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Legislative Council
Panel on Financial Affairs

Minutes of special meeting held on
Friday, 11 June 1999 at 9:30 am
in the Chamber of the Legislative Council Building

Members present	**:**	Hon Ambrose LAU Hon-chuen, JP (Chairman) Hon Eric LI Ka-cheung, JP (Deputy Chairman) Hon Kenneth TING Woo-shou, JP Hon James TIEN Pei-chun, JP Hon David CHU Yu-lin Hon Albert HO Chun-yan Hon Martin LEE Chu-ming, SC, JP Hon NG Leung-sing Hon Margaret NG Hon James TO Kun-sun Hon CHEUNG Man-kwong Hon Ambrose CHUNG Wing-sum, JP Hon HUI Cheung-ching Hon Bernard CHAN Hon SIN Chung-kai Dr Hon Philip WONG Yu-hong Hon Jasper TSANG Yok-sing, JP Hon FUNG Chi-kin
Members attending	**:**	Hon LEE Kai-ming, SBS, JP Hon Fred LI Wah-ming, JP Dr Hon LUI Ming-wah, JP Hon CHAN Yuen-han Hon CHAN Wing-chan Hon CHAN Kam-lam Hon LEUNG Yiu-chung Hon Emily LAU Wai-hing, JP
Members absent	**:**	Hon Cyd Ho Sau-lan

Dr Hon David LI Kwok-po, JP
Hon Ronald ARCULLI, JP
Hon Timothy FOK Tsun-ting, SBS, JP

Public officers Attending	:	Hon D Y K TSANG, JP Financial Secretary Mr K Y TANG Government Economist Mr Philip YUNG Administrative Assistant to Financial Secretary
Clerk in attendance	:	Ms Estella CHAN Chief Assistant Secretary (1)4
Staff in attendance	:	Ms Pauline NG Assistant Secretary General 1 Ms Connie SZETO Senior Assistant Secretary (1)1

I Briefing by the Financial Secretary on the overall economic development of Hong Kong
(the First Quarter Economic Report 1999 issued on 28 May 1999; briefing material tabled at the meeting and subsequently issued vide LC Paper No. CB(1)1507/98-99)

Overall economic development of Hong Kong

Upon the Chairman's invitation, the Financial Secretary (FS) briefed Members on the economic development of Hong Kong since mid-1997. He also gave his assessment of the overall economic prospects in 1999 and beyond. The briefing was conducted with the aid of 19 charts which illustrated changes and recent developments in respect of the external trade, financial and labour sectors, the domestic economy, and the Hong Kong dollar exchange rate.

2. FS said that although the overall economic situation remained weak and the Gross Domestic Product (GDP) recorded a 3.5% drop in real terms in the first quarter of 1999, Hong Kong's economy had in fact bottomed out in the third quarter of 1998 and was on the road to recovery since then. Signs of improvement were evident in certain segments of the economy including

improved performance of exports, inbound tourism and local consumer spending, the rise in Hang Seng Index and further easing of local interest rates, as well as stabilisation in residential property market. On economic prospects, FS remarked that the recovery of the Hong Kong economy would hinge, among other things, on three factors namely, continued improvement in Mainland's exports and its entry to the World Trade Organisation (WTO), maintenance of a stable exchange rate between the Japanese yen and the US dollar and prevention of a further credit crunch in Asia, and stability in the US stock market, which would have a positive impact on Hong Kong's securities market.

(*Post-meeting note:* The revised estimate of GDP growth for the first quarter of 1999, released in August 1999, was-3.2%.)

3. Noting that the majority of East Asian economies which had been hard-hit in the Asian financial turmoil had already recorded growth in GDP, Mr CHEUNG Man-kwong enquired about the reasons for the slow recovery of the local economy and queried whether the linked exchange rate (LER) system had been a hindrance to economic revival. While Miss Emily LAU expressed concern about Hong Kong's competitiveness which seemed to remain weak vis-à-vis the speedy recovery in other Asian economies, Dr LUI Ming-wah considered it important for the Government to act proactively and requested details on concrete measures to expedite economic recovery.

4. FS remarked that due to differences in economic systems of East Asian countries, it was inappropriate to make direct comparisons on the pace of their economic recovery, which would depend on changes in the regional and global economic environment. Notwithstanding that Hong Kong's GDP still recorded a decline in real terms in the first quarter of 1999, it had reached the bottom in the third quarter of 1998 and had begun to pick up since then. On the comparative competitiveness of Hong Kong amidst other East Asian economies, FS stressed that under the LER system, downward adjustments in asset prices were inevitable. A stable exchange rate was crucial to Hong Kong's trade, the volume of which was two and a half of the times GDP. Whilst during the past two years there had been a significant decline in market rentals and consumer prices, adjustments in wages had been moderate. This in a way had helped maintain a harmonious employer-labour relationship and sustain consumer spending. He added that although sharp depreciation in currencies of East Asian economies might enhance the competitiveness of these countries' exports in the short term, rapid economic rebound would eventually put appreciation pressure on their currencies and lead to higher inflation in the long run. As far as Hong Kong's economy was concerned, its fundamentals remained strong. The LER system had underpinned the success of Hong Kong's economy and stability of the Hong Kong dollar. Hong Kong's foreign currency reserves currently stood at around US$90 billion. With prudent management of public finances, the Administration had accumulated about US$50 billion of fiscal reserves. The sound regulatory regime over the banking sector had helped the industry emerge from the crisis of

the Asian financial turmoil in good shape. Nevertheless, the Government recognized the need for Hong Kong to continue to strengthen these fundamentals and further improve its competitiveness in the long run through enhancement in productivity and cost-efficiency in both the public and private sectors.

5. On the concern about the disadvantages of having a LER system for economic recovery, FS stressed that the system was suitable for Hong Kong as a small open economy with a large external sector. Apart from having been successful in maintaining stability of the Hong Kong dollar since its introduction in 1983, the LER system had helped to prevent a possible collapse of Hong Kong's monetary and financial systems and maintain local and international confidence in the Hong Kong dollar during the Asian financial turmoil and periods of speculative attacks on the Hong Kong dollar. This stable monetary environment was essential to the economy in dampening interest rate volatility and boosting investments, thus contributing to economic revival. FS re-iterated the Administration's resolve and commitment in maintaining the LER system and dispelled the suggestion of abolishing the LER system, which might lead to an immediate confidence crisis on the local currency and open the opportunity for currency speculators to attack the Hong Kong dollar.

6. Messrs. James TIEN and Albert HO were concerned about the adverse effect of the high level of interest rates on economic recovery. Mr James TIEN particularly enquired about the assistance that could be offered to small and medium enterprises (SMEs) under the circumstances.

7. FS said that the Administration recognised the inevitable prices Hong Kong needed to pay for the LER system. Under the LER system, the local and US interest rates should largely be at par. With the return to a more stable monetary environment, Hong Kong's interest rates had declined significantly from the peaks in 1998. With the enhancement in international and local confidence in the markets and successful completion of the economic adjustment in Hong Kong, it was expected that interest rate pressure would ease further.

8. As regards the concern about assistance to SMEs and the credit crunch being experienced by them, FS remarked that the banking industry needed to review its lending policies and risk management systems with a view to diversifying its business to include more commercial lending rather than concentrate on property-related loans and enhancing the quality of assets to avoid over-exposure to volatile collateral provided by borrowers. It was also necessary for SMEs to improve their operation to adapt to the changing economic environment. Instead of switching their patronage from bank to bank on the slightest improvements in loan terms, SMEs should benefit from maintaining longer term relationship with a bank, hence allowing banks to have more confidence in the viability of their business by assessing their past performance records. On the other hand, the Government had been providing assistance to support SMEs through a comprehensive range of programmes including those

involved obtaining working capital, adoption of innovative technology and enhancing productivity, etc.

9. In view of the new competition and changes in economic environment resulting from economic recovery of neighbouring countries and the Mainland's possible entry into WTO, Mr CHAN Kam-lam asked about Hong Kong Government's strategy in adapting to and taking advantage of the new development.

10. FS advised that the Mainland's entry into WTO would benefit Hong Kong's economic revival by stimulating its economic growth. The Administration was fully aware that the new development would offer new opportunities to Hong Kong, hence a working group had been set up to study relevant issues and appropriate strategies to be adopted for Hong Kong in order to reap the maximum benefits in terms of broadening new markets for trade and promoting various service industries.

11. Noting from the First Quarter Economic Report 1999 the decrease in number of authorised institutions and the total assets held, Mr NG Leung-sing enquired about the reason for the decline and Government's assessment of the prospect of the banking industry. FS explained that the Asian financial turmoil had led to the withdrawal of a large number of second-line financial institutions from Hong Kong, particularly those that were incorporated in Japan. However, the total deposits with these institutions were comparatively small. It was envisaged that the banking environment would remain difficult in 1999. The increase in non-performing loans and bad debts in the banking sector had necessitated adjustments by the industry. Despite these problems, Hong Kong's banking system was rated as one of the healthiest and most robust in Asia by international financial rating agencies. The local banking industry was expected to be further consolidated through mergers and acquisitions among institutions, which would enhance the overall competitiveness of the industry.

12. Miss CHAN Yuen-han expressed concern about the possible deterioration of unemployment, which, coupled with the continued trend of moderating income, might dampen domestic spending and adversely affect economic recovery.

13. FS stressed that adjustments in the labour market in the form of laying-off and lowering of wages were necessary for upholding Hong Kong's competitiveness. With downward adjustments in wages progressing slowly, it was inevitable that the unemployment rate would remain at a relatively high level. Unemployment rate was an indicator which after lagged behind economic development. Thus it would not improve instantly even when the economy started to recover. The rise in unemployment rate had however tapered recently, indicating that the situation was stabilising.

14. In reply to Mr HUI Cheung-ching's enquiry about the reasons for the decrease in re-exports to the Mainland despite continued growth in the latter's import demand, the Government Economist explained that the growth in the Mainland's import was mainly due to the growth in demand for materials imports and capital equipment for infrastructure construction which were usually directly imported by the Mainland. With the Mainland's reduced demand for imported material inputs for outward processing as its exports performance slackened, Hong Kong's re-exports to the Mainland therefore recorded a further decline.

15. Responding to Mr Ambrose CHEUNG's suggestion that lowering of airport charges and enhancement in competition among airlines might help reducing operating cost, thus promoting the tourism industry, FS said that there was no direct relationship between the performance of the tourism industry and the level of airport charges and competition among airlines. On the other hand, the tourism industry had shown further improvement in the first quarter of 1999 as evidenced by a remarkable increase in the total number of inbound tourists. As regards measures to revive tourism in Hong Kong, FS advised that the Commissioner for Tourism had been appointed with the duty to promote the development of the tourism sector. The Administration was pressing on with a number of new initiatives including the proposal of constructing a Disney theme park to enhance Hong Kong's appeal as a tourist destination. The Administration and the Walt Disney Company had been engaged in discussions on the project for sometime and the Administration would report on the position by end of June 1999.

Revision of Government fees and charges

16. FS took the opportunity to inform Members of his decision announced to the media that morning about not proceeding further for the time being with consulting the Legislative Council (LegCo) in the proposal to lift the moratorium on fees and charges for Government services upon its expiry in September 1999. He said that the decision had been made taking into account concerns expressed by the public and Members of LegCo. The Administration would re-visit the issue when the year-on-year GDP growth rate turned positive. FS re-affirmed the Administration's commitments to upholding the "users pay" and "full cost recovery" principles in setting fees and charges for most Government services, improving the efficiency in the provision of Government services, and controlling expenditure growth.

17. Mr SIN Chung-kai said that he welcomed the Administration's new approach of combining various revenue proposals in the 1999-2000 Budget required to be effected through legislative amendments in the omnibus Revenue Bill which had facilitated consideration by LegCo. He opined that the Administration should incorporate Government fees and charges revision proposals in the 2000-2001 Budget so that LegCo Members would be presented

with a comprehensive picture on the revenue and expenditure proposals in considering the Budget.

18. In response, FS stressed that under the policy of prudent management of public finances, it was necessary for Government to revise fees and charges with a view to regaining fiscal balance and avoiding excessive deficits. He re-iterated that the freeze in fees and charges was only temporarily extended. The revision would have to be re-considered once the local economy recovered and GDP growth rate turned positive, the timing of which might not correspond with that of the Budget.

19. The Chairman and FS shared the view that the meeting had enhanced the communication between the Administration and Members.

II Confirmation of the draft report of the Panel 1998-99
(LC Paper No. CB(1)1494/98-99)

20. Members endorsed the draft Panel report for 1998-99 and authorized the Chairman and Panel Clerk to make necessary amendment to the report to incorporate new developments on various issues before the report would be tabled at the Council meeting on 30 June 1999.

21. The meeting ended at 11:00 am.

Legislative Council Secretariat
25 October 1999