



The 2009-10 Budget

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**The Financial Secretary
invites
your
views**



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The Financial Secretary is consulting Members of the Legislative Council, representatives from various sectors and the people of Hong Kong on the 2009-10 Budget.

We welcome and value your advice on the Budget. You can provide us with your advice via the budget website www.budget.gov.hk or in writing to the Financial Secretary's Office, 5th floor, Main Wing, Central Government Offices, Lower Albert Road, Hong Kong.

Contents

I. Economic Environment

- Economic principles and strategy 4-7
- Economic performance and prospects 8-19

II. Fiscal Environment

- Principles of management of public finances 20-21
- Fiscal position 22-23

III. Budget Objectives

- Expenditure 24-27
- Infrastructure spending 28-29
- Revenue 30-33
- Distribution of taxpayers 34-37
- Innovative revenue measures 38-39
- How we coped with past difficulties 40-41
- Challenges ahead 42-43

Economic principles

- Big Market, Small Government
- Fiscal prudence by keeping expenditure within the limits of revenue
- Raise the quality of life and build a harmonious, family-based society
- From welfare to self-help

- Our economic policies are guided by the principle of “Big Market, Small Government”. The size of public expenditure is kept under 20% of GDP by maintaining fiscal discipline. *What is the role of Government in economic development?*
- We will adhere to the principle of fiscal prudence by keeping expenditure within the limits of revenues in the management of our public finances as enshrined under Article 107 of the Basic Law. *Do we have to balance our budget every year?*
- Consistent with our pro-market economic policy, we will follow the principle of “from welfare to self-help” in tackling poverty, creating job opportunities, mobilising business community to support social initiatives, and improving the livelihood of the low-income groups and the disadvantaged. We have been investing heavily in education to enhance social mobility and alleviate cross-generational poverty. *What should we do to enhance even greater social mobility? How do we achieve a more caring society?*



Economic strategy

- Build Hong Kong as the international financial centre of our nation and secure an essential role in our nation's development
- Strengthen Hong Kong's position as the region's hub for headquarters, trade, logistics, shipping and aviation, and as a favoured destination for tourism
- Invest in infrastructure and develop our human capital
- Improve our "soft" strengths - heritage conservation, cultural and arts development, creativity

- The rapid economic developments in the Mainland have provided and will continue to provide ample opportunities as well as challenges for us. We shall continue to make the most of our advantages to capitalise on the rise of the Mainland economy and to play an important role in our nation's development. We will also extend and strengthen our links with emerging economies around the world.
- We need to enhance our status as an international financial centre and play our hub role more effectively. Hong Kong is also highly competitive as a location for company headquarters. We shall strengthen our external competitiveness and rise to the challenge of global competition, by strengthening our human resources, investing in infrastructure and improving our “soft” strengths.
- *How do we harness the results of economic development in the Mainland? What role should we play?*
- *In a globalised world, how do we maintain our competitiveness?*

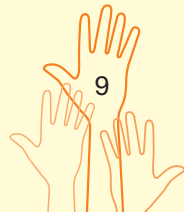


Latest 2008 economic indicators

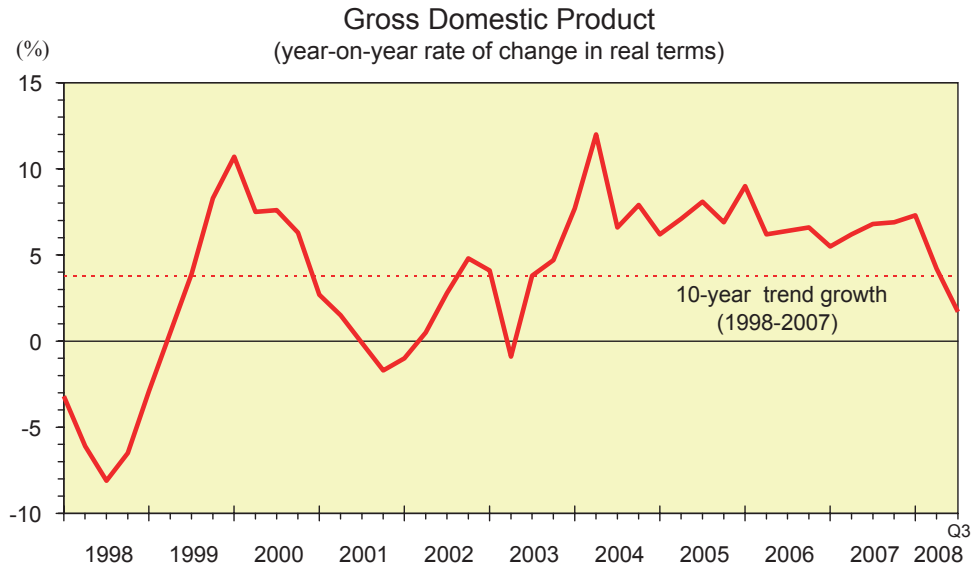
GDP real growth	January to September	4.3% (Third quarter 1.7%)
Unemployment rate	August to October	3.5% (May to July: 3.2%)
CCPI inflation	January to October	4.6% (October 1.8%)

Except for unemployment rate, the above percentages represent year-on-year changes.

- Affected by slowing global economic activity and the initial effects of the financial market fallout, economic growth in Hong Kong slowed notably to 1.7% in the third quarter.
- As highly externally-oriented economy, Hong Kong has been affected by the spreading of the financial turmoil.
- Job prospects have worsened, with unemployment rate edging up.
- Inflation rose distinctly over the past year, driven mainly by the global-wide surge in food prices. After a prolonged period of rapid economic expansion, domestic demand, particularly in the faster increases in private housing rentals and in prices for various goods and services, has also contributed to inflation. With food prices in the international market and in particular in the Mainland tapering off lately, food inflation in Hong Kong has begun to ease in recent months, reducing the upside risk of inflation in the near term.



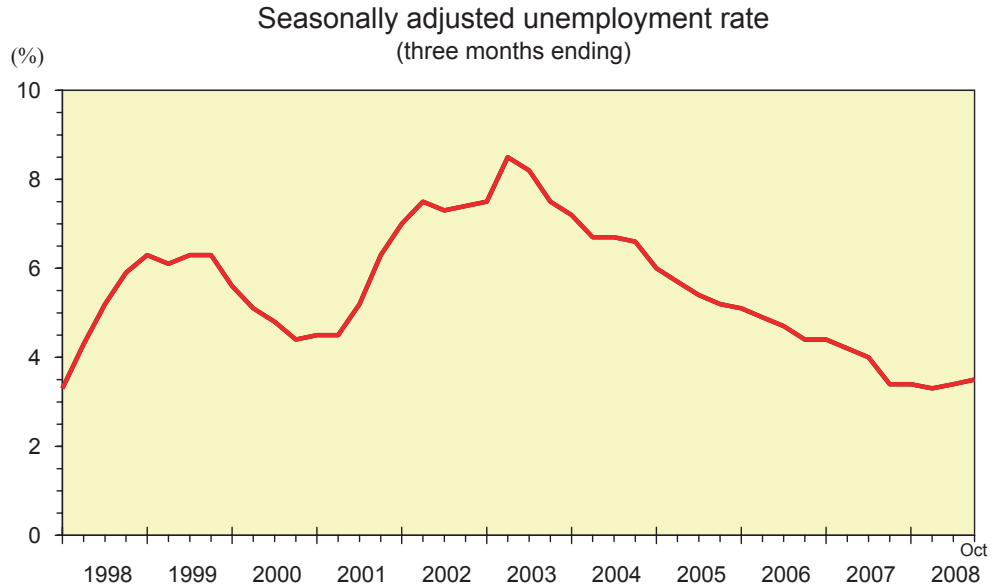
Economy slowing



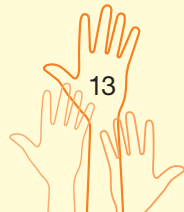
- The slowing-down of the Hong Kong economy is not totally unexpected, given the global downturn and the fact that our economy has experienced a prolonged period of robust economic expansion since mid-2003.
- Last year, we introduced a series of measures to “leave wealth with the people”. *With the economy expected to suffer further from the global downturn, how should we prioritise the targets for assistance?*



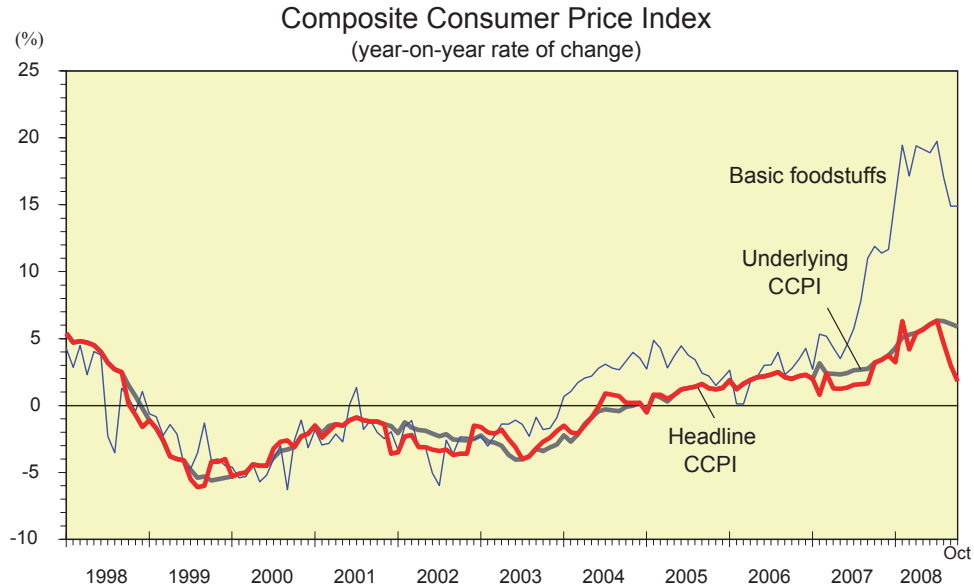
Unemployment rate edging up



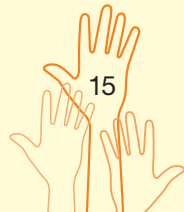
- The unemployment rate has bottomed out at 3.2% in mid-2008. Labour market conditions are deteriorating and the unemployment rate is set to rise in the coming months. The trend of rising wages and earnings in the past couple of years can no longer be assumed.
- *What should we do to deal with the expected rise in unemployment?*



Food inflation tapering off



- Local food inflation has begun to come down as world food supply improved and as food prices in the international markets, including the Mainland, eased. But private housing rentals continued to pick up due to the lagged effects of the earlier rental rise. Underlying CCPI inflation edged down to 5.9% in October. This is a good sign for Hong Kong having experienced many months of rising inflation led by a food price surge.
- The relief measures introduced in the last Budget and by the Chief Executive in July have helped lower headline CCPI inflation, which eased from 6.3% in July to 3.0% in September and further to 1.8% in October.
- Our principal concern lies with the impact of escalating costs of living on the lower-income groups and the disadvantaged. We will continue to monitor closely the inflation trend and its impact on society.
- In the last Budget, we shared our fruits of economic growth by leaving wealth with the people. *What do you expect during an economic downturn? To whom should we accord our priority in providing assistance?*



Latest forecast for 2008

GDP real growth 3% – 3.5%

CCPI inflation 4.2%

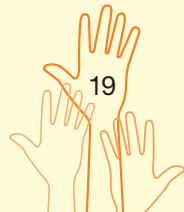
- With the external environment worsening, the local economy is set to slow down further in the quarters ahead.
- Taking into account the GDP growth of 4.3% in the first three quarters of the year, economic growth for the year of 2008 as a whole is forecast at 3% to 3.5%.
- With commodity prices including food and oil prices falling further, the upside risks to CCPI inflation are likely to abate. If these favourable factors continue to play out, CCPI inflation can be expected to arrest the rising trend which had troubled the community over the past year or so.
- The relief measures announced in the last Budget and by the Chief Executive in July would help lower the headline inflation notably in the latter part of the year. Headline CCPI inflation for 2008 as a whole is forecast to average 4.2%.
- *What should the Government do, without compromising fiscal prudence and market efficiency, during a period of economic difficulty?*



Economic uncertainties

- Financial market turbulence dragged out for much longer than expected
- Global economic downturn more severe and protracted
- Global inflation remains elevated despite growth slowdown
- Rise of protectionist sentiments and lack of progress in global trade talks

- Being a small open economy, Hong Kong's well-being is inevitably affected by global events. *Are our products, financial and labour markets flexible and resilient enough to respond to external challenges? What can we do to better manage risks in the financial markets? Are our market institutions, regulatory structures and fiscal positions robust enough to weather the impacts of external shocks? As the global financial and economic landscape goes through turbulent changes, where do the new economic opportunities lie and how should we respond to capture them? What can we do to help the lower-income groups and the disadvantaged to cope with economic changes? What are the medium-term issues that we should bear in mind, such as those related to an ageing society, while dealing with the short-term challenges?*



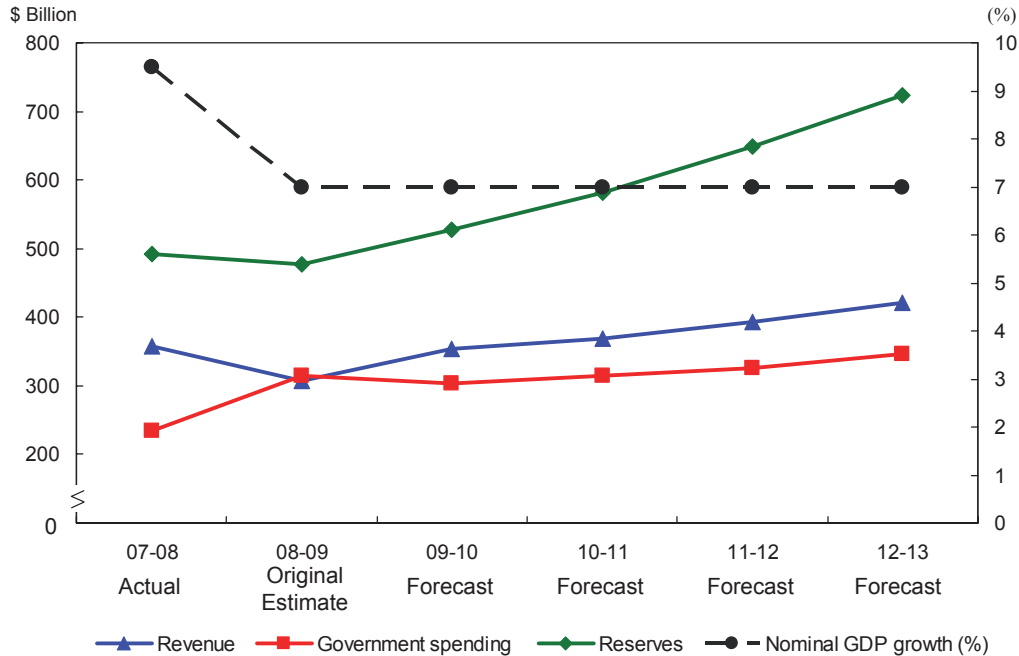
Principles of management of public finances

- Commitment to society
- Sustainability
- Pragmatism

- We will continue to uphold our principles of public finance management. We will continue to exercise prudence by keeping expenditure within the limits of revenues, maintaining a low and simple tax regime and following the direction of “Market Leads, Government Facilitates”. In drawing up the budget, we will adhere to three basic principles –
 - ◆ Commitment to society
 - ◆ Sustainability
 - ◆ Pragmatism



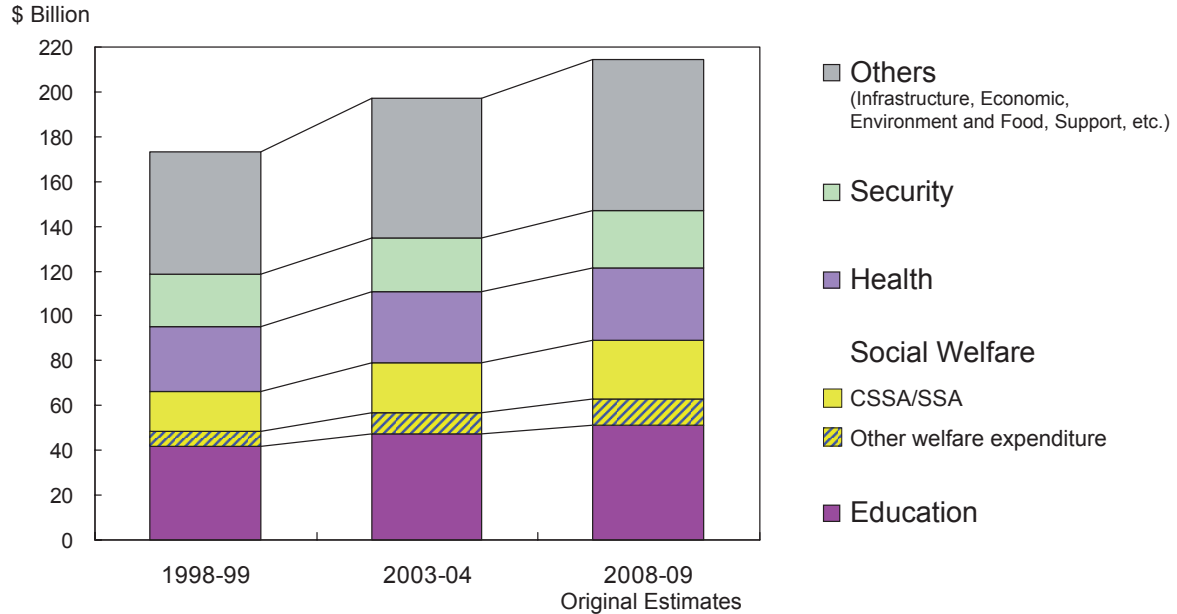
Medium Range Forecast in 2008-09 Budget



- The Medium Range Forecast announced in the Budget this February is based on certain economic and revenue assumptions. Recent developments in our economy have already altered the shape of our forecast.
- Taking into account the additional spending measures, including the relief measures announced by the Chief Executive in July, our total expenditure will be higher.
- Looking ahead –
 - ◆ *What will be our GDP performance in 2009-10, and the rest of the MRF period?*
 - ◆ *How much will be our revenue? Should we introduce new revenue items or increase the rates of current revenue items?*
 - ◆ *Should expenditure be commensurate with the growth in GDP, or should we spend more and draw on our fiscal reserves, and budget for deficits?*



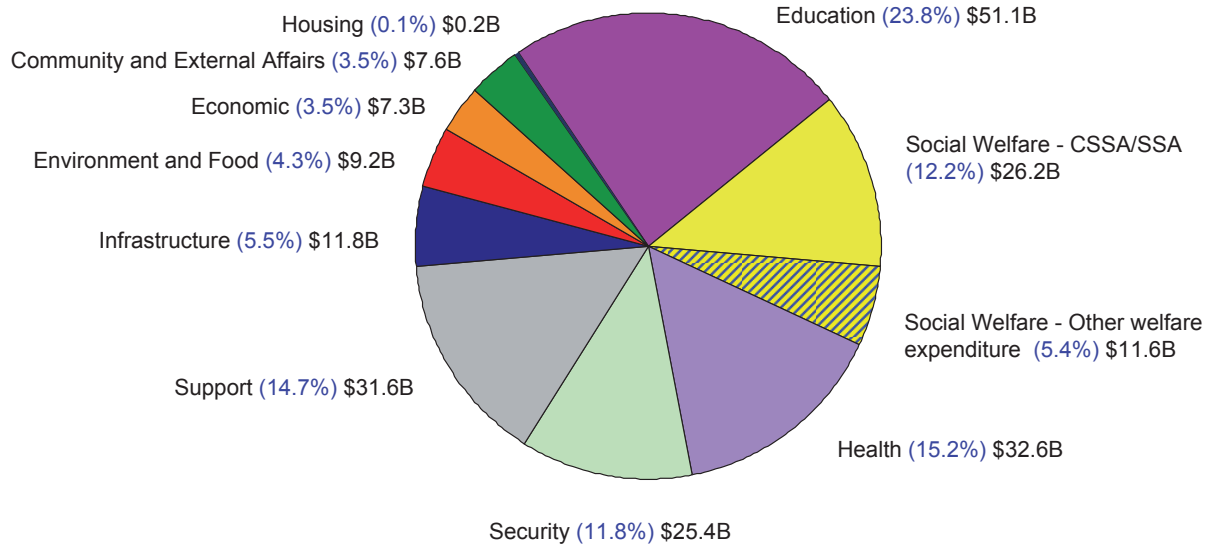
Recurrent expenditure in past ten years



- Total recurrent government expenditure increased by some \$41.3 billion or 24% over the past ten years.
- Recurrent spending on Education and Social Welfare have seen significant increase –
 - ◆ Education +22.8%
 - ◆ Social Welfare +51.6%
 - *Comprehensive Social Security Assistance (CSSA) Scheme* +41%
 - *Social Security Allowance (SSA) Scheme* +64.9%
 - *Other welfare expenditure* +62.2%



Recurrent expenditure for 2008-09

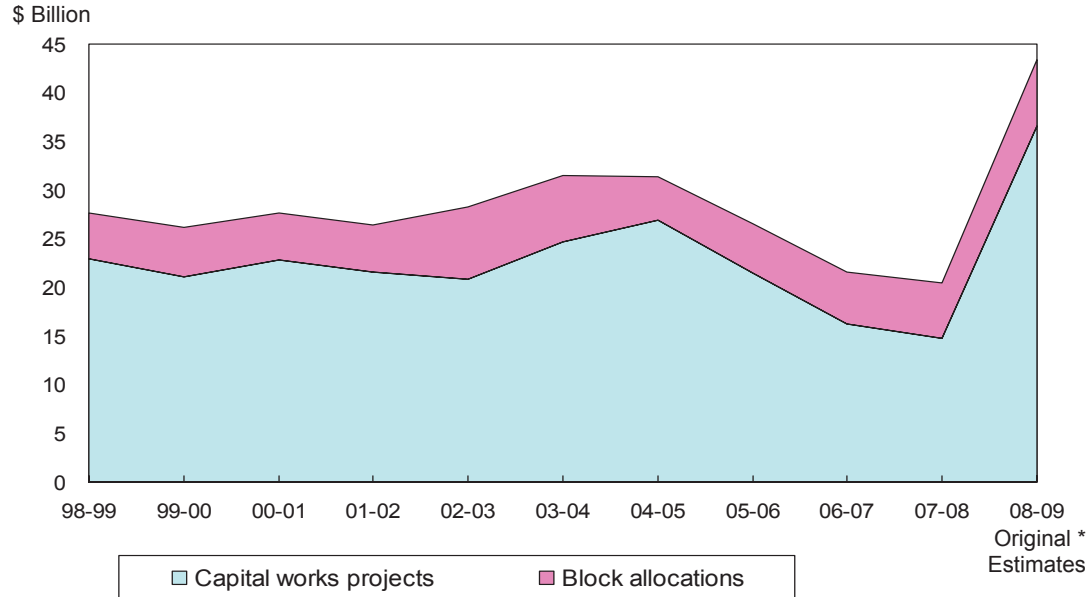


Total recurrent government expenditure: \$214.6 billion (68% of total government spending of \$315.4 billion)

- Based on the 2008-09 Original Estimates, the spending on Education (23.8%), Social Welfare (17.6%), Health (15.2%) and Security (11.8%) together accounts for about 68.4% of total recurrent government expenditure.
- We will ensure optimal allocation and efficient utilisation of resources according to strategic priorities. Government has committed to increasing the share of health care expenditure to 17% of its recurrent expenditure by 2011-12. Inevitably the allocation in terms of percentage to some other policy areas will have to be reduced even though the allocation in dollar terms is still higher than the 2008-09 level. *In view of our commitment to increase the expenditure on health from 15% to 17%, which policy areas should have a smaller share?*



Essential infrastructure



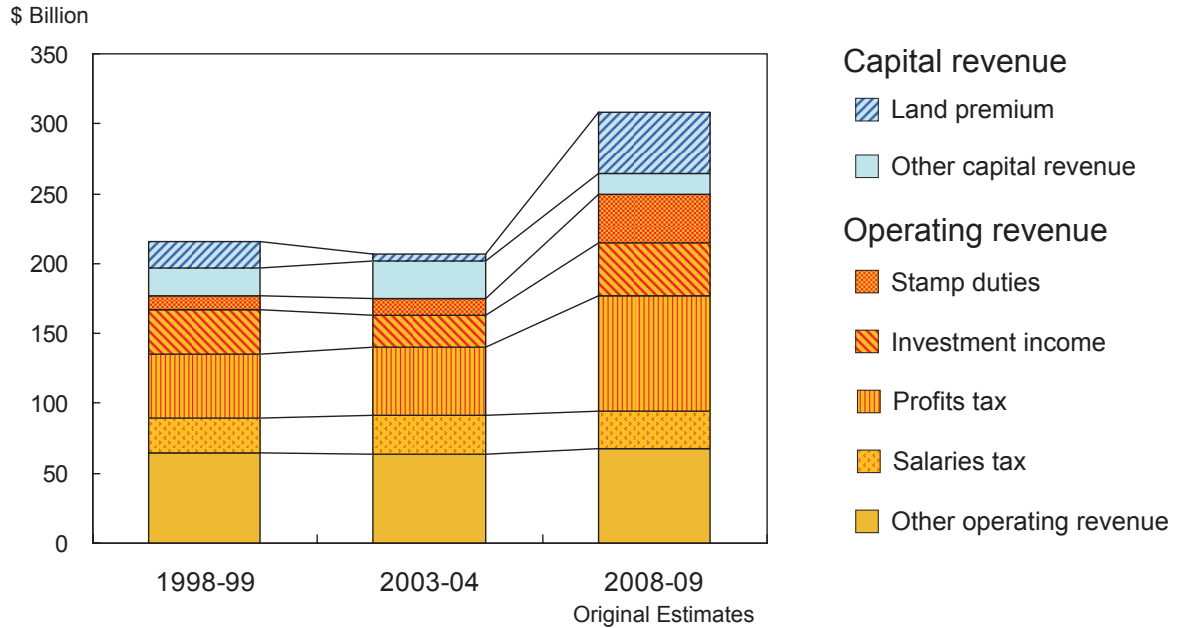
* including the upfront endowment of \$21.6 billion to the West Kowloon Cultural District Authority

Capital works expenditure

- The Government remains committed to taking forward projects necessary for the future economic development of Hong Kong.
- We will continue to earmark on average \$29 billion a year for spending on public works projects.
- The 2008-09 Budget includes an upfront endowment of \$21.6 billion to the West Kowloon Cultural District Authority. Over the next few years, the capital works expenditure is likely to stay at a higher level as we vigorously implement various infrastructure projects, including the ten major infrastructure projects announced by the Chief Executive in the 2007-08 Policy Address. The construction of the infrastructure projects will provide some cushioning effect to the economy amidst an adverse external economic environment. It is roughly estimated that the ten major infrastructure projects upon reaching a mature stage, will help create over \$100 billion of added value to our economy annually and some 250 000 additional new jobs.
- We envisage our infrastructural spending will increase substantially in the next few years.
How should we spread our coming infrastructural spending?



Revenue in past ten years

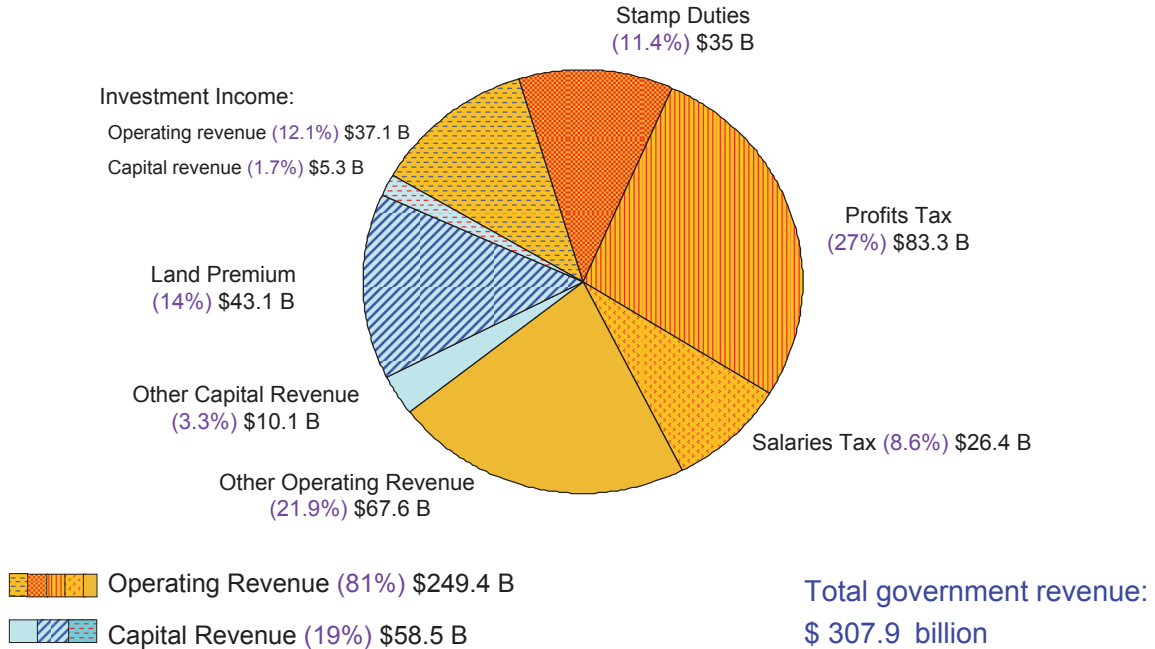


Total government revenue

- Profits tax has been our largest operating revenue. It varied from \$37.7 billion in 1999-2000 to \$91.4 billion in 2007-08.
- Salaries tax has been our second or third largest operating revenue. It varied from \$24.8 billion in 1999-2000 to \$38.6 billion in 2006-07.
- Stamp duties varied from \$7.5 billion and \$51.5 billion for the period.
- Investment income, mainly from our reserves, is the second largest operating revenue in our 2008-09 Budget. In the past, it has fluctuated widely from \$0.3 billion in 2001-02 to \$36.8 billion in 1999-2000. Since 1 April 2007, we have adopted a new arrangement whereby the rate of investment return is pre-determined based on past returns to stabilise this revenue source. We expect that investment income from fiscal reserves will continue to play a major role in our operating revenue.
- As for capital revenue, land premium has been volatile, fluctuating from \$5.4 billion to \$62.3 billion in the past ten years.



Revenue for 2008-09



- Profits and salaries taxes are the major sources of government revenue, accounting for 35.6% of total government revenue in the 2008-09 Original Estimates. The next largest single source is land premium, which accounts for 14% of the total.
- For the first six months of the financial year, revenue from land premium amounted to only \$12.4 billion against the budget of \$43.1 billion.
- The rate of investment return for 2008 is 9.4%. This rate for 2009 will be revised having regard to the return achieved by the investment portfolio of the Exchange Fund from 2003 to 2008.



Distribution of taxpayers

Salaries tax

2008-09 (Provisional assessment)

Estimated total working population	3 550 000
- Not paying any salaries tax	2 250 000 (63.4%)
- Taxpaying	1 300 000 (36.6%)

Distribution of taxpayers



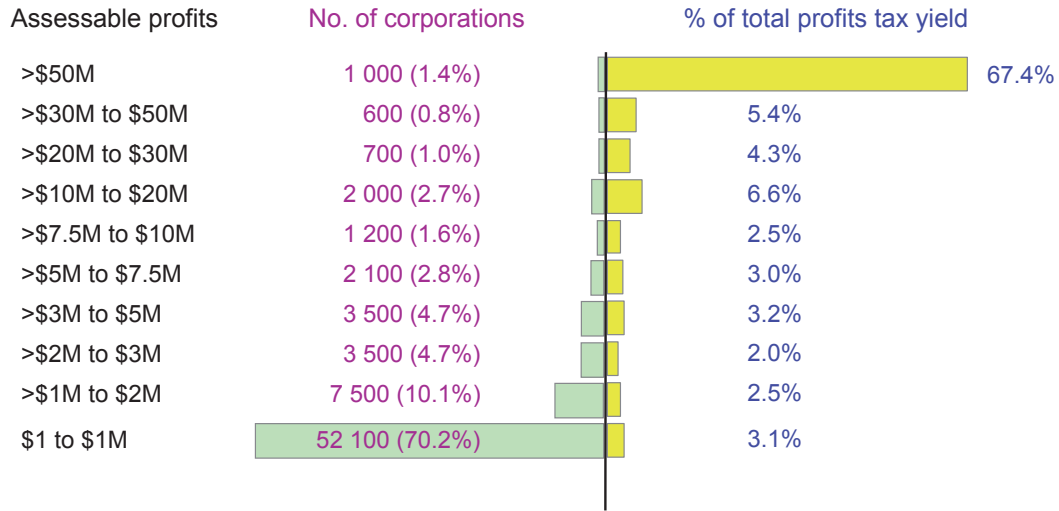
- Among the 3 550 000 total working population, only 1 300 000 people (36.6%) pay salaries tax.
- According to their salaries tax bills, the top 100 000 taxpayers will contribute 64.7% of the total revenue from salaries tax in 2008-09. The share contributed by this group was 60.9% in 1998-99 and 71.2% in 2006-07.
- Only 1.5% of the taxpayers pay tax at the standard rate of 15%. The average tax rate for a salaries taxpayer is about 7.5%. The tax burden is low in comparison with other economies around the world.



Distribution of taxpayers

Profits tax

2006-07 (Actual revenue)



- In the year of assessment 2006-07, about 67% of our profits tax is contributed by the top 1 000 taxpaying corporations out of more than 74 000 corporations. Most small businesses pay little or no tax.
- We expect a drop in tax revenue because of the economic downturn. *Do we still have room to cut taxes?*



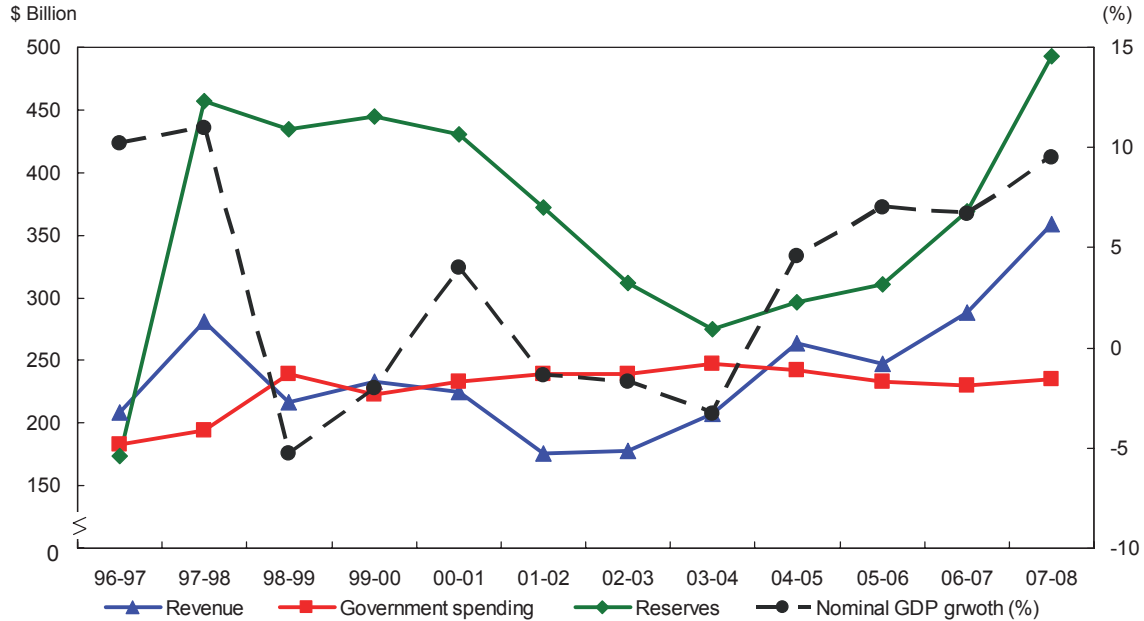
Innovative revenue measures

- Exemption of offshore funds from profits tax
- Abolition of estate duty
- Concession in trade declaration charges for gold
- Exemption of duties on alcoholic beverages except spirits

- To promote Hong Kong as a major asset management centre in Asia, we announced in the 2005-06 Budget the exemption of offshore funds from profits tax and the abolition of the estate duty. Hong Kong's combined fund management business amounted to \$9,631 billion (US\$1,235 billion) as at end-2007, representing an increase of 56.5% from 2006 and a growth of 112.8% from 2005.
- In the 2006-07 Budget, we announced the provision of a concession in trade declaration charges for gold bars of 995.0 fineness or above to promote Hong Kong as a logistic hub and gold trading centre. The re-exports of gold bars greatly increased from about 14 tonnes in 2006 to over 22 tonnes in 2007. During the first seven months of 2008, the growth trend continued and the re-exports amounted to about 37 tonnes.
- We announced in the 2008-09 Budget the exemption of duties on wine, beer and other non-spirit alcoholic beverages, and removed the related administrative controls. The effect on the wine trading and distribution business has been encouraging. The value of wine imports in the four months after the Budget grew by about 143% relative to the same period last year.
- *Any other innovative ideas that could bring overall benefits to Hong Kong?*



How we coped with past difficulties



Starting from 1 July 1997, the fiscal reserves include the net assets transferred from the former HKSARG Land Fund.

- In the 2008-09 Budget, we have pointed out the risk of global economic slowdown, the possibility that the situation might deteriorate in the near future, and that the fallout may be prolonged. We may now be at a point of entering another cycle of economic difficulties. It is useful to make reference to how we coped with past periods of economic and fiscal difficulties.
- Despite reductions in GDP and revenue, we have maintained our expenditure at a relatively stable level. This is achieved by using our reserves.
- The fiscal reserves played a crucial role, allowing us to maintain expenditure despite downturn in the economy and reduction in revenue.
- *Looking ahead –*
 - ◆ *Are there any existing services which are no longer essential or are less than cost-effective, and for which public funding should be reduced to make way for more pressing initiatives?*
 - ◆ *If Government were to spend more to stimulate economic activities, should we target at specific sector or should we go for spending measures that would give more room for the market to drive itself?*



Challenges Ahead

- Economic downturn
- Narrow tax base
- External competitiveness
- Ageing population
- Better environment

- The Government should respond promptly to the calls of the community and prepare to meet the challenges ahead.
- *How do we weather the economic downturn?*
- *How do we further promote economic growth through innovative measures?*
- *How do we maintain financial resilience in light of the volatile nature of our revenue and the expenditure requirements? What should be the priority of government spending? How shall we broaden the tax base?*
- *What do we need to do to sustain Hong Kong's competitiveness?*
- *How to prepare Hong Kong for the challenges of an ageing population? What will make Hong Kong an even better place to live?*



Your views are welcome!

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