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**REPORT FROM THE COMMISSION TO THE COUNCIL
AND THE EUROPEAN PARLIAMENT**

**Second Annual Report by the European Commission on the Special Administrative
Region of Hong Kong**

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1. INTRODUCTION

The European Union's basic policy on Hong Kong is set out in the Communication from the European Commission of 23.4.97 entitled "The European Union and Hong Kong: Beyond 1997"¹. The Communication was followed by Council conclusions adopted on 3 June 1997.

The EU considers that effective implementation of the "one country, two systems" principle enshrined in the Joint Declaration and in Hong Kong's Basic Law, is a prerequisite for Hong Kong's lasting stability and prosperity. Hong Kong has long been a model and an example for other countries in the region, and a crucial point for exchanging not only goods and services, but also ideas and ways of living and thinking.

Hong Kong is important for the EU. The EU has for years maintained a dynamic trade and investment relationship with Hong Kong, and Hong Kong has played a role as a centre for economic and cultural exchange between Europe and Asia. Hong Kong is part of China; maintaining a free, open and autonomous Hong Kong is beneficial for China, and Hong Kong can offer valuable expertise as China sets about economic reform and building the rule of law.

The Commission undertook in its 1997 Communication to produce an annual report on the relations between the Hong Kong Special Administrative Region and the EU. The annual report intends to assess the state of the relations between Hong Kong and the EU, and to consider developments in the implementation of the Joint Declaration and Basic Law in Hong Kong. The report also discusses the interests of EU businesses in Hong Kong, examines possible areas for developing further cooperation and covers issues which, in the view of one or other of the parties, require certain action.

2. DEVELOPMENTS IN HONG KONG

Hong Kong's commitment to the rule of law and to the independence of the judiciary continues to be strong. The European Commission shares this commitment and supports the policy of maximum vigilance over monitoring the robustness of the rule of law and the operation of the "one country, two systems" principle. However, 1999 was not without some controversies, most notably in legal and constitutional matters, as illustrated by some of the following examples.

The Legal System

Legal developments in 1999 were dominated by the difference between the two legal systems referred to in Hong Kong's constitution. In line with the "one country, two systems" principle, the autonomy of the Hong Kong Special Administrative Region (HKSAR) is exercised under the umbrella of the Constitution of the People's Republic of China and also Hong Kong's common law - with the written constitution of the "Basic Law".

¹ Com (97) 171 final.

Court of Final Appeal Ruling on the Right of Abode Issue

Following two judgements of the HKSAR Court of Final Appeal (CFA) concerning right of abode immigration issues, in which the CFA gave an interpretation of, i.a., article 24(2)(3) of the Basic Law, the HKSAR Government (HKSARG), pursuant to article 158(1) of the Basic Law, decided to refer to the National People's Congress Standing Committee (NPCSC) in Beijing the question of interpretation of these provisions of the Basic Law.

In the HKSARG's opinion, the interpretation given by the CFA violated the "original legislative intent" of the relevant provisions. It constituted a serious cause of concern in view of the large number of potential immigrants that, on the basis of the CFA's interpretation, might obtain the right of abode in Hong Kong. It was therefore felt appropriate to request from the NPCSC a clear statement of the true legislative intent so as to provide certainty and clarity on the correct interpretation of these provisions and free the courts from future controversies.

This unprecedented decision was strongly criticised in some quarters as potentially undermining the authority of the CFA and setting a precedent, which undermined the independence of Hong Kong's judiciary. Several options had been available to HKSARG, among them (a) to amend the Basic Law; (b) to seek new rulings by the CFA to limit the extent of the right of abode granted by its previous decisions or (c) to request the NPCSC to give its own interpretation of the Basic Law's right of abode provisions. The HKSARG chose option (c). For many people, including some of the leading members of the legal profession, this option was the most damaging in terms of legal and constitutional orthodoxy.

The Standing Committee's interpretation endorsed the HKSARG's view and ruled that the Hong Kong courts should follow the Committee's interpretation when adjudicating future cases on right of abode.

Although some experts continue to debate the legality of the request for interpretation, others thought the approach followed by the HKSARG not to be contrary to the provisions of the Basic Law. Politically, however, concern remains that the HKSARG might have set an unwelcome precedent. For their part, the HKSARG argued that this was an exceptional case, which had required exceptional action, although they did not rule out the possibility of taking similar action in the future.

The European Commission considers it is important for Hong Kong's reputation that this episode should remain wholly exceptional. Besides, it shares the concern expressed by the Human Rights Committee that "a request by the executive branch of government for an interpretation under article 158(1) of the Basic Law could be used in circumstances that undermine the right of a fair trial under article 14" of the International Covenant on Civil and Political Rights.

Democratic Process

Universal Suffrage

Hong Kong's Basic Law allows for the gradual introduction of universal suffrage, with, ultimately, the free selection of all members of the Legislative Council (LegCo). In 2004, the number of elected members of LegCo should increase from one third to fifty percent. The Basic Law allows for all LegCo members and the Chief Executive to be elected after 2007. But there is no requirement for this to happen. The HKSARG has been reluctant to give any

commitment to, or timetable for, the introduction of a fully elected legislature, despite calls for a public debate on the issue by opposition parties and some members of the international community.

The European Commission reiterates the calls it has made on a number of previous occasions (including Mr Santer's visit to Hong Kong in 1998, as President of the EC), for the HKSARG to state its unequivocal commitment to a fully elected system of government and to announce a timetable for its introduction.

Human Rights

As agreed in 1998, the Chinese Government submitted to the UN reports on the HKSAR for 1999, in accordance with the provisions of the International Covenant on Civil and Political Rights and the International Covenant on Economic, Social and Cultural Rights, as well as a report under the UN Convention against Torture and other Cruel, Inhuman or Degrading Treatment or Punishment. The UN's Human Rights Committee made several recommendations on a number of issues of concern, including some referred to in this report. The European Commission welcomes the submission of the reports and encourages the HKSARG to give full attention to the implementation of the recommendations of the Human Rights Committee.

Labour law

The Provisional Legislative Council has not re-instated the laws covering collective bargaining, funding of trade unions and the prevention of anti-union discrimination that were suspended in 1997. The absence of an adequate legal framework for trade union activity in the HKSAR has aroused concern on the part of the international trade union movement and the International Labour Organisation.

Freedom of Travel

A number of incidents have been reported where Chinese dissidents have been prevented from entering Hong Kong. In other cases, some Hong Kong politicians (including LegCo members) have been prevented from entering Mainland China without any explanation. While the refusals to grant entry into China appear to have been decisions made by the Chinese authorities - without any involvement of the Hong Kong Government, the cases raise considerable concern.

Flags

A further legal test case with individual freedom implications relates to the interpretation of provisions on the desecration of national and regional flags. The Court of Appeal ruled in March 1999 that certain parts of the National Flag and National Emblem Ordinance enacted on 1st July 1997 were contrary to Art. 39 of the Basic Law in that they restricted rights and freedoms enjoyed by Hong Kong residents under the provisions of the International Covenant on Civil and Political Rights (ICCPR). The Government argued that the limits to freedom of speech introduced by the Ordinance were justifiable and not contrary to the Basic Law or the ICCPR. The Hong Kong SAR Government requested the Court of Final Appeal to review its judgement.

On 15 December, the Court of Final Appeal issued its judgement. The CFA overruled the Court of Appeal's decision and upheld the consistency of the Ordinance with both the Basic

Law and the International Covenant on Civil Rights. The Court stressed in its reasoning that the type of restrictions on the freedom of speech contained in the Ordinance were limited and justified by the need to protect other values, which were also worthy of constitutional protection. The CFA cited as reference decisions of Italian and German courts upholding the constitutionality of laws which protect the national flag and punish, by imprisonment or imposition of fines, the non-respect of their provisions.

Rendition of Offenders

Concern has also been expressed about the lack of arrangements for rendition of offenders between the mainland and the SAR. Two cases brought special attention: one mainland resident and several Hong Kong residents were tried, convicted and executed in the mainland. All of them had allegedly committed crimes in Hong Kong. The fact that the Hong Kong authorities had not called for jurisdiction in those cases troubled a number of legal and human rights observers. The HKSARG has said repeatedly that discussions are being conducted with the Central Government authorities on an agreement in this area.

Press Council

The Law Reform Commission introduced, in September, a proposal to set up a press council to stop media invasion of privacy. Journalists and media professionals overwhelmingly rejected the proposal out of fear that such a council could threaten Hong Kong's hard-earned press freedom. Under the proposal, a set of professionals' codes of practice would be drawn up and any violation of these codes could bring heavy fines.

The proposal came amid growing concerns in Hong Kong over the quality of the local media and cases of unethical practice by journalists, such as intrusion into people's private lives. At the time of compiling this report, discussions on the proposal were continuing.

Controversy was also triggered by the statement by a mainland Chinese official regarding the reporting by the Hong Kong media of events in Taiwan following the presidential election there.

Conclusions

As a general conclusion concerning the respect of fundamental rights and freedoms, the European Commission wishes to reiterate its firm support for the principles of the Basic Law of the SAR and in particular those that guarantee those fundamental freedoms. The implementation of the concept of "one country, two systems" should not impede or limit the respect of those fundamental principles, since they form an integral part of the concept itself. Despite the doubts expressed about the above issues, and the concerns they have raised, Hong Kong clearly remains a free society.

The Economy

The economic situation in Hong Kong after the handover was badly affected by the Asian financial crisis. The economic difficulties, however, had nothing to do with political developments and were completely unrelated to the transfer of sovereignty, even though the two events coincided in time. The first signs of recovery are evident and in the second quarter of 1999 Hong Kong emerged from 15 months of recession. Other economic indicators also showed positive trends during 1999: the trade deficit narrowed, re-exports increased, stock

market prices recovered their July 1997 level, and unemployment stabilised. Speculation on the stock and currency markets has abated and the peg to the US dollar is not, unlike in 1998, the subject of discussion and controversy.

Hong Kong's market economy continues to operate in very much in the same manner as it did before the handover. Isolated and controversial developments, such as the Government's intervention in the stock, market have been the exception rather than the norm. For most observers they are the result of economic, and not political, developments. Some liberalisation is taking place in areas which were highly regulated and where competition was restricted, such as the banking sector, telecommunications, airport services, etc. in part as a result of WTO commitments and in part as a result of the HKSARG's own initiative.

The renewed prospects for China's membership of the WTO will present challenges to Hong Kong, but will also offer new opportunities as well.

On the economic front, two major events in 1999 were the liberalisation of the financial markets through the demutualisation, merger and listing of the securities and futures exchanges, and the first steps taken to dispose of the stock portfolio that the Government acquired in the summer of 1998.

All factors in the economic area seem to indicate that the HKSARG is conducting its finances and its economic policy with full independence from the Central Government, in accordance with the provisions of the Basic Law. In addition the Heritage Foundation recently confirmed HK being one of the freest economies in the world.

3. EU PRESENCE AND EU INTEREST IN HONG KONG

Hong Kong is one of the most important cities, if not the most important, in terms of location for EU interests in Asia. About 46,000 EU citizens from all the Member States are resident in Hong Kong. In 1999, at least 250 EU companies were using Hong Kong as their regional headquarters, while 471 had regional offices in the city.

In terms of foreign investment the EU was, in 1997, the number one source of investment for Hong Kong. The cumulative value of realised direct investment from the EU in that year amounted to ECU 29 billion, accounting for 34% of the total. Although figures are not yet available for 1999, indications are that EU investment continued to be strong in that period.

The EU presence in Hong Kong covers a large variety of sectors. EU industry is involved in a number of activities ranging from financial services, trading and manufacturing to communications and construction. In the insurance sector, EU companies ranked first in number of overseas insurers operating in Hong Kong. Forty-six banks licensed in Hong Kong were incorporated in the EU. In 1998, EU companies were awarded contracts totalling ECU 145 million in the public works sector. The EU also has a very important role in shipping and in air transport.

The EU was Hong Kong's third supplier of goods in the first eleven months of 1999, after China and Japan, and was Hong Kong's third biggest market for its domestic exports, after the United States and China.

The EU's economic interest in Hong Kong is, of course, not limited to the Hong Kong market but looks beyond to China and other countries in the region. Re-exports of EU origin goods

through Hong Kong to China increased by some 2500 times, from HK\$ 18 million in 1978 (the year China announced its modernisation programme) to HK\$ 44.5 billion in 1999.

Statistical data on EU-Hong Kong trade for the period 1985-1999 is contained in Annex I to the report.

The EU is also active in Hong Kong in the cultural and educational fields and a number of European cultural institutions are present in Hong Kong. These institutions, together with the Consulates General of the EU Member States and the Office of the European Commission in Hong Kong, have been cooperating in a Working Group for Culture which, for seven years, has organised a number of events with a European focus in Hong Kong and in Macau. In addition, European universities have developed a network of cooperation projects with Hong Kong universities.

Under the EC's Framework programme for research and technological development, Hong Kong receives financial support from the EC for its participation in the EC's dedicated S&T programme of Research for Development. Hong Kong is involved in 2 joint research projects on agriculture development issues with the financial support of the EC. The combined value of these projects (which include European as well as other Asian partners) is 1.2 Million Euros in grant support from the Research for Development programme. In addition Hong Kong is eligible to participate on a non-financed basis in a broad range of S&T programmes, as result of the EU/China S&T Agreement, however so far Hong Kong is not active in these programmes.

4. HONG KONG SAR AS AN INTERNATIONAL PARTNER

The HKSAR is fully competent, in accordance with the Basic Law, to conduct its own trade policy as a separate Customs territory. As such it is an independent member of the WTO and of a number of other international organisations.

Hong Kong is a particularly active Member of the WTO and maintains close and regular contact with the European Commission. The EU and Hong Kong share a number of common goals and objectives in the WTO and have a close working relationship, which is greatly appreciated by the EU.

5. COOPERATION BETWEEN THE HONG KONG SAR AND THE EUROPEAN UNION

1999 saw an important milestone in expanding cooperation between HKSAR and the EU with the signature and entry into force of the Customs Cooperation Agreement² between the European Community and Hong Kong (China). This cooperation Agreement is the first binding Customs Cooperation Agreement concluded by the HKSAR since the handover. It was negotiated and concluded under Article 151 of the Basic Law, which provides that the HKSAR may, on its own, conclude and implement agreements in trade and economic matters. It is a good example of the high degree of autonomy that the HKSAR enjoys as a separate customs territory. The Agreement underlines the close economic ties between the HKSAR and the EU, and will facilitate exchange of information and coordination between customs authorities to ensure the effective application of their respective customs legislation. The Agreement provides for mutual administrative assistance and for exchange of information and

² OJ L 151 of 18.6.1999, p. 21-26.

expertise. The Agreement formalises the cooperation between Customs authorities, which was already taking place, and puts it on a more permanent footing. The Commission welcomes this upgrading of the cooperation and looks forward to further cooperation in other fields.

Furthering Cooperation

The Commission believes that the conditions are ready for furthering cooperation between the European Union and Hong Kong and considers, in particular, that education and the environment are areas in which cooperation could be developed. As noted above, European and Hong Kong universities have established a network of cooperation projects and many exchanges of students and teachers are taking place. There is, however, considerable scope for expanding this co-operation and it is an area that has been designated as a priority by the Chief Executive of the SAR, in his most recent Policy Address.

The environment has continued to deteriorate in recent years, paradoxically at the very time when manufacturing industry has moved away from Hong Kong and when the technical means can be found to prevent environmental damage. The environment was also designated as a priority in the Chief Executive's 1999 Policy Address. The European Union has considerable expertise and know-how in this area and looks forward to exploring ways in which further cooperation and interchange can be developed.

Meeting Demands

The protection of Intellectual Property Rights (IPR) in Hong Kong continues to be a matter of concern for the European Union. This concern is shared by the industry and other third countries, notably the United States. The HKSARG has made considerable efforts recently to improve the situation: enforcement has been stepped up and an increased number of officers have been assigned to combat copyright piracy and manufacturing and selling of counterfeit products. These efforts are extremely welcome and the EU and Hong Kong will continue to cooperate within the framework of the Customs Cooperation Agreement, signed in May.

The European Union made representations to the HKSARG in relation to this issue and, through the work of its Trade Commissioners' Group in Hong Kong is carefully monitoring developments in this area.

The Commission applauds the efforts undertaken by the Hong Kong authorities and encourages the HKSARG to continue the fight against piracy and counterfeiting, while ensuring that production equipment will not simply be moved to neighbouring countries.

Visa Free access

On 26 January 2000 the Commission adopted a proposal for a Council Regulation where holders of passports from Hong Kong SAR have been added to the proposed list of countries whose nationals would be exempt from the visa requirement.

This reflects the Commission's assessment of HKSAR against various criteria such as its legal situation (one country, two systems), the provisions relating to immigration, border controls and security of travel documents.

Its geographical location and its air-traffic facilities make HKSAR one of the major transit points in Asia for travellers towards Europe. For this reason, the HK Immigration Department dedicates to the "Control Branch" important human and technical resources to deter illegal

migrants from different Asian countries, and in particular those from Mainland China, from taking advantage of those transit facilities.

According to the Basic Law, the HKSAR Government is authorised to issue travel documents (passports, documents of Identity) to Chinese citizens who hold permanent identity cards of the HKSAR which state their right of abode in the Region.

The HKSAR Passport issuing system and the record check system for authentication utilise a technologically advanced procedure.

The HKSAR authorities issue also Documents of Identity for visa purposes to HKSAR residents who cannot obtain national passports from any other State/Region. The vast majority are Chinese nationals from the Mainland who are not yet eligible to hold a HKSAR passport (they have not completed a 7 years continuous residence).

Both documents (passport and document of Identity) contain security and anti-forgery features.

The Commission hopes that its assessment will be shared both by the Council and by the European Parliament during the procedure for adoption of the proposed draft Regulation.

The EU-HK and HK-EU Business Cooperation Committees

The EU-HK and HK-EU Business Cooperation Committees held their second meeting in October 1999. The Committees play an important role in promoting contacts between Hong Kong and EU business circles. The changes that are taking place in the HKSAR as well as the very important changes taking place in Europe, such as the introduction of the Euro and furthering enlargement of the EU, require a clear and regular exchange of information, which the Committees can achieve.

6. CONCLUSIONS

The European Commission considers that two and a half years after the handover of Hong Kong to China, the “one country, two systems” principle remains intact and is generally working well. Hong Kong remains one of the most free societies in Asia. There have been some difficulties, but we should not exaggerate them. The European Commission will continue to monitor the position closely, particularly the continuing independence of the courts and adherence to the rule of law.

The economy is recovering well from the effects of the Asian financial crisis. EU companies continue to invest heavily in Hong Kong, which demonstrates confidence in its future. The European Commission welcomes the continuing close working relationships it has with Hong Kong in international trade matters, and looks forward to pursuing together, through the WTO, a number of shared objectives.

It will be important for Hong Kong’s image internationally that the HKSARG and the Government of China clearly demonstrate their continuing commitment to the “one country, two systems” principle. Hong Kong people are running Hong Kong and doing so effectively. The European Commission notes the provisions in the Basic Law regarding the pace of democratisation and encourages open and public debate on this matter in Hong Kong. A faster pace of democratisation would set to rest many of the anxieties expressed about Hong Kong’s present and future.

The European Commission considers co-operation with Hong Kong should be increased in a number of ways, to the benefit of both parties, and will seek to identify suitable opportunities to take this forward in the year ahead.

ANNEX 1

1.1. Trade Trend between the EU and Hong Kong for the period Jan 1985 – Oct 1999

	<u>IMPORTS</u> <u>(ECU</u> <u>MILLION)</u>	<u>EXPORTS</u> <u>(ECU</u> <u>MILLION)</u>	<u>TOTAL</u> <u>TRADE (ECU</u> <u>MILLION)</u>	<u>BALANCE</u> <u>(ECU</u> <u>MILLION)</u>
1985	4819	4551	9370	-268
1986	5300	4229	9529	-1071
1987	5507	4777	10284	-730
1988	6318	6767	13085	450
1989	6413	7022	13453	591
1990	5909	6598	12507	689
1991	6401	7395	13796	994
1992	5908	8782	14690	2874
1993	6438	11392	17830	4954
1994	6493	13087	19580	6594
1995	7156	15796	22952	8639
1996	7262	17509	24771	10248
1997	8371	20441	28812	12070
1998	9706	17296	27002	7591
Jan-Oct 1999³ (million Euro⁴)	8475	12701	21176	4226

Source: EUROSTAT

For the period Jan 1985 to Dec 1998, total bilateral trade between the EU and Hong Kong increased almost threefold and the EU balance of trade was transformed from a deficit of ECU 268 million in 1985 to a surplus of ECU 7591 million in 1998. EU imports from Hong Kong doubled, while exports increased more than three times. It should be noted that the decrease of EU exports to Hong Kong between 1997 and 1998 was mainly due to the Asian Financial Crisis.

³ Latest available statistics from the Eurostat.

⁴ On 1 January 1999, the Euro became the official currency of 11 Member States of the European Union with a fixed conversion rate against their national currencies. At the same time, the ECU disappeared as an international and common unit for comparison of EU figures.
Figures from 1985 to 1994 include only 12 Member States