

Hong Kong Growing as Part of China: A Historical Perspective

Y. C. Richard Wong and Alan K. F. Siu

The University of Hong Kong

Introduction

The story of the transformation of Hong Kong into a modern metropolis from a small fishing village on the south China coast is now standard fare in almost all history books about the territory. What doesn't make it into these books is the fact that Hong Kong had a history long before the British arrived in the territory. While much is still unknown about that early period, evidence that archaeological findings and written records have produced suggest that Hong Kong was a busy crossroad of trade and cultural intercourse. Indeed, Hong Kong's fortune rose and fell with its changing relationship with the Chinese mainland over two millennium.

With sovereignty over Hong Kong having been restored to China from Britain on 1 July 1997, it is useful to recount the early history and to review the period under British rule so as to get our bearings and be able to view the future in the context of the past. This historical background is especially important, for it puts into perspective the British contribution to the economic development of Hong Kong, especially in the post-war period. It also puts into perspective the many economic and social policy debates that are surfacing now and will be developing in the years ahead.

Hong Kong's relationship with the Chinese mainland is fundamental to defining the shape and scope of economic and social affairs in the territory. It sets in motion forces that in their totality determine the environment for public policy choices that the Hong Kong government faces not only in terms of political affairs but also in economic and social

matters. The government's choice of a light handed approach to public policy in the post-war period is often considered to be a unique British contribution, even though Britain did not adopt it for itself. Yet to what extent the laissez faire approach to governance was driven by Hong Kong's fundamental relationship with the Chinese mainland is an open question that deserves investigation. For those who believe that Hong Kong's laissez faire economic system was responsible for the post-war economic miracle, the answer will be of great relevance in forecasting the economic future of the territory.

The Period before British Rule

The term "barren island" was apparently first used by Lord Palmerston, British Foreign Secretary, who dismissed the acquisition of Hong Kong as that of "a barren Island with hardly a House upon it." A census in 1841 put the inhabitants on the island at about 7500. But long before the British arrived, the waters and the area around the island was a natural crossroad between East and West and a gateway to China. This fact is borne out by archaeological findings and written records that date back to some two millennium ago. As early as the fourth century, the Tuen Mun area (which could mean the area from modern-day Lantau to today's Tuen Mun to Nantou in present-day Shenzhen) was sailors' first port of call after crossing the South China seas. A modern-day observer may well marvel at the fact that Hong Kong's container and river boat terminals, which handle the largest volume of throughput in the world today, are located in the same area. Indeed the airport at Chek Lap Kok scheduled to open next year will also be situated there.

Historically the Pearl River estuary region was well known for its salt pans. After the Han conquest of Nanyue in A.D. 111 an imperial outpost to administer the salt monopoly was established in Panyu, to the northwest of present-day Hong Kong. During the Tang Dynasty trade flourished in the city of Guangzhou, which had a monopoly over foreign trade, and a reported colony of foreign traders was over 100,000 strong. For many centuries Tuen Mun

served as an outer port for Guangzhou, a naval base, a center for religion, and a production center for salt.

During the Song Dynasty the administration of the government salt monopoly was relocated to present-day Kowloon City next to the existing Kai Tak airport, known at the time as Guanfu. As a religious center Tuen Mun played host to Buddhist monks and Islamic mullahs. It is therefore not accidental that today's Tuen Mun and Lantau are still renowned for their Buddhist, Taoist, and Catholic monasteries.

Nevertheless the Tuen Mun area went into decline after the Mongols successfully invaded China and founded the Yuan Dynasty. In the war against the Mongols the Tuen Mun area was ravaged for having supported the ill-fated last Song emperors in its final resistance. The customs points was subsequently moved from the Tuen Mun area north up the Pearl River to Huangpu, and Tuen Mun was reduced to a mere anchorage.

The subsequent Ming Dynasty was extremely insular and banned all forms of foreign trade except tribute trade for many years. This led to the growth of a large illicit trade in the area, coastal piracy, and numerous military adventures in which foreigners--primarily Portuguese and Japanese--were also engaged. Trade was finally legitimised because it was impossible to stamp out piracy, but the Tuen Mun and Guanfu area did not recover.

The worst was yet to come during the Qing Dynasty, when the Ming loyalist Zhen Chengong retreated to the Island of Taiwan. He continued to harass the China coast, forcing the Qing court to adopt a policy of "moving the territories" in 1622. All land within twenty-five kilometers of the sea coast was abandoned. The population had to be evacuated and the buildings demolished so that no food or assistance would be available to the loyalists. Most of present-day Hong Kong was affected.

The policy of "moving the territories" was subsequently abandoned in 1669, but re-population was only allowed after 1683. Most of those who came were Hakkas (a term used

to describe non-native immigrant groups). Trade was restored in a number of coastal cities but was later restricted to the city of Guangzhou and the Macau settlement. Tuen Mun and Guanfu ceased to be an outer port for Guangzhou and became mainly a lair for pirates who preyed on the lucrative trade. The most active pirates were led by a legendary woman known as Zheng Yisao and her common-law husband Zhang Bao. They had some 20,000 to 30,000 followers, and their field of operation stretched from Vietnam to Fujian. The Hong Kong waters were their base.

There is some circumstantial evidence to suggest that trading activities started to develop in Hong Kong after the Chinese navy eradicated the pirates. The British opium traders in particular used Hong Kong waters for moorings and relied on the migrant Hakkas to be the purveyors, the commissariat, and to transport coolies of the foreigners and the Tankas--the local fishing population--to provide boatmen and pilots for the foreign trade.

From this limited record of Hong Kong's early history two points stand out. First, the territory has been a natural crossroad for trade and cultural intercourse since time immemorial by virtue of its geographic location and natural endowments. Second, the territory thrived during the Tang and Song dynasties, when the government in China pursued an open-door policy, and it declined during the Yuan, Ming, and early Qing dynasties, when policies became insular. The forcible opening of China during the Qing dynasty, resulting in the Opium wars and the loss of Hong Kong to Britain, heralded a new chapter in Hong Kong's development.

From Barren Island to Refugee Haven

The establishment of British rule provided Hong Kong with a certain degree of insulation from policy decisions in China. Hong Kong could pursue its own natural advantages in trading activities with limited interference from China. It also coincided with British interests in Hong Kong, which were to use it primarily as a trading post. Given the

importance of trade to Hong Kong's economic livelihood, it is not surprising that Hong Kong was declared a free port. Although the opium trade dominated at the beginning, over time it gave way to other merchandise trade, with the expansion of entrepot trade with China.

One of the distinguishing features of trade with China was the difficulty of navigating its customs bureaucracy and penetrating the domestic market. British traders relied heavily upon Chinese middlemen, even for the opium trade. The Chinese merchant class grew rapidly both in numbers and in wealth. A survey conducted in the late nineteenth century found that Chinese families far outnumbered all others among the wealthiest group in the territory.

As the economy expanded, workers from the mainland streamed into Hong Kong. In the period from 1842 to 1949 the population flow between Hong Kong and China was unrestricted except during the war years. The workers who came to Hong Kong during this period were predominantly men in search of jobs. It was only much later that some of their families started to join them. The earliest available records show that in 1845 out of an estimated total population of 23,817 there were 19,201 men, 2,862 women, and 1,754 children. The balance of the sexes improved over time as more families settled in Hong Kong. Nevertheless, large numbers of people would continue to move back and forth between Hong Kong and the Chinese mainland. It was not uncommon for 10 percent to 20 percent of the population to leave Hong Kong and return to the mainland in any one year, and in some years the figure was as high as 35 percent.

The fact that the population flow between the Chinese mainland and Hong Kong was unrestricted suggests that there were no significant differences in the standards of living between the two areas. This in turn suggests that although there were many Chinese families who accumulated huge fortunes as a result of their trade activities, it is unlikely that the vast majority of the laborers prospered. Indeed, life in Hong Kong was far less entertaining and

exciting than was life in Shanghai, which was then clearly the leading industrial and commercial center of China.

The predominance of recent migrants and sojourners within the population generated very few demands on the government to provide public assistance or services. Private charities and missionaries were the main sources of social support and services. On the whole it was both possible and expedient for the government to adopt a light handed approach to social intervention. Public expenditure and revenue were kept simple, and for many years the government opium monopoly provided most of the public revenue. Indeed, the only well-organized group that stood up to defend its own interests was probably the indigenous rural inhabitants in the New Territories, who to this day have continued to succeed in protecting their special privileges.

The fortune of Hong Kong took a dramatic turn at the end of the World War II, when refugees escaping the ravages of a civil war and the uncertainties of its outcome streamed into Hong Kong in droves. The population of Hong Kong rose from 600,000 at the end of 1945 to 2.1 million in 1950. When the Chinese Communist Party came to power the border was effectively closed on the Chinese side to prevent people from leaving.

The refugees who arrived were mainly laborers and farmers from Guangdong province, but they also included numerous entrepreneurs and industrialists from Shanghai. These businessmen brought management and technical know-how and market knowledge from one of the most advanced economic centers in Asia. They represented numerous industries, including manufacturing, retail business, banking, movies, shipping, and the professions. This concentration of skills was much broader than were the trading activities that existed in Hong Kong.

As a result of a curious turn of events, Hong Kong's traditional advantage in entrepot trade came to a halt after the Korean War broke out and the United Nations imposed a trade

embargo against China. The combination of external events turned Hong Kong into an autonomous economic entity insofar as the Chinese mainland was concerned. Export-oriented manufacturing production replaced entrepot trade to become Hong Kong's new comparative advantage. Manufacturers were able to obtain credit from Hong Kong banks and to work with the British trading companies in entering first the Commonwealth market and later the North American market.

Both as a matter of necessity and out of conviction, the government continued to pursue a light handed approach to economic policy and to allow Hong Kong's business community to pursue economic gains in accordance with market signals. The response of the Hong Kong government to the imposition of voluntary export restraints by the U.S. government through the Multi-Fiber Agreement is exemplary and unique among victimized economies. Instead of trying to administer the quotas directly, The Hong Kong government chose to allocate them to the manufacturers in proportion to their historical production figures at no charge and to allow them to transfer the quotas freely at market prices.

The fact that these new entrepreneurs were recent immigrants also reduced the level of business lobbying, which would otherwise have led to more government intervention. The view that the British government in Hong Kong had a high discount rate is consistent with the view that it had little interest in indulging in grandiose schemes to promote economic development but was much more eager to ensure that Hong Kong would not become a burden of the home government. And, finally, the British government probably recognized the fact that its mandate to govern was in the final analysis at the pleasure of the Chinese government and with the acquiescence of the local population.

The contrast between Hong Kong and Singapore is obvious. Singapore's natural advantage, like that of Hong Kong, was in entrepot trade and not in export oriented manufacturing. But, unlike Hong Kong, Singapore did not receive an infusion of

entrepreneurial talent on the eve of its independence and it never lost its advantage in entrepot trade due to external forces. As a consequence, Singapore had to develop a manufacturing base in the absence of favorable market signals. As a young and independent nation struggling to find its rightful place among suspicious neighbors, the government enthusiastically embraced numerous interventionist policies to attract and target foreign investments into manufacturing with the support of forced savings mobilized through a central provident scheme that required mandatory contributions of some 40 percent of earnings.

The renowned entrepreneurial spirit of the Hong Kong business community may well be the result of the self selection process of an immigrant population and the minimalist policies of the government that provided clear, simple, and predictable rules of the game. For example, how taxes facilitated the taking of risks and the accumulation of wealth. It is interesting to speculate as to whether economic integration between Hong Kong and the mainland would have proceeded so quickly if, on the eve of China's opening, Hong Kong was more like Singapore and lacked a large contingent of energetic entrepreneurs that was ready to take risks in the mainland.

To be sure, the government played a very large role in the provision of public housing, public health care, and education subsidies. The historical genesis of this involvement can ultimately be traced to the sudden influx of a large refugee population in the late 1940s. Hong Kong was totally unprepared for this influx, and its response took the shape of a series of ad hoc measures with path-dependent consequences that led to the dominance of the state in these affairs.

The closing of the borders between Hong Kong and the Chinese mainland ushered in an era in which Hong Kong's economic environment was further insulated from events within China. A series of historical events resulted in a fundamental shift in Hong Kong's

economic advantage. Perhaps the most important cause of the post-war economic miracle has been the influx of vast amounts of human capital, whose value was maximized through a light handed government policy that respected market signals. In this period, as a result of its relative isolation from the Chinese mainland, Hong Kong's location as the gateway to south China receded in importance. The situation would change with the opening of China in 1979.

The Permeable Border

The momentous impact of China's opening on Hong Kong is highly visible. Within a span of eighteen months between 1980 and 1981 some 400,000 individuals crossed the border into Hong Kong. The impact on labor market conditions was swift. Real wages failed to increase for several years, but Hong Kong's labor-intensive manufacturing industries received a new lease on life as competitiveness was restored with the injection of a new army of workers.

Nevertheless, the sudden influx quickly led to an agreement between Chinese and Hong Kong authorities to regulate and limit the flow to 75 individuals per day as a result of public concern over consequences for labor markets and for social-educational, housing, health, and infrastructure services. Although the number has increased to 150 over time, illegal immigrants continue to be a problem.

The fear of population inflows from the mainland is still a cause of anxiety for many Hong Kong residents. However, there is a clear difference between the attitudes of capital and labor towards such inflows. Capital typically welcomes them, but labor is both angry and jealous.

The opening of China began to have an even more perceptible impact on the economy as Hong Kong's manufacturing base migrated northwards across the border. At its peak, manufacturing enterprises in Hong Kong employed some 900,000 workers. Today they

reportedly employ as many as six million workers on the mainland and less than 250,000 in Hong Kong.

These changes have important social dimensions that have had an enormous impact on the lives of individuals and families in Hong Kong. As many as 500,000 middle-aged workers have had to seek new jobs in service industries after losing their manufacturing jobs. Organized labor in Hong Kong has since found an enduring agenda in a hostility towards labor inflows--an alien concept throughout the history of Hong Kong, where before the war most inhabitants were sojourners and since the war most have been first- or second-generation immigrants.

Today hundreds of thousands of individuals in Hong Kong's workforce commute regularly across the border to work on the mainland, and millions from Hong Kong enter China every year for short visits. As social and economic contacts continue to grow between the two places, a rising number of marriages have been taking place between Hong Kong and mainland residents.

The presence of draconian laws to limit the flow of individuals from China into Hong Kong has created a heart-wrenching phenomenon. An increasing number of families now have members who are forced to live apart for years, separated by a border. The sight of children and mothers torn from their families and forcibly repatriated back to the mainland is a familiar one to television viewers.

The human cost is immense today. Tomorrow it will be even more staggering as numbers and the prolonged agony of those waiting to be united keeps growing. It is inconceivable that people living in two economies and societies so close to each other with such intense contact will fail to develop better ties and relations.

Divided families lead eventually to a society of alienated individuals, fostering social divisiveness. The day of reckoning for Hong Kong will arrive when the social pressures of a

distorted family life, a lonely and isolated childhood, maladjusted youth, and lasting memories of despair, humiliation, anxiety, and unfulfilled promises finally erupt in full force. Hong Kong will pay dearly for its current policies to regulate and limit population inflows, but the choices are limited.

In contrast to these worrying social forces that have been released by the opening of China, the economic impact on Hong Kong is far more positive. The many complementary areas between the mainland and Hong Kong have created numerous opportunities for economic cooperation to the benefit of both Hong Kong and the mainland. The areas in which cooperation is easiest have probably already been exploited, and further integration would require that liberalization and deregulation increase even further on the mainland. However, even very modest progress in these areas would generate enormous opportunities for the Hong Kong business community.

Nevertheless, the huge economic strides made by Hong Kong have their price. Given that Hong Kong operates an exchange rate regime that is similar in many respects to the currency board system and is linked to the U.S. dollar, consumer price inflation has outstripped price inflation of tradable goods. This is a familiar situation that is often observed in fast-growing economies in which productivity of the tradable sector rises faster than does that of the non-tradable sector. Inflation is now a permanent feature of an economy that is always operating at full capacity, even during cyclical downturns. The capacity constraint is to a large measure a result of the policy to regulate and limit the inflow of population and labor from the mainland.

The damaging effects of inflation are most serious in their impact on savings. Families in Hong Kong have little choice but to buy property as a means to protect their savings, thereby further fueling property prices in a market already suffering from severe

shortages. Property ownership today divides society into the “haves” and the “have-nots,” and the gulf that separates them appears to be ever widening.

Rising property prices have implications for a whole range of policy choices. Retired people are finding that their pensions and savings cannot support the lifestyle they had planned for and are lobbying for public assistance and old-age security support. Their numbers are growing as the population ages, and they will make their voices heard at the ballot box.

Industrialists blame high housing costs for having driven up wages and for making them less competitive than their neighbors. They have called upon the government to support technology and raise productivity to enhance their operations in Hong Kong and the mainland. They have also lobbied for a more liberal system of arranging work permits for workers, technicians, and engineers on the mainland to come to Hong Kong.

These conflicting voices have one thing in common: they all invite government intervention in forms that previously were either not present or went unheeded. They are ultimately the consequences of a border that, while it has become more permeable, is still not completely so. Some lobby for greater permeability and others for less. Permeability is seen both as a curse and a blessing.

Managing the Permeable Border

By any yardstick, 1997 will be a significant year for the future of both Hong Kong and China. However, the economic and social forces unleashed in 1979 at the onset of China’s open-door policy, and Hong Kong’s response to them, are what may ultimately determine the territory’s fate.

Given the disparity in the level of economic development and the differences in the economic system between Hong Kong and the mainland, there are obvious benefits to greater integration, and this entails making the border more permeable. Yet the privileges and

scarcity rents that accrue to Hong Kong residents are ultimately derived from the fact that the border must remain nonpermeable to some extent.

Managing the permeability of the border has to become an integral part of all economic and social policies within Hong Kong, as the two matters will have implications for each other. The period prior to 1949 was one in which there was perfect border permeability, and standards of living in Hong Kong and the mainland were similar. Between 1949 and 1979 there was essentially no or very limited permeability, and standards of living in the mainland and Hong Kong therefore diverged. In both periods the government was able to pursue a laissez faire system without any fundamental inconsistency. Since the opening of China, this is no longer the case. With the border being quasi-permeable, and with great disparities in standards of living and differences in economic systems, it is no longer obvious that the laissez faire too many people will maximize local welfare or be politically feasible.

Nevertheless, there will be certain policies that would help preserve the vitality of a market system based on free enterprise and individual responsibility. For example, Hong Kong could adopt a policy to sell the existing stock of public housing to sitting tenants as a solution to many problems. The sales could take place at prices below market levels, and tenants should have the right to transfer the unit on the free market and to keep any capital gains that arise from the sale.

For the more than a third of Hong Kong's households living in public housing, privatization would provide a genuine asset that could be an effective hedge against inflation. The asset could be used as collateral for financing business activities, as an annuity to provide for old-age retirement, or as a bequest to loved ones. At almost no cost to society, the inseparable gulf between the "haves" and "have-nots" would to a large measure be eliminated.

If Hong Kong were to become a predominantly propertied society, the hostility of local residents toward immigrants would be greatly reduced. It would become clear that the arrival of immigrants enhances property and capital values and does not depress wages and take away jobs.

If the government adopts a clear, credible policy to allow spouses and children of Hong Kong residents to arrive in Hong Kong after July 1 anytime they wish, it need not trigger an immediate rush into Hong Kong. Most parents are, after all, responsible individuals who will not send for their dependants until arrangements for settling them in Hong Kong have been made.

In the longer run, such a policy would also enhance the desirability of local residents as marriage partners for mainlanders, while Hong Kong would be able to attract a better mix of immigrants through marriage. Children from these marriages would be able to benefit from a better-quality education here. Indeed, Hong Kong has much to gain from a long-term policy to reunite separated families. Such a policy would also entail making provision for Hong Kong to develop as a metropolis with a much larger population than that which is currently contemplated in official forecasts.

The intellectual and political challenges facing Hong Kong in terms of managing integration with the mainland are enormous. Only time will tell whether it will be successful, and as Hong Kong's own past history has shown, there may well be events that the territory cannot control or influence. The reward for success would have the winning over of one-fourth of humanity. And that is a worthy goal.