

ARTICLE FOR THE EDGE

HONG KONG'S PROTESTS: WHAT ARE THE WIDER IMPLICATIONS?

Hong Kong has been in turmoil for three months now and there is no sign of a resolution to the protests that were sparked off by the Hong Kong government's extradition bill that would have allowed easier repatriation of offenders from Hong Kong to other legal jurisdictions including China. Far from fizzling out, the protests have continued on a large scale, drawing in people from all walks of life, ages and occupations. On the other side of the confrontation, neither the Hong Kong city government nor the Beijing authorities have shown any willingness to relent either. In fact, warnings from Chinese and Hong Kong officials as well as state media have grown shriller.

Where will it all end? And, what are the implications, for Hong Kong and the wider region?

Our view is, first, that a brutal crackdown similar to the Tian An Men incident in June 1989 is not likely. However, the Hong Kong authorities will probably take tougher but calibrated action in the coming months to end the protests. Second, the long term impact will be substantial and mostly negative for Hong Kong – although there will be some mitigating factors. And, third, while rival global hubs such as Singapore may gain more business at Hong Kong's expense as a result, there will in reality be few winners from Hong Kong's predicament.

Most likely short term scenario: gradual and calibrated suppression of protests

There is little likelihood of the protests fading away on their own. A recent survey showed that 90% of the protestors were determined to sustain their campaign. Indeed, a surprising 93% even said that radical actions should be contemplated.

Neither is there a strong chance of the Beijing authorities mounting a brutal crackdown in the near term. Despite videos showing security forces supported by heavy equipment massing just across the border from Hong Kong, China's leaders will be loath to risk a violent confrontation between mainland Chinese forces and ordinary Hong Kong folks. Beijing will be patient for now, so long as the Hong Kong authorities do not lose control, violence remains limited to a small radical fringe and the protests are not infecting mainland Chinese.

But Beijing's patience is limited: it will not tolerate a prolonged period of unrest. Once the celebration of the 70th anniversary of the founding of the People's Republic of China is over by early October, it will be more prepared to take action. A plausible scenario is that the Hong Kong authorities will invoke the Emergency Regulations Ordinance, which gives them wide powers including detention of opponents and censorship. A carefully calibrated security operation to end the protests could then be carried out, mostly by Hong Kong's own police forces. The action would be made more palatable by being combined with some concessions to a few of the protestors' demands (such as a complete withdrawal of the extradition bill and the institution of a commission of inquiry into the protests and police actions).

In this scenario, the short term damage will probably be limited to a sharp economic slowdown in Hong Kong, but with much less impact outside Hong Kong.

The longer term implications could be more harmful for Hong Kong

It is therefore the longer term consequences that are more important for the rest of the region.

First, the protests have crystallised longstanding uneasiness with the Communist regime in China among a large segment of Hong Kong people. In June, soon after the protests started, a University of Hong Kong survey found that 53% of respondents identified as Hong Kongers, while only 11% identified as Chinese, the latter was the lowest level of identification with China since 1997. Hong Kong is also a more divided society now, since a significant proportion of the population oppose the protesters. A crackdown, even the modest one in our baseline scenario will produce a sullen population, divided and with social trust broken.

Second, it is clear that the way China ruled Hong Kong is not working. The Hong Kong political leadership lacks legitimacy because it is seen as unelected and the instrument of Beijing. The political economy has been dominated by certain business groups including property developers who have been allowed to enrich themselves at the expense of ordinary Hong Kong people. Finally, there is a dearth of civil society leaders with the moral authority to arbitrate in a conflict and broker a compromise. Consequently, differences are not bridged through consultation and consensus-building – leaving dissidents to take to the streets instead, creating the mayhem that China's leaders find unacceptable.

As a result, China will want changes to Hong Kong's politics, partly to establish a more workable system and partly to ensure that such protests are never repeated. What it might do to achieve this objective could be damaging to Hong Kong's value proposition as a global heart of commerce:

- Without explicitly changing Hong Kong's constitution, the Basic Law, laws and regulations will probably be introduced to limit protests and organisation of dissent. Since the new laws and regulations would eventually dominate over previous ones, the use of English common law – something quite important to international businesses who base themselves in Hong Kong – could diminish over time.
- Moreover, there are already signs of a climate of fear being induced to limit expressions of hostility against the mainland. Recent media reports indicate pressure on Hong Kong as well as multinational companies such as Cathay, the Big Four accounting firms to rein in what their staff comment on.

The result will be that Hong Kong's institutions – media, judiciary, civil service, regulatory agencies, and so on – would gradually become seen as less and less "British" and more and more resembling their counterparts in the mainland. Another impact would be that trust in Hong Kong could be weakened: but trust is critical to the success of a global financial and business hub.

Third, there are two reasons why big power rivalry in the East Asian region may become more pointed as a result of the Hong Kong turmoil.

- Taiwan's attitude to mainland China is hardening. The protests in Hong Kong and China's reaction to them have reminded Taiwanese why they fear China. A Mainland Affairs Council poll in late July found that 88.7% of respondents rejecting the "one country, two systems" model which China has offered to Taiwan. This is up from 75.4% in the January survey. China's relations with Taiwan are likely to worsen and Taiwan is likely to turn increasingly to China's rivals in East Asia – the United States and Japan – for protection.
- In addition, America and the West in general will interpret China's actions in Hong Kong as confirming their fears that China would not follow the Western path of political development where economic progress eventually leads to political freedoms that would make China more like the West. The West would become less trusting of China and less willing to cut it slack. There is a growing chance that the US Congress

may use any changes China makes to Hong Kong's political system as an excuse to withdraw the special status that the United States accords Hong Kong, as a separate territory for trade, immigration and other purposes. Without that special status, Hong Kong's business and financial centres will struggle.

Will there be any mitigating factors to help Hong Kong?

While the current political turmoil will certainly have all these adverse implications, it is not the entire story. There are some mitigating factors:

- Global centres of commerce and finance are quite resilient. Given the critical mass of interlocking activities, each depending on the other, it takes a huge disaster for activities to relocate on a big scale. Even with all the possible downsides discussed above, Hong Kong will retain a strong position as a trading, financial, aviation and headquarters location for global firms.
- Hong Kong will be part of China's far-sighted Greater Bay Area plan which will integrate major urban areas of the Pearl River Delta including Hong Kong, Shenzhen, Guangzhou and several other cities into a single urban agglomeration of more than 70 million people producing USD1.5 trillion of economic output a year. There are few other urban agglomerations in the world which would enjoy the same economies of scale and scope – Hong Kong would enjoy all the benefits of being part of this super-competitive region.
- Even as some of Hong Kong's current unique traits erode, others will remain in place. It is unlikely, for instance, that the Hong Kong Dollar's peg to the US Dollar will be abolished any time soon – that peg will still provide a buffer of stability for Hong Kong, especially its financial centre.

What will the economic fallout be?

Putting all this together, how will the rest of the region be impacted? In essence, Hong Kong will lose some of its appeal as a global heart of commerce, which could benefit its main and perhaps only real rival – Singapore - in the following areas:

- **Shift of regional headquarters of global firms:** The possible changes in Hong Kong – erosion of the common law, a climate of fear, diminished recognition as a legal entity separate from China – would reduce the trust that is so vital to a global

hub. At the margin, more global firms may therefore choose to locate key parts of their Asian headquarters in Singapore over Hong Kong. Certainly, firms from countries already suspicious of China such as American and Indian firms will veer more and more to Singapore. Highly-skilled talent from abroad may also prefer Singapore over Hong Kong – particularly if Singapore were to address weaknesses such as its low ranking in press freedom and related areas.

- **Some financial market activity, but not most, could also shift:** Those activities which depend on trust and the use of common law such as private banking will tend to prefer Singapore. However, the bulk of financial activities which depend more on the critical mass of Hong Kong's cluster of financial institutions and markets plus those which principally serve China will not move – e.g., fund management, equities trading and equity IPOs/listings.
- **High-end tourism such as conventions:** When it comes to hosting major events such as large-scale conferences and conventions, Americans will probably prefer Singapore. Thus, this lucrative component of tourism could move in Singapore's favour.

The bottom line

Hong Kong may only be a small part of China now, but what happens there can still have outsized impacts on the rest of the region. The long term effects of today's turmoil may well diminish some segments of Hong Kong's economy to the benefit of rivals such as Singapore – but only in limited areas. Overall, Hong Kong plays a complementary not competitive role even for competitors such as Singapore – any damage to Hong Kong will be in general adverse for the region as a whole.

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