

Ref : CB1/PL/FA/1

**Legislative Council  
Panel on Financial Affairs**

**Minutes of meeting held on  
Tuesday, 8 June 1999, at 2:30 pm  
in the Chamber of the Legislative Council Building**

- Members present** : Hon Ambrose LAU Hon-chuen, JP (Chairman)  
Hon Eric LI Ka-cheung, JP (Deputy Chairman)  
Hon Kenneth TING Woo-shou, JP  
Hon James TIEN Pei-chun, JP  
Hon Cyd HO Sau-lan  
Hon Albert HO Chun-yan  
Hon Martin LEE Chu-ming, SC, JP  
Hon NG Leung-sing  
Hon Margaret NG  
Hon CHEUNG Man-kwong  
Hon Ambrose CHEUNG Wing-sum, JP  
Hon HUI Cheung-ching  
Hon Bernard CHAN  
Hon SIN Chung-kai  
Dr Hon Philip WONG Yu-hong  
Hon Timothy FOK Tsun-ting, JP  
Hon FUNG Chi-kin
- Members attending** : Hon LEE Cheuk-yan  
Hon Fred LI Wah-ming  
Hon CHAN Kam-lam  
Hon LAU Chin-shek, JP
- Members absent** : Hon David CHU Yu-lin  
Dr Hon David LI Kwok-po, JP  
Hon Ronald ARCULLI, JP  
Hon James TO Kun-sun  
Hon Jasper TSANG Yok-sing, JP
- Public officers** : Agenda item IV

**attending**

Mr Rafael S Y HUI  
Secretary for Financial Services

Mrs Rebecca LAI  
Deputy Secretary for Financial Services (1)

Mr Bryan P K CHAN  
Principal Assistant Secretary for Financial Services  
(Securities)

Agenda item V

Ms AU King-chi  
Deputy Secretary for Financial Services (2)

Ms Julina CHAN  
Principal Assistant Secretary for Financial Services  
(Companies)

Agenda item VI

Miss Denise YUE  
Secretary for the Treasury

Mrs Lesley Y C WONG  
Principal Assistant Secretary for the Treasury

Agenda items VII and VIII

Mr M M GLASS  
Deputy Secretary for the Treasury

Agenda item VII

Mr M J T ROWSE  
Director of Business & Services Promotion Unit

Mr Roy TANG  
Principal Assistant Secretary for Transport

**Attendance by invitation** : Agenda item IV

Mr Andrew SHENG  
Chairman, Securities and Futures Commission

Mrs Laura CHA, JP  
Deputy Chairman  
Securities and Futures Commission

**Clerk in attendance** : Ms Estella CHAN  
Chief Assistant Secretary (1)4

**Staff in attendance** : Ms Connie SZETO  
Senior Assistant Secretary (1)1

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**I Confirmation of minutes and matters arising**  
(LC Paper Nos. CB(1)1266 and 1428/98-99)

The minutes of the meetings held on 7 December 1998 and 7 January 1999 were confirmed.

**II Information papers issued since last meeting**  
(LC Paper No. CB(1)1369/98-99 - Final Report on Strategies for Reviving the Japanese Economy)

(LC Paper No. CB(1)1401/98-99 - Publications from the Stock Exchange of Hong Kong)

2. Members noted that the above information papers had been issued since last meeting.

**III Items for discussion at the next meeting**  
(LC Paper Nos. CB(1)1429/98-99(01) and (02))

3. Members agreed to discuss the following items at the next regular meeting scheduled for Monday, 5 July 1999 -

- (a) Progress of development of Growth Enterprises Market;
- (b) Banking Sector Consultancy Study;

- (c) The Composite Securities and Futures Bill; and
- (d) Regulatory mechanism for auditors.

Due to the numerous items on the agenda, members agreed that the meeting would start early at 9:45 am.

*(Post-meeting note: A new item on Exchange Fund Investment Limited's proposal to dispose the securities acquired during the August 1998 operation was subsequently added to the agenda. The meeting was further advanced to start at 9:00 am.)*

4. The Chairman reminded members that a special meeting had been scheduled for 11 June 1999, at 9:30 am to receive a briefing from the Financial Secretary (FS) on the overall economic development of Hong Kong.

5. Members noted the list of follow-up actions prepared by the Secretariat to facilitate the Panel in monitoring actions undertaken by the Administration which were still outstanding.

#### **IV Securities and Futures Market Reform** (LC Paper No. CB(1)1427/98-99(03))

6. The Secretary for Financial Services (SFS) briefed members on the progress of the three-prong reform of the securities and futures market announced by FS in his 1999-2000 Budget Speech. In respect of the market regulatory reform, he said that it would be built upon the earlier draft Composite Securities and Futures Bill (the Bill) put forward by the Securities and Futures Commission (SFC). The Panel would be briefed on the Bill in more detail at its meeting on 5 July and the industry would be consulted. The Administration aimed at introducing the Bill into the Legislative Council (LegCo) by the end of 1999. As regards progress of the market structure reform to demutualize and merge the two Exchanges and their associated Clearing Houses into a new holding company (NewCo), SFS informed that the Coordinating Committee on Market Structure Reform (CCMSR) had held meetings to discuss important issues, such as the public function of NewCo, its corporate governance structure, trading rights under NewCo, and rationalization of regulatory functions between SFC and NewCo. While the Administration considered that the valuation exercise was a commercial process to be left to the Exchanges and other relevant parties, it was carefully considering the public policy aspects of the reform with a view to protecting the wider public interests and enhancing the overall economy of Hong Kong.

7. Concerning the reform to upgrade the market infrastructure, the Chairman of SFC (C/SFC) said that the Steering Committee on Enhancement of Financial Infrastructure (SCEFI) had been looking at key issues including the setting up of a single clearing arrangement, the feasibility and technical requirements for straight

through processing across the financial market, and the introduction of a scripless securities market. Two subcommittees on market users and financial technology had been set up. The two subcommittees had respectively held four and six meetings to discuss issues of their concern. SCEFI would submit its recommendations and implementation timetable to FS by mid-September 1999.

8. Mr Eric LI opined that in order to convince market users that they would benefit from the various market reforms, the Administration would need to quantify benefits, say in terms of actual savings in transaction cost, the number and price of shares of NewCo available for public offering, etc.

9. In response, C/SFC stressed that upgrading of market infrastructure would benefit the market. For instance, enhancement in the financial technology architecture would improve settlement efficiency in stock transaction and reduce risk. The current settlement requirement in Hong Kong was two days after the transaction date, i.e. T+2, vis-a-vis T+3 in most overseas markets. As many overseas markets were planning to move to T+1 in 2001, it would imply that Hong Kong might need to move to T+0. He said that SCEFI would take reference from international experience to maximize the benefits of the financial infrastructure reform to the market and its users.

10. SFS re-iterated that the market structure reform would be in the best interest of Hong Kong, the Exchanges and their members through improvements in the governance structure of NewCo, separation of trading right from ownership of NewCo, and the listing of NewCo on the stock exchange. Details of these respective areas would be worked out when the reform progressed.

11. Mr CHEUNG Man-kwong was concerned that the market structure reform might not proceed according to the Administration's timetable, under which the listing of NewCo was to be achieved by September 2000, in view of the complexity of the legislative proposals requiring detailed scrutiny by LegCo before its term ending in June 2000, and the difficulty in rallying support from members of the Exchanges for the merger proposal. He enquired about alternative actions to be taken by the Administration in the event that members of the Exchanges voted against the proposal. Mr Ambrose CHEUNG, quoting the Australian Stock Exchange as an example, which took over two years to complete its listing process, considered the Administration's timetable too hasty and unrealistic.

12. SFS said that the Exchanges and the securities industry were, in general, supportive of the principle of the market structure reform. LegCo Members had also expressed their strong support at the motion debate on the issue on 5 May 1999. It was recognized that failure to implement the strategic reform was not an option for Hong Kong as competition from other financial centres and the emerging alternative trading technology would rapidly erode Hong Kong's competitive advantages and adversely affect Hong Kong's status as a regional and international financial centre. On the other hand, satisfactory progress had been

made since the merger proposal was announced in March 1999. The Administration was optimistic that difficult issues could be resolved on a timely basis and that the reform would be implemented on schedule. Without prejudging the voting results of the Exchanges, SFS remarked that the Administration would be fully prepared to pursue alternative actions to achieve the primary objectives of the strategic reform should the process fail to deliver the intended results. He pointed out that some of the possible alternatives had already been highlighted in the Policy Paper on Securities and Futures Market Reform (the Policy Paper) released in March.

13. Noting that it would be essential for NewCo to be commercially oriented and allowed to make profit, Mr NG Leung-sing enquired about the proposed structure and regulation of NewCo for maintaining an appropriate balance between the company's profitability and overall interest of the public.

14. SFS said that an appropriate corporate governance structure and a regulatory control scheme would be put in place to ensure a right balance between NewCo's public and commercial goals. The board of directors, being the policy-setting and the highest decision-making body of NewCo, would comprise representatives of the shareholders, market users, investors, as well as independent individuals drawn from professions related to the industry as well as from the community at large. There would also be Government appointed representatives. Although members of the Exchanges would be the initial shareholders of NewCo, as NewCo's ownership diversified over time through the listing and trading of its shares in the stock market, representation of shareholders' interest in the board would also increase. Since NewCo would be allowed to retain the current monopoly status of the Stock Exchange of Hong Kong (SEHK) over the stock market, its operation would be subject to regulatory control of SFC. The regulation would strike a proper balance between restrictions which were required for reasons of public interest and the need to pursue NewCo's commercial objectives. The important public roles of NewCo and the regulatory framework for the new market structure were under discussion by CCMSR. The details would be incorporated into the legislative proposals as were necessary to implement the reform.

15. Mr HUI Cheung-ching sought the Administration's view on SEHK's suggestion that the valuation of SEHK for the purpose of allocating shares in NewCo should include an appropriate portion of the assets of the Hong Kong Securities Clearing Company Limited (HKSCC). The Deputy Secretary for Financial Services(1) advised that the status of HKSCC in the valuation exercise had been clearly spelt out in the Policy Paper. She stressed that while HKSCC would be integrated into NewCo, the process would not involve any allocation of shares in NewCo in respect of HKSCC. She further clarified that notwithstanding that SEHK and five banks were members of HKSCC, HKSCC was at present a non-profit making company limited by guarantee which had no issued shares and, accordingly, no shareholders or owners. In the event that HKSCC was wound up, its assets would have to be transferred to a new clearing house or given to a charity

body and none of its members would have any right to receive any dividend or distribution of assets and profit. Although SEHK and the five banks had respectively provided loans of \$150 million to finance the establishment of HKSCC, all loans had been repaid in full by 1993-1994, i.e. within the first five years after the establishment, together with interest calculated at the then prevailing prime rate plus 2%. The loan provided by SEHK had been funded by its reserves which were partly made up by its income from transaction levies.

16. Notwithstanding NewCo's monopoly status in the domestic securities market, Mr FUNG Chi-kin was concerned that globalization of financial activities enabling investors to diversify their trading through various markets and rapid development of new modes of trading, such as through the Internet, would undermine the monopoly position of NewCo. In order to ensure business for NewCo, he suggested to explore the feasibility of requiring overseas trading of locally listed shares to be cleared and settled in Hong Kong. Mr Martin LEE also sought the Administration's views on competition from other major financial centres in the region, such as Singapore.

17. SFS responded that the Administration recognized the need to allow NewCo to maintain the SEHK monopoly status to enable it to operate in an internationally competitive environment. However, NewCo had to evolve and devise appropriate strategies to lower transaction cost, to improve efficiency and to develop new products and services so as to compete with other financial centres and new modes of trading. He further remarked that while competition from new modes of trading systems might pose a threat to the traditional market, it was unlikely that exchanges would be completely replaced as their attractions, including high liquidity, better risk management and investor protection systems still remained. C/SFC supplemented that the success of NewCo in maintaining its monopoly position and its competitiveness vis-a-vis other financial markets would depend on its ability to develop and diversify its products that could attract investors worldwide. The presence of international demand for its products would ensure viability of NewCo.

18. On competition from Singapore, SFS remarked that Hong Kong's and Singapore's markets had their respective strengths and that their economic systems as well as market regulatory frameworks were very different, it would be inappropriate to make a direct comparison of their competitive edges. While Singapore enjoyed the geographical advantage due to its central position in Southeast Asia, the Mainland as the hinterland of Hong Kong, had offered numerous opportunities for developing the Hong Kong market. Moreover, Hong Kong was a truly internationalized city meeting world standards and was fully committed to upholding an open and free market and maintaining a level playing field. Indeed, with global investors' increasing desire to trade around the clock, large financial markets in the U.S. and Europe, due to their high liquidity and depth, would capture much of the business. It would work to the common interests for Asian markets operating within the same time-zone to co-operate rather than to

compete among themselves, and to form into strategic alliances which would be conducive to the development of a vibrant Asian market.

19. On the broader issue of positioning Hong Kong's securities and futures market for the next millennium, Mr Ambrose CHEUNG enquired whether the Administration's target was to enhance Hong Kong's status as a major international financial centre or the regional centre in Asian.

20. C/SFC remarked that the mission of Hong Kong's securities and futures market involved the performance of three inter-related roles namely, to serve as the capital raising centre for the Mainland, to excel as the leading financial centre in Asia and to reinforce its position as a global financial centre. To achieve these aspirations, Hong Kong would need to step up its efforts to attract Mainland issuers to list in the local market, to develop the debt and money markets, as well as to promote and offer diversified products which would attract global investors.

21. Mr Albert HO stressed the importance of providing training to improve the standard of professionals serving in the financial services industry and to prepare new recruits for the industry. C/SFC said that recognizing the importance of ensuring an adequate supply of human resources of the right calibre for the financial services sector, SFC had been heavily investing in education and training for market practitioners and participating in the formation of the Financial Services Institute.

## **V Report on Consultation on Proposed Statutory Procedures for Corporate Rescue** (LC Paper No. CB(1)1427/98-99(04))

22. Members noted that the Panel was consulted at its meeting on 1 February 1999 on how employees' outstanding entitlements should be settled if a company which owed these debts initiated a corporate rescue procedure. Such a procedure as recommended by the Law Reform Commission (LRC) involved the introduction of statutory 'provisional supervision' (PS) of the company to allow for the working out of a voluntary arrangement that would assist a viable business to survive, thus saving it from going straight into liquidation. During PS, a moratorium of 30 days, which could be extended subject to creditor or court approval, would be imposed to prevent individual creditors including employees from exercising their normal right to take proceeding of winding up the company. Four options had been put forward in the consultation exercise namely, Option A (LRC's proposal), to use the Protection of Wages on Insolvency Fund (PWIF) to meet outstanding claims from employees; Option B, to require the employer to clear all arrears/statutory entitlement of laid off employees prior to the company undergoing corporate rescue; Option C, to give employees the right to petition to wind up the company even when corporate rescue was invoked and allow them to make claim on PWIF; and Option D, to use PWIF to pay laid off employees and to

recoup the full amount from the company as priority debt in a voluntary arrangement among creditors.

23. The Deputy Secretary for Financial Services (2) (DS/FS(2)) said that after considering all views received the Administration had decided to adopt Option B. It would proceed with drafting the necessary legislation for introducing the corporate rescue procedure and submit the bill to LegCo by the end of 1999.

24. Mr Eric LI conveyed the Hong Kong Society of Accountants (HKSA)'s reservations over Option B. The option was considered unworkable due to the impracticability of demanding a financially troubled company to pay a lump sum upfront to clear its indebtedness to employees. Such requirement would undermine the success of the rescue for the company and was unfound in corporate rescue schemes of other jurisdictions. He requested the Administration to provide local and overseas examples which had succeeded in carrying out the rescue plan with such an arrangement.

25. On the rationale for adopting Option B, DS/FS(2) explained that all of the 26 submissions received were in support of the principle of a corporate rescue scheme recognizing the more benefits it would offer to a financially troubled company, its employees and creditors than those available under a liquidation procedure. The insolvency professionals and practitioners were broadly in favour of Option A or the option with some modifications, and there was support for Option D from the financial sector. However, respondent employer and employee bodies, who would be most directly affected by the proposed rescue procedure, were unanimously against all four options and were strongly against extending the use of PWIF to cover statutory corporate rescue due to the concern about additional pressure on PWIF and abuses in its use. This had in effect closed the doors for Options A, C and D which involved changing the ambit of PWIF. Results of the consultation prompted the Administration to revisit Option B. DS/FS(2) supplemented that Option B was the only option offering full protection for employee's rights in line with existing labour legislation. The option could prevent evasion of statutory obligations towards employees by unscrupulous employers through corporate rescue. Moreover, as the laying off exercise would be financed by the assets of the company coming into the hands of the provisional supervisor, this would help ensure that lay-offs were cost-effective and kept to an optimal scale. Whilst recognizing that Option B would make company rescue operations more challenging for a provisional supervisor, the Administration was confident that this was a practical solution enabling the corporate rescue scheme to make a start and practitioners to build up the required expertise and experience.

26. As regards the experience of voluntary corporate rescue plans undertaken locally, DS/FS(2) said that professionals concerned had successfully conducted some 60 informal 'work-out' schemes for local companies over the past two years. Clients of these schemes were mostly public companies listed in Hong Kong employing about 50 to 200 employees and with a market capitalization of \$100 million to \$150 million. Professionals pointed out that, given their size, potentially

viable companies undergoing corporate rescue were expected to be able to pay their employees. As these payments were not significant compared with the debts owed by the companies, it was unlikely that they would pose any material impact on the success of a work-out. If a company could not even pay its employees, there should be serious doubts about the success of a corporate rescue scheme.

27. On whether there were corporate rescue schemes operating with similar arrangements in other jurisdictions, DS/FS(2) said that LRC had conducted research on practices of various common law jurisdictions and discovered that corporate rescue arrangements varied from place to place and there was no specific provision addressing the settlement of employees' arrears when a company went into provisional supervision.

28. Mr Eric LI pointed out that the local experience referred to by the Administration were practices of 'voluntary winding-up' initiated by the companies concerned. However, the corporate rescue procedure recommended by LRC was mainly designed to help those financially troubled companies which were likely to face involuntary winding-up by court. It was doubtful that the Administration's proposal would address the problems faced by these companies. In this connection DS/FS(2) clarified that the scheme would be applicable to a company whether or not it was able to pay its debts or likely to face either voluntary or involuntary winding-up.

29. Mr Albert HO opined that given the large capital size of companies quoted in the Administration's illustration above, the substantial professional fees involved in a corporate rescue procedure, and the requirement for employers to clear all arrears of wages prior to initiating the rescue, it would be unlikely for the proposed corporate rescue scheme to benefit small and medium sized enterprises (SMEs) which comprised the majority of local business and were the most in need of assistance. He suggested the Administration to consider establishing a separate fund or extending existing assistance schemes available to small and medium enterprises, such as the Special Finance Scheme, to fund corporate rescue plans for small businesses.

30. DS/FS(2) responded that while there would be no restriction on the capital size of companies to be covered by the proposed corporate rescue scheme, it was true that small companies were less likely to use the scheme as their financial problems were comparatively less complicated and only a small number of creditors were involved. It might not be cost-effective for SMEs to engage a provisional supervisor in view of the professional fees involved. As regards setting up a separate 'corporate rescue fund', there was some support for the suggestion from respondents. However, funding for this option would be a major consideration. While the business sector would be against any increase in the cost of doing business, the Administration was mindful that it would be inappropriate to use public money to bail out financially troubled business. On whether the ambit of existing schemes for helping SMEs could be extended, DS/FS(2) undertook to consult the relevant bureau on the suggestion and revert to the Panel.

31. Members noted that the provisional supervisor would be given extensive power regarding laying off of employees and would decide whether a company was viable and hence worth rescuing. The court would also rely heavily upon the advice of the provisional supervisor in deciding whether the 30-day moratorium against winding-up a company should be extended. Some members were concerned that adequate checks and balances should be put in place to ensure the standard and proper performance of these professionals who worked as provisional supervisors. Mr Martin LEE suggested that the criteria of 'a viable business worth rescuing' should be stipulated. Mr LEE Cheuk-yan was concerned about protection of the rights and benefits of retained employees. Mr Kenneth TING opined that there should be proper monitoring on the fees charged by provisional supervisors.

32. In response, DS/FS(2) remarked that the Administration appreciated the concern about the gate-keeping role of the provisional supervisor and would pay particular attention to prevent possible abuses of the rescue procedure by non-viable companies and unscrupulous employers. If necessary, the court might approve the appointment of a provisional supervisor to be in charge of a particular rescue plan. Details of the rescue plan would be submitted by the provisional supervisor to the court upon expiry of the initial 30-day moratorium or the provisional supervisor might seek the courts' approval for extension of the moratorium. She added that there would be further discussion with professional bodies on details of the requirements on provisional supervisors, their duties and rights. The relevant legislative proposals would include details such as clear responsibilities of these professionals and the code of professional standards expected, etc. The fees for the provisional supervisors should be agreed with the company before the appointment. It would be against the professional standards of provisional supervisors to charge unreasonable fees for the service.

## **VI Proposed arrangement for Government fees and charges revision upon the expiry of the moratorium on 30 September 1999**

(LC Paper No. CB(1)1427/98-99(06))

33. Members noted that two papers were tabled at the meeting for their information namely, examples of Government fees and charges revision provided by the Administration and a submission from the Federation of Hong Kong Hotel Owners Limited. (The two papers were circulated vide LC Paper Nos. CB(1)1484(01) and 1484(02)/98-99 after the meeting.)

34. The Secretary for the Treasury (S for T) presented the paper which sought Members' views on the Administration's proposals to revise the fees and charges for Government services in four tranches over the next 12 months following the expiry of the moratorium on 30 September 1999. She explained that the proposals were in line with Government's well-established policy to apply the 'user pays' and 'full cost recovery' principles for setting the fees and charges for most

Government services and to maintain the level of subsidy in real terms for subsidized services. Since the 18-month moratorium beginning on 18 February 1998, these important principles were no longer being achieved. Indeed, the fees and charges for some items had not been revised over the last three or five years. The rates of fee revision as set out in the information paper had been made with reference to movement of Government Consumption Expenditure Deflator (GCED). The proposed increase of 3% or 5% was moderate. In formulating the fee proposals, the Administration had taken into consideration all relevant factors including the 'user pays' principle, existing cost-recovery levels, current and forecast economic conditions.

35. Members strongly opposed the Administration's proposed plan to increase fees and charges for Government services. They criticized the Government for not being considerate of the financial hardship being faced by the general public and the business sector in the current economic downturn. Amongst Members of the Democratic Party, Mr Martin LEE and Mr LAU Chin-shek opined that the proposals were unacceptable as Hong Kong was still suffering from a decline in Gross Domestic Product (GDP) and serious unemployment problems. Mr Fred LI expressed concern that the move would also prompt other utility companies to raise their charges. Miss Cdy HO of the Frontier expressed that she was particularly concerned about the additional financial burden on the grass root sector which was the most hard-hit during the economic recession. Mr James TIEN said that the Liberal Party was supportive of the 'user-pays' principle but it opposed the proposed fees increase as this would dampen Hong Kong's economic recovery. Mr CHAN Kam-lam conveyed the Democratic Alliance for the Betterment of Hong Kong's objection to the proposals pointing out that it conflicted with the objective of the economic adjustment process to restore Hong Kong's competitiveness through lowering of domestic costs and prices. Mr FUNG Chi-kin also stated opposition of the Hong Kong Progressive Alliance against the proposal.

36. While fully aware of the financial difficulties facing the community during the downturn of the economy, S for T stressed the importance of revising fees and charges to enable the Government to regain the fiscal balance over the medium term and to uphold the 'user pays' and 'full cost recovery' principles. Notwithstanding that the First Quarter Economic Report 1999 released recently had recorded a 3.5% drop in GDP in real terms, other indicators showed that the Hong Kong economy was picking up. The Government Economist also predicted that local recovery would progress steadily in the second half of 1999 and therefore maintained the forecast GDP growth rate of 0.5% for 1999. As regards the concern about the financial burden on the grass-roots sector, S for T said that most of the items of increase were not directly related to general livelihood. The Government was also mindful of the policy to subsidize basic services and set much lower target cost recovery rates, such as 18% and 50%, for education and water services. According to the proposed increase, the majority of households would pay additional amounts of \$15 to \$25 for senior secondary education and \$0.1 to \$1 for water charges each month.

37. Mr LEE Cheuk-yan queried the motive behind the proposals in anticipation of the strong opposition by LegCo. He was concerned that the Administration might use this as an excuse to raise taxes. Mr Ambrose CHEUNG enquired about possible alternatives to cover the estimated revenue of \$250 million to be generated upon full implementation of the proposals.

38. S for T stressed that there was no hidden motives behind the proposal. She clarified that the present consultation was pursuant to FS's decision made in his Budget Speech for 1999-2000 to extend the freeze on Government fees and charges for six months and commit the Administration to seek the views of LegCo Members with a view to reaching a consensus on the level of increase and the priority of adjusting different fees and charges upon the expiry of the moratorium. She re-iterated that besides the adverse impact on the fiscal position, further extension of the freeze would necessitate steeper increases in fees in the future which neither the Government would prefer nor the community would accept. On the alternatives for raising the forecast revenue of \$250 million, S for T clarified that rather than pursuing a particular level of income from fees and charges, the revision exercise was more to uphold the important principle of 'use pays' in the management of public finances. While in the absence of any fee revision the Administration would continue to explore other revenue raising measures and strive for greater and cost-effectiveness in provision of services, increasing taxes would also be a practicable option for generating additional revenue.

39. With a nil inflation rate and the downward trend in operating costs in the private sector, Mr James Tien queried the increase in the cost of providing Government services as reflected in the forecast increase of 0.03% in GCED in 1999. Sharing the view, Miss Margaret NG expressed concern over the effectiveness of such initiatives as Enhanced Productivity Programme (EPP) and Civil Service Reform (CSR) in improving efficiency and cost-effectiveness of the public sector. Mr Eric LI opined that the GCED figure might not have accurately reflected the operating cost of the Government and pointed out that if the Administration stepped up with efforts in containing growth in recurrent expenditure, the pressure on increasing fees and charges might be lowered.

40. In response, S for T stressed the Administration's firm commitment to improving the efficiency in provision of Government services and controlling expenditure growth. As such, the Administration had decided to freeze civil service pay in 1999 and initiated EPP with the aim of attaining productivity gain of 5% by 2002-2003. Moreover, there were plans to implement CSR which would cover, inter alia, reviews on the salaries and conditions for new recruits, civil service appointment policy and the appraisal system.

41. As regards the concern about the growth in cost of provision of public services during a period of economic downturn, S for T explained that there were fundamental differences between Government and the private sector in possible ways to control expenditure growth. She further advised that the Administration

conducted costing exercises for all of its services every four years in order to gauge changes in cost over time and made reference to the movement of GCED for the purpose of determining the annual rate of fee revision for the interim period. The forecast of a 0.03% increase in GCED for 1999 was significantly lower than that of the past two years, of which the increase in recurrent expenditure for civil servant salaries was a major component. Despite the pay freeze in 1999, over half of the serving civil servants would still be entitled to annual increments. On whether savings to be achieved by various efficiency enhancement measures could off-set the growth in expenditure, S for T advised that benefits from enhancement programmes took time to materialise. Notwithstanding that the Administration would strive to achieve better productivity gains in EPP over the pledged target wherever possible, the target of 5% would be achieved in phases starting with 1% in 2000-2001, 3% in 2001-2002 and 5% in 2002-2003. Similarly, results of CSR might not be evident in the medium term. Hence, it was envisaged that there would still be slight increases in GCED in the next few years. If the Administration was to completely contain growth in recurrent expenditure, there would be a need to go further than a pay freeze for the civil service in the coming few years.

42. Pointing out that the LegCo was already scrutinizing the Revenue Bill (the Bill) which was concerned with revenue concession and revenue raising proposals in the 1999-2000 Budget, Mr SIN Chung-kin opined that the present proposal to increase fees and charges should have been incorporated in the Bill. Moreover, noting that the budget planning process of many other jurisdictions generally took a longer period and involved examination of both revenue and expenditure proposals within the same exercise, he suggested the Administration to make reference to the overseas practices and experience with a view to improving Hong Kong's budgetary process.

43. S for T clarified that the current proposals were separate from the Bill the purpose of which was to amend a number of ordinances to give legislative effect to the various revenue proposals in the 1999-2000 Budget. This new approach of combining revenue proposals which needed to be effected through legislative amendments in one omnibus bill would facilitate consideration by LegCo. However, as regulations on fees and charges for Government services were subsumed in numerous ordinances and fee revision was normally effected by amending the subsidiary legislation, it would be technically impossible to draft a composite bill for such purpose. On the other hand, the existing budgetary process involved the scrutiny of the Appropriation Bill covering all expenditure proposals, while the revenue proposals were put under separate bill(s) to be introduced into LegCo at a later stage. It would be a fundamental change involving complicated legal issues if the existing budgetary practices were to be amended. However, S for T took note of Mr SIN Chung-kin's view on improving the consultation process in preparing the budget.

44. As regards the appropriate timing for revising the fees and charges, members opined that the moratorium should be further extended until substantive

economic improvement was evident. Mr SIN Chung-kai remarked that fee revision should not be considered until mid 2000 while Mr FUNG Chi-kin opined that the freeze should last for at least another six months.

45. In response, S for T undertook to convey members' views to FS who would make the decision.

## **VII Privatization of Government services** (LC Paper No. CB(1)1427/98-99(05))

46. The Director of Business & Services Promotion Unit (D/BSPU) said that the policy of encouraging private sector participation in provision of public services underpinned the Administration's commitment to small government and enabled benefits such as improvement in the cost-effectiveness and quality of services and reduction in prices for services as a result of enhanced competition, to be available to the community at large.

47. Noting that the policy was nothing new to Hong Kong and there were many successful privatization projects overseas, Mr SIN Chung-kai requested the Administration to provide information on any detailed analysis in this respect, in particular the quantitative statistics on benefits to the community by way of improvements to the quality and cost-effectiveness of provision of these services.

48. In response, D/BSPU said that experience of overseas privatization projects had generally achieved productivity gains, price reductions, and improvements in standards of services. For instance, although the amount of efficiency gain attributed by the process of privatization was unclear as it was implemented during a period of rapid technological development, the Australian Government's experience of privatizing its telecommunication department had achieved 40% efficiency gain when the department was corporatised. Another 40% gain had been achieved upon full privatization of the service. Regarding local experience in transfer of public services, D/BSPU pointed out that the bought place scheme in elderly homes had been successful as the Government was able to obtain better quality accommodation and services for the elderly at comparable or even lower cost from the non-government organizations than by providing subvention to voluntary bodies for running the services. Moreover, the experience of allowing developers to undertake works which were performed by the Government had resulted in a reduction in construction cost and completion dates of projects were expedited by one to three months. He undertook to provide more information, including financial gains, regarding the examples mentioned in paragraph 3 of the information paper after the meeting.

BSPU

*(Post-meeting note: The information was circulated to members vide LC No. CB(1)1711/98-99 dated 15 July 1999.)*

49. While expressing support to the spirit of the policy of privatizing public services, Mr Ambrose CHEUNG enquired about the way forward in implementing the policy and the progress of two projects namely, private sector participation in water supply services and listing of the Mass Transit Railway Corporation (MTRC).

50. D/BSPU re-iterated that the greater cost-efficiency achieved in the Administration's past experience and overseas practices in transferring public services to private sector had strengthened the Administration's resolve to move forward with the policy of privatization. A "D2" post had been created in May in the Unit to formulate the policy. Work was underway to identify potential departments or services appropriate for private sector participation. While the whole public sector would be covered, certain departments such as the disciplinary forces, would be ruled out fairly quickly due to their special circumstances. He assured members that in implementing the policy, the Administration would have due regard to important issues including enhancing efficiency without compromising standard of service, putting in place proper infrastructure to ensure accountability and performance of service providers, as well as staff concerns, and made reference to both local experience and overseas practices.

51. On the issue of privatizing the water supply service, D/BSPU clarified that there was no proposal to privatize the Water Services Department at the moment. A consultancy study, to be completed by the end of June, would identify options for inviting private sector participation in providing the service. The study would cover issues such as the ultimate and long term goals to be achieved and appropriate steps to be taken in the interim. The Administration would examine the consultancy report carefully, assess the implications of the proposal and work closely with departmental management and consult staff in moving ahead with any plan. LegCo would also be involved and consulted in the process.

52. Regarding the proposal to privatize a substantial minority share of MTRC through public offerings, the Deputy Secretary for Treasury (DS for T) said that as the proposal involved the transfer of a successfully run commercial corporation to a partially listed entity, issues to be addressed were different from those projects of importing more private sector participation in the provision of public services. Upon the project's successful implementation, it would become the benchmark for privatization, where appropriate, of other government owned public corporations. D/BSPU supplemented that the privatization project of MTRC illustrated the possibility of distinguishing ownership of public services from its management. In considering the option of privatizing government services, the Administration would examine the feasibility of both modes of operation and conduct proper consultation. The Administration was in the process of drawing up the necessary legislation to enable the partial privatization of MTRC and planned to introduce the bill into LegCo within the 1999-2000 session. In this connection, the Chairman advised members that details of privatization of MTRC would be further discussed by the Transport Panel at its meeting scheduled for 25 June 1999.

53. Mr LEE Cheuk-yan pointed out that in transfer of public services, it was essential for the Government to address important issues of a proper regulatory framework for monitoring performance of service providers and mechanisms for reviewing fees and charges for services, as well as concerns of civil servants over their benefits and the possibility of redundancy. He quoted the unsuccessful experience of UK Government in 1990 in contracting out its manpower training services. Another example which had caused grave concern to civil servants was the Housing Department (HD)'s plan to privatize its estate management services.

54. On the concern about the mechanism for reviewing service fees and charges, D/BSPU stressed that the process of privatization did not by itself change the existing systems for reviewing fees and charges. The power vested in LegCo for approving fee revisions would remain unchanged unless a change was agreed by LegCo. As regards concerns about staff benefits, a mixed staff structure comprising civil servants on secondment and employees recruited from outside could be allowed upon corporatization of a department and hence the salaries and benefits of serving staff would not be diminished. The situation where the corporation was fully privatized would be different as this would involve a different legal relationship between the individual staff and the private entity. As to the issue of redundancy, he said that he was not aware of any corporatization proposal involving large scale redundancy. The HD's case was unique and did not apply to any other public service situation. It involved the rights of owners under the Tenants Purchase Scheme to select their own management arrangement and a six-year period had been proposed to phase out existing HD's management team. He further pointed out that problems could be avoided if the corporatization plan was to proceed progressively. While the benefit of savings from staff cost would be deferred, this might be well justified if the situation so warranted.

55. On the concern about accountability of the entity after corporatization, D/BSPU said that this would be best ensured under a competitive market situation where service operators would be held directly accountable to consumers and be responsive to their demands and needs. As far as privatization of MTRC was concerned, he advised that the Secretary for Transport would remain answerable to the public for transportation matters relating to the corporation generally even after it had been partially privatized.

56. Concurring that implementation of the policy of privatization would have significant impact on the civil service, Mr Albert HO opined that the Administration should also consult the staff side on the policy as part of the CSR consultation exercise. He also enquired whether a consultation paper would be produced on the subject of privatization of government services.

57. In response, D/BSPU clarified that a distinction should be drawn between the Public Sector Reform (PSR) and CSR. PSR had been a long standing policy implemented for years. It was an institutional and structural reform within the public sector aiming at improving the efficiency, quality and cost-effectiveness of government services and involving review on the most appropriate means of

delivering services. CSR, on the other hand, was concerned with reforming the civil service systems and covered areas like pay and conditions of service and the disciplinary system. The Administration had recently published a consultation document on CSR and was actively conducting consultation with parties concerned.

58. As provision of public services always required heavy investments on advanced technology systems and human resources training, Mr Eric LI enquired about successful overseas experience in this respect and the reference for Hong Kong. D/BSPU responded that the Administration would make suitable reference to overseas practices in formulating its work plans. While insufficient capital investment in information technology systems had been a problem in the UK and New Zealand experience, it should not be the case for Hong Kong. Moreover, it would be essential for commercially minded operators to invest in capital infrastructure wherever appropriate, as this would generate more productivity gains.

### **VIII Any other business**

#### Sale of duty-free goods on arrival (LC Paper No. CB(1)1388/98-99(01))

59. Members expressed support for the proposal to allow the sale of duty-free goods to arrival passengers at Lo Wu Railway Station and the Hong Kong International airport.

60. DS/T took note of Mr SIN Chung-kai's view on the need to ensure competitive operation on the sale of duty-free goods and said that he expected that the Kowloon-Canton Railway Corporation and the Airport Authority would grant the new duty-free franchises through competitive tendering in line with the present arrangement for sale of duty-free goods in departure areas.

61. There being no other business, the meeting ended at 5:50 pm.