

OFFICIAL REPORT OF PROCEEDINGS**Wednesday, 28 February 1979****The Council met at half past two o'clock****PRESENT**

HIS EXCELLENCY THE GOVERNOR (*PRESIDENT*)
SIR CRAWFORD MURRAY MACLEHOSE, GBE, KCMG, KCVO

THE HONOURABLE THE CHIEF SECRETARY
SIR JACK CATER, KBE, JP

THE HONOURABLE THE FINANCIAL SECRETARY
MR CHARLES PHILIP HADDON-CAVE, CMG, JP

THE HONOURABLE THE ATTORNEY GENERAL
MR JOHN WILLIAM DIXON HOBLEY, CMG, QC, JP

THE HONOURABLE THE SECRETARY FOR HOME AFFAIRS
MR LI FOOK-KOW, CMG, JP

THE HONOURABLE DAVID HAROLD JORDAN, CMG, MBE, JP
DIRECTOR OF TRADE, INDUSTRY AND CUSTOMS

THE HONOURABLE DAVID AKERS-JONES, CMG, JP
SECRETARY FOR THE NEW TERRITORIES

THE HONOURABLE LEWIS MERVYN DAVIES, CMG, OBE, JP
SECRETARY FOR SECURITY

THE HONOURABLE DAVID WYLIE McDONALD, CMG, JP
DIRECTOR OF PUBLIC WORKS

THE HONOURABLE KENNETH WALLIS JOSEPH TOPLEY, CMG, JP
DIRECTOR OF EDUCATION

THE HONOURABLE DAVID GREGORY JEAFFRESON, JP
SECRETARY FOR ECONOMIC SERVICES

THE HONOURABLE ALAN JAMES SCOTT, JP
SECRETARY FOR HOUSING

THE HONOURABLE GARTH CECIL THORNTON, OBE, QC
SOLICITOR GENERAL

THE HONOURABLE EDWARD HEWITT NICHOLS, OBE, JP
DIRECTOR OF AGRICULTURE AND FISHERIES

THE HONOURABLE THOMAS LEE CHUN-YON, CBE, JP
DIRECTOR OF SOCIAL WELFARE

THE HONOURABLE DEREK JOHN CLAREMONT JONES, CMG, JP
SECRETARY FOR THE ENVIRONMENT

DR THE HONOURABLE THONG KAH-LEONG, JP
DIRECTOR OF MEDICAL AND HEALTH SERVICES

THE HONOURABLE ERIC PETER HO, JP
SECRETARY FOR SOCIAL SERVICES

THE HONOURABLE JOHN CHARLES CREASEY WALDEN, JP
DIRECTOR OF HOME AFFAIRS

THE HONOURABLE JOHN MARTIN ROWLANDS, JP
SECRETARY FOR THE CIVIL SERVICE

THE HONOURABLE JAMES NEIL HENDERSON, JP
COMMISSIONER FOR LABOUR

THE HONOURABLE OSWALD VICTOR CHEUNG, CBE, QC, JP

THE HONOURABLE ROGERIO HYNDMAN LOBO, CBE, JP

THE HONOURABLE JAMES WU MAN-HON, OBE, JP

THE HONOURABLE HILTON CHEONG-LEEN, OBE, JP

THE HONOURABLE LI FOOK-WO, CBE, JP

THE HONOURABLE JOHN HENRY BREMRIDGE, OBE, JP

DR THE HONOURABLE HARRY FANG SIN-YANG, OBE, JP

THE HONOURABLE LO TAK-SHING, OBE, JP

THE HONOURABLE ALEX WU SHU-CHIH, OBE, JP

THE REV. THE HONOURABLE JOYCE MARY BENNETT, OBE, JP

THE HONOURABLE CHEN SHOU-LUM, OBE, JP

THE HONOURABLE LYDIA DUNN, OBE, JP

DR THE HONOURABLE HENRY HU HUNG-LICK, OBE, JP

THE HONOURABLE LEUNG TAT-SHING, JP

THE REV. THE HONOURABLE PATRICK TERENCE MCGOVERN, OBE, SJ, JP

THE HONOURABLE PETER C. WONG, JP

THE HONOURABLE WONG LAM, OBE, JP

DR THE HONOURABLE RAYSON LISUNG HUANG, CBE, JP

THE HONOURABLE CHARLES YEUNG SIU-CHO, JP

DR THE HONOURABLE HO KAM-FAI

THE HONOURABLE ALLEN LEE PENG-FEI

THE HONOURABLE DAVID KENNEDY NEWBIGGING, JP

THE HONOURABLE ANDREW SO KWOK-WING

ABSENT

THE HONOURABLE FRANCIS YUAN-HAO TIEN, OBE, JP

IN ATTENDANCE

THE CLERK TO THE LEGISLATIVE COUNCIL
MR STEPHEN TAM SHU-PUI

Papers

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

<i>Subject</i>	<i>LN No</i>
Subsidiary Legislation:	
Boilers and Pressure Receivers Ordinance. Boilers and Pressure Receivers (Exemption) (Consolidation) (Amendment) Order 1979	45
Tax Reserve Certificates Ordinance. Tax Reserve Certificates (Fourth Series) (Amendment) Rules 1979	46
Public Health and Urban Services Ordinance. Food Business (New Territories) Regulations (Exemption from Regulation 31(1))(No 2) Notice 1979	47
Public Health and Urban Services Ordinance. Hawker (Permitted Place) Declaration No 1/1979	48
Interpretation and General Clauses Ordinance. Specification of Public Office	49
Public Order Ordinance. Marine Closed Area (No 3) Order 1979	50
Merchant Shipping Act 1974. Merchant Shipping (Indemnification of Shipowners) (Hong Kong Dollars Equivalents) Order 1979	51
Merchant Shipping (Oil Pollution) Act 1971. Merchant Shipping (Limitation of Liability for Oil Pollution) (Hong Kong Dollar Equivalents) Order 1979	52
Merchant Shipping (Oil Pollution) (Hong Kong) Order 1975. Merchant Shipping Act 1974 (Commencement) Notice 1979	53

<i>Subject</i>	<i>LN NO</i>
Country Parks Ordinance. Tai Lam, Tai Mo Shan and Lam Tsuen Country Parks (Designation) Order 1979.....	54
Public Health and Urban Services Ordinance. Pleasure Grounds (Amendment) By-laws 1979	55
Interpretation and General Clauses Ordinance. Amendment of the Definitions of 'British Territory' and 'Commonwealth' .	56
 Sessional Papers 1978-79:	
No 38—Statement of Accounts of the Prisons Department Welfare Fund ended 31 March 1978 (published on 28.2.79).	
No 39—Supplementary Provisions approved by the Urban Council during the third quarter of the fiscal year 1978-79 (published on 28.2.79).	
No 40—Draft Estimates of Expenditure 1979-80 (published on 28.2.79).	
No 41—Draft Revenue Estimates 1979-80 (published on 28.2.79).	
No 42—Draft Supporting Financial Statements and Statistical Appendices from the Estimates of Revenue and draft Estimates of Expenditure 1979-80 (published on 28.2.79).	
No 43—Report of the Establishment Sub-Committee of Finance Committee for 1978-79 (published on 28.2.79).	
No 44—Estimates of Revenue and Expenditure for the year ending 31 March 1980—Report of the Public Works Sub-Committee of Finance Committee 1978 (published on 28.2.79).	

Government business

First reading of bill

APPROPRIATION BILL 1979

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 1979**

THE FINANCIAL SECRETARY moved the second reading of:—‘A bill to apply a sum not exceeding \$12,454,070,000 to the service of the financial year ending on 31 March 1980.’

He said:—

	<i>Paragraphs</i>
MOTION	1
ACKNOWLEDGEMENTS	2
STRUCTURE OF SPEECH	3 - 4

PART I: THE ADJUSTMENT PROCESS

(1) External Dependence and the Adjustment Process:	
(a) Theoretical framework	5 - 14
(b) Role of Government Policy:	
(i) General	15 - 16
(ii) Social and related policies	17
(iii) Government as an employer	18
(iv) Government expenditure	19 - 22
(v) Land policy	23 - 24
(vi) Regulation of markets	25 - 30
(2) Course of the Adjustment Process, 1972 to 1978:	
(a) Introduction	31
(b) Under a fixed exchange rate regime, 1972 to 1974	32 - 34
(c) Under a floating exchange rate regime, 1975 to 1978:	
(i) 1975 and 1976	35 - 37
(ii) 1977 (Provisional estimate of GDP)	38 - 44
(iii) 1978 (Preliminary estimate of GDP)	45 - 55
(iv) Implication of differences between the forecast of GDP in 1978 and the preliminary estimate	56 - 62

PART II: MANAGEMENT OF THE PUBLIC FINANCES

(1) General Objectives of Budgetary Policy	63 - 64
(2) Restatement of Budget Guidelines:	
(a) Relative size of the public sector	65 - 66
(b) Construction of the annual budget	67 - 68
(c) Balance of the fiscal system	69
(d) Steady progression	70
(e) Fiscal reserves	71 - 72
(f) Summary	73

	<i>Paragraphs</i>
(3) Assessment of Performance, 1972-73 to 1978-79:	74
(a) 1972-73 to 1974-75	75 - 77
(b) 1975-76	78
(c) 1976-77 to 1978-79:	79
(i) 1976-77	80
(ii) 1977-78 (Final Accounts)	81
(iii) 1978-79 (Revised Estimates)	82 - 90
(4) Summary of Present Position:	
(a) Growth rate of public expenditure and relative size of public sector	91 - 92
(b) Budget guidelines	93
(c) Balance of the fiscal system	94 - 95
(d) Financial position	96 - 99

PART III: THE ECONOMY AND THE PUBLIC SECTOR, 1979 TO 1982

(1) Introduction	100
(2) Forecast of Expenditure, 1979-80 to 1982-83	101 - 103
(3) Initial Forecast of GDP in 1979	104 - 107
(4) Emphasis of Budgetary Policy in 1979-80	108
(5) Acceptable Expenditure Limits for 1979-80	109-112
(6) Final Forecast of GDP in 1979:	
(a) Cash inputs and assumptions	113
(b) Private consumption expenditure	114 - 115
(c) Gross domestic fixed capital formation	116 - 118
(d) Exports	119 - 120
(e) Imports	121
(f) Total expenditure on GDP	122 - 123
(g) Prices	124
(h) Conclusion	125
(7) Outlook for the Economy in the Forecast Period, 1980 to 1982:	
(a) Protectionism	126
(b) Anti-inflationary policies of overseas governments	127
(c) Advisory Committee on Diversification	128
(d) Economic relations with China	129
(e) Immigration	130
(f) Trend growth rate	131

	<i>Paragraphs</i>
PART IV: THE BUDGET FOR 1979-80	
(1) Introduction	132
(2) Draft Expenditure Estimates:	
(a) General	133
(b) Total expenditure	134 - 135
(c) Recurrent	136 - 140
(d) Capital	141 - 142
(e) Pattern of expenditure (broad trends)	143 - 146
(f) Expenditure on selected services	147 - 154
(3) Revenue Estates:	
(a) Total revenue	155
(b) Recurrent	156 - 162
(c) Capital	163 - 164
(4) Outturn and Summary	165 - 168
(5) Revenue Proposals for 1979-80:	
(a) General	169 - 170
(b) Direct taxation:	
(i) Depreciation allowances	171 - 172
(ii) Salaries tax: supplementary personal allowance	173
(iii) Salaries tax: 30% marginal rate	174 - 177
(iv) Estate duty: controlled companies	178 - 182
(v) Estate duty: gifts <i>inter vivos</i>	183
(c) Indirect taxation:	
(i) General	184 - 186
(ii) Duty on liquors	187
(iii) Duty on tobacco	188
(iv) Duty on hydrocarbon oils	189 - 192
(v) First registration tax	193 - 197
(d) Fees and charges:	
(i) General	198
(ii) Cost-related	199
(iii) Royalty-loaded	200
(iv) Tax-loaded:	201
(A) Motor vehicle licences	202 - 210
(B) Buoy and anchorage fees	211 - 212
(C) Business registration fee	213 - 214
(e) Implementation	215
(6) Revised Outturn for 1979-80	216 - 217
(7) Fiscal Policy in the Future:	
(a) Reform of the tax system:	
(i) Third Inland Revenue Ordinance Review Committee	218 - 224

	<i>Paragraphs</i>
(ii) Taxation treatment of retirement benefits	225 - 226
(iii) Share options	227
(iv) Stamp Ordinance	228
(b) Rating	229 - 230
(c) Management of public utilities	231 - 233
PART V: ACHIEVEMENT OF GENERAL OBJECTIVES OF BUDGETARY POLICY	
(1) Introduction	234
(2) First and Second Objectives: Expenditure Proposals and Fiscal Policy	235
(3) Third Objective: Maintenance of Flexibility of the Cost/Price Structure	236 - 240
(4) Fourth Objective: Monetary Implications of the Government's Bank Balances	214 - 243
(5) Fifth Objective: Economic Stability	244 - 265
CONCLUSION	266 - 267

MOTION

Sir, I move that the Appropriation Bill 1979, which was published in an issue of the *Gazette Extraordinary* at 2 o'clock today, be read the second time.

ACKNOWLEDGEMENTS

2 Laid on the table today, Sir, are the Draft Estimates of Expenditure for 1979-80, and the Revenue Estimates, together with the usual supporting documents, the scope of one of which, namely, the *Graphic Guide*, has been widened. Yet again, I must publicly acknowledge the diligent efforts of all concerned in their preparation: I refer particularly to my colleagues in the Finance Branch of the Government Secretariat on whom the main burden falls and also to my colleagues in the Economic Services and Monetary Affairs Branches, in the Census and Statistics Department and in the revenue departments; and, of course, on the production side, I refer to the very uncomplaining efforts of secretarial staff in the Finance Branch, to the highly competent team of translators in Chinese and typists assembled for me by the Home Affairs Department and to the Government Printer and his staff in the Printing Department. I must also thank heads of departments for their cooperation and understanding during what was being, in some ways, a

singularly difficult estimates season. Finally, I am most grateful for the assistance of Unofficial Members of the Economic Review Committee in the preparation of the *Economic Background* document.

STRUCTURE OF SPEECH

3 Budgetary policy, using that term in its generic sense to include fiscal, economic and monetary policies, must always seek to be at least compatible with the likely movement of various economic aggregates and costs and prices. But, in certain circumstances, namely, a slowing down in the growth rate of the economy and/or a situation of threatened demand-pull inflation, the need to ensure compatibility between budgetary policy and the process whereby the economy adjusts to changing internal and external influences assumes a critical importance.

4 In order to stress that my budgetary strategy for 1979-80 *has* had full regard to the present situation of, and the outlook for, the economy—indeed the economy has been my starting point—this year's budget speech follows a rather different pattern from those of recent years. Thus, I shall begin by analysing the implications of a floating exchange rate regime for the adjustment process concluding with an analysis of the consequences of the growth rate of total final demand exceeding the growth rate of the economy's output, there being signs, I now realize with the benefit of hindsight, that this was beginning to happen in early 1978 (PART I). After identifying five general objectives of budgetary policy, I shall then go on to review how successfully, or otherwise, the public finances as such have been managed in recent years in terms of our budget guidelines (PART II). The inescapable emphasis of budgetary policy in 1979-80 will then begin to become apparent and, after surveying the prospects for our economy on the basis of certain assumptions (PART III) I shall spell out the Government's own budget for 1979-80 concluding with a brief reference to fiscal policy in the future (PART IV). Finally, in assessing the extent to which the five general objectives of budgetary policy are likely to be achieved in 1979-80, I shall explain that, as the beneficial effect of the budget itself on the growth rate of total final demand is limited, other measures of restraint are required if the necessary emphasis of budgetary policy is to be recognized (PART V).

PART I: THE ADJUSTMENT PROCESS

(1) External Dependence and the Adjustment Process

(a) Theoretical framework

5 Our present situation is characterised by an increasing imbalance between demand for the output of the economy and the economy's ability to supply that output. That is to say, total final demand, defined as private consumption expenditure, Government consumption expenditure, gross domestic fixed capital formation and exports of goods, total final demand is growing faster than the gross domestic product.

6 The three post-recession years, 1976 to 1978, have seen a higher growth rate of GDP in real terms, and the GDP *per capita*, than any similar period in the past⁽¹⁾. My concern, therefore, is not so much with our aggregate performance as such, as with the cost at which it has been achieved. Despite the steady deceleration of the growth rate of GDP in the last two of the three post-recession years—from 17% in 1976 down to 12% in 1977 and to 10% in 1978—the growth momentum of the economy has involved a faster growth rate of imports than of exports and thus has only been sustained at the cost of a widening visible trade deficit, a depreciation of the exchange value of the Hong Kong dollar and the very real prospect of accelerating inflation.

7 Thus there are two questions to which we must address our minds: *first*, how will the economy respond to this situation? *Secondly*, can the Government help the economy to adjust to a growth rate that is both rapid *and* sustainable (that is to say, can the Government help to bring about a situation in which the economy is growing as rapidly as it can, consistent with the maintenance of both internal and external equilibrium)? In applying our minds to these two questions, we must obviously have due regard for the different social consequences of particular courses of action.

8 Internal equilibrium involves the demand for, and supply of, the output of the economy remaining roughly in balance without domestic prices changing any faster than is justified by changes in the world prices of Hong Kong's imports. External equilibrium involves the balance of payments remaining in balance without any need for the relationship between interest rates in Hong Kong and interest rates elsewhere to change or any need for the effective exchange rate of the Hong Kong dollar to maintain the balance.

(1) Or, at any rate, since estimates of expenditure on the GDP have been compiled (ie since 1961), viz:

	<i>GDP</i> (%)	<i>GDP</i> <i>per capita</i> (%)
1962	10.2	5.6
1963	11.7	7.9
1964	8.3	5.7
1965	18.3	15.3
1966	6.2	5.3
1967	8.9	6.2
1968	4.5	2.3
1969	14.0	12.2
1970	5.7	3.2
1971	3.2	1.0
1972	7.2	5.4
1973	14.2	11.6
1974	2.2	—0.3
1975	2.9	1.1
1976	16.7	15.4
1977(*)	11.9	10.1
1978(**)	10.0	7.8

Notes: (*) Based on provisional estimate.

(**) Based on preliminary estimate.

9 A growth rate of output which is consistent with the maintenance of external equilibrium is dependent in part on Hong Kong's export performance which, in turn, is dependent on the growth rate of world trade, on the extent to which the pattern of our exports fits the pattern of demand of the rest of the world and on the extent to which Hong Kong is able, *and* allowed, to take advantage of export opportunities.

10 However, external equilibrium cannot be considered independently from internal equilibrium. Both to produce for export and to help satisfy domestic demand, Hong Kong must import. Thus, if the growth rate of total demand from these two sources, that is to say, the growth rate of total final demand exceeds the growth rate of GDP and if, at the same time, domestic capacity is fully utilized, there will be a tendency for imports to rise very rapidly, for costs and prices to rise and for firms producing for the domestic market to bid away resources from firms producing for export⁽²⁾. In other words, external disequilibrium can arise both from external influences and, as at present, from internal disequilibrium.

11 In no economy can disequilibrium be sustained indefinitely and forces will be generated to effect an adjustment. But the longer disequilibrium persists the more severe will be the necessary correction⁽³⁾. So any government must consider whether there are any steps that it can, and should, take to facilitate and expedite the adjustment process. So far as *this* Government is concerned we have to think through, at the same time, the implications of the present floating exchange rate regime.

12 Pure economic theory suggests that, under a fixed exchange rate regime, provided the cost/price structure is flexible, deficits and surpluses in the balance of payments will be eliminated by changes in the money supply and in the level of real incomes. By contrast, under a floating exchange rate regime, such deficits and surpluses are seen as being eliminated by changes in the exchange rate with little or no effect on the money supply⁽⁴⁾. Under a floating exchange rate regime, the emergence of excess demand which is, indeed, characteristic of our present situation⁽⁵⁾, is not constrained, to anything like the same extent, by the loss of foreign exchange reserves that would

(2) *Or, at least, to prevail in the competitive bidding for additional resources as they come on to the market.*

(3) *Indeed, an offsetting over-correction is likely to be required before equilibrium can be restored.*

(4) *More sophisticated analyses modify this simple view by allowing for the interactions between interest rates, exchange rates and international capital movements, but the relatively stark contrast between the implications of the two regimes tends to be maintained.*

(5) *Such excess demand can arise as a result of an increase in the relative size of the public sector, even if this does not involve a deficit in the public accounts. It can also arise from an overrapid expansion of domestic credit leading to the growth rate of the money supply seriously outrunning the growth rate of the economy's ability to produce. In the absence of any direct influence by the Government over the creation of credit, the eventual adjustment to a sustainable growth rate may be seriously delayed.*

result, under a fixed exchange rate regime, from a deficit in the balance of payments.

13 Given the problems of being linked to one currency while others are floating, and of choosing a suitable and acceptable currency to be linked to, we have no option but to have the Hong Kong dollar floating relative to all other currencies. However, it does not necessarily follow that the best course of action is to allow changes in the exchange value of the Hong Kong dollar to be the main mechanism through which the adjustment process operates. In an open economy as dependent on external trade as Hong Kong, and given the fact that demand for imports in Hong Kong is price inelastic—because we are so dependent on imports—the exchange rate changes required to correct large deficits in the balance of trade may be very large indeed. They may be even unacceptably large in terms of their inflationary impact on the domestic prices of imported goods and, indeed, on the internal cost/price structure generally.

14 A depreciation of the exchange value of the Hong Kong dollar would not improve the competitiveness of domestic exports if, at the same time as the Hong Kong dollar cost of imports increased, the other elements in the cost of production also increased to the same extent. As these other cost components are mostly wages and profits, what is needed for a depreciation to be fully effective in restoring the competitiveness of domestic exports is for labour costs and/or profit margins to be flexible downwards⁽⁶⁾ at least in real terms. In the mature phase of the upswing, when the labour market is tight, the extent to which reductions in labour costs, on the one hand, and a squeezing of profit margins, on the other, assist the adjustment process will be reduced. Thus, it may be appropriate, in the case of such an economy as ours, particularly at present, to seek to spread the burden of the adjustment process by bringing into play other mechanisms.

(b) *Role of Government policy*

(i) *General*

15 Before considering what these might be, and the one which springs immediately to mind is interest rates, I must review the role of Government policy in the way the economy develops and in the way the adjustment process operates. This role has always been more limited than in many, perhaps most, other economies, but it is still of some significance.

(6) *Historically, the flexibility of Hong Kong's cost/price structure has largely been a consequence of three inter-related factors. First, the determination of wages has been largely a function of the forces of supply and demand. Hence, money wages are relatively less rigid downwards here than elsewhere. Secondly, the supply of labour here is relatively wage elastic. However, this may be changing. Thirdly, the labour force is mobile, both geographically and between, and within, industry sectors.*

Experience elsewhere suggests that, as the overall standard of living improves, workers' attitudes change. Also, as industries tend to use more capital-intensive and/or skill-intensive techniques, the labour force may become less mobile. If this were to happen here the result would be a less flexible cost/price structure.

16 Through its social and other policies, as well as its direct role as an employer, the Government strongly influences how the labour market operates. Through Government expenditure it influences the pressure of demand and the distribution of resources within the economy. Through the provision of infrastructural facilities, it contributes directly to the productive capacity of the economy. Through its policy on land production and disposal it has an influence on the availability and price of land. Finally, through the regulation of certain markets, and its influence on other markets, and the taking of such decisions as the decision to allow the Hong Kong dollar to float, the Government alters both the environment within which the adjustment process operates and the form of the mechanism itself.

(ii) *Social and related policies*

17 The Government must weigh carefully the possible effects of public policy decisions aimed at bettering the social conditions of our labour force on the efficiency of the adjustment process. On the one hand, Hong Kong's continuing economic prosperity requires that, whenever possible, the flexibility of the cost/price structure and the mobility of resources are preserved. On the other hand, such decisions may have a tendency unintentionally to reduce that flexibility and mobility. As a consequence, the Government may have to take more positive steps to help the operation of the adjustment process to offset any deterioration that may have taken place in the efficiency of its operation flowing from the implementation of social policies.

(iii) *Government as an employer*

18 The Government *directly* employs almost 6% of all employees in Hong Kong⁽⁷⁾ making it the largest single employer and, although formally, Civil Service salaries and conditions of service are determined by comparisons with salaries in the private sector, there can be no doubt employers in the private sector make comparisons with the Civil Service. Thus there is, in practice, a degree of inflationary leapfrogging, particularly under conditions of labour shortage.

(iv) *Government expenditure*

19 Because of the extremely open nature of the Hong Kong economy, the scope for using changes in Government expenditure as a means of altering the growth rate of the economy is more limited than in most other economies. An increase or a decrease in the growth rate of Government expenditure will be limited in its effect on the level of domestic demand because of the high import content of such demand but, to the extent that domestic demand would, as a consequence, grow more rapidly or more slowly, an increase or a decrease will tend to alter the growth rate of GDP.

(7) *In the third quarter of 1978, employment in the Civil Service was 117,835 and total employment in the economy was 2,003,000, so that 5.9% of employees were employed in the Civil Service.*

20 Should the growth rate of Government expenditure increase during the mature phase of an upswing, not only will this add to the pressure of demand, particularly if it tends to be concentrated in a particular sector of the economy, such as the building and construction sector, but also it may distort the cost/price structure and attract resources away from other sectors.

21 Although the Government's capital works programmes are essential to the growth rate of the economy in the medium and longer term, their impact in the short-term on the market for the output of the building and construction industry can be considerable and this is particularly so when their relative importance is growing rapidly. In terms of both employment⁽⁸⁾ and expenditure⁽⁹⁾, the public sector (defined here in national accounts terms and therefore inclusion of the Mass Transit Railway project) now absorbs about half of total output.

22 If a rapid increase in the public sector's demand for the output of the building and construction industry leads to an increase in the work-load of that industry, it is likely to have a disproportionate effect on prices and the demand for resources⁽¹⁰⁾. This is because, as virtually all machinery must be imported, increased investment in machinery to meet an upsurge in demand takes time to organize, and because the supply of suitably skilled labour is limited. Apart from the higher wages required to attract additional labour, that labour will be unskilled, at least initially and, because of lower productivity, its employment will raise labour costs per unit of output. Although in most markets in Hong Kong, there is some restraint on the rate of increase of prices imposed by competition from imported products, the nature of the building and construction industry ensures that prices for its

(8) *Number of manual workers on building and construction sites:*

<i>In September</i>	<i>Public(*)</i>	<i>(MTR)</i>	<i>Private</i>	<i>Total</i>	<i>Public/Total</i>
					<i>(%)</i>
1976	16,019	(3,442)	28,829	45,848	34.9
1977	27,761	(6,937)	32,879	60,640	45.8
1978	34,808	(7,275)	33,163	67,971	51.2

Note: (*) *Including MTR.*

(9) *Expenditure on building and construction at current prices (\$ million):*

	<i>Public(*)</i>	<i>(MTR)</i>	<i>Private</i>	<i>Total</i>	<i>Public/Total</i>
					<i>(%)</i>
1976	1,815	(646)	2,548	4,363	41.6
1977(**)	2,815	(1,382)	3,489	6,304	44.7
1978(***)	4,194	(1,876)	4,345	8,539	49.1

Notes: (*) *Including MTR.*

(**) *Provisional estimates.*

(***) *Preliminary estimates.*

(10) *In any market, where one buyer has a dominant role, that buyer's expenditure will have an important influence on the prices charged by the suppliers and the prices they can offer to attract resources. If total demand for the suppliers' output is close to their total capacity to supply, any increase in demand will tend to raise prices and/or increase the amount of resources absorbed by this industry. The distribution of these effects will depend on how specialized the resources required are and, in the short run, on the rate at which total demand is increased.*

output are protected from such competition. Thus, the public sector has a dominant influence in an industry which is largely protected from competition from imports, and in which the prices received for its output and the prices paid for its labour inputs will tend to feed through to the rest of the economy. Also, decisions on whether or not to award contracts for public works projects are not taken on purely financial grounds and, therefore, the constraining influence of price increases is limited.

(v) *Land policy*

23 The market for land is another area in which the Government's influence is marked and this has been a source of comment, especially recently, as the Government is virtually the only source of *new* land for industrial, commercial or residential purposes. The Government is not, however, and this is often forgotten, the *only* source of land. Land already in private hands is continuously being sold for redevelopment. Nevertheless, the Government does have an important influence on the land market. We have generally attempted to exercise that influence in a largely non-interventionist manner, disposing of land to the highest bidder in the belief that this will ensure its most efficient use. But, of course, the Government has inevitably influenced land prices by the rate at which land has been produced, the proportion of land produced which has had to be reserved for public housing and GIC use and, to a lesser extent, by the special payment terms offered to buyers of industrial sites and of large commercial/residential sites.

24 The recent rapid increases in land prices, particularly in the urban areas, reflect not only the fact that the supply of land is limited, but also our recent prosperity and the view currently being taken about the future. The best response to rising land prices is the provision of more land and the Government was able to feed more land on to the market this year 1978-79 than I had thought possible⁽¹¹⁾; and we expect to make available increasing quantities of land in the coming year⁽¹²⁾. However, as most of this land will be in the New Towns, the increased supply may have only a limited influence on land prices in the main urban areas.

(vi) *Regulation of markets*

25 Finally, the Government is committed to ensuring that markets generally are allowed to respond freely to competitive forces, but within certain constraints and ground rules. Of particular relevance in this context at present is the Government's attitude towards the financial services sector. Here I think three considerations are central: *first*, the need to ensure that the financial services sector assists the growth of the economy and does not hinder it; *secondly*, the need to provide the users of financial services with some protection, particularly where they can be affected by circumstances in which,

(11) See *f.n. (98) below*.

(12) See *Annex (1)*.

however intelligent they may be, they cannot be protected to protect themselves; and *thirdly*, the need to protect Hong Kong's reputation as a financial centre.

26 There are a number of current issues in this field, such as the determination of interest rates and the minimum liquidity requirements to be observed by deposit-taking companies. But here I would only mention the question of the unification of the stock exchanges.

27 The main functions of a stock exchange are, *first*, to provide a means of raising capital for industry and commerce; and, *secondly*, to provide a market in which investors can deal in the securities that are issued as a consequence of the first function. These functions involve an exchange in a responsibility to those who have committed their funds to the market by way of investment and to those who wish to invest. In particular, investors must be satisfied that adequate information about listed companies is available and that the conduct of listed companies and those connected with listed companies is subject to effective regulation; that the conduct of members of a stock exchange is subject to effective regulation; and that the stock exchange itself is conducted efficiently.

28 Hong Kong is unusual in having as many as four exchanges. Most cities with a significant stock market have a single exchange; and the fact that Hong Kong has four has not had a reassuring effect on investors generally and has hampered the development of international confidence in the stock market here⁽¹³⁾.

29 So, for some time now, Government policy has favoured unification, preferably arranged by the exchanges themselves. I reported their progress towards this end in answer to a question in this Council on 15 February 1978. I said there had been 'considerable discussion and some agreement ... but as yet nothing (had) actually happened on the ground ... however I said I (hoped) that shortly we should see tangible evidence that the exchanges (would) be unified'. I am bound to say that no further 'tangible evidence' has been forthcoming.

(13) *Three weaknesses stemming from having four exchanges spring immediately to mind:*

- (a) *the fact that the four exchanges are in competition for company quotations tends to lead them to adopt a flexible interpretation of their own listing rules. This is in the interests neither of the securities industry nor of investors;*
- (b) *the Commissioner for Securities and the committees of the stock exchanges have greater difficulty in regulating the conduct of members of the four exchanges than they would have if there was only one exchange;*
- (c) *one exchange could be run more efficiently and economically than four exchanges and could make use of more sophisticated means of trading, including electronic data processing. The market itself would be less volatile in that brokers would not be able to indulge in arbitrage between exchanges; it would provide a better service and improved protection for investors in Hong Kong and overseas in that the more unified the market the greater its liquidity; and, with unified rules and procedures, it would be a more attractive market for overseas investors for whom the present fragmented structure acts as a disincentive.*

30 In the circumstances, the Securities Commission has advised that legislation to bring about unification, formulated as far as possible with the advice and agreement of the stock exchanges, should be introduced; and Executive Council has now advised that such legislation should be drafted. Accordingly, a bill will be introduced into this Council later this session.

(2) *Course of the Adjustment Process, 1972 to 1978*

(a) *Introduction*

31 Although it is difficult empirically to match the economy's actual performance⁽¹⁴⁾ with the theoretical framework⁽¹⁵⁾, it is important to try to do so in order to predict what is likely to happen next and to take a view on how the Government might influence events, not that any direct analogies can be drawn between the present situation and past experience. From now on until the time being unless I state otherwise I shall be speaking in real (or constant price) terms.

(b) *Under a fixed exchange rate regime, 1972 to 1974*

32 In 1973 there was a superficially similar situation to our present situation. The growth rate of GDP at 14% was more rapid than in 1978, the growth rate of domestic demand⁽¹⁶⁾ at 15% was greater than that of exports of goods at 12%, and much greater than that of *domestic* exports of goods at 7%. The rate of increase of prices was rapid⁽¹⁷⁾, and the balance of trade

(14) *Annual growth rates (%) in real terms of:*

	Private consumption expenditure	Domestic demand	Exports of goods	Total final demand	Imports Of goods	GDP	GDP deflator	Consumer prices
1972	4.2	4.6	7.2	5.7	3.8	7.2	7.4	6.1
1973	15.1	15.0	12.2	13.8	9.9	14.2	11.4	18.2
1974	0.8	1.1	-9.4	-3.4	-10.0	2.2	12.2	14.4
1975	3.6	2.5	5.9	3.8	4.0	2.9	2.7	2.7
1976	12.6	13.0	28.0	19.1	24.6	16.7	8.6	3.4
1977(*)	15.6	17.2	5.4	12.0	7.9	11.9	3.8	5.8
1978(**)	15.9	16.1	14.4	15.4	22.1	10.0	5.6	5.9

Notes: (*) *Based on provisional estimates.*

(**) *Based on preliminary estimates.*

General Notes: *The treatment of trade aggregates in the national accounts differs from that in the trade accounts (see f.ns. (32), (34) and (51)).*

(15) *A major difficulty in adapting this pure theory so that it provides a usable theoretical framework for understanding what is actually happening in an economy at any point in time is that the adjustment process never takes place smoothly and instantaneously. That is to say, under both exchange rate regimes, the speed and efficiency with which the adjustment process operates to restore equilibrium will depend, in addition to the factors already mentioned, upon the competitiveness of the various markets which make up the economy, the absence of distortions (caused, for example, by public policy decisions) and the mobility of resources. For example, consider a situation in which the level of domestic demand is such as to lead to a substantial widening of the trade deficit: this may continue for some time even after exchange rate has depreciated.*

(16) *That is, private consumption expenditure, Government consumption expenditure and gross domestic fixed capital formation.*

(17) *Change over previous year (%) of:*

	Consumer prices	GDP deflator
1972	6.1	7.4
1973	18.2	11.4
1974	14.4	12.2

was moving further into deficit⁽¹⁸⁾. However, the similarity between the situation in 1973 and that of today is not complete. The growth rate of domestic demand was only slightly higher than that of total final demand⁽¹⁹⁾. The growth rate of GDP was actually greater than that of total final demand and the growth rate of imports was less than that of either the GDP or total final demand, suggesting that the economy was still enjoying a margin of surplus capacity.

33 Further, domestic price increases were more a consequence of increases in world prices than of domestic pressures on the cost/price structure. Similarly, the trade deficit did not widen very much and such widening as did occur was the consequence of a slight deterioration in the terms of trade rather than of imports growing faster than exports⁽²⁰⁾.

34 Thus, the problems facing the economy at the end of 1973 were less severe than those facing it today and there were signs that it was adjusting to such problems as had emerged. Interest rates were raised five times between March and September 1973⁽²¹⁾. Thereafter the slow down in world trade and the increases in crude oil prices in October 1973 and January 1974 combined to widen the trade deficit. As one would expect under a fixed exchange rate regime, these developments reduced the money supply⁽²²⁾.

(18) Trade deficit (\$ million):

	<i>Exports of goods</i>	<i>Imports of goods</i>	<i>Trade deficit</i>
1972	19,400	21,764	2,364
1973	25,999	29,005	3,006
1974	30,036	34,120	4,084

(19) That is, domestic demand plus exports of goods.

(20) Unit value indexes (1973=100):

	<i>Domestic exports</i>	<i>Imports</i>	<i>Terms of trade</i>
1972	85	84	101
1973	100	100	100
1974	121	131	92

(21) The Best Lending Rate was increased from 7% where it had been since 15 October 1971 to 9¾%; and the rate paid by principal banks on three months fixed deposits was increased from 4½% to 8%.

(22) Money supply (\$ million):

	<i>M1(*)</i>	<i>M2</i>
End January 1973	15,241	30,525
End June 1973	11,881	27,697
End September 1973	11,555	27,881
End December 1973	11,761	29,329
End June 1974	12,129	32,007
End October 1974(**)	12,013	33,178(***)
End December 1974	11,370	34,207

Notes: (*) Old series.

(**) That is, before the Hong Kong dollar was floated.

(***) The picture here was distorted by capital inflows caused by political changes in South East Asia. Nevertheless, compared with the growth rates of GDP in money terms of 27.2% in 1973 and 14.7% in 1974, the small changes in the money supply are significant.

and led to a slowing down of the growth rate of the economy in 1974 to 2%.

(c) *Under a floating exchange rate regime, 1975 to 1978*

(i) *1975 and 1976*

35 Led by a rapid growth rate of exports which started in the third quarter of 1975, the economy then began to recover from the recession⁽²³⁾. As a result, in 1975 as a whole, the growth rate of total final demand exceeded the growth rate of GDP and so the growth rate of imports accelerated from —10% in 1974 to +4% in 1975. This was not because of any shortage of productive capacity, but largely because of the extra imports of materials⁽²⁴⁾ needed to enable production to be increased. With the trade deficit narrowing⁽²⁵⁾ and the Hong Kong dollar floating, the effective exchange rate strengthened slightly over the year⁽²⁶⁾.

36 In 1976, the growth rate of GDP accelerated in line with an export-led acceleration in the growth rate of total final demand. Indicative of an above average level of stock building and, possibly of the emergence of some domestic supply bottlenecks, the growth rate of imports was much greater than that of either total final demand or GDP. A further indication of supply bottlenecks was a rapid rise in export prices⁽²⁷⁾.

37 Despite the rapid growth rate of imports, the more rapid growth rate of domestic exports, combined with an improvement in the terms of trade⁽²⁷⁾,

(23) *Quantum index of domestic exports to all countries (1973=100):*

	1974	1975	1976
<i>Q1</i>	93	81	113
<i>Q2</i>	103	96	128
<i>Q3</i>	102	111	139
<i>Q4</i>	88	110	137

(24) *Quantum index of imports (1973=100):*

	1974	1975	% change
<i>All imports</i>	90	93	3.3
<i>Foodstuffs</i>	94	100	6.4
<i>Consumer goods</i>	87	85	—2.3
<i>Fuels</i>	103	96	—6.8
<i>Raw materials</i>	87	94	8.0
<i>Capital goods</i>	97	97	—

(25) *Visible trade (\$ million):*

	<i>Exports of goods</i>	<i>Imports of goods</i>	<i>Trade deficit</i>
1974	30,036	34,120	4,084
1975	29,832	33,472	3,640

(26) *As measured by the trade weighted exchange rate index of the Hong Kong dollar (18 December 1971=100):*

<i>End December 1974</i>	105.9
<i>End December 1975</i>	107.4

(27) *Unit value indexes (1973=100):*

	<i>Domestic exports</i>	<i>Imports</i>	<i>Terms of trade</i>
1975	117	124	94
1976	129	129	100

resulted in both the trade deficit narrowing⁽²⁸⁾ and the exchange rate appreciating⁽²⁹⁾ further.

(ii) 1977 (*Provisional estimate of GDP*)

38 Sir, I now turn to the second post-recession year, 1977, and here I shall combine my analysis of the course of the adjustment process with a discussion of the provisional estimates of expenditure on the GDP in 1977⁽³⁰⁾.

39 At current prices, the provisional estimate of expenditure on the *gross domestic product* in 1977 is \$54,836 million. At constant prices this represents a growth rate of 12% over the final estimate of GDP for 1976. Although less than the rapid growth rate of 17% achieved in 1976⁽³¹⁾, it is still significantly higher than the average annual growth rate for the five years 1972 to 1976 of 8.5%.

40 Taking each component of expenditure on the GDP in turn: the growth rate of *private consumption expenditure* accelerated from 13% in 1976 to 16% in 1977, being partly influenced by the rapid growth rate of GDP in 1976. The growth rate of *Government consumption expenditure* also accelerated from 8% in 1976 to 13% in 1977. As the post-recession building and construction boom got underway, coinciding with large investment outlays on transport equipment and construction machinery, the growth rate of *gross domestic fixed capital formation* was 25% in 1977, compared with 16% in 1976.

(28) *Visible trade (\$ million):*

	<i>Exports of goods</i>	<i>Imports of goods</i>	<i>Trade deficit</i>
1975		29,832	3,640
1976	41,557	43,293	1,736

(29) *Trade weighted exchange rate index of the Hong Kong dollar (18 December 1971=100):*

<i>End December 1975</i>	107.4
<i>End December 1976</i>	114.4

(30) *Various estimates of GDP are published from the forecast released in the budget speech to the final estimate published in the half-yearly Economic Report for the following year. Thus:*

<i>Forecast</i>	<i>Budget Speech, 1979</i>
<i>Revised forecast</i>	<i>Speech by the Financial Secretary at a public function around September, 1979</i>
<i>Preliminary</i>	<i>Budget Speech and Economic Background, 1980</i>
<i>Revised preliminary</i>	<i>Half-Yearly Economic Report, 1980</i>
<i>Provisional</i>	<i>Budget Speech and Economic Background, 1981</i>
<i>Final</i>	<i>Half-Yearly Economic Report, 1981</i>

The latest estimates of expenditure on the gross domestic product are as follows:

	<i>At current prices</i>		<i>At constant (1966) prices</i>	
	<i>\$ mn</i>	<i>% increase</i>	<i>\$ mn</i>	<i>% increase</i>
1976 (<i>final</i>)	47,226	26.7	23,608	16.7
1977 (<i>provisional</i>)	54,836	16.1	26,415	11.9
1978 (<i>preliminary</i>)	63,686	16.1	29,061	10.0

(31) *This was the second highest growth rate since 1961, the first year for which official GDP estimates are available. The highest growth rate (18.3%) was recorded in 1965.*

41 In contrast with these high growth rates of the three components of domestic demand, the growth rate of *exports of goods*⁽³²⁾ decelerated from 28% in 1976 to a little more than 5% in 1977. This was chiefly the result of unexpectedly depressed demand for textiles and clothing in the EEC, and occurred despite a continued depreciation of the Hong Kong dollar throughout the year⁽³³⁾. Reflecting the state of total final demand, especially export demand, the growth rate of *imports of goods*⁽³⁴⁾ also slowed down from 25% in 1976 to 8% in 1977.

42 In line with the rapid growth rate of private consumption expenditure, *consumer prices*, as measured by the Consumer Price Index (A) increased by 6% in 1977 over 1976, compared with rather more than 3% in 1976 over 1975. The slowing down of the growth rate of exports between 1976 and 1977 meant that there was only limited scope for exporters to increase their prices despite the depreciation of the Hong Kong dollar⁽³⁵⁾. The rate of increase in the prices of domestic exports fell from 10% in 1976 to 2% in 1977 and, as the rate of increase in import prices remained unchanged at 4%, the terms of trade shifted slightly against us⁽³⁶⁾. This resulted in the rate of increase in the general price level, as measured by the GDP deflator, falling from rather less than 9% in 1976 to 4% only in 1977.

43 Thus, in 1977, the growth rate of total final demand fell to 12% and GDP grew at the same rate. On the face of it, this could be taken as an indication that the economy was in a state of internal equilibrium, but two factors indicated that this was not so and the situation was not sustainable. The growth rate of GDP at 12% was accompanied by an acceleration in the rate of increase of consumer prices and was only achieved by a fall in unemployment⁽³⁷⁾. Further, at rather more than 5%, the growth rate of exports had fallen very sharply and was less than that of imports at 8%

(32) *Exports of goods, as defined in the national accounts, consists of merchandise exports and re-exports and expenditure in Hong Kong of foreign airline and shipping companies on fuel oils.*

(33) *Trade weighted exchange rate index of the Hong Kong dollar (18 December 1971=100):*

<i>End December 1976</i>	114.4
<i>End December 1977</i>	106.6

(34) *Imports of goods, as defined in the national accounts, consist of merchandise imports (including a percentage of retained imports of gold) and import of water.*

(35) *The export weighted exchange rate index (18 December 1971=100) fell from 118 at the end of December 1976 to 112.5 at the end of December 1977.*

(36) *Unit value indexes (1973=100):*

	<i>Domestic exports</i>	<i>Imports</i>	<i>Terms of trade</i>
1976	129	129	100
1977	132	134	99

(37) *Unemployed persons as a percentage of the labour force:*

<i>March 1976:</i>	5.6
<i>September 1976:</i>	4.6
<i>March 1977:</i>	4.5
<i>September 1977:</i>	4.1

and, as a result, the trade deficit widened⁽³⁸⁾. The depreciation of the Hong Kong dollar⁽³⁹⁾ reflected this and was the first step towards correcting what in fact was a state of external disequilibrium.

44 However, the growth rates of total final demand and of GDP continued to exceed the growth rate of the economy's productive potential and thus were contributing to the widening of the trade deficit. At the same time, the growth rate of the money supply continued to be rapid⁽⁴⁰⁾, much more rapid than the growth rate of GDP in money terms⁽⁴¹⁾. This discrepancy between the growth rate of the money supply and the growth rate of GDP at current prices or in money term can be partly explained by the change in the composition of total final demand⁽⁴²⁾; and, at the same time, it must have been the case that the process of credit creation was helping to sustain the rapid growth rate of domestic demand. But the economy had yet to experience the full impact of the rapid growth rate of credit creation which had been encouraged by the reduction in interest rates during 1977⁽⁴³⁾.

(iii) 1978 (Preliminary estimate of GDP)

45 This was the background against which I made my forecast of expenditure on the GDP in 1978 in last year's budget speech⁽⁴⁴⁾ and I shall now review that forecast in the light of the preliminary estimates which are now available⁽⁴⁵⁾, taking each component of expenditure in turn.

46 Last year, I said that there appeared to be little doubt that the growth rate of *private consumption expenditure* would slow down in 1978 to about 10%. But this did not happen: the preliminary estimate shows that private

(38) *Visible trade* (\$ million):

	<i>Exports of goods</i>	<i>Imports of goods</i>	<i>Trade deficit</i>
1976	41,557	43,293	1,736
1977	44,833	48,701	3,868

(39) *Trade weighted exchange rate index of the Hong Kong dollar* (18 December 1971=100):

<i>End December 1976</i>	114.4
<i>End June 1977</i>	112.3
<i>End December 1977</i>	106.6

(40) *Money supply* (\$ million):

	<i>M1</i>	<i>%increase</i>	<i>M2</i>	<i>% increase</i>
<i>End December 1976</i>	14,050	23.1	48,413	21.0
<i>End December 1977</i>	18,082	28.7	58,451	20.7

(41) *GDP* (at current prices):

	<i>\$ mn</i>	<i>% increase</i>
1976	47,226	26.7
1977	54,836	16.1

(42) See f.n. (14) above.

(43) The Best Lending Rate was 6% up to 8 January 1977, when it was reduced to 5½%. On 14 April 1977, it was further reduced to 4¾%.

(44) B.S., 1978, paras. 39-54.

(45) For full details, see Tables 1.1—1.3 in 1979-80 Budget: Economic Background.

consumption expenditure continued to grow as rapidly as in 1977, that is to say, at 16%⁽⁴⁶⁾.

47 Last year, I estimated that the growth rate of *Government consumption expenditure* on goods and services, as defined for national accounts purposes, would be 14%⁽⁴⁷⁾. At 15%, the preliminary estimate for 1978 is slightly higher than this.

48 Last year, I forecast that the growth rate of expenditure on *gross domestic fixed capital formation* would be 15%. The preliminary estimate is 17%. The difference is largely the result of higher than expected investment in plant and machinery: 13% as opposed to the forecast of 10%. I took the view, incorrectly as it turned out, that manufacturers' plans to expand capacity would be affected by what I thought would be a somewhat uncertain trading environment.

49 My forecasts for investment in building and construction have proved to be reasonably accurate. I forecast a growth rate of about 20%. The preliminary estimate is for a growth rate of 19% made up of a growth rate of construction employment of about 14% and of productivity of about 5%. But I under-estimated the extent to which there would be a further shift in the proportion of the output of the building and construction industry which would be absorbed by the public sector. This proportion now stands at 49%, compared with 45% in 1977 and 28% in 1972⁽⁴⁸⁾.

50 I was wide of the mark in my forecast of the growth rate of (total) *exports of goods*, the preliminary estimate being 14% compared with my forecast of 6%. The preliminary estimate of the growth rate of domestic exports is almost 11% which is more than double my forecast of 5%. The difference is the result of unexpectedly high growth rates of domestic exports to the Federal Republic of Germany and to the United Kingdom⁽⁴⁹⁾, thanks to an acceleration of consumer demand in these markets coupled

(46) *Partly due to expenditure on household furnishings and equipment being at a high level as completions of flats by the private and public sectors were well up on 1977; and another factor of some importance was purchases by Hong Kong residents of durable consumer goods for gifts to relatives in China following upon some relaxation of Chinese customs regulations.*

(47) *This estimate was derived from the Draft Estimates for 1978-79 (Consolidated Account: Recurrent).*

(48) *Growth rates of expenditure on building and construction (%):*

	1976	1977	1978
<i>Private sector</i>	13	25	10
<i>Public sector</i>	15	42	31

(49) *Growth rates of domestic exports (%) to:*

	1977	1978 forecast	1978 Preliminary
<i>United States</i>	18	6	7
<i>Federal Republic of Germany</i>	—13	4	13
<i>United Kingdom</i>	—8	3	18
<i>Total domestic exports</i>	5	5	11

with the substantial depreciation of the Hong Kong dollar against the deutschemark and sterling during 1977 and 1978⁽⁵⁰⁾.

51 I also under-estimated the growth rate of re-exports. My forecast was 8%, but the preliminary estimate of the actual outturn⁽⁵¹⁾ shows 26%. Similar dramatic surges in the re-export trade have been experienced in the past, but have not been sustained. Although it is still too early to say whether the growth in 1978 will be maintained, it may well be that this particular surge is a more permanent manifestation of Hong Kong's reemerging role as an entrepot based on our modern and efficient port facilities and our growing importance as a financial and communications centre.

52 At 9% I was also wide of the mark in my forecast of the growth rate of *imports of goods*. The preliminary estimate is 22%. This difference reflects the extent to which my forecasts of the growth rate of private consumption expenditure, of investment in plant and machinery, and of exports⁽⁵²⁾. This difference reflects the extent to which any forecast of those components of GDP were too low. I shall explain the significance of this difference shortly.

53 Although there are large differences between the forecasts of growth rates given in last year's budget speech for some of the components of expenditure on GDP and the growth rates shown in the preliminary estimates, the preliminary estimate of expenditure on the *gross domestic product* as a whole at current prices is \$63,700 million and this is virtually the same as my forecast of \$63,500 million. This represents a growth rate of 16% which is a little less than my forecast of 17% because, instead of the slight strengthening I forecast for the terms of trade, there was actually a slight deterioration. At constant (1966) prices, the preliminary estimate is \$29,100 million, compared with my forecast of \$28,800 million. This represents a growth rate of 10%, which is at the upper end of the range of 8% to 10% for growth in real term which I forecast this time last year.

(50) *Depreciation of Hong Kong dollars (%) against:*

	1977	1978
<i>Deutschemark</i>	10	17
<i>Sterling</i>	10	9

(51) *In estimating the growth rate of re-exports in real terms in the national accounts, the value of re-exports is deflated by the unit value index of imports. The reason why import prices are used instead of re-export prices is that, in doing so, changes in re-export margins can be taken into account implicitly. When the unit value index of re-exports is used as the deflator, as is the case in the analysis of the trade statistics in the Economic Background, the growth rate in 1978 becomes 21%. The national accounts estimate of re-exports also includes a small element of re-exports of fuel oil, which does not come into the trade statistics. This is derived from estimates of expenditure in Hong Kong of foreign airlines and shipping companies on fuel oils.*

(52) *Quantum index of imports (1973=100):*

	1976	% change	1977	% change	1978	% change
<i>All imports</i>	116	24.7	125	7.6	152	21.9
<i>Foodstuffs</i>	107	7.0	112	4.9	119	6.2
<i>Consumer goods</i>	109	28.2	126	15.1	165	32.2
<i>Fuels</i>	115	19.8	124	7.8	129	4.6
<i>Raw materials</i>	124	31.9	129	3.3	162	26.1
<i>Capital goods</i>	114	17.5	129	13.3	151	17.0

54 Turning to *prices*, all consumer price indexes⁽⁵³⁾ and the preliminary estimates of the GDP deflator show an increase of about 6% in 1978. The fact that this is more or less the same as my forecast of 5% for consumer goods and 7% for the GDP deflator is, I regret to say, quite accidental.

55 The reasons for this are as follows: as a matter of convenience, I assumed that the exchange value of the Hong Kong dollar would be stable during 1978; but, in practice, the Hong Kong dollar depreciated by 13%⁽⁵⁴⁾. The bulk of this depreciation was against the currencies of the countries from which we buy most of our imports. So, despite lower world prices of primary commodities in 1978 compared with 1977, the Hong Kong dollar import prices of food, raw materials and semi-manufactures increased. In the case of consumer goods, as world prices were increasing, the increases in the Hong Kong dollar prices were fairly rapid. But it does not appear that these increases have been transmitted in full into retail prices of consumer goods⁽⁵⁵⁾, the increases in the consumer goods components of the consumer price indexes being relatively modest. Nevertheless, an increase of about 6% in import prices was higher than the 4% I forecast. With the increase in export prices estimated to be about 5% (as forecast) there was a deterioration in the terms of trade but, as I have said, the GDP deflator only increased by 6% instead of my forecast of 7%.

(iv) *Implications of differences between the forecast of GDP in 1978 and the preliminary estimate*

56 An analysis of the reasons for these differences between my forecast of expenditure on the GDP in 1978 and the preliminary estimate of the GDP in 1978 is very necessary for an understanding of the likely future course of the adjustment process.

57 I under-estimated the growth rate of total final demand in 1978. I under-estimated the growth rate of private domestic demand in 1978⁽⁵⁶⁾, because I did not fully appreciate the implications of a switch from a fixed

(53) *Increase in 1978 over 1977 (%)*:

<i>CPI (A)</i>	5.9
<i>CPI (B)</i>	5.9
<i>Hang Seng Index</i>	5.7

(54) *Trade weighted exchange rate index of the Hong Kong dollar (18 December 1971=100)*:

<i>End December 1977</i>	106.6
<i>End December 1978</i>	93.2

(55) *For a detailed analysis see 1979-80 Budget: Economic Background, Chapter 6. But, briefly:*

	<i>Import unit value index of consumer goods(*)</i>	<i>Consumer goods component of CPI (A)(**)</i>
<i>1977 Q4</i>	116	114
<i>1978 Q1</i>	118	116
<i>Q2</i>	122	118
<i>Q3</i>	125	120
<i>Q4</i>	128	122

Notes:(*) 1973=100.

(**) July 1973-June 1974=100.

(56) *That is, private consumption expenditure plus gross domestic fixed capital formation by the private sector.*

to a floating exchange rate regime for domestic credit creation. Under a fixed exchange rate regime, the widening of the trade deficit to a record figure of \$9,147 million would have had powerful repercussions on the banks' ability to extend credit which, in turn, would have dampened down private domestic demand. This is not the case under a floating exchange rate regime. I also under-estimated the extent to which the growth rate of exports would increase. This increased growth was partly due to the improvement in our export competitiveness as a result of the continuing depreciation of the Hong Kong dollar. Having under-estimated the growth rate of total final demand, I consequently under-estimated the growth rate of imports and thus the widening trade deficit and the depreciation of the exchange value of the Hong Kong dollar (although other factors were influential at times during the year such as the demand for US dollars for gold arbitrage transactions which were not wholly unwound).

58 The more rapid than expected growth rates of exports and of private domestic demand meant that, in the 1978-79 budget, I over-estimated the volume of domestic resources that could be made available to the public sector without putting domestic sources of supply under strain, as reflected in the record low level of unemployment. Although output, as measured by the GDP, grew rather more rapidly than I had expected⁽⁵⁷⁾, it did not grow sufficiently rapidly to match the growth rate of final demand and, as a result, there was a disproportionately rapid growth rate of imports⁽⁵⁸⁾.

59 Despite the large trade deficit, the growth rate of the money supply showed little sign of being constrained until towards the end of the year and the overall growth rate was rapid⁽⁵⁹⁾. Interest rates were increased

(57) As reflected in the number of unemployed persons as a percentage of the labour force:

September 1977:	4.1(*)
March 1978 :	3.0
September 1978:	2.7(*)

Note: (*) Gross of school leavers.

(58) See f.n. (14) above.

(59) Money supply:

	\$ mn	% increase over previous quarter	% increase over a year ago
M1(*)			
1977 Q4	18,082	6.5	28.7
1978 Q1	18,169	0.5	25.1
Q2	19,348	6.5	22.9
Q3	22,025	13.8	29.7
Q4	22,281	1.2	23.2
M2(**)			
1977 Q4	58,451	7.3	20.7
1978 Q1	61,819	5.8	23.3
Q2	66,297	7.2	25.9
Q3	70,869	6.9	30.1
Q4	73,406(***)	3.6	25.6

Notes: (*) M1 = notes and coins in the hands of the non-bank public plus current account deposits with banks.

(**) M2 = M1 plus savings and time deposits with banks.

(***) M3 = M2 plus deposit liabilities of deposit-taking companies to the public less claims by deposit-taking companies on banks and less deposit-taking companies' holdings of notes and coins. On the basis of returns submitted for the first time by 241 deposit-taking companies for 31 December 1978, M3=\$77,088 million.

several times during the year⁽⁶⁰⁾ but, so far, the growth rate of loans and advances has not been affected and, indeed, is still accelerating⁽⁶¹⁾; over 1978 as a whole the increase in loans and advances by banks accounted for 107% of the increase in M2, compared with 73% in 1977 and 53% in 1976, in which years net acquisitions of foreign currency assets were relatively more important.

60 Sir, I warned Honourable Members on 16 November last that there was 'a very real threat ... (of) an inflationary situation ... developing'. Statistics that have become available since then confirm this prognostication and, indeed, the rate at which prices are increasing is accelerating. Consumer prices in the third and fourth quarters of 1978 increased by 6% and rather more than 8% compared respectively with the same quarters in 1977. The rate of increase in the labour and materials cost index for the building and construction industry accelerated from 16% in the third quarter of 1978 over the third quarter of 1977 to about 20% in the fourth quarter of 1978 over the fourth quarter of 1977, which I must have been affecting the cost/price structure of the economy as a whole. Prices of imported raw materials and semi-manufactures in the third and fourth quarters of 1978 increased by 4% and 9% respectively compared with the same quarters in 1977⁽⁶²⁾. Partly reflecting this faster rate of increase in the prices of raw materials and partly reflecting higher prices as a result of the shortage of domestic resources,

(60) *The Best Lending Rate was increased from 4¾% to 5½% on 1 May, to 6% on 17 July to 7¼% on 30 October and to 8¾% on 9 November 1978; and the rate paid by principal banks on three months fixed deposits was increased from 1¾% to 4½% over the same period.*

(61) *Loans and advances in Hong Kong:*

	\$ mn	% increase over previous quarter	% increase over a year ago
1977 Q4	36,856	9.2	25.0
1978 Q1	39,833	8.1	28.3
Q2	42,640	7.0	28.8
Q3	46,476	9.0	37.7
Q4	52,814(*)	13.6	43.4(**)

Notes: (*) *Net loans by deposit-taking companies in Hong Kong amounted to \$3,584 million at 31 December 1978 (on 6.8% of loans and advances by banks).*

(**) *By categories of borrowers:*

	% increase	C.f. (%)	
		1977	1976
<i>Manufacturing</i>	52	16	26
<i>Transport and transport equipment</i>	43	39	—7
<i>Building and construction</i>	73	34	26
<i>General commerce</i>	31	15	11
<i>Private loans</i>	38	28	24
<i>Others</i>	48	37	29
	<u>43</u>	<u>25</u>	<u>18</u>

(62) *Unit value index of imports of raw materials and semi-manufactures (1973=100):*

	1977	1978
Q1	128	127
Q2	127	130
Q3	128	133
Q4	127	138

export prices increased by 4.5% in the third quarter of 1978 compared with the third quarter of 1977 and then accelerated to 9% in the fourth quarter compared with the fourth quarter of 1977⁽⁶³⁾.

61 The increases in Hong Kong dollar terms of the prices of imports of primary commodities in 1978 were largely caused by the depreciation of the exchange rate rather than by changes in world prices. However, in 1979, price increases arising from the imbalance between the demand for and supply of real resources may be compounded not only by the effect (delayed or otherwise) of the depreciation of the Hong Kong dollar in 1977-78, but also by accelerating world prices of primary commodities⁽⁶⁴⁾ and, of course, oil products⁽⁶⁵⁾. Even under a floating exchange rate regime, the export sector is unlikely to be able to absorb this upward pressure on the cost/price structure as easily as the sector catering for domestic demand. In consequence, the imbalance in the distribution of domestic resources between the two sectors is likely to be aggravated to the disadvantage of the export sector.

62 Thus we entered 1979 with the growth rate of total final demand exceeding the growth rate of the economy's output resulting in a very rapid growth rate of imports. The depreciation of the Hong Kong dollar has had the beneficial effects expected of it on the growth rate of exports, and, indeed, exports may already be growing at a rate faster than can be maintained, *but* the trade deficit continues to widen⁽⁶⁶⁾. The pressure of demand

(63) *Unit value index of domestic exports (1973=100):*

	1977	1978
Q1	131	134
Q2	131	136
Q3	134	140
Q4	132	144

(64) *Prices of primary producers' commodity exports (in US dollars)*

% increase	Agricultural			All commodities
	Food	industrial materials	Metals and minerals	
1977	37	7	7	23
1978	—9	5	2	—4
1979 (forecast)	5	8	10	7

Source: UK National Institute of Economic and Social Research.

(65) *Scheduled increases in the prices of crude oil (and, therefore, the minimum increases likely to be experienced in view of current developments):*

	% increase over previous quarter
1979 Q1	5.0
Q2	3.9
Q3	2.2
Q4	2.7

(66) *The point to be stressed here is that the trade deficit is widening, rather than the actual size of the deficit itself. At 15% the ratio of the trade deficit to total imports in 1978 was, in fact, the same as ten years ago in 1968. The ratio fluctuated between 10% and 15% during the period 1969 to 1975. The surge of exports in 1976 reduced it to an all time low of 4%, after which it doubled to 8% in 1977 and almost doubled again in 1978.*

allied with the depreciation of the exchange rate is resulting in a gradual acceleration of the rate of increase in prices. The growth rate of imports is showing itself resistant to the effects of rising import prices and can probably only be reduced by reducing the pressure of demand. Although the pressure on real incomes implicit in rising prices should eventually bring this about, this may be unacceptably and dangerously delayed as long as domestic credit creation continues at its present rate.

PART II: MANAGEMENT OF THE PUBLIC FINANCES

(1) *General Objectives of Budgetary Policy*

63 Time, and Honourable Members limited patience, do not permit me to analyse in any detail how successful, or otherwise, we have been in recent years in fulfilling the general objectives of budgetary policy which are, *first*, to implement Government policies and programmes; *secondly*, to ensure that the required revenue is raised as equitably as possible as between particular classes and groups of taxpayers; *thirdly*, to minimize any adverse effects of public expenditure and of the fiscal system on the internal cost/price structure of the economy, on the supply of human effort and on private investment decisions; *fourthly*, so to manage the public finances generally as to minimize the extent to which the monetary environment is disturbed; except when, *fifthly*, an objective must be to influence the growth rate of total final demand.

64 Obviously, the emphasis of budgetary policy as between these five objectives will vary from year to year but, whatever the emphasis may be, decisions have to be taken each year in respect of: the relative size of the public sector, appropriately defined⁽⁶⁷⁾; the construction of the expenditure budget itself; the emphasis of fiscal policy; and the rate at which policies and programmes can be implemented having regard to prevailing capacity and other economic considerations. To assist us in this annual decision-making process, we subject our thinking in each of these four areas to the discipline of certain guideline ratios. As it is necessary for an understanding of our present situation to review our performance over the past seven years in terms of these guideline ratios, I make no apology for restating them, albeit briefly.

(2) *Restatement of Budget Guidelines*

(a) *Relative size of the public sector*

65 Given the extent to which the Hong Kong economy is externally oriented and subject, therefore, to volatile conditions in our markets, there is a compelling need to ensure that the relative size of the public sector is

(67) See f.n. (69) below.

such as to leave the private sector as much room as possible to react to changing trading conditions⁽⁶⁸⁾.

66 Quite arbitrarily, but the important thing is to be consistent over time, we define the public sector to include all activities financed from public funds no matter by whom the expenditure is incurred⁽⁶⁹⁾. And, incidentally, as I have stressed on other occasions, the acceptable relative size of the public sector is smaller on the upswing phase of the trade cycle than on the downswing, but it will tend to increase again as the recovery phase matures⁽⁷⁰⁾. This does *not* mean, of course, that the growth rate of public expenditure should not be trimmed back on the downswing as part and parcel of the process of the economy deflating out of trouble or when the pressure of demand is such that a situation of demand-pull inflation is threatened.

(b) Construction of the annual budget

67 The annual budget itself is set in the context of revenue and expenditure trends in the current year and in preceding years and, also, in the context of a forecast of revenue and expenditure over the three years following the budget year. To begin with, an appropriate relationship between the recurrent and capital accounts has to be determined, because the rate at which our recurrent commitments grow in relation to recurrent revenue must be limited in order to secure the financing of the capital account. Our guidelines are that recurrent expenditure should absorb no more than 80% of recurrent revenue and that at least 60% of capital expenditure should be financed by the surplus on recurrent account. Furthermore, an upper limit is set to recurrent expenditure of 70% of total expenditure. But, as the surplus on recurrent account could finance a quantum of capital expenditure which these ratios do not define, separate absolute guideline figures have to be set for the various components of the capital account and these are revised periodically.

68 Next, we take the view that the residual deficit on capital account, if any, should be financed in a certain way, that is to say, at least 50% by capital revenue and no more than 50% by debt although, as it happens,

(68) *In other economies, less dependent on external transactions, there need not be the same emphasis on not diverting resources away from the private sector.*

(69) *That is, expenditure covered by the Consolidated Account, viz: thus expenditure by the Urban Council and the Housing Authority is included and so is expenditure by institutions in the private or quasi-private sector to the extent of their subventions; and the activities of Government departments which are partly financed by charges raised on a commercial basis are also included (eg Kowloon-Canton Railway, Airport, Waterworks). But excluded are those organizations, including even statutory organizations, in which the Government only has an equity position such as the Mass Transit Railway Corporation.*

(70) *When the economy is enjoying strong growth, the relative size of the public sector should fall. It will anyway because the growth rate of public expenditure tends to lag behind the growth rate of the economy on the upswing, but room should be left for the public sector to expand relative to the economy as a whole on the downswing.*

capital revenue has always been more than sufficient to finance the residual deficit without recourse to debt⁽⁷¹⁾.

(c) *Balance of the fiscal system*

69 As regards the financing of expenditure, I have taken the view that the balance of the fiscal system needs to be defined in terms of two ratios: the ratio of direct to indirect taxation (55:45); and the ratio of direct and indirect taxation taken together to all other recurrent revenue (70:30). These ratios serve to remind us of the significance of indirect taxes and fees and charges in our circumstances⁽⁷²⁾. In a low tax environment, and particularly one which is characterised by very high tax thresholds, public services which can be related to individual needs must be charged for wherever possible, provided adequate remission arrangements are available where required.

(d) *Steady progression*

70 But the maintenance of a proper balance between the public sector and the economy as a whole, and the construction of budgets which conform (or do not conform for acceptable reasons) which certain guideline ratios, do not, in themselves, ensure the steady implementation of the Government's policies and programmes. So, we need to have some idea of the rate at which expenditure may be allowed to grow over time in real terms. For the time being, and notwithstanding the need to limit the relative size of the public sector, I have set this rate at 10% which is a little higher than the historical trend growth rate of GDP. In any particular year, the rate may well have to be lower than 10% and it could be higher in others. Indeed, in five of the last seven years the growth rate of expenditure on General Revenue Account has been higher than 10% and higher than the growth rate of GDP⁽⁷³⁾.

(71) *On the only occasion in recent years when it has not been (1974-75), we were able to call upon our fiscal reserves and not resort to debt. But, just in case there is a period of years during which there is a continuous recourse to debt to finance the residual deficit on capital account, I have put on record—admittedly without much logic, as proponents of cost/benefit analysis have been quick to point out—that debt service charges should not, at any time, exceed income earned on our fiscal reserves.*

(72) *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 most indirect taxes and fees and charges are, rightly, and by their very nature, much less so.*

(73) *Annual growth rates in real terms (%):*

	GDP	Expenditure (General Revenue Account)
1972/1972-73	7.2	13.2
1973/1973-74	14.2	18.2
1974/1974-75	2.2	10.2
1975/1975-76	2.9	1.4
1976/1976-77	16.7	3.5
1977/1977-78	11.9	15.8
1978/1978-79	10.0	25.1

(e) *Fiscal reserves*

71 Needless to say, steady, as opposed to erratic, progress is not just a matter of fixing upon a growth rate of expenditure which is practicable and consistent with the need to contain the relative size of the public sector. It also depends on the extent to which we are able to insulate the management of the public finances from short-term deviations from the trend paths of revenue and expenditure. I say this because such deviations should not, ideally, affect the implementation of the Government's policies and programmes or involve adjustments to tax rates and charges. Of course, a sudden change of pace is inevitable in a situation in which the world trading environment shifts adversely; *or* when, perhaps through failure to exercise proper control over expenditure, a risk of persistent deficits emerges; *or* when the growth rate of expenditure has been accelerating and a period of consolidation is desirable (for instance, on administrative grounds); *or* when a situation of demand-pull inflation threatens the ability of the economy to maintain internal and external equilibrium. But situations involving a short-lived tendency for expenditure to exceed revenue or for revenue yields to fall below expectations are best dealt with by having available adequate fiscal reserves.

72 To cope with these situations (in short-term situation), our net fiscal reserves (that is to say, net after allowing for contingent liabilities) should bear a certain relationship to General Revenue Account expenditure. I have taken the view that our net fiscal reserves at the beginning of a financial year should always be sufficient to finance at least 15% of estimated expenditure in that year.

(f) *Summary*

73 In theory, the total effect of our guideline ratios is that, taking one year with another, we should achieve a balance between revenue and expenditure, allowing surpluses to accrue when the economy is growing faster, and revenues flushing, and not seeking to eliminate deficits that arise from a temporary slowing down of the economy's growth rate. In other words, in theory, the impact of General Revenue Account transactions on the growth of the money supply is, on average, neutral (after making due allowance for any necessary additions to our fiscal reserves in line with the growth of expenditure and our contingent liabilities). But this is not necessarily true of the transactions of the public sector as a whole⁽⁷⁴⁾.

(3) *Assessment of Performance, 1972-73 to 1978-79*⁽⁷⁵⁾

74 Having restated our budget guidelines I turn now to an assessment of their application over the seven years, 1972-73 to 1978-79.

(74) *Particularly if the transactions of the Mass Transit Railway Corporation are included within the definition of the public sector for this purpose.*

(75) *For the basic statistics see the tables in Annex (2).*

(a) 1972-73 to 1974-75

75 In each of the three years 1972-73 to 1974-75 budgetary policy sought to ensure that the relative size of the public sector as a whole⁽⁷⁶⁾ responded correctly to the fluctuating course of the economy. The relative size of the public sector was 16.1% in 1972-73 and increased only slightly to 16.4% in 1973-74, as the growth rate of the economy (in real terms, of course) accelerated from 7% in 1972 to 14% in 1973. The relative size of the public sector then increased to 18.8% in 1974-75 as the growth rate of the economy slowed down to between 2-3% in 1974.

76 The annual estimates⁽⁷⁷⁾ in each of these three years were constructed so as not to breach our guidelines. But, while capital expenditure remained fairly close to the estimates⁽⁷⁸⁾, there was a tendency for recurrent expenditure to exceed the estimates in each of the three years⁽⁷⁹⁾ and to grow at a faster rate than recurrent revenue⁽⁸⁰⁾. By 1974-75, recurrent expenditure absorbed more than 80% of recurrent revenue and, as capital expenditure was close to the estimate, the surplus on recurrent account met only 52% of capital expenditure as opposed to at least 60% required by the guideline. As capital revenue did not make up the difference, a deficit was the inevitable result.

77 In real terms, actual total expenditure increased at an average annual growth rate of 14%⁽⁸¹⁾ over this period, which was higher than the steady progression guideline of 10%.

$$(76) \frac{\text{Expenditure on Consolidated Account}^{(*)}}{\text{GDP at current prices}} \times 100$$

Note: (*) See f.n. (69) above.

(77) General Revenue Account.

(78)	Approved Estimates (\$ mn)	Actual Expenditure (\$ mn)
1972-73	1,112	1,081
1973-74	1,369	1,413
1974-75	1,833	1,798

(79)	Approved Estimates (\$ mn)	Actual Expenditure (\$ mn)
1972-73	2,295	2,469
1973-74	2,814	3,231
1974-75	3,632	4,175

(80)	Annual Increases (in money terms)	
	Recurrent Expenditure (%)	Recurrent Revenue (%)
1972-73	25.1	29.8
1973-74	30.9	13.5
1974-75	29.2	13.3

(81)	\$ mn	Annual Increases	
		In money terms (%)	In real terms (%)
1972-73	3,550	30.6	13.2
1973-74	4,644	30.8	18.2
1974-75	5,973	28.6	10.0

(b) 1975-76

78 As we ran into a deficit situation in 1974-75—I budgetted for a surplus of \$98 million, but the outturn was a deficit of \$380 million—and as the economic future looked ominous, the 1975-76 budget sought to trim the growth rate of expenditure (in real terms) back from nearly 20% in 1974-75 to around 7%. In the event, we underspent the cash limits by \$583 million and the deficit I budgetted for of \$431 million was converted into a surplus of \$224 million⁽⁸²⁾. As this was largely due to underspending on capital account, recurrent expenditure, at 74% of total expenditure, exceeded the guideline of 70%. Actual total expenditure in real terms increased by just over 1% only of virtual standstill—and the relative size of the public sector therefore fell back from 18.8% 74/75 to 17.6% 75/76 since the economy's growth rate remained at between 2-3%.

(c) 1976-77 to 1978-79

79 In each of the three post-recession years the emphasis of budgetary strategy changed from containing the relative size of the public sector to attempting to make up for ground lost during the year of the so-called recession budget, 1975-76.

(i) 1976-77

80 In 1976-77 I budgetted for an increase in expenditure of 16%⁽⁸³⁾ (the equivalent of what I believed to be about 10% in real terms) with a view to allowing the relative size of the public sector in this first post-recession year to rise to 20%. I budgetted for a deficit of \$355 million⁽⁸⁴⁾ as I was prepared to see recurrent expenditure absorb a larger proportion of recurrent revenue (and hence to represent a larger proportion of total expenditure) than the guideline ratios permitted. But the economy whipped out of recession earlier and much faster than forecast⁽⁸⁵⁾ with the result that the relative size of the

(82)	<i>Approved Estimates (\$ mn)</i>	<i>Actual Results (\$ mn)</i>
<i>Revenue</i>	6,184	6,256 + 72 mn
<i>Expenditure</i>	6,615	6,032 — 583 mn
<i>Deficit/Surplus</i>	<u>— 431</u>	<u>+ 224</u>
(83)		(\$ mn)
<i>Revised estimates of expenditure in 1975-76</i>		6,222
<i>Approved Estimates, 1976-77</i>		<u>7,212</u>
<i>Increase</i>		<u>990) (=16%)</u>
(84)		(\$ mn)
<i>Revenue</i>		6,857
<i>Expenditure</i>		<u>7,212</u>
<i>Deficit</i>		<u>— 355</u>

(85) *The actual growth rate (in real terms, of course) being nearly 17% as opposed to the forecast of 9%.*

public sector fell back further to 15.6% back from 17.6%. Moreover, we underspent the cash limits by \$621 million (and so actual total expenditure in real terms increased by only 3.5%). As actual revenue exceeded the estimate by \$636 million, we ran an overall surplus of \$902 million⁽⁸⁶⁾. The only guideline breached was the ratio of recurrent expenditure to total expenditure, which was as high as 79%.

(ii) 1977-78 (*Final Accounts*)

81 Thus, when I came to prepare the 1977-78 budget, I sought to lift the level of expenditure to a new plateau: the Approved Estimates envisaged an increase in expenditure of nearly 21% on the revised estimates for 1976-77⁽⁸⁷⁾, the equivalent of what I believed to be about 15% in real terms. However, although actual expenditure at \$8,174 million was very close to the estimate of \$8,245 million, the growth rate of the economy did not slow down as much as I had forecast⁽⁸⁸⁾ with the result that the relative size of the public sector came out at 16.7% as opposed to the 17.6% I had anticipated.

(iii) 1978-79 (*Revised Estimates*)

82 This, combined with the fact that we ran an 'automatic' surplus of \$1,236 million⁽⁸⁹⁾, compared with the surplus I budgetted for of \$30 million, and the concomitant fact that only the guideline relating to the ratio of recurrent expenditure to total expenditure was (again) breached⁽⁹⁰⁾ meant that, when I came to construct the budget for 1978-79 I was, for the third year running, less concerned than perhaps I should have been with purely financial considerations. Thus I budgetted for an increase in expenditure of 26% on the revised estimates for 1977-78⁽⁹¹⁾, the equivalent of what I believed to be about 21% in real terms.

(86)	<i>Approved Estimates (\$ mn)</i>	<i>Actual Results (\$ mn)</i>
<i>Revenue</i>	6,857	7,493 = +636
<i>Expenditure</i>	<u>7,212</u>	<u>6,591 = -621</u>
<i>Deficit/Surplus</i>	<u>- 355</u>	<u>+ 902</u>
(87)		(<i>\$ mn</i>)
<i>Revised estimates of expenditure in 1976-77</i>		6,843
<i>Approved Estimates, 1977-78</i>		<u>8,245</u>
<i>Increase</i>		<u>1,402 (=21%)</u>
(88) <i>The actual growth rate (in real terms) was 12% compared with the forecast of 7%.</i>		
(89) <i>Recurrent revenue was almost sufficient to finance total expenditure of \$8,174 million and thus the surplus on recurrent account was sufficient to finance virtually all our capital expenditure of \$1,955 million.</i>		
(90) <i>At 76% compared with the guideline of 70%.</i>		
(91)		(<i>\$ mn</i>)
<i>Revised estimates of expenditure in 1977-78</i>		8,160
<i>Approved Estimates, 1978-79</i>		<u>10,266</u>
<i>Increase</i>		<u>2,106 (=26%)</u>

83 Effectively, I budgetted for a balance for the second year running: after taking account of my revenue proposals⁽⁹²⁾, the difference between estimated expenditure of \$10,266 million and estimated revenue of \$10,246 million was only \$20 million.

84 The revised estimates of revenue and expenditure for 1978-79 are \$12,374 million and \$11,162 million respectively. Thus the year's operations will result in a surplus of \$1,212 million⁽⁹³⁾. This figure is lower than the estimate of the surplus derived from the Treasury's cash book at 20 February last of \$1,750 million, but I have a feeling that the truth lies somewhere between these two figures and so I shall use a figure of \$1,600 million as my prediction of the surplus when considering our cumulative financial position at 1 April next⁽⁹⁴⁾.

85 In analysing our revenue and expenditure performance this year, I shall have to use the revised estimates as printed. In any case, a surplus of \$1,212 million compared with a \$20 million deficit or surplus I can't remember now that I budgetted before (*laughter*). A surplus of \$1,212 million deserves an explanation, particularly as, if it turns out to be \$1,600 million, it will be the highest on record⁽⁹⁵⁾. For the second year running the surplus is due to a flush of revenue rather than a failure of expenditure⁽⁹⁶⁾. By contrast, in

(92) *At a cost to the revenue of \$120 million: see B.S., 1978, paras. 195-222.*

(93)	\$ mn		\$ mn	
	O/AE	RE	O/AE	RE
<i>Recurrent Account:</i>				
Revenue	9,010	9,932	—	—
Expenditure	7,323	7,444	+1,687	+2,488
<i>Capital Account:</i>				
Revenue	1,236	2,442	—	—
Expenditure	2,943	3,718	-1,707	-1,276
Overall Deficit/Surplus	—	—	— 20	+1,212

Notes: O/AE = Original/Approved Estimates.

RE = Revised Estimates.

(94) Paragraph 98 below. I think the difference between \$1,212 million and \$1,600 million will be equally divided between (increased) revenue and (reduced) expenditure.

(95)	Surplus (\$ mn)	% of total revenue
1976-77	902	12.0
1977-78	1,236	13.1
1978-79 (RE)	1,212	9.8

In the two years affected by the recession, namely, 1974-75 and 1975-76 we incurred a deficit of \$380 million (=6.4% of total expenditure) and a small surplus of \$224 million (=3.6% of total revenue) respectively.

(96)	Revenue (\$ mn)		Expenditure (\$ mn)	
	OE	Actual	AE	Actual
1976-77	6,857	7,493	7,212	6,591
1977-78	8,275	9,410	8,245	8,174
1978-79	10,246	12,374 (RE)	10,266	11,162 (RE)

Notes: OE = Original Estimates.

AE = Approved Estimates.

	Deficit/Surplus (\$ mn)	
	Budget	Actual
1976-77	—355	+ 902
1977-78	+ 30	+1,236
1978-79	— 20	+1,212

1976-77 the turn-round from a budgetted deficit of \$355 million to an actual surplus of \$902 million was almost equally shared between excess revenue and under-spending.

86 At \$12,374 million the revised estimate of *revenue* exceeds the original estimate of \$10,246 million by \$2,128 million, or by 21%.

87 Recurrent revenue is up by a net \$922 million, or by 10% on the original estimate⁽⁹⁷⁾. Capital revenue is up by \$1,206 million, or I regret to say by 98% on the original estimate as premia from land transactions have yielded \$1,166 million more than I expected due to 249 acres of land being sold instead of what I was told was going to be sold of 88 acres⁽⁹⁸⁾; and to land prices being higher than expected⁽⁹⁹⁾ and to pronounced tendency for purchases to pay premia in a lump sum rather than by instalments. Three very good reasons why I was wrong. (*laughter*)

88 At \$11,162 million the revised estimate of *expenditure* is \$896 million, or nearly 9%, up on the approved estimate which is in sharp contrast to experience in recent years when actual expenditure has been below the approved estimates⁽¹⁰⁰⁾.

89 On recurrent account, there is net over-spending of \$121 million largely due to the 1978 salaries revision which cost us \$340 million⁽¹⁰¹⁾.

(97) *Of \$9,010 million. No less than \$385 million of this excess is from Stamp duties: despite a drastic reduction in the number of documents subject to stamp duty, receipts are 97% up on the original estimate due to higher than expected turnover on the stock exchanges, and in the number and value of assignments; interest earnings on Government cash balances and investments are up by \$162 million for obvious reasons; receipts from earnings and profits taxes are up by \$144 million (which is only 4% above the original estimate); motor vehicle taxes have yielded an extra \$89 million (or 54% more than the original estimate, reflecting the boom in personal spending on consumer durables generally); but revenue from dutiable commodities is up by \$24 million only (or by only 3% more than the original estimate). For a detailed analysis of the differences between the revised estimates of revenue and the original estimates see the Memorandum Notes on the Revenue Estimates.*

(98) *In BS, 1978, paragraph 94, I envisaged that 68 acres of non-industrial land and 20 acres of industrial land would be sold. In the event, 63 acres of non-industrial land were sold (26 acres in the urban areas and 37 acres in the New Territories) and no less than 186 acres of industrial land (of which 133 were in the New Territories, including 114 acres of dockyard land in Tsuen Wan).*

(99) *To explain the greater part of this large increase over the original estimate another way: sales of urban lots in 1978-79 and instalments of premia in respect of sales in previous years fetched \$600 million more than expected, while private treaty grants fetched an extra \$376 million; modifications brought in an additional \$121 million.*

(100)	\$ million
1975-76	—583
1976-77	—621
1977-78	—71(*)
(1974-75)	(+508)
Note: (*)	<i>After extracting \$823 million for transfers to the Mass Transit Fund and the Home Ownership Fund for the payment of land premia.</i>

(101) *The fact that net over-spending is not closer to the cost of the salaries revision is due to the fact that the assumptions made regarding the filling of vacant and new posts were not borne out in practice. So the provision inserted in the Approved Estimates proved to be excessive.*

90 On capital account there is net over-spending of \$775 million⁽¹⁰²⁾ which is more than accounted for by over-spending of \$837 million on the two Public Works Programme components of the capital account⁽¹⁰³⁾. Having regard to what I thought was the spending capability of the Public Works Department and the Housing Authority, only \$2,008 million was inserted in the estimates for these two components of the capital account compared with the absolute guideline figure of \$2,530 million⁽¹⁰⁴⁾. In the event, expenditure is likely to be \$2,845 million. Of the excess of \$837 million, \$220 million is to enable total drawings from the Development Loan Fund by the Housing Authority to be increased to \$616 million⁽¹⁰⁵⁾, probably another \$288 million

(102)	<i>Approved Estimates 1978-79 (\$ mn)</i>	<i>Revised Estimates 1978-79 (\$ mn)</i>
<i>Component</i>		
(1) <i>Public Works Programme (other than New Towns and Housing)</i>	858	1,150
(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>	1,150	1,695
(3) <i>Subventions</i>	114	73
(4) <i>UPGC</i>	71	41
(5) <i>Departmental Special Expenditure</i>	201	123
(6) <i>Defence Costs Agreement: Capital Works</i>	29	35
(7) <i>Home Ownership Fund</i>	399	399
(8) <i>Miscellaneous</i>	<u>121</u>	<u>202</u>
	<u>2,943</u>	<u>3,718</u>

Notes: *Capital subventions and capital expenditure by the UPGC are down by \$71 million on the approved estimate of \$185 million owing to slippage. Departmental special expenditure is down by \$78 million on the approved estimate of \$201 million—largely, again, because of delayed deliveries—and the Miscellaneous component is up by \$81 million on the approved estimate of \$121 million because of a new commitment of \$75 million in respect of the re-siting of the Little Sai Wan Communications Centre and a grant of \$20 million to the Urban Council in respect of the 1978 salaries revision.*

(103) *In the first two post-recession years, there was net under-spending on the Public Works Programme components of the capital account, viz:*

	\$ mn
1975-76	—354
1976-77	—474
1977-78	+ 73

(104) *BS, 1978, paragraph 98.*

(105) *Capital expenditure by the Housing Authority in 1978-79 on the rented housing programme and ancillary facilities is likely to be \$709 million financed as follows:*

	\$ mn
<i>Authority's own resources (difference between rent income and running expenses plus premia from commercial lettings)</i>	93
<i>Drawings from Development Loan Fund</i>	<u>616</u>
	<u>709 (*)</u>

Note: (*) *Total capital expenditure on housing=this figure of \$709 million plus \$298 million on the Home Ownership Scheme plus \$162 million by the Public Works Department=\$1,169 million.*

is required for unprovided for cost increases and about \$312 million is required because the Public Works Department were able to let contracts, on authorized projects of course, earlier than anticipated. This improved ability to plan and design projects and bring them forward to the stage when they are ready to be put out to tender is to be welcomed but, of course, there is a limit to the number of contracts which can be in hand at any one time; and the fact that such an exceptionally large number of new contracts have been let this year has certain implications for the number of new contracts which can be let in 1979-80, having regard to the acceptable level of expenditure on capital account generally.

(4) *Summary of Present Position*

(a) *Growth rate of public expenditure and relative size of public sector*

91 To sum up, therefore, I budgetted for an increase in expenditure in 1978-79 of 26% with a view to achieving a growth rate of expenditure in real terms of 21% and thereby bringing the average annual growth rate for the five years 1974-75 to 1978-79, virtually up to the guideline figure of 10%. I believed this could be done without crowding out the private sector, even though I estimated that the relative size of the public sector as a whole would increase from 17.2%, calculated on the basis of the revised estimates for 1977-78 then before me would increase from 17.2%⁽¹⁰⁶⁾, to 18.4%.

92 In the event, the revised estimates of expenditure for 1978-79 on General Revenue Account as opposed to Consolidated Account, envisage an increase in expenditure of the order of 37% in money terms: on recurrent account, the increase is 20%; and on capital account it is 90%. The increase of 37% overall in money terms is the equivalent of 25% in real terms: on recurrent account, the increase is 13% and on capital account it is as high as 67%. So the average annual growth rate of expenditure for the five years 1974-75 to 1978-79 in real terms will be 11%, by *any* standards a remarkable performance. As a consequence, the relative size of the public sector as a whole is likely to increase to 19.6% and, and even though the growth rate of the economy in real terms is, at 10%, relatively healthy, this increase in the relative size of the public sector is contrary to our oft-declared aim of leaving room during the upswing for an increase in the relative size of the public sector on the downswing to enable us to maintain a steady growth rate of expenditure throughout the course of a cycle of activity.

(b) *Budget guidelines*

93 But at least we are not in breach of any of our guidelines relating to the desirable relationship between recurrent and capital expenditure and the role

(106) *The actual percentage turned out to be 16.7%.*

which recurrent revenue should play in the financing of the capital account⁽¹⁰⁷⁾, all this thanks to the buoyancy of both recurrent and capital revenue. But I must stress that the yield from the main item of capital revenue, namely of capital revenue, namely, land sales varies widely and even most unpredictably from year to year. In other words, unlike most items of recurrent revenue which can be forecast, more or less accurately, from trend growth factors, the revenue from land sales depends on such factors as completion dates of development works, the prevailing state of the property market and the extent to which buyers opt for their own somewhat obscure reasons sometimes to pay by instalments. Thus we must not be overly impressed with the figures of outturn for 1978-79.

(c) *Balance of the fiscal system*

94 I explained, Sir, last year⁽¹⁰⁸⁾ that there is now no alternative to a relatively high dependence on direct taxation for the financing of recurrent services and to help finance the deficit on capital account and that this dependence is likely to grow rather than diminish in the future. I, therefore, revised the ratios for assessing the balance of the fiscal system: the ratio of direct to indirect taxation became 55:45 and the ratio of direct and indirect taxation taken together to all other recurrent revenue became 70:30. This did not alter the purpose of these ratios, which is to remind us of the importance of trying to maintain the yield from indirect taxes and from fees and charges.

95 Already we are drifting away from these revised ratios. Just taking the three post-recession years the first ratio has slipped from 55:45 in 1976-77 to 56:44 in 1978-79; and the second ratio has slipped from 72:28 in 1976-77 to 75:25 in 1978-79. I shall return to this gloomy subject in Part IV of this speech.

(d) *Financial position*

96 Turning finally to our cumulative financial position: paradoxically, perhaps, the surge of expenditure in the last two years has not been accompanied by any breaching of the guideline which defines adequate fiscal

(107)		\$ mn	%	Guideline
(1)	$\frac{\text{Recurrent revenue}}{\text{Total expenditure}}$	$\frac{9,932}{11,162}$	= 89	At least 88%
(2)	$\frac{\text{Recurrent expenditure}}{\text{Recurrent revenue}}$	$\frac{7,444}{9,932}$	= 75	No more than 80%
(3)	$\frac{\text{Surplus on recurrent account}}{\text{Capital expenditure}}$	$\frac{2,488}{3,718}$	= 67	At least 60%
(4)	$\frac{\text{Recurrent expenditure}}{\text{Total expenditure}}$	$\frac{7,444}{11,162}$	= 67	No more than 70%
(5)	$\frac{\text{Capital revenue}}{\text{Capital expenditure}}$	$\frac{2,442}{3,718}$	= 66	At least 20%

(108)BS, 1978, paras. 154-159.

reserves, thanks to the way in which revenue (on both recurrent and capital account) has flushed simultaneously with the surge of expenditure⁽¹⁰⁹⁾.

97 Calculating our fiscal reserves on the same basis as at present, that is to say, by reference to the General Revenue Balance only⁽¹¹⁰⁾, and allowing for differences in exchange values and in the book values of fixed interest bearing assets in the relevant period⁽¹¹¹⁾, the following picture emerges⁽¹¹²⁾: our fiscal reserves at the 1 April 1972 represented as much as 85% of budgetted expenditure in 1972-73, but at 1 April 1976 they represented only 39% of budgetted expenditure in 1976-77. When I decided in 1977 that we had to make specific provision to secure our significantly larger contingent liabilities⁽¹¹³⁾, on the basis of a gearing of three, our 'free' reserves stood at \$1,213 million⁽¹¹⁴⁾, or nearly 15% of budgetted expenditure in 1977-78 of \$8,245 million. This 15% was equal to the guideline I then selected. Since then the size of our fiscal reserves improved to \$1,749 million⁽¹¹⁵⁾ or 17% of budgetted expenditure in 1978-79 of \$10,266 million.

98 At the beginning of the financial year ahead of us, I estimate that our fiscal reserves will stand at \$6,549 million⁽¹¹⁶⁾. After allowing, say, \$3,200 million as cover for our formal contingent liabilities (which peak at the

(109)	Revenue (\$ mn)	% increase	Expenditure (\$ mn)	% increase	Surplus/Deficit (\$ mn)
	4,769	40.2	3,550	30.6	+1,219
	5,017	5.2	4,644	30.8	+373
	5,593	11.5	5,973	28.6	—380
	6,256	11.9	6,032	1.0	+224
	7,493	19.8	6,591	9.3	+902
	9,410	25.6	8,174	24.0	+1,236
	12,374	31.5	11,162	36.6	+1,212
(110)	<i>This balance is the excess of the Government's financial assets over its short-term liabilities and is available, if needed, over and above the general revenues of the Colony for appropriation.</i>				
(111)	<i>That is, in the period up to 31 March 1976, since when virtually all the General Accounts foreign currency assets were transferred to the Exchange Fund against interest bearing debt certificates: see B.S., 1976, paras. 75-84. Incidentally, the Hong Kong dollar balances of the General Account over and above the Treasury's current cash requirements are also now held in the Exchange Fund debt certificates in accordance with the concept of the Exchange Fund being effectively banker to the Government.</i>				
(112)			Fiscal Reserves (\$ mn)	Budgetted Expenditure (\$ mn)	(1) as % of (2)
			(1)	(2)	
			2,916	3,407	86
			3,089	4,183	74
			2,809	5,465	51
			2,522	6,615	38
			2,810	7,212	39
(113)	<i>BS, 1977, paragraph 106.</i>				
(114)	<i>Fiscal reserves at 1 April 1977=\$3,713 million, minus \$2,500 million being 1/3rd of contingent liabilities at 31 March 1981 (ie end of the then forecast period) =\$1,213 million.</i>				
(115)	<i>Fiscal reserves at 1 April 1978=\$4,949 million, minus \$3,200 million being 1/3rd of contingent liabilities at 31 March 1982 (ie end of the then forecast period) = \$1,749 million.</i>				
(116)	<i>That is \$4,949 million plus predicted surplus of \$1,600 million =\$6,549 million.</i>				

31 of March 1982 at \$9,700 million falling to \$9,100 million a year later, that is to say at the end of the new forecast period⁽¹¹⁷⁾, after allowing, say, \$3,200 million as cover for our formal contingent liabilities we shall have 'free' reserves of around \$3,350 million to finance our seasonal deficits on General Revenue Account⁽¹¹⁸⁾ and any unexpected short-term difficulties which cannot be—and, indeed, should not be—dealt with by a revision of expenditure authorities or by fiscal measures. Thus our 'free' reserves at 1 April 1979 will be the equivalent of 27% of estimated expenditure next year of \$12,454 million, which is distinctly better than our guideline of 15% of estimated expenditure in the ensuing year. In other words, we are now very well placed to maintain a given level of expenditure if and when a purely financial constraint emerges (and/or emergency situations befall us). By a given level of expenditure, I mean a level necessary for administrative and social reasons and appropriate in terms of the capacity of the economy.

99 The available assets in the Development Loan Fund and the Lotteries Fund are not included in our fiscal reserves for they are committed to approved loan allocations⁽¹¹⁹⁾. Nor are the net proceeds from the sale of our

(117) At 31 March:

	1979	1982	1983
	(\$ mn)	(\$ mn)	(\$ mn)
Guarantees of MTRC debt	2,703	5,868	4,967
Export Credit Insurance Corporation: outstanding amounts	1,680	2,220	2,270
Home Ownership Scheme: guarantees to banks	—	842	989
ADB: uncalled capital	227	463	463
Gold coins	100	170	194
Building and Loan Agency: guaranteed notes	165	165	165
Demonetized currency notes	10	10	10
	<u>4,885</u>	<u>9,738</u>	<u>9,058</u>

(118) These normally peak in October after which EPT receipts begin to flow in.

(119) Available assets in the Development Loan Fund at 1 April 1979 will be \$69 million against outstanding allocations of \$791 million, of which \$395 million is for housing (*), \$11 million for non-profit making schools, \$27 million for loans to students and \$341 million for the Industrial Estates Corporation. As the available assets in the Fund are not sufficient to meet the anticipated calls to be made on the Fund during 1979-80, estimated at \$1,118 million (including a further drawing of \$550.6 million in excess of the approved allocation for the Housing Authority), a sum of \$1,000 million has been entered in the commitment and provision columns under Head 84—Transfers to Funds Subhead 351 Payment to Development Loan Fund. Available assets in the Lotteries Fund at the same date will be \$52 million to which must be added estimated receipts during the year of \$36 million. Payments in 1979-80 against approved and new allocations are likely to be \$41 million, leaving a balance in the Fund of \$47 million at 31 March 1980. Outstanding allocations will amount to \$18 million. However, it is expected that the accumulating surplus in the Fund will be exhausted within the forecast period as a result of increased demand on the Fund's resources in connection with proposals in the Social Welfare White Paper.

Note: (*) Housing Authority (\$316 million for public housing and \$35 million for the commercial elements of the Home Ownership Scheme); Housing Society (\$30 million for the Urban Improvement Scheme); Local Government Officers' Housing Scheme (\$7 million); and Hong Kong Building and Loan Agency Ltd (\$7 million for guaranteed notes).

gold coins: when the accounts for the Year of the Goat coin have been finalized the surplus in the Special Coin Suspense Account is expected to be about \$65 million⁽¹²⁰⁾, and I expect when the Lunar New Year series of gold coins is completed, the surplus in the Suspense Account should exceed \$300 million.

PART III: THE ECONOMY AND THE PUBLIC SECTOR, 1979 TO 1982

(1) Introduction

100 Obviously, Sir, when I came to prepare the 1979-80 budget, one of my main preoccupations was to ensure that the level of public sector expenditure⁽¹²¹⁾ provided for would not be such as further to aggravate the present situation. So I began by asking the econometricians to work out for me the implications for the economy of meeting all departmental demands on General Revenue Account, as revealed by the returns submitted to the Finance Branch in connection with the annual forecasting exercise, *plus* other expenditure provided for in the Consolidated Account.

(2) Forecast of Expenditure, 1979-80 to 1982-83

101 For the purpose of forecasting total expenditure on General Revenue Account for 1979-80 and for the following three years 1980-81 to 1982-83, departments were required to submit returns at the end of July last which distinguished between, on the one hand, commitments in respect of maintaining present services and of expanding them to meet demand at existing standards⁽¹²²⁾ and, on the other hand, new services⁽¹²³⁾. After the returns were submitted, other unavoidable commitments came to light provision for which had to be added in⁽¹²⁴⁾. All the figures were then corrected by Finance Branch for errors and omissions and separately compiled forecasts for the two Public Works Programme components of the capital account were then added in.

102 I shall refrain from offering Honourable Members a detailed analysis of the results of this exercise. Suffice it to say that the exercise threw up total bids for 1979-80 on recurrent account of \$8,720 million and on capital

(120) *As the state of the secondary market clearly indicates that none of the coins will be returned to the Treasury for redemption, this surplus will be progressively available for public purposes and when the series is completed the surplus in the Suspense Account should exceed \$300 million. So far we have earmarked \$13 million for the Morrison Hill Indoor Stadium(*) and \$25 million for the Jubilee Sports Centre at Sha Tin.*

Note: (*) *Of the total cost of \$43.45 million, the balance of \$30.45 million is being financed as follows: General Revenue, \$15.15 million; Urban Council, \$5.3 million; Royal Visit Commemorative Fund, \$10 million.*

(121) *As defined in f.n. (69) above.*

(122) *Appendices I and II referred to in the circular at Annex (3).*

(123) *Appendices III and IV, *ibid.**

(124) *For example, staff for the Immigration Department for the hydrofoil service to Canton.*

account of \$5,600 million representing increases of 17% and 51% in money terms of course respectively on the revised estimates for 1978-79⁽¹²⁵⁾.

103 In order to arrive at figures of cash inputs for an initial forecast of expenditure on the gross domestic product in 1979, estimates of expenditure by the Urban Council and the Housing Authority financed from their own resources and of expenditure charged to existing balances in, and income accruing to, the Development Loan Fund, the Lotteries Fund and the Home Ownership Fund, had to be added on to the forecast of expenditure on General Revenue Account. The cash input figures so calculated were \$9,800 million for recurrent expenditure⁽¹²⁶⁾ and \$6,500 million for capital expenditure⁽¹²⁷⁾, and these two figures together comprise what I call public sector expenditure as a whole.

(3) *Initial Forecast of GDP in 1979*

104 Now, these cash inputs, when converted into national accounts terms and appropriately deflated, imply a growth rate of Government consumption expenditure of 14% in 1979, compared with the preliminary estimate of 15% in 1978, and a growth rate of Government expenditure on building and construction of 30%, compared with 43% in 1978. For convenience, the heroic assumption was made that the exchange rate of the Hong Kong dollar against the US dollar would remain constant throughout 1979. In effect, taking account of the likely changes in 1979 in the exchange value of the US dollar against the currencies of our major trading partners, this assumption implies a further depreciation in the effective exchange rate of the Hong Kong dollar of about 5%. The likely effect on the import prices of oil products of the announcement on the 17th of December last by OPEC relating to crude oil prices in 1979 was also allowed for.

105 This initial forecast exercise yielded the following growth rates for the various components of GDP: private consumption expenditure: 10%, compared with the preliminary estimate of 16% in 1978; gross domestic fixed

(125) *For the three years of the new forecast period the bids came to:*

	<i>Recurrent</i>	<i>Capital</i>	<i>Total</i>
	(\$ mn)	(\$ mn)	(\$ mn)
<i>1980-81</i>	9,661	5,934	15,595
<i>1981-82</i>	10,414	5,549	15,963
<i>1982-83</i>	11,114	5,262	16,376

(126)

<i>General Revenue Account</i>	<i>\$ million</i>
	8,720
<i>Other public sector expenditure</i>	<u>1,067</u>
<i>Total expenditure on Consolidated Account, say</i>	<u><u>9,800</u></u>

(127)

<i>General Revenue Account</i>	<i>\$ million</i>
	5,600
<i>Other public sector expenditure</i>	<u>878</u>
<i>Total expenditure on Consolidated Account, say</i>	<u><u>6,500</u></u>

capital formation: 13%⁽¹²⁸⁾, compared with 17% in 1978; exports of goods: 8%, compared with 14% in 1978; and imports of goods: 11%, compared with 22% in 1978. These growth rates, when combined with the assumed growth rate of Government consumption expenditure of 14%, result in a forecast of the growth rate of total expenditure on the GDP of 8%, compared with 10% in 1978.

106 The implications of this initial forecast are fairly self-evident: *first*, the growth rate of total final demand at 10% exceeds the growth rate of GDP at 8%. As a consequence, the growth rate at which imports are sucked in continues to be very rapid at 11%. *Secondly*, the growth rate of domestic demand at 11% exceeds the growth rate of exports at 8%, involving a relative worsening of the share of resources for exports compared with 1978 (when the growth rates of domestic demand and exports were 16% and 14% respectively). *Thirdly*, within domestic demand there is a further increase in the share of resources used by the public sector (including, of course, the MTR for I am here talking of the public sector in national accounts terms): the growth rate of public sector demand at 17% exceeds the growth rate of private domestic demand at 10%. *Fourthly*, and of critical importance, the growth rate of imports at 11% still exceeds the growth rate of exports at 8%. As a consequence⁽¹²⁹⁾, the visible trade deficit, which had already widened to over \$9,000 million in 1978 continues to widen. *Fifthly*, such a further widening is almost certainly inconsistent with the original assumption that the exchange rate of the Hong Kong dollar against the US dollar remains stable, although it is consistent⁽¹³⁰⁾ with the implicit assumption of a further depreciation in the effective exchange rate of the Hong Kong dollar. The original assumption *could* be validated in circumstances in which there was a widening of the invisible trade surplus and/or substantial capital inflows. But, on balance, there is likely to be continuing downward pressure on the exchange value of the Hong Kong dollar. *Sixthly*, with the growth rate of total final demand continuing to exceed the growth rate of GDP, the imbalance between the demand for, and the supply of, domestic resources is likely to persist, with certain consequences for the rate at which prices increase. Even on the basis of the optimistic assumption about the exchange value of the Hong Kong dollar, this initial forecast, which takes into account also the likely changes in world prices in 1979, shows an acceleration in the rates of increase of prices. For example, the forecast rates of increase in the prices of imports and exports fall within the range of 8% to 10%. These rates of increase are roughly in line with the trends which became apparent

(128) *Based in part on the assumed growth rate of Government expenditure on building and construction of 30%. When the intentions of the Mass Transit Railway Corporation and private sector demands on the building and construction industry are allowed for, together with a forecast for investment in plant and machinery by the economy as a whole, the forecast for expenditure on this component (g.d.f.c.f.) works out at 13%.*

(129) *And with a forecast of no change in the terms of trade.*

(130) *At least in direction, if not in magnitude.*

towards the end of 1978. The forecast for the consumer price index shows a rate of increase of 10% and that for the GDP deflator shows a rate of increase of 11%. No doubt these rates of increase would be even higher if, in addition, the Hong Kong dollar depreciated against the US dollar.

107 Clearly, the economy cannot be allowed to develop this way in 1979. If the present pattern and the growth rate of demand is allowed to continue to distort the structure of the economy, both the magnitude and the duration of the subsequent adjustment is likely to be very painful indeed in terms of its consequences for individuals. And before this adjustment takes place, continuing inflation will erode the real incomes of many groups within the community.

(4) *Emphasis of Budgetary Policy in 1979-80*

108 So, in these circumstances, the emphasis of budgetary policy in 1979-80 must be to slow down the growth rate of total final demand in order to bring it more into line with the growth rate of the economy's output⁽¹³¹⁾ and to do this in such a way as to facilitate a relative shift and resources in favour of exports. This requires us: *first*, inasmuch as it is a component of domestic demand, to slow down the growth rate of Government expenditure, thereby preventing the relative size of the public sector as a whole increasing and, ideally, reducing it below the present record high of 19.6%⁽¹³²⁾; *secondly*, so to arrange the slow down in the growth rate of Government expenditure as to minimize the distortions within individual markets (*eg* the market for the output of the building and construction industry); and *thirdly*, to constrain the growth rate of private domestic demand by reducing the growth rate of the money supply in the hands of the non-bank private sector.

(5) *Acceptable Expenditure Limits for 1979-80*

109 So I asked the Finance Branch to calculate the level of vote provision required, *first*, to maintain our existing services and to expand them as necessary to meet demand at present standards, *secondly*, to provide for some new services, to meet contractual commitments in respect of on-going

(131) *Fifth objective in paragraph 63 above.*

(132)	Annual increases in real terms (%):		Relative size of public sector $(\frac{CA}{GDP} \times 100)$
	GDP	CA Expenditure	
1972/1972-73	7.2	13.6	16.1
1973/1973-74	14.2	17.7	16.4
1974/1974-75	2.2	12.0	18.8
1975/1975-76	2.9	—0.2	17.6
1976/1976-77	16.7	6.0	15.6
1977/1977-78	11.9	16.4	16.7
1978/1978-79	10.0(*)	24.9(**)	19.6

Notes: (*) *Preliminary estimate.*

(**) *Revised estimate.*

contracts⁽¹³³⁾ and, *thirdly*, to let new contracts for projects which we are obliged, for various reasons⁽¹³⁴⁾, to complete by certain dates.

110 As regards *recurrent expenditure*: for the maintenance of existing services and their expansion to meet demand at present standards, I took the view that they could be adequately provided for within a figure of \$8,050 million. Heads of departments were then advised to prepare their Draft Estimates submissions for existing recurrent services within this figure.

111 Having regard to the likely outturn for 1978-79, the likely size of the capital account in 1979-80 and several policy decisions in the social services field, in particular in relation to the White Paper on Senior Secondary and Tertiary Education, I took the view that some \$150 million could be afforded for new proposals contained in the forecast returns for 1979-80. Following advice from the Chief Secretary's Committee, certain departments were invited to submit subsidiary estimates for those high priority proposals for new services caught within this figure of \$150 million. The total acceptable limit for recurrent expenditure thus became \$8,200 million. The total of departmental estimates submissions came to \$8,667 million. Careful pruning by Finance Branch reduced this, with the agreement of departments, to \$8,160 million. It was a very amicable process. By agreement, this figure was reduced to \$8,160 million, (*laughter*) which was \$40 million below the limit I had set. To this figure, I added myself \$200 million to cover additional commitments⁽¹³⁵⁾, likely to arise during the year and at present unforeseen but not additional commitments of any substantial nature. To this figure, I added \$200 million to cover additional commitments which might arise during the year making the total estimate for recurrent expenditure of \$8,360 million.

112 As regards *capital expenditure*: Finance Branch took as their starting point the guideline figure of \$3,100 million⁽¹³⁶⁾. This implied expenditure of \$2,600 million on the two Public Works Programme components of the capital account, including transfers from General Revenue to the Development Loan Fund for on-lending to the Housing Authority, leaving \$500 million for all other components. Another \$400 million had to be added on

(133) *Including the letting of new contracts for projects which are 'linked' for technical, economic or financial reasons to these contracts.*

(134) *That is, for socio-political reasons, eg housing and dangerous slopes; on account of public commitments which have led to decisions by other organizations, eg Sha Tin Hospital; by virtue of contractual obligations, eg HQ British Forces; or as inevitable consequences of the Government's support of infrastructural projects undertaken by other organizations, eg MTRC and HKIEC.*

(135) *Already I am aware of possible calls on this subhead amounting to about \$80 million. If the proposals concerned, which were included in the forecast submissions, and accorded a high priority by the Chief Secretary's Committee, had been processed in time they might well have been included in the relevant heads of the Draft Estimates. But they were not in a form to enable this to be done.*

(136) *This is an updated version of the absolute guideline figure of \$2,790 million set in 1977 for the second year of the then forecast period (see BS, 1977, paragraph 99).*

to cover other inescapable commitments, mainly in respect of increased compensation payments for land resumptions in the New Territories⁽¹³⁷⁾. In the event, and taking into account the financial implications of a serious bunching of public works projects, and the Housing Authority's construction programme, a figure of \$3,599 million had to be inserted in the Draft Estimates in respect of the two Public Works Programme components of the capital account (including a transfer of \$1,000 million from General Revenue to the Development Loan Fund for on-lending to the Housing Authority). For all other components of the capital account, departmental submissions came to \$744 million which, after scrutiny by the Finance Branch, was reduced to \$495 million, or within \$5 million of the guideline figure. Thus the total estimate for capital expenditure came out at \$4,094 million.

(6) *Final Forecast of GDP in 1979*⁽¹³⁸⁾

(a) *Cash inputs and assumptions*

113 After combining these estimates of recurrent and capital expenditure on General Revenue Account with estimates for other public sector expenditure, the cash input figures used for a final forecast of expenditure on the gross domestic product in 1979 became \$9,427 million⁽¹³⁹⁾ and \$4,972 million respectively for recurrent and capital expenditure⁽¹⁴⁰⁾. When converted into national accounts terms and appropriately deflated, these cash inputs imply a growth rate of Government consumption expenditure of 9% in 1979 and of Government expenditure on building and construction of 4%, compared

(137) *Under the revised Letter B scheme approved by Finance Committee on 5 July 1978: see paragraph 142 below and Annex (4).*

(138) *The details are at Annex (5). This forecast (and the initial forecast) has been derived from: first, a crude econometric model designed to forecast trade aggregates. The model consists of 34 equations relating relevant economic aggregates of Hong Kong's major trading partners with Hong Kong's trade aggregates. Because of the lack of historical data, the specifications and the quality of some of the equations in the model are not satisfactory; and, because the system of equations is not fully articulated, the results thrown up may not agree with the original assumptions put in. Secondly, results from another simple income determination model which is built upon two functional relationships: between private consumption expenditure and GDP and between imports and GDP. When Government consumption expenditure, gross domestic fixed capital formation and exports are exogenously determined, a forecast of GDP can be arrived at. Thirdly, results from a survey of economic prospects conducted by the Census and Statistics Department. At the end of the day, personal judgments are invoked to qualify the end products of these statistical calculations.*

(139)		\$ mn
	General Revenue Account	8,360
	Other public sector expenditure	<u>1,067</u>
	Total expenditure on Consolidated Account	<u><u>9,427</u></u>

(140)		\$ mn
	General Revenue Account	4,094
	Other public sector expenditure	<u>878</u>
	Total expenditure on Consolidated Account	<u><u>4,972</u></u>

with the growth rates of 14% and 30% respectively used in the initial forecast. Apart from these changes, the assumptions used in the initial forecast were also used for this final forecast. To the extent that the growth rate of total final demand is reduced, the assumption that the exchange rate of the Hong Kong dollar against the US dollar will remain constant throughout 1979 is that much more reasonable. So, taking each of the other components of expenditure on the GDP, in turn, I shall now give my final forecast; and I should say here that reductions in the growth rates of the various components in the final forecast compared with the initial forecast arise as a consequence of the slower growth rate of Government expenditure defined in terms of the consolidated account.

(b) Private consumption expenditure

114 As far as the determination of private consumption expenditure is concerned, in Hong Kong the major influence is income; but also important, at least in the short-run, are the effects of wealth and of credit availability. The so-called 'wealth effect' results in people spending more on consumption the wealthier they feel. Thus, if, for example, the index of share prices rises, holders of shares will feel better off and spend more, even if they do not realize their capital gains. A similar effect will influence the owners of property in periods when property prices are rising. As regards credit availability, the more easily and cheaply credit is available, particularly in real terms, the greater consumption expenditure is likely to be. As cheap credit will be associated with low interest rates (sometimes negative interest rates in real terms) on savings, there will tend to be, at the same time, a lower propensity to save.

115 In arriving at the forecast for the growth rate of private consumption expenditure, it was assumed that both the 'wealth effect' and the effect of credit availability would be neutral (despite the further increase in interest rates effective from 2 January 1979⁽¹⁴¹⁾). By this, I mean no sharp appreciation or depreciation of financial and fixed assets held by consumers and a growth rate of the money supply roughly consistent with the growth rate of the economy in money terms, as measured by the growth rate of GDP at current prices. The forecast for the growth rate of private consumption expenditure is now about 9%, compared with 10% in the initial forecast.

(c) Gross domestic fixed capital formation

116 The growth rate of investment in plant and machinery in 1979 will be around 8%. This represents a slowing down when compared with the growth rate of 13% achieved in 1978 and is lower than the initial forecast of 9% in 1979. As regards the comparison with 1978, *first*, the fact that the growth

(141) *The Best Lending Rate was increased from 8¾% to 9½% and the rate paid by the principal banks on three months fixed deposits was increased from 4½% to 5¼%. The latest increase in the Best Lending Rate to 10½% effective from 19 February was announced after the forecast had been completed.*

rates of investment in plant and machinery in the past three years have been significantly higher than the trend growth rate of 7% for the seven years 1972 to 1978, suggests a slowing down is likely in 1979, particularly as, *secondly*, the growth rate of GDP is not expected to be as high as in 1978. But, *thirdly*, there is a likelihood of increases in imports of transport equipment.

117 As for investment in building and construction by the private sector, although a better balance between supply and demand is generally expected in the property market, in particular in residential property, so that building starts in terms of floor area may fall in 1979, the rapid increase in the volume of work arising from projects already started in 1977 and in 1978 will still entail a high level of activity in 1979. Against this background and having regard, on the one hand, to the revised growth rate of public sector demand on the building and construction industry (including here the intentions of the Mass Transit Railway Corporation). Against this background and having regard, on the one hand, to the revised growth rate of public sector demand on the building and construction industry of 7% and, on the other hand, to the possibility of further expansion in the capacity of the industry, a growth rate of 12% may be possible in private investment in building and construction.

118 So, as far as total investment in building and construction is concerned, the final forecast is for a growth rate of about 10%, probably made up of a 5% growth rate in building and construction employment and a 5% growth rate in productivity. Combining this with the forecast of investment in plant and machinery, the final forecast for the growth rate of gross domestic fixed capital formation is 9%, compared with 13% in the initial forecast.

(d) *Exports*⁽¹⁴²⁾

119 Turning now to exports: the growth rate of domestic exports to the *United States* in 1979 is likely to be affected by the mixed economic prospects in this market and the constraints we have been obliged to accept on our exports of textiles and clothing. The outcome of the recent negotiations sought by the United States to modify the bilateral agreement entered into in 1977, provides an additional threat. So I forecast a slowing down in the growth rate of Hong Kong's domestic exports to this market to about 5% (c.f. 1978: 7%). In contrast, order books suggest that domestic exports to the *Federal Republic of Germany* may be rather buoyant in 1979, particularly during the first half of the year. For the second half of the year, there is

(142) *Distribution of domestic exports by main markets in 1978:*

<i>Market</i>	<i>\$ mn</i>	<i>% of total</i>
<i>US</i>	<i>15,125</i>	<i>37.1</i>
<i>Germany</i>	<i>4,426</i>	<i>10.9</i>
<i>UK</i>	<i>3,871</i>	<i>9.5</i>
<i>Japan</i>	<i>1,856</i>	<i>4.6</i>
<i>Rest of world</i>	<i>15,433</i>	<i>37.9</i>
<i>Total</i>	<i>40,711</i>	<i>100.0</i>

some uncertainty about prospects in this market because, for certain key items of clothing and textiles, quotas may, by then, have been exhausted. Nevertheless, it appears that a growth rate of about 10% may be possible (c.f. 1978: 14%). Our domestic exports to the *United Kingdom* face much the same problem, except that the likely growth rate of demand in this market appears to be less rapid. On balance, I feel that a forecast of a growth rate of about 7% is reasonable (c.f. 1978: 18%). My forecast for the growth rate of domestic exports to the *rest of the world* is 8% (c.f. 1978: 12%), giving a final forecast for the growth rate of domestic exports overall of 7% (c.f. 1978: 11%) which compares with an actual out-turn of 17% in 1978.

120 With my forecast for the growth rate of re-exports at 12%, which compares with the out-turn for 1978 of 27%, the final forecast for the growth rate of exports of goods for total exports is 8%, which compares with final out-turn for 1978 of 14%. This final forecast involves no change from my initial forecast. But there is a possibility that the slower growth rate forecast for domestic demand may relieve, somewhat, the upward pressure on the domestic cost/price structure and, at the same time, result in a depreciation of exchange rate the effective exchange rate smaller than that assumed. Although the extent to which the effects are likely to offset each other is difficult to determine, the net outcome may be that domestic exports will remain as competitive in 1979 as they were in 1978, thus leading to a rather better performance than I am now forecasting. But, in view of the inevitable leads and lags in the adjustment process, I do not think it is necessary to alter the forecast.

(e) *Imports*

121 The growth rate of imports that is consistent with the final forecasts for the other components of GDP becomes 10% compared with 11% in the initial forecast, and I might add of 22% in 1978.

(f) *Total expenditure on GDP*

122 After making due allowance for exports *less* imports of services and for adjustments to stocks, the final forecast for the growth rate of GDP is 7% compared with 8% in the initial forecast. Thus the final forecast of GDP at constant (1966) prices is \$31,160 million.

123 Although the final forecast is an improvement on the initial forecast, its implications are still unsatisfactory in terms of the necessary emphasis of budgetary policy in 1979-80. *First*, the growth rate of total final demand at rather less than 9% exceeds the growth rate of GDP at 7%. As a consequence, the growth rate at which imports are sucked in continues to be rapid at 10%. *Secondly*, the growth rate of domestic demand at 9% exceeds the growth rate of exports at 8%: this is an improvement on the initial forecast, but it still represents a relative worsening in the share of resources going to exports compared with 1978. But, *thirdly*, within domestic demand there is actually

a slight decrease in the share of resources used by the public sector (including the MTR): compared with the growth rate in the initial forecast of 17% and 10% respectively, the growth rate of public sector demand at 8% is less than the growth rate of private domestic demand at 9%. *Fourthly*, the growth rate of imports at 10% still exceeds the growth rate of exports at 8%: as a consequence although, again, there is an improvement on the initial forecast, the visible trade deficit continues to widen. *Fifthly*, as a result of the trade deficit widening less than in the initial forecast and with the growth rate of total final demand being reduced from 10% in the initial forecast to under 9%, the downward pressure on the exchange value of the Hong Kong dollar should be less. But the terms of trade may deteriorate slightly⁽¹⁴³⁾. *Sixthly*, with the growth rate of total final demand still in excess of the growth rate of GDP, the imbalance between the demand for, and the supply of, domestic resources still persists. But, with some slackening of the pressure of demand on resources, the rate of increase in prices should be less than shown in the initial forecast.

(g) *Prices*

124 Consumer prices should show a rate of increase of about 9% compared with 10% in the initial forecast, but the GDP deflator should show a rate of increase of only 8% compared with 11% in the initial forecast⁽¹⁴⁴⁾. This implies a forecast of the growth rate of GDP at current prices of just under 16% (c.f. 1978: 16%) bringing it to a value of \$73,600 million.

(h) *Conclusion*

125 So, as a result of reducing the growth rate of Government expenditure, this final forecast represents an improvement over the initial forecast, particularly as regards the implied threat of inflation. But there is still a need for a further restraint of domestic demand before the growth rate of the economy is sustainable particularly in respect of the trade deficit and I shall revert to this subject in Part V of this speech.

(7) *Outlook for the Economy in the Forecast Period, 1980 to 1982*

(a) *Protectionism*

126 Turning now to the outlook for the economy in the forecast period, 1980 to 1982: last year⁽¹⁴⁵⁾, I drew attention to the threat to the longer term prospects for our economy of the shift to protectionism that was apparent in our major markets. In 1978, quotas for certain key clothing products to major markets were exhausted before the end of the quota year. As the growth rates for quotas permitted in the present agreements are low, quotas are likely to constrain the growth rate of exports of textiles and clothing in

(143) *Depending on the course of export prices.*

(144) *This is a very useful reduction, but it is still higher than the average annual rate of increase of 7% for the seven years 1972 to 1978.*

(145) *BS, 1978, paras. 56-58.*

the years to come, even if world trade continues to expand and the terms of existing agreements remain unaltered; and I do not need to remind Honourable Members that textiles and clothing still constitute around 45-50% of the total value of our domestic exports⁽¹⁴⁶⁾. Although there was no substantial tightening of restrictions during 1978, there are very few signs that protectionist pressures are easing. Indeed, there are some signs that the likely consequence of the tariff reductions which emerge from the present Multilateral Trade Negotiations will be yet further moves towards yet further quantitative restrictions. This is despite the fact that a number of studies have shown that the impact on the levels of output and employment in the economies of our major markets of imports from, say, Hong Kong, is significantly less important than other factors⁽¹⁴⁷⁾.

(b) Anti-inflationary policies of overseas governments

127 The fear of accelerating inflation causing the United States to adopt less expansionary policies and relatively little evidence that unemployment levels in OECD countries will be reduced, add support to the view that there is little likelihood that the strength of protectionist sentiments will lessen. The series of price increases for crude oil presently scheduled by OPEC, and any other increases over and above these, made the adoption of reflationary policies even less likely. Thus, we face a situation in which the growth rate of world trade in manufactures will be no more than 6% compared with the trend growth rate of 9% experienced from the mid-1960s to the mid-1970s at a time when we shall be severely restricted in the extent to which we are allowed to take advantage of such growth as there is.

(c) Advisory Committee on Diversification

128 One response by the Government to the shift to protectionism, but within the context of our general commitment to the market-based free enterprise system, was the setting up of the Advisory Committee on Diversification. It was initially hoped that the Committee would have reported to you, Sir, by now, but the task you set us has proved to be very time-consuming, and has had to be fitted in with other pre-occupations. Two of the six sub-committees on country studies, vocational education and training, land, industrial development, financial facilities, and shipping, two of these sub-committees have now completed their reports and the other four will complete theirs shortly. I hope the Advisory Committee will assemble its ideas during the next few months and report to you, Sir, in definitive terms, by this Autumn.

(146) Textiles and clothing as a percentage of total domestic exports by value:

	%
1976	53
1977	47
1978	44.5

(147) Such as imports from other developed countries and increased productivity in the importing countries.

(d) *Economic relations with China*

129 One development which is only just getting underway but which appears to have significant implications for Hong Kong's economy is the change in the relationship of China's economy with the rest of the world. I do not intend to speculate here on the direct and indirect implications for the pattern of our domestic exports of China's emergence as an exporter of light manufactures. I would only point out that, to the extent that China's international trade expands, Hong Kong's role as an entrepot must tend to expand. Hong Kong is ideally situated as a port for China and as a base for those doing business with China. Thus the shift in the relative importance of the tertiary services sector in our GDP that has been such a feature of our diversifying economy in the 1970s, can be expected to continue and, even, accelerate.

(e) *Immigration*

130 The present medium population projection, based on the 1976 By-Census, envisages an average annual growth rate of the population over the period 1976 to 1986 of 1.5% compared with an actual growth rate of 1.8% over the period 1966 to 1976. Thus the expectation was that the growth rate of the population of working age would decline from 3.1% a year to just over 2% a year between these two ten-year periods. However, the 1976 population projection was based on an assumption that the rate of net immigration would be only 12,000 a year, which is *very* much lower than the estimated net intake of 33,000 in 1977 and of 96,000 in 1978. These figures are seen in a very worrying perspective if one compares them with the figures of natural increase of 56,500 in 1977 and 56,900 in 1978. Furthermore, our present expectation must be for a very large number of immigrants in 1979 also. If the present high level of net immigration is maintained for any length of time, and on the basis of certain assumptions about the demographic characteristics of immigrants and labour participation rates, the effect will be to raise the growth rate of the labour force itself. But this is not an unmixed blessing even in economic terms (and I am, of course, not over-looking the grave social and other implications of the present rate of net immigration not just from China, but potentially from elsewhere as well; and already, of course, we have over 15,000 refugees held on boats and in camps pending determination of their future).

(f) *Trend growth rate*

131 Although these historic developments relating to China should benefit Hong Kong in the long run, neither they nor the present high rate of net immigration seem likely to affect the growth rate of productivity⁽¹⁴⁸⁾ in the forecast period, 1980 to 1982, very much. Thus, a higher growth rate of the labour force will raise the growth rate of the productive potential of the economy and could help to maintain, in the forecast period, the trend growth

(148) *That is GDP per head of the employed labour force.*

rate of GDP experienced so far in the 1970s of about 9% (on the basis of all sorts of assumptions, of course, about the future course of world trade). But I do *not* rate our chances of maintaining the present rate of improvement in real living standards (of which real GDP *per capita* is an inadequate measure) I do not rate our chances of maintaining the present rate of improvement in real living standards over the next few years very highly in the face of the multiplicity of pressures caused by further increases in the population such as we experienced in 1978, of 3.4%, the highest increase by far since 1962; and this is what I meant when I said that the effect of net immigration on the growth rate of the labour force is not an unmixed blessing even in economic terms.

4.45pm

HIS EXCELLENCY THE PRESIDENT:—Perhaps at this point, Members might like a short break. Council will resume in 10 minutes.

5.00pm

HIS EXCELLENCY THE PRESIDENT:—Council will resume, Financial Secretary.

THE FINANCIAL SECRETARY:

PART IV: THE BUDGET FOR 1979-80

(1) Introduction

132 Sir, before returning to the question of slowing down the growth rate of total final demand—which, as I have said, must be the main emphasis of budgetary policy in 1979-80⁽¹⁴⁹⁾—I must present to Honourable Members the Draft Estimates of Expenditure, the Revenue Estimates and my revenue proposals for 1979-80 and thereafter. At the same time, I hope I shall be able to satisfy them that we shall be continuing to implement satisfactorily Government policies and programmes on the basis of agreed priorities⁽¹⁵⁰⁾; to demonstrate that it is our intention to continue to pursue fiscal policies which seek to be equitable⁽¹⁵¹⁾; and yet at the same time to assure them that the budget is not likely to be detrimental to the stability of the economy⁽¹⁵²⁾ or inconsistent with the main emphasis of budgetary policy generally.

(2) Draft Expenditure Estimates

(a) General

133 The Draft Estimates of Expenditure are supported as usual by compendious Memorandum Notes which I commend to Honourable Members

(149) See paragraph 108 above.

(150) That is, the first general objective of budgetary policy referred to in paragraph 63 above.

(151) Ibid, the second objective.

(152) Ibid, the third objective.

and to serious students of our affairs for close study. This year some of these Notes have been re-written *ab initio* with a view to making them reflect, and describe, more accurately the programmes in which the department concerned is participating. I should also like to draw attention to the inclusion, for the first time, of the title of the officer in whom this Council will vest responsibility for the control of the funds voted. Taken together with the establishment last year of the Public Accounts Committee and a bill which I hope to be introducing later this session to provide for a system of statutory control over public expenditure, the Controlling Officer concept represents a further step in the reorganization of our system of financial administration.

(b) *Total expenditure*

134 Actual expenditure seven years ago in 1972-73 was only \$3,550 million. In the first post-recession year, 1976-77, it was only \$6,591 million. At \$11,162 million the revised estimate of expenditure in 1978-79 is 37% up on actual expenditure of \$8,174 million in the second post-recession year, 1977-78.

135 The Draft Estimates for 1979-80 provide for total expenditure of \$12,454 million. This represents an increase of \$1,292 million, or nearly 12% over the revised estimate for 1978-79. So, although I cannot disguise my general concern with the growth rate of public expenditure in recent years, I am satisfied with the extent to which the growth rate has been slowed down in the year ahead of us.

(c) *Recurrent*

136 The provision for expenditure on recurrent services⁽¹⁵³⁾ is \$8,360 million, including \$200 million for additional commitments of an unavoidable nature arising during the year⁽¹⁵⁴⁾. This represents an increase of \$916 million, or 12%, over the revised estimate for 1978-79 of \$7,444 million.

137 Personal emoluments and allowances (but not on-costs) at \$3,151 million account for 38% of recurrent expenditure, compared with an average of 40% for the four years 1975-76 to 1978-79. But, as regards next year, I would make two points: *first*, although the estimate includes \$80 million

(153) *That is to say:*

Personal Emoluments

Departmental Other Charges

Public Works Recurrent

Recurrent Subventions (including UPGC)

Pensions

Defence

Public Debt

Miscellaneous

See Annex (6).

(154) *Head 52 Miscellaneous Services, Subhead 100 Additional commitments.*

for about 6,500 posts which have not yet been approved by Finance Committee, a special effort has been made to calculate the provision under the personal emoluments subheads more accurately⁽¹⁵⁵⁾. It is unlikely, therefore, that the total cost of any salaries revision in 1979 and of recommendations of the Standing Commission on Civil Service Salaries that the Government may accept can be absorbed within available provision. I shall return later to the implications of having to seek additional appropriations for Civil Service emoluments for the outturn for which I am budgeting⁽¹⁵⁶⁾. *Secondly*, the Civil Service has grown rapidly over the past three years. At 1 April 1976 the approved establishment stood at 114,692. We shall begin 1979-80 with a total establishment of 133,422 posts⁽¹⁵⁷⁾ and it is at least arguable that management overheads are now too thinly stretched.

138 Provision for all other recurrent expenditure amounts to \$5,209 million, but I shall only mention here three components⁽¹⁵⁸⁾: Departmental other charges⁽¹⁵⁹⁾ at \$1,222 million have been kept to just under 15% of recurrent expenditure, which is roughly the same as the average for the past four years.

139 Public Works Recurrent expenditure⁽¹⁶⁰⁾ at \$503 million accounts for 6% of recurrent expenditure, a little below the average of the past four years. Normally, I think we should allow about 7% of total recurrent expenditure for the maintenance of our various assets and to operate the services covered by this component.

140 Recurrent subventions (including the UPGC) at \$2,153 million will absorb just under 26% of recurrent expenditure, compared with an average

(155) *I do not anticipate that Finance Branch will process any applications for new posts other than those for which the Appropriation Bill seeks provision. Hopefully, internal redeployment should alleviate any really pressing manpower difficulties.*

(156) *See paragraph 246 below.*

(157) *Of which 121,200 are likely to be filled.*

(158) *Expenditure on pensions at \$332 million accounts for 4% of recurrent expenditure, compared with an average of 3.7% for the past four years. Our contribution to the cost of the Armed Forces stationed here will be \$392 million (*) or 3.1% of total expenditure in 1979-80 compared with 3.6% in 1978-79 (revised estimate) and 1.6% in the last year of the previous Agreement (1975-76).*

Note: (*) *This figure excludes the re-provisioning and related exercises referred to in note (****) to f.n. (161) below. The Defence Costs Agreement as such provides for the Hong Kong Government's share of the total cost (recurrent and capital) of the agreed garrison of 4 1/3rd major units, as recalculated from time to time by reference to measures of inflation, to be 50% in 1976-77, 62½% in 1977-78 and 75% from 1978-79 onwards.*

The cost of our public debt (interest charges and actual repayments or sinking fund contributions), will represent just 0.4% of total expenditure, which is the same proportion as this year although it was over 0.1% in 1974-75.

(159) *That is, all recurrent expenditure other than personal emoluments, Public Works Recurrent, recurrent subventions, defence, pensions, interest and service charges on the public debt and miscellaneous services.*

(160) *That is, all expenditure connected with the maintenance of Government assets and the operation of various services such as water supply, sewage works, quarries, street lighting, etc.*

of 26.2% for the past four years. Overall, taking recurrent and capital subventions together, almost 20% of *total* expenditure on General Revenue Account is disbursed by subvented organizations.

(d) *Capital*⁽¹⁶¹⁾

141 The provision for capital expenditure is \$4,094 million made up of \$1,299 million for the Public Works Programme, other than New Towns and Housing, \$2,300 million for the Public Works Programme (New Towns and Housing) and \$495 million for all other components.

142 A comparative analysis of the capital account by component is provided in f.n.⁽¹⁶¹⁾ to the printed version of this speech. I should point out that the guideline figure for the New Towns and Housing component of the capital account \$1,300 million⁽¹⁶²⁾ had to be revised upwards by \$400 million to \$1,700 million, mainly to meet the higher cost of land resumptions in the New Territories⁽¹⁶³⁾. The figure of \$1,700 million had to be revised

(161)	Component	Guideline figures(*) (\$ mn)	Draft Estimates 1979-80 (\$ mn)	C.f. Revised Estimates 1978-79 (\$ mn)
(1)	Public Works Programme (other than New Towns and Housing)	1,300	1,299 (**)	1,150
(2)	Public Works Programme (New Towns and Housing, including transfer from General Revenue to the Development Loan Fund for on-lending to the Housing Authority)	1,700	2,300 (***)	1,695
(3)	Subventions	100	107	73
(4)	UPGC	80	85	41
(5)	Departmental Special Expenditure	200	184	495 123
(6)	Defence Costs Agreement, Capital Works	30	30	35
(7)	Home Ownership Fund	—	—	399
(8)	Miscellaneous	90	89 (****)	202
		<u>3,500</u>	<u>4,094</u>	<u>3,718</u>

Notes: (*) At 1978 prices.

(**) Under present accounting arrangements that part of expenditure on three projects met from loans from the Asian Development Bank amounting to \$44.1 million in 1979-80 is not included here (see Memorandum Note on Head 61 Public Debt, paras. 2-4 on page 434 of the Estimates and the Memorandum Note on Asian Development Bank Loans on page 830 of the Estimates).

(***) Includes \$1,000 million for transfer to the Development Loan Fund for on-lending to the Housing Authority. It is estimated that the Authority will draw \$1,005 million from the Fund for the construction of public housing for renting (\$932 million: interest free, repayable over 40 years), for the construction of flatted factories (\$45 million: on terms still to be approved by Finance Committee) and for the construction of commercial facilities for estates built under the Home Ownership Scheme (\$28 million: 8% repayable over 20 years).

(****) Public debt repayments, reprovisioning of Victoria Barracks and RAF Kai Tak and Lyemun and Sham Shui Po Barracks, other additional capital works for the Armed Forces outside the terms of the Defence Costs Agreement and transfers from General Revenue to the Emergency Relief Fund and the Mass Transit Fund.

(162) See also paragraph 112 above.

(163) See Annex (4).

further upwards by \$600 million, for drawings on the Development Loan Fund by the Housing Authority in 1979-80 will be as high as \$1,005 million of which \$932 million will be required by the Housing Authority for the rented public housing programme alone. So, total estimated expenditure on the New Towns and Housing component of the capital account is \$2,300 million which is \$605 million, or 36%, more than the revised estimate for 1978-79 and \$1,150 million, or 100%, more than the approved estimate for 1978-79. This very substantial increase has meant that expenditure on the Public Works Programme, other than New Towns and Housing, has had to be constrained by a rephrasing of the start dates of contracts for some new projects.

(e) *Pattern of expenditure (broad trends)*⁽¹⁶⁴⁾

143 In recent years, through the Green Pages in the Estimates, the Finance Branch has prepared an analysis of General Revenue Account (and Consolidated Account) expenditure on a functional basis. I must again draw attention to certain developing trends, now that expenditure has grown so dramatically, that is to say, from \$3,550 million in 1972-73 to \$6,591 million in 1976-77 to \$12,454 million in 1979-80.

144 The pattern of expenditure provided for in the Draft Estimates for 1979-80 is as follows: general services (including law and order)⁽¹⁶⁵⁾ will absorb 16.4% of total expenditure; economic services⁽¹⁶⁶⁾ 7.7%; community services⁽¹⁶⁷⁾ 22.5%; social services⁽¹⁶⁸⁾ 42% (and remember that, additionally, housing is partly financed outside the General Revenue Account from the Housing Authority's own resources); and all other services⁽¹⁶⁹⁾ will absorb 11.4%.

145 Over the four years 1975-76 to 1978-79 the pattern was rather different⁽¹⁷⁰⁾ with general services absorbing as much as 18.8% of total

(164) See Annex (7).

(165) Administration, law and order, defence, public relations, revenue collection, financial control.

(166) Primary products, airport and harbour, commerce and industry, communications, statistics, land and survey, Royal Observatory, certain miscellaneous subventions.

(167) Transport, roads and civil engineering, water, fire services, amenities and related services.

(168) Education, medical and health, housing (including commercial facilities for estates of the Home Ownership Scheme and flatted factories), social welfare, labour.

(169) Launches and dockyard, printing, supplies, common supporting services such as E and M Office and BOO, the Government computer, quarters, passages, telephones, telegrams, public debt, pensions and gratuities.

(170)	<i>That is:</i>	%
	<i>General services</i>	18.8
	<i>Economic services</i>	7.9
	<i>Community services</i>	22.0
	<i>Social services</i>	41.6
	<i>Other</i>	9.7
		<u>100.0</u>

expenditure and social services 41.6%, but with economic services and community services absorbing about the same. I expect the current emphasis on social services to remain with us for some time to come.

146 The pattern of expenditure by groups of services in 1979-80 seems satisfactory to me. But, even though we have managed actually to reduce expenditure on general services in 1979-80 by \$53 million compared with the revised estimate for 1978-79, we must never be complacent about the cost of general services and the various services in the residual group, which have risen by 57% and 118% respectively since 1976-77, the first post-recession year, for we must maximize our efforts in respect of the economic, community and social services groups⁽¹⁷¹⁾. Expenditure on the latter, I might add on social services, has risen by 98% since 1976-77 and by 321% since 1972-73.

(f) *Expenditure on selected services*

147 That is the broad picture. The Government's intentions, on both recurrent and capital account, in respect of certain services in the coming year and how they are provided for in the Draft Estimates are spelled out in Annex (8) to the printed version of this speech. I can only draw attention to a few salient points.

148 As regards *law and order*: it is intended to increase the size of the Police Force by some 2,100 posts, accompanied by improvements to amenities for policemen and their families.

149 As regards *education*: an extra 4,000 places will be provided for handicapped children in special schools and classes. The current rapid expansion of junior secondary places will continue (there will be an additional 30,000 places) so that we can meet our target of a place for every child aged 12 to 14 by the beginning of the school year beginning September 1980. At the senior secondary level, a further 4,250 places will be provided as part of our overall policy to provide places for every child leaving Form III who is capable of benefiting from education at this level. For the first time, certain registered post-secondary colleges will receive financial assistance so that they can participate in the meeting of White Paper targets for the provision of education at this level. With a view to improving the

(171)	Draft		% increases on	
	Estimates 1979-80	\$ mn	Revised Estimates 1978-79	Actual Expenditure 1976-77
<i>General services</i>	16.4	2,047	— 2.5	57
<i>Economic services</i>	7.7	959	24	71
<i>Community services</i>	22.5	2,806	13	96
<i>Social services</i>	42.0	5,228	10	98
<i>Other</i>	11.4	1,414	36.5	117.5
	<u>100.0</u>	<u>12,454</u>	<u>12</u>	<u>89</u>

quality of secondary education we also intend to bring about 70 private non-profit making schools onto full Government subsidy with effect from September 1979. Although no specific provision for this has been made in the Draft Estimates, allowance has been made within the \$200 million for additional commitments of an unavoidable nature.

150 As regards *medical and health services*: we shall provide an additional 450 hospital beds, bringing the total number to 18,000 by March 1980. The Community Nursing Service, hitherto operating on an experimental basis, will become a permanent feature of our medical facilities and will be expanded through the provision of an additional 75 nurses.

151 As regards *social security*: 1979-80 will be the first full year of the implementation of the proposal to reduce the minimum qualifying age for the non-means tested Old Age Allowance from 75 to 70 years. This will cost us an additional \$39 million and is one of the main factors contributing to the 13% increase in social security expenditure next year. Provision for social security represents an increase of 65% since 1975-76, the first year of the four year period I have been using largely for comparative purposes.

152 As regards *infrastructural facilities*: major projects in progress or nearing completion at Kai Tak Airport include the new departure baggage handling system for 68 check-in positions. Work will commence on the electrification of the railway to Lo Wu, and will continue on a number of major highways projects. Development of the new towns and of public housing will continue apace, and I would remind Honourable Members that the provision sought in the Draft Estimates for 1979-80 is double that in the Approved Estimates for this year.

153 As regards *public housing* for renting and as regards also related facilities: the Draft Estimates provide for expenditure of \$1,100 million but, if drawings from the Home Ownership Fund are also taken into account, total disbursements will be of the order of \$1,450 million⁽¹⁷²⁾, an increase over the revised estimate for 1978-79 of \$373 million or 35%. No less than \$932 million, representing an increase of \$417 million or 81% over the revised estimate for 1978-79 of \$515 million, is to be transferred to the Development Loan Fund for on-lending to the Housing Authority for the

(172) That is:	\$ mn	\$ mn
<i>Drawings from Development Loan Fund:</i>		
<i>Rented housing</i>	932	—
<i>Commercial facilities, Home Ownership Scheme</i>	28	—
<i>Flatted factories</i>	45	1,005
<i>PWD expenditure</i>	95	—
<i>Drawings from Home Ownership Fund</i>	350	1,450
<i>Add: expenditure by Housing Authority from own resources</i>	150	1,600 (*)

Note: (*) Equals total expenditure on all public housing and ancillary facilities in 1979-80 (c.f. \$1,169 million in 1978-79).

rented housing programme. This substantial increase is necessary for the first year of a four-year construction programme aimed at achieving a level of production of public housing⁽¹⁷³⁾ of some 35,000 flats a year, for which total drawings from the Development Loan Fund of \$3,260 million at mid- 1978 prices will be required. This four-year construction programme will be reviewed and rolled forward annually.

154 As regards the Government's *Home Ownership Scheme*, I would make two points: *first*, there may be a case, eventually, for increasing the proportion of public housing produced for sale, if this can be justified by increased demand and if adequate mortgage facilities can be found to back up increased purchases, for the cash flow advantages implicit in re-cycling a given allocation of funds at a much faster rate than in the case of the rented housing programme are obvious. *Secondly*, the income limit for eligibility for home ownership in the public sector of \$3,500 a month was set in February 1977. As incomes have increased in both real and money terms over the last 2 years, the income criterion of eligibility needs to be revised. Otherwise, the scheme obviously will be catering for a lower income group than it was originally meant to assist.

(3) *Revenue Estimates*

(a) *Total revenue*

155 The Revenue Estimates as printed anticipate that total revenue collections will be \$13,882 million which represents an increase of \$1,508 million, or over 12%, over the revised estimate for 1978-79 of \$12,374 million.

(b) *Recurrent*

156 My estimate of recurrent revenue is \$11,470 million, an increase of \$1,538 million, or 15.5%, over the revised estimate for 1978-79 of \$9,932 million.

157 Earnings and profits taxes account for \$5,070 million or 44% of recurrent revenue. This represents an increase of \$936 million, or nearly 23%, over the revised estimate for 1978-79 (which was \$777 million, or 23%, up on actual collections in 1977-78).

158 The estimate makes due allowance for the effect of bringing the taxation treatment of profits of banks and similar institutions into line with the treatment of all other profits generated by businesses located in, and

(173) *Defined in this context as domestic flats (including ancillary commercial facilities) produced by the Housing Department and the Public Works Department for the Housing Authority's rented housing programme, and domestic flats for sale produced by the Housing Department for the Government's Home Ownership Scheme.*

operating in, Hong Kong⁽¹⁷⁴⁾, the reintroduction of dependent parent relief⁽¹⁷⁵⁾ and the exemption of clubs from the payment of property tax⁽¹⁷⁶⁾.

159 On rates, Honourable Members will recall that, because of the significant increases in rateable values resulting from the 1976 revaluation, a scheme of relief was introduced whereby, irrespective of the increases in the values, the rates payable by a ratepayer in 1977-78 did not increase by more than $33\frac{1}{3}\%$ of the rates paid by him in 1976-77, and the rates payable in 1978-79 did not increase by more than $33\frac{1}{3}\%$ of the rates paid by him in 1977-78. For pre-war rent-controlled premises, the relief scheme will continue after 1978-79 so that, in each successive year, the rates actually payable will not increase by more than $33\frac{1}{3}\%$ of the amount paid in the immediately preceding year⁽¹⁷⁷⁾. But, for all other premises, the rates payable with effect from 1 April 1979 will be the full rate based on the rateable value of the premises.

160 The cessation of the scheme of relief will restore some \$9 million to the yield from rates and after allowing for increased percentage charges in respect of the phasing-in of rates for new areas in the New Territories, I estimate that rates revenue should increase from \$807 million in 1978-79 (revised estimate) to \$882 million in 1979-80, or by nearly 9.3%. It is for this reason that, other than in regard to the phasing-in programme of the New Territories, I shall not be proposing any change in the General Rate which was reduced to $7\frac{1}{2}\%$ with effect from 1 April 1977.

161 I have assumed that the yield from stamp duties will be up from \$780 million⁽¹⁷⁸⁾ in 1978-79 (revised estimate) to \$800 million and I have assumed that the yield from bets and sweeps taxes will be up from \$502 million in 1978-79 (revised estimate) to \$630 million in 1979-80, for obvious reasons

(174) *After taking into account the two instalment system, the yield will be about \$144 million in 1979-80 (from final assessments 1978-79 and provisional assessments 1979-80) and \$80 million in a full year. See paragraph 218 below and Annex (9).*

(175) *The loss of revenue is now estimated at \$69 million in 1979-80 (final 1978-79 plus provisional 1979-80) and \$42 million in a full year. See Annex (10).*

(176) *The loss of revenue will be about \$2 million a year.*

(177) *In 1978-79, some 10,800 ratepayers enjoyed the benefit of the scheme of relief. Of these, some 5,800 in pre-war rent-controlled premises will continue to enjoy the benefit in 1979-80 and thereafter. The remaining 5,000 will cease to enjoy any relief as from 1 April 1979.*

But, notwithstanding the cessation of the scheme of relief for these 5,000 ratepayers, the payment of full rates will not involve an increase in the rates payable by the majority in excess of the increase that would have applied had the scheme continued. In other words, for some 3,600 of these ratepayers the increase in the rates payable for 1979-80 will not in fact be more than $33\frac{1}{3}\%$ of the rates paid in 1978-79, and for about half of them the increase will be no more than 10%. In effect, therefore, 87% of all those currently enjoying relief will not have to pay more than $33\frac{1}{3}\%$ more, in 1979-80, than they paid in 1978-79. The remaining 13% will have increases in excess of $33\frac{1}{3}\%$ of what they paid in 1978-79.

(178) *Original estimate: \$550 million. As stamp duty is now only levied on transfers of property, including shares and marketable securities, there is a case for regarding stamp duty revenue as capital revenue.*

(contributing, I might add for those Honourable Members with a vested interest in the subject, 5.5% to total recurrent revenue).

162 The estimated yield from excise duties in 1979-80 at \$791 million is only \$25 million up on the revised estimate for 1978-79 of \$766 million which was only \$25 million higher than the original estimate. But excise duties are important and will contribute, nevertheless, 6.9% to total recurrent revenue, which is not all that far short of the contribution from Rates of 7.7%

(c) *Capital*

163 My estimate of capital revenue is \$2,412 million which is a decrease of \$30 million on the revised estimate for 1978-79 of \$2,442 million. Within the estimate of \$2,412 million, land transactions are expected to bring in \$1,972 million, taxi concessions may be \$293 million and estate duty may be \$135 million.

164 Within the estimate of \$1,972 million for land transactions, land *sales* should yield \$1,300 million from the sale of 135 acres⁽¹⁷⁹⁾, compared with the revised estimate for 1978-79 of \$1,184 million from the sale of 58 acres⁽¹⁸⁰⁾; private treaty grants should yield \$322 million, down on the revised estimate for 1978-79 of \$477 million; and *modifications and regrants* should yield \$350 million, again down on the revised estimate from 1978-79 of \$381 million⁽¹⁸¹⁾.

(4) *Outturn and Summary*

165 The difference between my estimate of revenue of \$13,882 million shown in the Revenue Estimates as printed and the Draft Estimates of Expenditure amounting to \$12,454 million is \$1,428 million. This is the surplus I am budgeting for on General Revenue Account⁽¹⁸²⁾.

(179)		<i>Industrial</i>	<i>Non-industrial</i>	<i>Total</i>
	<i>Urban areas</i>	16.1	41.3	57.4
	<i>New Territories</i>	24.2	52.9	77.1
	<i>Total</i>	<u>40.3</u>	<u>94.2</u>	<u>134.5</u>
(180)		<i>Industrial</i>	<i>Non-Industrial</i>	<i>Total</i>
	<i>Urban areas</i>	8.1	17.0	25.1
	<i>New Territories</i>	18.8	13.6	32.4
	<i>Total</i>	<u>26.9</u>	<u>30.6</u>	<u>57.5</u>
(181)	<i>Due to fewer expiry of leases next year and an assumption that more owners will opt to pay premia by instalments.</i>			
(182)			\$ mn	\$ mn
	<i>Revenue:</i>			
	<i>Recurrent</i>		11,470	—
	<i>Capital</i>		<u>2,412</u>	<u>13,882</u>
	<i>Expenditure:</i>			
	<i>Recurrent</i>		8,360	—
	<i>Capital</i>		<u>4,094</u>	<u>12,454</u>
	<i>Surplus on recurrent account</i>		—	3,110
	<i>Deficit on capital account</i>		—	1,682
	<i>Overall surplus</i>		—	1,428

166 The budget I have just presented conforms with all five guidelines relating to the relationship between the recurrent and capital accounts. Indeed, the ratios are well within the guidelines⁽¹⁸³⁾, thanks again to the buoyancy of capital revenue and the slowing down of the growth rate of recurrent expenditure compared with the growth rate in recent years and in relation to the growth rate of recurrent revenue⁽¹⁸⁴⁾. In real terms, the provision in the Draft Estimates of Expenditure implies a growth rate of about 5% compared with 25% in 1978-79 (revised estimates).

167 However, I have to admit that I have failed to reduce the relative size of the public sector as a whole. But, at 19.6% next year⁽¹⁸⁵⁾, it will at least be no greater than this year⁽¹⁸⁶⁾. This is not good enough *either* in terms of the part the public sector should play in helping to reduce the growth rate of total final demand, *or* in terms of the need to leave room for the public sector to expand relative to the economy as a whole should the growth rate of the economy be below my forecast (in response, say, to a recession in world output and trade).

(183)		\$ mn	%	Guideline
(1)	$\frac{\text{Recurrent revenue}}{\text{Total expenditure}}$	$\frac{11,470}{12,454}$	92	At least 88%
(2)	$\frac{\text{Recurrent expenditure}}{\text{Recurrent revenue}}$	$\frac{8,360}{11,470}$	73	No more than 80%
(3)	$\frac{\text{Surplus on recurrent account}}{\text{Capital expenditure}}$	$\frac{3,110}{4,094}$	76	At least 60%
(4)	$\frac{\text{Recurrent expenditure}}{\text{Total expenditure}}$	$\frac{8,360}{12,454}$	67	No more than 70%
(5)	$\frac{\text{Capital revenue}}{\text{Capital expenditure}}$	$\frac{2,412}{4,094}$	59	At least 20%

(184)	Actual 1977-78 (*)	RE 1978-79	Estimate 1979-80
	(%)	(%)	(%)
Recurrent expenditure	+19.0	+19.7	+12.3
Recurrent revenue	+19.0	+21.9	+15.5

Note: (*) On actual 1976-77.

(185)		\$ mn	
	$\frac{\text{Consolidated Account expenditure (*)}}{\text{Final forecast of GDP at current prices in 1979}}$	$\frac{14,399}{73,600}$	= 19.6%

Note: (*) Draft Estimates for 1979-80.

General Note: *The reason why the relative size of the public sector as a whole will not be less in 1979-80 compared with 1978-79, despite the fact that the growth rate of expenditure on General Revenue Account at 5% is less than the forecast growth rate of GDP at 7% is as follows: the growth rate of expenditure on Consolidated Account will be as high as 7.5% because, unusually, owing to the rate of drawings on resources already lying in, for example, the Home Ownership Fund, the relative importance of expenditure on General Revenue Account in the Consolidated Account will be only 86.5% rather than 89.2% in 1978-79 (c.f. 89% in 1977-78 and 89.5% in 1976-77).*

(186)		\$ mn	
	$\frac{\text{Consolidated Account expenditure (*)}}{\text{Preliminary estimate of GDP at current prices in 1978}}$	$\frac{12,514}{63,686}$	= 19.6%

Note: (*) Revised Estimates for 1978-79.

168 As regards the balance of the fiscal system, the Revenue Estimates, as printed, show a ratio of direct to indirect taxation of 58:42 and a ratio of direct and indirect taxation taken together to all other recurrent revenue of 76:24. So we shall continue to deviate from the guidelines of 55:45 and 70:30 respectively, and I shall have more to say about this subject in just a moment.

(5) *Revenue Proposals for 1979-80*

(a) *General*

169 I turn now to my revenue proposals for 1979-80 and would begin by making three points: *first*, in view of the value to our economy of a stable and predictable tax environment and the problem of assessing precisely the impact of particular tax changes, it is not my intention to use fiscal weapons to drain off purchasing power in order to slow down the growth rate of private domestic demand. But, certainly, it would be quite inconsistent of me not to propose compensating increases in other taxes and charges, if they can be justified, to offset the cost of any reforms of the tax system thought desirable on equity or administrative grounds. *Secondly*, the balance of our fiscal system does not adhere even to the guideline ratios as revised in last year's budget speech⁽¹⁸⁷⁾. I have just pointed out they are likely to slip even further next year. Whilst there is an inherent tendency for the relative importance of earnings and profits taxes to increase, this should not deter us from at least trying to maintain the yield from indirect taxes and charges. This leads me on to my *third* point which is that our system of fees and charges—be they cost-related, only partly cost-related⁽¹⁸⁸⁾, royalty-loaded or tax-loaded—our system of fees and charges should be continually updated in response to cost/price changes. (I am *not*, incidentally, referring here to the prices charged by the various public utility type undertakings⁽¹⁸⁹⁾ owned and operated by the Government for I do not regard the pricing policies followed by these undertakings as being subject to ordinary fiscal considerations. Thus, for this reason, the recent revision of water charges was announced outside the context of the annual budget⁽¹⁹⁰⁾).

170 Accordingly, I have nine proposals to put to Honourable Members: one is a reform measure of interest to accountants and industrialists; two are reform measures designed to reduce the tax liability of certain taxpayers; one is a revision of an out-of-date allowance in the Estate Duty Ordinance;

(187) *See paragraph 94 above.*

(188) *Because, for one policy reason or another, the costs of the services concerned are borne in part by General Revenue.*

(189) *Lion Rock Tunnels
Government car parks
Kowloon Canton Railway
Airport
Post Office
Waterworks*

(190) *See Annex (11).*

one is designed to close a loophole in the Estate Duty Ordinance; and four others are designed to update certain indirect taxes and charges.

(b) *Direct taxation*

(i) *Depreciation allowances*

171 The Third Inland Revenue Ordinance Review Committee noted the relatively high administrative cost of keeping track of individual items of plant and equipment for the sake of making a balancing allowance or charge in the event of a disposal. The Review Committee thought that there might be scope for ‘pooling’ the capital expenditure on two or more assets ranking for the same rate of annual allowance. Then, if one of those assets was disposed of, a balancing allowance or charge would not have to be made as a separate operation: instead, the same broad result could be achieved, in the long run, by diminishing the so-called ‘pool’ for the purpose of later annual allowances by the amount of the proceeds of disposal for the asset no longer represented in the ‘pool’. The Review Committee made no specific recommendation on this mildly esoteric subject, but I do accept that the existing method of calculating capital allowances involves complicated record keeping. Subject, therefore, to consultations with the Hong Kong Society of Accountants on technical details, I propose that a ‘pooling’ system should be introduced as soon as practicable⁽¹⁹¹⁾.

172 The administrative savings from a ‘pooling’ system are greater when the number of separate ‘pools’ ranking for the same rate of allowance is fewer. At present, for the purpose of ascertaining the annual allowance to be made under the Ordinance, the rates of depreciation as prescribed in the third column of the First Part of the Table annexed to the Inland Revenue Rules range between 5% and 30%⁽¹⁹²⁾. I propose, therefore, to invite the Board of Inland Revenue to make a new Table to Rule 2 so that the existing 20% rate of depreciation allowance, which applies to 11 heads, will be increased to 25%. The number of heads attracting this rate will thus become 15 out of a total of 33 heads in the table. The principal beneficiaries of this proposal will be in the manufacturing sector. After allowing for the two instalment system, the cost to the revenue in 1979-80 will be \$22.5 million, for both final 1978-79 assessments and provisional 1979-80 assessments will be involved, and roughly \$12.5 million will be the cost in an ordinary full year⁽¹⁹³⁾.

(ii) *Salaries tax: supplementary personal allowance*

173 With effect from the year of assessment 1976-77, single and married taxpayers have been given an additional or ‘supplementary’ personal

(191) *Amendments to sections 37(2) and 37A(2) of the Inland Revenue Ordinance will be necessary.*

(192) *The Table was last revised in 1974 (see BS, 1974, paras. 144-146).*

(193) *In the long term, the cost will be nil for the effect is simply to accelerate the rate at which allowances are granted, although the beneficial cash flow effect should not be overlooked.*

allowance of \$2,500 and \$5,000 respectively which is reduced or 'clawed back' by 15% of the amount by which the taxpayer's income exceeds \$12,500 and \$25,000 respectively until the point is reached where the entire 'supplementary' allowance disappears. Thus the 'supplementary' personal allowance is eliminated when the single taxpayer's income reaches \$29,167 and when the married taxpayer's income reaches \$58,334. I propose to reduce the 'claw-back' to 10% effective for final salaries tax (and for personal assessment also) for the year of assessment 1978-79 and for provisional salaries tax for 1979-80⁽¹⁹⁴⁾ at a cost to the revenue in 1979-80 of \$37 million, after allowing for the two instalment system⁽¹⁹⁵⁾. A full year's cost will be around \$22 million. The 'supplementary' allowance will now not disappear until a single taxpayer earns \$37,500 which may be compared with the present point of \$29,167 and the 'supplementary' allowance will not now disappear until a married taxpayer earns \$75,000 a year which may be compared with the present point of \$58,334.

(iii) *Salaries tax: 30% marginal rate*

174 In addition, I propose the scrapping of the 30% rate applicable to net chargeable income in excess of \$50,000 a year⁽¹⁹⁶⁾. Again, the scrapping of this rate will be effective for final salaries tax and personal assessment for the year of assessment 1978-79 and for provisional salaries tax for 1979-80. The cost to the revenue in 1979-80 will be \$20 million after allowing for the two instalment system. A full year's cost will be \$13 million. Thus the top marginal rate will be, in future, 25% on net chargeable income in excess of \$40,000 a year. Although there has always been an arithmetic relationship between the top marginal rate and the standard rate, the former being twice the latter, I can see no logic in this and I think the level of income at which the standard rate applies should be lifted and the progression of effective rates stretched out. Thus a single taxpayer will enter the standard rate zone on an income of \$75,000 a year in future (c.f. \$70,000 at present), a married taxpayer will enter the standard rate zone in future on an income of \$100,000 (c.f. \$90,000 at present) and a married taxpayer with two dependent children will enter the standard rate zone in future on an income of \$117,500 (c.f. \$104,000 at present).

175 The effect of these two proposals together will be to reduce the effective rate of tax payable by a single taxpayer on, say, \$20,000 a year from 2.16% to 2.06% and on \$30,000 a year from 5% to 4.75%; by a married taxpayer on, say, \$30,000 a year from 0.96% to 0.92%, on \$60,000 a year from 8.33% to 7.83%, on \$80,000 a year from 13.13% to 12.5%, and on \$90,000 a year from 15% to 13.89%; and by a married taxpayer with two dependent

(194) *An amendment to section 42B of the Inland Revenue Ordinance will be necessary.*

(195) *Provisional tax does not apply to personal assessment.*

(196) *An amendment to the Second Schedule of the Inland Revenue Ordinance will be required.*

children on, say, \$60,000 a year from 6% to 5.5%, on \$90,000 a year from 12.67% to 11.94% and on \$104,000 a year from 15% to 13.7%⁽¹⁹⁷⁾.

176 I cannot refrain from mentioning here that, after allowing for the two instalment system, the total cost to the revenue in 1979-80, of the reintroduction of the Dependent Parent Allowance already approved by this Council, the proposed reduction of the 'claw-back' of the supplementary personal allowance to 10% and the scrapping of the 30% top marginal rate (all proposals applicable to final assessments for 1978-79 and provisional assessments for 1979-80), the total cost will be \$126 million in 1979-80; and a full year's cost will be \$77 million.

177 Before I am again told how hard pressed Hong Kong taxpayers are (particularly middle class taxpayers) I would ask Honourable Members to study carefully the firm evidence to the contrary in Annex (13) to the printed version of this speech.

(iv) *Estate duty: controlled companies*

178 The unrivalled complexity of some of the provisions of the Estate Duty Ordinance are aimed, so it is said, at combatting avoidance. But our system of estate duty is based on two very simple concepts: *first*, only assets situated in Hong Kong are taken into account for estate duty purposes; and, *secondly*, provided the deceased had divested himself of his estate three years before death the property so divested is not chargeable to duty.

179 Although estate duty makes a most useful contribution to the revenue—\$135 million this year—for some time it has been claimed that in Hong Kong it is virtually a voluntary tax. This is because duty is only levied on assets located in Hong Kong, irrespective of whether the deceased was domiciled in Hong Kong. So, provided timely action is taken, Hong Kong assets can be exchanged for foreign assets and removed from the ambit of the charge.

180 In recent years, the effectiveness of the Ordinance has been further undermined by a fairly simple device dreamt up by lawyers. This device consists of the transfer of Hong Kong assets to a company specially incorporated for the purpose in a tax haven. Shares in these companies are not assets located in Hong Kong and, therefore, escape duty.

181 Sections 35—45 of the Ordinance were introduced in 1958 to bring to charge assets of companies controlled by a deceased person, to the extent to which he took benefit or had power to take benefit. This amendment was aimed at countering avoidance which involved the transfer, during the lifetime of a person, of a person's assets to a company in which he held only a few shares, but which was effectively controlled by him, whether

(197) See Annex (12).

the company was incorporated in Hong Kong or elsewhere. The amendment was based on United Kingdom legislation, despite the fact that estate duty in the United Kingdom was based largely on domicile (as is the new capital transfer tax) and not on the location of the assets as in Hong Kong.

182 The loophole which exists arises from a combination of the application of sections 10(b) and 35 and 40(4) of the Ordinance whereby, in effect, where the value of a deceased person's own shares in a company located *outside* Hong Kong exceeds the amount of what would otherwise be a valid controlled company claim, no Hong Kong duty can be levied, thus vitiating the underlying intent of the controlled company provisions. Subject, therefore, to the advice of the Executive Council, I intend to introduce an amending bill into this Council shortly to reinstate the original intention of the Ordinance.

(v) *Estate duty: gifts inter vivos*

183 But, by way of demonstrating that I am as anxious to update the value of concessions, exemptions and allowances in our tax laws as to tighten administration in the interests of maintaining the productivity of the system and thus avoiding the need for increases in tax rates, I propose that the duty free limit of \$5,000 on gift *inter vivos* made less than three years before death (or one year in the case of charitable donations) provided for under section 6(1)(c) of the Ordinance be raised to \$50,000 in respect of estates of persons dying on or after the 1 April 1979. The present limit was set in 1959 and since then the exemption limit for estates as a whole has gone up from \$50,000 to \$400,000⁽¹⁹⁸⁾. I hesitate to mention this, but I am happy to report that the cost to the revenue of this most imaginative gesture will only be about \$200,000 a year. (*laughter*)

(c) *Indirect taxation*

(i) *General*

184 Having regard to the present imbalance in our fiscal system as between direct taxation, on the one hand, and indirect taxation, on the other, I began my search for compensating revenue by examining the extent to which the yield from our main sources of indirect taxation might be improved. In doing so, I was as conscious of the need to avoid wandering beyond the point of diminishing returns, as I was of the need to try to restore the balance between direct and indirect taxation by increasing the yield from the latter as well as conceding as I have just done on the former.

185 I have already said that I shall not be proposing any change in the General Rate⁽¹⁹⁹⁾ as I consider the yield from this source is quite satisfactory,

(198) *BS, 1977, paragraph 221.*

(199) *See paragraph 160 above.*

but I shall deal later with the question of a reassessment of rateable values. Similarly, I consider the yields from stamp duties and from taxes on bets and sweeps and on entertainment are such as not to require any increases at this time.

186 So I looked specifically to the remaining major source of indirect taxation, namely, excise duties. The yields from duties levied under the Dutiable Commodities Ordinance have grown very slowly in recent years compared with the yields from earnings and profits taxes⁽²⁰⁰⁾. This may be due to the fact that after the various increases in the rates of duties in 1974, 1975, 1976 and 1978⁽²⁰¹⁾ we have reached a plateau of yields from some duties, higher disposable incomes being offset by consumer resistance to higher retail prices generally and changing habits. Nevertheless, the increases in retail prices which were experienced in recent months and years have resulted in a decline in the incidence of duty on liquor, tobacco and hydrocarbon oils declining.

(ii) *Duty on liquors*

187 The specific rates of duty on intoxicating liquors were last revised in February 1975 in order to restore a loss of revenue resulting from a fall in consumption. The rates were further increased in December 1975 partly to eliminate Commonwealth preference margins and partly to raise additional revenue⁽²⁰²⁾, and these rates have remained unchanged since then. The retail prices of some categories of intoxicating liquor have increased during the past three years, and the incidence of the duty has fallen in consequence. However, the degree of erosion is not yet so serious as to warrant a revision, so I do not propose any increase in the rates of duty at this time.

(iii) *Duty on tobacco*

188 The retail prices of certain brands of imported cigarettes have also recently been increased, by as much as 20 cents a packet, thus eroding the duty incidence here as well. I have considered whether this should be rectified, but I have come to the conclusion that an immediate increase in the rate of duty is not necessary, particularly as I increased the rate on manufactured tobacco in imported cigarettes by \$1.65 per pound, to \$20.15 per pound, as recently as last year.

(200)		<i>Revised</i>			
		<i>Actual</i> 1976-77	<i>Actual</i> 1977-78	<i>Estimates</i> 1978-79	<i>Estimates</i> 1979-80
		(%)	(%)	(%)	(%)
<i>Earnings and profits taxes</i>		+21	+24	+23	+23
<i>Duties under the DCO</i>		+22	+8	+4	+3
(201)	27 February 1974	: liquor and tobacco			
	26 February 1975	: liquor and tobacco			
	3 December 1975	: liquor and tobacco			
	25 February 1976	: hydrocarbon oils			
	1 March 1978	: imported cigarettes			
(202)	BS, 1976, Annex (4).				

(iv) *Duty on hydrocarbon oils*

189 The rates of duty on hydrocarbon oils were last revised in 1976⁽²⁰³⁾. The objectives then were two-fold: *first*, partially to restore the duty element in the retail price of both petrol and automotive diesel fuel; and, *secondly*, to restore the contribution of duty on hydrocarbon oils to total recurrent revenue.

190 The incidence of the duty in 1966 was 54% for both petrol and automotive diesel fuel, following increases made to the rates in that year. By 1976, ten years later, the duty element had fallen to 31% and 29% respectively, and the effect of the 1976 increase was partially to restore the incidence to 35% and 34% respectively. These percentages have been reduced as a result of price increases since 1976 and, following the announcement by OPEC that the price of crude oil will be increased in stages beginning on the 1 January 1979, by a total of some 14.5% in 1979, the price of petrol has recently been increased again by 40 cents per gallon and of automotive diesel fuel by 35 cents per gallon⁽²⁰⁴⁾. The incidence of duty is now only 32% in the case of petrol and 31% in the case of automotive diesel fuel.

191 Over the years, the contribution to total recurrent revenue of duty on hydrocarbon oils has also fallen, from nearly 3% in 1976-77 to just over 2% in 1979-80⁽²⁰⁵⁾.

192 Having regard to the 1976 objectives, I should seek not only to restore the incidence of duty to at least 35%, but also to restore the contribution of duty on hydrocarbon oils to recurrent revenue to at least 3%. To restore the incidence of duty to about 35% would require an increase in the rates of duty of about 30 cents per gallon, from \$2.20 to \$2.50 for petrol, and from \$1.60 to \$1.90 for automotive diesel fuel. But the contribution of duty on hydrocarbon oils to recurrent revenue would still remain somewhat less than 3%. And as the likelihood is there will be further increases in retail prices during 1979, the incidence of the duty will again be eroded requiring yet another increase in the rates of duty next year. So for all these reasons, I think the rates of duty should be left as they are until the present position is clearer.

(203) BS, 1976, paras. 191-197.

(204) See f.n. (65) above; and, incidentally, the increase of 40 cents is 6.3% and of 35 cents is 7.2% on the previous retail prices.

(205)	(a)	(b)	(b) as %
	<i>Recurrent Revenue and Receipts</i>	<i>Revenue from hydrocarbon oils</i>	<i>of (a)</i>
	(\$ mn)	(\$ mn)	
1976-77 (Actual)	6,849	188	2.74
1977-78 (Actual)	8,151	217	2.66
1978-79 (Revised Estimate)	9,932	225	2.27
1979-80 (Estimate)	11,470	232	2.02

(v) *First registration tax*

193 Having failed to persuade myself that immediate increases in at least some of the rates of excise duties should be introduced, I am left with one source of indirect taxation in my desperate search for compensating revenue —that is to say, first registration tax on motor vehicles. The revenue from this source has increased steadily from \$102 million in 1976-77 to \$148 million in 1977-78 to \$254 million in 1978-79 (revised estimate); and the estimate for 1979-80 is over \$300 million. We are clearly nowhere near the point of diminishing returns, and I consider that this is one source which could and I am afraid, will contribute more to the revenue.

194 At present, non-enfranchised buses⁽²⁰⁶⁾, goods vehicles and taxis attract an *ad valorem* rate of tax of 15%. These categories of vehicles were brought within the scope of the Motor Vehicle (First Registration Tax) Ordinance for the first time in December 1975, when Commonwealth preference on motor vehicles was abolished. The 15% rate of tax levied was the same as that previously levied on such vehicles of non-Commonwealth origin. I do not think it is yet time for this particular rate of tax to be increased.

195 But private cars attract an *ad valorem* rate of tax in accordance with a scale which was introduced last year. This scale distinguishes between basic cars, for which the rate of tax is 30%, semi-luxury cars, for which the rate of tax is 35%, and luxury cars, for which the rate is of tax 40%. I defined a basic car as one which costs the importer no more than \$20,000 in respect of the manufacturer's price and the cost of freight and insurance; I defined a semi-luxury car as one which costs between \$20,000 and \$30,000, and I defined a luxury car as one which costs more than \$30,000.

196 The 30% rate of tax was previously applied to all private cars. So, in effect, the scale introduced last year was designed not only to bring in a degree of progressivity, which was already an established feature of our system of personal taxation and of our system of annual tax on the ownership of motor vehicles, but also to impose a higher *rate* of tax on the more expensive cars. I argued that the purchaser of an expensive car, such as a Cadillac or Rolls Royce, *should* be taxed at a higher rate than the person who can just afford, say, a Honda Civic.

197 Whereas increases in landed costs have not been such as to make it necessary to re-define the scale which defines basic, semi-luxury and luxury cars, I propose that the rate of tax should now be increased as follows: for the basic car from 30% to 35%; for the semi-luxury car from 35% to 40%; and for the luxury car from 40% to 45%. In line with the new rate of tax for basic cars, I propose that the rate for motor cycles and motor tricycles should be increased from 30% to 35%⁽²⁰⁷⁾. The value of imports of cars

(206) *That is, non-enfranchised public buses, private buses, public light buses and private light buses.*

(207) *Amendments will be required to the Schedule to the Motor Vehicles (First Registration Tax) Ordinance.*

increased by 41% in 1977 over 1976, and by 76% in 1978 over 1977. Clearly, the existing rates of First Registration Tax are no discouragement to aspiring car-owners. I do not think that the proposed rates will be significantly more discouraging, which is very *encouraging* for the revenue to the tune, probably, of \$35 million in 1979-80. The possible effect of these increased rates on the retail prices of a sample of new vehicles is shown in Annex (14) to the printed version of this speech.

(d) *Fees and charges*

(i) *General*

198 I said earlier, Sir, that our system of fees and charges be they cost-related, partly cost-related only, royalty-loaded or tax-loaded should be continually updated in response to cost/price changes. A failure to do so means, inevitably, that an increasing burden is placed on general taxation.

(ii) *Cost-related*

199 The Finance Branch monitors over some 1,500 cost-related fees and charges of various kinds, to ensure that the responsible departments take appropriate action on a regular basis to review and up-date them. Inevitably, because of the numbers involved, the tendency is to place greater emphasis on the up-dating of cost-related fees and charges for the services most in demand; and those fees and charges which are only partly cost-related, for policy reasons, tend to be reviewed and up-dated less regularly. Even so, I am not satisfied that even our cost-related fees and charges are reviewed frequently enough, and so I shall be asking Finance Branch to consider ways of improving their system of monitoring.

(iii) *Royalty-loaded*

200 There are several royalty-loaded fees which really ought to be up-dated, but I have decided not to propose any changes on this occasion, partly because I am not satisfied that we have yet identified all cases where a royalty-loading should apply.

(iv) *Tax-loaded*

201 As far as tax-loaded fees and charges are concerned, a recent review by the Management Accounting Services Division of the Treasury has revealed that, with cost increases over the years, there has been a significant erosion of the tax-loading element. So I have decided that those most seriously affected should be revised upwards to offset this erosion.

(A) *Motor vehicle licences*

202 Fees for motor vehicle licences were deliberately tax-loaded in 1974⁽²⁰⁸⁾; that is to say, they cover the administrative costs of the licensing process and,

(208) BS, 1974, paras, 158-165.

additionally, include a tax element. As I have an uneasy feeling that I shall be misunderstood, I must here stress that my proposals have nothing whatsoever to do with future transport policy; nor do they partly anticipate any measure that might be taken in pursuance of that policy. They are justified in their own right, and they are being put to Honourable Members for fiscal reasons alone.

203 Fully to restore the tax-loading, existing fees would have to be increased by between 23% and 26%. However, it would not be appropriate to apply a flat increase to *all* fees and I propose to make certain other adjustments to remove some of the anomalies that now exist⁽²⁰⁹⁾.

204 As regards *private cars*, I propose to increase the fees by 20%, with the exception of the fee for the small car of up to 1,000 c.c. which I propose to round down to \$400. This will result in the following increases in the six rates—

Up	to	1,000 c.c.	from	\$ 350	to	\$ 400
Up	to	1,500 c.c.	from	\$ 500	to	\$ 600
Up	to	2,500 c.c.	from	\$ 750	to	\$ 900
Up	to	3,500 c.c.	from	\$1,000	to	\$1,200
Up	to	4,500 c.c.	from	\$1,250	to	\$1,500
Over		4,500 c.c.	from	\$1,500	to	\$1,800

205 Applying the same order of increase to *motor cycles*, and maintaining the existing 50% differential with small cars of up to 1,000 c.c., raises the fee from \$175 to \$200 and I so propose.

206 As regards *goods vehicles*, the present fee for a vehicle not exceeding 20 cwt unladen is \$300. I can see no reason why the fee for this type of vehicle should continue to be less than that for a private car with an engine capacity of up to 1,000 c.c. So I propose to set the fee for a goods vehicle not exceeding 20 cwt at the same level as will apply to a private car in the lowest category, that is to say \$400. This represents an increase of $33\frac{1}{3}\%$ and I propose to apply the same rate of increase to the other three fees, in order to maintain the existing percentage differentials between the fees, as follows—

Up	to	20 cwt	from	\$ 300	to	\$ 400
Up	to	45 cwt	from	\$ 600	to	\$ 800
Up	to	75 cwt	from	\$ 900	to	\$1,200
Over		75 cwt	from	\$1,200	to	\$1,600

207 The *only* adjustment I propose to make for public service vehicles relates to *taxis*, and that is because the present fees are quite anomalous. The present fee for a Hong Kong and Kowloon taxi is \$20 for the driver

(209) *Amendments will be required to the Third Schedule to the Road Traffic (Registration and Licensing of Vehicles) Regulations.*

and \$60 for each permitted passenger seat in the vehicle, making a total of \$320. The present fee for a New Territories taxi is \$500.

208 I am mindful that the licence for a Hong Kong and Kowloon taxi is granted after a public tender (the licence for a New Territories taxi being granted after a ballot) *and* that taxi fares have recently been increased. But the annual fee charged for the licence is a charge for road use. And a taxi occupies road space for about 10-15 times longer than the average private car. I can see no reason, therefore, why the fee for a taxi should not have regard to the fee for a private car, or why there should be any distinction between Hong Kong and Kowloon taxis and New Territories taxis. Generally speaking, the engine capacity of the average taxi lies between 1,500 c.c. and 2,500 c.c., that is to say the third platform for private cars. So I propose that the fee for all taxis should be set at \$900 a year.

209 Finally, to remove one further anomaly, I propose to increase the fee for a private light bus licence. I am sure someone would get that wrong. (*laughter*) I propose to increase the fee for a private light bus licence which has remained at its present level of \$480 since 1 September 1969, to \$900. Again, the engine capacity of these vehicles generally falls within the third category for private cars.

210 I estimate that the additional revenue accruing from these various increases and adjustments in 1979-80 will be \$41 million.

(B) *Buoy and anchorage fees*

211 In 1975 I referred to a suggestion made by a certain Member of this Council that the yield from the hire of buoys in the harbour might be improved by a 400% increase in the fees of \$150 a day for an 'A' buoy and \$100 a day for a 'B' buoy⁽²¹⁰⁾. I felt that this was perhaps too steep an increase to make at one time and, instead, increased the fees by 300%, (*laughter*) to \$600 a day for an 'A' buoy and \$400 a day for a 'B' buoy. I also increased the anchorage fees by the same percentage, from \$3 to \$12 per 100 tons a day inside the harbour limits, and from 80 cents to \$3.20 per 100 tons a day elsewhere in Hong Kong waters. Thus revenue from these two fees increased from \$4.4 million in 1974-75 to \$15.4 million in 1975-76; but over the three years 1976-77 to 1978-79 the yield has levelled out at just over \$17 million a year.

212 I estimate that an increase of at least 16% is now necessary to restore the tax-loading. So I propose to increase the buoy fees to \$700 a day for an 'A' buoy and to \$450 a day for a 'B' buoy, and to increase the anchorage fees to \$14 per 100 tons a day inside the harbour limits and \$4.00 per 100 tons a day elsewhere in Hong Kong waters⁽²¹¹⁾. I estimate the additional revenue next year from these increases will be at least \$3 million.

(210) *BS, 1975, paragraph 128.*

(211) *An amendment will be required to the Shipping and Port Control Regulations.*

(C) *Business registration fee*

213 A business registrable under the Business Registration Ordinance pays an annual fee. This fee was last revised in 1975 when I introduced a tax-loading element thereby increasing it from \$50 to \$150. In effect, I restored, but only partially, a charge introduced in 1952 at \$200 a year, but subsequently reduced to \$25 in 1959 and then raised to \$50 in 1974 simply to cover increased costs. The introduction of a tax-loading element was designed to obtain a contribution to the public revenue from the proprietors of businesses who do not pay profits tax because their chargeable profits are covered by allowances available under personal assessment.

214 To restore the tax-loading would require an increase in the fee of about 20%. I, therefore, propose that the fee should be increased to \$175 a year⁽²¹²⁾. I do not consider that this will constitute a hardship at today's prices and the additional yield will be \$6.5 million in 1979-80.

(e) *Implementation*

215 As Your Excellency this morning signed the necessary Orders under the Public Revenue Protection Ordinance, the increased rates of first registration tax on private cars and motor cycles and the increased vehicle licence fees will be effective from midnight tonight. The increase in the business registration fee will be effective from 1 April next and the proposed increases in buoy and anchorage fees will become effective as soon as the necessary regulations are made, probably in the middle of April.

(6) *Revised Outturn for 1979-80*

216 The cost to the revenue of the four concessions I have proposed under the Inland Revenue Ordinance and the Estate Duty Ordinance amount to \$79.7 million in 1979-80 (or \$47.7 million in a full year) and the additional revenue yields I expect from first registration tax, vehicle licences, buoy and anchorage fees and business registration fees amount to \$85.5 million. So, effectively, I am budgetting for a surplus of \$1,434 million; and I might just add that this surplus will mean that the level of our 'free' fiscal reserves at 31 March 1980 will be not far short of \$5,000 million, providing us with a welcome and necessary degree of security in these uncertain times.

217 These revenue proposals for 1979-80 will have the effect of slightly improving the balance of the fiscal system compared with what it would have been without them: the ratio of direct to indirect taxation will be 57.7:42.3 compared with 58.3:41.7 on the basis of the Revenue Estimates and the ratio of direct and indirect taxation taken together to all other recurrent revenue will be 75.4:24.6 compared with 75.8:24.2.

(212) *An amendment will be required to the Schedule to the Business Registration Ordinance.*

6.09pm

THE CHIEF SECRETARY:—Sir, in accordance with Standing Order 68, I move the suspension of Standing Order 8(2), so that today's business may be concluded.

Question put and agreed to.

THE FINANCIAL SECRETARY:—Thank you very much.

(7) *Fiscal Policy in the Future*

(a) *Reform of the tax system*

(i) *Third Inland Revenue Ordinance Review Committee*

218 So much for my immediate proposals. I turn now to fiscal policy in the future. An up-to-date summary of the Government's position on the various recommendations of the Third Inland Revenue Ordinance Review Committee is at Annex (15) to the printed version of this speech. During 1978 the Working Party set up to examine the Review Committee's recommendations was concerned with the preparation of drafting instructions for the bill, introduced into this Council on 12 April 1978, to amend the Inland Revenue Ordinance so as to bring to charge profits from interest arising from business carried on in Hong Kong by banks and other financial institutions not already brought to charge⁽²¹³⁾. The bill was passed on 16 August last and its provisions came into effect for the year of assessment 1978-79.

219 In September 1978, the Commissioner of Inland Revenue issued Departmental Interpretation and Practice Notes for the information and guidance of taxpayers. As modern international banking is highly complex and as practice will vary from company to company, it is not possible for the Commissioner to lay down a comprehensive formula governing what profits are or are not chargeable. The Commissioner will, nevertheless, endeavour to process the returns of financial institutions for 1978-79 as speedily as possible to enable them to know where they stand. But let me stress, yet again, no new tax has been imposed; the amendment to the Ordinance did no more than to correct an existing anomaly by bringing the profits tax liability of financial institutions in line with that of other businesses carried on in Hong Kong.

220 So far 29 new banking licences have been granted to international banks very prestigious international banks that satisfy the Government's licensing criteria. The amendment to the Ordinance has not apparently deterred foreign banks from coming to Hong Kong. However, it is possible that, due to anticipatory fears, the loan portfolios of some banks have

(213) See Annex (9).

undergone changes; offshore lending has shown certainly in statistics something of a decline⁽²¹⁴⁾. Not until the returns are assessed, can the precise impact of the amendment to the Ordinance be known.

221 There are three recommendations of the Review Committee which have been looked at by the Working Party in recent months which deserve a special mention.

222 *First*, with a view to rationalizing the present law, the Review Committee made several specific recommendations⁽²¹⁵⁾ for increasing the potential tax yield from shipping profits without straining the territorial ambit of the charge. Whilst existing legislation admittedly has limitations, the recommendations of the Review Committee would be of little benefit to the revenue. So long as tax havens continue to exist, a change to taxing the whole of the profits of resident shipping companies would not be very productive to revenue (perhaps the yield might be \$10 million a year). There would also be difficulties of enforcement, and the amending legislation would be still open to avoidance measures unless steps were taken to go considerably beyond the Review Committee's recommendations. The Government has concluded, therefore, that the Review Committee's recommendations should not be implemented.

223 *Secondly*, the Review Committee pointed out an anomaly in the application of the withholding system⁽²¹⁶⁾ adopted for interest tax purposes. That is to say, a trustee receiving interest that has already suffered withholding tax is obliged to deduct tax a second time from interest paid by him to the beneficiaries of the trust fund. The Review Committee recommended that relief should be available where trustees both receive and pay out interest. The Government agrees that the anomaly is capable of being removed and an amending bill is now being drafted.

224 *Thirdly*, the statutory description of interest within the charge to tax refers to interest arising or derived 'on any debenture, mortgage, bill of sale, deposit, loan, advance or other indebtedness whether evidenced in writing or not'. This all sounds very comprehensive, but it may be inadequate to render liable to tax the surplus thrown up on the redemption or realization of certificates of deposit and similar entitlements to receive a stated sum of money. The Review Committee recommended that any gap in the interest tax charge on surpluses arising from certificates of deposits should be closed⁽²¹⁷⁾. Whilst the Government agrees that a possible lacuna in the Ordinance should be rectified and the question of chargeability put beyond doubt, the subject matter is complex and is being further examined.

(214) *From a peak of \$19,634 million at the end of February to \$16,411 million at the end of December 1978 (= - 16%).*

(215) *Paras. 184, 185, 187 and 190 of TIRORC Report.*

(216) *Paragraph 93 of TIRORC Report.*

(217) *Paragraph 94 of TIRORC Report.*

(ii) *Taxation treatment of retirement benefits*

225 In this Council on 2 August 1978, Sir S. Y. CHUNG spoke on the subject of taxation treatment of retirement benefits. He questioned the discretionary powers exercised by the Commissioner of Inland Revenue in withholding approval from unfunded and self-administered retirement schemes. He proposed that a second category of approved schemes should be given official recognition, that is to say, non-contributory retirement schemes, the funds of which are not separately funded and administered, but are left in the company's own business.

226 I undertook to look into this question but, after careful consideration, I am afraid that, both the Commissioner of Inland Revenue and I have come to the conclusion that there would be as many objections to Sir S. Y.'s proposals as there are said to be to the present arrangements.

(iii) *Share options*

227 I have received representations that the treatment of share options granted to employees should be altered. Under the existing provisions of the Inland Revenue Ordinance the recipient of share options becomes liable to tax at the time he exercises his option to buy shares, and the amount of tax is assessed on the basis of the difference between what he pays for the shares and their market value at the time. So, on a rising market, the tax liability increases the longer the exercise of the option is deferred. I do not necessarily accept that this is unfair, as the employee is obtaining the benefit of shares with a higher market value at no additional cost. But I would not wish to dispute the idea of encouraging the giving of share options to employees and I have, therefore, asked the Commissioner of Inland Revenue to see whether anything can be done to alleviate the tax liability; but, I must say, I do not see too much prospect of our being able to devise an acceptable and administratively simple scheme which would not be open to abuse. At the same time, I have been advised by the Commissioner of Inland Revenue that there are signs that even the existing charge is being avoided. So a review of the relevant provisions of the Ordinance is called for anyway, particularly as they are based on a recommendation of the Second Inland Revenue Ordinance Review Committee which reported as long ago as 1966.

(iv) *Stamp Ordinance*

228 Following the proposals I put forward in last year's budget speech⁽²¹⁸⁾, the ambit of the Stamp Ordinance was drastically reduced, so that the Ordinance now applies only to three major sources of duty: namely, transactions in shares and marketable securities, assignments of immovable property and leases and agreements for leases. As I said last year⁽²¹⁹⁾, despite this major surgical exercise, there are still unsatisfactory features in the

(218) *BS, 1978, paras. 214-217.*

(219) *BS, 1978, paragraph 218.*

Stamp Ordinance which require a residual tidying up exercise. To achieve this, a stamp duty specialist has been appointed and is now working on drafting instructions for a new Ordinance which, in both language and intent, will reflect the realities and practices of commercial life in the latter part of the (19th) 20th century. (*laughter*)

(b) *Rating*

229 A reassessment of rateable values was last carried out in 1976, effective from 1 April 1977. The new values then established involved very significant increases over the previous values which were set as the result of a revaluation in 1972. These large increases reflected the marked upward trend in market rentals in the long interval of four years between the two exercises. To avoid a repetition of this my intention was that a further revaluation should be carried out in 1978. As the Commissioner of Rating and Valuation was satisfied that there were no clearly established trends at the beginning of 1978 which made it essential to revise the base values as soon as possible, I deferred the intended revaluation for the time being.

230 Although some trends are now more clearly discernible, I propose to continue to defer the revaluation exercise. But, clearly, serious consideration will need to be given during the year to the possibility of a revaluation in 1980, with or without a compensating reduction in the rate percentage, bearing in mind that at least four years will have elapsed since the last exercise. There are two reasons for this: two reasons for revaluation, *first*, to ensure that rateable values are kept up-to-date and thus remain an effective tax base; and, *secondly*, and this is of equal importance, to ensure that relative changes in values between different premises are taken fully into account so that the incidence of the tax remains fairly distributed.

(c) *Management of public utilities*

231 Finally, in this survey of what the future may hold for taxpayers and the public generally, I must refer to the pricing policy we must adopt for Government owned and operated public utility undertakings. The basic principle of pricing policy must be that consumers—be they individuals or trades and industries—should be charged the full cost of the resources consumed by each undertaking. This principle is not invalidated simply because the services are not provided by the private sector or because they are of a type that only the Government can provide. As a corollary to this principle, I regard the pricing of public utility services as outside the ambit, as it were, of fiscal policy as such.

232 For some years notional commercial accounts have been prepared for these undertakings though not on a standardized basis. As I said last year, the underlying accounting principles were being examined and standardized⁽²²⁰⁾. I am pleased to report that this exercise is now completed

(220) *BS, 1978, paragraph 188.*

and that, as a result we have standardized sets of accounts for all undertakings with effect from 1977-78 with five year projections through to 1982-83.

233 We have now therefore a rational basis for pricing policies and capital investment decisions. A summary of these accounts is set out in, I beg a pardon, is not set out. It was to be set out in another annex to this speech but that we did not have the time to type. (laughter)

PART V: ACHIEVEMENT OF GENERAL OBJECTIVES OF BUDGETARY POLICY

(1) Introduction

234 Before Honourable Members have the exquisite pleasure of seeing me sit down, they will wish to be satisfied that the five general objectives of budgetary policy, which I defined long ago at the beginning of Part II of this speech, will be achieved and, more specifically, that due emphasis is being placed on the slowing down of the growth rate of total final demand, by one means or another, to bring it more into line with the growth rate of the economy's output⁽²²¹⁾.

(2) First and Second Objectives: Expenditure Proposals and Fiscal Policy

235 I think I have already demonstrated in Part IV that the first and second objectives of budgetary policy will be achieved, that is to say, we shall continue to implement approved Government policies and programmes at a satisfactory rate and, after taking into account the net effect of my several revenue proposals, the required revenue will be raised as equitably as possible as between different classes and groups of taxpayers (and raised, also, as inexpensively as practicable for, in a low tax environment, costly administrative overheads cannot be afforded).

(3) Third Objective: Maintenance of Flexibility of the Cost/Price Structure

236 The third objective of budgetary policy is to minimize any adverse effect of public expenditure and of the fiscal system on the ability of the internal cost/price structure to react appropriately to changing trading circumstances.

237 Although I said earlier⁽²²²⁾ that the relative size of the public sector could be allowed to increase in the mature phase of an upswing, on *this* occasion it should *at least* be held at the present level of 19.6%, as it should not have increased by as much as three percentage points in 1978-79⁽²²³⁾. So I have no intention of allowing the relative size of the public sector to increase beyond 19.6% and, at this point, I should warn Controlling Officers

(221) See paragraph 108 above.

(222) In paragraph 66 above.

(223) As I said in paragraph 91 above I anticipated that the relative size of the public sector would increase to only 18.4%.

for heads of expenditure that they really *will* be required to regard the vote provision available under each head as a cash limit. They must not assume that additional funds in the form of supplementary provision will be automatically provided during the course of the year simply because they might otherwise be unable to provide those goods and services which are implied in the Draft Estimates; at the same time, they should not be *so* cautious that unnecessary under-spending results. While these cash limits will be applied firmly, they will also be applied flexibly and fairly. It would be, for example, quite unacceptable for them to be applied to the old age allowance scheme; nor should their application result in the construction of half finished bridges or of roads that lead to nowhere.

238 When seeking to reduce the growth rate of expenditure on General Revenue Account—that is to say the component of public sector expenditure⁽²²⁴⁾ over which the Government has the most direct control—I concentrated on the capital account because evidence was accumulating that the growth rate of demand by the public sector, including the Mass Transit Railway project, for the output of the building and construction industry was leading to a build up of inflationary pressures which were probably spilling over into the economy as a whole⁽²²⁵⁾.

239 Now, whereas the growth rate of Government consumption expenditure in national accounts terms should slow down from 15% in 1978 to 9% in 1979, the growth rate of Government expenditure on building and construction in national accounts terms should slow down from 43% (no less) in 1978 to 4% in 1979; and the growth rate of expenditure on building and construction by the public sector in national accounts terms, and therefore defined here, remember, to include the Mass Transit Railway project, should slow down from 31% in 1978 to 7% in 1979.

240 Finally, so far as the fiscal system is concerned, as it has long been designed for so long to be largely neutral in its effect on the internal cost/ price structure, on the supply of human effort and on investment decisions, there is never much scope for innovation. But I have managed to smooth and stretch out the progression of effective rates of salaries tax up to the standard rate of 15%. I have offset the cost of these concessions by higher rates of other levies, which will marginally dampen down private consumption expenditure; and, as a reform measure, I have amalgamated all items attracting an annual depreciation allowance of 20% with those attracting an allowance of 25%.

(4) *Fourth Objective: Monetary Implications of the Government's Bank Balances*

241 The fourth objective of budgetary policy is so to manage the public finances generally as to minimize the extent to which the monetary environment

(224) *As defined in f.n. (69) above.*

(225) *See paragraph 60 above.*

is disturbed, that is to say, to minimize the extent to which the growth rate of the money supply is altered by an expansion or contraction of currency in circulation or by a budget surplus or deficit.

242 Since the middle of 1972, when the Hong Kong dollar ceased to be tied to sterling, whenever the note issue has been expanded, Certificates of Indebtedness have been issued against the creation of Hong Kong dollar deposits rather than, effectively, against sterling receipts. Similarly, an increase in coins in circulation is now effected by the sale of coins by the Exchange Fund against the creation of Hong Kong dollar deposits. It has not always been possible, particularly since the floating of the Hong Kong dollar in November 1974, to use these Hong Kong dollar receipts to acquire foreign currency assets because the effect on the exchange value of the Hong Kong dollar would have been unacceptable. Thus the monetary environment has been disturbed inasmuch as an expansion of currency in circulation has not been matched by a reduction in bank deposits in Hong Kong and has, therefore, not been neutral in its effect on the money supply.

243 Paradoxically, for the same reason, namely, a desire not to disturb the exchange value of the Hong Kong dollar, we have not disposed of anything like the same proportion of the budget surpluses we have been generating recently⁽²²⁶⁾, largely involuntarily, as we did prior to 1972. So there has been no constraining effect, as a result of this budget surpluses, on the growth rate of the money supply. This is because a surplus on budgetary account involves a transfer of deposits from the non-bank private sector to the Government's bank accounts. If this surplus is retained in Hong Kong in the form of Hong Kong dollar deposits, the effect on the money supply is largely neutral⁽²²⁷⁾, because the surplus can be re-circulated to the non-bank private sector through the creation of bank credit. Only if there is a net transfer of Hong Kong dollar assets into foreign currency assets held overseas (or *vice versa*) is the money supply significantly affected.

(5) *Fifth Objective: Economic Stability*

244 To avoid disturbing the monetary environment is not, as it happens, an objective to be pursued in 1979-80. Thus I come to the fifth objective of budgetary policy which is to influence the growth rate of total final demand. Present and foreseeable circumstances require me to take positive steps to slow it down. I have already taken steps to slow down the growth rate of public sector demand, but public sector demand (on any definition⁽²²⁸⁾)

(226)	\$ mn
1976-77	902
1977-78	1,236
1978-79 (RE)	1,212 (say, 1,600: see paragraph 84 above).
(227)	<i>If there is a deficit on budgetary account, there is a transfer of deposits from the Government's bank accounts to the non-bank private sector and the effect on the money supply is again largely neutral.</i>
(228)	<i>That is to say, General Revenue Account; or Consolidated Account; or, in national accounts terms, Government consumption expenditure plus public sector expenditure on building and construction (including, of course, that on the Mass Transit Railway project).</i>

is only one component of domestic demand. If the growth rate of total final demand is to be slowed down *sufficiently* to prevent inflationary pressures developing further, and in such a way as to facilitate a relative shift of resources in favour of the export sector, the growth rate of private domestic demand must *also* be constrained.

245 To begin with, we must limit the extent to which the Government's Hong Kong dollar balances can be used as a base for domestic credit creation, and this applies particularly to annual accretions to these balances whether they arise through an expansion of currency in circulation or through budget surpluses. Indeed, it would be quite inconsistent not to do so in circumstances where I am deliberately budgetting for as large a surplus as possible⁽²²⁹⁾ by slowing down the growth rate of expenditure on General Revenue Account and, by and large, maintaining existing tax rates.

246 It is true that the surplus on Consolidated Account is, at \$1,215 million⁽²³⁰⁾, less than the surplus I am budgetting for on General Revenue Account of \$1,428 million. This only serves to emphasize that, with the growth rate of the money supply continuing to be excessive⁽²³¹⁾, I must attempt to ensure that the surplus on General Revenue Account has its full constraining effect on total final demand (although I must admit, if my revenue estimates do not turn out to be conservative, this surplus could well be eroded as a result of Civil Service salary adjustments and

(229) *Of \$1,428 million (or \$1,434 million if my revenue proposals are included). The surplus is equal to more than 10% of estimated revenue.*

(230)		\$ mn	\$ mn
	<i>Revenue:</i>		
	<i>Recurrent</i>	12,768	—
	<i>Capital</i>	<u>2,846</u>	<u>15,614</u>
	<i>Expenditure:</i>		
	<i>Recurrent</i>	9,427	—
	<i>Capital</i>	<u>4,972</u>	<u>14,399</u>
	<i>Surplus</i>	<u>—</u>	<u>1,215(*)</u>

Note: (*) *The difference of \$213 million between this surplus and the surplus on General Revenue Account of \$1,428 million is made up as follows:*

	\$ mn
<i>Urban Council</i>	—126
<i>Housing Authority</i>	— 2
<i>Development Loan Fund</i>	—101
<i>Lotteries Fund</i>	— 5
<i>Home Ownership Fund</i>	+ 21
	<u>—213</u>

(231) *Money supply (% increase on a year ago):*

	M1	M2
<i>End October 1978</i>	25.0	27.6
<i>End November 1978</i>	20.7	26.8
<i>End December 1978</i>	23.2	25.6
<i>End January 1979</i>	22.2	25.7

General Note: *Later evidence suggests a further slight slowing down.*

additional commitments arising from the need to contain an/or cope with immigration). Given that to transfer a substantial proportion of this surplus abroad would probably put unacceptable pressure on the exchange rate, I have been forced to devise a means to limit the extent to which the Government's Hong Kong dollar balances, whatever their origin, form a base for the creation of credit.

247 The Government's Hong Kong dollar balances held by the Exchange Fund (and the Treasury, although these will eventually be limited to some working balances) the Government's Hong Kong dollar balances amounted to \$5,800 million at 31 December 1978, the monthly average during 1978 being around \$5,500 million. These balances are likely to be of the order of \$6,400 million by 31 March next⁽²³²⁾. However, even at 31 December, the Government's Hong Kong dollar balances at \$5,800 million represented nearly 9% of total bank deposits⁽²³³⁾ and, indeed, would have been much higher, but for certain arrangements we were able to make during 1978 with the note-issuing banks to acquire foreign currency assets outside the market. The level of our balances at 31 December 1978 may be compared with \$4,200 million at 31 December 1977 (representing 7.9% of total deposits) and \$2,300 million at 31 December 1976 (representing only 5.2% of total deposits). Thus our Hong Kong dollar balances increased by 83% in 1977 and 38% in 1978, that is to say, much faster than the growth rate of M2 which was 21% in 1977 and 26% in 1978; and faster than the growth rate of loans and advances in Hong Kong in 1977, which was 25%, and nearly as fast as the rate at which such loans and advances grew in 1978, namely, 43%.

248 The relative importance of our Hong Kong dollar balances and the rate at which they have increased suggest that the Government has involuntarily contributed to the undesirable growth rates of the money supply and bank advances ever since the growth rate of domestic demand began to play a prominent role in determining the growth rate of the economy. Given that banks in Hong Kong are required by the Banking Ordinance to maintain a minimum ratio of 25% of specified liquid assets against their deposits from non-bank customers⁽²³⁴⁾—the balance of up to 75% being potentially lendable to customers given that banks in Hong Kong are required by the Banking Ordinance to maintain a minimum ratio of 25% of

(232) *On the basis of certain assumptions about the seasonal contraction of the note issue (—5%), and the fact that, when the Government's accounts are in surplus, it is in the last 4-5 months of the financial year and particularly in January and February that the surplus builds up quickly. As a matter of interest, they could well be as high as, say, \$9,000 million by 31 March 1980; and, if more than \$7,000 million is held against debt certificates issued in favour of the General Revenue Account (see f.n. (239) below), the Exchange Fund's borrowing powers will have to be increased by resolution made under section 3(5) of the Exchange Fund Ordinance.*

(233) *Total deposits held by non-bank customers, that is, total deposits excluding inter-bank balances=\$66,858 million.*

(234) *See section 18 of the Banking Ordinance.*

specified liquid assets against their deposits from non-bank customers— *in theory* the level of the Government's Hong Kong dollar balances at the end of December 1978 could support, through the conventional process of credit creation, loans and advances of over \$17,000 million. *In practice*, as the banking system tends to hold around 45% of its deposits in specified liquid assets, the Government's balances could generate loans and advances up to at least, say, \$7,000 million.

249 Clearly, therefore, and as there are limits to the extent to which arrangements can be, and indeed should be, negotiated with the note-issuing banks to acquire foreign currency assets without going through the market, it is necessary for me to find some means of ensuring that any build-up of the Government's Hong Kong dollar balances which may be desirable or unavoidable in terms of protecting the exchange value of the Hong Kong dollar does not, at the same time, contribute to an excessive expansion of loans and advances by the banking industry as a whole.

250 The problem inherent in the accumulation of Hong Kong dollar balances arises because the banks holding these balances on deposit are under no constraints on the use made of them, apart from the statutory minimum liquidity ratio. Only if the deposits can be 'frozen', in whole or in part, by the compulsory matching of assets will their credit creation potential be limited.

251 A bank has to hold a minimum of 25% of specified liquid assets against deposits of any maturity from non-bank customers (*ie* including deposits held in accounts in the name of the Exchange Fund or the Government). But, against *short-term* deposits⁽²³⁵⁾ from other banks, each bank has to hold 100% liquid assets. Against *long-term* (*ie* time) deposits from other banks there is no liquid assets requirement at all.

252 Subject to the advice of Executive Council, I propose to introduce into this Council a bill to amend the Exchange Fund Ordinance so that, for the purposes of the Banking Ordinance, *short-term* Hong Kong dollar deposits of the Exchange Fund shall be deemed to be deposits from a bank (and so subject to the 100% liquid assets requirement), while *long-term* deposits of the Fund will continue to be regarded as deposits from a non-bank customer (and so subject only to the 25% liquid assets requirement).

253 This will have the immediate effect of increasing the minimum liquid assets which have to be held by the banks concerned against these deposits. Furthermore, the impact of the requirement can easily be altered by converting

(235) *Defined in section 18(2A) of the Banking Ordinance as balances payable on demand, money at call and money at short notice.*

verting part or all of the Exchange Fund's long term deposits (at 25%), into short term deposits (at 100%) or *vice versa*⁽²³⁶⁾.

254 Any stiffening of this requirement by shortening the maturity pattern of the Exchange Fund's deposits will, of course, entail some loss of revenue to the Fund, because we can normally expect to earn a lower rate of interest on the Fund's short term deposits than we can on its long term deposits. But this is a completely legitimate outcome. The Fund was set up in 1935 with the stated purpose of regulating the exchange value of the Hong Kong dollar⁽²³⁷⁾: that remains its prime function. Then, three years ago, we transferred to the Exchange Fund the foreign currency assets of the General Revenue Account to centralize the management of the Government's foreign currency assets, and to relieve general revenue of the cost of positional exchange losses and book losses on fixed interest investments⁽²³⁸⁾. And we are now in the process of progressively transferring to the Exchange Fund all Hong Kong dollar balances of the General Revenue Account (except for working balances with the Treasury). So the Exchange Fund has become, effectively, banker to the Government⁽²³⁹⁾. It is quite in order for the Fund to forego some revenue on its Hong Kong dollar balances, if the increase in those balances was caused by our desire not to disturb the exchange value of the Hong Kong dollar.

255 The implementation of the proposed requirement is not likely to lead to an exactly proportionate reduction in the amount of loans and advances by the banks holding the Government's deposits, because they will probably adjust their conventional liquidity ratio downwards. But there is a limit to the extent to which they will be willing, and able, to do this since banks habitually choose to hold a cushion of liquid assets in excess of the statutory minimum. The size of this cushion represents a target (or rather a range) selected by each bank in the light of its own criteria and its own particular situation: an initial reduction in the size of the cushion brought about,

(236) *To deem all deposits (short and long term) of the Exchange Fund to be deposits of a bank would have a rather different effect, because banks do not have to hold any liquid assets at all against long term deposits from other banks. So, to have the same leverage on the liquidity ratio of the banks concerned, a higher proportion of the Exchange Fund's total deposits would have to be at short term: that would reduce the scope of the influence that could be exerted by the Government. It would also not be particularly welcome to the banks—it is easier for them to manage their liquidity with a higher proportion of deposit liabilities due to be repaid on known dates, rather than at unforeseeable call.*

(237) *Section 3 of the Exchange Fund Ordinance.*

(238) *B.S., 1976, paras. 75-84.*

(239) *Balances held by the Exchange Fund in Hong Kong dollars and in foreign currencies plus the small working balances with the Treasury equal the monetary assets of the Hong Kong Government. These assets comprise the Government's fiscal reserves (represented by balances with the Treasury and balances placed, on behalf of the General Revenue Account, in the Exchange Fund against the issue of interest bearing debt certificates) plus the Exchange Fund's own balances (represented by its liabilities in respect of non-interest bearing Certificates of Indebtedness issued to the note issuing banks and of coins in circulation plus the accumulated surplus of the Fund).*

effectively, by a Government decision will lead to each bank concerned taking steps to restore its cushion, at least partially.

256 But, despite the fact that the banks concerned will be able to avoid the full impact of the proposal, the ability of the banking system as a whole to expand its loans and advances on the basis of Government deposits will be significantly reduced. The credit creation potential of the banking system has been, as I said before, involuntarily increased by the accumulation of the Government's Hong Kong dollar balances as a consequence of our not limiting the size of these balances in a situation in which the Hong Kong dollar is freely floating and, for the time being, under some pressure in the market. That is to say, it is a consequence—yet another consequence—of our economy having to operate under a floating as opposed to a fixed exchange rate regime. This proposal is, *in no way*, an attack on the lending behaviour, as it were, of the Government's own bankers. Rather, it simply stems from a realization that it is unlikely that the Government's Hong Kong dollar balances can be easily removed from the system and, therefore, the Government has an obligation to limit their contribution to the growth of loans and advances by the banking system as a whole.

257 The Government, having put its own house in order, so to speak, by assuming powers to limit the *supply* of credit based on its own Hong Kong dollar balances, the question now to be considered is the control of the growth rate of the money supply to the extent that it is determined by the *demand* for credit⁽²⁴⁰⁾ which, in turn, is influenced by the rates of interest at which loans and advances are offered by the banks.

258 Before concluding that the only really satisfactory and practicable method of exercising control over the growth rate of the money supply in Hong Kong is the use of interest rates, I had various possible methods of restraint examined including, for example, an imposition of ceilings on loans and advances for specified purposes and a limitation on the growth of bank resources. All methods examined were evaluated in terms of whether their effects would be equitable as between different categories of banks (and deposit-taking companies), whether there would be any adverse effects on banks' offshore lending business, whether there would be unacceptable effects on the exchange rate or on interest rates and, of course, whether they would effectively achieve the objective. My conclusion was that none of the methods devised would be wholly effective and some of them would be objectionable in terms of one or more of these criteria; and I was seized of a further consideration: no matter how skilfully the case for the imposition of a form of direct control might be presented, it

(240) *Apart from changes in the cash element and in the Government's own balances, the growth rate of the money supply is also determined by the net acquisition of foreign currency assets by banks in Hong Kong. These assets are either purchased in the open market from the non-bank private sector in Hong Kong or acquired, in the open market or by swap arrangements, from head offices or other banks overseas.*

would be interpreted by some as a radical change of policy by the Government and all sorts of idiotic and erroneous conclusions drawn from this.

259 I would, of course, prefer not to impose any form of direct control on the supply of credit in Hong Kong anyway: I would *much* prefer to leave matters to the banking system itself. Nonetheless, while it has so far proved difficult to devise suitable constraints for Hong Kong's particular circumstances, I am in no doubt that *some* form of constraint *could* be devised, if necessary. And we do, of course, have one constraint ready to hand, in the form of the minimum liquidity ratio.

260 Three years ago, the Financial Secretary was given the power to raise or lower the minimum liquidity ratio of 25% 'in exceptional circumstances' for any particular bank or for all banks. When I moved the second reading of the Banking (Amendment) (No 2) Bill 1975, I said '...exceptional circumstances could ... arise in which, for prudential reasons, the ratio might need to be raised for individual banks or for all banks ... (but) it is not envisaged that the ratio would ever be varied for monetary control purposes...' ⁽²⁴¹⁾. Nevertheless, I believe that an increase in this ratio might, in certain circumstances, be appropriate for the purposes of monetary policy. So I have changed my attitude since 1975, but it would not be particularly equitable to use this mechanism, it would not be particularly equitable as between groups of banks, and it would not be totally effective in achieving its purpose, but it *is* a constraint which *does* lie to hand. A similar constraint could, in due course, be applied to deposit-taking companies ⁽²⁴²⁾ even though we have not yet set the minimum liquidity ratio to be observed by them.

261 But let me emphasize, again, that I do not at present intend to raise the minimum liquidity ratio. For the time being, it is, I believe, more appropriate to continue to depend primarily on interest rates to influence the growth rate of loans and advances, and hence of the money supply. Our experience in the past four months, when the Best Lending Rate has been increased from 7¼% (30 October) to 10½% (19 February) might lead one to suppose that the demand for loans and advances is not all that interest rate sensitive ⁽²⁴³⁾. But, leaving aside seasonal distortions, it is unlikely

(241) *Hansard*, 5 November 1975, page 189.

(242) *Section 24A (8) of the Deposit-taking Companies Ordinance.*

(243) *Bank loans and advances in Hong Kong (% increase on a year ago):*

	%
<i>End October 1978</i>	41.5
<i>End November 1978</i>	43.1
<i>End December 1978</i>	43.4
<i>End January 1979</i>	43.8

General Note: *The ratio of loans and advances in Hong Kong to total deposits rose from 68.2% at end October 1977, to 75.3% a year later in October 1978, to 79% at end December 1978 and to 80.6% at end January 1978, which is uncomfortably close to the highest recorded ratio of 82.4% at the end of 1973. Between end June 1976 and end June 1978 the ratio stayed within the range 68% to 71% and, even during the three months July, August and September 1978 it was only between 71% and 72%.*

that those customers with access to facilities already negotiated will be in a position to limit the extent to which they utilize these facilities, and it is unlikely that other potential borrowers will be willing to revise their expenditure intentions immediately solely in response to the higher cost of bank finance. So the effects of higher interest rates are bound to be lagged and I am confident that evidence will begin to emerge within a few months that they are having the desired effect. I believe also that banks —certainly some banks— are not only widening the margins over the Best Lending Rate for certain categories of borrowers, but also I am now looking at requests for advances more critically.

262 This still leaves open, however, the question of whether the way in which interest rates are determined ensures that their critical role in helping the economy to maintain internal and external equilibrium under a floating exchange rate regime is adequately recognized⁽²⁴⁴⁾. I am referring here, of course, to both lending rates and deposit rates, and I believe that there is now a wider recognition of their respective roles in relation to the management of the economy and to the exchange value of the Hong Kong dollar⁽²⁴⁵⁾; and, incidentally, I do not think there need be, or should be, in all circumstances, a fixed relationship between lending and deposit rates. As evidence of this, of the wider recognition of the significance of interest rates, I would refer Honourable Members to the terms of the announcement by the two note-issuing banks on 17 February relating to the increase from 9½% to 10½% in their best lending rates; this announcement had the explicit support of the Exchange Banks' Association itself. I also welcome the recent decision (announced on 3 February) to convene the Working Party of the Exchange Banks' Association concerned with the administration of the agreement on deposit rates on a regular twice-monthly basis and on other occasions whenever necessary.

263 Since I am confident that my proposal to deem short term deposits from the Exchange Fund to be deposits from a bank, together with the recent increases in lending rates, will have the effect of slowing down the growth rate of loans and advances, the growth rate of total final demand will be influenced in a way which is consistent with the emphasis of budgetary policy in the coming year, which is to slow it down.

264 Lest it be thought I am seeking to place too *much* emphasis on the slowing down of the growth rate of private domestic demand, let me recall the contribution to be made by the slowing down of the growth rate of public sector demand. In national accounts term⁽²⁴⁶⁾ the growth rate of total Government expenditure in 1978 was 22%; using cash inputs based on departmental returns the initial forecast exercise for 1979 showed

(244) See paras. 14 and 15 above.

(245) Other interest rates which are important in relation to the exchange value of the Hong Kong dollar are the interbank rates and the rates offered by deposit-taking companies.

(246) See f.n. (228) above.

a prospective growth rate of 19%. But using cash inputs which recognized that the necessary emphasis of budgetary policy in 1979-80 had to be to slow down the growth rate of total final demand, the growth rate of total Government expenditure in the final forecast is 7%. This reduction lowers the forecast growth rate of total final demand to 9%, compared with 15% in 1978.

265 The strict application of cash limits for the purpose of controlling expenditure provided in the Draft Estimates will mean that, unless the rate of increase in prices is less than has been assumed, the growth rate of total Government expenditure will be at most 7%. To the extent that prices increase faster than has been assumed, the growth rate of total Government expenditure will be less than 7% in real terms. This would be a perfectly appropriate reaction to price increases which were above expectations, and would occur automatically.

CONCLUSION

266 That concludes, Sir, my presentation of the budgetary, fiscal, economic and monetary policies which the Government intends to pursue during 1979-80. The extent to which we are successful in achieving the five general objectives of these policies will depend not only upon a united and singleminded Administration, but also upon Officials and Unofficials, and the Government and the private sector, working closely together. Fortunately, concord and co-operation are said to be two of the attributes characteristic of the Year of the Goat.

267 On that note, Sir, I now move that the debate on this motion be adjourned.

ANNEXES

	<i>Pages</i>
(1) Forecast of Land Production	558
(2) Basic Statistics relating to the Management of the Public Finances, 1972-73 to 1978-79	561
(a) Revenue and Expenditure, 1972-73 to 1979-80	562
(b) Relative Size of the Public Sector, 1972-73 to 1978-79	562
(c) Budget Guideline Ratios, 1972-73 to 1978-79	563
(d) Revenue and Expenditure Trends, 1972-73 to 1978-79	564
(e) Original/Approved Estimates compared with the Revised Estimates in the previous year, 1972-73 to 1978-79	564
(f) Balance of the Fiscal System, 1972-73 to 1978-79	565
(3) Financial Circular No 6/78: Five Year Forecast of Revenue and Expenditure 1978-79 to 1982-83	566

	<i>Pages</i>
(4) Expenditure on New Territories Urban Land Acquisitions	572
(5) Final Forecast of Expenditure on the Gross Domestic Product in 1979	575
(6) Summary of Expenditure by Main Components, 1972-73 to 1979-80	576
(7) Summary of Expenditure by Groups of Services, 1972-73 to 1979-80	577
(8) Expenditure on Selected Services	578
A Law and order	578
B Defence	579
C Education	579
D Medical and health services	582
E Social welfare	583
F Infrastructural facilities	585
G Public housing and related facilities	589
(9) Speeches by the Financial Secretary in Legislative Council on the Second Reading of the Inland Revenue (Amendment) (No 3) Bill 1978	593
(1) 12 April 1978	
(2) 16 August 1978	
(10) Speeches by the Financial Secretary in Legislative Council on the Second Reading of the Inland Revenue (Amendment) (No 5) Bill 1978	594
(1) 15 November 1978	
(2) 29 November 1978	
(11) Speech by the Financial Secretary in Legislative Council on Wednesday, 24 January 1979 on Water Charges	595
(12) Effect on salaries tax of proposed reduction in 'claw-back' from 15% to 10% and abolition of 30% top marginal rate	596
(13) Examples of salaries tax having regard to dependent parent allowance, reduced 'claw-back' and abolition of 30% top marginal rate	597
(14) Effect of new rates of first registration tax on typical retail prices	599
(15) The Government's decisions on the recommendations of the Third Inland Revenue Ordinance Review Committee	600

Annex (1)

FORECAST OF LAND PRODUCTION

(1) *Special Committee on Land Production*

The Special Committee on Land Production was appointed in May 1977 to assess the amount of land that will become available from development schemes already in hand or being planned, and to identify all areas in which additional land could be formed for development, it completed its report in July 1977.

2 The Special Committee found that the forecast production of land should ensure a fairly steady supply up to 1981-82, mainly because of the continuing development of the New Towns. Thereafter, however, the rate of production may decline. So the Committee recommended that a comprehensive investigation of North Lantau and an investigation of certain areas of the mainland of Hong Kong should proceed.

3 The Special Committee was re-appointed in May 1978 to produce a further report, within 18 months, to give an assessment of demand for land in all categories up to 1988; to recommend when and how this demand, and further demand beyond this period, should be met; and to recommend how a continuing land production programme could be maintained.

(2) *Forecast of supply*

4 The estimates of land production contained in the first Report of the Special Committee were revised in August 1978. The revised estimates envisage the production of formed and serviced land for development as follows:

<i>Category</i>	<i>Status⁽¹⁾</i>	<i>Production⁽²⁾ by Production⁽²⁾ after</i>	
		<i>1982-83 (hectares)</i>	<i>1982-83 (hectares)</i>
Industrial	Definite projects	434	66
	Indefinite projects	7	268
Private non-industrial	Definite projects	281	186
	Indefinite projects	13	423

(1) *Land to be produced under definite projects includes land already formed and serviced, but not yet developed; land to be produced under projects included in Categories A, D and E of the Public Works Programme; land to be produced by projects which are likely to reach Category A within about 5 years (eg the later stages of the New Towns programmes); land to be produced under projects implemented by other organizations (eg the Hong Kong Industrial Estates Corporation); and land scheduled to be made available to developers with varying degree of commitment by the Government in respect of formation and servicing (eg certain sale sites). Land to be produced under indefinite projects includes land not covered by the foregoing definitions, and includes land-producing projects in the Public Works Programme which are not expected to reach Category A within five years. They also include some projects in the investigation stage for which no decision has been taken on the timing of implementation of development works.*

(2) *Land produced by a certain date means that the land will generally have been formed and serviced by that date, but for a variety of reasons the land may not necessarily be made available immediately for the purposes for which it has been produced. The estimates of production are net of the land requirement for roads.*

<i>Category</i>	<i>Status⁽¹⁾</i>	<i>Production⁽²⁾ by 1982-83 (hectares)</i>	<i>Production⁽²⁾ after 1982-83 (hectares)</i>
Public housing	Definite projects	509	9
	Indefinite projects	—	65
Government, institutional and community	Definite projects	589	202
	Indefinite projects	15	332
Open space	Definite projects	522	239
	Indefinite projects	28	180
Undesignated	Definite projects	39	20
	Indefinite projects	—	80
	Total, definite projects	<u>2,374</u>	<u>722</u>

Note: 1 hectare=2.471 acres.

5 Very rough orders of land production costs have also been calculated with the revised estimates of production, but these require closer and more detailed examination. During 1979-80 the Special Committee intends to develop a guide to land production costs so that possible development areas may be ranked in an order of priority, having regard not only to environmental and economic considerations, but also to the orders of cost involved.

(3) *Feasibility studies*

6 In addition to the two major investigations recommended by the Special Committee, two other major investigations associated with possible development areas have been approved for inclusion in the Public Works Programme. The four major investigations comprise: *first*, a land development feasibility study of North Lantau, including engineering investigations for a possible airport at Chek Lap Kok, undertaken by the Public Works Department⁽³⁾; *secondly*, a feasibility study by consulting engineers of the alignment and form of a proposed fixed crossing linking Lantau, Ma Wan, Tsing Yi and the Mainland⁽⁴⁾; *thirdly*, an engineering and planning study by consulting engineers of Junk Bay; and, *finally*, a study by consulting engineers of six possible development areas on the Mainland⁽⁵⁾.

7 The first study (North Lantau) is nearing completion and preliminary findings are likely to be made available during 1979. The second study (Lantau fixed crossing) will shortly be completed. Preliminary findings point to a suspension bridge initially providing for four lanes of traffic but structurally capable of being expanded to take eight traffic lanes. The preliminary order of cost of a bridge between Lantau and Tsing Yi,

(3) *Head 71 PWRN: Engineering Subhead 537 North Lantau development—investigations. Approved project estimate: \$4.9 million; estimated expenditure to 31 March 1979: \$3.5 million; Draft Estimates for 1979-80: \$1.0 million.*

(4) *Head 71 PWRN: Engineering Subhead 875 Lantau fixed crossing—further investigation and design. Approved project estimate: \$34 million; estimated expenditure up to 31 March 1979: \$6.5 million; Draft Estimates for 1979-80: \$8.0 million.*

(5) *PWP item NDEM 10 'Preliminary investigation of potential development areas in the north-western New Territories' was included in Category A in December 1978.*

including extensions to the mainland and associated road connections, but excluding consequential improvements to the existing and planned road network in the New Territories and Kowloon, is \$1,000 million. The third study (Junk Bay) has been completed and suggests that about 267 hectares⁽⁶⁾ (or about 660 acres) of land could be formed for a new township in Junk Bay with a population of 240,000 over a ten-year period. A rough order of cost of development is about \$1,370 million at mid-1977 prices. This study will soon be considered by the Land Development Policy Committee and is expected to lead to a further engineering study of the requirements for road access and water supply to the area. The fourth study has not yet started and its scope is being re-examined to determine whether it needs to be expanded to cover a larger area in the north-western part of the New Territories.

(4) *Forecast of demand*

8 The Special Committee is also expected to consider the long-term demand for land resources during 1979-80. This area of study is likely to be difficult, and any evaluation of long-term demand is likely to be imprecise. However, every effort is being made to complete the revision of the Hong Kong Outline Plan during 1979-80. This document contains land planning standards, partly for such public sector activities as the provision of public housing, recreational space, schools and other community facilities, and partly for private sector land requirements. The application of these standards to known programmes of services and activities in the public sector will provide an estimate of the present and likely future requirement for land by that sector. The Plan will also include an estimate of the present and likely future requirement for land by the private sector. In addition to the Hong Kong Outline Plan, a separate assessment of demand for industrial land has also been undertaken for the Advisory Committee on Diversification, and the *preliminary* findings of this assessment suggest that the estimated demand up to 1982 is unlikely to outstrip the estimated supply.

(5) *Future planning of land production*

9 When the forecast of demand is finalized and the forecast of supply is up-dated, the Special Committee will be able to address itself to the task of formulating a programme for land production over the next decade or so.

(6) *The land production potential of these four studies is not reflected in the forecast of production in paragraph 4.*

Annex (2)

BASIC STATISTICS RELATING TO THE MANAGEMENT OF THE PUBLIC FINANCES, 1972-73 TO 1978-79

- (a) Revenue and Expenditure, 1972-73 to 1979-80.
- (b) Relative Size of the Public Sector, 1972-73 to 1978-79.
- (c) Budget Guideline Ratios, 1972-73 to 1978-79.
- (d) Revenue and Expenditure Trends, 1972-73 to 1978-79.
- (e) Original/Approved Estimates compared with the Revised Estimates in the previous year, 1972-73 to 1978-79.
- (f) Balance of the Fiscal System, 1972-73 to 1978-79.

Notes: With effect from 1 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 reimbursements from the Urban Council and Housing Authority were taken below-the-line. For purposes of comparison, the figures given in the tables in this annex in respect of 1972-73 to 1974-75 have been adjusted to exclude these transactions.

2 In addition, the following adjustments have been made:

- (a) *Capital expenditure 1972-73:*
actual figures exclude payment of \$500 million to the Mass Transit Fund.
- (b) *Capital expenditure 1973-74:*
actual figures exclude payment of \$300 million to the Mass Transit Fund.
- (c) *Capital Revenue 1975-76:*
revised and actual figures exclude loans and grants totalling \$264 million credited to General Revenue.
- (d) *Capital Revenue 1977-78:*
excludes land premia of \$335 million (actual figures and revised estimates) from the Mass Transit Railway Corporation, \$488 million (actual figures) and \$528 million (revised estimates) from the Home Ownership Scheme, credited to General Revenue and \$27 million (revised estimates) in respect of loans.
- (e) *Capital Expenditure 1977-78:*
excludes payments of \$335 million (actual figures and revised estimates) to the Mass Transit Fund and \$488 million (actual figures) and \$528 million (revised estimates) to the Home Ownership Fund.

Table (a)

REVENUE AND EXPENDITURE, 1972-73 TO 1978-79

	1972-73	1973-74	1974-75	1975-76	1976-77	1977-78	1978-79 Revised Estimates	1979-80 Draft Estimates
	(\$ mn)	(\$ mn)						
Recurrent Revenue	4,008	4,550	5,156	5,843	6,849	8,151	9,932	11,470
Less Recurrent Expenditure	<u>2,469</u>	<u>3,231</u>	<u>4,175</u>	<u>4,450</u>	<u>5,224</u>	<u>6,219</u>	<u>7,444</u>	<u>8,360</u>
Surplus on Recurrent Account	1,539	1,319	981	1,393	1,625	1,932	2,488	3,110
Capital Revenue	761	467	437	413	644	1,259	2,442	2,412
Less Capital Expenditure	<u>1,081</u>	<u>1,413</u>	<u>1,798</u>	<u>1,582</u>	<u>1,367</u>	<u>1,955</u>	<u>3,718</u>	<u>4,094</u>
Surplus/deficit	<u>1,219</u>	<u>373</u>	<u>—380</u>	<u>224</u>	<u>902</u>	<u>1,236</u>	<u>1,212</u>	<u>1,428</u>
Total Revenue	4,769	5,017	5,593	6,256	7,493	9,410	12,374	13,882
Total Expenditure	3,550	4,644	5,973	6,032	6,591	8,174	11,162	12,454

Table (b)

RELATIVE SIZE OF THE PUBLIC SECTOR 1972-73 TO 1978-79

	Consolidated Account Total Expenditure at current prices (adjusted for capital transfers) (\$ mn)	GDP at current prices (\$ mn)	Relative size of the Public Sector (%)
1972/1972-73	3,887.4	24,156	16.1
1973/1973-74	5,049.0	30,736	16.4
1974/1974-75	6,612.8	35,252	18.8
1975/1975-76	6,573.9	37,268	17.6
1976/1976-77	7,362.1	47,226	15.6
1977/1977-78	9,181.4	54,836(**)	16.7
1978/1978-79	12,513.8(*)	63,686(***)	19.6

(*) Revised Estimate.

(**) Provisional estimate.

(***) Preliminary estimate.

Table (c)

BUDGET GUIDELINE RATIOS, 1972-73 TO 1978-79 (\$ MILLION AND %)

	<i>Guideline</i>	<i>1972-73</i>	<i>1973-74</i>	<i>1974-75</i>	<i>1975-76</i>	<i>1976-77</i>	<i>1977-78</i>	<i>1978-79 Revised Estimates</i>
(1) $\frac{\text{Recurrent Revenue}}{\text{Total Expenditure}}$	At least 88%	$\frac{4,008}{3,550}=113$	$\frac{4,550}{4,644}=98$	$\frac{5,156}{5,973}=86$	$\frac{5,843}{6,032}=97$	$\frac{6,849}{6,591}=104$	$\frac{8,151}{8,174}=100$	$\frac{9,932}{11,162}=89$
(2) $\frac{\text{Recurrent Expenditure}}{\text{Recurrent Revenue}}$	No more than 80%	$\frac{2,469}{4,008}=62$	$\frac{3,231}{4,550}=71$	$\frac{4,175}{5,156}=81$	$\frac{4,450}{5,843}=76$	$\frac{5,224}{6,849}=76$	$\frac{6,219}{8,151}=76$	$\frac{7,444}{9,932}=75$
(3) $\frac{\text{Surplus onRecurrent Account}}{\text{Capital Expenditure}}$	At least 60%	$\frac{1,539}{1,081}=142$	$\frac{1,319}{1,413}=93$	$\frac{981}{1,798}=55$	$\frac{1,393}{1,582}=88$	$\frac{1,625}{1,367}=119$	$\frac{1,932}{1,955}=99$	$\frac{2,488}{3,718}=67$
(4) $\frac{\text{Recurrent Expenditure}}{\text{Total Expenditure}}$	No more than 70%	$\frac{2,469}{3,550}=70$	$\frac{3,231}{4,644}=70$	$\frac{4,175}{5,973}=70$	$\frac{4,450}{6,032}=74$	$\frac{5,224}{6,591}=79$	$\frac{6,219}{8,174}=76$	$\frac{7,444}{11,162}=67$
(5) $\frac{\text{Capital Revenue}}{\text{Capital Expenditure}}$	At least 20%	$\frac{761}{1,081}=70$	$\frac{467}{1,413}=33$	$\frac{437}{1,798}=24$	$\frac{413}{1,582}=26$	$\frac{644}{1,367}=47$	$\frac{1,259}{1,955}=64$	$\frac{2,442}{3,718}=66$

Table (d)

REVENUE AND EXPENDITURE TRENDS, 1972-73 TO 1978-79

	<i>Revenue</i>			<i>Expenditure</i>		
	<i>Actual</i>	<i>Increase over</i>		<i>Actual</i>	<i>Increase over</i>	
	<i>(\$ mn)</i>	<i>(\$ mn)</i>	<i>(%)</i>	<i>(\$ mn)</i>	<i>(\$ mn)</i>	<i>(%)</i>
1972-73	4,769	1,367	40.2	3,550	832	30.6
1973-74	5,017	248	4.9	4,644	1,094	30.8
1974-75	5,593	576	11.5	5,973	1,329	28.6
1975-76	6,256	663	11.9	6,032	59	1.0
1976-77	7,493	1,237	19.8	6,591	559	9.3
1977-78	9,410	1,917	25.6	8,174	1,583	24.0
1978-79	12,374	2,964	31.5	11,162	2,988	36.6

(Revised Estimates)

Table (e)

ORIGINAL/APPROVED ESTIMATES COMPARED WITH THE REVISED ESTIMATES IN THE PREVIOUS YEAR 1972-73 TO 1978-79

	<i>Revenue</i>				<i>Expenditure</i>			
	<i>Original</i>	<i>Increase over</i>		<i>Revised</i>	<i>Approved</i>	<i>Increase over</i>		<i>Revised</i>
	<i>Estimates</i>	<i>revised estimate of</i>	<i>previous year</i>	<i>Estimates</i>	<i>Estimates</i>	<i>revised estimate</i>	<i>of previous year</i>	<i>Estimates</i>
	<i>(\$ mn)</i>	<i>(\$ mn)</i>	<i>(%)</i>	<i>(\$ mn)</i>	<i>(\$ mn)</i>	<i>(\$ mn)</i>	<i>(%)</i>	<i>(\$ mn)</i>
1972-73	3,537	210	6.3	4,421	3,407	660	24.0	3,616
1973-74	4,697	276	6.2	5,052	4,183	567	15.7	4,608
1974-75	5,563	511	10.1	5,701	5,465	857	18.6	6,171
1975-76	6,184	483	8.5	6,015	6,615	444	7.2	6,222
1976-77	6,857	842	14.0	7,400	7,212	990	15.9	6,843
1977-78	8,275	875	11.8	9,235	8,245	1,402	20.5	8,160
1978-79	10,246	1,011	10.9	12,374	10,266	2,106	25.8	11,162

Table (f)

BALANCE OF THE FISCAL SYSTEM, 1972-73 TO 1978-79 (\$ MILLION AND %)

	1972-73	1973-74	1974-75	1975-76	1976-77	1977-78	1978-79(*)
<u>Direct</u>	1,083	1,680	2,144	2,234	2,699	3,357	4,134
<u>Indirect</u>	1,794 =38:62	1,471 =53:47	1,404 =60:40	1,815 =55:45	2,245 =55:45	2,611 =56:44	3,312 =56:44
<u>Direct and Indirect</u>	2,877	3,151	3,548	4,049	4,944	5,968	7,446
<u>All Other Recurrent Revenue</u>	1,131 =72:28	1,399 =69:31	1,608 =69:31	1,794 =69:31	1,905 =72:28	2,182 =73:27	2,486 =75:25

(*) Revised Estimates.

Annex (3)

FINANCIAL CIRCULAR NO 6/78(*)

FIVE YEAR FORECAST OF REVENUE AND EXPENDITURE 1978-79
TO 1982-83*Five Year Forecast Returns*

In connexion with the preparation of the Five Year Forecast of Revenue and Expenditure for the period 1978-79 to 1982-83, Heads of Departments are requested to complete the returns in the form of Appendices I—V(**). These appendices are designed to distinguish between:

- (a) the financial implications of maintaining existing activities at the present levels (Appendix I);
- (b) the financial implications of increasing, or reducing, the present levels of existing activities, or of introducing new activities, depending upon whether:
 - (i) this is within approved policies with specifically agreed timing (Appendix II);
 - (ii) this is within approved policies, but without specifically agreed timing (Appendix III); and
- (c) the financial implications of increasing the present levels of existing activities or of introducing new activities, for which the policy has not yet been approved (Appendix IV).

(*) This is an abridged version of the original Circular and the Appendices to the Circular are not attached.

(**) These appendices are explained in greater detail in the Notes attached to this annex.

2 The completed returns, in duplicate, should reach the Finance Branch, *with a copy* to the appropriate policy Secretary, *not later than 31 July 1978*.

3 Appendix II this year combines last year's Appendices II, III and IV. This should simplify the completion of the returns. The returns are designed to enable information to be obtained to assist in determining priorities and, towards this end, Heads of Departments are asked to forecast their financial requirements in accordance with the programmes which have been identified and which are listed in Appendix VII to this Circular. Heads of Departments have already been asked in Management Circular No. 1/78 to prepare the Third Development Plan: 1978-79 to 1982-83; their response to that Management Circular will assist in their completion of the Five Year Forecast returns invited by this Circular.

4 As regards activities included in Appendices III and IV, Heads of Departments are invited to indicate the priorities which they would suggest as being appropriate, in accordance with the following classification:

Category I — activities for which implementation is considered essential or unavoidable,

- Category II —activities for which implementation is highly desirable and for which deferment would cause *serious* inconvenience,
- Category III —activities for which implementation is desirable and for which deferment would be inconvenient,
- Category IV —activities which rate a lower priority than Categories I to III.

5 On receipt of the returns, the Finance Branch will conduct a detailed examination in consultation with departments and policy branches. In examining the returns the Finance Branch will be mainly concerned with ensuring, first, that the activities are entered in the correct appendices and, second, that the levels and timing of expenditure envisaged are realistic.

6 Following examination of the returns, Heads of Departments will be given an indication of the provisional acceptable levels of annually recurrent expenditure in respect of existing activities and, where relevant, new activities for their submissions for the draft Estimates 1979-80. These may have to be changed as the situation develops, but it is hoped that any such change will be a matter of fine-tuning. These provisional acceptable levels of expenditure will be notified by 1 October, when the draft Estimates call circular will issue, and draft Estimates submissions will have to reach Finance Branch not later than 1 November. As Heads of Departments will thus have only one month in which to make their submissions for the draft Estimates *they should start compiling their submissions well before receiving the call circular.*

7 It is thus essential that the information given in the Five Year Forecast returns is accurate, realistic and sufficiently detailed and descriptive, so that activities can be properly identified, as the information derived therefrom will be used to determine the provisional acceptable levels of expenditure for 1979-80 and the priorities in respect of new activities. Heads of Departments are personally responsible for this, and for ensuring that the appropriate policy Secretary is *fully* consulted, particularly in respect of suggested priorities for activities included in Appendices III and IV of their returns.

Public Works Programme

8 The Five Year Forecast returns called for by this circular *exclude* direct expenditure on projects in the Public Works Programme. The forecast of direct capital expenditure on the Public Works Programme will be dealt with separately. But the returns must *include* all other expenditure arising from a Public Works Programme project—*eg* staff costs and recurrent running expenses. To assist Heads of Departments in preparing their returns, the Director of Public Works will be forwarding to departments tentative completion dates for all projects currently under construction or likely to be started in the current year. A further list giving tentative completion dates for other projects not yet under construction and not scheduled to begin in the current year, but which are likely to be completed within the forecast period (*ie* before 1 April 1983), will be issued as soon as possible.

NOTES FOR COMPLETION OF FORECAST RETURNS

General

All figures used in the returns should be given in \$ million and rounded off to the nearest *one* decimal place, and should be at constant mid-1978 prices. A price escalation factor must *not* be applied.

2 With regard to salaries, 'mid-1978 prices' means the approved salary scales already *in force* on 1 April 1978. Salary increments are not a price increase, and making allowance for increments is therefore not precluded in Appendix I where *actual* salaries are used. In those exceptional circumstances where it is not possible to determine actual salaries for Appendix I, notional mid-point costs may be used, and notional mid-point costs should in any case be used throughout in Appendices II-IV. Where notional mid-point costs are used, *no* allowance should be made for increments.

3 Where references are made to 'approved policies' these mean acceptance of the policy at the appropriate level—*eg* by Executive Council or by the Secretariat, as appropriate. Policy has not been approved where a proposal has not yet received approval at the proper level, no matter how far it has proceeded within a department, or inter-departmentally, or within Secretariat branches. The cut-off date for determining whether or not a policy has been approved will be *25 July 1978*.

4 The timing of implementation of an approved policy has been specifically agreed if the financial implications of the timing have been accepted by Finance Committee, or if the financial implications involve an approved capital project which is expected to be completed within the forecast period (*ie* before 1 April 1983). A capital project is approved if it is already in the Public Works Programme or, in the case of capital subvented projects, if it has been specifically approved or is included in an accepted plan. It is possible to have a policy approved without the timing of the financial implications having been agreed by Finance Committee (*eg* a ten-year programme where the overall target has been accepted, but the individual component items have not been specifically agreed by Finance Committee); cases of this sort should be dealt with in Appendix III.

5 All returns should be supported with sufficient details and explanations as to how the forecast figures have been determined.

Appendix I Forecast of revenue and expenditure on existing activities at present levels

6 The purpose of Appendix I is to analyse the approved Estimates for 1978-79 by *programmes*, and to show the estimated expenditure and revenue implications of *maintaining present activities without expansion* over the forecast period 1979-80 to 1982-83. 'Existing activities' should be interpreted literally to mean the activities for which financial resources have been approved in the current financial year.

7 The approved Estimates for 1978-79 should be used as the basis for Appendix I, adjusted as necessary to take into account any supplementary provision and any offsetting frozen provision approved up to and including 25 July 1978. Adjustments should be fully explained in a separate note, to be attached to Appendix I. Adjustments to the approved revenue figures should be made only where it is absolutely certain that significant differences can be expected.

8 It is expected that Heads of Departments will experience difficulty in breaking down the approved Estimates for 1978-79 by programmes. This should, of course, be done as accurately as possible, but it is recognized that there will be problems. The Finance Branch will not examine critically the breakdowns determined by departments, and will generally accept the allocations as submitted.

9 The breakdown should be by the programmes listed, in respect of each department, in Appendix VII to this Circular. A separate sheet should be used for each programme, and all the organizational sections of a department which contribute to the same programme should be amalgamated on this one sheet. A possible organizational breakdown of departments over the various programmes is given in Annex B to Management Circular 1/76.

10 As regards *personal emoluments*, the figure included for 1978-79 for each programme should be determined by the breakdown of the approved personal emoluments provision in the 1978-79 Estimates (as adjusted under paragraph 7 above). For 1979-80 this figure should be re-calculated to take into account the full-year cost of the estimated *strength* at 1 April 1979. For each of the subsequent three forecast years, 1980-81 to 1982-83, an allowance of 3% per annum should be added to this figure to take account of increments. But if, exceptionally, notional mid-point costs are used for 1979-80, then the figure so derived should also be used for the subsequent three forecast years *without* any allowance for increments. No further allowance should be made for any increase in the establishment, or for any increase in strength over and above the estimated strength at 1 April 1979, as to maintain the present actual level of activities should not require any increase in posts or strength.

11 As regards *annually recurrent other charges*, the figure for 1978-79 for each programme should again be determined by the breakdown of the 1978-79 Estimates (as adjusted under paragraph 7 above). For 1979-80 this figure should be further adjusted to take into account the full-year cost of activities introduced during 1978-79, but no change should be necessary for each of the subsequent three forecast years, as the figures are on a constant price basis.

12 As regards special expenditure, the figures for 1979-80 onwards should represent only the residual payments for orders placed during or before 1978-79, plus any new payments required for replacements of existing plant and equipment.

Appendix II Forecast of additional or reduced revenue and expenditure resulting from changes in the present levels of existing activities, or from introducing new activities, within approved policies with specifically agreed timing

13 The purpose of Appendix II is to show the additional or reduced expenditure and revenue likely to result from extending, expanding or improving existing activities, or from introducing new activities, within approved policies where timing of implementation has been specifically agreed.

14 Allowance should be made for expanding existing activities in response to changes in the volume of demand only where such response is within approved policy, and either the timing of implementation of the expansion has been specifically agreed, or the expansion is inescapable to avoid any unacceptable deterioration of existing standards. Where responding to changes in the volume of demand is not covered by approved policy, Appendix IV should be used. Where responding to changes in the volume of demand is covered by approved policy, but there is no specifically agreed timing of implementation, or it is not necessary in order to avoid a deterioration of existing standards, Appendix III should be used.

15 Allowance for qualitative improvements should only be made where this is within approved policy *and* timing of implementation has been specifically agreed. Otherwise, Appendix III or IV should be used, as appropriate.

16 For extending existing activities, or introducing new activities, timing of implementation may be deemed to be agreed where there is an *approved* capital works involvement. Where the capital works involvement has not yet been approved (*eg* there is no item in the Public Works Programme), Appendix III or IV should be used, as appropriate.

17 A separate sheet should be used for each activity, with a brief description given and a clear indication of the programme to which the activity belongs. Where there is a capital works involvement, this should be identified (*eg* P.W.P. project number and title).

Appendix III Forecast of additional revenue and expenditure resulting from changes in the present levels of existing activities, or from introducing new activities, within approved policies where the timing of implementation has not been specifically agreed

18 The purpose of Appendix III is to show the additional expenditure and revenue likely to result from extending, improving or expanding existing activities, or from introducing new activities, where these are *within approved policies* but the timing of implementation has not been specifically agreed.

19 Where there is an approved capital works involvement, this may be taken as implying agreed timing, and Appendix II should be used.

20 A separate sheet should again be used for each activity, with a brief description, and the programme to which the activity belongs should be identified.

Appendix IV Forecast of additional revenue and expenditure arising from increasing the present levels of existing activities, or from introducing new activities, the policy for which has not yet been approved

21 The purpose of Appendix IV is to show the estimated expenditure and revenue likely to arise from the introduction of new activities, or from the extension, improvement or expansion of existing activities, for which the policy has not yet been approved.

22 A separate sheet should be used for each activity, identifying the programme to which it belongs.

Appendix V

23 Appendix V is no more than a summary of the totals shown in the preceding four appendices, together with actual expenditure and revenue for the years 1974-75 to 1977-78 which should agree with the Reports of the Director of Accounting Services. If the 1977-78 figures are not available the most accurate estimate will suffice. For the purpose of Appendix V the *overall* totals should be given on the *one* sheet, without regard to individual programmes.

Annex (4)

EXPENDITURE ON NEW TERRITORIES URBAN LAND ACQUISITIONS

(1) *Background*

The urban development programme in the New Territories requires the acquisition of private land in increasingly large quantities. The outstanding land exchange commitment was estimated in September 1977 at over seven million square feet of building land and forecast resumptions implied a further annual commitment to provide four million square feet of building land for exchanges. Against this background and having regard to the need to devise an acceptable substitute for the then land exchange system, a Working Group on New Territories Urban Land Acquisition was appointed in October 1977 to 'examine, in the light of the current and future resumption programme, the methods by which leased land in New Territories towns is acquired by the Government, including the rates of compensation paid and the land exchange scheme; and to recommend to the Governor any changes needed.'

(2) *Recommendations of the Working Group*

2 The Working Group submitted its report in April 1978 and its recommendations were considered by the Executive Council and the Finance Committee of the Legislative Council in June and July 1978. The recommendations of the Working Group which have financial implications are—

- (a) a new offer to replace the then letter B offer for private *agricultural* land should be adopted comprising—
 - (i) an option for a 5:2 exchange entitlement (that is two square feet of building land for five square feet of agricultural land) for up to half of the land surrendered;
 - (ii) an increased cash offer per square foot in respect of the remaining land, including any land for which an exchange entitlement was not taken up under (i);
 - (iii) an increased credit value for the exchange entitlement;
- (b) in respect of *building* land surrendered, an offer of *ex-gratia* cash compensation in addition to statutory compensation; and
- (c) the rates of cash compensation and the credit value of the exchange entitlement for agricultural land should be adjusted half-yearly, by reference to an index derived from the weighted average land values in the New Territories urban development areas.

These recommendations were put into effect on 1 July 1978.

(3) *Effect of the recommendations*

3 Under the pre-July 1978 system, building lots were selected for sale by tender to holders of exchange entitlements (letters B). In these tenders, letters B were weighted in such a way that the older they were the greater the

number of points assigned to them. The successful tender was the one which offered parcels of letters B sufficient for the area of the land tendered which had the highest aggregate number of points, and a premium was payable for the land at the rate established for that land at the time the letters B were issued. The average gap between the date of resumption (that is to say, the date of issue of the letter B) and the date the land is made available for exchange was at least five or six years. So a revenue loss arose from that system, equal to the difference between the premium payable and the current market value of land exchanged. The effect of this was that the Government had been running up a public debt in terms of land. For the holder of letters B the system represented a form of speculative lending in expectation of increases in land values.

4 The measures introduced with effect from 1 July 1978 had the immediate effect of halving the future exchange commitment and the assumption is that it should be possible by about 1984-85 to make land available for exchange for a letter B in the same year in which that letter is issued. At that time there would be no financial advantage in opting for a letter B exchange as the premium payable would be at current market value. Thereafter a revenue benefit is expected to arise, and the expenditure incurred as a result of the new measures would be recovered, as a result of current market values being paid for land that would otherwise have been reserved for letter B exchange for which premia would have been paid on historical values. However, these assumptions are entirely dependent on land values continuing to increase.

(4) *Implications for the 1979-80 Draft Estimates*

5 The 1979-80 draft Estimates reflect, for the first time, the implications of adopting the recommendations of the Working Group, to the extent that about \$126 million of the \$176 million included under Head 72 Public Works Non-Recurrent: New Towns and Public Housing (other than Housing Authority) Subhead 994 Compensation and *ex-gratia* allowances for resumption and clearance of land is for acquisition of private land.

6 It has been recognized, however, that the existing cash accounting system does no more than reflect land acquisitions in cash terms and there is an argument for not regarding such cash transactions as expenditure. Moreover, whether the absolute guideline figures for expenditure under the two Public Works Programme components of the capital account should include provision for the payment of cash compensation has been called into question, because the implications for the economy of expenditure on cash compensation are not necessarily the same as those of investment expenditure. Finally, in view of the expected revenue benefit in the long term mentioned in paragraph 4 above, it is essential that a monitoring system be devised that would enable all land acquisition transactions to be recorded and a view to be taken from time to time on whether the new measures would generate the revenue benefit they set out to achieve.

(5) *Present intentions*

7 The Finance Branch intends to establish such a monitoring system, and alternative methods of doing this are now being considered. The method might be no more than a recording system based on a set of memorandum accounts; or it may be decided to establish a stock fund account; or, even, to develop an integrated accounting system for this and other major items of capital expenditure operating alongside the Government's existing cash accounting system.

Annex (5)

FINAL FORECAST OF EXPENDITURE ON THE GROSS DOMESTIC PRODUCT IN 1979

<i>Component</i>	<i>At current prices (\$ mn)</i>	<i>At constant (1966) prices (\$ mn)</i>	<i>Growth rate in real terms (%)</i>	<i>Rate of increase in prices (%)</i>
Private Consumption Expenditure	58,760	28,070	9	9
Government Consumption Expenditure	5,150	2,230	9	3
Gross Domestic Fixed Capital Formation ⁽¹⁾	20,080	7,520	9	12
of which: Plant and machinery	8,670	3,430	8	9
Building and construction	10,760	3,700	10	15
of which: Private	5,600	1,930	12	15
public— Government	2,770	955	4	15
public— Mass Transit Railway	2,390	820	11	15
Exports of goods ⁽²⁾	63,780	26,160	8	8
of which: Domestic exports ⁽³⁾	47,050	18,840	7	8
Re-exports	15,960	7,120	12	9
Imports of goods ⁽⁴⁾	75,740	33,490	10	9
Exports <i>less</i> Imports of Services	1,570	670	not applicable	not applicable
Increase in Stocks ⁽⁵⁾				
Gross Domestic Product	73,600	31,160	7	8

- (1) Not shown here is a small element of net expenditure incurred in connection with the transfer of ownership of land and of existing buildings, this element is calculated as the sum of stamp duty collections, together with the legal fees and charges involved in the transactions. The growth rate of this small element is assumed to be the same as that of the other components in gross domestic fixed capital formation.
- (2) Not shown here is a small element of re-exports of fuel oil, estimated from expenditure in Hong Kong of foreign airline and shipping companies.
- (3) Growth rates in real terms of domestic exports by major markets: US, 5%; FRG, 10%; UK, 7%; rest of the world, 8%.
- (4) This consists of merchandise imports, an estimate of imports of non-monetary gold and imports of water.
- (5) It is difficult to offer precise forecasts for these components. The figures given are based on the view that the balance of exports *less* imports of services will remain roughly the same as in 1978, and that stock building will be less in 1979 than in 1978.

Annex (6)

SUMMARY OF EXPENDITURE BY MAIN COMPONENTS, 1972-73 TO 1979-80

The figures in this summary are a breakdown by main components of the total expenditure given in Table (a) of Annex (2).

	1972-73	1973-74	1974-75	1975-76	1976-77	1977-78	1978-79	1979-80
	<i>Adjusted</i>	<i>Adjusted</i>	<i>Adjusted</i>	<i>Actual</i>	<i>Actual</i>	<i>Actual</i>	<i>Revised</i>	<i>Draft</i>
	<i>actual</i>	<i>actual</i>	<i>actual</i>	<i>Actual</i>	<i>Actual</i>	<i>Actual</i>	<i>Estimates</i>	<i>Estimates</i>
	(\$ mn)	(\$ mn)	(\$ mn)	(\$ mn)	(\$ mn)	(\$ mn)	(\$ mn)	(\$ mn)
Recurrent Account								
Personal Emoluments	1,072	1,336	1,674	1,782	2,135	2,475	2,921	3,151
Departmental Other Charges	332	498	739	781	794	844	1,114	1,222
Public Works Recurrent	198	224	263	277	287	458	459	503
Subventions	551	742	881	950	1,122	1,327	1,592	1,778
UPGC	97	159	187	217	255	307	353	375
Defence	56	56	60	51	195	270	365	362
Pensions	97	117	151	166	194	234	266	332
Public Debt	2	3	5	9	27	28	30	34
Miscellaneous	64	96	215	217	215	276	344	603
Total Recurrent	2,469	3,231	4,175	4,450	5,224	6,219	7,444	8,360
<i>Capital Account</i>								
PWP (other than New Towns and Housing)	773	1,418	1,518	759	727	753	1,150	1,299
PWP (New Towns and Housing, including transfers from General Revenue to the DLF for on-lending to the Housing Authority)	—	—	20	513	401	784	1,695	2,300
Subventions	42	74	68	44	32	53	73	107
UPGC	30	26	37	93	40	25	41	85
Departmental Special Expenditure	61	50	79	69	74	76	123	184
Defence Costs Agreement—								
Capital Works	51	32	38	44	22	23	35	30
Home Ownership Fund	—	—	—	—	—	99	399	—
Miscellaneous	124	83	38	60	71	142	202	89
Total Capital	1,081	1,413	1,798	1,582	1,367	1,955	3,718	4,094
Total Expenditure	3,550	4,644	5,973	6,032	6,591	8,174	11,162	12,454

Annex (7)

SUMMARY OF EXPENDITURE BY GROUPS OF SERVICES, 1972-73 TO 1979-80

The figures in this summary are a breakdown by groups of services of the total expenditure figures given in Table (a) of Annex (2).

	1972-73	1973-74	1974-75	1975-76	1976-77	1977-78	1978-79	1979-80
	<i>Adjusted</i>	<i>Adjusted</i>	<i>Adjusted</i>	<i>Actual</i>	<i>Actual</i>	<i>Actual</i>	<i>Revised</i>	<i>Draft</i>
	<i>actual</i>	<i>actual</i>	<i>actual</i>	<i>Actual</i>	<i>Actual</i>	<i>Actual</i>	<i>Estimates</i>	<i>Estimates</i>
	(\$ mn)	(\$ mn)	(\$ mn)	(\$ mn)	(\$ mn)	(\$ mn)	(\$ mn)	(\$ mn)
General services								
Law and order	349	452	601	637	764	906	1,067	1,107
Others	288	320	349	349	539	729	1,033	940
Economic services	373	441	533	553	560	624	776	959
Community services								
Transport, roads and civil engineering	358	595	716	640	739	1,100	1,780	1,978
Water	366	485	629	486	476	473	405	449
Others	113	189	308	148	216	261	307	379
Social services								
Education	694	990	1,145	1,268	1,403	1,625	1,952	2,196
Medical and Health	379	457	560	562	648	756	948	1,150
Housing	77	104	219	439	217	444	1,286	1,164
Social welfare	82	144	262	352	359	393	541	655
Labour	11	13	16	16	20	24	31	63
Common supporting services	200	238	318	245	270	344	464	487
Unallocable expenditure	161	98	165	168	162	235	283	572
Other financial obligations	99	118	152	169	218	260	289	355
Total	<u>3,550</u>	<u>4,644</u>	<u>5,973</u>	<u>6,032</u>	<u>6,591</u>	<u>8,174</u>	<u>11,162</u>	<u>12,454</u>

Annex (8)

EXPENDITURE ON SELECTED SERVICES

A Law and order

The Draft Estimates provide for expenditure of \$1,090 million on law and order services⁽¹⁾. This represents 9% of total expenditure in 1979-80.

2 Following the visit of advisers from the Home Office in early 1978, major reviews of the Police Force took place during 1978-79 and are still continuing. Particular attention has been paid to communications within the Force and between the Force and the public. In a force with an establishment of some 22,700 posts (consisting of some 2,000 officers, 17,000 rank and file and 3,700 civilians), this is an area requiring continuing attention⁽²⁾, particularly in view of the operational requirement for some 2,100 additional posts in 1979-80. Other proposals, aimed at improving morale, have also been approved. These include the provision of colour television sets in rest rooms in police stations, the development of a sports centre and a staff club at Kai Tak and the improvement of grants for welfare. Further improvements are currently being considered.

3 The Force Training Programme has also been reviewed, and proposals to expand and improve the Police and Detective Training Schools have been included in the Public Works Programme. Comprehensive proposals for on the job and part-time release training are currently being examined, and provision for this has been included in the Draft Estimates. It is encouraging, therefore, that violent crimes⁽³⁾ and serious crimes⁽⁴⁾ have continued to drop. This has been reflected in the drop in the prison muster from 7,184 in January 1978 to 6,406 in January 1979; the latter figure does not include 1,013 illegal immigrants, a feature which can be expected to figure more prominently during 1979. The scale of the exodus from Vietnam is particularly alarming when seen as an increment to the large numbers arriving, legally and illegally, from China.

(1) *Immigration, ICAC, Judiciary, Legal, Police, Prisons, Registrar General.*

(2) *Police establishment: 1978-79 Approved Estimates 22,076*
1979-80 Draft Estimates 22,687

(3) *Violent crimes:*

		%
1974	18,838	—
1975	18,423	-2
1976	16,436	-11
1977	14,731	-10
1978	14,376	-2

(4) *Serious crimes (ie reported crimes less blackmail and minor offences):*

		%
1974	52,981	—
1975	52,050	-2
1976	52,812	+1
1977	51,610	-2
1978	52,383	+1

B Defence

4 Provision in the Draft Estimates of \$453 million for defence⁽⁵⁾ is mainly for the Hong Kong Government's 75% share, under the Defence Costs Agreement, of the cost of the garrison and for the full cost of certain major reprovisioning works, both under and subsequent to the Agreement. The reprovisioning of RAF Kai Tak has been completed at a capital cost to the Hong Kong Government of about \$81.5 million and the land released at Kai Tak (108 acres) was handed back to the Government on 30 June 1978. Similarly the reprovisioning of Victoria Barracks has now virtually been completed, at a capital cost of about \$133 million, and the land released (42 acres) is currently being vacated by the services. Land (33 acres) at Sham Shui Po Camp has also been released, and work is due to start on a further major reprovisioning to enable the remainder of Sham Shui Po Camp (12 acres), Lyemun Camp (73 acres) and Bowring Camp (10 acres) to be released by 1983. Although not reflected in the Draft Estimates because no expenditure will be required in 1979-80, Finance Committee has approved funds for the replacement of the five naval patrol craft at an estimated cost to the Hong Kong Government of \$200 million. The replacements would be particularly useful in a repeat of the current situation on illegal immigrants and refugees.

C Education

5 The Draft Estimates provide for expenditure of \$2,196 million on education⁽⁶⁾. This represents 17.6% of total expenditure in 1979-80.

6 In line with the Government's policy that no child should have to travel an unreasonable distance to attend primary school, provision has been made for an additional 11,565 new primary school places in developing areas in 1979-80 to be offset by a reduction of existing places in areas of over provision. New primary schools will continue to be built, wherever possible, in conjunction with the development of public housing estates; nine such schools are expected to open in 1979-80.

(5) *Auxiliary Medical Service, Civil Aid Services, Miscellaneous Measures, Royal Hong Kong Auxiliary Air Force, and Royal Hong Kong Regiment (The Volunteers).*

(6) <i>Recurrent:</i>	<i>\$ mn</i>
<i>Education Department</i>	301.3
<i>Education subventions</i>	1,234.4
<i>UPGC</i>	375.9
<i>Student fare subsidies</i>	38.1
	<u>1,949.7</u>
<i>Capital:</i>	
<i>Government-built schools including technical institutes (PWNR)</i>	77.6
<i>Education subventions</i>	77.0
<i>UPGC</i>	85.5
<i>Departmental special expenditure</i>	6.0
	<u>246.1</u>

7 The coming year will see a continued expansion in the number of places for handicapped children in government and aided schools. A further 2,383 places will be provided in special schools and 1,810 places in special classes in ordinary schools, as part of the overall plan for rehabilitation as set out in the 1977 White Paper 'Integrating the Disabled into the Community: A United Effort'. In addition, screening and assessment services for primary school children will be further extended. In order to improve services and to integrate the work of all departments involved in the education and training of handicapped children, the Government, with the advice of the Rehabilitation Development Co-ordinating Committee, has been reviewing the management and staffing of special schools. The Draft Estimates provide funds to enable certain proposals, in the form of revisions to the relevant Codes of Aid, to come into effect in April 1979.

8 At the secondary level tuition fees were abolished in all Forms I—III places in Chinese and Anglo-Chinese schools in the public sector with effect from the 1978-79 academic year. At the same time, a public sector place in Form I was provided for every child leaving Primary 6. Additional places in Form II and eventually in Form III will be required for these children, and so a further expansion, to provide an additional 29,932 Forms I—III places, will continue in 1979-80 with a view to accommodating all children in the 12-14 age-group by the beginning of the 1980-81 academic year⁽⁷⁾.

9 The White Paper 'The Development of Senior Secondary and Tertiary Education' was published in October 1978. Its proposals are far-reaching and include the provision of places in Forms IV and V in government and aided schools to meet the *full* demand from students leaving Form III who are able to benefit from continued full-time education at this level⁽⁸⁾. In accordance with this new aim the 1979-80 Draft Estimates provide for an additional 4,242 Forms IV—V places in secondary schools. They also provide for increases at the technical institutes (including a fifth technical institute which will open in Kowloon Tong in September 1979) in full time students from 3,400 to 4,300, and in students on part-time day release courses from 8,600 to 12,200. These places will further augment the range of opportunities for Form III leavers.

10 The Draft Estimates also include provision for the first stage of a scheme to assist certain approved registered post-secondary colleges to provide places at the Form VI and tertiary levels. These places will contribute to the meeting of targets envisaged in the White Paper. Detailed financing arrangements are still under discussion with the relevant college authorities but funds have been earmarked to enable assistance to be provided for 950 Form VI places in September 1979.

(7) See table in paragraph 10 of the Memorandum Note on Head 31 Education Department on page 100 of the Estimates.

(8) See table in paragraph 11 of the Memorandum Note on Head 31 Education Department on page 100 of the Estimates.

11 In addition to re-examining quantitative goals the White Paper also proposes significant measures to improve the quality of secondary education. Chief amongst these will be the bringing onto full government subsidy of about 70 private schools where Government, at present, provides financial assistance in respect of a limited number of 'bought' places only. It is proposed to bring these schools under the Code of Aid for Secondary Schools over a four year period beginning in September 1979. However, as the details of the interim financial arrangements are still being worked out, no specific provision has been included in the appropriate heads in the Draft Estimates. The estimated cost over the four year period will be about \$146 million.

12 The expansion and improvement of services described in the White Paper will result in an increase in recurrent expenditure on senior secondary and tertiary education of \$177 million in 1979-80, rising to \$644 million by 1985-86 (at 1978 prices). Capital expenditure will total about \$940 million over the same period. Against this background it is appropriate to look closely at the level of fees charged at the senior secondary and tertiary levels to ensure that they continue to reflect a reasonable level of contribution to the cost of the services provided. In this context the White Paper has indicated that the standard senior secondary school fees, which have remained static since 1965, will rise to \$600 a year in Forms IV and V and \$800 in Form VI by 1980⁽⁹⁾. The first phase of these increases, to \$500 and \$620 respectively⁽¹⁰⁾ will take place in September 1979, but students from low-income families will continue to be protected by the existing fee remission schemes.

13 The two universities and the Polytechnic embarked on a new triennium in mid-1978, by the end of which there will be 10,330 students at the universities and 11,400 full-time equivalent students at the Polytechnic. These figures reflect the White Paper's proposals that the university student population should continue to expand at approximately 3% per annum over the present triennium and that the number of full-time equivalent students at the Polytechnic should continue to expand towards a target of 12,000 fulltime equivalent places. This is likely to be achieved in the early 1980s, at which time the facilities at the Polytechnic will be at full capacity. However, the technical institutes will, by then, have assumed a greater role in the

(9) *Phasing of the increase of school fees:*

	<i>Annual school fees (\$)</i>				
	<i>1978-79</i>	<i>1979-80</i>	<i>1980-81</i>	<i>1981-82</i>	<i>1982-83</i>
<i>Forms IV-V</i>					
<i>Standard fee</i>	400	500	600	600	600
<i>Non-standard fee</i>	200	300	400	500	600
<i>Form VI</i>					
<i>Standard fee</i>	450	620	800	800	800
<i>Non-standard fee</i>	220	330	450	620	800

(10) \$300 and \$330 respectively in the case of non-standard fees which apply mainly to schools in the New Territories.

provision of courses at the Ordinary Diploma and Certificate levels thereby releasing capacity at the Polytechnic for a higher proportion of courses at the Higher Diploma and Higher Certificate levels.

D Medical and health services

14 The Draft Estimates provide for expenditure of \$1,117 million on medical and health services. This represents 9% of total expenditure in 1979-80.

15 Priority will continue to be given to the strengthening of a regionalized infra-structure of hospitals and clinics to provide general and specialist medical services to all members of the community. At present there are four regions: each centred on a fully-equipped regional hospital designed to cope with emergency cases and other acute patients. A fifth regional hospital at Sha Tin is now under construction and will admit patients in 1982. This project will serve the whole of the eastern New Territories, including Sha Tin new town, and will also provide clinical teaching facilities for the new Medical School at the Chinese University. The Financial Secretary signed an agreement with the Asian Development Bank in October 1978 for a loan of US\$19.5 million towards the cost of the hospital and supporting polyclinic facilities.

16 One of the main aims of the regionalization scheme is to achieve the maximum possible utilization of hospital beds. The annual cost of operating an 'acute' level hospital bed (in a subvented hospital) varied between \$21,000 and \$36,000 in 1978-79 and will probably rise to between \$22,000 and \$45,000 in 1979-80. It is, therefore, important that such beds are used as intensively as possible. This is being achieved within the various regions by a policy of transferring less seriously ill or convalescent patients to nearby district hospitals, thus releasing much-needed acute beds in the main regional hospitals. Subvented hospitals play a vital role in this coordinated service and, to reflect their specific responsibilities, the Government has, where appropriate, brought hospitals onto a full deficiency grant subsidy. During 1978-79 the Yan Chai Hospital in Tsuen Wan and the Caritas Medical Centre in Kowloon came onto deficiency grants and these hospitals will help to relieve pressure on the Princess Margaret Hospital as well as provide improved services to their local communities.

17 As a further measure for the better utilization of hospital beds, the community nursing service, set up on an experimental basis in 1976, will be expanded to cover almost all parts of the territory by 1985. This service enables convalescent patients to complete their treatment at home with the help of regular visits from a trained nurse. The Draft Estimates provide for the number of community nurses to expand from the present 33 to 108 in the coming year.

18 The Draft Estimates provide for an additional 449 hospital beds in government and subvented hospitals which will bring the total number

to 17,966 by March 1980⁽¹¹⁾. Major projects which will provide more beds and which are either already under construction or which will begin during the financial year include, in the government sector, the Sha Tin Hospital and polyclinic, a psychiatric wing to the Princess Margaret Hospital and an extension and improvements to the Fanling Hospital. Other important projects in the pipe-line include an urban clinic at Lei Muk Shue, and, in the subvented sector, a cardio-thoracic centre at the Grantham Hospital and a clinical pathology building for the Kwong Wah Hospital.

E Social welfare

19 The Draft Estimates provide for expenditure of \$680 million on social welfare services⁽¹²⁾. This represents 5.5% of total expenditure in 1979-80 and means that expenditure on these services has increased three-fold over the last five years.

20 The proposals included in three Green Papers published in 1977 dealing with improvements to the scope of benefits under the social security system and with services for the elderly and young people will shortly be published in a comprehensive White Paper on social welfare. In advance of publication, a number of its recommendations have been implemented during the course of 1978-79 and supplementary funds approved by Finance Committee⁽¹³⁾. These include a number of measures which will be of particular benefit to old people. With effect from 1 April 1978, an old age supplement has been introduced which will be payable to recipients of public assistance who are, themselves, aged 60 or over, or who have a family member over 60 who is not eligible for the non-means tested Old Age Allowance. In addition, in October 1978, the minimum qualifying age for the Old Age Allowance was reduced from 75 to 70 years in one step—rather than in

(11) *Net annual increases in beds:*

	1978	1979	1980	1981	1982	1983	1984	1985
<i>Government</i>	107	48	1,392	—	400	1,430	1,364	1,500
<i>Government-assisted</i>	604	401	340	449	100	225	300	—
<i>Private</i>	(-131)	38	380	600	600	—	500	—
<i>Total</i>	<u>580</u>	<u>487</u>	<u>2,112</u>	<u>1,049</u>	<u>1,160</u>	<u>1,655</u>	<u>2,164</u>	<u>1,500</u>

(12) *These funds include expenditure on the Social Welfare Department, subventions to voluntary agencies, certain miscellaneous subventions and the Legal Aid Department.*

(13) *The following have been implemented with effect from 1 April 1978:*

- (a) *Old Age Supplement*
 - (b) *Long Term Supplement*
 - (c) *Disregard of Earnings*
 - (d) *Extension of Old Age and Disability Allowances to those living in residential institutions.*
- As from 1 October 1978: Welfare Allowances Scheme Lowering of the qualifying age for Old Age Allowance from 75 to 70.*

two as originally proposed in the Green Paper. As a result an additional 70,000 elderly people have become eligible for this allowance⁽¹⁴⁾.

21 The Draft Estimates anticipate expenditure of \$405 million on all forms of social security in 1979-80⁽¹⁵⁾. This represents an increase of nearly 500% over the figure of \$72 million five years ago. The proposals in the White Paper will entail an additional \$235 million in recurrent expenditure by 1982-83⁽¹⁶⁾. During the same four-year period for 1979-80 to 1982-83, capital expenditure, including disbursements from the Lotteries Fund, will total \$88 million at 1978 prices. These figures do not include the cost of expanding services to the disabled as outlined in the 1977 White Paper on rehabilitation which will, in addition, involve an increase of \$298 million in recurrent expenditure by 1982-83⁽¹⁷⁾.

(14) *Old Age Allowance:*

Additional expenditure arising from reducing the age of eligibility from 75 to 70 over the next 5 years is

	1979-80	1980-81	1981-82	1982-83	1983-84
Population of age group	76,000	80,700	86,800	94,400	102,700
Cost (based on a take-up rate of 80%)	\$73.0 m	\$77.5 m	\$83.3 m	\$90.6 m	\$98.6 m
Cost (100% take-up rate)	\$91.2 m	\$96.8 m	\$104.2 m	\$113.3 m	\$123.2 m

(15) *Total provision for all social security in the 1979-80 Draft Estimates:*

	1979-80 \$
(a) Public assistance scheme	203,000,000
(b) Special needs allowance	
(i) Old age allowance	150,400,000
(ii) Disability allowance	51,700,000
	<u>202,100,000</u>
Total	<u>405,100,000</u>

These figures do not include provision for compensation for victims of crimes of violence (\$1,400,000), for the Traffic Accident Victims Assistance Scheme (\$15,000,000) or for emergency relief.

(16) *Additional recurrent expenditure arising from the implementation of the White Paper on social welfare proposals:*

	1978-79 (\$ mn)	1979-80 (\$ mn)	1980-81 (\$ mn)	1981-82 (\$ mn)	1982-83 (\$ mn)
Services for the elderly	1.0	9.4	19.4	28.6	35.6
Personal social work among youth					
Social security	2.2	16.4	22.6	25.4	26.9
(a) Public assistance scheme	45.1	42.4	44.6	46.7	48.0
(b) special needs allowance	32.0	76.5	90.0	96.0	104.9
Traffic accident victims assistance scheme	—	15.0	16.6	17.8	19.1
	<u>80.3</u>	<u>159.7</u>	<u>193.2</u>	<u>214.5</u>	<u>234.5</u>

(17) *Additional recurrent expenditure on implementing the White Paper on Rehabilitation Services:*

	1978-79 (\$ mn)	1979-80 (\$ mn)	1980-81 (\$ mn)	1981-82 (\$ mn)	1982-83 (\$ mn)
Education services	42.2	60.1	77.2	92.5	105.6
Medical services	66.4	84.9	107.2	127.5	131.5
Social welfare services	21.2	30.3	39.9	51.0	61.4
Total	<u>129.8</u>	<u>175.3</u>	<u>224.3</u>	<u>271.0</u>	<u>298.5</u>

22 A major portion of increased recurrent expenditure will be channelled through social welfare subventions. The Draft Estimates provide \$117 million for this purpose, representing an increase of 17% compared with the approved provision for 1978-79. As in previous years the bulk of this sum will be disbursed, on the advice of the Social Welfare Advisory Committee, in the form of discretionary grants to voluntary agencies.

23 As envisaged in the 1978 Budget Speech some thought has been given during the year to the role of the voluntary sector in the provision of social welfare services, in particular, relating to the form which Government's financial assistance to them should take. A Working Party has, during the past few months, been reviewing the respective roles of the Government and the voluntary sector in the provision of social welfare services. It will shortly make recommendations as to how the two sectors might best work together to achieve the planning targets embodied in recent Green and White Papers. These recommendations should provide a frame-work for the strengthening and improvement of the administration of social welfare subventions.

F Infrastructural facilities

Airport

24 The eastern extension of the terminal building⁽¹⁸⁾ and the new office block extension⁽¹⁹⁾ were completed in early 1978 and put into operation. Construction works currently in progress or nearing completion include Stage I of a multi-storey car-park⁽²⁰⁾, a new fire station⁽²¹⁾ the extension of the vehicular podium, a new restaurant and kitchen block, and two additional passenger piers with aerobridges⁽²²⁾, refurbishing of the existing terminal building⁽²³⁾ with a new departure baggage handling system for 68 check-in positions and two more baggage reclaim conveyors for arriving passengers⁽²⁴⁾.

(18) Head 70 PWN: Buildings Subhead 450. Approved project estimate: \$141.136 million; anticipated expenditure to 31 March 1979: \$91.39 million; Draft Estimates for 1979-80: \$9.9 million.

(19) Head 70 PWN: Buildings Subhead 452. Approved project estimate: \$8.0 million; anticipated expenditure to 31 March 1979: \$3.45 million; Draft Estimates for 1979-80: \$0.6 million.

(20) Head 70 PWN: Buildings Subhead 456. Approved project estimate: \$15.5 million; anticipated expenditure to 31 March 1979: \$5.41 million; Draft Estimates for 1979-80: \$1.4 million.

(21) Head 70 PWN: Buildings Subhead 503. Approved project estimates: \$6.463 million; anticipated expenditure to 31 March 1979: \$5.39 million; Draft Estimates for 1979-80: \$0.7 million.

(22) Head 70 PWN: Buildings Subhead 454. Approved project estimate: \$40.95 million; anticipated expenditure to 31 March 1979: \$13.71 million; Draft Estimates for 1979-80: \$27.2 million.

(23) Head 70 PWN: Buildings Subhead 450. Approved project estimate: \$141.136 million; anticipated expenditure to 31 March 1979: \$91.39 million; Draft Estimates for 1979-80: \$9.9 million.

(24) Head 70 PWN: Buildings Subhead 455. Approved project estimate: \$23.3 million; anticipated expenditure to 31 March 1979: \$0.52 million; Draft Estimates for 1979-80: \$9.5 million.

The design of a new air-mail centre⁽²⁵⁾ is currently under way and the building is expected to be ready for use in 1980.

Kowloon-Canton Railway

25 There is provision for fourteen railway projects in the Draft Estimate: their total estimated project cost is \$1,210.5 million⁽²⁶⁾. Most of these projects are related to the double tracking and electrification of the 34 kilometre line from Hung Hom to Lo Wu. Work is well under way on doubletracking from Hung Hom to Tai Po⁽²⁷⁾ with the new double track tunnel through Beacon Hill expected to be completed towards the end of 1980⁽²⁸⁾. Consultants have been assigned to undertake the electrification of the railway⁽²⁹⁾.

Highways

26 Work has begun on the footbridge system at Connaught Road Central⁽³⁰⁾, the Wong Nai Chung Gap Road/Stubbs Road flyover⁽³¹⁾ and the elevated link between Pok Fu Lam Road and Connaught Road West⁽³²⁾. Reclamation for the first stage of the Hong Kong Island eastern corridor⁽³³⁾, construction of the new North Point vehicular ferry pier⁽³⁴⁾ and the widening of Pok Fu Lam Road by stages⁽³⁵⁾ are now well under way. Work on the Ap

(25) Head 70 PWRN: Buildings Subhead 764. Approved project estimate: \$4.9 million; anticipated expenditure to 31 March 1979: nil; Draft Estimates for 1979-80: \$1.0 million.

(26) Head 71 PWRN: Engineering Subheads 620-633. Approved project estimate: \$1,210.5 million; anticipated expenditure to 31 March 1979: \$257.66 million; Draft Estimates for 1979-80: \$155.9 million.

(27) Head 71 PWRN: Engineering Subheads 621 and 629. Approved project estimate: \$122.1 millions; anticipated expenditure to 31 March 1979: \$37.64 million; Draft Estimates for 1979-80: \$14.54 million.

(28) Head 71 PWRN: Engineering Subhead 628. Approved project estimate: \$97.0 million; anticipated expenditure to 31 March 1979: \$27.32 million; Draft Estimates for 1979-80: \$35.086 million.

(29) Head 71 PWRN: Engineering Subhead 625. Approved project estimate: \$39.0 million; anticipated expenditure to 31 March 1979: \$7.86 million; Draft Estimates for 1979-80: \$13.914 million.

(30) Head 71 PWRN: Engineering Subhead 680. Approved project estimate: \$33.72 million; anticipated expenditure to 31 March 1979: \$15.60 million; Draft Estimates for 1979-80: \$6.0 million.

(31) Head 71 PWRN: Engineering Subhead 698. Approved project estimate: \$66.7 million; anticipated expenditure to 31 March 1979: \$5.37 million; Draft Estimates for 1979-80: \$20.0 million.

(32) Head 71 PWRN: Engineering Subhead 705. Approved project estimate: \$29.03 million; anticipated expenditure to 31 March 1979: \$5.55 million; Draft Estimates for 1979-80: \$8.20 million.

(33) Head 71 PWRN: Engineering Subhead 682. Approved project estimate: \$373.0 million; anticipated expenditure to 31 March 1979: \$11.25 million; Draft Estimates for 1979-80: \$10.0 million.

(34) Head 71 PWRN: Engineering Subhead 563. Approved project estimate: \$22.45 million; anticipated expenditure to 31 March 1979: \$3.0 million; Draft Estimates for 1979-80: \$9.0 million.

(35) Head 71 PWRN: Engineering Subhead 686-688. Approved project estimate: \$30.12 million; anticipated expenditure to 31 March 1979: \$12.61 million; Draft Estimates for 1979-80: \$2.8 million.

Lei Chau bridge⁽³⁶⁾, the Aberdeen Tunnel⁽³⁷⁾, the Canal Road flyover extension⁽³⁸⁾, all of which will form an important part of the highways network linking the Island to the New Territories, is progressing well. On the Mainland, sections of this network under construction include, in the west, the West Kowloon Corridor⁽³⁹⁾, the Tsuen Wan By-pass⁽⁴⁰⁾, the second stage of Tuen Mun Road⁽⁴¹⁾; and in the east, the Airport Tunnel and its approach roads⁽⁴²⁾. In the north, the refurbishing of the first Lion Rock tunnel⁽⁴³⁾ was completed and the construction of the flyover at the junction of Cornwall Street, Waterloo Road and Junction Road has begun⁽⁴⁴⁾.

Water Supplies

27 Following the completion of the main elements of the High Island Water Scheme in 1978-79, the largest project in progress is for the additional water supply from the East River⁽⁴⁵⁾. The investigation of potential water resources to meet future demand⁽⁴⁶⁾ is also under way. Capital expenditure on water supplies for the whole territory, including the New Towns, in 1979-80 is expected to total \$166 million, compared with a revised estimate of \$119 million in 1978-79.

-
- (36) Head 17 PWR: Engineering Subhead 690. Approved project estimate: \$60.0 million; anticipated expenditure to 31 March 1979: \$30.24 million; Draft Estimates for 1979-80: \$15.0 million.
- (37) Head 17 PWR: Engineering Subhead 708. Approved project estimate: \$306.0 million; anticipated expenditure to 31 March 1979: \$91.04 million; Draft Estimates for 1979-80: \$66.0 million.
- (38) Head 17 PWR: Engineering Subhead 707. Approved project estimate: \$97.0 million; anticipated expenditure to 31 March 1979: \$51.34 million; Draft Estimates for 1979-80: \$16.0 million.
- (39) Head 17 PWR: Engineering Subhead 771-773. Approved project estimate: \$15.30 million; anticipated expenditure to 31 March 1979: \$59.01 million; Draft Estimates for 1979-80: \$9.8 million.
- (40) Head 72 PWR: New Towns and Public Housing Subheads 600-601. Approved project estimate: \$84.10 million; anticipated expenditure to 31 March 1979: \$21.13 million; Draft Estimates for 1979-80: \$37.39 million.
- (41) Head 72 PWR: New Towns and Public Housing Subheads 861. Approved project estimate: \$134.0 million; anticipated expenditure to 31 March 1979: \$15.62 million; Draft Estimates for 1979-80: \$25.0 million.
- (42) Head 71 PWR: Engineering Subheads 755-757 and 760. Approved project estimate: \$335.62 million; anticipated expenditure to 31 March 1979: \$173.55 million; Draft Estimates for 1979-80: \$59.35 million.
- (43) Head 72 PWR: New Towns and Public Housing Subhead 742. Approved project estimate: \$14.80 million; anticipated expenditure to 31 March 1979: \$14.18 million; Draft Estimates for 1979-80: \$0.2 million.
- (44) Head 71 PWR: Engineering Subhead 751. Approved project estimate: \$42.0 million; anticipated expenditure to 31 March 1979: \$5.34 million; Draft Estimates for 1979-80: \$10.10 million.
- (45) Head 73 PWR: Waterworks Subhead 904. Approved project estimate: \$117.3 million; anticipated expenditure to 31 March 1979: \$26.8 million; Draft Estimates for 1979-80: \$46.5 million.
- (46) Head 73 PWR: Waterworks Subhead 910. Approved project estimate: \$19.5 million; anticipated expenditure to 31 March 1979: \$5.4 million; Draft Estimates for 1979-80: \$6 million.

New Towns

28 For the continuing development of the New Towns \$1,300 million is provided in 1979-80, exceeding the approved provision for 1978-79 by 73% and the revised estimate by 21%. A large proportion of expenditure in 1979-80 will be devoted to the provision of engineering infrastructure and community facilities in line with the policy of making each New Town a self-contained entity.

29 In *Tsuen Wan*, development of the northern part of the town has been accelerated, as a result of the decision to extend the Mass Transit Railway to the area and to site the depot in Tsuen Wan North. About \$146 million is included for civil engineering in the Draft Estimates for 1979-80, compared with a revised estimate of about \$98 million in 1978-79. In *Sha Tin*, following the completion of major roadworks, priority is being given to the construction of the first stage of a major sewage treatment plant⁽⁴⁷⁾ and works associated with the double tracking and electrification of the Kowloon-Canton Railway. Expenditure on civil engineering in 1979-80 is expected to be about \$248 million, compared with a revised estimate of about \$258 million in 1978-79. In Tuen Mun, land production, roadworks and provision of essential water and sewage treatment services continues to be the main focus of development. Expenditure on civil engineering is expected to be of the order of \$179 million compared with a revised estimate of \$161 million in 1978-79.

30 652 acres of land were formed during 1978-79 in the New Towns, market towns and rural townships, and a further 788 acres will be formed in 1979-80. This does not include the Tai Po Industrial Estate where 47 acres were formed in 1978-79.

Mass Transit Railway

31 The cost of the Mass Transit Railway project is estimated at \$9,885 million⁽⁴⁸⁾. This figure allows for cost escalation at an assumed rate of 7% per annum, but excludes finance charges and the cost of certain land transactions. By the end of 1978, about 80% of the civil engineering works involved in the construction of the Modified Initial System had been completed. The Mass Transit Railway Corporation expects to open a part of the Modified Initial System (Kwun Tong to Shek Kip Mei) in September 1979, and the whole of the System in March 1980. The Corporation has let most of the civil engineering and electrical and mechanical

(47) *Head 72 PWNR: New Towns and Public Housing Subhead 711. Approved project estimate: \$219.8 million; anticipated expenditure to 31 March 1979: \$43 million; Draft Estimates for 1979-80: \$35 million.*

(48) <i>Made up of:</i>	<i>\$ mn</i>
(a) <i>the Modified Initial System</i>	5,800
(b) <i>Tsuen Wan Extension</i>	4,085
	<u>9,885</u>

engineering contracts for the Tsuen Wan Extension, construction of which began in October 1978. During 1979 the Corporation estimates that it will spend \$3,120 million, excluding finance charges but including some \$156 million on estate development and management.

32 At 31 December 1978, the Corporation had an authorized capital of \$2,000 million, made up of 20,000 shares of \$100,000 each. At that date 11,422 shares had been issued to the Government (against drawings of \$807 million from the Mass Transit Fund and \$335 million in respect of land premium for the acquisition of the Kowloon Bay Depot site). In addition, the Corporation has negotiated \$8,155 million in medium-term and long-term loans, of which \$2,878 million had been drawn down. It is estimated that by 31 March 1982 outstanding loans likely to have been guaranteed by the Government will amount to \$5,900 million.

G Public housing and related facilities

Introduction

33 In this context, public housing is defined as domestic flats (including ancillary commercial facilities) produced by the Housing Department and the Public Works Department for the Housing Authority's rented housing programme, domestic flats for sale produced by the Housing Department for the Government's Home Ownership Scheme and flatted factory units produced by the Housing Department. The following table shows how public housing and related facilities are financed—

<i>Public Housing</i>	<i>Source of funds</i>
(a) Flats (and ancillary commercial facilities) produced by the Public Works Department for the Housing Authority's rented housing programme.	Appropriations from General Revenue reflected in Head 72—Public Works Non-Recurrent: New Towns and Public Housing.
(b) Flats (and ancillary commercial facilities) produced by the Housing Department for the Housing Authority's rented housing programme.	Drawings from the Development Loan Fund and the Housing Authority's own resources.
(c) Flats produced by the Housing Department for the Government's Home Ownership Scheme.	Drawings from the Home Ownership Fund.
<i>Related facilities</i>	<i>Source of funds</i>
(d) Commercial facilities in the Home Ownership Scheme.	Drawings from the Development Loan Fund debited to a separately approved allocation.

*Related facilities**Source of funds*

(e) Flatted factory units.

Drawings from the Development Loan Fund debited to the allocation under (b), but with effect from 1979-80 drawings from the Development Loan Fund to be debited to a separate allocation to be approved.

Actual and forecast production of public housing

34 In the four years 1975-76 to 1978-79 the Public Works Department and the Housing Authority completed 51,640 flats with a capacity for 340,000 persons. Over the next four years, 1979-80 to 1982-83, a further 142,220 flats are expected to be completed, including 25,400 flats to be built under the Home Ownership Scheme.

35 The annual production figures are—

<i>Year</i>	<i>The Housing Authority's rental housing programme (flats)</i>	<i>Home Ownership Scheme (flats)</i>	<i>Total</i>
1975-76 (actual)	14,900	—	14,900
1976-77 (actual)	9,620	—	9,620
1977-78 (actual)	13,020	—	13,020
1978-79 (estimated)	14,100	—	14,100
1979-80 (estimated)	27,200 ⁽⁴⁹⁾	8,400	35,600
1980-81 (estimated)	31,800	3,800	35,600
1981-82 (estimated)	29,200 ⁽⁴⁹⁾	6,600	35,800
1982-83 (estimated)	28,600	6,600	35,200

The Home Ownership Scheme

36 As foreshadowed last year⁽⁵⁰⁾, a memorandum of arrangements has been agreed between the Government and the Housing Authority defining the relationship between the Government and the Authority in respect of the Home Ownership Scheme.

37 The revised estimate for 1978-79 of payments from the Home Ownership Fund on the production of the 12,733 flats in Phases I and II of the construction programme is nearly \$298 million. The estimate for 1979-80 is \$349 million⁽⁵¹⁾. The revised estimate for 1978-79 of drawings from the Development Loan Fund for financing the commercial facilities in Phases I and II is nearly \$66 million. The estimate for 1979-80 is \$28 million.

(49) Includes 5,200 flats and 600 flats to be produced by the Public Works Department in 1979-80 and 1981-82 respectively.

(50) BS, 1978, paragraph 134.

(51) See Memorandum Note on the Home Ownership Fund on page 832 of the Estimates.

The Housing Authority's rented housing programme

38 The Public Works Department's revised estimate of expenditure for 1978-79 on construction work on those estates on which planning had already started when the new Housing Authority was established on 1 April 1973 is \$162 million, and the estimate for 1979-80 for the completion of construction work on these estates is \$95 million.

39 The Housing Department's revised estimate of expenditure on construction for the rented housing programme in 1978-79 is \$608 million, of which about \$515 million (or 85%) will be met from drawings from the Development Loan Fund. The estimate of drawings for 1979-80 is \$932 million.

40 The forecast of production of public housing in paragraph 35 above for 1979-80 and the three forecast years 1980-81 to 1982-83 is based on the Government's aim to achieve an annual level of about 35,000 flats (including flats produced under the Home Ownership Scheme). The financial implications of this aim for drawings from the Development Loan Fund are as follows—

	1979-80	1980-81	1981-82	1982-83	Total 1979-80 to 1982-83
	(flats)	(flats)	(flats)	(flats)	(flats)
Forecast Production by Housing Department ⁽⁵²⁾	22,000 (\$ mn)	31,800 (\$ mn)	28,600 (\$ mn)	28,600 (\$ mn)	111,000 (\$ mn)
Estimated drawings from the Development Loan Fund ⁽⁵³⁾	932	1,198	852	278	3,260

41 At the end of 1978-79, the balance of the existing allocation⁽⁵⁴⁾ of \$1,030 million from the Development Loan Fund to the Housing Authority is estimated to be \$315.9 million. This allocation is for flatted factory units as well as the rented housing programme. The approval of Finance Committee will be sought to replace this balance with a new allocation of \$3,260 million for the rented housing programme alone, for the period 1979-80 to 1982-83.

42 It is intended to review this four-year programme annually. At each review, the programme will be rolled forward by a year on a new price base to be determined, and on the basis of maintaining the production of public housing at an annual level of about 35,000 flats (including flats produced under the Home Ownership Scheme).

(52) This forecast excludes production by the Public Works Department and for the Home Ownership Scheme.

(53) These estimates do not include provision for the construction of flatted factory units for the financing of which a separate allocation from the Development Loan Fund will be proposed.

(54) Approved by Finance Committee on 26 October 1977.

Flatted factory units

43 During 1978-79, approval has given for the establishment of three temporary industrial areas and for reviving the construction of flatted factory units, in recognition of the increasing size of the Government's clearance commitments and the number of squatter industrial undertakings eligible for and wanting re-accommodation in flatted factory estates. The revised estimate for 1978-79 of expenditure on the construction of flatted factory units is \$35 million, to be met in full from drawings from the Development Loan Fund. The Housing Department's estimate of demand for flatted factory units in the three years 1979-80 to 1981-82 is 5,448 units, and the forecast of supply for the same period is 5,857 units, of which 1,245 units are expected to be produced during 1979-80. The estimated cost of production is \$199 million, of which \$45 million will be required in 1979-80.

44 The construction of factory units is currently financed from the same allocation from the Development Loan Fund as that for the construction of domestic flats for the rented housing programme. It is intended to seek the approval of Finance Committee for a separate allocation from the Development Loan Fund for the financing of flatted factory units. The terms for these drawings will be different from those applicable to drawings for the financing of domestic flats.

Summary of expenditure, 1978-79 and 1979-80

45 The revised estimate for 1978-79 and the estimate for 1979-80 of expenditure on public housing and related facilities, excluding the Housing Authority's own resources, is \$1,076 million and \$1,449 million respectively—

	<i>1978-79</i>	<i>1979-80</i>
	<i>Revised</i>	<i>Draft</i>
	<i>Estimates</i>	<i>Estimates</i>
	<i>(\$ mn)</i>	<i>(\$ mn)</i>
(a) Flats produced by the Public Works Department for the Housing Authority's rented housing programme	162	95
(b) Flats produced by the Housing Department for the Housing Authority's rented housing programme (drawings from the Development Loan Fund only)	515	932
(c) Flats produced by the Housing Department for the Government's Home Ownership Scheme (drawings from the Home Ownership Fund)	298	349
(d) Commercial facilities in the Home Ownership Scheme (drawings from the Development Loan Fund)	66	28
(e) Flatted factory units (drawing from the Development Loan Fund)	35	45
Total	<u>1,076</u>	<u>1,449</u>

*Annex (9)*SPEECHES BY THE FINANCIAL SECRETARY IN LEGISLATIVE COUNCIL ON THE
SECOND READING OF THE INLAND REVENUE (AMENDMENT) (NO 3) BILL 1978

(1) 12 APRIL 1978

(Please see Hansard Report 1977/78 pages 759-764).

(2) 16 August 1978

(Please see Hansard Report 1977/78 pages 1314-1323).

*Annex (10)*SPEECHES BY THE FINANCIAL SECRETARY IN LEGISLATIVE COUNCIL ON THE
SECOND READING OF THE INLAND REVENUE (AMENDMENT) (NO 5) BILL 1978

(1) *15 November 1978*

(Please see Hansard Report 1978/79 pages 165-169).

(2) *29 November 1978*

(Please see Hansard Report 1978/79 pages 248-249).

Annex (II)

SPEECH BY THE FINANCIAL SECRETARY IN LEGISLATIVE COUNCIL ON
WEDNESDAY, 24 JANUARY 1979 ON WATER CHARGES

(Please see Hansard Report 1978/79 pages 382-390).

Annex (12)

EFFECT ON SALARIES TAX OF PROPOSED REDUCTION IN 'CLAW-BACK' FROM 15% TO 10% AND ABOLITION OF 30% TOP MARGINAL RATE

I *Single sperson*

<i>Income (per annum) (\$)</i>	<i>Present</i>		<i>Proposed</i>	
	<i>Tax Payable (\$)</i>	<i>Effective Rate (%)</i>	<i>Tax Payable (\$)</i>	<i>Effective Rate (%)</i>
20,000	431	2.16	412	2.06
(29,167)	1,417	4.86	1,333	4.57
30,000	1,500	5.00	1,425	4.75
(37,500)	2,625	7.00	2,625	7.00
40,000	3,000	7.50	3,000	7.50
50,000	5,000	10.00	5,000	10.00
60,000	7,500	12.50	7,500	12.50
70,000	10,500	15.00	10,000	14.29
(75,000)	11,250	15.00	11,250	15.00

II *Married person, with no children*

30,000	287	0.96	275	0.92
40,000	1,225	3.06	1,150	2.88
50,000	2,812	5.62	2,625	5.25
(58,334)	4,667	8.00	4,333	7.43
60,000	5,000	8.33	4,700	7.83
70,000	7,500	10.71	7,375	10.54
(75,000)	9,000	12.00	9,000	12.00
80,000	10,500	13.13	10,000	12.50
90,000	13,500	15.00	12,500	13.89
100,000	15,000	15.00	15,000	15.00

III *Married person, with two children*

40,000	525	1.31	475	1.19
50,000	1,762	3.52	1,575	3.15
(58,334)	3,267	5.60	2,950	5.06
60,000	3,600	6.00	3,300	5.50
70,000	5,750	8.21	5,625	8.04
(75,000)	7,000	9.33	7,000	9.33
80,000	8,400	10.50	8,250	10.31
90,000	11,400	12.67	10,750	11.94
100,000	14,400	14.40	13,250	13.25
(104,000)	15,600	15.00	14,250	13.70
110,000	16,500	15.00	15,750	14.32
(117,500)	17,625	15.00	17,625	15.00

Annex (13)

EXAMPLES OF SALARIES TAX HAVING REGARD TO DEPENDENT PARENT ALLOWANCE, REDUCED 'CLAW-BACK' AND ABOLITION OF 30% TOP MARGINAL RATE

Example 1 Annual earnings of \$48,000

	Single (\$)	Single with 2 dependent parents (\$)	Married without children (\$)	Married with 2 children (\$)	Married with 2 dependent children and 2 parents (\$)
Salary per annum	48,000	48,000	48,000	48,000	48,000
less Personal allowance	12,500	12,500	25,000	25,000	25,000
	<u>35,500</u>	<u>35,500</u>	<u>23,000</u>	<u>23,000</u>	<u>23,000</u>
add 'Claw-back'	2,500	2,500	2,300	2,300	2,300
	<u>38,000</u>	<u>38,000</u>	<u>25,300</u>	<u>25,300</u>	<u>25,300</u>
less Child allowance	—	—	—	7,000	7,000
less Dependent parent allowance	—	8,000	—	—	8,000
	<u>38,000</u>	<u>30,000</u>	<u>25,300</u>	<u>18,300</u>	<u>10,300</u>
Net chargeable income	38,000	30,000	25,300	18,300	10,300
Tax thereon	4,600	3,000	2,295	1,330	530
Effective rate	9.58%	6.25%	4.78%	2.77%	1.10%

Example 2 Annual earning of \$72,000

Salary per annum	72,000	72,000	72,000	72,000	72,000
less Personal allowance	12,500	12,500	25,000	25,000	25,000
	<u>59,500</u>	<u>59,500</u>	<u>47,000</u>	<u>47,000</u>	<u>47,000</u>
add 'Claw-back'	2,500	2,500	4,700	4,700	4,700
	<u>62,000</u>	<u>62,000</u>	<u>51,700</u>	<u>51,700</u>	<u>51,700</u>
less Child allowance	—	—	—	7,000	7,000
less Dependent parent allowance	—	8,000	—	—	8,000
	<u>62,000</u>	<u>54,000</u>	<u>51,700</u>	<u>44,700</u>	<u>36,700</u>
Net chargeable income	62,000	54,000	51,700	44,700	36,700
Tax thereon	10,500	8,500	7,925	6,175	4,340
Effective rate	14.58%	11.80%	11.00%	8.58%	6.03%

Example 3 Annual earnings of \$96,000

Salary per annum	96,000	96,000	96,000	96,000	96,000
less Personal allowance	12,500	12,500	25,000	25,000	25,000
	<u>83,500</u>	<u>83,500</u>	<u>71,000</u>	<u>71,000</u>	<u>71,000</u>
add 'Claw-back'	2,500	2,500	5,000	5,000	5,000
	<u>86,000</u>	<u>86,000</u>	<u>76,000</u>	<u>76,000</u>	<u>76,000</u>
less Child allowance	—	—	—	7,000	7,000
less Dependent parent allowance	—	8,000	—	—	8,000
	<u>86,000</u>	<u>78,000</u>	<u>76,000</u>	<u>69,000</u>	<u>61,000</u>
Net chargeable income	86,000	78,000	76,000	69,000	61,000
Tax thereon	14,400	14,400	14,000	12,250	10,250
Effective rate	15.00%	15.00%	14.58%	12.76%	10.68%

Example 4 Annual earnings of \$120,000

	<i>Single</i>	<i>Single</i>	<i>Married</i>	<i>Married</i>	<i>Married</i>
	<i>(\$)</i>	<i>with 2</i>	<i>without</i>	<i>with 2</i>	<i>with 2</i>
		<i>dependent</i>	<i>children</i>	<i>children</i>	<i>and 2</i>
		<i>parents</i>	<i>children</i>	<i>children</i>	<i>dependent</i>
		<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>parents</i>
		<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>
Salary per annum	120,000	120,000	120,000	120,000	120,000
<i>less</i> Personal allowance	12,500	12,500	25,000	25,000	25,000
	<u>107,500</u>	<u>107,500</u>	<u>95,000</u>	<u>95,000</u>	<u>95,000</u>
<i>add</i> 'Claw-back'	<u>2,500</u>	<u>2,500</u>	<u>5,000</u>	<u>5,000</u>	<u>5,000</u>
	110,000	110,000	100,000	100,000	100,000
<i>less</i> Child allowance	—	—	—	7,000	7,000
<i>less</i> Depndent parent allowance	—	8,000	—	—	8,000
	<u>110,000</u>	<u>102,000</u>	<u>100,000</u>	<u>93,000</u>	<u>85,000</u>
Net chargeable income	110,000	102,000	100,000	93,000	85,000
Tax thereon	18,000	18,000	18,000	18,000	16,250
Effective rate	15.00%	15.00%	15.00%	15.00%	13.54%

Annex (14)

EFFECTS OF NEW RATES OF FIRST REGISTRATION TAX ON TYPICAL RETAIL PRICES

Basic

<i>Model</i>	<i>Value on which FRT is assessed</i>		<i>FRT at Price</i>	<i>Recent retail price</i>	<i>FRT at</i>	<i>FRT as % of recent retail</i>
	<i>30%/35%/40%</i>	<i>35%/40%/45%</i>				
	<i>%</i>	<i>%</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>	<i>(\$)</i>
Honda Civic (1,200 c.c.)	13,807	4,142	28,300	4,832	17.07	
Toyota Corolla (1,200 c.c.)	13,917	4,175	25,600	4,871	19.03	
<i>Semi-luxury</i>						
Cortina Ghia	22,336	7,818	40,900	8,934	21.84	
Datsun 200L	28,250	9,888	45,850	11,300	24.65	
<i>Luxury</i>						
Mercedes Benz 280S	83,157	33,263	153,000	37,421	24.46	

Annex (15)

THE GOVERNMENT'S DECISIONS ON THE RECOMMENDATIONS OF THE THIRD INLAND REVENUE ORDINANCE REVIEW COMMITTEE

<i>Recommendations of the Review Committee</i>	<i>Chapter and paragraph references in the Review Committee's Report</i>	<i>The Government's decision</i>
	Chapter 2— Voluntary Aggregation under Personal Assessment	
Composite return forms should be brought into use.	paragraph 45	The Government has come to the conclusion that further consideration of compulsory aggregate assessment should be deferred for the time being.
Assessments on aggregate income should be mandatory.	paragraph 47	The legislative and organizational changes implicit in a change to a mandatory system would be considerable and, having regard to the fact that the Inland Revenue Department is currently in the throes of a major computerization programme which involves the implementation of an integrated data base system, it would be unwise to place any further strain on its management and operational resources at this time.
	Chapter 3— The Taxation of Husbands and Wives	
Earnings of a wife which are aggregated with income of her husband should attract a new allowance not exceeding an amount to be specified.	paragraph 62	The original working wife's allowance was repealed in 1973 (*). Such an allowance offends the principle that to vary allowances according to the conditions of, and the standard of living expected or enjoyed by, different classes of taxpayers is inequitable. To give relief for expenditure which is domestic and private, specifically disallowed as a deduction by the Inland Revenue Ordinance, is also inequitable.
The new allowance should, where appropriate, be available also against trading or professional profits.	paragraph 64	From the point of view of sound tax administration and equity between taxpayers, the present system is preferred (**).
	Chapter 4— Dividends and Corporate Profits	
The plan to introduce a dividend withholding tax	paragraph 89	The Government accepts the Review Committee's recommendation in favour

(*) *BS, 1973, paras. 74-76.*(**) *BS, 1978, paragraph 178, Annex (15); and CS, 1978, paras. 23-36.*

<i>Recommendations of the Review Committee</i>	<i>Chapter and paragraph references in the Review Committee's Report</i>	<i>The Government's decision</i> of abandoning the 1975 plan to introduce a dividend withholding tax and retaining the present surcharge on tax on corporate profits (***)).
should be abandoned. If dividends and corporate profits are to make an extra contribution to the revenue, the present type of surcharge on corporate profits is preferable.		
	Chapter 5—Interest and Relief for Interest Paid paragraph 93	The Government agrees with the Review Committee's recommendation.
Relief should be available where trustees both receive and pay out interest.		
A possible lacuna in the legislation in regard to the chargeability to tax of surpluses arising from certificates of deposit should be rectified.	paragraph 94	The Government agrees that the question of chargeability should be put beyond doubt. However, the subject is complex and must, therefore, be given further and careful consideration.
Interest tax should extend to interest paid by a person carrying on a trade or business in Hong Kong on borrowed money employed or expended to produce assessable profits.	paragraph 100	The Government considers that the implications of adopting this recommendation are unacceptable (****).
	Chapter 6— Ambit of the Charges paragraph 126	
Profits tax should extend to profits which a business actively carried on in Hong Kong obtains without the substantial intervention of any branch elsewhere.		Paragraph 126 specifically requires that the profit to be brought to charge must be the 'profit accruing in the course of the carrying on of a trade or business actively exercised in Hong Kong which was not substantially caused by the action (on behalf of the trade or business) of a branch located outside Hong Kong'. The conclusion, reached reluctantly, is that the Review Committee's recommendation is uncertain in purpose and limited in effect and would, incidentally, give rise to practical difficulties in administration. Rather, in the context of modifying the scope of the profits tax charge, specific targets should be selected and defined.
The same principle should apply to interest obtained by banks and deposit-taking institutions.	paragraphs 131-132	The Inland Revenue Ordinance has been amended to give effect to the Review Committee's recommendations, with effect from 1 April 1978.

(***) *BS, 1978, paragraph 177.*

(****) *BS, 1978, paras. 170-171.*

<i>Recommendations of the Review Committee</i>	<i>Chapter and paragraph references in the Review Committee's Report</i> Chapter 7— Benefits in Kind paragraph 142	<i>The Government's decision</i>
In the case where an employer meets the utility bills or the wages of indoor and outdoor servants, the cost of these outlays should be included as remuneration from employment.	paragraph 142	In the form recommended, the estimated yield from implementing this recommendation would not be in excess of \$0.5 million. But there would be practical difficulties of apportionment (<i>eg</i> of servants' salaries where more than one person makes use of them in a block of flats); and again there would be difficulty where some part of the expenditure related to <i>bona fide</i> business expenses incurred in the production of profits chargeable to profits tax. In other words, this recommendation is not in keeping with the need to retain the relative simplicity of the tax system and is not accepted.
Where a director's remuneration from a director-controlled company is artificially low, the Commissioner should have power to increase the amount taxable in respect of the value of quarters by reference to net assessable value.	paragraph 143	There is no evidence of widespread abuse. In view of the complexity of the amending legislation that would be required, it is considered not worth pursuing the point. The Review Committee also considered the general subject of the conventional value which the Ordinance attributes to an employee's quarters (see paragraphs 135-137 of the Review Committee's Report). The Committee felt that as the conventional value had only recently been increased, they could not recommend any change. When the valuation of free or subsidized accommodation was increased in 1975 from 7½% to 10%, reference was made to the need to consider a further increase. A difficulty is that if the valuation is increased by as little as 2½ percentage points there could be a fairly substantial increase in the tax of employees in certain income bands: if the full market value were assessed the result would be traumatic (indeed, in some cases, the total tax would be increased more than twofold). There is a further factor which must be taken into account: a large number of persons in the taxable bracket occupy subsidized accommodation for which they pay rent of 10 per cent or less of their income. It would be difficult to justify singling out employer-provided accommodation without also considering such other subsidized accommodation.

<i>Recommendations of the Review Committee</i>	<i>Chapter and paragraph references in the Review Committee's Report</i>	<i>The Government's decision</i>
The exploitation of the ownership of property should be treated as the carrying on of a business and consequently the separate property tax charge be abolished.	Chapter 8— Property Tax paragraph 161	These recommendations are interlocked with that on compulsory aggregate assessment. To assess property tax on the basis of actual rental income without, at the same time implementing mandatory aggregate assessment, would be a large operation. It is considered that further consideration of these recommendations should be deferred for the time being at least
Section 16(1)(b) of the Ordinance should be extended to cover excessive rents paid to directors of controlled companies in addition to members of trading partnerships.	paragraph 164	
All relevant receipts by a resident shipowner under charter parties, wherver signed, should rank as Hong Kong receipts; conversely, a non-resident ship-owner's receipts under charter parties signed in Hong Kong should be excluded from Hong Kong receipts.	Chapter 9— Specific Classes of Taxpayer paragraphs 184-185	Whilst the Government acknowledges the limitations in the existing legislation, the conclusion is that the recommendations of the Review Committee would add little to the revenue yields from this source. The amending legislation would be, on the one hand, controversial and, on the other hand, still open to avoidance devices unless steps were taken to go considerably beyond the Review Committee's recommendations. Furthermore, at the end of the day, any legislation designed to tax the operations of shipowners on the high seas is bound to contain an element of arbitrariness.
Charter hire should be redefined by including all receipts under charter parties with the exception of those from general charters without demise.	paragraph 187	
Non-resident ship-owners should be assessed on a fixed percentage of Hong Kong receipts.	paragraph 190	
Non-trading clubs should not pay property tax on club premises.	paragraph 199	This recommendation has been accepted by the Government and the Inland Revenue Ordinance amended to give effect to it from 1 April 1979. By analogy with clubs, the exemption has been extended to trade and business associations, clans, families or t'ongs, provided that, in all cases, the property is not exploited commercially.
Trustees' profits tax liability (The Review Committee made no specific recommendations).	paragraphs 212-213	The Review Committee has called attention to section 14 of the Inland Revenue Ordinance which directs that profits tax is to be charged on 'every person carrying on a trade...in

<i>Recommendations of the Review Committee</i>	<i>Chapter and paragraph references in the Review Committee's Report</i>	<i>The Government's decision</i>
		respect of his profits' and to the possibility of arguing that the possessive adjective 'his' might be thought to confirm liability to those cases where the recipients of business profits were beneficially entitled to those profits. The Review Committee felt that there was no equitable distinction between trustees and an absolute owner in this respect. The Government agrees that the trustees' profits tax liability should be put beyond doubt by effecting appropriate amendments to the Ordinance.
Subscriptions to professional societies concerned with spreading knowledge, or with indemnifying members of a profession, should be deductible for salaries tax purposes.	Chapter 10—Relief for Expenses paragraph 232	Given the low effective rate of tax and the existence of an existing extra-statutory concession (*****), there would be little point in adopting this recommendation which would involve complex amending legislation. This recommendation is, accordingly, not accepted.
Relief should be given for premiums, akin to rent in advance, for certain short leases.	paragraph 270	A review has been conducted which indicates very few of these cases are encountered. The principle, that in computing chargeability to profits tax relief for capital expenditure is not granted, should be maintained. This recommendation is, accordingly, not accepted.
There may be scope for the simplification of the existing calculation of capital allowances by the introduction of what is known as the 'pooling system'.	paragraphs 271-273	The Review Committee could see no argument against this, but made no specific recommendations. The Government agrees that the existing method of calculating capital allowances requires considerable record keeping and accepts in principle the concept of pooling of capital allowances ranking for the same rate of depreciation.
When a trading loss is carried forward for set-off, under personal assessment, it should reduce the aggregate income for all tax purposes.	paragraph 277	The implementation of this recommendation has already been effected through an extra statutory concession, but an amendment to the Inland Revenue Ordinance is also required.

(*****) *Inland Revenue Department pamphlet Departmental Interpretation and Practice Notes: No. 9 states: '.....in practice an allowance is admitted where the holding of a professional qualification is a prerequisite of employment and where the retention of membership and the keeping abreast of current developments in the particular profession are of regular use and benefit in the performance of the duties.'*

<i>Recommendations of the Review Committee</i>	<i>Chapter and paragraph references in the Review Committee's Report</i>	<i>The Government's decision</i>
A gift in kind to a charity should be recognized as an 'approved charitable donation'.	paragraph 285	Complicated questions could arise as to the correct valuation of a gift in kind. The valuation of gifts including works of art, antiques and other articles such as clothing and furniture could pose enormous practical difficulties. On the question of principle, there is a distinction between a gift of money and a gift in kind. If relief was given in terms of the value of the gift in kind, there is a danger that deduction would be given for something which cost the taxpayer nothing (<i>eg</i> a work of art acquired by inheritance or gift). This recommendation is, accordingly, not accepted.

Debate adjourned pursuant to Standing Order 54(2).

Adjournment and next sitting

HIS EXCELLENCY THE PRESIDENT:—In accordance with Standing Orders I now adjourn the Council until 2.30pm on Wednesday 14 March.

Adjourned accordingly at five minutes to seven o'clock.