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Author(s): William H. Overholt

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Hong Kong and China after 1997: The Real Issues

WILLIAM H. OVERHOLT

Since the Tiananmen Square incident in June 1989, the conventional wisdom has been that when Hong Kong reverts to China in July 1997 China will promptly use its newfound sovereignty to cripple Hong Kong. In this view, China cannot be trusted; therefore, the Joint Declaration of 1984, which promises Hong Kong fifty more years of capitalism after 1997, is worthless. Moreover, the Basic Law, China's recently enacted constitution for Hong Kong, is not democratic, and it can and will be used to subvert freedom and the free market. Knowing this, Hong Kong's inhabitants and its capital are fleeing to a degree that will destroy its viability in anything like its present form long before 1997.

This view raises many questions. First, if that is what Beijing intends to do, why has it decided to wait until 1997? For at least three decades, China could have absorbed Hong Kong simply by walking in and taking it. The British garrison was pitifully small, could not have been reinforced to counter a Chinese invasion, and would not have been reinforced even if it could have been. In fact, to conquer Hong Kong, all China had to do was to cut off the water supply. Hong Kong is not like the Falkland Islands geographically, strategically, demographically, or psychologically.

Moreover, even in its moments of greatest insanity, China has chosen to protect Hong Kong. The most insane time in several centuries was 1967, the height of the Cultural Revolution, when the degree of turmoil, irrational behavior, and xenophobia exceeded anything that occurred in the Iranian Revolution. But when Red Guards approached the Hong Kong border, China had the local army commander clear them away. Most surprisingly, China — concerned about the impact on Hong Kong — refused to accept sovereignty over Macau when Portugal attempted to give it back.

During tense periods of Sino-British negotiations over Hong Kong's future

from 1981 to 1984, China subsidized financial stability in Hong Kong. Since that time, China has made huge investments in Hong Kong. The Bank of China Building, Asia's tallest structure, symbolizes China's investments in Hong Kong real estate, buildings, and companies. The Bank of China has located 14,000 of its total 20,000 employees in Hong Kong. China has large holdings in Hong Kong companies, such as HK Telecom and Cathay Pacific Airways. If it plans to take arbitrary actions that would severely damage the Hong Kong economy, these huge investments by a regime short of capital make no sense whatsoever.

China refrained from taking Hong Kong neither from fear, nor from legal concern (China has always refused to recognize the legality of Britain's Opium War acquisition), nor from concern over the reactions of third parties, but from self-interest in the perpetuation of Hong Kong in its present role. This self-interest derives from an age-old dilemma. For centuries, China has been socially and politically fragile and hence properly frightened of giving foreigners unimpeded access to Chinese society. On the other hand, China has had no choice but to deal with foreigners. The solution has been to deal with them through an enclave system. While the form of the enclaves has evolved over time – foreign-run customs services, treaty ports, and contemporary Hong Kong being the principal variants – the basic enclave strategy has persisted. Periodically, China has tried isolation, but that is always a disaster – either because the foreigners force open the door or because China's economy collapses when deprived of foreign technology, trade, capital, and stimulation. The ruthless termination of the foreign concessions and treaty ports other than Hong Kong was an aspect of China's failed attempts to resolve its problems through isolation.

Since 1978, China has definitively abandoned isolation. Even the current conservative leadership does not propose to close the door. Consequently, China's ancient dilemma has become worse. With tens of thousands of its citizens abroad, and with trade having risen from \$29.3 billion in 1979 to \$111.6 billion in 1989, China's contacts with the outside world have multiplied and will continue to do so. But these contacts have also exposed China to foreign ideas and standards (as Deng Xiaoping says, opening the window lets in flies and mosquitoes), and Chinese Communist society has become more vulnerable. With the worsening of this dilemma, China's need for enclaves has expanded, not contracted. This ensures that Hong Kong will not go the way of Weihaiwei or the old foreign concessions in Shanghai and elsewhere.

China has in fact responded by enlarging the enclaves. Since Deng gained the helm, China has created numerous other investment zones, thereby broadening the enclave strategy to encompass far larger populations and territory and, more important, far greater impact on its development. The new conservative leadership has cut back some of the special advantages of these zones, but, as with the broader strategy of economic opening, has not reversed course. It is in fact creating a new investment zone, Pudong near Shanghai, one-third the size of Singapore. It is discussing policies that conservative critics inside China denounce

as Hong Kong imperialism – moving the effective border back so that Hong Kong would incorporate Shenzhen and attaching Guangdong to Hong Kong in a joint development program.

China recognizes that it has a vital interest in Hong Kong, repeatedly articulates its interest in Hong Kong’s “stability and prosperity,” and whenever necessary takes action to preserve its interests. The interest in Hong Kong’s capitalist prosperity, and the strategy for preserving it, are one of the few areas of consensus for China’s otherwise deeply fragmented leadership. Current Beijing officials, dissidents, and scholars with access to the leadership’s deliberations on Hong Kong all testify to that consensus.

Can China be Trusted?

The analysis of China’s self-interest can shed light on a second central issue – whether the government can be trusted to implement its promise of fifty years of post-1997 autonomy and capitalism for Hong Kong. After the June 1989 Tiananmen Square massacre, it became popular to argue that China’s promises could not be trusted and therefore Hong Kong could not rely on the Joint Declaration of 1984 for Hong Kong’s future autonomy.

This extremely negative view displaced the previous, overwhelmingly positive conventional wisdom that China had never dishonored a major international commitment and therefore could be trusted to honor this one in exactly the way it was interpreted by Western press commentators. Truth lies in the middle of these extreme views. Contrary to post-June 1989 wisdom, it remains true that China has never dishonored a major international commitment, but it should surprise nobody that it interprets the Joint Declaration in its own way.

China’s record for honoring its commitments is indeed unusually strong. In some ways, its record is superior to those of the major industrial democracies. But it is also true that China tends to write agreements that are subject to considerable adjustments of interpretation, depending on the circumstances and the interpreter (as if it had a particularly good Western lawyer). For instance, it gave Tibet autonomy under central leadership – and autonomy got the emphasis during the negotiations while central leadership got the emphasis later. Thus, there is a dual lesson in any survey of China’s behavior: first, after setting aside many footnotes about commercial behavior that is different from the West’s, its credibility at honoring most formal agreements is remarkably good; second, it is vital to understand how Beijing interprets those agreements and to understand that its interpretation will of course align with its self-interest. Whether the Hong Kong agreement works disastrously like Tibet’s or well like some agreements with surrendered Guomindang generals depends on Beijing’s perception of its self-interest.

One positive aspect of the record is clear. The ups and downs of Chinese domestic politics have rarely interfered with honoring international agreements. The principal exception was mob behavior toward diplomats at the height of the

Cultural Revolution. This must be reassuring to those concerned about Hong Kong's fate, given the periodic power struggles in Beijing. And the reassurance is overwhelmingly strengthened by China's enduring consensus that Hong Kong should continue in roughly its present form – without the British government.

China made no international promises about its handling of domestic political behavior focused on Deng's commitment to the Four Principles, ensuring the persistence of socialist economics and Communist politics in China. His oft-repeated oaths on this subject were widely ignored before Tiananmen Square. Afterward, the real problem would seem to be not that he broke his promises but that he kept them.

More negatively, the Joint Declaration contains exactly the kinds of ambiguity noted above with respect to Tibet. On the one hand, the Joint Declaration says that Britain will govern Hong Kong until July 1997 and then Hong Kong will have the same system for another fifty years. Most Western journalists took this to mean that Britain could do whatever it liked in restructuring Hong Kong's politics toward democracy and that China was stuck with the results. On the other hand, the Joint Declaration also says that Hong Kong will be governed by a Basic Law, to be written by China.

To the surprise of most Western editorial writers, China has emphasized the latter clause. It has, moreover, instructed Britain on the necessity of "convergence," namely that what Britain does before 1997 should fit the Basic Law. Most Western commentary has treated all of this as China's treachery over its promises, compounded by Britain's betrayal of its principles.

It is better understood as a typical diplomatic agreement, where differences of view that cannot be resolved are papered over by including in the agreement crucial ambiguities or even euphemistically worded contradictions that have to be resolved later. In the later resolution, China held all the power, while Britain held little aside from the ability to destroy Hong Kong before it left. What China and Britain did was neither treachery nor betrayal but diplomacy. Anyone who ever parsed a Strategic Arms Limitation Talks (SALT) treaty would understand.

China's actions in Tiananmen Square were murderous, incompetent, and uncivilized; but they broke no promises and implied nothing about promises made to Hong Kong. Moreover, those actions were not a break with the past. China has always treated dissidents brutally, honored its international agreements, and protected Hong Kong. These three continuities are not inconsistent.

The prospects for China's honoring its agreements over Hong Kong rest on three foundations. First, China has an excellent record in honoring past agreements. Given the great importance of Hong Kong (and the high risks to China if Hong Kong somehow goes wrong), given the ambiguity of the agreement, and given that Hong Kong is predominantly a domestic issue for China, this pillar might be regarded as weak if taken alone.

Second, China has frequently stated its determination to use the success of the "one country, two systems" formula as a basis for eventual unity with Taiwan. Despite the psychological setback to this strategy after Tiananmen Square, China

has stuck to it without deviation under both liberal and reactionary leaderships. And if unity is measured in broad functional terms, the strategy is working: despite Tiananmen Square, Taiwanese investment and tourism are increasing, Taiwan is about to legalize two-way trade, the People's Republic of China (PRC) and Taiwan are about to begin direct air service, and the Taiwanese diplomatic stance is becoming more flexible almost monthly.

Third, and most important, China's vital economic self-interest is at stake. Two-thirds (65.7 percent) of foreign direct investment in China between 1978 and 1987 came from Hong Kong. Some 25 to 30 percent of all Chinese foreign exchange earnings come through Hong Kong, and most of China's technology purchases and managerial advice come through Hong Kong. Behind China's spectacular growth in the 1980s were two key trends: imports from Hong Kong grew at an 85 percent annual rate, and Guangdong Province, adjacent to Hong Kong, had a phenomenal real growth rate of 35 percent a year. The terms of the Joint Declaration are the minimum China needs to make Hong Kong work as an efficient enclave and relay point for capital, technology, trade, and tourism.

Finally, the post-Tiananmen Square period has severely tested China's promises to Hong Kong. The Chinese leadership was fearful of instability at home, determined to repudiate the excesses (as it saw them) of its liberal predecessor, and, not incidentally, furious at the way Hong Kong residents demonstrated against the leaders. In this difficult period, China took firm steps to control its own organizations in Hong Kong and to prevent subversion by Hong Kong, but its senior spokesmen repeatedly promised – for a while – that there would be no retribution against people who demonstrated inside Hong Kong against Chinese policies. On 4 April 1990, the most reactionary top leader in China's conservative leadership, President Yang Shangkun, affirmed in the preamble to Hong Kong's Basic Law that "the socialist system and policies will not be practiced in Hong Kong." For this leadership, in this particular period, such commitments showed considerable restraint and willingness to honor promises under pressure.

One thing China did not promise Hong Kong was Western democracy. It did promise "a high degree of autonomy" and that Hong Kong people would rule Hong Kong – promises subject to many degrees of interpretation short of treachery – and it committed itself to Hong Kong's "stability and prosperity." None of these promises implies a Western democratic system.

More interesting, neither did the British negotiators, whose view most of the time was that the future Hong Kong should be as much like the present Hong Kong as possible. Present Hong Kong is not a democracy. It is a consultative colony. It is an admirable, successful, prosperous, and reasonably free consultative colony, but not a democracy. Hong Kong is ruled from London through a governor. The governor consults a variety of elite local bodies, some of whose members are elected by a tiny electorate. The virtues of this system are that it is politically benign; allows broad personal freedom, a free press, and an independent judiciary; and is enormously prosperous because of a free-wheeling capitalism that no populist democracy would ever tolerate.

In order to perpetuate this system insofar as it is possible, Britain believed that it would be dangerous to create a political vacuum and that it was therefore essential to mobilize public support through a broader system of elections. But the effect of elections on policy was to continue being buffered by indirect election of the governor and councillors. Britain did not intend to incur any risk of populism.

There is a certain convergence between the British theory of how to govern a colony by consultative colonialism and the Chinese theory of how to govern a country by democratic centralism. The difference is not in the structure but in the use of the structure: Britain uses the structure for liberalism and capitalism, while the Chinese leaders use it in China proper for communism and socialism. In Hong Kong, China has promised to use the structure for capitalism and to include elements of liberalism (such as the free movement of people and capital) that are essential to making capitalism work.

It is noteworthy that Hong Kong's Chinese business elite, which serves as the consultative fulcrum of consultative colonialism, largely shies away from full-fledged Western democracy. Equally, some of the central British institutions that make Hong Kong successful deviate widely from accepted practice in Western democracies. (ICAC, the anticorruption agency, was at some pains after the 1990 enactment of a bill of rights in Hong Kong, to point out how severely the bill would constrain its activities. The British government takes great and justifiable pride in the results of ICAC but refrains from publicizing its methods. Chinese Prime Minister Li Peng could come to love ICAC.)

It would be wrong to ignore structural differences. For instance, the Chinese leaders rule through a political party and do not allow judicial autonomy, whereas the British deemphasize political parties and insist on judicial autonomy. Behind British colonial rule is the benign Westminster Parliament, whereas behind China's Basic Law lie the rough games of the National People's Congress (NPC). But it would be obtuse to miss the degree of similarity: the two sides have in mind structures that are sufficiently similar to allow a workable convergence; and, in the case of Hong Kong, China conceded that its goals (ensuring a flow of foreign capital, technology, and social techniques into China while keeping foreigners' access to China proper limited) can be attained only by allowing the structure to continue pursuing a largely capitalist and liberal path.

In short, Britain has always been a willing accomplice in subordinating democracy in Hong Kong to stability and prosperity. And this may be wise rather than unprincipled. Hong Kong is small, divided by severe ethnic rivalries, intensely fearful, transient in population, confused in loyalties, vulnerable to triad pressures, and irredeemably neither a nation-state nor a city-state. It is part of China and universally acknowledged to be so. It continues to exist exclusively because of its value as an economic utility. It maintains stability only by virtue of policies, growth rates, and numbers of police that have never been characteristic of liberal democracies. Under such circumstances, the prospects for democracy are inherently poor.

A system that will allow direct election of only twenty out of sixty legislators, that will permit Chinese review of laws concerning foreign affairs and national security, and that will choose a governor through an electoral college ratified by China's NPC is hardly a democracy. It is also more than could reasonably be expected based on historical experience elsewhere.

Despite the shortfall of democracy, the prospects for maintaining a high degree of personal liberty, press freedom, and judicial fairness (by Third World standards) alongside stability and prosperity are far from hopeless. Britain has striven to achieve this; and if it were to succeed in any significant measure, the appropriate world response would be to applaud a noble achievement and to measure that achievement in comparison with the real alternatives, which are quite visible – and quite appalling – in neighboring societies.

Hong Kong's Economic Vulnerability

China has a powerful interest in making its Hong Kong system work, and it has established a system that could work well. But any system can be mismanaged. Although China will have great influence, it lacks Britain's centuries of experience with light-handed colonial management. Chinese residents of Hong Kong fear that there might be circumstances under which China could invoke national-security concerns to deprive them of rights to which they are accustomed. Companies fear that there might be circumstances under which, for instance, disputes with Chinese companies might rise to the level of the National People's Congress and be settled under Chinese law. Hong Kong banks fear that the Bank of China will assert itself in damaging ways. And everyone fears China's epidemic corruption.

Such fears have not, so far, seriously damaged the economy, but they have induced widespread efforts to escape Chinese legal jurisdiction. Most major companies have relocated their legal domicile to more trustworthy jurisdictions; most notably, Jardines to Bermuda, Hongkong and Shanghai Bank to London. And a major proportion of the educated population has said it is interested in the possibility of emigration. To what extent has this endangered the future of Hong Kong as a prosperous, stable, free enclave?

The shift of legal domiciles by Hong Kong companies has no economic or political consequences; they do not shift their business along with their nameplate. But there are some real business shifts. Many companies have diversified their business geographically beyond what would seem to be justified by purely business calculations. This is difficult to quantify, since there is a natural logic to the diversification of many extraordinarily successful companies by taking over their Western counterparts. Nonetheless, particularly among the major British companies, there is clearly some deliberate diversification; for instance, Hong Kong Land is not investing aggressively in Hong Kong. Likewise, Hong Kong companies tend to borrow heavily for Hong Kong investments and then put considerable investments overseas. Is this capital flight from a dying Hong

Kong or aggressive acquisition by a dynamic Hong Kong? Predominantly it is the latter, although there is certainly significant diversification based on fear.

Similarly, more individuals are keeping money offshore, and the average individual may be keeping somewhat more of his money offshore. These trends are definitely real but easily exaggerated. Hong Kong money has always been footloose. Individuals as well as firms have always kept a high proportion of their assets overseas. The proportions have increased, but if capital flight were too vast, there would be upward pressures on real interest rates and downward pressures on the Hong Kong dollar that simply are not there.

The most vital issue is not capital but people. People, especially the most skilled workers, are leaving Hong Kong in large numbers: about 45,000 left annually from 1987 to 1989, roughly double the rate in 1984. The rate is expected to rise to perhaps 60,000 in 1991, reflecting the Tiananmen Square incident. This high rate of emigration disrupts offices, creates skill shortages, and worsens Hong Kong's currently severe inflation. To pessimists, the brain drain means doom.

For perspective on this admittedly serious problem, one can compare Hong Kong with Singapore. The press is as unanimous about Singapore's economic success and excellent economic prospects as it is about Hong Kong's morbidity. Prime Minister Lee Kuan Yew, in his 1989 National Day address, bemoaned the 1988 loss of 4,707 families from Singapore's top 25 percent, up from only 1,000 earlier in the decade.¹ Singapore has less than half the population of Hong Kong and its brain drain has risen much faster. It involves the same kinds of people emigrating to the same countries (largely Canada, Australia, and the United States) for similar reasons (disdain for current rather than prospective political constraints in their lives). And it is proportionately much more serious, because Singapore previously had a policy of severely restricting higher (especially post-graduate) education and consequently has a proportionately much more limited pool of high-level skills. Considering all these factors, its loss of talent has been of a similar order of magnitude.

The brain drain can hardly imply doom for Hong Kong and be consistent with rosy optimism for Singapore. It is in fact a serious but manageable problem for both countries. Hong Kong is just beginning to experience a return flow of people (10 to 15 percent of the outflow but highly concentrated among the most talented and ambitious emigrants) who have already received their Canadian and Australian passports, and it is the recipient of a vast inflow of highly talented people from Japan, North America, Western Europe, and Southeast Asia. In addition, many of China's most talented people are also immigrating—older people who have achieved such influence that they and their families can move to Hong Kong and younger people who have the ability to seize educational or job opportunities abroad.

The notion that Hong Kong is politically doomed is usually substantiated by reference to the 1989–90 economic downturn. The downturn has indeed been dramatic; the 13.8 percent real growth rate in 1987 fell to 2.5 percent in 1989 and probably to a similar figure in 1990. By extrapolating, one can indeed arrive at

a doom-laden conclusion. However, the evidence is that Hong Kong is experiencing a typical Hong Kong cycle, not a monotonic trend. Periodically, it goes through such cycles. Booms occur when the American and Chinese economies are strong and when a weak United States dollar weakens the Hong Kong currency and encourages exports. Down cycles occur under opposite conditions. For instance, the strong United States dollar forced down Hong Kong exports in 1985 to a level that created negative real growth. For much of 1988–90 Hong Kong faced a cyclically weak American economy, a cyclically weak Chinese economy, and a strong United States dollar, compounded by major political uncertainties. In consequence, it suffered a cyclical downturn very much like the one in 1981–82. That downturn was followed by a great upturn and a historic bull market. When the foreign economic factors turn up, the Hong Kong economy will turn up also. Historically, political problems have been consequential when the economy was in difficulty but far less significant when the economy was booming. This pattern is likely to repeat itself.

Moreover, since Hong Kong is much more than just a supplier for China, it can prosper even when China experiences political and economic trauma. The lesson of Tiananmen Square was not that Hong Kong businesses in China are at risk, but that, even in a time of terrible strife in Beijing, not one Hong Kong factory in southern China (where most are located) suffered any loss of production. And few of these businesses are dependent on Chinese demand. Most are processing centers for goods that will eventually satisfy Japanese, European, or American demand. China can experience vast political strife together with frightening economic downturns, as in 1958–61 and 1966–68, and Hong Kong can still grow.

Even if Hong Kong's problems are manageable in themselves, one could argue that they may sap its competitiveness, a potentially fatal problem in this hyper-competitive region. To test this idea, it must be examined for each of Hong Kong's major roles.

Hong Kong's first role is as an air lock for China, an entry point for technology, capital, management skills, and ideas. No other country can compete with Hong Kong in this respect. In theory, the special economic zones could become competitors. In practice, they have become colonies of Hong Kong because its investment totally dominates these zones. In the future, Shanghai or even Taiwan could become competitors, but that possibility is decades away.

Hong Kong's second major role is as a major financial center, the world's third largest if measured by the number of banks present or fourth largest if measured by the number of offshore loans originated. Hong Kong is also a major center for funds management, with U.S. \$114 billion under management, as compared with \$15 billion in Singapore. Most potential competitors are disqualified from the start: Bangkok because its telephones and infrastructure are inadequate, Manila and Jakarta because of that and many other reasons, Kuala Lumpur because it is politicized, and Taipei because its security environment is restrictive. Tokyo is the region's capital for the distribution of loans, but it cannot take over Hong Kong's origination role because it is too expensive, the language is not yet

widely understood by foreigners, Japan's culture is both esoteric and xenophobic, and its financial markets are so large and complex that they are becoming all-absorbing preoccupations for Tokyo financial executives.

That leaves Singapore, a serious competitor with none of the above deficiencies, which has managed to surpass Hong Kong in the volume of foreign-exchange transactions. But Singapore's tight controls on most markets and on the press will limit its role until controls are changed—and there is no prospect of early change. Most modern financial enterprises need the *Asian Wall Street Journal*, the *Far Eastern Economic Review*, and other publications that are banned in Singapore, and they cannot thrive in an atmosphere of heavy-handed business regulation.

It is noteworthy that, despite Singapore's years of campaigning to attract Hong Kong workers, only thirty-five actually moved from 1985 to 1988. This writer received almost as many résumés from Singaporeans wanting to move to Hong Kong as the total emigrants from Hong Kong to Singapore in these years. Hong Kong people seek Singapore residence permits as an insurance policy but most do not want to move there. There are unofficial reports that after Tiananmen Square 500 to 600 people accepted Singapore's offer of permanent residence permits; but even if this is true, Singapore emigration to Hong Kong in four years (873 people) was greater than Hong Kong emigration to Singapore in five years. Proportionately, Singapore migration to Hong Kong was more than double. Singapore officials confirm privately that similar trends continue.

Hong Kong's third role is that of a major manufacturer. Actually, Hong Kong is going out of the manufacturing business, except for certain specialized sectors. But it is becoming the manager of manufacturing in southern China. Like New York, Hong Kong has evolved from manufacturing to management, design, and finance. The roughly 2 million employees of Hong Kong firms in China are double the total number of workers in Hong Kong itself. There are many competitors for this role, but there is also plenty of work for all of them, and Hong Kong's role as a manager and designer is increasingly a regional one, with factories in Thailand, Malaysia, Indonesia, and even Sri Lanka.

A fourth major role for Hong Kong is as a regional headquarters. Most major firms require a headquarters in Tokyo and another for non-Japan Asia. In addition to the reasons for choosing Hong Kong or Singapore as a financial center, tax and other incentives make these two city-states the locations of choice. Hong Kong is regarded as a superior environment for cultural and entertainment opportunities, but Singapore has a more placid physical and social ambience. Both city-states appear to have entrenched roles in this respect, depending on a particular firm's sector and geographic orientation. There is no evidence of a large net movement of headquarters from Hong Kong to Singapore; some, such as British Airways, have moved the other way. The number of regional headquarters in Singapore is somewhat exaggerated by firms' tendencies to set up a miniregional headquarters in Singapore (often reporting to Hong Kong), in order to qualify for Singapore's special headquarters incentives.

Hong Kong is also Asia's press center. No other country offers comparable facilities and press freedom. Singapore has superior printing capabilities but it severely restricts press freedom. In the next few years, there will be no serious competitors for Hong Kong's role. However, depending on China's attitude, Hong Kong's long-term attractiveness in this area could weaken substantially at a time when one can imagine possible improvements in Singapore or Bangkok. This is a role that Hong Kong can lose. China will certainly be tempted to curb "slander" and "rumors" about China, as Lee Kuan Yew currently does in Singapore; but today, under Li Peng's conservative regime, the *Asian Wall Street Journal* is available in China and banned in Singapore.

The roles as an airlock for southern China and as a manager of huge manufacturing industries, together with its superb harbor and world-class communication and transport facilities, ensure continuation of Hong Kong's other roles as a major tourism center and entrepot. For two of the past three years, Hong Kong has had the world's most active container port. (Singapore was second, Rotterdam third, and New York seventh in 1988. Singapore took first place in 1989.) Tourism was hurt by the Tiananmen Square incident but has already rebounded.

In short, most of Hong Kong's major roles are secure — despite the brain drain — unless deterioration exceeds what seems likely. There is considerable margin for error without losing these roles. China may limit press criticism of itself, Hong Kong may become more bureaucratized, the brain drain may increase, crime and corruption may increase significantly, and China may undergo severe political strife in the succession to Deng Xiaoping — but the historical record shows that Hong Kong could still prosper.

A mainland version of the competition thesis holds that Shanghai is envious of Hong Kong's success and will seek to raise itself by suppressing Hong Kong. As evidence of the seriousness of this risk, some argue that China's bureaucracy dealing with Hong Kong and Macao affairs is dominated by Shanghainese.

This writer has sought to substantiate the thesis of Shanghai red-eye disease through interviews in Guangzhou and Beijing and discussions with figures from Shanghai. The evidence goes the other way. Shanghai perceives its problems as caused by China's excessive taxation, not by competition from Hong Kong. It seems more desirous of emulating Hong Kong than of suppressing it. Guangdong officials and scholars express no concern about being suppressed by Shanghai; they believe the Pudong economic zone outside Shanghai will follow a quite different model from their own, and they believe their proximity to Hong Kong and their superior ties to the overseas community ensure their continued success. Objectively, there is plenty of room for both Hong Kong/Guangdong and Shanghai to succeed. Shanghai is not burdened by Hong Kong but by its own internal problems and by excessive taxation. (Shanghai provides the bulk of the central government's revenues.)

The only shadow of validity to this argument is that China's tax problems, exemplified by Shanghai's excessive burden and by declining central-government revenues during a period of extraordinary economic growth, ensure an early

reform of China's tax system. The authors of the forthcoming Eighth Five-Year Plan have told a group of economists, including this writer, that the national tax system will be revamped and that the coastal areas are likely to lose some of their special tax privileges. But a fair tax system is not a Shanghai conspiracy, and Guangdong will retain its special cultural and geographic advantages, along with its head start in developing a modern economic system.

Implementing "One Country, Two Systems"

The central issues of Hong Kong's future concern the ability of both sides to implement a policy of "one country, two systems." There are three prerequisites for success of "one country, two systems": (1) neither side must subvert the other's political system; (2) China must actively support Hong Kong's autonomous capitalist economic system; and (3) Hong Kong must govern itself with economic efficiency. Each of these requirements poses important challenges. Whether one is optimistic or pessimistic, these three issues are the key to the future, so a disinterested analyst calculating Hong Kong's future prospects should focus on these. The only alternative to "one country, two systems" is "one country, one system." Making "one country, two systems" work is therefore a prerequisite for all discussion of future Hong Kong capitalism or liberalism or democracy or economic growth. As a corollary, speaking of democracy without considering the requirements of "one country, two systems" is futile.

After the Tiananmen Square incident, there was much talk of Hong Kong's crisis of confidence and of the risk that China would abrogate its promises and subvert Hong Kong's economic and political freedom. However, the real issue was the opposite. While Hong Kong did indeed have a crisis of confidence, it was not because China tried to subvert it; instead, China initially reaffirmed Hong Kong's freedom to demonstrate against Chinese policies without fear of retribution.

Hong Kong political groups did not stop, however, at demonstrating against Chinese brutality and denouncing it in the press. Some also sent large sums of money to support dissident groups in Beijing and in Paris. Some initiated fax campaigns to send political materials into China. Some helped smuggle leading dissidents out of China. A group led by two strong supporters of democracy called for the overthrow of the Chinese leadership and, according to China, asked the army to turn against the leadership.

China at this point had an even greater crisis of confidence than Hong Kong. A million dissidents assembled in the capital city. The prospect of such a huge dissident movement allied to large amounts of money from Hong Kong appeared to be a serious threat indeed. Hong Kong has a history as a base from which to subvert the central government of China. Moreover, China had lost control of its own apparatus in Hong Kong: its Chinese-owned newspapers were all denouncing their masters, and the New China News Agency (NCNA), which serves not only as China's propaganda arm but also as its shadow government

in Hong Kong, appeared to be completely in the hands of dissidents. It was as if Washington, D.C., had been swamped by a million dissidents, who had temporarily immobilized the army, while Manhattan, with all its media and financial power, was threatening to secede and throw its resources behind the rebellion.

China responded to this by disciplining its own people (installing a hardliner at NCNA in Hong Kong and firing newspaper editors) and by warning that Hong Kong would not be allowed to subvert China. It followed up by writing an antisubversion clause into the Basic Law. It specifically warned liberals Martin Lee and Szeto Wah to stop organizing for the overthrow of China's leadership.

These developments sharply polarized Hong Kong opinion. The liberal press denounced China for having the temerity to fire newspaper editors for their political opinions. Liberal politicians denounced the antisubversion clause as an attempt to undermine Hong Kong's autonomy. Much of the British and British-oriented population took the view that it was their inherent right as citizens of a democracy to send their money and their faxes wherever they pleased, and China's objections were deliberate subversions of Hong Kong's democracy. Martin Lee said he was not trying to subvert China—he was just advocating the overthrow of the Beijing leadership, not the termination of socialism.

China on the other hand took the view that "one country, two systems" meant that each of the two systems had to refrain from subverting the other; that trying to overthrow the leadership was indeed subversion; and that since it was respecting the internal affairs of Hong Kong, Hong Kong has a reciprocal obligation to respect China's internal affairs. China thought it had the right to fire its own newspaper editors, who are paid propagandists, without being accused of interfering in Hong Kong's autonomy. China said that Hong Kong people would be forgiven for protesting in Hong Kong about Chinese policies but could not carry those protests across the border.

The bloodbath of Tiananmen Square made virtually the whole world unsympathetic to Chinese arguments. But suppose that China had sent large amounts of money to Hong Kong groups advocating the immediate overthrow of the Hong Kong government, inundated Hong Kong's fax machines with propaganda advocating the overthrow of the government, organized major political groups around the theme of overthrowing the government, and smuggled revolutionary organizers across the border. Would Hong Kong have accepted this as consistent with the "one country, two systems" policy?

China does retain one right in Hong Kong that Hong Kong does not formally have in China, namely, the right to own newspapers and disseminate other forms of propaganda while attempting to limit capitalist "spiritual pollution" inside China itself. Formally, this is unfair. But the asymmetry derives from Hong Kong's system, which gives everyone the right to own newspapers and express his views. In practice, the asymmetry of rights does not work out unfairly. Since the height of the Cultural Revolution, China has not used its propaganda to undermine Hong Kong, since it has no interest in doing so. The Hong Kong

population, with British-level living standards, is not susceptible to China's ideology. In practice, Hong Kong radio and television stations reach a vast audience in southern China, and that audience is totally susceptible to the lure of capitalism.

The essence of the "one country, two systems" approach to Hong Kong's survival is that the two systems that ideologically detest each other must coexist for a long time. This is not unthinkable in the historical context of China's diversity and pragmatism. But it is difficult. It means that China must refrain from intervening against social practices and market consequences that it finds utterly despicable. And it means that Hong Kong has to be a good neighbor to a country that is brutally authoritarian. The real world provides no choices other than coexistence or absorption of Hong Kong into the Communist system.

In this situation, the view of some liberals that they are only exercising their democratic rights in actively subverting the Communist regime amounts to callousness about the fate of Chinese people who have to live in Hong Kong for many years. Most of the leading Hong Kong Chinese democratic "radicals" have foreign passports and therefore are not at risk. And the view that it is a sellout to demonstrate inside Hong Kong but not send money over the border belongs to a fairyland that has no place in real politics; those who have profound commitments to human rights have the right to put themselves at risk but not the right to put large, innocent populations at risk without their consent.

This perspective should guide every discussion of unification. The minimum that such a perspective implies is that Hong Kong must accept that it is under China's sovereignty after 1997 and must not try to compromise that sovereignty. Virtually the whole world has accepted Chinese sovereignty over Hong Kong; there is no alternative. Proposals by Hong Kong politicians or overseas friends of Hong Kong to internationalize the Hong Kong issue fly in the face of Chinese sovereignty. They ensure the maximum nationalistic reaction from China and the consequent defeat of the goals of the sponsors. How would the United States react to a Soviet proposal to internationalize New York?

Many denounced the Hong Kong government for not harboring the *Goddess of Democracy* propaganda ship; they should consider whether their views are consistent with maintaining "one country, two systems." The *Goddess of Democracy* may or may not be a good idea, but for Hong Kong to harbor it would be suicidal. The freedom of Hong Kong residents would not be enhanced by suicide.

Likewise, when the press discusses whether people should be prosecuted for using loud hailers without permission (a major local issue in 1990), the central issue should be whether the groups in question are using the loud hailers for purposes that are ultimately consistent with the rule of mutual nonsubversion. Whether the law has been invoked consistently in the past is nearly irrelevant. The relevant issue, aside from the minor one of noise pollution, is enforcement of the rules of "one country, two systems." If the ultimate purpose of an activity is to subvert China, then the government should invoke every archaic law available to suppress it. If not, government should ignore the loud hailers as it does in other cases. It is a sign of the confusion of the times in Hong Kong that one

can read dozens of press clippings on this controversy without being able to reach any firm conclusion as to the facts on the central issue. In this as in many other controversies, Hong Kong leaders must start to focus on the central issue.

It is also characteristic of the times that the government gave no clear statement of its policy, if such was its policy, to prosecute a group for using loud hailers because it believed their purpose to be inconsistent with the rule of mutual non-subversion.

Meanwhile, China's policy may have hardened. In December 1989, Beijing warned, somewhat ambiguously: "When Hong Kong compatriots want to raise opinions to the central government, they should do it through legal channels and in a legal way, such as, through the National People's Congress deputies, or the Chinese People's Political Consultative Conference National Committee members, or submitting a written statement and appealing to the higher authorities. If unsuitable means are adopted to express one's own viewpoints, things might go contrary to his wishes and damage might be brought upon the friendly relationship between the mainland and Hong Kong."²

While it promulgated this Delphic warning, China did not take action against any particular demonstration or editorial criticizing its policies. However, in February 1990, Li Hou, deputy director of the Hong Kong and Macau Affairs Office, warned that the Hongkong Alliance in Support of the Patriotic Democratic Movement in China might be banned after 1997 for advocating the overthrow of China's current leadership. After Hong Kong demonstrations in June 1990 commemorating the Tiananmen Square turmoil, Li Hou explicitly denounced the demonstrations as subversive. This seemed to be a clear reversal of the tolerant policy of a year earlier.

Several significant demonstrations and denunciations were held without Chinese protest. An NCNA representative who read the above paragraph subsequently invited this writer to lunch to assure him that Li Hou was not expressing official policy. Moreover, copies of the two most virulent opponents of the Chinese leadership among major world newspapers, the *Asian Wall Street Journal* and the *South China Morning Post*, are circulated free in major hotels in Guangdong and are available at major hotels and elsewhere in Beijing. This means that they circulate widely among the Chinese elite. There seems to be contradiction and change in the Chinese position, and this means that at a minimum there is room for negotiation.

Both sides are in a state of flux and confusion on this issue. They need an explicit understanding. Currently, the Hong Kong government is enforcing an antsubversion rule but not making it public and explicit; this confuses the public. Partly because the issue has not been squarely and publicly faced, the liberal press reports controversial issues without addressing the central concern and exacerbates public anxiety. On their side, some Chinese leaders have moved so far toward a hard line that they are raising legitimate doubts about whether freedom of press and opinion after 1997 will be adequate to sustain information-intensive businesses like regional banking, stockbroking, and publishing, and

also to sustain a large population of sensitive, opinionated, highly educated individuals who are the principal resource of such businesses.

The Hong Kong government can afford to surface this issue, endure the heat of controversy, and build a public consensus. The Chinese government can afford to take a magnanimous view, as on occasion it does, in the interest of sustaining the confidence and the service industries of Hong Kong. Many Chinese representatives have had great difficulty understanding the necessity to allow public criticism of China in Hong Kong. They need to reflect on the willingness of the Hong Kong government to allow strong public criticism of themselves; this demonstrates that accepting criticism and even demonstrations is a matter of principle. It shows strength, not weakness. If authoritative Chinese officials show understanding of this point and stop asking the Hong Kong government to suppress public criticism of Hong Kong, then Hong Kong's confidence will soar. After post-Tiananmen Square passions have subsided, an explicit, published agreement in principle between Britain and China should not be impossible, although there will always be difficult borderline cases. Whether this is accomplished is the single most important issue for Hong Kong's future, and those concerned about Hong Kong's future should monitor it more closely than any other.

While China has honored its commitment not to subvert Hong Kong better than Hong Kong has honored its obligation not to subvert China, there remain areas of profound concern for the future, most notably in the integrity of Hong Kong's judicial system. In China, the state controls the courts and expects to get the results it wants. In Hong Kong, the state writes the laws, but independent courts administer them and interpret them. Lawyers are accredited by the court, not the state. Hong Kong's economy could not survive a major compromise with China's system, because international firms expect to be able to sue the state, to sue firms belonging to the state without prejudice, and to have complex disputes adjudicated under the final authority of an independent court system. The further China goes toward ensuring the detailed continuation of such a system, excepting national security and foreign-policy issues, the more prosperous Hong Kong will be. The difficulty of dovetailing the two legal systems is compounded by a second difficulty: maintaining the competence of a system of English common law, based on vast archives of centuries of English cases, in a context where the language of the law and of general social intercourse will inevitably be shifting toward Chinese.

So far, neither the Chinese nor the British government has articulated a strategy to deal with these difficulties proactively. The Chinese leaders have ensured that they will have control of foreign affairs and national security, that they will control the court of highest appeal, and that they will have more influence over the process of appointing top-level judges and judicial administrators than would be possible under the British system. The Hong Kong government and legal profession have reacted defensively, sharply criticizing the changes. The Hong Kong Law Society has argued that it must severely restrict access by any outsiders,

especially Americans, to the practice of law in Hong Kong, lest China use any opening to swamp Hong Kong with its lawyers who would subvert the system. While the Hong Kong government has recognized that the Law Society is heavily motivated by a desire to preserve its members' oligopoly profits, it has bowed to the pressure, at least temporarily.

The resulting standoff is very important. Indeed, the ambiguities thereby created fully justify the widespread efforts of individuals and firms to establish legal domiciles elsewhere. In all probability, no feasible policies would alter the legal uncertainties about 1997 sufficiently for most large companies to keep their legal domicile in Hong Kong. But beyond this there is a risk that real business as well as legal domiciles will migrate unless the degree of uncertainty is limited. Such limitation can be achieved only by abandoning the fortress mentality of Hong Kong's legal system.

Three trends are inevitable. First, a substantial proportion of Hong Kong's lawyers will emigrate or repatriate to Britain. Second, the language of the law will gradually shift to Chinese. Third, lawyers from China will play an increasing role. Current Hong Kong policy seeks to roll back these tides. More sensible policy would attempt to channel them in positive directions. A protectionist Hong Kong legal system, the one created by current policy, will inevitably be weakened and swamped by these trends and will detract from Hong Kong's role as a hub of regional manufacturing headquarters and of the regional services industry. A more enlightened policy could bring an inflow of talented foreign lawyers to offset the current outflow (as is happening in other areas of business). A combination of welcoming Chinese lawyers, setting extremely high standards for them to be allowed to practice, and modest financial assistance to enable the most promising to meet the standards would create the basis for transition to a high-quality legal system dominated by Chinese Western-style lawyers from both Hong Kong and China.

This approach of channeling history's tides rather than opposing them should easily attain the assent and active collaboration of China, which in any case has an interest in expanding its capability to deal with Western legal systems and to obtain highly skilled advice about the refinement of its own legal system. And the proposal is hardly radical; it amounts to facilitating the same process in the legal system that is occurring quite fruitfully in ordinary business.

More broadly, China will have powerful agents of various kinds in Hong Kong: bankers, security officials, political figures, and a wide variety of others. Many of these people are likely to believe that they can improve on the way things are done in Hong Kong. Many will perceive ways in which they think they can further China's interests or those of powerful groups in China by making minor alterations in Hong Kong procedures, or by making minor exceptions to Hong Kong rules. Without a firm policy to the contrary and strong enforcement measures, such efforts can undermine Hong Kong very quickly, even if unintentionally. China has taken some measures to discipline its business operations in Hong

Kong. This is auspicious. China should indicate its intention to continue to insist that all its representatives respect the Hong Kong system.

To take the extreme case, Hong Kong residents fear a Chinese military presence. It is foolish for Hong Kong officials to argue against a Chinese military presence in Hong Kong, since no self-respecting regime would accept a rule excluding its military from a vitally important territory and the most strategically important port of all China. It is not in Hong Kong's interest for the Hong Kong government to propose such a rule. But, having established its nationalistic right, China could enhance the prospects for "one country, two systems" by indicating that in normal times such a force would be small, elite, and rigorously limited in its authorized activities.

If political coexistence is the most important issue, economic coexistence is a close second. Hong Kong's capitalism and China's socialism are radically opposite, yet the two are inextricably connected. Hong Kong businesses employ far more workers in China proper than in Hong Kong itself. Most foreign investment in China comes from Hong Kong. One-quarter of China's trade squeezes through tiny Hong Kong.

The problem of "one country, two systems" in economics is more subtle than in politics. Hong Kong's successes are inherently subversive of much of the rigidity of China's socialism. But China acknowledges that it has benefited from this "subversion." Many of China's legal and market-oriented economic reforms are based on lessons learned from Hong Kong, and China freely acknowledges that Hong Kong benefits its economy. The price that China pays for these benefits is that Guangdong will always be one step ahead of the rest of China and Hong Kong will always be several steps ahead of Guangdong. Put another way, Hong Kong will always appear a bit economically subversive of China. To avoid killing the golden goose, China must deal with this "subversion" primarily by policing its own side of the border. It must not consider Hong Kong economically subversive if all Hong Kong does is to set an example of success. China's acceptance of the Hong Kong system demonstrates that to a large degree China understands and accepts this view.

In the future, a corollary will be equally important. When China is policing its own side of the border, it will have to do so in a way that does not disrupt the increasingly substantial operations of Hong Kong companies. This means that policy changes affecting Hong Kong investors must be made gradually and consistently – not so easy a lesson for a regime that frequently tries great experiments and suddenly changes its mind. But it is noteworthy that neither the turmoil of May-June 1989 nor the subsequent reversals of political and economic policy disrupted major Hong Kong investments in southern China.

In turn, Hong Kong must fully accept its role as an outpost of southern China. When its policies will have far-reaching consequences for China, Hong Kong must voluntarily coordinate its decisions with Beijing. There are natural limits to autonomy, and Hong Kong will have to recognize these. The proposed new

airport is an obvious example. This huge project would affect the development of southern China's transportation system for at least two generations and affect China's credit ratios for one generation. The financial markets will refuse to support a deal China has not endorsed, so it can exercise a veto without doing anything. Such interdependence transcends the legal niceties of promised autonomy. Failure to recognize and cope with this can only lead to financial and political embarrassment for Hong Kong and to bitter but inappropriate recriminations about "interference." What raises concern for the future is that success in such regional ventures requires a level of mutual balance and respect that will take great effort to achieve and is little evidenced today.

These aspects are important, but one will be decisive: China will have to police its own system as it affects Hong Kong. If subsidized mainland firms are allowed to undercut Hong Kong companies or if mainland political clout is used to subvert the Hong Kong decision-making process, then all the effort to create a "one country, two systems" model will have been in vain.

Among sophisticated observers, this is most commonly regarded as the Achilles' heel of "one country, two systems." When a senior official of a major Chinese company writes to the government demanding an increase in telephone rates, bypassing normal channels in an apparent effort to obtain by political clout what the company board could not obtain through normal procedures, the Hong Kong system shudders. When political influence in Beijing seems to be the primary consideration in allocating airline routes, then Hong Kong business becomes fearful. So far, the integrity of the system is largely intact. But whether it can remain so is the second key question in Hong Kong's future.

Improving Hong Kong-China Relations

These proposed policies can be successfully negotiated only in an atmosphere of considerable confidence and amity between Hong Kong and China. To date, both sides have been too fearfully defensive to adopt fully constructive negotiating postures. Much of the British community, and of the Hong Kong Chinese community that has most assimilated British mores, reacts to any cooperative approach to Beijing, or any adaptation to Beijing's way of doing things, as a "sellout." Much of the international press parrots this attitude, particularly since the Tiananmen Square incident. Government officials are applauded, and applaud one another, when they outspokenly make decisions without consulting China and then announce loudly to the press that they have done so, as was the case when the Hong Kong government announced that it would finance the new airport itself. While this is psychologically understandable, it does not contribute to the patterns of respect that are the only way Hong Kong can maintain its freedoms as well as its prosperity.

A friendly, consultative approach based firmly on an understanding that Hong Kong is a part of southern China and can succeed only as an integral part of southern China's economy has some hope of success. Reasonable analysts can

disagree on the chances of success, though some chance exists. But a confrontational relationship between Hong Kong and China has no upside.

Policy toward Hong Kong since Tiananmen Square has been defensive rather than constructive. Chinese officials have understandably spoken out against Hong Kong subversion but have been less eloquent in taking positive initiatives. Ritualized reassurances are not enough. They understandably denounced the Hong Kong government's unilateralism regarding the airport but only later balanced this with an acknowledgment that Hong Kong needs an airport. They still should acknowledge that its government has demonstrated for decades a superb capability in managing such projects.

China can afford to shift from a posture of defensive threats to one of firm but supportive management. China holds all the cards. It can kill an airport with a whisper or even with silence. It can change the political and economic mood in Hong Kong with a few curt sentences. It should begin actively to build the kind of Hong Kong it wants rather than just denouncing what it does not want.

The Burden of Autonomy

Assuming that China gives Hong Kong the high degree of autonomy that it has promised, will Hong Kong be able to cope with it? The Hong Kong debate has generally been conducted on the assumption that autonomy, democracy, and a high rate of economic growth are all connected. In proper circumstances, as in modern Japan, they can be. But self-rule can also bring self-indulgence, and a degree of democracy can also mean a degree of populism that impedes proper economic management. One does not have to be an ultraconservative to look across the South China Sea to the Philippines and fear the consequences of populism there.

The Asian countries that have achieved high growth have generally done so under strong leadership—Lee Kuan Yew, Park Chung Hee, Chiang Kai-shek, Chiang Ching-kuo, and in Hong Kong's case a firm British governor. Thailand, a partial exception, achieved takeoff only during the years of stronger leadership under Prem Tinsulanonda in the 1980s and suffered serious problems from populism between 1973 and 1976. Some of these problems recurred during 1988–90 and stimulated the coup of February 1991.

Hong Kong shows no signs of producing a strong leader, and China is unlikely to encourage a strong local leader. While Hong Kong is full of highly educated managers and other talented people, so is the Philippines. So far, good sense and stability have largely prevailed. Both Britain and China have sought to create a post-1997 Hong Kong that is elitist rather than populist. But there are signs of self-indulgence that need to be watched.

The Law Society's successful campaign in 1989–90 to prevent American law firms from hiring Hong Kong lawyers and providing advice on Hong Kong law was potentially destructive of Hong Kong's progress in becoming the headquarters of a booming regional service economy. Moreover, the intemperate xenopho-

bia of that campaign was if anything more disturbing than its outcome. Doctors and nurses are inclined to follow the lawyers' example. Facing a shortage of nurses, Hong Kong's nurses have nonetheless campaigned against acceptance of foreign nurses. When Hong Kong doctors proved insufficient to care for Vietnamese refugee camps, they nonetheless campaigned fervently against entry of highly skilled Belgian and French doctors on the ground that lacking Commonwealth certification, the latter were technically unqualified.

Second, the ability of local teaching groups to abort efforts to raise Hong Kong's standard of English by effectively freezing out native English speakers is equally disturbing. It is perhaps unfair but nonetheless true that the economic future of Cantonese-speaking Hong Kong lies largely with English and Mandarin (with Japanese increasing). The subtle populist resentment of this unfair fact of international economic life increasingly impedes the ability of international firms to get their work done efficiently, and now interest groups are presenting formidable obstacles to reform of the system. Executives find that employees trained in China are far better prepared and far more willing to improve their standard of English than locally trained people. Continuation of this trend would do more than anything else to diminish Hong Kong's competitiveness vis-à-vis Singapore.

Third, the ability of the police and civil service to hold an increasingly autonomous government to ransom for inflationary benefits may be greater than under a relatively secure British administration. The unwillingness of a fearful Hong Kong administration to confront excessive civil service wage demands sets a standard that the private sector must follow and is perpetuating a serious inflation that threatens Hong Kong's competitiveness.

These trends contain two potential dangers. One is that domestic interest groups could steadily erode Hong Kong's competitiveness by pursuing narrow concerns at the expense of broader economic progress. In doing so, they would also undermine its stability as the mentality of narrow interests spreads, bringing disorder as well as inefficiency. The second is that such a development could lead to a decisive intervention by China – with considerable support from aggrieved groups in Hong Kong. This is far from an urgent danger, but it bears watching.

Along with self-indulgence, the second risk of autonomy is immobilism. A Hong Kong government dominated by the business elite, as it has been designed to be, could be paralyzed by competitive efforts to curry favor with China and avoid any policies that would antagonize it. Likewise, any Hong Kong government could be paralyzed, as much of China's government is, by strong interventions from a Communist leadership that frequently changes its mind. The need for Hong Kong authorities to be able to act is one of the most important reasons for China to encourage free-wheeling debate and vigorous political competition, even when some aspects of that debate and competition may be unpleasant.

Hong Kong will not survive an extended bout of either self-indulgence or immobilism. Its internal stability results from rapid economic growth based on stern economic priorities and rapid decisions. And its usefulness to China as an

autonomous entity derives exclusively from its economic utility. Politically, Hong Kong is a thorn in China's side; its survival depends on continued economic dynamism. For this reason, it is good indeed that the Hong Kong system has been designed around a strong chief executive. It is essential that the decision-making process be designed for efficiency, not just for local autonomy and convenience. What remains to be seen is whether China will endorse a strong, locally oriented chief executive who is a product of the Hong Kong system and will act firmly in its interest.

Prospects for Hong Kong

The thrust of this argument has been that the concerns most often expressed about Hong Kong's future do not stand up in light of the evidence. On the other hand, there are valid concerns as to whether both sides will do what is necessary to make "one country, two systems" work and to make autonomous government function. Whether one is optimistic or pessimistic about the areas of concern, it should be possible to agree on what they are: political coexistence, economic coexistence, constructive engagement, successful autonomy, and governmental effectiveness.

In the meantime, some noteworthy trends will vitally affect Hong Kong's prospects. First, Hong Kong's economy retains a vitality that leaves little doubt that its standard of living in the year 2000 will exceed Britain's.

Second, regardless of any Chinese action, uncertainty over its attitude toward the legal system will be sufficiently great to cause large-scale continued migration of company domiciles and individuals out of the territory. Hong Kong will never be so attractive politically as it is economically. The failure to distinguish political from economic prospects has caused much fruitless debate. Hong Kong's destiny is to be an economic utility of China that will provide the minimum freedom necessary to make the economic magnet work; that minimum should keep Hong Kong a relatively free as well as prosperous place to live. But Hong Kong will never be a thoroughgoing democracy and has never had any prospect of being one. Concomitantly, educated people will always seek foreign passports—and China's interest will be better served when it recognizes that people are more likely to remain if they have their foreign passports.

Third, China has had the most successful economic reform in the history of the Communist world. Even after Tiananmen Square, it has not abandoned economic reform; indeed, it is gearing up for another major wave of reform. The income gains of the 1980s reforms were so spectacular that popular demand for further reform is overwhelming. This is auspicious for Hong Kong.

Fourth, the outstanding Chinese record of honoring international agreements remains intact, and China's self-interest leans overwhelmingly on the side of interpreting the agreements about Hong Kong in ways that are favorable to Hong Kong. Moreover, China understands this.

Fifth, Hong Kong continues to be given effective management control over

large parts of the southern Chinese economy, even by an extremely conservative Chinese government, and the benefits to China are so great that they create further momentum. The most important lesson of Tiananmen Square for Hong Kong was that even such a terrible struggle did not disrupt Hong Kong's role in the Chinese economy. These are powerful forces for optimism.

The risks to the future are also substantial. Hong Kong is likely to be economically successful even if China's leadership remains relatively conservative and insecure, but the future would be much brighter if China regained its composure and adopted a posture of confident magnanimity. China's insecurities have led it to a prickly nationalism that damages its own interest in Hong Kong stability by, among other things, refusing to recognize British passports given to Hong Kong residents and adopting a threatening tone toward Hong Kong demonstrations. One cannot predict how this will evolve by 1997. The leadership's insecurities could be either much worse or much better.

A more important source of risk is the natural limitations to Hong Kong's autonomy regardless of treaties. The importance of Hong Kong's airport to China, the indivisibility of the Hong Kong and Guangdong economies, the flow of knowledge across the border, the dominance of Hong Kong capital in southern China, the presence of powerful Chinese interests in Hong Kong, and the inevitability of efforts by Hong Kong businessmen to gain competitive advantage by exploiting political connections in China have inextricably bound Hong Kong and southern China. This means that it will take an active effort by China, not just restraint, to maintain Hong Kong's distinctive system.

Finally, and most important of all, there would be an overwhelming risk in continued failure by the Hong Kong government and the Hong Kong press to take a much more open and controversial stand on the subversion issue, achieve a degree of public consensus, acknowledge legitimate Chinese concerns, reach an explicit accommodation with China, and extract in return some explicit assurance that it must be acceptable for Hong Kong residents to criticize China, debate about it, and even demonstrate so long as they confine themselves to Hong Kong. The government has dealt with the policy problem effectively and quietly. The "quietly" part must be abandoned. Hong Kong has only two choices: one country, two systems or else one country, one system. The risks it faces in making one country, two systems work are substantial, but they are less overwhelming than is widely believed, and they are not disproportionate to the political risks faced by a number of other highly successful third world societies.

NOTES

1. Prime Minister Lee Kuan Yew, "Prime Minister's Eve of National Day Broadcast," 8 Aug. 1989, p. 4. He said "over 4,000 families." The press gave more detailed numbers.

2. *Beijing Review*, 25-31 Dec. 1989. I am indebted to Alan Romberg of the Council on Foreign Relations for pointing this out.