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

Hong Kong Special Administrative Region: Annual Report 2004

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As regards the implementation of the 'One Country Two Systems' principle, 2004 was characterised by a trend toward greater influence of the Mainland authorities in the governance of the Territory, notably through the involvement of the Standing Committee of the National People's Congress (NPCSC) in the constitutional development process. This created concerns both within and outside the territory about the integrity of the concept of 'Hong Kong people ruling Hong Kong people'.

The year had begun with high expectations for political reform among pro-democracy groups, with an estimated 100,000 Hong Kong citizens marched peacefully through the streets on 1st January expressing their will to participate more in politics and government. They were further encouraged when on 7th January the Hong Kong Government set up a Constitutional Development Task Force which started public consultations.

However, on April 26th the NPCSC, on the request of the local authorities, issued a decision interpreting the Basic Law governing Hong Kong that allows for only minor changes in the election systems for the HK Chief Executive in 2007 and for Legislative Councillors in 2008. Subsequently the Hong Kong SAR Government complied with this decision and prospects for significant progress towards universal suffrage, which is the 'ultimate aim' under the Basic Law, have not improved. An EU diplomatic demarche expressing concern about the NPCSC referral's inconsistency with the high degree of autonomy guaranteed under the Basic Law was made in Beijing and in Hong Kong on 28 May.

Notwithstanding these developments, orderly elections held for the Legislative Council in September produced a record high turn-out, with 62% of voters supporting pro-democracy candidates, indicating that there remains a strong preference within the territory for greater democracy. That said, given the nature of the electoral system, only 25 out of the 60 seats in the new Legislative Council from the pro-democracy camp. Pro-government parties retain a majority. The overall conduct of the elections was testament to the political maturity of the SAR, and showed that there is a sound base for further democratisation.

Hong Kong civil society and press continued to operate freely and became more vociferous and critical during the year. As a result, their relations with the HK SAR government and its leadership deteriorated somewhat, and this eroded the popular support of some HK government leaders. For their part, some journalists also claimed to have been under pressure to moderate their criticism of government policies.

The European Commission welcomed the publication in September 2004 of draft legislation on racial discrimination and hopes that a comprehensive text in line with international standards will be passed in 2005.

The HK government's management policy and some of its specific projects have been severely criticised during the year. It is to the credit of the government and the political system that some of these criticisms were acknowledged and even came through reports commissioned by the government itself, such as on the mismanagement of the SARs

epidemic. Other examples are the public controversies surrounding some major government property development transactions (the Hunghom Peninsula housing project, the West Kowloon Cultural District project, and the delayed flotation of the REIT Links public housing share issue) that have been the subject of general accusations of collusion between government and business.

The fact that the last of these transactions was blocked following a successful legal objection in the courts is an encouraging sign of the continuing independence of the judiciary and the rule of law in Hong Kong. Continued freedom of expression in the Territory is shown in the way that senior government officials have been subject to such sustained public criticism. Some have resigned as a result of the pressure- such as the Secretary for Health in mid-2004 due to the SARs report. The Chief Executive himself finally resigned (for “health reasons”) in March 2005.

The Central Government’s economic policies in 2004 were increasingly helpful for Hong Kong. The coming into force in 2004 of the CEPA I (Closer Economic Partnership) arrangement and its future deepening through CEPA II, the beginning of Pan Pearl River Delta Cooperation co-operation discussions, and – perhaps most important – the introduction of the Mainland Visitor’s Scheme provided a real confidence boost for the HK economy that was only just in 2004 emerging from a six-year downturn that had been exacerbated during 2003 by the impact of the SARs epidemic.

During 2004 the economies of Hong Kong and China became more symbiotic, inter-dependent and convergent. The increased interpenetration of the two economic systems can be seen as positive for both China and Hong Kong, with many Hong Kong business practices becoming more widespread on the mainland, to the benefit also of Hong Kong’s economic development.

By the middle of the year the economy was recovering well. Economic growth in 2004 was 8.1% for the year, unemployment was falling, property and share markets had risen, deflation had been replaced by modest price inflation and the government deficit was narrowing.

Trade and financial flows between Hong Kong and the European Union continued to expand and deepen. The EU was HK’s third largest supplier of goods in 2004 after Mainland China and Japan, and was the third largest market for HK exports after the US and Mainland China. EU companies are leaders in many sectors, especially in financial and other services.

The European Commission continued to express its concern about the lack of a competition law in HK, but little progress was registered in 2004. Resolving this issue will remain a top priority in the EU’s economic relationship with the Territory. The EC also recognised the SAR’s efforts to protect IPR, although Hong Kong was still the third largest provenance of counterfeit goods imported into the EU and further work is needed.

EU-HK official relations and co-operation on trade, immigration, customs and business dialogue also continued to deepen in 2004. European Commissioner for Trade, Pascal Lamy, paid an official visit to Hong Kong in March 2004. In September the Hong Kong Secretary for Justice and Home Affairs, Mr. Ambrose Lee met with the European Commissioner for Justice and Home Affairs and opened the first meeting of the Joint EC-Hong Kong Readmissions Committee in Brussels. The 5th EC-HK Joint Customs Co-operation Committee was held in Brussels in September. The 5th Plenary session of the EU-HK Business Co-operation Committee took place in Hong Kong in March 2004. And the Commission

welcomed the WTO agreement to hold the 6th Ministerial WTO Conference in Hong Kong in December 2005.

Full details of the Commission analysis is given in the Commission staff working document SEC(2005) 922.