

CHAPTER FIVE

THE HONG KONG ECONOMY

Preserving Prosperity

It is of course important that China should fully appreciate that the economic prosperity of Hong Kong is not something that can be seen in isolation, it is something which itself is the product of the free way of life and the rule of law in Hong Kong.

China's trade and Hong Kong's freedoms are not mutually exclusive, but are complimentary. Because anybody wishing to invest money in China requires timely, accurate economic information to enable (them) to make correct commercial decisions. Hong Kong is the only place that can supply that information.

(Martin Lee QC)¹

5.1 The Joint Declaration embodied the commitment of Great Britain and the People's Republic of China to ensure that Hong Kong retains its 'current social and economic system' and a 'high degree of autonomy', and to provide for an 'orderly, smooth' transition to Chinese rule. To date, the transition has proceeded largely within the spirit, if not always the letter of the agreement. Agreement has been reached in the Joint Liaison Group on arrangements enabling the Hong Kong Special Administrative Region to maintain, inter alia, autonomy over its economic relations, its status as a separate customs territory, its foreign exchange, commodities and stock markets, its control over capital flows and finances, its participation in the World Trade Organisation (WTO) and other international agreements such as Asia Pacific Economic Cooperation (APEC), and a freely circulated and convertible currency.

5.2 Where difficulties have arisen, they have generally been on questions of the pace and scope of democratic reform, particularly the extent of popular political participation and direct representation in the elected legislature, the degree to which the Hong Kong SAR legal system will operate free from Beijing's political control, and the safeguarding of human rights and civil liberties as provided for under existing legislation in the territory. As such these difficulties can be considered to be largely political in nature, and do not, on the surface, appear to interfere with the arrangements to ensure the continued, smooth functioning of Hong Kong's free market system.

5.3 It can, however, be argued that many of the concerns underlying these political difficulties, do impinge on Hong Kong's ability to sustain economic growth and prosperity in the longer term. Such concerns, in particular those that relate to the maintenance of the rule of law, the integrity and independence of Hong Kong's judiciary, the soundness of administration, the freedom of expression and information, are intimately linked to investor

1 ABC Lateline 18 February 1997.

confidence and in turn, the decisions of business. In an institutional sense, the principles on which these concerns rest, legitimacy, accountability, predictability, impartiality, are arguably as central to the workings of an open, rules-based market system as they are to the development of democratic political structures and the protection of civil liberties.

5.4 Certainly there is little argument amongst scholars and commentators that Hong Kong's economic wealth and prosperity has depended, in part, on the vitality of the territory's common law based legal system. There are widely diverging views, however, on the extent to which the transfer to Chinese political control will challenge the integrity of this system, judicial independence, the rule of law, and through that, destabilise investor confidence in the economy. In this context, it is possible to construct two basic arguments, or scenarios, which conceive Hong Kong's economic future under Chinese rule as following distinctly different paths.

5.5 The pessimistic outlook is that Hong Kong will suffer from China's political control and the attendant maladies of a compromised judiciary, partial administration, and selective regard for the protection of rights which will inevitably undermine the integrity of the legal framework that governs commerce. Consequently, as uncertainty permeates the system, business confidence will decline, resulting in a gradual redirection of foreign trade and investment flows to safer havens, such as Singapore. Although over-simplified, this argument clearly places emphasis on investor confidence in institutional framework as one of the keys to sustained economic buoyancy.

5.6 In contrast, the optimistic outlook, which has a number of parts, maintains that Hong Kong's enormous importance to China, in economic, strategic and political terms, practically ensures that the Chinese Government will do little to disturb the 'status quo'. Further, its numerous advantages, including developed infrastructure, location, efficiency, dynamism, as well as its pivotal role as a trade intermediary with China, are all reasons which will compel continued international trade and investment in the territory. Concerns over the integrity of the legal system, the durability of the rule of law, and even the circumscription of certain civil freedoms, to the extent that they are present, are likely to dissipate as Hong Kong continues to flourish under China's reasonable, pragmatic stewardship. This argument, while not denying the importance of institutional setting to investor confidence, places greater emphasis on economic factors as the key determinant of Hong Kong's continued growth.

5.7 Whether one subscribes to the pessimistic view, or adopts a frankly more bullish position, would seem to rest largely then on a number of assumptions about: the strength of the arrangements which seek to preserve the nature and autonomy of Hong Kong's economic and social system; the durability of the legal framework governing Hong Kong's commerce and trade; and the extent to which institutional change in the long term will flow from the mainland or vice versa.

5.8 Before taking up the question of the possible economic implications of these legal, political and civil concerns, it is instructive to look briefly at the substantial bases for confidence in Hong Kong's economic future: the assurances provided by the Joint Declaration and the Basic Law; the sound state of the territory's economy and trade relations; and finally Hong Kong's increasingly pivotal role as a trade intermediary which is continuing to facilitate the territory's integration into the Greater China economy.

Legal Assurances

5.9 The Joint Declaration expressly stipulates that Hong Kong under Chinese rule 'will enjoy a high degree of autonomy, except in foreign affairs and defence', and will be allowed to retain its current social and economic systems for at least fifty years after 1997. Among the other guarantees provided in the Joint Declaration, the following five provide the most significant indication of the PRC's commitment to ensuring Hong Kong's continued economic success:

The Hong Kong Special Administrative Region...

...will retain the status of a free port and a separate customs territory;

...will retain the status of an international financial centre, and its markets for foreign exchange, gold, securities and futures will continue. There will be a free flow of capital. The Hong Kong dollar will continue to circulate and remain freely convertible;

...will have independent finances. The Central People's Government will not levy taxes on the Hong Kong SAR;

...may establish mutually beneficial economic relations with the United Kingdom and other countries, whose economic interests in Hong Kong will be given due regard; and

...using the name of 'Hong Kong, China', the Hong Kong SAR may on its own maintain and develop economic and cultural relations and conclude relevant agreements with states, regions and relevant international organisations.²

5.10 The Basic Law enshrines and elaborates upon the basic commitments undertaken by the People's Republic of China in the Joint Declaration and Annexes to that agreement. In doing so, it effectively provides a constitution for the Hong Kong Special Administrative Region. As a general principle, Article 2 of the Basic Law states that:

The National People's Congress authorizes the [HKSAR] ... to exercise a high degree of autonomy and enjoy executive, legislative and independent judicial power, including that of final adjudication, in accordance with the provisions of this law [the Basic Law].

2 Taneja, P, *Hong Kong and Australia: Towards 1997 and Beyond*, 1994, Centre for the Study of Australia Asia Relations, p. 2.

More explicitly, Article 5 stipulates that:

The socialist system and policies shall not be practised in the Hong Kong Special Administrative Region, and the previous capitalist system and way of life shall remain unchanged for fifty years.

5.11 Chapter 5 of the Basic Law, covering the economy of the HKSAR, including public finance, monetary affairs, trade and commerce, gives effect to these general principles. In particular, Article 105 provides protection for the property rights of individuals, including enterprise ownership and investment from outside the region. Article 109 and 110 respectively states that the Government of the HKSAR shall 'provide an appropriate economic and legal environment for the maintenance of the status of Hong Kong as an international finance centre'³ and shall, 'on its own, formulate monetary and financial policies, safeguard the free operation of financial business and financial markets, and regulate and supervise them in accordance with the law'.⁴

5.12 Though clearly proscriptive in nature, the provisions of the Basic Law regarding the retention, protection and promotion of Hong Kong's existing economic system would appear to detail sufficiently the commitments made by the People's Republic of China in the Joint Declaration, and give substance to the principle of 'one country, two systems'.

5.13 More recently, China's Ministry of Foreign Trade and Economic Cooperation outlined the policy framework to govern post-1997 relations between the PRC and the HKSAR. This framework reiterates China's commitment to the terms of the Joint Declaration and the 'one country, two systems' principle, and provides that:

- (a) Hong Kong will enjoy strict autonomy in economic and trade affairs and will remain a free port with free trade and free flow of capital;
- (b) Mainland Hong Kong economic relations will be governed by international rules of economic cooperation and trade. Hong Kong will continue to enjoy its autonomy, pursuing its own trade policies, including an independent tariff system and export quotas. The PRC will not set special tariffs for Hong Kong and products imported from Hong Kong will be subject to the PRC's unified tariff policies;
- (c) Investment in the PRC from Hong Kong will continue to be treated as foreign investment. Disputes emerging between parties from either side will be settled using international trade rules;
- (d) Hong Kong will retain the ability to deal separately with foreign countries and regions on economic and trade relations, as in the case of the World Trade Organisation and the Asia Pacific Economic Cooperation.⁵

5.14 Taken together, these assurances would seem to provide an important indication of the PRC's firm resolve to retain a buffer between the Chinese economy and that of the Hong Kong SAR, the 'one country, two systems' principle in practice. Equally importantly, it

3 Basic Law, Article 109, p. 59.

4 *ibid*, p. 60.

5 Asia Pacific Economic Group, *Asia Pacific Profiles 1996: Hong Kong*, Parliamentary Library, p. 142.

can be argued, they provide the Chinese Government with the 'incentive' to honour its pledges. Any breach of the formal commitments would severely dent China's international credibility, investor confidence in the territory and perhaps its prospects for eventually extending political control over Taiwan.

5.15 More important to a consideration of Hong Kong's longer term economic growth and stability prospects, is the fundamentally sound state of the economy at present. The following overview of Hong Kong's economy highlights not only its enormous worth, real and potential, to the People's Republic of China, but its attractiveness to investors from around the world. At the same time, it suggests an underlying fragility, related to the complexity and sophistication of its increasingly tertiary service-driven industry, and dependence on international capital and trade flows.

Economy

5.16 The Hong Kong economy is open, externally-oriented and heavily reliant on the flow of trade and international capital. It is regarded as one of the world's leading financial centres, ranking fifth largest in terms of the volume of external banking transactions and foreign exchange transactions, and eighth largest in terms of stock market capitalisation.⁶ It has Asia's second largest Stock Exchange (behind Tokyo), with over 700 foreign companies maintaining regional headquarters in Hong Kong, including 85 of the world's top 100 banks in terms of assets.

5.17 Its strategic location, natural deep harbour, highly developed infrastructure, stable government and efficient administration, skilled workforce and entrepreneurial culture have helped make it a major axis of the East Asian economic region.⁷ In addition to its international trade and investment profile, Hong Kong is also a regional hub for international air travel, media and telecommunications. Its airport facility is among the world's top five in both cargo and passenger volume, and its container port is the world's busiest.⁸

5.18 Over the past two decades, the Hong Kong economy has more than quadrupled, and its per capita GDP has tripled to approximately US\$24,500 - higher than that of the United Kingdom, Canada or Australia.⁹ After a recent slowdown during late 1995 and early 1996, GDP growth for 1996 was 4.7 per cent, a steady and modest gain given the high rates sustained over the past decade and the structural transformation of the economy which has taken place.¹⁰ Forecast growth is estimated at around 5.5 per cent for 1997, although some estimates have placed it as high as 5.7 per cent.¹¹ It is expected that growth will be driven by improved consumer demand, continued high levels of public infrastructure development and a stronger export climate.

5.19 The economy has returned to near full employment, after a relative troughing of the labour market in 1995. According to Hong Kong Government figures the seasonally adjusted unemployment rate for the period November 1996-January 1997 was 2.4 per cent,

6 Exhibit No. 1(r), *An Overview of Hong Kong's Economy*, Hong Kong Information Services Department.

7 Exhibit No. 7(h), DFAT, *Country Economic Brief: Hong Kong*, p. 17.

8 Exhibit No. 4, USIS Washington File: Text of testimony by DAS Jeffrey Bader to HRIRC, 13 February 1997 on Hong Kong reversion.

9 Exhibit No. 4, Reuters News Service, 13 March 1997.

10 Economist Intelligence Unit, *Country Profile 1996-97: Hong Kong and Macau*, p. 14.

11 DFAT, Transcript, 17 February 1997, p. 224.

with an underemployment rate of 1.4 per cent.¹² Despite growing unemployment in the lower skilled sectors, tight labour conditions continue to prevail in many other sectors, such as construction, services and technology intensive manufacturing.

5.20 Inflation, which has traditionally been high, rose from an estimated 8.1 per cent in 1994 to 8.7 per cent in 1995, however was expected to moderate to around 7.5 per cent in 1996.¹³ The strength of inflation is a result of a number of factors, among them:

- strong economic growth, and, up to 1995, the effective maintenance of full employment, leading to upward pressure on wages and prices;
- a 'pegged' exchange rate with the US dollar, preventing independent monetary policy designed to control inflation;
- continued economic integration with Southern China, resulting in spill-over inflation in prices for imported goods.¹⁴

5.21 The Hong Kong Government traditionally has adopted a minimalist approach to economic management by allowing market forces relatively free rein. With the exception of a number of interventionist measures, such as the \$US currency peg and the restrictions on labour inflow and property market speculation, the Government has earned itself a reputation as one of the most *laissez faire* administrations in the world. It maintains a simple, low rate tax regime, with personal and corporate rates on income earned in the territory up to 15 per cent and 16.5 per cent respectively. Additionally, capital gains, payroll and foreign income are not taxed.

5.22 This minimalist approach has extended to fiscal policy. The territory has consistently posted budget surpluses, although a deficit was recorded for the 1995-96 financial year of around 0.2 per cent of GDP due to increased expenditure on social welfare, housing and major capital works such as the Port and Airport Development Scheme (PADS).¹⁵ Still, the government has managed to accumulate substantial fiscal reserves, aided partly by receipts from land sales, stamp duty on shares and gambling. It is estimated that at present, reserves amount to HK\$330 billion¹⁶, with an additional US\$60 billion in foreign exchange holdings (the world's seventh largest).¹⁷

12 Exhibit No. 4, *Asia Pulse*, 19 March 1997.

13 Exhibit No. 7(h), DFAT, op. cit., p. 11.

14 Asia Pacific Economic Group, op. cit., p. 140.

15 Exhibit No. 7(h), DFAT, op. cit., p. 12.

16 Exhibit No. 4, Reuters Wire Service, 13 March 1997.

17 Economist Intelligence Unit, op. cit., p. 43.

Structural Change

5.23 Hong Kong's role as a leading international trade and services centre is reflected in the changing economic structure of the territory. Hong Kong's industrial development was shaped largely by the lack of physical space and natural resources on the Kowloon Peninsula. Through the post-war decades, labour-intensive industries flourished, such as clothing and textiles, fabricated metal products, printing, electronics and processed foodstuffs.

5.24 However, as labour costs started rising in the 1980s, and as China opened its doors to foreign investment, manufacturing firms were able to adapt successfully to increasing competition from other low-cost producers by moving upmarket to sophisticated, higher quality products and shifting much of their productive capacity to the mainland. Many manufacturers based in Hong Kong have shifted their operations, and now predominantly engage in production activities offshore, mainly in the southern provinces. In Guangdong Province, Hong Kong investors (in some 19,500 firms) employ almost 3.5 million people,¹⁸ a number larger than Hong Kong's own labour force.

5.25 The trend toward industrial re-location offshore is reflected in the declining importance of manufacturing to Hong Kong's overall economic output. The contribution of the manufacturing sector to GDP has fallen from 17.6 per cent in 1990 to around 9.3 per cent of GDP by 1994.¹⁹ Similarly, the manufacturing sector share of the total workforce has continued to decline, representing 12.5 per cent in 1995 compared to approximately 26 per cent in 1990.

5.26 The garment industry (textiles, apparel and clothing) remains the most important contributor to manufacturing output, and is also the territory's most important domestic export industry, accounting for around 32 per cent of total domestic export earnings in 1995. However, much of the processing of textiles actually takes place in the southern mainland provinces, with final processing occurring in Hong Kong, thus enabling firms to claim Hong Kong status of origin on exports.²⁰ Hong Kong also continues to retain sophisticated, high value-added and technologically intensive industries, specialising in computers and peripherals, electronic parts and components, special industrial machinery and optical and photographic equipment.²¹ It is estimated that the electronics sector is now the largest recipient of foreign investment in Hong Kong, accounting for around 30 per cent of the total, followed by electrical products, textiles and clothing and food processing.

5.27 To a large extent, the shift in manufacturing offshore has driven, and been driven by, rapid expansion in the service sector. Services are the largest, fastest growing sector of the economy, accounting for nearly 83 per cent of GDP in 1995 (up from 69 per cent in 1980).²² The major service sub-sectors are the wholesale, retail, import/export, catering and tourism related industries and the finance, insurance, realty and business services industries. In 1995, the Hong Kong Government affirmed the importance of the service sector to the territory, outlining a range of initiatives to promote and support growth in priority industries,

18 DFAT, Submission, p. S394.

19 Exhibit No. 7(h), DFAT, op. cit., p. 21.

20 Economist Intelligence Unit, op. cit., p. 34.

21 Senate Foreign Affairs, Defence and Trade References Committee, *Australia China Relations*, June 1996, p. 197.

22 BIS Shrapnel, *East Asia Economic Outlook: 1997-2007*, p. 41.

such as banking, financial markets and fund management services, insurance services, import and export trade services, tourism and wholesale and retail services.²³

5.28 Hong Kong's financial services sector rates as among the most important in the world. The growth of financial services has played a huge role in the development of the economy in the past decade. Together with insurance, real estate and business services, financial services contributed 26.1 per cent of GDP in 1994 compared with 15.6 per cent in 1984, and as of September 1995 (latest figures available) employed 16.4 per cent of the total labour force.²⁴ Hong Kong offers a full range of financial institutions and services, predominantly banking in the past, but increasingly in the fund management, stock, securities and debt markets.

5.29 Tourism remains a solid growth sector in the Hong Kong economy, recording 9.7 per cent growth in 1995 compared to around 4.5 per cent in 1994.²⁵ Total tourism receipts, flowing from an estimated 10.23 million visitor arrivals, amounted to HK\$72.93 billion in 1995, making it the second largest foreign exchange earner after apparel and clothing.²⁶ Unofficial estimated growth in tourist arrivals through 1996 is expected to peak in the first part of 1997, however should be offset by continued increase in the number of transit visitors from Taiwan and China. Despite the impact of escalating consumer prices, reductions in the numbers of hotel beds and relative improvements in China's own tourist infrastructure, the Hong Kong Tourist Association expects tourism to grow and become Hong Kong's top foreign exchange earner by the year 2000.²⁷

5.30 Hong Kong's importance as a regional transport hub is reflected in the consistently high volume of freight and passengers passing through its airports, ports and road facilities. The number of air passengers utilising the existing Kai Tek airport increased by 8.7 per cent in 1995 to 27.4 million, with a further slight increase in throughput expected to have taken place in 1996.²⁸ Outward and inward air cargo was 1.5 million tonnes for 1995, representing a 13.2 per cent increase on the previous year. Similarly, outward and inward sea-borne cargo increased by 14.5 per cent in 1995, totalling some 125 million tonnes. Hong Kong has been the world's busiest container port since 1992, with 11.4 million twenty foot equivalent units processed in 1995. The port has become heavily congested, which is having an impact on operating efficiency, although continuing investment in terminal loading and stacking equipment and an increase in mid-stream cargo processing is expected to alleviate the problem in the short term. DFAT noted that the current levels of cargo throughput suggest that Hong Kong will need to build a new four berth container terminal every two years to effectively keep pace with demand.²⁹ Three four berth container terminals and a river trade terminal are currently planned and have been approved in principle by the People's Republic of China, however negotiations over consortia arrangements for the first of these terminals, CT-9, are continuing to progress slowly.³⁰

23 Exhibit No. 7(h), DFAT, op. cit., p. 22.

24 Economist Intelligence Unit, op. cit., p. 31.

25 Exhibit 7(h), DFAT, op. cit., p. 23.

26 Economist Intelligence Unit, op. cit., p. 33.

27 BIS Shrapnel, op. cit., p. 42.

28 Economist Intelligence Unit, op. cit., p. 28.

29 Hong Kong's Port Development Board expects container volumes to grow by 250 per cent in the next 10 years: Wallis, K., 'Asia's Money Machine' in *Worldlink*, September/October 1996, p. 51.

30 Exhibit No. 7(h), DFAT, op. cit., p. 23.

5.31 Another important, though proportionally small sector of the economy is construction (5.4 per cent of GDP). Although the level of construction and building activity has remained relatively constant over the past three to five years, the sector has benefited from the increased emphasis placed on services growth and development. As part of the Hong Kong Government drive to improve the territory's infrastructure and encourage investment, it has embarked on a program of large scale infrastructure projects, which includes the Port and Airport Development Strategy (PADS).³¹ It is estimated that the construction of the new airport at Chek Lap Kok alone will cost some US\$20.3 billion.³² Additional developments include the new port facilities, a suspension bridge, a mass transit rail system, a second freight line to China, a third cross harbour tunnel and major road works.

5.32 Despite factors such as persisting inflation, unsteady employment rates in the lower-skilled sectors of the economy, and the continuing fragility of consumer confidence, Hong Kong's outlook for the short term appears relatively bright. The economic indicators point to continued 'mature' growth, stimulated in part by a 'bottoming out' of the property market, improved consumer demand and export prospects resulting from continued growth in the economies of major trading partners, including the United States. They also suggest an underlying flexibility or adaptability, inherent in the structural transformation and service specialisation, which should enable Hong Kong's economy to sustain momentum in the face of changes in international economic conditions.

Trade

5.33 Due to the lack of a natural resource base, and the relatively limited size of its domestic market, Hong Kong has traditionally been reliant on trade to fuel economic growth. The importance of trade to Hong Kong's economy is underlined by the fact that the value of total exports, including re-exports, is around one and a half times its Gross Domestic Product.³³ In 1995, Hong Kong's total two way merchandise trade was estimated at US\$366.7 billion, a growth of 17 per cent on 1994 figures. Merchandise exports, including re-exports, accounted for US\$173 billion, compared to total merchandise imports of approximately US\$193.3 billion.³⁴

5.34 Re-exports continue to provide the impetus for growth, rising by 14.7 per cent in 1995 compared with the same period in 1994, and accounting for 83 per cent of total exports.³⁵ However, this growth is expected to plateau as Hong Kong's trade patterns increasingly shift away from re-exporting through the territory to simple trans-shipment. This shift would appear to be the result of China's improved capacity to process products and provide auxiliary services, as well as improving port facilities and transport infrastructure which are allowing more trade to be conducted directly between China and overseas markets.³⁶

5.35 More dramatic has been the decline of Hong Kong's domestic exports in the share of total exports, reflecting the shift in production to the mainland and recent sluggishness in Hong Kong's main export markets. In 1995, domestic exports accounted for around 17 per

31 *ibid.*

32 Exhibit No. 4, Reuter News Service, 21 February 1997.

33 BIS Shrapnel, *op. cit.*, p. 43.

34 Asia Pacific Economic Group, *op. cit.*, p. 156.

35 Exhibit No. 7(h), DFAT, *op. cit.*, p. 19.

36 Economist Intelligence Unit, *op. cit.*, p. 39.

cent (US\$29.9 billion) of total exports, compared to 35 per cent in 1990. However, this figure represented a slight increase of 1 per cent on domestic exports for 1994, and may indicate that the decline has bottomed out.³⁷

5.36 The flow of merchandise imports have not slowed in recent years, increasing by 19.5 per cent to US\$193.3 billion in 1995, compared to 14.1 per cent growth in 1994.³⁸ This reflects the accelerated growth in the level of retained imports (goods imported into the territory and not re-exported or used in outward processing) with retained imports of capital goods, such as office equipment and industrial machinery rising 23 per cent in real terms in 1995 over a year earlier.³⁹

5.37 As a result of continued high level of retained imports, the merchandise trade deficit exceeded HK\$146 billion, or 12 per cent of GDP, in 1995. Due to a recent relative slow down in the economy and weaker domestic demand, the merchandise trade deficit was expected to reduce to around US\$135 billion in 1996. However, the deficit is expected to rise steadily over the next two years, due to a forecast boost in domestic demand, spilling over into higher levels of imports.⁴⁰

5.38 Exports of services have grown rapidly over the past decade, causing the invisibles surplus to continue to widen (estimated at around US\$16.6 billion in 1995), in turn offsetting the merchandise trade deficit, and limiting the overall current account deficit to US\$3.4 billion. The most significant service item in the surplus is transportation, which includes freight and storage, totalling some HK\$86.4 billion in 1994, the latest year for which detailed figures are available.⁴¹

5.39 The growth in services trade reflects the structural transformation of Hong Kong's economy, the growing importance of Hong Kong's role as a trade intermediary to China, and the deepening interdependence between the two economies. It is perhaps useful to briefly focus on the significance of this trade interdependence.

Hong Kong - China

5.40 Hong Kong's economic ties with China have been the basis of the territory's existence from the time of its creation. In the last decade and a half, those ties have increased as China has undertaken two historic changes in its foreign and economic policy; opening the door to trade and other links with the rest of the world, and introducing market reforms to its formerly command or central plan economy. At the same time, Hong Kong's role in the development of the mainland economy, particularly since the implementation of China's open door policy in the late 1970s, has been critical to the latter's 'modernisation' thrust.

5.41 As such, Hong Kong's economic relations with China have become the single most important determinant of the territory's economic prospects. In 1995, total trade with Hong Kong accounted for US\$127.6 billion, an increase of 15.5 per cent on 1994 figures. China is now Hong Kong's largest trading partner, while the latter is now China's second largest (accounting for some 16 per cent of its total trade).

37 BIS Shrapnel, op. cit., p. 156.

38 *ibid.*

39 Exhibit 7(h), DFAT, op. cit., p. 19.

40 BIS Shrapnel, op. cit., p. 40.

41 Economist Intelligence Unit, op. cit., p. 42.

5.42 Much of this trade is dominated by re-exports. As a source of Hong Kong's total re-exports, China's share has stood at about 57 per cent in the 1990s, while its share as a destination of Hong Kong's re-exports has grown from 26.8 per cent in 1990 to around 35 per cent in 1995. Because of the re-export trade, China is easily the most important source of Hong Kong's total imports, and in 1995 overtook Japan as the largest source of Hong Kong's retained imports.

5.43 The increasing importance of re-exports has had important implications for trade patterns with other countries. Between 1986 and 1993, the United States share of Hong Kong's domestic exports fell from 41.7 per cent to 28.7 per cent, while China's rose from 11.7 per cent to 27 per cent. In 1995, China accounted for roughly a third (33.5 per cent) of Hong Kong's total exports, compared to the United States (21.7 per cent) and Japan (6.1 per cent).⁴²

5.44 Cross investment flows between Hong Kong and China have similarly deepened in recent years. Hong Kong has been by far the largest single investor in China, averaging nearly US\$2 billion per year between 1979 and 1990. According to Chinese statistics, this figure accounts for 62 per cent of total Foreign Direct Investment (FDI) in China over the period. However, it is likely that a considerable portion of recorded Hong Kong investment was actually finance capital from Taiwan, Japan and the United States, as well as recycled capital from mainland sources in Hong Kong.⁴³

5.45 In large part, the demand for FDI has been driven by an ailing state-owned sector, which requires additional capital to maintain State Owned Enterprise (SOE) efficiency and increasingly, viability. As of 1992, it was estimated that between one-third and two-thirds of all SOE's were operating at a loss. With firms largely propped up by public borrowing, local governments have increasingly looked to overseas investors Hong Kong as a source of equity capital.

5.46 Hong Kong investment is heavily concentrated in Guangdong, providing over 80 per cent of the province's cumulative FDI in areas such as manufacturing and large scale infrastructure projects. It is estimated that Hong Kong investors employ an estimated 3.5 million workers in Guangdong alone. In the Shenzhen Special Economic Zone (SEZ), which borders Hong Kong, it is estimated that between 19,000 and 21,000 Hong Kong-registered firms are currently in operation.⁴⁴

5.47 Conversely, China is generally considered to be the largest investor in Hong Kong, with over US\$25 billion in publicly declared investment. This figure may significantly understate the extent of actual mainland investment, which has been unofficially estimated at closer to US\$60 billion.⁴⁵ Much of this investment has occurred in Hong Kong real estate, particularly in the residential and commercial markets,⁴⁶ however diversification is resulting in significant share in other economic sectors, such as tourist related services, transportation and manufactures. According to some analysts, Chinese companies may already control at

42 Economist Intelligence Unit, op. cit., p. 39.

43 Asia Pacific Economic Group, op. cit., p. 150.

44 Exhibit 7(h), DFAT, op. cit., p. 12.

45 *ibid.*, p. 12.

46 According to DFAT, Chinese enterprises are estimated to have cornered in excess of 25 per cent of Hong Kong's commercial real estate; Exhibit No. 30, DFAT, op. cit., p. 11.

least one third of Hong Kong's banking, property and transport sectors.⁴⁷ Some 20,000 enterprises with direct links to China were estimated to be operating in Hong Kong in 1995, up from 200 a decade earlier. The largest Chinese investor in the territory is the Bank of China (one of the three note-issuing banks in Hong Kong), which controls more than 10 per cent of total Hong Kong banking assets and around 25 per cent of Hong Kong currency deposits.

Intermediation - Hong Kong's Pivotal Role

5.48 Despite China's growing commercial, trade and transport links with the outside world, reflecting the pattern of trade globalization, it is interesting to note that Hong Kong's role in China's economic relations is becoming more pivotal; as an increasing share of China's commodity and service trade and foreign investment is handled through the territory. Various reasons based on a theory of intermediation have been advanced to explain this trend.

5.49 In briefly examining the importance of this intermediary role to Hong Kong's economic future, it is perhaps useful to start by distinguishing intermediation from Hong Kong's other trade functions, such as that of a trading partner, financier and facilitator. In terms of commodity trade, intermediation generally encompasses entrepot trade, trans-shipment and brokerage in direct trade. Trans-shipment means that goods are consigned directly from the exporting country to a buyer in the importing country, although the goods are transported via an entrepot and may be temporarily stored at the entrepot for onward shipment. Unlike trans-shipment, entrepot trade is indirect trade, as imports for re-export are consigned to a buyer in the entrepot and the buyer takes legal possession of the goods after clearing customs. These imports may then be re-processed before being re-exported. Such re-processing might include packaging, grading, assembling, decorating or other minor manufacturing. Intermediation in services trade encompasses such areas as tourism, business and management consultancy, and loan syndication.⁴⁸

5.50 In simple terms, assuming that the establishment of a bilateral trade link between economic agents involves a fixed transaction cost, it can be argued that an exchange structure involving trade links between each and every agent is generally inefficient. An efficient exchange structure minimises the number of bilateral trade links and necessarily involves intermediation. The value of intermediation is enhanced by the economies of scale which generally accrue where production involves large fixed costs and small or declining marginal costs. For example, the production of market information, an integral intermediation service, involves considerable fixed cost, however the same market information can be used in multiple transactions.

5.51 Another feature of intermediary services is agglomeration, reflected in the tendency of traders and firms providing trade-related services to converge on a particular locale. Such clustering suggests the existence of certain external economies, such as reduced search and travel costs for service purchasers, increased opportunities for specialisation, risk minimisation and knowledge sharing among producers.⁴⁹ This implies that once a locale acquires a comparative or first mover advantage in providing intermediary services, this

47 Cheng, J Y, 'China, Taiwan and Hong Kong in the mid-1990s' in *Current Affairs Bulletin*, April/May 1996, p. 20.

48 Yun-Wing Sung, *The China Hong Kong Connection*, 1991, p. 29.

49 Asia Pacific Economic Group, op. cit., p. 153.

advantage may become self-generating; as more traders and intermediaries converge, efficiency will be enhanced.⁵⁰

5.52 Economies of scale and agglomeration in intermediary services has helped Hong Kong to maintain competitiveness in high value areas such as financial and business services. Moreover, as new Chinese trading companies base in Hong Kong to take advantages of the economies of agglomeration these economies will be further reinforced - a significant example of first mover advantage.

5.53 The theory of intermediation also explains why Hong Kong's role as a middleman continues to grow in the face of reduced transaction costs (communication, travel, administrative), which would tend to favour the growth of direct trade. Partly this is a result of Hong Kong's ability to continually raise efficiency in providing intermediary services, itself a product of the external economies cited above. It also relates to the notion that increasing product heterogeneity tends to increase search costs and hence the demand for intermediation. For example, specialised products such as high value-added manufactures far outweigh crude materials in terms of importance to Hong Kong's re-export trade. This dynamic is more evident in trade in services, where the products of service tend to be tailored to individual requirements and are thus more heterogenous than commodities.⁵¹

5.54 The existence of these factors, economies of scale and agglomeration, rising efficiency and service heterogeneity, as well as other factors such as the attractiveness of large trading centres, the absence of internal distortions, and cultural and political influences, all explain why Hong Kong's role as an intermediary to China should, theoretically at least, become more pivotal in the future. In practice however, there are many other factors which will shape Hong Kong's economic position in the future, including political developments within the People's Republic of China, the health of PRC-United States trade relations, and the increasing competitiveness of centres such as Singapore and Taipei in financial, banking and investment capital raising services.

5.55 This last factor, the increasing competitiveness, or attractiveness, of other centres in the East Asia region, may ultimately have the most significant bearing on Hong Kong's ability to fashion continued economic growth out of efficiency gains in entrepot trade and as a conduit of high volume capital flows to and from China. A number of witnesses to the inquiry addressed the emergence of other mainland centres, particularly Shanghai, and their possible impact on Hong Kong's position as China's leading economic, financial and trade centre.

5.56 Some suggested that China's efforts, in terms of investment and development of infrastructure in cities such as Shanghai, signal some determination to establish trade and financial hubs which will rival, if not supplant, Hong Kong's role as an entry and exit point to the Chinese hinterland.⁵² Most, however, agree that Shanghai will not provide direct competition to Hong Kong for a number of years, given the latter's advantages in infrastructure and services development.⁵³ Others have argued that the drive to develop world class infrastructure in other mainland cities will not necessarily undermine Hong

50 Yun-Wing Sun, op. cit., pp. 124-125.

51 *ibid.*, p. 40.

52 Jacobs, Transcript, 31 January 1997, p. 197.

53 BIS Shrapnel, op. cit., p. 48.

Kong's comparative advantages.⁵⁴ In the longer run, the development of centres such as Shanghai may be oriented more towards refinement and further specialisation of a particular niche (for example, providing business, financial, transport and storage services for the densely populated Yangtze region), rather than appropriating Hong Kong's intermediary functions as a financing, banking and trading base for the South China region. Ultimately, Hong Kong's competitiveness and further growth, in relation to other centres, will be determined by the extent to which the Joint Declaration and the Basic Law are implemented and can preserve the integrity and separate identity of Hong Kong.

Transfer Issues

5.57 The previous overview of Hong Kong's economy, its trade relations, and the dynamics driving Hong Kong's integration into the Greater China economy provides a suitably optimistic, albeit cautious, perspective within which to take up the question of whether and to what extent the legal, civil and political issues that have clouded the transition process are likely to impinge on Hong Kong's future economic prosperity. In particular, this section will focus on three inter-related issues that arguably link the causes of democracy and civil rights to those of business: maintenance of the rule of law and the continued independence of the judiciary, the future of 'sound' administration; and freedom of information and expression.

5.58 As mentioned above, the weight given to such concerns rests largely on a number of assumptions about: the strength of the arrangements which seek to preserve the distinctive structure and autonomy of Hong Kong's legal and social systems; the degree to which intermeshing of China's socialist based civil law and Hong Kong's common law system will take place; and more specifically, the longer term integrity of the legal framework governing commerce and trade in the territory.

Maintenance of the Rule of Law

5.59 The rule of law depends, at a fundamental level, on obedience to the established law. It depends critically on recognition and acceptance of the primacy of law; the assumption that governments, like individuals, are not above its jurisdiction, and that it can only be challenged in the courts of the land. In simple terms, it provides for order, stability and the protection of the rights of the individual against the arbitrary exercise of power. As Professor Jayawickrama noted:

the law is the thread that runs through every official act and every exercise of power in this territory. A public officer may only do that which he or she is authorised by law to do. A directive from anyone, however high or mighty, cannot be invoked as a substitute to justify what is otherwise an unlawful act.⁵⁵

5.60 That the rule of law is linked to the integrity and reliability of institutions and hence the confidence of economic agents engaged or contemplating engagement in the system is also assumed. Certainly the evidence taken by the Committee consistently emphasised the significance of the rule of law to Hong Kong's present and future prosperity.

54 Austrade, Transcript, 13 November 1996, p. 37.

55 Jayawickrama, Submission, p. S355.

In the light, then, of the recent decisions of the Central People's Government to disestablish Hong Kong's Legislative Council, install a provisional legislature and endorse the recommendations of the NPC to repeal existing human rights legislation, it would seem important to consider whether these decisions, and their implied threat to the rule of law, are ultimately likely to have any bearing on Hong Kong's trade balance sheet.

5.61 Advocates of the optimistic or 'bullish' outlook would argue that the Joint Declaration and the Basic Law provide ample assurance of China's intention to uphold the rule of law. In addition to pledging that the HKSAR shall safeguard the rights and freedoms of its residents and other persons in the region in accordance with law, the Basic Law states that an independent judiciary will be charged with applying substantially the same laws previously in force in Hong Kong, 'that is, the common law, rules of equity, ordinances, subordinate legislation and customary law ... except for any that contravene the Basic Law, and subject to any amendment by the legislature of the Hong Kong Special Administrative Region'.⁵⁶ Following this line, it can be argued that there is little reason to doubt the prospects for the continued stability and integrity of the legal order. The interests of economic agents will continue to be regulated and protected by the provisions of the territory's commercial, civil and administrative code, applied by courts operating according to common law practices and precedences.

5.62 Beyond the letter of these agreements, there are encouraging signs that the Chinese Government is gradually recognising the importance of the rule of law to its own legal system. According to Edward Epstein, the reform of Chinese legal system over the past eight years, has evidenced the emergence of elements of the rule of law, previously lacking, for example:

new economic relations...couched in terms of individual rights and duties, civil and procedural laws have defined personal rights more clearly and have provided for their enforcement, the legality of administrative decisions may now be challenged by citizens, and professional legal training and popular legal education have been greatly expanded.⁵⁷

5.63 In contrast, advocates of the bearish outlook argue that it is questionable whether the Chinese Government either accepts or recognises the importance of the rule of law to Hong Kong's future stability and prosperity. They maintain that quite apart from the assurances contained in the Joint Declaration and the Basic Law regarding the retention of Hong Kong's legal order after 1 July 1997, there is little evidence that demonstrates that the Central People's Government has an adequate understanding of the imperatives of the rule of law, and in particular, the importance of legal adherence, and hence predictability and certainty, to business, commercial and government activity.⁵⁸

Predictability, crucial because so many business decisions relate to happenings in the future, is achieved by established rules which attach specific consequences to particular acts or agreements. Rules of contract are especially important to bind others and to plan for the

56 Basic Law, Article 8.

57 Quoted in Exhibit 7(e), Wesley-Smith, op. cit., p. 109.

58 Dowd, Transcript, 30 January 1997, p. 127.

future...it is naturally important to a rules-based system that its rules be enforced competently, fairly and impartially.⁵⁹

5.64 A number of recent decisions of the Central People's Government, raise serious questions over China's understanding of and commitment to the principles of legal adherence in Hong Kong:

- (i) the Patten proposals on the legislative system were not in breach of the Basic Law, thus the decision to disestablish the existing Legislative Council on resumption of sovereignty would appear unjustifiable;
- (ii) the establishment of a provisional legislature is not within the provisions of the Basic Law or any other law;
- (iii) the constitution of the Court of Appeal would appear to take it outside the Basic Law.

One could equally argue that the grounds for repeal of certain provisions of the Hong Kong Bill of Rights Ordinance lie outside a reading of the Basic Law.

5.65 Pessimists argue that these decisions, and their cumulative effects, may be significant, not just for the prospects of democratic reform and protection of human rights, but for business as well. On one level, they reflect a partial regard for the laws that are to be in force in Hong Kong, and as such do little to engender confidence, public and business, in the assurances provided by the Chinese Government in the Joint Declaration and the Basic Law. On another level, the changes which these decisions affect, may have a direct bearing on the conditions for conducting business in the territory.

Independence of the Judiciary

5.66 A second issue, which proceeds from a broader consideration of the rule of law, is the implications for business and investment confidence of the modifications to Hong Kong's judicial system, in particular the arrangements for the future Court of Final Appeal, as provided for under the Basic Law and subsequent Hong Kong legislation enacted with the 'approval' of the Chinese Government. As detailed in Chapter 3 of this Report, the Court of Final Appeal is to be the highest court in the territory, in both civil and criminal matters, replacing the Judicial Committee of the Privy Council.

5.67 Advocates of the bullish outlook would argue that there is little reason at this stage to question the future competence, impartiality and independence of the Hong Kong judiciary. They maintain that the provisions of the Basic Law and related legislation will have negligible impact on the judiciary's ability to interpret and apply Hong Kong's domestic law. Rather, in addition to providing for the retention of most parts of the existing judicial system, the Basic Law provides for a final court that, unlike the Privy Council, will be wholly within the territory's jurisdiction. Optimists also point to the substantial 'through train' of legal personnel, provided for under Article 93 of the Basic Law, which is already taking place, and which will ensure the high standards of Hong Kong Courts are maintained.

59 Yash Ghai, 'The Rule of Law and Capitalism: Reflections on the Basic Law' in R. Wacks (ed.) *Hong Kong, China and 1997: Essays in Legal Theory*, 1993, p. 345.

5.68 Bearish advocates would argue that restrictions placed on the jurisdiction of the Court of Final Appeal by sections of the Court of Final Appeal ordinance and articles of the Basic Law open the legal door to political interference by the Central People's Government in matters referred to the courts, creating uncertainty in judicial process and potentially undermining the integrity of the judicial system.

5.69 The first concern relates to section 4(2) of the Court of Final Appeal (CFA) ordinance, which gives effect to Article 19 of the Basic Law, denying the courts of the HKSAR jurisdiction over 'acts of state'. Under a common law interpretation, 'acts of state' would clearly refer to matters such as the declaration of war, the appointment of ministers or the signing of a treaty.⁶⁰ However, there is no indication, provided in either the ordinance or the Basic Law, that this provision will not be subject to wider interpretation by the Chinese authorities. Moreover, the provisions of the CFA ordinance and Article 19 of the Basic Law ensure that any challenge to an issue which the Chinese Government deems an 'act of state' will be beyond the jurisdiction of the Hong Kong Courts, including the Court of Final Appeal. Such arbitrary provisions clearly afford little certainty as to the ultimate basis for decisions on matters referred to the highest court of the HKSAR: the Chinese Constitution, the Basic Law or the common law as received in Hong Kong.

5.70 A second, related concern centres on Article 158 of the Basic Law, which removes from the Hong Kong courts the right to interpret the Basic Law where the interpretation concerns either affairs which are the assumed responsibility of the Central People's Government, or the relationship between the Central Authorities and the HKSAR. Only the Standing Committee of the NPC may interpret such matters and their decision is to be binding on the courts of the HKSAR. Again, the ambit of what can be excluded from the jurisdiction of the HKSAR courts is generous, and clearly open to arbitrary application. 'Almost anything can fall within the scope of matters concerning the relationship between the Central Authorities and the HKSAR, particularly issues which are politically sensitive'.⁶¹

5.71 In practical terms, the potential implications for the business community of a judiciary, overtly compromised through politicised appointments or undermined by interference from the Standing Committee of the NPC, are not difficult to conceive. Interpretation, adjudication, application all become less certain procedures. Contract disputes, formerly resolved according to due process based on common law practices and precedents, may well be subject to interpretation based on other, political considerations. To illustrate the potential problems, one witness before the inquiry, Mr Justice John Dowd, offered a scenario in which a contract dispute referred to the Final Court of Appeal may not be determined by that court, but on the direction of the Standing Committee of the National People's Congress.⁶²

Administration

5.72 A third issue, which extends from a consideration of the rule of law, is the possible longer term ramifications of Chinese rule on the integrity and efficacy of Hong Kong's government administration, and through that, investor confidence in the territory as a place to do business. Again, the assumption here is that over time there will be some

60 Democratic Party, Submission, p. S690.

61 *ibid.*, p. S691.

62 See recommendation 5.

inevitable 'integration' of the two administrative systems, not least in terms of practices and culture.

5.73 Although the Basic Law is notably silent on the specifics of the intended structure and organisation of the HKSAR public administration, it clearly assumes that the present structures, based on Britain's common law institutional models and practices will remain in place. The Joint Liaison Group negotiations on matters of administrative transition and the commitment of the Chief Executive Designate to the 'through train' process for career civil servants would indicate that the Central People's Government shares this assumption. It is reasonable to conclude that the administration which is in place, and which is widely regarded as clean, efficient and impartial, is unlikely to be infused with the bureaucratic practices that have hindered administration in many parts of the People's Republic of China in the foreseeable future. However, in the longer term, there are concerns that many of the practices evident in the Chinese administrative system, might slowly appear in Hong Kong, potentially undermining confidence in both the efficacy and reliability of administration in the HKSAR.

5.74 The importance of Hong Kong's clean, efficient administration to Hong Kong's economic prosperity, stem from the assumptions, described by some as neo-liberal, which informs its operation - state control of society according to universal legal norms which apply equally to all groups in society, legal rules made and changed by an accountable legislature and particularised by the courts, and officialdom guided by rules and regulations rather than personal or political factors. To a large extent these principles arise out of and presuppose the existence of free markets, a democratic political process and the rule of law.⁶³

5.75 In contrast, the assumptions which underlie administration in the People's Republic of China are quite different. On the one hand, the fusion of all state functions, legislative, judicial, and administrative to the task of revolutionary socialism, has meant that the interests that these institutions seek to further and protect, are indivisible from those of the State, and ultimately the Party. On the other hand, cultural factors, such as paternalism, with its sensitivity to hierarchy and the maintenance of social order via micro-units, such as cliques and family, and personalism as a mechanism to establish reliable connections for the conduct of activity at all levels, sit uneasily within a framework of rigid, impersonal rules and proscribed practices which inform sound administration.

5.76 Following this line, it has been argued that one of the most serious threats to the integrity of, and hence confidence in, Hong Kong's public administration in the long run may be the inability or unwillingness of the Central Authorities to prevent politicization, arbitrariness, nepotism and practices of patronage, evident at all levels of Chinese administration, provincial and central, from spreading to the territory.⁶⁴ The prospect of the elevation of personal ties above established rules and procedures, of special consideration above impartiality, of appointment according to favour, and decision according to interest, are antithetical to the practices of consistency, predictability and legitimacy which presumably underlie confidence in government administration.

5.77 The effect of such ideological and cultural factors over time may be to reduce further the relations between government administration and the business community to one

63 Exhibit No. 4, Laird, C, 'Taming the Dragon?'

64 Tanaja, P, op. cit., p. 34.

of *guanxi* or personal connections. The practical implications for business of such a development would be significant. In this context, it is perhaps sufficient to echo the comments of Redding, cited by Yash Ghai, who reminds us that once *guanxi* is established, it quickly becomes a requirement for most significant activity, from distributing soft drinks to retailers, to renting land to obtaining approval to build a factory.

5.78 Such trends would not only erode confidence in a system built on contractual obligation, due process and impartiality, in other words, certainty, they would significantly reduce the openness and fairness of business conditions within the territory. Indeed, such fears have been raised by foreign businessmen dealing in Hong Kong, who have wondered to what extent and how they can compete in an environment which may become dominated by 'political favouritism', influence peddling and informal connections.⁶⁵ Others have expressed the view that it is quite likely that mainland Chinese firms will seek and obtain, special privileges from Hong Kong's administration, and may well already enjoy privileged access to official information and policy options. To the extent that Hong Kong's business playing field does increasingly tilt in favour of certain cliques or privileged groups that have the backing of one or more of the executive arms, and is seen as not operating in accordance with the law, investors may, as Martin Lee argues, simply elect to go elsewhere.⁶⁶

65 McMillen, D H, 'Security Interests in Hong Kong Politics', unpublished, 1996, p. 15.

66 ABC *Lateline*, 18 February 1997.

Corruption

5.79 Similarly, law enforcement issues such as corruption, which flow from a consideration of the rule of law and administrative integrity, are of significant concern to Hong Kong's economic future. It is fair to state that the corruption, rampant in China, if extended to Hong Kong, could prove disastrous for the territory. Although Hong Kong is not free of corruption (views on the level and extent of illegal business activity in the territory vary), it is generally accepted that work of the Independent Commission Against Corruption (ICAC), established in 1974, has enabled the Hong Kong Government to contain the problem and thereby provide an environment conducive to the growth of international business. The recent resignation of the Director of the ICAC, coupled with the lack of any real indication by the Central Authorities on the priority to be given to the work of the Commission in the HKSAR, however, raises concerns that government efforts to stamp out organised and white collar crime might become tokenistic. Certainly, to the extent that government administration in Hong Kong may increasingly become vulnerable to 'patrimonial' or informal practices,⁶⁷ it is relevant to question how effectively the ICAC will be able to exercise the statutory powers provided to it under Hong Kong law.

5.80 The Committee recommends that:

- 18. the Australian Government include in its annual report on Hong Kong to the Parliament (recommendation 24) comment on the continued effective operation of the ICAC.**

5.81 As noted by witnesses before the inquiry, the effects of an escalation in corruption and grey area business practices on foreign investment and investor confidence in the territory in the medium to longer term may be damaging. To some extent some escalation may be viewed as an inevitable consequence of the reversion to Chinese rule, and thus, an additional risk of doing business in the region. Peter Forsythe, Austrade representative, suggested that, if the rise of Chinese business practices in Hong Kong appears somewhat inevitable, so too does the prospect of political interference in economic activities in the territory, noting that, where the Central Government becomes involved with business in Hong Kong, it is 'going to naturally try to exert [*guanxi*] pressures on doing business...there will be efforts to leverage into business in Hong Kong'.⁶⁸ Whether Hong Kong's relatively level economic playing field becomes progressively more sloped for foreign investors, or merely the smaller players after 1 July 1997, may be one of degree.

5.82 The Committee recommends that:

- 19. the Australian Government continue to support, both multilaterally and bilaterally, the accession of the People's Republic of China to the World Trade Organisation (WTO) as a means to encourage the development of a consistent, transparent framework of rules and procedures for trade and commercial activity within the sovereign territory of China.**

Press Freedom, Information Flow and Market Dynamism

67 Yash Ghai, op. cit., p. 364.

68 Austrade, Transcript, 13 November 1996, p. 42.

5.83 A final issue which links the civil, political and legal concerns of the transfer to Chinese rule to the question of Hong Kong's future prosperity, is that of continued press freedom and possible inhibitions of the free flow of information within the territory post 1 July 1997. Certainly, there is little question that an 'important element of Hong Kong's success as an international business and finance centre is the free flow of information and ideas'.⁶⁹ That this has been achieved through a free press, a legal and regulatory framework that provides for the unfettered exchange of information, and government administration that adheres to such a framework and therefore accedes to accountability and transparency, is also largely beyond question.

5.84 What can be questioned is whether the Chinese Government, and through that the HKSAR Government, practically understand the importance of a free press, of unfettered information flow, to investor confidence. The provisions of Article 23 of the Basic Law, which requires the Government of the HKSAR to enact laws to prohibit, *inter alia*, any act of sedition, secession or subversion against the Central People's Government, coupled with indications given by various representatives on the parameters to be placed on freedoms protected by the Bill of Rights Ordinance and the Basic Law itself, raise concerns that the free press and information culture Hong Kong has traditionally enjoyed, and which Hong Kong business depends upon, may inevitably be curbed.

5.85 Advocates of the optimistic outlook would argue that the provisions of Article 27 of the Basic Law guaranteeing freedom of speech, of the press and of publication, together with the provisions of the Hong Kong Bill of Rights Ordinance which protect the same and which will remain in force, are important concessions by the Chinese Government to the need to ensure that Hong Kong's information culture is preserved. They maintain that the provisions of Article 23 of the Basic Law, and indeed the pronouncements of various Government Officials on that provision, impinge little on the interests of business, and in particular the ability of business to access accurate, impartial information.

5.86 In contrast, the less optimistic have argued that the guarantees, of freedom of speech, of the press and publication, provided for by the Basic Law and the Bill of Rights Ordinance, are potentially countered by the legislative requirements of Article 23 of the Basic Law, indications of the attitudes of senior Chinese officials towards press freedom and more blatantly, they argue, recent Chinese Government actions designed to inhibit expression by the press and public of views inimical to China's 'national' interests. These signals, pessimists argue, are clear indication of the restrictions to be placed on the free flow of information, restrictions which will affect business confidence in the territory as much as it affects public and political discourse.

5.87 The primary concern is that any legislation which gives effect to Article 23 of the Basic Law, particularly with regard to acts of sedition and subversion against the Central People's Government, may de facto legislate against political and economic reporting which would either be critical of the Central Authorities or otherwise 'insensitive' to China's interests. In this sense, it is quite possible to argue that the interests of business, in obtaining accurate information on economic and political developments both in Hong Kong and China, may well be affected by the provisions of Article 23 of the Basic Law.

69 DFAT, Submission, p. S381.

5.88 The recent case of Xi Yang, a Hong Kong journalist sentenced to 12 years imprisonment in March 1994 by a Chinese Court for publishing information on Chinese Central Bank economic strategies and loan interest rates (which it considered to be theft of State financial secrets), although not directly applicable, is nonetheless illustrative of the potential difficulties in establishing a practical distinction between the provision of basic, economic information and threatening State security.⁷⁰

5.89 A further concern relates to the implicit politicization of decisions affecting media operations in the territory. The recent difficulties experienced by the Next Media Group in securing an underwrite for a stock market listing, point to the possible danger to Hong Kong's future as an information centre; that media out of favour with the prevailing political winds may well find their business operations disadvantaged, or worse, curtailed.⁷¹ Through revoked licences or other regulatory means, or more subtle avenues that seek to encourage advertising toward more politically correct outlets or make it difficult for targeted publications to find partners for their business, the array of possible retaliatory or intimidatory measures available to the HKSAR administration is considerable.

5.90 Equally disquieting is the possibility that unofficial pressure may increasingly be placed on financial institutions, investment houses and other firms engaged in market analysis to put a favourable 'slant' on the economic information they provide. It has been reported recently that a number of brokerage firms in Hong Kong have been gently urged to re-assess, or in some cases ameliorate unfavourable analyses of mainland ventures favoured by the Central People's Government.⁷² Such evidence, obviously, does little to engender confidence that the information available to investors and the public, is either complete or impartial.

5.91 The Committee recommends that:

20. the Australian Government:

- a. **maintain the presence in Hong Kong of its broadcast and broadband media, Australia Television and Radio Australia - in short wave and via satellite with services in Mandarin and Cantonese, as an available source of independent news, analysis and information on political, social and economic developments in the region; and**
- b. **encourage private media concerns, including newsprint, radio and television broadcasters, to maintain their presence in Hong Kong as a means of encouraging continued international scrutiny of China's implementation of and adherence to the provisions and requirements of the Basic Law.**

Conclusion

5.92 Having considered the legal and institutional assurances provided by the Chinese Government through the Basic Law, the robust state of the territory's economy and trade relations, and perhaps most importantly, its increasingly lucrative role as a trade intermediary

70 Democratic Party, Submission, p. S695.

71 Exhibit No. 4, 'What Next?' Editorial, *Far Eastern Economic Review*, 13 March 1997, p. 5.

72 Exhibit No. 4, Willey, B, 'Gag Order', *Far Eastern Economic Review*, 11 July 1996, p. 23.

to China, it is difficult not to approach the central question of Hong Kong's economic future from a confident perspective. However, in the light of the civil, legal and political issues that have occupied much of this Report, and which continue to loom over July 1997, it is equally difficult not to be cautious about the economic implications of Chinese political control over Hong Kong. Ultimately, the question of Hong Kong's future prosperity cannot be divorced from that of the nature of its political authority; its ability and willingness to defend the Basic Law and all its constituent elements, political, civil, legal and economic, and thereby retain confidence, public and business, in the viability of the 'one country, two systems' policy.

5.93 The Committee recognises that, according to the Basic Law, China has jurisdiction over foreign affairs and defence matters; however, apart from foreign affairs and defence, it is important that the responsibility of the HKSAR administration is recognised in all other areas of administration.

5.94 The Committee recommends that:

21. the Australian Government:

- a. maintain direct links with the Government of the HKSAR to reinforce the status of the territory as largely autonomous, with executive, legislative and independent judicial authority as provided for under the Basic Law;**
- b. support, multilaterally and bilaterally, the continuing participation of the HKSAR as a separate entity in international trade agreements such as the WTO and APEC, further reinforcing its status as a largely autonomous territory.**

22. on the establishment of an elected legislature in Hong Kong, the Joint Committee on Foreign Affairs, Defence and Trade seek to establish links with a counterpart committee in that legislature.

