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JOINT REPORT TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

Hong Kong Special Administrative Region: Annual Report 2016

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Hong Kong Special Administrative Region: Annual Report 2016

Summary

Since the handover of Hong Kong 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) under the 'one country, two systems' principle. The EU adheres to 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 European Commission and the European External Action Service issue an annual report on developments in Hong Kong. This is the 19th report, covering developments in 2016.

The year was a politically challenging one for the Hong Kong SAR and for the 'one country, two systems' principle. Hong Kong society has become more polarised. People are increasingly anxious about Hong Kong's future after 2047, the date until which implementation of the 'one country, two systems' principle is guaranteed in Hong Kong's Basic Law. The year was also marked by ongoing concerns about the missing booksellers, the Mong Kok riot, the emergence of political groups advocating self-determination or even independence, Legislative Council elections and the disqualification of two pro-independence lawmakers, the decision by the National People's Congress Standing Committee (NPCSC) to issue an interpretation of the Basic Law provisions on oath-taking, voting for the Election Committee, and preparations for the Chief Executive elections.

The case of the five book publishers who went missing in 2015, which the EU regards as the most serious challenge to the Basic Law and the 'one country, two systems' principle since the 1997 handover, continued to unfold, and the circumstances of their disappearance have yet to be clarified. One of the publishers remains in detention without having been formally charged.

Despite the above mentioned issues, overall the 'one country, two systems' principle continued to work well in 2016.

The judiciary continued to demonstrate its independence and adherence to due process, despite being confronted with several politically sensitive judicial reviews and the NPCSC's interpretation of the Basic Law.

The rule of law remained the guiding principle for the government, economic stakeholders and the population at large. Anti-corruption action remained strong and good governance indicators were positive. Hong Kong was ranked 14th in Transparency International's Corruption Perceptions Index.

Freedom of speech and freedom of information were generally upheld. However, negative trends can be observed as regards press freedom and in the publishing industry as a result of

caution and self-censorship on the part of those reporting on PRC domestic and foreign policy developments. The disappearance of the book publishers contributed to this.

Hong Kong remained a competitive international business and financial centre and the world's premier hub for business with mainland China. It is also the main testing ground for China's capital market reform. To meet new challenges in the digital era, it is trying to re-focus its growth strategy by venturing into technology and innovation. The rule of law, a transparent regulatory framework, very low corruption levels and crime rates, along with an efficient public administration and an independent judiciary, all helped to preserve and foster the favourable investment climate that lies at the heart of Hong Kong's success.

The EU encourages the Hong Kong SAR and China's central government to resume electoral reform in line with the Basic Law and to reach agreement on an election system that is democratic, fair, open and transparent. Universal suffrage would give the government greater public support and legitimacy in pursuing Hong Kong's economic objectives and tackling social challenges such as the socio-economic and generational divides in Hong Kong society. Record turnouts in the Legislative Council (LegCo) and Election Committee elections show that people are eager to play an active role in political life and in deciding the future of the SAR.

Political developments

Hong Kong's political climate remained highly polarised between the pro-establishment and pro-democracy camps. Tensions were increased by the emergence of the 'localist' movement as a political force. Relations between the executive and the legislature continued to be strained, with opposition legislators staging a non-cooperation campaign and using filibustering to delay government initiatives. For example, LegCo failed for the second time to adopt the copyright amendment bill. This seriously compromised the government's attempts to establish Hong Kong as a regional hub for intellectual property rights as the current legal framework dates from the pre-internet era.

The case of the five **book publishers** who disappeared in late 2015 continued to unfold in 2016. Four of the publishers returned to Hong Kong in the course of the year, although the circumstances of their disappearance have never been clarified. Gui Minhai, a Swedish citizen, is still detained in China without having been formally charged. Three of the returned publishers said they went to mainland China voluntarily, to assist in investigations, while Lam Wing Kee alleged publicly that he had been kidnapped and interrogated by mainland security forces over a period of 8 months. Several booksellers took part in televised 'confessions'. The EU has repeatedly raised concerns about such practices.

The EU raised the case with both the Hong Kong and the Beijing authorities on numerous occasions. On 7 January, the spokesperson for High Representative/Vice-President Mogherini issued a statement on the case¹, describing it as 'extremely worrying'. On 4 February, the

¹ https://eeas.europa.eu/delegations/hong-kong/4962/statement-spokesperson-disappearance-individuals-associated-mighty-current-publishing-house_en

European Parliament adopted a Resolution expressing grave concern about the disappearances², and on 23 November it passed a Resolution on the case of Gui Minhai³.

The EU takes these matters very seriously and hopes that such incidents will not be repeated. All necessary steps should be taken to restore faith in Hong Kong's rule of law and the 'one country, two systems' principle.

One of the most remarkable political developments in 2016 was the **emergence of new political groups** following the failed electoral reform and Hong Kong's 'umbrella movement'. Several radical groups, loosely described as **localists**, campaign for the defence of Hong Kong's interests as opposed to China's, with some calling for self-determination (Demosisto) or outright independence (the Hong Kong Indigenous party, the Hong Kong National Party). The Hong Kong National Party said it would seek independence 'by whatever means', not ruling out violence as a last resort. According to media reports, at least 21 localist groups have been set up. Both the Hong Kong and Chinese central authorities have spoken out strongly against calls for independence or self-determination, on the basis that these would breach the Basic Law.

On 8 February (the first day of the Chinese New Year), violent clashes on a scale seldom seen in Hong Kong broke out between protesters and the police. Some 500 protesters threw bricks and started fires, with overwhelmed police forces firing two warning shots. The 10-hour **Mong Kok riot** left 128 people injured, among them 90 police officers. Of the 64 protesters who were arrested, 38 were charged with rioting (charges against 10 people were later dropped). Many of the protesters belonged to localist groups. The police described the riots as organised and pre-planned. The unprecedented violence may have been fuelled by social and political discontent, especially among young people.

Calls for self-determination or independence were made in the run-up to the **LegCo by-elections** in February and during the campaign for the LegCo elections in September. Not many people in Hong Kong genuinely support such radical ideas, but social and economic grievances, combined with dissatisfaction with the traditional political powers, seem to feed into support for localists. In this context, the EU recalls its adherence to its 'One China' policy and its support for the continued implementation of the 'one country, two systems' principle in Hong Kong.

In the by-elections on 28 February, a radical, anti-mainland Hong Kong indigenous candidate made a surprise breakthrough, winning 15 % of the votes. Although he failed to win a seat (this was won by the pan-democrat candidate), the result was highly significant as it lent political legitimacy to a hitherto marginal political movement.

On 5 August, thousands took part in the first-ever pro-independence rally. The organisers claimed that 10 000 people attended the rally, but the police put the number at 2 500.

² <http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P8-TA-2016-0045&language=EN>

³ <http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P8-TA-2016-0444&language=EN&ring=B8-2016-1256>

On 4 September, Hong Kong held elections to select the 70 members of LegCo. Despite the absence of universal suffrage, the elections were generally seen as free from interference and the process was by and large orderly. A record 2.17 million voters turned out (58 % of the electorate).

The pro-establishment camp maintained its majority, but the pro-democracy camp is now able to block legislation requiring a two-thirds majority. The elections confirmed increased political polarisation in Hong Kong and were marked by the election of several localist candidates, who secured nearly 19 % of the votes. The new LegCo also saw a major generational change. Nearly a third of lawmakers are new and many are much younger than previous members.

However, the elections were tainted by the exclusion of six pro-independence candidates on questionable grounds that have subsequently been subject to legal challenge.

The new LegCo term started with a chaotic **swearing-in ceremony**. Several lawmakers made changes to the wording of the oath or were otherwise deemed to have behaved disrespectfully. Some were asked to retake the oath on the spot, while others had an opportunity to do so in a separate LegCo session.

A particular problem arose in the case of two newly elected pro-independence legislators, Youngspiration representatives Sixtus Leung and Yau Wai-ching, who took the most radical action by directing offensive language at mainland China. The government launched a judicial review to prevent them from retaking their oaths and therefore oblige them to vacate their seats.

The case was still pending in Hong Kong's court when the NPCSC decided to intervene by issuing an interpretation of the Basic Law provisions on oath-taking (Article 104). The interpretation, unanimously passed by the NPCSC on 7 November, sent a clear message that Sixtus Leung and Yau Wai-ching should be barred from retaking their oaths and taking up office. The subsequent court ruling took the same line, although the judge emphasised that he would have come to the same conclusion 'with or without referring to the terms of the [NPCSC] interpretation'. The two lawmakers lost their appeals. In the meantime, they were ordered to vacate their seats.

While the NPCSC has the power to interpret the Basic Law, the timing of its interpretation – in the already politically charged climate – raised concerns about the rule of law and the independence of the judiciary in Hong Kong, and was seen as effectively pre-empting the court ruling.

Several other judicial reviews of the swearing-in of lawmakers were launched by private individuals, and the government sought the disqualification of four other pro-democracy legislators. These cases are still pending.

The final months of 2016 were marked by preparations for the Chief Executive elections. The current Chief Executive surprised many by announcing that he would not run. Elections for the 194-strong **Election Committee**, which will elect Hong Kong's Chief Executive, were

held on 11 December. The record turnout was almost double that in 2011 (46 % compared to 27.6 %). Although the pan-democrats did much better than in previous elections and will have some leverage, the pro-establishment camp still retains a very comfortable majority.

Rule of law and the judiciary

Despite the concerns arising from the case of the five missing publishers and high-profile judicial reviews, the rule of law was otherwise upheld and the judiciary maintained its high standards in 2016. The *Global Competitiveness Report 2016-2017*⁴ ranked Hong Kong eighth for judicial independence. Many lawyers expressed concern about the NPCSC's interpretation of Article 104 and marched in protest, claiming it was the most serious case of interference in Hong Kong's legal system since the handover.

Maintaining judicial independence and full respect for the rule of law are vital to upholding Hong Kong's democratic credentials, its standing as an international business centre, and its ambition to consolidate its role as an international centre for arbitration and mediation.

Equal opportunities, rights and freedoms

Hong Kong enjoys a great degree of freedom. Freedom of expression, freedom of the press and freedom of information are an integral part of its core values, in keeping with the 'one country, two systems' principle. They are also an essential component of its strength as a global business centre. The EU calls on all stakeholders to preserve these values.

The **media**, including digital media, continued to be largely free and to give voice to a variety of views. Nevertheless, there was a growing impression, documented in the Hong Kong Journalists Association (HKJA) annual report, that both the print and electronic media exercised self-censorship, especially when reporting on mainland China. The HKJA said that 2016 had been an 'extremely difficult' year for freedom of the press and that the 'one country, two systems' principle was under serious threat. It criticised the tendency to appoint people with close links to Beijing to key positions in local media management. The acquisition of several Hong Kong media outlets by mainland operators also caused concern. Hong Kong moved up one place to 69th in the *2016 World Press Freedom Index*, although the index did highlight a negative trend. In November, PEN International opened a centre in Hong Kong to defend freedom of speech.

Following the disappearance of the five publishers, some bookstores were reported to have taken publications critical of China's leaders off their shelves, some closed, and publishers reported disruption to printing, storage and distribution.

In 2015, appointments to university councils sparked major controversy over **academic freedom** and the independent governance of higher education institutions. Calls continued throughout 2016 for the removal of the Chief Executive as *ex officio* chancellor of all

⁴ http://www3.weforum.org/docs/GCR2016-2017/05FullReport/TheGlobalCompetitivenessReport2016-2017_FINAL.pdf

universities in Hong Kong. Many academics see this practice as a threat to independent university governance that could in the long run harm academic freedom in Hong Kong.

Hong Kong still does not have a comprehensive **anti-discrimination law**. In January, the Equal Opportunities Commission (EOC) released a study on discrimination on the grounds of sexual orientation, which found widespread discrimination against LGBTI people. Nevertheless, 55.7 % of the population supported legislation against discrimination. The EOC called on the government to launch a public consultation on the content of future legislation.

Following a lengthy period of public consultation and deliberation on the **Discrimination Law Review**, the EOC submitted recommendations to the government in March. High-priority areas include the rights of people with disabilities, equality for women, discrimination on the grounds of race, nationality, citizenship and residency status, and equal protection for cohabiting couples.

Foreign domestic workers, who number around 300 000, continued to suffer from a lack of labour and social protection. Two provisions are of particular concern: the live-in requirement and the ‘two-week’ rule, under which such workers must find work within two weeks of their contract expiring or face deportation. Also of concern are debt bondage and malpractices on the part of employment agencies. The government took steps to address these issues, in particular by issuing a non-binding code of conduct, but more resolute action is needed.

Trafficking in human beings remained a concern, particularly in the absence of a coherent legislative and policy framework. The government has set up a task force to address the issue and is working on it with the EU and other members of the international community.

There was a heated debate about **refugees** in 2016. The local and international community was alarmed by the Chief Executive’s remarks to the media that Hong Kong might consider withdrawing from the Convention Against Torture (CAT) to curb the influx of migrants claiming non-refoulement protection. Hong Kong is not a party to the CAT in its own right, but through the PRC. Several high-level officials subsequently gave assurances that Hong Kong had no intention of withdrawing. However, the Hong Kong government considers that there is a need to review the non-refoulement claims procedure, which it claims is vulnerable to abuse that has led to a backlog of around 10 000 cases.

Corruption was deemed to be under control, with the **anti-corruption system** remaining robust and resilient. Hong Kong boasts very high standards of transparency and anti-corruption measures. The authorities and political and business leaders recognise that transparency is vital for Hong Kong to remain strong as an international business centre, including for mainland firms.

Relations between Hong Kong and mainland China

Parts of Hong Kong society were concerned about a gradual erosion of Hong Kong’s ‘high degree of autonomy’ within the PRC and declining respect for its values and way of life under the ‘one country, two systems’ principle. The biggest challenges for Hong Kong’s relations with the PRC were the emergence of radical political tendencies in Hong Kong and the

NPCSC's interpretation of Article 104. The 2047 timeline only increases anxiety and uncertainty in Hong Kong society as to the future of the 'one country, two systems' principle, despite Beijing's repeated assurances that this will continue to be fully respected and faithfully implemented.

Following the public allegations made by one of the book publishers that he had been kidnapped by mainland forces, Chief Executive CY Leung wrote to China's central government requesting clarification. Hong Kong authorities and China's central government held several rounds of negotiations with the aim of reaching an agreement on a cross-border notification mechanism for Hong Kong residents who are detained on the mainland and vice versa.

The chairman of the National People's Congress, Zhang Dejiang, made an official visit to Hong Kong on 17-19 May, on the occasion of the Belt and Road Summit. The visit was the first by a high-ranking Beijing official following the failed political reform and the pro-democracy umbrella movement in 2014. Zhang sought to reassure Hong Kong people about the continued implementation of the 'one country, two systems' principle. He reached out to the opposition pan-democrats, but the heightened political tensions were not conducive to more fruitful contacts. At the end of the year, China's central government announced that it would issue home return permits (allowing travel to the mainland) to some pan-democrat politicians who did not have them.

Economic developments

In 2016, Hong Kong's GDP recorded 1.9 %⁵ growth in real terms, following the 2.4 % expansion in 2015. The external sector performed below expectations in the first half of the year owing to a lacklustre global trading environment. The sharp decrease in tourist arrivals from mainland China also had a negative impact on the retail sector. The economy rebounded steadily towards the latter half of 2016, with a pick-up in exports of goods and services. The labour market was at full employment, with a low unemployment rate of 3.4 % in 2016. Inflation remained in check, as consumer prices rose by 2.3 % over the year.

In his annual policy address on 13 January 2016, Chief Executive CY Leung announced a range of initiatives to develop the economy, boost innovation and technology, and improve education and healthcare. He placed strong emphasis on Hong Kong's role in China's 'One Belt, One Road' (OBOR) initiative and its 13th Five-Year Plan. Hong Kong would continue to pursue free-trade agreements (FTAs), investment promotion and protection agreements, comprehensive double-taxation avoidance agreements (CDTAs) and air services agreements with major trading partners along the Belt and Road.

⁵ Unless otherwise stated, all economic indicators pertaining to the Hong Kong economy have been sourced from the Hong Kong Census and Statistics Department.

The 2016-2017⁶ fiscal budget contained a number of relief measures to help businesses and residents weather a weakening economy and to stimulate consumption. It proposed various funding schemes and initiatives to encourage the development of innovation and technology (including financial technology (fin-tech)), nurture start-ups, help industries to find new markets and strengthen efforts to promote the OBOR initiative. In spite of continued increases in public expenditure over the years, the Hong Kong SAR accumulated substantial fiscal surpluses with fiscal reserves reaching HKD 935.7 billion at the end of the 2016-2017 fiscal year, equivalent to 37 % of GDP.

Following the blueprint adopted at the beginning of the year, the Hong Kong authorities worked on various fronts to embrace the national ‘One Belt, One Road’ strategy. A steering committee, to be chaired by the Chief Executive, was set up to formulate strategies and policies for Hong Kong’s participation in OBOR, along with a dedicated Belt and Road Office. In parallel, in July, the Hong Kong Monetary Authority set up the Infrastructure Financing Facility Office (IFFO) to promote Hong Kong as an infrastructure financing platform. On the regulatory front, Hong Kong signed aviation agreements and/or double-taxation avoidance agreements with several countries along the Belt and Road routes (Malta, Serbia and Latvia), to prepare for potential development opportunities. Still in the pipeline are negotiations for FTAs with Georgia and the Maldives, through which Hong Kong hopes to expand its FTA network into Eurasia. A number of official visits to the OBOR countries and promotional activities took place over the course of the year.

Hong Kong was the world’s largest market for initial public offerings for the second year running, raising a total of USD 24.8 billion⁷. Over 80 % of the funds raised were attributed to mainland Chinese financial institutions. Hong Kong maintained its competitive edge over Shanghai and Shenzhen as Chinese companies’ preferred fund-raising centre. However, development of the offshore renminbi (RMB) business in Hong Kong faced headwinds from the continued depreciation of the Chinese currency. The RMB liquidity pool and RMB transactions in Hong Kong contracted, mainly due to strong expectations of sustained RMB depreciation. Hong Kong continued to be the main testing ground for China’s capital market reform. Following the successful launch of the Shanghai-Hong Kong Stock Connect programme in November 2014, a second stock trading link with Shenzhen was launched on 5 December. The Shenzhen-Hong Kong Stock Connect trading scheme allows international investors to trade 881 Shenzhen-listed stocks, while eligible mainland investors have access to 417 Hong Kong stocks. The scheme marked a new milestone in China’s efforts to boost investors’ confidence in stock markets after the turmoil of summer 2015 and represented an important step forward in its financial market reforms. The Hong Kong Monetary Authority stated that both sides would explore the feasibility of a bond market connect scheme in due course.

While financial services flourished, cementing Hong Kong’s position as an international financial centre, some sectors of the economy (in particular, the port and related sectors and

⁶ Fiscal year of the Hong Kong SAR government runs from 1 April to 31 March of the following year.

⁷ Source: Hong Kong Stock Exchanges and Clearing Ltd. (HKEx) news release, 20 December 2016.

industries) continued to lose steam. The Port of Hong Kong faced mounting pressure from mainland ports as China relaxed its shipping policy to allow foreign vessels to load and unload cargo along its coast. As a result, Hong Kong is gradually losing its role as a transshipment point for goods to and from the mainland, which accounted for about 40% of its transshipment cargo. While Hong Kong was the largest container port in the world over a decade ago, it fell to the 5th place, trailing Shanghai, Singapore, Shenzhen and Ningbo in 2015⁸. In 2016, the container throughput of Hong Kong Port dropped further by 2.2%.

The SAR's industrial structure has remained largely unchanged since 1997. To meet new challenges in the digital era, Hong Kong is trying to re-focus its growth strategy by venturing into technology and innovation. In the 2016-2017 policy address and fiscal budget, the government set aside an unprecedented HKD 18 billion to promote innovation and technology development, including HKD 8.2 billion for the development of multi-storey industrial buildings for re-industrialisation. The Innovation and Technology Bureau was established in November 2015 to take the lead in the sector's efforts to catch up. In 2016, a HKD 500 million technology voucher pilot programme was launched to provide SMEs with financial assistance to improve their technological capacity. Other initiatives in the pipeline include the Innovation Technology Venture Fund (to promote public-private partnerships) and the Midstream research programme (for universities to convert research into commercial success).

The Hong Kong government has identified fin-tech as a promising potential growth area. In September, the Hong Kong Monetary Authority announced a series of policy initiatives in this area, including the setting-up of a fin-tech innovation hub and a fin-tech supervisory sandbox, which enable faster approvals for fin-tech experiments. The hope is that Hong Kong will edge ahead of Singapore and Tokyo as Asia's top financial centre.

Land and housing

The property market was buoyant, with home prices reaching a new peak in 2016. Residential housing prices increased markedly in the latter half of the year, led by small and medium-sized units. As a result, overall flat prices in December 2016 exceeded the 1997 peak by 77%⁹. To curb soaring house prices, the government raised stamp duty to a standard 15 % for non-first-time buyers and corporate buyers as from 5 November, replacing progressive tax arrangements under which the highest rate was 8.25 %. Nevertheless, property prices have remained beyond the reach of many, in particular the younger generation.

As a result, housing affordability has remained a thorny issue for the SAR government. Some global surveys ranked Hong Kong as the world's least affordable city in terms of owning a home¹⁰. The government has formulated a long-term housing strategy to supply 280 000 public housing units over the next 10 years. The 2016 progress report signalled that there

⁸ Source: Marine Department, Hong Kong SAR government.

⁹ Source: 2016 Economic Background and 2017 Prospects, Hong Kong SAR Government

¹⁰ According to the 12th Annual Demographia *International Housing Affordability Survey* (2016), of 367 cities Hong Kong has the least affordable housing, with average flat prices 19 times gross annual median income.

would be a shortfall of suitable land for public housing over the next decade, as it would be increasingly difficult to secure enough land for development. The search for and acquisition of suitable land for housing development has caused deep divisions, particularly in rural areas where landlords, brownfield¹¹ tenants (or illegal occupiers), villagers and green groups have potentially conflicting interests. The planning process has become lengthier and more complicated due to opposition from the various interest groups.

On the demand side, a significant development in the property market was the active participation of mainland Chinese companies, whose presence grew in Hong Kong¹². Mainland Chinese property developers took part in 62 % of government tenders for residential sites and won 24 % of awarded tenders in 2016¹³. Their increased activity on the Hong Kong public land sales market drove land prices up for some sites, pricing out local developers. Chinese financial institutions and conglomerates also became dominant buyers in the prime office market. Capital outflows brought about by the broadening of cross-border investment channels and expectations of further RMB depreciation against the US dollar underpinned demand from mainland financial institutions.

Business environment

The business environment in Hong Kong faced some headwinds in 2016. SMEs, start-ups, foreign companies and some individuals found it unnecessarily cumbersome and difficult to open bank accounts. Local and foreign chambers of commerce brought this to the attention of the authorities, arguing that the practice was inconsistent with Hong Kong's ambition to be the 'super-connector' between China and the world and a hotspot for innovation and start-ups. The Hong Kong Monetary Authority finally intervened and issued a circular to banks in September. Nevertheless, the issue has not been fully resolved.

Having entered into force in December 2015, the Competition Ordinance appeared to be bringing about gradual changes in business practices and culture in Hong Kong. For example, 19 trade associations removed price restrictions or fee scales in 2016. The Competition Commission received nearly 1 900 complaints and inquiries, of which 130 moved on to the second, further assessment stage. 'Property and property management' and 'professional and technical services' were the top two sectors involved. A number of complaints related to bid-rigging, which is prevalent in the building renovation sector. In the third quarter of 2016, the Competition Commission issued its first proposal for a block exemption order for certain shipping liner agreements. It still needs to address some distinctive features of the Hong Kong system, in particular the lack of a cross-sector merger regime, the absence of private actions, and the exemption of statutory bodies from coverage.

¹¹ Brownfield land is generally agricultural land in the rural New Territories, especially the relatively flat and more accessible areas. The land has been used for various unregulated industrial activities such as open storage, port back-up facilities, industrial workshops, logistics operations, recycling yards, construction machinery and materials storage.

¹² According to the Hong Kong Census and Statistics Department, the number of mainland Chinese companies in Hong Kong increased from 853 in 2012 to 1 123 in 2016.

¹³ Source: JLL, Hong Kong.

On environment policy, Hong Kong announced a decision to phase out the local ivory trade in 5 years. The relevant legislative amendment should be submitted to LegCo in the first half of 2017. In December, the government rolled out the city's first strategy and action plan to preserve biodiversity and support sustainable development, setting aside HKD 150 million for biodiversity initiatives in the first 3 years.

International commitments

Hong Kong made steady progress in implementing the Automatic Exchange of Financial Information in Tax Matters (AEOI) in compliance with the OECD standard¹⁴. In June, LegCo passed an ordinance amending the domestic law so as to provide the necessary legal framework for AEOI. Hong Kong will be ready to exchange tax information with Japan and the United Kingdom automatically from 2018 onwards. It has also invited 16 other EU Member States to commence competent authority discussions on agreements for the automatic exchange of financial information and will continue to negotiate tax treaties with more Member States.

In June, Hong Kong informed the OECD of its commitment to implementing the base erosion and profit shifting (BEPS) package. To satisfy OECD requirements, it aims to submit the relevant amendment bill(s) to LegCo in mid-2017. To that end, in October the government launched a consultation exercise to gauge views on the implementation of OECD measures to counter BEPS by businesses.

Hong Kong continued to strengthen its anti-money laundering and anti-terrorist financing regimes. In March, the Hong Kong Association of Banks issued all its members with a guidance paper (prepared in consultation with the Hong Kong Monetary Authority) on tackling 'trade-based' money laundering. It is claimed that Hong Kong's current regime make it an attractive jurisdiction not only for trade and investment, but also for illicit activities. The guidance paper is intended to help financial institutions translate the broad principles of the 2012 Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance into workable internal procedures. In December, the Security Bureau submitted proposals to LegCo for amendments to the United Nations (Anti-Terrorism Measures) Ordinance to take account of the latest Financial Action Task Force recommendations on countering terrorist financing and implement UN Security Council Resolution 2178. The new measures will fast-track the freezing of assets belonging to terrorism suspects and prohibit people from leaving Hong Kong or entering another state for terrorism purposes.

Despite its regulatory efforts, Hong Kong's reputation as an international financial centre suffered a blow in the wake of the Panama Papers leak. The leak raised questions as to whether Hong Kong has effective regulation in place to prevent abuse by offshore companies. According to the International Consortium of Investigative Journalists, Hong Kong was the leading market for Mossack Fonseca, the Panama-based law firm that helped clients manage their assets in secretive offshore structures. A large portion of the firm's clients came from or

¹⁴ Hong Kong signalled its support for the OECD standard in September 2014, with a view to holding initial exchanges with appropriate partners on a reciprocal basis by the end of 2018.

through Hong Kong-based affiliates. The Hong Kong authorities argued that there was no domestic law that prohibits companies or commercial entities from setting up companies in jurisdictions outside Hong Kong.

EU-Hong Kong bilateral relations and cooperation 2016

Bilateral relations between the EU and Hong Kong were further strengthened in 2016. As in previous years, the EU was Hong Kong's second largest trading partner after mainland China¹⁵, while Hong Kong was the EU's 14th largest trading partner for trade in goods and a key partner for trade in services.

Bilateral trade in goods between the EU and Hong Kong rose significantly by 7.3% in 2016 and amounted to EUR 53.2 billion, with the EU enjoying a trade surplus of EUR 16.8 billion¹⁶, its fifth highest external trade surplus. In 2015 (the most recent year for which data are available), bilateral trade in services amounted to EUR 22.77 billion, with an EU deficit of EUR 506 million.

Investment relations also continued to prosper. The EU was the third largest source of foreign direct investment (FDI) in Hong Kong in 2015 after the British Virgin Islands and mainland China¹⁷. Hong Kong is one of the top 10 investors in the EU. In 2015, the stock of EU direct investment to Hong Kong amounted to EUR 119.4 billion; the stock of direct investment from Hong Kong to the EU reached EUR 80.4 billion¹⁸. EU companies numbered 2 107, thus remaining the largest group of foreign companies established in Hong Kong¹⁹.

As the natural business and investment platform between China and Europe, Hong Kong can only stand to gain from increasing investment flows. In 2016, the EU and Hong Kong informally explored the role that Hong Kong could play as an investment platform in the Investment Plan for Europe and under the OBOR initiative.

The 10th EU-Hong Kong Structured Dialogue meeting in Brussels on 17 November achieved the following significant results.

- The two sides reached an understanding on measures to facilitate the export of meat and meat products from the EU.
- They agreed to pursue dialogue and cooperation on food safety and health-related issues.
- The EU and Hong Kong welcomed the promising cooperation in the framework of a newly set up Intellectual Property Working Group and agreed to have investment experts on both sides meet and exchange information on recent developments in their

¹⁵ The ranking is based on trade statistics released by the Hong Kong Census and Statistics Department.

¹⁶ Source: Comext, Eurostat's reference database for international trade in goods. Provisional data as of 14 February 2017.

¹⁷ Source: *External direct investment of Hong Kong in 2015*, the Hong Kong Census and Statistics Department.

¹⁸ Source: Eurostat and DG TRADE.

¹⁹ Source: *2016 annual survey of companies in Hong Kong representing parent companies located outside Hong Kong*, the Hong Kong Census and Statistics Department.

respective investment policies. The parties agreed to further strengthen their good cooperation in the WTO.

- They decided to coordinate efforts to combat wildlife trafficking.
- They updated each other on the implementation of measures in the field of transparency in tax matters and against BEPS under the aegis of the G-20 and the OECD.

The EU and Hong Kong continued to work well together under the action plan on cooperation in the customs enforcement of intellectual property rights. In March, they completed a six-month pilot project under which they exchanged intelligence on detention cases via secure means and jointly analysed border detention statistics. The pilot involved five airports in the EU. In the light of this positive experience, the EU and Hong Kong decided to expand the scope of their cooperation, in particular by including more EU airports.

To facilitate bilateral trade further, the EU and Hong Kong established a work plan that may lead to the Mutual Recognition of the respective Authorised Economic Operator (AEO) programmes.

In research and innovation, 2016 saw positive developments in the collaboration scheme between the European Commission and the Hong Kong Research Grants Council, set up in 2015 to foster cooperation in joint academic research projects under the EU's Horizon 2020 framework programme. In September, the Research Grants Council awarded the first sum of HKD 2 million for a project by Hong Kong Polytechnic University. In October, a second invitation was launched for applications under the Horizon 2020 call for 2016-2017.

As part of its agenda for fair taxation at global level, the EU continued to work on drawing up a common EU list of non-cooperative tax jurisdictions. It compiled a 'scoreboard of indicators' on the basis of a pre-assessment of all non-EU countries. The scoreboard is not a preliminary EU list and does not imply any judgment of non-EU countries. Hong Kong was flagged for the risk indicators transparency and preferential corporate income tax regime. In parallel, it stepped up its efforts, in particular by signing bilateral competent authority agreements (CAA) for the automatic exchange of financial information with the UK and Japan based on the OECD model. It approached nearly all EU Member States with a view to signing CAAs, CDTAs and tax information exchange agreements. It received favourable responses from a number of Member States and was awaiting feedback from others.

EU-Hong Kong relations in the field of financial services were strengthened by the new annual EU-Asia-Pacific Forum, which held its inaugural meeting in Singapore in October. All members of the International Organisation of Securities Commissions' (IOSCO) Asian-Pacific Regional Committee, the European Commission (represented by the Directorate-General for Financial Stability, Financial Services and Capital Markets Union) and the European Securities and Markets Authority gathered to exchange information and views on policy and regulatory developments. Hong Kong was represented by its Securities and Futures Commission. The purpose of the Forum is to exchange information on current regulatory frameworks and future developments, with the focus on opportunities for

strengthening Asia-Pacific coordination in the area of financial services; equivalence decisions to be taken by the European Commission and similar decisions to be taken by Asia-Pacific authorities; and emerging policy priorities for the global regulatory agenda.

EU business interests in Hong Kong are represented by the European Chamber of Commerce, a ‘chamber of chambers’ whose membership comprises the 15 European chambers based in Hong Kong and one in Macao. The ECC has five ‘business councils’ that focus on the automotive sector, brand protection, energy and the environment, financial services and information, communication and technology. It works closely with the EU Office to Hong Kong and Macao to facilitate dialogue with the government. In 2016, it continued work on implementing the EU Business Information Programme, which aimed to strengthen economic partnership and business cooperation with Hong Kong and Macao and ensure a stronger, coordinated representation of EU business interests.

The EU and Member State diplomatic missions in Hong Kong continued to work together to raise the EU’s profile. To this end, the EU Office organised a number of ‘dialogue’ meetings between EU Heads of Mission and senior members of the Hong Kong government, LegCo and the judiciary, and other leading figures, including business people. The EU and Hong Kong worked together to increase people-to-people contacts, in particular in the areas of academic cooperation, student mobility, culture and creative industries.

EU diplomatic missions and cultural institutes worked together with local partners on many people-to-people activities, including an EU Film Festival, organising a European Higher Education Pavilion at a large education and training fair, the EU Day of Languages, a schools calendar competition, and several events focusing on human rights, including a two-day workshop on trafficking in human beings and a conference on LGBTI rights and freedom of religion. The EU hopes to build on this momentum and to continue working with the government, civil society and business to promote exchanges on rights and freedoms.

The EU Academic Programme Hong Kong (EUAP), a consortium comprising the Hong Kong Baptist University, the University of Hong Kong, the Chinese University of Hong Kong and Lingnan University, continued to strengthen EU-Hong Kong relations through academic work and network-building with local, regional and European partners. The EUAP held a series of events on European ‘smart city’ case studies and organised conferences and seminars. It also hosted the Model European Union, a unique simulation of EU decision-making and politics in which students played the roles of heads of state or government of Member State in the European Council.

There were a number of high-level visits from the EU institutions in 2016. Visits from the European Commission included Vice-President Jyrki Katainen in July (who met the Chief Executive, the Chief Secretary and the Financial Secretary) and by the Commissioner for Agriculture and Rural Development, Phil Hogan, in November. The visit by Mr Hogan paved the way for the agreement on measures to facilitate EU meat exports to Hong Kong.