

OFFICIAL REPORT OF PROCEEDINGS**Thursday, 3rd April 1975****The Council met at half past two o'clock****PRESENT**

HIS EXCELLENCY THE GOVERNOR (*PRESIDENT*)
SIR CRAWFORD MURRAY MACLEHOSE, KCMG, MBE
THE HONOURABLE THE COLONIAL SECRETARY
MR DENYS TUDOR EMIL ROBERTS, CBE, QC, JP
THE HONOURABLE THE FINANCIAL SECRETARY
MR CHARLES PHILIP HADDON-CAVE, CMG, JP
THE HONOURABLE THE ATTORNEY GENERAL (*Acting*)
MR GARTH CECIL THORNTON, QC
THE HONOURABLE THE SECRETARY FOR HOME AFFAIRS
MR DENIS CAMPBELL BRAY, JP
THE HONOURABLE JAMES JEAVONS ROBSON, CBE, JP
SECRETARY FOR THE ENVIRONMENT
DR THE HONOURABLE GERALD HUGH CHOA, CBE, JP
DIRECTOR OF MEDICAL AND HEALTH SERVICES
THE HONOURABLE JAN MACDONALD LIGHTBODY, CMG, JP
SECRETARY FOR HOUSING
THE HONOURABLE DAVID HAROLD JORDAN, MBE, JP
DIRECTOR OF COMMERCE AND INDUSTRY
THE HONOURABLE LI FOOK-KOW, CMG, JP
SECRETARY FOR SOCIAL SERVICES
THE HONOURABLE DAVID AKERS-JONES, JP
SECRETARY FOR THE NEW TERRITORIES
THE HONOURABLE LEWIS MERVYN DAVIES, CMG, OBE, JP
SECRETARY FOR SECURITY
THE HONOURABLE DAVID WYLIE MCDONALD, JP
DIRECTOR OF PUBLIC WORKS
THE HONOURABLE KENNETH WALLIS JOSEPH TOPLEY, JP
DIRECTOR OF EDUCATION
THE HONOURABLE IAN ROBERT PRICE, TD, JP
COMMISSIONER FOR LABOUR
DR THE HONOURABLE CHUNG SZE-YUEN, CBE, JP
THE HONOURABLE WILSON WANG TZE-SAM, OBE, JP
THE HONOURABLE LEE QUO-WEI, OBE, JP
THE HONOURABLE OSWALD VICTOR CHEUNG, OBE, QC, JP
THE HONOURABLE ROGERIO HYNDMAN LOBO, OBE, JP
THE HONOURABLE JAMES WU MAN-HON, OBE, JP
THE HONOURABLE HILTON CHEONG-LEEN, OBE, JP
THE HONOURABLE LI FOOK-WO, OBE, JP
THE HONOURABLE JOHN HENRY BREMRIDGE, JP
DR THE HONOURABLE HARRY FANG SIN-YANG, OBE, JP
THE HONOURABLE MRS KWAN KO SIU-WAH, MBE, JP
THE HONOURABLE LO TAK-SHING, JP

ABSENT

THE HONOURABLE MRS CATHERINE JOYCE SYMONS, OBE, JP

THE HONOURABLE PETER GORDON WILLIAMS, OBE, JP

THE HONOURABLE FRANCIS YUAN-HAO TIEN, OBE, JP

IN ATTENDANCE

THE CLERK TO THE LEGISLATIVE COUNCIL

MR KENNETH HARRY WHEELER

Second reading of bill (resumed debate)**APPROPRIATION BILL 1975****Resumption of debate on second reading (19/20th March 1975)**

MR JORDAN: —Sir, as my honourable Friend Mr WU said, Hong Kong thrives on confidence, entrepreneurship and the industry of its people, and policies that undermine or discourage these could only bring calamity. He went on to deplore the lack of closer co-operation and proper co-ordination to achieve even better results.

But closer co-operation and proper co-ordination would not necessarily produce better results. There are plenty of examples in the world around us of co-ordinated economic development plans that have produced rather disappointing results.

On the other hand, Hong Kong's economic policy is *not* pure *laissez faire*. If it were we would have no companies legislation, no securities legislation, no statutory Export Credit Insurance Corporation, Trade Development Council nor Productivity Council, no Consumer Council, no labour legislation. Indeed we would never have disposed of land on special terms for industrial or any other particular use: we would sell all land to the highest bidder and let him do what he liked with it.

I could go on with many more examples—for instance, I doubt if we would have a Director of Commerce and Industry and I'm sure we wouldn't have a Trade and Industry Advisory Board at all—but perhaps I have given enough examples to make my point that in the past quarter of a century the Hong Kong Government has become steadily more involved in regulating economic activity and in providing

services to assist that activity; and that if *laissez faire* ever was an appropriate label for the Hong Kong Government's policy and attitudes it certainly isn't now.

So I think that the difference between my honourable Friend and me is on a question of degree rather than of principle.

He is concerned, as we all are, at the amount of unemployment and under-employment in Hong Kong at present. I would like to emphasize that the Government *is* concerned about this and is very conscious of the difficulties that everyone faces this year. But we must not forget that our long-standing policy of not *laissez faire* but minimum interference has proved itself over the last twenty-five years. Within the framework of that policy Hong Kong has transformed itself from a trading port to a great manufacturing centre, among other things. Twenty-five years ago we exported about five hundred million dollars' worth of Hong Kong manufactured goods; last year, twenty-three thousand million dollars' worth.

I am not suggesting that our present policies and practices are sacrosanct but only—if I may use a figure of speech that is for me rather close to home again just now—that we should take care not to throw the baby out with the bathwater (*laughter*). My honourable Friend would like to see greater co-operation and co-ordination, but co-ordination requires first the determination of the objects to be achieved and then, where voluntary co-operation fails, the invocation of authority. *Co-ordination* of the economic development of Hong Kong would, I believe, inevitably involve the "more Government controls and regulations" which my honourable Friend says must be vigorously resisted.

And I agree with him. Although it is part of the Commerce and Industry Department's job to encourage and assist and promote industrial investment and development, the business decisions must be left to the entrepreneur himself.

It will seem surprising to many people in other countries that, in a situation of recession, unemployment, deflation, the budget is only mildly inflationary and contains no special incentives for investment.

I am convinced that tax holidays, protective tariffs, industrial development grants, cheap loans, cheap land, tend to distort commercial judgment. They have in many cases resulted in the establishment of enterprises that are fundamentally unsound—that is they cannot survive without the incentives or protection that were intended only to help them get started.

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If we had had these things, we should now have, I believe, greater unemployment and more business failures. And if we were to make radical changes now to stimulate investment in new manufacturing enterprises they would make little contribution for some time to come. This year we must rely on our established industries. We have to get out and sell what we can make now. And that is what our manufacturers and exporters are doing.

We produce a wide range of consumer goods of good consistent quality and at competitive prices. We shall of course continue to move up the scale, spurred on by the competition from others. Present difficulties will inevitably, here as elsewhere, accelerate the decline of those industries and firms that are no longer competitive. We must put no obstacles in the way of the changes that are necessary to our survival.

I mentioned that it is one part of our job in the Commerce and Industry Department to encourage and assist and promote industrial development and investment. In this we are assisted by the Trade and Industry Advisory Board.

I am sorry that my honourable Friend who is now the longest serving member of the Board, should feel that it falls far short of his expectations in the evolution of economic policies. This may be partly because it doesn't have quite the role in the evolution of economic policies that he would like it to have. I have been Chairman of the Board for only two and a half years, and during that time I have certainly received a great deal of helpful advice from it.

The subjects the Board has discussed cover a pretty wide range and have included, during the past year or so, for example, the loans for small industry scheme, shortages of raw material supplies, industrial land policy and procedures, industrial investment promotion, the rice trade and the Government's rice control scheme, factories in domestic buildings and so on. The Industrial Land Committee of the Board has been instrumental in proposing quite far reaching revisions in the Government's land policy, and the Government action in 1973 temporarily to limit re-exports of plastic raw materials was taken off the Board's advice.

I am not the Government's spokesman on industrial land policy but I should like here to make a few comments on it. The Government

has traditionally sold land for industrial purposes at auction *as a matter of policy*. The policy has been pretty successful at least in the urban areas where the relatively high cost of land to the purchaser has encouraged him to erect high rise industrial buildings. These have provided some sixty million square feet of industrial floor space for our light industries and these industries in turn have provided employment for hundreds of thousands of workers. Had high rise buildings not been constructed in the urban areas it seems to me unlikely that a balance would have been struck between population and employment. In short, the operation of market forces has ensured full economic and social use of a scarce commodity, while also maximising its contribution to revenue.

The Government has over the years shown itself willing to modify the basic land policy when a real need arises. For instance, in the past, industrial sites have been sold at low prices on a restricted user basis in order to help relocate industries such as those in Junk Bay and Yau Tong Bay. More recently a major modification of land policy has been made because it had been demonstrated that such a revision might result in the development of economically attractive industries which cannot locate in high rise buildings. But sites sold by private treaty or tender for special industries will not normally be in the urban areas and this, in my view, makes a good deal of economic sense.

The consideration given to the construction of industrial estates is another example of Government response to industrial needs. I cannot, of course, predict the outcome of this consideration but I can say that many departments have been involved in a most detailed study of the various factors; that this work has been given a good deal of priority; and that the Trade and Industry Advisory Board and its Industrial Land Committee have been informed and consulted at every stage.

In recent years the Commerce and Industry Department and the Trade Development Council have expanded their efforts in the field of industrial investment promotion. A branch of the department is engaged full time in this work.

My honourable Friend Mr TIEN has suggested that the two hundred thousand dollars earmarked for this work is a meagre sum. While we could certainly make good use of more than this if we can get it, I should make it clear that this provision is only for the additional expense involved in overseas promotion work. The services of the Industrial Promotion Branch of the department are available in Hong Kong to local and overseas investors alike, and there is quite a good

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deal that we can do from our home base. As far as our effort overseas is concerned, we are of course limited by the financial provision made in the Estimates but I hope nevertheless that we shall be able to mount a few small-scale missions, with the assistance of the Trade Development Council. One such mission has recently returned from Australia and we are as a result now handling a number of encouraging inquiries from Australian manufacturers.

Before I turn to the other principal aspect of our overseas work—the protection of our access to our principal markets—I should like to comment on my honourable Friend Miss Ko's remarks on the work of the Consumer Council and on the need for improved consumer education and protection. I shall leave consumer education to the Consumer Council and my honourable Friend Mr TOPLEY, who is going to introduce this subject into his new syllabuses.

The department's involvement is principally in co-operation with the Council on consumer protection. Since the Council was set up a year ago, the department, using existing staff resources, has been able to carry out over sixty investigations on behalf of the Council. Some of these were quite time consuming and I am sure my honourable Friend will appreciate that we were breaking new ground in many cases and they therefore had to be conducted with concern for the legal rights of the individuals and companies concerned. Several prosecutions have been taken against firms which misrepresented goods sold to consumers. These prosecutions have had, I think, a beneficial effect on the conduct of retail trade in Hong Kong.

I hope that the influence that the Council brings to bear will reduce the need for legal action against retailers by making all sectors of the retail trade more conscious of their obligations to the consumer. In the meantime the department will continue to assist the Council as far as it is able to within its staff limitations.

I should perhaps here sound a note of warning about the passage into law of the proposed new Weights and Measures and Trade Descriptions Bills. These pieces of legislation, as presently drafted, would considerably increase the Government's responsibilities in the field of consumer protection and I have no doubt that they would be well received by the public. But their implementation will require additional trained staff. This could prove to be a fairly expensive undertaking and in the light of the present financial situation I am afraid we cannot hope to make much progress this year.

May I now turn to the four items concerning Hong Kong's commercial relations with some of our trading partners which were raised by my honourable Friend Mr TIEN?

First, the United States Generalized Scheme of Preferences. On 18th March President FORD issued two lists of countries. One of these lists contained the names of those countries which the President had designated as beneficiaries under the US Generalized Scheme of Preferences. Hong Kong wasn't on that list. Instead, it was on the second list, in which were named the countries which *could* be eligible for designation but in respect of which the US Administration had not yet taken a final decision.

We had, of course, been in close and constant touch with the US Administration through the British Embassy in Washington. The Embassy submitted earlier in the year an *aide-mémoire*, which spelt out Hong Kong's case for inclusion in the Scheme, and has been working vigorously on Hong Kong's behalf. However, although the latest indications are reasonably encouraging, it seems that there may still be some doubts about Hong Kong's case in Washington. I shall try to dispel them when I go to Washington later this month.

I won't go into the details of the Scheme, which is embodied in a complex piece of legislation. But I should mention that textiles, footwear, watches and certain designated electronic items are *excluded* from its provisions altogether—that is to say that there will be no preferences for anybody on these items and we shall all continue to compete on an equal footing.

We estimate that this leaves roughly \$2,000 million worth or about a quarter of our exports to the USA to which the Scheme could apply. But even this amount could be further reduced if the American International Trade Commission decides to extend the list of items to which the Scheme does *not* apply. But from our point of view the important thing is that unless we are included in the Scheme, our trade in the items that are covered by it will be put at a competitive disadvantage as compared with the beneficiary countries, which already include Korea, Taiwan and Singapore.

The other Generalized Scheme of Preferences of importance to Hong Kong is of course that of the EEC. This, too, is a complex piece of legislation which is reviewed and revised each year. It was in this latter connection that we received a visit last month from an EEC delegation led by Mr TRAN Van Think. Mr TRAN was cautiously optimistic that some of the discrimination against Hong Kong in the

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EEC's scheme will be removed when the details of the 1976 version are published later this year. Again, we are in constant touch with the Commission, and the Member States' governments where necessary, in attempts to have the discrimination against Hong Kong removed. In this connection the creation of the post of Minister for Hong Kong Commercial Affairs in Brussels has already proved invaluable, in that it has given us access to officials at higher levels. This is essential in view of the many items of importance to Hong Kong's trade relations with the Community that we have to deal with now.

My honourable Friend suggested that we should also consider inviting more EEC officials to visit Hong Kong. This is certainly a worthwhile suggestion which I shall pursue with our Minister in Brussels and with my honourable Friend the Financial Secretary.

Another major item of importance in Hong Kong's commercial relations with the EEC is the conclusion of an agreement to regulate Hong Kong's trade in textile products with the Community. The first round of negotiations in an attempt to conclude such an agreement was joined on 17th March and lasted four days.

I can say very little about these negotiations because this first stage didn't carry us very far. However, I can say that good—but slow—progress was made along lines that will help to make it possible to conclude a satisfactory agreement.

The next round will start on 12th May, again in Brussels. The two sides are expected to go into details, such as the coverage of the restraint sought by the Community and the justification for it. It is difficult to make any prediction as to how far this next round might carry us. Much depends on the extent to which the EEC can justify its request for restraint. It is up to them to establish that imports of particular products from Hong Kong are posing real risks of market disruption, which is defined in the International Arrangement under which these negotiations are being held.

We are, as is the Community, hopeful that we can reach an agreement, which will at least provide some certainty to the trade, an element lacking in the current unilateral arrangements which have been extended from time to time as the deadline of each period approaches.

The last item on my honourable Friend's list was the imposition of tariff quotas by the Australian Government on a wide range of textile imports. The quotas were applied without discrimination—all suppliers to the Australian market are affected—but this is one case in which Hong Kong does object to non-discriminatory action. The effect on Hong Kong's trade is bound to be significant since it is the Australian Government's professed intention to reduce imports very substantially; in other words the tariff quotas are intended to have the effect of quantitative restrictions. In our view such action should be taken only under Article XIX of the GATT and only when the provisions of the International Arrangement on Trade in Textiles have been shown to be inadequate to deal with a genuine problem. Since the Australian Government has not based its action on either Article XIX or the International Arrangement we have notified them that we reserve our right to seek consultations with them in accordance with Article IX of the Arrangement.

I should add that the Australian action has generated a great deal of international concern because of its inherent dangers for the future of the International Arrangement, of the Multi-lateral Trade Negotiations and perhaps even of the GATT itself. It has therefore been raised in the GATT Council and in the Textiles Surveillance Body, the organisation which has been created to police the Textiles Arrangement.

Discussions in Geneva have not yet been concluded, and I hesitate to predict the eventual outcome. We are, of course, actively involved in what is going on in Geneva, and we shall continue to be, in order to protect what we believe to be Hong Kong's legitimate trading rights.

Sir, I support the motion.

SECRETARY FOR HOME AFFAIRS: —Sir, three Members were good enough to mention Radio Hong Kong in terms which left no doubt as to their appreciation of its services. We have indeed had to cut expenses like everyone else and a cut in expenditure must mean a cut in services. These cuts will not mean that as important public issues arise we shall be without means to air them. I agree that the presentation of budget options was most helpful and we shall be able to do the same thing again on similar occasions.

Big expenditure in Radio Hong Kong is on good Chinese television. The Director of Broadcasting has enough money to keep the series "Below the Lion Rock" going for six months and I think we can get

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hold of other money to keep it going for another three—which is about as long as the programme will stand without a rest. "Needle-point" is popular with a big audience and will be maintained as will "Viewpoint and Angles" on the Chinese networks. On the English networks a different way of filling the viewpoint time slot will be introduced using mainly money hitherto spent on short films embodied in news bulletins.

Like many others I shall mourn the passing of some of the programmes I like best. It's been frightful trying to shave in the last few mornings without the good music from RHK 4 to give me strength to face the rigours of the day. Economic and social progress may receive some stimulus after the reduction in cricket coverage during working hours (*laughter*). I do not like cuts any more than anyone else and I do not propose to sit about waiting for the economy to recover without doing what I can to restore some of what we have lost by one means or another.

My honourable Friend, Mr BREMIDGE, spoke about the recreational possibilities of reservoirs. Of course he is right to say that reservoirs have an untapped recreational potential but this potential cannot be exploited without expense nor is all recreation barred now.

Fishing is in fact permitted in all reservoirs under licences which impose restrictions designed to leave enough fish to help to maintain the quality of the water.

Swimming and boating are another matter. While I should happily continue to drink my water unboiled even if I knew my honourable Friend had had a dip in the reservoir (*laughter*) it would be quite impossible to allow unrestricted use of reservoirs for swimming and boating. Swimming is universally frowned upon by water undertakings here and elsewhere not only because of pollution but also because of the danger to swimmers disappearing down those yawning bellmouth overflows. Boating is allowed elsewhere with restrictions on reservoirs miles away from the sea.

The demand for boating on reservoirs must be very limited because our big reservoirs are so near the sea. Only half of Plover Cove was taken into the reservoir. The other half is still available for boating and the Schools Sailing Association is building a sailing centre on the sea water half. They already have another sailing centre in Tytam

Bay just below Tytam reservoir. You can only get to Shek Pik reservoir after driving past miles of empty beaches. Tai Lam Chung dam is only a few yards away from the sea and when High Island reservoir is completed it will adjoin one of the most beautiful areas of sheltered sea water we have.

There are plans to convert a very small reservoir at Wongneichong Gap into a boating lake when funds can be found to divert the waterways which feed it.

Some further recreational use of reservoirs may be practical and desirable. Reservoirs would be a nightmare for dinghy sailing with wind coming from all over the place and except or the larger, more distant ones, they are too small for rowing for racing. In the New Territories there are many areas of sheltered sea water where people could, and in some cases do, enjoy rowing about in small boats. Perhaps there is a frustrated demand for this on the Island so we shall consider this further in the Council for Recreation and Sport; but in the meantime those who enjoy just looking at calm water will be able to continue to do so (*laughter*).

THE COLONIAL SECRETARY: —

Independent Commission Against Corruption

Sir, I am glad to hear that there has been no weakening of the strong support of honourable Members for the work and objectives of the Independent Commission Against Corruption.

One Member has suggested, and I realize he is voicing an opinion which has been expressed by some members of the public, that the Commission should limit its investigation to offences of corruption committed since the formation of the Commission in February 1974.

I must make it clear that the law requires the Commissioner to investigate corruption wherever this may be found. In practice, the majority of the resources of the Commission will be concentrated on present and future corrupt activities, but it would be totally wrong, and indeed a dereliction from the duty imposed by law on the Commissioner, for the Commission to refuse to investigate past corruption where this emerges.

Furthermore, it is often essential to study the past pattern of corruption in order to diagnose its present condition and its likely future development.

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There can, therefore, be no question of giving any general amnesty with regard to corrupt offences committed before any particular date. Indeed, I think it would be unprecedented for an amnesty, which is occasionally granted for offences connected with firearms or those which have some political element, to be applied to an ordinary criminal offence like corruption. I do not rule out the possibility that there might be circumstances in which a limited or special amnesty for corruption offences might be of positive value to the community and of assistance to the Commission in the attainment of its objectives. If so, then serious consideration will be given to it but such a time is, in my opinion, a long way off. The Commission has made a fine start and I believe it has secured a measure of public confidence. While we may all be encouraged by the first signs of fear which can be detected among the corrupt, the Commission is well aware that it has only begun to scratch the surface of corruption in Hong Kong and that a heavy task remains to it.

Some fears have been expressed that the efforts of the Commission may be having an adverse effect on police morale. Let me emphasize that the objective of the Commission is to root out corruption; it is not to launch a witch hunt or to bring fear to innocent and honest men. I know that the Commissioner of Police believes the morale of his Force will be positively improved by the weeding out of corrupt officers. From time to time, allegations are made that the Police Force is corrupt throughout. I have no doubt that honourable Members will agree with me that this is a gross exaggeration and unfair in the extreme to the thousands of members of the Force who are devoted, loyal and honest men, discharging a difficult, uncomfortable and frequently dangerous task with skill and determination. They are at anxious as we and the public to see a force which is free from corruption and is therefore a better instrument for dealing with crime, which unhappily remains a major social problem, because the force needs not only public support but public respect if it is to be fully effective.

The honourable Mr LI has expressed some doubts about the manner in which the estimates of the Commission are presented. Honourable Members are aware, of course, that details of each approved post and subhead of expenditure have been presented to and approved by the Finance Committee of this Council, although details of the expenditure on the Commission are not published in the Estimates in the same manner as those of Government departments, and the Judiciary and the Public Services Commission.

I should remind Members that the reason for including the estimates of the Commission as a "one line vote" in the same way as such other organizations as the Consumer Council on the TDC, was to underline its independence. It was always intended that the Commission's estimates should be published in its annual reports, the first of which will be laid on the table of this house very shortly.

However, if honourable Members attach importance to this procedural point, the expenditure of the Commission can be published in the same way and at the same time as those of the other bodies of an independent nature to which I have referred. Your Excellency has intimated that you see no objection to this and the Commissioner has told me that he would welcome the expenditure of the Commission being open to public scrutiny. I shall therefore arrange for the estimates of the Commission to be published in the same way as those of the Judiciary in future years.

The honourable Mr Lo referred to the infinitely larger sums of public money which are spent on subvented bodies, and I wonder if the honourable Mr Li feels as strongly that the details of this expenditure should be published at the same time as the estimates as he does about those of the Commission?

Meanwhile, I can assure honourable Members, and the public in general, that all requests for the provision of public funds for the purposes of the Commission are scrutinized with the same care as requests from Government departments. It is, therefore, unlikely that there is any wastage in the Commission's budget. I think it is right to remind honourable Members that the rooting out of corruption will inevitably involve us in substantial expense. I know that Members will agree that this must not deter us from a task which is so vital to the health of our society.

Civil service recruitment

There have been a number of references by Members to cuts, either in departmental expenditure or in the money provided for various projects, and it has been suggested or assumed that these have been imposed by the Financial Secretary.

I think I should remind Members that the allocation of resources is a corporate decision taken by the Colonial Secretariat and not by the Financial Secretary personally or by the Finance Branch on its own.

After the first submission of departmental estimates, the Finance Branch of the Secretariat performed its traditional functions of trimming

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from them any inessential items and achieving economies and cost reductions. When this process had been completed there remained a very heavy excess in departmental estimates over the amount of money which the Financial Secretary thought it prudent to spend, in accordance with his budgetary proposals.

The Colonial Secretary's Committee then undertook the task of deciding how this gap between departmental bids and available resources was to be closed and which items and projects would have to be reduced or deferred to achieve this.

One of the decisions taken by this committee was that there should be a maximum increase of 1,600 in the strength of the public service during the period from 1st January 1975 to the end of March 1976. This figure of 1,600 amounts to about 2% of the strength of the public service which was (excluding the Urban Services Department and Housing Department) about 83,000 on the 1st January this year, out of an authorized establishment on that date of about 92,000. In addition to the increase in strength of 1,600, departments will be permitted to replace any wastage which occurs during that period, as compared with the strength of the department on the 1st January 1975, so that the total strength of the public service may rise to about 84,600 by the end of March next year.

Clearly the division among departments of such a relatively small number of additional officers has been extremely difficult, and nobody agrees with the opinion of anybody else as to the relative priority which should be given to many very deserving objects.

The Committee has decided that more than half of the total must be allotted to the Police and the Prisons, to the Police because of the continuation of the high incidence of crime and to the Prisons Department because, as a result of this and of the heavier sentences which have been imposed by the courts in the past year or two, our prisons have become gravely over-crowded. Thereafter, we have given preference to those departments, particularly the Rating and Valuation and Inland Revenue, which are concerned with revenue collection. This leaves, I am afraid, a small balance for distribution among all the other departments, however valuable may be their services to the public. This will inevitably give rise to grave difficulties for some departments, but I am sure that honourable Members will agree that, in difficult times, the growth of the public service must be ruthlessly contained.

I would like to say how much I appreciate the loyal and helpful way in which heads of departments have reacted to the problems which have arisen from these restrictions.

The honourable Mr LOBO enquired about the auxiliary services and it is certainly true that some of them will suffer severely as a result of our financial constraints. The Government fully recognizes the importance of these services, not only because of the valuable work which they perform for the community but also because they encourage voluntary service and provide an admirable outlet for the energies and imagination of so many of our young men and women.

I can assure Members that the reduction in funds available for auxiliary services does not mean that the Government under-estimates their importance. When times improve we shall certainly hope to be able to build up the scale of their activities again.

Meanwhile, the funds provided will I am assured be sufficient to maintain training of members at a satisfactory level and I believe the Civil Aid Services will be able to continue to provide an effective service even though this will be at a much lower level than we would all like to see.

The honourable Dr. CHUNG has asked why the Government does not try to obtain more water from China.

During the past 15 years, we have established and maintained close contact with the appropriate Chinese authorities on this subject and there are frequent meetings between water engineers on both sides.

The practical results of this can be seen in the 1972 Agreement, which increased the annual amount supplied from China to 18,500 million gallons and the recent Agreement whereby a further 2,500 million gallons a year are to be made available.

However, it must be appreciated that, even assuming the availability of substantial further water from China, there are considerable technical problems to be overcome. The existing delivery systems would require to be extensively modified, including the construction of additional pipelines and pumping facilities on both sides of the border.

I am confident that our close and friendly relationships with the relevant Chinese authorities, based on a mutual understanding of each other's needs and problems, will continue and may in due course make it possible for further water to be supplied from China.

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Meanwhile, I am glad to have this opportunity of saying how much we appreciate the co-operation and complete reliability of the Chinese authorities under the various water agreements which we have had with them.

Sir, I support the motion.

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THE FINANCIAL SECRETARY: —

(1) *Introduction*

Sir, my colleagues and I are glad that honourable Members found the presentation of the budget for 1975-76 and the forecast of the situation we may face in the three forecast years 1976-77 to 1978-79 helpful and we are grateful to them for their very generous comments.

2. Sir, if I have read the sense of this debate correctly, honourable Members do not find themselves in fundamental disagreement with the four elements of my budgetary strategy or the balance struck between them or, indeed, with the content of each⁽¹⁾. I shall begin by disposing of two specific issues before dealing with the more general issues raised during the debate and the various suggestions made as to fiscal policy and the management of our affairs in the future.

(2) *Macao Ferry Terminal Passenger Charge*

3. When I proposed an increase in the charge at the Macao Ferry Terminal from 50 cents a single journey to \$5, I had in mind, of course, casual visitors to Macao and commuters from Macao. I fully take the point put forward by my honourable Friend Mr CHEUNG, on behalf of all Unofficial Members, that there may be travellers to and from Macao for other reasons. To cater for them I propose to modify the charge so that adults and children paying a fare (excluding the charge) not exceeding \$12 would pay a charge of \$2 for each journey, at a cost to the revenue of \$500,000. All others, including those travelling on complimentary tickets, would pay \$5 as I originally proposed. These charges will come into effect on 14th April.

4. I realized that this modification is theoretically capable of abuse in several ways. So I feel obliged to record, here and now, that if those concerned—both operators and passengers—attempt to evade artificially, as it were, the normal charge of \$5, I shall have to reconsider the wisdom of continuing with the concessionary \$2 charge.

5. As honourable Members are well aware, Sir, relations between Macao and Hong Kong have always been very close and it is inconceivable, therefore, that this Government would ever wish to act in a way that would result in material damage to Macao. Before proposing this charge, I satisfied myself that this would not happen.

⁽¹⁾ B.S., 1975, paragraphs 65.

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However, Sir, let me repeat today the assurance I gave in paragraph 127 of the budget speech that if, after a reasonable period of time, I was satisfied that the numbers travelling to and from Macao were seriously affected, I would be prepared to reconsider the tax-loading element in the charge.

(3) *Surcharge on Peak-hour Movements at Kai Tak*

6. My honourable Friend Mr BREMRIDGE delivered himself of a spirited attack on the surcharge I have proposed for peak-hour movements at Kai Tak. First of all let me say that this is not "a signal example of random taxation". Between midday and 6 *p.m.* is the peak period during which movements per hour exceed the average of movements per hour between 8 *a.m.* and midnight. More than half the number of daily movements fall into this six hour bracket. However, as the number of movements between midday and 1 *p.m.* only slightly exceeds the average during the 16 hours between 8 *a.m.* and midnight, I am generously prepared to re-define the peak period from 1 *p.m.* to 6 *p.m.* at a cost to the revenue of about \$1.2 million in 1975-76. Secondly, I did not, as my honourable Friend implied, propose this surcharge as a means of discouraging airlines from using the peak period. I am aware that the concentration of movements in the peak period is partially the result of Hong Kong's geographical position. My point was that peak movements are dictating the size of the Government's investment at the airport. The fact is that, if movements were spread out evenly over the day, the present facilities at the airport would be adequate and the substantial capital expenditure we are now undertaking would be unnecessary, at least for the time being. But if, as a by-product of the surcharge, some airlines do adjust their schedules, given that the runway is reaching saturation in the peak period, so much the better.

(4) *The Economy and Public Policy*

7. Like my honourable Friend the Director of Commerce and Industry I was disappointed that my honourable Friend Mr James Wu again sought to pin a *laissez-faire* label on this Government, despite all the evidence to the contrary and the many disclaimers in this Council in recent years. In my view, an objective description of our policies would be realistic pragmatism, not *laissez-faire* though if, by *laissez-faire*, is meant an absence of bureaucratic sprawl, I would not

be too defensive about the label. My honourable Friend seems, I am afraid, to define *laissez-faire* as a situation in which Government policies do not quite conform to his ideas (*laughter*) and yet the right economic and fiscal policies for Hong Kong are almost entirely dictated by our circumstances. We ignore those circumstances at our peril. If we recognize them and tailor our policies accordingly then, I venture to say, we shall achieve the goal set by Professor SAMUELSON and quoted by my honourable Friend, namely' "(the provision of), a favourable environment within which the people can have the widest opportunity for achievement." This Government's traditional approach indeed was, in fact, most adequately summed up by my honourable Friend Mr BREMRIDGE when he said ". . . commonsense, sensitivity and flexibility (marching) hand in hand with dogma." (*Laughter*).

8. Certainly, I would claim that the Hong Kong Government's overriding objective in the past 20 years has been, to quote my honourable Friend Mr WU again, "to increase the GNP" and I would also claim that we have achieved a considerable measure of "success". Consistent with our pragmatic approach we have demonstrated in recent years a willingness to respond with modified policies to changing circumstances, but we must not make mistakes. However, I can assure my honourable Friend that the potential supply of, and possible demand for, land for high density light industries as well as low density heavier industries over the next few years is the subject of very detailed consideration at this time.

(5) *Budgetary Strategy*

(a) *Draft Estimates of Expenditure*

9. A number of honourable Members, while accepting the case for the budgetary strategy generally, expressed concern about the emphasis in the budgetary strategy on the containment of expenditure, although a number of others—my honourable Friends Mr TIEN and Mr BREMRIDGE for example—commended the Government's prudence for not allowing, to quote the actual words of my honourable Friend Mr BREMRIDGE, "spending to exceed what we can properly afford." Let us not forget that the so-called cuts or reductions were largely in respect of departmental submissions and a study of the memorandum notes on each head of expenditure will reveal that services and programmes are for the most part being maintained and, in some cases, expanded, albeit on a more limited scale than most of us would argue was desirable in other circumstances. It is these memorandum notes on which we should focus our attention for they explain what the

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Government is going to do. I do not think it is logical to focus on what has not been accepted for inclusion in the draft Estimates for this motion concerns the Appropriation Bill, that is to say, it invites this Council to approve expenditure of \$6,600 million—yes, \$6,600 million or nearly three times expenditure at the beginning of this decade—as a charge upon the General Revenues of the Colony.

10. Furthermore, the provisions sought under each head and subhead are consistent with each other, that is to say, for each service and capital works project sufficient funds and staff are provided to enable stated intentions to be achieved. Of course I do not expect all my official colleagues readily to agree with me and there may be odd cases of inadequate provision and even omission. And, by the way, Sir, I read that particular sentence before I read the editorial in today's edition of one of our morning newspapers which, apart from being a rather obvious attempt to provoke dispute, confuses the draft Estimates of Expenditure for 1975-76 with the outlook for the forecast years and loosely uses such emotive terms as "major setbacks" and "tip of the iceberg". As I said, there may be odd cases of inadequate provision in the Estimates. But, as they have lectured the Civil Service on the same subject on many occasions, I am sure honourable Members will have listened to what I said in paragraph 69 of the budget speech with approval, "With submissions reduced overall by 10%, heads of departments will have to explore energetically ways and means of achieving maximum cost-effectiveness if services are to be maintained at a reasonably viable level" I am not suggesting, to quote my honourable Friend Mr LI Fook-wo, that "mere freezing or cutting down " leads to greater efficiency, but it is a necessary initial step and, for my part, I would say this to my honourable Friend Mrs SYMONS: I believe the Civil Service wishes—to quote her words—I believe the Civil Service wishes "to move ahead (with) the community in the whole area of hard work, discipline and viability".

11. I would certainly endorse the comments of my honourable Friend Mr T. S. Lo on the need for the subvented organizations to bear in mind cost-benefit considerations. He is very rightly concerned at the large sums being appropriated for these organizations. I can assure him that their activities are being increasingly tailored to fit into the Government's overall plans. On his plea for uniformity of treatment, the Finance Branch does provide a central point for looking at the requirements of each group of subvented organizations and

represents me on the Social Welfare Advisory Committee which advises on the allocation of subventions for social welfare organizations. On the control of expenditure, Finance Branch represents me on the executive committee of the deficiency grant medical organizations and I can assure honourable Members they do not pursue a passive role. Expenditure on the subvented educational organizations is controlled, in my view very effectively, through the codes of aid or through the University and Polytechnic Grants Committee. For all these organizations and those subvented on a discretionary basis, I would seek Your Excellency's authority for the Director of Audit to examine their accounts where the public interests so justify.

12. And while on the subject of the draft Estimates of Expenditure I would draw honourable Members' attention to the analysis of what we have done over the eleven years ending 1974-75 and what we are proposing to do in the budget year 1975-76 set out in the green pages of the Estimates.

13. I shall only make two points: first, I think it is a measure of the care with which departmental submissions were scrutinised at the first stage of the estimates exercise to achieve maximum economies and cost reductions⁽²⁾ that the share of total expenditure devoted to the social services in 1975-76 will be 46.8% on recurrent account; and 41.8% on both recurrent and capital account taken together. These are record figures and compare with an average of 41.6% and 38.3% respectively over the eleven years ending 1974-75⁽³⁾.

14. Secondly, my honourable Friend Mrs SYMONS asked me whether we had in mind a guideline limit for the share of total expenditure absorbed by education. Over the past eleven years recurrent expenditure on education absorbed 22.1% of total recurrent expenditure and in 1975-76 it will absorb 22.7%. Taking recurrent and capital account together, education absorbed 17.3% and in 1975-76 it will absorb 18.3%. I expect these percentages to increase further given our accent on the more expensive sectors, namely, secondary and tertiary, but I would not like to state what I think the upper limit should be for this will be determined by the strength of the competing bids for available funds. But I would certainly agree with my honourable Friend that, given the level of expenditure we are planning, the funds available from General Revenue must be augmented by income from increased fees for secondary and tertiary education. I have repeatedly said in this

⁽²⁾ *B.S., 1975, paragraphs 65, 69 and 72.*

⁽³⁾ *Appendix IX to the printed Estimates.*

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Council that those who can afford to pay for services provided by the Government should be normally required to do so. And, with reference to paragraph 121 of the budget speech, I should interpolate at this point an assurance to my honourable Friend Mr Wilson WANG that, in determining the level at which fees generally ought to be set, the services concerned are properly costed.

(b) Role of the public sector

15. Several honourable Members seemed to think that the Government was almost indifferent to the importance of public sector services and capital works programmes in the development of our society. I can assure them that we are entirely concerned to push ahead as fast as any sensible view of available resources will allow and I am grateful to my honourable Friend Miss Ko for recognizing that we are concerned "amidst all our financial difficulties."

16. I think, Sir, several honourable Members fail to distinguish between (a) programme targets as laid down, for example, in a White Paper or in a statement of policy, (b) the need to adjust the time span over which the targets are to be achieved as economic circumstances change and as other competing bids for available resources come into play and (c) actual implementation of a programme year by year and forecast period by forecast period. Phrases like "cutbacks in expenditure" were used by my honourable Friends Dr CHUNG and Mr Wilson WANG far too loosely. My honourable Friend Mr Li Fook-wo, on the other hand, correctly referred to cuts in "departmental submissions".

17. Of course, we made some cutbacks on actual expenditure in 1974-75 in the course of preparing the draft Estimates for 1975-76 but, on recurrent account, there is an overall increase in money terms of 10% which will probably mean an increase in real terms of about 6%. On capital account, the level of expenditure is being maintained at the 1974-75 level in money terms and, given the casing of building costs, this will almost certainly mean that the actual volume of work undertaken will be at least the same as in 1974-75. Furthermore, let us not forget that the average annual increase in the four years ending 1974-75 was 24% on recurrent account and 38% on capital account. In real (or constant price) terms, the increase in expenditure on capital account rose sharply in 1973-74 and 1974-75—by up to 50% altogether. To maintain it at this level in 1975-76 is no mean achievement and, for the time being, helpful too, inasmuch as capital expenditure by

the private sector levelled off in the last two years and may even decline in 1975. Not that I could go along with my honourable Friend Mr Hilton CHEONG-LEEN's suggestion that we should have, and I quote, "enough public works projects going in order to counteract the depressed state of our economy, while awaiting world trade to show some signs of improvement". Given the export oriented nature of our economy we could never use demand management techniques⁽⁴⁾ to maintain the level of incomes and employment for any length of time without running into serious balance of payments difficulties and, in the longer term, inflating our internal cost/price structure.

(c) The planning process and budgetary realities

18. I find it ironic that my honourable Friend Dr S. Y. CHUNG should accuse me of a tendency to be—and I quote—"overjoyed" with surpluses in "good year(s)" and "pessimistic" about deficits in "bad year(s)" and generally of over-reacting to what he describes as "the short term ups and downs in our economic progress." I have stressed repeatedly both in this Chamber and elsewhere that expenditure on both recurrent and capital account year by year should be designed to achieve steady progress; that the rate of growth of our expenditure commitments should be consistent with the trend of revenue which, in turn, is determined by the rate of growth of the economy; and that, if we wish to appropriate a larger proportion of the community's resources for the financing of the public sector, we should take great care not to damage the economy's growth prospects.

19. I seem indeed to remember having the greatest difficulty explaining to some honourable Members that the overall surpluses we ran during the years 1969 to 1974 were due to a combination of short term factors: the economy was surging and our ability to spend was lagging behind our ability to finance spending. In these circumstances, I argued that we should be careful not to over-react by increasing our ability to spend beyond our ability to finance spending in the longer term and, as a corollary to this, I resisted all sorts of pleas to spend our fiscal reserves. And my attempts to define the circumstances in which it would be legitimate to spend our reserves were not, I suspect, listened to all that sympathetically at the time.

⁽⁴⁾ *The Government does not attempt to regulate the economy either through its expenditure decisions or in other conventional ways, using monetary or fiscal devices. This is because the money supply is largely determined by the balance of trade as influenced from time to time by capital movements; whilst any major attempt to regulate demand through variations in tax rates or internal borrowing would tend to bring about changes in expenditure on imports rather than influence the volume of domestic output in the required direction.*

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20. I thus welcome the comments by my honourable Friends Mr LI Fook-wo and Mr Hilton CHEONG-LEEN on the role of the reserves. On one aspect of that role I am reminded of a story I read in the *Financial Times* recently which has a moral for us now that, for some time to come, we shall probably have to close the deficit on capital account with loan finance. Two property men were offered a development situation for £ 5 million sterling. They both liked the look of it but, being men of character, they decided to try to knock down the price. One of them went off to do the negotiating and came back in a somewhat emotional state. There was, he told his partner, some good news and some bad news. "So," said his partner, "what is the good news?" "I've got them down to £ 2½ million". "And the bad?" "We have to find a £ 50 deposit." (*laughter*)

21. So let me interpolate here the four assurances sought by my honourable Friends and my honourable Friend Mr WILLIAMS: the financial strength of the Hong Kong Government will be maintained; our monetary assets on both General Account and Exchange Fund Account will be managed effectively and with the assistance of a diversity of agents and advisers; the rate at which we accumulate debt will be limited by the guidelines I set out in paragraphs 166-169 of the budget speech; and, particularly at this time when the Hong Kong dollar is already relatively strong in the foreign exchange market, I shall certainly bear in mind what my honourable Friend Mr LI Fook-wo has said about the secondary monetary consequences of internal and offshore borrowing.

22. But to return to my honourable Friend, Dr CHUNG, I think I can categorically deny that this is a Government of "stop go". We have repeatedly, over many years, stressed the importance of steady progress and the continuity of policy. And it is this emphasis on continuity which has enabled us to sustain our efforts into 1975-76 despite our revenue prospects. It is true that the increase in public expenditure which we are budgeting for in 1975-76 is only 7% compared with an average of 28% in the four years ending 1974-75, but we are not—to quote Dr CHUNG—"(ignoring our) commitments" and a 7% increase does not amount to what my honourable Friend chooses to describe as "stop go". Rather it is a "change of pace", to paraphrase my honourable Friend Mr LOBO's apt metaphor, and a very necessary change of pace too for, in my view, the measure of what my honourable Friend Dr CHUNG described as "a good Government" is,

as my honourable Friend Mr LOBO put it, "to go the full distance in good time".

23. I am really rather surprised and not a little hurt that my honourable Friend Dr CHUNG has levelled this "stop go" charge because, later on in his speech, he recognises the essential role of the 1-3-10 concept which I developed last year: forward planning of expenditure requires that assumptions be made regarding our revenue prospects so that we may have some idea of where we are going, but the budget for each year must be based on close estimating of expenditure and as precise a view of revenue yields as possible. So, having prepared the budget for 1,975-76, for example, I set it in the perspective of an indication of the levels of expenditure I considered acceptable for planning purposes in the three forecast years 1976-77 to 1978-79 and in the context of explicit assumptions about the growth rate of the economy and hence revenue yields in those years. I am glad my honourable Friend recognised that this technique reconciles the planning process with annual budgeting realities and provides all concerned with an opportunity to consider our financial problems in advance of the preparation of the budget for each particular year. And, with respect to the edition of the newspaper I mentioned earlier, this technique itself demonstrates the intention of the Government to be totally frank.

24. Not that my honourable Friend seemed to be too convinced of my sincerity: he rather unkindly referred to my "juggling" with figures in Part V of the budget speech, whereas I was genuinely concerned to apply the 1-3-10 concept and, particularly, the "3" to the forecast years 1976-77 to 1978-79, and thereby clothe these years with some broadly illustrative arithmetic. I join my honourable Friend Mr Q. W. LEE in hoping that this arithmetic defining, as it does, my present view of acceptable levels of expenditure in the forecast years, will be taken seriously in the months following the passage of this year's Appropriation Bill. I would point out to my honourable Friend Dr CHUNG that in Part V of the budget speech I also explained that, as the surpluses we can expect on recurrent account in the coming years will be insufficient to finance our traditional deficits on capital account, we shall have to raise additional fiscal and non-fiscal revenue if we are to finance the levels of expenditure I tentatively suggested as being acceptable. (Incidentally, I do not follow my honourable Friend Dr CHUNG's reference to inflation as if the necessary reductions in the departmental forecasts of expenditure are thereby invalidated. I have consistently used April 1975 prices and values for the expenditure and revenue forecasts respectively throughout my analysis).

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25. My honourable Friend also accused me of several "stop-go" misdemeanours on the revenue side of the accounts. I am supposed to have over-reacted to the overall surpluses in the few years ending 1973-74 by making a number of relatively minor tax concessions—to quote him—"for no good reasons and against public opinion". Most of these concessions were connected with reform and I suggest my honourable Friend should refresh his memory by referring to Hansard for the many good reasons I spelled out and I do not recall any groundswell of public opposition to my various proposals for tax relief in my last three budgets amounting in all to \$175 million.

26. Nor do I feel in the least defensive about the specific question of entertainments tax on admissions to cinemas: I proposed its abolition two years ago for the reasons set out on page 489 of the 1973 Hansard and I have proposed its reintroduction this year for the reasons set out in paragraphs 117 - 120 of the budget speech. As I there admitted in 1973 I should have reduced the rates of tax to zero, but that is a technical point. Certainly, I really cannot see how I have "impaired" the Government's "credibility". As a matter of interest, the only counter-suggestion made in the course of the 1973 budget debate was by my honourable Friend Mr Wilson WANG that the tax should be retained for films of an unwholesome nature (*laughter*). As this would have involved practical difficulties it could not be accepted.

27. Furthermore, were I to behave in the way my honourable Friend suggested I have behaved in the past, were I to have "a tendency" to react too sensitively to "the short term ups and downs in our economic progress", I should have proposed stiffer tax increases this year. Yet I was at pains to ensure that my revenue proposals rested lightly on all concerned, whether they were profit-takers, ratepayers, consumers or users of public services. May I repeat, Sir, what I said in the budget speech:

"Each (of my) proposal(s) (is) as neutral as possible in its effect on investment decisions and industrial costs; (and) it (avoids) imposing hardship, somehow defined, on any particular income class"⁽⁵⁾.

⁽⁵⁾ B.S., 1975, paragraph 87.

And taking some liberty with what I said earlier in the budget speech:

"(To raise yet additional tax revenue) would involve net damage to the economy through the adverse effects both on investment and on our external competitiveness"⁽⁶⁾.

(d) *Fiscal policy*

(i) *Standard rate of earnings and profits tax*

28. Although, as I said earlier, Sir, honourable Members seem to be in general accord with my budgetary strategy for 1975-76, I detect a slight feeling that, maybe, we would "properly afford"—to quote my honourable Friend Mr BREMRIDGE again—we could properly afford to spend more because, with a little more imagination on my part, I could have found other reserves of taxability to tap.

29. In particular, two honourable Members explicitly argued that a higher standard rate of tax on earnings and profits would not deter would-be investors from overseas. Quite apart from the fact that the rate applicable to corporation profits is to be raised by 10% to 16½% and the further fact that overseas investment as such does not loom all that large in our total investment situation, I should not have thought this was the most significant criterion. While I am with my honourable Friend Mr LI Fook-wo in finding an increase in the standard rate at this time unacceptable, I do not hold this view as a matter of dogma. But the criteria by which we should consider raising the standard rate are first the effects on the economy; second, the productivity of the existing tax system; and, third, equity.

30. On the first, I would have thought that an increase in the standard rate, which affects profits, salaries, interest and income from property would have some bearing on output and productivity through its incentive effect on fixed investment and the supply of effort at shop floor and at the managerial and entrepreneurial levels: in other words, on what my honourable Friend Dr FANG has described as "the basic stability of our economy"; and that this was a risk we could not take at the present time for, to quote my honourable Friend Mr BREMRIDGE yet again, "it (would be) unwise to allow any feeling to develop at this juncture that we face plain sailing ahead". On the second and third criteria, productivity and equity, I do hold, as a matter of dogma, that we should avoid, as far as possible, increasing the standard rate until we have made the existing tax system as efficient as possible (taking

⁽⁶⁾ B.S., 1975, paragraph 61.

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a realistic view of the Inland Revenue Department's problems in this society); until we have broadened the tax base as far as we can; until we have restored the ambit of the profits tax charge in accordance with the original intentions of the drafters of the Inland Revenue Ordinance; and, possibly, until we have introduced an element of progression in the rate of tax applicable to the higher income levels. We just cannot go on simply raising the standard rate regardless of these considerations now that it is 15% and not, say, 7½% or 10%. So I would hope to be able to avoid proposing an increase in the standard rate until the third Inland Revenue Ordinance Review Committee has reported.

31. Honourable Members have rightly asked why such a committee cannot be appointed until the middle of 1976. Although heartened by this enthusiasm, which surely portends well for the revenue, I simply think it would be too much for the Inland Revenue Department to have to deal with a Review Committee on top of the difficult administrative problems involved in implementing the changes introduced recently to the Inland Revenue Ordinance and those to be introduced shortly. In addition, it will take some time to find a suitable chairman—and suitable he must be—and a full-time secretary. Meanwhile, we can start preparing the ground by planning our submissions to the Committee. With such a complex objective as a basic restructuring of the ordinance, we must study thoroughly the implications of the direction in which we may be proceeding. Incidentally, Sir, I do not envisage the terms of reference of the proposed Inland Revenue Ordinance Review Committee being cast beyond the direct tax field.

32. Before leaving the question of the standard rate, I can confirm the supposition of my honourable Friend Mr Q. W. LEE that I would not wish to be strait-jacketed by a pledge that the Government would not increase the standard rate above a certain level for a given period of time. We must retain our flexibility so that we can react unfettered to any circumstances with which we may be faced. Undertakings to maintain rates unchanged have a habit of becoming serious stumbling blocks in future years. I would remind honourable Members that, but for the pressures to modify the proposals to increase water charges in 1971, I might have had the greatest difficulty in raising charges for water until 1977 in spite of the dramatic increase in the cost of supplying it.

33. This said, I would repeat that, when considering fiscal measures, at the forefront of my mind will always be the consequences

for investment and hence the growth rate of the economy. And I would say this to businessmen and investors, both local and overseas: surely you can take considerable comfort from the Government's consistent record in this respect over the past 25 years.

(ii) *Dividends withholding tax*

34. On the question of the dividends withholding tax and the associated tax on undistributed profits, I would like to make a *cri de coeur*. Could I earnestly request honourable Members not to ask for refinements which, however justified they may be in theory will, in practice, be difficult and costly to administer and will introduce uncertainties into the legislation? And I would say this to my honourable Friend Mr WILLIAMS: providing the rate of the withholding tax is kept low, there is no more need to negotiate double taxation treaties than there is under the present system of taxation; not that there is any reason to believe that unilateral relief will not be granted to, say, U.K. resident individuals and companies. Indeed, he may not realise that in some ways non-resident shareholders will be better off with a dividends withholding tax than an increase in the underlying rate of tax.

35. I have just mentioned, Sir, the disappointment of some honourable Members that it is not possible to convene the Review Committee earlier. But, as I have said, I would like to allow the dust to settle on the recently introduced legislative changes and those that are about to be introduced. There is nothing which places quite so much strain on the fiscal system as frequent, albeit necessary and desirable, changes in the law. In the meantime, as honourable Members have pointed out, additional sources of revenue have to be tapped and so priority must be given to the implementation of the dividends withholding tax. I have made out a case for this tax which honourable Members have not seriously challenged. It is a comparatively simple measure and it can be introduced via an amendment to the present ordinance. It is on this that the Commissioner and his staff will be concentrating this year.

36. As regards the point made by my honourable Friend Mr James WU that the associated tax on undistributed profits would interfere with re-investment, I would remind him that, as stated in Appendix (6) to the printed version of my budget speech, the intention is that the tax would be levied only on a percentage of undistributed profits. This percentage would certainly be so fixed as to allow for a reasonable degree of reinvestment.

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(iii) *Proposal for a turnover tax*

37. My honourable Friend Dr CHUNG's decision to press his suggestion of a turnover tax took me, I must confess, utterly by surprise. I agree with him that a turnover tax would be insensitive to prevailing economic conditions but, surely, my honourable Friend is not seriously arguing that our direct tax system should be anything but sensitive to prevailing economic conditions? Not that I am entirely clear just what he has in mind anyway. On administrative grounds he cannot be suggesting a value-added tax. In Hong Kong business records are just not kept to a standard required for such a tax.

38. So maybe what he said is meant to be taken literally, that is to say, we should impose a tax of 1% on the turnover of every business in the Colony. Quite apart from the effect of such a tax on net profits and on businesses in a loss situation, the cumulative effect on the cost of living and on the competitiveness of our exports would be disastrous. It is true, one could make a turnover tax selective as regards firms and even types of goods, but the administrative problems would be considerable and there would still be a substantial effect on costs. And what about those businesses that are too small to file profits tax returns? Yet why should they escape my honourable Friend's "large tax net with smaller openings"?

(iv) *Balance of the tax system*

39. Both my honourable Friends Dr CHUNG and Mr Wilson WANG quizzed me on the guideline ratio for direct to indirect taxation of 45:55. The purpose of this guideline ratio is simply to remind us to maintain the significance of the yield from indirect taxation. This reminder is necessary for two reasons. First, while the yields from our earnings and profits taxes, being income-related, are sensitive to the growth rate of the economy and, in my view, rightly so, yields from indirect taxes are much less sensitive. For example, an increase in the yield from the fixed rate excise duties depends on consumption rather than value. Again, the yield from the General Rate depends mainly on frequent revaluations of properties, a mammoth task not possible frequently enough. So we have to keep the need to review indirect tax rates constantly in mind. Secondly, indirect taxes have the advantage of affecting a wider base than do direct taxes.

40. The actual ratio of 45: 55 for direct to indirect taxation I have advocated derives from the steady decline in the significance of the indirect element from 65% in 1964-65 to 56% in 1971-72. In subsequent years it would have continued falling even if we had not lost the yield from the Urban Council rate. So the logic of the ratio 45:55 is simply that it was designed, on an historical basis, to draw attention to a deteriorating situation. A shift away from this ratio in either direction does not necessarily imply that corrective action is called for and, indeed, a situation in which the yield from earnings and profits taxes declines thereby shifting the ratio in favour of indirect taxes merely reflects the relative income sensitivity of the former; and for the yield from earnings and profits taxes to increase, thereby shifting the ratio in the other direction, merely reflects the relative income insensitivity of indirect taxes. However, with the ratio in 1975-76 at 57:43 I can foresee, as I said in paragraph 156 of the budget speech, "the need to find new sources of indirect taxation later on if we are to avoid becoming too dependent on direct taxation".

(v) *Betting duty*

41. On my intention to raise at least an extra \$27.5 million from betting duty, my discussions with the Jockey Club have resulted in proposals which at least partially meet the feeling expressed by my honourable Friend Mr Hilton CHEONG-LEEN that I had—and I quote—"erred on the side of modesty." I now propose to maintain the present rate of 7 % on the traditional win, place, double, quinella and forecast bets, but to increase the rate on all other bets to 11%. And Your Excellency has signed an order under the Public Revenue Protection Ordinance bringing the new rate of 11% on pool bets into effect on 1st April 1975.

42. The effect should be to provide the additional revenue we are seeking without reversing the thoroughly desirable trend noticed recently for punters to drift away from illegal book-makers. And, to put my honourable Friend, Mr WILLIAMS' mind at rest, I have always appreciated that it is the move from illegal to legal betting that has caused the yield from betting duty to grow, rather than a tendency for the population as a whole to bet more (though betting is certainly not discouraged when prevailing economic conditions are depressed); and I hope the scope of the Betting Ordinance can be gradually extended to embrace—one way or another—fields other than horse racing for, with my honourable Friend Mr CHEUNG, I believe betting duty should play a larger role in our fiscal affairs.

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(vi) *Entertainment tax*

43. I have considerable sympathy with my honourable Friend Mr Hilton CHEONG-LEEN's helpful suggestion that we should impose entertainment tax on those attending professional football matches. I had considered this possibility. But I was advised that we would have difficulty in Hong Kong in defining professional football in such a way as to exclude amateur sport while still retaining the full intention of the tax. I can assure my honourable Friend that I shall reconsider taxing admissions to professional sporting events if this difficulty can be overcome and I look forward to his support when this Council is consulted. (*laughter*)

(vii) *Water charges*

44. As the Water Authority under the Waterworks Ordinance, my honourable Friend the Director of Public Works has dealt with the points honourable Members have raised in respect of the increased charges for water.

45. But I must deal with my honourable Friend Dr. CHUNG's accusation that I have failed to give a fair comparison between non-domestic and domestic consumers. What I did do was to give five reasons why non-domestic consumers should not be subsidized by domestic consumers for too long. My honourable Friend appeared to imply that they should be, because trade and industry provide jobs and economic benefits. This argument, once conceded, could lead to a succession of subsidies in respect of other costs. I just do not see how, in our circumstances, such subsidies could be justified. I have accepted that new and expanding enterprises should not be required to pay the full marginal cost of augmenting the supply system to meet their requirements. But there are no valid arguments that I can see—though, characteristically, I shall keep an open mind on the subject (*laughter*)—there are no valid arguments I can see for non-domestic consumers as a whole not paying in full on some basis for the water they consume. Their social and economic importance is fully recognized by the fact that the supply system is basically designed to maintain a full supply to them even when supplies to domestic consumers are restricted.

(viii) *Dependent parents allowance*

46. My honourable Friend Mr Hilton CHEONG-LEEN raised the question of dependent parents allowance. I must confess I thought I had disposed of the whole question of selective, as opposed to the basic personal, allowances at rather tedious length when I concluded the debate on the second reading of the 1973 Appropriation Bill. As regards the dependent parents allowance, as such, there was the further point that taxpayers were abusing the allowance to an extent which, added to the inherent difficulties the Commissioner of Inland Revenue was finding in administering it anyway, left me little alternative but to seek its abolition; but I did this as part and parcel of a general overhaul of our system of personal taxation at a cost to the revenue of \$16.8 million.

47. In passing, I should explain to my honourable Friend Mr Q. W. LEE that I did consider increasing personal allowances this year, but fairly quickly decided against it; first, because we simply cannot afford the loss of revenue; secondly, because such action would be inconsistent with my efforts in other directions to widen the tax net; and, thirdly because the allowances were so generously reviewed so recently.

(6) *Arrears of Revenue*

48. I share my honourable Friend Mr LI Fook-wo's sense of shock at the increase in arrears of revenue at the end of 1973-74 compared with 1972-73. This deterioration arises mainly from a substantial increase in the arrears for earnings and profits taxes from \$29 million in June 1973 in respect of 1972-73 to \$69 million in June 1974 in respect of 1973-74. As stated in the enclosure to the despatch to the Secretary of State tabled in this Council on 22nd January last together with the Director of Audit's report on the accounts for 1973-74, the Commissioner of Inland Revenue has put forward plans to reduce these arrears. But the fact of the matter is that, over the last two years, the proportion of assessed tax not paid on the due date has risen; and given the difficulties of 1974, I doubt if we shall see much improvement in the position at the close of 1974-75, particularly in respect of profits and property taxes. Recovery through the courts and by the other means permitted by the law is difficult and time consuming. Nevertheless, it is comforting to note the tax eventually written off as irrecoverable is still far below 1% of the total tax assessed.

49. My honourable Friend also commented that only 85,790 persons paid salaries tax in 1973-74. In fact, if persons assessed to

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tax for 1973-74 since the end of that year are included, the number rises to 102,000. As stated in Appendix (3) to the printed version of the budget speech, a further increase to 140,000 is likely in respect of 1974-75; and we expect a further increase still in 1975-76. Whether this represents a high proportion of those who ought to be paying salaries tax is difficult to say.

(7) *Revised Estimate of Outturn for 1975-56*

50. In my budget speech I calculated that all my revenue proposals should yield \$467 million leaving a deficit of \$429 million⁽⁷⁾ which I proposed to cover by means of various forms of loan finance⁽⁸⁾. The two adjustments I have now proposed to the revenue proposals in respect of passengers travelling to and from Macao on the cheaper tickets and in respect of peak-hour movements at Kai Tak will reduce the yield from the revenue proposals by \$1.7 million. The deficit to be financed with borrowed funds—it is essentially a deficit, of course, on capital account—thus becomes a little higher at about \$431 million.

(8) *The Hong Kong Dollar*

51. Sir, my honourable Friends Mr O. W. LEE, Mr LI FOOK-WO and Mr TIEN were concerned about the difficulties created for our trade and industry by money flows and technical factors leading to an appreciation of the exchange value of the Hong Kong dollar not consistent with the underlying realities of our trading account. I adhere to the view expressed—or, at least, implied—in paragraphs 12-16 of the budget speech that in Hong Kong the economy must, in principle, adjust to the exchange rate and not the exchange rate to the economy. The reason, of course is quite simple: external transactions in our case are such a large proportion of total transactions or, if you like, the value of external transactions is more than three times the Gross Domestic Product.

52. Nevertheless, in all the circumstances of our position in recent months, I would not wish to appear to be complacent about the exchange value of the Hong Kong dollar. When I delivered the budget speech on 26th February, the rate was about HK\$4.64 to the US dollar in interbank trading, having been briefly as strong as 4.54 at

⁽⁷⁾ B.S., 1975, paragraph 161.

⁽⁸⁾ B.S., 1975, paragraph 163.

the end of the previous week. This last figure represented a revaluation of 12% by comparison with the previously maintained parity, and a revaluation of 9½% by comparison with the rate on the day before the currency was floated on 26th November 1974. Since 26th February the Hong Kong dollar has weakened further. The revaluation, by comparison with the previous parity, is currently less than 5%; and by comparison with the rate on the day before we floated it is only 2½%. Now I realise that for the Hong Kong dollar to be strong, and at times strengthening, when orders are hard to negotiate is not helpful in the short term, but our internal cost/price structure is stable and I believe may even now be actually falling a little. So I do not regard the present position as too unsatisfactory; though I admit that, as our economy becomes more sophisticated, the adjustment process works through the system more slowly than heretofore.

53. Indeed, if we look not just at the US dollar—any general weakness of which is rather beyond my influence—but at the currencies of our other major trading partners and our trading competitors as well, on the basis of a trade-weighted index, we find that the Hong Kong dollar is now at about the same value overall as during the three or four months before we floated.

54. I have to take issue here with my honourable Friend Mr TIEN on one of the points that he made. He said that the revaluation of the Hong Kong dollar against the US dollar works against our export performance not only in the United States but also in Europe, since most commercial contracts are written in US dollars. With respect, I suggest to him that if the deutschemark, say, is strong against the US dollar, then the ability of German importers to obtain US dollars cheaply should be reflected in the US dollar price they are prepared to pay for exports from Hong Kong.

55. In the budget speech I said that it was perhaps too early to assess the results of the previous week's reduction in bank interest rates. There was subsequently a further reduction on 8th March and I think it is now clear that there has been a helpful effect on the exchange rate in addition to the direct benefit to manufacturers and exporters of lower lending rates, despite the none too enthusiastic reception accorded these reductions by my honourable Friends Mr James WU and Mr TIEN. It also seems that there is an increasing belief around the world that the US dollar has come to be seriously undervalued. This is certainly my own belief, not that the HK dollar/US dollar relationship is all that we should be concerned about in a world of floating rates. So I think I can reassure my honourable Friend Mr

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LI Fook-wo that the possibility of using interest tax as a positive regulator of the exchange rate has receded a little, but, in these uncertain times, I must be allowed to keep my options open. And, incidentally, my honourable Friend Mr LI Fook-wo is guilty of a very serious oversimplification when he argues that—and I quote—"the main reason for (the) continuing existence of (interest with-holding tax) is its power to generate a stable and substantial revenue". I invite him, if I may, to read again my reply to my honourable Friend Mr LOBO's question on this subject in this Council on 14th August 1974⁽⁹⁾, and for his convenience it's attached as an appendix to the printed version of this speech.

56. The danger clearly remains that large movements of funds can take place which we may have to choke off by allowing the rate to strengthen and a further use of the interest rate or even the tax weapon. One point is clear enough: it would not be realistic to refix the Hong Kong dollar until there are signs that a more fundamental stability has returned to the international monetary system. In such circumstances, I do urge upon traders the desirability of taking forward cover to protect themselves as far as possible from the uncertainties of the exchange rate situation that has been forced upon us.

(9) *Conclusion*

57. Sir, I saw this year's budget debate described the other day in one of our less percipient daily newspapers as—and I quote—"a merely routine affair of no importance to the community". While it may have lacked the excitement of controversy over such subjects as car parking charges, drivers' licences and insurance relief and honourable Members were not given the opportunity of complaining bitterly about the inaccuracy of the revenue estimates, I personally think that this year's budget debate had a special quality about it inasmuch as honourable Members have been able to concern themselves with broad issues. These have been—

first, the prospects of the economy and the relationship between the economy and the management of the public finances;

second, the budgetary strategy for 1975-76;

third, the role of the public sector in the development of our society;

⁽⁹⁾ *Reproduced as an appendix to this speech.*

fourth, the planning of public sector services and capital works programmes and the reconciliation of the planning process with budgetary realities year by year and in relation to a rolling three year forecast period; and

fifth, the underlying causes of our present and prospective deficit situations, the historical perspective in which they should be set and the implications for fiscal policy and tax reform.

58. Sir, there is no doubt that the world economy is in a serious recession and the general consensus of informed opinion remains that demand in the main industrial countries is unlikely to recover much before the end of this year. However, as inflation rates are likely to decline in the first half of this year, governments may well have some room for manoeuvre in taking reflationary action. But the scale of the present down turn is such that I adhere to the belief I expressed in the budget speech that a return to the rapid rate of growth we experienced in the latter part of the 1960s and the early 1970s will be delayed until late 1976 and early 1977. So it is vital that we tailor our budgetary and fiscal policies to this reality and I am confident we have done so this year and laid out a framework within which we can do so in the forecast years.

Sir, I beg to move.

Appendix

*REPLY BY THE FINANCIAL SECRETARY IN
LEGISLATIVE COUNCIL ON 14TH AUGUST 1974
TO A QUESTION BY MR LOBO ON INTEREST TAX
(page 1114 of 1973/74 Hansard)*

"The Government is perfectly willing to reconsider the abolition or partial abolition of interest tax but, in the absence of fresh argumentation, I am sure that our conclusions will not differ from those in this year's budget speech. Perhaps, Sir, I may be permitted to explain why I think so.

The basic fiscal policy question is whether the recipient of income derived in or arising from Hong Kong should be expected to contribute, through tax on that income, towards the cost of financing the public services and our capital works programmes. I believe that he should, and I see no reason why income in the form of interest should be treated more generously than the three other forms of income which are subject to tax under the Inland Revenue Ordinance. Under some fiscal systems, indeed, this form of income is treated as "unearned" and taxed more heavily than income treated as "earned".

But leaving aside this basic question of fiscal policy, what would abolition of interest tax cost the revenue? Receipts from interest tax amounted to \$75 million in 1973-74 and receipts in 1974-75 are now expected to be in the region of \$100 million. This is because the budget estimate was based on a lower interest rate structure than we are now experiencing. These figures, I should emphasise, relate to the net amounts—net of rebates under personal assessments—collected by withholding the tax at source. They take no account of profits tax arising from the interest earnings of a trade, profession or business. I have no separate figures for these earnings, but the tax collected on them will probably be some \$100 million for this year. If the Government accepted a case for the abolition of interest withholding tax, then it would have to follow, I think, that interest earnings caught up in profits tax assessments would also need to be exempted from profits tax. As I said in the 1973 budget speech the loss would then be aggravated by companies moving increasingly to loan finance, and all sorts of schemes would be hatched up to convert various forms of income into, or disguise them as, interest earnings. It is quite inconceivable that revenue losses of this order could be made good by increased profits tax on the borrowing or lending transactions that would be generated by the abolition of interest tax. So the loss of revenue would have to be made good by higher rates of other taxes or some other levy.

Turning now to the monetary aspects: I am well aware of the argument that the withholding of interest tax from payments of interest by banks (and finance houses) has the effect of encouraging companies and individuals resident in Hong Kong to transfer at least part of their excess liquidity abroad, with eroding effects on the Hong Kong dollar deposit base of the licensed banks and thus on their ability of finance Hong Kong's industry and commerce. But I maintain the view that interest tax is no more than a minor factor in decisions by resident depositors where to employ their funds. Apart from questions of convenience, they also have to take the exchange risk, and other risks, into account and they realise that, to the extent that higher interest rates are obtainable abroad, they reflect higher risks. In fact, deposits with the licensed banks in Hong Kong grew at an annual rate of over 20% in the first six months of this year, at a time when the banks were paying rather low interest rates compared with those obtainable abroad. This was a very respectable rate of growth and I expect it will have improved since the banks brought their interest rates more in line with international levels during July. If, indeed, interest withholding tax does influence resident depositors' decisions, it could be argued that the absence of a tax on interest earned abroad by Hong Kong residents is just as important as the tax imposed on interest earned here; but I have not heard of any suggestion for such a new tax to be imposed! And, anyway, it would be contrary to the present legal interpretation of how our territorial source criterion should be applied to interest earnings.

Quite apart from the very doubtful case for the abolition of interest withholding tax, there are at least two arguments against abolition. In the first place, the relief given would effectively wind up with the financial sector and the wealthier groups in our society and this would be inequitable, fiscally speaking. Secondly, the possibility would arise of non-residents switching highly volatile speculative funds into Hong Kong dollars when they decided to take a particular view of relative exchange risks and then switching them out again when that view changed. The consequences for the money supply and the exchange value of the Hong Kong dollar are obvious, and it would be irresponsible to overlook the dampening effect on destabilising inward flows of the withholding tax.

Several suggestions have been made from time to time for a partial abolition of interest withholding tax, but the difficulties seem to rule each of these out. One of these suggestions is that non-residents should be exempted from payment of the tax, but this would present enormous administrative difficulties both for the banks and for the Inland Revenue Department, which only the existence of exchange controls could overcome.

In any case, as I have just said, I would not be keen to encourage volatile inflows of speculative overseas funds.

Another suggestion which has been made is that interest withholding tax should be abolished for deposits with the licensed banks. Whatever restrictions should or should not be placed on deposit taking finance houses now operating in Hong Kong, I am entirely opposed to this form of discrimination in view of the damage it would cause to our developing money market.

Yet another suggestion for partial abolition and one which I myself floated in last year's budget speech is the exemption of certain foreign currency deposits. Such exemption would not, of course, solve the problem, if there is one, of the conversion of Hong Kong dollar deposits to gain exemption, and the consequent erosion of the local deposit base. It would simply give the business to local banks and finance houses instead of overseas institutions. This is a worthy motive. But, as I reported in this year's budget speech, all the indications I have are that the number of banks which would be prepared to pay the price, in the form of profits tax on their "turn", is very small. The majority of banks and finance houses, while eager for the prestige of a licence for a special department to borrow and lend foreign currencies and be exempt from the obligation to withhold tax on interest paid on deposits, would in practice continue to act simply as intermediaries in the placing of such business in other centres where it attracts neither interest tax nor profits tax. Until I am satisfied that a very substantial flow of income assessable to profits tax would be generated, I do not think that the setting up of the necessary machinery for these special departments would be justified."

Question put and agreed to.

Bill read the second time.

Bill committed to a committee of the whole Council pursuant to Standing Order 43(1).

Adjournment and next sitting

HIS EXCELLENCY THE PRESIDENT: —In accordance with Standing Orders I now adjourn the Council until 2.30 p.m. on Wednesday the 23rd of April.

Adjourned accordingly at ten minutes past four o'clock.