Oral evidence: The UK's relations with Hong Kong: 30 years after the Joint Declaration, HC 649

Tuesday 6 January 2015

Ordered by the House of Commons to be published on 6 January 2015

Watch the meeting

Members present: Sir Richard Ottaway (Chair); Mr John Baron; Ann Clwyd; Mike Gapes; Sandra Osborne; Andrew Rosindell; Frank Roy; Sir John Stanley; Nadhim Zahawi

Questions 258-279

Examination of Witnesses

Witness : **Duncan Innes-Ker**, Senior Editor/Economist, Economist Intelligence Unit, gave evidence.

Q258 Chair: I welcome members of the public to this sitting of the Foreign Affairs Committee and the seventh evidence session of our Hong Kong inquiry. I am delighted that the witness today is Mr Duncan Innes-Ker, who is a senior editor at the Economist Intelligence Unit. Thank you very much indeed for coming.

Duncan Innes-Ker: Thank you for the invitation.

Chair: We have been digging into this now for quite a long time. As you know, the platform on which we are operating is to scrutinise the Government's six-monthly reports on Hong Kong. Do you think that they are fair and accurate? Are they actually giving a good indication of what is going on in Hong Kong at the moment?

Duncan Innes-Ker: I think they give a broad coverage and a good, deep coverage, but I would agree with some of the witnesses who I believe have said that they sometimes lack colour and may not be giving a full sense of the feelings on the ground. In that respect, that may be a function of the nature of the reports themselves: they are public and the Government is aware of other needs that are impinging and presumably wants the reports not to interfere in these other goals that it may have. As a result, it may be keeping them as basic, shall we say, as possible, but in terms of the information conveyed in them, they seem to be pretty complete as far as I can see.

Q259 Chair: So you think they are giving an accurate picture.

Duncan Innes-Ker: They are giving an accurate picture as far as they go. They might be able to give more of a sense of the change in how things are, relative to how they were before, and also more in the way of opinion. That is perhaps the reason why they seem somewhat bland: they are a repetition of fact rather than an expression of opinion.

Q260 Chair: Okay. Do you think that in 10 to 20 years' time Hong Kong is likely to remain the largest financial services centre in Asia and a primary gateway for investment into China? We have had a lot of witnesses saying that there is a shift to Shanghai, yet quite clearly Hong Kong is very much the centre of the hub. Do you think that it will stay that way?

Duncan Innes-Ker: China will obviously be an economy with room for more than one financial centre; that is probably the way to start on that question. When you look at the situation, there is a bit of a break. In the five-year outlook, there is very little doubt that Hong Kong will remain a much more significant international financial centre than Shanghai, simply for the very basic facts that China's currency remains not freely convertible and that there are some obvious regulatory issues in Shanghai, not to mention reputational facts. In the five-year time frame, there is no question, but when you look out 20 years, it becomes a lot less predictable, partly because you are dealing in those circumstances with questions about what actually happens on the mainland in terms of political reform and financial reform.

If we see institutions become much more developed and if we see the trade and financial services totally liberalised on the mainland over that period, it is possible that Shanghai could overtake Hong Kong in that field. Having said that, Hong Kong has a very strong head start, it has also been historically very entrepreneurial in how it develops its financial sector, and it has an international culture that Shanghai will take a long time to come anywhere near matching. There are ways in which you can see that Hong Kong would start with a lot of advantages over Shanghai in that sort of area, but Shanghai will probably be more dominant when it comes to domestic finance raising.

Q261 Chair: Is it fair to say that China does not need Hong Kong in the way that it used to?

Duncan Innes-Ker: Absolutely. I was looking at some of the numbers in preparation and they say it all. In 1997, Hong Kong's economy was about a fifth of the size of the mainland's; it is now less than 3%, and according to our calculations Shanghai's GDP is going to be 30% bigger than Hong Kong's this year, so it is clearly no longer as economically relevant in that sense. Its role as an entrepôt has also essentially been diminished in terms of the actual trade in merchandised goods. It used to handle about 50% of China's goods trade in 1997; that has dropped to about 13%, give or take, on the latest numbers. All of Hong Kong's re-export trade is essentially coming to or from China. In that sense, Hong Kong is much more dependent on China now than it used to be in the past and China is much less dependent on Hong Kong.

Having said that, in any country with a continental mass like China's, each city will have a role to play and Hong Kong is still a vibrant, dynamic economy with an important role to play in the Chinese economy. It is, of course, still the richest Chinese city in terms of income per head if we ignore Macau. It is still important for China, but perhaps not in the way that it was in the past.

Q262 Chair: In the light of that, do you think that this colours their attitude to the political development there? Do you think they could be a bit more dismissive of Hong Kong? They made a commitment that it should have a high level of autonomy. Can they be a bit more cavalier about that now?

Duncan Innes-Ker: It certainly hasn't helped Hong Kong's case recently that it is increasingly seen as a supplicant to mainland China and that the relationship has quite often been seen in recent years as being benefits that China gives Hong Kong rather than stuff that Hong Kong is able to offer itself. That is obviously a factor of a number of elements ranging all the way through from the Asia crisis to SARS and so on, and the way that China helped Hong Kong through those difficult periods.

Having said that, I think that the idea that China can simply be dismissive of what is going on in Hong Kong is perhaps overstating the case. They have a great interest in political stability in Hong Kong and if the current structure is leading to continuous and ongoing public unrest, then that is a cause of major concern for the leadership over there. It is not as if they can simply ignore it; they have to deal with it somehow.

Q263 Sir John Stanley: From where you sit, could you tell us whether you agree with the evidence that we have had from some witnesses in this inquiry, and indeed similar evidence in previous inquiries by this Committee on Hong Kong, that the business community in Hong Kong is overwhelmingly concerned with prosecuting its business interests in Hong Kong, too ready to kowtow to the Chinese authorities in Hong Kong and insufficiently ready to stand up for the principles of the Joint Declaration, including the principle of a right to peaceful protest?

Duncan Innes-Ker: It is hard to generalise, of course, and the business community is more than just the tycoons. It was noticeable, for example, that when you saw the accounting companies come out with their position against the Occupy movement, there were also contributions from workers within those companies coming out in the opposite direction. One does not want to make too many generalisations about the business community.

Having said that, there is, on the one hand, a comfortableness with the existing arrangement, certainly among the local elite. You can sense that that comfortableness has perhaps gotten too close in recent years, particularly in terms of the number of cases that we are seeing of outright corruption and perhaps somewhat dubious connections between the local political community and the business sector. In that sense, you can see why the links between the politicians and the business people and their interests in preserving stability have developed in the way that they have, but you also have an awareness, which has perhaps been heightened recently, that, actually, it is no good for the local business community if you end up with a system in which you maintain the status quo at the expense of continuing political instability on the ground because that also has repercussions. One of the things that people used to be frightened of in the business community in the past was that if you allowed more of a public voice, you would see an end to low taxation, light regulation and so on. I think there is probably a growing recognition that that is going to happen anyway and it is a process that the business community needs to engage in, rather than fight in its entirety.

Q264 Mr Baron: Can you give us a bit of a better feel as to the importance of Hong Kong to British trade in the region? Various statistics would suggest that it is an important trading partner, but we still rank pretty low on Hong Kong's list of countries traded with. Do you think that Hong Kong is likely to retain its place as the hub for British businesses and investment in China, given the rise of alternative locations, such as, for example, Shanghai?

Duncan Innes-Ker: Sure. I will be quoting some Government statistics here, so I hope I will not repeat what you already know. For example, goods and services exports to Hong Kong are significant—about $7.5 billion in 2013. To put that in perspective, that is more than goes to Singapore, for example, but it is relatively low in the grand scheme of things and is only around 2% of earnings that the UK got from abroad in that year. So it is not dramatically important for Britain, in terms of the trade relationship, but it is important within the Asian context in particular.

There is a similar story on investment. If you look at the volume of investment, it is quite significant—about $130 billion in 2012, which again is more than Singapore, but a lot less than you would see elsewhere: for example, Belgium has a higher stock of UK investment. I should add that I am a little nervous about quoting the investment numbers in particular, because a lot of money gets channelled through offshore centres and as a result it is very difficult to say where investment tends to come from in precise detail.

Q265 Mr Baron: May I just stop you there, if you don't mind? There is no shortage of statistics out there, and you've been the first to admit it. Those figures in isolation sound like very big numbers, but life is relative. You look at the fact that the UK still ranks only—what?—10th, 11th or 12th in importance to Hong Kong when it comes to share of business, basically. Are you confident that Britain will be able to keep up, if not increase, its business with Hong Kong, relative to other businesses and business partners in countries? We rank well behind some countries very close to home in our dealings, despite our close links to Hong Kong, the rule of law and the fact that British business should very much feel on home-grown territory, given the close history between the two countries.

Duncan Innes-Ker: Yes. Looking at the broad picture, I think that a certain amount of erosion of the British relative standing is natural; that is simply a reflection of the fact that our ties are gradually easing as the years go by. It remains, together with Singapore, the most culturally friendly place to people who come from the UK. It is certainly much friendlier and easier to live in than anywhere else on the mainland, and I speak from experience there.

The real risk is not so much that we lose importance relative to western economies but the fact that Hong Kong is increasingly oriented towards Asian business partners, and the ones that we are more likely to be overtaken by are south-east Asian economies and people from that sphere of the world, simply because those economies are growing very fast and they are much closer to Hong Kong and, as a result, have much closer ties.

Within the China context, though, I think that Hong Kong will continue to be much easier for British businesses to operate in than any other Chinese city for probably the foreseeable future, and certainly until the end of the 50 years under the Joint Declaration.

Q266 Nadhim Zahawi: In your view, does the UK prioritise its trade and investment relationship with China above concerns relating to Hong Kong?

Duncan Innes-Ker: That is probably inevitable to an extent, if we are talking about political concerns, simply because China is already a much bigger trade relationship—more than twice the size in terms of exports—and has much stronger growth opportunities. Many others have debated the issue before the Committee, but I fall in the school that thinks that political issues do affect where China makes its purchases. In the longer term, it is true that if China wants something that you sell, it will probably come to you, but in many markets we are talking about products that are fairly easily exchanged with those in other markets. The example of Norwegian salmon has been mentioned, which is benefiting Scottish farmers. There are many other trade disputes where China has taken retaliation and brought the other side around to its position by imposing—usually unofficial—trade constraints. We see that in political disputes. For example, according to the Chinese data, exports this year from the UK to China are up by 25%, which is a much faster growth rate than we saw in the past couple of years when there was the issue over the Dalai Lama.

Q267 Nadhim Zahawi: Lord Patten and Jonathan Fenby told the Committee that economic relations with China would be unlikely to suffer if the UK took a more openly supportive position on democratic reform in Hong Kong. They actually cited the Prime Minister's meeting with the Dalai Lama, after which exports went up, not down. Do you agree that you can take a position politically and yet still do business?

Duncan Innes-Ker: This is one of those issues where a lot depends on which statistics you are looking at. The UK statistics show growth in exports. I am not entirely sure where the source of difference with the Chinese data is; it may be currency-related because the Chinese one is in US dollars, of course. It is an issue where you pick and choose your story, but a number of people certainly have felt the impact of the lack of support in China for their purchases because of the political issue. It affects business dealings that have a high level of political content, but there are an awful lot of those in China.

Q268 Nadhim Zahawi: That sounds to me like you disagree with the position that Lord Patten and Jonathan Fenby would take. If you disagree, what do you think would be the impact on UK-to-China trade if the FCO supported the pro-democrats more strongly?

Duncan Innes-Ker: It is very hard to say. A lot of it would depend on the importance that China attached to the UK position, how forcefully it was expressed and so on, but you can see from the example of Norway that at least some sectors—probably those politically most connected to the people who were making the most noise—would be disproportionately affected.

Q269 Mike Gapes: May I ask you about the recent protests? We have had conflicting information from different witnesses about the extent to which there were differences between the traditional, established, pro-democratic parties, and the new, student-led protest movement. Does the new movement mark a substantial, enduring change in the political landscape of Hong Kong?

Duncan Innes-Ker: That is a very good question, but it is still a little early to say. The interesting contrast is with the sunflower movement in Taiwan earlier in 2014. That was a student occupation movement and, from what I hear, it is fizzling out with very little impact on the ground and on the political scene because there was no real underlying dynamic behind it.

I think the situation is somewhat different in Hong Kong. The student movements have now demonstrated twice that they are well organised, capable of holding protests and quite astute at PR. There is a much higher chance of the student movements in Hong Kong turning into a more established organisation. What interests me is that that movement has a very young leadership who have managed to demonstrate impressive organisational skills. What Hong Kong has lacked on the pro-democracy side for some time is the next generation to follow up many of the leading lights of the democratic parties that have been around pretty much since 1997. This will give a lease of new blood and new activists to that cause, with democracy forming a pillar around which that movement can unite its fairly disparate elements.

Q270 Mike Gapes: This is obviously a speculative question, but I will try anyway: how do you think this new leadership and movement is likely to affect the relations between the Hong Kong Special Administrative Region and the UK Government? Will it present the UK with a more difficult set of issues to confront, or will it be business as usual?

Duncan Innes-Ker: Which particular aspects of the relationship do you mean?

Mike Gapes: This is a new generation with perhaps more focus on direct action and, as you said, younger. Does that mean that the UK will have to build a new relationship and deal with people who behave in slightly different ways from Martin Lee and the generation you referred to from before 1997 and afterwards?

Duncan Innes-Ker: Clearly, being a young generation, there are not the same colonial-era ties of the older generation. In terms of building new personal relationships, that is clearly something that people will aim to do over the next few years. In the way they operate, they are more activist, but I am not sure that that is a challenge for the UK. I think it is more a challenge for the local authorities and how they organise. The question is whether the UK has a role to play in bringing together the various disparate elements of the movement.

I know other witnesses talked about how politics in Hong Kong has become more polarised and that that has made coming to agreements more difficult. It strikes me that one of the roles the UK may have to play is serving as a potential bridge between the various different factions. If we don't do that, one imagines that someone will have to emerge who can play that role, because there are essentially three different factions in the Hong Kong political debate that are struggling to find ways to talk to each other, because there is a lack of trust between them: the mainland Government; the Hong Kong Government; and the pro-democracy opposition.

Q271 Mike Gapes: Is it not likely, if we try to play that role, that the British Government—not just the Foreign Affairs Committee—will be immediately denounced as interfering in internal affairs and so on?

Duncan Innes-Ker: It depends how publicly one is playing it and also whether that role was being encouraged by anyone. To be honest, I do not know what is going on behind the scenes in this regard and how the debates between the different factions are moving forward. I have not seen much in the public sphere and I have not heard much, which makes me think that there is a long way to go in improving communication channels.

Q272 Sandra Osborne: We have had quite a large number of submissions concerning the number of people from mainland China migrating to Hong Kong, which is within the power of the Chinese authorities rather than the Hong Kong authorities, and the increasing use of Mandarin as a language in Hong Kong, which threatens Hong Kong's autonomy. What effect do you think that the changing demographics will have politically, culturally and in terms of business relationships with the UK?

Duncan Innes-Ker: On the first point, I am not entirely sure how solidly the perception of the increased Chinese presence is based on actual reality on the ground. The numbers I have seen are that there are about 700,000 mainlanders now in Hong Kong, which is 10% of the population. That is significant, and certainly much higher than the percentage of other non-Chinese minorities, but it is still only 10% of the population. I think that any society can cope with that level of new arrivals. What perhaps increases the perception is that there are some 45 million tourists from the mainland in the country in any given year. As a result, you feel the presence of a lot more mainland Chinese than perhaps the data suggest are living there. Again, I am not sure how much is perception and how much is not being captured by the data, but the numbers tend to suggest that the perceptions are a little overplayed.

On the impact of a growing mainland presence on the UK's relationship with Hong Kong, the biggest concern is on English language standards. That concern is shared within Hong Kong itself in terms of how it relates to the international community. From our side, the concern is perhaps on education opportunities and so on. In general, this has been an ongoing concern for a number of years, and it is not deteriorating that noticeably. Many of the mainland Chinese who operate in Hong Kong in international fields also speak English. English will remain the main language for Hong Kong in the way it does business so long as it is focused primarily on international finance. Given that mainland Chinese cities are going to have a stronger competitive position in dealing with domestic finance, Hong Kong will need to focus on international affairs. In that sense, it will need to retain its English language capabilities.

Q273 Andrew Rosindell: Hong Kong is an outstanding economic success. At what point will the political impasse and the current situation in Hong Kong actually start to damage that economic success? At what point do you think we will see it truly undermined by what has been taking place?

Duncan Innes-Ker: Again, that is a very interesting question that probably requires a long answer. I will try to keep this a lot shorter than it should be. There are a lot of reasons for Hong Kong's success, but clear among them are the low and simple taxation system, and the light business regulatory touch, as I have said. It is inevitable in any system that has a higher degree of popular input and of responding to public concerns that those two elements will be eroded. We are already seeing more pressure for such things as minimum wages, which have already been introduced, with limited impact in most of the studies that come out. You are also talking about things like standard working hours and universal pensions, which they are discussing. Inevitably, as the Government try to assuage public concerns, they will start imposing businesses that erode Hong Kong's strength on that side, but it will still remain an outstanding low-regulatory environment for at least the next decade and probably beyond, partly because it competes so strongly with places such as Singapore. The bigger risk would be if politics got so bad that we saw any sort of intervention from China or if there was any political instability within China. Those two elements would have a very direct and immediate impact on the business environment in Hong Kong because people would probably no longer feel comfortable.

Q274 Andrew Rosindell: So we are not there yet, but if it got substantially worse, it would have potentially major implications.

Duncan Innes-Ker: It would have to get substantially worse, but people have perhaps awoken to the fact that the politics has an impact on the business environment.

Q275 Andrew Rosindell: Do you think that the UK could be affected more than others, bearing in mind the links between Hong Kong and the UK?

Duncan Innes-Ker: I think there would be significant issues in certain areas. There are obviously particular concerns relating to the banking sector—there are two very big British banks in Hong Kong. I am not sure precisely what the regulatory arrangements are, but there are exposures that presumably need to be monitored in that aspect, and there are a lot of businesses and UK citizens in Hong Kong.

Again, however, I do not want to over-hype the situation. The outcome of the recent process showed that, despite all the talk about the PLA potentially being sent in and that sort of thing, there is a lot more room for give and take in terms of the political scene than some of the more paranoid observers give credit for. We are very far away from any sort of situation that would require that sort of thinking.

Q276 Ann Clwyd: We have had quite a number of people give evidence to the Committee who were very critical of the UK Government's response to events in Hong Kong. How would you assess the UK's response to developments in Hong Kong since the White Paper?

Duncan Innes-Ker: Personally, I have very mixed feelings, partly because I was born and raised in Hong Kong and so I have a lot of attachment to the territory in itself. From that perspective, I agree with many of the criticisms of the Chinese Government's position on political reform as it has been stated, and I hope that Hong Kong is able to find a way to express public opinion and give genuine choice in the Chief Executive election. I also think that there is a responsibility to monitor under the joint declaration. It is a commitment that we made.

Having said that, as someone who knows how China operates and has a lot of experience in how it thinks, I also feel that it is very clear that it will be perceived in China as outside interference. Fundamentally, when it comes down to it, Hong Kong is a part of China and, ultimately, the Hong Kong people and the Chinese Government will have to come to some sort of arrangement between themselves. The UK's influence on that process is going to be very limited, so I have mixed feelings between what I would personally like and what I objectively think is both realistic and possible.

Q277 Ann Clwyd: Would it help the protesters if the UK was more vocal?

Duncan Innes-Ker: Honestly, I don't believe it would. The idea that outside forces would influence China's position is probably misguided—indeed, it is more likely to stoke the opposite type of reaction. The main influence it would have is to embarrass the Chinese Government, and this Administration appear less likely to be embarrassed into changing its mind than past Administrations were. I don't believe it would be that effective in terms of influencing the situation if we took a stronger position, whether or not there is a moral imperative on us to do so.

Q278 Chair: We are expecting a vote in the House at any second, and that just about completes our questioning on Hong Kong. Bearing in mind your day job, I would be interested to hear your views on the Chinese economy at the moment. Is it in as good shape as the Chinese Government would have you think, or is it actually in worse shape?

Duncan Innes-Ker: I will give you the brief story. The doomsayers may well be proved wrong. The Chinese have got themselves into a very difficult situation, particularly with regard to over-leverage and excessive dependence on investment, but they are making relatively good progress on addressing that problem—perhaps as good as we could have hoped. Investment has slowed sharply without having destabilising effects on the employment market, for example. The real challenge is that we still have major problems in the financial sector and a huge over-supply in the property market. Those two issues are still very early in the resolution process. It is very fragile, but things have gone as well as could be hoped in the past two or three years.

Q279 Chair: With a population of 1.4 billion, it seems a bit odd to say that there is over-supply in property, or does that point to a high level of inequality?

Duncan Innes-Ker: The main problem is that the "build it and they will come" school has become very established in China, partly because there are a lot of incentives on local officials to maintain high rates of GDP growth. In some places, that tactic will continue to work well for a long time, but in other places the urbanisation story, which has allowed it to be fuelled, is already beginning to run out of steam. Although we are still seeing massive flows of people from the countryside into the cities every year, the pace of that inflow is slowing, which means that in absolute terms you need fewer houses each year. What we are seeing is that although investment in housing is slowing, it is still growing, so you are still seeing increased amounts of property coming on to the market, even as the supply of people is decelerating, which is creating a widening gap between the underlying demand situation and the supply situation. It will probably be fine in many of the bigger cities, which can continue to attract people, but in places such as the north-east and the western parts of the country, you will probably start to see significant problems emerging in those housing markets fairly quickly.

Chair: Interesting. We could quiz you for a long time, but we invited you here to talk about Hong Kong. On behalf of the Committee, I thank you very much indeed for coming along. It is much appreciated.

Duncan Innes-Ker: Thank you.