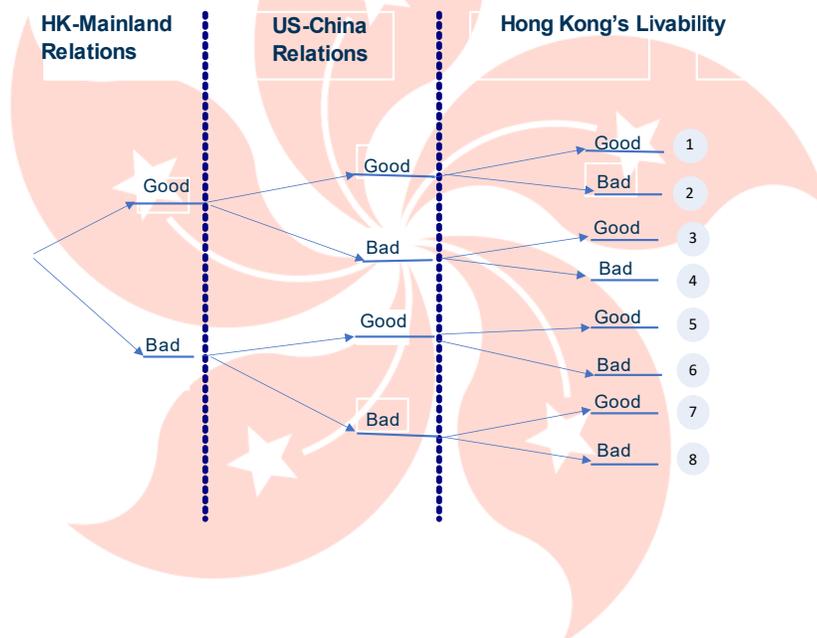


HONG KONG SCENARIOS

May 2022

Different Futures for Hong Kong



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I. Introduction

Hong Kong is going through a period of unprecedented change. Today's mood is largely pessimistic because of the disruption caused by the COVID-19 pandemic, greater intervention by Beijing that has met opposition by local democratic activists, and concerns that inflation could accelerate and economic growth slow as the world copes with the fallout from Russia's invasion of Ukraine. However, drawing long-term straight-line forecasts through a single point in time is never a good idea. The future will inevitably include change, much of it unexpected.

This report is designed to help companies prepare for the unexpected by thinking about alternative futures for Hong Kong. No matter how unsettling recent developments have been, Hong Kong's future is not written in stone. The SAR faces many possible futures, depending on such variables as government policy, Beijing's success in modernizing and growing the Mainland's economy, and the extent to which major nations in the world either cooperate on issues of mutual concern or assume more protectionist, confrontational approaches in dealing with each other.

Scenario analysis attempts to construct a set of different but internally consistent pictures of the future to aid planning and decision-making. Scenarios are not forecasts. They do not try to predict the future. Instead, by portraying several potential futures, they encourage individuals and organizations to think out of the box, be prepared for eventualities outside the conventional wisdom, and identify signposts or milestones that they can use to monitor future developments, including fundamental changes in direction.

Good sets of scenarios should be *plausible, different, useful for decision-making, and challenge* the organization's conventional wisdom about the future. The most powerful method for generating scenarios is to build them around the critical uncertainties in the environment external to the reader's organization. This is a much more powerful and realistic method than the "best case," "worst case," and "most likely case" (with best and worst then ignored as improbable, and the most-likely case is merely a modification of either the best or worst case). This is linear thinking. It rarely leads to effective results. It applies blinkers instead of helping organizations gain the flexibility to succeed, leaving organizations vulnerable to being blindsided by the unexpected.

There is no clear previous experience that can guide organizations to predict Hong Kong's development details with certainty. Given the complexity and velocity of change, it is better to think

of and prepare for multiple plausible futures than to bet on a single future and be caught out by events. Firms can then build their strategies based on understanding the different potential futures and develop a monitoring system to assess key milestones and adjust their strategy accordingly as the future unfolds.

The first step of the scenario process is to list all the variables you can think of that could affect your organization's operations in Hong Kong in the years ahead (say, the coming decade). Appendix 1 of this report lists the variables we considered when we first began preparing this study. Appendix 2 rearranges this list into different broad categories of variables. The same variable might be included in two or more general categories in a few cases. For example, we have the variable "disease" in both the group defining "livability risks" and the group defining "disruption risks." Similarly, the variable "currency convertibility" is included in both the group listing "government policy risks" and the one listing "systemic and infrastructure risks."

It does not matter if variations of the same variable are included. More is better than less. Step one should be a brain dump of ideas rearranged into major subcategories that are broad classifications of types of risks.

Critical drivers must have two things in common. One is that they involve uncertainty, with some variables more uncertain than others. The other is that they are essential to the organization and the question being asked, which in the case of this report is how your organization should position for the future in Hong Kong. A variable can have a low degree of uncertainty and a high degree of importance. For example, many organizations would consider the demographics of a particular market to be critical but one in which they have a relative degree of confidence in forecasting. Conversely, a variable can have an extremely high uncertainty but a low degree of importance. For example, it is uncertain exactly who Hong Kong's chief executive will be ten years from now, but this is not a particularly important variable to most organizations reading this report now. These types of variables do not qualify as "critical drivers."

Good scenarios need to be built around a limited number of variables with two characteristics: 1) They need to be extremely important to defining the business environment for the organization creating the scenarios. 2) They need to be very debatable, with "debatable" defined as having close to a 50:50 probability of happening. In other words, while almost everyone

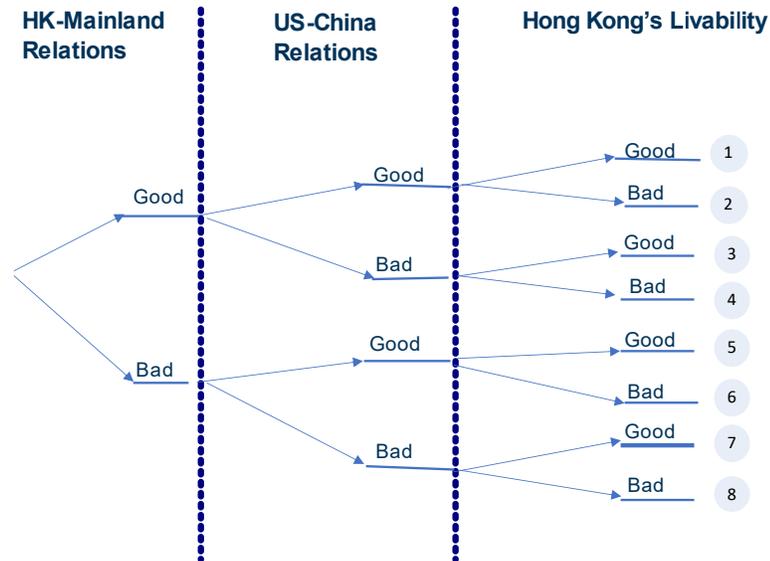
in your organization would agree that a specific variable is or is not important in shaping the future, there needs to be a healthy division of opinion on the direction in which the variable will move.

After looking at the list of variables in Appendices 1 and 2 of this report, we settled on three critical questions that will define the main parameters of change Hong Kong faces in the coming decade, with Hong Kong's current status as an international business center and one of the most cosmopolitan cities in Asia as a starting point. This first question involves Hong Kong's relationship with China. Will it move in a positive or negative direction, which we phrased as "good" or "bad"? The second question is China's relationship with the US. As in the case of the first question, will that move in a positive or negative direction, which we have also phrased as "good" or bad." Finally, although influenced by the first two, a third question deserves to be treated separately since there are numerous circumstances in which it needs to be considered in isolation. That question is the extent to which Hong Kong remains "livable." Will living conditions remain attractive enough to keep Hong Kong residents in Hong Kong and draw foreign expatriates to accept postings in Hong Kong, or will they deteriorate so much that residents try to migrate elsewhere and foreigners refuse to accept posting to the SAR? A Hong Kong that moves toward becoming more livable is "good," while a movement toward becoming less livable is "bad."

Each of these prime drives has two possibilities. Therefore, the total number of possible scenarios is $2 \times 2 \times 2$, for a total of eight separate Hong Kong scenarios, all of which are sketched out in the following sections. Each section includes views of how the individual scenario could evolve and critical milestones appropriate to different stages of the scenario being examined – early, middle and late. The idea is to illustrate the scenario process, the fundamental forces driving Hong Kong's development, which developments would consistently follow others and which ones would not, and the range of potential outcomes that firms could be facing in Hong Kong going forward – the parameters of uncertainty.

We have left space at the bottom of each scenario and signpost section so the reader can add their insights and refinements that are needed to customize the report and enhance its value to your specific situation. We have tried to make each scenario sketch logically consistent. However, there is still plenty of room to add more depth in ways that relate directly to your business, including your organization and competitors. If you have added to the list of variables in Appendix 1 or

Hong Kong Scenarios



created new categories in Appendix 2, take a few minutes after reading each scenario to consider how those variables would be affected.

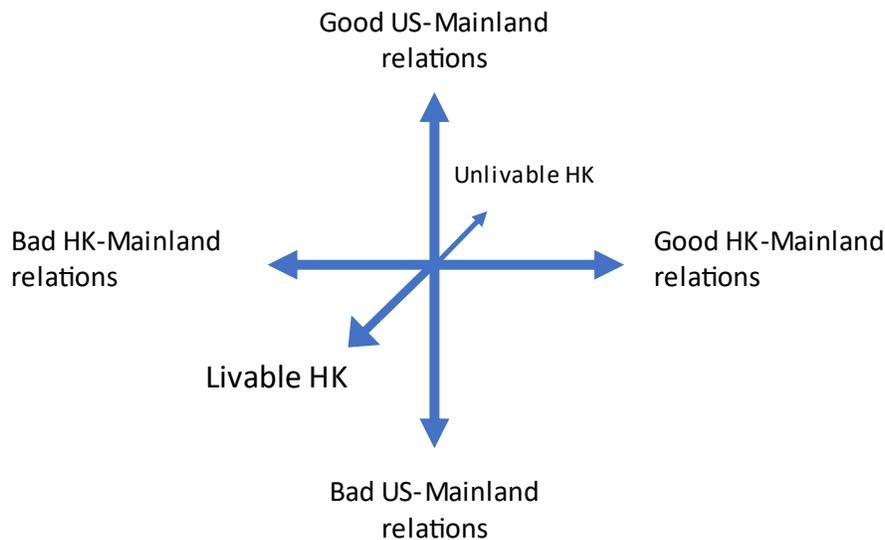
Similarly, use the space to add specific signposts you can think of. The ones we list are, by their nature, generic. However, the best signposts are very customized.

Also, take advantage of the space provided at the end of each signpost section to list specific opportunities and challenges that particular scenario would hold for your organization. Even the “best” or most positive scenarios have big challenges. For example, hiring and retaining the best talent in the most favorable scenarios is usually very challenging. This is why any follow-up to this report that includes internal customization of the scenarios should consist of people from different parts of your organization since they are the people in the best position to draw on their experience to recognize challenges and opportunities specific to their departments or job functions and to provide input into the best strategies for being in a position to manage these issues.

In other words, if you are going to get the most out of this scenario study, you will have to think your way through the report, not just read it. We have tried to make the process easier. But the real value-added has to come from you.

Once you have finished all eight scenarios, we are confident you will not be looking at the future in a two-dimensional framework. By design, this report is three-dimensional. Hong Kong has numerous possible futures. Commercial success will not be defined by guessing right now but by understanding the complexities, being on the alert for relevant signposts, and having well-thought-out plans to respond to changes. To the extent that you do so better than your competitors, your organization will have a distinct competitive advantage.

A 3D Look at Hong Kong's Futures



II. The Critical Uncertainties Defining Hong Kong's Futures

1. Hong Kong – Mainland Relations

The most critical variable shaping Hong Kong's future is its relationship with China. Although the specifics of that relationship cover a wide range of concerns, the primary question is whether that relationship is good or bad.

We define "good" as a smooth, mutually supportive relationship. On the other hand, "bad" is a relationship in which a great deal of friction exists that includes so much distrust and resentment that the dominant party in this relationship (the Mainland) uses its power to impose its will on the more vulnerable party (Hong Kong).

Hong Kong – Mainland is a driving axis presenting alternative futures for Hong Kong, with one extreme being close or good relations and the other extreme being extremely hostile or bad relations. Hong Kong is currently probably located somewhere in the middle of these two extremes. It moved away from the "good" toward the "bad" end of the axis for most of the past five years (certainly since the Occupy Central movement of 2014). It is not yet at an extreme "bad" point, and there is still plenty of time to reverse the current direction and return toward the "good" extreme. However, at this point, such a reversal cannot be assumed any more than it can be assumed that Hong Kong is inevitably headed to the "bad" extreme.

Graph 1: Hong Kong – Mainland Relations



Key Features of Good Hong Kong – Mainland Relations

There are three central requirements for good Hong Kong-China relations. The first is that Beijing wants Hong Kong to be prosperous and the population to be patriotic. China's national leadership works hard to create the conditions in which this prosperity can take place and win the loyalty of Hong Kong's resident population.

The second is that the resident population is satisfied with Hong Kong's political relationship with China. It must also identify culturally with Mainland Chinese and feel comfortable interfacing with them. There is no room for active hatred or discrimination based on origin in this scenario (either concerning how Hong Kong residents feel about Mainland Chinese or the way Mainland Chinese think about Hong Kong residents). Most importantly, Hong Kong residents must feel comfortable living in Hong Kong's system and raising their families in the SAR. Mainlanders who move to Hong Kong must feel comfortable interfacing with the local population.

The third requirement for a good Hong Kong-China relationship is that China's leadership succeeds in maintaining a high economic growth rate for the Mainland in which trading, investing, and interfacing with other countries play a critical role in supporting this growth.

Other features of the positive relationship flow from the three critical requirements. For example, for Beijing to feel comfortable with Hong Kong's role, China's national leaders would want to retain special control over Hong Kong for themselves. They would not want it to have the same status as every other Chinese city, even major municipalities like Shanghai, or to fold it into Guangdong Province. One thing that makes Hong Kong special today is that it is one city in China directly under the control of Beijing's national leadership (Macao is another example). This means it does not have the layers of bureaucracy between the national leadership and city governments like Guangzhou and Shanghai do. These layers often interfere with the way Beijing's instructions are carried out at the local level in China, giving rise to such adages as "the mountains are high and the emperor is far away."

Hong Kong might be far from Beijing in terms of physical distance, but it is at Beijing's fingertips in terms of direct influence. Hong Kong government leaders do not have the option of

ignoring or reinterpreting instructions from China's national leadership. Moreover, Hong Kong's local political leaders are not part of the Chinese Communist Party's career path. Unlike local leaders in cities like Shanghai, Guangzhou, Chengdu, and Dalian, they do not have the possibility of being promoted to national leadership positions or of supporting one faction or another in China during periods of leadership changes. They come from very different backgrounds or molds, and the highest positions to which they can aspire is to be appointed to a senior political position in Hong Kong and, possibly, be appointed to China's National People's Congress. They take their instructions directly from Beijing, which gives China's national leaders a special degree of control. It greatly reduces risks that could arise from political infighting on the Mainland, as well as the potential for ego clashes between national and local leaders.

It is easier for China's top leaders to monitor the international activities of major Chinese companies, including companies controlled by provincial and municipal governments, by pushing these bodies to use Hong Kong as a global doorway instead encouraging them to establish direct links abroad through their provincial cities, where supervision and approvals would be in the hands of the local authorities. Hong Kong has this special status because of its historical role as well as because of its separate, fully-convertible currency, the openness of its stock market to both foreign investment and Mainland IPOs, and its critical mass of support services (including legal, accounting, and financial). Beijing can also use Hong Kong's regulatory bodies to coordinate with and support its policy agenda. This includes supporting Beijing's anti-corruption efforts, monitoring and, when it wants, controlling illegal capital outflows, and keeping an eye on the activities of many of the Mainland's wealthiest entrepreneurs.

For the good Hong Kong-China relationship to the more extreme end-point, China's national leaders will need more success than they have achieved to date in winning the support of Hong Kong's local population. It is one thing asserting its control over the local government and passing legislation like the national security law that reduces the scope for political activism and criticism of Hong Kong's system. However, it is another thing to win the hearts and minds of Hong Kong-born residents, many (if not most) of whom still identify more with being part of Hong Kong than being part of China.

Gaining such loyalty will take time and effort. It will require action on many fronts, including education, policy quality, implementation sensitivity, and, if the movement to an

extreme “good” point of this axis is ever to be reached, shared experiences that build a sense of common nationhood. Achievements like international sporting victories in which Hong Kong and Mainland Chinese work as successful teams, major scientific breakthroughs like space achievements, and confronting national emergencies and threats together all have the potential to forge a shared national identity between indigenous Hong Kong residents and Mainland Chinese.

Hopefully, Hong Kong and China will never experience a nation-building experience like the people of Ukraine have been undergoing since the Russian invasion, but it is a reminder that shared adversity can help pull a people together. For example, the Mainland and Hong Kong have shared the SARS and COVID-19 crises. However, an opportunity seems to have been missed for the authorities to turn these into nation-building exercises as effectively as they might have, especially since the leaders on both sides of the border have chosen to isolate Hong Kong from the Mainland in ways that kept Hong Kong separate from the Mainland.

The fight against COVID could still become a more coordinated effort that makes Hong Kong residents and Mainland Chinese feel united rather than distinct from each other. However, the main glue that would bind Hong Kong people to Mainland China more closely would be if Hong Kong people become more convinced that that special relationship with China gives them advantages in securing their biggest priorities. If that priority is the right to have a fully democratic system, this is probably an impossibility. However, if aspirations for a fully democratic political system turn out to be a lower priority for Hong Kong residents than aspirations regarding housing, education, health, lifestyles, and careers, the main requirement is that Mainland China keeps growing rapidly economically and that Hong Kong fully participates in or even especially benefits from the role it plays in supporting this growth. In a good Hong Kong-China relationship, Hong Kong residents do not see integrating more with the Mainland as a negative development but as an opportunity for self-improvement that is bigger than what they might aspire to if they were to leave Hong Kong.

Key Features of Bad Hong Kong – Mainland Relations

The requirements for a bad relationship are the opposite of those that contribute to a good Hong Kong – Mainland relationship. If disgruntled local activists were to become

extremists who use or advocate violence to gain international headlines, Beijing would intervene to squash this threat.

However, Hong Kong does not need such a high level of extremism to develop to prompt Beijing to treat Hong Kong as a threat that needs to be suppressed. As much as China's leaders might want Hong Kong to be a prosperous success story that contributes to the Mainland's economic development and raises its regional and international influence, other considerations have a higher priority, most notably maintaining social stability in all of China and protecting the unchallenged authority of the Chinese Communist Party (CCP). If Hong Kong were seen by President Xi Jinping and other top leaders as a threat to their desire to consolidate political power and protect the dominant position of the CCP, they would do what they think is necessary to eliminate this threat.

The crackdown on democratic activists and changes in laws that limit some personal freedoms in Hong Kong that were not limited previously show Beijing's determination to keep Hong Kong firmly under its control. The response also shows that Hong Kong activists went beyond what Beijing considered to be acceptable limits of behavior. The crackdown reduced the immediate threat posed by Hong Kong political activists, but it came at a cost in terms of public comfort levels with the relationship between Hong Kong and the Mainland. Many Hong Kong residents blame the activists for forcing China's heavy-handed response, but others believe China overreacted.

The COVID-19 pandemic has hidden the full extent of what the fallout might be. Because of the lockdowns and heavy restrictions on international travel, Hong Kong residents who might have considered emigrating because of political discontent and economic hardship have been unable to do so. As COVID eases and international travel resumes, it is possible that there could be a significant exodus of both expatriates and Hong Kong residents to other countries, which would be further evidence of movement to the left (toward the "bad" extreme) along this driving axis.

However, other factors will also be at play. One is the fallout from the Ukraine War, which is resulting in a surge in refugees that could ultimately cause governments of countries to which Hong Kong people might want to move like Australia, the US, Canada, the UK, and the EU

countries to restrict their intake from other areas like Hong Kong while they digest the flood from Ukraine.

This could give China more time to win back the confidence of Hong Kong residents that it might have lost due to the political crackdown. It will be very difficult to win back the support of this section of the local population – difficult, but not impossible. China has already shown it can win back the support of young Chinese it has previously alienated through force. It took several years, but following the 1989 Tiananmen Square crackdown, it won back the support of young Chinese after Deng Xiaoping kick-started the economy by undertaking his 1992 “Southern Tour.” Rapid economic growth might not erase memories, but it can dull their edge. It is possible that Hong Kong residents would become more confident about the future and committed to Hong Kong if China’s economy can regain its strong forward momentum and incomes in Hong Kong rise sharply because of the SAR’s role in helping China achieve this growth. This would mean moving to the right along the Hong Kong-Mainland driving axis – toward the “good” extreme. However, if China’s economy now permanently downshifts to a lower growth rate and there is less business for Hong Kong to support, be it in terms of serving as a market for Mainland IPOs, outward direct investment from and inward investment to China, or as an entrepot for Mainland goods trade, it would mean Hong Kong’s economy performs weakly and is less of an incentive for both resident and expatriates to remain here or new ones to accept posting in Hong Kong.

This would mean moving to the left along the Hong Kong-Mainland driving axis. An extreme point toward the left could happen if discontent rises to such a level that it manifests itself in personal animosity toward Mainland tourists visiting Hong Kong and Mainland businesspeople working in Hong Kong. If discrimination becomes too blatant, Mainland Chinese will choose to visit areas other than Hong Kong, and Mainland businesspeople would not want to be posted in the SAR. There would be little sympathy toward Hong Kong and its people on the Mainland and, quite possibly, a reluctance to use it as an international doorway.

2. US-China Relations

US-China relations are critical to determining the extent that Hong Kong can be an international business center or is confined to being part of a smaller group of countries that make up “the China Bloc.”

The “good” side of this axis is defined by smooth US-China relations that involve cooperation and coordination, while a strained, confrontational relationship defines the “bad” side. In the “good” relationship, the US and China act more as allies who believe challenges can best be managed by working jointly. The people of China and the US are comfortable interfacing with each other in a spirit of mutual respect. There is no room for xenophobia to dominate this scenario. Instead, the US and China concentrate on how best both countries can share the global stage to benefit both and their allies.

In the “bad” side of the relationship, the two governments act more as enemies. There is little cooperation in dealing with significant challenges and most problems are dealt with without consulting the other side or by trying to pressure the other side to change. In other words, Washington and Beijing approach problems in a “win-lose” mindset. Instead of trying to share the global stage, they are trying to grab as much of it for themselves and their allies as possible, while edging the other side off the stage or isolating it.

The trend of US-China relations has been deteriorating for several years now. The starting point for the modern relationship was an extreme position on the “bad” side of the axis, which defined the US-China relationship before former President Richard Nixon’s breakthrough visit to China in 1972. There was gradual movement from left to right along this axis for many years after that, but it never reached anything close to an extreme point on the right or “good” side. Most of the improvement was in economic matters, including trade and investment – so much so that by the turn of the century, the economic links between the two countries were extensive.

However, significant political differences have always existed. It was only in 2001 that China was able to gain membership in the WTO – due mainly to the reluctance of the US to grant China permanent Most-Favored Nation trading status until that year. Since the collapse of the Soviet Union, a growing number of US national security experts have considered China’s

effort to expand its global influence to be one of the most significant threats to the US. Beginning with the election of Donald Trump as president in 2016, Washington has also adopted a harder line toward China on trade, investment, and other economic issues as well, while the US and China have been unable so far to move closer on other issues, including the fight against COVID or how best to respond to the Ukraine-Russia conflict.

The net impact of these forces has been to shift US-China relations back to the left – toward the “bad” end of the axis, as shown in Graph 2 below. The two governments are still going through the motions of cooperating on issues like fighting climate change. Despite threatening rhetoric, the status quo on major points of disagreement like the status of Taiwan and the South China Sea has prevailed. Most importantly, the two sides have not disengaged economically in substantive ways. Two-way trade and direct investment remain large. China

Graph 2: US – China Relations



plays a vital role in the supply chains of many US companies. Communication links remain intact, and both governments are still trying to operate within the common frameworks established by bodies like the WTO. One noticeable switch in roles in recent years is that since the election of Donald Trump, the US government seems to be moving away from its former commitment to embracing globalization and towards a policy that is more protectionist, while China is now pushing globalization harder and avoiding conflicts in which sanctions and other isolating measures are called for.

Key Features of Good US-China Relations

Features that would fit into this future would be a high level of trade between the US and China, high levels of direct investment in both directions, and a large flow of people involved with business travel and education. There would be a great deal of economic competition in this scenario, but the US and China would be members of the same bodies like

the World Trade Organization. They would compete within a framework of shared ground rules and standards.

This “good” side of this axis would be conducive to an environment in which globalization is promoted, with China and the US both playing prominent roles. Importantly, those standards would include how typical US multinationals and banks can co-exist with Chinese state-owned companies in these same industries. Chinese companies could list on US stock markets, implying agreement on specific accounting and governance standards. Over time, this scenario would find new ways to cooperate and set standards on new technologies and challenges, including the regulation of social media and the development of new frontiers like space.

The “good” side of the axis would include a high level of transparency, including sharing data on credit cards, the flow of news and information over the internet, and corporate reporting requirements. There would also be a high level of cooperation between the governments of the US and China in fighting money laundering and other crimes. An extradition agreement would be in place that deters alleged criminals from taking advantage of jurisdictional differences to avoid prosecution.

The US and China would be close allies at its most extreme point. They would conduct joint military exercises, cooperate on disaster relief around the region, and closely coordinate research into infectious diseases and reactions to cross-border health disasters and shared threats like climate change. Current differences that exist over the South China Sea and the status of Taiwan would be resolved in ways that are acceptable to both Beijing and Washington. When disputes do arise, the two governments would have mutually acceptable mechanisms in place to ensure they can be discussed and resolved peacefully.

Key Features of Bad US-China Relations

The US and China would be acting more like enemies on this axis’s “bad” side. Each government would view the other as one of their most significant national security threats. At the same time, the populations of both countries would be strongly biased against the other, interfering with personal exchanges, tourism, and business interactions.

Cooperation would be difficult in a bad US-China relationship even on problems shared by both like climate change and COVID-type health risks. Instead, each side would blame the other and insist that they make changes. There would be little sharing of information. Indeed, there would be strong efforts to block information flows, and the information classified as “sensitive” would be very broad.

This means firewalls would be erected on the internet and between cloud services. The news would be highly filtered and biased. There would be limited or no cooperation in fighting cross-border money laundering or other crime. Companies from one country would be discriminated against in the other country in terms of being allowed to make direct investments, bid for projects, and have access to local capital. There would be new export and import barriers. The thrust of a bad relationship would be to decouple the US and China economies as much as possible and limit access to the local market.

For an example of an extreme point in this driver, look at how Washington is trying to isolate Russia in the wake of the Ukraine War. There are sanctions against companies and influential individuals. Face-to-face interactions are limited. Travel is restricted. Assets are frozen. The threat of military confrontations has increased sharply, and each side tries to pressure allies to support their position, including by applying sanctions against the other side. Trade, investment, social media platforms, and access to capital markets would all be weaponized, focusing on isolating and hurting the other side as much as possible rather than on maximizing the economic benefit for all.

The Ukraine-Russia War is helpful in thinking about the extreme features of the bad US-China relations scenario. From the perspective of the US, it might like to think its success in pulling together its European allies and other governments more distant from the conflict like Japan, South Korea, Australia, and Canada places it in a firm global majority. However, it is worth remembering that at this point in the conflict (in May 2022), many countries have not condemned Vladimir Putin’s blatant violation of international law. They include China, India, Vietnam, South Africa, and 31 other countries, the combined populations of which, including Russia’s, comes to more than half of the world. In other words, if the bad US-China relations scenario were to degenerate into a complete decoupling with the US trying to isolate China as much as it could, there would still be many places around the world that would not sanction

China and might even give it active support. Moreover, Hong Kong would be one of those places. It has no choice.

3. Hong Kong's Livability

While the political environment, relations with China, and Hong Kong's ability to serve as an international business center are all important, another variable that influences its success in the long term is the quality of life it offers locally-born residents and expatriates. This refers to what people living in Hong Kong or visiting it find personally appealing or negative features. For example, looking back over the past two decades, two of the features that many individuals have found most attractive about the living environment are the low level of crimes against persons and property and the wide range and quality of restaurants available. On the other hand, two features on which most people would agree have deteriorated over the same period are air quality and the cost of housing.

Hong Kong's success as an international business center is highly dependent on the ability of companies to hire and retain quality local staff and be able to import staff with the skills needed to compete against other major business centers. If they can, that is good. If they cannot, that is bad.

Unlike the two driving axes discussed previously, where the current direction of change is negative but the position along the axis today is still close to the middle, Hong Kong's current position along the livability axis is already at an extreme point of the "bad" end. That is because COVID-19 has seriously disrupted life in Hong Kong, including the operations of many companies. Many companies are experiencing a heavy outflow of expatriate and local staff, they cannot find quality foreign staff to move to Hong Kong at this time, health risks and concerns have never been higher, and staff residing in Hong Kong cannot easily travel to other countries to perform the roles required of an international business center, and foreign managers of these companies cannot easily travel to Hong Kong to deal with local issues if needed.

If the current situation were to last in the medium term, Hong Kong would be unable to retain its status as an international business center. Many companies are experiencing financial losses that cannot be sustained in the medium term. If the COVID problem were to be shared

by other international business centers like Singapore, New York, and London, the entire concept of how to structure global businesses would have to be rethought. However, if Hong Kong is unique in being unable to rebuild confidence in its health system while other centers can move beyond COVID, it would lose many of its current functions to rival centers and possibly never get them back.

The current COVID pandemic is unlikely to last for so long and remain so severe that it causes Hong Kong to go into an irreversible downward spiral. That possibility cannot be rule out entirely, but it is much more likely that the COVID pandemic is a temporary feature and that there will be a movement back toward the center of this axis as a greater percentage of Hong Kong's population is vaccinated, other progress is made in treating COVID infections so it is no more deadly than the regular flu, governments remove travel restrictions and quarantine requirements, and people residing both inside and outside Hong Kong feel confident again in undertaking international travel.

This does not mean that Hong Kong's medium-term livability is secure. After Hong Kong moves back toward the middle of this axis, other factors could emerge that cause Hong Kong to lose its attractions and shift to the left again. A few of those factors are, in themselves, showstoppers. If they were to strike Hong Kong, they could be so disruptive that they shut down the Hong Kong economy and end its role as an international business center. As we have already noted, one example would be a COVID pandemic that remains severe in Hong Kong without a clear end in sight but not in other alternative business centers. Other showstoppers include a series of highly infectious pandemics originating in Mainland China, punctuated by limited virus-free periods, that cause Hong Kong (but not other alternative business centers) to trip from one health crisis to another. A war that strikes Hong Kong directly or causes it to shut down (such as what happened during World War II) would be another showstopper, as would a prolonged period of violent social unrest that paralyzes Hong Kong and disrupts daily life and business.

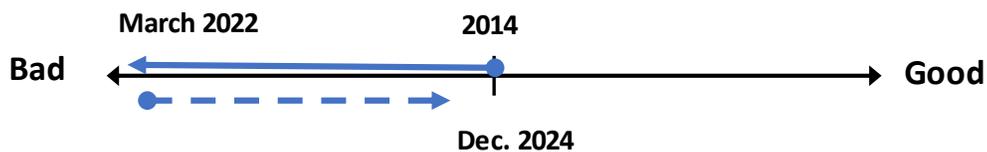
The scale and duration of such demonstrations would have to be much greater than the student protests of 2014-2019 or the 1967 pro-China riots during the midst of the Cultural Revolution in China, but if there were such a prolonged period of violence, Hong Kong could not

survive as an international business center for a sustainable period any more than Beirut, Lebanon could when chronic unrest hit that great city.

Most variables defining Hong Kong’s livability are not as cut and dry as the showstoppers. They represent aspects that make Hong Kong attractive or unattractive as a place to live and work. We have presented a partial list of these variables below. Some, such as tax levels and currency convertibility already act as significant drawing points supporting Hong Kong’s attractions as a business center. Others such as air pollution and the cost of housing are already major negative features that stop some foreigners from accepting postings in Hong Kong and cause some companies to lean toward locating their regional offices in other locations. However, no one of these variables probably has the potential to end Hong Kong’s days as an international business center. That would require enough of these variables to score so badly in the rating systems of individuals and companies that they opt for other locations such as Singapore that score better on the status of these variables.

However, it is possible that other developments could help Hong Kong to retain or even enhance its desirability as a place to live and work. This is why we have drawn the livability axis in a way that reflects the deterioration in livability that has taken place over the past five years (since the start of the Occupy Central demonstrations) to the extreme point on the left (defined by the worst point of the pandemic in March of this year) but have drawn a dotted line bringing it back toward the center of the axis in the coming two years. Looking beyond this point is wide open with possibilities in both directions, which we have tried to cover in the discussion below.

Graph 3: Hong Kong’s Livability



Key Features of Good Hong Kong Livability

The “good” half of this driving axis is defined by an environment in which people prefer to live in Hong Kong. This requires high standards of their three basic needs for themselves and

their families: housing, health, and education facilities. Accommodation must be adequate in size, quality, and cost to meet the requirements of those living in them and those responsible for covering the expenses. Reasonably priced mortgages need to be available, especially to young families just starting, while high-quality public housing needs to be open to residents who might not have the income required to buy their own homes.

People must feel there are no unreasonable health risks and that the quality of health care available is at least up to the standards in other international business centers, especially Singapore, New York, and London. It is also essential that people have confidence in the abilities of the government and the health care system to manage a crisis in ways that benchmark favorably against other countries and systems and that Hong Kong has access to the best medical technology and medicines available globally. They need to trust the information communicated by the government and health care professionals and the flexibility to make personal choices between alternative treatments when such options exist.

Expatriates need access to international schools that offer quality education for whatever university-level system they intend to send their children to. Diversity in the student bodies, shared experiences with children from different cultures, and the potential to develop long-term networks of friends should be strong incentives for expatriates to accept a posting in Hong Kong, along with other educational aspects like attention to special needs students, a drug-free and gang-free culture, and strong counseling.

Residents should have a wide range of educational opportunities, including access to the same international schools as expatriates, quality public schools, and quality private schools if they so desire. The local university system needs to benchmark against strong foreign university systems, and local students need to be able to aspire to the system they would prefer provided they meet competency requirements.

In short, both expatriates and locals need to have confidence in the local school system's ability to help students realize their full potential and to feel they are fortunate to have been able to experience a Hong Kong education.

However, there is a long list of other features too. Good livability in Hong Kong would require headway in reducing air and other forms of pollution. Expatriates and locals need plenty

of outlets for recreation and entertainment, which means a high quality of club life, hiking trails, restaurants, nightlife, and cultural attractions like music, art, museums, and theater. Crime needs to be kept well under control so people feel safe at any place and any time. Society needs an intolerance for racism in any form and to embrace diversity. Corruption needs to be low, especially involving public interactions with civil servants, and procedures for everything from getting through airport queues to renewing driving licenses need to be among the most efficient in the world.

Key Features of Bad Hong Kong Livability

The “bad” side of this axis is the mirror opposite of the “good” side. As in the “good” side, the variables are weighted differently and depend on the individual’s perspective. However, some variables, such as the COVID pandemic, can precipitate regulatory changes that can directly impact Hong Kong’s ability to serve as an international business center. For example, the behavior of individuals and companies in Hong Kong is shaped not only by their fears of catching the virus, but also by the real inconveniences caused by new regulations on travel, quarantines, and spacing requirements.

The table below lists variables that influence living and working conditions in Hong Kong. The first column names the variable. The first four rows are potential showstoppers in their own right. One (disease) is already happening, but this report is being written on the assumption that the current COVID problem will be temporary. However, if this turns out to be just the second in a series of pandemics that Hong Kong will experience over the next decade, it could indeed be a showstopper. The remaining roles are variables that are not game-changers alone but have the potential to be either major attractions drawing people and companies to Hong Kong or detractors that cause residents to leave, foreigners to refuse postings to Hong Kong, and companies to consider alternative locations for their regional offices. We color code these variables, with green indicating that we believe the variable to be a major positive feature of Hong Kong, yellow indicating a variable that has become a greater concern, and red being a variable that many individuals already consider to be a negative feature of Hong Kong, a deterrent to living there, and a reason companies might want to consider moving to an alternative location. Variables that have no color, such as the first one relating to war, have to

be regarded as potentially disruptive wild cards but are not something that has implications at present.

	Variable	Status or Example
Showstoppers	War	HK during WWII, Beirut.
	Social unrest	Beirut today, Extended version of Tiananmen Square 1989. Extended version of HK 2014 umbrella movement.
	Disease	SARS in 2003, COVID 2020-currently
	Natural disasters (including fallout from Global Warming)	None to date in HK. Tsunami in Banda Aceh in 2004. Fukushima nuclear disaster in 2011.
Weather	High heat and humidity during much of the year.	
Pollution	Low quality of air. Increasing noise and water pollution.	
Housing costs and quality	Among the most expensive housing and office rentals in the world.	
Medical system	Good reputation marred by a failure to deal with COVID more effectively.	
Education system	Good quality but expensive. Concerns that local programs might be politicized in ways that many families would oppose.	
Recreation (clubs, restaurants, fitness centers, sports, etc.)	Good variety, but entry can be selective, take time, and be expensive.	
Shopping (range and costs)	One of Hong Kong's main attractions.	
Cultural attractions (music, theater, museums, etc.)	More limited selection than in many other international business centers, especially New York and London.	
Crime and safety	Low crime risks are a major attraction of Hong Kong.	
Racism	It exists mainly in social situations, but is not a feature limiting business entry or competition. It has the potential to become a bigger problem if Mainland Chinese and Hong Kong Chinese fail to interface smoothly.	
Corruption	Not a big problem. Reducing this problem has been one of Hong Kong's most significant achievements it can point to over the past 50 years.	

Ease of cross-border travel, especially to China	Huge problem now, but usually this is a very positive feature for Hong Kong. It should return to green color once the COVID crisis is over.
Physical infrastructure	A major attraction of Hong Kong.
Utilities (quality and cost of water and electricity)	Attraction of Hong Kong.
International air links	Huge problem now, but usually this is a very positive feature for Hong Kong. It should return to green once the COVID crisis is over.
Availability of international news	Most major international news companies are available on cable TV. Also, most international publications can be purchased locally or subscribed to online.
The openness of the internet	No censorship or filtering.
Quality of local news	Censorship is increasing, especially self-censorship. Increasing Mainland bias in local political news, but economic news is balanced and readily available.
Civil service efficiency	Attraction of Hong Kong.
English and other language capabilities	A major attraction of Hong Kong.
Ease of obtaining employment visas for non-residents	Visas are easy to get and issued relatively quickly. A major attraction of Hong Kong.
Visa and ease of entry and exit requirements for business and tourist travelers	Huge problem now, but usually this is a very positive feature for Hong Kong. The situation should return that way once the COVID crisis is over.
Wage and salary levels	Satisfactory.
Ease of obtaining domestic help	Problem now, but not during regular times.
Regulatory environment	Historically this has been a very positive feature of Hong Kong, but the trend has been deteriorating, in part because of stricter compliance requirements that are increasing paperwork.
Comfort with the political system	Poor. The departure of people might have been slowed by the pandemic, which means this variable could deteriorate even after COVID lessens. The question will be how quickly it stabilizes and if lost talent can be replaced by imported labor.

Economic growth	Problem now, but not during regular times. Good potential to grow a business is why companies and households can afford to pay higher real estate prices and rents.
Convertibility of currency	Fully convertible. A major attraction of Hong Kong.
Real estate ownership limitations	No differential treatment except in the provision of public housing. A major attraction of Hong Kong.
Company ownership and employment regulations	Residents and foreign-owned companies are treated the same except in certain closed professions and cartels. A major attraction of Hong Kong.
Taxation	Low taxes and a simple tax system. A major attraction of Hong Kong.
A critical mass of clients, suppliers, and support services	One of the largest concentrations of companies and banks in any city in Asia. This has been a significant attraction of Hong Kong. However, it is also a variable that needs to be monitored closely. If there is evidence of a significant exodus of companies, it could hurt confidence and feed on itself.

III. Hong Kong Scenarios

The rest of this report discussing the specific scenarios is available for purchase for a price of US\$950. If you would like to order the report or have any questions, please contact the Hong Kong office of Political & Economic Risk Consultancy, Ltd. at info@asiarisk.com.

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