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THE HONG KONG TRANSITION AND U.S.-CHINA RELATIONS

PRESERVING HONG KONG'S POLITICAL AUTONOMY	<i>Michel Oksenberg</i>	5
THE ECONOMIC INTEGRATION OF HONG KONG AND MAINLAND CHINA	<i>Yasheng Huang</i>	15
CHINA'S DOMESTIC POLITICS AND HONG KONG	<i>Joseph Fewsmith</i>	27
CHINA, HONG KONG, AND HUMAN RIGHTS	<i>Merle Goldman</i>	39

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FOREWORD

Relations between the United States and China have become hostage to the approaching transition in Hong Kong. For many, the fate of Hong Kong represents a litmus test of China's commitment to abide by international agreements, to permit the free flow of goods and services in a market economy, and to strengthen the rule of law. Concerns about China's human rights record, trade surplus with the United States, military expenditures, and alleged contributions to U.S. political campaigns have heightened attention in America to the Hong Kong transition. Congressional debate this summer over extension of China's most-favored-nation (MFN) trade status will likely include proposals to link the renewal of MFN with China's handling of Hong Kong after July 1. Irrespective of the political questions over Hong Kong's future, the United States has a compelling interest in Hong Kong because of America's strong economic presence there (including 1,000 American firms and 35,000 U.S. citizens).

Chinese leaders are well aware of the international attention focused on Hong Kong and have pledged to grant it a "high degree of autonomy" as a Special Administrative Region. But the Hong Kong transition coincides with a reshuffling at the highest levels of the Chinese leadership, as major personnel decisions are worked out in preparation for the 15th Party Congress this fall. The outcome of this leadership adjustment is likely to have a major impact on how Beijing defines the "high degree of autonomy" it has pledged for Hong Kong.

The contributors to this issue assess important policy questions that have been largely overlooked in the Western press. They also offer perspectives on the Hong Kong transition that policymakers in Washington must consider if they are to rise above the political maelstrom now threatening U.S.-China relations. Michel Oksenberg, a senior fellow at Stanford University's Asia/Pacific Research Center, outlines the political and historical issues of the transition. Dr. Oksenberg begins by emphasizing that from the Chinese perspective the transfer of sovereignty is the celebrated end to colonialism. Further, Dr. Oksenberg points out that many in the United States want to make China responsible for upholding standards of democracy that did not exist in Hong Kong when Britain and China agreed in 1984 to the conditions for Hong Kong's transfer. Current American thinking neglects the fact that while Britain should be credited for establishing a legacy of thriving commerce and economic freedom in Hong Kong, it was not until the early 1990s that the British initiated democratization measures. In the coming months the leadership in Beijing will make key decisions that will indicate China's commitment to maintain "one country, two systems" in post-1997 Hong Kong. U.S. policymakers, Dr. Oksenberg proposes, should refrain from micro-managing the details of the transition, which are best resolved between Hong Kong and China.

Yasheng Huang, professor of political science at the University of Michigan, asserts that American policymakers and the press, in their fixation on political developments in Hong Kong, have overlooked the far more significant economic changes that are already underway. As one of the world's freest economies becomes integrated with one that remains largely dominated by state ownership, Dr. Huang contends that the erosion of Hong Kong's laissez-faire economic system is highly probable. Many Hong Kong firms are already seeking protection from patrons in Beijing-run "red chip" companies and groupings. Dr. Huang argues that the economic consequences of Hong Kong's integration with the mainland could have a substantial and far-reaching impact on the long-term viability of Hong Kong, including undermining American economic and commercial interests there. He recommends that U.S. policymakers pay attention to issues such as the preservation of economic freedom, markets, and the rule of law, rather than maintenance of the political system per se.

Joseph Fewsmith, professor of international relations at Boston University, places the Hong Kong transition in the context of an ongoing political realignment in Beijing. The transfer of Hong Kong to the sovereignty of the P.R.C. is taking place at a time when China faces a range of domestic political problems, and when division among the political elite over how to handle these problems is pronounced. Dr. Fewsmith points out that different leadership groups within the Chinese Communist Party have different stakes and interests in the Hong Kong transition. He concludes that the most critical long-term factor in Hong Kong's future is the institutionalization of the political process in the P.R.C.

Merle Goldman, professor of history at Boston University, offers a far more skeptical assessment of the prospects for a stable or salutary transition. In much the same way that Huang notes the difficulties of integrating two dissimilar economies, Goldman asserts that the fundamental differences in the two political systems do not bode well for the future of civil liberties in Hong Kong. She encourages U.S. policymakers to pressure China over Hong Kong and other issues in multilateral fora, where Chinese leaders, concerned with their international standing, are more likely to abide by international norms and conventions.

These essays suggest mixed prospects for Hong Kong's autonomy as a special administrative entity within the People's Republic of China. They offer different courses of action for U.S. policymakers over the short and medium term, but they concur that the issue will remain one of high priority in U.S.-China relations during the coming years, if not well into the twenty-first century.

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PRESERVING HONG KONG'S POLITICAL AUTONOMY

Michel Oksenberg

Introduction

Thirteen years ago, Britain and China reached an agreement on the return of Hong Kong to Chinese rule. One hundred fifty five years of colonial rule comes to an end on July 1, 1997. At the time of the 1984 agreement, 1997 seemed a long way off. Rarely if ever have two countries agreed on such a major change thirteen years in advance; rarely have a people been given such ample time to plan for a transfer in their rule.

Yet, as the time of the transfer approaches, much remains uncertain and unplanned. What does the transfer involve? Will Hong Kong in fact enjoy the political and economic autonomy it has been promised? What will be required for it to maintain a political system different from that of the mainland? And what are the American interests at stake? This essay explores these questions.

The American Interest

The United States has an interest in a tranquil transfer of power and in Hong Kong preserving a high degree of autonomy. The United States will be well-served if China adheres to the "one country, two systems"¹ formula after July 1 and allows Hong Kong to retain the qualities that have served it, China, Britain, the region, and the United States so well through the years. These include a professional and apolitical civil service; the rule of law; the freedom of its populace to receive and disseminate information, so crucial to the operation of a vibrant market economy; and a government capable of acting upon and defending the interests of its citizens.

Beijing will bear the major responsibility for enabling Hong Kong to endure and thrive. It seems clear that China's top leaders wish for Hong Kong to retain its special characteristics, but it is less certain that these leaders have the understanding, will, and capacity to discipline their entire regime to this end. After July 1, various ministerial and provincial bureaucrats in the People's Republic of China (P.R.C.) may be unable to resist the temptation to interfere in Hong Kong's internal affairs and to make their presence felt in a heavy-handed or oppressive manner. They would thereby destroy the delicate equilibrium that has enabled Hong Kong to perform its remarkable role as a meeting place between East and West.

Michel Oksenberg is senior fellow at the Asia/Pacific Research Center and professor of political science at Stanford University. A specialist on contemporary China, Asia-Pacific affairs, and U.S. policy toward the region, he has authored numerous publications, including *Policy Making in China: Leaders, Structure, and Process* (1988) and *An Emerging China in a World of Interdependence* (1994).

¹ The concept of "one country, two systems," generally attributed to Deng Xiaoping, says essentially that separate and autonomous socioeconomic systems can exist within a single nation. Deng used the phrase with reference to Taiwan as well as Hong Kong.

On the other hand, if the transition goes well, China will have made a giant stride in its peaceful and constructive involvement in world affairs. The Hong Kong transition offers the P.R.C. the opportunity to demonstrate that it honors the commitments it has undertaken and behaves in a responsible fashion. It will have demonstrated that it can rule one of the world's great cities effectively. Its credibility will soar. The outside world will have greater confidence in China. And its own internal development therefore will be greatly accelerated. This is surely in the American interest. And for that reason, along with all the countries of the Asia-Pacific region, the United States should wish Hong Kong, China, and Britain well as they approach a decisive moment in the history of East Asia.

Background

The transfer of Hong Kong from British to Chinese sovereignty is a genuinely historic event. Combined with the return of Macau to Chinese rule in 1999, Hong Kong's transfer terminates China's colonial experience. Indeed, with the lowering of the Union Jack in Hong Kong and the Portuguese flag in Macau, for the first time in four hundred years no foreign colony will exist in East, Southeast, or South Asia. Asia's encounter with Western imperialism has ended.

Britain acquired the island of Hong Kong and nearby territories through three separate treaties in the nineteenth century, each following successful imperialistic adventures by Britain against China. In the first treaty, signed in 1842, China ceded the island of Hong Kong to the British in perpetuity. The treaty came at the end of the Opium War, which the British had launched in order to open China to commerce; a major commodity the British wished to sell the Chinese was opium. Britain added the Kowloon Peninsula to its Hong Kong colony in 1862, following its victory over China in the Arrow War.

In the last treaty, signed in 1898 with a supine Qing government, Britain obtained a 99-year lease to another large amount of land. This is the so-called New Territories, where the new airport and many of Hong Kong's vast industrial and housing complexes are now located. Without that territory, Hong Kong is not a viable entity.

Throughout their 157 years of rule, the British governed Hong Kong as a colony. The governor—always British—was appointed in London without extensive prior consultations with the populace of Hong Kong. Until recently, the top civil servants were also British. Several major companies in the colony—Jardine Matheson, Butterfield and Swire, Hong Kong Cable and Wireless, the Hong Kong and Shanghai Bank, the Chartered Bank, and so on—were in British hands.

. . . only after 1991 did Britain initiate measures to turn Hong Kong into a democracy. Americans should not imagine a Hong Kong that never existed and then demand that China maintain—or more precisely help create—that idealized version of Hong Kong.

Much of the current American thinking about Hong Kong neglects this background. U.S. policymakers should remember the following points as they consider reaction to the Hong Kong transfer:

- (1) Hong Kong was the product of Western imperialism in Asia, belongs to China, and is returning to its rightful ruler.
- (2) The British ruled Hong Kong benevolently, subtly, and effectively. They preserved political tranquility. They maintained a delicate balance between extending in-

dividual liberties and maintaining social order. They kept the civil war between the communists and the nationalists from penetrating the colony. As a result, Hong Kong escaped the turmoil and strife that engulfed China during this century, and its people achieved great prosperity. But only after 1991 did Britain initiate measures to turn Hong Kong into a democracy. Americans should not imagine a Hong Kong that never existed and then demand that China maintain—or more precisely help create—that idealized version of Hong Kong.

- (3) Britain's only realistic choice was to transfer Hong Kong to China without eliciting the opinion of the local populace. Its 99-year lease on the territory expires on June 30, 1997. China had the legal right to reclaim the territory, and by 1982 its rulers had decided to exercise their right. China would have objected had Britain sought to give Hong Kong residents the right to self-determination. As a result, the destiny of a people who enjoy considerable liberty is being placed in the hands of China's authoritarian rulers.
- (4) Hong Kong's transfer to Chinese sovereignty is an unusual ending to a colonial experience. Most former colonies around the world emerged as independent countries when the imperial power left. In most instances, no neighboring country claimed their territory. And in the few instances in which a territory was transferred from one country to another (such as Goa, Timor, Irian Jaya, Taiwan in 1945, or Okinawa in 1972), the receiving country did not enter into an international agreement to extend political and economic autonomy to the residents of the territory.

Conflicting Perspectives

The British understandably depart with pride in their legacy. They leave a flourishing, diverse, and peaceful metropolis whose inhabitants enjoy liberty and economic opportunity and contribute enormously to China's economic development. On July 1, when Prince Charles and Hong Kong Governor Christopher Patten board the HMS *Brittania* and set sail for England, British heads will be held high.

Many residents of Hong Kong and most Western observers consider that the transfer of a free people to communist jurisdiction without consultation with the local populace betrays the principle of self-determination. They therefore view the transfer with regret and apprehension. The transfer seems contradictory to the global trend away from dictatorship and toward democracy. From this perspective, the lowering of the flag of a democracy and the raising of the flag of a dictatorship is a sad event.

Many Chinese, however, have a different perspective. They consider Hong Kong's sordid origins during China's military weakness in the nineteenth century to be a national humiliation. Its return to P.R.C. rule is to be celebrated: the event removes a stain in Chinese history. To many Asians, especially to most Chinese, the event is totally congruent with contemporary political trends: the erosion of Western domination, the end of imperialism, and the rise of Asia and China in world affairs.

Most Chinese on Taiwan share the joy of colonialism's end, but recognize that the transfer poses new challenges. Hong Kong has enabled indirect contact and trade between the people of Taiwan and the mainland, especially in the past ten years. Will Hong Kong continue to play that role, or will Beijing and Taipei—in their ceaseless competition for advantage—constrain their people from using it as a transit point? And after Hong Kong and Macau have been absorbed, will the People's Republic of China place greater pressure on Taiwan to reach an accord with it? Over twenty million people on Taiwan therefore will view the transfer of Hong Kong with ambivalence and concern about their own fate.

Most residents of Hong Kong probably partake of all sentiments: ready for the colonial era to end, confident that they have the capacity to govern themselves effectively, but apprehensive that their kinsmen to the north will not allow them genuine autonomy.

The Challenge

In 1984, Britain and China reached an agreement, in the form of a Joint Declaration, concerning the rule of Hong Kong after its transfer on July 1, 1997. The two sides agreed to cooperate in facilitating an orderly transfer of power. The 1984 Joint Declaration and the subsequent Basic Law on the Governance of Hong Kong—passed by China’s National People’s Congress in 1990 after consultation with the British—contain many ambiguous phrases that have been subject to further negotiation and interpretation. But the underlying spirit of the two documents is clear. Hong Kong would be a Special Administrative Region within the People’s Republic of China. Hong Kong would be ruled by people from Hong Kong. It would enjoy a high degree of autonomy under nominal Chinese rule. It would, for example, retain its own legal system, have its own legislature, issue its own currency, control the flow of people across its borders, maintain its own civil service, and enter into its own international commercial agreements.

Considerable doubt exists, however, as to whether Hong Kong will in fact enjoy the autonomy that the “one country, two systems” formula implies. Reasons for such doubt are abundantly clear. The formula commits China’s rulers to allow activities in Hong Kong that they do not permit in the rest of the P.R.C. But during the 48 years of Communist Party rule, Beijing’s instinctive reaction to developments it does not like all too often has been to assert its authority in order to bring matters under control. Toleration of dissent is not among the leaders’ virtues; an inclination to suppress is among their vices. Adherence to the “one country, two systems” formula would be a bold departure in their style of rule.

Moreover, the contribution of the British as outside arbiters in a society deeply riven by ideological, class, and geographical cleavages should not be underestimated. The judicial court of last resort was London, and common law prevailed. It is not yet clear that ethnic Chinese rulers will receive similar deference from all portions of the populace.

Yet the final years of British rule—marked by the rancorous relationship that developed between the government of Hong Kong and the authorities in Beijing following the 1992 arrival of the new governor, Christopher Patten—have complicated Hong Kong’s future. Governor Patten immediately and openly sought to accelerate the pace of democratization in Hong Kong and to expand the populace’s civil liberties. His initiatives were supported at first by a substantial portion of the Hong Kong population, even though many believed his confrontational style invited Chinese animosity.

Indeed, Beijing soon complained that Patten had set aside prior British commitments and private understandings that the Chinese government had reached with the British foreign ministry on these matters.² The charge has considerable merit, as does Governor Patten’s claim that the Chinese refused to conduct serious negotiations with him after his arrival and his public

² Specifically, in 1990 British Foreign Minister Douglas Hurd and Chinese Foreign Minister Qian Qichen had exchanged extensive correspondence concerning election of a portion of Hong Kong’s 60-member Legislative Council (Legco) in the 1991 election and elections thereafter. The British pledged that any expansion in the number of elected members after 1991 would take place after further consultations. The Chinese pledged that this Legislative Council would continue in place after 1997. The Beijing government, the available evidence suggests, was prepared to accept 20 elected seats to Legco in the 1993 elections and committed itself to permitting 24 elected members in 1999 and 30 in 2003. This commitment was contained in a private, January 20, 1990, message from Foreign Minister Qian. The British sought to increase the speed of democratization, without success. The negotiations apparently progressed no further until Governor Patten’s arrival on the scene two years later. Patten, apparently without knowledge of these negotiations, unilaterally announced plans for a rapid expansion of the election of the Legislative Council.

pronouncements. Patten also has correctly noted that the Beijing government has departed from some of its commitments in the 1984 Joint Declaration.

The result of the Patten-Beijing rift was that Patten pushed ahead with changes in the Hong Kong political system between 1992 and 1997. A democratically elected Legislative Council was introduced and the Civil Liberties Ordinance was revised. China's leaders made clear that they did not accept these changes and would abolish them after July 1, 1997.

The Record to Date

The transition is now well under way. The construction of the new government of Hong Kong—the government of the Hong Kong Special Administrative Region, led by Chief Executive C. H. Tung—has begun. Selected in December 1996, Mr. Tung emerged as Hong Kong's leader through a competitive and consultative, but not democratic, process. The process, orchestrated by Beijing, included many sectors of Hong Kong society. But others either abstained or were excluded.

The key question at present is whether Hong Kong will be a genuinely autonomous region; the early signs are mixed. For example, some in Beijing have sought to involve China's National People's Congress in the writing of specific laws that pertain to Hong Kong's governance. Moreover, Beijing has been quite intrusive in the work of the Preparatory Committee, established by China in January 1996 to work out the details of the transition, and the Provisional Legislature, which was set up by Beijing in January 1997 to be the first post-transfer legislature. In addition, Beijing has intervened in the selection of new officials, especially in the recent selection of the Executive Council, Mr. Tung's cabinet. Further, Beijing seems unwilling to allow the new government time to organize itself and to deliberate on basic issues of internal governance. Beijing appears to be setting the legislative agenda of the new government and to be demanding that decisions be taken now that could be deferred until the new government is well-established.

There are many positive signs as well. Most significantly, P.R.C. leaders have repeatedly indicated their commitment to the 1984 and 1990 documents, most recently during important conversations with Mr. Tung in Beijing. Also, Mr. Tung has made clear his desire to protect the integrity of the civil service. He also has indicated that he wants to secure the election of a new Legislative Council soon after the new government is in place. Moreover, the Chinese have indicated that their military forces in Hong Kong will remain in the barracks. China's national police force—the People's Armed Police (or *wu-jing*)—will not have a presence in the territory. The burden of maintaining order will be solely the responsibility of the Hong Kong police force. Further, good working relations generally exist among those responsible for the transfer. Several civil servants from the outgoing government have been offered positions in Mr. Tung's office. In addition, progress has been made in arranging for the formal handover ceremonies. Finally, the Hong Kong stock market and public opinion polls certainly do not reflect a sense of panic.

The Indicators of Political Autonomy

The Western media has focused on the disbanding of the existing democratically elected Legislative Council and the effort to retract the 1992 Civil Rights Ordinance. These, it is felt, signal Hong Kong's looming problems. These adverse developments should not be minimized; but they were predictable. Moreover, the best laws and a democratically elected legislature would not, by themselves, suffice to guarantee Hong Kong's political autonomy.

The government of the Hong Kong Special Administrative Region (SAR) will need to possess a number of qualities for the "one country, two systems" concept to become a reality. First,

[Hong Kong's] chief executive should enjoy immediate and unfettered access to the highest rulers in Beijing without having to pass through intermediate bureaucrats.

the chief executive should enjoy immediate and unfettered access to the highest rulers in Beijing without having to pass through intermediate bureaucrats. His immediate superiors within the Chinese political system should be the President of the P.R.C., the Chairman of the National People's Congress, and the Premier. He should participate in meetings in Beijing when the highest leaders consider issues affecting Hong Kong and not be relegated to a waiting room while China's top leaders decide the fate of the SAR. And Hong Kong should have strong, direct representation through a well-staffed office in Beijing.

Second, the chief executive should have a formal status in the Chinese system equal to his responsibility as the leader of a special autonomous region with 20 percent of the country's GNP. He should be accorded the rank of National People's Congress Vice Chairman, State Council Vice Premier, or at minimum State Councillor. Unless he is ranked higher than a provincial governor or minister (*bu-zhang*), officials at that level will disregard his entreaties when their minions intrude in Hong Kong. In short, by conferring very high status on the chief executive, the top leaders in Beijing will be signaling to others in the realm that he truly is an authoritative person.

The chief executive also will need to be the preeminent authority in the Hong Kong political landscape. He must secure the deference of the many mainland political figures who will be based in Hong Kong: including the head of the large, newly established Ministry of Foreign Affairs office, the head of the New China News Agency, the first secretary of the Hong Kong branch of the Chinese Communist Party, and the commanders of the People's Liberation Army forces based in Hong Kong. Many central government agencies already are represented in Hong Kong, and their number and size are growing. Maintaining Hong Kong's autonomy will require that the chief executive and his administration establish their preeminence among this constellation.

Another indicator of the SAR's political autonomy will be the extent to which the Hong Kong branch of the Chinese Communist Party refrains from establishing Party groups (*dang-zu*) within government agencies, universities, schools, newspapers, and enterprises that intrude on the prerogatives of management.³ Will the Party become involved in personnel appointments? Will Party members begin to have leadership responsibilities over government departments? These are major techniques through which the Communist Party leads governmental operations in China. If the Party begins to install the same mechanisms in Hong Kong, it will make a mockery of the slogan, "one country, two systems."

Furthermore, the Ministry of State Security (MSS) and the Ministry of Public Security (MPS), the covert Chinese intelligence and counter intelligence apparatus, should not establish an intrusive presence in Hong Kong. The MSS and MPS are the principal organizations that engage in surveillance and intimidation activities on the mainland. Will some of their operations be lodged in the new Ministry of Foreign Affairs building in the central business district of Hong Kong, as some knowledgeable Hong Kong citizens assert? Understandably, Beijing long ago established in Hong Kong a covert capability to detect operations aimed at the P.R.C. Will this apparatus now expand its surveillance over journalists, nurture a system of informants, or engage in extensive phone tapping? And will the new Hong Kong government—as the colonial government before

³ I refer here not to Party branches (*zhi-bu*) which organize the "Party activities" of its members—their study, some social activities, etc. Rather, the Party group intrudes in the realm of *policy*, and it reports through Party rather than government channels.

it—retain a robust, independent counterintelligence capability to monitor and discourage covert P.R.C. (or Taiwanese) actions that would create a chilling atmosphere of quiet fear and restraint.

In addition, if the “one country, two systems” approach is to become a reality, the autonomy, political neutrality, and professionalism of Hong Kong’s civil service must be maintained. Recruitment and promotions must continue to be based on merit and not political considerations. Similarly, the judiciary will need to remain independent and immune from political interference. The court of last resort is to be composed of Hong Kong residents plus one judge from a foreign country. It must not be susceptible to pressures from Beijing nor use P.R.C. precedents (for example, in deciding what kinds of behavior constitutes subversion or threats to national security).

The ability of Hong Kong’s inhabitants to continue to exist as a civic society—particularly to enjoy the right to form voluntary associations in pursuit of their interests—is also very important to the SAR’s autonomy. For example, government employees, such as school teachers or tram conductors, have been able under British rule to organize and to protest government actions. Will this continue?

Mr. Tung has stated that a balance must be struck between Hong Kong’s political stability and protection of individual freedom. The chief executive is correct. The new government cannot allow Hong Kong to become a battleground on which the various forces in the remnant Chinese civil war fight their battles. Specifically, it cannot allow Hong Kong to be used as a base for groups intent on overthrowing the P.R.C. regime. At the same time, those freedoms that are essential for a market economy to thrive and for the Hong Kong government to enjoy popular support and remain responsive to public opinion cannot be restricted. Thus, information that is derogatory about China—possibly considered “secret” on the mainland—must continue to circulate freely in Hong Kong, as must extremely critical comments about the Hong Kong leadership. But where on this continuum is the line to be drawn? This is the core issue, and thus far some on the mainland clearly seek a constrictive boundary that would cause Hong Kong to lose its distinctive flavor and economic dynamism.

The electoral procedures for the Legislative Council to be selected in 1998 will also be an important indicator of Hong Kong’s autonomy. Will Beijing interfere in the setting of the rules; and will the districting be so weighted that the pro-Beijing forces are overrepresented in terms of the popular support they actually enjoy? Districting and voting procedures (the number of electoral districts in the territory, whether districts are represented by one, two, or several legislators, for how many candidates a citizen may vote, etc.) can be designed to reflect the balance among voter preferences or can weight the process heavily in one direction.

Another important question concerns the status and intentions of democratic leaders like Legislative Council members Martin Lee, Sze-Tu Wah, Christine Loh, and others. What at this point is their objective and strategy? Do they intend forever to abstain from and oppose the emerging system? Or do they seek to be part of a “loyal opposition” to the Tung administration? How and when can they become a part of the process? Will they accept the implicit bargain necessary for the “one country, two systems” formula to work? The participation of the democratic forces in dialogue with the new chief executive is a promising development, as is Democratic Party leader Martin Lee’s announced intention to participate in the 1998 Legislative Council elections. However, Lee is quite apprehensive about the prospects for the political and social forces he represents. The Democratic Party, which is among the largest in Hong Kong, is heavily reliant on external funding, a source that will become unavailable under new laws going into effect after July 1. Moreover, Lee fears the voting procedures will be designed to reduce his party’s representation, and he remains concerned that additional restrictions on civil liberties will be adopted and enforced after the transfer. Lee clearly does not speak for all the democratic forces. Christine Loh has formed a separate party, and others, while not enthralled with Beijing or C.H. Tung’s pronouncements since his selection, are hopeful that the situation will remain stable after July 1.

Finally, and perhaps most subtly, the populace or important portions of it may alter their behavior in order to curry favor in Beijing or in fear of Beijing. Self-censorship in the media, for example, would be as harmful as imposed restrictions when the subject concerns such issues as economic conditions on the mainland. The Hong Kong economy deserves honesty on such matters.

The Road Ahead

These critical and complex issues will largely determine Hong Kong's long-run political fate. None of these matters, however, are even mentioned in the Basic Law or the Joint Declaration. These matters of detail, procedure, and politics are now in the hands of the new chief executive and his aides to negotiate with the authorities in Beijing and within the Hong Kong community. All these issues are well-known to Mr. Tung. Many of these issues obviously are very sensitive and cannot be openly discussed. They require private and personal understandings between Mr. Tung and China's top leaders. To secure cooperation from P.R.C. leaders, the new chief executive must elicit their trust and confidence, but he must not lose the support of his own community in the process. Mr. Tung merits support and confidence as he embarks on this delicate political task. But he too has a responsibility to demonstrate that he is prepared to act on behalf of his citizens when Beijing's inclination to interfere is excessive.

If the leaders in Beijing and the Democratic Party in Hong Kong permit, assist, and encourage Mr. Tung and the Hong Kong government to carve out a sphere of autonomy and establish their authority, then the new government will be able to:

- Maintain the rule of law and an independent judiciary and ensure that the roles of the police and military forces within Hong Kong are decided by the Hong Kong government;
- Create a democratically elected Legislative Council in 1998;
- Protect the freedom of access to and dissemination of information, which will be essential to Hong Kong's economic prosperity and market economy;
- Defend freedom of speech and religion more generally;
- Sustain the international nature of Hong Kong's cultural and social life, for example by preserving the international quality of the universities and a vibrant and free press;
- Protect the value of the Hong Kong dollar, defend the integrity of the banking system, and retain control over the foreign currency reserves that provide the Hong Kong dollar's credibility as a storehouse of value;
- Sustain the fragile arrangements that enable the market economy to flourish.

The transition could be hindered by opposition to the "one country, two systems" approach. Conservatives on the mainland oppose openness to the outside world. They realize that a successful transition will accelerate China's integration into the world economy. Disorder in Hong Kong and its suppression, on the other hand, would serve their purposes by severely setting back China's entry into world affairs. In addition, some elements in Taiwan may fear that a successful transition will place Taiwan under additional pressure to reach an accommodation with the mainland, while a disastrous takeover could increase the world's support for the emergence of an independent Taiwan. Finally, some residents of Hong Kong, deeply opposed to the mainland government, may wish to use the occasion of the transfer—when dignitaries from around the world and over 5,000 reporters will be amassed in Hong Kong—to express their views and embarrass the Chinese government.

American Policy

Responsibility for a successful transition now rests primarily upon the leaders of the new Hong Kong Special Administrative Region, the leaders of China, the outgoing colonial government, and the British. But the United States and the entire region have a major interest in Hong Kong's continued prosperity and the welfare of its people. The valuable role Hong Kong has played as a meeting place between China and the outside world is not immediately replaceable. It serves an important function in facilitating China's economic and political development. As a secondary actor in this drama, the United States government, acting in concert with its friends and allies, should express its views to the principal actors.

- To the new leaders of Hong Kong, the United States should indicate its desire and commitment to retain an extensive presence in Hong Kong. It should underscore the need for the Hong Kong government to retain the qualities that have contributed to the territory's remarkable tranquility, prosperity, and liberty. They are now establishing precedents that will last for decades. Mr. Tung and his colleagues deserve encouragement and support as they negotiate through politically treacherous waters.
- To the democratic forces in Hong Kong, the United States should observe that their participation in the new political system will enhance prospects for genuine democratization and continuation of civil liberties.
- To China, the United States should emphasize that it welcomes the end of the colonial era, attaches great importance to China's adherence to agreements on Hong Kong, and is concerned about the harm that would surely be done to Sino-American relations if China fails to abide by those agreements.
- To Taiwan, the United States should point out the benefits Taiwan would derive from a successful transition and the importance of Taiwan refraining from activities that would destabilize the transition.
- To the outgoing government of Hong Kong and the British, the United States should express American admiration for the economic and political legacy Britain leaves. Future historians will note that at the end, a genuine effort was made to create a democratic system. Now the time has come to temper the rhetoric, to extend a firm helping hand to the successors, and to monitor China's adherence to its commitments.

Congress should refrain from being drawn into the details of the transition, such as those concerning the Provisional Legislature or the repeal of post-1990 legislation. Such efforts at micro-management are likely to backfire.

In conclusion, the United States will have a continuing interest in the successful implementation of the 1984 Sino-British Joint Declaration. Not only are economic interests and the human rights of over six million residents at stake, but Hong Kong offers a litmus test of the kind of power China will be in the years ahead. The People's Republic of China voluntarily entered into an agreement with the British in 1984 as to how it would rule Hong Kong. This is arguably the most important, solemn international agreement the P.R.C. has undertaken since 1949. China now has the opportunity to demonstrate it can fulfill its commitments.

American concerns can best be pursued through maintenance of a robust official presence through the American Consulate, frequent Congressional visits, and a serious monitoring process both by the public and private sectors. Congress should refrain from being drawn into the details of the transition, such as those concerning the Provisional Legislature or the repeal of post-1990 legislation. Such efforts at micro-management are likely to backfire. The McConnell Act is on the books; it requires that the President report to Congress about China's adherence to the Sino-British Joint Declaration. Should Hong Kong cease to enjoy genuine autonomy within the P.R.C., the law mandates withdrawal of the special privileges, such as a separate textile quota, that Hong Kong currently enjoys in its relations with the United States.

But the United States should hope it will not have to confront such a choice. Above all, C.H. Tung and his appointees deserve the opportunity to demonstrate their capacity to lead Hong Kong effectively in its new era.

THE ECONOMIC INTEGRATION OF HONG KONG AND MAINLAND CHINA

Yasheng Huang

The lowering of the Union Jack in Hong Kong on July 1, 1997, will close a long chapter in China's troubled relations with Britain, but unfortunately it will immediately be followed by another difficult chapter focused on China's relations with the United States. It is all but certain that China and the United States are heading toward a collision course over what the United States sees as its duty to help maintain democracy and freedom in post-1997 Hong Kong and what China sees as its prerogative to shape the future of Hong Kong when it assumes sovereignty from the British.

This article discusses the transition of sovereignty in Hong Kong and how it may impact U.S.-China relations. The argument here is that much of the policy focus in the United States on the political status of Hong Kong is simply misguided. Until as recently as 1991, the political system in Hong Kong was never as free and democratic as the Chinese are now held responsible for maintaining. The United States is imposing a standard on China that Great Britain would have routinely failed in much of its 150-year rule of the territory.

While the United States is fixated on political developments in Hong Kong, profound changes are occurring in the way the territory's economy is governed. These changes could be quite detrimental to U.S. economic and commercial interests. The most significant change is the potential erosion of the laissez-faire character of the Hong Kong economic system, a very likely possibility given the fundamental differences in the economic philosophy and institutions between Hong Kong and China.

This essay first examines political status in Hong Kong and explains why the U.S. emphasis on politics is misguided. This is followed by a discussion of laissez-faire in Hong Kong and the increasing Chinese economic presence in the territory. Then the reasons that Chinese business activities may erode Hong Kong's laissez-faire economy are evaluated. The essay concludes by offering some policy implications.

The Political Status of Hong Kong and U.S. Policy

The history of Hong Kong's political democracy is much shorter than that of its economic liberalism. For much of its 150-year rule, the British did not find it necessary to democratize Hong Kong's political system. As of 1991, there was still no universal suffrage, and only ten of the sixty members of the Legislative Council were elected. The rest were appointed by the gov-

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error. The governor himself was chosen in London and Hong Kong citizens had no say in his appointment. Until the arrival of Governor Christopher Patten in 1992, the only significant political concession made by the British colonial government had been the inclusion of non-official, conservative, and politically docile elites—mainly from the business community—in the Legislative Council. But this did not occur until 1986.

As recently as 1987, the British were still seeking to delay rather than expedite direct elections in Hong Kong. That year, the Hong Kong government ignored the findings of independent opinion polls that showed popular support for direct elections, instead choosing to base its policy on its own polls that showed a lack of such support. The government's polls were widely criticized for their methodological flaws.¹ On the eve of their departure, the British suddenly embraced democracy—a form of government that they had previously found inconvenient. Understandably, the British stance provoked cynicism and charges of hypocrisy in Beijing. This has been the root cause of the diplomatic rows between China and Great Britain in the last six years.

This history notwithstanding, American politicians and the media wholeheartedly accepted Britain's moralistic rhetoric and arrogated themselves the standard bearer for democracy in Hong Kong in the wake of the British exit. Although the United States only had a marginal voice in the many rounds of negotiations between Britain and China in the 1980s that led to the two most important documents on the future of Hong Kong—the Sino-British Joint Declaration in 1984 and the Basic Law in 1990—Washington has inserted itself quite forcefully into the relations between Hong Kong and its future sovereign, the People's Republic of China (P.R.C.). The United States has been the lone voice unequivocally supporting the political reforms introduced by Governor Patten. In 1992, Congress passed the U.S.-Hong Kong Policy Act. Recently, to protect press freedom in Hong Kong after 1997, the United States has passed laws making it easier for Hong Kong journalists to emigrate to America.

The U.S.-Hong Kong Policy Act of 1992 requires the secretary of state to report annually to Congress about the status of Hong Kong as it relates to the interests of the United States. The topics to be addressed in these reports focus heavily on political issues such as the openness of Legislative Council elections, the independence of the judiciary, and the status of the Bill of Rights Ordinance (an ordinance introduced by the British government in 1991, primarily to negate the more draconian provisions that had existed in Hong Kong's colonial administration). Because the Chinese have established a provisional legislative council in place of the one that was democratically elected in 1995, and have significantly curtailed a number of key provisions in the Bill of Rights Ordinance, the United States and China are headed toward a collision course over Hong Kong.

This is truly unfortunate. As pointed out before, the British ruled Hong Kong in an autocratic manner and only began to undertake democratic reforms in preparation for their exit. What the Chinese have done so far amounts to no more than restoring Hong Kong's political system to its pre-1991 shape. The P.R.C. is not, as is commonly alleged in the media, establishing in Hong Kong its own authoritarian form of government. Direct democratic elections and the Bill of Rights Ordinance did not exist prior to 1992, and the United States and Britain had never clashed over the political system of Hong Kong. Yet the United States now is imposing far more demanding criteria on a communist government than it ever had on the British government. Chinese indignation over "foreign meddling" springs directly from the sentiment that the international community applies a double standard when it comes to the British and the Chinese rules over Hong Kong.

¹ These flaws centered on over-sampling of the business elites, who are more conservative in their outlook.

*The true danger to Hong Kong
is not in the political but in the economic arena.*

Economic Laissez-Faire in Hong Kong

The true danger to Hong Kong is not in the political but in the economic arena. China has promised to maintain Hong Kong's capitalistic way of life for 50 years. However, Hong Kong's prosperity is contingent on its integration into the Chinese economy. Integration of the two vastly different economies will inevitably mean some integration of economic institutions. While Hong Kong's entrepreneurship, business methods, and managerial expertise have been introduced into China along with its expanding investments, at a more macro and systemic level institutional convergence will move Hong Kong closer to China rather than the other way around. This is simply dictated by a combination of Beijing's political mastery over Hong Kong and a version of Gresham's law—it is always easier for bad institutions to drive out the good ones than the other way around.

Hong Kong's Laissez-Faire Economy

Hong Kong is the most open and liberal economy in the world. Rule of law, fair market competition, regulatory neutrality, and a politically independent bureaucracy are the true defining characteristics of the Hong Kong system. These characteristics are under great strains as a result of imminent Chinese rule and integration into the Chinese economy. China, on the other hand, remains one of the more illiberal economies in the world, despite significant strides in its economic reforms. The integration between these two very different economies will inevitably mean some changes in the ways each is going to be governed. Specifically, changes at the macro and systemic level will occur in the areas of government-business relations, market competition, contractual auctions, and dispute settlements.

That Hong Kong's economic institutions are the world's most laissez-faire can be shown in several ways. First, Hong Kong does not have a full-blown central bank, although the Hong Kong Monetary Authority performs some quasi-central banking functions. Two private banks—Hong Kong and Shanghai Bank and Chartered Bank—now joined by the Bank of China, issue the currency on behalf of the government. The government does not have fiscal targets to speak of for its budget and has a 15-percent flat tax rate. Government consumption is below 10 percent of Gross Domestic Product (GDP).²

Second, Hong Kong is a free trade port. In an aberration from the common patterns observed elsewhere in East Asia and China, the government does not have a development policy that either encourages import substitution or export promotion. Third, unlike other East Asian economies, which either restrict foreign firms (e.g., South Korea and China) or encourage them at the expense of domestic firms (e.g., Singapore), the government does not discriminate between Hong Kong and foreign firms and indeed does not actively collect statistics on the nationalities of the firms operating in Hong Kong.³

² World Bank, *World Trade Tables 1995*, Washington, D.C.: International Bank for Reconstruction and Development, 1995, p. 333.

³ The main exception to the textbook version of laissez-faire is the government's control and ownership of land. The colonial government historically has performed basic and minimal functions, but even performance of these functions costs money. To raise revenue, the colonial government got involved in land management. Today, the government owns all the land and leases it on a long-term basis to raise revenue. In addition, the government also controls rents in part of the private housing market and provides public housing to roughly half of the population. Government ownership and sale of land is one of the reasons why tax revenue as a proportion of GNP is low compared with other East Asian economies. Some scholars argue that the colonial government might have used the control over land release to affect industrial development and the control over immigration from China to affect wage costs in the colony. Even if this is true, there is no question that these are not specific industrial policies and the land and immigration policies do not favor some businesses over others.

The minimal functions of the state have several origins. One is simply historical. When Hong Kong was ceded to the British in the nineteenth century, Hong Kong served as a base for entrepôt trade. Furthermore, the British in the nineteenth century did not consider the colony to have an overwhelming strategic value. For that reason, Britain kept its colonial administration to a minimum. In addition, when the British landed on Hong Kong, there were only some twenty villages and some scattered fishermen. It did not take much for the British to establish administrative control because there were no entrenched local interests.

From an economic point of view, the small size of Hong Kong would render state control of economic activities both ineffective and irrational. An important reason that Hong Kong does not have its own central bank is that it does not need one. The Hong Kong dollar is pegged to the U.S. dollar, and essentially Hong Kong's monetary policy is made in Washington, D.C., by the Federal Reserve. Also, because it is a free port city, excessive taxation would drive businesses away to more competitive sites elsewhere in Asia.

However, these economic factors do not automatically prevent an activist government in economic management. Singapore, a similarly sized economy and city, has an extremely interventionist government in economic, social, and political affairs. The fundamental reason for the laissez-faire nature of the Hong Kong economy is a philosophical and temperamental one, and it is for this reason that laissez-faire under Chinese rule could be quite fragile. Generations of British finance secretaries in Hong Kong have believed that the government ought to have a minimal role in the economy. Indeed, until the 1960s the government even refused to collect statistics on Gross National Product lest such collection be viewed as government intervention. In addition, laissez-faire was very much in keeping with the British tradition of maintaining a small colonial administration.⁴

Chinese Economic Presence in Hong Kong

In examining the economic integration between China and Hong Kong, one needs to distinguish between two types of integration. One type involves increasing integration of the Hong Kong economy into the Chinese economy. This integration can be trade-related in the sense that Hong Kong exports to or imports from China. Or it can be investment-related: Hong Kong firms move their manufacturing sites to the mainland. The other type involves control by mainland Chinese firms over assets located in Hong Kong. Although these two types of economic integration are often lumped together, they in fact have different implications for government-business relations in Hong Kong. Whereas Hong Kong investment and trade in the P.R.C. has been largely driven by market forces and conforms to the laissez-faire nature of the territory, China's presence in the Hong Kong economy has been motivated in part by bureaucratic considerations and may therefore have a more detrimental effect.

Trade and investment integration with China is nothing new: Hong Kong has served as a trade entrepôt between China and the rest of the world since the founding of the P.R.C. in 1949. Investment integration began in the late 1970s in reaction to China's open-door policies. It is important to point out that the increasing trade and investment ties of this kind have not changed in any meaningful way the manner in which Hong Kong's economy is governed. Hong Kong has remained a laissez-faire economy despite the fact that an increasing proportion of its economic activity is with one of the more illiberal economies in the world.

Acquisition of Hong Kong assets by firms from the mainland is of a different order altogether. They are of far more recent vintage since they are closely connected with the imminent

⁴ See, for example, Stephan Haggard, *Pathways From the Periphery*, Cornell University Press: Ithaca, 1990.

transition to P.R.C. sovereignty. Before the Deng-era reforms, mainland Chinese economic presence in Hong Kong was very low profile. Mainland firms in Hong Kong had well-defined and non-overlapping scopes of business. For example, the Bank of China was the only P.R.C. firm in Hong Kong engaged in foreign exchange transactions. China Resources (Holdings) Co., LTD, was the only mainland firm involved in fuel and foodstuffs trade, and China Merchants International handled all shipping. They operated as the business arms of the P.R.C. government and seldom moved outside their established sphere of business.

During the reform era, the Chinese economic presence has grown rapidly. According to the Hong Kong Monetary Authority, the Bank of China Group owned \$89.7 billion in assets at the end of 1993.⁵ In addition, there have been new P.R.C. players in Hong Kong that have effectively broken the monopoly positions previously held by the four traditional Chinese firms. Some of these firms are motivated by the desire to establish trade and investment links for their operations in China; others wish to tap into Hong Kong's deep capital market to raise funds for their projects in China. This latter group is growing in importance. The financing operations of these P.R.C. firms probably will exert the strongest influence on the Hong Kong economy and economic institutions after the territory reverts to Chinese control. According to the *Wall Street Journal*, about 1,800 mainland companies are officially registered in Hong Kong with assets totaling at least \$42.5 billion. The Chinese economic presence will only grow with the change in sovereignty; until now Chinese investments in Hong Kong have been growing by more than 25 percent annually.⁶ The following paragraphs describe mainland Chinese investment activities in a number of economic sectors.

Financial Sector

Bank of China Group accounts for about 25 percent of total deposits in Hong Kong.⁷ It is estimated that as of 1995 Chinese-controlled firms accounted for 5 percent of the Hong Kong Stock Exchange's total capitalization. This includes both the H-shares issued by Chinese state firms and "red chips"—Hong Kong listed vehicles for Chinese state firms.

Growing Chinese investment in Hong Kong and the increasing presence of "China play" on the Hong Kong Stock Exchange have contributed to . . . the economic prosperity of Hong Kong.

Growing Chinese investment in Hong Kong and the increasing presence of "China play" on the Hong Kong Stock Exchange have contributed to the rapid rise of the Hang Seng index in the past decade and the economic prosperity of Hong Kong. In 1993, 39 companies listed on the Hong Kong Stock Exchange were controlled by firms from China; in 1996, the number grew to 70; and reportedly there are as many as 300 Chinese firms that now have plans to tap into the territory's wealth by listing themselves on the Hong Kong stock market. One common investment vehicle used by Chinese firms from the mainland is to acquire poorly-performing companies at an attractive price and to establish a controlling share. Typically the shares of these companies have not been actively traded prior to their acquisition. In 1992 and 1993, 19 such "shells" were purchased by P.R.C. concerns. In this way, the Chinese firms raised \$1.84 billion from the Hong Kong Stock Exchange.⁸

⁵ All dollar amounts are U.S. dollars. The Bank of China Group is the Bank of China's branch in Hong Kong.

⁶ See, for example, Kathy Chen, "Early Birds: China Businesses Flock to Hong Kong ahead of Beijing's Takeover," *Wall Street Journal*, November 29, 1996, p. 1. The *Wall Street Journal* figure apparently excludes assets owned by the Bank of China Group.

⁷ *Ibid.*

⁸ See, for example, Kathy Chen, *op. cit.*; Bruce Gilley, "Great Leap Forward," *Far Eastern Economic Review*, November 23, 1995, pp. 61-62; and Hing Lin Chan, "Chinese Investment in Hong Kong," *Asian Survey*, vol. 35, no. 10, pp. 941-954.

Infrastructure and Utilities

China International Trade and Investment Corporation (Citic) Pacific has an infrastructure investment portfolio totaling around \$1.6 billion.⁹ China Merchants International owns a 13 percent stake in a third cross-harbor tunnel in Hong Kong, and the Hong Kong press speculates that Chinese firms will also move to acquire shares of China Motor Bus and Hong Kong & China Gas.¹⁰

Aviation

In anticipation of Hong Kong's reversion to P.R.C. sovereignty, there has been a gradual shift of ownership from foreign to Chinese concerns. In early 1996, Swire Pacific relinquished its majority control over Cathay Pacific to Citic Pacific, apparently at a huge friendship price. In addition, Swire and Cathay Pacific's joint holding in Dragonair also dropped, from 43.16 percent to 25.5 percent, and they lost management control. The China National Aviation Corporation Group (CNAC) has picked up the relinquished shares and management control in Dragonair at a concessionary price of \$250 million.¹¹

Property

Buildings and infrastructure are extremely popular with investors from mainland China. Property stocks account for 40 percent of Hong Kong's total capitalization and almost all the major Chinese firms in the territory are involved in real estate. As of 1995, mainland Chinese were estimated to hold 12 percent of Hong Kong's property.¹² Citic Pacific has been extremely active on the property front.

Chinese investment in the manufacturing sector also has a heavy property component compared with investment from other countries. Sixty percent of Japanese fixed asset investments in the manufacturing sector are in machinery and equipment and 24 percent in land and buildings. The breakdown for U.S. investment is 62 percent in machinery and equipment and 18 percent in land and buildings. However, for Chinese investors in manufacturing industries, land and buildings account for 50 percent of the stock of fixed assets while equipment and machinery account for only 33 percent.¹³

Impact on the Regulatory System in Hong Kong

The ultimate irony of the Hong Kong story is that China is both its bane and its boon. On the economic side, closer integration to China has provided solutions to many of the problems that the Hong Kong economy has faced as it has matured, and the rapid economic growth of China has brought about enormous benefits to the Hong Kong business community. But inevitably, economic integration with China in combination with political integration may erode Hong Kong's laissez-faire economic institutions. In the short run, the costs of this erosion are not obvious and are masked by the benefits of Chinese economic growth. In the long run, however, these costs will become more significant and more permanent, as economic institutions are easily destroyed but very difficult to build up.

⁹ James Leung, "Firm Hand Steers China's Thriving Hong," *Asian Business*, April 1, 1996, pp. 30-31.

¹⁰ Bruce Gilley, *op. cit.*, pp. 61-62.

¹¹ See, for example, Michael Mecham, "China Expands Stake in Cathay, Dragonair," *Aviation Week & Space Technology*, vol. 144 (May 6, 1996), pp. 31-33.

¹² Emily Thornton, "Bamboo Bridges," *Far Eastern Economic Review*, October 12, 1995, pp.101-106.

¹³ *Survey of External Investment in Hong Kong's Manufacturing Industries*, Hong Kong Government Industry Department: Hong Kong, 1996.

Some argue that growing P.R.C. investment in Hong Kong may enhance the autonomy of the Hong Kong economic system through the so-called “hostage effect.” According to this argument, increasing investment by Chinese firms in Hong Kong will serve as a hostage to Beijing because the P.R.C. will hurt its own investments if it curtails the autonomy of Hong Kong and hurts Hong Kong’s economy in the process.

If there is any hostage effect, it is essentially redundant. The Hong Kong economy as a whole has already provided an enormous stream of benefits to the Chinese economy as a source of capital, technology, and managerial expertise. These benefits are many times the monetary value of mainland investments in Hong Kong. If these benefits do not provide a sufficient political guarantee, it is hard to see what the additional benefits are from the much smaller Chinese investments in Hong Kong. Furthermore, the direction of the hostage effect can be reversed. Greater economic integration into China and greater “China plays” on the Hong Kong stock market imply that Hong Kong will be increasingly beholden to China. Hong Kong’s prosperity depends increasingly on business opportunities in China.

The danger to Hong Kong’s laissez-faire system is real. The bedrocks of the economy in Hong Kong are the rule of law and fair market competition. The economic and political mergers of Hong Kong with China naturally raise questions about these two pillars of the territory’s economic institutions. The most pertinent issue is whether or not the regulatory authorities in Hong Kong can treat Chinese and non-Chinese firms equally in the eye of the law. Fair competition is the key ingredient to keeping Hong Kong a viable financial center, not only for the Chinese and indigenous capital but for international capital as well. Another issue is whether or not some Chinese enterprises compete with others from politically privileged positions.

There is widespread concern that the P.R.C. government may use its leverage as sovereign to achieve its policy objectives in Hong Kong. For example, it may want to reduce the influence of certain firms on economic or non-economic grounds while increasing Chinese control in strategic sectors. The harm to Hong Kong’s economic institutions will come not so much from the eventual outcome of Chinese control but from the fact that in achieving this outcome the process of regulatory neutrality would be compromised.¹⁴

However, as a practical matter, this kind of concern is only short-term; Hong Kong’s firms will be socialized into political loyalty sooner or later. In the long run, a more serious concern revolves around the proper role of the government in the economy. On the policy level, P.R.C. leaders believe in the developmental state concept of economic development, a vision common to leaders in Korea and Taiwan in the 1960s and the 1970s. According to this vision, the role of the government goes far beyond correcting market failures. It includes direct organization of investment and production activities, in addition to financing of economic activities and commercial regulations. The government is in the business “of creating future comparative advantages,” and in this spirit the Chinese government has issued a series of “industrial policies” explicitly fashioned after the Korean Heavy and Chemical Industrialization drives in the 1970s.¹⁵

¹⁴ There have been publicized cases in which the regulatory neutrality seems to have been compromised. One such case concerns one of the oldest firms in Hong Kong, Jardine Matheson Holding. In 1995, China refused to approve a \$1.6 billion dollar project to construct a container terminal in Hong Kong because it objected to Jardine’s lead role in the consortium that was awarded the contract. Some speculated that this was in revenge for Jardine’s instrumental role in the Opium War and its support for the political reforms advocated by Governor Christopher Patten; others speculated that the objection was related to Jardine’s decision to de-list from Hong Kong’s stock exchange and to move its domicile to Bermuda. On the Jardine case, see Edward A. Gargan, “The Humbling of a Heavyweight: In Hong Kong, Change Jolts a Colonial Business Power,” *The New York Times*, November 30, 1995, p. D1; and David Lindorff, “A Nasty Little Shoving Match in Hong Kong,” *Business Week*, October 3, 1994, p. 68.

¹⁵ For more details on Chinese industrial policy in the automotive sector, see Yasheng Huang, *Between Two Coordination Failures: The Automotive Industrial Policy in China*, Ann Arbor: University of Michigan, 1997.

The other long-term concern is institutional. China has made enormous strides in its economic reforms. Half of the industrial output today is generated in non-traditional sectors of the economy and China now trades actively in the international market. Despite these achievements, there is a vast gulf between the ways the Hong Kong and the Chinese economies are governed.

Some of the differences are obvious. Economic integration with China introduces into Hong Kong a very different kind of firm from the ones that it is accustomed to: state-owned enterprises (SOEs). These SOEs often have “deep pockets” that do not bear the full risks associated with their investment decisions—their investment risks are borne by the government and society as a whole. SOEs are known for their huge investment appetites because they are subject to soft-budget constraints and do not need to be concerned about profits or losses. One implication of soft-budget constraints is that SOEs may adopt overly aggressive investment stances and outbid Hong Kong firms in their acquisition activities.¹⁶ This problem is complicated by the fact that SOEs have a poor record of financial disclosure and lack a well-functioning corporate structure to monitor and supervise their investment activities. The appetite of Chinese firms for extremely volatile real estate is in part a function of soft-budget constraints. SOEs may also acquire Hong Kong assets not for their commercial viability but for extraneous policy benefits—as vehicles to make investments on the mainland in order to claim privileges in China accorded to foreign firms.¹⁷

The distinctions between the regulatory functions of the government and commercial operations of firms are either blurred or practically nonexistent in China.

In contrast to Hong Kong, the rule of law in the P.R.C. is rudimentary at best, despite the desire of the Chinese government to strengthen it. Furthermore, the P.R.C. bureaucracy remains heavily politicized, although there have been recent efforts to create a professional civil service system.¹⁸ One characteristic that will impact Hong Kong strongly is the lack of separation between commercial and regulatory functions of the government. Many firms in China are owned or operated by government departments that are also in charge of regulating the very same sectors in which these firms operate. The distinctions between the regulatory functions of the government and commercial operations of firms are either blurred or practically nonexistent in China. Not only is there no fire wall between the regulators and the regulated, but the regulatory agencies of the government often own and directly profit from commercial concerns that compete with other firms. The conflict of interest is inherent. This combination of ownership/control and regulatory functions gives these P.R.C. firms enormous political advantages over their Hong Kong rivals. The political advantages confer commercial advantages on these mainland firms either via an explicit or implicit threat of coercion or via opportunities for rent-seeking on the part of firms connected to the regulatory bodies.

The Cathay case illustrates this problem well. While many countries (including the United States) restrict or ban foreign ownership of their own airlines, and while it is quite understandable that the Chinese government may want to establish national control over Cathay and

¹⁶ For a more detailed discussion on the investment appetites of the SOEs, see Yasheng Huang, *Inflation and Investment Controls in China: The Political Economy of Central-Local Relations during the Reform Era*, New York: Cambridge University Press, 1996.

¹⁷ Elsewhere I have estimated this form of Chinese investments to account for about 35 percent of investments from Hong Kong. See, for example, Yasheng Huang, *The Management of Foreign Direct Investment in China from an Asian Perspective*, Singapore: Institute of Southeast Asian Studies, 1997.

¹⁸ For more details see King K. Tsao and John Abbott Worthley, “Chinese Public Administration: Change with Continuity during Political and Economic Development,” *Public Administration Review*, vol. 55 (March/April 1995), pp. 169–174.

Dragonair after 1997, the method of acquisitions raises concerns about fair competition. Both Citic Pacific and China Aviation Corporation are politically powerful firms in China. Citic Pacific is headed by Larry Yung, the son of P.R.C. Vice President Rong Yiren; China Aviation Corporation is the commercial arm of the P.R.C. agency that regulates the airline industry. Given this background, it seems likely that these two firms successfully used political leverage in their transactions with Swire Pacific. Swire would have little choice but to discount its sales of ownership to China Aviation Corporation because it would have risked being shut out of China's airline industry altogether by the parent agency of the China Aviation Corporation.

Even in the absence of any threats from China, given the combination of the regulatory and commercial functions in the Chinese firms, the Swire Group would be strongly motivated to discount its sale of Cathay as an act of "good will" both in order to protect its access to Chinese air space and to form an alliance with politically powerful corporations such as Citic Pacific and China Aviation Corporation. Other Chinese firms in Hong Kong are also commercial extensions of regulatory authorities in Beijing; Table 1 shows the patterns of cross-holdings of Chinese firms in Hong Kong.

Table 1
Interlocking holdings of Chinese firms in Hong Kong

Hong Kong-listed firms	Parent firms with oversight and share of control	Government departments over the parent firms
China Travel Services (HK)	75% by China Travel Service	Overseas Chinese Affairs Office
China Merchants Holdings	100% by Ministry of Communication	Ministry of Communications
China Merchants Hai Hong	65% by China Merchants Holdings	
China Resources	100% by Ministry of Foreign Trade and Economic Cooperation	Ministry of Foreign Trade and Economic Cooperation
China Resources Enterprise	57% by China Resources	
China Everbright Group	100% by State Council	State Council
China Everbright International	24% by China Everbright Group	
Citic HK	100% by Citic	State Council
Citic Pacific	45% by Citic HK	
Shougang Holdings HK	100% by Capital Iron & Steel	Beijing Government
Shougang Concord International Enterprise	49% by Shougang Holdings HK	
Shanghai Industrial Investment Holdings	100% by Shanghai Government	Shanghai Government
China Overseas Holdings	100% by China State Construction & Engineering	
China Overseas Land and Investment	75% by China Overseas Holdings	
China Ocean Shipping	75% by China Overseas Holdings	

The Cathay case points to a general problem for Hong Kong's regulatory authorities after 1997: how to impose market discipline on a group of Chinese firms that possess very different assets, employ very different business methods, and are motivated by very different considerations than Hong Kong firms. Many of the P.R.C. firms in Hong Kong possess huge political assets or powerful political backgrounds. Questions have arisen as to whether or not the P.R.C.'s own regulatory body in the securities industry, China Securities Regulatory Commission (CSRC), has been able to supervise their activities. If the CSRC has problems with these firms, the problems will be even greater for Hong Kong's Monetary Authority after 1997.

Chinese firms also possess sizable intangible political assets in the form of informal and familial connections. Regulating well-connected firms may become difficult when Hong Kong's regulatory authorities are beholden to political instructions from Beijing. For example, the son-in-law of Deng Xiaoping is the chairman of the board of three firms listed on the Hong Kong Stock Exchange: Silver Grand International Industries, Ltd., Onfem Holdings, Ltd., and Jin Hua. Others, such as Poly Investment Holdings, Ltd., Hoi Shing Holdings, Ltd., First Shanghai Investment, Ltd., and Continental Mariner all have political heavyweights sitting on their boards of directors.¹⁹ Their heavy political representation raises questions about the degree to which they use political power to gain commercial advantages. There is also a discipline problem. Once the regulatory authorities in Hong Kong are beholden to instructions from Beijing, regulating the politically-connected Chinese firms will be a problem.

Policy Implications for the United States

To politicians and influential commentators in Washington, Beijing's handling of Hong Kong has become a barometer of P.R.C. intentions and behavior not only toward the six million Hong Kong residents but toward China's neighboring countries and the United States. In part because of concerns over Hong Kong, the debate over MFN is likely to be rancorous again this year even though the Clinton Administration has reached a consensus about de-linking MFN with human rights. In addition, Congressman Richard Gephardt has proposed a bill that would require Congressional approval for Chinese accession to the World Trade Organization (WTO).²⁰

The first test of a policy is that it should do no harm. While one may argue that promoting democracy is intrinsically desirable, in fact the obsession with the political status of Hong Kong diverts attention away from the true danger that Hong Kong will face—the erosion of the most laissez-faire economic system in the world. Worse yet, some of the ideas tossed around in the corridors of power in Washington, such as once again linking MFN with human rights and denying Chinese accession to the WTO, will vastly exacerbate the problem by reducing the American commercial presence in Hong Kong and by slowing down the process of harmonizing the Chinese economic system with international norms and rules.

The United States should endeavor to preserve economic freedoms in Hong Kong. Corruption, politicization of the contract-auctioning process, and reliance on political connections for business dealings will have a direct detrimental impact on U.S. corporations in Hong Kong. American companies typically do not possess the kind of "political capital" necessary for success when the economic and regulatory environment is not neutral.

The U.S. government can pursue its economic and business concerns more productively with China without producing the kind of fallout associated with disputes over human rights and over scope of elections. Historically, the Chinese generally have been far more accommodating

¹⁹ Iting Lin Chan, "Chinese Investment in Hong Kong," *Asian Survey*, October 1995, pp. 941–54.

²⁰ Nancy Dunne, "Campaign Funds Row Puts China on Hold: Controversy is Adding to Sense of Unease about Future of U.S. Relations with Beijing," *Financial Times*, March 13, 1997, p. 6.

to legitimate economic grievances on the part of the United States such as those over export quota enforcement and piracy of intellectual property. Fundamentally, these grievances dovetail with the desires of the Chinese government to strengthen the rule of law and to develop a market economy.

Ultimately, the most effective economic diplomacy is not what the U.S. government preaches to the Chinese but the U.S. economic presence itself, which offers the single best protection for Hong Kong.

Ultimately, the most effective economic diplomacy is not what the U.S. government preaches to the Chinese but the U.S. economic presence itself, which offers the single best protection for Hong Kong. American firms are not just the beneficiaries but are also the mainstay of economic laissez-faire. U.S. firms are constrained by domestic legislation from offering bribes even in overseas business transactions and thus they have a deep interest in maintaining a level playing field in Hong Kong. There is also a less direct effect associated with the U.S. economic presence. The American market absorbs 40 percent of Chinese exports and is vital to the prosperity of the Chinese economy. Since Hong Kong capital finances the production of Chinese exports to the United States, if the market is withdrawn from them, Hong Kong's prosperity will be severely affected. A less prosperous Hong Kong is also less valuable to the P.R.C. because it undermines the P.R.C.'s rationale to at least tolerate some political autonomy in Hong Kong.

CHINA'S DOMESTIC POLITICS AND HONG KONG

Joseph Fewsmith

There is much controversy over the future of Hong Kong following its July 1, 1997, return to Chinese sovereignty. Much of this debate revolves around images, generally not well-grounded, of the People's Republic of China (P.R.C.). Nevertheless, if there is a nugget of truth in these images, it is that the future of Hong Kong is dependent on China, in particular on its future stability and continued reform. Hong Kong simply cannot be isolated from either the economic development of China or its political and social situation. An unstable China means an unstable Hong Kong.

Although the dependence of Hong Kong on the P.R.C. is obvious, it is often forgotten that Hong Kong will not be an entirely passive participant in this process. The political reunification of Hong Kong and China will continue the long-standing process of integrating their economies and social systems. Over the mid- to long-run, Hong Kong, with its prosperous and international economy and vibrant culture, will clearly have an impact on China. Indeed, Hong Kong has already had a tremendous impact on the P.R.C., influencing the development not only of neighboring Guangdong Province but also providing a training ground in which thousands of Communist Party cadres have gained experience in the ways of international commerce. In the future, the influence between Hong Kong and the P.R.C. will continue to be two-way. However, the degree to which Hong Kong's familiarity with international business practices and understanding of intellectual and artistic freedom can have a positive affect on China depends first and foremost on continued reform in China. That is to say, Hong Kong can affect China in important ways, but it can only do so on the margin, over the longer term, and if political conditions are opportune in China.

China's domestic politics get little attention in the international media, yet the evolution of the political situation will have profound implications for China, for its international relations, and for Hong Kong. Frequently, Chinese domestic politics are viewed in a highly reductionist manner and broad generalizations are made on the basis of little evidence. Scenarios that view the development of the P.R.C. in either highly optimistic or gravely pessimistic terms often assume that the course of China's future is fixed and that it is safe to make straight-line predictions on the basis of the present. What gets left out of these writings is the very active and wide-ranging debate within China over its own future. In fact, many elites and their advisors are struggling to deal with a whole host of problems, including but not restricted to assessing the successes and failures of the Dengist reforms, dealing with the legacy of the Tiananmen Square protests, and judging a rapidly changing international environment. In contrast to many of the generalizations often heard, Chinese society and politics are very much in flux and the guideposts to action are arguably less clear than at any time since the communist victory in 1949.

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In thinking about Chinese domestic politics, three points are particularly important. First, the range of opinion among Chinese elites and sub-elites (those who try to influence elite opinion through their research and writings) is considerable. The distance between the “left” and the “right” is as great, if not greater, than it has ever been, and this makes the job of holding the center (roughly General Secretary Jiang Zemin’s position) difficult and subject to challenge. Second, the impact of China’s foreign relations on elite and sub-elite opinion is very significant. It is difficult to imagine a China with a hostile international environment carrying out reform and opening up smoothly. Third, the return of Hong Kong seems likely to have important ramifications both for China’s domestic politics and for its international relations. A smooth return is likely, over time, to have a significant impact on China’s domestic scene and to impress other countries that China is continuing its course of reform. Conversely, a difficult transition will undoubtedly focus renewed attention on China’s abuses of human rights and other problems and complicate China’s domestic political situation.

China’s Political Spectrum

The debates among elites and sub-elites in contemporary China are more complex than can be described in a short chapter. Here, the focus will be primarily at the top of the political spectrum, where a considerable amount of contention continues to exist. In assessing the range of opinion at this level, the single most important factor is the decline of Marxism-Leninism. The impact of this ideological decline was apparent before Tiananmen and the collapse of communism in the Soviet Union and Eastern Europe; it has become even more apparent in the years since. It should also be noted that Tiananmen has had an important impact on Chinese political debate not simply because that event brought a continuing crackdown on those seeking democratic change, but also because it skewed the political debate, shifting the political “center of gravity” considerably to the “left”¹ and making even limited opening of the political system appear suspect.

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The decline of Marxism-Leninism and the tremendous changes that have occurred in Chinese society over the last two decades have led to the emergence of a wide array of opinion about the current situation in China. There are many ways of dividing up the wide spectrum of political opinion in contemporary China, but perhaps the following broad categories can provide a sense of the range of opinion and divisive issues.

(1) Marxist-Leninist Ideologues

One influential group of elites has responded to the decline of Marxism-Leninism by reaffirming the old verities and by launching a series of critiques of reform. Now led by former Propaganda Department head Deng Liqun, these remaining defenders of the faith argue that reform has weakened the Chinese Communist Party and brought about the possibility that socialism and the Party will be overthrown in China. The political beliefs of this group were articulated strongly

¹ In China, the “left” is associated with Mao Zedong, and thus refers to those with more orthodox understandings of Marxism-Leninism. Because the left stresses orthodoxy, it is often identified with conservatism in China.

and in systematic fashion in late 1995 with the circulation of a document entitled “Several Factors Influencing China’s National Security” (the so-called “10,000 character manifesto”). Among other things, this manifesto decried the decline of state-owned industry, the rise of “collective” (primarily township and village) and private enterprises, the decline of Party discipline, the rise of “individualism,” the cultural and economic influence of the West, and the increase in corruption. The manifesto accused the reforms of generating a “new bourgeoisie” and called for a return to the old communist orthodoxies. At the time of Deng’s death, these beliefs were articulated once again, this time in the form of a 20,000 character manifesto. In short, according to this school of thought, the reform program of Deng Xiaoping was fundamentally misguided.

The question is: How strong is this current of belief? There is no question that its main proponents are older Party members, most of whom served in the Propaganda apparatus, which suggests that their influence will fade as adherents age and pass on. Nevertheless, in the short run the influence of this group can be powerful enough to be disruptive. As one well-informed person said, “They don’t have the strength to accomplish anything, but they have more than enough strength to ruin everything.”²

(2) Neoconservatives

The category of “neoconservatives” is extremely difficult to define, not only because of the diversity of views held by so-called neoconservatives but also because few people so labeled are willing to describe themselves as neoconservatives. Nevertheless, there is a body of diffuse thought held by a number of people, some of whom seem to have substantial access or ties to the leadership, that criticizes the reform program as articulated over the years by Deng Xiaoping. Depending on the person or persons involved, this critique can emphasize cultural conservatism, the role of state-owned enterprises, the belief in the need for a stronger state (recentralization), skepticism about opening to the outside world, nationalism, and the need for the Party to have its own economic resources. Different people emphasize different themes, and there is considerable disagreement among neoconservatives, but taken as a whole they represent an effort to define China’s political system in terms that are statist, not Marxist-Leninist, and to reject “Westernization.”³

The lack of a coherent neoconservative view should not make us overlook its importance. To date, no political leader or intellectual has risen to give it a definitive shape, but that does not mean that such a person could not arise. In any case, there is a host of neoconservative ideas floating around for leaders to draw on. Some would argue that Jiang Zemin has referred to this body of thought to shape his own approach to politics, but “Jiang Zemin Thought” is still too diffuse, too much in flux, and too contradictory to be able to label it neoconservative with any confidence.

The appeal of neoconservative thinking, however, should not be dismissed. Squeezed by the entry of smaller and more nimble enterprises, state-owned enterprises have been suffering. According to official figures, 43.7 percent of state-owned industrial enterprises lost money in 1996—five percentage points higher than in 1995—while the amount of their losses surged almost 30 percent to 61.6 billion yuan (\$7.4 billion). At the same time, 150 billion yuan (\$18.1 billion) was tied up in excessive inventory.⁴ Moreover, millions of rural residents have been migrating to the cities for various periods of time in search of work. This migration, which includes at least 70 million people, reflects regional inequalities and has caused serious strains on the infrastructure of cities. It has also been blamed for the rise of crime in recent years. Corruption has also become a serious problem as the old system has disintegrated. These and other issues give neoconservative thought a clear emotional appeal.

² Author’s interview.

³ Joseph Fewsmith, “Neo-conservatism and the End of the Dengist Era,” *Asian Survey*, vol. 35, no. 7 (July 1995), pp. 635–651.

⁴ Benjamin Kang Lim, “Four Million of China State Firm Workers Jobless,” Reuters, January 27, 1997. Agence France Presse, January 27, 1997.

Because of these problems, neoconservatism seems likely to be a part of whatever political mix emerges in the coming years. It should also be noted that neoconservatism, precisely because of its current amorphousness, could evolve in many different directions. It could evolve into a status quo conservatism, or it could merge with nationalist and/or populist thinking to have a much sharper edge to it.

(3) Deng Xiaoping-Style Reformers

Despite the evident socio-economic problems facing China, there are still many people who believe that the original direction of reform charted by Deng Xiaoping—decentralization of authority, greater emphasis on market forces, greater tolerance of non-state enterprises, opening to the outside world, and greater tolerance of intellectual exploration—is still the only viable path. Just as neoconservatives lack a coherent ideology, the Dengist reforms have always had more of a direction than a blueprint. Reformers were, after all, seeking to “cross the river by feeling the stones.”

This incrementalist, non-ideological approach to reform still has considerable persuasiveness because it allows leeway for effective problem-solving. Local leaders confronted by problems of efficiency or enterprise debts tend to want to push reform forward rather than subscribing to an abstract ideology that does not face up to these problems. There are also still many central leaders who continue to adopt this approach to reform. The names of former Central Military Commission permanent secretary Yang Shangkun and former National People’s Congress Standing Committee Chairman Wan Li are often mentioned in this regard.

Although this strain of thought is likely to continue to make up the political mainstream, its weaknesses should be noted. In particular, Deng Xiaoping-style reformers have trouble responding to the various criticisms of reform that have emerged in recent years, since their natural inclination is to call for more of the same. Deng always had trouble articulating a vision of the future for the very good reason that his reforms largely consisted of dismantling the Maoist system rather than building a new structure. It was this lack of ideological coherence that Wang Shan, the author of the 1994 runaway best seller, *Looking at China Through a Third Eye*, criticized to great effect.⁵

(4) Privatizers and/or Democrats

Some people feel that the Dengist reforms have gone as far as they can and that the problems of contemporary China cannot be adequately addressed without moving beyond the old approaches to fundamental economic or political reform. Such assessments lead some economists, and no doubt some entrepreneurs, to believe that China’s economic problems can only be addressed through privatization, and others to believe that its political problems can only be addressed through a further opening up of the system, perhaps leading to democratization. It should be noted that privatizers do not necessarily seek political reform, at least in the immediate future, believing that economic reform is much more important than political reform for solving China’s current problems. Conversely, those who desire major political reforms often give short shrift to economic problems. Because demands for privatization or political reform are difficult to express openly, it is difficult to judge the strength of these forces, but they are strong enough to merit refutation by one of the Party’s leading ideologues.⁶

This brief delineation of the political spectrum is not intended to be all-inclusive or to suggest that China’s political leadership will adhere to one approach to the exclusion of others. As

⁵ Luo yi ning ge er [pseud. for Wang Shan], *Disanzhi yanjing kan Zhongguo* (Looking at China through a third eye), Taiyuan, Shanxi: Shanxi renmin chubanshe, 1994.

⁶ Xing Fensi, “Jianchi Makeshi zhuyi bu dongyao” (Uphold Marxism without wavering), *Renmin ribao*, June 6, 1996, p. 9.

in other political systems, China's leaders will draw on these and other views, mixing and matching, without identifying themselves too closely with any one approach. Having said that, there is likely to be a dominant approach, just as there was in the Deng Xiaoping era.

[An] outline of the political spectrum in China leads to two conclusions. First, very different, indeed antagonistic, approaches currently coexist and the range of opinion is very large. Second, it will be correspondingly difficult for China's political leadership . . . to forge a strong and stable coalition.

Jiang Zemin and China's Political Spectrum

The preceding outline of the political spectrum in China leads to two conclusions. First, very different, indeed antagonistic, approaches currently coexist and the range of opinion is very large. Second, it will be correspondingly difficult for China's political leadership, presumably headed by Jiang Zemin, to forge a strong and stable coalition.

Jiang's approach to political leadership so far has been to draw on what might be called a "center-left" coalition. That is to say, Jiang has sought to move the reform process forward, particularly in the economic sphere, while adopting a number of conservative or neoconservative themes. The intent of the latter effort is apparently to reduce his vulnerability to "leftist" political attacks (such charges of laxness in the face of "bourgeois liberalization," for example, brought down former general secretaries Hu Yaobang and Zhao Ziyang); to draw on conservative approaches to reinforce traditional Party mechanisms such as democratic centralism and Party discipline, which tend to strengthen Jiang's role in the political system; and perhaps to fend off pressures from the "right" that would demand greater ideological relaxation and stress on the rule of law (which tends to undermine Jiang because it does not emphasize Party control).

Nationalism

Even though nationalism overlaps and intersects in various ways the streams of thought described above, it bears separate discussion, especially given the amount of public attention that it has received recently.⁷ Nationalism is not a new phenomenon in China; on the contrary it has been the single most powerful force in modern Chinese politics, driving first the Revolution of 1911 and then those of 1927 (the Nationalist) and 1949 (the Communist). What is new, and the reason that nationalism has received so much attention recently, is that its current manifestation is so clearly linked with the decline of Marxism-Leninism as a legitimating ideology. The search for nationalistic alternatives to Marxism-Leninism can probably be traced to the mid-1980s, when young intellectuals began developing the notion of "new authoritarianism." Drawing on such social science works as Samuel Huntington's *Political Order in Changing Societies* and their observations of the experience of East Asian NIEs such as South Korea, Singapore, and Taiwan, a number of intellectuals explored the ways in which the power of the state could be used to push forward market forces, legitimating itself in the process. Such constructs were conspicuously devoid of Marxist-Leninist thinking and anticipated the rise of statist, nationalistic ideas in the early 1990s.

⁷ For a useful volume of essays, see Jonathan Unger, ed., *Chinese Nationalism*, Armonk, NY: M.E. Sharpe, 1996.

The other feature of contemporary nationalism that is new is that its expression is no longer monopolized by the Party. Following the communist victory in 1949, the Party was so completely identified with nationalism that the two were virtually indistinguishable; indeed, historical discussions of the Sinification of Marxism describe and analyze the ways in which a foreign ideology was integrated into Chinese political reality and made to express Chinese nationalism. Today, for the first time since the revolution, the Party's identification with nationalism is less than complete. Even as it promotes patriotism and nationalism, it nevertheless feels ambivalent about popular expressions of nationalism and is distinctly hostile toward popular actions intended to express nationalism. Thus, for instance, during the recent dispute between Japan and China over the Diaoyutai Islands (in Japanese, the Senkaku Islands), Chinese activists were detained and at least in one case sent to "labor reform."

Although nationalism can be useful to reinforce the role of the state domestically and to push its aspirations internationally, it can also complicate the conduct of diplomacy. Ministry of Foreign Affairs officials trying to promote a better relationship with the United States can find themselves facing criticism for being "too weak" in their dealings with Washington. The formulation and implementation of foreign policy can thus be a more difficult and more negotiated process than it used to be. Though very nascent, there is a discernible rise of "public opinion" in the conduct of foreign policy. While this trend should be generally welcomed, it can also complicate relations.

One has to be careful, however, not to exaggerate either the rise of nationalism or the Party's loss of control over nationalistic expression. Although there is evidence of an important undercurrent of "assertive" nationalism in recent years, a more normal, "confident" nationalism has continued to dominate foreign policy.⁸ At the same time, despite the cottage industry of books that has grown up criticizing the United States (and Japan) as well as the Chinese government's handling of foreign policy, the government still dominates expressions of nationalism. Moreover, the openness of the Chinese economy provides an important check on nationalistic feelings. There may well be xenophobic feelings among some sectors of the population, but the government remains intensely conscious that economic development, which is dependent on foreign trade and investment, is critical for China's modernization and social stability.

Chinese Politics and the International Arena

The implication of this mix of diverse political opinion and rising nationalism is that the Chinese political situation remains fluid. Although the political center seems likely to hold, it is obviously subject to challenge from both the left and the right, both in the short term and (more likely) the mid-term. China's political difficulties stem largely from its domestic situation. At the same time that the decline of Marxism-Leninism has eroded the legitimacy of the government and given rise to the search for new political approaches, the migration of millions from the countryside to the cities, the rise of corruption, the increase in crime, the large-scale layoffs from state-owned enterprises, and the problems besetting the financial sector present enormous challenges that would be difficult for any government to manage, much less solve. The growth of such problems has obviously fueled the divergence of political opinion and increased the likelihood of social protest, whether on a small-scale, scattered basis or on a larger, more sustained basis.

Given this volatile mixture of social, economic, and political factors, China's relations with the outside world inevitably affect the political balance of forces within the country. Deng Xiaoping always paired "reform" and "opening up," not only because China's economic development was dependent on the import of capital and technology and the export of products, but also because a

⁸ Allen Whiting, "Chinese Nationalism and Foreign Policy after Deng," *The China Quarterly*, no. 142 (June 1995), pp. 295-317, and Michel Oksenberg, "China's Confident Nationalism," *Foreign Affairs*, vol. 65, no. 3, pp. 501-523.

relaxed international situation had reverberations within China, undermining the protestations of Marxist ideologues and allowing economics, and economic reform, to come to the fore.

The protests and repression on Tiananmen Square in 1989 challenged Deng's formula not only by heightening domestic tensions (through such campaigns as those against "bourgeois liberalization" and "peaceful evolution") and by making domestic liberalization seem dangerous, but also by creating deep strains in China's relations with other countries, most importantly the United States. Although Deng himself blamed Tiananmen largely on the international "macro-climate," it was Deng who continuously resisted efforts by his more ideologically minded colleagues to step up criticism of the United States. It was also Deng who not only resisted pressures to criticize the Soviet Union as Gorbachev continued to press his program of glasnost and perestroika, but who also responded to the abortive coup in August 1991 with a vigorous new push for reform, against considerable opposition within the Party.

Although economic reform has continued in recent years, there seems little doubt that strained relations with the United States have helped fuel many strains of neoconservative thinking and the rise of nationalism.

Although economic reform has continued in recent years, there seems little doubt that strained relations with the United States have helped fuel many strains of neoconservative thinking and the rise of nationalism. Perhaps no incident did more to convince Chinese that the United States was not opposed to a repressive Chinese government but to the rise of China per se than the U.S. effort to block Beijing's bid to host the Olympics in the year 2000. Degenerating relations between the two countries contributed significantly to the tense relations in the Taiwan Strait in 1995 and 1996, a series of incidents that again contributed to anti-U.S. sentiment in China, not to mention to anti-Chinese feelings in the United States.

In the past year—following tensions over Taiwan—Sino-U.S. relations have improved markedly. A new consensus appears to have emerged in the U.S. government that a decent working relationship with China is important to U.S. interests and to the maintenance of peace and prosperity in the Asia-Pacific region. But this consensus, if one can really be said to exist, is a fragile one. It has been challenged harshly by both the left and the right in Congress and the body of public opinion. Allegations of Chinese donations to the Democratic campaign have already complicated the management of Sino-U.S. relations and are likely to make them even more difficult in the future.

Many critics of this new consensus assume that the future of China is fixed and that it poses a threat to U.S. values, to the stability of the Asia-Pacific, and perhaps to the United States itself. Such views ignore the complexity and fluidity of the situation in China, but their expression, particularly when it enters government policy, clearly runs the risk of exacerbating nationalist feeling in China and driving Chinese politics toward the "left" of the political spectrum. In short, Chinese domestic politics are affected significantly by the international arena, and critics of China may find their prophecies coming true, not because they are accurate, but because they are self-fulfilling.

Implications for Hong Kong

Sorting out the implications for Hong Kong of China's domestic politics and of the increasing role of nationalism is not as straightforward as it might appear at first glance. In general, it might

seem that attitudes toward Hong Kong vary along the “left” to “right” spectrum presented above, with the left taking a harsher approach and the right a more laissez-faire approach. Similarly, one would assume that the rise of nationalism would be ominous for Hong Kong. There is some truth in such generalities. One would expect that Marxist-Leninist ideologues, were they to gain significant influence in Chinese domestic politics, would be less willing to try to understand or tolerate the uniqueness of Hong Kong and would seek to exert a heavier hand. Conversely, one would expect privatizers and democrats to take a more hands-off approach toward Hong Kong.

Nevertheless, the situation appears more complicated than these generalities would allow. First, nationalism is expressed very differently by different groups. Those on the left of the political spectrum tend to be skeptical of the open door itself, and thus they tend to advocate turning inward rather than adopting an assertive or aggressive nationalism. Conversely, those of a more democratic or populist persuasion might find themselves appealing to nationalist passions if the political system were opened up. If nothing else, the sales figures of books such as *The China that Can Say No* suggest that the public at large (at least in the urban areas) is far more assertive than government elites. Like populists in other countries, China’s popular nationalists are both more anti-foreign and anti-government than is the political elite.

Second, the interaction between political competition and the rise of nationalism must be considered. It is not just that one group is more nationalistic than another, but that nationalism is a card that can be played in times of crisis and in the course of political competition. There were hints of this reality during the Taiwan Strait crisis in 1995–1996. No political leader can afford to be accused of being soft on Taiwan.

Third, in contrast to many other aspects of China’s policy of opening to the outside world, including the establishment of special economic zones, the issue of Hong Kong appears to have been generally kept at arm’s length from China’s domestic politics. This was not always the case, as the events of 1989 showed. At that time, Hong Kong became caught up in Chinese politics on two levels. First, Chinese officials in Hong Kong, most notably Xu Jiatur, head of the Xinhua News Agency office, wanted to see the protests in Beijing settled peacefully both because he was intensely conscious of the impact bloodshed would have on Hong Kong and because his political sympathies linked him to reform-minded officials such as Zhao Ziyang. Thus, conservative officials became suspicious that Xu was manipulating Hong Kong opinion to support Zhao. These suspicions subsequently led to Xu’s removal, and later to his self-imposed exile in the United States.⁹ Second, the events in Beijing aroused and politicized Hong Kong public opinion in an unprecedented fashion. Normally apolitical Hong Kong residents took to the streets in large numbers, organized financial contributions for students in Tiananmen, and later helped leading dissidents leave China. Thus, Chinese officials became worried that Hong Kong might become involved in Chinese political movements, leading to warnings that Hong Kong not become a base for “subversive” activities. Chinese suspicions about Hong Kong and Hong Kong concerns about China have clearly complicated discussions about the transfer of sovereignty in the past several years, and the possibility that Hong Kong would again become involved in Chinese domestic politics or bear the brunt of a major shift in Beijing’s political landscape cannot be excluded.

Apart from the not insignificant exception of 1989, Hong Kong was largely isolated from Chinese politics in the post-Mao period because Deng Xiaoping personally directed policy on Hong Kong. China’s foreign policy decision-making process has always been far more centralized than its domestic policy process (and the Hong Kong issue was treated as a foreign policy issue in terms of the decision-making process). Mao Zedong made all the major decisions on foreign policy, and Deng Xiaoping followed his example. There are indications that this situa-

⁹ See Xu Jiatur, *Xu Jiatur huiyilu* (Memoirs of Xu Jiatur), 2 vols., Taipei: Lien-ho pao, 1994.

tion is beginning to change as foreign policy becomes more institutionalized, as different bureaucracies develop different interests vis-à-vis foreign policy, and as “public opinion” (however limited) begins to exert some impact on foreign policy. Generally speaking, isolating the Hong Kong issue from the broader give and take of domestic and even foreign policy decision-making has been good for Hong Kong, and Jiang Zemin shows every indication of wanting to assert control over the Hong Kong issue.

What the above considerations suggest is that the most important factor determining the impact of Chinese domestic politics on Hong Kong will not be so much which approach prevails (within certain extremes) as the fundamental stability of the political system. What the delineation of political forces indicates is not just the breadth of political opinion in the P.R.C. but the difficulty Jiang Zemin (or any other political leader) will have in maintaining the stability of the political system and institutionalizing the process of political competition. This is particularly true if foreign policy becomes a major issue, exacerbating differences among the various approaches. Extending the fundamental stability that the Chinese political system has enjoyed over the past 18 years another 10 years or so would go a long way toward institutionalizing political processes and bringing about political stability. A rapid collapse of the political system could have disastrous affects on China’s domestic politics—and on Hong Kong.

The return of Hong Kong to P.R.C. sovereignty is likely to strengthen the linkage between China’s domestic politics and the international environment. Hong Kong will be returning to China at a time when the domestic problems facing China are formidable, the divergence of opinion within the political elite is considerable, and when Sino-U.S. relations exist on a fragile basis. The return of Hong Kong seems certain to affect all of these dimensions. Handled well, the Hong Kong transition could have a positive affect on Chinese politics, demonstrating the importance of law, honest public service, and respect for diversity. As a highly cosmopolitan city deeply embedded in the international economy, Hong Kong will give a new dimension to the link between reform and opening up. If, however, the return of Hong Kong goes poorly, it would have major ramifications for the domestic politics of China and for China’s relations with the international community.

Chinese officials have made it clear that they want the return of Hong Kong to go smoothly. They have assessed the political situation in Hong Kong, are intent on avoiding problems, and would regard significant difficulty there as a major policy failure. There have been extensive discussions between Chinese and Hong Kong officials, on the one hand, and between Chinese and U.S. officials on the other. A significant effort has been made to avoid misunderstanding. Yet miscalculation remains possible.

One level of difficulty could stem simply from the distance that continues to separate the mental worlds of officials in Beijing and residents in Hong Kong. Despite the extensive contact between Chinese officials and Hong Kong residents over the years, there still seems to be a gap of understanding. From the perspective of Hong Kong residents, Chinese officials can appear haughty and uncomprehending of the peculiarities that make Hong Kong so unique. Worse, they seem at times disparaging of Hong Kong’s special role in history. Thus, the recent demand that Hong Kong rewrite its history books to bring them more in line with Chinese interpretations of modern history seems to stem from an outdated and oversimplified notion of “colonialism.” It may also presage a more concerted effort to “cleanse” Hong Kong of its Britishness. Such efforts may not threaten the prosperity and well-being of Hong Kong, but they are likely to be resented.

More worrisome, at least in the short run, are conflicts over freedom of speech and assembly. Reports of the closing of publications, the curtailment of academic freedom at universities, and new limitations on demonstrations would clearly have an impact on international public

opinion, especially in the United States. The fragile consensus that has emerged in the United States could easily be broken, setting off reverberations in Chinese domestic politics. It is precisely in such a scenario that Hong Kong could get caught in the middle of political contestation in Beijing, much as happened in 1989.

Chinese awareness of sensitivities in Hong Kong and the ability of Hong Kong capital and talent to leave appear to be the best checks on Chinese behavior. In an age when billions of dollars can be electronically transferred around the world and when business professionals can move quickly to abodes already established in Vancouver and elsewhere, a loss of confidence could have huge ramifications for Hong Kong almost immediately. In a situation in which Hong Kong appears to have little political leverage, it is precisely the ability to leave that will give the residents of Hong Kong—at least the business community—the ability to influence Beijing.

The ability of Hong Kong residents to influence Beijing, however, will depend on continued stability in Chinese politics and on continued reform of the Chinese economy, both of which will be affected by the state of China's relations with the outside world, particularly the United States. If one assumes a stable domestic and international situation, over time the ability of Hong Kong to influence China could be considerable. Hong Kong has already had considerable impact on Guangdong Province and on south China in general. As these and other areas gradually absorb the impact of Hong Kong, the influence of the Hong Kong "model" seems likely to expand. China is already aware, for instance, of the need for civil service reform, including not only the recruitment and promotion of talented and professional individuals but also the ability to weed out corruption and establish a high level of public service. Few places have a better civil service than Hong Kong, and its influence in this area could be considerable. Similarly, the experience of the Hong Kong financial sector seems vital in this period in which Chinese banks are having so much difficulty. Hong Kong may not exactly "take over" China, as some optimists have predicted, but it could have a very positive impact in some areas.

Efforts to "contain" China are not only unfeasible and unsupported by U.S. allies in either Europe or Asia, but are likely to bring about the hostile China they allegedly seek to avoid. The consequences for Hong Kong of such a scenario are unpleasant to contemplate.

Conclusion

Much has been made in recent years of the "China threat." Some predict a "coming conflict" with China, while others call for a new era of containment.¹⁰ Such visions of a hostile and aggressive China not only overstate the capabilities of China,¹¹ they underestimate the problems that China faces. They also ignore the indeterminacy of China's political evolution and the degree to which that evolution may be affected by China's relations with the outside world. Efforts to "contain" China are not only unfeasible and unsupported by U.S. allies in either Europe or Asia, but are likely to bring about the hostile China they allegedly seek to avoid. The consequences for Hong Kong of such a scenario are unpleasant to contemplate.

¹⁰ Richard Bernstein and Ross Munro, *The Coming Conflict with China*, New York: Random House, 1997; and Robert Kagan, "What China Knows that We Don't: The Case for a New Strategy of Containment," *The Weekly Standard*, January 20, 1997.

¹¹ Robert Ross, "China II: Beijing as a Conservative Power," *Foreign Affairs*, vol. 76, no. 2 (March–April 1997), pp. 33–44.

The possibility of a downward spiral in Sino-U.S. relations, of China returning to the “defensive crouch” it assumed after Tiananmen, of rising nationalism and political intolerance in China, and of Hong Kong getting caught in the middle should lead to great caution on all sides. There will undoubtedly be bumps in the road, but with any luck such difficulties will be managed carefully and with an eye to the future.

Over the medium term, how well the return of Hong Kong is handled will depend to a significant degree on how well and how rapidly Jiang Zemin can consolidate his political position. At the current time, Jiang’s position appears strong. It is not clear, though, what concessions he will have to grant to various interests in the Party in order to gain their support and, more importantly, whether his position will remain secure if China faces serious domestic or international difficulties. What is important is not whether Jiang Zemin secures his political position but whether the conduct of politics can be better institutionalized. Such institutionalization will not come about through either political upheaval or political weakness but rather through the incremental processes of day-to-day politics. Given the opportunity, Hong Kong can contribute significantly to this process. Without it, the prospects for Hong Kong are less promising.

CHINA, HONG KONG, AND HUMAN RIGHTS

Merle Goldman

The United States has clashed with China over a number of issues—intellectual property rights, sales of nuclear weapons technology, the negative trade balance, and particularly the Taiwan conflict—but the issue that has the potential for becoming the most explosive in the near future is China’s takeover of Hong Kong on July 1, 1997. Deng Xiaoping formulated an ingenious policy for the takeover: “one country; two systems.” When Hong Kong reunites with China, Hong Kong will be able to continue its present system—characterized by the rule of law, freedom of the press, an independent legislature, a merit-based civil service, and a laissez-faire economy—for 50 years. This formula was written into the Joint Declaration signed by Britain and China in 1984. But the words and actions of China’s leaders in the past several months have already undermined the existing Hong Kong system.

Although China’s leaders do not want to kill the “golden goose” of Hong Kong and want to set a good example in Hong Kong for the future takeover of Taiwan, their own authoritarian system and narrow view of economic development limits their understanding of Hong Kong’s success. They view Hong Kong’s present prosperity and stability as purely an economic matter, dependent on its market economy, investment capital, entrepreneurs, and skilled, efficient workers. They do not seem to understand that Hong Kong’s non-economic characteristics—impartial courts, freedom of expression, rule of law, complete openness to the outside world, an independent legislature, and an honest, capable civil service—are equally important. Moreover, since the early 1990s Hong Kong’s formerly hand-picked Legislative Council, or Legco, has evolved into a democratically elected body. Although Hong Kong had been moving gradually in a democratic direction since the mid-1980s, the impetus for more direct democratic procedures came in reaction to China’s military crackdown on pro-democracy demonstrators in Tiananmen Square on June 4, 1989. At that time, over one million of Hong Kong’s six million citizens demonstrated against the crackdown and demanded more democratic institutions. Even before Governor Christopher Patten appeared on the Hong Kong scene in 1992, pressure for democratic legislative elections came from Hong Kong’s burgeoning middle class. Hong Kong had its first fully democratic election in 1995 when the Democratic Party, led by Martin Lee, became the majority party in the Legislative Council.

In the lead-up to the July 1, 1997, transition, Hong Kong’s economy is thriving, its stock market is soaring, and opinion polls show that the majority of the population is confident about the future. Nevertheless, China’s leaders have already started to subvert the non-economic institutions that have helped make Hong Kong the fourth largest trading power in the world after the

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European Union, the United States, and Japan, with a per capita standard of living higher than its British overlords.¹ Once China regains sovereignty, the subversion of Hong Kong's institutions and practices is likely to accelerate.

China's Subversion of Hong Kong Institutions

Although China's leaders claim knowledge of Hong Kong's institutions and practices, they have not experienced them, nor do they appear to understand them. They insist that they will maintain Hong Kong's rule of law so that business can continue to be conducted according to predictable, legal procedures. But since China itself is not governed by the rule of law, it is difficult for P.R.C. leaders to appreciate the fact that the rule of law is not simply laws on the books. They do not seem to understand that an independent, non-politicized judiciary is necessary to maintain the rule of law. Evidence of this is seen in the way Beijing has dealt with the issue of establishing a Court of Final Appeals (CFA), which is to take the place of the independent Privy Council, hitherto Hong Kong's court of last resort. Although Beijing agreed in 1991 to establish a CFA before the July 1 handover, it has balked. It insists that it will put the CFA in place after July 1997, which makes it unlikely that the eventual court of last resort will be impartial. At one point, the Chinese government even called for a "post verdict remedial mechanism," which meant that the rulings of the CFA could be overturned if the political leaders did not like them. Although Beijing withdrew that demand in return for the appointment of the CFA after July 1, its proposal revealed that it did not understand that the law rather than politics should be the final arbiter.

. . . even though China's leaders talk about the importance of the rule of law, they seem more than ready to carry over the political practices that are used at home.

Most ominous is Beijing's insistence that the CFA cannot rule on matters of "state affairs" such as foreign policy and security. This condition means that China's leaders can determine whether the actions or words of any person or group that they consider to be a threat to their authority are a matter of "state affairs" and should be dealt with by political rather than legal authorities. Thus, even though China's leaders talk about the importance of the rule of law, they seem more than ready to carry over the political practices that are used at home.

Similarly, P.R.C. leaders vow to maintain Hong Kong's freedom of expression and the press, but because they do not allow such freedom at home, they are unlikely to fully understand such liberties. China's Hong Kong and Macao Affairs Office Director, Lu Ping, assured Hong Kong citizens in June 1996 that Hong Kong's journalists would be allowed to write about anything they wish, but he warned that newspapers will not be able to publish articles calling for freedom for Taiwan, Tibet, or of course, Hong Kong. And P.R.C. Foreign Minister Qian Qichen said in an October 1996 interview that journalists would not be able to publish personal attacks on Chinese leaders. China's appointed chief executive for Hong Kong, C.H. Tung, asserts that the British media is not allowed to criticize the queen so the Hong Kong media should not be allowed to criticize China's leaders. Obviously Mr. Tung has not read the British tabloids. It is clear that China's leaders do not appreciate the robust, often muckraking quality of Hong Kong's 22 Chinese language dailies and three English language dailies. These newspapers are filled with a wide range of sharp political views, investigative reporting, and critiques of the prevailing leaders, whether they be British or Chinese.

¹ David Fung, "The Rule of Law in Hong Kong in the Run-up to 1997 and Beyond," Heritage Foundation Lecture, no. 561, January 30, 1996, p. 8.

As early as 1994 there was evidence of what China's leaders would do if a Hong Kong journalist reports something they do not want to be made public. They arrested Xi Yang, a reporter for Hong Kong's *Ming Pao* newspaper, when he was traveling in China because he revealed some economic information in a Jiang Zeming speech a few days before Jiang gave it. Xi Yang was sentenced to twelve years in prison for supposedly revealing "state secrets," an undefined term that Beijing typically interprets any way it wishes. Even though Xi Yang was released in February 1997 due to Hong Kong and foreign pressure, his arrest intimidated the Hong Kong journalist community.

Newspapers have already begun a form of self-censorship. For example, one of the cartoonists for the *South China Morning Post*, who satirizes Chinese as well as British officials, was fired in 1996 for his irreverent cartoons. Perhaps more ominously the same paper in April appointed a founding editor of the *China Daily*, Beijing's official English language paper, to an office across from its chief editor. The paper had been taken over by a Malaysian media tycoon in 1996 who is well-connected in Beijing, where he has large investments. The *Post's* independent stance, which has gradually been waning, is likely to be eliminated altogether after July. Similarly, at the *Commercial Daily*, previously staffed by Hong Kong citizens, three people from Beijing have been installed in top positions. Universities are also beginning to censor themselves. The administration of the Hong Kong University of Science and Technology informed some of the professors that they could talk about their disciplines, but not about politics, in a public arena.

Although Mr. Tung has reappointed Hong Kong's top civil servant, Chief Secretary Anson Chan, and her senior staff and says he will retain the merit-based civil service, in spring 1995 Beijing demanded to interview and look at the dossiers of senior government officials. Governor Patten refused Beijing's request, but the action nevertheless demoralized the civil service. And no matter how much credibility and confidence Hong Kong citizens have in Anson Chan, it will be much more difficult for her to refuse such demands once Hong Kong becomes part of China.

China's leaders have not even been able to keep their hands off Hong Kong's laissez-faire economy that they claim to want to preserve. There are examples of pressure already being put on Hong Kong-based businesses. The British-owned Cathy Pacific Airlines was threatened with the establishment of a P.R.C. state run airline in Hong Kong unless it reduced its shares in its own airline and sold shares at a large discount to an official from China's state-owned company Citic Pacific. Even a Hong Kong Chinese firm has been subjected to pressure. Outspoken critic of Beijing's leaders, Jimmy Lai Chee-ying, former co-owner of the retailer Giordano, which has stores all over Asia and China, and publisher of *Apple Daily*, the best-selling Hong Kong newspaper, was forced to sell his stake in Giordano so that the company could keep outlets in China. Even with Jimmy Lai out of the business, a number of Giordano stores in Beijing and Shanghai have been closed.

While China's subversion of Hong Kong's rule of law, freedom of the press, civil service, and laissez-faire economy is already underway and may be a gradual process, its treatment of the elected Legislative Council could precipitate an immediate and potentially violent response after the takeover.

Such pressures, along with practices used at home—personal connections (*guanxi*) and bribery—are already undermining Hong Kong's laissez-faire economy and its use of economic criteria and legal procedures in the conduct of business.

Legco—The Flashpoint

While China's subversion of Hong Kong's rule of law, freedom of the press, civil service, and laissez-faire economy is already underway and may be a gradual process, its treatment of the elected Legislative Council could precipitate an immediate and potentially violent response after the takeover. China's leaders claim that the electoral system that Governor Patten put in place in 1995 was done without their approval and was not spelled out in the Joint Declaration. Responding to the demands of the Hong Kong people, Patten expanded the electorate able to vote for the functional seats by increasing the number of occupational groups in the functional category. Most importantly, he established directly elected geographic seats and lowered the voting age from 21 to 18, thereby expanding the electorate not only for Legco but also for the local district boards and municipal councils. In the 1995 election, the electorate for the first time had the chance to choose 20 of the 60 legislators directly. The Democratic Party and its allies won 14 of the 20 directly elected seats, while the pro-Beijing Democratic Alliance for the Betterment of Hong Kong won only two seats. The functional seats, which represent a much smaller constituency and are indirectly elected, were also dominated by parties close to Beijing. Because the Democratic Party was clearly favored in the direct elections, it gained more status and legitimacy than its Beijing supported rivals.

Yet, Beijing plans to dissolve the Legislative Council on July 1, 1997, though Legco delegates will have served only two years of their four-year term. Through the Hong Kong Selection Committee of 400 hand-picked representatives, Beijing has already selected the delegates who will take their place. Half of the 60 newly selected delegates are in the present Legco, but others are candidates who were defeated in the 1995 election. They meet across the border in Shenzhen. Although the P.R.C. promises to hold new elections within a year after the takeover, Hong Kong's democratic leaders fear that it will use its hand-selected Legco to roll back the political reforms introduced since 1992 and thereby disqualify the leaders of the Democratic Party from participating in the elections.

While the survival of the elected Legco is not important to many members of Hong Kong's wealthy business community—most of whom have already made arrangements with Beijing to ensure their business interests after July 1—it is important to Hong Kong's middle class, which has no access to China's leaders. Moreover, whereas Hong Kong's wealthy businesspeople have the money to establish themselves abroad and get foreign passports so that they can vote with their feet if they become dissatisfied with Beijing's rule, Hong Kong's professionals, academics, small businesspeople, journalists, civil servants, and skilled workers do not have the material resources to become citizens in another country. The elected Legco has become the forum where their delegates express not only their apprehensions and grievances, but also hold their government accountable. Since Beijing's hand-picked legislature is much more representative of those with *guanxi* in Beijing, it is unlikely that it will serve the needs of the middle class. Without a forum in which members of the middle class can voice their discontent, they may turn increasingly to demonstrations and organized opposition that could be much more destabilizing than a democratically elected legislature. Thus the dissolution of the elected Legco sets the stage for a volatile political situation.

The present leaders of the Democratic Party have said that they will bring suit against the hand-picked Legco on the grounds that it is counter to the Basic Law, which calls for an elected legislature. They also plan to express their opposition through demonstrations. Every year since 1989 leaders of the Democratic Party and others have led demonstrations on June 4, where with loudspeakers they demand the release of people imprisoned for their political ideas. Beijing does not tolerate such events at home and is unlikely to tolerate them in Hong Kong.

There is clear evidence of this in Beijing's announcement of a revision in Hong Kong's Bill of Rights. This Bill, passed in 1991, made it possible merely to notify authorities when a protest was to take place. As explained by Mr. Tung, the revision would revive the British colonial laws that restricted the right to demonstrate and assemble. Even if this potentially explosive scenario does not come to pass, it appears that Hong Kong's days as an extraordinarily efficient, prosperous capitalist enclave are over. The economy may continue to boom for a while, but the erosion of the institutions, practices, and values that made Hong Kong so dynamic and stable will gradually slow.

Recommendations for U.S. Policy

More than 1,000 U.S. firms have corporate offices in Hong Kong, making it the largest base of American economic operations in Asia. Therefore, it is likely that when the British leave, the United States by default will become the defender of the Hong Kong system. What can the United States do to ensure that the commitments made in the Joint Declaration and Basic Law are fulfilled?

Because of China's size, history, predominance in Asia, and most importantly, its increasingly influential role in the global economy, the United States' ability to influence P.R.C. actions is marginal. Threats by Congress to impose economic sanctions if China continues its present strategy of extending "creeping authoritarianism" to Hong Kong and continues its human rights abuses only inflame the U.S. relationship with China. Moreover, those who want to maintain the present Hong Kong system, including Democratic Party leader Martin Lee, warn that economic sanctions will hurt Hong Kong as much as Beijing. Most important, such threats no longer evoke a positive response from China as they did for a few years after the June 4, 1989, crackdown on pro-democracy demonstrations in Tiananmen Square. China knows that the United States will not carry out economic sanctions because of the opposition of the American business community, competition from other nations, and the harm to the U.S. economy. Nevertheless, there is value in reviewing China's most-favored-nation status each year. The threat acts as a form of pressure that encourages China to limit human rights abuses if not stop them.

The United States can point out that a majority of Hong Kong's population shares Western democratic values, exemplified by the use of the rule of law, the election of the Democratic Party as the majority party, and active participation in a vigorous civil society. If we follow their lead and reinforce their criticisms of Beijing's policies, we cannot be charged with imposing alien values.

While some Hong Kong journalists and newspapers are already censoring themselves, other journalists and newspapers are demanding that Beijing spell out what it means by "state secrets" so that they will not suffer the same fate as Xi Yang. Hong Kong journalists are organizing to protect their right of free expression after the P.R.C. regains sovereignty. The U.S. government and Western journalists should support Hong Kong journalists and publishers in this effort. There is not much that Washington can do about the dissolution of the elected Legco, except to support the Democratic Party leaders who plan to bring suit and organize protests. The United States also can echo their demand that the hand-picked legislature open up its meetings to the public and the press, which it has not done hitherto, and try to ensure that the promised election for a new Legco be carried out democratically and with the participation of all members of the 1995-elected Legco.

Even if the United States uses only rhetoric or moral support to back up the efforts of Democratic Party leaders, Beijing will charge Washington with interfering in China's internal affairs and of trying to contain it. Furthermore, Beijing is adept at playing off one nation against another. Therefore, it is best to exert pressure in concert with our Western allies and other democratizing countries so that China cannot single out the United States as the only nation concerned about the Hong Kong system and human rights. The UN Commission on Human Rights is the

most appropriate forum in which to address these issues because it is a forum which China values. During the era of Mao Zedong (1949–1976), Beijing was generally unconcerned with its image in the outside world. But since the beginning of the Deng Xiaoping (1978–1997) era, China has attempted to be a major player on the world scene and a respected member of international organizations. Therefore, even though it professes to discount criticism of its human rights abuses, it puts tremendous effort into ensuring that a Western sponsored resolution critical of its human rights abuses, proposed for the past seven years at the yearly meetings of the UN Commission on Human Rights, does not pass.

Since the early 1990s, China has participated in the Commission's annual meetings in Geneva with large, predominantly youthful delegates who speak English well and claim to be specialists on human rights. Despite their active and ubiquitous presence, however, they do not participate in the broad range of human rights discussions. Their main focus is on preventing the passage of an annual resolution critical of China's human rights record. These resolutions contain relatively mild language because they are consensus statements and seek to garner the support of a wide array of nations. The moderately worded 1997 resolution called for the release of political prisoners and for China to sign the UN Convention on Civil and Political Rights. It also denounced restrictions on freedom of expression and urged that Tibetans be allowed to worship freely.

Human Rights Watch/Asia in its March 1997 Newsletter detailed the extraordinary effort, both financial and diplomatic, that China exerts to prevent the annual resolution from passing. Even though China has successfully blocked debate on the subject six times out of the seven it has been proposed, the threat of a resolution, as the Newsletter points out, "has itself been an effective form of pressure as illustrated by the time and resources China has spent in trying to counter it."² The fact that China expends so much energy, time, and money to ensure that its human rights record is not condemned in Geneva demonstrates that it cares about its image on this issue. This year, Beijing was successful in splitting even the Western bloc. France, Germany, Spain, Italy, Greece, Canada, Australia, and Japan did not support the resolution. The United States must launch an energetic lobbying effort in favor of the resolution not just at the meetings (as we did this year) but months before. Like the threat of MFN withdrawal, the threat of the resolution may not prevent abuses, but at least it may limit or moderate them. The Hong Kong people themselves have taken advantage of this forum to present their views. Each year Hong Kong's NGOs send one of the largest and most vocal delegations to the Geneva meetings. If China tries to prevent their participation, this would be another issue that the United States could point to as contravening China's promise to preserve the Hong Kong system for 50 years, as stipulated in the 1984 British-Chinese Joint Declaration.

The fact that a resolution criticizing China does not pass and carries no penalties or obligations would seem to make it an ineffectual method for dealing with China's human rights abuses. Nevertheless, because Beijing wants to be included in international forums and sign international treaties, the United States should hold China accountable to international obligations that it has accepted. China has signed onto the UN Declaration of Human Rights; it has also said it will sign the UN Covenant on Social and Economic Rights, though it has not yet agreed to sign the UN Covenant on Political and Civil Rights. We should continue to pressure China to sign this covenant. The most appropriate approach for dealing with human rights abuses in Hong Kong is to urge China's leaders to abide by the UN Declaration and to live up to what they have already accepted in the Joint Declaration—the maintenance of the Hong Kong system for 50 years. Furthermore, the approach of urging China to comply with its own stated positions should be used in all international forums in which China participates.

² Human Rights Watch/Asia, March 1997 Newsletter, p. 2.

Public exposure and criticism rather than the use of economic sanctions in dealing with human rights abuses in Hong Kong as well as in China . . . is the least damaging to American interests and . . . has been an approach to which China's leaders have not been unresponsive.

Public exposure and criticism rather than the use of economic sanctions in dealing with human rights abuses in Hong Kong as well as in China may seem rather ineffectual and a mild response to some of China's egregious human rights behavior and the erosion of Hong Kong's institutions. However, it is the least damaging to American interests and, more importantly, it has been an approach to which China's leaders have not been unresponsive. They have shown that they do not want to be stigmatized or lose face in the international community. Internal political change in China will come because of decisions made in China: the United States can only have a minimal influence. Economic sanctions that hurt mainland and Hong Kong Chinese would be counterproductive and further raise the increasingly xenophobic spirit of China's youth. The most constructive approach for the United States is to support, at international forums, in the halls of Congress, and during meetings of U.S. and Chinese leaders, those in China and in Hong Kong who are pushing for a more democratic society and working to free the political prisoners who have been arrested for their democratic beliefs. The Geneva meetings are the most relevant, least costly, and perhaps most effective of these forums for calling attention to the erosion of the Hong Kong system.