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Foreign and Commonwealth Office

London SW1A 2AH

4 August 1984 3

*Dear Puhin,*Future of Hong Kong: Education of the Chinese

For the talks in Peking on 2 and 3 August four papers have been prepared by the British side for handing over to the Chinese. These deal with the Legal, Financial, Economic and Monetary systems of Hong Kong. A set is enclosed in case the Prime Minister wishes to glance at them at any time in August.

The papers are aimed at helping the Chinese understand how things actually work in Hong Kong. They are intentionally of a factual nature and do not attempt to argue the need for the continuation of British administration: that has been done separately in the talks. They take account of contributions from London and from the Ambassador in Peking, and were cleared with EXCO.

The Prime Minister has expressed particular interest in the educative process. The Ambassador's views on this are in Peking telno 694 (copy enclosed). In practice the Hong Kong Government are pushing this as strongly as they can. Groups and individuals from Hong Kong continue to make trips to Peking where some of them are seen by officials dealing with Hong Kong, although none have yet repeated the good performance of the young professionals. There are also occasional visits to Hong Kong by officials from China, such as a recent group of legal experts. Within Hong Kong, the Governor and the Political Adviser are getting to know the new head of the New China News Agency (NCNA), Xu Jiatur, a more senior figure than his predecessor Wang Kuang. The Governor is giving Xu a dinner later this week.

/There

SECRET



4. There are also other visits to Peking made by senior British figures in eg banking, business and political spheres. Those visiting in the near future include Lord Rhodes and Mr Heath. The Chief Justice of Hong Kong is also planning a visit to China in the Autumn.

Yours ever

(J E Holmes)

John Holmes
Private Secretary

F E R Butler Esq
10 Downing St

SECRET

Tim BF 16/8
As requested

~~CF~~
Pse prepare
a package
as proposed by FERB



10 DOWNING STREET

~~CF~~ Tree
Keep around

Tim

~~Robin~~

I don't want to trouble the PM with these over this weekend when she should be preparing for next week's seminar. No doubt she needs ^{to look at the full papers of} ~~these~~ ^{at all}. Could you pl. make up a collection of the covering letter, the

The PM took these on telegram and the four summaries, which we could show her at some convenient moment. holiday but did not FERB

look at them. I would not have thought it worthwhile diverting much time to them this weekend given the amount of other reading which the PM has to do. You might however like to take them to Balmoral.

T

THE LEGAL SYSTEM OF HONG KONG

SUMMARY

The laws of Hong Kong derive from the common and statute law of England. The common law is a mass of published judicial precedents reaching back beyond the fifteenth century, through which legal rights and obligations have been elaborately developed on a case by case basis. Personal liberty, freedom of speech and assembly, the protection of property, compensation for injury, and the right to fair treatment before the courts, are enshrined in the common law as well as other fundamental principles of constitutional and private law.

2. This process of reasoned extension and development of legal principles continues throughout the common law jurisdictions. Hong Kong shares in this organic growth. Decisions of courts in England, Canada, Australia, East Africa, Singapore and elsewhere in the Commonwealth are cited in Hong Kong courts daily. There is a right of appeal from the Courts of Hong Kong to the Privy Council in Britain.

3. Features of the common law of England, evolved during the nineteenth century to meet the needs of the Industrial Revolution, have since become the basis of mercantile law throughout the world, especially in sale, banking, insurance and shipping. Hong Kong's importance as one of the world's leading international centres of banking, investment and trade has been underpinned by the maturity and sophistication of the English mercantile law, now familiar to all those persons engaged in international trade and commerce. They know that their contracts, fiduciary dealings and investments can be protected and enforced before courts whose laws are predictable and whose judges are trained in the common law systems derived from English law. The courts are known to be independent and

their decisions can only be reviewed by superior appellate courts. Lawyers from many overseas countries and the independent legal profession in Hong Kong play an essential supportive role in maintaining confidence in the legal system. As in cases between private citizens, in cases involving the Government lawyers are bound by rules of their profession to assert and defend their clients' interest at all times. Public funds are available to ensure that legal representation is widely available. Continuity of the legal system is essential to maintain confidence.

4. Other sources of law in Hong Kong, apart from the common law, include statute law and customary law. Statute law is largely in the form of Hong Kong Ordinances and its subsidiary legislation, much of it modelled upon UK or other common law precedents. Statute law also derives from UK Acts of Parliament extended to Hong Kong either by the provisions of the Act itself or by an Order in Council, or self contained Orders in Council. Chinese customary law is applicable in Hong Kong in certain limited spheres, for example in relation to land in the New Territories.

5. In Hong Kong, as in Britain, the system of Government has three separate elements, that are all subject to the rule of law.

- (i) In general, although the initiative may come from the Governor-in-Council, the power to make new laws to add to the inheritance of English law as adapted to the needs of Hong Kong lies with the Legislative Council.

(ii) The power to implement laws rests with the Governor and with the administrative and law enforcement agencies of Government

(iii) The power to interpret, declare and enforce the law when disputes arise rests with the judges whose independence is guaranteed by law.

6. The exercise of the power to govern is itself accountable to the law. Neither the Governor, the Civil Service nor any police officer is able to exercise a power unless he can point to some authority in law for his acts. An individual can seek redress before the Courts if the power of government is exceeded or abused and has against government generally the same remedies for wrong-doing as are available against fellow citizens. The independent judiciary responsible to the law itself and not to government, will intervene to protect the rights of individuals by a variety of remedies derived from English law. And those who frame new laws are inhibited from infringing human rights or well-established legal principles declared and developed by generations of judges.

THE ECONOMIC SYSTEM OF HONG KONGSUMMARY

Hong Kong has no natural resources beyond its harbour; has very little readily usable land; and has a population of some 5.3 million. It is completely dependent on trade. Hong Kong has to export on a sufficient scale to generate the foreign exchange earnings required for the import of goods and services needed to provide its people with the improving standard of living they have come to expect on the basis of actual performance over many years. If there was a drastic reduction in trade, serious unemployment would result.

2. Hong Kong's remarkable success as an exporter depends on the international competitiveness of its products, the flexibility of its economy, its highly motivated labour force and particularly its access to the major industrialised country markets (especially USA and EEC), where it enjoys most-favoured-nation status. This access derives from the UK's accession to the GATT on behalf of its dependent territories (including Hong Kong) in 1948. By virtue of the UK's founder membership of the GATT, Hong Kong has rights and obligations under the GATT as if it too were a founder member. The link with the United Kingdom is fundamental in guaranteeing that these rights are maintained.

3. Hong Kong also enjoys as a developing territory a beneficiary status under the generalised preference scheme of the European community which was secured for Hong Kong by the UK during its negotiations for membership of the European community. Following on this, Hong Kong has been included as a beneficiary under all other major generalised preference schemes.

4. Through its success in developing the inter-dependent sectors of manufacturing, trading, and financial and related services, the Hong Kong economy, based on its free port has achieved a high average growth rate of exports and achieved one of the highest growth rates of gross domestic product (GDP) in the world over the past decade and more. In 1982, GDP per head was HK\$30,060 (just under US\$5,000, at the average exchange rate for 1982).

5. The Hong Kong economy is fully integrated into the international trading community. More recently it has become an important link in the world's free market financial system. These developments, particularly the second, would not have occurred if Hong Kong did not provide a free enterprise business environment which is backed by stable, prudent and predictable economic policies and by an internationally recognised and accepted, and impartially administered system of law. The provision of such an environment makes Hong Kong attractive to firms and to the internationally mobile managerial and professional class as a place to do business. Its continuation is necessary if this confidence is to be maintained and Hong Kong's economic growth is to be sustained.

6. Economic success depends on entrepreneurs and organisations having sufficient confidence in Hong Kong and the business environment it provides to be willing to remain here and to continue to invest in the plant and equipment needed to keep Hong Kong's manufacturing capacity up to date and growing.

7. The external orientation of the Hong Kong economy with its concomitant need to maintain the international competitiveness of Hong Kong's products puts severe constraints on the economic policies that it is feasible for the Government to adopt without damaging export growth. As a result, the Government leaves most domestic economic decision-making in private hands and thus subject to the disciplines of the market both locally and internationally. A simple tax structure with low tax rates provides incentives for the labour force to work and for entrepreneurs to invest. Apart from expenditure to meet social needs, Government expenditure is largely concentrated on the provision of the necessary economic infrastructure that only it can provide.

8. Hong Kong, because of its success as an exporter, the cornerstone of which has been the special position in the GATT derived from the UK's founder membership, because of its expertise in the services sector, and because of the international confidence that it enjoys by virtue of the systems now in force, has achieved a measure of recognition and representation at a number of international and regional economic, trading and financial institutions. A benefit of participating in these international and regional fora is that it enables Hong Kong to coordinate with developing countries in some important international trade issues, for the purpose of safeguarding Hong Kong's trade interest.

THE MONETARY SYSTEM OF HONG KONG

SUMMARY

A wide spread of businesses, both local and international, providing financial and many ancillary services, combine to make Hong Kong one of the world's leading international financial centres. The services sector contributes 25% of GDP. There are many factors which have contributed to this development, the important one being underlying confidence in the stability of government, the steadiness and predictability of its policies, and the integrity of the administration of justice. An example of this is confidence that exchange controls will not be introduced. If confidence failed, Hong Kong would quickly cease to be a financial centre since the relevant assets and people are highly mobile. Other competing regional centres, for example Singapore, would be only too ready to take over Hong Kong's lead.

2. As a financial centre it is dependent on a group of highly skilled and internationally experienced professional people who are attracted and retained by the economic, legal and social environment of Hong Kong. Without them Hong Kong's position could not be maintained.

3. The currency of Hong Kong is the Hong Kong dollar. The exchange rate floats. There is no Government undertaking to hold it fixed by reference to any other currency. There are no exchange controls. While the purpose of the Exchange Fund is to influence the exchange rate, because of the open nature of the Hong Kong financial system the Government cannot fix or hold the rate at any particular level.

4. The bulk of the Government's financial assets are held by the Exchange Fund. The Fund's assets are held mostly in foreign currencies and are managed by the Hong Kong Government under the direction of the Financial Secretary so as to provide high liquidity at all times. The British Government plays no part in the management of the Fund and gains no benefit from it.

5. Reflecting its position as a leading international financial centre and the largest in Asia, Hong Kong has a mature foreign exchange market. There is also a well-developed interbank market in Hong Kong dollars. There are four stock exchanges, which are scheduled to be unified; the stock market, which attracts substantial investment from overseas, is a significant source of new capital to the business sector. Hong Kong also has a large local gold market, as well as providing facilities for trading gold in London, and a commodities futures market.

6. As well as locally incorporated banks, international banks are widely active in Hong Kong. Of 135 licensed banks 100 are foreign based. In addition, a further 115 foreign banks maintain representative offices. There are 29 licensed DTCs and 321 registered DTCs. These institutions with assets of about \$950 billion, are active in a wide range of services including the provision of a substantial amount of finance for Hong Kong's economy and trade, which are dependent on them.

7. Banks and DTCs are supervised in accordance with the principles of supervision agreed by the Committee on Banking Regulations and Supervisory Practices which meets regularly in Switzerland.

8. The Government's instruments of monetary policy include intervention in the foreign exchange market, and influence over interest rates both through the Hong Kong Association of Banks (where the Bank of China is one of three continuing members of the Committee) and by operating in the interbank money market.

THE FINANCIAL SYSTEM OF HONG KONG

SUMMARY

The financial system of Hong Kong is based on the British Parliamentary system of open accountability on all matters of taxation and public expenditure. It is derived from authority delegated from the United Kingdom under which Hong Kong enjoys almost complete independence in practice from the United Kingdom in the management of its internal finances.

2. Under the system -

- (i) there are no hidden transfers to the United Kingdom or anywhere else;
- (ii) all fiscal measures are subject to debate and approval in the Legislative Council; and
- (iii) the budget must take into account fiscal prudence, public acceptability in Hong Kong and the need to maintain international confidence in the sound management of Hong Kong's finances.

3. The Legislative Council, in which Unofficial Members are in the majority, approves the provision of funds for each category of expenditure. The Finance Committee of the Legislative Council is composed of all the Unofficial Members of the Council and three officials. Only the Unofficial Members have a vote. The Committee is the authority for examining the draft estimates of expenditure for the following year and for approving all proposals for additional funds during the financial year.

4. The accounts are prepared by the Director of Accounting Services, Statements of Account are published monthly in the gazette. The full accounts are published annually. Both are freely available. The accounts are audited by the Director of Audit. On the basis of this audit, the Public Accounts Committee, all of whom are Unofficial Members, can summon officials to account for expenditure and makes observations on the accounts.

5. Certain principles that have been developed through experience over the years are now followed in the formation of budgetary and fiscal policy -

- (i) the growth rate of public sector expenditure has regard to the growth rate of the economy;
- (ii) the pattern of public sector expenditure reflects the Government's view of the priorities for major government programmes (e.g. housing, education, transport, social services etc.) after a wide process of public consultation and debate; and

(iii) a balance needs to be maintained between direct and indirect taxation. (It is noteworthy that out of 2.4 million wage and salary earners, only 260,000 pay any salaries tax.)

6. In 1982-83, there was a deficit of \$3.5 billion. For 1983-84 estimated expenditure is \$35.5 billion based on the maintenance of all major government programmes at at least their present levels. The estimated revenue is \$32.3 billion, giving a deficit of \$3.2 billion which will be met from reserves, prudently accumulated in earlier years.

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THE FINANCIAL SYSTEM OF HONG KONG

Hong Kong

28 July 1983

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THE FINANCIAL SYSTEM OF HONG KONGSUMMARY

The financial system of Hong Kong is based on the British Parliamentary system of open accountability on all matters of taxation and public expenditure. It is derived from authority delegated from the United Kingdom under which Hong Kong enjoys almost complete independence in practice from the United Kingdom in the management of its internal finances.

2. Under the system -

- (i) there are no hidden transfers to the United Kingdom or anywhere else;
- (ii) all fiscal measures are subject to debate and approval in the Legislative Council; and
- (iii) the budget must take into account fiscal prudence, public acceptability in Hong Kong and the need to maintain international confidence in the sound management of Hong Kong's finances.

3. The Legislative Council, in which Unofficial Members are in the majority, approves the provision of funds for each category of expenditure. The Finance Committee of the Legislative Council is composed of all the Unofficial Members of the Council and three officials. Only the Unofficial Members have a vote. The Committee is the authority for examining the draft estimates of expenditure for the following year and for approving all proposals for additional funds during the financial year.

4. The accounts are prepared by the Director of Accounting Services, Statements of Account are published monthly in the gazette. The full accounts are published annually. Both are freely available. The accounts are audited by the Director of Audit. On the basis of this audit, the Public Accounts Committee, all of whom are Unofficial Members, can summon officials to account for expenditure and makes observations on the accounts. ..

5. Certain principles that have been developed through experience over the years are now followed in the formation of budgetary and fiscal policy -

(i) the growth rate of public sector expenditure has regard to the growth rate of the economy;

(ii) the pattern of public sector expenditure reflects the Government's view of the priorities for major government programmes (e.g. housing, education, transport, social services etc.) after a wide process of public consultation and debate; and

(iii) a balance needs to be maintained between direct and indirect taxation. (It is noteworthy that out of 2.4 million wage and salary earners, only 260,000 pay any salaries tax.)

6. In 1982-83, there was a deficit of \$3.5 billion. For 1983-84 estimated expenditure is \$35.5 billion based on the maintenance of all major government programmes at at least their present levels. The estimated revenue is \$32.3 billion, giving a deficit of \$3.2 billion which will be met from reserves, prudently accumulated in earlier years.

THE FINANCIAL SYSTEM OF HONG KONG

(1) CONSTITUTIONAL AUTHORITY

(a) Introduction

The system of financial administration in force in Hong Kong -

- (i) is based on the British Parliamentary system of open accountability on all matters of taxation and public expenditure (i.e. there are no hidden transfers to the United Kingdom or anywhere else);
- (ii) requires that all fiscal measures are subject to debate in the Legislative Council; and
- (iii) requires that the Financial Secretary must tailor his budgets to take into account fiscal prudence, public opinion and acceptability in Hong Kong, and the need to maintain international confidence in the sound management of Hong Kong's finances.

2. The Governor, with the advice and consent of the Legislative Council, is empowered to enact financial legislation. Proposals in the Legislative Council for expenditure from revenue arising within Hong Kong can only be made or allowed by the Governor. It is on this authority that the Financial Secretary introduces the budget. Further control is exercised by the requirement that any proposal to dispose of, or charge, any part of the revenue or other funds of Hong Kong shall, unless moved by an ex-officio or official Member of the Legislative Council, require the recommendation of the Governor.

(b) Finance Committee

3. In accordance with Standing Order No. 60 the Legislative Council has established a Finance Committee under the chairmanship of the Chief Secretary, the other members being the Financial Secretary, one other Official Member of the Legislative Council (at present the Secretary for Lands and Works) nominated by the Governor as President of the Council, and all the Unofficial Members of the Council. The role of Finance Committee is first to examine the draft estimates of expenditure for the following financial year and second to examine proposals for supplementary provision. All matters before the Committee are decided by a majority of members, but no ex-officio Member or Official Member has a vote.

4. The draft Government estimates are laid before the Legislative Council on the day when the Financial Secretary delivers his annual budget speech. Each head is then examined in detail by the Committee and those public officers who will eventually be responsible for expenditure from those heads are summoned to appear before it for cross-examination. The Committee's recommendations on the draft estimates are then reported to the Legislative Council and on the basis of this report, the Council votes a specific sum under each head of expenditure for the service of the financial year. The votes are included in an Appropriation Bill. The Bill is usually enacted by the Council a few weeks after the beginning of the financial year to enable Members of the Council to examine the proposals further and suggest amendments, where necessary. On enactment of the Ordinance the estimates are approved.

5. The Finance Committee meets from time to time when the Legislative Council is in session to examine proposals for expenditure which are in excess of the sums provided under each subhead of expenditure in the approved estimates. If approved by the Committee each proposal is submitted to the Council for consideration and approval. If, after the end of the financial year, it is found that, as a result of the approval of sums in excess of each subhead, actual expenditure under any head of expenditure is in excess of the sum appropriated for that head by the Appropriation Ordinance, the excess is included in a Supplementary Appropriation Bill. The Bill is introduced into the Legislative Council as soon as is practicable after the end of the financial year to which it relates.

(c) Public Accounts Committee

6. In accordance with Standing Order No. 60A the Legislative Council has established a Public Accounts Committee. The Chairman and the six members of the Committee are nominated by the Governor as President of the Legislative Council, and are all Unofficial Members. The specific duties of the Committee are to consider the annual report of the Director of Audit (see paragraph 16) on the accounts of the Government for the previous financial year (as set out in the annual report prepared and published by the Director of Accounting Services) as well as any other accounts required by law to be laid before the Council and any other matters incidental to the performance of his duties or the exercise of his powers under the Audit Ordinance (Chapter 122).

7. Upon receipt of the Director of Audit's report, the Committee may cross-examine any public officer or, in the case of a report on the accounts of a non-Government organization, any member of that organization regarding the matters set out in the Director's report. The Director's report and the Committee's report are then laid on the table of the Legislative Council at the same time. Within the following three months, the Administration lays on the table a Minute which comments as appropriate on the conclusions and recommendations of the Committee's report, indicates what action the Government proposes to take to rectify any irregularities which have been brought to notice by the Committee or by the Director of Audit and, if necessary, explains why it is not intended to take action.

(2) PUBLIC SECTOR COMPONENTS(a) Expenditure

8. For the purpose of formulating annual budgetary policies, the public sector is defined in terms of the deployment of funds under the government's control. Public sector expenditure therefore comprises, expenditure from the General Revenue Account (see paragraph 12), expenditure by the Urban Council and the Housing Authority, and expenditure financed from certain statutory funds. Expenditure by institutions in the private or quasi-private sector is included to the extent it is met by government subventions. But expenditure by those organisations in which the government has only an equity position, such as the Mass Transit Railway Corporation is not included.

9. The Urban Council draws up its own budget and expenditure priorities. This expenditure is financed mainly from the Urban Council rates and from fees and charges for services provided by the council.

10. The Housing Authority is also financially autonomous. Its income is derived mainly from rents. Where cash flow is inadequate to meet the construction costs of new estates, the Authority borrows from the Development Loan Fund (see paragraph 11(c)) on concessionary terms. The authority is provided with land at nil premium, but the value of the land is shown in the Authority's balance sheet as a government contribution.

11. The statutory funds included in the public sector comprise:

- (a) The Capital Works Reserve Fund which has been established for the purpose of financing the Public Works Programme and land acquisitions. The fund's income is entirely derived from transfers from the General Revenue Account, and the amount of such transfer each year is determined in the light of available resources, particularly from the proceeds of land sales.
- (b) The Home Ownership Fund which finances the cost of land and the construction of flats for sale under the Home Ownership Scheme. The Housing Authority is the government's agent for the design, construction and marketing of these flats. The fund was initially established by a transfer from the General Revenue Account, and derives its income from the proceeds of sales of the flats.
- (c) The Development Loan Fund which is used mainly to finance social and economic developments including, in particular, loans to the Housing Authority for the construction of public housing estates. Transfers are made from the General Revenue Account to the fund to meet the loan requirements of the Housing Authority. Otherwise the fund's income is derived from interest payments and capital repayments.

- (d) The Lotteries Fund which is used to finance the development of social welfare services through loans and grants.

- (e) The Student Loan Fund which is used to finance loans to students of the two universities, the Hong Kong Polytechnic and other approved post-secondary institutions, and to Hong Kong students studying in the United Kingdom. Transfers are made as necessary from the General Revenue Account to the fund to enable the fund to meet its commitments, the only other source of funds being loan repayments.

12. Expenditure on the General Revenue Account is usually around 88 to 90 per cent of public sector expenditure taken as a whole, and the General Revenue Account is thus the main instrument of budgetary policy. It is estimated expenditure on the General Revenue Account that makes up the draft estimates of expenditure, and it is the total estimated expenditure on the General Revenue Account for which appropriation is sought in the Appropriation Bill. The estimates of expenditure contain the details of estimated recurrent and capital expenditure of all government departments, including estimated payments to subvented organisations and estimated transfers to the various statutory funds.

(b) Revenue

13. Revenue estimates for the next financial year are simply the administration's forecast of the expected yield from various revenue sources. As such, they do not require legislative approval. The various main revenue sources are set out below and are described in Annex A -

(i) Recurrent

- Earnings and profits tax
- Duties
- Rates
- Internal revenue
- Royalties and concessions
- Fines forfeitures and penalties
- Properties and investments
- Reimbursements and contributions
- Utilities
- Fees and charges

(ii) Capital

- Estate duty
- Taxis concessions
- Land
- Others

14. Hong Kong receives virtually no grants or aid from other governments or from international agencies. It transfers no revenue to any other government. All the proceeds of the revenue are used to finance expenditure on behalf of Hong Kong.

(3) MANAGEMENT: CONTROL(a) Public Finance Ordinance

15. The Public Finance Ordinance, provides a statutory framework for the control and management of the public finances of Hong Kong. The Ordinance contains provision for the proper receipt of revenues, provides authorities for expenditure and inter alia, lays down the responsibilities of Controlling Officers. Further details of the provisions of the Ordinance are contained in Annex B.

(b) Audit Ordinance (Chapter 122)

16. The audit of the government's accounts is carried out by the Director of Audit. He also audits the accounts of the Urban Council, the Housing Authority and more than 50 statutory and non-statutory funds and other public bodies, as well as reviewing the financial aspects of the operations of the government-subsidised organisations. The Director's appointment, tenure of office, duties and powers are prescribed in the Audit Ordinance (Chapter 122) and the ordinance provides that he shall not be subject to the direction or control of any other person or authority. The Director of Audit's report on the annual accounts of the government is submitted to the Governor and it is then referred to the Public Accounts Committee.

these percentages illustrate only the share of total expenditure - in terms of absolute disbursements, expenditure on all services increased substantially (and as is apparent from the figures in para. 18 above expenditure in real terms on all services has increased).

20. The third principle is that having regard to past experience a certain balance should prevail between direct and indirect taxation, and that the tax system as such should meet certain defined requirements (see Annex C, Footnote 6). One of these requirements is that the tax system should be simple and easy to administer. It is noteworthy that out of a population of 2.4 million wages and salary earners only 260,000 pay any salaries tax.

21. The ratio between direct and indirect taxes moved from 55:45 in 1978-79 to 64:36 in 1981-82 and to 69:31 in 1982-83. This drift indicates a shift in the balance between direct and indirect taxation against the latter and arose because of the higher productivity of direct taxation. The large surpluses accrued in recent years made raising taxes unnecessary. In 1983-84 additional taxation was required to reduce the estimated deficit. An increase in profits tax was felt to be inopportune because of its possible effects on investment and thus employment, and an increase in salaries tax would affect the lowest paid. The budget proposals for 1983-84 thus introduced additional indirect taxes, based on expenditure rather than income, and as a result the ratio of direct to indirect taxation at 60:40 reverted to a balance which past experience suggested was desirable.

(4) MANAGEMENT: BUDGETARY AND FISCAL POLICY

17. Certain principles that have been developed through experience over the years are now followed in the formation of budgetary and fiscal policy. The first of the principles is that the growth rate of public sector expenditure should have regard to the growth rate of the economy. Clearly it should not exceed the growth rate of the GDP by a large margin, but actual margins require sensitive year to year adjustments in accordance with the overall state of the economy (The public sector may be defined with reference to the Consolidated Account, which covers all expenditure financed from public funds irrespective of who incurs the expenditure (see Annex C, Footnote 1)).

18. The average annual growth rate of expenditure on Consolidated Account in real terms for the five years 1978-79 to 1982-83 was 13.9%, and of Gross Domestic Product (GDP) was 9.5% (see Annex C, Footnote 2).

19. The second principle is that the pattern of public sector expenditure should reflect the Government's conscious view as to priorities. The determination of priorities involves a wide process of marshalling advice from representative bodies in the community and consultation within the administration. Between 1978-79 and 1982-83 the pattern changed, with the proportion of total expenditure absorbed by community services (see Annex C, Footnote 3) increasing from 25.5% to 28.7% as greater emphasis was placed on such services as transport, civil engineering and land production. The share of expenditure of the social services group (see Annex C, Footnote 4) decreased from 42.8% to 40.5%. The proportion of total expenditure absorbed by all other services (see Annex C, Footnote 5) decreased as a result from 31.7% to 30.8%, but

22. The fourth principle is that certain guidelines (see Annex C, Footnote 7) should be borne in mind in preparing the annual estimates of revenue and expenditure so as to ensure the financing of the capital account. In 1978-79 recurrent expenditure absorbed 72% of recurrent revenue, leaving a sufficient surplus to meet 78% of capital expenditure in that year. The surplus on recurrent account improved until 1981-82 when recurrent expenditure only absorbed 68% of recurrent revenue. This satisfactory trend was reversed in 1982-83 when recurrent expenditure absorbed 82% of recurrent revenue. Despite the improving trend between 1978-79 and 1981-82, the share of capital expenditure met from the surplus on recurrent account fell from 78% in 1978-79 to 41% in 1982-83. This was because capital expenditure increased by three times over the same period. Capital revenue continued to produce high yields until 1981-82 which more than covered the excess. The relative decline of capital revenue in 1982-83 coupled with further growth in capital expenditure and a reduced recurrent account surplus combined to produce a budget deficit.

(5) 1982-83 PERFORMANCE

(a) General Revenue Account

23. In 1982-83, total revenue on General Revenue Account was \$31.1 billion, comprising recurrent revenue of \$24.9 billion and capital revenue of \$6.2 billion. Total gross expenditure on the General Revenue Account was \$34.6 billion (against an estimate of \$35.5 billion), comprising recurrent expenditure of \$20.5 billion (against an estimate of \$19.5 billion) and capital expenditure of \$14.1 billion (against an estimate of \$16.1 billion). There was a deficit of \$3.5 billion. A breakdown of actual revenue and expenditure on General Revenue Account is at Annex D.

(b) Surplus and deficit on General Revenue Account

24. With only three exceptions, the General Revenue Account has shown a surplus at the end of each year in the past 20 years. The exceptions were 1965-66 when a deficit of \$137 million occurred, 1974-75 when there was a deficit of \$380 million and in 1982-83, which showed a deficit of \$3.5 billion. The deficit in 1982-83 was largely accounted for by a sharp fall in revenue from land transactions, which amounted to \$5.0 billion against an estimate of \$12.5 billion, and by a decline in interest rates and therefore in earnings from Government assets (from an estimate of \$4.1 billion to \$2.6 billion). At March 31 1983 the surplus on the General Revenue Account was \$19.1 billion (which may be contrasted with the public debt of \$312 million).

(c) Consolidated account

25. Expenditure on Consolidated Account (See Annex C, Footnote 1) in 1982-83 was \$35.5 billion, net of transfers from General Revenue Account to the funds, grants from General Revenue Account to the Urban Council and Asian Development Bank loan repayments. Public works and land acquisition are funded through the Capital Works Reserve Fund. Owing to wet weather, expenditure on capital works was \$7.6 billion against an estimated \$8.4 billion.

(d) Consolidated account as a proportion of
Gross Domestic Product

26. In 1982-83 expenditure on consolidated account represented 22.6% of the Gross Domestic Product.

(6) 1983-84 ESTIMATES

27. A summary of the Financial Secretary's budget is at Annex E. Briefly -

- (a) The estimate of total revenue for the General Revenue Account is \$32.3 billion, the estimate of expenditure is \$35.5 billion and the deficit for the year is estimated at \$3.2 billion (Annex D).
- (b) As regards the balance of the fiscal system, the ratio of direct to indirect taxation will be 60:40, a significant improvement on the ratio of 69:31 in 1982-83.
- (c) The budget proposals largely comply with the budgetary guidelines that is to say increased recurrent revenue will cover 78% of total expenditure, and the surplus on recurrent account will cover 38% of capital expenditure.
- (d) Total public sector expenditure on Consolidated Account is estimated at \$42.5 billion. This is an increase in money terms of \$7.0 billion, or 19.6%, over actual expenditure of \$35.5 billion in 1982-83. In real terms, it represents an increase of about 10%.

(e) Consequently the relative size of the public sector will remain unchanged at 24% of GDP (and estimated deficit on consolidated account will be only of the order of 2.5% of the GDP).

SOURCES OF REVENUE

(1) Internal revenue

The Inland Revenue Department collects the taxes, duties and fees making up the internal revenue. These consist of

(i) Business registration fees.

Business registration is compulsory for every company incorporated in Hong Kong, every overseas company with a place of business in Hong Kong, and every business operating in Hong Kong.

(ii) Entertainments tax.

Entertainments tax is imposed on the price of admission to cinemas and race meetings.

(iii) Estate duty.

Estate duty is imposed on that part of a deceased's estate which is situated in Hong Kong.

(iv) Hotel accommodation tax.

Hotel accommodation tax is imposed on hotel and guest house accommodation.

(v) Earnings and profit tax.

(See below)

(vi) Betting duties.

Betting duty is imposed on authorized totalizators and lotteries.

(vii) Air passenger departure tax.

2. Earnings and profits tax is levied under the Inland Revenue Ordinance (Chapter 112) using a schedular system of taxation whereby persons liable are assessed and required to account for tax on four separate and distinct sources of income, namely business profits, salaries, property and interest. Superimposed is a form of aggregation called personal assessment whereby a person can voluntarily elect to be assessed on his total Hong Kong income from these sources.

3. Profits tax is charged only on profits arising in, or derived from, Hong Kong from a trade, profession or business carried on in Hong Kong. Profits of unincorporated businesses are taxed at 15 per cent while profits of corporations are taxed at $16\frac{1}{2}$ per cent. There is a system of provisional payment of tax based on the profits of the preceding year of assessment. Profits assessable to profits tax in Hong Kong are the net profits. Generally, all expenses incurred in the production of assessable profits are deductible, as are charitable donations to the extent of 10 per cent of net assessable profits. There is no withholding tax on dividends paid by corporations, and dividends received from corporations are exempt.

4. Salaries tax is charged on emoluments arising in, or derived from, Hong Kong. The basis of assessment and the system of payment is similar to that under profits tax. Tax payable is calculated on a sliding scale which varies from 5 per cent to 25 per cent on \$10,000 segments

of net income. However, the overall effective rate is restricted to a maximum of 15 per cent of income before the deduction of various personal allowances for the tax payer and his dependents. Apart from expenses necessarily incurred in the production of income, and charitable donations up to 10 per cent of taxable income, there are no other allowances.

5. Property tax is charged on the owner of land and/or buildings in Hong Kong at the standard rate of 15 per cent on an amount calculated by reference to actual rent received, less an allowance of 20 per cent for repairs and maintenance. There are exemptions in respect of property occupied by an owner for residential purposes, vacant premises, premises owned by clubs and trade associations, for certain ancestral property, and for property in certain undeveloped parts of the New Territories. If the property is owned by a person carrying on a trade or business and is occupied by him for business purposes, the amount of property tax paid may be deducted from the profits tax payable. Property owned by corporations carrying on business in Hong Kong is exempt from property tax; however, the profits derived from the ownership is chargeable to profits tax.

6. Interest tax is normally deducted at source through a withholding system at 15 per cent on interest arising in, or derived from, Hong Kong. However, interest paid, on a foreign currency deposit is exempt from interest tax, and the tax rate in respect of interest payable on a Hong Kong currency deposit is 10 per cent, provided such deposits are made with financial institutions carrying on a business in Hong Kong. Interest received by a corporation carrying on a business in Hong Kong is chargeable to profits tax. There is exemption for interest paid by the government, and by licensed banks and public utilities provided it does not exceed a specified rate which varies from time to time.

7. Personal assessment is a form of relief from the full impact of the standard rate. A taxpayer in receipt of earnings and profits, normally taxed at 15 per cent on each separate source, may voluntarily elect to be assessed on total Hong Kong income. In addition to the allowances and sliding scale of rates applicable to salaries tax, any business loss is deductible before arriving at the amount on which tax is payable.

8. The Stamp Duty Ordinance (Chapter 117) imposes fixed and ad valorem duties on different classes of documents relating to assignments of immovable property, leases and share transfers.

(2) Rates

9. Under the provisions of the Rating Ordinance (Chapter 116), rates are levied on the occupation of landed property at a percentage of the assessed rateable value determined annually by resolution of the Legislative Council. General rates are charged at $5\frac{1}{2}$ per cent of the rateable values of tenements and Urban Council rates at 8 per cent of rateable values in the urban areas. A standard general rate of $13\frac{1}{2}$ per cent is also charged in the New Territories. No Urban Council rates are levied in the New Territories because the Council has no jurisdiction there. Rates are payable quarterly in advance but the government generally provides financial assistance towards the payment of rates to approved educational, charitable and welfare organisations. No refund of rates is allowed for vacant domestic premises, but half of the rates paid may be refunded in the case of vacant non-domestic premises.

(3) Duties

10. There is no general tariff on goods entering Hong Kong but, under the provisions of the Dutiable Commodities Ordinance (Chapter 109), duties are charged on four groups of commodities - alcoholic liquors, tobacco, certain hydrocarbon oils and methyl alcohol - irrespective of whether they are imported or manufactured locally. All firms engaged in the import, export, manufacture or sale of dutiable commodities must be licensed.

(4) Land transactions

11. Revenue from land transactions comprises sales of land by private treaty, grants of modifications of existing leases, and re-grants of expired non-renewable leases.

(5) Other revenue

12. Other revenue arises from taxes for the registration of motor vehicles, fines, forfeitures and penalties, royalties and concessions, yields from properties and investments, reimbursements and contributions, government utilities, and from fees and charges for the provision of a wide range of goods and services.

THE PUBLIC FINANCE ORDINANCE(1) General Revenue

Moneys received for the purposes of the Government shall form part of the general revenue (section 3). No expenditure may be charged on the general revenue without statutory authority (section 4). The general revenue is described in the Ordinance as being a part of the "public moneys" the custody of which is governed by detailed provisions (in Part IV).

(2) Authority for expenditure

2. The Ordinance provides that the Appropriation Bill shall be introduced into the Legislative Council at the same time as the estimates of expenditure are laid (section 6).

3. In order to underline the authority of the approved estimates, the Ordinance provides that the estimates shall be deemed to have been approved upon the enactment of the Appropriation Bill, and further lays down that expenditure shall be arranged in accordance with the heads and subheads of the approved estimates, and shall be limited by the provision in each subhead (section 6).

(3) Changes to the estimates

4. The Ordinance gives Finance Committee powers to approve not only supplementary provisions, but also all changes to the estimates (section 8). Changes may include

the creation of new heads or subheads of expenditure, supplementary provision in approved or new subheads, variations in the establishments of civil service posts and increases in the limit to the commitments which may be entered into in respect of expenditure which is not annually recurrent. The Ordinance makes it clear that Finance Committee's approval is required for all such changes to the estimates.

(4) Delegations

5. The Ordinance provides Finance Committee with statutory powers to approve changes to the estimates and to delegate these powers to the Financial Secretary. It also enables the Financial Secretary further to delegate his powers to any public officer where the delegation from Finance Committee provides for him to do so. The use of such powers must be reported to Finance Committee at the end of each quarter (section 8) and at the same time a summary of all changes tabled in the Legislative Council.

(5) Vote on account

6. To give Members of the Legislative Council sufficient time to examine the draft estimates, the third reading of the Appropriation Bill is set at a date well into the new financial year and the Appropriation Ordinance is not normally enacted until the end of April or early May. To enable Government services to continue between April and the enactment of the Appropriation Ordinance, a vote on account is sought by Resolution (section 7).

(6) Statutory charges

7. A statutory charge on general revenue may be defined as one which, in order to be met, does not require the separate appropriation of funds by the Legislative Council. The practice is to seek appropriation each year for the total estimated expenditure including estimated expenditure in respect of statutory charges, because it is simpler, and more convenient, to show total estimated expenditure in one place, and to give the Legislative Council a comprehensive picture including statutory charges (section 5).

(7) Controlling officers

8. Controlling officers are accountable for the public funds which they control, and the Ordinance lays down the main duties of controlling officers, and makes them personally responsible and accountable for expenditure under their control (sections 12-14).

9. The Ordinance gives authority for Controlling Officers to incur expenditure urgently, where time does not permit of authority being obtained in the normal way (section 15). Retrospective approval must be sought.

(8) Director of Accounting Services

10. The Director of Accounting Services is responsible for the compilation and supervision of the accounts of the Government. He publishes statements of account monthly in the gazette and full accounts annually. These are generally available. He is also responsible for the management of accounting operations and procedures, and for ensuring that all regulations, directions or instructions made or given under the Ordinance are complied with. He is the authority for making payments against expenditure incurred in accordance with the estimates of expenditure and for bringing to account all moneys received by the Government (section 16).

(9) Payments

11. Part IV of the Ordinance stipulates that no officer may make any payments from public funds except in accordance with a warrant or direction issued by the Financial Secretary or in accordance with an enactment (section 18).

12. The Ordinance provides for six types of warrant, namely general, vote on account, supplementary, advances, contingencies and imprest, to authorize expenditure.

(10) Funds

13. The Ordinance provides for the Legislative Council to establish funds by Resolution for a specific purpose, and existing funds so established are deemed to have been established in accordance with the Ordinance (section 29). These funds comprise the Development Loan Fund, the Capital Works Reserve Fund, the Lotteries Fund, the Student Loan Fund, the Home Ownership Fund and the Mass Transit Fund. Additionally there exists a Special Coin Suspense Account set up by Resolution and the Colonial Treasurer Incorporated Suspense Account for dealing with the management of property, the leases of which have expired.

(11) Surcharge

14. Part V of the Ordinance deals with the authorities and procedures for the surcharge of public officers responsible for a loss of public moneys or property, or for a failure to collect revenues. Deductions of surcharge are limited to 50% of an officer's monthly salary or pension.

FOOTNOTES

- (1) The Consolidated Account (CA) comprises expenditure by
- (a) the Urban Council,
 - (b) the Housing Authority,
 - (c) expenditure financed by statutory funds (Capital Works Reserve Fund, Development Loan Fund, Home Ownership Fund, Lotteries Fund and Student Loan Fund),
 - (d) expenditure on public works projects financed with loans from the Asian Development Bank,
 - (e) all expenditure charged to the General Revenue Account.

So expenditure by institutions in the private or quasi-private sector is included to the extent of their subventions. The activities of Government departments which are partly financed by charges raised on a commercial basis are also included (e.g. Airport, Waterworks). But not included is expenditure by those organizations, including even statutory organizations, in which the Government has only an equity position, such as the Mass Transit Railway Corporation.

(2) Growth rates in real terms:

<u>Year</u>	<u>C.A. expenditure</u> (%)	<u>G.D.P.</u> (%)
1978-79/1978	21.0	10.3
1979-80/1979	7.0	12.8
1980-81/1980	17.8	11.7
1981-82/1981	14.1	10.9
1982-83/1982	10.1	2.4
average rate p.a.	13.9	9.5

(3) Community Services: Transport, land and civil engineering, environmental protection, water, public safety, recreation, culture and amenities.

(4) Social Services Group: Education, medical, housing, social welfare, and labour.

(5) Other Services

Administration, support, public relations, revenue collection and financial control and unallocable expenses.

Defence, immigration, law and order.

Food supply, aviation and shipping, trade and industry and posts and telecommunications.

(6) The requirements are -

- (a) to help generate sufficient recurrent revenue to finance a major proportion of a given level of total expenditure and to maintain fiscal reserves at a satisfactory level;
- (b) 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;
- (c) that the laws governing the tax system are adapted from time to time to make them compatible with changing commercial practices;
- (d) that each and every levy is simple and easy (and therefore inexpensive) to administer for both the Government and the taxpayer, and does not encourage evasion;
- (e) that the tax system is equitable as between different classes of taxpayers or potential taxpayers and between different income groups; and
- (f) that, exceptionally, the tax system is capable of being used to achieve non-fiscal objectives when necessary.

(7) The guidelines are -

<u>Guideline</u>	<u>Ratio</u>	<u>1982-83</u> <u>Outturn</u>	<u>1983-84</u> <u>Estimate</u>
(1) <u>Recurrent revenue</u> <u>Total expenditure</u>	At least 77%	79%	78%
(2) <u>Recurrent expenditure</u> <u>Recurrent revenue</u>	No more than 85%	82%	83%
(3) <u>Surplus on recurrent account</u> <u>Capital expenditure</u>	At least 33%	41%	38%
(4) <u>Recurrent expenditure</u> <u>Total expenditure</u>	No more than 65%	65%	65%
(5) <u>Capital revenue</u> <u>Capital expenditure</u>	At least 20%	57%	28%

REVENUE AND EXPENDITURE ON
GENERAL REVENUE ACCOUNT

REVENUE

<u>Recurrent</u>	1982-83 Actual \$ million	1983-84 Estimate \$ million
Earnings & profits tax	11,849	11,961
Duties	1,246	3,000
Rates	697	1,077
Internal revenue	2,707	3,265
Motor vehicle taxes	384	550
Royalties and concessions	256	274
Fines, forfeitures and penalties	293	450
Properties and investments	2,957	2,933
Reimbursements and contributions	824	699
Utilities	1,841	1,956
Fees and charges	1,828	2,528
	<hr/>	<hr/>
Total recurrent revenue	24,882	28,693
 <u>Capital</u>		
Estate duty	313	220
Taxi concessions	268	250
Land	5,048	3,000
Others	587	107
	<hr/>	<hr/>
Total capital revenue	6,216	3,577
Total revenue	31,098 =====	32,270 =====

EXPENDITURE

	1982-83 Actual \$ million	1983-84 Estimate \$ million
<u>Recurrent</u>		
Personal emoluments	7,479	8,220
Personnel related expenses		
Pensions	742	871
Other	809	1,068
Departmental expenses	2,559	3,017
Other charges		
Additional commitments	-	1,300
Defence costs agreement	1,061	1,059
Public debt	24	30
Other	2,527	2,580
Subventions		
Education	2,989	3,104
Medical	725	789
Miscellaneous	294	332
Social welfare	267	352
University and Polytechnic Grants Committee	898	961
Vocational Training Council	125	125
Total recurrent expenditure	20,499	23,808
<u>Capital</u>		
Plant, equipment and works		
Defence costs agreement	64	114
Other	620	793
Other Non-Recurrent		
Additional commitments	-	200
Public debt	24	38
Other	309	111
Subventions		
Education	101	185
Medical	68	126
Miscellaneous	17	5
Social welfare	-	11
University and Polytechnic Grants Committee	133	211
Vocational Training Council	9	6
Transfers to Funds		
Capital Works Reserve Fund	10,800	8,000
Development Loan Fund	1,850	1,750
Student Loan Fund	104	117
Total capital expenditure	14,099	11,667
Total expenditure	34,598	35,475
Deficit	=====	=====
	3,500	3,205
	=====	=====

EXTRACTS FROM FINANCIAL SECRETARY'S BUDGET 1983-84(1) Estimates of expenditure

1. Internal guidelines for the 1983-84 budget limited the growth rate in public sector expenditure to about 10% in money terms. This involved a limit to total expenditure, taking the General Revenue Account and the Capital Works Reserve Fund together, of about \$36.5 billion.

2. The estimates provide for total expenditure of \$35.5 billion; but this figure includes a transfer of \$8 billion to the Capital Works Reserve Fund, whereas expenditure from the Fund is estimated at \$9.3 billion. Taking the General Revenue Account and the Capital Works Reserve Fund together, total expenditure is estimated at \$36.8 billion or only very slightly in excess of the 10% limit set.

3. On recurrent account, the provision of \$23.8 billion represents an increase of \$3.3 billion, or 16%, on the amount spent in 1982-83.

4. Personal emoluments at \$8.2 billion account for just under 37% of recurrent expenditure, compared with an average of nearly 38% over the past five years. This provision does not make allowance for a civil service salary adjustment, funds for which will come from the additional commitments vote. The provision for this is \$1.3 billion, which is for all unforeseen commitments not provided for in the estimates.

5. The approved establishment of civil service posts is 144,500. This includes 6,670 new posts created during 1982-83. The estimates provide for an increase of 6,700 posts, or 4.6%. The aim is to keep civil service growth overall to below 5%.

6. Personnel related expenses at \$1.9 billion account for 8.6% of recurrent expenditure compared with an average of 5.8% over the past five years. This increase is due principally to home purchase allowances payable to civil servants joining the home purchase scheme and to an increase in the number of pensioners.

7. Departmental expenses and other charges at \$6.7 billion account for about 30% of recurrent expenditure, which is about the same as the average proportion over the past five years.

8. Provision of \$5.7 billion for subventions represents 25% of recurrent expenditure, compared with an average of 26% over the past five years.

9. On capital account, the approved provision is \$11.7 billion. This includes \$8 billion for transfer to the Capital Works Reserve Fund, but excludes expenditure of \$9.3 billion which will be a charge on the Fund. Total capital expenditure from the General Revenue Account and the Capital Works Reserve Fund taken together is \$13 billion, which represents an increase of \$2.0 billion or 18.8% on actual expenditure for 1982-83.

10. Provision of \$1.8 billion is for transfer to the Development Loan Fund for on-lending to the Housing Authority. For all other components of the capital account provision of \$1.9 billion is sought, including \$200 million for additional commitments.

(2) Capital Works Reserve Fund

11. Provision of \$8 billion is for transfer to the Capital Works Reserve Fund. This, taken together with a surplus of \$3.2 billion in the Fund at the end of 1982-83, is sufficient to cover estimated expenditure of \$9.3 billion from the Fund and to leave a surplus of \$1.9 billion at the end of the financial year.

12. The estimated expenditure from the Fund on the Public Works Programme is \$7.6 billion, an increase of \$1,021 million or 15% over actual expenditure for 1982-83. On land acquisition the estimated expenditure is \$1.7 billion, compared with actual expenditure of \$1.0 billion for 1982-83.

13. The outstanding commitment in respect of projects in hand on 1st April 1982 was about \$26 billion. This was increased by about \$3.3 billion as a result of the injection of new projects during 1982-83, but reduced by roughly \$6.5 billion in expenditure. During 1983-84 work is scheduled to start on new projects of a value of about \$4.6 billion. The overhang on 1st April 1983 was \$27.4 billion. After allowing for the estimated expenditure during 1983-84 of \$9.3 billion, the outstanding commitment at 1st April 1984 will be \$18.1 billion, but will certainly be much higher as further new works are approved during the year.

14. Every effort has been made to accommodate in the programme of works for 1983-84 all land production and transport projects that are ready to proceed. The priority given to these and to public housing is reflected in the breakdown of expenditure on Consolidated Account. The estimated total expenditure on transport, roads, civil engineering, and land is \$7 billion, which is 16.3% of total Consolidated Account expenditure, compared with \$1.8 billion or 14.7% in 1978-79.

15. Government gross land production in 1983-84 is estimated to be 669 hectares compared with 676 hectares in 1982-83. Over the three years of the new forecast period 1984-85 to 1986-87 it is estimated to total 2,336 hectares.

(3) Public Housing

16. Within the total Consolidated Account expenditure on housing, \$3.7 billion will be spent on the actual construction of housing, including temporary housing areas. This is about the same as actual expenditure for 1982-83, to some extent reflecting a lower Tender Price Index. These figures exclude the value of land used by the Housing Authority for rental housing and for flats built under the Home Ownership Scheme sold after early 1982.

17. The Government's policy is that the public housing programme should achieve a level of production of at least 35,000 flats a year for both rental and sale by the Housing Authority, with a substantial addition by the Housing Society (through the development of rental housing and the Urban Improvement Scheme) and the Private Sector Participation Scheme. The forecast of production in the four years 1983-84 to 1986-87 of 143,800 flats exceeds production in the previous four years by 4,314 flats. These production figures do not include 2,602 Housing Society flats and 17,826 Private Sector Participation Scheme and Middle Income Housing Programme flats expected to come on stream during the same four-year period, achieving an average completion rate of 41,000 a year or 164,228 flats in the next four years.

18. Under the Home Ownership Scheme, 30,100 flats out of a total of about 42,100 flats in the first five phases will have been completed by the end of 1983-84. Work will be in hand on the balance and on a further 16,800 flats in Phases VI and VII.

19. The value of land is excluded from the calculation of the selling price of flats produced under the Home Ownership and Private Sector Participation Schemes and the Middle Income Housing Programme to keep them within the means of the potential purchasers.

(4) Revenue Estimates

20. The Revenue Estimates are \$32.3 billion, including \$28.7 billion in recurrent revenue and \$3.6 billion in capital revenue.

21. Recurrent revenue at \$28.7 billion is \$3.8 billion higher than the actual recurrent revenue for 1982-83. Earnings and profits tax are expected to yield \$12 billion. Increases are also expected from indirect taxes, mainly from the yield from the General Rate, from duties and from motor vehicle taxes. Revenue from properties and investments is expected to be \$2.9 billion or \$24 million lower than actual revenue from this source in 1982-83.

22. Services provided by the Government, and in particular the public utility-type undertakings, are not normally subsidized. Fees and charges are kept up to date.

23. The estimate of capital revenue at \$3.6 billion reflects the current state of the property market. For land transactions in 1983-84 revenue of \$3 billion is estimated, compared with actual revenue of \$5 billion for 1982-83 and \$9.7 billion for 1981-82.

24. The estimate of \$3 billion is based upon an assessment of the prices likely to be realized from the individual lots making up the land sales programme for 1983-84. That is to say, a view has been taken of the premia likely to be realized. This view is of necessity subjective. The 1983-84 land sales programme comprises 96.7 hectares of land, on which the revenue from premia is estimated at \$1.7 billion.

25. Revenue of \$1 billion is expected from private treaty grants and \$270 million from modifications and re-grants. Much depends, however, on premia anticipated from sites to be granted to the Mass Transit Railway Corporation for joint development.

(5) New revenue measures

26. In view of the deficit for 1982-83 and the anticipated deficit for the following year, the Financial Secretary raised taxes and charges on motor vehicle licences, business and companies registration fees and duties on liquor, tobacco, hydrocarbon oils, hotel accommodation, mooring buoy dues, bank licences, and betting. An airport departure tax was also introduced. The additional revenue yield is anticipated to be \$3 billion.

CONFIDENTIAL **機密**

THE MONETARY SYSTEM OF HONG KONG

Hong Kong

29 July 1983

CONFIDENTIAL **機密**

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THE MONETARY SYSTEM OF HONG KONGSUMMARY

A wide spread of businesses, both local and international, providing financial and many ancillary services, combine to make Hong Kong one of the world's leading international financial centres. The services sector contributes 25% of GDP. There are many factors which have contributed to this development, the important one being underlying confidence in the stability of government, the steadiness and predictability of its policies, and the integrity of the administration of justice. An example of this is confidence that exchange controls will not be introduced. If confidence failed, Hong Kong would quickly cease to be a financial centre since the relevant assets and people are highly mobile. Other competing regional centres, for example Singapore, would be only too ready to take over Hong Kong's lead.

2. As a financial centre it is dependent on a group of highly skilled and internationally experienced professional people who are attracted and retained by the economic, legal and social environment of Hong Kong. Without them Hong Kong's position could not be maintained.

3. The currency of Hong Kong is the Hong Kong dollar. The exchange rate floats. There is no Government undertaking to hold it fixed by reference to any other currency. There are no exchange controls. While the purpose of the Exchange Fund is to influence the exchange rate, because of the open nature of the Hong Kong financial system the Government cannot fix or hold the rate at any particular level.

4. The bulk of the Government's financial assets are held by the Exchange Fund. The Fund's assets are held mostly in foreign currencies and are managed by the Hong Kong Government under the direction of the Financial Secretary so as to provide high liquidity at all times. The British Government plays no part in the management of the Fund and gains no benefit from it.

5. Reflecting its position as a leading international financial centre and the largest in Asia, Hong Kong has a mature foreign exchange market. There is also a well-developed interbank market in Hong Kong dollars. There are four stock exchanges, which are scheduled to be unified; the stock market, which attracts substantial investment from overseas, is a significant source of new capital to the business sector. Hong Kong also has a large local gold market, as well as providing facilities for trading gold in London, and a commodities futures market.

6. As well as locally incorporated banks, international banks are widely active in Hong Kong. Of 135 licensed banks 100 are foreign based. In addition, a further 115 foreign banks maintain representative offices. There are 29 licensed DTCs and 321 registered DTCs. These institutions with assets of about \$950 billion, are active in a wide range of services including the provision of a substantial amount of finance for Hong Kong's economy and trade, which are dependent on them.

7. Banks and DTCs are supervised in accordance with the principles of supervision agreed by the Committee on Banking Regulations and Supervisory Practices which meets regularly in Switzerland.

8. The Government's instruments of monetary policy include intervention in the foreign exchange market, and influence over interest rates both through the Hong Kong Association of Banks (where the Bank of China is one of three continuing members of the Committee) and by operating in the interbank money market.

THE MONETARY SYSTEM* OF HONG KONG(1) CURRENCY(a) History

The currency of Hong Kong is the Hong Kong dollar. Until 1935, Hong Kong like China, operated on a silver standard, but when China abandoned the silver standard Hong Kong followed. The dollar was then pegged to sterling, at a rate which remained unchanged until 1967. Meanwhile, soon after the outbreak of the second world war Hong Kong became part of what was known as the Overseas Sterling Area; this meant operating within the net of exchange controls set by the UK authorities.

2. Although the dollar held fast to sterling when sterling was devalued in 1949, in 1967 the dollar was not devalued to the same extent as sterling against other currencies; nevertheless, it remained pegged to sterling, albeit at a new higher rate. When sterling was floated in June 1972 and the sterling area was dismantled, the dollar became in effect a fully independent currency. It was held within a narrow margin around a central rate against the US dollar until 1974, but since then has been floating, without the government undertaking to hold it fixed by reference to any other currency. Since 1972 there have been no exchange controls on the conversion of the dollar into other currencies.

* "Dollar" and "\$" refer to the Hong Kong dollar unless otherwise specified.

(b) Notes and coin

3. Notes are issued by the Hongkong and Shanghai Banking Corporation and the Chartered Bank. Apart from a very small fiduciary element (\$95 million), the note issue, which currently totals some \$13 billion, is backed by non-interest-bearing deposits which the issuing banks hold with the Government's Exchange Fund; the Fund issues certificates of indebtedness to the banks against these deposits. This procedure ensures that the seignorage (profits) from the note issue accrue to the Hong Kong Government which, in turn, meets most of the costs of the note issue. Coins are issued directly by the Hong Kong Government against payments to the Exchange Fund.

(2) EXCHANGE FUND(a) Background

4. The Hong Kong Government Exchange Fund was established in 1935 under the Exchange Fund Ordinance (Chapter 66) . From its inception the Fund has held the backing for the note issue (as described above). In more recent years the backing for the coin issue and surpluses, other than working balances, from the Government's general revenue account (the fiscal reserves) and other funds have been consolidated into the Exchange Fund, so that nowadays the Fund holds the bulk of the Government's financial assets. Operationally the Fund issues interest-bearing debt certificates in Hong Kong dollars to the general account or other fund in exchange for the surpluses deposited with it.

(b) The Fund's balance sheet

5. Thus, the liabilities of the Exchange Fund comprise certificates of indebtedness issued to the note-issuing bank, debt certificates issued to other government accounts and the Fund's liability in respect of the coin issue.

6. The assets of the Fund are held mainly in foreign currencies, but also in Hong Kong dollars. The foreign currency holdings are spread amongst US dollars, Canadian dollars, Deutschemarks, Swiss francs, guilders, yen and sterling. The assets are mainly held in the form of deposits with major banks, securities issued or guaranteed by governments that enjoy the highest international credit standings, and securities issued by certain international institutions such as the European Investment Bank, the International Bank for Construction and Development and the Asian Development Bank. The assets are managed so as to provide high liquidity at all times.

(c) Role and management

7. Under the Exchange Fund Ordinance (Chapter 66), the Fund "shall be used for such purposes as the Financial Secretary thinks fit affecting either directly or indirectly the exchange value of the Hong Kong dollar and for other purposes incidental thereto." The Fund is managed by the Monetary Affairs Branch of the Government Secretariat, under the control and direction of the Financial Secretary, in consultation with an Exchange Fund Advisory Committee. The British Government plays no part in the management of the Exchange Fund and gains no benefit from it.

(3) FOREIGN EXCHANGE AND MONEY MARKETS(a) Foreign exchange market

8. Hong Kong, as a major component of the international financial system, has a mature foreign exchange market where the local currency and major international currencies are actively traded. The development of this market has been an integral part of Hong Kong's emergence as a principal international financial centre and the largest in Asia. The absence of any exchange controls and confidence that such controls will not be introduced are two factors which have specifically stimulated the development of the foreign exchange market. Another is the fact that international banks trade through their Hong Kong offices at times when other centres are closed. Meanwhile, the continuous requirements of local industry and commerce in relation to their transactions with the rest of the world have ensured active trading of the local currency.

(b) Local money market

9. There is also a well developed "interbank" market, where wholesale Hong Kong dollar deposits are traded among the banks and deposit-taking companies. Other short-term instruments are less in evidence than in some other centres, partly because the Government is not itself active as a regulator of the monetary system's reserves through open market operations in such instruments, as is the case in most capitalist economies. Thus, although some bills of exchange are held in portfolios, they are not greatly traded. The same has been true of certificates of deposit (CDs) until quite recently, but the secondary market in locally issued CDs has become more active of late, having been helped by the Government's decision to allow CDs issued by licensed banks and licensed deposit-taking companies to count to a limited extent towards the statutory liquidity requirement of all banks and deposit-taking companies.

10. Hong Kong's outstanding borrowings from the Asian Development Bank amount to some \$0.5 billion. For constitutional reasons, these are guaranteed by the British Government. There is a small amount of Government-guaranteed debt issued by Government-owned bodies, namely bonds and notes issued by the Mass Transit Railway Corporation, and notes issued by the Hong Kong Building and Loan Agency: the total outstanding is some \$0.9 billion. But there is no marketable direct Government debt.

(4) OTHER MARKETS(a) Stock markets

11. There are at present four stock exchanges in Hong Kong: the Far East Exchange, the Hong Kong Stock Exchange, the Kam Ngan Stock Exchange and the Kowloon Stock Exchange.

12. As a result of the Stock Exchanges Unification Ordinance (Chapter 361) all members of the four existing stock exchanges have been invited to apply for membership of a new Exchange Company, The Stock Exchange of Hong Kong Limited, which will have the exclusive right to operate a stock market in Hong Kong from a date to be appointed by the Financial Secretary. The unification will bring better overall management of the exchanges and provide more effective regulation.

13. The stock exchanges represent a major source of capital to local enterprises and have attracted significant overseas investor interest. The total of new capital raised on the exchanges was \$10.1 billion in 1981, \$1.3 billion in 1982, and \$1.0 billion in the first half of 1983.

14. The Securities Commission, appointed by the Governor and including a majority of unofficial members, is responsible for ensuring compliance with the Securities Ordinance (Chapter 233), the Protection of Investors Ordinance (Chapter 335) and the Stock Exchanges Unification Ordinance (Chapter 361). The Securities Ordinance regulates registration of dealers and investment advisers and trading practices in securities, and provides for the establishment of a compensation fund and the elimination of improper trading practices. The Protection of Investors Ordinance aims at protecting investors by prohibiting the use of fraudulent or reckless means to induce investors to buy or sell securities or to take part in investment arrangements, and regulates the issue of related publications.

15. The staff of the office of the Commissioner of Securities monitor financial transactions concerning securities and scrutinize unusual movements in individual prices. They also investigate possible instances of insider dealing.

(b) Gold

16. The Chinese Gold and Silver Exchange Society operates a gold bullion market which is estimated to be among the four largest in the world. Gold traded in the Society is of 99 percent fineness, weighed in taels and quoted in Hong Kong dollars. Prices, after allowing for exchange rate fluctuations, parallel those in other major markets of London, Zurich and New York. Membership of the Society is closed to 194 member firms.

17. There is a second gold market in Hong Kong, activity in which has been growing in recent years, the so-called loco-London gold market. Dealings principally take place in US dollars per troy ounce of 99.95 percent fine gold, with delivery in London. Major international gold-trading companies are the main participants in this market.

18. The trading of gold futures takes place in the Commodity Exchange. Prices are quoted in US dollars per troy ounce of 99.5 percent fine gold, with a minimum lot of 100 ounces. Early contracts required delivery to an approved vault in London. Local delivery is also now available. Trading has so far been on a small scale.

(c) Commodities Exchange

19. The Commodities Trading Ordinance (Chapter 250), regulates trading in commodity futures contracts in Hong Kong. The Hong Kong Commodity Exchange Limited, established in 1977, is the only company which has been granted a licence under the Ordinance to operate a commodity exchange in Hong Kong. Four contracts are available: gold, cotton, sugar and soya-beans.

(d) Financial futures

20. The possibility of establishing a financial futures exchange in Hong Kong to be linked with London or Chicago is being examined.

(5) DEPOSIT-TAKING INSTITUTIONS

(a) Introduction

21. Three classes of institution are permitted to accept deposits: licensed banks, licensed deposit-taking companies (DTCs) and registered DTCs. This structure was adopted by the Government with two principal aims in mind: to exert some influence over interest rates and to protect so far as reasonably possible the interests of depositors.

(i) Licensed banks

22. The licensing authority for banks is the Governor in Council. The criteria against which applicants are judged are set out at Annex A. Only licensed banks may operate cheque accounts. They enjoy a monopoly of deposits in denominations of less than \$50,000 (or the equivalent in another currency). They also have the sole right to take deposits of less than \$500,000 with an original term to maturity of less than three months. The maximum rates of interest payable on deposits with maturities up to 15 months less one day are fixed from time to time by the Committee of the Hong Kong Association of Banks (HKAB), with the exception that banks may compete freely for deposits of \$500,000 or more taken for less than three months. HKAB is statutorily constituted under the Hong Kong Association of Banks Ordinance (Chapter 364): all banks must be members and observe the maximum rates; the Committee comprises three continuing members - the Hongkong and Shanghai Banking Corporation, the Chartered Bank and the Bank of China - and nine elected members.

(ii) Licensed deposit-taking companies

23. Licensed DTC's may take deposits with no limitation as to their term to maturity but with a minimum size of \$500,000 (or equivalent). There are no restrictions on the interest rates they may offer. The authority to grant licences to deposit-taking companies rests with the Financial Secretary. Licensed status is reserved for large companies which have a minimum issued share capital of \$100 million and paid up capital of \$75 million and which meet certain other criteria outlined in Annex B.

(iii) Registered deposit-taking companies

24. Registered DTC's are restricted to taking deposits of \$50,000 or more with an original term to maturity of at least three months. The authority to register DTC's rests with the Commissioner for Deposit-taking Companies. The Commissioner has, at the direction of the Governor, restricted new registrations to companies which, as well as meeting certain basic criteria such as minimum paid-up capital of \$10 million, are more than 50% owned by banks in Hong Kong or elsewhere.

(b) Numbers of deposit-taking institutions

25. In Hong Kong there are 135 licensed banks, 29 licensed DTC's and 321 registered DTC's. In addition 115 foreign banks have representative offices. The following table shows the distribution of licensed banks by their place of incorporation:

- 12 -

<u>Place of incorporation</u>	<u>Total</u>
Hong Kong	35*
China	9
USA	21
Canada	6
Japan	13
UK	8
France	7
Germany	8
Other parts of Europe	8
Other	<u>20</u>
Total	<u>135</u>

* includes 3 unincorporated banks

26. There are 1,373 bank branches. The number at the end June in the four years 1979 to 1982 was respectively 852, 964, 1091 and 1,269.

(c) Monetary sector statistics

27. At the end of May 1983, total assets of all deposit-taking institutions (i.e. banks and DTCs) were \$943 billion with the following breakdown:

	<u>Total assets</u>	
	(\$bn)	%
Licensed banks	658.4	70
Licensed DTCs	62.7	7
Registered DTCs	<u>221.9</u>	<u>23</u>
All institutions	<u>943.0</u>	<u>100</u>

The breakdown of currency denomination of these assets is as follows:

	<u>Total assets</u>	
	(\$bn)	%
Hong Kong dollars	328.4	35
Foreign currencies(*) (mostly in US\$)	614.6	65
All institutions	<u>943.0</u>	<u>100</u>

Note: (*) converted to their Hong Kong dollar equivalents.

28. The proportion of assets denominated in foreign currencies has been increasing. The proportion at the end of May 1983 was 65% compared with 55% at the end of 1980. While Hong Kong dollar denominated assets increased by 147% between the end of 1980 and the end of May 1983, foreign currency denominated assets increased by 280%. The pattern reflects Hong Kong's growing importance as an international financial centre, and particularly its emergent role as a foreign currency funding centre.

29. Total deposits (defined as deposits from customers - i.e. excluding those from local or overseas banks or DTCs) with all deposit-taking institutions as at the end of May 1983 were \$249.4 billion with the following breakdowns by currency and by type of institution:

	<u>\$HK deposits</u> ((\$bn)	<u>Foreign currency deposits (*)</u> ((\$bn)	<u>Total</u> ((\$bn)
Licensed banks	106.8	100.5	207.3
Licensed DTCs	3.3	8.0	11.3
Registered DTCs	<u>21.3</u>	<u>9.5</u>	<u>30.8</u>
All institutions	<u>131.4</u>	<u>118.0</u>	<u>249.4</u>

Note: (*) converted to their Hong Kong dollar equivalents.

The proportion of deposits denominated in Hong Kong dollars was 53% at the end of May 1983. This is lower than the corresponding figure of 86% at the end of 1980, largely reflecting the expansion of foreign currency business mentioned above, but also influenced by some switching out of Hong Kong dollar time deposits, often on a swap basis, because they have remained subject to interest tax.

30. Total loans and advances extended by all deposit-taking institutions as at the end of May 1983 were \$358.0 billion with the following breakdown by type of loans:

	<u>Loan and advances</u> ((\$bn)	%
To finance visible trade of Hong Kong	28.3	7.9
To finance merchandising trade not touching Hong Kong	2.6	0.7
Other loans for use in Hong Kong	197.8	35.3
Other loans for use outside Hong Kong	113.3	31.6
Other loans where the place of use is not known	16.0	4.5
Total	<u>358.0</u>	<u>100.0</u>

(e) Prudential supervision

31. The Commissioner of Banking is the authority for the prudential supervision of licensed banks. He is also the Commissioner of Deposit-taking Companies, with responsibility for the prudential supervision of deposit-taking companies.

32. The code of behaviour for banks and deposit-taking companies is laid down by the Legislative Council in the Banking Ordinance (Chapter 155) and the Deposit-taking Companies Ordinance (Chapter 328), which stipulate, among other things, minimum levels of capital adequacy and liquidity, and maximum holdings of certain classes of asset - for example, shareholdings, real estate and unsecured lending to directors and director-related companies.

33. The Commissioner's office exercises, under his direction, a comprehensive system of prudential supervision. This approach is in line with trends in banking supervision which have developed internationally.

34. The Commissioner's office includes an International Division, which obtains monthly returns from the overseas branches of Hong Kong incorporated banks and deposit-taking companies, and sends examination teams overseas to examine such branches (where this is permitted by the local authorities). The Government accepts the principles of the revised Concordat issued by the Committee on Banking Regulations and Supervisory Practices, which meets regularly at Basle in Switzerland, and also accepts and is putting into practice through the Commissioner's office, the principle of world-wide consolidated supervision of banking groups based in Hong Kong.

(6) MONETARY POLICY.

35. The monetary system of Hong Kong may be distinguished from that of most other capitalist economies in that there is, as noted earlier, no direct marketable Government debt, and no central bank. In fact the typical functions of a central bank are performed in Hong Kong either by the Government (e.g. managing the foreign exchange reserves through the Exchange Fund; supervising the commercial banks through the Commissioner's office) or by selected banks themselves (e.g. issuing notes; acting as bankers to the government).

36. The Government has the following monetary policy instruments at its disposal:

(i) Intervention in the foreign exchange market

The Exchange Fund is constituted for the purpose of influencing the exchange value of the dollar. This it can do by buying or selling the dollar against foreign currency in the market through its bankers and by operating in the interbank market. With a free exchange market and a highly open economy, the Exchange Fund is not able to fix the exchange rate or hold it at any particular level. Thus, for example, intervention during the past year has not been able to halt a further drop in the exchange rate of the Hong Kong dollar stemming in part from lack of confidence.

(ii) Influence over bank interest rates

All licensed banks are bound by certain rules of the Hong Kong Association of Banks (HKAB). This sets maximum interest rates payable on bank deposits of original maturities up to 15 months less a day, the only exception being deposits of \$500,000 or more for terms of less than 3 months, for which banks may compete freely.

In setting these maximum rates, HKAB is statutorily obliged to consult the Financial Secretary, although the final decision on the rates rests with the Association alone.

(iii) Money market intervention

The Exchange Fund operates a scheme which enables it to draw funds out of the local interbank market and ensure that these funds are not directly recycled into that market. This arrangement, which depends upon the cooperation of the Fund's bankers, is capable of tightening up the money market and putting upward pressure on market interest rates in the short term, and may be used to support a particular level of HKAB rates, or to signal an adjustment to those rates.

(iv) Liquidity ratio

The Financial Secretary has the power to vary, in pursuance of monetary policy objectives, the minimum statutory liquidity ratios applicable to banks and deposit-taking companies, but this power has never been exercised.

37. Monetary policy depends upon the spirit of cooperation and mutual trust that exists between the Government and the financial community, and upon the recognition by both parties of their common interest in the maintenance of monetary stability and confidence, both domestically and internationally.

(7) HONG KONG AS AN INTERNATIONAL FINANCIAL CENTRE

38. Hong Kong's position as a major international financial centre depends on the continued presence of large numbers of banks and deposit-taking companies; insurance companies; companies specialising in the management of pension funds and unit trusts, etc; foreign exchange and money brokers; stock and commodity brokers; accountants; lawyers; actuaries; average adjusters and others; which combine to provide a full range of services in the financial and related fields at an international level. Moreover, many providing these services are themselves overseas companies which have chosen to establish a presence in Hong Kong. Many of their customers are also overseas. If confidence failed, Hong Kong would quickly cease to be a financial centre since the relevant assets and people are highly mobile. Other competing regional centres, for example Singapore, would be only too ready to take over Hong Kong's lead. These centres have made no secret of their desire to drain away money, enterprises and people from Hong Kong because of uncertainty.

39. There is a variety of reasons why Hong Kong has evolved to such a position. International companies have been attracted to operate in Hong Kong, or to transact business through Hong Kong, because of its long record of stable and predictable government operating free of external control and its sound and well understood legal framework linked to the UK system and with recourse to an independent Judiciary. Taxation is comparatively low by international standards. Moreover, apart from essential prudential regulation, modest taxation, and the requirement that the Banks should consult the Government on interest rates, the Government does not interfere in business, and allows market forces full play.

40. Hong Kong also provides a satisfactory working and living environment for the highly mobile professional people required in a financial centre, and there is a flexible market in well educated and qualified staff at all levels. Thus, companies operating in Hong Kong can be reasonably confident of being able to attract necessary staff for their own business, whether locally or from overseas, and of obtaining the essential ancillary services that they may require.

41. Hong Kong's geographic position allows it to act as a time link in international financial markets which operate around the clock on a 24 hour basis. Hong Kong has developed and maintained excellent communications with the rest of the world, in respect of both transport and telecommunications, which are essential elements to its international trading role.

42. Hong Kong would never have achieved its pre-eminent position in the financial services field, and would be unlikely to sustain it, were it not for underlying international confidence in the stability of government, in the steadiness of its policies, and in the integrity of the administration of justice.

LICENSING POLICY FOR BANKS

(Based on Speech by the Financial Secretary
in the Legislative Council on 27 May 1981)

- (a) Applications would be accepted for licences to be granted under section 7 of the Banking Ordinance from banks incorporated outside Hong Kong which satisfy the following criteria:
- (i) incorporation in countries the monetary authorities of which exercise effective supervision and have no objection to the establishment of a branch in Hong Kong;
 - (ii) total assets (less contra items) in excess of US\$12,000 million (this figure to be reviewed annually against the list of the world's largest banks in The Banker);
 - (iii) availability of some acceptable form of reciprocity to Hong Kong banks.

(b) Each licence granted would be subject to the following conditions:

(i) the bank may maintain offices to which customers have access for the purpose of any business, including banking business, including banking business, in only one building. In this context the word office includes any automated teller machine or similar terminal device which provides facilities to customers of the bank;

(ii) the bank will become a member of the Hong Kong Association of Banks and thereafter, in accordance with and subject to the provisions of section 7(1) of the Hong Kong Association of Banks Ordinance, remain a member of the Association.

(c) The Governor in Council would retain discretion to refuse any such applications even though the criteria were satisfied.

LICENSING POLICY ON DEPOSIT-TAKING COMPANIES

(Based on Speech by the Financial Secretary
in the Legislative Council on 29 April 1981)

- (a) Minimum issued and paid-up shared capital of HK\$100 million and HK\$75 million respectively;
- (b) The applicant company is registered in Hong Kong or, if incorporated outside Hong Kong, it is subject to adequate prudential supervision by the recognised banking authorities of its country of incorporation; and that it was a registered deposit-taking company on 10th April 1981 (the date on which the Deposit-taking Companies (Amendment) (No. 2) Bill 1981 was gazetted).
- (c) The company has actively traded as a deposit-taking company for at least three years before the date of application;
- (d) The company is in reputable ownership (and that the beneficial owner of any holding of 10% or more of the voting share capital is identifiable and reputable).
- (e) The management of the company is in fit and proper hands (and the same should apply to the head office of the company if it is outside Hong Kong).

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THE ECONOMIC SYSTEM OF HONG KONG

Hong Kong

29 July 1983

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THE ECONOMIC SYSTEM OF HONG KONGSUMMARY

Hong Kong has no natural resources beyond its harbour; has very little readily usable land; and has a population of some 5.3 million. It is completely dependent on trade. Hong Kong has to export on a sufficient scale to generate the foreign exchange earnings required for the import of goods and services needed to provide its people with the improving standard of living they have come to expect on the basis of actual performance over many years. If there was a drastic reduction in trade, serious unemployment would result.

2. Hong Kong's remarkable success as an exporter depends on the international competitiveness of its products, the flexibility of its economy, its highly motivated labour force and particularly its access to the major industrialised country markets (especially USA and EEC), where it enjoys most-favoured-nation status. This access derives from the UK's accession to the GATT on behalf of its dependent territories (including Hong Kong) in 1948. By virtue of the UK's founder membership of the GATT, Hong Kong has rights and obligations under the GATT as if it too were a founder member. The link with the United Kingdom is fundamental in guaranteeing that these rights are maintained.

3. Hong Kong also enjoys as a developing territory a beneficiary status under the generalised preference scheme of the European community which was secured for Hong Kong by the UK during its negotiations for membership of the European community. Following on this, Hong Kong has been included as a beneficiary under all other major generalised preference schemes.

4. Through its success in developing the inter-dependent sectors of manufacturing, trading, and financial and related services, the Hong Kong economy, based on its free port has achieved a high average growth rate of exports and achieved one of the highest growth rates of gross domestic product (GDP) in the world over the past decade and more. In 1982, GDP per head was HK\$30,060 (just under US\$5,000, at the average exchange rate for 1982).

5. The Hong Kong economy is fully integrated into the international trading community. More recently it has become an important link in the world's free market financial system. These developments, particularly the second, would not have occurred if Hong Kong did not provide a free enterprise business environment which is backed by stable, prudent and predictable economic policies and by an internationally recognised and accepted, and impartially administered system of law. The provision of such an environment makes Hong Kong attractive to firms and to the internationally mobile managerial and professional class as a place to do business. Its continuation is necessary if this confidence is to be maintained and Hong Kong's economic growth is to be sustained.

6. Economic success depends on entrepreneurs and organisations having sufficient confidence in Hong Kong and the business environment it provides to be willing to remain here and to continue to invest in the plant and equipment needed to keep Hong Kong's manufacturing capacity up to date and growing.

7. The external orientation of the Hong Kong economy with its concomitant need to maintain the international competitiveness of Hong Kong's products puts severe constraints on the economic policies that it is feasible for the Government to adopt without damaging export growth. As a result, the Government leaves most domestic economic decision-making in private hands and thus subject to the disciplines of the market both locally and internationally. A simple tax structure with low tax rates provides incentives for the labour force to work and for entrepreneurs to invest. Apart from expenditure to meet social needs, Government expenditure is largely concentrated on the provision of the necessary economic infrastructure that only it can provide.

8. Hong Kong, because of its success as an exporter, the cornerstone of which has been the special position in the GATT derived from the UK's founder membership, because of its expertise in the services sector, and because of the international confidence that it enjoys by virtue of the systems now in force, has achieved a measure of recognition and representation at a number of international and regional economic, trading and financial institutions. A benefit of participating in these international and regional fora is that it enables Hong Kong to coordinate with developing countries in some important international trade issues, for the purpose of safeguarding Hong Kong's trade interest.

THE ECONOMIC SYSTEM OF HONG KONG(1) THE NATURE OF THE ECONOMY(a) General Description

Hong Kong has an area of just over 400 square miles, only a small proportion of which is suitable for development. It has virtually no natural resources beyond its large, natural deep-water harbour. Hong Kong has had to concentrate on manufacturing, trading and the provision of services.

2. In order to support its population of 5.3 million, Hong Kong has to import virtually all it requires. The prosperity of Hong Kong thus depends on its success in exporting or re-exporting on a sufficient scale to generate the foreign exchange earnings required to pay for the imports of goods and services needed to provide the people of Hong Kong with a reasonable standard of living. Visible trade flows of \$270.3 bn (US 44.5 bn at the average exchange rate for 1982 of HK\$6.07 to US\$1) are now equivalent to about 170% of Hong Kong's Gross Domestic Product (GDP) (\$157.3 bn) (US\$25.9 bn).

3. The relative shortage of readily usable land has limited the development of manufacturing largely to light manufacturing processes that can be operated successfully in multi-storey, flatted factory buildings.

4. International traders were Hong Kong's mainstay as its port provided one of the most efficient and convenient ways to trans-ship goods in and out of China. Although in the 1950s and 1960s this activity was largely superseded by manufacturing for export it has revived again in recent years. Re-exports both to and from China and to and from other economies in the region account for some 36% of total exports.

5. Originally much of Hong Kong's service sector was developed in support of manufacturers, exporters and shippers as well as the domestic economy generally. Today, as well as carrying out that role, it also exports its services throughout the surrounding region as a major link in the world's free market economic and financial systems.

(b) Past Performance and Present Position

6. In the 10 years from 1973 to 1982, Hong Kong's exports of goods increased by 10% p.a. in real terms, made up of a growth rate of 8.2% p.a. for domestic exports and 15.1% p.a. for re-exports. This has resulted in a growth rate of GDP over the same period of 9.6% p.a. in real terms, one of the fastest growth rates for any economy in the world. (Annual figures are given in Annex A. They show the years in which growth was slower and demonstrate the resilience of Hong Kong's economy.) Even allowing for a growth rate of population of about 2.4%, GDP per capita grew at 7% p.a.

7. This meant that in 1982 total exports were \$127.4 bn (US\$21.0 bn) of which \$83.0 bn (US\$13.7 bn) were domestic exports and \$44.4 bn (US\$7.3 bn) were re-exports. Gross domestic product was \$157.3 bn (US\$25.9 bn) and gross domestic product per head was \$30,060 (US\$4,952).

(c) Individual Sectors

8. Manufacturing accounts for about 25% of GDP but 36% of employment. It remains the mainstay of the economy, particularly in terms of employment. The financing, insurance, real estate and business services sector now accounts for the same share of the GDP as manufacturing but employs only 7% of the employed labour force. The next largest sector is wholesale and retail trades including

restaurants and hotels which account for over 19% of the GDP and 21% of employment. Of the remaining sectors only community, social and personal services (13%) contributes more than 10% of the GDP.

9. The three major sectors are to a large degree interdependent. In particular, whilst the prosperity of the financing and related services sector and the wholesale and retail trade sector are clearly dependent on the continued success of the entrepreneurs in the manufacturing sector in devising and producing competitive goods, the manufacturing sector in its turn is dependent on the continued efficient provision of services by the other two sectors. All these sectors share a common dependence for their prosperity on Hong Kong's full participation in the international economic system.

(2) DOMESTIC ECONOMIC POLICY

(a) Constraints on Policy Imposed by the Nature of the Economy

10. Given the external orientation of the Hong Kong economy (with 61% of all domestic exports going to the USA and the EEC), continuing prosperity depends on being able to export to these highly competitive markets. Hong Kong is only one of many newly industrialising territories attempting to export similar products to these markets. In assessing proposed economic policy actions, the Government must always take into account their likely effect on the international competitiveness of Hong Kong's products.

11. Hong Kong's dependence on international trade means both that it is exposed to fluctuations in world trade and that the Government is severely limited in taking policy steps to offset the effects of such fluctuations. Thus, if world trade is in recession leading to economic activity in Hong Kong being depressed because of lower exports, any attempt by the Government to offset this situation by increasing public sector expenditure is likely to go in large part to increasing the inflow of imports, which would make the balance of trade even more unfavourable. Moreover, given that export demand is a much larger part of total final demand than that accounted for by the Government, changes in the latter would have to be extreme in order to compensate.

12. Continuing pressure from population growth, which arises from both natural increase and from immigration, requires the maintenance of a high rate of economic growth if the standard of living of the population is to go on increasing at the rate the population has come to expect.

13. Thus the nature of the economy constrains the range of economic policies that are feasible.

(b) Principles Underlying Policy(i) Primary role of the private sector in private decision-making

14. The Government normally does not intervene in decisions taken by private entrepreneurs and organisations which involve their risking their own money. It, thus, aims to leave the industrial, commercial and financial sectors free and unfettered to compete in domestic and world markets, regulating only where the orderly conduct of business, fair treatment of the workforce and the good name of Hong Kong so require. To this end, the Government has developed a framework of ground rules and constraints, enshrined in some cases in the law, so as to ensure that there is an acceptable, stable, consistent and predictable legal, administrative and regulatory environment in which business can be carried on. This framework, based on the British model, is critical to the maintenance of both internal and external confidence.

(ii) The importance of consistency and continuity in the maintenance of confidence

15. The continued success of the Hong Kong economy depends not only on the workforce being well-trained, energetic and well motivated but also on the availability of a highly qualified and highly motivated managerial, professional and technical class to provide the necessary problem-solving and organising skills.

16. Economic success also depends on entrepreneurs and organisations having sufficient confidence in Hong Kong and the business environment it provides to be willing to remain here and to continue to invest in the plant and equipment needed to keep Hong Kong's manufacturing capacity up-to-date and growing. Given the critical position

occupied by exports in the Hong Kong economy, much of the business environment is subject to the vagaries of international trade and the actions of overseas governments. Because of this, even more in Hong Kong than elsewhere, the maintenance of business confidence requires that the domestic business environment be as predictable as the Government can reasonably make it. This in turn requires that whatever policies are adopted are adhered to consistently, are free of external interference and are not altered frequently or arbitrarily. It also requires a known, trusted and internationally accepted legal system, which is suited to the nature of Hong Kong's open market economy.

(c) Policy in Practice

(i) Low taxes and a simple tax system

17. The Government believes that it is important to maintain incentives both for workers and for risk-taking by entrepreneurs. It has therefore maintained a simple tax system with low tax rates, particularly in respect of those taxes that are most likely adversely to affect incentives. Thus the great majority of workers pay no direct tax.

(ii) Provision of infrastructure

18. Consistent with its aim of providing an environment conducive to economic growth, the Government's major role in fostering economic growth is in the provision of the necessary infrastructure, particularly that which only it can reasonably provide. In many cases Government's involvement arises because only the Government is in a position to undertake the comprehensive planning and the mobilisation of resources on the scale required.

19. The major areas of Government involvement in physical infrastructure are the provision of formed and serviced land and of transport links. Much of the land provided by Government is for public purposes. The remainder is usually disposed of by Government by open auction or by tender to the highest bidder with the minimum restrictions on its use that are consistent with requirements of good town planning. Thus, the market, not the Government, decides what a particular site is worth commercially.

20. Although Government is inevitably heavily involved in the provision of physical infrastructure, the private sector is brought in whenever possible. Apart from the provision of the site, the development of the Kwai Chung container terminal (the third largest in the world), including the land formation, was undertaken by the private companies operating the terminals.

21. The provision of an appropriately trained and educated population is essential to the success of the Hong Kong economy. To this end the Government builds and subsidises schools, colleges, universities, polytechnics and other educational and training facilities. There is continual pressure to achieve standards of education that are comparable with those in the United Kingdom and the USA and to provide the skills which are essential for the running of Hong Kong's economic system.

(3) INTERNATIONAL ECONOMIC RELATIONS

(a) Critical Importance of the General Agreement on Tariffs and Trade (GATT)

22. Hong Kong is the 17th largest exporter in the GATT international table of exporters. This export trade is sustained by a free trade policy which by maintaining Hong Kong as an open market provides the competitive edge to Hong Kong's exports. The maintenance of the framework under GATT within which international trade is carried on, and the safeguarding of Hong Kong's right of access to overseas markets, which is secured through Hong Kong's rights and obligations under GATT, are matters of vital importance to the continuing growth of the economy. GATT and the most-favoured-nation (MFN) treatment it affords are thus the cornerstone on which Hong Kong's external commercial relations rely.

(b) Rights and Obligations under the GATT

23. By virtue of the UK founder membership of the GATT, both in respect of its own metropolitan territory as well as territories for which it has international responsibility (including Hong Kong), Hong Kong has rights and obligations under the GATT as if it too were a founding member. This entitles Hong Kong to most-favoured-nation (MFN) treatment in the markets of all the contracting parties. Furthermore, because accession occurred at the commencement of the GATT in 1948, the other contracting parties did not have the opportunity to deny Hong Kong its full rights (which might be imposed on a new entrant.) These rights and obligations enshrined in the GATT are exercised on behalf of Hong Kong by the United Kingdom, as the contracting party responsible for Hong Kong's international relations.

(c) History of Hong Kong's International Economic Relations

24. Annex B sets out a number of precedents in the GATT negotiation which demonstrate Hong Kong's status therein. This shows clearly that Hong Kong's rights and obligations under the GATT are well established and that as regards the GATT the United Kingdom acts separately both on its own behalf and on behalf of Hong Kong.

(d) Hong Kong's Role in the Conduct of its International Economic Relations

25. The constitutional link with the United Kingdom gives rise to Hong Kong's rights and obligations under the GATT. Only with this link does Hong Kong enjoy de facto freedom in the management of its external economic relations;

- (i) When the United Kingdom joined the EEC in 1973, the GATT was informed by the United Kingdom that the position of Hong Kong in the GATT would remain unchanged. A practice was then evolved that at GATT meetings while the United Kingdom delegation would form part of the EEC delegation, a member of the United Kingdom delegation, usually a Hong Kong Government official, would continue to speak for Hong Kong and make clear that he was doing so on behalf of Hong Kong. This means that when necessary Hong Kong is able to take positions in GATT meetings which are different from those of the EEC and by implication the United Kingdom.

(ii) The growth of Hong Kong's domestic exports led to the first industry to industry textiles restraint agreement in 1959 when Hong Kong began to be increasingly enmeshed in international commercial relations. The position eventually crystallised in 1969 when it was recognised by the United Kingdom that Hong Kong's interests would be best served by a policy whereby in any negotiations with importing countries Hong Kong should determine the course of, and be responsible for the conduct of, its own external commercial relations. Since then, this understanding has governed the conduct of Hong Kong's external bilateral commercial relations in merchandise trade, but the link with the United Kingdom remains fundamental in guaranteeing Hong Kong's status in GATT.

(iii) The Arrangement regarding International Trade in Textiles (MFA) (and the Cotton Textiles Arrangement (CTA) which preceded it) is a derogation from the MFN principle in the GATT. The CTA/MFA provides a framework within which bilateral restraint agreements in the field of textiles (including garments) could be reached between exporting and importing participants to the Arrangement. As exports of textiles and garments still account for 41% of Hong Kong's export trade, Hong Kong attaches great importance

to the provisions of the MFA and to its role within the MFA. The MFA has been in force since January 1974: from 1962-1973 there was the CTA. Hong Kong is a member of the MFA (and previously of the CTA) by virtue of the United Kingdom's accession specifically on Hong Kong's behalf. In contrast, the United Kingdom itself participates in the MFA not as a member in its own right but as a member state of the EEC which is the party that accepted the MFA on behalf of all the member states of the European Community.

Since the CTA/MFA came into being, it has been extended in time or scope on a number of occasions. Hong Kong has played an increasingly significant part in the negotiations leading to each such extension.

A Textile Surveillance Body has been set up to supervise the implementation of the MFA. It meets in Geneva and consists of a chairman and eight members appointed by the participants to the MFA. In view of Hong Kong's prominence in international trade in textiles and garments, one seat on the Textile Surveillance Body has been assigned to Hong Kong and the Republic of Korea: they share the seat and take turns serving as a full member on an annual basis. In 1983 Hong Kong provides the full member, while the Republic of Korea serves as the alternate: in 1984 the position will be reversed.

26. The 1969 understanding between the United Kingdom and Hong Kong regarding the conduct of Hong Kong's external bilateral commercial relations in merchandise trade remains central to the role which Hong Kong plays in the bilateral negotiations under the MFA. The flexibility thus conferred has enabled Hong Kong to deploy fully its negotiating prowess and to secure the best available terms for Hong Kong in the bilateral agreements which Hong Kong has entered into. The importance of this can be seen in Hong Kong's position as the world's leading exporter of garments.

(e) Hong Kong's Role in Other International Institutions

27. For the purpose of safeguarding its interests and access rights, Hong Kong also embarks on a number of other activities in other international institutions.

(i) Generalised Preference Schemes

28. Hong Kong is accepted as a beneficiary under the generalised preference schemes operated by the developed countries. Under such schemes, imports into these developed countries from Hong Kong and other beneficiaries receive either duty free treatment or are accorded lower rates of duty. This is an important incentive in the development of Hong Kong's exports trade and provides an impetus for Hong Kong and for other beneficiaries to develop further their industries.

29. The recognition of Hong Kong as a beneficiary is a direct reflection of Hong Kong's position in the GATT. In the case of Hong Kong's beneficiary status under the generalised preference scheme of the EEC, this has been secured for Hong Kong by the United Kingdom during its negotiations for membership in the EEC. Apart from this, Hong Kong has no other special relationship with the EEC and its exports otherwise pay the EEC's common commercial tariff.

(ii) Coordination with developing countries

30. While Hong Kong's rights and obligations under the GATT depend upon its constitutional link to the United Kingdom, its conduct of its international economic relations has also enabled Hong Kong to forge a close link with developing countries which share common interests with Hong Kong. Over the years Hong Kong has developed a close working relationship with the developing countries regarding a number of important international trade issues. In the field of textiles and garments, such coordinated efforts with the developing countries have resulted in an improved capability for Hong Kong and the others involved to resist the harsher demands by the importing countries for more restrictive bilateral restraint agreements. On the safeguards issue, such efforts have so far successfully blunted attempts to introduce selectivity in the safeguard actions as would be permitted by the GATT.

(iii) Economic and Social Commission for Asia and the Pacific (ESCAP)

31. Hong Kong is an Associate Member of ESCAP. While its Committee on Trade and plenary sessions on matters affecting international trade are the main interests to Hong Kong, it has also contributed in other ESCAP meetings (e.g. social welfare, population, etc.) where Hong Kong's experience and developments may be of interest to the Region. The object is to identify with the developing countries of the Region in furtherance of the aims in paragraph 30 above.

(iv) Asian Development Bank

32. Hong Kong joined the Asian Development Bank in 1969. It now holds 4,700 shares (or just under 1% of the total number of shares) of the Bank valued at US\$10,000 each (US\$ as valued on 31st January 1966). Of these shares, 910 have been paid up and 3,790 are callable shares. In addition, Hong Kong has contributed US\$100,000 to the Technical Assistance Special Fund of the Bank and has agreed to contribute US\$1 million to the Asian Development Fund. As a regional developing member, Hong Kong has a right to borrow from the Bank and five loans totalling US\$101.5 million have so far been negotiated. Including interest and other charges, about US\$67 million of these loans remain outstanding. Under Article 3(3) of the Charter establishing the Asian Development Bank, the liability of Hong Kong to the Bank was guaranteed by the United Kingdom, since Hong Kong is a territory not responsible for its international relations. This liability includes the callable shares subscribed by Hong Kong, any unpaid subscription and the outstanding loans and charges thereon.

33. Because Hong Kong is a member of the Bank, the Financial Secretary of Hong Kong is a Governor of the Bank and Hong Kong takes part in the annual meetings of the Bank's members.

Table 1

EXPENDITURE ON THE GROSS DOMESTIC PRODUCT BY COMPONENT
AT CURRENT PRICES 1972 TO 1982 (\$MN)

	1972	1973	1974	1975	1976	1977
Private Consumption						
Expenditure	17,525	23,785	27,216	28,427	31,857	39,126
Government Consumption						
Expenditure	1,534	1,912	2,438	2,646	3,047	3,675
Gross Domestic Fixed Capital Formation						
Transfer costs of land and buildings	161	216	145	186	279	372
Building and construction	2,265	2,855	3,734	3,679	4,363	6,393
Private	1,638	1,891	2,242	2,164	2,548	3,571
Public	627	964	1,492	1,515	1,815	2,822
Government	627	964	1,492	1,283	1,169	1,440
M.T.R.C.	N.A.	N.A.	N.A.	232	646	1,382
Plant, machinery and equipment	2,939	3,627	3,864	3,985	5,056	6,251
Private	2,880	3,534	3,742	3,897	4,976	6,143
Public	59	93	122	88	80	108
Increase in Stocks	N.A.	303	678	731	2,979	1,702
Total Exports of Goods	19,400	25,999	30,036	29,833	41,557	44,833
Domestic exports	15,245	19,474	22,911	22,859	32,629	35,004
Re-exports	4,155	6,525	7,125	6,974	8,928	9,829
Imports of Goods	21,788	29,049	34,142	33,532	43,520	48,796
Exports less Imports of Services	3,818	4,316	4,817	4,619	6,355	6,059
Gross Domestic Product (GDP)	25,854	33,964	38,786	40,574	51,973	59,615
Per Capita GDP (\$)	6,282	8,062	8,979	9,230	11,695	13,219
Total Final Demand	47,642	63,013	72,928	74,106	95,493	108,411
Domestic Demand	24,424	32,698	38,075	39,654	47,581	57,519
Private	22,204	29,729	34,023	35,405	42,639	50,914
Public	2,220	2,969	4,052	4,249	4,942	6,605
GDP Deflator (1973 = 100)	88.6	100.0	112.2	114.8	123.7	128.8

Note: N.A. Not applicable.

Definitions of terms:

Total final demand = private consumption expenditure + Government consumption expenditure + gross domestic fixed capital formation + increase in stocks + total exports of goods + exports less imports of services.

Private domestic demand = private consumption expenditure + gross domestic fixed capital formation by the private sector + increase in stocks.

Public domestic demand = Government consumption expenditure + gross domestic fixed capital formation by the Government and the Mass Transit Railway Corporation.

Domestic demand = private domestic demand + public domestic demand.

Table 1 (Cont'd)

EXPENDITURE ON THE GROSS DOMESTIC PRODUCT BY COMPONENT
AT CURRENT PRICES 1972 TO 1982 (\$MN)

	1978	1979	1980	1981(*)	1982(**)
Private Consumption					
Expenditure	48,541	58,902	76,022	94,472	105,623
Government Consumption					
Expenditure	4,454	5,568	7,294	10,521	13,067
Gross Domestic Fixed					
Capital Formation	16,838	24,218	31,427	39,142	43,476
Transfer costs of					
land and buildings	563	669	1,110	1,965	1,638
Building and					
construction	8,035	11,457	14,996	17,676	21,320
Private	3,983	5,986	8,629	10,078	10,882
Public	4,052	5,471	6,367	7,598	10,438
Government	2,439	3,697	4,840	6,649	8,496
M.T.R.C.	1,613	1,774	1,527	949	1,942
Plant, machinery					
and equipment	8,240	12,092	15,321	19,501	20,518
Private	7,948	11,480	14,695	18,426	19,347
Public	292	612	626	1,075	1,171
Increase in Stocks	2,067	3,252	3,686	1,579	2,121
Total Exports of Goods	53,908	75,934	98,242	122,163	127,385
Domestic exports	40,711	55,912	68,171	80,423	83,032
Re-exports	13,197	20,022	30,072	41,739	44,353
Imports of Goods	63,263	86,339	111,794	139,246	143,611
Exports less Imports					
of Services	7,012	7,938	8,104	8,746	9,241
Gross Domestic Product					
(GDP)	69,557	89,473	112,981	137,377	157,302
Per Capita GDP (\$)	15,131	18,340	22,424	26,654	30,060
Total Final Demand	132,820	175,812	224,775	276,623	300,913
Domestic Demand	71,900	91,940	118,429	145,714	164,287
Private	63,102	80,289	104,142	126,520	139,611
Public	8,798	11,651	14,287	19,194	24,676
GDP Deflator					
(1973 = 100)	136.2	155.4	175.7	192.6	215.4

Notes: (*) Provisional estimates.
(**) Preliminary estimates.

Table 2

EXPENDITURE ON THE GROSS DOMESTIC PRODUCT BY COMPONENT
AT CONSTANT (1973) PRICES 1972 TO 1982 (\$MN)

	1972	1973	1974	1975	1976	1977
Private Consumption Expenditure	20,188	23,785	23,527	24,005	26,119	30,626
Government Consumption Expenditure	1,707	1,912	2,106	2,213	2,392	2,690
Gross Domestic Fixed Capital Formation	5,788	6,698	6,490	6,578	7,681	9,683
Transfer costs of land and buildings	157	216	136	149	202	260
Building and construction	2,637	2,855	3,187	3,387	3,868	5,171
Private	1,906	1,891	1,914	1,992	2,259	2,888
Public	731	964	1,273	1,395	1,609	2,283
Government M.T.R.C.	731	964	1,273	1,179	1,036	1,165
M.T.R.C.	N.A.	N.A.	N.A.	216	573	1,118
Plant, machinery and equipment	2,994	3,627	3,167	3,042	3,611	4,252
Private	2,933	3,534	3,067	2,975	3,554	4,179
Public	61	93	100	67	57	73
Increase in Stocks	N.A.	303	469	713	2,415	1,331
Total Exports of Goods	23,154	25,999	24,373	25,161	32,215	33,853
Domestic exports	18,149	19,474	18,935	19,538	25,294	26,518
Re-exports	5,005	6,525	5,438	5,623	6,921	7,335
Imports of Goods	26,247	29,049	26,068	27,046	33,743	36,424
Exports less Imports of Services	4,600	4,316	3,677	3,725	4,926	4,522
Gross Domestic Product (GDP)	29,190	33,964	34,574	35,349	42,005	46,281
Per Capita GDP (\$)	7,092	8,062	8,004	8,041	9,452	10,262
Real Income	29,409	33,964	33,129	34,247	42,005	45,885
Per Capita Real Income (\$)	7,146	8,062	7,670	7,791	9,452	10,175
Total Final Demand	55,437	63,013	60,642	62,395	75,748	82,705
Domestic Demand	27,683	32,698	32,592	33,509	38,607	44,330
Private	25,184	29,729	29,113	29,834	34,549	39,284
Public	2,499	2,969	3,479	3,675	4,058	5,046

Note: N.A. Not applicable.

Definitions of terms: See Table (1).

Real income is GDP after adjusting for the terms of trade effect. The terms of trade measure the relative movements in import and export prices, which result in a varying volume of imports being exchangeable for a given volume of exports.

Table 2 (Cont'd)

EXPENDITURE ON THE GROSS DOMESTIC PRODUCT BY COMPONENT
AT CONSTANT (1973) PRICES 1972 TO 1982 (\$MN)

	1978	1979	1980	1981(*)	1982(**)
Private Consumption					
Expenditure	35,984	39,389	44,811	50,280	51,147
Government Consumption					
Expenditure	3,033	3,356	3,613	4,532	4,880
Gross Domestic Fixed					
Capital Formation	11,287	13,372	15,707	17,766	17,722
Transfer costs of					
land and buildings	399	481	791	1,355	1,137
Building and					
construction	5,679	5,932	6,625	7,001	7,733
Private	2,813	3,083	3,806	3,990	3,950
Public	2,866	2,850	2,819	3,011	3,783
Government	1,725	1,928	2,138	2,633	3,081
M.T.R.C.	1,141	922	681	378	702
Plant, machinery					
and equipment	5,209	6,959	8,291	9,410	8,852
Private	5,024	6,607	7,952	8,898	8,347
Public	185	352	339	512	505
Increase in Stocks	1,572	1,974	2,394	1,201	945
Total Exports of Goods	38,517	46,030	54,192	61,251	60,187
Domestic exports	29,288	34,127	37,847	40,892	39,772
Re-exports	9,229	11,903	16,345	20,359	20,415
Imports of Goods	44,244	51,281	60,832	67,944	66,113
Exports less Imports					
of Services	4,903	4,725	4,407	4,234	4,252
Gross Domestic Product					
(GDP)	51,052	57,565	64,292	71,320	73,020
Per Capita GDP (\$)	11,106	11,799	12,760	13,838	13,954
Real Income	50,233	56,753	63,469	69,727	71,437
Per Capita Real					
Income (\$)	10,927	11,633	12,597	13,528	13,652
Total Final Demand	95,296	108,846	125,124	139,264	139,133
Domestic Demand	51,876	58,091	66,525	73,779	74,694
Private	45,792	51,533	59,754	65,724	65,526
Public	6,084	6,558	6,771	8,055	9,168

Notes: (*) Provisional estimates.

(**) Preliminary estimates.

Table 3

GROWTH RATES IN REAL TERMS OF COMPONENTS OF EXPENDITURE
ON THE GROSS DOMESTIC PRODUCT 1972 TO 1982 (%)

	1972	1973	1974	1975	1976	1977
Private Consumption						
Expenditure	6.2	18.4	-1.1	2.0	8.8	17.3
Government Consumption						
Expenditure	8.7	12.0	10.1	5.1	8.1	12.5
Gross Domestic Fixed						
Capital Formation	5.0	15.9	-3.1	1.4	16.8	26.1
Transfer costs of land						
and buildings	67.0	37.6	-37.0	9.6	35.6	28.7
Building and						
construction	4.8	8.3	11.6	6.3	14.2	33.7
Private	4.4	-0.8	1.2	4.1	13.4	27.8
Public	5.8	31.9	32.1	9.6	15.3	41.9
Government	5.8	31.9	32.1	-7.4	-12.1	12.5
M.T.R.C.	N.A.	N.A.	N.A.	N.A.	165.3	95.1
Plant, machinery						
and equipment	3.1	21.4	-12.7	-3.9	18.7	17.8
Private	2.6	20.5	-13.2	-3.0	19.5	17.6
Public	38.6	52.5	7.5	-33.0	-14.9	28.1
Total Exports of Goods	6.8	12.3	-6.3	3.2	28.0	5.1
Domestic exports	4.3	7.3	-2.8	3.2	29.5	4.8
Re-exports	17.3	30.4	-16.7	3.4	23.1	6.0
Imports of Goods	3.5	10.7	-10.3	3.8	24.8	7.9
Exports less Imports						
of Services	9.3	-6.2	-14.8	1.3	32.2	-8.2
Gross Domestic Product						
(GDP)	9.7	15.8	1.8	2.2	18.8	10.2
Per Capita GDP	7.8	13.1	-0.7	0.5	17.5	8.6
Real Income	11.4	14.9	-2.5	3.4	22.7	9.2
Per Capita Real Income	9.5	12.3	-4.9	1.6	21.3	7.6
Total Final Demand	6.7	13.4	-3.8	2.9	21.4	9.2
Total Final Demand						
Excluding Re-exports	5.7	11.7	-2.3	2.8	21.2	9.5
Retained Imports	0.7	6.0	-8.4	3.8	25.2	8.5
Domestic Demand	6.1	17.5	-0.3	2.8	15.2	14.8
Private	5.9	17.4	-2.1	2.5	15.8	13.7
Public	8.4	18.8	17.2	5.6	10.4	24.3
GDP Deflator	7.8	12.9	12.2	2.3	7.8	4.1
Consumer Price Index	6.1	18.2	14.4	1.2	3.4	5.8

Note: N.A. Not applicable.

Definitions of Terms: See Tables (1) and (2).

Table 3 (Cont'd)

GROWTH RATES IN REAL TERMS OF COMPONENTS OF EXPENDITURE
ON THE GROSS DOMESTIC PRODUCT 1972 TO 1982 (%)

	1978	1979	1980	1981(*)	1982(**)	Average annual growth rates: 10 years 1973 to 1982
Private Consumption						
Expenditure	17.5	9.5	13.8	12.2	1.7	9.7
Government Consumption						
Expenditure	12.8	10.6	7.7	25.4	7.7	11.1
Gross Domestic Fixed						
Capital Formation	16.6	18.5	17.5	13.1	-0.2	8.9
Transfer costs of						
land and buildings	53.5	20.6	64.4	71.3	-16.1	21.9
Building and						
construction	9.8	4.5	11.7	5.7	10.5	11.4
Private	-2.6	9.6	23.5	4.8	-1.0	7.6
Public	25.5	-0.6	-1.1	6.8	25.6	17.9
Government	48.1	11.8	10.9	23.2	17.0	15.5
M.T.R.C.	2.1	-19.2	-26.1	-44.5	85.7	N.A.
Plant, machinery						
and equipment	22.5	33.6	19.1	13.5	-5.9	11.5
Private	20.2	31.5	20.4	11.9	-6.2	11.0
Public	153.4	90.3	-3.7	51.0	-1.4	23.5
Total Exports of Goods	13.8	19.5	17.7	13.0	-1.7	10.0
Domestic exports	10.4	16.5	10.9	8.0	-2.7	8.2
Re-exports	25.8	29.0	37.3	24.6	0.3	15.1
Imports of Goods	21.5	15.9	18.6	11.7	-2.7	9.7
Exports less Imports						
of Services	8.4	-3.6	-6.7	-3.9	0.4	-0.8
Gross Domestic Product						
(GDP)	10.3	12.8	11.7	10.9	2.4	9.6
Per Capita GDP	8.2	6.2	8.1	8.4	0.8	7.0
Real Income	9.5	13.0	11.8	9.9	2.5	9.3
Per Capita Real Income	7.4	6.5	8.3	7.4	0.9	6.7
Total Final Demand	15.2	14.2	15.0	11.3	-0.1	9.6
Total Final Demand						
Excluding Re-exports	14.2	12.6	12.2	9.3	-0.2	8.9
Retained Imports	20.4	12.5	13.0	7.0	-4.0	8.0
Domestic Demand	17.0	12.0	14.5	10.9	1.2	10.4
Private	16.6	12.5	16.0	10.0	-0.3	10.0
Public	20.6	7.8	3.2	19.0	13.8	13.9
GDP Deflator	5.7	14.1	13.1	9.6	11.8	9.3
Consumer Price Index	5.9	11.6	15.5	15.4	10.6	10.1

Notes: (*) Based on provisional estimates.
 (**) Based on preliminary estimates.
 N.A. Not applicable.

PRECEDENTS OF CONCESSIONS AND COMPENSATIONS
GIVEN TO HONG KONG IN GATT NEGOTIATIONS

(Note: All references to Hong Kong in this Annex are recorded as "the United Kingdom in respect of Hong Kong" in GATT documents)

1. In the 1956 tariff negotiations, Hong Kong agreed to the bindings of duties on certain items to the United States, and the United States in return bound certain items to Hong Kong.
2. In November 1958, the Australian delegation to the GATT stated that "Australia recognises Hong Kong's principal supplying interests in respect of the concession to be withdrawn and, as compensation, would be prepared to bind duty free entry under the MFN tariff". Subsequently Hong Kong accepted the Australian offer to bind the MFN rates of duty on a number of items.
3. In the 1960-61 negotiations under Article XXIV(6) of the GATT, consequent upon the agreement of a common external tariff for the European Economic Community (EEC), the EEC gave certain bindings to Hong Kong to compensate for cases where the rates of duty in the common external tariff were higher than previously bound rates of duty on the same items in certain individual member states of the Community.
4. In the 1961 tariff negotiations, the United States gave compensation to Hong Kong for an increase in the bound rates of duty in rubber sole footwear.
5. In the 1965 tariff negotiations, the United States gave certain compensation to Hong Kong for net increases in duty rates on bound items where Hong Kong was the principal or substantial supplier.

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- (d) "The Making of Public Policy in Hong Kong", speech by the Hon. C.P. Haddon-Cave to Mont Pelerin Society on 4th September 1978.

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(d) "External Shocks: Their Impact on a small Open Economy and Policy Reaction - The Hong Kong Experience" paper by Dr. A.A. McLean, Deputy Secretary for Economic Services to Fifth Pacific Basin Central Bank Economists' Conference in Vancouver, 1st October 1981.

(5) Text of the GATT, especially

(a) Article I

(b) XXIV

(c) XXVI

(d) XXXV

(6) Protocol of provisional application of the GATT in respect of the UK & others.

(7) GATT L/3800 dated 29 December 1972: Hong Kong's status in GATT.

(8) Note on Hong Kong's Rights and Obligations in the GATT dated 28 February 1966.

CONFIDENTIAL 機密

THE LEGAL SYSTEM OF HONG KONG

Hong Kong

29 July 1983

CONFIDENTIAL 機密

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THE LEGAL SYSTEM OF HONG KONG

(1) RULE OF LAW

1. The processes whereby the law is manifested, adapted, administered and served in Hong Kong are an inheritance from the common law of England that has been successfully adapted to the needs of Hong Kong people over a century or more.

2. By the end of the nineteenth century, English law had developed through periods of agrarian and mercantile growth to accommodate the trading and commercial needs of an industrial society. Conflicts over the source and exercise of sovereign power had been settled by the seventeenth century, and the concept of the separation of powers had become established. In general the power to make new laws rested with the legislature, the executive carried them out and an independent judiciary interpreted and enforced the law. But, above all three, the law itself was supreme.

3. Since at least the fifteenth century, reports of judgments handed down by judges have established in detail the legal principles regulating the relationship between state and citizen, and between citizen and citizen. There are now some hundreds of thousands of reported English cases which comprise the common law. Fundamental principles still rest upon judicial decisions. When a judge imprisoned jurymen for their failure to convict religious dissenters in 1671, the Court that released them established the supremacy of the jury's verdict in criminal cases. Slavery ended when an African was released from a ship in Liverpool after the issue of a writ of habeas corpus in 1772. The limits of freedom of speech, freedom of assembly, freedom from arbitrary arrest or imprisonment have been spelled out in cases reaching back two centuries

or more, each one building upon the reasoning of earlier precedents. To this day, the basic principles of the law of contract, tort, alienation and use of property, succession, domestic relations, evidence, and elements of criminal law, are all largely derived from case law.

4. In declaring the law, the role of the judges is supreme. Their statements of the law can only be modified by enactment of a fresh Ordinance at the instance of the executive, provided it secures the support of public opinion and the legislature. The twentieth century has seen the increasing use of (in Hong Kong by Ordinance) legislation to adapt the law to the complex needs of modern administration and on occasions usefully to codify the law. But the legislature in practice is restrained in exercising its power by respect for the fundamental principles derived from judicial precedents.

5. The transplantation of the English common law throughout the world in the territories to which British rule extended is an historical fact. It proved to be most successful in those places where resources of natural wealth, manpower or trading advantages existed. This has been largely due to developments of law associated with the industrialisation of England during the nineteenth century. These brought about the introduction of limited liability corporations to generate risk capital for investment, together with rapid developments of commercial law governing credit arrangements, bills of exchange, insurance, transport and shipping. These built upon the already established law of contract giving binding force to agreements freely made between capable parties. A century later English law still lies at the heart of the world's banking, insurance and transport arrangements, now developed yet further through international conventions and the work of international agencies.

6. The development of Hong Kong from a centre for entrepot trade, as a manufacturing base, to become one of the world's leading international centres of banking, investment and trading institutions has been facilitated by the maturity and sophistication of the legal system in Hong Kong. The laws are predictable, they have developed over many decades in the context of trading problems arising in many different countries, and they are applied by impartial judges beyond corruption. It is an everyday occurrence for decisions of courts in England, Canada, Australia, East Africa, Singapore and elsewhere in the Commonwealth to be relied upon in argument before the courts of Hong Kong.

7. It is a feature of Hong Kong's legal system that it promotes certainty. Vague principles or precepts do not enable citizens to rely upon the law for too much depends upon their interpretation by the Administration or by the judges. The long period during which the principles of the English law have been established, refined, particularised and disputed before the courts enable laws of Hong Kong to be both comprehensive and detailed. English terminology is used in drafting Hong Kong Ordinances in the knowledge that its meaning is clearly revealed by case law. Equally, the law making agencies in Hong Kong are inhibited in departing far from the basic principles of human and personal rights that are entrenched in the common law. Essential freedoms and personal liberties are respected and established concepts of fairness of procedure are carefully incorporated.

8. Above all the rule of law dictates and experience has shown that all are equal before the law, however high or low they may rank in the community. The role of the judge is to sit and determine a dispute presented to him by the parties before the court. He does not of his own initiative search out the truth but rather, receives the evidence that the disputant parties adduce before him. These may both be private persons as for example in a dispute between a husband and wife, a bank and its trading

customer, a landlord and a tenant. Where the dispute is between the government or its agencies and a citizen, each party enjoys the same rights and opportunities to call evidence before the courts and to address its arguments to the courts. Similarly, as has been pointed out, it is open to a citizen aggrieved by an administrative decision reached by an executive agency to challenge it before the court; for example, a refusal to grant a trading licence or a refusal to permit an immigrant to remain in Hong Kong. Where the judge finds that essential facts relied upon by the executive cannot be established, or concludes that the exercise of a discretion by the executive is based upon irrelevant considerations or is unreasonable, he will intervene to protect the right of the individual. In that sense the parties before the court are equal and the law is applied without favour or fear and evenhandedly, regardless of the prestige of the government or the vulnerability of the citizen.

9. The quality of the law and the spirit in which it is applied, depend therefore upon its derivation from the well-worked and elaborate development of the English common law. It embodies those principles of constitutional law that have been applied to Hong Kong. It controls decisions of the Governor and the most junior administrator or police officer because they recognise the supremacy of the law. Neither the Governor, the Civil Service nor any person acting on behalf of the executive agencies is able to exercise a power unless he can point to some specific legislation or law which authorises his act. The rule of law ensures that accountability is not an empty concept. The rule of law guarantees basic freedoms to individuals in their personal lives and protects them from arbitrary or governmental power in excess of legal authority. By its certainty, consistency and the proven impartiality of the judiciary who ultimately declare and enforce the law, it induces confidence in those who carry on their business and their lives in Hong Kong in reliance upon the law.

(2) THE SOURCES OF LAW IN HONG KONG

10. The law in force in Hong Kong consists of -

- (i) English common law and equity;
- (ii) Statute Law; and
- (iii) in some fields, Chinese customary law.

11. By the Application of English Law Ordinance (Chapter 88), the common law and rules of equity are in force in Hong Kong -

- (i) so far as they are applicable to the circumstances of Hong Kong or its inhabitants;
- (ii) subject to such modifications as such circumstances may require;
- (iii) subject to any amendment by
 - (a) any Order in Council which applies to Hong Kong;
 - (b) any Act of the United Kingdom Parliament which applies to Hong Kong; or
 - (c) any Hong Kong Ordinance.

12. Chapter 88 also provides that certain specified Acts of Parliament apply to Hong Kong and that any other Act may be applied to Hong Kong by any Order in Council, any provision in that Act or any Ordinance.

13. Accordingly, unless it is supplanted by any statute in force in Hong Kong, the English common law and rules of equity are to be applied in Hong Kong.

14. That common law and those rules are to be found primarily in the judgments of the superior courts in Hong Kong, England and other common law jurisdictions.

15. In theory, common law and equity is a pre-existing body of law and applies, in the absence of statute, to any given case. In practice, the courts develop the law to meet novel situations.

16. Statute law in force in Hong Kong may take one of several forms -

(i) a Hong Kong Ordinance;

(ii) Hong Kong subsidiary legislation;

(iii) an Act of the Queen in Parliament extended to Hong Kong by the Act itself or by an Order in Council (for example, British Nationality Act 1981 extended to all dependent territories by section 53(5) and Merchant Shipping Act 1979 extended to Hong Kong by Order in Council 1980 No. 1514); or

(iv) a self-contained Order in Council (for example, Hong Kong (Appeal to Privy Council) Order in Council 1909).

17. Most statute law in force in Hong Kong is made locally and is contained in the Laws of Hong Kong (22 volumes consisting of 374 Chapters concerning matters of general application and 110 Chapters relating to matters such as the incorporation of trusts, hospitals and religious organizations). Legislation made in the United Kingdom applicable to Hong Kong is also published locally and is contained in 3 volumes of the Laws of Hong Kong. Such legislation usually concerns matters with an international aspect such as air navigation, merchant shipping and nationality.

18. As in England, a great deal of legislation is made under a delegated power. For example, an Ordinance may delegate to the Governor in Council (the Governor with the advice of the Executive Council) the power to make regulations to deal with the details of the implementation of a legislative scheme. Similarly, the Urban Council has, under the Public Health and Urban Services Ordinance (Chapter 132), the power to make by-laws concerning matters within its jurisdiction.

19. Legislation made in Hong Kong concerns every aspect of life and government. For example -

Crimes Ordinance (Chapter 200);
Legal Aid Ordinance (Chapter 91);
Immigration Ordinance (Chapter 115);
Banking Ordinance (Chapter 155);
Securities Ordinance (Chapter 333);
Landlord and Tenant Ordinance (Chapter 7);
Sale of Goods Ordinance (Chapter 26);
Partnership Ordinance (Chapter 38).

20. Chinese customary law is applicable in Hong Kong in certain spheres. For example, under section 13 of the New Territories Ordinance (Chapter 97), in relation to land in the New Territories, the courts may recognize and enforce Chinese customs or customary rights, and by section 11 of the Intestates' Estates Ordinance (Chapter 73), land in the New Territories devolves according to Chinese custom. Chinese law and custom is also recognized in the Legitimacy Ordinance (Chapter 184) and other Ordinances.

21. Over 300 international multi-lateral agreements and arrangements apply to Hong Kong, and laws to give effect to them may be contained in a United Kingdom Act of Parliament which is extended to Hong Kong or by a Hong Kong Ordinance. Hong Kong is thus linked to international arrangements dealing with matters such as trade and economic development, labour standards, human rights, civil aviation, maritime law and the control of pollution. Some specific examples are -

- (i) The General Agreement on Tariffs and Trade, Geneva 1947;
- (ii) International Covenant on Civil and Political Rights, New York 1966; and
- (iii) Convention on International Civil Aviation, Chicago, 1944.

As well as these multi-lateral agreements and arrangements, there are over 180 bi-lateral agreements with many countries throughout the world on matters such as extradition, consular arrangements and the promotion and protection of investments which apply to Hong Kong.

(3) THE MAKING OF HONG KONG LAW

22. Acts of Parliament are passed by both Houses of Parliament and assented to by the Queen. With rare exceptions consultation takes place before Acts are extended to Hong Kong.

23. Orders in Council are made by the Queen in Council on the advice of Her Majesty's Government. Again consultation with the Hong Kong Government takes place before Orders are made for Hong Kong.

24. In Hong Kong, legislation in the public area is made on the initiative of the administration; occasionally legislation is made on the initiative of a private person but only when it affects some particular association or corporation. The law-making power in Hong Kong is vested in the Governor acting by and with the advice and consent of the Legislative Council. Before the introduction of a Bill into the Legislative Council, the Governor takes the advice of the Executive Council.

25. Where important policy matters are concerned, the administration will frequently consult experts, interested parties and the general public before the legislation proceeds before the legislation proceeds; either informally or by means of a working group (e.g. the Committee of Review - Landlord and Tenant (Consolidation) Ordinance in 1981). The Law Reform Commission of Hong Kong takes an active part in this process and is currently examining a number of areas of the law where it may be appropriate to introduce reforms. The membership of the Commission and the sub-committees through which it works are drawn from community leaders and experts in the fields being examined who come from both the private and public sectors. The Commission consults a wide range of public

opinion, both through the issuing of press releases inviting comments from the general public and through the direct eliciting of submissions from interested parties. When it has been decided to introduce legislation further consultation often takes place both with the general public and with interested parties throughout the legislative process.

26. After initial consultation on proposed legislation has taken place the final draft Bill is then submitted to the Governor-in-Council (i.e. the Governor sitting with the Executive Council) for approval. The Bill is accompanied by a paper explaining the policy behind the measure, the financial and staffing implications, the legislative time table and giving other relevant information.

27. If the Governor in Council approves the introduction of the Bill into the Legislative Council, it is published in the Gazette and, at the same time, a press release is issued to publicise the measure and to invite public comments on the proposals.

28. These comments may be submitted to the administration directly or to the office of the unofficial members of the Legislative Council. The Unofficial Members have their own office in the central district of Victoria with a secretariat to handle its administration.

29. The Unofficial Members of the Legislative Council will, unless the Bill is uncontroversial, set up a committee to examine it and consider any comments by the public.

30. If the committee requires any further information or explanations relating to the measure or the public reaction to it, they will invite the administrators responsible for the Bill and the draftsman to attend one or more of their meetings.

31. At these meetings, any difficulties seen by the unofficials are discussed and, often, this will result in amendments being agreed to deal with these problems. In particular, the unofficials are concerned to see that the measure is designed to operate fairly in its impact on the public and their interest often ensures the insertion into a Bill of safeguards to guarantee its just operation.

32. After introduction into the Legislative Council, the Bill is given a formal First Reading and the Second Reading is moved at which the policy Secretary will speak on the general merits and principles of the Bill.

33. After the policy Secretary's speech, the Second Reading is adjourned. Usually, the matter is then reported upon in the press and this may result in public comment which will be considered by the administration and the Unofficial Members.

34. The Bill will be brought up again in the Council, usually not sooner than 2 weeks later, for the resumption of the second reading debate. On this occasion, the Unofficial Members will express their views, either supporting the measure or criticising it. In the face of strong opposition a bill is withdrawn for further consideration. If time permits, the amendments will be published in the Gazette before the bill proceeds to its next stage.

35. After the Second Reading, the Council moves, on the same day, to the Committee Stage, at which any amendments to the Bill are moved, and the Third Reading.

36. If the Bill is passed, the Governor assents to it and it is published in the Gazette. At the commencement of the day of publication, the Ordinance becomes law.

37. After this, the Ordinance, with a legal report explaining the 'reasons and occasion' for the measures, is transmitted to the Secretary of State. The Queen in Council maintains an ultimate power of disallowance over Hong Kong legislation.

38. This power of disallowance has not been exercised since 1913 when the Sugar Convention Ordinance was disallowed for technical reasons. Naturally, the Hong Kong administration is aware of the sensitive areas concerning which legislation may be disallowed and will consult the Foreign & Commonwealth Office before seeking to legislate in these areas.

39. Subordinate legislation is made in Hong Kong under a power delegated by an Ordinance. It must not exceed the limits set by the power contained in the principal Ordinance. It may take several forms. They may be -

- (i) resolutions of the Legislative Council;
- (ii) regulations made by the Governor in Council;
- (iii) regulations, rules or other subsidiary legislation made by some other person or body subject to the approval of the Governor in Council or the Legislative Council;
- (iv) subsidiary legislation made in certain limited areas after consultation with some other body or person; or

- (v) subsidiary legislation made without a built-in control or consultation (but this is subject to what is said in paragraphs 40 and 41).

40. All subsidiary legislation must be published in the Gazette (section 20 of the Interpretation and General Clauses Ordinance, Chapter 1) and, under Section 34 of Chapter 1, all rules, regulations and by-laws must be laid on the table of the Legislative Council at the next sitting after that publication.

41. Within 27 days after the sitting at which the subsidiary legislation was laid, the Legislative Council may revoke or amend that legislation by resolution. This is without prejudice to anything done under the regulations. The resolution must be published in the Gazette.

42. In this way, the Legislative Council retains ultimate control over subsidiary legislation made in Hong Kong.

(4) THE ADMINISTRATION OF JUSTICE

(a) The Judiciary

43. The Chief Justice, the Justices of Appeal and the Judges of the High Court are appointed by Letters Patent issued under the Public Seal of the Governor on instructions from the Queen, conveyed through the Secretary of State. District Court Judges are appointed by the Governor, by instrument under the Public Seal, and magistrates by the Governor by warrant. All Judges and Magistrates must have been qualified as legal practitioners in a common law jurisdiction and have had substantial professional experience. Before any judicial officer is appointed the impartial, independent and informal advice of the Judicial Services Commission is sought. The Commission is an independent statutory body constituted under the Judicial Service Commission Ordinance, Chapter 92 of the Laws of Hong Kong.

44. All Judges have security of tenure in office until they reach retirement age (which is normally 60 years for District Court Judges & 65 for others); they are irremovable unless and until the Judicial Committee of Her Majesty's Privy Council in London, advises the Queen that the particular Judge "ought to be removed from office for inability arising from infirmity of body or mind, or for misbehaviour". There is no known case of a judge being removed from the Bench in Hong Kong.

(b) The Role of the Judges

45. The principal work of the judges is to adjudicate upon disputes. In the exercise of this function the judges must apply the existing rules of law to the case before them. There are two aspects of this judicial function - the interpretation of legislation and the application of the doctrine of precedent. It is the duty of judges to ascertain the intention of the legislature following established principles of statutory interpretation, or to apply the existing law where the rule of law in question is a rule of common law.

(c) The Interpretation of Legislation

46. In Hong Kong, the general principles of statutory interpretation are laid down in section 19 of the Interpretation and General Clauses Ordinance, Chapter 1, which declares that an Ordinance shall be remedial and receive such fair, large and liberal construction and interpretation as will best ensure the attainment of the object of the Ordinance according to its true intent, meaning and spirit.

(d) The Doctrine of Precedent

47. (i) Hong Kong Courts In the interests of legal certainty, the Hong Kong courts apply the same doctrine of binding precedent as the English courts. Decisions of the Court of Appeal are binding on all inferior courts dealing with civil or criminal cases. Generally speaking, the Court of Appeal is bound by its own previous decisions although this rule is subject to some exceptions. Decisions of High Court judges sitting alone at first instance are binding on inferior courts but are not binding on other High Court judges.

48. (ii) Overseas Courts Decisions of the Privy Council, to which appeals lie from the Court of Appeal, are binding on the courts in Hong Kong. Decisions of the House of Lords on the common law are of very great persuasive authority because of the common membership of the judges of the House of Lords and the Privy Council. A House of Lords decision on the interpretation of legislation that is common to both England and Hong Kong is effectively binding on the Hong Kong Court of Appeal. Decisions of the lower courts in England and of other Commonwealth countries are of persuasive authority only, but their leading cases are generally followed in the courts of Hong Kong.

(e) The Courts

49. The Courts of Justice in Hong Kong are the Court of Appeal, the High Court (which are superior courts), the District Court, the Magistrates' Court, the Juvenile Court, the Coroner's Courts, the Lands Tribunal, the Small Claims Tribunal and the Labour Tribunal (which are inferior courts).

50. The Chief Justice is the president of the Court of Appeal and there are nine Justices of Appeal and 21 Judges of the High Court. There are 31 District Judges who sit in District Courts in Victoria, Kowloon, Tsuen Wan and Fanling. There are 46 Magistrates sitting in eight magistracies in Western, Causeway Bay, South Kowloon, North Kowloon, San Po Kong, Kwun Tong, Tsuen Wan and Fanling.

(f) Rights of Representation

51. Barristers have an exclusive right to represent litigants in the superior courts; solicitors may also appear on procedural matters in superior courts and generally before inferior courts (see paragraph 83 below). A private litigant has the right to appear in person. Legal officers employed in the Government's Legal Department have a right to appear before any court or tribunal.

(g) Criminal Jurisdiction of the Courts

52. Magistrates exercise criminal jurisdiction over a wide range of indictable and summary offences. Their powers of punishment are generally restricted to a maximum of two years' imprisonment, or a fine of \$10,000, though cumulative sentences of imprisonment up to three years may be imposed for two or more offences tried together.

53. There is a large panel of about 360 local people who are appointed as lay assessors to assist in the Magistrates' Courts. Being bilingual and with a knowledge of local customs, traditions and community feelings, the assessors sit and advise some magistrates recruited from overseas who are however, not bound by law to accept their advice.

54. Two Cantonese-speaking special magistrates, who are not legally qualified but are experienced in judicial work, were appointed in 1982 to deal with cases of a routine nature, such as hawking and minor road traffic cases. Their powers of punishment, however, do not include the power of imprisonment.

55. Appeals are brought from the Magistrate's Court to a Judge of the High Court.

56. Where a child (aged under 14) or a young person (aged between 14 and 16) has been charged with an offence other than homicide the Juvenile Court has jurisdiction to determine such charges.

57. More serious criminal cases are dealt with in the District Court to which cases are transferred from the Magistrates' Court upon the application of the Attorney General. Trial in the District Court is by a Judge sitting alone, who may not impose a sentence of more than seven years imprisonment. An appeal from the District Court lies to the Court of Appeal.

58. The most serious criminal offences of all, such as murder, rape, armed robbery and offences involving large quantities of drugs, are dealt with by the High Court to which cases are committed from the Magistrates' Courts. Trial in the High Court is by a Judge of that Court sitting with a jury of seven. It is the jury which decides whether the accused is guilty or not guilty. The decision of the jury must be unanimous in cases in which the law provides for a sentence of death. In other cases, a jury may return a majority verdict of five to two. Appeals from the High Court are determined by the Court of Appeal from which a further appeal lies to the Privy Council, but only with the leave of the Judicial Committee.

59. There are two full-time coroners who sit in the Coroners Court conducting inquiries into the cause of, or circumstances connected with deaths which occur suddenly, by accident or violence, or under suspicious circumstances. They may sit with a jury of three people.

(h) Civil Jurisdiction of the Courts

60. (i) Court of Appeal The Hong Kong Court of Appeal has unlimited jurisdiction to hear all appeals in civil cases from the High Court and the District Court.

(ii) The High Court The High Court has unlimited jurisdiction in civil matters. It also exercises jurisdiction in mental disability, bankruptcy and company winding-up matters and hears appeals from the Small Claims Tribunal and the Labour Tribunal.

- (iii) The District Court The District Court has jurisdiction over civil disputes in which the value of the subject matter is under \$20,000 (to be raised to \$40,000 on 1 September 1983) or \$15,000 (to be raised to \$30,000 on 1 September 1983) in the case of land. The District Court also has jurisdiction over divorce, legitimacy and adoption proceedings.
- (iv) The Small Claims Tribunal The Small Claims Tribunal has jurisdiction over civil disputes in contract or tort where the amount claimed is under \$5,000. The Tribunal operates as a quick and informal forum for dealing with small claims.
- (v) The Lands Tribunal The Lands Tribunal has jurisdiction over a wide range of matters including landlord and tenant disputes in respect of controlled premises, claims for compensation for resumption of land by the Crown and appeals against rating assessments.
- (vi) The Labour Tribunal The Labour Tribunal has jurisdiction to deal with individual money claims arising from contracts of employment. As with the Small Claims Tribunal its procedure is simple and informal.

(i) The Privy Council

61. Appeals from the Hong Kong Court of Appeal lie as of right to the Privy Council where the matter in dispute is worth \$200,000 or above. Otherwise an appeal lies, with leave of the Court of Appeal or the Privy Council, if the question involved in the appeal is one of general or public importance.

(j) Other Tribunals

62. There has, in recent years, been a steady growth in the number of tribunals (many of them composed of non-lawyers) that deal with appeals against administrative decisions of the Government. The most noteworthy are the Immigration Tribunal and the Transport Tribunal. The Inland Revenue Board of Review hears tax appeals. Other examples of tribunals are the Building Appeals Tribunal and the many disciplinary tribunals such as the Medical Council that deal with issues of professional conduct. There are, in addition, a number of non-statutory tribunals such as the Criminal Injuries Compensation Board and the Social Security Appeals Board. Finally, Tribunals are set up from time to time to deal with such matters as marine or air accidents or matters of great public importance, such as the Commission of Inquiry into the collapse of the grand-stand at Sek Kong. The tribunals conduct themselves within the sophisticated frame-work of administrative law developed in the United Kingdom, particularly in the last 30 years. The tribunals are, accordingly, subject to the overall control of the courts through the mechanism of judicial review noted below.

(k) Special Remedies

63. This paragraph describes the remedies open to private individuals who seek to challenge the authority of the Government to act (or not to act) in particular matters.

(i) Habeas Corpus The procedure known as habeas corpus (which derives from English common law dating back to at least 1412) is a process that enables the courts to inquire into the reasons why any person has been deprived of his liberty. If there is no legal justification for a person's detention, the court will order his release. The existence of this process ensures that, in any matter involving the liberty of a person, the actions of the Government and its officials are subject to the supervision and control of the courts.

(ii) Judicial Review In Hong Kong, following legal developments in England, the procedure known as judicial review confers on the High Court a supervisory jurisdiction over the proceedings and decisions of inferior courts, tribunals and other bodies or officials charged with the performance of public acts and duties. Judicial review enables the courts to pass judgment on the legality of acts of government. The process of judicial review has developed a body of administrative law which now imposes, as part of the rule of law, proper legal limits on the exercise of power.

(1) Arbitration

64. As an alternative to proceedings in the ordinary courts, parties to a dispute, particularly in the fields of commerce, shipping or building contracts, often prefer to refer their disputes to arbitration. The jurisdiction of arbitrators usually arises out of contract, though there are numerous statutory provisions which provide for the reference of disputes to arbitration. Hong Kong's law of arbitration is based on the English Arbitration Acts, with various improvements made recently following a report of the Hong Kong Law Reform Commission on the subject.

(m) Enforcement of Judgments and Awards

65. The judgments and awards of the Hong Kong High Court may be enforced in all countries of the Commonwealth and in consequence of international agreements and arrangements in many foreign countries, including France, Germany and Italy. Reciprocal arrangements exist for the enforcement in Hong Kong of the judgments of the superior courts of those countries that will enforce Hong Kong's judgments. Similarly, maintenance orders made in matrimonial proceedings can be enforced, on a reciprocal basis, in a number of overseas countries.

(n) International Co-operation

66. (i) Extradition Extradition is the formal surrender by one state to another, based on reciprocal arrangements, of a person accused or convicted of a serious criminal offence committed outside the territory of the extraditing country and within the jurisdiction of the requesting country which demands the fugitive's surrender. In Hong Kong, extradition is regulated by the United Kingdom Extradition Acts, which have been extended to Hong Kong and by the Fugitive Offenders Act 1967 (which deals with the arrest and surrender of fugitive offenders within the Commonwealth).
- (ii) Obtaining evidence The courts in Hong Kong have jurisdiction, on request from a foreign court, to obtain evidence in Hong Kong for civil or criminal proceedings in that court. Similarly, the courts in Hong Kong can issue Letters of Request to overseas courts for the obtaining of evidence.

(5) LEGAL SERVICES

(a) The Attorney General of Hong Kong

67. The Attorney General of Hong Kong is the Governor's Legal Adviser and has powers and responsibilities that are, with necessary modification, the same as those of the Attorney General in England.

(b) Responsibility in Respect of Prosecutions

68. The Attorney General is responsible for all prosecutions in Hong Kong. It is for him alone to decide whether or not prosecutions should be instituted in any particular case or class of case, and his responsibility to control and conduct them.

69. The Attorney General plays no part in the investigation of criminal offences: that is the responsibility of the police force and the other law enforcement agencies. However, once the agencies have gathered together the available evidence it is for the Attorney General to decide whether or not that evidence justifies the preferment of criminal charges against any person.

70. In making decisions on prosecution policy, the Attorney General acts as an independent officer - independent, that is, of the Government of which he is a member and of the Courts before which he prosecutes. The function which he exercises in this area is part of his function as guardian of the public interest and his decisions cannot be reviewed by the Courts.

71. The Attorney General does not make a decision on every prosecution which is brought - the vast majority of minor prosecutions heard before magistrates are routine matters which are dealt with by law enforcement agencies along settled guidelines issued under the authority of the Attorney General and without individual reference to the Attorney General's Chambers. The Attorney General does, however, supervise prosecutions generally and he personally or by way of specific delegation, considers many sensitive cases and all cases where the law provides that prosecutions may not be brought without his consent. These include prosecutions brought under the Gambling Ordinance, the Societies Ordinance, the Banking Ordinance and the Public Order Ordinance. These are all cases in which the Legislative Council has considered, for one reason or another, that there may be a special risk of an abuse of proceedings or that in some cases, even where sufficient evidence exists, to prosecute would be contrary to the public interest; the Legislative Council therefore has decided that the Attorney General should be empowered to exercise a veto, since without his consent in such cases the law cannot be set in motion at all.

(c) Civil Proceedings

72. The Attorney General is the defendant in all civil actions brought against the Government. Many of these concern disputes over building contracts where the sums claimed are very large, often involving foreign companies. Other actions involve claims against government hospitals and doctors for medical negligence. The Attorney General is also the defendant in actions for judicial review.

73. The Attorney General also has responsibility for bringing civil actions in the public interest with the object of enforcing public legal rights, for example, it may be the aim of such proceedings to prevent a public corporation from exceeding the legal powers conferred upon it by law, where the excess of powers may tend to injure the public. It is also sometimes necessary for the Attorney General to intervene in legal proceedings to which the Crown was not a party to represent the public interest, in which case he may appear as an 'amicus curiae' (friend of the Court) to assist the Court.

74. As guardian of the public interest, the Attorney General is the protector of charities and often intervenes in charity matters. Other examples of the Attorney General's responsibilities in the protection of the public interest are his powers to apply to the Court for a declaration that a person be declared a vexatious litigant and he acts in situations where in the course of petitions for divorce or nullity of marriage, the Court directs that the papers be referred to him or where information is received, such as suspected collusion by the parties, which might affect a proper decision by the Court in a particular case. It is also the Attorney General's duty, in appropriate cases, to bring proceedings for contempt of court.

(d) Executive and other Functions

75. The Royal Instructions provide for the Attorney General to be an ex-officio member of the Executive Council and the Legislative Council. In addition he is chairman of the Law Reform Commission of Hong Kong, a member of the Judicial Services Commission, a member of the Independent Commission Against Corruption Operations Review and the Complaints Committees, and a member of the Unofficial Member of the Executive and Legislative Council Office Complaints Against Police Group. He is titular head of the Hong Kong Bar.

(e) The Attorney General's Chambers

76. The Attorney General's Chambers is comprised of the Attorney General's Office and the Civil, Drafting and Prosecution Divisions. About 140 lawyers are divided among the four divisions. These lawyers came from many parts of the Commonwealth and bring with them a wide experience of many common law jurisdictions.

77. (i) The Attorney General's Office, aided by the Solicitor General is concerned with the formulation and resolution of major legal policy decisions and with administrative matters. The Office also comprises the Law Reform Commission Secretariat which services the Law Reform Commission.

(ii) The Civil Division headed by the Crown Solicitor provides all legal advice to government departments and conducts all civil litigation involving the Crown.

(iii) The Law Drafting Division is headed by the Law Draftsman who is also a member of the Legislative Council. The division is responsible for the drafting of all ordinances and regulations. In 1982 this task involved the drafting of 83 Bills and over 400 items of subsidiary legislation.

(iv) The Prosecutions Division, headed by the Crown Prosecutor, is responsible for advising on and conducting criminal prosecutions. Counsel from the division appear for the Crown in all but a few High Court and District Court trials and in Magistrates Court trials where complex issues or difficult points of law are involved. Apart from Crown Counsel, the Division also employs about 40 Court Prosecutors who prosecute only in the Magistrates Court. These prosecutors are not legally qualified but have attended a course of instruction run by the the Division.

(f) Registrar General's Department

78. This department is comprised of: the Land Office, the Commercial Division and the Official Receiver's Office.

79. The Land Office undertakes the drafting and settling of all conveyancing documents relating to the sale and purchase of land by the Government and also by the Hong Kong Housing Authority under the Home Ownership Scheme. The Land Office also provides legal advice to the Government on all matters relating to land. It also administers the Land Registration Ordinance for the registration of instruments affecting land as well as certain other land related legislation.

80. The Commercial Division consists of the Companies, Insurance, Trade Marks, Patents and Money Lenders Registries. The Companies Registry maintains the public files of all limited companies registered or with a place of business in Hong Kong and the number of such companies on the register is about 100,000. There are 1,574

companies incorporated outside Hong Kong who are registered as having a place of business in Hong Kong. Of these 365 were incorporated in the United States, 219 in the United Kingdom, 171 in Japan, 111 in Australia, 95 in Singapore, 93 in Panama, 54 in Liberia, 49 in the Bahamas, 45 in Switzerland and 39 in Canada. The Insurance Registry authorises and supervises the bodies carrying on life, motor, fire and marine insurance business in Hong Kong while the Trade Marks Registry deals with trade mark applications on similar criteria to the United Kingdom. The work of the Patents Registry is to re-register patents obtained in the United Kingdom and the Money Lenders Registry carries out various duties, mainly of an administrative nature, with regard to licensing of money-lenders.

81. The Official Receiver's Office is concerned with the liquidation of bankrupt estates and the winding-up of insolvent companies under the provisions of the Bankruptcy Ordinance and the Companies Ordinance. This involves litigation and commercial law. The Office is also involved with the administration of certain trusts and estates.

(g) Lawyers: the Private Sector

82. Lawyers practising in the private sector fall into four groups: barristers and solicitors in private practice; lawyers qualified overseas but not admitted to practice in Hong Kong who are employed in foreign law firms; 'corporation lawyers' who work in the legal departments of companies as 'in-house' legal advisers; and academic lawyers who teach law at Hong Kong University and other institutions. Only the first two groups need further explanation.

(h) Barristers and Solicitors

83. As in England, the legal profession in Hong Kong is divided into two branches : solicitors and barristers. There are about 200 barristers in private practice in Hong Kong and some 1,200 solicitors of whom about 30% are from the United Kingdom of whom about 70% are qualified to practice in commonw law jurisdictions overseas. As in cases between private citizens, in cases involving the Government, lawyers are bound by rules of their profession to assert and defend their clients' interests at all times.

(i) Foreign Lawyers

84. There are at present in Hong Kong over 20 foreign law firms staffed by over 80 foreign lawyers and the number of such firms is growing. These firms advise multi-national companies on matters of international law and on the domestic law of the countries from which they come. At present the majority of such firms come from the United States but there are also firms representing the Netherlands, France, West Germany, Canada and Australia.

(j) Legal Aid

85. Legal aid is available to any person in Hong Kong resident or non-resident, who satisfies the Director of Legal Aid on financial eligibility and justification for legal action.

86. The legal aid system is financed by the Government, but financial means test limits are imposed on applicants. At present, persons who have a disposable monthly income of not more than \$1,500 and a disposable capital of not more than \$15,000 are financially eligible. Disposable income and disposable capital are arrived at after 'allowances' have been deducted from actual earnings and capital of applicants.

87. To qualify for legal aid in civil cases, an applicant must satisfy the Director of Legal Aid that he has a reasonable chance of succeeding in his case and that he is financially eligible. Legal aid is available for most types of civil proceedings in the District Court, High Court, Court of Appeal and the Privy Council. Certain tenancy matters in the Lands Tribunal are also covered.

88. Traffic accident claims, claims in respect of industrial accidents and employees' compensation, tenancy matters and every branch of family law ranging from divorce, separation, maintenance and custody to wardship are included in the civil legal aid scheme. Admiralty, bankruptcy and companies' winding-up proceedings are also covered and the majority of these cases are of considerable importance since they deal mostly with employees' wages and severance pay.

89. Legal aid is available for criminal proceedings in the District Courts, the High Court and the Court of Appeal and the Privy Council. The majority of accused persons in the courts are legally aided. For a criminal trial legal aid is invariably given - subject to the means test - because of the severity of the charges coupled with the possible gravity of sentences. Legal aid can also be given to conduct pleas in mitigation of sentence. For appeals against conviction for murder, irrespective of whether there are grounds for appeal, legal aid is mandatory. For all other criminal appeals, including appeals from the decision of magistrates, legal aid will be given subject to the means test if the Director of Legal Aid is satisfied that there are arguable grounds of appeal.

90. There were 15,000 applications for legal aid for civil cases in 1982 and 3,000 for criminal cases. In 1982-83 expenditure on the schemes was \$49 million. In addition to the legal aid scheme free legal representation is available to defendants for certain criminal cases heard in the magistrates court. The service is funded by government subvention which in 1982-83 was \$9.2 million. Further, people throughout Hong Kong may seek legal advice on any matter from legal practitioners who voluntarily attend at one of 6 centres.

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- (f) The company should be in good standing in the Hong Kong (and, if relevant, in the international) money markets.
- (g) The company should have substantial assets (net of contra items) on its books in Hong Kong with a record of steady growth and prudent trading for at least three years.
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