

INSTITUTE OF CURRENT WORLD AFFAIRS

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Pyungchang Dong
Chungno Ku
Seoul 110, Korea
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1997

Mr. Peter Bird Martin, Director
Institute of Current World Affairs
4 West Wheelock St.
Hanover, NH 03755

Dear Peter,

The harbor gives nothing away. Dozens of ocean-going freighters piled high with crates or modern container units lie at berth while smaller boats scurry in and out, off-loading cargo or bringing in fresh supplies. In the evening, strings of lights on two American destroyers--running straight over the mast from bow to stern--sparkle in reflection on the waves, while their crews liven up the nearby bar district of Wanchai. Old ferry boats ply the water, their ranks augmented by fast hovercraft that transport Hong Kong's suburban sprawl to the outer islands. Fishing junks and sampans bob like toy boats in the water so chopped up with heavy traffic.

On the streets, I can't walk for more than a block or two without covering my ears from the racket of jackhammers or turning my eyes from the glare of a welder's torch. A building boom that struck the colony a decade has gradually transformed the skyline. Tall, slender apartment buildings rise from precarious perches on slopes overlooking the business districts. In North Point a wall of cream-colored buildings has completely obscured the green hills behind. Near the Central District a skyscraper covered with gold mirrors that is both elegant and gaudy houses a new financial center.

To the eyes and ears, Hong Kong is normal.

But the truth is that Hong Kong, a free trader's mecca for one-hundred and forty years, is facing its worst crisis of confidence ever. It is not a sudden upheaval, as in 1967, when China's Cultural Revolution spilled over to produce rioting in the streets of Hong Kong. Then, many who feared a quick take-over by China bolted the colony and lost their fortunes. But China never came. Now Hong Kong lies in the wide jaws of a slow vice that is gradually closing in.

The colony has only one conversation these days. You can overhear it on every bus and in every restaurant. If you visit a friend's home it will dominate your dinner. You cannot avoid all of the ins and outs, all the pros and cons of each startling detail.

The topic is 1997. In 1997 China plans to take control of Hong Kong from the British.

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On the weekend of September 24th, the fear of 1997 boiled over briefly before returning to a slow simmer. In a day and a half, the Hong Kong dollar lost over 20% of its value, dropping to a giveaway price of 9.60 against the U.S. dollar. When I changed money on the 23rd, I waited behind long lines of elderly Chinese women, carrying in stacks of yellow one-thousand Hong Kong dollar notes. Some left minutes later with an equally tall stack of green one-hundred dollar U.S. bills. But most traded their yellow paper for yellow metal--square and round gold coins tucked securely inside strips of clear plastic. The rate boards at the Hang Seng Bank instantly broadcast to those waiting on line how much they had lost by arriving an hour late.



A shopper who arrived too late.

Hong Kong's market-conscious consumers then put two and two together. Hong Kong imports nearly all its food. With the Hong Kong dollar dropping by 20%, food prices would go up just as much. A shopping spree on Saturday and Sunday left most supermarkets bare of rice, cooking oil, eggs, sugar, popular brands of soy sauce, and toilet paper. The colony faced no serious shortages. Merchants restocked their shelves in the following days, but at higher prices.

Expatriots paid in U.S. dollars went on a buying spree of their own when they discovered that the stereo they eyed a week earlier for a thousand U.S. dollars suddenly cost only \$800. A six thousand dollar car cost only \$5,000. Some merchants began to quote prices only in U.S. dollars to protect themselves, and one unconfirmed rumor circulated that a chicken peddler in Kowloon City would only take green backs. The Hong Kong dollar teetered on the edge of complete collapse.

Only strong statements by the government on Sunday and apparent heavy intervention in foreign exchange markets on Monday morning stabilized the situation. But Hong Kong's weary people can only wonder for how long.

1997. It has worried Hong Kong seriously only for the past year and a half. Before then, the Chinese government had always said it did not recognize the treaties that ceded control of Hong Kong to the British. It did not recognize the lease on the New Territories--covering some 90% of the colony's land--that would expire in 1997. Nonetheless, China seemed happy with the situation. When asked, China always said not to worry about Hong Kong. It belonged to China but only at some "appropriate time" would China take control.

Most people took China's assurances at face value, reasoning that China needed a capitalist Hong Kong in order to earn foreign exchange. In the past, at least, China obtained 40% of its annual foreign exchange earnings by selling food, clothing and a host of other goods to the colony's five million Chinese residents. China actively encouraged prosperity in the colony. It supplied petroleum when the world supply was down. It participated in long-range projects to supplement the colony's inadequate water supply. As China began to stress modernization, Hong Kong became even more important as a window on China, providing modern services for many companies doing business in there. Domestically China was growing more pragmatic. Surely China would be "rational" about Hong Kong, most people reasoned.

It was a legal issue that initially aroused concern in the colony. In the 1970s Hong Kong's industrial and residential development began to spill over heavily into the New Territories, once just a rural hinterland for the colony. Banks had issued 15 year loans for the projects, but in 1982 the banks hesitated. With the lease for the New Territories expiring in 1997, loans due for collection after that date may lack enforceability.

In the spring of 1981 a group of "patriotic" Chinese land owners from Hong Kong paid a visit to Beijing and pressed China for reassurances, for some legal way to extend the lease and assure that business could proceed as normal. To their surprise, the Chinese told them that China would take control of the colony in 1997. Some of these men returned to Hong Kong and began quietly selling their pro-



The Star Ferry

perty. Still the story did not break.

The story became public in July after a Hong Kong leftist discreetly advised an American teaching in Hong Kong University not to buy a flat. It might not be a good investment because when British Prime Minister Margaret Thatcher visits Beijing in September, he was told, the Chinese will tell her they intend to take control of Hong Kong in 1997. The American, John Burns, wrote an article for the Asian Wall Street Journal. The next day the Chinese language papers picked up the item and a day after that the Hong Kong stock market dropped a hundred points.

Mrs. Thatcher's visit to Beijing in September 1982 set the two sides at loggerheads from the start. On arrival in Hong Kong afterwards, Mrs. Thatcher declared that the 19th century treaties gave Britain sovereignty over Hong Kong Island, which was ceded rather than leased. The Chinese rebutted that the treaty was signed at the point of a gun and had no legal standing. They did not recognize the terms of the treaty. Hong Kong always was and always will be Chinese.

Land prices tumbled, dropping 30% from their highs earlier in the year. The Hang Seng index of the Hong Kong stock market dropped over 300 points, to the mid-700s, from a high of over one-thousand earlier in the year. The Hong Kong dollar also began its slide. Many companies that had speculated on Hong Kong's booming land market could not repay their loans and went bankrupt. Banks faced a serious liquidity crisis.

The British-Chinese negotiations on Hong Kong's future began in such an atmosphere. Still there was hope. An idea circulated that China might accept a face-saving formula in which the British would concede Chinese sovereignty over Hong Kong, but Britain would continue after 1997 to administer the "former" colony, appointing a governor from London. Everyone assumed that communist bureaucrats could not administer Hong Kong and maintain the colony's prosperity. Thus, it was in China's interest to have the British stay.

A news blackout on the negotiations allowed these ideas to flourish. The Hang Seng index began to pick up and regained most of its lost ground in the spring of 1983. The property market did not recover, but this could in part be attributed to overbuilding in the 1970s, and the worldwide recession.

The optimists--and there are still some--make two arguments. First, China and Britain have both said repeatedly they want to maintain Hong Kong's prosperity and stability. China, for one, has many incentives to be moderate because Hong Kong is so important for its economy. China plans to quadruple its gross domestic product by the year 2000, and it needs foreign exchange. China's domestic policy has become more realistic and pragmatic. This same spirit could apply to Hong Kong. But secondly, many people argue that China needs to show it can keep Hong Kong prosperous if it ever wishes to regain control over Taiwan. If Hong Kong becomes a fiasco, China will never be able to convince Taiwan that its plan for an autonomous Taiwan under Beijing's control would ever work.

Despite the official news blackout on the talks, China has released a steady dribbling of odd unofficial comments to miscellaneous visitors and reporters. The comments may indicate something of what China has in mind for the colony, and some of it does not sound so

bad. China has said that Hong Kong can run its own affairs under an unspecified system of autonomy (although Beijing would appoint the governor). The economy will remain capitalist. Hong Kong will issue its own currency. The unhibited flow of goods and money in and out of the colony will continue. The people of Hong Kong can keep their current life-style, with freedom of the press and freedom to travel abroad. Hong Kong will continue to issue its own passports and identity cards. In other words, China says life can continue in Hong Kong pretty much as it always has.

Of course, no one in Hong Kong believes them. Despite China's unofficial smile on Hong Kong's unsocialist ways, the official British and Chinese negotiations had stalled. By August the atmosphere had become nasty as the Chinese made more of their basic negotiating stance (or perhaps unnegotiable stance) clear, and began to turn an ever fiery tongue on the British.

From the boom and bust gyrations of the Hong Kong stock market to the bustle of the gold and currency exchanges, Hong Kong has one of the least regulated capitalist systems in the world. There is no social security. Depositors have no insurance against bank failure. The Hong Kong currency rises and falls with minimal interference by the government. Private banks issue the currency.

This uniquely free economy has boomed in recent years, growing at rates over 10% in the 1970s. Little Hong Kong is the world's largest exporter of textiles. The ease of doing business, unincumbered with rules, regulations and taxes, yet protected by an effective British legal system, has attracted many foreign investors. Hong Kong has grown into the financial capital of Asia, making it one of the most important in the world--a place where most international banks have major regional centers, and often a network of consumer banking facilities. The prosperity has brought near full employment to Hong Kong's hard-working labor force, despite the constant influx of refugees and legal emigres from China.

The people of Hong Kong do not have democracy. But they enjoy freedom. They can live as they please, travel abroad, and say what they like. They can and do criticize the British, the Chinese or anyone, daily, in newspapers that run the spectrum from far left to right. They know they will not be arrested without a charge, imprisoned without a trial, or tried without a defense. Their judges will be independent.

A street in Causeway Bay



Many Hong Kong Chinese complain about the insensitivity of their British colonial rulers. They complain about inadequate education and health facilities. They complain that the British have made them second class citizens, since they hold British passports but do not have the right to enter Britain. They complain they have too few channels to influence the government. They complain about discrimination toward Chinese in professional hiring and about the privileges that many expatriots receive merely for living a long ways from home.

But things have gradually improved. Although Hong Kong Chinese far from control the government, more channels have opened up in recent years. Chinese now dominate most professions, and they have moved in greater numbers into higher places in the government. Local Chinese are no doubt right when they say that they can run Hong Kong as well as the British. The British government now mainly provides a buffer between local Chinese and the communists. As one man put it, "We have no exaggerated opinion of the British. But with the British here, that means freedom for us."

Britain has in fact made something of a public show of consulting with "local opinion" as it proceeds to negotiate Hong Kong's future. It talks mainly with the Unofficial Members of the Executive and Legislative Councils--Umelco for short. The Executive and Legislative Councils function as advisory and supervisory bodies for the Hong Kong government. The governor carefully selects and appoints their members. Many are prominent, successful Chinese--lawyers, bankers and businessmen. Recently, though, the composition of the councils has changed slightly to include elected members of the Urban Council and district boards, democratically elected bodies that have highly circumscribed decision powers on minor issues.

At the time of this writing, Umelco members are in London consulting with Mrs. Thatcher and her cabinet on Britain's negotiating position. They have been privy to the progress of the talks, and although they are sworn to secrecy, it is apparent from various public statements what Umelco

members told Mrs. Thatcher: Stand fast and bargain hard for an extended transition period that will guarantee a strong British presence in Hong Kong after 1997. And when British negotiators carry this message to Beijing, they claim to have Hong Kong public opinion, the Hong Kong people, on their side. They were apparently trying to convince the Chinese that sovereignty and administrative power need not go

Ralliers in Victoria Park support the status quo.



together, and have bargained for a compromise solution that Britain will publically recognize Chinese sovereignty in return for a longer transition period under British rule.

The Chinese have not bought it. What Britain did not bargain for was the Chinese reaction. Beijing evidently feel insulted by the suggestion that China is incapable of administering Hong Kong and retaining its prosperity. And this is, truly, an insult, whatever its truth. Beijing doesn't like the idea that Britain claims to speak for Hong Kong public opinion when 98% of the people are Chinese. Hong Kong is important to China's economy. But China has been known to bear a sacrifice when national honor and territorial sovereignty are at stake. Territorial sovereignty is an explosive issue everywhere in the world.

With a timing that cannot have been accidental, in mid-September, the Chinese released a film in Hong Kong entitled "The Burning of the Summer Palace." The film illustrates in graphic, bloody detail the barbarism of British troops as they marched on Beijing in 1860 and torched the Summer Palace, auctioning off its fabulous art treasures as flames leapt in the background. On the way, they raped and pillaged in wanton abandon. The film was terrible. But its virtue was a clear message: Hong Kong is ill-gotten war booty.

China began to grow feisty over the summer. Beijing sent a high-ranking official, Xu Jiatun, to head the New China News Agency in the colony. Since his arrival, Mr. Xu has begun acting something like the Chinese unofficial governor. One of his jobs has been to canvas local public opinion. And by wondrous serendipity he has found many local Chinese--local patriots that is--who welcome China to return in 1997 and administer Hong Kong.

Mr. Xu has taken a number of tours around the colony and met directly with local elected district board members and businessmen. In a meeting with students of Hong Kong University, he suggested that even after 1997 "rightists" may continue to speak out, and may even criticize the Communist Party. He evidently did not consider that mere use of the term "rightist" might make some people uneasy. "Rightists" in China have not had a happy fate, and who in Hong Kong is not "rightist?"

Mr. Xu also told the students, with serene self-confidence, that he knows Hong Kong public opinion. "The industrial and commercial sectors wish to continue their pursuit of profit, the intellectuals stress democracy and freedom, and those in the middle and lower strata of society want to improve their standard of living." China has bitterly accused Britain of "playing the public opinion card." Evidently it has found a way to deal out its own.

In the middle of August, the left-wing unions in Hong Kong, including the Hong Kong Federation of Trade Unions, the Transport Workers Union, the Seamen's union, and the Union of Chinese Working in Western-style Employment, all issued statements endorsing the Chinese position that sovereignty and administrative control cannot be separated. They welcomed the Chinese to return in 1997. The Chinese evidently meant the statements to bolster their position in the negotiations with Britain. But local Chinese were intimidated by the exercise. Hong Kong Chinese know only too well how skillful the communists are at manipulating and subverting from within.

In August, the left-wing publication Zheng Ming, which in the past has had a line on important stories from Beijing, printed an article discussing whether or not China would send its army into Hong Kong to take control. Many commentators discounted the reliability of the story, but the damage was done. The South China Morning Post later published a story claiming that Beijing had discussed a contingency plan in which it would take control of Hong Kong within nine to eleven hours if the British suddenly withdrew. China watchers do not take these stories at face value, but the stories are a barometer of China's anger over lack of progress in the negotiations.

By September the colony had a serious case of the jitters. The Hong Kong dollar, which had hovered just over seven to the U.S. dollar since May, slid down to 7.8 by the middle of the month, and the left-wing papers in Hong Kong began to blast the Hong Kong government for failing to take measures to defend the currency. The currency's decline had nothing to do with fears about an uncertain future, they said. China had, after all, repeatedly said what the future would hold: Hong Kong would maintain its prosperity under Chinese rule. Britain, they claimed, was now playing the "economic card"---intentionally manipulating the currency in order to put pressure on the Chinese government. China, meanwhile, was losing millions of dollars on its sales to the colony. The left-wing papers threw out all their fire and brimstone and accused the British of acting like old-style colonialists seeking to perpetuate their rule over Hong Kong. China would not be intimidated they insisted. Come what may, China would take control over the colony in 1997.

Obviously China would do nothing to help stabilize the situation. Many pointed out, in fact, that the Bank of China had been heavily selling Hong Kong dollars during the month. (This is, however, a normal way for China to turn its sales to the colony into U.S. dollars.) With China not helping out, people looked to the Hong Kong government to do something.

On September 16, the colony's Financial Secretary, Sir John Bremridge, released a fairly optimistic economic forecast---a 6% growth in the colony's gross domestic product for the year. It would be double digit, he claimed, but the for "confidence factor." There would be a 15% decline in private sector construction and a 1% decline in capital formation. But missing in the report was any positive step to shore up the currency. Many had expected the lifting of a withholding tax on Hong Kong dollar deposits (there are none on foreign currency deposits), if only as a symbolic gesture. Instead, Sir John indicated that since the reasons for the decline were political, he could not fight them with economic measures. The market would determine a proper rate.

Believing that the Hong Kong government would now do nothing to protect them, people sold more and more dollars. The Hong Kong dollar sunk easily past the 8 to the U.S. dollar mark and the left-wing papers rained criticism on the Financial Secretary.

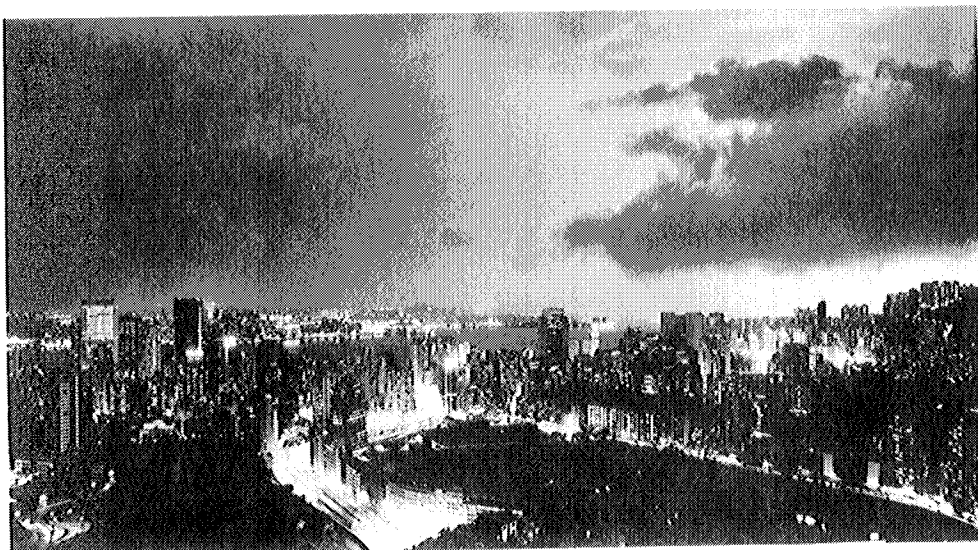
Lest I create the wrong impression, I should point out the logic and consistency of the Chinese position. It was the British and not the Chinese who initially pushed for a clarification of 1997. China had always said that the 19th century treaties were invalid and that Hong Kong belonged to China. And I've yet to meet Chinese, whatever their politics, who argue that sovereignty over Hong Kong seriously belongs to Britain. Despite its economic dynamism, for China, Hong Kong has always been a more or less embarrassing political anachronism, a continuing reminder of China's humiliating 19th century encounters with the West. Could China stand the embarrassment of officially endorsing and extending an arrangement it had always denied?

Instead, China very reasonably said it would negotiate with the British for an orderly fifteen year transition period, at the end of which time Hong Kong would maintain its basic capitalist economic system, style of living--including freedom of the press--and its prosperity. The only difference is that China would run Hong Kong instead of Britain. What could be more reasonable?

But rather than recognizing the basic reason and moderation of the Chinese position, Britain insists it has sovereign rights over Hong Kong. It further implies--and others state it baldly--that the wisdom of British rule is solely responsible for Hong Kong's modern success, not the hard work of its Chinese residents or China's cooperative attitude. They insult all Chinese people by implying that Chinese are incapable of maintaining Hong Kong's prosperity by themselves.

Instead of taking steps to reassure the people of Hong Kong about China's good intentions, and taking steps to stabilize the economy, the Hong Kong government--and the British government too--blame the Chinese for creating instability and panic. They falsely accuse China of divulging the British negotiating position. The Chinese, after all, have not divulged any secrets. They have only stated the unnegotiable truth--that sovereignty and administrative power are inseparable and that China will take control over Hong Kong in 1997.

Hong Kong by storm.



On Wednesday evening, September 21, heavy clouds blotted out the sky and the bright Autumn harvest moon. But the weather did not stop thousands of families from celebrating the Mid-Autumn Festival, one of the merriest of the Chinese lunar calendar. With children in tow, they trooped to Victoria Park or the Peak, which has a commanding view of the harbor below, carrying paper lanterns lit by candles, or electric torches illuminated by plastic threads sprouting out the end.

The next day, a public holiday, Hong Kong rested (with currency markets gratefully closed), while British and Chinese negotiators met in Beijing for another round in the talks. Television pictures on the evening news showed the British delegation arriving on time, but with no Chinese there to greet them. The British proceeded into the conference room. Five minutes later a beaming, self-confident Chinese delegation descended from the second floor. The British apparently had been snubbed. (This view persisted despite all attempts to explain away the missed greeting.)

When talks concluded on noon the following day, the negotiators had nothing to say. The Hong Kong dollar sunk to 8.65 to the U.S. dollar. At 3pm a terse statement finally appeared announcing that the British and Chinese had met and would meet again in October. This confidence-inspiring message sent droves of people to the banks to buy gold and U.S. dollars. On Saturday morning, the 24th, the Hong Kong dollar sunk to 9.6 and people stripped bare the supermarket shelves.

The main Kowloon branch of the Hang Seng Bank on Nathan Road in Monkok has a spacious circular lobby. The cream-colored walls and floors, the burnished brass pillars, the ring of incandescent bulbs sparkling in refraction through hanging pieces of crystal, the huge crystal chandelier in the lobby center looking like an inverted atomic mushroom cloud--these are the symbols of stately luxury designed to inspire confidence. With the normal flow of customers, the near-empty lobby would be imposing and grand.

On Monday morning, September 26th, hundreds of people filled the lobby. A thin crowd two or three deep shouldered up to the foreign exchange and gold trading windows. The rest stood behind, milling back and forth, chattering away, fiddling with calculators and note pads, occasionally breaking from the crowd to trade at a window, and always keeping a close eye on a large electronic board, lit dimly with red digital numbers, listing the latest price for half a dozen foreign currencies.

This was not a panicked crowd. It was a crowd of speculators chortling over their profits and bemoaning their losses.

On Sunday the Hong Kong government had pricked the speculative bubble. The currency that had closed at 9.6 to the U.S. dollar on Saturday opened near 8.5. At 9:30 the Hang Seng Bank bought U.S. dollars at 7.5 and sold them at 8.3, the huge spread making it nearly impossible to make a quick profit on currency trading. Gold had dropped over 500 Hong Kong dollars in the morning, losing more than 10% of its value in an hour.

On Sunday the government announced that it would defend the Hong Kong dollar and that speculators would "burn their fingers." The government did not say what it would do, but it put the scare into everyone, and may have quietly bought Hong Kong dollars on Monday. The currency seemed magically to stabilize in the following week at just over 8 to the U.S. dollar.

The left-wing papers even grudgingly supported the government statements, although they could not resist getting in a few licks by pointing out that they were right all along. The Hong Kong government did intervene to stabilize the market despite repeated statements that it lacked the power to do so. Obviously, according to the left, the problem was not "lack of confidence" or "uncertainty about the future," but the government's failure to fulfill its responsibilities.

On Tuesday, the markets absorbed with surprised calm the failure of the Hang Lung Bank, which had branches throughout the colony. The Bank's failure had its roots in a run on the bank a year earlier and some bad loans. The more recent banking turmoil merely pushed it over the edge, with many people taking out their Hong Kong dollar deposits. The government stepped in immediately and took over the bank, guaranteeing to protect depositors. Had the government failed to do so, apparently a string of bank failures might have begun. But the markets were calm the day after the announcement, and again the left-wing papers supported the government's decisiveness (while pointing out that it did not get to the root of the problem).

I left Hong Kong on Friday, when an uneasy calm prevailed. The markets seemed suspended in air. Interbank interest rates skyrocketed as banks waited for an expected government announcement offering concrete measures to stabilize the currency. Everyone was waiting.

The drama over Hong Kong is far more than a contest between Britain and China for an agreement that suits them. The British and the Chinese governments can clink glasses and sign a piece of paper. But it was never a government agreement that caused Hong Kong to prosper. And the people who, in the end, will make Hong Kong's future have no representative at the talks.

If China wants to make Hong Kong's future prosperity more than an empty promise, and its recovery of the colony more than a hollow victory, it must convince people who live and work in Hong Kong that it makes sense to continue what they have done for the past decade and more--investing and working hard. On this score, people who live and work in Hong Kong do not speak with the same voice.

Many foreigners who do business in Hong Kong do not care about 1997. Most investors will earn back their money in a few years, and they have insurance against nationalization. Most businesses can easily export their equipment if they have to--it is light and compact. Hong Kong does not thrive on steel furnaces and petrochemical works that require large permanent installations. Many businesses that have moved to Hong Kong in the last decade are service industries--banking, investment, and insurance. Ship out the computer, the telex machine, and the typewriter and there isn't much left besides some old office furniture and a few disgruntled former employees. Some foreigners are almost sinfully gleeful about Hong Kong. It is still a great place to make money. Many businesses buy raw materials and sell finished goods abroad. If the Hong Kong dollar loses value, it merely saves them money on labor costs. Why worry about 1997?

Working people in Hong Kong also have less to fear. One cabbie who drove me into the bustling, gaudy tourist district of Tsimtsatsui reflected on China's taking back the colony.

"That's no problem for me," he said. "I'm a worker. I work for a living and don't have money. It's people with money--they have something to worry about. But not me."

But that same cab driver had no illusions about the future.

"Have you ever been to China?" he asked, looking at me over his shoulder for a moment. Without waiting for an answer he turned forward and continued. "The communists cannot run Hong Kong. It will never be prosperous like this after they come."

He gestured to the hotels, the jewelry and hi fi stores that line Nathan Road.

"Have you ever been to China?" he repeated. "Things are very slow there. They haven't accomplished very much there."

Working people comprise the majority in Hong Kong. Although their lot is far better than workers on the mainland, they do not earn much money and Hong Kong's retirement, welfare and medical insurance systems leave something to be desired.

But few people in Hong Kong have much respect for the competence of communist bureaucrats or the diligence of socialist workers. Hong Kong's economy has grown quickly because people in Hong Kong work hard. More than a few refugees from China have complained to me about this. They never knew they would have to work so hard just to hold down a job. Even workers who do not fear the communists have a sense that when the communists come, Hong Kong will slow down.

For Chinese professionals and businessmen, the fears are more intense. Beijing has promised that Hong Kong will continue as an autonomous economic zone under communist rule, pretty much as it has in the past. But who believes them? Whenever I point out that the Chinese have promised to allow freedom of the press, my Hong Kong friends laugh at me. Freedom of speech is guaranteed in China's current constitution, yet more than one Chinese citizen languishes in jail for exercising those rights. Many quickly recall the "patriotic" capitalists who stayed behind in Shanghai. Within a few years they were terrorized in a political campaign to assert control over their businesses. Five years later the state nationalized their companies.

Would China tolerate
anti-communist leafleting?

Real administrative and political autonomy under Chinese communist rule would require a complete departure from all precedent. It strains the imagination to foresee China touting the virtues of socialism in Beijing, while nurturing the world's boldest experiment in *laissez faire* capitalism in Hong Kong. It is one thing for the people of Hong Kong to enjoy wealth and freedom under British rule. Under Chinese rule it would instantly become privilege and inequality. How long would it be before the rest of China began to complain? Would China continue to patrol the border, and arrest Chinese who tried to flee into



Hong Kong? China has changed a great deal in recent years. But it hasn't changed that much.

People fear that the communist's notion of "Hong Kong people running Hong Kong" would mean Beijing appointing a few sympathetic loyal leftists to high positions in the government. This could easily subvert the entire authority structure. What if their decisions encountered resistance? Would judicial independence and legal protections become a thing of the past? Would the communists implement the household registration system they use to control population movement on the mainland? Would residence committees be set up to provide social services while handily keeping an eye on everyone? Would all of the freedoms and legal guarantees slowly disintegrate, to be replaced by the arbitrary authority of the local Communist Party boss?

Maybe not, but plenty of people in Hong Kong who value their freedom are not willing to take the risk. Visa applications have skyrocketed and emigration has doubled over the past year.

The communists have not helped things lately with the kind of statements that have been coming out of Beijing. In early October the Chinese for the first time issued statements directly attacking Margaret Thatcher. They announced that if no agreement were reached by the end of 1984, China would make its own unilateral statement on the future on Hong Kong. They further rattled sabers by asserting that China had the right to retake Hong Kong at any time.

These statements may succeed in convincing the British that they have no bargaining power, which happens to be true. China need only turn off the water supply and Hong Kong will be in deep trouble.

But the statements have thoroughly frightened people in Hong Kong. If Beijing has done this intentionally in order to intimidate, as some people think, it hardly inspires confidence in a future under communist rule. If the statements are merely a byproduct of hard bargaining, it shows the communists do not understand that confidence is vital to maintaining Hong Kong's prosperity. The communists indignant denial that their statements have affected the Hong Kong dollar and the stock market is almost laughably disingenuous. The denials have convinced many people that Beijing cares

A produce market.





"Outlook for 1997" - Happy visions outside a Mongkok restaurant.

less about saving Hong Kong's prosperity than saving its own national honor and face. Many in Hong Kong feel they are about to be sacrificed.

Reversing the erosion of confidence is no easy job. Intellectuals have already begun to wonder if they should speak their minds freely, when it seems nearly certain they will be under communist rule in the future. Many people have moved their Hong Kong dollar savings into gold or U.S. dollars. It may be a matter of time before it goes overseas. Financial analysts have said that there is no economic reason for the dollar's instability. If the Chinese will but moderate their position, the dollar will recover its true value. As Michael Sandberg, chairman of the Hong Kong and Shanghai Banking Corporation says, "A British link is necessary, whatever that means in practical terms."

But the Chinese have stated their position publically so many times, it is hard to see where they have left themselves room for compromise. If the financial analysts are right, and the Chinese do not compromise, their own predictions imply further decline. Given the recent history of the dollar, and the real possibility of further declines, the Hong Kong dollar is not a good place to put your life savings. And the more people that reason this way, and the more that sell their Hong Kong dollars, the more it feeds the spiral of pessimism.

Declines in the value of property have caused major difficulties for the banks and many companies that speculated heavily in real estate. Some spectacular bankruptcies have resulted, and the banks are having trouble collecting on many of their loans.

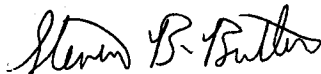
A string of bankruptcies is very possible if property declines much further, which some people feel is just a matter of time. If bankruptcies do throw many people out of work, it is not hard to imagine further social unrest in the colony. The Tin Tin Yat Po, a daily Chinese newspaper, has more than once suggested that China will be forced to enter Hong Kong earlier if social conditions deteriorate sharply.

This is a fairly extreme, and probably unlikely, view of what may come. But China's history over the past 150 years--let alone the past 30 years--has been full of many more catastrophic surprises. The scenario sounds less unreal to Chinese in Hong Kong than it does to foreigners who have a secure retreat outside. It is just one possibility among many that people contemplating Hong Kong's future have to consider.

Lawyers, doctors, and other professionals--those who may have at least a slim chance to leave--have to wonder what Hong Kong will be like when many of their colleagues who have made the decision, find a way to get out. If businessmen, professionals, and technicians manage to leave in large numbers, it is hard to see how Hong Kong could possibly prosper.

All told, despite occasional smiling words, China's leaders have not given people in Hong Kong any reason to trust them. If China wants to reverse the erosion of confidence it has to do something fast. Even now may be too late for many. The colony's prosperity came from people risking their money on a more or less uncertain market, but backed by a stable political and legal system that they counted on to protect their rights. The colony did not run on vague promises about the future. China's behavior over the summer has already shattered much of the optimism it apparently inspired in the early spring. The question for China is whether it can find the means to restore confidence. The more cynical, however, are already asking whether China cares enough to want to do so. That might, after all, require humility.

Best,



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