SECTION 4: HONG KONG

Introduction

In the wake of political turmoil and widespread protests surrounding implementation of reform in Hong Kong’s 2017 chief executive election, Hong Kong society remains politically divided. This section examines developments in Hong Kong’s electoral reform process; declining press, expression, and academic freedoms; and the deepening economic relationship between Hong Kong and mainland China. Findings in this section are based on the Commission’s July trip to Hong Kong, meetings with government officials and experts, think tank and media reports, and official statistics. The section concludes with a discussion of the implications of Hong Kong’s political and economic development for the United States.

Constitutional Relationship between Hong Kong and Mainland China

Constitutionally, Hong Kong is a special administrative region of the People’s Republic of China (PRC). While central authorities in Beijing are explicitly charged with managing Hong Kong’s foreign affairs and defense, Hong Kong is otherwise entitled to conduct its own administrative affairs in accordance with the Basic Law, the region’s mini-constitution, which grants it a “high degree of autonomy.” This autonomy allows Hong Kong to exercise executive, legislative, and independent judicial power. Hong Kong’s autonomy was established in accordance with the “one country, two systems” principle—introduced by Deng Xiaoping to realize the peaceful reunification of China—under which the region’s capitalist system and “way of life” would remain unchanged for 50 years after the 1997 turnover from British rule. Taken together, the laws and policies that govern the relationship between Hong Kong and mainland China dictate that the region’s autonomous powers are authorized through the Basic Law in accordance with the PRC constitution—the ultimate legal and political ground for Hong Kong’s high degree of autonomy.

Under this constitutional framework, provisions in the Basic Law that govern the democratic development of Hong Kong’s electoral process are subject to interpretation by the Standing Committee of the National People’s Congress (NPC), China’s de facto legislative body. According to the Basic Law, Hong Kong’s leader, the chief executive, is to be selected “by election or through consultations held locally,” but is accountable to and appointed by China’s central government. While the precise method for selecting the chief executive was left legally ambiguous at the time the Basic Law was implemented, the law set forth the intention to one day select the region’s leader “by universal suffrage upon nomination by a broadly...
representative nominating committee in accordance with democratic procedures."  

**Developments in Hong Kong’s Electoral Reform**

In 2007, the NPC Standing Committee first announced that universal suffrage—defined by the Hong Kong and central governments as election on a “one person, one vote” basis—may be instituted in the 2017 chief executive election. Current Chief Executive Leung Chun-ying (known as CY Leung) in July 2014 formally initiated the five-step process for amending the Basic Law when he submitted a report to the Standing Committee affirming the need to reform Hong Kong’s electoral method in the 2017 chief executive election. In August 2014, the Standing Committee completed the second step of the constitutional development process when it put forth an electoral framework with strict conditions on the adoption of universal suffrage, intensifying widespread and politically charged protests that grew out of public anger over a June policy paper. According to one Hong Kong lawmaker, the policy paper, which was published by China’s State Council, “eliminate[d] the possibility that the state would restrain itself” and “sent[ed] a clear message to Hong Kong that Beijing is omnipotent—all power comes from the National People’s Congress.”

The conditions on universal suffrage under the Standing Committee’s framework included a restrictive nomination mechanism that effectively precluded the nomination of prodemocracy candidates. Under the Standing Committee’s framework, only two or three candidates could be nominated to stand for election, and each candidate must be supported by more than 50 percent of the nominating committee, compared with 12.5 percent in the 2012 election. Because the new “broadly representative” nominating committee was to be formed “in accordance with the number of members, composition, and formation method of the [current] election committee,” it was expected to maintain the same Beijing-friendly bias as the current election committee. The Standing Committee’s framework also stipulated that the chief executive must be a “patriot” who “loves the country and loves Hong Kong.”

These constraints were met with fierce opposition among prodemocracy voices in Hong Kong. After Beijing unveiled its framework, all of Hong Kong’s 27 prodemocracy legislators (known in Hong Kong as pan-democrats) vowed to vote down what they believed to be a “fake” democratic model. Prodemocracy activists participated in extended protests throughout Hong Kong starting in mid-2014, with some arguing the proposed “rigid” voting framework was “unacceptable to the average voter.” As the protests dragged on, however, public frustration with the disruption caused by protests resulted in a partial loss of support and splintering of political views. The movement successfully delayed to January the second round of public consultation, but failed to cause the central government to alter or scrap the plan. Hong Kong Chief Secretary for Administration Carrie Lam stated, “There is no room for any concessions or compromises to be made” with regard to the NPC
Standing Committee’s decision. In the aftermath, actors across the political spectrum in Hong Kong have become further fragmented in their interpretations of the concept of universal suffrage and its application in the 2017 and future chief executive and Legislative Council (LegCo) elections.

Legislative Council Rejects Electoral Reform Proposal

After the protests dispersed in December 2014, the impetus for electoral reform shifted from grassroots activists to members of LegCo. After a second round of public consultation, Chief Secretary Lam on April 22 announced the main elements of the electoral reform legislation that would be introduced to LegCo and would require support from two-thirds of members to pass. Building on the Standing Committee’s framework, the legislation included the following elements:

- The composition of the nominating committee shall follow the current composition of the 1,200-member election committee, in which seats are divided among four “sectors” and 38 “sub-sectors.” Allocation of seats among subsectors, the method for selecting the members of each subsector, and the electorate of each subsector shall remain largely unchanged.

- The nominating committee shall approve nominees in two stages: first, potential candidates shall be recommended for consideration; second, the two or three individuals who garner the most recommendations shall be selected as official candidates and stand for election. This procedure differs from the current arrangement, under which members of the election committee jointly nominate candidates.

  - In the first stage, each committee member may recommend one person for consideration to become a candidate. To be eligible, a potential candidate must be endorsed by 120—or 10 percent of—nominating committee members. Under this system, at least five and at most ten potential candidates can seek nomination.

  - In the second stage, each committee member shall vote for at least two candidates from among those who secured the recommendation of 10 percent of the committee. The two or three candidates who win the most votes and secure endorsement of more than half of members shall be the official candidates to stand election.

- All eligible Hong Kong voters shall select a chief executive from among the two or three candidates chosen by the nominating committee in accordance with the “first-past-the-post” system (i.e., the candidate with the most votes wins).

Hong Kong government officials and other pro-establishment voices argued that even with its limitations, the reform package should be approved in LegCo to serve as the foundation from which further democratic reform of the electoral process in future elections could be pursued. Although the April reform package—by re-

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quiring a lower endorsement threshold for potential candidates—presented a slightly greater chance over the Standing Committee framework that a democratic candidate could be nominated, pan-democrats still considered the plan tantamount to giving the central government a backdoor to screen out candidates it does not like.²⁶ During the Commission’s July trip to Hong Kong, former Hong Kong Chief Secretary for Administration Anson Chan said allowing Hong Kong voters to choose only among candidates approved by Beijing is not true universal suffrage, but rather “gives fake legitimacy to the whole election process.”²⁷ According to Martin Lee, founder of Hong Kong’s Democratic Party and a former legislator, even if there were one acceptable candidate to emerge under the Standing Committee’s framework, “it would not be enough” to grant the chief executive any true legitimacy.²⁸

On June 18, 2015, all 27 pan-democrats—a bloc representing just over one-third of the legislators—and one pro-establishment lawmaker voted against the motion, rejecting the package as promised in August 2014. Shockingly, only eight pro-establishment lawmakers voted in favor of the plan, allegedly due to a miscommunication when 31 LegCo members walked out in a botched attempt to delay the vote while they waited for a prominent pro-establishment member who was stuck in traffic.²⁹ The failure of pro-establishment LegCo members to vote was considered an “embarrassing joke,” according to one pro-establishment legislator who met with the Commission in July.³⁰

As a result of LegCo’s defeat of the electoral reform proposal, the current election framework—whereby the chief executive is chosen by a committee representing only 0.02 percent of eligible voters—will be used in the 2017 chief executive election.³¹ China’s NPC blamed pan-democrat lawmakers for “insisting on their stubborn confrontation against the central authorities,” and reiterated that its August decision on Hong Kong’s electoral reform “will remain in force in the future.”³²

The governments of the United States and United Kingdom (UK) both expressed disappointment at the outcome of the electoral reform process. Scott Robinson, spokesman for the U.S. consulate in Hong Kong, reiterated the U.S. government position that “the legitimacy of the chief executive would be greatly enhanced if the chief executive were selected through universal suffrage and if Hong Kong’s residents had a meaningful choice of candidates.”³³ Likewise, a UK government representative called for a “constructive dialogue on future reforms ... reflecting the aspirations of the people of Hong Kong and in accordance with the Basic Law.”³⁴

Looking Ahead: Shifting Priorities

Hong Kong’s 2017 chief executive election is no longer open to substantial, if any, amendment, and the 2022 electoral method—likely to resemble the plan vetoed in June, according to the central government—is a distant thought for some Hong Kongers. Now, political actors in Hong Kong face the question of how to move forward with constitutional development. Chief Executive Leung and Zhang Xiaoming, director of the Liaison Office of the Central People’s Government in Hong Kong, suggested Hong Kong should not continue to debate its political reforms, but instead refocus on eco-
The respondent sample size in June 2014 was 1,018, and in July 2015 was 1,037.

Under the Basic Law, 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).

Public opinion in Hong Kong appears to reflect a similar sentiment: according to a survey conducted by the University of Hong Kong Public Opinion Program from June 2014 to July 2015, the number of respondents who named political developments as their top concern fell 4 percentage points, from 21.8 percent to 17.7 percent, while the number of respondents who listed livelihood problems as their top concern rose 5 percentage points, from 55.1 percent to 60.8 percent.

Because the window has closed for amending Annex I to the Basic Law, which governs the method for choosing the chief executive, constitutional reform of Hong Kong's electoral method will not be possible in time for the 2017 chief executive election or the 2020 LegCo elections. The Hong Kong government, should it choose to do so, could make the 2017 election more inclusive through local legislation—thereby sidestepping the constitutional development process and not requiring approval from the central government.

During the Commission’s trip to Hong Kong, Mrs. Chan proposed the election committee could be reconfigured to be somewhat more representative by widening the voting base and opening up seats to underrepresented groups; alternatively, the government could reduce the number of directly elected seats on the election committee, with the aim of “eventual abolition of functional constituencies.” Several LegCo members expressed pessimism about the prospect of achieving any progress on electoral reform before the 2017 election. Alice Mak, legislator with the pro-establishment Federation of Trade Unions party, explained that because two-thirds consensus in LegCo is needed to make any changes to the composition of the election committee as Mrs. Chan suggested, “it would not be easy to get support.” According to Ms. Mak, there are “no steps forward” on a timetable for achieving universal suffrage in future elections because the central government may not offer it again.

Lee Cheuk-yan, pan-democrat LegCo member with the Labor Party, expressed concern that pan-democrats may not be able to promote further electoral reform legislation if they lose their one-third minority in LegCo in 2020.

Even Hong Kong's organized university students, the driving force behind the prodemocracy protests, are shifting their priorities. Nathan Law, president of the Hong Kong Federation of Students, explained to the Commission that members of the student organization are no longer focused on 2017, but rather are looking ahead to 2047 when the “one country, two systems” arrangement governing Hong Kong’s handover to the PRC will expire. Those students who are concerned with the relationship between the PRC and Hong Kong are more focused on ideological discourse regarding Hong Kong’s future than on concrete action plans. Mr. Law said many students are now focusing on threats to academic freedom in Hong Kong.
Press, Information, and Academic Freedoms under Pressure
Declining Freedom of Press

Although local media remain relatively active in criticism of the region’s government and, to a lesser extent, China’s central government, press freedom in Hong Kong continued an overall downward trend in 2015, according to a number of press freedom watchdog organizations (see Figure 1). Freedom House, a U.S.-based independent advocacy organization, found Hong Kong fell nine spots to 83rd worldwide in its press freedom ranking in 2015, noting the enormous economic and political influence Beijing wields to exert indirect pressure on media, resulting in growing self-censorship. Reporters Without Borders, an international nonprofit, also reported a nine-position decline from 2014, ranking Hong Kong 70th among 180 countries and regions evaluated, primarily due to erosions of information and press freedoms throughout the prodemocracy protests in late 2014. Major contributors to the lower ranking include increasing violence against journalists, cyberattacks on politically active media outlets, and businesses withdrawing advertising from openly prodemocracy media outlets.

![Figure 1: Hong Kong’s Global Press Freedom Ranking, 2005–2015](image)


Legally, press freedom in Hong Kong is safeguarded by the Basic Law, the Hong Kong Bill of Rights, and the International Covenant

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on Civil and Political Rights. Specifically, Article 27 of the Basic Law provides for "freedom of speech, of the press and of publication; freedom of association, of assembly, of procession, and of demonstration; and the right and freedom to form and join trade unions, and to strike." Hong Kong's Bill of Rights incorporates the International Covenant provisions on press freedom into Hong Kong law; under those provisions, freedom of expression protects both "the dissemination of news and the process of newsgathering," as well as informal journalism such as blogging.

Violence against Journalists

Local journalists and members of the general public in Hong Kong highlighted violence in reports of the deteriorating press freedom environment there. Slightly more than half of respondents surveyed by the Hong Kong Journalists Association (HKJA) expressed concern about increasing reports of violence against journalists. More than 90 percent of Hong Kong journalists surveyed said they perceived an increase in the number of attacks by law enforcement officers in 2014 compared with the previous year, while 87 percent perceived an increase in the number of attacks by pro-establishment supporters.

The uptick in violence and violations of freedom of press and expression in 2014 coincided with local media coverage and support of the prodemocracy movement Occupy Central and criticism of the Hong Kong and central Chinese governments. While attacks against journalists and press members have seemingly escalated in Hong Kong for decades—the HKJA last year pointed to unresolved prior attacks on media actors in 1985, 1994, 1996, 1998, and 2013—the February 2014 maiming of Kevin Lau, then editor of Chinese-language newspaper Ming Pao, and the March 2014 beating of two news media executives brought concern over Hong Kong's press freedoms to new heights.* Mr. Lau's two attackers were found guilty of "causing grievous bodily harm" and stealing a motorcycle, and on August 21 were sentenced to 19 years in prison for accepting around $12,900 to carry out the attack, though it was never disclosed who ordered the attack and why. The four individuals arrested for the March attack pleaded not guilty; the case is still pending. Failure to adequately address physical violence against journalists and other media actors in Hong Kong has contributed to a worsening environment for press members there, especially those associated with the prodemocracy movement.

The HKJA recorded accounts of 24 alleged attacks on journalists from September 22, 2014, to October 29, 2014, in connection with the protests, with physical and verbal assaults inflicted by actors ranging from unidentified assailants to police. Aside from outright attacks, the HKJA reported continuous, unjustified "violent behav—

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†A full list of the alleged attacks reported to the HKJA can be found in PEN American Center, "Threatened Harbor: Encroachments on Press Freedom in Hong Kong," January 16, 2015, 40–44. The Hong Kong Government maintains the Hong Kong Police Force is politically neutral and does not consider the political stance of arrestees in carrying out duties. Letter from Millie Ng (Secretary for Security, Hong Kong Security Bureau) to Betty Ma (Clerk to the LegCo Panel on Security), June 1, 2015.
For example, seven Hong Kong police officers on October 15 were charged with causing bodily harm and common assault, and use of pepper spray against journalists carrying out legitimate reporting duties during the protests.*55 Another prominent target is Jimmy Lai, outspoken prodemocracy supporter and former head of outlet Next Media and news tabloid Apple Daily, whose home and Next Media headquarters were attacked with firebombs in January 2015.56 Mr. Lai had previously suffered various threats and attacks, including a failed assassination attempt, presumably for his prodemocracy stance.57

Politically Motivated Censorship

Since the outbreak of prodemocracy protests in mid-2014, news media outlets and journalists in Hong Kong continue to face political and economic pressure to self-censor, sometimes at the risk of shutting down or job loss. Journalists are particularly concerned: 537 journalists surveyed by the HKJA rated self-censorship in Hong Kong as averaging 7 out of 10, with 10 denoting the problem is very common.58 Seventy-one percent of those surveyed stated the Hong Kong government was one of the sources of press freedom suppression.59 Some media organizations, including television and print news outlets, faced accusations of self-censorship over coverage of the prodemocracy movement, raising concerns about the publications' credibility.60 This trend is highlighted by the shuffling of senior management and editors and controversial editorial practices at several of Hong Kong’s most prominent news outlets, as described below:

- In 2013, the Hong Kong Economic Journal, one of the more influential publications in Hong Kong, underwent major senior-level staffing changes after receiving letters of complaint about critical reporting on the chief executive.61 Throughout 2014, several Journal reporters and columnists reported receiving editorial guidance to withdraw or alter content critical of the chief executive or related to political matters.62

- In May 2014, Chong Tien-siong became de facto principal editor of Ming Pao, a position formerly held by Mr. Lau (who was assaulted shortly after his departure from the publication), raising suspicion that Mr. Chong’s appointment was related to his status as a prominent businessman on the Mainland.63 Under Mr. Chong’s management, an editorial director violated standard editorial procedures by making middle-of-the-night changes to the headline of a front-page story about the July 1, 2014, rally for universal suffrage. The headline wording—originally composed by the editing team in accordance with established practice—was altered to downplay the politically sensitive event. More than 190 Ming Pao staff members signed a joint statement calling on the editor to apologize for violating editorial practices, and the HKJA and the Independent Com-

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*55 For example, seven Hong Kong police officers on October 15 were charged with causing bodily harm and common assault for the beating—which was caught on video—of Ken Tsang, a prodemocracy activist and Civic Party member, during the 2014 prodemocracy demonstrations. Alan Wong, “Hong Kong Police Officers Are Charged in Beating of Protester,” New York Times, October 15, 2015.
mentators Association in Hong Kong condemned the editor’s action for “seriously undermining” editorial independence at the paper.64

- In February 2015, Mr. Chong was responsible for a unilateral editorial decision at *Ming Pao* to drop a front-page story on a Canadian government report about the 1989 Tiananmen Square Massacre and run it on an inside page, despite strong objections from senior editorial staff.65

- In April 2015, it was announced that an undisclosed stake in Young Lion Holdings—the controlling shareholder of 26 percent of shares of Television Broadcasts (TVB), the dominant free-to-air televised news channel in Hong Kong known for its pro-Beijing reporting—was sold to a company controlled by Li Ruigang, nicknamed “China’s Rupert Murdoch” for his status as a media mogul.66 Acquisition of the TVB shares by Mr. Li, former deputy secretary general of the Shanghai Communist Party’s administration office, marks a further injection of mainland capital into the local media, according to the HKJA.67

- In May 2015, Wang Xiangwei, chief editor of prominent English-language newspaper *South China Morning Post*, notified all columnists featured on its Opinion and Insight pages that regular column submissions were no longer required, and that columnists must instead submit proposals for topics to the op-ed editor for preapproval, marking a departure from the paper’s long-established policy of allowing regular columnists ample scope to decide what to write.68 As a result, several widely read regular columns have disappeared. After more than 40 years combined writing for the *Post*, four veteran columnists—three of whom had written government-critical columns in the past—were reportedly dismissed from the paper in May.69 The *Post* cited its updated op-ed policy as the reason for the change.70

Control of the media in Hong Kong is influenced by ownership. According to HKJA’s 2013 annual report, the influence of the Chinese and Hong Kong governments over major news outlets in Hong Kong is on the rise—media owners “controlled,” directly or indirectly, by the Hong Kong or central government hold leading positions in an estimated 86.7 percent of Hong Kong’s 30 major media outlets.71 Moreover, as of 2013, the owners of 36.7 percent of outlets had been appointed to China’s main political assemblies, the NPC and the Chinese People’s Political Consultative Conference.72 The HKJA’s research shows only four of the 30 outlets “escape[d] mainland or Hong Kong government favor” as of 2013; two of these four outlets were published by Next Media Group, known for its pro-democracy stance.73 Revelations that “some China-funded companies had pulled their advertisements from some Chinese-language newspapers,” including *Apple Daily*, the free daily *am730*, and the *Hong Kong Economic Journal*, stoked concerns about growing mainland interference in Hong Kong’s media.74
In a positive development, some newly established Hong Kong news outlets are pursuing crowdfunding in order to avoid the political and economic influence associated with media ownership. These outlets include bilingual investigative news agency FactWire, English-language news website Hong Kong Free Press, and Chinese-language site Initium Media, which seeks to “provide neutral, free, and professional news to the Chinese community around the globe.”

**Freedom of Information Legislation**

No law in Hong Kong governs the management of official archives, which results in stifled government transparency and accountability and generates concerns that certain documents and records made during the Occupy Central movement may be destroyed. Local journalists have consistently and strongly supported implementation of freedom of information legislation to ensure they and the general public have a legal right to access information held by the government and public entities; 89 percent of media workers surveyed by the HKJA indicated the government needed to protect press freedom through enactment of the legislation. In a 2014 report released after concluding a year-long study, Hong Kong’s Office of the Ombudsman recommended the enactment of such legislation after finding key components of freedom of information laws are “missing or are not adequately manifested” in the existing administrative code governing public requests for information. Despite this report, the legislative process has been held up by two relevant subcommittees, which were established by the Law Reform Commission of Hong Kong to make recommendations on options for reform. According to Freedom House, the Hong Kong government stated it would defer a decision on such legislation until the release of a report on the issue from a Law Reform Commission subcommittee. Stephen Wong Kai-yi, secretary of the Law Reform Commission, said the subcommittee’s report was expected before 2016. Despite signing a pledge to do so, Chief Executive Leung has not taken any action to promote freedom of information legislation.

**Academic Freedom Challenged**

Unlike in mainland China, universities in Hong Kong enjoy a high degree of academic freedom, autonomy, and freedom of expression. But the role of academics has come under government scrutiny following last year’s prodemocracy protests, organized by student groups and other academics. In 2015, this treatment extended to leadership at Hong Kong’s most prestigious university. In December 2014, a University of Hong Kong (HKU) search committee unanimously recommended former HKU law school dean Johannes Chan Man-mun for the position of pro-vice chancellor at the university. Mr. Chan was critical of the government during the prodemocracy protests (Benny Tai, leader of the Occupy Central movement, was one of Mr. Chan’s law school faculty members), and is a member of Hong Kong 2020, a prodemocracy group led by Anson Chan. But Mr. Chan’s appointment was postponed twice and ultimately blocked in September 2015 at the insistence of HKU’s 24-
The chief executive is chancellor of all eight UGC-funded institutions in Hong Kong. The Hong Kong chief executive not only serves as chancellor of all eight Hong Kong higher education institutions funded by the University Grants Committee (UGC), which advises the government on university funding and development, but also appoints members of the UGC.

According to one student representative present during the council’s deliberations, Mr. Chan was not appointed based on criticisms that he was not qualified because he lacked a Ph.D., had not published a sufficient number of academic works, and lacked integrity. However, some council members, academics, and students have claimed the prolonged delay and ultimate rejection of Mr. Chan’s appointment involved interference from the central and Hong Kong government. In February, Mr. Lau wrote that “some extremely influential people in the government” had contacted HKU council members, urging them to reject Mr. Chan’s promotion. The same month, two central government-run newspapers in Hong Kong, Wen Wei Po and Ta Kung Pao, published “Cultural Revolution-style” attacks on Mr. Chan spanning several pages, prematurely releasing an “extremely confidential” assessment by the UGC that HKU faculty’s research quality was lower than that of the Chinese University of Hong Kong, and attacking Mr. Chan for his “poor performance.” One Hong Kong journalist estimated the two newspapers alone published more than 300 articles targeting Mr. Chan since November 2014.

Students, professors, and alumni of Hong Kong’s universities have shown strong opposition to the council’s delay and ultimate rejection of Mr. Chan’s appointment and the flawed governance structure at higher education institutions there. On July 29, a group of students stormed the council’s meeting room after the council again voted to delay Mr. Chan’s appointment, while more than 100 alumni gathered there in support of academic freedom. More than 1,400 HKU alumni and members of the public signed a petition titled “Safeguard HKU,” calling for the preservation of the university’s independence and timely resolution of Mr. Chan’s appointment. In August, nearly 300 academics voiced opposition in a joint petition—at least the third major petition filed—in support of Mr. Chan out of concern that the government is interfering in university affairs. During the Commission’s July trip to Hong Kong, Nathan Law, president of the Hong Kong Federation of Students, expressed that the student organization wants to pursue reform of the university governance structure, but that such legislation is unlikely to garner LegCo or chief executive support. At an annual convocation of HKU alumni in September, 9,298 alumni overwhelmingly voted to revise the law so the Hong Kong chief executive is no longer chancellor of the university.

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*The chief executive is chancellor of all eight UGC-funded institutions in Hong Kong. The UGC is a non-statutory advisory committee responsible for advising the Hong Kong Government on the development and funding needs of its funded institutions. Its members are appointed by the chief executive and comprise local and overseas academics, higher education administrators and community leaders. University Grants Committee, “Brief History.” [http://www.ugc.edu.hk/eng/ugc/about/overview/history.htm](http://www.ugc.edu.hk/eng/ugc/about/overview/history.htm).
The Index of Economic Freedom is measured based on four categories of factors—rule of law, limited government, regulatory efficiency, and open markets—and is calculated by the Heritage Foundation, a conservative U.S. think tank based in Washington, DC.

† In accordance with the Basic Law, Hong Kong maintains its status as a free port and separate customs territory. However, it participates in international economic agreements as “Hong Kong, China,” as in The World Trade Organization, Hong Kong Special Administrative Region, “Hong Kong as Asia’s World City,” in The Basic Law and Hong Kong—The 15th Anniversary of Reunification with the Motherland, 142–143.

The controversy surrounding alleged government interference in HKU’s appointment procedures is only one example of Beijing’s interference in Hong Kong academia. Hong Kong legislators told the Commission that the central government is worried about Hong Kong universities producing “rebellious” students, especially after seeing the impact scholars like Benny Tai and student protest leaders like Joshua Wong had on the prodemocracy movement. As a result, there appears to be an effort to control the research topics, activities, and funding of liberal academics in Hong Kong. Joseph Cheng Yu-shek, a political science professor at the City University of Hong Kong, describes a phenomenon whereby pressure on academics to toe the Party line “trickles down” from top-level management to influence faculty promotion. Meanwhile, according to Mr. Cheng, academics loyal to Beijing are rewarded with honors and posts at mainland universities, but “if [academics] are perceived unfavorably, there are distinct difficulties.” Mr. Cheng, who founded a group called Alliance for True Democracy that was active during the Occupy Central protests, was attacked in Wen Wei Po and demoted from his position as chairman of the political science department at his university three months before his retirement.

Hong Kong’s Economic Ties with Mainland China

For the 21st consecutive year, Hong Kong in 2015 retained its ranking as the world’s freest economy for its efficient regulatory framework, simple and low taxation, and sophisticated capital markets, according to the U.S. think tank Heritage Foundation. With global foreign direct investment (FDI) inflows of $103 billion in 2014, Hong Kong was the second-largest recipient of FDI in Asia after China ($129 billion), while FDI outflows from Hong Kong reached $143 billion, ranking second highest behind U.S. outflows. Due to its status as a global financial hub, Hong Kong’s total stock of inward FDI by the end of 2013 reached $1.34 trillion—about 4.9 times its gross domestic product (GDP) that year—largely driven by incoming capital from tax haven economies like the British Virgin Islands (33.7 percent), the Netherlands (6.6 percent), and Bermuda (5.9 percent). Overall, Hong Kong’s economic growth moderated in 2014—real GDP growth fell from 3.1 percent in 2013 to 2.5 percent in 2014, and is projected to land between 2 and 3 percent in 2015—primarily due to the global economic recovery, slowing growth in China, and weaker tourist arrivals and spending, including on luxury goods, in Hong Kong.

The bilateral economic relationship between the United States and Hong Kong is strong. During the Commission’s July trip to Hong Kong, U.S. Consulate officials reported 85,000 Americans are living in Hong Kong, and around 1,300 U.S. businesses operate there. U.S. companies have 800 regional headquarters and offices in Hong Kong—the largest number of any country.
2014, cumulative U.S. FDI in Hong Kong measured $66.2 billion, according to official U.S. data, while total Hong Kong FDI into the United States measured $7.6 billion. Additionally, Hong Kong is a key U.S. trading partner. The United States maintains its largest trade surplus with Hong Kong: at $35.1 billion in 2014, the U.S. surplus with Hong Kong measured more than $12 billion greater than its trade surplus with the Netherlands, the second largest. Hong Kong is the tenth-largest market for U.S. exports and a top ten export market for U.S. agricultural products, led by tree nuts, beef, pork, fruit, and wine.

The region’s economy remains highly integrated with that of mainland China in terms of bilateral trade and investment. Hong Kong is the second-largest trading partner of mainland China after the United States, accounting for 8.7 percent of China’s total trade in 2014, according to China’s Customs statistics. Hong Kong plays the most important role in intermediating trade between China and the rest of the world by distributing a large fraction of China’s exports: according to Hong Kong government statistics, in 2014, 60 percent of re-exports were of Chinese origin, and 54 percent were destined for the Chinese mainland. Cross-border investment shows an even stronger trend: in 2014, Hong Kong was the largest source of overseas FDI in mainland China, with cumulative capital inflow from Hong Kong reaching $745.9 billion, or 49.3 percent of total FDI on the Mainland. Similarly, mainland China remains a leading investor in Hong Kong, with $428 billion in Chinese investment—or 31.9 percent of the total stock—flowing into Hong Kong at the end of 2013.

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

Historically, Hong Kong has played a pivotal role in pushing through mainland China’s economic and financial reform objectives. Aside from its significant role as a trade and direct investment partner, Hong Kong is the center for cross-border renminbi (RMB) trade settlement and offshore RMB business. In addition, mainland Chinese enterprises increasingly pursue listings on the Stock Exchange of Hong Kong (SEHK) to access foreign capital. In its capacity as an international financial center and offshore RMB hub, Hong Kong is being used by the Mainland to push through reforms, including development of its domestic financial market, improvement of the international competitiveness of its firms, and managed liberalization of its capital account. These developments are expected to enhance market transparency and foreign investor access on the Mainland, and enhance cross-border fund flows and complement the mature financial services industry in Hong Kong. Moreover, growing trade between the two markets will accelerate the JRF’s internationalization. But increasing Hong Kong’s exposure to the risks inherent in China’s underdeveloped equity market, such as recent stock market volatility and subsequent policy intervention by the central government, calls into question the pace of China’s future financial reforms and presents operational risks for some investors. Aside from systemic risks, foreign investment into mainland markets through Hong Kong faces structural limitations, especially given the incremental deployment of reform programs.
Trade Settlement

As the premier offshore RMB hub, Hong Kong plays a vital role in the Mainland’s capital account liberalization. (For more on China’s financial reforms, see Chapter 1, Section 3, “China’s State-Led Market Reform and Competitiveness Agenda,” of this Report.) In China’s 12th Five-Year Plan for financial development and reform (2011–2015), the central government set policy directives for freer cross-border capital flow and a higher degree of RMB capital account convertibility, with the ultimate aim of internationalizing the RMB.115 To achieve these goals, Chinese financial authorities employ Hong Kong as a testing ground for use of the RMB as a settlement, investment, and funding currency.116 As of December 2014, a total of 149 authorized banking institutions in Hong Kong engaged in RMB business, with RMB deposits worth more than $161 billion (RMB 1 trillion), accounting for approximately 24 percent of foreign currency deposits among authorized institutions there (see Figure 2).117 At year-end 2014, the value of outstanding RMB-denominated debt instruments and bonds lodged with the Central Moneymarkets Unit of the Hong Kong Monetary Authority reached $65.4 billion (RMB 407 billion)—52 percent of the total value of outstanding debt issues—representing a 6 percent increase year-on-year.118

Figure 2: RMB Deposits in Hong Kong Banking Institutions, 2005–2015

<table>
<thead>
<tr>
<th>Year</th>
<th>HKD billions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec-05</td>
<td>2,000</td>
</tr>
<tr>
<td>Dec-06</td>
<td>4,000</td>
</tr>
<tr>
<td>Dec-07</td>
<td>6,000</td>
</tr>
<tr>
<td>Dec-08</td>
<td>8,000</td>
</tr>
<tr>
<td>Dec-09</td>
<td>10,000</td>
</tr>
<tr>
<td>Dec-10</td>
<td>12,000</td>
</tr>
<tr>
<td>Dec-11</td>
<td>14,000</td>
</tr>
<tr>
<td>Dec-12</td>
<td>16,000</td>
</tr>
<tr>
<td>Dec-13</td>
<td>18,000</td>
</tr>
<tr>
<td>Dec-14</td>
<td>20,000</td>
</tr>
<tr>
<td>May-15</td>
<td>22,000</td>
</tr>
</tbody>
</table>


Hong Kong also serves as a platform for enterprises and financial institutions all over the world to conduct RMB trade settlement, payments, financing, and investments. In the first half of 2015, total RMB trade settlement conducted through banks in Hong Kong reached $513.4 billion (RMB 3.2 trillion) (see Figure 3).119
Stock Exchange Listings

Hong Kong’s active international securities market has consolidated its position as the second-largest initial public offering (IPO) market in the world—in 2014, nearly $30 billion (Hong Kong dollar (HKD) 232.5 billion) was raised, a 38 percent increase from the previous year. In line with China’s “going global” strategy, which encourages Chinese firms to both invest abroad and expand overseas operations, mainland firms are increasingly participating in Hong Kong’s equity market: among the $30 billion in IPO funds raised last year on the SEHK, Chinese firms contributed approximately 86 percent. As of December 31, 2014, 876 mainland enterprises were listed on the SEHK—50 percent of the total number of listed companies—accounting for 60 percent of the total market capitalization (see Figure 4). Mainland enterprises benefit from raising capital in a freely convertible currency and taking advantage of the Hong Kong market’s greater liquidity and more effective and better regulated risk management investment instruments.
Figure 4: Market Capitalization of Mainland Firms Listed in Hong Kong

Note: “Mainland firms” refers to the following: (1) H-share companies, which are incorporated on the Mainland and controlled by either mainland government entities or individuals; (2) red chip companies, which are incorporated outside of the Mainland and controlled by mainland government entities; and (3) mainland private enterprises, which are incorporated outside of the Mainland and controlled by mainland individuals. Hong Kong Exchanges and Clearing, “Market Statistics 2014,” January 8, 2015, 14.


Shanghai-Hong Kong Stock Connect

Another pillar of China’s currency internationalization efforts is the Shanghai-Hong Kong Stock Connect, a mutual market access service between the Shanghai and Hong Kong stock exchanges launched in November 2014. The link enables institutional or retail foreign investors for the first time to trade A-shares—shares in mainland China-based companies traded on Chinese exchanges—which were previously only available to certain investors licensed under China’s Qualified Foreign Institutional Investor (QFII) and RMB QFII programs. For Hong Kong, the Stock Connect provides additional liquidity and supports the region’s offshore RMB business and its role as a financial gateway to China.

The northbound link—referring to funds flowing north from Hong Kong to China—allows investors outside the Mainland to trade selected equities on the Shanghai Stock Exchange (SSE), routed through Hong Kong brokers; the southbound link—referring to funds flowing south from China to Hong Kong—allows investors in mainland China to trade selected equities on the SEHK, through members of the SSE (see Table 1).
Table 1: Framework of the Shanghai-Hong Kong Stock Connect

<table>
<thead>
<tr>
<th></th>
<th>Northbound</th>
<th>Southbound</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Asset Classes</strong></td>
<td>Selected SSE A-shares</td>
<td>Selected SEHK stocks</td>
</tr>
<tr>
<td><strong>Investors</strong></td>
<td>International and Hong Kong</td>
<td>Domestic institutional investors and qualified retail investors</td>
</tr>
<tr>
<td></td>
<td>institutional and retail investors</td>
<td></td>
</tr>
<tr>
<td><strong>Brokers</strong></td>
<td>SEHK members who fulfill eligibility requirements</td>
<td>SSE members who fulfill eligibility requirements</td>
</tr>
<tr>
<td><strong>Currency</strong></td>
<td>Traded and settled in offshore RMB</td>
<td>Traded in HKD and settled in RMB</td>
</tr>
<tr>
<td><strong>Trading Venue</strong></td>
<td>SSE</td>
<td>SEHK</td>
</tr>
<tr>
<td><strong>Clearing House</strong></td>
<td>ChinaClear</td>
<td>Hong Kong Securities Clearing Co.</td>
</tr>
</tbody>
</table>


RMB internationalization is still in the early stages, largely due to the deliberate and incremental pace of China’s regulators in their efforts to control potential risks. For this reason, trading is subject to a maximum cross-border investment quota (i.e., aggregate quota), together with a daily quota. The northbound aggregate quota is set at $49 billion (RMB 300 billion)—less than 1 percent of the total A-share market—and the southbound aggregate quota is set at $41 billion (RMB 250 billion).127 The daily quota limits the maximum net buy value of any cross-border trades under the program each day: the northbound daily quota is set at $2.1 billion (RMB 13 billion), and the southbound daily quota is set at $1.7 billion (RMB 10.5 billion).128 The program’s initial northbound aggregate quota of $49 billion is equivalent to 9 percent of all offshore RMB assets ($548 billion as of 2014) (see Figure 5).129 Before the launch of the Stock Connect, quotas for the QFII and RMB QFII programs—the only available channels for international investment in China’s A-shares—were $67 billion and $48 billion respectively in 2014, according to China’s State Administration of Foreign Exchange.130
Given the previous limits on access, the initial response from international investors was strong: northbound trading on the link’s first day attained 100 percent usage of the daily quota (see Figure 6). While subsequent months of operation saw less active northbound daily trading, Chinese investors for the first time used the entire southbound daily quota in April 2015, reaching a record high in turnover for the link at $4.8 billion (RMB 29.9 billion) and making the Hong Kong exchange the highest market capitalization exchange in the world.\textsuperscript{131} Some analysts credit the allowance by Chinese regulators for mutual funds to buy Hong Kong shares under the program the preceding week for the surge, a change that made it easier to get around southbound barriers like high capital thresholds.\textsuperscript{132}

\textit{Note:} Dim sum bonds are bonds issued outside of China but denominated in RMB. RQFII denotes the RMB QFII program.

A June 2015 report from research and consulting firm Celent * identified a number of restrictive features of the stock link that may create operational complexity and introduce risk. These include a complex settlement cycle, no day trading and limited support for short selling, a requirement to settle in RMB, asset fungibility issues, and onerous shareholder risk and reporting requirements. Despite these risks, however, the report predicts that forthcoming improvements to the program will enable greater participation by institutional investors and initiate inclusion of A-shares in global equity benchmark indices within the next few years. If Chinese regulators remain committed and active in opening the country’s capital account, quotas are expected to be expanded to meet investor demand. The Celent report estimates these factors will drive international holdings of A-shares to $428 billion by 2017, setting the stage for other similar joint initiatives such as a stock link between Shenzhen and Hong Kong. While a Shenzhen-Hong Kong stock link was initially slated to launch by year-end 2015, the project was reportedly put on hold in June due to technical difficulties. During the Commission’s July trip to Hong Kong, Andrew Wong, Permanent Secretary of Hong Kong’s Financial Services and the Treasury Bureau, said the technical issues had been sorted out, and China’s State Council would determine the best time to launch the program. In spite of the fluctuation in the mainland stock markets since late June, according to the Financial Services and the Treasury Bureau, “the Hong Kong securities markets have been trading and operating in an orderly and smooth manner.”

Because the level of trading through the Stock Connect is low, Hong Kong is not expected to suffer contagion from the downturn in the Mainland’s equity markets through that channel, according to Mr. Wong. But markets in the two economies tend to move

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* Celent, a division of management consulting firm Oliver Wyman, is a research and consulting firm focused on information technology in the financial services industry.
in tandem. Since the Hang Seng index—the main indicator of overall market performance in Hong Kong—hit a seven-year high in April, it has fallen 25.5 percent as of September 1, following Shanghai’s plummeting index, which has fallen more than 38 percent as of September 1 since it peaked this year in mid-June amid massive Chinese government intervention. Given the strong presence of Chinese companies listed on the SEHK—mainland firms account for 60 percent of market capitalization there—it is not surprising that falling valuations in Shanghai would affect the prices of their shares in Hong Kong. Overall, according to Mr. Wong, volatility in the mainland markets is partly related to the prevalence of margin financing (i.e., borrowing money to invest) among China’s retail investor-dominated traders.

During the Commission’s July trip to Hong Kong, U.S. Consulate officials indicated Hong Kong’s strict rules on transparency and strong regulatory capabilities highlight the maturity of its financial markets and enhance the ability of the SEHK to withstand sharp fluctuations in the mainland markets. Hong Kong has also introduced a host of measures to control risks. When the Stock Connect was established in late 2014, Hong Kong and Chinese regulators signed a memorandum of understanding to enforce information disclosure and sharing. In July 2015, Hong Kong Exchanges & Clearing Limited, the holding company of the SEHK, announced the introduction of volatility curbs that will use an auction at the end of the trading day to reduce volatility when calculating closing prices—a measure used by all major stock exchanges—when it goes into effect in mid-2016.

**Mutual Recognition of Funds**

In a move to further deepen financial cooperation and promote the joint development of the Hong Kong and mainland capital markets, the China Securities Regulatory Commission and Hong Kong Securities and Futures Commission jointly announced the introduction of a long-awaited “Mutual Recognition of Funds” initiative, giving international asset managers a channel to access mainland China’s growing and previously untapped retail investor market—the number of new individual investor accounts on the SSE grew thirty-fold year-on-year in June 2015—boosted by a growing middle class and a huge pool of domestic savings. Implemented on July 1, 2015, the Mutual Recognition of Funds initiative enables mainland China and Hong Kong funds to be distributed in each other’s markets through a streamlined vetting process, enabling non-mainland Chinese retail investors and fund managers to enter the Chinese retail fund market through Hong Kong. The move is expected to increase the diversity of asset management activities in Hong Kong’s asset management industry, which previously relegated fund management services largely to sales and marketing, by incentivizing fund managers to base their funds in the city. The initiative is intended to further expand cross-border RMB flows and facilitate China’s efforts to open up its capital markets and internationalize the RMB by providing an avenue to convert
domestic savings in mainland China into cross-border investments.\textsuperscript{148}

**Implications for the United States**

The United States has a long history of positive bilateral relations with Hong Kong and is committed to the region's stability, prosperity, and continued success as an international trade and financial center. The United States and Hong Kong share many values, including respect for rule of law and for civil liberties. To bolster Hong Kong's stability and prosperity, the U.S. government encourages Beijing and Hong Kong to continue to work together to further Hong Kong's democratic development in accordance with the Basic Law and the aspirations of the people of Hong Kong.\textsuperscript{149}

Hong Kong’s high degree of autonomy and economic freedom make it a valuable and preferable destination for U.S. investors and an important U.S. trading partner. Approximately 1,300 U.S. businesses operate in Hong Kong, drawn in part by the region's openness, transparency, free market, and strong rule of law.\textsuperscript{150} After mainland China, the United States is Hong Kong's second-largest trading partner. The United States maintains its largest trade surplus with Hong Kong and its tenth-largest goods export market.\textsuperscript{151} Moreover, Hong Kong and the United States continue to cooperate economically in a number of bilateral and multilateral fora, including the World Trade Organization, the Asia-Pacific Economic Cooperation, and the Financial Action Task Force. The two also maintain a strong law enforcement partnership in areas including customs, intellectual property rights protection, financial fraud, counterterrorism, and immigration.

In line with the Commission's recommendation in its 2014 Annual Report to Congress, the Hong Kong Policy Act report was updated in 2015 after an eight-year hiatus pursuant to H.R. 5013, the State, Foreign Operations, and Related Programs Appropriations Bill, 2015, which mandated the Secretary of State report to Congress on key developments in Hong Kong.\textsuperscript{152} According to the report, Hong Kong has maintained a sufficiently high degree of autonomy under the “one country, two systems” model to justify continued special economic treatment by the United States for bilateral agreements and programs.\textsuperscript{153} But recent trends have sparked U.S. concern over growing constrictions of Hong Kong's press and media freedoms, including increasing reports of political pressure to self-censor, violent assaults against members of the press, firing of journalists critical of the central government, and cyberattacks against prodemocracy media.\textsuperscript{154}

As the economies of Hong Kong and mainland China become even more integrated through liberalization efforts like the Shanghai-Hong Kong Stock Connect, U.S. investors will look to Hong Kong's regulators to uphold rule of law and international financial standards and best practices to minimize risks to the global financial system to the highest degree possible.

**Conclusions**

- In June 2015, Hong Kong’s Legislative Council voted down electoral reform legislation based on a framework designed by Chi-
na's central government. This framework would have limited the candidates eligible for chief executive nomination to those acceptable to Beijing. As a result, election of the chief executive in 2017 will employ the same method as the 2012 chief executive election, whereby a 1,200 member committee elects the leader.

- Members of the general public, legislators, students, and other vested parties lack consensus on how to pursue electoral reform in Hong Kong's future chief executive and Legislative Council elections.

- Press freedom in Hong Kong is increasingly under pressure due to recent instances of violence against journalists, increasing political and economic pressure to self-censor, and use of economic coercion to disrupt independent reporting. The absence of a freedom of information law in Hong Kong also contributes to a lack of transparency with regard to open access to and preservation of government records.

- Hong Kong's world-class economy, particularly its capital markets, is playing an increasingly pivotal role in mainland China's efforts to push through financial reforms, including development of its domestic financial market, improvement of the international competitiveness of its firms, and liberalization of its capital account.

- In an effort to internationalize the renminbi, among other objectives, Hong Kong and mainland China have jointly established a number of pilot programs, including the Shanghai-Hong Kong Stock Connect and the Mutual Recognition of Funds initiative, to boost international participation in China's markets. These developments are expected to enhance market transparency and foreign investor access on the Mainland and enhance cross-border fund flows.

- Deepening integration exposes Hong Kong to the risks inherent in China's volatile equity markets, presenting operational risks for some investors. Moreover, foreign investment into mainland markets through Hong Kong still faces structural and quantitative limitations.
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