



U.S. -Hong Kong Policy Act Report

As of April 1, 2004

As required by Section 301 of the United States-Hong Kong Policy Act of 1992 22 U.S.C. 5731 as amended

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I. SUMMARY

Hong Kong remains an international city and one of the world's most open and free economies. Hong Kong residents enjoy strong respect for the rule of law and civil liberties. Hong Kong is an independent customs territory and economic entity separate from the rest of China and continues to provide an effective and productive voice in a wide range of international organizations. The United States maintains substantial economic and political interests in Hong Kong and promotes Hong Kong's high degree of autonomy under Chinese sovereignty. The United States-Hong Kong Policy Act authorizes the United States government to treat Hong Kong as a separate customs territory distinct from China. The United States also supports Hong Kong's high degree of autonomy by concluding and implementing bilateral agreements; promoting trade and investment; arranging high-level visits; broadening law enforcement cooperation; bolstering educational, academic, and cultural links; and supporting the large community of resident U.S. citizens and visitors.

Hong Kong strongly supported the global campaign against terrorism. Hong Kong started participating in the Container Security Initiative in May 2003 and remains an important partner in eliminating funding for terrorist networks and combating money laundering. Our broader law enforcement relationship provides unique opportunities given Hong Kong's professional police forces and the common perspectives we share with respect to overarching law enforcement objectives.

Hong Kong's autonomy as an international economic actor remained intact as it participated as a full member of numerous international economic organizations, independently of China, such as the World Trade Organization (WTO), the Asia Pacific Economic Cooperation forum (APEC), and the Financial Action Task Force (FATF). We are monitoring closely to ensure Hong Kong maintains an effective export control system. The Special Administrative Region (SAR) continues to play an important role as an international finance center. During this reporting period, Hong Kong also continued its efforts to expand economic interaction with China, including concluding the "Closer Economic Partnership Arrangement," a free trade agreement with China.

The rule of law and an independent judiciary remained pillars of Hong Kong's free and open society. Chief Executive Tung Chee-hwa decided in September to withdraw proposed legislation pursuant to Article 23 of the Basic Law to criminalize treason, secession, sedition, subversion, theft of state secrets and links with foreign political organizations that are harmful to national security. This decision was made after a series of large protests and intense public debate about the impact of such legislation on civil liberties and fundamental freedoms. The government has not announced a timetable for resubmitting the bill.

Following the government's shelving of Article 23 legislation, public debate shifted to the Basic Law's provision for the ultimate aim of direct election of the chief executive and all members of the Legislative Council (Legco). There is as yet no consensus in Hong Kong on this subject. Strong popular support in favor of direct election of the chief executive in 2007 was evident in the fall of 2003, but voices to both the left and right of the middle-class mainstream were heard in opposition. A Hong Kong government task force was pursuing consensus in Hong Kong with a view to effecting changes in time for the 2007 selection. During the debate on constitutional reform, Beijing has emphasized the primacy of the central government in making any decisions regarding political reform, including direct elections, in Hong Kong. The Chinese government announced on March 26 that the National People's Congress Standing Committee, at an April 2-6 session, would provide interpretations of those sections of the Basic Law that govern the methods for selecting the chief executive and forming the Legislative Council.

The Hong Kong press remained free and continued to comment critically on issues, including on Article 23 and Hong Kong's constitutional development, China and its leaders, and the Hong Kong government. There were numerous demonstrations for and against government positions. Mainland Chinese companies in Hong Kong remained subject to the same laws and regulatory supervision as all other enterprises.

U.S. military ship and aircraft visits to Hong Kong, with one exception, were routinely approved by China, bolstering Hong Kong's reputation as an open, cosmopolitan, and internationally connected city.

II. BACKGROUND

After 156 years of British colonial rule, Hong Kong became a Special Administrative Region (SAR) of the People's Republic of China on July 1, 1997. Hong Kong's status is defined in two documents: the Joint Declaration signed by Britain and China in 1984, and the Basic Law promulgated by China in 1990. These documents formally

establish the concept of "one country, two systems" under which Hong Kong is guaranteed a high degree of autonomy, except in foreign affairs and defense, and state that Hong Kong's social and economic system, lifestyle, and the rights and freedoms enjoyed by the Hong Kong people shall remain unchanged for at least 50 years. The United States supports Hong Kong's high degree of autonomy and the United States-Hong Kong Policy Act of 1992, as amended, establishes the authority of the U.S. government to treat Hong Kong as a non-sovereign entity distinct from China for the purposes of U.S. domestic law based on the principles of the 1984 Sino-British Joint Declaration.

III. U.S. INTERESTS IN HONG KONG

U.S. interests in Hong Kong remain substantial. U.S. trade, investment, and business with Hong Kong, the world's 11th largest trading entity and 13th largest banking center, flourish in a largely open environment. In 2003, U.S. exports to Hong Kong totaled USD 13.5 billion, making Hong Kong our 14th largest overseas export market. U.S. direct investment in Hong Kong through 2002 amounted to over USD 35.8 billion. Over 1,000 resident American firms operate in Hong Kong, and Hong Kong is home to an estimated 50,000 American citizens. (Included in this total are many dual nationals not counted by Hong Kong authorities as resident Americans.)

Cooperation between the Hong Kong government and the U.S. Consulate General remains broad, effective, and mutually beneficial. The United States enjoys strong cultural and educational relations with the people of Hong Kong, including a substantial flow of tourists and students in both directions. The United States has significant interests in seeking Hong Kong's support in the global fight against terrorism, promoting economic and business relationships, maintaining a cooperative law enforcement relationship, and continuing access to Hong Kong as a port of call for our ships and aircraft.

The United States has strong interests in the protection of human rights and the promotion of democratic institutions throughout the world. The Hong Kong people share many values and interests with Americans and have worked to make Hong Kong a model of what can be achieved in a society based on rule of law and respect for civil liberties. Hong Kong remains an open and largely tolerant society, in which both local and foreign non-governmental organizations, businesses and persons continue to operate freely. Representatives of the media work with few government-imposed restrictions.

The protection of U.S. interests is enhanced by Hong Kong's continued autonomy, stability, and prosperity; the operation of a full-service Consulate General; the protection of civil liberties and promotion of democracy; and the preservation of Hong Kong's legal system, which permits sustained and effective cooperation on law enforcement issues. The United States works closely with the Hong Kong Special Administrative Region government and communicates our views on Hong Kong to the Hong Kong government, central government authorities in Beijing, and the people of Hong Kong.

IV. DEVELOPMENTS AFFECTING U.S. INTERESTS IN HONG KONG: April 1, 2003 to March 31, 2004

A. Anti-Terrorism Cooperation

During the period of this report, Hong Kong remained a strong partner of the United States in the war on international terrorism. Hong Kong has passed counterterrorism laws implementing the mandatory portions of UNSCR 1373, although it must still pass some additional implementing laws to come into complete compliance with UNSCR 1373 and the Financial Action Task Force (FATF) special anti-terrorism recommendations. Eight of twelve international anti-terrorism conventions apply in Hong Kong. In 2003, the Hong Kong government submitted legislation that will bring Hong Kong into compliance with an additional two of the twelve anti-terrorism conventions and it plans to adopt the final two conventions after PRC accession. (Note: Hong Kong is not a sovereign state and implementation of UN agreements and resolutions formally occurs via China. After China becomes a party to such international instruments, it has the authority to direct Hong Kong to implement them.)

Hong Kong has given excellent support to the effort to prevent weapons of mass destruction (WMD) from entering the United States. Hong Kong joined the Container Security Initiative (CSI) in September 2002, and the program became operational in May 2003. Cooperation between Hong Kong and the United States on CSI has been a model for how the program should work, and has resulted in additional indirect benefits. For example, in June, tips provided through CSI resulted in the seizure of three containers of counterfeit merchandise going from China to the United States that were worth nearly USD 1,300,000 – one of the largest counterfeit goods seizures ever in Hong Kong. Hong Kong and the United States have also conducted preliminary discussions on the Department of Energy's "Megaports" initiative, which involves the installation of radiological detection equipment at Hong Kong's port.

The Hong Kong police force continued to make counterterrorism a top priority, and Hong Kong customs and immigration officials were vigilant in the face of the global terrorist threat. During this reporting period, two of three individuals apprehended in 2002 for allegedly trying to purchase Stinger missiles for al-Qaeda use pled guilty in the United States to two counts of drug distribution conspiracy and one count of material support to a terrorist organization. Authorities regularly direct financial institutions to conduct searches for terrorist assets using U.S. and UN lists, although these institutions have found no such assets to date. Hong Kong continued to play an active and leading role in the anti-terrorism finance effort as a member of FATF. The government responded vigorously and to the U.S. government's complete satisfaction to requests for assistance in ensuring the security of Americans and American interests. For the third consecutive year, military representatives from the Pacific Command Explosive Ordnance Disposal community participated in the Hong Kong Police Force bomb disposal officer-licensing course.

B. Autonomy

Hong Kong continued to enjoy a high degree of autonomy, although China's efforts to shape Hong Kong's public debate on political reform have raised questions about Beijing's willingness to let the Hong Kong people and their government have a voice in the determination of the pace and scope of advances toward direct elections (see Section V.C below). As provided for in the Joint Declaration, matters related to Hong Kong's defense and foreign affairs remain solely in Beijing's hands. Hong Kong, one of the world's most open and dynamic economies, actively participated as a full member -- and in some cases as a leader -- in international organizations in which membership is not based on statehood. For example, Hong Kong is a separate and autonomous member of 26 multilateral organizations, such as the World Trade Organization, the Asia Development Bank, the Asia Pacific Economic Cooperation forum, the Bank for International Settlements and the World Customs Organization. In 2003, Hong Kong continued to participate actively in all these multilateral fora, working, for example, at the WTO Ministerial Conference in Cancun to find a compromise that would preclude a breakdown in talks, and offering to host the next ministerial meeting.

Hong Kong's high degree of economic autonomy remained intact. Customs and border controls remained in place, and Hong Kong authorities continued to develop, implement, and enforce their own trade laws and regulations. The government was responsive to Hong Kong businesspeople looking to take advantage of China's economic growth. The government continued work toward economic interaction with mainland China, especially in the Pearl River Delta. With this in mind, Hong Kong and China completed negotiations on their Closer Economic Partnership Arrangement (CEPA), a free trade agreement covering 273 goods and 18 service sectors (Note: The products covered have now been re-grouped and re-classified into 374 mainland 2004 tariff codes, covering the same set of goods.) The agreement came into force on January 1, 2004. CEPA included provisions allowing individual tourists from a number of mainland cities to travel individually to Hong Kong rather than as part of a tour group. China also authorized Hong Kong banks in February 2004 to begin providing deposit, remittance, exchange, and credit card services in Renminbi (the Chinese currency). The government has deployed additional staff and upgraded computer systems and screening technology to handle the larger flow of cargo, people, and funds across the border. The increasing economic activity between Hong Kong and China has occurred against the backdrop of Hong Kong's continuing commitment to a strong export control regime. Increased economic integration and interaction on both sides of the border have created new challenges that the United States and Hong Kong are working together to address. (See Section V.B below.)

Hong Kong began soliciting local views on Hong Kong's future democratization as prescribed by the Basic Law in February (see Section IV.C below). The government said it would seek a broad consensus within Hong Kong on how best to move forward on constitutional reform. Government officials have acknowledged that decisions on this front must take into account Beijing's concerns about how the issue would affect the implementation of the principle of "one country, two systems" and the Basic Law; the relationship between the Central Government and the SAR; the interests of various sectors of the community; and Hong Kong's long term prosperity and stability. The Chinese government has emphasized its control over changes in Hong Kong's political structure in keeping within the provisions of the Basic Law, including the method for selecting the chief executive and forming the Legislative Council. Pro-democracy advocates have criticized the government for not moving more aggressively toward the Basic Law's "ultimate aim" of universal suffrage. At the same time, activists from both the left and the right of the political spectrum have argued that more time is needed to establish appropriate conditions for universal suffrage. The Chinese government announced on March 26 that the National People's Congress Standing Committee, at an April 2-6 session, would provide interpretations of Annexes I and II of the Basic Law, which govern the methods for selecting the chief executive and forming the Legislative Council. This is the first time since 1997 that the Chinese government has taken the initiative to exercise its authority to interpret the Basic Law. In 1999, the Chinese government offered an interpretation of the Basic Law with respect to residency rights in Hong Kong, but this was done at the request of the Hong Kong government.

The People's Liberation Army (PLA) Hong Kong Garrison, whose stated primary role is national defense, remains a largely unseen and symbolic presence in Hong Kong. The Garrison hosts an annual open house day and participates in annual tree-planting and blood drive events. As provided for in the Basic Law, the Garrison may assist the Hong Kong government in maintaining public order and disaster relief if requested by Hong Kong's Chief Executive and approved by the Central Military Commission. There were no such instances during this reporting period. The Garrison did not engage in public security work or business activities.

Hong Kong law enforcement agencies remained independent of their Chinese counterparts. The continued assistance the Hong Kong government has given the U.S. in law enforcement, particularly in the apprehension and extradition of fugitives, is a good example of Hong Kong's judicial independence and exercise of a high degree of autonomy.

C. Political System

The Basic Law calls for "gradual and orderly" progress toward the "ultimate aim" of electing the Chief Executive and all members of the legislature by universal suffrage. Currently, a Basic Law-defined selection committee made up of roughly 800 Hong Kong residents chooses the chief executive. The number of directly elected seats in the sixty-member Legislative Council elected in September 2000 remained 24; at the next election in September 2004, that number will rise to 30 in accordance with the timetable laid out in the Basic Law.

During the year, and particularly after July 1, many citizens pressed the government to begin a public debate about procedural reforms needed to implement universal suffrage in the election of the chief executive in 2007 and Legco members in 2008. In response, the government initially announced that it would provide a timetable for public consultations by the end of the year. The government's notional plan was to commence consultations early in 2004 and 2005 and to enact necessary legislation in 2006. Although the government postponed the release of the timetable, the timetable remains viable.

In November, Hong Kong held its second post-handover District Council election, with a record turnout of one million voters. Pro-democracy candidates made major gains, while the pro-Beijing Democratic Alliance for the Betterment of Hong Kong (DAB), Hong Kong's largest political party, suffered significant losses. Following the election, there were increased calls for the chief executive not to exercise his authority to appoint additional District Councilors. However, the chief executive exercised his authority by appointing 102 District Councilors, the maximum number allowed under the law.

In December, Chief Executive Tung Chee-hwa met with President Hu Jintao and Premier Wen Jiabao during Tung's annual duty visit to Beijing. Characterizing the central government as "deeply concerned" about the course of constitutional reform in Hong Kong, President Hu said the territory's political system should be developed gradually, in accordance with the Basic Law and the "actual situation" in Hong Kong, precisely reflecting the Basic Law. Immediately after CE Tung departed Beijing, Xinhua, the Chinese news agency, published the views of four mainland legal experts, who emphasized that any changes in Hong Kong's electoral arrangements had to be approved by the National People's Congress, must not hurt China's overall interests, and had to maintain Hong Kong's social stability and economic development. China also criticized statements by the U.S. government urging movement toward direct elections in Hong Kong as interference in China's internal affairs.

The Hong Kong government postponed release of its constitutional reform timetable, and instead announced in January the establishment of a three-member Constitutional Development Task Force headed by Chief Secretary Donald Tsang. In January, the task force began public consultations on constitutional reform. The task force also made a trip to Beijing February 9 to consult with the central government on Hong Kong's constitutional development. For several weeks after the task force returned from Beijing, public discussion in Hong Kong was dominated by a debate over the meaning of patriotism and its implications for the pace and scope of constitutional reform. The backdrop for this development was a series of Xinhua commentaries outlining Beijing's views on key principles governing the application of the Basic Law, including one to the effect that a standard formulation or reference to Hong Kong's high degree of autonomy (i.e., "Hong Kong people ruling Hong Kong") should be redefined to mean "patriots" should comprise the main body of those governing Hong Kong. Some local pro-democracy figures have been branded as "unpatriotic" because of their views on such issues as the 1989 Tiananmen Square massacre and Taiwan. Citing a need to clarify issues of principle on the constitutional reform debate, Beijing announced March 26 that the National People's Congress Standing Committee, at an April 2-6 session, would provide interpretations of Annexes I and II of the Basic Law, which govern the methods for selecting the chief executive and for forming the Legislative Council.

D. Civil Liberties

Freedoms of speech, press, religion, assembly, association, and other basic human rights remained well respected and defended in Hong Kong. The press remained free and continued to publish a wide variety of news stories and opinions, including articles critical of the Chinese and Hong Kong SAR governments, and articles on Taiwan, Chinese leadership dynamics, Communist Party corruption, and human rights. The media have been especially active in reporting and editorializing on the debate over legislation on Article 23 of the Basic Law, on the issue of Hong Kong's further democratization, and on the government's handling of the Severe Acute Respiratory Syndrome (SARS) outbreak. In June, the Hong Kong Broadcasting Authority issued a warning to Commercial Radio over "Teacup in a Storm" talk show host Albert Cheung's treatment of HKG officials interviewed during the SARS outbreak. Media observers claimed Mr. Cheung was a victim of censorship. The Broadcasting Authority received ten times as many complaints over the sanction as over the original program content. Shortly afterwards, Commercial Radio was able to renew its license without incident, and Mr. Cheung's program -- anchored by guest hosts for a few weeks while he holidayed outside Hong Kong -- continues.

The Basic Law provides for freedom of association and assembly, and Hong Kong residents have enjoyed these fundamental freedoms during the reporting period. Over 8,400 societies have been registered since the 1997 reversion. No applications for registration have been denied. Demonstrations averaged over seven per day during the reporting period, well above the pre-handover rate. There were numerous demonstrations for and against the government, including some of the largest seen in Hong Kong since the handover. On July 1, at least 500,000 people marched through central Hong Kong to express dissatisfaction with the government and to protest the government's proposed Article 23 national security legislation. This was the largest demonstration seen in Hong Kong since 1989. On July 9, 50,000 people took part in a rally outside the Legislative Assembly to protest Article 23. There have been several demonstrations demanding movement toward universal suffrage, including one on July 13 that attracted 20,000 people, and a march on January 1, 2004 that drew some 100,000. Under the law, demonstrators must notify the police for a march involving more than 30 persons and for an assembly of more than 50 persons. The police must give a clear reply within 48 hours if there is any official objection. Out of thousands of applications to hold public rallies or marches submitted since 1997, police have objected to 21, nine of which went ahead after organizers changed their routes.

Groups continued to be free to demonstrate on issues of sensitivity to China. On June 1, some 2,500 persons marched through central Hong Kong to commemorate the June 4, 1989 massacre in Beijing's Tiananmen Square, and on June 4, approximately 50,000 attended an annual candlelight vigil. Falungong practitioners regularly conducted public protests against the reported repression of Falungong practitioners in the PRC. In September, an appeal hearing concluded for a group of Falungong practitioners who had been fined for obstruction in 2002 for refusing to remain in a designated demonstration area. The group is still awaiting the judge's ruling. In October, the High Court rejected an application for judicial review of a decision by the Immigration Department not to allow 80 overseas Falungong practitioners into Hong Kong to attend an annual international conference in the SAR in February 2003.

The Hong Kong government has respected freedom of movement, freedom of immigration, and freedom to enter and leave the territory since the handover. At the end of 2003, the HKG allowed former Tiananmen Square student leader Wuer Kaixi to enter the territory to attend Hong Kong pop star Anita Mui's funeral. In January 2004, members of the Commission on International Religious Freedom (CIRF) visited Hong Kong. Their visit was undertaken independently of PRC views of the committee's visit. In July and December 2003, Beijing denied visas to commission members.

E. Judicial and Legal Developments

Rule of law has continued to prevail in Hong Kong under the common law system dating from colonial days and as prescribed by the Basic Law. By law and tradition, the judiciary is independent and the Basic Law vests Hong Kong's highest court with the power of final adjudication; however, under the Basic Law, the Standing Committee of the PRC's National People's Congress (NPC) has the power of final interpretation of the Basic Law. Judicial appointments are made by a non-partisan commission that seems to operate well, although some have called publicly for the nomination process to be more transparent. Judges are well trained and highly qualified, and the Court of Final Appeal includes distinguished justices from other Commonwealth jurisdictions who take part on a case-by-case basis.

The most important legal development during this reporting period was the Hong Kong government's decision on September 5 to withdraw legislation on Article 23 of the Basic Law. Article 23 requires that the government enact legislation on its own prohibiting treason, secession, sedition, subversion against the Central People's Government, theft of state secrets and links that are harmful to national security with foreign political organizations. In 2002, the government released a consultation

document proposing guiding principles for the legislation. After the legislation was introduced into the Legislative Council in February, the government proposed a series of amendments to address concerns raised by interested parties, such as legal and media groups and ordinary citizens, that the bill could restrict fundamental rights and freedoms. Of particular concern were the proposed extension of treason, sedition, secession, and subversion criminal offenses to permanent residents, without regard to nationality or legal domicile; a proposal to ban organizations affiliated with mainland political organizations that have been banned by the PRC on national security grounds; a proposal for extended emergency powers for the police; uncertainty about the parameters of "unlawful disclosure" of state secrets; and other proposals perceived as potentially limiting freedom of speech and press. Opponents of the proposed legislation conducted a series of protests, including a demonstration on July 1 in which at least 500,000 persons participated. In response, the government announced in July that it was indefinitely postponing the bill. In September, the government withdrew the bill from the legislative process.

In January, the Court of Final Appeal ruled against the government on a case initiated by a public interest group, Society for the Protection of the Harbour, over a controversial land reclamation project in Hong Kong's Victoria Harbour. The decision represented the first time the Court of Final Appeal had overruled the government on a major land development project. In March, a lower court ruled in favor of the government's authority to proceed on a separate harbor reclamation project.

F. Bilateral Agreements

There are more than a dozen U.S.-Hong Kong bilateral agreements currently in force, including a stand-alone Air Services Agreement, and Extradition, Prisoner Transfer, and Mutual Legal Assistance Agreements that entered into force since reversion. These agreements have functioned very well, although Hong Kong legal requirements for "sovereign assent" by the Chinese government with respect to some forms of international liaison hindered timely cooperation.

G. Suspensions under 201(A), Terminations under Section 202(D), or Determinations under Section 201(B)

There were no suspensions under section 201(A), terminations under section 202(D), or determinations under section 201(B) of the United States-Hong Kong Policy Act of 1992, as amended, during the period covered by this report.

V. U.S.-HONG KONG RELATIONS: April 1, 2003 to March 31, 2004

A. Economic-Commercial

Hong Kong remains one of the world's most open economies, and U.S. companies continued to have a favorable view of Hong Kong's business environment, including its autonomous and impartial legal system, free flow of information, low taxes, and well-developed infrastructure. The American Chamber of Commerce's annual business confidence survey of its members, conducted in late 2003, showed that chamber members had an increasing level of confidence in the business environment and economic outlook over the next three years: 81% believed the business outlook for 2004 was "good" or "satisfactory." This number increased to 95% for 2005 and 2006. U.S. and other foreign companies also continue to find Hong Kong attractive as a headquarters location for China and the wider Asia region.

On June 29, 2003, Hong Kong and China signed the Closer Economic Partnership Arrangement (CEPA), a free trade agreement granting Hong Kong's manufacturers and service suppliers preferential access to the China market. Beginning January 1, 2004, Hong Kong-origin goods in 374 categories have received tariff-free treatment and Hong Kong-registered companies have enjoyed preferential access to 18 mainland service sectors. Preferential access for five types of value-added telecommunications services was implemented on October 1, 2003. CEPA has boosted confidence in Hong Kong's economic future. Both China and Hong Kong were committed to making the arrangement WTO compliant, and as a result, U.S. and other foreign firms with a significant presence in Hong Kong are eligible to take advantage of CEPA concessions to enter the mainland market.

Hong Kong maintains few non-tariff barriers and investment restrictions. Those remaining are in the area of professional services, such as the ability of doctors and lawyers to practice in Hong Kong. Although Hong Kong began opening its telecommunications market to greater competition starting in 1995, the Hong Kong government recently agreed to consider loosening the requirement for the dominant fixed-line service provider (PCCW) to provide its competitors access to its customer access network at government-set rates. Proponents of such a move argue that it will spur further investment in Hong Kong's telecommunications infrastructure, while critics worry such a change could signal the start of a roll back to the pro-competition measures that have increased consumer choice since Hong Kong first opened its fixed telecommunications market. In several other domestic service sectors, the absence of a general competition law and the high cost of local market entry have led to domination by major local companies.

Hong Kong has made significant progress over the past several years in fighting optical disc piracy and counterfeiting. Hong Kong Customs intelligence operations and raids on underground production facilities have shut down virtually all large-scale illicit manufacturing lines, forcing disc pirates to rely increasingly on smaller-scale copying technologies (such as disc-burners) or smuggled products. The Office of the U.S. Trade Representative regularly cites Hong Kong as a model for its strong overall protection of intellectual property rights and its tough enforcement against optical disc pirates.

Despite this positive track record, Hong Kong remains vulnerable to two types of infringement. The first is commercial end-use piracy, which is a widespread and growing problem for several U.S. industries, including publishers and business software makers. There are no criminal penalties for the unauthorized business-related copying of printed works. Business-related end-use piracy of computer programs, movies, television programs, and music is a criminal offense under Hong Kong law, but the government has had little success prosecuting end-use pirates. In March 2004 the Hong Kong government withdrew a draft amendment to the Copyright Ordinance that U.S. business groups feared would weaken criminal liability for end-use piracy. Helpful provisions aimed at cracking down on illicit copy shops were carved out from the rest of the bill and will be voted on by the Legislative Council by July. The Hong Kong Government has said it intends to introduce a new draft amendment during the next legislative session that will establish a comprehensive and balanced approach to end-use piracy. The United States has urged the Hong Kong Government to take the steps necessary to achieve effective deterrence against this kind of infringing activity.

Another area of vulnerability is patent protection for pharmaceutical products. Hong Kong's health authorities continue to issue marketing approval to generic drugs that infringe on valid patents, thus implying government sanction for an infringing activity that leads to lost revenue for research-based pharmaceutical manufacturers. The United States has encouraged Hong Kong to consider instituting a link between the drugs registration process and the patent system in order to address this problem.

Financial Secretary Henry Tang, in his March budget address, outlined a path for eliminating Hong Kong's persistent fiscal deficit by fiscal year 2008/09. He indicated that the government would follow a multi-pronged approach of reducing the shortfall by cutting expenditures, stimulating economic growth, selling government bonds for capital projects, securitizing revenue streams from tolls, and studying the possibility of introducing a goods and services tax (GST). Previously, deficits have been financed by running down fiscal reserves. Civil service unions agreed to a six percent pay cut, implemented in January 2004 and January 2005. Chief Executive Tung and other senior officials have reaffirmed the government's commitment to the existing currency board exchange rate system linking the Hong Kong dollar to the U.S. dollar.

During the reporting period, U.S. Customs conducted a textile production verification visit in Hong Kong in cooperation with Hong Kong Customs & Excise and CITB in November 2003. U.S. Customs visited 71 factories in Hong Kong. Evidence of transshipment was found at six factories and twenty-three factories were categorized as high risk for transshipment.

The Hong Kong government is deliberating its policy toward agricultural biotechnology products and considering various labeling options. As yet, the government has imposed no restrictions agricultural biotechnology products. However, the government is proposing nutritional label laws for pre-packaged foods – initially, on a voluntary basis, later to be mandatory. Under the government's proposal, nutritional labels would need to include health and dietary claims. The U.S. government is watching these consultations closely, as the adoption of any mandatory measures could affect U.S. exports to Hong Kong.

Hong Kong imposed a ban on U.S. beef effective December 24, 2003 following announcement of a BSE (bovine spongiform encephalopathy) case in the United States. Hong Kong also imposed a U.S.-wide ban on U.S. poultry effective February 11, 2004 following confirmation of avian flu outbreaks in Delaware. The bans have significantly disrupted trade in U.S. beef and poultry exports. In 2003, Hong Kong imported USD 270 million in U.S. poultry (17 percent of Hong Kong's total food imports from the U.S.) and USD 80 million in U.S. beef (5 percent of U.S. exports to Hong Kong). U.S. government officials have urged the Hong Kong government to lift the ban

on U.S. beef and take a regional approach to any ban on U.S. poultry products. The United States temporarily banned Hong Kong exports of poultry products and live birds to the United States following the outbreak of avian flu in several countries bordering Hong Kong. The U.S. ban was lifted March 10.

B. Export Controls

Hong Kong maintains an effective, highly autonomous, and transparent export control regime that the U.S. government has encouraged others to emulate. That said, the increasing integration between the Hong Kong and mainland Chinese economies has presented new challenges. The United States and Hong Kong are cooperating closely to address these challenges and ensure compliance with relevant export control regimes. The ninth round of formal bilateral interagency export control consultations is scheduled for May 2004. The last round took place in April 2003.

U.S. Department of Commerce representatives in Hong Kong continue, on a regular basis, to carry out pre-license checks and post-shipment verifications on companies in Hong Kong as part of the dual-use licensing, vetting, and post-issuance process. Likewise, Department of State and U.S. Customs officers carry out end-use checks on munitions items. In both instances, Hong Kong officials are neither informed of such checks nor involved in conducting the checks. These checks have been a key factor in determining whether Hong Kong continues to maintain an effective export control system. These efforts are supplemented by regular visits by Department of Commerce safeguards teams. These teams spend several days at a time in Hong Kong conducting pre-shipment and post-shipment verification checks. The most recent safeguards visits to Hong Kong were conducted in March and October 2003.

Over the past two years these checks have uncovered increased instances of illegal re-exports of U.S. dual-use technology to mainland Chinese firms, many of which are subsidiaries or partners of the re-exporting Hong Kong firms. The United States and Hong Kong have agreed to mount a joint campaign to educate Hong Kong importers and end-users about their obligations under U.S. and Hong Kong law to prevent such illegal re-exports. In addition, the Hong Kong Trade and Industry Department and the U.S. Department of Commerce concluded an agreement in March 2003 to enhance our ability to share licensing and enforcement information under the Agreed Minutes of Discussion on U.S.-Hong Kong Strategic Commodities Trade Controls of 1997. The agreement addresses some of the goals identified in the transshipment country export control initiative (TECI) of the U.S. Department of Commerce. The two sides have already shared information under this agreement, which is aimed at focusing enforcement resources on problematic export categories and facilitating the investigation of criminal offenses. At the same time, the United States continues to monitor the number of strategic trade cases pursued by Hong Kong Customs and has urged Hong Kong to step up enforcement of its export control regulations. The assignment of an export control attaché to the U.S. Consulate General in April 2004 will further these cooperative efforts.

Hong Kong has an active licensing system for both imports and exports of strategic trade, reflecting all the major multilateral export control lists. Recent enhancements to Hong Kong's export control system include the establishment of an online database of control items and the creation of an industry liaison position. Both of these initiatives aim to improve public outreach and education on Hong Kong's licensing regime.

In order to facilitate the growing flow of goods and people between Hong Kong and China, the two sides plan to locate both of their respective customs and immigration facilities on the mainland Chinese side of a proposed new border crossing that is expected to open by early 2006. The new border crossing will add to the four land border crossings that already exist with China. The Hong Kong government says it will retain full legal authority to enforce Hong Kong law at this facility and along the bridge that will link this facility to Hong Kong territory. The United States will continue to monitor the impact of co-location on the autonomy of Hong Kong's export control system.

C. Law Enforcement Cooperation, Extradition, and Mutual Legal Assistance

Law enforcement cooperation remained a central pillar of U.S.-Hong Kong relations. The Consulate General is home to six law enforcement agencies: Drug Enforcement Agency (DEA), Federal Bureau of Investigation (FBI), Department of Homeland Security Immigration and Customs Enforcement (ICE), U.S. Secret Service, Internal Revenue Service (IRS) Criminal Investigation Division, and the State Department Bureau of Diplomatic Security. U.S. and Hong Kong law enforcement agencies cooperated to combat activities such as terrorism, human smuggling, trafficking in persons, narcotics trafficking and precursor chemical control, commercial fraud, cyber crime, counterfeiting, credit card fraud, money laundering, violations of intellectual property rights, and general organized crime. A particularly noteworthy development was increased cooperation between Hong Kong Customs and DEA on drug precursor chemicals tracking and interdiction. For example, a joint Hong Kong - ICE/DEA operation tracking large pseudoephedrine combination tablet shipments exported from Hong Kong to Mexico for large-scale production of methamphetamine has resulted in significant seizures and arrests in Mexico. U.S.-Hong Kong agreements on extradition, prisoner transfer and mutual legal assistance, in effect since 1998, 1999, and 2000, respectively, all continued to function smoothly in most instances. During the period covered by this report, Hong Kong extradited seven people to the U.S., while the U.S. extradited two to Hong Kong.

D. U.S. Military Ship and Aircraft Visits

Hong Kong is a regular port of call for the U.S. military. During the period of this report, 19 ships, including one aircraft carrier battle group and the Seventh Fleet flagship with the Commander of the Seventh Fleet embarked, visited Hong Kong. This is half the number of visits last year, reflecting the surge of ships to the Arabian Gulf in support of Operation Iraqi Freedom -- operations that left insufficient time for ships to visit Hong Kong on their return transit -- as well as the impact of SARS. The U.S. Navy continued to provide deck landing qualification support to Government Flying Service helicopters during these visits. Force protection support provided by local authorities has been excellent. Although Beijing has not approved the visit of any U.S. Navy P-3 aircraft to Hong Kong since the April 2001 EP-3 incident, more than two dozen aircraft missions other than P-3s have been approved. The U.S. military also continued to play a major role in Hong Kong's annual Search and Rescue Exercise, the only multi-national exercise involving both U.S. and Chinese units.

E. Passport and Visa Regime

The HKSAR passport is issued to Chinese nationals holding Hong Kong permanent identity cards. The British National Overseas (BNO) passport is issued by the British government. China, however, recognizes the BNO passport as a travel document only, and not as evidence of citizenship. Most Hong Kong residents are entitled to hold BNO passports and HKSAR passports concurrently. The Hong Kong government continued to seek visa-free access for the HKSAR passport to other countries, with 130 places currently affording visa-free entry. U.S. citizens visiting Hong Kong for a temporary stay of less than 90 days may enter without a visa. The ability of the United States to reciprocate -- to offer visa-free entry to holders of the HKSAR passport -- continues to be governed and limited by the terms of the Visa Waiver Program in section 217 of the Immigration and Nationality Act, 8 U.S.C. Section 1187. The United States currently issues ten-year multiple-entry visitor visas to qualified applicants, the maximum validity period available under U.S. law.

F. Cultural, Educational, Scientific, and Academic Exchanges

Exchanges between Hong Kong's seven universities and other educational institutions and their U.S. counterparts range from short-term visits by American faculty and summer programs for students to ambitious multi-year exchanges of faculty and staff. The Fulbright program in Hong Kong supports four U.S. lecturers and one to two U.S. students in Hong Kong each year. The Hong Kong government, through the Research Grants Council, funds post-graduate research in the United States for four Hong Kong academics for up to one academic year. The Hong Kong-America Center, which has been in operation since 1993 with support from five local universities and the Department of State, handles the selection of Hong Kong Fulbrighters doing research in the United States. The Department of State supports the University of Hong Kong's American Studies degree program by providing a Fulbright Scholar to the program each year. The Institute of International Education (IIE) office in Hong Kong provides educational advisory services and conducts outreach programs for schools and thousands of Hong Kong and Macau students who wish to pursue studies in the United States. The Department of State International Visitor Program supports a wide variety of professional exchanges for candidates sponsored by the Consulate General. In 2003-04, over 14 individuals from Hong Kong and Macau, including journalists, politicians, and government and law enforcement officials, have traveled or will travel to the United States on study tours. There was an 18 percent decline in the number of student visas issued in 2003 versus 2002. This decline could be due to the softening of the Hong Kong economy, increased competition from other countries, higher U.S. tuition fees, or the perception that tightened U.S. security procedures made applying for a student visa a more uncertain prospect.

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