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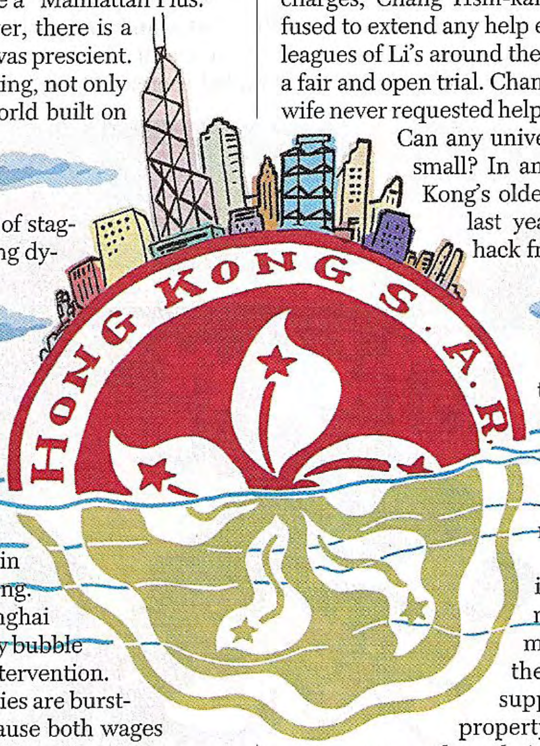
Is Hong Kong Dying?

Maybe FORTUNE's notorious 1995 death knell wasn't so far off the mark

IN 1995 *FORTUNE* MAGAZINE, A SISTER PUBLICATION OF TIME, published a famously controversial article entitled *The Death of Hong Kong*, which predicted that after 1997, when communist China resumed sovereignty over the city, it would cease to be a "vibrant international hub." The ensuing years made the argument seem naive, and Hong Kong's élite still cite it as an example of foreign ignorance. Local hubris hit a high recently when a senior official proclaimed that Hong Kong is destined to become a "Manhattan Plus."

Underneath the bravado, however, there is a growing fear that perhaps FORTUNE was prescient. Hong Kong is having trouble competing, not only with a rising China, but against a world built on brains, not asset trading. As the mainland maintains its rapid growth rates, Hong Kong is barely above water after three years of stagnation. To the question "Is Hong Kong dying?" a prominent barrister recently offered this reply, made only half in jest: "It is already dead."



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Hong Kong's basic problems are well known. It is too expensive, in terms of both wages and real estate, and its government is too big. University graduates have poor skills not only in English but in Chinese, too. Corporations are hiring in the mainland, and firing in Hong Kong. Premier Zhu Rongji, a former Shanghai mayor, allowed the mainland property bubble to burst in the mid-'90s without intervention. Now, Shanghai and other Chinese cities are bursting with new businesses in part because both wages and asset prices are but a fraction of Hong Kong's.

Restoring the territory's competitive foundation can be done—but at a price. The local dollar could be repegged to the U.S. dollar at a lower rate—from the current 7.8 to 10, say—and exporters, the services sector and the tourist trade would grow while consumers would suffer. But the government has ruled out repegging, insisting, mistakenly, that a change would lead to destabilizing currency speculation.

An alternative would be to allow asset prices and wages to deflate until the market finds its own equilibrium. But the government fears a negative effect on Hong Kong's corporations, especially its banks, which rely heavily on real-estate revenue. It is also afraid of massive defaults, because numerous homeowners are believed to be suffering from "negative equity." These misguided concerns have frozen the debate: no one seems to care that lower property prices would attract new home buyers and businesses, creating employment. Without bringing costs down, however, Hong Kong doesn't have much of a future.

The problems aren't limited to politics and the economy. Hong Kong's seven well-funded universities have failed to do their job in helping to develop the territory into a creative city. No metropolis ever became important without world-class academic institutions. Consider the City University of Hong Kong. Earlier this year when one of its professors, Li Shaomin, disappeared into a Chinese jail on trumped-up spy charges, Chang Hsin-kang, City University president, refused to extend any help even as some 600 scholars and colleagues of Li's around the world signed a petition calling for a fair and open trial. Chang excused himself by claiming Li's wife never requested help. (In fact she had asked him twice.) Can any university become great if its leader is small? In another outrage, the head of Hong Kong's oldest university resigned in disgrace last year after kowtowing to a political hack from the Chief Executive's office to silence a poll-taking professor.

These leaders have sent a clear message to the academic community: "Don't make waves." But without intellectual integrity, can there be excellence? Without excellence these institutions are a burden, not an asset, to Hong Kong.

The business élite aren't helping either. Hong Kong sorely needs a political party to promote more market, less government. Yet the territory's business leaders have supported state interventions in the property and stock markets (which have propped up their wealth). Instead of facing up to Hong Kong's problems, they blame Britain, saying the former colonizers left behind "time bombs" that are now exploding. In fact, Britain left the world's third-largest pool of foreign reserves and the rule of law, which none of the tycoons would trade for communist-style justice. The truth is that Beijing's office for Hong Kong affairs, on the advice of many of these tycoons, created the property bubble in the 1980s by dictating that the British could sell only 50 hectares of land each year until the handover. Too little land, too much hot money and excessive optimism about a better Hong Kong under Chinese rule have landed the city in need of some intensive care.

Hong Kong is not quite dead, but it is bleeding. It badly needs leaders that can rally the community to accept short-term pain for long-term benefit. Otherwise, Hong Kong in 10 years' time won't be a "Manhattan," let alone its "Plus," but something more like a "Shanghai Minus." ■