

# **TAIWAN AND HONG KONG RE-EMBRACE**

## **EACH OTHER**

**By Yun-han Chu**

**January 2010**

For more than half a century, Hong Kong has played an indispensable and virtually irreplaceable intermediary role in cross-Strait relations. In an unintended way, Hong Kong has been the primary beneficiary of the protracted political standoff in the Taiwan Strait. But this will soon become history as we witness the dawning of a new era of rapprochement between Taipei and Beijing following the inauguration of President Ma Ying-jeou in May 2008. Since then, the pace of normalizing trade and investment relationships and deepening economic integration and cooperation across the Strait has progressed at a stunning speed. As negotiations between Taipei and Beijing about a new Economic Cooperation Framework Agreement (ECFA) seemed near a successful conclusion, both Hong Kong and Taiwan felt the need to rediscover each other's attractiveness and usefulness, redefine their common interests and complementary concerns, and reset their bilateral relation on a new and firmer footing.

Ever since 1949, Hong Kong's special political status, laissez faire economy, commercially friendly legal system, geographical location and efficient infrastructure have long earned it a unique place in cross-Strait relations. Before the 1997 handover, Hong Kong had served both as the most convenient hub as well as a politically-neutral buffer zone for the two sides to conduct indirect economic exchanges and social contacts. Torrential flows of mail, trade, investment and travelers have passed through Hong Kong as economic exchange between mainland China and Taiwan steadily accelerated since the early 1990s. After 1997, Hong Kong's pivotal role was not diminished. Both Beijing and Taipei wanted to preserve Hong Kong's intermediary function for their own reasons, and they made the necessary adjustments in their respective regulatory

framework to accommodate the new political realities resulting from the handover of Hong Kong to Chinese sovereignty.

In the recent past, two developments further strengthened Hong Kong's role in facilitating Taiwanese firms' expansion in the mainland. First, there was growing antagonism between Taiwan's business elite and the pro-independence Democratic Progressive Party (DPP) government, which persistently refused to normalize the trade and investment relationship and in particular remove the 40% cap on total investment in mainland China for listed Taiwanese companies. This prompted many of Taiwan's large companies to establish offshore operations to circumvent the restriction.

Second, the 2003 signing of the Closer Economic Partnership Arrangement (CEPA)—a free trade agreement between China and Hong Kong—induced many Taiwanese firms to re-package themselves as Hong Kong-based companies to enjoy preferential treatment in the mainland market. All major Taiwanese financial institutions wanted to improve their access to the financial services market of mainland China by obtaining business licenses in Hong Kong. Many mainland-based Taiwanese business owners also picked Hong Kong for launching their initial public offers (IPOs) of company shares. Between 2002 and March 2008, a total of 35 Taiwanese companies held IPOs in Hong Kong, which was double the combined total of Taiwanese companies' IPOs issued in Singapore, Paris, and New York over the same period.<sup>1</sup>

### **Up the Peak and Down Again**

Hong Kong's intermediary role reached its peak in the first half of 2008. In 2007, the total visits by Taiwanese travelers topped three million and there were 340 flights a week between Hong Kong and Taiwan, a historical record. The 2007 bilateral trade volume reached US\$39.8 billion, also a record. By 2008, Taiwan became Hong Kong's fifth largest trade partner, third largest market for Hong Kong-made products, eighth largest re-export market, and fourth largest import source. But since then all the trend lines have been dipping downward. For instance, the number of Taiwanese travelers declined 7% in 2008 and by a whopping 21% between January and October, 2009. Bilateral trade between Taiwan and

Hong Kong contracted by 19.2% during the first 10 months of 2009, partially due to the global economic downturn.<sup>2</sup>

A full-scale normalization of the cross-Strait economic relationship under the Ma administration pulled the rug from under the feet of Hong Kong. Within a year, the Kuomintang (KMT) government introduced direct air, sea and postal links and opened the door for mainland Chinese tourists. By July 2009, there were more than 270 direct flights per week between Taiwan and popular mainland destinations. Mainland tourists were also allowed to take cruise ships to visit Taiwan. The KMT government also lifted the ban on inbound investment by mainland Chinese firms and loosened up the 40% cap on mainland-bound investment. Mainland-based Taiwanese business owners are now lured back to launch their IPOs on the Taiwan Stock Exchange. Some Hong Kong-listed Taiwanese companies have been approached by Taiwan's exchange to consider delisting from Hong Kong and returning to Taipei. Also, the signing of agreements called memorandums of understanding (MOUs) between the two sides' banking, brokerage, and insurance regulatory authorities opened the door for Taiwanese financial institutions to enter the mainland market. The two sides also will soon sign a currency clearance arrangement so that renminbi (RMB) can be openly traded on Taiwan's foreign exchange market and Taiwanese banks can offer their clients RMB-based services.

All these developments suggest that Hong Kong's intermediary role might diminish in a substantial way. In the future, Hong Kong will have to earn its place in the Mainland-Hong Kong-Taiwan triangular relationship on the basis of what it does best, rather than because of its unique political status. Hong Kong will have to compete with Shanghai, Beijing and Shenzhen on the basis of its market-friendly regulatory regime, superior infrastructure, efficient financial service, free media and trustworthy legal system. In a nutshell, the Taiwan-Hong Kong relationship is embarking on a new era of normalization with minimum policy-induced distortion. At the same time, Hong Kong firms should expect to compete with Taiwanese firms in the mainland on a level playing field because most of the benefits they enjoy under CEPA will be accorded to Taiwanese companies when the new ECFA between Taipei and Beijing is completed.

## **“Unofficial” Contacts Only**

However, on balance the recent cross-Strait rapprochement will benefit Hong Kong-Taiwan relations in the long run. These have been embedded in the larger cross-Strait relations ever since the 1997 handover. In the past, Beijing laid down the overarching framework, popularly known as former Chinese Vice Premier Qian Qishen’s Seven-Point Announcement, that enabled the Hong Kong Special Administrative Region to continue its commercial and cultural relationships with Taiwan. Beijing also advised the HKSAR government on a day-to-day basis how to handle politically sensitive issues regarding Taiwan. Hong Kong customarily denied entry visas to DPP political figures and senior Taiwanese officials (above the vice minister rank), except under the auspices of international bodies such as the World Trade Organization or the Asia Pacific Economic Cooperation group.

To save itself from potential political liability, Hong Kong avoided direct contact with the Taiwanese government or its representative agencies and kept the bilateral relationship strictly “unofficial.” It did not keep any official or semi-official representative office on Taiwan, nor did its administration assign a Taiwan affairs portfolio to any department. Contacts usually were carried out by the Hong Kong Chief Executive’s private political advisor affiliated with the Central Policy Unit. Before May 2008, no senior HKSAR official had ever visited Taiwan. At the same time, Taiwan’s semi-official representative office in Hong Kong was registered as the Chung-Hwa Travel Agency to avoid any symbolism of officialdom.

Now cross-strait rapprochement is injecting new life into this relationship. Following the Ma inauguration, the big chill between Hong Kong and Taiwan government disappeared nearly overnight. Both sides have shown their willingness to upgrade the bilateral relationship and find ways to realize untapped synergy and develop new commercial and cultural ties in a balmier political climate. The two governments have made it much easier for travelers to visit each other. Any Taiwanese with a valid “Mainland Travel Permit for Taiwan Residents” issued by Beijing can enter Hong Kong without a visa. Hong Kong travelers can get visas upon

arrival if they had entered Taiwan previously and had not extended their stay. Taiwan also opened its domestic market to the listing of Hong Kong exchange-traded funds (ETFs) and will soon allow Taiwanese ETFs to list in Hong Kong.

The most meaningful breakthrough was the quiet abolition of Hong Kong's no-official-contact policy. Over the last 18 months, a stream of senior KMT figures and elected executive officials have visited Hong Kong and been received warmly by Chief Executive Donald Tsang.<sup>3</sup> The Hong Kong Secretary for Constitutional and Mainland Affairs, Stephen Lam, paid an unprecedented official visit to Taipei in June, 2009 at the invitation of the Mainland Affairs Council to discuss further enhancement of these ties. The Hong Kong government also approved a plan to have its Trade Development Council establish a branch office on the island and will let the Tourism Board do the same. A myriad of bilateral and trilateral cooperative mechanisms were launched, including a Taichung-Shenzhen-Hong Kong Forum, a Hong Kong-Taiwan Inter-City Forum, a Guangdong, Hong Kong and Taiwan Economic Cooperation Forum, a Shanghai-Taipei-Hong Kong-Shenzhen Culture Forum and others. All these institutionalized exchange and cooperation frameworks have the official blessing of both sides.<sup>4</sup>

### **Hong Kong Seeks Its Share**

Witnessing Beijing's new zeal in extending its peace overture toward and economic courtship of Taipei, Hong Kong feels pressured to gain its fair share of the action. Chief Executive Tsang made an important gesture in his annual policy address to the Legislative Council on October 14, 2009 by singling out Hong Kong's relations with Taiwan as a major topic of his speech. He indicated that his administration will establish a Hong Kong-Taiwan Economic and Cultural Cooperation and Promotion Council to promote multi-faceted, multi-level exchanges, consider setting up a multi-functional office in Taiwan to enhance high-level exchanges between the two sides, commence discussions with Taiwan on arrangements for avoidance of double taxation and play an active role in providing cross-strait RMB currency clearing services. During a press conference, he also indicated his strong desire to pay a personal visit to Taiwan before his current term expires in 2012.<sup>5</sup>

After years of strained relationships, Hong Kong and Taiwan are re-embracing each other. However, though both recognize the need to maintain strong economic and cultural ties and upgrade their political relationship, there are still formidable psychological barriers to overcome. Most Taiwanese people find Hong Kong too susceptible to Beijing's influence to be neutral. Most also have registered strong objection to the idea that Hong Kong's "One-Country Two-System" experiment might be a frame of reference for Taiwan's political future, while many Hong Kong people tend to view Taiwan as a part of Chinese territory waiting to be reunified with the motherland. Most Taiwanese consider their young democracy, despite all its problems, far more desirable than the caged self-governance that Hong Kong people live with under the HKSAR Basic Law, its de facto constitution.

Beyond these political quibbles, the two societies actually share many commonalities, probably more than people in Taiwan are ready or willing to acknowledge. Both remind the Chinese population of their humiliating past under imperialism. Both societies are burdened with a colonial legacy and are still struggling with their Chinese identity. Both societies are proud of their distinctive sub-national linguistic and cultural identity, and eager to preserve them within China proper. Both have benefited immensely from China's economic rise and have promoted themselves internationally as gateways to the vast mainland market. Both societies are politically divided by a dominant cleavage over their respective relationships with Beijing. Both share an increasingly integrated Mandarin-based culture industry and media market, with one excessively vulgarized media conglomerate, Next Media which owns the Apple Daily newspaper, playing havoc in both places. Both societies have recently if grudgingly given up their long-held sense of superiority over their mainland Chinese cousins and have begun to view China's miraculous economic rise with awe. Both are geographically and demographically small but economically and culturally influential. Both have been instrumental in facilitating China's economic modernization over the last three decades, and will continue to exert substantial soft power over developments in the mainland.

Above all, both are wrestling with Beijing's steady encroachment of their

political autonomy, with Taiwan trying very hard not to become the next Hong Kong.

*Yun-han Chu is Distinguished Research Fellow at the Institute of Political Science of the Academia Sinica, Professor of Political Science at the National Taiwan University and President of the Chiang Ching-kuo Foundation for International Scholarly Exchange in Taipei. He holds a PhD from the University of Minnesota and has been a visiting professor at Columbia University and Peking University.*

---

<sup>1</sup> "Hong Kong Consolidates its Role as a Fund-raising Platform for the Greater China Region with Increased Listing of Taiwanese Companies," Hong Kong Securities and Futures Commission, Research Department, Supervision of Markets Division, Research Paper No. 40, May 2008

<sup>2</sup> Please refer to Taiwan's Mainland Affairs Council's website for various statistics.  
<http://www.mac.gov.tw/public/Data/912111552871.pdf>

<sup>3</sup> "Hong Kong, Taiwan leaders agree to strengthen economic ties," AFP, Jul 18, 2008

<sup>4</sup> "HK, Taiwan agree to strengthen ties," China Post, April 16, 2009

<sup>5</sup> "Taiwan would welcome Donald Tsang visit", Taipei Times, October 16, Page 3.