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**Notes on the Special Briefing for Finance Committee Members
on Thursday, 6 March 2003, at 10:30 am
in the Chamber of the Legislative Council Building**

Members present:

Dr Hon Philip WONG Yu-hong, Chairman of the Finance Committee (Convenor)
Hon NG Leung-sing, JP, Deputy Chairman of the Finance Committee
Hon Kenneth TING Woo-shou, JP
Hon James TIEN Pei-chun, GBS, JP
Dr Hon David CHU Yu-lin, JP
Hon Cyd HO Sau-lan
Hon Albert HO Chun-yan
Hon LEE Cheuk-yan
Hon Martin LEE Chu-ming, SC, JP
Hon Eric LI Ka-cheung, JP
Hon Fred LI Wah-ming, JP
Hon Margaret NG
Hon Mrs Selina CHOW LIANG Shuk-ye, GBS, JP
Hon James TO Kun-sun
Hon CHEUNG Man-kwong
Hon HUI Cheung-ching, JP
Hon CHAN Kwok-keung
Hon Bernard CHAN, JP
Hon CHAN Kam-lam, JP
Hon WONG Yung-kan
Hon Jasper TSANG Yok-sing, GBS, JP
Hon Howard YOUNG, JP
Hon LAU Chin-shek, JP
Hon LAU Kong-wah
Hon Ambrose LAU Hon-chuen, GBS, JP
Hon Emily LAU Wai-hing, JP
Hon Andrew CHENG Kar-foo
Hon SZETO Wah

Dr Hon LAW Chi-kwong, JP
Hon TAM Yiu-chung, GBS, JP
Dr Hon TANG Siu-tong, JP
Hon Abraham SHEK Lai-him, JP
Hon LI Fung-ying, JP
Hon Henry WU King-cheong, BBS, JP
Hon Tommy CHEUNG Yu-yan, JP
Hon Michael MAK Kwok-fung
Hon LEUNG Fu-wah, MH, JP
Hon WONG Sing-chi
Hon IP Kwok-him, JP
Hon LAU Ping-cheung
Hon Audrey EU Yuet-mee, SC, JP
Hon MA Fung-kwok, JP

Public officers attending:

Mr Antony LEUNG, GBS, JP	Financial Secretary
Mr Frederick MA Si-hang, JP	Secretary for Financial Services and the Treasury
Mr Alan LAI Nin, JP	Permanent Secretary for Financial Services and the Treasury (Treasury)
Mr Stanley YING, JP	Deputy Secretary for Financial Services and the Treasury (Treasury) 1
Mr Howard LEE	Administrative Assistant to Financial Secretary
Mr K T LI	Principal Assistant Secretary for Financial Services and the Treasury (Treasury)
Mr K Y TANG, JP	Government Economist

Staff in attendance:

Ms Pauline NG	Assistant Secretary General 1
Miss Polly YEUNG	Chief Assistant Secretary (1)3
Ms Rosalind MA	Senior Assistant Secretary (1)9
Ms Caris CHAN	Senior Legislative Assistant 1
Mr Frankie WOO	Legislative Assistant 2

The Convenor welcomed Mr Frederick MA Si-hang, Secretary for Financial Services and the Treasury (SFST) and his colleagues to the briefing. He also informed members that Mr Antony LEUNG, Financial Secretary (FS), would arrive at about 11:30 am.

Introduction by the Secretary for Financial Services and the Treasury and the Financial Secretary

2. With the aid of power-point presentation, SFST briefed members on the salient features of the 2003-04 Budget, as follows:

- (a) The Administration would adhere to the fiscal targets for 2006-07 laid down in the 2002-03 Budget, i.e. to restore balance in the Operating and Consolidated Accounts and to reduce public expenditure to 20% of GDP or below.
- (b) Education was the top expenditure item accounting for about \$61 billion out of \$ 286.5 billion of total public expenditure in 2003-04.
- (c) Personal emoluments, personnel-related expenses, salary-related portion of subventions and social security were the major recurrent expenditure components accounting for 77.3% of the government recurrent expenditure in 2003-04.
- (d) It was necessary to raise an additional recurrent revenue of some \$20 billion between now and 2006-07. The various revenue-raising measures proposed in 2003-04 Budget would raise a total recurrent revenue of \$14 billion in a full year. The remaining \$6 billion would be raised by measures to be proposed as appropriate in the next three years.
- (e) The proposed adjustments to Salaries Tax and Property Tax would bring the tax levels back to the 1997-98 level, and to raise the standard rate by 1%. The increase would be implemented in two phases. It was also proposed that Profits Tax be increased from 16% to 17.5%.

3. At the Convenor's invitation, FS highlighted that in formulating the 2003-04 Budget, he was mindful of the need to demonstrate the Government's commitment in eliminating the deficit problem in the medium term, as well as to minimizing the impact of various fiscal measures on the community. FS stressed that the measures proposed in the Budget aimed at tackling the deficit problem and providing an environment which was conducive to economic recovery.

The fiscal deficit

4. Mr CHAN Kam-lam expressed grave concern about the problem of structural fiscal deficit. Noting that the fiscal reserves would be reduced to about 10 months' government expenditure in 2006-07 and a total of \$112 billion worth of assets might be securitized in the next five years, he considered that the next term of government in 2007-08 would be under tremendous pressure even if fiscal balance could be achieved in 2006-07.

5. FS recapped that the causes of the current fiscal deficit were four-fold, namely, cyclical economic adjustment, economic restructuring, population ageing and evolution of government policies. Since the fiscal deficit was as high as 5.5% of GDP, it might not be feasible before 2006-07 to implement long-term measures to raise operating revenue. However, maintaining fiscal balance by 2006-07 would hopefully lay a solid foundation for the next term of government. The 2003-04 Budget had nevertheless set the scene for further community-wide discussion on issues such as the proportion of direct and indirect taxes, government expenditure as a percentage of GDP etc. On the relationship between operating expenditure and operating revenue, FS said the principle set by Sir Philip Hadden-Cave (past Financial Secretary) that operating expenditure should not take up more than 80% of operating revenue was indeed quite reasonable. The surplus in operating revenue could then be used to fund capital expenditure.

6. Mr Andrew CHENG queried why FS had set 2006-07 as the target year for restoring balance in the Operating and Consolidated Accounts and for reducing public expenditure to 20% or below of GDP. In response, FS reiterated that to maintain investors' confidence in Hong Kong, the Government must demonstrate determination and ability to solve the structural deficit problem in the medium term. Although in the short term, various fiscal measures might have an impact on the community, FS considered that they had to be implemented in the long term interest of Hong Kong.

Impact of revenue-raising measures

7. Several members highlighted the hardship inflicted on the middle class and low-income earners by the revenue-raising measures proposed in the Budget. Citing the proposed adjustments in Salaries Tax which would canvass some 90 000 employees into the tax net, Mr LAU Chin-shek was gravely concerned that the middle class and low-income earners would have to suffer under the overwhelming objective to eliminate fiscal deficit. Mr LAU also queried the justification for increasing various government fees and charges as the costs borne by the Government should have been lowered due to persistent deflation over the past 52 months. He asked whether those fees and charges which were related to livelihood would be exempted from any upward adjustment.

8. In response, SFST appreciated that any tax increase would inevitably have an impact on the community. However, it was necessary to implement suitable measures to tackle the deficit problem so as to maintain investors' confidence in the economy. He recapped that notwithstanding the proposed increase, Salaries Tax would only be reverted to the 1997-98 level. On government fees and charges, SFST assured members that in considering how best to adjust individual fees and charges under their purview, individual bureaux would take into consideration all relevant factors including deflation and the impact of the increase.

9. Mr Albert HO highlighted the predicament of the middle class and negative assets owner as they would be required to meet some \$6.8 billion of additional revenue through paying higher Salaries Tax. Mr CHEUNG Man-kwong also considered that the fiscal measures proposed in the 2003-04 Budget had imposed considerable hardship on the middle class whose confidence and financial position were far below the pre-1998 level.

10. While reiterating that the Administration had no intention to target the fiscal measures at any particular sector of the community, FS pointed out that for some 446 000 wage earners within the annual income bracket of \$108,000 to \$210,000, the tax rate as a percentage of income would only be increased from 0.82% to 1.42% after implementation of the adjustment. For those within the \$210,001 to \$300,000 bracket, the relevant tax rates before and after the adjustment would be 2.26% and 3.46% respectively. In this connection, FS cautioned that if fiscal measures were not implemented in time to tackle the huge deficits, investors' confidence would be eroded and the linked exchange rate might be attacked, pushing interest rates to rise. Such a financial crisis would deal an even heavier blow to the middle class and property owners. As public expenditure could no longer be supported by high land price, it had become necessary to implement expenditure-cutting measures, as well as to suitably raise certain taxes.

11. Mr LEE Cheuk-yan recalled that he had supported last year's Budget on account of its proposed concessions. However, he remarked that the 2003-04 Budget would deal a heavy blow to the average employees and socially disadvantaged groups because of the proposed increases in tax and reduction in social security assistance. He urged the Administration to take heed of growing public discontent which might lead to social unrest. Mr Michael MAK considered that the 2003-04 Budget lacked fairness as the middle class and the under-privileged sectors of society would be disadvantaged.

12. In response, FS referred to the experience of Argentina and stressed that if suitable measures were not implemented in time to tackle the huge fiscal deficit, it would be the middle and lower income groups that would be the hardest hit in case the Hong Kong dollar came under attack. He re-affirmed

that the Government was providing services for the well-being of the entire community.

13. Noting the Administration's target to raise an additional \$6 billion over the next three years, Mr Tommy CHEUNG and Mr James TIEN opined that the middle class, small and medium enterprises (SMEs) and the business sectors would have to bear the brunt of the Government's revenue-raising measures. Mr CHEUNG and Mr Howard YOUNG also conveyed the concern of SMEs about the level of licence fees they had to pay irrespective of whether they could make a profit. Mr HUI Cheung-ching was concerned that the Administration might resort to tax increases and the introduction of new taxes such as the Goods and Services Tax.

14. FS stressed that the Government had no intention whatsoever to target its revenue-raising measures at certain sectors of the community. He said that it might be necessary to introduce a Goods and Services Tax in the long term to broaden the tax base. However, in consideration of the present economic conditions and the possible impact on the community, the Administration would not introduce such consumption-related tax for the time being but would continue to study the subject. Regarding details of specific measures to raise the additional \$6 billion, they would be worked out in due course.

15. Mr Howard YOUNG sought information on the proposed Air Passenger Departure Tax (APDT), especially its implementation timetable. In reply, FS advised that the Administration would introduce the necessary legislation to implement the APDT and urged members to support its early passage. He undertook to provide further information on the arrangements for the APDT including the implementation schedule.

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Efforts to cut expenditure

16. Mr James TIEN said that the business sector had accepted the increase in Profits Tax on the expectation that the increased revenue would be used to help the underprivileged sectors in society, instead of to meet civil service-related expenditure such as increased expenditure in pension payment. He also doubted whether the Administration would be able to achieve the target savings given that it would rely primarily on the Voluntary Retirement (VR) Scheme to reduce the size of the civil service. Mrs Selina CHOW also cautioned that the VR Scheme might result in the outflow of capable staff.

17. In response, SFST advised that with the full implementation of the civil service pay reduction in two phases, the Government would be able to save about \$7 billion annually on salary expenses and subventions. By reducing the establishment of the civil service by 10% to about 160 000 posts by 2006-07, some \$4.7 billion could be saved. This, together with the reduction in the staffing establishment of subverted organizations, the Administration was

confident that the target savings could be achieved by 2006-07.

18. Mrs Selina CHOW referred to the Government's operating expenditure provided in the 2003 Medium Range Forecast which remained in the region of \$200 billion in the five years from 2003-04 to 2006-07. She was of the view that the Government had not done enough to cut expenditure and enquired about concrete plans, if any, to achieve greater savings instead of meeting the shortfall through raising revenue. Mr CHAN Kam-lam also urged the Administration to step up efforts to cut operating expenditure.

19. In response, FS explained that the estimated operating expenditure of \$213.6 billion for 2003-04 had been worked out on the basis of the original estimate of \$211.3 billion for 2002-03. Despite the downward adjustment in the rate of payment, experience in the past six years or so indicated that the expenditure on social security payments had been on an upward trend due to an increase in the number of recipients. Civil Service pension was also forecast to rise. Moreover, a provision of \$3.3 billion had also been earmarked in the 2003-04 Estimates to meet the pensions and compensation payments under the second VR Scheme. However, he highlighted the reduction of civil service salary to the level in cash terms as at 30 June 1997, as well as the target to reduce civil service establishment by 10% by 2006-07. He said that if similar cost reduction could be achieved by subvented bodies, considerable savings could be achieved.

20. While appreciating the possible constraints faced by the Administration in implementing various efficiency measures, Mrs Selina CHOW suggested that the Administration should also streamline and simplify its work processes and critically examine whether certain services should continue to be provided by the Government.

21. In response, FS referred to the "3R1M" approach adopted by the Government to re-prioritize its services, re-organize its structure, re-engineer its procedures and make the best use of the market, so as to optimize resources and provide better services to the public. He added that the Chief Secretary for Administration had designated the Director of Administration, together with the Head of the Efficiency Unit, to co-ordinate the efforts of departments in using resources more cost-effectively and in avoiding waste.

22. In this regard, Mr Tommy CHEUNG suggested that the Administration should consider whether the number of inspections by Health Inspectors to catering establishments could be reduced, as well as the feasibility of outsourcing the administration of the Trade Effluent Surcharge.

23. Mr LAU Kong-wah considered that the thrust of the fiscal measures was on raising revenue rather than on cutting expenditure. Referring to past recommendations of the Public Accounts Committee on ways to improve cost-

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effectiveness of services such as street cleaning, he urged the Administration to critically re-examine its procedures. Specifically, he suggested that the Chief Secretary for Administration should also invite the Director of Audit to join the Head of the Efficiency Unit and the Director of Administration in co-ordinating efforts to optimize cost-effectiveness. FS took note of Mr Tommy CHEUNG's and Mr LAU Kong-wah's suggestions for consideration.

24. Regarding Mr LAU Kong-wah's request to disclose the reports on expenditure-cutting proposals submitted by individual departments, FS said that individual bureaux/departments were already accountable to Members and the public for their work, including their efficiency efforts. He nevertheless pointed out that in examining whether certain services should be trimmed or abolished, the Administration was also mindful of the need to strike a balance between resources consideration and the interests of different sectors of the community.

25. On whether the currently proposed public works projects were indispensable, FS advised that the Secretary for the Environment, Transport and Works was working closely with relevant bureaux/departments in scrutinizing public works projects with a view to ascertaining their economic benefits. As a result, a number of water supply projects which were not cost-effective had been withheld. Another area of concern being looked into was the mechanism for setting realistic tender prices, given the lapse of time between preparation of tender documents and tender invitation.

26. Mr LAU Ping-cheung considered that the Administration would be in a better position to ascertain the size of the civil service and expenditure-cutting measures after reviewing whether the certain services should in fact be outsourced. He opined that greater private sector participation should be enlisted for infrastructure projects. While agreeing with the need to make full use of the market, FS advised that individual bureaux would need to examine their respective portfolios and identify those areas of work which could be undertaken by the private sector, having regard to the nature of and needs for the services.

27. Mr Michael MAK disagreed that the community should be asked to sacrifice in the face of the fiscal deficit. Given the demand for health services, he was gravely concerned about reduced expenditure on health services in 2003-04. Miss Margaret NG also expressed concern about the impact of reduced expenditure on the quality of legal services in Hong Kong.

28. In response, FS reiterated that expenditure-cutting measures were not intended to target at particular policy areas. The Government was delivering public goods and services to the entire community and the cost of doing so should also be borne by the community at large. On the proposed reduction in health-related expenditure, FS said that the estimated expenditure for 2003-04

had been worked out in consultation with the relevant Directors of Bureau having regard to the planned services and resources required under their respective purview.

Land Fund

29. Noting that the Administration intended to move an amendment Resolution in the Council to permit the transfer of funds from the Land Fund to the General Revenue Account (GRA) in order to meet government expenditure requirements, Miss Margaret Ng sought clarification on whether only the investment income on the Land Fund would be transferred to the GRA. In reply, FS confirmed that as the investment income on the Land Fund would be ploughed back into and form part of the Fund, therefore, the scope of transfer would cover all funds available under the Land Fund.

Developing human resources

30. On the proposal in the Budget to attract young people from outside Hong Kong to receive basic education and remain in Hong Kong to further their studies, Mr TAM Yiu-chung enquired about the considerations underlying the proposed initiative and how it would work for the betterment of Hong Kong. Referring to overseas experience, Mr TAM pointed out that a thriving education sector was an essential component of economic growth.

31. In this connection, FS said that the importance of education in a knowledge-based economy had been confirmed by studies of the Organization of Economic Cooperation and Development. A thriving education sector also generated plentiful employment opportunities. He advised that the proposed initiative would hopefully serve the dual purpose of developing Hong Kong's economy and alleviating the problem of an ageing population. His initial thinking was that the education sector in Hong Kong could diversify by providing primary and secondary schooling with boarding facilities. This could meet the demand of parents in the Mainland to send their children abroad for studies and strengthen Hong Kong's role as a regional metropolis. Nevertheless, details of the relevant policies and measures would need to be worked out by the bureaux/departments involved in education, immigration and land supply.

Budget-related considerations

32. Ms Emily LAU referred to a submission from the Equal Opportunities Commission which she had copied to FS earlier on. She recapped salient points in the submission including the importance of equitable distribution of resources to ensure the development of social cohesion and the rights of individuals to an equitable share of community resources, the policy objective to protect and increase cost-effective programmes for human development and

reducing poverty, as well as the need to engage disadvantaged groups in the Government's economic and social policy-making process. Ms LAU also drew the Administration's attention to a joint submission by Christian and Catholic bodies urging LegCo Members to vote against the Appropriation Bill 2003 because the proposed fiscal measures were selectively targeted at socially disadvantaged groups. Ms LAU sought FS's comments on the criticisms expressed in the submissions.

33. In response, FS re-affirmed that the fiscal measures proposed in the 2003-04 Budget aimed at providing an environment which was conducive to economic growth. He further pointed out that the community at large would be able to benefit from more vibrant business activities and the creation of more employment opportunities. At the same time, the Government would ensure that a basic safety net was available for those who were in need of assistance.

Economic growth and domestic consumption

34. While agreeing with the objective to strengthen Hong Kong's international position, Mr Henry WU considered that the measures to stimulate domestic consumption were not adequate. He referred in particular to the Administration's decision to remove the minimum brokerage commission rate with effect from 1 April 2003 without any corresponding reduction or abolition of stamp duty on stock transactions. In this regard, FS highlighted that domestic consumption should be stimulated not just by fiscal measures, but also by economic policies and measures such as "big market and small government" and measures to minimize barriers to economic activities. He also stressed that the fiscal and economic measures to be implemented should be acceptable both locally and also internationally, having regard to Hong Kong's relatively small but open economy in a globally connected environment.

35. Mr Michael MAK questioned whether domestic consumption could be stimulated since a number of tax increases had been proposed. Mr Andrew CHENG said that the various expenditure-cutting and revenue-raising measures might result in less disposable income for the public at large and weaken consumption. In this regard, FS considered that apart from internal consumption, it was equally important to increase external demand for goods and services in Hong Kong, such as by attracting more foreign and Mainland enterprises to set up offices in Hong Kong.

36. Ms Cyd HO remarked that Hong Kong's export had experienced growth, but the community at large had not been able to benefit probably due to limitations inherent in the existing institutional system. She also enquired about the impact of various expenditure-cutting and revenue-raising measures on the current deflation in Hong Kong.

37. In reply, FS and the Government Economist advised that the impact of the fiscal measures on the economy would be minimal. Based on the econometric model adopted by the Government, the growth rate of the economy and price movement would adjust downwards as a result of the various fiscal measures by an annual average of 0.14% and 0.21% respectively between 2003 and 2007.

38. Given the current economic performance, Mr Fred LI queried whether the forecast GDP growth rate of 3% per annum over the medium term period 2003-07 was over optimistic. He was concerned that if Hong Kong's economic performance fell short of the forecast growth, the Administration would resort to more drastic revenue-raising measures which would add to the burden of the community. In response, FS advised that while changes in external circumstances would have an impact on Hong Kong's economy which was externally oriented, the forecast GDP growth rate of 3% was the best estimate which could be made on the basis of currently available information.

39. Responding to Mr Tommy CHEUNG's concern about the local economy, FS said that Hong Kong should strengthen its position as a strategic two-way platform for business between the Mainland and the rest of the world. The Administration would take measures to attract more overseas companies to set up offices in Hong Kong, and to encourage people from overseas and the Mainland to take up studies or seek medical treatment in Hong Kong.

40. In reply to Mr Jasper TSANG's enquiry about specific measures to boost the economy, FS pointed out that the Administration would continue to support a free market as this would lead to optimal distribution of resources. To facilitate Hong Kong's development into a regional metropolis, the Government was speeding up discussion on the Mainland/Hong Kong Closer Economic Partnership Arrangement with the Central Government with a view to reaching an arrangement on the main parts in June 2003. The completion of all the berths of Container Terminal 9 by 2005 thereby increasing the port capacity by 20% and the opening of the Disneyland in the same year were some of the milestones in the economic development of the territory.

41. The Convenor thanked FS and his colleagues for attending the briefing.

42. The briefing ended at 1:00 pm.