

## **Chapter II : Revenue Collection and Financial Control**

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2.1 At the Chairman's invitation, the Secretary for the Treasury (S for Tsy), Miss Denise YUE, highlighted the key directions the Finance Bureau would pursue in the coming years in respect of its two policy areas - management of public finances and provision of some common services to users within the Government (Appendix V-1).

### **Comparison of growth in government expenditure and the economy**

2.2 Mr Jasper TSANG referred to the finding of the Task Force on Public Expenditure that due to the price rigidity in government expenditure, government expenditure in money terms had been rising faster than the nominal economic growth in recent years, resulting in a fiscal gap. He asked when the Administration first became aware of the phenomenon, and in the light of the phenomenon, how the Administration would adjust its budgetary strategies.

2.3 S for Tsy replied that while Article 107 of the Basic Law stipulated that the Hong Kong Special Administrative Region should keep the growth of government expenditure commensurate with the growth rate of Hong Kong gross domestic product (GDP), there was no provision in the Basic Law specifying whether the trend growth of government expenditure and that of the economy should be calculated in real or money terms. In fact, as early as 1986, the Administration had consciously decided to adopt the principle of aligning government expenditure growth with economic growth. Since then, the Finance Bureau had been monitoring the differences between economic growth and government expenditure growth in both real and money terms in drawing up the annual Budget, although the Administration had only published the comparison in real terms in its budget publications in past years. This year, the Financial Secretary (FS) had directed that when presenting the cumulative growth of government expenditure with the cumulative growth of the economy, information showing both real terms and money terms should be provided.

2.4 S for Tsy elaborated that during the period from 1986 to 1997, the cumulative government expenditure growth had been broadly in line with the cumulative economic growth in money terms. During these years, there had been general inflation in the economy. Although the prices pertaining to government spending had risen faster than the general price level in the economy, the fiscal gap created by the differential price movements had been somehow offset by the lower growth of government expenditure than the growth of the economy in real terms. The latter was in turn attributed to fact that government expenditure had been

## **Chapter II : Revenue Collection and Financial Control**

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planned on the basis of the projected economic growth, and in most of the years from 1986 to 1997, the actual economic growth had been higher than the projected economic growth. From 1998 to 2001, substantial deflation had occurred in the economy. However, certain key expenditure items, e.g. civil service salaries, pensions and social security payments were not adjusted correspondingly. Unforeseen economic factors had also caused projected economic growth to be higher than actual growth during these years. As a result, although the growth in government expenditure had been lower than the growth in GDP in real terms in 2000-01 and 2001-02, the gap between the cumulative growth in government expenditure and that in GDP in money terms had still widened during these two years.

2.5 As regards future budgetary strategies, S for Tsy confirmed that the Administration would strive to control the growth of government expenditure in money terms, in addition to controlling it in real terms in the coming years. She said that FS had projected that from 2002 to 2006, the real economic growth trend would be about 3% per year. In money terms, this would be about 3.5% per year. From 2003 to 2006, the Administration would control real expenditure growth at 1.5% per year, which would be lower than the projected economic growth by 1.5 percentage points. In money terms, the expenditure growth would be controlled at 1% per year. Thus government expenditure growth would be controlled at a level below economic growth, in both real and money terms.

2.6 Mr SIN Chung-kai noted that according to the Administration's projections, government expenditure at current prices would be HK\$254.2 billion, HK\$253.3 billion and HK\$255.6 billion for 2002-03, 2003-04 and 2004-05 respectively. Since the Administration had also projected that there would be minor inflation during the aforesaid years, the real value of the projected government expenditure for 2003-04 and 2004-05 would in fact be lower than that for 2002-03. He asked from which area(s) would the savings be generated during these two years. S for Tsy replied that the projected decline of government expenditure was based on the assumption that the salary of civil servants and the Personal Emoluments related subventions would be reduced by 4.75% from October 2002. Thus the full year effect of this assumed reduction would only be felt in 2003-04, thereby partly explaining the reduction in projected government expenditure for 2003-04 compared with 2002-03.

## **Chapter II : Revenue Collection and Financial Control**

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2.7 In response to Mr SIN's enquiry about the effect of the reclassification of expenditure of the former provisional municipal councils from public expenditure to government expenditure since January 2000, S for Tsy undertook to provide the information to Mr SIN in writing after the meeting.

### **Restoring fiscal balance**

2.8 Ms Emily LAU referred to the announcement made by FS in his Budget Speech to reduce public expenditure to 20% of GDP or below by 2006-07 and to control government expenditure growth at 1.5% and 1% in real and money terms. She was given to understand from some Bureau Secretaries and Controlling Officers that FS had not thoroughly discussed this target with them, and thus was concerned that there was a lack of participation of Bureau Secretaries and Controlling Officers in the course of drawing up the Budget as well as a lack of consensus within the Administration on whether and how the growth of public expenditure should be controlled at the announced level.

2.9 S for Tsy replied that FS had conveyed a clear message in the Budget Speech that a change to the current mode of government spending was necessary to restore fiscal balance and to ensure fiscal sustainability. To achieve the target of reducing public expenditure to 20% of GDP or below by 2006-07, FS had announced that the annual real growth in public expenditure would be 1.5% in the years from 2003-04 to 2005-06, and that the annual nominal growth would be 1% for the same period. This target was a great challenge that could only be achieved with full co-operation and commitment of government bureaux and departments to enhancing productivity and efficiency.

2.10 S for Tsy further advised that the overall process for the formulation of the Estimates this year was similar to that of previous years, though there might have been minor changes. At the beginning of the current financial year, FS had held discussions with the Finance Bureau and the Government Economist to arrive at the target level of growth of government expenditure for the next financial year. The Finance Bureau then coordinated the resource allocation exercise. During the process, individual bureaux and departments had been consulted on their resource requirements for the coming financial year in the light of their respective policy objectives and service programmes. The resource allocation exercise had largely been completed by the time the Chief Executive delivered his Policy Address, and the details were presented in the annual Estimates. S for Tsy stressed that the Administration was aware of the need to exercise more stringent control over

## **Chapter II : Revenue Collection and Financial Control**

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expenditure in the coming years, and various bureaux and departments would work together to face the challenge.

### **Enhanced Productivity Programme and service quality**

2.11 Mr Albert HO Chun-yan noted that from 2000-01 to 2002-03, the Administration had achieved savings of 5.2% (as against the target of 5%) or \$5.4 billion of the baseline expenditure with the implementation of the Enhanced Productivity Programme (EPP). He asked if the EPP would continue after 2002-03 and if so, in what manner the target would be set. He also asked if the Administration had reviewed whether savings had been achieved at the expense of service quality and whether the implementation of the EPP had exerted undue pressure on some staff.

2.12 S for Tsy replied that the Administration had not taken a decision on whether similar savings targets for 2000-01 to 2002-03 would be made for the years thereafter. However, given the overall direction to control government expenditure growth, FS would be discussing with various bureaux in the coming months to study how this direction could be best achieved.

2.13 As regards service quality, S for Tsy said that one of the main features of the EPP was the proviso that service quality must not be compromised. All Controlling Officers were committed to their respective performance pledges on service quality. Additionally, members and the public could refer to the quantified performance targets and indicators set out in the Estimates for information on the changes in performance of individual government bureaux and departments. She assured members that the savings achieved under the EPP had mainly been generated through computerization, streamlining of work flow, outsourcing of services and voluntary redundancies etc. In the course of implementing these measures, the Administration had been mindful to maintain service quality and the committed service levels.

2.14 Mr Albert HO suggested that complaints made to departments and the Ombudsman should also be reviewed so as to ascertain whether the quality of government services had been maintained. S for Tsy responded that she could not undertake to look into the complaints for the purpose suggested by Mr HO, as this might wrongly implicate that the alleged unsatisfactory services were necessarily attributed to actions taken to achieve savings.

## **Chapter II : Revenue Collection and Financial Control**

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### **Inland Revenue Department**

2.15 Mr Howard YOUNG said that under the current economic downturn, many employees had fallen outside the tax net as a result of salary cuts, while personal allowances and other concessions for personal income tax had not been adjusted downward. He enquired if this would entail a reduction in the workload of the Inland Revenue Department (IRD) in tax assessment and collection of tax payments.

2.16 The Commissioner of Inland Revenue (C of IR) replied that in working out the resource provision for IRD for 2002-03, the Administration had thoroughly assessed the resource requirements of the department's different services and new initiatives, including the work associated with personal income tax. She advised that with the continued implementation of EPP, IRD would achieve cost savings of up to \$25 million in baseline operating expenditure and reduction of 56 posts in 2002-03.

### **Combating illegal supply and sale of dutiable commodities**

2.17 Mr CHAN Kam-lam noted that in 2001, the Diesel Oil Enforcement Division had seized 628 546 litres of hydrocarbon oil, compared to 813 391 litres in 2000, and asked if the Customs and Excise Department (C&ED) had planned to step-up efforts to combat illegal distribution, storage and sale etc. of dutiable commodities. He was particularly concerned about the situation of smuggling activities at sea. In response, the Commissioner of Customs and Excise (C of C&E) said that C&ED with the collaboration of other relevant departments, had been actively raiding illegal filling stations in the past year. In 2001, it had raided 487 illegal filling stations, and had reduced the black spots for such illegal activities from 110 in 2000 to about 35 as at end of 2001. The decline in the quantity of hydrocarbon oil seized in 2001 in fact indicated that the situation was under control. This was attributed to strengthened enforcement measures on the one hand, and the legislative amendments to the Dutiable Commodities Ordinance (Cap. 109) effected in July 2000 and in February 2001 enabling strengthened enforcement and prosecution actions of C&ED against the supply and sale of illicit fuel. In the coming year, C&ED had planned to deploy its Marine and Land Enforcement Command in addition to its Special Task Force to conduct regular as well as ad hoc search and raids on the illegal activities in respect of the above items.

2.18 As regards the enforcement against smuggling activities at sea, C of

## **Chapter II : Revenue Collection and Financial Control**

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C&E advised that the Marine and Land Enforcement Command had been working with the relevant Mainland authorities, deploying increased intelligence and conducting intensified surveillance to combat smuggling activities at sea.

### **Government supplies services**

2.19 Mr NG Leung-sing noted that arranging bulk/term contracts and setting up Standing Offer Agreements with selected suppliers were among the procurement strategies adopted by the Government Supplies Department (GSD). He recalled that a recent report of the Audit Commission had highlighted the problem of GSD having accumulated vast quantities of supplies, which would not be used up even after decades. He was concerned that bulk purchases might result in unnecessary stockpiling and wastage. He was also concerned that bulk/term contracts might not be to the Administration's advantage, since prices could not be flexibly adjusted to reflect deflation in the economy. In regard to Standing Offer Agreements, he sought clarification as to how the Administration would be able to ensure timely purchases at competitive prices under this mode of procurement.

2.20 The Director of Government Supplies (DGS) concurred that in the light of the current deflation trend, it might not be economical to purchase large quantities of supplies at one time, and therefore GSD would carefully review the current bulk/term purchase arrangements. At present, the term contracts normally lasted for about 2 years, or even shorter for some particular items. In regard to Standing Offer Agreements, DGS explained that under this procurement mode, up to five suppliers, or more, would be selected depending on the items to be purchased. The price quoted by the suppliers in the agreement would be the maximum price. When actual purchases were to be made, quotations would be obtained from the selected suppliers again, and any price exceeding the maximum price quoted previously would not be accepted. The supplier quoting the lowest price would be awarded the procurement contract.

2.21 Mr NG noted that the value of orders handled by GSD was \$4.4 billion in 2000 and this had increased to \$6.4 billion in 2001. He enquired about the reasons for the substantial increase. DGS advised that the value of the supplies procured during the year hinged on the purchase requirements made to GSD from various departments. The increase in the value of orders handled by GSD in 2001 was mainly a reflection of the increase in value and/or quantity of the items required by various departments. He clarified that the GSD's role was to act as an intermediary to facilitate the procurement of goods and services by government

## **Chapter II : Revenue Collection and Financial Control**

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departments. The expenditure on the goods and services procured through GSD was chargeable to the relevant government departments rather than to GSD.

2.22 The Chairman thanked S for Tsy and representatives of the Administration for attending the meeting.