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"Hong Kong One Year Later", The Asia Society

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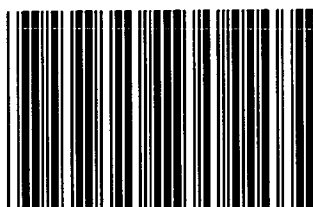
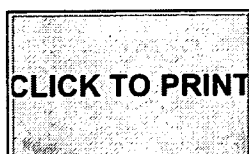
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BAUCUS

"Hong Kong One Year Later"

Senator Max Baucus
The Asia Society
Seattle, Washington

June 15th, 1998

Mr. President:

As the first chapter of the Analects of Confucius says, "is it not a great joy when friends come from far away?"

This week we have had the pleasure to welcome two good friends to Washington -- President Kim Dae-jung of the Republic of Korea, and Chief Secretary Anson Chan of the Hong Kong Special Administrative Region.

And today, as President Clinton prepares to make the first visit of any sitting President to Hong Kong, I would like to offer some thoughts on the events of the past year in Hong Kong.

THREE VIEWS OF HONG KONG

Let me begin with some context. When we speak about Hong Kong, we are really talking about three different Hong Kongs.

One Hong Kong is Hong Kong itself: a city of six million people on China's southern coast. It is a place of hard work, good humor and open debate; one of our major Asian trading partners; the site of \$15 billion in direct American investment and the base for much of our business in China; a site for 60 Navy port calls a year; a place many of us have visited and where our country has many friends.

A second Hong Kong is part of China. This Hong Kong, emerging from 150 years as a Crown Colony to become the Hong Kong Special Administrative Region, can play a unique part in China's future history. It combines a living western intellectual and legal heritage with a Chinese identity, and as such offers Chinese reformers a model for the rule of law and an open society, as well as for economic and financial management. And of course Hong Kong also plays a unique part in our own broader relationship with China.

And a third Hong Kong is the financial and management hub of a vast productive region which extends from southern China to Southeast Asia. And so Hong Kong is also bound up with our economic and trade relationship with most of Asia -- and in

particular the financial crisis which afflicts so many Asian nations this year.

In summary, history has placed a very heavy responsibility on Hong Kong and its people -- for the management of their own city; for China's future; and for Asia's prosperity.

THE LAST YEAR: POLITICS

How have they managed these responsibilities since the Union Jack went down and the Bauhinia went up last July 1st?

Here I will quote the very succinct view of an American businessman based in Hong Kong, who came to see me back in February:

"Everything we thought might be a problem is not a problem. Everything we assumed would be fine has become a problem."

He was referring, of course, to politics and economics. Last year at this time, many were worried about Hong Kong's political future, asking whether Chinese sovereignty would mean a controlled press and repression of political debate. Few saw any threat to its economic future. And what have we seen since?

- Hong Kong residents retain and exercise their rights. The Hong Kong Alliance holds its regular commemoration of the Tiananmen Square massacre. Han Dongfang's China Labor Bulletin and the Human Rights Monitor operate just as before. All are freely and widely covered in the Hong Kong press -- as are American China policy debates, the recent interview given by the Chinese political reform advocate and former political prisoner Bao Tong, and much more.
- Hong Kong's elections May 24th went off more freely and its results were more interesting than anyone might have expected. Turnout rose from 35% in 1995 to 55% this year. The Democratic Party, along with the other parties which opted out of the Provisional Legislature, participated and did brilliantly. Equally interesting, the success of the Democratic Alliance for the Betterment of Hong Kong, traditionally identified as a "pro-Beijing" party, may point toward the eventual establishment of a two-party system in Hong Kong.
- And China has, as far as I can tell, kept its promises to stay out of the Hong Kong government.

These facts, I believe, disprove two theories. After this election, nobody can now pretend that Hong Kong people are indifferent to political rights and elections and care only about money. Likewise, after the election, the view that China has malevolent intentions and will inevitably crack down on Hong Kong seems naive at best. And although one year is a short time in which to judge, the facts also tend to show that the

one-country, two-systems idea may work. And it is a disappointment, but not a surprise, to see that none of last year's doomsayers have stepped up to the plate and admitted they sold Hong Kong -- and China -- short.

ONE YEAR LATER: ECONOMICS

Unfortunately, what they should have been selling short was not Hong Kong -- nor its government, nor its citizens, nor the Chinese government -- but the Hang Seng Index. And those of us who were optimistic about Hong Kong's prospects last year should also admit that we didn't get it quite right. The things we felt would not be a problem -- Hong Kong's economy -- has become not only a problem but a crisis.

I last visited Hong Kong in May of 1997, as the last stop on a trip that also included Seoul, Pyongyang and Beijing. At that time, the Koreans were worrying about a slowdown in growth rates -- maybe to 5.5% or 6% -- and some scandals in the chaebols. And The Economist magazine ran a cover story on financial problems in Bangkok. And in Hong Kong, I asked a few people what might show that the transition was going wrong -- and a few said that one clue might be a speculative boom in the Hong Kong markets. Not a single person I met -- and that includes American diplomats, tycoons, civil servants, Chinese dissidents, legislators from the Democratic Party, the Citizens Party and the Liberal Party -- predicted that the economy might go wrong.

What has happened since?

-- We need no longer worry about a speculative boom in the markets. The Hang Seng is down from nearly 16,000 then to below 8,000 this week.

-- Hong Kong is in its first recession ever, with growth at negative 2% so far this year. Some predict that the contraction could be 5% or worse.

-- Unemployment is already at 4% and will rise in the months ahead.

-- This, ironically enough, has overshadowed the political divisions in the new Legislative Council, to the point that the Democrats, the DAB, the Liberals and other parties have come together to criticize the government's budget and push for emergency economic relief.

Why has this happened? The answer is obvious. The problem is not the Hong Kong economy per se -- its properties may have been overvalued, but the real problem is the crisis affecting every country around Hong Kong. When a typhoon blows, everyone feels the wind and rain.

US INTERESTS

In summary, as Chief Secretary Chan comes to Washington, she represents a

territory whose politics are in better shape, and whose economy is in worse shape, than anyone guessed last year would be possible. And with that let me now turn from the lessons of the past year to the issues we must address, together with Hong Kong, in the next.

Our interest is clear: a prosperous, healthy Hong Kong whose politics are free and open, which integrates peacefully with China, and which continues to play its part as the center of a prosperous Asian economy. And to secure this interest, we need three things: first, a solution to the Asian financial crisis; second, a working relationship with China, especially in the field of economics and trade; and third, a continued good relationship with Hong Kong's government, political leaders and people.

THE NEXT YEAR: ASIAN FINANCIAL CRISIS

And let me begin with the first of these. When a typhoon blows, people feel the wind and the rain. But they also tend to see, perhaps more than they might in easier times, that they need to work together. We see that in Hong Kong's Legislative Council today. And we see it on a larger scale, as the crisis has brought together the countries hardest hit by the crisis, Hong Kong and China, Japan, and we ourselves.

The affected countries -- particularly Thailand and Korea -- have acted with a great deal of courage and good sense. And as bad as the times may be, their approach is working. In the last few months their currencies have stabilized and capital flight ended. The task now is no longer stopping a panic, but restoring financial health, enduring recession and protecting the most vulnerable people. Indonesia, with an even more difficult economic situation and a weaker political system, thus far, has weathered an even more difficult situation with a weaker political without descending into violence.

China and the Hong Kong Special Administrative Region have responded admirably. Hong Kong's refusal to devalue the dollar last October did more than any single other action, anywhere in the world, to prevent the crisis in Southeast Asia and Korea from becoming a meltdown. And China's refusal to devalue the yuan since then has allowed markets to recover and begin acting more rationally. The proof is that the revolution in Indonesia, as earthshaking an event as that is, has not created a new currency panic. And continued commitment by China and Hong Kong will make sure that the worst-affected countries can get back on their feet.

This will impose tremendous strain on China in the months to come, because China is in no way immune to the crisis itself. The Central Bank Governor, Dai Xianglong, said yesterday that while China will stick to its commitment not to devalue:

"The economic adjustment in Southeast Asia and the sluggish Japanese economy, particularly the depreciation of the yen, have all produced a very negative impact on China's imports, exports and inflow of investment funds, and

increased pressure on the restructuring of our country's economic system."

This points to the need for rapid action in Japan to pass its fiscal stimulus package and perhaps to go further to prevent recession. In this crisis, Japan should be importing and growing; if it slumps and devalues its currency we can expect the situation to worsen.

And we in the United States must act sensibly and seriously. Our open market is as important to recovery as the currency commitments by China and Hong Kong. So far, we have not given in to fears or temptations to reduce imports as our exports to Asia have fallen, and that should continue. We must pass our IMF replenishment, as the Senate has done. And we should give a strong endorsement to China's MFN status. As Ms. Chan said on arrival to the United States, revoking MFN status:

"[W]ould not only deal a devastating blow to business confidence in Hong Kong when we are grappling with the fallout from the regional turmoil, it would also undermine our ability to continue to play the role of firewall in the Asian financial crisis. Eventually it would take away a powerful line of defense in the economies of the region. None of us, including the United States, can afford another wave of uncertainty."

CHINA'S WTO ACCESSION

As this comment indicates, our annual debate over MFN status has become a pointless and essentially destructive affair. It does nothing to promote human rights, political reform or better security policies in China; instead it threatens jobs here and economic stability in Hong Kong and China. And that brings me to the second point: our economic relationship with China, and in particular to China's accession to the WTO.

As Governor Dai's comments indicate, China is by no means immune from this crisis. Its growth rate has fallen; its export growth rates dropped by nearly half; and foreign investment in China is off. These are some of the early warning signs we saw in Southeast Asia two years ago. And that should worry us -- because today's China is not so different from yesterday's Southeast Asia.

China has some advantages that its neighbors lacked. It has more fixed investment, less short-term debt, and larger foreign currency reserves than its neighbors. But it also has many of the problems they had before the crisis. We see a level of bad debts about the same, or even higher, as Thailand had before a year ago. We see nepotism, corruption and intimate ties between big business and the state; politically directed loans to unnecessary industrial policy projects in fiber optics, semiconductors, autos and other areas; property bubbles in the big cities; foreign investment dropping; and early signs of an economic slowdown that could worsen if the Asian crisis deepens. And all this is combined with a brittle political system, intolerant of

opposition and with only a weakly developed rule of law, that in the event of crisis may not offer China the flexibility it needs to get through economic difficulties without a social upheaval.

Part of the answer must be political reform. China has a good example, inside its own political borders, with Hong Kong's strong rule of law and open society in a Chinese society; and when the one-country, two-systems formula comes to an end in 2047, political development in China may be its most important legacy. But in the short term, the economic reforms WTO accession will bring are equally crucial for China's economic health.

WTO accession, on the commercially meaningful basis we should expect, will reduce subsidies and break the links between ministries and their semi-privatized profit-making offspring. Promote open competition at the expense of rigged markets. And strengthen the rule of law. This will produce a more rational economy which is more open to imports; has less interference by ministries in the market; which is run more by the rule of law than by informal connections; and offers more freedom for ordinary Chinese to determine their own future. And in the long run it will help ensure that China has a stable, sustainable economy.

So as President Clinton's state visit approaches -- and in its aftermath if necessary -- we should push as hard as we can to reach a commercially meaningful agreement. We must not accept less than we should; that would be unfair to our own country and it would mean little to China. But we should work hard to get the job done right. And of course, when it happens we should live up to our own responsibilities by granting China permanent MFN status.

CONCLUSION: THE CITY

Finally, let me turn back to the first Hong Kong -- the one that is simply a city.

A year after the transition, Hong Kong faces an extraordinary array of challenges. It is at the eye of an economic storm worse than any Asia has faced since the Vietnam War. It is adapting to a political role unique in China and probably unique in the world. And its own government and constitution are very new.

These challenges might bring a lesser city to its knees. But Hong Kong has handled them about as well as anyone could have. And beyond that -- as far as I can tell from ten thousand miles away -- it has grown because of them.

Last May's election, to me, indicates that the ordinary Hong Kong people understand how important a responsibility history has given them this year. The qualities we have always associated with Hong Kong -- hard work, good humor, honest government -- have been amplified by growing civic responsibility, democratic participation and political maturity.

In summary, a year after the transition, Hong Kong has defended its rights; acted to good effect in an economic crisis; and can look ahead with confidence. And as President Clinton prepares for the first visit any sitting American President has ever made to Hong Kong, he is going to a city whose future is bright.

Thank you, Mr. President, and I yield the floor.