

An hourglass-shaped graphic with a globe inside. The top bulb is dark blue, and the bottom bulb is light blue. The globe is centered in the narrow neck of the hourglass. The top bulb is filled with a dark blue color, and the bottom bulb is filled with a light blue color. The globe is centered in the narrow neck of the hourglass.

WikiLeaks Document Release

<http://wikileaks.org/wiki/CRS-97-311>

February 2, 2009

Congressional Research Service

Report 97-311

*Hong Kong's Reversion to China: Problems and Remedies
for the United States*

Kerry Dumbaugh, Foreign Affairs and National Defense Division

March 3, 1997

Abstract. The Hong Kong Policy Act and the ongoing discussions about agreements appear to address the potential U.S.-Hong Kong issues that can be foreseen at present. But the uniqueness of Hong Kong's impending transition of sovereignty suggests that some issues affecting U.S. interests may be unresolved-even unknown-by the transition date.

WikiLeaks

CRS Report for Congress

Received through the CRS Web

Hong Kong's Reversion to China: Problems and Remedies for the United States

Kerry Dumbaugh
Specialist in Asian Affairs
Foreign Affairs and National Defense Division
Coordinator

March 3, 1997

<http://wikileaks.org/wiki/CRS-97-311>

HONG KONG'S REVERSION TO CHINA: PROBLEMS AND REMEDIES FOR THE UNITED STATES

SUMMARY

Concern over the future of Hong Kong-U.S. interaction led Congress in 1992 to enact the Hong Kong Policy Act (HKPA), thus providing the statutory authority for Hong Kong's treatment as a separate entity under U.S. law despite its return to Chinese sovereignty on July 1, 1997. Nevertheless, a number of unprecedented and complicated questions remain about the continued validity of U.S. bilateral and multilateral agreements with Hong Kong that were negotiated, signed, and implemented while Great Britain was the sovereign.

Over the past year and more, U.S. policymakers have been holding discussions with Hong Kong and Chinese officials on a range of important issues for U.S. policy after the 1997 transition falling into five categories: current U.S.-Hong Kong bilateral agreements that will remain in force in Hong Kong, but not be extended to the PRC; current U.S.-PRC bilateral agreements that will be extended also to Hong Kong; current multilateral agreements that will continue in force for Hong Kong, even though the PRC is not a party; current multilateral agreements in force only for the PRC and the United States, and which will be extended to Hong Kong; and mechanisms for administering the various agreements that will ultimately be in place.

As of early 1997, U.S. Administration officials had formed preliminary positions on the future status of existing agreements. In addition, there have been varying degrees of progress on a range of new agreements where discussions are being held either with Hong Kong (when the matter concerns areas where Hong Kong has been promised autonomy) or with the PRC, as appropriate. These include discussions with Hong Kong on a number of law enforcement-related issues, including a new extradition agreement (already concluded); discussions with Chinese officials on U.S. consular arrangements in Hong Kong; and discussions with Chinese officials on security and defense-related issues. According to U.S. officials, the purpose in these discussions is not to create new situations for the United States in Hong Kong that did not exist before, but instead to determine how best to continue the status quo arrangements that have already existed in U.S.-Hong Kong relations.

The Hong Kong Policy Act and the ongoing discussions about agreements appear to address the potential U.S.-Hong Kong issues that can be foreseen at present. But the uniqueness of Hong Kong's impending transition of sovereignty suggests that some issues affecting U.S. interests may be unresolved -- even unknown -- by the transition date.

This report, originally prepared as a memorandum for the House International Relations Committee, Asia Pacific Subcommittee, has been released for general congressional use by the Chairman, Rep. Doug Bereuter.

TABLE OF CONTENTS

CURRENT U.S. LAW	1
THE HONG KONG POLICY ACT (P.L. 102-383)	1
AMENDING THE HONG KONG POLICY ACT IN THE 104TH CONGRESS	2
OVERVIEW OF LAWS GOVERNING	
INTERNATIONAL AGREEMENTS	4
U.S.-HONG KONG AGREEMENTS AND TREATIES	5
BILATERAL INVESTMENT TREATY	5
WTO MEMBERSHIP	6
U.S.-HONG KONG ECONOMIC RELATIONS AFTER 1997	9
U.S. Trade Data	9
Textile Agreement	10
Taxation	11
ISSUES FOR U.S. POLICY	11
EXPORT CONTROLS AND PROLIFERATION ISSUES	12
TECHNOLOGY	12
THE WASSENAAR ARRANGEMENT	12
WEAPONS OF MASS DESTRUCTION (WMD)	13
Issues for U.S. Policy	14
SECURITY ISSUES	14
DEFENSE-RELATED ISSUES	15
Issues for U.S. Policy	15
REGIONAL BALANCE OF FORCES	16
Issues for U.S. Policy	16
FOREIGN POLICY ISSUES	16
IMMIGRATION	16
CONSULAR ARRANGEMENTS	17
HUMAN RIGHTS AND POLITICAL FREEDOM	18
Provisional Legislature	18
Freedom of the Press	18
Issues for U.S. Policy	19
LAW ENFORCEMENT AND OTHER LEGAL ISSUES	19
EXTRADITION	19
MUTUAL LEGAL ASSISTANCE	20
PRISONER TRANSFER	21
Issues for U.S. Policy	21
HONG KONG'S JUDICIAL STRUCTURE	22
OVERVIEW	22
COURT OF FINAL APPEAL	23
BILINGUALISM	23

HONG KONG'S REVERSION TO CHINA: PROBLEMS AND REMEDIES FOR THE UNITED STATES

CURRENT U.S. LAW¹

THE HONG KONG POLICY ACT (P.L. 102-383)²

Much of current U.S. policy concerning the Hong Kong transition is encapsulated in a single public law -- the Hong Kong Policy Act of 1992, introduced by Senator Mitch McConnell. The law sets forth prescriptions for how the United States should conduct bilateral relations with Hong Kong when it becomes a non-sovereign entity. It is the Hong Kong Policy Act that authorizes the U.S. government to continue to treat an autonomous Hong Kong as a separate legal entity -- both in U.S. law and with respect to international agreements and treaties -- even after Hong Kong's incorporation into Chinese territory under the "one country, two systems" policy. The substantive core of the Act does the following:

- ◆ States that U.S. laws shall continue to apply with respect to Hong Kong after the transition to Chinese rule after July 1, 1997, in the same manner as they were applied before the transition.
- ◆ Extends congressional approval for all treaties and international agreements between the United States and Hong Kong so that they continue in force after July 1, 1997, and requires the President to report to Congress if he determines either that Hong Kong is not competent to carry out its obligations, or that it is not "appropriate" for Hong Kong to have rights or obligations under any such treaty or international agreement.
- ◆ States that the President may issue executive orders on or after July 1, 1997, to suspend portions of, or entire, U.S. laws that treat Hong Kong separately from the People's Republic of China (PRC) if he determines that Hong Kong is not sufficiently autonomous, and states that the President should consider the terms, obligations, and expectations in the Joint Declaration in making such a determination. The law also states that the President may terminate any such executive order if he determines Hong Kong has regained sufficient autonomy.
- ◆ Requires the President to report to Congress by March 31 in each of six years -- 1993, 1995, 1997, 1998, 1999, and 2000 -- on eight specific factors regarding Hong Kong, including: (1) significant developments in Hong Kong and agreements the United States has entered into with Hong Kong; (2) developments surrounding the transition

¹ Prepared by Kerry Dumbaugh, Specialist in Asian Affairs, Foreign Affairs and National Defense Division (FAND).

² 22 U.S.C. Section 5701 et seq.

to Chinese sovereignty; (3) the nature and extent of official and unofficial Hong Kong-U.S. exchanges; (4) any U.S. laws suspended or re-instituted under Section 201 and Section 202 of the public law (described above); (5) treaties and international agreements the President has determined Hong Kong is incompetent to carry out under Section 201(b) of the public law; (6) significant problems in U.S.-Hong Kong cooperation on export controls; (7) the development of democratic institutions in Hong Kong; and (8) the nature and extent of Hong Kong's participation in multilateral fora.

- ◆ Requires, where applicable, a separate report on "China: Hong Kong" in other U.S. reports that are compiled on a country-by-country basis, including human rights reports required by Sections 116(d) and 502(B) of the Foreign Assistance Act of 1961; trade barrier reports required by Section 181 of the Trade Act of 1974; and economic policy and trade practices reports required by Section 2202 of the Export Enhancement Act of 1988.

AMENDING THE HONG KONG POLICY ACT IN THE 104TH CONGRESS

In P.L. 104-107, the FY1996 Foreign Operations Appropriations Act (H.R. 1868), the 104th Congress amended the U.S. Hong Kong Policy Act (the HKPA) by requiring a report to be submitted also in 1996 (the original HKPA did not call for a 1996 report), and by requiring additional detailed information to be included in the 1996 report only. Other requirements included information on: 1) Hong Kong's new Basic Law³ and its consistency with the Joint Declaration; 2) the openness and fairness of elections to Hong Kong's legislature; 3) the openness and fairness of the election of Hong Kong's new chief executive, and the executive's accountability to the legislature; 4) the treatment of political parties in Hong Kong; 5) the independence of Hong Kong's judiciary and its power to exercise final judgment over Hong Kong law; and 6) Hong Kong's Bill of Rights.⁴

In H.R. 4278, the FY1997 Omnibus Appropriations Act (P.L. 104-208), the 104th Congress again directed that the Administration include additional information in the annual Hong Kong report -- again, for one report only, the 1997 report, as required by Section 301 of the original Hong Kong Policy Act. The additional requirements imposed by the Omnibus Act were almost identical to those required under the FY1996 Foreign Operations bill.⁵

³ The Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China will serve as Hong Kong's de facto Constitution after the July 1, 1997, transfer of sovereignty.

⁴ Although the FY1996 Foreign Operations Appropriations bill could have amended the Hong Kong Policy Act to permanently require the additional information in future reports, the appropriators dealt only with the requirements of the March 1996 Hong Kong report, and not with the requirements of future reports.

⁵ In the Omnibus Appropriations bill (P.L. 104-208), Congress reflected China's decisions on Hong Kong's legislature, changing the reporting requirement from one on the "fairness of elections for the legislature" to the *new* requirement of a report on China's plans to dissolve Hong Kong's elected legislature and replace it with a provisional body. The other five additional requirements

(continued...)

Earlier, the 104th Congress had included language in the Foreign Relations Authorizations Act, FY1996 (S.908/H.R. 1561) that would have increased and made permanent the reporting requirements currently required under the HKPA. The President vetoed this bill for reasons unrelated to the Hong Kong provisions.

OTHER RECENT CONGRESSIONAL ACTIONS

In 1996, the Senate also considered legislation to extend diplomatic privileges, exemptions, and immunities to Hong Kong's Economic and Trade Offices in the United States. Now, representatives of Hong Kong stationed in the United States receive their diplomatic privileges as representatives of the United Kingdom (U.K.). S. 2130 sought to give Hong Kong U.S. diplomatic privileges in its own right under the provisions of the International Organizations Immunities Act.⁶ Since the House did not act on the measure prior to adjournment, no such statute on diplomatic status has been enacted.

Concern for the future of Hong Kong residents also led Members of Congress in the past to address immigration issues outside the Hong Kong Policy Act framework. Congress has acted several times, for instance, concerning visas for Hong Kong residents. The 101st Congress enacted the Immigration Act of 1990, which establishes a separate immigrant visa quota for Hong Kong and offers a deferred visa to Hong Kong residents, thereby providing a possible future refuge without provoking an immediate exodus.⁷ In the 103rd Congress, Senator Connie Mack and Representative John Porter each introduced legislation (S. 665 and H.R. 1265) that would have provided a certain number of deferred visas to Hong Kong journalists and their families; neither bill was enacted, but similar legislation is expected to be introduced early in the 105th Congress.

ISSUES FOR U.S. POLICY

Congress has demonstrated an ongoing interest in the specifics of future U.S.-Hong Kong agreements and in U.S.-Hong Kong relations generally. Efforts in the 104th Congress to further amend the Hong Kong Policy Act in 1995 and 1996 may well continue in the 105th Congress. In 1997, Members may try again to extend the annual March reporting requirement mandated by the Hong Kong Policy Act beyond its current cutoff date in the year 2000. Or, Members may seek to make permanent the additional reporting requirements mandated for the 1996 and 1997 reports in the appropriations bills for those fiscal years. New reporting requirements may be posed that reflect new issues arising in the coming months, perhaps including reports on extradition matters, on the Hong Kong government's cooperation with the United States, or on

⁵(...continued)
are the same as those listed for the FY1996 Foreign Operations Appropriations bill (P.L. 104-107).

⁶ 22 U.S.C. Section 288. S. 2130 was an original measure reported to the Senate by Senator Helms on September 25, 1996, without written report.

⁷ U.S. visas must be used within the fiscal year that they are issued. The Immigration Act of 1990 created visas for Hong Kong residents, the use of which could be deferred until the year 2001. The "deferred visa" is unique to Hong Kong.

whether U.S. businesses operating in the territory are being treated as before. Congress also is likely to give early consideration to another measure concerning Hong Kong's diplomatic privileges in the United States. But in addition to revisiting these measures considered by the 104th Congress, new actions may be initiated on specific developments unfolding in Hong Kong as the transition progresses. Options for further congressional action on a wide range of issues are addressed in the sections below.

OVERVIEW OF LAWS GOVERNING INTERNATIONAL AGREEMENTS⁸

Hong Kong's reversion to the PRC raises a number of questions regarding the post-1997 status of bilateral and multilateral agreements to which the United States, Hong Kong, and the PRC are parties. Under the Vienna Convention's "Moving Treaty-Frontier Rule," all treaties to which Hong Kong is a party, as well as all those concluded by Great Britain and extended to Hong Kong, would no longer be in effect as of July 1, 1997, while all treaties entered into by the People's Republic of China would apply to Hong Kong instead. Notwithstanding this rule, the parties involved can agree to a different arrangement. U.S. practice in such instances has been to extend the existing treaty or agreement rather than negotiate a new one.⁹

1984 SINO-BRITISH JOINT DECLARATION

Hong Kong's treaty relations are addressed in the 1984 Sino-British Joint Declaration, which states the following general principles: the Hong Kong Special Administrative Region (HKSAR) "will maintain a high degree of autonomy, except in foreign and defence affairs," (Art. 3(2)) and using the name "Hong Kong, China," the HKSAR "may on its own maintain and develop economic and cultural relations and conclude relevant agreements with states, regions and relevant international organizations" (Art. 3(10)).

The Joint Declaration also allows the continued application of Hong Kong's existing agreements under the following standards: (1) the application to the HKSAR of international agreements to which the PRC is or becomes party will be decided by the PRC Government, "in accordance with the circumstances and needs" of the HKSAR and "after seeking the views" of the HKSAR; (2) international agreements to which the PRC is not a party "but which are implemented in Hong Kong, may remain implemented" in the HKSAR; and (3) the PRC "shall, as necessary, authorize or assist" the HKSAR "to make appropriate arrangements for the application to the Hong Kong Special Administrative Region of other relevant international agreements" (Art. XI, ¶ 2).

To facilitate the transfer of sovereignty, Annex II of the Declaration further established the Sino-British Joint Liaison Group (JLG) for the purpose of discussing all matters relating to the transfer of government, including the status of Hong Kong's treaties and agreements. The JLG

⁸ Prepared by Jeanne J. Grimmer, Legislative Attorney, American Law Division.

⁹ American Law Institute, *Restatement (Third) of the Foreign Relations Law of the United States* § 210, Comment h (1987).

has been reviewing bilateral and multilateral agreements to which Hong Kong is a party.¹⁰ The United States would need to consent to the continuation in force of any such agreements that currently apply to the United States, and U.S. officials have formed a preliminary position about which of these existing agreements will apply and which will not. Decisions may also be required as to whether U.S.-PRC bilateral agreements should apply to Hong Kong.

U.S.-HONG KONG AGREEMENTS AND TREATIES

In addition to deciding upon current agreements with Hong Kong that either should or should not continue past the transition date, the United States is negotiating or has concluded agreements with Hong Kong in the areas of civil aviation, extradition, mutual legal assistance, prisoner transfers, and consular arrangements. These will replace agreements on the same subjects previously entered into with the U.K. and extended to Hong Kong. The United States is also negotiating a bilateral investment treaty with Hong Kong. Finally, the U.S. Department of Defense is holding discussions with PRC officials about allowing U.S. navy ships to continue to visit the port of Hong Kong.

In case of both bilateral agreements between the PRC and the United States and multilateral agreements to which both are parties, the Moving Treaty-Frontier Rule would make these automatically applicable to the HKSAR. Under the Joint Declaration, however, the application to the HKSAR of international agreements to which the PRC is or becomes party will first be decided by the PRC government.

BILATERAL INVESTMENT TREATY

Among other agreements currently under discussion, the United States is negotiating a bilateral investment treaty (BIT) with Hong Kong. The U.S.-Hong Kong Policy Act expressed the sense of Congress that the United States should negotiate a BIT with Hong Kong, in consultation with the PRC.¹¹ The Clinton Administration hopes to complete negotiations and submit the BIT to the Senate during the first part of 1997. If the treaty is ratified and enters into force before July 1, 1997, it may continue to apply in Hong Kong under Article XI, ¶ 2 of the Joint Declaration. Some 12 countries have already entered into investment promotion and protection agreements with Hong Kong with the intent that they apply after July 1.¹²

The U.S. BIT program, under which well over 40 BITs are currently in force, seeks to create a stable climate for U.S. investments worldwide subject to the rule of agreed and understood laws. The treaty with Hong Kong will presumably contain the following provisions, which have long been fundamental elements of the U.S. prototype: a broad definition of

¹⁰ U.S.-China Business Council, *Hong Kong's Transition to Chinese Sovereignty: Legal and Business Issues* 7 (October 1996)[hereinafter cited as *Hong Kong's Transition*].

¹¹ Act, § 103(10), 22 U.S.C. § 5713(10).

¹² Hong Kong's Transition, *supra* note 4, Appendix B (listing Australia, Austria, Belgium, Denmark, Italy, France, Germany, Luxembourg, The Netherlands, New Zealand, Sweden, and Switzerland).

"investment"; the extension of the better of most-favored-nation (MFN) or national treatment to investments of the parties; a prohibition on performance requirements;¹³ a requirement that expropriations meet international law standards, including the payment of prompt, adequate and effective compensation; an obligation to allow the unrestricted transfer of investment-related funds; and consent to binding international arbitration for investor-State disputes.

WTO MEMBERSHIP

Consistent with its grant of autonomy to Hong Kong in economic matters, the Joint Declaration envisions Hong Kong's continued participation in the General Agreement on Tariffs and Trade (GATT), now the World Trade Organization (WTO). Hong Kong is an original Member of the WTO, a status to which it was entitled as a Contracting Party to the GATT 1947. Like the GATT, the WTO Agreement allows both sovereign nations and independent customs territories to become parties. China is not a member of WTO.

Hong Kong originally took part in the GATT as a dependency of the U.K., but became a Contracting Party in 1986 after the U.K. invoked GATT Article XVII, allowing parties who had accepted the agreement on behalf of a customs territory to sponsor it for separate and full membership if the territory had or acquired "full autonomy in the conduct of its external commercial relations and of the other matters provided for in this Agreement." Prior to this, the PRC had assured GATT Members that after the 1997 reversion Hong Kong would maintain the autonomy required under Article XVII.¹⁴ The United States intends to respect the separate membership of Hong Kong in the WTO, a policy set forth in the United States-Hong Kong Policy Act.¹⁵

In joining the WTO, Hong Kong has accepted the multilateral agreements that are a condition of membership, including the WTO Dispute Settlement Understanding. Hong Kong is also likely to become a member of the WTO Agreement on Government Procurement, its accession having been approved in December 1996 on terms negotiated.¹⁶ The United States and

¹³ Performance requirements typically place restrictions on investors, such as requiring investors to sell all or a portion of their goods for export.

¹⁴ J. Jackson, *The World Trading System* 47 (1989), citing GATT Doc. 1384, April 26, 1986.

¹⁵ The Act expresses the sense of Congress that the United States should respect Hong Kong's status as a separate customs territory and as a Contracting Party to the GATT, whether or not the PRC is a member, and should continue to grant the products of Hong Kong MFN status under U.S. law by virtue of its GATT membership. Act, §§ 102(3), 103(4), 22 U.S.C. §§ 5712(3), 5712(4).

¹⁶ WTO Press Release No. 61 (Dec. 5, 1996) <http://www.wto.org/wto/Whats_new/press61/htm [hereinafter cited as *WTO Press Release*]. As of February 25, 1997, Hong Kong had not yet deposited its instruments of accession with the WTO Director General. The Agreement will enter into force for Hong Kong 30 days after it does so. Hong Kong has been a party to the Tokyo Round Agreement on Government Procurement.

22 other WTO Members are currently party to this accord.¹⁷ Parties are obligated, among other things, to grant national and MFN treatment to firms of other parties bidding for goods or services contracts and to refrain from using offsets, such as local content or investment requirements. Obligations under the Agreement apply only to procurements by government agencies listed in each party's Annex in the event the value of a contract equals or exceeds a certain threshold amount (\$ 182,000 for purchases of goods or services by central government entities). An original signatory of the Agreement, Hong Kong had listed some 69 central government agencies in its Annex, along with two sub-central bodies (the Urban Council and Urban Services Department, and the Regional Council and Regional Services Department).

ISSUES FOR U.S. POLICY

In the event the PRC becomes a WTO Member, questions may arise as to the precise legal relationship of the PRC and the HKSAR, particularly with respect to which should bear international responsibility for violations of WTO obligations that may involve both parties.¹⁸ U.S. officials could ask the WTO to create a working party to monitor Hong Kong's trade actions under the agreement. The United States also could seek to link China's accession to the WTO with Hong Kong's continued autonomy, although some U.S. policymakers point out that such a linkage could counteract the stated goal of U.S. policy, which is to reinforce Hong Kong's separate status from China.¹⁹ U.S. policymakers undoubtedly also will want to monitor what the effects will be of Hong Kong's WTO status while China remains a non-member.

Other concerns involve the implications of not having a U.S.-Hong Kong investment treaty. If the United States cannot conclude its BIT discussions prior to July 1, 1997, for instance, some suggest that this will place U.S. investors at a competitive disadvantage relative to other investors in Hong Kong. Many BITs have annexes excluding certain sectors from national treatment for foreign investors; some also are concerned, then, if Hong Kong is seeking to exclude any sectors in its ongoing BIT talks with the United States.

¹⁷ Other parties are Canada, the European Communities and 15 member states, Israel, Japan, Republic of Korea, Aruba, Norway and Switzerland; Singapore and Liechtenstein have completed accession negotiations and Chinese Taipei is currently in the process of negotiating the terms of its accession. *WTO Press Release, supra* note 14.

¹⁸ See, e.g., Skeen, "Can Capitalism Survive Under Communist Rule? The Effect of Hong Kong's Reversion to the People's Republic of China in 1997," 29 *Int'l Law*. 175, 195-196 (1995).

¹⁹ U.S. policy goals on separate treatment for Hong Kong are spelled out in the Hong Kong Policy Act.

COMMERCIAL AND ECONOMIC ISSUES²⁰

TABLE 1. U.S.-Hong Kong Trade: 1986-1995 (\$Billions)			
	U.S. Exports	U.S. Imports	U.S. Trade Balance
1986	3.0	8.9	-5.9
1987	4.0	9.9	-5.9
1988	5.7	10.2	-4.6
1989	6.3	9.7	-3.4
1990	6.8	9.5	-2.6
1991	8.1	9.3	-1.1
1992	9.1	9.8	-0.7
1993	9.9	9.6	0.3
1994	11.4	9.7	1.7
1995	14.2	10.3	3.9
1996	14.0	9.9	4.1

Source: U.S. Department of Commerce.

Growing investment and trade links between Hong Kong and China have played a major, even critical, role in the development and growth of both economies. Hong Kong is by far the largest foreign investor in China, accounting for 60% of total foreign direct investment (FDI) in China. Actual Hong Kong FDI in China in 1995 totalled \$20 billion. Hong Kong's dominant position as China's largest foreign investor gives it a large stake in the Chinese economy. In addition, nearly half of China's exports to the world are first shipped to Hong Kong (then re-exported), and a large share of China's imports enter through Hong Kong. China and Taiwan, which until recently maintained no direct trade links, currently ship most of their trade with each other through Hong Kong.²¹

Under the terms of Sino-British agreements, Hong Kong will retain the status of a free port and be free to continue its free trade and liberal investment policies after July 1, 1997. These

²⁰ Prepared by Wayne M. Morrison, Specialist in International Trade and Finance, Economics Division, with contributions on taxes by Kerry Dumbaugh, FAND.

²¹ On January 22, 1997, China and Taiwan reached consensus to end a 48-year ban on direct shipping links -- a move with significant potential implications for Hong Kong's historic role as a conduit for trade between the two. According to the *South China Morning Post*, a Hong Kong newspaper, China-Taiwan trade in 1996 was estimated at approximately \$20 billion (U.S.)

same agreements promise that Hong Kong will continue to formulate its own monetary and financial policies, maintain its own currency, and control its foreign exchange reserves. As a result, it is expected that Hong Kong will maintain its policy of pegging its currency to the U.S. dollar. However, some analysts argue that China might attempt to limit Hong Kong's ability to use its foreign exchange reserves to prop up its currency in the event of extensive currency speculation after 1997.²² Relatedly, Hong Kong will continue to participate in various international economic forums, such as the WTO and the Asia-Pacific Economic Cooperation (APEC).

Hong Kong was the 13th largest U.S. trading partner in 1996, and an important center for U.S. economic ties with Asia. As of January 1997, about 37,000 Americans reside in Hong Kong. Over 1,000 U.S. firms have offices in Hong Kong, of which about 400 are regional headquarters. Total U.S. foreign direct investment in Hong Kong at the end of 1995 stood at \$13.8 billion, with Hong Kong often acting as a middleman between Chinese and U.S. firms for trade and investment. U.S. exports to, and imports from, Hong Kong totalled \$14.0 billion and \$9.9 billion, respectively. The U.S. balance of trade with Hong Kong has improved from a \$5.9 billion deficit in 1986 to a \$4.1 billion surplus in 1996 (see table 1). This is largely explained by the fact that many of the products the United States used to import from Hong Kong are now being imported from China -- some manufactured by Hong Kong-owned enterprises in China.²³

U.S.-HONG KONG ECONOMIC RELATIONS AFTER 1997

Chinese trade and economic officials are projecting that Hong Kong's transition to Chinese rule will create more business opportunities.²⁴ According to a December 1996 survey, U.S. business confidence in Hong Kong has increased by four percentage points over 1995.²⁵ Nevertheless, U.S. concerns remain over the stability of the political system and governmental institutions; the free flow of information; and the viability of the legal system and the dependable rule of law, including the enforcement of contracts, the protection of individual and property rights, and the maintenance of a reliable system of commercial dispute resolution. In addition, U.S. policymakers remain concerned about the potential turnover in senior Hong Kong government officials after 1997.

U.S. Trade Data

After the 1997 transition, the United States will continue to treat Hong Kong as a separate customs territory for a variety of economic relations, including the collection of trade data and for rules of origin purposes. As in the past, China will argue that U.S. trade data on imports from

²² See *Far Eastern Economic Review*, December 19, 1996, p. 16.

²³ The U.S. trade deficit with China has grown from \$1.7 billion in 1986 to \$39.5 billion in 1996.

²⁴ According to the New China News Agency in a January 20, 1997 report on the comments of an assistant minister for Foreign Trade and Economic Cooperation in Beijing.

²⁵ The American Chamber of Commerce (Hong Kong) Survey of Business Confidence, Dec. 1996, reports 95% of their members find the business environment in Hong Kong "favorable."

China are overstated because (1) a large share of China's U.S. exports is from Hong Kong-owned factories in the mainland, and (2) many of China's exports to the United States are transshipped through Hong Kong, where additional value is added by Hong Kong firms; while U.S. trade statistics attribute the full value of the final product in these cases as originating from China. The size of the U.S. trade deficit with China is a highly political issue. Some U.S. policymakers perceive it to be largely a direct result of significant Chinese export malpractices and trade barriers against U.S. exports. Some economists note that while the United States does face significant Chinese trade barriers, such barriers are more likely to affect the composition rather than the level of U.S. exports to China. Still, the size and growth of the U.S. trade deficit with China is likely to be a continuing source of trade friction.

Textile Agreement

The United States will continue to allocate textile quotas to Hong Kong separately from those it allocates to China.²⁶ But U.S. officials remain concerned over efforts by Chinese producers to avoid U.S. textile and apparel quotas by transshipping them through third parties, including Hong Kong. In June 1996, the U.S. Customs Service implemented new rules requiring additional import documentation on certain textile imports from Hong Kong and tightened rules of origin for certain products, in order to control illegal transshipments from China.²⁷ U.S. Customs officers have visited Hong Kong at the invitation of Hong Kong's Customs and Excise Department to observe Hong Kong's textiles export control system and to inspect its textile factories to ensure that transshipments have not occurred. Hong Kong has pledged to continue its efforts to stop illegal textile transshipments after 1997.

Intellectual Property Rights Protection

China has agreed to allow Hong Kong to apply major international intellectual property-related agreements and to participate in relevant organizations. Many of Hong Kong's intellectual property rights (IPR) laws are based on U.K. legislation, requiring Hong Kong to localize many of its IPR laws before July 1997. After 1997, Hong Kong is expected to maintain an independent intellectual property regime which will have authority over Hong Kong's IPR policies, laws, and enforcement efforts. Hong Kong officials have pledged to ensure continuity in the IPR protection that exists under current law and to improve other laws which will bring it into compliance with the Trade Related Aspects of Intellectual Property Rights (TRIPS) agreement under the General Agreement on Tariffs and Trade (GATT) and its successor, the WTO.

The United States remains concerned over the rising piracy of U.S. software and compact disc music in Hong Kong but especially the high level of pirated products produced in China, many coming into Hong Kong. Some of these pirated products have been produced by Hong Kong owned firms in China. In April 1996, the U.S. Trade Representative (USTR) announced it would conduct an out-of-cycle review of Hong Kong's IPR protection practices to determine if U.S. action were warranted. In December 1996, USTR noted that Hong Kong had improved

²⁶ International Trade Report, June 19, 1996, p. 1007.

²⁷ U.S.C. cite for new rules.

its IPR protection, and that consequently no action was needed.²⁸ Should Hong Kong fail to enforce IPR laws and textile quotas, the United States could impose trade sanctions. Key aspects of such enforcement will be the ability of the Hong Kong government to prevent Hong Kong firms from illegally transshipping products from China through Hong Kong, and the ability of the Hong Kong government to prevent intellectual property theft by China.

Taxation

Hong Kong's reversion to China also has potential consequences for the U.S. tax code's treatment of U.S. companies operating in Hong Kong and China. Under Subpart F, Section 951-964 of the U.S. Internal Revenue Code, corporations are subject to U.S. income tax on income earned by the foreign corporation that is considered to have been artificially shifted to another country with lower taxes. Some members of the U.S. business community have suggested that treating Hong Kong as a jurisdiction separate from China could have adverse tax consequences for U.S. businesses with subsidiaries in both China and Hong Kong by making income taxable in the United States once it was moved from one of these tax jurisdictions to the other.

None of the provisions of the Hong Kong Policy Act address the U.S. tax code directly. Nevertheless, Section 201(a) of the Act states that the United States will treat an autonomous Hong Kong separately after the transition and apply current laws in the same manner as before. Under current law, the United States considers Hong Kong to be separate -- and not part of the U.K. -- for Subpart F tax purposes. The U.S. tax treaty with the PRC was ratified by the Senate with the understanding that its provisions would not apply to Hong Kong. Thus, some American businesses have suggested that it is unclear how Subpart F of the Internal Revenue Code is to be applied to businesses operating in Hong Kong after the July 1 transfer. According to an official of the U.S. Treasury, the Treasury Department intends to issue guidance on the Subpart F issue in the near future.

ISSUES FOR U.S. POLICY

One of the key trade questions involving Hong Kong's transition involves whether the United States will be able to maintain its currently close working relations with Hong Kong trade officials on commercial issues, including the exchange of information and cooperation on enforcement. Another question involves the independence of Hong Kong trade officials -- whether they will be able to operate without interference from high-level Chinese government officials, and whether they will be able to continue to devote sufficient resources to enforcing Hong Kong's trade and IPR laws. The United States will probably be monitoring Hong Kong government actions to determine if there is an increase in corruption or reduced cooperation with the United States on trade issues. Should China interfere in Hong Kong's economic and political affairs, U.S. policymakers may consider a number of options, including imposing sanctions directly against China, delaying U.S. support of China's accession to the WTO, or refusing to grant China permanent MFN treatment. China's potential countermeasures to such actions would appear formidable.

²⁸ For example, Hong Kong enacted legislation to outlaw the production of pirated goods by Hong Kong firms outside of Hong Kong.

EXPORT CONTROLS AND PROLIFERATION ISSUES

TECHNOLOGY²⁹

The U.S. government has generally been satisfied with Hong Kong's current export control regime. As a result, the United States has allowed Hong Kong to import, license-free, most controlled high technology dual-use items under the U.S. Export Administration Act of 1979, the primary authority for controlling U.S. exports.³⁰ U.S. and Hong Kong trade officials maintain close contact and cooperation, ranging from exchanges of information to joint investigations of suspected illegal diversions of exports. Hong Kong officials expect that they will be able to maintain an autonomous export control regime after 1997. If so, the United States will likely continue to give Hong Kong separate export control treatment for advanced technology items; still, Hong Kong is also likely to be subject to close U.S. review to ensure that certain exported U.S. technologies to Hong Kong are not illegally transshipped to China or elsewhere. If Hong Kong's export control regime deteriorates after 1997, the United States might respond by tightening controls on exports to Hong Kong.

THE WASSENAAR ARRANGEMENT³¹

The Wassenaar Arrangement is a multilateral accord "to contribute to regional and international security and stability, by promoting transparency and greater responsibility in transfers of conventional arms and dual-use goods and technologies,³² thus preventing destabilizing accumulations." It is the result of three years of negotiations to replace the Coordinating Committee For Multilateral Export Controls (CoCom) -- the Cold War organization for controlling sensitive exports to the communist bloc. The new group has much broader membership and smaller lists of controlled goods. Under Wassenaar, each national government regulates its own exports, whereas under CoCom, any member could disapprove the export by any other member of a controlled item to a proscribed destination. The Arrangement complements the existing export control regimes for nuclear, chemical, and biological weapons and their delivery systems, and other transparency mechanisms such as the UN Register.

Hong Kong had the status of a "cooperating country" under CoCom. That status dissolved when CoCom ceased to exist in mid-1994. Hong Kong, as a territory of Great Britain, currently participates in the Wassenaar Arrangement. After reversion, Hong Kong will not be allowed to

²⁹ Prepared by Wayne Morrison, Analyst in International Trade and Finance, Economics Division.

³⁰ U.S. State Department. *United States-Hong Kong Policy Act Report*, March 31, 1996, p. 9. The Export Administration Act expired in 1994 but has continued in effect through authority invoked by the President under the International Economic Emergency Powers Act.

³¹ Prepared by Robert Shuey, Specialist in Defense Issues, Foreign Affairs Division.

³² Dual-use exports are those commodities, processes, or technologies created primarily for civilian purposes which can also be used to develop or enhance the capabilities of military equipment.

become a Participating State, because it is not a separate country; it will no longer be able to participate as an element of Britain; and it will not be able to participate as part of China because China is not a Participating State.³³

Wassenaar is twice the size of CoCom (33 participating countries compared to 17) but has no "cooperating countries." Countries are either Participating States or have no official status with the Wassenaar Arrangement. The PRC had no status with CoCom and is not a Participating State of Wassenaar. According to Administration officials, China has not been invited to join Wassenaar because of concerns regarding Chinese weapons exports to Iran and Pakistan and other shortcomings in its export control system.³⁴ Participating States agree to control exports and retransfers of items on a common Munitions List based on the categories of major conventional weapons used for the Conventional Forces-Europe Treaty and the United Nations Arms Register, and more than 100 items on a List of Dual-Use Goods and Technologies. The decision to allow or deny transfer of an item is the sole responsibility of each Participating State. Hong Kong has agreed to conform to these policies.

The Arrangement is not directed against any state, but is designed "to enhance cooperation to prevent the acquisition of armaments and sensitive dual-use items for military end-uses, if the situation in a region or the behaviour of a particular state is, or becomes, a cause for serious concern..."³⁵ The Participating States have generally agreed that significant transfers to the military establishments of Iran, Iraq, Libya, or North Korea could threaten international or regional security or stability. All have national policies to prevent transfers of arms and sensitive technologies to these pariah countries. Neither Hong Kong nor China is subject to restraints on exports due to any Wassenaar actions or policies.

WEAPONS OF MASS DESTRUCTION (WMD)³⁶

Hong Kong has been responsible and cooperative in working with other countries and multilateral groups in trying to prevent the spread of nuclear, chemical, and biological weapons and missile delivery systems. Although it is not a member of the Nuclear Supplier's Group, the Australia Group, or the Missile Technology Control Regime (MTCR), it has exchanged information on suspected illicit transfers and has participated in workshops and meetings addressing these issues. In one recent case, Hong Kong seized a shipment of ammonium perchlorate that was being passed through the territory on the way from North Korea to Pakistan.

³³ Telephone conversations with State and Commerce Department officials, January 1997.

³⁴ Statement of Thomas McNamara, Assistant Secretary of State for Political-Military Affairs, before the Senate Committee on Banking, Housing and Urban Affairs, Subcommittee on International Finance and Monetary Policy. September 21, 1995. *Washington Post*, September 20, 1995, p. A15. Lynn Davis News Conference. Reuters transcript, January 23, 1996.

³⁵ The Wassenaar Arrangement on Export Controls for Conventional Arms and Dual-Use Goods and Technologies, Initial Elements, as adopted by the Plenary of 11-12 July 1996.

³⁶ Prepared by Robert Shuey, Specialist in Defense Issues, FAND.

This chemical is used with others to produce rocket fuel and is controlled under the MTCR. Hong Kong has helped identify and stop other dangerous shipments to the Middle East.³⁷

Authorities in Hong Kong, including Director-General of Trade Alan N. Lai, say they will continue to uphold high standards of export control and nonproliferation. Director-General Lai has been assured by Chinese officials that Hong Kong will be able to maintain its export control system after reversion. It is his view, that Hong Kong officials will be able to verify the nature, end-use, destination, and propriety of exports from Hong Kong, including goods being transferred through Hong Kong to other destinations.³⁸ These officials say it is in China's and Hong Kong's interests that Hong Kong continues to maintain high export control standards so that other countries will continue to trust it as a trading partner and afford it beneficial trade status.

Issues for U.S. Policy

After reversion, the Secretariat of the Wassenaar Arrangement will no longer be able to share the organization's reported information with Hong Kong because it will not be a Participating State. The United States has the option of deciding to continue sharing intelligence with the Hong Kong government. U.S. officials will face decisions about what kinds of intelligence will continue to be shared and what the mechanism will be for making those decisions. Hong Kong authorities recently have uncovered several instances of unauthorized weapons and other materials being shipped through Hong Kong. This may be a good sign, showing that Hong Kong authorities are effectively monitoring the situation and are adept at enforcement. On the other hand, some could view it less positively, alleging that illegal transshipments are increasing and are likely to continue to do so after July 1, 1997. U.S. policymakers face serious policy questions in deciding how to monitor Hong Kong's performance on export controls and what steps should be taken in the event that Hong Kong's export controls should be judged insufficient.

SECURITY ISSUES³⁹

U.S. Defense Department, State Department, and other security department/agency officials agree generally with the goals noted by Clinton Administration public spokespersons regarding

³⁷ "Hong Kong, Pakistan: Fuel said Bound for Pakistan Agency Suspected by the West," in *South China Morning Post*, Dec. 13, 1996, p. 4, cited in FBIS-CHI-96-242; "Hong Kong, Pakistan: DPRK Firm Said Behind Rocket Fuel Bound for Pakistan," in *South China Morning Post*, Dec. 13, 1996, p. 4, cited in FBIS-CHI-96-242.

³⁸ Discussions with Director-General Lai, Jan. 23, 1997, and with other Hong Kong Trade Department officials in July 1996.

³⁹ Prepared by Robert Sutter, Senior Specialist in International Affairs, Foreign Affairs and National Defense Division. This is based on a longer analysis prepared in February, 1997, for the House International Relations Committee's Subcommittee on Asia/Pacific Affairs.

the reversion of Hong Kong to PRC sovereignty and what this means for U.S. interests.⁴⁰ In particular, they would like to see current levels of U.S. security-related cooperation with Hong Kong continued after Hong Kong's reversion to PRC sovereignty. Nonetheless, the shift of Hong Kong's sovereignty from Great Britain -- a close military ally of the United States -- to the PRC poses a number of questions and issues for U.S. policymakers concerned with issues such as defense relations, intelligence sharing and operations, and proliferation controls. Thus far, U.S. government officials have not publicly offered definitive answers to these questions or firm resolutions of these issues.

DEFENSE-RELATED ISSUES

On average, 70 U.S. Navy ships visit Hong Kong each year for crew rest and for naval support services such as ship repairs, resupply, maintenance, and refueling. The procedures by which U.S. and British officials handle notification of such visits are efficient, usually involving a few days advance notice to British authorities in Hong Kong by the U.S. Hong Kong Consulate. PRC officials stated during the Chinese Defense Minister's visit to Washington in December 1996 that an agreement "in principle" was reached between the United States and China allowing continued U.S. Navy ship visits to Hong Kong after July 1, 1997. U.S. Defense Department officials are now in the process of working with their Chinese counterparts on the specific details of this agreement.

Another issue concerns actions of U.S. military personnel in Hong Kong. Under British rule, incidents of U.S. military personnel being arrested for breaking laws in Hong Kong have usually involved the accused being transferred by Hong Kong government authorities to U.S. military authorities for judgment and punishment. Continuation of this practice under Chinese sovereignty, however, is not necessarily a safe assumption, and is under discussion with the PRC.

Another set of defense relations issues has to do with the presence of four or five U.S. Military Attaches and related support personnel in the Defense Liaison Office of the U.S. Consulate in Hong Kong. These officials are involved in arranging for the U.S. Navy ship visits to Hong Kong and other matters involving military cooperation such as flight clearances. The Defense Department hopes to continue these activities in Hong Kong after July 1, 1997.

Issues for U.S. Policy

The U.S. Navy is expecting to continue to use Hong Kong as an important port of call for its Asian fleet at a comparable number of annual visits as in the recent past. One key issue for the Navy will be whether the notification and approval procedures for these ship visits will become more difficult in the future under Chinese rule. Another issue of concern is whether U.S. military personnel accused of violating Hong Kong laws after July 1, 1997, will continue to be returned to U.S. military authorities for judgment and punishment, as was the case under British sovereignty. If not, decisions will need to be made about whether some more formal arrangement may be needed to protect the safety of U.S. military personnel in Hong Kong while providing for the legitimate legal rights of the Hong Kong and PRC governments.

⁴⁰ The views of these officials were obtained in private interviews conducted in Washington, D.C. January 6-10, 1997.

It seems doubtful that U.S. Defense Attaches in Hong Kong will continue to share information and interact in the same way with Hong Kong authorities as they do now. Questions remain about what relationship U.S. military officials stationed in Hong Kong will have with the PRC, which is formally in charge of Hong Kong's defense, and with the PRC's People's Liberation Army (PLA) Garrison, due to begin work in Hong Kong on July 1, 1997.

REGIONAL BALANCE OF FORCES

Hong Kong has rarely been seen as strategically important in determining the balance of forces in East Asia. The British garrison was quickly subdued in Japan's march to Southeast Asia in the 1940s, while the British government was among the first western powers to recognize the People's Republic of China, in part because London judged that Hong Kong was strategically untenable if attacked.

Nonetheless, the reversion in July 1997 does give Chinese military forces unprecedented free access and control in one of the major ports along the Pacific rim. It also frees Chinese military planners of any concerns they might have had about the area falling into the hands of forces prepared to confront the PRC.

Issues for U.S. Policy

Hong Kong's reversion to the military control of the PRC raises questions about the potential impact of the transfer on the overall balance of forces in the East Asian region, and, in particular, on U.S. military concerns in the region. U.S. policymakers may wish to explore whether Chinese military planners in the past were concerned about Hong Kong becoming a strategic problem for the PRC and, if so, how serious those concerns were. In particular, U.S. strategic planners will undoubtedly be exploring any current or potential negative consequences of the transfer for U.S. military concerns in the region.

FOREIGN POLICY ISSUES

IMMIGRATION⁴¹

The transfer of sovereignty over Hong Kong implicates two sets of migration rules under U.S. law: those governing permanent or temporary entry, and those permitting humanitarian sanctuary. Under the Immigration and Nationality Act of 1952 (INA), as amended, (8 U.S.C. 1101 *et seq.*) visas to resettle in the U.S.--*immigrant visas*--are generally allocated based on country of origin. But nothing prohibits Congress from granting entities other than foreign States their own, separate allocation of immigrant visas, and Congress has treated Hong Kong as though

⁴¹Prepared by Ruth Wasem, Education and Public Works Division, and Larry Eig, American Law Division.

it were a foreign State since the INA was modified by the Immigration Act of 1990.⁴² The separate treatment of Hong Kong would appear to continue to apply after the transfer of sovereignty. We do not know of any objection the PRC has made to our continuing this treatment. There are significant backlogs for family-based visas from the PRC, and folding Hong Kong into the PRC would increase, not reduce, these backlogs.

Over the past decade, there has been a twofold increase (to 152,000) in the number of *nonimmigrants visas--i.e.*, temporary entries for students, tourists, business people, temporary workers, and the like--issued to Hong Kong residents. A basic requirement for issuance of a nonimmigrant visa is that the applicant intends to return home. Any significant change in conditions in Hong Kong may make it more difficult to show a likelihood of return and thus result in tightening up of nonimmigrant visa issuances. Changing conditions also may affect how human rights provisions in the INA are applied to Hong Kong residents, many of whom relocated in Hong Kong to flee repression in the PRC. In cases of individualized persecution, the refugee and asylum provisions in the INA allow for admission based on past persecution, or on a well-founded fear of prospective persecution, due to political opinion, race, religion, ethnicity, or membership in a social group. The 104th Congress specified that coercive population control policies constitute political persecution and allows up to 1,000 such refugees or asylees annually. The INA also gives the Attorney General authority to grant blanket relief to aliens here from countries undergoing civil strife or natural disasters.

Reportedly, Hong Kong has been a base for some organized crime syndicates that operate alien smuggling rings. The transfer of sovereignty may facilitate PRC-Hong Kong cooperation in combatting smuggling and thereby affect the extent to which Hong Kong continues to be a back door for illegal immigrants. With respect to assuring continued access of Americans to Hong Kong, the INA grants the President power to suspend or otherwise restrict the entry of any class of aliens when public interest requires.

CONSULAR ARRANGEMENTS⁴³

Because the operative U.S. consular agreement in Hong Kong was negotiated and signed with the U.K., U.S. Administration officials for months have been holding discussions with Chinese officials on a matter that will be within the PRC's sole jurisdiction -- U.S. consular arrangements in Hong Kong. According to State Department officials, the U.S. goal is to reach an agreement that will permit the status quo in Hong Kong to continue. They say they will vigorously resist PRC efforts to use the consular agreement to limit the size and staffing of the U.S. consulate in Hong Kong below current levels. For instance, U.S. Administration officials would like an agreement that allows the United States to continue to share information with Hong Kong authorities on law enforcement, intellectual property rights, and export control issues -- all

⁴² As an inducement to remain in Hong Kong at least until sovereignty is transferred, the 1990 Act also granted visa preference to certain employees of American companies and allowed Hong Kong residents who were issued certain types of visas until year 2000 to resettle here. The 1990 Act included a special provision for certain employees of the U.S. mission in Hong Kong.

⁴³ Both this section and the section on Human Rights and Political Freedom were prepared by Kerry Dumbaugh, Foreign Affairs and National Defense Division.

important current functions of the U.S. Consulate in Hong Kong. Currently, U.S. officials operating in the U.S. Hong Kong Consulate include officials of the U.S. Customs Service, the Federal Bureau of Investigation, the Drug Enforcement Administration, the Immigration and Naturalization Service, and the Secret Service. Some of these or other current consular functions may be particularly sensitive to the PRC.

HUMAN RIGHTS AND POLITICAL FREEDOM

Provisional Legislature

Beijing's decision to dissolve the elected Legislative Council (Legco) on July 1, 1997, and replace it with an appointed temporary body, the so-called "provisional legislature," is likely to be an acid test for American confidence about the "one country, two systems" concept. A provisional legislative body is not provided for in either the Joint Declaration or the Basic Law, and Beijing's decision to appoint such a group is viewed by many American policymakers as but the beginning of heavy-handed Chinese interference in Hong Kong's promised decisionmaking autonomy. How the provisional legislature behaves, what legislative actions it takes during its tenure, how long it will be before elections are held for the first Hong Kong SAR Legislative Council (and whether Beijing honors its commitments about the first legislature),⁴⁴ and how democracy advocates in Hong Kong react to the provisional body -- all these are likely to have continuing repercussions for U.S. policy.

Freedom of the Press

In addition to the dissolution of Legco, the extent to which China allows freedom of expression -- including freedom of the press and freedom of assembly -- is another key variable. Under the Basic Law, China has accepted a number of legal guarantees for Hong Kong's political and economic future. Among these is one contained in Article 27 of the Basic Law, which declares, "Hong Kong residents shall have freedom of speech, of the press and of publication; freedom of association, of assembly, of procession and of demonstration; and the right and freedom to form and join trade unions, and to strike."

Despite the apparent clarity of such language, Chinese officials routinely make statements that suggest either a more restrictive approach or total disregard of these provisions will prevail

⁴⁴ On April 4, 1990, China's Seventh National People's Congress adopted a document entitled the Decision of the National People's Congress on the Method for the Formation of the First Government and the First Legislative Council of the Hong Kong Special Administration Region (SAR). Paragraph 6 of this document states: "The first Legislative Council of the Hong Kong SAR shall be composed of 60 members, with 20 members returned by geographical constituencies through direct elections, 10 members returned by an election committee, and 30 members returned by functional constituencies. If the composition of the last Hong Kong Legislative Council before the establishment of the Hong Kong SAR is in conformity with the relevant provisions of this Decision and the Basic Law of the Hong Kong SAR, those of its members who uphold the Basic Law of the Hong Kong SAR of the People's Republic of China (PRC) and pledge allegiance to the Hong Kong SAR of the PRC, and who meet the requirements set forth in the Basic Law of the Region may, upon confirmation by the Preparatory Committee, become members of the first Legislative Council of the Region."

after the transition to Chinese rule. China's Foreign Minister, Qian Qichen (who is also chairman of the Preparatory Committee), was quoted in an October 16, 1996, *Asian Wall Street Journal* article as saying that journalists would be able to publish criticism, "but not rumours or lies" or personal attacks on Chinese leaders. Apart from the dissolution of Legco, how Beijing handles the issue of personal freedoms in Hong Kong could be the most potentially explosive issue surrounding the transition.

Issues for U.S. Policy

The dissolution of Hong Kong's elected Legislative Council and its replacement with a provisional legislative body poses a number of implications for the United States. There are questions about whether decisions by such a provisional body will have the effect of law in cases where U.S. interests are involved. Opponents of the provisional body may advise or even pressure U.S. investors in Hong Kong to refuse to acknowledge the provisional legislature as a legitimate law-making body or to abide by its decisions. Significant curbs on press freedom in Hong Kong may harm U.S. news bureaus operating out of Hong Kong, and may also influence U.S. business and investment decisions in the territory.

LAW ENFORCEMENT AND OTHER LEGAL ISSUES

EXTRADITION⁴⁵

International extradition is the process of transferring individuals between States to stand trial or face punishment. Standards and procedures that guide U.S. extradition practice are contained in bilateral and multilateral agreements and implemented under Federal statute (18 U.S.C. §§ 3181-3195). Federal officials lack power to extradite an individual absent a treaty or independent statutory authority.

By a 1976 exchange of Notes, the United States and the U.K. agreed to apply the U.S.-U.K. extradition to Hong Kong. There is no U.S.-PRC treaty. However, the JLG has approved a model extradition agreement, and the PRC has approved a number of negotiating partners, including the United States. Within this framework, the Hong Kong government, under entrustment from the U.K., concluded a new extradition agreement with the United States. The PRC approved the text of the agreement in September 1996, and the agreement was formally signed in December 1996, by representatives of the U.S. and Hong Kong governments. The new agreement is intended to govern U.S.-Hong Kong extradition upon its adoption and to continue to govern extradition after U.K. sovereignty lapses.

The Administration intends to submit the U.S.-Hong Kong agreement to the Senate soon for approval under treaty approval procedures. The Administration apparently has decided not to regard the agreement as an executive agreement that was implicitly authorized in advance by the U.S.-Hong Kong Policy Act. A Fugitive Offenders Agreement has been approved by the PRC, through the JLG, and is pending before the Hong Kong Legislative Council (Legco).

⁴⁵ Prepared by Larry Eig, American Law Division.

On January 7, 1997, a U.S. district court judge questioned the continuation of extradition to Hong Kong without an agreement with the PRC. The Court treated the situation as one of extradition to the PRC, and did not address the question of Hong Kong's separate and autonomous judicial system. The Court's decision disallowed the extradition under the U.K. treaty on the grounds that judicial proceedings could not be completed prior to Hong Kong's transfer of sovereignty. But the decision also looked unfavorably upon extending extradition obligations beyond that time by executive agreement with Hong Kong authorities. The government has appealed the January 7 decision, and oral arguments are expected to be heard by mid-March, 1997, at the latest.

Whatever its legal fate, the January 7 decision embodies a wider concern about the ultimate independence of the Hong Kong judicial system than was expressed by the Clinton Administration in connection with its extradition negotiations with Hong Kong. In this regard, it is important to note that U.S. extradition practice allows the Secretary of State to refuse the extradition of an otherwise extraditable individual upon finding that extradition is being sought to punish the individual because of his or her political views. The U.S.-Hong Kong agreement is similar. The U.K.-U.S. extradition treaty, which heretofore has governed extradition to Hong Kong, does not allow for a judicial role in assessing the motives of an extradition request or how the judicial system will treat a person who is transferred. In a January 21, 1997 statement issued in response to the January 7 court decision, a Chinese spokesman reiterated that the Hong Kong courts will continue to apply Hong Kong law after July 1997 free from any interference, and said that it was "groundless" to question the independent nature of the judicial system of the future.

MUTUAL LEGAL ASSISTANCE⁴⁶

The United States, like other States, historically was reluctant to aid in the enforcement of foreign penal law. Nevertheless, the increase in transnational financial and drug crime has led to a series of bilateral agreements, known as mutual legal assistance treaties (MLATs), to assist foreign prosecutions. Even now, however, the shared interest in facilitating the prosecution of transnational crime is viewed as being outweighed at times by unwillingness to provide information to those with different standards of criminality and professional conduct.

The Senate approved an MLAT with the U.K. during the summer of 1996. Unlike the case with the U.S.-U.K. extradition treaty, we do not know of any exchange of Notes that apply the U.K. MLAT to Hong Kong. Still, Hong Kong authorities have been directly negotiating a mutual legal assistance agreement with the United States. An agreement apparently has been initialed and is now undergoing review by PRC authorities. The Administration is likely to seek Senate approval of the agreement through the treaty approval process.

While Congress favored continued cooperation with Hong Kong under the U.S.-Hong Kong Policy Act, concerns about entering into MLATs generally will resonate louder with respect to Hong Kong the less independent the Hong Kong judiciary and law enforcement authorities are perceived to be. MLATs themselves contain certain safeguards from abuse, including provisions that allow a State to deny assistance when its security or similar national interests would be compromised. In furtherance of these safeguards, Senator Jesse Helms has

⁴⁶ Prepared by Larry Eig, American Law Division.

successfully sponsored understandings that have been attached to several MLATs that allow withholding assistance to States whose officials are corrupt. In the past, Senator Helms and other members of the Senate Foreign Relations Committee have also worried that MLATs could be used as "fishing expeditions," or could facilitate foreign investigations of activities we do not regard as criminal--activities with respect to "capital flight," for example.

PRISONER TRANSFER

Separate from the MLAT, the United States and Hong Kong have negotiated a prisoner transfer agreement. If it follows the format of other prisoner transfer agreements, an individual convicted of a crime by a party State may be transferred to the individual's home country to serve out his or her sentence. But prior prisoner transfer agreements have required, and Federal statute now requires, that the prisoner give prior consent to the transfer.

Issues for U.S. Policy

The extradition treaty has already generated some controversy with potentially far-reaching implications in light of the U.S. District Court's allegations that China's harsh, non-democratic judicial system would be the judicial system likely to exist in Hong Kong after the 1997 transition.⁴⁷ The Court's view raises some questions about the ability of U.S. policymakers to effectively pursue policies designed to ensure Hong Kong's separate treatment.

In the case of the prisoner transfer agreement, there may be implications for the United States and China if prisoners being transferred to Hong Kong routinely refuse to give their consent, as required by U.S. law. Given the U.S. district court case, future cases under the new extradition agreement may also be challenged on the grounds that PRC itself, while having approved the agreement, is not the signatory party. To resolve some of these difficulties, some U.S. officials may advise pressing the PRC to give written notification of its approval for new treaties and agreements, despite those agreements having been approved by China in the JLG process.

⁴⁷ Lui Kin-Hong v. United States, No. 96-CV-10849 (D. Mass., filed April 24, 1996), Memorandum and Order, January 7, 1997, Tauro, C.J.

HONG KONG'S JUDICIAL STRUCTURE⁴⁸

OVERVIEW

Hong Kong's current judiciary is independent from the executive and legislative branches of the government. The territory's most senior court is the Supreme Court. But decisions of the Hong Kong Supreme Court are not final. Instead, the supreme court of appeal is in London in the Judicial Committee of the Privy Council, which served as a general court of appeal for British colonies. As citizens of a British Crown Colony, Hong Kong litigants who have exhausted all local appeals have been able to appeal court decisions directly to the Privy Council. This will not be the case after the transition to Chinese sovereignty.

The Basic Law,⁴⁹ which will serve as the de facto Constitution of the Hong Kong SAR, deals with the HKSAR judiciary in Chapter IV, Section IV, articles 80-96, and also in articles 19 and 158.⁵⁰ The Basic Law provides that Hong Kong's current judicial system -- that is, the system of English Common Law -- will continue after the transition. It declares that the courts are to exercise judicial power "independently, free from any interference," that trial by jury and presumption of innocence are to be maintained, and that citizens will continue to have the right to a prompt, fair trial (arts. 85-87).

After a long delay, a new court dedicated to hearing human-rights related civil cases began its operations in Hong Kong on February 17, 1997. All cases classified as "administrative law" -- challenges under the Bill of Rights, election petitions, habeas corpus applications, and so on -- are to be organized into one court list. Plans to include criminal cases involving Bill of Rights issues were shelved in July 1996. Human rights advocates fear that the current overseer of the special court, Mr. Justice Brian Keith, could be replaced after reversion with a judge who is not sympathetic to human rights issues.⁵¹

⁴⁸ The sections below on the Judicial Structure of Hong Kong, the Judiciary Under the Hong Kong Special Administrative Region, Arbitration, Contract Law, and related Areas of Potential Concern for the United States, were prepared by Mya Saw Shin, Senior Legal Specialist, and Wendy I. Zeldin, Legal Research Analyst, of the Law Library of Congress.

⁴⁹ Adopted by the Third Session of the Seventh National People's Congress of the People's Republic of China on Apr. 4, 1990. It was drafted pursuant to paragraph 3(12) of the Joint Declaration of the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the People's Republic of China on the Question of Hong Kong (Dec. 19, 1984). For the English text of the Basic Law, *see for example* Ming K. Chan and David J. Clark, eds., *THE HONG KONG BASIC LAW: BLUEPRINT FOR "STABILITY AND PROSPERITY" UNDER CHINESE SOVEREIGNTY?* 165-209 (Armonk, N.Y., M.E. Sharpe, Inc. 1991). The English text of the Joint Declaration is at 259-288.

⁵⁰ The Joint Declaration deals with the judiciary in its Item 3(3) and in Annex I (Elaboration by the Government of the People's Republic of China of Its Basic Policies Regarding Hong Kong), Section I and especially III.

⁵¹ *Court Dedicated to Human Rights Cases To Start Next Week*, SOUTH CHINA MORNING POST, Feb. 10, 1997, at 5, retrieved from FBIS on-line, Feb. 11, 1997.

COURT OF FINAL APPEAL

Both the Basic Law and the original Joint Declaration provide for a Court of Final Appeal (CFA), to be established and located in Hong Kong, which will serve as the highest appellate court for Hong Kong cases after July 1997. The CFA will have jurisdiction over everything except "acts of State." However, "acts of State" will be construed under the vague wording of article 19 of the Basic Law, not under the Common Law definition. This has raised concerns that Chinese leaders may choose to interpret "acts of state" so broadly as to seriously limit the kinds of cases that can be appealed to the CFA. Whenever questions arise in adjudicating such issues, the courts must obtain a certificate from the Chief Executive on questions of fact concerning acts of state, which will be binding. Before issuing the certificate, the Chief Executive must obtain a certifying document from the Chinese Central Government (para. 3). Related to concerns over acts of state, there is also concern about whether Chinese authorities will seek to use article 23 of the Basic Law to define a wide variety of possibly benign activities as crimes against the state, and therefore outside the CFA's jurisdiction. (Article 23 deals with "treason, secession, sedition, subversion against the Central People's Government, or theft of state secrets...")

In January 1997, it was reported that the drafting of the procedures and regulations for the CFA were about to be completed.⁵² Also, the registrar of the Privy Council in Hong Kong has set March 1, 1997, as the date on which London's Privy Council will stop accepting cases from Hong Kong, although that date "is for guidance only and is not a guarantee that a case submitted before that date will be heard before July 1, 1997."⁵³

BILINGUALISM

The Basic Law prescribes that in addition to the Chinese language, English may also be used as an official language by the executive authorities, legislature, and judiciary (art. 9). The Common Law tradition in Hong Kong has been built in English, but 98% of Hong Kong residents are Cantonese speakers and less than half of them are bilingual, which means that statutes must be translated into Chinese if the Common Law is to survive in the HKSAR.⁵⁴ Since April 1989, new legislation has been drafted bilingually; a program to translate the laws in place before that time began in 1987. The drafts must be approved by the Bilingual Laws Advisory Committee, comprised of lawyers, linguists, and legislators, in order to be authenticated, then confirmed by the Legislative Council and endorsed by the Executive Council.⁵⁵ The drafting

⁵² *Shih chieh jih pao* [World Journal] (New York), Jan. 14, 1997, at A8.

⁵³ *Hong Kong Sets Cut-Off Date for Appeals to Privy Council in London*, AGENCE FRANCE PRESSE, Jan. 15, 1997, from Nexis, Curnws file.

⁵⁴ Jonathan Karp, *Torting in Tongues: Translating Law Into Chinese Proves a Massive Task*, FAR EASTERN ECONOMIC REVIEW 18 (July 8, 1993).

⁵⁵ *Id.*

team set the end of 1995 as a deadline for completing their task. The target date for adoption of bilingualism in the courts is June 30, 1997.⁵⁶

ARBITRATION

The PRC is a party to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, and the agreement has been in force for Hong Kong.⁵⁷ The Convention, now incorporated into the Arbitration Ordinance, is extended to Hong Kong by virtue of the United Kingdom's adherence, although Hong Kong itself is not a signatory. Now, arbitral awards made in Hong Kong are enforceable in the PRC and vice versa. This will no longer be true after reversion, since the Convention does not cover enforcement of awards within one sovereign state. While the Hong Kong Government recognizes this problem and has tried to put it on the agenda of the JLG for discussion with China, the issue's resolution does not seem imminent.⁵⁸

Hong Kong enacted a modified version of the 1979 English Arbitration Act in 1982,⁵⁹ and in 1989 adopted the United Nations Commission on International Trade Law (UNCITRAL) Model Law.⁶⁰ At present, the Ordinance contains two regimes, one applying to domestic arbitration (Part II) and another applying to international arbitration (Part IIA). Hong Kong has also adopted its own set of domestic arbitration rules, which came into effect in April 1993.⁶¹ Hong Kong courts recognize and enforce arbitration awards made in those countries that are signatories to the New York Convention. For international arbitration, the Hong Kong International Arbitration Centre (HKIAC) recommends the use of its Procedures for Arbitration, which includes UNCITRAL Rules.⁶² Those parties who do not wish to arbitrate under the UNCITRAL Model Law for international arbitrations may opt out of it and into the domestic regime set out in the Arbitration Ordinance. Parties choosing this route may also opt out of any judicial review of the award pursuant to the terms of the Ordinance.

⁵⁶ Xinhua in English, June 9, 1995, as carried in FBIS, June 13, 1995, at 94.

⁵⁷ Arbitration (Parties to New York Convention) Order, subsidiary legislation to Chapter 341, Arbitration Ordinance, 23 Laws of Hong Kong, at A1-A3.

⁵⁸ P. Baldinger, section on "Hong Kong's Transition," in *Hong Kong's Transition to Chinese Sovereignty: Legal and Business Issues* 19 (Washington, D.C., The US-China Business Council, 1996).

⁵⁹ Cap. 341, 23 LAWS OF HONG KONG.

⁶⁰ K. P. Berger, *INTERNATIONAL ECONOMIC ARBITRATION* 3 (Deventer, Kluwer, 1993).

⁶¹ E. E. Bergsten, *comp. and ed., National Rules and Enactments: Hong Kong, I.b, in 3 INTERNATIONAL COMMERCIAL ARBITRATION* (Dobbs Ferry, Oceana, 1996).

⁶² *Id.* at 9.

Commercial arbitration is an area in which Sino-British negotiations have been deadlocked for some time.⁶³ China has two options: either (1) developing domestic legislation placing Hong Kong arbitral proceedings in a special category of special enforcement, which would enable them to be brought before the PRC courts for enforcement, or (2) relying on a specific provision of the New York Convention. This provision states that the Convention shall apply to arbitral awards not considered as domestic awards in the States where their recognition and enforcement are sought. China's record of enforcing foreign arbitration awards is described as spotty at best, although Hong Kong courts have enforced sixty Chinese awards during the four years leading up to 1996.⁶⁴

ISSUES FOR U.S. POLICY

Although Hong Kong's judicial processes are to be completely separate from those in the PRC, some wonder whether Chinese officials after the transfer will seek to have legislation made by legislative bodies in the PRC applied to Hong Kong. In any case, Chinese officials may seek to block judicial independence or influence judicial proceedings in Hong Kong through indirect means, such as controlling judicial appointments or narrowing the jurisdiction of the courts. This is of particular concern since about 25% of higher court judges either are now or will soon be eligible for retirement.⁶⁵ Other concerns relate to whether court proceedings will continue to be conducted in English, as in the past.

⁶³ SOUTH CHINA MORNING POST, Jan. 9, 1997, at 18, retrieved from FBIS online, Jan. 9, 1997.

⁶⁴ P. Baldinger, *supra* note 1, at 20.

⁶⁵ *HK's Last Legal Year Under British Rule Begins Amid Exodus of Judges*, AGENCE FRANCE PRESSE, Jan. 13, 1997. Four higher court judges have indicated that they will quit and eleven others are nearing retirement age.