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Source: *Asian Survey*, Vol. 24, No. 4 (Apr., 1984), pp. 471-484

Published by: University of California Press

Stable URL: <http://www.jstor.org/stable/2644339>

Accessed: 16/06/2010 14:58

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HONG KONG AND THE CRISIS OF SOVEREIGNTY

_____ William H. Overholt

Britain seized Hong Kong Island in 1841 to punish China for confiscating large amounts of opium that Britain was importing into China and forced on China the 1842 Treaty of Nanking. In 1860 China ceded the Kowloon peninsula to the British in the Treaty of Tianjin. In the 1842 and 1860 treaties, China ceded the territory in perpetuity. In 1898 Britain forced China to sign a 99-year lease on the much larger “New Territories” (now 92% of the total territory) in order to balance concessions China had made to France. The Chinese attitude toward all three treaties is roughly what the U.S. attitude would be to a treaty that ceded Russia sovereignty over New York as punishment for U.S. laws banning importation of massive amounts of heroin.

At the same time, Hong Kong has played a useful economic role in China. For the Qing dynasty, the early Republican government, the warlords, the Kuomintang, and the Communists alike, Hong Kong has been a crucial source of foreign exchange and a place where one could do needed business with the foreign devil capitalists while isolating most of China from dangerous contact with Western society. The economic importance of Hong Kong is greater for the Communists than for their predecessors because the Communists have a great need for Western currency and technology and an even greater need to isolate most of the Chinese population from contacts with Westerners.

The policy of the People’s Republic of China (PRC) has been to protect Hong Kong as a necessary economic and financial gateway. China’s government has repeatedly stated that the “unequal treaties” ceding Hong Kong had no validity and that therefore the ending of the

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lease in 1997 was a matter of no concern. Even at the height of Cultural Revolution radicalism, Chinese troops ensured that rampaging Red Guards were prevented from causing trouble for Hong Kong. When the Portuguese tried to return Macao to China, the Chinese government refused to accept it, in part because the PRC wished to avoid panic in Hong Kong. But this was always a pragmatic economic choice, not a concession of ultimate sovereignty or of the validity of the treaties.

The 1982 Crisis

In 1979, on the occasion of the first visit to China by a Hong Kong governor, Deng Xiaoping said, "Your investors should put their hearts at ease." He repeated that formula in 1981. By 1982, however, according to British government sources, China indicated that it was thinking about the future of Hong Kong. At most, such thoughts were at a very early stage, and China did not feel ready for any formal discussions. But certain important Hong Kong investors, noting that the lease termination date was only fifteen years away, pressed Prime Minister Thatcher to insist on a formal extension of the lease. Mrs. Thatcher, perhaps more responsive to the issue than she would have been in the absence of the earlier Falkland Islands crisis, publicly announced her concern about such requests and raised it with the Chinese during a trip to Beijing in September 1982. The result was a mild communique characterizing their discussions as friendly and announcing diplomatic negotiations to ensure the stability and prosperity of Hong Kong.

When she left China, however, Mrs. Thatcher visited Hong Kong and made a speech in the course of which she declared, in reference to Hong Kong, that "treaties are made to be kept." In doing so, she reportedly disregarded the advice of Britain's professional diplomats, whom she regarded as discredited in the context of the Falkland Islands War. The Chinese took this to be an assertion of the validity of Britain's treaty from the Opium War and denounced Mrs. Thatcher bitterly. This diplomatic storm coincided with the peaking of a Hong Kong stock market boom, the nadir of the global recession, and the pricking of the extraordinary Hong Kong real estate bubble. Real estate prices fell about 40%. Because government revenues depend heavily on real estate taxes, this caused a large government budget deficit. The stock market fell from 1445 in August 1982 to 646 in October. Some conspicuous capital flight occurred. The Hong Kong dollar fell in value. Long visa lines formed outside the major Western embassies. The officers of one local subsidiary of a U.S. bank collectively demanded that the bank help them obtain U.S. visas, and the secretaries as a group demanded that the bank pay for Mandarin lessons so they would be ready when China took over.

Two major firms collapsed, and many firms were shaky. Fearful of cascading financial problems, the government decided to ask 90 of the colony's 357 deposit-taking companies to close their doors.¹ Foreign banks such as the Bank of China and Malaysia's Bank Bumiputra, among others, suffered from the property market fall. There was concern over the possibility of a wide-ranging economic collapse.

By mid-1983 the stock market and the Hong Kong dollar had partially recovered. The stock market climbed briefly past 1100 the third week of July 1983. The Hong Kong dollar was 6.11 to the U.S. dollar in September 1982, fell to 7.75 in June, and recovered to 7.24 by the end of July.² The atmosphere of panic disappeared. Expatriate investors recovered most of their confidence, but local Chinese businessmen remained deeply fearful. (Many of Hong Kong's Chinese business leaders came from Shanghai, where the nearly Communist government had reassured them about the future of their businesses in 1949 and then subsequently ruined them; for these businessmen, the trauma remains fresh.) The real estate market remained depressed because of severe overbuilding and lack of political confidence. The real estate depression clouded the future of the stock market, which depends heavily on real estate, and severely affected local credit markets because Hong Kong permits only real property (not merchandise) to be used as collateral. Hong Kong's problems, however, were lightened by a surprisingly early (fourth quarter 1982) pickup in textile orders as some of the Western economies began to recover. But severe political uncertainty will remain until Britain and China come to terms.

Early negotiations on Hong Kong took place in Beijing between a British team led by Sir Percy Cradock and a PRC team led by Zhang Wenjin. They appeared to make little progress, burdened as they were by the recent Thatcher declarations that "those who will break one treaty will break another" and by published Chinese support for the idea of self-governance by Hong Kong. While these talks were going on, Beijing covertly consulted Hong Kong's business and political leaders. The passage of the PRC's fourth constitution in December 1982 gave Chinese leaders a firmer base for making decisions. Zhang Wenjin was eventually given another assignment, the chief Chinese spokesman on Hong Kong Liao Chengzhi died, and a key British figure, Lord Belsted, was replaced after the 1983 British election that also provided Mrs. Thatcher with a firm political base for hard decisions.

1. Jesse Wong, "Colony to Ask Some DTCs to Close Shop," *Asian Wall Street Journal*, May 17, 1983.

2. The *Far Eastern Economic Review (FEER)* and the *Asian Wall Street Journal* carry exchange rates and Hang Seng stock market indices.

In May 1983 a delegation of private Hong Kong citizens went to Beijing to express their fears about the consequences of the self-rule proposal and were treated hospitably and seriously. By this time both sides appeared to have cooled off, to have consulted their experts, and to have put key domestic political controversies behind them. Further talks were held between the Chinese and Hong Kong Governor General Youde in Beijing in the summer of 1983 and subsequently, amid rumors that Britain was expressing its understanding of China's feelings on sovereignty and in the wake of China's return to its earlier formula that it sought to ensure both the stability and the prosperity of Hong Kong. Subsequent rounds of negotiation once again increased uncertainty, however, as China denounced British positions, pressed Hong Kong Chinese to demonstrate their loyalty to China, and threatened to impose a settlement unilaterally if negotiations did not succeed by September 1984. By early 1984 confidence increased again as differences were reported by the Chinese to be narrowing, due largely to British concessions.

The critical issues of *principle* in the negotiations are Beijing's determination to assert formal sovereignty and Britain's commitment to uphold the interests of Hong Kong's population. China regards the issue of sovereignty as a vital national interest and refuses to acknowledge Britain's right to speak for any of the interests of Hong Kong's Chinese population (who in Beijing's eyes are Chinese citizens). By late 1983 Britain had privately conceded sovereignty and was attempting to protect local Hong Kong interests in practical detail rather than asserting an overarching moral obligation.

The *practical* issues have been whether change will occur in 1997, earlier, or at "an opportune moment" in the indefinite future; whether Britain will retain a major role in Hong Kong after the change; whether China or the Chinese Communist Party will play any direct role in Hong Kong's governance; what changes in political and administrative arrangements will be made, and whether Britain will retain a role; whether Hong Kong will become self-governing; what guarantees if any will be provided by China to ensure Hong Kong's capitalist prosperity; and what social and economic policy changes if any might be required by Beijing's social and political principles. By early 1984 Britain had conceded any formal post-1997 administrative role, while China had promised to abstain from sending a governor from outside Hong Kong, to maintain a capitalist system and its prerequisites, to amend the new Chinese constitution to permit such an arrangement, and to maintain the negotiated arrangements for at least 50 years after 1997.

*CHINA'S INTERESTS AND
BARGAINING POWER*

China seeks above all to assert its sovereignty over Hong Kong. This is an overwhelmingly important issue, but what China seeks is acceptance of its moral position, not necessarily direct rule over Hong Kong. Second, China seeks to maintain Hong Kong's prosperity because China's economy needs Hong Kong: Almost one-third of China's foreign exchange comes from Hong Kong.³ China has invested US \$5 billion in Hong Kong, and has 13 banks with 150 branches in Hong Kong. Much of the current government's outward-looking economic strategy depends on Hong Kong. Third, and also very important, China urgently seeks a solution in Hong Kong that will reassure rather than frighten Taiwan.

To assert its interests, China has a dominant military, economic, and moral position. Militarily, it can seize Hong Kong at any time. But it wishes to use its military position only as a bargaining lever in peaceful negotiations because a military solution would destroy the Hong Kong economy and frighten Taiwan. More important, because of the way Hong Kong was seized by the British, and because Hong Kong is surrounded by China, populated largely by Chinese, and was historically part of China, the Chinese government would have the unified support of its own people and the acquiescence of almost all foreign governments in an assertion of Chinese rule. China controls Hong Kong's water supply and much of its power and food supply. China also has the ability to stir up political difficulties or to cause economic uncertainty inside Hong Kong whenever it wishes.

*BRITAIN'S INTERESTS AND
BARGAINING POWER*

Britain's goals are to avoid humiliation over Hong Kong, to continue to extract economic benefits from its administration of Hong Kong,⁴ to maintain good relations with China, and to ensure a livable future for Hong Kong's people. Although Hong Kong is the world's fourth largest financial market and a major British trading partner, Britain's economic and political interests in Hong Kong are relatively far less than China's,

3. See Frank Ching, "China Beginning to Reveal Earnings from Hong Kong," *Asian Wall Street Journal*, February 18, 1983, p. 1.

4. For an analysis of U.K.-Hong Kong economic interactions, see "Britain and Hong Kong," *Hong Kong Economic Report*, Hong Kong and Shanghai Banking Corporation, June 1983.

and are weakened further by the view of much of British labor that Hong Kong represents unfair competition for British workers.

Britain has strong bargaining power, however, because a Sino-British confrontation could wreck Hong Kong's economic usefulness to China, frighten Taiwan, and cause uneasiness toward China elsewhere in the world. Britain also controls billions of dollars, including the HK \$32 billion Exchange Fund, that are crucial to Hong Kong's financial stability.⁵

THE BARGAINING POSITIONS

Britain's initial position was that the existing treaties should be honored, that British administration of Hong Kong is required to maintain the colony's prosperity, and that China should negotiate an extension of effective British rule beyond 1997. However, Britain made clear that it would be flexible.

China's stated position is that China's sovereignty over Hong Kong cannot be questioned, but that Beijing will maintain the economic and social status quo in Hong Kong in order to ensure the territory's prosperity. Chinese leaders have explicitly stated that Hong Kong will remain capitalist, that it will remain a free port, and that the interests of local Chinese capitalists, overseas Chinese capitalists, and foreign capitalists will all be protected.⁶ They have stated that "Hong Kong should be governed by Hong Kong laws."⁷ The Bank of China has supported the Hong Kong and Shanghai Bank's plan to give mortgages running for 20 years.⁸ China has made substantial investments in Hong Kong and in nearby projects, such as a nuclear power plant, that will be economically viable only if Hong Kong is stable. China has suggested that Hong Kong should be ruled by Chinese, but by local Chinese rather than by PRC Chinese from outside Hong Kong; it has specifically suggested that no Chinese soldiers or administrators would be necessary and that British advisors would be welcomed in the absence of formal British administration.

All of this was very reassuring. But other Chinese officials suggested sporadically that China would want to clean up Hong Kong's crime and

5. See Anthony Rowley and Christopher Wood, "Hitting the Panic Button," *FEER*, June 2, 1983, pp. 108-110.

6. Author interviews in China, September 1982. See also Derek Davies, "The Pragmatists Prevail," *FEER*, January 20, 1983, esp. p. 27.

7. Derek Davies and Mary Lee, "Forward to Square Two," *FEER*, July 21, 1983, p. 13.

8. David Bonavia, "Alarms and Diversions, Then the 16-Character Solution," *FEER*, January 20, 1983, p. 32.

to put a cap on “unhealthy speculation” (the Bank of China was one of the biggest losers in the recent real estate collapse). A few Chinese officials, probably unrepresentative of top level thinking, initially suggested that Hong Kong could benefit from a dose of class struggle. There have been suggestions from other Chinese officials that the fall of the Hong Kong dollar was a conspiracy to weaken China’s bargaining position or the work of a handful of speculators, rather than a market response to political uncertainty.⁹ Such ideas suggested that China’s leaders might not fully understand the prerequisites of Hong Kong’s capitalist prosperity.

THE PREREQUISITES OF HONG KONG’S PROSPERITY

Hong Kong’s prosperity depends on a *free press* to circulate accurate, credible information and on an *appropriate educational system* for a capitalist economy; it can survive a ban on Taiwan’s propaganda and on violent criticism of Beijing, but not much more. It depends on *freedom of travel, of capital movement, and of trade*. This implies, among other things, passports or other internationally acceptable travel documents different from those of PRC citizens. Hong Kong’s economy needs a *convertible currency*, because international trade is Hong Kong’s life blood. It needs a *Western legal system* to mesh with international concepts of the validity of contracts and security of individuals. It needs the *diplomatic status* to negotiate international agreements, for instance over textile quotas. To continue its extraordinary economic vitality, it needs a *market economy*, in which mismanaged or obsolete firms go bankrupt and forward-looking individuals and firms become rich—without much government damping of such transitions. It needs for its firms to have *control of their technology and information* and the *capacity to make their own decisions swiftly*. In addition, Hong Kong must have sufficient *confidence in the future* to avoid bouts of panic when factions change in Beijing. It must maintain sufficient confidence to encourage a flow of capital investment and to permit retention and expansion of a base of human skills. And it must avoid the kinds of welfare state pressures that would raise taxes and reduce the flexibility of the territory’s economy.

While China wishes to be pragmatic and flexible, some of these requirements are subtle. The reasons why they are necessary may appear to many officials in Beijing, who have mostly lived their entire lives in isolation from the Western capitalist world, to be ideologically unaccept-

9. Mary Lee, “Softening on the Hard Issues,” *FEER*, June 9, 1983, p. 43.

able nonsense. Cumulatively, they represent a rather heavy dose of concessions that would be questioned by some factions in Beijing.

FACTORS INFLUENCING THE ECONOMY AND THE NEGOTIATIONS

The most reassuring aspect of the negotiations from Hong Kong's viewpoint is the almost total agreement of China and Britain as to the importance of maintaining Hong Kong's prosperity and the resultant necessity of maintaining the social and economic status quo. Moreover, there is substantial consensus within Hong Kong on this point. Rarely do two (really three) sides to a negotiation have such a consensus on the desirable outcome. But the overriding priority of China's need to demonstrate sovereignty, and Britain's initial perception of a need to maintain some sort of official political preeminence to undergird its administrative and legal systems, present a formidable difficulty in ensuring the mutually desired socioeconomic status quo.

This difficulty creates uncertainties that will have real economic consequences regardless of the outcome of the negotiations. Moreover, the uncertainties have been exacerbated by overreactions on both sides. China reacted with enormous vehemence to Mrs. Thatcher's September 1982 speech in Hong Kong, and in the process probably changed the substance of its own negotiating position to an extent that did not serve China's long-term interests. While Thatcher's speech was ill considered, it could reasonably have been dismissed by Beijing as perfunctory rhetoric. On the Hong Kong side, there was excessive emphasis on the instability of Chinese politics and the implications of this for Hong Kong; but surely the long history of a stable Chinese relationship with Hong Kong, as outlined above, and the protection of Hong Kong even at the height of the Cultural Revolution, underline the stability of China's position on the subject.

While uncertainties persist, there will be some capital flight. More importantly at the moment, there is a tendency for capital to bypass Hong Kong and a tendency for indigenous capital to avoid longer-term investments. The Hong Kong government and the PRC are quick to reassure people that there is net capital inflow to Hong Kong. But the statistics measure only flows through banks, and much of Hong Kong's capital does not circulate through banks. The statistics also do not measure the extent to which Hong Kong has missed opportunities for capital inflow, the extent to which special inflows from Indonesia and elsewhere have sometimes masked important outflows, the extent to which government manipulation of the way it pays its own bills has masked outflows, and the extent to which the people of Hong Kong have shifted

their holdings from Hong Kong currency into other currencies. (This latter shift, worsened by tax discrimination in favor of foreign currencies, has weakened the Hong Kong dollar.) There is limited panic outflow, but there is a large opportunity cost.

The uncertainty affects the sectoral growth of Hong Kong. Much of Hong Kong's economy, notably textile manufacturing, thrives on a short-term, risk-averse perspective, and is little affected by current uncertainties. Textiles continue to flourish. Hong Kong's role as a tourist center and entrepot is somewhat affected by uncertainties, but not much. Indeed, in the short run, the cheap Hong Kong dollar has substantially enhanced tourism. For the important electronics industry, there may be a more significant cost. Although Hong Kong can work wonders overnight in many aspects of electronics, the pace of change in key parts of the electronics industry may require somewhat longer-term investment these days (there are legitimate controversies about this). Certainly the electronics industry requires a middle class with high technological skills. Probably the greatest cost to Hong Kong of the current uncertainty is the fear within this middle class that their families have no future in Hong Kong; when this group shifts, as much of it has, from enthusiastic devotion to raising a family and fortune in Hong Kong to preoccupation with an assured escape route, the electronics industry has a long-term problem.

The most severe problem is that of the overbuilt real estate industry. Much of the important building activity assumes payback periods of 15 to 20 years. The real estate market is so glutted that only a broad-based, longer-term recovery can match demand to supply. Real estate therefore will not revive completely in the presence of uncertainty about the immediate future and the 13-year future. As noted earlier, other key aspects of the economy are, for the time being, greatly affected by real estate.

Finally, the future of Hong Kong is connected to that of the adjacent special economic zones of China, notably Shenzhen. These are areas where China has allowed foreign firms special access, created exceptions to China's economic rules in order to attract foreign capital, and provided special infrastructure. They are halfway houses to Hong Kong, designed to serve the same purposes as Hong Kong: gaining the economic benefits of Western methods while limiting the exposure of the Chinese population to Western culture. Much of China's grand economic strategy depends on the success of these zones.

Fear has been expressed that, if these are too successful, then Hong Kong could become obsolete. So far, the opposite seems to be occurring. Shenzhen grows ducks for Hong Kong's restaurants, provides housing

for Hong Kong's population, provides a destination for Hong Kong tourists, allows Hong Kong firms to bypass Hong Kong's textile quotas in the U.S. and Europe by operating out of Chinese territory, and even sells graveyards for HK \$10,000 per plot as compared with HK \$200,000 in Hong Kong itself. China is building a nuclear plant that would not be viable financially without Hong Kong's demand. Therefore, China's dependence on Hong Kong's continued capitalist prosperity is actually increased by Shenzhen. Meanwhile, China has also invested directly in Hong Kong; among others, the Bank of China made a major property investment in 1982 and committed itself to a major textile venture in 1983.¹⁰

Scenarios for the Future

Economically, the ideal scenario for Hong Kong's future would be the *status quo with British sovereignty*. The vast majority of the Hong Kong population wants this. There is no possibility whatever of its occurring. The feelings in China simply run too deep. Likewise, China absolutely rejects the possibility of an *independent Hong Kong*. Only a Hong Kong under China's flag, with important but unspecified administrative manifestations of PRC sovereignty, will satisfy China's nationalism. A third possible outcome, exemplified by Beijing's frequent suggestions that Hong Kong's indigenous population should rule, is local autonomy based on democracy. Two groups have sprung up within Hong Kong to press for such an outcome.¹¹ This democratic solution gives rise to several subscenarios.

Aden scenario Aden, like Hong Kong, was a tremendously successful entrepot, but at independence it became a wild, violent, barbaric communist outpost. Hong Kong's different culture, higher level of education, and susceptibility to Chinese power, along with British determination not to pass power in Hong Kong to such radical groups, ensure that this could not occur.

Democratic Welfare State scenario Self-rule could quickly lead to the emergence of pressure groups for welfare, for slower adjustment to economic forces, etc., in the manner of successful democracies nearly everywhere. Maintenance of the existing economic rules of the game

10. See Victor Keung Fung, "China Forms First Industrial Venture in Hong Kong," *Asian Wall Street Journal*, June 10, 1983, p. 1.

11. The groups are "Meeting Point" and "Hong Kong Observers." See Hong Kong Observers, *Pressure Points* (Hong Kong: Summerston Eastern Publishers, 1981), among others.

under democratic self-rule would be likely if Hong Kong had a homogeneous population that understood and uniformly accepted those rules, including meek acquiescence by the losers in the economic struggle. But in fact the rules are imposed by the British on exceedingly diverse and assertive population groups, many of which neither fully comprehend nor fully accept the system that produces their economic benefits. Hence, autonomy and full democracy would mean slower growth. This would not serve China's economic interests, but some approximation of it is not an unthinkable outcome. Probably, though, China and Britain would both perceive themselves as having such an interest in more rapid growth and would both sufficiently fear explosive forces within a slower growing Hong Kong that they would prefer a system more centrally controlled in politics and more free-wheeling in economics.

Singapore scenario An evolution along the lines of Singapore, which began as a somewhat leftist welfare-state democracy but quickly evolved into a one-party-dominant state under Lee Kwan Yew, would serve everyone's economic interests and would gratify Britain politically. But China would do whatever was necessary to resist the rise of a political leader as strong as Lee. Moreover, strong political leadership on the Lee Kwan Yew model presupposes Singapore-style government control of the economy; movement from Hong Kong's almost laissez-faire system to Singaporean state-managed entrepreneurship would be a drastic transformation, potentially disastrous if done quickly.

Because each of these self-rule scenarios has severe defects from Beijing's point of view, as well as from that of Hong Kong's population, a quick move toward any of these scenarios in any pure form would bring a collapse of confidence. In May 1983 a group of Hong Kong leaders led by Allen Lee bluntly informed Beijing that this was so.¹² Thus, despite China's early enthusiasm for self-rule, within the social and economic status quo, such a scenario has risks that would threaten full economic success. More desirable for those who seek to preserve Hong Kong's economic dynamism is an upgrading of local influence that stops far short of full democratic self rule. To the extent that Hong Kong moves toward docile self-rule of any kind, it will sacrifice its extraordinary economic dynamism.

Some people initially believed in a *Hong Kong ruled by a Chinese-appointed communist official* who, however, would have the job of maintaining Hong Kong's existing system. This certainly would not be stable, because any communist official, or even Beijing-appointed noncom-

12. See *Asiaweek*, June 24, 1983, p. 72.

minist official, would inevitably come under pressures from factions within the Communist Party and from groups in Hong Kong itself to undermine some of the prerequisites of capitalist success listed earlier. For much of the Communist Party, such issues are not just pragmatic choices but immoral practices. This scenario relies on an image of a communist governor who would reign but not really rule and under whom Hong Kong's able public administration would continue to operate. Such an image has two flaws. First, the administration cannot function without decisive political direction; there is no such thing as administration without politics. Hong Kong's leadership faces almost as broad a range of domestic political decisions as the leadership of most independent states. Second, the key role would not be that of the governor, but of the Communist Party, which would insist on the right to organize and would therefore become, willy nilly, a major political force. China understands this and has never pressed for such a solution.

Direct Chinese management is an outcome currently desired by neither China nor Britain nor any major portion of Hong Kong's population. It would therefore result from negotiating miscalculations. When both China and Britain were posturing in October of 1982, there was risk of a collapse of confidence of such magnitude that the British position would become untenable and China might have to move in.¹³ While a negotiating impasse, a return to dangerous posturing, and a collapse of confidence are still theoretically possible, the likelihood of such an outcome was never great and has now been minimized.

Finally, China could in effect grant an explicit *management contract* to Britain or, in an implicit version of the same thing, throw its weight behind an expatriate/local coalition that would enhance the role of the indigenous Chinese, but maintain the essence of the current system. The coalition would have to have real political power, not just administrative authority, but this could be consistent with Chinese concepts of sovereignty. This would create a *combination of indirect democracy and trusteeship*. Wags have suggested that the Board of Directors of the Hong Kong and Shanghai Bank, which is divided roughly evenly between British and Chinese industrialists and financiers, would constitute the ideal Hong Kong leadership. Such a leadership, rendered partially self-perpetuating by an indirect system of election and by support from Beijing, but also rendered modestly susceptible to popular pressures by

13. For such a scenario with emphasis on the financial aspects, see Anthony Spaeth, "Bad Dreams About Hong Kong's Future," *Asian Wall Street Journal Weekly*, July 11, 1983, p. 15. See also Anthony Rowley, "A Crisis is Averted But Root Causes Remain," *FEER*, November 26, 1982, p. 60.

the fact of elections, could conceivably manage Hong Kong so as to preserve its ruthless dynamism. Those who advocate democracy would not be happy with such a system. The key point here is that PRC and British economic goals, which are the paramount interests of those two powers, would be well served by such a system. The new Chinese constitution permits "special administrative zones," Communist China has always had autonomous regions, Chinese tradition legitimizes such pragmatic arrangements, and China is anxious to demonstrate to Taiwan that such a formula can work. Presumably this is the outcome most desired by realistic British negotiators. But it would be acceptable to China only if Britain were to capitulate completely on all symbolic issues associated with sovereignty. China would probably also require substantial upgrading of the representation of local Chinese in the Hong Kong government at the expense of expatriates. China would then designate Hong Kong a special administrative zone.

Such a system seems the logical outcome of British and Chinese national interests and of current negotiating trends. In theory, it would work. There is no guarantee, however, that the two powers will concur completely or that, even if they concur, they will find a fully workable solution on the first try. To the extent that they miss the mark, Hong Kong's future economic performance will decline from the roughly ten percent per year performance of the past generation. If there is a problem, it would most likely consist of too much Beijing influence, too much influence by pressure groups indigenous to Hong Kong, too much uncertainty about the details of the 1997 transition, too much regulation (including requirements to disclose information or to obtain prior approval for key decisions), or too much uncertainty about the ways in which the previously discussed prerequisites of economic success are to be defended.

If there is a significant decline in economic dynamism, this would not inherently constitute a disaster. If, for instance, growth declined from ten percent to five or six percent, this would still be far superior to the economic performance of most of the Third World. But in Hong Kong there would be risks even in such relatively superior performance. Long-run expectations of five or six percent growth would create enormous incentives for the professional class to emigrate; the political and economic risks of Hong Kong are acceptable only if offset by extraordinary opportunity. Hong Kong's economy depends on the commitment of large numbers of professionals and entrepreneurs to focus their short-term attention on making money in Hong Kong rather than on escaping, and on their long-term commitment to raise families in Hong Kong. Thus expectations of a serious reduction in growth rates are more

serious in Hong Kong than elsewhere; there is a potential multiplier effect at work in the decline of professional and entrepreneurial commitment and in the willingness of the working class to accept Hong Kong's rigors.

In summary, there is a theoretical solution to the dilemma of Hong Kong. This solution would not be rigorously democratic, but it could be politically popular and economically successful. But the success of the negotiations does not ensure the success of the economy, and the negotiated political outcome will not be durable if economic performance deteriorates too much. Both sides are negotiating in good faith. Both have long records of honoring their commitments. But no guarantee of the status quo until 1997 and of the socioeconomic status quo for 50 years thereafter will be sustainable if uncertainties or misjudgments create a hemorrhage of professionals and entrepreneurs. Expectations of declining growth could trigger a sudden, early crisis of confidence that would force Beijing's intervention, or longer-term declines could force Beijing to exercise more supervision. Or, realization of such difficulties could lead to favorable course corrections. The end of the negotiations may well prove to be just the beginning of the shaping of Hong Kong's future.