

OFFICIAL REPORT OF PROCEEDINGS**Wednesday, 2 March 1988****The Council met at half-past Two o'clock****PRESENT**

HIS EXCELLENCY THE GOVERNOR (PRESIDENT)

SIR DAVID CLIVE WILSON, K.C.M.G.

THE HONOURABLE THE CHIEF SECRETARY

SIR DAVID ROBERT FORD, K.B.E., L.V.O., 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.

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

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

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

THE HONOURABLE DONALD LIAO POON-HUAI, C.B.E., J.P.

SECRETARY FOR DISTRICT ADMINISTRATION

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

THE HONOURABLE JOHN JOSEPH SWAINE, C.B.E., Q.C., 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.

THE HONOURABLE CHAN YING-LUN, J.P.

THE HONOURABLE MRS. RITA FAN HSU LAI-TAI, O.B.E., 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, O.B.E., C.P.M., J.P.

THE HONOURABLE KIM CHAM YAU-SUM, 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 CHENG HON-KWAN, J.P.

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

DR. THE HONOURABLE CHIU HIN-KWONG, J.P.

THE HONOURABLE CHUNG PUI-LAM

THE HONOURABLE THOMAS CLYDESDALE, J.P.
THE HONOURABLE HO SAI-CHU, M.B.E., J.P.
THE HONOURABLE HUI YIN-FAT
DR. THE HONOURABLE CONRAD LAM KUI-SHING
THE HONOURABLE MARTIN LEE CHU-MING, Q.C., J.P.
THE HONOURABLE DESMOND 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
THE HONOURABLE SZETO WAH
THE HONOURABLE TAI CHIN-WAH
THE HONOURABLE MRS. ROSANNA TAM WONG YICK-MING
THE HONOURABLE TAM YIU-CHUNG
DR. THE HONOURABLE DANIEL TSE, O.B.E., J.P.
THE HONOURABLE ANDREW WONG WANG-FAT
THE HONOURABLE LAU WONG-FAT, M.B.E., J.P.
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
THE HONOURABLE NATHANIEL WILLIAM HAMISH MACLEOD, J.P.
SECRETARY FOR TRADE AND INDUSTRY
THE HONOURABLE EDWARD HO SING-TIN, J.P.
THE HONOURABLE GEOFFREY THOMAS BARNES, J.P.
SECRETARY FOR SECURITY

ABSENT

THE HONOURABLE PETER C. WONG, C.B.E., J.P.
THE HONOURABLE HU FA-KUANG, O.B.E., J.P.
DR. THE HONOURABLE HENRIETTA IP MAN-HING, O.B.E., J.P.
THE HONOURABLE RICHARD LAI SUNG-LUNG
PROF. THE HONOURABLE POON CHUNG-KWONG
THE HONOURABLE HELMUT SOHMEN
THE HONOURABLE GRAHAM BARNES, C.B.E., J.P.
SECRETARY FOR LANDS AND WORKS

IN ATTENDANCE

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

Papers

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

<i>Subject</i>	<i>L.N. No.</i>
Subsidiary Legislation:	
Public Order Ordinance	
Public Order Curfew (Variation) Order 1988.....	36/88
Inland Revenue Ordinance	
Inland Revenue (Interest Tax) (Exemption) (Amendment) (No. 2) Notice 1988	37/88
Tax Reserve Certificates (Fourth Series) Rules	
Tax Reserve Certificates (Rate of Interest) Notice 1988	38/88
Hong Kong Airport (Control of Obstructions) Ordinance	
Hong Kong Airport (Control of Obstructions) (Consolidation) (Amendment) Order 1988.....	39/88
Public Health and Municipal Services Ordinance	
Public Health and Municipal Services (Amendment of Fifth Schedule) Order 1988	40/88
Employment Ordinance	
Women and Young Persons (Industry) (Amendment) Regula- tions 1988	41/88
Registration of Persons Ordinance	
Registration of Persons (Application for New Identity Cards) (No. 2) Order 1988	42/88
Small Claims Tribunal Ordinance	
Small Claims Tribunal (Fees) Rules 1988.....	43/88
Labour Tribunal Ordinance	
Labour Tribunal (Fees) Rules 1988	44/88
Lands Tribunal Ordinance	
Lands Tribunal (Fees) Rules 1988.....	45/88
Coroners Ordinance	
Coroners (Fees) Rules 1988.....	46/88
Legal Practitioners Ordinance	
Legal Practitioners (Fees) (Amendment) Rules 1988.....	47/88
New Territories Leases (Extension) Ordinance 1988	
New Territories Leases (Extension) Ordinance 1988 (Com- mencement) Notice 1988	48/88

Sessional Papers 1987-88:

- No. 46—Police Welfare Fund Income and Expenditure Accounts with balance sheet and certificate of the Director of Audit for the year ended 31 March 1986
- No. 47—Draft Estimates for the year ending 31 March 1989 Estimates Summaries—General Revenue Account and Fund Accounts including Controlling Officers' Reports on Heads of Expenditure
- No. 48—Draft Estimates for the year ending 31 March 1989 Supporting Details Section I: General Revenue Account
- No. 49—Draft Estimates for the year ending 31 March 1989 Supporting Details Section II: Funds

Government Business

First Reading of Bill

APPROPRIATION BILL 1988

Bill read the First time and ordered to be set down for Second Reading pursuant to Standing Order 41(3).

Second Reading of Bill

APPROPRIATION BILL 1988

THE FINANCIAL SECRETARY moved the Second Reading of: 'A Bill to apply a sum not exceeding \$49,975,838,000 to the service of the financial year ending on 31 March 1989'.

	<i>Paragraphs</i>
INDEX	
INTRODUCTION	1- 6
THE ECONOMY IN 1987	7- 18
PRESENT STATE OF PUBLIC FINANCES AND REVISED ESTIMATES 1987-88	19- 24
ECONOMIC PROSPECTS FOR 1988	25- 28
STRATEGY FOR PUBLIC FINANCES	29- 30
The Medium Range Forecast	31- 35
Strategy for expenditure	36- 46
Strategy for revenue	47- 50
The Government's reserves	51
DRAFT ESTIMATES 1988-89	52
Draft Estimates of Expenditure	53- 63
Draft Estimates of Revenue	64- 67
Summary of Draft Estimates	68- 72
REVENUE MEASURES	73
Dutiable commodities	74- 81
Fees and charges	82- 88
Tax concessions	89
Personal taxation	90- 91
Taxation of married women	92- 94
Profits tax	95- 96
Property tax, interest tax and profits tax paid by unincorporated businesses	97
Stamp duty	98- 99
Air passenger departure tax	100
IMPLEMENTATION	101
SUMMING UP	102-110
	<hr/>
	<i>Pages</i>
APPENDICES A—F	817-864

He said: Sir, I move that the Appropriation Bill 1988 be read the Second time. Last year in presenting my first Budget to this Council I warned that Hong Kong remained as vulnerable as ever to external forces, and that volatility in our economic performance was inevitable. Like others I recognised that there were some clouds on the horizon but I did not predict when the storm would break. The warnings I gave then remain valid today. Already there are signs that the extraordinarily rapid growth we have enjoyed over the last two years is slowing down.

2. As 1987 progressed, it became apparent that the economy, including our stock market, was becoming overheated. Few, however, foresaw the full extent of the October crash, which affected not only Hong Kong's stock market but also stock markets worldwide. I shall be referring later in this speech to those events and the aftermath. But I mention them now for three reasons. First, I think it is important to note that we still cannot say with any certainty what will be their effect on the world economy and therefore on Hong Kong itself. Secondly, in Hong Kong and in some other major markets attention has become sharply focussed on the operation and structure of the market place. Many are asking what improvements need to be made to ensure that the markets are capable of carrying out the job for which they are intended. Thirdly, perhaps the single most important message that has come through clearly is that technology has increasingly made the world a single market. There may be many players but there is only one play.

3. But today we must not let ourselves be overcome by gloom. Almost all the economic indicators show that Hong Kong has done extremely well in the last 12 months and our immediate prospects are good. What I shall be saying this afternoon will reveal the extent to which our buoyant economy will enable me not only to increase the provision of government services but also to ease the tax burden on the community without putting our economy or the longer-term stability of our budgetary management at undue risk.

4. A Budget speech does not merely give a snapshot of the state of the economy and the public finances at a particular point in time. More importantly, it gives us the opportunity to examine our performance since the last Budget and to forecast what the economy may have in store for us next year and in the years beyond. This approach reflects what I believe should be the underlying theme in the management of our public finances—the careful planning of public services in the light of what we can afford over the longer term. I must stress that the prudent management of our public finances, given the cyclical nature of our economy, depends to a great extent on our continuing to pay close attention to trends and on taking early action where necessary to avoid more extreme measures at a later date. As I reveal my budgetary proposals for 1988-89, I hope it will be apparent how this underlying theme of steady management has, once again, been woven into my thinking.

5. From time to time, Members have usefully commented on the presentation of the documents supporting the Budget. This year, I have altered the format of the Draft Estimates. Under each head of expenditure, we have provided sufficient detail to enable Members to identify not only the objectives of each department but also how the funds to be appropriated to each head will be devoted to achieving those objectives. In addition, we have attempted to give measures of both output and effectiveness. I hope that the changes that we have made will be seen by Members as an improvement. The task continues. I am particularly conscious of the need to give further consideration to the refinement of our Consolidated Account definition.

6. I shall now embark upon the substance of this Budget by describing the performance of the economy in 1987⁽¹⁾.

THE ECONOMY IN 1987

7. The trend begun in 1986 of strong export-led growth continued through 1987. The sharp rise in our domestic exports and re-exports in turn boosted incomes and domestic demand. As a result, our gross domestic product (GDP) recorded a growth rate of about 13.5 per cent in real terms⁽²⁾. Thus we have enjoyed two consecutive years of double-digit growth⁽³⁾.

8. This remarkable economic performance has benefited Hong Kong in a number of ways. First, the buoyant economic conditions led to a substantial increase in capital investment and an active property market. Secondly, with the unemployment rate staying at a historic low level of 1.8 per cent during much of 1987, we had in effect full employment throughout the year. Thirdly, wages and salaries rose rapidly, resulting in a significant increase in personal incomes, even after allowing for inflation. The community at large shared in the fruits of our economic success.

(1) See '1987 Economic Background' for further details.

(2) Unless otherwise indicated all subsequent growth rates for the economy are in real terms. This growth rate for the GDP is a preliminary estimate. The growth rates of the various major components of expenditure on the GDP in 1987 are as follows:

	<i>percentage</i>
<i>Private consumption expenditure</i>	10.8
<i>Government consumption expenditure</i>	4.7
<i>Gross domestic fixed capital formation</i>	15.2
<i>of which, in building and construction</i>	6.6
<i>in plant and machinery</i>	27.3
<i>Total exports of goods</i>	33.0
<i>Domestic exports</i>	23.2
<i>Re-exports</i>	45.9
<i>Imports of goods</i>	31.7
<i>Net exports of services</i>	29.4
<i>Gross domestic product</i>	13.6

(3) The provisional estimate of the growth rate of GDP in 1986 is 11.2 per cent.

9. At a time when the economy was operating at full capacity, public sector expenditure grew more slowly than that of the private sector. This minimised, as was entirely appropriate, the extent to which resources were absorbed by the public sector⁽⁴⁾.

10. During the year, our imports also increased rapidly in line with the strong growth in our economy. Overall our visible trade account in 1987 was roughly in balance⁽⁵⁾. So although we have been maintaining trade surpluses with many of our major markets we have used our export earnings to buy what we need from our major suppliers, with many of whom we run large trade deficits. We do not amass vast surpluses on our visible trade account. We are free traders in the full sense of that term.

11. I draw particular attention to our visible trade account and our large trade deficits with a number of economies because our trade surpluses with some economies, particularly the United States, have been cited as a reason for changing the linked exchange rate. Our overall visible trade balance provides no justification whatsoever for a change in the linked rate, especially since a change would involve a revaluation of the Hong Kong dollar against the currencies of trading partners with whom we already have large visible trade deficits.

12. In the light of the intense speculative pressure to which our exchange rate has been subjected from time to time, I wish to emphasise that the Government must have regard to the long-term overall interests of Hong Kong and its community. The linked rate system is a vital element of stability for Hong Kong; and it provides a mechanism for monetary control. I have no intention of altering the current rate.

(4) *Government expenditure in national accounts terms differs from that shown in the Consolidated Account. Details of the difference are given in Appendix A. In national accounts terms, public sector expenditure grew by about 6 per cent in 1987; the corresponding growth rate of private sector expenditure was about 12 per cent. Taking into account changes in prices, the share of public sector expenditure in aggregate domestic demand dropped from 11 per cent in 1986 to 10.6 per cent in 1987. However, as regards expenditure on building and construction, a growth rate of 6.9 per cent was recorded for the public sector in 1987, compared with a figure of 6.4 per cent for the private sector.*

(5) *Hong Kong's visible trade in 1987:*

	<i>\$ million</i>	<i>percentage of increase in money terms</i>
<i>Domestic exports</i>	<i>195,254</i>	<i>26.8</i>
<i>Re-exports</i>	<i>182,780</i>	<i>49.2</i>
<i>Total exports</i>	<i>378,034</i>	<i>36.7</i>
<i>Imports*</i>	<i>379,989</i>	<i>36.9</i>
<i>Visible trade balance</i>	<i>(1,955)</i>	

*Visible trade deficit as a percentage of the
total value of imports of goods 0.5 per cent*

** Including an estimate of imports of gold for industrial and commercial use.*

13. The essence of our system is that adjustments do not take place through the exchange rate itself, but through changes in other aspects of the economy, a process which may include changes in the rate of inflation. Our recent inflation rate crept up over the course of 1987, but remains fairly moderate by historical standards⁽⁶⁾. In the fourth quarter of 1987, the Consumer Price Index (A) was 6.7 per cent higher than a year earlier, while for 1987 as a whole, the average annual increase was 5.5 per cent. Some of the inflation was imported, partly reflecting the weakening of the Hong Kong dollar against most other major currencies, and some arose on the high liquidity and pressure of demand within the economy.

14. With the economy operating at full capacity, labour shortages became widespread in 1987. And in response, local producers have displayed a remarkable degree of flexibility and ingenuity in increasing productivity. They have also made significantly more use of outward processing facilities in China. This increased inter-relationship of our economy with that of China was a marked feature of last year and seems likely to continue this year. There are benefits for all in the development of this relationship.

15. The pressure of demand and the resulting labour shortages set in train the adjustment process, which is bringing about a gradual slowdown in the growth rate of the economy. In the later part of last year, the growth rate of our exports eased somewhat, and more recently there have been some signs that the pressure of demand on resources is beginning to slacken.

16. The events of last October in the world's stock markets may have lessened some of the pressure on resources and thus shortened this adjustment process in our economy. Before I leave monetary and economic matters, therefore, I must say a few words about our own securities market. Much has been written and said about the crash and its implications. What took place in our market was in part a response to world events. The sharp falls were not a reflection of weaknesses in our economy. Nevertheless, there is no doubt that our systems were shown to be less than adequate, and it was for this reason, Sir, that you appointed the Securities Review Committee to examine critically the relevant structures and systems with a view to recommending improvements. We in Hong Kong are not alone in recognising the need to draw lessons from the crash. Other major markets, including London and New York, are conducting somewhat similar reviews. Our Securities Review Committee, under the able chairmanship of Mr. Ian Hay DAVISON, is now hard at work and we look forward to its report.

(6) *Rate of increase of consumer prices over the past decade:*

<i>Rate of increase of CPI(A) (per cent)</i>			
<i>1978</i>	<i>5.9</i>	<i>1983</i>	<i>9.9</i>
<i>1979</i>	<i>11.6</i>	<i>1984</i>	<i>8.1</i>
<i>1980</i>	<i>15.5</i>	<i>1985</i>	<i>3.2</i>
<i>1981</i>	<i>15.4</i>	<i>1986</i>	<i>2.8</i>
<i>1982</i>	<i>10.5</i>	<i>1987</i>	<i>5.5</i>
<i>Average 8.7 per cent</i>			

17. In the meantime, various improvements are being carried out by both the Stock Exchange and the Futures Exchange in order to deal with immediate problems that have been identified. It is important that where steps can be taken to further safeguard investors those steps should not be delayed pending the recommendations of the Securities Review Committee.

18. The Government, for its part, continues to put together proposals in relation to the disclosure of beneficial interests in the shares held by directors and other substantial shareholders of public listed companies. Comments on the published White Bill have been received and I intend to seek the advice of the Executive Council in the near future. The subject of insider trading is also under active consideration, and again I am on the point of taking proposals to the Executive Council.

PRESENT STATE OF PUBLIC FINANCES AND REVISED ESTIMATES 1987-88

19. Sir, I turn now to the present state of our public finances. In sum, the expected position at the end of the financial year 1987-88 is one of higher than forecast revenue yields but with expenditure close to Budget. The surge in government revenue which began in 1986-87 has continued through 1987-88. Two years of double-digit economic growth have lifted our revenue base significantly.

20. The revised estimate of expenditure on General Revenue Account of \$44.5 billion, including transfers to funds, is close to the original Estimate for the year. Expenditure on our various funds of \$11.3 billion is about 5 per cent above Budget, due mainly to a purchase of quarters for the police force which was not allowed for in the original Estimates. Therefore, spending in cash terms on General Revenue Account and funds taken together is about 1 per cent above the original Estimates⁽⁷⁾. Nevertheless, higher than expected inflation means

(7)	<i>Expenditure 1987-88</i>		
	<i>\$ million</i>		
	<i>Revised Estimate</i>	<i>Original Estimate</i>	
<i>General Revenue Account</i>	44,474	44,409	
<i>Less transfers to funds</i>	6,600	6,600	
		37,874	37,809
<i>Capital Works Reserve Fund</i>	7,700	7,050	
<i>Development Loan Fund</i>	1,638	1,690	
<i>Home Ownership Fund</i>	751	752	
<i>Mass Transit Fund</i>	1,109	1,102	
<i>Student Loan Fund</i>	93	103	
<i>Total—funds</i>		11,291	10,697
<i>Total General Revenue Account +funds</i>		49.165	48.506
<i>(excluding transfers to funds)</i>			

that 'real' expenditure growth for the year is, in fact, slightly below the budgetted figure.

21. In Consolidated Account terms, real expenditure growth is now expected to be about 4.6 per cent compared with an original Estimate of 4.9 per cent⁽⁸⁾. Furthermore, as a result of the exceptional growth rate in the economy, Consolidated Account expenditure as a proportion of GDP has fallen from 16 per cent in 1986-87 to around 15 per cent. The growth in the establishment of the Civil Service at just over 3 per cent is in line with the budgetted figure⁽⁹⁾.

22. Transfers to the various funds from General Revenue Account of \$6.6 billion will be as budgetted.

23. The original Revenue Estimates for the year were formed on the assumption at that time of GDP growth of around 8.5 per cent in 1986 and 6 per cent in 1987. As we have seen, actual economic growth has been considerably better. I now expect the revenue yield on General Revenue Account to be 9 per cent above the original estimate. Combining General Revenue Account and fund account revenue the increase on the original Estimate is 11 per cent⁽¹⁰⁾. Stamp duty at \$5 billion is nearly double the original Estimate; whilst salaries tax, profits tax, motor vehicle first registration tax and land sales revenue, all of which normally benefit from a strong economic performance, also have higher than expected yields.

24. As a consequence of the gains in our revenue yields, I now expect a much higher than budgetted surplus on General Revenue Account of some \$6.1 billion. When combined with our fund accounts, the surplus becomes \$7.6

(8) See Appendix A, paragraph 22 for the definition of Consolidated Account.

(9) The position at the Budget cut-off date (19 December) compared to a year earlier.

	Revenue 1987-88	
	\$ million	
	Revised Estimate	Original Estimate
General Revenue Account	50,564	46,177
Capital Works Reserve Fund	3,380	2,220
Development Loan Fund	767	635
Home Ownership Fund	1,951	1,797
Mass Transit Fund	—	—
Student Loan Fund	76	76
Total—funds*	6,174	4,728
Total General Revenue Account +funds	56,738	50,905

*Excluding transfers from General Revenue Account.

billion⁽¹¹⁾. Substantial as this surplus may seem, it must be remembered that it is the product of two years of exceptional economic performance.

ECONOMIC PROSPECTS FOR 1988

25. I shall now say a few words about our economic prospects for the year ahead. Economic forecasting is always difficult; this year it is made even more so by the prevailing climate of uncertainty in the world economy. Subject to this caveat, I expect 1988 to be a year of consolidation, with a more balanced pattern of growth between external and domestic demand.

26. Nevertheless, the demand for Hong Kong's products in our major overseas markets remains crucial to our overall economic performance. In the United States, the likely setback in consumer demand carries with it the expectation of only a small growth in domestic exports to our largest overseas market. And, looking further ahead, the forthcoming exclusion of our exports from the United States Generalised System of Preferences seems likely to affect adversely our economic performance in 1989. Fortunately, the outlook is brighter for our domestic exports to Japan, the Federal Republic of Germany and the United Kingdom. And notwithstanding continued import controls, the recent growth trend in our domestic exports to China is still strong, although some reduction in growth during the course of this year seems likely as a result of a slower development in outward processing. Overall, I forecast an increase in domestic exports of 6 per cent. Re-exports are expected to grow by 12 per cent. Together these two forecasts result in a forecast growth rate of 9 per cent for total exports.

27. Domestically, private consumption expenditure is expected to grow more moderately in 1988, although at a higher rate than that of GDP, largely reflecting the recent rapid growth in incomes. Capital expenditure on building and construction is expected to rise moderately with most of the growth

(11)	<i>Surplus/(deficit) 1987-88</i>			
	<i>\$ million</i>			
	<i>Revised Estimate</i>			<i>Original Estimate</i>
	<i>Before transfers</i>	<i>Transfers</i>	<i>After transfers</i>	<i>(After transfers)</i>
<i>General Revenue Account</i>	12,690	(6,600)	6,090	1,768
<i>Capital Works Reserve Fund</i>	(4,320)	5,080	760	250
<i>Development Loan Fund</i>	(871)	1,000	129	(55)
<i>Home Ownership Fund</i>	1,200	—	1,200	1,045
<i>Mass Transit Fund</i>	(1,109)	500	(609)	(602)
<i>Student Loan Fund</i>	(17)	20	3	(7)
<i>Total—funds</i>	(5,117)	6,600	1,483	631
<i>Total General Revenue Account +funds</i>	7,573	—	7,573	2,399

attributable to the private sector. Expenditure on plant and machinery is likewise expected to show only a modest increase, following the substantial growth recorded in 1987.

28. This pattern of growth gives a forecast growth rate of GDP for 1988 of 5 per cent⁽¹²⁾. My forecast leads me to the following conclusions. First, given the tight labour market in 1987 the unemployment rate is likely to remain low this year despite a reduced rate of economic growth. Secondly, the rate of inflation is expected to average about 7 per cent⁽¹³⁾. Thirdly, as total final demand in the economy is likely to rise faster than the supply of output, some of this growth in demand will have to be met by additional imports⁽¹⁴⁾. Thus, our imports are forecast to grow by 9.5 per cent, and our retained imports by slightly over 7 per cent. This, coupled with a slight further deterioration in the terms of trade, should result in an increased visible trade deficit, giving further weight to some of the arguments I advanced against revaluation of our currency when I spoke of the state of the economy in 1987 a moment ago⁽¹⁵⁾. And lastly, the forecast growth rate of the GDP in money terms is about 13 per cent in 1988. At current prices, per capita GDP would thus reach about \$72,000, equivalent to US\$9,200.

STRATEGY FOR PUBLIC FINANCES

29. Before I describe in detail my strategy for the public finances, it is necessary for me to say a few words about the trend growth rate of GDP. As in last year's Budget, I have assumed a trend growth rate of 5.5 per cent in real terms for the forecast period. Whilst I accept that this may seem low when compared with two years of double-digit economic growth, the negative growth

(12) *The forecast growth rates of the various major components of expenditure on the GDP in 1988 are as follows:*

	<i>percentage</i>
<i>Private consumption expenditure</i>	6.5
<i>Government consumption expenditure</i>	5.6
<i>Gross domestic fixed capital formation</i>	4.0
<i>of which, in building and construction</i>	3.8
<i>in plant and machinery</i>	3.9
<i>Total exports of goods</i>	8.8
<i>Domestic exports</i>	6.0
<i>Re-exports</i>	12.0
<i>Imports of goods</i>	9.5
<i>Net exports of services</i>	10.0
<i>Gross domestic product</i>	5.5

For further details, see '1988 Economic Prospects'.

(13) *Rate of increase of the CPI(A) 7 per cent; of the GDP deflator 7.5 per cent.*

(14) *The forecast growth rate of total final demand (excluding re-exports), at slightly over 6 per cent, is higher than that of GDP, at 5 per cent.*

(15) *Import prices are forecast to increase by 4.5 per cent. Compared with a corresponding increase of 4.1 per cent for export prices, this would give a deterioration of 0.4 per cent in the terms of trade in 1988. The forecast of the visible trade deficit for 1988 is about \$6 billion, equivalent to 1.4 per cent of the total value of imports of goods.*

experienced in 1985 is a salutary warning that we should not be over-influenced by recent results. Furthermore, I have already commented on the likely impact of recent worldwide problems. In the light of these considerations, I prefer to maintain the 5.5 per cent trend growth rate assumption for the purposes of this Budget.

30. In the context of the economic and financial background I have just outlined, I shall now set the scene for the measures I propose for 1988-89. It will be clear from all that I have said so far that volatility and uncertainty continue to be facts of our economic life. Almost inevitably, we will experience considerable year to year variation in revenue dependent as it is on the performance of our economy. Notwithstanding these swings in revenue, our aim is to maintain stability in public expenditure growth. This strategy is essential to the orderly and efficient development of government services and the stability of our tax system. It is only through prudent and careful management, which involves looking ahead a number of years, that we can ensure that the Government's finances do not add to the innate volatility that affects our economy.

The Medium Range Forecast

31. Sir, Members will by now be familiar with the Medium Range Forecast, which we use to formulate our budgetary strategy. The forecast for the period up to 1991-92 is shown in an Appendix to the printed version of this speech and I commend it as a document for careful study⁽¹⁶⁾. Because it forms the basis for my specific Budget proposals for 1988-89, I shall highlight some of the more important features of this forecast.

32. First, while both performance and projections of government expenditure remain close to previous forecasts, revenue is running well ahead of earlier expectations. Two years of rapid economic growth have lifted tax yields to a higher base. If no further fiscal measures were taken, our average surplus over the forecast period up to 1991-92 would run at about \$5.9 billion a year.

33. Secondly, this level of surplus is well in excess of the \$2 billion or so that we need each year just to maintain the real value of our reserves. It reflects the underlying strength of our position and gives us some room for manoeuvre.

34. And thirdly, government expenditure in Consolidated Account terms as a proportion of GDP is forecast to remain slightly below the 16 per cent mark, around which it has been maintained in recent years. Our aim of not crowding out the private sector with public sector demand is being achieved. This is particularly important at a time when our economy is already running up against capacity constraints.

35. If we are to maintain stability in our public finances, expenditure plans must be related to our longer-term prospects rather than shaped on the basis of

(16) *Appendix A.*

just two years of exceptional revenue yields. It follows, therefore, that any adjustments in 1988-89 should relate primarily to revenue. In the light of the results we have achieved and taking account of our projections over the period of the Medium Range Forecast, some further lowering of tax rates is thus possible; it has been earned by the efforts of the community. But you will not be surprised to learn that the measures I shall outline to you later retain a proper element of caution dictated by the uncertainties against which we must continue to guard.

Strategy for expenditure

36. Average annual growth in Consolidated Account expenditure over the forecast period is projected to be 5.4 per cent in real terms. This is just a little higher than the 5 per cent contained in my 1987-88 Budget strategy, but remains within the trend growth rate assumption for GDP.

37. It is important not to lose sight of the fact that such a growth rate in expenditure means that public sector expenditure will almost double by the end of the next decade. As we face this overall and perhaps inevitable growth in spending, we must pay particular attention to recurrent expenditure; I have in mind staff and departmental expenses. We must ensure that these continuing and ever increasing commitments do not exceed our longer-term ability to finance them. Against this background, I draw attention to the fact that the detailed Estimates which I present today make provision for growth in the size of the Civil Service of some 4 per cent in 1988-89⁽¹⁷⁾. This is largely due to the staffing impact of some major new medical facilities and the build up of the Police Tactical Unit in preparation for taking over the work of the British garrison. These and other factors push staff growth beyond our target of 2.5 per cent a year.

38. There are potentially serious implications if such a high growth rate of 4 per cent in the size of the Civil Service were to continue. I have in mind the relationship between the size of the Civil Service and that of the labour force as a whole. The total labour force, which expanded by an average of 3.8 per cent in the 1970s and 2.4 per cent in the first part of this decade, is expected to grow by only 1.4 per cent for the remainder of this decade. Also, this rapid growth in the size of the Civil Service occurs at a time when the unemployment rate is particularly low. It may be unavoidable in the short term, but it cannot be permitted to continue indefinitely.

39. In a period of sustained expenditure growth, attention to priorities and to the effective deployment of resources is particularly important. It is therefore essential that our systems for appraising resource allocation be further refined. We aim to ensure that decisions are made in the context of planning for several years ahead. The Medium Range Forecast as an instrument to be utilised in the

(17) *After allowing for project slippage and savings from further Value for Money studies.*

determination of appropriate fiscal policies was one of the early developments in furtherance of this objective. From this beginning, our financial planning machinery is being developed to focus attention on relative priorities between programmes. There is now an increasing emphasis in the Budget documents on what is being done with money and what is being achieved.

40. In an effort to make the total Budget package more readily understood, new material has been provided this year to illustrate the distribution of resources between programmes⁽¹⁸⁾. As well as providing historical data, it also forecasts changes in the balance of spending in the light of current plans and commitments.

41. Let me draw attention to some of the major features. Since the beginning of this decade there has been a steady shift in emphasis towards the social services. In particular, education, medical and social welfare programmes have each significantly increased their share of total spending. The forecast indicates that this trend is set to continue. There are measures to improve welfare assistance for the elderly and the disabled who require constant attendance, a planned expansion of various welfare services, and major new facilities coming on stream such as the Hong Kong University of Science and Technology, the Tuen Mun Hospital and the Pamela Youde Hospital at Shau Kei Wan. Taken together, these result in a growth pattern in respect of social services that will ensure this sector an increasingly large slice of the cake in the coming years. Although we should accept this trend as a reflection of the aspirations of a developing community as it grows more prosperous, the burden on our Budget is something we must recognise and plan for. Also, when considering my revenue proposals, or indeed any possible revenue measures in future, it is important to bear in mind that this increased expenditure largely benefits the less affluent members of our community.

42. For many years, the driving force behind our development programmes has been the Government's determination to ensure that adequate housing is available for all. As a further step in this process it is intended that the Housing Authority will, with effect from next month, assume full financial responsibility for the Home Ownership Scheme, the Home Purchase Loan Scheme, temporary housing areas and cottage areas⁽¹⁹⁾. The new arrangements will ensure that the authority is able to plan a comprehensive housing programme in co-operation with the private sector, and with greater flexibility than before. The Government will, of course, continue to support the housing programme with finance and land as necessary, retaining its overall policy responsibility.

(18) *Appendix B.*

(19) *The new arrangements are subject to Legislative Council approval and their impact has therefore been excluded at this stage from the detailed estimate proposals and the Medium Range Forecast.*

43. We have already made a considerable impact on the provision of housing. Now the emphasis can increasingly be turned elsewhere. If we are to maintain economic progress we must ensure the efficient movement of people and goods within Hong Kong. Thus, greater priority must now be given to transport. In this respect, the Government is co-operating closely with the private sector in the planning and construction of several major transport projects such as the Eastern Harbour Crossing and Tate's Cairn Tunnel.

44. We need also to ensure that our external transport links-by land, sea, and air-remain adequate for our economic needs. We are continuing to improve our cross border road links; we are expanding the existing container port, and we are developing better facilities at Kai Tak. But there is a need to look beyond the short and medium term, towards the possible relocation of the airport and new port facilities. These long-term developments and their implications are receiving close government scrutiny.

45. Thus, it follows that beyond the present forecast period a higher proportion of the Government's total spending may have to be devoted to transport and infrastructural development even though we may look to the private sector to assume some of the financial burden. Bearing in mind our increasing commitments to the social services any additional public sector investment on our transport infrastructure will need to be carefully co-ordinated in order to ensure that our overall expenditure guidelines are not breached.

46. In the context of infrastructural development, I would like to say a few words about the Government's support for the manufacturing industry. The well-publicised rapid growth in importance of our financial and other services sectors has sometimes overshadowed the vital contribution that our manufacturing industry has made to our economic success. Industry remains a mainstay of our economy, accounting for some 22 per cent of our gross domestic product and 34 per cent of total employment. Our time honoured philosophy is that market forces should be allowed to determine the direction of our industry. Business decisions should be made by businessmen. Nevertheless, the Government accepts a responsibility to ensure a favourable environment for industry, with the availability of the necessary infrastructure and support services. So, on services related to industrial development, we are planning to spend, subject to this Council's approval, significantly more in 1988-89 than in earlier years and I shall be giving details later when I present my expenditure proposals.

Strategy for revenue

47. I turn now to my strategy for public revenue over the next few years. I have already indicated the potential that exists for a lowering of the tax burden. After allowing for the expenditure programmes, I am able to propose a package of taxation measures that overall will reduce recurrent revenue by about 5 per cent of present yields. The effect will be to reduce the average overall surplus in the Medium Range Forecast period to \$2.7 billion a year. This will still leave a

comfortable margin to maintain the value of our reserves in real terms and to provide a cushion for unforeseen events.

48. The balanced package that I shall detail later is however more than just a simple lowering of some tax rates. The particular measures I am proposing are designed to move our overall fiscal regime towards what I believe will be a more robust and equitable shape for the future.

49. When Members commented last year on my remarks about the potential value of a wider and more stable tax base, I gave an assurance that nothing would be proposed to alter the balance between direct and indirect taxes without the most careful consideration of the potential effects. Since then, we have been working to identify the advantages and disadvantages of different ways of bringing about such a move towards indirect taxes. In this regard, let me remind Members of the basic criteria which I consider any major new indirect tax should meet. First, it should produce a stable and worthwhile revenue yield at a low tax rate; secondly, it should cause minimal distortion to the economy; and thirdly, it should be simple and cheap to administer.

50. Whilst our researches are far from complete, they have tended to confirm my belief that a measure of tax diversification, together with some rationalisation of existing indirect taxes, is a practical proposition. What we have done so far suggests that a form of sales tax, though probably not at the retail level, best meets the criteria I have described. But this is a complex area and many factors remain to be considered. There is, therefore, much more to be done before I am able to present any proposals for public debate.

The Government's reserves

51. The impact of the strategy I have outlined on the level of the Government's consolidated reserves results in the forecast balances of \$40.5 billion at the end of 1987-88 rising to about \$46 billion by the end of 1988-89 after allowing for the taxation proposals that I shall be making this afternoon. The Medium Range Forecast shows that maintenance of these reserves in real terms will be achieved over the forecast period up to 1991-92. However, over this period the reserve balances will fall as a percentage of annual spending from about 77 per cent to 65 per cent⁽²⁰⁾. In this respect, our reserves have been higher only briefly in the early years of this decade when we experienced substantial windfall receipts from land sales. Sir, there can be no absolute guideline as to a satisfactory level of reserves. Nevertheless, the present position not only provides essential cover for our contingent liabilities and for fluctuations in our short-term cash flow but also assists us in maintaining fiscal stability over the longer term⁽²¹⁾.

(20) *Appendix A, paragraph 15.*

(21) *Contingent liabilities as at 31 March 1987 are listed in Appendix C.*

DRAFT ESTIMATES 1988-89

52. Against this background, I now present the Draft Estimates of Expenditure, the Revenue Estimates and my revenue proposals for 1988-89.

Draft Estimates of Expenditure

53. Dealing first with expenditure, the Medium Range Forecast, on which my Budget for 1987-88 was based, indicated that expenditure growth was expected to peak in 1988-89 due to the timing of payments in respect of the Kowloon Walled City clearance. As Members will see from the updated Medium Range Forecast, this is still the case. The Draft Estimates I submit today show expenditure on General Revenue Account of \$50 billion including transfers to funds. Expenditure on our various funds is estimated to be \$13 billion. Taking General Revenue Account and funds together, but excluding transfers, these Estimates represent an increase of about 13 per cent in cash terms over the Revised Estimate for 1987-88⁽²²⁾. This figure of \$50 billion for General Revenue Account includes \$3.8 billion for additional commitments to cover the usual range of new and unforeseen items that arise each year including possible salaries adjustments. In addition, this year, the provision allows for payments under a new Defence Cost Agreement when a new agreement is, in fact, concluded.

54. When coupled with the estimated expenditure of other public bodies such as the Housing Authority and the Urban and Regional Councils, the estimated growth rate on Consolidated Account is 15.7 per cent in cash terms and 7 per cent in real terms; that is to say 1.5 percentage points above our budgetary guideline. The Kowloon Walled City project accounts for some 1.2 percentage points of this real growth in Consolidated Account expenditure. I am, therefore, satisfied that after excluding this exceptional and one-off project, the remaining growth is broadly consistent with my intention of keeping the underlying trend to around 5.5 per cent.

(22)	<i>Draft Expenditure Estimates 1988-89 \$ million</i>	<i>Revised Estimates 1987-88 \$ million</i>
<i>General Revenue Account</i>	49,976	44,474
<i>Less transfers to funds</i>	7,410	6,600
	42,566	37,874
<i>Capital Works Reserve Fund</i>	10,180	7,700
<i>Development Loan Fund</i>	1,790	1,638
<i>Home Ownership Fund</i>	800	751
<i>Mass Transit Fund</i>	95	1,109
<i>Student Loan Fund</i>	109	93
	12,974	11,291
<i>Total—funds</i>	12,974	11,291
<i>Total General Revenue Account +funds (excluding transfers to funds)</i>	55,540	49,165

55. In coming to these figures, full allowance has been made for the cost of running new facilities and for responding to the underlying growth in demand for many of our services. In addition, there has been room within my guidelines to finance a number of major improvements or entirely new services. Some Members will note particularly that provision is made for the recently announced improvements in welfare benefits for the elderly. In all, the improvements in services planned for 1988-89 will cost \$560 million in the Budget year and about \$1.1 billion in a full year. A list of the more significant items is included in an Appendix to the printed version of this speech⁽²³⁾.

56. Consolidated Account spending on capital programmes, including the Kowloon Walled City clearance, is forecast to be \$16.9 billion—an increase of about 19 per cent on the previous year in cash terms. Major new projects to start in the year include several highway developments in both the New Territories and urban areas and land formation contracts in respect of the Tin Shui Wai development. Again, a fuller list is given in an Appendix⁽²⁴⁾.

57. As regards the composition of the expenditure estimates, I have already referred to the tendency in recent years for a higher proportion of our total resources to be devoted to social services. In this respect, 1988-89 will be no exception. In particular, we plan to spend on medical services \$6.1 billion on Consolidated Account, thus increasing the share from 9.4 per cent in the current year to 9.7 per cent as we service some of the major new facilities coming on stream. And on social welfare services, total spending is estimated at \$3.9 billion, an increase in the share from 5.7 per cent in 1987-88 to 6.3 per cent. This is partly due to the improvements in welfare benefits for the elderly and for the disabled who require constant attendance, but also is a result of the expansion of various welfare services. Furthermore, we should not lose sight of the impact of past Budgets. The cumulative real increase in spending on medical and social welfare services since 1983-84 will be 46 per cent and 45 per cent respectively.

58. Of the Consolidated Account expenditure in 1988-89, 12.6 per cent will be allocated to housing. In 1988-89, the Housing Authority expects to produce some 45 000 rental flats, the highest number of such flats ever produced in a single year. Twelve thousand one hundred and sixty flats are expected to be produced under the Home Ownership and Private Sector Participation Schemes next year, which is 21 per cent over the average annual production target under these schemes. This increased production level will help meet the very welcome demand for home purchase.

(23) *Appendix D.*

(24) *Appendix E.*

59. Net land production in 1988-89 is expected to be 165 hectares compared with a Revised Estimate of 174 hectares for 1987-88. Over the three years of the forecast period 1989-90 to 1991-92, total production is expected to be 1 092 hectares⁽²⁵⁾.

60. I referred earlier to the proposal to increase our expenditure significantly in support of our manufacturing industry. We are already committed to spending over \$1 billion a year on services for industry. Our plans for increased expenditure in 1988-89 include a grant to the Hong Kong Productivity Council for the first year of a new three-year programme for upgrading and expanding its productivity enhancement services, a grant to assist towards the creation of a plastics technology centre based on the Hong Kong Polytechnic and additional appropriations to enable the Industry Department to improve its promotional activities.

61. Although I am satisfied that my overall expenditure proposals for 1988-89 can be contained within my budgetary strategy, this means, as I have said, a growth in the civil service establishment of some 4 per cent. Of the total staff growth, some 26 per cent will accrue to the Medical and Health Department and 15 per cent to the police. It is likely that we shall witness a similar overall growth rate in 1989-90, but I shall look for a move towards our 2.5 per cent guideline thereafter.

62. I have provided for transfers amounting to \$7.4 billion from General Revenue Account to our various funds in 1988-89 to support the activities they finance. The transfers are broadly sufficient to ensure that the balances in the funds are maintained in real terms. I have also taken into account a switch of certain items to the Capital Works Reserve Fund in 1988-89 which were previously funded from General Revenue Account.

63. Overall, as a result of these Estimates, Consolidated Account expenditure as a proportion of GDP is estimated to increase from 15 per cent in 1987-88 to around 15.5 per cent.

(25) *This includes land to be formed (net of internal roads) under on-going and committed projects in the Public Works Programme and the Public Housing Development Programme and land to be formed by the private or subsidised sector under conditions of land sale grant. A breakdown of the total land production is as follows:*

<i>Year</i>	<i>Production(hectares)</i>
<i>1989-90</i>	<i>302</i>
<i>1990-91</i>	<i>343</i>
<i>1991-92</i>	<i>447</i>

Draft Estimates of Revenue

64. Turning now to the Draft Estimates of Revenue, total revenue on General Revenue Account before my Budget proposals is estimated to be \$55.6 billion⁽²⁶⁾. Revenue accruing to our various funds is estimated to be \$7.3 billion⁽²⁶⁾. Growth in total revenue, taking General Revenue Account and the funds together, is about 11 per cent.

65. Although I have forecast a slowdown in economic growth, revenue in 1988-89 will still be benefiting from two years of exceptional economic performance in 1986 and 1987. In particular, yields from profits tax, salaries tax, vehicle first registration tax and many of our fees and charges are expected to remain buoyant. The yield from rates will benefit from the recently announced property revaluation.

66. I have, however, been deliberately cautious on stamp duty, because stock market turnover recorded in the first half of 1987-88 was exceptionally high and unlikely to be repeated in 1988-89. Whilst the impact of the slowdown in economic growth on land prices is not yet clear, I have again preferred to use relatively conservative assumptions as to land sale yields.

67. In terms of the proportion of direct to indirect taxes, the direct element is forecast to rise slightly to about 61 per cent in 1988-89 before my revenue measures. The comparable Revised Estimate for 1987-88 is 58 per cent and the actual share for 1986-87 was 60 per cent.

(26)	<i>Draft Estimates</i> 1988-89 \$ Million	<i>Revised Estimates</i> 1987-88 \$ Million
<i>General Revenue Account</i>	55,550	50,564
<i>Capital Works Reserve Fund</i>	4,480	3,380
<i>Development Loan Fund</i>	786	767
<i>Home Ownership Fund</i>	1,981	1,951
<i>Mass Transit Fund</i>	—	—
<i>Student Loan Fund</i>	83	76
<i>Total—funds*</i>	7,330	6,174
<i>Total General Revenue Account + funds</i>	62,880	56,738

*Excluding transfers from General Revenue Account.

Summary of Draft Estimates

68. Taken together, the Draft Estimates of Revenue and Expenditure for 1988-89, before revenue measures, show a net surplus on General Revenue Account of \$5.6 billion and an increase in the balances of the funds of \$1.7 billion. In total, therefore, a potential overall surplus for the year of \$7.3 billion is indicated⁽²⁷⁾.

69. I have already suggested that there is scope for some reduction in taxation. In formulating my proposals, I have looked beyond 1988-89. I must emphasise that it will take time before the slower economic growth that I have forecast affects our revenue yields. Furthermore, the full impact on revenue yields of any tax concessions I introduce will not be felt until 1989-90.

70. With these considerations in mind, I am proposing a package of measures which will reduce our revenue yields by \$1.8 billion in 1988-89, but, more importantly, by \$2.7 billion in a full year. As I have indicated, the full year cost is equivalent to about 5 per cent of recurrent revenue yields. In 1988-89, these proposals will, therefore, reduce the estimated overall surplus on General Revenue Account from \$5.6 billion to \$3.8 billion and the overall surplus, when taken together with our funds, from \$7.3 billion to \$5.5 billion.

71. In terms of their impact on the ratio between direct and indirect taxes, my proposals will reduce the direct element in 1988-89 from what would have been 61 per cent of tax revenue to 60 per cent. Pending the further consideration of new indirect sources, to which I have referred, my proposals are intended merely to contain what is a tendency for the naturally buoyant direct sources to increase as a share of the whole.

72. I shall now present my revenue proposals.

(27)	<i>Estimated surplus/ (deficit) 1988-89</i>		
	<i>(Before revenue measures)</i>		
	<i>\$million</i>		
	<i>Before</i>		<i>After</i>
	<i>transfers</i>	<i>Transfers</i>	<i>transfers</i>
<i>General Revenue Account</i>	12,984	(7,410)	5,574
<i>Capital Works Reserve Fund</i>	(5,700)	6,200	4,480
<i>Development Loan Fund</i>	(1,004)	1,100	786
<i>Home Ownership Fund</i>	1,181	—	1,981
<i>Mass Transit Fund</i>	(95)	100	—
<i>Student Loan Fund</i>	(26)	10	83
	—————	—————	—————
<i>Total—funds</i>	(5,644)	7,410	1,766
<i>Total General Revenue</i>	7,340	—	7,340
<i>Account +funds</i>			

REVENUE MEASURES

73. The package is made up of a number of revenue-raising measures designed to yield \$390 million in 1988-89, equivalent to \$507 million in a full year. But this additional revenue is more than offset by tax concessions estimated to cost \$2.2 billion in 1988-89, and \$3.2 billion in a full year⁽²⁸⁾.

Dutiable commodities

74. I shall deal first with dutiable commodities. The principle underlying my proposals continues to be that specific duty rates should be maintained in real terms. I look for regular small changes broadly in line with inflation rather than less frequent, but inevitably larger, increases.

Imported hydrocarbon oils

75. The duty rates on hydrocarbon oils were revised last year⁽²⁹⁾. I propose to increase the duty rate on motor spirit from \$2.40 to \$2.55 a litre, and on diesel oil for road vehicles from \$1.20 to \$1.27 a litre⁽³⁰⁾. The refund on diesel oil to the franchised bus companies will remain at 65 cents a litre. The two increases come into effect this afternoon. I estimate the additional revenue yield to be \$98 million in 1988-89.

Intoxicating liquor and imported alcohol

76. Duty rates on intoxicating liquor were also revised last year⁽³¹⁾. This year I have three proposals. First, for cider and perry, beer, non-European type wines and Chinese type spirits, I propose an increase of 6 per cent in the specific duty elements to restore their real value.

77. Secondly, I propose to increase the basic rates for imported ethyl alcohol and methyl alcohol from \$4.30 to \$4.55 a litre. This will maintain the rates in real terms, and keep them in line with the rates for non-European type wines.

78. Thirdly, I propose to lower the differential on duty rates which exists at present between, on the one hand, brandy and, on the other, whisky, gin, liqueurs, rum, vodka and other spirituous liquors. I propose to reduce the specific duty rate on brandy by \$12 a litre, that is from \$67 to \$55 per litre, whilst leaving the others at the existing specific duty rate of \$48 per litre. However, to protect the real revenue yield, I propose to increase the ad valorem

(28) Details can be found in Appendix F.

(29) 1987 Budget speech, paragraph 103.

(30) If the full increase is passed on to consumers, petrol prices will rise by about 3.3 per cent and diesel prices by about 2.1 per cent.

(31) 1987 Budget speech, paragraph 106.

rates for all these liquors from 20 per cent to 30 per cent. This proposal is consistent with my predecessor's view that a purchaser of a cheaper brand should not be required to pay the same duty per bottle as a purchaser of a more expensive brand⁽³²⁾. The effect of lowering the differential between the duty rates imposed on brandy and whisky will mean that the duty on the cheaper brandies will be reduced by some 12.5 per cent, that is \$9 per litre, whereas there will be a modest rise in the duty on the cheaper whiskies. More expensive brandies and whiskies will attract more duty. Details of these new rates are given in an Appendix to the printed version of this speech⁽³³⁾. No changes are proposed to existing duty rates for champagne, and sparkling or still wines.

79. All these changes in rates are effective this afternoon. I estimate the additional revenue yield in 1988-89 to be \$40 million assuming no consumer resistance.

Tobacco

80. Members will recall that last month this Council approved the Dutiable Commodities (Amendment) Ordinance 1988, which amended Part II of the Schedule to the Dutiable Commodities Ordinance in order to remove the duty then payable on a weight basis on the import of unmanufactured tobacco and cigarettes, and to replace it with a duty payable per 1 000 cigarettes. The duty rate imposed of \$165 per 1 000 cigarettes was revenue neutral; the rates for other items in the Schedule were unchanged.

81. Tobacco duty rates were last revised in 1987⁽³⁴⁾. To keep all these rates broadly in line with inflation, I propose to increase the duty on cigarettes from \$165 to \$175 per 1 000 sticks. The duty on cigars will be increased from \$220 to \$233 a kilogram; on smoking tobacco from \$200 to \$212 a kilogram; and on Chinese prepared tobacco from \$43 to \$45.50 a kilogram⁽³⁵⁾. These increases come into effect this afternoon. I estimate the additional revenue yield to be \$69 million in 1988-89.

Fees and charges

82. I turn now to fees and charges. For 1988-89, I propose to increase the following fees and charges—first, vehicle and driving licence fees; secondly, bank and deposit-taking company licence and registration fees; thirdly, passenger embarkation and berthing fees; and, lastly, postal and telecommunication fees and charges.

(32) 1984 Budget speech, paragraphs 103-109.

(33) Appendix F(1).

(34) 1987 Budget speech, paragraph 111.

(35) If the full duty increase is passed on to consumers, the average price per packet of cigarettes will increase by about 20 cents. Further details can be found in Appendix F(1).

Vehicle and driving licence fees

83. Vehicle registration and driving licence fees were increased last year⁽³⁶⁾. I propose to increase these fees with immediate effect by about 6 per cent. I estimate that the additional revenue accruing from these increases will be \$62 million in 1988-89.

Bank and deposit-taking company licence and registration fees

84. Bank and deposit-taking company licence and registration fees were last increased in 1986⁽³⁷⁾. I propose with effect from 1 April 1988, an 8 per cent increase in these and related fees. Details are given in an Appendix to the printed version of this speech⁽³⁸⁾. The yield in 1988-89 will be around \$11 million.

Passenger embarkation and berthing fees

85. Passenger embarkation and berthing fees were increased in 1985 for Macau ferry services⁽³⁹⁾. At that time, my predecessor said that, as and when facilities at other terminals were improved, we would seek to raise additional revenue from those terminals at which operating costs were not being recovered.

86. In recent years, the Government has invested considerable additional resources to cater for the growth in passenger ferry traffic to China. In accordance with our general policy of cost recovery, I propose that when the China Ferry Terminal in Canton Road opens later this year, the passenger embarkation fee of \$15 be extended to those departing from this new terminal. Berthing fees at the China Ferry Terminal will then be set at the same level as those for vessels using the Macau Ferry Terminal⁽⁴⁰⁾. These fees will be reviewed regularly in line with the existing policy of recovering the full operating costs. I estimate the total additional revenue yield in 1988-89 to be \$6 million, and \$12 million in a full year.

Postal and telecommunication fees and charges

87. Postal and telecommunication fees and charges were last revised in 1985⁽⁴¹⁾. To restore the real value of these fees and charges, I propose to

(36) 1987 Budget speech, paragraph 119.

(37) 1986 Budget speech, paragraph 107.

(38) Appendix F(2).

(39) 1985 Budget speech, paragraph 109.

(40) Current fees for each berthing are:

	<i>Ferries— dynamically supported craft \$ per ton</i>	<i>Ferries— other than dynamically supported craft \$ per ton</i>	<i>Vessel not being a ferry vessel \$ per ton</i>
<i>Hong Kong—Macau Terminal</i>	2.0	1.0	2.0
<i>Hong Kong—China Terminal</i>	1.0	0.5	1.0

(41) 1985 Budget speech, paragraph 102.

implement during the next financial year a package of moderate increases in postal and telecommunication fees and charges. The additional revenue yield in 1988-89 is estimated at \$23 million, and \$70 million in a full year.

Other fees and charges

88. A number of other fees and charges, including those in relation to certain services provided by the Immigration Department, the Medical and Health Department, the Trade Department and the Water Supplies Department, are scheduled for their normal regular review in 1988. From these sources, I expect additional revenue of about \$81 million in 1988-89, equivalent to \$145 million in a full year.

Tax concessions

89. I now turn to tax concessions. My personal taxation package has been carefully structured to slow down the rate at which people move to higher tax brackets. At the same time, although allowances will be raised broadly in line with inflation, thus keeping a number of people outside the tax net, increases in real income will of course have the overall effect of increasing the number of taxpayers. It is through the combination of these features that I am seeking to move towards the more robust and equitable fiscal regime to which I referred earlier⁽⁴²⁾. I trust that Members will note that my proposals will be of particular assistance to the middle income group.

Personal taxation

90. For personal taxation, I propose:

First, to reduce the standard rate from 16.5 per cent to 15.5 per cent;

Secondly, that the Second Schedule of the Inland Revenue Ordinance be revised to provide both a lower initial tax rate and a more gradual progression through the various marginal rates as income increases⁽⁴³⁾. Furthermore, the

(42) 1988 Budget speech, paragraph 48.

(43) If the revision proposed is brought into law, the table in the Second Schedule of the Ordinance would be amended to:

For the year of assessment 1988-89 and each year thereafter:

	<i>Proposed</i>	<i>present</i>
<i>Upon the first \$10,000</i>	<i>3 per cen</i>	<i>5 per cen</i>
<i>Upon the next \$10,000</i>	<i>6 per cen</i>	<i>10 per cen</i>
<i>Upon the next \$10,000</i>	<i>9 per cen</i>	<i>15 per cen</i>
<i>Upon the next \$10,000</i>	<i>12 per cen</i>	<i>15 per cen</i>
<i>Upon the next \$10,000</i>	<i>15 per cen</i>	<i>20 per cen</i>
<i>Upon the next \$10,000</i>	<i>18 per cen</i>	<i>20 per cen</i>
<i>Upon the next \$10,000</i>	<i>21 per cen</i>	<i>25 per cen</i>
<i>Upon the remainder</i>	<i>25 per cen</i>	<i>25 per cen</i>

Examples of the effect on tax payable due to the revision of the marginal tax rates are given in Appendix F(3).

point at which the maximum 25 per cent marginal rate will begin to apply will be raised by \$10,000;

Thirdly, I propose that the additional personal allowance be increased from \$5,000 to \$7,000 for a single person, and from \$10,000 to \$14,000 for a married couple. Thus, the basic allowance plus the increased additional allowance will total \$36,000 for a single person, and \$74,000 for a married couple; below these income levels there will be no liability to tax. The new allowances at their maximum levels will be nearly 6 per cent higher than the present basic and additional personal allowances⁽⁴⁴⁾;

Fourthly, I propose that the child allowance be increased, for a first child from \$11,000 to \$12,000, and for a second child from \$8,000 to \$8,500; and

Lastly, that the allowance for a dependent parent be increased from \$9,000 to \$10,000. Thus, the total allowance in respect of a dependent parent residing with a taxpayer will be \$13,000.

91. I intend to introduce these concessions with effect from the year of assessment commencing 1 April 1988. Therefore, the first occasion on which they will apply will be to provisional and final salaries tax assessments for 1988-89, and also to 1988-89 personal assessments. I estimate that the cost to the revenue in 1988-89 will be about \$1.1 billion, and for a full year, \$1.5 billion.

Taxation of married women

92. Sir, in debating my Budget proposals last year, a number of Members urged that separate taxation should be introduced for working wives. In my speech concluding the debate on last year's Budget, I explained why I did not consider that separate taxation was appropriate⁽⁴⁵⁾. Since that time, there has been continued public debate on this subject; I am also aware of the trend in some other tax administrations in the direction of separate taxation. In all the circumstances, I am now prepared to consider further how separate taxation for working wives might best be introduced.

93. I must warn, however, that there are a number of difficult questions to be resolved not the least of which is the question of transferability of allowances between spouses. This is a complex subject with many options to be considered

(44) *Under section 42B(1) of the Ordinance, the present basic and additional allowances are:*

	<i>Basic Allowance</i>	<i>Additional Allowance</i>	<i>Total</i>
	\$	\$	\$
<i>Single</i>	29,000	5,000	34,000
<i>Married</i>	60,000	10,000	70,000

(45) *Speech concluding the debate on the Second Reading of the Appropriation Bill, 1987, paragraphs 29-30.*

if we are to ensure broadly equitable treatment. It would therefore not be feasible to introduce separate taxation overnight. Because of the difficulties involved in implementing separate taxation, and so that some benefit can be enjoyed now, I propose to introduce in 1988-89 an annual allowance of up to \$15,000 for working wives. This will cost a further \$240 million in 1988-89, and \$340 million in a full year. As this concession will be introduced with effect from the year of assessment commencing 1 April 1988, the first occasion on which it will apply will be to provisional and final salaries tax assessments for 1988-89, and also to 1988-89 personal assessments.

94. Examples of the effects of the personal taxation concessions upon various categories of taxpayers, together with the comparative tables, are set out in an Appendix to the printed version of this Speech⁽⁴⁶⁾.

Profits tax

95. As to profits tax, I propose a reduction in the rate of tax on corporate profits from 18 per cent to 17 per cent. The cost of the reduction proposed is \$370 million in 1988-89 and, for a full year, \$760 million. The new corporate rate of 17 per cent will apply to provisional and final assessments for 1988-89.

96. Some have argued that a stimulus should be provided to the manufacturing sector through an increase in capital allowances for expenditure incurred on the provision of plant and machinery. As I said earlier, in 1987 there was no reluctance on the part of manufacturers to invest. We are seeing more and more effort being made to increase capacity, improve productivity and enhance profitability. I do not believe that the selective inducement of an increase in capital allowances is what is needed at this time. Instead, I consider that the proposed reduction in the rate of tax on corporate profits will provide appropriate and proper encouragement to all those in business.

Property tax, interest tax and profits tax paid by unincorporated businesses

97. The reduction proposed in the standard rate from 16.5 per cent to 15.5 per cent will lower the yields from property tax, interest tax and profits tax paid by unincorporated businesses. Taken together, I estimate that this will cost a further \$70 million in 1988-89 and \$160 million in a full year. The new standard rate will apply to provisional and final profits tax and property tax assessments for 1988-89; it will apply also to final interest tax assessments for that year.

Stamp duty

98. I have a further concession; it relates to stamp duty. The concession is designed to facilitate wider home ownership and assist the middle income group. At present, the rate of duty payable on assignments varies according to the sale price or market value of the property, whichever is the higher. I intend to relax the rates applicable to small and medium-sized properties.

(46) Appendix F(3).

99. I propose with effect from 1 April 1988 to lift the threshold at which the 2.75 per cent rate begins to apply from the present \$500,000 to \$1.5 million; to cut the rate of duty for properties costing between \$250,000 and \$1.5 million; and to introduce a new formula for determining marginal relief, which will provide a greater benefit to duty payers and have the effect of pushing the various duty rate thresholds upward. I estimate that some 100 000 persons will benefit from these proposals, which will cost a further \$300 million in 1988—89. Details are given in an Appendix to the printed version of this speech⁽⁴⁷⁾.

Air passenger departure tax

100. Lastly, I have one other proposal. This relates to Air Passenger Departure Tax. The tax on passengers departing from Hong Kong by air was last increased in 1985 to its present level of \$120 for an adult and \$60 for a child. Over the last three years, the value of this tax has been eroded by inflation. Balancing one factor against another, and in the light of my overall budgetary strategy, I propose that from 1 April 1988 the tax on passengers departing from Hong Kong by air be revised to \$100 for an adult and \$50 for a child. This concession will cost \$120 million in 1988-89. I trust that not only our own travellers but also our many visitors will welcome this reduction.

IMPLEMENTATION

101. My proposals for air passenger departure tax, bank and deposit-taking company licence and registration fees, dutiable commodities, stamp duty and vehicle and driving licence fees were the subject of Public Revenue Protection Orders signed by you, Sir, this morning. During the current session, a Bill to amend the Inland Revenue Ordinance will be introduced into this Council to give effect to my proposals on tax concessions. Other increases in fees and charges will be brought forward during the year as the relevant reviews are completed.

SUMMING UP

102. Sir, that concludes my revenue proposals. This year I have again been able to propose an easing of the tax burden whilst increasing expenditure on public services and maintaining the value of our reserves. We have adhered to our policy of continuity and we are building for the future. The proposals that I have outlined offer something for all sectors of our community. The tax concessions, particularly for middle-income earners, and the efforts we are making to assist the less advantaged of our community are especially worthy of note.

103. In putting together my tax proposals, I have deliberately sought a broadening of the tax base to achieve greater fiscal stability. As and when people enjoy a real increase in their income, it is not unreasonable that they should contribute to the funding of our public services. I have also referred to

(47)Appendix F(4).

the work that we are carrying out in relation to a broadly based indirect tax, but I repeat my assurance that we will not rush into something that does not suit us.

104. It is in the context of my theme of continuity and forward planning that I believe we must remind ourselves of the need for prudence. The governance of Hong Kong is becoming increasingly complex and the range of functions required of the Administration is expanding. The private sector, too, is playing its part particularly in the provision of infrastructure. And we are making greater use of statutory authorities.

105. All this is evidence of dynamism and change. In such an environment, I remain aware of the need for continuing vigilance regarding the growth in public sector expenditure. Experience elsewhere shows that an expanding public sector in relation to the economy as a whole is often a major factor in dampening long-term economic prospects. This should not be allowed to happen in Hong Kong.

106. I recognise that my overall budgetary package could well provide a stimulus to the economy in 1988, but I believe that the effect will be tolerable. I have no doubt, however, given that the economy will still be operating at near full capacity, that any further stimulus would be inappropriate and could well result in higher inflation rather than greater real growth.

107. I am particularly conscious that the expenditure proposals I have put before you today imply real growth in our spending in 1988-89 higher than my forecast for economic growth. Furthermore, the indications are that the size of the Civil Service is set to increase, for at least the next few years, at a rate faster than that of Hong Kong's labour force.

108. It is inevitable, however, that in some years our spending will be above the trend. Continuing care is needed to ensure that in the longer term we move back to our planning criteria. If we fail in this regard, we may find ourselves locked into high expenditure growth rates that cannot be reduced if and when circumstances turn against us. We could then find ourselves in a position of being forced to increase taxation, and, through that increase, erode significantly our competitive edge bearing in mind the move towards lower tax rates worldwide.

109. But let me not end on such a sombre note. Hong Kong has prospered over the last two years and I have been able to return to our community some of the fruits of that prosperity. It is a task I have enjoyed. Finally, Sir, throughout this Budget speech, I have often stressed the continuity of our policies and so I conclude with the words of T. S. ELIOT:

‘What we call the beginning is often the end
And to make an end is to make a beginning.
The end is where we start from.’

110. Sir, I beg to move.

Debate adjourned pursuant to Standing Order 54(2).

Adjournment and next sitting

HIS EXCELLENCY THE PRESIDENT: In accordance with Standing Orders I now adjourn the Council until 2.30 pm on Wednesday, 9 March 1988.

Adjourned accordingly at nineteen minutes to Four o'clock.

(Note: The short title of the Bill listed in the Hansard have been translated into Chinese for information and guidance only; they do not have authoritative effect in Chinese.)

Appendices

	Page
A. Medium range forecast 1987-88 to 1991-92	818-827
Forecasting Government's expenditure and revenue in the period up to 1991-92 and setting these forecasts in a historical context.	
B. Trends in public expenditure 1983-84 to 1991-92	828-840
Showing the past and projected allocation of resources between service groups.	
C. Contingent liabilities	841
Setting out the more significant contingent liabilities of Government.	
D. The recurrent cost implications of major new or improved services to begin in 1988—89	842
Listing new items each with an annual recurrent cost of \$3 million or over and incorporated in the 1988-89 draft Estimates.	
E. Major capital works projects to begin in 1988-89	843
Listing projects each with a project cost of \$100 million or over budgetted to begin in 1988-89.	
F. Budget revenue measures	844-864
Containing further details of the revenue proposals made.	

Appendix A**MEDIUM RANGE FORECAST 1987-88 TO 1991-92****INTRODUCTION**

The Medium Range Forecast (MRF) is Government's planning tool for ensuring that budgetary policy, and in particular expenditure programmes, are developed and implemented within the context of the economy as a whole looking forward over a five year period. It is the starting point from which detailed expenditure programmes and taxation measures are developed and is a reflection of the financial consequences of policy decisions. The MRF is updated regularly.

2 This MRF is for the period 1987-88 to 1991-92 and has been used in the formulation of the 1988-89 budget. It is presented in three sections:

- (I) Forecasting assumptions and budgetary criteria.
- (II) The MRF for 1987-88 to 1991-92.
- (III) Commentary on the MRF in relation to budgetary criteria.

SECTION I—FORECASTING ASSUMPTIONS AND BUDGETARY CRITERIA

3 A number of computer based models are used to derive the MRF. These models reflect a wide range of assumptions about the factors determining each of the components of Government's revenue and expenditure. Some are economic in nature (the general economic assumptions) while others deal with specific areas of Government's activity (the detailed assumptions). These are supported by studies of historic and anticipated trends.

General Economic Assumptions*Growth in Gross Domestic Product (GDP)*

4 There is a clear link between many of Government's major revenue sources and economic growth. For planning purposes the medium range assumption as to annual GDP growth for the current MRF has been set at % in real terms.

Inflation

5 The inflation rate fell rapidly in 1985 and 1986 but, in recent months, has begun to edge upwards. Over the forecast period the average year on year assumption has been increased to % (from % in the previous Medium Range Forecast). It is emphasized that this is a trend assumption and the prospect in the short-term is that actual inflation will exceed this trend.

Detailed Assumptions

6 A wide range of detailed assumptions relating to developing expenditure and revenue patterns over the forecast period are taken into account. These include:

- estimated cash flow on capital projects.
- forecast completion dates of these capital projects and their related recurrent consequences in terms of staffing and running costs.
- the expected pattern of demand for individual services.
- the trend in yield from individual revenue sources.
- changes in taxation rates and fees and charges.

Budgetary Criteria

7 In addition to the above forecasting assumptions there are a number of criteria against which the results of forecasts are tested for overall acceptability in terms of budgetary policy. Any significant breach of these parameters results in a review of the underlying programmes and adjustments as necessary.

8 The following are the more important budgetary criteria:

—*Total cash flow surplus/deficit*

As a general aim, a cash flow surplus is sought each year to ensure that total reserves in General Revenue Account and in the Funds maintain their value in real terms. On the basis of the current level of reserves an annual surplus of around \$2.0 billion is necessary to achieve this objective.

—*Operating surplus/deficit*

With the reduction in importance of capital revenue from land sales a continuing substantial element of capital expenditure must now be financed from a surplus on operating account (recurrent revenue in relation to recurrent expenditure). A broad target of at least a 50% funding of capital expenditure from the operating surplus is adopted.

—*Total expenditure growth*

It is intended that expenditure growth should not exceed the trend assumption as to growth in GDP taking one year with another.

—*Capital expenditure growth*

By its nature some fluctuations in the level of capital expenditure are to be expected. However, taking one year with another the aim is to contain capital expenditure growth within overall expenditure guidelines, i.e. within the trend assumption as to GDP growth. Allowance is made for a number of major projects due to start in the forecast period. In planning the size of the capital programme regard is also had to the recurrent consequences of capital works (staffing, maintenance, etc.).

—*Size of the civil service*

This is a significant determinant of the growth rate of Government's expenditure. A target average annual growth of no more than % in the size of the civil service is adopted.

—*Taxation policy*

The projections reflect the taxation measures introduced in this year's budget. Thereafter, no major shifts in the tax burden are assumed. Account is taken, however, of the need to maintain the real yield from fees and charges, fixed duties etc. and to review periodically the various tax thresholds in the light of inflation.

SECTION II—THE FORECASTS

9 The current MRF is summarized in the following three tables which indicate the forecast operating position, capital cash flow and the aggregation of the two in a consolidated cash flow statement.

10 It is emphasized that the forecasts are based on trends and, therefore, the actual results of any individual year may vary significantly from the trend assumption. This is particularly so in Hong Kong's volatile economic circumstances.

Operating Statement (before budget revenue measures)

Table 1

—defines the relationship between expenditure and revenue of a regular (recurrent) nature, i.e. it excludes both capital expenditure and revenue which, by their nature, are a collection of one-off items.

	Revised Estimate	Forecast			
	1987-88	1988-89	1989-90	1990-91	1991-92
	\$mn	\$mn	\$mn	\$mn	\$mn
Recurrent expenditure	35,920	41,140	46,100	52,130	58,970
Capital expenditure of a regular nature	1,160	1,130	1,120	1,250	1,200
Total operating expenditure	37,080	42,270	47,220	53,380	60,170
Recurrent revenue before interest but before budget revenue measures	48,370	52,970	59,340	65,640	72,720
Operating surplus before interest	11,290	10,700	12,120	12,260	12,550
Interest on balances	1,280	1,820	2,360	2,570	2,860
Operating surplus after interest but before budget revenue measures	12,570	12,520	14,480	14,830	15,410

Capital Expenditure and Financing Statement

Table 2

—indicates the extent to which capital expenditure on major works is met by capital revenue.

	Revised Estimate	Forecast			
	1987-88	1988-89	1989-90	1990-91	1991-92
	\$mn	\$mn	\$mn	\$mn	\$mn
Capital expenditure					
General Revenue Account	790	290	310	350	470
Capital Works Reserve Fund	7,700	10,180	12,460	12,340	13,070
Other funds*	3,590	2,280	4,110	3,520	2,320
Bond issue repayment	—	—	1,000	—	—
Total capital expenditure	12,080	13,270	17,880	16,210	15,860
Capital revenue					
General Revenue Account	910	760	770	790	780
Capital Works Reserve Fund (land sales and interest)	3,380	4,480	3,190	3,240	3,400
Other funds*	2,790	2,850	3,030	3,200	3,370
Total capital revenue	7,080	8,090	6,990	7,230	7,550
Capital financing (deficit)	(5,000)	(5,180)	(10,890)	(8,980)	(8,310)

*Development Loan Fund, Home Ownership Fund, Mass Transit Fund and Student Loan Fund.

Appendix A—Contd.

Consolidated Cash Flow*Table 3*

—shows the extent to which the capital financing deficit is covered by the operating surplus and the combined cash flow impact on Government's total reserves.

	Revised Estimate	Forecast			
	1987-88	1988-89	1989-90	1990-91	1991-92
	\$mn	\$mn	\$mn	\$mn	\$mn
Capital financing (deficit)	(5,000)	(5,180)	(10,890)	(8,980)	(8,310)
Operating surplus before budget revenue measures	12,570	12,520	14,480	14,830	15,410
Consolidated cash surplus/(deficit) before budget revenue measures	7,570	7,340	3,590	5,850	7,100
<i>Less:</i> Impact of budget revenue measures*	—	(1,880)	(3,260)	(3,820)	(4,480)
Consolidated cash surplus/(deficit) after budget revenue measures	7,570	5,460	330	2,030	2,620
Reserve balances at 1 April	32,940	40,510	45,970	46,300	48,330
Reserve balances at 31 March	40,510	45,970	46,300	48,330	50,950

*Including impact on interest on balances.

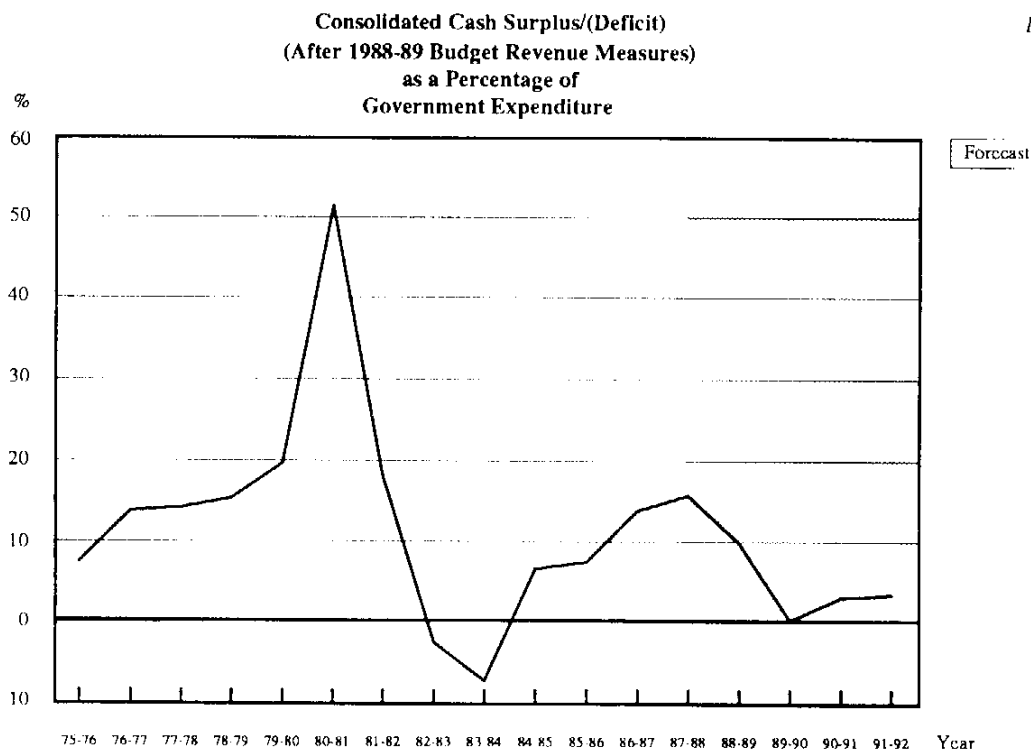
11 These tables relate to Government's overall finances. They provide no breakdown of the details between General Revenue Account and the various funds through which, for operational reasons, the Government controls its finances.

12 The significant increase in capital spending in 1989-90 and 1990-91 shown in these forecasts is due, exceptionally, to repayment of the 1984 bond issue and further injections of equity into Mass Transit Railway Corporation (MTRC). The latter amounts to \$2.5 billion and may not be needed if MTRC finances continue their recent improvement.

SECTION III—COMMENTARY ON THE FORECAST

The Fiscal Balance

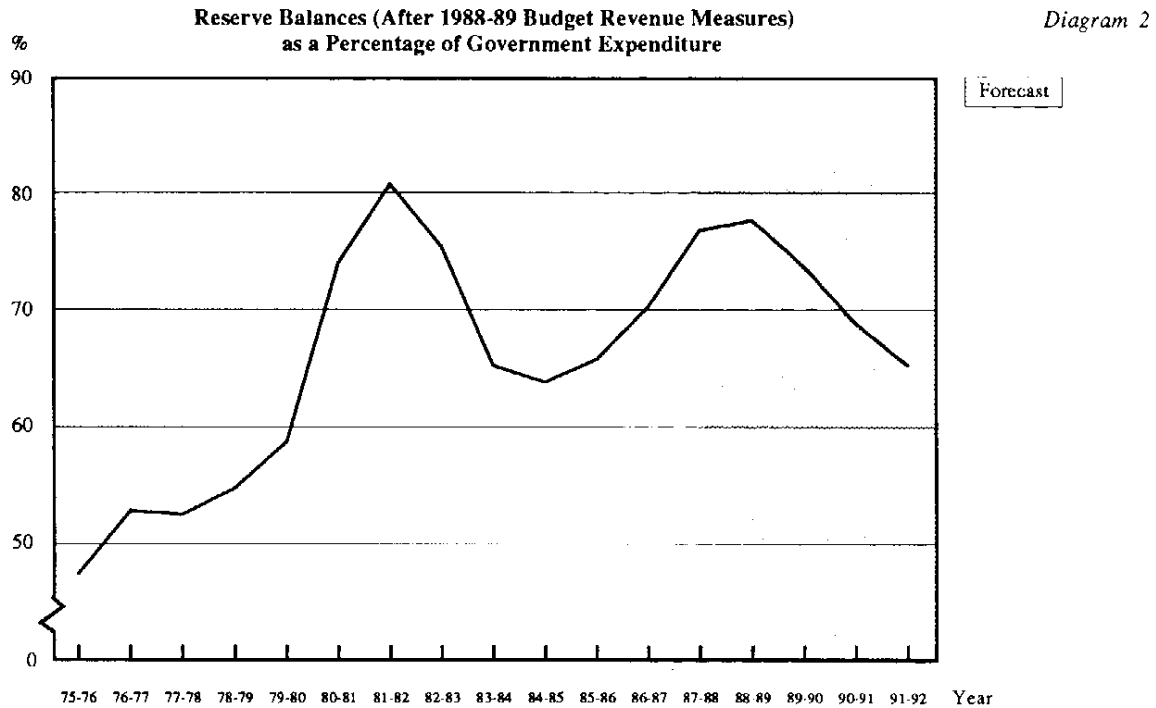
13 Before the 1988-89 taxation measures are taken into account, the forecasts indicate an average consolidated cash flow surplus over the forecast period from 1988-89 to 1991-92 of around \$5.9 billion. This drops to around \$2.7 billion after the taxation measures proposed in the 1988-89 budget are taken into account. An average surplus of this order is sufficient to ensure that reserve balances are maintained in real terms and provide a cushion for unforeseen events. An impression of the relative size of the forecast surplus/deficit can be gained by comparing it to the level of Government expenditure. The historic and forecast relationship in this respect is illustrated in Diagram 1.



14 The operating surplus after interest (recurrent revenue over expenditure) is sufficient to finance an average of some 90% of capital expenditure over the forecast period from 1988-89 to 1991-92 before budget revenue measures, but will fall to 69% with the implementation of these measures. This remains significantly above the minimum 50% target.

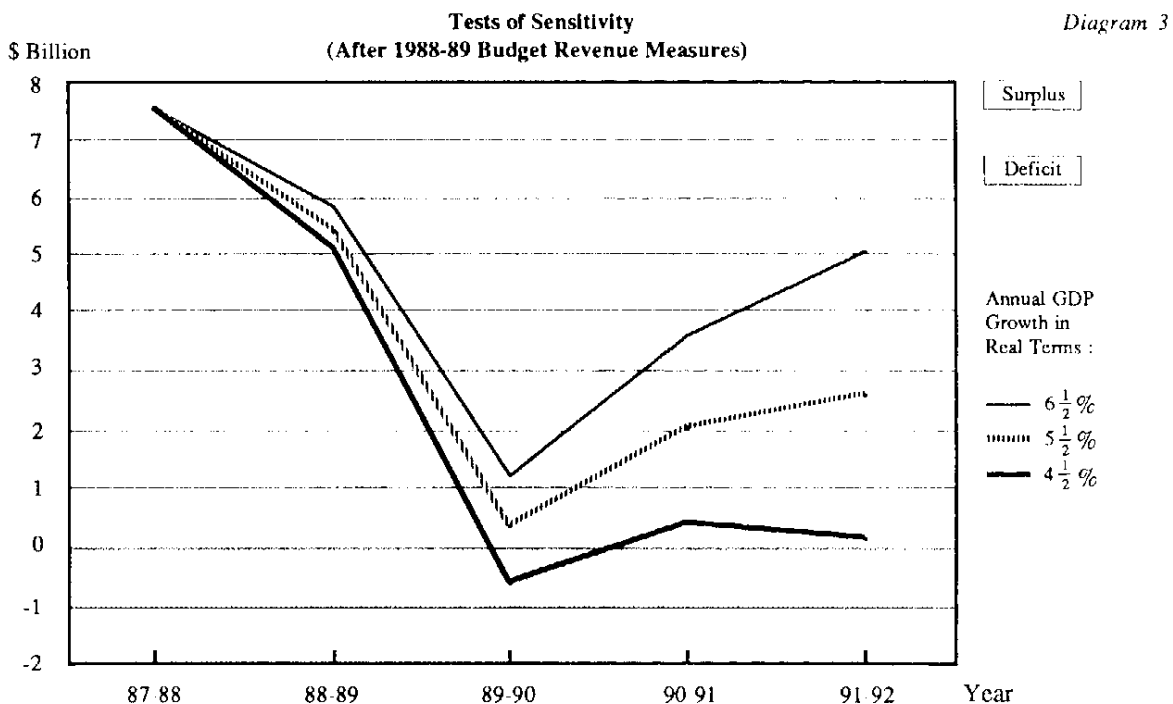
Appendix A — Contd.

15 Whilst paragraph 13 above indicates that the forecast level of surplus is sufficient to maintain fiscal reserves in real terms, an important additional consideration is the relationship of these reserves to Government expenditure. The past and forecast relationship in this respect is illustrated in Diagram 2.



16 It will be noted that the current level of reserves in relation to Government's overall expenditure has only been bettered in the early 1980's. The relationship is expected to decline following the taxation measures included in the 1988-89 budget, but will remain well above 50%.

17 The importance to these forecasts of the economic growth rate assumption has already been emphasized. The tests included in Diagram 3 indicate this sensitivity. It will be noted, however, that even under the lower GDP growth assumption tested, the position remains close to balance.



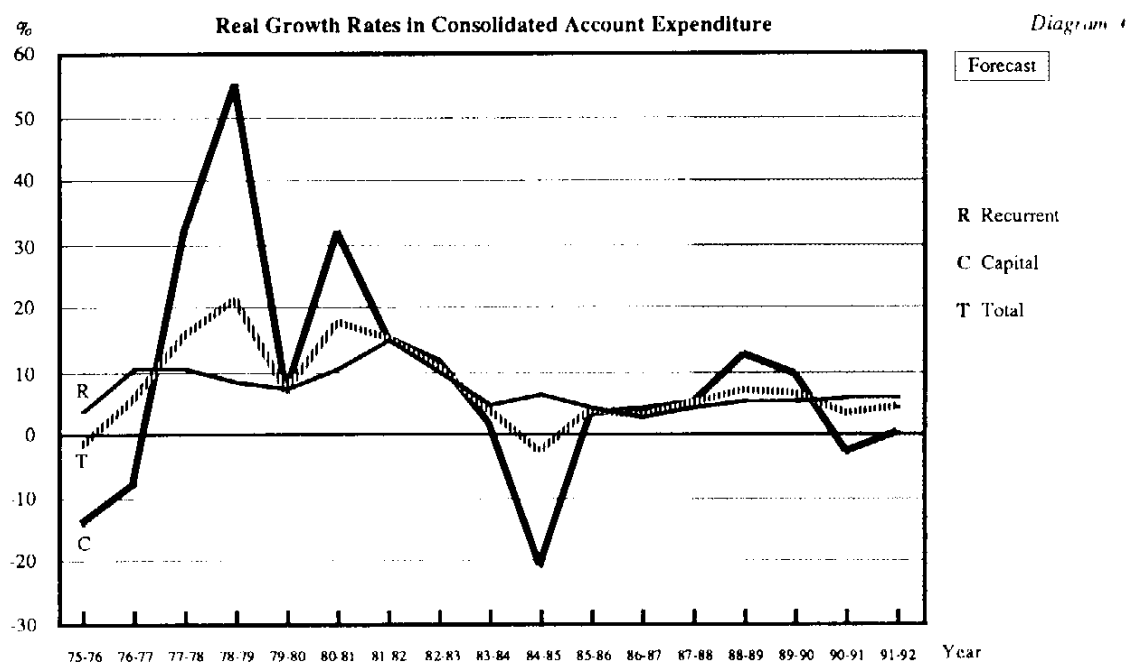
Appendix A— *Contd.***Expenditure Growth**

18 Diagram 4 indicates the pattern of expenditure growth allowed for in these forecasts compared with results since 1975-76. The following points are of note:

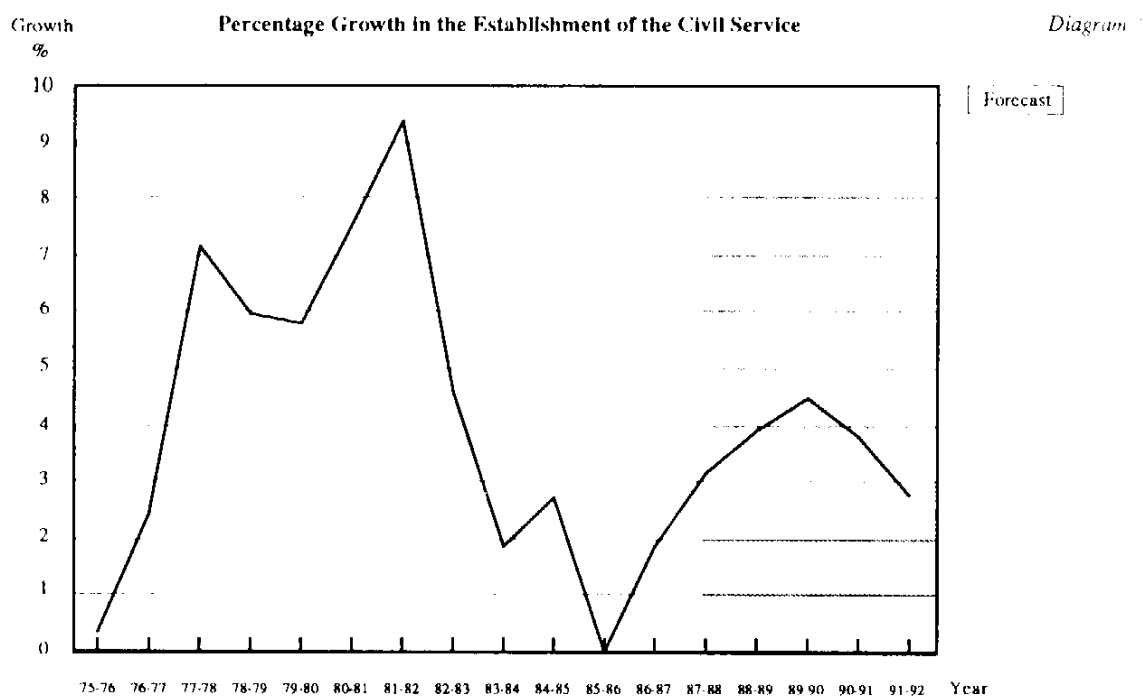
Recurrent expenditure growth has been successfully stabilized since 1983-84 at around 5%-6%. The forecasts assume a continuation of firm control over recurrent expenditure.

Capital expenditure growth is inevitably much more volatile and, indeed, was negative in 1984-85. The forecasts assume a return to growth albeit controlled to a narrower range.

Total real expenditure growth has fallen considerably since the late 1970's and early 1980's and is forecast to be controlled at just over 5% p.a.



19 The projected trend in staff growth implied in these forecasts is indicated in Diagram 5 as follows:



Appendix A—Contd.

20 After a period of high staff growth in the late 1970's and early 1980's, the rate of growth has stabilized from about 1983-84 onwards. However, the target rate (no more than 2 1/2%) will be exceeded in 1988-89 and in the next three years or so as a number of major medical facilities come on stream and as the Royal Hong Kong Police Force is expanded to take on new responsibilities.

Consolidated Account Expenditure in the Context of the Economy

21 Up to this point, the forecasts have dealt with Government's own expenditure. For monitoring purposes, this is consolidated with the expenditure of other public bodies such as the Urban Council in order to compare total Consolidated Account expenditure to the size of the economy.

22 The results of this comparison are set out in Table 4 and the historic and projected relationship between GDP and Consolidated Account expenditure is illustrated in Diagram 6.

Consolidated Account Expenditure in the Context of the Economy (Note 1) Table 4

	Revised	Forecast			
	Estimate	1988-89	1989-90	1990-91	1991-92
	1987-88	1988-89	1989-90	1990-91	1991-92
	\$mn	\$mn	\$mn	\$mn	\$mn
Operating expenditure	37,080	42,270	47,220	53,380	60,170
Capital expenditure	12,080	13,270	17,880	16,210	15,860
Total Government expenditure	49,160	55,540	65,100	69,590	76,030
Add: Other public sector bodies	6,320	7,050	8,150	9,350	10,680
Less: Debt repayments	(400)	—	(1,000)	—	—
MTRC equity injections	(1,000)	—	(1,500)	(1,000)	—
Total Consolidated Account expenditure	54,080	62,590	70,750	77,940	86,710
Gross Domestic Product (calendar year)(Note 2)	360,200	400,900	446,200	496,600	552,700
Growth in GDP					
Money terms	20.1%	11.3%	11.3%	11.3%	11.3%
Real terms	13.6%	5.5%	5.5%	5.5%	5.5%
Growth in Consolidated Account expenditure					
Money terms	12.8%	15.7%	13.0%	10.2%	11.3%
Real terms	4.6%	7.0%	6.5%	3.4%	4.4%
Consolidated Account expenditure as a percentage of GDP (at current prices)(Note 3)	15.0%	15.6%	15.9%	15.7%	15.7%

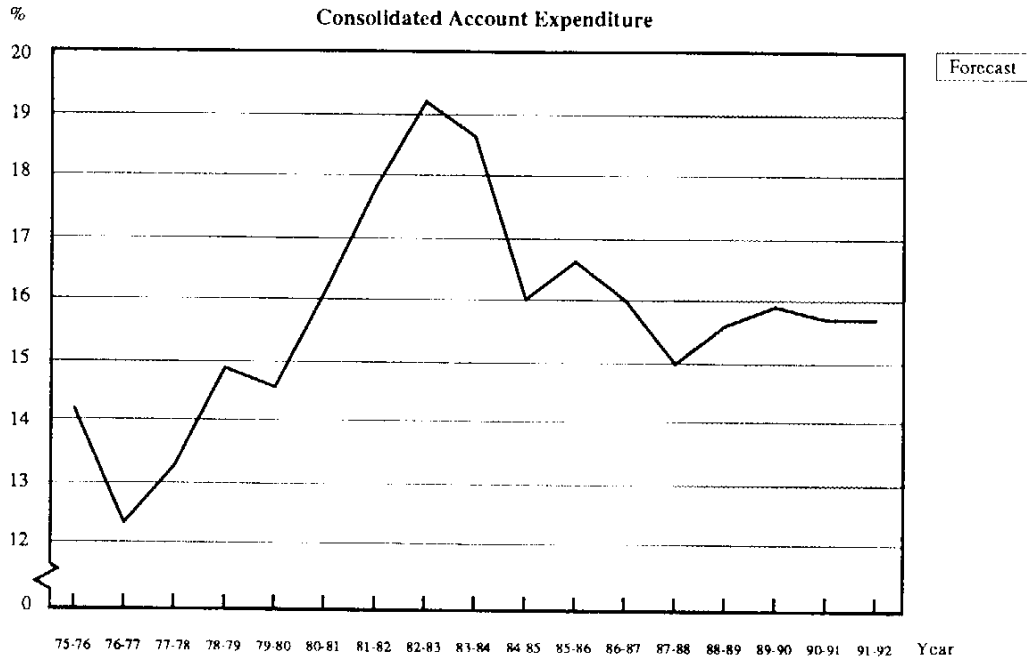
Note 1 The Consolidated Account comprises expenditure by the Urban Council, the Housing Authority and the Regional Council, expenditure financed by the Government's statutory funds and all expenditure charged to the General Revenue Account. Expenditure by institutions in the private or quasi-private sector is included to the extent of their subventions. The activities of government departments which are partly financed by charges raised on a commercial basis are also included (e.g. airport, waterworks). But not included is expenditure by those organizations, including even statutory organizations, in which the Government has only an equity position, such as the Mass Transit Railway Corporation and, post 1982-83, the Kowloon-Canton Railway Corporation. Similarly, debt repayments and equity payments are excluded as they do not reflect the actual consumption of resources by the Government.

Note 2 For years beyond the current year, the GDP figures are based on trend assumptions. The projection for 1988 is, therefore, slightly different from the specific forecast for that year published in the '1988 Economic Prospects'.

Note 3 Caution should be exercised in interpreting these percentages as the Consolidated Account expenditure is estimated on a fiscal year basis while the GDP is estimated on a calendar year basis.

**Historical and Forecast Relationship
between
Gross Domestic Product
and
Consolidated Account Expenditure**

Diagram 6



23 Table 5 indicates the relationship between Consolidated Account expenditure and Public Sector expenditure. The former has historically been used as a measure for control of Government's finances. On the other, Public Sector expenditure is an economic definition used in the context of national accounts for GDP estimation. It excludes, for instance, government transfers and current expenditure of government "trading" departments. Since the two series of statistics have different components, they may move differently and Table 5 brings out the extent of this difference in movement.

Relationship Between Consolidated Account Expenditure and Public Sector Expenditure as Defined for GDP Purposes

Table 5

	Revised Estimate	Forecast			
	1987-88	1988-89	1989-90	1990-91	1991-92
	\$mn	\$mn	\$mn	\$mn	\$mn
Total Consolidated Account expenditure (from Table 4)	54,080	62,590	70,750	77,940	86,710
Add: Imputed rent (Note 1) and expenditure by other public sector bodies not included in total Consolidated Account expenditure (Note 2)	5,680	6,440	6,380	7,120	8,570
Less: Transfers					
—recurrent and capital subventions (Note 3)	(11,010)	(13,200)	(14,830)	(17,000)	(19,760)
—other transfer payments made by Government (Note 4)	(5,480)	(6,890)	(8,040)	(8,280)	(8,420)
Current expenditure of government "trading" departments (Note 5)	(6,300)	(6,900)	(7,630)	(8,470)	(9,400)
Total Public Sector expenditure in national accounts terms (Note 6)	36,970	42,040	46,630	51,310	57,700
Growth in Public Sector expenditure					
Money terms	14.5%	13.7%	10.9%	10.0%	12.5%
Real terms	5.4%	5.1%	4.4%	3.1%	5.4%
Gross Domestic Product (calendar year) (Note 7)	360,200	400,900	446,200	496,600	552,700
Growth in GDP					
Money terms	20.1%	11.3%	11.3%	11.3%	11.3%
Real terms	13.6%	5.5%	5.5%	5.5%	5.5%
Public Sector expenditure as a percentage of GDP (at current prices) (Note 8)	10.3%	10.5%	10.5%	10.3%	10.4%

Note 1 An estimate of the notional rent of premises owned by the Government and occupied by the non-trading government departments.

Note 2 Capital expenditure by the Mass Transit Railway Corporation and the Kowloon-Canton Railway Corporation and current and capital expenditure by other public organizations such as the Vocational Training Council, Trade Development Council, Hong Kong Productivity Centre, Hong Kong Tourist Association and Consumer Council, etc.

Note 3 Financial assistance to government-assisted institutions in the private or quasi-private sector.

Note 4 Expenditure on land acquisitions, compensations, purchases of properties, welfare payments, grants and loans etc.

Note 5 Government trading departments are distinguished from other government departments in that they are engaged in the production of goods and services principally for sale to the public. The criteria for distinguishing the trading activities of the Government from its other activities are:

- (i) that the activity consists of the production of goods and services of a kind which might be provided by a private business; and
- (ii) that sales, either to the public or to other government departments, account for a major part of their activities. Some examples of departments regarded as being engaged in trading activities are Civil Aviation, Housing, Post Office and Water Supplies.

Note 6 Total Public Sector expenditure and its growth rates in this table are calculated on a fiscal year basis. These may, therefore, be different from those calculated on a calendar year basis and quoted elsewhere in the Budget Speech.

Note 7 The GDP growth rates for the years 1988 to 1991 (and the GDP figures thus derived) are the trend projections used for medium-range budgetary planning purposes. Fluctuations in economic activity from year to year are not taken into account. In particular, the trend figure for the GDP in 1988 differs slightly from the short-term GDP forecast quoted elsewhere in the Budget Speech.

Note 8 Caution should be exercised in interpreting these percentages as the Public Sector expenditure is estimated on a fiscal year basis while the GDP is estimated on a calendar year basis.

TRENDS IN PUBLIC EXPENDITURE 1983-84 TO 1991-92**INTRODUCTION**

The purpose of this appendix is to present trends in public expenditure (Consolidated Account) over the period from 1983-84 to 1991-92. It draws together the actual and forecast recurrent and capital expenditures during this nine year period and expresses them in terms of five main areas of government activity—General, Security, Economic, Community and Social (1). In this way the overall priorities for the resources of Government are identified and presented to show how they have changed since 1983-84 and how, on the basis of current plans and priorities they are likely to change over the following four years to 1991-92. The analysis therefore presents two perspectives:

Historical

- an analysis of the changes in the level of expenditure on individual service groups and the balance between service groups over the last five years (1983-84 to 1987-88).

Forecast

- an analysis of the planned changes in the level of expenditure on individual service groups and the balance between service groups over the next five years (1987-88 to 1991-92). This forecast is made on the basis of current trends and commitments (2), but does not take into account new or improved services not already planned.

(1) A key to the relationship between heads of expenditure and the five service groups is provided at the end of this appendix. The analysis is expressed in Consolidated Account terms as defined in Table 4 of Appendix A and include, for example, the expenditure of the Housing Authority, the Urban Council and the Regional Council.

(2) Planned changes take account of existing capital programmes, the recurrent consequence in terms of staffing and running costs of new capital assets once completed (e.g. a new fire station), underlying requirements for service (e.g. school populations) and service improvements either already under implementation or to be implemented as part of the 1988-89 budget proposals. They also include such major commitments as the Kowloon Walled City clearance and the Hong Kong University of Science and Technology.

Appendix B—*Contd.***HISTORICAL PERSPECTIVE: THE MAJOR FEATURES**

2 The changing level of expenditure on individual service groups and the balance between service groups over the period from 1983-84 to 1987-88 is illustrated in the following table:

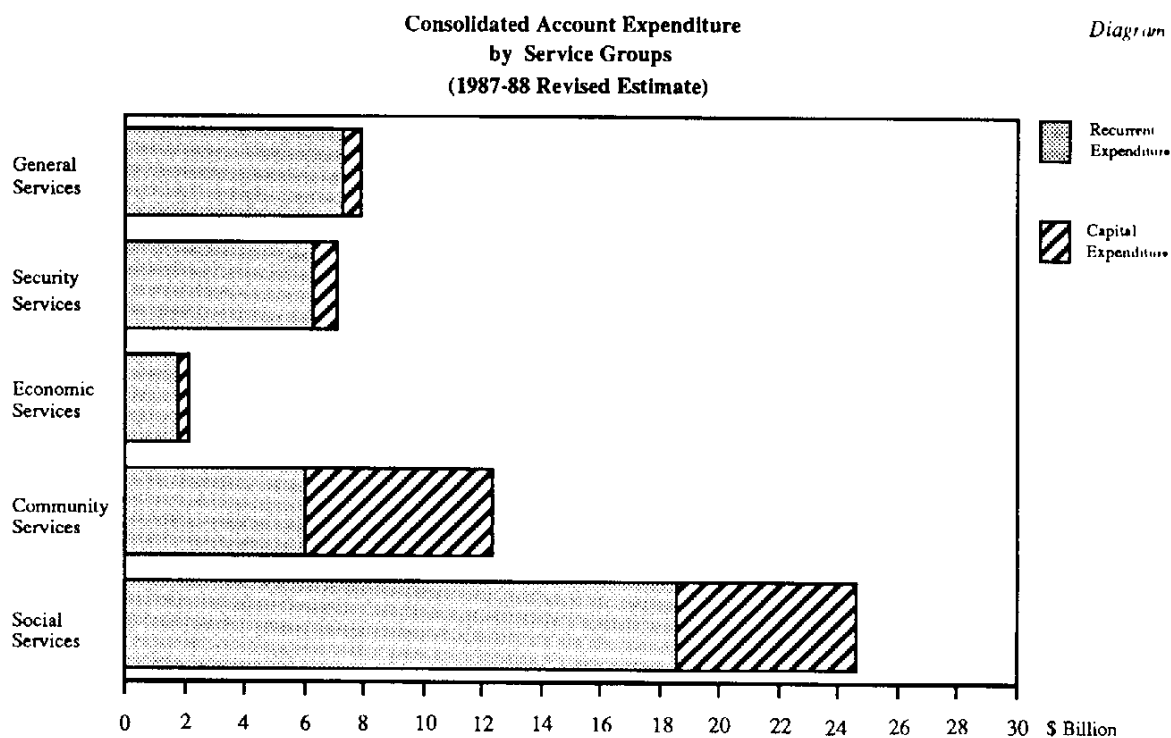
Consolidated Account Expenditure by Service Groups 1983-84 to 1987-88 *Table 1*

Services	Actual				Revised
	1983-84	1984-85	1985-86	1986-87	Estimate
	%	%	%	%	%
(A) General Services	14.1	14.9	15.6	14.8	14.6
(B) Security Services					
(1) Law and Order	8.3	8.3	8.7	9.3	8.9
(2) Immigration	0.7	0.7	0.8	0.9	0.9
(3) Internal Security	4.0	3.8	3.4	3.3	3.3
	13.0	12.8	12.9	13.5	13.1
(C) Economic Services	3.3	3.4	3.5	3.7	4.0
(D) Community Services					
(1) Transport	7.6	6.2	4.7	4.4	4.9
(2) Land and Civil Engineering	7.4	5.5	6.1	6.1	6.1
(3) Water	3.5	3.1	3.0	3.3	3.4
(4) Other	8.7	9.2	9.4	8.5	8.4
	27.2	24.0	23.2	22.3	22.8
(E) Social Services					
(1) Education	14.9	17.4	17.4	18.3	18.0
(2) Medical	7.7	8.3	8.7	9.3	9.4
(3) Housing	14.5	13.3	12.7	12.1	12.1
(4) Social Welfare	5.0	5.6	5.7	5.7	5.7
(5) Labour	0.3	0.3	0.3	0.3	0.3
	42.4	44.9	44.8	45.7	45.5
	100.0	100.0	100.0	100.0	100.0

	\$mn	\$mn	\$mn	\$mn	\$mn
Total Consolidated Account expenditure	38,596	39,882	43,444	47,930	54,080

Appendix B—Contd

3 It should be noted that the volatility in spending on some service groups is partly a reflection of a high element of capital spending within the total. Capital expenditure is, by its nature, volatile. The following diagram shows the relationship between capital and recurrent spending for each service group in 1987-88:



4 In particular, it will be noted that *Community Services* have a higher proportion of capital spending (51%) relative to other service groups. This is particularly so for *Transport* and *Land and Civil Engineering* within the *Community Services* group.

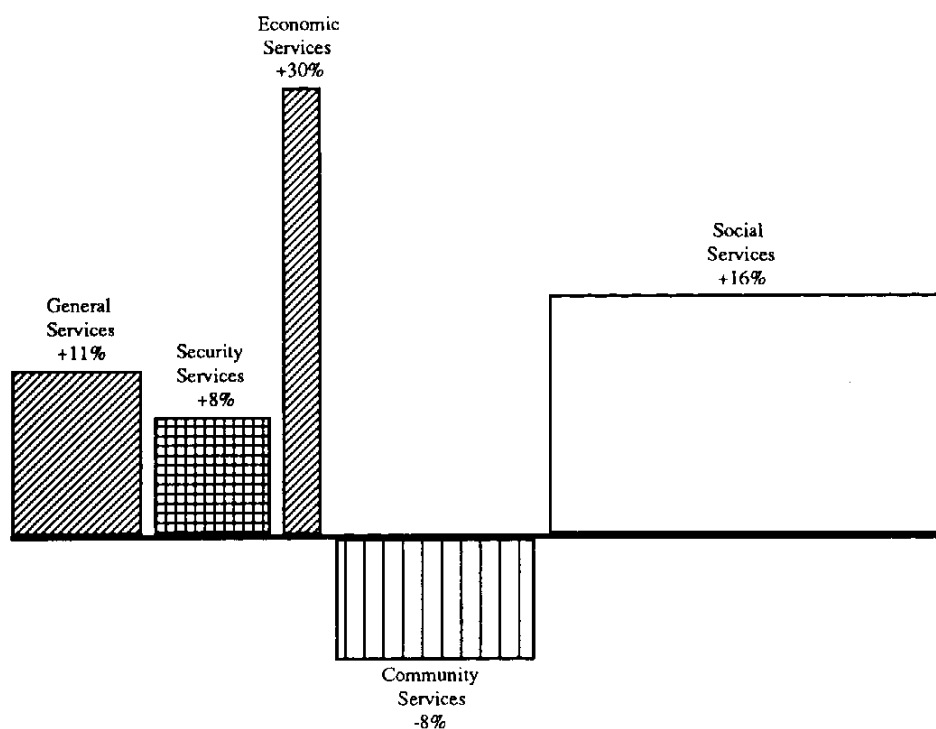
5 Since 1983-84 a significant shift in the allocation of Government's resources has taken place towards *Social Services*. In particular, *Education* has increased its share from 14.9% to 18.0%, *Medical* from 7.7% to 9.4% and *Social Welfare* from 5.0% to 5.7%. This shift reflects not only increases in the underlying demand for these services, but also the emphasis which the Government has placed on improving standards. The share for *Economic Services* has also grown (from 3.3% to 4.0%), due particularly to capital spending on extension works at the airport.

Appendix B—Contd.

The percentage changes in real terms for each service group comparing 1983-84 and 1987-88 is illustrated in following diagram:

Percentage Changes (in real terms)
in Spending for Service Groups
Comparing 1983-84 and 1987-88

Diagram 2



Note : The width of each bar on the horizontal axis is proportional to the 1987-88 Revised Estimate

Consolidated Account expenditure over this period increased by 8.5% in real terms equivalent to an average annual growth rate of about 2.1%. This overall growth rate reflects a period of relative constraint in public expenditure at a time of adverse budgetary circumstances. Nevertheless there were significant growth areas in the period as indicated below:

	Total Real Growth 1983-84 to 1987-88 %	Average Annual Growth Rate %
Education	30	7.0
Medical Services	33	7.4
Social Welfare	23	5.3

Transport spending has reduced by 30% in real terms over the period reflecting the completion of a number of major projects including Kowloon-Canton Railway electrification.

Appendix B—Contd.

FORECAST OF PLANNED TRENDS IN PUBLIC EXPENDITURE 1987-88 TO 1991-92

9 Table 2 shows forecast Consolidated Account expenditure over the period from 1987-88 to 1991-92 and the forecast share of individual services.

Consolidated Account Expenditure by Service Groups 1987-88 to 1991-92 Table 2

Services	Revised Estimate	Forecast			
	1987-88	1988-89	1989-90	1990-91	1991-92
	%	%	%	%	%
(A) General Services	14.6	14.6	14.3	14.2	14.2
(B) Security Services					
(1) Law and Order	8.9	8.7	8.8	8.8	8.9
(2) Immigration	0.9	1.0	1.0	1.0	1.0
(3) Internal Security	3.3	2.8	2.7	2.6	2.5
	13.1	12.5	12.5	12.4	12.4
(C) Economic Services	4.0	4.1	4.1	3.9	3.8
(D) Community Services					
(1) Transport	4.9	4.7	4.7	4.2	4.0
(2) Land & Civil Engineering	6.1	5.7	5.7	5.9	5.9
(3) Water	3.4	3.0	3.0	2.8	2.7
(4) Other	8.4	8.5	8.5	8.5	8.5
	22.8	21.9	21.9	21.4	21.1
(E) Social Services					
(1) Education	18.0	18.0	17.8	18.1	18.3
(2) Medical	9.4	9.7	9.7	10.3	10.9
(3) Housing	12.1	12.6	12.9	12.4	11.9
(4) Social Welfare	5.7	6.3	6.5	7.0	7.1
(5) Labour	0.3	0.3	0.3	0.3	0.3
	45.5	46.9	47.2	48.1	48.5
	100.0	100.0	100.0	100.0	100.0
Total Consolidated Account expenditure	\$mn	\$mn	\$mn	\$mn	\$mn
	54,080	62,590	70,500	76,670	84,140

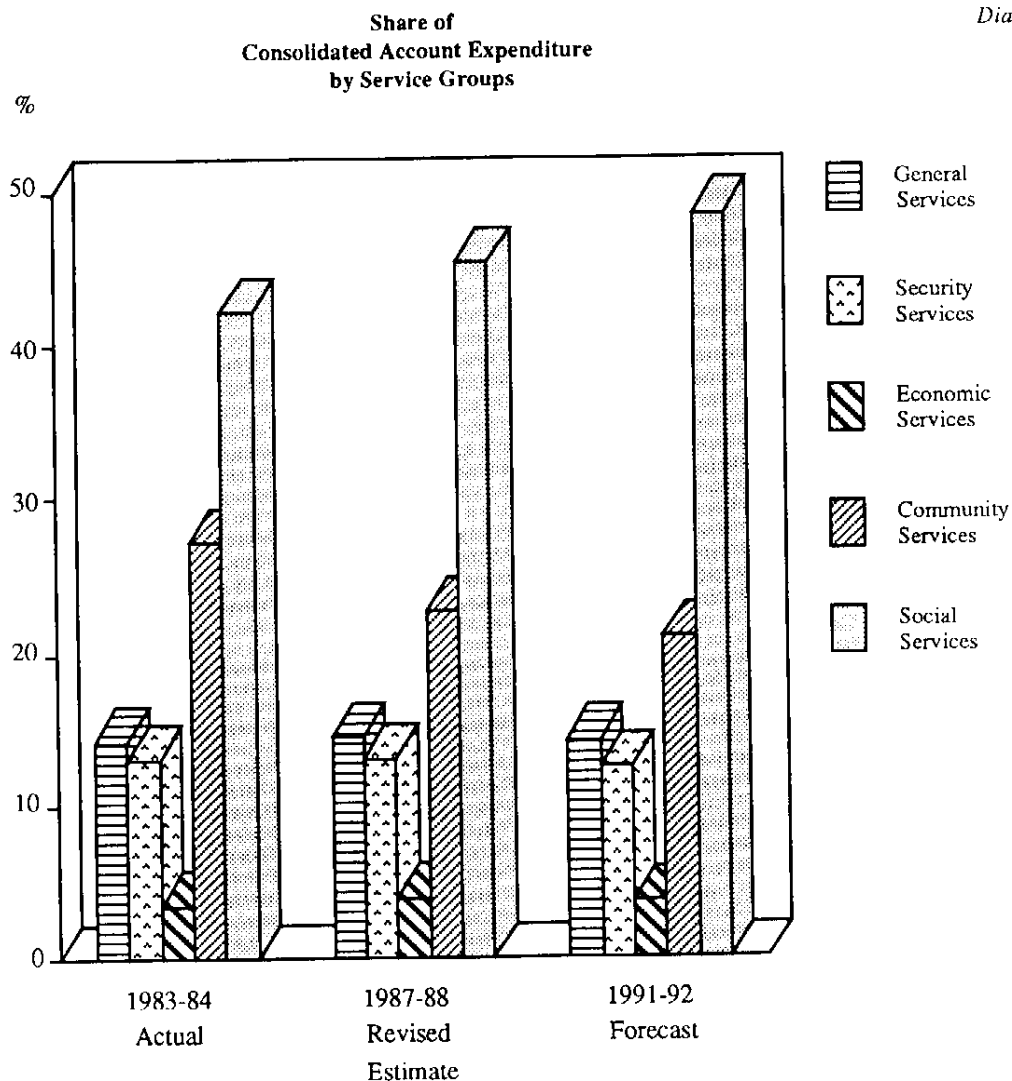
10 The above table only takes into account current trends and actual or planned commitments as defined earlier in footnote (2) on page 17. It does not, therefore, prejudge decisions relating to further new or improved services over the period which may be introduced within overall expenditure planning guidelines.

11 In considering these expenditure forecasts it should be remembered that individual service groups exhibit different characteristics which affect their underlying financial requirements. This may be due, for example, to the anticipated pattern of demand for a particular service, the phasing of capital programmes, the timing of the recurrent consequences of capital projects once completed, and the introduction of new or improved services to be implemented as part of the 1988-89 budget proposals.

Appendix B—Contd.

12 The actual and forecast shift between service groups over the period 1983-84 to 1991-92 is reflected in the following diagram:

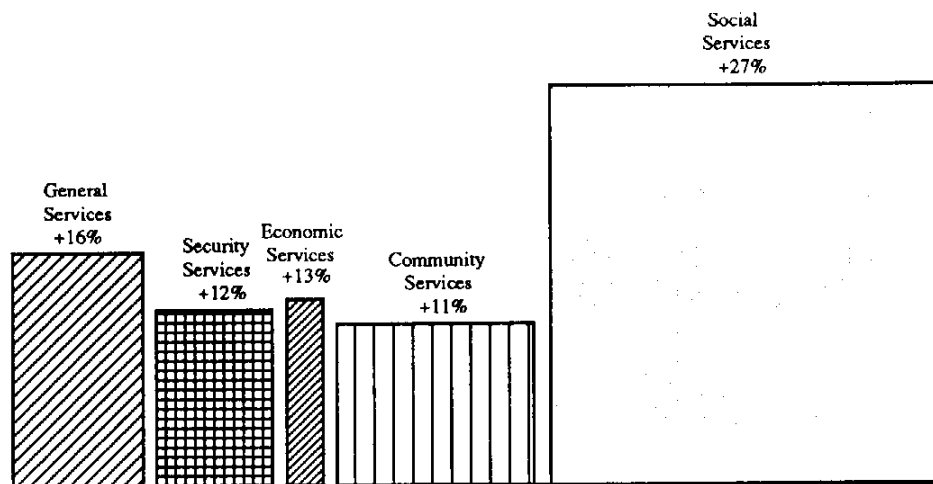
Diagram 3



13 The forecast percentage changes in real terms for each service group comparing 1987-88 and 1991-92 are indicated in the following diagram:

Percentage Changes (in real terms)
in Spending for Service Groups
Comparing 1987-88 and 1991-92

Diagram 4



Note: The width of each bar on the horizontal axis is proportional to the 1987-88 Revised Estimate

14 Table 2 and the diagram above indicate that current plans and commitments imply a continuation of the trend towards an increasing share of total resources going to *Social Services*. Within this service group, spending on *Medical* is expected to rise particularly sharply (+38% in real terms at an average annual rate of 9%), led by an expanding capital programme with its consequential increases in running costs for new hospitals and other facilities. *Social Welfare* will also increase significantly (+48% at an average annual rate of 11%) due, in part, to recent measures in respect of assistance to the elderly and the disabled and also to the planned expansion in the provision of welfare facilities and services. The Social Security component of this service group is expected to increase by 59%. It is again emphasized that these growth factors take no account of any new or improved services not already planned but which may be introduced within overall expenditure planning guidelines.

15 The share of spending devoted to *Housing* will rise for the first few years of the forecast period due to spending on the Kowloon Walled City project. Thereafter, it will fall slightly as a share of the total although underlying spending (excluding Kowloon Walled City) will still be increasing in real terms.

16 The share of overall spending on *Internal Security* will reduce with the gradual run down of the garrison although this will be partly offset by higher spending on *Law and Order* as the Royal Hong Kong Police Force is expanded.

17 Whilst the share of *Economic Services* shows a slight reduction due to completion of Stage V of the building programme at Kai Tak, this may be affected in the 1990's (beyond the forecast period) by several major economic infrastructure projects currently under consideration. *Transport* may be similarly affected. The impact on the relative share of these services will be reduced, however, by the extent to which the private sector participates in such projects.

The Scope for New or Improved Services

18 The forecast of Consolidated Account expenditure shown in Table 2 and as expressed in terms of relative shares in Diagram 3 does not take into account new or improved services not already planned. The scope for financing these is determined by the *Medium Range Forecast (MRF)* (see Appendix A). However, a comparison of the current MRF with the forecast made above on the basis of planned trends in expenditure up to 1991-92 (Table 2) may not provide a complete guide as to the scope for financing new or improved services. For example, existing development and improvement programmes already planned and built into the MRF are always subject to review as, is indeed, expenditure on existing services. Where such reviews lead to readjustment of priorities savings may result which can be redirected towards new or improved services. Moreover, and very importantly, the implementation of value for money studies can also result in a more efficient deployment of scarce resources so that existing tasks can be performed more cheaply and the resulting savings used for new services. Over the last 5 years, these studies have saved an estimated \$650 million.

Appendix B—*Contd.***KEY TO CLASSIFICATION OF EXPENDITURE**

Service Groups	Reference
(A) <i>General Services</i>	
(1) Administration	<p>His Excellency the Governor's Establishment</p> <p>General Expenses of the Civil Service (with the exception of leasing and management of quarters)</p> <p>Government Secretariat</p> <p>Government Secretariat: City and New Territories Administration</p> <p>Government Secretariat: Civil Service Training Centre</p> <p>Government Secretariat: Overseas Offices</p> <p>Miscellaneous Services— Allowances for Members of the Executive and Legislative Councils Contribution to the third/fourth replenishment of the Asian Development Fund Election expenses Subscription to the Asian Development Bank</p> <p>Office of Members of the Executive and Legislative Councils</p> <p>Public Service Commission</p> <p>Registrar General's Department</p> <p>Standing Commission on Civil Service Salaries and Conditions of Service</p> <p>Subventions: Miscellaneous— Subventions to New Territories organizations</p> <p>Capital Works Reserve Fund: payments in respect of— Major Systems—Government Secretariat Registrar General's Department</p>
(2) Support	<p>Architectural Services Department</p> <p>Census and Statistics Department</p> <p>Electrical and Mechanical Services Department</p> <p>General Expenses of the Civil Service— Leasing and management of quarters</p> <p>Government Data Processing Agency</p> <p>Government Laboratory</p> <p>Government Land Transport Agency</p> <p>Government Supplies Department</p> <p>Marine Department (Government dockyard and pool launches)</p> <p>Miscellaneous Services— Expenses of visiting advisers Hire of services and professional fees Office rents and rates</p> <p>Pensions</p> <p>Printing Department</p> <p>Royal Observatory</p> <p>Subventions: Miscellaneous— World Meteorological Organization</p> <p>Capital Works Reserve Fund: payments in respect of— Major Systems—Architectural Services Department Government Data Processing Agency Royal Observatory</p> <p>Support projects</p>

Appendix B—*Contd.*

Service Groups		Reference
(A)	<i>General Services—Contd.</i>	
(3)	Public Relations	Information Services Department Radio Television Hong Kong Subventions: Miscellaneous— Commonwealth Institute Capital Works Reserve Fund: payments in respect of— Major Systems—Radio Television Hong Kong
(4)	Revenue Collection and Financial Control	Audit Department Customs and Excise Department Inland Revenue Department Miscellaneous Services— Subscription to Customs Co-operation Council Rating and Valuation Department Treasury Capital Works Reserve Fund: payments in respect of— Major Systems—Customs and Excise Department Inland Revenue Department Treasury
(5)	Unallocable Expenses	Miscellaneous Services— Additional commitments Compensation Interest on tax reserve certificates Other miscellaneous items Refunds of revenue Write-offs Public Debt
(B)	<i>Security Services</i>	
(1)	Law and Order	Correctional Services Department Independent Commission Against Corruption Judiciary Legal Department Miscellaneous Services— Expenses of refugees not in Correctional Services institutions Police Complaints Committee Police: Royal Hong Kong Police Force Subventions: Miscellaneous— Commonwealth Legal Advisory Service Capital Works Reserve Fund: payments in respect of— Law and Order projects Major Systems—Independent Commission Against Corruption Police: Royal Hong Kong Police Force
(2)	Immigration	Immigration Department Capital Works Reserve Fund: payments in respect of— Major Systems—Immigration Department
(3)	Internal Security	Internal Security: Miscellaneous Measures Royal Hong Kong Auxiliary Air Force Royal Hong Kong Regiment (The Volunteers)

Appendix B—*Contd.*

Service Groups	Reference
(C) <i>Economic Services</i>	
(1) Food Supply	<p>Agriculture and Fisheries Department (excluding Conservation and Country Parks Branch)</p> <p>Subventions: Miscellaneous— Commonwealth Agricultural Bureaux</p> <p>Capital Works Reserve Fund: payments in respect of— Food Supply projects</p> <p>Development Loan Fund: payments in respect of— Fisheries Loans</p>
(2) Aviation and Shipping	<p>Civil Aviation Department</p> <p>Marine Department (excluding Government dockyard and pool launches)</p> <p>Capital Works Reserve Fund: payments in respect of— Aviation and Shipping projects Major Systems—Civil Aviation Department —Marine Department</p>
(3) Trade and Industry	<p>Industry Department</p> <p>Miscellaneous Services— Subscription to the General Agreement on Tariffs and Trade</p> <p>Subventions: Miscellaneous— Asian and Pacific Development Centre Asian Productivity Organization Commonwealth Foundation Commonwealth Fund for Technical Co-operation Consumer Council Hong Kong Design Innovation Company Limited Hong Kong-Japan Business Co-operation Committee Hong Kong Management Association Hong Kong Plastics Technology Centre Company Limited Hong Kong Productivity Council Hong Kong Tourist Association Hong Kong Trade Development Council Statistical Institute for Asia and the Pacific Trade Policy Research Centre United Nations Development Programme</p> <p>Trade Department Capital Works Reserve Fund: payments in respect of— Major Systems—Trade Department</p> <p>Development Loan Fund: payments in respect of— Flatted factories Industrial estates</p>
(4) Posts and	Post Office
Telecommunications	<p>Subventions: Miscellaneous— Asia-Pacific Telecommunity</p> <p>Capital Works Reserve Fund: payments in respect of— Major Systems—Post Office Post and Telecommunication projects</p>
(D) <i>Community Services</i>	
(1) Transport	<p>Civil Engineering Services Department (Railway Development Office)</p> <p>Highways Department</p> <p>Miscellaneous Services— Payment to Cross-Harbour Tunnel Company Ltd.</p>

	Service Groups	Reference
(D)	<i>Community Services—Contd.</i>	Subventions: Miscellaneous— Road Safety Association Special transport facilities for the disabled Transport Department Capital Works Reserve Fund: payments in respect of— Transport projects Mass Transit Fund payments
(2)	Land and Civil Engineering	Buildings and Lands Department (with the exception of Buildings Ordinance Office) Civil Engineering Services Department (excluding the Railway Development and Geotechnical Control offices) Government Secretariat: Lands and Works Branch Territory Development Department Capital Works Reserve Fund: payments in respect of— Civil Engineering projects Land Acquisition (excluding Kowloon Walled City projects) Major Systems—Buildings and Lands Department
(3)	Water	Water Supplies Department Capital Works Reserve Fund: payments in respect of— Water Supplies projects
(4)	Public Safety	Auxiliary Medical Services Buildings and Lands Department (Buildings Ordinance Office) Civil Aid Services Civil Engineering Services Department (Geotechnical Control Office) Fire Services Department Capital Works Reserve Fund: payments in respect of— Major Systems—Fire Services Department Public Safety projects
(5)	Recreation, Culture and Amenities	Government Secretariat: Municipal services Branch Subventions: Miscellaneous— Commonwealth Youth Programme Hong Kong Academy for Performing Arts Hong Kong Archaeological Society Outward Bound Trust of Hong Kong Royal Asiatic Society Royal Life Saving Society, Hong Kong Branch Subventions for performing arts activities Subventions for the promotion of sports Subventions to voluntary agency camps Television and Entertainment Licensing Authority Regional Council expenditure Urban Council expenditure Capital Works Reserve Fund: payments in respect of— Recreation, Culture and Amenities projects Subventions to Jubilee Sports Centre
(6)	Environmental Protection	Agriculture and Fisheries Department (Conservation and Country Parks Branch) Environmental Protection Department Miscellaneous Services— Payment in respect of air pollution mitigation measures

Appendix B—*Contd.*

	Service Groups	Reference
(D)	<i>Community Services—Contd.</i>	Subventions: Miscellaneous— Commonwealth Forestry Institute Royal Society for the Prevention of Cruelty to Animals (Hong Kong) Capital Works Reserve Fund: payments in respect of— Environmental Protection projects
(E)	<i>Social Services</i>	
	(1) Education	Education Department Education Subventions Subventions: Miscellaneous Hong Kong University of Science and Technology Technical Education and Industrial Training Department Universities and Polytechnics Capital Works Reserve Fund: payments in respect of— Education projects Education Subventions projects Technical Education and Industrial Training subvention projects Universities and Polytechnics subvention projects Development Loan Fund: payments in respect of— Loans to schools Student Loan Fund payments
	(2) Medical	Medical and Health Department Medical Subventions Subventions: Miscellaneous— Hong Kong Council on Smoking and Health United Nations Fund for Drug Abuse Control Capital Works Reserve Fund: payments in respect of— Major Systems—Medical and Health Department Medical and Health projects Medical Subvention projects
	(3) Housing	Housing Department Housing Authority expenditure Capital Works Reserve Fund: payments in respect of— Housing Kowloon Walled City projects (including Land Acquisition) Development Loan Fund: payments in respect of— Housing Home Ownership Fund payments
	(4) Social Welfare	Legal Aid Department Social Welfare Department Social Welfare Subventions Subventions: Miscellaneous— Commonwealth War Graves Commission Far Eastern Relief Fund Hong Kong War Memorial Fund Law Society Legal advice and duty lawyer schemes Magistrates poor box United Nations Children's Fund Capital Works Reserve Fund: payments in respect of— Social Welfare projects Lotteries Fund payments

Appendix B—*Contd.*

Service Groups	Reference
(E) <i>Social Services—Contd.</i>	
(5) Labour	Labour Department
	Registry of Trade Unions
	Capital Works Reserve Fund: payments in respect of— Major Systems—Labour Department

CONTINGENT LIABILITIES AS AT 31 MARCH 1987

A contingent liability is defined as a liability arising from a condition or situation which exists at the year end, where the amount of the liability, if any, and its timing will depend on the occurrence or non-occurrence of one or more uncertain future events.

2 The Government's contingent liabilities as at 31 March 1987 are listed below. The approximate maximum potential amount of each liability as at that date is indicated in brackets. It is not an assessment of actual risk.

- (1) Capital subscription to Asian Development Bank (\$671.8 million);
- (2) Outstanding currency notes demonetized under the Dollar and Subsidiary Currency Notes Ordinance (Cap. 67)(\$10.2 million);
- (3) One cent notes issued under Section 4(1) of the Dollar and Subsidiary Currency Notes Ordinance (Cap. 67) (\$1 million);
- (4) Gold coins issued in accordance with L.N. 97 of 1975 (\$369.7 million);
- (5) A guarantee on notes issued by the Hong Kong Building and Loan Agency Ltd. (\$320 million);
- (6) All moneys which may become due by the Hong Kong Export Credit Insurance Corporation under contracts of insurance (\$3,710 million);
- (7) Guarantees in respect of the repayment of loans made to and the discharge of indebtedness of the Mass Transit Railway Corporation under the facilities specified in the Schedules to L.N. 242 of 1975 and L.N. 105 of 1978 (\$5,860.7 million);
- (8) A guarantee in respect of the reimbursement of costs incurred by the Mass Transit Railway Corporation arising from the possible extension of the mass transit railway to Junk Bay (\$2 million);
- (9) Possible equity injections to the Mass Transit Railway Corporation to be made on or after 31 December 1989 (\$2,500 million);
- (10) Full and partial default guarantees in respect of mortgage loans made by banks and other financial institutions under the Home Ownership Scheme and the Private Sector Participation Scheme (\$5,774.4 million);
- (11) A guarantee in respect of the reimbursement to the developers of the projects under the Private Sector Participation Scheme for unsold flats and flats sold at a price below the stipulated average price (\$3,365.7 million);
- (12) A guarantee under Section 13 of the Kowloon-Canton Railway Corporation Ordinance (Cap. 372) in respect of the repayment of the principal of, the payment of interest on, and the discharge of any other financial obligation in connexion with any sums borrowed by the Kowloon-Canton Railway Corporation (\$500 million);
- (13) A guarantee in respect of a commercial loan to the City Polytechnic of Hong Kong for the acquisition of temporary premises (\$240 million);
- (14) A guarantee in respect of a commercial borrowing facility for the Hong Kong Nuclear Investment Company Ltd. (\$255 million);
- (15) Outstanding New Territories Land Exchange Entitlements (Letters A/B)(estimated monetized value of \$3,025 million);
- (16) Outstanding litigation (\$1,251 million).

THE RECURRENT COST IMPLICATIONS OF MAJOR NEW OR IMPROVED SERVICES TO BEGIN IN 1988-89

The following items (each costing \$3 million or over) have been included in the draft Estimates for implementation in 1988-89. Together with some other minor items costing under \$3 million each, the full year cost of proposals to be introduced in 1988-89 is \$1,060 million.

<i>Description</i>	<i>Full Year Cost (\$ million)</i>
General Services	
Establishment of the office of the Commissioner for Administrative Complaints	3.4
Strengthening liaison with Area Committees, Mutual Aid Committees/Owners' Corporations	5.7
Modified annual leave passage scheme for expatriate officers	17.4
Security Services	
Expansion of the Police Tactical Unit	72.3
Economic Services	
Expansion of the Hong Kong Productivity Council's productivity enhancement services	15.3
Establishment of a Hong Kong Government office in Tokyo	3.4
Community Services	
Implementation and enforcement of the proposed Noise Control Bill	6.0
Social Services	
Research grants for the five UPGC-funded institutions	30.0
Application of the Home Purchase Scheme to the five UPGC-funded institutions	6.5
Setting up costs for the Council of the new Hong Kong University of Science & Technology	11.5
Setting up of the Open Learning Institute of Hong Kong	6.5
Language improvement measures in public sector schools (two additional teachers of English for each secondary school using Chinese as the medium of instruction)	13.9
Providing higher disability allowance for the severely disabled who require constant attendance	119.6
Increases in old age allowances for the elderly (phased implementation of new rates for those aged 70 and above and extension to the 65 to 69 age group)	495.2
Improvements to the Public Assistance Scheme (improved rates for certain categories of recipients)	26.7
Extension of standard costs for subvented social welfare services	17.3
Increased grants for central administration of subvented social welfare agencies	7.3
Additional staff for guardianship and supervision cases in connection with proposed amendments to the Mental Health Ordinance and additional costs resulting from the establishment of a Mental Health Review Tribunal	8.0

2 The above growth in recurrent expenditure is in *addition* to growth arising from meeting the running costs of new buildings (schools, hospitals, etc.) and from responding to changes in the underlying demand for individual services. The latter may be due, for example, to population growth or changes in the number of persons eligible for a particular service.

MAJOR CAPITAL WORKS PROJECTS TO BEGIN IN 1988-89

The following projects, each with a project cost of \$100 million or over, are budgetted to begin in 1988-89:—

<i>Description</i>	<i>Project Cost* (\$ million)</i>
New Territories circular road improvements: Au Tau to Fan Kam Road—Au Tau bypass and widening of the circular road	260
Road improvement and pedestrian schemes in the Salisbury Road, Canton Road and Austin Road corridors	195
Yuen Long-Tuen Mun eastern corridor and Yuen Long west link	300
Yuen Long southern bypass	120
Government offices and car park at Wan Chai	410
Future increase of water supply from China—upgrading of Harbour Island pumping station and construction of land/submarine pipelines in Lantau Island	260
Water treatment and transfer facilities at Au Tau, Yuen Long—extension of treatment works and upgrading of pumping station	190
Pak Kong treatment works and water transfer facilities—extension of treatment works including sludge disposal facilities	434
Queen Mary Hospital (stage III)—extension and improvements to main hospital block and installation of central air-conditioning	118
Wong Chuk Hang complex for the elderly	100
Tsing Yi development—Tsing Yi Bay reclamation, site formation and construction of roads, pedestrian facilities and drainage	280
Widening of Kwai Chung Road from Lai Chi Kok to Tsuen Wan bypass	125
Completion of Texaco Road/Tsuen Wan bypass interchange and improvements to Texaco Road	295
Formation of a light rail transit reserve in the Tuen Mun-Yuen Long corridor and construction of roads, pedestrian facilities and drainage	175
Tin Shui Wai development—formation of 242 hectares of land and main drainage	243
Tin Shui Wai development—construction of roads, pedestrian facilities and drainage	235
Tuen Mun New Town development—construction of roads, pedestrian facilities and drainage in areas 14 and 16	105
Main drainage channels for Yuen Long and Kam Tin	250
Junk Bay development, area 86—reclamation, drainage and ancillary works	110
Junk Bay development, head of bay—reclamation and road link	150

*Including the part of works to be commenced in 1988-89 as well as the remaining parts which are to start in a later year.

PROPOSED RATES OF DUTY(i) INTOXICATING LIQUOR AND IMPORTED ALOOHOL

	<u>Present rate</u> (\$)	<u>Proposed rate</u> (\$)	
		<u>Specific</u> (per litre)	+ <u>Ad Valorem</u> (of value)
<u>Part I</u>			
Brandy	\$67/L + 20% AV	55.00	30%
Whisky, gin, Liqueurs, Rum, Vodka and other Spirituuous Liquors	\$48/L + 20% AV	48.00	30%
Champagne and Sparkling Wines	\$30/L + 20% AV	30.00	20%
Still Wines over 15%	\$20/L + 20% AV	20.00	20%
Still Wines not over 15%	\$17/L + 20% AV	17.00	20%
Intoxicating liquor in this part above the strength of 45% by volume, for every 1% above such strength in addition to the duties specified above	\$1.3/L	1.40	-
<u>Part II</u>			
Cider and Perry	\$1.28/L	1.36	-
<u>Part III</u>			
Beer not exceeding 1030° original gravity	\$1.28/L	1.36	-
and in addition for every degree by which the original gravity exceeds 1030°	\$0.043/L	0.045	-

Appendix F(1)(cont'd)

PROPOSED RATES OF DUTY(i) INTOXICATING LIQUOR AND IMPORTED ALOOHOL

	<u>Present rate</u> (\$)	<u>Proposed rate</u> (\$)	
		<u>Specific</u> (per litre)	+ <u>Ad Valorem</u> (of value)
<u>Part IV</u>			
Non-European Type Wines	\$8.30/L	8.80	-
Chinese Type Spirits and other Spirituous Liquors, Sake, Arrack	\$4.30/L	4.55	-
and in addition for every 1% by which the alcoholic strength by volume exceeds 30%	\$0.143/L	0.151	-
<u>Part V</u>			
Ethyl alcohol, and admixtures containing ethyl alcohol	\$4.30/L	4.55	-
Methyl alcohol, and admixtures containing methyl alcohol	\$4.30/L	4.55	-
and in addition for every 1% by which the alcoholic strength exceeds 30%	\$0.143/L	0.151	-

Appendix F(1)(cont'd)

(ii) TOBACCO

The effect of the proposed duty changes on the estimated average retail price of various categories of smoking products might be-

	<u>Existing duty rate</u>	<u>Proposed duty rate</u>	<u>Current average retail price</u>	<u>Estimated average retail price</u>	<u>% increase</u>
	<u>(\$/1,000 sticks)</u>	<u>(\$/1,000 sticks)</u>	<u>(\$/1,000 sticks)</u>	<u>(\$/1,000 sticks)</u>	
(1) Cigarettes					
(i) imported from US)			413.80	423.80	2.4
(ii) imported from UK)	165.00	175.00	450.00	460.00	2.2
(iii) locally manufactured)			327.50	337.50	3.0
	<u>(\$/kg)</u>	<u>(\$/kg)</u>	<u>(\$/kg)</u>	<u>(\$/kg)</u>	
(2) Cigars					
(i) ordinary grade)			670.70	683.70	1.9
(ii) deluxe grade)	220.00	233.00	2,877.40	2,890.40	0.45
(3) Smoking Tobacco	200.00	212.00	441.00	453.00	2.7
(4) Chinese Prepared Tobacco	43.00	45.50	115.00	117.50	2.2

Appendix F (2)

(i) VEHICLE AND DRIVING LICENCE FEES

	<u>Existing fees</u> (\$)	<u>Proposed fees</u> (\$)
1. <u>Driving Licences</u>		
Full	180 p.a.	190 p.a.
Driving instructor's	550 p.a.	580 p.a.
Leamer's	370 p.a.	390 p.a.
Temporary	180	190
Driving test	370	390
Driving instructor's	370	390
International driving permit	55 p.a.	60 p.a.
Duplicate licence	80	85
Duplicate international driving permit	55	60
Record of convictions	45	45
Certificate of no recorded conviction	45	45
2. <u>Vehicle Licences</u>		
<u>Goods Vehicle</u>		
not exceeding 1.9 tonnes	850	900
exceeding 1.9 tonnes but not exceeding 5.5 tonnes	1,650	1,750
exceeding 5.5 tonnes	3,300	3,500
<u>Taxi</u>	2,200	2,330
<u>Private Car</u>		
not exceeding 1,500 cc	2,750	2,915
exceeding 1,500 cc but not exceeding 2,500 cc	4,100	4,345
exceeding 2,500 cc but not exceeding 3,500 cc	5,450	5,775
exceeding 3,500 cc but not exceeding 4,500 cc	6,800	7,210
exceeding 4,500 cc	8,100	8,585
additional fee for private car using diesel fuel	1,050	1,115
<u>Electrically powered passenger vehicles</u>		
not exceeding 1 tonne	320	340
for each additional 250 kg	65	70
<u>Motor Cycle</u>	870	920
<u>Motor Tricycle</u>	870	920

(i) VEHICLE AND DRIVING LICENCE FEES

	<u>Existing fees</u> (\$)	<u>Proposed fees</u> (\$)
<u>Public Light Bus</u>	6,000	6,360
<u>Private Light Bus</u>	1,900	2,015
<u>Public Bus</u>		
for the driver	16	17
additional fee for each seat	37	39
<u>Private Bus</u>		
for the driver	16	17
additional fee for each seat	32	34
<u>Trailer</u>		
for each 250 kg or part thereof	21	22

Appendix F(2)(cont'd)

(ii) BANK AND DEPOSIT-TAKING COMPANY LICENCE FEES

	Existing fee (\$)	Proposed fee (\$)
1. Annual banking licence fee for bank, other than an unincorporated bank (section 19(1))	360,000	388,800
2. Registration fee (section 23(1))	50,000	54,000
3. Renewal of registration fee (section 23(2))	50,000	54,000
4. Deposit-taking licence fee (section 26(1))	170,000	183,600
5. Renewal of deposit-taking licence fee (section 26(2))	170,000	183,600
6. Inspection fee (section 27(3))	10	10
7. Fee for a copy or extract, per page (section 27(3))	5	5
8. Fee for the establishment of a local branch of a bank (section 45(1))	17,000	18,360
9. Annual fee for maintaining a local branch of a bank (section 45(1) and (2))	17,000	18,360
10. Fee for the establishment of a local branch of a deposit-taking company (section 45(1))	8,500	9,180
11. Annual fee for maintaining a local branch of a deposit-taking company (section 45(1) and (2))	8,500	9,180
12. Fee for the establishment of a local representative office (section 48(1))	17,000	18,360
13. Annual fee for maintaining a local representative office (section 48(1), (2) and (3))	17,000	18,360
14. Fee for the establishment of an overseas branch of a bank (section 51(1))	34,000	36,720
15. Annual fee for maintaining an overseas branch of a bank (section 51(1) and (2))	34,000	36,720
16. Fee for the establishment of an overseas branch of a deposit-taking company (section 51(1))	17,000	18,360
17. Annual fee for maintaining an overseas branch of a deposit-taking company (section 51(1) and (2))	17,000	18,360
18. Fee for the establishment of an overseas representative office of a bank (section 51(1))	8,500	9,180
19. Annual fee for maintaining an overseas representative office of a bank (section 51(1) and (2))	8,500	9,180
20. Fee for the establishment of an overseas representative office of a deposit-taking company (section 51(1))	8,500	9,180
21. Annual fee for maintaining an overseas representative office of a deposit-taking company (section 51(1) and (2))	8,500	9,180
22. Annual banking licence fee for unincorporated bank (section 109(1))	5,000	5,400

(i) EFFECT ON TAX PAYABLE DUE TO THE REVISION
OF THE MARGINAL TAX RATES

Chargeable income	Rate	<u>Present</u>		<u>Proposed</u>		Tax reduction (A) - (B)	Tax reduction (A) - (B)
		Tax	Cumulative tax (A)	Rate	Tax		
		(\$)	(\$)		(\$)	(\$)	(\$)(%)
First \$10,000	5%	500	500	3%	300	300	200 40.0
Next \$10,000	10%	1,000	1,500	6%	600	900	600 40.0
Next \$10,000	15%	1,500	3,000	9%	900	1,800	1,200 40.0
Next \$10,000	15%	1,500	4,500	12%	1,200	3,000	1,500 33.3
Next \$10,000	20%	2,000	6,500	15%	1,500	4,500	2,000 30.8
Next \$10,000	20%	2,000	8,500	18%	1,800	6,300	2,200 25.9
Next \$10,000	25%	2,500	11,000	21%	2,100	8,400	2,600 23.6
Next \$10,000	25%	2,500	13,500	25%	2,500	10,900	2,600 19.3
<hr/>							
\$80,000							
<hr/> <hr/>							

Appendix F(3)(cont'd)

(ii) BROAD EFFECT OF THE INCREASE IN ADDITIONAL PERSONAL ALLOWANCE ON SINGLE AND MARRIED TAXPAYERS

<u>Single</u>	No. of taxpayer s	Remarks
Full benefit (ie those with income below \$36,000 or with total allowances in excess of their income)	67 000	This group receives <u>full</u> benefit from the increase in personal allowance.
Partial benefit (ie those with income between \$36,001 and \$105,999)	340 000	This group receives <u>partial</u> benefit from the increase in personal allowance but the <u>full</u> benefit of the revision to the marginal tax rates.
No benefit (ie in situation where income exceeds \$106,000, clawback exhausts allowance)	34 000	This group receives <u>no</u> benefit from the increase in personal allowance but the <u>full</u> benefit of the revision to the marginal tax rates.
No effect - income subject to standard rate of 15 1/2%	13 000	Standard rate taxpayers.
<u>Married</u>		
Full benefit (ie those with income below \$74,000 or with total allowances in excess of their income)	26 000	This group receives <u>full</u> benefit from the increase in personal allowance.
Partial benefit (ie those with income between \$74,001 and \$213,999)	147 000	This group receives <u>partial</u> benefit from the increase in personal allowance but the <u>full</u> benefit of the revision to the marginal tax rates.
No benefit (ie in situation where income exceeds \$214,000, clawback exhausts allowance)	32 500	This group receives <u>no</u> benefit from the increase in personal allowance but the <u>full</u> benefit of the revision to the marginal tax rates.
No effect - income subject to standard rate of 15 1/2%	40 500	Standard rate taxpayers.
T O T A L	<u>700 000</u>	

Appendix F(3)(cont'd)

(iii) Distribution of Single and Married Taxpayers
by
different income groups in 1988-89

<u>Single</u>	<u>No. of taxpayers</u>
Low Income Group (I e those with income below \$84,000)	303 000
Middle Income Group (ie those with income between \$84,000 and \$144,000)	61 000
High Income Group (ie those with income in excess of \$144,000)	23 000
<u>Married</u>	
Low Income Group (ie those with income below \$120,000)	62 000
Middle In come Group (ie those with income between \$120,000 and \$240,000)	96 000
High Income Group (ie those with income in excess of \$240,000)	62 000
Total after Budget concessions	<u>607 000</u>
<u>Add :</u>	
No. of Taxpayers estimated to fall out and be kept out of the tax net [on account of the budget concessions but liable to pay 1987-88 final tax in 1988-89]	93 000
Total no. of Taxpayers estimated to pay tax in 1988-89	<u><u>700 000</u></u>

Appendix F(3)(cont'd)

(iv) EXAMPLES OF THE EFFECT THE PROPOSED INCREASE IN PERSONAL ALLOWANCE,
REDUCTION IN THE STANDARD RATE AND REVISION OF THE MARGINAL TAX RATES
WILL HAVE ON SALARIES TAX AT VARIOUS INCOME LEVELS

Single person

Annual income	Present tax payable (Exemption level: \$34,000)		Proposed tax payable (Exemption level: \$36,000)		Tax saving		Remarks
	Amount (A)	Effective rate	Amount (B)	Effective rate	(A) - (B)		
(\$)	(\$)	(%)	(\$)	(%)	(\$)	(%)	
35,000	55	0.2	-	-	55	100.0	This group receives <u>full</u> benefit from the increase in personal allowance.
36,000	110	0.3	-	-	110	100.0	
38,000	220	0.6	66	0.2	154	70.0	This group receives <u>partial</u> benefit from the increase in personal allowance but the <u>full</u> benefit of the revision to the marginal tax rates.
48,000	1,040	2.2	492	1.0	548	52.7	
60,000	2,790	4.7	1,476	2.5	1,314	47.1	
72,000	4,860	6.8	2,952	4.1	1,908	39.3	
84,000	7,500	8.9	5,004	6.0	2,496	33.3	
96,000	10,250	10.7	7,560	7.9	2,690	26.2	
105,000	12,500	11.9	9,875	9.4	2,625	21.0	
106,000	12,750	12.0	10,150	9.6	2,600	20.4	This group receives <u>no</u> benefit from the increase in personal allowance but the <u>full</u> benefit of the revision to the marginal tax rates.
120,000	16,250	13.5	13,650	11.4	2,600	16.0	
132,000	19,250	14.6	16,650	12.6	2,600	13.5	
144,000	22,250	15.5	19,650	13.6	2,600	11.7	
(161,765)	26,691	16.5	24,091	14.9	2,600	9.7	
168,000	27,720	16.5	25,650	15.3	2,070	7.5	
(172,105)	28,397	16.5	26,676	15.5	1,721	6.1	

(v) EXAMPLES OF THE EFFECT THE PROPOSED INCREASES IN PERSONAL AND DEPENDENT PARENT ALLOWANCES, REDUCTION IN THE STANDARD RATE AND REVISION OF THE MARGINAL TAX RATES WILL HAVE ON SALARIES TAX AT VARIOUS INCOME LEVELS

Single person, with two dependent parents

Annual income	Present tax payable (Exemption level: \$50,364)		Proposed tax payable (Exemption level: \$54,182)		Tax saving		Remarks
	Amount (A)	Effective rate	Amount (B)	Effective rate	(A) - (B)	(A) - (B)	
(\$)	(\$)	(%)	(\$)	(%)	(\$)	(%)	
54,000	200	0.4	-	-	200	100.0	This group receives <u>full</u> benefit from the increase in personal allowance.
56,000	310	0.6	60	0.1	250	80.6	This group receives <u>partial</u> benefit from the increase in personal allowance but the <u>full</u> benefit of the revision to the marginal tax rates.
58,000	420	0.7	126	0.2	294	70.0	
60,000	560	0.9	192	0.3	368	65.7	
72,000	2,070	2.9	876	1.2	1,194	57.7	
84,000	4,050	4.8	2,136	2.5	1,914	47.3	
96,000	6,300	6.6	3,900	4.1	2,400	38.1	This group receives <u>no</u> benefit from the increase in personal allowance but the <u>full</u> benefit of the revision to the marginal tax rates.
105,000	8,100	7.7	5,562	5.3	2,538	31.3	
106,000	8,300	7.8	5,760	5.4	2,540	30.6	
120,000	11,750	9.8	8,650	7.2	3,100	26.4	
132,000	14,750	11.2	11,650	8.8	3,100	21.0	
144,000	17,750	12.3	14,650	10.2	3,100	17.5	
156,000	20,750	13.3	17,650	11.3	3,100	14.9	
168,000	23,750	14.1	20,650	12.3	3,100	13.1	
180,000	26,750	14.9	23,650	13.1	3,100	11.6	
192,000	29,750	15.5	26,650	13.9	3,100	10.4	
204,000	32,750	16.1	29,650	14.5	3,100	9.5	
(214,706)	35,426	16.5	32,326	15.1	3,100	8.8	
(224,737)	37,081	16.5	34,834	15.5	2,247	6.1	Standard rate taxpayers.

Appendix F(3)(cont'd)

(vi) EXAMPLES OF THE EFFECT THE PROPOSED INCREASES IN PERSONAL AND CHILD ALLOWANCES, THE INTRODUCTION OF A WORKING WIFE ALLOWANCE OF \$15,000, REDUCTION IN THE STANDARD RATE AND REVISION OF THE MARGINAL TAX RATES WILL HAVE ON SALARIES TAX AT VARIOUS INCOME LEVELSMarried person, with two children

Annual income	Present tax payable (Exemption level: \$87,273)		Proposed tax payable (without working wife) (Exemption level: \$92,636)			Proposed tax payable (with working wife) (Exemption level: \$106,273*)			Remarks		
	Amount (A)	Effective rate	Amount (B)	Effective rate	Tax saving (A) - (B)	Amount (C)	Effective rate	Tax saving (A) - (C)			
(\$)	(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)	
92,000	260	0.3	-	-	260	100.0	-	-	260	100.0	This group receives <u>full</u> benefit from the increase in personal allowance and the working wife allowance.
94,000	370	0.4	45	0.1	325	87.8	-	-	370	100.0	
96,000	480	0.5	111	0.1	369	76.9	-	-	480	100.0	
108,000	1,920	1.8	714	0.7	1,206	62.8	57	0.1	1,863	97.0	This group receives <u>partial</u> benefit from the increase in personal allowance but the <u>full</u> benefit of the revision to the marginal tax rates and the working wife allowance.
120,000	3,900	3.3	1,812	1.5	2,088	53.5	606	0.5	3,294	84.5	
132,000	6,340	4.8	3,495	2.6	2,845	44.9	1,647	1.2	4,693	74.0	
144,000	9,100	6.3	5,670	3.9	3,430	37.7	3,225	2.2	5,875	64.6	
156,000	12,400	7.9	8,337	5.3	4,063	32.8	5,346	3.4	7,054	56.9	
168,000	15,700	9.3	11,625	6.9	4,075	26.0	7,959	4.7	7,741	49.3	
180,000	18,750	10.4	14,925	8.3	3,825	20.4	11,175	6.2	7,575	40.4	
192,000	21,750	11.3	18,225	9.5	3,525	16.2	14,475	7.5	7,275	33.4	
204,000	24,750	12.1	21,525	10.6	3,225	13.0	17,775	8.7	6,975	28.2	
213,000	27,000	12.7	24,000	11.3	3,000	11.1	20,250	9.5	6,750	25.0	
214,000	27,250	12.7	24,275	11.3	2,975	10.9	20,525	9.6	6,725	24.7	This group receives <u>no</u> benefit from the increase in personal allowance but the <u>full</u> benefit of the revision to the marginal tax rates and the working wife allowance.
228,000	30,750	13.5	27,775	12.2	2,975	9.7	24,025	10.5	6,725	21.9	
240,000	33,750	14.1	30,775	12.8	2,975	8.8	27,025	11.3	6,725	19.9	
252,000	36,750	14.6	33,775	13.4	2,975	8.1	30,025	11.9	6,725	18.3	
288,000	45,750	15.9	42,775	14.9	2,975	6.5	39,025	13.6	6,725	14.7	
(307,631)	50,657	16.5	47,682	15.5	2,975	5.9	43,932	14.3	6,725	13.3	
(308,823)	50,955	16.5	47,867	15.5	3,088	6.1	44,230	14.3	6,725	13.2	Standard rate taxpayers.
(347,105)	57,272	16.5	53,801	15.5	3,471	6.1	53,801	15.5	3,471	6.1	

* The examples shown above are calculated on the basis that the wife's income is in excess of the Working Wife Allowance of \$15,000.

Appendix F(3)(cont'd)

- (vii) EXAMPLES OF THE EFFECT THE PROPOSED INCREASES IN PERSONAL ALLOWANCE, THE INTRODUCTION OF A WORKING WIFE ALLOWANCE OF \$15,000, REDUCTION IN THE STANDARD RATE AND REVISION OF THE MARGINAL TAX RATES WILL HAVE ON SALARIES TAX AT VARIOUS INCOME LEVELS

Married person, with no children

Annual income	Present tax payable (Exemption level: \$70,000)		Proposed tax payable (without working wife) (Exemption level: \$74,000)			Proposed tax payable (with working wife) (Exemption level: \$87,636*)				Remarks	
	Amount (A)	Effective rate	Amount (B)	Effective rate	Tax saving (A) - (B)	Amount (C)	Effective rate	Tax saving (A) - (C)			
(\$)	(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)	
72,000	110	0.2	-	-	110	100.0	-	-	110	100.0	This group receives <u>full</u> benefit- from the increase in personal allowance and the working wife allowance.
74,000	220	0.3	-	-	220	100.0	-	-	220	100.0	
76,000	330	0.4	66	0.1	264	80.0	-	-	330	100.0	
84,000	1,040	1.2	360	0.4	680	65.4	-	-	1,040	100.0	
96,000	2,790	2.9	1,278	1.3	1,512	54.2	276	0.3	2,514	90.1	This group receives <u>partial</u> benefit from the increase in personal allowance but the <u>full</u> benefit of the revision to the marginal tax rates and the working wife allowance.
108,000	4,860	4.5	2,688	2.5	2,172	44.7	1,116	1.0	3,744	77.0	
120,000	7,500	6.3	4,608	3.8	2,892	38.6	2,472	2.1	5,028	67.0	
132,000	10,550	8.0	7,098	5.4	3,452	32.7	4,320	3.3	6,230	59.1	
144,000	13,850	9.6	10,150	7.0	3,700	26.7	6,720	4.7	7,130	51.5	
168,000	20,450	12.2	16,750	10.0	3,700	18.1	13,000	7.7	7,450	36.4	
180,000	23,500	13.1	20,050	11.1	3,450	14.7	16,300	9.1	7,200	30.6	
192,000	26,500	13.8	23,350	12.2	3,150	11.9	19,600	10.2	6,900	26.0	
204,000	29,500	14.5	26,650	13.1	2,850	9.7	22,900	11.2	6,600	22.4	
213,000	31,750	14.9	29,125	13.7	2,625	8.3	25,375	11.9	6,375	20.1	
214,000	32,000	15.0	29,400	13.7	2,600	8.1	25,650	12.0	6,350	19.8	This group receives <u>no</u> benefit from the increase in personal allowance but the <u>full</u> benefit of the revision to the marginal tax rates and the working wife allowance.
228,000	35,000	15.6	32,900	14.4	2,600	7.3	29,150	12.8	6,350	17.9	
240,000	38,500	16.0	35,900	15.0	2,600	6.8	32,150	13.4	6,350	16.5	
(252,941)	41,735	16.5	39,135	15.5	2,600	6.2	35,385	14.0	6,350	15.2	
(253,684)	41,857	16.5	39,321	15.5	2,536	6.1	35,571	14.0	6,286	15.0	Standard rate taxpayers.
(293,158)	48,371	16.5	45,439	15.5	2,932	6.1	45,439	15.5	2,932	6.1	

* The examples shown above are calculated on the basis that the wife's income is in excess of the Working Wife Allowance of \$15,000.

Appendix F(3)(cont'd)

(viii) EXAMPLES OF THE EFFECT THE PROPOSED INCREASES IN PERSONAL, CHILD AND DEPENDENT PARENT ALLOWANCES, THE INTRODUCTION OF A WORKING WIFE ALLOWANCE

\$15,000, REDUCTION IN THE STANDARD RATE AND REVISION OF THE MARGINAL TAX RATES WILL HAVE ON SALARIES TAX AT VARIOUS INCOME LEVELS

Married person, with two children and two dependent parents

Annual income	Present tax payable (Exemption level: \$8103,636)		Proposed tax payable (without working wife) (Exemption level: \$110,818)			Proposed tax payable (with working wife) (Exemption level: \$124,455*)				Remarks	
	Amount (A)	Effective rate	Amount (B)	Effective rate	Tax saving (A) - (B)	Amount (C)	Effective rate	Tax saving (A) - (C)			
(\$)	(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)	(\$)	(%)	
108,000	240	0.2	-	-	240	100.0	-	-	260	100.0	This group receives <u>full</u> benefit from the increase in personal allowance and the working wife allowance.
112,000	460	0.4	39	0.1	421	91.5	-	-	370	100.0	
116,000	860	0.7	171	0.1	689	80.1	-	-	480	100.0	
120,000	1,300	1.1	306	0.3	994	76.5	-	-	1,300	100.0	
132,000	3,180	2.4	1,197	0.9	1,983	62.4	249	0.2	2,931	92.2	This group receives <u>partial</u> benefit from the increase in personal allowance but the <u>full</u> benefit of the revision to the marginal tax rates and the working wife allowance.
144,000	5,380	3.7	2,580	1.8	2,800	52.0	1,035	0.7	4,345	80.8	
156,000	8,020	5.1	4,455	2.9	3,565	44.5	2,364	1.5	5,656	70.5	
168,000	11,200	6.7	6,909	4.1	4,291	38.3	4,185	2.5	7,015	62.6	
180,000	14,250	7.9	9,925	5.5	4,325	30.4	6,531	3.6	7,719	54.2	
192,000	17,250	9.0	13,225	6.9	4,025	23.3	9,475	4.9	7,775	45.1	
204,000	20,250	9.9	16,525	8.1	3,725	18.4	12,775	6.3	7,475	36.9	
213,000	22,500	10.6	19,000	8.9	3,500	15.6	15,250	7.2	7,250	32.2	
214,000	22,750	10.6	19,275	9.0	3,475	15.3	15,525	7.3	7,225	31.8	
228,000	26,250	11.5	22,775	10.0	3,475	13.2	19,025	8.3	7,225	27.5	
240,000	29,250	12.2	25,775	10.7	3,475	11.9	22,025	9.2	7,225	24.7	This group receives <u>no</u> benefit from the increase in personal allowance but the <u>full</u> benefit of the revision to the marginal tax rates and the working wife allowance.
252,000	32,250	12.8	28,775	11.4	3,475	10.8	25,025	9.9	7,225	22.4	
288,000	41,250	14.3	37,775	13.1	3,475	8.4	34,025	11.8	7,225	17.5	
324,000	50,250	15.5	46,775	14.4	3,475	6.9	43,025	13.3	7,225	14.4	
(360,263)	59,315	16.5	55,840	15.5	3,475	5.9	52,090	14.5	7,225	12.2	
(361,765)	59,691	16.5	56,073	15.5	3,618	6.1	52,466	14.5	7,225	12.1	
(399,737)	65,956	16.5	61,959	15.5	3,997	6.1	61,959	15.5	3,997	6.1	Standard rate taxpayers.

* The examples shown above are calculated on the basis that the wife's income is in excess of the Working Wife Allowance of \$15,000.

Appendix F(3)(cont'd)

(ix) INCOME LEVELS BELOW WHICH SALARIES TAXPAYERS
ARE NOT REQUIRED TO PAY TAX

	Present	Proposed	
		Without working wife allowance	With working * wife allowance
	(\$)	(\$)	(\$)
<u>No dependent parent</u>			
Single	34,001	36,001	-
Married	70,001	74,001	87,637
Married + 1 child	80,001	84,910	98,546
Married + 2 children	87,274	92,637	106,274
Married + 3 children	90,001	95,365	109,001
<u>Including two dependent parents</u>			
Single	50,365	54,183	-
Married	86,365	92,183	105,819
Married + 1 child	96,365	103,092	116,728
Married + 2 children	103,637	110,819	124,456
Married + 3 children	106,365	113,546	127,183
<u>Including two dependent parents with additional allowance</u>			
Single	55,819	59,637	-
Married	91,819	97,637	111,274
Married + 1 child	101,819	108,546	122,183
Married + 2 children	109,092	116,274	129,910
Married + 3 children	111,819	119,001	132,637

* The examples above are calculated on the basis that the wife's income is in excess of the working wife allowance of \$15,000.

Appendix F(3)(cont'd)

(x) INCOME LEVELS ABOVE WHICH SALARIES TAXPAYERS BEGIN TO PAY TAX AT THE MAXIMUM 25% MARGINAL RATE

	Present	Proposed	
		Without working wife allowance	With working * wife allowance
	(\$)	(\$)	(\$)
<u>No dependent parent</u>			
Single	88,545	99,636	-
Married	124,545	137,636	151,273
Married + 1 child	134,545	148,545	162,182
Married + 2 children	141,818	156,273	169,909
Married + 3 children	144,545	159,000	172,636
<u>Including two dependent parents</u>			
Single	104,909	117,818	-
Married	140,909	155,818	169,455
Married + 1 child	150,909	166,727	180,364
Married + 2 children	158,182	174,455	188,091
Married + 3 children	160,909	177,182	190,818
<u>Including two dependent parents with additional allowance</u>			
Single	110,364	123,273	-
Married	146,364	161,273	174,909
Married + 1 child	156,364	172,182	185,818
Married + 2 children	163,636	179,909	193,545
Married + 3 children	166,364	182,636	196,273

* The examples above are calculated on the basis that the wife's income is in excess of the working wife allowance of \$15,000.

Appendix F(3)(cont'd)

(xi) INCOME LEVELS AT WHICH SALARIES TAXPAYERS
ENTER THE STANDARD RATE ZONE

	Present	Proposed	
		Without working wife allowance	With working * wife allowance
	(\$)	(\$)	(\$)
<u>No dependent parent</u>			
Single	161,765	172,105	-
Married	252,941	253,684	293,158
Married + 1 child	285,294	285,263	324,737
Married + 2 children	308,823	307,631	347,105
Married + 3 children	317,647	315,526	355,000
<u>Including two dependent parents</u>			
Single	214,706	224,737	-
Married	305,882	306,315	345,789
Married + 1 child	338,235	337,895	377,368
Married + 2 children	361,765	360,263	399,737
Married + 3 children	370,588	368,158	407,631
<u>Including two dependent parents with additional allowance</u>			
Single	232,353	240,526	-
Married	323,529	322,105	361,579
Married + 1 child	355,882	353,684	393,158
Married + 2 children	379,413	376,053	415,526
Married + 3 children	388,235	383,947	423,421

* The examples above are calculated on the basis that the wife's income is in excess of the working wife allowance of \$15,000.

Appendix F(3)(cont'd)

(xii) ANALYSIS OF ESTIMATED SALARIES TAX YIELD (AFTER BUDGET CONCESSIONS) BY INCOME GROUP IN 1988-89

Assessable income group per annum (\$)	No. of taxpayer s	Percentage of total taxpayers (%)	Tax yield (\$M)	Percentage of total yield (%)
50,000 & under	223 000	31.9	50	0.7
50,001 - 100,000	228 000	32.6	430	5.6
100,001 - 240,000	180 000	25.7	2,110	27.5
240,001 - 300,000	26 000	3.7	1,150	15.0
300,001 - 500,000	30 000	4.3	2,030	26.5
500,001 & over	13 000	1.8	1,890	24.7
T o t a l	700 000	100.0	7,660	100.0

of 700 000 taxpayers only 53 000 (or 7.6%) are estimated to pay tax at the standard rate of 15 1/2 % in 1988-89. This small group of taxpayers, however, will contribute about \$4,300 million or 56% of the total tax yield and is composed of -

13 000	single persons with annual incomes of \$172,105 or more;
17 000	married couples with annual incomes of \$253,684 or more; and
23 500	married couples with one or more children and /or dependent parents and with annual incomes of \$285,263 or more.

Existing and Proposed Rates of Stamp Duty
on Property Assignments

(i) Proposed New Rates of Duty

The proposed **new rates** of duty, subject to marginal relief, are -

<u>Property consideration</u>	<u>Duty</u>
Up to \$ 250,000	\$20
\$ 250,001 to \$ 500,000	0.75%
\$ 500,001 to \$1,000,000	1.5%
\$1,000,001 to \$1,500,000	2.0%
Over \$1,500,000	2.75%

Marginal relief: under the proposed new formula, whenever the consideration of a property slightly exceeds a marginal point on the scale of rates, the amount required to be added to the duty payable will be 10%, as opposed to the present 100%, of the excess of the consideration over that point.

Appendix F(4)(cont'd)

(ii) COMPARISON OF EXISTING AND PROPOSED RATES OF DUTY

<u>Consideration</u>	<u>Existing rates</u>	<u>Proposed rates</u>	<u>Estimated no. of persons who will benefit under the proposal</u>	<u>Average duty saved per person (\$)</u>
Up to \$250,000	\$20	\$20	NIL	
\$250,001-\$252,505	\$20 + excess of consideration over \$250,000	\$20 + 10% of excess of consideration over \$250,000	1,800	1,100
\$252,506-\$270,057	1%			
\$270,058-\$500,000	1%	0.75%	71,500	900
\$500,001-\$508,997	\$5,000 + excess of consideration over \$500,000	\$3,750 + 10% of excess of consideration over \$500,000	800	5,000
\$508,998-\$544,130	2.75%			
\$544,131-\$1,000,000	2.75%	1.5%	20,600	8,900
\$1,000,001-\$1,062,520	2.75%	\$15,000 + 10% of excess of consideration over \$1,000,000	500	6,000
\$1,062,521-\$1,500,000	2.75%	2%	3,900	9,000
\$1,500,001-\$1,655,180	2.75%	\$30,000 + 10% of excess of consideration over \$1,500,000	900	5,600
Over \$1,655,180	2.75%	2.75%	NIL	
			<u>100,000</u>	

Appendix F(4)(cont'd)

(iii) **EXAMPLES OF THE EFFECT THE PROPOSED NEW RATES
WILL HAVE ON STAMP DUTY PAYABLE AT VARIOUS
LEVELS OF PROPERTY CONSIDERATION**

<u>Consideration</u> (\$)	<u>Existing duty payable</u> (\$)	<u>Proposed duty payable</u> (\$)	<u>Duty saved</u> (\$)
250,000	20	20	NIL
252,000	2,020	220	1,800 (89%)
255,000	2,550	520	2,030 (80%)
260,000	2,600	1,020	1,580 (61%)
300,000	3,000	2,250	750 (25%)
500,000	5,000	3,750	1,250 (25%)
510,000	14,025	4,750	9,275 (66%)
520,000	14,300	5,750	8,550 (60%)
550,000	15,125	8,250	6,875 (45%)
600,000	16,500	9,000	7,500 (45%)
1,000,000	27,500	15,000	12,500 (45%)
1,050,000	28,875	20,000	8,875 (31%)
1,100,000	30,250	22,000	8,250 (27%)
1,500,000	41,250	30,000	11,250 (27%)
1,600,000	44,000	40,000	4,000 (9%)
1,650,000	45,375	45,000	375 (1%)