

立法會
Legislative Council

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Legislative Council
Panel on Financial Affairs

Minutes of special meeting held on
Monday, 16 December 2002 at 11:00 am
in the Chamber of the Legislative Council Building

Members present : Hon Ambrose LAU Hon-chuen, GBS, JP (Chairman)
Hon Henry WU King-cheong, BBS, JP (Deputy Chairman)
Hon Kenneth TING Woo-shou, JP
Hon James TIEN Pei-chun, GBS, JP
Hon Albert HO Chun-yan
Hon LEE Cheuk-yan
Hon Eric LI Ka-cheung, JP
Dr Hon David LI Kwok-po, GBS, JP
Hon James TO Kun-sun
Hon Bernard CHAN, JP
Hon CHAN Kam-lam, JP
Hon SIN Chung-kai
Hon Jasper TSANG Yok-sing, GBS, JP
Hon Emily LAU Wai-hing, JP
Hon Abraham SHEK Lai-him, JP
Hon MA Fung-kwok, JP

Non-Panel members attending : Hon Cyd HO Sau-lan
Hon Fred LI Wah-ming, JP
Hon Margaret NG
Hon CHAN Yuen-han, JP
Hon Mrs Sophie LEUNG LAU Yau-fun, SBS, JP
Dr Hon LO Wing-lok
Hon Frederick FUNG Kin-kee

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Members absent : Hon NG Leung-sing, JP
Dr Hon Philip WONG Yu-hong

Public officers attending : Agenda Item I

Mr Edmond LAU
Principal Assistant Secretary for Financial Services and
the Treasury (Financial Services)

Mr CHOI Yiu-kwan
Executive Director (Banking Supervision)
Hong Kong Monetary Authority

Agenda Item II

Mr Antony LEUNG
Financial Secretary

Mr Frederick MA
Secretary for Financial Services and the Treasury

Mr Stanley YING
Deputy Secretary for Financial Services and the Treasury
(Treasury)¹

Attendance by invitation : Agenda Item I

Mr CHAN Kay-cheung
Executive Director & Deputy Chief Executive
The Bank of East Asia, Limited

Ms Mimi KAM
Senior Manager, Merger Management Office
The Bank of East Asia, Limited

Ms Suney CHAN
Chief Executive, East Asia Finance Company, Limited

Ms Amy LO Sau-han
Partner, Clifford Chance

Ms Joanna KWONG Ding-yan
Associate, Clifford Chance

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Clerk in attendance : Ms Anita SIT
Chief Assistant Secretary (1)6

Staff in attendance : Ms Pauline NG
Assistant Secretary General 1

Ms Bernice WONG
Assistant Legal Adviser 1

Mr Joey LO
Assistant Secretary (1)1

Miss Christy YAU
Legislative Assistant 7

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- I Briefing on a Private Member's Bill — The Bank of East Asia, Limited (Merger of Subsidiaries) Bill**
LC Paper No. CB(1)352/02-03(01) — Information note on the draft The Bank of East Asia, Limited (Merger of Subsidiaries) Bill with the draft Bill attached provided by Hon NG Leung-sing

The Chairman informed members that Mr NG Leung-sing, who would sponsor the Private Member's Bill in question, was not able to attend the meeting as he was out of town. He then invited Mr CHAN Kay-cheung, Executive Director and Deputy Chief Executive, The Bank of East Asia, Limited to speak on the draft Bill.

2. Mr CHAN Kay-cheung informed members that the Bill would provide for the merger of East Asia Credit Company Limited (EA Credit) and East Asia Finance Company, Limited (EA Finance) with The Bank of East Asia, Limited (Bank of East Asia). The merger was proposed to facilitate consolidation and better conduct of the businesses of EA Credit, EA Finance and Bank of East Asia. Mr CHAN explained that the three financial institutions were all incorporated in Hong Kong and were authorized institutions under the Banking Ordinance (Cap. 155). The Bill would provide for the vesting of the entire undertakings of EA Credit and EA Finance in Bank of East Asia on an appointed day to be determined by the board of directors of Bank of East Asia. Given the large number of outstanding agreements between EA Credit and/or EA Finance and their respective customers, the transfer of such undertakings by way of an ordinance was proposed with a view to minimizing inconvenience to the three institutions concerned and their customers. At the merger,

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the registration of EA Credit as a deposit-taking company and the restricted banking licence of EA Finance would be revoked.

3. Mr CHAN said that the proposed merger followed the trend of consolidation of the banking and financial sector in Hong Kong, which would enhance the competitiveness of the sector and contribute to its systemic stability in the longer term. Mr CHAN also briefly outlined how the draft Bill had duly taken into account and addressed various concerns raised by Members in scrutinizing previous Bills on bank mergers.

4. Mr CHAN also informed Members that the draft Bill had also been submitted to the Financial Services and the Treasury Bureau, the Department of Justice, the Companies Registry, the Inland Revenue Department, the Land Registry, the Office of the Privacy Commissioner for Personal Data, the Securities and Futures Commission and the Hong Kong Monetary Authority for comments. The Privacy Commissioner for Personal Data had advised that the draft Bill was in line with the provisions in the Personal Data (Privacy) Ordinance (Cap. 486) and the Hong Kong Monetary Authority had endorsed the proposed merger.

(Post-meeting note: The speaking note of Mr CHAN Kay-cheung was issued to members after the meeting vide LC Paper No. CB(1)542/02-03(01) dated 17 December 2002.)

5. The Chairman invited comments from the Administration on the proposed merger. The Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) said that it was the Government's stated policy to support consolidation of the banking sector in Hong Kong subject to the overriding aim to promote the stability of the banking system and to provide an appropriate degree of protection to the interests of customers and depositors. The proposed merger had the support of the Government.

Questions from Members

6. The Chairman then invited questions from Members.

7. Ms Emily LAU enquired whether the proposed merger would necessitate any staff increase or layoff. Mr CHAN Kay-cheung explained that the employment contracts of all existing staff of EA Credit and EA Finance were signed with Bank of East Asia. Hence, there was no need to provide for the transfer of employment contracts and retirement benefits in the Bill. Staff redeployment arrangements were being examined. There was no pressure for staff layoff upon the merger. In fact, Bank of East Asia was expanding its operation in certain business areas.

8. No further questions were raised by Members. The Chairman thanked representatives of Bank of East Asia and the Administration for attending the meeting. It was 11:15 am at this juncture. As the following item was scheduled to start at

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11:30 am, the Chairman advised that the meeting should adjourn for 15 minutes and resume at 11:30 am.

II Continuation of discussion with the Financial Secretary on fiscal deficits and the budgeting of Government expenditure for years from 2003-04 to 2006-07

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| LC Paper No. CB(1)502/02-03 | — | Minutes of special meeting on 25 October 2002 |
| LC Paper No. CB(1)127/02-03(02) | — | Paper on “Fiscal Deficits and the Budgeting of Government Expenditure for Years from 2003-04 to 2006-07” provided by the Administration |
| LC Paper Nos. CB(1)150/02-03(01) & (02) | — | Information pack for the Financial Secretary’s consultations with Legislative Council Members on the 2003-04 Budget |

9. The Chairman welcomed the Financial Secretary (FS) and other representatives of the Administration to the meeting to continue the discussion with Members on the fiscal deficit situation and the budgeting of Government expenditure for the years from 2003-04 to 2006-07.

The Financial Secretary’s presentation

10. FS said that apart from briefing Members on the fiscal deficit situation, he would also take the opportunity to inform Members his initial thinking on suggestions made by Members and the public for solving the problem.

The fiscal deficit problem

11. FS said that the fiscal deficit problem was very serious. The consolidated deficit in 2001-02 was approximately 5% of the Gross Domestic Product (GDP). As for 2002-03, due to the reduction of revenue from land sale and the deferment of the sale of the second tranche of MTRC shares, the figure was expected to be above 5% of GDP. FS said that international credit rating agencies and investors/speculators placed equal emphasis on the Government’s capability of maintaining a balanced Operating Account as its capability of maintaining a balanced Consolidated Account. There had been persistent deficit in the Operating Account since 1998-99 with an operating deficit exceeding \$350 billion in each financial year, and the situation was worsening. FS continued that the fiscal deficit problem, if not resolved promptly, would adversely affect the overall economy. Public confidence would be affected. Hong Kong’s economic outlook might be downgraded by international credit rating agencies, resulting in higher credit cost for local corporations. The problem would

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also put pressure on the Hong Kong dollar link with the US dollar, bring further deflation and even another economic recession.

12. ES explained that the fiscal deficit problem was mainly caused by a situation in which total Government expenditure grew faster than the GDP. The problem was aggravated by deflation as nominal GDP mattered more to Government revenue than real GDP. The Operating Account also faced a similar problem. The deficit problem would get worse if deflation continued to worsen.

Measures to address operating deficit

13. ES said that consultation through various channels revealed that the public at large acknowledged the seriousness of the fiscal deficit problem and saw an urgent need to resolve it. A three-pronged approach, i.e., reviving the economy, cutting expenditure and raising revenue was generally supported. On expenditure reduction, there were strong appeals for the Government to introduce robust expenditure cutting measures. Those included further streamlining of the Government structure through re-organisation and re-prioritization, reviewing civil service pay, reducing the size of the civil service and reviewing the Comprehensive Social Security Assistance (CSSA) Scheme. On the other hand, there were views that Government expenditure on infrastructural projects and education should not be reduced. As regards revenue raising, ES said that the introduction of General Sales Tax (GST) was generally considered inappropriate under the present economic situation. However, various measures had been suggested. Those included suitably widening the tax base, increasing profits and salaries tax rates, reducing salaries tax allowances, introducing a progressive rate structure for profits tax and salaries tax, implementing the Boundary Facilities Improvement Tax, introducing green tax, levy on foreign domestic helpers and soccer betting duty, and increasing existing betting duty rates. Issue of bonds and sale/securitization of Government assets had also been suggested. Other views expressed included the extension of specific duty concessions and continuation of the freeze on livelihood-related Government fees.

14. To summarize the situation, ES said that consensus by the community had emerged. There was common commitment to sharing the responsibility during the difficult time. The Administration would continue consultations with different sectors of the community on the issue. ES also said that while he understood the community's high expectation on public services and the wish for no increase in taxes and government fees, he must point out the dire consequences if the fiscal deficit problem was not resolved promptly.

15. As regards the approach for expenditure reduction, ES informed Members of the Administration's current plan to budget the operating expenditure in 2003-04 at \$210.4 billion as rendered in the 2002 Medium Range Forecast. However, the figure for 2006-07 would be reduced from \$219.8 billion to \$200 billion or by around 10%. Bureaux and departments would need to plan for a higher percentage cut than 10% in operating expenditure over the period from 2003-04 to 2006-07 in order to meet the

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\$200 billion target, as expenditure on pensions, the CSSA and some other types of social assistance would continue to increase over the years.

16. ES further said that Directors of Bureau would each be given an “Operating Expenditure Envelope” advising them the level of funds to be allocated to them. It would be up to the Directors of Bureau to work out their priorities in consultation with their respective Controlling Officers. However, they would be urged to act promptly to meet the aforesaid target in order to restore fiscal balance by 2006-07.

17. With regard to revenue, ES revealed that the Administration’s would propose to implement soccer betting duty and Boundary Facilities Improvement Tax in 2003-04 and would examine possible adjustments to taxes and fees and submit proposals to Members in March next year.

Reviving the economy

18. ES recapitulated that reviving the economy was the key to resolving the fiscal deficit problem. He would therefore take the opportunity to inform Members of the Administration’s strategies for reviving the economy.

19. ES said that the economy adjustment was mainly caused by cyclical downturns and structural shifts which occurred simultaneously in Hong Kong. The adjustment brought two recessions since 1997, accompanied by high unemployment, persistent deflation and huge fiscal deficits. ES explained that macro economic adjustment tools were limited in Hong Kong. Hence the Government would focus on improving the competitiveness of the real economy by introducing education reforms and policies to attract professionals, talents and entrepreneurs/investment immigrants. However, those measures needed time to achieve results.

20. ES said that the Government had a firm belief in free market. Its role would therefore be limited but pro-active. In that regard the Government’s strategies would include -

- (a) attracting talents to Hong Kong;
- (b) facilitating Hong Kong’s adjustment from an enclave to a metropolis;
- (c) reducing public expenditure;
- (d) clarifying Government’s role in the property market;
- (e) investing in infrastructure;
- (f) promoting development of high-value added industrial and commercial activities;

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- (g) developing sectors which would provide jobs for lower-skilled labour, and
- (h) maintaining Hong Kong's institutional strengths.

21. With regard to measures to control deflation, ES advised that as economic tools available to the Government were limited, the focus should be placed on how to increase foreign demands in areas such as tourism, investment, health care and education etc. In fact, Government's past efforts in these areas had shown effects. GDP in the third quarter of 2002 had grown by 3.3% and exports of goods and services had shown remarkable growth. Meanwhile, unemployment rate had slightly fallen. ES further advised that GDP growth would be cautiously optimistic in the short term. However, there were still medium term uncertainties, and deflation would likely continue.

22. ES concluded that the Government was committed to reviving the economy and solving the deficit problem, and stressed that support from Members and the public was needed to ride out the challenge of the deficit problem.

(Post-meeting note: The presentation notes tabled by the Administration were issued to Members after the meeting vide LC Paper No. CB(1)542/02-03 dated 17 December 2002.)

Discussion with Members

Attaining a balanced Operating Account by 2006-07

23. Referring to Chart 17 of the presentation notes regarding measures to address operating deficit, Mr LEE Cheuk-yan pointed out that according to the 2002-03 Budget, there would be a surplus of \$60 million in the Consolidated Account in 2005-06. He enquired why a \$20 billion cut in operating expenditure would be needed to attain a balanced account in 2006-07. Mr LEE also asked if the Administration had assessed the effect of such a magnitude of expenditure reduction on its measures to revive the economy. He pointed out that reduction in education expenditure would have a significant bearing on the supply of local talents. Similarly, downward adjustment of the civil service pay would aggravate the downtrend of local consumption.

24. With regard to the Administration's schedule to attain a balanced Operating Account, Mr LEE said that he was yet to be convinced of the need to set the deadline at 2006-07. He considered that more time should be allowed for the economy to garner strength. He believed credit rating agencies and financial analysts would place more emphasis on Hong Kong's overall economy rather than on the fiscal deficit as such. Hence, the target of attaining a balanced Operating Account should not outweigh the objective of reviving the economy.

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25. In response, ES explained that deflation was more serious now than the situation in March this year, implying that Government's revenue for 2002-03 would probably be lower than the estimate in the 2002-03 Budget. Further cuts in the operating expenditure would therefore be necessary. He said that while rating agencies and financial analysts would pay attention to the overall economy of Hong Kong, they would put equal emphasis on Government's Operating Account. The 2006-07 target date was chosen because a prolonged period of fiscal deficit was most undesirable. He pointed out that by that time, the Consolidated Account and Operating Account would have recorded consecutive deficits for 7 and 9 years respectively.

26. ES also said that the Administration was fully aware of the need to avoid affecting economic revival as it reduced Government expenditure. However, it was extremely important to attain a balanced Operating Account early. Moreover, since Hong Kong was a very open economy, the effect of Government expenditure on the economy was very limited. The multiplying effect assessed by the Government Economist was only 0.5. He assured Members that the Administration was moving in the right direction.

Seeking consensus with Members on budgetary measures

27. Referring to the earlier part of FS's presentation about the effect of the fiscal deficit on public confidence, Ms Emily LAU said that the public lacked confidence mainly because they could not see good prospects for the Hong Kong's economy. Their confidence in the Government was further weakened because many commitments in the 2002-03 Budget had yet to be delivered. She urged FS to seek to reach consensus with Members on the measures to revive the economy and to solve the fiscal deficit problem by having more discussions with them before finalizing the 2003-04 Budget.

28. In response, FS said that Members would recall that when the 2002-03 Budget was prepared, they had been actively consulted and in fact, consensus on a number of main issues had been reached. He assured Members that their views and those of the public would be duly taken into account in finalizing the 2003-04 Budget. Meanwhile, he would continue listening to views of Members and the public in the process of preparing the Budget.

Impact of expenditure cuts on vulnerable groups

29. On FS's appeal for shared responsibility by the community to solve the fiscal deficit problem, Miss CHAN Yuen-han pointed out that the vulnerable groups in the community, particularly the CSSA recipients, had expressed much concern. They worried that their livelihood would be seriously affected if the Government was to cut CSSA payments and reduce the resources for social welfare services. As regards FS's remark that increasing government's spending would have limited effect

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on reviving the economy, Miss CHAN said that it was partly attributed to the World Trade Organization (WTO) Agreement on Government Procurement signed by the Hong Kong Government in 1996. She suggested the Administration should review its position on this Agreement. She also asked whether the Administration would take steps to enable the local work force to be benefited from the employment opportunities arising from the various infrastructure projects in the pipeline.

30. On Miss CHAN's concern about the vulnerable groups in the community, ES assured her that when expenditure and revenue measures were determined, both the Government's stated policy commitments and the overall interests of the community would be taken into consideration. ES also said that while the Government had no plan to withdraw from the WTO Agreement on Government Procurement at this stage, every effort would be made to ensure that the interests of both the business sectors and the local work force would be looked after.

Impact of expenditure cuts on public confidence

31. Mr Albert HO pointed out that Government's plan to cut expenditure might undermine the confidence of the public in Hong Kong's economic prospects and thus further discourage them from spending. The vicious circle created subsequently would not be conducive to revival of the economy.

32. ES responded that the public was unwilling to spend because of a number of reasons, amongst which was the persistent deflation factor. The Government was fully aware of the problem and action had been taken to improve the situation. Measures had been introduced to stimulate external demands and there were signs that some of those measures had achieved results, as shown by the growth in GDP and the exports of goods and services over the past two quarters. He believed that progressive improvement in the overall economy would restore public's confidence. He also pointed out that instead of lavish spending by the Government, the more effective approach to control deflation was to increase external demands.

33. Mr Henry WU said that FS had suggested various expenditure reduction and revenue measures to address the fiscal deficit problem. However, such measures might not be supported by all. He asked whether FS had made an assessment on the acceptability of those measures and how he would resolve the different views held by different sectors of the community.

34. ES said that the community had generally acknowledged the seriousness of the fiscal deficit problem and agreed that there was an urgent need to introduce measures to address the problem. He was confident that acceptable and effective measures would be found through the Administration's consultation at different levels of the community. He remarked that the consultation was a continuous and dynamic process with extensive two-way communications.

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Participation of private sector in infrastructure projects

35. Mr Abraham SHEK said that he fully agreed that the entire community had to share responsibility during this difficult time. He was however concerned about the high unemployment rate. He suggested that in view of the huge fiscal deficit, the Government should provide more opportunities for private consortia to take part in the building and operation of infrastructural and community facilities. He considered that this approach would create more job opportunities thus easing unemployment. Mr SHEK also expressed his concern that the Administration had yet to make a decision on investment immigrants. He said those immigrants would bring in large amount of capital and thus help stimulate economic activities.

36. Regarding investment immigrants, FS informed Members that the Administration supported the suggestion and was in fact actively studying the subject. He said an announcement on the relevant policy would be made at the appropriate time. As regards participation of private consortia in infrastructure projects, he affirmed the Administration's support of the idea in principle. He said that the Bureaux concerned would actively look into this option in planning for new infrastructure projects.

Fiscal reserves

37. Mr CHAN Kam-lam expressed concern over the fiscal reserve situation. He said that given the marked increase in fiscal deficit in the current year and bearing in mind that measures to deal with the deficit might not be as successful as planned and took time to achieve results, the fiscal reserves would shrink gradually and by 2006-07, its level would have probably dropped considerably. As the level of the fiscal reserves was crucial to the stability Hong Kong's financial and monetary systems and the overall economy, he asked FS whether he would take that factor into account in preparing the 2003-04 Budget.

38. In response, FS said that he did not have a forecast figure of the fiscal reserves by 2006-07 at this stage and in fact there were a number of uncertainties involved. Those included, inter alia, the speed of the expenditure cuts and the amount of funds needed initially to introduce some of those cuts. He cited the example of the Voluntary Retirement Scheme, implementation of which would involve substantial one-off compensation payments. The Administration had yet to work out the number of staff involved and funds required for the implementation of the second phase of the Scheme. He thanked Mr CHAN for raising the issue of fiscal reserves and undertook to look further into the matter when preparing the 2003-04 Budget.

Impact of implementation of Article 23 of the Basic Law on the local economy

39. Ms Cyd HO said that being a small and externally-oriented economy, Hong Kong relied much on foreign investment. As pointed out by FS, views of

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international credit rating agencies and overseas investors were therefore important. She highlighted that these institutions and investors had expressed worries about the Administration's proposals for the implementation of Article 23 of the Basic Law. She asked whether the Administration had assessed the effect of those views on Hong Kong's economy and if the answer was in the affirmative, what measures the Administration would take to eliminate the worries and obviate possible damages to Hong Kong's economy upon the subsequent enactment of legislation under Article 23 of the Basic Law.

40. ES said that the Government was fully aware of the importance of free flow of information to our financial markets. He assured Members that the Administration accorded a very high priority to maintaining the free flow of information and the rights and freedom now enjoyed by Hong Kong citizens.

41. Ms Cyd HO said that she was pleased with FS's recognition of the importance of the issue but would suggest that a "bottom line" be drawn in the process of enacting legislation for implementation of Article 23 of the Basic Law with a view to ensuring that free flow of information and the rights and freedom of individual citizens would be fully protected.

III Any other business

42. There being no other business, the meeting ended at 12:55 pm.

Legislative Council Secretariat
23 January 2003