

**OFFICIAL REPORT OF PROCEEDINGS****Wednesday, 26th February 1975****The Council met at half past two o'clock****PRESENT**

HIS EXCELLENCY THE GOVERNOR (*PRESIDENT*)  
SIR CRAWFORD MURRAY MACLEHOSE, KCMG, MBE  
THE HONOURABLE THE COLONIAL SECRETARY  
MR DENYS TUDOR EMIL ROBERTS, CBE, QC, JP  
THE HONOURABLE THE FINANCIAL SECRETARY  
MR CHARLES PHILIP HADDON-CAVE, CMG, JP  
THE HONOURABLE THE ATTORNEY GENERAL  
MR JOHN WILLIAM DIXON HOBLEY, QC, JP  
THE HONOURABLE THE SECRETARY FOR HOME AFFAIRS  
MR DENIS CAMPBELL BRAY, JP  
THE HONOURABLE JAMES JEAVONS ROBSON, CBE, JP  
SECRETARY FOR THE ENVIRONMENT  
DR THE HONOURABLE GERALD HUGH CHOA, CBE, JP  
DIRECTOR OF MEDICAL AND HEALTH SERVICES  
THE HONOURABLE IAN MACDONALD LIGHTBODY, CMG, JP  
SECRETARY FOR HOUSING  
THE HONOURABLE DAVID HAROLD JORDAN, MBE, JP  
DIRECTOR OF COMMERCE AND INDUSTRY  
THE HONOURABLE LI FOOK-KOW, CMG, JP  
SECRETARY FOR SOCIAL SERVICES  
THE HONOURABLE DAVID AKERS-JONES, JP  
SECRETARY FOR THE NEW TERRITORIES  
THE HONOURABLE LEWIS MERVYN DAVIES, CMG, OBE, JP  
SECRETARY FOR SECURITY  
THE HONOURABLE DAVID WYLIE McDONALD, JP  
DIRECTOR OF PUBLIC WORKS  
THE HONOURABLE KENNETH WALLIS JOSEPH TOPLEY, JP  
DIRECTOR OF EDUCATION  
THE HONOURABLE IAN ROBERT PRICE, TD, JP  
COMMISSIONER FOR LABOUR  
THE HONOURABLE WILSON WANG TZE-SAM, OBE, JP  
THE HONOURABLE LEE QUO-WEI, OBE, JP  
THE HONOURABLE OSWALD VICTOR CHEUNG, OBE, QC, JP  
THE HONOURABLE ROGERIO HYNDMAN LOBO, OBE, JP  
THE HONOURABLE MRS CATHERINE JOYCE SYMONS, OBE, JP  
THE HONOURABLE PETER GORDON WILLIAMS, OBE, JP  
THE HONOURABLE JAMES WU MAN-HON, OBE, JP  
THE HONOURABLE HILTON CHEONG-LEEN, OBE, JP  
THE HONOURABLE LI FOOK-WO, OBE, JP  
THE HONOURABLE JOHN HENRY BREMRIDGE, JP  
DR THE HONOURABLE HARRY FANG SIN-YANG, OBE, JP  
THE HONOURABLE MRS KWAN KO SIU-WAH, MBE, JP  
THE HONOURABLE LO TAK-SHING, JP  
THE HONOURABLE FRANCIS YUAN-HAO TIEN, OBE, JP

**ABSENT**

DR THE HONOURABLE CHUNG SZE-YUEN, CBE, JP

**IN ATTENDANCE**

THE CLERK TO THE LEGISLATIVE COUNCIL

MR KENNETH HARRY WHEELER

**Papers**

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

<i>Subject</i>	<i>LN No</i>
Subsidiary Legislation:	
Clean Air Ordinance.	
Clean Air (Furnaces, Ovens and Chimneys) (Installation and Alteration) (Amendment) Regulations 1975 .....	36
Clean Air Ordinance.	
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Road Traffic Ordinance.	
Road Traffic (Road Crossing) (Amendment) Regulations 1974 (Commencement) Notice 1975.....	49
Immigration Ordinance.	
Immigration (Places of Detention) Order 1975 .....	50
Sessional Papers 1974-75:	
No 33—Annual Report of the Hong Kong War Memorial Fund Committee for the year 1973 (published on 26.2.75).	
No 34—Annual Report of the Li Po Chun Charitable Trust Fund for the year ended 31st August 1974 (published on 26.2.75).	
No 35—Trustee's Report of the Education Scholarships Fund for the year ended 31st August 1974 (published on 26.2.75).	
No 36—Draft Estimates of Revenue and Expenditure for the year ended 31st March 1976, including supporting financial statements and statistical appendices (published on 26.2.75).	
No 37—Report of the Establishment Sub-Committee of Finance Committee for the year 1974-75 (published on 26.2.75).	
No 38—Report of the Public Works Sub-Committee of Finance Committee for 1974 (published on 26.2.75).	

**Government business****Motion****TELEPHONE ORDINANCE**

THE FINANCIAL SECRETARY moved the following motion: —

That the Schedule to the Telephone Ordinance (as substituted by resolution of this Council made and passed on the 5th February 1975) be amended with effect from the 1st March 1975—

(a) in item 3 of Part II, by deleting "route and" and substituting the following—

“route-end”;

(b) in item 4(b) of Part IV, by deleting "\$400" and substituting the following—

"\$48"; and

(c) in the note at the end of Part IV, by deleting "*per annum* in item 4(c) or \$200 *per annum* in item 4(d)" and substituting the following—

“in respect of item 4(c) and \$200 in respect of item 4(d)”.

He said: —Sir, I move the motion standing in the name of the Attorney General on the order paper. Sir, I correct three straightforward arithmetical errors in the resolution passed by this Council on 5th February 1975.

*Question put and agreed to.*

**First reading of bill****APPROPRIATION BILL 1975**

*Bill read the first time and ordered to be set down for second reading pursuant to Standing Order 41(3).*

**Second reading of bills****APPROPRIATION BILL 1975**

THE FINANCIAL SECRETARY moved the second reading of: —"A bill to apply a sum not exceeding six thousand six hundred and fifteen

million, three hundred and ninety-four thousand dollars to the Public Service for the financial year ending the 31st day of March 1976."

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[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**

He said: —

*INTRODUCTION*

Sir, I move that the Appropriation Bill 1975, which was published in an issue of the *Gazette Extraordinary* at 2 o'clock this afternoon, be read the second time.

*STRUCTURE OF SPEECH*

2. Sir, this year's budget speech departs somewhat radically from that of previous years, largely to accord with the 1-3-10 concept that I developed last year<sup>(1)</sup>, and I shall be concerned to relate the coming financial year to the immediate past as well as to our future prospects<sup>(2)</sup>. So I hope to be able to convince honourable Members that the Draft Estimates of Expenditure and my revenue proposals are appropriate to our present circumstances, given all the conflicting cross pressures of a social, political, economic and financial nature with which we must contend.

*ACKNOWLEDGEMENTS*

3. Honourable Members will understand that the preparation of this year's Draft Estimates of Expenditure and the Revenue Estimates has been a particularly difficult exercise for all concerned: heads of departments and their staff, the Government Printer, the Legal Department, the Secretariat generally and the Finance Branch in particular. And I have had to call upon the heads of revenue departments and other collectors of revenue for help in the formulation of my revenue proposals and I am greatly appreciative of the efforts of all concerned.

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<sup>(1)</sup> That is, the coming year's revenue and expenditure estimates, set in the context of a forecast of revenue and expenditure in the following three years, set in the context of an order of cost of projected capital works over a ten year period.

<sup>(2)</sup> Part I deals with the economic and financial background against which the management of our affairs in the coming years must be considered. Part II offers a quantitative assessment of the economy's prospects for the coming year, but is largely qualitative when dealing with the three forecast years 1976-77 to 1978-79. Following on this, Part III takes a broad look at the budgetary prospects in the coming year and in the three forecast years and up-dates the ten year forecast of the order of cost of capital works to the years 1975-76 to 1984-85. Part IV deals with the actual budget for 1975-76 concluding with an analysis of the economic and fiscal implications of the strategy proposed. Then Part V deals with the financial implications of the strategy for the forecast period, 1976-77 to 1978-79. An assessment is made of the likely acceptable rate of expenditure in these forecast years and the speech concludes by indicating how such a rate of expenditure might be financed, with particular reference to possible revenue proposals in 1976-77.



*PART I: ECONOMIC AND FINANCIAL BACKGROUND**(1) The Economy in 1973 and 1974*

4. Sir, the Economic Background to the Budget publication laid today, which has been prepared with the help and advice of the Economic Review Committee, contains an authoritative account of developments in the economy over the five years ending 1974. So I shall confine myself to a brief review of the last two years in order to put my report on the 1973-74 and 1974-75 public accounts in perspective.

5. In terms of real growth, 1973 was a remarkably good year for the economy. The gross domestic product in real terms increased by 12½% or at double the average annual rate over the previous three years. In *per capita* terms the increase was 10% in 1973 compared with an average annual rate of 4% over the previous three years. As income derived from visible exports is equivalent to almost half the gross domestic product, a major factor in this growth was the buoyancy of overseas demand, but it was achieved in the face of wide fluctuations in exchange rates and an exceptional rate of inflation abroad (leading to a deterioration in our terms of trade). In money (or current price) terms the gross domestic product grew by no less than 25% and the Consumer Price Index increased by 18%.

6. By the end of 1973 and the early part of 1974 it was clear that the rapid growth in 1973 could not be sustained, either in the world economy or in our own. The single most important reason for this was, of course, the oil crisis: while the threat of a shortage of supplies was soon lifted, the repercussions of the 350% increase in crude oil prices between September 1973 and January 1974 have continued to spread throughout the world as a higher proportion of non-oil producing countries' foreign exchange earnings has been applied to their fuel bills.

7. These considerations, as I explained last year, lay behind my forecast that the growth rate of the Hong Kong economy as measured by the gross domestic product would be 14-15% in money terms in 1974, but no more than 4% in real terms<sup>(3)</sup>. The Census and Statistics Department's preliminary estimates for last year indicate that the increase in the gross domestic product was probably only about 12½% in money terms and only 1½% in real terms, with consumer prices increasing by 15%. In *per capita* terms real GDP may well have declined, although very slightly. The fact is I was too optimistic about

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<sup>(3)</sup> *Speech moving the second reading of the Appropriation Bill, 1974, paragraphs 34-41 (hereinafter referred to as B.S., 1974).*

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**

1974: demand in our major overseas markets was less than I anticipated. The weakness in demand was particularly noticeable in the latter part of the year and resulted in a fall in the actual volume of our exports of 7% over the year as a whole, interrupting a prolonged growth trend dating from at least 1959.

8. Gross domestic fixed capital formation, which had been increasing at an annual rate of about 12% in real terms during the years 1968-73, was affected in 1974 by the levelling-off in profits and the uncertain trade outlook. So there was a decrease of perhaps 4% in real terms, with an increase of 13% in money terms, compared with my forecast of 18% (in money terms). Within this aggregate, there was an increase of over 20% in real terms in the public sector, reflecting the demands of the Public Works Programme, and the ability of the construction industry to carry it out at a time when demand was falling. Private consumption expenditure increased by 18% in money terms, only a little less than I forecast last year. Government consumption expenditure, however, increased by 22½% in money terms or by more than the 14% I had anticipated. I shall have more to say about this later on.

9. The rapid turnaround undergone by the world economy, from boom in 1973 to recession in 1974, brought about, as I have already indicated, a sharp slowdown in the Hong Kong economy, through a slackening demand for our exports. The same forces were also responsible for the easy supply position and, as the year wore on, falling prices of many commodities were experienced. Thus, while manufacturing employment fell by 11% in the 12 months ending December 1974 (and there are signs that it is falling further) and money wage rates hardly rose at all, consumers began to feel in late 1974 the benefit of steadier prices.

10. The fall in domestic exports, in quantity terms, was accompanied by a reduction in the quantities imported of raw materials, consumer goods and, to an extent, foodstuffs; but, with increase in the quantities of fuel and capital goods imported, and with both import and export prices continuing to rise rapidly, the visible trade deficit widened considerably. In contrast to the position in 1973, however, when there was a net outflow of funds through the foreign exchange market (in which profit-taking on the stock market featured prominently) there was a substantial net inward movement in 1974.

11. In 1974, the money supply increased at about the same rate as the gross domestic product, in current price terms, that is, by 12½%. Advances and loans for trade and industry increased, in 1974, at about the same rate as in 1973, but they levelled-off in the second half of the year. This was partly on account of the slowing-down in economic activity, but the higher cost of borrowing, as interest rates continued to rise during much of the period, doubtless also made an impact. Interest rates began to fall towards the end of the year, in line with movements abroad. This helped to support stock market prices which had been falling for most of the year in the light of generally unfavourable short-term world trading prospects.

12. The net inflow of funds through the foreign exchange market in 1974 was consistent with the Hong Kong dollar remaining firm throughout the year. In late November, following a period of persistent selling of United States dollars for Hong Kong dollars, reflecting both a weakening of the United States dollar on foreign exchange markets abroad and a demand for Hong Kong dollars locally, the Hong Kong dollar had to be floated. The extent of the subsequent strengthening of the Hong Kong dollar demonstrated that the Exchange Fund would have had to commit enormous sums to keep the rate between the former margins; and, in doing so, it would have made a gift to the buyers of an artificially cheap currency. The floating added to the uncertainties facing the Hong Kong business community and the persistent strengthening of the Hong Kong dollar, in relation to the currencies of some of our major trading partners, has been detrimental to Hong Kong's exporters. Their main problem, however, is clearly a lack of orders; and, even if a weaker Hong Kong dollar allowed them to quote prices which were 3 or 4 per cent lower, there is no evidence that this would enable them to attract orders at the expense of their competitors elsewhere, although it would improve the profitability of the orders already in hand.

13. Some observers have argued that the Government should act in some way to weaken our currency for the sake of our export trade. Some have even suggested that we should follow the example of, say, South Korea, and devalue. But it is one thing to submit to the force of falling exports which is already bringing downward pressure on a currency and quite another to resist the force of an inflow of foreign funds which is driving the rate up even though exports may be falling. We cannot simply declare that the exchange rates shall be at such-and-such a level if the market is not willing to accept that rate.

14. Others have suggested that we should "print more money" or deliberately reflate the economy. In point of fact, the budget deficit

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**

we have been running this year, financed by our reserves, has had some reflationary effect, albeit involuntarily. But I think that any weakening of the Hong Kong dollar, as a result of reflation, would now follow only after a long delay, by which time such a weakening may no longer be desirable; and I think that it could work, if done on a large scale, in the wrong way for us—by producing a deterioration of our balance of payments on current account and partly, indeed, by making our export performance worse rather than better.

15. Reductions in interest rates in Hong Kong had seemed, to the Government and to the banks, to be the obvious means of easing the pressure of flows on capital account, apparently one of the main factors in the strength of the Hong Kong dollar. No fewer than six reductions in interest rates have been made in the three months since floating, but the impact on the rate has been disappointing, partly because the US dollar has continued to weaken in overseas markets and partly, perhaps, because these reductions have had a contrary psychological effect. But, maybe, it is too early yet to assess the results of last week's reductions. In any case, they will have made things easier for exporters in other ways.

16. A floating exchange rate is itself automatically self-regulating like any other price and, if the Hong Kong dollar rate is strong, reflecting excess demand for the currency and a tendency for funds to flow in from abroad, then the high price is one of the means of containing the inflow. It would be counter-productive to cheapen the currency artificially because, as soon as it became apparent that the market would not accept the lower rate, there would be a tendency for funds to flow in again. The result would be a renewed strengthening of the Hong Kong dollar rate. The automatic effects of the floating rate have probably been obscured so far because manufacturers' inventories of materials were large at the time we floated, so that the fall in exports which was already taking place was accompanied by an even sharper fall in imports, and an improvement, therefore, in our overall balance of payments surplus. At least one thing is clear: this particular combination of circumstances will not continue for ever. But, while it would not be right or productive, for the reasons I have given, to manipulate the exchange rate artificially, we shall continue to have no hesitation in intervening in the market to smooth out obviously erratic or wayward movements; and it is my intention that we shall take a closer interest in banks' foreign exchange positions from now on. As to other weapons, whilst I would not rule out the use of interest withholding

tax as a positive regulator, I am totally opposed to any ideas (for example, a two-tier rate system) which would involve a form of exchange control.

(2) *1973-74 Accounts*<sup>(4)</sup>

17. Sir, in last year's budget speech I predicted that the final accounts for the year 1973-74 would reveal a surplus of \$200 million<sup>(5)</sup>. In the event, the surplus was only \$72 million which I regard as really very close to my prediction given the very large figures we are dealing with these days. Revenue at \$5,241 million was only 9% up on 1972-73<sup>(6)</sup>, but expenditure at \$5,169 million was up by 28 %<sup>(7)</sup>.

18. Recurrent revenue in 1973-74<sup>(8)</sup> increased by 18%<sup>(9)</sup> or at half the rate in 1972-73 when we enjoyed quite exceptional yields from stamp duties and dealing profits. Capital revenue<sup>(10)</sup> was 39% down on 1972-73 when land sales alone produced a record figure of \$670 million.

19. Recurrent expenditure in 1973-74<sup>(11)</sup> increased almost twice as fast as recurrent revenue or by 28%, then the highest rate since the war and, consequently, 72% of recurrent revenue was absorbed by recurrent expenditure. Capital expenditure was 29% up on 1972-73<sup>(12)</sup>. At \$1,413 million, actual expenditure was then the highest ever achieved, but as much as 33% was covered by capital revenue.

(3) *Revised Estimates for 1974-75*

(a) *Outturn*

20. After taking into account various unprovided for commitments and my revenue proposals, my final estimate of outturn for

<sup>(4)</sup> *The amounts and percentages quoted both here and in section (3) below are inclusive of expenditure incurred on behalf of the Urban Council and the Housing Authority and subsequently reimbursed.*

<sup>(5)</sup> *B.S., 1974, paragraph 10.*

<sup>(6)</sup> *6% before allowing for revenue transferred to the Urban Council and the Housing Authority from 1st April 1973.*

<sup>(7)</sup> *20% if the transfers to the Mass Transit Fund in both 1972-73 (\$500 million) and 1973-74 (\$300 million) are included.*

<sup>(8)</sup> *\$4,774 million.*

<sup>(9)</sup> *14% before allowing for revenue transferred to the Urban Council and the Housing Authority from 1st April 1973.*

<sup>(10)</sup> *\$466 million.*

<sup>(11)</sup> *\$3,456 million.*

<sup>(12)</sup> *7% if the transfers to the Mass Transit Fund in both 1972-73 and 1973-74 are included.*

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**

1974-75 was for a surplus of \$12 million<sup>(13)</sup>, being the difference between estimated revenue of \$5,976 million<sup>(14)</sup> and estimated expenditure of \$5,964 million<sup>(15)</sup>.

21. The revised estimates of revenue and expenditure for 1974-75, as shown in the Draft Estimates for 1975-76 laid today, are \$5,983 million and \$6,453 million respectively. Thus the surplus of \$12 million I budgeted for has become a deficit of \$470 million. But the estimate of outturn thrown up by the revised estimates of revenue and expenditure always tends to be overstated. As usual, I do not propose to use this figure of \$470 million when discussing our likely financial position at 1st April next.

22. Instead, I intend to use a figure of \$410 million calculated on the basis of daily receipts and payments recorded in the Treasury's cash book up to 18th February last. Even so, a deficit of \$410 million represents a turn round of some significance, particularly as my original estimate of revenue for this year is probably about right.

*(b) Revenue*

23. At \$5,983 million the revised estimate of revenue for 1974-75 is 14% up on actual revenue in 1973-74, when it was \$5,241 million or 9% up on 1972-73<sup>(16)</sup>. The fact that the difference between the revised estimate of revenue of \$5,983 million and the budgeted estimate of \$5,976 million<sup>(17)</sup> is only \$7 million is gratifying, but it hides certain facts: excise duties and taxes on vehicles yielded \$124 million less than I estimated largely as a result of the impact of increased fuel prices; and land sales yielded \$170 million less. Internal revenue yielded \$323 million more than I anticipated as a result of increased yields from salaries, profits and interest taxes and from betting duty, partly offset by lower yields from stamp duties because of a decline in conveyances executed and in turnover on the stock exchanges<sup>(18)</sup>.

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<sup>(13)</sup> *Speech concluding the debate on the second reading of the Appropriation Bill, 1974, paragraph 62 (hereinafter referred to as CS., 1974).*

<sup>(14)</sup> *That is, \$5,845 million as shown in the approved Estimates for 1974-75 plus estimated reimbursement from the Mass Transit Fund of \$131 million for works undertaken since September 1969 by the Public Works Department. (See B.S., 1974, paragraph 78).*

<sup>(15)</sup> *That is, \$5,747 million as shown in the approved Estimates for 1974-75, plus the adjustments totalling \$217 million referred to in B.S., 1974, paragraphs 76 - 78.*

<sup>(16)</sup> *See f.n. (6).*

<sup>(17)</sup> *See f.n. (14).*

<sup>(18)</sup> *See Memorandum Notes on Revenue Estimates for 1975-76, page 19.*

(c) *Expenditure*

24. At \$6,453 million the revised estimate of expenditure for 1974-75 is \$1,584 million or 33%<sup>(19)</sup> up on actual expenditure in 1973-74, when it was \$1,069 million up on 1972-73 or 28%<sup>(20)</sup>. For the fifth consecutive year, actual expenditure is likely to exceed the budgeted estimate<sup>(21)</sup> and by no less than \$489 million or 8%<sup>(22)</sup>. In the post-1967 years, when we were trying to bring the rate of growth of expenditure more into line with revenue, this was a matter for some rejoicing. But not now for, with revenue accurately estimated for 1974-75, excess expenditure has led us into a substantial deficit.

25. The increase of \$489 million is a net figure made up of excesses over original estimates of \$623 million and shortfalls of \$134 million<sup>(23)</sup>. Of the excesses, \$240 million arose from the increase in Civil Service salaries and the consequential increases for subvented bodies and for pensions; \$180 million from unavoidable increases in prices, mainly in oils and related products<sup>(24)</sup>; \$120 million from essential new commitments, of which an increase in the number of cases eligible for social security payments was the most significant; and \$83 million for foreseeable, but unavoidable items which, for one reason or another, were omitted from budgeted expenditure<sup>(25)</sup>. Some of these items were allowed subject to agreed savings elsewhere; and such savings account for the bulk of the shortfalls of \$134 million.

26. As I have said, most of the additional provision was required for unforeseeable price increases and some of it was unavoidable in the sense that not to have sought it would have affected vital services or obliged us to dishonour contracts. Otherwise, the most significant factor was the increase in Civil Service salaries. But we have partially offset the substantial increase in expenditure involved by halving the rate of recruitment. In consequence, appointments to the Civil Service advertised in the first nine months of 1974-75 were 11,276 compared with 15,949 in the same period of 1973-74.

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<sup>(19)</sup> 25% if the transfer to the Mass Transit Fund in 1973-74 is included.

<sup>(20)</sup> \$869 million or 20% if the transfers to the Mass Transit Fund in both 1972-73 and 1973-74 are included.

<sup>(21)</sup> Of \$5,964 million (see f.n. (15)).

<sup>(22)</sup> C.f. previous years: 1970-71, 2.5%; 1971-72, 1.4%; 1972-73, 3.9%; 1973-74, 10.5% (excluding the transfers to the Mass Transit Fund in both 1972-73 and 1973-74).

<sup>(23)</sup> General Memorandum Note on the Estimates of Expenditure for 1975-76, pages 27-28, paragraph 4.

<sup>(24)</sup> And this, despite deliberate reductions in consumption.

<sup>(25)</sup> C.S., 1974, paragraph 63.

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading***(4) Financial Position**(a) As at 1st April 1974*

27. Sir, in last year's budget speech, I estimated that our available (that is to say, our spendable) fiscal reserves at the beginning of this financial year (in other words at 1st April 1974) would amount to \$3,066 million<sup>(26)</sup>. In the event, our reserves stood at \$2,882 million<sup>(27)</sup>.

*(b) As at 1st April 1975*

28. Two factors caused an erosion of our fiscal reserves in 1974-75; first, the deficit on budgetary account which will be of the order of \$410 million<sup>(28)</sup>. Secondly, the strength of the Hong Kong dollar in the foreign exchange market<sup>(29)</sup>, involving a fall in the value of our foreign currency assets in Hong Kong dollar terms of probably \$80 million<sup>(30)</sup>. This loss has been calculated by the Accountant General after taking into account compensation of \$45 million received from the United Kingdom Government under the unilateral sterling guarantee arrangement covering the period from 25th September 1973 to 31st March 1974.

29. Honourable Members may be surprised that I have not had to make some allowance for a probable fall in the book value of our fixed interest bearing sterling securities at 31st March next compared with a year ago. This is because, whilst the Financial Times Government Securities Index fell to an all time low of 49.2 on 3rd January 1975, it recovered by mid-February to the level ruling exactly a year ago. As regards our portfolio of non-sterling securities, book losses

<sup>(26)</sup> B.S., 1974, paragraph 22.

<sup>(27)</sup> Comprising \$2,809 million in the General Revenue Account and \$73 million in the Development Loan Fund. The difference between the estimate of \$3,066 million and the actual figure of \$2,882 million is largely accounted for by the smaller than anticipated surplus for 1973-74 (see paragraph 17 above.)

<sup>(28)</sup> See paragraph 22 above.

<sup>(29)</sup> The cumulative appreciation of the Hong Kong dollars as reflected by a trade weighted index of the currencies of our major trading partners was as follows:

Mid-December 1971	100
1st April 1974	100.4
25th November 1974	105.6
18th February 1975	109.3

<sup>(30)</sup> About \$35 million can be related to sterling assets and the bulk of the remainder to US dollar assets.



incurred so far on those denominated in US dollars have been offset by gains on those denominated in other currencies. With the influences bearing on interest rates changing so rapidly these days, it is difficult to know what the state of the markets will be even a month from now. But, for present purposes, I propose to assume that, when all our securities are revalued at the end of this year, book values will show little change overall from a year ago.

30. So I estimate that we shall begin 1975-76 with fiscal reserves amounting to \$2,371 million<sup>(31)</sup> a decline of \$511 million on the position at the beginning of this year. This estimate represents only 36% of estimated expenditure in 1975-76. By way of contrast our fiscal reserves at the beginning of this year represented 52% of estimated expenditure in 1974-75 and at 1st April 1973 they represented 75% of estimated expenditure in 1973-74<sup>(32)</sup>.

31. For the record, of our estimated fiscal reserves of \$2,371 million at 1st April next, I expect that \$315 million will be held with our bankers in Hong Kong<sup>(33)</sup> and that \$2,056 million will be held abroad to form part of the Colony's foreign exchange reserves. These consist of overseas assets owned by the Government<sup>(34)</sup> and the banking system and privately held assets<sup>(35)</sup>.

## *PART II: ECONOMIC PROSPECTS*

### *(1) In the Short Term*

32. In 1974, the gross domestic product increased by 1½% in real terms; bearing in mind the limitations surrounding estimates of this kind, such a small increase could just as easily reflect negative growth.

<sup>(31)</sup> *Comprising \$2,319 million in the General Account and \$52 million in the Development Loan Fund.*

<sup>(32)</sup>

	<i>Fiscal Reserves (1) (\$ million)</i>	<i>Estimated Expenditure (2) (\$ million)</i>	<i>(1) as a % of (2)</i>
<i>Ist April 1973- 74</i> .....	3,158	4,209	75%
<i>Ist April 1974- 75</i> .....	2,882	5,493	52%
<i>Ist April 1975- 76</i> .....	2,371	6,615	36%

<sup>(33)</sup> *Our total Hong Kong dollar position, i.e. inclusive of net liabilities, will be about \$1,100 million.*

<sup>(34)</sup> *That is, by the General Revenue Account, the Coinage Security Fund and the Rehabilitation Loan Sinking Fund.*

<sup>(35)</sup> *As with the Government's assets, the banking system's are also largely held against liabilities, mainly local liabilities.*

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**

So I think it is realistic to assume that our real growth rate last year in 1974 was zero or thereabouts.

33. The question is what can we expect in 1975? Obviously, our growth rate will continue to depend crucially on developments in the world economy and particularly in our major export markets in North America and Western Europe; and these are very uncertain, to say the least. Nonetheless, I must take a view of the future.

34. To begin with our own economy: I forecast that the growth rate of our gross domestic product in real terms in 1975 will, in effect, again be zero. It could even be negative to a small extent. This forecast is based on a whole range of assumptions, including the view that our exports will fall, in quantity terms, by up to 5%. And imports will, I forecast, fall by about the same amount.

35. Taking due account of a likely fall in import prices for raw materials and semi-manufactures and of an improvement in the terms of trade, I forecast that the visible trade deficit will fall from last year's record \$4,100 million to under \$3,000 million, in money terms, that is, to a little below the level for 1973<sup>(36)</sup>. The net income from invisible trade will, I assume, be much the same, in money terms, as last year.

36. The money supply is likely to increase at a slower rate in 1975 than in 1974: to a considerable extent this reflects the slowing down of inflation and should not be taken to mean that liquidity will become generally tighter. Nor should it be assumed that any slowing down in the growth of the money supply will, in itself, bring about an increase in interest rates: these will continue to move largely in sympathy with interest rates abroad.

37. In general, I forecast that income available for consumption and investment<sup>(37)</sup> will be much the same, in money terms, as last year. Consumer prices will continue to increase<sup>(38)</sup> but at nothing like the rates for 1973 and the first half of 1974 and, even allowing for the utilization of household savings, I forecast that real private consumption expenditure will fall, perhaps by up to 5%. This reflects the likelihood that wages and salaries, as well as other incomes, will increase

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<sup>(36)</sup> *When it was \$3,006 million.*

<sup>(37)</sup> *Public and private consumption and investment taken together.*

<sup>(38)</sup> *Possibly by around 5%.*

very modestly this year, in money terms, as well as the effects of a lower level of employment and more short time working.

38. Private investment expenditure also seems likely to fall, in real terms. Private sector demand for building and construction work has already fallen from the peak in 1973 and there is no sign yet of any recovery, despite the easing in building costs since mid-1974. Suggestions have been made that assurances on future rent control policies and relief from the payment of rates on vacant domestic premises would materially influence the climate of demand for domestic premises. I have my doubts for we are now witnessing the inevitable reaction to the earlier boom; yet both suggestions are being considered by the Government.

39. Government expenditure on both consumption and investment will, however, continue to increase, in money terms, and this will reflect limited real growth.

40. The view I have taken of the Hong Kong economy in 1975 is a view of the year as a whole and conceals movements within the year. I am not expecting any substantial upturn in overseas demand this year and I would have thought it likely that such expansion as may take place will not make any significant impact on output and employment in Hong Kong until 1976. But I have assumed that the economy will show *some* signs of increased activity towards the end of the year.

41. Moving on now, Sir, to the world economy; the question uppermost in everyone's mind is just what is going to happen? At the beginning of 1975 the world economy was in recession. The major economies of OECD had, on average, exhibited little or no growth in output in 1974. The symptoms of recession included a rapidly rising level of unemployment (particularly marked in some of Hong Kong's major markets), together with falls in the quantities of some trade flows. At the same time, the easing of demand pressures had led to a fall in the prices of raw materials, other than oil. Interest rates, too, had declined sharply by the end of 1974.

42. Thus, the weakness of demand has gone further than had been generally expected a year ago. For that reason, and also because inflationary pressures were beginning to show signs of easing, the stance of policy in most countries has now shifted in the direction of expansion. But the fear of inflation and the balance of payments problems that developed in the wake of the huge increase in oil prices have combined to restrict the scope for expansionary policies.

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**

43. All in all, I think it is reasonable to look forward to the beginning of a recovery in world output and trade before the end of 1975. But because the first half of 1975 and perhaps the first three quarters of 1975 is likely to continue depressed, the year as a whole is unlikely to show much growth of output or trade.

*(2) In the Longer Term*

44. So what view should be taken of the forecast period, that is to say, the three years 1976-77 to 1978-79? It seems likely that the potential for economic growth over this period is very considerable; and that rapid growth could compensate—*could* compensate—for the lack of growth in 1974 and 1975. While it is possible that such an above average rate of growth will take place, this would I think be a somewhat unduly optimistic basis on which to build a revenue and expenditure forecast. More realistically, it might well be quite difficult for us to maintain the 7-8% real growth rates achieved in the period 1966-73: we now face stiffer competition in many of our traditional export lines and markets. Nor can we discount the possibility that the growth in world trade will not regain the historically very high pre-1974 rates.

45. Yet I am confident that the economy will be in a position quickly to take advantage of whatever expansion of world trade does occur, when it occurs; and I adhere to my belief, expressed last year, that a 7% real growth rate for the economy is a realistic assumption for budgetary planning purposes. But to allow a little time for the growth rate to pick up I am assuming 5% in 1976 and 7% thereafter<sup>(39)</sup>.

*PART III: BUDGETARY PROSPECTS*

*(1) Introduction*

46. Against this background of our financial position at 1st April next and of our economic prospects, I must now consider the financial implications of the Government's policies as revealed by departmental submissions.

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<sup>(39)</sup> *The revenue implications of these assumptions about the growth rate of the economy are given in paragraph 57 below.*

(2) *Presentational Points*

47. All expenditure figures which I shall be using from now on and when dealing with the Draft Estimates for 1975-76 are at April 1975 prices<sup>(40)</sup>.

48. As well as being at April 1975 prices, the expenditure figures in departmental submissions followed a consistent philosophy, that is to say, they reflected what was thought to be administratively and technically possible given the availability of funds<sup>(41)</sup>.

49. The main presentational change in the Estimates is the exclusion of expenditure reimbursable by the Urban Council and the Housing Authority and by private donors. Our object here is to avoid inflating both sides of the Estimates in respect of expenditure over which this Council has no control. From 1975-76 such payments and receipts will be dealt with below-the-line.

50. The revenue estimates for 1975-76 are based on present rates of taxes and of fees and charges, present fiscal policies and departmental views as to what yields are likely to be. Revenue estimates in the forecast years are likewise based on present rates and policies and on the assumptions just made about the growth rate of the economy after 1975: that is to say 5% in 1976 and 7% in each of the following two years (in real terms).

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<sup>(40)</sup> *Provision for Annually Recurrent Personal Emoluments is based on current salary scales and allowances and allows for permitted growth in strength and for normal progression of staff up the scales. Provision for Annually Recurrent Other Charges is generally based on prices ruling in November when departments made their submissions (but, particularly as the number of subheads has been reduced, departments will have to absorb any increases in prices since then). Provision for expenditure on Public Works Non-Recurrent allows for price fluctuations up to April. Provision for other capital expenditure may be on the basis of inadequate knowledge of up-to-date prices; but, as most of the provision is in respect of orders already placed, the consequences are unlikely to be significant.*

<sup>(41)</sup> *On recurrent account they included present services; new and additional services within approved policies where timing was either integral to the policy concerned or was dictated by the Public Works Programme; and new and additional services which either had been approved, but for which timing was flexible, or had only reached some stage of consideration within the Administration. On capital account, the figures for the Public Works Programme and Housing were consistent with the guideline figure of \$2,200 million at April 1974 prices (see B.S., 1974, paragraph 101). The figures for other capital expenditure should have been consistent with the guideline figure of \$280 million, again at April 1974 prices, but the submissions added up to substantially more.*

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**(3) *The Year 1975-76*(a) *Expenditure*

51. Turning now to the departmental estimates of expenditure as submitted for the coming financial year: these came to a staggering total of \$7,987 million, being \$5,241 million for recurrent expenditure and \$2,746 million for capital expenditure.

52. The Public Works Programme and Housing<sup>(42)</sup> components of this latter figure came to \$2,095 million or \$105 million *below* the guideline figure of \$2,200 million at April 1974 prices which I suggested, this time last year, we could afford<sup>(43)</sup>. This is because the post-1974 budget exercise on the planning of capital works expenditure showed that if the guideline figure was not to be exceeded in later years, a phased build-up from 1976-77 was necessary.

53. This applied particularly to the infrastructure of the new towns and that part of the housing programme located in them. Thus, a planning concept was developed for the new towns, and endorsed by the Public Works Sub-Committee<sup>(44)</sup>, to enable development to proceed in a series of self-contained packages. The packages have been arranged in order of priority, starting from work expected to be completed by the end of 1974-75. The timing of public housing estates in the new towns—and hence the call on public funds—was based on a programme suggested by the Housing Authority. As regards Public Works Non-Recurrent expenditure other than on new towns and housing, the post-1974 budget exercise involved adjusting the rate at which contracts could be let so as to maintain annual expenditure within \$1,000 million. This involved re-examining priorities. The object was to strike a reasonable balance between different kinds of works<sup>(45)</sup> on the basis of the pattern of expenditure in 1974-75. The Public Works Sub-Committee has endorsed the results.

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<sup>(42)</sup> *That is, that part of the housing programme financed by transfers from General Revenue to the Development Loan Fund for on-lending to the Housing Authority.*

<sup>(43)</sup> *B.S., 1974, paragraph 101.*

<sup>(44)</sup> *Report of the Public Works Sub-Committee of Finance Committee for 1974, Fourth Review, page 209.*

<sup>(45)</sup> *That is, buildings, civil engineering, highways, waterworks and the miscellaneous items under Public Works Non-Recurrent, Headquarters.*

54. The other component of the figure of \$2,746 million for capital expenditure was \$651 million. This exceeded the guideline figure for other capital expenditure of \$280<sup>(46)</sup> million by \$371 million and was due largely to demands for funds for departmental special expenditure and for capital subventions (including the Polytechnic building programme).

55. But the problem of bringing expenditure on capital account down to a feasible level paled into insignificance when compared with the problem of coping with the demands for funds for recurrent services. The departmental submissions reflected the financial implications of our burgeoning public services, many of them of an open ended and non-means tested nature and thus difficult to control financially. Furthermore, despite an expected slowing down in the rate of cost inflation in 1975-76, the fact is that any cost inflation in 1975-76 is damaging to the prospects for expenditure in real terms because the total revenue estimated for the year revealed no growth at all on the revised estimate for 1974-75.

*(b) Revenue*

56. The revenue estimates for 1975-76 as submitted by departments and adjusted to take account of, for example, routine updating of fees and charges, amounted to \$5,719 million. As I have already said, this figure fell short of departmental expenditure submissions by no less than \$2,268 million. Recurrent expenditure alone at \$5,241 million virtually equalled recurrent revenue at \$5,289 million. Capital revenue at \$430 million was 7.5% of total revenue and covered only 16% of departmental submissions in respect of capital expenditure. But, clearly, a situation in which recurrent expenditure absorbs the whole of recurrent revenue, thereby leaving nothing for transfer to the capital account, is absurd.

<sup>(46)</sup> *The guideline figure of \$280 million at 1974 prices may be broken down and compared with actual departmental bids as follows:*

	<i>Breakdown of Guideline Figure (\$ million)</i>	<i>Actual Bids (\$ million)</i>
<i>Subventions .....</i>	<i>45</i>	<i>122</i>
<i>UPGC .....</i>	<i>60</i>	<i>153</i>
<i>Departmental Special Expenditure .....</i>	<i>70</i>	<i>208</i>
<i>Special Works for Armed Services .....</i>	<i>45</i>	<i>72</i>
<i>Miscellaneous .....</i>	<i><u>60</u></i>	<i><u>67</u></i>
	<i><u>280</u></i>	<i><u>622</u></i>
<i>Add for price increases .....</i>		<i><u>29</u></i>
		<i><u><u>651</u></u></i>

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**(4) *The Forecast Period, 1976-77 to 1978-79*

57. The situation in the three year forecast period was not quite as grim as this for it was possible to inject some optimism into the revenue figures. That is to say, I think it is reasonable to assume a growth rate for the economy of 5% in real terms in 1976-77 and the planning figure of 7% in 1977-78 and 1978-79, implying rather higher growth rates for certain income sensitive taxes and other levies. On various other assumptions as well<sup>(47)</sup>, I estimated that total revenue in each of the three forecast years would be \$6,400 million, \$7,000 million and \$7,700 million respectively at April 1975 values.

58. Even so, deficits of

\$2,300 million in 1976-77

\$2,100 million in 1977-78 and

\$1,800 million in 1978-79

were thrown up, because total expenditure in these years, as revealed by the November departmental submissions, amounted to

\$8,700 million in 1976-77

\$9,100 million in 1977-78 and

\$9,500 million in 1978-79.

Furthermore, a breakdown of these figures showed that recurrent expenditure absorbed 97%, 96% and 95% of recurrent revenue in each year leaving a quite inadequate surplus for transfer to the capital account<sup>(48)</sup>.

<sup>(47)</sup>Such as the planned revaluation of properties in 1975, effective from 1st April 1976, extension of rating in the New Territories, known interest bearing balances and land sales programmes.

<sup>(48)</sup>	1976-77 (\$ million)	1977-78 (\$ million)	1978-79 (\$ million)
<i>Expenditure:</i>			
(a) Recurrent .....	5,800	6,200	6,700
(b) Capital .....	<u>2,900</u>	<u>2,900</u>	<u>2,800</u>
	<u>8,700</u>	<u>9,100</u>	<u>9,500</u>
<i>Revenue:</i>			
(c) Recurrent .....	5,900	6,500	7,100
(d) Capital .....	<u>500</u>	<u>500</u>	<u>600</u>
	<u>6,400</u>	<u>7,000</u>	<u>7,700</u>
Overall Deficit.....	2,300	2,100	1,800
<i>Surplus on Recurrent Account</i>			
(i.e. (c) minus (a)) .....	100	300	400



(5) *Order of Cost of Projected Capital Works, 1975-76 to 1984-85*

59. Turning, finally, to the cost of our capital works programmes over the ten years from 1975-76 to 1984-85 I need only say that, at April 1975 prices which, for Public Works Non-Recurrent expenditure, are not all that different from April 1974 prices<sup>(49)</sup>, the order of cost is now put at \$29,648 million<sup>(50)</sup> Compared with \$24,945 million a year ago: an increase and quite largely in real terms an increase of 19%.

*PART IV: THE BUDGET FOR 1975-76*

(1) *Strategy*<sup>(51)</sup>

60. Sir, in last year's budget speech I said that, compared with the budgetary problems facing us in the three year forecast period 1975-76 to 1977-78, and thereafter, the problem we faced in 1974-75 was a relatively minor one<sup>(52)</sup>. I cannot pretend, however, that a year ago I envisaged that our budgetary problems for the year now coming up, 1975-76, and for the new forecast period, 1976-77 to 1978-79, would look quite so difficult today, a year later, as in fact they do. Furthermore, the prospect of a full year's expenditure even at the level of costs established by the end of this financial year, combined with virtually no growth in revenue next year, means that the 1975-76 budgetary problem is a peculiarly difficult one. The problem in the new forecast period looks almost as difficult.

61. Obviously, I could not contemplate budgeting for a deficit of \$2,268 million in 1975-76, or any figure remotely resembling it, quite apart from the dangerous inflationary and balance of payments consequences of a level of expenditure as high as \$7,987 million, or 29% up on the revised estimate for 1974-75. To cover the deficit revealed by the estimates as submitted by departments by large tax increases would involve net damage to the economy through the adverse effects both on investment and on our external competitiveness. To cover the deficit by resorting to short and long term loan finance would not

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<sup>(49)</sup> *By the beginning of 1975 building costs had fallen to the December 1973 level.*

<sup>(50)</sup> *An analysis of estimated expenditure on the Public Works Programme and by the Housing Authority as authorised at 1st April 1975 is at Appendix X of the Estimates.*

<sup>(51)</sup> *As mentioned in paragraph 49 above, all figures quoted from now on are exclusive of expenditure incurred on behalf of the Urban Council and the Housing Authority and subsequently reimbursed.*

<sup>(52)</sup> *B.S., 1974, paragraph 122.*

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**

be practicable, quite apart from the fiscal and monetary risks and adverse economic implications.

62. Equally, I could not contemplate putting the whole weight of the necessary adjustment in 1975-76 on to reductions in proposed expenditure. To do so would have meant either drastically cutting existing services or deferring capital projects essential to the development of the infrastructure of the economy.

63. So a simple, straightforward solution was not available to me. Instead, having regard to conflicting social, political, economic and financial considerations, I have had to deal with this deficit by devising a balanced strategy comprising reductions in proposed expenditure, the raising of additional tax and non-tax revenue and the use of loan finance. As our reserves have been run down by \$511 million this year to an estimated \$2,371 million at 1st April next, and given the uncertainties of 1975-76, I do not propose to budget for a deficit in the sense of deliberately planning to run our reserves down further.

64. Lest it be thought that I have tackled the problem of dealing with this deficit in a purely arithmetic way, let me hasten to add that it is based on an underlying philosophy, defensible in terms of the reality of the Hong Kong situation<sup>(53)</sup>.

65. My strategy comprised four elements: first, an attack on departmental bids for vote provision so as to achieve every opportunity for economies and cost reductions and to achieve savings by postponing the implementation of new and extended policies. This exercise reduced the deficit by \$1,009 million. Secondly, I searched around for

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<sup>(53)</sup> *As the Hong Kong economy is an externally oriented economy, fiscal weapons cannot be used to regulate the level of economic activity, except in the very short term. But as fiscal policies can be damaging, their influence must be as neutral as possible. This means that there are severe limits to the scope and levels of direct and indirect taxation if capital investment is to be sustained at a high level to offset the disadvantages suffered from lack of raw materials and if industrial costs are not to be inflated to the detriment of external competitiveness. For revenue, the Government is dependent essentially on the state of the economy. Only to a limited extent can yields be raised by adjusting tax rates. So the Government must plan and manage public expenditure in such a way that it can be adjusted to the circumstances of the day, as and when—whatever the reason—the rate of growth of expenditure tends to outstrip the rate of growth of revenue after making judicious use of available loan finance and calling upon the reserves to assist in abating the effects of short term difficulties (though the primary role of the reserves must be to finance additional expenditure and shortfalls in revenue unforeseen when the annual budget is prepared).*

ways and means of raising additional fiscal revenue, bearing in mind continuously the state of the economy, the level of real incomes and our economic prospects. My revenue proposals should raise about \$467 million in 1975-76. Having established at least tentative figures for the Draft Estimates of Expenditure and formulated revenue proposals, I then considered thirdly how much more had to come off the expenditure estimates, bearing in mind that the economy is pausing in between one period of growth which tapered off in mid-1974 and the next which, I hope, will begin towards the end of 1975. So the growth of the public sector must pause too, even if not to the same extent. In looking for actual cutbacks in some services and capital works we had to avoid breaching contractual obligations and distorting too much the balance of recurrent and capital expenditure. In the event, I decided the estimates had to be reduced by a further \$433 million<sup>(54)</sup> and so, altogether, \$1,442 million or 18% came off the November departmental submissions. Finally, I was left with a residual gap of \$359 million which I raised to \$429 million by adding on \$70 million<sup>(55)</sup> for inevitable additional commitments of an unavoidable nature arising during the year. I intend to close this gap of \$429 million by raising additional resources outside the fiscal system, both locally and offshore. I feel justified in doing this because the pause in the growth of revenue is only temporary, because expenditure could be further reduced only with the greatest difficulty and because, with a slack economy in 1975, the inflationary consequences of deficit financing will be minimal.

66. Loan receipts will be treated, of course, as capital revenue<sup>(56)</sup> and thus the guideline that 25% of capital expenditure should be covered by capital revenue<sup>(57)</sup> must be modified. I think we should limit recurrent expenditure to 80% of recurrent revenue so as to generate a surplus on recurrent account sufficient to finance at least 60% (as opposed to 75%) of capital expenditure, the maximum balance of 40% being financed by capital revenue supplemented, if feasible, by loan funds. On this basis the ratio of capital expenditure to recurrent expenditure would be 30:70. But in 1975-76 recurrent expenditure will absorb over 87% of recurrent revenue and so the surplus on recurrent account will only be sufficient to finance 34% of capital expenditure. However, the ratio of capital expenditure to recurrent expenditure will exactly accord with the guideline ratio of 30:70.

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<sup>(54)</sup> *A list of possible cutbacks in services and works, for which there were no contractual commitments, was prepared by the Finance Branch and ranked in order of priority by the Colonial Secretary's Committee. This list came to a total value of \$975 million.*

<sup>(55)</sup> *Roughly equal to 1% of total expenditure.*

<sup>(56)</sup> *And thus applied to capital expenditure.*

<sup>(57)</sup> *B.S., 1974, paragraph 62.*

[THE FINANCIAL SECRETARY] **Appropriation Bill—second reading**

67. I shall deal with the guidelines relating to the balance of the fiscal system when dealing with my revenue proposals<sup>(58)</sup>. Sufficient to say, now, that I have borne in mind the guidelines I laid down last year<sup>(59)</sup>.

(2) *Draft Estimates of Expenditure*<sup>(60)</sup>(a) *General*

68. As \$6,615 million the Draft Estimates of Expenditure for 1975-76 laid today represents an increase of \$431 million or 7% on the revised estimate for 1974-75<sup>(61)</sup>. It is substantially lower than increases in recent years<sup>(62)</sup>.

(b) *Recurrent*

69. Departmental submissions for recurrent expenditure came to \$5,241 million. The Finance Branch managed to negotiate reductions of \$549 million, admittedly after some pretty lively exchanges with heads of departments who understood the dictates of our present circumstances but who, understandably, produced telling arguments for preserving the levels of expenditure they had sought. With submissions reduced overall by 10%, heads of departments will have to explore energetically ways and means of achieving maximum cost-effectiveness if services are to be maintained at a reasonably viable level; for it must be remembered that any higher costs will still have to be absorbed and there are significant areas of expenditure where cost reductions are impossible without causing social distress.

70. For this latter reason and because short of actually dispensing with staff it is not easy to cut back recurrent services, when departmental submissions come to be looked at again, the main burden of the third element of my strategy had to fall on capital expenditure. However, of the \$433 million taken off at that stage, \$144 million was found from recurrent services.

<sup>(58)</sup> See paragraph 87 and paragraphs 156 - 157 below.

<sup>(59)</sup> B.S., 1974, paragraphs 58-59.

<sup>(60)</sup> A vote-on-account procedure is to be operated from 1975-76 as explained in Financial Circular No. 2175, reproduced at Appendix (1).

<sup>(61)</sup> That is, after allowing for expenditure incurred on behalf of the Urban Council and the Housing Authority of \$270 million in 1974-75.

<sup>(62)</sup> 1974-75 compared with 1973-74: 33% (excluding the transfer of \$300 million to the Mass Transit Fund in 1973-74 as well as expenditure incurred on behalf of the Urban Council and the Housing Authority); average annual increase in the three years ending 1973-74: 26%.

71. Thus the provision for expenditure on recurrent services shown in the Draft Estimates, laid today, is \$4,618 million<sup>(63)</sup>. This represents an increase of \$407 million or 10% on the revised estimate for 1974-75. But it is substantially lower than the increase in recent years<sup>(64)</sup>. There is one aspect, however, which is particularly distressing and that is the proportion of recurrent revenue absorbed by recurrent expenditure. According to the Draft Estimates, it will be 87% compared with the new guideline of 80%<sup>(65)</sup> and will have to be reduced by increasing recurrent revenue. But more about that somewhat unpleasant subject later on.

72. I do not propose this year to analyse in detail the reasons for the increase in recurrent expenditure but, instead, to draw attention to new developments which have been provided for. Provision has been included to bring an additional 19,000 secondary school places into the public sector to allow the increased intakes at Form I in previous years to progress through the schools; and to maintain sufficient places in Form I for 50% of those likely to apply. Continuing the emphasis on technical education, the provision will allow for the opening of two new technical institutes with a combined capacity of 2,400 full time students and for the planned expansion of the Polytechnic to provide for a further 400 full time students. The provision for social welfare allows for an increase in the number of cases eligible for public assistance<sup>(66)</sup> and for disability and infirmity allowances.

73. Princess Margaret Hospital, two polyclinics and a specialist clinic will be opened. The Tung Wah Group of Hospitals will be subvented for the opening of the new Centenary Block and the United Christian Hospital will be subvented to enable it to operate at full capacity for a full year. Allowance has been made for other social welfare and medical subvented organizations to meet increased prices, although they will be expected to economize as well.

<sup>(63)</sup> After adding back the \$70 million mentioned in paragraph 65 above for additional commitments of an unavoidable nature arising during the year.

<sup>(64)</sup> On a comparable basis: 1974-75 compared with 1973-74: 30%; average annual increase in the three years ending 1973-74: 22%.

<sup>(65)</sup> See paragraph 66 above. C.f. the position in previous years:

1974-75.....	80%
Average of three years ending 1973-74 .....	68%

<sup>(66)</sup> Up to an average of 44,700 cases throughout 1975-76, though this may be on the low side.

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74. We have, unfortunately, had to allow for a fairly dramatic increase in the prison population; and also for a substantial increase in the strength of the Police Force.

75. The Police will be one sector of the Civil Service in which recruitment will be allowed to increase the strength of the establishment next year, the others, for obvious reasons, being such related services as prisons and the Legal Department, and the revenue collecting departments. To contain the growth of expenditure on personal emoluments, the net increase in the strength of the establishment of the Civil Service as a whole, that is to say a net increase in the number of people actually employed will be limited to 1,600<sup>(67)</sup>. The establishment of the Civil Service as shown in the Draft Estimates represents only an increase of 0.7% on the establishment this time last year<sup>(68)</sup>. This limiting of increases in the establishment to essential areas will be continued in 1975-76. Provision for the Civil Service<sup>(69)</sup> will be reduced by this means to 38% of total recurrent provision, compared with 40% in 1974-75 and an average of 42% over the three years ending 1973-74.

(c) *Capital*

76. Departmental submissions for capital expenditure came, as I said earlier, to \$2,746 million. And I have already indicated earlier, the post-1974 budget exercise had already successfully contained expenditure on the Public Works Programme (including New Towns and Housing) at \$2,095 million within the guideline figure of \$2,200 million<sup>(70)</sup> and this figure was reduced quite painlessly by \$235 million<sup>(71)</sup> to \$1,860 million. Consequently, the Finance Branch was able to focus their attention on other capital expenditure and managed to agree

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<sup>(67)</sup> *At present, there are 8,000 vacancies.*

<sup>(68)</sup> *Compared with a net increase of 7.5% in the previous year.*

<sup>(69)</sup> *Including allowances, but excluding pensions.*

<sup>(70)</sup> *See paragraph 52 above.*

<sup>(71)</sup> *First, as a result of a decision to defer the recovery of capital charges for estates handed over to the Housing Authority on 31st March 1973 and of the Authority adjusting its programme of capital works, the amount for transfer to the Development Loan Fund for housing was reduced by \$135 million. Secondly, \$100 million included for price increases was considered to be unnecessary (see f.n. (49) above).*

deductions amounting to \$225 million, largely as a result of postponing the purchase of items of special expenditure for which orders have not yet been placed and by deferring the replacement of motor vehicles and other items of plant and equipment except where replacement is absolutely necessary.

77. But, to my regret, further postponements worth \$289 million were necessary as part of the third element of my strategy. These had to be achieved largely at the expense of the Public Works Programme and the New Towns<sup>(72)</sup>. I must stress that most of the works concerned are being postponed only. They can be undertaken readily enough as soon as the revenue position allows.

78. And I must also stress what is to be undertaken. Provision has been included for new contracts involving expenditure of \$140 million in 1975-76 for the Public Works Programme, other than New Towns and Housing, including building works at the airport and on prisons, road works to reduce congestion when the mass transit railway is being built and works related to the High Island Water Scheme. Contracts involving expenditure of \$111 million in 1975-76 will be let in the new towns. Provision of \$41 million has been included for housing estates under way in the urban area as part of the Public Works Programme and \$25 million has been included as a transfer to the Development Loan Fund towards the Housing Authority's expenditure on new housing projects.

79. As regards other capital expenditure, provision has been included to allow for contracts to be let for the Polytechnic, for subvented secondary schools, for implementing part of the approved programme for introducing economies through a greater use of electronic data processing, for the development of licensed areas for housing the homeless, for overhauling buoys and moorings in the harbour, for local public works in the New Territories and radios for police on beat patrol.

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<sup>(72)</sup> *The further postponements included \$121 million in respect of the Public Works Programme (other than New Towns and Housing), \$113 million in respect of the Public Works Programme (New Towns and Housing—but the only major housing projects affected were those connected with the redevelopment of Shek Kip Mei), and \$55 million in respect of other capital expenditure.*

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80. The estimate of \$1,997 million<sup>(73)</sup> for capital expenditure included in the Draft Estimates for 1975-76 represents an increase of only \$24 million on the revised estimate for 1974-75, but let us remember that the increase in 1974-75 was 40% on 1973-74 and the average annual increase over the three years ending 1973-74 was 37%<sup>(74)</sup>.

81. I shall doubtless be told that in the interests of the budgetary position, I should have reduced capital expenditure further, particularly on the Public Works Programme, including New Towns and Housing. My defence will be five fold. First, as I said earlier<sup>(75)</sup>, I have tried to bring expenditure within what I think we can reasonably afford without distorting the balance of recurrent and capital expenditure. The capital expenditure proposed is 30% of total expenditure, that is to say, it is equal to the guideline figure<sup>(76)</sup>. Second, we must avoid "stop go" in terms of both capital and recurrent expenditure by keeping up a steady flow of projects into Category A of the Public Works Programme; and, as my third point of defence, we must keep up a steady flow to the contract stage in the interests of the construction industry. Yet, fourth, we should get some competitive bids at this

<sup>(73)</sup> This figure may be broken down and compared with the guideline figure and with outstanding commitments at 1st April 1975 as follows:

	<i>Breakdown of Guide- line Figure* (\$million)</i>	<i>Draft Estimates (\$million)</i>	<i>Outstanding Commit- ments (\$million)</i>
<i>Public Works Programme (other than New Towns and Housing) .....</i>	<i>1,100</i>	<i>1,070</i>	<i>3,469</i>
<i>Public Works Programme (New Towns and Housing) .....</i>	<i>1,100</i>	<i>556</i>	<i>3,018</i>
<i>Subventions .....</i>	<i>45</i>	<i>78</i>	<i>237</i>
<i>UPGC .....</i>	<i>60</i>	<i>82</i>	<i>220</i>
<i>Departmental Special Expendi- ture.....</i>	<i>70</i>	<i>94</i>	<i>189</i>
<i>Special Works for the Armed Services .....</i>	<i>45</i>	<i>58</i>	<i>73</i>
<i>Miscellaneous .....</i>	<i>60</i>	<i>59</i>	<i>60</i>
	<u><i>2,480</i></u>	<u><i>1,997</i></u>	<u><i>7,266</i></u>

\* At April 1974 prices.

<sup>(74)</sup> Excluding transfers to the Mass Transit Fund in both 1972-73 (\$500 million) and 1973-74 (\$300 million).

<sup>(75)</sup> See paragraph 65 above.

<sup>(76)</sup> It compares with 32% in 1974-75 and the average for the three years ending 1973-74 of 29%.



time in response to our tenders for public works. And, fifth, the Public Works Programme has already been cut back substantially as part of the post-1974 budget exercise to get it within the various guideline figures.

(3) *Revenue Estimates*

(a) *General*

82. The Revenue Estimates as printed anticipate collections of \$5,719 million, an increase of only \$5 million over the revised estimate for 1974-75<sup>(77)</sup>. This illustrates clearly the slowing down of the economy and may be compared with the 14% increase in 1974-75 and the average annual increase of 20% in the three years ending 1973-74, on a comparable basis.

(b) *Recurrent*

83. The estimate of recurrent revenue is \$5,289 million, an increase of only \$18 million or 0.3% on the revised estimate for 1974-75<sup>(78)</sup>. Earnings and profits taxes account for \$2,147 million or 41% of total recurrent revenue. This estimate is only 2% down on likely collections in 1974-75. It assumes that the yield from profits tax will be down by 12½% and that yields from other taxes on earnings will increase by 17%. These assumptions are, I believe, consistent with the 12½% increase in the gross domestic product in money terms in 1974 and the forecast increase in money terms of only 1½% in 1975; but the estimate could well understate the likely effect of the stand-over provisions under the provisional tax system. Yet, if I have erred on the optimistic side in respect of earnings and profits taxes, present indications are that the betting duty base is expanding faster than appeared to be the case when the Revenue Estimates went to print; and so I think the yield from this levy will exceed the estimate.

84. Details of the other charges are included in the Memorandum Note on the Revenue Estimates<sup>(79)</sup> and I need only draw attention now to four heads: the yield from taxes on motor vehicles is expected to decline further in response to the combined effect of sluggish economic conditions and higher costs. Franchises will yield only \$49 million thanks to the surrender in recent years of royalties from various transport

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<sup>(77)</sup> That is, after allowing for reimbursements from the Urban Council and the Housing Authority of \$270 million in 1974-75.

<sup>(78)</sup> On a comparable basis, the increase in 1974-75 was 16% and the average annual increase in the three years ending 1973-74 was 22%.

<sup>(79)</sup> Pages 18-24 of the printed Estimates.

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enterprises and the Telephone Company. Our reduced surplus balances and declining interest rates will reduce earnings on our investments and deposits to \$300 million compared with \$368 million in 1974-75 (thereby reducing their contribution to recurrent revenue to 5.7% compared with 7% this year). Fees and Receipts, by contrast, should be more productive next year: of the \$56 million anticipated increase, \$19 million will arise from routine fee revisions and \$37 million from increased usage of services.

*(c) Capital*

85. Although my estimate of capital revenue at \$430 million<sup>(80)</sup> is \$13 million below the revised estimate for 1974-75, I expect an increase of \$52 million from premia on modifications and \$15 million from regrants of expired leases. Land sales will yield about the same as this year—around \$210 million—but I shall leave it to my honourable Friend the Director of Public Works to explain the details of his 1975-76 land sales programme.

*(4) Revenue Proposals**(a) Introduction*

86. In my last two budget speeches I categorized my revenue proposals, whether they related to tax-type levies or non-tax-type fees and charges, according to the purpose each was designed to achieve<sup>(81)</sup>. This year the primary purpose of my six sets of revenue proposals

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<sup>(80)</sup> Including a reimbursement from the Mass Transit Fund of \$30 million compared with \$100 million in 1974-75 for works undertaken since September 1969 by the Public Works Department.

<sup>(81)</sup> Slightly restated, these purposes are:

- (1) simply to raise extra revenue to finance essential expenditure,
- (2) to reform the tax system (that is to say, changes designed either to make the burden of the system more equitable and/or remove anomalies or to simplify the administration of the laws under which these taxes and levies are raised or to increase the efficiency of their administration in the sense that higher yields are derived from the same rates of charges);
- (3) to widen the tax base;
- (4) to afford relief in particular circumstances and/or to particular classes of taxpayers;
- (5) to strike a certain balance within the system as between one type of levy and another;
- (6) to achieve certain policy objectives via fiscal measures;
- (7) to avoid general revenue subsidizing those public services, particularly public utility type undertakings, which should also earn a return on capital employed; and
- (8) in buoyant times, to add to our fiscal reserves.

is to raise extra revenue though some will have the additional effect of widening the tax base.

87. Of course, whatever the immediate purpose of any revenue proposal may be, the proposal itself must have regard to certain broad considerations underlying our fiscal strategy (and here I revert back to my earlier remarks about my overall package being defensible in terms of the reality of the Hong Kong situation). Each revenue proposal should be as neutral as possible in its effect on investment decisions and industrial costs; it should avoid imposing hardship, somehow defined, on any particular income class; and the revenue yields should be consistent with the guideline ratios relating to direct and indirect taxation and to tax and non-tax revenue which I laid down last year. These were as follows: the ratio of direct to indirect taxation should be 45:55; and the ratio of direct and indirect taxation taken together to all other recurrent revenue should be 65:35<sup>(82)</sup>.

88. I think my proposals do have regard to these considerations though I shall be astonished if they are received with universal acclamation.

*(b) Tax increases*

*(i) Direct*

*(A) Corporation profits tax*

89. One of the features of the Inland Revenue Ordinance, which contrasts with the tax legislation of other countries, is that the rates of tax imposed are progressive only at the lower levels and thereafter become proportional rather than progressive. I would not accept that the steep progression encountered elsewhere is appropriate to the circumstances of Hong Kong. But, measured against the taxpayer's ability to pay, it is difficult to defend a system which can result in a taxpayer with an income of \$70,000 suffering the same rate of tax as one with an income of, say, \$7 million. I have given serious thought to ways of imposing some form of surcharge on high level salaries, profits and property incomes. However, the basic structure of the Ordinance, that is to say, the absence of a charge on total income and the existence of a system of separate charges on different types of income, coupled with the option to claim personal assessment, simply does not lend itself to the imposition of such a surcharge. But I shall be returning to this subject later in the context of my proposals for 1976-77.

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<sup>(82)</sup> *B.S., 1974, paragraphs 57 - 59.*

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90. Another feature of the Hong Kong tax structure which is, to say the least of it, unusual, is the absence of any form of taxation on dividends as such. There is, of course, a tax on the underlying profits, but this is not the same thing as a tax on dividends. The argument for this one-tier system has been that dividends have come from a taxed fund and for that reason should not be taxed in the hands of the recipients. Apart from the fact that the fund from which dividends have been paid has often not suffered tax at all, or only part of the fund has suffered tax, this argument takes no account of what I consider to be the practicalities of the situation, let alone the legal relationship between the corporation and its shareholders. However, a tax on dividends would have to be carefully constructed and appropriate legislation could not be introduced quickly enough to produce revenue during the coming financial year. But I shall revert to this subject also, in the context of my proposals for 1976-77.

91. This being the case, the question arises whether there is some simple way of bridging the interval between now and the introduction of a tax on dividends, so as to produce much needed revenue while having *broadly* the same effect as such a tax. Fortunately, there is such a way. I propose to raise the rate of tax on the profits of corporations<sup>(83)</sup> by 1½ percentage points, that is, from 15% to 16½% for the year of assessment 1975-76. Thus provisional tax for that year will also be calculated at the new rate.

92. This modest increase of 10% in the rate should produce \$100 million in 1975-76. Assuming a company retains 50 *per cent* of its profits after tax at the present rate of 15%, the new rate of 16½% will have the same effect on shareholders as a withholding tax of approximately 3.5%<sup>(84)</sup>. This is not to say, that I am in any way committed to a withholding tax of only 3.5 %, but I am making the point in the hope that the proposal will not cast a quite unrealistic shadow over the stock market!

93. In case honourable Members are wondering whether the tax can be avoided by director-controlled companies increasing payments

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<sup>(83)</sup> *The distinction, for profits tax purposes, between the profits of corporations and those of business entities other than corporations, which was abolished in 1970 (see Hong Kong Hansard, 1970, page 240), will have to be re-introduced for the purpose of calculating the rate of profits tax applicable to corporations.*

<sup>(84)</sup> *For example: if profits before tax = \$100, profits after tax = \$85. If the company retains \$42.50 and distributes \$42.50, then 1½% of \$100 = \$1.50 = 3.5% of \$42.50.*

of salaries to directors, the Commissioner of Inland Revenue will scrutinize salary adjustments carefully to ensure that these are not excessive. I am told that there is ample legal authority for doing this.

94. For the avoidance of doubt, I should make it clear that a corporation which is in a joint venture with another business will suffer tax at 16½% on its share of the profits. This is reasonable because, with effect from the year of assessment 1975-76, corporations will receive the benefit of a set off against their profits or losses incurred in a joint venture<sup>(85)</sup>.

(B) *Benefits in kind*

95. Another proposal, to take effect though from the final assessment for 1975-76, which I shall be putting to this Council, is in connection with the value, for salaries tax purposes, of quarters provided by an employer for his employees. This is, of course, part of the wider and vexed problem of assessing what can best be described as "benefits in kind". Under the salaries tax charge as at present framed, the Commissioner can only assess money, or what can be converted into money. The only exception that the Ordinance makes is in respect of the value of quarters provided rent-free, or at a less than an economic rate. This is included as income chargeable to salaries tax. The question of extending the charge to include the host of other benefits commonly encountered was carefully considered by the 1966 Inland Revenue Ordinance Review Committee. They recommended, and I quote, "In view of the practical difficulties in valuing other benefits in kind and the comparatively small additional revenue which this measure would produce, we decided that the introduction of special provisions to bring to charge for salaries tax the value of other benefits in kind was not to be recommended."

96. The Commissioner of Inland Revenue has informed me that there has been no change in this position and for this reason I do not propose any change in the law at present. I do feel, however, that the value of free or subsidized quarters should be assessed at a figure closer to their market value. At present, the value is assessed at 7½% of the income derived from the employer. Quite clearly, the true market value of the quarter is invariably well above 7½% of the employee's income and this gap has been widening in absolute, if not in relative, terms. I intend to propose, therefore, that the figure be raised to 10 *per cent* with effect from the final assessment for 1975-76. There will

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<sup>(85)</sup> See section 19C(4) of the Inland Revenue Ordinance.

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be proportionate increases for persons occupying hotel or hostel accommodation. I consider that those taxpayers who are privileged enough to be sheltered from the full impact of the high rents prevailing in Hong Kong (and, for that matter, from rates) can well afford to meet an additional impost. In fact, it may well be necessary to consider a further increase in this percentage at a later date to bring it up to the full market value. The yield from this measure for one year of assessment would be approximately \$3.5 million, although the revenue will not begin to benefit until 1976-77.

97. It would be foolish, however, to introduce this amendment without, at the same time, introducing a measure to counter the widely practised form of avoidance of even the nominal amount assessed at present. As the Ordinance is framed, it is only a place of residence provided by an employer which is the subject of the charge. The avoidance is achieved and widely achieved by ensuring that one person pays the employee's salary, whilst an associated person provides the free quarters, thereby ensuring that nothing can be assessed. In future, free or subsidized quarters provided by a person associated with the employer will also be brought to charge.

(ii) *Indirect*

98. These are my only proposals in the field of direct taxation in 1975-76. So I now turn to six proposals to increase various indirect taxes and to one proposal for a new or, at any rate, a resuscitated indirect tax. These six proposals are designed to produce extra revenue of \$212.5 million in 1975-76.

(A) *Betting duty*

99. Under the Betting Duty Ordinance the rate of duty on totalizator turnover is fixed at 7½%. The amount the Royal Hong Kong Jockey Club may deduct as commission is limited by the provision that at least 90% of the balance must be paid out by way of dividends<sup>(86)</sup>. Until this racing season the Club only deducted 7½% of the gross turnover as commission. But it now deducts between 9% and the maximum allowed of 9¼%<sup>(87)</sup> and the total deduction by way of duty and commission is now around 16¾%.

<sup>(86)</sup> That is, 90% of 92½% or 83¼%.

<sup>(87)</sup> 90% of 92½% = 83¼% and 92½% - 83¼% = 9¼%.

100. I cannot afford to ignore horse racing as a possible source of additional revenue particularly as totalizator betting over all seems to be quite insensitive to current economic conditions: almost the opposite, for the base seems to be expanding this season quite rapidly, thanks to the introduction and extension of off-course betting facilities and the attractions of more varied forms of pool betting. I had in mind proposing that the Ordinance be amended to provide for a 10% duty on every bet made with effect from 1st April to yield at least an extra \$27.5 million in 1975-76 and even more if my estimate of the base were to prove conservative. This new rate of duty would have left a maximum of 9% for the Club<sup>(88)</sup>.

101. However, a total take of 19% on all bets compared with the present 16¾%<sup>(89)</sup> might have the effect of pushing gamblers, now being attracted to legal off-course betting, back into the hands of illegal bookmakers. This would obviously run counter to other policy objectives, namely, to protect the revenue and to reduce one of the important areas of corrupt activity. So I propose to leave open for the moment just how this extra \$27.5 million minimum should be raised. There are several options and I intend to hold immediate discussions with the Club with a view to deciding which one to adopt. I propose no change in the present 25% duty chargeable on cash sweeps<sup>(90)</sup>.

102. I must stress that this \$27.5 million relates solely to the yield of betting duty from horse racing. Any proposals to extend the scope of the Betting Ordinance to embrace fields other than horse racing would be considered quite separately so far as the rate of duty is concerned.

### (B) *General Rate*

103. In last year's budget speech I gave notice of my intention to propose an increase in the General Rate from 9% to a level which would yield a sum equivalent to what would have been collected had the revaluation of properties due in 1974, effective from 1st April 1975<sup>(91)</sup>, not been postponed.

104. The last revaluation came into effect in April 1973 and, as a matter of general policy, revaluations should be carried out at frequent

<sup>(88)</sup>  $90\% \text{ of } 90\% = 81\% \text{ and } 90\% - 81\% = 9\%$ .

<sup>(89)</sup> *That is,  $10\% + 9\% = 19\%$  and  $7\frac{1}{2}\% + 9\frac{1}{4}\% = 16\frac{3}{4}\%$ .*

<sup>(90)</sup> *The yield from cash sweeps is declining. In 1972-73 it accounted for \$9.75 million or 19% of the yield from betting duty, in 1974-75 it is estimated to be only \$7 million or 8%.*

<sup>(91)</sup> *B.S., 1974, paragraphs 116, 182 and 183.*

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intervals. Having regard to the problem of revising assessments in the present uncertain economic climate and, in particular, the likely resultant shift in the burden of this tax from the non-domestic sector to the domestic sector, I am of the view that the revaluation should be postponed for yet another year. So, the next revaluation will be carried out during 1976 and new assessments brought in at 1st April 1977.

105. To restore the revenue as I anticipated it this time last year, the General Rate for Areas A, B and C would have to be increased by at least 2½ percentage points to 11½% and for Area D by a similar amount to 17½%, to yield \$115 million. Area E would remain at 11%<sup>(92)</sup>. The revenue foregone could now be put as high as \$300 million, because the overall increased value of assessments might well have been about 65%. But this assumes that the revaluation work would not have been hindered by the administration of the new tenure and rent controls<sup>(93)</sup>. It also assumes that interim valuations would not be interrupted. In reality, the Commissioner for Rating and Valuation would probably have done less this year and more next year if a revaluation was undertaken; and so an increase of 2½ percentage points would have produced something under 40% of the revenue foregone by the postponement of the revaluation.

106. In fact, I propose to increase the rate by two percentage points only, and not 2½, to yield \$91 million in 1975-76 and this will be effected by a resolution under section 18 of the Rating Ordinance. But a Revenue Protection Order will be necessary to enable demand notes for the first quarter to go out before 1st April. An increase of two percentage points will result in only modest increases in the monthly sum paid by occupiers of tenements<sup>(94)</sup> and these increases are set out illustratively in Appendix (2) of the printed version of this speech.

107. In accordance with his statutory obligation under the Rating Ordinance, the Collector of Rates will demand the new General Rate from the Housing Authority. However, as it was agreed last year that the rate would not be passed on to tenants of Group B (that is old Resettlement) Estates until 1976-77, the Government will put the Housing

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<sup>(92)</sup> *B.S., 1974, paragraph 134.*

<sup>(93)</sup> *Part II of the Landlord and Tenant (Consolidation) Ordinance.*

<sup>(94)</sup> *See Appendix (2).*



Authority further in funds to the extent of an additional \$5.6 million over and above the \$27.3 million to be paid over in 1975-76<sup>(95)</sup>.

108. Rates are basically a tax on the occupiers of premises for the various services; and the annual value of the premises reflects the value of services provided rather than a demonstrable ability to pay as with, say, earnings and profits taxes. Rates catch many who would otherwise contribute little or nothing to the revenue and this I suggest should be borne in mind by those who vociferously complain that the direct tax net is cast across too restricted a field<sup>(96)</sup>.

(C) *Duties on intoxicating liquors*

109. The increase of around 25% in duties on intoxicating liquors I introduced last year, the first for eleven years, were followed by reductions in consumption as a result of the failure of real incomes to advance at anything like a normal rate. Consumption is likely to continue falling for a while yet; but I propose nevertheless to raise duties by \$6 per gallon for spirituous liquors and by 10% per gallon for wines<sup>(97)</sup> imported from non-Commonwealth countries, with the existing absolute preference margins maintained for wines imported from Commonwealth countries in accordance with our GATT obligations. These increases should at least stabilize revenue yields in 1975-76 at around 1974-75 levels, or slightly above, and perhaps we might even get an extra \$1 million.

110. Not surprisingly, consumption of beer has been rising and an increase of 60 cents per gallon for locally produced and imported beer, should bring in \$10 million of extra revenue in 1975-76.

111. These increases, which came into effect at 2.30 *p.m.* today under a Revenue Protection Order Your Excellency signed this morning, will disappoint the trade and drinkers alike, but we cannot afford a declining yield—as opposed to diminishing returns—and as economic conditions pick up I have no doubt the restaurant trade and hence, for example, brandy drinking will revive. I hope it will be possible to leave the new rates in force for some years to come.

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<sup>(95)</sup> See Head 40 Housing Department, Subhead 103 Payment of rates for Group B Estates. The extra commitment of \$5.6 million will be a charge on Head 52 Miscellaneous Services, Subhead 100 Additional Commitments.

<sup>(96)</sup> In fact, the direct tax net is not as restricted as often claimed: see Appendix (3).

<sup>(97)</sup> Rounding off the duty to the nearest 50 cents.

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112. I do not believe that the increases proposed will further depress consumption, and hence revenue yields, because the increases per bottle will be modest. For instance, on a standard<sup>(98)</sup> bottle of brandy and whisky the increase will be \$1, on a standard bottle of sparkling wine about 90 cents and of still wine a maximum of 50 cents. On a small bottle of beer the increase will be 5 cents; and on a large bottle 10 cents.

(D) *Duties on tobacco*

113. I also raised the duties on tobacco last year by around 25%, the first increases for eight years. Whilst the yield may have been even higher in more prosperous times, this move did prove to be reasonably productive, revenue increasing by \$45 million over 1973-74 of which \$37 million was due to the increased duties. I think the trade could well bear another increase of about 25%, effective also from 2.30 *p.m.* today, to yield \$46 million in 1975-76. This increase will add, for example, \$2.50 a lb to imported unmanufactured tobacco and imported cigarettes; or about 10 cents to the price of a packet of 20 cigarettes.

(E) *Stamp duties*

114. The scope for raising additional revenue through the Stamp Ordinance should not be neglected and I have two proposals to put forward. The first concerns the fixed duty on cheques and allied instruments. Travellers' cheques are now chargeable at 25 cents; but other cheques drawn within Hong Kong, and cashier orders and dividend warrants, are all chargeable at only 20 cents. These rates have not been varied since 1969 and can no longer be related to current values. I propose, therefore, to increase the duty to 30 cents in all these cases, to yield an extra \$5 million in 1975-76.

115. To protect the revenue it will be necessary to have different dates of implementation for these instruments. I propose that the increased duty on travellers' cheques, cashier orders and dividend warrants shall become effective on 1st April 1975<sup>(99)</sup>. To postpone the increase of duty applicable to blank cheque forms to that date could invite widespread avoidance which would also be a source of

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<sup>(98)</sup> *Reputed quart.*

<sup>(99)</sup> *Travellers' cheques issued outside Hong Kong become liable to duty when they are endorsed or negotiated here; those issued in Hong Kong become liable on issue, as do cashier orders and dividend warrants.*

some embarrassment to the banks<sup>(100)</sup>. Your Excellency has, therefore, signed a Revenue Protection Order imposing 30 cents duty on all blank cheque forms issued in Hong Kong as from tomorrow morning.

116. My second proposal concerns *ad valorem* duty chargeable on certain conveyances on sale, voluntary dispositions *inter vivos*, and allied documents. The present rate of 2%<sup>(101)</sup> has been effective since 1948. But an additional charge (the so-called "excess duty") used to be levied on first conveyances on sale executed after the restoration of Civil Government in 1946. When he proposed the abolition of that excess duty of 3% in 1969, my predecessor said he had considered the possibility of making up the lost revenue by increasing the standard rate of duty from 2% to 3%. He decided not to do so, but he said, and I quote "that an increase in the standard rate of duty might be a priority object of taxation should we need to find extra revenue at some future date"<sup>(102)</sup>. That time has now arrived and I accordingly propose to increase the standard rate from 2% but to 2¼% only. The increased rate will apply to documents executed on or after 1st April 1975 and is estimated to yield \$11 million in 1975-76. Documents relating to land of a value not exceeding \$150,000 will not be affected in any way by the change proposed.

(F) *Entertainment tax*

117. In 1973, faced with a buoyant revenue situation, I proposed the abolition of the tax levied since 1930 on admission charges to cinemas at a cost to the revenue in 1973-74 of \$32 million. Cinema audiences were declining and operators' receipts were maintained by increases in admission charges. What I should have done was to have reduced the rates applicable to cinema admissions to zero and left the Ordinance otherwise unamended for the time has come to reintroduce the tax, but at rates less onerous than before for both operators and patrons.

118. There are 84 cinemas in operation at the present time in Hong Kong with an aggregate seating capacity of about 100,000. Most cinemas have a range of two to three standard seat charges; and there are two classes of cinemas, the more expensive group being the more numerous. It is a common practice for many cinemas to charge higher prices when particularly popular films are shown.

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<sup>(100)</sup> *Liability to duty on cheques (other than travellers' cheques) drawn in Hong Kong arises when the cheque forms are issued by banks to their customers.*

<sup>(101)</sup> *\$2 per \$100 and part thereof.*

<sup>(102)</sup> *Hong Kong Hansard, 1969, page 99.*

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119. I propose the reintroduction of entertainment tax as from 1st April next at varying rates which will reflect current admission charges, that is to say,

Where charges are under \$4	20 cents
Where the charge is \$4	40 cents
Where charges exceed \$4	40 cents for the first \$4 and 20 cents for each additional \$2.

Thus for seats at \$4 the duty will be 40 cents, at \$6 the duty will be 60 cents and at \$8 the duty will be 80 cents. The rates for these seats in the previous schedule were 70 cents compared with 40 cents, \$1.60 compared with 60 cents and \$2.20 compared with 80 cents<sup>(103)</sup>.

120. I estimate that the yield from this reintroduced tax at these lower rates will be about \$21 million in 1975-76 on various assumptions as to the seating capacity of cinemas currently in operation, the number of seats in each and the daily seat occupancy rate. The administrative costs of reintroducing this tax will be of the order of \$160,000 only. I should mention for the record that, when the Ordinance is amended, the opportunity will be taken to simplify the exemption procedure provided for under section 5<sup>(104)</sup>.

*(c) Fees and charges**(i) Introduction*

121. Over the years, successive Financial Secretaries have stressed the importance of our system of fees and charges in our overall revenue situation. However, the tendency for our economy to experience a fast growth rate, and for our income sensitive tax system thereby to yield sufficient revenue to cover both our recurrent expenditure and the deficit on capital account, has meant that we have not really developed clear cut ideas as to the role of different fees and charges. Thus there is a hidden reserve here of revenue to be tapped and, in future, I propose to distinguish between six groups of fees and charges:

*First*, fees and charges designed to cover the full cost (including capital charges) of the services provided;

<sup>(103)</sup> This schedule will still apply to admissions to race meetings, but the rates for the low price seats no longer sold will be excised from the schedule.

<sup>(104)</sup> For charity cinema shows and shows provided by, or on behalf of, the Urban Council.

*second*, fees and charges which are not so designed because, for one policy reason or another, the Government considers that part of the cost of the services concerned should be borne by General Revenue;

*third*, fees and charges raised by our public utility type undertakings designed to cover full costs and earn a fair return on capital employed;

*fourth*, fees and charges pitched deliberately at a level to deter usage for policy reasons;

*fifth*, fees and charges pitched well above full costs, but just below the level at which diminishing returns set in;

*sixth*, fees and charges pitched at a level to reflect that they represent a payment for belonging to trading groups enjoying monopoly or semimonopoly privileges.

I propose to refer to the last two groups as tax-loaded and royalty-loaded fees and charges respectively.

122. I have ten proposals altogether under fees and charges designed to bring in an extra \$154.5 million in 1975-76<sup>(105)</sup>.

(ii) *Tax loaded*

(A) *Business registration fees*

123. One group I do consider should contribute a little more to the revenue are the proprietors of businesses who do not pay profits tax because their chargeable profits are covered by allowances available under personal assessment. At the present time, a business, defined as "any form of trade, commerce, craftsmanship, profession, calling or other activity carried on for the purpose of gain", is registrable under the Business Registration Ordinance and pays an annual fee designed to cover costs. In April 1974, this fee was raised from the \$25 introduced in 1959 to \$50<sup>(106)</sup>. I now propose to introduce a small tax-loading element onto the fee by raising it to \$150. The increased fee will apply to all registered businesses, except those at present exempted from payment, but will remain a deductible expense for computing profits tax. This increase will have the effect of broadening the tax base at a cost to the businesses concerned of \$8.30 a month. In spite of the low incidence, I estimate the additional yield at \$20 million.

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<sup>(105)</sup> *But see also paragraph 154 below.*

<sup>(106)</sup> *See B.S., 1974, paragraph 174.*

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124. What I am doing in effect is restoring, but only partially, a charge introduced in 1952 at \$200 a year, but subsequently reduced to \$25 in 1959 on the grounds that a fee as high as \$200 constituted a hardship in many cases. I do not consider that a fee of \$150 would constitute a hardship at today's prices. I also propose that certain additional clubs should be brought within the ambit of the Business Registration Ordinance. At the present time, the Ordinance applies to clubs and the like only if more than half their gross revenue comes from sources other than their own members and they carry on a business for the purpose of gain. I do not see why clubs carrying on business for the purpose of gain should be exempt even if more than half their revenue comes from members. Nor do I see why clubs not operating for gain, but providing on their premises services their members would otherwise have to purchase elsewhere, should be exempt.

*(B) Company registration fees*

125. To be consistent with the tripling of the fee for registering businesses, I propose also to triple the fee for registering companies from \$100 to \$300 and to change the additional charge for each \$1,000 of nominal share capital (or increase in share capital) from \$2 to \$4 with effect from tomorrow morning. Not all registered companies are also registered businesses: for example, those that are registered in Hong Kong but carry on their business off-shore. On the other hand, it is true that some companies pay both the business registration fee and the company registration fee; but the company registration fee is once-for-all. I estimate the increased revenue from these proposals relating to company registration fees at \$17 million a year.

126. In passing, I should say that we are revising other fees chargeable under the Companies Ordinance, but simply to bring them up to date. There will be no tax-loading.

*(C) Macao Ferry Terminal passenger charge*

127. Another group which I consider could bear a tax-loaded fee is travellers to and from Macao. The present charge of 50 cents a single journey no longer recovers the cost of operating the Macao Ferry Terminal, but I think we can go much further than the recovery of costs and charge \$5 a journey from 1st April next. The extra yield will be \$22 million. As even this charge will be such a small proportion of the money spent by visitors to Macao, it should have no effect

on the numbers travelling. However, I have no wish to damage the prosperity of Macao and, if I were satisfied that the numbers were seriously affected, and I seriously do not believe that will happen, I would be prepared to reconsider the tax-loading element in the charge.

(D) *Buoy fees*

128. I am indebted to a certain honourable Member behind me on my right for the idea that the yield from the hire of buoys in the harbour might be increased. The use of buoys by conventional ships represents an enormous saving over going alongside a pier. My honourable Friend suggested a 400% increase in the present charge of \$150 a day for an "A" buoy and \$100 for a "B" buoy. This is perhaps a bit too steep at one time. Instead, I propose to increase the fees by 300% to \$600 a day for an "A" buoy and to \$400 a day for a "B" buoy; and also to increase anchorage fees from \$3 to \$12 per 100 tons a day inside the harbour limits and from 80 cents to \$3.20 per 100 tons a day elsewhere in Hong Kong waters. These rates will still be very much lower than dockage fees. I estimate the additional revenue next years from these increases will be \$11 million.

(iii) *Royalty-loaded*

(A) *Bank licences*

129. I turn now to two proposals for a royalty-loading on fees. As the number of licences issued is limited, banks are unquestionably in a privileged trading position. So, in future, the licence fees paid should not be fixed simply to recover the cost of the Office of the Commissioner of Banking as at present, but should reflect, to some small extent, the value of this privileged position.

130. I propose, therefore, that the annual fee for a bank licence should be \$200,000 as opposed to the present \$40,000 and for each branch \$10,000 as opposed to the present \$1,000. I should point out that the fee for a branch was due to be raised to \$2,000 anyway on cost recovery grounds. So the factor I have applied in fixing the new fees is five in each case, if that is any comfort. The additional annual revenue flowing from these higher fees will be \$17 million.

(B) *Registration of finance companies*

131. As I said in my statement to this Council on 8th January last on the related questions of bank licensing policy, protection of depositors and the control of finance companies, I hope a bill providing for the registration of deposit taking finance companies will be

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published very shortly. As registration will not only provide for a degree of supervision over the activities of registered companies, but also confine deposit taking business not already in the hands of the banks to these companies, there is no need to limit the fee charged to supervision costs. So, I propose that the annual fee shall be royalty-loaded at \$10,000 and this should bring in \$2 million on the assumption that 200 companies seek registration.

(vi) *Public utility undertakings*

(A) *Airport charges*

132. As I have said, Sir, on many occasions, our objective with the public utilities run by the Government must be to determine fees at a level at least sufficient to recover costs and earn a fair return on capital invested, unless the social consequences are unacceptable. The airport is a typical example of where we ought to expect a reasonably high return on capital employed. To develop an airport in Hong Kong to the standards expected internationally is expensive. And it can involve spending at times when there are other very telling pressures for proceeding with other projects. As a topical example, over and above works and orders currently in hand, which will involve expenditure of \$79 million next year, provision has been included in the Draft Estimates to enable new contracts to be let which will involve expenditure of \$34 million in 1975-76. While this expenditure is justifiable in terms of the use and economic importance of the airport, it is not so easily justified in terms of the other important projects we have been obliged to postpone.

133. In these circumstances, and remembering present landing fees have been in force since 1961, I propose to increase them by 15%. Furthermore, the concentration of air movements in the afternoon is becoming increasingly costly to cater for. So, on the advice of the Director of Civil Aviation, I propose also to introduce a surcharge of \$500 for movements between mid-day and 6 *p.m.* Such a peak hour surcharge would not be inconsistent with the practice at some other international airports.

134. To enable the airlines to prepare themselves, I propose that these revised charges should not come into effect until 1st July. On this basis, I estimate the additional yield in 1975-76 at \$19 million<sup>(107)</sup>.

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<sup>(107)</sup> *After allowing for a downward revision of the forecast of aircraft movements in 1975-76, regardless of any increases in charges.*



(B) *Postal charges*

135. The inland letter service is operated at a loss. It is to the credit of the present Postmaster General and his predecessors that Hong Kong has maintained a basic 10 cents inland letter rate since 1949<sup>(108)</sup>. One reason for this is that the economies of operating on an increasing scale have offset rising costs. But now rising costs are no longer being absorbed by increased traffic; and by a substantial margin. So I propose that the inland letter rate be raised to 20 cents an ounce with corresponding, but not quite so steep, increases for heavier letters<sup>(109)</sup>. Even these higher rates will be lower than for many other countries in this region.

136. I propose also, on the advice of the Postmaster General, that the differential between the rate for letters and post cards be restored by increasing the latter to 15 cents only.

137. Also consequential to the increase in the inland rate will be an increase in the surface rate to China, Macao and Taiwan. But, here also, I do not propose that the increase be as large as for inland post. The basic rate for the first ounce will be raised from 20 cents to 30 cents with appropriate increases for heavier letters<sup>(110)</sup>.

138. Meanwhile, the Postmaster General is reviewing the other rates for overseas mail in the light of the new criteria established by the Lausanne Convention of the Universal Postal Union.

139. Finally, the cost of registering mail, both inland and overseas items, now exceeds the revenue from the present charge of \$1. I propose that it should be increased to \$2.

<sup>(108)</sup> *In 1971 the rates for letters over 1 oz. were raised, but the basic charge for 1 oz. letters stayed at 10 cents.*

<sup>(109)</sup>	<i>Present</i>	<i>Proposed</i>
	\$	\$
1 oz. ....	0.10	0.20
2 ozs. ....	0.30	0.40
4 ozs. ....	0.40	0.50
8 ozs. ....	0.80	1.00
1 lb. ....	1.50	2.00
2 lbs. ....	2.50	4.00
4 lbs. ....	4.00	6.00
<sup>(110)</sup>	<i>Present</i>	<i>Proposed</i>
	\$	\$
1 oz. ....	0.20	0.30
2 ozs. ....	0.40	0.50
4 ozs. ....	0.50	0.65
8 ozs. ....	1.10	1.30
1 lb. ....	2.10	2.50
2 lbs. ....	3.50	4.50
4 lbs. ....	5.50	6.50

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140. These proposals will come into effect on 1st April. The Postmaster General expects little or no reduction in the use of the postal services and I estimate the additional revenue for next year at \$17 million.

(C) *Water charges*

141. Last year<sup>(111)</sup> I warned that water charges might have to be raised two years earlier than my predecessor intended in 1971<sup>(112)</sup>. The dramatic increase in the price of fuel oil, by 300% since the present charges were determined, has affected the operating costs of the supply system as a whole and of the desalter in particular. The notional accounts for 1973-74<sup>(113)</sup> put the accumulated deficit at \$13 million. At the end of the current year, that is to say not yet allowing for the capital costs of the desalter and the High Island Scheme, at the end of 1974-75 the Director of Water Supplies predicts the deficit will become an accumulated surplus of \$10 million. If the completed units of the desalter were to contribute at full capacity in 1975-76, the surplus would return to an accumulated deficit of \$38 million by the end of 1975-76. Honourable Members will appreciate the magnitude of such a deficit when I say that it is equal to 20% of the revenue expected from metered supplies during the year.

142. Obviously, expenditure could be reduced by deliberately not using the desalter with the consequence of water restrictions except in times of abnormally good rainfall. As it happens, because of the unusually heavy rainfall last autumn, the risk of water restrictions in 1975 would not be unacceptably high provided we have normal rainfall this year. Nevertheless, it is not a course of action I would recommend. Under the terms of the contract for the supply of the plant, the contractor must operate each unit at the Government's expense for six months and bear the cost of rectifying any faults. As Hong Kong is pioneering the operation of large scale desalting, the risks to public funds and to water consumers in not holding these commissioning trials are unacceptable. But by limiting operation to the commissioning trials, 4,600 million gallons will be added to the supply, the predicted accumulated deficit reduced from \$38 million to \$21 million and we should get rid of most of the plant's teething troubles at the contractor's expense.

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<sup>(111)</sup> *B.S., 1974, paragraph 180.*

<sup>(112)</sup> *Hong Kong Hansard 1970-71, pages 428 and 544.*

<sup>(113)</sup> *Appendix XVI of the printed Estimates for 1975-76.*

143. This deficit and the even larger potential deficit for 1976-77 when the desalter may be operating for the full year must, however, be eliminated. Basically, water is a commodity to be bought and sold like any other. Because of the way it has to be provided, it happens to be the Government that does the selling (although I personally can see no reason why desalted water should not be sold by an enfranchised private enterprise). Beyond the basic requirements for life and health, there are no social reasons why water should be subsidized to domestic consumers. And I can see no economic reasons why industrialists should be excused from having to include water in their costs any more than the costs of, say, their electricity and raw materials. So the water undertaking must be operated on a commercial basis. Water in Hong Kong is not an easy commodity to provide. It uses up large areas of one of our scarce resources, land. It involves heavy recurrent expenditure, \$215 million in 1975-76. It ties down large amounts of capital, \$2,000 million at the present time. And of the provision of \$1,601 million for expenditure on the Public Works Programme itself next year, \$376 million is in respect of water schemes<sup>(114)</sup>.

144. I also think that, as a consumer uses more water, thus requiring the development of progressively more costly additions to the supply system, the increased cost of that water arising from his increased demand should be passed back to him. Otherwise, less affluent persons who are frugal in their use of water will have to subsidize the excesses of others<sup>(115)</sup>.

145. On the basis of historical experience, we assume an 8% annual increase in demand for planning purposes. The causes of this high growth rate are the increase in the population, new and expanding industries and better standards of living. Clearly, we cannot require each addition to the population to pay the marginal cost of increasing

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<sup>(114)</sup> *Not including expenditure of \$9 million on the desalter financed by the ADB (see page 741 of the printed Estimates for 1975-76).*

<sup>(115)</sup> *The cheapest means of getting regular larger quantities of water requires the use of land, a scarce resource in Hong Kong. By the mid-60s, with the Shek Pik reservoir, we had run out of space for conventional schemes. We then turned to building reservoirs in the sea and supplementing our catchment areas with water from the Indus River and with larger quantities purchased from China. But, with the High Island Scheme, we shall have exhausted these possibilities, for we shall have exploited all the significant catchment areas. So we are forced by the growth of demand to adopt a yet more expensive way of producing water; desalting. Roughly, the cost of supplying water from the conventional schemes is about \$3.75 a thousand gallons of regulated yield. Water via the two reservoirs built into the sea costs slightly more than \$4 a thousand gallons. Water available from desalting costs about \$12.60 a thousand gallons (also of regulated yield).*

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the water supply to meet his or her requirements of water. Nor would it help the economy to do the same for each new industrial consumer. But I think we ought to charge a higher rate for large users of water, both domestic and non-domestic.

146. To take domestic consumers first: we can easily define their levels of consumption. The first is the minimum a family must consume to stay alive and healthy. This we have recognized in the present free supply of 2,700 gallons through each domestic meter in a four-month billing period<sup>(116)</sup>. The free allowance is equivalent to about four gallons a person a day. It would not be reasonable to expect a person to use less than this amount for basic cooking and cleaning; or for him to expect to be provided with more free of charge. If consumption in Hong Kong were limited to four gallons a head a day, we could manage on our pre-war supply system and provide water at about \$2.40 a thousand gallons. In spite of this cost, I propose that the free allowance be maintained.

147. The second level of consumption is that necessary for an individual to maintain a reasonable standard of living. This can be taken to be 20 gallons a day which is, in fact, very nearly the average consumption per head in Hong Kong at the present time. Expressed as consumption through each domestic meter in a four-month billing period, this is 14,000 gallons. I propose that those who manage to stay within this limit, and they comprise 80% of domestic consumers, should pay no more than the present charge of \$3 a thousand gallons. For 80% of domestic consumers, to repeat, there will be no change and I hope that this point will be neither overlooked nor misrepresented.

148. But those who use more, the third level of consumption, can surely be expected to pay at a higher rate. They comprise about 20% of domestic consumers and use about two-thirds of the domestic metered consumption. They are the takers of baths, rather than showers, and the owners of washing machines and washing-up machines, both of which consume far more water than does washing by hand. In other words, they are a group which can well afford to pay for the strain they impose by their habits on our ever more expensive supply system. I propose that they should do so at the rate of \$6 a thousand gallons for their consumption in excess of 14,000 gallons in a four-month billing period which I have suggested as a level necessary for a reasonable standard of living.

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<sup>(116)</sup> *Monetary* ~~provision~~ of 10,000 gallons a unit, worth \$8 a four-month billing period to each consumer.

149. These proposals will yield an extra \$22 million in 1975-76 after allowing for lags in the billing system<sup>(117)</sup>.

150. To give some idea of what my proposals will mean in terms of four-monthly water bills, those now paying \$34 or less will pay no more than they are now. But if a family uses 60 gallons a head a day, it will pay \$190 every four months rather than its present \$112. The bills of really extravagant users of 100 gallons a head a day will rise from \$190 to \$346. The flat rate charge for civil servants on un-metered supply will also have to be raised, possibly to a percentage of rent.

151. I cannot propose a more sophisticated form of differential pricing because of the limitation of the present billing system. But plans are already in hand for computerising the accounts. Funds for this purpose are included in the Draft Estimates to be reserved in the General Warrant until the details of the computerisation scheme have been approved by the Finance Committee of this Council. But in 1977-78 we should be ready to subdivide the top \$6 bracket and charge the very high users of water at an even steeper rate.

152. So much for domestic consumers. I would accept that a differential pricing system on the lines I have proposed might be more difficult to apply to non-domestic users. It could be argued that it would penalize large scale enterprises and other enterprises in certain industries which, although they use water on a large scale, are essential to our economy. Nor do I propose any increase in the present flat rate charge of \$4 a thousand gallons, at least until next year. And I do not propose to change the rates charged for other purposes<sup>(118)</sup> either, such as shipping, construction, flushing and pre-paid tickets.

153. This will mean that, in the short term, non-domestic users will be subsidized by other consumers. I do not consider that this situation should prevail for too long for five reasons: *first*, non-domestic consumers are privileged in the sense that the system is designed to maintain a 24-hour supply to them even when domestic consumers are on four hours a day. *Secondly*, until recently, non-domestic consumers must bear a greater responsibility than domestic consumers for pushing us into more expensive ways of augmenting the supply<sup>(119)</sup>. On the other hand, *thirdly*, it is the decline in non-domestic consumption in 1974 and predicted for 1975 that is a major

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<sup>(117)</sup> *The yield in 1976-77 will be \$38 million.*

<sup>(118)</sup> *Shipping, construction, flushing and pre-paid tickets.*

<sup>(119)</sup> *Within the 8% annual growth rate used for planning purposes, non-domestic users account for 13½% and domestic users for 4%.*

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factor in reducing the revenue from the present charge. *Fourthly*, I have no reason to suppose that non-domestic consumers economize in the use of water by, for example, recycling it. *Fifthly*, we cannot afford new water-intensive industries that are not prepared to pay on a full cost basis.

(v) *All other fees and charges*

(A) *Routine increases*

154. All routine increases in fees and charges whether already approved or in the pipeline have been allowed for in the Revenue Estimates as printed. By routine increases I mean increases designed to bring the fees and charges concerned into a certain relationship with costs<sup>(120)</sup>. Such increases should bring in about \$38 million in 1975-76<sup>(121)</sup> or nearly 7% more than the estimate net of these increases. Details of these increases are set out in Appendix (4) of the printed version of this speech.

(B) *Export licences*

155. But there is one *new* fee which does deserve to be treated as a budget proposal simply because it is new and may occasion comment. I propose that, with effect from 1st April, a fee of \$15 should be charged for textile export licences issued under the Import and Export (General) Regulations. Nearly 500,000 such licences were issued in the calendar year 1974 and a fee of \$15 per licence will yield \$7.5 million in 1975-76 and cover about 90% of the cost of issue<sup>(122)</sup>. In respect of items subject to restraint, export licences, like certificates of origin<sup>(123)</sup>, guarantee acceptance of shipments by the importing country. As regards items on subject to restraint, the export licensing system provides the Commerce and Industry Department with up-to-the-minute information on the pattern of exports of these items to particular markets and the department is thus able to respond immediately to requests for consultations by overseas governments. This

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<sup>(120)</sup> *In 1976-77, it may be possible to introduce an appropriations-in-aid system in respect of cost related fees and charges.*

<sup>(121)</sup> *For details see Appendix (4).*

<sup>(122)</sup> *About \$8.25 million (not including the cost of bilateral negotiations).*

<sup>(123)</sup> *For which fees designed to cover the full costs of the service have always been raised.*

minimizes the disruptive effects which any other slower system of collecting information would entail. So the trade benefits from the export licensing system and for 15 years the system has been a charge on General Revenue. The time has come when General Revenue must be relieved of most of the burden.

*(d) Revenue trends*

156. Turning now to the implications of my revenue proposals for our fiscal system, an analysis of the Revenue Estimates for 1975-76 as printed shows that the ratio of direct<sup>(124)</sup> to indirect taxation is 59:41. It will be 61:39 in 1974-75<sup>(125)</sup>. The ratios in both these years in other words are hardly consistent with the guideline ratio of 45:55<sup>(126)</sup> and represent a rather dramatic switch round from the average ratio for the three years ending 1973-74 when it was 47:53. The switch round reflects the relatively high yields from earnings and profits taxes recently and the buoyancy of yields from stamp duties earlier. My revenue proposals will result in the ratio becoming 57:43 in 1975-76, but I can foresee the need to find new sources of indirect taxation later on if we are to avoid becoming too dependent on direct taxation.

157. As to the balance of the fiscal system as a whole, in the printed Revenue Estimates the ratio of direct and indirect taxation taken together to all other recurrent revenue is 68:32; and it will be about the same in 1974-75. This compares with the ratio for the three years ending 1973-74 when it was 69:31 and with the guideline ratio of 65:35. My revenue proposals will not change the position shown in the printed Estimates namely 68:32 because of the relatively equal emphasis given to tax and non-tax measures.

*(e) Economic implications of revenue proposals*

158. Of the total yield of \$467 million from my revenue proposals plus the \$38 million to be raised by routine increases in fees and charges<sup>(127)</sup> and the extra \$3 million arising from the higher rate of hotel accommodation tax, I estimate that two-fifths will be payable by consumers and three-fifths by businesses. A proportion of the amount payable by businesses will also fall ultimately on consumers, but I estimate that the ultimate effect of all my revenue proposals<sup>(128)</sup> on

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<sup>(124)</sup> Recurrent only (i.e. excluding estate duty).

<sup>(125)</sup> On the basis of the revised estimates.

<sup>(126)</sup> See paragraph 87 above.

<sup>(127)</sup> See paragraph 154 above and Appendix (4)

<sup>(128)</sup> Including the indirect effect of the direct tax proposals and after allowing for lags.

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the Consumer Price Index will not exceed ½%. Export costs will be raised by about \$150 million and, at least in the short term, will have to be absorbed by lower profits, but this is the equivalent of less than 0.5 % of the total value of exports, or no more than 1% of value added.

(5) *Estimated Outturn for 1975-76*

159. In order to safeguard the revenue, three of the proposals I have just presented have to be implemented immediately. Accordingly, Your Excellency this morning signed the necessary orders under the Public Revenue Protection Ordinance bringing the new rates of duty on intoxicating liquors and tobacco into effect today and the new rate of stamp duty on cheques and the new fees for the registration of companies and increases in nominal share capital into effect tomorrow morning. As a result, the outturn for the current year will be affected by one month's additional revenue from these sources which I have taken into account in my estimate of a deficit of \$410 million for 1974-75<sup>(129)</sup>.

160. As it will not be possible to put the necessary legislation through this Council before 1st April, Revenue Protection Orders will also be necessary for whatever new rate or rates of betting duty are decided upon, the new General Rate, the new business registration fee, the restoration of entertainment tax on admission charges to cinemas, the new fee for bank branches and the other new rates of stamp duty.

161. All my revenue proposals added together should yield, as I have said, a further \$467 million, but this still leaves me with a deficit of \$429 million<sup>(130)</sup>.

<sup>(129)</sup> See paragraph 22 above.

<sup>(130)</sup> See paragraph 65 above, viz:

		\$ million	\$ million
	<i>Deficit revealed by departmental</i>		
	<i>submissions</i> .....	—	2,268
<i>Less:</i>	<i>Reductions in expenditure</i> .....	1,009	—
	<i>Cutbacks in services and works</i> .....	<u>433</u>	<u>1,442</u>
			826
<i>Add back:</i>	<i>Provision for additional commitments</i> .....		<u>70</u>
			896
<i>Less:</i>	<i>Revenue proposals</i> .....		<u>467</u>
			<u>429</u>



(6) *Financing of the Deficit*

162. I do not propose to finance this deficit by running down our fiscal reserves. They must be maintained at their present level having regard to the uncertainty of our economic prospects and hence of yields from our income-sensitive taxes, and to provide overt evidence of the financial strength of the Hong Kong Government. It is a pity we have had to run down our reserves this year as a result of expenditure exceeding the original estimate for it would be legitimate to use part of them to finance the deficit I am deliberately budgeting for in 1975-76, given that the deficit largely derives from a flattening of the revenue curve. But the reserves, at \$2,371 million or just over four months average expenditure, are at a minimum; and so, in budgetary terms, their role must be limited to covering any shortfall in estimated revenue which cannot be offset by an immediate adjustment of expenditure.

163. Expenditure control in 1975-76 must, of course, be tight, very tight, but flexible too so that it can be contracted if revenue falls short of expectations and expanded if it is better (not that I expect the economy's performance and hence revenue yields to exceed my expectations). As I have already mentioned<sup>(131)</sup>, a new subhead has been included under Head 52 Miscellaneous Services with provision of \$70 million against which all requests for supplementary provision approved by Finance Committee, which cannot be covered by, compensatory savings, will be recorded, and I sincerely trust that this figure will not be exceeded.

164. Since the reserves cannot be used to cover the deficit I am budgeting for, I have to look to various forms and sources of loan finance. The priority to be accorded to the various projects heads of departments seek to have included in our capital works programmes has to be determined in accordance with the whole range of economic, social and political considerations and not just in accordance with the availability of loan finance for particular (say, self-liquidating) projects. Thus a project-by-project approach to the question of loan finance is not really very satisfactory. Instead, what I must try to do is define the limits of loan finance within our overall budgetary strategy for the next few years. I do not propose to be *too* definitive today, but simply to suggest possible answers to four questions.

165. These four questions are: first, how much can we afford to borrow? Secondly, what forms and sources of loan finance are available and are most appropriate to our needs? Thirdly, what legislative

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<sup>(131)</sup> See paragraph 65 above.

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authority is required to authorize borrowings from these various sources? And, fourthly, should we set up institutional arrangements through which all borrowings are channelled to General Revenue and to statutory bodies dependent on the use of funds borrowed from the Government? And, if so, there is a related question, namely, what should these arrangements be?

166. The first two questions are, in a sense, inter-related. In deciding how much we can borrow, a distinction must be drawn between Hong Kong dollar borrowings and borrowings in other currencies and there are special reasons for limiting the latter. At any rate until the economy's trading prospects are more favourable, it would be undesirable for the Government to enter into external loan arrangements which were likely to be a net drain on the Colony's export earnings. The Government's only directly identifiable external income is the interest earned on its external financial assets. External debt service payments, therefore, should not be permitted to exceed the net Hong Kong dollar value of this income<sup>(132)</sup>. Excluding Exchange Fund earnings this is about \$200 million a year.

167. As to the total amount we can afford to borrow, I have explained why I do not propose to finance the 1975-76 deficit by running down our fiscal reserves. Nevertheless, the loss of income, were the reserves to be used, provides a guideline for calculating the maximum borrowings we can afford to finance at any moment in time. For, if the reserves were used, this loss would have to be made good through additional taxation, part of the proceeds of which would have to be switched in the foreign exchange market. Net interest earnings this year from our investments and deposits<sup>(133)</sup>, excluding the Exchange Fund, are estimated at about \$300 million, the equivalent of two points on the standard rate of earnings and profits taxes.

168. On the basis of these considerations, and given current interest rates, I do not think we can contemplate a level of loan financing involving servicing charges of more than about \$300 million a year. Even so, at this level we would be taking a risk for there is no guarantee that, in a situation in which we had to use the reserves, it would be possible to raise sufficient revenue by tax increases. In that event, unless we were able to re-negotiate loan repayment terms, we would be forced to cut back on services and capital works.

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<sup>(132)</sup> *That is net after allowing for direct Payments in foreign currencies, e.g. salaries, pensions and stores.*

<sup>(133)</sup> *Both foreign currency and Hong Kong dollar deposits.*

169. The answer to the first question I raised, therefore, is that we should not borrow beyond a level which generates debt servicing charges above \$300 million a year. And within this level we should not, for balance of payments reasons, raise external loans which would generate more than \$200 million a year in debt servicing charges<sup>(134)</sup>.

170. Due regard must also be given to the effect that local borrowings may have on rates of interest in Hong Kong. But, other things being equal, our aim will be to borrow as cheaply as possible and for our requirements in 1975-76 we are currently and actively considering several possibilities. These are the issue of Hong Kong dollar Treasury Bills<sup>(135)</sup>; medium term Hong Kong dollar denominated bonds, which may include a conversion offer to the holders of the Rehabilitation Loan bonds maturing in 1978; recourse to the Euro-currency credit market; a guaranteed line of credit to finance the purchase of goods and services from the United Kingdom<sup>(136)</sup>; private placements; and project finance from the Asian Development Bank. Because of the confidential nature of the various negotiations in hand, I am not able to give any more precise information at this time, but I am quite confident of acquiring the resources we need; and I hope honourable Members will accept that I have said enough to indicate how I propose to deal with the second question I posed a few moments ago.

171. On the third question relating to legislative authority, my honourable Friend the Attorney General tells me that the Hong Kong Treasury Bills (Local) Ordinance, which came on to the statute book in 1926<sup>(137)</sup>, even today provides sufficient authority for the issue of Treasury Bills, subject to resolution by this Council. A special ordinance will be necessary to authorize the raising of funds through the issue of Hong Kong dollar denominated bonds. But I understand it will be necessary only to add to the first schedule to the Loans (Asian Development Bank) Ordinance to authorize further borrowing from

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<sup>(134)</sup> *These figures are illustrative only, for the relevant figures at any time will be determined by prevailing interest rates, but they imply that the minimum outstanding at any time could be of the order of \$1,000 million.*

<sup>(135)</sup> *It may even be possible to make arrangements for part of our seasonal deficits to be financed by Treasury Bill issues, particularly as the cash flow effect of the arrangements for the payment of provisional profits tax and provisional salaries tax by instalments will have to be carried by our fiscal reserves acting in the role of working balances.*

<sup>(136)</sup> *Subject to normal tender procedures having been complied with.*

<sup>(137)</sup> *In much the same circumstances as prevail today: see Hong Kong Hansard, 1926, page 15.*

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the ADB. As to the three other sources of borrowing I have mentioned<sup>(138)</sup> no legal authority exists, and so the drafting of an enabling bill is now in hand.

172. The fourth question I raised concerned institutional arrangements. Next month Executive Council will be considering a proposal to establish an Industrial Estates Corporation. It would not be in the public interest for this Corporation and other similar bodies, such as the Housing Authority, to act on their own in the capital market. Quite apart from the fact that it would be the Government's credit that was being pledged, approaches to the market must be properly regulated and timed so that the best terms are negotiated and so as to avoid undesirable competition between different bodies and the building up of excessive and lumpy foreign exchange commitments<sup>(139)</sup>. I am considering, therefore, whether a Loans Board should be established which would take over the assets and liabilities of the Development Loan Fund. This board would handle all borrowings for the public sector, including the Government, and on-lendings to statutory and other bodies now assisted from the Development Loan Fund<sup>(140)</sup>.

(7) *Economic Implications of the Budget*

173. Sir, I have already referred to the economic implications of the revenue proposals. I shall now deal with the economic implications of the budget as a whole.

174. To begin with the public sector in relation to the economy: the ratio of total expenditure financed from public funds to the gross domestic product averaged 15% over the ten years to 1973-74. As a result of the very large increase in expenditure in 1974-75, there was a jump to nearly 20%. In 1975-76 I expect a further, but small, increase to a little over 20%.

175. Secondly, the increase in total expenditure financed from public funds<sup>(141)</sup> in 1975-76, at 7½% in money terms, will reflect some

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<sup>(138)</sup> *Euro-currency market, suppliers' credits and private placements.*

<sup>(139)</sup> *Leaving aside for the moment the question of what should constitute public sector borrowings for the purpose of the guideline limits on total borrowings (see paragraph 169 above).*

<sup>(140)</sup> *Although close liaison with the Mass Transit Railway Corporation will be necessary, it is not envisaged that the Loans Board would handle its borrowing programme.*

<sup>(141)</sup> *That is to say, total expenditure (excluding transfers to the Mass Transit Fund, but including expenditure by the Urban Council and the Housing Authority) as shown in Appendix VIII of the printed Estimates.*

increase in real terms, since the upward trend of costs, particularly in the building and construction industry, is now easing. Indeed, it is on this industry that public expenditure impinges most heavily. Because of the present recession, which is affecting the building and construction industry as much as any other, it is appropriate to maintain, and even increase, the level of spending through the Public Works Programme and the Housing Authority. The proportion of building and construction work undertaken for the public sector rose from 26% in 1971 to 44% in 1974 and will probably rise further this year. Outside the ambit of the Public Works Programme and the Housing Authority, the construction of the mass transit railway will hopefully soon result in local contracts being let at a time and hopefully when the industry is well placed to respond.

176. Turning, *thirdly*, to the macro-economic impact of the deficit I am budgeting for: in 1974-75 there was a major swing from surplus to deficit, with expenditure rising much faster than revenue. The impact of this swing on the economy was, of course, expansionary, though limited by the high leakage into imports. In 1975-76 there is no further increase in the estimated deficit, but the method of financing it, that is by borrowing rather than drawing on the reserves, is different; and extra fiscal revenue is to be raised to finance increased expenditure. Thus I think that the impact of the deficit I am budgeting for next year will be more expansionary than this year's deficit for two reasons: borrowing offshore increases the resources available to the economy, that is to say, it allows an increase in the money supply. And as the increases in taxes and fees, particularly those falling on businesses, are likely to be partly at the expense of savings, the net impact of these increases and of the expenditure thereby financed is likely to be in the direction of increasing demand, at least in the short term.

177. The 1975-76 budget is, without doubt, expansionary by comparison with 1972-73 and 1973-74 when we ran very large (albeit unexpected) surpluses and when compared with another obvious option: further cuts in expenditure. If I had reduced departmental submissions by more than a net \$1,372 million<sup>(142)</sup> and so eliminated the need for loan finance, I estimate that the gross domestic product would have been reduced in 1975-76 by up to 1½%. Whilst macro-economic implications have not been, and cannot be, at the heart of my budgetary strategy, it is as well to recognize them for what they are: the budget will make a modest contribution to the maintenance of the level of demand and employment.

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<sup>(142)</sup> See *f.n. (129)*: \$1,009 million + \$433 million - \$70 million = \$1,372 million.

**Appropriation Bill—second reading***PART V: THE FORECAST PERIOD 1976-77 to 1978-79**(1) Implications of Budgetary Strategy in 1975-76 for Forecast Period*

178. For the three year forecast period 1976-77 to 1978-79 the strategy I have adopted for the 1975-76 budget has three main implications.

179. First, to the estimates of total revenue I gave for each of the three forecast years<sup>(143)</sup> must be added the yield from my revenue proposals for 1975-76. The figures must then be adjusted to allow for the effect of postponing for a year the revaluation of properties<sup>(144)</sup> on the yield from the General Rate<sup>(145)</sup> and from property tax. Accordingly, I re-estimate total revenue in each of the forecast years at April 1975 values as:

\$6,600 million in 1976-77  
\$7,400 million in 1977-78 and  
\$8,200 million in 1978-79.

180. Secondly, while most of the capital expenditure postponed from 1975-76 can be taken up in later years by simply postponing expenditure on other projects beyond the three forecast years, some of the services cut back to reduce recurrent expenditure in 1975-76 will have to be restored in 1976-77. I estimate that recurrent expenditure amounting to at least \$36 million cannot be postponed further<sup>(146)</sup> and will have to be allowed for in 1976-77<sup>(147)</sup>.

181. Thirdly, the implications of loans raised in 1975-76 must be accounted for. Repayments will be a charge to the capital account and interest payments will be an unavoidable charge to recurrent revenue<sup>(148)</sup>.

<sup>(143)</sup> See paragraph 57 above.

<sup>(144)</sup> See paragraph 104 above.

<sup>(145)</sup> The yield assumed has been calculated on a purely arithmetic basis, that is, a 9% rate applied to the new rateable values.

<sup>(146)</sup> Includes postponed maintenance, reduced activities of the voluntary defence and allied forces, postponed training and reduced agricultural extension work.

<sup>(147)</sup> This expenditure was included in the departmental submissions from which the forecasts of expenditure quoted in paragraph 58 above were based.

<sup>(148)</sup>	1976-77	1977-78	1978-79
	(\$million)	(\$million)	(\$million)
Interest .....	45	36	27
Repayments .....	43	86	86

182. Accordingly, I must now revise the forecast of expenditure at April 1975 prices to:

\$8,800 million in 1976-77

\$9,200 million in 1977-78 and

\$9,600 million in 1978-79.

Thus the deficits for the forecast years become:

\$2,200 million in 1976-77

\$1,800 million in 1977-78 and

\$1,400 million in 1978-79<sup>(149)</sup>

and the proportion of recurrent revenue absorbed by recurrent expenditure would be:

95% in 1976-77

90% in 1977-78 and

88% in 1978-79.

(2) *Present View of Acceptable Rate of Expenditure in Forecast Period*

183. These deficits are clearly quite unacceptable. Furthermore, the options open to us for dealing with them are becoming more limited. Although I shall shortly be suggesting some ways in which we can raise additional revenue through the fiscal system, a significant increase in the yield from our direct taxes is dependent on reform and this will take time. Nor could I support a recourse to borrowing in excess of 20% of capital expenditure or involving debt servicing charges in excess of the guidelines I have established<sup>(150)</sup>.

<sup>(149)</sup> *C.f. with the table in f.n. (48):*

	1976-77 (\$ million)	1977-78 (\$ million)	1978-79 (\$ million)
<i>Expenditure:</i>			
(a) Recurrent.....	5,800	6,200	6,700
(b) Capital.....	<u>3,000</u>	<u>3,000</u>	<u>2,900</u>
	<u>8,800</u>	<u>9,200</u>	<u>9,600</u>
<i>Revenue:</i>			
(c) Recurrent.....	6,100	6,900	7,600
(d) Capital.....	<u>500</u>	<u>500</u>	<u>600</u>
	<u>6,600</u>	<u>7,400</u>	<u>8,200</u>
<i>Overall Deficit.....</i>	2,200	1,800	1,400
<i>Surplus on Recurrent Account</i>			
(i.e. (c) - (a) ).....	300	700	900

<sup>(150)</sup> *See paragraph 169 above.*

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184. I can today only indicate the levels of expenditure on both recurrent and capital account which I think are acceptable at least for planning purposes. On the basis of the guideline I laid down earlier that recurrent expenditure should absorb no more than 80% of recurrent revenue<sup>(151)</sup>, recurrent expenditure would be limited to:

\$4,900 million in 1976-77  
\$5,500 million in 1977-78 and  
\$6,100 million in 1978-79

involving in those three years increases of 6%, 12% and 11% respectively. These levels of recurrent expenditure would create a surplus on current account of:

\$1,200 million in 1976-77  
\$1,400 million in 1977-78 and  
\$1,500 million in 1978-79

and thus make it possible to finance capital expenditure of:

\$1,700 million in 1976-77  
\$1,900 million 1977-78 and  
\$2,100 million in 1978-79

after allowing for capital revenue. I am prepared to assume that we shall be able to finance, by one means or another, a further \$500 million a year, thus bringing total expenditure on capital account up to:

\$2,200 million in 1976-77  
\$2,400 million in 1977-78 and  
\$2,600 million in 1978-79

so bringing us eventually over the guideline figure of \$2,480 million I laid down last year for capital expenditure and which is not very different at April 1975 prices at least as far as Public Works Non-Recurrent expenditure is concerned. But to these levels of capital expenditure must be charged loan repayments.

185. Thus my present view of acceptable levels of total expenditure at April 1975 prices in the forecast years is:

\$7,100 million in 1976-77  
\$7,900 million in 1977-78 and  
\$8,700 in 1978-79

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<sup>(151)</sup> See paragraph 66 above; 80% applied to the recurrent revenue figures in f.n. (149).



involving reductions of:

\$1,700 million in 1976-77

\$1,300 million in 1977-78 and

\$900 million in 1978-79<sup>(152)</sup>

on the departmental submissions at November 1974 as revised<sup>(153)</sup>. Such reductions will be difficult to achieve, given such factors as debt servicing charges, the inevitable need to admit some new proposals and the likelihood of higher defence costs.

### (3) *Financing of Acceptable Rate of Expenditure*

#### (a) *Introduction*

186. Sir, as the present tax system is unlikely to be sufficiently productive even for a carefully controlled expansion of the Government's services and implementation of our capital works programmes and as there must be a limit on borrowings, I must now indicate the ways in which I think the extra fiscal revenue required in the forecast years must be found, but without being too specific as to timing and numbers<sup>(154)</sup>.

	1976-77 (\$ million) Revised		1977-78 (\$ million) Revised		1978-79 (\$ million) Revised	
	Depart- mental Submis- sions	Acceptable Level of Expenditure	Depart- mental Submis- sions	Acceptable Level of Expenditure	Depart- mental Submis- sions	Acceptable Level of Expenditure
<i>Expenditure</i>						
Recurrent.....	5,800	4,900	6,200	5,500	6,700	6,100
Capital .....	<u>3,000</u>	<u>2,200</u>	<u>3,000</u>	<u>2,400</u>	<u>2,900</u>	<u>2,600</u>
Total .....	<u>8,800</u>	<u>7,100</u>	<u>9,200</u>	<u>7,900</u>	<u>9,600</u>	<u>8,700</u>
<i>Reductions in Expenditure</i>						
Recurrent .....		900		700		
Capital .....		<u>800</u>		<u>600</u>		-
<u>300</u>		<u>1,700</u>		<u>1,300</u>		<u>900</u>

<sup>(153)</sup> See paragraph (182) above.

<sup>(154)</sup> For the record, a bill will shortly be published to strengthen the investigation powers and penalty provisions in Parts IX and XIV of the Inland Revenue Ordinance. This was anticipated in last year's budget speech (see B.S., 1974, paragraph 117).

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### *(b) Proposed appointment of an Inland Revenue Ordinance Review Committee*

187. In both my 1973 and 1974 budget speeches I said I hoped to introduce a bill to amend the Inland Revenue Ordinance to restore the ambit of the profits tax charge in respect of businesses generally and to widen the definition of charter hire so as to make a larger proportion of resident shipowners' profits chargeable to Hong Kong profits tax<sup>(155)</sup>. A bill was, indeed, drafted last year, 1974, repealing sections 14 and 15 of the ordinance and replacing them with two new charging sections, without in any way offending the spirit of the territorial source criterion. But it has been decided not to proceed with this bill and for the time being there the matter must rest.

188. Instead, I propose that the next step should be the appointment of a committee to review the Inland Revenue Ordinance. The terms of reference will be so drafted as to make it clear that the committee will be concerned with basic principles rather than administrative details. In this connection, I should mention that the 1966 Inland Revenue Ordinance Review Committee considered that they were not authorized to consider the basic structure of the ordinance<sup>(156)</sup>. I have already mentioned that I, myself, have serious reservations about the basic structure of the ordinance when I referred to the absence of any progression in the rates of tax at the higher income levels and I am sure others have similar reservations.

189. I hope that the appointment, membership and terms of reference of the committee can be announced around the middle of 1976. The public will, of course, be given ample opportunity to make their views known to the committee. Unfortunately, it will not be possible to move earlier because the Commissioner of Inland Revenue and his staff will be more than fully occupied in the implementation of recent legislative changes as well as those which this speech anticipates.

### *(c) Dividends withholding tax*

190. Pending the report of this third Inland Revenue Ordinance Review Committee and the introduction of the legislation necessary to give effect to whatever recommendations they might make, there is one measure which can be

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<sup>(155)</sup> *B.S., 1973, paragraph 126 and B.S., 1974, paragraphs 191-195.*

<sup>(156)</sup> *See Appendix (5).*

introduced for the year of assessment 1976-77, and which will, I am sure, because of its modest and reasonable nature,

receive the support of honourable Members of this Council, that is to say, a dividends withholding tax. This tax can be introduced by way of an amendment to the Inland Revenue Ordinance and a summary of what I think should be the main features of the tax is given in Appendix (6) of the printed version of this speech.

*(d) Rating*

191. I have already mentioned that the next revaluation of properties will be undertaken in 1976 to come into effect on 1st April 1977. To protect the revenue, a further upward movement of the General Rate in 1976-77 may, therefore, be necessary<sup>(157)</sup>.

*(e) Basis of assessment of property tax*

192. Quite apart from the administrative desirability of providing a separate roll of property owners<sup>(158)</sup>, values for property tax purposes should be assessed independently of the rating valuation lists. This would enable such values to be fixed in line with current market rental values and not on a tone of the list basis<sup>(159)</sup> and enable restricted rents to be taken into account in the assessments. As the next revaluation for rating purposes is to be postponed until 1976, the Commissioner for Rating and Valuation should have time to provide separate valuations for a new property tax roll which will be the basis for this tax in 1976-77 and will make it more productive.

*(f) Other possibilities*

193. I am sure it will occasion no surprise when I say that I have, in the back of my mind, the revenue implications of an eventual extension of the scope of the Betting Duty Ordinance to new forms of authorized off-course betting. And as my honourable Friends will doubtless have ideas of their own for new

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<sup>(157)</sup> I should also mention that seven new developed and developing areas of the mainland New Territories will be brought into assessment from 1st April 1976. The areas are Yuen Long, Tai Po, Sha Tin, Tuen Man, Clearwater Bay Road, Luen Wo Hui and Shek Wu Hui. Referencing has been completed and valuation has begun. Values will be based on the tone of the existing lists, viz: assessed values will be consistent with the general level of values applicable when the present valuation lists were prepared that is, in 1972.

<sup>(158)</sup> At present, under section 6 of the Inland Revenue Ordinance, property tax assessments are issued to rate-payers who are eligible to effect recovery from property owners.

<sup>(159)</sup> As provided for in section 7(4) and (5) of the Rating Ordinance.

and ingenious ways of raising additional revenue, I should finally mention that I have also looked into the possibility of a payroll tax (with a dual liability on employer

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and employee), a turnover tax and duties on a wider range of so-called luxury goods. But these three ideas involve difficulties and dangers which, in my view, rule them out for the present.

*CONCLUSION*

194. Sir, if the Year of the Tiger that has just drawn to a close was doubly depressing because it did not remotely resemble anyone's preconceptions, particularly from the late summer onwards, it is not easy to have any preconceptions at all about the coming year. So, whereas the keynote of the 1974 budget was caution, the keynote of the budget for the Year of the Rabbit must be even more so. But the Year of the Rabbit is believed to herald better things to come in the Year of the Dragon. And I am sure it will, provided that, in the coming months, we take particular care with the economy on the health of which all depends.

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

*Debate adjourned pursuant to Standing Order 54(2).*

## Appendix (1)

## FINANCIAL CIRCULAR NO. 2/75

Vote on Account Procedure for the Estimates of  
Expenditure 1975-76*Introduction*

The normal time-table for the Budget Session begins with the issue of the Draft Estimates and supporting documents to Members of the Legislative Council in mid-February. The Financial Secretary moves the Second Reading of the Appropriation Bill (*i.e.* makes his Budget Speech) at the end of February. The President then refers the Estimates to Finance Committee for examination before consideration of the Appropriation Bill in committee of the whole Council. The Legislative Council debates the Appropriation Bill in March with a view to its becoming law before 1st April.

2. This year, to allow Members more time to examine the Draft Estimates for 1975-76, the debate will take place later. This means that while Budget Day will still be 26th February 1975 (as indicated in Enclosure 2 of Financial Circular No 19/74), the debate will be postponed until 19th and 20th March and 2nd, 3rd and 23rd April. To enable departments to carry on existing services between the start of the financial year (*i.e.* 1st April 1975) and the issue of the General Warrant following the enactment of the Appropriation Ordinance (which is expected to be at the end of April or early May) a "vote on account" will be introduced.

*Vote on account procedure*

3. The Draft Estimates for 1975-76 will be prepared as set out in Financial Circular No 19/74. They will be printed and sent to Members of the Legislative Council in mid-February 1975. The Appropriation Bill will be in its usual form, seeking appropriation of the total amount included for expenditure in the Draft Estimates, supported by the normal schedule giving the amount under each head of expenditure. But in addition the Government will seek by Resolution funds on account under each head. The extent to which expenditure may be incurred, and commitments entered into, against the vote on account will be determined in accordance with the rules set out below—

*(a) Annually recurrent personal emoluments subheads*

The funds on account sought will be 20% of the provision entered in the Draft Estimates for 1975-76. Departments may

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not spend more than the funds on account, and expenditure may be incurred only on those posts already approved by the Finance Committee of the Legislative Council. All supernumerary posts normally lapse on 31st March. Those supernumerary posts which are proposed for retention in the 1975-76 Draft Estimates will continue in being until 31st May 1975 and will *then* lapse unless retained in the Estimates as approved. It should be emphasized that expenditure on overtime may not exceed 20% of the provision entered for this item in the Draft Estimates.

(b) *Annually recurrent other charges subheads*

The funds on account sought will be 20% of the provision entered in the Draft Estimates for 1975-76. Departments may not spend more than the funds on account nor may they commit more than 50% of the provision for each subhead entered in the Draft Estimates. Because of the nature of the expenditure and because of contractual requirements, the funds on account sought and the limit on commitment for certain subheads may have to be higher. No funds on account will be sought for annually recurrent other charges subheads appearing in the Draft Estimates for the first time, except where these are a continuation of subheads approved by Special Warrant in 1974-75. Heads of Departments must ensure that expenditure is incurred only on services already approved by the Finance Committee of the Legislative Council and for which provision has been included in the Draft Estimates. In particular, they must ensure that where increased provision under existing subheads has been included in the 1975-76 Draft Estimates to cover new and expanded services not yet approved by Finance Committee, expenditure is not incurred on these services until the General Warrant has been signed.

(c) *Special expenditure subheads*

Departments may incur expenditure only in respect of provision included in the Draft Estimates to cover outstanding balances on approved commitments carried over from 1974-75 (i.e. those subheads marked with symbol "c" in the Draft Estimates and those portions of subheads which represent outstanding balances carried over from the previous year as explained in the footnotes to the Draft Estimates).

(d) *Public Works Non-Recurrent subheads*

Expenditure may be incurred only in respect of amounts included in the Draft Estimates for subheads brought down from the previous year. Contracts must not be entered into and expenditure must not be incurred against new subheads not already approved by the Finance Committee of the Legislative Council.

*The provision of funds on account*

4. A vote on account warrant will be issued to the Accountant General on 31st March 1975 and departments may incur expenditure against the vote on account as from 1st April 1975. The issue of the vote on account warrant will be advised by Financial Circular, which will also specify the amount of funds on account approved for each subhead by reference to the Draft Estimates. Departments will be provided on or before 1st April 1975 with copies of the appropriate pages of the printed Draft Estimates (*i.e.* Revenue and Miscellaneous Services heads plus the expenditure heads under their control).

*Accounts procedure*

5. The provision under the vote on account will be subsumed upon the enactment of the Appropriation Ordinance. The General Warrant issued after enactment of the Appropriation Ordinance will replace the vote on account warrant and be effective from 1st April 1975. To allow actual expenditure against the vote on account to be more easily determined for control purposes, the General Warrant will be issued on the first day of the month following the enactment of the Appropriation Ordinance.

6. The Accountant General will issue a Treasury Circular in early March 1975 explaining how the new system will affect departmental accounting.

*Supplementary provision*

7. The Finance Branch will consider supplementary provision during the vote on account period only in the most exceptional circumstances. Departments will need to demonstrate that the additional expenditure must be incurred during this period.

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## Appendix (2)

## EFFECT OF INCREASE IN THE GENERAL RATE TO 11%

*Private Sector*

## Domestic (Post-war)

(i)	(ii)	(iii)	(iv)	(v)	(vi)
Class	Average Rent (*) (per month excluding rates)	Rates per month @ 15%	Average Rent (per month rates) (ii) + (iii)	Rates per month @ 2%	(v) as a % of (iv)
	\$	\$	\$	\$	\$
Small tenements.....	530	37.50	567.50	5.00	0.88%
Large tenements.....	695	48.00	743.00	6.40	0.86%
Small flats.....	1,015	76.50	1,091.50	10.20	0.93%
Medium flats....	2,175	144.50	2,319.50	19.30	0.83%
Large flats.....	4,180	301.00	4,481.00	40.20	0.90%
Houses .....	6,190	476.00	6,666.00	63.50	0.95%

*Private Sector*

## Non-domestic (Pre-war and post-war)

Ground floor shops .....	2,320	211.50	2,531.50	28.20	1.11%
Offices .....	3,850	286.50	4,136.50	38.20	0.92%
Commercial premises.....	5,610	547.50	6,157.50	73.00	1.19%
Factory premises.....	5,520	625.00	6,145.00	83.30	1.36%
Storage premises.....	12,475	1,252.50	13,727.50	167.00	1.22%

*Public Sector*

## (Hong Kong Housing Authority (Group A) and Hong Kong Housing Society)

Small tenements.....	275	23.00	298.00	3.10	1.04%
Large tenements.....	480	38.00	518.00	5.00	0.97%
Small flats.....	580	43.00	623.00	5.80	0.93%
Ground floor shops .....	1,235	123.00	1,358.00	16.40	1.21%

(\*) Average fair market rent as estimated by the Commissioner of Revenue and Valuation.



## Appendix (3)

## HONG KONG TAXPAYERS

There have recently been some inaccurate estimates of the number of earnings and profits taxpayers in Hong Kong. That these estimates are inaccurate is due to a misunderstanding of the basic structure of the Inland Revenue Ordinance. The point to be stressed is that, unlike the position in a conventional tax system, the Commissioner of Inland Revenue neither receives returns of total income from persons charged to tax nor issues assessments on total income.

2. There are taxes on—

- (a) *salaries*: in 1974-75, about 140,000 persons will pay salaries tax, husband and wife counting as one;
- (b) *profits*: in 1974-75, 50,000 businesses will pay profits tax. Far more than 50,000 persons will be affected, for a corporation may have several thousand shareholders receiving dividends from it and a partnership may have several partners;
- (c) *interest*: a single assessment based on a return from one bank may cover tax on interest payments to several thousand depositors;
- (d) *property*: in 1973-74, the Commissioner issued about 225,000 notices of assessment. This does not mean that 225,000 persons paid property tax, for one notice is assessed for each rateable unit and one owner may pay on a number (sometimes a large number) of units.

3. What this comes down to is that, under the existing tax structure, the number of persons who pay earnings and profits tax of one sort or another, is difficult to estimate accurately. But the figures currently being quoted publicly are far too low. The Commissioner estimates that (counting husbands and wives as one person and after eliminating double accounting of persons paying more than one type of tax) *at least* a quarter of a million persons are paying earnings and profits tax of one form or another. This number is certain to rise during 1975-76.

4. Thus about one person in seventeen of the Hong Kong population is paying. Taking into account the sex and age structure of the population and taking into account the personal allowances available under the Inland Revenue Ordinance, this proportion is not unreasonable.

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Appendix (4)

**ROUTINE INCREASES IN FEES AND CHARGES**

(effective during 1975-76 and allowed for in the Revenue Estimates)

*Head 6 Licences**Subhead**Remarks*

110	Dangerous drugs, pharmacy poisons and others			it is intended to introduce new fees for the examination and registration of medicines and drugs under the Pharmacy and Poisons Regulations 1975.
		1975-76	\$10.0 mn.	

*Head 8 Fees and Receipts**Subhead*

140	Travel documents			Revision of fees for all travel documents. Additional annual yield could be \$18 million, but only \$10 million will be collected in 1975-76.
		1975-76	\$10.0 mn.	
440	Quarry products			Revision of selling price from 1st January 1975.
		1975-76	\$ 3.5 mn.	
480	Deeds		\$ 2.0 mn.	Revision of fees for land registration, Official Receiver's fees and other fees under the Companies Ordinance.
490	Hong Kong Companies }		\$ 0.3 mn.	
510	Official Receiver		\$ 0.5 mn.	
590	Toll collections— Lion Rock Tunnel		\$ 2.5 mn.	Revision of toll charges.

*Head 12 Postal charges**Subhead*

30	Postage stamps			Revision of fee for Certificates of Origin, collected via postage stamps.
			\$ 3.0 mn.	

*All Others*

	Airport: Car parking and air craft parking charges			
	Film censorship fees			
	Post Office box charges }		\$ 6.0 mn.	
	Court fees			
	Innoculation and vaccination fees			
	Miscellaneous licences			
			<u>\$37.8 mn.</u>	

<i>Add:</i>	yield from increase in rate of Hotel Accommodation			
	Tax w.e.f. 1st April 1975		<u>\$ 3.0 mn.</u>	
			<u>\$40.8 mn.</u>	

## Appendix (5)

EXTRACT FROM THE REPORT OF THE 1966 INLAND  
REVENUE ORDINANCE REVIEW COMMITTEE

"7. The 1954 Inland Revenue Ordinance Committee with terms of reference similar to ours included the following in its report—

'We have acted throughout on the principle that it was no part of our duty to recommend changes in the system of taxation. We have, moreover, proceeded on the assumption that there will be no significant increase in the current rates of tax, for we are unanimous that the present system of taxation of earnings and profits is inherently an inequitable one, and is acceptable only on the assumption that the rate of tax remains sufficiently low to make the inequities tolerable. The comparatively low rate of tax now in force has strongly influenced us in all our deliberations; many of our recommendations would unquestionably have been different if the rates of tax had been higher.'

8. We found ourselves in much the same position as the 1954 Committee since we too considered that we were not authorized by our terms of appointment to propose a change in the present system of taxation of earnings and profits, which the previous Committee were unanimous in declaring as inherently inequitable. Indeed, whilst comments on this aspect might be considered to be equally beyond our terms of reference, we feel obliged at least to record our observations, which now follow, on the operations of the present system."

## Appendix (6)

## PROPOSED DIVIDENDS WITHHOLDING TAX

(1) It will be a separate tax on dividends paid or credited on or after 1st April 1976 by companies *resident in Hong Kong*. This is the only practical and enforceable way of imposing this tax. Any other tests would give rise to administrative problems which are simply not justified in view of the low rate envisaged. In keeping with the belief that there should be no attempt to go beyond the dividend itself when imposing the new tax, there will be no question of exempting any portion of a dividend on the grounds that it was paid out of profits which

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were of a capital nature in the hands of the company paying the dividend. A similar practice, based on case law, is adopted in most countries imposing taxes on dividends.

(2) The tax will be withheld at source by the company declaring the dividend and will immediately be passed over to the Commissioner of Inland Revenue.

(3) It will be necessary to impose a comparable tax on undistributed profits over a certain percentage. It will be appreciated that companies in a position to do so would otherwise be tempted to shield their shareholders from payment of the tax by simply withholding payment of a dividend.

(4) Since a shareholder who receives a dividend through a series of companies, for example, from an investment company, would be double taxed, relief from withholding tax previously deducted will be given by way of a credit against deductions which companies are, in turn, obliged to make from dividends paid by them.

(5) Dividends will not be included in personal assessment. Otherwise, dividends would be subject to rates of tax varying from 5 *per cent* to 30 *per cent*. By the same token, there can be no question of refunding the tax to those who would be exempt if they elected personal assessment.

(6) The rate of tax will be modest and will replace the additional levy on corporation profits proposed for 1975-76.

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**EVIDENCE (AMENDMENT) BILL 1975****Resumption of debate on second reading (5th February 1975)**

*Question proposed.*

*Question put and agreed to.*

Bill read the second time.

*Bill committed to a committee of the whole Council pursuant to Standing Order 43(1).*

**MERCHANT SHIPPING (RECRUITING OF SEAMEN)  
(AMENDMENT) BILL 1975**

**Resumption of debate on second reading (5th February 1975)**

*Question proposed.*

*Question put and agreed to.*

Bill read the second time.

*Bill committed to a committee of the whole Council pursuant to Standing Order 43(1).*

**POLICE FORCE (AMENDMENT) BILL 1975**

**Resumption of debate on second reading (5th February 1975)**

*Question proposed.*

*Question put and agreed to.*

Bill read the second time.

*Bill committed to a committee of the whole Council pursuant to Standing Order 43(1).*

**Committee stage of bills**

Council went into Committee.

**EVIDENCE (AMENDMENT) BILL 1975**

Clauses 1 to 5 were agreed to.

**MERCHANT SHIPPING (RECRUITING OF SEAMEN)  
(AMENDMENT) BILL 1975**

Clauses 1 to 5 were agreed to.

**POLICE FORCE (AMENDMENT) BILL 1975**

Clauses 1 and 2 were agreed to.

Council then resumed.

**Third reading of bills**

THE ATTORNEY GENERAL reported that the

Evidence (Amendment) Bill

the Merchant Shipping (Recruiting of Seamen) (Amendment) Bill

and the Police Force (Amendment) Bill

had passed through Committee without amendment and moved the third reading of each of the bills.

*Question put on each bill and agreed to.*

Bills read the third time and passed.

**Unofficial Member's bill****First reading of bill****BOY SCOUTS ASSOCIATION (AMENDMENT) BILL 1975**

*Bill read the first time and ordered to be set down for second reading pursuant to Standing Order 41(3).*

**Second reading of bills****BOY SCOUTS ASSOCIATION (AMENDMENT) BILL 1975**

MR CHEUNG moved the second reading of: —"A bill to amend the Boy Scouts Association Ordinance."

He said: —Sir, after that *tour de force* from my honourable Friend the Financial Secretary, I feel like I was someone appearing with an accordion before an audience that has heard a national symphony orchestra play a Beethoven symphony. This modest measure, Sir, is to allow the Boy Scouts to change their name to "Scouts" (*laughter*) and to give them authority to purchase property and other purposes which

I think are adequately set out in the Explanatory Memorandum. I move that the motion on the debate for the second reading be adjourned.

*Motion made. That the debate on the second reading of the bill be adjourned*—MR CHEUNG.

*Question put and agreed to.*

**MARYKNOLL SISTERS OF ST DOMINIC INCORPORATION  
(AMENDMENT) BILL 1975**

**Resumption of debate on second reading (5th February 1975)**

*Question proposed.*

*Question put and agreed to.*

Bill read the second time.

*Bill committed to a committee of the whole Council pursuant to Standing Order 43(1).*

**Committee stage of bill**

Council went into Committee.

**MARYKNOLL SISTERS OF ST DOMINIC INCORPORATION  
(AMENDMENT) BILL 1975**

Clauses 1 to 3 were agreed to.

Council then resumed.

**Third reading of bill**

MR LO reported that the

Maryknoll Sisters of St Dominic Incorporation (Amendment) Bill

had passed through Committee without amendment and moved the third reading of the bill.

*Question put and agreed to.*

Bill read the third time and passed.

### **Adjournment and next sitting**

HIS EXCELLENCY THE PRESIDENT: —In accordance with Standing Orders I now adjourn the Council until 2.30 p.m. on Wednesday the 19th of March.

*Adjourned accordingly at ten minutes past five o'clock.*