

SECTION 3: HONG KONG

“... the United States-China Economic and Security Review Commission ... shall investigate and report exclusively on—

...

“REGIONAL ECONOMIC AND SECURITY IMPACTS—The triangular economic and security relationship among the United States, Taipei and the People’s Republic of China (including the military modernization and force deployments of the People’s Republic of China aimed at Taipei), the national budget of the People’s Republic of China, and the fiscal strength of the People’s Republic of China in relation to internal instability in the People’s Republic of China and the likelihood of the externalization of problems arising from such internal instability. ...”

Introduction

The Chinese central government in Beijing has continued to expand its influence over the government and economy of Hong Kong, despite formal denials of interference from Beijing and explicit safeguards in the 1984 Sino-British Joint Declaration setting the terms of the handover of Hong Kong from British to Chinese control.*

Beijing has moved decisively in several areas to exert increased influence over the Hong Kong Special Administrative Region’s (SAR) government. Beijing has been strengthening its official liaison office in Hong Kong, the Central Government Liaison Office, even to the point of attempting to influence day-to-day affairs in Hong Kong. The central government in Beijing took an active role in limiting demonstrations in Hong Kong to mark the 20th anniversary of the Tiananmen Square massacre. The global financial crisis and Beijing’s response have allowed the central government increased leverage over Hong Kong’s much smaller economy, which is dependent on financial and trade ties to the mainland.

Beijing’s Growing Political Influence over Hong Kong

A frequent theme during the Commission’s May 2009 meetings in Hong Kong was the concern expressed by some residents and of-

*In 1992, Congress passed the United States-Hong Kong Policy Act, in which the United States agreed to treat Hong Kong as an entity separate from mainland China as long as its political, economic, and trade systems remain autonomous. The act required the secretary of State to submit an annual report to Congress on the conditions of Hong Kong through the year 2000, and it was amended to extend the reporting requirement through 2006. Since 2007, no reporting requirement has been reestablished. *United States-Hong Kong Policy Act*, 102nd Cong., 2nd sess., 1992, Pub. L. 102-383, 106 Stat. 1448. http://hongkong.usconsulate.gov/ushk_pa_1992.html.

ficials that the government in Beijing has been deliberately and steadily encroaching upon the autonomy of Hong Kong's government. In particular, meeting participants said that the Chinese central government has been strengthening the Central Government Liaison Office in order to increase Beijing's oversight over the Hong Kong government. A 2008 article in a newspaper affiliated with the Chinese Communist Party's (CCP) Central Party School was frequently cited. This article stated that Beijing has the right to exert its influence over the Hong Kong SAR government in certain key areas.²¹⁴ This line of reasoning appears to contravene article 22 of Hong Kong's Basic Law, as explained later in this section.

Prodemocracy Hong Kong Legislative Council delegates expressed concern at a May 10, 2009, meeting with the Commission about the growing influence of the Central Government Liaison Office in Hong Kong's domestic affairs. According to the delegates present, the liaison office was taking on a more active role in the daily affairs of Hong Kong. Some complained that the office was orchestrating elections within the Hong Kong government, in part by requiring the office to review and approve all potential candidates, effectively operating as a "second government" in Hong Kong.²¹⁵ U.S. consulate staff also noted that the Central Government Liaison Office was "taking a more active role in Hong Kong civil affairs." Consulate staff viewed the growing strength of the office as something that should be closely monitored, especially given that the U.S. consulate had yet to make contact successfully with the liaison office by the time of the Commission's trip, despite repeated U.S. attempts.²¹⁶

According to the Central Government Liaison Office's Web site, as Beijing's representative office in Hong Kong, the office's official functions are the following:

1. "Integrate the Ministry of Foreign Affairs' Special Delegation Office in Hong Kong and the Hong Kong detachment of the Chinese People's Liberation Army.
2. Integrate and help the mainland's relevant departments to manage Chinese investment organizations.
3. Promote economic, educational, science and technology, cultural, and athletic exchanges and cooperation between Hong Kong and the mainland. Integrate with Hong Kong people from all levels of society, and advance the exchanges between the mainland and Hong Kong. Report on the Hong Kong residents' views toward the mainland.
4. Handle relevant issues that touch upon Taiwan.
5. Undertake other matters handed over from the central government."²¹⁷

The Central Government Liaison Office's membership guarantees its loyalty to Beijing. For China's leaders, it is particularly important to have "loyalists" upon whom it can consistently rely to carry out Beijing's will.²¹⁸ Currently, the liaison office's senior leadership consists entirely of individuals who have previously held trusted positions within CCP organizations. For example, the current director of the liaison office, Peng Qinghua, was once secretary of the CCP's Central Organization Department, director of the Party Building Research Institute, and editor of the CCP journal, *Party Building Research*.²¹⁹ Li Gang, a deputy director of the Central

Government Liaison Office, was previously a deputy director of the CCP's Office of Foreign Propaganda.²²⁰

In essence, this concern revolves around the interpretation of article 22 of the Basic Law, Hong Kong's de facto constitution. According to article 22, Beijing is not allowed to interfere in the Hong Kong government's local affairs.²²¹ However, the previously cited 2008 CCP newspaper article argued that Beijing does indeed have the right to exert its influence over Hong Kong on certain issues. The author, Cao Erbao, currently the director of the Central Government Liaison Office's Research Department, wrote that after Hong Kong reverted back to Chinese control on July 1, 1997, it went from being ruled by one entity to being ruled by two: the Hong Kong government and "a team of Central and Mainland authorities carrying out Hong Kong work." Mr. Cao stated that Beijing has responsibility for issues related to China's sovereignty and Beijing-Hong Kong relations, while the Hong Kong SAR government is responsible for internal issues.²²² Furthermore, Mr. Cao wrote that the central government representatives

*exercise constitutional powers to govern the Special Administrative Region (including handling relationships between central and mainland authorities, and the Hong Kong Special Administrative Region, in accordance with our constitution and the Basic Law of the Hong Kong Special Administrative Region, without interfering in affairs within the scope of Special Administrative Region self-government.*²²³

Most importantly, Mr. Cao also wrote that the relationship between the central authorities and the Hong Kong SAR government is one of "authorizer and authorized," respectively.²²⁴ According to Ching Cheong, a senior writer at the Singapore-based newspaper *The Straits Times*, Mr. Cao's article demonstrated that Beijing is taking "a very liberal interpretation" of the Basic Law. Furthermore, if Mr. Cao's views were to be implemented, it would result in "a very serious change to the Basic Law."²²⁵

Article 22 of Hong Kong's Basic Law

No department of the Central People's Government and no province, autonomous region, or municipality directly under the Central Government may interfere in the affairs which the Hong Kong Special Administrative Region administers on its own in accordance with this Law.

If there is a need for departments of the Central Government, or for provinces, autonomous regions, or municipalities directly under the Central Government to set up offices in the Hong Kong Special Administrative Region, they must obtain the consent of the government of the Region and the approval of the Central People's Government.

All offices set up in the Hong Kong Special Administrative Region by departments of the Central Government, or by provinces, autonomous regions, or municipalities directly under the Central Government and the personnel of these offices shall abide by the laws of the Region.

Article 22 of Hong Kong's Basic Law—Continued

For entry into the Hong Kong Special Administrative Region, people from other parts of China must apply for approval. Among them, the number of persons who enter the Region for the purpose of settlement shall be determined by the competent authorities of the Central People's Government after consulting the government of the Region.

The Hong Kong Special Administrative Region may establish an office in Beijing.²²⁶

One example of Beijing exerting its influence over Hong Kong was the Hong Kong SAR decision to deny visas for people seeking to enter Hong Kong to attend demonstrations commemorating the 20th anniversary of the Tiananmen Square massacre. According to news reports, several individuals—mostly participants in the original Tiananmen protest in 1989—were alternately denied visas or entry to Hong Kong. Tiananmen-era dissidents Xiang Xiaoji (a U.S. citizen) and Yang Jianli (a U.S. permanent resident) were denied entry to Hong Kong, while Wang Dan and Wang Juntao, both exiled Chinese citizens residing in the United States, were denied entry visas.²²⁷ In addition to former Tiananmen protesters, Jens Galschiot, a Danish artist who created a sculpture depicting victims from the Tiananmen massacre, was also denied entry to Hong Kong.²²⁸

Transshipment of Controlled Technology of China, and the Particular Problem of Hong Kong

The transshipment of controlled technology through false end-users in other countries or regions is a significant means of illegal technology transfer from the United States to other nations.²²⁹ Expert testimony presented to the Commission this year indicated a problem with Hong Kong serving as a way station for illegal dual-use technology exports into the People's Republic of China (PRC). Under U.S. law, the Hong Kong Special Administrative Region and the PRC are treated as separate customs entities for purposes of export control. Hong Kong is treated more liberally as an export destination than is the PRC, and some items subject to the U.S. government's Export Administration regulations that require an export license for exports to the PRC do not require such a license for exports to Hong Kong.²³⁰

There are instances in which this dual system has made Hong Kong an export destination for those wishing to do an end-run around U.S. export control regulations, notwithstanding strict Hong Kong regulations.²³¹ As James Mulvenon, an expert on the Chinese military-industrial complex, testified to the Commission:

*Hong Kong ... was established as a separate customs entity during the handover [from Britain to China] for very ... noble and pure reasons, but [it] has now become a very troubling transshipment point for Chinese economic espionage. ... I would submit that it is a significant problem ... [and] a large percentage of the export control cases that I have seen have involved Hong Kong transshipment.*²³²

This may present a particular problem in light of the long history of Hong Kong as a center for PRC intelligence operations.²³³ Furthermore, well-connected relatives of high-level CCP cadres, known as “princelings,” within the People’s Liberation Army (PLA) hierarchy also have a long record of involvement with enterprises in Hong Kong,²³⁴ including the alleged placement of agents in companies such as the Everbright Group and China Resources Holding Company.²³⁵ However, the proliferation of “entrepreneurial espionage” carried out by private actors on behalf of the PRC means that virtually any firm willing to profit from service as a middleman could potentially act as a legally and geographically convenient transshipment point for controlled technology headed to an unauthorized end-user in the PRC. (For further discussion of “entrepreneurial espionage” and illicit technology transfers conducted on behalf of the PRC, see chap. 2, sec. 3 of this Report, “China’s Human Espionage Activities that Target the United States, and the Resulting Impacts on U.S. National Security.”) The ease of transshipment from addresses in Hong Kong to the PRC represents a significant and exploitable weakness in U.S. export control policy related to China.

Impact of the Global Economic Crisis, and Hong Kong’s Growing Dependence on Mainland China

Hong Kong’s economic success stems from its reliance on the rule of law, its open markets, its banking system, and from being one of the world’s biggest ports and the financial gateway to Asia and mainland China in particular.* China is Hong Kong’s biggest and most important trading partner, with bilateral trade in 2008 amounting to HK\$2.7 trillion (\$359 billion).²³⁶ So it is little surprise that the global financial crisis, which has depressed demand for Chinese exports shipped through Hong Kong, triggered Hong Kong’s biggest contraction since the Asian financial crisis in 1997. The year-on-year decline in Hong Kong’s gross domestic product (GDP) narrowed from 7.8 percent in the first quarter to 3.8 percent in the second quarter.²³⁷ Hong Kong’s exports slid by the largest amount since 1954, dropping 13.9 percent in August 2009 over the year earlier, after shrinking 19.9 percent in July 2009 year-on-year.²³⁸ The unemployment rate, which has been rising steadily since September 2008, climbed to 5.4 percent in August 2009.²³⁹ Due in part to improved export performance and to the pickup in economic activity in China, in the second quarter of the year Hong Kong’s economy actually grew by a seasonally adjusted 3.3 percent, suggesting that the recession may be over in Hong Kong.²⁴⁰ This was the first positive growth in Hong Kong’s economy, following four consecutive quarters of decline.²⁴¹

Costs for shipping goods have fallen in the past year, partly because retailers are paring orders due to weak consumer spending. Container lines have parked ships and delayed deliveries of new

* Since 1983, the Hong Kong dollar has been pegged to the U.S. dollar at a rate of \$1 to 7.8 Hong Kong dollars, and since 2005 the Hong Kong dollar has been allowed to trade up to five cents on either side of that level. The fixed exchange rate against the dollar has conferred several advantages on Hong Kong, including the ability to withstand speculative attacks (as was the case during the Asian financial crisis) and the indirect subsidization of its exports through undervaluation.

vessels to curb excess capacity. Shipping lines are also trying to delay deliveries of new vessels to ease a capacity glut.²⁴² Investors hope, however, that a revival of the Chinese economy may help Hong Kong recover as well. Despite the downturn, K.C. Chan, Hong Kong secretary for Financial Services and the Treasury, told the Commission during its 2009 trip to Hong Kong that Hong Kong's banking system is very healthy and less leveraged, unlike that in the West, so there is much less worry over the financial crisis, despite short-term volatility in the stock market.

To help increase its exports, Hong Kong has rolled out HK\$87.6 billion (\$11.2 billion) of stimulus measures, including increased transportation infrastructure spending and various tax cuts.²⁴³ Hong Kong's economic distress also has provided an opportunity for the central government in Beijing to come to the rescue and, in doing so, to forge closer economic and political ties. In a December 2008 meeting with Hong Kong's Chief Executive Donald Tsang, Premier Wen Jiabao promised that Beijing would implement 14 measures to help Hong Kong deal with the financial crisis.²⁴⁴ These include

- Strengthening cooperation on financial affairs between the mainland and Hong Kong, including allowing companies to settle trade in renminbi (RMB) with Hong Kong. The People's Bank of China and the Hong Kong monetary authority entered into a currency swap agreement with the Hong Kong Monetary Authority on January 20, 2009, providing liquidity support of up to HK\$227 billion or 200 billion RMB (\$29 billion).²⁴⁵
- Launching measures to help small- and medium-sized enterprises, including increasing tax rebates on exports and assisting trade and providing guarantees to help small- and medium-sized enterprises get capital.
- Expanding the individual travelers' program, allowing mainlanders living in Shenzhen to apply for 12-month, multientry visas to travel to Hong Kong.²⁴⁶
- Opening up the mainland's service industry to Hong Kong companies.
- Speeding up infrastructure projects, such as the Hong Kong-Zhuhai-Macao Bridge, and ensuring a stable supply of food, water, electricity, and natural gas.
- Strengthening economic cooperation between Hong Kong and the Pearl River Delta region.
- Encouraging Hong Kong firms to participate in the construction of the Shenzhen railway.

The initial plan for individual travelers' program would have extended it to some eight million other mainlanders living in Shenzhen although not registered in Guangdong Province, but Beijing suspended the project in May 2009 without any definitive timetable for implementation.²⁴⁷ Hong Kong Secretary for Commerce and Economic Development Rita Lau Ng Wai-lan said she anticipates that the new multientry visas would significantly increase tourism, which would benefit the hospitality, retail, and entertainment sectors battered by the economic crisis and assuage fears relating to the H1N1 ("swine flu") influenza.²⁴⁸

On May 9, 2009, Hong Kong and mainland China also signed a sixth round of the Closer Economic Partnership Agreement, originally launched in 2003 in the midst of the SARS epidemic.²⁴⁹ Under the new supplement, which came into effect on October 1, 2009, qualified mainland securities firms will be able to set up subsidiaries in Hong Kong upon approval by regulatory authorities, while Hong Kong banks will be able to open branches in Guangdong more easily. Also, securities firms in the mainland and Hong Kong will be allowed to set up joint-venture advisory companies in Guangdong.²⁵⁰ In addition, China eliminated import tariffs on 28 goods from Hong Kong, including food, medicine, and textiles, starting July 1, 2009.²⁵¹ The Closer Economic Partnership Agreement also eased visa rules, allowing mainland tourist groups to visit Taiwan and Hong Kong using a single visa.²⁵²

The introduction of the pilot program on April 8, 2009, to use RMB to settle cross-border trade with Hong Kong is a particularly important step. Following calls by the People's Bank of China to replace the U.S. dollar as the global reserve currency, China has been promoting greater use of the RMB in international trade, including 650 billion RMB (\$95 billion) in swap agreements with Hong Kong, Argentina, Indonesia, South Korea, Malaysia, and Belarus (see chap. 1, sec. 1, for more details).²⁵³ The new cross-border trade program with Hong Kong, however, will be a first true test for the use of the RMB outside of mainland China. The program would allow Shanghai and four cities in the Pearl River Delta—Shenzhen, Guanzhou, Zhuhai, and Dongguan—to settle international trade in RMB. The Bank of China, China's largest foreign exchange bank, announced on July 6, 2009, that it had transacted the first cross-border RMB trade settlement deal.²⁵⁴ Hong Kong Chief Executive Donald Tsang said the program will further the city's bid to become a regional RMB clearing center and help shield companies doing business with the mainland from exchange-rate risk.²⁵⁵

During the Commission's May trip to China and Hong Kong, Hong Kong democratic activists expressed concern that China plans to marginalize and eventually absorb Hong Kong. According to the activists, following the July 1, 2003, protests to oppose the antirule of law Hong Kong Basic Law article 23, the Chinese government started using its vast financial resources to penetrate Hong Kong's political and economic establishment. Hong Kong's growing economic dependence on the mainland is seen by some as a weakness, making Hong Kong's political development subject to China's financial clout.

At the same time, China is trying to reduce its dependency on Hong Kong by developing Shanghai into a major global financial center and shipping hub by 2020.²⁵⁶ For many years, Hong Kong has profited from its status as the gateway to trade and investment in mainland China as well as from its rule of law, open business environment, taxation policy, and more rigorous regulatory regime. As China positions Shanghai as a major financial center, the various pilot programs that the central government is running in the Pearl River Delta are challenging Hong Kong's role. Hong Kong's competitive edge is its independence, financial freedom, and rule of law. This transition will be a gradual process, however, because the

RMB is still not convertible, and China's institutions and the rule of law do not provide the protection of Hong Kong's. If the RMB were to become convertible, Shanghai would have a much broader appeal, especially for companies trying to get access to RMB business, leading to a possible flight of capital and a relocation of business from Hong Kong to the mainland.

Politicians on both the mainland and in Hong Kong have consistently played down the rivalry between Hong Kong and Shanghai, underscoring their complementary natures.²⁵⁷ Hong Kong has international standing, while Shanghai has advantages in China's domestic markets, including the large number of state-owned enterprises that are listed on Shanghai's stock exchange.

Speaking about Hong Kong's economic cooperation with the central government during the Commission's trip to China, Secretary K.C. Chan stressed that Hong Kong is very independent and sets its own economic policy. Secretary Chan said that there is a very clear understanding, however, that future economic growth in the region will depend on China. According to Mr. Chan, Hong Kong does its own lobbying in Beijing, but Hong Kong's access to the central government is not as good as that of the mainland provinces, such as Guangdong Province.

Media Control in Hong Kong

There are signs of "creeping repression" for journalists in Hong Kong. Journalists from Hong Kong have expressed concerns that China's increasing economic influence in their territories could undermine local press freedom.²⁵⁸ For example, Hong Kong-based reporter Daisy Chu was fired from her position at the Hong Kong edition of *Esquire* magazine when she reported on her blog that the magazine's editors withdrew her story on the 20th anniversary of the Tiananmen massacre.²⁵⁹ Journalists from Hong Kong are now required to obtain a press pass from the central government and the consent of interviewees in order to travel to the mainland to report.²⁶⁰ When reporting in the mainland, Hong Kong journalists' operations have been subject to a disproportionate amount of violence and harassment.²⁶¹ For example, on September 4, 2009, three reporters from Hong Kong were "kicked, punched, shoved to the ground, handcuffed by police and detained for about three hours" as they were trying to escape tear gas fired to disperse crowds in Urumqi.²⁶²

On February 25, 2009, Macao's legislative assembly enacted a national security law that included the same vaguely worded "state secrets" provisions that are used on the mainland to intimidate, detain, and punish dissidents.²⁶³ This is significant for Hong Kong as well, because the government of Hong Kong tried to introduce similar legislation in 2003 but backed down in the face of strong public opposition.²⁶⁴ Now, concerns are mounting that this move could pressure Hong Kong authorities to follow and that Macao's legislation could act as a template.²⁶⁵ According to the Hong Kong Journalists Association, "Media freedoms remain largely intact [but] the scope for expressing dissenting views—in particular on subjects that are sensitive to Beijing—is narrowing."²⁶⁶

Conclusions

- The influence of China's central government in Hong Kong is increasing, including in the political and economic spheres.
- As a very export-dependent economy, Hong Kong has been severely impacted by the current economic crisis, both in its own right and as result of a fall in demand for Chinese exports.
- Beijing has been very active in offering economic support to Hong Kong, but democratic activists are worried about Hong Kong's growing economic dependence on the mainland, which they see as undermining Hong Kong's autonomy and international competitive edge.
- Beijing appears to be increasing its influence over the Hong Kong SAR government by strengthening the position of its official representative organization, the Central Government Liaison Office, and promoting pro-Beijing political parties within the Hong Kong Legislative Committee.
- A crucial component of Beijing's strategy of reining in Hong Kong appears to be its policy of chipping away incrementally at the legal support for Hong Kong's autonomy in domestic affairs. Evidence exists that Beijing already may be interfering in Hong Kong's domestic issues.
- Due to its geographic convenience as a transshipment point, as well as the long-standing presence of Chinese government-affiliated intelligence and commercial interests, Hong Kong could emerge as a significant transshipment point for transfers of export-controlled technologies into China in violation of U.S. law.