of their wealth to the 2000 London property boom. Starting with buying and selling one-bedroom apartments in London, their property group soon invested in commercial real estate, benefiting from some well-timed investments, like Polish petrol stations and a Scottish whisky distillery. Once millionaires, the brothers were a fixture of the Monaco jet set and were often pictured in glossy society magazines. While Vincent Tchenguiz shunned the spotlight, Robert Tchenguiz made headlines in the British tabloids for dating models and holding a lavish 40th birthday party "with 500 guests, a Louis XIV theme and a performance by Cirque du Soleil acrobats" (Werdigier 2011). In New Zealand, as financial houses closed their doors, the SFO began charging multi-millionaires, mostly men who lived ostentatiously while their institutions in some cases owed hundreds of millions of

dollars to small investors, with criminal malfeasance. This was nothing new, however. At the height of the share market boom before the October 1987 crash, illegal and dodgy commercial practices were rife. According to Bruce Jesson (1999: 126), for example, "Not only did the ethical standards of business collapse during the share market boom, but so also did the notion that there should even be ethical standards..."<sup>9</sup> It can also be argued that the radical state sector reforms in New Zealand during the 1980s and 90s, which abolished the unified career service, and introduced the contractualized "out-sourcing" of many public services, have attenuated standards of ethical probity in governmental organizations (Gregory, 1999; Moynihan, 2007).

Clearly, a governmental system has serious problems if hard core corruption is endemic. However, systems that are characterised by *defensible* or *discrete* activity operate in a more tenuously balanced grey area between standards of legality and legitimacy, balances that will generate different political-administrative problems. The "golden handshakes" paid to New Zealand state executives in the late 1990s can be seen as examples of "defensible" corruption—that is, corruption of the expectation that underperformance in office should be sanctioned rather than rewarded by a contractualist regime of fixed-term appointments. Similarly, there is the courting of politicians and officials by corporate and other lobbyists, and gift-giving, though in these cases some line has to be drawn, or to emerge, beyond which it is generally considered to be wrong (or illegal) to go. Some may also argue that the "fire sales" of some New Zealand state assets in the late 1980s and early 90s also constituted a form of *defensible* corruption or even "cronyism" among political, bureaucratic and private sector participants (Jesson 1999). In this regard, Monika Bauhr's (2011) distinction between 'need' and 'greed' corruption suggests how the latter, which involves collusion rather than extortion, can be much less obvious than the former (which is essentially 'petty' corruption by poorly paid lower level officials), even in countries with high levels of institutional trust and which are not normally seen to have significant corruption problems.

Because *defensible* activity occurs in situations when administrative law or procedure lags behind changing normative standards, defensibility itself becomes increasingly more difficult, leading to serious legitimacy problems. Older forms of political patronage in public service appointments have long since become unacceptable in the face of emerging rules designed to enhance public service impartiality and professionalism. Similarly, in many areas of government administration the coercive application of rules which are out of step with public sentiment will be seen as increasingly illegitimate. In the case of *discrete* activity, rule-bending or even outright disregard for the rules may be considered acceptable in the pursuit of legitimate outcomes until unacceptable consequences demand that systems be "tightened up" and the rules enforced more rigorously, usually in the name of greater "accountability."

Both *defensible* and *discrete* modes also give rise to different forms of ethically

and/or morally dubious activity. Whether or not any of these various activities are regarded as being "corrupt" depends on changing public sentiment. Clearly, like the concept of terrorism (one person's terrorist is another's freedom-fighter, as the cliché has it), the concept of corruption is politically and socially constructed. While British Prime Minister Margaret Thatcher saw the defence official, Clive Ponting, as a criminal law-breaker, the jury found that he acted in the public interest in leaking official documents to the Labour opposition, in regard to the British forces' sinking of an enemy warship during the Argentine conflict in 1982. In New Zealand, as in other western democracies, so-called "whistle-blowers" now have protection under recently enacted Public Disclosures legislation. Their unauthorized disclosures may or may not be illegal, depending on the type of information disclosed, but the legitimacy of their actions is a matter of political judgment. Today, political patronage in New Zealand, at least in the sense of a "spoils system," is largely confined to the appointments made by governments to the boards of crown entities, and even in this case such appointments must be publicly justifiable on the grounds of professional competence rather than political party membership or sympathies.

Corruption in New Zealand is especially a concern in the area of international business relations, as noted above. One example is foreign investment in New Zealand. For instance, the Natural Dairies bid for the Crafar Farms led to joint investigations with the Hong Kong Independent Commission against Corruption and resulted in charges being laid in Hong Kong (Serious Fraud Office 2012). New Zealand agencies have also participated in investigations in Bahrain, Switzerland, Panama, USA, UK and the Cook Islands. The recent Deloitte Bribery and Corruption Australia and New Zealand Survey, suggested exposure to bribery and corruption is on the rise and many organizations either do not recognise the risks, or are not addressing them. Their key findings were:

- "34% of organizations have operations in high risk offshore jurisdictions, but 48% of these have never conducted a corruption risk assessment, and 21% do not discuss corruption risk at management or board level
- Only 25% of organizations with offshore operations have a comprehensive understanding of relevant anti-bribery and corruption legislation, while 40% said they are not concerned with risks arising from non-compliance
- 14% of organizations that have never undertaken a risk assessment have experienced a foreign bribery and corruption incident in the last five years
- 80% of organizations with offshore operations either do not regard foreign bribery and corruption as a high level risk to their business in the next five years, or said the risk was not applicable to their organization."

Given the events of the past few years, together with the albeit extreme case of Iceland, corruption concerns should be taken seriously in New Zealand, despite its



topmost CPI ranking. While actions have been taken on a number of fronts, questions remain. The collapse of so many quasi-banks, accompanied by investment fraud, and an intense increase in global linkages, raises the question of whether or not New Zealand's recuperative actions have been too little, too late. Are the remedies substantive, or just band aids? Do government, businesses and others need to do more, or act differently, given the changing nature of business and the sophisticated actions of corrupt individuals and organizations? Is the continuing failure of New Zealand to ratify the UNCAC indicative of a deeper non-responsiveness, or even worse?

As Director of the SFO, Adam Feeley continually sought to implement a coherent and effective legal definition of corruption in New Zealand. His failure to accomplish this, which at best would have required the full cooperation of Parliament, likely owes more to the amorphous and multi-dimensional character of corruption than to any lack of trying.

A Brief Discussion of Corruption and Perceptions of Corruption

Corruption is necessarily a broad topic that does not lend itself well to comparative analysis. With the possible exception of "wrath", *corruption* seems to cover in one way or another all of the seven deadly sins. It is a word, in short, that lacks any positive connotations, is almost necessarily imprecise, and leaves the researcher with a sense that corruption is both inevitable and everywhere. Moreover, it is highly variable, best captured in the cultural nuances of a society, from norms in gift-giving, to traditional patron-client relations, to a society's caring concern for families, which can easily shade into nepotism. There are, of course, some straightforward definitions of corruption. Jacob van Klavern (1989: 25) noted that

In everyday life corruption means that a civil servant abuses his authority in order to obtain an extra income from the public. This conception, however, expresses a value judgment that is altogether temporal and did not always exist. If it were possible to determine the amount of the civil servant's salary by objective measures, that is, by determining the functional value of the civil servant's performance for the achievement of the social product in its broadest sense, then a value-free definition of corruption would be possible. Since such a functional definition of the distribution of income is neither possible for private business nor for [public] administration, this approach leads us nowhere.<sup>10</sup>

Huntington likewise stressed this aspect of the term: "corruption is behaviour of public officials which deviates from accepted norms in order to serve private ends" (1989: 377). It is not always easy to identify "civil servants" or "public officials" from private individuals, however. Indeed, the term raises the tendentious definition of "the state," as well as perceptions of the state. If we agree with a range of observers that

banks (private or public) and major financial institutions are *de facto* components of the state, it becomes far easier to understand the charges of corruption that were levelled in Iceland after the banking collapse. It is our contention that critical functions exercised by private banks and financial institutions are at least perceived by most citizens of developed countries as state functions, and that this represents one important element of the Icelandic reaction to the financial crisis of 2008-2010 as "corruption". This would place the banking collapse somewhere between quadrant 1 and quadrant 4 in Figure 5, the graphic explanation of Gregory's typology of the range of practices (Gregory *et al*, 2012), that is mid-range legality with low legitimacy. We are thus distinguishing between the various and most well-cited forms of "hard-core" (transactive) corruption and those other forms which, although not involving *illegal* behaviour, nevertheless challenge the concept of *legitimate* (as distinct from legal) conduct (Gregory, 2002). These dimensions of behaviour, and their obvious complexity, can be identified in the axes of a two-by-two matrix, as noted in **Figure 5**:

Figure 5: Legitimacy and Legality in Levels of Corruption

		Legitimacy	
		Low	High
Legality	High	<i>Defensible</i> <i>1</i>	<i>Optimal</i> <i>2</i>
	Low	<i>4</i> <i>Hard Core Corruption</i>	<i>3</i> <i>Discrete</i>

The first quadrant constitutes actions which, while quite legal, nevertheless are widely considered to be morally or ethically unacceptable, possible cases of "corruption" in common lexicon. These are here called *defensible*, since their legitimacy is in effect politically and socially defined. As has been seen since the international financial crisis of 2008, the substantial assets that were retained by senior bank officials and owners in Iceland and elsewhere were not politically acceptable, less legitimate, than might have been the case previously. Many Icelanders certainly saw the retention of such assets as a form of corruption.

A further revelation from the crisis in Iceland was that *legitimacy* (getting something worthwhile done) tended to trump *legality* (bending or breaking the rules). Finally, *hard core corruption* is located in the fourth quadrant. Plainly, this covers activities such as fraud, theft, or bribe-taking, which are which are both illegal and socially and politically illegitimate. There was some bank fraud, no doubt, in Iceland,

just as New Zealand's SFO has uncovered a good deal of fraud in the post-2008 financial sector in New Zealand. However, as Adam Feeley has noted, it is difficult to define most cases of fraud as corruption. However, general perceptions in Iceland after 2008 were apparently not subject to this constraint.

In fact, most observers, particularly in the country's news media, tended to characterise the aftermath of the Icelandic banking collapse as the results of *rampant corruption*. In New Zealand, on the other hand, before the state sector reforms of the 1980s and 90s, some forms of extra-legal behaviour were almost institutionalized in some public sector departments, and involved a range of activities, including the "borrowing" (often a euphemism for downright theft) by government staff of time, equipment and materials for personal use. By 2008, when a number of New Zealand lending institutions went under, and the SFO began prosecuting their boards of directors for fraud, the myth of New Zealand's green, un-corrupt society was at least partly exposed, although nowhere near the degree to which this had happened in Iceland. Yet in 2011 New Zealand remained at the top of the CPI, the country perceived by its business people as the least corrupt nation in the world.

It is important to note that fundamental attitudes have been "globalised." The 2008 market forces, and the ethos of the private sector—the grist of globalization as it were—had deeply penetrated governments everywhere, including in Iceland and New Zealand. Governmental organizations had become "accountable" businesses, functioning on the ethos of the private sector.<sup>11</sup> The crime of *fraud*, which New Zealand's SFO had increasingly and effectively prosecuted in New Zealand, often looked to be very similar to corruption, on the one hand, and to standard business practices, on the other, as did the massive and unregulated banking expansion in Iceland. Public officials were involved in both cases, although typically as private citizens. However, the news reports emanating from both countries increasingly spoke of "corrupt" practices, and this language escalated to sweeping allegations of corruption. The media was likely reflecting popular discourse, although this, in turn, had the capacity to influence perceptions of corruption, and hence the CPI. In Iceland, the victim of a far more serious economic collapse, the CPI ranking dropped dramatically. In New Zealand, the CPI ranking continued, inexplicably, to rise.

James Scott (1972: 3) noted, in language that is much more relevant to the cases of New Zealand and Iceland, that at its most general level, corruption "involves a deviation from certain standard behaviour...Broadly speaking there are three criteria from which to choose: the public interest, public opinion, and legal norms." The government of China has recently made it illegal to offer bribes, not only to public officials but to anyone involved in any business relationship. This means the problem of corruption is now officially seen to relate not only to the public sector but to the commercial sector as well, whether or not corrupt activities in the latter involve public officials (Wedeman 2011). In China too, the concept of "collective corruption" has

received official recognition—that is, not just the actions of individuals or small groups but also networks of corrupt officials guarded by "protective umbrellas" in the form of officials and politicians, who use their power to "cover up corruption by their subordinates, block investigations, and frustrate attempts to prosecute subordinates who get caught, perhaps in return for a cut of the illicit gains but also for political reasons" (Wedeman 2011: 2). *Bribery, nepotism, influence peddling and official fraud* (usually overlapping) are the four major categories of corruption. The definition of bribery, then, like that of corruption, is necessarily complex. As Daniel Lowenstein (1989: 30-31, emphasis in the original) noted, in regard to the United States:

"...the crime [of bribery] as defined in the federal and most state statutes consists of the following five elements:

1. There must be a public official.
2. The defendant must have corrupt intent.
3. A benefit, anything of value, must accrue to the public official.
4. There must be a relationship between the thing of value and some official act.
5. The relationship must involve an intent to influence the public official (or to be influenced if the defendant is the official) in the carrying out of the official act."

Members of TI-NEW ZEALAND have begun to express their concern that New Zealand's consistently high ranking in the CPI might contribute to inertia and complacency regarding potentially corrupt practices for exactly this reason. On the other hand, New Zealand has benefitted from an absence of a culture of gratuities (tips). In the complex continuum between innocent gifts and corrupt bribes, tips are thought to sit somewhere about the mid-range. John T. Noonan, Jr., a long-term judge in the US Ninth Circuit Court of Appeals, noted in his book, *Bribes*, that gifts and tips (to government officials) "are equally hard to tell from bribes" (Noonan 1984: 688). In this context, he adds, a culture of tipping easily accommodates the development of a culture of bribing. An expectation of gift-giving, in fact, can be translated facily into a rationalisation for bribery. A popular example in the new Pacific nations involves politicians who defend their receipt of certain payments in exchange for their political support, which is seen as an acceptable form of traditional gift-giving. Taito Philip Field, the first New Zealand MP to be convicted and imprisoned for corruption, proclaimed at his trial in 2009 that New Zealanders simply did not understand the time-honoured Pacific tradition of gift-giving. The Supreme Court, which later unanimously rejected his appeal, said that any gift-giving to officials with the power to influence a relevant case represented corruption. Some apparent expressions of philanthropy, for instance, as in the use of private donations to influence local government investment in leisure facilities, can be fraught with such implications of these five elements only the first, that the person bribed must be a public official, is relatively straightforward. The cases of Iceland and New Zealand raise other possibilities, however, including *bank and*

*financial fraud* and *clientelism* as well. Banks, even privatised banks, probably represent critical components of the state, as noted above. Their rampant deviation from accepted banking norms, particularly when they are declining rapidly in assets, represents the perception, if not the legal reality, of official malfeasance in most cases. However, the conditions immediately preceding the collapse of the banking system in Iceland, which had recently become a major European banking centre, and which had created an unprecedented accumulation of capital in that country without the creation of industrial or agricultural value, did not trigger alarm bells.

Charges of *nepotism*, a possible element of the perceptions of corruption in Iceland, given the sense that traditional clientelism led to the handing over of the banks to major families, have declined rather dramatically since the early and mid-20th century, when Western governments increasingly embraced the merit principle to displace political patronage in civil service recruitment and promotion. Anti-nepotism laws, as such, have largely disappeared, replaced by constitutional commitments to the idea of "political neutrality" and professional, merit-based public service. It has also become the norm in most Western states that close family members can occupy official positions, often in the same government department, for example. It is also increasingly the case that *spousal accommodation* is practised (in public universities, for example) to attract top academic candidates. However, if a public official uses his or her influence to give advantage to a relative, this clearly constitutes a conflict of interest, and hence a contemporary example of nepotism. For example, the then head of New Zealand's immigration service, Mary Anne Thompson, was seen to have practised nepotism (as well as previously misrepresenting herself through some fraudulent CV details) in 2008, in attempting to gain residency to New Zealand for some of her Pacific Island extended family members.

*Influence peddling*, the most insidious of the categories (although it shades neatly into bribery) is the most difficult to detect. Did it explain perceptions of corruption in Iceland? It is generally identified by assumption: thus, if a public servant has inexplicably large assets, this may be proof positive of a *quid pro quo*, an exercise of influence in exchange for personal financial gain. A court of law must determine any such relationship, a difficult task at best.

In an era when the marketing of government goods and services has increasingly held sway, *official fraud* has become much more of a problem. As noted above, official fraud can be as limited as including false information in a CV in pursuit of public sector employment or promotion, or as extensive as misrepresenting the state of a government's finances in order to maintain or improve the value of government bonds. Again, the difficulty in determining a legal definition of official fraud should not be underestimated. Is bank fraud the primary link to perceptions of corruption in Iceland?

It seems far likelier that perceptions of Icelandic corruption, and ostensibly

corruption in New Zealand, will devolve upon some notion of *political corruption*. Joseph Nye (1967: 417) noted in his influential discussion of the relationship between corruption and national development that, "not only is the study of corruption prone to moralism, but it involves one of those aspects of government in which the interests of the politician and the political scientist are likely to conflict." In its most primary form, *political corruption* is "the misuse of public office for illegitimate personal gain." The conundrum presented to lawmakers who would pass legislation making "corrupt" acts "illegal" is plain: they simply will obtain no particular guidance from this definition, other than the mandate to make illegal those acts that "should be" illegal. In 1999, Susan Rose-Ackerman saw corruption as "a symptom that something has gone wrong in the management of the state" (9), following on from her classic 1978 economic definition of corruption as one of many "allocative mechanisms" for the distribution of scarce resources (Rose-Ackerman 1978:1), particularly in cases where the government has attempted to limit market incentives. For his part, Nye (1967: 419) argued that corruption poses serious problems: "Broadly defined as perversion or a change from good to bad, it covers a wide range of behaviour from venality to ideological erosion." His definition is therefore laden with examples:

Corruption is behavior which deviates from the formal duties of a public role because of private-regarding (personal, close family, private clique) pecuniary or status gains; or violates rules against the exercise of certain types of private-regarding influence. This includes such behavior as bribery (use of a reward to pervert the judgment of a person in a position of trust); nepotism (bestowal of patronage by reason of ascriptive relationship rather than merit); and misappropriation (illegal appropriation of public resources for private-regarding uses). This definition does not include much behavior that might nonetheless be regarded as offensive to moral standards. It also excludes any consideration of whether the behavior is in the public interest, since building the study of the effects of the behaviour into the definition makes analysis of the relationship between corruption and development difficult (Nye 1967: 419).

Having said all this, however, the complexity and multi-faceted nature of definitions of corruption stand in stark contrast to the visceral sense, that most people have, that corruption consists of government officials misusing (however that word is defined) their influence as office-holders for personal gain (in various forms). It is also far easier, as Nye's definition shows, to describe some of the key expressions of what is popularly regarded as corruption. According to Nye, *bribery* typically stands out as the most egregious, if often the most harmless, category. *Nepotism* is likewise regarded as a major component. *Misappropriation* of public resources is another fundamental notion. Nye does not mention *influence peddling*, although this is clearly implied in his conceptualisation of corruption. Other forms of *gross immorality* by public officials can combine with the above to constitute corruption as well, though such forms may more commonly be referred to, in their own right, as "sleaze." Peter deLeon (1993: 25,



*emphasis in the original*) summarises the definition of *political* corruption inclusively:

Reduced to its quintessential meaning, *political corruption is a cooperative form of unsanctioned, usually condemned policy influence for some type of significant personal gain, in which the currency could be economic, social, political, or ideological remuneration.*

With Nye's and deLeon's conceptualizations, we come full circle. Corruption, it seems, is corrupted influence. General perceptions of corruption, and the level of corruption, are probably its most accurate measures. However, while definitions vary and are often pointedly vague, there is little disagreement that the causes of corruption require careful study, because the costs for society of corruption are often extremely high.

Among the hundreds of empirical studies, only a few substantiate any close correlative relationships, or possible "causes" of corruption. The strongest of these, as noted by Johann Lambsdorff's (1999: 2-12) macro-analysis, are: government involvement in private markets, a large government budget relative to GDP, heavy government regulation of the private sector—or, ironically, too little government regulation of the private sector—low levels of civic cooperation and trust, low civil servant salaries relative to manufacturing salaries, low levels of economic competition, and contact with corrupt global markets (1999:12). Lambsdorff's analysis points to studies that have shown that an abundance of natural resources, and a cultural acceptance of social hierarchies are conditions that favour corruption. The rapid onset of the perception of fabulous wealth in tiny Iceland, an abundance of resources beyond all imagination, followed by sudden impoverishment, would clearly have triggered this sort of response.

Perhaps the greatest potential political cost of corruption is a decline in democratic *governability*, of particular concern in regions of high corruption, such as South America. John Bailey (2009: 60) defines democratic governability as encompassing "not only how power is achieved and the rules of the game (democracy as regime), but also the exercise of power by state agencies acting within a legal framework to address priority problems in a society (governability)." In this sense, corruption represents a kind of illegitimate privatisation, and therefore a weakening of government, just as informal economies marginalise governments. Iceland's dynamic democratic responses to its crisis, throwing out the government deemed responsible, electing a human and progressive government in its place, and writing a new national constitution, all with high levels of participation and consensus, seem to be direct responses to just the sort of political corruption that Nye and others have discussed.

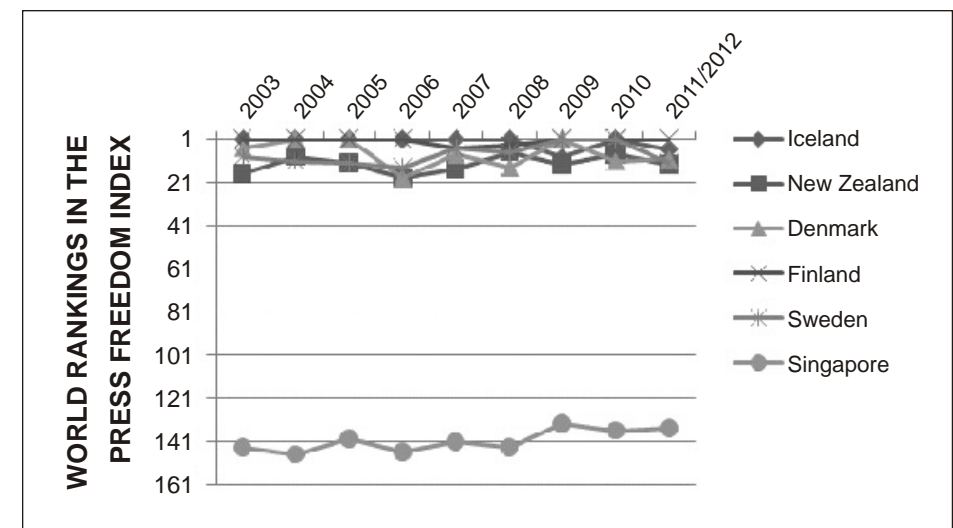
The economic and political significance of corruption at a global level is notoriously difficult to determine. However, the last Transparency International global

survey noted that almost six out of 10 respondents reported that corruption levels in their country had increased over the three years to 2010. Furthermore, eight out of ten respondents judged political parties to be corrupt, making this the most corrupt institutional sector. Not surprisingly, government action to fight corruption was often seen by respondents to be ineffective. Bribery was thought to be commonplace: one out of every four users of public services reported paying a bribe in the previous 12 months. This evidence suggests that costs are very significant in some jurisdictions.

## Conclusions: Clientelism, Corruption and Perceptions of Corruption

Perceptions of corruption in a given society can bear some relation to legal frameworks as well as to the freedom accorded to the media. A key element of our conclusions involves legal frameworks, and their relationship to perceptions of corruption, as measured in the World Governance indicators. First, however, it may be useful to examine the freedom of the national media as a means of comparison. A free and active media, it would seem, can relate to a popular awareness of the possibility of corruption, at least in democratic countries. An examination of the World Press Rankings Index since 2003 (when all six of the top CPI countries were first included), demonstrates that, except for Singapore (which ranks below most of the countries of the world in this index), the top CPI countries tend to be countries with largely free presses:

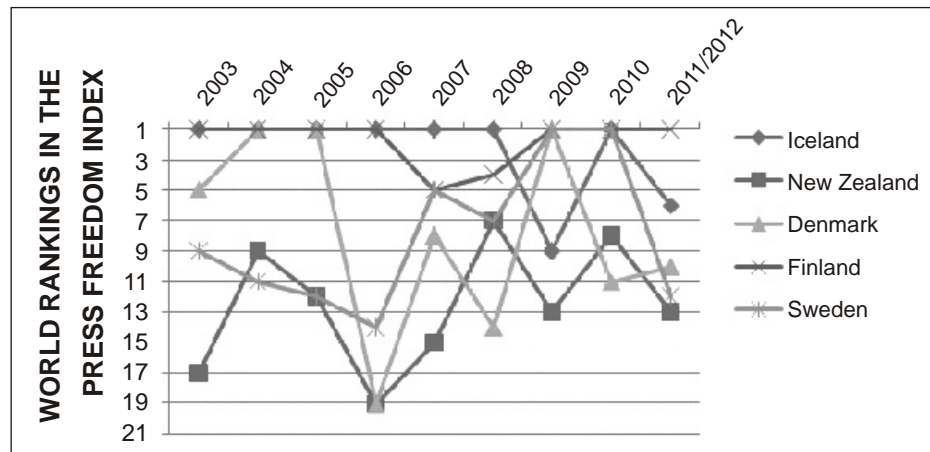
Figure 6: World Press Freedom Index for Top CPI Countries



Source: <http://en.rsf.org/press-freedom-index-2011-2012,1043.html>

A closer examination of the relative rankings, with Singapore excluded, demonstrates a good deal more variability year-to-year than in the CPI, HDI or other major indices:

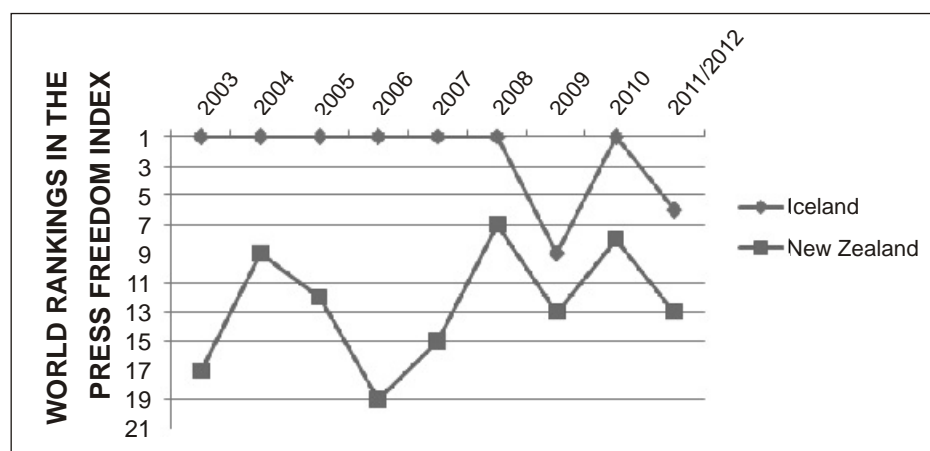
Figure 7: Press Freedom Rankings for Top CPI sans Singapore



Source: <http://en.rsf.org/press-freedom-index-2011-2012,1043.html>

The principal observable characteristic of this index over time for our purposes is the similar patterns after 2008 evinced by Iceland, Sweden and New Zealand. If we examine Iceland and New Zealand's scores in the Press Freedom Index against each other, they evince very comparable patterns after 2008, despite Iceland's dramatic drop in the CPI, and New Zealand's continuing status in first place. It is difficult to explain the comparability, and New Zealand's lower ranking, in the context of comparative rankings in the CPI. We are left with the conclusion that media reports may have less to do with perceptions of corruption than we might suppose.

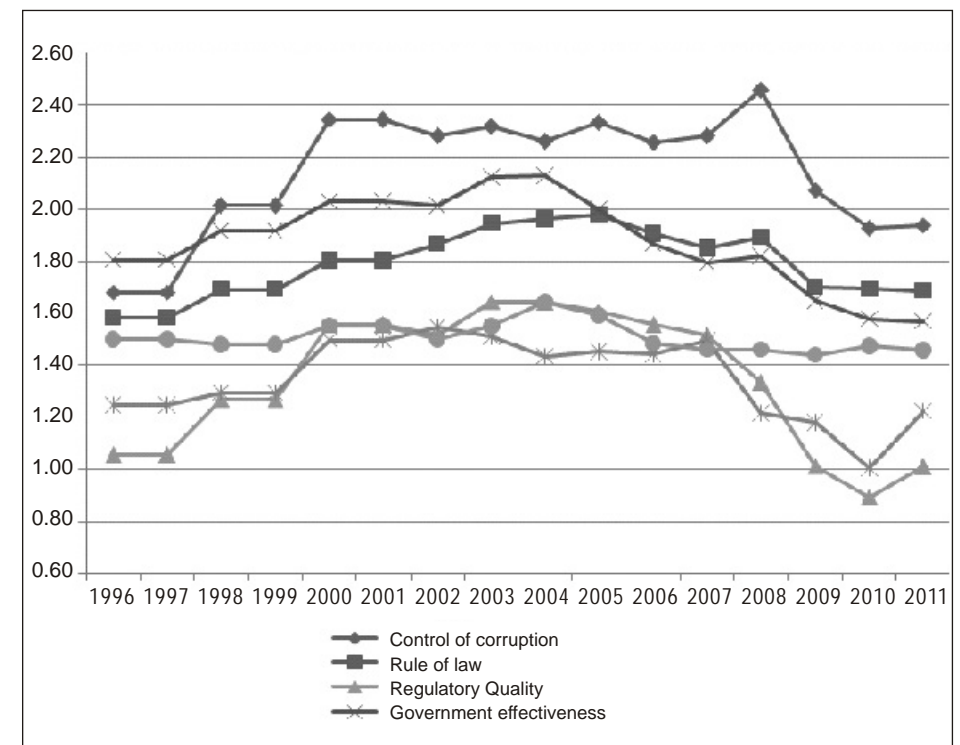
Figure 8: Iceland and New Zealand on the Press Freedom Index



Source: <http://en.rsf.org/press-freedom-index-2011-2012,1043.html>

The *World Governance Indicators* project (Kaufmann, Kraay and Mastruzzi, 2010), based on a compilation from a range of data sources, much like the CPI,<sup>12</sup> point to a range of indicators that clarify both the close comparisons and striking differences between the top-ranked CPI countries, as Figures 6 and 7 suggest. The five indicators employed by Kauffman, Kraay and Mastruzzi (2010) roughly correlate in the case of

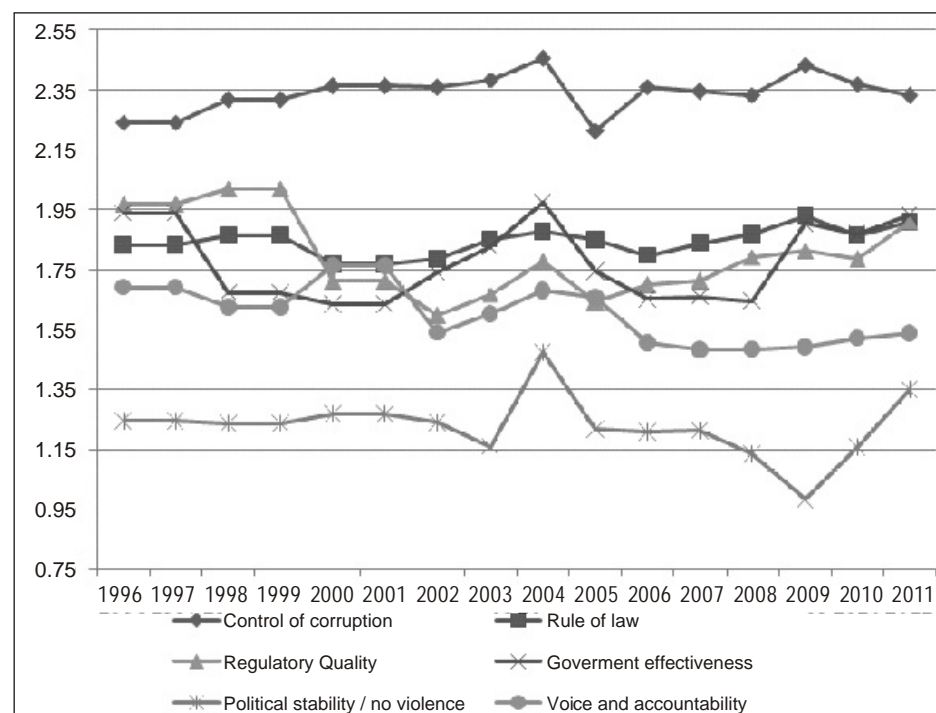
Figure 9: Iceland World Governance Indicators, 1995-2011



Source: Kaufmann, Kraay and Mastruzzi (2010).

Iceland. In particular, "political stability/no violence," "regulatory quality," and "control of corruption" all dip (and then recover, to some extent) simultaneously after 2007. It is a pattern that reinforces our understanding of the dramatic rise of perceptions of corruption in Iceland during that period, as indicated by the CPI. The indicators for New Zealand, however, as noted above, are confusing at best, and do not seem to reflect complementarity. In particular, a significant dip and then major rise in "political stability/no violence" after 2008 was accompanied by a significant rise in the "government effectiveness" score, and a slight rise and then gradual decline in "control of corruption." While this latter score fits the continuously high CPI score, the pattern is counter-intuitive as regards the first two scores.

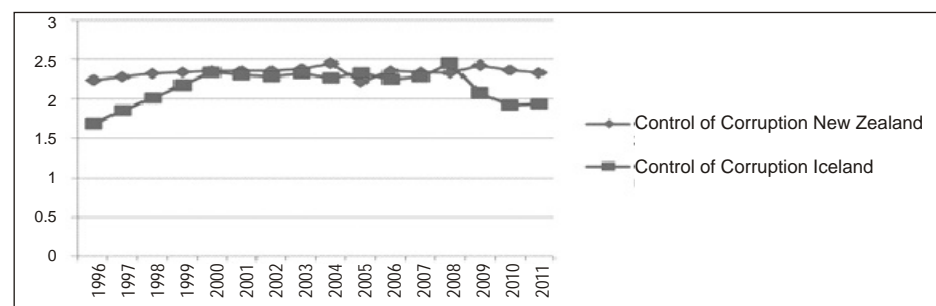
Figure 10: New Zealand's World Governance Indicators, 1995-2011



Source: Kaufmann, Kraay and Mastruzzi (2010).

It seems likely that Iceland's tradition of clientelism, or "northern clientelism" (Kristinsson 2001) ultimately complicated its ability to control corruption *after* the collapse of its banks, as Figure 8 clarifies. However, the drop in Iceland's HDI relates to the apparent rise in perceptions of corruption, particularly given that the financial institutions of Iceland were integral parts of the state, privatized or not. This would seem to explain the rise in perceptions of corruption in Iceland's largely un-corrupt society after 2008. New Zealand's scores in the World Governance Indicators suggest that there has been little variability over the last two decades, save for 'Political Stability/No Violence,' which seems to have changed a year prior to national elections, and may well represent the anticipation, rather than the reality, of change.

Figure 11: Control of Corruption in New Zealand and Iceland, 1996-2011



Source: Kaufmann, Kraay and Mastruzzi (2010).

Would this represent a similar problem for New Zealand? While the severity of the change in Iceland is unlikely to occur in New Zealand, it is reasonable to suppose that two elements in the rising perceptions of corruption in largely un-corrupt Iceland might eventually apply. First, as the general well-being of a population declines noticeably as the result of the failure of financial institutions, this seems, at least in the case of Iceland, to relate directly to an increase in perceptions of corruption (and a decline in the CPI). The collapse of a range of quasi-banks, loan and investment firms, in New Zealand between 2009 and 2012, and the prosecution of many of their directors (including financial and political elites) for fraud, on the face of it do not bode well for the future of New Zealand's top ranking in the CPI. Second, Iceland's relative inability to exercise effective controls over corruption during the financial crisis, perhaps in part because of a lack of preparedness—institutional and procedural measures already in place—contributed to the significant rise in perceptions of corruption in that country. Moreover, in countries with very low corruption rates, the recognition of corruption is difficult. As Trætteberg noted, "businesses and the society as a whole were largely unaware of the level of corruption in Iceland and therefore unable to address it properly" (2010: 371). It would seem that, like a Greek tragedy, Iceland's *agonistes* ultimately stemmed from its hubris and/or complacency, a near-fatal flaw in either case. "We are not a corrupt country," the reasoning apparently went, "and thus we do not need a modern and effective anti-corruption protocol." While these are disturbingly similar beliefs to those prevailing in New Zealand today, not every case of overweening complacency necessarily results in a tragedy. Reassurance comes with a capacity to successfully answer the question: why not?

## Notes

1. Mishkin and Herbertsson (2011: 107) note that "Iceland is unique in that it is the smallest country in the world to have its own currency and flexible exchange rate."
2. Chartier notes that "for many foreigners, Iceland [prior to 2008] represented a model, an ideal, almost a utopia, that seemed unshakeable" (2010: 39).
3. Johann Lamsdóttir's (1999) key macroanalysis of corruption papers examines dozens of learned studies of the measurement of corruption and concludes that public perceptions (as defined by the CPI to emphasise business people) are the most accurate and consistent measurement.
4. Chartier, after examining hundreds of newspaper reports on Iceland's crisis, referred to the "incestuous climate in Iceland's spheres of power [that] weakened the country's economy by undermining the checks and balances..." (103).
5. The HDI brings together data on life expectancy, income and education levels in an algorithm that tends to maintain stable scores over time, but whose relative rankings evince greater year-to-year change than does the CPI.
6. A banking collapse was out of the question, given that most of New Zealand's banks are Australian, and are heavily regulated under Australian law. However, the collapse of the financial institutions, quasi-banks in many instances, ruined thousands of people, many of whom were business people, and should have registered in the CPI ranking if this relationship between the HDI and the CPI were causal.
7. As Timothy Mitchell noted in 1991, "The line between state and society is not the perimeter of an intrinsic entity, which can be thought of as a free-standing object or actor. It is a line drawn internally, within the network of institutional mechanisms through which a certain social and political order is maintained" (90).
8. "Many 'gift quota' recipients were quick to sell off their interest in the fishing industry to while away



- the dreary Icelandic winter in their vacation homes in Spain, while Icelandic fishermen struggled against the cold Atlantic winds far off at sea" (Thoroddsen 2011: Kindle loc 214-16).
9. A similar comment was made by New Zealand's Commissioner of Police, quoted in Gregory (1995).
  10. While Britain has simply limited its definition of corruption to bribery (Doig 1996: 36), the narrowness of this definition has led to complications from time to time.
  11. Gregory (1995: 59-60) has noted in the case of New Zealand in this regard that, "In state sector reforms there has emerged a huge contrast between the fulsome attention paid to accountability and the very sparse consideration of responsibility". He adds that, "Whereas accountability is expressed to another party or other parties, responsibility is accepted for the actions of oneself or others" (emphasis in the original).
  12. The World Governance Indicators follow 31 different data sources, including surveys, much like the CPI's 12 primary data sources for most countries.

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## Transnational Subcontracting of Filial Piety in East Asia? Contradictions of Cross-Borders Home-Helping Regime in Ageing Societies

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### Abstract

*Foreign home helpers (FHH) for domestic works in middle-class families becomes norm in East Asia: over 285,000 FHH are working in Hong Kong, whilst Taiwan employs around 170,000 FHH to serve the frail aged — more and more families are taking such option (innovation?) to cope with the caring of their aged seniors. Obviously, a new regime of transnational care is establishing as flexible labour regime and income differentials in East Asia enable FHH to take care of the elderly — due to (female) labour shortage and the preferred caring for the elderly at home. This seemingly attractive alternative option is also an extended form of filial piety (FP, respect and taking care of the seniors) sub-contracting that FHH serve for the aged 24-hour as they live-in, paralleling the round-the-clock global production regime. Socio-culturally, the modus operandi of "out-sourcing" and "sub-contracting" of traditional customs, particularly filial piety, confirms the socio-economic changes of family system in 21st Century Asia. FHH are one of the major the carriers for the (withering) cultural virtue of FP, yet they bear contradictions in hyper-modernizing Asia as well: migrant workers are at best are nomadic with minimal terms of social inclusion (-as outsider of the society); but FHH are indeed the "insider" of the family as they know the daily tasks of it — and in some instances they enable the socio-cultural norms (filial piety) re-making. For public policy development and social innovation, this paper examines these contradictions and dynamics, in a new flexible labour regime for caring ageing population.*

### Hyper-Modernizing Economic-Demographic Miracle: Asian Ageing?

Three distinct dynamics are intertwined yet interacting in Asia's newly industrializing economies (NIEs: South Korea, Taiwan, Hong Kong and Singapore, mainland China). Firstly, the hyper-modernizing demographic transitions towards ageing society; secondly the emerging regime of flexible (cross-border migrant-workers for domestic home helping or caring) labour market with more and more mobility of foreign home-helpers (FHH), and last but not least the (rejuvenation of the) thousand-

year old social norms and virtues for filial piety (FP)—taking care of one's aged parents, in terms of inter-generation reciprocity (Ting 2009a/b). To cope with the ageing challenges, the differential adaption of all three dynamic forces will shape the destiny of social development. Examine the developmental trend and dynamics, this paper addresses to the implications for elderly policy development and social innovation.

Asia's Confucian societies like the Greater China (of Hong Kong, Taiwan and mainland China), South Korea and Japan, have their common social foundation with social virtues of filial piety—intergeneration and reciprocal care for the seniors (Ting 2009b). With no exception, these social values, norms and ethics have been shaping and framing many public policies development, ranging from public housing provision and health services to family-based elderly care.

For the last few decades, the hyper-modernizing economic miracle in the globalization project has been leading its demographic transitions; problematically manifesting as a global challenge due to the ageing momentum which is at its high speed in recent decades (Lai 2007, 20008a/b). To put ageing dynamism in its historical place, the United Nations estimates in 2007 (UNPD 2007) noted that the societal ageing ratio (percentage of those age 65 or above in the total population), in the developing countries, was a low at 6% in 2005, but was forecast to rise to 7.5% in 2020 and 14.6% in 2050.

Hyper-modernization goes along with hyper-urbanization processes, enhancing the individualization of social development. The estimates by the United Nations (2009) confirm such trend too. Hence, their elderly ratio was forecasted to double in around 30 years. According to the estimates, from 2009 to 2050, the number of persons aged 60 or over will grow almost to triple, globally, increasing from 739 million in 2009 to 2 billion by 2050. For the same period, a correspond increase from 65% to 79% of the world older person live in the less developed regions (U.N., 2009, p.x). Here, the demographic challenge is not only for the developed countries with a decline birth rate and prolonged longevity, but also for newly industrializing economies (NIEs) which follow a speedy rate of ageing trend in recent decades, East Asia in particular (Lai 2007, 2008a). China is one of such examples that, due to its one-child policy since 1979, it has over 12% of the population are aged 60 or above in 2009; but will gradually rise to 33% in 2050 (Xinhua News Agency, 4 July 2009).

The global ageing challenge, as stressed by the U.S. Centre for Strategic and International Studies (CSIS 2009), has a strategic significance for human survival if the problem is not probably dealt with. The critical problems for ageing society in developing economies are many, not least are the 'cash'—the financing (in terms of health care and pension system), the labour supply for caring services—the 'care' of the fragile aged (CSIS 2009, Jackson, et.al., 2009; see Figure1).

**Figure 1: Asia in Global Ageing, 2013** (% of Population aged 65 or above)

Japan	23%	Italy	20%	Swiss	16%
Hong Kong	13%	Sweden	19%	U.K.	15%
Taiwan	12%	Germany	18%	Netherlands	14%
South Korea	12%	Norway	17%	USA	13%
China	11%	Spain	17%	Australia	13%
Singapore	9.5%	Austria	16%	Canada	13%
		France	16%		

Source: the author's compilation from various sources from references of this paper

Compared with ageing process in the Western developed economies, demographic transitions began much later in East Asia than in the West (Mason and Kinugasa 2008), but the momentum is more dramatic with a hyper and speedy one (Lai 2008a, Tsuno and Hooma 2009). In less than 30 years, demographic transitions occurred in Japan and all Asia's NIEs: South Korea, Taiwan, Hong Kong and Singapore. These countries have been transformed from the high birth and death rate population model to a low birth rate (less than 1.5 in terms of Total Fertility Rate, TFR) and ageing one. Japan had 23% of the total population aged 65 or above, whilst Korea achieved 11% in 2012 (Birdsall, et.al. 2001; Rostow 2000; Lai 2007, 2008a; NIPSSR 2012, 2013).

Historically, Japan led the post World War II rapid economic development in East Asia, from mid-1960s to 1980s, and later followed by South Korea, Taiwan and Hong Kong and Singapore in the 1980s to 1990s. They are undoubtedly representatives of the phenomenal East Asian Economic Miracle, a term coined by the World Bank (World Bank 1993). Here, the positive role of the baby boomers at the post World War II industrialization is important, supplying sufficient labour force for economic development; but the developmental trend towards ageing is the history, which will be likely repeated in other NIEs.

The demographic transitions in Japan (since 1960s), South Korea and Taiwan (since 1970s) towards ageing society have been very much due to natural growth—all three countries are a "closed" population system with minimal immigration (less than 1.5% of the population); China resembles such a closed system. Whilst the population systems in Hong Kong and Singapore are somewhat relatively "open", with large immigrants throughout the second half of 20th Century. In spite of the differences in the population systems, all economies experience demographic transitions towards ageing, with a decline of fertility and mortality (Mason and Kinugasa 2008).

Global ageing is a challenge for every developed economy. The destiny of any country's economy depends on longevity: the demography driven demands to shape community and service market (Beck 2000; Milanovic 2003). As demographic transitions developed, there is, and will be, shortage of manpower to take care for the



ageing family members; especially to fulfill the virtue of caring the aged in Asian familial-cultural ethos.

### The Remaking of Thousand-year Old Filial Piety in 21st Century Asia?

In East Asia, Confucianism defines socio-cultural ideals for China, Korea and Japan in particular. One of the key virtues of Confucianism is filial piety (FP)—taking care of the ageing parents in one's life course. The obvious virtues are shown in the Chinese classics, the *Twenty-Four Paragon of Filial Piety*. Here, social reciprocity and familial loyalty, following Confucian norms, attribute to FP as both virtue and behaviours (Chow 2006, Meyer 2000).

With blood-tie, the sense of belonging and togetherness and the synergy of time, space and the upward oriented inter-generational social reciprocity, define FP. The most obvious, or the extreme manifestation/demonstration of FP, presents in funeral activities—customs, ritual and rule; yet the customization of funeral can easily move into a service industry. More specifically, funeral ceremony marks the end as well as the new beginning of FP (Lee 2003, Suzuki 2000).

Yet, there is a global trend of lowering fertility rate as rapid economic development: all Asian NIEs have been experiencing a significant drop of total fertility rate (TFR) to less than 1.5 per woman (K-S.Chang 2003, M-C.Chang 2004, Eu 2003, Golini 2003, Tu 2003, Yap 2003). Hence, the supply side of FP (sons and daughters) is sharply reduced following the drop of TFR. In this section, socio-economic familial changes will be discussed in relation to the FP practice—caring the elderly.

### Work Life Balance vs. Intergenerational Caring: Overloading or Burnt-Out?

Under economic liberalization, particularly for labour mobility in hyper-modernization, traditional role model for caring the aged within the realm of FP has its limits, if not withering away: a nation-wide survey by the Japanese Ministry of Health and Welfare in 1994 found that 60% of the care-givers thought their burden was too much. Furthermore, the ever-increasing demand for paid job performance and the service for family life are making heads of family (women in particular) overloading, if not burnt out; the burnt out tendency will be much increased if the duty of FP is included in the consideration.

This is in strong contrast to the early 1970s that women were willing to scarify for FP; Salaff (1995) has rightly pinpointed, and it has been well researched by feminist literature, that the down-side of FP in Asian societies and family (in the case of Hong Kong) during industrialization era, has been exploiting the women's life chance. To cope with external demands that the family members are differentially, gender-specific, exposed to the burden of responsibility, women (the never-married daughters and/or

daughters-in-law) are mostly positioned to bear the FP responsibility (Sung 2003, Zhan and Montgomery 2003). For Chinese patriarchy culture, which is contradictory in nature, women mostly have to be scarified for familial goals (Meyer 2000).

Under a more flexible, globalizing, production regime, workers have to moving into different localities for job and to engage in a 7-day-and-24-hour (7-24) working cycle—people are more nomadic yet less available for taking care of the ageing parents. More specific, the modern societal and economic demands for family (and its members) are more than ever under the conditions of labour market restructuring and uncertain economic outlooks. Women participation in economy becomes a norm yet this undermines the time-space arrangement for managing work-family life. Except family gifted by economic and cultural assets, most families in present economic conditions (ups and downs of business cycle) are under stress, though most families can still be functional but not healthy.

For younger generations, the modernist ideas of planning and choosing how to live one's life fit into the neo-liberal economics of consumer sovereignty: people have the idea that their own actions determine their own success or failure—definitely this orientation is exactly the spirits (ideology) of Asian Miracle and its instrumentalism for welfare development (Kwon 2005). But the built-in effect of this orientation is the repetitive planning (for better alternative choice) without the moral calling (have to get married and give birth) for actual experiencing the social reality on the one hand, and the procrastination of the social life-task (responsibility) in the name of continuing learning, life-long education—the biographization of life course (Vinken 2004; Mayer 2004). But all these shape the de-standardization of life course, developmental tasks and moral obligations that have not been taking up by younger generation—these are the inertia for those kid-adults to moving on to take up social (citizenship) responsibility, as well as the familial one of FP (Lai and Abe 2005).

More specific, global economic restructuring creates the sense of uncertainty, particularly in labour market: job insecurity and instability for people; particularly for the younger generation. This sense of uncertainty is paradoxically anchored with the ever-increasing calculative, rational planning for possible future work and familial engagements (FP against which job, where to live, with whom for courtship and marriage, etc.). The systematic planning future is not just affecting the younger one, the middle-age workers are called upon for retraining, as well as their continuing education (Beck 2000).

The upwardly mobile, better-off family (in comparison with their previous cohort) dynamics reinforce the delaying and "exit" strategies of the younger generation not to take up socially expected role for adulthood, fatherhood / motherhood... as well as FP. Furthermore, the developmental state's further extension of higher education (postgraduate level), equal opportunities for men and women, and the promotion of

progressive rights for women, also reinforce the personalized, individual choice for alternative life course. In short, the global system-demanded high mobility (working across-borders) and flexibility (working at home and off-hour over time work) of the labour is the embryo for disruptive family life course and cycle: late or never marriage, or no FP duties, reflecting the individualistic lifestyle orientation, as well as the lifestyle options-seeking and experimentation for both sexes; particularly the case for those who want to be 'career' woman than housewife.

### Commercialization of Elderly Care: Short-Cut to, or Short-Circuit of, FP?

Thanks to economic liberalization driven labour specialization and mobility, commercialization-cum-professionalization of nursing care for elderly seemingly is a way of FP sub-contracting—the role of carer shift from one's blood-tied family member or relative to the outsider of the family (see Lai 2007, Lan 2002 for discussion on sub-contracting and out-sourcing of elderly care): the state funded welfare agencies sometimes reinforce this trend—perhaps the more extreme form is the so-called 'Social Hospitalization' (Lai 2001, Wu 2004, MHLW 2008).

Adjusting and adaptive to the ever-increasing care-burden (short cut to, and short-circuit) of FP will become a permanent feature of caring the aged, in our hyper-modern life course. In reality, professional care protocols (regulations on family member-visitors) are more often than not, unintentionally limit the extent of FP. Or, in its variations, professionalism legitimizes a regime of FP sub-contracting; for instance, mobile-ambulance (day/time) caring regime in the so-called community caring regime. In short, the state intervention shapes the very different, mostly with unintended consequences, form of caring regime and therefore FP can be negotiable and adaptive, even following the logic of marketization (Lai 2007, Lan 2002). Distancing from their traditional role of familial carer, in a highly competitive society, women have to work and be independent—that is the new form of the (Western state) sponsored feminism. They gain money from paid work, and renegotiate the caring role with the husband or their parents.... Yet, daughters-in-law turn to the employment of waged caregivers not only because of their shortage of time and to lessen the burdens of labour, but also to retrieve some autonomy from the authority of their mothers-in-law (Lan 2002, Kim et al. 1991, Kim and Kim 2003, Liu et al. 2000).

For caring the aging population, in Asian societies excepting Japan, migrating guest/foreign domestic labour is more than obvious. More recently, in Hong Kong, it is not uncommon that in private middle-class nursing home, foreign home helper (FHH), totally over 285,000 in 2010 (see Fig. 2), are also assisting the more formal case, though the children and relatives of the aged do visit them regularly. And the trend for FHH home and elderly care is prevailing and likely to be part of the Hong Kong (middle class) family system; isn't it a new version of caring regime powered by mobile guest workers or out-sourcing and/or sub-contracting of elderly care?

**Figure 2: Foreign Domestic Helpers by Origin in Hong Kong, 2011**

	Philippines	Indonesia	Thailand	Others	Total
2005	118,030	96,900	4,510	3,760	223,200
2006	120,788	104,129	4,292	3,572	232,781
2007	123,545	114,411	4,072	3,503	245,531
2008	23,943	123,341	3,820	3,493	256,597
2009	129,875	130,448	3,858	3,597	267,778
2010	137,313	140,941	3,695	3,732	285,681

Source: Hong Kong Immigration Department

The caring *modus operandi* of the filial piety out-sourcing and sub-contracting regime is seemingly functional and coupling with the state-advocated familism, which emphasizes on the quality of care and less-resources for better-quality of family life, in open (labour) market where efficiency and timeliness are the key for success. Yet, the adoption of FHH in family and/or community life is becoming a norm in Hong Kong, Singapore and Taiwan; and for this, Japan is timely considering this option to cope with labour shortage in the long term care for ageing population.

### Familial Duties Out-sourcing under Flexible Regional Divisions of Labour

The (ideologically driven) neo-liberal global project, i.e., the creation of global free market and the dominance of Anglo-American capitalism within world's economic regions, has been cemented by networks of transnational corporations. In addition, free market capitalism is reinforced within the frameworks of global economic institutions, like WTO, IMF, World Bank and G7, which enable the further deregulation, privatization, structural adjustment programmes, and limited government. The globalization project is by default a regime of migrating (free flow of) labour supplies. But the globalization processes hence have put state-society at very peculiar position, as both exposed to the challenges of 'external' forces: capitals, goods, labour (and jobs) are more mobile than the previous regime of global order. Here, migrant labours become important for those (dirty) works not readily taken up local people.... This is particularly the case for the long-hour caring work tasks which require specific temporal locality-bound, in-situ (not transferable), *modus operandi* of service delivery: guest home helpers (domestic maids in the olden days)!

### Borrowed Time from Guest Work for Filial Piety in the "Care" Market?

To highlight and specify the new *modus operandi* of caring the needy ageing population, we take the case of Taiwan as example in this section.

The 2008 estimate for the aged (65 or above) population in Taiwan were 10% of the total population, with the long term nursing care service need for the ageing population is ca. 396,000 senior adults, and it is projected that in 2028, the aged (65 or

above) population will reach 22.5% of the total population, with the nursing care needs of 811,000 elderly (*United Daily News*, 13 July 2009). The responsibility for caring the frail (396,000) aged persons is unequally divided by three major human labours, of the local (semi-)professional agencies (caring 50,000 elderly), 168,000 FHH-supported home stay and the family members' supported home stay for 180,000 aged persons. (*United Daily News*, 29 May 2009).

Since 1992, with the stringent regime for the certified nursing care needs by the health authority or professionals (very different from Hong Kong's "free-to-hire" model), the importation of guest nursing helper (the FHH equivalent) has been the major source (a form of FP out-sourcing) of human resources taking care of the fragile aged, and in 2008, the total numbers of FHH were 168,000.

But the labour rights of the guest workers are not protected within the labour law in Taiwan—their official social rights are minimally attached to the norms of labour market. This neglect of, or the abuse on, guest workers are among hosting societies in Asia (Law 2002, Lyons 2005). Hence, they are the sub-classes of semi-normal citizenship in their host countries. More critically and in spite of the global recession which has stopped the inflow of guest workers to Taiwan, the demand for guest migrants-embedded nursing care for ageing population has never been matched, and the trend for increasing migrant nursing care worker from overseas is more than prevalent.

### Globalization-driven Social Sub-Classes of Nomadic Sub-Citizenship

Welfare rights in the Western (welfare states) have been much theoretically anchored upon T.H.Marshall's concept of social rights—an extended, 20th century capitalist state financed basic welfare provisions, yet integrated part of citizenship rights from civil and political rights won in the 18th and 19th centuries (Holmwood 2000). The fully developed welfare state in the post-war era highlights the state's project for full social protection against developmental risks of human society: constituting nationhood with people solidarity—the very notion of citizenship-cum-social contract, within a closed system of the nation state's population and territorial bound socio-economic development.

On the other hand, the East Asia Miracle demonstrates the alternative to social development that socio-economic progress with people's loyalty and hope for the future—the legitimacy of the governing state, can be derived from the economic contract for "free choice" without a fully developed social (welfare) citizenship regime. Hence welfare citizenship could be decoupled from the labour market social contracting, as long as social contract(s) between the labour (workers) and capital (the firms/government as employer) can work-out economic efficiency in the 'compressed' modernization phase of rapid economic growth (Chiu and So 2005, Paehlke 2003).

Under economic liberalization, the globalization forces reinforce the momentum of labour mobility, the higher rate of globalization links to: the higher rate for both legal and illegal migrants, as well the migrant-workers; and the higher will be the socio-economic disparity and differential in one locality. How to cope with this heterogeneous yet mixed category of the nomads-of-globalization, the newly 'borrowed' sub-citizenship of globalization (minorities? ethnic groups? people-in-transits?), within and beyond the territorial boundary of nation/local state, is a critical social policy challenge (Fix, et.al. 2009; Sainsbury 2012).

Traditional networks and families expose to hyper-modernization demands. Under global labour market restructuring, the unsecured tenure for labour class has exerted tremendous pressure on family system—families under high growth economies have been stretched to their limits for caring those family members with special care, against the context where families are heavily 'taxed' by home mortgage and oligarchic retailing networks.

In reality, lower class and socio-economic deprived migrants are discriminated against not just by their host communities, but also by the systematic neglects (sometime even policy targeting) of the government. In mainland China, over billions of migrant workers lack the parity of living chance, vis-à-vis their counterparts of normal residents with normal household registration in cities; over 285,000 migrant domestic helpers from Southeast Asia working in Hong Kong's families lack adequate social protection, and over 170,000 of migrant domestic nursing-care workers in Taiwan have been problematically surviving.

In East Asia, majority of the female migrant-workers are for domestic work: FHH move from Indonesia, Sri Lanka and the Philippines to the Middle East, Hong Kong and Singapore. Many also come from Myanmar and Cambodia to work in Thailand, but these are largely illegal. Employed in private households 7 day-24 hour (7-24 working mode), these women are lack of normal basic labour rights, deprived of socio-cultural and welfare rights (of social citizenship) and can be very isolated and vulnerable (Stalker 2008; Piper 2008, Ed., 2008). How to integrate these mobile and sub-classes of new comers in the hosting societies needs to be addressed not just in social (security and inclusion) citizenship terms but also in terms of human rights.

### Public Policy Innovations in Nomadic Transnational Labour Regime

Our discussion above highlights the contradictions of the hyper-modernizing, rapidly ageing, Asia and the differential caring regime, human resourced by flexible migrant (predominantly female) workers. FHH are enabling some form of the assisted ageing with care—isn't towards a rejuvenated regime of filial piety? But to what extent can the mobile, migrant labour force in shaping global ageing future? A critical ending remark to the key aspects of public policy innovations is provided here.



Socio-culturally, the *modus operandi* of the "out-sourcing" (from the family member to other non-family member) and "sub-contracting" (the FHH employing agencies and family members downward sub-contracting to the individual FHH) of the traditional custom, filial piety (FP, respect and taking care of the seniors), confirms the change of home care regime in 21st Century (see Lan 2002 and Lai 2007 for detail discussion). FHH in actuality are one of the main carriers for the (withering) cultural virtue of FP, but they are paradoxically as outsiders of the host family and at best a nomadic social sub-class or under-class (vis-à-vis T.H.Marshall's concept of social citizenship), without welfare rights. But the demand for guest workers' FP-compatible job performance is contradictory to their nomadic social (sub)citizenship status (having minimal social inclusion)—FHH are both outsiders (for the hosting family and country) and insiders (working 7 day-24 hour [7-24] within the host family and performing FP duties as if they were the daughter or daughter-in-law) for the socio-cultural norms making! All these have been reinforcing the contradictions within the East Asian family system based upon FP, and exacerbating the problems of exploitation due to 7-24 caring the aged—but FHH have no compatible or equitable economic, social and cultural (ESC) rights. Hence, human rights at large for migrant-labours in hyper-modernizing Asian societies are not protected (Piper, Ed. 2008).

### The Sub-contracting Regime of "Care" by Outsiders-(as Insiders)

The elderly care in Asia's NIEs is a 7-24 caring service industry, mostly staffed by low-paid female workers and/or the FHH. This is within the context of the regional labour migration that the capacity of caring service is substantially upgraded with a new regime of elderly care out-sourcing / sub-contracting and mobile labour force: it seems that nursing home in Hong Kong and Taiwan, if granted more flexibility for guest labour (co-nursing FHH workers), their experimentation will give insights for Japanese and other societies to learn for coping with their ageing population.

The Japan's trade talks with South Korea, Indonesia, Malaysia, Thailand and the Philippines for Free Trade Agreement (FTA) highlights the trend toward a more mobile labour regime for nursing care workers: a few thousands caring workers are planned for elderly care policy experiment. More specifically, Japan wants the Philippines to give greater investment and services trade opportunities to Japanese businesses in the FTA, while the Philippines wants Japan's job market opened to Filipino nurses and lawyers. For Thailand, to lower tariffs on Japanese auto parts, and Bangkok's insistence that Japan open its markets to Thai rice, chicken and other agricultural products, and to ease its foreign labour rules so Thai physical therapists can work in Japan. In actuality, around a few thousands guest nursing care workers from Indonesia, Thai and the Philippines are now in training in Japan -- the importance of guest professionals, para-professionals and guest home helpers are more than obviously demanded by ageing society. Coping with ageing population in East Asia, the regime of flexible nursing or

home-helping labour migration is establishing; though it cannot solve the fundamental shortage of local nursing worker supplies (say the shortfall is nearly half a million in Japan).

From the supply side of migrant workers, we can also see paralleling trend of the importance of female ones in the overall migrant-workers' mobility (see Fig.3). Recent migration studies also show the feminization of migration in Asia region (Piper 2008, Ed., 2008; Yamanaka and Piper 2006). Hence, the female guest workers tend to assume the socio-cultural role of caring agency not just within the familial boundaries, but also extending to the cross-borders trading and commercialized transaction of filial piety.

**Figure 3: Outflow of (Migrant-) Workers and Percentage of Women, 2007**

Country	Outgoing Workers (in 000s)	Percentage of Woman (%)
Philippines	1070	59
Indonesia	593	69
Sri Lanka	204	57
Vietnam	79	57

Source: adapted from Stalker 2008, p.9 and p.12

For the flexible, nomadic labour regime in Asia, three obvious issues need to be addressed. Firstly, the pro-family policy re-orientation should not be targeting to the individuals and families by various types of high profile campaign (using mass media and hence wasting people's time and resource to entertain such events), but we should change the policy and business practice that will enable more freedom and time for family members to interacting among themselves: work-life balance in terms of inter-generational care is crucial for socio-familial development.

Secondly, global ageing is a challenge for every developed economy. We have shown that the back-side of active FP might produce the burnt-out of caregivers, which is prompting to elderly abuse (Yan and Tang 2003). With the demographic trends of fewer children and ageing population, coupled with the economic problems in East Asia is experiencing, attitudes toward supporting elderly parents and aged relatives are also changing significantly. It is becoming increasingly difficult to expect that families will provide full support for their elderly, and the problems of illness and long-term care have been identified as the greatest concern of the elderly (Lai 2001, cf. Ornatowski 1996).

Last but not least, it is not just the disparity of life chance between the rural and urban sector, between the rich and the poor; but also the de-humanization of work, the disharmony (if not conflicts) between work-family life. To cope with the overwhelming demands for caring both the young and older generations by the working class, public policy should re-orientate itself towards an intergenerational care friendly one: the

enabling of FP and parental duties, by granting FP leaves at work place; these are some possible initiatives.

As a social virtue, many Asians (even Westerner) support the filial (piety) duty. But in a turbulent reality of flexible production regime, a mixing of work-and-family life, as well as the nomadic life experience for job (insecurity) and survival, the individual's contribution to FP is quite another thing—all these are contextually negotiated in the de-standardized life course. On the other hand, the ageing population (the more educated one, like us) is seemingly, fatalistically yet realistically, accepting the non-FP reciprocity and they (we in future) do not expect nor blame much about non-fulfilment of filial duty (K-S Chang 2003, cf. Hwang 1999, Jang et al. 2000).

To recapitulate, the new regional labour migration regime enables the shifting of FP burden (who and where to take care of the parents, how and how much?) from the blood-tie and familial one to foreign guest workers, FHH. In actuality, the change of labour regime is being championed by regional and international governmental bodies like WTO and IMF, for the globalization project. But the liberalized flexible labour regime has not provided basic human (economic, social and cultural) rights (minimal social rights) for migrant workers at the hosting countries.

### Home Care in Asia's Nomadic Labour Regime: Opportunism with Curse?

The ageing rate, historically, for doubling of the elderly ratio (from 7% of the total population age 65 or above) used to occur at a steady pace. In the developed countries, it took 105 years in France, 85 years in Sweden, but in Japan, only 24 years. The Japanese case is in fact the fore-runner for Asian newly industrializing economies, like South Korea (Eu 2003), Taiwan, Hong Kong and Singapore, as well as the rapidly ageing China (after 2030). In all cases of ageing population, they are structurally linked to the rapid industrialization, urbanization and hyper-modernization, at a time of high and sustained economic development. Still, caring the aged population is a challenge for all.

Comparative studies have shown that the cultural virtues, say, filial piety (FP), might produce the burnt-out of caregivers (Sung 2003), which is prompting to elderly abuse (Yan and Tang 2003; Lai 2007). Distancing from their traditional role of familial carer, in a highly competitive society, women have to work and be independent—that is the new form of the (Western state) sponsored feminism. They gain money from paid work, and renegotiate the caring role with the husband or their parents. Yet, daughters-in-law turn to the employment of waged caregivers not only because of their shortage of time and to lessen the burdens of labour, but also to retrieve some autonomy from the authority of their mothers-in-law (Lan 2002, Kim et al. 1991, Kim and Kim 2003, Liu et al. 2000).

For individuals, the living chance of living in one's own local communities is contingent upon the ups-and-downs of global business cycle, with a flexible regime of labour productivity and mobility... Here, younger people having no choice but are more nomadic and mobile for paid job anywhere and anytime, whilst the aged one is mostly community-bound and locality-fixated. All these are likely shaping social-familial changes, challenging the very basic ideas of good virtue and customs (say, filial piety) of familial and inter-generational reciprocity in one's own home in the same community (Hwang 1999, Meyer 2000).

For caring the aging population, in Asian societies excepting Japan, the use of guest/foreign domestic labour is more than obvious. The caring *modus operandi* for out-sourcing and sub-contracting regime is seemingly functional and coupling with the state-advocated familism, which emphasizes on the quality of care and less-resources for better-quality of family life, in open (labour) market where efficiency and timeliness are the key for success. Yet, the adoption of FHH working 7-24 in family and/or community life is becoming a norm. More recently, in Hong Kong, it is not uncommon that in private middle-class nursing home, FHH are also assisting the established professionals like social workers and nurses, to perform some basic yet important tasks of nursing care. Their caring role is more than materialist or behaviourist per se; emotional supports for the aged ones are not uncommon: isn't it a new version of caring regime powered by FHH for elderly care?

Under economic liberalization regime and high mobility capital, labour and goods, labour force can be mobile, flexible and adaptive not just to the manufacturing of goods, but also helping to caring the aged as a form of service-for-foreign-currencies (an out-sourcing of FP for elderly care). Recently, the remittances from guest workers overseas back home are important for the local development; this is particularly the case for Asian migrant workers' exporting countries, like Bangladesh, Indonesia, the Philippines, Sri Lanka, Thailand and Vietnam (Fix, et.al. 2009; Piper 2009).

In spite of the fact that the ideal for filial piety is not practical in a turbulent reality of flexible production regime, against the compressing work-and-family life of the nomadic life experience for (most of us are some form of) migrant workers, various studies on the so-called sojourns' mobile communication, using mobile phone for cross-border yet intra-familial communication, highlight the liberating aspect of the benefits of being in the information age: in what P-C. Lan (2006) describes as the global Cinderella with a mobile phone. The icon of the nomadic Cinderella represents migrant workers' mobile communication with their distant family members in the information age.

Who care for those FHH's aged parents? Through mobile phone, migrant workers can enjoy not just inter-generational communication, but also the encrypted informative instruction texting for managing family wealth; the (instruction and the digital proof for)

remittance of fund back to the home becomes a way of life (Migrant Remittances 2005).

As world remittance market is having exponentially growth with flexible global workforces recently, coupled with the ever-increasing mobile phone user by migrant workers, Vodafone and Citigroup launch a Vodafone-branded mobile-based international money transfer service targeting the global remittance market worldwide. (Citigroup 2007). The new (sojourns-targeted) service provides senders and receivers of money with a simple, easy to use, secure, transparent and convenient method for sending money home with mobile phone or via the internet. Hence this new sojourn experience and mobile communication practice can, and will, enable their elders or parents to be readily ageing-in-place, with both communicative and financial supports from remote distance relatives.

To recapitulate, the contradictions in new transnational labour regime of 7 day-24 hour home caring services provided by outsiders (guest workers)-as-insiders, following new FP practices, is contradictory and problematic: when one society's virtues (say FP) become the transnational curse for guest (outsider-as-insider) workers, are not these social virtues still worth to be pursued? The present welfare sub-classification of, or in some cases discrimination against, guest workers (FHH) is more than obvious; not a fair and just regime for migrant workers' economic, social and cultural rights as globally recognized by international communities, nor in accordance with basic human rights.

### Implications for Public Policy Innovation in/beyond Hong Kong

The trilogy of Asia's developmental dynamics—of the hyper-modernization driven demographic lowering fertility and ageing, with a flexible regime of migrant domestic helpers (FHH) and the partially rejuvenated, or the rediscovery, of Confucian filial piety of inter-generational socio-familial reciprocities to caring the seniors and the aged, will likely shape Asian societies' destiny in 21<sup>st</sup> Century. But before any specific policy initiative to taking on the comparative (dis-)advantages of these developing-trendy offerings, there is an urgent need to recognize, as well as to make sense of, the social reality we are in—all these are relevant for the policy initiatives and social innovations.

Obviously, the most important approach for public policy planning and social innovations in the coming years is to bring back, and to re-examine, the case of FHH and their nomadic labour regime, say the least to recognize their role so far for societal-family development: how they fit into different policy development scenarios to cope with the challenges of rapidly ageing population. Up to now, not many policy studies (on housing, children education, family friendly, health care, welfare and elderly alike) have touched upon the several decades existence of (over 285,000) migrant-workers in Hong Kong: though they are almost everywhere in health care clinics and hospitals, nursing homes and outside the schools...all importantly "accompany" the aged, children

and women, family at large. And more importantly, they provide a supportive role for the so-called gender-equality (for the best possible opportunities and achievement for women) in Hong Kong's socio-economic miracle. This reality-check is indeed just a small step towards the so-called (which might be so popularly over-discussed among policy science professionals and politicians) "evidence-based and informed policy making". In actuality, it is great surprising that we (and you) cannot find any existence, hence any role, of such a large women power residing and working 7-24 in several hundred thousand families, in any (both before and after the 1997) Hong Kong government policy papers, executive orders, directives and guidelines. For this, recent policy research on Filial Piety—commissioned by the Central Policy Unit, Hong Kong SAR Government (Ting 2009a/b) is a welcoming one, to re-addressing the (main supportive) role of FHH in family function in a hyper-modernizing society. Hopefully, this realistic calling contributes to Hong Kong's public policy agenda-setting and evolution, as well as social innovations, for the benefits of ageing population, citizens and residents at large.

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## The Sino-Japanese Relations from Jiang Zemin to Hu Jintao: Continuities and Changes of Beijing's Policy Towards Japan Since the Mid-1990s

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### Abstract

*After the Cultural Revolution (1966—1976), it is undeniable that the Chinese Communist Party (CCP) did suffer from severe governance crisis, ranging from 'Confidence, Trust and Religious Belief' among the populace in China. In the understanding of Deng Xiaoping along with his rise of power in 1978, the CCP has been since then supported by three main pillars: economic growth, stability and nationalism. Especially in the post-Deng Xiaoping era, nationalism has long been known as a progressively notable 'artifact' to legitimize one-party rule. From the mid-1990s, China has also witnessed the emergence of a genuinely society-driven nationalism. Although the anti-foreignism stance of society-driven nationalism has at most gone along with the official-led ideopolitical education, its independent existence would still more or less undermine the Party's hegemonic status over the nationalist discourse. In this particular scenario, nationalism will backfire if it goes too far beyond the CCP's control. In this paper, with regard to the development of Sino-Japanese relations from the mid-1990s, I am going to explore how and why nationalism in post-Deng Xiaoping China can be understood as a double-edged sword from the perspective of CCP. Continuities and changes of the Beijing's policy towards Japan under Jiang Zemin and Hu Jintao administrations will be further discussed as well.*

### Introduction

A considerable amount of groups in addition to organizations have their own political systems which make binding decisions for that company, university, college, football club and family. That of course will involve decisions about how money will be spent, who will get which jobs, in addition to how the time will be allocated. With reference to the field of politics, in particular political science, such as the ideas provided by Easton (1979), systematic political scientists have put their attention on the binding decisions made by the political system and implemented for the society as a whole.

In light of the modern state-society relations, people would least likely accept such

binding decisions simply because of coercion. According to Birch (2001), he pointed out the fact that the political authority should be widely accepted by most population so that it may be a sign of the loss of authority when the military, police, secret police and surveillance are always exercised out within the territory. Political legitimacy, differing from coercion as another source of power, is treated as the ultimate pillar which bestows a government with the right to rule in the long run. If a government lacks political legitimacy, there are only relations of power but no authority between leaders and followers. Much of that government's resources will therefore be consumed for minimum survival rather than provided for good governance at large.

In the words of Barker (1990), political legitimacy can be defined as 'the belief in the rightness of a state... so that command are obeyed not simply out of fear or self-interest... because subject believe that they ought to obey'. Simply speaking, it is the subjective belief of people that a government has the authority to rule, and the existing political arrangements and institutions should be noted as the most appreciated ones which can obtain popular support within the territory. Hence, there is probably no exaggeration to say that political legitimacy should be regarded as the prerequisite for a government for maintaining its own stability for a longer time span by rendering laws and decisions authoritative so that the populace can abide by those decisions made by that government.

Political legitimacy is of utmost importance in governance without questioning. Yet the CCP miserably underwent an inevitable legitimacy crisis after the 10-year's Cultural Revolution (1966—1976). Having suffered from this turmoil, the CCP did encounter an inevitable governance crisis by then: it was simultaneously plagued by the lack of confidence and trust from the populace, in addition to the aftermath of banishing religious beliefs in the people of China. Deng Xiaoping, with his rise in 1978, steered China away from Hua Guofeng's idea of 'Whateverism'. This marked the beginning of a new chapter of Chinese history: the era of economic reform and the 'Open Door Policy', in which the order and stability was restored. Since then, the CCP has sustained and legitimized itself by harnessing these three important pillars: economic growth, stability and nationalism (Laliberte and Lanteigne, 2008).

For the governance of China after Deng Xiaoping (i.e., under the rulership of Jiang Zemin and later Hu Jintao), nationalism has been regarded as a progressively crucial 'artifact' besides of economic growth and stability to legitimize one-party rule. Borrowing the words from Gries (2004a), the 'Chinese nationalist politics today exhibits the claim-response dynamic central to the negotiation of legitimacy in all political systems. Popular nationalists both support and challenge the state's claims to legitimacy—and issue their own rival nationalist claims. And the Party (i.e., the CCP) both suppresses and responds to challenges to its nationalistic credentials. The suppression of legitimate nationalistic claims, however, causes the Party to lose face and authority before the Chinese people. Such suppression signals a reversion to

coercive forms of power, undermining regime stability. Successful responses to popular nationalist demands, by contrast, allow the Party to gain face before nationalist audiences, solidifying regime legitimacy'. As Gries stated in his analysis, nationalism since the mid-1990s in domestic China has encompassed an in-depth hidden meaning beyond the original notion known as 'sense of nation': both Jiang Zemin and Hu Jintao have tremendously turned nationalism into a significant source of political legitimacy which can help them generate spontaneous or voluntary obedience and even support for their governance within the nation.

With the nature of a double-edged sword, yet nationalism can still sometime backfire once this tool goes too far beyond the CCP's control. With reference to the Sino-Japanese relations since the mid-1990s, in the following sections, I am going to explore how and why nationalism in post-Deng Xiaoping China can be understood as a dilemma from the perspective of CCP. By looking into how nationalism in China had influenced and shaped the country's diplomatic tactics for Japan, both continuities and changes of the Beijing's policy towards the island nation throughout the times of Jiang Zemin and also Hu Jintao rulership are to be discussed respectively in this paper.

### **Continuities of Beijing's Policy Towards Japan between Jiang Zemin and Hu Jintao Administrations**

#### **Close Bilateral Economic Relations**

In 2001—2006, at the time when Koizumi served as the Prime Minister of Japan, the Sino-Japanese relations were in one of the worst stages, yet the bilateral economic relations between China and Japan did not deteriorate as indicated in *Figure 1*: the Sino-Japanese trade value between 1999 and 2008 still followed a general trend of growth (as cited in Statistics Bureau of Japan, 2009). As Wan (2006) wrote, such bilateral trade in particular saw a significant rise during the time of Jiang Zemin as the Party Secretary (1989—2002). The trend had soared, almost exponentially, from 2002 to 2012 during the era of Hu Jintao. According to the record of Japan External Trade Organization (JETRO), a Japanese government-related organization that strives to promote mutual trade and investment between Japan and the rest of the world, China became Japan's biggest trading partner regarding the dollar volume of exports and imports in 2009, as the global economic downturn in 2008 massively jeopardized the well-being of Japan-US trade partnership (as cited in People's Daily Online, 19 Aug 2009).

The intention of keeping consistent and most importantly mutually beneficial Sino-Japanese economic relations could be clearly detected from the remarks of the government personals of both countries. Li Peng said that 'China's economic growth is not a threat to Japan' (as cited in Wan, 2006); equally, the then Japanese Prime Minister Koizumi openly warned that 'the Chinese and Japanese economies are complementary' (as cited in Wan, 2006). Their respective outward economic policies had remained of



stable regardless of the decline of the general Sino-Japanese relations since the mid-1990s until the early 21<sup>st</sup> century. He (2007) later interpreted that in 'the absence of obvious economic damage (between China and Japan), there should be no strong economic incentives to alter their diplomatic positions'.

These relatively stable bilateral economic relations from the Jiang Zemin era to Hu Jintao administration had primarily to do with the CCP's practical need, which was explained by Samuel Huntington as below. Political legitimacy can be derived from procedural and in the meantime performance means (Huntington, 1991). However, the western-style procedural legitimacy of course cannot be drawn by those non-democratic regimes such as China. One of the tangible characteristics in this particular sense is that elections held in most non-democratic regimes have not been practicing the universal suffrage, resulting in the under-representation for public volition. Without accumulating sufficient public consent and also support from the procedural channel, the CCP can at most be granted political legitimacy from good performance. Conspicuously, a non-democratic state (especially for China after Deng Xiaoping) has no other options but tends to heavily rely on 'performance legitimacy' (i.e., the GDP-led economic growth) for its survival. Thus China's close bilateral economic ties with Japan from the mid-1990s can be rendered as one of the effective means to help China itself further its own economic modernization and globalization, which in turn consolidates the CCP's reign on China.

The close bilateral economic relations from Jiang Zemin era to Hu Jintao administration can be decoded by the notable factor of 'liberal internationalism' (Nakai, as cited in Suzuki, 2009). Although the Sino-Japanese trade relations are not trouble-free, China's ascending integration into the world economy (especially when China was finally approved to join WTO in the late 2001) has increased the likelihood that economic disputes will not be overpoliticized and will instead be settled rather smoothly. As the deepening economic interdependence is exceedingly conducive to reduce political tensions (i.e., historical and territorial disputes) among different polities such as between China and Japan, as a result, the two countries have a more realistic concern (i.e., economic consideration).

### **Nationalism as the Legitimation Tool**

Since the Third Plenum of the Eleventh CCP Central Committee held in December 1978, the paramount importance of 'Marxism-Leninism' and 'Mao Zedong Thought' in China has gradually eroded with the launch of Deng Xiaoping's economic reform and the 'Open-door Policy' in line with the demise of Hua Guofeng's 'Whateverism'. Particularly after the 'June Fourth Incident' occurred in 1989, the CCP initially hoped but eventually failed to re-portray Lei Fung as the role-model for all Chinese youngsters to learn in searching their livelihood (Reed, 1991). In spite of all the efforts paid by the CCP, a study conducted by Zhang and Zhang in Jaocheng county of Shanxi province in 1990 revealed a counterproductive outcome: Lei Fung was extremely unpopular chief

amongst most secondary school students. What was done by Lei Fung seemed naïve and also laughable to them, and most respondents agreed that money was their chief concern instead (as cited in Rosen, 1993).

In order to allow more room for introducing reforms, considerable efforts were made by the post-Mao reformists in order to loosen up the ideological atmosphere. This pragmatic approach has facilitated a more rational management of the economy and most importantly led to economic prosperity. As *Figure 2* indicates, the post-1978 economic reforms have been able to generate a rapid GDP-oriented economic growth in China's 30 provinces (Wang, 2006). However, at the same time, one should bear in mind that not all Chinese have benefited from the economic reforms accordingly.

On 8 October 2006, the People's Daily Online published an article concerning the Gini coefficient of China. As an indicator to measure of income disparity, the Gini coefficient has risen to 0.46, which is considered as an alarming level, whereas other unofficial academic researchers suggested that it could have risen to 0.49 (as cited in Saich, 2011). In present-day China, there are indeed numerous deprived groups such as a large number of workers being 'laid-off' or even unemployed under the restructuring of State-owned Enterprises (SOEs). As Cai (2006) pointed out, these 'Chinese "laid-off" workers often take actions to achieve concrete economic goals, so their participation is determined by estimations of success and the risks or costs involved'. Thus the underlying question for the government becomes the question of what can be done to dampen the workers' incentives to take action in order to proceed with reforms without hindrance. The author's observation above reveals explicitly that the mass 'laid-off' or the *de facto* unemployment in townships and cities has been and will be dangerous for the long-term CCP governance, as there lays a great potential for social unrest. According to the Ministry of Public Security, even though such official data might be largely underestimated, the occurrence of 'Mass Incidents' (i.e., 'Mass Incidents' officially stem from 'Contradictions within the Populace' with reference to the CCP's doctrine, and can be broadly defined as 'large-scale demonstrations, which have the potential to develop into violent stand-offs between crowds of demonstrators and the authorities, or violent attacks on government organs, factories, or other property') in China has still dramatically climbed from 8,709 in 1993 to 87,000 in 2005 (as cited in Saich, 2011). Estimates by the Chinese Academy of Social Sciences (CASS) later gives an embarrassing figure of over 90,000 'Mass Incidents' in 2006 and further unspecified increases in 2007 and 2008 (as cited in Saich, 2011).

With the rapid decline of those communist ideologies and the growing cases of those socio-economic problems in China, nationalism undoubtedly became an alternative legitimation tool for the CCP under Jiang Zemin and Hu Jintao to promote social cohesion and ensure political stability in the nation. This could be observed by the response of China in regard to the collision among a Chinese trawler and two Japanese Coast Guard ships in September 2010. The Chinese Government reacted with

a series of diplomatic measures aiming at safeguarding China's sovereignty in the disputed waters of the East China Sea against Japan (Beukel, 2011). The then Premier Wen Jiabao openly and seriously urged the Japanese Government to release the detained Chinese captain immediately and unconditionally in no time. In the end, Japan was 'willing' to act in accordance with his demand.

It is ostensible that the development of the above Sino-Japanese territorial dispute concurred with the discernment of Przystup (2010): the Chinese Government, regardless of the leadership of Jiang Zemin or Hu Jintao, was interested in performing a high-level diplomacy with Japan (i.e., the deep and open involvement of Chinese Government's top leaders in Sino-Japanese conflicts), such as through state-controlled media including CCTV and the People's Daily, in the purpose of winning applause from most ordinary Chinese people. Apparently, the CCP tends to make its claim to political legitimacy based on the promise of delivering on nationalistic aspirations to a comprehensive rise in the global community during the 21<sup>st</sup> century. Differing from the less than desirable official reaction to foreign encroachment in the 19<sup>th</sup> and 20<sup>th</sup> centuries, 'the Party (i.e., the CCP) is now dedicated to restoring China to greatness as a power in the world and thereby redressing all past humiliations. Under its (i.e., the CCP) leadership, despite several setbacks after 1949 (c.f., frequent occurrence of 'Mass Incidents' in present-day China), the Chinese people still 'rise up' (Burton, 2008).

### **Nationalism as the Diplomatic Tool Against 'Containment Policy'**

With the dismemberment of USSR, the bipolar political system was dissolved along with it. However, since 1991, a new bipolar world order (i.e., US vs. China) has redeveloped as US President George Bush spoke of a 'New World Order' (Best et al., 2008), which is a system involving the cooperation of diverse states against common threats and claims to be less confrontational and more institutionalized. The system serves to consolidate military, political and economic position of the states involved. Being the most influential socialist state in the Post-Cold War world, China since the early 1990s has been identified as the biggest potential enemy of US.

With this bipolar mentality, even though there have been continual conflicts over bilateral trade and the opening of Japanese market since the Pizza Accord in 1985, different cabinets in Japan still have a very high intention of continuing, and if possible, even strengthening or stepping up the alliance with the US according to the blueprint of Yoshida doctrine foreign policy model. Even until the Koizumi's cabinet of Japan in 2001—2006, the Japanese foreign policy was still more or less the same as the old one by retaining both ties and constraints to the US's interests and right-wing nationalist ideals (Heazle, 2007). This fact was evident in the increasing support for regional defense efforts offered by the US in the Asia-Pacific region (Sutter, 2005), which echoed with the prior Hashimoto's decision to 'reaffirm' or 'redefine' the 'US-Japan Security Treaty' through the announcement of 'Japan-US Joint Declaration on Security Alliance for the 21<sup>st</sup> Century' in 1996. Borrowing the ideas of Edstrom, in the reason of

the 'Lost Decade' and 'Great-Power Bias', 'increasing myopia seems a perfectly rational reaction for a country (i.e., Japan) having a security treaty with the remaining superpower (i.e., the US)' (as quoted in Heazle, 2007).

While China has gradually become an economic powerhouse in the early 21<sup>st</sup> century, the 'China Threat' will be more and more popular in the US. Hence, the US 'Containment Policy' with Japan towards China seems to be inevitable. In line with the explanation of 'Power Transition Theory', it is considered that if China continues its remarkable GDP growth, such non-democratic regime (i.e., China) will sooner or later transform itself into a military power and finally engage in an unavoidable and keen competition with the hegemonic status of the US (Mearsheimer, 2001). The recent rise of China has already and thus dismayed Japan, especially when China replaced Japan as the second largest world economy in 2010 (BBC News Business, 14 Feb. 2011).

Facing the 'Containment Policy' under the coordination of the US as well as burgeoning popularity of 'China Threat' among the Western world plus Japan during the early 21<sup>st</sup> century, the CCP, regardless of whose leadership, tends to make good use of nationalism as an effective tool to downplay, if not frighten both the US and Japan of ever trying to contain China. This approach, according to the CCP itself, can be known as the actualization of China's 'Peaceful Rise' in the globe, and at the same time such harmonious Sino-foreign relationship will continuously help China stimulate its sustainable export-oriented economic growth (i.e., nearly 70% for the China's annual GDP) through the mass injection of Foreign Direct Investment (FDI) as time passes.

### **Changes of Beijing's Policy Towards Japan between Jiang Zemin and Hu Jintao Administrations**

#### **Deterioration of China's Good Neighbourly Policy**

Compared with the Jiang Zemin era, the CCP under Hu Jintao administration tends to adopt a more 'hard line' policy towards the historical and particularly territorial disputes with Japan. The territorial row over the Diaoyu Islands between China and Japan in 1996 would serve to manifest the CCP's approach under Jiang Zemin. Nevertheless, the anti-Japanese mass demonstrations in China during 2005 would be another good example to depict the dramatic changes under Hu Jintao rulership.

When a group of right-wing Japanese landed on the Islands and hence set up a lighthouse as a symbol of Japanese sovereignty in 1996, both the Chinese and Japanese governments responded by reinforcing their claims over the Islands. This eventually led to a series of spontaneous anti-Japanese demonstrations on Chinese streets, which were efficiently suppressed by the CCP within a short period of time (Weatherley, 2006). The suppressive measures utilised were as follows: the then vice-minister of foreign affairs went to Peking University personally to ensure that students remained calm; the idea that *China Can Still Say No*, which was critical to the CCP's foreign policy towards Japan, was banned since then; students were not allowed to access the internet for ten

days (Gries, 2004b). Apparently in Jiang Zemin era, the CCP merely repeated its claims over the territorial dispute in a verbal manner but still refused to empower occurrence of those society-driven demonstrations. Nationalism under Jiang Zemin leadership as revealed from this example was predominately state-led.

Yet this scenario changed immensely under Hu Jintao governance. The 2005's anti-Japanese demonstrations in 18 China's cities would best exemplify such an obvious change in approach: the Chinese Government did allow the violence to take place for a number of days before suppression. The protests reached the climax on 16 April in Shanghai, where thousands of Chinese people protested outside the Japan Consulate-General. Many bottles and stones were thrown at the building. The police later reported that 52 'hooligans' rather than patriots were arrested. Until that moment, Hu Jintao began to take oppressive measures to curb those anti-Japanese protests (e.g., arresting rock throwers; closing down excessively inflammatory websites). From all these, it can be seen that Hu Jintao, in comparison, was more inclined to opt for a more 'hard line' policy towards Japan: the then Chinese Government initially seemed to have some ulterior motives as it gave a free hand to the outbreak of anti-Japanese rallies in the 18 China's cities. As seen from this scenario, nationalism has clearly been altered from a state-led approach to a society-driven one. Since the relationship between the Chinese Government and populace has become more and more ambiguous under the rapid erosion of CCP's legitimacy in the post-Deng Xiaoping China, Hu Jintao was under this circumstances coerced to pay a higher governance cost in domestic China (e.g., the initial tolerance towards large-scale anti-Japanese demonstrations in 2005), which lied upon an obvious message that the CCP will be the sole pioneer in leading China to prosperity and national prestige in the foreseeable future.

The anti-Japanese mass demonstrations and Chinese Government's response in 2005 were meanwhile in line with the observation of Lam (2006): 'the leadership (in China) made no effort to control either the number of demonstrators or their actions. One consideration might be that as in the past, Beijing wanted to put pressure on the Japanese Government by flexing the "people opinion" card'. The antagonism shown by the CCP implies that the Chinese Government under Hu Jintao tended to exploit popular outbursts to intimidate Japan, especially when Japan wanted to obtain a permanent seat at the United Nations Security Council (UNSC) in 2005. Gries's (2004b) analysis again best explained the transition of nationalism from state-led to society-driven in China: 'the Party's (i.e., the CCP's) movement away from suppression and towards cooption or acquiescence suggests that a popular nationalism is currently emerging in China that increasingly challenges the party-state. Struggling to keep up with popular nationalist demands, the Party is slowly losing its hegemony over Chinese nationalism'.

### **Nationalism as an Engine to Marginalize the Sino-Japanese Cooperation**

In light of the ascent of online nationalism, Hu Jintao administration expended

abundant resources in order to monitor public sentiments, internet debates and popular media coverage on nationalistic issues. Each ministry has been required to submit a daily 'Internet Report'. As Reilly (2010) wrote, these 'Internet Report(s)' compiled by Xinhua News Agency and also Public Security Bureau are surpassingly crucial for policy-making in China. Their utmost importance can be observed with the account of Chinese foreign minister Li Zhaoxing regarding the comments of 'netizens', 'I have read the comments before that our diplomacy is sometimes too "soft" or too "hard". We take such concerns seriously' (Li, as quoted in Zhang and Wang, 2003).

Indeed, the China's high-speed railway project (c.f., meanwhile known as the 'Shinkansen' project) should be regarded as a tangible case to demonstrate this. In 2002, the Chinese Government decided to issue contracts to foreign enterprises to assist the construction of the high-speed railway linking up Beijing and Shanghai, which the Japanese bid was at that moment openly warmed. On 31 May 2003, Hu Jintao explicitly told the then Japanese Prime Minister Koizumi that he would like to foster China-Japan cooperation in this railway project (as cited in Reilly, 2010). Despite all, online nationalism apparently shaped the later decision-making process and the ironical bidding result of China's high-speed railway project in 2003. Reilly (2010) commented thus, 'after public protests began in summer 2003, the decision became a highly contested political choice for the Chinese leadership (under Hu Jintao). Online protests interjected emotional factors into the decision making process and forced a more public debate while delaying decisions. Railway officials later indicated in private interviews that public emotion (against Japan) had become a critical factor in their considerations after 2003'. Further seeking to appease the public including those Chinese 'netizens', the then China's Railway Minister Liu Zhijun even announced, somewhat inaccurately, that the high-speed railway project would adopt an entirely domestic technology (as cited in Reilly, 2010).

The failure of this collaborative high-speed railway project between China and Japan in 2003 could be characterised as a typical pillory to indicate how the nationalistic sentiments could bluntly override the long-term strategic and economic interests of China. It was evident that comparing with the Jiang Zemin rulership, Beijing's policy towards Japan by Hu Jintao was 'increasingly reactive to nationalistic opinion, rather than proactive to China's national interests' (Gries, 2005). Perhaps with the fast development of modern communication technology including 'Microblogging' and 'WeChat' in China, nationalism has become prevalent and more influential in Chinese politics. Popular nationalists in China are now increasingly able to act contrary to the state. Yet the dilemma is that Hu Jintao administration could not simply ignore the populace voices or its political legitimacy would be questioned (Gries, as cited in Zhou, 2007). Similar to what a Peking University professor warned, 'the basic policy of our government (i.e., the Chinese Government) has been to be conciliatory to Japan and the rest of the world, but that policy has become less viable today, when (Chinese) people are demanding a harder line' (Kahn, as quoted in Zhou, 2007).



## Conclusion

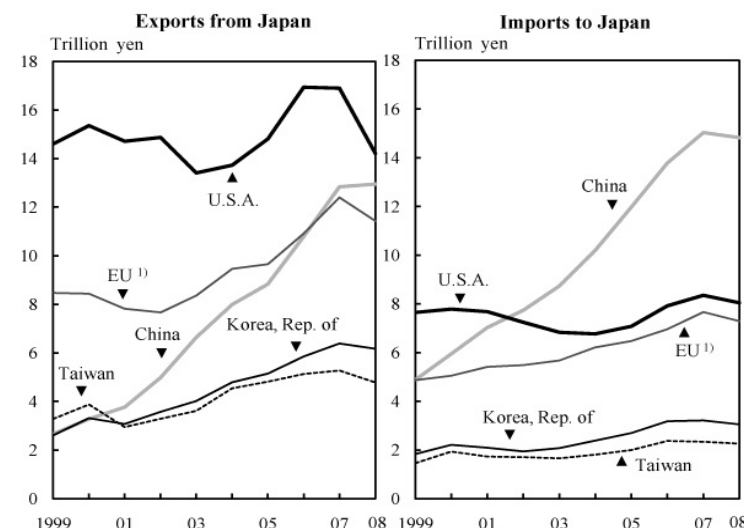
For China after Deng Xiaoping, the CCP has merely been able to attain political legitimacy particularly from the remarkable economic growth (i.e., such as the close economic ties with Japan) but not through consistent procedural means (i.e., universal suffrage in all levels) as in the Western world (Huntington, 1991). Without doubt, both Jiang Zemin and Hu Jintao in particular sense should understand that nationalism has been considered as another potent force to legitimize the CCP supremacy in post-Deng Xiaoping China. Nationalism would further be treated as a powerful diplomatic weapon while dealing with other foreign countries such as Japan.

Yet due to the surge of popular nationalism since the mid-1990s, such an irretrievable trend has gradually spoiled the Beijing's policy towards Japan from the leadership of Jiang Zemin to Hu Jintao. In the mid-1990s, the CCP headed by Jiang Zemin mostly fended off direct confrontation with Japan by forbidding Chinese nationalist activists from taking substantial anti-Japanese action. Instead, the then Chinese Government at most expressed diplomatic gestures or claims to Japan in the initial stage. Yet when Hu Jintao came into office in 2002, nationalism remarkably transformed as the key for him in managing social unrest and surviving politically in domestic China. This could further be evidenced by the immense use of the internet as a vehicle for online discussion, something which the CCP has found more difficult to control (Deans, 2004). In other words, if Hu Jintao had appeared 'too weak' to stand up to Japan, such domestic online critics from Chinese netizens could have more or less turned against him and even worse, someone might take it as an opportunity to use such nationalist appeals in mobilizing popular support for overthrowing the CCP.

With the increasingly society-driven demonstrations against Japan from Jiang Zemin to Hu Jintao rulership, such an independent role of nationalism has inevitably undermined the CCP's hegemonic status over the nationalist discourse even under the current fifth generation rulers headed by Xi Jinping. Worse still, such a society-driven nationalism in the foreseeable future may even ignore or reject the CCP as the only organ that can lead to national prestige. To score such nationalist legitimacy in the 21<sup>st</sup> century, the CCP has no alternative but will be 'coerced' to appease a group of 'angry youth' or those anti-foreign protestors known as a potential threat to the long-term CCP rule in China.

## Appendices

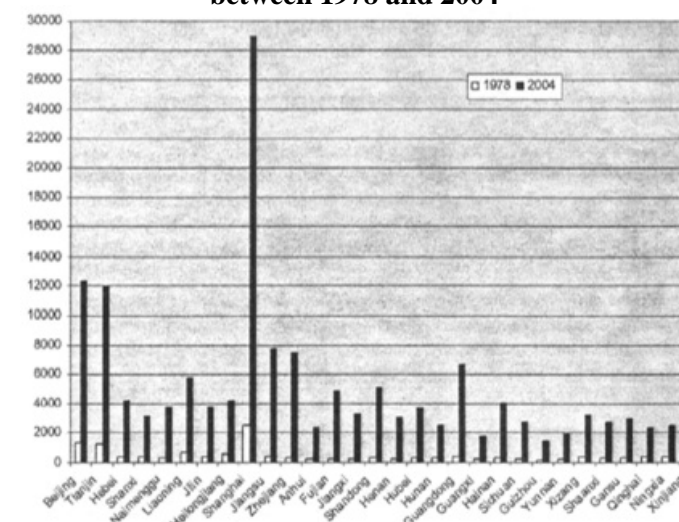
**Figure 1:**  
**Trends in Japan's Trade by Country/ Region, 1999–2008**



1) EU member countries were: 15 countries, before May 2004; 25, from May 2004 to Dec. 2006; 27, from Jan. 2007 onward.  
Source: Ministry of Finance.

Source: as cited in Statistics Bureau of Japan, 2009

**Figure 2:**  
**Comparing GDP per capita for 30 provinces in China between 1978 and 2004**



Source: Wang, 2006

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## Towards a Step-by-Step Approach to Developing a Knowledge-Based Economy In Hong Kong

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A prime role for any Government in the age of a developing knowledge-based economy (KBE) is to promote, encourage and stimulate participation across all sectors in this KBE: the HKSAR Government has made some promising moves in this respect but there still remains much that can be done when we compare regional economies such as Japan, Singapore and South Korea.

The story to be told in this paper is about Hong Kong's political economy—how to build the institutional support and the political consensus needed to move forward Hong Kong's economic transformation into a high value-added knowledge-based economy.

The HKSAR Government said it will target economic development. "This government wants to be proactive," said C.Y. Leung after the first meeting of the Economic Development Commission held on 13 March 2013. Mr. Leung also acknowledged Hong Kong's uniquely separate legal and administrative structure under "One Country, Two Systems" in the economic development section of his election manifesto. From his viewpoint as the Chief Executive of Hong Kong, there is a strong desire to create high-value-added jobs expected by the highly educated younger generation.

There is a general consensus that the Hong Kong economy needs to diversify from heavy reliance on the financial services and property sector. In April 2009, "Six New Industries" were proposed by The Hon. Donald Tsang and there was an attack from the Hong Kong General Chamber on this sector biased approach to economic support.

In papers published in 2011 and 2012, the Asia Pacific Intellectual Capital Centre had suggested that Hong Kong should seek a new role in the context of a rising China and the globalised Knowledge-based Economy. Tam, at the time a Member of the Legislative Council of Hong Kong, in a newspaper article in 2012 proposed the formal recognition of a Guangzhou-Hong Kong Knowledge Corridor. A South China Morning Post editorial (SCMP 15 April 2013) also noted Hong Kong's unique advantages: free economy, first-rate infrastructure and low tax rates. The same editorial, however, suggested "... lack of entrepreneurship" as the primary cause of the slowdown in Hong Kong's economic progress. SCMP claimed that no one had studied the subject of entrepreneurship in Hong Kong. Yet Getz and Segal (2008) in an Israeli study ranked Hong Kong as number two in the world in terms of "Overall entrepreneurship ranking." Hong Kong was ranked just behind Iceland (which went bankrupt after the Global Financial Crises) and was ahead of Israel, Taiwan, USA, Canada, Ireland, Australia and Singapore.

There were strong hints from the Central Government<sup>1</sup> suggesting that in moving forward Hong Kong's economic transformation into a high value-added knowledge-based economy, Hong Kong should put emphasis on implementation and try to make things happen. Hong Kong, however, has yet to develop a sound intellectual argument and a sound strategy. We still do not have practical SME support policies that link Hong Kong SMEs to their counterparts in the rest of the world that are anxious to use Hong Kong as a bridge to do business with China in the area of innovation and technology.

At the end of the day, Hong Kong has to look more closely at its own prospect for long-term economic survival. In coming up with a new "Political Economy"<sup>2</sup> to support Hong Kong's next stage of economic development, we need to be proactive. Consensus must be built in the local community on whether Hong Kong should invest in innovation and technology. At this moment, there is close to nothing in between the high-level macroeconomic goals of economic development and high-end job creation and implementation at the ground level. The tasks ahead are not straight forward ones as Hong Kong cannot rely on the policies handed down from the Central Government in Beijing—mainland policy measures may not work in the free market economy of Hong Kong. Now the British are gone, it is not politically correct to copy the UK model either. Hong Kong is a local government of China from a political perspective. But it is also a separate economic entity the size of a small country in Europe. In 2012 Miller and Côté showed that there is no one-size-fits-all strategy for successful innovation: Hong Kong must find its own, unique solution.

If the answer cannot come from the UK or from mainland China, the reasonable way to seize this opportunity is for us to come up with answers from within Hong Kong. However, we need to have a good understanding of the economic goals, transformation and implementation processes of the relevant OECD countries<sup>3</sup> since the early 1990s. Then we need to apply the knowledge and come up with strategy, community consensus, support from the Legislative Council and specific implementation steps to make things happen. Nothing will happen unless we can come up with a clearly stated strategy, coordinated policies and some practical implementation steps, even in the absence of an Innovation and Technology Bureau.

### Why Should Hong Kong Diversify Through a Knowledge-based Economy Strategy?

The argument is made in this section that, in order to diversify and grow its economy, Hong Kong should diversify horizontally, placing emphasis on knowledge-based innovation in any sector of business, and that this should be a strategic aim of HKSAR Government policy.

OECD acknowledges the link between knowledge-based economy and creation of high-wage and high-quality jobs. OECD also links productivity to the rate of knowledge accumulation and identifies the need to have sound government policy in place to make things happen. As described by Lung in a 2012 SCMP Opinion Page, this knowledge-based economic development strategy, however, seems to lie in the "I don't



know that I know" portion of Hong Kong's collective intelligence. Hong Kong does not seem to recognize its own potential and has so far failed to find a strategy for the much needed economic diversification and creation of high-end jobs expected by the younger generation. Suspicion of this economic development mode based on intangible knowledge assets has put considerable uncertainty on Hong Kong's prospects to become one of the leading knowledge-based economies of the world.

Hong Kong has always been about free trade, "good law, well administered" and a strong belief in the "free market" principle. We have always thrived on new ways of thinking and doing thing. We have all the basic conditions needed to make things happen, yet we don't seem to recognize that we are already a developed economy and the game-changing opportunity must be based on innovation and action, not on suspicion of the unknown, dogmatic adherence to "lines-to-take"<sup>4</sup> indecision and inactivity.

#### **Hong Kong's own innovation system — linked to but separate from the national systems**

"Knowledge-based Economy" is not just about R&D and the pursuit of knowledge in universities. It is also about making money and economic development. It is not a novelty in OECD countries. It has also been a proven economic development strategy amongst many OECD countries since the early 1990s. Implementation of such a strategy does not contradict Hong Kong's traditional free market philosophy, nor is it about "Central Economic Planning." Instead, it is about having a strategy, coordinated public policies and practical facilitation measures that focus on helping all industries—not selected sectors of the economy that have successfully lobbied the HKSAR Government for support—to engage in more high value-added economic activities.

A difficult task is ahead for Hong Kong as the Innovation & Technology Bureau proposed by the C.Y. Leung administration just before July 2012 did not happen. The Innovation and Technology Commission (the unit that is currently taking charge) is essentially a department under the Commerce and Economic Development Bureau of the HKSAR Government. A comprehensive strategy-making and funding unit equivalent to the TEKES of Finland is essentially missing in Hong Kong. Unlike Korea, Taiwan and Singapore, Hong Kong had not really thought of innovation and technology before 1997. The short burst of enthusiasm led by Mr. C.H. Tung and the push toward the construction of the Hong Kong Science and Technology Park did not lead to a fully developed innovation and technology capacity in Hong Kong, but even in the absence of a policy making unit, the HKSAR Government still needs to invent an intellectually sound economic development argument and needs to gain broad community support for a separate innovation system that is linked to, yet separate from, the national innovation system of China.

In the more developed economies around the world today, innovation and technology policies are understood in the context of a system.<sup>5</sup> Different players, including non-technology actors, need to interact under a complex and increasingly

globalized system to make things happen. The technology-push (or supply-push) and university-industry cooperation as practiced in Mainland China cannot be easily adopted in Hong Kong because firstly, it may not work. In a free market economy, the government does not have control over economic activities and such a model may not work in Hong Kong. Secondly, good science and technology does not necessarily lead to innovation and commercialization. Thirdly, it is now understood that policy makers need to look beyond input of R&D resource, and also consider social, economic and geographic interaction of those resources and the management of those resources. In Hong Kong's case, those links and interactions must be built with mainland China and with the rest of the world.

There is no simple answer for Hong Kong. We cannot simply copy China's system or the UK's system. Instead we need to build our own "Sub-national Innovation Eco-system" (HK-SIS) that is linked to but separate from the China National Innovation Eco-system (China-NIS). At the same time, HK-SIS must be integrated into the innovation eco-systems of the OECD countries. This Sub-national system (HK-SIS) to be built in Hong Kong is not unusual nor a special case within national boundaries of countries around the world. There are similar situations in Canada, USA and South Korea. But it will be a rather unique case for Hong Kong as we will have the opportunity to make use of Hong Kong's difference from the national innovation system of Mainland China (China-NIS) to create a substantial external economy of scale and economic benefits for Hong Kong and for China. As Hong Kong is a very open economy, these benefits for Hong Kong can be used by the OECD countries around the world that are happy to use Hong Kong as a gateway for economic cooperation with China in the innovation and technology areas.

#### **Political economy lesson from South Korea — From "catch-up" to "creative" development**

This change in focus was reported by Keenan in 2012 and a political commentary<sup>6</sup> has noted that the economy—not North Korea, will be the newly elected President Park Geun-hye's biggest challenge. Relatively few people in Hong Kong have noticed the establishment of Park's Ministry of Science Future Planning and Korea's shift from the emphasis on "catch-up" (i.e. as a less developed country) to a "creative" mode of development (i.e. as global leader amongst the OECD countries). At the core of this shift in national development strategy is the shift away from supporting the "Chaebols" (large family-owned business conglomerates) of the old economy to the emphasis on trying to create economic growth through knowledge-intensive SMEs.

The main task ahead of Park Geun-hye is Korea's economic convergence with the more advanced OECD countries and ending the dependence on a long history of economic growth started on the basis of providing cheap capital to the "Chaebols" by former president Park Chung-hee (Park Geun-hye's father) and exploitation of the labour force. As the second largest developed economy in Asia after Japan, South Korea can no longer rely on the traditional mode of "input-based" economic growth. Even though Korea has already been applying innovation and technology in industries, such a

shift in direction is still a difficult political task as it will involve the realignment of supporting institutions, new government structures and new rules of engagement between government and businesses. To make things happen at the ground level, South Korea will have to: develop the appropriate skills needed, strengthen the SMEs, increase and realign R&D spending and promote internationalization.

Policy makers in Hong Kong should take note that Korea has formally abandoned the "catch-up" mentality and is beginning to think of itself as a global leader of the world's economic development. To achieve this, Korea policy makers have decided that a change in the political economy rules (i.e. the Meso-economics) is a necessary step in changing the Marco-economic structure. There will be a shift away from an economic support policy centered around government-affiliated research institutes and the "Chaebols". Instead, Korea has decided to rely on the strength of knowledge-intensive SMEs as a primary source of economic growth. This is a strategic shift at the national level and fortunately for Korea, there are signs that the "Chaebols" are becoming more supportive of the SMEs as they found they could make good use of the SMEs as a source of innovation.

### **Strengthening the innovative capacity of SMEs**

Hong Kong started as a trading port and later became Asia's financial centre. Hong Kong has always been about trade but its membership as one of Asia's four "Asian Dragon" and one of the five developed economies of Asia (along with Japan, Korea, Taiwan and Singapore) is not primarily based on innovation or the growth of knowledge-intensive SMEs. Korea's economic development history and model are not something that could be duplicated easily in Hong Kong. Korea is clearly very far ahead of Hong Kong in terms of its R&D capacity and their strengths in specific industrial sectors, such as heavy industries and electronics. However, Hong Kong probably has a more international outlook and as we move forward in charting Hong Kong's economic future, policy makers in Hong Kong should be able to get some clear lessons and insights from South Korea's shifts in its political economy strategy.

One of those insights Hong Kong should take note of is that generating economic growth through knowledge-intensive SMEs is what "Silicon Valley" is about. The shining Asian example of this mode of economic development is Taiwan. This "New Economy" strategy of trying to put innovative SMEs at the centre has been adopted not just by Korea, but by many OECD countries. It was observed that industries in Hong Kong have been "hollowed out" by extensive moves of Hong Kong's manufacturing industries into mainland China in the late 70s and 80s, primarily for costs reasons. Many of those SMEs that have not invested in technology or build up their own brand and distribution network now find it difficult to survive in low profit margin OEM manufacturing.

The Economic Development Commission established by the HKSAR Government will probably come up with a new SME support policy. A policy of picking and factors

predicting winners or using quasi-government agencies to support certain industrial sectors at the expense of others is not helpful, nor is it a feasible solution. The key success factors of the future Hong Kong SME policy ought to include a horizontal industry support policy. Hong Kong needs to provide support to all knowledge-intensive SMEs— including SMEs in the service sector as they are the source of many innovative ideas and economic development capacity to other industrial sectors of the economy. All the fundamental conditions needed to build a knowledge-based economy in Hong Kong are already there. Hong Kong does not need a miracle to make things happen. Some clear-headed thinking and small policy adjustments will do.

### **Winning the Political Argument for Offering Proactive Support to Economic Development**

In this section the advantages and disadvantages of proactive support to economic development are considered in the context of Hong Kong: the main underlying conclusions are that it is necessary to provide cogent political arguments for providing this support and that the HKSAR Government has a key role to play.

The most recent Budget Speech announced on 27 March 2013 by the Financial Secretary probably reveals the real difficulties in engineering a new economic development strategy for Hong Kong over the next decade. It also shows a weakness in the intellectual foundation of the economic development policy of Hong Kong. It seems that the HKSAR Government genuinely cares about the "Freest Economy in world" rating given to Hong Kong by the Heritage Foundation and Cato Institute of the USA. Former Hong Kong Monetary Authority (HKMA) official Tony Latter<sup>7</sup> in 2007 has pointed out the strong dose of "tycoonocracy"—the strong influence of large local business conglomerates in the policy-making process of Hong Kong's economic and social development. The HKSAR Government, however, also sees itself as a broker of policies and therefore, can be swayed by popular opinions. The cumulative effect is, fifteen years after Hong Kong's return to China, there is no strong signal that the HKSAR Government would be able to come up with a coherent economic development blueprint that could hold up against vigorous testing from the "purist" supporters of the free market and other public opinions that have strong "socialist" tendencies.

### **"Free Market" versus "Economic Planning"**

The HKSAR Government should recognize the Knowledge-based Economy potential of Hong Kong. In a free market economy such as Hong Kong, the government does not have direct control over economic activities. It cannot predict the winning industries or where the next burst of economic growth might come from. Policy makers within the government of Hong Kong have always admired John Cowperthwaite (Financial Secretary, 1961-1971) and his "Positive Non-Intervention" economic development philosophy. However, Hong Kong does not seem to fully understand the "Positive" part of Cowperthwaite's philosophy—that is government must not stand still and must do as well as it possibly can to facilitate economic development. It should be

noted that the governments in Hong Kong have always tried to facilitate. Hong Kong has always thrived on new way of thinking and doing. We should not hang on to dogma or on to success of the financial services industry only. As a high-cost economy, Hong Kong does not have any choice but to follow the examples of OECD and European Countries in climbing up the economic ladder.

Considerable political leadership is needed to make maximum use of a high level of autonomy under "One Country, Two Systems" in Hong Kong's economic development process. Inspiring hope and providing opportunities for the next generation will involve developing an economic philosophy that would be supported by the vast majority of Hong Kong's population. It will be a process of creating new ideas and not about sticking to old rules of doing things and the political dogma of free market economics. High-level macro-economic goals: job creations, quality economic growth and wishes for Hong Kong to do well need to be translated into practical action on the ground.

### **Liberalize the economy by supporting young entrepreneurs**

Hong Kong needs a good understanding of what it takes to build a knowledge-based economy based on a more liberal economic structure that provides real economic growth and advancement opportunities—particularly for the more educated youth who have high expectations for their future. Inspiring hope comes from political leadership and the ability to communicate vision and is also about winning the political argument for proactive support of economic development in the context of a globalized knowledge-based economy. We need to recognize that fostering economic development is not just about "Input Economics"—allocating money or resource against stated macro-economic goals. It is also about "Meso-economics"—knowing about institutions and rules of engagement between government and industries that have direct effect on the "Output" and therefore "Outcomes" of public policies.

Post-World War II economic growth of South Korea and Finland relied heavily upon accumulation of capital in the "old" industries. In the case of Finland, it was the exploitation of raw materials, particularly forestry and a "Pulp and Paper" economy. The Korean "Chaebol" model was essentially a copy of the "Zaibatsu" model of Japan's industrialization process from the Meiji Period to the end of World War II. Both Finland and Korea have a highly educated and technology-oriented population. Both of these two economies were able to make good use of innovation and technology to transform through intensive use of knowledge and technology since the mid-1980s to early 1990s, which is quite recent in economic development terms.

In today's Hong Kong, policy makers need to acknowledge that economic development policy that relies on the accumulation of capital and assets may not be the best growth strategy for Hong Kong. The accumulation of capital implies an oligopoly of the market and economic opportunities (e.g. in the financial industry, real estate development and port facilities). Such a development mode implies that very large business conglomerates will seek maximum profit from capital investment. Such "rent"

seeking behavior sometimes works against the interest of other sector of the economy and the wishes of the majority of the population that believes Hong Kong was built on a foundation of equal opportunity and liberalism.

One way to further liberalize Hong Kong's economic development is to seek to create a more liberal capital formation structure—bearing in mind that in today's world "capital" includes intangible "Knowledge Capital" as well as "Financial Capital" that are needed to create economic wealth at the company or micro-economic level. Hong Kong prides itself as a rule-based society that relies on a level-playing field and fair play. Adopting a strategy of investing more of Hong Kong's wealth into education, an innovation eco-system and supporting young people who have entrepreneurial skill and science and technology knowledge is an intellectually sound and politically defensible economic development strategy. This strategy has been taken up by many OECD countries and should be adopted by the HKSAR Government.

### **Focus on creating economic growth through SMEs**

The globalized knowledge-based economy as we know it today first happened in the USA and Europe in the early 1990s. Hong Kong had not paid attention to it as it was a period of time when Hong Kong was preparing for a change from British rule to Chinese rule. Even though Mr. C.H. Tung, the first Chief Executive of Hong Kong (1997-2004) did try to inject innovation and technology as an economic growth engine for Hong Kong, the policy was not further developed in Sir Donald Tsang's administration (2004-2012). This was probably because the second Chief Executive of Hong Kong did not believe in such a policy direction.

Opponents of innovation and technology often criticize Mr. C.H. Tung for focusing on a policy of picking winner, rather than providing a business environment where winner would be selected by market circumstances. Proponents of such a free-market policy probably err on the side of a Free Market "Purist" opinion as such an approach ignores the fact that the SMEs of smaller economies such as Hong Kong do not have the same resources or expertise as the Multinationals of the USA or Europe. It also ignores the reality that even the developed economies of Europe—particularly the smaller economies that are about the size of Hong Kong—recognize that there is a market failure and SMEs need facilitation to move up the value chain. In the complex and highly competitive world of a globalized knowledge-based economy, no government can afford to watch the world go by without providing clearly stated policy and the necessary support measures to SMEs to upgrade themselves.

Hong Kong may have become less confident in itself since 1997. Some say that Hong Kong has lost its entrepreneurial spirit. Others blame it on a divisive and belligerent legislature and Hong Kong's uncertainty over its on-going political development. Hong Kong has been practicing a fairly hands-on approach to economic development but could do much better if the HKSAR Government recognizes our own unique strengths and implements sound policy decisions based on sound strategic analysis confidently and consistently.



## Building Hong Kong's Innovation Eco-system

In this section the case is made for taking a long, hard look at Hong Kong's Innovation Eco-system and for taking significant steps to simplify and provide readily accessible information and support. This role of promoting, encouraging and stimulating companies, particularly SME companies, in their entry into participation in the KBE is, as can be seen from simply looking at the most developed nations, a role for Government.

An innovation eco-system is the environment—institutions, rules, regulations, internal and external relations under which entrepreneurs and investors of an economy operate. It is also an implementation strategy of offering highly focused support to knowledge-intensive SMEs as a long-term economic development strategy. An innovation eco-system includes the key success factors that need to be present so that an innovative economy can emerge. An important component of the innovation eco-system is government policy that considers corrective measures for market failures, including the ones faced by many in Hong Kong in our economic transformation process.

### Innovation is more than R&D

Broadly speaking, Hong Kong needs to understand and focus more attention on the conception, design, creation and implementation process for knowledge-intensive products and services. An analysis of the innovation eco-system of Israel (Avidor, 2011) reveals that a successful innovation eco-system encompasses many factors, but they can be grouped into four categories:

1. Economic incentives and institutional support: the expected return to the investor must be positive, otherwise, he or she will not invest in the project. In developing economies, many factors can cause negative return on investment, such as the cost of capital being too high, weak financial infrastructure, weak manpower supply, a small market, lack of entrepreneurial skills or poor intellectual property rights protection. Hong Kong probably rates quite well in the area of providing economic incentives. There is the issue of Hong Kong being a "small market", but this issue could be overcome through CEPA (Closer Economic Partnership Agreement) and other formal and informal social and economic cooperation with Mainland China.
2. Availability of financial capital and an effective innovation system: Venture capital typically plays a very limited role in Early-stage Technology Development Funding (ESTD) around the world, particularly in Hong Kong. According to a study made by Auerswald and Branscomb in 2002, venture capital only accounts for 5% of ESTD Funding in the USA. The rest came from: universities 3%; government 27%; angel investors 27%; internal corporate sources 39%. The HKSAR Government currently does not provide angel funding and the capacity provided by angel investor is also small in Hong Kong. ESTD is one of the major issues Hong Kong needs to overcome. There are proven models in Finland and in Israel, such as

YOZMA,<sup>8</sup> where the public sector shares the risk with private sector investors and is able to recapture the public funds invested, but implementation of such models will be a major shift in direction for Hong Kong.

3. Supply of human capital: Hong Kong does not have all the engineering and scientific skills needed. However, this shortcoming is compensated by Hong Kong's international outlook, an open economy, links to Mainland China under "One Country, Two Systems" and strong skills in commerce and finance. Further investment in knowledge intensive industries and innovation and technology will create jobs expected by the local graduates and will also attract talents from Mainland China and from around the world to come to Hong Kong.
4. Access to information and a modern information infrastructure: Hong Kong scores well in the access to information factors. Press freedom, a liberal political environment and use of English as the primary business language are important but fairly under-rated competitive advantages unique to Hong Kong. The internal and international links between inventors, academics, technology evaluation experts, investors and industrial practitioner are still missing as an economic development capacity that needs to be built up. However, Hong Kong has always been extremely good at networking; this knowhow and capacity deficit is not a fundamental weakness and could be overcome fairly easily if there were clearly stated policies from the HKSAR Government.

In the past ten to fifteen years, governments in South Korea, Taiwan, Singapore and Israel have responded by adjusting their systems to a changing environment. Somehow, the HKSAR Government will also have to respond with the right policy measures even in the absence of an Innovation and Technology Bureau. Other than "Access to Information" and "Economic Incentives", Hong Kong also ranks high in terms of Intellectual Property Rights Protection. "Human Capital" and particularly the availability of "ESTD" (Early-stage Technology Development Funding) are the weaker links. All of the above factors will need further refinement and alignment if Hong Kong is to have an effective innovation eco-system.

### Focus on Hong Kong's market niche — internationalization and the last 10% of R&D

Hong Kong would be wise not to try to duplicate what Mainland China and the rest of the world are already doing. The "National Innovation System of China" (China-NIS) deployed in Mainland China is primarily based up massive mobilization of government resources on science and technology on a scale and speed that Hong Kong could not possibly match. In 2008 an "OECD Reviews of Innovation Policy: China" observed that the massive investment made by China has not yet translated into a proportionate increase in innovation performance. The "Hong Kong Sub-national Innovation System" (HK-SIS) is still composed of government, university and industry. But the HK-SIS should try to cooperate with the China-NIS and the NIS of the rest of the world.

In this respect, Hong Kong would particularly be useful in:

1. Providing a platform for China to "Go Out" and international enterprises to "Go in": Hong Kong possesses a well established legal and administrative system, free access to information and a liberal free thinking environment needed by the Mainland as their convergence with the world's innovation system continues to develop. Developed economies of the world want to use Hong Kong's separate legal and administrative system as a gateway and bridge to do business with China;
2. Providing the service capacity for Chinese enterprises: Hong Kong has a niche role in making best use of its strong service sector capacity and international connectivity and help to improve the innovation performance of the China-NIS, in both effectiveness and efficiency terms. Such a strategy has been clearly stated in China 12th Five Year Plan and would be supported by mainland governments and enterprises;
3. Commercialization: Hong Kong should try to understand the demand side—what the China-NIS and the rest of the world want from the HK-SIS. One element for Hong Kong is to focus on the last 10% of R&D that leads to commercialization of science and technology from Mainland China and from around the world. Hong Kong is ideally placed to do this type of work because of our international outlook and strong expertise in commerce and industry.

The Hong Kong SAR Government is unlikely to follow the example of the Israel's Office of the Chief Scientist (OCS) in funding 50% of private sector R&D (60% for start-ups). As a newcomer to the field of innovation and technology Hong Kong cannot match the scale and depth of the China-NIS and the USA-NIS. There is no demand for military technology so there is no military R&D in Hong Kong. The opportunity for civilian application of military-sector R&D done within Hong Kong does not exist—but such applications do exist for commercialization of military R&D done outside of Hong Kong.<sup>9</sup> It is difficult, if not impossible, for Hong Kong to catch up with the institutions and experience built up over the least thirty to forty years in Taiwan, Korea, Finland and Sweden within a few years. This is why finding and focusing on a specific market niches are important as Hong Kong will need to build its own innovation eco-system as the Hong Kong Sub-national Innovation System (HK-SIS) of China. The answer probably is: focusing on "commercialization", "Internationalization" and the "last 10% of R&D".

#### **Review the Meso-economic structure—institutions, rules and regulations**

The British Hong Kong Government before 1997 basically provided the legal and administrative framework that enables businessmen to get on with the business of making money. One of the hallmarks of British rules in Hong Kong was certainty and predictability of government policy. At a practical level within the civil service, those government policies inherited from the days of British rule have been transformed into a set of rules and regulation and a memory of what were the "lines" taken in the past.

One of those "memories" ("lines-to-take" or political economy rules) that needs to be changed must take account of the fact that the support deployed by the HKSAR Government and the Hong Kong-SIS can no longer be based on the "supply side" alone. The HKSAR Government can no longer rely on the traditional budgetary approach of allocating resources alone and hoping that things will work out. The existing innovation eco-system has many unconnected "dot" or initiatives, but they do not necessarily connect into a line. Political leaders of post 1997 Hong Kong need to know when rules become a dogmatic process and which rules can be changed, so that the dots can be connected to become coordinated policies. This approach is about knowing "what are the right things to do", not just "doing things right" and it involves advanced political skills that require knowledge and how to make sensible policy choices.

Political leaders in Hong Kong are now fully expected to demonstrate that they have the political skill and ability to change the rules of engagement between the government and the public when appropriate. For example, we already know that Hong Kong is unlikely to be dogmatic about non-intervention, but we should also be aware that the innovation eco-system of China (China-NIS) cannot be blindly fitted into the Hong Kong circumstances either. A comprehensive study published by the OECD in 2008 and referenced above has concluded that China needs to shift from a sustained (by government investment) to a sustainable growth mode. This report also highlighted: "... the importance of broad-based framework conditions for innovation for building a market-based innovation system." There are many issues within the current China-NIS that need to be solved, and they include: role and performance of China's public research institutes, relationships between the China-NIS and globalization of R&D and governance issues.

Attempts by the HKSAR Government to change the industry support rules will have to be carried out in a convincing and confident manner. Since neither the option of copying from Mainland China nor the option of copying from another OECD country are available, Hong Kong needs to develop its own policies. These policy measures need to bring economic diversification and high-end economic development, more opportunities and high-end jobs expected by the younger generation in HK through innovation and technology and the realization of HK's unique economic role in the context of Hong Kong as part of a rising China.

#### **Address the systemic dimension of innovation**

There needs to be a comprehensive review of the Hong Kong sub-national innovation system (i.e. HK-SIS) since no single HKSAR Government department or quasi-government unit can fully deliver the innovation eco-system needed by Hong Kong. The review will probably need to include a review of the current systemic dimension of innovation and institutions that are supposed to be delivering innovation service to the community. The systemic dimension includes linkages between industries and institutions that are funded by the Innovation & Technology Commission, R&D funded by the Research Grant Committee (RGC), the local linkages and international

roles now being performed by the Intellectual Property Department.

Innovators and entrepreneurs are not usually the type of people who have the capacity to examine the innovation eco-system that has direct implication on what they are doing. Such a review often affects the interests of the existing government and quasi-government units that are within the current system and this review and the prospect of change goes against the grain of the bureaucracy that are more than happy to stick to existing rules and process. Unless there is strong leadership at the political level, civil servants often resist change and ask if the proposed innovative activities and process are proven around the world, in Mainland China and in Hong Kong. In addition to the need for political leadership, there are also obstacles, e.g. skills shortages, competence gaps, the requirement for finance and appropriation of resources. In the experience of OECD countries (Oslo Manual 2005), linkages need to be built between "creation" and "diffusion"—R&D inputs and non-R&D inputs within the innovation process. There are also few incentives for the HKSAR Government to innovate. Therefore, the HKSAR Government can also inadvertently create obstacles that prevent the use of knowledge and skills that are available in the market.

While there is no lack of entrepreneurial and innovation skills in Hong Kong, the absence of clearly stated goals and strategy at the HKSAR Government level creates uncertainties. Small breakthroughs involving sometimes heroic efforts of small companies or individuals do not lead to long-term systemic and consistent application and these tend to result in isolated actions, which do not increase the total innovation capacity that is much needed in Hong Kong. This is the reality and probably the main reasons why Hong Kong has not been able to establish an economic transformation strategy and a meaningful capacity that is based on "Knowledge" and "Innovation and Technology".

### **Implementation in Hong Kong: the Five Steps**

The implementation of a support structure to build up the economic development capacity to create a fully blown knowledge-based economy in Hong Kong contains five key steps: in this section these steps are described and arguments are made as to why Government has a key role to play.

When Hong Kong Chief Executive C.Y. Leung went to see President Xi Jin-ping in Beijing on 18 March, 2013, Xi said Leung's policy idea, of seeking change while maintain stability has been widely recognized by Hong Kong citizens but he also urged Leung and the HKSAR Government to fully implement the ideas.<sup>10</sup> When Politburo Standing Committee member Zhang Dejiang met a Hong Kong business and professional delegation in Beijing on 27 April, 2013, he warned that Hong Kong may be losing its competitive edge and at risk of being "swept downstream if it does not forge ahead."<sup>11</sup> Consensus needs to be built within Hong Kong and the HKSAR Government also needs to acknowledge that Hong Kong could be losing its competitive edge<sup>12</sup> versus other mainland cities. While a clearly stated policy is required, the adjustments needed by Hong Kong are not radical ones as it is possible for Hong Kong

to make small adjustments and build an innovation eco-system based on the existing resources and institutions. However the task ahead will involve consensus building, political leadership and very strong implementation skills.

### **The Five Steps**

Fortunately, Hong Kong's weakness is not in implementation. If the HKSAR Government was to make up its mind and forge ahead with building up the economic development capacity to support a knowledge-based economy in Hong Kong, the following are some of the specific steps needed to make things happen:

Step I: Develop and Utilize Appropriate Skills: Hong Kong under-performs in the skill development area amongst the developed countries. It ranks 37 in the world (Global Competitiveness Report 2012-2013, World Economic Forum)<sup>13</sup> in terms of "Tertiary Education and Training". In the longer term, Hong Kong should obviously invest more in tertiary education and directly finance more higher education opportunities.<sup>14</sup> In the shorter term, the HKSAR Government could partially fund and encourage universities in Hong Kong to provide post-graduate degree or diploma courses that are more directly related to the implementation of the knowledge-based economy, innovation and technology.<sup>15</sup> A skill inventory audit, policy participation from the Education Bureau and coordination at the highest level of the HKSAR Government are needed before these skill development policy measures could be put into action. There is no shortage of knowhow and suitable course content is available from around the world as Hong Kong uses English as the primary medium of instruction.

Hong Kong just needs to start an audit to find out what skills are needed, where to find them and how to put to use those skills to achieve the desired economic development and job creation objectives.

Step II: Strengthening SME's Innovation Capacity through a SMBA and EEN-HK: As Keenan reported in 2012, Korea's "catch up" phases of economic development (1960s-late 2000s) have focused on the "Chaebols" and, until recently, largely neglected the SMEs. Until recently, Taiwan-not Korea-has been the shining Asian example of SME-centric economic development. The Small and Medium Business Agency (SMBA) of Korea now operates five major schemes to support SMEs.<sup>16</sup> Korea also operates six offices of Enterprise Europe Network-Korea,<sup>17</sup> with three offices in Seoul.

In the case of Hong Kong, there is no dedicated Hong Kong unit of EEN. Although Hong Kong says it supports "Free Market Economy" and "Positive Non-intervention", in reality, large local business has always had a dominant role in influencing government policies. Currently, SME support often follows the "colonial" tradition of offering this through quasi-government agencies or departments. Sometimes, these services are offered at market rate in competition with SME services suppliers.<sup>18</sup> Support measures to SMEs in Hong Kong,



particularly the knowledge-intensive SME manufacturers and service suppliers who form part of the Meso-economic structure, consist of rules, regulations and processes through which government and quasi-government units in Hong Kong engage the public and the business community. These will need a comprehensive review. The traditional engagement process of adding fragmented measures in piecemeal and scattered manner without changing the political-administrative structure is unlikely to help Hong Kong to move forward to become a knowledge-based economy.

Step III: Re-align and Coordinate R&D Spending: Closely related to SME support is availability of financial capital. Even though Hong Kong ranks number two in the world in terms of "Venture Capital Availability",<sup>19</sup> VC companies in Hong Kong are not doing well because the links between incubation and Angel Capital/Venture Capital financing are essentially missing. Both the government and the business sector spend very little on R&D and the funding support measures provided by the HKSAR Government are essentially inadequate. Hong Kong has very little experience in this area but could look into how the Israeli Government<sup>20</sup> fund and support innovation and technology startups through OCS (Office of Chief Scientist) and YOZMA ("initiatives" in Hebrew) — a government sponsored Venture Capital Scheme which has since been privatized because of its success.

In the case of Hong Kong, it might be too difficult to persuade the HKSAR Government to start an OCS that funds up to 60% of private sector R&D, but the HKSAR Government already funds R&D in universities through the RGC (Research Grant Committee) of the Education Bureau. The ITC (Innovation and Technology Commission) also provides some support to R&D in the private sector directly and provides some support to technology startups through the Cyberport and Hong Kong Science and Technology Park (HKSTP). Thus it should not be too difficult to persuade the HKSAR Government to provide a more systematic support and screening system modeled after proven technology transfer processes (e.g. from Aalto University of Finland and University of Waterloo of Canada) and link the improved Hong Kong process to the Hong Kong version of YOZMA—a US\$100 million venture capital funding that offers an option to private sector partners to buy back the government's share (maximum of 40% of total investment) within five years at cost, after charging a 5-7% interest.

Step IV: Internationalize: South Korea and Taiwan have been using and trying to attract native ethnic returnee while Israel has been using Jewish scientist from Russia and other parts of the diaspora in supporting their development. Singapore has a strong track record of importing international expertise, one example of which is the importing of University of Dundee (Scotland) know-how and personnel, including a Nobel Laureate, to start a Biotechnology Sector and there are also various schemes to attract foreign students to increase the local pool of

R&D talents. Even though Hong Kong is already a very international market place and has acquired many international contacts through the financial, trading and OEM manufacturing sectors, HKSAR Government support is still needed if Hong Kong is to participate fully in international forums and networking in the scientific and commercialization of R&D fields. The proposed Enterprise Europe Network-Hong Kong (EEN-HK) application is a good example of this type of international link. In this specific innovation and technology area, Korea is clearly ahead of Hong Kong as they operate six EEN-Korea offices throughout Korea (three in Seoul). Israel also operates EEN-Israel under three leading industrial consortia<sup>21</sup> that focus on different aspects of cooperation with Europe.

Ironically, English is probably more widely spoken in Hong Kong (particularly amongst the youth) than in South Korea, Taiwan or Israel and this fundamental "competitive advantage" amongst us is probably underused because of absence of a coordinated economic transformation policy that make best use of two of Hong Kong's fundamental strength— Hong Kong's English speaking capacity and international outlook.

Step V: The South Korean experience and implications for Hong Kong: Significant institutional changes came with Korea's shift from "catch-up" mode to a "creative" (leadership) mode of development, including changes in the interaction and action amongst several Korean institutions. During the Asian Financial Crisis of 1997, one-quarter of Korea's Chaebols did not earn enough money to meet the interest payment on their loans. They were, therefore, a major target of governance and transparency reform. In many cases, institutions that had worked well in the "catch-up" phase were reconstituted or dismantled. Chaebols had to sell off unprofitable businesses to foreign firms. A similar situation did not happen as Hong Kong faced a severe economic downturn, and the Hong Kong financial sector survived well in both the 1998 Asian Financial Crisis and Global Financial Crisis of 2008.

Hong Kong should also learn from Korea and stop thinking of itself as a passive dependent of the developed economies. Hong Kong is already developed in every respect. It should not be beyond the imagination of everyone in Hong Kong— policy makers in the HKSAR Government, industrialist, bankers and the younger generation —that we could become one of the leading commercialization centres of the world, serving mainland China, Europe and other countries. The technical and policy solutions are already there. The political and consensus building situation is far from straightforward or easy: this is the political economy aspect—the rules and arrangement of how government and quasi-government institutions interact with the community. There are other experiences which Hong Kong may need to learn from around the world as we move forward. Hong Kong, however, is less entrenched in its innovation and technology support institutions than Korea was, and could face an easier task than the one faced by Korea today.

## Next Steps: Making Things Happen

In this section we state the obvious: in order to promote, encourage and stimulate entry of the majority of Hong Kong companies into full participation in the KBE, it will take more than words. Actions need to follow and, with an opportunity of this scale and complexity, HKSAR Government involvement is absolutely indispensable. We have recommended the first tangible actions needed.

There have been deeply rooted tensions in the overall policy systems of Hong Kong for some time. We mentioned the problems and opportunities facing the Government in running Hong Kong under "One Country, Two Systems". We suggested how the "Free Market" versus "Economic Planning" argument could be resolved by borrowing South Korea's new SME centric economic development strategy which might work well in Hong Kong. We have also alluded to the absence of an innovation eco-system in Hong Kong and the misguided policy of requiring quasi-government agencies to compete with private sector suppliers. Mr. C.Y. Leung, the current Chief Executive of Hong Kong, has noticed<sup>22</sup> the skewed income distribution, falling living standard and lack of upward mobile opportunities for young people. These social and economic problems will not go away and the resources needed to solve them can only come from new bursts of economic activities similar to the political and economic energy released by South Korea, Taiwan, Singapore and Israel when they perceive themselves to be in crisis situations.

The HKSAR Government should try to inspire hope and opportunities for the next generation. Telling young people to start their own business, "Go West", "Go North" without providing the tools and systematic support they need is the same as telling them to "Go Away". However, inspiring hope is only part of the story. There are competing rationales within the HKSAR Government, short-termism in thinking and many unresolved strategic issues regarding Hong Kong's political economy and economic development policy. Hong Kong must make its own policy choice—neither the Central Government in Beijing nor the protesting youth groups can tell us the right things to do. In Israel, they say: "... if you don't believe in miracles, you are not realistic." Hong Kong does not have all the ingredients needed to create a "Knowledge-based Economy" but we do have most of the ingredients many countries in Asia could only dream about. A miracle is not needed—some small adjustments will do the trick.

To make things happen, Hong Kong needs to:

1. Adopt a horizontal industry support policy that include SMEs and SME Start-ups: Once a strategy and a direction are found and articulated, the HKSAR Government needs to back up those strategies with a comprehensive policy framework—to add new resources and to ensure resources and initiatives that are already embedded in other policy domains (e.g. education, cultural policy, healthcare, inbound investment and trade) can be properly released. Strong publicity is also needed to gain support from the Legislative Council and from the community.

2. Coordinate policy practices: We must first assume that the HKSAR Government's agenda and vision would include developing a "Knowledge-based Economy". Without recognition of such a strategic vision, things will simply not happen. At the same time government departments and agencies, perhaps with the help of the "Efficiency Unit" under the Chief Secretary's Office, should try to coordinate their practices to achieve optimum results. Some believe that this is a "best practice", since innovation could be implemented directly by departments and agencies at the ground level. But since "Knowledge-based Economy" is still a new subject within the HKSAR Government, coordination may need to be initiated at as high as the "Policy Committee"<sup>23</sup> chaired by the Chief Secretary. Such an intervention could be a short-term one. The objective is to turn coordination of practices within the HKSAR Government into a coordinated structure and standard operating procedures.
3. Government to provide financial support: The "Knowledge-based Economy" and innovation and technology should make best use of existing initiatives across the Government, and include other important elements, such as the technology incubation systems used in universities and within industries. Stronger links between Hong Kong, Mainland and international institutions in Europe also need to be built. Industry associations and SMEs (particularly the SME-startups) deserve some financial support from Government. Whether Hong Kong should follow the Israeli example of starting YOZMA, a US\$100 million joint funding scheme with private venture capital, is an open question. The measures needed will include a substantial scheme of financial support that will require discussion at the political economy and community-wide level. Trajtenberg in 2000 provided a detailed overview of R&D Policy in Israel, while Fisher and Eilan in 2011 followed this up with a country report on Israel and Senor and Singer in 2009 provided focus on Israel as a "start up nation." The experience of other leading nations can be of benefit to Hong Kong.
4. Political leadership and policy integration: A comprehensive innovation policy spans boundaries of policy bureaux of the HKSAR Government, yet policy implementation throughout the Government should be coherent and mutually supportive. Hong Kong is likely to face a situation faced by many other governments where there is often a lack of understanding of innovation policy. This could undermine communication and co-ordination. There could also be different beliefs in the economic development, international relations and scientific domains. These different schools of thought and particularly the "Sector-based Support" now favored by the HKSAR Government versus "Horizontal Support" favored by OECD need to be reconciled. Knowledge and political skills are needed to create a common vision if Hong Kong stands any chance of moving forward into this new economic frontier.
5. Build intelligence systems—domestically, in mainland China and internationally: The creation, implementation and governance of innovation and technology

policies are knowledge-intensive. Policy production, policy evaluation and policy implementation need to be linked to policy-relevant knowledge. Even though Hong Kong has very little experience in this area, we are extremely fortunate that Hong Kong uses English as a business language and can build links with OECD, European Union and leading government, non-government organization and knowledge networks extremely quickly. While the task may seem daunting at the beginning, NGOs, trade organizations and Quasi-government units are ideally placed to take up different policy and knowledge domains in trying to assist the HKSAR Government build a comprehensive framework and structure. The Central Policy Unit, the Government's official think tank, will have a role. Again, the main difficulty now faced by the HKSAR Government is that it needs to be done in the absence of policy advice from an Innovation and Technology Bureau.

### Conclusion

In conclusion this paper is a discussion about the political economy of Hong Kong's economic transformation. To make things happen, policy plans and implementation steps need to be included into the next Policy Address. Government must be prepared to lead politically, soliciting support from the business community, from the public and from the Legislative Council. The focus needs to be on implementation, accountability and governance—ensuring that the "Knowledge-based Economy" is based on sound experience from the more developed countries and ensuring that it is built well and built quickly. Only then can the promotion, encouragement and stimulation of entry of the majority of Hong Kong companies into full participation in the KBE be achieved, and in this transformation process, there is a key role for the HKSAR Government to play.

### Notes

1. Xi Jin-ping urged C.Y. Leung to fully implement the policy idea of "...seeking change while maintaining stability" at a meeting in Beijing on 18 March 2013.
2. Rules, regulations and government structures—including project funding structures.
3. They include: Korea, Taiwan, Singapore, Israel, UK, Finland and The Nordic Countries of Europe.
4. "Line-to-take" is bureaucratic jargon. Essentially, it is a concise briefing circulated within the Administration that describes defensive positions taken up by the HKSAR Government. These "lines" include historical lines that form the memory and therefore the unsaid rules and regulations (i.e. Meso-economic Structure) of how Hong Kong is run today. They are often difficult to break as civil servants are, by their nature, conservative.
5. Chapter 3, Concept of national innovation system, in a background paper entitled "Enhancing the competitiveness of SMEs: sub national innovation systems and technological capacity-building policies," Dr. Deok Soon Yim, Science and Technology Policy Institute (STEPI) of South Korea (January 2006).
6. Georgetown Journal of International Affairs, Walsh School of Foreign Service of Georgetown University, 27 March, 2013.
7. Tony Latter was a former Deputy Secretary for Monetary Affairs for Hong Kong (1982-1985) and Deputy Chief Executive of the Hong Kong Monetary Authority.

8. YOZMA is Israel's success story in venture capital investment strategy and in encouraging in technology start-ups in Israel. It was a scheme that replaced INBAL, a government-sponsored scheme that gave 80% guarantee to VC investments. Instead, YOZMA offered an option to buy the government's share (maximum 40% of the investment) within five years at cost (i.e. after charging a 5-7% interest).
9. The NXT flat speaker is an example of a technology that has origin in military research, developed in the UK from Ministry of Defence technology. After many iterations, the company now named HiWave is selling technology into the market place and has strategically placed an office in Hong Kong Science and Technology Park.
10. Xinhua News Agency, 18 March 2013
11. South China Morning Post, Page A1, 28 April 2013.
12. The front page story of SCMP (28 April 2013) quoted Zhang Dejiang: "Only when the economy continues to thrive will livelihoods improve. Everything else is empty talk." A similar warning was made by Deputy Director Zhou Bo of the Hong Kong and Macau Affairs Office. However, Professor Chan Ka-keung, Secretary for Financial Services, disagreed with such warnings, citing the financial market as an example of Hong Kong's success.
13. "Tertiary Education Enrollment Rate," Global Competitiveness Report 2012-2013, World Economic Forum: More than 80% of young Koreans today are participating in tertiary education. Korea world ranking: 1; United States:2; Finland:3; Taiwan:7; Singapore:19; Israel:28; Japan:36; Hong Kong:37; UK:40; China:79.
14. Hong Kong claims a 60% participation rate in post-secondary education. However, only 18% of those places are degree courses funded by the University Grant Committee. The rest are self-financed sub-degree courses.
15. Relevant courses include: Post Graduate Degree Courses for IP Attorney, Part-time Post Graduate Diploma Course in: Intellectual Capital Management, Commercialization and Technology Transfer Business Executives.
16. The SME support programmes include: Inno-Biz, KOSBIR, SMEs Technology Innovation Programme and Transfer Technology Development Project.
17. Enterprise Europe Network is a Government sponsored Pan-European Union technology transfer and business support network, providing all its services free of charge at the point of use.
18. A consultancy study titled "Consultancy study to review the role, management and operation of the Hong Kong Productivity Council (HKPC)" conducted in 2002 reveals that HKPC has an annual operation budget of approximately HK\$600 million but is only given a block grant of HK\$200 million per year. This funding policy has remained largely unchanged. The HKPC still competes for funding and business revenue with the private sector. This practice has, in fact, prevented many knowhow and practices of the knowledge-based economy from being introduced to Hong Kong. An exemption clause in the Hong Kong's Competition Laws to be enacted in Hong Kong also protects the HKPC from being prosecuted for anti-competitive behavior.
19. "Data Table 8.05, Venture Capital Availability" of the Global Competitiveness Report 2012-2013. Qatar ranks:1; Hong Kong:2; Israel:3; Singapore:4; Taiwan:9; USA:10; Finland:13; UK:16; China:22.
20. The Israeli Government funds R&D through military research and programmes under the Office of Chief Scientist (OCS) of the Ministry of Industry, Trade and Labor (MOIT). YOZMA (1993-1998) is the government sponsored programme started by Yigal Erlich, the chief scientist of the OCS that brought Israel from "nothing" to ranks number three in the world in terms of "Venture Capital Availability."
21. They are: MATIMOP of the OCS (international R&D focus), Manufacturing Association of Israel (MAI—international technology collaboration focus) and Israel Export and International Cooperation Institute (IEICI—focused on facilitating international commercial collaboration), <http://www.enterpriseisrael.org.il/about-us/enterprise-europe-network/>.
22. Mr. C.Y. Leung's speech at the Hong Kong Democratic Foundation on 24 September 2009.



23. The Policy Committee, comprising the Secretary for Justice and all Secretaries of Bureaux, is the main platform for policy co-ordination and initial clearance within the HKSAR Government. The Committee will carefully consider all policy proposals before they are submitted to the Chief Executive in Council for deliberation and decision.

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