

立法會
Legislative Council

LC Paper No. CB(1)604/06-07

(These minutes have been seen
by the Administration)

Ref : CB1/PL/FA/1

Panel on Financial Affairs

**Minutes of meeting
held on Monday, 6 November 2006 at 8:30 am
in the Chamber of the Legislative Council Building**

Members present : Hon CHAN Kam-lam, SBS, JP (Chairman)
Hon Bernard CHAN, GBS, JP (Deputy Chairman)
Hon James TIEN Pei-chun, GBS, JP
Hon Albert HO Chun-yan
Ir Dr Hon Raymond HO Chung-tai, SBS, S.B.St.J., JP
Dr Hon David LI Kwok-po, GBS, JP
Hon James TO Kun-sun
Hon Emily LAU Wai-hing, JP
Hon Abraham SHEK Lai-him, JP
Hon Jeffrey LAM Kin-fung, SBS, JP
Hon Andrew LEUNG Kwan-yuen, SBS, JP
Hon WONG Ting-kwong, BBS
Hon Ronny TONG Ka-wah, SC
Hon CHIM Pui-chung
Hon TAM Heung-man

Members attending : Hon CHAN Yuen-han, JP
Hon WONG Kwok-hing, MH

Member absent : Hon SIN Chung-kai, JP

**Public officers
attending** : Agenda Item IV

Hong Kong Monetary Authority

Mr Joseph YAM, GBS, JP
Chief Executive

Mr William RYBACK, JP
Deputy Chief Executive

Mr Y K CHOI, JP
Deputy Chief Executive

Mr Peter PANG, JP
Deputy Chief Executive

Agenda Item V

Mr FUNG Hing-wang, JP
Commissioner of Census and Statistics

Mr SIU Yiu-choi
Senior Statistician
Census and Statistics Department

Ms Cora HO
Principal Assistant Secretary for Financial Services and
the Treasury (Financial Services) 3

Agenda Item VI

Mr Henry TANG, GBS, JP
Financial Secretary

Mr Frederick MA, JP
Secretary for Financial Services and the Treasury

Mr Alan LAI, GBS, JP
Permanent Secretary for Financial Services and the
Treasury (Treasury)

Mr K C KWOK, BBS, JP
Government Economist

Ms Vivian SUM
Administrative Assistant to Financial Secretary

Clerk in attendance: Miss Salumi CHAN
Chief Council Secretary (1)5

Staff in attendance : Ms Pauline NG
Assistant Secretary General 1

Miss Polly YEUNG
Chief Council Secretary (1)3

Ms Annette LAM
Senior Council Secretary (1)3

Ms Rosalind MA
Senior Council Secretary (1)8

Ms May LEUNG
Legislative Assistant (1)8

Action

I Confirmation of minutes of meeting
(LC Paper No. CB(1)184/06-07 — Minutes of meeting on 12 October 2006)

The minutes of the meeting held on 12 October 2006 were confirmed.

II Information papers issued since the regular meeting held on 3 July 2006
(LC Paper No. CB(1)1968/05-06 — 5-Year Investment Performance Review of the Mandatory Provident Fund System (1 April 2001 – 31 March 2006)
Summary Report

LC Paper No. CB(1)2111/05-06 — Securities and Futures Commission Quarterly Report for April to June 2006

LC Paper No. CB(1)2143/05-06 — Half-yearly Economic Report 2006 and the press release

LC Paper No. CB(1)2154/05-06 — Mandatory Provident Fund Schemes Statistical Digest — June 2006

LC Paper No. CB(1)2190/05-06 — The programme rundown and relevant papers for the Economic Summit on "China's 11th Five-Year Plan and the Development of Hong Kong" held on 11 September 2006)

2. Members noted that the above papers had been issued for the Panel's information.

III Date of next meeting and items for discussion

Conflict of interest issue involved in and after the listing of The Link Real Estate Investment Trust

(LC Paper No.
CB(1)2335/05-06(01)

— Letter dated 29 September 2006 from Hon James TO to the Chairman of the Panel

Relevant information

LC Paper No. CB(1)2182/05-06(01) — Letter dated 21 July 2006 from the Clerk to Panel to Mr Paul CHENG (with a list of further questions for the written response of Mr Paul CHENG and the letter dated 29 June 2006 from Hon James TO (Letter D)

LC Paper No. CB(1)2182/05-06(02) — Mr Paul CHENG's written response dated 31 August 2006

LC Paper No. CB(1)2228/05-06(01) — Letter dated 21 July 2006 from the Clerk to Panel to the Secretary for Housing, Planning and Lands (with a list of further questions for the written response of the Administration and the letter dated 29 June 2006 from Hon James TO (Letter C)

LC Paper No. CB(1)2228/05-06(02) — The Administration's written response dated 14 September 2006)

3. The Chairman said that pursuant to the Panel's agreement on 3 July 2006, Mr Paul CHENG and the Administration had been invited again to attend a meeting of the Panel to discuss the relevant issues to ascertain whether conflict of

interests were involved in Mr Paul CHENG's dual roles as the Chairman of the Board of Directors of The Link Management Limited (The Link) and as a Senior Advisor to Deutsche Bank. Mr CHENG and the Administration had provided their written responses (LC Paper Nos. CB(1)2182/05-06(02) and 2228/05-06(02) respectively). As indicated by Mr CHENG in his response, he had already provided detailed answers and that he was declining the Panel's invitation as a matter of principle, and not out of being disrespectful. Noting the written responses from Mr Paul CHENG and the Administration, Mr James TO wrote to the Chairman on 29 September (LC Paper No. CB(1)2335/05-06(01)), suggesting the Panel to discuss at today's meeting how the matter should be followed up. The Chairman invited members' views on the subject.

4. Mr James TO considered that the written responses from Mr Paul CHENG could not adequately address his concern about the possible conflict of interests arising from Mr CHENG's two roles. As Mr CHENG had repeatedly declined the Panel's invitation to attend a meeting and discuss the subject, Mr TO was of the view that the Panel should take appropriate measures to secure Mr CHENG's attendance, such as by seeking authorization of the Council to exercise the power under the Legislative Council (Powers and Privileges) Ordinance (Cap. 382) (LegCo (P&P) Ordinance) to order Mr CHENG to attend the Panel meeting.

5. Mr Abraham SHEK considered that Mr Paul CHENG had already responded in writing to all the questions raised by members. If members had any further questions, they might well be forwarded to Mr CHENG and/or The Link again for written response. Given that the requested information could be furnished in writing, Mr SHEK was of the view that it was not necessary for the Panel to invite Mr CHENG again to a meeting to discuss the subject.

6. Ms Emily LAU shared Mr James TO's view and recapped that it was the Panel's decision that Mr CHENG should be invited again to a meeting. She pointed out that the provision of written responses by the invited parties was no substitute for the personal attendance of the parties concerned, unless members were satisfied that the written responses could address all their concerns and that no follow-up was necessary.

7. Given that members had diverse views, the Chairman proposed and members agreed that a decision be made through the casting of vote. The Chairman put to vote the motion proposed by Mr James TO that the Panel should seek authorization of the Council to exercise the power under the LegCo (P & P) Ordinance to order Mr Paul CHENG to attend a future Panel meeting. Of the members present, four voted for and six voted against the motion. The Chairman declared that the motion was negated.

8. Dr David LI, who joined the meeting after the casting of vote had taken place, stated his view that Mr Paul CHENG's personal attendance to a Panel meeting was necessary for addressing members' concerns about conflict of interests arising from Mr CHENG's dual roles.

9. Mr James TO pointed out that even if the Panel would not compel Mr Paul CHEUNG's attendance at a meeting, the Panel should consider pursuing the subject further by inviting other involved parties to meet with the Panel and provide information. Having regard to the circumstances of the case, Mr TO considered that the Panel should invite Mr LEUNG Chin-man, former Permanent Secretary for Housing, Planning and Lands (Housing), to a meeting of the Panel.

10. Members noted that while the Secretary for Housing, Planning and Lands had provided written responses to members' questions, these questions had not previously been forwarded to Mr LEUNG Chin-man for response. In this connection, Mr Jeffrey LAM, Mr WONG Ting-kwong and Mr Abraham SHEK stated their view that as Mr LEUNG Chin-man had not been invited to provide his written response on the case, it would be more appropriate to first invite Mr LEUNG to provide written information, instead of inviting him to attend a meeting in the first instance.

11. Given that members had different suggestions on the proposed invitation to Mr LEUNG Chin-man, the Chairman suggested and members agreed that a decision be made through the casting of vote. The Chairman put to vote the motion proposed by Mr James TO that the Panel should invite Mr LEUNG Chin-man to a meeting of the Panel to respond to members' questions on the conflict of interest issue. Of the members present, six voted for and two voted against the motion. Two members abstained from voting. The Chairman declared that the motion was passed. In this connection, members had no objection that Mr LEUNG Chin-man would also be invited to provide written information for the Panel's consideration. The Chairman said that the Panel would write to the Administration inviting Mr LEUNG Chin-man, former Permanent Secretary for Housing, Planning and Lands (Housing), to attend a meeting of the Panel. He directed the Clerk to follow up accordingly.

(*Post-meeting note:* With the concurrence of the Chairman, the Clerk to Panel wrote to the Secretary for Housing, Planning and Lands (SHPL) on 11 November 2006, inviting Mr LEUNG Chin-man and other representatives of the Administration to attend the Panel meeting scheduled for 5 January 2007. The written responses dated 7 December 2006 from SHPL and Mr LEUNG were issued to members vide LC Paper Nos. CB(1)472/06-07(02) and (03) respectively on 8 December 2006.)

Discussion items for the meeting in December 2006

(LC Paper No. CB(1)185/06-07(01) — List of outstanding items for discussion

LC Paper No. CB(1)185/06-07(02) — List of follow-up actions)

12. Members agreed to discuss the following items proposed by the Administration at the next meeting scheduled for 14 December 2006 and the meeting be held from 10:00 am to 12:45 pm –

- (a) Briefing by the Financial Secretary on Hong Kong's latest overall economic situation; and
- (b) Proposal for implementing a replacement computer system to replace the existing procurement computer system of the Government Logistics Department.

Impact of banks branch closure and fee-charging on the public

(LC Paper No. CB(1)181/06-07(01) — Interim reply dated 25 October 2006 from the Hong Kong Association of Banks)

13. Noting the interim reply dated 25 October 2006 from the Hong Kong Association of Banks (HKAB), members agreed to the request of HKAB that the discussion originally scheduled to be held in December 2006 on the "Impact of banks branch closure and fee-charging on the public" be deferred so as to allow more time for HKAB to discuss with the parties concerned on the various recommendations of its Task Force. Members also noted that HKAB undertook to update the Panel in writing on the progress made and provide the requested information by 24 November 2006.

14. Highlighting that the subject was a matter of public concern, Ms Emily LAU opined that the Panel should meet with HKAB as soon as possible to follow up the discussion at the Panel meeting held on 3 July 2006. In this connection, Ms LAU suggested that HKAB should be invited to attend the Panel meeting on 5 January 2007 for the purpose. The Chairman directed the Clerk to liaise with HKAB for the meeting arrangements accordingly.

(Post-meeting note: The written information provided by HKAB was issued to members vide LC Paper No. CB(1)390/06-07(01) on 28 November 2006.)

IV Briefing on the work of the Hong Kong Monetary Authority

(LC Paper No. CB(1)185/06-07(03) -- Paper provided by the Hong Kong Monetary Authority)

Briefing by the Hong Kong Monetary Authority

15. At the invitation of the Chairman, the Chief Executive of the Hong Kong Monetary Authority (CE/HKMA) gave a power-point presentation on HKMA's key areas of work, as follows:

- (a) On currency stability, the Hong Kong dollar exchange rate remained stable within the Convertibility Zone. The Aggregate Balance remained stable at around \$1.3 billion. While there was market expectation that the Hong Kong dollar might appreciate in parallel with the renminbi (RMB), it should be noted that the position of the Government on maintaining the Linked Exchange Rate (LER) System remained clear and firm. The results of recent research conducted by HKMA showed that the impact of US shocks on output and inflation in Hong Kong was more significant than the impact of Mainland shocks. The US dollar continued to be the appropriate anchor for the Hong Kong dollar. It was technically not possible for RMB to be a currency anchor in any case given that it was not a freely convertible currency and not a reserve currency.
- (b) On banking sector performance, the banking sector remained well capitalized. Overall asset quality was maintained at a stable and high level. Net interest margins remained low by historical standard (about 1.7%), reflecting keen competition in the banking system. The number of residential mortgages in negative equity was 8 800 cases at the end of September 2006, which was a slight change when compared with the quarter earlier. The number was down by 92% from the peak in June 2003. HKMA had made good progress in banking supervision, including the implementation of Basel II in Hong Kong, Anti-money Laundering and Counter Terrorist Financing and the Deposit Protection Scheme.
- (c) On market infrastructure, projects for establishing a multi-currency platform to facilitate domestic and international financial intermediation were in good progress. The absence of any hiccup in the interbank payment system on the payment and refund days of the Initial Public Offering (IPO) of the Industrial and Commercial Bank of China was quite an achievement.
- (d) On maintaining the status of Hong Kong as an international financial centre (IFC), the Focus Group on Financial Services discussed and endorsed the five-pronged strategy proposed by HKMA at the Economic Summit on "China's 11th Five-Year Plan and the

"Development of Hong Kong" (the Economic Summit). HKMA was working on the details for incorporation into the report and action agenda to be formulated by the Focus Group for submission to the Chief Executive of the Hong Kong Special Administrative Region Government by end 2006 or early 2007.

- (e) On management of the Exchange Fund (EF), EF set its priorities differently from other typical investment funds. Capital preservation, liquidity, full backing of the Hong Kong dollar Monetary Base and maintenance of the long-term purchasing power of the assets came before yield enhancement. A true and fair measurement of the investment performance of EF should be the difference between the rate of investment return of EF and that of the benchmark portfolio, i.e. the alpha. The alpha had been positive in the past seven years except in 2004 when it was zero. The investment income of EF in 2006 as at the end of September 2006 amounted to \$67.8 billion and the Treasury's share was \$19 billion. However, it must not be taken for granted that the Treasury's share for the whole year would exceed the original forecast of \$18.2 billion as financial markets remained uncertain in the fourth quarter of 2006.

Discussion

Hong Kong dollar exchange rate

16. Noting that according to HKMA's research findings, the US dollar continued to be the appropriate anchor for the Hong Kong dollar, Mr Jeffrey LAM enquired whether consideration would be given to adjusting the present level of LER (i.e. one US dollar against 7.80 Hong Kong dollars). In response, CE/HKMA reiterated that the position of the Government on maintenance of the LER System remained clear and firm, including both the anchor currency and the exchange rate for the link.

17. Referring to HKMA's research findings that significant variations in output and prices in Hong Kong could be explained by US shocks rather than Mainland shocks, the Chairman sought elaboration on the details of such findings. The Chairman opined that as Hong Kong was more reliant on the Mainland than US for supply of daily products such as food and other consumer goods, price movements in the Mainland should have a greater impact on prices in Hong Kong.

18. While the price movements in Mainland might have a greater impact on those in Hong Kong, CE/HKMA pointed out that the purpose of the research was to examine, from a macro-economic perspective, the synchronization of Hong Kong's business cycle with those of the Mainland and the US. As the degree of business cycle synchronization between two economies had important implications for the optimal monetary arrangement between them, the research findings would facilitate the consideration of the appropriate exchange rate anchor for the Hong Kong dollar to maintain exchange rate stability. The research

findings indicated that there was little correlation between business cycles in Hong Kong and the Mainland in the absence of common US shocks. As such, the conclusion of the research was that the US dollar continued to be the appropriate anchor for the Hong Kong dollar in the foreseeable future.

Appreciation of RMB and expansion of RMB business

19. Referring to an earlier comment by CE/HKMA in October 2006 that there was a 50% chance for the RMB exchange rate to hit the psychological level of 7.80 yuan against one US dollar within six months, Mr Jeffrey LAM enquired whether such an expectation would still be valid in the light of the recent appreciation of RMB.

20. CE/HKMA said his comment in October was based on the internal statistical analysis of HKMA. He pointed out that the recent appreciation of RMB breaking the psychological levels of 8.00 yuan and 7.90 yuan against the US dollar had only had very short-term effects on the Hong Kong dollar exchange rate. Hopefully, further appreciation of RMB to the psychological level of 7.80 yuan against the US dollar would not destabilize the exchange rate of the Hong Kong dollar. In response to Mr Jeffrey LAM's concern about the impact of the appreciation of RMB on the economy of Hong Kong, in particular the manufacturing sector with production plants in the Mainland, CE/HKMA said that the appreciation of RMB might result in higher costs for manufacturers with production plants in the Mainland. Nevertheless, as the appreciation of RMB was not too abrupt, CE/HKMA considered that the manufacturers should be able to prepare ahead and cope with the possible increase.

21. Responding to Mr Jeffrey LAM's further enquiry on HKMA's work in the expansion of RMB business in Hong Kong, CE/HKMA advised that HKMA had made preparatory arrangements for the expansion of RMB business and would continue to monitor progress. He pointed out that while it was understandable that people in Hong Kong were keen to seek expansion in the scope of RMB business, they must also appreciate the prudent approach adopted by the Mainland authorities in order to manage the risks that rapid financial liberalization might pose to the stability of the financial system in the Mainland.

22. On how long the interest rate differential between the Hong Kong dollar and the US dollar was expected to last, CE/HKMA advised that it would be difficult to make a forecast as the duration would hinge on factors like market expectation and reaction to the appreciation of RMB, in particular when the psychological level of 7.80 yuan against the US dollar would be reached. A modest interest rate differential between the Hong Kong dollar and the US dollar would not give rise to concerns on the part of HKMA. Nevertheless, given the interest rate differential and the highly competitive business environment, banks in Hong Kong might be under pressure to reduce interest rates at the retail level.

Economic adjustment and control measures implemented in the Mainland

23. Referring to some control measures recently implemented by the Mainland authorities such as those for control on the import and export of raw materials, Mr WONG Ting-kwong was concerned whether these control measures would have any impact on the financial and monetary position of Hong Kong. Mr WONG was particularly concerned about the new customs requirements on Hong Kong exporters to provide cash deposits, resulting in a large amount of capital being held up and causing cash flow difficulties for some businesses.

24. In reply, CE/HKMA advised that while market response to the macro-economic adjustment measures on the Mainland might have an impact on the Hong Kong dollar, the control measures for import and export mentioned by Mr WONG above would not have any significant impact on Hong Kong from the macro-economic perspective. Nevertheless, he appreciated the cash flow difficulties faced by the affected businesses and would try to explore appropriate channels to relay any specific concerns to the relevant authorities. CE/HKMA further pointed out that the monetary measures and administrative measures implemented in the Mainland under the latest round of macro-economic adjustment, if implemented effectively, would benefit the economy of Hong Kong. In his view, macro monetary measures such as control over interest rates and raising the reserve requirement ratio would be better tools for macro-economic management because ad-hoc administrative measures might delay the necessary economic adjustments and lead to greater magnitudes of the adjustments.

Maintaining Hong Kong as an International Financial Centre

25. Referring to the five-pronged strategy proposed by HKMA to maintain Hong Kong's status as an IFC, Mr Andrew LEUNG commented that the success of the strategy would hinge on whether Hong Kong could enhance its strengths in the provision of financial services to meet the challenges and competition posed by other financial centres in the Mainland such as Shanghai. In this connection, Mr LEUNG was concerned whether and how the financial markets of Hong Kong could attract fund raisers and investors from the Mainland. He was of the view that Hong Kong should leverage on its competitive strength by specializing in certain financial services so that Hong Kong and other financial centres in the Mainland would complement each other and achieve a win-win situation in striving to be the region's IFC.

26. In response, CE/HKMA highlighted that maintaining its position as an IFC was of strategic importance to Hong Kong and conscious efforts must be made to achieve this objective. CE/HKMA pointed out that the efficacy of financial intermediation in the Mainland markets had yet to be improved and there was a lack of quality financial instruments to attract investors. The financial markets of Hong Kong were popular capital-raising platforms for Mainland enterprises launching IPOs as their listing in Hong Kong would help enhance their international profile in terms of the standard of business operation, corporate governance and transparency. CE/HKMA considered that given the large demand for financial services in the Mainland, a win-win situation underpinned by a number of financial centres complementing each other's strengths could be

achieved for the financial development of the country. Apart from enhancing the inflow of fund raisers, investors and financial institutions from the Mainland to Hong Kong, it was also important that effort should continue to be made to enhance the access of Hong Kong financial institutions to the Mainland market.

27. Noting that the five-pronged strategy proposed by HKMA focused on developing financial services and strengthening financial-infrastructure links with the Mainland, Mr Ronny TONG was concerned that it was equally important to take active steps to attract fund raisers and investors from other neighbouring territories (such as the Philippines) in order that Hong Kong could continue to thrive as an IFC instead of merely a financial centre of China. In this connection, Mr TONG sought information on measures to enhance the financial markets of Hong Kong to attract enterprises in neighbouring territories to launch IPOs in Hong Kong.

28. In response, CE/HKMA advised that in view of the control measures on capital flow in place in the Mainland, it was necessary to take active measures to enhance the mobility of fund raisers and investors from the Mainland. On the other hand, investors from places like European and South East Asian countries were more mobile in terms of launching IPOs and fund-raising activities in Hong Kong. As to Mr Ronny TONG's view on the provision of one-stop service to facilitate overseas investors, CE/HKMA said that in addition to work of the Hong Kong Exchanges and Clearing Limited and the Securities and Futures Commission, the Focus Group on Financial Services of the Economic Summit had examined measures to further enhance Hong Kong's status as an IPO centre. On whether neighbouring territories were users of Hong Kong's financial services, CE/HKMA informed members that HKMA had been promoting the use of the payment and settlement systems in Hong Kong, such as the US dollar real time gross settlement system, through collaboration with central banks in the Asian region. He added that HKMA would make a joint announcement with a central bank in Asia shortly on further enhancement measures.

Property market

29. Referring to Chart 19 of the power-point presentation material provided by HKMA, Ms Emily LAU noted with concern the significant increases in property prices from the summer of 2003 (with 99% increase in prices of large residential flats and 148% and 90% increases in prices of offices and retail shops respectively). Ms LAU queried whether such a sharp increase in property prices was a healthy market development and whether it might jeopardize the Hong Kong financial market.

30. CE/HKMA highlighted that fluctuations in property prices were driven by market forces of demand and supply. The increase in property prices since the trough in 2003 might appear to be substantial in terms of percentage but the actual price levels still fell below the levels recorded before the burst of the property boom bubble in 1997. By way of illustration, CE/HKMA said that with an average of about 65% to 70% drop in property prices from the peak in 1997 to the trough in

2003, even a 100% increase in price from the level in 2003 would only raise the property price to about 70% of the 1997 level. Nevertheless, CE/HKMA assured members that HKMA would be mindful of the development of the property market and the possible emergence of a property bubble which might have an adverse impact on the stability of financial markets of Hong Kong.

31. Ms Emily LAU remained concerned about rising property prices and the possible adverse impact on the economy of Hong Kong if there was another burst of the property boom bubble. She commented that under the existing Application List system, the supply of land was not freely determined by market demand. She was concerned about the possible recurrence of a property boom bubble and whether the market could attain an equilibrium in property prices whereby problem of negative equity could be alleviated while maintaining a healthy property market.

32. CE/HKMA pointed out that in monitoring the number of mortgage loans in negative equity, the major concern of HKMA was the impact on banking stability instead of the level of property prices per se. Nevertheless, he was keenly aware of the need to prevent a recurrence of the property boom bubble which occurred in 1997 as this would cause considerable hardship to property owners and jeopardize stability of the banking system. Referring to the graphical analysis in Chart 20 of the power-point presentation material, CE/HKMA advised that by August 2006, the size of the hexagon showing the six key property market indicators remained considerably smaller than that in the second and third quarters of 1997. He confirmed that HKMA would continue to monitor changes in property prices and ensure that the banking sector observed the guideline on the 70% loan-to-value ratio for mortgage loans.

Management of the Exchange Fund

33. On the investment performance of EF, Miss TAM Heung-man considered the investment return on the low side and enquired whether the current investment strategy and benchmark portfolio of EF could be modified so that part of the reserves could be invested in higher return financial instruments while at the same time fulfilling the primary objective of EF to safeguard the exchange value of Hong Kong's currency. Ms Emily LAU expressed similar concern about the performance of EF.

34. In this regard, CE/HKMA advised that under the Exchange Fund Ordinance (Cap. 66) (EFO), the Financial Secretary (FS) was the Controller of EF and certain powers were delegated to the Monetary Authority (MA) for the management of EF. The investment strategy and benchmark portfolio of EF had been determined by balancing relevant factors including risk, liquidity and capital preservation. Devising a more aggressive benchmark portfolio would involve the complicated question of what constituted an "adequate" level of foreign reserves to be maintained for meeting the statutory objectives of EF. Given the number of external factors (such as geo-political tension) which might pose risks to currency stability, there was no easy answer to this question. From the perspective of MA

as the manager of EF, a higher level of foreign reserves would provide greater safeguard for currency stability. CE/HKMA said that a consensus of the community on the "adequate" level of foreign reserves to be maintained for meeting the objectives of EF must be reached before any changes to the investment benchmark were to be contemplated. While the balance of foreign reserves over and above the "adequate" level might be invested in higher-yield instruments, it was worth noting that such investments might involve lower liquidity and higher risks. CE/HKMA noted that there had been different views in the public on whether a more conservative or more aggressive investment portfolio for EF should be adopted.

35. Pointing out that the accumulated surplus of EF and the placement by the fiscal reserves to EF amounted to nearly \$800 billion, Ms Emily LAU enquired about the mechanism for transfer of income from EF into the general revenue. Miss TAM Heung-man expressed a similar concern. In response, CE/HKMA advised that the mechanism for transfer of EF to the general revenue or other funds had been specified under section 8 of EFO. On Ms Emily LAU's further enquiry on what constituted an "adequate" level of reserves, CE/HKMA said that he had discussed the subject of the appropriate level of foreign reserves with FS.

36. Ms Emily LAU requested HKMA to provide the latest figures on the accumulated surplus of EF and the placement by the fiscal reserves in HKMA's future briefings for the Panel. CE/HKMA responded that the requested information was already available to the public through a monthly press release on "Exchange Fund Abridged Balance Sheet and Currency Board Account".

(Post-meeting note: HKMA's written response dated 10 November 2006 to the request in paragraph 36 above was issued to members vide LC Paper No. CB(1)268/06-07(01) on 13 November 2006.)

37. Miss TAM Heung-man was of the view that the existing arrangement for sharing the investment income of EF with the Treasury should be improved with a view to providing a higher return on the placement by fiscal reserves. In response, CE/HKMA said that the sharing arrangement had been changed in the past. For example, the current sharing arrangement came into force in 1998-99, before which it was based on the payment of a fixed rate of interest to the fiscal reserves.

V Proposal on hosting of the 59th Session of the International Statistical Institute in 2013

(LC Paper No. CB(1)185/06-07(04) — Paper provided by the Administration

LC Paper No. CB(1)239/06-07(01) — Power-point presentation material provided by the Administration (tabled at the meeting and issued to members on 7 November 2006)

Briefing by the Administration

38. At the invitation of the Chairman, the Commissioner for Census and Statistics (C for C&S) gave a power-point presentation on the Administration's proposal to host the 59th Session of the International Statistical Institute (ISI) in 2013. He pointed out that ISI was a prestigious professional body which promoted the development of statistical standards and methods and their applications in the international statistical community. C for C&S also gave a brief introduction on the ISI Session, the hosting cities in the past, benefits to Hong Kong as the hosting city and the indicative financial implications for hosting the 59th Session of ISI as set out in the power-point presentation material (LC Paper No. CB(1)239/06-07(01)). He advised that the Administration would make a formal bid for hosting the 59th Session to ISI by February 2007 and it intended to seek the Finance Committee's (FC) approval in principle of the rough order of costs for hosting the event before making the formal bid. If the bid was successful, the Administration would make a separate submission to FC for approval of the actual financial commitment when the details were finalized, probably in 2009-10.

Discussion

39. The Chairman noted that the Administration intended to seek FC's approval in principle for the proposed financial commitment for hosting the 59th Session of ISI and that a detailed breakdown of estimated expenditure was not yet available at this preliminary stage. As such, he remarked that members of the Panel could at most express an indication of support in principle. In this connection, the Chairman was concerned whether more detailed information on the financial implications of the proposal would be provided for members' consideration in the Administration's submission to FC.

40. In response, C for C&S referred members to the indicative financial implications of hosting the 59th Session of ISI in the Annex to the paper provided by the Administration and advised that the estimated expenditure and income for the event had been worked out with reference to the experience of hosting past Sessions of ISI. The estimated total expenditure of \$25 million was broken down by major items such as venue, publicity, staff cost etc. in the Annex to the Administration's paper. C for C&S remarked that if the bid from Hong Kong was

successful, the Administration expected to receive an indication of initial support and the formal approval to host the event from the ISI Council in mid-2007 and 2009 respectively. The Administration would then hold further discussions with ISI on the host obligations and work out a more detailed budget for FC's approval, probably in 2009-10. In response to Ms Emily LAU's enquiry on the timetable for submitting the initial proposal to FC, C for C&S informed members that the Administration would seek FC's approval in principle of the rough order of costs at the FC meeting on 15 December 2006.

41. Referring to the experience of the Sixth Ministerial Conference of the World Trade Organization (WTO MC6) held in Hong Kong in December 2005, Mr WONG Ting-kwong asked whether the Administration would anticipate any difficulty in relevant arrangements associated with international events such as public security and order during the 59th Session of ISI if the event was to be held in Hong Kong.

42. In response, C for C&S advised that according to the experience of past Sessions of ISI, such as the 50th Session held in Beijing in 1995, there had not been difficulties arising from public security and order. Given that the purpose of the ISI Sessions was for local and overseas statistical practitioners to exchange expertise on statistical issues of mutual concern and the event would be participated mainly by senior officers of the official statistical agencies, professionals and academics, it was not expected that demonstrations or disorders similar to those happened during the WTO MC6 would occur during the ISI Session. C for C&S further said that the well-developed infrastructure in Hong Kong, including transport networks and facilities and venues for large scale conventions etc, should be able to cope with the event with about 2 000 participants. Hence, the Administration would not anticipate major difficulties in making the logistics arrangements for hosting the event.

43. While not objecting to the proposal, Ms Emily LAU questioned whether there were any standard policy guidelines/criteria for the Administration to assess whether it should host an international event which was initiated by a non-governmental and/or professional organization. Ms LAU was of the view that any proposals or invitations from non-governmental and/or professional organizations should be assessed against standard policy guidelines/criteria to ensure consistency and objectivity. This would also facilitate consideration of the relevant funding proposals by FC.

44. As far as the proposal in question was concerned, C for C&S highlighted that the ISI Session was regarded as the Olympiad of the international statistical community and it was a great honour for cities to be chosen as the host of the event. In addition to the tangible economic benefits, the Administration anticipated that the hosting of the event would benefit Hong Kong in general by raising its international profile and enhancing the professional standard and competitiveness in the statistical field. The Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)³ added that when considering to make a bid to host the 59th Session of ISI, the Administration had

taken into account all relevant factors including the economic and other intangible benefits to be brought about, as well as the fact that the event had been organized by the official statistical agencies of other cities. The majority of the hosting cities for past ISI Sessions were either the capital or major cities of the respective countries. The Administration therefore considered that the hosting of the event would enhance Hong Kong's collaboration with relevant professional bodies in the Asian region and the status of Hong Kong in the international arena of statistics.

Admin 45. At the request of Ms Emily LAU, the Administration undertook to incorporate, in its paper to be presented to FC, the following information:

- (a) Whether there were any standard policy guidelines/criteria for the Administration to assess whether it should host an international event which was initiated by a non-governmental and/or professional organization;
- (b) If the answer to (a) above was in the affirmative, to provide the guidelines/criteria, and illustrate with past examples of international events hosted by the Administration, on how the guidelines/criteria had been applied in assessing the hosting proposals as well as the financial resources involved for hosting the events; and how far the current proposal on hosting of the 59th Session of ISI could meet the guidelines/criteria; and
- (c) If the answer to (a) above was in the negative, to set out the criteria adopted by the Administration in assessing whether it should host the 59th Session of ISI.

46. Responding to Ms Emily LAU's enquiry on whether there were bids from other cities competing with Hong Kong to host the event, C for C&S said that in addition to Hong Kong, ISI had extended invitation to New Dehli, India for indication of interest in hosing the 59th Session of ISI. He further advised that ISI preferred the hosting of the event to be well spread over different regions in a balanced manner. To follow the past practice, ISI wished to have a Session held in a renowned Asian city in the 2010's and therefore extended an invitation to Hong Kong. As to how ISI would process relevant bids, C for C&S said that in considering the bids made by the potential hosting cities, i.e. Hong Kong and New Dehli, ISI might liaise with these two cities for discussion of the details of their bids before giving an indication of initial support followed by a formal approval to the successful bid.

VI The 2007-08 Budget consultation

(LC Paper No. CB(1)185/06-07(04) -- Information pack for the Financial Secretary's consultations on the 2007-08 Budget
(Tabled at the meeting and issued to members on 7 November 2006))

Briefing by the Financial Secretary

47. At the invitation of the Chairman, FS gave a power-point presentation on the background information for the 2007-08 Budget consultation. FS highlighted the following points:

- (a) On economic positioning and prospects, the Hong Kong economy was expanding solidly, with a 6.6% growth in Gross Domestic Product (GDP) for the first half of 2006, which marked the eleventh consecutive quarter that GDP growth had notably exceeded the trend growth of 3.9% over the past ten years. A mild growth close to the trend growth of about 4% was healthy for Hong Kong as rapid and continuous growth for a mature economy like Hong Kong would exert inflationary pressure on the economy. Consumer price inflation remained benign. The Composite Consumer Price Index (CCPI) rose by 2.1% in September over a year earlier and consumer price inflation averaged at 2% for the first nine months of 2006 as a whole. The economic outlook for the rest of the year was for a further expansion at a solid pace. It was anticipated that the Hong Kong economy should be able to attain 5% growth. The forecast rate of change in CCPI for 2006 was 2%, still a moderate level when viewed in conjunction with the robust pace of GDP expansion over the past two years.
- (b) On government financial position, both the Operating and Consolidated Accounts recorded a surplus in 2005-06 for the first time since 1997-98. The consolidated surplus for the year amounted to \$14 billion. It was anticipated that the Government would continue to achieve surplus in the Operating and Consolidated Accounts for the coming five years to 2010-11. Fiscal reserves by end-March 2007 would be \$316.3 billion and would rise gradually to 401.5 billion by end-March 2011. Nevertheless, given the substantial shrinkage (by \$190.3 billion) over the seven years from 1998 to 2005, the level of fiscal reserves in 2011 under the Medium Range Forecast (MRF) would be 21.9% of GDP while in 1998, the relevant percentage was 33.5%.

- (c) On recurrent expenditure, expenditure on education, social welfare, health and security together accounted for about 67.9% of the total recurrent government expenditure in the 2006-07 Original Estimates. Total recurrent expenditure increased by 39.6% over the past ten years, with the growth in recurrent spending on education and social welfare outpaced other policy areas. The Government would continue to earmark an average of about \$29 billion a year for spending on public works projects.
- (d) On the revenue side, profits tax and salaries tax together accounted for about 45% of government revenue. Such reliance on the income taxes would highly expose Hong Kong's public finances to variation in global economic cycles and external shocks. Non-tax revenue, which was primarily derived from land premium and earnings from the fiscal reserves, could not be relied upon to help Hong Kong get over the tax base deficiency as it was subject to volatility.
- (e) Over the past ten years, government revenue oscillated around \$170 billion to \$280 billion while on the other hand, there was a degree of rigidity in government spending. The share of tax revenue contributed by the top 100 000 taxpayers was expected to stay at 59.6% of the revenue from salaries tax in 2006-07 which was the same percentage share for 2004-05. The top 800 taxpaying corporations contributed 63.8% of the revenue from profits tax in 2004-05. The rapid ageing of the population (with the percentage of persons aged 65 or above expected to rise to 26.8% by 2033 from 12.1% in 2005) would lead to an increase in health care and social welfare expenditure for the elderly, and a decrease, in relative terms, in revenue from salaries tax.
- (f) When taking forward the current tax reform consultation and examining whether Goods and Services Tax (GST) was an appropriate option for Hong Kong, the Government had taken into consideration three principles of tax reform as set out in Chart 23 of the information pack.

Discussion

Economic positioning

48. Noting the information on the important shares of exports, tourism and stock market turnover in Hong Kong's economic growth (Chart 3 of the information pack), Mr James TIEN was concerned that with increasing integration with and reliance on the Mainland as a key growth driver of the local economy, Hong Kong might lose its competitive edge as an IFC and become merely one of the major cities in China. Whilst appreciating the opportunities and benefits brought to Hong Kong by the collaboration with the Mainland, Mr TIEN called on the Government not to overlook the need to sustain Hong Kong's position as an

IFC through active measures to attract investment from other parts of the world as well.

49. In this regard, FS advised that the integration of the economies of Hong Kong and the Mainland had brought opportunities, as well as challenges, for Hong Kong. The economic development of Hong Kong and that of the Mainland were inter-dependent and complementary to each other. To meet the challenges posed by the shift of production base and back-up services from Hong Kong to the Mainland where the costs for labour and land were far lower, FS pointed out that it was necessary for Hong Kong to move up the value chain and develop into a knowledge-base economy. To this end, more investment in education would be required to nurture and train the needed talents. Referring to local and foreign media reports and articles on the potential of the financial market of Hong Kong to outperform those of New York and London, FS expressed optimism that Hong Kong should be able to sustain its position as an IFC with the concerted effort of all sectors of the community.

Level of fiscal reserves and Treasury's share of investment income of the Exchange Fund

50. Ms Emily LAU pointed out that the accumulated surplus of EF together with the balance of the fiscal reserves amounted to nearly \$800 billion. She enquired whether the Administration would work out the appropriate level of reserves to be maintained so that the amount in excess of that level could be transferred to the general revenue. Ms LAU recalled that she had asked CE/HKMA a similar question during his briefing on the work of HKMA earlier at the meeting and was informed by CE/HKMA that he had discussed the subject of the appropriate level of foreign reserves with FS, who was the Controller of EF.

51. Mr James TIEN expressed similar concern. Noting that Hong Kong did not have to bear expenses in areas like national defence and was by and large free from devastating natural disasters, Mr TIEN was of the view that transferring part of the accumulated surplus of EF to the general revenue would provide the Government with the necessary financial resources to cope with future economic downturns. Such an arrangement would also remove any imminent need on the part of the Government to broaden the tax base for the purpose of seeking sustainable revenue.

52. FS advised that as the Controller of EF, he was responsible for ensuring that the statutory objectives of EF would be achieved. Given the primary objective of EF to maintain currency stability, FS pointed out that an adequate level of foreign reserves must be maintained to preserve local and overseas confidence in the Hong Kong dollar. EF's ability to meet its objective would be reviewed from time to time taking into account the changing international monetary environment and the latest developments of the financial markets with a view to striking a proper balance between returning part of the wealth to the people of Hong Kong and maintaining currency stability. As regards expenditure on national defence, FS said that contrary to common perception, national defence did not take up a

very substantial portion of government expenditure. For example, the expenditure of the United States in this area only amounted to about 4% of its GDP. He stressed that the Government was committed to keeping public expenditure within an appropriate percentage of Hong Kong's GDP. At present, the public expenditure was equivalent to about 17.7% of GDP, which was within fiscal targets.

53. Noting from Chart 11 of the information pack that the fiscal reserves by end-March 2007 would be \$316.3 billion, equivalent to 15 months of government expenditure, Miss TAM Heung-man enquired whether FS would devise an indicator or threshold of fiscal reserves whereby the Government would spend the "amount in excess" in policy areas like education and social welfare in order to return wealth to the people.

54. In response, FS recapped that in his first budget for the 2004-05 financial year, the estimates of fiscal reserves under the MRF only ranged from seven to ten months of government expenditure due to the fiscal deficit faced by the Government at that time. The level of fiscal reserves amounted to 33.5% of GDP before the economic downturn in 1997 and was now only 21.8% of GDP. Given the volatility in Government revenue, FS said that the question of the appropriate level of fiscal reserves to be maintained as a percentage of GDP had to be examined in greater detail and he would listen to the views of Members and the public.

55. As to Miss TAM Heung-man's concern about expenditure on education and social welfare, FS pointed out that the Government attached great importance to these two policy areas. By way of illustration, the growth in recurrent spending in education and social welfare over the past ten years had outpaced other policy areas, amounting to 40.5% and 109.7% respectively of the total recurrent government expenditure which had only increased by 39.6%. The growth in spending for social welfare still exceeded 90% having disregarded the growth in expenditure relating to the Comprehensive Social Security Assistance (CSSA) Scheme and other social security schemes.

56. The Chairman opined that to secure more stable government revenue, FS should explore with CE/HKMA possible changes to the existing arrangement of sharing of investment income of EF with the Government. One option might be to fix an annual fee as the Government's share. The Chairman recalled that this and other suggestions had been put forward to FS for consideration some time ago but no progress had been announced so far.

57. In reply, FS pointed out that despite the volatility of the financial markets in the last three years since he had taken up the office as FS, there had not been significant variations in the Government's share of EF's investment income (which was \$14.7 billion, \$10.4 billion and a forecast of \$18.2 billion in 2004-05, 2005-06 and 2006-07 respectively). He had examined with CE/HKMA from time to time feasible options for achieving a more stable return from the fiscal reserves in EF, such as investing part of EF in higher return financial instruments without

undermining the objective of safeguarding currency stability; or setting a fixed amount of annual return for the Government. In this connection, FS highlighted that any change to the existing sharing arrangement would be a significant policy change which should not be resorted to lightly in the near future in order not to pre-empt the policy decision of the next term of Government.

Addressing problems of poverty and widening wealth gap

58. Noting from Chart 19 of the information pack that from 1997-98 to 2006-07, the taxpaying population was on the decrease while the working population outside the salaries tax net was rising, Mr WONG Kwok-hing opined that this was a reflection of working poverty and a widening gap between the rich and the poor. He urged the Administration to take into consideration the hardship faced by low-income workers and to introduce measure in the 2007-08 Budget to alleviate the problem of poverty.

59. Noting Mr WONG's concern, FS stressed that the Administration had attached much importance to addressing poverty. The Commission on Poverty (CoP) had been working in collaboration with relevant government departments and non-governmental organizations to devise appropriate support measures. He pointed out that the primary objective of the various support measures was to provide a safety net for the needy and to achieve self-reliance in the long run. To this end, training and re-training programmes to help the unemployed or low-income workers to acquire the necessary job skills or upgrade their qualifications had been one of the core tasks of the Administration and CoP. Responding to Mr WONG's further concern about tax relief measures, FS pointed out that as a large proportion of the working population was outside the salaries tax net, the introduction of tax relief measures might not benefit low-income workers.

60. Mr Ronny TONG pointed out that as a result of deflation, the standard rates of CSSA had been reduced in 2003. With the recent economic recovery, Mr TONG urged the Administration to adjust upward the standard rates of CSSA to the 2003 level so that the purchasing power of CSSA recipients would be maintained. Mr TONG also noted with concern the increase in CSSA payment despite the reduction in standard rates and questioned whether this was the result of an increase in the number of CSSA recipients, reflecting a widening wealth gap in Hong Kong.

61. In response, FS explained that reviews of the CSSA standard rates were conducted in accordance with an established mechanism, based on the movements of the Social Security Assistance Index of Prices (SSAIP). He advised that as revealed in the statistics on adjustments of CSSA standard rates and the movements in SSAIP, the purchasing power of CSSA recipients had not been eroded in recent years as the extent of reduction in the standard rates had been smaller than the deflation rate.

62. Mr Ronny TONG further commented that the existing adjustment mechanism might not reflect adequately changes in the expenditure pattern of

CSSA households over the years and therefore should be reviewed. In this regard, FS advised that the existing adjustment mechanism had been working well in ensuring the maintenance of a basic standard of living for CCSA recipients. Any proposed changes in the component items for SSAIP would involve the fundamental question of what should be regarded as a reasonable standard of living for CSSA households as compared with non-CSSA households. A review of the adjustment mechanism would therefore involve major policy considerations under the purview of the Health, Welfare and Food Bureau.

63. Noting that the recurrent expenditure on social welfare had grown by more than 90% after discounting the expenditure on CSSA and other social security schemes, Mr Bernard CHAN said that according to the feedbacks he had received, the social welfare sector did not subscribe to the view held by the Administration about the double digit growth. For further illustration, FS advised that the total expenditure on social welfare in 1996-97 and 2006-07 was \$16.5 billion and \$34.6 billion respectively (i.e. an increase of 109.7%) while the expenditure after disregarding expenditure on CSSA and other social security schemes in 1996-97 and 2006-07 was \$5.3 billion and \$10.1 billion respectively (i.e. an increase of 90.6%).

Management and planning of public finances

64. Noting that FS's current term of office would be up to June 2007 only, Ms Emily LAU was concerned whether FS would be in a position to make financial planning for the Government for the entire financial year of 2007-08 in the coming Budget to be released in February 2007. In reply, FS said that he would prepare a Budget for the 2007-08 financial year and provide a MRF for the period 2007-08 to 2011-12. However, he would leave as much room as possible for the next government with regard to public finance management and various budgetary measures.

65. Miss TAM Heung-man recalled that according to the value-for-money audits conducted by the Director of Audit, there was room for further compressing expenditure and increasing operational efficiency in some government departments. In this connection, Miss TAM was concerned whether FS would propose relevant measures to improve the cost-effectiveness in the delivery of public services in the 2007-08 Budget.

66. In response, FS advised that all along, he had developed his budgetary proposals on the basis of the principle of "prudent management of public finances and keeping expenditure within revenue limits". As a result of the effort of the civil service and the support of the community, the Government had, for the second successive year, achieved reduction in operating expenditure. This achievement was by no means an easy task for any government in the world. He stressed that the Government was committed to managing public finances prudently and would spare no effort in taking forward the recommendations of the Director of Audit and/or the Public Accounts Committee in seeking to improve the cost-effectiveness in delivering public services.

67. Mr Bernard CHAN opined that apart from heavy reliance on income taxes, fluctuations in other important sources of revenue (e.g. revenue derived from land premium) would constrain the Government's ability in planning and management of public finances in the longer term. FS agreed that premium from land sale and other related revenue such as rates and stamp duty were subject to fluctuations in the economic cycle and the property market. The revenue from land premium actually fluctuated from its high level of \$71.4 billion in 1997-98 to \$5.4 billion in 2003-04. The variations in revenue (including tax and non-tax revenue) in the light of the prevailing macro-economic conditions were very much beyond the control of the Government and would pose uncertainty and constraint on its fiscal planning.

Delivery of public works projects

68. Referring to Chart 14 of the information pack, Mr WONG Kwok-hing pointed out that the average of about \$29 billion earmarked for public works projects each year had not been fully utilized, as evidenced by the slow progress in implementing these projects, in particular those planned for the new towns. Mr WONG also expressed grave concern about the unemployment problem in the construction sector and urged the Administration to expedite the implementation of public works projects so that more employment opportunities would be created for the building and construction sector.

69. In response, FS highlighted that the Government was committed to taking forward public works projects in an expeditious manner in order to facilitate economic development, job creation as well as improvement in the living environment. In fact, a number of public works projects of different scales were in the pipeline. Nevertheless, FS drew members' attention to certain statutory requirements and procedures that were applicable to public works projects, notably those relating to environmental impact, reclamation and public consultation, which must be complied with before the projects in question could be taken forward. Public debates and discussion on project design and scope also took time before any broad support or consensus could emerge. This partly explained why some mega projects (such as the Kai Tak Development) had been put on hold for some time.

70. Miss CHAN Yuen-han did not subscribe to FS's explanation that public debates had held up the delivery of public works projects. Taking the example of the Kai Tak Development, Miss CHAN was of the view that had the Administration been more sensitive to public sentiment about preserving the harbour, it would not have put forward a planning proposal involving large-scale reclamation; and the need to redesign the project to comply with the Court of Final Appeal ruling could have been obviated.

71. In this connection, Ms Emily LAU remarked that the outstanding projects of the Ex-Municipal Councils had the support of the respective District Councils and the Legislative Council. The Administration should therefore expedite the delivery of these projects. In reply, FS supplemented that among the public work

projects taken forward by the Administration, quite a number were outstanding projects of the Ex-Municipal Councils.

Property market

72. Referring to the information provided by HKMA on the increases in property prices from 2003 to 2006 (an increase of 148% and 90% in prices of offices and retail shops respectively), Ms Emily LAU sought FS's view on whether the significant increases would give rise to a cause for concern. Pointing out that under the existing Application List system, the supply of land was not freely determined by market demand, Ms LAU questioned whether there was any room for change in the system for land sale.

73. In response, FS advised that the operation of the Application List system was to meet market demand. Sites at prime locations for commercial development were available in the Application List if there was such a demand by developers. By way of illustration, recent applications by private developers for sale of three sites in the Application List had been successful and these sites would be put up for auction shortly. Responding to Ms Emily LAU's further enquiry on the circumstances under which the Administration would consider other options for land sale, FS said that while the Application List system had been operating effectively so far, the Administration would monitor its operation and would not rule out the possibility of making adjustment and/or improvements where appropriate.

74. The Chairman pointed out that if members so wished, the operation of the Application List system could be referred to the Panel on Planning, Lands and Works (PLW Panel) for follow-up. As requested by Ms Emily LAU and with no objection from other members, the Chairman directed the Clerk to refer the subject to the PLW Panel.

(Post-meeting note: The subject had been referred to the PLW Panel for follow-up as agreed in paragraph 74 above.)

Tax reform proposals

75. Miss CHAN Yuen-han said that to cope with the challenges of a rapidly ageing population and globalization, it was time for the Government to put in place necessary measures to prepare for the rainy days should future economic crises occur. Referring to the option of GST in the tax reform consultation, Miss CHAN said that as the community at large had expressed objection to the proposal, the Government should consider other tax reform options, including progressive rates for profits tax and capital gains tax, instead of putting forward GST as the only option. Moreover, Miss CHAN urged that in considering appropriate tax reform options, the Government should ensure that the principle of "ability-to-pay" be observed so that those who were more capable of paying would shoulder a greater tax burden.

76. Ms Emily LAU expressed similar concern. She stressed that the principle of fairness and "ability-to-pay" should be strictly adhered to in considering options to broaden the tax base. Referring to the Final Report of the Advisory Committee on New Broad-based Taxes (the Advisory Committee) issued in February 2002, Ms Emily LAU urged the Administration to re-visit the 13 other options in addition to GST examined by the Advisory Committee (and other possible options proposed), such as tax on dividends and capital gains tax, instead of putting forward GST as the only proposal. To facilitate in-depth discussion by the community on the merits or otherwise of different tax options, Ms LAU considered that the Administration should provide the necessary background information and statistics for public reference. Miss CHAN Yuen-han was also of the view that the other tax options explored by the Advisory Committee should be critically re-considered.

77. FS referred to Chart 23 and pointed out that apart from the fairness and the "ability-to-pay" principle, the Administration would also take into consideration the principles that the reform proposal should be able to produce stable and substantial revenue to respond to future needs and to maintain Hong Kong's simple and low tax regime and international competitiveness. He stressed that the three principles of tax reform were inter-related and assured members that the Government would observe these principles in examining any options for tax reform. He pointed out that progressive rates for profits tax would not broaden the tax base as this would only increase tax payment by the same group of taxpaying corporations. Mr James TIEN agreed that introducing progressive rates for profits tax was not an option for broadening the tax base.

78. FS further assured members that the Government had an open mind to various options for broadening the tax base and would welcome views from the community. As a responsible Government, the current public consultation had been launched to stimulate public discussions on the important but controversial subject of tax reform. The Administration hoped that after public discussion, an acceptable regime could be found.

79. Mr WONG Ting-kwong considered that the implementation of GST might complicate the simple tax regime which was one of Hong Kong's competition edges. He therefore doubted whether it would be practicable for the Administration to take forward the tax reform in accordance with the principle of maintaining a simple and low tax regime without undermining the international competitiveness of Hong Kong. In response, FS advised that the proposed feature of a GST as set out in the consultation document released in July 2006 would be a simple tax with a high turnover threshold for registration and low compliance cost for businesses. As such, the Administration considered that the implementation of a GST with the proposed features would be consistent with the principle of maintaining a simple and low tax regime.

80. Ms Emily LAU suggested that the Panel on Financial Affairs should arrange to discuss the alternative tax reform options at a meeting as soon as possible. Miss CHAN Yuen-han supported Ms LAU's view. The Chairman said

that as the public consultation on the tax reform was underway, it would be a better arrangement if the Panel would discuss the subject when the Administration was ready to report the outcome of the consultation to the Panel. Members had no objection.

81. FS advised that since the launch of the public consultation in July, some of the objectives of the consultation exercise had been achieved. For example, rational discussions on the subject of tax reform had been stimulated. The community had also expressed their views and concerns on the proposed implementation of a GST and requested further consideration of other tax options examined by the Advisory Committee. FS said that an interim report on the consultation would be released. Ms Emily LAU welcomed the issuance of an interim report by the Administration to facilitate in-depth discussion of the tax reform options. The Chairman re-stated his invitation to FS to report to the Panel on the outcome of the consultation in due course.

(*Post-meeting note:* The interim report on the public consultation on tax reform was issued to members vide LC Paper No. CB(1)438/06-07 on 5 December 2006).

Assistance for small and medium enterprises

82. Noting from Chart 20 of the information pack that most small businesses paid little or no tax, Mr WONG Kwok-hing said that the small and medium enterprises (SMEs) were operating in a very difficult business environment with low profit margin and high rent. He pointed out that many retail shops operating in premises managed by The Link Management Limited had to cope with difficulties in increases in rental. As the majority of enterprises in Hong Kong were SMEs, Mr WONG urged the Administration to devise measures to facilitate the growth of the local economy and to provide a more business-friendly operating environment for SMEs.

83. In response, FS expressed recognition for the contribution of SMEs to the economy as they constituted some 98% of the business enterprises in Hong Kong. The Administration had already implemented a series of business facilitation measures for SMEs. As to Mr WONG Kwok-hing's concern about the high rental cost borne by SMEs, FS pointed out that the subject must be examined in a cautious manner as any form of market intervention by the Government might bring about unintended adverse consequences. Referring to the information in Chart 20, FS elaborated that an uneven distribution of profits tax burden was observed, under which only 63 000 out of some 230 000 economically active corporations were taxpaying and some 60% of the profits tax income was contributed by the top 800 taxpaying corporations. Hence, in considering appropriate tax reform options, such as the suggestion of introducing progressive rates for corporate profits tax, the Government would need to take into account the three principles set out in Chart 23, as well as make reference to the existing sources of revenue and the distribution of tax burden among taxpaying corporations.

VII Any other business

84. There being no other business, the meeting ended at 12:25 pm.

Council Business Division 1
Legislative Council Secretariat
4 January 2007