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## 1. DEVELOPMENTS IN THE APPLICATION OF THE “ONE COUNTRY, TWO SYSTEMS” PRINCIPLE

### – Re-affirmation of the principle

In his last report on the work of the government delivered at the opening session of the National People’s Congress in March 2003, the then Premier Zhu Rongji re-affirmed China’s adherence to the principle of “One country, two systems” in accordance with the Basic Law of the Hong Kong Special Administrative Region.

In a speech delivered on 29 June 2003 in Hong Kong, on the occasion of the signing of the Mainland/Hong Kong Closer Economic Partnership Arrangement (CEPA), new Premier Wen Jiabao said that China’s new leadership remained “unswervingly commit[ted] to the policies of “One country, two systems”, “Hong Kong people administering Hong Kong” and a high degree of autonomy and the Basic Law of Hong Kong” and that “these set policies of the Central Government towards Hong Kong [would] not change”.

### – Practical implementation

There were some new trends in the implementation of the “One country, two systems”, which is a dynamic and evolving process. The signing of the CEPA and the other measures taken by the Central Government to assist the Hong Kong Special Administrative Region economically, though taken on request of the Hong Kong business circles and authorities, represent a set of new instruments in Beijing’s strategy towards Hong Kong and an important step towards further economic integration.

With regard to the Central Government’s revitalisation of Hong Kong’s economy, it was made clear to Guangdong officials by Vice President Zeng Qinghong, the new appointee in charge of Hong Kong and Macao affairs, that the individual interests of different provinces and cities in the Mainland would have to give way to “China’s overall interests”, since the Central Government had decided that helping Hong Kong’s economic situation was a top priority.

The economic integration of Hong Kong into the Pearl River Delta had already been initiated by Hong Kong business people during the 1980’s. The further integration of Hong Kong SAR into the Pearl River Delta development strategy, now sponsored by the Central, Guangdong and HKSAR Governments represents a consolidation of the “One country” part of the equation. A wide consensus seems to have been reached in Hong Kong that the concept of “One country, two systems” would not be at odds with greater interaction between Hong Kong and the Mainland’s economy. On the other hand, the outbreak of SARS in Guangdong and then in Hong Kong, revealed some inadequacies in communication between the two systems of the neighbouring regions. After SARS, in early August 2003, the health authorities of Guangdong, Hong Kong and Macao reached an agreement on how to notify each other of any cases of infectious diseases.

The further integration and coordination between Guangdong province and Hong Kong SAR resulted in the setting up of a new framework cooperation mechanism. Guangdong and Hong Kong also agreed to upgrade the level of the meetings of the Joint Conference between the two parties. Starting from the Sixth Plenary of the Joint Conference, the meeting is to be chaired by the Guangdong Governor and the Chief Executive of Hong Kong SAR.

## 2. ARTICLE 23 OF THE BASIC LAW

The debate over the draft national security legislation for the enactment of Article 23 of the Basic Law dominated Hong Kong's political agenda for the first three quarters of 2003. After three months of intense public consultation during the last quarter of 2002, the government published the draft legislation on national security in mid-February. The draft bill contained many refinements compared to the initial proposals of September 2002 and a series of amendments already announced at the end of January. Those amendments were aimed at addressing several of the concerns raised by local and foreign communities during the consultation period. The main ones included:

- Abandoning the proposals to: i) create a new offence of possession of seditious publications, ii) give extra-territorial coverage to the offence of treason, and iii) make misprision of treason a statutory offence.
- Amending the offence of disclosure of protected information through “unauthorised access” by limiting it to access through criminal means.
- Re-defining: i) the provisions on proscription so that they would only apply to organisations “subordinate to” instead of “affiliated to” Mainland organisations, ii) the investigative powers of the police and the related judicial safeguards.
- Specific proclamation in the law that all the provisions in the Bill must be interpreted, applied and enforced in a manner consistent with international human rights conventions, and that all offences under Article 23 would be tried by a jury.

During the same period, the government also publicised a compendium of 18 volumes, which included the public's reactions to the proposals. The government stated that the analysis of the 97,000 submissions on the bill showed there was overwhelming public support for enacting the law. However, the opposition disputed the figures, accusing the government of mishandling and omitting several submissions. The government promised to correct the mistakes but the incident increased political tensions.

The amended draft legislation prompted a lukewarm response from the public, as time was needed to analyse its complex provisions. There were some positive comments from the business sector and a few academics. However, a majority of those associated with the democratic camp, notably the Bar Association, the Article 23 Concern Group and the Catholic Church, remained deeply sceptical about the necessity of the bill and its impact on the situation of rights in Hong Kong. Their main concerns were: the closed door hearings, the extension of police investigative powers, the “link” established between the legal system of Hong Kong with that of the Mainland through the proscription mechanism, the handling of the seditious publications offences and the lack of “public interest” defence.

The draft legislation was submitted to the Legislative Council for first reading on 26 February. A record number of fifty lawmakers joined the Bills Committee, which was charged with scrutinizing the draft legislation. During the legislative process, the government announced its intentions to see the Bill approved by the Legislative Council by 9 July at the latest. Legislators from the opposition parties reacted by using various parliamentary tactics to delay the proceedings. Several motions introduced by the opposition to launch a new public consultation period or to give the Bills Committee more time to examine the legislation were

voted down. During the SARS outbreak, there were several calls on the Government to defer the discussion of the Bill until the epidemic was over.

At the same time, both domestic and international actors continued to voice their concerns about the draft legislation. In a statement issued on April 15, the European Union, while acknowledging the steps already taken by the SAR government to address a number of aspects of the proposed legislation, highlighted the EU's remaining concerns about the Bill. Particular reference was made to the proscription mechanism and the broad definition of sedition. The statement also reiterated the EU's hope that Hong Kong would achieve the ultimate aim of universal suffrage, as laid down in the Basic Law.

Also in April, the European Parliament, in a unanimously approved resolution on the European Commission's third and fourth annual reports on the Hong Kong SAR, expressed its serious concerns with regard to several aspects of the proposed Article 23 legislation, particularly those relating to the proscription of organisations outlawed in Mainland China on national security grounds and the "totally inadequate appeal mechanism, which runs contrary to the spirit of Article 35 of the Basic Law". It also regretted the decision of the SAR Government to ignore the "legitimate and strongly supported" demands for the publication of a white bill on Article 23, to be followed by a second round of public consultation.

Meanwhile, the United Kingdom, the United States, Australia and Canada, as well as numerous international (Amnesty International, Human Rights Watch, Asian Human Rights Commission, etc) and local organizations (Hong Kong Bar Association, Hong Kong Christian Institute, Hong Kong Journalists Association, etc) issued statements and/or introduced submissions indicating similar concerns to those of the EU.

Against this background, the government decided in June to introduce some committee stage amendments to the Bill, as a response to mounting criticism. The main ones were: i) narrowing the definition of the sedition offence, ii) time limitation for prosecution for the sedition offence, iii) clarification of appeal venues for all cases of proscription of organisations on national security grounds, iv) strengthening of the human rights protection clauses through enlarged reference to chapter III of the Basic Law.

While technical in nature, the new amendments were generally welcomed, as they served to limit the scope of some of the highly sensitive issues. However, they still fell short of the fundamental changes critics argued were needed to safeguard rights and freedoms. Responding to the accusation that the legislation was being rushed through, the government insisted that it had been thoroughly scrutinised by the Bills Committee, with more than a hundred hours of debate, while allowing more than 100 individuals or non-governmental organisations to make representations in four special Legislative Council sessions.

As the 9 July deadline approached, criticisms and protests against the Bill continued to increase. The Hong Kong Government came under substantial international pressure in June to amend the controversial issues of the Bill, with some foreign governments issuing strongly worded statements. On 1 July, more than 500,000 people took to the streets of Hong Kong, in a mass demonstration, to protest primarily against the enactment of the legislation. The huge participation in the rally had a profound effect on Hong Kong's political life. In its first response, on 5 July, the SAR Government announced three major amendments on the most sensitive provisions of the draft legislation in an *in extremis* effort to save the Bill. These changes, long-claimed by the opposition, were: i) the suppression of the proscription mechanism of local organisations subordinated to a Mainland organisation, ii) the

introduction of the notion of “public interest” defence in order to protect press freedom, iii) the removal of proposed emergency police investigation powers without a court warrant.

Despite these important amendments, in the face of mounting public discontent, the government decided to postpone the 2<sup>nd</sup> reading of the draft national security legislation and announce that it would conduct a fresh round of public consultation in late September. The move came after the Chairman of the Liberal Party, James Tien, resigned from the Executive Council on 7 July, after his call to further delay the Bill was rejected by the government. This resulted in the government losing the majority necessary to pass the bill in the Legislative Council. Meanwhile, another two big demonstrations against the bill went ahead in July, despite the postponement decision. As a result, Secretary for Security Regina Ip, who was responsible for the smooth introduction of the national security Bill, submitted her resignation on 25 June, which was accepted by the Chief Executive on 16 July.

The EU reacted to the events of July by issuing two statements. In the first, on 7 July, just before the SAR Government announced the three major amendments to the Bill, the European Union regretted that the elements relating to the proscription of local organisations remained fundamentally unchanged. It also warned that these proposals, if implemented, would blur the line between the Hong Kong and Mainland legal systems and could undermine Hong Kong’s autonomy. In its second statement on 16 July, the EU welcomed the latest three amendments to the Bill and the postponement of the legislative proceedings. It reiterated the EU’s hope that Hong Kong would achieve the aim of universal suffrage and expressed satisfaction on the launching of a new public consultation in order to allow more time for calm debate in Hong Kong over the proposed legislation.

The 1 July demonstration, for which Article 23 was a catalyst, changed almost every aspect of the government’s efforts to pass the national security law, including any imposition of a deadline. The newly appointed Secretary for Security, Ambrose Lee, adopted a more flexible and low profile approach than his predecessor. He started a series of consultations with the political parties in Hong Kong, notably the DAB, the Democratic Party and the Liberal Party. During these consultations, a very significant shift of position of the main pro-Beijing force in Hong Kong emerged. The DAB, a staunch supporter of the rapid enactment of the security laws, proposed the postponement of the legislative process on Article 23 until the next Legislative Council elections, in September 2004. Its leadership claimed that it was necessary to give sufficient time for the community to better understand the proposed legislation. However, this change of position reflected the important shift in popularity between the main political parties following the July protests, a trend later confirmed by the outcome of the District elections (see below under chapter 6).

On 5 September, Hong Kong’s Chief Executive, Tung Chee-Hwa, announced that he was withdrawing the draft national security legislation on the grounds of lingering doubts and concerns among Hong Kong residents that the legislation would curb their civil liberties. He underlined that it was instead crucial for the government and the community to concentrate their efforts on revitalising the economy. In parallel, he announced that a special working group would be established to review the legislative work and that there was no pre-determined timetable for further work in this area.

The withdrawal of the security legislation was the last in a series of concessions that the Chief Executive had made since the protest of 1 July. Politicians, social and professional groups, academics and legal experts, and the international community welcomed, in general terms, this important decision of the government. Its impact on Hong Kong’s political scene was far-

reaching. As of 31 December 2003, there was no indication from the SAR Government as to when a new consultation document on Article 23 would be introduced. It is worthwhile mentioning that the Central Government did not issue any official statement on Article 23 during the year 2003. The European Union followed with particular attention the development of Article 23, issuing four statements from December 2002 to July 2003. The European Commission will continue to monitor this important issue very closely.

### **3. DYNAMISM OF CIVIL SOCIETY IN HONG KONG**

Hong Kong's civil society has shown a renewed dynamism in the year 2003. In addition to the groups created in 2002 (Civil Human Rights Front, Democratic Development Network, Power For Democracy) several new ones were established during this year (Article 23 Concern Group, Article 45 Concern Group, the Project Democracy, 71 People Pile, Secondary Student's Union, etc.).

These diverse groups and movements played a leading role in the calls for more democracy, review of the constitutional system and the organisation of many important demonstrations against the government in the political or environmental fields. They actively contributed to promoting the awareness of Hong Kong citizens on diverse political and social issues. The high turnout for the 1 July rally was triggered by the feeling among many Hong Kong people that the draft national security legislation might curb their freedom and civil liberties. The protest was also made against the background of high unemployment, the perceived mishandling of the SARS outbreak, a sagging property market with an increased number of property owners having negative assets and a series of incidents involving the Government (see below under chapter 5).

The 1 July rally was called and organised by the Civil Human Rights Front, a coalition of more than 40 political, religious and social groups, established in September 2002. The aim of the group was to arouse public concerns about Article 23 and pursue the human rights issues.

The rally marked an important milestone in the development of civil society actions in Hong Kong. It also marked a turning point in the process of democratisation and political reform in the SAR.

Two other rallies followed: about 50,000 people took part in a night vigil on 9 July to protest against the initially scheduled final reading of the draft national security bill (the Government, in the meantime, had decided to postpone the legislative process). The third rally took place on 13 July, calling for universal suffrage for the election of the Chief Executive and of all members of the Legislative Council. The rally was organised by the Democratic Development Network. The Network was established in July 2002 by Reverend Yiuming Chu and Father Louis Ha and represents more than 30 social and political groups calling on the Government to establish public consultation on electoral reforms and universal suffrage for the election of the Chief Executive and all members of the Legislative Council.

It is noteworthy that all three July rallies took place in a peaceful manner despite the long waiting and marching hours in the heat. They illustrated the civic sense and political maturity of the Hong Kong people. The rallies also showed that Hong Kong people cherish the freedoms and rights they continue to enjoy after the handover. From this point of view, it is worth noting that a group (with the rather provocative title) "Anti Tung Solidarity" was

registered as a society under the Societies Ordinance, despite some delay in the registration process.

Civil society in Hong Kong is interested not only in political rights and the democratisation process. Some non-governmental organisations are active in particular in the field of environmental protection in Hong Kong. This is the case of the Society for the Protection of the Harbour, which aims to limit land reclamation with regard to the Wanchai Development Phase II.

#### **4. THE IMPLEMENTATION OF THE ACCOUNTABILITY SYSTEM**

The accountability system introduced on 1 July 2002 with the second term of the Chief Executive was further put to the test during the year 2003. On the eve of the first anniversary of the implementation of the accountability system, many people from academic, media and political circles commented on the implementation of the system in rather critical terms, including the then Chairman of DAB and the Chairman of the Liberal Party who were both members of the Executive Council.

On 18 July, the Secretary for Constitutional Affairs released the “Twelve month” Report on the implementation of the accountability system for Principal Officials. This report underlined the progress made in terms of improving the Government’s accountability, the political neutrality of the civil service, and the cooperation between the Executive and the Legislature. It was then discussed by the Legislative Council Panel on Constitutional Affairs on 21 July. In general, the legislators, including leaders of pro-Government parties, were dissatisfied with the performance of the system and disagreed with the assessment of the report. The report itself also underlined that “as a new system of governance, the accountability system is still evolving and will continue to undergo change” and that there was room for improvements to be made, notably in greater efforts to communicate with the public and the Legislative Council, in order to better take account of public opinion. This report seemed to indicate that the Government was aware of the shortcomings which led to a series of incidents and the demonstration of 1<sup>st</sup> July.

These incidents include: the handling of the outbreak of SARS by the Government, the draft legislation on national security (Article 23 of the Basic Law), the failure of the Harbour Fest, a government-supported event aimed at re-launching Hong Kong after SARS, the resignation of the Equal Opportunities Commission Chairman and the unpopular Harbour reclamation plan. On each occasion, some legislators in the opposition together with sectors of public opinion called for the resignation of the respective Principal Official. It is true that the introduction of the accountability system has made Hong Kong people even more demanding than in the past vis-à-vis each member of the Government.

The Government has acknowledged that the accountability system is designed to subject the Principal Officials to the scrutiny of the Legislative Council, the media and the public. The turn of events in July, which culminated in the Chief Executive’s acceptance of the resignation of two members of the Government, (the Secretary for Security, Mrs Regina Ip and the Financial Secretary, Mr Antony Leung, who had already offered his resignation in March when it was not accepted by the Chief Executive), demonstrated the force of the media and public scrutiny. However, the Secretary for Constitutional Affairs refused to state whether these two resignations were given on accountability grounds.



## **5. DISTRICT COUNCIL ELECTIONS**

The district council elections on 23 November attracted a record turnout of 1,066,373 voters, or 44.1% of all eligible voters, significantly higher than the 35.82% achieved in the 1999 polls. A total of 326 contested seats were available in 18 districts. An additional 102 seats were directly appointed by the Chief Executive on 28 December, despite rising calls from the pro-democracy camp for the Chief Executive to abolish the appointment system which is seen as overly biased in favour of the administration.

The pro-democracy camp, embracing the Democratic Party, the Association for Democracy and People's Livelihood, The Frontier, Chan Wai Yip's Alliance, Power for Democracy, Neighbourhood and Workers Service Centre and the Confederation of Trade Unions took up 145 seats, while the pro-government forces (Democratic Alliance for the Betterment of Hong Kong, Hong Kong Progressive Alliance and the Civic Force) won a total of 99 seats. The Democratic Party claimed an overwhelming victory, successfully securing 95 of the 120 seats it contested, a success rate of 79.2%. While the Liberal Party retained its forces, winning 14 of 25 contested seats, the pro-government DAB suffered a heavy defeat. Only 30% of the 206 candidates fielded by the DAB won, compared to a 47% success rate in the previous district elections. The DAB Party Chairman Tsang Yok-sing resigned on 24 November over what he described as "the worst defeat" the party has suffered since it was founded in 1992. He was replaced by the party's Secretary General, Ma Lik, in December.

Political analysts had widely seen the district council elections as a litmus test for the 2004 Legislative Council polls. The significant turnout was an important step in the territory's democratic development. The extent of the pro-democracy camp's victory reflects the impact that the massive July demonstrations had on Hong Kong society and the people's growing dissatisfaction with the SAR government's performance.

## **6. TOWARDS CONSULTATION ON THE REFORM OF THE HONG KONG POLITICAL SYSTEM**

The aspiration of Hong Kong citizens for further participation in public and political life has come to the forefront in the debate on the evolution of Hong Kong SAR's political system. Ordinary citizens, political parties and groups, the Legislative Council, the SAR Government and Central Government have all taken a position on this important topic.

Hong Kong citizens' desire for the improvement of governance and reform of the political system was shown both by their active participation in many rallies for democratisation and by the high turn out in the November district elections. The main slogans of the July rallies were in favour of more democracy through universal suffrage for the election of the Chief Executive in 2007 and all members of the Legislative Council in 2008.

Articles 45 and 68 of the Basic Law explicitly foresee the "ultimate aim" of the election of the Chief Executive and all 60 members of the Legislative Council by universal suffrage. This aim is shared by most, if not all, political parties and groups in Hong Kong. They differ, however, on the timing and the modalities of the political reform before reaching the "ultimate aim" set by the Basic Law. The Democratic Party and allied parties and groups have urged for an early consultation process on political reform so that all the necessary measures would be ready for the election of the third Chief Executive by universal suffrage in 2007. The Democratic Alliance for the Betterment of Hong Kong (DAB) also took a clearer position

by supporting this aim after the November District elections. On the contrary, in June the Liberal Party amended its 1993 founding manifesto that was in favour of the election of the Chief Executive in 2007 and of all legislators in 2008 through universal suffrage for a more gradual and orderly development of the political system. After 1<sup>st</sup> July the founding Chairman of the Liberal Party, Mr Allan Lee urged his former party to return to its initial position.

In the Legislative Council, a motion urging the Administration to conduct a public consultation as soon as possible on constitutional reforms was rejected on 20 February 2003. The Legislative Council also held debate motions (respectively on 21 May and 12 November) on the election of the Chief Executive and all members of the Legislative Council by universal suffrage. Although both motions were rejected, it is worth noting that according to a DAB legislator, her party only voted against the 12 November motion on the grounds that the motion urged the abolition of the appointed and ex-officio seats in District Councils as well.

During the debate on the February motion, the Secretary for Constitutional Affairs, Mr Stephen Lam declared “in 2003, we will concentrate on preparing for the review. We have already commenced our internal research on issues, including the procedural steps of the review and the public consultation as well as the time required for the entire process”.

In his speech delivered at the National Day Reception on 1<sup>st</sup> October, the Chief Executive, Mr Tung Chee-Hwa clearly indicated that the SAR Government is aware that the people of Hong Kong expect it to “improve standards of governance and promote democratic advancement according to the Basic Law”.

During a meeting held on 13 October with members of the Hong Kong Democratic Development Network, the Secretary for Constitutional Affairs said that the Government would do its best to make a decision before the end of the year on the content and timetable for the public consultation. After a meeting on 20 October with the Constitutional Affairs Committee of the Legislative Council, the Secretary for Constitutional Affairs gave further details by stating that the Administration would:

- begin public consultations on constitutional developments in 2004 and start listening and gathering views;
- if necessary, deal with the procedures stipulated in the relevant Annexes of the Basic Law in 2005; and
- if necessary, enact any Hong Kong legislation that would prove necessary for democratic development in 2006.

Furthermore, Mr Lam stated on 12 November that, “if there is a need, amendment to the method for selecting the third term Chief Executive may be considered”, provided of course the Chief Executive and the Central Government approve the development according to the provisions laid down by the Basic Law.

However, in an interview given on 8 October, Chinese Premier Wen Jiabao said that Hong Kong needed “gradual development of democracy” to safeguard the rights and freedoms it enjoyed under the Basic Law. President Hu Jintao confirmed this view on 3 December during the visit of the Chief Executive for consultations with the Central Government. President Hu said, “The Central Government is highly concerned with Hong Kong’s political development. Our position on the principle is clear, Hong Kong Special Administrative Region’s political

system should develop gradually and orderly in accordance with the Basic Law and the political situation in Hong Kong”. He expressed confidence that the Hong Kong Community “will reach a broad-based consensus on the issue”. The next day, four Mainland legal experts (three of whom were former members of the Committee involved in drafting the Basic Law) made it clear in an interview with the official Chinese News Agency that the manner in which the Chief Executive and legislators of Hong Kong are elected is not the exclusive preserve of the Hong Kong SAR and a domestic matter to be decided by Hong Kong people alone”. They considered that “the Central Government has important interests in the development of Hong Kong’s political system”. The main legal and political arguments put forward by the four Mainland legal experts were:

- “One country” is the premise of “One country, two systems” and must be firmly upheld and safeguarded;
- appropriate handling of political reform would be conducive to maintaining Beijing-Hong Kong relations.

The Chief Executive confirmed that the views expressed by the four Mainland legal experts did reflect the Central Government’s role and its concerns.

The views of the four Mainland legal experts triggered legal and political debates in Hong Kong on the role of the Central Government in the SAR’s political reform process. The Secretary for Constitutional Affairs said on 12 December that the Central Authorities had a constitutional role to play in matters related to the constitutional development of the Hong Kong SAR. He said, “under the ‘One country, two systems’ principle, the Basic Law has authorised the Hong Kong SAR to exercise a high degree of autonomy but not complete self-rule”.

On 15 December, Mr Lam announced that the timetable for consultation on political reform would only be published in January 2004 instead of at the end of year 2003 as initially planned.

## **7. NEW STEPS TOWARDS LEGISLATION ON RACIAL DISCRIMINATION**

In its previous report on Hong Kong for the year 2002, the European Commission had pointed out the first steps taken by the HKSAR government towards legislation on racial discrimination. The Hong Kong Coalition for Racial Equality, formed by groups representing the interests of ethnic minorities and new arrivals, again urged the SAR Government to speedily enact legislation against racial discrimination. The Legislative Council adopted a motion in favour of such legislation in March. The Secretary for Home Affairs, Dr Patrick Ho, announced on 19 June that the Chief Executive agreed in principle to the need for legislation against racial discrimination and that a draft legislative proposal should be published for public consultation.

According to Dr Ho, the proposed legislation would re-affirm the HKSAR Government’s commitment to human rights and enable Hong Kong to meet its obligations under the International Convention on the Elimination of all Forms of Racial Discrimination. The Government plans to introduce a Bill on racial discrimination in the Legislative Council in the 2004-2005 session.

In the meantime, a new political party, “The Rights Party”, was set up with an agenda of defending ethnic minorities’ rights. Three members of that party, of Pakistani origin, stood in the district council elections to raise awareness of issues affecting ethnic minorities.

## **8. SARS (SEVERE ACUTE RESPIRATORY SYNDROME)**

In February, Hong Kong became the epicentre of the outbreak of SARS, a new form of a contagious atypical pneumonia. It was the territory’s worst epidemic in decades. It originated from the Guangdong province in Mainland China, was transmitted to Hong Kong by an “index patient” and then spread into the wider community. The disease, which infected 1755 people and claimed 299 lives, caused serious damage to Hong Kong’s social fabric and inflicted great economic losses, which are analysed in the economic section of this report. It also unveiled several shortcomings in Hong Kong’s public healthcare system, and highlighted information and communication problems between Hong Kong and Mainland China.

The Government’s first reaction to the outbreak was relatively slow but the disease was previously unknown and the notification system between Guangdong and Hong Kong was deficient. Having regard to these problems, Hong Kong handled the crisis rather well. Within three and a half weeks of the “index case”, the Government adopted a host of drastic measures to prevent the further spreading of the virus, which included: quarantine for persons who had been in contact with SARS patients and aggressive contact tracing; schools suspension; publication of information on buildings where residents had developed or were suspected of having developed SARS; mandatory health declarations upon arrival in Hong Kong and temperature checks for all arriving, departing and transit passengers at Hong Kong airport, and all ports and boundary areas. The last two measures remained in place on 31 December 2003. In parallel, Hong Kong and the Central Government authorities undertook to establish an enhanced co-operation and communication mechanism on infectious diseases. In addition to these measures, Hong Kong authorities played a leading role in their research efforts in an attempt to find an appropriate SARS treatment and vaccine and study the corona virus DNA and its mutations.

The WHO decided to lift the travel ban on the territory on 23 May, after the SARS new cases remained in single digits for 20 consecutive days. It praised the measures taken in Hong Kong to stem the spread of SARS and commended Hong Kong officials on the level of transparency shown when reporting the SARS situation in the territory.

Confronted with their worst economic and social crisis in recent years, the citizens of Hong Kong, with doctors and nurses in the frontline, coped with the disease with resilience, dedication, determination and decency, despite the obvious fear and anxiety triggered by the unfamiliar disease. In order to emphasize hygiene rules and prevention of infectious diseases, the Government created a task force named “Team Clean” under the direction of the Chief Secretary in order to build a cleaner and healthier living environment for the citizens of Hong Kong, with some tangible results already visible.

In October, two reports on SARS (one from a multinational SARS Expert Committee, commissioned by Hong Kong’s Chief Executive and the second from the Hong Kong Hospital Authority) sparked controversy in the territory on the way Hong Kong authorities had handled the epidemic. Although the reports revealed significant weaknesses in the system, especially during the early stages of the spread of the disease, such as lack of clear leadership, co-ordination and communication among responsible departments, inadequate

hospital provisions, as well as the insufficient capability of the public healthcare system to cope with emergencies or major disease outbreaks, both reports stopped short of singling out any individual official or department for overall blame. Additionally, both reports gave detailed recommendations for curing those inadequacies and establishing a modern and efficient infectious diseases prevention system in Hong Kong. Meanwhile, the Government decided to set up a HK\$155 million trust fund for the SARS affected families.

The failure to make any official accountable prompted public dissatisfaction and raised questions on the effectiveness of the accountability system. Against this background, the Legislative Council unanimously endorsed a motion to set up an eleven-member select committee to inquire into the way the SARS outbreak had been dealt with. The Committee, under the chairmanship of the Democratic Party's legislator Law Chi-kwong, is due to submit its final report in July 2004.

## 9. THE ECONOMY

2003 was a year of ups and downs for Hong Kong's economy, with the outbreak of SARS causing serious damage to growth and to the morale of both business and consumers, before a return of optimism at the end of the year. The July demonstrations precipitated policy decisions that would foster faster and deeper economic integration between Hong Kong and Mainland China. This series of support measures by the Central Government of the PRC contributed to improving confidence in the territory's economy, which quickly rebounded in the last quarter of the year. Domestic demand was strengthened, boosting confidence. This, together with a strong trading sector, led to a respectable GDP growth of 3.3% for 2003.

The economy performed fairly well in the beginning of the year 2003, building on the growth momentum of the export sector since the second half of 2002. However, the outbreak of SARS in March interrupted the growth trend. Tourism related sectors suffered heavily. At the worst point, tourist arrivals plunged by 70%; hotel occupancy rates fell to single digits; the unemployment rate peaked at a post-1997 record, and the deflationary pressure intensified further during that period. While exports of goods were unaffected, the gloomy sentiment pervaded nearly every sector of the economy.

Political difficulties also added to the depressed climate, especially after the 1 July demonstration. Knowing that a quick economic recovery would help ease mounting political and social discontent, the Hong Kong Government requested favourable treatment from Mainland China. In the event, the Central Government approved some important measures that helped revitalise the economy of Hong Kong. The measures included:

### – The Closer Economic Partnership Arrangement (CEPA)

A free trade arrangement between Mainland China and Hong Kong was signed on 29 June followed by six detailed annexes on 29 September. CEPA provides liberalisation measures in goods and services trade, and the framework for trade and investment facilitation between the Mainland and Hong Kong. Under CEPA, 273 Hong Kong products or about 60% in value of Hong Kong's domestic exports will benefit from zero tariffs as from 1 January 2004. For trade in services, 18 sectors are offered earlier or easier access to the Mainland market, ahead of China's WTO timetable. In some sectors, such as construction and real estate services, logistics services, transport services, distribution services, legal services, and audio-visual services, the concessions extend beyond China's WTO commitments. The criteria for

qualifying as a Hong Kong company to benefit from CEPA have been formulated on the notion of “substantive business operation” based in Hong Kong for most sectors. The WTO was notified of CEPA on 27 December 2003.

– Relaxation of travel restrictions for individual visitors from Mainland China

The Central Government agreed to relax restrictions to facilitate Mainland residents visiting Hong Kong, increasing in parallel their spending limit in the territory. Starting from July 2003, residents of selected Guangdong cities (and subsequently the whole of Guangdong province by 2004), Shanghai and Beijing are no longer required to join group tours when visiting Hong Kong, and can travel in their personal capacity.

– The Hong Kong- Zhuhai-Macao Bridge

First launched more than 10 years ago by the private sector, the bridge proposal was studied by the SAR Government with renewed interest. The Central Government subsequently agreed on 4 August that the governments of Guangdong, Hong Kong and Macao should set up a Hong Kong-Zhuhai-Macao Bridge Advance Work Co-ordination Group with Hong Kong as the convenor and press ahead with the advance work for the construction of the bridge.

– Renminbi banking services

A memorandum of understanding on renminbi (RMB) banking services was signed on 18 November between the Hong Kong Monetary Authority and the People's Bank of China (PBOC). Following approval from the Central Government, the PBOC has agreed to provide clearing arrangements for banks in Hong Kong to conduct RMB personal business on a trial basis starting from January 2004. The scope of RMB business is confined to transactions that facilitate personal spending but do not involve investment and other capital account transactions.

Following the relaxation of restrictions on individual travellers, there was a marked rebound in the retail and tourism related sectors in the latter half of the year. Visitor arrivals from Mainland China increased sharply (+24.1%, amounting to a total of 8.4 million visitors), in spite of an overall drop in visitor arrivals from the rest of the world (15.5 million visitors, a 6.2% decrease compared with 2002). Average spending in Hong Kong of Mainland visitors reached 5639 HK\$ (€ 587), surpassing spending of American and Japanese tourists.

Merchandise exports performed favourably on the back of improving global trading outlook and under a weak US dollar environment. According to Hong Kong trade statistics, total exports of goods rose by 11.7% to HK\$ 1,742.4 billion in 2003 (€ 181.5 billion), of which re-exports increased by 13.4% and domestic exports dropped by 7.1%, as production continued to contract in Hong Kong. Total imports grew by 11.5% to HK\$ 1,805.8 billion (€ 188.1 billion) in the same period. The territory ran a trade deficit of HK\$ 63.3 billion in 2003 (€ 6.6 billion).

The asset markets picked up very quickly towards the end of the year, as businesses and consumers regained confidence in the economic prospect of Hong Kong. CEPA and the influx of Mainland visitors boosted confidence. Property prices and the transaction volume trended upwards, after six years of slump. The equity markets recorded strong results with active listing and capital raising activities. The Hang Seng Index reached a two-and-a-half year high

during the year and total average daily turnover recorded a year-on-year growth of 59% in 2003.

It is also noted that the deflationary cycle that started in late 1998 tapered off along with the recovery towards the end of the year. The Composite Consumer Price Index slid to -4% in July and rose steadily back to -1.9% by December. For the year as a whole, the CCPI fell only by an average of 2.6% (after a 3% decline from 2001 to 2002). Meanwhile, the unemployment rate remained at high levels throughout the year. It peaked at 8.7% during the SARS period and fell back to 7.3% by the end of the year.

Despite the improving outlook of the economy, the record fiscal deficit remained a key concern. The SAR Government has now recorded fiscal deficits in three consecutive years, contrary to its tradition of running a balanced or small budget deficit in the past. The fiscal deficit for 2003-04 is estimated to reach HK\$49 billion or about 4% of its GDP, and the deficit problem will remain for some years. Fiscal reserves are estimated to be HK\$ 266.4 billion at the end of the financial year of 2003-04, compared to HK\$ 311.4 billion at the end of 2002-03.

The former Financial Secretary, Mr Antony Leung, formulated a series of measures with the goal of balancing the budget by 2006-07. Major measures included raising salaries tax rates and profits tax rate, introduction of some new taxes, and a plan to sell government assets. On the spending side, the salary of civil servants will be reduced by 6% in two phases over 2004-05 and 2005-06.

The new Financial Secretary, Mr Henry Tang, however, has delayed the target of fiscal balance by two years to 2008-09, acknowledging that under the current economic environment, it was practically impossible to balance the books by 2006-07. Furthermore, the Boundary Facilities Improvement tax proposal was shelved. He expressed that the government would explore other financing options, including issuing government bonds to finance infrastructure projects and possibly the introduction of sales tax in due course.

Hong Kong remains one of the most important cities in Southern China and its leading position in the Pearl River Delta is unchallenged. CEPA should provide more business opportunities and stimulate market sentiment. However, the initial response of business community to CEPA has been cautious and its impact on the economy has yet to be fully seen.

## **10. TRADE ISSUES**

In accordance with the Basic Law, the Hong Kong SAR conducts its own trade policy for which it has full competence as a separate customs territory. Hong Kong is a founding member of WTO and a number of other international organisations. As a token of their commitment to the WTO system, free trade and multilateral rule-making, the EU and Hong Kong should remain strongly committed to achieving progress in the ongoing trade round. Hong Kong has offered to host the Sixth WTO Ministerial Conference. The EU has supported Hong Kong's bid and will continue to work together with Hong Kong to ensure further progress in these negotiations covering all substantial issues of the Doha Development Agenda (DDA). The European Commission hopes that both sides will continue to work constructively for ambitious results and the successful conclusion of this round with a view to further liberalised trade and to develop and strengthen the rules-based system under the WTO.

The Closer Economic Partnership Arrangement with Mainland China represented a significant change in Hong Kong's trade policy, which had previously maintained that free trade areas and regional trade agreements could detract from multilateral progress. The shift was earlier seen in Hong Kong's exploratory talks with New Zealand concerning the possible establishment of a Free Trade Agreement a few years ago. The European Commission will closely monitor how CEPA is implemented, notably with regard to compliance with WTO rules. It will in particular be concerned to ensure that EU companies established in Hong Kong are not in any way disadvantaged.

Hong Kong is a signatory to the Government Procurement Agreement under WTO. In 2003, a dispute on tendering procedure concerning Victoria Harbour Reclamation Plan arose. Observing the GPA bid challenge system, the Hong Kong Government set up an independent review body to handle the contractors' complaint. The review body subsequently found that the government had treated one of the bidders unfairly and recommended that the contract be re-tendered.

The Commission welcomes the efforts of the Hong Kong authorities in putting stringent anti-piracy legislation in place and the vigorous enforcement actions of the Hong Kong Customs. However, the EU industry continues to express concern about the presence of pirated and counterfeit goods, mainly as concerns the activities of "street hawkers". Greater involvement of the Police in the enforcement of intellectual property rights would help in combating such infringements more effectively. In addition, because of its proximity to some areas of active production of counterfeit and pirated goods, Hong Kong remains vulnerable as a transshipment hub for the distribution of such goods to the rest of the world. EU statistics on counterfeit goods indicate that Hong Kong still accounted for 5% of the counterfeit goods seized at the EU borders in the first half of 2003 (Mainland China 15%). The Commission urges the Hong Kong authorities to keep policing the situation and step up efforts with the Mainland authorities concerned in tackling cross-boundary IPR issues.

The passage of a mergers and acquisitions law, that is the Telecommunications (Amendment) Ordinance 2003, is welcomed by the Commission. This law safeguards fair competition in the telecommunications market and provides a clear regulatory framework for mergers and acquisitions activities for the telecommunications industry. However, the Commission remains concerned about the absence of general competition legislation in Hong Kong. It believes that such legislation would ensure a level playing field for all businesses and further safeguard a competitive environment, also in the light of continuing reports on the part of EU business and industry regarding anti-competitive practices in Hong Kong.

The Commission is concerned with the exceptionally high excise duty on wine (80%) in Hong Kong and conducted a demarche, together with certain wine exporting countries, to the Financial Secretary in 2003. The Commission fully understands the urgency and necessity to raise tax revenue in view of the deficit problem, but remains reserved on the net gain the wine duty would have on trade and the economy as a whole.

## **11. EU - HONG KONG RELATIONS**

The EU is well represented in various sectors of the Hong Kong economy. In terms of foreign investment, the EU was the third largest source of external direct investment for Hong Kong in 2002 after British Virgin Islands and Mainland China. The cumulative value of direct



investment from the EU in that year amounted to HK\$ 304 billion (41.2 billion euro), accounting for 11.6% of the investment total, well ahead of the US (7.1%) and Japan (5.4%).

The EU was Hong Kong's third largest supplier in 2003 after Mainland China and Japan, and was the third biggest market for Hong Kong's exports, after Mainland China and the US. According to Eurostat, total bilateral trade between the EU and Hong Kong reached € 27.3 billion (imports from Hong Kong to the EU: € 9.34 billion; exports to Hong Kong from the EU: € 17.96 billion), a slight decrease from 2002 (€ 29.6 billion).

EU companies are an important group of market players in the financial services of Hong Kong. There were 111 foreign licensed banks in Hong Kong of which 35 were incorporated in the EU in 2003. In addition, a total of 70 EU companies were engaged in securities and commodities trading business in 2003. In the insurance sector, the EU ranked first in the number of overseas insurers operating in Hong Kong in 2003. Of the 188 insurance companies authorised in Hong Kong, 33 were incorporated in the EU.

EU companies that based their regional headquarters and regional offices in Hong Kong amounted to 284 and 641 respectively in 2003. There were 39,158 EU nationals residing in Hong Kong at the end of 2003.

Ten EU Member states have signed investment Promotion and Protection agreements with Hong Kong. They are Austria, Belgium, Denmark, France, Germany, Italy, Luxembourg, the Netherlands, Sweden and the UK.

A meeting took place in Brussels on 25 June between the Secretary for the Civil Service of the Hong Kong SAR, Mr Joseph Wong and the Vice-President of the European Commission responsible, *inter alia*, for Administrative Reform, Mr Neil Kinnock. Messrs Kinnock and Wong exchanged views on reforms in the Hong Kong Civil Service and at the Commission and discussed possible cooperation between Commission and Hong Kong SAR Government civil services and agreed to conduct further exploratory talks at working level.

On 17 December 2003, the Council of the European Union approved the EC-Hong Kong readmission agreement, which entered into force on 1 March 2004.

## **12. CONCLUSION**

The year 2003 was particularly eventful in Hong Kong. Both the Government and Hong Kong people were put to the test by SARS and its disruptive consequences on the social fabric and the economy, and a governance crisis. In this difficult period as well as during the rallies calling for democratisation and the reform of Hong Kong's political system the people of Hong Kong have shown their calm and civic sense, their discipline and political maturity. These qualities shown by Hong Kong people prove to a large extent that they are ready to participate fully in a democratic political system.

The European Commission takes note of the signing of the "Closer Economic Partnership Arrangement" (CEPA) between Mainland China and Hong Kong SAR. It recalls that the implementation of the Arrangement should be WTO-compatible and not discriminate against other WTO members. The European Commission is pleased to see that Hong Kong's economic restructuring started to produce positive effects and that Hong Kong's economic

situation improved steadily during the last quarter of 2003. This bodes well for further improvement in 2004, which will probably see the end of the long lasting deflation.