
The furor over a proposed airport and harbor project for Hong Kong found China and Britain at odds yet again over the territory's future. According to the author, the two countries settled the dispute because of "overlap between British and Chinese interests" in Hong Kong.

China and British Hong Kong

BY WILLIAM H. OVERHOLT

Hong Kong's contemporary history revolves around the interplay of China and Britain's shared interest in the prosperity and stability of Hong Kong and British-Chinese struggles over the purpose and management of the territory. World press reports have generally portrayed the British viewpoint almost exclusively, when in fact neither side has had a monopoly on justice or goodwill.

The shared interests are very powerful. Hong Kong is the crown jewel of British colonial management: under British rule it has attained global financial importance.¹ For China, Hong Kong is the source of about one-third of its foreign exchange earnings, two-thirds of all foreign investment, most of its high-technology products, and a large proportion of its tourists. Hong Kong is also China's principal window to the outside world and is becoming its capital for international finance.

Shared interests have allowed even serious crises to be satisfactorily resolved, though not without fear among Hong Kong Chinese and vertigo on the part of investors in Hong Kong's stock market. Hong Kong survived the West's isolation of China after the 1949 Communist Revolution. It survived the Cultural Revolution, the violent explosion of xenophobia that, at its height in 1967, saw Red Guards approach the border

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¹Britain acquired Hong Kong from China in three phases, beginning in 1842 when Hong Kong island became the principal territorial prize of the Opium War. While Hong Kong and Kowloon (acquired in 1860) were ceded to the British in perpetuity, the New Territories, which constitute the bulk of Hong Kong, were leased from China in 1898, the lease to run until 1997. Contemporary Hong Kong, which has a population of 6 million people, is not viable without the New Territories. It also requires the support of China, which provides not only most of the colony's food but also most of its water.

of Hong Kong, leading Prime Minister Zhou Enlai to call the local Chinese commander and tell him to defend Hong Kong.

The recent tension between China and Britain over the future of Hong Kong has its roots in the treaties by which Hong Kong was ceded and leased. Britain considered the treaties "normal" and binding. In China's view they were "unequal," unfairly imposed by imperialists for immoral purposes—most notably, to force China to import opium from British traders. Under the Communists, China has not recognized the validity of the treaties.

In such circumstances, the most likely result would be severe, perhaps armed, conflict; China and Britain's shared interest in Hong Kong, however, overcame the difference in their views. When Britain sought to renegotiate its lease on the New Territories, due to expire in July 1997, China countered that it wanted to regain sovereignty over all of Hong Kong. In 1984, after negotiations, the countries issued a Joint Declaration that called for the termination of British rule with the expiration of the lease.

PLANS FOR DEMOCRACY

The euphoria that followed the Joint Declaration was succeeded by a second period of tension. Under the terms of the agreement, Britain would rule until 1997 and the territory's capitalist economy and its social system would be preserved until the year 2047. Britain believed that this meant it could do whatever it liked before 1997, including installing full-blown Western democracy, and that China would be stuck with the results until 2047. However, another section of the Joint Declaration stated that before 1997 China would write a constitution (the Basic Law) for Hong Kong's post-1997 governance. China interpreted this to mean that it would write the rules for Hong Kong before 1997, and that the Basic Law would determine how the existing economic and social systems were to be maintained until 2047.

Britain proceeded to plan for direct legislative elec-

tions and for Hong Kong's transformation into a democracy. Various local groups prepared to form Western-style political parties. In October and November 1985, China announced that such changes were inconsistent with the Joint Declaration, and warned of chaos if the British made radical alterations in the way Hong Kong was governed.

The British press quickly declared that China was not honoring the terms of the agreement. But in fact each side could in good faith assert that its views were consistent with the Joint Declaration. The British believed they had governed Hong Kong in a democratic spirit, and that therefore a change to democracy was within the bounds of the Joint Declaration.

China in the end prevented the installation of democracy in Hong Kong, mainly because it was afraid of populist pressure on the territory's relationship with China. But in doing so it did not renege on its commitment to maintain the existing system in Hong Kong. If anything, it was the British effort to turn Hong Kong from a consultative colony into a democratic polity that contravened the Joint Declaration.

Ultimately, the British government's proposals for direct elections to the Legislative Council were confined to 18 of the 60 seats in the council. Plans for formal political parties were abandoned, and the stock market and real estate prices rose once again.

OUTPOST OF FREEDOM OR EXPORT-PROCESSING ZONE?

The conflicting interpretations of the Joint Declaration by China and Britain point up the two countries' deeply different perspectives on Hong Kong. Britain sees the purpose of maintaining the existing system primarily in political terms—namely, preservation of the freedoms and autonomy of Hong Kong's people. For China the purpose is primarily economic—ensuring that the foreign exchange, foreign investment, growth, and technological benefits of contemporary Hong Kong remain to aid China in future development.

For China, Hong Kong is a complex export-processing zone. South Korea and Taiwan originated the modern version of the export-processing zone, which is typically a small territory in which certain laws and regulations are suspended to facilitate economic activity. Typically these zones lift the normal restrictions on importing and exporting goods, and they may also allow for the easier inflow of capital, or suspend restrictive labor practices.

China itself was an early beneficiary of the concept of the export-processing zone. China has long felt endangered by the activities of Westerners, and yet has needed to deal with the West on a fairly large scale. An early adaptation to these contradictory requirements was the Imperial Maritime Customs Service, through which China delegated management of customs func-

tions to the British. Later the treaty ports were imposed on China but they also served an important Chinese purpose, evolving as airlocks through which China could deal effectively with the West and contain the deleterious foreign influences in a narrow geographic space.

Hong Kong, which began as a British-managed port for the Chinese, is the most successful modern export-processing zone. Not only have the rules on the import and export of goods been relaxed in order to encourage manufacturing, but so have rules on a broad range of modern service functions. This has made Hong Kong a global financial center; a regional headquarters for manufacturing firms and for other services such as accounting; a trade window for China, especially in technology purchases; the international financial capital for China; and the management consulting center for southern China.

To fulfill these functions, Hong Kong must have a wide range of rules that are different from those of the People's Republic. The free flow of people, capital and information (including political information that affects financial markets) must be ensured; the territory must possess a convertible currency and an independent Western-style legal system. Simply stated, Hong Kong can maintain its economic momentum only if it retains sufficient freedom and the situation there is sufficiently predictable to keep the top firms and people from leaving and to attract new ones of the same caliber.

These issues were addressed in the Basic Law, the constitutional document that will serve as the basis for Hong Kong's future after 1997. In it China adhered to the terms of the Joint Declaration, and even went so far as to write in detailed capitalist policies, such as a low-tax rule. But the Basic Law, which was promulgated in 1990, included elements that raised concern among the British and Hong Kong's British-oriented population.

Direct elections were severely circumscribed under the Basic Law. Beijing could name the territory's governor if it asserted its full power, and it acquired considerable leverage over top judicial appointments. Foreign policy and national security issues came entirely under the jurisdiction of the People's Republic. A key clause forbade Hong Kong's people from "subverting" China. All this, though consistent with the letter of the Joint Declaration, raised fears of future abuse among the people of Hong Kong. At the same time China reiterated its commitment to the full range of freedoms necessary to maintain Hong Kong's capitalism, and conservative Chinese President Yang Shangkun prefaced the Basic Law with a promise that socialism would not be practiced in Hong Kong.

FLIGHT FROM UNCERTAINTY

Uncertainty over how China will ultimately interpret the Joint Declaration has led to a corporate, capital,

and brain drain in Hong Kong. Most major corporations have relocated their legal domicile to places where the jurisdiction of Western-style legal systems is assured—Jardines to Bermuda, the Hongkong and Shanghai Bank to London, and so on. They have done so in case China uses its influence over Hong Kong's legal system to undermine it. The implications of these corporate "moves" are mainly legal, since changing the legal domicile does not alter the location or nature of the business.

Potentially more significant is the transfer of vast amounts of capital out of Hong Kong—how vast it is difficult to determine. The significance of these movements must be kept in perspective, however.

First, Hong Kong capital has always been footloose; individuals and corporations have always kept enough capital offshore to survive in the event of catastrophic changes in China. Second, this is an era of Asian investment overseas. When Hong Kong firms buy overseas companies (SemiTech buys Singer, New World buys Ramada Inns, Hong Kong watch companies buy up their Swiss counterparts), the Western press labels this capital flight. When a Japanese or Taiwanese company does the same thing, the press sees this as an economic victory for Japan or Taiwan. Many Hong Kong companies have purchased offshore assets to diversify their risks and relied on bank loans rather than equity for the acquisition of Hong Kong assets. Before becoming overly alarmed about capital flight from Hong Kong, one must first determine whether current "hedgies" are proportionally larger than in the past. Studies by the Hongkong and Shanghai Bank have concluded that they are proportionally smaller than in previous crises.

More critical is the brain drain. Fear of what China might do after 1997 has led most members of Hong Kong's middle and upper classes to seek foreign citizenship, usually from Australia or Canada because English is spoken in those countries and they are easier to immigrate to than Britain or the United States. Emigration from Hong Kong had risen to about 45,000 people a year before the suppression of the democracy movement in Tiananmen Square on June 4, 1989; more than 60,000 people have left each year since then. This level of emigration disrupts businesses, but it falls far short of a catastrophe. Indeed, outflows of Singapore's highly trained workers have often been at similar levels, after taking into account the difference in population and in the percentage of those with advanced education (Hong Kong has almost three times as many people as Singapore, and a much higher proportion of the population holds graduate degrees).

The outflow of emigrants has been balanced in part by inflows of executives from the United States, Japan, Europe, Southeast Asia, and China itself, and by a significant number of returning Hong Kong businesspeople who have already acquired their Canadian or

Australian passports. The brain drain has been Hong Kong's most serious problem, but so far it has proved manageable.

THE EFFECT OF TIANANMEN

Skepticism about China's intentions toward Hong Kong intensified after the Tiananmen massacre. The brutal smashing of the democracy movement by Chinese troops led many to doubt China's promises to maintain a capitalist Hong Kong. However, China has always brutalized its dissidents and it has always protected Hong Kong; the two aspects of Chinese policy are not inconsistent. Moreover, China's attitude toward Hong Kong during the crisis was remarkably tolerant.

The most fundamental rule of the "one country, two systems" approach taken in the Basic Law must be that neither China nor Hong Kong is allowed to subvert the other. But during the crisis in Beijing, Hong Kong people funded the democracy movement, backed it with propaganda, smuggled its leaders into and out of China, channeled news of the massacre into southern China, and mounted demonstrations in support of the dissidents that drew as many as 1 million people. The Chinese government responded by complaining and by writing a nonsubversion rule into the Basic Law. Thus while Hong Kong ignored the implicit rules of "one country, two systems," Beijing honored them; Western sympathy for the democracy movement and for the Hong Kong people supporting it kept Westerners from appreciating the fact that, however understandable its motivations, the Hong Kong people's behavior was potentially suicidal.

The Hong Kong government chose neither to debate the nonsubversion rule publicly nor to form a public consensus on the range of permissible behavior nor to write explicit laws against future subversion. Instead, it quietly imposed restrictions that accomplished what the Chinese wanted; for example, it prosecuted a group calling for democracy, resurrecting a law forbidding the use of bullhorns without government permission.

The English-language press routinely denounced each government effort to implement nonsubversion rules as a concession to China by crass leaders who cared more about good British-Chinese commercial relations than the rights of the Hong Kong people. These were utterly inaccurate descriptions of British motives, but the government's unwillingness to deal with the problem publicly ensured that any of its actions on the matter would be viewed as shameful. It also left a dangerous ambiguity in Hong Kong's relations with China.

THE AIRPORT CONTROVERSY

Another area of contention is the economic management of Hong Kong. Until recently, the British government believed that confidence in Hong Kong could be

restored by demonstrating that the major decisions on Hong Kong's economy could be made without involving China or taking China's interests into account.

The British government decided to create the largest confidence builder imaginable, a dramatic example of its decisiveness and autonomy: an all-encompassing Port and Airport Development Scheme (PADS) that would be the most extensive and expensive (more than \$16 billion) civil-engineering project in the world. The airport and port projects were a response to a real need; the British government had determined in the early 1980s that Hong Kong needed a new airport but then had backed off because of the economic slowdown and its own preoccupation with British-Chinese politics through the mid-1980s. It redirected its attention to the project at the end of the decade.

The project became mired in problems almost immediately. Most of the Hong Kong business community doubted the wisdom of putting the port and airport projects together since it made the overall effort look so expensive. The first real crisis occurred when international banks balked at supporting the project. The Hong Kong government had planned to finance PADS primarily through bank loans. The banks responded that, since the repayments would all fall after 1997, when China would be the territory's owner, they would not fund the project without both a strong Chinese endorsement of it and a Chinese financial contribution of more than 20 percent of the project's total cost. The British conception of totally autonomous decision making thus initially ran afoul not of Chinese interference but of the most basic rules of prudent banking.

Meanwhile, the Chinese authorities said that the PADS project would shape southern China's transportation system into the next century, so some coordination with the Chinese infrastructure seemed appropriate. Moreover, the financing of the project would also shape China's future financial position in the eyes of the banks, and they believed that China should have a voice in the matter. All this occurred while post-Tiananmen Western sanctions against China were in effect, and in the midst of emergency Chinese efforts to increase reserves and decrease borrowing.

The Joint Declaration specified that any decision with consequences beyond 1997 (the new airport was scheduled to open in 1997) would require mutual consultation. Britain chose to ignore both this treaty obligation and China's concerns about the airport plans. The Hong Kong government informed Beijing about the airport decisions through a letter written in English that was sent to Beijing only two days before the Hong Kong governor, David Wilson, publicly announced the decision. When Beijing requested additional information, the Hong Kong government did not respond for 90 days and then sent a huge technical report in English.

China complained to the British that this response

was inadequate. Britain finally agreed that China could send a consultation team to Hong Kong. At the same time, the problem with the banks came to a head. In October 1990, just before the Chinese consultation team was to arrive, the Hong Kong government announced that it would finance much of the project itself. Wilson and his principal aide made strong public statements that they were under no obligation to consult with China on the huge financing decision, and would not do so.

Both before and after this decision, the British argued that they had adequately consulted with the Chinese about the project. But the British concept of consultation was to inform the Chinese selectively of the reasons Britain had made its decisions. The Chinese concept of consultation was that when vital Chinese interests were involved, Chinese officials would participate in the decision making.

Active Chinese participation in the decision-making, however, was contrary to the strong British interpretation of autonomy (an interpretation difficult to square with financial reality and with the language of the Joint Declaration). Moreover, keeping the Chinese out of the process would avoid the great nemesis of Hong Kong decision makers—close involvement by the ponderous and corrupt Chinese bureaucracy in major Hong Kong decisions that could see the Chinese still arguing among themselves about the airport well into the next century.

While the British point out that the word "consult" has a wide range of meanings, there is no meaning of it consistent with a policy that completely refuses either to take the other party's interests into account or to engage in an exchange of views during the decision-making process. To inform abruptly is not to consult.

The sometimes high-handed British approach gave China the strongest possible reason for believing that national pride as well as vital interests required involvement in PADS. The result was a diplomatic impasse and a decline in public and investor confidence in Hong Kong—this from a project specifically designed to boost confidence.

The impasse between China and Britain was exacerbated by mutual suspicion of each other's motives. China believed that Britain was unwilling to treat Hong Kong as an autonomous part of China and to help work Hong Kong into China's overall development program. Britain interpreted Chinese efforts to coordinate development programs as attempted subversion of the territory's autonomy, and was desperately afraid of the immobilization of Hong Kong by a corrupt Chinese bureaucracy that does not understand the requirements of Hong Kong's capitalist system and in particular does not know how to manage investments or build airports. China was right about British intentions, and Britain was right about the Chinese bureaucracy.

By mid-summer 1991, China had made it clear to

Britain that it would not allow huge expenditures for the airport without consultation. Britain was also told by international bankers that an airport could not be financed without Chinese support. In July, after secret negotiations, Britain accepted China's right to be consulted, accepted limits on the borrowing that could be done without Chinese permission, and accepted a Bank of China representative as part of the group that would oversee decisions on the airport. China endorsed the need for an airport and, by installing a Bank of China representative, gave political legitimacy and financial authority to the airport decision-making process.

The Hong Kong-British government's attempts to avoid the consultation requirements of the Joint Declaration certainly resulted in greater Chinese veto power than would have emerged if consultation had been adequate. American newspapers denounced the deal as a crass British sell-out of Hong Kong. But Hong Kong capitalists understood the more important implication: just as the 1986 confrontation had established a viable Beijing-Hong Kong political relationship, so the 1991 confrontation established a potentially viable Beijing-Hong Kong economic relationship. The formula for success in both cases was British acquiescence that China's legitimate interests had to be taken into account, followed by Beijing's reassurance that it would use its influence in a restrained manner. Less than a month after the accord was reached, prices on the Hong Kong stock exchange broke their all-time record and real estate prices jumped as much as 10 percent.

EXPANDING HONG KONG

A final disparity of views concerns Hong Kong's geography and role in China's future development. China, with its economic perspective on Hong Kong, envisions Hong Kong enlarging its territory and increasing its economic scope; Chinese reformists welcome this and Chinese conservatives fear it, but both see Hong Kong as strengthened economically by it. Britain, with its political and colonial perspective, sees Hong Kong as threatened by it.

Hong Kong has already naturally expanded its role in the Chinese economy. Hong Kong investment, which currently accounts for two-thirds of total foreign investment in China, has been the main source of growth for Chinese trade. Hong Kong firms dominate China's Special Economic Zones (SEZs), which the Chinese have effectively (though not intentionally) turned over to them to manage; a similar role is emerging for Taiwan. The Hong Kong dollar is the currency of choice in much of Guangdong, a province the size of France; Hainan is considering allowing a formal role for the Hong Kong dollar. Shenzhen's stock exchange is modeled on Hong Kong's and looks to Hong Kong for support. Guangdong hopes to marry its superiority in basic science to Hong Kong's superior strength in marketing and finance in order to create an export-oriented manufacturing powerhouse that neither could build alone.

As Hong Kong's functional role expands, Chinese officials are planning to extend its geographical area. In the early 1990s visa requirements will be abolished for Hong Kong people wanting to visit the Shenzhen SEZ north of Hong Kong. In the subsequent decade Guangdong's leaders hope that Shenzhen's economic progress and institutional development will make it sufficiently similar to Hong Kong to allow the abolition of travel restrictions in the other direction. Tight controls on travel from the rest of China into Shenzhen would be retained to keep the zone from being swamped by impoverished immigrants from elsewhere in China. The plan would effectively move the border back, making the territory of Hong Kong several times larger.

British officials denounce such changes as insidious plots to subvert Hong Kong's autonomy, and British institutions have reacted completely defensively, thereby missing opportunities. For example, the legal profession has adopted a desperate xenophobic protectionism designed to keep all foreign lawyers, especially Chinese but also American, from advising on Hong Kong law; there has been no thought of assisting in the training of lawyers in the People's Republic in order to ensure that China can work with an autonomous Hong Kong.

A CASE FOR OPTIMISM

The overlap between British and Chinese interests remains large and leaves room for optimism. The satisfactory resolution of the 1985 conflict over Hong Kong's political structure and of the 1991 conflict over economic relationships provides the foundation for successful implementation of the concept of "one country, two systems." The key in both cases was Britain's willingness to back away from one-sided positions and China's restraint in exercising its new influence over Hong Kong's future.

These successes were achieved in the poisonous post-Tiananmen Square period by an angry, fearful, and xenophobic Chinese government dealing with a British Hong Kong government that was extraordinarily self-righteous while ignoring provisions of treaties it had recently signed. That agreement was reached under such inauspicious circumstances augurs well.

The two sides will have to continue to work on a compromise understanding of autonomy. As it did in the airport dispute, Britain must acknowledge China's legitimate interests and make plans for Hong Kong's future as a part of China. Major future economic decisions must take Chinese interests into account. Conversely, China's assertion of its interests must be confined to broad policy and stop short of involvement that would destroy Hong Kong's initiative and paralyze the capitalist process. Britain must abandon its unrealistically extreme interpretation of autonomy, and China must reassure Hong Kong that autonomy includes sufficient restraints on the Chinese bureaucracy to permit continued economic dynamism. Both sides will have to demonstrate that they have learned the lessons of 1986 and 1991. ■