

CRS Report for Congress

Hong Kong: Ten Years After the Handover

June 29, 2007

Michael F. Martin
Analyst in Asian Political Economics
Foreign Affairs, Defense, and Trade Division



Prepared for Members and
Committees of Congress

Report Documentation Page

Form Approved
OMB No. 0704-0188

Public reporting burden for the collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington Headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington VA 22202-4302. Respondents should be aware that notwithstanding any other provision of law, no person shall be subject to a penalty for failing to comply with a collection of information if it does not display a currently valid OMB control number.

1. REPORT DATE 29 JUN 2007		2. REPORT TYPE		3. DATES COVERED 00-00-2007 to 00-00-2007	
4. TITLE AND SUBTITLE Hong Kong: Ten Years After the Handover				5a. CONTRACT NUMBER	
				5b. GRANT NUMBER	
				5c. PROGRAM ELEMENT NUMBER	
6. AUTHOR(S)				5d. PROJECT NUMBER	
				5e. TASK NUMBER	
				5f. WORK UNIT NUMBER	
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) Congressional Research Service, The Library of Congress, 101 Independence Ave, Washington, DC, 20540-7500				8. PERFORMING ORGANIZATION REPORT NUMBER	
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)				10. SPONSOR/MONITOR'S ACRONYM(S)	
				11. SPONSOR/MONITOR'S REPORT NUMBER(S)	
12. DISTRIBUTION/AVAILABILITY STATEMENT Approved for public release; distribution unlimited					
13. SUPPLEMENTARY NOTES					
14. ABSTRACT					
15. SUBJECT TERMS					
16. SECURITY CLASSIFICATION OF:			17. LIMITATION OF ABSTRACT	18. NUMBER OF PAGES	19a. NAME OF RESPONSIBLE PERSON
a. REPORT unclassified	b. ABSTRACT unclassified	c. THIS PAGE unclassified			

Hong Kong: Ten Years After the Handover

Summary

In the 10 years that have passed since the reversion of Hong Kong from British to Chinese sovereignty, much has changed and little has changed.

On the political front, the Hong Kong Special Administrative Region (HKSAR) has selected its first Chief Executive, only to have him step down and be replaced in a process not without some controversy. Meanwhile, belated changes by the British in the makeup of Hong Kong's Legislative Council (Legco) were initially undone, but subsequent changes in the Legco selection process have brought things back nearly full circle to where they stood prior to the Handover. There is also unease about the independence of Hong Kong's judicial system and the protection provided by Hong Kong's Basic Law in light of decisions made by the Chinese government.

Similarly, the civil liberties of the people of Hong Kong remain largely intact. In part, this can be attributed to the increased politicization of the people of Hong Kong. The freedom of the press in Hong Kong is still strong, but also faces challenges — both on the legal front and from allegations of self-censorship on the part of the media owners reluctant to antagonize the People's Republic of China. Yet, even with these challenges, many Hong Kong residents do not appear to perceive a decline in their civil liberties since 1997.

Economically, Hong Kong is still a major international financial center and a leading gateway into China. However, Hong Kong's economic interaction with the Chinese mainland has grown deeper and broader over the last 10 years than was expected, increasing the city's economic connections with China. This closer tie to the mainland is being bolstered by the signing of a free trade agreement in 2003, called the "Closer Economic Partnership Arrangement," or CEPA, between China and Hong Kong. Current economic and trade dynamics have raised concerns that Hong Kong's relationship with China will shift in the long run from one of synergy to full integration, possibly undermining the HKSAR's "high degree of autonomy."

Recent social and cultural trends appear to reflect some apprehension about the long-term implications of current economic and political trends. There has been a decline in Hong Kong's expatriate ("ex-pat") community, including U.S. nationals. Also, there is a perception that Hong Kong's "middle class" is disappearing. Underlying many of these social and cultural trends is a redefinition of Hong Kong by its residents, indicating a closer identification with China.

At present, few of these long-term trends have had a significant effect on Hong Kong's political or economic situation and its relations with the United States. Under the U.S.-Hong Kong Policy Act of 1992 (P.L. 102-383), the United States treats Hong Kong as a separate entity in a variety of political and economic areas so long as the HKSAR remains "sufficiently autonomous" from China. While Hong Kong government continues to fulfill its obligations to the United States under existing bilateral and multilateral treaties and agreements, there are still some minor issues that might warrant action by Congress. This report will be revised as circumstances warrant.

Contents

Introduction	1
Changes in Hong Kong Since 1997	2
Political Developments	4
The Chief Executive	5
Legislative Council	7
Hong Kong's Courts	10
Interpreting the Basic Law	10
The Growth in Civil Cases	12
Political Parties	12
Democratic Party	13
Frontier Party	13
The Civic Party	13
The League of Social Democrats	13
The Liberal Party	13
DAB	13
Politicization of Hong Kong Residents	14
Civil Liberties	15
Freedom of Speech and Assembly	15
Article 23 Controversy	15
Falun Gong and Other Demonstrations	16
Press Freedom	17
Self-Censorship	17
Radio Television Hong Kong (RTHK)	17
ICAC Raid	18
Economic Developments	18
External Shocks and Recovery	18
Asian Financial Crisis and SARS	19
Road to Recovery	20
Deepening Economic Interaction with China	22
CEPA	22
Pan-Pearl River Delta	23
Synergy or Integration?	24
Economic Relations with the United States	26
Important Social and Cultural Trends	29
Declining "Ex-Pat" Community	29
Disappearing Middle Class	31
Historical Preservation	31
Redefining Hong Kong	32
Implications for U.S. Policy and Congress	33
Democratization	33
Civil Liberties	34
Economic Relations	34

Appendix 1. Hong Kong Interviews	36
--	----

List of Figures

Figure 1. Map of Hong Kong	35
----------------------------------	----

List of Tables

Table 1. Hong Kong's Recession, 1997-2003	20
Table 2. Hong Kong's Economic Recovery, 2003-2006	22
Table 3. Hong Kong's Total Trade with the World, China, and the United States, 1997-2006	25
Table 4. U.S. Merchandise Trade with Hong Kong, 1997-2006	27
Table 5. Ethnic Composition of Hong Kong's Population: 1996, 2001, and 2006	30

Hong Kong: Ten Years After the Handover

Introduction¹

Ten years have passed since the establishment of the Hong Kong Special Administrative Region, or the HKSAR, on July 1, 1997. The event, commonly referred to as the Handover, marked the end of 155 years of British colonial rule and China's resumption of full sovereignty over Hong Kong. During the last 10 years, there have been modest changes in Hong Kong's political situation and more significant changes in its economy. These political and economic changes have had an impact on Hong Kong's social and cultural identity. Despite some political and economic setbacks, the HKSAR remains a vibrant international trade hub in Asia.

The actual transferral of sovereignty over Hong Kong was governed by the "Joint Declaration of the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the People's Republic of China on the Question of Hong Kong" (commonly referred to simply as the "Joint Declaration") signed on December 19, 1984 in Beijing.² Under the terms of the Joint Declaration, China promised that Hong Kong would "enjoy a high degree of autonomy" and "the current social and economic systems in Hong Kong will remain unchanged" for 50 years. The Joint Declaration also required China's National People's Congress (NPC) to pass "a Basic Law of the Hong Kong Special Administrative Region" (generally referred to as the "Basic Law") stipulating China's policies on Hong Kong that are consistent with the terms of the Joint Declaration. The National People's Congress passed the Basic Law on April 4, 1990.³

Hong Kong has long been important to the United States in several ways. First, Hong Kong is a major entrepôt in Asia, especially for trade with China. Second, Hong Kong's longstanding open trade policy has made it a major ally for U.S. efforts to liberalize international trade. Third, Hong Kong's Common Law legal system and its respect for civil liberties are a bellwether in Asia for human rights.

¹ The content of this report is based upon the author's personal experience living and working in Hong Kong in 1984, 1991, 1992, and 1994 to 1998, as well as a series of interviews conducted in Hong Kong in May and June 2007 (see **Appendix 1**) and a variety of studies and reports on the status of Hong Kong since the Handover. Staff of the Hong Kong Economic and Trade Office in Washington, DC, and their colleagues in Hong Kong helped arrange and facilitate the Hong Kong interviews.

² The complete text of the Joint Declaration is available at [http://www.info.gov.hk/cab/topical/bottom1_2.htm].

³ The complete text of the Basic Law is available at [http://www.info.gov.hk/basic_law/fulltext/index.htm].

Congressional interest in Hong Kong was demonstrated by the passage of the United States-Hong Kong Policy Act of 1992 (P.L. 102-383). The act commits the United States to treating the HKSAR as a separate entity from the rest of China in a variety of political, economic, trade and other areas so long as the HKSAR remains “sufficiently autonomous” to warrant special treatment. Section 202 of the United States-Hong Kong Policy Act empowers the President to make the determination of the status of Hong Kong’s autonomy, specifying the factors for consideration to be “the terms, obligations, and expectations expressed in the Joint Declaration with respect to Hong Kong.” The United States-Hong Kong Policy Act makes no mention of the Basic Law.

In addition, the United States-Hong Kong Policy Act states that “Hong Kong plays an important role in today’s regional and world economy” and that the United States has a strong interest in the continued “vitality, prosperity, and stability of Hong Kong.” The act also stipulates that the “support for democratization is a fundamental principle of United States foreign policy,” which “naturally applies to United States policy toward Hong Kong.” Plus, the act states that “the human rights of the people of Hong Kong are of great importance to the United States” and “also serve as a basis for Hong Kong’s continued economic prosperity.”

Title III of the United States-Hong Kong Policy Act required the Secretary of State to transmit to the Speaker of the House of Representatives and the chairman of the Committee on Foreign Relations of the Senate an annual report by March 31 (through the year 2000) on the conditions in Hong Kong “of interest to the United States.” The act was amended in subsequent years to require this report each year through 2006.⁴ No report is required from 2007 onward.

Changes in Hong Kong Since 1997

On Hong Kong’s political front, there has been little progress in the democratization of the selection of the HKSAR’s Chief Executive and Legislative Council (Legco) and towards the goal of universal suffrage in Hong Kong. In the area of civil liberties, the freedoms enjoyed under British rule have continued since the Handover virtually unchanged, with the notable exception of the controversy surrounding the proposed anti-sedition legislation in 2003. The freedoms of speech and assembly appear to have been largely respected by the Chinese and HKSAR governments, but there is concern about self-censorship by some in the Hong Kong media.

After 1997, Hong Kong’s economy was subject to a series of external shocks that precipitated and prolonged a recession. The Asian Financial Crisis of 1997,⁵ which began almost concurrently with the Handover, had a ripple effect on Hong

⁴ For further information on the U.S.-Hong Kong Policy Act see CRS Report 97-311, *Hong Kong’s Reversion to China: Problems and Remedies for the United States*, by Kerry Dumbaugh.

⁵ For more information about the Asian Financial Crisis of 1997, see CRS Report 98-434, *The Asian (Global?) Financial Crisis, the IMF, and Japan: Economic Issues*, by Dick K. Nanto.

Kong, resulting in a major asset value realignment, commodity price and wage deflation, and a decline in the city's gross domestic product (GDP). Hong Kong's economic recovery was then delayed by the outbreak of Severe Acute Respiratory Syndrome, or SARS, in the beginning of 2003. However, since the end of the SARS outbreak, Hong Kong's economy has rebounded, in part due to its deepening trade relations with the Chinese mainland.⁶

In addition to Hong Kong's extended recession and recent recovery, the last 10 years have witnessed a deepening and broadening of its economic and trade ties with the Chinese mainland. This has occurred in part due to global market conditions, but also due to the Closer Economic Partnership Arrangement (CEPA) between Hong Kong and the Chinese mainland, and the Individual Visit Scheme, a new tourism policy for mainland visitors to Hong Kong, introduced by the Chinese government on July 28, 2003. According to some observers, Hong Kong has become the hub of a pan-Pearl River Delta economic region that is one of the major engines of China's high economic and trade growth rates.

The last 10 years have also seen changes in Hong Kong society and its culture. Hong Kong has experienced a significant decline in the size of its "ex-pat" population and a concurrent rise in its "mainland" population. In addition, Hong Kong's "middle class" has endured declining incomes and a loss of economic security. Also, there is a growing interest and concern about the preservation of "Hong Kong culture," best exemplified by a popular movement to preserve "historic buildings," such as the old railroad clock tower in Tsim Sha Tsui. These social and cultural changes have raised the issue of a "Hong Kong identity" that is distinct and separable from a "Chinese identity."

Basic Facts about Hong Kong

Population (2006): 6,900,700
Area: 1,104 sq. kilometers (426 sq. miles)
GDP (2006): 1.474 trillion Hong Kong dollars (US\$ 189 billion)
Real GDP Growth (2006): 6.9%
Per Capita GDP (2006): 215,006 Hong Kong dollars (US\$ 27,565)
Unemployment Rate (2006): 4.8%
Inflation (CPI - 2006): 2.0%
U.S. Trade with Hong Kong (2006): Exports - US\$ 17.8 billion; Imports - US\$ 7.9 billion
Sources: Census & Statistical Department, HKSAR; U.S. International Trade

At present, these political, economic and cultural changes do not appear sufficient to erode Hong Kong separateness from the Chinese mainland. However, there are aspects to these changes that warrant monitoring. The economic changes appear to be blurring the existing border between Hong Kong and the Chinese mainland, while the social changes may be blurring the difference between being Chinese and being a "Hong Konger." Over time, if the separation between the Chinese mainland and Hong Kong effectively disappears for all practical purposes,

⁶ For purposes of this report, the term, "Chinese mainland," will be used to refer to the People's Republic of China, excluding Hong Kong and Macau. The use of this term is designed to clarify the distinction between the Chinese mainland and the Hong Kong, both politically and economically.

then the United States and Congress may choose to revisit the decision to extend Hong Kong special treatment.

Political Developments⁷

The HKSAR is an executive-led government, with much of the power in the hands of the Chief Executive and his or her appointed department secretaries. The two most important department secretaries are the Chief Secretary for Administration and the Financial Secretary. Hong Kong's legislature, Legco, has comparatively limited powers; it can effectively veto legislation proposed by the Chief Executive, approves or disapproves of the annual budget, and has some oversight over the operations of the executive branch. Hong Kong's courts have the exclusive power to adjudicate HKSAR legal cases, with the exception of matters related to national defense, foreign policy and the interpretation of the Basic Law. Legal cases involving these three topics are handled by the Standing Committee of China's NPC.

Since the Handover, there has been serious political debate over the details of Hong Kong's independent executive, legislative, and judicial powers. There have been controversies over the selection process for the chief executive, as well as the chief executive's term in office. Regarding the HKSAR's legislative powers, the key issues have centered about the composition of Legco and the manner by which its members are selected. As for Hong Kong's judicial powers, the main area of concern has been the scope of its powers, particularly with respect to the interpretation of the Basic Law, Hong Kong's de facto constitution.

Besides these general "constitutional" issues, there also has been a notable change in Hong Kong's political parties and the level of political involvement of the Hong Kong people. Hong Kong's political parties have changed in both name and character over the last 10 years, indicating the possible development of broad-based parties. Concurrent with the change in the political parties, the people of Hong Kong appear more interested, informed and involved in politics than before the Handover. The politicization of the Hong Kong population in part can be attributed to an increase in their opportunities to be involved in political activities, such as elections. It is also in part due to a widely-held perception that the HKSAR government was somewhat dysfunctional during the first few years after the Handover, forcing people to pay more attention to political issues than they did when Hong Kong was a British colony.

⁷ For a more detailed analysis of Hong Kong's political developments since 1997, see *From Nowhere to Nowhere: A Review of Constitutional Development, Hong Kong — 1997-2007*, by Carine Lai and Christine Loh, Civic Exchange, 2007.

The Chief Executive⁸

The Basic Law fleshes out the process by which the HKSAR's Chief Executive is to be selected. Article 45 stipulates that the Chief Executive "shall be selected by election or through consultations held locally and be appointed by the Central People's Government." The article continues by stating "the method for selecting the Chief Executive shall be specified in the light of the actual situation in the Hong Kong Special Administrative Region and in accordance with the principle of gradual and orderly progress." It also indicates that "(t)he ultimate aim is the selection of the Chief Executive by universal suffrage upon nomination by a broadly representative nominating committee in accordance with democratic procedures."

Annex I of the Basic Law provides the specifics on how the Chief Executive, who serves a five-year term, is to be selected. It stipulates that a "broadly representative Election Committee" of 800 people select the Chief Executive.⁹ To be nominated, a person must receive at least 100 votes from the Election Committee. The selection of the Chief Executive is based a "secret ballot on a one-person-one-vote basis." However, Annex I is not specific about how to choose the Chief Executive after 2007, saying only that "(i)f there is a need to amend the method for selecting the Chief Executives for the terms subsequent to the year 2007, such amendments must be made with the endorsement of a two-thirds majority of all the members of the Legislative Council and the consent of the Chief Executive, and they shall be reported to the Standing Committee of the National People's Congress for approval." Ambiguity in the language in the Basic Law and historical circumstances have led to two specific controversies about the selection and term of office of the Chief Executive.

Hong Kong's first Chief Executive, Tung Chee Hwa,¹⁰ was selected by the first Election Committee in December 1996 and was selected for a second term in March 2002. However, Tung proved to be a very unpopular chief executive, and resigned for health reasons in March 2005, part way through his second term. Tung's Chief Secretary for Administration, Donald Tsang Yam Kuen, was appointed acting Chief Executive.

⁸ For a performance review of the HKSAR's first two Chief Executives, see *Reflections of Leadership: Tung Chee Hwa and Donald Tsang, 1997 - 2007*, by Christine Loh and Carine Lai, Civic Exchange, 2007.

⁹ The 800 members of the Election Committee are to be equally divided among four groups — 1) representatives of Hong Kong's industrial, financial, and commercial sector; 2) representatives of Hong Kong's "professionals;" 3) representatives of "labour, social services, religious and other sectors;" and 4) "members of the Legislative Council, representatives of district-based organizations, Hong Kong deputies to the National People's Congress, and representatives of Hong Kong members of the National Committee of the Chinese People's Political Consultative Conference."

¹⁰ Chinese names in this report will be presented in the traditional Chinese order with the surname first, and the given names after. In cases where the person has an adopted Western given name, that will be listed before the Chinese surname.

Tung's resignation raised the first controversy, which was about the length of the term of his replacement. According to some legal scholars, the Basic Law only provides for the Chief Executive to serve a five-year term, so the replacement should serve a full five-year term. To others, the replacement should only serve out the last two years of Tung's term, with a new selection taking place in 2007.

In April 2005, Tsang requested a binding legal decision from Beijing on the duration of the replacement's term in office, arguing that a legal review in Hong Kong independent judiciary would take too long. The Standing Committee of the NPC decided that the replacement should finish out Tung's term, and the next selection should take place as scheduled in 2007. Members of Hong Kong's "pro-democracy" political parties and the Hong Kong Bar Association objected to Tsang's request for a decision from Beijing, as well as to the actual decision, on the grounds that it violated the Basic Law and undermined Hong Kong's autonomy. Tsang was selected to fill out the balance on Tung's term in July 2005.

Following the selection of Tsang in 2005, the second controversy almost immediately emerged in the form of a campaign to change the selection process for the Chief Executive in 2007. Prior to the resignation of Tung in 2005, the Standing Committee of the NPC announced in April 2004 that the selection of the Chief Executive by universal suffrage in 2007 "shall not be applied," but that the specific method of selection could be "appropriately modified."¹¹ A proposal from Tsang to make incremental modifications in the selection process for Chief Executive in 2007 (as well as the Legislative Council in 2008) was defeated by the Legislative Council in December 2005.¹² As a result, no changes were made in the 2007 selection process.

Although there was no progress towards universal suffrage for the 2007 Chief Executive selection, Tsang's bid for reelection by the Election Committee did not go unchallenged. Despite Tsang's strong backing by the Chinese government, Alan Leong Kah Kit of the newly-formed Civic Party, ran against Tsang. Leong was able to secure 132 votes in the Election Committee's nomination ballot, making him an official candidate for Chief Executive. During the campaign, Tsang and Leong held two public debates that were broadcast live on television and radio, an unprecedented event for Hong Kong. Although Leong lost the election to Tsang, he did secure 123 votes in the Election Committee. Tsang won with 649 votes.¹³

Supporters of direct popular election of the Chief Executive point to the precedents set by the 2007 selection process (contested election, public debates, split vote in the Election Committee) as evidence of modest progress. Pro-democracy advocates also point to the ratings for the two debates — surveys show nearly one

¹¹ "NPC Rules Out HK General Elections in 2007, 2008," *Xinhua*, April 26, 2004.

¹² For more details about Tsang's 2005 proposal and its rejection, see the U.S. Department of State's "U.S.-Hong Kong Policy Act Report," April 1, 2006, available online at [<http://www.state.gov/p/eap/rls/rpt/65340.htm>].

¹³ For a brief analysis of the 2007 Chief Executive campaign, see Frank Ching, "Election Fever: A Major Event in Hong Kong's Political Evolution," Brookings Northeast Asia Commentary, Brookings Institute, April 2007.

quarter of Hong Kong's population watched — as evidence that Hong Kong is ready for democratic elections. However, the Chinese government maintains that it is too early to introduce direct election of the Chief Executive.

During the summer of 2007, the Commission on Strategic Development's Committee on Governance and Political Development, an advisory body to the Chief Executive, is expected to release a legislative "Green Paper"¹⁴ examining possible "models, roadmaps and timetables for electing the Chief Executive by Universal Suffrage."¹⁵ The initial expectation was that the "Green Paper" would contain up to three specific proposals for Hong Kong's transition to universal suffrage. However, confidential sources report that the final "Green Paper" to be issued by the Hong Kong government will probably consist of a summary of the range of options for each of the main topics — models, roadmaps and timetables. For the Chief Executive selection process, among the elements to be discussed in the "Green Paper" are: 1) the number of people on the nominating committee; 2) how members of the nominating committee are selected; 3) number of votes required to be nominated; 4) limits on the number of candidates; and 5) transition process to universal suffrage.

At present, there is no clear indication how soon Hong Kong's Chief Executive will be selected by universal suffrage. The earliest possible date is 2012, but few believe that the Chinese government will approve such a direct transition. Instead, analysts believe the Chinese government will endorse an interim measure that expands the number of people on the Election Committee from 800 to either 1,200 or 1,600 people. According to Cherry Tse Kit Ching Ling of Hong Kong's Department of Constitutional Affairs, the resolution of the model and roadmap will come before the decision on when to have direct election of the Chief Executive by universal suffrage. According to Legco member Leung Kwok Hung, the soonest the Chinese government would consider the direct popular election of the Chief Executive is 2022. However, some observers are concerned that delaying universal suffrage for the selection of the Chief Executive until 2022 — half way through the 50 year guarantee stipulated in the Joint Declaration — is altogether part of a Chinese mainland strategy to block democratization in Hong Kong.

Legislative Council

The post-Handover story of Hong Kong's legislature, the Legislative Council (Legco), is rather complicated. For most of its history under British rule, Legco consisted of members appointed by the British Governor to represent the interests of Hong Kong's business community. The first time members of Legco were "elected" was in 1985, when 12 members were elected by "functional constituencies" based on

¹⁴ A legislative "Green Paper" is a government report of a proposal without any commitment to action, often the first step in changing the law. "Green Papers" may result in the production of a "White Paper," which is the formal proposal.

¹⁵ Notes from the April 12, 2007 meeting of the Commission on Strategic Development's Committee on Governance and Political Development, Paper No. CSD/GC/3/2007.

Hong Kong's most important business and economic sectors,¹⁶ 10 were elected by members of Hong Kong's district boards, one from among the members of Hong Kong's Urban Council, and one from among the members of Hong Kong's Regional Council.

After the signing of the Joint Declaration, the last British Governor, Chris Patten, implemented a series of reforms reconstituting Legco into a more democratic institution. In 1995, the last Legco under British rule was selected with 20 of the 60 seats selected in geographical elections with universal suffrage, 30 seats selected by functional constituencies in which 1.1 million people were eligible to vote, and 10 selected by members of a special Election Committee.¹⁷ In addition, the voting age was lowered from 21 to 18. The stated goal of the Patten reforms was to broaden participating in the election, and to select a Legco that would serve both before and after the Handover. This so-called "through train" Legco would provide some additional stability to Hong Kong's government during the transition, according to Patten.

However, the Chinese government objected to Patten's Legco reforms (except for the lowering of the voting age to 18), stating that they violated the terms of both the Joint Declaration and the Basic Law. On August 31, 1994, the NPC ruled Patten's Legco incompatible with the Basic Law, and passed legislation stipulating how a "Provisional Legislative Council" would be created to take office after the Handover. On December 21, 1996, China's Election Committee selected the members of the Provisional Legislative Council, which met in Shenzhen until the Handover, and replaced the reformed Legco after the Handover. The Provisional Legislative Council remained in office until 1998, when the first post-Handover Legco elections were held.

In 1998, Hong Kong selected a new Legco to serve a two-year term, as stipulated in Article 69 of the Basic Law. The 60 members of the Legco were divided into 20 members from geographical constituencies, 30 members from functional constituencies, and 10 from the Election Committee — a return to the Patten seat formula of 1995, but without the broader voting base for the functional constituencies.

Nearly 1.5 million people voted for the geographical constituency seats in 1998, a turnout of about 53% of the eligible voters. In 2000, Hong Kong's third post-Handover Legco was selected, this time with 24 members elected by geographical constituencies, 30 from functional constituencies, and six by the Election Committee to serve a four-year term. Turnout for the 2000 Legco geographical elections was down from 1998 — about 43% of the eligible voters participated. The elections of September 2004 saw of a 30-30 split of Legco members between geographical and

¹⁶ The functional constituencies in 1985 were: commercial (2 seats); industrial (2 seats); labour (2 seats); financial; medical; social services; teaching; legal; and engineering, architectural, surveying, and planning.

¹⁷ In contrast to the post-Handover Election Committee, the 1995 Election Committee was comprised of members of Hong Kong's District Boards, which were regional government bodies that administered various social and community service programs.

functional constituencies. The seats reserved for Election Committee were eliminated. The turnout rate for the geographical constituencies rose in 2004 to over 55% — 12% higher than in 2000 and 2% higher than in 1998.

Paralleling the push for universal suffrage for the election of Chief Executive, there was increased discussion about the democratization of Legco following the 2004 election. As was previously stated, in April 2004, five months prior to the 2004 Legco elections, the Chinese government announced that while it was open to reforms in the selection of Legco members in 2008, it opposed a direct move to universal suffrage for all Legco seats. This discussion was complicated because it involved not only the issues of universal suffrage and “one person, one vote,” but also how Legco was to be constituted and the process of its transformation.

Tsang’s proposed 2005 reforms also included changes in the size and constitution of Legco for the next election in 2008. The number of seats would be increased to 70, equally divided between geographical and functional constituency seats. The five additional functional constituency seats would be filled by increasing the number of Legco members selected by the District Councils¹⁸ from one to six.

To some observers, Tsang’s proposal would have been a first-step along the path towards universal suffrage and democratization. It would have increased the number of Legco members directly elected by popular vote, plus have added five functional constituency members who were to be selected by District Council members, three-quarters of whom were elected by popular vote. Also, it was thought that most of the newly-added Legco members would be “pro-democracy,” increasing the likelihood of additional reforms in the future.

Opponents to Tsang’s proposal countered that it would have increased the number of functional constituency seats without expanding the number of people eligible to vote for those seats. For some “pro-democracy” advocates, the goal is to eliminate the functional constituency seats, not expand them. For others, the goal is to create a system in which every eligible voter in Hong Kong can vote in one geographical district and in one functional constituency. Neither group saw Tsang’s reforms as a positive step towards their respective goal.

In December 2005, Legco voted against Tsang’s incremental reforms. In response, Tsang authorized the Committee on Governance and Political Development to investigate alternative models, roadmaps and timetables for implementing universal suffrage for Legco.

When compared to universal suffrage for the selection of the Chief Executive, the democratization of the Legco elections is relatively complex, particularly because of the functional constituencies. According to Annex II of the Basic Law, any change

¹⁸ Hong Kong is divided into 18 districts, each with a District Council, responsible for administering a variety of public facilities and community services. There are a total of 529 District Council members, of which 400 are elected by the residents of the district, 102 are appointed by the Chief Executive, and 27 are ex-officio members selected by the Rural Committee, a body representing Hong Kong’s indigenous people.

in the formation of Legco requires the approval of two-thirds of the current Legco, the consent of the Chief Executive and “shall be reported to the Standing Committee of the National People’s Congress for the record.” Because of the two-thirds requirement, there is concern that the current functional constituency members can effectively block any proposal that dilutes or eliminates their power. Also, in light of previous decisions by the Chinese government on the interpretation of the Basic Law (see below), some observers believe the language of Annex III will be used to argue that any changes made must be approved by the Standing Committee of the NPC.

Hong Kong’s Courts

In general, the operations and authority of Hong Kong’s independent judicial system have remained intact since the Handover. The most important exception has involved legal issues regarding the interpretation of the Basic Law. In particular, there have been three high profile cases where the Chinese government has made decisions on the meaning of the Basic Law that were seen by some as eroding the independence of Hong Kong’s courts and the legal protections provided by the Basic Law itself. Another interesting post-Handover development is the significant increase in the number of civil cases.

Interpreting the Basic Law. To some, there is ambiguity about legal cases involving the interpretation of the Basic Law. Article 2 of the Basic Law grants the HKSAR “independent judicial power, including that of final adjudication, in accordance with the provisions of this Law.” Article 82 vests the power of final adjudication in the newly-created Hong Kong Court of Final Appeal. Article 85 reiterates the independence of the Hong Kong courts, stating that they should be “free from interference.”

However, Chapter VIII of the Basic Law, entitled “Interpretation and Amendment of the Basic Law,” vests the power to interpret the Basic Law in the Standing Committee of the NPC. In turn, Article 158 stipulates that the Standing Committee “shall authorize the courts of the [HKSAR] to interpret on their own, in adjudicating cases, the provisions of this Law that are within the limits of the autonomy of the Region.” Article 158 also states that the HKSAR courts “may also interpret other provisions of this Law in adjudicating cases.” However, if these are not appealable decisions “concerning the relationship between the Central Authorities [the Chinese government] and the Region” or “affairs which are the responsibility of the Central People’s Government,” then the HKSAR courts are to seek an “interpretation” from the Standing Committee via the Court of Final Appeal prior to rendering a decision.

Since 1997, there have been three high profile cases where the Chinese government has announced decisions regarding the interpretation of the Basic Law that to some people circumvent or supercede the provisions of the Basic Law. Two of those cases — the April 2005 decision on the length of Tsang’s term in office and the April 2004 announcement that there would not be universal suffrage for the 2007 and 2008 elections — were discussed earlier in this report. The third case arose in 1999 and involved the interpretation of Articles 22 and 24 of the Basic Law.

Article 24 defines who will be considered a “permanent resident” of Hong Kong and who has a “right of abode” in Hong Kong. The first two categories of people eligible for “permanent resident” status are: 1) Chinese citizens born in the HKSAR before or after the Handover; and 2) Chinese citizens who have resided in Hong Kong for seven continuous years either before or after the Handover. In addition, Article 24 describes a third category as “Persons of Chinese nationality born outside of Hong Kong of those residents listed in categories (1) and (2).” Article 24 also grants all permanent residents the “right of abode” — the right to live in Hong Kong. However, Article 22 stipulates that “people from other parts of China must apply for approval” for entry into the HKSAR. This includes “the number of persons who enter the Region for the purpose of settlement.”

Following the Handover, a suit was filed in Hong Kong courts on behalf of children born in the Chinese mainland who had at least one parent eligible for permanent resident status in Hong Kong. The suit claimed that these children had the right of abode in Hong Kong under the third category of Article 24, and should be allowed to reside in Hong Kong. The Hong Kong government argued that under the terms of Article 22, these children must obtain the approval of the Chinese government.

The court case created some apprehension about the number of children that would be eligible move to Hong Kong if the courts ruled in their favor. According to one Hong Kong government study, 1.6 million children in China — nearly a quarter of Hong Kong’s population — were potentially eligible to immigrate into Hong Kong. The Hong Kong government, and many Hong Kong residents, feared that the influx of so many children would greatly overburden schools, housing and other social services of Hong Kong. As a result, there was a strong desire to see the courts rule against such a broad definition of eligibility for permanent resident status.

On January 29, 1999, Hong Kong’s Court of Final Appeal ruled in favor of the broad definition. In response, then Chief Executive Tung went to Beijing to ask the Standing Committee of the NPC for its interpretation of the Basic Law as it applies to this case. Some legal scholars in Hong Kong protested that Tung’s request violated Article 158 of the Basic Law, which states that such a request should come from the Court of Final Appeal before it rendered its final decision.

On June 26, 1999, the Standing Committee announced its decision, siding with the Hong Kong government in favor of a more restrictive interpretation of the Basic Law. In its decision, the Standing Committee stated that children could emigrate to Hong Kong only if one of their parents was already a permanent resident of Hong Kong at the time of their birth and if they obtained approval, as required under Article 22 of the Basic Law. Some commentators were highly critical of the NPC decision, terming it not an “interpretation” of the Basic Law, but a “reinterpretation.”¹⁹ There continue to be periodic protests in Hong Kong on behalf

¹⁹ For example, see the testimony of Human Rights Watch to the Senate Foreign Relations Committee East Asian and Pacific Affairs Subcommittee in July 1999, available online at [<http://hrw.org/english/docs/1999/07/01/china5753.htm>].

of the mainland children being kept out of Hong Kong under the restrictive interpretation.

Although the “right of abode” issue has become less prominent over time, when combined with the NPC decisions on Tsang’s term and universal suffrage in the 2007 and 2008 elections, the “right of abode” issue has brought into question the independence of Hong Kong’s courts and the degree of protection the Basic Law provides to the people of Hong Kong.

The Growth in Civil Cases. Another major development in Hong Kong’s judicial system is the rapid increase in the number of civil cases. The number of civil cases rose from 8,161 in 1996 to 17,270 in 2006, more than doubling in 10 years.

According to a representative of Hong Kong’s Department of Justice, the rise in civil cases is in part due to the greater use of the Chinese language in post-Handover Hong Kong courts.²⁰ Under the Basic Law, all legal proceedings can be held in either English or Chinese. In addition, all of Hong Kong’s laws are available in both Chinese and English. As a result, more people in Hong Kong have access to the laws and may feel more comfortable bringing disputes to court.

In addition, there is a view that the rise in civil cases also reflects increased awareness and concern among Hong Kong people about their legal rights. In this view, the economic downturn from 1998 to 2003, and the perceived incompetence of the Tung administration (see below), forced people to become more attentive to politics and to Hong Kong’s legal system. Also, as people’s economic circumstances became difficult, they turned to civil suits to protect themselves — an alternative made easier because of greater access to Chinese language versions of Hong Kong’s laws.

Political Parties

Prior to 1997, what political parties existed in Hong Kong were generally small in size, and often associated with one prominent person. Since the Handover, there has been a trend towards the creation of larger political parties (although still small by U.S. standards), organized around shared political perspectives. In addition, some of the older political parties are going through a generational shift, as past leaders move towards retirement and new leaders emerge. However, people in Hong Kong generally vote based on their opinion or the politician, not based on loyalty to a political party.

In the local parlance, Hong Kong parties are generally referred to as being either “pro-democracy” or “pro-Beijing.” The leading “pro-democracy” parties are the Democratic Party, the Frontier Party, the relatively new Civic Party, and the newly-created League of Social Democrats. The main “pro-Beijing” parties are the Liberal Party and the Democratic Alliance for the Betterment and Progress of Hong Kong, or DAB. The common view in Hong Kong is that the current Legco consists of 25

²⁰ Under British rule, Hong Kong courts used English, and translation services were made available to people who did not understand English.

“pro-democracy” members and 35 “pro-Beijing” members. Below is brief description of each of the major Hong Kong political parties.

Democratic Party. Hong Kong’s Democratic Party was founded on October 2, 1994; it currently has over 600 members. Prior to 1997, it was one of Hong Kong’s most popular pro-democracy parties, winning 19 of the 60 seats in the 1995 Legco elections. However, since the Handover, its political fortunes have suffered, in part due to internal disagreements on the party’s position on various political and economic issues, including its opposition to a minimum wage law. In 2002, some members left the party because of its stance on economic issues, and joined the Frontier Party. In the 2004 Legco elections, the Democrats won nine seats — 10 less than they held in 1995 — of which seven were in geographical constituencies . The party’s current chairman is Albert Ho Chun Yat. One of the party’s best known leaders, Martin Lee Chu Ming, stepped down as party chairman in 2001.

Frontier Party. The Frontier Party is closely associated with Emily Lau Wai Hing. In 2002, the Frontier Party benefitted from the arrival of some ex-Democratic Party members. The Frontier Party did relatively well in the 1998 and 2000 Legco elections, winning five seats in the geographical constituencies. However, in the 2004 elections, the party won only one geographical seat, held by Lau. The Frontier Party supports the enactment of a minimum wage law and anti-trust legislation.

The Civic Party. One of Hong Kong’s newer “pro-democracy” parties, the Civic Party emerged from the protests surrounding the proposed enactment of anti-secession legislation. After its founding on March 19, 2006, six members of Legco joined the Civic Party, making it the second largest “pro-democracy” party in Legco. One of the party’s Legco members, Alan Leong Kah Kit, ran against Tsang in the 2007 Chief Executive election, but lost (see above). According to Leong, the party has about 700 members, consisting mostly of lawyers and professionals.

The League of Social Democrats. The newest (founded in October 2006) and most radical of the “pro-democracy” parties, the LSD is closely associated with long-time political activist, Leung Kwok Hung, commonly referred to by his nickname, “Cheung Mo,” or “Long Hair.” The party states as its purpose to “take a clear-cut stand to defend the interests of the grassroots.” It also supports the passage of minimum wage and anti-trust legislation. The LSD has two members in Legco — Leung and Albert Chan Wai Yip.

The Liberal Party. Another of Hong Kong’s older parties, the Liberal Party is closely associated with Hong Kong’s business community. Founded in 1993, the Liberal Party holds a conservative stance on most political and economic issues. It opposes the passage of minimum wage and anti-trust legislation. The Liberal Party has 10 Legco members, with two — James Tien Pei Chun and Selina Chow Liang Shuk Yee — elected in geographical constituencies.

DAB. Founded in 1992, the DAB is the oldest of major political parties in Hong Kong. In contrast to most of the other political parties, DAB relies heavily on grassroots organizing for its political support. As a result, DAB has over 10,000 members — significantly more than the other major parties. DAB also has the most Legco seats of any political party — nine by geographical constituencies and three

by functional constituencies. Its chairman, Ma Lik, recently caused a controversy in Hong Kong by questioning the severity of the events in Tiananmen in 1989. The party has since apologized for Ma's comments.

Politicization of Hong Kong Residents

According to various experts, several factors have combined over the last 10 years to raise the political awareness and involvement of the people of Hong Kong. First, the perceived failure of the Tung administration to respond adequately to several economic and social problems pushed people to pay more attention to politics than they did under British rule. Second, the Hong Kong media — television, radio and newspapers — became more political and more critical of local politics and politicians. Third, changes in Hong Kong's government have altered the relationship between the government and the Hong Kong population, making it more acceptable for people to express their views about government officials.

China's selection of Tung Chee Hwa to be the first HKSAR Chief Executive was not surprising, but it did not instill people with great confidence. Tung was a businessman with little political experience, known for his conservative economic and perceived close ties with some top government officials in Beijing. Almost immediately after assuming office, Tung faced a series of crises — including the Asian Financial Crisis, a speculative run against the Hong Kong dollar, Avian Flu, and the problem-plagued opening of the new Chek Lap Kok Airport — to which his administration responded in what was widely regarded as a faltering and ineffective fashion. In response to the shortcomings of the Tung administration, people in Hong Kong became more politically aware and at times critical of the Hong Kong government.

At the same time, the Hong Kong media also increased the political content of its coverage. In particular, talk radio stations began to feature more hosts who emphasized local politics and government shortcomings in their shows. Some of these talk show hosts have themselves been subject to sharp criticism — as well as threats of physical harm — but the shows have become very popular.

Finally, the shift from British colony to “highly autonomous” region has also altered the nature of Hong Kong's top government officials, especially in the executive branch. When Hong Kong was a colony, the Governor and the department secretaries were generally British civil servants appointed by the British government. Similarly, for most of Hong Kong's colonial era, Legco members were appointed by the Governor. Given that the key political figures were foreigners chosen by foreigners, there were few incentives for Hong Kong residents to engage in politics.

Since the Handover, the selection of the Chief Executive and the members of Legco is done locally, and the top government officials are generally born and raised in Hong Kong. According to a member of the current Legco,²¹ the fact that the government leadership is now local means that Hong Kong people have different

²¹ Conversation with Legco member Bernard Charnwut Chan at Carnegie Endowment for International Peace, June 18, 2007.

expectations of the officials and are more comfortable expressing their opinions about the officials.

Civil Liberties

Under the terms of both the Joint Declaration and the Basic Law, Hong Kong residents are supposed to continue to enjoy the same civil liberties they did prior to the Handover. According to the Joint Declaration, “Rights and freedoms, including those of the person, of speech, of the press, of assembly, of association, of travel, of movement, of correspondence, of strike, of choice of occupation, of academic research and of religious belief will be ensured by law in the Hong Kong Special Administrative Region.” In turn, these rights are enumerated in detail in Chapter III (Articles 25 to 42) of the Basic Law.

Since the Handover, there have been relatively few instances where either the Chinese or Hong Kong governments have threatened or undermined the civil liberties of Hong Kong residents. However, there have been perceived threats of the freedom of speech and assembly, and erosion of press freedoms from non-governmental sources.

Freedom of Speech and Assembly

Under Article 27 of the Basic Law, Hong Kong residents have freedom of speech and freedom of assembly. Since 1997, these freedoms have been generally upheld by the Chinese and Hong Kong governments. Political demonstrations occur on a regular basis, with minimal interference by the authorities. In the few cases where there were questions about the behavior of the Hong Kong police at these demonstrations, the Hong Kong courts have upheld the rights of Hong Kong residents.

However, in the summer of 2003, an estimated 500,000 Hong Kong residents — roughly one in every 14 people in Hong Kong — attended a rally to protest the so-called “Article 23” legislation introduced in Legco by the Chief Executive that arguably would have undermined the freedom of speech and assembly. By the same token, the Hong Kong government has done very little to prevent or infringe upon protests organized by the Falun Gong and other dissident groups since the Handover, often in contrast to the actions of the Chinese government.

Article 23 Controversy. Article 23 of the Basic Law requires that the HKSAR enact legislation to “prohibit any act of treason, secession, sedition, subversion against the Central People’s Government.” On September 23, 2002, then Chief Executive Tung released his proposed legislation to comply with the requirements of Article 23.

The proposed legislation was met with immediate widespread opposition, a smaller number of voices of support, and a growing wave of demonstrations. Lawyers, journalists, religious leaders, and others argued that the proposed legislation could be used by the Hong Kong government to ban or prosecute organizations or

individuals for political purposes. In addition, the proposed legislation seemed to extend authority of some mainland laws into Hong Kong, diminishing the autonomy of Hong Kong's legal and judicial systems. Supporters rejected these claims, arguing that it had been five years since the Handover and it was time for Hong Kong to comply with the requirements of Article 23.

While the verbal debate on the merits and demerits of the proposed legislation continued, public demonstrations grew in number and size. On December 12, 2002, thousands of Hong Kong residents held a protest rally. Then, on July 1, 2003, over half a million people — the second largest demonstration in Hong Kong history²² — marched from Victoria Park to the Central Government Offices on Hong Kong Island in protest of the Article 23 proposals. The rally lasted well into the night and included people of all ages, ethnic backgrounds and economic classes in Hong Kong.

The size and depth of the public opposition to the Article 23 proposals apparently surprised Tung and his senior advisors. Meanwhile, initial support for the legislation from the “pro-Beijing” Liberal Party weakened. On July 6, 2003, Liberal Party leader and Legco member James Tien Pei Chun announced that he was resigning from the Executive Council and that he would advise Liberal Party Legco members to vote for a postponement of consideration of the proposed legislation. Ten days later, Secretary of Security Regina Ip Lau Suk Yee and Financial Secretary Anthony Leung Kam Chung resigned, citing personal reasons.²³ However, most observers believe they were asked to resign in light of the massive protest and widespread opposition to the Article 23 proposals. On September 5, 2003, Tung withdrew the proposed legislation.

Besides fending off a perceived threat to civil liberties in Hong Kong, the public outcry and demonstrations against the Article 23 proposals had several lasting political effects. First, many people saw the events as proof that the people of Hong Kong could directly affect government policy. Second, some of the organizers of the 2003 protests went on to form the “pro-democracy” Civic Party (see above). Third, the perceived “unrest” in Hong Kong may have contributed to the eventual stepping down of Tung.

Falun Gong and Other Demonstrations.²⁴ While some people point to the Article 23 proposals as a threat to civil liberties in Hong Kong, others cite the ongoing and regular demonstrations by the Falun Gong — a group outlawed on the Chinese mainland — and other groups as evidence that the Hong Kong government is continuing to protect the rights of Hong Kong residents. Although there have been occasional arrests of Falun Gong supporters and others at various demonstrations since the Handover, the Hong Kong courts have regularly upheld the rights of free speech and assembly of Hong Kong residents.

²² The largest demonstration in Hong Kong history took place following the Tiananmen incident; over one million people participated in that protest.

²³ Leung was also under investigation for illegally using his office to avoid paying taxes on a new automobile. The pending case against Leung was dropped in December 2003.

²⁴ For more information, see CRS Report RL33437, *China and Falun Gong*, by Thomas Lum.

Every year since the Handover, there are public rallies on June 4 (the anniversary of the Tiananmen Incident) and on July 1 (the anniversary of the Handover) in support of the human rights of the residents of Hong Kong and the Chinese mainland. In addition, Falun Gong supporters are maintaining a continuous protest near the Hong Kong pier of the Star Ferry. This protest is treated by many people as a “fact of life,” and since the dismissal of cases by the Hong Kong courts, the protesters are largely left alone by the Hong Kong police.

Press Freedom

Much as is the case with the freedom of speech and assembly, there is little evidence of significant change in press freedom in Hong Kong since the Handover. However, in addition to the concerns raised about the Article 23 proposals of 2003, there are three areas frequently mentioned as possible threats to press freedom in Hong Kong.

Self-Censorship. There are frequent allegations of an increase in self-censorship by the local Hong Kong media since the Handover. As evidence of this self-censorship, people point to the dismissals and resignations of several journalists and radio announcers who were critical of the Chinese and Hong Kong governments.²⁵ While there are some who maintain that these dismissals were quietly orchestrated by Chinese officials, the more common explanation is that the owners of the newspapers, magazines and radio stations were fearful that the opinions expressed by the journalists would hurt advertising revenues, especially from mainland companies.

Radio Television Hong Kong (RTHK). In January 2006, the Hong Kong government announced that it had set up the Committee on Review of Public Service Broadcasting. While the members of the committee include representatives of the privately-owned media in Hong Kong, it does not include someone from Radio Television Hong Kong (RTHK), Hong Kong’s sole public broadcaster. In its 2006 annual report, entitled “RTHK Under Siege,” the Hong Kong Journalists Association treats Tsang’s decision to form the committee with some suspicion, pointing to past attempts by both the Chinese and Hong Kong government to influence program content at RTHK.

On March 28, 2007, the committee submitted its final report to the Chief Executive, recommending the creation of a new public broadcasting entity in Hong

²⁵ Examples of journalist dismissals and resignations include the following. In 1997, Nury Vittachi, author of the popular column, “Lai See,” was dismissed by *South China Morning Post* after he had criticized a pro-Beijing group; in 2002, editor Willy Lam Wo Lap left the *South China Morning Post* after he was publically castigated by a major stockholder of the newspaper, Robert Kuok Hock Nien; and in 2004, the hosts of the radio shows “Smoke Signals” (*Fung Yin*), “Teacup in a Tempest” (*Fung Bor Lui Dik Cha Bui*) and “Someone who Cares about Political Matters” (*Zhing Si Yau Sum Yan*) claimed that they were “pressured” to resign because of the political content of their shows.

Kong.²⁶ In the second half of 2007, the Hong Kong government will issue a “public consultation document which will set out the Government’s views on the way forward.”²⁷ In addition to the committee’s recommendation to for a new public broadcaster, several proposals about the future of public broadcasting in Hong Kong are being publicly discussed, ranging from making RTHK into an information agency to “comprehensively introduce and promote to the public the various public policies of the government” to transforming RTHK into a not-for-profit entity that is provided substantial financial support by the Hong Kong government. There is also consideration of selling RTHK to private investors.

ICAC Raid. In July 2004, Hong Kong’s Independent Commission Against Corruption (ICAC) searched the offices of seven Hong Kong newspapers as part of its investigation of the disclosure of the name of a person being protected under Hong Kong’s witness protection program. Under Hong Kong law, the disclosure of the witness’ name is punishable by up to 10 years in jail. According to the ICAC, the commission was not investigating the newspapers, but trying to find evidence that a lawyer had disclosed the name of the witness to the newspapers.

While one of the journalists involved in the story later revealed the source of the witness’ name, a Hong Kong court in August 2004 set aside the warrant, stating that the ICAC could have used “less intrusive measures” in its investigations. However, the ICAC raids have raised concerns about the maintenance of the freedom of the press in Hong Kong.

Economic Developments

The history of Hong Kong’s economy is replete with examples of major restructuring and transformation, especially in the face of unanticipated challenges. The last 10 years are yet another example of Hong Kong’s ability to recreate itself following severe economic shocks. As a result, Hong Kong’s economy in 2007 is significantly different than it was in 1997. While most of the changes appear to be for the better, there are some developments that may portend future problems.

External Shocks and Recovery²⁸

In the months prior to the Handover, most analysts anticipated that the greatest challenges facing the new HKSAR were political, not economic. It seemed that no

²⁶ The committee’s report is available online at [<http://www.cedb.hk/ctb/eng/new/pr28032007.htm>].

²⁷ “Government Receives Report on Public Service Broadcasting,” press release issued by Hong Kong Commerce and Economic Development Bureau, March 28, 2007.

²⁸ For an overview of Hong Kong’s economy from 1997 to 2005, see International Monetary Fund Country Report No. 06/50, “People’s Republic of China — Hong Kong Special Administrative Region,” February 2006.

one foresaw the impending external economic shock, the Asian Financial Crisis,²⁹ which would push Hong Kong into an extended recession. Nor could anyone predict the arrival of Severe Acute Respiratory Syndrome (SARS) and its ability to derail Hong Kong's economic recovery.

Asian Financial Crisis and SARS. Almost simultaneously with the Handover ceremony held in the Hong Kong Convention and Exhibition Centre, the Asian Financial Crisis struck many of the economies of Southeast Asia. The crisis quickly spread across most of East Asia and by the end of 1997, most of the Asian currencies had experienced significant losses in value with respect to the U.S. dollar, ranging from a 13% decline for the Japanese yen to a 55% decline for the Indonesian rupiah. However, two Asian currencies — the Chinese renminbi and the Hong Kong dollar — did not experience the same decline in value due to their link to the U.S. dollar.³⁰

The Hong Kong dollar's linked exchange rate did not completely insulate the Hong Kong economy from the effects of the Asian Financial Crisis. A speculative attack on the Hong Kong dollar in August 1998 to force a de-linking was successfully fought off to a large part by the \$15 billion intervention of the Hong Kong government in the Hong Kong stock market, orchestrated by then Financial Secretary and future HKSAR Chief Executive Tsang and HKMA Chief Executive Joseph Yam Chi Kwong, and by the HKMA's decision to raise the overnight rate from 8% to 19%.

While these interventions saved the linked exchange rate, it forced Hong Kong's economy to adjust by prompting a sharp decline in the domestic prices of real estate, stocks, consumer goods, as well as major wage cuts. For a period of time, then Chief Executive Tung made a short-term effort to fend off the decline in real estate values — an action for which he was widely criticized as being more concerned about protecting his tycoon friends than helping the average Hong Konger — but in the end, property prices fell nearly 40% in value in the third quarter of 1998. Hong Kong soon found itself in a deflationary recession with rising unemployment (see **Table 1**). However, there were indications of a recovery developing by 1999 and building steam in 2000.

²⁹ For a summary of the causes and responses to the Asian Financial Crisis, see CRS Report 98-434, *The Asian (Global?) Financial Crisis, the IMF, and Japan: Economic Issues*, by Dick Nanto.

³⁰ The Hong Kong dollar has been linked to the U.S. dollar at a rate of 7.8 Hong Kong dollars per U.S. dollar since 1983.

Table 1. Hong Kong's Recession, 1997-2003

Year	Real GDP Growth	CPI	Unemployment Rate
1997	5.1%	5.8%	2.2%
1998	-5.5%	2.8%	4.7%
1999	4.0%	-4.0%	6.2%
2000	10.0%	-3.8%	4.9%
2001	0.6%	-1.6%	5.1%
2002	1.8%	-3.0%	7.3%
2003	3.2%	-2.6%	7.9%

Source: Census and Statistics Department, HKSAR.

Another set of external shocks struck just as Hong Kong's recovery began. A "dot.com" speculative bubble burst in Hong Kong Stock Exchange in the later half of 2000, leading to a loss in investor confidence. Plus, the September 11, 2001 attacks on the World Trade Center and the Pentagon led to a decline in Hong Kong's tourism industry, among other things.

Hong Kong's recovery from the second set of external shocks was slower and weaker than its rebound from the Asian Financial Crisis. Although the HKSAR experienced real economic growth between 2001 and 2003, domestic prices continued to fall and the unemployment rate continued to rise. A lack of confidence in the Hong Kong business community and tourists in the streets resulted in the closing of many companies and retail stores across Hong Kong. The city had seemingly lost its well-known resilience.

Hong Kong was then struck by a third external shock — Severe Acute Respiratory Syndrome, or SARS.³¹ Between November 2002 and July 2003, 299 people in Hong Kong died of SARS. For Hong Kong, SARS had a double impact on the economy. First, it significantly reduced tourism, particularly arrivals from the United States and western Europe. Second, many Hong Kong residents were afraid to leave their homes for fear of infection. As a result, Hong Kong restaurants, hotels, retail stores and other local service industries experienced a sharp decline in business.

Road to Recovery. As the outbreak of SARS subsided, Hong Kong businesses and residents began to recover, but the economy remained weak. There were calls for leadership from Tung, but the Chief Executive seemed more interested in promoting his unpopular Article 23 proposals than facilitating Hong Kong's economic recovery. In the end, it was arguably the actions of the government in

³¹ For a description of the global response to the outbreak of SARS, see CRS Report RL32072, *Severe Acute Respiratory Syndrome (SARS): The International Response*, by Rhoda Margesson and Tiaji Salaam-Blyther.

Beijing that provided the confidence boost that expedited the return of economic growth to Hong Kong.

On July 28, 2003, the Chinese government announced a new travel policy for mainland residents visiting Hong Kong. Under the old policy, mainland residents could only travel to Hong Kong on a business visa or as part of a group tour. Under the new policy, dubbed the Individual Visit Scheme (IVS), individual mainland tourists could obtain a seven-day visa to Hong Kong, subject to the approval of China's Public Security Bureau. The IVS proved to be very popular; about 600,000 mainland residents applied for a visa over the next four months, and more than 450,000 were granted visas. Between 2001 and 2006, the annual number of mainland visitors — including business travelers and tourists — to Hong Kong jumped from 4.4 million to 13.6 million people, accounting for over half of Hong Kong's visitors in 2006.³²

In addition, starting on January 1, 2004, a mini free trade agreement between the Chinese mainland and Hong Kong went into effect. “The Closer Economic Partnership Arrangement,” or CEPA, provides Hong Kong companies preferential access to the markets of the Chinese mainland. CEPA eliminates import tariffs for over 1,400 types of Hong Kong products, representing about 90% of Hong Kong's domestic exports to China. CEPA also provides Hong Kong service providers easier access to the mainland market.

The impact of the IVS and CEPA on Hong Kong was strong, but not without its unexpected consequences. The presence of mainland tourists in Hong Kong brought welcome relief to Hong Kong's ailing hotel, retail, restaurant, and manufacturing industries. Many of the mainland tourists were from China's *nouveau riche*, spending money at top quality hotels, restaurants and retail stores. However, the influx of mainland tourists meant also the influx of large quantities of renminbi and pressure on Hong Kong's services sectors to learn a third business language — *Putonghua*, or Mandarin Chinese.³³ As a result, Hong Kong became more accustomed to conducting business in renminbi and in Mandarin.

Following the end of the SARS outbreak and the introduction of the IVS, Hong Kong's economy has experienced several years of strong economic growth (see **Table 2**). Hong Kong's real GDP is growing at rates comparable to its last expansionary period before the Handover. Six-years of price deflation came to an end in 2005. Furthermore, Hong Kong's unusually high unemployment rate — peaking at 7.9% in 2003 — started a gradual decline of about 1% per year.

³² Data from Census and Statistics Department, HKSAR.

³³ Mandarin Chinese, or *Putonghua* (literally, the “common language”) is the official language of China. The vast majority of Hong Kong residents speak Cantonese (*Guangdonghua*). The two Chinese dialects are not mutually comprehensible when spoken, and there are significant differences in how they are written.

Table 2. Hong Kong's Economic Recovery, 2003-2006

Year	Real GDP Growth	CPI	Unemployment
2003	3.2%	-2.6%	7.9%
2004	8.6%	-0.4%	6.8%
2005	7.5%	1.0%	5.6%
2006	6.9%	2.0%	4.8%

Source: Census and Statistics Department, HKSAR.

As the economy recovered, the confidence of the people and businesses of Hong Kong also appeared to recover. When compared to the opinions expressed at the depths of the recession, people in Hong Kong now seem much more confident about their future. However, as will be described later in this report, there is an underlying uncertainty expressed by some Hong Kong residents about the HKSAR's relationship with the Chinese mainland.

Deepening Economic Interaction with China³⁴

One of the largely unexpected effects of the Handover has been rapid increase in economic interaction between the economies of Hong Kong and the Chinese mainland. Prior to 1997, Hong Kong was generally viewed as the hub of a regional economic network, reaching from across Southeast Asia up into the Chinese mainland.³⁵ However, due in part to the effects of the Asian Financial Crisis, Hong Kong's manufacturing and trading companies have reduced their investment flows and activities in Southeast Asia. Meanwhile, the comparatively fast growth of the Chinese economy — and its booming consumer market — have proven to be a more attractive alternative location for business expansion. As a result, the economic relationship between the Chinese mainland and Hong Kong has grown faster and deeper than expected prior to the Handover.

CEPA. Another factor driving the deepening of economic interaction between China and Hong Kong is CEPA. Because China and Hong Kong are separate customs territories, trade between the two effectively is treated as trade across an international border. Bilateral shipments of goods and materials must clear either Hong Kong or Chinese Customs, and people crossing the border must pass through either Hong Kong or Chinese immigration even though the Chinese mainland and Hong Kong are parts of the same country. In addition, under Chinese law, Hong

³⁴ For an analysis of the economic relationship between China and Hong Kong, see "Towards an Integrated Market: The Future of Hong Kong's Economy and its Interaction with the Chinese Mainland," by Zhu Wen Hui, *Brooking Institution*, October 2005.

³⁵ For a description of the pre-Handover Hong Kong economic network, see *Hong Kong Advantage*, by Michael Enright, Edith Scott, and David Dodwell, Oxford University Press, 1997.

Kong companies wishing to invest in the Chinese mainland are considered foreign companies, just like U.S. companies seeking entry into China.

By negotiating a free trade agreement with China, Hong Kong has bolstered its competitive advantage on the Chinese mainland. Under the terms of CEPA, over 1,400 products of Hong Kong origin can be imported into China tariff-free. In addition, a wide variety of service sectors are provided greater access to the mainland market than stipulated in China's WTO accession agreement. For some service sectors, CEPA allows Hong Kong companies to establish wholly-owned subsidiaries in the Chinese mainland that can compete in the mainland markets. For many of the professional services (legal, accounting, etc.), Hong Kong practitioners are able to provide limited services in the Chinese mainland that are prohibited to other "foreign" practitioners. Finally, in the financial sector, Hong Kong banks are allowed to offer bank accounts, credit cards, and remittances denominated in renminbi, while Hong Kong residents are allowed to convert more currency into renminbi than other "foreigners" plus they are able to open renminbi checking accounts in banks in Guangdong Province.

According to research done by the Hong Kong Trade Development Council (HKTDC),³⁶ CEPA has led to an increase in Hong Kong's domestic exports to China, led by rapid growth in the tariff-free product categories. According to a report submitted to the Legco Panel on Commerce and Industry, by the end of 2006, 6.8 billion Hong Kong dollars (\$870 million) worth of goods have been sent to the Chinese mainland under the tariff-free provisions of CEPA, plus 305 million Hong Kong dollars (\$39 million) of net capital investment in Hong Kong manufacturing has been induced by CEPA. The report also states that CEPA has caused a net increase in net capital investment in the services sector of 4.8 billion Hong Kong dollars (\$615 million).³⁷

Both China and Hong Kong view CEPA as a "work in progress," with on-going discussions to expand the scope of the arrangement to include more products, more services, and to foster greater access for Hong Kong businesses and professionals to the Chinese mainland market. For Hong Kong manufacturers, one of the main appeals of CEPA is the ability to sell to mainland consumers, allowing a shift away from export-oriented operations. Similarly, for Hong Kong service providers, CEPA opens up new business prospects in a large and growing mainland market. Finally, for Hong Kong's financial sector, by granting renminbi-denominated transactions, Hong Kong banks and other finance companies have improved access to Chinese companies and consumers.

Pan-Pearl River Delta. In a sense, CEPA is part of the larger story of the economic development of the pan-Pearl River Delta. Over the last 10 years, a number of studies have been done on the economic relationship between Hong Kong and the

³⁶ This research is available online at [http://cepa.tdctrade.com/cepa_index.aspx?data=cepa_index_en&w_sid=194&w_pid=602&w_nid=&w_cid=&w_idt=1900-01-01&w_oid=&w_jid=].

³⁷ "Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) — Impact on the Hong Kong Economy," LC Paper No. CB(1)1849/06-07(04).

Pearl River Delta in the Chinese mainland.³⁸ According to one study, the “economic interaction between Hong Kong and the Pearl River Delta region has been critical to the development of both economies.” According to these studies, Hong Kong serves as the business hub for the Pan-Pearl River Delta region, maintaining the high-value added administrative and financial activities in Hong Kong, while the Chinese mainland increasingly takes on the less technical operational and support activities in addition to the manufacturing activities.

As a result, when taken as a whole the Hong Kong-Pearl River Delta economic region is comparable in GDP and trade volume to China’s Yangtze River Delta region, utilizing about half the land mass and population of its northern competitor.³⁹ However, a major difference between the Pan-Pearl River Delta region and the Yangtze River Delta region is the existence of the immigration and customs border within the former region, complicating economic and trade flows within the region. As a member of Legco recently described it, “The border was once seen as an assurance, but is now viewed as a hindrance.”⁴⁰ Some analysts believe economic pressures will push Hong Kong government officials to work more closely with their colleagues in southern China to find ways to reduce the complications created by and at the border.

Synergy or Integration? The first 10 years of the HKSAR have witnessed deepening economic interaction between the Chinese mainland and Hong Kong. As previously described, Hong Kong businesses continue to invest in mainland facilities and are transferring more of their operations into the Chinese mainland. Meanwhile, mainland companies are investing in Hong Kong. Hong Kong’s total foreign direct investment in the Chinese mainland was worth nearly \$190 billion at the end of 2005, and mainland investments in Hong Kong exceeded \$163 billion.⁴¹ As of 2006, China-related companies accounted for nearly a third of the companies listed on the Hong Kong Stock Exchange, and had a market capitalization value of over \$870 billion, up from just \$67 billion in 1997.

Possibly the most obvious evidence of the deepening economic relationship between the Chinese mainland and Hong Kong is the growth in bilateral trade. Total merchandise trade with China more than doubled in value between 1997 and 2006 (see **Table 3**). In 1997, 35% of Hong Kong’s foreign trade was with China, but by 2006, 46% of its total trade was with China. By contrast, Hong Kong’s trade with the United States increased by less than \$4 billion over the last 10 years, and trade with the United States declined from 15% to 9% of Hong Kong’s total trade.

³⁸ Two such studies are: *Hong Kong & the Pearl River Delta: The Economic Interaction*, by Michael J. Enright, Chang Ka Mun, Edith Scott, and Zhu Wen Hui, sponsored by the 2022 Foundation; and *The Greater Pearl River Delta*, by Michael J. Enright and Edith Scott, commissioned by Invest Hong Kong.

³⁹ The Yangtze River Delta region includes Shanghai and portions of the neighboring provinces of Jiangsu and Zhejiang.

⁴⁰ Statement by Bernard Chan at presentation at Carnegie Endowment for International Peace, June 18, 2007.

⁴¹ Census and Statistical Department, HKSAR.

Table 3. Hong Kong's Total Trade with the World, China, and the United States, 1997-2006

(U.S. \$ in billions)

Year	World	China	United States
1997	401.5	141.0	58.3
1998	361.7	131.4	55.1
1999	355.3	133.1	54.2
2000	417.0	157.7	61.4
2001	393.6	154.5	55.8
2002	410.5	167.4	54.2
2003	463.0	193.1	53.9
2004	539.1	228.8	56.6
2005	593.0	263.1	60.1
2006	658.4	301.5	62.1

Source: Global Trade Atlas

Hong Kong's trade in services with China has also increased substantially since the Handover.⁴² In 1997, Hong Kong's services exports to China equaled \$6.8 billion and its import of services totaled 7.8 billion. In 2005, Hong Kong exported \$16.4 billion in services to China and imported \$9.1 billion in services from China. During that time period, China's share of Hong Kong's services exports rose from 19.4% to 26.3%, and its share of Hong Kong's services imports decreased from 31.1% to 27.0%.

The growing economic ties between the Chinese mainland and Hong Kong also raise questions about the long-term status of the HKSAR as a "highly autonomous" economic entity. In many ways, the Chinese mainland is currently more important for Hong Kong's economy than Hong Kong is important for China's economy. At present, various institutions and structures — such as the Hong Kong dollar, the separate Customs and Immigration Departments, and compliance with the Joint Declaration and the Basic Law — permit the Hong Kong government to maintain a degree of economic separation from the Chinese mainland. As a result, it is possible to refer to the current economic dynamic between Hong Kong and the Chinese mainland as a synergetic relationship.

However, there are elements in the current economic trends that could portend the eventual integration of Hong Kong into the Chinese mainland economy in the long run. Mainland companies are growing in influence in Hong Kong's stock exchange, inward investment flows, and other business activities. A rising share of Hong Kong business transactions are denominated in renminbi — rather than the Hong Kong or U.S. dollar — and Hong Kong's financial sector plans on introducing more renminbi-denominated financial services. At a recent presentation, a prominent

⁴² All data in this paragraph from the Census and Statistical Department, HKSAR.

Hong Kong professor suggested that the Hong Kong dollar may become a collector's item to show to one's grandchildren.⁴³

To some observers, the level and nature of business activity between Hong Kong and the Chinese mainland may eventually supercede the ability of the structural institutions to maintain a viable degree of separation. According to this scenario, as more and more trade and financial flows in Hong Kong are conducted in renminbi rather than Hong Kong dollars, it will become increasingly difficult to support the current linked exchange rate with the U.S. dollar — or possibly maintain a separate Hong Kong currency. Similarly, it is argued that it will become hard to distinguish between a Hong Kong company that has most of its actual business activities taking place in the Chinese mainland from a mainland company that is listed on the Hong Kong stock exchange and operates mostly from its Hong Kong office. So too, the legal distinction between a product of Hong Kong and a product of China may become increasingly difficult to make as the flow of goods and services across the border grows, especially if the product in question makes multiple trips into and out of Hong Kong and the Chinese mainland. In short, there is a possibility — of unknowable likelihood at this time — that global market forces will push the economies of Hong Kong and the Chinese mainland to become fully integrated, which has implications for whether Hong Kong's economy is judged “highly autonomous” from the Chinese mainland.

Economic Relations with the United States

According to the U.S.-Hong Kong Policy Act, economic and trade relations between the United States and Hong Kong were to remain virtually unchanged after the Handover. Section 102 of the act supports Hong Kong remaining a separate customs territory from China and Hong Kong's separate party to the General Agreement on Tariffs and Trade (GATT). Section 103 states that the United States “should seek to maintain and expand economic and trade relations with Hong Kong and should continue to treat Hong Kong as a separate territory in economic and trade matters . . .” The section also grants Hong Kong “most favored nation status” (now referred to as “normal trade relations” status), provides for the free exchange between the U.S. and Hong Kong dollars, allows for continued trade of “sensitive technologies” under U.S. export controls, and calls for the negotiation of a bilateral investment treaty (BIT) between Hong Kong and the United States, “in consultation with the Government of the People's Republic of China.” Section 104 recognizes Hong Kong as “an international transport center,” continues U.S. recognition of Hong Kong ship and airplane registrations, and calls for the direct negotiation of new air service agreements with Hong Kong.⁴⁴

In general, there have been few changes in the institutional aspects of U.S.-Hong Kong economic and trade relations since the Handover. Hong Kong remains a

⁴³ Comment by Stephen Cheung Yan Leung at the Carnegie Endowment for International Peace, June 18, 2007.

⁴⁴ For more details about U.S. actions designed to treat the HKSAR separately from the Chinese mainland under U.S. law, see CRS Report 97-311, “Hong Kong's Reversion to China: Problems and Remedies for the United States,” by Kerry Dumbaugh.

separate member of the World Trade Organization (WTO), and often is a helpful ally in trade negotiations seeking to further international trade and investment liberalization. The United States and Hong Kong recognize each other as separate customs territories and their customs authorities enjoy a productive and generally friendly professional relationship. The exchange of products subject to U.S. export controls continues, without serious problems.⁴⁵ The Hong Kong and U.S. dollars are both fully convertible and openly exchanged in international markets. The two governments successfully concluded a new air services agreement in 2002 that liberalized air services between the United States and Hong Kong. However, there has been no progress on the suggested U.S.-Hong Kong BIT.

According to official U.S. statistics, U.S. trade with Hong Kong has experienced very little growth since the Handover (see **Table 4**). While there has been a modest increase in exports to Hong Kong, there has also been a slight decline in imports from Hong Kong. As a result, total merchandise trade between the United States and Hong Kong increased by about \$300 million over the last 10 years, but the U.S. bilateral trade surplus with Hong Kong increased by \$5.0 billion. Also, both exports to and imports from Hong Kong noticeably declined following the events of September 11, 2001. U.S. exports to Hong Kong have since recovered, but imports from Hong Kong have continued to decline, largely due to the relocation of Hong Kong's manufacturing into the Chinese mainland. U.S. service trade with Hong Kong totaled \$8.6 billion in 2005 [latest available data], with U.S. exports of \$3.7 billion and imports of \$4.9 billion.⁴⁶ In addition, majority U.S.-owned affiliates operating in Hong Kong provided \$9.0 billion in services in 2004 [latest available data], and majority Hong Kong-owned affiliates operating in the United States provided \$1.4 billion in services.⁴⁷ As of the end of 2005, U.S. foreign direct investment in Hong Kong totaled \$37.9 billion.⁴⁸

Table 4. U.S. Merchandise Trade with Hong Kong, 1997-2006
(U.S. \$ in billions)

Year	Exports	Imports	Total Trade	Trade Balance
1997	15.1	10.3	25.4	4.8
1998	12.9	10.5	23.5	2.4
1999	12.6	10.5	23.2	2.1
2000	14.6	11.5	26.1	3.2
2001	14.1	9.6	23.7	4.4

⁴⁵ The 2006 State Department report on Hong Kong states, "Hong Kong maintains an effective, highly autonomous, and transparent export control regime that the U.S. government has encourage other to emulate."

⁴⁶ Data from United States Trade Representative, "2007 National Trade Estimate Report on Foreign Trade Barriers - Hong Kong," available online at [http://www.ustr.gov/assets/Document_Library/Reports_Publications/2007/2007_NTE_Report/asset_upload_file400_10950.pdf].

⁴⁷ Ibid.

⁴⁸ Ibid.

Year	Exports	Imports	Total Trade	Trade Balance
2002	12.6	9.3	21.9	3.3
2003	13.5	8.9	22.4	4.7
2004	15.8	9.3	25.1	6.5
2005	16.3	8.9	25.2	7.4
2006	17.8	7.9	25.7	9.8

Source: U.S. International Trade Commission

While the formal aspects of U.S. economic and trade relations with Hong Kong remain intact, and bilateral trade and investment continues to flow, there are a few areas of long-term concern about U.S.-Hong Kong trade relations. In its most recent survey of its members, the American Chamber of Commerce in Hong Kong (AmCham HK) found that “98% of AmCham member companies indicated that they were satisfied with the overall business environment in Hong Kong,” and half of the companies said they planned on expanding their business in the next three years.⁴⁹ However, AmCham HK has also expressed concern about specific aspects of U.S. and Hong Kong policies that they see as hindering better economic and trade relations.

One of the perennial issues for AmCham HK is the U.S. policy to tax overseas income.⁵⁰ According to AmCham HK, the United States is one of only five nations that tax foreign earned income.⁵¹ While the U.S. tax code contains a relatively high exclusion (\$82,400 in 2006) that is adjusted for inflation, recent changes in the U.S. tax code⁵² increased the effective tax rate by altering the treatment of housing and educational allowances and expenses. According to AmCham HK, the U.S. taxation of foreign earned income makes it nearly twice as expensive to hire U.S. nationals to work in Hong Kong as other “ex-pats,” and is pushing U.S. companies in Hong Kong to hire foreign nationals from Australia, Britain, Canada, and New Zealand rather than hire U.S. citizens. Not surprisingly they have called on the United States to discontinue the taxation of overseas incomes, and see the raising of the income exclusion as a minimal step to reduce the negative impact on U.S. companies and individuals operating in Hong Kong.

The second major concern of AmCham HK is the rising problem of air pollution in Hong Kong. During the month of May 2007, hourly air pollution readings conducted by the Hong Kong government at roadsides around the city were “high”

⁴⁹ “2006 Business Outlook Survey,” American Chamber of Commerce in Hong Kong, December 2006.

⁵⁰ For a discussion of the issue of taxation of overseas income, see U.S. Senate, Committee on the Budget, “Tax Expenditures: Compendium of Background Material on Individual Provisions,” Committee Print, 109th Congress, 2nd Session, prepared by Congressional Research Service. Washington: Government Printing Office, December 2006, pp. 27-31.

⁵¹ The other nations are Eritrea, North Korea, the Philippines and Vietnam.

⁵² Changes made in section 515 of the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222).

more than two-thirds of the time.⁵³ On particularly bad days, it is impossible to see across Victoria Harbour, a distance of little more than one kilometer.

Air pollution is also a growing issue for the people of Hong Kong, and is a high priority of the Hong Kong government. Air quality in Hong Kong has been on the decline since the 1980s, following the opening of southern China to Hong Kong manufacturing facilities. Because the prevailing wind direction is from the Chinese mainland, much of the pollution emanating from Hong Kong-owned factories in Guangdong Province ends up drifting over Hong Kong. In addition, rising traffic congestion and the construction of taller buildings along the waterfront have been cited as contributing factors to Hong Kong's air pollution problem.

The Hong Kong government is making a concerted effort to reduce the city's air pollution. In July 2006, Chief Executive Tsang announced the "Action Blue Sky" Campaign, designed to raise public awareness of air pollution. Hong Kong has already converted nearly all of its taxi cabs from diesel to liquified petroleum gas (LPG) to reduce emissions, and is pushing the private bus companies to convert their fleet of vehicles to LPG. The Hong Kong government is also working with utility companies in both Hong Kong and the Chinese mainland to find ways of reducing emissions at power generation facilities. Despite these and other actions, Hong Kong continues to have a significant air pollution problem.

The third issue raised by AmCham HK is the quality of education available for the children of "ex-pats" in Hong Kong. Hong Kong has an extensive network of "international schools" that provide an education comparable to the curriculum offered back in the home country. However, the return of many Hong Kong residents to Hong Kong following the Handover has increased the demand for the limited number of openings at these schools.

Important Social and Cultural Trends

Declining "Ex-Pat" Community. Whether it is for the reasons cited by AmCham HK or other causes, there has been a noticeable decline in the number of "ex-pats" in Hong Kong since the Handover, especially from Britain, Canada, and the United States (see **Table 5**). Between 1996 and 2001, the number of British "ex-pats" living in Hong Kong decreased by nearly 150,000 people. Much of this dramatic decline is attributable to the removal of British troops from Hong Kong following the Handover. However, there is no similar "troop withdrawal" to account for halving of U.S. ex-pats in Hong Kong between 1996 and 2001, or the 64% decline in the Canadian population.

⁵³ Information from the web page of the Hong Kong Environmental Protection Department.

**Table 5. Ethnic Composition of Hong Kong's Population:
1996, 2001, and 2006**

Ethnicity	1996		2001		2006	
	Number	%	Number	%	Number	%
Chinese	5,688,184	91.4	6,338,762	94.4	6,460,273	94.2
Filipino	120,730	1.9	143,662	2.1	115,349	1.7
Indonesian	22,057	0.4	54,629	0.8	110,576	1.6
South Asian*	20,955	0.3	28,6420	0.4	29,963	0.4
British	175,395	2.8	25,418	0.4	24,990	0.4
Thai	15,993	0.3	14,791	0.2	16,151	0.2
Nepalese	N.A.	N.A.	12,379	0.2	15,845	0.2
Japanese	19,010	0.3	14,715	0.2	13,887	0.2
American	28,946	0.5	14,379	0.2	13,608	0.2
Canadian	32,515	0.5	11,862	0.2	11,976	0.2
Others	93,771	1.5	49,150	0.7	51,728	0.8
Total	6,217, 556	100.0	6,708 ,389	100.0	6,864,346	100.0

Source: Census and Statistics Department, HKSAR

*Includes Indians, Pakistanis, Bangaldeshis, and Sri-Lankans.

The “disappearance” of the Western “ex-pats” and the arrival of more mainland Chinese has had a subtle change in the look and feel of Hong Kong. According to some observers, its international quality has declined, while its Chinese cultural attributes are on the rise. In addition, a significant number of executive positions in the private sector that previously were filled by Western “ex-pats” are now being done by mainland immigrants. Meanwhile, at the other end of the income spectrum, many jobs previously done by Hong Kong Chinese are being taken by recent mainland immigrants as well.

The perceived influx of mainland Chinese at both the top and bottom of the income distribution is causing some tensions within the Hong Kong Chinese population. Much as the United States experienced with its waves of immigrants, some people in Hong Kong view the “newcomers” with suspicion.⁵⁴ This suspicious attitude towards mainland immigrants was reinforced by the Tung administration when it released rather dire predictions of the effects of the arrival of mainland children and their families during the “right of abode” controversy. It is not uncommon to hear claims in Hong Kong that mainland immigrants are responsible for a rise in crime, the decline in the quality of education, and a general loss of good manners in Hong Kong since the Handover.

⁵⁴ Hong Kong currently allows up to 150 “mainlanders” to immigrate into Hong Kong each day. This quota has gone largely unfulfilled for the last couple of years.

Disappearing Middle Class. Along with the decline in its “ex-pat” population, there is a perception that Hong Kong may be losing its “middle class.” With more and more of the middle management jobs being relocated into the Chinese mainland, analysts say Hong Kong residents are being forced to work harder for less pay. Recent income statistics show some evidence to support this claim. During the depths of Hong Kong’s recession, nominal salaries and wages in the private sector declined every quarter from the beginning of 2002 to the end of 2004.⁵⁵ In addition, the Hong Kong government recently announced that Hong Kong’s Gini coefficient⁵⁶ had risen from 0.518 in 1996 to 0.533 in 2006. By contrast, the U.S. Gini coefficient in 2005 was 0.469⁵⁷ and China’s Gini coefficient in 2005 was 0.46.⁵⁸

There are also indications that the Chinese government is concerned about the status of Hong Kong’s middle class. During a May 2007 interview with Hong Kong Cable TV, Lu Ping, former director of the State Council’s Hong Kong and Macau Affairs Office, stated that prior to the Handover, the Chinese government’s “biggest concern was that big businesses, particularly the ones overseas, might pull out.”⁵⁹ In retrospect, Lu believes, “Although we had paid attention to people in the middle-class and the grassroots level, who make up the majority after all, it wasn’t enough. More could have been done for them.”⁶⁰

Historical Preservation. Even before 1997, an undercurrent of nostalgia swept around Hong Kong. While there were very few public expressions of disapproval of Hong Kong’s return to China, there were many private disclosures of sadness at seeing the departure of the photo of the Queen in government buildings and other attributes of Hong Kong’s British heritage. In addition, musician Anthony Wong Yiu Ming performed a concert to sell-out crowds in 1997 entitled “People Mountain, People Sea” (*Yan San, Yan Hoi*⁶¹) that featured a well-known love song in which one half of an ex-couple expresses his or her sorrow about the end of the relationship, as well as his or her appreciation for everything the other person taught the singer. During the concert, Wong performed the song while dressed up in an outfit patterned after the British Union Jack. The symbolism of Wong’s clothing was not lost on the audience.

Since the Handover, there continues to be an interest in preserving Hong Kong’s distinct cultural heritage. The Hong Kong government has increased its efforts to

⁵⁵ Nominal wage data from the Census and Statistics Department, HKSAR.

⁵⁶ The Gini coefficient is a measure of income distribution ranging from zero (totally equal income) to 1 (totally unequal income).

⁵⁷ Based on U.S. Census Bureau data.

⁵⁸ Statement by Lou Jiwei, China’s Vice Minister of Finance, reported in “China Shouldn’t Mechanically Apply Gini Coefficient,” *China Daily*, June 29, 2006.

⁵⁹ “Secret Sino-British Pact for the HK Dollar,” by Damon Pang and Marco Lui, *Hong Kong Standard*, May 21, 2007.

⁶⁰ *Ibid.*

⁶¹ The Chinese expression, *yan san yan hoi*, can be roughly translated as a “large crowd of people.”

preserve historical buildings, both of Chinese design (such as village temples) and colonial origin. An example of the Hong Kong government's efforts to preserve historical buildings is the reconstruction of Murray House in Stanley in 1999.⁶²

More recently, the proposed demolition of the Railroad Clock Tower in Tsim Sha Tsui and the Queen's Pier on Hong Kong Island gave rise to series of public demonstrations and an occupation of the pier by more than 20 protesters, prolonged debates in Legco, and the advancement and withdrawal of proposals by Chief Executive Tsang to relocate and preserve these historic buildings.⁶³ At the time this report was drafted the future of both structures was uncertain.

Redefining Hong Kong. Taken as a whole, the social and cultural developments mentioned above are indications of a general reevaluation and reexamination taking place in Hong Kong about its identity. One major aspect of this process is defining — or redefining — Hong Kong's relationship with China.

An example of the redefinition of Hong Kong's relationship to China is how Hong Kong residents identify themselves.⁶⁴ In a survey conducted just after the Handover, 35% of the respondents referred to themselves as "Hong Kong citizens" (*Heunggongyan*), 25% said they were "Chinese Hong Kong citizens" (*Chunggwok gei Heunggongyan*), 20% called themselves "Hong Kong Chinese citizens" (*Heunggong gei Chungwokyuan*), and a bit more than 18% used the term "Chinese citizens" (*Chungwokyuan*). In a December 2006 survey, 22% used the term "Hong Kong citizens," 32% preferred "Chinese Hong Kong citizens," 20% said "Hong Kong Chinese citizens," 24% answered with "Chinese citizens" — revealing a slight shift towards greater association among Hong Kong residents with their Chinese identity.

Self-identification is not a trivial matter for today's Hong Kong citizen. To some pro-Beijing politicians, criticism of the Chinese government is viewed as being unpatriotic and disloyal. However, for pro-democracy politicians, the criticism may be considered an expression of patriotism if the goal is to make Hong Kong and/or China a better place. For typical Hong Kong citizens, the issue becomes one of resolving the tension between one's loyalty to Hong Kong and to China.

Combining the social and cultural changes with the post-Handover economic dynamics, the issue of Hong Kong's long term ability to remain separate and distinct

⁶² Murray House was originally part of Murray Barracks in the Central District of Hong Kong Island. In 1982, the building was dismantled so that the Bank of China building could be constructed, and the materials were placed in storage for the next 16 years. In 1990, Hong Kong's Housing Department suggested that Murray House be reassembled in Stanley (an area on the south side of Hong Kong Island). The building reopened in Stanley in 1999, with the Hong Kong Maritime Museum located on the ground floor and shops and restaurants located in its two upper floors.

⁶³ For one account of the protests surrounding Queen's Pier, see "Pier Pressure," by Krista Mahr, *Time*, June 7, 2007.

⁶⁴ The survey was conducted by the Public Opinion Programme of the University of Hong Kong. Results are available at [<http://hkupop.hku.hk>].

from the Chinese mainland resurfaces. At present, the Hong Kong government is emphasizing Hong Kong's identity as "Asia's World City," as well as the entryway into the emerging Chinese mainland market. The focus is on projecting Hong Kong as being an international and cosmopolitan city and the natural bridge into China. What cannot be determined at this time is if and for how long Hong Kong can remain both part of and separate from China.

Implications for U.S. Policy and Congress

At present, most analysts believe there are very few issues that indicate a need for significant changes in U.S. policies about Hong Kong. By and large, the provisions of the U.S.- Hong Kong Policy Act are being met, and Hong Kong is fulfilling its obligations to the United States under the existing bilateral and multilateral treaties and agreements. There are, however, several areas that Congress may chose to consider that could have an impact on U.S.-Hong Kong relations.

Democratization

The support for the democratization of Hong Kong is written directly into the U.S.-Hong Kong Policy Act, and there appears to be strong and widespread support for democracy among the people of Hong Kong. In public opinion polls, Hong Kong residents routinely support the direct election of the Chief Executive by universal suffrage and to almost an equal extent, support the election of the members of Legco by universal suffrage. For example, in surveys conducted prior the Standing Committee of the NPC announcement of April 2004, between 70% and 80% of the respondents supported the direct election of Chief Executive in 2007.⁶⁵ A similar set of surveys found that nearly three-quarters of the people supported direct election of Legco before the Standing Committee of the NPC stated its opposition to the direct elections, and nearly two-thirds continued to support direct elections afterwards.

Two possible ways for Congress to promote Hong Kong's progress towards universal suffrage and democracy are: 1) closely monitor the work of the Committee on Governance and Political Development as it develops the "Green Paper" on "models, roadmaps and timetables for electing the Chief Executive by Universal Suffrage," as well as its Legco reform proposals; and 2) provide assistance to the current Legco in its ongoing research into the policies and practices of the U.S. Congress. In FY2006, the State Department's Human Rights and Democracy Fund allocated \$450,000 to a project in Hong Kong designed to strengthen political parties and civil society organizations. Also, the State Department's Country Report on Human Rights Practices for China contains a separate section on Hong Kong, including analysis of its progress towards democracy. In addition to these programs, Congress may wish to provide information and resources to Hong Kong's political parties as they explore the possible creation of broader, grassroots-based parties.

⁶⁵ The surveys were conducted by the Public Opinion Programme of the University of Hong Kong. Results are available at [<http://hkupop.hku.hk>].

Civil Liberties

Outward indications seem to support the view that the civil liberties of the people of Hong Kong remain relatively unchanged since the Handover. Public opinion polls conducted regularly since the Handover reveal no perceived erosion in the freedoms of speech, press, or assembly among Hong Kong residents. At present, the only issue that clearly raised concerns about civil liberties in Hong Kong — the Article 23 proposals — is on hold until Chief Executive Tsang or the Chinese government decide to press the matter again with Legco and the people of Hong Kong. Beyond continuing to monitor civil liberties in Hong Kong, Congress might contemplate consultations with Legco about alternative legal options in drafting legislation on issues such as treason, sedition, and subversion.

Economic Relations

Economic and trade relations between Hong Kong and the United State are by most accounts strong, positive, and friendly. Both parties are reportedly fulfilling their bilateral and multilateral obligations under existing treaties and agreements. Trade and investment flows between the two economies have recovered from a recent downturn, but do not exhibit the same level of growth seen in trade relations with other economies. Also, the decline of U.S. nationals in Hong Kong, may indicate a reduction in U.S. influence in Hong Kong.

Based on the comments of U.S. business representatives in Hong Kong, there are some actions Congress could consider taking to counter the possible decline in U.S. influence. Not surprisingly, the U.S. business community in Hong Kong favors a congressional re-examination of U.S. laws governing the taxation of foreign earned income and consideration of ways of balancing the revenue generated by the tax against the implicit cost it creates for U.S. companies wishing to hire U.S. nationals overseas. In addition, Congress may wish to support technical assistance to Hong Kong in its efforts to reduce air pollution. Also, Congress might choose to explore direct and indirect ways of fostering the creation of more international schools in Hong Kong with curriculum consistent with the U.S. educational system.

Finally, Congress may include language in suitable legislation to reactivate the Section 301 provision of the U.S.-Hong Kong Policy Act that requires an annual report from the State Department to Congress on the status of Hong Kong.

Figure 1. Map of Hong Kong



Appendix 1. Hong Kong Interviews

Much of the information and analysis contained in this report is based on a series of interviews conducted by the author in Hong Kong during the week of May 28 - June 1, 2007. Below is a list of the people interviewed (in alphabetical order); some of whom wished to remain anonymous.

Anonymous Hong Kong business consultant
 Anonymous Hong Kong Customs official
 Anonymous Hong Kong physician
 Anonymous Hong Kong retiree
 Fred Armentrout, Communications Director, American Chamber of Commerce in Hong Kong
 Nicholas Chan Chun Tak, Senior Administrative Officer, Central Planning Unit, Hong Kong Government
 Philip Chan Kwan Yee, Research Director, Central Planning Unit, Hong Kong Government
 Watson Chan Li Wah, Research Department, Legislative Council
 Michael Degolyer, Professor of Government and International Studies, Hong Kong Baptist University
 Michael Enright, Professor of Business Administration, University of Hong Kong
 He Dong, Head of Economic Research Division, Hong Kong Monetary Authority
 Anthony Hutchinson, Director of Public Affairs, U.S. Consulate General in Hong Kong
 Linda Lai Wai Ming, Deputy Secretary, Hong Kong Department of Commerce, Industry, and Technology
 Emily Lau Wai Hing, Member of the Legislative Council
 Alan Leong Kah Kit, Member of the Legislative Council
 Leung Kwok Hung, Member of the Legislative Council
 Nancy W. Leou, Consul, Economic/Political Section, U.S. Consulate General in Hong Kong
 Edward Leung Hoi Kwok, Chief Economist, Hong Kong Trade Development Council
 Amelia Luk Siu Ping, S. P., Deputy Law Officer, Hong Kong Department of Justice
 Jack Maisano, President, American Chamber of Commerce in Hong Kong
 Julie Mu Fee Man, Assistant Director of Community Relations, Independent Commission Against Corruption
 Ng Chun Hung, Professor of Sociology, University of Hong Kong
 James Tang T. H., Professor of Politics and Public Administration, University of Hong Kong
 Cherry Tse Kit Ching Ling, Permanent Secretary, Hong Kong Department of Constitutional Affairs
 David Webb, Economist
 Pansy Yau Lai Ping, Assistant Chief Economist, Hong Kong Trade Development Council
 Yeung Yue Man, Director of Hong Kong Institute of Asia-Pacific Studies, Chinese University of Hong Kong