

# OFFICIAL REPORT OF PROCEEDINGS

Wednesday, 25th February 1976

The Council met at half past two o'clock

## PRESENT

HIS EXCELLENCY THE GOVERNOR (*PRESIDENT*)  
SIR CRAWFORD MURRAY MACLEHOSE, KCMG, KCVO, MBE  
THE HONOURABLE THE COLONIAL SECRETARY  
SIR DENYS TUDOR EMIL ROBERTS, KBE, QC, JP  
THE HONOURABLE THE FINANCIAL SECRETARY  
MR CHARLES PHILIP HADDON-CAVE, CMG, JP  
THE HONOURABLE THE ATTORNEY GENERAL  
MR JOHN WILLIAM DIXON HOBLEY, QC, JP  
THE HONOURABLE THE SECRETARY FOR HOME AFFAIRS  
MR DENIS CAMPBELL BRAY, CVO, JP  
THE HONOURABLE JAMES JEAVONS ROBSON, CBE, JP  
SECRETARY FOR THE ENVIRONMENT  
DR THE HONOURABLE GERALD HUGH CHOA, CBE, JP  
DIRECTOR OF MEDICAL AND HEALTH SERVICES  
THE HONOURABLE IAN MACDONALD LIGHTBODY, CMG, JP  
SECRETARY FOR HOUSING  
THE HONOURABLE DAVID HAROLD JORDAN, CMG, MBE, JP  
DIRECTOR OF COMMERCE AND INDUSTRY  
THE HONOURABLE LI FOOK-KOW, CMG, JP  
SECRETARY FOR SOCIAL SERVICES  
THE HONOURABLE DAVID AKERS-JONES, JP  
SECRETARY FOR THE NEW TERRITORIES  
THE HONOURABLE LEWIS MERVYN DAVIES, CMG, OBE, JP  
SECRETARY FOR SECURITY  
THE HONOURABLE DAVID WYLIE MCDONALD, JP  
DIRECTOR OF PUBLIC WORKS  
THE HONOURABLE KENNETH WALLIS JOSEPH TOPLEY, CMG, JP  
DIRECTOR OF EDUCATION  
THE HONOURABLE IAN ROBERT PRICE, TD, JP  
COMMISSIONER FOR LABOUR  
DR THE HONOURABLE CHUNG SZE-YUEN, CBE, JP  
THE HONOURABLE LEE QUO-WEI, OBE, JP  
THE HONOURABLE OSWALD VICTOR CHEUNG, OBE, QC, JP  
THE HONOURABLE ROGERIO HYNDMAN LOBO, OBE, JP  
THE HONOURABLE MRS CATHERINE JOYCE SYMONS, OBE, JP  
THE HONOURABLE JAMES WU MAN-HON, OBE, JP  
THE HONOURABLE HILTON CHEONG-LEEN, OBE, JP  
THE HONOURABLE LI FOOK-WO, OBE, JP  
THE HONOURABLE JOHN HENRY BREMRIDGE, OBE, JP  
DR THE HONOURABLE HARRY FANG SIN-YANG, OBE, JP  
THE HONOURABLE MRS KWAN KO SIU-WAH, MBE, JP  
THE HONOURABLE LO TAK-SHING, OBE, JP  
THE HONOURABLE FRANCIS YUAN-HAO TIEN, OBE, JP  
THE HONOURABLE ALEX WU SHU-SHIH, OBE, JP

**ABSENT**

THE HONOURABLE PETER GORDON WILLIAMS, OBE, JP

**IN ATTENDANCE**THE CLERK TO THE LEGISLATIVE COUNCIL  
MR KENNETH HARRY WHEELER

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**Papers**

The following papers were laid pursuant to Standing Order 14(2):—

	<i>Subject</i>	<i>LN No</i>
Subsidiary Legislation:		
	Port Control (Cargo Working Areas) Ordinance.	
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Sessional Papers 1975-76:		
	No 37—Annual Report of the Li Po Chun Charitable Trust Fund for the year ended 31st August 1975 (published on 25.2.76).	
	No 38—Draft Estimates of Revenue and Expenditure for the year ended 31st March 1977, including supporting financial statements and statistical appendices (published on 25.2.76).	
	No 39—Report of the Establishment Sub-Committee of Finance Committee for the year 1975-76 (published on 25.2.76).	

No 40—Report of the Public Works Sub-Committee of Finance Committee for 1975 (published on 25.2.76).

**Oral answer to question**

**Parliamentary question**

DR CHUNG asked:—

Sir, is the honourable Colonial Secretary aware that in the House of Commons on 12th February 1976 Mr HOOLEY asked the following two questions:

- "(a) How many Unofficial Members of Hong Kong's Legislative Council have financial interests in organized prostitution; and
- (b) how many Unofficial Members of Hong Kong's Legislative Council have financial interests in organized gambling;"

and that to both questions the Minister of State answered "none", and will the Colonial Secretary comment?

THE COLONIAL SECRETARY:—Sir, I fully sympathize with honourable Members over the offensiveness of the innuendo in the questions and am very glad that it was so firmly rejected by the Secretary of State.

I know that the Secretary of State has complete confidence in the honour and integrity of Members of this Council.

DR CHUNG:—Sir, is it not regrettable that questions with such serious imputations were asked in the House of Commons? While I am most grateful to the honourable Colonial Secretary for his under-standing comments, will my honourable Friend convey to the Secretary of State the appreciation of the Unofficial Members for his confidence?

THE COLONIAL SECRETARY:—The answer to both those questions is "yes".

**Oral answers**

MR LO:—Does the honourable Colonial Secretary also sympathize with those members of Government whose responsibility it is to advise on the appointments of Unofficials?

THE COLONIAL SECRETARY:—I am sure that all those who may have been in any way concerned with the appointment of Unofficials would also have been offended by the innuendo.

**Government business****First reading of bill****APPROPRIATION BILL 1976**

*Bill read the first time and ordered to be set down for second reading pursuant to Standing Order 41(3).*

**Second reading of bill****APPROPRIATION BILL 1976**

THE FINANCIAL SECRETARY moved the second reading of:—"A bill to apply a sum not exceeding \$7,211,910,000 to the Public Service for the financial year ending the 31st March 1977."

He said:—

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**[THE FINANCIAL SECRETARY] Appropriation Bill—second reading***MOTION*

Sir, I move that the Appropriation Bill 1976, which was published in an issue of the *Gazette Extraordinary* at 2 o'clock today be read the second time.

*STRUCTURE OF SPEECH*

2. Sir, with the Year of the Dragon, we enter the second half of this decade and the underlying assumption of my budgetary policy for 1976-77 is that the economy is now emerging from two years of pause and in good shape in terms of external cost competitiveness and the stock of money. So the slowing down in the growth of public expenditure, particularly in 1975-76, may now end. But, so that the community does not lose the very real benefits in terms of the more efficient use of public funds resulting from the austerity of the past two years, expenditure will be expanded selectively: that is to say, the extra resources available in the coming year will be applied, in a carefully planned manner, in those areas which the Government believes to be of the highest priority and of public concern.

3. So honourable Members will wish to be assured that the proposals for 1976-77 in the draft Estimates of Expenditure laid today do have adequate regard to past achievements and future needs. Likewise, they will wish to be assured that the revenue estimates and proposals for 1976-77 are soundly based and that the revenue prospect for later years is consistent with the growing commitment implied in the pattern and level of recurrent services and capital works programmes envisaged in the draft Estimates. They will also wish to be assured that, in constructing the budget for the coming year and setting acceptable levels of expenditure, on both recurrent and capital account, for the three forecast years 1977-78 to 1979-80, I have followed my self-imposed guidelines<sup>(1)</sup> consistently.

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(1) *That is to say:*

- (a) *recurrent expenditure should absorb no more than 80% of recurrent revenue;*
  - (b) *at least 60% of capital expenditure should be financed by the surplus on recurrent account;*
  - (c) *at least 20% of capital expenditure should be financed from capital revenue.*
- From (a) and (b) two further guidelines may be derived, namely;*
- (d) *recurrent expenditure should not exceed 70% of total expenditure;*
  - (e) *at least 88% of total expenditure should be met from recurrent revenue.*

4. So I shall begin by taking a hard look at the economy in the 1970s: my main concern will be to develop a view of the economy's prospects in 1976 and in the following three years<sup>(2)</sup>, but this must be preceded by an analysis of the earlier years of growth, followed by the last two years of pause (PART I).

5. I shall then consider the Colony's public finances in the 1970s: in broad terms, the first five years to 1974-75; and, in detail, I shall report on the present state of the public accounts. This will lead me on to a forecast of expenditure over the four years 1976-77 and 1977-78 to 1979-80 (PART II).

6. Thus the stage will be set for a proper presentation of the budget for the coming year and I shall be offering an analysis of the Government's proposals in certain selected areas of expenditure as well as an explanation—and defence—of my financing strategy. This defence will draw heavily on my view as to the right fiscal policy for Hong Kong, the volume of public sector activities our economy can sustain and the short and medium term outlook for the economy; and I shall relate my tax proposals—for I fear there are some—to my fiscal guidelines<sup>(3)</sup> (PART III).

7. I shall conclude the speech by considering the acceptability of the forecast of expenditure for the three years 1977-78 to 1979-80; and with a brief reference to several outstanding fiscal questions (PART IV).

#### ACKNOWLEDGEMENTS

8. Sir, although the colour scheme chosen for this year's budget documents<sup>(4)</sup> may occasion some unkind comment, before going any

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(2) *Namely, 1977, 1978 and 1979 which are roughly equivalent to the three year forecast period used for financial planning: 1977-78, 1978-79 and 1979-80.*

(3) *That is to say:*

(a) *the ratio of direct to indirect taxation should be 45:55;*

(b) *the ratio of direct and indirect taxation taken together to all other recurrent revenue should be 65:35;*

(c) *to the extent that there is an uncovered deficit on capital account, after allowing for capital revenue and the surplus available on recurrent account, the use of loan finance is legitimate, provided debt servicing charges—interest and amortization—do not, at any time, exceed interest earned on our fiscal reserves.*

(4) *Draft Estimates of Expenditure revenue Estimates Economic Background Graphic Guide Gross Domestic Product 1961-74, Hong Kong in figures, Report of the Establishment Sub-Committee of Finance Committee, Report of the Public Works Sub-Committee of Finance Committee, and supporting Financial Statement and Statistical Appendices.*

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**

further I must extend to all concerned my very sincere appreciation of the immense amount of work that has gone into their preparation. I would mention the Finance Branch, in particular, and the Government Printer, the Economic Services Branch, the Census and Statistics Department and the revenue departments. The preparation of the expenditure estimates has involved intensive discussions with heads of departments and their staffs and they have all readily given of their time and patience. The budget documents have to be prepared over a relatively short period of time and notwithstanding normal duties. I hope they will be studied by all concerned with our affairs, both at home and overseas, with the attention I believe they deserve.

*PART I: THE ECONOMY IN THE 1970s*

(1) *Growth, World Trade and Domestic Developments, 1970 to 1973*

9. Being so externally oriented, Hong Kong's economy naturally tends to reflect developments in world trade. So we cannot long diverge from developments in the economies of our major trading partners. But, even so, in the three years 1973 to 1975, domestic factors, largely associated with the stock market and property boom and slump, also played an influential part.

10. There are, of course, considerable fluctuations from year to year in our growth rate, depending upon the state of demand in our overseas markets and on our domestic monetary situation. But, over a run of years, the growth rate is determined by the development of the productive capacity of the economy. Thus, in recent years the growth rate of the Gross Domestic Product (the GDP) in real or constant price terms<sup>(5)</sup> has been just over 7%. In 1969, a very high growth rate of 14% was achieved but, thereafter, there was a progressive slowing down. The annual growth rates at constant prices in 1970, 1971 and 1972 were 6%, 3% and 7% respectively. In 1973, however, a growth rate of just under 14% was again achieved, due partly to the coincidental peaking of demand in our main markets overseas and partly to domestic developments.

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(5) *Taking 1966 prices as the base here and throughout this part of the speech.*

11. The underlying trend growth rate can be attributed partly to increases in the labour force<sup>(6)</sup> and partly to the growth of productivity due to capital investment and new and improved productive processes. In the first five years of this decade (1971 to 1975), the labour force grew by 22%<sup>(7)</sup>. The total increase in GDP per worker at constant prices between 1971 which was a trough year and 1974 which was another trough year was 6%, making the average annual increase 2%<sup>(8)</sup>.

12. On the other hand, the age structure of our population has been changing so that, in the first five years of this decade, the population of working age increased by about 4% a year, while the total population grew at only 2% a year. So the trend growth in GDP *per capita* of the whole population at constant prices in the first five years of this decade was 5.4% a year.

(2) *Inflation in 1973*

13. Because of the high level of world trade in 1973, resulting from a peaking of boom conditions in all major countries simultaneously, as well as developments in the local stock and property markets, it was not surprising that that year was also one of well above average growth in Hong Kong. The growth rate of the GDP was nearly 14%; of GDP *per capita*, 11.5%; of private consumption expenditure, 15%; of public consumption expenditure 14%; of private investment expenditure, 12%; and of public investment expenditure, 34% all measured at constant prices. But, by the middle of the year, the sharp fall in asset values resulting from the stock market decline, and the associated outflow of capital overseas, began to produce a monetary squeeze that was relatively larger than that experienced in other economies. And this was followed, at the end of 1973, by the oil price explosion and the first signs of a downturn in the world economy.

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(6) *Labour force is defined as persons aged 15-64 who were engaged in productive work for at least 15 hours during the 7 days before enumeration (the hour criterion did not apply to the self-employed and unpaid workers); and persons aged 15-64 who would have been engaged in productive work, but were currently unemployed. The definition applies to the land, civilian, non-institutionalized population only.*

(7) *The 1971 figure is from the 1971 Census and the 1975 figure is from the September 1975 Labour Force Survey conducted by the Census and Statistics Department.*

(8) *The comparison has been made between 1971 and 1974 to avoid distorting the growth by using a second recessionary year (1975). The labour force for 1974 was derived from the age structure of the population and estimates of age specific participation rates were based on the assumption that they were similar to those obtained from the Labour Force Survey mentioned in f.n. (7).*

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**(3) *Two Years of Pause, 1974 and 1975*

14. After 1973, therefore, Hong Kong's economy had to adjust to two deflationary forces: first a sharp decline in the growth of the stock of money, which was accentuated by an initial widening in the visible or merchandise trade deficit<sup>(9)</sup>; and secondly, a recession in world output and trade, accompanied and accentuated by the sharp increase in crude oil prices between October 1973 and January 1974.

15. As regards the first deflationary force: at the beginning of 1973 the stock of money in Hong Kong stood some 41% above the level in January 1972<sup>(10)</sup>. It declined continually up to the middle of the year when it was only 13% higher than the level in June 1972<sup>(11)</sup>. Modest increases in the second half of the year meant a total increase of 6.6% over the much higher December 1972 level<sup>(12)</sup>. Movements such as this were bound, eventually, to exert a significant braking effect on both internal and external spending.

16. As regards the second deflationary force: the recession in the world's economy, which deepened and accelerated throughout 1974, and into the early part of 1975, has proved to be the worst since the 1930s. The quantities of Hong Kong's exports and imports declined sharply from the middle of 1974 and, by the end of that year, exports were as much as 23% below the level reached at the end of 1973<sup>(13)</sup>. As a consequence, the growth rate of the GDP at constant prices slowed down from nearly 14% in 1973 to zero and below zero over the next 18 months: wage rates stopped rising, and in some cases fell<sup>(14)</sup>; and the number of jobs available declined, especially in the 12 months ending mid-1975<sup>(15)</sup>. Government expenditure could not be adjusted immediately to these changed circumstances and the public accounts

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(9) *The merchandise trade deficit for 1972 was \$2,364 million (at current prices). It rose to \$3,006 million in 1973 and \$4,084 million in 1974.*

(10) *The stock of money, broadly defined as notes and coins held by the public plus demand, time and savings deposits, was \$21,587 million in January 1972 and \$30,524 million in January 1973.*

(11) *June 1972: \$24,498 million; June 1973: \$27,697 million.*

(12) *December 1972: \$27,525 million; December 1973 \$29,329 million.*

(13) *The quantum index of exports in each quarter of 1973 was: 130, 141, 166 and 159; and for 1974: 134, 147, 149 and 125. Similarly, the quantum index of imports was: 149, 160, 169 and 182; and 148, 164, 150 and 133.*

(14) *The index of nominal daily wage rates in manufacturing declined by 1% in the 12 months ending 31st March 1975.*

(15) *Employment in registered and recorded manufacturing establishments declined by 9.6% between December 1973 and December 1974.*

were in involuntary deficit in 1974-75. But, thereafter, the rate of growth of public consumption and investment expenditure in GDP terms at constant prices was slowed down from 17% in 1974 to 3.5% in 1975; and this was consistent with a similar slowing down in the rate of growth of revenue as a result of the recession.

17. Because Hong Kong's economy had to go through an above average adjustment in 1974 and 1975, the outcome was also above average. For instance, because of the squeeze on our internal cost structure, price inflation was reduced to virtually nil<sup>(16)</sup>, which was considerably better than the performance of all major economies operating with some form of market determined prices. Very largely because of this exports from Hong Kong started growing again from the spring of 1975. For the fact is that competitiveness, in terms of price and other factors as well, has been an important determinant of this renewed growth. As a result, although our exports were still falling in the early part of 1975, they picked up sufficiently later in the year to show a net 4% gain at constant prices over the year as a whole compared with 1974. Associated with this, and the growth of other expenditure components of the GDP, imports in turn grew by 2% over the year, again at constant prices.

18. The component showing largest growth was public consumption expenditure which rose by 9% at constant prices. Although plans for public investment expenditure also suggested some growth, for various reasons the outturn showed a decline of 6% at constant prices<sup>(17)</sup>.

19. Private consumption expenditure at constant prices remained unchanged in 1975 compared with 1974 and this was the second year of no growth in consumption. Private investment expenditure as a whole at constant prices fell by 3%: investment in building and construction, with most of the growth in offices and the mass transit railway, increased by 14%, but investment in plant and machinery fell by 11%.

20. The preliminary estimate of expenditure on the GDP in 1975 is \$35,407 million at current prices, or \$19,428 million at constant prices. This represents a growth of 0.8% in real terms over 1974. Honourable Members would suspect that something was amiss if I did not recall my forecast this time last year for 1975 when I predicted no growth

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(16) *The general consumer price index increased by 1% in 1975 compared with 1974; the average general consumer price index for 1975 was 189.8 (1963-64=100).*

(17) *See also paragraph 67 below.*

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**

in the GDP at constant prices. While I wish to take full credit for that accurate judgment, I have to admit that my forecasts of the components of GDP were not very accurate (*laughter*). I under-estimated the ability of the economy to achieve a fast rate of growth of exports once overseas demand appeared; I under-estimated private consumption expenditure; and was rather too optimistic about public investment expenditure.

21. The fact that imports declined more sharply than exports contributed to a renewed growth in our stock of money, which was 16.6% higher in December 1974 than a year earlier and, in the following twelve months to December 1975, there was a further growth of 16.9%<sup>(18)</sup>. Furthermore, political uncertainties in the region and our own success in controlling inflation, in marked contrast with the rest of the world, has also resulted in some inflow of capital, part of which has been due to Hong Kong companies and individuals repatriating funds previously held abroad. So, having restored our cost competitiveness and with increased liquidity in the economy, Hong Kong is now well placed to take advantage of any further recovery of world trade.

(4) *The Hong Kong Dollar*

22. Before proceeding to a forecast of the economy's prospects in 1976, I should make a parenthetic reference to our currency. At the time when I reviewed developments in the exchange rate in the course of winding up last year's budget debate, a very sharp strengthening of the Hong Kong dollar in the early part of 1975 was in the process of being turned round. I have subsequently let it be known that the Government played a part in that turning around process by buying US dollars for the Exchange Fund. This I saw as a correction of an erratic or wayward movement in the exchange rate, for it seemed clear that a rate of around HK\$4.60 = US\$1 reflected quite exceptional circumstances and was not consistent with Hong Kong's trading situation at the time.

23. In intervening in the market—on a quite significant scale throughout March last year—the Government was fortunately sailing with the wind, in that confidence in the US dollar around the world was by then returning quite strongly. Indeed, we were able to withdraw from the market once the rate reached about HK\$4.85 = US\$1, and it continued to move in the same direction without our help, returning to

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(18) *The stock of money, as defined in f.n. (10), was \$34,207 million in December 1974 and \$39,995 million in December 1975.*

above HK\$5.00 = US\$1 in July. It has since remained with the limits which were maintained before the Hong Kong dollar was allowed to float, even though the US dollar had some fresh periods of weakness reflecting New York City's financing problems and declining US interest rates<sup>(19)</sup>.

(5) *Forecast of the Economy in 1976*

24. Some of the factors affecting the economy's course in 1976 have already been determined both in Hong Kong and the rest of the world. Recent monetary developments I have already described. Other influences are the developments in the economies of our main markets and the decisions of overseas buyers, consumers and investors. These are important in determining the prospects of our various export industries, although they cannot easily be quantified.

25. The starting points for a forecast of GDP in 1976 must be the rest of the world. In 1975, GDP for the OECD countries<sup>(20)</sup> had, on average, declined by more than 2% in constant price terms and this was accompanied by a high level of unemployment and a slowing down in world trade. Most countries were in deep recession in the first half of the year but, after this, improvements began to show, with the reflationary policies launched by, for example, the United States, beginning to take effect.

26. A survey of informed opinion indicates that it would be reasonable to assume that GDP for the OECD countries in real or constant price terms will, on average, grow by 5% in 1976. Our three largest markets are the United States, Germany and the United Kingdom: the best prospects are for the United States economy, which has led the recovery so far, and I have assumed that it will grow at 6% in 1976. It appears that the expected recovery in Germany has also started, with increases in output as well as personal consumption, and a growth rate of 4% for the German economy in 1976 would appear to be a reasonable forecast. In the United Kingdom, the recession began later and, although there are now some signs of a modest recovery, many commentators consider that they are not sufficient to justify much more than zero growth next year, which will leave the United Kingdom economy below its 1974 level.

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(19) *Movements in the trade weighted average value of the Hong Kong dollar were less marked. From an index of about 105 (18th December 1971=100) in the 2 to 3 months before the Hong Kong dollar was allowed to float and of about 106 at the end of 1974, it moved above 110 in February 1975. It fell to 104 by mid-1975, but returned to 107.5 by the end of December, and was 107.4 in mid-February 1976.*

(20) *Western Europe, the United States, Canada and Japan.*

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**

27. Associated with these assumptions there are several specific features that are important for an understanding of the world trading environment that Hong Kong is likely to face. Although world trade will recover quite rapidly to the 1974 level, output will not rise so fast that capacity is fully utilized. This, and the associated higher levels of unemployment that have been experienced, are unlikely to result in an atmosphere favourable to a further reduction in world trade barriers.

28. Furthermore, despite the low levels of capacity utilization, it would be wrong to expect low rates of world inflation which are, even now, at this early stage of recovery, high by the standards of ten or more years ago. Although world inflation will continue, however, the different timing of recovery in different countries—the United States leading, followed by Canada, Japan, Germany and the United Kingdom in that order—is unlikely to produce a repetition of the very strong inflationary upsurge experienced during the last upturn in 1973. I have, therefore, assumed an increase in the prices of raw materials and semi-manufactures of 13% in 1976 which will, with our relatively stable exchange rate and rising demand, result in Hong Kong's own prices starting to move upwards. But concern over renewed inflation is likely to lead government to forms of intervention in the recovery and to moderating its speed.

29. In Hong Kong, we start the year having passed the turning point. The first half of 1975, described in detail in the Economic Background to the Budget publication laid today, was very depressed and the economy was operating well below capacity in all sectors. So, any growth in the first half of 1976 will appear, superficially, very high, but this should be seen as a reflection of the low level reached this time last year rather than a high level of output relative to the capacity of the economy.

30. Honourable Members, Sir, will have guessed from all this that I am raising the forecast of the growth rate of the GDP in real or constant price terms for 1976 that I made last year<sup>(21)</sup> from 5% to 9%. I expect exports, the main engine of our growth, to increase by 8% over 1975, but this will certainly not exceed the trend capacity of our

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(21) *B.S., 1975, paragraph 45.*

economy to produce goods for export<sup>(22)</sup>. The quantity of exports will only be 5% above the level achieved in 1973 and, meanwhile, there has been an 8% increase in the population of working age between 1973 and 1975 and continuing investment, albeit at a lower rate, that will have contributed to the productivity of the labour force.

31. Private consumption expenditure was probably above its trend growth level in 1973<sup>(23)</sup>, but virtually no growth between then and 1975 has left room for some catching up. The growth of the stock of money relative to output in the last two years is also likely to contribute to the growth of consumption. An 8% increase in private consumption at constant prices will still mean only a modest average growth in *per capita* consumption over the period 1973 to 1976<sup>(24)</sup>.

32. Public consumption expenditure is forecast to grow by 10% at constant prices. This is a further increase over last year's growth rate of 9%, but below the very rapid growth between 1972 and 1973.

33. Investment expenditure will always be the hardest component of the Gross Domestic Product to forecast. Confidence within the private sector has probably been restored already; and the low interest rates resulting from the overall surplus on our balance of payments, and the consequent liquid position of the banks<sup>(25)</sup>, will make any financial constraint on investment in 1976 unlikely. Furthermore, there is likely to be a large increase in the demand for building and construction investment and this will come from both the private and public sectors. The actual level of investment will probably be determined more by considerations of supply than any level of demand. So I forecast a growth of 20% in investment expenditure in 1976.

34. The other main component of GDP expenditure is imports, which are forecast to grow at 10% in real terms, reflecting the demand

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(22) *The growth in the quantity of domestic exports in the years 1968 to 1973 has displayed a clearly discernible trend. If this trend growth rate is project into the future (up to 1976) it gives a quantum index for domestic exports of 180 which is a rough measure of what the economy could produce with a continuation of the previous growth of export capacity. The quantum indices for 1973, 1974 and 1975 (first 9 months) were 149, 139 and 143.*

(23) *\$15,500 million would be a level of private consumption, at 1966 prices, consistent with an extrapolation of the previous trend growth of this component of the GDP. The actual level in 1973 was some 5% higher at \$16,346 million.*

(24) *The growth in per capita consumption 1973-76 implied by the forecast is 3%, an average annual rate of 1%.*

(25) *The average level of specified liquid assets in December as a percentage of deposits at the end of November was 49.8% in 1975, 44.9% in 1974 and 40.4% in 1973.*

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**

generated by the growth rate forecast for exports and the other components of expenditure. The forecast for exports and imports at current prices implies a visible trade deficit of \$4,600 million in 1976, compared with \$3,641 million in 1975.

35. Expenditure by foreign tourists in Hong Kong and expenditure by Hong Kong residents abroad are the most important elements in the estimates of exports and imports of *services*. With the gradual recovery in most economies in 1976, I expect there will be an increase of 10% in the number of tourists coming to Hong Kong and an increase of 3% in per capita expenditure at constant prices. This gives an increase of 13% in total expenditure at constant prices of foreign tourists in Hong Kong in 1976. I expect expenditure of Hong Kong residents abroad in 1976 to increase by about 16%. These and other items produce a modest increase of 5% in our favour in the difference between exports and imports of services at constant prices.

36. The resulting 9% growth in the GDP will still leave the economy working below capacity and such growth is not, therefore, high compared with what the economy should be capable of, although we should be wary of too rapid a movement towards full working capacity. This does not mean, of course, there will be no sector not working up to capacity and above it; nor does it mean we shall continue to enjoy the almost complete absence of price inflation. There will be pressure on the internal price level, mainly because we are an open economy operating with what amounts to a fixed exchange rate in a world experiencing much higher rates of price increases.

37. Whether Hong Kong's prices move with world prices or, for a short term, diverge and move at a higher rate, will largely depend on how the liquidity of the banking system is used. An increase of 6% in Hong Kong's prices is broadly in line with likely developments in world prices, and so this is the implicit inflator used in the GDP forecast, giving a 15% increase in the GDP in money or current price terms. I am, however, very conscious of the pressures that will be put on the construction industry, both by the Government's capital works programmes and the mass transit railway, and by the demand in the private sector for certain kinds of property. There is a specially strong link between financial and property assets in Hong Kong and there is scope for pressure on the construction industry and hence on property prices to feed back on to the prices of financial assets, especially if encouraged by bank lending. All this could combine to produce price

increases in other sectors that would be out of line with the rest of the world, if only for a short period. Nevertheless, I think that the Government's and the community's recollection of the events of 1972-73 is sufficiently vivid to make a repetition unlikely and the forecast, therefore, assumes that Hong Kong does not diverge from world developments.

38. Here, Sir, I would just interpolate one specific reference to the stock market: the twelve months ending 30th June 1973 covered the greater part of the stock and property market boom. During this period 190 companies went public. Of these, over two thirds used the method of private placement and less than one third the orthodox method of direct offer to the public. The method of private placement has some decided disadvantages for investors and should only be accepted in certain circumstances. The unrestricted use of this method in 1972-73 gave rise to practices which left much to be desired. I feel bound to say, therefore, that should the current recovery in confidence in the stock market result in an upswing in the number of companies going public, the method of private placement will be subject to close regulation by the Securities Commission under the authority conferred by the Securities Ordinance.

(6) *The Economy in the Three Year Forecast Period, 1977 to 1979*

39. We must assume, as I hinted earlier, that the recovery in world trade will not continue for very long, mainly because it has started with all major countries experiencing inflation rates considerably higher than were considered acceptable ten years ago. The recovery will tend to lift these rates and it would be unusual if this did not call forth some response. I do not see 1977, therefore, as a year of accelerating growth for Hong Kong. While 1976 will see a growth rate modestly above trend, I consider that 1977 will probably start slightly better than trend, but will close with the growth rate starting to slow down. In other words, 1977 will probably be one of those rare years of average growth, even though it will not be a period of constant growth.

40. I cannot peer further into the future than this. I am simply assuming that we shall experience average developments, both in overseas demand and in our own domestic economy. Given an average annual growth rate for our economy of 7.4% over the first five years of this decade, this means that I cannot be accused of over optimism if I adopt a range of 6-7% for the later 1970s.

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading***PART II: THE PUBLIC FINANCES IN THE 1970s*(1) *General*

41. Sir, as I said earlier, now that we are entering the second half of the present decade, hopefully the difficulties of the past two years are beginning to recede. But one's view of the present, and assumptions about future prospects, must always be set in an historical context. And I think it is particularly important to do so when considering the question which really lies behind this motion on the Appropriation Bill 1976: that is to say, what should be our budgetary strategy for 1976-77? I propose, therefore, to approach this question by reviewing the public finances over the five years ending 1974-75, by following this up with a detailed report on the accounts for 1975-76, and then by describing the results of a new style forecast of recurrent expenditure and capital expenditure, other than the two components of the Public Works Programme for which guidelines were laid down in my 1974 budget speech<sup>(26)</sup>. I shall then be in a position to put to honourable Members my budget for 1976-77.

42. The picture that will emerge is one of rapidly expanding services and expenditure in the first prosperous four years of the decade. Then came two years in which, despite the pause in economic growth, services were expanded, but in a highly selective manner. I believe it is to the credit of this Government that, even though our economy is sensitive to the state of the world economy and yields from our direct taxes, in particular, are sensitive to the state of our own economy, we successfully avoided "stop-go" in the provision of public services and the implementation of capital works programmes. For the rest of the decade, I foresee steady uninterrupted progress.

(2) *The First Five Years, 1970-71 to 1974-75*(a) *Introduction*

43. To begin with the first five years of this decade, 1970-71 to 1974-75: except when otherwise stated, all revenue and expenditure figures I shall be using are at current (market) prices and, in the interests of arithmetic consistency, the figures will include the transactions of the Urban Council and those of the Housing Authority so far as they relate to the activities of the former Resettlement Department and the Housing

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(26) B.S., 1974, paragraph 101 and B.S., 1975, paragraph 52.

Division of the Urban Services Department<sup>(27)</sup>. I shall analyse our performance in these years in four ways: the financing of the capital account, the main components of recurrent and capital expenditure and expenditure by main services and, finally, I shall take a brief look at revenue trends.

(b) *Financing of the capital account*

44. The financing of the capital account depends on the surplus available in the recurrent account<sup>(28)</sup>. Recurrent expenditure increased from \$1,900 million in 1970-71 to \$4,488 million in 1974-75, or at an annual average rate of 24%. Only in 1974-75 was the surplus on recurrent account insufficient to finance the deficit on capital account. Indeed, in the first four years, we ran overall surpluses and so our General Revenue balance was credited with no less than \$2,024 million and the mass transit fund was credited with \$800 million. Expenditure on capital account was lifted from \$552 million and \$754 million in 1970-71 and 1971-72 respectively to \$1,100 million in 1972-73, to \$1,402 million in 1973-74 and to \$1,814 million in 1974-75. Taking the first three years of the decade together, capital revenue was sufficiently buoyant to finance 58% of capital expenditure, even though capital expenditure was over 26% of total expenditure, which is not far short of our present guideline figure of 30%. In the following year, 1973-74, capital revenue covered only 33% of capital expenditure, which rose to 29% of total expenditure, very close to the guideline figure of 30%. The break with tradition came in 1974-75: the surplus on recurrent account of \$1,010 million was sufficient only to finance 73% of the deficit on capital account of \$1,377 million and so we ran an overall deficit of \$367 million.

45. The portents were there in the trends of total revenue and expenditure: between 1970-71 and 1972-73 revenue flushed from \$3,071 million to \$4,936 million, or by 61%, whereas expenditure increased from \$2,452 million to \$3,800 million, or by only 55%. The revenue growth trend then weakened to 8% in 1973-74 (on 1972-73), recovering to 11% in 1974-75 (on 1973-74), partly as a result of the revenue proposals in my 1974 budget. But expenditure raced on to increase by 29% in each of these two years, producing our third deficit since the war<sup>(29)</sup>. Once the proportion of recurrent revenue absorbed by recur-

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(27) See Annex (1).

(28) The content of the recurrent and capital accounts is defined in Appendices III and IV of the Estimates.

(29) The deficit in 1959-60 was \$45 million, or 6.8% of total revenue; in 1965-66 it was \$137 million, or 8.4% of total revenue. C.f. the deficit in 1974-75 of \$367 million, or 6.2% of total revenue.

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**

rent expenditure exceeded 80%, as it did by 1974-75<sup>(30)</sup>, and capital expenditure increased just as fast as recurrent expenditure, an overall deficit was inevitable—at any rate, in the absence of a windfall of capital revenue.

*(c) Components of recurrent and capital expenditure*

46. My present guideline for the relationship between recurrent and capital expenditure is that the former, that is to say recurrent expenditure, should not exceed 70% of total expenditure. This was not the case in 1970-71 when recurrent expenditure was as much as 77% of total expenditure, but there was an overall surplus of \$619 million in that year. By 1974-75, recurrent expenditure was only 71% of total expenditure, but there was an overall deficit of \$367 million. So, what I would regard as a correct relationship between recurrent and capital expenditure had been established, but the latter — capital expenditure—had grown too fast: from \$552 million in 1970-71 to \$1,814 million in 1974-75, or by 229%. By comparison total expenditure increased from \$2,452 million to \$6,302 million, or by 157% only. Thus, even in the absence of economic recession in 1975, in order to maintain this correct relationship the growth of capital expenditure envisaged by departments in 1975-76 would have had to be levelled off.

47. The main component of recurrent expenditure is, of course, personal emoluments<sup>(31)</sup>, but its relative significance declined over the period from 48% to 44%<sup>(32)</sup>, despite a major salaries revision effective from 1st April 1971 and salary adjustments in each of the following years. The Civil Service, as measured by the number of posts occupied, increased from 81,500 to 104,300 between January 1971 and January 1975, or by 28%. As the growth of recurrent expenditure in real or constant price terms was probably around 52%, this indicates some improvement in my view in the productivity of the Civil Service.

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(30) *Recurrent expenditure as a percentage of recurrent revenue:*

	%
1970-71 .....	69
1971-72 .....	67
1972-73 .....	65
1973-74 .....	72
1974-75 .....	82

(31) *Salaries and allowances of the civil service.*

(32) 1970-71: \$908 million of \$1,900 million=48%;  
1974-75: \$1,956 million of \$4,488 million=44%.

*(d) Expenditure by main services<sup>(33)</sup>*

48. An analysis of trends in expenditure by groups of services between 1970-71 and 1974-75 does not necessarily reflect the Government's planning priorities during that period, but rather the results of previous decisions. Thus, there was a growing emphasis on community services, particularly water, civil engineering works, works for land development and roads: the share of this group increased from 19% to 28%<sup>(34)</sup> over the period. The Plover Cove Scheme was completed, the dams were subsequently raised, the construction of the High Island Scheme and the 40 m.g.d. desalter was begun, 772 acres of land were created for development and 50 miles of motor roads and 15 flyovers were built.

49. Because the growth of expenditure on general services<sup>(35)</sup> and on economic services<sup>(36)</sup> was kept well below the growth of total expenditure, the share of these two groups of services in total expenditure declined from 20% to 14% over the period<sup>(37)</sup>. Thus, despite the emphasis on community services, it was possible for the law and order group of services<sup>(38)</sup> to maintain its 1970-71 share of well over 9% over the period<sup>(39)</sup>; and the social services group<sup>(40)</sup> could be allocated 39% of total expenditure in both 1970-71 and 1974-75<sup>(41)</sup>.

50. Put in practical terms, over the first five financial years of this decade, the establishment of the Police Force increased from 14,300 to 19,200 men, or by 34%, and six additional sub-divisional stations were built. The number of secondary enrolments in Government and subvented schools increased from 69,600 to 191,500. The enrolment at technical institutes increased from 7,300 to 13,400. The enrolment at our two universities increased from 5,048 to 6,860. The Polytechnic was formally established in 1973 and by 1974-75 had an enrolment of

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(33) See Annex (2).

(34) 1970-71: \$475 million of \$2,452 million=19%;  
1974-75: \$1,747 million of \$6,302 million=28%.

(35) Administration, defence, public relations and revenue collection.

(36) Agriculture, fishing, and mining, airport and harbour, commerce and industry and communications.

(37) 1970-71: \$496 million of \$2,452 million=20%;  
1974-75: \$882 million of \$6,302 million=14%.

(38) Police, ICAC, prisons, immigration, judiciary, Registrar-General and legal aid.

(39) 1970-71: \$240 million of \$2,452 million=9.8%;  
1974-75: \$601 million of \$6,302 million=9.5%.

(40) Education, medical and health, housing, social welfare and labour.

(41) 1970-71: \$966 million of \$2,452 million=39.4%;  
1974-75: \$2,437 million of \$6,302 million=38.7%.

**[THE FINANCIAL SECRETARY] Appropriation Bill—second reading**

full time equivalents of 3,668<sup>(42)</sup>. In the medical and health field, the number of public beds increased from 14,321 to 14,908 only, but construction on several new hospitals was begun<sup>(43)</sup>. The number of outpatient attendances at Government and subvented hospitals and clinics increased from 9.3 million to 11.6 million. The Public Works Department and the Housing Authority completed public housing for 521,300 people and planning and construction started on the new towns. At the end of the period, contracts were in hand for 40,500 flats to house 242,700 people. Finally, there is the dramatic story of social welfare subventions and the new found emphasis on cash assistance to maintain family incomes and to assist the disabled and the infirm. Social welfare subventions increased from \$12 million to \$38 million; the number of public assistance cases increased from 7,300 to 45,800; and the number of disabled and infirmity cases was 56,400 by 31st March 1975. The total cost of all forms of assistance increased from \$5.4 million in 1970-71 to \$166 million in 1974-75 and I shall be returning to our commitments in this particular field later on.

*(e) Revenue trends*

51. My two fiscal guidelines relating to the ratio of direct to indirect taxation (45:55) and the ratio of direct and indirect taxation taken together to all other recurrent revenue (65:35) are designed as reminders of the significance of indirect taxes and fees and charges in our circumstances. The yields from our system of earnings and profits taxes are income sensitive and must remain so, if the economy's internal flexibility is not to be damaged, whereas yields from indirect taxes and fees and charges are, rightly and by their very nature, much less so. There is the further point that, in a low tax environment, all public services must be charged for, at least on a cost-related basis, unless there is a specific policy reason for not doing so<sup>(44)</sup>.

52. Over the first five years of the decade the ratio of direct to indirect taxation shifted from 43:57 in 1970-71<sup>(45)</sup> to 56:44 in 1974-75<sup>(46)</sup>,

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(42) *In terms of the actual number of day and evening students this figure becomes 17,800.*

(43) *Government: Princess Margaret;*

*Subvented: United Christian, Pok Oi, Buddhist, Tung Wah Centenary Block, Nam Long.*

(44) *B.S., 1975, paragraph 121.*

(45) *Direct: \$778 million; indirect: \$1,030 million.*

(46) *Direct: \$2,144 million; indirect: \$1,711 million.*

an almost complete turn-round. Over the five years taken together the ratio was 47:53<sup>(47)</sup>, very close to the guideline.

53. The ratio of direct and indirect taxation to all other recurrent revenue shifted from 66:34 in 1970-71<sup>(48)</sup> to 70:30 in 1974-75<sup>(49)</sup>. Over the five years taken together the ratio was 69:31<sup>(50)</sup>. So we tended more or less to observe this particular guideline ratio in these years.

### (3) *The Present State of the Public Accounts*

#### (a) *1974-75 accounts*

54. Sir, now I turn, to the present state of the public accounts and from now, to the end of this speech, the amounts and percentages I shall be quoting are *exclusive* of all transactions of the Urban Council and the Housing Authority financed by the Urban Council's own revenue and the Housing Authority's rent income and borrowings<sup>(51)</sup>.

55. On this basis, in last year's budget speech, I predicted that the final accounts for the year 1974-75 would reveal a deficit of \$410 million<sup>(52)</sup>. In the event, the deficit was a little less than this at \$380 million<sup>(53)</sup>, mainly due to a demand note for \$24 million from another postal administration in respect of imbalance of mail not being presented on time. Revenue was \$5,593 million and expenditure was \$5,973 million, the deficit of \$380 million being 6.8% of revenue. Although recurrent expenditure absorbed only slightly more of recurrent revenue than the guideline figure of 80%, the surplus on recurrent account of \$981 million covered 55% of capital expenditure, compared with the guideline figure of 60%. Capital revenue covered 24% of capital expenditure, but this was not enough and so the General Revenue balance had to be charged with the balance of \$380 million, being the equivalent of 21% of capital expenditure.

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(47) Direct: \$6,614 million; indirect: \$7,489 million.

(48) Direct and indirect taxation: \$1,808 million; all other recurrent revenue: \$9.36 million.

(49) Direct and indirect taxation: \$3,855 million; all other recurrent revenue: \$1,643 million.

(50) Direct and indirect taxation: \$14,103 million; all other recurrent revenue: \$6,405 million.

(51) See Annex (3).

(52) B.S., 1975, paragraph 22.

(53) C.f. the deficit of \$367 million based on revenue and expenditure inclusive of Urban Council and Housing Authority transactions and referred to in paragraph 47 above.

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**(b) *Revised estimates for 1975-76*(i) *Outturn*

56. After taking into account my revenue proposals, I budgeted for a deficit of \$431 million in 1975-76<sup>(54)</sup>, being the difference between estimated revenue of \$6,184 million and estimated expenditure of \$6,615 million. The revised estimates of revenue and expenditure for 1975-76, as shown in the draft Estimates laid today, are \$6,015 million and \$6,222 million. Thus the deficit is \$207 million or \$224 million less than I budgeted for and has been more than covered by the proceeds of the Hong Kong dollar bond issue, a small Euro-dollar loan for the purchase of new coinage and two small grants towards the cost of looking after the Vietnamese refugees<sup>(55)</sup>.

57. The revised estimates of expenditure are prepared on the basis of returns submitted by departments at the beginning of November and the last adjustments have to be made by Finance Branch by mid-December, because of the printing timetable. Inevitably, therefore, there is always a tendency for the revised estimates to over-state actual expenditure as shown in the accounts. The revised estimates of revenue can usually be more accurately estimated by the revenue departments because the printing deadline is the first week in February. I have made a practice, therefore, in recent years of making my own assessment of likely outturn for the current year, checking this assessment against the state of the Treasury's cash book shortly before budget day. As the total volume of our transactions grows—and it is now over \$12,000 million—the *absolute* difference between the surplus or deficit thrown up by the revised estimates of revenue and expenditure and this intuitive assessment tends to be larger. This year, mainly because I think the revised estimate of expenditure over-states likely actual expenditure<sup>(56)</sup>, I think the final outturn will be less than \$207 million. So, although

(54) *B.S. 1975, paragraph 161 and C.S., 1975, paragraph 50.*

(55) *The following amounts have been credited to General Revenue:*

	<u>\$ mn</u>
$6\frac{1}{2}$ % Hong Kong dollar bonds 1980.....	247.4
Euro-dollar loan for coinage .....	15.3
Grants from the UK Government and the United Nations for Vietnamese refugees.....	<u>1.4</u>
	<u>264.1</u>

(56) *To take just one example: at \$1,795 million personal emoluments could well be too high. This figure is the aggregate of departmental estimates and is a little higher than a figure produced by a projection of the Treasury's actual payments.*

I shall have to use the revised estimates as printed when analysing our expenditure performance this year, when discussing our likely financial position at 1st April next and putting my budgetary strategy for 1976-77 to honourable Members, I shall be assuming a deficit of \$50 million only.

(ii) *Revenue*

58. At \$6,015 million, the revised estimate of revenue for 1975-76 is \$422 million, or 7.5%, up on actual revenue in 1974-75 of \$5,593 million, when it was 11% up on 1973-74. The revised estimate falls short of the original estimate of \$6,184 million<sup>(57)</sup> by \$169 million<sup>(58)</sup> or by 2.7%. This figure of \$169 million is the algebraic sum of shortfalls of \$308 million and excesses of \$139 million<sup>(59)</sup>.

59. The two main shortfalls are in respect of interest earnings on investments and bank deposits (\$42 million), due to lower interest rates overseas and a decline in cash balances held locally, and earnings and profits taxes (\$151 million). Both the Commissioner of Inland Revenue and I knew earnings and profits taxes would be difficult to estimate accurately for 1975-76. There were two reasons for this: the likelihood of the holdover provisions of the provisional profits tax system being invoked and the implications for our cash flow of the concession offered to both profits and salaries taxpayers whereby they could meet their liabilities to provisional tax in two instalments, the first of 75% on the normal due date and the second approximately three months later<sup>(60)</sup>. This shortfall is offset by higher than expected yields from bets and sweeps taxes<sup>(61)</sup>: up by \$37 million; stamp duties, thanks to the recent recovery of trading on the stock market: up by \$52 million; and estate duty: up by \$22 million.

60. In all the difficult circumstances of estimating revenue in 1975-76, I think an error of only 2.7% is really quite gratifying and compares favourably with the error we managed to make in the previous five years of this decade: in the first three years to 1972-73 for instance, the yields from our fast growing economy were consistently and

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(57) That is, the figure of \$5,719 million shown in the Revenue Estimates for 1975-76 laid on 26th February 1975 plus the estimated yield of \$465 million from the revenue proposals for 1975-76.

(58) Or by \$193 million if the effects of the increased duties on tobacco and intoxicating liquors and the abolition of Commonwealth preference tax announced on 3rd December 1975 are excluded (see Annex (4)).

(59) For actual details see Memorandum Notes on the Revenue Estimates for 1976-77, pages 14-25.

(60) Ordinance No. 7 of 1975.

(61) As envisaged: see B.S., 1975, paragraph 83.

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**

substantially under-estimated<sup>(62)</sup>. In 1973-74, we did a little better in that we only under-estimated revenue by 7%. In 1974-75, I was lucky enough to get within 1%.

61. So an error this year of 2.7% the other way is not too reprehensible though, with an error of 6.7%, the Commissioner of Inland Revenue and I did not do so well in respect of earnings and profits taxes. But, in our defence of this error of 6.7% which was offset by errors the other way in other areas I would say this: in estimating yields from earnings and profits taxes, trends for a period of up to 35 months, both known and anticipated, have to be taken into account. Where this covers a period of violent fluctuations and patchy performances, this can be a hazardous task. Take profits tax for instance, different accounting periods mean that profits over a period of 23 months have to be taken into account<sup>(63)</sup>. To put this in the context of next year's estimates, this means estimating profits for the period 1st May 1974 to 31st March 1976. Since the introduction of the provisional profits tax system, an additional complication has entered into the computation and the Commissioner has had to forecast what profits will be like for the twelve months ending 31st March 1977<sup>(64)</sup>. An upturn in profits in that period will not affect the tax yield at all but, if there is a downturn, taxpayers have the right to ask for provisional tax to be heldover, either in whole or in part.

62. Then there is one factor which affects all four taxes imposed under the Inland Revenue Ordinance (except perhaps interest tax), namely, the volume of arrears, that is to say the amount of tax which will be in default at the end of the financial year. As the bulk of the tax is due in the four months immediately preceding the end of the

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(62) *Actual revenue compared with original estimate:*

1970-71: +19%

1971-72: +14%

1972-73: +33%

(63) *For example, the year of assessment 1975-76 could be based, at the one extreme, on profits for the year ended 30th April 1975 and at the other extreme, the year ended 31st March 1976, depending on the financial year of the company concerned.*

(64) *These 12 months added to the 23 months referred to in f.n. (63) gives the maximum period of 35 months referred to in the second sentence of the paragraph.*

financial year, any change in the pattern of defaults, for whatever reason, can make revenue estimates look rather silly. Unfortunately, the percentage of tax going into default has been uneven and has increased substantially over recent years—not, I might add, due to any less persistent follow up action by the Inland Revenue Department<sup>(65)</sup>.

63. The yield from stamp duties is also difficult to estimate accurately, particularly in respect of conveyances and contract notes. The former is dependent on the state of the real estate market and the latter of course on the state of the stock market.

(iii) *Expenditure*

64. At \$6,222 million the revised estimate of expenditure for 1975-76 is \$249 million, or 4.2%, up on actual expenditure in 1974-75 when it was \$5,973 million, or 29% up on 1973-74<sup>(66)</sup>. After exceeding the budgeted estimate for five consecutive years, actual expenditure this year will be (at least) \$393 million<sup>(67)</sup> less than the original estimate of \$6,615 million, despite net supplementary provisions of \$165 million<sup>(68)</sup>. This estimate of \$6,615 million represented a budgeted increase of 7% over the revised estimate for 1974-75 and turned out to be 11% over actual expenditure for that year.

65. As the principal objective of the budgetary strategy for 1975-76 was to bring the rate of growth of expenditure, as far as possible, into line with the rate of growth of the economy, the fact that the revised estimate of expenditure is below the budgeted estimate may be regarded with equanimity, particularly as a 4% increase in money terms on

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(65)

<i>Year</i>	<i>Arrears (\$ mn)</i>	<i>As a percentage of tax assessed</i>
1970-71 .....	18	2.2
1971-72 .....	30	3.1
1972-73 .....	40	3.5
1973-74 .....	95	4.9
1974-75 .....	170	6.4

(66) *After excluding the transfer to the Mass Transit Fund of \$300 million.*

(67) *See paragraph 57 above.*

(68) *That is, supplementary provisions of \$407 million approved up to 31st January 1976 less frozen provisions of \$242 million, of which \$96 million has been found from Head 52 Miscellaneous Services Subhead 100 Additional commitments.*

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**

1974-75 is at least the equivalent of 4% in real terms, thanks to the behaviour of prices in recent months. Nevertheless, a shortfall of \$393 million or more deserves an explanation, representing as it does 6% of budgeted expenditure compared with excesses of 11% and 10% in the two years 1973-74 and 1974-75 and an average excess of 3% in the first three years of the decade<sup>(69)</sup>. But, in these five years, supplementary provisions represented a higher proportion of original estimates than in the current year, there were regular revisions of Civil Service salaries and there was a persistent upward pressure on all other costs.

66. The error of \$393 million is made up of excesses over the original estimate of \$232 million and shortfalls of \$625 million<sup>(70)</sup>. On recurrent account, the net shortfall is only \$22 million, although this is almost certainly under-stated somewhat because the revised estimate for personal emoluments at \$1,795 million (or \$55 million up on the original estimate) is not supported by a projection of the Treasury's actual payments. Honourable Members will also recall that, as part of the budgetary strategy for this year, recruitment against vacant posts was limited in such a way as to restrict the net growth in the strength of the Civil Service to 1,600 on the actual strength at 1st January 1975. This figure was subsequently raised to 2,700 to enable the police to recruit a further 900 men and three revenue departments were permitted to recruit between them an extra 200 staff<sup>(71)</sup>.

67. The main cause of the overall shortfall of \$393 million is to be found in the two Public Works Programme components of the capital

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(69) *Actual expenditure compared with original estimate:*

1970-71: + 3%

1971-72: + 2%

1972-73: + 4%

1973-74: + 11%

1974-75: + 10%

(70) *Analysed by head of expenditure in paragraph 4 of the General Memorandum Note on pages 29-30 of the Estimates.*

(71) *At 31st January 1976 the strength of the establishment of the Civil Service was 84,181 compared with 82,677 a year ago.*

Account<sup>(72)</sup>: the shortfall here is \$341 million, or 21% of the original estimate and, at \$1,285 million the revised estimate of expenditure is \$253 million, or 16%, down on actual expenditure in 1974-75. The closeness of these two percentage figures is explained by the fact that I budgeted this year for expenditure, in real terms, on the Public Works Programme roughly equal to actual expenditure in 1974-75.

68. There are two main reasons for this shortfall and three less important reasons<sup>(73)</sup>. The main ones account for two thirds of the shortfall and were, first, lower tender prices and lower payments on existing contracts as a result of materials and wages fluctuations clauses working in our favour; and, secondly, lower compensation payments because of delays in clearances which, in turn, resulted in delays in works commencing, and lower resumption payments because more lessees opted for land exchange rather than cash. The other three reasons were as follows: the unusually rainy summer in 1975, later than expected starts on some new projects for a variety of reasons and delays in deliveries of equipment from overseas.

69. The only other shortfall to which I should draw honourable Members' attention is in respect of education subventions. Because school managements closed more primary classes and opened fewer secondary classes than expected expenditure is down by \$52 million, or 6.5%, on the original estimate.

(72)

<i>Component</i>	<i>Approved Estimates, 1975-76 (\$ mn)</i>	<i>Revised Estimates, 1975-76 (\$ mn)</i>
(1) <i>Public Works Programme (other than New Towns and Housing).....</i>	1,070	779
(2) <i>Public Works Programme (New Towns and Housing, including transfers from General Revenue to the Development Loan Fund for on-lending to the Housing Authority).....</i>	556	506
(3) <i>Subventions.....</i>	78	60
(4) <i>UPGC.....</i>	82	95
(5) <i>Department Special Expenditure.....</i>	94	70
(6) <i>Special Works for the Armed Services.....</i>	58	51
(7) <i>Miscellaneous.....</i>	<u>59</u>	<u>65</u>
	<u>1,997</u>	<u>1,626</u>

(73) See Memorandum Note on Heads 67-71 Public Works Non-Recurrent, paragraphs 5-10 on page 488 of the Estimates.

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70. On the other hand, grants paid out by the University and Polytechnic Grants Committee are up by \$25 million due to faster progress on the construction of the Polytechnic (Phase I) and the updating of recurrent grants. And the Social Welfare Department will be spending \$43 million more than budgeted for on public assistance.

71. So much for the relationship between the revised estimates of expenditure and the original estimates. Before moving on to an analysis of our present financial position, I think I owe it to heads of departments to refer to their success in holding to their original estimates. Gross supplementary provisions this year were only \$407 million<sup>(74)</sup> of which \$242 million was covered by offsetting savings<sup>(75)</sup>. I would also like to place on record the positive response of heads of departments to the suggestion that departmental cost reduction committees should be set up to investigate ways of effecting economies, to review the need and cost of existing services and to monitor expenditure.

*(c) Financial Position**(i) As at 1st April 1975*

72. In last year's budget speech, I estimated that we would begin 1975-76 with fiscal reserves, or free surpluses<sup>(76)</sup>, amounting to \$2,371 million<sup>(77)</sup>. This estimate was based on the assumption that there would be a loss of some HK\$80 million in the value of assets denominated in foreign currencies, and on the further assumption that the value of our securities, in terms of the currencies in which they are denominated, would show little change<sup>(78)</sup>. In the event, we ended the year with fiscal reserves amounting to \$2,522 million<sup>(79)</sup>, partly because the deficit was lower than I had anticipated<sup>(80)</sup>, and partly because of a net gain of \$93 million, in Hong Kong dollar terms, in the value of our foreign currency assets.

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(74) *C.f.* 1974-75: \$1,423 million; 1973-74: \$1,466 million; 1972-73: \$1,195 million; 1971-72: \$406 million; 1970-71: \$301 million.

(75) *See f.n.* (68) above.

(76) *That is to say, the balance available for appropriation, if need be, over and above the general revenues of the Colony.*

(77) *B.S., 1975, paragraph 30. This figure includes \$52 million being the cash estimated to be available in the Development Loan Fund, but this is not really a free surplus. The practice of including this cash in the calculation of the Colony's fiscal reserves is questionable and has been discontinued.*

(78) *B.S., 1975, paragraphs 28-29.*

(79) *Not including the cash balance in the Development Loan Fund (see f.n. (77) above).*

(80) *See paragraph 55 above.*

(ii) *As at 1st April 1976*

73. I estimate that we shall begin 1976-77 with fiscal reserves, or free surpluses, amounting to \$2,626 million, an increase of \$104 million on the position at the beginning of this year. There are four reasons for this increase: first, borrowings and grants amounting to \$264 million have been credited to General Revenue<sup>(81)</sup>. Secondly, there is the estimated deficit of \$50 million this year. Thirdly, the strength of the Hong Kong dollar in relation to most of the currencies in which the majority of our assets are held has meant that, on our books, an exchange loss of \$145 million has had to be recorded. Fourthly, a net gain on revaluation of investments of \$35 million has resulted from a decline of interest rates<sup>(82)</sup>.

(d) *Management of Foreign Currency Assets*

74. Some of the losses in the value of our foreign currency assets since the Hong Kong dollar was allowed to float stem from the book-keeping and valuation methods employed. Because of this, part of the losses shown in our accounts are unreal. During the course of a year, securities are bought and sold to take advantage of opportunities to make switching profits. Each transaction is recorded in our books in two currencies: the currency in which the securities are denominated and the Hong Kong dollar. To simplify book-keeping procedures, the rate of exchange which approximates to that ruling at the beginning of the financial year is used to calculate Hong Kong dollar values for all transactions completed during the year.

75. At the end of the year, the securities are valued at mid-market prices of the currencies in which they are denominated and converted into Hong Kong dollar values at actual mid-market exchange rates. For the bulk of our securities, the prices on which these end of year valuations are based include accrued interest, as do the prices of most of the securities traded during the year. But all interest received is credited to revenue at the rate fixed at the beginning of the year. It follows that if, late in the year, a stock is bought which has an interest payment due before the close of the year, a capital loss equivalent to the accrued interest in the price when the stock was bought will be recorded. This is an unreal loss because, if the general level of security prices does not change, the capital loss will be more than offset when the accrued interest is received and credited to General Revenue.

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(81) *See paragraph 56 and f.n. (55) above.*

(82) *The net loss of \$110 million (\$145 million less \$35 million) may be compared with the net gain of \$93 million last year.*

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76. These losses are exaggerated when the Hong Kong dollar is generally strong or a currency in which a substantial part of our reserves is invested is weak. For example, for 1975-76 all purchases and sales of sterling securities, and interest receipts from such securities, will be converted into Hong Kong dollars at \$11.7 to £1. But, for most of the financial year, sterling has been well below \$11.7 to £1. Consequently, in Hong Kong dollar terms, sterling interest accruals and profits made on switches have been over-valued and, unless there is a dramatic improvement in the sterling/Hong Kong dollar exchange rate, the Hong Kong dollar value of these accruals and profits will have to be written down at the end of the year. Although the overall effect in our accounts is neutral, the use of a fixed exchange rate of \$11.7 to £1 throughout 1975-76 will result in the depreciation of assets, exchange losses and overseas payments and receipts being over-stated in terms of Hong Kong dollars.

77. I have felt it necessary, Sir, to provide this explanation of the effect of our valuation methods because their impact will be greater this year than in other years due to the weakness of the currencies in which a large part of our overseas assets are held. However, having provided this explanation for the first time, I can now say that a similar explanation will not be needed again because, with effect from 1st April 1976, the bulk of the foreign currency assets of the General Account and all the foreign currency assets and Hong Kong dollar assets of the Coinage Security Fund will be taken into the Exchange Fund.

78. Hong Kong's official foreign currency assets are now held in four accounts, the Exchange Fund, the Coinage Security Fund, the General Account and the Rehabilitation Loan Sinking Fund. But, as I have just said, with effect from 1st April 1976, I have decided to transfer the bulk of the foreign currency assets of the General Account and all the assets of the Coinage Security Fund to the Exchange Fund. The Rehabilitation Loan Sinking Fund assets which are, by law, managed by the Crown Agents will not be transferred. The assets of this Fund will, in any event, be needed for the repayment of the Rehabilitation Loan on 15th January 1978.

79. I have decided to transfer the assets of the Coinage Security Fund to the Exchange Fund because, in my view, they and the interest which flows from them, should be used, like the assets of the Exchange Fund, primarily to regulate the exchange value of the Hong Kong dollar and not, as at present, to benefit General Revenue. The Exchange

Fund's assets are derived from the note issue and from retained earnings, whereas the Coinage Security Fund derives its assets from coins in circulation. Coins and notes have a different physical form, but they serve similar monetary functions, and I can think of no substantial reason why the assets that back the coins in circulation should not serve the same purpose as the assets backing the note issue. The illogicality of the present arrangements becomes obvious when one considers the effect that would follow the planned replacement of the \$5 note by a coin of the same value, were the present arrangements to continue. If no change was made before the \$5 coin is introduced next August, approximately \$110 million would move from the Exchange Fund to the Coinage Security Fund, and the resources available to regulate the exchange value of the Hong Kong dollar would be reduced by this amount. Clearly, this change in the physical form of the \$5 currency unit could not possibly reduce the regulatory demands on the Exchange Fund to an extent which would justify the transfer of \$110 million from that Fund. The change in the form of the \$5 unit is, in fact, unlikely to affect these demands in any way.

80. Turning now, Sir, to my reasons for deciding to transfer the foreign currency assets of the General Account, other than necessary working balances, to the Exchange Fund. Over the post-war years, but particularly in 1969-70, 1970-71 and 1971-72 the General Account's holdings of such assets increased substantially, largely as the result of a series of budgetary surpluses, part of which has been invested overseas. When the Hong Kong dollar was linked to sterling these transfers were usually made to take advantage of higher London interest rates.

81. While the Hong Kong dollar was linked to sterling at a constant rate and our overseas investments were in sterling, a permanent loss of value in Hong Kong dollar terms could only be incurred if securities were sold at a price below that at which they were bought. This is no longer the case, and a permanent loss can be recorded through changes in the exchange rate. Such losses would be acceptable if a deliberate decision had been taken to maintain overseas investments for the benefit of the General Account, after the sterling/Hong Kong dollar link was broken. However, this is not the reason why these assets are still held. They are, in fact, being held for monetary reasons and because repatriation could put pressure on the Hong Kong dollar exchange rate. In other words, they are being used to serve the same function as the Exchange Fund, namely, to regulate the exchange value of the Hong Kong dollar.

82. Because of the growth of the banking habit and the introduction of electronic transfer systems, the resources available to the

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Exchange Fund have not grown in proportion to the regulatory demands that may be made on the Fund and, from time to time, it has indeed been necessary to utilise Hong Kong dollar balances in the General Account. It is in the public interest for these transactions to take place; but there is no reason why the General Account, and hence our free surpluses, should be reduced as a result. The arrangements I have in mind will ensure that, in future, all losses resulting from intervention in the foreign exchange market are carried, as they should be, by the Exchange Fund though, to avoid misunderstanding, Sir, let me hasten to add that intervention is designed only to correct wayward movements in the exchange rate—resulting from money flows and technical factors—and in the interests of stability, and never to obviate the need for the economy to adjust to changed external circumstances.

83. The Exchange Fund will pay interest on the debt certificates issued to the General Account in exchange for the foreign currency assets taken over. The net effect of these new arrangements will simply be to change the form in which the General Accounts assets are held. As the certificates will be denominated in Hong Kong dollars, the interest rate will reflect local conditions.

(e) *Establishment of Board of Treasury*

84. In last year's budget speech, I described the loan sources we were investigating and the legislative authority needed to sanction borrowings and I sketched out certain institutional arrangements then being considered<sup>(83)</sup>.

85. As I remain very doubtful whether Treasury bills are an appropriate debt instrument in Hong Kong, we have not issued any this year<sup>(84)</sup>; nor have we borrowed through the medium of private placements. Other sources I mentioned last year have, however, been tapped. A loan of HK\$250 million at  $6\frac{1}{2}\%$  has been raised through the issue of 5-year bonds<sup>(85)</sup>. We have negotiated a US\$60 million 5-year loan from the Euro-currency market at  $1\frac{1}{4}\%$  over the London interbank rate; and a loan of US\$3.2 million has been raised to finance the purchase of

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(83) *B.S., 1975, paragraphs 170-172.*

(84) *I said last year that the Hong Kong Treasury Bills (Local) Ordinance provided sufficient authority for the issue of Treasury Bills. But on further examination, it became clear that this Ordinance, which was enacted in 1926, would not, after all, provide a wholly satisfactory authority for the issue of Treasury Bills and it will need to be amended.*

(85) *Under the authority of the Loans (Government Bonds) Ordinance 1975.*

coins from the United Kingdom at  $1\frac{1}{8}\%$  over the London interbank rate<sup>(86)</sup>. This latter loan was not what I had in mind last year when I mentioned the possibility of a line of credit to finance the purchase of goods and services in the United Kingdom, but it was offered during the course of discussions about this line of credit. Through no fault of ours, an agreement on the line of credit has not been concluded, but discussions are continuing. An agreement has been negotiated to borrow US\$20 million from the Asian Development Bank to finance part of the cost of the Sha Tin Sewage Treatment Works, but the actual agreement documents have not yet been signed. The Asian Development Bank loan would have a term of fifteen years, including a grace period of five years, with interest at  $9\frac{1}{2}\%$  *per annum*.

86. The US\$60 million Euro-dollar loan has not yet been drawn down, but the way I intend to utilize it will become apparent later on.

87. As I mentioned in this Council on 30th July last, further consideration has been given to the establishment of a Loans Board or, rather, a Board of Treasury, to take over the assets and liabilities of the Development Loan Fund. We found it difficult to write terms of reference until we had developed our ideas for consolidating all our foreign currency assets in, and centrally managing them through, the Exchange Fund. I envisage that the Board of Treasury would assume responsibility for all Hong Kong dollar bond issues for the public sector including the Mass Transit Railway Corporation, the Housing Authority and the organization to be set up for industrial estates; and for regulating their timing and frequency, having regard to their monetary implications. The board would also monitor all public sector offshore borrowings, having regard to the total contingent liabilities being assumed by the Government and the effect on the foreign exchange market of the remittance of the proceeds to Hong Kong and the subsequent outflows on account of interest charges and the repayments of principal.

(f) *Gold Coins*

88. Before leaving our accounts I should mention the two gold coins we have issued during 1975-76.

89. The sales proceeds from the Royal Visit coin exceeded the cost by \$12.8 million and, together with the accumulated interest credited to the Special Coin Suspense Account, this issue has so far earned a total of about \$13.1 million.

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(86) *Under the authority of the Loans Ordinance 1975.*

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90. When moving the motion to establish the Special Coin Suspense Account on 19th March 1975, I said that the Royal Visit coin might be one of a series of fourteen coins, of which twelve would be issued to mark the twelve lunar years. As honourable Members know, a coin for the Year of the Dragon has been issued. The final results will not be known for some time as the overseas sales campaign has not yet ended but, in Hong Kong, a total of 34,659 applications were received for the 15,500 coins we offered here. The net proceeds—the *net* proceeds—from the dragon coin could be as high as \$20 million. In this event, the Suspense Account will have a credit balance of \$33 million.

91. The Accountant General has given some thought to the possibility of offering those who are prepared to put money up in advance a guarantee that they will obtain a coin each year and a very clever idea which I am now considering is to offer a gold coin certificate for sale, to which would be attached six coupons (*laughter*). The coupons would give the holder of the certificate a right to buy a gold coin in each of the next five years. The sixth coupon would give the holder the right to buy a certificate with coupons for the last six coins in the series (*laughter*). The certificate would be registered and would be transferable and I would hope and expect an active market in these certificates to develop.

(4) *Forecast of Expenditure for 1976-77 and 1977-78 to 1979-80*

92. As I explained in my budget speech last year<sup>(87)</sup>, departmental estimates submissions for 1975-76 came to \$7,987 million, being \$5,241 million for recurrent expenditure and \$2,746 million for capital expenditure. These submissions were eventually reduced to \$6,615 million, made up of \$4,618 million for recurrent expenditure and \$1,997 million for capital expenditure. The preparation of the Draft Estimates of Expenditure for 1975-76 was, therefore, a painful process but inevitably so, as we were not simply adjusting to a more even rate of growth, but having to slow down in the face of a serious economic recession which began to bite in late 1974.

93. As the forecast of expenditure for the three years 1976-77 to 1978-79 presented in Part V of last year's budget speech\* envisaged levels of expenditure which were clearly unacceptable—and I said so

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(87) *B.S., 1975, paragraph 51.*

\* *1974-75 Hansard p. 520-26.*

at the time<sup>(88)</sup>—we developed a different approach this year so that, when the 1976-77 budget was being constructed, the emphasis could be placed on what was possible, rather than on what was unacceptable.

94. Thus, heads of departments were asked to forward their forecast returns for the four years 1976-77 and 1977-78 to 1979-80 earlier and were warned that the figures in the previous year's forecast for total expenditure in the three years 1976-77 to 1978-79 would need to be substantially reduced to figures of the order of those I suggested last year, namely, \$7,100 million in 1976-77 rising to \$7,900 million in 1977-78 and \$8,700 million in 1978-79<sup>(89)</sup>. The approach adopted, therefore, involved special guidance to heads of departments in the preparation of their estimated submissions for recurrent expenditure and capital expenditure other than the two components of the Public Works Programme for which guidelines had already been laid down<sup>(90)</sup>.

95. To enable the Finance Branch to distinguish between the minimum provision necessary to sustain existing services, on the one hand, and the additional provision required for expanded and new services, on the other, heads of departments were asked to prepare their forecast submissions in six parts, namely:

- I Present services.
- II Expansion of present services dictated by an increased volume of demand, but only to the extent necessary to maintain present standards.
- III Restoration of services deleted in 1975-76 for budgetary reasons<sup>(91)</sup>.

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(88) *After adjustments to take account of the effects of the 1975-76 budget, the forecast of expenditure at April 1975 prices became:*

	\$ mn
1976-77.....	8,80
1977-78.....	9,20
1978-79.....	9,60

*involving deficits of \$2,200 million, \$1,800 million and \$1,400 million. (See B.S., 1975, paragraph 178-183).*

(89) *B.S., 1975, paragraphs 45, 57, 179, 184 and 185.*

(90) *B.S., 1975, paragraph 52.*

(91) *Including the \$36 million worth of deletions referred to in B.S., 1975, paragraph 180.*

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- IV Expansion of services within approved policies, (for which timing had been specifically agreed).
- V Expansion of services within approved policies for which timing had not yet been agreed.
- VI New services for which the policy had not yet been approved.

96. The total of the submissions for each of the four years 1976-77 and 1977-78 to 1979-80 came to \$6,010 million, \$6,510 million, \$6,790 million and \$7,160 million respectively. With the guideline figure of \$2,200 million for the two components of the Public Works Programme added in for each year, the total figures became \$8,210 million for 1976-77 and \$8,710 million, \$8,990 million and \$9,360 million for the forecast years.

*PART III: THE BUDGET FOR 1976-77*

(1) *Strategy*

(a) *Provisional acceptable levels of recurrent expenditure*

97. Sir, I turn now to the budget for 1976-77. I have just explained that the total of the forecast submissions for 1976-77 for recurrent expenditure and capital expenditure, other than the two components of the Public Works Programme, came to \$6,010 million. The next step was to separate unavoidable commitments<sup>(92)</sup> on existing services from new proposals. Unavoidable commitments came to \$5,680 million and new proposals to \$330 million. Extracting the capital element, the figures for recurrent expenditure became—recurrent expenditure alone became—\$5,440 million and \$210 million respectively for unavoidable commitments and new proposals. The figure of \$5,440 million for unavoidable commitments was reduced to \$5,170 million by the Finance Branch after a critical examination of each department's fore-

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(92) *Recurrent expenditure for expanded and new services, for which capital expenditure was already being incurred, was treated as unavoidable.*

Cast submission to ensure economy of expenditure<sup>(93)</sup> which, of course, is an end in itself, and to make the maximum amount of room available for new proposals which is also certainly an end in itself. Heads of departments were then given provisional limits within which to prepare draft estimates for unavoidable commitments on existing services and advised that they would be informed later whether budgetary considerations would permit any expenditure on new proposals. After the Colonial Secretary's Committee had ranked the list of new proposals<sup>(94)</sup> in order of priority, and having regard to the view I had by then formed of the economy's prospects, I took the view that, provided departments kept within their provisional limits for unavoidable commitments, some \$80 million could be committed to new proposals. The departments concerned were then asked to submit what we called subsidiary estimates for the high priority proposals for new services caught within the figure of \$80 million. The total of both departments' main estimates submissions and their subsidiary submissions came to \$5,320 million or \$70 million in excess of the \$5,250 million<sup>(95)</sup> I regarded as acceptable at that stage. Eventually, I had to settle for \$5,289 million.

(b) *Guidelines for capital expenditure*

98. The preparation of the estimates of capital expenditure involved a rather different sequence of events: the Finance Branch took the figure of \$2,200 million which I suggested last year might be acceptable for 1976-77<sup>(96)</sup>. They took this figure and this enabled the \$550 million provided in 1975-76 for the new towns and housing component of the Public Works Programme to be raised to a level of \$800

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(93) *Reductions and corrections were made for unrealistic assumptions about recruitment, inadequate consideration of the pattern of expenditure in 1975-76, arithmetic errors, wrongful inclusion of essentially new proposals, etc.*

(94) *Prepared by the Finance Branch from the five year forecast submissions.*

(95) *That is, \$5,170 million for unavoidable commitments and \$80 million for new proposals.*

(96) *B.S., 1975, paragraph 184.*

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million, making \$1,900 million in all for the two components of the Public Works Programme<sup>(97)</sup>.

99. The Education and Medical Departments were given limits for capital subventions and, likewise, the University and Polytechnic Grants Committee. The limit for capital works for the armed services was set by the new Defence Costs Agreement at \$30 million. The limit for the miscellaneous component was determined by debt repayments and the costs of reprovisioning Victoria Barracks, largely in HMS Tamar, and RAF Kai Tak, largely at Sek Kong. Subsequently, in the light of apparent trends in contract prices, the limit given to the Public Works Department for the two components of the Public Works

(97)

<i>Component</i>	<i>Guideline figure (*)</i>	<i>1975 acceptable level of capital expenditure for 1976-77 (**)</i>	<i>Adjusted to April 1976 prices</i>
	<i>(\$ million)</i>	<i>(\$ million)</i>	<i>(\$ million)</i>
(1) <i>Public Works Programme (other than New Towns and Housing).....</i>	1,100	1,100	1,000
(2) <i>Public Works Programme (New Towns and Housing, including transfers to the Development Loan Fund for on-lending to the Housing Authority).....</i>	1,100	800	730
(3) <i>Subventions .....</i>	45	45	45
(4) <i>UPGC.....</i>	60	60	60
(5) <i>Departmental Special Expenditure .....</i>	70	85	85
(6) <i>Defence Costs Agreements: capital works .....</i>	45	30	30
(7) <i>Miscellaneous.....</i>	<u>60</u>	<u>60</u>	<u>60</u>
	<u>2,480</u>	<u>2,180</u>	<u>2,010</u>

(\*) As set out at April 1974 prices in B.S., 1975, f.n. (73).

(\*\*) As given in B.S., 1975, paragraph 184; and including adjustment between components (5) and (6) in the light of changed circumstances.

Programme was reduced to \$1,730 million<sup>(98)</sup>. So the total guideline figure became \$2,010 million<sup>(99)</sup>. Eventually, a total of \$1,923 million was inserted in the draft Estimates<sup>(100)</sup>.

(98)

	(\$ million)
<i>Public Works Programme (other than New Towns and Housing)</i> .....	1,000
<i>Public Works Programme (New Towns and Housing)</i> .....	606
<i>Add: transfers from General Revenue to the Development Loan Fund for on-lending to the Housing Authority</i> .....	<u>124</u>
	<u>1,730</u>

See also Memorandum Note on Heads 67-71, Public Works Non-Recurrent, paragraphs 3-4 on pages 486-487.

(99) See last column of table in f.n. (97).

(100)

Component	Acceptable level of capital expenditure adjusted to April 1976 prices	Draft Estimates
	(\$ million)	(\$ million)
(1) <i>Public Works Programme (other than New Towns and Housing)</i> .....	1,000(*)	1,008(*)
(2) <i>Public Works Programme (New Towns and Housing, including transfers to the Development Loan Fund for on-lending to the Housing Authority)</i> .....	730(*)	594(*)(**)
(3) <i>Subventions</i> .....	45	53
(4) <i>UPGC</i> .....	60	47
(5) <i>Departmental Special Expenditure</i> .....	85	120
(6) <i>Defence Costs Agreement: capital works</i> .....	30	26
(7) <i>Miscellaneous</i> .....	<u>60</u>	<u>75(***)</u>
	<u>2,010</u>	<u>1,923</u>

(\*) Under present accounting arrangements, that part of expenditure on two projects met from loans from the Asian Development Bank (see Memorandum Note on Head 59 Public Debt, paragraph 2 on page 398 of the Estimates) is not included here.

(\*\*) Not including \$124 million, being the commitment entered in Head 50 Miscellaneous Services Subhead 358 Payment to Development Loan Fund for on-lending to the Housing Authority which may or may not be required depending on the state of the liquid asset balance of the Fund.

(\*\*\*) Public debt repayments, re-provisioning of Victoria Barracks and RAF Kai Tak and new coinage (but see paragraph 79 above).

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(c) *Financial guidelines*

100. I was prepared to accept estimates of expenditure totalling \$7,212 million, being \$5,289 million for recurrent expenditure and \$1,923 million for capital expenditure because, at 16%, the increase over the revised estimate for 1975-76 was consistent both with my view of revenue yields at existing tax rates and the additional taxation that I believed could be safely raised, and with loan finance facilities already available to me. Furthermore, the internal structure of the budget I am about to present to honourable Members fairly closely obeys my guidelines. That is to say, recurrent expenditure at \$5,289 million will absorb 83% of recurrent revenue at \$6,369 million<sup>(101)</sup> and recurrent expenditure will account for 73.3% of total expenditure of \$7,212 million<sup>(102)</sup>.

101. At \$1,080 million the surplus on recurrent account will finance 56.2% of capital expenditure of \$1,923 million<sup>(103)</sup> and at \$6,369 million recurrent revenue will finance nearly 88.3% of total expenditure<sup>(104)</sup>. Finally, at \$488 million capital revenue will finance 25.4% of capital expenditure<sup>(105)</sup>, leaving \$355 million, 18.5% only 18.5% to be financed by other means<sup>(106)</sup>.

(2) *Draft Estimates of Expenditure*

(a) *Presentational points*

102. Before coming to the actual proposals contained in the draft Estimates of Expenditure, I must make the following points on their presentation: first, an appropriations-in-aid system has been introduced<sup>(107)</sup>, which means that fees and charges for providing services to the public are classified as appropriations-in-aid and used to offset approved expenditure instead of being credited to General Revenue. This system is reflected in the Appropriation Bill 1976 which seeks both the necessary appropriations from General Revenue and the authority of this Council for the application of receipts appropriated-

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(101) C.f. guideline of 80%.

(102) C.f. guideline of 70%.

(103) C.f. guideline of 60%.

(104) C.f. guideline of 88%.

(105) C.f. guideline of at least 20%.

(106) C.f. guideline of not more than 20%.

(107) The details of the system are described in Financial Circular No. 24/75 reproduced at Annex (5).

in-aid to meet expenditure. This system will encourage departments to have greater regard to the direct cost of services in relation to the level of fees being charged, will establish the true cost of the Government's activities to General Revenue and will underline the need to keep fees under review. I would make two comments on the new system. The first is that any excess of appropriations-in-aid over departmental expenditure cannot be regarded as profit. This is because departmental expenditure does not include such future liabilities as the cost of pensions and such expenditure as leave, passages, training courses and, particularly, public works charged to other heads. My second comment is that Finance Committee's authority over the provision of funds will not be affected by this system, as provisions will continue to be controlled on the basis of gross expenditure; and supplementary provisions will still have to be sought, in the normal way, where the approved provisions under subheads are inadequate to meet the gross expenditure. However, the revenue figures which I shall be using from now on are inclusive of receipts appropriated-in-aid for ease of comparison with past years' figures.

103. Secondly to facilitate the implementation of the appropriations-in-aid system within the Public Works Department, the Public Works Recurrent head of expenditure has been broken up and its constituent parts are shown under each of the Public Works Department heads of expenditure.

104. Thirdly, as from 1st April 1976, the rate of recruitment will be controlled not only by the number of vacancies in the approved establishment, but also by the provision in each personal emoluments subhead. In past years, recruitment was permitted within the approved establishment without regard to the adequacy of funds, and supplementary provisions for personal emoluments subheads were automatically approved where necessary. This meant that there were wide differences between the original approved estimates and the actual expenditure on personal emoluments. The change has required a more careful calculation of the provisions in the Draft Estimates for personal emoluments<sup>(108)</sup>.

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(108) *These are based on the Treasury's computer print-outs of the actual requirement for existing staff, adjusted to a full 12-months' provision and providing for normal increments, to which has been added additional provision for the filling of vacancies in the approved establishment, having regard to the practical difficulties in attracting adequately qualified applicants in certain grades and to the time required to complete recruiting processes.*

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading***(b) Analysis of Draft Estimates**(i) General*

105. The draft Estimates for 1976-77 provide for expenditure of \$7,212 million. This represents an increase of \$990 million, or 16%, on the revised estimate for 1975-76 of \$6,222 million. It is substantially above the increase in 1975-76 on 1974-75, namely, 4.2%. In real or constant price terms the increase in 1976-77 is 10%<sup>(109)</sup> or nearly twice the increase in 1975-76 on 1974-75 of 5.6%<sup>(110)</sup> and is comparable with the average annual rate of increase in real or constant price terms in the first five years of the decade, namely, 13%<sup>(111)</sup>.

*(ii) Recurrent*

106. The provision for expenditure on recurrent services is \$5,289 million, including \$100 million for additional commitments of an unavoidable nature arising during the year<sup>(112)</sup>. This represents an increase of \$693 million or 15% on the revised estimate of \$4,596 million for 1975-76. Personal emoluments account for only 37% of recurrent expenditure compared with 39% in 1975-76 on the basis of the revised estimates and an average of 43% over the first five years of the decade. This downward trend reflects four factors: first, no contingency element has been included in the personal emoluments subheads for a possible salaries revision in 1976-77<sup>(113)</sup>, a point to which

(109) Recurrent: + 8.5%;  
capital: + 12.7%

(110) Recurrent: + 9.5%;  
capital: - 5.5%.

(111) Recurrent: + 11%;  
capital: + 19%.

(112) Head 50 Miscellaneous Services Subhead 100. Given the approach adopted when the budget for 1976-77 was being constructed (see paragraph 93 above), the provision in the draft Estimates should be adequate for all but the quite unforeseen commitments.

(113) The difference between the estimate for personal emoluments in 1976-77 of \$1,970 million and the revised estimate for 1975-76 of \$1,795 million is \$175 million made up as follows:

	\$ mn
Net increase in strength.....	84
Increments.....	48
ICAC (from one-line vote to ordinary estimate).....	33
12 months provision for staff recruited in 1975-76 .....	10
	175

I shall revert later on<sup>(114)</sup>. Secondly there was a freeze on Civil Service salaries in 1975-76. Thirdly, this freeze was coupled with a limiting of increases in the establishment of the civil service to under  $\frac{1}{2}$ % between 1st April 1975 and 1st April 1976<sup>(115)</sup>. Fourthly, a restriction was imposed on recruitment designed to limit the net increase in the strength of the establishment of the Civil Service.

107. Further to accord with our philosophy of making the maximum amount of room available for advances in certain selected areas of expenditure and to retain the cost-efficiency benefits of two years of financial stringency, departmental other charges at \$937 million have been kept to 17.7% of recurrent expenditure, compared with \$845 million, or 18.4%, in 1975-76 and an average of 16% over the first five years of the decade when expenditure on public assistance and disability and infirmity allowances was much less significant. Sir, I regard the figure of 17.7% is very satisfactory indeed.

108. Recurrent subventions (including UPGC) at \$1,312 million will absorb 25% of recurrent expenditure compared with \$1,200 million, or 26%, in 1975-76. Overall, taking recurrent and capital subventions together, a fifth of total public expenditure is disbursed by subvented organisations, a fact which explains the greater degree of attention now being paid by the Director of Audit to the manner in which subvented organizations spend the very considerable sums of public money placed at their disposal. I can see no reason why the organizations concerned should not be subject to the same degree of public accountability as that which applies to Government departments. The financial administration of subvented organizations should be conducted at the highest possible level of efficiency and I fully support the Director of Audit in bringing to my notice any cases in which waste, extravagance or mismanagement may have occurred.

109. Finally, the cost of our public debts and of defence will loom larger in our affairs from next year than hitherto. For convenience, I shall take here both recurrent and capital expenditure together: the cost of our public debt will increase from \$18 million in 1975-76 to \$43 million next year (that is to say from 0.3% of total expenditure to 0.6%); whilst defence costs will increase from \$101 million in 1975-76 to \$215 million next year<sup>(116)</sup> (that is to say from 1.6% of total expen-

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(114) See paragraph 204 below.

(115) At 1st April 1975, the establishment of the Civil Service was only 1.32% up on the establishment at 1st April 1974, when it was 7.55% up on 1st April 1973.

(116) Plus \$16 million, being the Hong Kong Government's share of the cost of technical services and direct labour provided by the Public Works Department.

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diture to 3%). The new Defence Costs Agreement<sup>(117)</sup> provides for the Hong Kong Government's share of the total cost of the agreed garrison of  $4\frac{1}{3}$  major units, as recalculated from time to time by reference to measures of inflation, to be  $62\frac{1}{2}\%$  in 1977-78 and 75% thereafter.

(iii) *Capital*

110. The estimate of capital expenditure in 1976-77 is \$1,923 million<sup>(118)</sup>, or roughly the same as the original estimate for 1975-76, but 18% up on the revised estimate of expenditure of \$1,626 million. Actual expenditure may be higher than this if the drawings by the Housing Authority from the Development Loan Fund are such as to require further transfers from General Revenue to the fund by up to perhaps \$100-\$125 million<sup>(119)</sup>. In addition \$15 million will be required for Licensed Areas<sup>(120)</sup> and \$12 million for the conversion of a number of primary schools to secondary schools<sup>(121)</sup>.

(iv) *Expenditure by expanded and new services*

111. So much for financial arithmetic. I would now like to spell out the results of our efforts to provide for measurable advances, on both recurrent and capital account, in certain selected areas, namely, the maintenance of law and order with particular reference to the police, education with particular reference to secondary and tertiary education, housing, medical services and recreation. I shall also draw honourable Members' attention to certain aspects of social welfare expenditure which should not be overlooked and, finally, to development works within the capital account of importance in themselves.

(A) *Law and Order*

112. I said last year that, in spite of significant reductions in departments' submissions for expenditure and in spite of some cut-backs in recurrent services to bring expenditure within the revenue available, I had been obliged to allow for a substantial increase in the strength of the Police Force and in the prison population<sup>(122)</sup>. This concentration

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(117) From 1st April 1976 for seven years, initially, signed in London on 18th December 1975.

(118) See table in f.n. (100) above.

(119) Component (2).

(120) Component (2).

(121) Component (3).

(122) B.S., 1975, paragraphs 74 and 75.

} See also paragraphs 132, 137 and 125 below.

of effort on law and order seems to have paid off for the Commissioner of Police now seems to be containing the growth of crime<sup>(123)</sup>. But it remains a problem of great public concern and, having contained it, the Government has every intention of reducing it. So, once again, expenditure on law and order services has an important place in the draft Estimates, accounting for \$763 million or 10.6% of total expenditure compared with 10.4% in 1975-76<sup>(124)</sup>.

113. The Police Force will cost us \$521 million in 1976-77 or 68% of the total cost of law and order services. This represents an increase of \$53 million, or 12%, over the revised estimate for 1975-76, and is largely accounted for by our intention to bring the operational strength of the Police Force up to full establishment which will involve creating an extra 1,000 posts for a training reserve<sup>(125)</sup>. If recruiting is successful, and ignoring wastage, these should be up to 1,700 extra policeman available to the Commissioner for active duty by the end of the financial year. To assist in the recruiting process, the capacity of the Police Cadet School will be increased from 300 to 600 by the opening of an extension at Dodwell's Ridge<sup>(126)</sup>.

114. The effectiveness of this larger Police Force should be greatly assisted by the provision of \$34 million for the final stage of implementing the beat radio scheme and for other extra equipment. The contact of the Force with the public will be assisted by the establishment of 28 reporting centres in housing estates<sup>(127)</sup> and the creation of a further 500 mutual aid committees so as to achieve the target of 2,030 such committees set for 1977.

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*(123) Reported crime (excluding minor offences):*

1970-71	29,595
1971-72	32,713
1972-73	34,975
1973-74	43,595
1974-75	57,016

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1974-75 (first 10 months)	48,276
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1975-76 (first 10 months)	48,381 (provisional)
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*(124) Over the first five years of the decade, law and order accounted for over 9% of total expenditure (as defined in paragraph 43): see paragraph 49 above.*

*(125) The approved establishment of the Force will be, therefore, 20,264 compared with 19,224.*

*(126) This will involve the creation of a few additional instructor posts for which provision has been included in the draft Estimates.*

*(127) Provision for 8 is in the draft Estimate and a further 20 will be charged against Head 50 Miscellaneous Services Subhead 100 Additional commitments.*

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115. Full details of the estimates of the Independent Commission Against Corruption are now included in the blue pages of the Estimates<sup>(128)</sup>. The increase of \$13 million, or 52%, over the revised estimate for 1975-76 of \$25 million allows for more intensive investigations by the Operations Department and for filling all the posts in the Community Relations Department.

116. The Prisons Department is inevitably costing us more, year by year: in 1976-77 it will cost \$122 million or nearly 50% more than in 1974-75. One point which honourable Members will wish to note I am sure is that provision has been included in the draft Estimates for developing prison industries, hopefully with some consequences for the level of expenditure by other departments as these industries become capable of meeting some of their requirements.

(B) *Education*

117. The draft Estimates provide for expenditure of \$1,376 million on education in 1976-77, made up of \$1,260 million for recurrent expenditure by the Education Department, on subventions and by the University and Polytechnic Grants Committee, and \$116 million for capital expenditure<sup>(129)</sup>. The revised estimate for 1975-76 is \$1,294 million. The figure of \$1,376 million represents 19.1% total expenditure in 1976-77, compared with 20.8% in 1975-76<sup>(130)</sup>.

118. Additionally, some \$33 million is expected to be drawn in 1976-77 as loans from the Development Loan Fund to assist in the financing of new school buildings in the aided and private sector, and for loans to students at the universities, the Polytechnic<sup>(131)</sup> and the Baptist College<sup>(132)</sup>. Borrowings from the Development Loan Fund for

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(128) Pages 744-747.

(129)		(\$ million)
	Government built schools (PWNR)	19.2
	Subventions	49.5
	UPGC	47.6
	Departmental special expenditure	<u>0.1</u>
		<u>116.4</u>

(130) Over the first five years of the decade education accounted for just over 19% of total expenditure (as defined in paragraph 43): see paragraph 50 above.

(131) Loans to students at the Polytechnic will be introduced if proposals to raise fees are agreed.

(132) In addition, \$11 million will be drawn from the Development Loan Fund by the Construction Industry Training Authority and the Clothing Industry Training Authority.

education purposes amounted to \$78 million during the first five years of the decade and \$25 million in 1975-76<sup>(133)</sup>.

119. Of the total expenditure of \$1,376 million envisaged for 1976-77, \$624 million will be spent on primary education, \$353 million on secondary education, \$29 million on technical education, \$292 million on the universities and the Polytechnic and \$78 million on administration, educational television, examinations, further education, the inspectorate, recreation and sports and student fare subsidies.

120. The White Paper on Secondary Education tabled in this Council on 16th October 1974 stated that "the Government's main objective (in the field of education) is to make available by 1979, subsidised education for every child for nine years, that is to say, six years in primary school followed by three years in secondary school".

121. The first part of this objective, namely, the provision of six years of subsidized, in the sense of free, in this case, primary education for every child seeking it, is already more than fully provided for. On the basis of the 1971 Census, the number of children of primary school age is estimated to be 524,300 by the end of the current financial year. The number of places available in Government and aided primary schools is well in excess of this, at about 625,600<sup>(134)</sup>. Of course, because of repeaters and over-age children, actual enrolment is always higher than the number of children in the appropriate age group. At present, actual enrolment is 548,000, but is expected to fall during 1976-77 to about 541,000. Consequently, there is a considerable under-utilisation of capacity, particularly in Government primary schools. My honourable Friend, the Director of Education, is actively considering alternative uses to which surplus places and buildings might be put, including of course conversion to secondary use<sup>(135)</sup>.

122. This is not to say that new primary schools will not be opened. The Government's aim is to ensure that no child will have to travel an unreasonable distance to attend primary school and, with the expected shift of population, it will be necessary to provide a substantial number of new primary school places in the new towns. The draft Estimates envisage that some 20,400 new places will be provided during the year in areas which have, or will have, a local shortage, although there will be an overall net reduction of some 11,500 places in Government

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*(133) Loans to students are from a revolving fund and hence gross borrowings are higher than these figures.*

*(134) A further 101,000 places exist in private primary schools.*

*(135) See also Memorandum Note on Head 34 Education Department, paragraph 5 on page 136 of the Estimates.*

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and aided primary schools. The Education Department will continue to look after the interests of serving teachers in these schools through the placement service which began operating successfully this year.

123. The need to reduce the number of places available in primary schools to reflect more closely the number of children in the primary school age group will not affect the Government's special commitment to provide suitable school places for handicapped children. It is intended to provide a further 2,900 such places to bring the total up to about 12,100 in September 1976.

124. The provision of six years of subsidized primary education for each child seeking it having been achieved, the next logical step in the further implementation of the general objective stated in the White Paper is to make available a sufficient number of subsidised places in Forms I and subsequently in Forms II and III of secondary schools to accommodate all Primary 6 leavers who want secondary education. The draft Estimates for 1976-77 envisage a major step forward in the achievement of this next logical step. Provision has been included to enable Form I places, available for allocation by means of the Secondary Schools Entrance Examination in September 1976, to be increased to some 67,300 places about 18,800 more than were available for allocation in September 1975. My intention will be to provide in the draft Estimates for 1977-78 and 1978-79 for further increases in the number of subsidised Form I places so as to produce a sufficient number of such places in September 1978 for all Primary 6 leavers wanting secondary education. But I should insert a warning here, which will not be unexpected, the warning is that a comprehensive system of subsidized secondary education for all must be eventually accompanied by an upward revision of fees with the fee remission system of course continuing to protect the poorer parents.

125. In order to make available a sufficient number of subsidized places in Form I of secondary schools to accommodate all Primary 6 leavers wanting secondary education, the number of Forms I—III places in Government and aided schools will have to be increased by 74,400 from the present 156,800 to 231,200 in September 1978. So, there should be enough Form I places to make it possible for the last Secondary Schools Entrance Examination to be held in 1977, that is

to say, a year earlier than envisaged in the White Paper<sup>(136)</sup>. In order to achieve such a massive expansion over a short space of time, it will be necessary to rely heavily on buying places already existing in private schools. At the same time, it will be necessary to exhaust the possibilities of voluntary flotation of classes in existing Government and aided schools, and to make full use of an extended day system of operation. These must be recognized as temporary measures which, consistent with the quality objectives of the White Paper, must eventually be replaced by building and equipping new schools. Precisely when these new schools can be built and equipped will depend on our ability to find the additional resources to meet the very substantial cost of doing so, having regard to competing bids for other services. Nevertheless in the draft Estimates for 1976-77, it has been possible to provide for a start on 21 new secondary schools—ten sponsored and eleven Government built in the new towns—and 12 are to be created by converting a number of primary schools, that is to say a total of 33 new secondary schools will be started in 1976-77.

126. Meanwhile, some immediate improvement in quality will be achieved by bringing on to full subsidy 36 existing private assisted schools. These schools are already in the process of converting to full subsidy<sup>(137)</sup> and the draft Estimates for 1976-77 provide for the second stage of a three-stage conversion which will be completed by September 1978.

127. I expect, Sir, that, later in the debate on this motion, my honourable Friend, the Director of Education, will be explaining in more detail the implications of this massive programme of expansion, including the implications for the employment of teachers graduating from teacher's colleges in 1976.

128. For children wishing to proceed beyond Form III, the draft Estimates provide for an additional 1,600 places in Forms IV and V, increasing the total number of such places to 40,700 by September 1976. There will also be an increase of about 1,000 places in Form VI to

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(136) *If, in the event, more places are required, funds will have to be provided to enable more to be bought.*

(137) *See Memorandum Note on Head 82 Subventions: Education, paragraph 17 on page 660 of the 1975-76 Estimates.*

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bring the total of such places to 10,000. In September 1976 total enrolment in the three technical institutes is expected to be about 3,300 full-time students (or the equivalent of full-time students) an increase of about 1,000 over September 1975. Construction of a fourth technical institute, at Cheung Sha Wan, has already started and will continue during 1976-77, and work on a fifth institute at San Po Kong will begin during the year at an estimated building cost of \$14.2 million.

129. At the tertiary level, the Government's objective is to achieve targets of 8,850 students at the universities and 8,000 full-time equivalent day students at the Polytechnic by 1977-78. The draft Estimates for 1976-77 provide for grants to be made through the University and Polytechnic Grants Committee to enable the number of students enrolled at the universities to be increased to 8,250 in September 1976, an increase of some 700 over September 1975. Because most courses are for three years, this implies an enrolment of 8,850 in September 1977, that is to say, the target figure. At the Polytechnic, the number of full-time equivalent day students enrolled in September 1976 is expected to be 5,950 compared with 4,991 in September 1975<sup>(138)</sup>. By September 1978, the target of 8,000 full-time equivalent day students should be almost reached since Phase 2 of the development of the Polytechnic will begin in 1976-77 when it is expected that \$17 million of the project estimate of \$37 million will be spent.

**(C) Housing**

130. In the first five years of the decade, 1970-71 to 1974-75, the Government and the Housing Authority completed new public housing accommodation for 521,300 people. Additionally, work was in progress at the end of 1974-75 on the construction of 40,500 flats for 242,700 people<sup>(139)</sup>. In the second five years of the decade, 1975-76 to 1979-80, some 96,400 flats for 578,100 people are expected to be completed, that is to say, nearly 11% more than the addition to the

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(138) In terms of the actual number of day and evening students, these figures become 7,872 and 16,000 compared with 6,633 and 15,516.

(139) See paragraph 51 above.

housing stock in the first five years<sup>(140)</sup>. And, of course, work on the construction of further estates will be in progress at the end of 1979-80 for completion in the early 80s. It is hoped that, by 1984, adequate public housing will be available to meet over 80% of the estimated demand, compared with 57% at the end of 1975-76.

131. But this, Sir, is not really good enough. So we are now exploring the possibility of building flats specifically for sale, largely to existing tenants of public housing estates so that, as they move out, room is made for others more in need of low cost rented accommodation to move in. To produce, say, 5,000 flats capable of housing an additional 30,000 people a year, such a scheme would involve establishing a revolving fund of very roughly \$300 million and finding about 25 acres of land a year. The terms of sale would have to be carefully devised—very carefully devised—so as not to inhibit private development. It would also need to be supported by adequate mortgage facilities, on fairly attractive terms, from sources outside the Government, so that the fund would revolve fast enough to continue financing the construction of 5,000 flats a year. The Housing Authority has welcomed this proposal of the Government in principle and I hope to be able to raise the necessary loan finance to establish a revolving fund within the Development Loan Fund. A great deal of detailed work will then be required to produce a really practicable scheme.

<i>(140)</i>	<i>Flats</i>	<i>People</i>
<i>Construction in progress at end of 1974-75.....</i>	<i>40,500</i>	<i>242,700</i>
<i>New contracts let in 1975-76.....</i>	<i>19,900</i>	<i>136,200</i>
	<hr/> <i>60,400</i>	<hr/> <i>378,900</i>
<i>Less: Accommodation completed during 1975-76 .....</i>	<i>-16,500</i>	<i>-99,000</i>
	<hr/> <i>43,900</i>	<hr/> <i>279,900</i>
<i>Construction in progress at the end of 1975-76</i>	<i>43,900</i>	<i>279,900</i>
<i>New contracts to be let in 1976-77 .....</i>	<i>44,300</i>	<i>267,400</i>
	<hr/> <i>88,200</i>	<hr/> <i>547,300</i>
<i>Less: Accommodation expected to be completed during 1976-77 .....</i>	<i>-15,700</i>	<i>-94,000</i>
	<hr/> <i>72,500</i>	<hr/> <i>453,300</i>
<i>Construction in progress at the end of 1976-77.....</i>	<i>72,500</i>	<i>453,300</i>
<i>Less: Accommodation expected to be completed during the 3 year forecast period 1977-78 to 1979-80.....</i>	<i>-64,200</i>	<i>-385,100</i>
	<hr/> <i>8,300</i>	<hr/> <i>68,200</i>
<i>Construction in progress at the end of 1979-80 on contracts let before 31st March 1977 .....</i>	<i>8,300</i>	<i>68,200</i>
	<hr/> <hr/> <i>8,300</i>	<hr/> <hr/> <i>68,200</i>

Note: *The sum of the minus figures=96,400 flats and 578,100 people.*

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132. Meanwhile, Sir, the Housing Department estimate that it will be spending, during 1976-77, about \$220 million on the Housing Authority's existing building programme, of which rather more than half will be met from borrowings from the Development Loan Fund and the balance from the Authority's own funds.

133. The Public Works Department will continue construction work on the twenty estates on which planning had already started when the new Housing Authority was formed. As the Public Works Department's involvement in the actual construction of public housing estates declines, so the Housing Department's part in the building programme will increase.

134. The draft Estimates for 1976-77 envisage some \$170 million being spent by the Public Works Department on these estates. They comprise eleven estates in the urban area on which \$64 million will be spent, and nine in the new towns of Tsuen Wan, Sha Tin and Tuen Mun on which expenditure will be \$106 million including, in respect of Sha Tin and Tuen Mun, the necessary community facilities to ensure a balanced development. Over and above this, an additional \$25 million will be spent on making good deficiencies in community facilities in the older town of Tsuen Wan.

135. As for recurrent expenditure, the draft Estimates provide for the continuing control and clearance of squatters, and for the shortfall between income and expenditure in the management of certain estates and cottage areas to be met from General Revenue.

136. The control and clearance of squatters remain a Government responsibility although undertaken by the Housing Authority on Government's behalf. The cost in 1976-77, net of income from licensed area fees but including compensation payments, is estimated at \$29 million. This is roughly the same as the net expenditure on clearances and squatter control in 1975-76. Cost increases have been largely offset as a result of increased fees charged in certain licensed areas. These increased fees were introduced for new and existing licensed areas where improvements have been made in the form of part-built structures, electricity and water supplies and more open spaces.

137. This programme for the development of improved licensed areas was approved in July 1974 at a cost of nearly \$28 million. It has now been virtually completed and the total capacity in all licensed areas is about 49,000 spaces. Another programme is being drawn up and will be put to Finance Committee as soon as possible. As I said

earlier, an additional \$15 million is likely to be required for this purpose in 1976-77 and will be sought by supplementary provision<sup>(141)</sup>.

138. The rental income in respect of the old resettlement estates and cottage areas handed over to the Authority in 1973 still leaves a considerable gap as between income and expenditure, even ignoring amortisation of land and building costs, and the prospect of closing this gap is remote. The gap is met by the Government in the form of a deficiency grant to the Authority. In 1975-76, the deficiency grant is \$53 million and, in addition, a special grant of \$32 million is being paid to meet increased rates in respect of these estates. The special rates grant was approved in 1974 for two years, that is to say, up to the end of 1975-76<sup>(142)</sup>. It was hoped that it would be possible during these two years to pass this liability on to the tenants, where it rightly belongs, by increasing the rent levels. Notwithstanding an increase in the rent levels of five cents a square foot with effect from December 1974, the abolition of the special grant in 1976-77 will mean, I am afraid a substantial increase in the deficiency grant. The grant is expected to be \$82 million in 1976-77 and provision of this amount is included in the draft Estimates<sup>(143)</sup>.

139. This brings me, Sir, to the general question of rents in public housing estates. The Housing Authority has a statutory responsibility to pay its way, which means that its income from rents should be adequate to meet operating expenses and management costs, to meet interest payments on loans required to finance its building programme, and to meet amortization charges on its lands and buildings. The Authority has traditionally paid a concessionary premium for land, and to meet the premia and the construction costs of estates, it borrows, where necessary, from the Development Loan Fund. It pays, on such borrowings, interest at a concessionary rate of 5%. But, as it is not required for the time being to make any capital repayments to the Development Loan Fund, the Authority's recovery of amortization charges, through rents, is available for meeting in part the cost of its building programme, thereby reducing the need for further borrowings.

140. The concessionary formula for calculating land premia and the low rate of interest charged on borrowings from the Development Loan Fund, in themselves represent a substantial subsidy from General Revenue towards public housing. Notwithstanding this, rising costs due to higher prices (including land prices) and improved standards,

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(141) See paragraph 110 above.

(142) B.S., 1974, paragraph 137-138 and B.S., 1975, paragraph 107.

(143) Rates, being a statutory liability, will be a first charge against rent income.

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are tending to produce rent levels which may present difficulties for some families. The improved standards derive from the Authority's determination not to allow these new estates to deteriorate into the conditions which are now so typical of the older resettlement estates. Emphasis is, therefore, being placed on the planned provision of community and commercial facilities in the new estates and, wherever possible, standards of the design and construction of the domestic accommodation itself are being improved.

141. Nevertheless, rents for public housing should cover all costs, somehow defined, and should reflect the environmental and locational factors of the various estates. Yet they should be within the ability of most tenants to pay. However, because of rising costs, the Housing Authority will face increasing difficulties in determining rents which reconcile both the need to cover costs and the means of its tenants. In this connection, it is incumbent on the Housing Authority to review all input costs for public housing accommodation to ensure that the rents derived from them do not become unrealistically high in comparison with what its tenants can afford. On the other hand, I know the Housing Authority has very much in mind the related problem of ensuring that rents do not lag far behind cost increases.

142. But even when cost-related rents have been properly established within the means of the majority, there may still be a problem in that the Authority is being required to provide accommodation for people who, as squatters, have been paying little or nothing towards accommodation prior to being re-housed. There is an understandable reluctance and, perhaps, even difficulty, on their part to adjust their budgets to meet the new commitment. The problem is, in my view, a social rather than a housing one. I suggest therefore a review of the situation may be called for aimed at establishing whether existing forms of assistance towards rent payments should be improved for those who have genuine difficulty in meeting cost-related rents in public housing estates. Such a review, if carried out, must however be based on the firm assumption that all other tenants should continue to be subsidized only to the extent of the concessionary formula for calculating the land premia and the low rate of interest charged on borrowings from the Development Loan Fund.

(D) *Medical services*

143. The draft Estimates provide for expenditure of \$631 million on medical services in 1976-77, compared with the revised estimate

of \$590 million in 1975-76. This represents 8.7% of total expenditure in 1976-77, compared with 9.5% in 1975-76<sup>(144)</sup>. Provision has been included for the Princess Margaret Hospital to operate at its full capacity of 1,340 beds, for the opening of two polyclinics<sup>(145)</sup> and a specialist clinic<sup>(146)</sup> we had hoped would be able to open this financial year, and for the opening of the extension of the Nam Long Hospital and of the Tung Wah Centenary Building. These projects will increase the number of beds from 18,137 at 31st March 1976 to 18,831 by 31st March 1977<sup>(147)</sup>, and will result in an improvement in the ratio of beds to the population<sup>(148)</sup>.

144. Although the Medical Development Advisory Committee has yet to complete its review of the 1974 White Paper on Medical Services, our present financial planning over the three year forecast period, 1977-78 to 1979-80, allows for the building of the psychiatric wing of the Princess Margaret Hospital<sup>(149)</sup> and of new hospitals in East Kowloon and Shatin, to pick out three major projects for special mention.

145. Meanwhile, we shall be expecting the recommendations of the University and Polytechnic Grants Committee on the development of the medical school at the Chinese University. And provision is included in the draft Estimates to finance the steps necessary to bring unregistrable doctors up to standard.

146. All in all, by the end of 1979-80 that is to say by the end of the new three year forecast period, we should see both a significant increase in the ratio of beds to the population<sup>(150)</sup> from 4.18 to 4.55 per thousand and a further improvement in the standard of our medical services. I estimate that recurrent expenditure on medical services at constant prices will increase from about \$600 million in 1976-77 to over \$720 million by the end of the three year forecast period 1979-80. Capital expenditure might have to be as high as \$430 million over the four years 1976-77 that is to say the budget year, and the three forecast years 1977-78 to 1979-80.

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(144) *Over the first 5 years of the decade, medical services accounted for 9.6% of total expenditure (as defined in paragraph 43); see paragraph 50 above.*

(145) *Kowloon East and South Kwai Chung.*

(146) *Tang Chi Ngong at Morrison Hill.*

(147) *For further details see Memorandum Note on Head 49 Medical and Health Department, paragraph 4 on page 286 of the Estimates.*

(148) *From 4.11 per 1,000 as at 31st March 1976 to 4.18 at 31st March 1977.*

(149) *Formerly known as the Second Mental Hospital.*

(150) *From 4.18 to 4.55 per 1,000.*

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147. One area to which you, Sir, attach particular importance is the development of recreational facilities. The draft Estimates allow for additional expenditure of \$6 million to develop the countryside for recreation, particularly in the Sai Kung, Shing Mun, Aberdeen and Bride's Pool areas, and to staff two new management centres. I would also be prepared to seek supplementary provision if I can be satisfied that additional funds can be usefully spent within the coming year. In addition, towards opening up the considerable recreational potential of Lantau, a programme for spending roughly \$5 million a year for some years to come on improving the South Lantau road will get under way next year.

148. Provision has been included to enable the Director of Urban Services to provide additional swimming facilities in the New Territories<sup>(151)</sup>. In addition to work already in progress, contracts will be let for further additional recreational facilities in Kwai Chung<sup>(152)</sup>; and the Public Works Department will also be letting contracts to the value of over \$40 million for recreational facilities in the urban area on behalf of and for the Urban Council<sup>(153)</sup>.

149. But, possibly, the most significant development is that the competitive tenders we have been getting for works contracts has meant that there is room in the Public Works Programme for tenders to be called for, and for work to start on, the indoor stadium at Hung Hom in 1976-77, a year earlier than anticipated<sup>(154)</sup>. The floodlighting at the Hong Kong Stadium is also to be improved next year at a cost of \$1.8 million.

150. The object of providing these facilities is to encourage recreation. The Council for Recreation and Sport gives advice on precisely how this should be done. The means is provided by the Recreation and Sports Scheme which is taking a leading part in organizing sporting events and recreational activities. Then there is the Opportunities for Youth Scheme and Hong Kong's participation in international, and the

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(151) *Butterfly Beach will be opened up and the Tsuen Wan swimming pool will be open for 15 hours a day.*

(152) *Kwai Chung Area 9 playground; and Kwai Chung sports ground.*

(153) *The total contract value of projects already in hand (i.e. in 1975-76) is \$65 million and the revised estimate of expenditure in 1975-76 is \$21 million.*

(154) *The approved project estimate is \$68 million and it is estimated that \$7.5 million will be spent in 1976-77.*

organization of local, sporting events. Nearly \$6 million has been provided in the draft Estimates for all these activities, an increase of \$3 million on the provision in 1975-76. Expenditure on recreation and sport has been supplemented by about \$4 million from special funds in the last two years and we shall now have to think about such alternative sources of revenue for this expenditure as the Lotteries Fund from which, anyway there has been a steady flow of grants to improve facilities in recent years.

(F) *Social welfare*

151. I think it is now worth dwelling, Sir, for a few minutes on certain aspects of the development of expenditure on social welfare<sup>(155)</sup> estimated to be \$422 million in 1976-77, compared with the revised estimate of \$370 million in 1975-76. This represents 5.8% of total expenditure in 1976-77, compared with 5.9% in 1975-76<sup>(156)</sup>.

152. The provision in 1976-77 for recurrent expenditure for the Social Welfare Department and for social welfare subventions totals \$406 million. The first obvious point to note about this provision is that, on the same price base as that used for the calculations in the Five Year Plan for Social Welfare Development in Hong Kong 1973-78 published in 1973, this figure of \$406 million is nearly double the level of expenditure the plan envisaged by 1976-77<sup>(157)</sup>.

153. The second point to which I would draw honourable Members' attention is that, again at constant prices, expenditure, excluding public assistance and disability and infirmity allowances, is some 5% higher than the plan predicted<sup>(158)</sup>. One of the reasons for this is the dramatic increase in subventions for social welfare in the last few years: in money terms, the increase was from \$12.4 million in 1970-71 to \$38.5 million in 1974-75 (or by 210%); to \$47.5 million in 1975-76; and to \$52 million in 1976-77. This growth in expenditure is remarkable against the background of the economic difficulties we have experienced.

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(155) Defined so as to include Social Welfare Department, social welfare subventions, certain miscellaneous subventions and Legal Aid Department.

(156) Over the first 5 years of the decade, social welfare accounted for 2.8% total expenditure (as defined in paragraph 43): see paragraph 50 above.

(157) At 1973 prices the plan predicted \$159 million on recurrent expenditure for the Social Welfare Department and for social welfare subventions by Year 4 (1976-77).

(158) At 1973 prices, the plan predicted recurrent expenditure by the Social Welfare Department and on social welfare subventions of about \$75 million, excluding public assistance and disability and infirmity allowances, compared with about \$79 million (at 1973 prices) allowed for in the draft Estimates for 1976-77.

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I should interpolate here that, in addition to enabling voluntary agencies to maintain existing services, the provision sought for 1976-77 will allow the introduction of some new services, including the implementation of the Child Care Centres Ordinance from 1st June.

154. But the third and most significant point about this expenditure on social welfare is that no less than \$297 million has had to be included in the Draft Estimates for 1976-77 for disability and infirmity allowances and public assistance. Those eligible for disability and infirmity allowances are old persons over the age of 75 and persons suffering a complete loss of earning capacity as a result of disabilities. The number claiming the allowances had risen to nearly 64,000 by November of last year; and the draft Estimates provide for a further increase to 75,000 by the end of 1976-77, compared with roughly 34,000 implied in the five year plan. About 82% of these cases are persons over the age of 75; and, as these cases represent about 80% of the over-75 age group<sup>(159)</sup>, the Social Welfare Department will not be far off the maximum number of cases.

155. As applicants for disability and infirmity allowances are not means-tested, the number of cases is unlikely to be significantly affected by improvement in the economy. The public assistance scheme, by contrast, being designed to maintain family incomes at certain basic levels, has to be based on means-testing. When allowing for an increase in payments from \$65 million in the approved Estimates for 1974-75, to \$105 million, being the revised estimate for 1974-75, to \$135 million in the draft Estimates for 1975-76, to \$174 million, being the revised estimate for this year, I was reasonably satisfied that the increases in the rates, in line with the public assistance index, and the demands on the scheme likely to result from the depressed state of the economy, justified this ever growing expenditure. But, given the expected improvement in the economy, and the lack of movement in the index in recent months because of our lack of inflation, I was certainly not expecting to have to include yet a further \$33 million in the draft Estimates for 1976-77.

156. The reason why I have accepted the need for an estimate of \$207 million is that the Director of Social Welfare has assured the Finance Branch that the number of families successfully claiming unemployment of the breadwinner as the reason for seeking public assistance has increased only from 530 as at 1st April 1974 to 3,240

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(159) *The Census and Statistics Department's medium projection predicts an over-75 population of 76,800 by mid-1977.*

at 30th November 1975, when they accounted for under 6% of the caseload. If we add in those claiming "low earnings", the percentage of the caseload represented by those claiming public assistance on economic grounds increases from 14% in 1974 to 23% in 1975. From these percentages, the Director of Social Welfare has argued that an improvement in the economy will probably result in his shedding only 5,000 cases from his November 1975 caseload of 55,000.

157. In other words nearly 80% of the caseload appears to be for social rather than economic reasons and, therefore, it is expected that the caseload will continue to rise until it begins to level off at about 72,000. The caseload we have allowed for in the draft Estimates by the end of 1976-77 is 66,000, compared with the forecast caseload in the Five Year Plan of 25,000. As 50% of the caseload claim "old age" as the reason for applying for assistance and as, for some reason I personally do not understand, "old age" starts at 55 for public assistance, I suspect that some of the old age cases might be shed as the economy improves. So the caseload may start to level off before the figure of 72,000 is reached and I certainly hope so.

158. Nevertheless, if the relationship between unemployment and the number of cases on public assistance is anything like as slender as experience suggests, then we have in fact changed over, no doubt under the stimulus of our recent economic difficulties, from social welfare in kind to social welfare in cash at a speed and at a cost far exceeding that envisaged in the plan. In the circumstances, I would suggest that a lot of very hard rethinking is necessary to establish where the need for continuing to expand social services, apart from cash payments, truly lies. We must not forget that our expenditure on social welfare is irreducible in times of economic hardship although, admittedly, on the next economic downturn, the increase in the number of public assistance and disability and infirmity cases may not be as dramatic as it has been recently.

(G) *Communications and development works*

159. As always, Sir, we have not allowed these promising improvements in social services to diminish the effort we put into the development of the economic infrastructure. To draw honourable Members' attention to some of the more significant and systematic developments which the draft Estimates allow for, I would begin by citing the dramatic improvements in the vital road links between the industrial

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'area of Kwun Tong and the container terminal<sup>(160)</sup> between Kowloon and Sha Tin and beyond to Tai Po<sup>(161)</sup> with its new industrial estate for which a commitment of \$60 million has been included in the Development Loan Fund<sup>(162)</sup>; between Kowloon and the significant development planned for Tuen Mun<sup>(163)</sup> and to the important rail link between Kowloon and China<sup>(164)</sup>.

160. Hong Kong's communications overseas will be strengthened by the improvements to cargo handling arrangements planned for the harbour<sup>(165)</sup>; by the major improvements being undertaken at the airport<sup>(166)</sup>; and by the start planned on the construction of the International Mail Centre<sup>(167)</sup> as an adjunct, as it were, to the new General Post Office Building which should be completed next year<sup>(168)</sup>. And

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(160) Head 69 Public Works Non-Recurrent: Engineering, Subheads 798-806. Approved project estimates: \$158 million; expenditure of 31st March 1976: \$134 million; draft Estimates for 1976-77: \$22 million.

(161) Head 70 Public Works Non-Recurrent: New Towns and Public Housing (Other than Housing Authority), Subheads 800-801. Approved project estimates: \$39 million; expenditure to 31st March 1976: \$2 million; draft Estimates for 1976-77: \$16 million.

Head 69 Public Works Non-Recurrent: Engineering, Subheads 907-909. Approved project estimates: \$24 million; expenditure to 31st March 1976: \$1 million; draft Estimate for 1976-77: \$6 million.

(162) The Tai Po Industrial Estate will eventually comprise 90 acres of usable industrial land on a reclamation of 136 acres. The loan of \$60 million is for the formation of 60 acres of land, being Stage 1 of the project.

(163) Head 70 Public Works Non-Recurrent: New Towns and Public Housing (Other than Housing Authority), Subhead 880. Approved project estimate: \$304 million; expenditure to 31st March 1976: \$123 million; draft Estimates for 1976-77: \$96 million.

(164) Head 69 Public Works Non-Recurrent: Engineering, Subheads 690-697. Approved project estimates: \$200 million; expenditure to 31st March 1976: \$141 million; draft Estimates 1976-77: \$26 million.

(165) Head 48 Marine Department, Subheads 351, 354, 357 and 368. Draft Estimates for 1976-77: \$1 million.

Head 69 Public Works Non-Recurrent: Engineering, Subhead 629. Approved project estimate: \$6 million; expenditure to 31st March 1976: \$2 million; draft Estimates for 1976-77: \$1 million.

(166) Head 68 Public Works Non-Recurrent: Buildings, Subheads 450-454. Approved project estimates: \$229 million; expenditure to 31st March 1976: \$73 million; draft Estimates for 1976-77: \$73 million.

Head 69 Public Works Non-Recurrent: Engineering, Subheads 450-459. Approved project estimates: \$245 million; expenditure to 31st March 1976: \$195 million; draft Estimates for 1976-77: \$19 million.

(167) Head 68 Public Works Non-Recurrent: Buildings, Subhead 791. Approved project estimate: \$33 million; expenditure to 31st March 1976: \$3 million; draft Estimates for 1976-77: \$5 million.

(168) Head 68 Public Works Non-Recurrent: Buildings, Subhead 791. Approved project estimate: \$43 million; expenditure to 31st March 1976: \$29 million; draft Estimates for 1976-77: \$8 million.

perhaps this is an appropriate place to mention the provision included in the draft Estimates for my honourable Friend, the Director of Commerce and Industry, to continue his defence of Hong Kong's trading rights—I stress rights—in overseas markets, and the efforts being made to attract overseas industrial investment to Hong Kong in conjunction with the Hong Kong General Chamber of Commerce and the Trade Development Council. Nor has the need to assist the Productivity Council, the Tourist Association and the Trade Development Council in their efforts to strengthen the economy been overlooked. About \$70 million is provided in the draft Estimates for these various activities, of which \$35 million is for the Trade Development Council.

161. On Hong Kong Island, the emphasis in the draft Estimates is inevitably on the works necessary to lift the moratorium on development in the mid-levels<sup>(169)</sup>. Thus provision is included for continuing to widen Pok Fu Lam Road, for improving the road through Aberdeen and for a start on the Aberdeen Tunnel and the roads leading to it<sup>(170)</sup>. Work will start on improvements to various junctions in the mid-levels<sup>(171)</sup> and planning will start on the design of the western link between Pok Fu Lam Road and Connaught Road West<sup>(172)</sup>.

162. Further plans to increase the land available for development include the reclamations at Aldrich Bay and Aberdeen and further drainage works at Kowloon Bay and improvements in the Sham Shui Po area<sup>(173)</sup>. Additional land for public and private development amounting in all to 155 acres will also become available with effect from 1978 and 1979 respectively as a result of the reprovisioning of the facilities at Victoria Barracks in HMS Tamar and of RAF Kai Tak at Sek Kong. The cost of this reprovisioning will be \$175 million of which \$34 million will be spent in 1976-77.

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(169) *Moratorium imposed under the Temporary Restriction of Building Development (Pok Fu Lam and Mid-levels) Ordinance.*

(170) *Head 69 Public Works Non-Recurrent: Engineering, Subheads 727-728. Approved project estimates: \$271 million; expenditure to 31st March 1976: \$15 million; draft Estimates for 1976-77: \$60 million.*

(171) *Head 69 Public Works Non-Recurrent: Engineering, Subheads 715-720, 723-725. Approved project estimates: \$78 million; expenditure to 31st March 1976: \$22 million; draft Estimates for 1976-77: \$20 million.*

(172) *Head 69 Public Works Non-Recurrent: Engineering, Subhead 726. Approved project estimate: \$28 million; expenditure to 31st March 1976: nil; draft Estimates for 1976-77: \$16 million.*

(173) *Head 69 Public Works Non-Recurrent: Engineering, Subheads 566-568, 616-617, 621-622. Approved project estimates: \$102 million; expenditure to 31st March 1976: \$20 million; draft Estimates for 1976-77: \$26 million.*

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163. This review of the main areas of emphasis in the draft Estimates would be quite incomplete without a general reference to the new towns. The object is to provide in these towns for an additional population of about 1.5 million people in balanced development over about 6,500 acres of land. In 1976-77, the emphasis in Tsuen Wan will be on making more land available in Tsing Yi and Kwai Chung and on developing further community facilities in the old town<sup>(174)</sup>. Work in Sha Tin will also be aimed at making more land available for development, including the reclamation of 147 acres by a private developer<sup>(175)</sup>. But priority will be given to providing an adequate and efficient sewage disposal scheme<sup>(176)</sup>. Expenditure in Tuen Mun will be dominated by the large housing estate the Public Works Department is completing as part of the Government's commitment arising from the arrangements under which the present Housing Authority was set up. But progress will be made on the engineering work necessary for preparing further areas for development<sup>(177)</sup>.

164. All these developments in the new towns are consistent with the packaging concept adopted by the Public Works Sub-Committee in 1974 for the phasing of expenditure on a balanced and flexible basis<sup>(178)</sup>.

(3) *Revenue Estimates*(a) *General*

165. The Revenue Estimates as printed anticipate collections of \$6,721 million, an increase of \$706 million, or 12%, over the revised estimate for 1975-76. About \$77.5 million of this increase is accounted for by policy decisions contained in my budget speech last year relating

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(174) Expenditure in 1976-77 on Tsuen Wan New Town will be about \$150 million. See Memorandum Note on Heads 67-71 Public Works Non-Recurrent, paragraph 29 on page 494 of the Estimates.

(175) Of which the developer will retain 40 acres.

(176) Expenditure in 1976-77 on Sha Tin New Town will be about \$162 million under Head 70 Public Works Non-Recurrent: New Towns and Public Housing. See Memorandum Note on Heads 67-71 Public Works Non-Recurrent, paragraph 30 on page 496 of the Estimates. A further \$15 million will be spent from the loan from the Asian Development Bank for the sewage treatment works (see page 742 of the Estimates).

(177) Expenditure in 1976-77 on Tuen Mun New Town will be about \$200 million. See Memorandum Note on Heads 67-71 Public Works Non-Recurrent, paragraph 31 on page 498 of the Estimates.

(178) See B.S., 1975, paragraph 53 and Report of the Public Works Sub-Committee of Finance Committee for 1974, page 209.

to the new basis of assessment of values for property tax<sup>(179)</sup>; the assessment of the value of free or subsidized quarters at 10% of the taxpayer's income rather than  $7\frac{1}{2}\%$ <sup>(180)</sup>; the extension of rating to 7 new areas in the New Territories<sup>(181)</sup>; by the yield from property tax in these new areas; the registration of deposit-taking finance companies<sup>(182)</sup>; and an increase in the rate of hotel accommodation tax from 3% to 4% with effect from 1st April 1976<sup>(183)</sup>. A further \$69 million of this increase is accounted for by the increased duties on intoxicating liquors and tobacco and the application of first registration tax to certain classes of motor vehicles previously exempt effective from 3rd December 1975<sup>(184)</sup>. But the estimate of \$6,721 million is in my view generally consistent of the economy's prospects in the coming year after allowing for various lags in the system, which will be reflected in revenue yields in 1977-78.

(b) *Recurrent*

166. The estimate of recurrent revenue is \$6,235 million, an increase of \$610 million, or 11%, on the revised estimate for 1975-76.

167. Earnings and profits taxes account for \$2,400 million, or 38% of recurrent revenue. It is estimated \$304 million above, likely collections in 1975-76 or 15% more. It assumes that profits tax will be up by 6% that is to say by \$86 million and that yields from other taxes on earnings will be up by 31% that is to say up by \$218 million. These assumptions are, I believe, consistent with the increase of 3% in the GDP in money or current price terms in 1975 and the forecast increase of 15% in 1976<sup>(185)</sup>. I do not think I have made insufficient allowance for the stand-over provisions or the cash flow implications of the instalment payments system.

168. Full details of the other changes in the Revenue Estimates are included in the Memorandum Notes on the Revenue Estimates which, incidentally, have been recast and a statement of ambit of each head has been included. I need only draw attention here to the

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(179) B.S., 1975, paragraph 192 and see also Annex (6).

(180) B.S., 1975, paragraphs 95-97.

(181) B.S., 1975, paragraph 191 and f.n. (157). But see also paragraph 187 below.

(182) B.S., 1975, paragraph 131. The *Deposit Taking Companies Ordinance* was enacted on 7th January and will be brought into effect on 1st April 1976.

(183) Hansard, 1975, pages 444-446 and B.S., 1975, Appendix (4).

(184) See Annex (4).

(185) But see paragraphs 59-61 above for a reference to the hazards of estimating earnings and profits taxes.

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effect of reduced cash balances on interest earnings, \$30 million down on the revised estimate for 1975-76; the general effect on the expected earnings of our public utility type undertakings<sup>(186)</sup> of the expected improvement in the economy \$65 million up on the revised estimate for 1975-76; and the continuing emphasis on the updating of cost related fees and charges generally<sup>(187)</sup>.

*(c) Capital*

169. My estimate of capital revenue is \$486 million which is \$96 million, or 25%, up on the revised estimate for 1975-76. The sales programme envisages putting 28 acres of industrial land and 27 acres of residential and commercial land on the market in 1976-77 to yield about \$184 million in lump sum payments and instalments. About \$113 million will be payable on past sales made on an instalment basis; and modification premia will yield an estimated \$79 million.

*(4) Revenue Proposals**(a) Introduction*

170. The difference between the draft Estimates of Expenditure amounting to \$7,212 million, and my estimate of revenue of \$6,721 million as shown in the printed Estimates is \$491 million<sup>(188)</sup>. For two reasons, it could be argued that I should refrain from proposing further fiscal changes for next year: first, I have had to call on loan finance in the current year to a very limited extent only<sup>(189)</sup> and so we are a long way indeed from reaching the stringent limits I laid down in last year's budget speech for borrowings<sup>(190)</sup>. Secondly, at \$2,626 million, our

(186) *Water Undertaking, KCR, Airport and Post Office.*

(187) *B.S., 1975, paragraphs 121 and 165. See also Annex (7).*

(188) *As only 85% of recurrent revenue has to be earmarked for recurrent expenditure (but c.f. guideline figure of 80%), this deficit is a deficit on capital account only, viz:*

	\$ mn	\$ mn
<i>Expenditure:</i>		
(a) <i>Recurrent</i> .....	5,289	-
(b) <i>Capital</i> .....	1,923	7,212
<i>Revenue:</i>		
(a) <i>Recurrent</i> .....	6,235	-
(b) <i>Capital</i> .....	486	6,721
<i>Overall deficit</i> .....	-	491
<i>Deficit on capital account</i> .....	-	1,437
<i>Surplus on recurrent account</i> .....	-	946

(189) *See paragraph 56 and f.n. (55) above.*

(190) *B.S., 1975, paragraphs 166-169 and paragraphs 66 and 183.*

fiscal reserves at 1st April 1976 seem to be in a fairly healthy state and up by \$104 million on a year ago.

171. For the Hong Kong Government to maintain tax rates, even introduce measures of reform and relief in favour of tax-payers during boom years, as we did in 1970 to 1973; to hold the rate of growth of expenditure down so that taxes need only be increased neutrally during recession years, as we did in 1974 and 1975; and then to maintain tax rates during recovery, having faith that revenues will flush, would be entirely consistent with the philosophy which is always underlying our fiscal policies. This philosophy is that they must be designed to secure the highest possible growth rate of the economy and our historical experience has vindicated this philosophy. But, for three reasons, I am not wholly convinced by the argument for no fiscal changes next year: first, I wish to keep such borrowing capability as we have, at fine rates, in hand, as there are likely to be specific or project-linked borrowing requirements separate from the financing of the capital account<sup>(191)</sup>. Secondly, even in advance of reform of our system of earnings and profits taxes to make it more productive of revenue at given tax rates, I believe there is still some scope for raising additional revenue neutrally, and let us not forget the essentially economic significance of many areas of public expenditure. Thirdly, our fiscal reserves, at 36% of estimated expenditure in 1976-77 are no more than adequate to see us through unforeseen circumstances during a year and to provide that very necessary support for our growing contingent liabilities<sup>(192)</sup>.

172. Accordingly, I have six revenue proposals. Each is designed specifically to raise extra revenue<sup>(193)</sup> and, together with the proposals already in the Revenue Estimates as printed<sup>(194)</sup>, they will have the effect of slightly shifting the balance of the fiscal system with a view to bringing it more into line with my guideline ratios<sup>(195)</sup>. I am confident that none of my proposals will have any damaging effect on

(191) See, for example, paragraph 131 above.

(192)	Fiscal Reserves (1)	Estimated Expenditure (2)	(1) as a (2) % of (2)
	\$ mn	\$ mn	
1st April/1974-75 .....	2,809	5,493	51
1st April/1975-76 .....	2,522	6,615	38
1st April/1976-77 .....	2,626	7,212	36

(193) B.S., 1975, paragraph 86 and f.n. (81).

(194) See paragraph 165.

(195) See f.n. (3) above and B.S., 1975, paragraphs 156-157 and C.S., 1975, paragraphs 39-40.

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investment decisions or inflate industrial costs or have more than a very slight effect on disposable personal incomes, let alone involve hardship for any particular income class. For various reasons, not the least being revenue considerations, I have no proposals for tax reforms or concessions, but I shall be alluding to the unpopular subject of tax reform latter on.

(b) *Direct*

(i) *Corporation profits tax*

173. With effect from the year of assessment 1975-76, a 10% surcharge was imposed on the standard rate of profits tax paid by corporations. Thus, provisional tax for this year has been calculated at a rate of  $16\frac{1}{2}\%$ . This surcharge was a temporary measure designed to bring in much needed additional revenue pending the introduction of a tax on a hitherto untaxed form of income, namely, dividends, with effect from the year of assessment 1976-77. I pointed out at the time that  $1\frac{1}{2}$  percentage points on corporation profits tax was roughly the equivalent of a  $3\frac{1}{2}\%$  dividend withholding tax, assuming a 50% payout factor<sup>(196)</sup>.

174. Subsequently, a bill to amend the Inland Revenue Ordinance was drafted. The bill had three inter-related objectives: the first was to impose a dividend withholding tax of  $3\frac{1}{2}\%$  on all dividends paid or credited in a year of assessment by corporations resident in Hong Kong<sup>(197)</sup>. The second objective was to tax undistributed profits in excess of 50% of profits earned-less profits tax and dividends paid-of corporations resident in Hong Kong. The rate was to be 7%. Such an undistributed profits tax is necessary in order to discourage corporations from trying to shield their shareholders by refraining from declaring dividends and, instead, substituting other forms of payment such as the issue of bonus shares. The retention allowance of 50% of profits was selected as being sufficiently generous not to deter reinvestment. The third objective was to provide that, in the case of non-resident corporations, profits tax would be charged at the present rate of  $16\frac{1}{2}\%$  so as to avoid a situation in which resident corporations would be placed at a disadvantage *vis-à-vis* their non-resident counterparts, once

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(196) *B.S., 1975, paragraph 92. I might well have added that this was a small price to pay for the statutory privilege of limited liability.*

(197) *Residence being defined in terms of whether the corporation is managed and controlled in Hong Kong (a test well understood in Commonwealth case law on the subject).*

the rate of profits tax for resident corporations had reverted to the standard rate of 15%. To extend dividend withholding tax and undistributed profits tax to non-resident corporations would have breached our territorial source criterion and led any way to difficulties of enforcement.

175. Although there was very little reaction during last year's budget debate, either inside or outside this Council, to the proposal to tax dividends, when Unofficial Members came to consider the draft bill they expressed what could only be described dissatisfaction with both the underlying principles and the details of their implementation. I made it clear to them that the latter—the details of their implementation were negotiable, but only if the former were acceptable, but they were not. At the same time, several leading commercial and industrial associations expressed opposition to the very concept of a tax on dividends. So, the implication was that the bill would have a slow, painful and difficult passage through the Legislative Council. Yet, if the amending ordinance was not enacted by the end of November, the Commissioner of Inland Revenue could not make the necessary administrative arrangements in time for its provisions to be implemented for the year of assessment 1976-77. In all these circumstances, I had no alternative but to defer the bill. I shall explain what I mean by defer later on but, for now, I need only say that I remain convinced of the case for a tax on dividends and am personally of the view that the criticisms of the proposal have been either misdirected or irrelevant or both.

176. But, if logic is not to prevail, then we must persevere with the present temporary bridging measure. That is to say, the 10% surcharge on corporation profits tax must be continued into 1976-77. But, so that it is at least as productive of revenue as I estimate a dividend withholding tax would be, policed by an undistributed profits tax and accompanied by a surcharge on the rate of profits tax paid by non-resident corporations, I propose that the rate of corporation profits tax for the year of assessment 1976-77 should be 17% yielding \$35 million, but only \$28 million will actually be collected in respect of this extra  $\frac{1}{2}$  % in 1976-77. The second instalment of \$7 million will be collected in 1977-78. At 17% this will mean that there will be a gap of two percentage points between the rate of corporation profits tax and the standard rate of tax on other forms of earnings and profits. This, to my mind, is just—but only just—acceptable from a technical point of view.

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**(ii) *Estate duty*

177. Although it has come under attack from time to time, on the grounds that it discourages the inflow and encourages the outflow of capital, estate duty is an essentially fair tax in Hong Kong. I have four reasons for saying this: our system of earnings and profits taxes is based in a limited charge and is largely proportional rather than progressive; there is no capital gains tax in Hong Kong; quite unusually in terms of practice elsewhere<sup>(198)</sup>, a territorial location criterion is applicable here in respect of estate duty; and there has been a progressive reduction in the top rate of estate duty and a shortening of the schedule. From 52% on estates over \$30 million for persons dying before 1st April 1948, the top rate has been progressively reduced to 15% on estates over \$1 million for persons dying after 1st April 1974. Over the same period, the exemption limit has been raised from \$500 to \$300,000, and the schedule shortened from 37 steps to 10 steps, now that's tax reform if you like.

178. At 15% the top rate was equated with the standard rate of earnings and profits tax. But there was never any very rational basis for this and I think the schedule could be quite safely stretched by three steps and the top rate set 20% higher at 18%. Thus I propose that, in respect of persons dying after the enactment of the necessary amending legislation, for estates over \$1.5 million the rate should be 16%, for estates over \$2 million the rate should be 17% and for estates over \$3 million the rate should be 18%. Estates over \$3 million of persons dying before 1st April 1972 attracted duty of 20% and, for persons dying before 1st April 1970, estates over \$3 million attracted a rate of duty at least of 23%. So I regard this proposal as providing a useful, albeit modest, addition to our capital revenue. The yield from estate duty is particularly difficult to estimate for obvious reasons (*laughter*), but the additional revenue should eventually be at the very very least \$5 million a year and, in some years, very much more than this, but rather less in the first year 1976-77.

(iii) *Other proposals considered*

179. I have no other proposals in the field of direct taxation. I have considered others and remain concerned about the proportionality of our earnings and profits tax system at upper levels of income, but

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(198) Although the territorial source criterion is adopted for income tax purposes elsewhere (e.g. South Africa and Malaysia).

a relative shift—and I stress relative shift—of the tax burden must await reform of the system. I have given further consideration this year to some form of surcharge on high level salaries, profits and property incomes but, as I said last year, the absence of a charge on total income and the existence of a system of separate charges on different types of income, coupled with the option to claim personal assessment, makes the imposition of such a surcharge far too difficult and unsatisfactory technically.

180. I have also considered whether there was a case for reducing the tax liability of those at the lower end of the schedular system of salaries tax and personal assessment, but to do anything worthwhile would be too expensive in terms of revenue foregone. For example, an increase of \$500 in the allowance for the first and second child would cost about \$14 million in the first year and \$7 million thereafter<sup>(199)</sup>.

181. I am also rather concerned with the rapid growth in the number of salaries taxpayers at the lower end of the schedular system, because nearly 70% of all taxpayers even in 1974-75 were in the assessable income range of \$12,000 to \$36,000 *per annum*, but contributed only 11% of total tax collected, compared with 47% contributed by the 5% of taxpayers charged at the standard rate. The total number of active salaries tax files at the close of 1974-75 was 167,000 and there were a further 55,000 review files. The Commissioner reckons that the number of active files will have increased to 230,000 by 31st March 1976<sup>(200)</sup>. The salary tax assessed *per capita* in 1974-75 was \$2,438, a decrease of \$195 on 1973-74 due to the large number of cases coming into the tax net at the lower end. For several reasons the question whether personal allowances should be increased from \$10,000 to say, \$12,000 in order to reduce the number caught in the tax net does arise, but this would cost \$80 million in the first year and \$40 million thereafter<sup>(199)</sup> and such a surrender of revenue is out of the question.

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(199) *The fact that the cost in the first year is twice that of the second year is because provisional tax has to be calculated on the net chargeable income of the previous year.*

(200) *As a result of the reform of the personal tax system in 1973 (B.S., 1973, paragraphs 65-84), departmental staff costs for salaries tax and personal assessment fell from 3.7% of tax collected in 1972-73 to 2.6% in 1974-75. However, departmental staff costs for profits tax have also declined from 0.8% to 0.5%.*

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**(c) *Indirect*(i) *General Rates*

182. As I announced in last year's budget speech, the revaluation of tenements scheduled for 1975-76, effective from 1st April 1976, was postponed until the coming year, 1976-77, in view of the uncertain economic climate then prevailing<sup>(201)</sup>. To offset the loss of revenue from this postponement, I increased the General Rate in Areas A, B and C (Hong Kong, Kowloon and New Kowloon) and Area D (Tsuen Wan/Kwai Chung) by two percentage points, that is, from 9% to 11% and from 15% to 17% respectively<sup>(202)</sup> to produce about one third of the revenue foregone by the postponement of the revaluation; and I warned<sup>(203)</sup> that a further offsetting increase might be necessary in 1976-77.

183. There is no intention of postponing the revaluation further: although the revenue can be protected by adjusting the applicable rates, it is clearly more satisfactory for the base figures—the rateable values—to reflect market values and an updating of rateable values permits the valuation of new premises on a realistic basis<sup>(204)</sup>. A revaluation in 1976-77, moreover, can be carried out in conjunction with the establishment of assessable values for property tax purposes thus spreading the cost of the exercise. This new basis of assessment for property tax is necessary in order to protect the revenue because the standard rate of property tax cannot be freely adjusted in the same way as General Rates.

184. Fully to restore the benefit to the revenue had a revaluation been carried out in 1975-76, effective from 1st April 1976, would require an increase in the General Rate for the three urban areas of  $4\frac{1}{2}$  percentage points from 11% to  $15\frac{1}{2}$ % and for Tsuen Wan/Kwai Chung by  $4\frac{1}{2}$ % to  $21\frac{1}{2}$ % that is to say from 17- $21\frac{1}{2}$  and such increase will yield \$215 million<sup>(205)</sup>. Tsing Yi would remain, at the present arrangements at 11%.

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(201) B.S., 1975, paragraph 104.

(202) Area E (Tsing Yi remaining at 11%, in accordance with the policy decision to levy a rate of only 11% for the 4 years 1974-75 to 1977-78.

(203) B.S., 1975, paragraph 191.

(204) Under the Rating Ordinance, rateable value assessed for new premises after a revaluation has taken place have to reflect the level of values established for the lists in force which, in relation to the current lists, is 1972.

(205) Assuming interim valuations would not have been interrupted.

185. I propose, however, an increase of one percentage point only to yield \$48 million, that is, from 11% to 12% for the three urban areas and from 17% to 18% for Tsuen Wan/Kwai Chung, with Tsing Yi continuing to remain for the time being at 11%. The effect of these increase on the main classes of ratepayers is set out in Annex (8) to the printed version of this speech and it will be seen that, for the majority of domestic ratepayers, occupying tenement floors, the increase will mean, on average, an additional monthly rates payment of no more than \$3 while, even for houses, the average additional payment is only likely to be a little over \$30 per month. So far as non-domestic tenements are concerned, the effect of the increase will range from around an average of \$11 per month for shops to about \$45 per month for flatted factories.

186. Before leaving the subject of rating, I must deal with the particular problem of the rating of the seven new areas, Areas F to M<sup>(206)</sup>: applying the policy adopted for Tsing Yi, the rate levied for the first four years should be 11% to yield \$13 million in 1976-77, or some \$82 million over the four years 1976-77 to 1979-80 after allowing for the revaluation effective from 1st April 1977. It has been represented to me that, instead of an initial rate of 11% for four years for these new areas, it would be preferable to phase in on the following basis: first year, 50% on the General Rate of 18%; second year, 60% of whatever the General Rate may be; third year, 70% and so on up to 100% in the sixth year<sup>(207)</sup>. The effect of this approach, if authorized by a resolution of this Council, will be to raise only \$11 million, or \$2 million less, in the first year, but very nearly the same over the whole period of five years.

(ii) *Stamp duty on conveyances*

187. As a result of a proposal put forward in my budget speech last year<sup>(208)</sup>, the rate of stamp duty charged on certain conveyances on sale, voluntary dispositions *inter vivos* and allied documents<sup>(209)</sup> was raised from 2% to  $2\frac{1}{4}$ % of the consideration with effect from 1st April 1975. I estimated that the resulting extra revenue would be \$11 million in 1975-76 and this has proved to be the case. The total yield from stamp duty on these documents is put at \$95 million for 1976-77 in the Revenue Estimates as printed.

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(206) *Yuen Long, Tai Po, Sha Tin, Tuen Mun, Clearwater Bay Road, Luen Wo Market and Shek Wu Hui.*

(207) *Rounding up the percentage to the nearest 0.5%.*

(208) *B.S., 1975, paragraph 116.*

(209) *Heads 5, 6, 19(1), 19(2), 32(1), 32(7) and 53(2) of the Schedule to the Stamp Ordinance.*

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**

188. I think the rate of duty could be increased by another half a percentage point to 2% and I so propose. I estimate that the additional revenue from this increase will be \$20 million in 1976-77. Documents relating to transactions where the consideration does not exceed \$75,000 or \$150,000 will bear duty at the concessionary rates of 20 and 1% respectively. Logically, with the standard rate at  $2\frac{3}{4}\%$ , compared with 2% when the concessionary rates were introduced<sup>(210)</sup>, the concessionary rates should be revised, but I wish to do nothing which would imply however incorrectly a lack of sympathy with home ownership aspirations.

(iii) *Business registration fee*

189. In last year's budget speech, Sir, I proposed a tax loading of \$100 on the annual fee paid by businesses under the Business Registration Ordinance<sup>(211)</sup> and brought certain additional clubs within the ambit of the ordinance. This year I propose to extend the ambit much further. There are a number of companies which, whilst enjoying the convenience and protection afforded by our laws, make virtually no regular contribution whatsoever to the revenue, apart from the small service fee of \$10 which is paid when filing annual returns with the Registrar of Companies. These so-called "shelf" companies are incorporated for the most part by solicitors and accountants to be used or sold as the need arises. At present, by reason of the fact that they are not carrying on a business, they are not liable to register under the Business Registration Ordinance. I propose, therefore, that with effect from 1st April 1976 the ordinance should be amended so that *all* companies incorporated or registered under the Companies Ordinance will also be obliged to register under the Business Registration Ordinance and pay the annual fee of \$150. In addition to "shelf" companies this will bring into the net those companies which, although incorporated in Hong Kong, carry on such business as they do outside Hong Kong. The increased revenue will be at least—and probably rather more—at least \$1 million in 1976-77.

(iv) *Excise duties on hydrocarbon oils*

190. I have left to the last one of my most important proposals in terms of additional revenue to be raised because I want it to be considered in the context of my proposals as a whole, though I have a

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(210) *Hansard*, 1967, page 92 and *Hansard*, 1973, page 448.

(211) *B.S.*, 1975, paragraph 123.

sinking feeling that the reaction to it in certain well known quarters will be out of all proportion to its significance.

191. I increased the specific rates of duty on intoxicating liquors and tobacco in February 1974, after they had remained unaltered since 1963 and 1966 respectively, in order to restore the incidence of duty which had declined as a result of price increases<sup>(212)</sup>. I increased the rates again in February 1975 in order to offset the effect on the revenue of declining consumption in the case of intoxicating liquors and to increase the revenue in the case of tobacco<sup>(213)</sup>. I further increased them in December 1975 partly to eliminate Commonwealth preference margins and partly to raise additional revenue in anticipation of this budget<sup>(214)</sup>.

192. By contrast, the rates of duty on petrol and automotive diesel fuel have remained unchanged since 1966 when they were increased by 30 cents to \$1.80 and \$1.30 a gallon respectively<sup>(215)</sup>. The duty element in the retail price of both petrol and automotive diesel fuel in 1966, after the increase in duty, was 54%. By early 1974, that is to say, after the sharp increases in prices in October/November 1973<sup>(216)</sup> and February 1974<sup>(217)</sup>, the duty element had fallen to 34% and 31% respectively. As a result of the further price increases in November 1974<sup>(218)</sup> and November 1975<sup>(219)</sup>, the duty element is currently only 31% and 29% respectively. Although the contribution of the motorist and other road users to general revenue through excise duties and other tax type levies<sup>(220)</sup> has increased over the past ten years from \$136 million in 1966-67 to an estimated \$359 million in 1976-77<sup>(221)</sup>, as a proportion of recurrent revenue it has fallen from 8% to 5.8%. And the contribution of duties on hydrocarbon oils to recurrent revenue, after allowing for the removal, with effect from 1st March 1972, of duties on all

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(212) *B.S., 1974, paragraphs 127-131.*

(213) *B.S., 1975, paragraphs 109-113.*

(214) *See Annex (4).*

(215) *Hansard 1966, pages 82-83 and pages 96-97.*

(216) *Petrol: \$4 to \$4.40 per gallon; automotive diesel fuel: \$2.90 to \$3.30 per gallon.*

(217) *Petrol: \$4.40 to \$5.25 per gallon; automotive diesel fuel: \$3.30 to \$4.15 per gallon.*

(218) *Petrol: \$5.25 to \$5.45 per gallon; automotive diesel fuel: \$4.15 to \$4.20 per gallon.*

(219) *Petrol: \$5.45 to \$5.85 per gallon; automotive diesel fuel: \$4.20 to \$4.45 per gallon.*

(220) *Commonwealth preference tax, first registration tax, licences for vehicles and drivers and excise duties on petrol and automotive diesel fuel (and, for 1966-67 only, royalty payable by the bus companies).*

(221) *As shown in the Revenue Estimates as printed.*

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'hydrocarbon oils other than petrol and automotive diesel fuel, has declined more sharply: from 4.2% in 1966-67 to an estimated mere 2.4% in 1976-77<sup>(222)</sup>.

193. I have no wish, obviously, to go beyond the point of diminishing returns, but I think the time has now come when the trade could stand some upward revision of the rates of duty. In the case of petrol, demand by the first quarter of 1976 had recovered to the level of the third quarter of 1972. It then took off to the exceptionally high level experienced in late 1972 through to the middle of 1973 when it declined sharply due to a combination of price increases, economic factors and the fiscal measures introduced in my 1974 budget<sup>(223)</sup>. In the case of automotive diesel fuel, demand is fairly price inelastic. Even in 1974, although the growth curve flattened, there was a slight increase over 1973. By the second and third quarters of 1975, the rate of increase had returned to normal and has only slowed down a little as a result of the November 1975 price increase of 25 cents per gallon.

194. The price of crude oil has been frozen by OPEC until June of this year and it is likely that future increases will be more modest than in recent years. The price increases announced by the oil companies last November of 40 cents per gallon in the case of petrol and 25 cents per gallon in the case of automotive diesel fuel were said to include an element for increases in local costs. So I would not expect any increases in duty to result in price increases in excess of the duty increases. Whether or not they are less will depend on whether the oil companies are more concerned with total profits than with margins.

195. To restore the incidence of the duty to its 1966 level of 54% in both cases would require an increase in duty from \$1.80 to \$4.70 per gallon in the case of petrol and from \$1.30 to \$3.70 per gallon in the case of automotive diesel fuel and such increases are out of the question. But I think it is reasonable to aim for a restoration of the incidence to about 35% and so I propose increases in the rate of duty of around 23%, that is to say, from \$1.80 to \$2.20 or 40 cents per gallon in the case of petrol and from \$1.30 to \$1.60 or 30 cents per gallon in the case of automotive diesel fuel. At an increase of 23%, it will restore the incidence to around 35%. The retail prices of these products should increase to no more than \$6.25 per gallon and \$4.75 per gallon, making the duty element, as I have said, round about 35

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(222) *As shown in the Revenue Estimates as printed.*

(223) *B.S., 1974, paragraphs 156-171 and C.S., 1974, paragraphs 46-59.*

and 34% respectively. I estimate that the additional revenue yield in 1976-77 will be about \$37 million. This will have the effect of restoring the contribution of duties on hydrocarbon oils to recurrent revenue to 2.9%<sup>(224)</sup> from its present 2.4%.

196. These proposals relating to petrol and automotive diesel fuel will not increase the Consumer Price Index by more than 0.02% and the effect on the operating accounts of the bus companies will be minimal and will certainly not require any adjustments of fares just for the record.

(v) *Other proposals considered*

197. Apart from a re-examination of several ideas for widening the range of dutiable commodities (for example, perfumes and toiletries), I have also given further thought to the question of water charges for non-domestic consumers. Domestic consumers are now charged for the water they consume on a differential pricing basis at three levels, namely, free supply, \$3 and \$6 a thousand gallons, applicable according to the amount of water consumed<sup>(225)</sup>. Thus, those whose consumption reaches the third level contribute appropriately to the expensive additions they bring about to the supply system. I said last year that a differential pricing system on the same basis would be difficult to apply to non-domestic consumers<sup>(226)</sup>. But I hinted that some change would be necessary to the present flat rate of \$4 a thousand gallons.

198. A change to the present flat rate for non-domestic users is not practicable until water accounts are processed by computer. We have not proceeded as quickly as we would have liked with this project of computerization, largely because we have had difficulty in recruiting the necessary technical staff. These difficulties have now been overcome. But, in consequence of these difficulties, we shall not be in a position to review the charges for non-domestic consumers until this time next year.

199. As it happily happens, this postponement by one year is not particularly serious. Although demand for water has been as predicted for 1975-76, the exceptionally heavy rains last summer have meant that we have not been obliged to use our expensive new desalting facilities<sup>(227)</sup>. In consequence, the accounts of the Water Undertaking

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(224) *Revenue Estimates as printed plus all revenue proposals for 1976-77.*

(225) *B.S., 1975, paragraphs 146-150.*

(226) *B.S., 1975, paragraph 152.*

(227) *Indeed, revised arrangements for the desalter's commissioning trials are being negotiated with the contractor which will result in further economies of expenditure this year (c.f. B.S., 1975, paragraph 142).*

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**

should be in surplus by the end of this year although land costs are not included and amortization periods are artificially long. Nevertheless, if industrial consumption in particular continues to expand with the economy as we expect, a situation in which domestic consumers are subsidizing non-domestic consumers is bound to arise sooner or later. For reasons I put forward last year<sup>(228)</sup>, such a situation cannot be allowed to prevail for too long. The Water Undertaking, like all our public utility type undertakings, must be operated on at least a quasicommercial basis, given our tax system.

*(d) Implementation of revenue proposals*

200. In order to safeguard the revenue, Your Excellency this morning signed an order under the Public Revenue Protection Ordinance bringing the new rates of duty on petrol and automotive diesel fuel into effect from 4 o'clock today. As a result, the revenue will benefit this year by all of \$3 million.

201. As it will not be possible to put the necessary legislation through this Council before 1st April, Revenue Protection Orders will also be necessary for the new General Rates and for the new rate of stamp duty on conveyances and to implement the proposal to collect business registration fees from "shelf" companies.

*(5) Estimates Outturn for 1976-77*

202. My proposals should yield additional revenue of \$136 million in 1976-77, making total estimated revenue \$6,857 million. As estimated expenditure is \$7,212 million this leaves me with a deficit of \$355 million which is, in effect, the residual or uncovered deficit on capital account<sup>(229)</sup>.

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(228) B.S., 1975, paragraph 153.

(229)		<i>\$ mn</i>
	Capital expenditure .....	1,923
	Less: Capital revenue .....	488
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	Deficit .....	1,435
	Less: Surplus on recurrent account .....	1,080
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	Residual deficit (*) .....	355
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(\*) Strictly speaking, this estimated deficit should be \$8 million more if allowance is made for the new arrangements for coinage envisaged in paragraph 80 above. Expenditure will be less by \$16 million (see f.n. (100)) and revenue credited to Head 9 Revenue from Properties and Investments will be \$24 million less.

(6) *Financing of the Deficit*

203. As we are well within my guideline for the use of loan finance, namely, that debt servicing charges—interest and amortization—should not exceed interest earnings on our fiscal reserves, I consider it would be perfectly legitimate to finance this residual deficit by drawing upon the unused portion of about \$214 million<sup>(230)</sup> of the proceeds of the 6½% Hong Kong dollar bond issue 1980 and by drawing down the US\$60 million facility which we've already negotiated<sup>(231)</sup> to whatever extent is necessary. In case some honourable Members are wondering whether even this Government is embarked on a course of financial irresponsibility, let me remind them that the use of debt is limited by the stringent—albeit, perhaps, not very scientific—guideline I have just referred to and, in a few minutes, I shall be informing them that, by the second year of the forecast period (that is to say by 1978-79), I have every intention of ensuring that we are again at least in overall balance<sup>(232)</sup>.

204. There is one remaining question of relevance to my financing strategy in the coming year, namely, a possible salaries revision for the Civil Service. Civil Service salaries were last revised to restore their real value at 1st April 1974, having regard to the fact that wages and salaries in the private sector had been revised to at least the same extent. There could be no question of a further revision with effect from 1st April 1975, whatever the case may have been, because there are two conditions which must be satisfied before Civil Service salaries can be revised to maintain their real value: first, this must be consistent with the current practice of the private sector<sup>(233)</sup>; and, secondly, the Government's general financial situation must be such as to enable a revision to be paid for.

205. It is possible that a case put forward for a Civil Service salaries revision based on movements in the relevant indices of consumer prices during 1974-75 and 1975-76, and having regard to pay trends in the private sector, could lead the Government to conclude that a salaries revision, with effect from 1st April 1976, was justified. If so, the question I must consider is whether the economy will grow at a rate at which

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(230) *The actual amount will depend on outturn in 1975-76. As explained in paragraph 56 and f.n. (55) and paragraph 73 above, the full proceeds of the issue (\$247.4 million) have already been credited to General Revenue.*

(231) *See paragraph 86 above.*

(232) *See paragraph 214 below.*

(233) *That is to say, revision of Civil Service salaries must follow the evidence in the private sector even during an upturn of the economy when there always tends to be a general shift to wages.*

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**

such a revision can be afforded, so that it can be financed at existing tax rates and fitted into, as it were, the expenditure side of the budget. As I believe we have budgeted for a volume of expenditure somewhat in excess of what will prove to be possible in practice and as there is a possibility that, once again, on the upturn revenue yields will be more than anticipated in the Revenue Estimates, I think a salaries revision of a certain order can be catered for, but with two provisions: the case must be clearly established to the satisfaction of the Finance Committee of this Council; and implementation must depend upon my view of the economy in 1976 being vindicated by events.

(7) *Economic Implications of the Budget*

206. I shall now deal, Sir, with the economic implications of the budget, and, indeed, of all public sector activities in 1976-77 defined, for this purpose, to include the Urban Council and the Housing Authority as well as the Central Government. There are three aspects to be considered: the size of the public sector, costs and the macroeconomic implications of next year's deficit.

207. Public expenditure tends to be determined by political and social, as well as economic, considerations and so it is important that the size of the public sector does not exceed a certain limit. Otherwise, there is a risk that public sector activities will damage the growth rate of the economy. It is a matter of opinion when this limit is reached, but it is clearly lower in an open economy such as ours, necessarily dependent on a relatively narrow range of industries manufacturing for export, than in a closed economy. But, in my opinion, if one measures the size of the public sector in terms of the ratio of total public expenditure to the GDP, the outside limit should be set at 20%; and, when the economy is enjoying strong growth, the ratio should fall. Inevitably, the ratio rose in the two years of economic recession 1974 and 1975, to just over 19%, after being just over 16% in 1972 and 1973 and just under 14% in the first two years of the decade. In the coming year, the ratio will rise a little further to just over 20%, assuming total public expenditure is as high as budgeted for (at \$8,225 million) and the GDP at current prices is of the order of \$41,000 million.

208. If the ratio were to be as high as this in a year in which the economy grows at an above average rate, then we shall have to ask ourselves whether there is any likelihood of it ever falling for it would be dangerous for it to be 20% or even higher on the next downturn leaving no room for the public sector to expand temporarily as it has been able to do so recently.

209. Not only does it appear that the ratio of public expenditure to the GDP in 1976 will be high, but the increase in budgeted expenditure in 1976-77 over 1975-76 is as high as \$1,447 million, or 21%. As \$653 million of this increase is for capital expenditure there is bound to be pressure on the building and civil engineering industries. The total demand of the public sector will continue to account for about 45% of the total capacity of the industry provided it is reasonable to assume a 25% increase in the output of this industry from its previous 1973 peak. Even this large increase will not allow for any growth in the private sector if the mass transit railway plans are to be fulfilled; but we are already aware of strong demand for private residential flats and flattened factories.

210. In the sense of total financing needs, the public sector as a whole is likely to be in deficit by about \$35 million only this year whereas next year, in theory, it could be in deficit by as much as \$820 million, but I think it is unlikely that the actual deficit will exceed \$400 million. To the extent that this is financed by the proceeds of the US\$60 million facility already negotiated it will add to the stock of money. To the extent that it is also financed by drawings on the Development Loan Fund<sup>(234)</sup>, the ownership of part of the stock of money will be changed from public to private hands but, simultaneously, it will increase the level of economic activity and hence the demand for money. The increased demand will easily be met as the banks are in a highly liquid position. The effect will be, therefore, to increase the stock of money. It follows that this will cause some upward pressure on prices towards the end of the financial year but, as a public sector deficit of say \$400 million is only 1% of forecast GDP, this is likely to be slight. The effect on the price level would be greater, of course, if part of Government expenditure was not to be financed by additional fiscal revenue<sup>(235)</sup>.

*PART IV: THE FORECAST PERIOD, 1977-78 to 1979-80<sup>(236)</sup>*

(1) *Recurrent Account*

211. Earlier, using departments' submissions, I gave recurrent expenditure and capital expenditure, other than the two components of the Public Works Programme, for each of the three forecast years,

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(234) By, for example, the Housing Authority and Housing Society; and for industrial estates and school managements.

(235) That is, the \$77.5 million and \$69 million mentioned in paragraph 166 plus the \$136 million mentioned in paragraph 202.

(236) All figures are at April 1976 prices.

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**

1977-78 to 1979-80<sup>(237)</sup>. After adjusting these figures to take account of proposals postponed from 1976-77 and extracting the capital element, they become \$5,840 million in 1977-78, \$6,270 million in 1978-79 and \$6,630 million in 1979-80. Expenditure on existing services which, by 1977-78, will include those new proposals being implemented with effect from 1976-77, account for all but \$130 million of the forecast expenditure in 1977-78, \$230 million of the forecast expenditure in 1978-79 and \$310 million of the forecast expenditure in 1979-80.

212. Taking recurrent expenditure at \$7,200 million in 1977-78, at \$7,850 million in 1978-79 and at \$8,580 million in 1979-80<sup>(238)</sup> and applying my guideline that no more than 80% of recurrent expenditure should be absorbed by recurrent revenue, recurrent expenditure should be limited to \$5,760 million in 1977-78, \$6,280 million in 1978-79 and \$6,860 million in 1979-80. After earmarking the amounts necessary to meet the cost of continuing commitments, including those new commitments provided for in the draft Estimates for 1976-77, and for certain other new commitments arising in the forecast period for which the timing of implementation has already been agreed, the recurrent revenue available for essentially new services to be introduced after 1976-77 becomes as follows: \$50 million in 1977-78, \$240 million in 1978-79 and \$540 million in 1979-80.

213. I would stress that these figures, like all the figures for the forecast period, are tentative. But they do at least indicate that, whilst we may not be able to start up new proposals in 1977-78 to the same extent as in 1976-77<sup>(239)</sup>, there will be considerable scope in the following two years<sup>(240)</sup>. As the amounts concerned are relatively small compared with the growing cost of existing services, there is an urgent need for regular scrutiny of existing services and their cost.

(237) See paragraph 96 above, viz: \$6,510 million in 1977-78; \$6,790 million in 1978-79; and \$7,160 million in 1979-80.

(238) Assuming, *inter alia*, tax rates as at 1st April 1976, a revaluation of rateable values w.e.f. 1st April 1977 (together with a downward adjustment of the General Rate) and a 7% growth rate for the economy.

(239) See paragraph 97 above.

(240) That is to say:

	1977-78	1978-79	1979-80
	(\$ mn)	(\$ mn)	(\$ mn)
Departmental forecast submissions for new services .....	130	230(*)	310(*)
Available for new services.....	50	240(*)	540(*)

(\*) Including the cost of new services introduced in the previous year(s).

(2) *Financing of the Capital Account*

214. If the full 80% of forecast recurrent revenue is spent on recurrent expenditure, then \$1,440 million will be available towards capital expenditure in 1977-78, \$1,570 million in 1978-79 and \$1,720 million in 1979-80<sup>(241)</sup>. Capital revenue is forecast at \$440 million, \$540 million and \$550 million respectively. So we should be able to finance capital expenditure of \$1,880 million in 1977-78, \$2,110 million in 1978-79 and \$2,270 million in 1979-80. The implication of these figures is that the capital account should only need topping up with loan finance for one more year, in 1977-78, as they are very close to the guideline figures<sup>(242)</sup>. But I would hope that, by 1978-79, we are in overall balance<sup>(243)</sup> by which I mean that we shall be enjoying higher yields from our earnings and profits taxes as a result of the recommendations for reform put forward by the Third Inland Revenue Ordinance Review Committee. It is to that subject I now wish to turn by way of concluding this speech.

(3) *Fiscal Reform*

215. In last year's budget speech, after saying that earlier proposals to restore the ambit of the profits tax charges generally and to widen the definition of charter hire had to be shelved, I announced the Government's intention to appoint a third Inland Revenue Ordinance Review Committee in 1976<sup>(244)</sup>. This announcement was generally welcomed.

(241) That is 20% of \$7,200 million, \$7,850 million and \$8,580 million.

(242) 1977-78: \$2,190 million (being the figure of \$2,400 million mentioned in B.S., 1975, paragraph 184, adjusted to April 1976 prices).

1978-79: \$2,280 million (being the guideline of \$2,480 million mentioned in f.n. (97) above, adjusted for price changes).

1979-80: \$2,280 million (ditto).

(243)	1977-78 (\$ mn)	1978-79 (\$ mn)	1979-80 (\$ mn)
<i>Revenue:</i>			
(a) Recurrent.....	7,200	7,850	8,580
(b) Capital.....	440	540	550
	<hr/> 7,640	<hr/> 8,390	<hr/> 9,130
<i>Expenditure:</i>			
(a) Recurrent.....	5,760	6,280	6,860
(b) Capital.....	2,190	2,280	2,280
	<hr/> 7,950	<hr/> 8,560	<hr/> 9,140
Overall deficit.....	-310	-170	-10
Deficit as percentage of total revenue.....	4	2	-

(244) B.S., 1975, paragraphs 188-189.

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**

The terms of reference and membership of the committee will be announced within a day or two.

216. The first two Review Committees appointed in 1954 and 1966 did not consider that the basic structure of the ordinance fell within their purview and so their recommendations were largely of a technical and administrative nature only. By contrast, the intention is that the third Review Committee will examine the basic structure of the ordinance. By "basic structure" I mean such matters as the existence of separate schedular taxes, the territorial ambit of the charge and the lack of progression in the rates. The committee will also be asked to consider the treatment of dividends and, in particular, the proposals formulated in 1975 for a dividend withholding tax and associated measures. The committee will not be required to concern itself with administrative matters<sup>(245)</sup>, nor with questions of fiscal policy, that is to say, actual rates of tax. Administrative matters have been thrashed out in detail in recent years; and fiscal policy questions must be left to the Government. In addition, the Committee will not deal with the level and extent of personal allowances, except insofar as they are related to any particular term of reference, such as the taxation of husbands and wives<sup>(246)</sup>.

217. In case the appointment of this committee generates a degree of despondency, let me hasten to add that there is no intention on the part of the Government to pursue change for the sake of change, particularly where it can be claimed that the present system works. But the fact is that the underlying principles on which the present ordinance is structured were formulated in war-time haste 35 years ago and it is time we considered whether or not they still meet the needs of modern Hong Kong. Quite apart from the fact that there are certain inherent inequities in the present system<sup>(247)</sup> I am doubtful whether, at given tax rates, it is as productive of revenue as it could be. This is not just a matter of rates, let alone efficiency of administration, but of the provisions of the ordinance itself. In our circumstances, characterised as they are by a unique dependence on external trading transactions, our direct tax system must be low so as to ensure, *inter alia*,

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(245) By "administrative matters" is meant matters of machinery such as the collection of tax, the Commissioner's powers, appeal provisions, scale of penalties, etc.

(246) Salaries tax in Hong Kong is based on the principle of aggregation of earnings of husbands and wives and the system of personal allowances and the rates of tax chargeable are geared to this.

(247) This is not to say that they necessarily involve hardship.

a high rate of capital investment and a high growth rate of the economy. It must also be simple and inexpensive to administer<sup>(248)</sup>. But if we are to maintain our low tax system—as I firmly believe we must— and yet, at the same time, meet our obligations as a Government—as obviously we must—then the ordinance must be more productive of revenue.

### *CONCLUSION*

218. Sir, the budget I have just presented to honourable Members seeks to provide appropriately for what I described earlier as measurable advances in certain high priority areas of concern now that improved economic conditions are in prospect. At the same time, it is consistent with that traditional mix of fiscal conservatism and economic liberalism which I firmly believe is the mainspring of progress in our circumstances and, like you, Sir, I take it as a good omen that we enter the second half of this decade in the Year of the Dragon.

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*(248) It is often assumed that a system of schedular taxes is comparatively easy to administer, but this is not necessarily the case because it inevitably involves substantial duplication of assessments and payments.*

*Annex (I)*

SUMMARY OF REVENUE AND EXPENDITURE,  
1970-71 TO 1974-75

With effect from 1st April 1973 the transactions of the Urban Council and the Housing Authority were excluded from the Government's General Revenue Account, with the exception of services provided by the Government for which the expenditure was charged to expenditure subheads and the reimbursements from the Urban Council and the Housing Authority were credited to revenue subheads. These services mainly involved expenditure on personal emoluments and on public works non-recurrent projects. The figures in this summary in respect of the two years 1973-74 and 1974-75 have been adjusted to include the transactions of the Urban Council and of the Housing Authority in so far as they relate to the previous activities of the Resettlement Department and the Housing Division of the Urban Services Department, in order to make them comparable with the figures for 1970-71 to 1972-73.

	1970-71	1971-72	1972-73	1973-74	1974-75
	(\$ mn)	(\$ mn)	(\$ mn)	(\$ mn)	(\$ mn)
Recurrent Revenue .....	2,744	3,227	4,175	4,864	5,498
<i>Less:</i> Recurrent Expenditure .....	1,900	2,147	2,700	3,500	4,488
Surplus on Recurrent Account .....	844	1,080	1,475	1,364	1,010
Capital Revenue .....	327	314	761	467	437
<i>Less:</i> Capital Expenditure .....	552	754	1,100 <sup>(a)</sup>	1,402 <sup>(b)</sup>	1,814
Surplus/deficit .....	619	640	1,136	429	-367
Total Revenue .....	3,071	3,541	4,936	5,331	5,935
Total Expenditure .....	2,452	2,901	3,800	4,902	6,302

*Notes:*

(a) Excluding \$500 million transferred to the Mass Transit Fund.

(b) Excluding \$300 million transferred to the Mass Transit Fund.

*Annex (2)*

SUMMARY OF EXPENDITURE BY FUNCTION  
1970-71 TO 1974-75

The figures in this summary are a breakdown by function of the total expenditure figures given in Annex (1).

	<i>1970-71</i>	<i>1971-72</i>	<i>1972-73</i>	<i>1973-74</i>	<i>1974-75</i>
	(\$ mn)				
General services .....	216	242	288	320	349
Law and order services .....	240	285	349	452	601
Economic services.....	280	320	373	441	533
Community services.....					
Transport, roads and civil engineering	170	243	358	595	716
Water.....	146	201	366	485	629
Others.....	159	196	249	308	402
Social services.....					
Education .....	498	587	694	990	1,145
Medical and health.....	525	305	379	457	560
Housing.....	172	179	191	243	454
Social welfare.....	36	55	82	144	262
Labour.....	8	9	11	13	16
Common supporting services .....	159	159	200	238	318
Unallocable expenditure.....	44	44	161	98	165
Other financial obligations.....	72	76	99	118	152
Total.....	<u>2,452</u>	<u>2,901</u>	<u>3,800</u>	<u>4,902</u>	<u>6,302</u>

Annex (3)

SUMMARY OF REVENUE AND EXPENDITURE  
1975-76 TO 1979-80

With effect from 1st April 1975 expenditure on services provided by the Government on behalf of the Urban Council and the Housing Authority, comprising mainly personal emoluments and public works non-recurrent projects, and the reimbursements from the Urban Council and the Housing Authority, were taken below-the line. For purposes of comparison, the figures given in the summary in respect of 1973-74 and 1974-75 have been adjusted also to exclude these transactions.

	<i>1973-74 Adjusted actual (\$ mn)</i>	<i>1974-75 Adjusted actual (\$ mn)</i>	<i>1975-76 Revised Estimate (\$ mn)</i>	<i>1976-77 Estimate (\$ mn)</i>	<i>1977-78 Forecast (\$ mn)</i>	<i>1978-79 Forecast (\$ mn)</i>	<i>1979-80 Forecast (\$ mn)</i>
Recurrent Revenue.....	4,550	5,156	5,625	6,235	7,200	7,850	8,580
<i>Less: Recurrent Expenditure ...</i>	<u>3,231</u>	<u>4,175</u>	<u>4,596</u>	<u>5,289</u>	<u>5,710</u>	<u>6,040</u>	<u>6,320</u>
Surplus on Recurrent Account.....	1,319	981	1,029	946	1,490	1,810	2,260
Capital Revenue	467	437	390 <sup>(a)</sup>	486	440	540	550
<i>Less: Capital Expenditure ...</i>	<u>1,413</u>	<u>1,798</u>	<u>1,626</u>	<u>1,923</u>	<u>1,784</u>	<u>1,074</u>	<u>785</u>
Surplus/deficit...	<u>373</u>	<u>-380</u>	<u>-207</u>	<u>-491</u>	<u>146</u>	<u>1,276</u>	<u>2,025</u>
Total Revenue	5,017	5,593	6,015	6,721	7,640	8,390	9,130
Total Expenditure ...	4,644	5,973	6,222	7,212	7,494 <sup>(b)</sup>	7,114 <sup>(b)</sup>	7,105 <sup>(b)</sup>

## Notes:

- (a) Excluding loans and grants totalling \$264 million credited to General Revenue.
- (b) The forecast of expenditure for the three years 1977-78 to 1979-80 are for existing services only, *i.e.* they indicate the expenditure necessary to maintain services at the 1976-77 level and to meet commitments entered into up to and including 1976-77.

*Annex (4)*STATEMENT BY THE FINANCIAL SECRETARY IN  
LEGISLATIVE COUNCIL ON 3RD DECEMBER 1975

Sir,

As I have already informed you in accordance with Standing Order 20(1), I wish to made a statement on the action that this Government proposes to take to honour the undertaking given to the United States Government should Hong Kong be designated as a beneficiary of the US Generalized Scheme of Preferences. This undertaking was conveyed to the United States Government on 1st May 1975 in the following terms:

"(that the Hong Kong Government would take, before 1st January 1976, being the starting date for the Scheme) the necessary legislative steps to eliminate all tax or duty preferences in favour of developed countries."

As we have now received official confirmation that Hong Kong has been designated as a beneficiary of the Scheme, the time has come to honour this undertaking.

2. I need only very briefly explain why we gave this undertaking, that is to say, why we sought to be designated as a beneficiary of the Scheme: as a matter of principle we wish to avoid being discriminated against in favour of our competitors in this region. The Scheme will not provide for preferences to any country or territory in a range of goods comprising the greater part of Hong Kong's trade, including textiles, clothing, footwear, electronic products and watches. Yet some 25% of our exports to the United States, on the present pattern of trade, will qualify for preferential treatment. So, had we been left out of the Scheme we would have been quite seriously discriminated against in favour of our competitors; and, in addition, the economies of our competitors would have benefited further at our expense to the extent that the preferences available under the Scheme assisted in the diversification of their industrial investment. I am sure my honourable Friend, the Director of Commerce and Industry, will be able to describe the potential advantages of the Scheme to Hong Kong's trade and investment, and its mechanics, at length on some suitable later occasion should honourable Members so wish. Meanwhile, I am sure there is widespread gratification in trading and industrial circles that Hong Kong has been designated as a beneficiary and that there will be no discrimination against our exports in our largest market.

3. The preferences to be eliminated in order to honour our undertaking to the United States Government fall into two groups: *first*, the preferential exclusion of Commonwealth motor vehicles from the tax levied under the Commonwealth Preference (Motor Vehicles) Ordinance. This tax is levied at the time of first registration at 15% of the value of the vehicle as defined in Section 7 of the Ordinance. The *second* group of preferences is to be found in the Dutiable Commodities Ordinance. Imports of spirituous liquors and manufactured tobacco from Commonwealth countries, and unmanufactured tobacco from Malawi attract lower rates of duty than similar imports from other countries.

4. Honourable Members will not be surprised—or I trust dismayed—to learn that the 1976 budget, now in the course of preparation, will have to contain proposals designed to raise extra revenue. These proposals will, as usual, be entirely consistent with the underlying principles of our fiscal policy clearly set out in paragraph 64 read with footnote 53, paragraph 86 read with footnote 81, paragraph 87 and paragraph 156 of this year's budget speech and paragraphs 28-33 and 39-40 of my speech winding up the budget debate. I have decided that the changes necessary to honour our undertaking to the United States Government should be coupled with several of these proposals in order to avoid disrupting the trades concerned twice within a short period and to protect the revenue against possible speculative withdrawals from the dutiable commodities bonds in the weeks preceding budget day. As such speculative withdrawals are to an extent forced upon manufacturers and importers by speculative build-up of stocks by retailers, there have been complaints that attempts by the Commerce and Industry Department to regulate withdrawals disrupt the relationships between different sectors of the liquor and tobacco trades.

5. Turning now to what is actually proposed and beginning with motor vehicles: all motor vehicles of whatever origin are to pay First Registration Tax at the effective rates now applicable to vehicles of non-Commonwealth origin. In other words, there will be no change in the effective rates of tax on non-Commonwealth motor vehicles. In terms of legislation, this will involve repealing the Commonwealth Preference (Motor Vehicles) Ordinance and amending the Schedule to the Motor Vehicles (First Registration Tax) Ordinance. To effect the former, I shall be introducing a repealing bill later in this sitting and honourable Members will be asked to take it through all three readings and the Committee Stage. To effect the latter, Your Excellency this morning signed the necessary Order under the Public Revenue Protection Ordinance bringing new rates of first registration tax for all motor vehicles into effect as from 6 p.m. today.

6. To be specific about this Order: it provides *first* for the bringing of all buses (other than those operated by enfranchised companies), goods vehicles, taxis and enfranchised public cars within the scope of the Motor Vehicles (First Registration Tax) Ordinance for the first time, but at a rate of tax equal to that being now paid on such vehicles of non-Commonwealth origin. Non-Commonwealth origin vehicles currently account for up-wards of two thirds of the total number of such vehicles imported. *Secondly*, the Order provides for an increase in the rate of tax on private cars, non-enfranchised public cars, motor cycles and tricycles, which are already charged First Registration Tax, by the amount non-Commonwealth origin vehicles are paying under the Ordinance to be repealed. Non-Commonwealth origin vehicles currently account for upwards of four fifths of the total number of such vehicles imported.

7. Thus the new Schedule to the Motor Vehicles (First Registration Tax) Ordinance will provide for tax to be levied on an *ad valorem* basis as follows:

Enfranchised public buses	Nil (as now)
All other buses (i.e. non-enfranchised public buses, private buses, public light buses and private light buses)	15% (compared with 15% on non-Commonwealth vehicles only)
Goods vehicles	15% (compared with 15% on non-Commonwealth vehicles only)
Taxis and enfranchised public cars	15% (compared with 15% on non-Commonwealth vehicles only)
Non-enfranchised public cars	30% (compared with 15% on Commonwealth vehicles and 30% on non-Commonwealth vehicles)
Private cars	30% (compared with 15% on Commonwealth vehicles and 30% on non-Commonwealth vehicles)
Motor cycles and tricycles	30% (compared with 15% on Commonwealth vehicles and 30% on non-Commonwealth vehicles)

8. As I said earlier, imports of spirituous liquors and manufactured tobacco from Commonwealth countries and imports of unmanufactured tobacco from Malawi attract lower rates of duty than similar imports from other countries. As this preference accorded to Malawi is a relic of the Kennedy Round of Multilateral Tariff Negotiations, I propose to maintain the absolute margin of preference in respect of unmanufactured tobacco from Malawi for the time being. But, as regards imports of spirituous liquors and manufactured tobacco from Commonwealth countries, I propose to eliminate the preference margins by raising the rates to the level of the rates applicable to imports from non-Commonwealth countries. However, as the revenue implications of doing this are small, I propose *in addition* to raise the general rates on most products to levels which will yield part of the extra revenue needed in 1976-77. The new rates *may* slightly discourage sales, but I am confident that there will be no question of diminishing returns and, as I shall show later, the effect on the Consumer Price Index will be minimal.

9. The new rates of duty are set out in an Order made under the Public Revenue Protection Ordinance and signed by Your Excellency this morning. They came into effect at 3.00 p.m. today. To be specific: *as regards spirituous liquors*, the rates applicable to beer, non-European type wines, Chinese type spirits and industrial type liquors produced in Hong Kong have been increased by the same absolute amounts as the rates applicable to imports in order to preserve the same absolute preference margins. I considered eliminating these margins also, but we have no international obligation to do so under the G.A.T.T. and I do not wish to run any risk of disrupting long established trading patterns. However, I have eliminated what I consider to be quite anachronistic preference margins for brandy and other European type spirits of Hong Kong origin because these are not, in fact, produced locally and I do not think a preference margin should exist artificially to encourage new production, particularly if the possibility of its introduction is remote and if the product, anyway, is unlikely to be competitive with spirits of a roughly similar quality from, say, Macao or China.

10. The new (general) rate of duty on non-Commonwealth *brandy* is an increase of 19.4% to \$123 per gallon. The elimination of the Commonwealth preference rate affects 94% of imports of all *other European type spirits*, such as whisky and gin, and results in an effective duty increase of 9.1%. As the incidence of duty per standard bottle is already appreciably higher than on all other spirituous liquors (53% on an ordinary whisky and 56% on gin compared with 34.5% on a

Three Star brandy) I do not propose to go further than this with this group.

11. The new (general) rate of duty on *wines* is an increase of about 18% to \$71 per gallon for champagne and sparkling wines, and to \$39 per gallon for still wines above 15% of alcohol by volume and to \$32.50 for still wines with not more than 15% of alcohol by volume.

12. The new rate applicable to *imported beers* is \$3.40 per gallon, an increase of 9.7%. To preserve the same absolute margin of preference *beer of Hong Kong origin* will be charged at \$2.70 per gallon.

13. The new rate applicable to *imported non-European type wines* is \$19.50 per gallon, an increase of 18.2% (which is consistent with the increase for European type wines). To preserve the same absolute margin of preference, *non-European type wines of Hong Kong origin* will be charged at \$17.50 a gallon.

14. The new rate applicable to *imported Chinese type spirits* is \$9.90 per gallon, an increase of 9.4% (which is in line with the increase for European type spirits).

15. Finally, the new rate for *imported ethyl alcohol*, \$9.90 per gallon, is the same as for Chinese type spirits. Ethyl alcohol is used for industrial and medical purposes on a limited scale but, as it can be used in the manufacture of Chinese type spirits, the rate must be kept in line with that applicable to Chinese type spirits. To preserve the same absolute margin of preference, *ethyl alcohol of Hong Kong origin* will be charged at \$8.75 per gallon.

16. As the way I have described my proposals so far is more intelligible to the trade than to we drinkers, I shall now give some examples of the new rates in terms of duty paid per bottle (rounding off very slightly for simplicity's sake):

Brandy	\$19	(18.94 compared with \$14.63 on Commonwealth origin, and \$15.86 on non-Commonwealth origin, imports)
Other European type spirits	\$16	(\$15.95 compared with \$14.61)
Champagne and sparkling wines	\$12	(12.00 compared with \$10.22)
Still wines above 15%	\$ 6	(\$6.01 compared with \$5.08)
Still wines below 15%	\$ 5	(\$5.01 compared with \$4.24)

Beer, imported, small bottle	\$0.25	(\$0.25 compared with \$0.23)
Beer, local, small bottle	\$0.20	(\$0.20 compared with \$0.175)
Chinese type spirits, imported	\$1.65	(\$1.65 compared with \$1.51)

17. To be specific, *as regards tobacco*: the new (general) rates of duty on manufactured tobacco have been increased by about 15% to \$19.80 per pound for cigars, to \$18.50 per pound for cigarettes and to \$3.70 per pound for Chinese Prepared Tobacco. The absolute increase of \$2.40 per pound in the duty on cigarettes has been applied to the old rate for unmanufactured tobacco (other than imports from Malawi) to produce a new rate of \$14.90 per pound for unmanufactured tobacco. The new rate of duty paid per packet of 20 imported cigarettes will be between \$0.75 and \$0.85.

18. The effect of these increases in duties on the cost of living may be considered in two ways: *first*, in terms of prices of particular products in the shops. This will depend on the extent to which the increases are absorbed within the profit margins of importers and manufacturers, on the one hand, and retailers, on the other, as opposed to being passed on to customers. Given the wide range of sizes of bottles, containers and packets I can only give indicative examples of the increases in duty on various types of liquor and tobacco: on a standard bottle of (non-Commonwealth) brandy, \$3.00; and on a standard bottle of (Commonwealth) whisky, \$1.35. The increase on a small bottle of beer is only \$0.02 (and on a large bottle \$0.04). On a packet of 20 cigarettes, the duty increase is rather more or rather less than \$0.10, depending on weight and, to an insignificant extent, on origin.

19. *Secondly*, there is the effect of these increases in duty on the overall cost of living as measured by the Consumer Price Index: I am advised that the effect will not exceed 0.1% (and this figure includes a tiny element for the increase in the rate of First Registration Tax on vehicles).

20. I have, Sir, endeavoured to explain and describe the action the Government is taking today. Justification in terms of budgetary and fiscal policy in 1976-77 must await the budget speech due to be delivered on 25th February next. However, I should indicate to honourable Members the revenue implications of this action: the removal of the preferential exclusion of Commonwealth motor vehicles from Commonwealth Preference Tax should yield about \$9 million in a full year assuming no deterrent effect and the revenue should benefit by about \$3 million this financial year.

21. The various adjustments to the rates of duty levied under the Dutiable Commodities Ordinance should yield \$55 million in a full year: \$20 million from spirituous liquors and \$35 million from tobacco. Because, in total, imports from non-Commonwealth countries are predominant, only about \$4.5 million of this total figure of \$55 million may be attributed to the elimination of the margins of preference presently enjoyed by imports from Commonwealth countries. In the remaining four months of this financial year the revenue should benefit by about \$20 million after allowing for the fact that these months cover two festive seasons which, I trust, honourable Members will still enjoy. Perhaps they will let me know on 24th and 25th March next when they will be speaking on the Second Reading of the 1976 Appropriation Bill and, particularly, on 25th March when I shall be moving the necessary motions to give permanent effect to the Revenue Protection Orders before their validity expires in four months' time.

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*Annex (5)*

FINANCIAL CIRCULAR NO. 24/75

INTRODUCTION OF AN APPROPRIATIONS-IN-AID SYSTEM  
IN THE 1976-77 DRAFT ESTIMATES

*Introduction*

The existing system for appropriating funds follows Colonial Regulations. All Government expenditure is met from funds appropriated in full by the Legislature and, apart from a few minor exceptions, all above-the-line receipts are credited to General Revenue.

2. Under the existing system no distinction is made between "true" revenue on the one hand (e.g. duties and taxes), and receipts which are in effect a full or partial recovery of the cost of providing particular services on the other hand (e.g. inoculation fees, fees for replacing identity cards, charges for water). The overall cost of Government services is thus artificially inflated by appropriating funds to meet expenditure on services the cost of which is recovered from the users of those services.

3. This situation can be avoided if those fees and charges which can be related directly to the provision of a service or facility are treated as a form of reimbursement of the expenditure, and are "appropriated-in-aid" of such expenditure. Accordingly, a system of appropriations-in-aid is to be introduced for the 1976-77 draft Estimates.

*The appropriations-in-aid system*

4. Under the appropriations-in-aid system certain fees and charges will not be credited to General Revenue, but will be used to offset approved expenditure. Such fees and charges will be termed "appropriations-in-aid". The funds required to be appropriated from General Revenue under each department's head of expenditure in the Appropriation Ordinance will amount to the total estimated expenditure *less* the estimated appropriations-in-aid. The Appropriation Ordinance will also authorize the use of the appropriations-in-aid.

5. Broadly speaking, the receipts classified as appropriations-in-aid will be moneys realized or recovered by departments in the process of providing services to the public. Examples are fees for certain certificates and licences, receipts from the sale of stores, receipts from charges for work executed on private account and receipts for charges for the use of such services as the Airport, the Railway, the Post Office and Water Supplies. Into General Revenue will be paid the yield from duties and taxes, fines, forfeitures, penalties, the tax element in licence fees and revenue from properties and investments. As expenditure charged to departmental heads does not in any way represent the full cost of services, receipts classified as appropriations-in-aid which are in excess of approved departmental expenditure will be credited to General Revenue.

6. The funds under each subhead of expenditure in the Estimates will continue to be provided for gross expenditure. As at present, departments will be required to control their gross expenditure by subheads and to apply for supplementary provision or virement when gross expenditure under a subhead is likely to exceed the amount included in the Estimates for that subhead. In this respect there will be no change in the existing system of expenditure control.

7. But in addition, during the financial year departments will have to monitor their expenditure in relation to their actual receipts of appropriations-in-aid. Should it become apparent during the year that their actual receipts of appropriations-in-aid are likely to be below

the amount estimated, they will have *either* to reduce expenditure *or* to justify an increase in the funds appropriated from General Revenue. On the other hand, if actual receipts of appropriations-in-aid are greater than estimated, the excess will be transferred to General Revenue in order to ensure that the total funds available to the department in a particular financial year do not exceed the amount necessary to meet expenditure approved in the Estimates. To maintain administrative simplicity, supplementary provision will be met from General Revenue rather than from additional appropriations-in-aid.

*Advantages of the new system*

8. The advantages are—
  - (a) as expenditure will in many cases be offset in whole or in part by related receipts, the true cost of the Government's activities to General Revenue will be more readily apparent;
  - (b) in preparing the draft Estimates, as receipts appropriated-in-aid can be more directly related to departments' expenditure, disparate variations in both will be more readily discernible. The cause might be a failure to keep the level of charges up-to-date with increased costs, in which case the remedy might be to revise the rates. Or it might be a failure to adjust overheads to suit a lower volume of operations as evidenced by the lower level of receipts. In this event the remedy might lie in reducing expenditure on the particular service;
  - (c) also in preparing the draft Estimates, departments' proposals for expenditure will be assisted by the extent to which the expenditure is covered by departmental receipts;
  - (d) and although, as stated in paragraph 7, for administrative simplicity supplementary provision will be met from General Revenue rather than appropriations-in-aid, departments' submissions for supplementary provision will be strengthened to the extent that they can be supported by additional departmental receipts during the year;
  - (e) the system will serve to remind departments to consider the need to revise departmental charges if costs rise during a financial year;

- (f) as departments will have to rely in part on their receipts from fees and charges to meet their direct expenditure in a particular year, they will have greater incentive to ensure collection; and
- (g) an appropriations-in-aid system will encourage departments to seek additional sources of receipts more actively.

### *Implementation*

9. Other than making physical allowance for appropriations-in-aid, the present form of the Estimates and system of estimating remain unchanged. Implementation in the 1976-77 draft Estimates is on the lines of the following paragraphs.

10. To the present two divisions of each departmental head of expenditure into "Annually Recurrent" and "Special Expenditure" will be added, where appropriate, a third division "Appropriations-in-aid". The sum of the provision in the first two divisions now referred to as "Total Expenditure" will become "Total Gross Expenditure". The net total of the third division will be "Total, Appropriations-in-aid". The final total for the head will then be "Net Expenditure".

11. Within each "Appropriations-in-aid" division there will be a standard subhead "999 Appropriations-in-aid". This subhead will be broken down into items by significant sources of receipt.

12. Charges with only a small element designed to recover costs (e.g. vehicle and driving licences and business registration fees) will continue to be classified as revenue and included in the appropriate Revenue Heads. Those which have only a small tax element will be classified as appropriations-in-aid. Where both the cost element and the tax element are significant, the receipts will be divided between the two according to approved percentages. The departments concerned (Marine and Registrar General's) are being notified separately.

13. In the case of a few departments whose receipts from fees and charges exceed their total expenditure, the yield allowed to be appropriated-in-aid will be limited to the amount necessary to cover their approved expenditure for the year. The funds to be appropriated from General Revenue to these departments will be "nil". The receipts over and above the amount necessary to cover approved expenditure will be transferred to General Revenue.

*Expenditure control*

14. During 1976-77, departments will be required to monitor—
- (a) their gross expenditure and contain it within the approved provision under each subhead, applying for supplementary provision or virement by subhead in the normal way if circumstances so justify;
  - (b) their receipts under appropriations-in-aid with a view to explaining any deviation from the Estimates; and
  - (c) their net expenditure to ensure as far as possible that any likely shortfall in appropriations-in-aid is matched by a corresponding reduction in expenditure so as not to exceed the net expenditure approved. If it becomes apparent that actual receipts for the year may be less than the amount estimated and the shortfall cannot be matched by a corresponding reduction in expenditure, authority to maintain the level of approved expenditure notwithstanding the shortfall in receipts must be sought from the Finance Branch. This authority must be deemed to be limited to the extent of the actual shortfall in receipts. As the use of this authority will involve increasing the "Amount of Vote" sought in the Appropriation Ordinance, the Finance Branch's authority in this respect will derive from the Legislative Council and the amounts so authorized will be covered eventually by a Supplementary Appropriation Ordinance.

15. To maintain administrative simplicity and legislative control, there will be no facility for increasing the amount of appropriations-in-aid during a financial year. So although all relevant receipts will be credited to the appropriations-in-aid items, any amounts over the appropriations-in-aid estimate will be transferred to General Revenue. But in preparing the following year's draft Estimates (*i.e.* for 1977-78), the increased receipts will be reflected in a department's estimates of appropriations-in-aid for that year.

16. As the existing provisions under Colonial Regulations 185 and 186 require the inclusion of *gross* receipts under the Revenue Estimates, exemption from the Secretary of State has been obtained for introducing the appropriations-in-aid system in the 1976-77 draft Estimates. The Finance Committee of the Legislative Council has also agreed to the new system.

**SPEECH BY THE FINANCIAL SECRETARY IN LEGISLATIVE  
COUNCIL ON 5TH NOVEMBER 1975**

Sir,

I move that the Inland Revenue (Amendment) (No 6) Bill 1975 be read the second time.

In paragraph 192 of my Budget Speech, I gave notice of my intention to provide for property tax values to be assessed independently of the rating valuation lists with effect from the year of assessment 1976-77. The main purpose of the Bill before Council is to give effect to this proposal. The proposed changes will enable property tax values to be fixed in line with current market rental values and not on a "tone of the list" basis. The justification for this departure is that, whereas rates are basically a tax on occupiers of premises, property tax is intended to be a tax on income derived from ownership of property. Re-assessments will generally be timed to coincide with revaluations for rating but, whenever these are carried out less frequently than, say, every two years and rents take, meanwhile, an upward course, fresh assessable values for property tax purposes can be provided in advance of a revaluation for rating (in order to protect the revenue).

The new concept of "assessable value" of property and its determination is introduced in Clause 4 of the Bill. Whilst still based on a valuation prepared by the Commissioner of Rating and Valuation, it nevertheless departs from the concept of "rateable value" in two important aspects. First, it takes into account that rent might be restricted by Parts I and II of the Landlord and Tenant (Consolidated) Ordinance. As a consequence, the concessionary property tax charge of one-half the standard rate on rent restricted pre-war buildings is no longer necessary. Secondly, it ignores the "tone of the list" so that any property becoming subject to property tax for the first time will have an assessable value which has been estimated on the basis of rents ruling at that date. Provision is made to retain the existing allowance of 20 percent for repairs and outgoings, and for this allowance to be varied in future by resolution of this Council.

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

Annex (7)

**ROUTINE REVISIONS OF FEES AND CHARGES***(a) Significant revisions implemented for 1975-76*

(All references to heads and subheads are to those in the Estimates 1976-77.)

<i>Head</i>		<i>Subhead</i>	<i>Fees</i>	<i>Additional revenue p.a. (\$ million)</i>	
<i>A. Fees and charges mentioned in Appendix (4) to the Budget Speech 1975-76</i>					
Head 8	Fees and Receipts other than Appropriations-in- Aid	490	Companies	Certain fees charged under the Companies Ordinance revised from 31st July 1975.	0.3
Head 25	Civil Aviation Department	999030	Aircraft parking fees	Fees for aircraft parking revised from 1st July 1975.	0.9
		050	Airport car parking fees	Fees for car parking at the Airport revised from 1st July 1975.	0.5
Head 37	Home Affairs Department	999010	Film censorship fees	Fees charged on films shown for censorship revised from 8th November 1974.	0.3
Head 49	Medical & Health Department	999020	Inoculation and vaccination certificates	Fees for inoculation and vaccination certificates revised from 1st June 1975.	0.1
Head 56	Post Office	999030	Postage stamps	Fees collected <i>via</i> postage stamps for certificates of origin revised from 1st April 1975.	3.0
		060	Rent of private boxes and bags	Charge for private boxes and bags revised from 1st September 1974.	1.0
Head 63	Public Works Department: Engineering Development	999010	Quarry products	Selling price for products of Government quarries revised from 1st January 1975.	2.1
Head 74	Registrar General's Department	999020	Deeds registration fees	Fees for registering deeds revised from 1st December 1974.	4.4
Head 83	Transport Department	999010	Toll collections— Lion Rock Tunnel	Charges for using Lion Rock Tunnel revised from 1st April 1975.	2.5

<i>Head</i>		<i>Subhead</i>	<i>Fees</i>	<i>Additional revenue p.a. (\$ million)</i>	
<i>B. Fees and charges not mentioned in Appendix (4) to the Budget Speech 1975-76</i>					
Head 43	Judiciary	999020	Court fees	Various fees made by the Chief Justice under the Supreme Court Fees Rules and charged under other legislation revised during 1975-76.	2.8
		030	Possession		
		040	Other fees		
Head 48	Marine Department	999090	Miscellaneous craft licences	Fees for craft licences revised from 27th May 1975.	0.5
		120	Port clearance fees	Fees for port clearance certificates revised from 29th July 1975.	0.2
Head 49	Medical & Health Department	999030	Medical and dental charges	Fees for hospital beds revised from 1st November 1975.	4.4
		050	Out-patient clinics	Fees for out-patients revised from 1st November 1975.	1.2
Head 74	Registrar General's Department	999050	Official Receiver's fees	Fees related to bankruptcy and winding-up revised from 7th January 1976.	0.5
					24.7

*(b) Significant revisions outstanding at 1st February 1976*

(All references to heads and subheads are to those in the Estimates 1976-77.)

<i>Head</i>		<i>Subhead</i>	<i>Fees</i>	<i>Estimated additional revenue p.a. (\$ million)</i>	
Head 35	Fire Services Department	999020	Dangerous goods licences	Fees for various licences to be revised.	1.2
Head 39	Immigration Department	999020	Travel documents	Fees for various travel documents to be revised.	10.0*
Head 49	Medical & Health Department	999010	Dangerous drugs, pharmacy, poisons and other licences	Various fees to be introduced under the Pharmacy and Poisons Ordinance.	4.8*
		060	Miscellaneous receipts	Increase in registration fees for doctors, dentists, nurses and other para-medicals.	0.5
				16.5	

\* Included in Estimates 1976-77.

- (c) *Salient points in Finance Branch Internal Circular No 2/76 on procedures for regular revision of fees and charges*

### *Introduction*

In paragraph 121 of the 1975 Budget Speech, the Financial Secretary set out what he considered to be the role of different fees and charges. The six groups are—

*First*, fees and charges designed to cover the full cost (including capital charges) of the services provided;

*Second*, fees and charges which are not so designed because, for one policy reason or another, the Government considers that part of the cost of the services concerned should be borne by General Revenue;

*Third*, fees and charges raised by our public utility type undertakings designed to cover full costs and earn a fair return on capital employed;

*Fourth*, fees and charges pitched deliberately at a level to deter usage for policy reasons;

*Fifth*, fees and charges pitched well above full costs, but just below the level at which diminishing returns set in;

*Sixth*, fees and charges pitched at a level to reflect that they represent a payment for belonging to trading groups enjoying monopoly or semi-monopoly privileges.

2. All fees and charges should be reviewed regularly (at least once a year)—

(a) to ensure that the objective of the fees or charges is not lost as a result of increases in cost; and

(b) to consider whether a change in category (as listed in paragraph 1) is appropriate e.g., whether the fees for a service which were previously set at a level to subsidize that service should now be revised to recover the full cost of providing that service.

3. The review should normally be initiated by the department responsible for collecting the fees or charges. But if a department fails to act, it is the responsibility of the appropriate Finance Division in Finance Branch to take steps to ensure that the relevant information

is obtained from the department to enable a review to be carried out and the fees and charges revised. The Management Accounting Division is designing a comprehensive system which will include regular returns from departments to enable a review of fees on a regular basis rather than the present *ad hoc* arrangements; this will form the basis of a separate circular.

*Management Accounting Division to advise on "no-loss" level of fees*

4. Proposals should be passed to the Management Accounting Division so that the costings can be checked and an up-to-date "no-loss" figure determined. The Management Accounting Division will contact the department direct for any additional information it may require in order to determine the "no-loss" level of charges. The Management Accounting Division will not advise on the appropriate level of fees. This is a matter for the Finance Divisions to determine in consultation with the policy branch.

*Policy Branch to be consulted*

5. On receipt of the results of the Management Accounting Division's studies, the subject officer will then consult the policy branch to determine an appropriate level of the revised fees, bearing in mind in which of the categories in paragraph 1 the fees in question fall. In the normal course of events, there should be no delay in reaching agreement on the appropriate level of fees. But if consideration of a change in the role of the fees is likely to delay implementing the revised fees, then the Assistant Financial Secretary of the Finance Division should be consulted at once for a decision on whether to proceed with implementing the revised fees and taking up other changes as a separate issue.

Annex (8)

EFFECT OF AN INCREASE IN THE GENERAL RATE  
BY 1% POINT

Class	Approximate number of assessments	Average rateable value	Rates per month @ 11%	Rates per month @ 12%	Increase in rates per month
		\$	\$	\$	\$
Domestic:					
Small tenements ....	105,600	3,150	28.87	31.50	2.63
Large tenements ....	108,700	4,070	37.30	40.70	3.40
Small flats .....	73,600	6,280	57.56	62.80	5.24
Medium flats .....	21,300	11,970	109.72	119.70	9.98
Large flats .....	8,000	25,160	230.63	251.60	20.97
Houses.....	1,320	39,100	358.41	391.00	32.59
Non-domestic:					
Ground floor shops	43,200	13,640	125.03	136.40	11.37
Commercial premises	8,000	46,910	430.00	469.10	39.10
Commercial offices	13,500	24,150	221.37	241.50	20.13
Flatted factories.....	11,300	53,660	491.88	536.60	44.72

*Motion made. That the debate on the second reading of the bill be adjourned—*THE FINANCIAL SECRETARY.

*Question put and agreed to.*

**Adjournment and next sitting**

HIS EXCELLENCY THE PRESIDENT:—In accordance with Standing Orders I now adjourn the Council until 2.30 p.m. on Wednesday, the 10th of March.

*Adjourned accordingly at two minutes to six o'clock.*

**Price: \$33.00**  
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