

OFFICIAL REPORT OF PROCEEDINGS**Thursday, 9 April 1981****The Council met at half past two o'clock****PRESENT**

HIS EXCELLENCY THE GOVERNOR (*PRESIDENT*)
SIR CRAWFORD MURRAY MACLEHOSE, G.B.E., K.C.M.G., K.C.V.O.

THE HONOURABLE THE CHIEF SECRETARY
SIR JACK CATER, K.B.E., J.P.

THE HONOURABLE THE FINANCIAL SECRETARY
SIR CHARLES PHILIP HADDON-CAVE, K.B.E., C.M.G., J.P.

THE HONOURABLE THE ATTORNEY GENERAL
MR. JOHN CALVERT GRIFFITHS, Q.C.

THE HONOURABLE THE SECRETARY FOR HOME AFFAIRS
MR. DENIS CAMPBELL BRAY, C.M.G., C.V.O., J.P.

THE HONOURABLE DAVID AKERS-JONES, C.M.G., J.P.
SECRETARY FOR THE NEW TERRITORIES

THE HONOURABLE LEWIS MERVYN DAVIES, C.M.G., O.B.E., J.P.
SECRETARY FOR SECURITY

THE HONOURABLE DAVID WYLIE McDONALD, C.M.G., J.P.
DIRECTOR OF PUBLIC WORKS

THE HONOURABLE DAVID GREGORY JEAFFRESON, C.B.E., J.P.
SECRETARY FOR ECONOMIC SERVICES

THE HONOURABLE ALAN JAMES SCOTT, J.P.
SECRETARY FOR INFORMATION

THE HONOURABLE DEREK JOHN CLAREMONT JONES, C.M.G., J.P.
SECRETARY FOR THE ENVIRONMENT

DR. THE HONOURABLE THONG KAH-LEONG, C.B.E., J.P.
DIRECTOR OF MEDICAL AND HEALTH SERVICES

THE HONOURABLE ERIC PETER HO, J.P.
SECRETARY FOR SOCIAL SERVICES

THE HONOURABLE JOHN MARTIN ROWLANDS, C.B.E., J.P.
SECRETARY FOR THE CIVIL SERVICE

THE HONOURABLE JAMES NEIL HENDERSON, J.P.
COMMISSIONER FOR LABOUR

THE HONOURABLE GERALD PAUL NAZARETH, O.B.E., Q.C.
LAW DRAFTSMAN

THE HONOURABLE WILLIAM DORWARD, O.B.E., J.P.
DIRECTOR OF TRADE, INDUSTRY AND CUSTOMS

THE HONOURABLE JOHN MORRISON RIDDELL-SWAN, J.P.
DIRECTOR OF AGRICULTURE AND FISHERIES

THE HONOURABLE DONALD LIAO POON-HUAI, O.B.E., J.P.
SECRETARY FOR HOUSING

THE HONOURABLE GRAHAM BARNES, J.P.
DIRECTOR OF HOME AFFAIRS

THE HONOURABLE SELWYN EUGENE ALLEYNE, J.P.
DIRECTOR OF SOCIAL WELFARE

THE HONOURABLE COLVYN HUGH HAYE, J.P.
DIRECTOR OF EDUCATION

THE HONOURABLE OSWALD VICTOR CHEUNG, C.B.E., Q.C., J.P.

THE HONOURABLE ROGERIO HYNDMAN LOBO, C.B.E., J.P.

THE HONOURABLE LI FOOK-WO, C.B.E., J.P.

THE HONOURABLE LO TAK-SHING, O.B.E., J.P.

THE HONOURABLE FRANCIS YUAN-HAO TIEN, O.B.E., J.P.

THE HONOURABLE ALEX WU SHU-CHIH, O.B.E., J.P.

THE REVD. THE HONOURABLE JOYCE MARY BENNETT, O.B.E., J.P.

THE HONOURABLE CHEN SHOU-LUM, O.B.E., J.P.

DR. THE HONOURABLE HENRY HU HUNG-LICK, O.B.E., J.P.

THE REVD. THE HONOURABLE PATRICK TERENCE MCGOVERN, O.B.E., S.J., J.P.

THE HONOURABLE PETER C. WONG, O.B.E., J.P.

THE HONOURABLE WONG LAM, O.B.E., J.P.

DR. THE HONOURABLE RAYSON LISUNG HUANG, C.B.E., J.P.

THE HONOURABLE CHARLES YEUNG SIU-CHO, O.B.E., J.P.

DR. THE HONOURABLE HO KAM-FAI, J.P.

THE HONOURABLE DAVID KENNEDY NEWBIGGING, J.P.

THE HONOURABLE ANDREW SO KWOK-WING, J.P.

THE HONOURABLE WONG PO-YAN, O.B.E., J.P.

THE HONOURABLE WILLIAM CHARLES LANGDON BROWN, J.P.

THE HONOURABLE CHAN KAM-CHUEN, J.P.

THE HONOURABLE JOHN JOSEPH SWAINE, O.B.E., Q.C., J.P.

THE HONOURABLE STEPHEN CHEONG KAM-CHUEN

ABSENT

THE HONOURABLE KENNETH WALLIS JOSEPH TOPLEY, C.M.G., J.P.
CHAIRMAN, COMMITTEE TO REVIEW POST-SECONDARY AND TECHNICAL EDUCATION

DR. THE HONOURABLE HARRY FANG SIN-YANG, C.B.E., J.P.

THE HONOURABLE LYDIA DUNN, O.B.E., J.P.

THE HONOURABLE ALLEN LEE PENG-FEI, J.P.

THE HONOURABLE HU FA-KUANG, J.P.

IN ATTENDANCE

THE CLERK TO THE LEGISLATIVE COUNCIL

MRS. LORNA LEUNG TSUI LAI-MAN

Second reading of bill

APPROPRIATION BILL 1981

Resumption of debate on second reading (8 April 1981)

Question Proposed.

DIRECTOR OF TRADE, INDUSTRY AND CUSTOMS:—Sir, it was apparent from several contributions to this debate by my Unofficial colleagues that the future of the so-called Multi-Fibre Arrangement, or M.F.A., is a major preoccupation.

That this should be so is really not surprising. The relative importance of the textiles and garment industry to our economy is almost certainly unparalleled elsewhere. Last year it employed fifty per cent of our industrial work force and provided forty per cent of our earnings from domestic exports. And roughly two thirds of these exports were subject to quantitative limits through bilateral agreements negotiated under the terms of the M.F.A.

This is by no means a new situation. For over twenty years now there have been similar bilateral restraints negotiated under the M.F.A. or one of the predecessor arrangements. It has been said, and rightly, that the textile and clothing industries of the developed world have enjoyed a degree of protection from developing country competition greater and more protracted than any other manufacturing sector since the Industrial Revolution.

The current—second—four-year term of the M.F.A. expires with 1981. Between now and the end of this year, the participants will be considering and negotiating its future. And it will be against the outcome of this effort that Hong Kong will be required to negotiate, in 1982, the future of its current five-year agreements with the United States and the European Economic Community.

This is the situation which Miss DUNN, with the aid of her Oxford Dictionary, described as ‘a period of danger or suspense’. The reasons are sadly obvious. Although the whole twenty-year series of multilateral textile arrangements were designed explicitly to moderate *temporarily* the growth of certain exports likely to cause ‘market disruption’, their existence is now so much taken for granted by the industries which have enjoyed their protection that they no longer attempt to justify them, merely to call for their intensification.

Mr. TIEN and Mr. CHEONG both made reference to the fallacies, special pleading and lack of objective justification which tend to characterize the demands for greater protectionism. Miss DUNN spoke of the frustration felt by Hong Kong manufacturers and exporters at the lack of respect for the M.F.A. rules of behaviour; their indignation when at least one major trading partner comes back year after year to look for more concessions despite the existence of a freely negotiated agreement; and their apprehension for the future.

Sir, having recently returned from a visit to Europe and the United States, of which this subject was the main focus, I regret to say that this apprehension is justified. It is regrettably a fact that the M.F.A. falls to be renegotiated at a time when there is widespread economic recession and falling employment.

It is easy to demonstrate - indeed it is widely conceded - that the ills which undoubtedly are afflicting some of the textile industries of the west, notably those in Europe, are not attributable to imports from the third world. In the United Kingdom, for example, where 100,000 jobs were lost in the textiles industry last year, the Minister for Trade, Mr. Cecil PARKINSON, recently told the British Textile Employers' Association that 'the problem of cheap textile imports is being overstated'. He pointed out, furthermore, that three quarters of Britain's textile imports came from the developed world in 1980 and exports to the so-called low cost countries had actually grown faster than imports. A three-hour debate on the textile, clothing and footwear industries in the House of Commons on 26 February last was notable for the fact that as far as problem imports were concerned the focus was almost entirely on the United States. Much play was made of the *unfair* competition arising from non-M.F.A. situations, such as those to which Mr. TIEN made reference. Hong Kong surprisingly was mentioned only twice, once when it was recognized that the U.K. industry could only reasonably hope to compete with us at the high quality end of the garment market; and the other occasion surprisingly when it was alleged the United States was underselling us.

Elsewhere in the E.E.C. there is no reason to suppose the situation is markedly different. Unemployment is high, economic activity is low, the problems are similar. On the face of it, however, that situation should pose no particular threat to Hong Kong in the context of a new M.F.A. The sources of the problems are either internal or lie elsewhere. Imports from Hong Kong represent only about 3 per cent of E.E.C. consumption of textiles and garments. In the so-called sensitive categories they actually declined slightly last year. The arguments, as the Financial Secretary said in his budget speech, are certainly on our side.

The risk, however, remains, for the real problems are either so intractable or politically potent that there must be a temptation for governments to try to quiet the protectionist demands by directing efforts at surrogate targets. It even seems possible that the discredited policies adopted by the E.E.C. in 1977 will be advocated again. These, it is scarcely necessary to remind anyone here, were predicated on two very dubious propositions. *First*, that there should be a finite limit to imports from developing countries, but no limit on others; and, *secondly*, that the M.F.A. system, originally intended to moderate import growth, should be distorted into an instrument of aid policy whereby established trade opportunities would be arbitrarily taken from some restrained suppliers and given to others considered more needy.

The actual consequence was, of course, that the trade potential taken away from Hong Kong and other major suppliers went in fact to the rich, notably the United States, not the poor. It will be not only depressing but destructive if that

experience is ignored. The developing country exporters have not forgotten it and are facing the coming negotiations with a cohesiveness they have not previously shown. As I speak, a workshop seminar is in progress in Djakarta, following up on the first co-ordination meeting of M.F.A. developing countries which I had the privilege of attending in Bogota, Colombia last November. I assure Miss DUNN, Mr. TIEN and Mr. CHEONG that Hong Kong will continue to play an active part in this series of meetings—and we expect there to be more as the year goes on —as well as in the less obvious but very substantive informal contacts which take place from day to day, mainly in Geneva. Our aim in this effort will be to devise in concert with the other developing countries a cohesive strategy. We recognize the futility of inviting confrontation by challenging the justification for having an M.F.A. at all, although a logical case could be made. Instead we shall seek to encourage a responsible and realistic approach to the M.F.A. negotiations which we would expect to be reciprocated by the developed importing countries.

It may have been noted that, in reviewing the situation, I have so far mentioned the United States directly only in the context of the major threat they are seen by the European industry to be posing to them. This is probably the most dramatic new element as we consider the future of the M.F.A.

In Washington D.C., just over two weeks ago I saw a report in the highly regarded Washington Post headlined 'Profits, Progress Loom Large for Textile Makers'. It documented the dramatic results of a capital spending of U.S.\$11 billion by U.S. mills over the last decade and predicted another U.S.\$23 billion in the eighties. Although 1980 profits were only 7.2 per cent up over 1978, it was, and I quote: 'the first time in memory that the mills had survived a recession unscathed—a remarkable performance, in the face of auto and housing slumps'. The article closes with a senior industry executive saying flatly and confidently: 'There is no question now that we can compete'.

That is, of course, the mill sector. The U.S. apparel industry is more fragmented and less capital intensive. It does, however, enjoy over 85 per cent of *consumption* in the biggest single market in the world. About 85 per cent of U.S. *imports* are controlled under bilateral agreements. Imports into the U.S. from 1971 to 1979 increased at an average rate of only 2.7 per cent a year. And Hong Kong, as the major supplier, had only 1.3 per cent of U.S. *consumption* in 1979.

I mention these facts and figures to make this basic point. I think we will be amply justified this year in looking to the United States, in its own enlightened self interest, to exercise its considerable authority and influence to ensure that negotiations on the future of the M.F.A. are realistically and fairly conducted; that the provisions sought by the developed importing countries are commensurate with what economic circumstances clearly justify; and, most particularly, that developing country exporters are not somehow held accountable for difficulties and problems for which they are not responsible.

In placing emphasis on the E.E.C. and the United States in this appraisal, I am not intending to underestimate the importance of other developed countries as

participants in the M.F.A. and as trading partners of Hong Kong. I am, however, bound by the time available to focus on the major elements in the total situation.

Mr. TIEN asked for an assurance that my Department would have adequate resources to conduct the extensive and, for Hong Kong, fundamentally important bilateral and multilateral negotiations which we face over the next year or more. Sir, I consider that we are fortunate to have available for deployment a group of experienced and capable negotiators, both locally in the Department and in our overseas offices, and it is my intention to form from it a task force whose primary function from, say, September this year will be the conduct of these negotiations. This can only be done at the cost of some loss of effectiveness elsewhere in the Department, but the circumstances do not allow of any other solution. And I know I can count on my colleagues outside the task force to make an extra effort to maintain a service to the public and keep up momentum on such important issues as consumer protection, trade controls and industrial development.

The subject of industrial development was one touched on by Mr. Stephen CHEONG when he made a plea for Government intervention to assist the dyeing and finishing industry to relocate and provide an adequate service to our mill and garment sectors. When this concept was first mooted some three years ago, I caused a survey of opinion to be made among the finishers and dyers. Their response was, however, generally unenthusiastic and the idea was not pursued. When the proposal was revived recently, the Federation of Hong Kong Industries decided to conduct a full study of the situation and to try to provide Government with a detailed assessment of the needs of the industry and proposals showing the land and infrastructure requirements, taking full account of the environmental aspects of the problem. The results of that study, Sir, will be given careful consideration when they are received.

Finally, Sir, I turn to Mr. NEWBIGGING's suggestion of a concerted effort on the part of Government, and I quote, 'to create the right impact and to develop relationships at the top level in the United States, to nurture an understanding of why Hong Kong is one of the most important cities in Asia, and thus to build up the confidence upon which the realization of our destiny is so dependent'; end of quote.

Mr. NEWBIGGING suggests this should supplement the 'piecemeal' impact of efforts by the private sector, by the Hong Kong Trade Development Council and the Hong Kong Tourist Association and should be along the lines of similar efforts made in the United Kingdom.

This proposal is refreshingly free of the vague exhortations to 'influence public opinion' and 'develop a Hong Kong image' which are unrealistically made from time to time. It rightly places emphasis on the need for a targetted effort directed at those in positions of influence and authority. The trouble with the United States, however, is that the targets are numerous, scattered and in the sights of

many others at any given time. And the different centres of governments, commerce and finance, industry and so on are spread all over that vast continent. I recall, to illustrate that, a British businessman cabling his agent in San Francisco to ask if he would meet his daughter arriving by ship in New York. The American by cable replied 'Meet her yourself, you're nearer' (*laughter*).

My main point is that the scale and nature of the efforts we have made in recent years in the U.K. would almost certainly not be adequate or appropriate for the U.S. That is not to say that we are not already doing a good deal there at the official level. The Hong Kong office in the British Embassy in Washington D.C. now has three diplomatic level staff. And I hope within this year to establish an American office for the purpose of industrial promotion. The opportunities are always taken when you, Sir, and other senior members of this Government visit the United States to pay calls at appropriately high levels. And of course we receive many high ranking visitors from that country in Hong Kong.

I am bound to say that my own experience in recent visits to Washington D.C. at least has not given me the impression that the significance of Hong Kong was overlooked; in some cases, unfortunately, quite the contrary. And I have detected a growing awareness of the potential of Hong Kong as a market and as an entrepot, an awareness that all sectors in Hong Kong would do well to stimulate as the U.S. shows greater and greater interest in export development. Harking back to the problems of protectionism on which I have already spoken, I do believe that one of the most effective counters to them is to stimulate the interest of the countries concerned to sell to us. The new found competitiveness of the U.S. textile industry, for example, should mean that it can obtain for itself a larger share of our import market for yarns and fabrics which, at over HK\$14 billion last year, is one of the largest in the world.

Having said that, I do note Mr. NEWBIGGING's suggestion and we shall reexamine the nature and level of our official efforts in the United States to see what more could and should be done.

With these remarks, Sir, I support the motion.

SECRETARY FOR ECONOMIC SERVICES:—Sir, I would like to answer briefly two points raised by my honourable Friend Mr. Allen LEE and one made by my honourable Friend Mr. S. L. CHEN.

Industrial Estates

The first is my honourable Friend Mr. LEE's belief that progress in developing our industrial estates has been too slow.

As a member of the Board of the Industrial Estates Corporation I must first declare an interest, and second disagree with my honourable Friend at least in part.

My honourable Friend quotes the 117 hectares being formed by the Corporation at Tai Po and Yuen Long, and contrasts it with only 29 sites for which leases have actually been signed.

There are two good reasons for the contrast. *First*, the Corporation must keep the development of the estates well ahead of the granting of lots to successful applicants. It is clearly important that, if they are not to be discouraged, possible users of the estates should see well laid out and serviced sites ready to be granted. One of the reasons why the granting of sites has so far not gone as fast as my honourable Friend would have liked, is that in the early days all the management could show to those interested, was land in the process of being formed.

Second, the Corporation has firmly borne in mind the object for which it was formed, 'to broaden Hong Kong's industrial base by catering for those industries which cannot operate in multi-storey buildings'. The Corporation has drawn up a series of criteria by which it judges the extent to which applications meet this object. Rightly, it has applied these criteria with some austerity. In particular it has heeded seriously the warning of honourable Members in the debate on the second reading of the Hong Kong Industrial Estates Bill in this Council to the effect that, because of the substantial land subsidy involved, no applicants should be granted sites on the Estates if they would thereby be given an unfair competitive advantage over similar industries already established in Hong Kong outside the estates.

So I would say that the contrast between the amount of land being made available on the estates and the number of sites being developed, derives from virtue rather than from a failing on the part of the Corporation. In any case, the situation is not quite as bad as my honourable Friend painted. So far, the Corporation has received 171 applications and has approved 55. Also, I can confirm my honourable Friend's belief that the quality of the applications has improved, now to the point where over half are successful.

To speed up the development of the estates, my honourable Friend suggested the Government should examine three critical areas.

The *first* was 'promotion'. Here, I agree, we might have done better. And now that, on the recommendation of the Advisory Committee on Diversification, we have reorganized industrial promotion and placed it firmly under the Director of Trade, Industry and Customs, I can assure my honourable Friend that deficiencies in this respect are being remedied. The Industrial Promotion Committee, the Advisory Committee on Diversification recommended, is now operating and the Chief Executive of the Industrial Estates Corporation is a member of it.

The *second* was 'criteria'. I have already explained the Corporation's attitude. What I haven't said is that the Board of the Corporation, which with the exception of the Chief Executive, consists entirely of Members of this Council, constantly reviews the criteria. I can assure my honourable Friend that these reviews are *not* just lip-service. The members of the Board are at their most critical, and dare I say it, their most cantankerous, when this subject comes up.

The *third* was 'conditions of lease'. These have to be fairly tough to ensure that successful applicants use the sites for the purposes which caused the Corporation to grant them. Inevitably, some I think rather naive souls don't like the conditions. They are granted their sites for manufacturing, say, super-sophisticated electronic widgeits (which every child knows require very heavy floor loadings and enormously high ceilings, are totally unsuited to production in multi-storey buildings and are *not* being made at all in Hong Kong). Then on being granted sites they allege that circumstances have suddenly changed and market forces now dictate that they should make socks. When the Corporation objects, they object rather noisily. But they are very much a minority. By far the majority of successful applicants understand why we have to have fairly tight lease conditions and accept them without complaint.

Some of the words my honourable Friend used could be interpreted as a criticism of the management of the Corporation. I don't think he meant them to be taken in that sense. Nevertheless I would like to assure honourable Members how much the members of the Board have appreciated the hard, and we think successful, work of the Corporation's staff.

Design and Packaging Councils

The second subject my honourable Friend raised was the Hong Kong Industrial Design and Packaging Councils. The Government fully recognizes the importance and value of the work of these two Councils to Hong Kong's trade and industry. We also appreciate that the level of subvention to the two Councils had remained the same for a number of years, largely to encourage the Councils themselves to generate the maximum income from other sources. The Councils have, indeed, responded well to this challenge. But we accept that the nature of their work is such that they cannot rely wholly on income from the sale of their services. The subvention will have to continue and we are now reviewing with the Federation of Hong Kong Industries what the level should be. Depending on the outcome of this review, we may well seek to increase the subvention for 1981-82.

Technical Education

Finally, I would like to amplify slightly the reference by the Secretary for Social Services yesterday to what my honourable Friend Mr. S. L. CHEN said about technical education and industrial training. My purposes in so doing is to place on record the importance the Government attaches to both in terms of the future development of the economy.

The Advisory Committee on Diversification considered them in great detail and devoted Chapter IX of their Report to them. Basically, the Advisory Committee's recommendations concerning technical education are now being dealt with by the Committee to Review Post-Secondary and Technical Education and those on industrial training are being implemented by the Hong Kong Training Council. The Economic Services Branch is now represented on both. Every six months we put reports to Executive Council on progress in implementing all the Advisory Committee's recommendations. We also send copies of these progress

reports to Members of this Council. For the details in respect of the recommendations concerned with education and training, I would refer honourable Members to Progress Report No. 7 which was issued on 7 March.

Sir, I support the motion.

SECRETARY FOR THE ENVIRONMENT:—Sir, there is one prediction that can, I think, be made with fair certainty about these annual debates, and that is our Unofficial colleagues will have quite a bit to say about land. In that respect their performance this year has been about par for the course (*laughter*). But, of course, they are right to have this concern for, especially in Hong Kong, the availability of land is the starting point for all further development, whether for housing, industry, commerce or community facilities.

Miss DUNN and Mr. NEWBIGGING have called for a greater involvement by the private sector in land development and Mr. S. L. CHEN suggests that the terms of reference of the Hong Kong Industrial Estates Corporation should be extended to enable it to assist more in the provision of industrial land. There is certainly a part to be played by the private sector in the production of new land and this has already been recognized. For instance, two such schemes involving the reclamation of sea bed and producing 47 hectares of land for the Government and 21 hectares for the developers are now nearing completion in Sha Tin. The electricity companies and the China Cement Company are also forming their own large sites for their new developments and the same has happened with certain projects for special industries. The recent sale of unformed land at Red Hill to provide 13½ hectares for high class housing is another example, while the Government's new programme for the redevelopment of some of its quarters sites is providing an opportunity for the private sector to participate with the Government on a joint venture basis.

A good deal is thus being done in this direction and the Government would be very willing to consider other constructive suggestions. Indeed, we are now ourselves preparing a submission for the Special Committee on Land Production on how the private sector contribution might be increased, and no doubt Miss DUNN and her colleagues will be very ready in due course to give it their critical attention.

I would, however, add the caveat that, although the involvement of the private sector in land production will lessen the call on Government staff resources and reduce direct Government expenditure, it will still make demands on the construction industry and on the economy as a whole. And it will not, in the last analysis, reduce Government spending, net of revenue, on the projects concerned.

I would remind Mr. CHEN also that the Hong Kong Industrial Estates Corporation has hitherto been an instrument to construct and manage industrial estates and to dispose of leases of land, at cost, to applicants who meet extremely strict criteria of benefit to Hong Kong. The Corporation has also so far operated

entirely on money loaned to it by the Government. To extend these activities, other than very marginally, would risk blurring the Corporation's original purpose and I see no particular benefit in it acting as an intermediary in forming and selling land for ordinary industrial purposes.

Mr. NEWBIGGING commented on the shortfall in land sales during the year compared with the estimated figure forecast last year. There has indeed been a shortfall of just over 16 hectares, but this is bound to be the case when inevitable difficulties such as geotechnical or clearance problems hold up land availability. Most of the land concerned will, however, appear in the 1981-82 sales programme. Certainly there is no reserve of land deliberately held back from which new sites can be found to replace those which have been lost from, or delayed in, the programme.

An associated problem which I should like to mention is that of ensuring that land, once sold, is developed as quickly as possible. Although this is not as yet a major problem, some developers do seem to have been unduly slow with their works. To counter this the Government is now using its powers of re-entry more often where no building work has been done during the covenant period. And, in other cases, it is basing charges for the extension of building covenants on current prices rather than the original purchase price of the land.

Miss DUNN has asked for an assurance that the way in which modification premia are granted should not discourage development. The principle upon which modification premia are assessed is that the lessee must pay for any increase in the value of the lot, that is the land, arising from the modification. No doubt if the premia charged were to be reduced below the increase in value this would encourage development; but it would also put windfall gains into the pockets of the lessees by allowing them to pay less than the market price for the further development rights. To take such a step would only be justified if it was clear beyond reasonable doubt that desirable redevelopment opportunities were being lost through present practices. As in 1980, however, more than 80% of applicants for modifications accepted the terms offered, this would not seem to be the case.

Nevertheless, in a broader sense, I would agree with Miss DUNN. There are a number of older districts in the Urban Area where redevelopment is desirable but where it seems to be happening much too slowly. Usually the lots involved are small and in multi-ownership; and it is the problems of acquisition and amalgamation which form the main obstacle to sensible redevelopment rather than considerations of premium. Some progress is being made with comprehensive redevelopment schemes, particularly through the Housing Society, but more can be done in this regard and possible ways and means of encouraging such schemes are being examined.

Miss DUNN also again mentioned the possibility of creating a unified Lands Department. Here I can only say that the modalities involved in such a creation are now being examined in depth and I hope that a decision can be made before very long.

Finally, as regards land, my Friend the Director of Trade, Industry and Customs has already referred to Mr. Stephen CHEONG's plea for land to be made available to the dyeing and finishing industry. I can confirm that, when the study being undertaken by the Federation of Hong Kong Industries is received in the Government, it will be given careful and sympathetic consideration within the established interdepartmental machinery set up to deal with these matters. I should, however, add the rider that, if a request were to be made for the provision of land on special conditions, the case would need to be clearly demonstrated, not just in terms of this particular industry alone, but also in terms of benefit to industry—and, indeed, the economy—as a whole.

To turn to another subject, Sir, Mr. LOBO has reminded us that the standard of cleanliness of our streets and public places has been deteriorating since the last Keep Hong Kong Clean Campaign of eight years ago. The Government is grateful for Mr. LOBO's welcome for the new campaign scheduled to begin in the autumn of this year, and I note his hope that this will involve a sustained and determined effort and not just a short-term publicity exercise.

Certainly this is also the Government's hope and I am sure that it is the hope of the Urban Council as well. The Campaign Organization has now been established and the stage of detailed preparations is commencing. Here I can assure Mr. LOBO that the Government intends, to use his words, 'to clean its own house'. Very substantial resources will be devoted, not only to the campaign itself but also to establishing the capacity to mount and sustain an increased cleansing effort, particularly in the New Territories.

As I indicated in this Council on 17th of December last year when answering a question from Mr. Charles YEUNG, the Chief Secretary will be making a statement early in the summer with more details on how the campaign will be organized.

Before concluding, Sir, I must express my gratitude for the encouraging remarks made by Mr. So on the subject of environmental protection. As a member of the Environmental Protection Advisory Committee (E.P.C.O.M.), Mr. So will be aware of the steady and solid efforts which are being made to get to grips with the problems in this field in a pragmatic manner and of the significant advances which have been, and are being, achieved.

Not only are we now bringing forward and putting into effect the various new pieces of environmental legislation but, as Mr. So says, the Environmental Protection Agency is now solidly established and has started its work on the monitoring of pollution levels in the various parts of Hong Kong. The control units in departments are also being strengthened and their work will be coordinated through the Agency. Large new developments such as the new power stations, the cement plant and various chemical installations are being constructed

in ways which take full account of environmental impact assessments agreed with the Agency and approved by E.P.C.O.M. It is hoped also very soon to declare Tolo Harbour as the first Water Pollution Control Zone and to initiate comprehensive monitoring and steps to ensure that its water quality does not further deteriorate. The Waste Management Policy Committee is getting into its stride and it is preparing a comprehensive programme to ensure that waste arisings are disposed of in cost-effective and environmentally acceptable ways. In all of this work our aim is, and will be, to fine tune and to impose controls only when, and to the extent that, they are clearly shown to be necessary to prevent a significant deterioration in environmental conditions in a particular area or to bring about a positive benefit in relation to the costs involved. This I consider to be a sensible approach and I am glad to see from my television set that it has the endorsement of one as rigorous in his thinking as Professor Milton FRIEDMAN (*laughter*).

I might add that the examples I have quoted are no more than examples of the work that is now being undertaken or planned in the environmental protection field. Mr. So will be pleased to know, however, that work is also starting on measures that can be taken to deal with the problems created by the large open nullahs to which he referred. For instance, with the agreement of E.P.C.O.M., I have just initiated a study on the short, medium and long term measures necessary to tackle the Kai Tak nullah problem and their likely costs and timing. Mr. So's suggestion that the nullahs should be covered is one possibility being examined, although I fear that more radical measures will be needed if we are to achieve any lasting improvements.

Sir, with these remarks I have pleasure in supporting the motion.

SECRETARY FOR HOUSING:—Sir, we have just concluded the first financial year of the new decade, with a most satisfactory start being made to the housing programme. During 1980-81 combined production from the public and private sectors reached its highest level ever. In the public sector the Housing Authority exceeded its target with the completion of 35,443 flats. In addition, 1,506 flats were provided under the Private Sector Participation Scheme while the Housing Society produced a further 618 flats. The private sector also maintained its high output, making a total of well over 60,000 flats from both sectors for the year.

Since 1979-80, as a result of our high level of public housing production, it has proved possible, for the first time in many years, to reduce the waiting list. However, the improvement has been only marginal and I share Mr. NEWBIGGING's concern regarding the need to reduce the list further and thus reduce the waiting time and encourage *all* families who are in need to seek entry to public housing by this means.

This underlines the need to increase our production of all types of public housing whenever possible. Sufficient land and other resources have been made available and contracts have either been let or are being prepared to ensure that production is maintained at its current high level well into the mid-1980s.

Nevertheless, any increase above these levels should be effected gradually and must take into account the availability of resources. Dr. Henry Hu expressed the hope that we could spend more on public housing in future. Sir, as far as our present programme is concerned finance is not a constraint. The draft Estimates for 1981-82 include provision of \$3,072 million for public housing, representing an increase of more than 15% in real terms over the very high provision of \$2,325 million for 1980-81. As Members are aware, in accordance with accepted procedure this level of expenditure is rolled forward annually, on a four-year basis.

However, the continuation and expansion of the housing programme is, above all, dependent on the availability of an adequate supply of land. In this connection the Special Committee on Land Production has recommended the necessary site reservations for all types of housing for the second half of the decade, taking account of the fact that sites becoming available during this period will be generally more difficult to form and service. Present indications are that it may be necessary to identify approximately 20% to 25% more sites than would normally be required in order to cover these problems, to allow for a possible gradual expansion of output and to guard against slippage in land production.

Since the Home Ownership Scheme was launched in October, 1977, altogether 13,453 flats have been sold to eligible families, including the 1,506 flats produced under the Private Sector Participation Scheme. In addition, over 31,000 applications have been received for the latest phase of 3,099 flats due for completion later this year.

About half of the home ownership flats produced so far have been sold to public housing tenants. This arrangement will continue with later phases, and thus meets the point made by both Miss DUNN and Mr. WONG Lam, since it provides the opportunity for a substantial number of better-off tenants to purchase their own flats, thereby making available their rental flats for reallocation to other families in need of such housing.

Turning to the 'sandwiched' families referred to by Mr. LOBO, within the framework of the Private Sector Participation Scheme the Government has already decided to extend a form of help to those whose family income exceeds the limit laid down for the main Home Ownership Scheme. Tenders have been invited for the development of a large site at Tuen Mun to provide over 2,000 flats ranging in size from 50 square metres to 80 square metres, which will be offered for sale to this group.

Miss DUNN has suggested a need to subsidize the Government's Home Ownership Scheme by providing land at less than full market value. In this context it is worth noting that there are various ways by which the prices of flats can be, and have been brought within the means of people who could not otherwise afford to buy their own homes. First of all, the profit element is removed from these schemes; then, economies are realized by the production of flats in large numbers, and to a standard design; *also* a form of subsidy exists

in the favourable mortgage loan terms made available by the financial institutions participating in the scheme in response to a partial Government guarantee in respect of funds so loaned. Under the existing arrangements it has been possible to offer flats for sale under the Home Ownership Scheme at prices *conservatively* estimated at between 26% and 34% below market levels for the successive phases. Furthermore, within each batch of flats sold there are price differentials reflecting such factors as size and location. The effectiveness of these measures can be judged from the fact that the number of applications for flats has consistently exceeded by many times the number of flats available.

As the Financial Secretary has stated, the Working Party will be reconvened shortly to review the Home Ownership Scheme and the Private Sector Participation Scheme. The intention is to examine ways and means by which more flats can be built to meet the aspirations of those whom the schemes are designed to benefit. If, in order to meet those aspirations, it is considered necessary to introduce any further direct subsidies, the Working Party will have to give detailed thought to the additional restrictions on disposal which would clearly have to go hand in hand with any such extra assistance.

Another point for the Working Party to consider is Mr. WONG Lam's suggestion that criteria other than family income should be used to assess eligibility for both rental and home ownership flats. The present policy on the allocation of *rental* housing does in fact take into account several measures of housing need, including size of household, space and facilities of accommodation occupied, and in certain cases, the proportion of income paid in rent. However, since subsidized housing is provided for less well-off families who are unable to rent or purchase flats on the open market, income must remain a major criterion for the allocation of both types of such housing.

With these remarks, Sir, I support the motion.

THE CHIEF SECRETARY:—Sir, a number of Unofficial Members have touched upon matters which relate to the overall administration and organization of this Government.

Government Organization and the Civil Service

Miss DUNN was moved to express doubts about the Government's organization and the management of the civil service; she also offered the view—and it is one which I fully support—that every effort should be made to ensure that our civil service is not only united and content, but at the same time is efficient, productive and concerned to give of its best to the public it serves. I must agree too with her contention that the civil service is still under-managed. When I became Chief Secretary some two and a half years ago, I recognized that a major concern of mine would have to be the management of the civil service: that with the introduction of imaginative, socially and politically essential, but staff-hungry schemes to improve social services and the quality of life, too little regard had been paid to the management of the civil service, to the

management of the very people who had to make these important schemes work. And if one adds to that the simple, stark fact that for long in much of the civil service there had been neglect of the basic concepts of proper, caring staff-management, one can see what a daunting, enormous problem this was and unhappily, still is. If she were here, I am sure that Miss DUNN would agree that one cannot overcome decades of neglect in the short space of a few years. It takes a long time, not only to select, train and place staff in key positions; also, in particular, it takes a very long time to achieve the necessary change of attitude required in respect of staff relations and staff management. Certainly—and I say this sadly, Sir, for as you well know it is a matter I feel strongly about—certainly it is not going to be achieved in my time as Chief Secretary. There has been serious over-stretch in the service in the past: that is undeniable. It is also undeniable that a great deal of over-stretch still exists today. That is not to say that nothing has been done about this problem: quite the contrary—very considerable extra resources have been and are being provided to strengthen the management of the civil service and conscious efforts are now being made to identify those areas which are under-managed: in other words we are not sitting back and waiting for problems to show themselves, we are taking action to rectify such situations before they assume troublesome proportions. Channels of communication between the Secretariat and departments and between staff at the different levels of management are being constantly reviewed and improved to ensure that there is a sense of direction. As well, efforts continue to be made to improve the effectiveness of resource and staff management within departments. The strengthening of directorates, in particular of our major departments, will enable more attention to be devoted to improving the relationship between staff and management at all levels and to the enhancement of staff productivity. This is a priority area for all heads of departments and we are proceeding in the light of the guidance given by the Standing Commission on Civil Service Salaries and Conditions of Service in its Report on the Consultative Machinery in the Civil Service.

I have spoken at some length on this subject, Sir, not only because it is important, and because Miss DUNN has shown a continuing, and most welcome, interest in the civil service, but also to put the matter in perspective. There are a substantial number of dedicated heads of departments and civil servants who have been putting, and will continue to put, a great deal of well-directed effort into the improvement of staff relations and staff management: they deserve recognition—and this I now willingly give.

Mr. BROWN made an important point about the danger of allowing a very large pensionable establishment to grow up in an era when office technology is constantly improving; this in terms of possible consequential redundancy at some future date. This is something that should be kept under review. It is not a problem we have so far encountered but obviously the Government must always strive to keep its system and methods abreast of modern technology and innovation. I note with special interest Mr. BROWN's suggestion that consideration be

given to the possibility of a greater degree of interchange of staff between Government and the private sector at all levels of seniority.

Now Mr. BROWN is a careful man, and careful of his words: I note that he used the term 'greater degree of interchange'—a clear recognition that there is *a* degree of interchange at present and one at any rate, at a very high level (*laughter*).

But to Mr. BROWN's suggestion. It is an idea on which I have personally been keen for some time. I have seen it at work, and working well, elsewhere. The last time I discussed this with a few members of the private sector I was rather discouraged however—discouraged by what I thought was a narrow point of view: 'don't' said one taipan, 'don't expect to get our best chaps—we want to train them our way, and in our image. And if they are senior and any good, we couldn't spare them anyway (*laughter*). I imagine too that you wouldn't be so silly as to let the private sector have your flyers—you'd lose them for good' (*laughter*). I could see—just see—his point of view: but in my view, (and I am sure Mr. BROWN would agree), unless those chosen for the interchange had potential and were likely to benefit from such interchange, the scheme would probably fail, or at best not be so successful as it might have been.

There are of course a number of civil servants seconded to work in subvented organizations and the experience gained suggests that the secondment is beneficial both to Government and to the subvented organizations.

In spite of my earlier experience, I agree that there is good sense in trying again, and perhaps this time rather more formally. There may be scope, for example, in the exchange, or interchange, of staff dealing with personnel management matters: the possibility of introducing some trial exchanges is being looked into by the Civil Service Branch. Sir, I thank Mr. BROWN for his interest and encouragement in this matter.

As to expenditure on civil service training, I agree with Mr. Peter WONG that a note on the scope and cost of the training programmes provided at the different levels in the Civil Service would be of general interest. Such a note is being prepared by the Civil Service Branch and the information will be published in due course.

Miss DUNN raised the question of whether the central Government Secretariat concept remains relevant to the Government of modern Hong Kong and, a little surprisingly, suggested that no effort has been made to address this question and the related question of the organizational relationship between staff of the Secretariat and those of the executive departments, other than when the policy-secretary concept was introduced in 1974. I express a little surprise at Miss DUNN's comments, Sir, as my predecessor in the budget debate of 1978 reported, in answer to remarks by Miss DUNN and others, that an in-house study of the post-McKinsey Secretariat organization and relationships with departments has in fact started in 1977 and was still being carried out at the time he spoke. The survey was completed in 1978 when it was concluded that no solid grounds existed for any fundamental change in a system which had been in operation for

a bare five years. Perhaps those who reached the conclusion of 'no change' were mindful of the fact that the system which preceded it had been in being for almost a century. And whilst I would not advocate waiting quite such a long time before the next review, Sir, and whilst no organization should remain static and while organizational improvement should be on-going, I am repeatedly reminded by some of my colleagues that over-frequent organizational upheavals can be traumatic and seriously direct attention away from the task in hand. There have, of course, been changes in the Government Secretariat system since 1974: and very soon I shall be putting before Your Excellency in Council new, major proposals concerning the administration of Transport and of Land and Works. I think it only fair to say, however, that without the organizational reforms of 1973-74 the Hong Kong Government would not have been able to come through a period of major expansion as well as it has done. But that last in-house study of the McKinsey-style Secretariat system was carried out in 1978: I have to agree with Miss DUNN that the time has come for another look at the overall organization of the central Government. Indeed earlier this year I gave instructions that a reappraisal of the very issues Miss DUNN has mentioned be undertaken by the Administration Branch.

Miss DUNN also referred again to the role of Unofficials. This is a subject I should be very pleased to discuss further with her and her U.M.E.L.C.O. colleagues although again I am bound to say that the evolutionary nature of that role which she refers to as 'somewhat accidental' is, in my view, absolutely nothing of the sort. As I said in this Council only last November, this evolutionary process is quite deliberate and has been going on for a number of years. If some strengthening of the U.M.E.L.C.O. Office is indeed required, for research or for other purposes, I can say without hesitation that a case for such strengthening will be most sympathetically considered.

Government's Office Accommodation and Quarters

Dr. Henry HU and Mr. Peter C. WONG raised the question of leased office space and quarters. Of the \$525 million sought in the estimates for the rental of premises, \$390 million or 74 per cent is to continue existing leases through this financial year and \$135 million or 26 per cent is for new leases. \$369 million is for offices and \$156 million for quarters. A further \$25 million is sought for minor fitting-out works.

A degree of leasing is unavoidable to establish offices in areas where a Government building would not be economic (many Post Offices, C.D.O. Sub-Offices, for example, fall into this category). The Government recognizes, however, that it is preferable to locate its offices wherever possible in Government-owned buildings. Plans have been drawn up for over half a million square metres of general purpose offices to be built over the next six years. Allowing for additional office requirements over the period, and for the demolition of 51,000 square metres of existing offices for redevelopment or for sale of the sites, this building programme will reduce the proportion of leased

offices from the present high figure of 66 per cent to 21 per cent by the end of the 1986-87 financial year.

Regarding quarters, there are currently 1,640 Government-owned and 758 leased Non-Departmental Quarters. A building and redevelopment programme has been started under which over 1,600 new quarters will be built by the end of 1985-86 and some 460 demolished. (The additional quarters are required to reduce the number of quarters leased and to meet forecast additional needs). The majority of these projects will proceed as joint-ventures with private sector developers.

While these buildings for offices and for quarters are being put up, the Government will—obviously—have to continue to lease accommodation at the present high levels. However, the proportion of leased accommodation is planned to reach a peak in 1983-84 for both offices and quarters, and to decline—fairly rapidly—thereafter.

Hong Kong/Britain Relationship

Finally, on a matter not concerned with the administration of the Government but one concerning Hong Kong's relationship with Britain. In a timely, statesman-like commentary Mr. Alex Wu exhorted us not to confuse the expedient with the fundamental. Mr. Wu said in part:

‘What Britain does about expenditure on education, how Britain behaves in trade negotiation, even how Britain arranges her nationality and immigration affairs, cannot be lumped together as evidence of a fundamental change in the relationship between Britain and Hong Kong.’

There is no evidence of such a change and it is vitally important for Hong Kong that we should understand the real motives of British policies, the problems which Britain faces and the options which are open to her politicians.’

Of course, Alex Wu is right: and we would be doing ourselves a great disservice if we were to call our relationship with Britain into question by relating to it issues which, however important, however serious, are nevertheless not fundamental questions about the responsibility of Britain for Hong Kong.

I am sure, Sir, that Mr. Wu was much heartened, as I, and no doubt others were, by Lord CARRINGTON's simple but firm statement that a major purpose of his recent visit to Hong Kong was to demonstrate, to reiterate, the unshakeable commitment of the British Government to the prosperity and stability of Hong Kong. A fundamental statement, Sir, about fundamental matters.

Sir, I support the motion.

THE FINANCIAL SECRETARY: —

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(1) <i>Reply by the Financial Secretary to a question from Mr. Francis Tien in Legislative Council on Wednesday, 7 January 1981 (on the impact of high interest rates on industry)</i>	<i>f.n. (19)</i>	794
(2) <i>Press Release issued by the Commissioner of Securities on 3 March 1981 (on the disclosure of share holdings and share dealings)</i>	<i>f.n. (22)</i>	795
(3) <i>Speech by the Financial Secretary in Legislative Council on Wednesday, 25 March 1981 (on the Deposit-taking Companies (Amendment) Bill 1981)</i>	<i>f.n. (24)</i>	796

(1) *Introduction*

Sir, this has been a memorable debate for at least six reasons (*laughter*): *first*, the several dilemmas I sought to resolve when preparing this year's budget were reflected in a number of speeches, indicating a realization that these dilemmas existed and that there was no easy way to resolve them. *Secondly*, Unofficial Members have been kinder than usual and, hopefully, not just because this is my

last budget debate (*laughter*). Even if that thought did cheer them up, I am, nonetheless, sincerely grateful to them for their complimentary remarks. *Thirdly*, two new terms were coined: 'cumulative interventionism' by Miss DUNN and 'negative interventionism' by Dr. Hu. *Fourthly*, as a professional teacher of many years standing, Miss BENNETT set a commendable example to her pupils by demonstrating that she, herself, had not lost the art of learning inasmuch as she adopted the footnote technique (*laughter*) to elaborate a point in the text of her speech (*laughter*). *Fifthly*, Dr. Hu's positively heroic declaration that he actually enjoyed listening to my budget speeches (*laughter*) was most gratifying (*laughter*). Equally so, *sixthly*, was Mr. Oswald CHEUNG's historic announcement—doubtless made after much heart searching—that he intended to cast his vote in favour of the motion when put by you, Sir, later this afternoon (*laughter*). And I hope that I say nothing during the course of the next couple of hours or so, to cause him to change his mind (*laughter*).

2. In winding up this debate I shall group what I have to say under seven headings, namely, the size of the public sector, the pattern of public expenditure, fiscal policy, financial management, diversification of the manufacturing sector and the management of the economy. I shall then go on, as usual, to review the present state of the economy as revealed by such statistics as have become available since my forecast of expenditure on the G.D.P. in 1981 was prepared two months or more ago.

(2) *Importance of a Balanced Approach*

3. But, before doing so, I should like to take issue with Mr. LOBO who, if I read him correctly, seems to be under the mistaken impression that I am a talker and not a listener. It is true that after ten years of being exposed to cross-pressures and bombarded with bright ideas by commentators who rarely have any sympathy for the circumstances surrounding, and the constraints upon, luckless doers, my irritability threshold has been lowered somewhat (*laughter*). But to respond, gently or otherwise, to criticism which is, as he so rightly said, 'a natural, healthy aspect of political life' does not indicate resentment.

4. I have always regarded the annual budget speech as the Financial Secretary's contribution to the task of '(bridging) the gap between the governed and the governing' for, of course, I agree with Mr. LOBO that everyone has 'opinions on levels of taxation (and) on the disposal of public funds'. But, speaking quite frankly, it is easy for Mr. LOBO to argue that I should be more 'sympathetic to the views of the less well informed', when the Government's primary concern must be for the common good and the broad public interest. In exposing the Government's thinking I thought I was '(establishing a basis for) dialogue' and I have usually '(yielded) to reasonable arguments'. It is a fact, however, that of all the arguments thrown at me, from time to time, many have been *unreasonable* (*laughter*). Certainly, I would deny that I am unaware of what Mr. LOBO describes as 'the facts of life' and I would deny that I view the world through a statistical looking-glass. I am well aware of the human aspects of the disruptions and the forced adjustments which are the concomitant of economic progress.

But, in response to Mr. LOBO's proposition that 'a gap (has developed) between what is statistically satisfactory and what is personally satisfying', I would say this: that what is statistically *unsatisfactory* is most unlikely to be 'personally satisfying'.

5. I would not wish to suggest that Mr. LOBO is not right to warn us against being careless of the impact on the 'quality of life' of, for example, development works. I agree too that 'environmental conditions which were tolerable 20 years ago are no longer acceptable'. I am an enthusiastic supporter of the upcoming Keep Hong Kong Clean Campaign and no one would disagree with Mr. So that our polluted nullahs do not do us, as a community, much credit. Nor would I disagree with Miss BENNETT's dictum that 'quality, not just quantity, must be our aim', although I feel bound to say that I detected in Miss BENNETT's reference to 'those concerned for the state of our society' a suggestion that anyone who supports the proposed level of expenditure on the social services in 1981-82⁽¹⁾ is not to be counted among those so 'concerned'.

6. As Dr. Hu so succinctly put it: 'the key to success in (the management of the) public finances ... is to maintain ... balance'. I took him to be referring to the four principles on the basis of which Hong Kong's public finances have been managed for many years, that is to say: a balance between public sector expenditure and the economy; a balance between competing departmental bids for available resources, having regard to the Government's view of relative priorities; a balance within the fiscal system; and a balance between revenue and expenditure, having regard to the state of our 'free' fiscal reserves.

(3) *Size of the Public Sector*

7. Mr. Oswald CHEUNG had the last word on the relative size of the public sector⁽²⁾: a consistent critic of my emphasis on containing it, and of setting a range within which it might fluctuate over the course of a cycle of activity he, nevertheless, came out flatly in favour of an upper limit but, regrettably, he put it at no less than 25% and, by implication, this was acceptable to him whether the economy was in an upswing or a downswing phase. I am afraid this would not be acceptable to me in either phase (*laughter*).

8. By contrast, Miss DUNN expressed disappointment that the average annual growth rate of public sector expenditure in real terms for the five post-recession years, at 13.8%, exceeded the average annual growth rate of the economy, at 11.3%, by 2½ percentage points, thereby putting the adjustment mechanism at risk. However, the growth rate of public sector expenditure did lag in 1976-77 and budgetary policy did successfully engineer a slow down in 1979-80 as part of

(1) *At \$11,906 million, or 42.1% of total expenditure on Consolidated Account of \$28,268 million.*

(2) *As measured by the ratio of expenditure on Consolidated Account to the G.D.P. in money terms.*

our anti-inflationary stance in that year⁽³⁾; and I doubt whether she can entirely escape a charge of inconsistency in suggesting more expenditure on our housing programmes by taking refuge in a plea for 'a more austere view of priorities'.

9. Mr. NEWBIGGING's attempt to avoid such a charge was even less convincing and quite illogical as well (*laughter*): he expressed concern that the relative size of the public sector should exceed 20%, but said 'we must also press ahead with our massive infrastructure development programmes ... and there is a strong case for actually accelerating the public housing programme'. His solution was to transfer part of the Public Works Programme to the private sector. This may or may not be a good thing in itself, but the public sector must be defined consistently over time and, if the definition is changed, then our view as to a safe upper limit for the relative size of the public sector, so redefined, has to be revised downwards, obviously⁽⁴⁾. So his solution would be no more than an arithmetic sleight of hand.

(3)

Year	Growth rates in real terms:		Relative size of public sector (%)
	C.A. expenditure (%)	G.D.P. (%)	
1975-76/1975	-2.1	2.2	16.2
1976-77/1976	5.2	18.8	14.2
1977-78/1977	15.5	10.2	15.4
1978-79/1978	21.0	10.2	17.4
1979-80/1979	7.0	8.6	18.1
1980-81/1980	21.4	9.0	21.2
1981-82/1981	12.8(*)	8.0(**)	22.4

Notes: (*\$=n) Estimate.

(**\$=n) Forecast.

(4) It is very easy 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 of public sector expenditure selected. For the purpose of formulating annual budgetary policies, what is needed is a practical definition of public sector expenditure and one that is applied consistently over time. Thus our approach has been to define the public sector for this purpose in terms of the deployment of funds under the Government's control. Even this approach can be varied. viz:

Year	General Revenue Account		Consolidated Account		Consolidated Account plus M.T.R. expenditure		G.D.P. (\$ mn)
	expenditure (\$ mn)	As % of G.D.P.	expenditure (\$ mn)	As % of G.D.P.	(\$ mn)	As % of G.D.P.	
1975-76/1975	6,023	14.8	6,576	16.2	7,076	17.4	40,574
1976-77/1976	6,577	12.7	7,355	14.2	8,355	16.1	51,973
1977-78/1977	8,158	13.7	9,168	15.4	11,168	18.7	59,615
1978-79/1978	10,956	15.8	12,122	17.4	15,022	21.6	69,491
1979-80/1979	13,820	16.0	15,619	18.1	18,919	22.0	86,113
1980-81/1980	19,677	18.5	22,517	21.2	25,017	23.6	106,088
1981-82/1981	24,643	19.5	28,268	22.4	29,768	23.5	126,430

Note: (*\$=n) This is the ratio normally used.

10. Only Mr. Stephen CHEONG and Mr. BROWN attacked the upward drift in the relative size of the public sector without simultaneously pleading for more expenditure: Mr. CHEONG was worried about the implications of a further increase as and when the growth rate of the economy slows down and Mr. BROWN, by implication, supported my view that the growth rate of public expenditure on General Revenue Account should be limited to 5-6% in real terms in the new forecast period, compared with the average annual growth rate in the six postrecession years to 1981-82 of 12.7%.

11. Several years ago⁽⁵⁾ I propounded the proposition that the upper limit of the relative size of the public sector should be 18% on the upswing and 20% on the downswing, but I later concluded that this was a somewhat mechanistic approach. In a period of sustained upswing, the growth rate of public sector expenditure exhibits an inevitable tendency to catch up with the growth rate of the economy; and if, in addition, the public sector is in surplus, it is very difficult to hold its growth rate down. Even so, the growth rate of public sector expenditure in real terms (on Consolidated Account) is to be eased back from 21.4% in 1980-81 to 12.8% in 1981-82, but not so much, it is true, that the relative size of the public sector will not increase further from 21.2% to 22.4%. Administration, like politics, I would remind Miss DUNN when she points to 'an alarming inability' on my part—that is to say, on the Government's part!—'to put theory into practice', is the art of the possible. Of course, it is not *impossible* to hold the growth rate of public sector expenditure down when we have to and we did so in 1979-80 when there were clear signs that the growth rate of public sector demand was contributing to domestically generated inflation⁽⁶⁾. The irony of our 'externally oriented and ... vulnerable (situation)', to quote Mr. Stephen CHEONG, is that the growth rate of public sector expenditure has to be slowed down on the upswing for domestically generated inflation will, sooner or later, damage our external competitiveness; *and* on the downswing too in order to avoid frustrating the adjustment process (as in 1975-76⁽⁷⁾).

12. Anyway, despite Mr. CHEONG's plea for an 'arbitrary ... ceiling', I have refrained recently from being too specific about an upper limit for the relative size of the public sector for, as our economy is enlarged, so a relatively larger public sector can be tolerated. Instead, I have limited myself to expressions of concern about a persistent upward drift. That drift will now have to be contained, that is to say, the growth rates of public sector expenditure and the G.D.P. will have to be brought more into line with each other.

13. The question is: why must it be contained, given the buoyancy of our revenues and the state of our fiscal reserves? The answer lies in the fundamental reason underlying the first of our four principles of management of the public finances, namely, that the growth rate of public sector expenditure, appropriately defined, should have regard to the growth rate of the economy and, allied to this, the relative size of the public sector should be carefully watched. The public

(5) *B.S.*, 1976, paras. 210-211 and *C.S.*, 1976, paragraph 32.

(6) *See f.n. (3) above.*

sector is not subject to the discipline of the profit and loss account⁽⁷⁾ and has virtually unlimited power, with or without invoking the use of debt instruments, to bargain resources away from the private sector. But if the Government chooses to use this power, it must be aware of the consequences. Thus the need for self-imposed restraint is self-evident, for this is the only safeguard against the private sector being deprived of access to competitively priced resources, inflationary pressures being generated and balance of payments difficulties emerging.

(4) *Pattern of Public Expenditure*

14. The application of the second principle on the basis of which Hong Kong's public finances are managed, namely, that the pattern of public sector expenditure should reflect the Government's conscious view of priorities, is much more dependent on value judgments than the first. So, inevitably, the determination of priorities of expenditure is disputatious, but rightly so for different people have different ideas, at different times, and not everything can be done at once.

15. Two Unofficial Members, namely, Mr NEWBIGGING and Dr. HU, recognized the priority accorded to our housing programmes, but they felt, nevertheless, that the programmes should be enlarged, even though expenditure on them represents over 33% of total capital expenditure on Consolidated Account. Two others, namely, Miss DUNN and Mr. WONG Lam, argued for more Government built or Government arranged housing for purchase by the lower middle income groups. Miss BENNETT was dissatisfied with the absolute amounts earmarked for, and the relative priority accorded to, expenditure on education. If there is to be relatively less emphasis in 1981-82 on education—but, at \$3,705 million it will be 13.1% of total expenditure on Consolidated Account—this simply reflects the emergence of other priorities rather than a lessening of our efforts in absolute terms, as indeed Miss DUNN pointed out. And Miss BENNETT's claim that the increase in expenditure on education between 1976-77 and 1981-82 (of \$2,274 million or 159%) was 'mainly required to combat inflation' is clearly erroneous. Five Unofficial Members, namely, Mr. F. W. LI, Mr. WONG Lam, Dr. Ho, Mr. F. K. Hu and Dr. Hu were concerned that there was insufficient emphasis on caring for the disadvantaged, although I would point out that \$1,253 million is to be spent on social welfare alone in 1981-82, compared with \$908 million in 1980-81.

16. Unfortunately, none made any practical suggestions as to *where* savings should be made to accommodate the increased expenditure proposed. I cannot accept that it would be wise to increase *total* expenditure, and thereby the relative size of the public sector in 1981-82 beyond the high point forecast of 22.4%, and I would refer Members again to the actual figures of proposed expenditure in Table 12 of the Statistical Appendix and to the descriptive analysis in Annex (2) to the printed version of the budget speech.

(7) *Competitive tendering procedures for the procurement of supplies and for works contracts are simply the means whereby choices are made between suppliers and contractors respectively.*

(5) *Fiscal Policy*

17. The third principle on the basis of which Hong Kong's public finances are managed is that a certain balance should prevail between direct and indirect taxation and between direct and indirect taxation taken together and all other recurrent revenue, and that our tax system as such should meet certain defined requirements⁽⁸⁾.

18. I assume, from the absence of any critical comment from Unofficial Members that, in their view, my proposals to lift the thresholds for personal taxation, to stretch the impact of effective rates of tax over a broader spectrum of incomes and to lift the levels of gross income at which the standard rate of tax of 15% is applicable⁽⁹⁾ represent a reasonable response to fiscal drag. For the avoidance of any misunderstanding, however, and although I realize that Mr. F. W. LI and Mr. CHEN were being kindly, I really did not put forward these proposals in a 'generous and charitable (spirit)...tint(ed) with sweetness' (*laughter*). Rather, I put them forward because I believed they were consistent with the fifth requirement of our tax system, namely, that it should be equitable as between different classes of taxpayers or potential taxpayers, and between different income groups, and because the system should rest as lightly as possible on the disposable incomes of those at the lower end of the income spectrum, or leave them untouched.

19. Mr. WONG Lam returned to the charge on the question of separate assessment of a wife's income and asked me to reconsider my previously stated view, which he had not found 'very convincing'. The Third Inland Revenue Ordinance Review Committee, whilst recommending the reintroduction of a working wife allowance—which the Government did not accept, given our opposition to selective allowances—the Review Committee did not recommend separate assessment⁽¹⁰⁾. The system of aggregation of the incomes of married couples provided for in the Inland Revenue Ordinance⁽¹¹⁾ remains our preferred arrangement given the essential simplicity and high thresholds of our personal tax system. It involves treating the family as a convenient tax unit bearing in mind that the total income of the unit is normally employed to the benefit of the family.

20. Furthermore, those who plead for separate assessments are perhaps unaware of the limited value of such an approach. It would never be advantageous for couples to opt for separate assessment on incomes which were below \$55,000 for couples without children, \$62,000 for couples with one child, \$67,000 for couples with two children and \$81,000 for couples with two children and two dependent parents, irrespective of the income split. Separate assessment, in fact, would be disadvantageous in most situations (except in some standard rate cases) where, in the case of a couple with no children, the income of one of

(8) *B.S., 1981, paras. 94-100.*

(9) *B.S., 1981, paras. 228-231.*

(10) *Third Inland Revenue Ordinance Review Committee, Report (1976), paragraph 62.*

(11) *Section 10.*

the spouses is below \$22,500 *or* where the income of the spouse who maintains the children and dependent parents is below a figure of \$22,500 *plus* child allowances and dependent parent allowances.

21. It is argued, of course, that without separate assessment for husband and wife there is inequity. On the contrary, I would suggest that, given the acceptance of the family concept in our system, any reduction of liability through the adoption of separate assessment for a wife's income would itself give rise to inequity. Is there really any valid reason why one family with an income of, say \$100,000, should pay less tax than another family with a similar income, simply because, in the first case the \$100,000 is produced by the husband and wife, whereas in the second case the husband (or wife) alone contributes to the support of the family?

22. The estimated number of working wives in the tax net in 1980-81 was 66,000 of whom the Commissioner of Inland Revenue estimates only 20,000 would benefit from separate assessment, or rather less than 6% of the total number of persons who pay salaries tax.

23. So separate assessment is not the terribly attractive proposition so commonly believed and, to repeat, I believe it would introduce a quite inappropriate complexity into our system of personal taxation which does rest lightly on the middle income group. This is not to say that, for other reasons, the middle, or lower middle, income group does not face certain difficulties. But, as regards their treatment under our system of personal taxation, I would again refer Mr. WONG Lam to the actual facts of liability as set out in Annexes (4)—(7) to the printed version of the budget speech.

24. I proposed the removal of the half percentage point loading levied with effect from the year of assessment 1976-77 on the surcharge of 1½ percentage points on the standard rate of corporation profits tax not so much as a concession as such, but rather because its continuance was no longer justified. It is no part of our fiscal policy to persevere with the imposition of a levy, declared at the outset to be temporary, when circumstances change. The move was not *designed*, with respect to Dr. HU, to 'strengthen our competitive position *vis-a-vis* other major cities in South East Asia' and, therefore, 'to enhance the status of Hong Kong as a financial centre'. Again, it is no part of our fiscal policy to adapt our revenue laws, let alone our tax rates, specifically to attract particular types of business here. The same principle lies behind the proposed improved depreciation allowances: they are designed to encourage manufacturers and others to re-equip and upgrade their plant and equipment to assist the diversification process generally and not specifically to make Hong Kong a more attractive place for investment.

25. This brings me to Dr. HU's warning about the implications of certain clauses in the Stamp Bill for the unit trust industry. The representations made in respect of the proposed liability of unit trust transactions are now being studied by Mr. F. W. LI's *ad hoc* group and there will be ample opportunity for debate

later this month and next, but let me state now that our general approach is in accordance with the third requirement which our tax system has been designed to meet, namely, that the laws governing the tax system are adapted from time to time to make them compatible with changing commercial practices, regardless of whether or not the outcome is in favour of the taxpayer or the revenue.

26. If we did not consistently obey this third requirement (and the second requirement⁽¹²⁾, the neutrality principle would be offended. Should changes in the law result in unnecessary or unwise alterations in yields in favour of the revenue, or erode yields to an extent which causes budgetary embarrassment, then we would adjust the rates of charge in favour of, or against, whole classes of taxpayers. Incidentally, Sir, we do not seek to make our system of direct taxes so neutral or apply the territorial source criterion so consistently as to be doctrinaire. Nor are we so careless of economic considerations as to eschew a sensible degree of pragmatism from time to time.

27. We have always, too, resisted special pleadings to abandon our nondiscriminatory approach and we intend to go on avoiding preferential fiscal distortions; and this is the thinking underlying the Inland Revenue (Amendment) (No. 2) Bill dealing with the interest tax treatment of 'gains' derived from the sale, or on redemption on maturity, of certificates of deposit.

(6) *Financial Management*

28. The fourth principle on the basis of which Hong Kong's public finances are managed is that, in the preparation of the annual estimates of revenue and expenditure, certain guidelines are borne in mind. These reflect the underlying theory in the management of the General Revenue Account that, taking one year with another, we should at least achieve a balance between revenue and expenditure.

29. Mr. Stephen CHEONG, Mr. CHEN and Mr. NEWBIGGING all drew attention to the size of the yield we expect from land transactions, and Mr. CHEONG warned that 'we cannot assume that such bonanzas will continue indefinitely'. Mr. CHEN suggested that the financing of the public sector 'has become increasingly dependent on land related capital contributions' and 'that there is a need (therefore) to produce land more efficiently and economically'. Mr. NEWBIGGING attributed the increase in revenue from land sales to 'the steep rise in property prices' rather than the 'actual acreage sold', and suggested the offer of what he rather charmingly described as 'terms' to the private sector in return for 'carrying out certain public sector type projects'.

30. All three Unofficial Members have, I suggest, overlooked the original purpose of our budgetary guidelines, which is to secure the financing of the capital account by ensuring that a certain level of capital expenditure is met by the

(12) *Namely, that the tax system is as neutral as possible as regards the internal cost/price structure, the supply of human effort and private investment decisions (and this means, inter alia, that apart from a degree of progressivity for personal taxation, the emphasis should be on proportionality).*

surplus on recurrent account, with the balance being met by capital revenue with recourse to debt, or to calls upon our 'free' reserves, being severely limited and preferably avoided. That purpose of our budgetary guidelines remains valid and so do the guidelines, if not the actual ratios, despite the fact that the financing of capital expenditure is not currently dependent on a certain surplus on recurrent account. And, incidentally, I would point out to Mr. CHEN, in particular, that of the estimated overall surplus of \$9,323 million in 1980-81, \$6,424 million is on recurrent account and of the budgetted for surplus of \$7,881 million in 1981-82, \$5,417 million is on recurrent account. It is true that the surrender of recurrent revenue of \$1,237 million, being the cost of four of my five revenue concessions, means that Guideline (3) which requires that at least 88% of total expenditure should be financed by recurrent revenue has been breached and so has Guideline (1), which requires that the surplus on recurrent account should be sufficient to meet 60% of capital expenditure⁽¹³⁾. But these breaches are acceptable, for the financing of capital expenditure in 1981-82 is in no way dependent on the surplus on recurrent account (capital revenue being 126% of capital expenditure).

31. This brings me to Mr. CHEN's complaint that I failed to say 'how the "free" fiscal reserves ... might be utilized'. I would ask Mr. CHEN to look again at paragraph 111 of the budget speech (printed version). Our 'free' fiscal reserves will have an essential role to play in the event that we fail to contain expenditure on the capital account (and, of course, our total fiscal reserves are invested in high quality interest-bearing assets to the benefit of General Revenue⁽¹⁴⁾). The problem is not so much how to maintain our present high level of capital revenue but, rather, to ensure that we do not get locked into a level of capital expenditure that cannot be sustained as and when the level of capital revenue settles down.

32. That is not to say that we should not maximize capital revenue, a very large part of which is derived from land transactions⁽¹⁵⁾. It is, of course, no part of the Government's policy or practice to seek to influence land prices by regulating the availability of land for sale. It is equally no part of the Government's policy or practice to subsidize land prices except where there are good social reasons for doing so. I hope, therefore, that Miss DUNN does not have in mind a subsidy element being built into the premia payable on modifications of lease terms. Her request for 'a review of the way in which modification premia are calculated' can be met, but there can be no alternative to basing modification premia on market prices.

(13)

<i>Guideline</i>	<i>Before revenue proposals (\$ mn)</i>	<i>After revenue proposals (\$ mn)</i>
(1) <i>Recurrent revenue</i>	21,84	20,605
<i>Total expenditure</i>	224,643 =89%	24,643 =84%
(2) <i>Surplus on recurrent account</i>	6,654 =70%	5,417 =57%
<i>Capital expenditure</i>	9,455	9,455

(14) B.S., 1981, paragraph 207.

(15) \$11,498 million, or 96% of total estimated capital revenue, in 1981-82.

33. But Miss DUNN specifically suggested a subsidy in respect of land used in the Home Ownership Scheme and the Private Sector Participation Scheme. She claimed that the imposition of full market value in these schemes reflected a lack of a 'coherent land policy'. She has, I think, misunderstood the underlying purpose of these schemes: as the Secretary for Housing has just pointed out, they are intended to make home ownership possible for lower middle income families at cost, without a profit element and with access to mortgage facilities on favourable terms; and, furthermore, the calculation of full market values for the sites concerned probably understates the true market prices likely to be realized at auctions. The Housing Authority in managing rented public housing has a statutory responsibility only to ensure that its income matches its expenses. As land is granted to the Authority at nil premium for the construction of flats for rent, clearly the Authority's rentals should not include any element for the cost of the land. But, under the Home Ownership Scheme and the Private Sector Participation Scheme, the flats are *sold*, not rented, and there is no compelling argument for public funds to be used to subsidize individuals in the acquisition of permanent assets.

(7) *Diversification of the Manufacturing Sector*

34. I did not detect any serious disagreement with my assessment of the economy's likely performance in 1981⁽¹⁶⁾ or my brief prognostication of the likely structure of the economy in this decade⁽¹⁷⁾. But I certainly detected a degree of anxiety that the Government should facilitate the diversification of our economy, and the manufacturing sector in particular, in a way which is consistent with allowing market forces to operate.

35. So Dr. HU recommended that the initial allowance for depreciation should be increased not from 25% to 35%, but to 50%, which would mean that, for a piece of equipment ranking for the annual rate of allowance of 30%, the write-off allowed for profits tax purposes in the year of purchase would be no less than 65%, compared with 54.5% under my proposal. It is true that, in the long run, the cost to the revenue would be minimal for the effect of any increase in depreciation allowances is simply to accelerate the rate at which allowances are granted. In other words, it is the beneficial cash flow effect which is important to the business community, but I believe that an improved initial allowance of 35% will provide sufficient encouragement to investment.

36. Once again I would stress that it is the neutrality of our tax system, enshrined in the second requirement⁽¹⁸⁾, which is important, rather than the presence or absence of fiscal incentives and this is why I am entirely opposed to any form of subsidy for producers or consumers (other than, so far as the latter are concerned, on compelling social grounds). The fact is that, sooner or later, the neutrality of our fiscal system generally would be eroded, for subsidy payments

(16) *B.S., 1981, paras, 125-150.*

(17) *B.S., 1981, paras, 258-265.*

(18) *See f.n. (12) above.*

eventually have to be financed. Thus, for example, if we were to adopt Mr. CHEN's suggestion and set up a fund from which loans were extended at below market rates to manufacturers for the purchase of plant and equipment, the contribution to recurrent revenue of earnings on our fiscal reserves would fall with ultimate consequences for our narrowly based tax system with low rates of charge. Maybe one or two arguably one-off subsidy payments would not be the end of the world, but one-off payments would inevitably become one or two on-going schemes and one or two on-going schemes would inevitably breed others, some of which might well be more justifiable in themselves than those which triggered off the change of policy. As regards Mr. WONG Po-yan's suggestion that 'leading banks (should revive) ... (their) ... (1979)scheme (of) ... preferential interest rates to industry', I can do no more than refer him to my reply to a question by Mr. TIEN in this Council on 7 January last⁽¹⁹⁾.

37. At the same time I cannot accept Mr. CHEN's claim that the manufacturing sector is 'flagging'. This claim is simply not borne out by our export performance in recent years. If some industries are 'flagging', it is because they have ceased to be competitive for one reason or another and, in order to preserve our cost-competitiveness and flexibility of response, market forces must be allowed to operate in such a way as to divert resources elsewhere. This is not to say that the Government has no role to play in the diversification of the manufacturing sector which, as Mr. WONG Po-yan reminded us, still contributes nearly 27% to the G.D.P. and employs about 40% of the labour force. Mr. WONG pointed out the progress we are making with implementing the recommendations in Chapter X of the Report of the Advisory Committee on Diversification. He focussed particularly on that rather difficult and elusive subject 'research and development'⁽²⁰⁾. The Advisory Committee's conclusion was that, in Hong Kong's

(19) See Annex (1).

(20) *The Advisory Committee's lengthy deliberations on this subject are summarized in paragraphs 439 and 440 of the Report, viz: We consider that a research and development service is required to assist manufacturers in improving existing processes and products, and in developing new ones. In this connection, we envisage the establishment of laboratories and workshops, initially to provide services in support of the metal working and metal finishing industries, but capable later of expansion to support other industries. These laboratories would be concerned with research and development work specifically in the advancement and appraisal of processes and products. Indeed, such new processes should result in improvements in the design and manufacture of existing products, as well as facilitate the development of new products.*

The emphasis of such research and development work must be client oriented. That is to say, the emphasis of such work should be to respond to a particular company's requirements or, less specifically, to the needs of a group of companies within a particular industry which has decided to collaborate in the establishment of a common facility, and to sell them improved processes and product designs at economic prices. We envisage that this work will be done typically under contractual arrangements with the eventual purchasers. It follows that the organization (or organizations) doing this work should also be equipped to provide its clients with training in the use of improved processes. Indeed, we would not rule out such development work being extended to cover turnkey operations involving the design financing, construction, equipping and trial running of the production facility to be sold. We understand that such development work is being carried out extensively in the developed countries and that it is also being carried out, albeit on a limited scale, in Hong Kong.

circumstances, research and development must be firmly focussed on what clients in Hong Kong require and must not become an end in itself.

38. Mr. WONG suggested a 'central body (should be established) ... for the planning, co-ordination and conduct of scientific and technological research and development to meet the needs of our industries'. The Advisory Committee recommended⁽²¹⁾ that the Productivity Council should become the organizational focus for improving industrial support facilities, which include research and development. The Council has put up a number of proposals, which the Industrial Development Board has considered, or is currently considering, covering various support facilities. But both the Productivity Council and the Industrial Development Board are still working out how to tackle research and development, and Mr. WONG's views will certainly be taken into account.

(8) *Management of the Economy*

39. Finally, before turning to the present state of our economy, several Members referred either generally or in specific terms to questions of management. Miss DUNN, Mr. Peter WONG, Dr. HU and Mr. Allen LEE recognized the Government's genuine commitment to the concept of the market disciplined economy and the free enterprise system and our preoccupation with the adjustment mechanism. But I must confess to some dismay that Miss DUNN and Mr. NEWBIGGING should imply that I was in danger of straying from the primrose path of positive non-interventionism by hurriedly introducing a batch of ill-thought out reform measures which might, according to Miss DUNN, 'damage the freedoms of our market place', and possibly lead, according to Mr. NEWBIGGING, to 'uncertainty as to the Government's true motives and objectives'. There is ample evidence in our past record to demonstrate that, in adapting the institutional and regulatory framework within which markets in Hong Kong operate, our 'true motives and objectives' are to secure the efficient operation of market forces. This puts our 'motives and objectives' beyond any possible reproach (*laughter*).

40. I take Miss DUNN's point about the dangers of what she labelled as 'cumulative interventionism' and I accept, without reservation, an obligation to explain each and every measure carefully, particularly when several come forward, for quite accidental reasons, together. I also take Miss DUNN's point that confidence is 'a delicate flower in Hong Kong' and I take her point for this reason: if businessmen are required to face up to the realities of the market place without any form of protection or subsidy, albeit in return for reaping attractive net rewards after tax for their risk taking function, then they need to have a precise idea as to the Government's regulatory intentions, such as they are. I might add, for the benefit of several journalists, who shall be nameless, that interventionism in our economy is *not* inevitable.

41. There will be ample opportunity for the fiscal, commercial and monetary reform measures proposed in paragraphs 278 to 296 of the budget speech

(21) *Report, paragraph 462.*

(printed version) to be debated in this Council: the several fiscal reform measures have, in accordance with our normal practice, been long-heralded⁽²²⁾. As I have already mentioned, the two Bills containing them are now before this Council and it is a fair assumption that we shall willingly consider amendments, for technical or other reasons, if persuasively argued and soundly based, and provided of course that we agreed with them (*laughter*).

42. The reform measures proposed in the field of companies law generally, and in respect of disclosure of shareholdings and dealings in shares by directors and senior executives of public companies and by major shareholders, are enshrined respectively in the Companies Bill published on 18 July 1980 and in a statement of intent by the Securities Commission issued on 3 March 1981⁽²³⁾. The Registrar General is digesting comments on the Companies Bill and will then hold consultations with Unofficial Members prior to its introduction into this Council early next year. The Securities Commission is digesting comments on the question of disclosure prior to the preparation of drafting instructions which will then be worked up into an additional part to the Companies Bill for further consideration by Executive Council. In drafting this new part to the new bill, careful consideration will have to be given to the combined effect of a disclosure requirement for major shareholders and the new trigger point arrangement introduced into the Takeovers Code for mandatory bids for minority share-holdings. Executive Council will also wish to be assured that the two main purposes of disclosure by major shareholders, whether of holdings or dealings, namely, to provide investors generally with sufficient information on which to base their decisions and to assist in discouraging insider dealing, are met without being counter-productive. Two other aspects will have to be carefully considered by the Securities Commission when drawing up drafting instructions for the Legal Department: these are the mechanism for keeping track of dealings and the dissemination of information relating to holdings and dealings.

43. Turning now, and at much greater length, to monetary reform: I introduced the Deposit-taking Companies (Amendment) Bill 1981 into this Council on 25 March last to provide for the Governor to direct the Commissioner of Deposit-taking Companies temporarily to suspend consideration of applications for registration of deposit-taking companies from noon on 17 March although, when the Bill is enacted, it is the Governor's intention to direct the Commissioner to continue to register companies which are subsidiaries of recognized banks⁽²⁴⁾.

44. Tomorrow, a bill to amend the Banking Ordinance and a bill further to amend the Deposit-taking Companies Ordinance will be published. Their two related purposes are to redefine banking business to cover, *inter alia*, the business of taking from the general public *any* moneys repayable in less than three

(22) *B.S., 1981, paragraph 101, B.S., 1980, paras. 277-278 and B.S., 1979, paras. 223-224 and paragraph 228 (and see paras. 26-27 above).*

(23) *See Annex (2).*

(24) *See Annex (3).*

months⁽²⁵⁾; and to create a new category of licensed deposit-taking companies which may take any deposits in excess of \$500,000. Registered deposit-taking companies would be restricted to taking deposits in excess of \$50,000 and for periods in excess of three months. Thus a three-tier structure would be created and the position of licensed banks in the market would be, in the future, as follows: they would continue to have a monopoly of all deposits, whatever their original term to maturity, of up to \$50,000. They would also have the sole right to take deposits with an original term to maturity of less than three months up to \$500,000. For larger deposits of any maturity, they would have to compete with the proposed new category of licensed deposit-taking companies ('merchant' or 'wholesale' banks for short). For deposits of \$50,000 or more with an original term to maturity of three months or more, they would have to compete with those deposit-taking companies not licensed as so-called 'merchant banks'.

45. Despite contrary views expressed by him on other occasions, Mr. F. W. LI had reservations about this proposal to restructure the monetary sector arguing that the present arrangements '(work) well enough (and do) not stand in need of ... change'. Mr. LI is very well aware that this question of the definition of banking business has been exhaustively considered in both the Banking Advisory Committee and the Deposit-taking Companies Advisory Committee. I am fully seized of the importance of not making mistakes, at any rate serious mistakes, in these matters: to quote Mr. LI, '(proceeding) with all due caution'. Admittedly, too, in the absence of any agreement with either of the two advisory committees which took up diametrically opposed positions—oversimplifying, the former, that is to say, the Banking Advisory Committee, arguing for a term criterion and the latter, that is to say the Deposit-taking Companies Advisory Committee, arguing for a size criterion—we officials came up with the proposal to create a three-tier system which confers on the banks the sole right to accept short-term deposits in any amount under \$500,000. This proposal has been reluctantly accepted by the banks, but noted with regret by the deposit-taking companies.

46. So there are two related questions to be asked: why create this three-tier system and why confer this right on banks? The reason is quite simple: the need to have an effective interest rate agreement. This agreement has assumed a new significance since the floating of the Hong Kong dollar, a significance which it did not have when the Hong Kong dollar had a parity relationship with the U.S. dollar, let alone when it was tied to sterling. In those days, the growth rate of the money supply was mainly determined by shifts in the net external balance. Put the other way round, deficits and surpluses in the balance of payments⁽²⁶⁾ were largely eliminated by changes in the money supply, that is to say, the adjustment mechanism operated through the money supply. Under a *floating* exchange rate

(25) *The existing definition covers, inter alia, the taking of money on current, deposit or other similar account from the general public or the collecting of cheques and the making of advances; and receiving money on savings account from the general public repayable on demand or within three months or at three months' notice or less.*

(26) *Strictly speaking, tendencies for deficits and surpluses to emerge.*

regime, such deficits and surpluses are eliminated, in theory at least, by changes in the exchange rate with little or no effect on the money supply. But in an open economy like ours, where the value of our visible and invisible trade is 2.3 times as large as the value of our G.D.P., and given the low price elasticity of demand for imports, the exchange rate changes required to correct large deficits or surpluses in the balance of payments may be too large to be tolerable. Thus, it is necessary to support the role of exchange rate changes in the adjustment mechanism by influencing the growth rate of the money supply, as determined by the demand for credit and net flows of funds across the exchanges, by appropriate adjustments to interest rates.

47. It is true that the origin of the interest rate agreement lay in the banking crisis of the early 1960s brought about by cut-throat competition for deposits and loans by the banks. Its purpose now is not so much to prevent cut-throat competition—and there are many ways in which banks and other deposit-taking institutions can compete for business amongst themselves—and to preserve to the banks a monopoly of short-term deposits as an end in itself. Rather it is to ensure that the interest rate agreement operates in respect of a substantial share of the total Hong Kong dollar deposit base so that interest rate changes are influential. If non-bank deposit-taking institutions can offer more attractive rates for short-term deposits, then some banks will seek aggressively to expand their deposit garnering activities by setting up wholly owned deposit-taking company subsidiaries, whilst others will then be forced to protect their share of the market by likewise setting up subsidiaries. This is what has happened as I shall demonstrate in a moment and the outcome has been that the effectiveness of the interest rate agreement is now seriously threatened.

48. It is true that instead of adopting a minimum term criterion in order to define banking business a minimum size of deposit criterion could have been adopted, but this would have entailed an interest rate agreement covering both banks and deposit-taking companies which would have been difficult to police, except by statute, and it is difficult to see how deposit-taking companies could survive under such an agreement. Mr. F. W. LI has quite misdirected himself when he said the purpose of the redefinition of banking business is 'to minimize the serious competition offered by (deposit-taking) companies to those banks with a significant domestic deposit base'. Rather, as I have said, it is to preserve the banks' interest rate agreement and to make it more effective by ensuring that it is applicable to the bulk of short-term deposits. The interest rate weapon is effectively our only weapon of monetary policy, that is to say, the only means at our disposal to influence the growth rate of domestic loans and advances and shifts in the net acquisition of foreign currency deposits and therefore, of the money supply.

49. It is misleading of Mr. LI to suggest that the banks have lost a proportion of the Hong Kong dollar deposit base in 'fair' competition. That is simply not the point, even if it were true. Furthermore, the *banks* will still have to compete with all registered deposit-taking companies for deposits over \$50,000 for terms

longer than three months and the new category of *licensed deposit-taking companies* (or ‘merchant’ or ‘wholesale’ banks) may have to compete with the banks for deposits in excess of \$500,000 for any term, for the interest rate agreement may be amended to restrict it to deposits of less than \$500,000 (and it is already not applicable to deposits with an original term to maturity of more than 18 months).

50. It is all very well too for Mr. LI to argue that small depositors are interest rate-sensitive as well as large depositors. The fact is the Government has to have regard to macro-economic considerations, which requires that influence can be exercised over the growth rate of the money supply *via* the creation of credit and, therefore, the Hong Kong dollar deposit base; and the Government must also have regard to the security of the monetary system as a whole, and to answer a point made by Mr. NEWBIGGING, the interests of ordinary depositors in particular, which requires a reduction in the ‘gap’ between borrowing and lending maturities and the avoidance of a rate war. Mr. LI has lent his support in the past to arguments that small depositors should be safeguarded and I am sure he would do so today. But small depositors cannot be safeguarded if the system itself is not soundly based. Free for all competition for deposits, and this could be the end result of following Mr. LI’s line, if I have understood him correctly, could put them at risk as well as the monetary system and the economy as a whole. Yet, in the absence of the Government creating an ever increasing volume of debt instruments to trade in the market and thereby act as a market leader, a cartel arrangement over which the Government can exercise influence is the only other course open to us.

51. Nor do I accept that our approach has been ‘piecemeal’; sequential yes, but not ‘piecemeal’ (*laughter*) and I have no idea what Mr. LI means when he refers to ‘mistakes’ (*laughter*). The Deposit-taking Companies Ordinance has been in operation for five years, and there are now 340 companies on the register. The rapid growth in the number on the register over the last two years, their diverse nature and other developments in the monetary sector, including the incorporation by statute of the Hong Kong Association of Banks, have all combined to make this an opportune time to reconsider the role of deposit-taking companies and that means, essentially, the question of the definition of banking business.

52. The Deposit-taking Companies Ordinance came into operation on 1 April 1976. Its original purpose was to discover the number of non-bank deposit-taking institutions in Hong Kong, recognizing that their number had been growing rapidly (for a number of reasons, including the inability of overseas banks to obtain banking licences in Hong Kong). A system of registration, as opposed to licensing, with relatively limited and easy-to-fulfil criteria, was introduced with the aim of encouraging as many existing companies as possible to register. The only prudential controls imposed on a deposit-taking company at that time were capital-related limits on loans to individual customers, or to customers connected to the company.

53. In 1978 the Ordinance was amended to require deposit-taking companies to make monthly returns to the Commissioner (implemented from end-December 1978), and to comply with a minimum liquidity requirement (implemented, after some further amendment, from 1 January 1980). These changes, and the power given to the Commissioner to inspect deposit-taking companies, reflected the Government's decision to begin exercising a more positive prudential role. But the relatively relaxed approach to registration as such has continued up until now, although proposals to tighten the criteria for registration, and to impose some additional prudential controls on deposit-taking companies, will shortly be put to Executive Council along with various proposed amendments to improve the quality of the prudential provisions of the Banking Ordinance⁽²⁷⁾.

54. Three broad categories of deposit-taking companies can be identified, although the dividing lines between these categories are not always precise: it is a matter for subjective judgment on some occasions as to which category a company should fall into.

55. The *first* category consists of 30 subsidiaries of licensed banks in Hong Kong, which are used primarily as a means of avoiding the Hong Kong Association of Banks interest rate agreement: their main function is to garner in deposits at rates of interest above those permitted by the agreement and to on-lend those deposits to their parents.

56. The *second* category consists of 180 companies doing a 'merchant' banking, or 'wholesale' banking, or quasi-banking, business. Such companies may be subsidiaries or associates of licensed banks, or subsidiaries or branches of overseas banks which have not, for one reason or another, obtained a banking licence here, or they may be subsidiaries of non-bank companies. A substantial part of their business is offshore, in currencies other than the Hong Kong dollar.

57. The *third* category consists of 130 'finance companies' which are carrying on, basically, domestic business in Hong Kong dollars, in consumer credit, hire-purchase, mortgage finance and so on and so forth. They may be owned by overseas or local interests (including some licensed banks).

58. Since the end of 1978 there has been a substantial increase in the number of credit-granting institutions in Hong Kong, with the addition of 41 deposit-garnering licensed banks and 99 deposit-taking companies: this has, to some extent, created a borrowers' market and led to many expressions of concern about the rate of expansion of the monetary aggregates, but it cannot be said too often that interpretation of presently available statistics is difficult.

59. The share of the total Hong Kong dollar deposit base held by banks has decreased from 85% of total deposits of \$70 billion at the end of December 1978 to 66% of \$139 billion at the end of February 1981. The growth in the total deposit base since the end of December 1978 has largely been caused by an increase in loans and advances in Hong Kong over the same period of \$78 billion,

(27) *Deposit-taking Companies (Amendment) (No. 3) Bill and the Banking (Amendment) (No. 2) Bill.*

or 138%. The disproportionate growth in deposits with deposit-taking companies is largely a response to the higher nominal rates of interest offered by them and the increasing interest rate-sensitivity of depositors in a period of double digit inflation, compared with the maximum rates offered by members of the Hong Kong Association of Banks: banks reacted by using subsidiary or associated deposit-taking companies to bid for deposits outside the interest rate agreement, and successfully, for the 94 companies concerned have about 75% of all deposits with deposit-taking companies; and nearly 70% of these deposits are on-lent to the parent banks (but at a higher cost to the banks and probably to borrowers too).

60. The interest rate agreement is the key to the distribution of deposits between deposit-taking companies and banks. So long as the maintenance of that agreement remains an essential element in the Government's monetary policy, the Government's aim should be to reinforce the agreement by preventing any further relative diminution of the banks' deposit base and, indeed, by rolling back some of the recent shift of funds. So the problem to be tackled is this: how can the banks' deposit base be strengthened without causing unacceptable damage to the business of deposit-taking companies? Three considerations are particularly important: *first*, the presence in Hong Kong, under a non-bank label, of a number of international banks, and the damage which their departure would cause to Hong Kong's international standing as a financial centre; *secondly*, the impact on the exchange value of the Hong Kong dollar of an outflow of 'wholesale' deposits stimulated by interest rate differentials; and, *thirdly*, the effect of withdrawing a source of funding for the domestic business of the locally owned non-bank deposit-taking companies.

61. As regards the *first*, the international consideration: 75 registered deposit-taking companies are subsidiaries or associates of banks incorporated outside Hong Kong, but not licensed as banks in Hong Kong under the Banking Ordinance. There are also 11 deposit-taking companies incorporated outside Hong Kong, which are recognized as banks in their countries of origin, or are wholly-owned subsidiaries of such banks. It is likely that, if these deposit-taking companies were not permitted to take funds in any currency of up to three months, some of them would leave Hong Kong, to operate elsewhere. If they were to stay in Hong Kong, they would find it difficult to compete with financial institutions located in other centres.

62. As regards the *second* consideration concerning the 'wholesale' market: there is a need, in Hong Kong as elsewhere, for a competitive market in which companies (and individuals) can place large deposits for short or long periods. Since, because of the existence (and necessary continuation) of the banks' interest rate agreement, 'wholesale' funds do not earn a competitive rate if they are placed with licensed banks, these funds are placed either with deposit-taking companies in Hong Kong, or with banks outside Hong Kong. The interest rate differential between euro-dollar deposits and deposit-taking company deposits is a more important influence on flows across the exchanges than is the differential between

euro-dollar deposits and bank deposits; and it would be unwise knowingly to add to these potential outflows by removing from all deposit-taking companies their ability to take large short-term deposits.

63. As regards the *third* consideration concerning the need to support the domestic credit business of deposit-taking companies owned by local interests other than licensed banks: in theory, there is no over-riding necessity for this credit function to be carried out by such deposit-taking companies. Banks are available to do such lending at rates which reflect the credit risk. In practice, if these 'finance' company deposit-taking companies were prevented from taking short-term deposits, they would not be prevented from lending: they would simply have to lengthen the maturity span of their deposits.

64. To sum up: it is this analysis and this sequence of events which led us to the conclusion that there is a case for creating a new class of deposit-taking institution, so that the business of taking deposits would in future be carried out by three distinctive classes of institution, namely, *licensed banks*, which take deposits of any maturity in the course of their banking business, but with such deposits being subject to the interest rate agreement, with the possible exception of deposits over \$500,000; *licensed deposit-taking companies*, which carry out the existing functions of deposit-taking companies, except that they would be permitted to take deposits of less than \$500,000; and *other deposit-taking companies*, which carry out the existing functions of deposit-taking companies, except that they would no longer be permitted to take short-term deposits.

65. I hope I have provided Members, Sir, and Mr. LI and Mr. NEWBIGGING in particular, with a sufficiently coherent explanation of the reasons underlying this re-structuring proposal to enable them to concentrate on the detailed provisions of the two Bills when published tomorrow and, in particular, on the transitional arrangements and the criteria to be met by those institutions seeking to be licensed as 'wholesale' deposit-taking companies.

(9) *Present State of the Economy*

66. Turning now to the present state of the economy: in working up the forecasts of expenditure on the several components of expenditure on the G.D.P. in 1981⁽²⁸⁾, I paid special attention to the implications of our experience in the second half of 1980. This is because developments in the second half of 1980 were so markedly different from those in the first half that they are likely to influence the course of our economy this year to an unusual extent. Statistics that have become available since then suggest that this is proving to be the case.

67. Taking the two significant developments identified in the budget speech in turn⁽²⁹⁾: the *first* was the slow down in the growth rate of domestic exports from 18% (in real terms, of course) in the first half of 1980 to only 5% in the second half. This slowing down process seems to have stabilized as the economy

(28) *B.S., 1981, paras. 125-150.*

(29) *B.S., 1981, paras. 119-124.*

moved into 1981⁽³⁰⁾. The value of domestic exports in the first two months of this year was 13% higher than in the first two months of 1980, suggesting a growth rate in real terms of 5%; and it seems, from an analysis of the export declarations lodged and processed so far, the growth rate in March is likely to be higher than 5%. It is too early to deduce conclusively that the growth rate of domestic exports is bottoming out, but the fact that the growth rate has ceased to fall is encouraging. I might add here that, while a growth rate of 5% or thereabouts is less than my forecast growth rate of 7% for the year as a whole, this is consistent with my expectation that our export performance will gradually improve during this year⁽³¹⁾.

68. As supplementary evidence that this expectation may be borne out, the growth rate of employment in the manufacturing sector has also shown some improvement recently. While the growth rate during the twelve months ending September 1980 was only 1.4%, the growth rate during the twelve months ending December accelerated to 4%.

69. Further, the growth rate of retained imports of raw materials and semi-manufactures has also accelerated in recent months. The year-on-year growth rate of retained imports of raw materials and semi-manufactures was 5% in real terms in the first two months of this year, compared with -2% in the third quarter of 1980 and 4% in the fourth quarter⁽³²⁾.

70. The *second* significant development identified in the budget speech was the acceleration in the growth rate of private consumption expenditure as reflected in the acceleration of the growth rate of retained imports of consumer goods (in real terms) from 22% in the first half of 1980 to 35% in the second half. The growth rate in the first two months of this year continued to be rapid at 33%, which suggests that the growth rate of private consumption expenditure has remained at least as rapid as in 1980.

(30) *Growth rates of domestic exports (%)*:

<i>Year-on-year comparison</i>	<i>In money terms</i>	<i>In real terms</i>
1980/1979:H1	33	18
H2	14	5
Q3	16	7
Q4	12	4
1981/1980:Jan.-Feb.	13	5

(31) *B.S., 1981, paras. 132-141.*

(32) *Growth rates, in real terms, of retained imports by end-use categories (%)*:

<i>Year-on-year Comparison</i>	<i>Food-stuff</i>	<i>Consumer goods</i>	<i>Fuels</i>	<i>Raw material and semi-manufactures</i>	<i>Capital goods</i>
1980/1979:H1	11	22	17	15	29
H2	9	35	3	1	13
Q3	11	34	-2	-2	6
Q4	6	36	9	4	21
1981/1980:Jan.-Feb.(*)	6	33	0	5	10

Note: () Preliminary estimates only*

71. So, with domestic demand being the more important determinant of growth, there has been an inevitable tendency for the visible trade 'gap' to widen. The 'gap' in the first two months of this year was 17% compared with 15% in the first two months of 1980, continuing the trend which became apparent in the second half of 1980; and there was also a net outflow of funds. But with the differential between interest rates in Hong Kong and in the United States narrowing⁽³³⁾, the exchange value of the Hong Kong dollar has remained fairly stable in recent months⁽³⁴⁾.

72. At the same time, the growth rates of the monetary aggregates seem to have been slowing down, but the seasonal factors involved are such that a definitive view cannot be taken at this stage. The seasonal decrease after the Lunar New Year of the public's holdings of notes and coins and, to a lesser extent, of the amount of money held by the public on demand deposit with banks, led to a decrease in M1 by 2.1% during the first two months of this year, but M2 and M3 still recorded increases of 4.5% and 5.9% respectively. To a certain extent the differences in these growth rates were the result of interest rates remaining high, despite expectations that they would fall in line with trends in U.S. dollar rates, thus affecting the distribution of deposits. The slow down in the growth rate of loans and advances is more obvious, despite seasonal factors arising from the need to pay profits and salaries taxes: during the first two months of this year, loans and advances in Hong Kong grew by 8.4%, compared with 10.5% during the previous two months. Weekly statistics collected from banks suggest a further decrease in M1 and a moderate increase in both M2 and L2 (bank loans and advances in Hong Kong) during March.

73. Although the rate of increase in prices is still fairly rapid, it seems to have slowed down in the first two months of this year. The annual rate of increase in consumer prices, for example, had slowed down to 11.4% in February 1981, compared with an annual rate of 14.3% in December 1980. The depreciation of the exchange value of the Hong Kong dollar during 1980 of nearly 5% does not appear yet to have exerted any significant effect on the rate of increase in prices over and above that arising from world inflation. Furthermore, domestic influences on the rate of increase in prices continued to be favourable for the growth rate of the supply of domestic resources continued to match or exceed the growth rate of demand. This applied in the labour market where the unemployment rate has probably continued to increase from the seasonably adjusted rate

(33)

<i>With effect from</i>	<i>Prime rate charged by leading banks in the United States (%)</i>	<i>B.L.R. in Hong Kong (%)</i>	<i>Differential (% points)</i>
<i>20 December 1980</i>	<i>21 to 21½</i>	<i>17</i>	<i>4 to 4½</i>
<i>31 January 1981</i>	<i>19½ to 20</i>	<i>17</i>	<i>2½ to 3</i>
<i>31 March 1981</i>	<i>17 to 17½</i>	<i>17</i>	<i>0 to ½</i>

(34) *The trade-weighted exchange rate index at 7 April was 88.9 compared with 88.2 at the end of December 1980, an appreciation of 0.8%*

of 3.8% recorded in September 1980. But the increase will only have been modest in view of the growth rate of employment recorded in all sectors of the economy⁽³⁵⁾.

74. In the property market, supply responses have been particularly noticeable in the case of non-residential accommodation. There was an increase in the supply of new shop space of 38% in 1980, compared with 1979; in the case of offices, there was an increase of 66%; but, in the case of flatted factories, there was a decrease of 24%, although the stock of vacant space remained high. The rapid increase in 1980 in the supply of new shop and office space has been accompanied by fairly rapid rates of increase in prices and rentals, but it is clear that the growth rate of supply caught up with that of demand by the end of the year: about 65% of the supply of new shop space in 1980 was completed in the second half of the year and 40% in the fourth quarter; and about 86% of the supply of new office space in 1980 was completed in the second half of the year and 52% in the fourth quarter. This supply response will persist for some time yet and, given that the present level of interest rates will make it very expensive for landlords to 'warehouse' their premises, a dampening effect on asking prices and rentals should soon become apparent.

75. So, overall, despite developments in the second half of 1980 causing anxiety about our immediate prospects, the economy has been adjusting favourably in the past few months, in line with the expectations underlying the budget speech forecast. The export sector is holding up extremely well in the face of generally unfavourable economic conditions in our major markets. The rate of inflation is slowing down as expected, although not as rapidly as everyone would wish. The growth rates of the monetary aggregates are also slowing down and the exchange value of the Hong Kong dollar has been stable. Growth with stability in 1981 looks to me to be not impossible of achievement.

(10) *Conclusion*

76. As this is the last time I shall wind up a budget debate, I should like to conclude by thanking Unofficial Members for their patience over the years (*laughter*). I am sure my successor will be equally well treated. As Mr. Oswald CHEUNG said it was inevitable—and, I would add, absolutely right—that we would not always be in agreement. I must also pay tribute again to my various colleagues, past and present, for their unstinting loyalty and for their instinctive understanding as good civil servants of Plato's profound truth that 'whatever be your lot, work is best for you' (*laughter*).

(35) *Growth rates of employment (%)*:

<i>Sector</i>	<i>1980 Q4 on 1979 Q4</i>
<i>Manufacturing</i>	4.3
<i>Financial and related business services</i>	16.4
<i>Wholesale and retail trades</i>	9.4
<i>Restaurants and hotels</i>	6.5
<i>Building and construction (including civil engineering)</i>	6.6
<i>Civil Services</i>	7.9

77. Sir, I beg to move.

Question put and agreed to.

Bill read the second time.

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

Adjournment and next sitting

His Excellency the President:—In accordance with Standing Orders I now adjourn the Council until 2.30 p.m. on Wednesday 29 April 1981.

Adjourned accordingly at twelve minutes to five o'clock.

Annex (1)

REPLY BY THE FINANCIAL SECRETARY TO A QUESTION
FROM MR. FRANCIS TIEN IN LEGISLATIVE COUNCIL
ON WEDNESDAY, 7 JANUARY 1981
(*on the impact of high interest rates on industry*)

Question:—Will Government consider taking steps to ease the impact of the present high interest rates on industry?

Reply:—No, Sir. It is no part of the Government's approach to the management of our economy for cost inputs to be subsidized, except indirectly where social considerations apply as they do, for example, in the case of public housing and education.

It is true that interest rates are at the moment high and affect manufacturing costs and costs generally. But, even if we had a convenient mechanism to influence the cost of borrowing, the balance of advantage lies in allowing interest rates to find their own level, which they do as Hong Kong has an open economy, a freely floating exchange rate and no exchange controls (which means incidentally that borrowers are free to seek cheaper funds offshore and would no doubt do so if they were prepared to accept the exchange exposure). As high interest rates are a world wide phenomenon at the present time interest rates here are also high by historical standards, but not relatively when compared with interest rates elsewhere. For our interest rates to be kept substantially lower than the general level in, say, North America would tend to cause funds to be moved out of Hong Kong, thus affecting the exchange rate. This would particularly be the case if the lower interest rates in Hong Kong meant that the return to lenders in Hong Kong was negative in real terms to any significant extent. In the event, the result would probably be that industry would find it increasingly difficult to borrow at all; and, incidentally, I doubt whether there would be any way of ensuring that loans extended on special terms were in fact used to finance manufacturing and not other activities.

In this latter connection, I should mention that certain banks did introduce in 1979 preferential interest rates to industry for financing imports of raw materials and capital equipment, but this arrangement lapsed when interest rates were lowered in the middle of last year. The experience gained on that occasion did indeed demonstrate that it was very difficult to identify precisely loans that genuinely qualified for preferential treatment, and to ensure that such loans were in fact used for the purpose in respect of which they were granted.

Annex (2)

PRESS RELEASE ISSUED BY THE COMMISSIONER OF SECURITIES
ON 3RD MARCH 1981
(on the disclosure of share holdings and share dealings)

Following recommendations from the Securities Commission, Executive Council advised today that legislation should be introduced requiring disclosure of share holdings and share dealings of directors, of substantial shareholders (having 10 per cent or more of the issued share capital) and of officers, senior executives and professional advisers of public companies in Hong Kong.

2. This legislation is to be introduced in order to protect the interests of shareholders and investors and, subject to the agreement of Legislative Council, will bring the law in Hong Kong into line with the requirements of other major financial centres. The proposed change in the law is particularly important on account of the increasing interest being taken by overseas investors in the Hong Kong stock market and in Hong Kong companies. The disclosure of major dealings and holdings will assist in protecting investors in the Hong Kong stock market from the distortion in share prices occasioned by, among other factors, the direction of the companies' assets by unknown interests, whether local or overseas.

3. It is considered proper that information concerning major holdings and dealings in public companies should be available to all shareholders, the directors and the investing public.

Background notes

4. There is, at present, no provision in the Companies Ordinance which requires directors, substantial shareholders and others closely connected with companies to disclose their holdings of, or dealings in, securities of those companies or their associated companies. In this respect, the law in Hong Kong differs from that generally in force overseas.

5. In its Second Report, the Companies Law Revision Committee considered the case for requiring directors, substantial shareholders (that is, persons holding 10% or more of a company's issued shares), employees and professional advisers to disclose their holdings of, and dealings in, securities of the companies concerned and their associated companies, whether directly or through nominees. A majority of the Committee recommended that such a requirement should not be introduced. However, a minority report recommended that holdings and dealings should be disclosed within 24 hours in the public registers maintained at the companies's registered offices.

6. Following speculation as to who was behind certain moves to gain control of companies in Hong Kong, the Securities Commission examined the general question of disclosure requirements. In the last two years the Commission has

become increasingly concerned about speculation centred on the acquisition and consolidation of control in the absence of any disclosure requirements.

7. The Commission appreciates that the investment climate in Hong Kong had changed significantly since the Second Report of the Companies Law Revision Committee. It also notes that, since disclosure of major and connected interests is made in both prospectuses and takeover documents, either under law or practice, it seems logical to extend this requirement.

8. The disclosure requirements should not be looked at in isolation. The Companies (Amendment) Bill was published for information on 18 July 1980 and this Bill, if it is eventually enacted, will introduce wide-ranging amendments to the Companies Ordinance. There has been considerable interest, both local and overseas, in the workings of the Takeovers Code and of the local stock market. The unification of the stock exchanges is likely to reinforce the appeal of the market as an avenue of investment. Virtually all countries with well-developed securities markets have disclosure requirements: the absence of such requirements in Hong Kong weakens the appeal of the market to serious investors and is a subject of adverse comment both in Hong Kong and elsewhere.

Annex (3)

SPEECH BY THE FINANCIAL SECRETARY IN
LEGISLATIVE COUNCIL
ON WEDNESDAY, 25 MARCH 1981
(*on the Deposit-taking Companies (Amendment) Bill 1981*)

Sir, I move that the Deposit-taking Companies (Amendment) Bill 1981 be read the second time.

2. This Bill is intended to permit the creation of a breathing space in the registration of applicants as deposit-taking companies under section 10 of the Deposit-taking Companies Ordinance which provides that the only grounds on which the Commissioner shall *refuse* to register an application are, *first*, that its issued or its paid up capital is less than \$5 million or \$2.5 million respectively; *secondly*, that the objects of the company do not include the business of taking deposits; and *thirdly*, that the name of the company contains any word in contravention of any other Ordinance or that it appears to the Commissioner that the company is not a fit and proper body to be registered.

3. The original purpose of the Ordinance, which came into operation on 1 April 1976, was to discover the number of non-bank deposit-taking institutions in business. A system of registration, with relatively limited and easy to fulfil criteria, was introduced with the aim of encouraging as many existing companies as possible to register.

4. Since 1976, the Government has adopted a more explicitly supervisory role in relation to registered deposit-taking companies, with the addition of certain prudential controls in 1978. Further prudential controls will be the subject of a bill I expect to introduce into this Council in the very near future. But no steps have hitherto been taken to *restrict* the number of companies added to the register.
5. The number of registered deposit-taking companies has risen particularly sharply in the last two years: from 241 at the end of 1978, to 269 at the end of 1979, to 302 at the end of 1980, and to 330 as at 23 March 1981.
6. This recent sharp growth in the number of registered deposit-taking companies prompted an examination of whether there is a need for some form of quantitative control over registration. Apart from the change in the original purpose of the Deposit-taking Companies Ordinance, which I have just mentioned, there are two other arguments in favour of such an approach.
7. The *first* argument is that Hong Kong now has enough deposit-taking companies to cater for its domestic needs. This is particularly valid in respect of deposit-taking companies which are not connected with banks in Hong Kong or overseas. The argument is possibly not so valid in respect of deposit-taking companies which are connected with banks *not* licensed in Hong Kong. Such companies are established here primarily to carry out offshore, rather than domestic, business and their presence here enhances Hong Kong's status as an international financial centre without adding appreciably to domestic pressures.
8. The *second* argument is that the number of companies on the register is in danger of expanding faster than the supervisory system can handle. This is a particularly relevant consideration in the context of the proposal to create a new category of deposit-taking company which I outlined in paragraphs 287 to 293 of this year's budget speech (printed version).
9. Meanwhile, uncertainty must surround the effect of the proposed amendments to the prudential provisions of the Deposit-taking Companies Ordinance and the proposal to create a new category of deposit-taking company on the number of future applications for registration and the number of companies which choose to remain on the register. It could be that the number of companies on the register could continue to expand at an unacceptable rate.
10. In all these circumstances, it is proposed to limit *temporarily* the registration of new applications in order to allow time for the impact on *existing* deposit-taking companies of the various legislative amendments, if approved, to be observed and, equally important, to allow time for the Commissioner to supervise the implementation of the new provisions of the Ordinance.
11. I turn now, Sir, to the Bill itself. *Clause 2* amends section 3 of the Ordinance to empower the Governor to give directions to the Financial Secretary and the Commissioner of Deposit-taking Companies with respect to the exercise or

performance of their respective powers, functions and duties under the Ordinance. It further empowers the Governor to direct the Commissioner to suspend the further registration of companies as deposit-taking companies and to refuse to register as a deposit-taking company any company by reference to any class or description. *Clause 3* makes a consequential amendment to section 10 of the Ordinance. *Clause 4* contains a transitional provision to authorize the Commissioner lawfully to suspend consideration of applications for registration as deposit-taking companies during the period from noon on 17 March 1981 to the date of enactment of this Bill, following which the Commissioner must comply with any direction given to him by the Governor under the new section **3B** in clause 2.

12. Sir, on 17 March 1981, you instructed the Commissioner of Deposit-taking Companies to suspend consideration of any application for registration received after noon on that day.

13. At this juncture, Sir, I should explain our attitude towards the registration of new deposit-taking companies during the breathing space, that is, until such time as a decision has been made as to whether a permanent form of quantitative control over registration is necessary and, if so, in what form. As I stated earlier, the arguments in favour of quantitative control suggest that, during the breathing space, the only applicants which should be registered as deposit-taking companies should be companies which are subsidiaries of recognized banks.

14. Accordingly, Sir, you have authorized me now to state the terms of the direction which you intend to give to the Commissioner of Deposit-taking Companies on the date of the commencement of the amendment to the Ordinance. They are as follows—

‘In exercise of the power vested in me by section 3B(2) of the Deposit-taking Companies Ordinance, you are hereby directed to refuse, under section 10(2) of the Ordinance, to register any company unless you are satisfied that—

(a) more than 50% of its voting capital is held by a bank which is recognized as such in the country or place in which it is incorporated; and

(b) such bank is adequately supervised by the prudential supervisory authorities of that country or place.’

15. I now move, Sir, that the debate on this motion be adjourned.