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Hong Kong 2005: Changes in Leadership and Issues for Congress

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Summary

The Hong Kong Special Administrative Region (HKSAR) has recently recovered from an economic downturn and the SARS virus outbreak of 2002-2003 which crippled trade and tourism. There has also been a major change in top government personnel, with the former Chief Executive, Tung Chee-Hwa, being replaced by Donald Tsang as the new Chief Executive of Hong Kong. The next major issue to be addressed in Hong Kong is the pace of further democratization and the extent to which the next elections for the Legislative Council will be based on direct elections of all seats or a larger portion thereof.

Hong Kong continues to participate productively and constructively in numerous multi-lateral fora encompassing economic, security, and trade issues. Hong Kong maintains an active and independent voice in organizations such as the World Trade Organization (WTO), the Asia Pacific Economic Cooperation (APEC) forum, Interpol, and the Financial Action Task Force. In addition, Hong Kong has to date been a very proactive partner with the United States in the Container Security Initiative (CSI) and continues to support anti-terrorism efforts through its law-enforcement and anti-money laundering efforts.

The rule of law and the existence of an independent judiciary remain the main foundations of Hong Kong's vibrant economy. The legal system of Hong Kong also provides a model for the Mainland in regards to legal reforms and resources for the institution building necessary for such reforms to take root and hold.

Freedom of speech, religion, press, association, and assembly continue to be respected and defended in Hong Kong with few exceptions. Those exceptions that do arise are viewed by some observers as a result of pressure from Beijing on politically sensitive topics such as the Falun Gong, challenges to Chinese sovereignty, and the reach of democratic reforms. There have also been numerous allegations and rumors of "self-censorship" in the press, though this is mostly anecdotal. Some members of the press and broadcast media perceive retaliation for highly critical editorials or unfavorable news reports by the alleged threat of withholding advertising revenues and access to government officials.

For further information on this subject see the following Congressional Research Service products: CRS Report RS20786, *Hong Kong-U.S. Economic Relations*, CRS Report RL30895, *Hong Kong's Ongoing Transition: Implications of Chinese Sovereignty in 2001*, and CRS Report 97-311, *Hong Kong's Reversion to China: Problems and Remedies for the United States*. This report will not be updated.

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Congressional Interests

The United States retains substantial economic and political interests in the Hong Kong Special Administrative Region (SAR).¹ Support for the economic, personal, and political freedoms of Hong Kong, and its nearly seven million citizens remains a cornerstone of U.S. policy towards Hong Kong under Chinese sovereignty. Towards this end, the United States Congress enacted the U.S.-Hong Kong Policy Act (P.L. 102-383) which was designed to ensure that Hong Kong is treated separately from China for purposes of U.S. trade laws, immigration, and security cooperation.² Under the act, the United States Congress is charged with oversight of the required provisions including the promotion of an autonomous and democratic Hong Kong.

Pursuant to P.L. 102-383, the Bush Administration has continued the practice of past presidential administrations by publishing and certifying the Annual Hong Kong Report (prepared by the Department of State) that Hong Kong has adhered to its responsibilities under the above mentioned legislation and has continued to preserve its democratic and economically liberal character as a separate Special Administrative Region of China as agreed to under the Basic Law. The President has the authority to end this separate treatment for Hong Kong if he determines that Hong Kong is no longer able to act autonomously.

Political Status of Hong Kong

Election of Donald Tsang as Chief Executive. Tung Chee-Hwa's early resignation (due to unspecified health reasons), was seen by many as an acknowledgment that Beijing found his growing unpopularity, aloof administrative approach, and poor handling of the economy was a political liability for the Mainland Chinese government.³ However, his resignation was seen by many observers as a way for China to save "face" without acknowledging Beijing's political failure and

¹ Hong Kong, in accordance with the Sino-British Joint Declaration, was handed over by the United Kingdom to China on July , 1997 and has since been governed by its constitution, the Basic Law.

² U.S.-Hong Kong Policy Act of 1992, 22 U.S.C. 5731, as amended; see [<http://uscode.house.gov/download/pls/22C66.txt>]

³ Tung Chee-Hwa was the first Chief Executive of Hong Kong, appointed July 1, 1997, and he governed Hong Kong through a turbulent period which saw the Asian financial crisis, the SARS outbreak, and an economy that seemed to be on a downturn.

Tung's poor management of Hong Kong's nascent political scene. This interpretation carries some weight as Tung was appointed to a new position as the Vice Chairman of the Chinese People's Political Consultative Conference (CPPCC), a post of mostly symbolic value with no power.

Donald Tsang's election and subsequent appointment as Chief Executive (CE), replacing Tung Chee-Hwa, is seen by many Hong Kong analysts as a watershed moment for the SAR⁴. While unsure of Mr. Tsang's future agenda, many of Hong Kong's people see him as a more effective advocate of Hong Kong's interests in relation to the central government in Beijing. Unlike his predecessor, Tsang is a product of the civil service and a former member of the colonial administration while Tung was a successful businessman.⁵ As such, some analysts surmise that Tsang may have a better chance of gaining the civil services' loyalties and allaying Hong Kongers' fears that their political freedoms will be compromised. In addition, Tsang currently enjoys a very high public approval rating of around 75% and the support of many business interests in Hong Kong, most of whom are seen as advocates of close relations with China and the central government.⁶

Thus, with the support from both pro-Beijing and pro-democracy forces, Tsang has a unique potential to administer from the center. However, it is also said that Beijing hardliners worry about Tsang's close association with the former British administration and, as such, plan on keeping a close eye on Hong Kong's administration.

Many analysts believe that Tsang's British connection is the reason for his "probationary period" of two years instead of the full five normally provided by the Basic Law. The National People's Congress (NPC) Standing Committee created the special two-year term according to its "interpretation" of the Basic Law, Hong Kong's constitution. The Basic Law did not specify a mechanism for selecting a replacement for a Chief Executive who does not fulfill his or her full term. At issue was whether the new Chief Executive would complete the prior Chief Executive's term or whether the replacement would be elected to a full five-year term in office.

After much discussion and some public protest by "pro-democracy" activists, the Hong Kong government argued that Mr. Tung's replacement should only fill out his remaining term, and the NPC Standing Committee ruled in favor of this position. To many critics this was seen as an attempt by Beijing to limit Tsang's policy leeway and ensure that if Tsang does not work out as planned, there would be an opportunity to replace him shortly. Some opponents of this decision pointed out that, had a full five-year term been allowed, the possibility for a reform of electoral laws would have

⁴ While the Chief Executive is ostensibly "elected" by an 800-member Election Committee in Hong Kong, the Committee members themselves are appointed by Beijing, and many, thus, see the Chief Executive under these circumstances to be Beijing's de facto appointment.

⁵ Donald Tsang was knighted (KBE) as Sir Donald Tsang by Prince Charles in June of 1997 after more than three decades of distinguished service to the British colonial administration.

⁶ Marianne Bray, "Tsang Set to Clinch HK Leadership", *CNN*, July 13, 2005.

been postponed until the next election and, therefore, the Chinese government would be seen as “delaying” the implementation of popular democracy.⁷

Once the issue of the length of term in office to be served was settled, the process continued and Donald Tsang (with the support of big business and pro-Beijing groups) was nominated by over 700 members of the 800-person Election Committee, won an uncontested election, and was confirmed by the policymaking PRC State Council. The real test of the incoming Chief Executive is likely to come in October 2005, when he will give his first policy address. Tsang is also likely to face an early test when the Hong Kong government’s Task Force on Constitutional Development report reveals its plan on the timing of further democratization. Tsang has stated that while, “of course democracy is our ultimate aim, it must occur in an orderly and measured fashion” and that, “Hong Kong is a relatively late starter in the race to democracy and it took the United States over 200 years to reach full democracy. Hong Kong is still very young.”

It is interesting to note that while in the summer of 2003 over 500,000 of Hong Kong’s citizens marched in the streets (on the July 1 anniversary of Hong Kong’s return to China) against the controversial national security bill then being pushed by Tung Chee-Hwa, and in July 2004 over 200,000 people demonstrated for democracy, in 2005 the crowd turnout was comparatively light at 20,000 people, less than the pro-Beijing event earlier in the day which drew approximately 30,000 supporters.⁸ Some people feel that this decline in the number of Hong Kong protesters reflects greater public confidence in Tsang than his predecessor.

Legislative Council and 2004 Elections. Hong Kong’s other main political institution is the 60-seat Legislative Council (also known locally as the Legco), consisting of 30 geographically based seats that are directly elected at the district level and 30 seats that are elected by “functionalities:” industrial sector interest groups, professional groups, and unions.⁹ Traditionally, the functional seats are seen as more likely to elect a pro-Beijing candidate. However, that perception is changed somewhat as pro-democracy parties made limited inroads in picking up functional seats in the 2004 election.

Hong Kong Political Parties. Hong Kong has a vibrant political scene, evidenced by the high voter turnout in the last election, with many parties contesting in Legco elections and advocating different visions of Hong Kong’s future. The most prominent of these are the Democratic Party of Hong Kong (DP), the Democratic Alliance for the Betterment of Hong Kong (DAB), and the Liberal Party (LP). The political parties tend to be associated with one of two general camps — one that is “pro-Beijing” and one that is “pro-democracy”. On some issues, however, such as on constitutional reform, party ideologies have blurred.

⁷ The Hong Kong government subsequently amended the Chief Executive Election Ordinance to clarify the replacement procedures for a Chief Executive who does not serve out his full term.

⁸ “HK Sees Muted Anniversary Protest,” *BBC News*, July 1, 2005.

⁹ “Election Blow for HK Democrats,” *CNN*, September 12, 2004.

In the last election, the pro-Beijing DAB party did much better than many had expected, almost doubling its representation in the Legco among the directly elected seats and maintaining its dominance amongst the functional seats. Some observers interpret this as a sign of voters' desire for stability and smoother, more constructive relations with Beijing. The DAB won 12 seats in the 2004 elections and forms the largest party in the Legislative Council.

The Liberal Party's origin dates back to a business grouping that had existed for some time prior to the handover and was the first to organize itself as a political party under the new system. It is reliably pro-business and often cooperates with the DAB to form a pro-government majority. In the 2004 election, the Liberal Party retained its role as a crucial swing bloc in the Legco. The LP won 10 seats to surpass the Democratic Party as the second largest party.

The Democratic Party is the most vocal party in support of more democracy and the introduction of direct elections for both the entire Legco and the position of Chief Executive. They experienced slim gains (picking up only one seat) in the geographical constituencies but unexpectedly picked up several more in the functional constituencies. The DP called for and received a partial recount for alleged voting irregularities but the electoral commission was able to explain the irregularities and the final results did not change.¹⁰ Overall, the Democratic Party took 9 seats to become the third largest party in the Legco. This represents a slight slippage in Democratic seats from the past.

Political Trends. It appears as if Hong Kongers' are optimistic in the face of the resignation of former Chief Executive Tung Chee-Hwa and his replacement by Donald Tsang. The pro-Beijing political parties experienced a substantial boost in legislative success and, according to some analysts, could effectively stymie most attempts by pro-democracy groups to pressure for more direct elections and a rapid implementation of democratic reform. The pro-democracy groups have had political difficulties in recent years due to internal dissension and to charges that they are not particularly attentive to their constituents' concerns or problems. There has been some fracture in the pro-democracy camp and a greater number of aligned, but non-party, independents have been elected who generally tend to support the pro-democracy parties in Legco sessions. Thus, the resignation of Tung and the subsequent appointment appears to have aided the pro-Beijing parties in the last election.

Beijing appears to have acquired greater leverage over governmental policymaking and is seen by some as slowly eroding Hong Kong's democratic orientation that is enshrined in the Basic Law, Hong Kong's constitution. The fact that Mainland authorities were able to assume the role of the final arbiter in the Chief Executive's appointment and successfully push for a shortened term of office for Tsang, was decried by some democracy supporters as an infringement on Hong Kong's democratic system and a sign of a slow, almost imperceptible rollback of democracy. Britain has voiced concern over this and has maintained that Hong Kong should retain the democratic character written into the Basic Law as agreed upon in the 1984 Sino-British Joint Declaration.

¹⁰ "Democrats Demand HK Recount," *CNN*, September 12, 2005.

The timing of electoral reform appears to be the next contentious issue on the horizon and has the capability of sowing more dissent and political instability. Beijing and many Hong Kong democracy activists disagree as to the speed and extent of electoral reforms as the Basic Law is unclear as it relates to the timing and mechanisms of any reform. Some are focused solely on increasing the number of directly elected seats in the Legco and phasing out the functional or occupational seats. Furthermore, others are pushing for the direct election of the Chief Executive. Mainland officials view this as a violation of the Basic Law and are concerned that if done too soon, electoral reform will weaken their influence in Hong Kong and have, in their view, undesirable effects on nearby Mainland provinces. Some analysts posit that this weakening of Beijing's control could possibly paralyze legislation and create strains between the two governments.

Flow of Political Ideas from Hong Kong to the Mainland. Beijing authorities fear political contagion or the possibility of political seepage across the Mainland borders. Some Hong Kong analysts have argued that China is attempting to stop the 'seeds' of democracy from having any effect on China. Some have reported a slow spread of the legal and political philosophies of Hong Kong into adjacent mainland provinces into southern China. The Pearl River Delta in particular, including the city of Guanzhou (Canton) seems to be agitating for increased rule of law and more political openness in part due to its close proximity and interaction with Hong Kong. Indeed, migration (along with tourism and access to diverse media) into and out of Hong Kong seems to drive much of this transfer of ideas. In 2000, there were approximately 20,000 people who migrated to Hong Kong from the Mainland. In 2004, there were over 500,000 people permanently migrating to Hong Kong.¹¹ Increasing numbers of workers in Hong Kong are also opting to move to the Mainland where the cost of living and property is substantially lower and commuting to and from their jobs in the city. This serves as a feedback loop of sorts as these movements often bring their values with them and share them with their new neighbors or communities. For many analysts, Hong Kong represents a "Trojan Horse" of sorts for the transmission and dissemination of Hong Kong's cultural and political values into China.

However, this is not just a one way street. There are signs of increased nationalism and "patriotism" in Hong Kong that many believe come from greater interaction with the Mainland. When the China-Japan tension flared up in May-June 2005, there were anti-Japanese protests and rallies in Hong Kong as well as in Shanghai and Beijing.

Other Political Issues

Rule of Law. Hong Kong retains its common law heritage from the British colonial administration. The rule of law is often credited with Hong Kong's economic success and political stability. Many citizens state that it is the feature that most distinguishes the SAR from China and that it is a major reason that corruption in Hong Kong is so low. The rule of law also ensures that the transparency of the

¹¹ Presentation by Michael DeGolyer, Associate Professor, Government and International Studies Department, Hong Kong Baptist University, July 7, 2005.

system is maintained. In addition, social stability is enhanced by the perception of many that one's wealth and status is of no consequence to the independent judiciary and therefore, "everyone is equal in the eyes of the courts." The judiciary is well-renowned for its political neutrality, strict adherence to the Basic Law, and openness to other jurists hailing from other common law nations such as Australia, Britain, and others.

Hong Kong's Effect on the "One Country, Two Systems" Model.

Hong Kong is the example that China often uses in its attempts to persuade Taiwan to "re-unify" with the Mainland. It points to the success that Hong Kong has had since its return to China in 1997 and China's ability to successfully maintain its "one country, two systems" promise. Consequently, some say it is in China's interest to ensure harmony, and economic growth in Hong Kong and any perceived rollbacks of democracy would likely hurt its negotiating strength to convince Taiwan to accept a similar system. Taiwanese also carefully scrutinize the situation in Hong Kong due to the size of their investments in the region and the implications of Hong Kong's situation for China's policy on Taiwan.

Religious Freedoms and the Falun Gong. The freedom to practice one's religion is guaranteed by Hong Kong's Basic Law and, as such, differs greatly from China's approach to organized religion. An example of this difference is highlighted by the fact that Hong Kong's new Chief Executive, Donald Tsang, is a devout, practicing Catholic with a long tradition of contributing to Catholic organizations involved in lay work and relief. There are many religions practiced in Hong Kong including Christianity, Taoism, Buddhism, Hinduism, Islam, and Sikhism amongst many others that freely congregate and worship with no interference from governmental authorities. China, on the other hand, requires religious groups to register with the state and has banned unregistered or "unofficial" religious practices.

Civil society, in the form of religious organizations, also reinforces the right to worship freely without governmental intervention by engaging actively with both the public and the government to ensure its continued unencumbered status in Hong Kong. Religious groups also have influence with business interests as many have successful businessmen on their charity programs' boards of directors and receive large donations from many of Hong Kong's business tycoons.

While the Falun Gong are officially banned in China (listed as a "threat to state security" and branded as an "evil cult" by the state organs responsible for regulating and overseeing religious institutions), in Hong Kong, the Falun Gong have the freedom to worship as they please and often publicly criticize Beijing's treatment of Falun Gong practitioners. In March 2002, sixteen Falun Gong practitioners were arrested outside the central government's liaison office in Hong Kong while holding a peaceful protest.¹² Police were called in and the members were arrested and convicted for obstruction of a public place and assaulting an officer of the peace. On

¹² Raymond, Ma, "Falun Gong May Sue for Unlawful Arrest; Activists Consider Legal Options After Convictions Are Quashed", *South China Morning Post*, May 8, 2005.

appeal to the Court of Final Appeals, the justices dismissed the charges of obstruction and reaffirmed the right of Hong Kong's citizens to protest and demonstrate.¹³

Press Freedom. Hong Kong has a vibrant and vocal press, one of the largest per capita in Asia. While noted for its openness and its history as a center for Asian publishing industries, there have been allegations of “self-censorship” in the press in Hong Kong and dissatisfaction among the ranks of some journalists who work for many of the large daily papers. Critics say that, unlike many news divisions, editorial content is subject to certain “pressures” from Beijing to not publish material that could possibly damage their position.¹⁴ These alleged “pressures” include threats to take away ad revenue, isolated harassment of editors and publishers, and an occasional threat of bodily harm. Others say that these rumors are baseless and that there is no proof of such behavior. Citizens of Hong Kong have unrestrained access to diverse print, cable, and internet media from Chinese and internationally derived sources.

Economic Situation in Hong Kong

Hong Kong Economy. According to economic forecasts, GDP growth will slow from 8.1% in 2004 to 4.6% in 2005 and 3.6% in 2006, in line with global trends of a slowing world economy. Trade data for April 2005 showed a 7.8% year-on-year increase in exports and a 3.8% increase in imports. The recovery of the property market and the subsequent recovery of the construction industry have led to the decline in the government's budget deficit. In addition, the Hong Kong logistics industry is growing robustly as a consequence to China's boom and an increase in tourism from the Mainland continues to power further growth.¹⁵

Regional economic risks include a slowdown in the Chinese economy, increased regional tension between China and Japan, a recurrence of Avian Flu, and any unforeseen natural disasters like the Indian Ocean tsunami of 2004. Also, the volatility of the stock market is a concern as “hot money” continues to flow into Hong Kong on speculation of a further change in China's Renminbi (Yuan). In response, Hong Kong has introduced a refinement to its exchange rate mechanism to prevent speculators from using Hong Kong dollars as a proxy to bet on a revaluation in China. Finally, trade disputes between China and the United States are a growing concern for Hong Kong businessmen as the United States is a major export market and their goods may be impacted by any restrictionary trade legislation passed by Congress.

U.S.-Hong Kong Business Interests. Hong Kong is a vital entrepot for trade between China and the United States. In 2004, approximately US\$36 billion in Chinese exports to the United States flowed through Hong Kong. Twenty-eight percent of all China-U.S. trade is routed through Hong Kong. Six billion dollars, or

¹³ Albert Wong, “Falun Gong Victory on Right to Protest,” *The Standard*, May 6, 2005.

¹⁴ “Hong Kong Printer Agrees to Keep Falun Gong-Linked Newspaper Running for Two More Months,” *Associated Press*, May 18, 2005.

¹⁵ Hong Kong Country Report, *Economist Intelligence Unit (EIU)*, June 2005.

13% of Chinese imports from the United States, transfers through Hong Kong on route to their final destinations in the interior of the Mainland. Hong Kong itself imported US\$ 14 billion worth of goods from the United States. The biggest imports consist of jewelry, agricultural products and foodstuffs, electronics, and computer software.

There are over 1,200 U.S. companies, including many of the largest U.S. multinational corporations, with offices in Hong Kong, and over 800 U.S. firms have their regional headquarters located in Hong Kong due its strategic position in relation to Asian markets. Tokyo, Beijing, Manila, Seoul, Bangkok, Singapore, and other Southeast Asian capitals are within easy traveling distance for business executives and Hong Kong is an important conduit for exports to the United States. from Asia as whole. More than 50,000 American citizens live in Hong Kong, forming one of the largest expatriate communities in the territory.

As a major global financial center, Hong Kong has attracted US\$ 49 billion in U.S. foreign direct investment as of 2003.¹⁶ Hong Kong's securities and futures markets are actively pursued by U.S. stockbroking and fund management groups, including Lehman Brothers, Merrill Lynch, Bear Sterns, Citigroup, Fidelity, Goldman Sachs, Morgan Stanley Dean Witter, and many others.

Conversely, in 2004, the United States was Hong Kong's largest overseas market for domestic exports.¹⁷ The majority of U.S. imports from Hong Kong are apparel, photographic and optical equipment, electrical machinery, integrated electronics, and office machines and products. Over three quarters of Hong Kong's exports consist of clothing and textiles which, as of January 1, 2005 enter the country tariff-free. Hong Kong has consistently been ranked as one of the world's freest economies.

Port of Hong Kong's Strategic Importance. Hong Kong's port system has been its central commercial feature for hundreds of years. Its sheltered, natural harbor continues to provide good access and efficient services to vessels from around the world. In terms of tonnage, Hong Kong's port is one of the world's largest. In 2001, a total of 37,350 vessels made a port call in Hong Kong. Its container port, the Kwai Chung Container Port, handled 17.8 million TEUs (20-foot equivalent units), making it the world's busiest container port. The recently completed terminal, Container Terminal Nine (CT9), adds six new berths for a total capacity of over 14 million TEUs a year. The Hong Kong shipping registry is a major location for ship owning and management with over 34 million gross tonnes owned or managed in Hong Kong. The port also has extensive ferry service to the outlying islands of Hong Kong and ferry jet service to Macau.

The port and shipping lanes that Hong Kong has historically provided continue to be vital to trans-Pacific commerce. Many products of third-country provenance pass through Hong Kong on their way to many commercial centers including

¹⁶ United States Department of Treasury, *National Trade Estimate (NTE) Report*, 2005.

¹⁷ Hand-out, Government of the Hong Kong Special Administrative Region, Trade and Industry Department, July 2005.

Australia, China, Japan, South Korea, India, the Middle East, Europe, and the United States. While the Port of Hong Kong is not irreplaceable, with Singapore and Shanghai offering credible alternatives, the shipping lanes are vital for modern shipping logistics and safer than almost all of the alternatives in the area. On a related note, the Port of Hong Kong is also an important port of call for the U.S. Navy's Pacific Fleet, and other than EP-3 Aries aircraft,¹⁸ units requesting permission to operate in the area have generally been allowed to do so. These military assets play a crucial role in patrolling and securing the shipping lanes for commercial traffic.

International Financial, Business, and Trade Hub. Hong Kong holds the distinction of being one of Asia's premier international financial and business centers and the most strategic location for many regional headquarters in the Asia-Pacific region. Hong Kong is the seventh largest center for foreign exchange transactions with three-quarters of the world's top 100 banks having operations in the city.

Hong Kong's stock market is the second largest in Asia after Tokyo and is among the top ten stock exchanges in the world. In April 2004, over 863 companies with a market capitalization of US\$ 679 billion were listed on the Main Board. Hong Kong's Stock Exchange also serves as a entry point for foreign investors seeking to invest in China through Hong Kong partnerships or subsidiaries. Chinese firms have also joined the Main Board, expanding the list by 274 enterprises and adding extra depth and breadth in the securities markets. Hong Kong is also the leading fund management center in Asia, drawing in over US\$ 378 billion in assets (63% of this from overseas investors) and 93 fund management companies approved to manage fund investments.¹⁹ Other important trade and financial services include the robust insurance industry and two active gold markets whose customers include banks, major bullion houses, and gold trading companies.

After China, Hong Kong ranks as the second best performing host economy for foreign direct investment (FDI) in Asia.²⁰ In 2003, FDI amounted to US\$13.6 billion, the equivalent of 8.7 percent of GDP.²¹ Hong Kong still far outpaces Shanghai as a financial, business, and trade hub for foreign investors looking to do business in China due to Hong Kong's highly cosmopolitan character, its impressive transportation and telecommunications infrastructure, and its institutionalized rule of law. With economic forecasts pointing towards a modest rebound of growth rates

¹⁸ This may be due to Chinese sensitivities that arose with the Hainan-EP-3 incident that took place on April 1, 2001.

¹⁹ Hand-out, Government of the Hong Kong Special Administrative Region, Trade and Industry Department, July 2005.

²⁰ World Investment Report 2003, *United Nations Conference on Trade and Development (UNCTAD)*.

²¹ World Investment Report 2003, *United Nations Conference on Trade and Development (UNCTAD)*.

to around 4.6%, Hong Kong looks set to maintain and extend its dominance in serving as the entrepot-of-choice to China from the rest of the world.²²

Industry. Hong Kong enjoys a vibrant industrial sector that features a laissez-faire regulatory system and a dynamic export market. One of the world's leading exporters of textiles, clothing, toys, and timepieces, Hong Kong exports 80% of its manufactured goods to China, the United States, the United Kingdom, and Germany. Much of this success can be credited to the simple tax structure and low tax rates and a firm commitment to free trade and a free market economy. However, much of Hong Kong's manufacturing base has migrated to the nearby Pearl River Delta on the Mainland in search of cheaper inputs such as land and labor; Hong Kong has responded by emphasizing its service economy and it has identified the service industry as the main area for economic growth in the future. Economic planning in Hong Kong is practically non-existent. There is no state protection, state assistance, or subsidization of industry in Hong Kong beyond that of ensuring the necessary infrastructure is in place for an efficient, effective business environment.

Tourism. As Asia's most popular tourist destination, tourism is one of the main drivers of economic growth in Hong Kong. In 2002, over 16.5 million people, a 20% increase over the previous year, visited Hong Kong with over half coming from the Mainland. With Hong Kong Disneyland opening in August of 2005 many analysts expect the attraction to bring over 5 million people and 1.5 million new tourists to Hong Kong in its first year of operation. In addition to the new Disney theme park, there are plans to improve the tourism facilities in Hong Kong by upgrading many cultural, art, and entertainment areas in Kowloon, by promoting Lantau Island as a tourist destination, by renovating the historic and entertainment districts in Central, and by further developing Ocean Park's position as the focus of the new Aberdeen Harbour tourism node.

Hong Kong's film industry also serves as a bellwether of sorts for gauging the success of the tourist and cultural industries in the city. Hong Kong's long legacy of being a leader in Asia's film industry has also cemented its place in the global film circuit with films being shown at renowned film festivals such as Sundance and Cannes and at theaters globally. Hong Kong has developed tourist attractions that showcase actors, directors, and other film artists and bring hundreds of thousands of Mainlanders to Hong Kong to pay homage to their favorite film stars.

The Pearl River Delta. Twenty years ago, the Pearl River Delta (PRD) in Guangdong Province was mostly undeveloped agricultural land too far removed from any major industrial centers to develop much of an economy beyond subsistence farming and trade in animal husbandry goods and foodstuffs. Now it is one of the world's fastest growing economies and home to over 53,000 Hong Kong companies that employ over 10 million people in and around the PRD.

The Greater PRD Region is composed of 49 million people in over 14 Mainland cities and provinces, Hong Kong, and Macau. It serves as a leading trading hub, manufacturing base, consumer market, and a leading destination of foreign direct

²² Hong Kong Country Report, *Economist Intelligence Unit (EIU)*, June 2005.

investment in Asia. The PRD's combined GDP of US\$634 billion in 2003 places it in the top twenty economies in the world. It is comparable to the 10-member ASEAN group, and it is the most affluent region in China, with Hong Kong leading the way. Hong Kong provides essential financial, legal, and logistical services to complement the lower labor costs, cheaper property, and large manufacturing base on the Mainland. Hong Kong serves as a transportation hub for over US\$ 350 billion worth, or 80%, of the PRD's exports. It is a symbiotic economic relationship that many have labeled, "the Factory of the World".

Hong Kong and the PRD are constructing new transportation infrastructure, including a new bridge to Macau, to accommodate increased growth and are working together to enhance the five "flows" across their mutual boundary — labor, goods, capital, information, and services. Economic planners hope that the end result will be a vastly improved infrastructure and a more tightly integrated economy.

CEPA: Mainland-Hong Kong Free Trade Pact. On January 1st, 2004, a new free trade agreement went into effect between the Mainland and Hong Kong. This new agreement allowed tariff-free trade and early market access to Hong Kong's products, in some cases beyond that of the Mainland's WTO commitments. When combined with China's tariff concessions under the WTO, over 90% of goods of Hong Kong origin are granted tariff-free access. Over 18 service sectors and over a thousand different products now have preferential market access including key sectors such as banking, legal services, accounting, insurance, transport, management consulting, marketing, and tourism.²³

The CEPA has also led to agreements in the areas of customs inspection and clearance, electronic commerce, trade and investment promotion, and legal/regulatory transparency. This greatly enhances the role Hong Kong plays as an international business center while helping the Mainland develop a better regulatory framework, spur the implementation of transparent business laws, and discourage corruption.

Other Commercial Issues

Intellectual Property Rights (IPR). Hong Kong has a separate set of intellectual property rights (IPR) laws than China and has a very rigorous enforcement framework in place. Piracy and trademark counterfeiting, once a substantial problem, has largely been addressed by instituting stringent regulatory requirements and spot checks of merchandise by the government's Intellectual Property Department which handles the registration of patent, copyrights, and trademarks, and the Customs and Excise Department, which handles the enforcement of criminal prosecutions of such rights infringement. In fact, the United States has highly praised the IPR regime in Hong Kong and has pointed it out as a model of achievement in the area.²⁴ However, while most large-scale counterfeiting and pirating has been disrupted, small scale violations still occur, particularly in digital

²³ Closer Economic Partnership Agreement (CEPA), see [<http://www.tid.gov.hk/english/cepa/fulltext.html>].

²⁴ See United States Department of State, *U.S.-Hong Kong Policy Act Report for 2005*, April 2005.

entertainment. Another issue is the transnational IPR piracy transiting through Hong Kong from Chinese cities on the Mainland such as Shenzhen and Guangzhou

Export Control Policy Toward Hong Kong. The framework for U.S. licensing policy for dual-use exports to Hong Kong is the U.S.-Hong Kong Policy Act of 1992 and the Export Administration Regulations, Executive Order 12984. This legal framework allows the continuation of export of dual-use goods to Hong Kong as was practiced before Chinese sovereignty was established. U.S. policy is to continue the preferential treatment of Hong Kong for dual-use licensing contingent on continued cooperation from Hong Kong's Customs Authorities and successful spot checks by United States Department of Commerce personnel.

The United States continues to monitor trade to Hong Kong to protect restricted export technologies from being diverted or misused. Currently, there is no change foreseen to this regimen and the Department of Commerce, Bureau of Export Administration has certified Hong Kong as being in good standing under the applied regulations for 2005.



Source: Central Intelligence Agency, World Factbook 2005, Map of Hong Kong.