

Executive Summary

Present Economic Relationship Between China, Hong Kong and Taiwan and Future Prospects for Economic Integration

1. China has drafted development strategies spanning the period up to the next century which will further promote a market economy. In order for the economy to develop stably, however, it is necessary to establish macroeconomic control, rebuild the state sector, arrest stagnation in the agricultural sector, contain the increasing qualitative economic disparities between regions and sectors, and respond to limitations of resources and the environment. The Jiang Zemin administration is aware of these needs and is beginning to design revisions to previous Deng Xiaoping-style reform and open-door policy. These revisions are likely to greatly influence the economic relationship between China and Hong Kong and Taiwan.
2. Adjustments to policy concerning the introduction of foreign direct investment (FDI) based on industrial policy, replacing the policy of regional hospitality that means opening coastal regions to FDI, will be implemented in the future. As a result, FDI in labor-intensive sectors, which has mainly been conducted in the past by Hong Kong and Taiwanese capitals in China, will be likely to gradually decrease, and FDI which tended to be concentrated in the coastal regions, will also become extended. On the other hand, however, investment opportunities for foreign capital, including capital from Hong Kong and Taiwan, have expanded since China began opening domestic markets.
3. Along with the Chinese economy, Hong Kong and Taiwan have experienced high economic growth through an investment-oriented strategy by which the expansion of investment in China has expanded trade with China. The stagnation of growth with this strategy, however, is becoming evident, and is being influenced by the changes in China's policy already described and by the progress of industrialization in China. A breakthrough lies in upgrading economies of Hong Kong and Taiwan in line with economic growth in China. The responses from Hong Kong and Taiwan, however, are likely to differ somewhat.
4. Presuming integration with the Chinese economy, Hong Kong is likely to develop a strategy to maintain its leading position as an international finance center and further upgrade both its soft and hard infrastructure to serve as a trade and distribution base in the southern China region. As is evident in the concept of an "Asian Pacific Operational Center," Taiwan is working to form an independent industrial basis by upgrading its manufacturing industry (fostering high-technology industry) and encouraging infrastructural upgrading. The success or failure of this strategy will strongly influence future relationships between China, Hong Kong and Taiwan.
5. Development of the economic integration of China with Hong Kong and Taiwan is likely to strengthen the leadership of China in the relationships between the three. On the other hand, the development of economic

integration will also place restrictions on China. In terms of post-return Hong Kong in particular, the future formula of "one country, two systems" will serve as a valuable test case in so far as the unification of China and Taiwan is concerned.

6. From the beginning of the 1990s, new trends have emerged in regional economic changes in China. Post-return Hong Kong is also likely to be incorporated in these changes. The Hong Kong-Guangdong link has served as an influential model for regional economic development in the past. In the future, however, the Shanghai-Yangtze link is likely to receive international attention. China expects the Hong Kong economy to function as a "buffer zone alleviating the contradictions experienced during the transition phase in the conversion to a market economy" after its return, in addition to its conventional function as a "capital procurement and export base." In time, however, economic leadership is likely to shift toward the Yangtze economic sphere.

Chinese Policy Toward Hong Kong and Taiwan and Future Prospects for Political Integration

7. Work towards the return of Hong Kong is entering its final stage, and China is beginning to assume leadership through the committee for preparation of the Hong Kong Special Administrative Region (SAR), and elections for the first chief executive and Provisional Legislative Council members have progressed favorably. Progress is also being made in preparations for stationing troops from the People's Liberation Army in Hong Kong. Work on the return of Hong Kong itself has already been incorporated as a domestic political issue, and disputes over who will assume leadership in post-return Hong Kong are intensifying within the Jiang Zemin administration. In addition to these post-return issues, difficulties concerning the resolution of conflicts between the SAR government and the Chinese central government and responses to friction between SAR and other regions are likely to emerge.
8. Demonstrations opposing Japan have developed among the Hong Kong residents over the Senkaku Islands (Diaoyutai in Hong Kong) issue. The Chinese government has expressed its support for the movement as a manifestation of "patriotism," but was apprehensive of the broadening of these demonstrations to within China itself. No indication was offered of the standards for response to political demonstrations in Hong Kong following its return, but the Chinese government's response to the recent demonstrations opposing Japan may be referred to in this regard.
9. "Basic Law of the Hong Kong Special Administrative Region" demands that the previous administrative structure be maintained within the SAR government and that the stability of Hong Kong society be ensured. The Hong Kong government office's personnel localization and retraining civil servants (including Chinese-language education) should respond to this demand, and this practical preparation should also be positive for the SAR government. Policy coordinated with that of the Chinese central government poses a difficult issue for the SAR government. Discussions over

education policy and the maintenance of the U.S. dollar pegged system following return manifest the concern felt in Hong Kong society over the expansion of central government influence.

10. As has been suggested in various public opinion surveys, some destabilization of the identity of Hong Kong residents caught up in the return is predicted. Rash conclusions cannot be made that the encouragement of demonstrations by residents over the Senkaku Islands dispute in the summer of 1996 is the precursor of future destabilization. Hong Kong residents, however, will undoubtedly face the difficulty of forming an identity as Chinese people in the future.
11. In his inaugural speech, Taiwanese president Li Teng-hui expressed his conditional intention to visit the mainland, but the tepid response from China to these remarks made clear the country's continuing severity toward President Li. There is little possibility that progress can be made on high-level talks between China and Taiwan on the problem of unification. China is working, on the other hand, to pursue further economic exchange with Taiwan, and policy towards Taiwan is likely to be initially characterized by a double-sided strategy involving (1) anti- "pragmatic diplomacy" using economic profit as a weapon in destabilizing Taiwanese relations with its friendly nations, and (2) confusion of the Taiwanese community through the separation of politics and economics.
12. Taiwanese authorities are moving toward the relaxation of regulations in its practical relationship with China and are working to improve relations. Concern over Chinese policy towards Taiwan, however, has not receded, and with the economic slump, a movement in Taiwan to restrict investment to China is also emerging. Both Taiwan and China are targetting recognition from countries recognizing the other, and competition between them within the international community is intensifying. The treatment of diplomatic offices of those countries recognizing Taiwan that are located in Hong Kong and organizations handling Taiwan's practical interests that are located in Hong Kong (including Chung Hwa Travel Service) is likely to pose problems immediately following the return of Hong Kong.
13. Demonstrations opposing Japan over the Senkaku Islands dispute have also emerged among the Taiwanese public. Although such organizations as the New Party have advocated cooperation with Hong Kong and China, the Democratic Progressive Party objected to this cooperation as leading to unification with Chinese leadership. Taiwanese authorities have expressed the following four principles for dealing with this issue: (1) advocating the Taiwanese right of land possession, (2) peaceful resolution, (3) rejection of cooperation with China, and (4) placing priority on protecting the profits of fishermen. Taiwan is also likely to aim for a peaceful resolution of this issue with Japan.