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**First annual Report by the European Commission on the Special  
Administrative Region of Hong Kong**

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## ***Introduction***

An effective enforcement of the 'one country two systems' concept enshrined in the Joint Declaration and Basic Law is fundamental to Hong Kong's lasting stability and prosperity. This in turn will benefit the European Union, which, like other world partners, has for many years enjoyed a dynamic trade and investment relationship driven in part by Hong Kong's independent free market economy. It will also benefit mainland China, for whom a robust, globally integrated Hong Kong is a powerful buttress to its own economic reforms. The EU therefore sees the upholding of the Hong Kong Special Administrative Region's autonomy, within the 'one country two systems' concept, as a central plank of its policy towards the territory and a major component of its relationship with China as a whole.

The EU set about upgrading its links with the SAR in April last year by adopting a Communication from the European Commission entitled « The European Union and Hong Kong : beyond 1997 ». The aim was to set Europe's ties with the territory on a deeper, more permanent footing, while supporting its autonomy, helping to strengthen its role in Asia and the world, and monitoring respect for the rights guaranteed to its citizens under the Joint Declaration and the Basic Law of the Hong Kong Special Administrative Region. For the EU, these rights are not just valid in themselves. They are inseparable from the autonomous system upon which Hong Kong's lasting success depends.

In the context of this Communication, the Commission undertook to produce an annual report on relations between the EU and Hong Kong. This is the first such report. The Commission notes that the European Parliament has produced its own report on Hong Kong, and duly transmits this document to the Parliament and the Council of Ministers for information. <sup>♦</sup>

## ***The economy***

In the summer of 1997 all eyes were on the handover and the ability of China to ensure a smooth transition with minimum disruption to Hong Kong's economic dynamism. In the event, the

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<sup>♦</sup> Report on the European Union and Hong Kong: Beyond 1997 (COM(97)0171 – C4-0214/97), produced by the European Parliament's Committee on Foreign Affairs, Security and Defence Policy. Rapporteur: John Cushnahan.

handover went smoothly thanks to careful and sensitive handling by the authorities both in Hong Kong and Beijing. The focus then changed with the onset of the Asian financial crisis. The root causes of the crisis – among them weak financial regulation, inappropriate exchange rate pegs, excessive foreign borrowing and over-spending on infrastructure – were prevalent in some Asian economies, but not in Hong Kong, whose commitment to transparency and sound finance has remained exemplary. The SAR subsequently became a victim of the contagion, not a cause of the turmoil, although it did expose the weaknesses of inflated property and stock markets as well as slackening competitiveness.

### The impact of the financial crisis

The immediate effect was felt in stock prices and a spate of speculative attacks on HK's currency, resisted by the Government's credible and robust defence of its currency board pegging it to the US dollar. The more lasting effect, compounded by the weakening Yen and an economic slowdown in China, has been to throw Hong Kong into recession, with falling output, falling property prices, a shortage of credit, rising business closures and record unemployment of 5%, the highest for 15 years. Domestic exports have suffered heavily, falling by 5.4% in the first six months of 1998, although re-exports through Hong Kong have in some cases benefited from weakened currencies in the country of production, notably when sold on to markets with strong currencies like the US and the UK. In August the Government announced an estimated negative growth of -4% for the whole of 1998.

### Hong Kong's reaction to the crisis

The SAR Government has reacted to the crisis by vigorously defending its currency peg. This has brought pain, for the currency board is statutorily bound to hold the peg by measures that have led to high interest rates which in turn have discouraged investment and consumption.

Latterly, the SAR Government has introduced a series of measures designed to curb speculation on the currency and stock markets, arguing that Hong Kong requires emergency action to restore financial stability because it is so heavily dependent on trade:

- Firstly, it instructed the Hong Kong Monetary Authority in mid-August to intervene in the Hong Kong equities and futures markets. In the event, an estimated 10-15% of the territory's total reserves were spent, boosting the Hang Seng Index by 19% over two weeks. Although these holdings have been said to be temporary, this has left the SAR Government and its related agencies as one of the largest shareholders in the territory.
- Secondly, it passed a series of measures in September to strengthen the currency board system, increase the transparency of the Exchange Fund and reinforce the linked exchange rate by increasing liquidity in the banking system. The aim has been to smooth out the sharp swings in overnight and one-week interbank interest rates. These interbank rates have indeed fallen as a result, providing greater interest rate stability.

- Thirdly, it outlined on a 30-point programme to tighten up the disciplines in the securities and futures markets. The programme aims to strengthen regulation and enforcement regarding the practice of selling currency and using futures contracts to profit from the subsequent rise in interest rates and drop in share prices. The package contains rules to increase disclosure requirements, improve cross-market supervision, cap the size of open positions allowed for any one futures trader in relation to his own capital, and tighten up on the deadline by which traded shares must be settled. In addition, it calls for heavier penalties for breaches of securities legislation and market rules relating to unreported short-selling and default on settlements.

All financial markets require sophisticated and effective regulation. The overriding purpose of regulation must be to supervise trading and ensure the solvency of traders within those markets notably through rules to prevent over-exposure and improve transparency. It is clear that many of the measures announced by the Hong Kong authorities fit this description.

However, a fine line exists between necessary regulation and forms of intervention that may distort the free play of market forces. Regulation should not aim to restrict the forms of trading in which traders are engaged, as these enable markets to move in line with economic fundamentals. Measures to curb speculation, if inappropriately applied, may run the risk of distorting the corrective nature of the markets themselves. In this context, the Commission is reassured by the SAR Government's statement that the intervention in the equities and futures market by the HKMA in August was short-lived and does not herald a departure from Hong Kong's long-standing economic policy.

In June the Government announced a multi-billion dollar package which included a freeze on the sale of public land to shore up property prices, tax exemption on interest earned in Hong Kong in order to encourage repatriation of funds, and a scheme to help SMEs obtain loans. Measures of this kind are designed to tackle the crisis where it has hit hardest – in falling property prices, capital flight and business closures. These are unlikely to be misread as signs of a departure from fiscal prudence, as the policy commitment to fiscal prudence is buttressed by the fact that Hong Kong is constitutionally bound to prudent fiscal policies and a balanced budget under Article 107 of the Basic Law.

### The economic relationship between the SAR and China

The degree of interdependence between Hong Kong and the rest of China is considerable. Visible trade between Hong Kong and the mainland has grown on average 28% a year since 1978. In 1997, two-way trade grew a moderate 6%, with imports from China rising by 7%, re-exports back to China by 6% and domestic imports from Hong Kong to the mainland by 4%. Hong Kong was the mainland's second largest trading partner in 1997, while China was Hong Kong's biggest trading partner. China was by far the largest source and destination (90%) for Hong Kong's re-export business. There has also been a major increase in invisible trade and investment flows from Hong Kong to the mainland, while Hong Kong remains a major service centre for China, notably in financial and business support services. Hong Kong is also China's

top source of foreign direct investment, while China itself is the second largest source of FDI in Hong Kong in terms of stock of investment. Hong Kong residents made 34 million trips to the mainland during 1997.

The fate of the Chinese and Hong Kong economies is therefore closely intertwined. Hong Kong's heavy involvement in China means its recovery from current difficulties depends in part upon the progress of economic reform in China itself. Likewise, China needs continued trade, investment and know-how from the SAR to sustain the high growth on which its reforms are based. Above all, both need the stability of each other's currencies in order to reduce the side-effects of the financial crisis. Hong Kong and China naturally see each other as sources of mutual support, a tendency that may have increased since the onset of financial turmoil. This should not be misread as interference in the management of each other's economies.

### **The return of business confidence**

It is of the utmost importance that business confidence should return to Hong Kong as soon as possible, not only for the future health of bilateral trade and investment but to ease pressure for devaluation both in the SAR and China, thereby sustaining the credibility of China's own economic reform programme. Despite the severe economic downturn currently hitting Hong Kong, the Commission remains convinced that wherever the economic fundamentals are broadly sound, as they are in Hong Kong, confidence will never be gone for long. However, that confidence will depend significantly on the SAR maintaining an open trade and investment regime. Hong Kong should continue to set an example to neighbouring countries that may be tempted to learn the wrong lessons from the turmoil by closing their own markets or slowing down reforms. This in turn will help restore the confidence of the business community.

## ***Government and legislation***

### **The way government functions**

Hong Kong's Chief Executive governs with the support of the Executive Council and Legislative Council (LegCo) backed by an independent civil service. The Chief Executive leads the Government, decides on Government policies and issues executive orders. He implements the Basic Law, and signs bills and budgets passed by the LegCo. He liaises with the Chinese Government, reporting budgets and accounts to it for the record, nominating top SAR officials for appointment by Beijing and implementing directives issued by China as provided for by the Basic Law. He appoints and removes judges and public office-holders in accordance with legal procedures, as well as handling external and other affairs as authorised by the Chinese Government.

The Executive Council advises the LegCo on all principal legislation before it is introduced into the LegCo, and has the power to make subsidiary legislation under a number of ordinances

passed by the LegCo. Where the Executive Council advises on matters involving the expenditure of public funds, its advice is subject to such funds being approved by the Finance Committee of the LegCo.

The Basic Law provides for a number of checks and balances that govern relations between the Chief Executive and the LegCo. In particular, bills relating to government policies cannot be introduced by LegCo members without the written consent of the Chief Executive. The Chief Executive must sign and promulgate bills passed by a two-thirds majority of the LegCo on second reading or otherwise dissolve the LegCo. The Chief Executive may also dissolve the LegCo if it fails to pass a budget or other major bill introduced by the Government. For his part, the Chief Executive must resign if after dissolution of the LegCo, the newly elected LegCo continues to refuse to pass the same bill which led to dissolution in the first place, or which the Chief Executive refused to sign. None of these provisions have been invoked since the Basic Law entered into force.

The political relationship between the Chief Executive and the LegCo has at times been strained. Disagreements have occurred between the executive and the legislature on issues ranging from LegCo rules and procedures, amendment of the holiday bill, and extension of the loan scheme to help first-time buyers, to the review of the SAR's municipal structure. Differences of view between the executive and legislative branches of government are quite natural and can bring creative tension to the governmental process. However, concerns have been expressed about the executive-led structure in which no politically appointed ministers sit in the Chief Executive's Cabinet. This centres all the political responsibility on three top Government officials and more specifically on the Chief Executive himself and does not allow the burden of defending government policies and actions to be spread across different levels. This has led some LegCo members to call for a ministerial-type cabinet. In his 1998 Policy Address delivered on October 7, the Chief Executive, while reaffirming that Hong Kong should continue to have an executive-led Government, stated his intention to improve cooperation between the various institutions of the SAR.

### The legislative programme

For most of the past year, the legislative role has been carried out by the Provisional LegCo, selected before the handover and now replaced by the full LegCo following the elections in May this year. By October a total of 63 bills had passed through the Provisional LegCo, 50 of them since the handover. The overwhelming majority of these bills have not prompted questions as to the autonomous functioning of the legislative process in Hong Kong.

A significant development was the SAR Government's stated intention not to introduce draft legislation in the immediate future for the purpose of enacting laws on treason, secession, sedition, subversion against the Central People's Government, or theft of state secrets, as well as regulating the activities of foreign political organisations.

On October 7, the Chief Executive delivered his second annual policy address, entitled "From Adversity to Opportunity". In it he predicts that growth will shrink by 4% and unemployment, already at 5%, will continue to rise as a result of the crisis. He promises to stimulate growth by aiding investment in new technology and by reforming well established businesses, notably financial services. Priority will be given to small and medium sized companies. The policy address emphasises the SAR's continued commitment to free markets. It reiterates the need to improve education and the environment, while signalling a certain shift away from the building of subsidised housing and towards better loaning facilities for house-buyers. The address refers extensively to improving links with the mainland, for example by improving the climate for investment there for SAR-based companies.

On the political side, it alludes to the reduction in the number of lower government levels, replacing regional and local councils with district boards. The policy address states that the direct election of the LegCo and the Chief Executive remain the ultimate aim, but does not elaborate on how or when this will be done.

### **The fight against corruption**

The SAR authorities have shown determination to maintain Hong Kong's reputation for clean government and business. There has been a rise in the number of allegations of corruption reported to the Independent Commission Against Corruption (ICAC) - 1,780 cases in the first half of 1998, a 20% increase over the same period last year - but this may reflect the growing confidence among SAR citizens to resort to the ICAC rather than an actual increase in corruption itself. Most complaints are from the private sector, including financial services, trade and property, while some cases referred to the ICAC have included gifts received by government officials, illegal betting and the alleged inflation of a newspaper's circulation figures. There have been few if any complaints of a general fall in business standards this last year, despite fears voiced before the handover.

A legislator, Chim Pui-chung, was disqualified from the LegCo in September this year after being sentenced to three years in prison for attempting to forge share-transfer documents. The Basic Law allows for disqualification of a member convicted of at least one month's imprisonment. Chim was released on bail and is appealing against his sentence.

### **The judicial system**

The independence of the judiciary, as laid down in the Joint Declaration and Basic Law, is central to the smooth functioning of the 'one country two systems' formula. The Joint Declaration states that laws in place before the handover will remain unchanged, the judiciary will operate independently, trial by jury and the right to a fair trial will continue, and Hong Kong will have its own Court of Final Appeal with jurisdiction and power of adjudication over all cases except acts of state related to defence and foreign affairs.

This independence has been respected in the vast majority of cases since the handover. The Court of First Instance adjudicated more than 1300 appeals in civil and criminal cases in 1997, while the Court of Appeal dealt with some 750 cases in the same year. The Court of Final Appeal delivered just one ruling while examining the validity for appeal of eight others. Of all these cases, very few have raised questions about the independent functioning of the SAR judiciary.

Shortly after the handover, a case arose concerning a defence (the Ma Wai Kwan case) based on the claim that laws and indictments predating the handover were invalid on the grounds that the Provisional LegCo which carried them over was itself created in breach of the Basic Law. The Hong Kong Court of Appeal took the view that no decision or institution sanctioned by the Chinese National People's Congress could be examined by the courts of the SAR. The practical impact of this specific case may be limited as the Provisional LegCo has since been dismantled, but it did cast a temporary shadow over the immediate post-handover period, when sensitivities about the one-country-two-systems formula were particularly strong.

On its last day in office, the Provisional LegCo passed a bill under which certain privileges granted to institutions under British rule are transferred to Chinese State bodies to reflect China's resumption of sovereignty. Under the colonial regime, laws did not apply to British Crown institutions unless expressly stated in Hong Kong's law. The SAR Government has interpreted the bill to include Xinhua, the New China News Agency, among those Chinese State organs and agencies which should enjoy similar privileges. However, SAR law requires that Chinese State organs and agencies must carry out executive functions, must not engage in commercial activity and must act within their mandate. One particular area of concern is Xinhua's apparent involvement in overseeing China's state-owned enterprises in the SAR, as well as the precise remit of Xinhua since the handover.

### ***Human rights, political freedoms and public order***

The Basic Law guarantees widespread freedoms for the people of Hong Kong, including free speech, a free press, freedom to publish, freedom of association, assembly, procession and demonstration, the right to join trade unions and the right to strike, freedom from arbitrary arrest, freedom of movement, and freedom of religious belief.

A high degree of freedom has been maintained in all of these areas since the SAR came into being. Public demonstrations are an almost daily occurrence. Citizens have demonstrated freely on economic issues, such as high rents and the closure of investment banks, and against government positions and policies. They have also commemorated the Tiananmen Square incident twice, once with an attendance of 40,000 people.

There have been no reports of any violation of fundamental rights since the handover. No human rights activists, political opponents or Chinese dissidents have been detained or harassed, and human rights organisations continue to operate with no apparent curtailment of their activities or pressure from the authorities.



## The right to demonstrate

The Provisional LegCo introduced restrictive amendments to two colonial laws – the Societies Ordinance and the Public Order Ordinance - both within the Hong Kong Bill of Rights. Firstly, demonstrators must now obtain advance permission from the police rather than merely giving them notice. Secondly, all societies must now be registered, and this can be refused on 'national security' grounds. It should be added that no difficulties appear to have been encountered as a result of this provision and no applications for registration have been rejected, in the words of the Secretary for Justice, "for political or any other reasons." Furthermore, over 1,600 demonstrations took place in the first year after the handover.

## Labour law

The Provisional LegCo also suspended four labour laws passed before the handover by the previous LegCo. Those laws concerned unions' rights of collective bargaining on salaries and on funding for political activities, prevention of anti-union discrimination by employers, and a broadening of the Bill of Rights. Three months later, in October 1997, the Provisional LegCo then repealed the laws on collective bargaining and anti-union discrimination, while amending the law on union funding by requiring prior permission from the Chief Executive. This has aroused concern among international trade union bodies, and the Commission continues to monitor it closely.

## Implementing the UN Covenants

In April 1998 the Government produced draft reports on the implementation of the two UN Covenants, one on Civil and Political Rights and the other on Social and Cultural Rights. These drafts referred to the Societies Ordinance and the Public Order Ordinance mentioned above and to the repeal of the pre-amendment Bill of Rights, as well as other issues including the right of abode of mainland-born children of Hong Kong people, the fight against bird flu, contingency plans on unemployment and staffing problems in public hospitals. However, the reports did not mention the repeal of the labour laws or the introduction of the anti-subversion bill. The Government said it was too early to say whether such controversial issues would be included in the report.

The drafts were opened for public consultation in April and were to be submitted to the Foreign Ministry by the end of the year. They would then be passed on to the UN by Permission Mission of the People's Republic of China in New York. The SAR Government has stated that the Beijing authorities do not have the right to amend the reports, but that they have to be formally submitted to the UN by the sovereign power, China, rather than directly by the SAR itself. A total of eleven submissions on the draft reports were received by various interest groups during a five-week consultation period in March. In addition, a report under the Convention on the Elimination of All Forms of Discrimination against Women was recently submitted to the United Nations.

## Press freedom

There have been no reports of any attempts by the authorities to interfere in the editorial independence of the media. The European Commission is encouraged by the degree to which the Hong Kong press remains active in its coverage of demonstrations, in the space it devotes to the debate on human rights in the SAR and throughout China, and in its reporting of the views of opposition parties. The Hong Kong media also freely exploits its own editorial right to criticise the policies of the SAR Government and those of the Chinese authorities.

However, last February a prominent deputy from the National People's Congress in Beijing accused Radio Television Hong Kong (RTHK) of being too openly critical of the SAR Government, prompting a heated debate as to whether adverse public comment from Beijing amounted to interference in SAR affairs. The SAR leadership reacted by defending RTHK's editorial independence while expressing hope that all media would be fair and objective in reporting government policies. This, like other episodes during the last year, shows how so many one-off events in the early months of the SAR were immediately subjected to close scrutiny for any bearing they may have on the functioning of the one-country-two-systems concept.

## Freedom of information and data protection

The Commission is reassured that freedom of information has been broadly respected during the first year of the SAR. It notes, however, that the Xinhua news agency declined a request made by legislator Emily Lau under the data protection Ordinance to have access to her file. Xinhua did not react to the request within the prescribed 40-day time limit and the Secretary for Justice declined to prosecute Xinhua. The situation raised concern that Xinhua had been placed above the law because it was a Chinese State organisation. The SAR Government has repeatedly denied the claim, and has announced separately that the Ordinance will be reviewed.

## The role of the Chinese garrison

When Chinese delegations visit, police presence tends to be stepped up in order to keep demonstrators at bay. The Chinese garrison stationed in the SAR has kept a low profile throughout the year, in keeping with the Joint Declaration which states that the garrison will not interfere in the internal affairs of the SAR.

## ***The democratic process***

A fair analysis of the democratic process in Hong Kong needs to take account of three key factors: the degree of democracy achieved so far, a comparison with the situation before the handover, and progress towards the ultimate goal of universal suffrage to which the territory is committed.

The Chief Executive and the Government have honoured their pledge to hold elections for the Legislative Council during the first year of the SAR. The Provisional LegCo was duly dismantled, making way for the election of a new LegCo last May which will run until the year 2000. The elections were marked by a record turnout of 53%, well above the previous record of 35.8% in 1995, and a major success for the Democratic Party, which won 13 seats, 9 of them in the geographical constituencies where full suffrage was in operation. The result indicates a strong appetite for democracy in Hong Kong, particularly at a time when the prospect of recession has shown many that economic prosperity can no longer be taken for granted.

### The May elections

New electoral rules were adopted in time for the May elections, according to which 20 of the 60 seats were returned through geographical constituencies by proportional representation, and 30 through 'functional' constituencies representing professional sectors. The remaining 10 seats were subject to election one month earlier by an 800-strong Election Committee comprising businessmen, professionals and the labour, social and religious services, as well as political figures, including local deputies to the National People's Congress in Beijing. The new electoral rules, while not being contrary to the Basic Law, mark a step back from the reforms introduced in 1995. While the number of seats open to full suffrage remained the same (20), the number of people eligible to vote in the functional constituencies was reduced (180,000 instead of 2.7 million, ie just professionals rather than all employees).

### Moves towards universal suffrage

A more lasting test of the SAR Government's long-term commitment to democracy will come from the pace and means with which full universal suffrage is introduced. The Basic Law commits the SAR to the gradual and orderly introduction of universal suffrage for the election of both the Chief Executive and the LegCo. The Basic Law stipulates that the direct election of 50% of the LegCo's seats must be achieved by 2004. For the 2007 elections and thereafter, it is in the hands of the Hong Kong SAR itself as to when universal suffrage is introduced.

The SAR Government is within its rights to accelerate this process, although this would require an amendment to the Basic Law. For this, the approval of the Chief Executive and a 2/3 majority in LegCo would be needed, and the amendment would have to be reported to the National People's Congress for the record. On July 15 this year, opposition parties called for such an acceleration, proposing universal suffrage for the LegCo in 2000 and for the Chief Executive two years later. The motion was rejected by the LegCo. The Chief Executive has voiced his own commitment to the goal without pinning a particular date to it : « after 2007, it is up to us, the people of Hong Kong, to decide for ourselves the further development of the democratic process, with the ultimate aim of universal suffrage » (*CH Tung, Brussels, October 20 1997*).

The Commission will continue to pay close attention to the development of democracy in the SAR. The Commission has asked Hong Kong to clarify in advance how and when the move towards universal suffrage will be completed. The Commission has stressed on several

occasions that the EU was generally encouraged by the SAR Government's long-term commitment to full democracy, adding that the authorities would earn considerable respect at little cost if they were to announce soon their intention to introduce universal suffrage by a specific date. Hong Kong should announce soon its unequivocal commitment to universal suffrage and fix a reasonably early date for its full implementation.

### ***International relations***

Hong Kong retains a wide degree of autonomy in its ability to deepen relations with its world trading partners. It is also a member of the World Trade Organisation in its own right, and participates actively as a separate member of other multilateral bodies. The Commission has sought over the last year to set the EU's ties with the SAR on a more permanent footing as a means of enhancing trade and investment, upholding Hong Kong's own autonomy and strengthening the multilateral trading system to which both the EU and Hong Kong are particularly attached.

The EU-Hong Kong Business Cooperation Committees, which bring business leaders from the EU and the SAR together, are proving to be a successful vehicle to explore the reinforcing of economic and commercial ties between the two sides. The Commission also notes that Hong Kong has set up a council of international advisers – including European business figures – to help it revitalise its economy and assert its role on the international stage.

### **Bilateral agreements**

As regards bilateral agreements with the SAR, the Basic Law states that Beijing is responsible for foreign affairs and defence, while the SAR will conduct external relations in such areas as trade, the economy, financial and monetary affairs, shipping, communications and tourism. The SAR Government has concluded at least 21 bilateral agreements since July 3<sup>rd</sup> 1997. These cover air services, mutual legal assistance and the transfer of sentenced persons, visa abolition, and the promotion and protection of investment. The EC and Hong Kong have pursued the creation of a customs cooperation agreement throughout the year, and negotiations have proceeded smoothly. The Commission believes such an accord will consolidate the global view of Hong Kong as a separate customs territory, as well as strengthening the fight against copyright abuse, counterfeiting, drug trafficking and other common concerns.

### **Multilateral trade**

In the multilateral field, the Commission vigorously supports the SAR's independent voice in international bodies. Over the last year Hong Kong has been a powerful advocate of further trade liberalisation, encouraging Asian neighbours to open their financial services markets through the WTO agreement reached last December at a time when the regional crisis was providing tempting, if misguided, arguments against such opening. Also through its voice in the WTO, Hong Kong has supported calls for a new comprehensive set of trade liberalisation negotiations

from 1999 onwards, whilst also advocating further liberalisation through the Apec forum. Hong Kong officials have also participated in other international bodies, in the area of civil aviation for example, as part of the Chinese delegation.

### **Promoting trade liberalisation in China**

The Commission also believes Hong Kong is well placed to advocate greater trade liberalisation within China itself, and has frequently discussed China's WTO accession negotiations in its regular contacts with the SAR during the year. Hong Kong will be one of the major beneficiaries of Chinese membership of the WTO, and this in turn will benefit China. The Commission believes Hong Kong's own liberal, transparent economy, as well as its effective voice within the WTO, will act as an example to all China of how an open, globally integrated market is necessary to achieve lasting economic strength.

### ***Visas and immigration***

The SAR has the authority to issue passports and other travel documents, as well as applying its own immigration controls.

While the Commission has no direct responsibility for the issuing of visas, it does have a competence for proposing the list of third countries whose nationals should be subject to a visa obligation by all Member States. Under the Amsterdam Treaty, that competence will be extended to cover making proposals to establish the list of countries whose nationals should be exempted from the visa requirement by all Member States. In these contexts, it will have to consider what visa regime to propose for Hong Kong. Under the current arrangements, holders of SAR passports are visa-exempt for two EU Member States (the UK and Ireland) in recognition of the special position of the territory. The Commission is well-disposed to the continued recognition of this special status. It is also aware of the importance which Hong Kong, including in particular its business community and European companies operating there, attaches to being accorded similar visa-exempt status by as many Member States as possible. It further notes Hong Kong's sustained determination to demonstrate that its immigration policy, particularly vis-à-vis citizens from the mainland, is adequately enforced, and that its travel documents are protected by state-of-the-art forgery-proofing. In the light of these efforts, whose successful implementation will need to be carefully monitored, the Commission believes that a generous attitude from EU Member States would further underpin Hong Kong's status as a separate customs territory with its own immigration policy, a key pillar of the one-country-two-systems formula.

## **Conclusion**

The 'one country two systems' approach is a key element in Hong Kong's stability, freedom and prosperity following the resumption of Chinese sovereignty over the territory. After one year it is already proving to be a workable formula that deserves the full support of the European Union and other partners. The handover itself has gone smoothly, and the authorities of both Hong Kong and Beijing have followed it up with a determination to make the division of responsibilities between them function effectively and clearly.

During the early months of the SAR, every new law, legal case or government act has been closely scrutinised by civil rights activists, opposition politicians, the media and the public at large for its potential threat to Hong Kong's autonomy, and on isolated occasions they have prompted questions about the SAR authorities' commitment to upholding that autonomy. Such intense scrutiny is in itself a healthy sign that Hong Kong's people and institutions feel willing and able to provide a necessary check on the authorities that run their lives. In its own scrutiny of developments in the SAR since the handover, the European Commission does not detect an overall policy shift towards greater restrictiveness. The Commission will continue to monitor events in the Hong Kong SAR in the belief that a strict application of the one-country-two-systems formula holds the key to its lasting economic prosperity and the wellbeing of its citizens.

The May elections, although limited in their degree of suffrage, were a positive step on the road to universal democracy as stipulated by the Basic Law. The result reflects a growing appetite for the democratic process, not least at a time when financial troubles have removed the certainty of economic wellbeing for many Hong Kong citizens.

The financial crisis has deprived the SAR, at a delicate stage in its development, of the high growth and business confidence that has characterised Hong Kong's economy in the past. Its strict adherence to transparency, prudent budgetary control and a stable currency is therefore all the more admirable in the face of such adversity. This will ultimately encourage the return of business confidence once the financial crisis subsides.

The Commission has little doubt that such confidence will soon return, provided the SAR Government sticks closely to the principles of sound regulation and open trade, as well as the unimpeded functioning of markets with intervention strictly limited to internationally accepted standards and practices. The Commission also welcomes the chance to exchange views with Hong Kong regarding the improvement of the international financial architecture. Hong Kong remains one of the most open economies in the world. Its well tested economic principles, together with close adherence to the political and social freedoms enshrined in the Basic Law, will be the territory's best guarantor of future stability. The EU has an important role to play in that process through continual support for the SAR anchored in an ever deeper and more permanent relationship.