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THE U.S. INTEREST IN HONG KONG

INTRODUCTION

On July 1, 1997, Britain will cede sovereignty over the territory of Hong Kong to the People's Republic of China. This transfer of sovereignty is the result of negotiations between Britain and China during the 1980s, and is an outcome the United States cannot change. The United States, however, does have substantial interests at stake in Hong Kong—interests that will endure long after the transfer of sovereignty next July. The foremost concern of the United States during the transition from British to Chinese sovereignty is the security of the more than 35,000 U.S. citizens and 1,000 U.S. firms that reside in Hong Kong. Beyond this most fundamental national interest, the United States has an interest in maintaining close cooperation with Hong Kong authorities in fighting such international security threats as drug trafficking, money laundering, illegal immigration, and the proliferation of weapons and sensitive technologies.

The Hong Kong transition will have a tremendous impact on the long-held interests of the United States in regional peace and stability as well as market access. Because much of U.S. trade and investment in China flows through Hong Kong, a continued free, open, and safe business environment in Hong Kong is vitally important to U.S. access to China's markets. More important, the approach Beijing takes in dealing with free market democracy in Hong Kong will be a key indicator of how Beijing intends to deal with Taiwan and other free market democracies in Asia. Encroachment on the freedom and autonomy of Hong Kong, or an assertive Chinese military presence there, will fuel cross-strait tensions with Taiwan and heighten already growing security concerns throughout Asia.

The legal basis for the transfer of sovereignty over Hong Kong is the Sino-British Joint Declaration on the Question of Hong Kong signed on December 19, 1984.¹ The

¹ Hereafter the term "Joint Declaration" shall refer to the Joint Declaration of the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the People's Republic of China on the Question of Hong Kong.

Joint Declaration is a bilateral treaty registered with the United Nations, and its principles were incorporated into Chinese law as the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China—sometimes called Hong Kong's post-1997 constitution. The Basic Law was passed by the National People's Congress on April 4, 1990.² China's collective promises to Hong Kong in the Joint Declaration and Basic Law can be summed up in one phrase: Hong Kong people will govern Hong Kong with a high degree of autonomy. Beijing will take on the responsibilities of defense and foreign affairs for Hong Kong, but all other legal, social, and economic issues will be left to the discretion of the Hong Kong Special Administrative Region (SAR) government.

The United States recognized the Joint Declaration as a legitimate international treaty in the U.S.–Hong Kong Policy Act of 1992. The Hong Kong Policy Act declares U.S. support for developing democracy in Hong Kong, protecting human rights, and maintaining Hong Kong's confidence and prosperity as it fulfills its role as an international financial center. The Act also requires the Secretary of State to transmit annual reports to Congress on developments related to the transfer of sovereignty as they relate to U.S. interests in Hong Kong. This annual report must address such topics as the openness and fairness of elections for the Legislative Council and the Chief Executive, the independence of the judiciary, and the status of Hong Kong's Bill of Rights. But because the United States is not a party to this treaty, the U.S. government does not offer any legal interpretation of British or Chinese obligations under this international agreement.

As July 1 draws nearer, key questions remain about Beijing's willingness or ability to keep its word with regard to Hong Kong's level of autonomy and the preservation of its economic, cultural, and social way of life. Questions also remain about what, if anything, the United States can do to ensure that the commitments made in the Joint Declaration are fulfilled. Beijing plans temporarily to replace Hong Kong's democratically elected Legislative Council with an appointed provisional legislature and has left unclear what role pro-democracy parties will play in Hong Kong's post-1997 government. Similarly, it remains unclear to what extent Beijing intends to micromanage Hong Kong, as opposed to simply handling its defense and foreign affairs.

To protect U.S. interests and to help preserve the freedom, stability, and prosperity of Hong Kong, the United States should:

- **Beware of the impact U.S. policy toward China has on Hong Kong.** Politically generated trade friction between the United States and China, such as is created by threats to revoke China's most favored nation trading status, puts U.S. interests in Hong Kong in jeopardy and destabilizes Hong Kong.
- **Articulate U.S. interests in Hong Kong to leaders in China.** A clear understanding of how the United States intends to protect the security of the 35,000 U.S. citizens and 1,000 U.S. firms in Hong Kong, as well as its multibillion-dollar investment and trade interests, will help China's leaders avoid miscalculation when responding to U.S. actions in Hong Kong.

2 Hereafter the term "Basic Law" shall refer to the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China.

- **Maintain a strong U.S. presence in Hong Kong.** U.S. officials, businessmen, students, and tourists are a vital source of information, and their presence demonstrates to the people of Hong Kong that the United States is observing the transition process carefully.
- **Strongly urge Beijing to allow the current democratically elected Legislative Council to serve out its term.** If Beijing insists on replacing the current legislature, the United States should urge Beijing to shorten the term of the provisional legislature by preparing now for elections to take place as soon after July 1 as possible.
- **Support Hong Kong's continued participation in international organizations.** As the world's freest economy, Hong Kong should play a key role in international organizations in leading the world toward a more free and open trading system.
- **Urge Beijing to sign international human rights covenants.** Such a move by China would assuage the fears that led Hong Kong's residents to demand a Bill of Rights Ordinance in the first place.
- **Closely cooperate with the Hong Kong Special Administrative Region government to fight drug trafficking, money laundering, alien smuggling, and commercial piracy.** For this cooperation to work, it is important that the United States not allow differences with Beijing to alienate or put at risk the new SAR government.

HONG KONG'S COLONIAL HISTORY: FROM A BARREN ROCK TO THE PEARL OF THE ORIENT

In 1841, after learning that Hong Kong island would be ceded to Britain, Foreign Secretary Lord Palmerston described Hong Kong as "a barren island with hardly a house upon it." After more than a century and a half of colonial management, Hong Kong touts a standard of living that surpasses Britain's and is described by many as the "Pearl of the Orient" or the "Crown Jewel" of the British empire. Britain established a system of common law to protect property and civil rights in Hong Kong. This sound legal system, its large deep-sea ports, and its proximity to Canton (Guangzhou), made Hong Kong an ideal gateway into the China market.

Hong Kong unexpectedly became a gateway for Chinese immigrants as well, despite its tough legal restrictions on immigration. Few thought that the Chinese would cross over and live under a foreign flag, but millions have thrived under liberal British rule. They traditionally asked little of the colonial government, other than to be left alone. Large flows of immigrants coincided with traumatic events on the mainland—the collapse of the Qing (Manchu) Dynasty early in this century, the Chinese civil war during the 1940s, and the Great Proletariat Cultural Revolution in the 1960s.

Hong Kong's legal system, port facilities, proximity, *laissez faire* government, and abundant supply of immigrant labor are the key ingredients in what has become one of the greatest economic miracles of the modern age. During the 1950s and 1960s, the United Nations embargo on trade with China forced Hong Kong to turn inward and develop a light industrial manufacturing base. After China began to reopen for trade in the 1970s and 1980s, Hong Kong resumed its role as entrepot for global trade with China. Because of their familiarity with the language, government, and business practices in both cultures, Hong Kong's people have been excellent go-betweens for China and the

THE ORIGIN OF HONG KONG

The territory commonly called Hong Kong today was acquired in three stages. First, the island of Hong Kong itself was ceded to Britain in perpetuity as the result of the Sino-British Opium War of 1840-1842. The Kowloon peninsula then was ceded in perpetuity to Britain after a second series of Sino-British wars from 1856 to 1860. This gave Britain control of both sides of what is known today as Victoria Harbor. The final piece of today's Hong Kong, the New Territories, was leased from China for 99 years in June 1898. The New Territories, by far the single largest land area in Hong Kong, is comprised of the area north of Kowloon up to the Shenzhen River. The British sought control of this area to fulfill the requirements for the defense of Hong Kong. This military concern was originally aimed not at China, but at securing Hong Kong against other foreign powers seeking concessions from China, like France and Russia.

predominantly Western trading world. Hong Kong's *laissez faire* business environment of limited government, low taxes, and free capital flows is still tremendously successful at attracting foreign resources to match up with trade and investment opportunities in China. Indeed, Hong Kong has the freest economy in the world, according to the 1997 Heritage Foundation/Wall Street Journal *Index of Economic Freedom*. In this way, a barren rock with virtually no natural resources transformed itself into one of the most advanced, prosperous, and free trading economies in the world.³

For China, however, Hong Kong's colonial success has not necessarily been a source of pride. The Treaty of Nanjing, which ceded Hong Kong to Britain at the end of the first Sino-British war in 1842, was viewed by the Chinese as the first in a series of "unequal treaties" imposed on China by imperialist foreign powers and marked the beginning of what the Chinese call a "century of national humiliation."

During this time of national weakness from the 1840s through the 1940s, Germany, France, Russia, Britain, and Japan carved out safe havens, or spheres of influence, in key cities along China's coastline. Internal rebellion and foreign encroachment led to the fall of the Qing (Manchu) Dynasty, and China disintegrated into a period of regional warlordism during the 1920s. Throughout the 1930s and 1940s the Nationalists and the Communists engaged in a long and costly struggle for legitimacy over a reunified China, interrupted temporarily by the Japanese occupation of much of China (including Hong Kong) during World War II.

Thus, when the Communists took control in 1949, China was a poor and backward nation ravaged by famine and war. The Communists succeeded in unifying all of China, save Taiwan and Hong Kong, under one central government. Because of this history, the Chinese assign symbolic importance to Hong Kong as the first national wound suffered during this long period of setbacks. From Beijing's point of view, the "Pearl of the Orient" should be returned to China to continue the process of national reunification.

3 Hong Kong, "one of the most economically free regions on earth," ranked number one in the 1997 Heritage Foundation/Wall Street Journal *Index of Economic Freedom*.

CHINA'S FORMULA FOR NATIONAL REUNIFICATION: "ONE COUNTRY, TWO SYSTEMS"

A shift in Chinese policy from open hostility toward capitalism in the 1950s and 1960s to a more peaceful accommodation in the 1970s and 1980s was made possible by two significant developments: (1) Deng Xiaoping's modernization plan, and (2) Western diplomatic normalization. The normalization of diplomatic relations with the West, especially with the United States and Japan in the early 1970s, eased China's security concerns and opened the way for the development of foreign trade and investment. Deng saw the Western system of trade and investment as a means to modernize China and raise the living standards of the Chinese people. The Chinese territories of Taiwan and Hong Kong, because of their connections and success within the Western capitalist system, would make ideal intermediaries between socialist China and the capitalist West. Similarly, modernization and economic reform in China, according to Deng, would make peaceful rapprochement and eventual reunification with Taiwan and Hong Kong easier.

The concept of "one country, two systems" gradually evolved into a means for China's national reunification in the late 1970s and early 1980s. The concept, attributed to Deng, was that separate and autonomous socioeconomic systems could co-exist within a single, sovereign nation. In Deng's view, a socialist mainland and a capitalist Taiwan could co-exist peacefully within one China. At the time, Taiwan was the primary target of this peaceful reunification strategy. During the 1970s, the United States and other major world powers shifted diplomatic recognition away from the Republic of China on Taiwan to the People's Republic of China on the mainland.⁴ Because of China's strategic importance, diplomatic clout, and economic potential, many analysts, especially on the mainland, considered reunification with Taiwan to be inevitable and near.

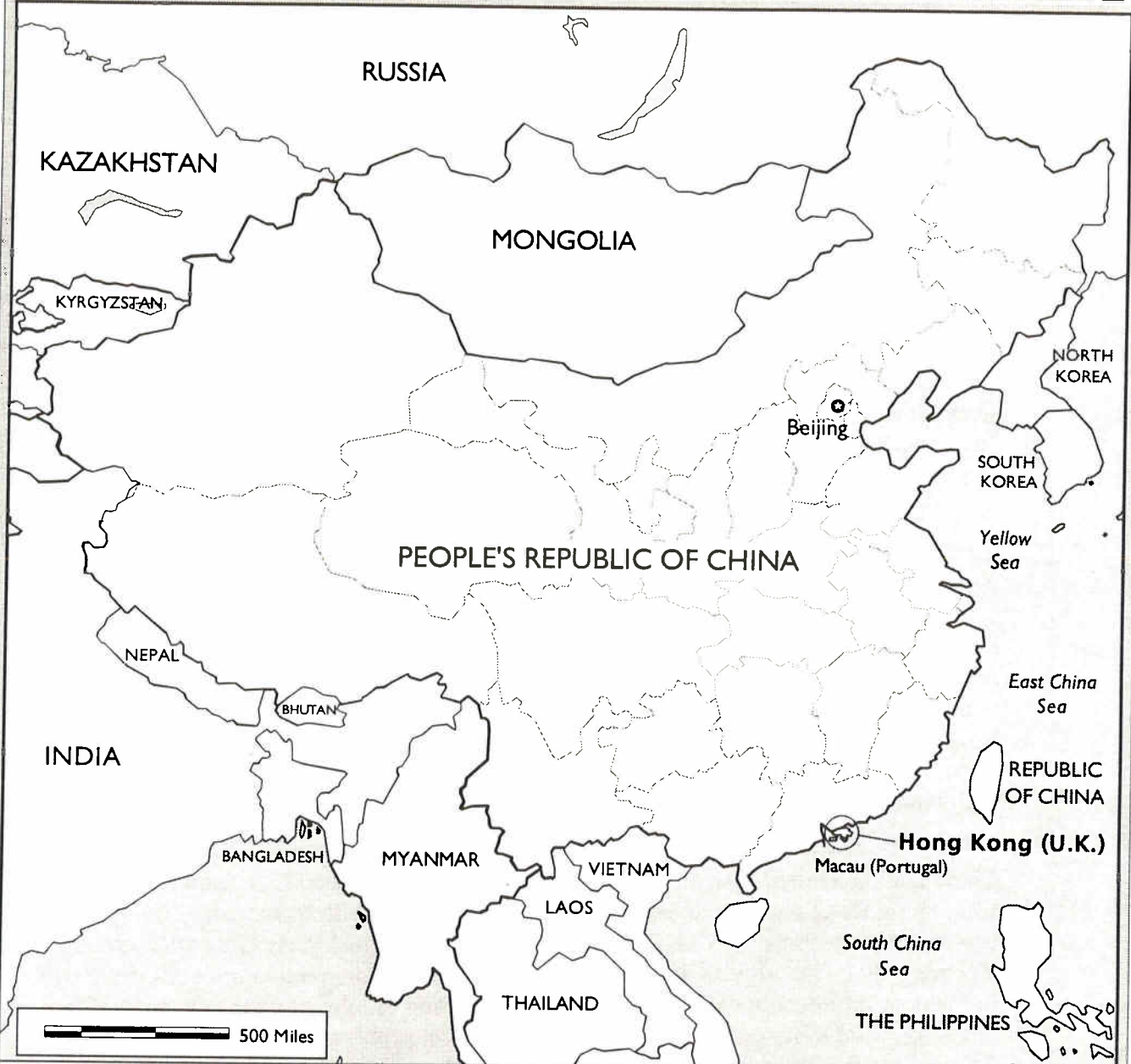
By 1982, however, the near-term prospects for reunification with Taiwan dimmed as China and the United States clashed over the issue of continued U.S. arms sales to Taiwan. Hong Kong and Macau began to arise in Chinese public commentary on the "one country, two systems" model. In February 1982, Communist Party General Secretary Hu Yaobang said, "Besides the implementation of the open-door economic policy, we will, in the near future, adopt another method—the method of allowing the existence of two kinds of *social* systems in one country—to solve the problems of the reunification with Taiwan and the recovery of our sovereignty over Hong Kong and Macau."⁵

That same year, land owners and investors in Hong Kong became increasingly concerned that legal rights granted under agreements signed prior to the July 1, 1997, expiration of the New Territories lease would remain in force for their full term. Business interests in Hong Kong intensified pressure on the British government to secure written guarantees for property rights in the New Territories after 1997. Fifteen years is a typical

4 The Republic of China government under Chiang Kai-shek fled to Taiwan after being defeated by the Communist army in the late 1940s in a civil war on the Chinese mainland. The Communist army never took control of Taiwan, however, and two separate governments have governed the respective areas ever since.

5 Luo Ping, "Hu Yaobang on Hong Kong-Macao Policy," *Cheng Ming*, August 1, 1982, 8-11, in FBIS, August 5, 1982, W6. Cited in Enbao Wang, *Hong Kong, 1997*, pp. 45-46. Emphasis added.

Map 1



Hong Kong Factsheet

Land Area:	414 square miles
Population:	5.542 million
Economic Growth:	4.6%
Gross Domestic Product:	\$143.6 billion
Per Capita GDP:	\$22,527
Exports:	\$173.75 billion
Exports to U.S.:	\$10.29 billion
Imports:	\$192.77
Imports from U.S.:	\$14.23 billion

Note: All figures are for 1995.
 Source: *U.S. and Asia Handbook, 1996 Edition*, The Heritage Foundation.



term for a mortgage or lease of land. Thus, by 1982, both Britain and China felt compelled to resolve the post-1997 status of the New Territories and Hong Kong.

When negotiations with Britain over the future of Hong Kong began in late 1982, China already had formulated its strategy for returning Hong Kong to Chinese sovereignty. The Sino-British Joint Declaration that emerged in 1984 represents a more concrete articulation of the policy with which the Chinese entered into the negotiations. It commits China to allow Hong Kong people to rule Hong Kong with a high degree of autonomy, except in the areas of defense and foreign affairs. It also obliges China to allow Hong Kong's separate social and economic systems to remain unchanged for at least 50 years, and to preserve the current rights and freedoms of individuals. The tenets of the Joint Declaration were later incorporated into Chinese law in the 1990 Basic Law of the Hong Kong Special Administrative Region. From this point forward, Hong Kong, instead of Taiwan, was destined to become the first test case for Deng's "one country, two systems" theory.

Tiananmen Disrupts the Transition. Throughout the 1980s, Deng's reforms achieved remarkable results. The pace and direction of change in China was viewed very favorably in Hong Kong, Taiwan, and the United States. There was a reasonably high degree of confidence in the viability of the Joint Declaration and the prospects for a smooth transition in Hong Kong. There were also high hopes for improvement in cross-strait relations with Taiwan. Many outside observers believed that political reform naturally would follow such rapid and impressive economic liberalization.

The Tiananmen Square massacre in 1989, however, destroyed that optimism and planted seeds of skepticism and distrust between Beijing and its counterparts in Hong Kong, Taiwan, and the United States. The student-led demonstrations in Beijing's Tiananmen Square during May and June 1989, and their brutal suppression on June 4, profoundly changed the way Hong Kong and Beijing viewed one another. During the demonstrations, supporters from Hong Kong sent food and supplies to the students on the square. Some Hong Kong democracy activists even traveled to Beijing to be with the students. The day after China's military crushed the student uprising, more than 1 million residents filled Hong Kong streets in protest of Beijing's excessive authoritarianism.

The governments in Beijing and Hong Kong each enacted legislation to address the fears provoked by the Tiananmen incident. For example, in 1990 Beijing amended the Basic Law to keep Hong Kong activists out of China's politics. Article 23 was intended to protect China's political system from any future interference by forces within Hong Kong or from the outside. The article states, "The Hong Kong Special Administrative Region shall enact laws on its own to prohibit any act of treason, secession, sedition, subversion against the Central People's Government, or theft of state secrets, to prohibit foreign political organizations or bodies from conducting political activities in the Region, and to prohibit political organizations or bodies of the Region from establishing ties with foreign political organizations or bodies." Article 23 has raised serious concerns in Hong Kong about how Beijing would interpret the article and what impact it will have on civil rights in the soon-to-be Special Administrative Region.

Hong Kong's Bill of Rights Ordinance. Hong Kong authorities had their own reaction to the massacre. Tiananmen Square provided the impetus to institutionalize Hong Kong's body of human rights law in a comprehensive statute that would establish unambiguously the primacy of basic human rights guarantees.⁶ This statute became the Hong Kong Bill of Rights Ordinance, enacted in June 1991. The Bill of Rights Ordinance codified the protections elaborated in the International Covenants on Civil and Political Rights into Hong Kong law.⁷ This ordinance appears to be consistent with the Joint Declaration and Basic Law and should not have drawn any objection from Beijing.

Beijing objects to the Bill of Rights Ordinance. The Bill of Rights calls for the repeal of all laws that contravene it or are inconsistent with it. China, however, has declared that the Basic Law will be the supreme law of Hong Kong. Beijing therefore posits that the Bill of Rights Ordinance raises questions as to which law—the Basic Law or the Bill of Right Ordinance—has primacy. Moreover, Beijing also claims that the human rights protections contained in the Basic Law are adequate, so the Bill of Rights Ordinance is, therefore, unnecessary. On these two grounds, a Beijing-appointed group has proposed a selective repeal of portions of the Bill of Rights Ordinance.⁸

Beijing also has rejected the report's obligations of the international covenants. The covenants require the sovereign of Hong Kong to submit reports to the United Nations on the implementation of the covenants in the territory. Although China has promised that the provisions of the international human rights covenants as currently applied to Hong Kong shall remain in force after 1997, it still has refused to submit reports on Hong Kong on the grounds that Beijing itself is not a signatory to the covenants.

Beijing's refusal to abide by the reporting obligations of the international covenants on human rights, together with the proposal of a selective repeal of the Bill of Rights Ordinance, have raised serious concerns in Hong Kong and abroad. Indeed the question arises as to why Beijing would choose to press this issue at all. Even if the Bill of Rights is superfluous in light of the promises made in the Basic Law, if it grants the residents of Hong Kong an added degree of confidence or peace of mind, why not leave it alone?

Legislative Council Elections in Hong Kong. Accelerating the development of democracy was the second step Hong Kong took to protect its people from Tiananmen-style oppression. This was done by opening all seats on the Hong Kong Legislative Council to elections. Prior to 1991, all seats in the Legislative Council were appointed or elected indirectly. Unfortunately, democratic reform was late in coming to Hong Kong. Indirect election to the Legislative Council was partially introduced as late as 1985, and by the late 1980s, domestic demand for direct elections was on the rise. In the aftermath of the Tiananmen massacre, Governor Chris Patten was sent to Hong Kong with a mandate, from London as well as from within Hong Kong, to accelerate Hong Kong's de-

6 "United States–Hong Kong Policy Act Report" as of March 31, 1996, as required by Section 301 of the United States–Hong Kong Policy Act of 1992, 22 U.S.C. 5731, as amended.

7 The provisions of the International Covenant on Economic, Social, and Cultural Rights were left out of the Bill of Rights Ordinance because these provisions cannot be enforced easily in the courts.

8 In October 1995, the Preliminary Working Committee proposed that three sections of the Bill of Rights Ordinance should be repealed and that six other Ordinances that have been amended in light of the Bill of Rights Ordinance should be restored to their original form.

mocratization process. Although recent elections have taken place at the district and municipal levels, attention has been focused most keenly on the Legislative Council.

In 1992, Governor Patten proposed measures toward a more accountable and democratic political system. In June 1994, following 17 rounds of unsuccessful talks between Britain and China, and over Beijing's strong objections, the Legislative Council approved proposals to: (1) lower the voting age from 21 to 18; (2) open all District and Municipal Board seats to direct election; and (3) increase significantly the number of voters selecting Legislative Council seats through indirect elections. In addition, the Hong Kong government opened all Legislative Council seats to elections in 1995.⁹

The September 1995 Legislative Council elections were fair and open, and resulted in the most representative and democratic legislative body in Hong Kong's history. Even pro-Beijing politicians disputed early charges in the local Beijing-controlled press that the elections had been unfair.¹⁰ The strong showing of pro-democracy candidates in the 1995 legislative election in Hong Kong is a clear signal that the people do not trust Beijing's pledges to respect their autonomy and freedoms.¹¹

China strongly opposed Hong Kong's electoral reforms and questioned the legitimacy of the 1995 elections on two grounds. First, Beijing claimed that the reforms violated the promise in the Joint Declaration that the "laws currently in force in Hong Kong will remain basically unchanged."¹² Second, Beijing objected to Hong Kong's proceeding with its reform package without Beijing's prior approval. In retaliation, Beijing declared that the newly elected Legislative Council would not be permitted to serve out its four-year term (through 1999). Instead, Beijing plans to replace the Legislative Council with an appointed provisional legislature on July 1, 1997, which will serve until elections for a new Legislative Council can be held on Beijing's watch (sometime before June 30, 1998).¹³

Article 68 of the Basic Law stipulates that the

Legislative Council of the Hong Kong Special Administrative Region shall be constituted by election. The method for forming the Legislative Council shall be specified in the light of the actual situation in the Hong Kong Special Administrative Region and in accordance with the principle of gradual and orderly progress. The ultimate aim is the election of all the members of the Legislative Council by universal suffrage.

It is difficult to understand how the elections in any way violated these principles, even if the process went beyond the parameters prescribed in an Annex of the Basic Law.¹⁴

9 "United States-Hong Kong Policy Act Report" as of March 31, 1996.

10 *Ibid.*

11 Brett C. Lippencott, "America's Stake in Hong Kong," Heritage Foundation *Asian Studies Center Backgrounder* No. 137, p. 1, October 24, 1995.

12 Joint Declaration, Section 3.3.

13 The provisional legislature is to be elected indirectly by a 400-member Selection Committee, as opposed to the people of Hong Kong who elected the current legislature. Because the modalities of the selection of the provisional legislature have yet to be decided, it is debatable whether the provisional legislature will be an elected or appointed body.

14 Annex II: "Method for the Formation of the Legislative Council of the Hong Kong Special Administrative Region and Its Voting Procedures."

Both the Bill of Rights Ordinance and the Legislative Council elections were direct responses to Beijing's excessive authoritarianism at Tiananmen. In both cases, Beijing has failed to explain to the people of Hong Kong why it objects to these developments if it really intends to follow through on promises made in the Joint Declaration. There is a real concern in Hong Kong that a provisional legislature appointed by pro-Beijing operatives would place limits on the freedoms protected in the Bill of Rights Ordinance. There is also a real concern that Legislative Council elections held after July 1, 1997, may not be free and fair and may exclude groups or individuals who are critical of Beijing.

U.S. CONCERN FOR HONG KONG

There are several reasons for the United States to be concerned about how the transition in Hong Kong unfolds. The United States first must be concerned about the high security and economic stakes at risk in the transition. Traditional U.S. interests in Asia are maintaining peace and stability, freedom of navigation, and access to markets, and keeping any one power from dominating the region to the exclusion of the United States. A failed transition in Hong Kong would threaten the U.S. interest in regional peace and stability. It would destabilize not only Hong Kong, but China's relations with its Asian neighbors and the United States as well. It also would increase the likelihood of armed conflict in the Taiwan Straits, the South China Sea, or the East China Sea.

As one of the most free and efficient ports in the world, Hong Kong is vital to U.S. interests in free navigation and access to markets, especially the China market. Hong Kong is an important entrepot for trade between United States and China. In 1995, 42 percent (\$4.9 billion) of U.S. goods destined for China and 60 percent (\$27.4 billion) of China's exports to the United States were routed through Hong Kong.¹⁵

Hong Kong is an important economic partner with the United States. Hong Kong is the 11th largest export market and 15th largest trading partner of the United States. Hong Kong itself imported \$14.2 billion worth of goods from the United States in 1995, up 25 percent from 1994. Hong Kong was also home to \$13.8 billion in direct foreign investment in 1995 alone. Most important, the United States has an interest in protecting the property of over 1,000 U.S. firms and the safety of more than 35,000 U.S. citizens that reside in Hong Kong.¹⁶

Hong Kong's Dependence on Trade. Hong Kong's dependence on foreign trade is a cause for concern because a loss of autonomy could diminish its global competitiveness and put at risk the jobs of millions of workers. In 1995, the total value of Hong Kong's trade amounted to \$367 billion, or around 256 percent of gross domestic product. Hong Kong was the world's eighth largest trader in goods in 1995.¹⁷ Such heavy reliance on trade makes Hong Kong vulnerable to government interference, either by undermining competitiveness through burdensome regulation or politicizing its economic institutions.

15 "The United States and Hong Kong: Some Important Facts," Hong Kong Government Trade Department.

16 Statistical sources: United States Department of Commerce and "The United States and Hong Kong: Some Important Facts."

17 "China and Hong Kong: Some Important Facts," Hong Kong Government Trade Department.

Limitations on Freedoms and Democracy. Limitations on freedoms and democracy in Hong Kong are of concern to not only political activists, but businessmen as well. Imposed political limitations unintentionally may diminish economic growth and market efficiency. Beijing's intention to replace the Legislative Council and limit the application of two international covenants on human rights raises serious questions about its tolerance for freedom and democracy within its "one country, two systems" model. Similarly China's harassment of Hong Kong reporter Xi Yang, together with the widespread fear of self-censorship in the Hong Kong press, has caused concern about the viability of freedom of the press after 1997. A free press is not only vital to democracy; the free and efficient flow of information is also vital to free markets.

Corruption and the Rule of Law. With the establishment of Chinese sovereignty over Hong Kong, many have feared that the corruption that has plagued business in China will find its way into Hong Kong. One of Hong Kong's main attractions has been the clean, modern business and legal environment it provides for foreigners to conduct business with China. Notwithstanding the real success of the Independent Commission Against Corruption in fighting corruption in Hong Kong since 1975, the import of Chinese-style corruption greatly would diminish the attractiveness of Hong Kong as a regional operations center for international business.

Hong Kong has a standard of living that exceeds that of Britain, Sweden, and most other West European countries. It is the fourth largest trading power in the world after the European Union, the United States, and Japan, and the fourth largest financial center after London, New York, and Tokyo. None of these benefits would be enjoyed if Hong Kong were not served by a mature, efficient, and incorrupt legal and judicial system.¹⁸

The People's Liberation Army. The role of the People's Liberation Army in Hong Kong after 1997 is critical to the success or failure of the transition. An assertive military presence will undermine confidence in Hong Kong's future autonomy. China's military—the People's Liberation Army (PLA)—will replace the British Garrison currently stationed in Hong Kong as part of the transition process. The mission of the PLA in Hong Kong is to provide for the territory's defense, and interference in the local affairs of the Region is forbidden. But Article 14 of the Basic Law states that the SAR government can ask Beijing "for assistance from the [PLA] garrison in the maintenance of public order." With Tiananmen still fresh in their minds, some Hong Kong residents want protection from, not the protection of, the PLA. And if the Chief Executive of the SAR is appointed by Beijing, the people of Hong Kong will wonder how cautious he will be about requesting such "assistance."

REASONS FOR OPTIMISM

Notwithstanding these concerns, there are also reasons for optimism. The stakes in Hong Kong are high not only for the Hong Kong and the United States, but for China as well. More than any other country, China needs an autonomous Hong Kong to bring in goods and capital, to keep Taiwan from declaring independence, and to prop up the le-

18 Daniel R. Fung, Q.C., J.P., "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.

gitimacy of Communist Party rule that has lost its ideological appeal. These substantial incentives for China to maintain Hong Kong's autonomy, on balance, cause the reasons for optimism to outweigh the causes for concern.

China's Economic Dependence on Hong Kong. Hong Kong's high level of investment in China, not to mention China's high level of investment in Hong Kong, may be Hong Kong's best security guarantee. Hong Kong plays a vital role in facilitating trade and investment with China. Moreover China's economic development depends on foreign investment and trade. Because China's access to foreign trade and investment depends on the continued rule of law and free flow of capital, goods, and information in Hong Kong, Beijing may not be inclined to do anything to destabilize or undermine international confidence in Hong Kong. Doing otherwise could deal a fatal blow to its own economic development.

Hong Kong is the engine that drives China's economic reform process. It fuels China's economy with investment capital and facilitates merchandise trade. Hong Kong accounts for one-third of China's annual foreign exchange earnings and nearly 60 percent of all foreign direct investment contracted in China since 1979. It is China's largest export market, taking in 24 percent of China's total exports in 1995. Hong Kong also provides increased employment and skilled labor for China. It is estimated that around 122,000 residents of Hong Kong currently work in China, and Hong Kong firms employ more than 4 million Chinese workers in neighboring Guangdong province alone.¹⁹

Hong Kong is the most important entrepot for China because about half of China's exports are handled by Hong Kong. Out of Hong Kong's total re-exports (\$143.8 billion in 1995), 88 percent either originated from or are destined for China. Since 1978, re-exports of Chinese-origin goods through Hong Kong increased by 177 times, from \$781 million in 1978 to \$92 billion in 1995. Re-exports to China through Hong Kong rose dramatically by 1,794 times, from \$46 million in 1978 to \$49 billion in 1995.

China also has substantial investments in Hong Kong. Almost every province, region, and municipality in China now has resident representative offices, agents, or distributors in Hong Kong. At the end of 1995, there were 1,800 mainland Chinese enterprises registered in Hong Kong, with total assets valued at \$50 billion. As of December 1994, 18 of the 185 licensed banks in Hong Kong were China-owned. The Bank of China and its 12 sister banks are now the second largest banking group in Hong Kong, after Hongkong Bank. Hong Kong's financial markets are a natural vehicle for the raising of capital by Chinese companies, and Hong Kong's banking system, the best in Asia, is a natural haven for Chinese savings.

Communist Party Legitimacy. China's Communist Party's need for a successful transition in Hong Kong to bolster its own legitimacy is another reason for optimism about Hong Kong's future autonomy. The Communist Party has made reunification of the motherland a key pillar of its legitimacy. Increasing the living standards of the Chinese people is the second pillar. A turbulent assimilation of Hong Kong into Chinese sovereignty would threaten to destroy both pillars and thereby undermine the legitimacy of Communist Party rule in China. A destabilized Hong Kong would obstruct the vital

19 Statistical sources for entire section: "China and Hong Kong: Some Important Facts," and "Economic and Trade Information on Hong Kong," available on the Internet at <http://www.info.gov.hk>.

flow of foreign investment and trade that supports Beijing's current economic reform and modernization. The failure to sustain economic growth and development along with the failure to fulfill the mission of national reunification thoroughly would undercut both pillars of Communist Party legitimacy.

The Taiwan Factor. The dramatic effect an infringement on Hong Kong's promised autonomy would have on the independence movement in Taiwan is another reason for optimism. The importance of Taiwan in Beijing's Hong Kong calculations cannot be overstated. China's "one country, two systems" model was crafted with reunification with Taiwan in mind, and Hong Kong is the critical first test of this model. Although a successful transition in Hong Kong is no guarantee that the "one country, two systems" approach will work with Taiwan, a failed transition would eliminate virtually any possibility of peaceful reunification with Taiwan. Nothing would mobilize domestic and international support for Taiwan's independence—an outcome Beijing wants desperately to avoid—more than a botched transition in Hong Kong.

Familiarity with the Mainland. Hong Kong's familiarity with mainland China is another reason to be optimistic about the success of the transition. Hong Kong's transfer to mainland sovereignty is no blind date. To residents of Hong Kong, China is a known quantity. In fact, Hong Kong's prosperity today is a testament to its knowledge of and ability to work within the Chinese system. The wealthy in Hong Kong achieved that status because of their connections inside China and in the West. They have profited from helping join foreign capital with opportunity in China. For this small but very influential group, the transfer of Hong Kong's sovereignty is a matter of politics catching up with economic reality.

Progress of the Joint Liaison Group. Significant progress has been made to adapt Hong Kong's independent legal and judicial systems to post-1997 requirements. Since 1984, the Sino-British Joint Liaison Group has done a tremendous amount of work to pave the way toward a smooth transition. Major achievements of the Joint Liaison Group include the Sino-British agreement on the construction of the new airport, the establishment of the Court of Final Appeal in Hong Kong on July 1, 1997, Hong Kong's continued participation in 30 international organizations, and the continued application of some 200 multilateral treaties to Hong Kong after 1997.

THE ROLE OF THE UNITED STATES

Even though a successful transition that maintains Hong Kong's high level of autonomy clearly serves China's own best interests, the United States must remain vigilant in its efforts to protect U.S. interests at risk in the transition. The United States must protect the many U.S. citizens and businesses in Hong Kong as well as minimize the risk to market access and regional peace and stability generated by uncertainty over Hong Kong's future. U.S. interests will be served best by a realization of the level of autonomy promised Hong Kong in the Joint Declaration. To protect U.S. interests and help preserve the freedom, stability, and prosperity of Hong Kong, the United States should:

- **Beware of the impact U.S. policy toward China has on Hong Kong.** Protection of U.S. interests in Hong Kong depends very much on the China policy of the U.S. government. Hong Kong's success is built upon bringing Western capital together with Asian opportunity. No relationship is more important to Hong Kong's continued suc-

cess than that between the world's largest developed country, the United States, and the world's largest developing country, China. Politically generated trade friction between the United States and China, such as is created by threats to revoke China's most favored nation trading status, puts U.S. interests in Hong Kong in jeopardy and destabilizes Hong Kong.

- **Articulate U.S. interests in Hong Kong to leaders in China.** A clear and unambiguous understanding of how the United States intends to protect the security of the 35,000 U.S. citizens and 1,000 U.S. firms in Hong Kong, as well as its multibillion-dollar investment and trade interests, will help China's leaders avoid miscalculation when responding to U.S. actions in Hong Kong. These interests are communicated best through frequent face-to-face interaction between the leaders of the United States and China at the highest levels. These interests should be articulated in both capitals and in a formal setting that reflects the importance the United States attaches to achieving U.S. interests through cooperation.
- **Maintain a strong U.S. presence in Hong Kong.** U.S. officials, businessmen, students, journalists, and tourists are a vital source of information about the transition in Hong Kong. Their presence demonstrates to the people of Hong Kong that the United States has not abandoned them and is carefully observing the transition process.
- **Strongly urge Beijing to allow the current democratically elected Legislative Council to serve out its term.** If Beijing insists on replacing the current legislature, the United States should urge it to shorten the term of the provisional legislature by preparing now for elections to take place as soon after July 1, 1997, as possible.
- **Support Hong Kong's continued participation in international organizations.** Considering Beijing's promises of autonomy, including Hong Kong's separate currency and tax system, Hong Kong deserves to represent the interests of its economy in international forums. As the world's freest economy, Hong Kong should play a key role in international organizations in leading the world toward a more free and open trading system.
- **Urge Beijing to sign international human rights covenants.** Such a covenant would resolve the issue of whether Beijing will, as the British have, make annual reports to the United Nations on the status of human rights conditions in Hong Kong. This also would assuage the fears that prompted Hong Kong residents to demand a Hong Kong Bill of Rights Ordinance.
- **Closely cooperate with the Hong Kong Special Administrative Region government to fight drug trafficking, money laundering, alien smuggling, and commercial piracy.** This cooperation is of critical strategic importance to the United States. For this cooperation to work, it is important that the United States not allow differences with Beijing to alienate or put at risk the new SAR government.

CONCLUSION

The transfer of sovereignty over Hong Kong to the People's Republic of China is not simply a domestic Chinese issue. It is a historic event with global implications. Hong Kong will be the critical first test of China's "one country, two systems" model for national reunification, and it also will be a test of China's ability to deal with a democracy

and free market in its midst. How China deals with Hong Kong's free market democracy will be a key indication of how it intends to deal with Taiwan and other free market democracies in Asia. In the balance will be global strategic and economic interests, as well as the fate of China's economic modernization. A successful and smooth transition in Hong Kong is vitally important to China and the world.

The 1984 Sino-British Joint Declaration promises that Hong Kong's people will rule Hong Kong with a high degree of autonomy. The United States has recognized the Joint Declaration as an international treaty. It is, therefore, a matter of international law that both parties to this treaty abide by the solemn obligations undertaken in the Joint Declaration. The United States must be strong in urging Beijing to grant Hong Kong the level of autonomy promised in the Joint Declaration.

China must come to terms with the impact on Hong Kong of its aggression at Tiananmen Square. Many of the challenges China faces in this transition process are direct responses to Tiananmen and are, therefore, of China's own making. The reassurances that the people of Hong Kong seek—a local Bill of Rights and a democratically elected legislature—are not too much to ask. The promises made in the Joint Declaration are sufficient to protect the future freedom, stability, and prosperity of Hong Kong.

At present, the reasons for optimism about Hong Kong's future autonomy outweigh the causes for concern, but the several U.S. economic and security interests at stake in Hong Kong will be secure only if promises made in the Joint Declaration are kept.

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