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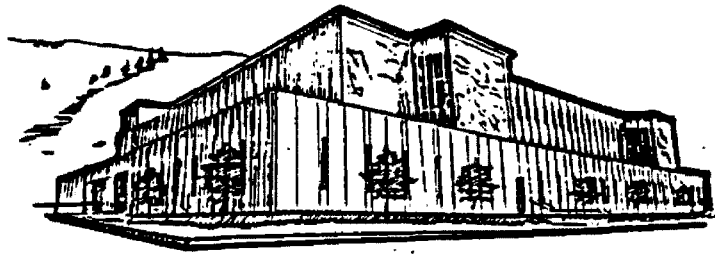
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**HONG KONG - A GATEWAY BETWEEN
THE PEOPLE'S REPUBLIC OF CHINA & THE UNITED STATES OF AMERICA**

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Xiaojun Guo

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1981, P. R. China

Presented in Partial Fulfillment of the Requirements

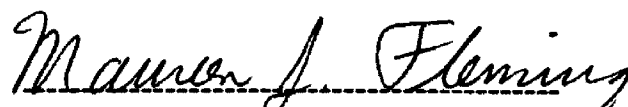
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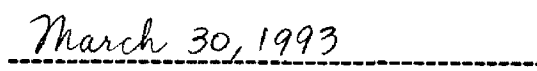
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Business Administration

Hong Kong - a Gateway Between the People's Republic of China & the United States of America

Director: Maureen J. Fleming *MF*

For over one hundred years, Hong Kong has played an important role in world affairs, both economically and politically, as a gateway between China and the West.

As the time approaches toward the transfer of sovereignty of Hong Kong from Great Britain back to the Chinese Government in 1997, the British influence over the territory will continue to diminish while the role of the United States will increase. Today, there are more American expatriates living in Hong Kong than any other nationality. The United States is Hong Kong's third largest trading partner next to China and Japan.

Hong Kong will be continuing its transition toward becoming a shipping, marketing, and finance center although much production has shifted to southern China. Hong Kong's underlying economic strength will continue to offer the United States opportunities.

The theme of this paper examines this relationship with Hong Kong placed as a gateway between the United States and the People's Republic of China. The purpose of this paper is to review the progression of this relationship in the past, study of it in the present and forecast it into the next century.

CHAPTER I

INTRODUCTION

The name "Hong Kong" in the Cantonese language means "Fragrant Harbor." In the mid 1800's this harbor, considered by many to be the most perfect natural harbor in the world, was the only real advantage for the islands on the north entrance of the Pearl River Delta of the South China coast.

250 Islands currently make up the Territory. Hong Kong Island, although not the largest of the islands, forms a narrow sheltered harbor on its west side facing the Kowloon peninsula, ideal for the sailing ships that began in mid 1850's to tie China more closely to the United States and other parts of the West.

The average Hong Kong adult is aware of the true beginnings of the Territory even though many of the international investors may not be aware of these origins. There were many valuable commodities for export from China such as tea and porcelain, but the Chinese were not interested in British currency or English or European goods in exchange. A need had to be created. The British and other Europeans used opium as a means of trade during the 1800's. Over many years, the Opium was imported to China in exchange for the valuable Chinese Exports, and in the process, vast numbers of the general population became addicted to the drug.

The Opium War, in the early 1830's, was fought because of the Chinese Government's growing impatience with and concern over the increasing amounts of the drug being shipped into the Country. As millions of Chinese became enslaved to the drugs imported by the English and other Europeans, the entire structure of Chinese society began to deteriorate.

The Government of China had for centuries been more interested in building monuments and temples for the Emperor rather than in modernizing to meet the developments of the West. This was particularly unfortunate, since many of the very early technical advancements of mankind, such as gun powder and printing presses, were invented by the Chinese.

By the 1850's, China had fallen behind the Western world in many technological areas, especially militarily. Due to the superior military power of the British, China lost the Opium War in 1839 and was forced to sign the Treaty of Nanking in 1842. This Treaty in effect made Hong Kong Island an English Colony. Later, prior to the turn of the century, additional treaties gave Britain control of the New Territories and the 250 plus surrounding islands.

In 1970, the Ambassador of the People's Republic of China wrote officially to the United Nations committee stating that Hong Kong was a Chinese territory under the occupation of British authorities. The Chinese Government requested that the category of "Colony" be applied to Hong Kong rather than that of an independent governmental state, since there was strong pressure in the world, at that time to return the Colonies to the sovereign countries. This request was

granted by the United Nations, and was a first step toward the return of Hong Kong to the People's Republic of China.

In December 1984, the Sino-British joint declaration was signed. This declaration allows for the transfer of Hong Kong on July 1, 1997, from the status of Colony of Great Britain to a Special Administrative Region of the People's Republic of China.

After the previous Government was driven from the mainland by Mao Tse Tung's Communist forces and the People's Republic was founded in 1949, China was for the most part closed to the outside world. From this time until the present, Hong Kong has flourished as a capitalist enclave just out of the reach of the Beijing Government. In 1997 this status will change as Hong Kong will return to the rule of the Beijing Government.

In spite of the communist ideology outwardly expressed by the central government, China has for many years used Hong Kong as a doorway to export and import goods and technology from the outside world. Much of the export products of China over the past 20 years have gone through Hong Kong to the outside world and in turn, much of the income of precious foreign currency has flowed back through Hong Kong into the coffers of the Beijing Government.

In the process of using Hong Kong as a trade link with the West, China has also received, much to the dismay of the aging communist rulers, the culture of the West through the doorway of Hong Kong. In both trade and culture, the East or China has met the West through this unusual focal point known as Hong

Kong.

To be more specific, Hong Kong has become, and will remain, a focal point between the People's Republic of China and the United States of America. In the past, Hong Kong has been a strategic middle ground between great powers. Presently major political changes are occurring which will make this "floating island and fragrant harbor" of even more importance. As the People's Republic of China and the United States of America continue to increase their economic romance, Hong Kong will continue to provide a pleasant meeting place for the two "giants."

The purpose of this paper is therefore, to study the relationship between the U.S., Hong Kong and the People's Republic of China, to analyze the impact of the transfer of sovereignty of the Colony from Great Britain to the People's Republic of China in 1997, and to review the economic trends between the United States and the People's Republic of China via Hong Kong in this transition period.

CHAPTER II

THE TRANSFER OF SOVEREIGNTY IN 1997

Review Political Factors

In 1949, the communist armies lead by Mao Tse Tung drove the leaders of the former nationalist government of China from the mainland across the Formosa strait to the island of Taiwan. Since that time, these two opposing governments have co-existed with much tension and hostility toward one another. Only in the last few years have tensions begun to subside as new generations of leaders gradually gain power.

In between the Communist Government on the mainland and the government of Taiwan was Hong Kong, both geographically and politically. During the 1950's the Communist Government in Beijing was heavily influenced and financed from the former Soviet Union, while the government of Taiwan was heavily influenced and financed from the United States. Hong Kong, a British Colony, was in between two great powers, and at the same time controlled and heavily influenced by Great Britain.

As the gap between China and Taiwan widened, and with the increased political tensions in the late 1950's and through the 1960's, Hong Kong, being more closely associated with Great Britain and the United States, was more and more severed from the mainland. Many Chinese began to migrate to Hong Kong

as political refugees and the population exploded from only 500,000 at the end of World War II to five million in the early 1970's.

Many of these refugees from the mainland were wealthy and successful Chinese capitalists fleeing humiliation at the hands of communist radicals. With these capitalists and industrialists and their families came much of their money to establish new enterprises in Hong Kong. As the population increased, so did the collective wealth of Hong Kong.

As more and more Chinese fled to Hong Kong, the Territory began to take on a distinct Anti-Communist nature. Even as recently as the early 1980's, there was a stark contrast as one traveled across the border from the New Territories into China. This contrast was not only one of economic conditions but ideology and belief. China and Hong Kong became two worlds set apart by a small river crossing at the village of Lo Wu where the New Territories met the Mainland border.

More recently, just before and after the Tiananmen Square incident, Hong Kong became a hotbed of intense political activity. As the student demonstrators were crushed in Beijing, the entire city area on Hong Kong Island and the Kowloon peninsula came to a stand still. Over one million of the seven million inhabitants took to the streets in massive demonstrations in protest of the repression by the Beijing Government.

In spite of the constant infiltration of mainland Chinese business and government into Hong Kong, this political opposition remains strong. This

opposition takes many forms, from the most radical anti communist movements to moderate groups that seek only to influence the Chinese rulers through reason and friendship.

When people in the West discuss the 1997 return of Hong Kong to China, most of them do not understand the true conditions of the change. The current agreement provides several important economic conditions to assure the prosperity of the Territory. For example, Hong Kong business law, modeled after English law as is currently practiced, will prevail for a minimum of 50 years from 1997. The currency of Hong Kong, the Hong Kong Dollar, will also remain in force for 50 years. The borders will remain in the same locations and the citizens of Hong Kong will retain their passports with the same travel privileges.

Beijing's Policy Toward Hong Kong

Between now and 1997, with less than one-half decade of transition before China regains its sovereignty over Hong Kong, Beijing's policies regarding Hong Kong will become increasingly crucial. A basic framework for the social, legal, political, and economic systems of post-1997 Hong Kong are coming into being. In the face of this situation, local residents in the Territory will feel increasing pressure to decide their future. Likewise, foreign investors must be more aware of the potential benefits and risks in the Hong Kong market.

It is important to point out that not only Beijing's Hong Kong policy will dominate Hong Kong's future. Considering current events and trends, it is

probable that, unlike the former U.S.S.R., the People's Republic of China will remain politically and economically stable in the future. This positive outlook for China will then have a major effect on the future of Hong Kong. As Zhang Wuchan, professor of economics at Hong Kong University comments, "if China continues its open door policy, it will be the most positive factor to Hong Kong. The future of China is the future of Hong Kong".¹ The major political posture of China will determine Hong Kong's future.

This section discusses Beijing's Hong Kong policies and mainland China's major changes in the decade before 1997. These observations are made by examining the factors upon which the policies have been and will be made, such as, Beijing's perception of the issues, its economic needs in regard to Hong Kong, its limitations in dealing with the issues, and its considerations of policy, benefit and costs.

In general, Beijing's basic positions, as indicated in both the Joint Declaration and the Basic Law draft, involve three aspects: 1) sovereignty over Hong Kong; 2) maintenance of Hong Kong's social and political stability; and 3) continuation of prosperity in the Territory of Hong Kong. The Beijing leaders label this approach as "One Country, Two Systems" after China resumes its authority.

To the Chinese leaders, sovereignty over Hong Kong is the most important principle involved in the issue. Seemingly, Beijing's strong posture in this respect has not so much to do with its communist nature as with the notion of national

integration. For this reason, Beijing rejected Britain's stance that the "British presence" in Hong Kong after 1997 was a condition for stability and prosperity of the region as a "de facto renewal of the unequal treaties."² During the early negotiations with the British, Beijing made its position clear that the principle of sovereignty was not negotiable. It appears that Beijing was so attached to the issue of sovereignty that it was ready to stand opposed to the British by any means, even at the expense of Hong Kong's economy.

Maintenance of Hong Kong's social and political stability has been another of Beijing's major positions over the issue. To Beijing, methods utilized by the Hong Kong government to improve the efficiency of the administration are welcome, but any changes in social or political structure that could possibly lead to instability in Hong Kong are not acceptable. Therefore, the event that most bothered Beijing involved the political reform planned by the British government concerning certain seats on the Legislative Council. In the reforms, it proposed a shift from the previous appointive system to an elective system. This political reform appears to worry the Chinese leaders because it raises the possibility of new instability in the Territory. Since the elections have stimulated a considerable degree of party politics in Hong Kong, the Chinese leaders are apparently concerned about the development of a situation that they feel will be difficult to defuse in the future. In the face of pressure from Beijing, the Hong Kong government cancelled its plan for the election in 1988 and postponed it to the 1990s.

Beijing's third position is that prosperity in Hong Kong must be preserved. After decades of development, Hong Kong's economy has become one of the miracles of Asia. The Chinese leaders have demonstrated concerns that this "golden goose" would be damaged by negative factors. For years, Beijing has been careful not to contribute to the local business instability by excessive political involvement. In the face of a considerable outflow of local capital, Chinese officials tried, from time to time, to convince businesses in Hong Kong to maintain the prosperity in the Territory. At the same time, China in recent years has increased its commercial and financial investment in Hong Kong to create new sources of funds for local manufacturers and real estate developers. Moreover, to maintain the stability of the local monetary system, Beijing has joined the Hong Kong government in bailing out certain financially troubled banks.

Several years of efforts have brought China its economic power in Hong Kong. China's economic activities in Hong Kong involve major sectors such as banking, securities trading, import and export, real estate, manufacturing, transportation, and service. In 1990, it was estimated there were more than one thousand mainland companies based in Hong Kong.

Also, Beijing's continuing efforts to boost its link with Hong Kong prior to regaining sovereignty in 1997, are particularly apparent in the British Colony's property market, where, according to a survey,³ China-backed companies have displaced the Japanese as the largest group of foreign investors.

Because of the Chinese economic involvement in Hong Kong, China's interests have increased its own commitments to local development. Also, China, not another country, is going to have Hong Kong after 1997. Any damage to this "golden goose" at the present time is not desirable for the future.

Based on the above factors, it appears that Beijing will continue its efforts to maintain stability and prosperity in Hong Kong. Further, Beijing will utilize Hong Kong for domestic development and continue to attract investment and technology from Hong Kong for China's economic development. As a major monetary center of the world, Hong Kong will surely continue to provide many conveniences and opportunities for the Chinese monetary development in the coming years.

Maintaining a continuance of the current system in Hong Kong after 1997 will be Beijing's basic Hong Kong policy. For economic and political considerations, both in the short term and the long term, this policy will motivate Beijing to apply this experimental model of "One Country, Two Systems" as a solution to the future of Hong Kong.

The Chinese leaders are also well aware of the importance of the alignment of Beijing, London, and local big business in Hong Kong to maintain the stability and prosperity in Hong Kong. Since the Joint Declaration, cooperation between China and Britain has developed smoothly in spite of certain disagreements over various issues. So far, Beijing appears to be happy with the British help and concessions that have enabled China to increase its influence

over the development of the Hong Kong reunification issue.

A major strategic consideration by the Chinese leadership is to maintain stability and prosperity in Hong Kong, and to work with the local elites because of their deep rooted connections in the Territory. Moreover, those who enjoy political and economic prestige in local affairs will more likely accept Beijing's position, maintaining the status quo in Hong Kong. Therefore, Beijing has developed numerous close ties with important firms in the Territory. Also, because contacts between mainland China and Taiwan will continue to increase in the coming years, Beijing will take further steps in its reunification efforts, such as the establishment of certain joint committees and organizations for mutual interests. In this respect, Hong Kong will still be able to provide the ideal "third party place" for such organizations.

In addition, international support of the Hong Kong issue is of significant importance to the Beijing Government. Economically, the Beijing needs recognition of Hong Kong's post-1997 status from various international organizations. Politically, if Beijing succeeds in convincing international opinion of the feasibility of "one country, two systems" as a solution to the Hong Kong issue, it will provide Beijing with a favorable climate in which to deal with other issues, especially that of the integration of Taiwan as the Beijing Government has desired for many years. Meanwhile, Beijing will continue its efforts, to its own benefit, to widen the scope of Hong Kong's foreign relations.

Questions for 1997

Much has been said and written about the "Brain Drain" in Hong Kong or the exit of educated Chinese from Hong Kong prior to the change in 1997. Many people have immigrated to the U. S., Canada or Australia, but many have returned with foreign passports to guarantee their freedom to leave at will after the communist government takes over. It should be noted though, that there is only a small percentage of the educated population of Hong Kong that has ever been concerned enough or able to either exit Hong Kong or to obtain foreign passports.

The main concern of the Hong Kong population then has not been economic stability of the Territory after 1997 as this appears secure. The real concern has been the departure of the British military from Hong Kong and the entrance of the People's Liberation Army. This represents, in effect, the loss of personal freedom, at least to the extent the Hong Kong People have enjoyed for over a hundred years.

CHAPTER III

THE BUSINESS ENVIRONMENT OF HONG KONG

The Economic Factors

When the communists took over China in 1949, the economy of Hong Kong was no better than that of other major cities in China. In fact, the cities of Shanghai, Tianjin and Canton were more advanced economically than Hong Kong.

As the communist government exerted more and more control during the 1950's many business and professional people fled to Hong Kong with their families and their wealth. During this period, thousands of businesses were started in Hong Kong utilizing low cost labor to export from the Territory to other parts of the world, especially the United States and Great Britain.

Also, either by design or by accident, Great Britain instituted a system of business law export regulations which were more favorable to capitalist entrepreneurs than any other system in the world. This condition, coupled with the immigration of thousands of previously successful capitalists with their previously acquired capital, caused the Hong Kong economy to explode from the 1960's to the present.

With this combination of business expertise and capital from China, low cost labor, and the most ideal platform of economic laws and free trade practices, this "Barren Rock" as it was called in the early 1800's blossomed in front of the

barbed wire border entrance to the People's Republic of China.

Today the barbed wire remains at the border from Hong Kong to China, but instead of Chinese refugees fleeing outward to the Colony, well dressed Hong Kong businessmen carrying cellular phones are streaming back toward the mainland in search of profit.

Hong Kong has become, over the past ten years more of a tourist, banking and service center rather than a low cost manufacturing center. Factory labor is now as expensive in Hong Kong as in some European countries. Real Estate values in prime office areas are now equal to or exceeding those in Japan. The cost of managerial or engineering personnel in Hong Kong is now equal to the U. S., and the concentration of luxury automobiles is the highest in the world.

Table 1 provides selected economic data for the year 1989, 1990, and 1991.⁴

Table 1 - Selected Economic Statistics, 1989 - 1991:

	<u>1989</u>	<u>1990</u>	<u>1991</u>
1. GDP (Gross Domestic Product - US \$ in million)	62,924	70,097	79,210
2. GDP projected average growth rate(%)	2.3	2.4	3.6
3. GDP per capita (US \$)	10,922	12,084	13,534
4. Public expenditure as % of GDP	15.4	17.0	18.3
5. Inflation(%)	10.1	9.8	10.5
6. Unemployment(%)	1.3	1.4	1.4

Hong Kong has become an affluent, service-oriented economy. Were it not for what looks to be a nasty spell of double-digit inflation, most of Hong Kong's citizenry could be looking toward a virtually secure economic future. Per capita GDP grew 2.4 percent in 1990 and 3.6 percent in 1991. Hong Kong's economy will grow much faster in the next few years because of the booming Chinese market.

Review of Social Factors

With a total of 98% of Hong Kong's population being Chinese and the vast

majority of these people being Cantonese, it is important to consider this special ethnic group in regard to social factors involved in the transfer of sovereignty in 1997. It is equally important to note that until the mid 1950's, the division between Hong Kong and South China was much less distinct. It was only after China began to shut itself off from the outside world in the late 1950's that a split occurred between the larger Cantonese population of Guangdong Province and Hong Kong.

In a sense, from a cultural point of view, 1997 represents somewhat of a reunion of a people and of extended families. But, over the past 20 years, the border between the new Territories and Hong Kong has been easy to cross. Cantonese families, separated for years, were allowed to meet again. At first, it was the Hong Kong citizens who were allowed to cross the border back into China, but now it is not difficult for Guangdong citizens to apply for entrance into Hong Kong for business or pleasure.

As 1997 approaches the interface between the Cantonese Chinese on both sides of the border will increase; and as Guangdong continues to prosper, the economic and social differences will be reduced, but a vast difference will still remain. Hong Kong and Guangdong are getting richer and more developed each year, but there will still be a contrast between the two well into the next century.

From a social point of view, Hong Kong holds great influence over South China. Hong Kong television and radio broadcast far into Guangdong Province with both Chinese and English speaking programming. Only ten years ago,

Chinese men and women in South China dressed very traditionally, but now the western styles of Hong Kong are spreading throughout South China.

Hong Kong residents in pursuit of quick riches in South China real estate has been an important factor that has aided South China's economic boom. Thanks primarily to Hong Kong investment, Shenzhen has grown over the past decade from a rural town into a city with 2.5 million residents, traffic gridlock and a stock market. Recently in Shenzhen, about 600,000 people battled police and one another in a scramble to buy stocks.⁵

There are two distinct markets in South China real estate. One for Chinese nationals and one for foreigners. Although growing fast, the domestic market is well behind the one for foreigners. Housing sold to "outsiders" - a majority of them from Hong Kong and the remainder from Taiwan - is priced far beyond the means of ordinary Chinese citizens. This market was awakened last year after hard-liners in the Chinese communist leadership toned down their hostility toward the idea of private property ownership.

In terms of social trends, there is a real question as to who will take over whom in 1997. If the current trends continue, as they have in the past few years, Hong Kong will be the social capital of China and especially South China, in terms of dress, entertainment, etc.

Unfortunately, the social influence of Hong Kong over China extends not only with positive factors, but also in negative ones. Prostitution, drugs, criminal societies, and diseases such as AIDS are also spreading across the border into

China. As China's senior leader, Mr Deng Xiao Ping stated "When you open a window, you not only get fresh air, but some flies."⁶

Hong Kong as the Ideal Trading Center

In order to understand Hong Kong's future direction, it is important to understand where it has been. Economically, the growth of the past twenty years has been much faster than that of Western industrialized countries. The engine of economic growth and development in Hong Kong has always been trade. In the past three decades, Hong Kong's total trade has increased more than 34-fold. In fact, the value of its visible imports and exports is almost twice the size of its GNP.⁷

Hong Kong is pure capitalism at its best, just outside the door of the only major surviving communist country in the world. The absence of import restrictions or duties and the ease of business transactions allowed by law, make Hong Kong a place where almost anyone with reasonable intelligence and a will to work can make money.

The legal establishment of business in Hong Kong is by far the easiest in the world. "Shelf Companies" can be purchased for only a few hundred U. S. Dollars and put into immediate operation doing business in any type of legal activity. It has been said that a person can fly into Hong Kong in the morning and be legally open for business with their own company in the afternoon.

Hong Kong is one of the world largest ports, with a 14 percent⁸ increase

in tonnage in 1990. Port terminal expansion projects underway and planned will enable Hong Kong to significantly increase (by a factor of 3-5 times)⁹ its throughput capabilities.

By 1986, the need for additional airport and port infrastructure became apparent, with existing facilities reaching saturation more rapidly than expected. This led to the initiation of the PORT AND AIRPORT DEVELOPMENT SCHEME studies in March 1988 and other studies. The intent was to provide for the provision of adequate and expanded port and airport facilities, together with the development of a related infrastructure network. The cost for the new airport and related core projects was estimated at around HK \$ 100 billion (US\$ 14 billion).¹⁰ This is one of the most costly and aggressive development programs ever undertaken. It will provide Hong Kong with one of the largest and most advanced sea ports and one of the largest passenger and cargo airports in the world.

With this program, the Hong Kong Government will open a flood gate which will make it even easier to export from China and import to China. Goods, services and people always take the path of least resistance, and Hong Kong will be that path to and from China for many years to come. With these new developments, Hong Kong's position as a trading center can only improve and prosper.

However, the development of the airport, which is scheduled for completion in mid-1997, has been stalled by a dispute between British and

Chinese officials over its financing. Beijing is concerned that the cost will saddle the post-1997 Beijing government with excessive debt.

There is a new proposal under consideration by both the Chinese and British Governments. Under this proposal, the new funds could be raised through the sale of about 153 acres of land along the railway link, which will be auctioned off in addition to the sale of 124 acres sold each year under a previous Sino-Hong Kong Agreement. This proposal would reduce the project's maximum debt level from HK \$ 73 billion (US \$ 9.5 billion) to HK \$ 22.9 billion (US \$ 2.9 billion).¹¹

The final Agreement has still not been resolved.

Hong Kong as a Financial Center

Hong Kong is a major regional finance center with 168 fully licensed banks operating in the Territory. Of the 138 licensed overseas banks in Hong Kong at the end of 1990, over half were among the world's top 100 banks.¹² Banking services such as letters of credit, document collection, and international remittance are widely available. Residents as well as non-residents may maintain bank accounts denominated in any of a variety of foreign currencies. Risk of financing receivables can be evaluated via locally available credit information. Prospective exporters can make use of banking relationships to determine credit risks when entering into a trading relationship.

The importance of trade, finance and competitive pressures have resulted in a high level of bank efficiency in providing import payment services.

Standardized payment terms are available, but exact specifications depend upon negotiations between importers and exporters.

The Hong Kong Dollar has been, for many years, a stable currency recognized on the world exchange market. The value of the Hong Kong Dollar has been pegged to the U.S. Dollar, and should remain so for the foreseeable future. The Hong Kong Government pursues a free trade policy and does not impose counter trade requirements. Some products are subject to local excise taxes on a nondiscriminatory basis, but all goods enter Hong Kong free of customs duty.

There are currently 20 licensed banks in Hong Kong with U.S. ownership, representing all top ten U.S. banking institutions.¹³ Other banks, including Japanese and European, maintain extensive correspondent banking relationships with the United States.

Hong Kong has maintained one of the most active stock markets in Asia for years. Within the past few years, the mainland government has authorized the establishment of stock markets across the border in Shenzhen and Shanghai. As all other aspects of trade and commerce expand, this area of the economy will expand as well.

Hong Kong is one of the major banking centers of the world, and as compared to Tokyo, is the second largest banking center in Asia. As a sign of things to come, the Bank of China, the main financial institution of the P.R.C., recently completed the new Bank of China tower in the Central District of Hong

Kong Island. This 75 story building, towering over the financial district, and also over the Hong Kong Shanghai Bank, and the Standard Charter Bank, speaks of the future domination of this financial center by the P.R.C.

There is an interesting condition which is strengthening the Hong Kong currency. Over the past ten years, the Hong Kong Dollar has been spreading deeper and deeper into South China. Today, in some parts of Shenzhen, it is difficult to use Chinese currency. Many times, major hotels will only accept payment in Hong Kong Dollars.

In recent years, the Chinese market has been more and more opened to the outside world. Chinese export trading has increased dramatically, and the Chinese currency (RMB) has continued to depreciate. This should cause the actual or black market exchange rate for the Chinese currency to move closer the official rate.

The Tax System of Hong Kong

Another factor that makes Hong Kong the world's ideal haven for capitalists, is its tax system. Sales taxes do not exist. Property tax is low. Personal income tax is held to a maximum of 16%. While corporate tax is held to a maximum of 18%,¹⁴ with many special deductions and conditions, the actual tax level paid by citizens and companies is usually much less. Many times, small Hong Kong companies pay little or no taxes under the system of tax deductions.

There are many reasons why the Hong Kong Government can provide a

good infrastructure with such a low tax level. The Government is, first of all, debt free. Secondly, the Government holds heavy equity in highly inflated land holdings. Other positive factors include the absence of a military and any form of old age social security program. Many expensive social programs, common in both the U.S. and Europe are not evident in Hong Kong.

Expatriate Life for Americans in Hong Kong

In 1990, the non-Asian population of Hong Kong totalled more than sixty thousand, with the biggest single group within this number (23,000) being American. Expatriate families can live under similar conditions as they would in their own countries, if the companies sponsoring them can afford the expense.

Hong Kong has become, over the past decade, one of the most expensive places in the world to live. It is common for a multinational company to spend US \$ 250,000 to US \$ 500,000¹⁵ per year in Hong Kong to cover the total living cost of senior executives and their families. For example, a typical western style, three bedroom apartment, in a good location rents for US \$ 3,000 to US \$ 5,000 per month.

More recently, a new kind of expatriate has developed in Hong Kong. Some call this the "Brain Gain" rather than the "Brian Drain." After years of fear that Hong Kong would lose its best educated workers in the brain drain to the West before China's take-over in 1997, the Colony's booming economy is not only keeping many productive citizens home, it is attracting more skilled workers from

the recession wrecked U.S.

Current projections by Hong Kong officials predict that the number of American expatriates in Hong Kong may double by 1997. These are middle managers, engineers and technicians coming to Hong Kong to seek employment, in many cases, with Hong Kong companies.

Another trend in Hong Kong is to promote Chinese professionals to higher levels of senior management within foreign companies. The total cost difference is so dramatic considering the high living and home leave costs for expatriates, that many foreign companies are now opting for Chinese executives who may receive the same salaries as their expatriate counterparts, but do not require the expensive living and home leave costs.

Hong Kong as The Commercial Center of East Asia

Because of its character and its location, Hong Kong has become the center of gravity of the new East Asia. Not only major multinational corporations, but publishers, broadcasters, financial traders, and lawyers have found Hong Kong an ideal base of operations.

The American Chamber of Commerce in Hong Kong concisely summarizes the reasons why so many U.S. companies have selected Hong Kong as a base for their operations. The factors, in order of importance, are outlined as follows:

1. Geographic location - No center is better located than Hong Kong to support commercial activities in China, South East Asia, and East Asia.

2. **Communications Network** - All domestic and international services are modern, efficient and relatively inexpensive.
3. **Infrastructure** - Hong Kong has the world's second largest container port, and the second busiest international airport. Hong Kong is the base for one of the world's best airlines - Cathay Pacific Airways. Also, many major shipping lines are headquartered in the Territory making it one of the busiest ports in the world. In addition, Hong Kong offers sophisticated financial, educational, manufacturing, and recreational facilities.
4. **Low Taxes** - Hong Kong's tax system is simple, efficient and fair. There is no withholding tax on interest.
5. **Favorable regulatory environment** - Hong Kong's Government maintains a laissez faire economy and non-interventionist practice, congenial to commercial development.
6. **Presence of the China market** - As the "Gateway to China",¹⁶ Hong Kong is the leading investor in China, the place for over one-third of China's external trade, and a base for a large number of directly and indirectly P.R.C. controlled companies, banks agencies, and organizations.

Hong Kong's position as a tourist center has only been enhanced as the borders into China have continued to be opened in recent years. Not only are many Westerners drawn to Hong Kong and in turn to China, but millions of Chinese from Taiwan, the U.S. and other countries make their way through the Territory each year to visit relatives and tour their homeland. During the most

important holiday of the year, The Chinese New Year, hundreds of thousands of overseas Chinese fly into Hong Kong and then pass across the border into South China through one very congested customs crossing.

The Territory is known for several of the best hotels in the world, with oriental service unknown in the Western world. Within these hotels, as well as along many crowded side streets, are many of the best and most famous restaurants in the world -- all types of Chinese, Japanese, French, Indian and even Mexican fare at every level of quality are available almost any hour of the day or night. Hong Kong is truly an international city and an exciting tourist attraction in and of itself. This fact is one of the biggest assets of the Territory.

CHAPTER IV
THE TRADING RELATIONSHIP BETWEEN
THE UNITED STATES
&
THE PEOPLE'S REPUBLIC OF CHINA VIA HONG KONG

Past Trading Trends Between the U.S., The P.R.C. and Hong Kong

In the years after World War II, Hong Kong was known for its cheap labor and poor quality products. Simple labor intensive toys and other commodities were produced in the small to medium sized factories of Hong Kong and the adjoining New Territories and exported directly to the U.S. and other Western countries.

Until U.S. President Nixon visited Beijing in the early 1970's to re-open relations between the U.S. and the P.R.C., there was little or no trade from China directly to the U.S. Some trading was done from the P.R.C. via Hong Kong, but not a significant amount.

This situation has changed dramatically in the past fifteen years. Approximately 40%¹⁷ of China's current external trade today passes through Hong Kong. More than two-thirds of Hong Kong's GDP is generated outside of the manufacturing sector, much of which has moved to adjacent southern China. The

shift from a manufacturing dependent economy is evidenced by the constant level of exports in 1989 and 1990, while re - exports have grown more than 20 percent each year. Two way trade with China was expected to reach US \$ 60 billion in 1991.¹⁸ Again, Hong Kong's future depends not only on its own efforts to construct a post colonial administration, but also upon its strategic position as the doorway to China and its inseparable relationship with the Mainland.

Table 2 shows the recent trade statistics between the United States and Hong Kong.

Table 2 - U.S. and Hong Kong Trade Relationship, 1989 - 1991 (US \$ millions)¹⁹

	<u>1989</u>	<u>1990</u>	<u>1991</u>
1. Total Hong Kong annual exports	73,142	82,140	90,354
2. Total Hong Kong annual imports	72,151	82,481	90,575
3. Exports from Hong Kong to the U.S.	9,251	8,520	8,179
4. Imports from the U.S. to Hong Kong	5,927	6,648	7,246
5. U.S. share of Hong Kong's total imports (%)	8.2	8.0	8.0

The United States was Hong Kong's largest export market absorbing \$8.5 billion goods, and accounted for about 10.5% of the total exports in 1990, although it fell to about 11% in the recent two years.

Table 3 provides the major products and services traded Between the U.S. and Hong Kong.

Table 3 - The Principal U.S.-Hong Kong Export and Import Products and Services²⁰

<u>Exports to Hong Kong from U.S.</u>	<u>Imports from Hong Kong to the U.S.</u>
Machinery & transport equipments	Articles of apparel & clothing accessories
Electrical machinery apparatus & appliances & parts	Watches & clocks
Artificial resins & plastic materials	Baby carriages, toys, games & sporting goods
Office machines & automatic data processing equip.	Parts for office/auto data processing machines
Tobacco manufactured	Telecommunication equip. & parts

Exports of all textile goods accounted for 39% of Hong Kong's domestic exports in 1990.²¹ Other major categories included electronics and timepieces. Furthermore, the Government's environmental-related projects also offered U.S.

consulting and engineering firms excellent prospects. Finally, if controversy with China over construction of a new airport is resolved, U.S. companies in the aviation field may enjoy excellent prospects.

The following statistical information shows Hong Kong's past trade balances with its three leading partners - P.R. China, Japan and the United States.

Table 4 - Hong Kong's Trade Balance with Its Three Leading Trading Partners in 1990 (US \$ in millions)²²²

<u>Partners (Countries)</u>	<u>Trade balances with Hong Kong</u>
China	-24,188
Japan	-11,703
USA	1,870

About 40% of re-exports consist either of goods made in China and shipped abroad via Hong Kong, or goods imported into China from abroad via Hong Kong. China, Hong Kong's chief supplier, accounted for about 37% of the territory's total imports.²³ The United States is the primary destination for finished re-export goods. Japan remained the largest source of Hong Kong's imports retained for local use.

Optimism Over China's Reforms

Since the 1980's, the China market, motivated by economic reforms instigated by the Central Beijing Government, developed rapidly. This development is now spontaneous and almost uncontrollable. Many experts agree that the economic trends, especially in South China, are now irreversible. It appears that there can be no turning back the clock of reform in China. It is also clear from recent Chinese experience, that democratic politics are not a prerequisite for the development of a market economy.

Never before has economic growth been driven in such a large part by widespread optimism over Hong Kong's future role in the Chinese Economy. Mainland buyers have purchased approximately half of the HK \$ 14.7 billion of commercial property buildings²⁴ that were sold in the last year. Many of these buyers, armed with cheap financing from Mainland Chinese banks, came from China's booming southern Provinces.

Another factor relating to the stability and growth of the Territory is the change of attitude toward China over the past three years. Immediately after the June fourth, 1989, Tiananmen incident, world-wide sentiment was very strong against the actions of the Beijing Government. Gradually, the Communist Leadership in Beijing proved to the Bush Administration that in spite of the communist language being spoken, China was moving toward openness and a more liberal market driven economy.

A June, 1991, survey by the American Chamber of Commerce, indicated

substantial improvement in U.S. business sentiment toward Hong Kong as compared to a similar survey in early 1990. Fifty-six percent of respondents said that their Hong Kong company performance would be "very good" over the next 3 years and 42 percent said that it would be "satisfactory."²⁵ In 1990, only 28 percent had the first answer and 65 percent gave the second. Attitudes toward investing in China showed more dramatic improvements, with 3 times more respondents giving China "favorable" or better investment ratings in 1991 than in 1990.

Other than manufacturing in Hong Kong and trading goods on the export market, there are two major export methods currently practiced in Hong Kong.

As the labor cost in Hong Kong, even for unskilled labor, has skyrocketed over the past 20 years, most Hong Kong factories have moved across the border into Guangdong Province. In many cases, they maintain their original factories in Hong Kong, but transform them into final assembly or quality control centers. The real manufacturing is in South China. The basic products are produced in South China by subcontractors, joint venture companies, or wholly owned Hong Kong companies. These products are shipped to Hong Kong for final assembly and/or quality control and then re-exported to the world market. This "re-export trade" has accounted for a major share of Hong Kong's increase in exports during the past years.

Another means of trade for Hong Kong is to act as traders for Mainland Chinese factories. In many cases, Chinese manufacturers lack the ability or

knowledge necessary to market their products on the world market. They may also have less ability to enter into direct foreign contracts or to obtain export licenses. Many major Hong Kong trading houses are known in the Cantonese language as "Honggs." These traders, which in many cases were the original "Taipans" of Hong Kong in the early 1800's, are now massive multinational companies with billions of U.S. Dollars in trading per year. At this point, 40% of the export output of the People's Republic of China is funneled in this way through Hong Kong.

The secret of Hong Kong's current economic boom in the face of 1997, lies in the increasing merger of Hong Kong with adjoining Guangdong Province. In the late 1970's, Deng Xiao Ping²⁶ had the foresight to establish various Special Economic Zones or SEZ's along the coast of China. The most important of these is Shenzhen,²⁷ which adjoins the border of the new Territories and extends westward for a few miles. Beyond this second border is another SEZ (Hwang Poo) extending further toward the city of Guangzhou (formerly Canton). The closer to Hong Kong one gets through this series of three borders, the more relaxed the business laws become. Tax advantages are offered in increasing numbers as one nears the border to Hong Kong, and even the medium of exchange gradually transfers from the Chinese RMB to the Hong Kong Dollar.

For the past 15 years, Hong Kong factories have continually moved their operations across the border into Guangdong Province. Currently, Hong Kong companies employ only 700,000 factory workers in the Colony, but they employ

over 3,000,000 in Guangdong Province.²⁸

As export restrictions continue to relax and more Chinese manufacturers are allowed to deal directly with foreign customers, this trend may decline. The most important factor which will continue to make Hong Kong China's export window to the world is its infrastructure and geography, but a critical factor in Hong Kong's future is the political action of the new Clinton Administration of the U.S. Government.

China's Most Favored Nation Status

One major point of concern at the present is whether or not the new Clinton Administration will attempt to revoke China's "Most Favored Nation" (MFN) status. Unfortunately, many people do not understand the basic facts of the situation in China. Little is mentioned by the U.S. press that countries with MFN status are not favored in any way, but that MFN is a "normal" economic status.

Under normal or MFN status, there are no discriminatory duties placed on products being imported to the U.S. For example, commodities like toys, hardware and clothing may be subject to only a 5% to 7% duty, with relatively high annual quotas. Another aspect of the MFN status is that there are few restrictions concerning the import of high technology that could be used for the production of military equipment.

When a country loses the normal MFN status, duties on various products

can be increased as high as 100% and strict conditions can be placed on the import of high technology equipment such as computers and computer chips.

Many people in the United States respond to the human rights abuses and trade policies of the Beijing Government, with demands for the elimination of China's MFN status or at the least the attachment of stringent conditions. Non-Chinese people do not understand that these actions will result in more harm than good to both the Chinese and world's economy and to the Chinese people.

China has a long history of domination and abuse by foreign powers. Even with the problems communism has caused in China since 1949, it is important to note that the government has kept China free of foreign exploitation. The leaders in Beijing are very aware and proud of this, and for this reason, they will only succumb to this type of foreign pressure when they have no other choice. They would rather have China suffer major economic set backs for many years than to bow to U.S. pressure. The sovereignty of Beijing is of much more value than the MFN status.

To revoke the MFN is a slap in the face of the Beijing government before the whole world. Beijing will not react with reforms, but, with anger, it will increase isolation or sever many relations with the West or the United States. The short-term result will be increased human rights abuses. The end result will be that the liberals in Washington, protesting against the human rights violations, will indirectly increase the problem.

A better approach to the problem of human rights violations in China

would be to voice disapproval while increasing trade, establishing more joint ventures and lending more money to China. This would result in a more prosperous Chinese population, more open to and more knowledgeable of the outside world, and effect more change in the Beijing government than anything else.

In general, the Chinese people have a favorable view of Americans. But, if China's MFN status is revoked, the real victims will be the over one billion Chinese people. If China's MFN status is revoked, the real loser will be Hong Kong and Guangdong Province. It is difficult to calculate the losses for Hong Kong if the MFN is revoked, but they will be very serious. Because of the importance of re-exports, renewal of Most Favored Nation (MFN) status for China by the United States is essential for Hong Kong's trading health. Revocation of the MFN status will dramatically raise U.S. tariffs on Chinese goods and plunge Hong Kong's re-export trade into a tailspin. To put this in simple terms, a loss of the MFN status will close the Gateway between China and the U.S.

Future Trading Trends Between the U.S., the P.R.C. and Hong Kong

Much has changed in the past twenty years concerning the trading relationship between the U.S., the P.R.C., and Hong Kong. Hong Kong has become a high cost service center with much of the low value fabrication work being transferred to Hong Kong joint ventures or wholly owned companies across

the border in China. Factory labor costs in Hong Kong have risen to levels equal with Korea, Taiwan, and Singapore. For example a skilled worker in Hong Kong is paid approximately US \$ 20,000 per year. Another factor that makes the production of export goods so expensive in Hong Kong is the high cost of land and factory floor space.

Most small factories are located in high rise buildings where two small factories can be located on one floor. The cost of purchasing 2,500 square foot of warehouse space can be in the range of US \$ 250,000. This high cost of commercial space coupled with the high utility and telephone costs and higher labor costs, makes Hong Kong one of the most expensive cities in the world to produce goods. These cost factors are one of the major reasons that much of the actual factory production has moved from Hong Kong into south China over the past ten to fifteen years.

A much higher percentage of the Hong Kong population is now working in the service sectors, banking, trading and tourism, which accounts for the reduction in real physical exports from Hong Kong to the U. S. These numbers are continually being reduced, while at the same time, the trading transactions via re-export and other means of trade are causing the territory to expand continually.

It should also be noted that although these real physical exports to the U.S. from Hong Kong are on the decline, the total dollar volume of exports from Hong Kong is rapidly increasing. As mentioned earlier, this situation can be explained by noticing several factors. First, many Hong Kong companies have moved their

manufacturing into southern China. They may bring products into Hong Kong for final assembly and quality control, but they are again "re-exported" as finished goods. These re-exports now make up a large percent of Hong Kong's total export products.

Another factor that has caused Hong Kong's total exports to increase is that many organizations in China do not have the right to enter into export contracts directly with foreign organizations. For this reason, they must contract with major Hong Kong traders to pass goods through Hong Kong to the world market. This trading activity also increases Hong Kong's total export turnover, without increasing the actual production of the Territory.

Trading Trends Between Hong Kong and Other Asian Countries

The relationship China has with Taiwan and South Korea is still strained and direct trade remains difficult or even impossible due to government regulations on both sides. The answer, of course, is to use Hong Kong traders as the connecting link between these countries.

Hong Kong, as a trading center, has for many years benefitted from the difficult political situation of opposing forces in Asia. China and North Korea, as communist states, have opposed Taiwan and South Korea since the late 1940's. In a sense, Hong Kong has prospered as an intermediary between enemies, and this role is profitable for Hong Kong businesses. This situation also directly relates to the U.S., in that both South Korea and Taiwan have been close allies

with the U.S. for the past thirty to forty years.

Other countries within Asia are affected to some extent by these opposing ideologies with one major additional factor. Many Chinese have emigrated from China over hundreds or thousand years, and many of these people were successful entrepreneurs, with financial capital and business experience.

Chinese business people dominate many countries within Asia, especially, Singapore, Malaysia, Indonesia, Vietnam and Thailand. Hong Kong, because of its special status and location, functions as a hub for these many Asian business people. In many cases, the local Chinese business communities dominate not only the economies of these countries, but their governments as well. The result is a strong tendency on the part of these Chinese business people to increase trade and investment in China. To accomplish this, they need a gateway to the vast Chinese market and Hong Kong is the obvious entry point.

Trading Trends Between the U.S. and Hong Kong After 1997

Hong Kong will remain a strong trading partner to the U.S. after 1997 and well into the next century, but there are many factors that will change this relationship. In the past, Hong Kong has been a trading center through which goods from all of China have passed. Also, many imported products from the U.S. to all parts of China pass through Hong Kong. This is destined to change.

Hong Kong will remain a trading center for only South China in the future. The Beijing Government is expanding the special economic zones all along the

coast of China. There is also much port development in the cities of Fujian, Shanghai and Tianjin. The Beijing Government does not want to limit itself to only one "Window to the World," but wants to open several windows to the North.

This is not to say that Hong Kong as a trading center will decline after 1997. The opposite is the case. The reason Hong Kong's importance will increase as a trading, service, banking and tourist center is twofold. First, Hong Kong will continue to be the trading capitol of Guangdong Province. This region will be a major economic force by the year 2000. The second reason Hong Kong will grow, is that in 1997 the new Port and Airport Development Program will have been completed. Airports in nearby Macao and Shenzhen will also be completed to make the region at the mouth of the Pearl River Delta one of the most modern air and sea ports in the world. It is only common sense to assume that if this doorway to South China is widened and modernized, more trade between the U.S. and South China will result.

CHAPTER V
TRADE AND INVESTMENT ISSUES/BARRIERS
IN
HONG KONG & SOUTH CHINA

Joint Venture Establishments

In spite of the political ideology expressed by the Beijing Government in the north, the economic transformation in the south is significant. Hong Kong and Guangdong Province are increasingly becoming one region. There has been much talk over the past few years concerning the "four Dragons of Asia" namely, Hong Kong, Taiwan, South Korea, and Singapore. Now Guangdong, the Province with a population of over 64,000,000 is said to be the fifth Dragon of Asia. Hong Kong/Guangdong Province or the developing region of "Canton" is rapidly becoming one of the most powerful economic forces in the world, backed by the more slowly emerging "Sleeping Giant" of China.

Foreign joint ventures have been established in Hong Kong over the recent years, but the foreign companies are now following the same methods as Hong Kong companies. Foreign joint venture companies located in Hong Kong are actually establishing factories across the border in China to take advantage of low cost labor.

The following information shows the investment by U.S firms in the Hong

Kong manufacturing sector.²⁹ In 1989, the total foreign direct investment in the Hong Kong manufacturing sector was US \$ 3,812 million. The U.S. direct investment in the Hong Kong manufacturing sector accounted for US \$ 1,191,02 million, on 31.2% of the total foreign direct investment. The three principal foreign investors in the manufacturing sector were U.S., Japan, and China, respectively.

Table 5 - The Three Principal Foreign Direct Investment in the Hong Kong Manufacturing Sector in 1989 (US \$ in millions)

<u>Country</u>	<u>Total Investment</u>	<u>% of Total Investment</u>
<u>USA</u>	1,191.02	31.2%
<u>Japan</u>	1,107.95	29.1%
<u>China</u>	407.44	10.7%

Incentives and Advantages Offered in China's Special Economic Zones (SEZs) Adjoining Hong Kong

A major advantage of the SEZs is that they offer foreign organizations access to the low cost labor of China, while at the same time, offering advantages over operating in other areas of China. The SEZs in general have better infrastructures than other parts of China. They also have much better access to

raw materials. In South China, the proximity of the SEZs to Hong Kong is a big advantage.

There are different levels of SEZs and each offer increasingly favorable incentives to foreign companies and joint ventures in regard to taxes. Export licenses are much easier to obtain or in some cases are not required in the SEZs. In Shenzhen, the SEZ adjoining Hong Kong, much of the Hong Kong business law prevails.

Barriers To Trading and Investment By U.S. Firms in Hong Kong and China

The main barriers to trading and investment by U.S. firms in Hong Kong and South China are more cultural and political than economic. As U.S. politicians protest against human rights violations by the Beijing government and the alleged use of prison labor for exports, association with China is sometimes not popular in liberal circles within the U.S..

There are other major trading barriers between the United States and Hong Kong/China, such as, trade imbalance and protection of intellectual property of U.S. firms. This is especially the case in the production of electronic components. Some highly technical components are manufactured in Hong Kong, but labor intensive assembly is now done for the most part in China. One major disagreement between the U.S. government and the Beijing government is currently the subject of protection for U.S. patents and intellectual property rights. In the past few years, many highly technical products from the U.S. and other

countries have been sold within China only to be copied by Chinese manufacturers.

It has been estimated that well over US \$ 1 billion worth of sales would be lost if the United States Government established punitive import tariffs against China's electronics industry. This would be the cost of the PRC's unwillingness to establish and enforce acceptable laws protecting intellectual property rights and patents. If no settlement is reached and such actions are taken by the U.S. government, the losses for Hong Kong will be significant.

The protection of the intellectual property of U.S. Firms in Hong Kong and China has been a major concern of the U.S. Government, and a major cause of political tension between the two governments. The situation is in some cases worse in Hong Kong than in China. There are laws to protect intellectual property in Hong Kong, but enforcement of these laws is lax. A good example is the problem of software patent protection in Hong Kong. Today, it is possible to go to open shopping centers in Hong Kong to purchase the latest type of pirated software programs with counterfeit documentation. Once a week or so, the police raid the shopping center, arrest a few violators and confiscate their goods. As soon as the police leave, it is back to business as usual.

In China, on the other hand, recent agreements have been reached between the U.S. and the P.R.C. to protect patents and trademarks. Enforcement is still more lax than it should be, but due to the mounting political pressure from the U.S. as a result of the trade imbalance between the P.R.C. and the U.S., much

headway has been made in this regard.

Also, the language and cultural differences between the non Chinese U.S. population and Hong Kong/South China are vast. It is easy to understand the problems associated with two of the most different languages in the world, English and Cantonese Chinese, but the cultural differences are much more complex and harder to comprehend because of the long history of the oriental culture. This is the major reason why it is sometimes difficult to find non Chinese Americans to relocate to Hong Kong on a permanent basis.

CONCLUSIONS

As 1997 approaches, the communist ideology of the Beijing Government must give way to economic forces, but this will occur in a much different way than in the former Soviet Union.

In the early 1970's Mr Gorbachev was the Minister of Agriculture in Moscow. He studied the success of the early economic reforms put into action by Deng Xiao Ping in rural China, and was impressed with them to the point that he attempted this openness of reform in his country. The big difference is that Mr Gorbachev decided to not only concentrate on economic reforms, but also political and ideological reforms at the same time. He actually placed more emphasis on the political and ideological reforms. This dual approach led to the loss of power by the Soviet Central Government and the collapse of the Soviet Union.

Most of the "old leaders" in China may be set in their ways, but they understand that the most important strategy is rapid economic reform with strong military and social controls that make the country stable. The political ideology is secondary and they speak of it only among themselves and to the Chinese people.

Hong Kong offers the old leaders in Beijing an unusual opportunity. They can still talk about Chinese communism and promote the one country two system

doctrine, while at the same time, fill their accounts with profits from this highly successful and profitable little territory on their southern coast. As conditions in China continue to improve and the general population becomes more and more prosperous and open to the rest of the world, communist ideology will become less and less important. Marxism is becoming only a tool for political and social control. The Beijing Government hopes that Hong Kong will become an economic model for China but not a political model. Beijing does not want Hong Kong to become a democratic base of influence over the mainland. This is the reason for Beijing's recent stance against the last Hong Kong Governor for his effort in pushing for political reform.

The principal fact is, the Chinese Government has practiced pure economic reforms without ideological change over the past 10 years, and it has been successful in the development of China. Also, as Beijing knows, the autocratic system coupled with a capitalistic economy, has been very successful in several other Asian countries with Chinese culture, such as Singapore.

As each day passes toward 1997, the shift of power continues. The real power in China is located in two places. First, it is at the top of the Beijing Government in the hands of a small group of old men, many of whom fought along with Mao Tse Tung and took the long march with him. These elders know that they must hold on to the ideology and central power, but they also know that they must accept economic reform. This is the major difference between the former Soviet Union and China. The leaders in China want most of all to keep

the power and stability centralized in Beijing, and at the same time they want the rewards of capitalism. The second power is the economic capital and most of this capital is concentrated in Hong Kong and South China.

China has always been divided in many ways between the North and South and it now appears that economic power is moving to the South while the political power remains in the North. This balance of power depends upon many factors, but the most important is this triangular relationship between the People's Republic of China, Hong Kong and the United States of America.

If the U.S. Government continues to understand the true situation in China and Hong Kong and reacts with skill in their dealings at the highest levels of government, both Hong Kong and China will continue the dramatic economic growth they have experienced over the past one and half decades.

All of Asia will be affected by the little fire that has been burning on the south coast of China. This "little fire" is the fiercely capitalistic city state known as Hong Kong. Today, 40% of the foreign income of the Beijing Government is derived from taxes in Guangdong Province. Hong Kong is already the actual economic and social capitol of Guangdong Province with a total population larger than Japan. After 1997 this "capitol" in the South will ensure the growth and will surely erode the power of the North Central Capitol (Beijing). Again, as Deng Xiao Ping said, " When you open a window you not only get fresh air but a few flies." By this time, all of China and the Beijing Government may not only get a "few flies" through the window of Hong Kong, but huge swarms of flies!

The real question of 1997 is not simply the stability and security of a small group of islands off of the South China coast, but the future of all China with one fourth of the earth's people. In the Chinese language, "China" means center country.

The final question is, if these trends continue, how will the U.S. market and the markets of the world contend with the economic power of the "Sleeping Giant" that is about to be awakened. As the trade barriers of the nations of the world continue to be lowered to favor a world global economy, how will the rest of the world's markets be protected against a big Hong Kong with 1.2 billion success hungry entrepreneurs.³⁰ This may be the China the world must face by the year 2000.

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