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FOR 2019

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HIGH REPRESENTATIVE
OF THE UNION FOR
FOREIGN AFFAIRS AND
SECURITY POLICY

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JOINT REPORT TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

**HONG KONG SPECIAL ADMINISTRATIVE REGION:
ANNUAL REPORT FOR 2019**

JOINT REPORT TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

HONG KONG SPECIAL ADMINISTRATIVE REGION:

ANNUAL REPORT FOR 2019

Summary

Since Hong Kong's handover to the People's Republic of China (PRC) in 1997, the European Union (EU) and its Member States have closely followed political and economic developments in the Hong Kong Special Administrative Region (SAR). The EU stands by its 'one China' policy and supports the 'one country, two systems' principle and its implementation. In line with the commitment given to the European Parliament in 1997, the Commission issues an annual report on developments in Hong Kong. This is the 22nd report, covering 2019.

2019 was an exceptionally challenging year for Hong Kong, with sustained unrest initially triggered by proposals to amend the law governing extradition, which had a first reading in the Legislative Council on 3 April 2019. The second half of the year saw large demonstrations, protests and associated violence, sieges of universities, vandalism, and disruption of transport networks, the airport and other aspects of daily life. Protesters articulated five demands on the Hong Kong Government. Reasons for the unrest included both political and socioeconomic concerns. The Government's response included the withdrawal of the extradition bill, the invocation of emergency powers for the first time since 1967 to establish an 'anti-mask' law, and some limited engagement with the protest movement through community dialogue. Allegations of police abuse underpinned demands by protesters for a wide-ranging commission of inquiry. However, the Hong Kong Government refused to set up any such independent commission. The Independent Police Complaints Council (IPCC) is reviewing several cases of alleged abuses by the police and was due to release a preliminary report in early 2020. The adequacy of its powers, however, has been questioned.

The peaceful conduct of the District Council elections in November fostered hopes of a de-escalation of violence. The historically high turnout of 71.2% was a testament to the importance attached by the people of Hong Kong to the exercise of their democratic rights. In the wake of the polls, largely peaceful mass protests and some violent incidents continued to the end of the year.

The EU continues to encourage the Hong Kong SAR and the Central Government authorities to resume electoral reform as enshrined in the Basic Law, and to reach agreement on an electoral system that is democratic, fair, open and transparent. Universal suffrage would give the Hong Kong Government greater public support and legitimacy, which would help in attaining Hong Kong's economic objectives and tackling its socioeconomic challenges. A convincing response is needed to the grievances expressed through the ongoing protests in order to secure Hong Kong's stability in the longer term.

Concerns have intensified about the erosion of the 'one country, two systems' principle and Hong Kong's autonomy. In general, key freedoms continue to be upheld in Hong Kong, and the rule of law and independence of the judiciary remain as key safeguards. However, there have been some worrying trends with respect to freedom of speech, notably in the context of the ongoing protest. The High Court ruling on 18 November on the unconstitutionality of the 'anti-mask' law prompted remarks from Beijing suggesting that the Hong Kong courts cannot

rule on the constitutionality of Hong Kong's legislation and its compliance with the Basic Law. Any steps to curb the prerogatives of the courts in this respect would undermine the autonomy vested in Hong Kong, including the independence of its judiciary and the rule of law. The anti-corruption system remained vigorous and resilient.

On the economic front, 2019 was a difficult year for Hong Kong, with a 1.2% GDP contraction and its first budget deficit in 15 years. This was largely due to external factors already present towards the end of 2018, i.e. the slowdown in the Chinese economy and the US-China trade dispute, although the unrest in the second half of 2019 had a critical effect, especially on sectors linked to tourism. However, Hong Kong has large fiscal and foreign currency reserves that enable it to face the challenging environment, ensure currency stability and support business. Its financial and banking sectors remain resilient and highly competitive, enabling it to remain the world's first hub for initial public offerings (IPOs) and to avoid panic-driven capital outflows.

The European business community in Hong Kong has been affected to varying degrees by the economic situation and the unrest. European companies are mostly in 'wait and see' mode, although they are deeply concerned by the political impasse, the violence and the unprecedented pressure on business. The European business community prizes Hong Kong's robust legal system, judicial independence, fundamental rights and freedoms, and a business environment free of political interference as key elements in the region's competitiveness. Any erosion of these assets would negatively affect Hong Kong's attractiveness in this regard and its edge over other business centres.

The EU issued several statements and declarations during the year. The EU spokesperson made three statements, on 12 June, 1 July and 13 August. The High Representative made three Declarations on behalf of the European Union, on 17 August, 2 October and 18 November. These Declarations underscored issues including the need to:

- reject violence,
- engage in inclusive dialogue, noting the European Union's willingness to support those who are willing to work towards de-escalation and establishing such a dialogue,
- ensure respect for key freedoms,
- institute a comprehensive inquiry into violence, use of force and the root causes of the protests.

The European Parliament held a debate on 18 July on Hong Kong and adopted a resolution on the situation.

Political developments

2019 was dominated by the debate over the **Fugitive Offenders and Mutual Legal Assistance in Criminal Matters Legislation Bill ('Extradition Bill')** and the mass protests triggered by the proposed measure. The Hong Kong Bureau of Security put forward the proposal in February 2019 with a view to facilitating the extradition of offenders to China, Taiwan and elsewhere. The lack of a basis for extraditing a Hong Kong citizen facing a murder charge to Taiwan was cited as one justification for the reform.

The Extradition Bill was fiercely criticised by the legal profession, business, and civil society. The main grounds for criticism were that the initial draft encompassed a wide range of offences, that it failed to provide for sufficient scrutiny of proposed extradition cases, and that the mainland legal system did not provide adequate protection for human rights and due process. In response, the Hong Kong Government revised the proposal, reducing the list of

extraditable offences from 46 to 37, and specifying that extraditable offences must be punishable by more than three years in prison. Public opposition to the proposal intensified, with large rallies and intense debates in the Legislative Council (LegCo).

As confrontation on the issue escalated, the administration reduced scrutiny of the draft legislation in the LegCo Committee. The inclusion of additional safeguards in the Bill did not diminish public opposition. The Civil Human Rights Front claimed that one million people joined an anti-bill march on 9 June. Chief Executive Carrie Lam announced the suspension, but not abandonment, of the Extradition Bill on 15 June. A further march on 16 June attracted a reported two million participants - the largest such gathering in Hong Kong's history. Both marches were peaceful. Subsequently, the Legislative Council building and other government buildings became a focus for protesters. Some protesters ransacked the Legislative Council building on 1 July, causing substantial damage, after which the building was closed for three months. There was a public outcry following violent attacks on passengers by a group of masked men at a mass transit railway (MTR) station in Yuen Long. The attack took place after a march against the extradition bill and followed warnings that protesters would face retribution if they went to Yuen Long. The police were strongly criticised for not intervening to quell the violence in a timely fashion. This incident is currently under the scrutiny of the IPCC.

The Bill was only fully and formally withdrawn on 23 October. The partial concession in June failed to quell protests, with demonstrators now articulating five demands:

1. the formal withdrawal of the Bill;
2. the establishment of an independent Commission of Inquiry to examine matters including alleged police abuses during the unrest;
3. an end to the use of the word 'riot' by the authorities, as a characterisation of protests, with that offence carrying a heavy prison sentence of up to 10 years;
4. an amnesty for those arrested; and
5. the introduction of universal suffrage for the election of the Chief Executive and Legislative Council polls, in line with provisions in the Basic Law.

The tactics of the 'leaderless', but well organised, protest movement have evolved in the course of the protests. In addition to regular authorised and unauthorised rallies and marches, there have been recurrent blockages of Hong Kong's transport system. Mass sit-ins and protests at the international airport between July and September severely disrupted services and led to the imposition of restrictions on entry to terminals. The mass transit system has been a particular target of disruption and vandalism in the light of the protesters' assertions that the corporation responsible for operating the system has colluded with the government to impede protests, by means including the closure of stations at protest sites. Business chains with owners or management seen as sympathetic to Beijing also became targets of vandalism.

Regular and serious violence has scarred some of the protests, with the throwing of petrol bombs and hurling of other objects. There are concerns about the radicalisation of some in the protest movement. The police have frequently resorted to discharging tear gas and firing rubber bullets and bean bag rounds. Live bullets have also been fired. Several improvised explosive devices were discovered in the course of the year. In November, a protester sustained serious injuries after being shot in the stomach by police, a protester died after falling from a carpark and a man was severely wounded after being set alight following an argument with protesters.

There have been **numerous allegations of excesses and abuse by the law enforcement authorities.** Some incidents of such abuse have been captured on camera. Allegations are being examined by the Independent Police Complaints Council (IPCC), tasked with drawing

up a public report on the force's handling of protests by the beginning of 2020. Many in the protest movement lack confidence in the IPCC, whose credibility was affected when the five-strong body of international experts appointed by the Government in September 2019 to assist in its work stood aside. The experts asserted publicly that the IPCC lacked adequate investigative powers and capabilities. The publication of the IPCC's interim report has been delayed pending the outcome of a judicial review to ascertain whether the IPCC has the requisite powers to conduct the investigations linked to the civil unrest.

In November, **demonstrators occupied university campuses**. The Chinese University and the Polytechnic University witnessed violent stand-offs with police and sieges lasting several days. Many injuries were sustained and numerous arrests were made. Several prominent civil society figures, including some traditionally close to Beijing, made efforts to mediate between police and protesters, securing safe passage for some demonstrators. Strong concerns were raised about the arrest and ill-treatment of medical workers providing emergency medical care at the Polytechnic University; it was noted that this deterred injured protesters from seeking medical attention and that it violated humanitarian norms. As a result of the damage to facilities and the febrile atmosphere, university semesters have been cut short, with a consequent reliance on distance learning. The District Council elections in November ushered in a calmer period in December, with a return to largely violence-free mass rallies and marches. The police demonstrated a greater readiness to authorise gatherings, with the Civic Human Rights Front (CHRF) permitted to organise a march for the first time since August. Broad support continues for the protest movement: turn-out for authorised marches has remained substantial, with the CHRF estimating that 800,000 people took part in a march on 8 December to mark UN Human Rights Day.

The **Hong Kong Government's response to the sustained unrest has included recourse to far-reaching emergency powers** established during the colonial era. In October, the Chief Executive in Council invoked the Emergency Regulations Ordinance (ERO) of 1922 to establish a regulation outlawing the wearing of face masks at public gatherings with effect from 5 October ('Prohibition on Face Covering Regulation'). This was the first use of such powers since 1967. Whilst the move attracted support from many in the pro-establishment political wing, it also drew sharp criticism for the restriction of personal freedom it entails, its unenforceability, and the absence of scrutiny afforded to lawmakers.

A legal challenge resulted in the High Court determining on 18 November that the regulation was incompatible with the Basic Law and that the restrictions of rights entailed by the law were deemed to be disproportionate to legitimate government aims. A ruling by the Court of Final Appeal on the issue is awaited.

On 26 September Carrie Lam faced tough questions from 150 members of the public at the only **public community dialogue** occasion to date. A Dialogue Office to steer dialogue endeavours has been established within the administration's Policy Innovation and Coordination Office. International partners, including the EU, have encouraged efforts to intensify dialogue in order to de-escalate the situation. Civil society has also sought to foster dialogue.

On 21 November, the US Congress enacted the **US Hong Kong Human Rights and Democracy Act** and the Protect Hong Kong Act. The Government of the People's Republic of China and the Hong Kong administration sharply criticised the move. However, it was received positively by many in the protest movement. The Act provides for a regular assessment of the degree to which Hong Kong's autonomy is being upheld, linked to the special trading status accorded to Hong Kong by the US, and establishes a basis for possible

sanctions against individuals who violate human rights in Hong Kong. The Protect Act forbids the export of certain law enforcement goods to Hong Kong.

The **District Council elections** went ahead on 24 November, despite fears by some in the protest movement that the polls might be suspended in the context of the unrest. Violence did mar the campaign period, with some physical attacks on candidates and vandalism of party premises. The elections themselves, however, were held in a peaceful atmosphere, and there was an unprecedentedly high turn-out of 71.2%. Pan-democratic representatives secured 395 of the 452 seats and control of 17 out of 18 councils. The District Councils have only limited advisory and policy powers, and they oversee substantial budgets. However, district councillors determine 117 of the 1200 seats on the election committee that selects the Chief Executive, and the pan-democratic faction on the election committee is now strengthened ahead of the next scheduled appointment of a Chief Executive in 2022.

The ongoing unrest and the Government's response to it have taken a toll on public support for the administration. The results of a public opinion survey released in October revealed that the Chief Executive's approval rating had dropped to a record low of 20.2%. Other surveys towards the end of the year highlighted the detrimental impact of the protests on public trust in the authorities.

The EU issued several statements and declarations in response to developments in Hong Kong during the year. The High Representative of the Union for Foreign Affairs and Security Policy (HR/VP) issued Declarations on behalf of the EU on 18 November, 2 October and 17 August. There was also a joint statement with the Foreign Minister of Canada on 17 August. The High Representative's spokesperson issued statements on 13 August, 1 July and 12 June. The European Parliament held an emergency debate on 18 July on the situation in Hong Kong and adopted a resolution on the situation. Reference was made to the situation in Hong Kong in EU statements to the UN General Assembly Third Committee and the UN Human Rights Council.

Rights, freedoms and equal opportunities

The espousal of self-determination or independence continued to lead to exclusion from electoral processes. Joshua Wong, the Secretary-General of the Demosistō party, was excluded from standing as a candidate in the District Council elections on 24 November. He was the only candidate amongst 1,098 prospective councillors to be disqualified. In three letters to the authorities, and in response to questions from the returning officer, Joshua Wong distanced himself from earlier support for independence. The returning officer contended in the explanation for the disqualification that neither Wong nor Demosistō had genuinely changed their stance on independence.

In September 2019, the High Court considered the exclusion of Agnes Chow from running in a Legislative Council by-election in 2018 on the basis of her affiliation with Demosistō and its advocacy of self-determination. The High Court found in favour of Ms Chow's petition on the procedural grounds that she had not been given a fair opportunity to respond to the claim that she would not uphold the Basic Law. The judge found that there had been a 'breach of the principle of natural justice or procedural fairness'. However, he added in his ruling that advocacy of self-determination or independence would not be compatible with the Basic Law.

Hong Kong's **media**, including online media, remain diverse and continue to enjoy a high level of freedom. However, there are concerns about political influence over some sections of the media and about self-censorship. Concerns have also been raised about the alleged targeting of journalists, including the use of violence by police during protests, and about the

impeding of journalists' work in the context of the unrest. The Foreign Correspondents Club and the Hong Kong Journalists Association are among those that have issued statements¹ in this regard. Hong Kong was ranked 73rd in the World Press Freedom Index compiled by Reporters Without Borders (RSF).

Freedom of assembly was largely respected during a difficult year for public order, with the authorities granting permission for many public rallies and marches. As violence intensified, denial of permission for such gatherings on security grounds became a more frequent phenomenon. One consequence was a greater tendency towards unauthorised gatherings, with an attendant risk of confrontation between protesters and police.

Rights of LGBTI people. The new Chair of the Equal Opportunities Commission (EOC), Ricky Chu Man-kin, has signalled that efforts will be made to advance anti-discrimination measures in order to protect the rights of LGBTI individuals. At present, equality legislation encompasses only sex, disability, race, and family status. Cases brought by LGBTI activists in the courts have had some success in effecting legal reform. The EU Office joined other missions in attending the annual LGBTI parade.

Hong Kong continued to invest in efforts to tackle **trafficking in human beings**, and has drawn up an action plan to this end. Additional resources are being provided for measures including screening for possible victims. The reliance on a web of legislation to tackle trafficking, rather than a single enactment, has been cited as a weakness in Hong Kong's response. The EU and Hong Kong continued to cooperate closely on the issue. Trafficking was discussed at the annual EU-Hong Kong Structured Dialogue in November. The fourth annual EU-Hong Kong workshop on the prevention of trafficking, funded under the EU's TAIEX programme, took place on 12 – 13 December. It addressed issues of shared concern, such as cooperation with civil society and the private sector, and the trafficking of children.

Shortcomings remain in ensuring effective legal protection for **foreign domestic workers**. The statutory minimum wage does not apply to such workers, they are required to live with their employers, and they have to find work within two weeks of losing employment, or face deportation. The Government has taken some steps to address concerns, including the establishment of a dedicated hotline for foreign domestic workers seeking advice and assistance. Enhanced screening of such workers to check for cases of trafficking and forced labour has also been introduced. The EU Office hosted a film and a panel discussion on the rights of foreign domestic workers at the Chinese University on 15 September.

Poverty and inequality remain real concerns, with around 20% of the population living below the poverty line. Few can afford to purchase a home in the world's most expensive real estate market and almost 45% of the population live in rented public housing. The Chief Executive announced several measures to address socioeconomic grievances in her Policy Address on 16 October.

The **anti-corruption** system remained vigorous and resilient. Hong Kong boasts very high standards of transparency and anti-corruption measures. The authorities and political and business figures recognise that transparency is vital in maintaining Hong Kong's strong position as an international business centre.

¹ Both have issued specific statements on violence, all of which are available here: https://www.fcchk.org/fcc-statements/?wpv_aux_current_post_id=1532&wpv_view_count=861-TCPID1532&wpv_paged=2

Economic developments

Hong Kong's economy deteriorated significantly in 2019 with a 1.2% contraction in GDP. In the first half of the year the economy continued a slowdown which had started in 2018, resulting in GDP growth of only 0.6% year-on-year (y-o-y). Hong Kong's reliance on trade and international finance and its role as a trading, business and financial bridge between China and the rest of the world makes it particularly vulnerable to external headwinds and to developments in the mainland. With the start of the unrest in June, Hong Kong's economy then fell into recession and GDP dropped by -2.8% in the second half of the year.

By the end of 2019, Hong Kong recorded its **first budget deficit in 15 years**, due to lower land sales and tax revenues and an increase in spending. In September, Fitch Ratings downgraded Hong Kong's credit rating to AA (from AA+), with a negative outlook, and Moody's also changed Hong Kong's outlook to negative. However, even after the downgrade, the territory's ratings remained solidly in the investment grade and Hong Kong has large fiscal reserves accounting for about 40% of its GDP.

Hong Kong's **external trade** was hurt by the challenging external environment. Exports and imports of goods fell by 4.1% and 6.5% respectively during the year. This, in turn, had ripple effects on trade-related services sectors, which account for some 20% of Hong Kong's employment and GDP. In addition, **retail sales collapsed** dramatically in the second half of the year due to the unrest and were 11.1% lower for the year as a whole. External trade, retail sales, and GDP growth had already started to weaken in 2018, indicating that the economy was losing momentum well before the start of the unrest in June.

One of the most visible consequences of the unrest has been **the fall in the number of tourists**. After June, tourist arrivals fell by 39% y-o-y. Traditionally, some 80% of tourists are from mainland China and they are estimated to account for roughly 40% of total retail sales in the city, notably in the luxury sector. Beside retail sales, the drop in tourist arrivals was also felt hard in the hospitality, food and beverage, and transport sectors.

Despite the downturn, **unemployment** increased only marginally – from 2.8% in the last quarter of 2018 to 3.3% in the last quarter of 2019. However, the labour market could be under more pressure if the economy does not rebound. Inflation remained under control, with underlying consumer price inflation at 3% for the year.

Property prices fell by 4.5% between May and December, but, thanks to a strong start to the year, prices were up 5.4% for 2019 as a whole. Hong Kong remains one of the world's least affordable urban centres for home buyers. The average waiting time for public rental housing has lengthened to 5.4 years.

Though the financial sector has been more resilient than the rest of the economy, given its large exposure to China and the region and the relatively low importance of local operations, it was not entirely spared the impact of the downturn. The number of initial public offerings (IPOs) fell in the third quarter but rebounded starting from September – including Alibaba's broadly publicised secondary listing. For the year, Hong Kong even kept its crown as the leading IPO hub worldwide. However, daily turnover on the market was down 18.9% y-o-y and the Hang Seng index lagged behind other major indexes. Stock market trends were strongly influenced by developments in mainland China and ongoing US-China trade tensions. The banking sector, however, remained solid, with banks' capitalisation and liquidity levels above international standards. Hong Kong also has large foreign currency reserves in support of the Hong Kong dollar currency board, and it largely avoided panic capital outflows.

Hong Kong continued to profile itself as a hub for **green finance** in the region, based on its asset management industry and the Government's supportive green finance policy. It raised US\$1 billion in May 2019 through the inaugural US\$-denominated green sovereign bond. In 2019, the Hong Kong authorities also focused on developing market infrastructure (i.e. on building green finance capacity in financial institutions).

An **audit reform** was implemented in 2019, reshuffling the Financial Reporting Council (FRC) as an independent oversight body regulating auditors and advancing the transition from self-regulation to independent oversight, in line with international standards. In November 2019, SFC adopted a new regulatory approach to **virtual assets trading platforms**, regulating them on a voluntary basis. Only operators that meet high regulatory standards may be licensed. The **Faster Payment System** (FPS) has been developed further, with interconnected e-wallets of various banks, including for RMB payments. While e-wallet services are also offered in mainland China, no interconnection is possible yet.

As regards the **Hong Kong Government's support for the economy**, the Hong Kong Monetary Authority (HKMA) was able to follow the US Federal Reserve and lowered its interest rates several times during the year. The countercyclical capital buffer was also lowered in October, from 2.5% to 2%, to support bank lending. On the fiscal front, the Government rolled out packages of relief measures worth HKD 30 billion (€ 3.5 billion). This was done largely to relieve the financial burden on households, to support SMEs, and to shore up the transport and tourism sectors. Observers criticised the packages for being too small, accounting for only 1% of GDP. It is worth noting here that in November, the IMF advised increased public spending, to support the economy and to address structural challenges (housing shortage, income inequality, etc.)

In October, the Chief Executive issued her **2019 Policy Address**, focusing on housing and welfare. On welfare, it partly recycles previously announced relief packages, while adding a patchwork of new measures. On housing, the most striking proposal was to use the Lands Resumption Ordinance to take back from developers land zoned for high-density housing development, but for which there were no development plans yet, and to use that land for public housing.

Throughout 2019, **European businesses** largely maintained a 'wait and see' approach. Those companies using Hong Kong as a regional hub for the wider Asia-Pacific region were essentially affected by the US-China trade war and weak global trade. For companies focused on local sales, the unrest was a major concern, especially in the retail sector (notably luxury goods), hospitality, and the food and beverage sector. Significant reductions in sales were recorded in these sectors, the main reason for this being the sharp decline in visitors and consumer spending. Some businesses decided to downsize operations. If the situation does not improve, companies could be forced to consider further measures.

The now abandoned extradition bill and its adoption process were of great concern to the European business community. As the unrest unfolded, European companies unequivocally condemned violence, while expressing their serious concern at the political impasse and how it affected the business climate in Hong Kong.

Growing political pressure and interference in the conduct of normal business were new elements in Hong Kong in 2019, observed with concern by the business community in general. Hong Kong's operational efficiency, its role as the Chinese mainland's primary offshore financial centre, its high level of autonomy, its independent judiciary and the wider respect of the rule of law are perceived as key competitive advantages. Erosion of any of these would make Hong Kong less attractive as an international business hub.

Trade and other policies

In March, Hong Kong signed a **free trade agreement** (FTA) with Australia. The FTA with ASEAN (signed in 2017) entered into force for Laos, Myanmar, Singapore, Thailand, Vietnam and Malaysia in 2019. Hong Kong also publicly announced its intention to join the Regional Comprehensive Economic Partnership (RCEP) and to negotiate further FTAs, notably with Thailand, and with the UK after its departure from the EU. No new investment promotion and protection agreements were concluded in 2019, although negotiations with Russia, Iran and Turkey are ongoing.

Encouraging **research and innovation** remains a priority for the Hong Kong Government: the Chief Executive's Policy Address announced the revamp of several support schemes for innovation and technology. To support innovation, Hong Kong also introduced an original grant patent system. Innovation is also encouraged in the field of finance, with the aim of making Hong Kong a leader in technology for the provision of financial services (so called "fintech") and green finance: 2019 saw the granting of the city's first eight virtual banking licences and the issue of a first batch of government green bonds worth US\$ 1 billion².

Environmental protection and decarbonisation remained substantial challenges for Hong Kong in 2019. In the field of waste, the Government took action to reduce the use of plastic straws and polyfoam food containers in premises serving mainly government employees. However, a long-discussed waste charging scheme introduced in the Legislative Council in November 2018 is still awaited. The only noteworthy plan to cope with the increasing amount of waste generated in the city is the building of a large waste-to-energy incinerator. Policies and instruments to reduce, recover and recycle waste remain largely absent. A significant step forward with respect to air pollution was the entry into force in January 2019 of a regulation under which vessels in Hong Kong waters must use only fuel with a limited sulphur content (not above 0.5%). Hong Kong also published a public consultation on decarbonisation, with a view to developing a long-term decarbonisation strategy for the territory.

Relations between Hong Kong and mainland China

The ongoing protests have had a marked impact on relations between Hong Kong and mainland China. The Government of the People's Republic of China has publicly supported the use of force against protesters by the authorities. Moreover, it has asserted, with very limited evidence, that the protests are a vehicle for those seeking independence for Hong Kong and that foreign powers are responsible for fomenting unrest. The mainland has cited socioeconomic grievances as the principal driver of public dissatisfaction. President Xi Jinping termed the violence a 'blatant challenge' to the 'one country, two systems' precept.

Fears that Hong Kong's 'high degree of autonomy' under the 'one country, two systems' principle is being eroded have continued to accumulate.

The media have reported an increase in the number of People's Liberation Army (PLA) soldiers stationed in Hong Kong. A detachment of PLA soldiers emerged from their barracks in Kowloon in November and proceeded to clear barricades and debris that had been strewn on thoroughfares during unrest. Under the terms of the Basic Law, the Hong Kong

² Hong Kong has set up a green bond programme for up to HK\$100 billion (€11.5 billion). In May, the Hong Kong Monetary Authority (HKMA) also unveiled a set of measures to support and promote Hong Kong's development of green finance.

Government may request the PLA to assist with disaster relief or the maintenance of public order. However, no such request was made in this case.

Following the High Court ruling on the unconstitutionality of the face mask ban, a spokesman for the Legislative Affairs Commission of the People's Republic of China stated that only the Standing Committee of the National People's Congress can decide whether Hong Kong's laws comply with the Basic Law. In a statement, the Bar Association of Hong Kong noted that this position was 'legally incorrect', that the courts in Hong Kong had previously struck down unconstitutional laws, and that any suggestion that Hong Kong courts cannot conduct constitutional review circumscribes the exercise of judicial power which these courts have always enjoyed, and is contrary to the Basic Law.

The political unrest has led to increasing pressure, from both sides of the political spectrum, on the Hong Kong business community. Employees of some companies in Hong Kong have been penalised, through measures including dismissal, for participating in demonstrations and protests, and for pro-protest comments on social media. The companies themselves have come under pressure, resulting in well-publicised cases of business leaders resigning and public apologies being issued over the political views and actions of their staff. Businesses perceived as pro-China have been extensively targeted by those sympathetic to the protests. This has taken the form of boycott in some cases, but also violent actions, in particular vandalism of their premises.

In 2019, Hong Kong remained a **major trading hub for mainland China**, while the mainland remained by far Hong Kong's largest trading partner: 55% of Hong Kong's exports went to mainland China, while 47% of Hong Kong's imports originated from the mainland. In turn, Hong Kong was China's fifth -largest trading partner in 2018 (after the US, the EU, Japan and Korea). Mainland China (particularly Guangdong Province), remains an important outward-processing base for Hong Kong.

Hong Kong has also remained **China's key offshore financial centre and investment hub**. It is the mainland's largest source of inward foreign direct investment (FDI), accounting for 54% of the total (at the end of 2018) and the first destination for outward FDI, accounting for 65% of the total. In turn, the mainland was Hong Kong's second-largest source of inward FDI (accounting for 25.5% of Hong Kong's total stock at the end of 2017)³. There are 1,241 mainland enterprises listed in Hong Kong, accounting for 51% of the 2,449 companies listed in Hong Kong, but 73% of the total market capitalisation (end of 2019). There are 1,146 mainland enterprises listed in Hong Kong, accounting for 50% of the 2,315 companies listed there, but 68% of the total market capitalisation (end of 2018). Hong Kong and mainland China's capital markets are connected via the **Stock Connect scheme** linking the Hong Kong Stock Exchange with its counterparts in Shanghai and Shenzhen, **and the Bond Connect** mutual market access scheme for bond markets.

During the year, Hong Kong and mainland China have continued to develop their relationship under the **China-Hong Kong Comprehensive Partnership Agreement (CEPA)**. In November, the two signed an amendment under the CEPA on trade in services, introducing further liberalisation measures in sectors such as financial and legal services, construction and engineering, testing and certification, entertainment, and tourism services. The amendment is due to be implemented in June 2020.

The long-awaited **Guangdong-Hong Kong-Macao Greater Bay Area (GBA)** blueprint was released in February 2019. Hong Kong was identified as one of the four core cities in the

³ <https://www.tid.gov.hk/english/aboutus/publications/factsheet/china.html>

region (together with Shenzhen, Guangzhou and Macao). Hong Kong was assigned a key role in developing the GBA, particularly for professional services (including financial services), and as a global offshore Renminbi hub. Since the release of the blueprint, measures have been announced including strengthening cooperation on intellectual property rights and customs, and making it easier for Hong Kong people to live, work and conduct scientific research within the GBA. However, because of the unrest, there are growing concerns in Hong Kong that its role in the GBA could be reduced in favour of other participating cities.

EU-Hong Kong bilateral relations and cooperation in 2019

The **13th EU-Hong Kong Structured Dialogue** meeting took place in Hong Kong on 28 November 2019. The dialogue provided an opportunity to discuss cooperation in an extensive range of fields, including bilateral trade, WTO reform, financial services, investment, procurement, customs, innovation and technology, and trafficking in human beings.

According to the 2019 survey carried out by the Hong Kong Special Administrative Region (SAR) Government, over 2,300 EU companies have set up their businesses in Hong Kong and more than half have their regional headquarters or regional offices there. EU business are present in a wide range of sectors, mainly financial and business services, trading, logistics, retailing, food and beverages, and construction.

In 2019, Hong Kong was the EU's 18th-largest trading partner in goods and ranked as the EU's ninth trading partner in Asia, with a total trade of €48.0 billion (+3.4% y-o-y). EU exports of goods to Hong Kong amounted to €36.7 billion, while imports from Hong Kong totalled €11.3 billion, resulting in a sizeable surplus of €25.4 billion for the EU (its fourth-highest bilateral trade surplus). The EU also maintained its position as Hong Kong's second-largest trading partner after mainland China. The EU was Hong Kong's second-largest export destination and third-largest import supplier during the year.

Hong Kong remained a major entrepôt for trade between mainland China and the EU. In 2018, more than €10 billion of the mainland's imports from the EU were routed through Hong Kong, while re-exports of mainland-origin goods to the EU through Hong Kong exceeded €35 billion.

Hong Kong remained the EU's fifth-largest **trading partner in services** in Asia, after China, Singapore, Japan, and India. In 2018 (the most recent year for which data are available), bilateral trade in services amounted to €29.3 billion (+8.7% y-o-y). EU imports of services from Hong Kong reached €14.8 billion, while exports to Hong Kong reached €14.5 billion, resulting in a small deficit of €325 million for the EU.

Two-way **investment** between the EU and Hong Kong continued to be extremely significant. Hong Kong statistics show that, excluding offshore centres, the EU is the second-largest foreign investor in Hong Kong, with over 2300 companies and stock totalling €136.2 billion and contributing 8.2% of total FDI stock by the end of 2018 (latest available figures). In turn, by the end of 2018 the total stock of FDI from Hong Kong into the EU totalled €168 billion, making Hong Kong a noteworthy source of FDI into the EU.

Hong Kong's owes its prominent position in investment relations with the EU in part to the fact that a sizeable proportion of what is recorded statistically as 'Hong Kong FDI' in fact originates from the mainland. Indeed, according to the Hong Kong Trade Development Council, more than 60% of outbound Chinese investment is directed to or channelled through Hong Kong. Likewise, a significant percentage of EU FDI into China transits via Hong Kong.

The presence of high-quality service providers and Hong Kong's predictable regulatory environment and rule of law are among the main reasons for this.

During the year, the EU and Hong Kong continued to work together in the field of **customs**, under an action plan to improve protection of intellectual property rights (IPR) financed under the 'IP Key' framework. The action plan was extended in 2019 to sea ports in the EU, for joint cooperation and joint control of transshipment cargo. A meeting of the EU-Hong Kong IP Working Group was held in Hong Kong in March, and the 11th meeting of the EU-Hong Kong Joint Customs Cooperation Committee was held in Brussels in July. Despite excellent cooperation, Hong Kong remained the second place of provenance by value of IPR-infringing goods imported into the EU, even if these goods are not produced in the territory. Both sides are reflecting on how to further tackle the issue and improve cooperation in this field.

The Hong Kong authorities published two new application calls for funds to support **Horizon 2020** participants from the SAR. During the Structured Dialogue, the EU and Hong Kong agreed to explore the possibility of broadening Hong Kong's co-funding mechanism for Horizon 2020 and beyond to include the private sector.

As regards **cooperation on tax matters**, in February 2019 Hong Kong amended the two remaining regimes for offshore funds and offshore private equity funds to address EU concerns over their ring-fencing features. On this basis, the Council agreed in March 2019 that Hong Kong had honoured its commitments on good governance in the taxation field.

In the field of **anti-money laundering and countering the financing of terrorism**, the Financial Action Task Force (FATF) issued the mutual evaluation report of Hong Kong in September 2019⁴. Hong Kong is a jurisdiction with significant company formation activities. It recently upgraded its regime to ensure that companies collect and maintain beneficial ownership information at their premises, but the effectiveness of such new measures has yet to be fully demonstrated. Hong Kong should also take further action to ensure that beneficial ownership information in relation to legal arrangements is more readily available, and that it is accurate.

The EU and Hong Kong continued to work together to increase **people-to-people contacts**, notably in the areas of research, academic cooperation, student mobility, culture, and creative industries.

The EU Office in Hong Kong implemented a wide range of cultural, economic and public diplomacy activities, often in partnership with EU Member States and their cultural institutes. Highlights of the year included the EU Film Festival, the EU Day of Languages, the Hong Kong Book Fair, participation in Hong Kong's annual LGBTI Pride gathering, a workshop on single-use plastics, partnership with the IOM on the Global Migration Film Festival, the EU-Hong Kong trafficking prevention workshop and a film screening and panel discussion to explore the rights of foreign domestic workers. The EU Office met frequently with government officials, law-makers, academia and civil society.

⁴ <http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-Hong-Kong-China-2019.pdf>