

**OFFICIAL REPORT OF PROCEEDINGS****Wednesday, 18 March 1987****The Council met at half-past Two o'clock****PRESENT**

HIS EXCELLENCY THE ACTING GOVERNOR (*PRESIDENT*)  
SIR DAVID AKERS-JONES, K.B.E., C.M.G., J.P.

THE HONOURABLE THE CHIEF SECRETARY  
MR. DAVID ROBERT FORD, L.V.O., O.B.E., J.P.

THE HONOURABLE THE FINANCIAL SECRETARY  
MR. PIERS JACOBS, O.B.E., J.P.

THE HONOURABLE THE ATTORNEY GENERAL  
MR. MICHAEL DAVID THOMAS, C.M.G., Q.C.

THE HONOURABLE LYDIA DUNN, C.B.E., J.P.

THE HONOURABLE CHEN SHOU-LUM, C.B.E., J.P.

THE HONOURABLE PETER C. WONG, C.B.E., J.P.

DR. THE HONOURABLE HO KAM-FAI, O.B.E., J.P.

THE HONOURABLE ALLEN LEE PENG-FEI, O.B.E., J.P.

THE HONOURABLE HU FA-KUANG, O.B.E., J.P.

THE HONOURABLE WONG PO-YAN, O.B.E., J.P.

THE HONOURABLE CHAN KAM-CHUEN, O.B.E., J.P.

THE HONOURABLE STEPHEN CHEONG KAM-CHUEN, O.B.E., J.P.

THE HONOURABLE CHEUNG YAN-LUNG, O.B.E., J.P.

THE HONOURABLE MRS. SELINA CHOW LIANG SHUK-YEE, O.B.E., J.P.

THE HONOURABLE MARIA TAM WAI-CHU, O.B.E., J.P.

DR. THE HONOURABLE HENRIETTA IP MAN-HING, O.B.E., J.P.

THE HONOURABLE CHAN YING-LUN, J.P.

THE HONOURABLE MRS. PAULINE NG CHOW MAY-LIN, J.P.

THE HONOURABLE PETER POON WING-CHEUNG, M.B.E., J.P.

THE HONOURABLE YEUNG PO-KWAN, C.P.M., J.P.

THE HONOURABLE JOHN WALTER CHAMBERS, O.B.E., J.P.

SECRETARY FOR HEALTH AND WELFARE

THE HONOURABLE JACKIE CHAN CHAI-KEUNG

THE HONOURABLE HILTON CHEONG-LEEN, C.B.E., J.P.

DR. THE HONOURABLE CHIU HIN-KWONG

THE HONOURABLE CHUNG PUI-LAM

THE HONOURABLE THOMAS CLYDESDALE

THE HONOURABLE HO SAI-CHU, M.B.E., J.P.

THE HONOURABLE HUI YIN-FAT  
THE HONOURABLE RICHARD LAI SUNG-LUNG  
DR. THE HONOURABLE CONRAD LAM KUI-SHING  
THE HONOURABLE MARTIN LEE CHU-MING, Q.C., J.P.  
THE HONOURABLE LEE YU-TAI  
THE HONOURABLE DAVID LI KWOK-PO, J.P.  
THE HONOURABLE LIU LIT-FOR, J.P.  
THE HONOURABLE NGAI SHIU-KIT, O.B.E., J.P.  
THE HONOURABLE PANG CHUN-HOI, M.B.E.  
THE HONOURABLE POON CHI-FAI  
PROF. THE HONOURABLE POON CHUNG-KWONG  
THE HONOURABLE HELMUT SOHMEN  
THE HONOURABLE SZETO WAH  
THE HONOURABLE TAI CHIN-WAH  
THE HONOURABLE MRS. ROSANNA TAM WONG YICK-MING  
DR. THE HONOURABLE DANIEL TSE, O.B.E., J.P.  
THE HONOURABLE ANDREW WONG WANG-FAT  
THE HONOURABLE GRAHAM BARNES, J.P.  
SECRETARY FOR LANDS AND WORKS  
THE HONOURABLE RONALD GEORGE BLACKER BRIDGE, O.B.E., J.P.  
SECRETARY FOR EDUCATION AND MANPOWER  
THE HONOURABLE MICHAEL LEUNG MAN-KIN, J.P.  
SECRETARY FOR TRANSPORT

**ABSENT**

THE HONOURABLE ERIC PETER HO, C.B.E., J.P.  
SECRETARY FOR TRADE AND INDUSTRY  
THE HONOURABLE DONALD LIAO POON-HUAI, C.B.E., J.P.  
SECRETARY FOR DISTRICT ADMINISTRATION  
THE HONOURABLE JOHN JOSEPH SWAINE, O.B.E., Q.C., J.P.  
THE HONOURABLE MRS. RITA FAN HSU LAI-TAI, J.P.  
THE HONOURABLE KIM CHAM YAU-SUM, J.P.  
THE HONOURABLE CHENG HON-KWAN  
THE HONOURABLE TAM YIU-CHUNG  
THE HONOURABLE LAU WONG-FAT, M.B.E., J.P.  
THE HONOURABLE DAVID GREGORY JEAFFRESON, C.B.E., J.P.  
SECRETARY FOR SECURITY

**IN ATTENDANCE**

THE CLERK TO THE LEGISLATIVE COUNCIL  
MR. LAW KAM-SANG

**Papers**

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

<i>Subject</i>	<i>L.N. No.</i>
Subsidiary Legislation:	
Banking Ordinance	
Banking Ordinance (Deposit-Taking Exemption) Notice 1987 .....	66/87
The Chinese University of Hong Kong Ordinance	
Statutes of the Chinese University of Hong Kong (Amendment)	
Statutes 1987.....	67/87
Public Health and Municipal Services Ordinance	
Slaughter-Houses (Regional Council) (Amendment) By-Laws	
1987 .....	68/87
Jubilee Sports Centre (Amendment) Ordinance 1987	
Jubilee Sports Centre (Amendment) Ordinance 1987 (Com-	
mencement) Notice 1987 .....	69/87

**Statement****Licensing policy for banks incorporated outside Hong Kong**

FINANCIAL SECRETARY: Sir, members may recollect that on 26 November 1986 in this Council I commented upon a point made by Mr. David LI in relation to the criteria applied to applications for banking licences. I said that our discretionary criterion for minimum assets now at US\$14 billion was not meant to be inflexible and that there was some discretion.

The size criterion has recently been considered by the Executive Council, and to clarify the implementation of the policy the existing statement has been amended and amplified<sup>(1)</sup>.

By way of background, the current policy on applications for banking licences was introduced in May 1981. There had been a rapid increase in the number of licensed banks before then, following the lifting of the 13-year licensing moratorium from 1965 to 1978<sup>(2)</sup>. 41 new licences were granted during the period from March 1978 to August 1979<sup>(3)</sup>. Against this background the

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- (1) *Attached to the printed version of this statement is a copy of the statement on the full licensing policy with the amendments duly included.*
  - (2) *There was in fact some relaxation of the moratorium from 1972 to 1975 to allow applications to be considered against a set of restrictive criteria, but these proved difficult to administer and, as a result, the full moratorium was reimposed in 1975 after only one applicant had been granted a licence.*
  - (3) *There were fears that the expansion of the banking sector was becoming disorderly. So the grant of further licences was again suspended in August 1979, pending a review of the licensing policy.*

asset criterion was designed to moderate the influx of foreign banks into Hong Kong by restricting the pool of eligible applicants.

The policy has achieved this objective; from 1981 to 1986, an average of about seven new licences a year were granted. It has also ensured that successful applicants are of high standing.

However, in setting a high asset threshold, the policy has inevitably favoured banks incorporated in countries with relatively large economies. Of the 41 banks licensed from 1981 to 1986, 18 are from Japan, 13 from EEC countries, six from North America and four from Australia. No licences in the last few years have been granted to banks from any of the smaller countries in the Asian-Pacific region, although the region is well represented by virtue of earlier entry.

There have been some changes in circumstances since 1981. First, about 75 per cent of the largest 100 banks in the world are already licensed in Hong Kong; another fast influx is therefore unlikely. Second, the size of a bank's assets is no longer regarded as the only measure of its soundness; other measures such as capital adequacy, profitability, quality of management, are also relevant. Third, as Hong Kong has advanced as an international financial centre in the last few years, there has also been a rapid growth of international banking, with more countries opening their doors to foreign banks.

Sir, there can be no simple, universal and satisfactory measure of a bank's intrinsic soundness. Furthermore, standards of prudential supervision and international co-operation of bank supervision have been substantially improved under the auspices of the Basle Committee, that is, the international Committee on Banking Regulations and Supervisory Practices based in Basle.

Having regard to all these factors, an element of flexibility in administering the asset criterion is now warranted. Flexibility is also needed if that criterion is not to stand in the way of further widening the geographical spread of international banking presence in Hong Kong.

So it has now been decided that, in considering applications from foreign banks, the Governor-in-Council may approve applications even though the asset criterion is not satisfied. This discretion would be exercised by the Executive Council, on a case by case basis, where—

- (a) the applicant is of undoubted standing; and
- (b) granting a licence to the applicant would serve Hong Kong's interest as a broad-based international financial centre taking account of the representation in Hong Kong by banks from the applicant bank's country.

Administration of these guidelines will necessarily depend on subjective judgment. But as there is already wide country representation of foreign banks in Hong Kong, I expect that the number of applications that satisfy these discretionary criteria will be very limited. In every case, the two other licensing

criteria—reciprocity, and effective prudential supervision in the applicant's country of incorporation—will continue to apply.

FOOTNOTE (1)

**Policy on applications from banks incorporated outside Hong Kong**

Present policy is as follows—

- (a) Applications should normally be accepted for licences to be granted under section 16(1) of the Banking Ordinance from banks incorporated outside Hong Kong which satisfy the following criteria—
  - (i) incorporation in countries the monetary authorities of which exercise effective supervision and have no objection to the establishment of a branch in Hong Kong;
  - (ii) total assets (less contra items) in excess of US\$14,000 million (this figure to be reviewed annually against the list of the world's largest banks in 'The Banker'); and
  - (iii) availability of some acceptable form of reciprocity to Hong Kong banks;
- (b) Applications may also be accepted even though criterion (a)(ii) is not fulfilled. These exceptional applications will only be accepted where—
  - (i) the applicant is of undoubted standing;
  - (ii) granting a licence to the applicant would serve Hong Kong's interest as a broad-based international financial centre taking account of the representation in Hong Kong by banks from the applicant bank's country;
- (c) Each such licence granted should be subject to the following conditions—
  - (i) the bank may maintain offices to which customers have access for the purpose of any business, including banking business, in only one building. In this context the word office includes any automated teller machine or similar terminal device which provides facilities to customers of the bank; and
  - (ii) the bank will become a member of the Hong Kong Association of Banks and thereafter, in accordance with and subject to the provision of section 7(1) of the Hong Kong Association of Banks Ordinance, remain a member of the Association;
- (d) the Governor-in-Council will retain discretion to refuse any application even though the criteria are satisfied.

In considering each application, the Council will also have regard to the number of banks from the applicant bank's country of origin which already hold licences under the Banking Ordinance and will consider the present, and potential future, levels of bilateral trade and other commercial relations between Hong Kong and the applicant's country.

## Government Business

### Second Reading of Bill

#### APPROPRIATION BILL 1987

#### Resumption of debate on Second Reading (25 February 1987)

MISS DUNN: Sir, once again we have divided ourselves into groups for this debate. This time there are seven groups, which have focussed on economic and community services; industry, trade and labour; security services; education; medical and health services; social welfare; and general services. Members speaking after me will speak in these groups, 22 today on the first two subjects and 19 tomorrow on the remainder. We will try to limit our speeches to about 10 minutes each.

I shall confine myself to three subjects—  
—the Budget itself,  
—the presentation of the Budget and all the related documents, and  
—direct and indirect taxation.

#### *The Budget*

Sir, I welcome the Financial Secretary's first Budget. In particular, I welcome the Financial Secretary's statement that a strategy for the medium term is essential to the stability of the Government's finances and the steady development of the economy. He could easily have taken advantage of the improvement in the economy and the \$5 billion surplus that it has generated to produce a more obviously 'popular' Budget. Instead, he has accepted that balanced Budgets are not enough (though the medium range forecast still says they are). As I said last year, we must aim to maintain the real value of our reserves and to do that we must aim at steadily increasing annual surpluses. We must not forget that our contingent liabilities total about \$25 billion although, of course, we do not expect them all to come home to roost.

I have three brief comments about capital expenditure, the Exchange Fund and duty rates.

Capital expenditure has fallen by about 20 per cent over the last three years, despite those frequent assurances we were given that nothing has been cut, while recurrent expenditure continues to grow. I am glad to see that the Financial Secretary is now providing for an increase in the pace at which we are tackling our long list of outstanding projects.

The Exchange Fund is at present not allowed to borrow more than \$30 billion from any one source. The Financial Secretary proposes that this limit should be raised so that the Government can continue to lend the bulk of our accumulated reserves to the fund. It is impossible to form a judgment on the merits of \$30

billion or any other figure as a general limit without more information about the size and other aspects of the Exchange Fund. I suggest, therefore, it would be more acceptable to set the limit above \$30 billion for Hong Kong Government funds only or to express the limit as a percentage of the Exchange Fund's holdings.

The Financial Secretary says that he has adopted the principle that duty rates should be maintained in real terms. With respect, there is no such principle. When additional revenue is needed, the real yield argument can be used to justify a particular increase, but if the revenue is not needed, there is no earthly reason why the rates should not be left alone, or reduced, or abolished altogether.

#### *Presentation of the Budget and Related Documents*

I turn now, Sir, to the presentation of the Budget documents. In 1985 I asked that the form and content of the tables, appendices and statements should be examined with a view to making them as complete and accurate and presenting them as simply and clearly as possible. At that time, although the Budget documents weighed nearly nine pounds, they did not disclose the Government's true financial position; we had no complete list of the Government's liabilities; and we had no forecast whatever of future revenue and expenditure.

The situation now is greatly improved, except as regards the weight of paper. It is, for instance, not too difficult to work out that the true overall deficit for 1982-83 was not \$3.5 billion but only about \$400 million, that that for 1983-84 was only \$2.5 billion against the reported \$3 billion and that since then we have not had a true deficit at all but rather seen the total balances, that is of the General Revenue Account plus the funds, increase by over \$10 billion to an estimated \$32 billion by the end of this month. Had our attention been focussed on these overall figures rather than on the General Revenue Account figures, we might have been a little less ready to accept tax increases designed to raise \$1.5 billion in 1984-85.

So I am very glad that the Financial Secretary has decided to state the true position clearly in his Budget speech. He has told us both what the General Revenue Account surpluses and the overall surpluses are expected to be for the current year and for the year ahead of us. The overall outcome is, of course, by far the more important of the two.

However, there is still plenty of room for further improvement. The White Paper on Representative Government said that our aim was to make the Government—and I quote—'more directly accountable to the people of Hong Kong'. If this aim is to be achieved, one of the essentials is information—complete, clear and comprehensible information. But we must also remember the law of diminishing returns: the quantity of information absorbed varies inversely with the quantity of information presented. The Government must make a real effort—at least as far as the Budget is concerned—to cut down on the quantity and improve the quality and the presentation.

I suggest that, just as the Government appoints an editor for the Annual Report—Hong Kong 1987—so it should appoint an editor for all the Budget documents. He should, for instance, say to everyone who produces one of the innumerable tables of figures in these documents, ‘Just what information is the table meant to convey? Is it really necessary? Does it convey the information as clearly as possible?’ For example, all those figures about the true financial outturn of each year should be put together in one table, instead of being scattered among three pages of tables in Appendix A(2) to the Budget speech.

The editor should also look out for jargon, incomprehensibility and inconsistency in the texts. Let me cite just one example. Footnote 3 on page 7 of the 1986 Economic Background says this, and I quote:

‘GDP is defined as total final demand (TFD) minus imports of goods and services (M), where TFD includes private consumption expenditure, government consumption expenditure, gross domestic fixed capital formation, and exports of goods and services. The GDP deflator is a composite price index of TFD but with M deducted from the total. If the rate of increase in imports prices is faster than the rate of increase in the TFD deflator, as in the case of 1986, the rate of increase in the GDP deflator will be lower than that in the TFD deflator.’

Hands up everyone who understands that [*laughter*]. But if you do not it does not really matter because it is not even true. As far as I am concerned, GDP is not TFD minus anything. It is, as one of the other Budget documents, Estimates of Gross Domestic Product 1966 to 1986, correctly says, ‘the aggregate measure of the total value of net output’.

A more important matter, which calls for more than mere editing, is the definition of the public sector. It is vital to keep a grip on the ratio of public sector expenditure to GDP for if the ratio goes too high, economic disaster follows. So we really do need a definition of the public sector that is clear and comprehensible and makes sense. Last year the then Financial Secretary cheered me up a bit by saying that a full review of our consolidated statistics was in hand. But that review seems merely to have produced so far a re-statement of the ‘consolidated accounts’ and the ‘national accounts’ definitions, despite the manifest absurdity of both. It is as absurd to pretend that the MTRC and the KCRC are not in the public sector as it is to pretend that subventions to private or quasi-private institution are not part of public sector expenditure. I hope the Financial Secretary will continue the struggle to find a sensible definition that we can all accept.

#### *Direct and indirect taxation*

Sir, the Financial Secretary invites comments on the relative merits of direct and indirect taxation. I shall rise to that challenge. In the 1985 Budget debate I spoke on this subject; and it is a subject in which principle and practice must be considered together. The principle behind direct taxation is that payment



should be related to ability to pay; that behind indirect taxation is that payment should be related to consumption.

A third principle—that every citizen should make some contribution towards the public expenditure from which all benefit—generally leads to governments adopting a mixture of direct and indirect taxes. If all taxation is indirect, there will be too heavy a burden on the poor for it will not be possible to raise enough revenue by taxing only luxuries. If it is all direct, then many people will make no contribution because it is uneconomic to collect direct tax on small incomes.

In Hong Kong we are guided by three additional principles:

- that the general level of taxation should be kept low;
- that the system should be simple to administer;
- and that it should be easy to understand.

No tax system can be fair to everyone. So long as the burden is not too heavy and the inequities not too great, this is tolerable. But if people feel that the system is badly wrong, then they will do something about it. No tax system can cope with widespread evasion without great expense, and even then success will be only partial.

The British experience with value added tax has a lesson for us. The tax is very unpopular and widely avoided by means of unrecorded cash transactions—even by people who in every other way are quiet, law-abiding citizens. It is a literally demoralising tax. I do not think we should have anything like that here.

The precise ratio between direct and indirect tax is unimportant so long as we have some of both and stick to our principles—our principles that the general level of taxation should be kept low, that the system should be simple to administer and that it should be easy to understand. But whatever we do, I am sure we should not impose any new tax at high rates nor increase an existing one sharply. That sort of measure can seriously affect people's livelihood—and people will quite rightly object strongly—as the taxi drivers did.

### *Conclusion*

Sir, the resumption of economic growth and the Financial Secretary's consequent ability to present an optimistic surplus Budget reflect great credit on those who manage our public finances. But sound financial management cannot by itself produce economic growth. That depends on the enterprise, skill and sheer hard work of everyone involved in our economy. We can have every confidence in our future so long as the Government continues to preserve and foster an economic environment favourable to enterprise, investment, job creation and wealth creation. And I have been very glad to note the Financial Secretary's intention, which he stated in his summing up, to do just that.

I support the motion.

MR. CHEN: Sir, first of all, I would like to congratulate the Financial Secretary for producing a balanced and prudent Budget. Although Hong Kong's financial position has improved significantly over the past two years, there is no room for complacency. As the Financial Secretary pointed out quite correctly, our economy is still as vulnerable as ever to external forces. Protectionism is mounting in our major overseas markets whilst our competitors in the southeast Asia region are catching up strongly on both technological and managerial skills. Therefore, we must not fall into the trap of being overoptimistic on our economic performance during the past year. We should, instead, strive to maintain a stable pace of advancement, paying careful attention to changes in the environment and to formulate appropriate strategies in response to such changes as they may emerge, including unforeseeable rainy days.

The budgetary proposals put forward by the Financial Secretary bear out the above considerations. There is no major departure from the existing fiscal policies, nor is there any drastic increase in public expenditure which could so easily put us back into deficit when the external environment becomes less favourable. Despite this, the Budget clearly demonstrates the Government's confidence on the long-term future of Hong Kong and its commitment towards improving the quality of life of the local people through various improvements on public services and facilities.

As regards the revenue proposals, I fully agree with the broad principle of maintaining a low and predictable tax regime in Hong Kong to attract foreign investments and the Financial Secretary's remark that a higher contribution from indirect taxes is more desirable in the longer term for Hong Kong. Sir, as I indicated in the 1984 Budget debate, I am in favour of a different mix of direct and indirect taxes, moving progressively towards a higher proportion of indirect tax in our revenue structure. This should be a more equitable arrangement since out of a population of nearly six million, there are only about 850 000 direct taxpayers in Hong Kong, most of whom (at least about 600 000) are salary earners who have no other means to mitigate the effect of tax increase apart from hoping for the best for a salary increase. In this respect, Hong Kong must be unique among the western democracies in that so much tax burden rests on the shoulders of so few. By increasing the indirect tax component of our revenue, we would have a much better chance in maintaining our low and predictable tax regime. In other words, by broadening the source from which our tax revenue is derived, not only will the Government be less vulnerable to fluctuations in our economic performance which could bring about a reduction in revenue from direct taxes, the so-called 'sandwiched' class will also be relieved from bearing the brunt of the tax burden. Moreover, it is in line with the spirit of open government that whilst demanding a more active role in the administration of Hong Kong, our citizens should also learn to accept their obligation of contributing towards the resources required for the efficient functioning of our Government.

Sir, having established the broad theme of my argument, I must emphasise that imposition on any indirect taxes should not be aimed at shifting the tax burden onto the less fortunate members of our community. As to the practical implementation, there are many options for raising more taxation on an indirect basis, applied where possible to indulgences but not necessities, to ensure that no undue hardship is caused to the man in the street. Sir, I have already cited a number of possibilities in the 1984 Budget debate and there is no need for me to repeat them here. None the less, I must emphasise that I do not support the imposition of any form of general sales tax similar to the value added tax (VAT) currently levied in Britain and some European countries. This will bring about a major departure from our philosophy of maintaining a simple, easy-to-administer tax system in Hong Kong. Worst still, such a sweeping tax reform will create incentives for tax avoidance and lead to costly enforcement problems. Rather than introducing a new form of taxation, therefore, it seems more logical for us to proceed on the basis of our existing system to bring in progressively more categories of items into the tax net. In this regard, I fully share the Financial Secretary's view that a practical approach should be adopted to avoid any damage to the confidence of foreign investors.

Sir, with these remarks, I support the motion.

MR. PETER C. WONG: Sir, in the words of Viscount Sherbrooke, 'A financial secretary is entrusted with a certain amount of misery which it is his duty to distribute as fairly as he can'. Continued prosperity in 1986 and a bright economic future have given the present Financial Secretary a much smaller amount of misery to distribute in his maiden Budget. While there will always be debates about whether he has distributed the misery as fairly as he could, I congratulate him on using this year's surplus both to provide substantial concessions in personal taxation and to stimulate commerce and industry by cutting profits tax. I also congratulate him on having resisted the temptation to relax the very sound and successful policy of containing the growth of the public sector, which of necessity had to be enforced during the past few years. In the best of traditions, he has wisely chosen to preserve continuity.

A healthy and balanced Budget allows us the luxury and time to sit back and examine the principles behind our fiscal system. Instead of agonising over whether certain harsh measures ought to be introduced in order to reduce deficits, we are able to examine ways of distributing the misery of taxation in a fairer and more stable manner. In a most refreshing speech, the Financial Secretary has invited discussion on two possible changes to make our tax system more equitable and flexible. The first concerns the introduction of separate taxation for married women, a matter which has been the subject of intelligent public discussion for a number of years, with renewed intensity in the week or two preceding the Budget. No doubt, we will be hearing more about it this afternoon and in the weeks and months to come. On my part, I believe the principle of separate taxation for women is sound. Whether or not it fits into

our existing tax structure is a matter for further deliberation. I am sure, the Financial Secretary is keenly aware that to tax and to please, no more than to love and to be wise, is not given to men.

Sir, the second suggested change, which is of fundamental importance, is whether a broader and more stable tax base should be adopted by increasing the proportion of revenue which is derived from indirect taxes. This thought-provoking suggestion deserves a few comments. And that is exactly what I intend to do this afternoon.

Sir, we pride ourselves in Hong Kong on having a simple tax system which is cheap to administer and easy to enforce. The burden is borne mainly through direct taxes supplemented by a few clearly defined and very lucrative indirect taxes, such as the duty on tobacco, alcohol and oil. More recently, indirect taxes have been re-introduced on such commodities as cosmetics and soft drinks in order to avoid having to increase the rate of direct taxation. When these two categories of products were brought under the Dutiable Commodities Ordinance two years ago I drew attention to difficulties in the definition of cosmetics. As a result, some amendments were made. But there are still difficulties, and only recently Members of this Council received a representation from a local importer objecting to the inclusion of a certain brand of facial cleanser, which is in his view essentially soap. Imagine what would happen if indirect taxation were extended to other goods and services which are even less easy to define and quantify. The opportunities for argument, confusion, and avoidance would be many. These difficulties are by no means insurmountable. But systemic planning and careful judgment are required if we are to avoid them.

Sir, a more fundamental question is whether it is right for a government to choose arbitrarily which goods and services are luxuries and which of these luxuries should be taxed. The Government has singled out certain products which it considers to be luxuries, thus bringing them within the tax net. Some have argued that soft drinks are not luxuries, and they may have good grounds for this. But the real inequity, in my view, arises from the unevenness and perhaps discrimination involved in taxing selectively a small number of products and leaving untouched many other luxury items which might just as reasonably be subject to tax. Why tax soft drinks and not chocolate or cakes? Why cosmetics and not jewellery or silk dresses? Frankly, I do not have the answer. I suppose we are not living in a perfect world, and would therefore have to accept a certain degree of inequity and inconsistency.

A possible and perhaps more equitable solution to this problem is to spread the load very widely by taxing at varying rates a wide range of goods and services, thereby producing a system of indirect taxation along the lines of the value added tax system in the United Kingdom, commonly known as VAT. While such a system may help to spread the misery more fairly it also increases that misery. Complicated tax schemes, which need constant supervision by an

army of inspectors, must be paid for by more taxes. The perplexity and quantity of tax return forms for businesses in the United Kingdom as a result of VAT has caused many small businesses to close down. In the short time that VAT has been in existence in the United Kingdom, the VAT inspector has already become a symbol of predatory bureaucracy. The lesson to be learnt from the United Kingdom experience is clear. Let us keep our simple tax system simple.

Sir, but at the end of the day, if we chose to move in the direction of a broadly based indirect tax, then it might be necessary to devise a simplified version of VAT, easy to administer and suitable for application within the framework of our simple tax structure. And in order not to impose too heavy a burden on the less well-to-do, essential goods and services should enjoy exemption. Obviously, it would not be easy. As pointed out by the Financial Secretary, we would have to think the package through with meticulous attention to the consequences that might follow.

Sir, indirect taxation has many permutations. We do not necessarily have to follow the United Kingdom example of complicated but evenly spread VAT. Nor do we necessarily have to extend our own highly selective but cheaply administered system of duties. There are difficulties in both extremes and the solution for Hong Kong probably lies somewhere in between. And, whatever the problems, indirect taxation does have the advantage of preserving the individual's basic right of choice. On the other hand, an unduly high rate of direct taxation would not be conducive to promoting incentives. The Financial Secretary is wise in wishing to take precautions against difficulties that might arise from having a revenue too dependent on narrowly-based direct taxes. He is even wiser in saying that caution should be our guiding principle. On balance, I am in favour of widening the tax base. But until we can find satisfactory answers to the questions I posed, we must exercise caution in extending the range of indirect taxes. I have no wish, Sir, in this short speech to go into the philosophy, criteria or economics of taxation. Nor will I dwell on the relative merits of progressive, regressive or proportional taxes. I do wish, however, to point out that no tax system is perfect. Modern tax systems are essentially a compromise. Our quest is to find the right compromise in the context of Hong Kong.

Sir, I look forward to general debate on this important issue—whether it is possible to increase the proportion of revenue raised from indirect taxation in a manner which is simple, flexible and yet equitable. Obviously, with constant changing circumstances, there is a need to rationalise our tax system to ensure that the right balance and emphasis is maintained and enhanced.

Sir, I support the motion.

DR. HO: Sir, on balance, the Financial Secretary's Budget proposals for 1987-88 were generally applauded for his pragmatic fiscal approach, for the concessions on personal and corporate taxes, and for the introduction of a variety of higher tax allowance. His financial stewardship steered our economy

to an overall surplus of HK\$4.9 billion for this year, and brought the general reserves to HK\$20 billion. He was confident that Hong Kong could look forward to an average annual surplus of HK\$1.5 billion over the remainder of the decade. On all this good work, I extend my congratulations to him.

However, the relief arising from the proposed 0.5 per cent lowering of the standard salaries tax is minimal. If the Financial Secretary wishes to see a substantial alleviation of tax burden on the tax-payers, a one percentage drop will be more appreciated. The current rate of corporate profits tax is not particularly onerous compared with those of other countries, and if it remains unchanged, it will not pose a threat to overseas investment.

#### *Indirect taxation*

In response to the Financial Secretary's call, I would like to make a few comments on his suggestion of a broadly based tax system. Sir, I can see some merits in widening the scope of indirect taxation, so long as the general taxation guidelines laid down by the previous financial secretaries are being observed. Under these circumstances, indirect taxes are complementary to, but not replacing, direct taxes in revenue raising; through indirect taxes the burden of tax is merely spreaded more widely across different segments of our community.

However, there are genuine fears that the Government will have few alternatives but allow indirect taxation to slip into the role of a major instrument of revenue raising—especially in the face of a less than satisfactory export performance and/or under the constant pressure from the public who demand more spending on social services—since the Government is firmly committed to the belief of a low direct tax system in order to make Hong Kong more attractive for foreign investment. The social implications of such a taxation policy are far-reaching. Members of the public, who have to pay these taxes, must be helped to appreciate the consequences and must be convinced of the relative merits of this shift in taxation policy.

The public's reactions towards indirect taxes will in part be related to the categories of goods being levied upon, the tax forms and the tax rates. If daily necessities, including staple products, are levied, the opposition will likely be loud and persistent, because this is tantamount to an across-the-board reduction of income. These levies are probable to trigger off an inflationary spiral, which, if coupled with an import-generated inflation, will cause great hardship to the salaried workforce, especially to those workers in the low-economic groups. In general, excise duties are less objectionable psychologically, because they are built into the prices of the items purchased. Sales taxes are most unpalatable, especially when they are levied on food or services where service charges are already imposed. Should sales tax be levied, my personal view is that it must not be higher than 5 per cent of the cost of the goods or services consumed.

On the philosophical plane, indirect taxation totally disregards the ability to pay. Taxes are paid by the consumer of goods or services, irrespective of their

income level. This type of taxation is therefore considered regressive in that it tends to run counter to the principle of social equity. A well-conceived taxation system for a modern government must achieve wider goals of social significance, apart from revenue raising. Although Hong Kong Government is oriented toward a mercantile economy, it has, nevertheless, in the past decade taken on the functions of a caring and benevolent government. These positive features of the government are well suited to the unique developments of Hong Kong, and should not be put in jeopardy by adopting a taxation policy that is insensitive to the people's ability to pay.

The spread of income, especially disposable income, in the community, is not just a result, but also a determinant, of the performance of an economy. It has been established by research that a less polarised distribution of economic resources is more likely to encourage aggregate domestic consumption, thus creating more employment. The spiral effect is the acceleration of economic development. A wide range of fiscal measures, such as concessions on income or salaries tax, higher personal allowances, old-age or children's grants, disability benefits, and working wife's allowance, are designed to narrow income gaps and hence will enhance consumption capability.

Economic hardship and deprivation could breed class hostility and ill-feelings, and thus pose a threat to social and political stability. An ill-conceived indirect taxation system, coupled with wide gaps in income distribution currently prevailing in Hong Kong, may likely accentuate negative sentiments in the community at these sensitive times of transition. As a matter of fact, Hong Kong Government has been making generous provisions in the last 10 to 15 years, for housing, education, health and welfare, to the benefit of all and in particular to those in the low economic strata. This benevolent government policy can be readily verified by references to the previous annual policy speeches and Budget speeches. I wish the Government could give a definitive statement that our Financial Secretary's thinking on indirect taxation is not a hint to signify a reversal of the policies advocated by our former governors and financial secretaries.

There are attempts in some countries to make indirect taxes less socially repugnant. Exemptions are allowed under certain conditions. For example, in cases of sales taxes, levies on clothing items and shoes for children under 16 years of age and for elderly people are exempted. No additional charges are collected on meals consumed in restaurants or food shops under a specified amount. These tax exemptions have social implications. However, these concessions will inevitably make the taxation system complicated, costly to administer and open to abuse, resulting in losses of revenue.

One of the reasons advanced by our Financial Secretary in support of a broadly-based indirect taxation is the stability of revenue source. The soundness of this argument hinges on several conditions. First and foremost is the consideration on the demand elasticity of the consumer goods concerned. For

those commodities that can be forgone with ease, no revenue will be generated. Non-essential items come under this category of commodities. Ample examples are available in Hong Kong, for example, the actual tax yields from dutiable goods fall far short of the expected revenue. Changes to non-dutiable substitutes are a legitimate way to evade taxes. Reduced consumption or diminished purchasing power on the part of the consumers on account of poor employment or under-employment will likewise result in shrunken revenue. A more assured and long-term measure to boost the yields to the public coffers is to further improve our ability to export through a package of government-sponsored plans: infrastructural investment, credit facilitation, research and productivity promotion, technological transfer, training and upgrading of manpower, marketing information and so on. Through the combined efforts of government guidance and support on the one hand, and the entrepreneurship and industry of the private sector on the other, we have fared quite successfully in our economy in the face of trade recessions, inflated import prices and overseas protectionism. On the basis of such experiences over the years, I am convinced that our export capabilities are the genuine locomotives of our economy and the more reliable generator of public revenue.

In examining the Budget proposals, I came to realise that the Financial Secretary has as much a role to play in creating national wealth as in controlling public spending. Creation of the much-needed resources is a prerequisite before we decide on how they are going to be expended. In this regard, the community looks to the Financial Secretary for dynamic and effective guidelines to expand and uplift the economy to a higher level of development.

It is welcome to have a low rate of direct taxation, if it comes about as a result of economic growth. However, if it comes about as a trade-off for a widening net of indirect taxation, I am afraid that this policy option must have overlooked other objectives of great social and economic significance. Indirect taxation, when applied to the fullest extent, is likened to asking every consumer, regardless of his income level, to pay for himself. This blatantly violates the principles of social justice, threatens social stability and reverses the Government's long-established policy 'to help those least able to help themselves'.

Finally, I risk repeating myself in order to remind the Financial Secretary that he must exercise great care and undertake thorough consultation before designing a right mix of direct and indirect taxes to yield the required resources to meet the expanding public sector expenditure against a set of goals compatible with the unique situations of Hong Kong. These goals are, namely:

- (i) to have proper regard to the people's ability to pay,
- (ii) to avoid aggravating the distribution gaps among economic classes in our society,
- (iii) to maintain an adequate level of social service provision in the interest of the less fortunate, and
- (iv) to further accelerate growth in the manufacturing and financial sectors.



*School social work service*

Before closing my speech, I would like to say a few words on the programme of school social work. This programme has been a subject of discussion for years between the relevant government departments and the social workers, school principals, youth workers and community leaders concerned with juvenile delinquency. The long-drawn discussions culminated into the setting up in 1986 of the 'Working Group on an Overall Review on the Delivery of School Social Work Service'. The functions and the value of this service were assessed and were finally confirmed by the said working group. One of the recommendations was to improve the manning ratio to 1 school social worker to 3 000 students. This particular recommendation, together with others, were subsequently supported by other high-power advisory bodies, such as the Social Welfare Advisory Committee and the Fight Crime Committee. The OMELCO Social Welfare Panel also endorsed this recommendation. Assurances had been given by the government representatives in the meetings of the Social Welfare Advisory Committee and the Fight Crime Committee to put this recommendation into implementation at the earliest possible time, that is in 1987-88 (please refer to paragraph 16 of the Minutes of the SWAC meeting held on 27 October 1986 and to paragraph 77 of the Minutes of the Fight Crime Committee meeting held on 3 January 1987).

It is to my utmost dismay that the Social Welfare Department has made no provision in the 1987-88 Budget Estimates for the agreed improvement of the school social work service. The financial implications for implementing this service are estimated to be HK\$2.8 million for the 1987-88 fiscal year, if it commences in September, and \$5.6 million for a full year. This is a very tiny sum in comparison with the total Budget for social welfare subvention for the coming year, representing less than half a percentage point. Weighing against the immense benefits that this school social work service could bring to the academic, moral and behavioural developments of our teenagers, the Government should take a positive decision and allocate the needed resources immediately. May I therefore ask the Government to make known its position on this long-standing issue?

With these remarks, Sir, I support the motion.

MR. WONG PO-YAN: Sir, first of all, I wish to congratulate the Financial Secretary for being able to present a surplus in his first Budget. This Budget is quite a departure from those of his predecessor who had to contend with deficit Budgets except for the final one throughout his tenure. I recall Sir John quoted Dickens in his last paragraph of his Budget speech delivered in 1985 how happiness or misery can be derived from the way one manages his income and expenditure.

*The Budget*

On the Budget for 1987-88, I must say that, by and large, it is well received by the community as many people will benefit from it one way or another because of the various tax reductions and concessions.

However, I share the disappointment of the suppliers and consumers of soft drinks because the duty on non-alcoholic beverages, which was re-introduced in 1985-86 mainly as a revenue raising measure, has not been removed even with the improved overall revenue position. Admittedly, the estimated revenue of \$190 million is a sum not to be belittled. Yet, on reflection, the large quantity, that is, about 320 million litres of soft drinks consumed in a year as represented in this estimate stands to argue against the main reason for re-introducing the duty which is, in Sir John's words, I quote 'Soft drinks are a pleasant indulgence, not a necessity' unquote.

#### *The Economy*

On the economic scene, it is encouraging to note that Hong Kong has progressed from strength to strength. The economic performance of Hong Kong for 1986 has been most rewarding with tremendous growth in exports and re-exports resulting in a very promising GDP growth.

Despite this strong performance in 1986, however, the Financial Secretary's view is that the performance in the next fiscal year is expected to be a slight set-back in some respects as compared with our current position. Accordingly, his Budget adopts a line of moderation and aims at stability.

Generally, I am convinced of the resilience of our economy, and remain optimistic of our economic growth even though we have had different problems at different times. What we lack in natural resources is more than made up by the outstanding abilities and qualities of our human resources. Therefore, I am certain that in the short term, there should be no serious problems and our economy should be able to grow. I will not be surprised if the tenor of the economic growth in 1987 may be better than what we expect at this stage. However, I can see the problems in the long run and against them I would like to see active measures taken as soon as possible to enable us to deal with them before they assume a proportion larger than what we can handle.

#### *The Industry*

It is common knowledge that Hong Kong economy survives on export trade, the lifeblood of which flows from the manufacturing industry whose mainstays are the textile and the garment industries. The products of these industries have made themselves such a name in the world market that they have become obvious targets of protectionism. As I see it, our textile and the garment industries will maintain their leading position in Hong Kong and in the world for many years to come. Therefore to counteract these protectionist restrictions, we need to diversify our products as well as to upgrade their quality. We also have to develop new markets. I am glad to say that no effort has been spared by all concerned in this regard. It is well known that the effort made by the Trade Development Council has achieved much in promoting such moves all over the world. Credit must also go to the Federation of Hong Kong Industries which twenty years ago in late 1960s started to promote the importance of design and

helped the planning of design education in Hong Kong. These are examples to illustrate the need of a far-sighted policy to develop our economy.

Looking at our other important industries, that is, electronics, electrical and machinery industries, we are less fortunate. We are lagging far behind our neighbours owing to insufficient resources and efforts devoted to research and development.

Many have pointed out repeatedly the need for Hong Kong to turn to high technology. Unfortunately, we have only recently made a very small positive start in this direction. A number of industrialists have begun to introduce CAD/CAM processes in their factories. Government has also provided some degree of assistance to various bodies such as the Hong Kong Productivity Council and tertiary education institutions in research and development activities. Our efforts and investments in this field, Sir, I must say, is still inadequate. We are still lagging far behind our neighbours in this area of activities and they are keen competitors vying with us for the world market. It is not sufficient if we are to rely on the Government alone to fund and push research and development activities and to await the outcome of the practical application of the results of research and development in the industries. I think the industrialists have to take the initiative in this matter and collaborate with the Government to achieve a better result. Of course, we are establishing a new university of science and technology which will, no doubt, devote its resources to research and development, but some special effort is needed immediately. It may be necessary, for example, to reconsider the suggestion of charging certain industries a levy for this purpose.

As international competition goes on all the time and gets keener every day, we can ill-afford to lose out on the time element. To quicken the pace, we must inject more resources into this effort. Besides that, as I mentioned on other occasions, perhaps certain Chinese technologies could be employed to upgrade our industries if appropriate arrangements are made.

Sir, I know that some factories which are rather labour-intensive and using only simple manufacturing techniques are moving to China now, and it is certain that this trend will continue as long as China maintains its open policy. Therefore I am concerned that if we do not develop high technology for our production in time, we may not be able to create enough jobs for our better educated and better trained workers. The end result is that the wages of our labour force would be too high to enable us to take on labour-intensive jobs; yet, our industries are not in a position to produce enough products of high quality which are competitive in the world market. This will be a real problem for the future if we fail to start systematically and actively mapping out a plan to develop our industry and its work force to adopt high technology.

#### *Pollution control*

Our experts in pollution control should be commended for their hard and patient work under a tight Budget over more than 10 years. We now welcome

the upgrading of the Environmental Protection Agency into a department, with a substantial Budget and an enlarged establishment. I hope that not only will its staff be empowered by law to combat pollution but they will also educate and advise the industrialists on the need for environmental health for the well-being of the whole community. The department should devote more of its efforts in this direction and resort to prosecution only if an offender repeats an error. Sir, I sincerely hope that in reporting its work and achievements, the department will demonstrate its achievements in improvements made in the control or reduction of pollution in a certain area, and not just pride its work by the number of prosecutions made.

#### *Monetary issues*

In the past few years, we encountered some problems in our banking and deposit-taking institutions. I agree with the analysis contained in paragraphs 23 to 32 of the Budget speech on monetary issues. We should learn from the lessons of the mess we experienced in these institutions and enforce the Ordinance strictly. We cannot afford to have similar incidents happening again and be made to be responsible for the rescue. In addition to the powers under the new Banking Ordinance, the Office of the Commissioner of Banking and deposit-taking companies has also been provided with more staff for 1987-88. This should enable the Government to closely supervise these institutions in accordance with the Ordinance.

#### *The Options*

Now, I wish to come to my final point. The Financial Secretary, in paragraphs 44 to 48 of his speech, invited Members' views on the principles of widening the scope of indirect taxes and other options such as widening the salaries tax net. Personally, I find the choice between them quite a dilemma. If my memory serves me right, I seem to recall that in the early 1970s, some of the white collar and blue collar workers had a sense of pride if they were in the tax net and required to pay tax. I am not clear whether this was the result of an affluent society or having a sense of belonging or simply a show of social status or a combination of all these. I wonder if this feeling still exists.

On the other hand, what we hear today are requests for increasing the tax allowances in order to let more people remain outside the tax net. Government also has in mind the administration cost of taxing the lower income section. Government is conscious too, no doubt, of the public opinion urging for separate tax returns for married couples and revision of the existing allowances for tax payers, their children, their dependant parents, and so on.

If Government is to accede to these appeals, revenue has to be made up by other means to meet public expenditure. Thus, widening of the scope of indirect tax is inevitable. Again, this is not welcome by some as expressed in the representations recently. Besides, by widening the scope of indirect tax, most probably the burden will be borne eventually by those in the lower income

bracket. But if we are to introduce it to the so-called luxury items, it is difficult to define such items and it may have adverse effect on our tourism industry.

Obviously, in consideration of attracting investment, to increase or maintain a higher tax rate is undesirable. What then is our choice? Of course, there is much to be said on the pros and cons of this question but, I merely wish to point out some arguments that are obvious to me at this juncture. I believe that it is necessary for this Council to give the matter further consideration in the coming months and to take in the overall economic circumstances of Hong Kong in the intervening period before the Financial Secretary draws up the next Budget.

Sir, I must apologise for the length of my speech, but, with these words, I beg to support the motion.

MR. STEPHEN CHEONG: Your Excellency, this debate is not just about the state of finances of our Government but also about economic policies, the adoption or rejection of which would have far-reaching implications on Hong Kong's future economic well-being. It is perhaps fitting to sombrelly remind ourselves that the majority of the people in Hong Kong would agree that economic well-being is our key towards continued survival and progress. Our Government, be it now or in 1997 or even in 2047, must give herself a priority task and that is, to maintain an environment of economic stability that will be conducive to the majority of our citizens to continue to be able to work so as to feed ourselves, to clothe ourselves and to have a decent roof over our heads.

Before addressing issues relating to the Bill, forgive me, Sir, for straying momentarily into an area which may at first glance seem different from the mainstream of this debate. Yet, I am convinced whatever that will be brought up lies within the ambit of having important bearings on our future economic developments. Our future can only be best served through all of us debating and reaching some sort of basic understanding on some hard but home truths. First, politics in Hong Kong should not take precedence over our work to enhance economic well-being of our people. Furthermore, politics in Hong Kong cannot take the same dimension as in other independent countries. Independent countries which have sovereign rights can, if their people wish to, devise political systems and constitutions that are conducive to adversarial politics. In other words, in independent countries, formation of political parties is encouraged so that there may exist in their legislatures opposition parties. Differing parties form differing policies and compete against one another for power with one voice so that by and large, the discipline of party members is maintained and enforced. Such scenario would be highly unlikely to happen in Hong Kong nor would it be beneficial to Hong Kong if it were to happen. In the first place, we have accepted we are part of China and that we will never be an independent nation. Under such circumstances, we must not adopt a system that is too reminiscent of that of an independent nation. Secondly, political parties and adversarial politics are definitely not conducive to future development of the livelihood of the majority of the Hong Kong people. One may ask

why? The answer is perhaps simplistic but still merits careful reflection by all of us. It is generally accepted that the most effective way to play adversarial politics is to appeal through the media and employ tactics to play up the fears and emotions of the people thereby hoping to galvanise the masses towards the party's political goal. Pressurising and confrontational tactics are generally deployed too. Little wonder that there exists a saying that the political business is a dirty business. In a society like Hong Kong which is very young in its exposure to politics, the playing of adversarial politics and the constant employment of pressurising and confrontational tactics invariably have a greater risk of breeding instability in the society. Instability is certainly not conducive to economic development. Without economic development, there will be less opportunity for jobs. Less jobs bring undesirable effects to the livelihood of those unemployed. This in turn breeds further instability and so on.

The second home truth is that Hong Kong has progressed so much economically in the past and it is also a fact that practically everyone in Hong Kong wishes to maintain this progress and our way of life. We achieved what we have achieved without adversarial, or party politics. There is no reason why we should yield to the desire possibly for idealism and tamper with great haste our formula of success. Some people strongly advocated that the British are different from the Chinese therefore we must have western style democracy firmly entrenched in Hong Kong in order to have a weapon to fight China if the need arises. On the surface, this argument sounds attractive. Yet, it will not bear practical fruit. No doubt, the majority of our citizens may still be weary of possible excesses from China, but do we really need to condition our citizens in doubting China every step of the way through the transition period? Must we fan up fears by constantly referring to postulations on what bad things China might do in 1997? Would such tactics serve our purpose of stability and prosperity especially for those who cannot or do not wish to emigrate from Hong Kong? Even if one assumes that China may not understand fully Hong Kong's ways of life and ways of doing things, would continuous deployment of confrontational tactics really help her to understand better? Or would it be more effective if we sit down patiently and explain our difficulties so that changes may come about after better understanding of one another's viewpoints?

Thirdly, I have had very useful experiences in quite a number of international negotiations over Hong Kong's thorny trade issues. Allow me, therefore, to share with my colleagues one important lesson I learnt and that is no negotiation can ever be successfully conducted if megaphone tactics were to be deployed all the time. Certainly no negotiation is ever fruitful if either side were to choose to negotiate through the media. I sincerely plead, therefore, that all political aspirants in Hong Kong should, if their intention is to serve Hong Kong and do good for Hong Kong, think very carefully before embarking again on the use of non-productive rousing tactics because the end result would more likely than not, lead Hong Kong to a more adverse situation which, surely, we all would not like to see.

Before making some observations on our public finances and the future state of our economy, may I first congratulate the Financial Secretary in presenting to the people of Hong Kong a very good Budget. There will invariably be differences of opinions from commentators on what should or should not have been done. Yet, it cannot be denied that the Financial Secretary had been extremely pragmatic in his first balancing act and it is precisely this display of pragmatism and caution that underlines his wealth of wisdoms. The basic philosophies adopted, as described fully in paragraphs 3 to 6 and 142 to 144 of the Budget speech, deserve our full support. They succinctly summarise what was and what will be needed to keep on facilitating Hong Kong to tick. His call for debate on the ratio of direct and indirect taxation is timely. On this issue, I support in principle the Financial Secretary's underlying thoughts. However, I do not think it wise to eventually move the ratio beyond 50/50, therefore the small swing margin of 10 per cent should be initially explored with the aim of levying a heavier burden on consumption of luxurious items, such as Rolls Royces, Ferraris and Lamborghinis as well as various expensive jewelry items. Given the short period of time within which we have to respond, the complexities of different computations, and a colourful debate in between, I regret for not being able to offer more concrete suggestions at this stage for any meaningful consideration.

On the state of our future economy, I agree totally with the Financial Secretary that we should be cautious. The projected growth rate of GDP for 1987-88 at 6 per cent may well turn out to be slightly conservative if we can weather the storm of protectionism looming in the horizon. (A range of 7-8 per cent is achievable given that our exports to countries like Japan and West Germany have a good chance to accelerate.) On the other hand, if unforeseen problems with our exports to the United States indeed turn out to plague us, then we may well be in for a rough time. Also, the tremendous third-world debt hanging over the heads of the international banking sector is another factor we should not discount lightly. If this was to develop into uncontrollable crisis situations, I have no doubt the ensuing chaos arisen would have tremendous adverse impacts on our near to medium-term economic development. Since there exists such external uncertainties, we have to be even more vigilant in the home front so that we will not be landed unnecessarily with aggravating problems within our domestic economy. In this regard, Sir, I wish to sound a note of caution on the recent euphoria that seemed to have swept through our stock and property market.

Fuelled by low interest rates and the tremendous local liquidity of financial institutions, some operators from abroad seems to me to have been less than prudent in their pursuit of a quick buck in Hong Kong. I am of course no high financier and do not profess to understand fully some of the finer intricacies involved in this mega-money field. Yet, based on what I have heard and read so far, there does not seem to be much money being brought in from abroad for such huge investments. Rights issues were arranged or to be arranged in

mind-boggling sums designed to reduce gearing ratios with local money. As a true believer in the free market economy, I am quite prepared to wish them good luck and all the successes. However, as someone who had witnessed what Hong Kong had gone through during the last boom and bust cycle of our property and stock market, which contributed significantly to the banking crises we experienced in the last few years, I feel it duty-bound to urge that our Government should be fully aware of the dangers of a self-blown balloon being burst through indiscriminate overstretching. As we may face uncontrollable or unforeseen external factors, Hong Kong certainly can ill afford another major setback precipitated by less than prudent wheeler dealers. Our financial institutions need to take note of the dangers too. Our economy now or even in future should be built on solid foundations such as trade, tourism and industry. Our traders and industrialists should be encouraged to expand their activities and increase their investments. Sir, results of the review studies commissioned by Government on various industrial sectors all point to one handicap experienced by different sectors of industrialists—that of difficulties in obtaining the necessary financial support for their expansion and upgrading programmes. Let me hasten to clarify immediately that I am not angling for soft loans for our manufacturing sector, nevertheless, the results of the reviews do raise some interesting food for thought for all concerned. Accordingly, I look forward very much to the report of the special committee set up by the Association of Banks tasked to review and look deeper into this particular issue. Government should also take a close interest on this too. It is high time that the importance of industry to Hong Kong should not just be recognised by empty words but also by some well balanced and well thought out actions. Our future stability is very much dependent on the ability of the manufacturing sector to continuously offer job opportunities to our citizens. It is my firm belief that Hong Kong can only progress if we can continue to maintain a low unemployment and under-employment rate. It behoves all of us to work towards that goal—now as well as in the years running up to 1997 and beyond.

Sir, I have great pleasure in supporting the motion.

DR. IP: Sir, my concept of a good Budget is that proposals to raise revenue should cover anticipated expenditure by ensuring that everyone pay a fair share of tax, except for the very poor. In considering what is fair, we render those who earn more pay proportionately more tax, without suppressing the incentive to work hard. To achieve our target, the framework of the tax structure should remain simple. Last but not least, no group should be singled out to pay a disproportionate amount of tax.

As long as the Budget proposal were to cover these general points, I feel it unnecessary to scrutinise any further. I would therefore like to congratulate the Financial Secretary on his maiden Budget proposal for it covers four out of my five points. My only comment is that if he had also considered separate taxation for married women, his Budget would have been a perfect one! The increase this



year of allowances for married couples has partly offset the longstanding injustice to married women. However, it would be unavoidable and unforgivable if separate taxation for married women should be excluded in the next year's Budget, since my proposal in 1983 for separate taxation for married women has now been unanimously supported by all the Unofficial Members of this legislature.

Turning now to the analysis of the Budget estimate for expenditure, I have come to the following conclusions after five years in this Council. The overall standard by which controlling officers minimise expenditure based on existing policies are commendable. Save for one or two controlling officers, the in-depth knowledge of their own departmental spending amazes me, considering that most of them stay only a few years in each post. Deficiencies which are highlighted during the examination of the Budget estimate has always been with the policies than with its administration.

I will therefore confine myself to proposing changes in policies which influence the effectiveness of our expenditure.

1. Firstly we must be more sensitive to the changing needs of our society. When past needs have been relatively satisfied compared to new emerging ones, we must be bold to retract with no fear of sectoral challenge. The withdrawal of weekend transport subsidy for studies is an excellent example. We should review constantly and not when expenditure spirals to a noticeable level. Perpetuating an expenditure for historical reasons, or refusal to make review because of the small financial implication is not acceptable. During the Budget estimate exercise, for each item of expenditure, controlling officers ought to ask themselves firstly whether the need for such expenditure still exists, secondly whether recent introduction of new services has caused duplication, before calculating how much more is needed to meet rising cost and improve quality. School medical service is one in which Government accepts a duplication. Since the health of our children far exceeds that of the handicapped and the elderly, it is time that Government should have a rethink on its justification. In fact it would not be a bad idea for controlling officers to produce a few historical items of expenditure of lower priority for re-justification with the view to possible deletion, whenever introducing a new one.
2. When we recognise deficient areas, we must be prepared to create expenditure to meet these needs, without fear of starting a precedence as long as we proceed cautiously, define clearly areas of commitment, and starting in a small scale. Dental needs of the elderly is an area where Government should attempt to meet. Payment to non-profit making subvented agencies to provide dental service for the elderly is economical. Setting a lower limit of age to say 65 years is a feasible commitment.
3. Sometimes, minimising expenditure excessively or inadequate provision in one section of a department, may have untoward effects of reducing

overall effectiveness of that or of another department. For example, inadequate staffing at the Accident and Emergency units may result in a twofold increase of work elsewhere, as it is the checking point of hospital admission. Inadequate provision of half-way houses for the mentally ill, district nursing, home for the aged, convalescent beds, and home for the severely mentally handicapped serve as a blockage to hospital discharge, thereby wasting acute hospital bed space. There is a lot to be said of allowing a higher increase in manpower and expenditure in such strategic areas. The trend of such increase does exist but is inadequate.

4. Fourthly, as Government often allows a certain percentage of annual increase in expenditure based on the previous one for each department, there is a tendency for large departments to grow and new ones to remain small. ICAC and the Environmental Protection Department are examples of these two extremes. There is no doubt that we have now a cleaner Hong Kong in terms of corruption but a far dirtier one in terms of pollution. ICAC played a very important and successful role but time has changed and I would like to see a reduction in the expenditure of this department in reverse correlation to its past success. Whereas more funds should be allocated to the Environmental Protection Department, but not at the expense of the Medical and Health and Social Welfare Department. We all recognise that the Environmental Protection Department has a very big task ahead of it.
5. Fifthly and lastly, turning to the Civil Service. Other than a restraint in civil service growth, Government ought also look into ways of maximising work output. Allowing an annual single increment to all staff across the board gives no short-term incentives. It is not distinguishing the angels from the devils. Furthermore, it is unfair to those who work hard when those who do not are likewise credited.

A hard to come by and long awaited promotion is an inadequate stimulating factor in management terms. There should be variable increments without ruling out decrements.

About Government's establishment, it has a fine fleet of well qualified executive officers who ought to be given far more responsibility than they are at present. Work which can be delegated to clerical workers should release more executive officers to other important tasks now handled by administrative officers.

It has always disturbed me how some frustrated civil servants on leaving the Civil Service blossom in the private sector. I think the question we should ask ourselves is whether it is our system which at times can breed incompetence and complacency. I have been told by more civil servants than one, that the prospect of promotion is based more on how few mistakes one makes rather than on points one scores, as it is easier to identify who made a mistake than to discover who contributed to an achievement. Never making any decisions seems therefore to be the best solution!

A lot of valuable man-hours are wasted when decisions which can be made at a personal level are loaded onto committees for fear of ICAC. We have now got a fine Civil Service. It is about time we give them more trust.

Sir, these are but a few macro-economical ways on how government departments as a whole can improve the effectiveness of our expenditure. We are always faced with new emerging needs and we must tackle them. To balance our books without imposing spiralling higher tax, we must cut expenditure where needs are relatively met. With these words, I support the motion before Council.

MRS. NG (in Cantonese): Sir, first of all, I would like to describe this year's Budget as a 'through-go' one. The Financial Secretary is very cautious in managing our public finances and I must commend him for that. Having said that, I would like to say something on taxation, public housing and social services for the benefit of our Financial Secretary.

#### *Taxation*

First of all, I must welcome Financial Secretary's raising the allowance for the children. However, for the dependent parents, there is no comparable increase.

Secondly, I welcome that the third tax band, that is, the 15 per cent tax band is widened from \$10,000 to \$20,000 so that it is the same as the fourth band. If other bands can be widened similarly, then the general public would be even happier.

Thirdly, I am very glad that the personal allowances have been raised, for example, a single person has an increase of \$5,000 and a married couple has an additional allowance of \$10,000. However, this concessionary measure has been restricted by one additional condition, that is, for the singletons, their monthly salary should not exceed \$7,000. If their salary exceeds \$7,000, they would not be able to enjoy this additional allowance. Perhaps, the Financial Secretary has identified the middle income class as the easiest to exploit. When the former Financial Secretary was here, the middle class income group has already voiced their dissatisfaction. And now I would like to appeal to this Financial Secretary that this time, please do not turn a deaf ear to us any more. Please take practical measures to alleviate the taxation pressure on the middle income group. Therefore, I would like to know why the Administration has stipulated that singletons who have a salary more than \$7,000 will not be able to enjoy the additional allowance this year. And according to the Financial Secretary's assessment, how much cost would follow if the restriction was lifted? I raise this question because I would like the Financial Secretary to let me know why the middle class income group has to pay more tax and because I think that this taxation system is becoming more complex.

Now fourthly, I would like to say that I welcome the standard rate being lowered from 17 per cent to 16.5 per cent. But I remember when our financial performance was not very good, the standard rate was raised from 15 per cent

to 17 per cent. The increase was by a factor of 2 per cent. However, we are experiencing a surplus. The rate of decrease was only 0.5 per cent. So it was a rapid increase and a slow decrease.

Fifthly, I would like to talk about the separate taxation for married women. Now here I must declare my interest. This time, the Financial Secretary has not paid heed to the appeal of people of the public and he has stipulated that couples should still declare their tax together. Of course he did not explain on this in the financial Budget. He only asked us to pay attention to the 1983 Budget speech by the then Financial Secretary, and now I quote:

‘The adoption of a system of completely separate taxation for husbands and wives would represent a radical departure from our traditional concept of the family unit as the fiscal unit of charge. Hong Kong remains essentially a Chinese community where filial piety and family unity are an integral part of our existence. It would be unfortunate indeed if, in our endeavours to remove an alleged affront to one arguably small sector of our society, we succeeded in giving greater offence to the community at large.’

This is the former Financial Secretary’s speech. In present day society, does this argument still hold? And I think the members of the public would be able to give an answer. Here, I would like to tell you my own opinions.

First of all, working females are making a contribution to the society and it is very important for the Hong Kong economy to benefit from their efforts. Actually the Government should encourage women to work and should not discourage them with taxation. According to the bi-census last year, the female work force increased from 49 per cent of five years ago to 51 per cent. These statistical figures are here to tell us that the Hong Kong females are becoming more and more economically independent. The relevant authority should help these women who have an interest and ability to work to be economically productive. Now the married couple’s taxation is raising the tax for married couples and so the females are forced to give up their work so that we have less and less high quality labour in society.

Secondly, from the point of view of equity, income tax should be aimed at the source of income and the earner. So a woman’s income should not be added onto her husband’s income and the husband should not be the one to pay all the tax. Undoubtedly, couples should be independent in financial matters. Of course, the couples are allowed to declare their tax separately. However, when it comes to calculation, it is calculated together and also legally speaking, the husband is the ultimate person responsible for the paying of tax.

Thirdly, on social justice, this is having a very great impact on the so-called ‘sandwiched’ class and these people take up about 70 per cent of all tax payers. Actually they contribute very much in balancing the finance and economy of our society. However, when it comes to social welfare, for example, housing, medical benefits, we do not see any comparable increase. With the promotion

of tertiary education and better financial performances, this middle class is going to increase. In many advanced countries, this middle class is the power behind social stability. Therefore, tax burden should not be levied too much on this middle class or 'sandwiched' class.

Lastly, those who object to separate taxation for couples always cite difficulties in the administration as a reason. However, a lot of couples have already declared their taxes separately. In 1985-86, there have been already 11 250 couples who declare their taxes separately. And in the coming year, I am sure this figure is going to rise. Now we are computerising our taxation system. So it should be more efficient for us in handling the files and there should not be any major problems. The Government has earlier on hinted that it would cost the Government \$400 million. Actually this accounts for less than 2 per cent of the total tax revenue. This should be acceptable to the Government. However, if this \$400 million is divided among these 110 000 couples, they have to pay an average sum of \$3,600. This is by no means a small sum. And when we have to pay tax, it is always near to the lunar new year. So the two hurdles are very difficult for them when it is taken at the same time.

#### *Housing*

Now I want to say something on housing. The achievements of public housing can be seen by everybody. In the coming four years, the Government, the PSPS and housing society will altogether be constructing 197 000 units and on the average, we would be able to produce 49 000 units every year. This is a very good figure. Now the Home Ownership Scheme (HOS) has been commended by all sectors of the society after its introduction. So I hope the ratio between the rented public housing unit and the home ownership scheme unit would be adjusted from the present 3:1 to 2:1 so that more people would be able to buy HOS flats. For the income limit of HOS flats, I think it is now on the lower side. I hope it will be adjusted so that more middle income group families would be able to apply for a HOS flat.

#### *Outreached social work*

Lastly, I would like to say something about outreached social work. Recently, I have received the outreached social work assessment report by the Government and I am able to tell you my opinions. Now I am sure that the Administration has already consulted different sectors of the society and different bodies about the insufficient outreached social work. We have a total of 18 outreached social work teams after its introduction in 1979. The location of the 18 teams are: Central and Western (three), Southern (one), Wan Chai (one), Eastern (one), Kwun Tong (three), Sham Shui Po (two), Yau Ma Tei (two), Mong Kok (one), Tsuen Wan (two), Kowloon City (one) and Tuen Mun (one). However, newly developed towns like Sha Tin, Tai Po, Kwai Ching, Yuen Long, Sai Kung and the Northern district are deprived of any outreached social work teams. The Government should adjust the situation accordingly to the demography and population of the districts.

Sir, with these remarks, I support the motion.

MR. PETER POON: Sir, let me first begin by congratulating the Financial Secretary on his first Budget speech, which is both sound and sensible. We are happy to hear that the expected final results for 1986-87 will be a healthy surplus of \$3 billion on General Revenue Account. The Financial Secretary has also reminded us that the bonanza is a pleasant surprise, and is mainly the result of the rapid recovery of our economy since the second half of 1986 and the unexpected high yield from taxes, including stamp duties from the buoyant property and stock markets. The substantial depreciation of the Hong Kong dollar under the linked exchange system also helped in increasing our competitiveness in exports. Though the outlook for 1987-88 is still good, we cannot expect the same favourable factors to improve our growth on the same scale. It is easy to criticise this Budget as being too conservative and lacking in a long-term strategy. One must remember, however, that Hong Kong has always been an open economy and vulnerable to external forces which are often beyond our control. I agree that to maintain stability and continued prosperity, a cautionary approach, which has served us so well, is the right one. Our accumulated reserves of \$20 billion are not large compared with those of Singapore and Taiwan. Though we hardly have any external debts, we do not have many resources either.

This Financial Secretary has referred to the latest fashion in the banking and securities market being 'securitisation'. Formerly, when corporation needed money, they would raise it through capital issues or seek finance from banks. Now it would appear that they can print their own money without giving securities or personal guarantees from directors. Such new instruments are usually unsecured or even subordinated and rely mainly on the reputation of the issuing company. The rationale is supposed to be that it would reduce the risks of the banks if there was an active secondary market. But if there is no such market to spread the risks, it seems that the banks, deposit-taking companies or funds are shouldering a high proportion of risks at interest which is substantially less than that for the usual unsecured loans. The Financial Secretary has noted this scenario in Hong Kong and that a change in interest rate trend will immediately affect their market value considerably. I also understand that the Secretary for Monetary Affairs is reviewing the situation. Timely monitoring of such issues with proper guidelines is needed before the occurrence of any possible undesirable effects that such innovations might bring to the Hong Kong financial market.

As the Financial Secretary has said, both the disclosure of shares in public listed companies and insider dealing are controversial subjects but these problems need to be addressed. I look forward to the recommendations of the Standing Committee on Company Law Reform, but I am sure the issues will be fully debated before any laws are introduced. As an international financial centre, Hong Kong needs to be seen to maintain its reputation in the field of protection of investors and proper ethics and conduct in the financial sector.

As Hong Kong becomes more prosperous, demand for increased public expenditure in the field of education, medical services, housing and social welfare will grow. Once committed, Government must have sufficient revenue to finance these services. Budgetary policy should reasonably be consistent to maintain a steady improvement of the quality of life of the people of Hong Kong. Therefore, the general rule of keeping government expenditure within the growth of our GDP is a sensible one. This does not, however, mean that it should be so rigid that we can not go into deficit in any one year and finance it by our reserves or issuing bonds if necessary. But the aim of building up our reserves gradually to a stronger level can hardly be faulted. There are still some dark clouds ahead, not the least of which is 'protectionism', against which we have no defence. Our open economy is susceptible to economic and political shocks and the volatility funds of our own people and foreign investors.

The question of broadening the tax base in Hong Kong is a very sensitive issue. Admittedly, a proportionately few people bear a majority portion of the direct taxes in Hong Kong and the trend in other countries has been to reduce direct taxes and increase indirect taxes. Over-reliance on direct taxes may not be desirable because in hard times, increasing the tax rate substantially may not necessarily bring in a lot of revenue if business is generally bad and profits are either down or losses have been incurred. On the other hand, public expenditure once committed has to be met. The Financial Secretary has floated the idea for general discussion and is himself concerned that any package that has a marked adverse effect on the cost of living and is moreover expensive and difficult to administer would not be right for Hong Kong. In my view, a value added tax type of indirect tax completely fits this formula and ought not to be considered. It has been argued that indirect taxes are regressive in nature since the rich and poor pay the same. It has also been argued that many people who enjoy the benefit of Hong Kong's prosperity and do not pay any direct taxes at all should at least contribute something to finance public expenditure. Whether other forms of indirect taxes which broaden the tax base without undesirable effects should be introduced can form the basis of further consideration.

I now turn to revenue measures for 1987-88. Tax concessions are estimated to cost \$690 million but additional revenue raising measures are expected to bring in \$365 million. Therefore, the overall tax reduction is actually only \$325 million. The moderate adjustments proposed on various fees, mostly to take into account of inflation, are reasonable. As to tax concessions, the business community, while appreciating the 0.5 per cent reduction in corporation tax and profits tax, would probably like to see further reductions, preferably to the standard rate since the former increases were made during difficult times. In any case, since our tax philosophy is to have a simple and low tax regime, the 0.5 per cent reduction is an indication of Government's commitment in this respect. The proposed increases in personal and child allowances and the extension of the third band of taxable income in the Second Schedule of the Inland Revenue Ordinance are welcome. This will exclude from the tax net over 100 000 persons.

No less than 710 000 persons (being 94 per cent of the estimated salaries tax-paying population) will get some benefit in 1987-88. But such new reliefs will also reduce considerably the workload of the Inland Revenue Department. Nevertheless complaints will naturally come from the middle-range salary earners. If they earn more than \$84,000 as a single person or \$170,000 as a married couple, they will not benefit from this additional allowance of \$5,000 at all in view of the clawback provision. These people have definitely lost out to inflation.

As to separate taxation, I am rather disappointed that despite the large surplus, the Financial Secretary has not found it appropriate to be a little more generous in this regard. The Financial Secretary's 1983 Budget speech refers to the adherence to the 'Family Unit Concept' of assessment of married couples and the reluctance to forgo tax revenue which may be lost if separate assessment is implemented. Since a large proportion of women are now working and social attitudes have changed during the years, the first argument is not necessarily valid any more. As to revenue which will be lost, if it is inequitable to combine the working wife's income with that of her husband and create additional tax burden, the inequities should be remedied. If the present situation is allowed to continue, the cost of implementing separate taxation will increase every year and Government will have more excuses for not addressing the problem. From the point of view of the married couples affected, it is not a question of Government's forgoing the revenue but of its continuing to impose an unfair tax burden on them. The cost of implementing separate assessment is quoted to be \$17 million, not a very large sum to afford proper relief to over 110 000 married couples. But the matter is getting to be quite emotional. Separate assessment will not benefit a taxpayer with a working wife in every case. There can be unabsorbed personal allowance for married couples, for instance when the wife's income is not high. The tax saving on separate assessment will normally only be a few hundred dollars to four or five thousand dollars a year. Now whether this would be sufficient temptation to 'live in sin' is debatable. But the fact remains that, despite that the allowance for married couples is slightly more than double that for a single person, a working wife has additional expenses to incur and yet she is penalised for earning income as a wife instead of as a single person. One argument of the Financial Secretary advanced is that we should keep our system simple. If that is the case, I see no reason why a working wife allowance of, say up to \$20,000 should not be granted to alleviate the unfair tax burden on many working wives and I therefore suggest that the Financial Secretary should give serious consideration to this and introduce it even if he cannot accede to the request for separate taxation for married women for the time being. This is in line with the recommendations of the Third Inland Revenue Review Committee and involves little expense to implement under the present computerised system of assessment. Though there can never be absolute fairness to all taxpayers under any tax system, I urge strongly that the matter should be given sympathetic and early consideration.



I am pleased to note that progress has been made in reviewing the question of double taxation, particularly in relation to employees of Hong Kong companies who make frequent trips to China. Basically, Hong Kong taxation is on a territorial basis. We do not tax profit or income arising outside Hong Kong and there is not much we can do to prevent other countries with a higher tax rate from imposing tax on the same income. However, the problems are being quantified and the proposed legislation on time-apportionment should reduce some of these problems. No doubt, business and professional organisations will be able to contribute information and evidence of alleged hardship so that such legislation can quickly deal with the immediate situation pending further study of the double taxation problem. At present, Hong Kong has no double tax agreement with any country at all. It has not been necessary so far, since our rates are low and other countries normally grant relief or rebate for tax paid in Hong Kong in relevant circumstances.

Finally, I wish to say a few words on anti-avoidance legislation. The Financial Secretary refers to the 'Myer Scheme' named after an Australian case concerning 'asset refinancing arrangement'. Though the Inland Revenue Department may be able to attack such tax-avoidance schemes under the general anti-avoidance provision introduced last year, the Financial Secretary proposes to introduce legislation specially aimed at such schemes to prevent loss of tax revenue in Hong Kong.

Whilst I agree that such a measure should be considered as a matter of priority, we should be careful not to introduce any complicated anti-avoidance legislation which may hamper legitimate or normal business activities. I am sure that, as in the case of the general anti-avoidance legislation introduced last year, there would be proper consultation to avoid such a danger. In Australia, the Government has been extremely aggressive in combating blatant tax avoidance schemes widely marketed there, resulting in very harsh and complicated retroactive legislation.

Sir, with these remarks, I support the motion.

MR. JACKIE CHAN (in Cantonese): Sir, first of all, I would like to congratulate the Financial Secretary, Mr. P. JACOBS for the first Budget which he had presented to this Council. The contents of the Budget are simple and clear. Improvement in the local economy and government finances, in particular, makes us feel optimistic and fully confident towards the future of Hong Kong. Even though we may have comments on the Budget, I must admit that upon reading the Budget, one feels happy as it neither makes people worried nor uneasy.

I am very delighted that the Financial Secretary can carry forward the excellent tradition of discreet financing practised by his predecessors. He is able to put the principle of value for money into effect such that an increase in expenditure is only made to achieving definite and fixed policy objectives. The

general public are happy to learn that revenue from tax is spent for a good cause, just as the British Prime Minister Mrs. Margaret THATCHER had said, 'Every penny has to be used for a meaningful purpose.'

For a businessman, the worthiest expenditure is one which brings in a return. The Government is not a commercial set-up. Yet it has the responsibility of creating a favourable environment for the development of Hong Kong's economy and let the people of Hong Kong find the right way of earning a living. The Financial Secretary proposes in his Budget to spend \$7 billion on infrastructure projects and reduce the profits tax rate by 0.5 per cent to preserve a simple tax system with a view to maintaining a favourable environment for investment. In this way, Hong Kong, the goose that lays golden eggs, will be nursed back to health and it may continue to contribute towards the well-being of Hong Kong people, the Hong Kong Government, as well as other areas.

I was therefore surprised and disappointed to find that the Financial Secretary did not say a word in his Budget about the assistance offered to local industries or any effective measures to encourage manufacturers to re-invest. All along, the Government has been making use of the nonintervention policy as a pretext of refusing to offer assistance to local industries. In my opinion, the Government will not go against its non-intervention policy by offering assistance to industries. There is no need for the Government to offer assistance to a particular industry. All it has to do is to strengthen Hong Kong's industrial base, in the same way as it actively improves the trading environment without intervening economic activities.

Last year, the Hong Kong dollar, being linked with the American dollar, devaluated, resulting in a tremendous growth in domestic exports. Of course, this favourable factor is not everlasting. What shall we rely on to maintain the important position which our exports have attained in the international market when we can no longer benefit from the devaluation of the American dollar? It goes beyond doubt that Hong Kong must follow the path of introducing hi-technology to improve the quality of our products. The role played by the Government in this respect is one of positively offering assistance to local industries so that the latter may take up the challenge in hi-tech development. I wish to put forward the following points for consideration by the Government if it ever attempts to encourage local industries to move towards hi-tech development:

- (1) the Government must draw up short-term as well as long-term strategies to guide the hi-tech development of our industries;
- (2) the information network must be widened and fortified so that the industrial sector may absorb in the first instance the most up-to-date knowledge of advanced countries in industrial science and technology;
- (3) assistance should be offered to the universities and polytechnics in their research on developments of science and technology;

- (4) the possibility of co-operation with China in the study of the move towards science and technology for our industries should be examined; and
- (5) the study of application of science and technology should be enhanced so that achievements in scientific and technological research can be promptly applied in the improvement of industrial production.

Sir, I have said that I support the principle of discreet financing adopted by the Financial Secretary, and that I also support the principle of maintaining a simple and low tax rate in Hong Kong. However, I would not like the Government to give the public an impression of being mean and unapproachable. The difference between saving money and accumulating wealth by unfair means is just too narrow. I trust that the public would be delighted to see fiscal surplus each year, but they would not like to learn that the ultimate aim of the Government is to amass wealth by heavy taxation. Now that the Government has a huge surplus, and the financial forecast is rather promising, it is high time for the Government to actively improve the quality of life of the people.

What I mean by this is certain tax concessions and an enhancement of the services for the elderly. In the area of tax concession, I am greatly dissatisfied with 'the clawback system on additional personal allowance.' Under this system, single persons earning more than \$7,000 a month and couples earning more than \$14,200 a month would have a feeling of 'rejoicing too soon and being let down at the end.' Moreover, the complicated clawback rate violates the simple taxation system being practised in Hong Kong. Thus I suggest that the Financial Secretary cancels the clawback rate in his next Budget as a kind of tax concession.

In the field of services for the elderly, expenditure on allowance from the retarded and infirmity allowance increases by 5 per cent, which is even lower than the 6 per cent inflation rate predicted by the Financial Secretary. If I have to point out which group of people are not being benefitted by the Budget, I would say that tens of thousands of old people, who are most in need of government care, are being neglected. I think that under the present situation of economic abundance, the Government should slightly increase the longstanding old age allowance of \$250 per month. As the rate of adjustment is not too high, it would not cause great economic burdens, and the respectable old people would all feel happy. Furthermore, the capacity of the care and attention homes only increases by 100 places or less than 7 per cent, which cannot meet actual needs. I urge that apart from extending the services for the elderly, the Government should also formulate a long-term service strategy for the elderly. In this way, the social ethics problems brought about by the gradual ageing of the population of Hong Kong can be solved.

On the other hand, two kinds of taxes which were expediently levied during the times of financial difficulties several years ago should be cancelled or drastically reduced now that the financial situation is improved. One of the

taxes is levied on soft drinks, whereby children and teenagers who are financially dependent have to shoulder the tax burden. This is absolutely unfair. The Government should, as soon as possible, give up collecting taxes from the pockets of children. Another one is the airport tax which hinders the long-term development of Hong Kong's tourist industry. It only benefits the Government but undermines the overall interest of Hong Kong. The collection of the two above-mentioned taxes can be justified as an expedient measure during times of financial difficulties; but now as the economy is extremely prosperous, the Government should make appropriate adjustments.

Last year, Sir John BREMRIDGE, the former Financial Secretary, devoted much time to talk about the advantages of saving money. This year, Mr. JACOBS seldom talked on this subject in the Budget, but he has put much effort in building up the reserve. I would like to remind our Financial Secretary by quoting an old Chinese saying: 'Save money in the people.' The Financial Secretary said in his Budget that he would extend the tax net and to increase the proportion of indirect taxes. I hope the Government would conduct an overall review of the tax system before implementing new taxation measures, so that the public's shares of the tax burden would be fair and more reasonable. The Government should not intensify the disparity between the rich and the poor just for the sake of increasing public revenue.

Sir, with these remarks, I support the motion.

MR. CHEONG-LEEN: Sir, since the Financial Secretary introduced his first Budget in this Council last month, I have heard the Budget described in a number of ways, such as 'pragmatic', 'cautious', 'well-balanced', 'disappointing', 'short-sighted' and so on.

In this respect, I would prefer not to be too descriptive but to simply join the group who feel the Budget is good for the majority of Hong Kong people, even though there are certain areas where fine-tuning is desirable, and where the public good in my view can be even more enhanced in the long run.

But I am not here today simply to praise the Financial Secretary on his Budget, I shall embark instead on my fine-tuning mission without further ado.

#### *Personal taxation*

The reduction of the standard rate on personal taxation from 17 per cent to 16.5 per cent is most welcome, even though reducing it to 16 per cent would have been even more welcome. But I assume the Financial Secretary is adopting a cautious approach, and that the trend for the standard rate should be downward in the coming years, and hopefully not upwards.

One allowance which has so far not been offered but which I think has merit is an allowance for home ownership, which should be a boon for lower-income earners, and which could be in the region of at least \$20,000. For families in the

lower income brackets every bit of savings counts, and this allowance could act as a further incentive for families who are now in rented public accommodation to buy their own homes at an earlier date than might have been the case.

*Taxation of married women*

The Financial Secretary has this year side-stepped the issue of introducing separate taxation for married women on the grounds that it will cost the public purse \$400 million per annum at 1986-87 levels of income, plus an additional \$17 million administration cost. But his cautious approach is understandable as this year is his first Budget, and he cannot afford to burn his bridges yet. As an impartial male observer, may I say this issue will not recede—and if anything it will become more sharply focussed with the number of women in Hong Kong becoming increasingly involved in public life and hence more vocal.

In principle, I would support the view that there should be separate taxation for married women on an optional basis so as to give more proper regard to equality of the sexes in Hong Kong.

It is also claimed that allowing married women to be taxed separately would benefit the 'sandwiched class'. Some members of the public have suggested a working wives' allowance of say \$20,000, but this approach if at all adopted may not end up as a permanent solution. I therefore look forward to what the Financial Secretary has further to say on this subject during the course of the debate.

*Strategy for public finances*

I wonder whether the Financial Secretary knows what he is in for by inviting Legislative Councillors to express their views on the strategy for public finances. Not that I am opposed to the idea, because it gives me the opportunity to become an instant tax expert and economist. It is an opportunity which I can only seize with alacrity.

Let me start off by saying I wholeheartedly agree with the Financial Secretary when he said during his speech that 'caution should be our guiding principle'.

Being as vulnerable as ever to external forces, with the clouds of protectionism still hanging over us, and our annual economic performance subject to the volatility of the economic market place internationally, it is vitally important that our budgetary management be characterised by consistency, prudence and stability. We went through a difficult patch during the past few years, let us hope this will not recur during the coming years, and that our maxim will continue to be 'to hope for the best but prepare for the worst'.

I therefore fully support the Financial Secretary when he reaffirmed our commitment to maintaining a low and predictable tax regime, where tax rates are low and not complicated in collection, where we are committed to the spirit of private enterprise and thoroughly dedicated to continuous improvements in the public services.

Although our unemployment rate of 2.2 per cent is relatively low, I think one area in which there is room for research and improvement is in the underemployment rate of 1.2 per cent—perhaps this is one area where we should aim to wipe out altogether as educational standards rise and the system of vocational training, job placement and job retraining is improved.

Concern has been expressed by many district boards at the number of young persons who are illegal hawkers, particularly in the urban areas. This is a problem that requires an integrated approach, and the fullest support should be given to the Urban Council and the Regional Council by Government, the police and other concerned departments. I believe this is an area which requires close monitoring if we are to increase the productivity of our existing manpower, and in the process bring about an improvement in traffic flow and in urban living environment.

But in getting back to our strategy for public finances, I am strongly in favour of a continuation of what I would like to describe as the ‘Yin and Yang’— balance of ‘Yin’ (indirect taxation) and ‘Yang’ (direct taxation) where both can live in harmony together for the long-term economic growth and social stability of our community.

While there is no immutably correct ratio between yields from direct and indirect taxes, in broad terms I believe that in a low tax territory like Hong Kong with its proven record of economic success, we should aim for a 50-50 ratio in the yields from direct and indirect taxes, bearing in mind of course that rates are also a component of indirect taxation.

At the same time, spreading the tax burden more widely across the community on a rationally selective item-by-item basis, and with the need to review annually the level of indirect tax on each specific item should be an ongoing exercise.

In other words, there seems to be widespread consensus that we do not want in Hong Kong any form of across-the-board consumption or VAT tax, and the best approach is by:

- (a) keeping under constant review the number of specific items which can come within the indirect tax regime; and
- (b) as incomes rise, to ensure that the number who remains in the direct tax net remains relatively broadly balanced in terms of those who pay indirect taxes, without causing hardship to the relatively poor or the lower and middle layers of the ‘sandwiched’ groups.

This is a tall order for the Financial Secretary to meet, but at the end of the day what we all want is a budgetary strategy which meets the wishes of the greater majority of our people with the absolute minimum of hardship or discontent, and with plenty of incentive for all who want to work hard and to prosper and to make Hong Kong prosperous as well.

May I at this juncture remind the Financial Secretary of representations made by the travel industry and the beverage industry to reduce the level of the current indirect taxes imposed.

I am told that today—true or false news I do not know for sure—the airport tax of \$120 is the highest in the world, and that because of this factor international tour operators in order to remain competitive in their package rates are beginning to short-sell Hong Kong more and more. I urge the Financial Secretary to look into this complaint seriously and if he cannot see his way to reduce the airport tax to half as proposed by the industry, then to at least make an adjustment that can be helpful—say to \$80 or \$100—which would give confidence to the industry that the medium-term prospects for the number of inward bound tourists to increase are more firmly assured.

The other complaint is from the beverage manufacturing industry which claims that the estimated duty revenue for 1986-87 will be only \$177 million against the original estimate of \$210 million. May I urge the Financial Secretary to look into this complaint to see whether an adjustment is necessary in order to stimulate sales in the soft drinks industry with minimal damage to the public purse.

*Economic and industrial development*

On the general question of economic and industrial development, linked with our major programmes and policies and the related expenditure estimates, I would like to offer a few comments.

The Administration wisely seeks to contain the growth of the public service in financial terms of 3 per cent. The value-for-money studies in the major departments are leading to greater productivity and efficiency, so much so that I would say that the quality and standards of our public service deserve the commendation and support of the community. However, let us be ensured that the salary levels in the public service be kept well within the rate of inflation and will be broadly comparable—even though not identical—with the private sector, so that inflationary costs will be kept at a minimum and that the public service will be still able to attract bright and able young people to join its ranks with a long-term career in mind.

I am glad to see that government support for the manufacturing industry is taking on a higher and more sophisticated profile, as will have been seen in the recent opening of the CAD/CAM Centre by the government supported Hong Kong Productivity Council.

There are 800 000 workers—representing 33 per cent of total employment in Hong Kong—in the manufacturing sector working mostly in medium or small-scale factories, and the need for government support services for the small factories is as great as ever.

A serious problem facing many small factories is related to the long service payment provisions which were implemented on 1 January 1986. As of 1987 the cut-off date for reckonable service of the employee is 1979 (or eight years of service) and next year it will be 1978 (or 10 years of service). Many small factories are deeply concerned about their capability to fulfil these provisions and are transferring their production into China as fast as is practicable. We will have to expedite the development of high technology and higher productivity to replace the labour intensive industries which are inexorably being transferred into China.

Looking at the future in terms of preserving stable labour relations, I would urge Government to move towards a public consensus on a provident fund system which does not have to be a government managed system, but which will be adapted to Hong Kong conditions, give protection to workers in their old age, and still keep Hong Kong products competitively priced in the world markets. Furthermore, in order to encourage greater participation in provident fund schemes, the employees' share of the provident fund contribution should be tax free by way of an allowance on the same basis as the employers' share.

It was refreshing to hear the Secretary for Trade and Industry the other day warning the local electronics industry to either move forward into new areas of design and application, or risk being left behind by other Asian competitors such as South Korea, Taiwan and Singapore. I gather that this is what the industry had been saying for a long time but the message had fallen on deaf ears with Government until just recently. Therefore the series of measures Government is now taking to expand industrial and infrastructural support in the electronics industry is most commendable. I would urge also continued and positive government support services in other key industries in Hong Kong.

*Community and welfare services*

Before I sit down, Sir, may I raise four points in regard to community and welfare service programmes.

The first point has to do with services for the elderly, where there is a need for greater co-ordination in order to get maximum value-for-money in the wide range of services for the elderly, whether by way of government services or subvented services. I hope that Government is actively considering the suggestion made in this Council last year on the setting up of a Commissioner for Services for the Elderly office in order to plan and co-ordinate policies and their implementation to make life more bearable and enjoyable for our growing number of senior citizens. Perhaps that matter can be reviewed at an early date in view of what I am told is not likely to be 'false news' that the rate of suicide among the elderly has been rising in the past few years.

The second point has to do with public housing. In this International Year of Shelter for the Homeless, I am sure that the majority of us in Hong Kong are rightly proud of our record of providing subsidised housing for those in need. I



am furthermore pleased that Government is committed to providing additional good quality, subsidised housing for nearly 800 000 people in the next four years.

In terms of strategic planning, I would urge the Financial Secretary to encourage the Housing Authority to give greater emphasis to home ownership schemes during the next four years. Even lower-income families would nowadays like to own their own homes, and Government should give them every practical support possible in order to build up their sense of belonging and commitment to Hong Kong.

In political terms, it is most undesirable for any district to have a preponderance of the population living in rented public accommodation, as in the case of Wong Tai Sin, with 80 per cent of its population of over 400 000 living in Housing Authority rented accommodation.

The third point has to do with services for the mentally ill, I am told—and again I hope I am not uttering ‘false news’ that anywhere between 10 per cent to 12 per cent of our population are or have been suffering from one kind of mental problem or another in varying degrees, and this is not helped in any way by the high degree of competitiveness in the Hong Kong living environment, plus overcrowding, excessive noise levels, and so on. Our institutions for psychiatric treatment are overcrowded and specialist medical care and facilities are in short supply, so it is welcome news that the Financial Secretary has found it possible to allocate funds for the building of four new half-way houses for ex-mentally ill citizens. I would urge that within the financial and other resources available that Government re-double its efforts to provide better services and facilities for those in need of psychiatric care and assistance. I believe a large-scale public education programme is now called for.

The final point has to do with Government doing something more to encourage the private sector to sponsor more cultural, recreation and sports programmes. As an example, it is estimated that public expenditure on development of the performing arts, whether by way of facilities or activities, amounts to about \$250 million annually; this is a substantial figure. I understand that the previous Commissioner for Recreation and Culture had commenced some sort of dialogue—and again I hope that this is not ‘false news’—with the Financial Secretary on what fiscal measures by way of tax rebates could be given to the private sector to provide increased sponsorship to the arts and sports. I would urge the Financial Secretary to give this matter his attention and to advise this Council if he has any constructive way to use fiscal measures to encourage the private sector to give more financial sponsorship to culture and sports on the basis of community service or enlightened self-interest.

Sir, there is much that is going for Hong Kong, providing we continue to have faith and confidence in ourselves. In the run-up to 1997 and beyond, Hong Kong should continue to be a vital link with China, in terms of technological transfer, managerial expertise, financial services, investment and fund-raising.

In order to reinforce and enhance our position as an international financial centre, Hong Kong must retain its low tax structure, minimum red tape and regulations, low-economic overheads, and political, legal, and social stability. This in turn would foster the right environment in Hong Kong for further industrial development and longer-term investment commitment. By so doing we will be keeping in our possession the key to making the future 'One Country—Two System' become a successful reality by 1997.

Sir, I support the motion.

5.05 pm

HIS EXCELLENCY THE PRESIDENT: I think at this moment Members might like a short break.

5.28 pm

HIS EXCELLENCY THE PRESIDENT: Council will resume.

MR. CLYDESDALE: Sir, thank you for the stimulus afforded by that short break.

I join those who welcome this Budget.

Although some have expressed disappointment at the minor level of concessions which have been proposed it appears to have been well received by the general community at large and by the business sector in particular.

The Financial Secretary clearly intends to balance conflicting needs to keep tax down and to improve public facilities and services. This is commendable.

It is a prudent Budget. We walk in the shadow of trade protectionism which poses very substantial dangers to any economy like ours which is heavily dependent upon external trade. In such circumstances, prudence is a virtue and extravagance a vice.

Today I would like to comment briefly on the subject of broader-based indirect taxes which the Financial Secretary raised for debate. In doing so however I think it might be helpful to take a close look at the Government's finances.

Like his predecessor, the Financial Secretary has been circumspect in the manner in which he has portrayed the Government's overall financial position. If I had to single out just two points on this subject for fellow Council Members this afternoon, they would be these. First, the Government's finances are in the best shape they have ever been. Second, government finances have never been in bad shape and are a good deal better than they appear at first glance.

In arriving at these conclusions I have found it useful to think carefully about exactly what is meant by the Budget surplus or deficit announced by the

Financial Secretary each year in the course of his Budget speech. I have in fact reviewed the Government's Accounts since 1960 to date and have found that a surplus has been announced in 22 of the 27 years which have elapsed since that time. Deficits have been announced in only five. As has already been noted by Miss DUNN three of these deficits of course occurred quite recently—in the three successive years to March 1985 to be precise—and they amounted in total to the fairly sizeable sum of HK\$7 billion. But a close look at those deficits reveals that they related only to the cash deficit arising on General Revenue Account after cash transfers had been made to other Government Accounts (or funds as they are called). If we deduct the build-up of cash resources in these other funds the accumulated deficit of HK\$7 billion for those three years reduces to the much lower figure of HK\$900 million! Not a large amount in relation to three years comprising, perhaps the worst period in Hong Kong's Budget history. I have not been able to determine the reasons for the two other deficits announced in 1965-66 and 1974-75 but they were not large in terms of government reserves at the time.

The process of arriving at the originally announced deficit was described as 'smoothing' by the Financial Secretary's predecessor. I think the term 'salting away for a rainy day' is probably more appropriate.

It should also be remembered that the Government's system of cash accounting, that is writing off assets as soon as they are paid for, increases the deficit and means that many valuable assets are not included in the overall financial position. I am talking here about such assets as the Mass Transit Railway Corp., the Kowloon Canton Railway Corp., loans made to the Housing Authority through the Development Loan Fund, and the investment in Cable and Wireless (Hong Kong) Ltd., and the Cross Harbour Tunnel Company. Lurking in the background is of course the Exchange Fund itself with its undisclosed riches.

Now I accept that the cash system is appropriate for public sector accounting in Hong Kong but it is probably safe to say that we have not been in 'deficit'—as the private sector would understand that term—in any of the last 27 years.

I repeat, government finances are and always have been in excellent shape and they are better than they appear at first glance. Last year the Financial Secretary stated that no further build-up in funds was planned and yet funds have once again increased by some \$1.9 billion and if I am not mistaken are planned to rise again next year by at least a further \$600 million.

With this background I want now to speak directly on the subject of indirect taxes.

Hong Kong has had its ups and downs, and yet experience shows that revenues have always been sufficient. The present mix of direct tax and indirect

tax however narrowly based, has yielded sufficient revenue both in bad years as well as the good years.

In view of the Government's financial position there does not appear to be any compelling need to make a move towards a broadly-based indirect tax system.

The Financial Secretary's view that a value added tax would be wholly inappropriate deserves support. It is a multi-stage tax that would involve too much administration with attendant high costs. Other countries currently operating value added tax have experienced difficulties in this respect.

Even if a single-stage 'Broadly Based Consumption Tax' has theoretical fiscal advantages, one questions whether its social impact would be acceptable. I think we must always remember that the distribution of income in Hong Kong is somewhat different to that in those countries which have adopted VAT.

Consumer goods would cost more. Consumption tax is regressive. In plain language this means it will affect poor people more than rich people and that it could work inequitably in social terms.

If a consumption tax is so carefully tailored (for example by excluding essential goods) as to have a neutral effect on low income groups, it too will be a narrowly based tax. This makes one wonder whether socially acceptable reform in this direction could achieve anything meaningful.

In my view, the case remains strong for maintaining the present progressive system. It is a better redistributor of wealth. Also, as business profits and salaries normally mirror movements in GDP, revenues from the present tax regime should continue to produce sufficient revenues to meet planned government expenditure. As we all know public expenditures are to be linked with movements in GDP, be they upwards or downwards.

No doubt the Government will make available the results of its own studies on indirect tax. Also various firms and organisations will be preparing their own position papers. In the meantime, Members who have a particular interest in this field could do worse than read the Australian Government's Study on Indirect Tax Reform. This document explains with admirable clarity the fiscal and social implications for any country intending to introduce greater indirect tax.

Let me now turn briefly to some of the other tax proposals.

The 60 day rule for outbound executives has great potential as a practical solution to the many salaries tax disputes that would otherwise arise, and to one aspect of the problem of double tax with China. Great care will be required in defining a 'day out of Hong Kong'. I would suggest that this should not be so literally defined as to require return after midnight.

Likewise, a particularly deft touch is called for in drafting the proposed anti-avoidance provision to counteract 'Myer-inspired' tax based financing arrangements. Let us hope that the draftsman selects a rifle rather than a blunderbuss, as there is a great danger that anti-avoidance provisions of this type catch more than the mischief for which they are intended.

I would conclude my remarks by drawing Members' attention to the fact that if present economic trends continue, Government will enjoy in 1987-88 that is next year, the full impact of revenues from 1986 business profits which were generally well up on the previous year. I would hope, therefore, that in next years' Budget, the Financial Secretary will seriously reconsider my earlier suggestion of last year that the 1.5 per cent premium rate of tax on corporate profits be removed. Also, the duties on soft drinks and cosmetics should in my opinion be removed, regardless of the fact that an effort has had to be made to put in place the machinery for collection. There is no need for discriminatory levies of this nature in the present healthy state of government finances.

Finally, I must join with others in deploring the fact that Hong Kong has the highest airport departure tax in the world. This is indeed a dubious distinction and I suggest that the Financial Secretary does not need to wait until his next Budget to reduce the tax to a level which will keep our travelling businessmen happy and our tourists returning to Hong Kong again and again. I hesitate to put a figure on the amount but certainly \$50 would be a great deal more sensible than \$120.

Sir, with these remarks, I support the motion.

MR. LEE YU-TAI (in Cantonese): Sir, a Government official in ancient Chinese once referred to writing articles or drafting speeches for the Government as painting a picture of the bottle-shaped gourd in the same pattern year in year out. Even though the painting is done in the same pattern every year, you can of course widen parts of the gourd or narrow some other parts. It so happened that Budgets are prepared in exactly the same way. On the whole, every year, there are some additions or deletions for some items in the Budgets. The Budgets are normally conservative and not innovative. It is just like an annual routine activity. If the Government is not in favour of being ridiculed as a lame duck Government and if the Government does not want to stick to the British track regarding financial management, I think the Government should consider my proposals made last year, that is, there should be a comprehensive review of the overall taxation system. Several reviews were made, the last one being in 1975. The Hong Kong SAR will only be established in 10 years time. I think the present time is an appropriate time to conduct another survey. Such a survey will lay down the long-term strategy regarding taxation and will boost confidence.

Industrial and commercial exports are the cornerstones of our economy. In the Budget, it is said that domestic export has increased by 16 per cent in 1986,

the tone is optimistic. But in fact, 16 per cent increase is not really outstanding. In Taiwan and South Korea, the increase has been 20 per cent and also in those areas, the currency is more stable. So the increase rate for Hong Kong is not as great as those countries. So I think the Government should encourage industrial development. For example, the rate of depreciation for plants and equipment should be increased so that the industrialists can benefit from the taxation policy. Tax relief should also be given to first investment in high technology and large scale investment in order to attract more foreign investment.

Now I want to talk about direct and indirect taxation, not direct and indirect election. Please take note of that. In Hong Kong, we have public utilities, for example, water and some kinds of transport. They are paid by the consumers instead of being subsidised by the Government. So the Government should take note of this special feature of Hong Kong. Now if we get commodities we will have to pay; therefore I am in favour of increasing the proportion of indirect tax in our total revenue. The present proportion of 40 per cent from indirect tax is not good enough. I think that if we cut down on direct tax then we will encourage the citizens to work harder and also the industrialists will invest more in order to reap bigger profits. Indirect taxes are based on consumption. So if the commodities are not essential items, the residents can change the habit of consumption thereby avoiding indirect taxes for those items.

Now on indirect taxes. I think the present way of collecting indirect taxes is neither fair nor objective. The Government is in fact arriving at a certain level of revenue. That being the case, the Government then over-taxes certain commodities, for example, the tax or the duties on beverages, motorcars or petrol are too high. Therefore I suggest that we should conduct a consumers' behaviour survey to find out which are the essential items and which are the luxury items. Then we can tax the luxury items or increase the indirect taxes on luxury items. I suggest that we should try to delete airport tax as soon as possible. We can offset this by an increase in hotel accommodation tax. I believe that the airport tax for Hong Kong is the highest in the world while the 5 per cent hotel accommodation tax is lower than other countries such as USA or Japan. I believe that travelling by aeroplane is not a luxury activity because certain places are only accessible by air.

#### *Direct taxation*

Regarding direct taxation, the greatest concern to the residents is of course income tax. There have been some changes to the allowance for the first two children, but the benefit for the tax payers is not too great and also the claw back system for additional allowance is very complicated. Members of the public may not be able to understand it and may involve administrative cost. Stipulations regarding family income tax is also out of step with the present social system in Hong Kong. In Hong Kong, we practise family planning and normally in a family we only have two children. But now we have allowances for the third to ninth children. In fact, the families will not be able to benefit from it.

Therefore I suggest that for the allowances for the other seven children which total \$12,000 should be allocated to the first two children so that there will be an additional allowance of \$6,000 for the first two children. In that case, the first child will be entitled to an allowance of \$17,000 while the second one will be entitled to \$14,000. In that case, most families will benefit from it. Such a move is rather simple to implement and the loss in revenue will be slight. But the Budget does not consider this. I wonder whether it is because the authority is unaware of the situation or whether the Administration is not attaching enough importance to this.

Last year I talked about separate taxation for married couples. Recently various parties also are asking for this but the Budget turns this down. The Financial Secretary said that such a move will entail a loss of \$400 million for the Administration. In fact it is not a matter of loss for the Government, rather the Government has been over-taxing the married couples. Taxation should be based on income not marital status. The sandwiched class bears the brunt of taxation as they are not able to benefit from public housing or any kind of social welfare. So I think they are not being given good treatment. In fact, they are being ill treated. If the ill feelings on the part of the sandwiched class accumulate, bearing in mind that we have a large number of people in the sandwich class, the stability of the society will be affected.

We have a surplus of \$4.9 billion this year, but the increase for education, medical services and social welfare services is slight if you take into consideration the rate of inflation. Now for education, we have some \$9 billion, it is about 18 per cent of the total Budget. Well, it is quite good. But we must also bear in mind cost effectiveness now we have the nine-year compulsory education. How effective it is? And also regarding the language capacity or ability of the students, we should undertake a review. The moral standards of the students and the personal development of students should also be considered. We have also learnt the importance of school social workers. Earlier on we agree that the ratio should be one social worker to 3 000 students. Why have funds not been allocated for this purpose? I am in favour of implementing this manning ratio as soon as possible and also we should consider improving the ratio to 1:2 000.

Commercial crimes are rather common recently. For example in some syndicated companies and bank crisis, there are elements of malpractices or deceit. It has to do, to a certain extent, to the lack of moral training in school; the lack of importance attached to moral training in society; and the fact that some bad elements in society are trying to reap the greatest benefit before they leave Hong Kong. Recently we have a case involving a travel agency. As a Chinese saying goes: 'It takes more than one cold day for the river to freeze three feet.' So I am afraid that in future we will have similar cases as the bad elements are still engaged in unscrupulous activities. They feel that they are hard pressed for time and therefore they will stop at nothing to obtain personal gains. Such actions will certainly have far-reaching effects on our society and I hope that the Government will take note of commercial crimes and take preventive measures as soon as possible.

Sir, I hope the Administration will response to the points I have made. As for the Budget, though it is not an insightful one, I am still willing to endorse it.

MR. DAVID LI: Sir, may I congratulate the Financial Secretary on presenting us with a prudent Budget. After three consecutive Budget deficits between 1982 and 1985, it is most heartening that we have achieved yet another Budget surplus at relatively little additional cost to the taxpayer. Most of us should be happy with the tax concessions given by the Financial Secretary in his maiden Budget. Indeed, our record of balanced Budgets with only six deficits in the last 40 years underscores the resilience and soundness of government economic policy, and long may this continue.

None of us here needs to be reminded that free trade is vitally important to the prosperity of Hong Kong. Persistent protectionism in our largest export market, the United States, has created a serious threat to our export-oriented manufacturing industries. Because Hong Kong is a free trade territory, we are not in a position to retaliate. But we do need to take measures against protectionism, by convincing our trading partners of our commitment of free trade, thus mitigating the potential damage to our economy. Although I very much appreciate the hard work of our trade representatives, I urge Government to intensify our campaign against protectionism.

Realistically, we must admit that the threat of protectionism will not disappear overnight. There are, however, at least two ways for our industrialists to survive in this environment. One is to trade up existing products. The other is to diversify into high technology industries. To adopt these strategies effectively, more investment in our industrial sector has to be encouraged. Last November in this Council, I urged Government to provide more incentives for our industrial investment. May I now take this opportunity to suggest again that Government should consider a more liberal depreciation and investment allowance scheme to encourage investment in plant and machinery. I also urge Government to take two specific measures to further develop our industrial sector. First, Government must carry out an in-depth study on the future development of our manufacturing industries. However, this study must not be done in the previous superficial manner. Secondly, Government should devote significant resources to supporting research and development programmes that will benefit the long-term growth of our industries.

We continuously hear talk about the need to revalue the Hong Kong dollar. Hong Kong is a free market without exchange control. Hong Kong people are free to buy all the imported goods they want. A revaluation of the Hong Kong dollar would mean the abandonment of Government's commitment to a stable exchange rate for our currency. If Government revalues the Hong Kong dollar now, who will believe it later on if it says that it will not devalue? We have made known our commitment to the linked exchange rate system. This position must be strongly defended. However, one of the most worrying monetary issues is the projected rise in inflation for 1987, which the Government must do everything in its power to combat.



The process of financial innovation, including securitisation, poses new opportunities as well as new challenges. To cope with the rapid changes in the financial sector, our Banking Ordinance, as I have long advocated, should be administered with a high degree of flexibility. In particular, Government should allow authorised institutions to have greater freedom in dealing with securities-related business. Government should also at its discretion grant exemption from some specified provisions of the Banking Ordinance for particular authorised institutions. While I support financial innovation, I would also like to comment here on the longer-term implications of securitisation for our banking sector and the securities market. By channeling an ever-increasing share of financial business through the securities market rather than through the banks, securitisation of corporate debts may move us to a less stable credit system—that is, one with less rigorous methods for screening and monitoring credit performance, and with less effective and flexible arrangements for dealing with inevitable credit problems. If I had a choice between a credit system which depended on securities underwriters or on senior bank credit officers, my choice would be an easy one.

Securitisation can also give rise to a false sense of liquidity. Although these financial instruments when held by banks are deemed liquid assets, they are nevertheless difficult to dispose of at a short notice. Bear in mind that there has yet to be a real test of these new financial instruments whose recent growth has been encouraged by sustained economic activity, low inflation and declining interest rates. Furthermore, we have neither a formal rating system nor an official discount facility. Our secondary market is relatively small. Since the potential danger arising from a liquidity crisis under current arrangements is ever present, Government must seriously consider building in the necessary safety valve, namely an official discount facility.

In raising these longer-term issues, I am not suggesting we could or even should try to reverse the course of financial innovation taking place in the banking industry. But I do think it is important to point out areas of potential risk so that efforts can be made both in the market and by regulating authorities to strengthen safeguards as we move closer to more integrated banking and capital markets. In matters relating to securitisation, we have at present the problem of authority divided between the Commissioner of Banking and the Commissioner of Securities. May I suggest, Sir, that the Secretary for Monetary Affairs should devise a system whereby all such matters as far as they affect the banking industry would be dealt with solely by the Commissioner of Banking.

To maintain Hong Kong's attractiveness as an international financial centre, I repeat that the implementation of the new Banking Ordinance should be flexible. I strongly believe that Government should seriously consider my previous proposal on issuing restricted licences for institutions with restricted functions.

With regard to Government's fiscal policy, I disagree strongly with the Financial Secretary's suggestion that the tax burden should be spread more

widely across our community. Given the present provision of social welfare benefits, it would be grossly inequitable for Government to shift more of the tax burden on to those less able to bear it, particularly by the imposition of more indirect taxes.

Apart from the high administrative cost associated with indirect taxes, they have two major shortcomings. Indirect taxes, imposed on some selected goods and services, will distort relative prices, resulting in a misallocation of resources and affecting Hong Kong's position as a low-tax centre. Airport departure tax is a case in point. At the time of introducing this tax in 1983, the then Financial Secretary, Sir John BREMRIDGE, indicated it was levied 'in extremis'. In view of the much improved state of our public finances, I think Government should consider reducing this tax which is deeply resented by the tourist industry. The gravest defect of indirect taxes is that they are regressive, particularly if necessities are taxed. Indirect taxes on necessities should increase the tax burden on our lower income groups and have a disincentive effect on our workforce. The idea of more indirect taxes should be dismissed out of hand.

I welcome the Financial Secretary's decision to reduce the standard rate of tax, and to increase the personal and child allowances, but I cannot praise him for his refusal to consider separate taxation for married women. It is true that there could be a loss in revenue if separate taxation was implemented. But Government should be fair to middle-income working couples. It is unsatisfactory that our young men and women have to pay more in taxes simply because they have been to the marriage registry. In the Bible the wages of sin are death but under our Financial Secretary, the wages of sin are \$3,000 per annum. This unreasonable levy should be eliminated.

Turning to the revenue and expenditure account of Government, I see both good news and bad news. The good news is that with less dependence upon the fluctuating income from land sales, Government revenue is now based on more stable sources. Income from land sales, which accounted for 28.2 per cent of total revenue for 1981, contributed only 1.7 per cent of total revenue for last year. May I suggest that Government should continue to develop this policy under which our revenue is based on stable sources.

On the other hand, the bad news is that the balanced Budgets for the last two years were achieved mainly through a reduction in Government's capital expenditure with little attempt to control recurrent expenditure, particularly the salary and staff related expenses of the Civil Service. Between 1981 and 1986, while Hong Kong's Gross Domestic Product grew at an average rate of 12.1 per cent, Government's recurrent expenditure grew at a rate of 14.7 per cent per year while capital expenditure plus transfers to funds contracted at an annual rate of per cent. At the same time, the salary and staff related expenses of the Civil Service grew at a rate of 16.8 per cent per annum, representing an average per capita annual increase of 12.6 per cent in remuneration, after taking into account the growth in number of civil servants. I am disturbed by the fact that

Government has failed to restrain the increase in cost of the Civil Service. The morale of our public servants is maintained at the expense of all taxpayers and at the cost of a reduction in Government's commitment to long-term investment projects. It should be Government's priority, on the one hand, to increase the productivity of the Civil Service; and on the other hand, to commit sufficient capital for the development of Hong Kong's physical and social infrastructure.

I concur with the dictum that 'taxes are what we pay for a civilised society'. But tax collectors should look at every possible way to alleviate the taxpayer's suffering in paying his taxes. Unfortunately, the present provisional tax system, requiring people to pay their personal income tax in advance, is not an alleviation, but a genuine hardship. In my view, the tax should be collected by equal half yearly instalments payable in arrears.

A good government must be a generous government. The Financial Secretary has gone part of the way to showing that generosity. I trust that in the light of the comments made in this Council today and tomorrow, his next Budget will merit him the title of generous JACOBS.

Sir, with these remarks, I support the motion.

6.00 pm

CHIEF SECRETARY: Sir, with your consent, I move that Standing Order 8(2) should be suspended so as to allow the Council's business this afternoon to be concluded.

*Question put and agreed to.*

MR. TAI: Sir, having sat in this Council for almost a year, I still cannot really grasp the true financial position of the Hong Kong Government because of its hidden reserve, the various funds that it processes and the frequency of transfer to and from those funds. And by listening to Mr. CLYDESDALE'S speech, it looks as if our Government's financial position is not as bad as what one thinks that it would be during our bad years and we are performing even better than our good years. If we take into account the various transfers to our reserve, it looks as if Hong Kong Government is much richer than she claims to be. But none the less, when we ask quite often for more allocation of funds during the bad year, we are often told that Hong Kong must tighten her belt. During the good years, we are told that we must save up for the rainy days.

As the Financial Secretary mentioned in his speech, Hong Kong's economy has recovered significantly over the past year and this upward momentum is continuing. The forecast growth rate of GDP for 1987 of over 6 per cent is very encouraging. Like the past two years, the Budget for 1987-88 again shows a surplus. These results are mainly due to prudent financial policy and the sensible workforce. Whilst I agree that these encouraging signs should not be used as an excuse for asking greater increase in government expenditure, none the less over cautions or tightly controlled expenditure will cause unnecessary hardship to

those in need and to improve the living standard of our citizens, we must strike a sensible balance.

Sir, I would like to make a few observations relating to the Budget.

People in urban areas and satellite towns enjoy a comparatively up-to-standard living, whilst the villages and rural population enjoy appreciably less than their urban counterparts. The population living in the country and the villages outside the new towns in New Territories is about 300 000 and the expenditure allocated to Local Public Works for 1987-88 is about \$13 million. Bearing in mind the size of the New Territories which comprises of about 600 villages, the amount allocated will be inadequate to cope with necessary improvements in rural facilities and in the environment of villages in the New Territories. The rural village population continues to have to tolerate a poor hygienic environment. Provision should be made to alleviate the discomfort of these people living in the rural area.

There is also the problem of rural isolation and difficulty of access to and between villages in the New Territories. It has been the usual practice for the Government to build roads albeit on private land. However, the question of private land is the major obstacle in building and maintaining village access roads. The Government can do nothing without the consent of the landowners and therefore building and maintenance proposals come to a standstill. One possible solution is for the Government to compensate landowners for the land needed to improve communications. The Government should re-examine whether this option to acquire private land for building access roads is practicable and feasible, and the budgetary implication.

Pollution of rivers and nullahs in the New Territories is a really serious problem and totally unbearable for those living in the vicinity. The Administration is now trying to tackle this problem by imposing severe controls of animal waste and the live-stock industries. Implementing this control directly affects the livelihood of about a quarter of a million people who derive their living through rearing livestock. They no longer find it possible to continue their occupations due to the fact that in reaching the required standards means a change of technology and an inflow of capital which the farmers can ill afford. I would, on the one hand, fully support the Government in its determination to combat the severe pollution problem, but, on the other hand, I strongly urge this Council to allocate the necessary funds to relieve the people that will be affected by the control or to assist them.

The next topic I want to deal with is the medical services. Total expenditure for the medical services in 1987-88 will be \$5.2 billion; an increase from 8.9 per cent to 9.6 per cent of the Consolidated Account Expenditure. I am pleased to see the increased provision of medical services which demonstrates an increased commitment by the Administration. I appreciate also the provision of \$1.2 billion for the Tuen Mun Government Hospital, in addition to the \$899 million for last year. As that hospital will begin to operate in 1988, the high demand for

medical services within the vicinity will be alleviated. This will provide a better standard of medical care which has been long awaited by the residents of that area.

Nevertheless, I am disappointed that there is no mention in the Financial Secretary's speech regarding the recommendations of the Australian consultants report. The consultants report was finalised and forwarded to the Government last year. Although some of the recommendations are highly controversial; such as the establishment of a hospital authority which requires more time for discussion, the other proposals are less controversial and could be implemented easily, provided sufficient funds are available. However, the Government declines to acknowledge to the public in specific terms that the recommendations are practical and will be adopted by the Government. I can see no reason why the Administration is reluctant to implement the non-controversial parts of the report. Therefore, I urge the Administration to take the initiative in clarifying to the public the feasibility of the non-controversial parts of the Australian consultants report which if implemented would greatly benefit and improve the welfare of the people. Lastly, Sir, I would like to take this opportunity to reflect some of the discontent faced by the subvented hospitals regarding the financial provision.

The financial provisions for subvented hospitals are usually discussed and during a long consultation process with various levels of officials in the Medical and Health Department. Then an estimate is prepared and submitted to the Administration. The final provisions allotted often counts only a quarter of half of the estimate sought. The subvented hospitals are unaware of the reasons why their requests as stated in their estimates have been reduced and come to the usual complaint of inadequate funds being allocated to them. Obviously, it must be the one who holds the money has the final say but none the less, in view of the service provided by this sector to the public and as a recognition of their services, I do not think an explanation or reason as to why a particular requests for funds or for a particular purpose is turned down should be denied. Sir, therefore I appeal to this Council to consider the option of setting up a machinery similar to the hospital authority recommended in the consultants report so as to improve the efficiency of Budget preparation and communications between the Medical and Health Department and the subvented sector. This would greatly improve the morale of subvented hospital staff.

Sir, with these observations, I support the motion.

MRS. ROSANNA TAM: Sir, Mr. JACOB'S first Budget since his taking up the office of Financial Secretary has been a balance and conservative one. He has exercised quick caution in the planning of revenue and public spending. An issue in focus has been a separate taxation for married women which concerns the group with middle income most. He has adamantly rejected widespread public plea for separate taxation and continued to tax married couples jointly. It has been a centre of much hitted discussion. So, today, I would like to

particularly discuss the issue of taxation of the middle income group. In addition, I would also raise suggestions on matters concerning the central administration of voluntary social welfare agencies and the development of personal social work services among young people.

Firstly, on the issue of taxation of the middle income group. Hong Kong has traditionally maintained a low taxation policy. Income tax is kept at a low level, so that at present no matter how much a person earns, the amount of tax payable will not exceed 17 per cent of his total earnings. This effectively protect high income earners. However, it is notable that for many years, the progressive tax bands by which salaries tax is calculated has not been revised in relation to the upward movement of the consumer price index. Consequently, a situation has developed whereby many middle income earners now pay salary tax at almost a standard rate. For example, a single person earning \$10,000 a month pays out 14.4 per cent of his income in tax. If he earns \$3,281 more a month, he will be taxed at a standard rate of 17 per cent. Comparatively speaking, our middle income earners are required to pay salary tax at a much higher level than that levied by some neighbouring countries where their overall tax rate is higher than that of Hong Kong. In 1984, for example, the effective tax rate in Hong Kong for a single person with an annual income of a hundred thousand dollars was 13 per cent, as compared with 9.7 per cent in Singapore and 12.3 per cent in Japan for persons earning an equivalent sum. The 17 per cent tax rate for persons earning \$150,000 a year also compares unfavourably with 13.7 per cent in Singapore and 15.2 per cent in Japan. Although they are required to pay the relatively high rate of tax, the middle income earners in Hong Kong unfortunately are unable to enjoy the full range of community services and benefits so that in economic terms they become the luckless sandwiched class.

The need for housing, education, medical services and social welfare are very important to our community. Since the late 1960s, we have seen a comprehensive development of social services by the Government mainly to cater for the needs of the low income group. Eligibility to many of such services often depends on a means test designed to exclude the middle income group. First, an example in housing. The Home Ownership Scheme is devised basically to provide better accommodation for those better off public housing tenants and members of the public. But by way of the monthly income restriction \$8,500, the general middle income families are made ineligible and must therefore purchase or rent accommodation from the private sector at very high cost. As for education, while nine-year free education is provided for all school-age children, irrespective of family income, government assistance for tertiary education is provided only for children of families below a certain income limit. Here, again, children of middle income families are excluded. Should the cost of tertiary education be raised drastically in future, it will be the middle income families who bear the brunt again. A final example is medical service. Due to the absence of the so-called 'B' class bed at existing government hospitals, most of the middle income group who are dissatisfied with the services

of the ordinary class bed but are willing to pay slightly more for higher standards of services do not have any other choice except to go to a private hospital at a considerably higher cost or make do with the basic service of the government hospitals. Now, it can be seen from the three examples above that the middle income group now find themselves in the unfortunate position of being prevented from enjoying much of the welfare of the community because of the income. On the one hand, they have to pay for higher cost for housing, education and other essential services and on the other, they are being taxed at the maximum and near maximum rate. Now, it is easy to understand why the middle income group, after deducting tax and other essential expenditure, may have even less money at their disposal than lower income families.

Sir, equity and reason are what we value in this society. Not only do we need a generally low tax rate, we also wish to distribute the burden reasonably across the whole community. To alleviate the difficulties of the sandwiched class, I think we should seriously consider at least the following three aspects.

First, there should be an overall review of the present progressive scale for salary tax in order to alleviate the burden of the middle income group by either pushing up the tax band or splitting them up together with a reduction of the difference in tax rate. For the last 13 years, since the 1973-74 fiscal year when the chargeable income from each tax band was increased from \$5,000 to \$10,000 and the tax rate from 2.5 per cent to 5 per cent, no substantial adjustment to the progressive scale had been made. As a result, middle income earners, in particular, suffer tax losses due to inflation. For example, a single person having an annual income of \$50,000 in 1973 was required to pay only \$5,000 or 10 per cent of his earning for salaries tax. An annual income of \$50,000 in 1973 would be equivalent today, 13 years later, to \$133,500 as calculated by the 2.67 times increase in the Consumer Price Index A. As not much adjustment has been made to the progressive salary tax scale through the past 13 years, this person with an annual income of \$133,500 now has to pay \$20,625 in tax or 15.4 per cent of his income which is 5.4 per cent higher than that of 13 years ago. Sir, for this reason, I really think that the Government should seriously consider an overall review of the present progressive salary tax scale.

Second, the Government should reconsider the issue of separate taxation for working couples. As a working mother myself, I have to declare interest on this issue. Both before and after the publication of the Budget, many members of the public have urged the Government to allow working couples to be taxed separately. Regrettably, the Financial Secretary has failed to accept their views. I pledge support of the request of the public for separate taxation of working couples. There is now an increasing tendency for both husbands and wives to work. The refusal to allow separate taxation has in fact a discouraging effect on such tendency by making them liable to extra taxation. The society is going to lose a valuable workforce. As it was agreed last year, the couples could submit tax returns separately and therefore having separate files, the Government

should, as a matter of principle, allow separate taxation. As separate files have already been created, there should not be too much administrative cost. I therefore, call on the Government to give further consideration to this proposal.

Third, as rightly pointed out by the Financial Secretary, there is no immutable or clearly correct ratio between the yields from direct and indirect taxation. In the past, the contribution of direct taxes fell at one time to 60 per cent of the total tax yield; but this has started to add up again in recent years. I agree, in principle, that the proportion of direct taxes should not rise above the present level so that the Government need not be over dependent on narrowly based direct taxes and that the tax burden could be spread out among more people. Nevertheless, I think that the Government should bear in mind that dutiable commodities such as tobacco and alcohol are considered to be daily necessities of a lot of people. Increases in duties with these items will increase the tax burden. I therefore propose that luxury items should be considered in the first instance when selecting suitable areas for increasing indirect taxes so that those who can afford it are made to share the tax burden.

Sir, I now turn from the tax problem of the middle income group to personal social work services among young people and the problem of central administration of voluntary welfare agencies.

Now, although there is a slight increase in expenditure in social welfare this year, its share of consolidated expenditure remains at last year's level which is 5.8 per cent. Now, due to the mismatch in timing no specific provision this year is made for the improvement of school social work services, that is by lowering that ratio of one school social worker to 3 000 students. Now, the importance of such service has long been recognised and I hope that out of the surplus of \$6 million from this year's provision on voluntary welfare agencies, \$2.8 million should be allocated to fund the improvement of school social work service from September this year to March next year. At the same time consideration should also be given to expanding the outreaching social work service whose value was recognised in an earlier review. In 1979, when the 18 outreaching teams were established, the new towns have not yet reached full development. In view of the rapid migration of the population to the new towns, the Government should, according to the existing guidelines for outreaching services, conduct reviews in various new towns and urban areas to identify any shortfall so that priorities can be established for the provision of the service as soon as possible.

Now, the problem of central administration of voluntary welfare agencies. There has never been any established criteria to govern the ratio between the number of administrative staff and the size of the agency. This has resulted in confusing standards among them. In fact, how an agency is centrally run has a great bearing on the allocation and management of resources. Now, due to present discrepancy in standards, voluntary agencies often have difficulties applying for funds for their central administration. Consequently, they find it hard to extend or to improve their services because of inadequate staff. What is



more important as I said is a direct impact on the management and use of funds. I therefore urge the Government to conduct a comprehensive review of the central administration of voluntary welfare agencies and to consider the formulation of a set of reference criteria not only for the agencies but also for the authorities concerned with assessing funding applications. Through the use of these guidelines, the authority may effect gradual improvement to the allocation of funds for the central administrative functions of the voluntary agencies.

Sir, I strongly believe that an improved central administrative machinery will be conducive to good management and use of funds and the upgrading of the services of the voluntary agencies.

Sir, with these remarks, I support the motion.

MR. ANDREW WONG: Sir, the major theme of the 1987-88 Budget, my hon. Friend the Financial Secretary Mr. Piers JACOBS' first Budget, must be taxation. This is so not because we are now in any way financially tight nor do we expect it next year, but because by the close of the current financial year 1986-87, we expect to enjoy a historic surplus, so much so that Government can no longer ward off sentiments demanding, clamouring for tax concessions. Such sentiments are nothing but fair as no Government ought to tax more than it plans to spend.

That taxation is the major theme of next year's Budget is encouraged by the Financial Secretary himself who has toyed with the idea of a 'broadly based tax system' without venturing into a magical direct to indirect taxation ratio but suggesting that this could be effected 'through widening the scope of indirect taxes'. Taxation as the major theme is also fueled by clamours both within this Chamber and without for separate taxation for husband and wife. On these two questions, the Financial Secretary appears or would like us to believe that he does have an open mind. He said and I quote: 'I have as yet taken no hard and fast stand (on the question of a broadly based tax system). I hope I shall hear Members' views on the principles, if not the mechanics'. And: 'I have no doubt I shall hear more on this subject (of separate taxation) and look forward to hearing Members' views with interest'. And he shall hear more, but first a few words on the surplus.

I have said earlier that the expected surplus for 1986-87 will be a historic one. This must be put into perspective. The Financial Secretary said, 'we can now expect in the current financial year a surplus on general revenue account of some \$3 billion!' Looking through surplus/deficit figures since 1946-47, the two years which registered larger surpluses were 1980-81 (\$6.7 billion) and 1981-82 (\$6.5 billion). Now obviously, a \$3 billion surplus, though no mean feat and though practically dwarfs all other years except the two I mentioned and perhaps also 1979-80, with a \$2.9 billion surplus, cannot be historic, but I think otherwise for two reasons. First, the Financial Secretary went on to say, 'although partly due to revenue of a windfall nature, the balances in our capital funds have gained by \$1.9 billion.' I am not sure if these two sums could be

added up, but in the Appendices attached to the Financial Secretary's Budget speech, they were added up. So, if so, the surplus would be \$4.9 billion. If not, the expected \$3 billion surplus should be viewed in the context of depreciated or deflated surpluses for the other years concerned as the capital works reserve fund which holds most of the balances and the other funds were created subsequently and the Capital Works Reserve was created by resolution of this Council as late as 1982 presumably partly also due to such embarrassing surpluses. It is to be regretted that in revamping the estimates format for 1987-88, the Financial Secretary who should be complimented for compiling statistics on the overall state of our finances in Appendix A(1) of his Budget speech has thought it fit to discontinue one particular statistical appendix to the 86-87 version and to the previous version of the estimates, that is, Appendix I which presents a summary of revenue and expenditure together with surpluses and deficits of the General Revenue Account, and I urge the Financial Secretary to continue the run by updating figures for 1985-86 and 1986-87 and estimating those for 1987-88 so that the state of our General Revenue Account, past, present and future could be examined in one single, simple statistical table, together with a future run on the overall state of our finances.

Second, with the signing of the Sino-British Joint Declaration in 1985, we have entered into an arrangement whereby part, theoretically half, of our land sales premia is to be credited into an account for the future Special Administrative Region's Government. For 1986-87, the sums to be credited to the Hong Kong Government and the SAR Government are estimated to be \$2.2 billion and \$1.8 billion respectively. (The smaller sum for the SAR government is due to its share in land formation costs.) The \$2.2 billion for the Hong Kong Government is already accounted for in our General Revenue Account, but the \$1.8 billion for the SAR Government, in all respects is a surplus, it is never shown in our books. If this sum is to be added to the \$3 billion General Revenue Account surplus and the \$1.9 billion balances in our Capital Funds, the surplus should be as large as \$6.7 billion which equals that for 1980-81. Sir, before I move to another subject, I wish to bring our attention to Mr. now Sir Y.K. KAN's half joking and half serious remarks made in 1971 on the occasion of Sir John COWPER THWAITE's last Budget and I quote: 'from the figures which I have been able to gather—and I have them here, Sir, in case Sir John challenges me on them—in the ten years that he and I served together in this Council, he has consistently over-estimated our expenditure or under-estimated our income.' Sir Y.K., I surmise, meant both, over-estimating expenditure and under-estimating income. I personally think the latter is the case. Windfalls obviously cannot be predicted with any degree of accuracy but were they really windfalls?

Sir, I now turn to the question of taxation. I must first of all mention that I am in agreement with the Financial Secretary that our or any tax system ought to be broadly based not only because I, too, believe that 'such a system is more resilient', but also because such a system imbues the whole population with a sense of responsibility and participation, the sense that we are all in it and the

sense that we are in it all, which sense is that of community so essential for an active democracy with or without the accompanying democratic structures. I must also declare that I am an advocate of the principle of proportionality in the tax burden, that is, the more one earns, the more one pays, and the less one earns, the less one pays, but all at the same tax rate. As such an advocate, I cannot agree with regressivity such as any per capita flat sum tax which is in nature regressive vis-a-vis income. Now, Sir, the regressive nature of indirect taxes is well appreciated. It is for this reason, short of abolishing indirect taxes altogether (which is well nigh impossible and impracticable for revenue and other social reasons), that indirect taxes should not constitute the bulk and perhaps not even a sizable share of all tax revenue. In other words, I am opposed to the Financial Secretary's strategy of 'achieving a broader tax base ... through widening the scope of indirect taxes, which we currently limit to a relatively small number of specific items'. From the Financial Secretary figures, we learn that in 1982-83, indirect taxes comprised 31 per cent of the total tax yield, which rose to 40 per cent in 1983-84 and is beginning to fall again. So I think that is good news. He then said that 'for the longer terms', he does 'not believe that a higher relative contribution from direct taxation (or in other words, a lower relative contribution from indirect taxation) is desirable for Hong Kong'. I am prepared to be convinced as to why a smaller share from indirect taxation is indeed undesirable particularly after he has uttered the words of wisdom that 'there is no immutable or clearly correct ratio between the yields from direct and indirect taxes', thus effectively also demolishing or at least casting into great doubt the wisdom of Sir (then Mr.) Philip HADDON-CAVE who had toyed with the idea of a ratio since this first Budget speech in 1972 culminating in a magic ratio in 1974, and I quote: 'in the long term, I (meaning Sir Philip) think we should aim for a balance of the order of 45:55 between direct and indirect taxation'. How we have deviated now that it is in the region of 60:40, or have we not deviated but progressed in the right direction after all?

Sir, it is for the above reason, and not for reasons that I drive, I smoke and I drink that, I accept with reluctance the indirect tax revenue proposals which on the whole are gentle. But I fear the ramifications. Mine is not an academic argument but one which goes to the roots as to what constitutes a fair taxation system. We certainly have to think the package through, as in the Financial Secretary's words, 'with meticulous attention to the consequences that might follow'. Its effects on the cost of living and its cost effectiveness will have to be considered. Why not also fairness?

Sir, I am no ideologue of proportionality, given the realities of life that indirect taxes are here to stay, I accept, in fact, welcome an element of progressivity in direct taxes and I think our present system has more or less struck the balance except for two thorny questions: first, the question of separate taxation for husband and wife which interests many, particularly members of the fairer sex, and second, the question of the effects of the non or slow revision of the tax bands and their tax rates and of the allowances which

does not appear to have caught the public imagination. Both questions have to do with the larger question of the plight of the sandwiched middle class whose plight is aggravated by the so-called lack of services provided specifically to them but which is a question separate from the taxation issue and which ought to be tackled separately. That these two are in fact one and the same question of the sandwiched middle class is plain, because when one's income reaches a certain level, the level to which the standard rate applies (now the standard rate is reduced, thanks to the Financial Secretary, from 17 per cent to 16.5 per cent), the distorting effects of allowances and the tax bands and their tax rates would have been wiped out, and when one's income and one's spouse's income taken together or separately reaches that level, the distorting effects of conjoined household taxation would have also been wiped out.

Now, Sir, without disputing the need to give this two-in-one or one-in-two question full consideration as it obviously touches on all kinds of issues some of immense moral persuasion, such as the livelihood of the poor, the status of the woman, and so on, and some of a more mundane nature such as the Government cashing in, in a windfall manner, additional revenue arising simply because of a failure on the part of the Government to update the allowance and tax band figures to fall in line with inflation. And for example, the cost effectiveness of such changes in the tax law and so on.

However, Sir, I must point out that this question of the sandwiched middle class has to be viewed in perspective. As I have said before, I believe in the principle that every citizen has an obligation to shoulder the tax burden and the principle that the tax burden ought to be proportionally borne on the basis of incomes earned. It follows, therefore, that all exemptions, allowances and tax rates and marginal rates applicable prior to the standard rate threshold, could and should be regarded as concessions provided for moral-social reasons such as alleviating the plight of the poor and the weak and for administrative fiscal reasons such as cost effectiveness of the tax system.

Now from this perspective, there is no question of injustice whatsoever, because all those who are paying at the lower rates or who are not paying at all, are all better off than those who are paying the standard rate. I therefore appeal to my hon. Friends in this Council and to members of the public to argue, to discuss and to debate but always with the kind of moderation and gentleness which has so characterised our community and for so long. Now no human being has all the reasons, on her or his side, even if she or he believes that she or he does, being human, there is always the possibility that she or he is mistaken.

Now having said in no uncertain terms that I regard these as concessions and that there is no question of injustice when compared to those on the standard rate, I hasten to add that there still exist issues of inequity which have to be tackled. These have to do not with the relativities within the group of persons enjoying the concession but with the sudden additional tax burden imposed on an individual whose income has not increased out of step with inflation or has

not increased at all but whose marital status has changed or whose tax band happens to have changed. I do not have very specific recommendations to make. I would simply like to urge that the Financial Secretary should, as a matter of urgency, comprehensively review our existing tax bands and the tax rates which were last revised comprehensively more than ten years ago in 1973. I also wish to lend my support to my hon. Friend Mr. Peter POON's suggestion that a working-wife's allowance be introduced and be increased. I would prefer to term it 'wife's earned income relief' or better still 'spouse's earned income relief'.

Sir, despite my critical speech, I sincerely believe that the Financial Secretary ought to be congratulated for having presented to us a prudent yet forward-looking Budget and presented to us with an opportunity to debate at length our taxation policy. I beg to support the motion that the Appropriation Bill 1987-88 be read a Second time.

MR. HO SAI-CHU (in Cantonese): Sir, in the past few years, the performance of our economy was undermined by various factors both external and internal. But we should be glad that the situation was improved last year. In the previous financial year, we see very marked improvement in our economic situation. We see 16 per cent increase in the domestic export, 9 per cent increase in the GDP and we see a surplus of over \$3 billion. Looking at the achievements, I must say that we should congratulate the cautious approach adopted by our controlling officers but the most influencing factor was to show the hard work of all our citizens. I think this reflects our sense of belonging and our commitment to Hong Kong.

Sir, this year's Budget is prudent and balanced but slightly conservative. Of course, the cautious attitude our Financial Secretary is comprehensible. We know that the economic growth of Hong Kong has been export-oriented in the past and I am sure that that trend will continue in future. The performance of our economy will depend on the economic situation of our major export market and we know that the situation is completely beyond our control. Out of such circumstances and particularly under the shadow of protectionism, a cautious approach to have a surplus Budget is acceptable.

Sir, I entirely agree that saving up for rainy days is a good habit but we must realistically assess the function of such a habit. If we just rely on our surplus to face future crisis, this is very passive.

Sir, looking at the present financial position, I think the Government can devote more resources in industries or encourage the manufacturers to invest in plant and machinery. I think this will help the industrial sector to develop and make improvements. I think the Government should speed up the research work in industry and to provide more assistance to industry so that we can trade up our products.

Sir, talking about industrial development and about the Government's responsibility and commitment, we have already discussed very lengthily on the

14 January, and I do not want to repeat all the points. I would just like to repeat one thing and that is industrial development takes time and now the time is ripe to review our industrial policy. Sir, I think we should extend our industrial foundation, strengthen research and expand our export markets. These are the things we should do. Sir, we know that the industrial and commercial sectors welcome the deduction in private tax rate. We know that a reduction of 0.5 per cent is very low but this expresses the Government's determination to have a low tax rate system. Sir, I welcome the Financial Secretary's attention to the industrial sector but I think the increase in oil tax should be postponed and this will achieve a better effect. We know that, in the recent months, we have seen rapid increase in imported oil product prices and I know that this has added to the financial burden of our industrial and commercial sectors. I think the Government should have increased oil tax only when we have a decrease in imported oil price. I think people will criticise me for asking special attention to industrial and commercial sectors but I would like to point out that our industry and commerce form the blood line to economy. A prosperous and thriving industrial and commercial sector would not just benefit the businessmen and the manufacturers but will benefit everyone in Hong Kong.

Sir, now I would like to talk about the tax concession proposal in the Budget. I do not doubt the sincerity of our Financial Secretary to treat everybody fairly but we know that some people are not being fairly treated. Although we see an increase in additional tax allowances, we also see a 10 per cent clawback or we see a line drawn for \$7,000 or \$34,000 of income for single persons and married couples respectively. We see a very big burden being borne by our sandwiched class and I think that the Government should increase tax allowance rate and adjust our tax band to lessen their burden. On the other hand, I cannot agree with the Government's approach on separate taxation of married women. I think the most important thing is the principle here and that is married women should not be paying more tax than single woman. I urge the Government to conduct a review to change the unfair measure adopted now. The Government should allow women to pay tax separately or give them a special tax allowance. This may increase the workload or administrative cost on the Government's part but if we would like to have a fair tax system, I think the Government cannot shirk the responsibility in this field.

Sir, the Financial Secretary suggests that there would be an advisory committee to review tax matters and I welcome such a proposal. I hope that the advisory committee will be able to bring about a more prudent, sensible and more far-sighted tax system. The Financial Secretary has also talked about adjusting the ratio between direct and indirect tax. I would like to talk about the proportion of the taxes here but I would like to say one thing and that is only real luxury items should be taxed and I think the non-alcoholic items being included in the tax bracket is not right.

Sir, with these words, I support the motion.

MR. LAI: Sir, the Financial Secretary set out to bring forth a Budget that would benefit everyone in the community. That was not an easy task—it would not have been an easy task for anyone—I commend him for his ambition.

On balance, by increasing tax allowances, widening a tax bracket, lowering standard tax rates for individuals and corporations, a lot of people would indeed be benefited. I welcome all these changes. However, one question remains: 'Is that the best we can do?'

The Financial Secretary repeatedly reminded us in his speech on 25 February that we had to be cautious in our approach in drafting the Budget because Hong Kong's economic performance was so heavily dependent upon the uncertain economic climate of the world market. In the light of the difficulties we experienced in the last two years, I can understand his reservation about committing too much in expenditure. While the Budget might be beneficial to us all in the long run, as I see it, is still too cautious.

I would like to look at the Budget from two angles. Firstly, in principle. The Financial Secretary suggested modifying the proportion of direct and indirect tax base of our revenue so that it would be less subjective to the performance of our economy. Surely, wider indirect tax base would be better able to stabilise the stream of revenue over the years, however, it would also increase the tax burden of the lower classes in that they would not be able to take shelter under the umbrella of tax allowances. Even though there are no specific proposal yet, I urge the Financial Secretary to bear this in mind when he ponders upon this issue again. Our budgetary policy must not be drawn up only to effect a stable income to the public coffer, it also has a social function of redistributing wealth in the society. This can be achieved by having a progressive direct tax system in which those who make more money has to give more to society. Indirect taxes have no such discrimination.

Another aspect that I cannot condone to in principle is that separate taxation for married women is not provided for this year's Budget. Other Members of this Council have gone into details on this; I wish only to say that the interest of married women should not continue to be sacrificed for the sake of expedience and savings to the Government. The burden of financing public spending must be shared equitably among different sectors of society.

Secondly, with regard to the specific measures contained in the Budget, I wish to make the following remarks.

I was extremely happy to see that the spending to be allocated to the Environmental Protection Department would be about 80 per cent more than last year's. It demonstrates the Government's commitment to the environmental issue which has not been accorded sufficient attention until very recently. Specific legislation with respect to implementing various policies in different areas, for instance in noise and air pollutions, in the management of animal waste, in cleaning up our harbours, give people confidence that the Government is committed to the cause of securing a better living environment for the people. However, this exhilarating assurance makes the development strategy in Tsing

Yi all the more difficult to understand. Here again the Government is to put people and hazardous industries together. Past developments of mixed industrial and residential communities have proved that the proximity of industries to residential developments forestalls effective environmental management in later years. Moreover, Tsing Yi's particular geographical position makes her more vulnerable to disruption that may be caused by accidents in the transportation of oil, gas, chemicals and possibly in future, dangerous waste through the Tsing Yi Bridge which is the only land link between Tsing Yi and the New Territories. The trend of moving more hazardous industrial installations to Tsing Yi is not consistent with the objective of developing it to be a heavily populated centre. I strongly urge the Government to decide its policies one way or the other, certainly not implementing two policies at the same time as it would really not be fair to the local residents in Tsing Yi.

Sir, the early repayment of the entire HK\$77 million loan by the Kowloon-Canton Railway Corporation to the Government demonstrates the ability of the corporation to succeed in a competitive environment. This puts into question the necessity of providing a transit service area for the operation of the Light Rail Transit system. The reason that was given for the need of carving out a privileged zone in which the LRT could operate was that the revenue generated therefrom would enable the early development of other routes to serve the community. Recently, we learnt that the route connecting Yuen Long to Tai Wo would be given first priority over the Tsuen Wan link because the former would be economically more viable even though ridership forecast of the latter was about twice that of the former. I contend that a Crown corporation should set the interest of the public in the forefront; the social responsibility of the Crown-owned KCRC should be above and beyond commercial consideration. Besides the development of new towns depends on the transportation available; it has been reported that companies in the new towns especially Yuen Long, Tuen Mun, have difficulties in recruiting high calibre personnel to work there because of traffic inconvenience. To develop these and other new towns, efficient transportation is necessary. If the Tsuen Wan route would serve more people and provide a more effective linkage between the urban areas and the new towns, it should be given preference over other routes despite their commercial unattractiveness. After all, privately owned transportation companies have to operate loss-making routes to serve the community in exchange for the right to run profitable ones; I fail to understand why the duty of a Crown corporation to service the community is not a paramount consideration. I urge Members of the Executive Council to take full consideration of public representation and responses bearing in mind that not only they have the responsibility of endorsing government policy but also a duty to the community at large as well!

With regard to profit tax cut, I wish to remark that since Hong Kong offers many attractions to investors, the half per cent profit tax cut would not be a determining factor to investor. The Financial Secretary suggested that this would give investors confidence that this Government would always maintain



an environment in which business could flourish. I wonder whether this could be achieved without the estimated HK\$310 million a year price tag. In the Financial Secretary's speech, there is little mention of measures that may be adopted to stimulate the growth of the manufacturing sector on which Hong Kong's economic well-being still heavily depends. Perhaps Government could look into more positive ways to encourage investment and re-investment (for example adjusting depreciation allowance rate for newly purchased equipment) and the development of our industrial infrastructure to accommodate the transformation of our industries to the higher technology environment.

The duty increases on tobacco and liquor are socially defensible. The same cannot be said of the increase on imported hydrocarbon oil which puts extra burden on industrial and individual consumers alike, especially after the recent rise of oil product prices. As well, airport departure tax and duty on soft drinks and cosmetics should be reduced to stimulate growth in various markets.

Sir, in concluding my observation. I would like to say that overall, this Budget is too cautious and perhaps even too conservative in the light of the projected growth of our economy and our surplus last year which is ten times that of forecast. Granted we are still under the threat of renewed protectionist sentiments in our foreign market, and granted that a sense of continuity in public financial policy is something that the community will appreciate, an over-cautious approach, however, could very easily be construed as being lacking in imagination and initiative.

Sir, with these remarks, I support the motion.

MR. NGAI (in Cantonese): Sir, I am delighted that the Financial Secretary has produced a sound and surplus Budget, and has included in it proposals for reducing certain taxes: although it will probably not completely satisfy everyone's expectations, it should at least be generally welcomed. My colleagues have already spoken in considerable detail on the industrial, commercial and taxation aspects, and I hope to offer a few views on the fiscal policy.

We often hear foreigners describe Hong Kong as an 'economic miracle', which shows their appreciation and admiration for Hong Kong's economic success, which they find quite unbelievable. This so called 'miracle', in fact, is not the result of any fortune bestowed on us from heaven. It is due to the fact that Hong Kong people know how to utilise fully and intensively their own abundant human resources and their geographical position. In addition to these two advantages, we have an efficient economic framework which produces the same effects. Notwithstanding this, Hong Kong's economy is on a very small scale and entirely dependent on its export trade. It could, therefore, be said that it is a fairly 'fragile' economy which is constantly susceptible to external factors beyond our control.

From the above background, we can gather that the Government has two overriding principles in composing its financial estimates. First, the Government must take as its main object a balanced revenue and expenditure account and should at

the same time make every effort to avoid raising loans. Secondly, the Government must try its best to keep expenditure on the public sector at a low level in order to avoid the possible failure to make ends meet in the event of an economic downturn. We can all observe the efforts made by the Government in adhering to these two principles in its past financial Budgets. Occasional deviations are, however, unavoidable, but Budgets are generally based on these principles.

The Government has established a set of Budget guidelines for putting together its financial estimates in order to conform fully to the above principles. The guidelines are as follows:

- (1) recurrent revenue should be at least 77 per cent of the total expenditure;
- (2) recurrent expenditure should not exceed 85 per cent of the recurrent revenue;
- (3) surplus in the recurrent account should be at least 33 per cent of the capital expenditure;
- (4) recurrent expenditure should not exceed 65 per cent of total expenditure; and
- (5) capital revenue should be at least 20 per cent of capital expenditure.

You can refer to the table at footnote (7) of Appendix (A) in the speech by the previous Financial Secretary moving the Second Reading of the Appropriation Bill for the fiscal year 1985-86. I do not know on what the Government bases these criteria but, since they have been made public, there must be some logic behind them.

We can note that the percentage accounted for by the recurrent expenditure as a part of total expenditure has increased from 1983-84 onwards; and quite clearly there has been a tendency to depart further and further from the established standard of 65 per cent—in the 1986-87 revised estimate it was 81 per cent and in the 1987-88 estimate it is also 81 per cent: this tendency should be causing us some concern.

Since 'Personal Emoluments' and 'personnel Related Expenses' form the main part of recurrent expenditure and account for 35 per cent of recurrent expenditure in the 1987-88 Budget, I consider that there is a need for further study in this area.

First, on the trend of increase in 'Personal Emoluments' in the past four years. The actual expenditure on 'Personal Emoluments' for 1983-84 took up 25 per cent of the total expenditure; 26 per cent in 84-85; 27.5 per cent in 85-86; and 30 per cent in the revised estimate of 86-87. In the estimate of 87-88, it is 28.5 per cent, but judging from the trend since 1983-84, I can almost be certain that the actual expenditure will exceed 30 per cent. And the percentage accounted for by 'Personnel Related Expenses' as a part of total expenditure has also been moving upwards unceasingly: the estimate for this item in 1987-88 is 6.5 per cent. Since the base on which the above percentages are calculated (that is, the total expenditure) is also raised annually, the actual growth rates of 'Personal Emoluments' and 'Personnel Related Expenses' items should, therefore, be greater compared with the figures given.

The above two examples illustrate the fact that no matter how painfully the Government tries to contain the growth of public sector expenditure, it is almost impossible to contain the growth of recurrent expenditure. I believe that this situation is not unique in Hong Kong and that similar problems also occur in other places because expenditure on the public sector expends every year as a matter of rule and is completely unaffected by overall economic performance. Even in times of economic depression, when the profits made by the industrial and commercial sectors decline considerably or there are no profits at all, and the incomes of employees in the private sector also generally decline, the Government is still committed to pay higher recurrent expenditure. Looking back at the past few years, recurrent expenditure has never been reduced even in the year of least economic growth.

I wish to point out, Sir, that unless the Government has a long-term strategy and adheres to the established guidelines in composing its financial estimates, recurrent expenditure will not be contained and there will always be a commitment to pay more sums in future. This issue really deserves our deep consideration.

Another issue about which I am concerned is the fiscal reserves in the Government General Revenue Account. The Financial Secretary has estimated in his Budget that our accumulated reserves by the end of this financial year will reach \$20 billion, representing an increase of about \$4 billion compared with the estimated figures for the same period in the last fiscal year: this obviously indicates an improvement. I fully agree with the Financial Secretary that there is no hard and fast rule to determine how much it is appropriate to hold in the way of reserves. But from the subjective point of view, I think the above figure appears to be low. Take for instance a random comparison. The estimated total expenditure for the public sector has reached \$44.4 billion, whereas the estimated fiscal reserves are not yet half that figure: I consider that we should pay attention to this issue. Moreover, the Financial Secretary has said in his speech: 'they remain in real terms slightly below their level at the start of this decade before we fell into deficit'. Should we feel satisfied with this situation? Is there a need to adopt certain policies or lay down certain criteria in this respect?

Sir, considering the fact that the Government's usual fiscal strategy is to avoid raising loans and to achieve a balanced Budget, the expenditure can only be expanded when the economy is booming, while they should be cut during times of economic recession and when the revenue level is dropping if the Government retains the policy of having a fixed taxation rate. On the other hand, if the Government is to contain public sector expenditure at a fixed level, a balanced Budget would have to rely on the policy of reducing the taxation rate when the economy is good while raising it in times of recession. A floating taxation rate is not, however, an advisable course to take unless it is absolutely necessary, since it would certainly be detrimental to economic activity, considering the fact that a low tax rate is the main factor in attracting industrial, commercial and private investment. At the same time, as direct taxes outweigh indirect taxes in our present taxation

system, the Government is usually reluctant to resort to raising the direct tax rate to balance its Budget even if this does happen occasionally. The Reserve Fund should, therefore, take up a regulatory role in balancing the Government's revenue and expenditure, and as a matter of fact there have been former instances of the Government using the fund to supplement financial deficits. Sir, I consider the question of how the Government decides on transferring funds to the Reserve Fund to be very important. It may be necessary to fix a specific percentage or to maintain the amount of the Reserve Fund at a certain level.

I turn now to speak on infrastructure, an area which is so closely related to industrial development. The Government has many times reiterated its nonintervention principle in its industrial policy whilst on the other hand encouraging industrial development by providing efficient infrastructure. Now, I would like to try to examine this policy through the present Budget.

Sir, I must first emphasise that it is undeniable that the Government has provided more and better industrial infrastructure than before. But as the Financial Secretary says, it is the underlying trend which is important. My concern, therefore, is about the future trend of development.

Since the greater part of the Government's capital expenditure is handled through a variety of fund accounts rather than through the General Revenue Account, we can roughly observe the situation of provision for infrastructure by looking at the income and expenditure of the fund accounts.

The Capital Works Reserve Fund, established in the year 1982-83, is the biggest of the funds. The fluctuation of its expenditure during the past five years can directly reflect how the Hong Kong's economy has varied during the same period. I have said earlier that the growth of recurrent expenditure is not affected by trade cycles. But the situation with expenditure from the funds is just the opposite, the same is true for the Development Loan Fund. I am not sure whether the reduction of the funds' expenditure has anything to do with the difficulty in containing the growth of recurrent expenditure, but one thing for sure is that Transfers to Funds have not been increased annually. Although it is true that the provisions for infrastructure have to be adjusted according to the overall financial situation and demand, the purpose of establishing these funds was 'to smooth the inevitable fluctuations to which capital revenue and expenditure are subject.' (see paragraph 66 of the 1986-87 Budget: Speech by the Financial Secretary, moving the Second Reading of the Appropriation Bill 1986). Moreover, as these funds would be directly used for the provision of infrastructure, fluctuations in the amount of the allocations would directly affect the quantity and quality of the infrastructure to be provided in future, which would be detrimental to the community at large and to trade and industry in particular. For this reason, Sir, I consider that the Government should be very prudent in handling these funds and some guidelines in this respect might be necessary so as to avoid curbing the future development in the provision of infrastructure.

The Financial Secretary has stated in paragraph (6) of his Budget speech: 'I believe that as our wealth grows, it is entirely reasonable and natural that our

community should expect improvements in public services'. I have reservations about this statement. The situation might be just the contrary in reality. As society grows more prosperous and rich and the income of the public is generally raised, they should be more able to afford the services they so require or they should be happier to pay more for those services in return for more independence. Taking medical services as an example, I believe a person would certainly choose to go and consult a private medical practitioner when he falls ill if he can afford to pay the consultation fees simply because he wants to avoid the inconvenience of making the trip to a government hospital and the trouble and time in queuing up. He can also always decide on a suitable hour for the consultation. This instance can prove that the demand for public services by the public might not necessarily be in direct proportion to the growth in prosperity of our society. The improvements to and expansion of public services should be based on their actual needs. The Government should be responsible for providing and improving services for which there are genuine and urgent demands. Therefore, Sir, I wish to stress particularly the importance of the Reserve Fund and the Capital Works Reserve Fund. The Government should, as a long-term policy and at a time when the wealth of society is growing and the public revenue is increasing, make planned preparations in increasing the Reserve Fund as well as the Transfers to Funds for future use.

Sir, with the above remarks and observations, I support the motion.

MR. PANG CHUN-HOI: Sir, the 1986-87 financial year saw a remarkable revival of economic activities in Hong Kong and domestic exports picked up substantially to attain a growth rate of about 16 per cent, far exceeding the estimate made by the former Financial Secretary last year. As a result, the Government obtained a large surplus in 1986-87.

The Financial Secretary has been very cautious in presenting the 1987-88 Budget. Although the expected economic growth is lower than that in 1986-87, the Financial Secretary is still able to strike a balance between revenue and expenditure, while maintaining a certain level of surplus.

With the intention to attract foreign investments and to stimulate the local business sector to re-invest, the Financial Secretary proposes to reduce the rate of corporate profits tax and the standard tax rate by 0.5 per cent respectively. But he also admits that such a slight reduction can hardly achieve the goal of promoting investments. Nevertheless, it can be certain that the business sector will benefit from the reduction in tax. In fact, low tax is only one of the advantages of investing in Hong Kong. What is most important is the existence of an industrious labour force, both skilled and semi-skilled, among various trades in Hong Kong, so that products could be made in Hong Kong at a low cost and with a high quality which is up to international standard.

To the low income group, the proposed increase of personal allowance from \$29,000 to \$34,000 will certainly provide some sort of relief. But the 'sandwiched class', however, cannot benefit from it at all because they receive no tax

concession in real terms. While a slight increase is proposed for the child allowance, there is no corresponding increase in the dependent parent allowance which seems to have been neglected by the Financial Secretary. Despite the great importance attached to the problem of elderly people by the society and the general sympathy expressed by this Council during an adjournment debate on the issue and the fact that a considerable amount of surplus is expected, the Financial Secretary has not raised the dependent parent allowance and the level of public assistance and special allowance for the unfortunate and helpless old people is still maintained at the level laid down on 1 February 1984. It is hoped that the failure of the Financial Secretary to improve the level of assistance to those who have once dedicated their youth and energy to the society is only an act of negligence rather than discrimination.

The Government is very keen on the collection of indirect taxes and even wants to cast the net wider to include more items. I wholly disagree with the Financial Secretary's conception in this respect. Other than luxury items which could be taxed heavily without much affecting the general public, duty should not be levied on non-alcoholic and thirst-quenching drinks which are mostly consumed by students and children. I had already raised my objection to this last year. I hope the Government will abolish the duty on soft drinks.

The Financial Secretary estimates that there will still be a considerable surplus in the 1987-88 financial year. But the provision allocated to the Labour Department is merely 0.3 per cent of the total expenditure. With the continued development of new towns, the regular increase in the number of factories and construction sites, the workload of the Labour Department increases accordingly. But funds allocated to the department have long remained at such a low ratio. I must point out that the Government is evidently attaching little importance to the department, and thus it could be seen why so many labour problems are left unheeded.

The Financial Secretary has also rejected the public's proposal to introduce separate taxation for married women, using the excuse that such a measure will cost the Government \$400 million revenue in addition to the \$17 million administration cost required to dodge a general request from the public.

Lastly, though I think it is far more satisfactory to propose a Budget with surpluses than one with deficits, yet this is not absolutely true because creative ideas or breakthrough have been sacrificed for the sake of giving concessions to suit special needs. I do not care too much about whether there will be any surplus in the government revenue. I just want to make sure that every dollar from the public coffers is spent to meet actual needs and fulfils the 'value-for-money' purpose.

With these remarks, Sir, I support the motion.

PROF. POON: Sir, first of all, I would like to congratulate the Government for the achievements made in fiscal year 1986. Areas like: a 16 per cent growth

in domestic exports; a 9 per cent growth in GPD; a reduction in unemployment and underemployment rate to 2.2 per cent and 1.2 per cent respectively; and a surplus on General Revenue Account of \$3 billion are indeed encouraging. I would further like to congratulate the Financial Secretary for a prudent Budget. The Budget proposals for fiscal year 1987 is clearly aimed at sustaining the economic revival in Hong Kong. I am pleased to note that 'Education' will be allocated 18.3 per cent of consolidated account expenditure compared with a 14.3 per cent five years ago which is in line with the Government's policy of improving educational facilities in Hong Kong. I also appreciate the introduction of a new basic personal allowance which will benefit some 100 000 people of the lower income group.

However, I am disappointed that there is no direct reference in the Budget proposals which aim at improving industrial development in Hong Kong. Today, I wish to comment on five areas relating to industrial development to be considered by the Financial Secretary:

1. *An effective mechanism for technology transfer*

Hong Kong has long been playing the passive role of 'matchmaker'—keen matching of imported technological products and processes with local industrial production needs. The approach is probably profitable in the short term but will be much less so in the medium or long term. It hinders flexibility, reduced cost effectiveness, and stifles innovation. If Hong Kong should move into high value-added production, we must breakthrough the current 'black-box' state in technology transfer. A solution to this is the strengthening of local research and development activities and developing local expertise who can make the best use of the imported technology. To accomplish this, there should be an effective mechanism in Hong Kong to co-ordinate various aspects associated with technology transfer, such as the promotion of emerging technologies in product innovations and industrial design, the provision of a satisfactory environment and facilities for product research and prototype development, and the disseminations of technological know-how to local industrialists.

2. *Tax incentive for local industries*

The proposed increase in duty on imported hydrocarbon oil, coupled with the Government's intention to impose stricter controls on pollution would result in an extra financial burden on local industries. The Government should consider adopting a policy to protect local manufacturing industries from any damaging effects, especially for the small and medium-sized factories, in the course of implementing a stricter pollution control for better living conditions of the community. I request the Government to consider providing tax concessions, by way of an incentive, to those industrialists who help to improve the environment by taking effective steps, such as using more expensive oil, adding extra equipment, using more expensive industrial processes to reduce the level of industrial pollution.

3. *Constant monitoring of the progress of industrial development*  
In 1979, a report to review Hong Kong's strategy in industrial development was published by the Advisory Committee on Diversification. While the Industry Department is still making references to this report in industrial development, it must be noted that many variables have changed in the last eight years. It is critical to reappraise the issue. I, therefore, fully support the request made by my colleague the hon. Stephen CHEONG last year that the Government should consider, review and assess in detail: (a) the achievements since the publication of that report; (b) the effects, adverse or otherwise, of actions taken by the Government on our manufacturing sector; and (c) the measures which have to be taken in the future to enhance the prospect of future economic growth in Hong Kong.
4. *More pragmatic market studies on industrial development*  
I appreciate the efforts made by the Industry Development Board in conducting techno-economic and marketing research studies on various industries to identify trends for industrial development. However, knowing that there will usually be a time lag between the publication of study results and the appropriate action to be taken, I think the studies should incorporate the dynamic and volatile features in the market and include projections and forecasts which are capable of being acted upon in time. A continual monitoring of these studies to ensure their validity is also important. I request the Government to increase the funding for this effort. In the long term, this will benefit the economy as a whole.
5. *The establishment of an occupational safety and health council*  
There has been a recent up-trend of industrial accidents in Hong Kong. Many of these were caused by the lack of sufficient preventive measures or by the ignorance or negligence of the proprietors or employees on matters concerning industrial safety. Currently we have the Labour Department shouldering three different responsibilities altogether in industrial safety, that is, advisory; inspection; and prosecution. The prosecution role of this department would intimidate those who wish to seek advice on safety matters. To avoid such conflict of interests, I request the Government to set up an independent body such as an Occupational Safety and Health Council. This body should carry the functions of technical and professional consultancy; monitoring and advising on relevant Government policies, and promoting education and training programmes in industrial safety.

To recap, I request the Government to consider seriously the following five areas relating to industrial development in Hong Kong:

- (1) an effective mechanism for technology transfer;
- (2) tax incentive for local industries;
- (3) constant monitoring of the progress of industrial development;



- (4) more pragmatic market studies on industrial development; and finally
- (5) the establishment of an occupational safety and health council.

With these remarks, Sir I support the motion.

MR. SOHMEN: Sir, the difficulty in being the last man on the totem pole is how to be original—the other speakers have said it all before. The great advantage is that only half the Members are left to hear the repetitions.

Firstly, may I add my congratulations to those of many of my colleagues in applauding the Financial Secretary's first Budget. It is one of realism and prudence. There is always the temptation with a greater than expected surplus to offer it up speedily on the altar of popularity; the Financial Secretary has competently resisted doing this. But then of course he does not need to worry about elections! [*Laughters*] I fully concur in his warning that our current excellent economic performance is not based on any inherent strengths, but is derived from—and in turn very much dependent on—external factors. The weak US dollar especially, and our linked exchange rate have provided Hong Kong with good chances in 1986 to improve export performance, opportunities which Hong Kong was fortunately able, and ready, to exploit. And while I see no reason for the US dollar to rebound in the short term, major currency swings have become so unpredictable and largely uncontrollable that we should never be foolish enough to believe that we can rest on our laurels. The Government's short- and medium-term estimates can probably only be considered educated guesses, as recent evidence confirms, and although I do not disagree with them—they may for 1987-88 in fact be erring again on the side of caution—there is certainly no assurance that they will actually come true. So good housekeeping should continue, particularly since the Financial Secretary did not really have to deprive any one sector of what is needed; the commitments of HK\$6 billion in new capital spending speak for themselves. Of course, not everyone ever will and can be satisfied, and there is a hallowed tradition of nitpicking when assessing any Budget, even one as good as this.

In this nitpicking category, I would like to mention three items: one an omission, one a delay, and one an observation, for the Financial Secretary's further consideration.

The airport departure tax has been widely criticised for being too high, discouraging additional tourist traffic, and as being inequitable and burdensome particularly for the many thousands of Hong Kong residents travelling annually to the mainland by air. While the tax is admittedly productive and cost effective, these are not in themselves good enough reasons for it not to be reduced at least in times of surplus, since it was introduced and later increased in deficit years for the purpose of raising additional revenue. With many new investments in hotels and exhibition and convention facilities

coming to fruition over the next few years, everything possible should be done to maintain Hong Kong's competitive edge in tourist and business travel. Alternatively, and if the Financial Secretary remains stubbornly committed to this tax, perhaps he should imaginatively consider it as a possible source for the solution of the current problems related to consumer protection, following the regular failures of travel agencies and Government's apparent reluctance to get too much involved in an effective supervisory role over them.

The next issue of detail is the question of double taxation. Echoing Mr. Peter POON and Mr. CLYDESDALE, I am somewhat disappointed that not more progress has been made on that front to-date. The proposed time apportionment arrangements are welcome but are being introduced for the sake of administrative convenience and do not address the questions of double taxation which is particularly relevant in the light of the strengthening economic links between Hong Kong and the People's Republic of China. In this connection, I would also like to mention a new problem looming ahead for the local ship-owning industry (I must declare an interest as one of its members), resulting from the passage of the US Tax Reform Act of 1986. This legislation imposes a tax liability on the beneficial owners for gross freight earnings from ships trading to US ports irrespective of the vessel's flag. If the territory of domicile of the beneficial majority owner of the vessel concerned, such as Hong Kong, has no agreement with the United States providing for mutual exemption or reduction of tax liability, owners may possibly need to consider such extremes as physical relocation away from Hong Kong. I am sorry to mention tax aspects of shipping operations in every second speech I make, but shipping is and will remain an important industry for Hong Kong and this new difficulty will have to be addressed with some urgency. The shipping community is presently working on more background for appropriate liaison with the Financial Secretary and his senior advisers.

The observation I have concerns another old chestnut of mine: the size of, and remuneration for the Civil Service. It is not always a question of restraining growth rates year on year, commendable as this may be, but also whether the given size is absolutely necessary. Let us remember that in Hong Kong we have one civil servant for roughly every 30 citizens. Now, I am not suggesting that we are not getting value for our money, since by and large we have an effective Civil Service—I only wonder whether we could do with a little less gold-plating, or possibly with more privatisation.

Back to generalities. Over the past 15 years, Hong Kong has been eminently successful in developing its services sector, so much so that its growth is now outpacing the manufacturing sector. Financial services, in particular, have seen a rapid expansion during the past few years, no longer mainly geared to the support of local manufacturing, trading, or infrastructural development but also increasingly dealing internationally. This development has brought with it (1) greater pressures to adapt the local regulatory framework to that applying in other financial centres, and (2) a greater exposure by Hong Kong's financial

system to global banking problems, for example LDC debts or problems in major commodity markets. It would be extremely short-sighted to believe that the repercussions of significant debtor defaults around the world would not also be felt in Hong Kong, and actions such as those taken by financial institutions to strengthen their capital base should therefore not only be encouraged but be imitated whenever possible. I agree that we do need some further regulation in the financial and securities sectors to avoid fraudulent practices or obvious mismanagement, but I am also very much in support of the Financial Secretary's suggestion that we must proceed with caution in this area, particularly—I believe—on the question of criminalisation of insider trading. Reputation of a market is one thing, but the risk of also driving bona fide business away at the same time, on which so many of our financial institutions increasingly depend, is another.

Sir, I would today like to join the growing chorus of those who argue that we must continuously be creative in our thinking, and generous with our purse, to do all we can in Hong Kong to upgrade our manufacturing and production skills. Although capital investment fortunately showed an increase again in the last year, we must ensure that we do not fall too much behind our neighbours in the high-technology race, and that we retain a high level of productivity—keeping in mind also the tight labour market and that production facilities are operating near capacity. I particularly welcome the additional commitments made in the field of education in this Budget, as I did warmly support the decision to establish the third university earlier.

Finally, a word on the interesting question posed by the Financial Secretary as to the advisability of trying to achieve a broader tax base by widening the net of indirect taxes. This seems to be a fashionable topic in a number of countries. In Japan, for example, such proposals are presently causing considerable political controversy—something we should avoid in Hong Kong, if at all possible, since we have enough controversies already. There is a lot of logic in the Financial Secretary's quoted list of advantages in an increase in indirect taxes, especially since in Hong Kong the direct tax base is indeed unusually small. The Financial Secretary's reference to the possibility of a more stable fiscal regime with lower direct taxes is, of course, appealing, and one must give him credit for emphasising that a move in the direction of indirect taxes ought to be checked against cost-of-living effects, and both the economy and efficiency of collection. These criteria would favour something like a general manufacturer's sales tax covering all goods manufactured or imported into Hong Kong. A value added tax on the other hand has shown itself to be expensive in collection and is unpopular in many countries which have adopted it; it would no doubt be unpopular here and difficult to enforce. A general indirect tax would also be preferable to a selective tax only on a range of specified goods, since a general tax is less likely to distort relative prices.

Indirect taxes broadly applied (that is, not just on 'luxury' items—assuming we can actually even get agreement on these definitions) are considered regres-

sive as they increase the tax load on the lower income groups. In political terms it may therefore be difficult to introduce them in a place such as Hong Kong where there is still a considerable difference between higher and lower income earners. The move towards a larger scope for indirect taxation would have to defuse possible criticism that they are imposed to produce benefits mainly for those now bearing the burden of direct taxes, in other words, those in the higher salary brackets, and corporate entities. For this reason, too obvious a link between the widening of the scope of indirect taxes and a lowering of direct taxes might need to be avoided, although questions would then undoubtedly be asked why indirect taxation is to be extended at all in the absence of any immediate need to generate additional revenue.

One other drawback of indirect taxation is its more limited responsiveness in revenue terms to positively changing economic fundamentals; on balance, therefore, I would advise the Financial Secretary to tread very carefully when walking down this particular road, even though I agree with him that the proportion of direct taxes contributing to total revenue should be kept at a level of certainly not more than 60 per cent. Perhaps we should watch the outcome of the debate in other countries a bit longer, or as Mr. CLYDESDALE has suggested, let us read the Australian tax paper, and then ask Government to produce a comprehensive set of options and their respective pros and cons before we jump. Understandably, no government wants to show too many of its cards too soon on the tax front, but since we are talking about a significant change in tax philosophy, any new approach should have had the benefit of objective and wide professional scrutiny before being introduced. There is no particular urgency just now.

However, Sir, as there is probably some urgency to conclude the debate for today, I would now like to support the motion.

### **Suspension of sitting**

HIS EXCELLENCY THE PRESIDENT: In accordance with Standing Orders I now suspend the Council until 2.30 pm tomorrow.

*Suspended accordingly at twenty-five minutes to Eight o'clock.*