

SECTION 3: CHINA AND HONG KONG

Introduction

The year 2016 saw notable developments in Hong Kong politics and society. Many of these events were indicative of mainland China's increasing efforts to control political life and the flow of information, and Hong Kong citizens' resistance to them. This was illustrated most clearly in the September legislative election, which saw a record voter turnout and prodemocracy candidates gaining three seats, despite Beijing's efforts to undermine those running on prodemocracy or pro-independence platforms. The election outcome was influenced in part by the emergence of a small but vocal political minority supporting self-determination (and among some, outright independence). The election took place against the backdrop of an alarming rise in mainland interference in Hong Kong. One example of this was the apparent abduction and detention of five Hong Kong booksellers by mainland authorities and the consequent chilling effect on the publication and distribution of politically sensitive books and books that have been banned in the Mainland. This incident has threatened the maintenance of the "one country, two systems" framework* and led some observers to question Hong Kong's long-standing status as a leading global financial hub.

In addition to these developments, this section examines Hong Kong's economic and security ties with the Mainland, and the implications of these trends for the United States. It is based on open source research and analysis and consultations with U.S. and foreign nongovernmental experts.

Hong Kong's Changing Political Landscape

Background

As previous Commission reports have illustrated, Hong Kong's politics and governance since the United Kingdom's (UK) handover of Hong Kong to Beijing in 1997 have been characterized by its unique "one country, two systems" framework and two competing impulses: mainland China's desire to exercise control over Hong Kong, and Hong Kong citizens' desire for greater autonomy and more democratic governance. This tension has been evident in recent years, particularly as it relates to Hong Kong's electoral process.

In June 2014, Beijing moved to restrict Hong Kong's political development, rejecting calls for democratic reform and shaping the conditions of Hong Kong's current political strife. That month, the Mainland's State Council Information Office issued a strongly

*The "one country, two systems" framework is a policy measure adopted by the People's Republic of China following the establishment of Hong Kong and Macau as Special Administrative Regions. The system grants Hong Kong and Macau the right to self-govern their economy and political system to a certain extent, excluding foreign affairs and defense.

worded white paper on the implementation of the “one country, two systems” policy in Hong Kong. The white paper reiterated Beijing’s jurisdiction over Hong Kong and asserted that “loyalty” and “loving the country” are “basic political requirements for Hong Kong’s administrators,”¹ prompting concerns among Hong Kong’s prodemocracy advocates.²

Two months later, according to procedures set out in Hong Kong’s mini constitution, the Basic Law, mainland China’s central government submitted its proposal for the nomination mechanism in Hong Kong’s upcoming 2017 chief executive election. After an earlier ruling by the Mainland’s legislature that Hong Kong’s 2017 election could be decided by universal suffrage—defined as election on a “one person, one vote” basis³—many in Hong Kong were hopeful Beijing’s proposal would feature robust reforms and the introduction of universal suffrage (currently, Hong Kong’s chief executive is chosen by a committee representing only 0.03 percent of eligible voters).⁴ In a major disappointment for prodemocracy advocates, Beijing’s proposed reform stopped far short of true universal suffrage. Although the proposal would have allowed all Hong Kong permanent residents to vote, it still would have used a nomination mechanism that impeded democratic candidates from standing for election and effectively guaranteed the ultimate selection of a Beijing-approved candidate. The proposal violated the spirit of Beijing’s commitments made in the Basic Law to hold elections “in accordance with democratic procedures” and eventually institute universal suffrage.⁵

The combination of the “loyalty” requirements and electoral reform proposal was perceived by many as a blow to Hong Kong’s democratic progress,⁶ and dissatisfaction gave rise to the Occupy Central prodemocracy protests (also referred to as the “Umbrella Revolution”), which advocated for true universal suffrage according to international standards in future Hong Kong elections. The largely nonviolent protests, which lasted 79 days and concluded in December 2014, demonstrated Hong Kong citizens’ frustration with Beijing’s increasing reach into Hong Kong and served to bring more students and young people into the political process.*

When it came time to vote on Beijing’s proposal in June 2015, Hong Kong’s legislative body, the Legislative Council (LegCo), rejected it. Although the Hong Kong government supported the proposal as a baseline for future reforms, and pro-Beijing (or “pro-establishment”) legislators largely voted in favor of the proposal, prodemocracy legislators (known as “pan-democrats”) asserted it was a “sham” that would provide an opportunity for Beijing to screen out candidates it opposes, and prevented the proposal from moving forward.⁷ As a result, the 2017 chief executive election will be decided based on the preexisting election framework, and the next opportunity to implement electoral reform will be ahead of the 2022 chief executive election.†

* For more information on the 2014 prodemocracy protests, see U.S.-China Economic and Security Commission, *2014 Annual Report to Congress*, November 2014, 523–527.

† For a more in-depth examination of the electoral reform process and political development in Hong Kong in 2015, see U.S.-China Economic and Security Review Commission, *2015 Annual Report to Congress*, November 2015, 533–537.

Developments among Hong Kong's Political Groups in the Run-up to the 2016 LegCo Elections

Fueled in large part by the fallout from the electoral reform debate and the Occupy movement, mounting feelings of frustration and disillusionment among prodemocracy advocates—particularly among young people—appear to be driving divisions in the prodemocracy camp between the traditional, older cohort favoring gradual reform through working with Beijing and the new, younger cohort favoring more comprehensive reforms and a more confrontational approach toward Beijing. Some of the student-led groups affiliated with the 2014 Occupy movement shifted their attention away from electoral reform to the September 2016 LegCo elections. In March 2016, Joshua Wong Chi-fung—one of the student leaders of the 2014 protests—established the political party Demosistō, which would run one candidate in the LegCo elections. Rather than focusing on electoral reform, Mr. Wong said the party would turn its attention to Hong Kong's future after 2047, at which time the “one country, two systems” governance framework established during Hong Kong's handover from the UK in 1997 will expire.⁸ Mr. Wong said the party would advocate for a referendum for Hong Kong voters to decide whether to split from mainland China after 2047.⁹ Oscar Lai Man-lok, one of the party's leaders, said, “No one in the legislature right now has brought up the issue of Hong Kong's future after 2047. We're going to bring the same dogged resistance protesters showed in the Umbrella Movement into the legislature.”¹⁰

The emergence of new “localist” political parties in the run-up to the LegCo elections also demonstrates this division.* Localists are a political minority predominantly composed of students who support self-determination (and in some cases, outright independence) and the preservation of Hong Kong's culture. In February 2016, after protesting the apparent crackdown on unlicensed food vendors in Mong Kok District, over 700 localist activists clashed with police in a ten-hour standoff. Some observers called it the most violent mass demonstration since the 1967 riots triggered by pro-Beijing protesters against British colonial rule.†¹¹ The localist parties, many of which are led by former student participants in the 2014 Occupy protests, were previously viewed as fringe political actors

* Like the chief executive elections, LegCo elections are not decided by universal suffrage. The Mainland's legislature ruled that universal suffrage cannot be implemented in LegCo elections until it is implemented in the chief executive election. Standing Committee of the National People's Congress, *Decision of the Standing Committee of the National People's Congress on Issues Relating to the Methods for Selecting the Chief Executive of the Hong Kong Special Administrative Region and for Forming the Legislative Council of the Hong Kong Special Administrative Region in the Year 2012 and on Issues Relating to Universal Suffrage* (Adopted at the 31st Session of the Standing Committee of the Tenth National People's Congress on December 29, 2007).

† It is unclear what led to the unrest. According to some sources, reports that food and health inspectors were cracking down on unlicensed street food vendors led localist activists to organize protests in defense of the vendors. However, the Hong Kong government claimed inspectors were only conducting “general squad patrol” in the area when they were “surrounded, scolded, and pushed around” by over 50 people, leading the inspectors to call for police assistance. The clashes resulted in at least 100 injured—most of which were police, according to the Hong Kong government. According to the Hong Kong police commissioner, 54 were arrested in the immediate aftermath of the incident. Reports in the months following the incident indicate at least 75 people were arrested in total. Alan Wong, “China Labels Protesters ‘Radical Separatists,’ and They Agree,” *New York Times*, February 20, 2016; Legislative Council Panel on Security, *Hawker Management and Policy*, February 16, 2016; Asia Times (Hong Kong), “HK's Mong Kok Protesters: ‘This is the First Time, But Won't Be the Last,’” February 11, 2016; and BBC, “Hong Kong Clashes as Police Clear Food Stalls,” February 9, 2016.

among mainstream political circles in Hong Kong, but increasing support among Hong Kong citizens—especially young people—for greater Hong Kong autonomy from mainland China has given these groups momentum. According to a July 2016 poll conducted by the Chinese University of Hong Kong—the first ever poll measuring support for Hong Kong independence—over 17 percent of Hong Kong citizens and nearly 40 percent between the ages of 15 and 24 support full independence after 2047.¹²

Annual Vigil to Commemorate the Tiananmen Square Massacre

On June 4, Hong Kong held its annual candlelight vigil to commemorate the victims of the 1989 Tiananmen Square Massacre and express support for political change in mainland China.¹³ According to the vigil organizers, 125,000 people attended, but the turnout was 10,000 fewer than the 2015 event and the lowest attendance since 2009, which commemorated the 20th anniversary.¹⁴ Although the event has long been one of the most popular and visible demonstrations of prodemocracy sentiment in Hong Kong, some young prodemocracy activists and nearly all university student unions decided not to attend the vigil, viewing the 2016 event as less relevant to the challenges Hong Kong currently faces under Beijing's increasing encroachment.¹⁵ Instead of attending the vigil, many of the groups hosted or attended other events across Hong Kong, including seminars discussing what the Tiananmen Square Massacre means in the context of today's Hong Kong and its future.¹⁶

The 2016 LegCo Elections

The specter of Beijing's control loomed over the September 2016 LegCo elections as well. Less than two months before the election, the Hong Kong Electoral Affairs Commission*—reportedly under pressure from Beijing¹⁷—announced a new requirement for all LegCo candidates: to sign a form agreeing Hong Kong is an “inalienable” part of China that “come[s] directly under the Central People's Government.”¹⁸ Those who refused to sign the form would face potential disqualification, and candidates who signed it but did not follow through with the pledge would face potential criminal charges, according to a spokesperson for the Electoral Affairs Commission.¹⁹ In response to the announcement, most pan-democratic candidates refused to sign the pledge, viewing the requirement as political censorship and arguing it had no legal basis; some filed legal challenges to the new form.²⁰ However, civil servants tasked with reviewing the candidate application forms, which were fully supported by the Hong Kong government,²¹ decided the action of signing or not signing the form had no bearing on whether a can-

*The Electoral Affairs Commission describes itself as an “independent, impartial, and apolitical body” of the Hong Kong government, and is charged with overseeing elections. Electoral Affairs Commission, Government of the Hong Kong Special Administrative Region, *Chairman's Welcome Message*. <http://www.eac.gov.hk/en/about/chairman.htm>.

didate could run in the elections—only the measure of a candidate’s character based on previous activities would determine candidate eligibility. In the end, however, six candidates were banned, reportedly for refusing to back down from their pro-independence stance,* despite several signing the pledge.²² One of these candidates whom observers viewed as having good prospects for winning a seat, was Edward Leung Tin-kei of localist party Hong Kong Indigenous.† Just days before the deadline to confirm all candidates, in an apparent effort to adhere—or at least appear to adhere—to the Electoral Affairs Commission’s new requirements, Mr. Leung retracted his previous pro-independence statements, including on social media platforms, and signed the pledge form. Despite this, the officer overseeing his application denied his candidacy, arguing Mr. Leung’s apparent policy shift was not genuine.²³

Mainland China’s heavy-handed efforts to limit support for the prodemocracy camp backfired, however. Demonstrating the Hong Kong public’s deepening dissatisfaction with Beijing’s moves to apply pressure on Hong Kong’s political system, a record 58 percent voter turnout saw prodemocracy candidates capture 30 of 70 total seats in the LegCo elections.²⁴ Although prodemocracy candidates won a majority of the popular vote,‡ the Basic Law only allows the general public to vote for a total of 35 seats, while a small group of electors in functional constituencies decide the remaining 35 seats; these seats heavily tilt in Beijing’s favor and therefore ensure pro-establishment candidates retain a majority of seats in LegCo.§

With a net gain of three seats, the pan-democrats denied the pro-establishment camp the two-thirds majority it needed to pass major changes to the Basic Law (such as electoral reform).²⁵ Notably,

* One of these candidates was Chan Ho-tin, a former activist in the 2014 Occupy protests and convener of the Hong Kong National Party—the first political party in Hong Kong to publicly advocate for outright independence from mainland China. Beijing and the Hong Kong government have strongly opposed the party since its formation in March 2016. Although the party probably will remain on the fringes of the political landscape, its presence alone sheds light on the widening gap between some political groups in Hong Kong and shows Beijing’s fear of pro-independence parties gaining popular support. Xinhua, “China Voice: ‘Hong Kong Independence,’ A Dangerous Absurdity,” April 1, 2016; Hong Kong Special Administrative Region Information Services Department, *Independence Calls Breach Basic Law*, March 30, 2016; and KC Ng and Owen Fung, “Hong Kong National Party Is Born: Will Push for Independence, Will Not Recognize the Basic Law,” *South China Morning Post* (Hong Kong), March 29, 2016.

† Mr. Leung surprised observers with strong results, despite a lack of political experience, in the February 2016 New Territories East by-election to fill a vacant seat in LegCo until the September elections. He participated along with his political group, Hong Kong Indigenous, in the violent Mong Kok demonstrations weeks before the by-election. Gary Cheung, “Despite Facing a Rioting Charge, Localist Edward Leung Garnered 16 Per Cent of Legco By-Election Votes. Who Voted for Him . . . and Why?” *South China Morning Post* (Hong Kong), February 29, 2016.

‡ According to the *South China Morning Post*, for the 35 seats decided by popular vote, pro-establishment candidates won 871,864 votes (40.3 percent), pan-democrats captured 586,595 votes (27 percent), “localist/radical” candidates received 601,851 votes (27.6 percent), and moderates won 5 percent of the vote. In total, prodemocracy candidates received 59.7 percent of the vote compared to pro-Beijing candidates’ 40.3 percent. *South China Morning Post* (Hong Kong), “2016 Legislative Council Election Counting Room.” <http://multimedia.scmp.com/counting-room/>; Suzanne Pepper, “The Voters Have Spoken . . . But is Anyone Listening?” *HK Focus* (Blog), September 20, 2016.

§ Electors who choose the 35 functional constituency seats are part of 28 different groups that include businesspeople, professionals, and corporations. Of the 239,724 electors registered in 2016, 167,257 votes were cast, electing 24 of the pro-establishment camp’s 40 seats. *South China Morning Post* (Hong Kong), “2016 Legislative Council Election Counting Room.” <http://multimedia.scmp.com/counting-room/>; Suzanne Pepper, “The September Election: Early Polling,” *HK Focus* (Blog), August 18, 2016; Voter Registration of the Hong Kong Special Autonomous Region Government, *Distribution of Registered Electors by Functional Constituencies in 2016*, July 16, 2016; and Tanna Chong, “Legco Election 2016: How a Handful of Voters Select 30 Hong Kong Lawmakers,” *South China Morning Post* (Hong Kong), February 6, 2016.

eight of the prodemocracy candidates who won seats—five of whom are part of the post-Occupy generation of prodemocracy political parties—advocate for self-determination; several of these winning candidates are young localists.²⁶ These newly elected lawmakers unseated some veteran prodemocracy legislators, reflecting the recent shift in Hong Kong’s political landscape.²⁷ Demosistō’s Nathan Law Kwun-chung, one of the student leaders of the 2014 prodemocracy protests, at 23 years old became the youngest legislator ever elected to LegCo, overcoming numerous roadblocks along the way.* Mr. Law and several other new lawmakers have pledged to continue filibuster tactics used in the previous legislative session (2012–2016) to oppose the Hong Kong administration’s policies, suggesting LegCo will remain deadlocked as its membership becomes further polarized.²⁸

Beijing heavily restricted all mainland media coverage of the election and censored discussion of the election on the Internet and social media in mainland China.²⁹ A spokesperson for the State Council’s Hong Kong and Macau Affairs Office in Beijing issued a statement expressing its “resolute opposition to any form of Hong Kong independence activities inside or outside of [LegCo], and support for the Hong Kong Special Administrative Region government to punish [such activities] according to law.”³⁰

Disappearance of Hong Kong Booksellers

Among the many incidents over the last several years that have caused a steady erosion of the freedoms guaranteed to Hong Kong citizens under the Basic Law, perhaps none has had as significant a chilling effect as the mainland authorities’ apparent abduction and detention of five Hong Kong sellers of political gossip books banned in mainland China. The booksellers were all tied to Mighty Current Media, Hong Kong’s largest political gossip book publisher (which reportedly produced around one-third of such books over the last five years).³¹ It is unclear what exactly instigated Beijing’s crackdown on the booksellers, but a source at Mighty Current suggested the publishing company was preparing to release a particularly salacious book on Chinese President and General Secretary of the Chinese Communist Party (CCP) Xi Jinping’s love life.³² The incident involved not only Hong Kong residents, but also a British citizen and a Mainland-born bookseller with a Swedish passport. The disappearance of the booksellers, whose whereabouts were unknown for six months, raised concerns about Hong Kong’s autonomy and rule of law among Hong Kong citizens, including those not previously worried about such issues, and demonstrated the deterioration of the “one country, two systems” framework.³³

*These roadblocks included delays in government approval for campaign mailings and for registering Demosistō as a company for fundraising purposes. Cannix Yau, “Six Months and Counting: Demosisto Party Still Waiting for a Reply on Its Registration,” *South China Morning Post* (Hong Kong), September 11, 2016; Chester Yung, “Hong Kong Elections: New Parties Pick Up Seats,” *Wall Street Journal*, September 5, 2016; and Tony Cheung, “Undue Caution? Joshua Wong Blasts Hong Kong Officials over Hold-Ups in Demosisto Party Registration and Mailings,” *South China Morning Post* (Hong Kong), August 4, 2016.

Hong Kong's Political Gossip Book Industry

The market for banned books in mainland China was a key driver in the emergence of Hong Kong's political gossip book industry. Customers included Chinese citizens interested in learning about the inner workings of Chinese politics, and mainland officials using the publications to either leak salacious details about other officials or seek out these details in existing publications for political gain.³⁴ Observers note that in recent years, following the Bo Xilai scandal,* the industry has expanded significantly and become highly profitable.³⁵ In a January 2016 interview, Bei Ling, a U.S.-based exiled Chinese journalist and close friend of one of the detained Hong Kong booksellers, estimated that about half of all books published in Hong Kong are on topics banned in the Mainland and reach nearly one million people per month (but these numbers appear reduced in light of the booksellers incident, as discussed below). According to Mr. Bei, "The severe restrictions on information in China, and its huge number of readers, makes Hong Kong the perfect venue for vendors of banned political books."³⁶

Within a nine-day span in October 2015, three Hong Kong citizens tied to Mighty Current and one of its Hong Kong bookstores, Causeway Bay Books, went missing from Hong Kong and mainland China. These included Mighty Current shareholder and general manager Lui Por (also spelled Lu Bo), Mighty Current assistant general manager Cheung Chi-ping (also spelled Zhang Zhiping), and Causeway Bay Books manager Lam Wing-kee. Mighty Current shareholder and Swedish national Gui Minhai, went missing from his vacation home in Thailand that same month.[†]³⁷ In December 2015, a fifth person, Mighty Current shareholder and dual British and Hong Kong citizen Lee Bo disappeared after crossing into mainland China. It is unclear how Mr. Lee crossed the border into the Mainland, and many suspect Chinese agents were involved in abducting him.³⁸ The booksellers remained missing for months until mainland authorities finally confirmed in January and February 2016 that they were in Chinese custody in the Mainland.³⁹

The behavior and activities of the booksellers during the ordeal suggest they were intimidated and otherwise treated unlawfully. Following a trend throughout President Xi's anticorruption campaign in which individuals detained in the Mainland have issued confessions on state-run television, all five of the detained booksellers appeared on Chinese television to confess to their alleged crimes.⁴⁰ Notably, Mr. Lee said he decided to relinquish his British

* Bo Xilai was a member of the CCP Politburo and the party secretary of Chongqing Municipality from 2007 to 2012. In April 2012, the CCP removed Mr. Bo from his party positions, and the following September he was found guilty of corruption, bribery, and abuse of power and sentenced to life in prison. BBC, "Bo Xilai Scandal: Timeline," November 11, 2013.

† In May 2016, Mr. Gui's daughter testified before the U.S. Congressional-Executive Commission on China regarding her father's case. She said her father was abducted by "Chinese state agents" in Thailand, and he has not had any legal representation or access to consular visits with his home country Sweden. Congressional-Executive Commission on China, *Hearing on The Long Arm of China: Global Efforts to Silence Critics from Tiananmen to Today*, written testimony of Angela Gui, May 24, 2016.

passport as a result of the case. He said, “Many have sensationalized my British citizenship and have complicated the situation, so I have decided to give up my British citizenship.”⁴¹ It is unclear if the detained individuals had access to a lawyer or were forced to confess.⁴²

After months in detention, Beijing finally allowed three of the booksellers—Mr. Cheung, Mr. Lui, and Mr. Lee—to return to Hong Kong in March 2016. Upon arrival, the booksellers told the Hong Kong authorities to cancel their missing persons investigations, and then returned almost immediately to mainland China.⁴³ Mr. Lee informed Hong Kong police he went to mainland China “by his own means voluntarily,” and told the media he would never publish books again.⁴⁴ In June, the Chinese authorities allowed Mr. Lam to return to Hong Kong, reportedly to retrieve and bring back a hard drive containing records of the bookstore’s customers.⁴⁵ Instead, he stayed in Hong Kong and held a press conference with then Democracy Party lawmaker Albert Ho Chun-yan, describing in detail his detention after crossing into mainland China to see his girlfriend. Mr. Lam said he was sent to a detention facility in Ningbo and forced to sign away his rights to a lawyer and not contact any family members. During his five months in Chinese custody, he was under constant monitoring and was forced to read from a script in a filmed statement he made confessing to operating an illegal business.⁴⁶ In the days following the press conference, Mr. Lam led thousands of people in Hong Kong protesting the booksellers’ detention.* Perhaps indicative of mainland efforts to discredit Mr. Lam’s account, shortly thereafter a Hong Kong news outlet published interviews with several individuals—including some of the other detained booksellers and Mr. Lam’s girlfriend—challenging Mr. Lam’s version of events.⁴⁷ As of the publication of this Report, Mr. Gui is reportedly the only bookseller still in Chinese custody.⁴⁸

As the situation unfolded, the Hong Kong government expressed concern, while emphasizing the importance of adhering to the “one country, two systems” framework and the Basic Law.⁴⁹ Chief Executive Leung in January 2016 said the Hong Kong government was “highly concerned” about the situation, and that if mainland authorities conducted law enforcement activities in Hong Kong it would be “unacceptable and unconstitutional.”⁵⁰ The Hong Kong government stated that police have yet to find any evidence to indicate mainland agents conducted law enforcement across the border in Hong Kong.[†]⁵¹

*Notably, Mr. Lam was scheduled to lead the annual July 1 protest against mainland China marking the day the UK returned Hong Kong to the PRC, but cancelled after feeling “gravely threatened” by apparent Chinese security forces closely tracking his movements. Rishi Iyengar, “Freed Hong Kong Bookseller, Due to Lead Massive Protest, Pulls out Citing Threats,” *Time*, July 1, 2016; Luisetta Mudie, “Returned Hong Kong Bookseller Leads Thousands on Protest March,” Radio Free Asia, June 18, 2016.

†Following Mr. Lam’s revelations to the media in June 2016, Chief Executive Leung wrote a letter to Beijing expressing Hong Kong’s concern about the case and indicated he would seek to improve the cross-border notification mechanism system between the Hong Kong and Mainland authorities. The mainland government responded that it would work with Hong Kong authorities to improve the mechanism in place. The two sides have held several meetings to date. Hong Kong Special Autonomous Region Government, *Hong Kong and Mainland Hold Second Meeting on Notification Mechanism*, July 28, 2016; Kris Cheng, “Beijing Agrees to Talks on HK-China Communication Mechanism Following Bookseller Incident,” *Hong Kong Free Press*, June 27, 2016; Reuters, “Hong Kong Presses Beijing on Case of Missing Booksellers,” June 21, 2016;

Many Hong Kong and international observers have voiced concerns that mainland China is depriving Hong Kong of its rights granted under the Basic Law, and that the incident could impact Hong Kong's status as a global financial center.⁵² In February 2016, a U.S. Department of State spokesperson said, "These cases, including two involving individuals holding European passports, raise serious questions about China's commitment to Hong Kong's autonomy under the "one country, two systems" framework as well as its respect for the protection of universal human rights and fundamental freedoms."⁵³ The same month in a biannual report on developments in Hong Kong, then British Foreign Secretary Philip Hammond said the "involuntary removal" of Mr. Lee to the Mainland "constitutes a serious breach of the Sino-British Joint Declaration on Hong Kong and undermines the 'One Country, Two Systems' principle, which assures Hong Kong residents of the protection of the Hong Kong legal system."⁵⁴ An April 2016 European Commission report to the European Parliament and Council stated the following:

*The [EU] considers the case of the five book publishers to be the most serious challenge to Hong Kong's Basic Law and the "one country, two systems" principle since Hong Kong's handover to the [People's Republic of China (PRC)] in 1997. The case raises serious concerns about the respect for human rights and fundamental freedoms and about the application of PRC criminal law to acts that are not punishable under Hong Kong law. The case has potentially lasting implications for Hong Kong's rule of law and could impact on Hong Kong's standing as an international business centre.*⁵⁵

While the long-term effects of the Hong Kong booksellers incident are unclear, immediate impacts were felt throughout the book publishing industry and beyond. In April 2016, Hong Kong lawyer and blogger Jason Ng released his new English-language account of the 2014 Occupy movement, after facing a more than three-month delay because local printing companies refused to take on the work. Mr. Ng's British publisher, who has run a Hong Kong-based publishing company since 2003, said this was the first time he had been declined by a local printer.⁵⁶ In addition, Andrei Chang, founder of the influential defense magazine *Kanwa Asian Defense* (which carries analysis of People's Liberation Army [PLA] developments), decided to move from Hong Kong to Tokyo out of fear for his safety following Chinese Foreign Minister Wang Yi's comments describing one of the detained booksellers and British passport holder Lee Bo as "first and foremost a Chinese citizen."⁵⁷ Mr. Chang had held both Hong Kong and Canadian passports until he decided to cancel his Hong Kong passport shortly after Minister Wang's remarks.⁵⁸

Perhaps most troubling, several Hong Kong bookstores have reportedly removed politically sensitive titles and stopped selling banned books altogether.⁵⁹ Some bookstores known for carrying

and Jeffie Lam, et al., "Delegations, Notifications, and a Formal Letter: CY Leung's Three-Pronged Strategy for Settling Booksellers Row," *South China Morning Post* (Hong Kong), June 20, 2016.

books banned in the Mainland have closed entirely, notably in the Hong Kong airport, where some have been replaced by Chinese state-owned Chung Hwa Book Company.* The scope of the impact of the booksellers incident is not yet clear,† but the Chinese government's willingness to strike fear in an industry that represents Hong Kong's role as a bastion for free speech and political openness does not bode well.

Joshua Wong Denied Entry to Thailand and Returned to Hong Kong

In October 2016, following the LegCo elections, Joshua Wong Chi-fung was invited to speak at two universities to share his experiences about the 2014 Occupy protests and youth participation. When he arrived at Bangkok's main airport, Mr. Wong said more than 20 Thai police and immigration officers were waiting for his arrival. According to Mr. Wong, they confiscated his passport and detained him for almost 12 hours without access to a lawyer, providing little explanation except that he was on a "blacklist" and would never be allowed entry into Thailand.⁶⁰ The Thai authorities eventually placed him on a flight back to Hong Kong and upon his arrival he said that he felt lucky to have not shared the same fate as Gui Minhai, the Hong Kong bookseller who was apparently abducted from Thailand and sent back to mainland China.⁶¹ A Thai student activist who was to meet Mr. Wong at the airport said that Thai authorities claimed Beijing wrote a letter requesting Mr. Wong be denied entry to Thailand, but Bangkok denied receiving such a request.⁶² In a similar incident in May 2015, Malaysia blocked Mr. Wong's entry into the country, where he was due to participate in Malaysian youth activist forums, citing the visit could "jeopardize [Malaysia's] ties with China."⁶³

Declining Freedom of Expression in Hong Kong

Press Freedoms Continue to Be at Risk

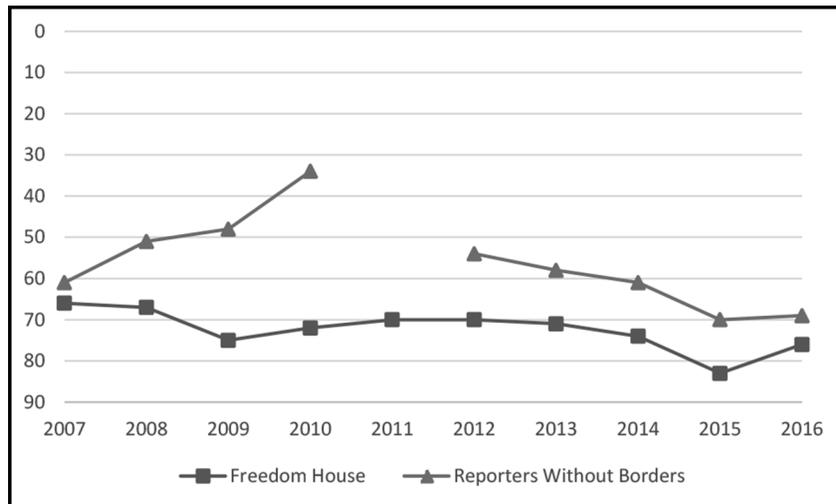
In addition to the impact of the booksellers case on freedom of expression in Hong Kong, according to watchdog organizations several other developments demonstrate continued strains on press freedom, even though the Basic Law guarantees freedom of the press in Hong Kong (see Figure 1). International nonprofit Reporters Without Borders ranked Hong Kong 69th among 180 countries and territories evaluated in its 2016 global press freedom index,

* According to the Hong Kong Airport Authority, it decided to consolidate the number of bookstores from 16 to 10 based on "a regular customer survey and an assessment on passenger needs." Elaine Yu, "Hong Kong Airport Shuttles Bookstores Amid Fears of Eroding Press Freedoms," CNN, April 12, 2016.

† Some in Hong Kong's book publishing business have contested the impact of the incident on the industry, citing the continued publishing of some political gossip books and the active underground market. Oliver Chou, "Banned Books: Hong Kong Publication Industry Collapsing," Sings Chief Editor of New York-Based Publishing House, *South China Morning Post* (Hong Kong), March 11, 2016.

moving up one place compared to 2015.* Despite the slightly improved position on the index, Hong Kong's overall score declined, mainly due to the encroaching influence of the Chinese government in Hong Kong newspapers' editorial positions and Chinese e-commerce group Alibaba's purchase of the *South China Morning Post* (discussed later in this section).⁶⁴ According to Freedom House, an independent international organization, Hong Kong's position also improved in the organization's global press freedom ranking—moving up seven spots to 76th among 199 countries and territories evaluated—primarily due to easing tensions following the 2014 pro-democracy protests and the establishment of several new online independent Hong Kong media organizations.[†] However, Freedom House also dedicated a special section of its global press freedom report to Hong Kong developments, asserting the further deterioration of Hong Kong's press freedom due to Alibaba's acquisition of the *South China Morning Post* and the booksellers incident.⁶⁵ Notably, both rankings only account for developments occurring in 2015, and thus do not include full coverage of the Hong Kong booksellers incident.

Figure 1: Hong Kong's Global Press Freedom Ranking, 2007–2016



Note: Reporters Without Borders did not publish a report in 2011 and instead published a 2012 report reflecting events between December 1, 2010, and November 30, 2011.

Source: Reporters Without Borders, "Hong Kong," April 2016. <https://rsf.org/en/hong-kong>; Freedom House, "Freedom of the Press 2016," April 2016. <https://freedomhouse.org/report/freedom-press/freedom-press-2016>.

Moreover, Hong Kong citizens are increasingly disappointed with the level of press freedom, according to recent polls. An April 2016 survey conducted by the University of Hong Kong's Public Opinion Programme found that only 46 percent of people are satisfied with

* In this ranking, 180 represents the country or territory with the lowest press freedom. Reporters Without Borders, "Hong Kong," April 2016.

† In this ranking 199 represents the country or territory with the lowest press freedom. Freedom House, "Freedom of the Press," April 2016, 23.

press freedom, while 33 percent are dissatisfied—the highest level of dissatisfaction for press freedom since the handover of Hong Kong to the PRC in 1997.⁶⁶

Violence against Journalists

Violence against journalists in Hong Kong persisted over the past year. The Hong Kong Journalists Association in its 2016 Annual Report reported that at least seven journalists were attacked from July 2015 to June 2016.⁶⁷ Although this is a slight improvement over recent years, it still far exceeded what the Association refers to as “normal” years, in which two to three incidents take place.⁶⁸ Six of the seven attacks occurred during the February 2016 Mong Kok incident, and were perpetrated by both demonstrators and law enforcement.⁶⁹ One reporter for Hong Kong Chinese-language newspaper *Ming Pao* was assaulted by police even after complying with orders to show his press credentials; he required treatment at a local hospital after sustaining head and hand injuries.⁷⁰

Politically Motivated Censorship

Mainland China is able to impart influence on media companies in Hong Kong through Chinese ownership and other means of applying pressure. According to the Hong Kong Journalists Association, the Chinese government or Mainland-based corporations have either direct control or stakes in 8 of 26 mainstream media organizations,* and the owners or news department leadership in 80 percent of these organizations have received appointments or awards from pro-Beijing bodies or individuals.† In recent years, self-censorship has increased as a result of pressure applied by Chinese and foreign companies to induce Hong Kong media to align with the CCP in their portrayal of news, resulting in journalists removing articles and editorials critical of the party. In other cases, editors and staff have been removed from their posts. Over the last year, examples of politically motivated censorship include the following:

- In April 2016, Chong Tien-siong—the principal editor of *Ming Pao* and a prominent businessman in the Mainland—fired a popular senior editor at the paper, Keung Kwok-yuen, shortly after he published a front page story on offshore holdings connected to Hong Kong’s elite that were disclosed in the International Consortium of Investigative Journalists’ “Panama Papers” leaks (for more information on the economic implications of the Panama Papers for Hong Kong, see the textbox later in this section on “Hong Kong and the ‘Panama Papers’ Case”).⁷¹ Mr. Keung’s termination was widely viewed among *Ming Pao* staff and other media as related to his work on politically sensitive reporting. Since assuming his position in May 2014, Mr. Chong has overseen violations in editorial practices and

*These news outlets include: *Ta Kung Pao*, *Wen Wei Po*, *Hong Kong Commercial Daily*, *China Daily* (Hong Kong edition), *Sing Pao Daily News*, Phoenix Satellite Television, TVB, and the *South China Morning Post*. Hong Kong Journalists Association, “One Country, Two Nightmares: Hong Kong Media Caught in Ideological Battleground,” July 2016, 5.

†For example, in July 2016, owner of Phoenix Satellite Television and media tycoon Liu Changle won an award for his distinguished service at the Hong Kong government’s annual awards ceremony. Hong Kong Journalists Association, “One Country, Two Nightmares: Hong Kong Media Caught in Ideological Battleground,” July 2016, 5; Ng Kang-chung, “Hong Kong Award Winners Announced: Carrie Lam Receives Top Civic Medal,” *South China Morning Post* (Hong Kong), July 1, 2016.

quashed articles that were politically sensitive.* In response to the firing of Mr. Keung, some *Ming Pao* columnists refused for days to write their regular columns,⁷² and around 400 journalists, activists, and politicians led a protest outside the *Ming Pao* offices. In addition, the Hong Kong Journalists Association issued a joint letter from eight journalist groups calling for Mr. Keung's reinstatement.⁷³

- In December 2015, China's largest e-commerce firm, Alibaba, announced its \$266 million purchase of the *South China Morning Post*, Hong Kong's most popular English-language newspaper.⁷⁴ Alibaba said the main driver of the deal was to help improve China's image abroad and offer an alternative to what it perceives as bias in Western media.⁷⁵ However, Jack Ma, the company's chief executive officer, said the newspaper would maintain editorial independence and not censor content.⁷⁶ According to David Bandurski, editor of the China Media Project at the University of Hong Kong, such claims would probably be difficult to maintain.⁷⁷ Mr. Bandurski said, "[I think] that a lot of [Hong Kong] newspapers in Chinese, and also the [*South China Morning Post*] even before this purchase, have carefully considered what to report in light of their business interests or [political] pressure."⁷⁸ Others note that although a foreign businessman supportive of China owned the newspaper previously, Alibaba's purchase would more firmly place the paper under Beijing's influence due to its close connection to the Chinese government.⁷⁹

Challenges to Academic Freedom

Universities in Hong Kong have historically enjoyed a high degree of autonomy and academic freedom, as protected under the Basic Law. Nonetheless, in recent years such freedoms have been challenged, as Beijing and the Hong Kong government remain wary of prodemocracy activism—and especially the spread of pro-independence thought more recently—among university students and academics.

In 2015, the governing council at the University of Hong Kong (HKU), Hong Kong's premier academic institution, made a controversial decision to delay and ultimately reject the appointment of a prodemocracy academic for a leadership position at the university. The incident caused many in the university community and at other academic institutions to assert that Beijing and the Hong Kong government blocked the appointment.†

Further controversy at HKU continued into 2016. In January 2016, Arthur Li Kwok-cheung, a member of the HKU governing council‡ that helped block the aforementioned academic's appoint-

* For examples of Mr. Chong's decisions as editor of *Ming Pao*, see U.S.-China Economic and Security Review Commission, *2015 Annual Report to Congress*, November 2015, 540–541.

† For more information about this case, see U.S.-China Economic and Security Review Commission, *2015 Annual Report to Congress*, November 2015, 542–543.

‡ The HKU governing council consists of 24 members, including current Chairman Arthur Li Kwok-cheung; six members appointed by HKU Chairman (and Hong Kong Chief Executive) CY Leung; six members appointed by the Council; two members elected by the Court; the university president (and vice chancellor); the university treasurer; four faculty members; one university employee (non-faculty); and two students. University of Hong Kong, "Governance Structure—The Council." http://www.hku.hk/about/governance/governance_structure/the-court/council_membership.html.

ment, was appointed as chairman of the governing council. Mr. Li, who is pro-Beijing, was appointed to the chairmanship by his close friend Chief Executive Leung, and he concurrently serves as a member of the Chinese People's Political Consultative Committee, the Chinese government's chief advisory body. In response to the appointment, 20 student and activist organizations led a march to protest Chief Executive Leung's decision (organizers said over 3,000 people participated, while police said protesters only numbered 830).⁸⁰ Student groups also led a one-week boycott of classes at the start of the semester, voicing their concerns about the university losing its democratic freedoms and facing increasing pressure from Beijing. Professor Timothy O'Leary, head of HKU's School of Humanities and co-organizer of HKU Vigilance, a group of professors examining academic freedom, said, "We are [protesting] to make sure the universities can go on being places in which people are free to think and ask questions . . . that some people do not want them to think about and to discuss."⁸¹ University students are pushing for reforms in the school's governance structure, but the governing council and students have been unable to agree on terms to set up a meeting.⁸² In April 2016, the council formed an independent three-person panel* to review the school's governance mechanisms and discuss potential reforms; the panel's findings are expected by the end of 2016.⁸³

Responding to the rising popularity of pro-independence views among students in Hong Kong,⁸⁴ Beijing and the Hong Kong government have stepped up efforts to restrict discussion of independence and related topics in schools. In August 2016, a mainland official stated that discussions of independence should be banned in primary and secondary schools, as such discussions would "poison" students' minds.⁸⁵ The Hong Kong Education Bureau announced that teachers could lose their jobs if they promote the idea of Hong Kong independence, sparking a debate across Hong Kong civil society.⁸⁶ Hong Kong Secretary of Education Eddie Ng Hak-kim, reportedly after returning from meetings with officials in Beijing, elaborated that "students [could] discuss anything if they are under the guidance of teachers," but the topic "should be discussed from the position of the Basic Law."⁸⁷ Chief Executive Leung reiterated the need to remove discussion of independence from schools, arguing, "it's not an issue of freedom of speech, but being able to tell right from wrong."⁸⁸ Some teachers and prodemocracy advocates have said they fear the new policy would lead to self-censorship in schools and further constraints on academic freedom.⁸⁹ One teacher said, "I am very worried that this will give rise to a chilling effect, and that this warning is very close to [ideological] direction . . . and that it will be on a list of banned topics. Nobody will dare to touch it at all."⁹⁰ The Hong Kong government has yet to clarify the legal basis for this new policy amid calls from teachers' unions and legal scholars and has remained vague as to what actions would constitute a breach of the policy.⁹¹

*Panel members include Chancellor of the University of York Sir Malcom John Grant, who will serve as the panel's chairman, Professor William C. Kirby of Harvard University, and Peter Van Tu Ngyun, a former Hong Kong high court judge. University of Hong Kong, "HKU Council Establishes the Review Panel on University Governance and Appoints Members to the Panel," April 26, 2016.

Chinese Censorship of Prize-Winning Hong Kong Film *Ten Years*

During the past year, some Hong Kong film critics celebrated the release of the low-budget, independent Hong Kong movie *Ten Years* as one of the top Hong Kong films in decades. The movie consists of short stories set ten years from the present day, portraying a dystopian future where Hong Kong has lost much of its culture and freedoms to mainland China. Over the film's short time in theatres, it led box office sales, beating out *Star Wars* in one theatre's box office receipts where both films appeared.⁹² The *Global Times*, a nationalist state-run Chinese newspaper, called the movie "absurd," "pessimistic," and a "thought virus."⁹³ Less than two months after gaining a wide release in Hong Kong, the film was abruptly removed from theatres, leading many to question Beijing's involvement in quashing the movie. Shu Kei, a film critic and professor at the Hong Kong Academy for Performing Arts, said, "I have never heard of anywhere else that a film that sells full houses at every single screening is pulled out from the theatres, but no exhibitor will admit censorship or direct pressure from China."⁹⁴

Moreover, after *Ten Years* received a nomination for best film—which it would later win—at the Hong Kong Film Awards, the city's version of the Oscars, Beijing enacted a ban on the show's broadcast in mainland China for the first time and censored all mentions of the movie in media reporting about the ceremony.⁹⁵ Chinese censorship of the awards show broadcast follows a tightening on media controls in mainland China and a crackdown on any form of independent thoughts or ideas promoting prodemocracy stances.

Hong Kong's Economy and its Economic Ties with Mainland China

Hong Kong remains an important global financial hub. According to a UN report, Hong Kong is the world's second largest recipient of foreign direct investment (FDI) inflows (\$175 billion) after the United States, and third largest in terms of FDI outflows in Asia (\$55 billion) after Japan (\$129 billion) and mainland China (\$128 billion).⁹⁶ In 2015, Hong Kong's gross domestic product (GDP) grew by 2.4 percent, down from 2.7 percent growth the previous year, and is expected to grow by 1–2 percent in 2016.⁹⁷ This downward trend is mostly a result of declines in incoming visitors and retail sales, especially luxury goods, likely related to the Mainland's recent economic slowdown and Beijing's anti-corruption drive.* From January to June 2016, Hong Kong experienced a 7.4 percent year-on-year decline in tourism after a 3.9 percent year-on-year increase in 2015; mainland visitors, who made up over 77 percent of total visitors, declined by 10.6 percent over the same period in 2016

*For example, Hong Kong's Chow Tai Fook, the largest jeweler in the world, has seen sales drop 22 percent from April through June on an annualized basis. Other luxury retailers have reportedly been closing stores over the past year. Ben Bland, "Hong Kong: One Country, Two Economies," *Financial Times*, July 19, 2016.

after increasing 5.6 percent year-on-year in 2015.⁹⁸ Merchandise exports—the largest being jewelry and precious or semi-precious materials⁹⁹—faced sluggish demand, dropping 3.9 percent year-on-year from January to June 2016.¹⁰⁰ Because of Hong Kong's close ties with the Mainland, China's recent economic weakness has exacerbated Hong Kong's economic downturn.¹⁰¹

Beijing continues to rely on Hong Kong as one of its most important economic partners.* Hong Kong is China's top entrepôt, where 61 percent of re-exports † (i.e., goods made in China, shipped to Hong Kong, and then re-exported to the Mainland and other foreign markets) were from mainland China; 54 percent of re-exports were shipped to mainland China in 2015, according to the Hong Kong Trade Development Council.¹⁰² Hong Kong is China's largest source of FDI, totaling 51 percent of all foreign investment in China by the end of 2015.¹⁰³ Likewise, mainland China is a leading investor in Hong Kong, with Chinese investment reaching approximately \$448 billion (30.1 percent of inbound Hong Kong investment) by the end of 2014.¹⁰⁴ These investment data are distorted, however, as “roundtripping” is a common practice. Just as trade between Beijing and Hong Kong involves a significant number of re-exports, analysts estimate 40 percent of all FDI flows into Hong Kong are then reinvested in China.¹⁰⁵

Hong Kong and the “Panama Papers” Case

The so-called Panama Papers—11.5 million financial documents of one of the world's leading firms incorporating offshore companies, Panamanian law firm Mossack Fonseca, leaked to the German newspaper *Süddeutsche Zeitung* and then posted online by whistleblower nonprofit International Consortium of Investigative Journalists (ICIJ)—exposed Hong Kong's central role as one of the world's largest hubs for intermediary companies (including banks, law firms, accountants, and others) to operate. From the documents, the ICIJ found that relatives of three CCP Politburo Standing Committee officials, including relatives of General Secretary Xi, have controlled offshore firms, exposing how Chinese elites move wealth out of mainland China.¹⁰⁶ According to the Panama Papers, of the more than 14,000 intermediaries that served clients of the law firm, over 2,200 operated in Hong Kong. Over the last 40 years, Mossack Fonseca incorporated 37,675 companies in Hong Kong—more than in any other country or territory.¹⁰⁷ Hong Kong's status as an attractive territory for such activity is largely a product of its independent legal system, simple tax regime, and free trade and capital flow. Among other things, the revelations in the Panama Papers illustrate the recent pattern of Chinese capital flight through Hong Kong into

*Although Hong Kong is part of China, it has a separate legal structure and is treated as “overseas” for the purposes of most regulations governing the ability of mainland Chinese to trade, travel, transfer funds, and conduct other transactions.

† Re-exports are exports of imported goods, typically in the same state as previously imported. UN International Trade Statistics, “Distinction between Exports and Re-Exports/Imports and Re-Imports.” <http://unstats.un.org/unsd/tradekb/Knowledgebase/Reexports-and-Reimports>.

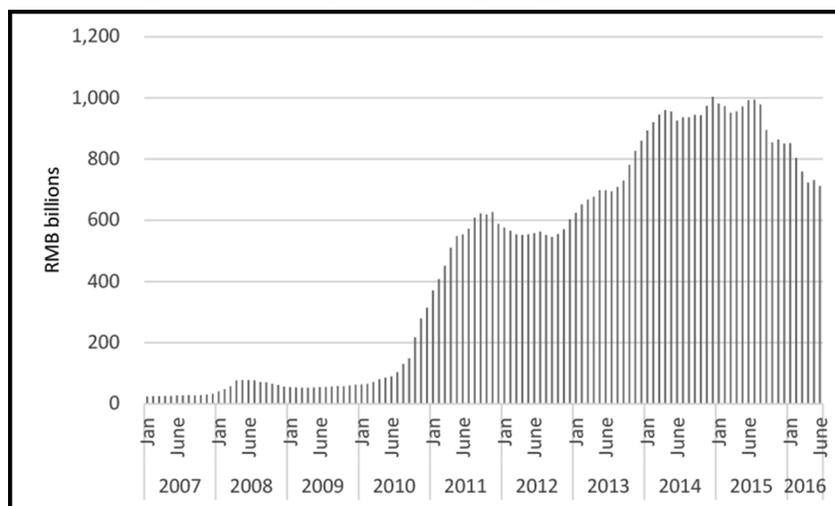
Hong Kong and the “Panama Papers” Case—Continued

foreign tax havens.¹⁰⁸ Although the impact of the disclosures on Hong Kong’s role as a hub for intermediary companies is unclear, it could lead the families of Chinese officials and other wealthy individuals to keep their assets in offshore entities filed outside of Hong Kong to maintain greater protection from whistleblowers.¹⁰⁹

Hong Kong’s Role in Mainland China’s Financial Reforms

Due to Hong Kong’s status as a global financial hub, China uses Hong Kong as its main platform to drive internationalization of the renminbi (RMB). China’s 13th Five-Year Plan (2016–2020), announced in March 2016, emphasizes capital account liberalization and RMB internationalization (for more information on China’s most recent five-year plan, see Chapter 1, Section 3, “China’s 13th Five Year Plan”).¹¹⁰ Beijing seeks to expand the use of the RMB around the world by allowing the currency to be traded in the global marketplace. In November 2015, the International Monetary Fund’s decision to include the RMB in its basket of Special Drawing Rights (effective October 1, 2016) was viewed as an opportunity to increase international demand for the RMB (see Chapter 1, Section 1, “Year in Review: Economics and Trade,” for more on this development).¹¹¹ One of the key challenges facing Beijing is continuing to boost RMB deposits in Hong Kong while more investors convert their money into Hong Kong dollars (HKD) to move capital out of mainland China.¹¹² As of June 2016, RMB customer deposits in Hong Kong have fallen over 28 percent year-on-year compared to 2015, according to Hong Kong Monetary Authority data (see Figure 2).¹¹³

Figure 2: RMB Deposits in Hong Kong, 2007–June 2016

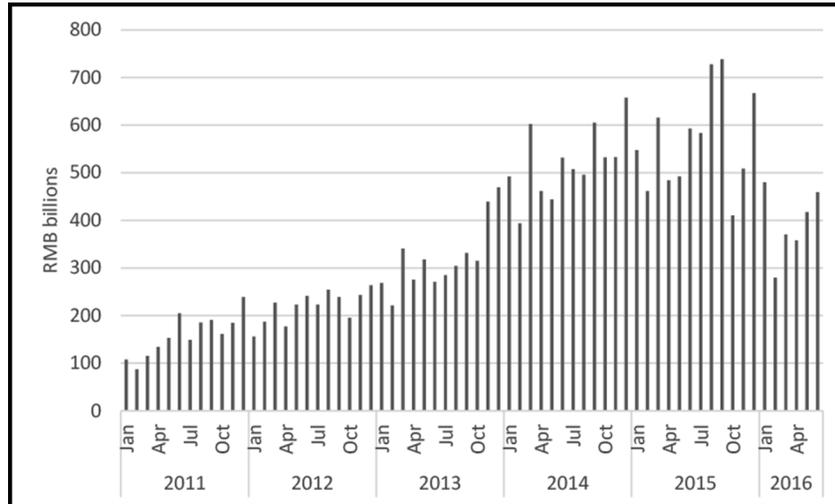


Source: Hong Kong Monetary Authority.

RMB Trade Settlement

Hong Kong banking institutions serve local and foreign banks and companies to conduct RMB trade settlement, payments, financing, and investments—another important component of Beijing’s strategy to internationalize the RMB. Hong Kong continues to be the largest hub for offshore RMB trade settlement, capturing over 90 percent of the world’s total as of the end of 2014.¹¹⁴ In 2015, RMB trade settlement grew over 9 percent year-on-year to RMB 6.8 trillion (\$1.03 trillion).¹¹⁵ However, in the first six months of 2016, trade settlement declined to RMB 2.4 trillion (\$355.5 billion), down 26 percent year-on-year (see Figure 3).¹¹⁶

Figure 3: Monthly Cross-Border RMB Trade Settlement through Hong Kong Banks, 2011–June 2016



Source: Hong Kong Monetary Authority.

Shanghai-Hong Kong Stock Connect

Viewed by many observers as one of the most important developments in recent years to advance Beijing’s efforts to internationalize the RMB, the Shanghai-Hong Kong Stock Connect launched in November 2014, linking the Shanghai and Hong Kong stock exchanges.* Mainland China intended to establish the stock connect as a gateway to bring foreign investment into Chinese shares, but the program has disappointed since its launch. After an initial period of investor excitement, trading volume has declined considerably and, since late 2015, inflows to Hong Kong via the stock connect have been increasing relative to inflows to Shanghai. In January 2016, Chinese investments in Hong Kong stocks outpaced flows

*For more information about the establishment of the Shanghai-Hong Kong Stock Connect and developments over its first year of operations, see U.S.-China Economic and Security Review Commission, *2015 Annual Report to Congress*, November 2015, 548–552.

in the opposite direction for the first time, likely due to Chinese investors seeking to escape market volatility in mainland China.¹¹⁷

Since its launch, the platform has encountered a number of obstacles that continue to hinder its effectiveness in bringing greater foreign investment inflows into Shanghai's market. One of the main challenges is that the two sides have important regulatory differences. Beijing maintains a daily quota on total investments into Hong Kong—with northbound trading capped at around \$1.9 billion and southbound trading capped at \$1.6 billion¹¹⁸—and restricts the ability of Chinese citizens to participate based on minimum account balances. In addition, China restricts short selling and suspends companies that rise or fall by 10 percent for the day, while Hong Kong does not have such limits.¹¹⁹

Financial analysts in Hong Kong believe the Shanghai-Hong Kong Stock Connect may be boosted by the opening of a Shenzhen-Hong Kong Stock Connect, which has faced a months-long delay due to Chinese market volatility* and regulatory obstacles on the Chinese side.¹²⁰ The Shenzhen-Hong Kong Stock Connect, which will remove limits imposed on foreign investors in the Shenzhen stock market, marks a step toward financial liberalization after Chinese trading regulators tightened their control following market volatility.¹²¹ In a statement before the State Council, Chinese Premier Li Keqiang indicated that the link, which will reportedly be implemented by November 2016, seeks to “exert the geographic advantages of Shenzhen and Hong Kong, and enhance the cooperation between the mainland and Hong Kong.”¹²² Because Shenzhen is a center for China's emerging industries, the new link is expected to have greater appeal to global investors, particularly in sectors like technology, pharmaceuticals, and clean energy.¹²³ Shenzhen is already China's most active exchange, handling \$1.2 trillion in trading in July 2016, the second highest in volume globally behind only the New York Stock Exchange.¹²⁴ Mainland authorities will remove aggregate trading caps for both Shenzhen's and Shanghai's stock connects with Hong Kong,¹²⁵ but Shenzhen will inherit the same daily quotas as Shanghai's exchange system.¹²⁶

Hong Kong's Security Ties with Mainland China

Since the handover of Hong Kong to the PRC in 1997, the Chinese government has been responsible for Hong Kong's defense under Article 14 of the Basic Law and in accordance with the “one country, two systems” policy.¹²⁷ The PLA has stationed forces in the Hong Kong Garrison, and its presence has gradually expanded over time but has remained relatively discreet compared to its activities and operations in and around mainland China. Nonetheless, the PLA has worked to expand its outreach efforts to Hong Kong citizens in a number of areas, including the following:

- *Opening the garrison to Hong Kong citizens:* Continuing a legacy program from the British era,¹²⁸ the PLA hosts an annual

* For more on China's recent stock market volatility, see Nargiza Salidjanova, “China's Stock Market Melted Down Shakes the World, Again,” *U.S.-China Economic and Security Review Commission*, January 14, 2016.

“open day” in which it usually opens several bases to Hong Kong citizens for military demonstrations, souvenir giveaways, and other activities.¹²⁹ The PLA reported that as of 2015, a total of 587,000 Hong Kong citizens had attended.¹³⁰

- *PLA outreach to young people:* The PLA hosts military summer camps for Hong Kong teenagers to teach them about PLA military life and mainland China. Around 500 students participated in the 2016 edition, twice as many as the previous year.¹³¹ The PLA also occasionally visits Hong Kong schools and civic groups. In December 2015, PLA personnel visited a kindergarten class to help the students make holiday presents for the elderly as part of the PLA’s “Care for Young Children” campaign.¹³²
- *Participating in Hong Kong community outreach:* PLA soldiers regularly participate in Hong Kong Tree Planting Day and blood donation activities. As of 2015, the PLA reported that garrison soldiers have planted 82,000 trees and over 6,800 troops have given blood.¹³³
- *Delivering messages through its information office:* The garrison issues messages to Hong Kong citizens, usually around the Lunar New Year, to support developmental initiatives key to Beijing. In February 2016, the garrison’s commander and political commissar issued a Lunar New Year’s greeting through the garrison’s information office, emphasizing that Hong Kong take advantage of the Mainland’s “One Belt, One Road” initiative and 13th Five-Year Plan.¹³⁴

The PLA’s Hong Kong Garrison has also conducted increasingly complex military exercises in recent years (see Table 1). Many of these exercises have occurred during particularly sensitive times in Hong Kong, causing prodemocracy advocates and other observers to assert that the CCP is using the PLA as a tool to apply pressure on Hong Kong citizens to fall in line with Beijing’s demands.¹³⁵

Table 1: Select PLA Hong Kong Garrison Exercises, 2011–October 2016

Date	Exercise Type (Name, if applicable)	Platforms and Services Involved (if reported)	Details and Perceived Political Sensitivity (if reported)
August 2016	Special Forces Exercise	Not reported	The exercise, which took place in Hong Kong, involved air, land, and sea drills, and urban combat using live ammunition. Although the dates of the five-day exercise are unclear, Chinese media broadcast video from the exercise the day before Hong Kong’s first pro-independence rally. ¹³⁶

Table 1: Select PLA Hong Kong Garrison Exercises, 2011–October 2016—Continued

Date	Exercise Type (Name, if applicable)	Platforms and Services Involved (if reported)	Details and Perceived Political Sensitivity (if reported)
2015 (various)	“Defenders of Hong Kong” Exercises	PLA Army, Navy, and Air Force	Four live-fire exercises held from May to October 2015 covered maritime defense, air defense, army-air operations, and joint operations. The July exercise was the first exercise ever open to the public, ¹³⁷ and occurred three days after China passed a new national security law that emphasized Hong Kong’s responsibility to defend China’s national security. The October exercise was intended to improve joint operational capabilities, while some Hong Kong media reported that it appeared targeted at pro-independence groups. ¹³⁸
1/24/2014	Sea-Air Joint Patrol	Two frigates and three helicopters	The patrol through Victoria Harbor (between Hong Kong Island and Kowloon) was staged less than one month after anti-PLA protests.* ¹³⁹
7/4/2013	Sea-Air Joint Patrol	Two Type 056 frigates and four armed rescue helicopters	Frigates newly introduced in early 2013 participated in the joint patrol, which was staged several days after the annual July 1 prodemocracy march. ¹⁴⁰
3/24/2013	Live-Fire Helicopter Exercise	Helicopters	The exercise was the first live-fire exercise in Hong Kong since 1997. It reportedly involved simulating the response to an external attack. ¹⁴¹
10/24/2012	Anti-Separatist Exercise	Helicopters, armored vehicles, and surface ships (PLA Army, Navy, and Air Force)	The exercise reportedly simulated armed combat against a “blue force” Cantonese-speaking army in an urban environment and included the seizure of a mountainous area outside the city. ¹⁴²
3/9/2011	Sea-Air Joint Patrol	PLA Army, Navy, and Air Force	The patrol involved surveillance, reconnaissance, and target tracking as well as sea and air emergency response. ¹⁴³

*For more information on the protests surrounding the building of a Chinese military port, see U.S.-China Economic and Security Review Commission, *2014 Annual Report to Congress*, November 2014, 528–529.

China Denies U.S. Navy Flotilla Port Call in Hong Kong

In April 2016, Beijing refused to allow the U.S. aircraft carrier *John C. Stennis* and supporting vessels a routine port call at the Hong Kong Garrison for the first time since August 2014. The decision to reject the U.S. Navy flotilla appeared to be in response to U.S. Navy freedom of navigation operations in the South China Sea challenging China's claims and those of other claimants.¹⁴⁴ Since 2013, an average of 14 U.S. Navy ships per year made port calls in Hong Kong,¹⁴⁵ and China has only refused U.S. port visits four times since the handover of Hong Kong to the PRC in 1997.¹⁴⁶

Implications for Taiwan of Beijing's Control over Hong Kong's Political Development

As Beijing's actions to restrict Hong Kong's autonomy intensify and the Hong Kong prodemocracy movement grows increasingly pessimistic about mainland China's control over Hong Kong—especially given its disregard for rule of law and lack of concessions on electoral reform—Taiwan activists are watching these developments with concern. In the event Taiwan could be brought under the “one country, two systems” framework in the future, which is Beijing's preferred model for Taiwan,¹⁴⁷ it would likely encounter similar encroachment on its democratic values and system of government. Mainland China's recent actions violating its commitments under the 1997 Sino-British Joint Declaration—the handover agreement of Hong Kong from the UK to the PRC—and reflected in the Basic Law to allow “a high degree of autonomy” in Hong Kong¹⁴⁸ do not bode well to achieve its goal of reunifying Taiwan with mainland China. Moreover, Taiwan has already rejected any potential framework similar to Hong Kong. According to Ma Ying-jeou, Taiwan's president from 2008 to 2016 who presided over a period of positive cross-Strait ties, “Taiwan [has] made it very clear that we would not accept [the “one country, two systems” formula]. If between two systems one is better, that system should prevail.”¹⁴⁹ During the Commission's trip to Taipei in June 2016, several Taiwan interlocutors emphasized that Taiwan citizens and the Tsai Ing-wen Administration do not want a relationship with mainland China resembling Hong Kong's “one country, two systems” model.¹⁵⁰ (See Chapter 3, Section 2, “China and Taiwan,” for more information on developments in Taiwan.)

Implications for the United States

U.S. policy toward Hong Kong remains based upon the U.S.-Hong Kong Policy Act of 1992, which outlines U.S. support for Hong Kong's democratization, human rights, and autonomy under the “one country, two systems” framework. Advocating for freedom of expression and democratic ideals serves as an important pillar of U.S. policy in the Asia Pacific. The 2016 LegCo elections serve as a vivid example of Hong Kong's democratic progress, particularly in resisting interference from Beijing. A spokesperson for the U.S. Department of State Bureau of East Asia and Pacific Affairs said, “[The record turnout was an] affirmation of the commitment of [the Hong Kong] people to participate in the democratic process.

[The Obama Administration] looks forward to working with all elected leaders to build strong relations between the United States and Hong Kong and achieve mutually beneficial goals.”¹⁵¹ However, the recent downward trends in Hong Kong with regard to electoral reform, press freedom, and academic freedom run counter to U.S. interests and values.

The case of Hong Kong—particularly as it relates to the booksellers incident and encroachment on press and academic freedoms, and the new loyalty “pledge” required for legislative candidates—reflects a broader pattern of behavior in which Beijing disregards norms, agreements, or laws (either in spirit or in letter) in pursuit of its objectives. It calls into question Beijing’s ability to retain its commitments to its neighbors. This is especially relevant when it comes to China’s commitment not to encroach on Taiwan’s autonomy, which in recent years has been increasingly threatened. The United States and Asia Pacific countries are already concerned about Beijing’s assertive actions in the region more broadly, particularly its island building in the South China Sea and aggressive behavior defending its claims, including by violating the spirit of the UN Convention on the Law of the Sea, to which China is a signatory.

Moreover, Hong Kong’s traditional standing as a global financial hub has significant economic implications for the United States, as U.S. trade and investment ties with Hong Kong are substantial. Hong Kong is the ninth-largest importer of U.S. goods, and the United States retains its largest trade surplus with Hong Kong (\$35.1 billion), according to 2014 data.¹⁵² U.S. FDI in Hong Kong ranked sixth in the world as of year-end 2014 (HKD 385 billion, \$49.6 billion).¹⁵³ In addition, Hong Kong is home to more than 1,400 U.S. firms, which depend on Hong Kong’s supportive business environment.¹⁵⁴ At the multilateral level, Hong Kong is a helpful participant alongside the United States in key international economic institutions, including the World Trade Organization, Asia-Pacific Economic Cooperation, the Financial Action Task Force on money laundering, and the Financial Stability Board on monitoring the global financial system.¹⁵⁵

Nonetheless, many in the Hong Kong business community, including U.S.-based and global firms, are beginning to question Hong Kong’s future as a global financial center due to the deterioration of the “one country, two systems” model, particularly as a result of the booksellers incident over the past year.¹⁵⁶ According to an executive at a foreign chamber of commerce in Hong Kong, “For many businesses, the [booksellers] incident has raised many questions about the rule of law, which is one of the absolutely key aspects that makes Hong Kong work and gives people the confidence to do business here.”¹⁵⁷ In February 2016, after months of deliberation, UK bank HSBC ultimately decided not to move its headquarters from London to Hong Kong; the decision was likely influenced in part by the lack of confidence in the maintenance of the “one country, two systems” framework in Hong Kong.¹⁵⁸ The chill felt across the Hong Kong business sector could negatively impact U.S. interests if the present climate persists.

Conclusions

- In the highest voter turnout to date for the 2016 Legislative Council elections, Hong Kong citizens rejected Beijing's heavy-handed efforts to limit support for prodemocracy candidates, resulting in the pan-democrats winning 30 out of 70 total seats (a net gain of three) and maintaining their ability to block pro-Beijing legislation. The election of five candidates from political parties founded in the aftermath of the 2014 Occupy protests demonstrated progress in Hong Kong's democratic development, particularly the increasing involvement and influence of young people in the political process.
- The case of the five Hong Kong sellers of political gossip books banned in mainland China who appeared to have been abducted and detained by Chinese authorities led many, including those not previously concerned, to call into question the state of Hong Kong's ability to maintain its independent legal system; Hong Kong's autonomy under the "one country, two systems" model; and the city's standing as a global financial center. Although long-term impacts are unclear at this time, the incident has already caused a chill throughout the book publishing industry, leading to bookstore closures and increased self-censorship.
- Beijing's refusal in 2014 to allow democratic reforms to the chief executive nomination process along with increased pressure on Hong Kong's political discourse over the past year, have led to greater disillusionment and pessimism among Hong Kong prodemocracy advocates regarding China's commitment to the "one country, two systems" framework.
- Hong Kong continues to face pressure on press and academic freedoms guaranteed under its mini constitution, the Basic Law. Schools in Hong Kong are facing increasing pressure, limiting open debate about democratic ideas and independence. Chinese e-commerce giant Alibaba's acquisition of the Hong Kong-based English-language newspaper *South China Morning Post* demonstrated Beijing's increasing reach into Hong Kong. Hong Kong citizens and international press freedom watchdogs have expressed their concern regarding these developments.
- In 2016, Hong Kong played an increasing role in Beijing's push to internationalize the renminbi. Although the existing Shanghai-Hong Kong Stock Connect has not lived up to expectations thus far due in part to regulatory deficiencies, as it matures over the coming years the platform could help facilitate greater investment into mainland stock markets. In November, Beijing plans to establish a second stock connect between Shenzhen and Hong Kong, which is expected to have greater appeal to global investors as Shenzhen is a base for the Mainland's emerging industries and its most active stock exchange.
- As Hong Kong's sole provider of defense under the Basic Law, the People's Liberation Army (PLA) has retained a relatively low-key presence, but has gradually expanded its outreach efforts to Hong Kong citizens. The PLA has also conducted increasingly sophisticated exercises in recent years, particularly during sen-

sitive periods in Hong Kong, leading some to accuse Beijing of using the exercises to pressure Hong Kong citizens.

- China's efforts to exert influence over Hong Kong in ways that undermine Hong Kong's autonomy under the Basic Law reflect a broader pattern of reliance on tools of pressure and coercion—rather than norms, laws, and agreements—to advance its interests vis-à-vis its neighbors. This pattern is also evident in China's relations with Taiwan and its recent behavior in the South China Sea.
- Hong Kong's standing as a global financial hub has significant economic implications for the United States, as U.S. trade and investment ties with Hong Kong are substantial. Nonetheless, some observers in Hong Kong are beginning to question its future as a global financial center due to the deterioration of the "one country, two systems" framework resulting in large part from the booksellers incident over the past year.

RECOMMENDATIONS

China and Hong Kong

The Commission recommends:

- Congress express that China's apparent abduction and detention of five Hong Kong and foreign national booksellers based in Hong Kong for selling banned books to customers in mainland China violates its commitments to maintaining a "high degree of autonomy" in Hong Kong under the "one country, two systems" framework. In addition, members of Congress in their meetings in China should continue to express support for human rights and rule of law in Hong Kong.
- Congress continue to renew annual reporting requirements of the U.S.-Hong Kong Policy Act of 1992, in an effort to ensure policymakers have the most up-to-date and authoritative information about developments in Hong Kong.
- Congress direct the U.S. Department of State to prepare a report that assesses whether Hong Kong has maintained a "sufficient degree of autonomy" under the "one country, two systems" policy, due to the deterioration of freedom of expression in Hong Kong and Beijing's increasing encroachment.

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