

OFFICIAL REPORT OF PROCEEDINGS**Thursday, 12 April 1979****The Council met at half past two o'clock****PRESENT**

THE HONOURABLE THE CHIEF SECRETARY (*PRESIDENT*)
SIR JACK CATER, KBE, JP

THE HONOURABLE THE FINANCIAL SECRETARY
MR CHARLES PHILIP HADDON-CAVE, CMG, JP

THE HONOURABLE THE ATTORNEY GENERAL
MR JOHN WILLIAM DIXON HOBLEY, CMG, QC, JP

THE HONOURABLE THE SECRETARY FOR HOME AFFAIRS
MR LI FOOK-KOW, CMG, JP

THE HONOURABLE DAVID HAROLD JORDAN, CMG, MBE, JP
DIRECTOR OF TRADE, INDUSTRY AND CUSTOMS

THE HONOURABLE DAVID AKERS-JONES, CMG, JP
SECRETARY FOR THE NEW TERRITORIES

THE HONOURABLE LEWIS MERVYN DAVIES, CMG, OBE, JP
SECRETARY FOR SECURITY

THE HONOURABLE DAVID WYLIE McDONALD, CMG, JP
DIRECTOR OF PUBLIC WORKS

THE HONOURABLE KENNETH WALLIS JOSEPH TOPLEY, CMG, JP
DIRECTOR OF EDUCATION

THE HONOURABLE DAVID GREGORY JEAFFRESON, JP
SECRETARY FOR ECONOMIC SERVICES

THE HONOURABLE ALAN JAMES SCOTT, JP
SECRETARY FOR HOUSING

THE HONOURABLE THOMAS LEE CHUN-YON, CBE, JP
DIRECTOR OF SOCIAL WELFARE

DR THE HONOURABLE THONG KAH-LEONG, JP
DIRECTOR OF MEDICAL AND HEALTH SERVICES

THE HONOURABLE ERIC PETER HO, JP
SECRETARY FOR SOCIAL SERVICES

THE HONOURABLE JOHN CHARLES CREASEY WALDEN, JP
DIRECTOR OF HOME AFFAIRS

THE HONOURABLE JOHN MARTIN ROWLANDS, JP
SECRETARY FOR THE CIVIL SERVICE

THE HONOURABLE JAMES NEIL HENDERSON, JP
COMMISSIONER FOR LABOUR

THE HONOURABLE OSWALD VICTOR CHEUNG, CBE, QC, JP

THE HONOURABLE ROGERIO HYNDMAN LOBO, CBE, JP

THE HONOURABLE JAMES WU MAN-HON, OBE, JP

THE HONOURABLE HILTON CHEONG-LEEN, OBE, JP

THE HONOURABLE LI FOOK-WO, CBE, JP

THE HONOURABLE JOHN HENRY BREMRIDGE, OBE, JP

DR THE HONOURABLE HARRY FANG SIN-YANG, OBE, JP

THE HONOURABLE FRANCIS YUAN-HAO TIEN, OBE, JP

THE REV. THE HONOURABLE JOYCE MARY BENNETT, OBE, JP

THE HONOURABLE CHEN SHOU-LUM, OBE, JP

THE HONOURABLE LYDIA DUNN, OBE, JP

DR THE HONOURABLE HENRY HU HUNG-LICK, OBE, JP

THE HONOURABLE LEUNG TAT-SHING, JP

THE REV. THE HONOURABLE PATRICK TERENCE MCGOVERN, OBE, SJ, JP

THE HONOURABLE WONG LAM, OBE, JP

DR THE HONOURABLE RAYSON LISUNG HUANG, CBE, JP

THE HONOURABLE CHARLES YEUNG SIU-CHO, JP

DR THE HONOURABLE HO KAM-FAI

THE HONOURABLE ALLEN LEE PENG-FEI

THE HONOURABLE DAVID KENNEDY NEWBIGGING, JP

THE HONOURABLE ANDREW SO KWOK-WING

ABSENT

HIS EXCELLENCY THE GOVERNOR
SIR CRAWFORD MURRAY MACLEHOSE, GBE, KCMG, KCVO

THE HONOURABLE EDWARD HEWITT NICHOLS, OBE, JP
DIRECTOR OF AGRICULTURE AND FISHERIES

THE HONOURABLE DEREK JOHN CLAREMONT JONES, CMG, JP
SECRETARY FOR THE ENVIRONMENT

THE HONOURABLE LO TAK-SHING, OBE, JP

THE HONOURABLE ALEX WU SHU-CHIH, OBE, JP

THE HONOURABLE PETER C. WONG, JP

IN ATTENDANCE

THE CLERK TO THE LEGISLATIVE COUNCIL
MR STEPHEN TAM SHU-PUI

THE PRESIDENT:—Members may have heard that the Governor is unwell and that, on his doctor's advice, he has cancelled his public engagement for today. I shall therefore, be presiding at this sitting of Council in accordance with Standing Order No 3. Council will resume and continue the debate on the Appropriation Bill 1979.

Second reading of bill (Resumed debate)

Appropriation Bill 1979

Resumption of debate on second reading (11 April 1979)

Question proposed.

SECRETARY FOR THE CIVIL SERVICE:—Sir, I listened with interest to the various comments which Mr BREMRIDGE, Mr CHEONG-LEEN, Mr T. S. LO, Mr WONG Lam and Mr NEWBIGGING made on the size of the civil service, on its organization, its management and efficiency.

Mr NEWBIGGING pointed out that despite the growth of the civil service in recent years the total number of civil servants had stayed constant at about 6 per cent of the workforce. He wondered whether this was not too low a proportion, given the present scale of the Government's activities. Views on this question are necessarily subjective. My own is that in the circumstances now prevailing the total strength of the civil service is about right in relation to the total workload: but we are short of really experienced officers and we do need to make better use of our manpower.

The proportion of the workforce employed in the civil service varies widely from country to country and valid comparisons are difficult. However, conditions in Hong Kong and Singapore are sufficiently similar to enable one to compare like with like:

In Hong Kong the civil service accounts for
6.0 per cent of the workforce
and 2.6 per cent of the total population

In Singapore the equivalent parts of the civil service account for
7.6 per cent of the workforce
and 3.0 per cent of the total population.

While one should not read too much into these figures, they hardly suggest that the Hong Kong Government is a profligate user of manpower.

Nonetheless I agree with Mr CHEONG-LEEN and Mr WONG Lam that we must do all we can to improve our organization and efficiency, so that we may meet our work commitments with the smallest civil service possible.

Of the various steps we have already taken in this direction I would mention five:

- (a) A dozen departments have recently had their senior management structures improved. Other reorganization schemes are in the pipeline.
- (b) Management training for senior officers has been stepped up.
- (c) Pressure is being applied throughout the service to improve staff reporting standards.
- (d) Staff management ability is now a criterion for promotion to management posts.
- (e) Most important of all, is the setting up of the Standing Commission on Civil Service Salaries and Conditions of Service. This major institutional advance is designed to help the Government to provide civil servants generally with an up-to-date, balanced and satisfying career package, so encouraging the individual civil servants to be both productive and efficient.

But much remains to be done and Mr T. S. LO is right in pointing to the need to pay more attention to the management of the civil service. Management is defined by one authority as 'control of the affairs of an organization'. It is therefore an all-embracing term, covering control over policy, finance, operations, systems, works, properties, supplies, vehicles, and of course staff.

When Unofficial Members spoke earlier in this debate about management of the civil service I believe they had staff management particularly in mind. Other aspects of management are no less important, but it should be recognized that, for any given level of public expenditure, it is the quality of staff and staff management which largely determines the extent to which the civil service achieves the policy objectives of the Government.

We shall therefore place special emphasis on staff management during the coming year, and I should like now to tell this Council something of our present thinking.

Good staff management means giving departments the right organization for managing, getting the right people into the right jobs, training and motivating them properly, providing them with a satisfying career package and the right conditions of service, maintaining harmonious staff relations, and so on and so forth. All this is fairly obvious, so that the question to be answered is not what to do, but how best to do it. The answer is not easy, given the size of our civil service and the fact that every one of the forty-seven Government departments has its own identity and its own special problems.

One possibility would be to bring in outside consultants to advise us. I reject this as unnecessary, since we already have within the service many officers with good track records as managers who know what needs to be done, and understand the problems involved in doing it.

Another possibility would be to create a new cadre of professional personnel managers in departments, but I do not favour that. It would be costly and would take too long to produce results. It would also be evading one of the central issues, namely the need to develop the role of line managers and encourage *them* to spend more time on staff management. Moreover, when it comes to technical personnel work, departments are already well served by their departmental secretaries, and while their role will undoubtedly evolve, I doubt the need for any major change.

A third option would be to give Civil Service Branch additional staff so that it could itself organize staff management work, but I do not favour that either. It is in departments that the work needs to be done, and adding to the staff of the Secretariat is unlikely to be of much help. Moreover, the Secretary for the Civil Service needs to find ways of devolving responsibility and work to departments, and not gather more to himself.

A fourth option would be to rely on a massive training programme, coupled with a flow of exhortatory circulars, but while some training is needed, the experience elsewhere is that training by itself does not produce good managers.

What then would be the best method for us to adopt? Before answering that question I would like to suggest four important criteria which any scheme should meet if it is to stand a fair chance of success:

Firstly, it should make full use of expertise already available within the service, and be economical of scarce staff resources;

Second, it should be capable of early implementation for a modest initial expenditure;

Third, it should be capable of adaptation to meet the different circumstances found in departments; and

Fourth most important of all, it should not detract in any way from a Head of Department's responsibility for managing his own department.

After much thought I conclude that the best arrangement is likely to be the setting up of a Civil Service Staff Management Advisory and Liaison Service. This would advise departments and provide liaison links between departments, as well as between them and the Secretariat. I envisage that the service would operate on a trial basis for an initial period, perhaps three years.

The head of the service should ideally be someone who has served as a Head of Department. He would be assisted by a small number of senior officers drawn from various departments. I do not envisage the service having any permanent staff of its own, apart from clerical support, but rather being staffed by officers seconded to it from departments for tours of three years or so. The service might start with a nucleus of half a dozen staff, rising to a total of perhaps 25 in the second year.

A key point is that the service should be advisory to Heads of Departments. It is a Head of Department's responsibility to manage, and I foresee confusion

and conflict if the Staff Management Service is given executive authority. For similar reasons, although the head of the Staff Management Service might be responsible to the Secretary for the Civil Service, he and his staff ought almost certainly to be outside the hierarchy of Civil Service Branch.

To complete the picture, I see the Staff Management Service giving a powerful impetus to such subjects as management training, staff relations and staff welfare, though control of resources for these purposes would remain with departments. As a general rule the Staff Management Service would work through others, thus it would ask the Civil Service Training Division to organize seminars for it, or the Management Services Division to undertake any management studies. The new service would also be drawing on the wealth of experience available in departments.

I have dwelt on this subject at some length because of the importance which I know Unofficial Members attach to it. During the coming weeks we shall continue with our studies. If these confirm that a Staff Management Advisory and Liaison Service is indeed the best answer, then I propose to bring the service into being by 1 April 1980, subject to provision of the necessary funds by this Council.

Sir, I support the motion.

SECRETARY FOR ECONOMIC SERVICES:—

Replacement airport

Sir, I am in full agreement with my honourable Friend Mr BREMRIDGE that we must be cautious in our consideration of the timing of the construction of an airport to replace Kai Tak.

As I explained in answer to a question by my honourable Friend Sir S. Y. CHUNG in this Council on 26 April last year, it is for this reason that we have adopted a 'stage by stage approach' to the problem. This means that before we embark on a new stage of the planning or the preparatory process, we shall seek the advice of Executive Council on whether, in the light of up-dated air traffic forecasts, we should proceed to the next stage, *or* wait for a while, *or* abandon the idea of a replacement airport at least for the time being. In this disciplined way, we should not drift *either* into having a replacement airport *or* into not having one, but come to conclusions on the best possible data and arguments available at the time.

The stage we are at present embarked upon involves

- a civil engineering study of the feasibility of forming land on Chek Lap Kok for a replacement airport;
- the preparation of a layout plan to show the configuration of the runways, the airport approach zones and the boundaries of the airport within which the required areas for all the necessary airport facilities and functions can be determined;

- the collection of meteorological data; and
- a comprehensive assessment of the implications of closing Kai Tak and, of course
- updated traffic forecasts

but *no more*.

We shall then go back to Executive Council with the results and seek advice on what we should do next. But as my honourable Friend so rightly pointed out, at the end of this process there will be an agonizing decision to be made in the context of the priorities of the Government as a whole.

Hong Kong Productivity Centre

My honourable Friend, Mr Hilton CHEONG-LEEN, said that 'there is an obvious need to accelerate implementation of the Productivity Council's third Five Year Plan'. And I suspect my honourable Friend Mr S. L. CHEN was possibly making an oblique reference to the Productivity Council among other organizations, when he said that the 'shoe-string budget (on which such bodies operate) is certainly not conducive to improving the efficiency and competitiveness of our industry'. He urged that 'very serious efforts, including the provision of adequate financial resources . . . be made if the infrastructure is to be in a position to help Hong Kong's industry to keep abreast with its competitors in the world market'.

The subvention of \$7.7 million proposed for the Productivity Council and Centre in 1979-80 represents an increase of nearly \$1.5 million over that approved for 1978-79, and is the amount which the Council and Centre indicated they would require when the Government was preparing its own five year forecast of income and expenditure in the middle of last year. I recognize this amount of \$7.7 million falls somewhat short of the sum which the Productivity Council subsequently sought to meet the programme which it finally set itself for 1979-80. But the Council is subvented on a discretionary basis, and in arriving at the amount of subvention, the Government must have regard not only to the Council's programme in respect of those activities the Government has agreed to assist, but to overall budgetary considerations. The latter dictate that this year the Productivity Council should seek to generate more of its own revenue from its activities.

Nevertheless I am confident that the Centre will continue to be able to serve Hong Kong's industry as effectively as it has in the past if not more so.

Consumer Council

Similar budgetary considerations apply in the case of Consumer Council. But while it is true to say that, as my honourable Friend Mr Allen LEE pointed out, \$770,000 have been included in the Council's subvention for 1979-80 as payment of staff terminal gratuities agreed between the Government and the Council, the picture for the Council is not quite as black as my honourable Friend has painted. In arriving at the Council's subvention

for other recurrent items of expenditure, about a 10% increase has been allowed for staff salaries other than terminal gratuities, and about a 21% increase has been allowed under Other Charges to cater for an expansion of the Council's activities.

And I should like to take this opportunity to endorse the comment of my honourable Friend that the Consumer Council has been successful in the field of 'consumer education and protection'. It can take credit for the reputation which it is developing both in Hong Kong and overseas for its work in respect of both aspects.

Invisibles

I agree with my honourable Friend Mr NEWBIGGING that there is a need to quantify 'with a reasonable degree of accuracy, the contribution (to the economy) of (the) less well documented elements of our invisible trade', and that such information 'might even put the widening gap in our visible trade in a different light'.

I do assure my honourable Friend that the Government is not ignoring the growing importance of this aspect of our economy, even in a statistical context. As my honourable Friend rightly recalled, the Financial Secretary, on 16 November 1978 in the debate on His Excellency's Annual Address, said that 'surveys of ... industries (engaged in invisible trade) are now in hand'. Then on 20 December 1978, the Census and Statistics (Survey of Imports and Exports of Services for 1978) Order 1978 was laid on the table of this Council. The purpose of the survey, as explained in detail in the covering memorandum of the Survey Order, is to provide information which

'will be useful for improving the estimates of the Gross Domestic Product, and will result in a better understanding of the structure of those service industries covered and their contribution to the current account flows in the Balance of Payments'.

In addition, we recognized that

'as the importance of the service industries *vis-a-vis* the manufacturing industry (had) increased, imports and exports of services (were) likely to have assumed a relatively more important role in the current account Balance of Payments. It (was) important that a special effort should be made to start collecting information from these industries'.

The survey is now in progress. About three weeks ago, the Commissioner for Census and Statistics sent out nearing 3,000 questionnaires, consisting of 10 different designs to suit the differing activities in which the service industries are engaged. The Commissioner hopes that, with the cooperation of our business community, results from the survey will be available for analysis towards the end of 1979. So, I don't think my honourable Friend will be 'disappointed' yet again next year that 'virtually no reference (has been) made in the budget speech to invisible earnings'.

Industrial development and promotion

I was particularly pleased to hear my honourable Friend Mr Allen LEE say that 'the growth in the industrial sector ... is an amazing achievement in anybody's terms'. For it certainly is, and the fact is well worth repeating. In a way, though, it answers his question: 'Can we learn from some of the (other) industrialised countries?'.

But there is a danger that its very success could cause us to assume that there are no areas in which it is having difficulties that could be avoided. So it is as well that the serious constraints now imposed on the growth of our trade in textiles and clothing have resulted in the appointment of the Advisory Committee on Diversification 'to advise whether the process of diversification of the economy, with particular reference to the manufacturing sector, can be facilitated by the modification of existing policies or the introduction of new policies'.

The present policies include providing the infrastructure in which industry can develop (land, roads and a low tax structure for example), maintaining access to overseas markets and removing barriers, as far as possible, to development (inadequate technical education for example). Of more immediate direct assistance, perhaps, are the industrial estates and our promotion of industrial investment.

As far as learning from other countries is concerned, an answer lies in the fact that the Advisory Committee is required to consider 'comparative practices in comparable economies which have successfully encouraged the establishment of new industries'. In pursuit of this obligation, the Advisory Committee is near to completing its study of the economic policies of a number of Asian countries, studies that have been backed by visits to these countries as appropriate.

I do not wish to anticipate the Advisory Committee's findings. But I trust I have said enough to persuade my honourable Friend that the Government *is* 'pondering', as he puts it, whether it 'should change its current policy and assist industry in order to sustain growth in exports'.

Oil supplies

Finally, Sir, I would like to refer briefly to the question of oil supplies.

We have been advised that, as a result of the recent troubles in Iran and the reaction of other OPEC members to the results of these troubles, there is now a world shortage of supplies of crude oil.

The oil companies are affected in different ways, roughly depending on the extent to which their production was dependent on supplies from Iran and the Middle East. Although estimates of the general world shortfall vary to restore the balance between supply and demand, the International Energy Agency is aiming to achieve cuts in 1979 oil consumption generally of 5%.

Not all products are equally affected as far as Hong Kong is concerned. Although we are unlikely to experience a significant reduction in respect of most products, we shall be affected in respect of fuel oil which is used both for the production of electricity and directly by industry.

It now looks fairly certain that Hong Kong will have to aim to reduce its consumption of fuel oil by at least 5%, which happens to be consistent with the figure the International Energy Agency has adopted as the saving for all products. But this must be done as painlessly as possible. And, to protect our exports and our employment, our primary object must be that industry should *not* have to curtail production through lack of electricity or of fuel oil. Any shortfall in supply that will still remain even if such savings can be achieved, will be met by drawing down, but not eliminating entirely, reserves in Hong Kong.

Towards achieving the 5% reduction in consumption of fuel oil by means of reduced consumption of electricity, the Government is considering a number of measures including a ban on the use of electric light for advertising, display or floodlighting except between 7.00pm and 11.30pm; savings in the Government's use of electricity; daylight saving; reduced spinning reserve by the power companies; no air conditioning at below 26° C; and a general exhortation to all to save electricity.

I might add that such measures would be similar to those already adopted by Singapore and Japan. And I can assure Honourable Members that those which are introduced will be lifted just as soon as the supply situation begins to improve.

Sir, I support the motion.

SECRETARY FOR SECURITY:—Sir, four Members have spoken about immigrants and the problem of refugees from Vietnam in particular which has beset us.

Since then the Governor has referred in a recent Press conference to the problems of immigration and the worrying figures of both legal and illegal immigration from China in spite of repeated representations. His Excellency, is on record as having stressed this issue at all levels in Canton and Peking and as to the sympathetic reply you received to Hong Kong's predicament. The Chinese authorities have said that measures to reduce the number of legals have not been as effective as intended and so more would be done. But it would take time. The Chinese authorities also said that they strongly disapprove of the illegals and would step up counter measures. It is unnecessary (and indeed impertinent) for me to add to these important statements other than to say that we remain very much on the alert for illegal immigrants from China. Our security forces are stepping up measures to apprehend them.

Because of our already crowded conditions, any inflow of people poses particular problems for us. This also applies to those coming here from Vietnam. What seems to have been given insufficient weight however is that Vietnamese refugees are only landed here temporarily pending resettlement by UNHCR in other countries. So whilst it may take time to disperse them, that is the basis on which they are here.

The Administration has been taken to task for adopting a passive and wavering attitude and for resting on its laurels and hoping for the best. By the debating language of this Council these are quite sharp criticisms. (*laughter*)

The record of the Administration in coming to grips with this intractable problem is by no means negative. Well before the MV Huey Fong arrived I had formulated plans to deal with such a situation. The threat had already been identified. Our advance precautions kept the ship at our boundary and subsequently a lot of men and women spent a great deal of time, energy, effort and ingenuity to try to get the ship to continue on its voyage. We were not successful, and I concluded that the ship would not leave Hong Kong despite the stand we had taken.

The decision to tell the Captain that he would not be physically prevented from entering after 27 days on our boundary was a Hong Kong Government decision taken on my advice. This advice was not influenced by any view expressed from the United Kingdom nor by the consideration, an appearance of humanity here might lead to humanity elsewhere. There were of course different views about what to do on this, as on all other issues, but this was the view which prevailed.

It is natural in a problem of this kind that everybody learns as time goes on. Not long after the Huey Fong came into Hong Kong, the Skyluck arrived with another 2,642 people on board. This ship did not stop at our boundary. She came in by stealth during the night. There is no doubt that our action in holding the Huey Fong at our boundary seriously bothered those on the Skyluck and they learned from this experience. We have done so too. Apart from the sick none from the Skyluck has yet been allowed off the ship. This is right, but Members should not underestimate the human consequences of that course.

The Administration believes that its actions have in fact discouraged other ships getting into the business of carrying large numbers of people. What we have not been able to discourage is the steady flow of people arriving from Vietnam in small boats. Within the limits of civilized behaviour I do not see much prospect of doing so.

Our efforts to prevent the arrival of large ships are being pursued vigorously—

first, we have devised a system which identifies the ships which may possibly be about to engage in the trade. We know some who are in the business and appropriate and I hope, discouraging action is taken:

second, we keep in touch with other Administrations and when we deem it advantageous we take concerted action against such ships:

third, we are carrying out sea and air reconnaissances, to provide an early warning system and some deterrent, and

fourth, there are the provisions of the recently amended law.

The problem of the small boat arrivals is different, as I have said. They are detected readily enough—simply because they want to bring themselves to our notice. There is no attempt to evade immigration control and there is no way in which entry can effectively be refused. There is no way either that I have been able to devise and to which I would be a party in which either such a boat or those on board can be removed.

Criminal proceedings have, as Members know, been instituted against the number of people involved in the arrival here of the Huey Fong. Criminal proceedings have also been instituted in a case where people from Vietnam were allegedly transhipped from a large ship to a smaller one for the actual landing in Hong Kong. And it is convenient here to refer to Miss DUNN's suggestion that investigation on the circumstances of the Huey Fong's arrival and the charging of defendants was a long drawn out process. That suggestion is entirely without foundation. The investigation was not a simple one and much credit is due to all involved for the speed with which it was accomplished.

Against this background, I reject Mr T. S. LO's description of the Administration as 'rushing around in frenzied activity doing the best we can to cope after the refugees have arrived upon our shores.'

What we have not done is to act contrary to our obligations under the international Safety of Life at Sea Convention—down the barrel of a gun as at least one authority did, and as confirmed by an eyewitness account which I read some time ago. We have not attempted to tow away heavily overloaded ships containing masses of women and children to face whatever fate may be in store. This is what the 'way' if you have the 'will' actually means. Despite the undoubted need to 'look after our own people' in Miss DUNN's words, and despite the actions of other administrations, I do not believe it would be right or to Hong Kong's credit to send to sea a heavily overloaded ship—which would not normally be permitted to sail with more than 12 passengers—thus committing people to the deep on the basis that they can take their chance somewhere else and in breach of our Convention obligations.

If any reminder of what this implies for a small ship is required, we need only refer to the recent reports of the loss of life when a refugee vessel capsized while reportedly being towed off the Malaysian coast.

The only real solution to the problem of those who wish to leave Vietnam is a scheme which will ensure a controlled outflow from that country. In this respect, through the United Kingdom Government, we brought diplomatic pressure to bear on the Vietnamese authorities to abandon their participation in the traffic by means of large ships and to put a stop to others doing it. We believe that we discouraged at least one ship from loading by such means. We have taken note, too, of the Deputy High Commissioner for Refugees' visit to Hanoi in late February and early March, during which arrangements for a programme of orderly departures from Vietnam were formulated. If these can be made to work, and there is the will to work them in Vietnam and resettlement countries, we should see some much needed order coming into the outflow of these people.

The other solution is to get these refugees moved on to countries where they can settle—as quickly as possible. We have made strenuous efforts to do so, though the offers we have received are by no means commensurate with them.

Miss DUNN has given Council my figures of resettlement so far this year and the estimate for the future. These figures may prove optimistic. In any case they are not particularly encouraging, but we are pressing UNHCR and other Governments to increase the rate of resettlement and are seeking to obtain further offers.

As I said, however, Vietnamese refugees are here in transit. I accept that this means that initially we have to provide for them until they can be processed and handed over to UNHCR for accommodation and resettlement overseas. Of the 17,650 here yesterday 5,600 have already been handed over to UNHCR: 9,400 are in Government camps and will be handed over to the UNHCR as soon as it can provide accommodation and 2,642 are aboard the Skyluck. Agreement has been reached with the UNHCR for it to meet the maintenance costs of refugees in Government camps who fall within their responsibility.

Sir, deep as concern is about people coming here from Vietnam that problem must be seen in the perspective of new arrivals from China to which I referred at the outset. In answering a question in this Council on the 29 November, you spoke about the implications of this inflow for our social services and other programmes. Unhappily the increasing number coming to Hong Kong since then has accentuated the problems for our various programmes. At that time we were discussing immigration from China at the rate of inflow for 10 months in 1978. You then postulated that if this rate continued it would increase the population over the medium population projection by 400,000 by 1986. Since then the rate of inflow has increased. I estimate that we have had an increase in population overall from China (legal and illegal who are permitted to stay) of 160,000 in the 15 months from January 1978. It is for this reason that we attach so much urgency to restricting immigration and to do so as quickly as possible. These stark

figures emphasize, too, our concern that the international community should assist in the resettlement of Vietnamese refugees at a substantially higher rate than the current level of offers.

I support the motion.

THE FINANCIAL SECRETARY:—

OUTLINE

	<i>Paragraphs</i>
(1) Introduction	1
(2) Fiscal Questions:	
(a) The 'sandwiched society'	2 - 5
(b) Administration of the Inland Revenue Ordinance	6 - 8
(c) Dutiable commodities	9 - 10
(d) Motor vehicle taxation	11 - 13
(e) Road tolls	14
(3) Management of Trading Departments:	
(a) Operating accounts	15-18
(b) Hiving-off	19 - 20
(4) Subvention Policy for Social Welfare Services	21 - 22
(5) Emphasis of Budgetary Policy in 1979-80:	
(a) General attitude of Unofficials	23
(b) The decision-making process	24 - 27
(c) Programme plans versus the Annual Estimates	28 - 30
(6) The MTR Project and the Public Sector	31 - 38
(7) Growth Rate of Public Expenditure	39-45
(8) Growth Rate of Private Domestic Demand:	
(a) Introduction	46
(b) Interest rates	47 - 51
(c) Exchange Fund	52 - 53
(d) Premium Savings Bond Scheme	54
(e) Deposit-taking companies	55 - 56
(f) Finance for industry	57 - 58
(9) Prospects for the Economy in 1979	59 - 71
(10) Conclusion	72
(11) Valedictory	73

(1) *Introduction*

Sir, there were two main themes in this debate on the Second Reading motion of the Appropriation Bill 1979, namely, the prospects for our economy and the likelihood of the strategy proposed in the budget speech containing the inflationary pressures which threaten us so that really painful adjustments to restore internal and external equilibrium can be avoided. However, before

dealing with these two main themes, I must reply to a number of separate points falling outside them.

(2) *Fiscal Questions*

(a) *The 'sandwiched society'*

2 In thanking Mr WONG Lam and Mr LOBO for their support for my proposal to benefit 'the middle income group', I must admit to listening with some perplexity to Mr LOBO's subsequent claim that those belonging to the so-called 'sandwiched society ... have a very real right to look forward to a time when their taxes and their sacrifices will have earned them a less strenuous and a brighter future'.

3 I assume that, in describing the 'sandwiched society' as 'the class in the middle', Mr LOBO has in mind those taxpayers who earn from about \$3,000 a month to about \$7,000 a month. The question then is: does the tax system operate unfairly, in some sense or other, in respect of these taxpayers? As an indication of the amount of tax they pay, the average tax paid in respect of the year of assessment 1976-77 by taxpayers at the lower end of this range is about \$900 a year, or just below 2.5% of their annual incomes; and the average tax paid by taxpayers at the upper end of the range is \$7,500, or about 10% of their annual incomes⁽¹⁾. It cannot be denied that these percentages are very low absolutely and by world standards.

4 In addition, the proposed reduction in the 'claw-back' factor from 15% to 10% and the abolition of the 30% top marginal rate, taken together, not only will reduce the effective rate of tax for the generality of taxpayers, but also will lift the point at which the standard rate applies, thereby stretching and evening out the progression of effective rates to the benefit of the 'class in the middle'. I would, once again, urge Mr LOBO to study carefully Annex (13) to the printed version of the budget speech and, if he remains unimpressed, I would ask him to adduce evidence in support of his statement that the 'sandwiched society' is hard pressed or, as Mr BREMRIDGE would say, 'embattled', from the tax point of view.

5 Given the present standard rate of salaries tax of 15%, to single out the 'sandwiched society' for preferential tax treatment would upset the internal relativity between this class of taxpayers and other classes of taxpayers, thereby distorting the even progression of effective rates.

(b) *Administration of the Inland Revenue Ordinance*

6 While Mr LOBO is concerned with the burden of the 'class in the middle', Mr CHEONG-LEEN made the point that 'the time has come to cast the net wider' because there are 'many more (people) capable and willing to pay

(1) See Schedule 15 to the Report of the Inland Revenue Department for 1977-78.

income tax, but have not been approached by the Government to do so'. (*laughter*) The facts do not support this rather charming idea. (*laughter*) Although, under the law⁽²⁾, the onus for declaring chargeability rests with taxpayers, the Commissioner of Inland Revenue has never relied on this. (*laughter*) He *does* send out invitations very polite invitations to taxpayers and potential taxpayers asking them to declare their incomes for tax purposes. This year, for example, the Commissioner will send out about 403,000 salaries tax return forms. Allowing for working wives, it is likely that some 500,000 salary earners who are liable to pay tax, or who may be just below our (very high) tax thresholds, will be covered. Furthermore, returns will be sent to employers requiring details of the earnings of well over 500,000 employees. Apart from salaries tax returns, the Commissioner will send profits tax return forms to unincorporated businesses covering some 162,000 individuals⁽³⁾. Every fourth year he also sends profits tax return forms to businesses the profits of which are, on the basis of past returns, well below the tax threshold, in order to keep their potential liability under review; these cover some 120,000 individuals. All these returns cover some 782,000 individuals, (although there may be some double counting in the case of those who are subject to both salaries tax and profits tax). There are also those recipients of income from property and interest who are not required to file personal returns, but who are, of course, taxpayers.

7 In this statistical context, I am not sure why Mr CHEONG-LEEN has seized on the 70,000 individuals paying tax under personal assessment to illustrate his point. This is, indeed, the very last figure which should be used to demonstrate that the number of returns should be higher. Personal assessment returns are issued only to individuals who *elect* for personal assessment because it is in their interests to *reduce* their tax liability.

8 As regards Mr CHEONG-LEEN's belief that 'many more (people) are capable and willing to pay income tax', all available evidence indicates, regrettably, that those who are 'capable' may not be all that 'willing'. For example, in 1977-78, there were well about 143,000 cases where the Commissioner had to impose penalties for late payments and for such non-compliance of the law as failure to file returns and filing incorrect returns. In addition, there were some 1,807 successful prosecutions through the Courts for various offences. I am happy to report, Sir, that the total yield from these prosecutions was almost \$25 million which was roughly the cost of Radio Television Hong Kong in that year or near at home half the cost of the Inland Revenue Department.

(2) *Section 51, subsection (2) of the Inland Revenue Ordinance reads as follows:*

(2) *Every person chargeable to tax for any year of assessment shall inform the Commissioner in writing that he is so chargeable not later than 4 months after the end of the basis period for that year of assessment unless he has already been required to furnish a return under the provisions of subsection (1).*

(3) *This makes allowance for partners and wives working in the business.*

(c) *Dutiable commodities*

9 Mr LEUNG Tat-shing suggested that 'consideration be given to abolishing duty on locally produced Chinese spirits'. There is already a preferential rate of duty on all non-European type spirits. There is a further preferential rate on those of Hong Kong origin. Thus the rate of duty (at \$8.75 per gallon) on Chinese-type spirits of Hong Kong origin is already very low compared with that on imported European-type spirits of similar strength (at \$95.50 a gallon). Under the rules of the GATT, this preference margin cannot be increased. As the incidence of duty is only just over \$1 per pint, I do not think, in any case, that the abolition of the duty at a cost to the revenue of \$11.5 million would be justified.

10 Mr BREMRIDGE asked me 'to consider some further degree of sumptuary taxation in the years ahead'. His gloomy suggestions in this respect concentrated on new or increased rates of duty or tax on a variety of luxury items ranging from private swimming pools to perfumes (the alcoholic content of which is already dutiable, incidentally). Whilst, as always, he has given me food for thought, I am sure he would agree that we should be very careful not to steer ourselves in the direction of self-righteously penalizing the affluent when, as he admits, 'the total return may be relatively low' and, I would add, the administrative costs are bound to be relatively high.

(d) *Motor vehicle taxation*

11 As part of his suggestion that we should 'consider possible alternative taxes on usage not possession' of vehicles, Mr BREMRIDGE said that 'area tax rules with timing criteria, and above all increased taxation on use, *eg* on fuel cost, merit much closer attention'. I have noted what he had to say, but would remind him that my proposals on motor vehicle taxation had nothing to do with future transport policy; I put them forward on fiscal ground only⁽⁴⁾.

12 Mr LOBO however 'fails to understand why private buses or coaches ... have been spared'. As regards first registration tax, there are at present 1,466 vehicles registered as non-enfranchised public buses which are generally available for hire and 234 vehicles registered as private buses which are used generally to serve schools, factories, tourists and some residential premises. However for my part, I fail to understand Mr LOBO's question: His question being 'why were private buses and coaches spared?' He asked a further question indeed 'are we creating another class of business and private vehicles?' These buses (unlike enfranchised public buses which are not subject to first registration tax) these buses were first brought within the scope of the Motor Vehicles (First Registration Tax) Ordinance, *together with* goods vehicles and taxis, at an *ad valorem* rate of 15% when Commonwealth preference on motor vehicles was abolished in December 1975.

(4) *B.S., 1979, paragraph 202. And see also paragraph 169.*

As I implied in the budget speech, I see no need at this time to pick out non-enfranchised buses for special treatment⁽⁵⁾.

13 The licence fee for non-enfranchised public buses is calculated on the basis of \$10 for the driver and \$30 per passenger seat (the same as for enfranchised public buses) and for private buses licensing fee is calculated on the basis of \$10 for the driver and \$25 per passenger seat. The effective fee is, therefore, somewhere between \$1,000 to \$1,200 per vehicle. Bearing in mind that buses of all kinds are a desirable form of transport, and, as I did not wish to become tangled up with the touchy subject of public service vehicles generally, I left the fees at their present levels for the time being.

(e) Road tolls

14 I have every sympathy with Mr BREMRIDGE's failure to 'understand (the Government's) refusal to consider tolls for the Tuen Mun freeway'. The Government's policy is to impose tolls wholly or partly to meet the cost of providing such a facility if its adequate utilization would not thereby be jeopardised. But we must be practical: to collect tolls on the use of tunnels is easy—and particularly justified where alternative routes are available—but it would be complicated and expensive to charge vehicles using, for example, the Tuen Mun highway given the number of entry and exit points.

(3) Management of Trading Departments

(a) Operating accounts

15 I am sorry that Miss DUNN 'was disappointed that (the operating) accounts (for the six Government-owned and operated public utility undertakings) were not included (in) ... the budget speech'. She will now find summaries of them in Annex (1) to the printed version of this speech.

16 Miss DUNN put three questions to me about these accounts. As regards the returns on average net fixed assets employed, we have not yet finally decided on the appropriate rates of return for all the undertakings involved. For example, we have not yet done so in respect of water and when I introduced, recently, increases in water charges, I merely sought to bring the waterworks accounts into balance. Incidentally, Sir, in reply to Mr Allen LEE's point about the limitation of the concessionary tariff to large trade consumers, I would, if I may, refer him to my speech in this Council on 14 February last.

17 With regard to the management of these undertakings, I accept there *is* room for improvement, and I am sure the heads of departments concerned would agree with me. The operating accounts now available to us

(5) *B.S., 1979, paragraph 194.*

will enable us to develop rational pricing and capital investment policies and they can also be used to appraise how efficiently resources are being used.

18 It will probably be no surprise to Miss DUNN when I say it is more difficult to give a succinct answer to Miss DUNN's third question about our approach to long-term planning to meet demand and to keep up to date technically. But there are development plans for the larger utilities, such as the waterworks and the airport, and have been for many years.

(b) *Hiving-off*

19 Mr BREMRIDGE considered that 'the Civil Service is too large' and suggested that certain trading departments should be sold off to commercial interests or converted into quasi-Government corporations thus leading to 'major consequent savings plus a tighter, more competent Civil Service'. Certainly, the Civil Service has grown rapidly in the last three years and I agree it is arguable that management overheads are now too thinly stretched⁽⁶⁾.

20 I do not believe, however, that the hiving-off of certain activities would achieve the objectives Mr BREMRIDGE has in mind. There would be disadvantages too, especially where there must remain a degree of financing from General Revenue. The Government either would not have the necessary control, or would need to be involved in their managerial decisions to such an extent that any advantage in hiving them off these undertakings would be diminished. But I see no point in creating autonomous corporations with the Government retaining power subsequently to claw back control over, say, the use of any surplus funds generated. Yet without this power, the Government would lose a source of revenue which could otherwise be applied to other services as priorities dictate.

(4) *Subvention Policy for Social Welfare Services*

21 Dr Ho has ably identified the problems which beset us in trying to rationalize the procedures by which discretionary subventions are allocated to voluntary agencies in the field of social welfare. Despite the high hopes placed on the concept of unit rate subvention, its application to day nurseries has brought to light problems which must be resolved before we can consider its extension, on any scale, to other areas. Clearly, it is not possible to devise a single type of financing arrangement which would be satisfactory in respect of all the very wide range of services presently provided by voluntary agencies. Thus, I believe Dr Ho is correct when he recognized that a definition of priority areas should go hand in hand with any revision of our subvention policy. This will mean devising financial and administrative

(6) *B.S., 1979, paragraph 137.*

arrangements which are flexible both in terms of the type and extent of government subsidy and of the role to be played by funds raised privately by voluntary agencies or allocated to them by the Community Chest.

22 As mentioned in paragraph 23 of Annex (8) to the printed version of the budget speech, a working party has, in recent months, been reviewing the problems which Dr HO has identified. I very much hope that its recommendations will lead to a strengthening and improvement of the currently somewhat haphazard and, I suspect, wasteful arrangements for the disbursement of public funds.

(5) *Emphasis of Budgetary Policy in 1979-80*

(a) *General attitude of Unofficials*

23 I turn now, Sir, to the two main themes of this debate. Of the nineteen Unofficial Members who have spoken, seventeen expressed general support for the emphasis of budgetary policy in 1979-80, which is to slow down the growth rate of total final demand⁽⁷⁾ in order to bring it more into line with the growth rate of the economy's output, and for the strategy to be adopted in respect of both public and private domestic demand⁽⁸⁾. Their support for the general emphasis of budgetary policy and for the strategy to be adopted, their support was expressed in terms which were not entirely uncritical, and legitimately so, for as Disraeli once said, admittedly in a rather different context, 'no government can be long secure without formidable (criticism)'. At the same time, they put forward a number of suggestions to encourage and direct the growth rate of the economy's output.

(b) *The decision-making process*

24 Mr T. S. LO did not indicate his intentions. I shall deal with his trenchant charge that 'Government's actions have had a significantly adverse effect on (our) economy' later on. But I must deny straight away that the Government's budget for 1979-80 reflects 'discord within ... the Administration', unless by discord he means argument and debate. The budget certainly does reflect argument and debate and rightly so: in any bureaucracy, even one which operates within a consultative rather than an orthodox parliamentary framework, the decision-making process is a highly argumentative process, particularly when the dictates of economic policy require restraint despite a relative plenitude of purely financial resources in any particular year.

25 The decision-making process is an argumentative process because there has to be a reconciliation of conflicting views, *first*, about the provision of public services and of those elements of the social and economic infrastructure which only the Government can sensibly provide (which, in turn,

(7) *Total final demand=private consumption expenditure+Government consumption expenditure +gross domestic fixed capital formation+exports of goods.*

(8) *Domestic demand=total final demand-exports of goods.*

involves a whole series of arguments about the relationship between the public and private sectors); *secondly*, about the recognition to be accorded to those social needs which have a moral rather than an economic justification, views on which will tend to change over time adding a further dimension to the argumentative process; and, *thirdly*, about the emphasis to be placed on cost-effectiveness and cost-efficiency. Such conflicting views in these three areas have to be resolved in order to maintain what Mr NEWBIGGING described as 'a delicate balance' and in a way which ensures that the general objectives of budgetary policy⁽⁹⁾, so clearly set out in paragraph 63 of the Budget Speech, are achieved.

26 For two reasons, it is asking too much of civil servants simply to rely on commonsense and value judgements when budgetary policy is being formulated: *in the first place*, there is the reality of all the cross-pressures to which they are subject; and, *secondly*, there is the virtual absence of that mechanistic instrument of discipline, the profit and loss account, which makes the decision-making process in the private sector much simpler. Thus our thinking has to be subjected to the discipline of certain guidelines⁽¹⁰⁾. But the application of these guidelines has to be pragmatic which is *not* the same thing as Mr LO's 'lip service'. So the decision-making process, being an argumentative process, often leads to results which do not conform exactly with our guidelines. The fact is administration, as well as politics, is the art of the possible and that is *not*, whatever Mr LO might say, a 'lame excuse'. Furthermore, our record, which I have sought to document in paragraphs 74-99 of the budget speech, indicates that the degree of non-conformity has been, usually, only marginal.

27 Mr LO also pleaded with the Administration 'to trust this Council and inform Members fully and without reservation' how policies are determined, and thereby, by implication, to explain how conflicting views have been reconciled. And reconciled they have been, by definition: as Financial Secretary, I laid the Draft Estimates and moved the Second Reading of the Appropriation Bill on behalf of the *Government*. An obvious point but one which is perhaps not as well appreciated as it might be. Certainly I would have thought that the budget speech did take this Council into '(the Administration's) trust' and exposed our underlying thinking. However, if I was too elliptical this year, and if it is Honourable Members' wish, I would be happy to spell out our thinking next year even more carefully. *(laughter)*

(c) *Programme plans versus the Annual Estimates*

28 I cannot say that Mr CHEUNG's speech was a helpful contribution to solving '(the problem of) the trade deficit and inflation' as he put it. As Disraeli long ago, and Mr BREMRIDGE more recently, have observed 'it's much easier to be critical than to be correct'.

(9) *B.S., 1979, paragraph 63.*

(10) *B.S., 1979, paras. 65-73.*

29 Mr CHEUNG ignored the distinction between programme plans and policy targets, on the one hand, and annual rates of implementation which must have regard to prevailing financial and/or economic circumstances, on the other. As the Governor put it in the very same speech from which Mr CHEUNG hand-picked his quotations:

‘...the need for flexibility and adaptability in the design and implementation of our programmes in changing circumstances is, of course, well understood’⁽¹¹⁾.

This need is not well understood by Mr CHEUNG, yet I do not recall his ever questioning our attitude towards our steady progression guideline (of 10% a year in real term). As I have stressed on several occasions, the growth rate of public expenditure, in any particular year, may well have to be lower than 10% and it could be and, indeed, frequently has been, higher in others⁽¹²⁾.

30 So it is all very well for Mr CHEUNG to ask: ‘is there no other way?’ The fact is ours is an over-employed economy and, if we are to avoid really painful adjustments later on to restore internal and external equilibrium, we must change down into a lower gear, that is to say, slow down the growth rate of total final demand. The growth rate of public expenditure must be adjusted downwards as a contribution to this end. Mr CHEUNG refers to ‘savage cuts’ and my ‘arid’ approach in ‘knifing the Public Works Programme’⁽¹³⁾ with the object, I presume, of discrediting the emphasis of budgetary policy this year. Were the Government to sit back and disregard changing economic circumstances, despite the views of his colleagues, the painful adjustments to be subsequently endured would give Mr CHEUNG even greater scope for displaying his considerable powers of destructive rhetoric.

(6) *The MTR Project and the Public Sector*

31 Both Miss DUNN and Mr T. S. LO argued that my budgetary strategy for 1979-80 and, indeed, my assessment of the role of public expenditure in the course of our economy in recent years, were at least partly invalidated by the exclusion of expenditure on the Mass Transit Railway project from my definition of the public sector, which I confined this year, as heretofore, to expenditure shown in the Consolidated Account. I do not wish to become involved in conceptual arguments as to what areas of activity may properly be regarded as within the so-called public sector from a legal, institutional or national accounting point of view. Obviously, the relative size of the public sector will be different according to the particular definition

(11) *Governor’s Address to the Legislative Council on 11 October 1978, paragraph 109.*

(12) *B.S., 1979, paragraph 70.*

(13) *That is Heads 69, 70, 71, 72 and 73; but see also Heads 32, 51, 84 and 87 of the Draft Estimates of Expenditure for 1979-80.*

of public sector expenditure selected. For the purpose of formulating annual budgetary policies, we need to adopt a practical definition of public sector expenditure (and to apply that definition consistently over time). Thus I have defined the public sector for this purpose in terms of the deployment of funds under the Government's control.

32 Of course, this does *not* mean, despite what Mr LO said, that the demands of the Mass Transit Railway Corporation are 'ignored' when evaluating the validity of the Government's annual budgetary policies. I have not done so. As I said right at the beginning of the budget speech, 'the economy (was) my starting point' and, when deciding upon acceptable expenditure limits for 1979-80, I specifically referred to the MTR project in the following terms:

'When seeking to reduce the growth rate of expenditure on General Revenue Account—the component of public sector expenditure over which the Government has the most direct control—I concentrated on the capital account because evidence was accumulating that the growth rate of demand by the public sector, including the Mass Transit Railway project, for the output of the building and construction industry was leading to a build up of inflationary pressures which were probably spilling over into the economy as a whole.'⁽¹⁴⁾

33 Even at the risk of Mr LO responding by reminding me, this time correctly, that Disraeli once said that 'there are three kinds of lies: lies, damned lies and statistics', I would ask Honourable Members to study the statistics in Annex (2) to the printed version of this speech. These show the growth rates of expenditure in real terms on Consolidated Account, and on Consolidated Account *plus* the MTR project taken together. I do not think it can be fairly concluded from these statistics that expenditure on the MTR project since 1975-76 has been such that budgetary policy has been, or is being, frustrated. The growth rate of expenditure on Consolidated Account and the MTR project taken together in 1978-79 at 25% was roughly the same as the growth rate of expenditure on Consolidated Account alone; and, in 1979-80, the rate will be actually lower: 6% with the MTR project included compared with 7.5%⁽¹⁵⁾ with the MTR project excluded. It is true that, in the three previous years, 1975-76 to 1977-78, the effect of including expenditure on the MTR project is to increase the growth rate quite substantially but, in these years, the economy was not operating close to full capacity as it was in 1978-79 and is certainly forecast to be in

(14) *B.S., 1979, paragraph 238. See also paragraphs 106 and 117.*

(15) *This is because the growth rate of MTR expenditure in 1979-80 will be less than that of expenditure on Consolidated Account:*

<i>Growth rate (%) in 1979-80</i>	<i>MTR</i>	<i>Consolidated Account</i>
<i>in money terms</i>	13.8	15.1
<i>in real terms</i>	—	7.5

1979-80. Consequently, inflationary pressures as reflected in, for example, the rates of increase of prices, were much less⁽¹⁶⁾ in those three years.

34 So I think, Sir, I can fairly claim that, my definition of the public sector notwithstanding, budgetary policy *has* had regard to the likely demands of the private sector, including the MTR project, on the resources available to the economy.

35 It may be that one of the reasons why both Miss DUNN and Mr LO are so pre-occupied with the MTR project is that they, in common with many other commentators, tend to over-emphasize the influence of the construction phase of this project on the course of our economy in recent years. In 1978, for example, the MTR project employed under 11% of the number of manual workers on building and construction sites and less than 0.5% of the economy's labour force. It cannot be denied that, if expenditure on the MTR project *is* included, the relative size of the public sector, so defined, is lifted: by 1½ percentage points in 1975-76, by about 2 percentage points in 1976-77, by about 3½ percentage points in 1977-78 and by about 4½ percentage points in 1978-79 and 1979-80⁽¹⁷⁾.

36 But, quite apart from the fact that the rapid growth phase of the MTR project is over and so the relative importance of the project will tend to decline over the next couple of years, why do Miss DUNN and Mr LO pick on the MTR project simply because, as it happens, it is a publicly owned undertaking? Mr LO even went so far as to declare that '(all) non-export orientated expenditure...is inflationary'; taken to its logical conclusion this argument could lead to some peculiar policy decisions, including the arbitrary drafting of solicitors to work in our factories I should refrain, Sir, from suggesting a suitable occupation for barristers. But, on a more serious note, it simply cannot be denied that investment in transport facilities is as essential a form of support to our export-oriented economy as is investment in office buildings, in power supplies, in harbour facilities, or in godowns. Furthermore, if the MTR project had not been decided upon other forms of investment in transport facilities (*eg* roads) would have been necessary, on public or private account, involving a call upon the economy's resources.

37 Finally, Miss DUNN is correct when she says that the public sector, as defined by her to *include* the MTR, will be in deficit in 1979-80. But from

(16) *Change over previous year:*

	<i>Consumer prices</i>	<i>GDP deflator</i>	<i>Labour and material cost index</i>
	(%)	(%)	(January 1969=100)
1975	2.7	2.7	-10.2
1976	3.4	8.6(*)	3.7
1977	5.8	3.8	9.9
1978	5.9	5.6	14.5

Note:(*) *Due to buoyant export prices.*

(17) *See Annex (2).*

this it does *not* follow that the budget 'will not be as disinflationary as the Government claims'. I am budgetting for a surplus on General Revenue Account of \$1,428 million and on Consolidated Account of \$1,215 million and, given all the other demands on the economy's resources, of which the MTR project is only one example, the Government has every intention of seeing that Controlling Officers keep within their cash limits.

38 Not that it would be really possible to slow down the rate of construction on a project such as the MTR project. There is a world of difference between delayed starts and the rephasing of such relatively simple projects as road widenings and reclamations, on the one hand, and the delayed completion of an integrated project, such as an underground railway system, having consequences also for the system's projected cash flow, on the other. I must admit that even Mr LO did not suggest this, for his call for a reduction in the relative size of the public sector implied little, if any, rephasing of expenditure on the MTR project.

(7) *Growth Rate of Public Expenditure*

39 But, apart from these questions relating to the attitude towards the MTR project in the formulation of budgetary policy, several Unofficial Members were doubtful whether public expenditure, defined in terms of the Consolidated Account, had been slowed down sufficiently, having regard to the necessity to slow down the growth rate of domestic demand.

40 Miss DUNN was particularly concerned that 'the (forecast) growth rate of total final demand (at 9% was) so much faster than the growth rate of GDP (at 7%)'; and she pointed out that, in real terms, the growth rate of public expenditure on Consolidated Account at 7.5% would be, yet again, higher than the forecast growth rate of GDP Mr LO implied that planned public expenditure on Consolidated Account should be reduced by over \$1,000 million in order to reduce the relative size of the public sector which, as he rightly pointed out, I had failed to do (although I did not fail to admit that the relative size of the public sector should by now be such as to leave more room for expansion when the growth rate of the economy slows down⁽¹⁸⁾). Mr CHEN, Mr NEWBIGGING and Mr WONG Lam expressed general doubts about the levels of expenditure envisaged in the Draft Estimates—they suggested they might prove to be on the high side—and Mr CHEN expressed particular fears about the size of the capital account, which he thought might require 'further rephasing'.

41 By contrast, several others, whilst in general support of the levels of recurrent and capital expenditure proposed for 1979-80, with or without regrets, put forward special pleas for additional expenditure: Mr CHEN wanted further expenditure on manpower training and additional funds for various subvented organizations; Miss BENNETT had expensive ideas for

(18) *B.S., 1979, paragraph 167 in relation to paragraph 108.*

education; Mr YEUNG put forward a long list of projects for the New Territories which should be put in hand immediately by a revision of priorities or 'as exception(s) to the...general rule...of overall constraint'; Dr HO pressed for some form of income protection scheme which could well involve a call on public funds and his views on subvention policy for social welfare could be, taking to their extremes, quite expensive. Mr CHEUNG was unimpressed by the vast programme of capital works provided for in the Draft Estimates⁽¹⁹⁾. He dismissed any concept of balance between the demands of the public and private sectors of the building and construction industry if certain projects of particular interest to him were not, as a consequence, to be proceeded with immediately.

42 Mr CHEUNG's solution to the problem of inflation appeared to me to be virtually unlimited investment in development and engineering works designed to produce more land and improved facilities for movement. Not only would a larger Public Works Programme in 1979-80 have no effect whatsoever on the supply of land becoming available *in* 1979-80 which as Secretary for the Environment pointed out yesterday will be substantial anyway. Not only will a larger public works programme in 1979-80 have no effect on the supply of land becoming available in 1979-80, but also it would be inconsistent with the necessary emphasis of budgetary policy this year: that is to say, not only must Government expenditure make a contribution to the slowing down of the growth rate of domestic demand but also, at the same time, there is an especial need *now* to reduce the pressures so evident *now* in the building and construction industry. The fact is that ours is *now* an over-employed economy with a widening trade deficit and, if we are to avoid painful adjustments later on, we must take action *now* to restore internal and external equilibrium⁽²⁰⁾.

43 I would not wish to claim that the Draft Expenditure Estimates provide for exactly the right growth rate of expenditure on General Revenue Account, or that they represent a perfect reconciliation of competing claims for resources which can be legitimately made available. Except in an ideal world the argumentative process never works quite that well; but I would point out that none of our guideline has been breached⁽²¹⁾, except that relating to the relative size of the public sector (in the sense that it should be, at this stage, smaller). But, as seventeen Unofficial Members have expressed their intention to support the motion, I can only assume that they at least have taken a generally favourable view of the Draft Estimates as a whole. That is to say, they approve of the effort made to expand existing recurrent services at approved standards to meet demand; and, within

(19) *On Consolidated Account, expenditure of \$4,972 million is envisaged in 1979-80 which may be compared with a revised estimate of expenditure for 1978-79 of \$4,156 million which, in turn, may be compared with the approved estimate for 1978-79 of \$3,468 million.*

(20) *B.S., 1979, paragraph 265.*

(21) *B.S., 1979, f.n. (183).*

the capital account, they approve, for example, of the bias in favour of public housing⁽²²⁾ where our investment really is enormous and represents 27% of total capital expenditure on General Revenue Account (and 32% on Consolidated Account).

44 I also assume, Sir, that they support a slowing down of the growth rate of expenditure on General Revenue Account, in real terms, from 25% in 1978-79 (revised estimates) to 5% in 1979-80. If, during the course of the year, prices tend to increase faster than forecast, as expected by Miss DUNN, our intention to apply cash limits strictly—Mr CHEN's doubts notwithstanding—will reduce the growth rate of expenditure, in real terms, to below this figure⁽²³⁾. At the same time, higher than expected prices will be reflected in higher revenue yields and thus an 'automatic' surplus, over and above the surplus I have actually budgetted for, should be the outcome and, with the enactment of the Exchange Fund (Amendment) Bill shall be in a better position to ensure that such a surplus will have a constrain effect on the private sector component of domestic demand.

45 On Consolidated Account the growth rate of expenditure provided for is 7.5% in real terms which, as Miss DUNN has quite fairly pointed out, is in excess of the forecast growth rate of GDP of 7.2%. This means that, for six years out of the eight years 1972-73 to 1979-80, the growth rate of public sector expenditure (as defined by the Consolidated Account) will be in excess of the growth rate of GDP, but at least it is forecast to be only just in excess in 1979-80, whereas in 1977-78 and 1978-79 it was significantly so: 16.4% compared with 11.9% in 1977-78 which did not over-strain the economy; and 24.9% compared with 10% in 1978-79 which, with hindsight, I admit contributed to the economy becoming over-strained⁽²⁴⁾.

(8) *Growth Rate of Private Domestic Demand*

(a) *Introduction*

46 So much, Sir, for the public sector component of domestic demand: when moving the second readings of the Exchange Fund (Amendment) Bill, the Banking (Amendment) Bill and the Deposit-taking Companies (Amendment) Bill yesterday⁽²⁵⁾, I discussed the need to limit the contribution to the growth of loans and advances which is formed by the Government's

(22) *B.S., 1979, paragraph 142 and Annex 8(G).*

(23) *B.S., 1979, paragraph 265.*

(24) *The reason for the divergence between the growth rates of expenditure on General Revenue Account and on Consolidated Account lies in the rate of drawings on resources already lying, for example, in the Home Ownership Fund and so the relative importance of expenditure on General Revenue Account in the Consolidated Account will be only 86.5% compared with around 90% normally.*

(25) *See Annex (3).*

Hong Kong dollar balances; and I referred to the possibility of increasing the minimum liquidity ratios of banks and deposit-taking companies, if further action were needed to influence the growth rate of the private sector component of domestic demand⁽²⁶⁾. So all I need do today is to pick up other points concerning this component made by several Honourable Members in their speeches on this motion.

(b) Interest rates

47 Mr LI Fook-wo expressed concern at the cost to the manufacturing sector of bank finance at current interest rates. I understand his concern. But I must say, again, that I see the interest rate mechanism as an essential instrument to bring the growth rate of total final demand into line with the growth rate of the economy's output to check the tendency for the visible trade deficit to widen and so to reduce inflationary pressures (which pressures, if left unchecked, would do far more damage to our economy and so to our exports of manufactures). And I think the banks also see the interest rate mechanism as essential to this end.

48 Mr NEWBIGGING expressed confidence that banks will continue '(to give) some priority...to those who wish to borrow to finance industrial investment for exports'. I have no doubt, from my conversations with a number of bankers, that his confidence is well placed.

49 Mr LI suggested that the Exchange Fund 'might be given additional statutory powers to influence directly (the fixing of) interest rates'. Quite apart from the fact that this is far from the purpose for which the Exchange Fund was established, I do not believe that such powers are necessary. Furthermore, I believe it would not be in the public interest to create the Government debt that would be needed to enable the Exchange Fund to conduct the open market operations that his proposal implies. This debt could be created by, for example, the Exchange Fund acquiring all the foreign currency assets of the banking system, and accepting the exchange risk, but before anyone suggests that that would be a good idea, let me remind Honourable Members that a system of exchange control would be necessary—and perish that disastrous thought'.

50 Mr LI also asked what I proposed to do if the measures announced in the budget speech proved to be inadequate to influence the growth rate of loans and advances. I said yesterday, and I now repeat, that I do not envisage making immediate use of the proposed new powers, under the Banking Ordinance and the Deposit-taking Companies Ordinance to increase the minimum liquidity ratios so as to immobilise part of the present relatively high level of liquidity in the system. But, hopefully, the powers will shortly be available for use if the need arises. I accept that an increase in these ratios would not be totally effective in reducing the growth rate of loans and advances, but an increase would undoubtedly have

(26) *B.S., 1979, paragraph 125 and paras. 244-265.*

some impact; and I shall not hesitate to make use of my powers as and when it is necessary to do so. Mr LI mildly rebuked me for not '(elaborating) on the various measures which could be introduced by stages to control inflation'. I am not very sure what measures he is looking for beyond what I have proposed, but he may rest assured that, if the measures proposed in the budget speech *do* prove to be inadequate, others will be devised as I suggested yesterday. Let me stress, however, that I do not envisage any radical changes in our present institutional arrangements, despite the belief, held in some circles, that such changes would, in themselves, be beneficial.

51 Mr LI went on to assert that the growth rate of loans and advances was 'an acknowledged area requiring regulation'. I am afraid I cannot accept that assertion because, in the present circumstances of our economy, this is an area where influence rather than regulation is likely to be more effective. For this reason, I believe it would be wrong to adopt his proposal to allow unlimited loans to the manufacturing sector with a ceiling on loans for all other purposes. Whilst, at first sight, it might seem that, to channel loans to selected industries, would be in the general public interest, it would, I suspect, need the wisdom of a Solomon to achieve an efficient and effective reallocation of resources by this device.

(c) *Exchange Fund*

52 Mr Hilton CHEONG-LEEN suggested that the Government, through the Exchange Fund, 'could play a more sophisticated role in stimulating the timely reallocation of resources or credit jointly with the private banking sector'. I may not have fully grasped his point but if, as I suspect, it is that a proportion of the resources of the Exchange Fund should be directly invested in selected industries, then I must respond by saying that this would be outwith the purpose of the Fund, which is '(to regulate) the exchange value of the currency of Hong Kong'⁽²⁷⁾; and I, for one, would not wish to see the Fund's resources being used in the way he has suggested. And here I would interpose that neither our fiscal reserves, nor the assets held against our currency are left to 'stagnate' in the Exchange Fund, as Mr CHEN rather unflatteringly put it. I can assure him that the resources of the Exchange Fund⁽²⁸⁾ are invested in high quality interest bearing assets of selected currencies, and in consultation with the Exchange Fund Advisory Committee.

53 Mr CHEONG-LEEN's suggestion about the role which the Exchange Fund could play in the development of the economy is linked to one of his other suggestions about the need for an institution similar to the Hong Kong Building and Loan Agency Limited to provide loans to industry. But I question whether it would be proper, or generally acceptable to the public. for the Exchange Fund to hold, particularly as backing for our currency, private sector assets which could not be easily realized.

(27) *Section 3 of the Exchange Fund Ordinance.*

(28) *See B.S., 1979. f.n. (239).*

(d) *Premium Savings Bond Scheme*

54 Mr Hilton CHEONG-LEEN suggested that, in an attempt to obtain 'public support to curb inflation', the Government might encourage the propensity to save through a Premium Savings Bond Scheme. I am not convinced that such a scheme would assist in curbing inflating and, to the extent that it encouraged withdrawals from savings accounts with banks (which currently pay some 1¾% below the rate which Mr CHEONG-LEEN suggests should be paid under a Premium Savings Bond Scheme), it might well have an inflationary impact by forcing banks to widen the margins between their borrowing and lending rates; it could also, if it were widely supported, have a serious and undesirable impact on the liquidity of the banking system.

(e) *Deposit-taking companies*

55 Mr Hilton CHEONG-LEEN and Mr BREMRIDGE both stressed the need for deposit-taking companies to be subject to minimum liquidity requirements. Honourable Members, Sir, may rest assured that it is our intention later this year to implement section 24A of the Deposit-taking Companies Ordinance, which will enable me to set minimum liquidity ratios to be observed by every registered deposit-taking company. But may I repeat the point I made on 18 October last year when I moved the Second Reading of the Deposit-taking Companies (Amendment) Bill 1978? It would be quite wrong to impose minimum liquidity ratios on these companies before we have had the opportunity to examine and consider in detail the monthly returns which the Commissioner of Deposit-taking Companies started to collect with effect from end-December last. Furthermore, I expect to put forward, at the same time, complementary proposals to revise the liquidity provisions of the Banking Ordinance, so as to ensure the smooth and efficient working of the money markets.

56 In the meantime, Sir, let us look at the published figures for deposit-taking companies in a sensible perspective: total loans and advances in Hong Kong by deposit-taking companies at the end of February amounted to \$9,900 million; but, after taking into account \$7,200 million lent to these companies by banks in Hong Kong, the net increase in loans and advances to the non-bank private sector in Hong Kong was only \$2,700 million, or 4.7%⁽²⁹⁾. These figures are by no means as large as some commentators would lead us to believe.

(f) *Finance for industry*

57 Mr James WU, Mr Hilton CHEONG-LEEN and Mr LI Fook-wo made special pleas for Government sponsored financial assistance to industry and they were supported by Mr CHEUNG. Mr CHEONG-LEEN and Mr LI suggested that such assistance might be provided by a special institution set up for this

(29) Compare 7.1% at end-December 1978 and 6.2% at end-January 1979.

purpose, whilst Mr James WU thought that such assistance might best be channelled through the existing banking system.

58 The idea of an Industrial Development Bank has been mooted on various occasions since 1959 when Sir Robert BLACK appointed a committee to examine the need for such a bank. The committee advised that no such need existed. I must confess that I am not aware that the manufacturing sector of our economy is presently experiencing any difficulty in obtaining funds for commercially viable projects. Nor could I be easily persuaded that there is a case for subsidizing a particular industry by the provision of finance at preferential rates of interest, whether the subsidy is paid for by bank shareholders or, as is more likely, by the general public through the Government. However, sources of finance for industry are now being examined by the Advisory Committee on Diversification and, in particular, by a subsidiary working group on financial facilities. So I would prefer to withhold a definitive reply for a few months, just as I think Mr James WU might have refrained from describing the attitude of his colleagues on the Country Studies Sub-Committee as 'negative' until the Advisory Committee's report is available. Meanwhile, as he seems to be under a complete misapprehension about the comparative performance of our economy in the post-recession years, I would ask him to examine the statistics in footnote⁽³⁰⁾ to the published version of this speech.

(9) *Prospects for the Economy in 1979*

59 Sir, I think my Official Colleagues and I have now dealt, really quite comprehensively, with all the points raised by Unofficial Members in their speeches on this motion. But, before the motion is finally put, I think *all* Honourable Members of this Council would wish to be satisfied that the economy has not started to take a markedly different course from the one I described six weeks ago⁽³¹⁾ thereby, possibly, invalidating our budgetary strategy for the coming year.

60 From the statistics that have become available in the past two months, there is some evidence that the economy has started to take a slightly more reassuring course from the one I forecast, but the evidence is very slight. At the same time, there is no evidence of any really *adverse* changes in the rates at which any of the key variables and aggregates are moving, compared with the forecasts in the budget speech.

(30) *Growth rate of gross domestic product in real terms (%)*:

	<i>South Korea</i>	<i>Singapore</i>	<i>Taiwan</i>	<i>Hong Kong</i>
1976	14.6	6.8	6.2	16.7
1977	10.3	7.8	6.2	11.9
1978	12.5	7.5	8.7	10.0

(31) *B.S., 1979, paragraph 62 read in conjunction with paras. 106 and 123.*

61 As regards the external sector: the growth rate of total exports for the first quarter of 1979 compared with the first quarter of 1978 has probably overtaken the growth rate of imports; and the growth rate of *domestic* exports was roughly the same as that of *retained* imports⁽³²⁾. This is a reverse of the situation in 1978 when the growth rate of imports was significantly higher than that of total exports⁽³³⁾. From the point of view of the relative share of resources taken up by the export sector, this is an encouraging sign. Indeed, even towards the end of last year, the export sector seemed better able to attract additional labour despite rapidly increasing wage rates, inasmuch as the growth rate of manufacturing employment picked up⁽³⁴⁾. There are still indications, however, that manufacturers are having difficulty in meeting all their requirements for labour.

62 But, as regards the domestic sector, the growth rate of domestic demand does not yet seem to be slowing down: the growth rate of bank loans and

(32) *Estimated arrived at by a rough count of the values appearing on trade declarations (for March) processed so far show the following growth rates of the trade aggregates for the first quarter of 1979 compared with the first quarter of 1978:*

	<i>In money terms</i> (%)	<i>In real terms</i> (%)
<i>Imports</i>	32	19
<i>Domestic exports</i>	28	15
<i>Re-exports</i>	54	34
<i>Total exports</i>	35	20
<i>Retained imports</i>	27	14

The likely growth rates for the first quarter are higher than my forecasts for the whole of 1979. But this is because the levels of the trade aggregates were relatively low in the first quarter of 1978; they picked up strongly in the second half of 1978. So similar comparisons for the later quarters of 1979 are likely to show lower growth rates.

(33) *Growth rates, in real terms, of:*

	<i>Imports</i> (%)	<i>Domestic exports</i> (%)	<i>Re-exports</i> (%)	<i>Total exports</i> (%)
1978 Q1	13	3	10	5
Q2	17	10	30	15
Q3	27	12	20	14
Q4	29	15	22	17
1979 Q1 (*)	19	15	34	20

Note: (*) *Estimates arrived at by a rough count of the values appearing on trade declarations (for March) processed so far and by assuming a continuation of recent trends in the rates of increase in the prices of imports, domestic exports and re-exports.*

(34) *Manufacturing wage rates increased in money terms by about 16% during the year ending September 1978 (per capita GDP in 1978 was, in money terms, 13.8% higher than in 1977). Manufacturing employment in December 1978, at over 800,000, was 5.9% higher than in the corresponding month a year ago; in September 1978, it was 4.3% higher. The employed labour force, for which estimates are available half-yearly, in September 1978 was 7.1% higher than in September 1977.*

advances actually accelerated during the first two months of this year⁽³⁵⁾, although the growth rate of the money supply has shown clear signs of decelerating⁽³⁶⁾; and, for Mr LI Fook-wo's benefit, I would hazard a guess that the annualized growth rate of M2 is now beginning to approach the forecast growth rate of GDP in money terms. However, it is still too early to assess definitively the effects of the recent increases in interest rates⁽³⁷⁾.

63 But a growth rate of exports which exceeds the growth rate of imports does not mean that the visible trade deficit will not continue to widen in the short-term although, as a percentage of imports, the trade deficit in the first quarter of this year is a little below that of the first quarter of last year. And, incidentally, I do not think it is very logical of Mr LO to consider the visible trade deficit in relation to exports and it is certainly not logical of Mr NEWBIGGING to relate it to private consumption expenditure. Equally, there is nothing necessarily 'unacceptable', to use Mr NEWBIGGING's term, in a trade deficit of a particular absolute size. It is useful to consider the trade deficit as a percentage of imports for this is the best measure of the relative size of the deficit, that is to say, of the extent to which the cost of visible imports is not covered by earnings from visible exports⁽³⁸⁾. The implications

(35) *Bank loans and advances in Hong Kong:*

	\$ mn	% increase over previous month	% increase over a year ago
End December 1978	52,814	3.8	43.3
End January 1979	55,077	4.3	45.2
End February 1979	56,550	2.7	46.9

Note: Later evidence (weekly figures supplied informally by licensed banks) indicates possibly a slight slowing down.

(36) *Money supply:*

	\$ mn	% increase over previous month	% increase over a year ago
M1 (*)			
End December 1978	22,281	6.3	23.2
End January 1979	23,511	5.5	22.5
End February 1979	22,099	-6.0	22.4
M2 (**)			
End December 1978	73,406	2.7	25.6
End January 1979	76,097	3.7	26.2
End February 1979	75,982	-0.2	24.6
M3 (***)			
End December 1978	77,088	—	—
End January 1979	79,901	3.6	—
End February 1979	79,701	-0.3	—

Notes: (*) M1=notes and coins in the hands of the non-bank public plus current account deposits with banks.
 (**) M2=M1 plus savings and time deposits with banks.
 (***) M3=M2 plus deposit liabilities of deposit-taking companies to the public less claims by deposit-taking companies on banks and less deposit-taking companies' holdings of notes and coins.

(37) The Best Lending Rate was increased from 8¾% to 9½% on 2 January, to 10½% on 19 February, to 11% on 20 March and to 11½% on 10 April; and the rate paid by principal banks on three months fixed deposits was increased from 4½% to 6¼% over the same period.

(38) See B.S., 1979, f.n. (66).

of an increase in this ratio over time for the current account of the balance of payments depend upon the growth rate of net invisible earnings, the importance of which should increase as our economy diversifies.

64 As the rate at which the trade deficit is widening has not yet begun to slow down appreciably, it is hardly surprising that the exchange value of the Hong Kong dollar has declined recently. In the month of March, the trade-weighted exchange rate index of the Hong Kong dollar fell by 2.3% and up to yesterday, the 11 April it declined by a further 2.2%⁽³⁹⁾. But the *speed* of this decline is an aberration of the market place. What we are presently suffering from—as so many other currencies have suffered in the past—what we are presently suffering from is the self-fulfilling expectation by the market place of a decline in the rate, accentuated by some commercial leading and lagging. At some stage—and sooner rather than later—the market will recognize that the Hong Kong dollar has become *too* cheap, and market will turn round. In other words, I do *not* regard the *speed* of the decline in recent weeks as being in the least justified by the underlying state of our economy. Furthermore, given the way sterling and the US dollar, both of which are heavily weighted in the trade-weighted exchange rate index, have been appreciating rather unexpectedly (against most currencies), too much emphasis must not be placed on the decline in the index in any assessment of the impact of the decline in the exchange value of the Hong Kong dollar on our economy. What is more important for such an assessment is the relative movements of the import-weighted and export-weighted exchange rate indexes. Between end-February and 11 April, the import-weighted index depreciated more slowly at -3.8% than the export-weighted index at -5.3%. If these trends continue the rates at which the prices of imports increase will slow down and Hong Kong's export competitiveness will improve⁽³⁹⁾.

65 As regards prices, the rates of increase are continuing to accelerate. The cost of labour and materials used by the construction industry increased by 19% in the six months ending January 1979 compared with 5.7% during the six months ending July 1978. This is an area in which internally generated cost increases are significant and in which adjustments to the growth rate of demand by the public sector can exert a strong influence. The increase in consumer prices in the three months ending February 1979 compared with the three months ending February 1978 was 7.2% and this increase may be compared with the increase during the whole of 1978 over 1977 of 5.9%⁽⁴⁰⁾.

(39) *Trade-weighted exchange rate indexes (18 December 1971=100):*

	<i>Trade-weighted</i>	<i>Import-weighted</i>	<i>Export-weighted</i>
<i>At end of December 1978</i>	93.2	87.6	101.0
<i>January 1979</i>	95.6	89.9	103.0
<i>February 1979</i>	94.8	89.4	102.2
<i>March 1979</i>	92.6	87.7	99.3
<i>At 10 April 1979</i>	91.5	86.8	97.8

(40) *See also B.S., 1979, paragraph 60.*

66 As regards Mr CHEUNG's inconceivable claim that Hong Kong has 'been experiencing double digit inflation for the past 25 years', such a rate of inflation would be quite inconsistent with the impressive performance of our externally oriented economy, a performance which has clearly illustrated how competitive we have been. On his specific point about the high cost of land and rents, rents are reflected in our consumer price indexes and in the prices of goods and services produced in the economy and hence in the GDP deflator. They are also taken into account in our various other price indexes, including the unit value indexes of exports.

67 The object, Sir, of our budgetary strategy is to speed up and smooth out the adjustment process, the adjustment process whereby excess demand for, over the supply of, domestic resources is eliminated and internally generated inflationary pressures are removed. I must stress at this point that our strategy is no substitute for the adjustment process. It is simply designed to lessen the unacceptable consequences of relying entirely upon it. And I must agree with Mr Alex WU when he said that: 'Economic management which involves fine tuning and manipulating aggregates has to be delicate and (has) to avoid over-kill and under-kill. The danger lies, particularly, in over-kill; it is easier to do and difficult to remedy'. So in seeking to exercise 'constraint with restraint', to quote from one newspaper editorial, I have taken care *not* to do too much. However, I can assure Honourable Members that the Government stands ready to take further measures if these prove necessary.

68 What is at stake is not, as Mr T. S. LO puts it, our 'very existence', but the speed at which our economy adjusts. Under a floating exchange rate regime, competitiveness lost through inflation is regained through a depreciation of the exchange rate, albeit at a cost in terms of real incomes. In this context, we need to preserve the flexibility of our cost/price structure so that any loss of competitiveness is relatively shortlived. And here I *would* agree with Mr T. S. LO that 'it is vitally important for the Government to assess the economic implications (as opposed to the purely financial implications) of each of its policies'. Unfortunately, last year we had a high growth rate of domestic demand which was artificially sustained as a result, on the one hand, of the Government misjudging the amount of room available for the implementation of its policies and programmes (as I admitted in the budget speech⁽⁴¹⁾) and, on the other hand, of private domestic demand being stimulated by the availability of relatively cheap credit, partly as a result of the way in which we handled the Exchange Fund's balances. Thus the Government, inadvertently, contributed to making the lag in the adjustment process longer than would otherwise have been the case. We have no intention of repeating these errors; and thus, for example, my emphasis on the importance of our adhering to our cash limits.

(41) B.S., 1979, paragraph 58.

69 One obvious development since budget day is the even higher than expected increases in oil prices which, as Miss DUNN rightly pointed out, were not, and could not have been, sufficiently allowed for when the econometricians were making their forecasts⁽⁴²⁾. These increases will, of course, lead to a sharper acceleration in the rates of increase in the prices of oil products in Hong Kong, of goods with a high oil content and of services relying heavily on oil. However, the proportion of household expenditure accounted for by 'fuel and light' in our consumer price indexes is only about 3%. So, although there are services that rely fairly heavily on oil, notably public transport (where oil costs presently represent between 6% and 17% of total operating costs), so although there are other services that rely heavily on oil, the overall impact of increases in oil prices of the order of magnitude of those announced recently⁽⁴³⁾ is unlikely to be all that serious. The direct impact on, for example, manufacturing costs will also not be particularly significant, because the cost of fuel and electricity as a proportion of total gross output is only around 1% (although of course some of our manufacturers will be affected more seriously than this average percentage implies); but we should not forget that our competitors will be similarly affected.

70 It is the indirect effects which are more worrying. *First*, sharper increases in oil prices and shortages of supply will inevitably have an unfavourable effect on the growth rates of the economies of some of our major markets, in the sense that they make the adoption of reflationary policies more unlikely. Hence, the growth rate of demand for Hong Kong's exports may be slower than would otherwise be the case and competition for business will be keener. Given the present state of order books, these indirect effects will take time to work through and probably will have little effect on Hong Kong before the end of 1979; but perhaps a shadow has been cast over our prospects in 1980. *Secondly*, as Mr James WU rightly pointed out, the prices of such oil related raw materials as plastics will be affected and the resultant pressure on the domestic cost/price structure may further affect the demand for our exports.

71 But the likelihood is that, in the short-term at least, the effect of increases in oil prices on the visible trade deficit will be offset by the reduced consumption the Secretary for Economic Services has said is likely to be necessary as a result of shortages in supply.

(42) *But the likely effect on the import prices of oil products of the announcement on 17 December 1978 by OPEC relating to crude oil prices in 1979 had been allowed for.*

(43) *OPEC decided on 27 March 1979 to increase the price of crude oil by 8.8% starting 1 April 1979 instead of 3.8% as they had previously decided in December last. It was also decided that individual members of OPEC could charge a premium over the official price. But to the extent that this premium may be higher (or lower) than the premium prevailing during the first quarter, as a result of the shortage arising from events in Iran, the increase in crude oil prices may be higher (or lower) than 8.8%. The actual increases in the prices of oil products are likely to differ from that of crude oil.*

(10) *Conclusion*

72 To sum up, Sir, I have, in effect, now re-examined my budgetary strategy in the light of Honourable Members' probing questions and the latest information on the course of the economy. My conclusion is that the strategy is still what our situation requires if the adjustment process is to be assisted and the more unpleasant consequences of the adjustment process being delayed are to be avoided. It is too early to expect to see solid evidence in support of this conclusion. Inevitably, some time must elapse before the benefits of what we are doing become evident. Meanwhile as one editorial put it yesterday, we must beware of being forced into drastic correctives; in other words, we must not lose our nerve and try further to speed up the process in order to provide the evidence earlier for, as Mr WONG Lam said 'hasty adjustments (by the Government) ... might produce more obvious results, but ... might lead to very undesirable consequences'. Rather, I would suggest that, whilst we should not discount our present difficulties, we should also count our blessings, for our situation is at least one of inflation with, indeed partly due to, over-full employment, rather than inflation with a sluggish growth rate and rising unemployment, which is the more common experience elsewhere. This does not mean that our situation is less complex than situation elsewhere. But let us remember that there are few, if any, situations that cannot be solved by careful analysis and adherence—not necessarily complacent adherence—adherence to well tried principles, coupled with cooperative effort between the Government and the community which, I venture to say, has seen us through greater difficulties in the past.

(11) *Valedictory*

73 Sir, before sitting down and with your permission, may I record my appreciation of the work of an officer in the Finance Branch, Mr TANG Hing-ip, MBE, who is presently in charge of the Common Estimates Section and who will be shortly retiring? On joining the Hong Kong Civil Service in 1947 he was posted to the Finance Branch and has spent all of his 32 years of service there. He has thus served under each of the four Financial Secretaries who have held office since the war. For 23 of these years, since 1957-58, he has been directly involved in the preparation of the Annual Estimates. It is really a rather nice coincidence that, in these 23 years, total Government expenditure has also increased by about 23 times! Mr TANG is known to many Honourable Members past and present and I am sure they would wish to join me in wishing him a happy and very well earned retirement.

74 Sir, I beg to move.

ANNEXES

	<i>Pages</i>
(1) Summary of the Operating Accounts for Government Owned Public Utility Undertakings for 1977-78	773
(2) Growth Rate and Relative Size of the Public Sector (variously defined)	775
(3) Speeches by the Financial Secretary in Legislative Council on 11 April 1979	776
(1) Exchange Fund (Amendment) Bill 1979	776
(2) Banking (Amendment) Bill 1979	776
(3) Deposit-taking Companies (Amendment) Bill 1979	776

Annex (1)

SUMMARY OF THE OPERATING ACCOUNTS FOR GOVERNMENT OWNED PUBLIC UTILITY UNDERTAKINGS FOR 1977-78

The following is a descriptive summary of the accounts for the year 1977-78 for the six government owned and operated public utility undertakings—

(a) Lion Rock Tunnel

The second Lion Rock Tunnel was opened in January 1978. The first tunnel was then refurbished. This work was completed in October 1978. Since then both tunnels have been in operation. For 1977-78, the Lion Rock Tunnels made a small surplus of \$0.1 million, but it is estimated that a deficit of \$4.3 million will be incurred for the year 1978-79, with further deficits being incurred in future years unless toll charges are increased.

(b) Government Car Parks

The utilization of government car parks grew steadily during the year. The surplus accruing from all car parks amounted to \$2.1 million in 1977-78, despite a loss of \$1.9 million incurred in the operation of open-air car parks. The Hung Hom multi-storey car park was reopened in November 1978. A surplus of \$6.8 million is estimated for 1978-79 and, on average, there is likely to be a surplus of \$9 million in each of the next four years.

(c) Kowloon-Canton Railway

The railway enjoyed a large increase in passenger and freight traffic during 1977-78. However, the considerable increase in operating costs kept the surplus down to \$1.4 million for the year. The railway is now undergoing a complete redevelopment which will eventually result in the whole length being double tracked and electrified. Because of this expansion, projections show that even with large increases in traffic, there is likely to be a continuing deficit unless the present passenger fare and freight charges are restructured.

(d) Hong Kong International Airport

The accounts for 1977-78 showed a surplus of \$102 million largely attributable to the increase in wide-bodied aircraft arrivals with a corresponding 10% growth in the number of passengers. This represents a return of 8.6% (after interest) or 13.4% (before interest) on average net fixed assets employed.

(e) General Post Office

1977-78 was a successful year for most postal services except for the China Letter Post and surface parcels. The surplus for the year amounted

to \$87.6 million and is expected to remain roughly the same in 1978-79. The increase in income of \$8 million from the recent revision of postal rates for printed matter will be offset by the substantial increase in operating costs. It is estimated that the surplus will gradually decline to a deficit situation by 1982-83 if there is no further revision of postal rates.

(f) *Water Authority*

The serious drought experienced during 1977-78 brought about water restrictions from June 1977. These had the effect of reducing income and increasing operating costs because of the need to operate the desalter at full capacity. These developments, together with the commissioning of the High Island Water Scheme, resulted in a deficit of \$232.8 million in 1977-78. It is estimated that a deficit of \$106.9 million will be incurred in 1978-79. With effect from April 1979, a new price structure was introduced which should enable the accounts to break even over the years 1979-80 to 1982-83. The need for this revision of charges was prompted by the fact that, without such a revision, an estimated deficit of \$389 million would have been incurred over these four years.

2 The following table summarizes financial performance of each undertaking in 1977-78:

	<i>Lion Rock Tunnel</i>	<i>Kowloon Car Parks</i>	<i>Hong Canton Railway</i>	<i>Hong Kong Airport</i>	<i>General Post Office</i>	<i>Water Authority</i>
	(\$ mn)	(\$ mn)	(\$ mn)	(\$ mn)	(\$ mn)	(\$ mn)
Income	8.6	20.2	44.5	277.2	300.8	430.8
Expenditure	<u>8.5</u>	<u>18.2</u>	<u>43.1</u>	<u>174.5</u>	<u>213.2</u>	<u>663.7</u>
Surplus (deficit) after interest	0.1	2.0	1.4	102.7	87.6	(232.9)
Interest paid (received)	<u>2.9</u>	<u>7.2</u>	<u>(0.5)</u>	<u>57.0</u>	<u>(6.8)</u>	<u>224.3</u>
Surplus (deficit) before interest	3.0	9.2	0.9	159.7	80.8	(8.6)
Average net fixed assets employed	34.4	121.9	241.0	1,188.2	100.3	3,637.8
	(%)	(%)	(%)	(%)	(%)	(%)
Surplus (deficit) after interest on average net fixed assets employed	0.3	1.6	0.6	8.6	87.4	(6.4)
Surplus (deficit) before interest on average net fixed assets employed	8.6	7.5	0.4	13.4	80.5	(0.2)

Annex (2)

GROWTH RATE AND RELATIVE SIZE OF THE PUBLIC SECTOR (VARIOUSLY DEFINED)

	<i>General</i>	<i>Growth</i>			<i>Growth</i>			<i>Consolidated</i>	<i>Growth</i>			<i>Growth</i>
	<i>Revenue</i>	<i>rate in real</i>	<i>As % of Consolidate</i>		<i>rate in real</i>	<i>As % of</i>		<i>Account plus</i>	<i>rate in real</i>	<i>As % of</i>		<i>rate in real</i>
	<i>Account</i>	<i>terms</i>	<i>GDP</i>	<i>d Account</i>	<i>terms</i>	<i>GDP</i>	<i>MTR (*)</i>	<i>terms</i>	<i>terms</i>	<i>GDP</i>	<i>GDP</i>	<i>terms</i>
	<i>(\$ mn)</i>	<i>(%)</i>		<i>(\$ mn)</i>	<i>(%)</i>		<i>(\$ mn)</i>	<i>(%)</i>		<i>(\$ mn)</i>		<i>(%)</i>
1972/1972-73	3,550.0	13.2	14.7	3,877.4	13.6	16.1	3,877.4	13.6	16.1	24,156		7.2
1973/1973-74	4,643.9	18.2	15.1	5,049.0	17.7	16.4	5,049.0	17.7	16.4	30,736		14.2
1974/1974-75	5,973.3	10.0	16.9	6,612.8	12.0	18.8	6,612.8	12.0	18.8	35,252		2.2
1975/1975-76	6,032.2	1.4	16.2	6,573.9	-0.2	17.6	7,073.9	7.2	19.0	37,268		2.9
							(500)					
1976/1976-77	6,590.9	3.5	14.0	7,362.1	6.0	15.6	8,362.1	12.0	17.7	47,226		16.7
							(1,000)					
1977/1977-78	8,173.9	15.8	14.9	9,181.4	16.4	16.7	11,181.4	24.1	20.4	54,836		11.9
							(2,000)					
1978/1978-79	11,162.0	25.1	17.5	12,513.8	24.9	19.6	15,413.8	25.3	24.2	63,686(**)		10.0
							(2,900)					
1979/1979-80	12,454.0	4.7	16.9	14,399.0	7.5	19.6	17,699.0	6.0	24.0	73,600(***)		7.2
							(3,300)					

Note: (*) Bracketed figures refer to rough estimates of MTR expenditure by financial year.

(**) Provisional estimate.

(***) Preliminary estimate.

Annex (3)

SPEECHES BY THE FINANCIAL SECRETARY IN LEGISLATIVE COUNCIL ON 11
APRIL 1979

(1) *Exchange Fund (Amendment) Bill 1979*
(Please see Hansard Report 1978-79 pages 705-708)

(2) *Banking (Amendment) Bill 1979*
(Please see Hansard Report 1978-79 pages 708-710)

(3) *Deposit-taking Companies (Amendment) Bill 1979*
(Please see Hansard Report 1978-79 pages 710-711)

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).

THE PRESIDENT:—In accordance with Standing Orders I now adjourn the Council until 2.30pm on 25 April 1979.

Adjourned accordingly at twenty-five minutes past four o'clock.