

## What Will Happen to Hong Kong?

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Hong Kong has long been recognized as a prime example of the efficacy of the market. Although it became a leader in manufacturing by being a low-cost producer, a crucial competitive edge now held by Hong Kong is its ability to quickly transform its economy from manufacturing to services without causing high unemployment and to rapidly get goods to world markets. Within the past two decades manufacturing has reduced its labor market portion from greater than 50 percent to 14 percent while the services sector labor shares climbed from 44 percent to 82 percent.<sup>1</sup> Such agility has helped Hong Kong rapidly transition its metropolitan economy. The fact that its economy has weathered the Asian crisis as well as it has is a testimony to its economic strength.

The longer-term challenge is to maintain its competitive markets as a Special Administrative Region (SAR). Although the slogan is Aone country, two systems,@ the longer-run effects on Hong Kong are unknown. Manufacturing jobs have been created as Hong Kong companies have moved into China to avoid higher labor costs and high rents in Hong Kong. In doing so, Hong Kong has provided both financial capital and technical expertise while simultaneously containing costs to maintain competitiveness in the global market.

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<sup>1</sup>Yeung Wai Hong, "Free Trade and the Future of China's Market Economy: Insights from Hong Kong," @ *China in the New Millennium*, ed. James A. Dorn, Cato Institute, 1998, pp. 126-127.

Hong Kong and China have become one another=s largest trading partners. Approximately 80 percent of Hong Kong manufacturers have invested in China with their total investment account for 60 percent of total foreign investment.<sup>2</sup> Ninety percent of the foreign syndicated loans made available to China have originated in Hong Kong. Additionally, the credit card was introduced into China from Hong Kong. All major credit cards are now accepted in China. Such has been an impetus to tourism and retail trade (Pang).

Although China=s state owned enterprises employ two-thirds of China=s 170 million urban workforce, they account for less than one-third of industrial output.<sup>3</sup> For Hong Kong firms which have relocated manufacturing operations, the main office remains in Hong Kong and focuses on marketing design and logistics. Although much of the production formerly within Hong Kong has been shifted to China, the scale of production by Hong Kong has been enhanced; i.e., while AMade in Hong Kong@ has fallen, AMade by Hong Kong@ has grown (Berger, Lester). Indeed, Hong Kong is the major port for both exports from and imports to China. Daniel Burstein and Arne de Keijzer have commented:

One=s opinion of Hong Kong=s future depends on which of two conflicting promises one accepts about Beijing=s thinking. On the one hand, it is clearly in China=s material interest to maintain the status quo and continue to profit from a robust, successful Hong Kong. On the other hand, when forced to deal with certain levels of political issues, China has always been willing to forgo its economic interests in order to make a political point (Burstein & Keijzer, 1998).

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<sup>2</sup>Ibid., p. 134.

<sup>3</sup>ABeijing Rules: China=s State owned Enterprises.@ *The Economist*. May 3, 1997, pp. 54-55.

Nevertheless, the conventional wisdom is that China will tolerate some degree of political differences in Hong Kong that it would not allow within the mainland because of enlightened self-interest; i.e., Hong Kong is its major source of financial capital. Since 1987, approximately 120 billion dollars of investment has flowed into China from Hong Kong and overseas. Also, several hundred of the leading enterprises in China has invested about 45 billion dollars in Hong Kong=s economy. During the first few months of the Asian financial crisis, China stood ready to reinforce Hong Kong=s stand to maintain its currency peg to the U.S. dollar. China does stand to gain in world prestige if things go well with Hong Kong. China hopes that it can leverage such prestige over time to factor into the Taiwan equation (Burstein & Keijzer). Again, Burstein and Keijzer emphasize:

While we understand that China has material interests in Hong Kong=s stability and prosperity, we disagree with the widely held Western belief that Hong Kong is too important to China for the situation to be mishandled. Hong Kong may be the goose that lays the golden egg, but as the well-known Asian, Lord Chambers Johnson, has pointed out, Chinese history is filled with incidents in which such geese were killed anyway (Burstein & Keijzer).

According to this view, Beijing will not long endure any perceived serious political threats from Hong Kong.

To others, the real threat to Hong Kong is not political or outright governmental takeover, but the potential damaging impact of what Timothy Roe of Solomon Brothers has called Chinese management of the environment, infrastructure, and social structures. His concern is not the possibility of direct expropriation of Hong Kong enterprises, but more subtle manipulation of Hong Kong markets and business practices (Burstein & Keijzer).

The subtle challenge may also extend to displacing Hong Kong=s role by other Chinese cities which believe they can do everything Hong Kong can do. For example, a considerable amount of Hong Kong=s industrial and financial expertise came by way of

the post-1949 fight of Shanghainese. Jiang Zemin and others he recruited to central government from Changhai apparently have aspirations to make that city the leading financial and business center of China, and hence, Asia (Burstein & Keijzer). As Joseph Kahn and Marcus Brauchli have stated, AShanghai will not be able to catch Hong Kong immediately, but Shanghai will be Asia=s number one commercial city. This has already been decided at the highest levels@ (Kahn & Brauchli). Indeed, during my visit to Hong Kong in July of 1998, one Hong Kong businessman commented that it was only a matter of time before Shanghai becomes the head of the dragon with Hong Kong becoming one of the dragon=s feet. According to one of Hong Kong=s leading newspapers, *The South China Morning Post*, APut simply, Hong Kong ignores Shanghai at its own peril.@<sup>4</sup>

Shanghai aspires to become an international financial center comparable to Hong Kong.<sup>5</sup> Prior to 1949, Shanghai was China=s center for international capitalism. As the Communists clamped down to create the urban proletarian masses, many Shanghainese entrepreneurs resettled in Hong Kong where they sought the freedom of enterprise that was taken from them in Shanghai. William Kemenade states that, Anow in the late 1990s, there is little doubt that Shanghai will eventually overtake Hong Kong in terms of sheer economic power.@ However, he comments, A...but it is difficult to imagine it even acquiring the sophistication, the symbiosis of East and West, the civil order and legal security, and the freedom of information that Hong Kong now enjoys@ (Van Kemenade, 1997). Kemenade has also commented that:

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<sup>4</sup>ADragon Head Thinks Big,@ *South China Morning Post*, China Business Review Section, July 9, 1998, p. 1.

<sup>5</sup>Ibid., p. 93.

Hong Kong is one of the most spectacularly successful city states in world history.... Never, not even in Venice in the late Middle Ages or in Amsterdam in the seventeenth century, has such immense wealth been accumulated in such a short time. Hong Kong owes its success to the unique synergy of flamboyant Chinese opportunism and the rule of law and stability of British colonial >enlightened despotism.= Its per capita income is already higher than that of its >stepmother country,= England, and forty times that of its historical mother, China (Van Kemenade).

The above views regarding shanghai=s potential, although expressed by several whom have considerable expertise on China, are not shred by this writer. Shanghai lacks the essential economic freedoms of Hong Kong, which are the sine qua non of wealth creation.

Frederick Stitz and Anthony R. de Souza state that, AHong Kong is too important to China for Beijing to alter the status quo.@ However, they contend that AChina=s resumption of sovereignty will result in a subtle erosion of civil liberties....@ (Stitz & de Souza). It is to be noted that under the formula of Aone country, two systems,@ Beijing has promised to maintain a market economy in Hong Kong for half a century following the handover of July 1, 1997.

Stitz and de Souza have remarked that:

At present, economic optimists are ascendant. Firms and banks are signing long-term contracts.... Savings show foreign investors more confident in Hong Kong=s future now than they were two years ago.

But for those looking at Hong Kong through a political lens, the future looks somewhat less rosy. Hong Kong under the British rule was never democratic. Politics was dominated by a governor and a hand-picked group of local advisors. But the colonial administration generally respected civil

liberties and provided an efficient and even-handed legal system. China has started to erode civil liberties already (Stitz & de Souza).

Again, regarding the importance of economic freedom, Professor Tseng Shu-ki of Hong Kong Baptist University had stated:

.... vested interest in keeping Hong Kong functioning as a capitalist enclave are so huge that China cannot rationally >absorb= Hong Kong, and turn it into just >another city= in the country. A capitalist enclave plays a unique role in helping China to attract foreign capital, technology, and managerial expertise.... (Tseng, 1998).

Shanghai could not likely overtake Hong Kong unless shanghai were granted the same substantial economic and civil liberty realized by Hong Kong. On the other hand, poor policy decisions by Beijing may implement a form of ancient Chinese statecraft and, Akill the chicken to scare the monkey@ (Kahn & Brauchli). In other words, if Hong Kong should come to be considered as a source of ideas on political economy which challenge the political power base on the Chinese mainland, then Hong Kong would be radically changed for the worse.

The nexus between economic and political freedom is delicate. While China has allowed more economic freedom, Beijing yields little in the way of political freedomCparticularly if political action attempts to manifest itself in the form of visible opposition to the prevailing government. Should the privatization process of state-owned industry in China be accompanied by slower economic growth (GDP has to increase by approximately eight percent per annum to absorb labor force growth), higher unemployment could cause serious socio-political unrest. To reduce the likelihood of a political revolt or even serious and widespread visible social and political unrest, glasnost (openness) could be sharply curtailed. The leadership in Beijing is cognizant that Mikhail Gorbachev

ultimately was ousted after allowing considerable glasnost before perestroika (economic restructuring) could be accomplished.

Hong Kong governmental leaders have expressed different views on the issues of governmental direction and economic freedom. For example, Anson Chan, Chief Secretary of Hong Kong states in a 1997 speech in Mania that Hong Kong has prospered on the premise that business decisions are best left to businessmen, not bureaucrats (McGurn).

Another viewpoint was stated in 1997 by Tung Chee Hwa, Chief Executive of Hong Kong. In an address to the Chinese Chamber of Commerce, Mr. Tung remarked, "A non-interference policy would not meet the needs and strengthen the competitiveness of today's Hong Kong" (Sing). In other words, the SAR may need to reconsider its opposition to industrial policy.

One year following the return of Hong Kong to China and the implementation of the formula of "one country, two systems," an editorial in the *South China Morning Post* stated:

The unique nature of the experiment launched one year ago means that it will not be business as usual here for a long time to come. Dealing with a constantly evolving situation in which there are, in the end, so few certainties—particularly given the unexpected economic crisis—is the challenge and the opportunity which Hong Kong has faced since July 1, 1997.<sup>6</sup>

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<sup>6</sup>Meeting Expectations, *South China Morning Post*, July 1, 1998, P. 18.

Nevertheless, the editorial noted that Hong Kong and Beijing had thus far met the challenge better than many might have expected. As one writer commented, "While the SAR (Special Administrative Region) is already one year old, in certain key respects, the transition has yet to come" (Lau).

China will, of course, not only have an impact upon Hong Kong, but in one way or another will influence the rest of the world. K. D. Chen, former editor of the Chinese language Hong-Kong based *Huanan Economic Journal*, has said, "For years people have complained that it is difficult to adjust and to fathom the Japanese—their is a very different world. It is even more difficult to understand and try to work with the Chinese. Japan has 126 million people. China has 1.2 billion people.... Who can afford to ignore China?" (Naisbitt).

Internet guide to Asia states that, "Hong Kong's dynamism is unforgettable. Despite being one of the last British colonies to go, Hong Kong has always struck to its roots, and the culture beneath the glitz is pure Chinese."<sup>7</sup> Such notwithstanding, the complex combination of the Cantonese mystical union of feng shui (wind and water balance) and the Hong Kong culture's pragmatic can-do attitude is best captured in the statement by Sun Yat-sen which is quoted at the beginning of this paper.

Almost 20 years ago, Professor Huge Buhner of the School of Oriental and African Studies at the University of London, aptly portrayed "Hong Kong Man," as a unique and social animal...neither Chinese, nor British...quick-thinking, flexible, tough for survival, ...sophisticated in material tastes, and self made in a strenuously competitive world (Baker).

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<sup>7</sup>Internet address: <http://as.orientation.com>.



The economic and financial strength as well as the fantastic wealth creating ability of Hong Kong has been phenomenal—particularly given Hong Kong's tiny size and its dearth of natural resources. Hong Kong is a notable example of what can be accomplished when property rights, civil liberties, and an unfettered market are allowed to exist. As William McGurn has noted, "It requires more energy, intelligence, and will not to intervene in an economy than to intervene" (McGurn).

Perhaps the long-term challenge to Hong Kong resulting from trying to maintain its competitive advantage may be summarized within the context of a Chinese world view by the two Chinese characters for the world crisis—*Wei Ji*—literally means "Danger" and "Opportunity." As stated by Daniel Burstein and Arne de Keijzer, "In the context of events that beset Asia, no world (crisis) and no two characters (danger and opportunity) are more appropriate. Asia faces a period of exceptional volatility—and danger—in economic, political, and social terms. But there is also unparalleled opportunity to be had" (Burstein & Keijzer, 1998).

Regarding the potential opportunity, more than seven decades ago, Sun Yat-sen suggested that if he could design a China of the future, it would look like Hong Kong (McGurn). Regarding the potential danger, Nobel laureate, Milton Friedman, has expressed his doubts that Hong Kong, itself, will long remain such a dynamic and energetic urban economy (Friedman, 1998). At this point in time, perhaps the term *Wei Ji* best describes the possibilities.

It is my opinion that "one country, two systems" will, over time, become one country with one system. Which system—bureaucratic with very limited economic freedom or free enterprise—is the question. Either Hong Kong will become a model for China or Hong Kong will be absorbed into China by way of state industrial planning. The positive aspect of *Wei Ji*, the opportunity, is clearly for Sun Yatsen's vision to become reality. Such a path is in the best long-term interest of the Chinese people.

