

立法會
Legislative Council

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by the Administration)

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Panel on Financial Affairs

Minutes of meeting
held on Monday, 29 November 2010 at 9:00 am
in the Chamber of the Legislative Council Building

Members present : Hon CHAN Kam-lam, SBS, JP (Chairman)
Hon CHAN Kin-por, JP (Deputy Chairman)
Hon Albert HO Chun-yan
Ir Dr Hon Raymond HO Chung-tai, SBS, S.B.St.J., JP
Dr Hon David LI Kwok-po, GBM, GBS, JP
Hon James TO Kun-sun
Hon Vincent FANG kang, SBS, JP
Hon LEE Wing-tat
Hon Jeffrey LAM Kin-fung, SBS, JP
Hon Andrew LEUNG Kwan-yuen, GBS, JP
Hon WONG Ting-kwong, BBS, JP
Hon Ronny TONG Ka-wah, SC
Hon KAM Nai-wai, MH
Hon Starry LEE Wai-king, JP
Dr Hon LAM Tai-fai, BBS, JP
Hon Paul CHAN Mo-po, MH, JP
Hon Mrs Regina IP LAU Suk-ye, GBS, JP

Members attending : Hon LEE Cheuk-yan
Hon WONG Kwok-hing, MH
Hon IP Wai-ming, MH

Members absent : Dr Hon Philip WONG Yu-hong, GBS
Hon Emily LAU Wai-hing, JP
Hon Abraham SHEK Lai-him, SBS, JP
Hon CHIM Pui-chung

**Public officers
attending**

: Agenda Item III

Mr John TSANG, GBM, JP
Financial Secretary

Mrs Helen CHAN, JP
Government Economist

Mr Arthur AU
Administrative Assistant to Financial Secretary

Agenda Item IV

Mr John TSANG, GBM, JP
Financial Secretary

Prof K C CHAN, SBS, JP
Secretary for Financial Services and the Treasury

Mr Stanley YING, JP
Permanent Secretary for Financial Services and the
Treasury (Treasury)

Mr Arthur AU
Administrative Assistant to Financial Secretary

Agenda Item V and VI

Mr Patrick HO, JP
Deputy Secretary for Financial Services and the
Treasury (Financial Services) 2

Agenda Item VI

Miss Emmy WONG
Principal Assistant Secretary for Financial Services
and the Treasury (Financial Services) 3

**Attendance by
invitation**

: Agenda Item VI

Ms Gabriella YEE
Chief Manager (Policy Development and Research)
Mandatory Provident Fund Schemes Authority

Clerk in attendance : Ms Anita SIT
Chief Council Secretary (1)5

Staff in attendance : Mr Noel SUNG
Senior Council Secretary (1)4

Ms Haley CHEUNG
Legislative Assistant (1)8

Action

I Information papers issued since the last meeting

(LC Papers No. CB(1)360/10-11(01) — Further submission from a member of the public regarding assessment of property tax and the Administration's response) and (02)

Members noted the information papers issued since the last regular meeting on 1 November 2010.

II Date of next meeting and items for discussion

(LC Paper No. CB(1)524/10-11(01) — List of outstanding items for discussion

LC Paper No. CB(1)524/10-11(02) — List of follow-up actions)

Meeting in January 2011

2. Members agreed to discuss the following items proposed by the Administration at the next regular meeting scheduled for 3 January 2011:

- (a) Creation of a Supernumerary Administrative Officer Staff Grade C Post for the establishment of an independent Insurance Authority and a Policyholders' Protection Fund; and
- (b) Latest developments in regulating the over-the-counter derivatives market.

(Post-meeting note: At the request of the Administration and with the concurrence of the Chairman, a discussion item "Proposed establishment

of an Investor Education Council and a Financial Dispute Resolution Centre-Consultation conclusions" was added to the agenda of the meeting on 3 January 2011. An updated agenda was issued to members vide LC Paper No. CB(1)818/10-11 on 15 December 2010.)

Measures to curb speculation in the property market

3. Mr Ronny TONG suggested that the Panel discuss issues relating to the measures recently introduced by the Administration to curb speculative activities in the property market. He said that there were concerns that since the measures only covered residential properties, their implementation would have the effect of diverting speculative activities to non-residential properties such as commercial properties. Mr Albert HO shared Mr TONG's concern, and said that there would be a limitation on the scope of deliberations during the scrutiny of the Bill on the new measures. Mr HO opined that the Panel should also hear the views of the public, including those from scholars and relevant parties, on the measures. Ms Starry LEE suggested that before deciding on whether and how the Panel should discuss the issue, the Administration should be requested to provide relevant information to the Panel.

4. The Chairman said that related issues had been discussed at Council meetings and the Panel on Housing. He would liaise with the Administration on the arrangement for the Panel to follow up the matter.

(Post-meeting note: On the advice of the Chairman, the Administration had been requested and had provided members with an information paper (LC Paper No. CB(1)941/10-11 dated 31 December 2010) on the recent development of the commercial and industrial property markets, and the possible impact of the recent measures to curb speculation on residential properties on the prices and rentals of industrial and commercial properties.)

III Briefing by the Financial Secretary on Hong Kong's latest overall economic situation

(LC Paper No. CB(1)436/10-11(01) — Third Quarter Economic Report 2010 and the press release

LC Paper No. CB(1)524/10-11(03) — Administration's paper on Hong Kong's recent economic situation and near-term outlook)

Briefing by the Administration

5. At the invitation of the Chairman, the Financial Secretary (FS) briefed members on the latest economic situation by highlighting the following –

- (a) The global economy continued to recover in 2010. In October 2010, the International Monetary Fund (IMF) had revised the global economic growth for 2010 from 4.2% to 4.8%, which mainly reflected the strong economic performance of the emerging markets. Hong Kong's economy continued to see a robust recovery in the third quarter of 2010. Real GDP leaped by 6.8% over a year earlier, following a strong 7.2% growth in the first half of the year. The seasonally adjusted GDP level in the third quarter of 2010 surpassed the pre-crisis peak in the first quarter of 2008 by some 2.3%. The rapid recovery of Hong Kong's economy was mainly attributable to the strong economic growth in the Mainland and Asia.
- (b) Total exports of goods maintained strong growth momentum in the third quarter of 2010. Merchandise exports surged by 20.6% in real terms over a year earlier. The Asian markets continued to be the key driver for growth in merchandise exports, thanks to the strong domestic demand in these economies and also the increase in intra-regional production activity. Export of services continued to perform well. Export of travel services were buoyed by robust growth in incoming visitors across most major markets. Exports of transportation and trade-related services continued to benefit from the vibrant trade flows in the region and the resurgence in trade with the rest of the world. Export of financial and business services also expanded further.
- (c) The domestic sector held up well in the third quarter of 2010. Supported by improving job and income prospects, private consumption spending picked up further. Overall investment spending increased marginally after a strong growth for three quarters. Expenditure on building and construction grew notably, again driven by the continued surge in public sector works. The labour market improved further on a broad front, reflecting the effects of the Government's measures to protect jobs. Total employment continued to climb back, pushing the unemployment rate down by 1.3%, from 5.5% in mid-2009 to 4.2% in August-October 2010. The average salaries of employees in the second quarter of 2010 had surged by 4.9% on a year-on-year

basis. Deducting the effect of inflation, a growth rate of 2.4% was recorded. Confidence of investment and consumer spending was positive. In the first three quarters of 2010, GDP expanded strongly by 7.1% in real terms over a year earlier. Even allowing for some possible deceleration in the fourth quarter, GDP growth in 2010 should exceed the forecast of 5 to 6% announced in August 2010, and was now revised upwards to 6.5%.

- (d) With confidence and united efforts, Hong Kong had successfully tided over the impact of the global financial crisis. Nevertheless, Hong Kong still had to face further challenges posed by the worldwide economy. The fundamentals of the advanced economies were still fragile, compared with the marked development of the emerging markets. The lingering European sovereign debt problem, the weak recovery of the economy in the US and Japan, and the rise of protectionism had continued to cloud the global economic outlook with considerable uncertainties. Whether the new round of "quantitative easing" in the US could bolster its economic recovery remained to be seen. As a result of "quantitative easing" in the developed economies, there was a large influx of capital into the Asian markets. Hong Kong and other Asian economies would have to face the pressure of increased inflation, the risk of asset price bubbles and the volatility of the financial market. Inflation in Hong Kong was likely to go up further, as the rise-back in domestic costs, as well as higher import prices amid a weaker US dollar and elevated global food and commodity prices, continued to feed through. Inflation of 2.3% was recorded in October 2010, slightly higher than the average inflation rate of 2.0% for the third quarter of 2010. If viewed in conjunction with the strong GDP growth of 6.8% in the third quarter of 2010, the inflation rate of around 2% lately was relatively moderate. However, the pressure of world commodity price upsurge would continue to feature, possibly even more blatant in 2011. The appreciation of Renminbi and the escalating prices of food items imported from the Mainland would also add pressure. Underlying consumer price inflation was now forecast at 1.7% for the year as a whole, revised upwards from 1.5% forecast in August 2010.
- (e) As regards the property market, "quantitative easing" of the advanced economies had led to an influx of capital into the market. The Government had issued warnings of the risk of a property market bubble and introduced several rounds of measures to ensure the stable and healthy development of the property market.

The various measures had already yielded some of the intended effects to enhance the supply of residential units and the transparency of transactions and to prevent excessive mortgage lending. On the back of abundant global liquidity, exceptionally low interest rates and relatively tight supply of residential properties in recent years, flat prices staged an unusual upsurge of 47% starting in early 2009. Among flats of various sizes, prices of large flats (size of at least 100 square metres) had already exceeded the peak in 1997 by 10%. While prices of mass market flats (size of less than 70 square metres) were still 12% below the peak in 1997, lately there were signs that the pace of increase was accelerating. Trading activities were active. In the first ten months of 2010, transaction volume soared by 17% over a year earlier. Both prices and transactions indicated that market exuberance had started spreading from the luxurious market to the mass market. The sharp pick-up in short-term trading activities also showed that speculative activities had shifted to a shorter horizon. The rapid gains in flat prices had exceeded the income growth of the general public. Home purchase affordability had deteriorated from 32% in the fourth quarter of 2008 to around 42% in the third quarter of 2010. Should interest rates increase by 3 percentage points, the affordability ratio would rise significantly to 54%, exceeding the long-term average. Under the effect of "quantitative easing" and the rush of buyers into the property market, market exuberance was expected to intensify further, increasing the risks of a property market bubble. If and when the bubble burst, the whole financial market would have to pay a heavy price. The measures introduced by the Government on 19 November 2010 aimed to curb the overheated speculative activities in the property market, and prevent excessive leverage in mortgage lending, with a view to ensuring the stability of the financial market and the economy. The Government would continue to monitor the situation of the property market, and would not hesitate to introduce appropriate measures if and when necessary.

6. The Government Economist (GE) gave a powerpoint presentation on the latest developments in the Hong Kong economy, the updated economic forecasts for 2010 as a whole, the economic outlook for 2011 and the situation of low-income households.

(Post-meeting note: The presentation notes (LC Paper No. CB(1)614(10-11(01))) were issued to Members by a Lotus Notes e-mail on 29 November 2010.)

Discussion

Inflation

7. Mr Jeffrey LAM was concerned that with the "quantitative easing" policy of the developed economies and the influx of large amount of capital, together with the Linked Exchange Rate System adopted by the Government, the pressure on inflation would mount, resulting in increases in the prices of food, raw materials, rentals, etc. Mr LAM enquired what measures the Government would take to alleviate the pressure of inflation on businesses and the general public. Mr LAM was also concerned that the measures to curb speculation in the residential property market might have the effect of aggravating the speculative activities in other areas, such as the stock market, thereby causing the formation of asset price bubbles in these areas. Mrs Regina IP echoed Mr LAM's concern and remarked that office workers, low-skill workers and the elderly would not benefit from the implementation of the major infrastructure projects and the productivity enhancement initiatives.

8. FS responded that the headline inflation rate for the whole year was expected to be 2.5%, not particularly high when seen in conjunction with the brisk economic expansion in 2010. With the rapid growth in GDP and the ensuing increases in rentals and salaries, coupled with the upsurge of food prices and the depreciation of the US dollar, the upside risk of inflation had indeed increased. The new round of "quantitative easing" (QE2) in the US had also triggered further funds influx into the region, putting further pressure on inflation. In fact, most economies in Asia now had to deal with rising inflation risks, and Hong Kong was no exception. Given the small size of the public sector, the macro-economic management tools at hand were admittedly rather limited. The Government's measures introduced recently to curb speculative activities in the housing market would help alleviate some of the inflation pressure from rising rentals. Also, the Mainland authorities' measures to stabilise food prices would help to lessen imported inflation facing Hong Kong in due course.

9. As to the possible spill-over effects of the Special Stamp Duty on the stock market, FS said that the Hong Kong stock market had a high participation rate of international investors. The majority of local investors were experienced investors and were well aware of risk management issues. The Government would continue to ensure the transparency of the operation of the stock market and effective dissemination of information with a view to enabling investors to make informed investment decisions. He explained that when faced with the influx of capital, it was of paramount importance to ensure sound macro economic fundamentals and to maintain the stability of the financial market. The Securities and Futures Commission would enhance

regulation of the market, and conduct stress tests on the intermediaries for the purpose of protecting the interests of investors. To forestall the risk of upward price spiral and high inflation over the medium to long term, the Government would strive to promote continued productivity upgrading as an effective cushion against local price pressures. The Government's investment in large infrastructure projects and in manpower training and retraining should help in this regard.

10. Mr WONG Kwok-hing expressed concern about the worsening inflation situation. Mr WONG asked whether the Government would consider introducing one-off relief measures, such as providing subsidies on electricity charges, transport fares and housing rentals, increasing the Old Age Allowance and making special contribution to the Mandatory Provident Fund Schemes, in order to alleviate the pressure of inflation on the low income group.

11. FS responded that the Government would strive to ensure continued development in the economy in the long run, so as to generate employment for both the lesser and high skilled, so that the whole community would benefit. The average income for the workforce had indeed improved, with a year-on-year increase of 4.9%, or an increase of 2.4% in real terms after deducting the inflation factor, in the second quarter of 2010. On the upsurge of food prices, he said that the increase was 2.8% in the third quarter of 2010, up from that of the first two quarters of the year. The Government was concerned about the impact of such an increase on the livelihood of the general public, especially the low income group. Members were welcomed to give suggestions to tackle the problem during the preparation of the 2011-2012 Budget.

12. Mr Ronny TONG commented that the upsurge of food prices and travel expenses had the greatest impact on the livelihood of the public, especially the low income group. While expressing concern about the increase in bus fares and tunnel tolls, Mr TONG remarked that more information on the increase in food prices and travel expenses should be provided, as such increases were expected to be much higher than the overall inflation rate.

13. FS responded that the Government was closely monitoring the impact of the increase in food prices and charges of public utilities such as transport, electricity, gas and housing, on the livelihood of the community, especially the low income group. The Government would introduce appropriate measures to deal with the issues if and when necessary. GE supplemented that the rise in inflation was mainly attributable to the increase in food prices and rental costs. In line with the global trend, prices of basic foodstuffs had increased by 5.7% in October 2010, up from 4.1% in the third quarter of 2010. This compared to an increase of over 20% in world food prices during the first nine months of 2010. As for transport expenses, the year-on-year increase was 2.7% in October 2010.

The increase in public utilities' charges as a whole had contributed to an increase of 0.15% in the Composite Consumer Price Index in 2010.

14. While expressing concern about the inflation situation, Mr Paul CHAN remarked that the relevant Government bureaux/departments should be very careful in vetting applications from public utility companies for raising their charges. Mr CHAN pointed out that, for instance, the assessment of the Kowloon Motor Bus Company Limited's application for increase of bus fares showed that based on the agreed fare adjustment formula, the increase should be 6.5% only, instead of an 8.6% increase proposed by the company. Given that there would likely be a large fiscal surplus this year, and that the Government had provided subsidies to ferry companies operating outlying island routes, Mr CHAN opined that the Government should consider using part of the fiscal surplus to offset the increase in transport fares.

15. The Deputy Chairman was concerned that, apart from buying properties, Mainland residents also came to Hong Kong to buy daily necessities, which would push up the prices of such commodities. He asked whether the Government would consider improving the supplies of daily necessities.

16. FS responded that Mainlanders coming to Hong Kong was a welcome development given the benefits they brought to Hong Kong's tourist industry and the retail businesses. Given the wide range of sourcing, he believed that the suppliers/retailers could make the necessary sourcing arrangements to meet the increased demand arising from Mainland visitors.

Linked Exchange Rate system

17. Ms Starry LEE opined that Hong Kong had to face the rise of asset prices and inflation rate for an extended period, partly due to the Linked Exchange Rate System. Given the low interest rate environment, the impact of QE2 and the appreciation of Renminbi, Hong Kong people had to resort to investments in various instruments, such as securities, taxi and minibus licences, in order to counteract the effects of inflation. The widening of the wealth gap between the rich and the poor was also attributable to the sustained increase in asset and food prices. Ms LEE enquired whether the Government agreed with her observation.

18. FS maintained that the Linked Exchange Rate System was suitable for Hong Kong's economic setting. There was no need nor any intention to change the system. Significant appreciation of Renminbi would inevitably adversely affect Hong Kong's export competitiveness, though visitors from the Mainland would also be willing to spend more in Hong Kong. On this, the Central Government had already reiterated that the mechanism for improving the

exchange rate system for Renminbi would be implemented on its own initiatives, and in a controllable and gradual manner, with a view to preventing extreme volatility of Renminbi. The chance of a swift and substantial appreciation of Renminbi was thus slim. Indeed, the appreciation of Renminbi had been moderate in recent months, by about 3% between June and October in 2010. Past experience showed that the appreciation of Renminbi of 20% between 2005 and 2008 had not posed much pressure on Hong Kong's inflation, nor brought about significant adverse effects on Hong Kong's economy. An earlier study by the Hong Kong Monetary Authority (HKMA) revealed that for every 10% appreciation in the exchange rate of Renminbi against the US dollar, Hong Kong's inflation rate would rise by 0.5% from the channel of higher imported inflation.

19. At the request of Ms Starry LEE, FS said that HKMA would provide information on the analysis of the possible impact of Renminbi appreciation on Hong Kong's inflation.

(Post-meeting note: The information provided by HKMA was circulated to Members vide LC Paper No. CB(1)816/10-11 on 15 December 2010.)

Anti-property speculation measures

20. While supporting the recently introduced anti-property speculation measures, Mr LEE Wing-tat opined that the Government should consider providing an appeal channel for genuinely aggrieved persons, e.g. families whose breadwinner had passed away or suffered from serious disease affecting the families' livelihood, and families which were forced to sell their residential properties under the compulsory sale arrangement, to apply for exemption from payment of the Special Stamp Duty. Mr LEE was of the view that the supply of adequate land and residential units would prevent an over-heated property market.

21. FS responded that the Government had put in a lot of efforts to increase the supply of residential units. In the next three to four years, about 61 000 residential units would be completed and put on the market. The Chief Executive had also indicated that in the next ten years, the Government would ensure that land supply was sufficient for a supply of about 20 000 residential units each year on average, in addition to the public housing units provided by the Housing Authority. As regards the exemption arrangements under the new anti-property speculation measures, the Secretary for Transport and Housing had already explained the Government's stance at the relevant LegCo Panel meeting, and the arrangements would be further deliberated at the Bills Committee stage. The anti-property speculation measures should not affect genuine home-owners and long-term investors. There would be difficulty to deal with the exceptional situations mentioned by Members, and the Government would consider ways to deal with such cases when they arose.

22. While supporting the recently introduced anti-property speculation measures, Mr Paul CHAN was concerned that speculators might circumvent the Special Stamp Duty by effecting residential property transactions through the transfer of shares of limited companies. The stamp duty for the transfer of the shares of a company was much lower. Mr CHAN opined that, in order to plug the loophole, the Government might follow Australia's practice in that any transfer of a company whose assets comprised a certain percentage of properties and/or land would be subject to the same rate of stamp duty for transactions of land and properties. Mr CHAN remarked that such a taxation arrangement should be made a standing policy. Mr CHAN further pointed out that some speculators might purchase residential properties under the name of an off-shore company, and might evade payment of stamp duty after the transaction of a property. For the purpose of preventing tax evasion, Mr CHAN said that the Government should consider requiring lawyers to retain part of the proceeds for the seller of a property, for payment of stamp duty, in case the seller absconded.

23. Mr James TO expressed concern that in June 2010, he had put forward similar anti-property speculation proposals for the Government's consideration, and at that time the responsible Government officials had criticised the proposals as being erroneous in principle, too complicated, unfair to the users who had a genuine need to purchase properties, and having an adverse effect on Hong Kong's simple taxation system. Yet only five months later, the Government introduced the anti-property speculation measures similar to those he had proposed. Mr TO opined that the way that his proposals had been handled would have an adverse impact on the credibility of the Government.

24. With regard to the anti-property speculation measures announced by the Government on 19 November 2010, Mr Jeffrey LAM enquired as to what measures would be taken to stabilise the property market if there was a sharp fall in property prices as a result of the measures.

25. FS responded that the anti-property speculation measures were introduced as an extraordinary means to tackle an extraordinary macro economic situation, in view that speculation activities on properties had already spread to the mass market affecting the general public. FS said that he had already explained on various occasions in public the rationale for introducing the measures.

26. The Deputy Chairman pointed out that based on the Government's analysis, an increase of the existing interest rate by 3 percentage points would lead to an increase of the affordability ratio to 54%, exceeding the long-term average of 52% for the past 20 years. The Deputy Chairman asked whether the Government had conducted an analysis of the estimated timing of the next cycle of interest rate increase, the pace and level of such increases, etc.

27. FS responded that it would be difficult to predict the timing of the next cycle of interest rate increases, as there were many factors which might affect the monetary stance in US and Europe, e.g. the effects of QE2 had yet to be seen, and there were uncertainties as to whether there would be QE3 or more. Given that home purchase was a major investment decision for many people, prospective home buyers should be very careful in their investment decisions. They should be aware of the impact on their repayment abilities should interest rate eventually rise back.

Poverty

28. Mrs Regina IP was concerned about the poverty situation and remarked that the number of low income households, standing at 164 000, remained high.

29. FS responded that poverty was a complicated issue. With a closer economic partnership with the Mainland, there was a surplus supply of low-skilled labour in Hong Kong. The development of a knowledge-based economy had resulted in greater disparities between different types of workers. The division of larger households into smaller ones and the ageing population also led to an increase in low income households. FS said that the relevant Government bureaux/departments would continue to monitor the situation and draw up measures to tackle the poverty issue.

30. The Deputy Chairman opined that the threshold for defining a low income household should be adjusted for inflation over time as the \$4 000

threshold was set in 2000, noting that the CPI had risen by about 4% from 2000 to 2010. GE responded that she would explore the possibility of such adjustments, in collaboration with the Census & Statistics Department.

Government bonds

31. Mr Albert HO remarked that many people considered that officials responsible for the financial affairs in Hong Kong had little room for manoeuvring, as they lacked the flexibility in adjusting the interest rate, the tax levels and the value of the currency. Mr HO pointed out that while the public had been warned against a possible asset bubble, members of the public had to face rising inflation and depreciation of their money. Mr HO enquired whether consideration would be given to issuing Government bonds with an interest rate adequate to cover inflation for sale to the Hong Kong public. Mr James TO supported Mr HO's proposal and pointed out that the issue of Government Bonds with reasonable yields to the Hong Kong public would help instil confidence in the economy.

32. FS pointed out that in the current global economic environment where interest rates were near zero in many places, higher interest rates would only lead to a larger influx of capital. Even in places like Australia, Singapore and Taiwan where interest rate instruments could be deployed under a floating exchange rate regime, experience showed that higher interest rates were not at all effective in forestalling the formation of asset price bubbles. Property prices in Singapore had also shot up significantly despite the exchange rate appreciation there. Instead the Hong Kong Government would ensure that the macro economic fundamentals were sound, and the regulatory bodies would continue to exercise vigilance to ensure the stability of the financial and banking systems. The Government would consider Members' views and suggestions to support and develop the economy, including the issue of Government bonds for subscription by the Hong Kong public.

Supply of skilled labour

33. Ir Dr Raymond HO was concerned that many skilled workers lost their jobs or were forced to change their jobs when there was a downturn of the economy, whereas there would be a shortage of skilled labour when the Government actively implemented the major infrastructure projects. Ir Dr HO opined that the Singapore government had a better arrangement to cope with the problem of skilled labour. Ir Dr HO enquired what measures would be taken to deal with the labour situation arising from the fluctuations of economic conditions. Ir Dr HO further enquired whether, similar to the Singapore government, the Government would consider ways to provide training for non-skilled labour in order to turn them into low-skilled workers.

34. FS pointed out that the Singapore government had resorted to importation of foreign workers on a massive scale to add flexibility to the labour supply situation, but such arrangement was clearly a non-option for HKSAR Government. That Hong Kong's economy was able to recover swiftly from the impact of the global financial crisis owed much to the resilience of the local workforce, as evidenced by a remarkable 3% productivity growth per annum over the past few years. The Government would continue to put in enormous resources in tertiary education and for the training and re-training of labour, to ensure that the local workforce could meet the demand of a knowledge-based economy. Specifically for the construction sector, FS pointed out that a number of measures/incentives had been introduced in the last Budget to attract young people to join the labour force for the construction industry.

35. At about 10:40 am, the Chairman ordered a break of five minutes, and that the meeting would proceed to the next agenda item after the break.

IV 2011-2012 Budget consultation

(LC Paper No. CB(1)524/10-11(04) — Information pack for the Financial Secretary's consultations on the 2011-2012 Budget)

Briefing by the Financial Secretary

36. FS said that since the reunification with the Mainland in 1997, Hong Kong had experienced several financial crises. During the 1997-1998 Asian financial crisis, currencies in the region were subject to speculation, which led to severe volatility of the currencies, escalation of interest rates, and pressure on the stock market. Hong Kong's tourist industry and retail business were hard hit during the outbreak of the SARS in 2003. Consumer spending was weak and the economy was adversely affected. The global financial market experienced the most wide-spread and abrupt shrinkage in sixty years amid the global financial crisis which broke out in 2008 with the collapse of the subprime mortgage market in the United States (US). As an open economy, Hong Kong was inevitably affected. Different sectors and strata of the community were hard hit by the global financial crisis. The community had to face the problems of unemployment, reduction in income and an uncertain future. In face of the financial crises, Hong Kong had been able to tide over the challenges and emerge from the doldrums, mainly due to the determination and the unity of the community to overcome the difficulties. When Members were

consulted on the preparation of last year's Budget, Hong Kong's economy and employment situation had started to improve. As a result of low interest rates and the "quantitative easing" policy of the European countries and the US, there had been capital flows into the property and stock markets in Hong Kong. At that time, he had described that there were sights of "green buds" for economic recovery.

37. FS said that owing to the resiliency and adaptability of Hong Kong's market mechanisms, and the grasp on the development opportunities emerged in the region, Hong Kong's pace of economic recovery had been strong in the past year. As he had reported under the preceding agenda item, basically Hong Kong had totally recovered the grounds lost in the economic recession in the year before. Hong Kong had fared very well in exports, retail spending, business confidence and employment. Recently, international credit rating agencies had adjusted upward Hong Kong's sovereign credit ratings, which reflected the international community's affirmation of Hong Kong's strong economic and monetary fundamentals. In addition, the stimulus measures introduced by the Government in the past few years to stabilise the employment market, support consumer spending confidence and sustain the economic recovery had proved to be effective, and had mitigated the effect of the global financial crisis on Hong Kong.

38. FS said that in the past year, Hong Kong witnessed the growing of the "green buds" of the economy. Despite the current good performance of Hong Kong's economy, there were challenges ahead, especially in view of the hidden and uncertain factors of the external economic environment. For instance, the effectiveness of the economic stimulus measures of the developed financial markets were doubtful; the European countries were still troubled by the sovereign debts problem. The imbalance of trade among different markets and the high unemployment rates in some countries gave rise to protectionism, and a demand for the appreciation of Renminbi. All these factors had slowed down the pace of economic recovery in the world. Besides, the second phase of "quantitative easing" had resulted in even larger influx of capital into the Asian markets, leading to increased inflation, and greater risks of asset price bubbles, and more volatile financial markets in the region. Hence the Government had to be vigilant and prepared to take appropriate steps to maintain the economic fundamentals and growth trend. The following issues needed to be carefully considered -

- (a) With regard to financial services, how should the use of resources be prioritised to meet the various challenges at the domestic and external fronts?

- (b) For manpower development, how should the quality and competitiveness of the labour force be strengthened?
- (c) On economic development, what growth strategies should be adopted to sustain Hong Kong's competitiveness, and at the same time contain the bubbles risks?
- (d) What steps should be taken to broaden and deepen the economic integration with the Mainland, while maintaining the unique advantages of Hong Kong as a special city of China?
- (e) Given the immense challenge of an ageing population, how should the fiscal sustainability over the medium to long term be ensured, and what should be the appropriate balance between expenditure and fiscal reserves?

39. FS said that Members were welcomed to give their views on the various issues, and he would seriously consider the suggestions, while upholding the principles of prudent financial management and spending within the means, in order to prudently utilise public money. A pragmatic and appropriate Budget would be drawn up having regard to the prevalent economic and social conditions. FS said that the objective was to promote the sustainable development of Hong Kong's economy, and maintain the long term stability of the Government's financial situation, so as to enable Hong Kong to meet the various economic challenges and changes in the social structure.

40. FS then gave a powerpoint presentation on the background information for the 2011-2012 Budget by highlighting the salient points in the information pack for the 2011-2012 Budget consultation. He then invited Members to give views on the preparation of the 2011-2012 Budget

(Post-meeting note: The information pack for the 2011-2012 Budget consultation was tabled at the meeting and was issued to Members vide LC Paper No. CB(1)615/10-11 on 30 November 2010.)

Discussion

Poverty and broadening of the tax base

41. Mrs Regina IP said that Members were concerned about the poverty problem and the need to provide a safety net for the poor, and that public expenditure on health services, social services and education had continued to grow, especially when the population was ageing. She enquired whether the Government would conduct a public consultation exercise to explore ways to broaden the tax base, so as to meet the increased expenditure of the

Government, including the provision of comprehensive retirement protection for the community. Mrs IP further enquired whether the Government would consider Mr David Webb's proposal to change the existing front-end loading payment system for land auctions and issuing Government bonds with interest rates higher than inflation, so as to provide stable sources of income for the Government.

42. FS responded that the Government was very concerned about the poverty issue, and the relevant Government bureaux/departments would continue to monitor the situation and draw up appropriate measures. The relevant LegCo Panels would be consulted on new initiatives to be introduced to tackle the issue. FS said that the Government would welcome views from Members and the public on ways to widen the tax base. In view of the recent rapid changes of the global and local economic situations, the Government had no plan to conduct a public consultation exercise on the issue for the time being. As regards the arrangements for land auctions and issue of Government bonds, FS said that the Government would consider Members' suggestions.

Relief measures

43. Ms Starry LEE opined that the Budget should support the policy initiatives set out in the Chief Executive's Policy Address, e.g. provisions should be made for development of the six priority industries. Given that a substantial surplus was expected for the current financial year, Ms LEE enquired, apart from "handing out candies (派糖)", whether the Government would consider any systemic reform of the taxation system in order to narrow the wealth gap between the rich and the poor, and introducing measures to stabilize transport fares and the prices of daily necessities so as to alleviate the pressure of inflation on the general public.

44. FS responded that making substantial changes to the fiscal policy and taxation system might not be acceptable to the public as the public preferred to maintain a stable economy for the development of Hong Kong. The Government would welcome concrete proposals from Members and the public for any systemic changes of the existing fiscal policy and taxation system in order to assist the low income group. The Government would review the arrangement for introducing relief measures, in view of the possible impact of the measures on fuelling inflation, and the International Monetary Fund (IMF)'s recent comment that Hong Kong should continue its anti-cyclical economic strategy whereas the introduction of further relief measures might not be appropriate. The Government was prepared to hear the views of Members and the public in this regard.

45. Mr WONG Kwok-hing enquired, given the advent of higher inflation, what measures would be taken to assist the lower income group, e.g. whether, similar to the arrangement of the Macao government, the Government would consider handing out cash to the public. Mr WONG opined that the Government should consider one-off relief measures such as freezing Government fees and charges, rebates on electricity charges and rentals, tax breaks on salaries taxes, in order to alleviate the burden of the middle and lower income groups.

46. FS responded that, similar to the situation in other areas of the region, the increase in food prices would lead to higher inflation, and the lower income group would suffer most since a major portion of their income was spent on food. The Central People's Government had already taken steps to stabilise the prices of food items. Members were welcomed to make concrete proposals for assisting the middle and lower income groups, bearing in mind the IMF's comment that Hong Kong should continue its anti-cyclical economic strategy and the fact that one-off relief measures would also fuel inflation.

47. In response to Mr WONG Kwok-hing's enquiry on whether the Government would introduce measures to revitalise the small businesses, such as resuming the issue of itinerant hawker licences and setting up flea markets, FS said that he would discuss with the relevant Government bureau regarding Mr WONG's suggestions.

48. Mr Ronny TONG said that the Government should consider the following measures to tackle the inflation problem and assist the middle and lower income groups:

- (a) using part of the fiscal surplus to offset the tunnel tolls payable by bus companies so as to stabilize the level of bus fares;
- (b) providing subsidies to public transport companies so that the elderly and the disabled using public transport would only have to pay half fare;
- (c) allowing green minibuses to increase their capacity to 20 seats so as to relieve the pressure for a fare increase;
- (d) reducing the tunnel tolls of the Eastern Harbour Crossing so as to rationalize cross-harbour traffic flows;
- (e) stabilising food prices by offering subsidies on imported staple food items;

- (f) extending the Special Stamp Duty measure to commercial properties with a view to stabilizing shop rentals; and
- (g) formulating a comprehensive strategy to promote sports and provide financial support to professional athletes.

49. Mr LEE Wing-tat said that the lower income households including the elderly and retired persons were most hard hit by the increases in food prices and the higher inflation rate. The Government should consider introducing relief measures for these persons such as waiving the payment of rates, public housing rentals and increasing the Old Age Allowance. Mr LEE opined that the Government should also make use of this year's fiscal surplus to improve the facilities and services of old aged homes. Mr LEE was also concerned that people like those who were not living in public housing estates and did not own any property had not benefitted from the relief measures introduced in past years.

50. FS said that he would discuss with the relevant Government bureaux/departments regarding Members' proposals. FS pointed out that people who could not benefit from the one-off relief measures, such as those who were not public housing tenants and did not own any property, could still benefit from the increased public expenditure on education, social and health services.

51. Mr LEE Cheuk-yan remarked that instead of "handing out candies" every year, the Government should carry out systemic reforms to solve various structural problems and problems arising from the ageing population etc. For instance, the Government should consider using the fiscal surpluses to set up a comprehensive retirement scheme for the benefit of the whole community. Mr LEE asked whether the Government would consider departing from the principle of containing the annual Government expenditure within 20% of the Gross Domestic Product (GDP).

52. FS responded that he had drawn up the annual Budgets based on the need to meet the demands of the community and the prevailing economic and social conditions. While GDP had grown by about 5% in recent years, public expenditure had increased by about 30%. When the need to implement a particular policy was justified, funds would be made available for implementation of the policy. The Government would continue to abide by the guideline on containing the annual public expenditure within 20% of the GDP.

Civil service pay

53. Given that the pay for senior civil servants had been reduced by 5.38% in 2009-2010, and the economy had already recovered with many private companies adjusting upward the salaries of their employees recently, Mrs Regina IP enquired whether the Government would consider increasing the salaries for senior civil servants.

54. FS responded that there was an established mechanism to deal with civil service pay, and any adjustment to the salaries for civil servants would be handled according to the established mechanism.

General issues

55. Mr WONG Ting-kwong opined that in order to optimize the use of available resources to assist the genuine needy, the Government should consider implementing the following measures:

- (a) actively consider buying back the Eastern Harbour Crossing and Western Harbour Tunnel so as to ensure a more evenly distributed traffic among the three cross harbour tunnels and reduce the economic loss;
- (b) provide funding support to environmental protection industries;
- (c) consider the establishment of a special industrial park jointly with the relevant authorities in Guangdong;
- (d) review section 39E of the Inland Revenue Ordinance (Cap. 112) with a view to granting depreciation allowance for machinery and plants used under the "import processing" arrangement; and
- (e) actively consider the provision of reverse mortgage for the elderly.

56. FS responded that said that the proposed initiatives had been discussed at the relevant Panels/Committees before, and he would further study the issues with the relevant Government Bureaux/Departments. If the Government decided to take forward any of the proposals, funding for implementation of the proposals would be made available. As regards the proposal for provision of reverse mortgage, some of studies and focus group discussions had been conducted, and the feedback from the elderly was not very forthcoming. The Hong Kong Mortgage Corporation would conduct further studies on the issue.

57. The Deputy Chairman remarked that with an improved economy, the whole community would benefit. The Government should therefore consider offering concessions/incentives to encourage multi-national companies to

establish their headquarters in Hong Kong so as to promote Hong Kong's economy and create more job opportunities. The Deputy Chairman opined that if the Government could not introduce, in the near term, any systemic reform to the taxation system for purposes including wealth re-distribution, one-off relief measures were still required to relieve the financial burden of the needy. The Deputy Chairman noted with grave concern that of the 633 000 registered corporations, only 80 000 or 13% paid profits tax, and nearly 90% of the corporations did not pay any tax. The Deputy Chairman remarked that the Government should check whether the situation was in line with that of other jurisdictions, or whether there were any loopholes in the profits tax system.

58. FS shared the view of the Deputy Chairman that all strata of the community would benefit from the improvement of the economy. Efforts were being made to explore new markets for Hong Kong's exports, and during his overseas visits, e.g. in Chile and Brazil, he would encourage overseas companies to set up their regional headquarters in Hong Kong. FS said that the fact that only 13% of the corporations registered in Hong Kong were paying profits tax was mainly a result of the taxation policy over the years to grant different types of concessions and allowances to businesses. The Permanent Secretary for Financial Services and the Treasury (Treasury) supplemented that the Government aimed to provide an environment to facilitate business and promote entrepreneurship. The threshold for payment of profits tax in Hong Kong was lower than that of other jurisdictions. Many companies might not be making profits and hence were not subject to profits tax, resulting in a narrower tax base.

59. Mr Paul CHAN said that he would conduct a survey in his professional constituency in order to collect proposals from the constituents for the Budget. He would put up the proposals to FS later. Mr CHAN said that despite the expected fiscal surplus for the current financial year, the Government should refrain from lowering the tax rates for profits tax and salaries tax for the high income group. Instead, the Government could consider (a) reviewing the tax levels for different income groups; (b) providing tax allowances for mortgage and medical insurance premium payments over an extended period; and (c) providing additional tax allowances for taking care of the elderly and for continuing education or training. Such measures could help alleviate the burden of the middle income group. Mr CHAN remarked that an overall review of the taxation system should be conducted in order to ensure the competitiveness and equitability of the system.

60. FS pointed out that revising the taxation levels for different income groups might result in less revenue for the Government. Given the low interest rates for mortgage loans, any additional tax allowance for repayment of mortgage loans might further aggravate the risk of a property market bubble.

FS said that the Government would consider the proposed measures to assist the middle income group. As far as health services were concerned, the Secretary for Food and Health would take into account Members' views in drawing up the healthcare policies.

61. The Chairman said that while he supported prudent management of public finance, he considered that the Government should gainfully deploy the fiscal surplus to solve problems such as poverty arising from the ageing population and the mismatch of manpower resources. The Government should also strive to enhance co-operation with the Mainland for the development of Hong Kong's economy and provision of social services for Hong Kong citizens, especially the aged, with a view to alleviating the pressure of social service provision on the public coffer.

V Extension of a supernumerary directorate post in the Financial Services Branch to coordinate anti-money laundering matters

(LC Paper No. CB(1)524/10-11(05) — Administration's paper on extension of a supernumerary directorate post in the Financial Services and Treasury Bureau (Financial Services Branch) to coordinate anti-money laundering matters

LC Paper No. CB(1)523/10-11 — Background brief on proposal to extend a supernumerary directorate post to coordinate anti-money laundering matters prepared by the Legislative Council Secretariat)

62. The Deputy Secretary for Financial Services and the Treasury (Financial Services) (DS(FS)) briefed members on the staffing proposal, by highlighting the salient points in the paper.

63. While supporting the staffing proposal, Mr WONG Ting-kwong was concerned that the relevant anti-money laundering (AML) work might not be completed by July 2012, in which case the supernumerary post might have to be extended beyond 15 July 2012, i.e. beyond the current term of the Legislative Council.

64. DS(FS) responded that the present proposal was made based on the existing and anticipated workload in relation to the enhancement of the AML regime in Hong Kong. If there were subsequent changes in circumstances and it was considered necessary to extend the tenure of the supernumerary post based on actual requirement, the Administration would submit a proposal well before July 2012 to extend further the term of the supernumerary post.

65. After consulting members, the Chairman said that the Panel supported the staffing proposal.

VI Treatment of accrued benefits derived from mandatory contributions for Mandatory Provident Fund in the case of bankruptcy of a scheme member

(LC Paper No. CB(1)524/10-11(06) — Administration's paper on treatment of accrued benefits derived from mandatory contributions for Mandatory Provident Fund in the case of bankruptcy of a scheme member)

66. The Deputy Secretary for Financial Services and the Treasury (Financial Services) (DS(FS)) briefed members on the proposal to amend the Mandatory Provident Fund Schemes Ordinance (Cap. 485) (MPFSO) to put it beyond doubt that accrued benefits derived from mandatory contributions (MC accrued benefits) in a registered Mandatory Provident Fund (MPF) scheme in respect of a scheme member were not to be vested in a trustee-in-bankruptcy (TIB) in case of bankruptcy of the scheme member, by highlighting the salient points in the Administration's paper.

67. Mr WONG Kwok-hing said that while he supported the proposed legislative amendment, he was concerned whether there were other appeal cases relating to provident funds. Mr WONG enquired about the Administration's plan to introduce further legislative proposals to improve the MPF System, given that the MPF System had been implemented for about 10 years and there had been calls for improvements to the System. Mr WONG further enquired about the timetable for implementation of the "Employee Choice Arrangement" (ECA).

68. Mr WONG Ting-kwong declared that he was a non-executive director of the Management Board of the Mandatory Provident Fund Schemes Authority (MPFA). He expressed support for the proposed amendment and considered

that the legislative work should be taken forward expeditiously. He shared Mr WONG Kwok-hing's concern and enquired about the progress of the preparatory work for implementation of the ECA. Mr WONG asked, given the heavy workload of the Department of Justice, whether the Government would consider outsourcing the law drafting work for other legislative proposals related to the MPF System in the pipeline.

69. DS(FS) responded that apart from the appeal case relating to the Subsidized Schools Provident Fund Rules (Cap. 279D) made under the Education Ordinance (Cap. 279), there were no other cases. The current legislative proposal aimed to better protect the interest of MPF scheme members in respect of their MC accrued benefits in registered schemes, by putting it beyond doubt that in the event of bankruptcy of a scheme member, the relevant benefits would not be made available to the creditors of that scheme member. DS(FS) said that as pointed out in previous replies to Members' questions, the MPFA was reviewing various aspects of the operations of the MPF System, including the restrictions on withdrawal of MC accrued benefits from MPF schemes, the transparency of fees and charges of MPF funds and the information that should be included in the annual benefit statements issued to scheme members. As regards the implementation of the ECA, the Administration and the MPFA were working on the legislative framework for the regulation of MPF intermediaries in consultation with other regulators. The Administration planned to brief the Panel on the legislative proposals in the next few months. The Financial Services Branch had been liaising with the MPFA and the Department of Justice regarding the manpower resources required for the relevant legislative work, and would not rule out any possible arrangement that could help speed up the drafting process.

70. Noting that the Court of Appeal had granted leave for an appeal to the Court of Final Appeal regarding the case concerning the Subsidized Schools Provident Fund Rules (Cap. 279D), Mr KAM Nai-wai asked whether and how the outcome of the appeal case would have impact on the current legislative proposal.

71. DS(FS) responded that the court case was related to the Education Ordinance (Cap. 279) but not the MPFSO (Cap. 485), and the appeal was made by the subsidized school teacher and not the Government. Since the wordings in the relevant provisions and the scope and application of the two Ordinances were different, the outcome of the appeal case should not have direct impact on the treatment of MC accrued benefits in MPF schemes under the MPFSO (Cap. 485). The Government put up the current legislative proposal simply to put it beyond doubt that where an MPF scheme member was adjudged bankrupt, his right or entitlement to any MC accrued benefits in his registered MPF scheme(s) was excluded from the "property" of the scheme member for

the purposes of the Bankruptcy Ordinance (Cap. 6). Since the outcome of the appeal case would not have any implication on MPF schemes, the future amendment bill could be scrutinized by the Legislative Council without having to await the completion and outcome of the appeal case.

72. The Deputy Chairman enquired whether the MC accrued benefits of a scheme member would be affected if he declared bankrupt at the time when he was eligible for drawing out his MC accrued benefits from the MPF scheme.

73. DS(FS) responded that under the legislative proposal, a scheme member's MC accrued benefits in a registered MPF scheme were excluded from the "property" of the scheme member for the purposes of the Bankruptcy Ordinance (Cap. 6) until the scheme member had withdrawn his MC accrued benefits from the MPF scheme.

74. Mr IP Wai-ming enquired whether the mandatory contributions to the MPF scheme of a scheme member, who had been adjudged bankrupt but was still working, were calculated based on the whole sum of his salary, or the deducted salary after payment to his creditors.

75. DS(FS) responded that under the MPFSO (Cap. 485), employer's and employee's contributions to an MPF scheme should be made based on the whole sum of salary paid to the employee, irrespective of whether the employee had been adjudged bankrupt.

VII Any other business

76. There being no other business, the meeting ended at 12:32 pm.

Council Business Division 1
Legislative Council Secretariat
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